



REALTY  INCOME  
THE MONTHLY DIVIDEND COMPANY®  
New York Stock Exchange "O"

REALTY INCOME 2005 ANNUAL REPORT

# REALTY INCOME'S MONTHLY DIVIDEND UNIVERSITY



**THE COLLEGE FOR INCOME INVESTORS**

## UNIVERSITY MISSION

Monthly Dividend University (MDU) is an institution of higher learning that is dedicated to teaching investors about investing for dividend income and about Realty Income, The Monthly Dividend Company®. Upon the completion of course work, students will have a broad understanding and knowledge of the operations and performance of Realty Income during 2005, as well as how investing for dividend income may fit within their overall investment objectives.



## Undergraduate Curriculum

Bachelor of Arts (BA) in Monthly Dividends

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# PSYCH 101

## "THE PSYCHOLOGY OF INVESTING FOR INCOME"

BY VISITING STUDENT, MONTHLY DIVIDEND GIRL



Thank you for attending Psychology 101 today. Class, here's an important question. What is the difference between investing for income and investing for other objectives? The simple answer is that people who invest for income tend to want to own companies that pay dependable dividends, or to own bonds issued by companies or government entities that pay interest. But the reality is, not only does the payment of income to investors set investing for income apart from other investing styles, it is the absolute need for income by these investors, to fund the activities of their daily life, that truly differentiates them. "Investing for income" is where people get to when they have spent enough time "paying their investment portfolio" and now need "their investment portfolio to pay them!"

By definition, income investors desire a cash return rather than growth and a high dependable yield rather than an overall total return. Income investing is as different from growth or total return investing as baseball is different from tennis or golf. In all of these sports the idea is to get a ball somewhere and win the game. In investing, the idea is to allocate capital carefully in order to achieve a certain objective. In both cases, it is very important to know which game you are playing and then to effectively pursue a strategy that will allow you to win that game. Well, you get the idea. Income investors are just playing a different game, with different rules than other investors.

That's not to say that there's anything wrong with other investment styles, just as there's nothing wrong with playing different sports. At different points in life we may have approached investing differently, just as we might have played different sports from the ones we play now. Right now we may find we're at the point where we want to use our portfolio to produce a "retirement paycheck" to fund our income needs, to provide income while we pursue a new career, or replace salaried income while we engage in a wide variety of activities. As such, it may be the time when we're ready to become an income investor.

Achieving the goals of the various investment styles requires a certain discipline. So, what are the goals of each of these investment strategies? Let's run through growth and total return investing for a minute before focusing our attention on the subject of this class, which is the psychology of income investing.

**Investing for growth** can be defined as "An investment strategy to increase capital by buying stocks that an investor thinks will go up in price." Investing for growth can generally be simplified to the following:

- Buy low
- Sell high
- Buy and sell things you think will go up
- Make a lot of money to do something with later in life.

**Investing for total return** can be defined as "An investment strategy that seeks a return on investment that includes income from interest or dividends as well as appreciation or depreciation in the price of a security over a given period of time." Investing for total return can generally be simplified to the following:

- Buy Low
- Sell High
- Get a little income while you are doing it
- Accumulate money to do something with later in life.

By contrast then, **investing for income** can be defined as "An investment strategy which emphasizes current income in the form of dividends from stocks or interest payments from bonds, rather than emphasizing growth." Investing for income could then be simplified to the following:

- Buy investments that pay dependable income
- Use the income to fund our current lifestyle
- Receive income that increases over time
- Hold these investments as long as they pay increasing income.

As you can see, these are three very different investment styles and sets of goals. In the case of income investing, we're likely to hold our investments for a very long time. With growth and total return investing, we must pay careful attention to when we buy and sell so that we accumulate money to do something else with later in life.

As income investors, when the goal is to receive income for life, we will probably want the company providing the income to, not only be in business for the foreseeable future, but to conduct their business in a manner that gives us a relatively high degree of confidence in the dependability of the income being paid. We might tend to look for stable businesses, generating dependable earnings, from which they can pay regular dividends or interest payments over a prolonged period of time. Such performance is more likely to offer the stability and low degree of volatility that is important to us as investors who rely on our investment income to fund our current activities.

We also might tend to prefer receiving stock dividends over fixed interest payments. Dividends have the ability to grow and keep up with inflation in comparison to fixed interest payments, which tend to remain constant through the life of the investment. We would also, generally, prefer an income stream that consistently grows over time, because the longer we hold our investment, the more money we receive.

And most importantly, we also should understand that it will take a certain amount of discipline to stick with our investment choice. The investment landscape is filled with opinions, ideas and suggestions that can tempt us to go off our "game". It may sometimes be tempting to follow the idea or investment fad of the week, particularly if we've not only enjoyed steady dividends, but we've also seen our principal increase over the years. But since we're disciplined income



investors we understand that cashing in on that price appreciation not only ends the dividend income stream we rely on, but also invites the tax man to the table. This is an unwelcome event that takes money out of our pockets and so the fact that the stock price has gone up tends to be irrelevant to us because we own the stock for the increasing income it provides over a prolonged period of time. In other words, we know to stick to our game plan and stay with the program.

This is rather like the dairy farmer who owns a milk cow that he hopes will produce milk for many years to come. He's unlikely to be very concerned with what the price of beef is doing after he buys his cow, since he's in the business of producing milk from the cow he owns. The dairy farmer also knows he would just have to go out and buy another cow to produce the milk he needs if he sold his milk cow. As income investors we are all like the dairy farmer because we're in the business of keeping our cows and drinking the milk, rather than turning our cows into hamburger!

So does this mean that income investing is a better investment strategy than any other. Not necessarily. It's just different and whether or not we pursue an income strategy depends on our needs. Again, we need to consider where we are in life, the risks we want to take and what we want to achieve with the money we have to invest. It's also important to understand that investing for income is fundamentally different from investing for all other objectives.

The secret to passing this class and investing wisely (Time to take notes, Class) is to be able to identify which game you're playing, what the goals of that game are and to demonstrate how well you achieve these goals. Here at good old Monthly Dividend University (MDU) the answer is, of course, that we are all income investors, and monthly income investors to boot. Remember that and you're sure to get an A+ on your final.

(Disclosure: Monthly Dividend Girl is a visiting student who is also a shareholder of and head cheerleader for Realty Income.)

# MATH 101

## “THE MAGIC OF YIELD ON COST”

BY PROFESSOR TOM A. LEWIS

Welcome Class. I'm pleased that you're here and interested in learning about something that, I believe, is the “holy grail” of income investing. You've already learned the rules and psychology of income investing, but now we need to get to the “Magic” of how to manage your investments so that you can obtain investment income that lasts as long as you need it to last.

The secret is in how we analyze our income investments. Conventional financial advice has historically been to put together a portfolio that involves some income combined with a gradual drawing down of one's principal. All of this is predicated on an estimate as to how long one plans to live and how much the cost of living will increase.

Building a retirement portfolio in this way can be fraught with complications. Attempting to predict how long we'll be retired or what the cost of maintaining our style of living will be is difficult at best, particularly since people are living much longer than ever before. There is also the constant monitoring of the portfolio, making adjustments as needed, worrying over such moves and paying the costs associated with them. Add to this the tax ramifications of trading and it is not surprising that a number of investors are challenged to

meet their income and financial goals once their earning years are over.

“OK then, Investing for Income is for me” you might say. But, how exactly can we measure the ongoing success of our income investments. The answer is, of course, we measure success differently than how growth and total return investors measure success in their portfolios. For income investors, measuring success involves the use of a great income investing metric. When this “Magic” metric is used in combination with a long-term outlook and a conservative orientation, we have a better chance of accurately measuring our results and obtaining the increasing income we need over time. Many Realty Income investors have achieved investment success by applying this “holy grail” of income investing—**Yield on Cost**—in measuring their investment results.

The formula for calculating Yield on Cost is relatively simple. Divide your current annual dividend by the original cost you paid for your shares of stock and the result is your Yield on Cost. For those of you who took basic algebra in high school the formula would be:

$$\frac{\text{Current Annualized Dividend}}{\text{Original Cost Per Share}} = \text{Yield on Cost}$$

Pretty simple, huh? What this metric tells us, on any given day, is what our dividend yield is today on our original investment. As owners of Realty Income, for example, the dividend has been regularly increased over the past eleven years, so our income (and Yield on Cost) has continued to increase over time. This means that \$10,000 invested in Realty Income shares in 1994, at \$8.56 per share, today has a Yield on Cost of 16.3%, based on a current annualized dividend per share amount of \$1.395. So, if we use our formula for Yield on Cost, our calculation would be:

$$\frac{\$1.395 \text{ (Our current annualized dividend)}}{\$8.56 \text{ share price at 12/31/94}} = 16.3\% \text{ (current yield on cost for shares purchased in 1994)}$$

**“I suspect that many more investors will become shareholders of Realty Income once the Baby Boomers begin to look for more secure avenues of depositing their capital. Annuities are sound, but they yield too little for someone trying to fight inflation. Realty Income offers something wonderful by means of dividends. Take the \$1.11 dividend back in 2000 yielding about 11%. Now that old money is yielding 13.95% today, something no annuity or money market fund could come close to touching.”**

Michael Whitten  
2nd Lieutenant, U.S. Army, (stationed in Germany),  
Shareholder and Yield on Cost Expert

**EXAMPLE:**



<b>SHAREHOLDER YIELD ON COST</b>						
Name of Company	Ticker Symbol	1,000 Shares Purchase Date	INFORMATION BASED ON ORIGINAL COST		INFORMATION BASED ON CURRENT VALUE 12/31/05	
			Yield at Purchase Date	Total Annual Dividend at Purchase	Current Yield on Original Cost	Total Annual Dividend
REALTY INCOME	O	10/18/94	11.3%	\$ 900	17.4%	\$ 1,395
REALTY INCOME	O	12/31/94	10.5%	\$ 900	16.3%	\$ 1,395
REALTY INCOME	O	12/31/95	8.3%	\$ 930	12.4%	\$ 1,395
REALTY INCOME	O	12/31/96	7.9%	\$ 945	11.7%	\$ 1,395
REALTY INCOME	O	12/31/97	7.5%	\$ 960	11.0%	\$ 1,395
REALTY INCOME	O	12/31/98	8.2%	\$ 1,020	11.2%	\$ 1,395
REALTY INCOME	O	12/31/99	10.5%	\$ 1,080	13.5%	\$ 1,395
REALTY INCOME	O	12/31/00	8.9%	\$ 1,110	11.2%	\$ 1,395
REALTY INCOME	O	12/31/01	7.8%	\$ 1,140	9.5%	\$ 1,395
REALTY INCOME	O	12/31/02	6.7%	\$ 1,170	8.0%	\$ 1,395
REALTY INCOME	O	12/31/03	6.0%	\$ 1,200	7.0%	\$ 1,395
REALTY INCOME	O	12/31/04	5.2%	\$ 1,320	5.5%	\$ 1,395
REALTY INCOME	O	12/31/05	6.5%	\$ 1,395	6.5%	\$ 1,395

The chart above demonstrates the Yield on Cost based on various dates of purchase and gives us an idea of what our yield on cost might be. But, more importantly, it demonstrates that the longer one owns shares of a company, where dividends are regularly increased, the yield on one's original investment actually accelerates, over time.

This leads us to a critical investment principle of holding an income investment for the long-term. As long as the company continues to be a reliable producer of increasing income and maintains a conservative, long-term perspective, the ideal would be to hold such an investment forever.

The lesson here is that, since our objective is to obtain increasing income over time, our best measure of success in achieving this objective is to calculate our current Yield on Cost, for a specific investment, to see how it has increased over time.

If the Yield on Cost has continually increased over the life of our investment, there is very little reason for us to sell our shares.

With this simple calculation we can easily determine how well our income investments have performed for us when the temptation arises to sell our source of dependable income.

What a great way to measure the success of our investments! This is particularly true for an investor whose primary objective is to receive increasing dividend income over a long period of time!

A new income investment paradigm, therefore, is to find investments that pay high quality, increasing income, and keep them as long as they continue to produce a rising yield on cost over time. Once you've "got" this lesson, you'll not only receive an A in the class, but you'll also be able to build and maintain an income portfolio that is designed to last a lifetime.

(Disclosure: Professor Lewis serves as adjunct professor in Math at MDU and moonlights as Realty Income's Chief Executive Officer.)

# PHILOSOPHY 101

## “THE PHILOSOPHY OF THE MONTHLY DIVIDEND COMPANY®”

BY PROFESSOR GARY M. MALINO



Welcome to class, students. Today's subject is the philosophy of The Monthly Dividend Company®. The faculty of Monthly Dividend University strongly believe that a well thought-out philosophy, which a company uses to guide its activities and operations, is

critical to its long-term success. I believe that The Monthly Dividend Company® is one of many such companies that operate their business in a manner consistent with their overall philosophy and this is one of the key reasons Realty Income has been successful for many years.

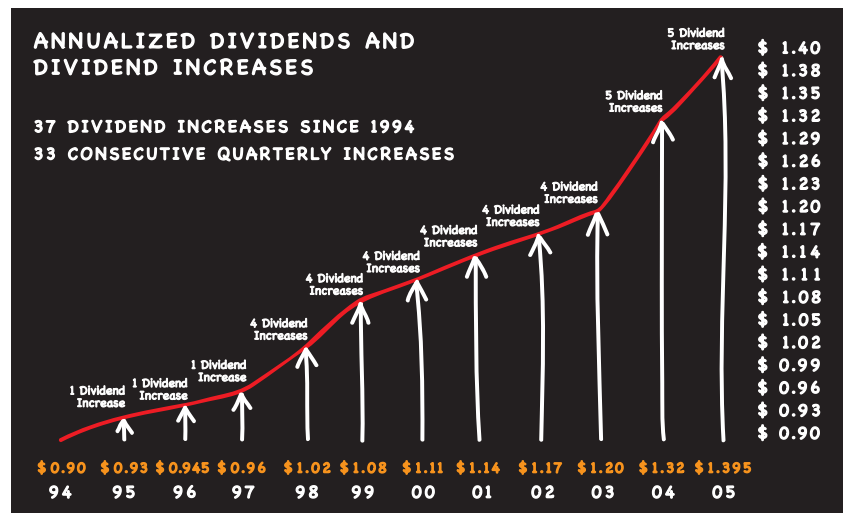
The philosophy of The Monthly Dividend Company® is, quite simply, to provide all of its shareholders with increasing monthly dividends every month, year after year, for the rest of their lives. This philosophy, simple as it may sound, colors every decision the Company makes, dollar it spends, its management discussions, and all of the employee's activities undertaken each day at Realty Income. Since the guiding principle of the Company is to provide income-focused investors with a check every month for the rest of their lives, the responsibility to act prudently and appropriately to accomplish this mission is the absolute priority for Realty Income employees. That being said, how does Realty Income go about achieving the objectives that result from this philosophy?

The Company's strategy of owning a sizable portfolio of properties, operated under long-term lease agreements with large retail chains, is the means to continuing to provide monthly dividends. These properties are leased to a large number of retail chains under 15- to

20-year, net-lease agreements, where the retailer generally pays the property taxes, maintenance costs and property insurance payments, as well as a monthly rental payment to Realty Income. This rental revenue has been a reliable generator of cash to pay monthly dividends to the Company's shareholders over a long period of time.

A second important point is the conservative operating focus of The Monthly Dividend Company®. Since the Company was founded, it has never carried a mortgage on any of the properties that it owns. In addition, Realty Income also focuses on maintaining a conservative balance sheet, preferring to fund most of its real estate acquisitions by issuing additional shares of common stock. Keeping the amount of debt the Company carries at a modest amount, along with controlling operating expenses, frees up the majority of Realty Income's rental revenue for the payment of monthly dividends to its shareholders.

The success of this methodology is demonstrated by the payment of over 425 monthly dividends since the Company's founding in 1969, combined with 37 dividend increases since the Company went public in 1994. This consistent record of dividend payments and increases earned Realty Income a



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spot in Mergent Inc.'s, Dividend Achiever Handbook in 2005 (*Mergent's Dividend Achiever* is a guidebook that identifies companies that have increased their annual dividend payments for ten or more consecutive years.) The Company is one of just 313 public companies that qualified for inclusion in this prestigious guide to dividend-paying stocks, out of approximately 10,000 plus North American-listed, dividend-paying common stocks. In fact, Mergent also ranked Realty Income in the top 50 for compound annual dividend growth.

Realty Income's consistent operating strategy and dividend-paying track record is the day-to-day result of a philosophy rigorously applied. Since the philosophy of providing dependable monthly dividends is at the center of the Company's activities, a certain "point of view" is present at all times. This point of view mandates that Company employees and managers understand and place the needs of income investors ahead of all other considerations. This also means that, because the Company is focused on providing dependable monthly income over a prolonged period of time, it does not do other things that may temporarily be popular in the investment world but could distract them from their core mission. This philosophy also tends to keep Realty Income from focusing on activities that might boost short-term growth prospects at the expense of the Company's long-term objectives.

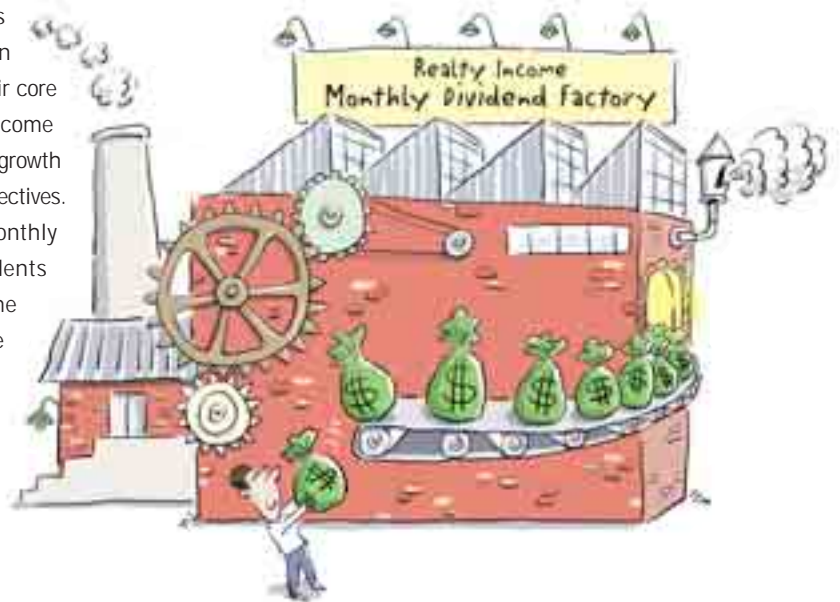
Because of this focus, owning shares of The Monthly Dividend Company® may not be for everyone. Students and investors should understand that Realty Income is an income investment and, therefore, pursues the goals and plays by the rules of income investing. Other types of investors, such as growth and total return investors, have much different goals than income investors. While shareholders, with verifying investment styles, can own Realty Income shares, they

should know the Company is run specifically to meet the needs of income-oriented investors.

Given all of this, how does the "faculty" of MDU view their investment in Realty Income?

We enjoy owning shares of Realty Income because it provides us with increasing, spendable income that we look forward to receiving for the rest of our lives. The shares that we own are, generally, a large portion of our total assets and so we depend on this income to support our families. With that said, there is risk in any investment and we recommend that all shareholders (including MDU's faculty and Realty Income's management team) remain diversified and have a wide variety of investments to generate the income they need. We must also make sure that each of the companies we depend upon to generate our income have an overriding philosophy that supports the payment of dividends and that their strategy and activities match our income needs.

That's it for today's lecture. Thanks for coming to class!



(Disclosure: Professor Malino is Chairperson of MDU's Harley Davidson Club ("Lord help us!") as well as President and Chief Operating Officer of Realty Income.)



# HISTORY 101

For the Years Ended December 31,	2005	2004	2003
Total revenue <sup>(1)</sup>	\$ 197,733,000	\$ 177,606,000	\$ 150,370,000
Net income available to common stockholders	89,716,000	90,168,000	76,722,000
Funds from operations ("FFO") <sup>(2)</sup>	129,647,000	118,181,000	103,366,000
Dividends paid to common stockholders	108,575,000	97,420,000	83,842,000
Special dividend paid <sup>(3)</sup>			
<b>AT YEAR END</b>			
Real estate at cost, before accumulated depreciation <sup>(4)</sup>	\$ 2,096,156,000	\$ 1,691,283,000	\$ 1,533,182,000
Number of properties	1,646	1,533	1,404
Gross leasable square feet	13,448,600	11,986,100	11,350,800
Properties acquired <sup>(5)</sup>	156	194	302
Acquisition cost <sup>(5)</sup>	\$ 486,553,000	\$ 215,314,000	\$ 371,642,000
Properties sold	23	43	35
Number of retail industries	29	30	28
Number of states	48	48	48
Portfolio occupancy rate	98.5%	97.9%	98.1%
Remaining weighted average lease term in years	12.4	12.0	11.8
<b>PER COMMON SHARE DATA<sup>(6)</sup></b>			
Net income (diluted)	\$ 1.12	\$ 1.15	\$ 1.08
Funds from operations ("FFO")	1.62	1.50	1.45
Dividends paid	1.346	1.241	1.181
Special dividend			
Annualized dividend amount <sup>(7)</sup>	1.395	1.32	1.20
Common shares outstanding	83,696,647	79,301,630	75,818,172
<b>INVESTMENT RESULTS</b>			
Closing price on December 31,	\$ 21.62	\$ 25.29	\$ 20.00
Dividend yield <sup>(8)(9)(10)</sup>	5.3%	6.2%	6.7%
Total return to stockholder <sup>(10)(11)</sup>	-9.2%	32.7%	21.0%

<sup>(1)</sup> Total revenue includes amounts reclassified to income from discontinued operations, but excludes revenue from Crest Net Lease, a subsidiary of Realty Income.

<sup>(2)</sup> Refer to Management's Discussion and Analysis for FFO definition and reconciliation to net income available to common stockholders.

<sup>(3)</sup> The 1994 special dividend reflects the final partnership distributions.

<sup>(4)</sup> Does not include properties held for sale.

<sup>(5)</sup> Includes properties acquired by Realty Income and Crest Net Lease.

<sup>(6)</sup> All share and per share amounts reflect the 2-for-1 stock split on December 31, 2004.

<sup>(7)</sup> Annualized dividend amount reflects the December declared dividend rate per share multiplied by twelve.

	2002	2001	2000	1999	1998
\$	137,600,000	\$ 121,081,000	\$ 116,310,000	\$ 104,510,000	\$ 85,132,000
	68,954,000	57,846,000	45,076,000	41,012,000	41,304,000
	93,539,000	76,378,000	67,239,000	65,917,000	62,799,000
	78,042,000	64,871,000	58,262,000	55,925,000	52,301,000
\$	1,285,900,000	\$ 1,178,162,000	\$ 1,073,527,000	\$ 1,017,252,000	\$ 889,835,000
	1,197	1,124	1,068	1,076	970
	9,997,700	9,663,000	9,013,200	8,648,000	7,824,100
	111	117	22	110	149
\$	139,433,000	\$ 156,472,000	\$ 98,559,000	\$ 181,376,000	\$ 193,436,000
	35	35	21	3	5
	26	25	24	24	22
	48	48	46	45	45
	97.7%	98.2%	97.7%	98.4%	99.5%
	10.9	10.4	9.8	10.7	10.2
\$	1.01	\$ 0.99	\$ 0.84	\$ 0.76	\$ 0.78
	1.38	1.30	1.26	1.23	1.18
	1.151	1.121	1.091	1.043	0.983
	1.17	1.14	1.11	1.08	1.02
	69,749,654	65,658,222	53,127,038	53,644,328	53,634,206
\$	17.50	\$ 14.70	\$ 12.4375	\$ 10.3125	\$ 12.4375
	7.8%	9.0%	10.6%	8.4%	7.7%
	26.9%	27.2%	31.2%	-8.7%	5.5%

<sup>(8)</sup> Dividend yield was calculated by dividing the dividend paid per share during the year by the closing share price on December 31 of the previous year.

<sup>(9)</sup> Dividend yield excludes special dividends.

<sup>(10)</sup> The 1994 dividend yield is based on the annualized dividends for the period from August 15, 1994 (the date of the consolidation of the predecessors to the Company) to December 31, 1994. The 1994 total return is based on the price change from the closing on October 18, 1994 (the Company's first day of trading) to December 31, 1994 plus the annualized dividend yield.

<sup>(11)</sup> Total return was calculated by dividing the net change in the share price during the year plus the dividends paid per share during the year by the closing share price on December 31 of the preceding year.

	1997	1996	1995	1994
	\$ 67,897,000	\$ 56,957,000	\$ 51,555,000	\$ 48,863,000
	34,770,000	32,223,000	25,600,000	15,224,000
	52,188,000	47,139,000	40,414,000	39,050,000
	44,367,000	42,794,000	36,710,000	38,816,000
		5,285,000		5,850,000
	\$ 699,797,000	\$ 564,540,000	\$ 515,426,000	\$ 450,703,000
	826	740	685	630
	6,302,300	5,226,700	4,673,700	4,064,800
	96	62	58	4
	\$ 142,287,000	\$ 55,517,000	\$ 65,393,000	\$ 3,273,000
	10	7	3	5
	14	8	7	5
	43	42	42	41
	99.2%	99.1%	99.3%	99.4%
	9.8	9.5	9.2	9.5
	\$ 0.74	\$ 0.70	\$ 0.63	\$ 0.39
	1.11	1.04	1.00	0.98
	0.946	0.931	0.913	0.300
		.23		
	0.96	0.95	0.93	0.90
	51,396,928	45,959,074	45,952,474	39,004,182
	\$ 12.719	\$ 11.9375	\$ 11.25	\$ 8.5625
	7.9%	8.3%	10.7%	9.9%
	14.5%	15.4%	42.0%	28.5%

## HISTORY 102

### "THE HISTORY OF THE MONTHLY DIVIDEND COMPANY®"

BY PROFESSOR TERE H. MILLER

Realty Income, also known as The Monthly Dividend Company®, was founded in 1969 by William and Joan Clark. The Company was originally formed to invest in high quality, commercial properties, leased to regional and national retail chains, under long-term leases that produced monthly rental income. The founding ideology, then, was to "preserve capital and to produce monthly income" by owning these type of properties.

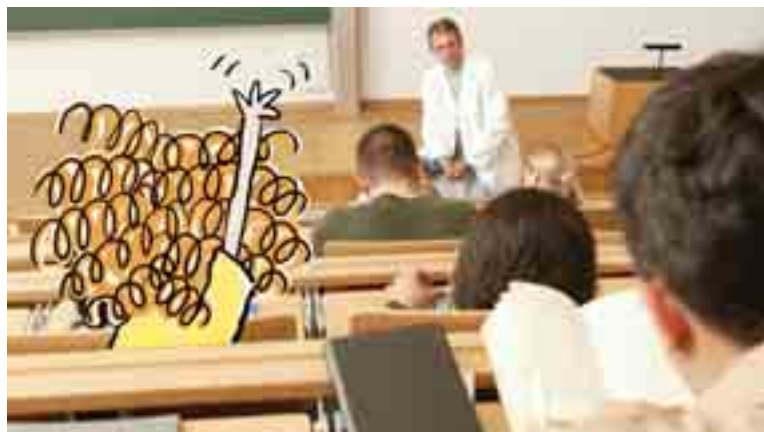
For approximately 25 years, between 1969 and 1994, investors received regular monthly distributions from Realty Income's investment programs. Then, in August 1994, Realty Income merged 25 programs into one entity, which began trading on the New York Stock Exchange in October of that same year.

Since that time investors have continued to receive a monthly dividend check from Realty Income. As you can see, not much has changed in 37 years. Realty Income has continued to pay monthly dividends and still focuses on the ongoing needs of income-oriented investors. And these dividends continue to be supported by the income generated from retail properties that offer goods and services meeting "basic human needs."

In 2005, Realty Income celebrated over One Billion Dollars in cash dividends paid and 11 very successful years of trading on the New York Stock Exchange. The Company continues its successful operations, maintaining a legacy of conservative management and a focus on generating dependable monthly income. Let's take a look at the Company's progress over the past eleven years:

- Since 1994, the Company has, on average, raised the dividend approximately 5% every year and has grown the annualized dividend amount from \$0.90 per share to \$1.395 per share, an increase of 55%.
- As of December 31, 2005 Realty Income has paid a total of \$1.1 billion in dividends.
- The size of the Company's real estate portfolio, at cost, has grown from \$451 million in 1994 to \$2.1 billion today.
- The number of retail properties owned has grown from 630 to 1,646.

(Disclosure: Professor Miller heads up MDU's annual walk-a-thon and serves as Vice President of Corporate Communications and Investor Relations of Realty Income.)



- The Company increased revenues more than 305%, from \$49 million in 1994 to over \$197 million as of the end of 2005.

Realty Income has enjoyed a relationship with many shareholders who have owned shares since the early days of the Company's operations, as well as new income-oriented shareholders who have been attracted to the Company's conservative track record and consistent monthly dividend. This loyal shareholder base continues to benefit from a strategy that has proved to be resilient throughout a variety of economic conditions over the years. They've weathered everything from high inflation to low inflation, recession to double digit economic growth, high interest rates to low interest rates and high unemployment to strong employment. Through it all, year-after year, the monthly check they rely on has been in the mail.



## MODERN HISTORY 101B

### 2005 REVIEW (THE SHORT VERSION)

GENERAL COMMENT:	Another good year for the operations of The Monthly Dividend Company®
FINANCIAL PERFORMANCE:	<ul style="list-style-type: none"><li>• Revenue increased 13.2% to \$196.7 million</li><li>• FFO per share increased 8.0% to \$1.62</li></ul>
DIVIDEND UPDATE:	<ul style="list-style-type: none"><li>• Paid 12 monthly dividends</li><li>• Increased the dividend 5 times</li><li>• Paid 425 consecutive monthly dividends since 1970</li></ul>
SHARE PRICE PERFORMANCE:	12/31/04 closing price: \$25.29 12/31/05 closing price: \$21.62 14.5% decrease
RETURNS TO SHAREHOLDERS:	Dividend yield of 5.3% Share price decrease of 14.5% Total return of -9.2% for 2005
TOTAL MARKET CAPITALIZATION:	\$2.8 billion on 12/31/05
BALANCE SHEET:	Very strong
PROPERTY MORTGAGE DEBT:	Zero (\$0)
REAL ESTATE PORTFOLIO:	1,646 retail properties leased to 101 retailers in 29 retail categories located throughout 48 states
PORTFOLIO OCCUPANCY:	98.5% on 12/31/05
PROPERTY ACQUISITIONS:	156 properties for \$486.6 million Initial average lease term of 15.8 years

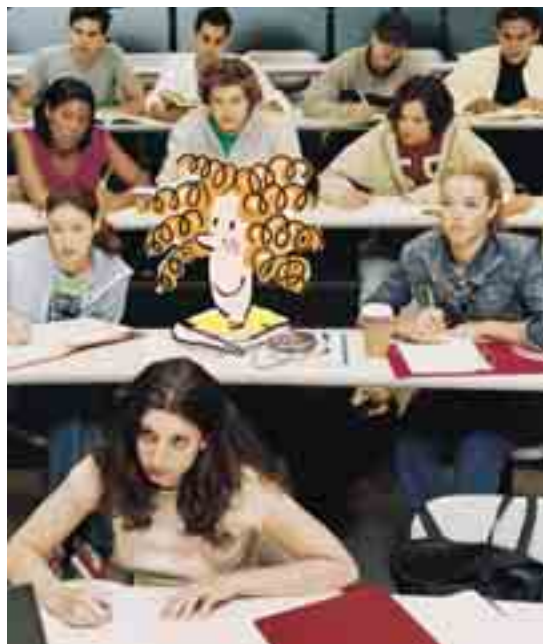


## OBJECTIVE SETTING 101

### 2006 BUSINESS PLAN\*

- PAY 12 MONTHLY DIVIDENDS
- RAISE THE DIVIDEND
- MAINTAIN A CONSERVATIVE BALANCE SHEET
- MAINTAIN HIGH PORTFOLIO OCCUPANCY
- ACQUIRE ADDITIONAL PROPERTIES
- TELL MORE PEOPLE ABOUT THE MONTHLY DIVIDEND COMPANY®
- REMAIN CONSERVATIVE

\* THIS BUSINESS PLAN WILL LOOK FAMILIAR TO MDU ALUMNI



# ACCOUNTING 101

## REALTY INCOME'S 2005 OPERATING RESULTS AND FINANCIAL PERFORMANCE

BY PROFESSOR MICHAEL R. PFEIFFER

Realty Income's senior management team is pleased to report another successful and profitable year for the operations of The Monthly Dividend Company®. In fact, in many ways 2005 was the best year in the history of the Company. During the year, the Company enjoyed success in all areas of its business operations including, strong overall property portfolio performance, outstanding access to capital at attractive rates, as well as a record number of property acquisitions, the highest in the history of the Company. As a result, Realty Income also ended the year with record revenue, funds from operations (FFO) and dividends.

Revenue growth is an important objective of the Company because it is crucial to Realty Income's ability to increase FFO and dividends. During 2005, revenue increased 13.2% to \$196.7 million, as compared to \$173.7 million during 2004. This revenue growth is primarily attributable to the high level of property acquisitions achieved in both 2004 and 2005. As of December 31, 2005, Realty Income and its Crest Net Lease subsidiary had acquired 156 new properties for \$486.6 million. Realty Income invested \$430.7 million in 135 properties, to be held for long-term investment in the Company's core portfolio, while Crest Net Lease acquired 21 properties for \$55.9 million and these properties were marketed for resale. Realty Income's properties are located in 28 states, have an initial average lease rate of 8.4% and an initial average lease term of 15.6 years.

As a result of higher than average acquisition activity, FFO available to common shareholders also increased 9.6% to \$129.6 million, as compared to \$118.2 million during 2004. On a diluted per common share basis, FFO increased 8.0% to \$1.62 per share, as compared to \$1.50 per share for 2004. FFO is a common measurement for a real estate investment trust, or REIT. It is an alternative non-GAAP measure that is

also considered to be a good indicator of a company's ability to pay dividends. A reconciliation of net income available to common shareholders to FFO per common share, is included in Management's Discussion and Analysis of Financial Condition and Results of Operations on page 60.

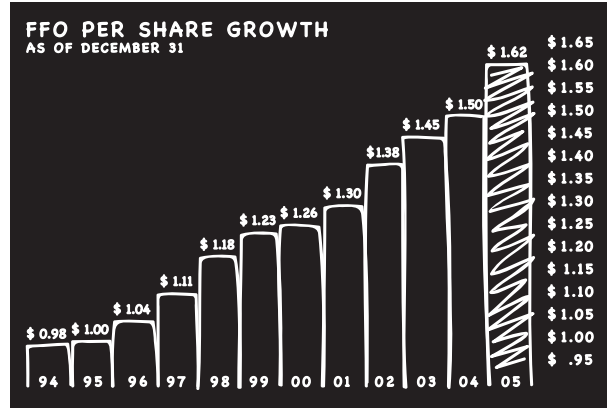
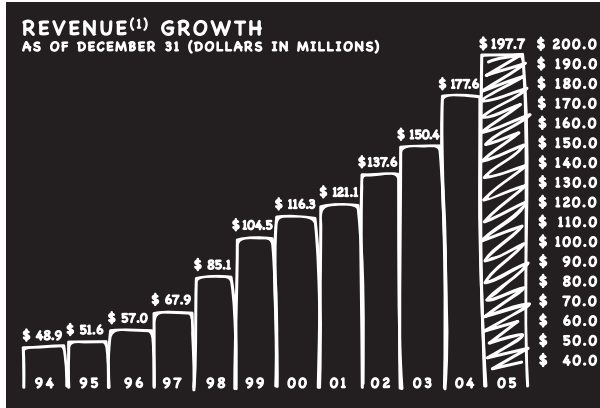
Net income available to common shareholders, as of December 31, 2005, was \$89.7 million as compared to \$90.2 million in 2004. On a diluted per common share basis, net income was \$1.12 per share in 2005 as compared to \$1.15 per share in 2004. (The calculation to determine net

income for a real estate company includes gains from the sales of investment properties and impairments. The amount of gains from property sales and impairments vary from year to year according to the timing of property sales. This variance can significantly impact net income.)

Realty Income's subsidiary company, Crest Net Lease, Inc., also contributed to Realty Income's earnings growth during 2005. Crest was formed to capitalize on the opportunities to acquire and sell retail properties for

a profit. Crest's primary purpose, however, has been to enable Realty Income to complete the acquisition of large portfolios of properties and then provide the vehicle to subsequently sell the properties that the Company does not plan to hold. While Crest has been successful in assisting Realty Income in its acquisition efforts, Crest has also added each year to Realty Income's profitability. During 2005, Crest generated \$2.8 million, or \$0.03 per share, in FFO for Realty Income, in comparison to \$7.8 million, or \$0.10 per share, in FFO for Realty Income in 2004. At December 31, 2005 Crest held inventory of \$45.7 million in 17 properties being marketed for sale.





The Company continued to enjoy consistent performance on the 1,646 properties that comprise Realty Income's retail real estate portfolio. Occupancy remained strong throughout 2005 and was 98.5% on December 31, 2005. During 37 years of operations, and through varying economic situations, the Company's occupancy level at the end of each year has never fallen below 97%. Such performance speaks to Realty Income's focus on acquiring properties where retailers provide basic human needs goods and services that consumers use every day.

The ongoing solid operating and financial performance of Realty Income has made possible the payment of 425 consecutive dividends since 1969, 33 quarterly dividend increases and a total of 37 increases in the amount of the monthly dividend since 1994. In addition, the amount of the annualized dividend has increased from \$0.90 per share in 1994 to \$1.395 per share, as of December 31, 2005, an increase of 55%. Shareholders also received \$1.34625 in dividends paid during 2005 for a yield of 5.3% based on the closing share price of \$25.29 on December 31, 2004.



(Disclosure: Professor Pfeiffer coaches MDU's swim team and also writes voluminous legal documents as Realty Income's Executive Vice President, General Counsel and Secretary.)

<sup>(1)</sup>Total revenue includes amounts reclassified to income from discontinued operations, but excludes revenue from Crest Net Lease.



## REAL ESTATE 101

### “IDENTIFYING AND ACQUIRING RETAIL PROPERTIES”

BY PROFESSOR KIM KUNDRAK



When an investor purchases retail real estate for income, that investor needs to ascertain both the feasibility of the property as a retail location, as well as the financial and operational health of the prospective retail chain that will occupy the property. This analysis provides the individual real estate investor with the confidence that lease payments will be made as agreed. For a large real estate investment company like Realty Income, dedicated to providing dependable monthly income for thousands of investors, this scrutiny is of the utmost importance for long-term success. It is worth spending some class time to discuss how Realty Income identifies and analyzes retail real estate that will be a reliable generator of income.

Acquiring quality retail properties begins with the Company's ability to uncover a large number of potentially viable transactions from which it can select the properties it wishes to purchase. Finding these opportunities is a key component to Realty Income's ability to continue to increase the size of the Company's real estate portfolio and the rental revenue it generates. This process involves a tremendous amount of activity that focuses on identifying which retail industries will require capital over the coming years and, as such, wish to sell their properties in order to acquire that capital. Another activity involves identifying attractive retail chains, in select industries, that own the type of real estate the Company would like to purchase. And finally, Realty Income works with prospective retail chains to structure potential transactions that fit both the needs of the retailer and the

investment criteria of Realty Income. This effort requires the ability to anticipate when certain retail industries require financing, to understand the financial requirements of various retail industries, and a thorough knowledge of the retailer's operations and real estate.

Over the years Realty Income has worked with a number of industries at opportune times, such as fast food restaurants in the 1970's, child daycare in the 1980's, the convenience store industry in the 1990's, to mention just a few. Uncovering such opportunities continues to be a focus of the Company's efforts. However, over the past few years, an environment of increased competition and decreasing lease yields has demanded greater emphasis on utilizing Realty Income's size and cost-of-capital advantages, as well as its transaction expertise, in order to maintain the Company's leadership in the sale-leaseback financing arena.

The Company has also had to continually generate new strategies for acquiring properties and research additional industries to remain agile and successful in its acquisitions efforts. Realty Income's acquisition officers are the driving force in developing the Company's new business. Seven real estate and finance executives call on various, strategically identified, retail chains and other entities to generate investment opportunities throughout the year. Each of these professionals is assigned either an area of the country for which they are responsible, or a particular industry segment in which they develop specific expertise. In all cases, these calling officers are the eyes and ears of the Company and the first line of inquiry and information relative to generating transactions for Realty Income.

Identifying new industries and retailers with whom to do business every year is just one aspect of remaining competitive and supporting the Company's ability to grow the real estate



portfolio. Assessing the feasibility of prospective properties is the other critical function. Realty Income's real estate research group does the footwork, performing individual site and demographic analysis, assessing traffic flows, monitoring competitive operations and meeting with local market experts for every single property that the Company plans to purchase.

Realty Income's retail research group provides the competitive, operational and financial review of prospective retail tenants. Since the Company is relying on these retailers to occupy its properties and pay rent for 15 to 20 years, selecting the right retail industries and chains is crucial. The retail research group follows economic and industry trends on over 29 different retail industries and scrutinizes operations of all 101 retail chains in the Company's current investment portfolio. They also meet with the management of retail chains the Company is considering, assess their business plans, review their competitive position in the marketplace and make recommendations regarding the suitability of a particular industry or retail chain for the Company's portfolio.

The research assembled by both the real estate and retail research group, combined with the acquisition prospects uncovered by the acquisitions team, provide the potential investment packages for Realty Income's Investment Committee to consider. The Investment Committee consists of the four senior executive officers of the Company. This Committee meets one or more days each week to analyze every investment opportunity that has gone through the due diligence process. In 2005, the Investment Committee reviewed about \$2.8 billion in potential real estate acquisitions involving over 1,700 properties. This was not only the highest volume of potential transactions ever reviewed by the Company, but this activity ultimately led to a record year for Realty Income's portfolio acquisitions department.

During 2005, Realty Income and its Crest Net Lease subsidiary acquired 156 properties for \$486.6 million. Of the 156 properties purchased, Realty Income invested

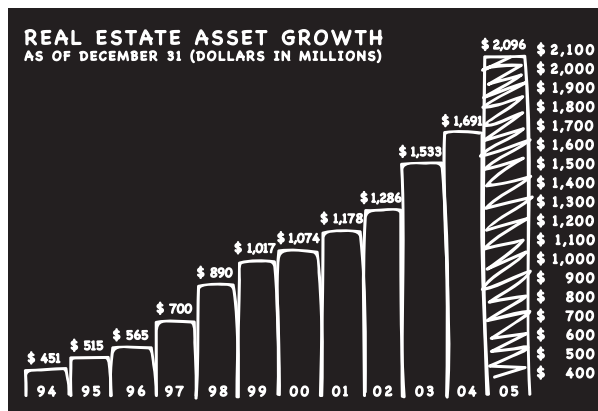
\$430.7 million in 135 properties to be held for long-term investment in the Company's core portfolio. These properties are located in 28 states, have an initial average lease rate of 8.4% and an initial average lease term of 15.6 years. They are leased to 13 different retail chains in seven retail industries. Crest Net Lease acquired 21 properties for \$55.9 million and these properties were marketed for resale. These acquisitions contributed to increased lease revenue that generated FFO per share growth during 2005.

Realty Income usually counsels investors that this level of acquisition activity is not something to be taken for granted. The fact that the Company had a record year in 2005 does not necessarily establish a trend that can be extrapolated into the future. The environment for net-lease retail properties has

become increasingly competitive over the years and the Company projects that this situation is likely to continue into the foreseeable future. Additionally, in any given year it is the Company's objective to buy ONLY the properties that meet its investment criteria and are considered suitable to generate long-term rental revenue from which to pay

dividends. As such, acquisition volumes will vary considerably from year to year, depending on the ability of the Company to find and acquire the properties that meet its stringent investment requirements.

With that said, however, Realty Income has been very active in working with large companies that are in the process of acquiring other retailers, pursuing other growth initiatives, recapitalizations, balance sheet restructurings or other financial events where Realty Income's acquisition of properties, to generate capital for the retailers, can be useful. The Company's ability to purchase large portfolios of properties within a specific time frame is a vital competitive advantage in these types of transactions. So too is Realty Income's 37 years of experience in sale-leaseback financing, its sizable resources, access to capital and experienced management team that seeks to add value to every transaction for its retail customers.

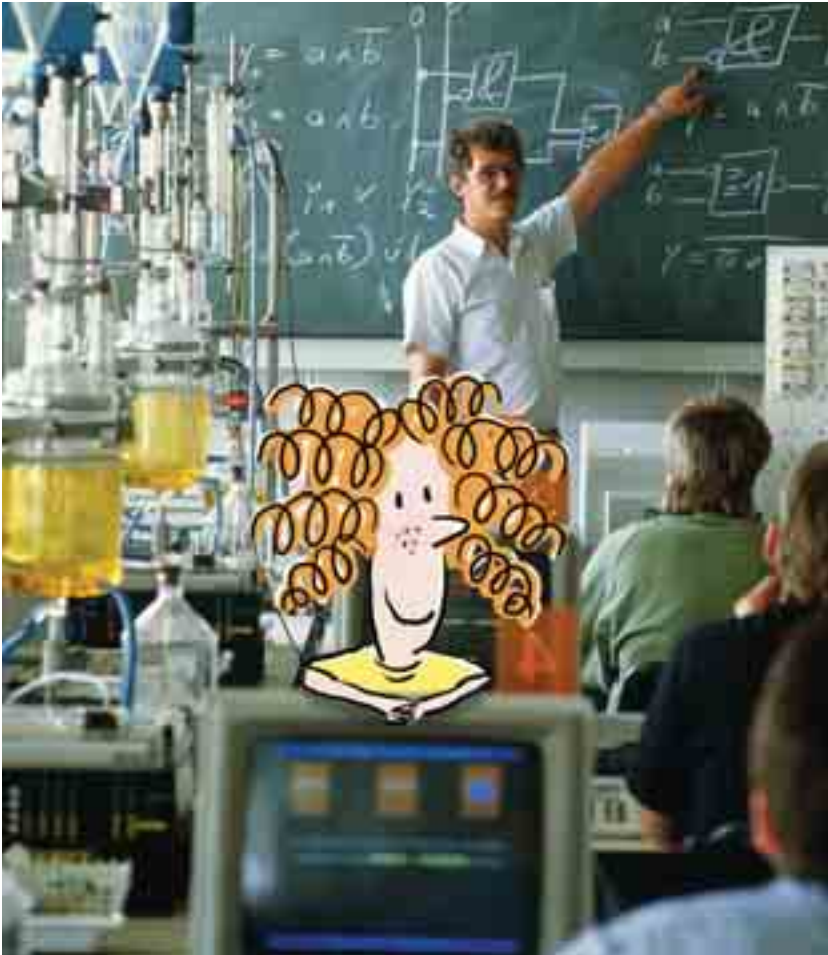


(Disclosure: Professor Kundrak plays on MDU's faculty basketball team and serves as Senior Vice President, Portfolio Acquisitions for Realty Income.)

## SCIENCE 101

### “THE SCIENCE OF PORTFOLIO MANAGEMENT”

BY PROFESSOR RICHARD COLLINS



What is the “Science of Portfolio Management”? At first glance, managing a net-leased property portfolio appears fairly straightforward. When a net-lease agreement is combined with a solid tenant, the result is a reliable income stream, rather like combining hydrogen and oxygen to form water. Theoretically then, owning a portfolio of net-leased properties is a simple proposition, right?

To the extent that Realty Income’s properties and tenants have passed a rigorous due diligence process, the Company enjoys a certain degree of confidence that its tenants will meet

their 15- to 20-year contractual lease agreements. The Company has always called this a fairly “simple concept.” Behind the scenes, however, there is a great deal that must be done to ensure that the Company’s portfolio of 1,646 properties continues to perform as desired. After all, the objective is for Realty Income to receive lease payments every month so that it can then pay dividends each month to its shareholders for a long period of time.

There are several aspects to consistent portfolio performance that support the payment of monthly dividends. Effectively managing the portfolio, so that occupancy remains high, is one factor. Fortunately, Realty Income has enjoyed more than 97% occupancy throughout its 37 years of operations. As of December 31, 2005, portfolio occupancy was 98.5% and there were just 25 properties available for lease out of 1,646 properties in the portfolio. Diversification across 29 retail industries, 101 retail chains, and across 48 states is one reason why the Company has been able to maintain such high occupancy. Another reason is the Company’s focus on acquiring properties from retailers who provide basic human needs goods and services that consumers use every day. Both of these factors contribute to stable portfolio operations as well as to the safety of the dividend.

A vital component to sustaining strong portfolio performance and high occupancy is retail research. The importance of such research cannot be overstated. Realty Income’s portfolio management team, as good as they are, are not magicians. They can’t turn a challenging retail tenant into a good performing tenant, no matter how diligent they are. Thus, the foundation for ongoing solid portfolio operations is to purchase good properties with sound tenants in the first place. The retail research group at Realty Income follows economic and industry trends on over 29 different retail industries and scrutinizes operations of all

## PORTFOLIO OCCUPANCY

2005	2004	2003	2002	2001	2000	1999	1998	1997	1996	1995	1994
98.5%	97.9%	98.1%	97.7%	98.2%	97.7%	98.4%	99.5%	99.2%	99.1%	99.3%	99.4%

As of December 31



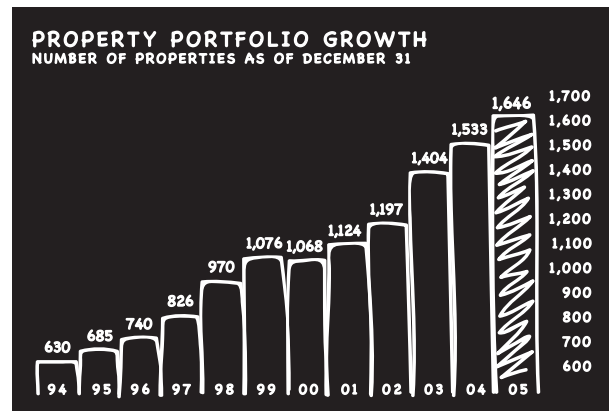
101 retail chains in the Company's portfolio. This research team continuously monitors tenant financial health and provides the Company with the regular, in-depth, tenant financial analysis that is required to ensure the consistent payment of rent every month.

Another important aspect of managing the Company's real estate assets is to know if a particular property should be sold. This is not only a strategic option during investment performance analysis, but it is also another source of capital for the Company. Property sales occur when management believes sale proceeds can be reinvested at higher returns, the sale of a property enhances portfolio credit quality, or selling a property increases the average remaining lease term in the portfolio. During 2005, Realty Income sold 23 properties for \$23.4 million, all of which met this criteria.

The primary reason that the Company's real estate portfolio has continued to perform well over the years, however, is the proactive management of the portfolio. Instead of waiting for a lease to expire to discover a retailer's intentions, the portfolio management team enters into discussions, considerably in advance of the expiration date, to determine the Company's

options. The markets where Realty Income owns properties with leases scheduled to expire are also closely monitored to gauge whether or not it would be better to re-lease a property to the same tenant, to a new tenant or to sell a property when the lease expires. This proactive management contributed to the successful administration of 105 lease expirations during 2005. In addition, in 2005, same store rent increases for Realty Income's portfolio were 0.8%.

As proficient as Realty Income has been in keeping portfolio occupancy strong over the years, the Company has, once again, been fortunate that its retailers performed well during another year of economic uncertainty. As always, Realty Income's management stresses that there is the possibility that a tenant, no matter how strong or recession-proof it may seem to be, could face unexpected financial difficulties and struggle to pay rent. This has happened in the past and will likely occur again in the future. Realty Income views this as "business as usual" and handles such events as routine occurrences when owning a large portfolio of properties. With 37 years of portfolio management experience behind them, however, Realty Income's management team has the know-how and resilience to work through a variety of economic challenges that may arise.



(Disclosure: Professor Collins is coach of MDU's racquetball squad and serves as Executive Vice President, Portfolio Management for Realty Income.)

## ECONOMICS 101

### “THE ECONOMICS OF CAPITAL FORMATION AND INVESTOR RETURNS”

BY PROFESSOR PAUL M. MEURER



#### CAPITAL FORMATION

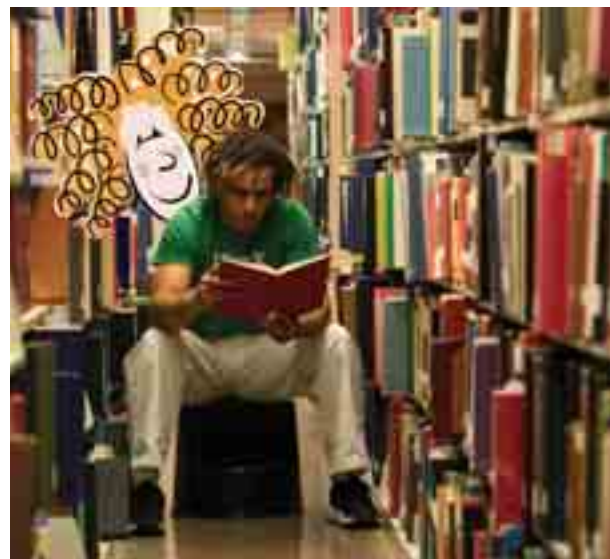
The primary purpose of Realty Income's capital markets activities is to permanently fund the Company's new property acquisitions. Since the growth of the Company's real estate portfolio is a primary driver of growth in earnings and dividends, access to capital to fund new property acquisitions is critical to achieving that growth. And, assembling the most efficient capital structure, so that the company enjoys uninterrupted access to cost-effective capital, is rather like selecting the right club to use when making an approach shot to the green in golf. Too much club and you'll overshoot the green, too little and you come up short, making it difficult to par the hole. For non-golfers, we're talking about knowing how to use certain tools and understanding when to use them so that the desired outcome is achieved.

Since the objective of a Company like Realty Income is to maintain the integrity of the cash flow used to pay dividends, a relatively conservative capital structure, in comparison to many other real estate companies, is what the Company strives for. Realty Income has a bias towards using common equity to fund acquisitions and carefully blends in other forms of capital to seek a balance between the best cost of capital and a conservative capital structure. Debt and preferred stock are generally used only when there are clear, cost-of-capital advantages. The balance between different capital components is monitored at all times so that the Company's conservative structure is maintained.

Realty Income uses its \$300 million unsecured acquisition credit facility, in the short term, to purchase properties so that the Company can efficiently acquire properties with no financing contingencies. The Company then permanently finances these acquisitions by issuing common or preferred stock or bonds and pays down the balance on its \$300 million acquisition credit facility. The principle behind this procedure is that permanently financing transactions on or soon after closing tends to minimize the amount of variable rate debt to which the Company is exposed. This strict, long-term Company policy has been instrumental in minimizing the impact rising interest rates might otherwise have had on Realty Income's cash flow throughout its operating history. Another important point is that the Company owns all of its properties free and clear of property level encumbrances, i.e. without mortgages, so that more of the Company's cash flow is available to pay dividends.

During 2005, Realty Income took advantage of favorable market conditions to permanently fund its recent acquisitions. Since the Company was able to achieve attractive pricing for both its common stock and unsecured bonds, Realty Income found it advantageous to use both of these sources of capital during the year.

Credit rating upgrades, received in 2003, facilitated the advantageous pricing of a March 2005 offering of \$100 million of 30-year, 5<sup>7</sup>/<sub>8</sub>% unsecured bonds due in March 2035. Subsequently, a Fitch Ratings agency upgrade of Realty Income's credit rating, in September 2005, was instrumental in attractively pricing a \$175 million, 12-year, 5<sup>3</sup>/<sub>8</sub>% unsecured bond offering due in 2017. The Company's senior unsecured debt ratings from Fitch Ratings Credit Agency rose to



BBB+ from BBB, and the Company's preferred stock ratings increased to BBB from BBB-.

Also in September 2005, Realty Income issued 4.1 million common shares priced at \$23.79 per share raising gross proceeds of approximately \$97.5 million. The proceeds from all of these transactions were used to fund acquisitions and for other general corporate purposes.

The Company's capital structure at the end of the year consisted of 64.0% in equity, 4.5% in preferred stock and 31.5% in debt (primarily long-term bonds.) According to certain research analysts, Realty Income ranks among the top five in the real estate industry for balance sheet strength in comparison to all other REITs. Maintaining a conservative balance sheet is among Realty Income's core operating objectives.

## INVESTOR RETURNS

While the Company performed well, in terms of its capital markets activities, as well as all other facets of the Company's operations, unfortunately the price of its shares on the New York Stock Exchange at the end of the year did not reflect the Company's positive operating results. The Company's closing price at the end of 2004 was \$25.29 per share in comparison to the closing stock price, as of December 31, 2005, of \$21.62 per share, a decrease of 14.5%. However, the dividends paid increased 8.5% and shareholders received \$1.34625 per share in dividends during 2005.

When dividends paid are combined with the year-end share price, the total return for the year was -9.2%. This may be somewhat disappointing, but it's important to realize that the Company believes there was no fundamental business or operational cause for this moderate share price

decrease. Interestingly, strong performance in the Company's operations every year may not correlate to the movement of the stock price over the short term. For instance, since 1999 Realty Income's annual Funds from Operations (FFO) per share growth rate was: 4.2% in 1999, 2.4% in 2000, 3.2% in 2001, 6.2% in 2002, 5.1% in 2003, 3.4% in 2004 and 8.0% in 2005. In comparison, the Company's stock price percentage change in the same years has been: -17.9% in 1999, 20.6% in 2000, 18.2% in 2001, 19.0% in 2002, 14.3% in 2003, 26.5% in 2004 and -14.5% in 2005. The point is that over the long term Realty Income believes that consistent increases in the Company's operating performance and dividends should lead to advances in the Company's share price over time.

To quote a well-known investor, Warren Buffett, "In the short run, the market is a voting machine but in the long run, it is a weighing machine." In other words, if a company continues to perform well over the long term, its share price should also tend to perform well over the long term. Thus, short-term fluctuations, which oftentimes reflect emotional reactions to news or changes in investor sentiments tend to even out if price performance is viewed over a longer period of time. Since most shareholders generally own Realty Income in order to receive an increasing monthly dividend check, short-term stock price fluctuations are usually not a great concern, though it's always more enjoyable to learn that the price went up rather than down for the year.

**For income investors, the most important information is how much was paid in dividends during the year.** Since dividend increases continued throughout 2005, Realty Income's annualized dividend amount per share has grown from \$.90 per share in 1994 to \$1.395 per share, as of December 31, 2005. In addition the annualized dividend yield was 6.5% as of the end of 2005. By comparison, as of December 31, 2005, the 10-year Treasury was yielding 4.40%, the Dow Jones Utility Index was yielding 3.30%, the national average for a 1-year CD was 3.39%, the S&P 500 was yielding 1.86% and the Dow Jones Industrial average was yielding 2.31%.

In comparison to all of these benchmarks, Realty Income represented an above average source of income for new income investors. Furthermore, for existing shareholders, the Yield on Cost, based on the price they paid for their shares at the time of purchase, continued to increase as the Company raised its dividend five times during 2005.

### YIELD COMPARISONS

REALTY INCOME	6.50%
S&P 500	1.86%
Dow Jones Industrial	2.31%
Dow Jones Utility Index	3.30%
10-Year Treasury	4.40%
1-Year CD	3.39%

As of December 31, 2005

(Disclosure: Professor Meurer also plays on MDU's faculty basketball team and serves as Chief Financial Officer, Treasurer, and Executive Vice President of Realty Income.)

# FINANCIAL INFORMATION

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OK. You guys are going to be  
in the annual report again.  
This time our theme is  
"Monthly Dividend  
University"...Here's  
the strategy...

psst...have you  
ever noticed  
the CEO's hair  
never moves?

shhhh, ya  
wanna get  
us fired?



## BUSINESS DESCRIPTION

### THE COMPANY

Realty Income Corporation, The Monthly Dividend Company®, is a Maryland corporation organized to operate as an equity real estate investment trust, or REIT. Our primary business objective is to generate dependable monthly cash distributions from a consistent and predictable level of funds from operations, or FFO per share. The monthly distributions are supported by the cash flow from our portfolio of retail properties leased to regional and national retail chains. We have in-house acquisition, leasing, legal, retail and real estate research, portfolio management and capital markets expertise. Over the past 37 years, Realty Income and its predecessors have been acquiring and owning freestanding retail properties that generate rental revenue under long-term lease agreements (primarily 15- to 20-years).

In addition, we seek to increase distributions to stockholders and FFO per share through both active portfolio management and the acquisition of additional properties. Our portfolio management focus includes:

- Contractual rent increases on existing leases;
- Rent increases at the termination of existing leases when market conditions permit; and
- The active management of our property portfolio, including re-leasing of vacant properties and selective sales of properties.

Our acquisition of additional properties adheres to a focused strategy of primarily acquiring properties that are:

- Freestanding, single-tenant, retail locations;
- Leased to regional and national retail chains; and
- Leased under long-term, net-lease agreements.

At December 31, 2005, we owned a diversified portfolio:

- Of 1,646 retail properties;
- With an occupancy rate of 98.5%, or 1,621 properties occupied of the 1,646 properties in the portfolio;
- Leased to 101 different retail chains doing business in 29 separate retail industries;
- Located in 48 states;
- With over 13.4 million square feet of leasable space; and
- With an average leasable retail space of 8,200 square feet.

Of the 1,646 properties in the portfolio, 1,641, or 99.7%, are single-tenant, retail properties and the remaining five are multi-tenant, distribution and office properties. At December 31, 2005, 1,617, or 98.5%, of the 1,641 single-tenant properties were leased with a weighted average remaining lease term (excluding extension options) of approximately 12.4 years.

In addition, our wholly-owned taxable REIT subsidiary, Crest Net Lease, Inc., owned 17 properties with a total investment of \$45.7 million at December 31, 2005, which are classified as held for sale. Crest Net was created to buy, own and sell properties, primarily to individual investors, many of whom are involved in tax-deferred exchanges under Section 1031 of the Internal Revenue Code of 1986, as amended, the "Code."

We typically acquire retail store properties under long-term leases with retail chain store operators. These transactions generally provide capital to owners of retail real estate and retail chains for expansion or other corporate purposes. Our acquisition and investment activities are concentrated in well-defined target markets and generally focus on retailers providing goods and services that satisfy basic consumer needs.

Our net-lease agreements generally:

- Are for initial terms of 15 to 20 years;
- Require the tenant to pay minimum monthly rents and property operating expenses (taxes, insurance and maintenance); and
- Provide for future rent increases (typically subject to ceilings) based on increases in the consumer price index, fixed increases, or to a lesser degree, additional rent calculated as a percentage of the tenants' gross sales above a specified level.

Realty Income commenced operations as a REIT on August 15, 1994 through the merger of 25 public and private real estate limited partnerships with and into the Company. Each of the partnerships was formed between 1970 and 1989 for the purpose of acquiring and managing long-term, net-leased properties.

The six senior officers of Realty Income owned 1.3% of our outstanding common stock with a market value of \$25.1 million at February 10, 2006. The directors and six senior officers of Realty Income, as a group, owned 2.7% of our outstanding common stock with a market value of \$51.6 million at February 10, 2006.

Realty Income's common stock is listed on The New York Stock Exchange ("NYSE") under the ticker symbol "O." Our central index key number is 726728 and cusip number is 756109-104.

Realty Income's Class D cumulative redeemable preferred stock is listed on the NYSE under the ticker symbol "OprD" and its cusip number is 756109-609.

Realty Income's 8.25% Monthly Income Senior Notes, due 2008 are listed on the NYSE under the ticker symbol "OUI." The cusip number of these notes is 756109-203.



At February 10, 2006, we had 69 permanent employees and four temporary employees, as compared to February 15, 2005 when we had 64 permanent employees and six temporary employees. The temporary employees have been working on a record retention project that is expected to conclude during 2006.

We maintain an Internet website at [www.realtyincome.com](http://www.realtyincome.com). On our website we make available, free of charge, copies of our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8 K, and amendments to those reports, as soon as reasonably practicable after we electronically file these reports with the SEC. None of the information on our website is deemed to be part of this report.

## RECENT DEVELOPMENTS

### Credit Facility

In June 2005, Realty Income entered into a new \$300 million acquisition credit facility to replace our existing \$250 million acquisition credit facility that expired in October 2005. Under the terms of the new credit facility, which commenced in October 2005, the borrowing rate was reduced to LIBOR (London Interbank Offered Rate) plus 65 basis points with a facility fee of 15 basis points, for all-in drawn pricing of 80 basis points over LIBOR, based on our current credit ratings. The new credit facility offers us other interest rate options as well. The term of the new facility expires in October 2008, unless extended as provided in the agreement.

### Common Stock Issuance

In September 2005, we issued 4.1 million shares of common stock. The net proceeds of \$92.7 million were used to fund new property acquisitions and for other general corporate purposes.

### Credit Ratings Upgrade

In September 2005, our credit ratings were upgraded by Fitch Ratings. Our senior unsecured debt rating was raised to BBB+ from BBB and our preferred stock rating was raised to BBB from BBB- with a stable outlook.

In February 2006, Moody's Investors Service, Inc. affirmed its ratings on our senior unsecured debt rating of Baa2 and our preferred stock rating of Baa3 and raised the outlook to "positive" from "stable."

### Issuance of 12-Year Senior Unsecured Notes

In September 2005, Realty Income issued \$175 million in aggregate principal amount of 12-year, 5<sup>3</sup>/<sub>8</sub>% senior unsecured notes due 2017. The price to the public for the notes was 99.974% of the principal amount for an effective yield of 5.378%. The net proceeds from the offering were used to repay borrowings under the Company's unsecured acquisition credit facility, for property acquisitions and for other general corporate purposes. Our outstanding notes and bonds are rated BBB+ by Fitch Ratings, Baa2 by Moody's Investors Service and BBB by Standard & Poor's Ratings Group.

### Issuance of 30-Year Senior Unsecured Bonds

In March 2005, Realty Income issued \$100 million in aggregate principal amount of 30-year, 5<sup>7</sup>/<sub>8</sub>% senior unsecured bonds due 2035. The price to the investor for the bonds was 98.296% of the principal amount for an effective yield of 5.998%. The net proceeds from the offering were used to repay borrowings under our unsecured acquisition credit facility and for other general corporate purposes.

### Acquisitions During 2005

During 2005, Realty Income and Crest Net invested, in aggregate, \$486.6 million in 156 new properties and properties under development. These 156 properties are located in 30 states and are 100% leased with an initial average lease term of 15.8 years. As described below, Realty Income acquired 135 properties and Crest Net acquired 21 properties.

Included in the \$486.6 million is \$430.7 million invested by Realty Income in 135 new properties and properties under development with an initial weighted average contractual lease rate of 8.4%. These 135 properties are located in 28 states, are 100% leased with an initial average lease term of 15.6 years and will contain over 1.7 million leasable square feet. The 135 new properties acquired by Realty Income are net-leased to 13 different retail chains in the convenience store, drug store, financial services, health and fitness, motor vehicle dealership, restaurant and theater industries.

Included in the \$486.6 million is \$55.9 million invested by Crest Net in 21 new retail properties and properties under development.

Of the \$430.7 million Realty Income invested in real estate during 2005, \$43.9 million was invested in 10 properties that were leased and under contract for development by the tenant at December 31, 2005 (with development costs funded by Realty Income). Rent on these properties is scheduled to begin at various times during 2006. At December 31, 2005, we also had committed to pay estimated unfunded development costs totaling \$42.2 million.

The initial weighted average contractual lease rate is computed as estimated contractual net operating income (in a net-leased property this is equal to the base rent or, in the case of properties under development, the estimated base rent under the lease) for the first year of each lease, divided by the estimated total costs. Since it is possible that a tenant could default on the payment of contractual rent, we cannot assure you that the actual return on the funds invested will remain at the percentages listed above.

### Investments in Existing Properties

In 2005, we capitalized costs of \$1.6 million on existing properties in our portfolio, consisting of \$570,000 for re-leasing costs and \$1.0 million for building improvements.

### **Net Income Available to Common Stockholders**

Net income available to common stockholders was \$89.7 million in 2005 versus \$90.2 million in 2004, a decrease of \$452,000. On a diluted per common share basis, net income was \$1.12 per share in 2005 as compared to \$1.15 per share in 2004.

The calculation to determine net income available to common stockholders includes gains from the sale of investment properties. The amount of gains varies from period to period based on the timing of property sales and can significantly impact net income available to common stockholders.

The gain recognized from the sales of investment properties during 2005 was \$6.6 million as compared to \$12.7 million during 2004.

### **Funds from Operations (FFO)**

In 2005, our FFO increased by \$11.4 million, or 9.6%, to \$129.6 million versus \$118.2 million in 2004. On a diluted per common share basis, FFO was \$1.62 in 2005 compared to \$1.50 for 2004, an increase of \$0.12, or 8.0%.

See our discussion of FFO in the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this annual report, which includes a reconciliation of net income available to common stockholders to FFO.

### **Crest Net Property Sales**

During 2005, Crest Net sold 12 properties from its inventory for \$23.5 million, which resulted in a gain of \$3.3 million.

### **Crest Net's Property Inventory**

Crest Net's property inventory at December 31, 2005 and December 31, 2004 totaled \$45.7 million and \$10.1 million, respectively, and is included in "real estate held for sale, net", on our consolidated balance sheets.

### **Increases in Monthly Cash Distributions to Common Stockholders**

We continue our 36-year policy of paying distributions monthly. Monthly distributions per share were increased in April 2005 by \$0.000625 to \$0.110625, in July 2005 by \$0.000625 to \$0.11125, in September 2005 by \$0.00375 to \$0.115, in October 2005 by \$0.000625 to \$0.115625 and in January 2006 by \$0.000625 to \$0.11625. The increase in January 2006 was our 33rd consecutive quarterly increase and the 37th increase in the amount of our dividend since our listing on the NYSE in 1994. In 2005, we paid the following monthly cash distributions per share: three in the amount of \$0.11, three in the amount of \$0.110625, two in the amount of \$0.11125, one in the amount of \$0.115, and three in the amount of \$0.115625 totaling \$1.34625. In December 2005, January 2006 and February 2006, we declared distributions of \$0.11625 per share, which were paid on January 17, 2006, February 15, 2006 and will be paid on March 15, 2006, respectively.

The monthly distribution of \$0.11625 per share represents a current annualized distribution of \$1.395 per share, and an annualized distribution yield of approximately 6.1% based on the last reported sale price of our common stock on the NYSE of \$22.78 on February 10, 2006. Although we expect to continue our policy of paying monthly distributions, we cannot guarantee that we will maintain the current level of distributions, that we will continue our pattern of increasing distributions per share, or what the actual distribution yield will be in any future period.

### **DISTRIBUTION POLICY**

Distributions are paid monthly to our common stockholders and Class D preferred stockholders if, and when declared by our Board of Directors. The Class D preferred stockholders receive cumulative distributions at a rate of 7.375% per annum on the \$25 per share liquidation preference (equivalent to \$1.84375 per annum per share).

In order to maintain our tax status as a REIT for federal income tax purposes, we generally are required to distribute dividends to our stockholders aggregating annually at least 90% of our REIT taxable income (determined without regard to the dividends paid deduction and by excluding net capital gains) and we are subject to income tax to the extent we distribute less than 100% of our REIT taxable income (including net capital gains). In 2005, our cash distributions totaled \$118.0 million, or approximately 113.2% of our estimated REIT taxable income of \$104.2 million. Our estimated REIT taxable income reflects non-cash deductions for depreciation and amortization. We intend to continue to make distributions to our stockholders that are sufficient to meet this distribution requirement and that will reduce our exposure to income taxes. Our 2005 cash distributions to common stockholders totaled \$108.6 million, representing 83.8% of our funds from operations available to common stockholders of \$129.6 million.

Future distributions will be at the discretion of our Board of Directors and will depend on, among other things, our results of operations, FFO, cash flow from operations, financial condition and capital requirements, the annual distribution requirements under the REIT provisions of the Code, our debt service requirements and any other factors the Board of Directors may deem relevant. In addition, our credit facility contains financial covenants that could limit the amount of distributions payable by us in the event of a deterioration in our results of operations or financial condition, and which prohibit the payment of distributions on the common or preferred stock in the event that we fail to pay when due (subject to any applicable grace period) any principal or interest on borrowings under our credit facility.

Distributions of our current and accumulated earnings and profits for federal income tax purposes, generally will be taxable to stockholders as ordinary income, except to the extent that we recognize capital gains and declare a capital gains dividend or that such amounts constitute “qualified dividend income” subject to a reduced rate of tax. The maximum tax rate of non-corporate taxpayers for “qualified dividend income” has generally been reduced to 15% (for taxable years beginning after December 31, 2002). In general, dividends payable by REITs are not eligible for the reduced tax rate on corporate dividends, except to the extent the REIT’s dividends are attributable to dividends received from taxable corporations (such as our taxable REIT subsidiary, Crest Net), to income that was subject to tax at the corporate or REIT level (for example, if we distribute taxable income that we retained and paid tax on in the prior taxable year) or, as discussed above, dividends properly designated by us as “capital gain dividends.” Distributions in excess of earnings and profits generally will be treated as a non-taxable reduction in the stockholders’ basis in the stock. Distributions above that basis, generally, will be taxable as a capital gain. Approximately 10.1% of the distributions, made or deemed to have been made in 2005, to our common stockholders were classified as a return of capital for federal income tax purposes. We are unable to predict the portion of future distributions that may be classified as a return of capital.

## **BUSINESS PHILOSOPHY AND STRATEGY**

### **Investment Philosophy**

We believe that owning an actively managed, diversified portfolio of retail properties under long-term, net leases produces consistent and predictable income. Under a net-lease agreement, the tenant agrees to pay monthly rent and property operating expenses (taxes, maintenance and insurance) plus, typically, future rent increases (generally subject to ceilings) based on increases in the consumer price index, fixed increases, or to a lesser degree, additional rent calculated as a percentage of the tenants’ gross sales above a specified level. We believe that a portfolio of properties under long-term leases, coupled with the tenant’s responsibility for property expenses, generally produces a more predictable income stream than many other types of real estate portfolios, while continuing to offer the potential for growth in rental income.

### **Investment Strategy**

In identifying new properties for acquisition, our focus is generally on providing capital to retail chain owners and operators by acquiring, then leasing back, retail store locations. We categorize retail tenants as: 1) venture market, 2) middle market, and 3) upper market. Venture companies typically offer a new retail concept in one geographic region of the country and operate between five and 50 retail locations. Middle market retail chains typically have 50 to 500 retail locations, operations in more than one geographic region, have been successful through one or more economic cycles, and have a proven, replicable concept. The

upper market retail chains typically consist of companies with 500 or more locations, operating nationally, in a proven, mature retail concept. Upper market retail chains generally have strong operating histories and access to several sources of capital.

Realty Income primarily focuses on acquiring properties leased to middle market retail chains that we believe are attractive for investment because:

- They generally have overcome many of the operational and managerial obstacles that can adversely affect venture retailers;
- They typically require capital to fund expansion but have more limited financing options;
- They generally have provided us with attractive risk-adjusted returns over time since their financial strength has, in many cases, tended to improve as their businesses have matured;
- Their relatively large size allows them to spread corporate expenses across a greater number of stores; and
- Middle market retailers typically have the critical mass to survive if a number of locations are closed due to under-performance.

We also focus on and have selectively made investments in properties of upper market retail chains. We believe upper market retail chains can be attractive for investment because:

- They typically are of a higher credit quality;
- They usually are larger public and private retailers with more commonly recognized brand names;
- They utilize a larger building ranging in size from 10,000 to 50,000 square feet; and
- They are able to grow because access to capital facilitates larger transaction sizes.

While our investment strategy focuses primarily on acquiring properties leased to middle and upper market retail chains, we also selectively seek investment opportunities with venture market retail chains. Periodically, venture market opportunities arise where we feel that the real estate used by the tenant is high quality and can be purchased at favorable prices. To meet our stringent investment standards, however, venture retail companies must have a well-defined retailing concept and strong financial prospects. These opportunities are examined on a case by case basis and we are highly selective in making investments in this area.

Historically, our investment focus has been on retail industries that have a service component because we believe the lease revenue from these types of businesses is more stable. Because of this investment focus, for the quarter ended December 31, 2005, approximately 81.2% of our rental revenue was derived from retailers with a service component in their business. Furthermore, we believe these service-oriented businesses would be difficult to duplicate over the Internet and that our properties continue to perform well relative to competition from Internet businesses.

### Credit Strategy

We generally provide sale-leaseback financing to less than investment grade retail chains. We typically acquire and lease back properties to regional and national retail chains and believe that within this market we can achieve an attractive risk-adjusted return on the financing we provide to retailers. Since 1970, our overall weighted average occupancy rate at the end of each year has been 98.5% and the occupancy rate at the end of each year has never been below 97.5%.

We believe the principal financial obligations of most retailers typically include their bank and other debt, payment obligations to suppliers and real estate lease obligations. Because we typically own the land and building in which a tenant conducts its retail business, we believe the risk of default on a retailers' lease obligations is less than the retailers' unsecured general obligations. It has been our experience that since retailers must retain their profitable retail locations in order to survive, in the event of reorganization they are less likely to reject a lease for a profitable location because this would terminate their right to use the property. Thus, as the property owner, we believe we will fare better than unsecured creditors of the same retailer in the event of reorganization. If a property is rejected by the tenant during reorganization, we own the property and can either lease it to a new tenant or sell the property. In addition, we believe that the risk of default on the real estate leases can be further mitigated by monitoring the performance of the retailers' individual unit locations and considering whether to sell locations that are weaker performers.

In order to qualify for inclusion in our portfolio, new property acquisitions must meet stringent investment and credit requirements. The properties must generate attractive current yields and the tenant must meet our credit profile. We have established a three-part analysis that examines each potential investment based on:

- Industry, company, market conditions and credit profile;
- Location profitability, if profitability data is available; and
- Overall real estate characteristics, including value and comparative rental rates.

The typical profile of companies whose properties have been approved for acquisition are those with 50 or more retail locations. Generally the properties:

- Are located in highly visible areas,
- Have easy access to major thoroughfares; and
- Have attractive demographics.

### Acquisition Strategy

We seek to invest in industries in which several, well-organized, regional and national chains are capturing market share through service, quality control, economies of scale, advertising and the selection of prime retail locations. We execute our acquisition strategy by acting as a source of capital to regional and national retail chain store owners and operators, doing business in a variety of industries, by acquiring and leasing back retail store locations. We undertake thorough research and analysis to identify appropriate industries, tenants and property locations for investment. Our research expertise is instrumental to uncovering net-lease opportunities in markets where our real estate financing program adds value. In selecting real estate for potential investment, we generally seek to acquire properties that have the following characteristics:

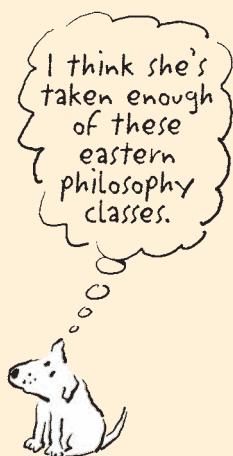
- Freestanding, commercially-zoned property with a single tenant;
- Properties that are important retail locations for regional and national retail chains;
- Properties that are located within attractive demographic areas relative to the business of their tenants, with high visibility and easy access to major thoroughfares; and
- Properties that can be purchased with the simultaneous execution or assumption of long-term, net-lease agreements, offering both current income and the potential for rent increases.

### Portfolio Management Strategy

The active management of the property portfolio is an essential component of our long-term strategy. We continually monitor our portfolio for changes that could affect the performance of the industries, tenants and locations in which we have invested. The portfolio is regularly analyzed with a view toward optimizing its returns and enhancing its credit quality. Our executives review industry research, tenant research, property due diligence and significant portfolio management activities. This monitoring typically includes regular review and analysis of:

- The performance of various retail industries; and
- The operation, management, business planning and financial condition of the tenants.

Monthly dividends,  
Monthly dividends,  
Monthly dividends.



We have an active portfolio management program that incorporates the sale of assets when we believe the reinvestment of the sales proceeds will generate higher returns, enhance the credit quality of our real estate portfolio, or extend our average remaining lease term. At December 31, 2005, we classified real estate with a carrying amount of \$47.1 million as held for sale, which includes \$45.5 million in properties owned by Crest Net. In addition, \$219,000 invested by Crest Net in real estate is included in other assets and was classified as intangible assets in accordance with Financial Accounting Standards Board Statement No. 141, *Business Combinations*. Additionally, we anticipate selling investment properties from our portfolio that have not yet been specifically identified from which we anticipate receiving between \$15 million and \$35 million in proceeds during the next 12 months. We intend to invest these proceeds into new property acquisitions. However, we cannot guarantee that we will sell properties during the next 12 months.

### **Conservative Capital Structure**

We believe that our stockholders are best served by a conservative capital structure. Therefore, we seek to maintain a conservative debt level on our balance sheet and solid interest and fixed charge coverage ratios. At February 10, 2006, our total outstanding credit facility borrowings and outstanding notes were \$886.6 million or approximately 30.3% of our total market capitalization of \$2.92 billion. We calculate our total market capitalization at February 10, 2006 as the sum of:

- Shares of our common stock outstanding of 83,880,873 multiplied by the last reported sales price of our common stock on the NYSE of \$22.78 per share, or \$1.91 billion;
- Aggregate liquidation value of the Class D preferred stock of \$127.5 million;
- Outstanding borrowings of \$131.6 million on our credit facility; and
- Outstanding notes of \$755.0 million.

Historically, we have met our long-term capital needs through the issuance of common stock, preferred stock and long-term unsecured notes and bonds. Over the long term, we believe that the majority of our future securities issuances should be in the form of common stock, however, we may issue additional preferred stock or debt securities from time to time. We may issue common stock when we believe that our share price is at a level that allows for the proceeds of any offering to be invested into additional properties on an accretive basis. In addition, we may issue common stock to permanently finance properties that were financed by our credit facility or debt securities. However, we cannot assure you that we will have access to the capital markets at terms that are acceptable to us.

We have a \$300 million revolving, unsecured acquisition credit facility that expires in October 2008. At February 10, 2006, the outstanding balance on the credit facility was \$131.6 million, with an effective interest rate of approximately 5.2%. A commitment fee of 0.15% per annum accrues on the

total \$300 million credit commitment of the credit facility. The credit facility has been, and is expected to be, used to acquire additional retail properties leased to regional and national retail chains under long-term, net-lease agreements. The credit facility has also been used to provide capital to subsidiaries for the purpose of funding the acquisition of properties. We regularly evaluate our credit facility and may seek to extend, renew or replace our credit facility, to the extent we deem appropriate.

We use our credit facility for the short-term financing of new property acquisitions. When outstanding borrowings under the credit facility reach a certain level (generally in the range of \$100 million to \$200 million) and capital is available on acceptable terms, we generally seek to refinance those borrowings with the net proceeds of long-term or permanent financing, which may include the issuance of common stock, preferred stock, convertible preferred stock, debt securities or convertible debt securities. We cannot assure you, however, that we will be able to obtain any such refinancing or that market conditions prevailing at the time of refinancing will enable us to issue equity or debt securities upon acceptable terms.

We are currently assigned investment grade corporate credit ratings, on our senior unsecured notes, from Fitch Ratings, Moody's Investors Service, Inc. and Standard & Poor's Ratings Group. Currently, Fitch Ratings has assigned a rating of BBB+, Moody's has assigned a rating of Baa2 and Standard & Poor's has assigned a rating of BBB to our senior notes. Moody's rating has a "positive" outlook and the other ratings have a "stable" outlook.

We have also been assigned investment grade credit ratings from the same rating agencies on our preferred stock. Fitch Ratings has assigned a rating of BBB, Moody's has assigned a rating of Baa3 and Standard & Poor's has assigned a rating of BBB- to our preferred stock. Moody's rating has a "positive" outlook and the other ratings have a "stable" outlook.

The credit ratings assigned to us could change based upon, among other things, our results of operations and financial condition.

We have no mortgage debt on any of our properties.

### **No Off-Balance Sheet Arrangements or Unconsolidated Investments**

Realty Income and its subsidiaries have no unconsolidated or off-balance sheet investments in "variable interest entities" or off-balance sheet financing, nor do we engage in trading activities involving energy or commodity contracts or other derivative instruments.

As we have no joint ventures, off-balance sheet entities, or mandatory redeemable preferred stock, our financial position and results of operations are currently not affected by Financial Accounting Standards Board Interpretation No. 46R, *Consolidation of Variable Interest Entities* and Statement of Financial Accounting Standards No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*.

## Competitive Strategy

We believe that to successfully pursue our investment philosophy and strategy, we must seek to maintain the following competitive advantages:

- **SIZE AND TYPE OF INVESTMENT PROPERTIES:** We believe smaller (\$500,000 to \$10,000,000) net-leased retail properties represent an attractive investment opportunity in today's real estate environment. Due to the complexities of acquiring and managing a large portfolio of relatively small assets, we believe these types of properties have not experienced significant institutional ownership interest or the corresponding yield reduction experienced by larger income-producing properties. We believe the less intensive day-to-day property management required by net-lease agreements, coupled with the active management of a large portfolio of smaller properties, is an effective investment strategy. The tenants of our freestanding retail properties generally provide goods and services that satisfy basic consumer needs. In order to grow and expand, they generally need capital. Since the acquisition of real estate is typically the single largest capital expenditure of many of these retailers, our method of purchasing the property and then leasing it back, under a net-lease arrangement, allows the retail chain to free up capital.
- **INVESTMENT IN NEW RETAIL INDUSTRIES:** Though we specialize in single-tenant properties, we will seek to further diversify our portfolio among a variety of retail industries. We believe diversification will allow us to invest in retail industries that currently are growing and have characteristics we find attractive. These characteristics include, but are not limited to, retail industries that are dominated by local store operators where regional and national chain store operators can increase market share and dominance by consolidating local operators and streamlining their operations, as well as capitalizing on major demographic shifts in a population base.
- **DIVERSIFICATION:** Diversification of the portfolio by retail industry type, tenant, and geographic location is key to our objective of providing predictable investment results for our stockholders, therefore further diversification of our portfolio is a continuing objective. At December 31, 2005, our retail property portfolio consisted of 1,646 properties located in 48 states, leased to 101 retail chains doing business in 29 industry segments. Each of the 29 industry segments, represented in our property portfolio, individually accounted for no more than 17.8% of our rental revenue for the quarter ended December 31, 2005.

- **MANAGEMENT SPECIALIZATION:** We believe that our management's specialization in single-tenant retail properties, operated under net-lease agreements, is important to meeting our objectives. We plan to maintain this specialization and will seek to employ and train high-quality professionals in this specialized area of real estate ownership, finance and management.
- **TECHNOLOGY:** We intend to stay at the forefront of technology in our efforts to efficiently and economically carry out our operations. We maintain sophisticated information systems that allow us to analyze our portfolio's performance and actively manage our investments. We believe that technology and information-based systems will play an increasingly important role in our competitiveness as an investment manager and source of capital to a variety of industries and tenants.

## PROPERTIES

At December 31, 2005, we owned a diversified portfolio:

- Of 1,646 retail properties;
- With an occupancy rate of 98.5%, or 1,621 properties occupied of the 1,646 properties in the portfolio;
- Leased to 101 different retail chains doing business in 29 separate retail industries;
- Located in 48 states;
- With over 13.4 million square feet of leasable space; and
- With an average leasable retail space of 8,200 square feet.

In addition to our real estate portfolio at December 31, 2005, our subsidiary, Crest Net had invested \$45.7 million in a portfolio of 17 properties located in nine states. These properties are classified as held for sale.

At December 31, 2005, 1,617, or 98.2%, of our 1,646 retail properties were owned under net-lease agreements. Net leases typically require the tenant to be responsible for minimum monthly rent and property operating expenses including property taxes, insurance and maintenance. In addition, tenants are typically responsible for future rent increases (generally subject to ceilings) based on increases in the consumer price index, fixed increases or, to a lesser degree, additional rent calculated as a percentage of the tenants' gross sales above a specified level.

Our net-leased retail properties primarily are leased to regional and national retail chain store operators. Most buildings are single-story structures with adequate parking on site to accommodate peak retail traffic periods. The properties tend to be on major thoroughfares with relatively high traffic counts and adequate access and proximity to a sufficient population base constituting a suitable market or trade area for the retailer's business.

The following table sets forth certain information regarding Realty Income's property portfolio (excluding properties owned by Crest Net) classified according to the business of the respective tenants, expressed as a percentage of our total rental revenue:

Industries	Percentage of Rental Revenue <sup>(1)</sup>						
	For the Quarter Ended	For the Years Ended					
	Dec. 31, 2005	Dec. 31, 2005	Dec. 31, 2004	Dec. 31, 2003	Dec. 31, 2002	Dec. 31, 2001	Dec. 31, 2000
Apparel stores	1.4%	1.6%	1.8%	2.1%	2.3%	2.4%	2.4%
Automotive collision services	1.2	1.3	1.0	0.3	—	—	—
Automotive parts	3.4	3.4	3.8	4.5	4.9	5.7	6.0
Automotive service	7.0	7.6	7.7	8.3	7.0	5.7	5.8
Automotive tire services	6.5	7.2	7.8	3.1	2.7	2.6	2.3
Book stores	0.3	0.3	0.3	0.4	0.4	0.4	0.5
Business services	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Child care	11.8	12.7	14.4	17.8	20.8	23.9	24.7
Consumer electronics	1.2	1.3	2.1	3.0	3.3	4.0	4.9
Convenience stores	17.8	18.7	19.2	13.3	9.1	8.4	8.4
Crafts and novelties	0.4	0.4	0.5	0.6	0.4	0.4	0.4
Drug stores	3.0	2.8	0.1	0.2	0.2	0.2	0.2
Entertainment	1.9	2.1	2.3	2.6	2.3	1.8	2.0
Equipment rental services	0.3	0.4	0.3	0.2	—	—	—
Financial services	0.1	0.1	0.1	—	—	—	—
General merchandise	0.5	0.5	0.4	0.5	0.5	0.6	0.6
Grocery stores	0.6	0.7	0.8	0.4	0.5	0.6	0.6
Health and fitness	3.3	3.7	4.0	3.8	3.8	3.6	2.4
Home furnishings	3.4	3.7	4.1	4.9	5.4	6.0	5.8
Home improvement	1.0	1.1	1.0	1.1	1.2	1.3	2.0
Motor vehicle dealerships	2.9	2.6	0.6	—	—	—	—
Office supplies	1.6	1.5	1.6	1.9	2.1	2.2	2.3
Pet supplies and services	1.2	1.3	1.4	1.7	1.7	1.6	1.5
Private education	0.7	0.8	1.1	1.2	1.3	1.5	1.4
Restaurants	9.9	9.4	9.7	11.8	13.5	12.2	12.3
Shoe stores	0.0	0.3	0.3	0.9	0.8	0.7	0.8
Sporting goods	3.1	3.4	3.4	3.8	4.1	0.9	—
Theaters	9.9	5.2	3.5	4.1	3.9	4.3	2.7
Travel plazas	0.3	0.3	0.4	0.3	—	—	—
Video rental	2.3	2.5	2.8	3.3	3.3	3.7	3.9
Other	2.9	3.0	3.4	3.8	4.4	5.2	6.0
Totals	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

<sup>(1)</sup>Includes rental revenue for all properties owned by Realty Income at the end of each period presented, including revenue from properties reclassified to discontinued operations.

Yes I know Alchemy  
didn't work for replicating  
Gold, but I don't think  
they ever tried it on  
Monthly Dividends.



The following table sets forth certain information regarding the properties owned by Realty Income (excluding properties owned by Crest Net) at December 31, 2005, classified according to the retail business types and the level of services they provide (dollars in thousands):

Industry	Number of Properties	Rental Revenue for the Quarter Ended Dec. 31, 2005 <sup>(1)</sup>	Percentage of of Rental Revenue
<b>Tenants Providing Services</b>			
Automotive collision services	11	\$ 672	1.2%
Automotive service	219	3,757	7.0
Child care	270	6,319	11.8
Entertainment	9	1,016	1.9
Equipment rental services	2	150	0.3
Financial services	4	53	0.1
Health and fitness	15	1,775	3.3
Private education	5	381	0.7
Theaters	29	5,305	9.9
Other	8	1,532	2.9
	572	\$ 20,960	39.1
<b>Tenants Selling Goods and Services</b>			
Automotive parts (with installation)	30	583	1.1
Automotive tire services	102	3,471	6.5
Business services	1	32	0.1
Convenience stores	394	9,572	17.8
Home improvement	3	73	0.1
Motor vehicle dealerships	15	1,566	2.9
Pet supplies and services	9	615	1.1
Restaurants	250	5,292	9.9
Travel plazas	1	170	0.3
Video rental	34	1,235	2.3
	839	\$ 22,609	42.1
<b>Tenants Selling Goods</b>			
Apparel stores	5	775	1.4
Automotive parts	74	1,242	2.3
Book stores	2	149	0.3
Consumer electronics	22	636	1.2
Crafts and novelties	4	211	0.4
Drug stores	29	1,630	3.0
General merchandise	12	257	0.5
Grocery stores	6	347	0.6
Home furnishings	39	1,814	3.4
Home improvement	15	465	0.9
Office supplies	10	844	1.6
Pet supplies	2	37	0.1
Shoe stores	2	—	0.0
Sporting goods	13	1,687	3.1
	235	\$ 10,094	18.8
<b>Totals</b>	<b>1,646</b>	<b>\$ 53,663</b>	<b>100.0%</b>

<sup>(1)</sup>Includes rental revenue for all properties owned by Realty Income at December 31, 2005, including revenue from properties reclassified to discontinued operations of \$59.



The following table sets forth certain information regarding Realty Income's property portfolio (excluding properties owned by Crest Net) regarding the timing of the initial lease term expirations (excluding extension options) on our 1,617 net leased, single-tenant and certain other retail properties as of December 31, 2005 (dollars in thousands):

Year	Total Portfolio			Initial Expirations <sup>(3)</sup>			Subsequent Expirations <sup>(4)</sup>		
	Total Number of Leases Expiring <sup>(1)</sup>	Rental Revenue for the Quarter Ended 12/31/05 <sup>(2)</sup>	% of Rental Revenue	Number of Leases Expiring	Rental Revenue for the Quarter Ended 12/31/05	% of Total Rental Revenue	Number of Leases Expiring	Rental Revenue for the Quarter Ended 12/31/05	% of Total Rental Revenue
2006	109	\$ 2,373	4.6%	50	\$ 1,111	2.2%	59	\$ 1,262	2.4%
2007	121	2,265	4.4	87	1,662	3.2	34	603	1.2
2008	104	2,334	4.5	66	1,634	3.2	38	700	1.3
2009	89	1,963	3.8	29	694	1.3	60	1,269	2.5
2010	69	1,527	2.9	43	1,072	2.0	26	455	0.9
2011	44	1,662	3.2	34	1,439	2.8	10	223	0.4
2012	44	1,379	2.7	42	1,329	2.6	2	50	0.1
2013	74	3,251	6.3	66	3,039	5.9	8	212	0.4
2014	48	2,007	3.9	36	1,752	3.4	12	255	0.5
2015	87	1,654	3.2	68	1,200	2.3	19	454	0.9
2016	17	513	1.0	15	431	0.8	2	82	0.2
2017	22	1,527	2.9	18	1,459	2.8	4	68	0.1
2018	23	1,090	2.1	23	1,090	2.1	—	—	—
2019	95	4,480	8.7	94	4,342	8.4	1	138	0.3
2020	82	2,603	5.0	81	2,593	5.0	1	10	*
2021	126	4,082	7.9	126	4,082	7.9	—	—	—
2022	96	2,592	5.0	95	2,591	5.0	1	1	*
2023	234	6,440	12.4	233	6,414	12.4	1	26	*
2024	57	1,707	3.3	57	1,707	3.3	—	—	—
2025	63	5,273	10.2	63	5,273	10.2	—	—	—
2026	2	89	0.2	2	89	0.2	—	—	—
2028	2	54	0.1	2	54	0.1	—	—	—
2030	1	21	*	1	21	*	—	—	—
2033	3	357	0.7	3	357	0.7	—	—	—
2034	2	230	0.4	2	230	0.4	—	—	—
2037	2	325	0.6	2	325	0.6	—	—	—
2043	1	13	*	—	—	—	1	13	*
Totals	1,617	\$ 51,811	100.0%	1,338	\$ 45,990	88.8%	279	\$ 5,821	11.2%

\*Less than 0.1%

<sup>(1)</sup>Excludes four multi-tenant properties and 25 vacant unleased properties, one of which is a multi-tenant property. The lease expirations for properties under construction are based on the estimated date of completion of those properties.

<sup>(2)</sup>Includes rental revenue of \$59 from properties reclassified to discontinued operations and excludes revenue of \$1,852 from four multi-tenant properties and from 25 vacant and unleased properties at December 31, 2005.

<sup>(3)</sup>Represents leases to the initial tenant of the property that are expiring for the first time.

<sup>(4)</sup>Represents lease expirations on properties in the portfolio, which have previously been renewed, extended or re-tenanted.

The following table sets forth certain state-by-state information regarding Realty Income's property portfolio (excluding properties owned by Crest Net) as of December 31, 2005 (dollars in thousands):

State	Number of Properties	Percent Leased	Approximate Leasable Square Feet	Rental Revenue For the Quarter Ended Dec 31, 2005 <sup>(1)</sup>	Percentage of Rental Revenue
Alabama	17	94%	146,600	\$ 419	0.8%
Alaska	2	100	128,500	259	0.5
Arizona	70	100	335,500	1,900	3.5
Arkansas	8	88	48,800	139	0.3
California	61	100	1,057,100	4,044	7.5
Colorado	46	100	385,700	1,785	3.3
Connecticut	16	100	245,600	929	1.7
Delaware	16	100	29,100	338	0.6
Florida	128	99	1,252,600	4,958	9.2
Georgia	103	99	699,300	2,733	5.1
Idaho	14	93	91,900	371	0.7
Illinois	55	100	696,200	3,184	5.9
Indiana	37	95	349,600	1,516	2.8
Iowa	12	92	63,800	181	0.3
Kansas	20	90	188,300	515	1.0
Kentucky	15	100	51,900	320	0.6
Louisiana	14	100	65,200	285	0.5
Maryland	24	100	218,800	1,182	2.2
Massachusetts	37	100	203,100	994	1.9
Michigan	13	100	81,600	300	0.6
Minnesota	20	100	337,100	1,278	2.4
Mississippi	38	89	205,200	711	1.3
Missouri	32	94	244,500	784	1.5
Montana	2	100	30,000	79	0.1
Nebraska	13	100	104,500	436	0.8
Nevada	15	100	191,000	837	1.6
New Hampshire	10	100	89,600	358	0.7
New Jersey	26	100	200,100	1,069	2.0
New Mexico	7	100	53,300	152	0.3
New York	28	96	386,300	1,871	3.5
North Carolina	50	100	322,800	1,470	2.7
North Dakota	5	100	31,900	35	*
Ohio	105	100	661,500	2,520	4.7
Oklahoma	20	95	99,300	685	1.3
Oregon	17	100	253,300	587	1.1
Pennsylvania	81	100	481,300	2,269	4.2
Rhode Island	1	100	3,500	29	0.1
South Carolina	55	100	215,800	1,416	2.6
South Dakota	7	100	18,300	30	0.1
Tennessee	98	100	451,400	2,199	4.1
Texas	182	98	1,835,500	4,859	9.1
Utah	6	100	35,100	108	0.2
Vermont	1	100	2,500	22	*
Virginia	62	100	431,900	2,309	4.3
Washington	37	100	243,900	783	1.5
West Virginia	2	0	16,800	—	0.0
Wisconsin	16	94	153,700	370	0.7
Wyoming	2	100	9,300	45	0.1
Totals/Average	1,646	99%	13,448,600	\$ 53,663	100.0%

\*Less than 0.1%

<sup>(1)</sup>Includes rental revenue for all properties owned by Realty Income at December 31, 2005, including revenue from properties reclassified to discontinued operations of \$59.

### Description of Leasing Structure

At December 31, 2005, 1,617 single tenant and certain other retail properties or 98.2% of our 1,646 properties were net leased. In most cases, the leases:

- Are for initial terms of 15 to 20 years;
- Require the tenants to pay minimum monthly rents and property operating expenses (taxes, insurance and maintenance); and
- Provide for future rent increases (typically subject to ceilings) based on increases in the consumer price index, fixed increases, or to a lesser degree, additional rent based upon the tenants' gross sales above a specified level. Where leases provide for rent increases based on increases in the consumer price index, generally these increases become part of the new permanent base rent. Where leases provide for percentage rent, this additional rent is typically payable only if the tenants' gross sales, for a given period (usually one year), exceed a specified level and is then typically calculated as a percentage of only the amount of gross sales in excess of that level.

### Matters Pertaining to Certain Properties and Tenants

Of the 25 properties available for lease or sale at December 31, 2005; all but one are single-tenant properties. At December 31, 2005, 17 of our properties under lease were unoccupied and available for sublease by the tenants, all of which were current with their rent and other obligations. During 2005, each of our tenants accounted for less than 10% of our rental revenue.

### Certain Properties Under Development

Of the 135 properties Realty Income acquired in 2005, all were occupied at December 31, 2005, except for 10 properties that were leased and being developed. In the case of development properties, we either enter into an agreement with a retail chain where the retailer retains a contractor to construct the improvements and we fund the costs of that development, or we fund a developer who constructs the improvements. In either case, there is an executed lease with a retail tenant at the time of the land purchase (with a fixed rent commencement date) and there is a requirement to complete the construction in a timely basis and within a specific budget, typically within eight months after we purchase the land. The tenant or developer generally is required to pay construction cost overruns to the extent that they exceed the construction budget by more than a predetermined amount. We also enter into a lease with the tenant at the time we purchase the land, which generally requires the tenant to begin paying base rent when the store opens for business. The base rent is calculated by multiplying a predetermined capitalization rate by our total investment in the property including the land cost for the property, construction costs and capitalized interest. In 2005, Realty Income acquired 21 development properties. Crest Net did not acquire any development property in 2005. Both Realty Income and Crest Net will continue to pursue development opportunities under similar arrangements in the future.

### Risk Factors

For a full description of the risk factors associated with the Company, see Item 1A "Risk Factors" in our Form 10-K for the fiscal year ended December 31, 2005.

*This class is an automatic A. Just use the words "Monthly Dividend" five times in your final essay and you've got it made.....*



**CONSOLIDATED BALANCE SHEETS**

December 31, 2005 and 2004 (dollars in thousands, except per share data)

	2005	2004
<b>Assets</b>		
Real estate, at cost:		
Land	\$ 746,016	\$ 624,558
Buildings and improvements	1,350,140	1,066,725
	2,096,156	1,691,283
Less accumulated depreciation and amortization	(341,193)	(301,728)
Net real estate held for investment	1,754,963	1,389,555
Real estate held for sale, net	47,083	17,155
Net real estate	1,802,046	1,406,710
Cash and cash equivalents	65,704	2,141
Accounts receivable	5,044	4,075
Goodwill	17,206	17,206
Other assets	30,988	12,183
<b>Total assets</b>	<b>\$ 1,920,988</b>	<b>\$ 1,442,315</b>
<b>Liabilities and Stockholders' Equity</b>		
Distributions payable	\$ 10,121	\$ 9,115
Accounts payable and accrued expenses	20,391	9,579
Other liabilities	9,562	6,286
Line of credit payable	136,700	23,600
Notes payable	755,000	480,000
<b>Total liabilities</b>	<b>931,774</b>	<b>528,580</b>
Commitments and contingencies		
Stockholders' equity:		
Preferred stock and paid in capital, par value \$1.00 per share, 20,000,000 shares authorized, 5,100,000 shares issued and outstanding	123,804	123,787
Common stock and paid in capital, par value \$1.00 per share, in 2005 there were 200,000,000 shares authorized and 83,696,647 issued and outstanding and in 2004 there were 100,000,000 shares authorized and 79,301,630 issued and outstanding	1,134,300	1,038,973
Distributions in excess of net income	(268,890)	(249,025)
<b>Total stockholders' equity</b>	<b>989,214</b>	<b>913,735</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 1,920,988</b>	<b>\$ 1,442,315</b>

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

**CONSOLIDATED STATEMENTS OF INCOME**

Years Ended December 31, 2005, 2004 and 2003 (dollars in thousands, except per share data)

	2005	2004	2003
<b>Revenue</b>			
Rental	\$ 196,322	\$ 172,714	\$ 142,888
Other	354	1,033	590
	196,676	173,747	143,478
<b>Expenses</b>			
Interest	40,949	34,132	26,413
Depreciation and amortization	46,438	39,874	32,231
General and administrative	15,421	13,119	10,616
Property	3,838	3,069	2,439
Income taxes	813	699	501
	107,459	90,893	72,200
Income from continuing operations	89,217	82,854	71,278
Income from discontinued operations:			
Real estate acquired for resale by Crest	2,781	7,847	4,588
Real estate held for investment	7,121	12,696	10,569
	9,902	20,543	15,157
Net income	99,119	103,397	86,435
Preferred stock cash dividends	(9,403)	(9,455)	(9,713)
Excess of redemption value over carrying value of preferred shares redeemed (see note 7C and 7D)	—	(3,774)	—
Net income available to common stockholders	\$ 89,716	\$ 90,168	\$ 76,722
Income from continuing operations per common share:			
Basic	\$ 1.00	\$ 0.89	\$ 0.87
Diluted	\$ 1.00	\$ 0.89	\$ 0.86
Net income available to common stockholders per common share:			
Basic and diluted	\$ 1.12	\$ 1.15	\$ 1.08
Weighted average common shares outstanding:			
Basic	79,950,255	78,518,296	71,128,282
Diluted	80,208,593	78,598,788	71,222,628

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

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

Years Ended December 31, 2005, 2004 and 2003 (dollars in thousands)

	Shares of		Preferred Stock and Paid In Capital	Common Stock and Paid In Capital	Distributions In Excess of Net Income	Total
	Preferred Stock	Common Stock				
Balance, December 31, 2002	4,125,700	69,749,654	\$ 99,368	\$ 855,818	\$ (232,731)	\$ 722,455
Net income	—	—	—	—	86,435	86,435
Distributions paid and payable	—	—	—	—	(94,336)	(94,336)
Shares issued in stock offerings, net of offering costs of \$5,854	—	5,750,000	—	110,842	—	110,842
Deferred stock compensation	—	318,518	—	2,370	—	2,370
Balance, December 31, 2003	4,125,700	75,818,172	99,368	969,030	(240,632)	827,766
Net income	—	—	—	—	103,397	103,397
Distributions paid and payable	—	—	—	—	(108,016)	(108,016)
Shares issued in stock offerings, net of offering costs of \$3,682	—	3,200,000	—	67,918	—	67,918
Shares issued in stock offerings, net of offering costs of \$4,187	5,100,000	—	123,787	—	—	123,787
Preferred shares redeemed	(4,125,700)	—	(99,368)	—	(3,774)	(103,142)
Deferred stock compensation	—	283,458	—	2,025	—	2,025
Balance, December 31, 2004	5,100,000	79,301,630	123,787	1,038,973	(249,025)	913,735
Net income	—	—	—	—	99,119	99,119
Distributions paid and payable	—	—	—	—	(118,984)	(118,984)
Shares issued in stock offerings, net of offering costs of \$4,980	—	4,100,000	17	92,659	—	92,676
Deferred stock compensation	—	295,017	—	2,668	—	2,668
Balance, December 31, 2005	5,100,000	83,696,647	\$ 123,804	\$ 1,134,300	\$ (268,890)	\$ 989,214

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

Let's have a look at his grades...  
 MONTHLY DIVIDENDS.....F  
 INVESTING FOR MONTHLY INCOME...F  
 MAILING MONTHLY DIVIDENDS.....F  
 SPENDING MONTHLY DIVIDENDS.....A  
 One more quarter like this and he's going to end up at "The Quarterly Dividend University" with his slower cousin.



**CONSOLIDATED STATEMENTS OF CASH FLOWS**

Years Ended December 31, 2005, 2004 and 2003 (dollars in thousands)

	2005	2004	2003
<b>Cash Flows from Operating Activities</b>			
Net income	\$ 99,119	\$ 103,397	\$ 86,435
Adjustments to net income:			
Depreciation and amortization	46,438	39,874	32,231
Income from discontinued operations:			
Real estate acquired for resale by Crest	(2,781)	(7,847)	(4,588)
Real estate held for investment	(7,121)	(12,696)	(10,569)
Cash from discontinued operations:			
Real estate acquired for resale by Crest	(510)	(2,407)	(1,629)
Real estate held for investment	809	3,509	6,339
Investments in real estate acquired for resale by Crest	(54,110)	(21,787)	(87,384)
Intangibles acquired in connection with acquisition of real estate acquired for resale by Crest	(1,780)	—	—
Proceeds from sales of real estate acquired for resale	22,195	74,995	45,226
Amortization of deferred stock compensation	2,155	1,426	940
Amortization of stock option costs	12	14	11
Gain on sale of real estate held for investment	(18)	(185)	—
Provision for impairment on real estate	151	—	—
Changes in assets and liabilities:			
Accounts receivable and other assets	(3,292)	1,094	1,751
Accounts payable, accrued expenses and other liabilities	8,290	(1,050)	5,194
Net cash provided by operating activities	109,557	178,337	73,957
<b>Cash Flows from Investing Activities</b>			
Proceeds from sales of investment properties:	22,300	34,601	20,773
Acquisition of and additions to investment properties	(417,347)	(195,470)	(280,587)
Intangibles acquired in connection with acquisition of real estate held for investment	(9,494)	—	—
Net cash used in investing activities	(404,541)	(160,869)	(259,814)
<b>Cash Flows from Financing Activities</b>			
Borrowings from lines of credit	400,300	280,400	360,600
Payments under lines of credit	(287,200)	(283,200)	(443,900)
Proceeds from note offerings, net	270,266	(28)	246,367
Proceeds from common stock offerings, net	92,659	67,918	110,842
Cash distributions to common stockholders	(108,575)	(97,420)	(83,842)
Cash dividends to preferred stockholders	(9,403)	(9,063)	(9,713)
Proceeds from preferred stock offerings, net	—	123,787	—
Redemption of preferred stock	—	(103,142)	—
Proceeds from other stock issuances	500	584	1,419
Net cash provided by (used in) financing activities	358,547	(20,164)	181,773
Net increase (decrease) in cash and cash equivalents	63,563	(2,696)	(4,084)
Cash and cash equivalents, beginning of year	2,141	4,837	8,921
Cash and cash equivalents, end of year	\$ 65,704	\$ 2,141	\$ 4,837

For supplemental disclosures, see note 12.

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

REALTY INCOME CORPORATION AND SUBSIDIARIES

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

## 1. ORGANIZATION AND OPERATION

Realty Income Corporation ("Realty Income," the "Company," "we" or "our") is organized as a Maryland corporation. We invest in commercial retail real estate and have elected to be taxed as a real estate investment trust ("REIT").

At December 31, 2005, we owned 1,646 properties in 48 states containing over 13.4 million leasable square feet, plus an additional 17 properties owned by our wholly-owned taxable REIT subsidiary, Crest Net Lease, Inc. ("Crest Net"). Crest Net was created to buy, own and sell properties, primarily to individual investors, many of whom are involved in tax-deferred exchanges, under Section 1031 of the Internal Revenue Code of 1986, as amended ("the Code").

A 2-for-1 stock split was declared in November 2004 and became effective after the market closed on December 31, 2004. Common stockholders received an additional share of common stock for each share they owned. The increase in the number of common shares outstanding and all per common share data has been adjusted for the stock split.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND PROCEDURES

**Federal Income Taxes.** We have elected to be taxed as a REIT under the Code. We believe we have qualified and continue to qualify as a REIT. As a REIT, we will be permitted to deduct distributions paid to our stockholders and, generally, will not be required to pay federal corporate income taxes on such income. Accordingly, no provision has been made for federal income taxes in the accompanying consolidated financial statements, except for federal income taxes of Crest Net, which totaled \$760,000 in 2005, \$2.8 million in 2004 and \$1.8 million in 2003. These taxes are included in "income from discontinued operations, real estate acquired for resale by Crest."

Earnings and profits that determine the taxability of distributions to stockholders differ from net income reported for financial reporting purposes due to differences in the estimated useful lives and methods used to compute depreciation and the carrying value (basis) on the investments in properties for tax purposes, among other things.

The following reconciles our net income available to common stockholders to taxable income for 2005 (dollars in thousands) (unaudited):

Net income available to common stockholders	\$ 89,716
Tax loss on the sale of real estate less than book gains	(7,260)
Elimination of net revenue and expenses from Crest Net	(718)
Dividends received from Crest Net	1,410
Preferred dividends not deductible for tax	9,403
Depreciation and amortization timing differences	11,546
Impairment losses	186
Other adjustments	(77)
Estimated taxable net income, before our dividend paid deduction	\$ 104,206

**Net Income Per Common Share.** Basic net income per common share is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during each period. Diluted net income per common share is computed by dividing the amount of net income available to common stockholders for the period by the number of common shares that would have been outstanding assuming the issuance of common shares for all potentially dilutive common shares outstanding during the reporting period.

The following is a reconciliation of the denominator of the basic net income per common share computation to the denominator of the diluted net income per common share computation, for the years ended December 31:

	2005	2004	2003
Weighted average shares used for basic net income per share computation	79,950,255	78,518,296	71,128,282
Incremental shares from share based compensation	258,338	80,492	94,346
Adjusted weighted average shares used for diluted net income per share computation	80,208,593	78,598,788	71,222,628

In 2005, 2004 and 2003, no stock options were anti-dilutive. In 2005, we had 305,476 nonvested shares from share based compensation that were anti-dilutive. No nonvested shares were anti-dilutive in 2004 or 2003.



**Discontinued Operations.** In accordance with Financial Accounting Standards Board Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* ("SFAS 144"), Realty Income's operations from four investment properties classified as held for sale at December 31, 2005, plus properties sold in 2005, 2004 and 2003, were reported as discontinued operations. Their respective results of operations were reclassified to "income from discontinued operations, real estate held for investment." We classify properties as held for sale in accordance with SFAS 144. We do not depreciate properties that are classified as held for sale.

Crest Net acquires properties with the intention of reselling them rather than holding them for investment and operating the properties. Consequently, we classify properties acquired by Crest Net as held for sale at the date of acquisition and do not depreciate them. In accordance with SFAS 144, the operations of Crest Net's properties are classified as "income from discontinued operations, real estate acquired for resale by Crest."

No debt was assumed by buyers of our investment properties or repaid as a result of our investment property sales and we have elected not to allocate interest expense to discontinued operations related to real estate held for investment.

In accordance with Emerging Issues Task Force No. 87-24, we allocate interest expense related to borrowings specifically attributable to Crest Net properties. The interest expense amounts allocated to the Crest Net properties are included in "income from discontinued operations, real estate acquired for resale by Crest."

The following is a summary of Crest Net's "income from discontinued operations, real estate acquired for resale" for the years ended December 31, 2005, 2004 and 2003 (dollars in thousands):

Crest Net's income from discontinued operations, real estate acquired for resale	2005	2004	2003
Gain on sales of real estate acquired for resale	\$ 3,291	\$ 10,254	\$ 6,217
Rental revenue	2,085	2,304	1,724
Interest expense	(1,139)	(674)	(561)
General and administrative expense	(453)	(464)	(566)
Property expenses	(60)	(93)	(24)
Income taxes	(943)	(3,480)	(2,202)
Income from discontinued operations, real estate acquired for resale by Crest	\$ 2,781	\$ 7,847	\$ 4,588

The following is a summary of Realty Income's "income from discontinued operations from real estate held for investment" for the years ended December 31, 2005, 2004 and 2003 (dollars in thousands):

Realty Income's income from discontinued operations from real estate held for investment	2005	2004	2003
Gain on sales of investment properties	\$ 6,573	\$ 12,543	\$ 7,156
Rental revenue	1,073	3,927	6,845
Other revenue	2	117	46
Depreciation and amortization	(226)	(984)	(1,684)
Property expenses	(266)	(534)	(552)
Provisions for impairments	(35)	(2,373)	(1,242)
Income from discontinued operations, real estate held for investment	\$ 7,121	\$ 12,696	\$ 10,569

The following is a summary of our total income from discontinued operations for the years ended December 31, 2005, 2004 and 2003 (dollars in thousands):

Total income from discontinued operations	2005	2004	2003
Income from discontinued operations:			
Real estate acquired for resale by Crest	\$ 2,781	\$ 7,847	\$ 4,588
Real estate held for investment	7,121	12,696	10,569
Income from discontinued operations	\$ 9,902	\$ 20,543	\$ 15,157
Per common share, basic and diluted	\$ 0.12	\$ 0.26	\$ 0.21

**Leases.** All leases are accounted for as operating leases. Under this method, lease payments that have fixed and determinable rent increases are recognized on a straight-line basis over the lease term. Any rental revenue contingent upon a tenant's sales is recognized only after the tenant exceeds their sales breakpoint. Rental increases based upon changes in the consumer price indexes are recognized only after the changes in the indexes have occurred and are then applied according to the lease agreements.

**Principles of Consolidation.** The accompanying consolidated financial statements include the accounts of Realty Income, Crest Net and other entities for which we make operational and financial decisions (control), after elimination of all material intercompany balances and transactions. All of Realty Income's and Crest Net's subsidiaries are wholly-owned.

**Cash Equivalents.** We consider all short-term, highly liquid investments that are readily convertible to cash and have an original maturity of three months or less at the time of purchase to be cash equivalents.

**Gain on Sales of Properties.** We recognize gains on sales of properties in accordance with Statement No. 66, *Accounting for Sales of Real Estate*.

**Depreciation and Amortization.** Depreciation of buildings and improvements are computed using the straight-line method over an estimated useful life of 25 years.

**Maintenance and Repairs.** Expenditures for maintenance and repairs are expensed as incurred. Replacements and betterments are capitalized.

**Provisions for Impairments.** We review long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Generally, a provision is made for impairment if estimated future operating cash flows (undiscounted and without interest charges) plus estimated disposition proceeds (undiscounted) are less than the current book value. Impairment loss is measured as the amount by which the current book value of the asset exceeds the fair value of the asset. If a property is held for sale, it is carried at the lower of cost or estimated fair value, less cost to sell.

Provisions for impairment of \$186,000 were recorded in 2005 on four retail properties, of which two were sold during 2005. These properties were classified in the following industries: one in child care and three in restaurant.

Provisions for impairment of \$2.4 million were recorded in 2004 on six retail properties, of which five were sold during 2004. These properties were classified in the following industries: one in automotive service, one in child care, two in consumer electronics, one in convenience store and one in restaurant.

Provisions for impairment of \$1.2 million were recorded in 2003 on 11 retail properties, all of which were sold during 2003. These properties were classified in the following industries: one in automotive service, three in child care, one in consumer electronics, three in home improvement and three in restaurant.

All of these provisions for impairment are included in income from discontinued operations, real estate held for investment on our consolidated statements of income, except for \$151,000 in 2005 which is included in property expenses.

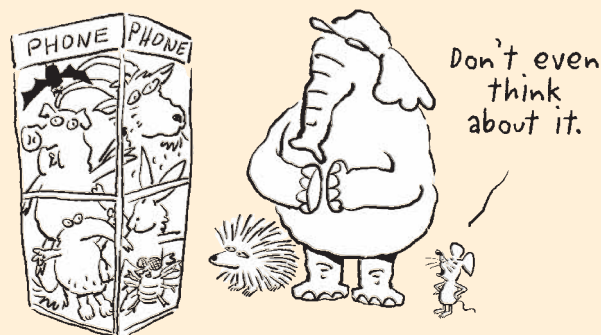
**Acquired In-place Leases.** In accordance with Financial Accounting Standards Board Statement No. 141, *Business Combinations*, (“SFAS 141”) the fair value of the real estate acquired with in-place operating leases is allocated to the acquired tangible assets, consisting of land, building and improvements, and identified intangible assets and liabilities, consisting of the value of above-market and below-market leases, the value of in-place leases and tenant relationships, based in each case on their fair values.

The fair value of the tangible assets of an acquired property (which includes land and buildings/improvements) is determined by valuing the property as if it were vacant, and the “as-if-vacant” value is then allocated to land and buildings/improvements based on our determination of the relative fair value of these assets. Our determinations are based on a real estate appraisal for each property, generated by an independent appraisal firm, which considered estimates of carrying costs during the expected lease-up periods, current market conditions, as well as costs to execute similar leases. In allocating the fair value to identified intangibles for above-market or below-market leases, an amount is recorded based on the present value of the difference between (i) the contractual amount to be paid pursuant to the in-place lease and (ii) our estimate of fair market lease rate for the corresponding in-place lease, measured over a period equal to the remaining non-cancelable term of the lease.

Capitalized above-market lease values are amortized as a reduction of rental income over the remaining non-cancelable terms of the respective leases. Capitalized below-market lease values are amortized as an increase to rental income over the remaining non-cancelable terms of the respective leases and expected below market renewal option periods.

The aggregate value of other acquired intangible assets consists of the value of in-place leases and tenant relationships. These are measured by the excess of the purchase price paid for a property, after adjusting for above or below market lease value, less the estimated fair value of the property “as if vacant,” determined as set forth above. The value of in-place leases, exclusive of the value of above-market and below-market in-place leases, is amortized to expense over the remaining non-cancelable periods of the respective leases. If a lease were to be terminated prior to its stated expiration, all unamortized amounts relating to that lease would be recorded to revenue or expense as appropriate.

**Stock Option Plan.** Effective January 1, 2002, we adopted the fair value recognition provisions of FASB Statement No. 123, *Accounting for Stock-Based Compensation*, and starting January 1, 2002 expensed costs for all stock option awards granted, modified, or settled. Stock option awards under the plan vest over periods ranging from one to five years.



The following table illustrates the effect on net income available to common stockholders and earnings per share if the fair value method had been applied to all outstanding and unvested stock option awards in each period (dollars in thousands, except per share amounts):

	2005	2004	2003
Net income available to common stockholders, as reported	\$ 89,716	\$ 90,168	\$ 76,722
Add: Stock option-based compensation expense included in reported net income	12	14	11
Deduct: Total stock option-based compensation expense determined under fair value method for all awards	(12)	(14)	(27)
Pro forma net income available to common stockholders	\$ 89,716	\$ 90,168	\$ 76,706
Net income available to common stockholders per common share:			
As reported—basic and diluted	\$ 1.12	\$ 1.15	\$ 1.08
Pro forma—basic and diluted	\$ 1.12	\$ 1.15	\$ 1.08

**Goodwill.** Goodwill is tested for impairment annually as well as when events or circumstances occur indicating that our goodwill might be impaired. We did not record any new goodwill or impairment on our existing goodwill during 2005, 2004 or 2003.

**Use of Estimates.** The consolidated financial statements were prepared in conformity with U.S. generally accepted accounting principles, which requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

**Reclassifications.** Certain of the 2004 and 2003 balances have been reclassified to conform to the 2005 presentation.

### 3. RETAIL PROPERTIES ACQUIRED

We acquire land, buildings and improvements that are used by retail operators.

A. During 2005, Realty Income and Crest Net, in aggregate, invested \$486.6 million in 156 new retail properties and properties under development. These 156 properties are located in 30 states, will contain over 1.9 million leasable square feet and are 100% leased with an average initial lease term of 15.8 years.

Of the \$486.6 million invested, \$95.1 million was used to acquire 34 properties with existing leases on the properties. In accordance with SFAS 141, Realty Income recorded \$10.1 million and Crest Net recorded \$1.8 million as the value of in-place leases and Realty Income recorded \$183,000 as the value of above-market rents. In addition, Realty Income recorded \$756,000 and Crest Net recorded \$66,000 as the value of below-market rents on these leases. The amounts recorded by Realty Income are included in "other assets" and "other liabilities" on our consolidated balance sheet and are amortized over the lives of the respective leases. Due to property sales, of the amounts recorded by Crest Net, only \$219,000 of in-place lease value is included in our consolidated balance sheet at December 31, 2005. Crest Net does not amortize the value of in-place leases because its properties are held for sale.

In comparison, during 2004, Realty Income and Crest Net, in aggregate, invested \$215.3 million in 194 new retail properties and properties under development. These 194 properties are located in 19 states, contain approximately 972,000 leasable square feet and are 100% leased with an average initial lease term of 17.5 years.

B. During 2005, Realty Income invested \$430.7 million in 135 new retail properties and properties under development, with an initial weighted average contractual lease rate of 8.4%. These 135 properties are located in 28 states, will contain over 1.7 million leasable square feet and are 100% leased with an average initial lease term of 15.6 years.

In comparison, during 2004, Realty Income invested \$193.8 million in 172 new retail properties and properties under development, with an initial weighted average contractual lease rate of 9.5%. These 172 properties are located in 18 states, contain over 913,000 leasable square feet and are 100% leased with an average initial lease term of 17.5 years.

C. During 2005, Crest Net invested \$55.9 million in 21 new retail properties and properties under development.

In comparison, during 2004, Crest Net invested \$21.5 million in 22 new retail properties and properties under development.

D. Crest Net's property inventory at December 31, 2005 consisted of 17 properties with a total investment of \$45.7 million and at December 31, 2004 consisted of eight properties with a total investment of \$10.1 million. These amounts are included on our consolidated balance sheets in "real estate held for sale, net", except for \$219,000 of intangible assets at December 31, 2005 which are included in other assets.

#### 4. CREDIT FACILITY

In June 2005, Realty Income entered into a new \$300 million acquisition credit facility to replace our existing \$250 million acquisition credit facility that expired in October 2005. Under the terms of the new credit facility, which commenced in October 2005, the borrowing rate was reduced to LIBOR (London Interbank Offered Rate) plus 65 basis points with a facility fee of 15 basis points, for all-in drawn pricing of 80 basis points over LIBOR, based on our current credit ratings. The new credit facility offers us other interest rate options as well. The term of the new facility expires in October 2008, unless extended as provided in the agreement.

The average borrowing rate on our credit facilities during 2005 was 4.3%, compared to 2.4% in 2004 and 2.2% in 2003. Our current credit facility is, and previous credit facilities were, subject to various leverage and interest coverage ratio limitations. The Company is and has been in compliance with these covenants.

In 2005, 2004 and 2003, interest of \$1.9 million, \$531,000 and \$697,000, respectively, was capitalized with respect to properties under development.

Our credit facility is unsecured and accordingly, we have not pledged any assets as collateral for this obligation.

#### 5. NOTES PAYABLE

In September 2005, we issued \$175 million in aggregate principal amount of 5<sup>3</sup>/<sub>8</sub>% senior unsecured notes due 2017 (the "2017 Notes"). The price to the investor for the 2017 Notes was 99.974% of the principal amount for an effective yield of 5.378%. The net proceeds of \$173.2 million from this offering were used to repay borrowings under our unsecured acquisition credit facility, to fund new property acquisitions and for other general corporate purposes. Interest on the 2017 Notes is paid semiannually.

In March 2005, we issued \$100 million in aggregate principal amount of 5<sup>7</sup>/<sub>8</sub>% senior unsecured bonds due 2035 (the "2035 Bonds"). The price to the investor for the 2035 Bonds was 98.296% of the principal amount for an effective yield of 5.998%. The net proceeds of \$97.0 million from this offering were used to repay borrowings under our acquisition credit facility and for other general corporate purposes. Interest on the 2035 Bonds is paid semiannually.

In November 2003, we issued \$150 million of 5<sup>1</sup>/<sub>2</sub>% senior unsecured notes due 2015 (the "2015 Notes"). The price to the investor for the 2015 notes was 99.508% of the principal amount for an effective yield of 5.557%. The net proceeds from this offering were used to acquire new retail properties and to repay borrowings under our unsecured acquisition credit facility. Interest on the 2015 Notes is payable semiannually.

In March 2003, we issued \$100 million of 5<sup>3</sup>/<sub>8</sub>% senior unsecured notes due 2013 (the "2013 Notes"). The price to the investor for the 2013 notes was 99.509% of the principal amount for an effective yield of 5.439%. The net proceeds from this offering were used to repay borrowings under our unsecured acquisition credit facility. Interest on the 2013 Notes is payable semiannually.

In January 1999, we issued \$20 million of 8% senior unsecured notes due 2009 (the "2009 Notes"). Interest on the 2009 Notes is payable semiannually.

In October 1998, we issued \$100 million of 8<sup>1</sup>/<sub>4</sub>% Monthly Income Senior Notes due 2008 (the "2008 Notes"). In May 1998, we entered into a treasury interest rate lock agreement associated with the 2008 Notes. In settlement of the agreement, we made a payment of \$8.7 million in 1998. The payment on the agreement is being amortized over 10 years (the life of the 2008 Notes) as a yield adjustment to interest expense. After taking into effect the results of a treasury interest rate lock agreement, the effective rate to us on the 2008 Notes is 9.12%. Interest on the 2008 Notes is payable monthly. The 2008 Notes are unsecured.

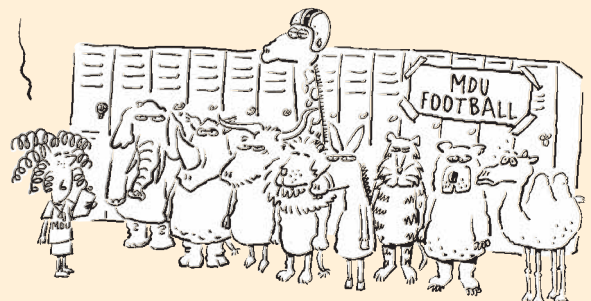
In May 1997, we issued \$110 million of 7<sup>3</sup>/<sub>4</sub>% senior unsecured notes due 2007 (the "2007 Notes"). In December 1996, we entered into a treasury interest rate lock agreement associated with the 2007 Notes. In settlement of the agreement, we received \$1.1 million in 1997. The payment received on the agreement is being amortized over 10 years (the life of the 2007 Notes) as a yield adjustment to interest expense. After taking into effect the results of a treasury interest rate lock agreement, the effective interest rate to us on the 2007 Notes is 7.62%. Interest on the 2007 Notes is payable semiannually.

Interest incurred on the 2017 Notes, 2035 Bonds, 2015 Notes, 2013 Notes, 2009 Notes, 2008 Notes and 2007 Notes collectively for each of the years ended December 31, 2005, 2004 and 2003 was \$39.5 million, \$32.0 million and \$23.6 million, respectively. The interest rate on each of these notes is fixed.

Our outstanding notes are unsecured and accordingly, we have not pledged any assets as collateral for these or any other obligations.

All of these notes contain various covenants, including: (i) a limitation on incurrence of any debt which would cause our debt to total adjusted assets ratio to exceed 60%; (ii) a limitation on incurrence of any secured debt which would cause our secured debt to total adjusted assets ratio to exceed 40%; (iii) a limitation on incurrence of any debt which would cause our debt service coverage ratio to be less than 1.5 times; and (iv) the maintenance at all times of total unencumbered assets not less than 150% of our outstanding unsecured debt. We have been in compliance with these covenants since each of the notes were issued.

OK, here are your positions, Lineman, Lineman, Lineman, wide receiver, kicker, Linebacker, Linebacker, Linebacker, & Hm..... Waterboy.



The following table summarizes the maturity of our notes payable as of December 31, 2005 (dollars in millions):

Year of Maturity	Notes
2006	\$ —
2007	110.0
2008	100.0
2009	20.0
2010	—
Thereafter	525.0
<b>Totals</b>	<b>\$ 755.0</b>

## 6. COMMON STOCK OFFERINGS

A. In September 2005, we issued 4.1 million shares of common stock at a price of \$23.79 per share. The net proceeds of \$92.7 million were used to fund new property acquisitions and for other general corporate purposes.

B. In March 2004, we issued 3.2 million shares of common stock at a price of \$22.375 per share. The net proceeds of \$67.9 million were used to repay a portion of our acquisition credit facility borrowings, which had been used to acquire 112 convenience store properties in March 2004.

C. In October 2003, we issued 5.75 million shares of common stock at a price of \$20.295 per share. The net proceeds of \$110.8 million were used to repay a portion of our acquisition credit facility.

## 7. DISTRIBUTIONS PAID AND PAYABLE

A. We pay monthly cash distributions to our common stockholders. The following is a summary of monthly distributions paid per common share for the years ended December 31:

Month	2005	2004	2003
January	\$ 0.110000	\$ 0.100000	\$ 0.097500
February	0.110000	0.100000	0.097500
March	0.110000	0.100000	0.097500
April	0.110625	0.100625	0.098125
May	0.110625	0.100625	0.098125
June	0.110625	0.100625	0.098125
July	0.111250	0.101250	0.098750
August	0.111250	0.101250	0.098750
September	0.115000	0.108750	0.098750
October	0.115625	0.109375	0.099375
November	0.115625	0.109375	0.099375
December	0.115625	0.109375	0.099375
<b>Total</b>	<b>\$ 1.346250</b>	<b>\$ 1.241250</b>	<b>\$ 1.181250</b>

The following presents the federal income tax characterization of distributions paid or deemed to be paid to common stockholders for the years ended December 31:

	2005	2004	2003
Ordinary income	\$ 1.210091	\$ 1.18315	\$ 1.10529
Nontaxable distributions	0.136159	0.05810	0.07596
Capital gain	—	—	—
<b>Totals</b>	<b>\$ 1.346250</b>	<b>\$ 1.24125</b>	<b>\$ 1.18125</b>

At December 31, 2005, a distribution of \$0.11625 per common share was payable and was paid in January 2006. At December 31, 2004, a distribution of \$0.11 per common share was payable and was paid in January 2005.

B. In May 2004, we issued 4.0 million shares of 7.375% Monthly Income Class D cumulative redeemable preferred stock, with a liquidation value of \$25 per share. All of these shares are outstanding. The net proceeds of \$96.4 million from this issuance were used to redeem a portion of the outstanding Class B and Class C preferred stock, repay borrowings outstanding under our \$250 million acquisition credit facility and for other general corporate purposes. Beginning May 27, 2009, the Class D preferred shares are redeemable at our option for \$25 per share. Dividends of \$0.1536459 per share are paid monthly in arrears on the Class D preferred stock.

In October 2004, we issued an additional 1.1 million shares of Class D preferred stock for \$25.4311 per share. The net proceeds of \$27.4 million were used to repay borrowings under our \$250 million acquisition credit facility.

We paid or accrued dividends to holders of our Class D preferred stock totaling \$9.4 million in 2005 and \$4.8 million in 2004. The dividends paid per share to our Class D preferred stockholders for 2005 of \$1.84375 and for 2004 of \$1.01406 were characterized for federal income tax purposes as ordinary income.

C. In May 1999, we issued 2,760,000 shares of 9<sup>3</sup>/<sub>8</sub>% Class B cumulative redeemable preferred stock, of which 2,745,700 shares were outstanding in 2003 and a portion of 2004. On June 6, 2004, all of the outstanding Class B preferred shares were redeemed. We paid dividends to holders of our Class B preferred stock totaling \$2.8 million during the first two quarters of 2004 and \$6.4 million in 2003. The dividends paid per share to our Class B Preferred stockholders in 2004 of \$1.01563 and in 2003 of \$2.34375 were characterized for federal income tax purposes as ordinary income.

In addition, when our Class B preferred stock was redeemed in 2004, we incurred a non-cash charge of \$2.4 million representing the Class B preferred stock original issuance costs that were paid in 1999.

D. In July 1999, we issued 1,380,000 shares of 9<sup>1</sup>/<sub>2</sub>% Class C cumulative redeemable preferred stock, all of which were outstanding in 2003 and for a portion of 2004. On July 30, 2004, all of the outstanding Class C preferred shares were redeemed. We paid monthly dividends to holders of our Class C preferred stock totaling \$1.9 million during the first seven months of 2004 and \$3.3 million in 2003. The dividends paid per share to our Class C preferred stockholders in 2004 of \$1.37882 and in 2003 of \$2.375 were characterized for federal income tax purposes as ordinary income.

In addition, when our Class C preferred stock was redeemed in 2004, we incurred a non-cash charge of \$1.4 million representing the Class C preferred stock original issuance costs that were paid in 1999.

## 8. OPERATING LEASES

A. At December 31, 2005, we owned 1,646 properties in 48 states, excluding 17 properties owned by Crest Net. Of these 1,646 properties, 1,641 are single-tenant retail locations and the remainder are multi-tenant, distribution and office locations. At December 31, 2005, 25 properties were vacant and available for lease or sale.

Substantially all leases are net leases where the tenant pays property taxes and assessments, maintains the interior and exterior of the building and leased premises, and carries insurance coverage for public liability, property damage, fire and extended coverage.

Percentage rent for 2005, 2004 and 2003 was \$1.2 million, \$1.3 million and \$1.2 million, respectively, including amounts recorded to discontinued operations.

At December 31, 2005, minimum future annual rents to be received on the operating leases are as follows (dollars in thousands):

For the years ending December 31,

2006	\$ 212,994
2007	203,830
2008	194,904
2009	185,524
2010	178,848
Thereafter	1,686,908
Total	\$ 2,663,008



B. Major Tenants—No individual tenant's rental revenue, including percentage rents, represented more than 10% of our total revenue for each of the years ended December 31, 2005, 2004 or 2003.

## 9. GAIN ON SALES OF REAL ESTATE ACQUIRED FOR RESALE BY CREST NET

In 2005, Crest Net sold 12 properties for \$23.5 million, which resulted in a gain of \$3.3 million. As part of one sale in 2005, Crest Net provided buyer financing in the form of a \$1.3 million promissory note. This note was paid in full in February 2006. In 2004, Crest Net sold 51 properties for \$75.0 million, which resulted in a gain of \$10.3 million. In 2003, Crest Net sold 27 properties for \$45.2 million, which resulted in a gain of \$6.2 million.

## 10. GAIN ON SALES OF INVESTMENT PROPERTIES BY REALTY INCOME

In 2005, we sold 23 investment properties and sold a portion of the land from two properties for \$23.4 million, which resulted in a gain of \$6.6 million. This gain is included in discontinued operations, except for \$18,000 that is included in other revenue.

In 2004, we sold or exchanged 43 investment properties and sold a portion of the land from four properties for \$35.4 million, which resulted in a gain of \$12.7 million. Of this gain, \$12.5 million is included in discontinued operations and \$185,000 is included in other revenue. Included in the 43 properties was one property leased by one of our tenants that we exchanged for another property owned by that tenant (see note 12E).

During 2003, we sold or exchanged 35 investment properties and exchanged three excess land parcels (from three properties) for \$23.1 million, which resulted in a gain of \$7.2 million. This gain is included in discontinued operations. Included in the 35 properties was one property leased by one of our tenants that we exchanged for another property owned by that tenant (see note 12F).

## 11. FAIR VALUE OF FINANCIAL INSTRUMENTS

We believe that the carrying values reflected in the consolidated balance sheets at December 31, 2005 and 2004 reasonably approximate the fair values for cash and cash equivalents, accounts receivable, and all liabilities, due to their short-term nature, except for the line of credit payable and notes payable. In making these assessments, we used estimates. The fair value of the line of credit payable approximates its carrying value because its terms are similar to those available in the market place at December 31, 2005. The estimated fair value of the notes payable at December 31, 2005 is \$755.0 million and at December 31, 2004 is \$500.9 million, based upon the closing market price per note or indicative price per each note at December 31, 2005 and 2004, respectively.

## 12. SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Interest paid in 2005 was \$36.4 million, in 2004 was \$31.3 million and in 2003 was \$32.5 million.

Income taxes paid by Realty Income and Crest Net in 2005 were \$1.4 million, in 2004 were \$6.9 million and in 2003 were \$0.8 million.

The following non-cash investing and financing activities are included in the accompanying consolidated financial statements:

A. In 2005, noncash additions to properties resulted in an increase in buildings of \$5.4 million, an increase in accounts payable of \$5.1 million.

B. In 2005, Crest Net sold a property for \$2.8 million and issued a mortgage note of \$1.3 million, which was paid in full in February 2006 and is included in other assets on our consolidated balance sheet.

C. In June 2004, when our Class B preferred stock was redeemed, we incurred a non-cash charge of \$2.4 million for the excess of redemption value over the carrying value.

D. In July 2004, when our Class C preferred stock was redeemed, we incurred a non-cash charge of \$1.4 million for the excess of redemption value over the carrying value.

E. In 2004, we exchanged one of our properties for a different property that was leased to the same tenant. As part of this transaction, land was reduced by \$160,000, building was increased by \$78,000, and accumulated depreciation was decreased by \$82,000.

F. In 2003, we exchanged excess land parcels from three different properties leased by one of our tenants for land (with improvements) owned by that same tenant. In 2003, we also exchanged one property leased by one of our tenants for another property owned by that tenant. As part of these transactions, accumulated depreciation was decreased by \$64,000 and gain on sale of \$64,000 was recognized.

G. In 2003, non-cash additions to properties resulted in an increase in buildings of \$1.7 million, an increase in real estate held for sale, net of \$289,000 and an increase in other liabilities of \$2.0 million.

H. Stock based compensation resulted in the following (dollars in thousands):

	2005	2004	2003
Deferred stock compensation	\$ 2,168	\$ 1,441	\$ 951

I. Distributions payable on our balance sheets is comprised of the following accrued distributions (dollars in thousands):

	2005	2004
Common stock distributions	\$ 9,729	\$ 8,723
Preferred stock dividends	392	392

## 13. EMPLOYEE BENEFIT PLAN

We have a 401(k) plan covering substantially all of our employees. Under our 401(k) plan, employees may elect to make contributions to the plan up to a maximum of 60% of their compensation, subject to limits under the IRS Code. We match 50% of our employee's contributions, up to 3% of the employee's compensation. Our aggregate matching contributions each year have been immaterial to our results of operations.

## 14. COMMON STOCK INCENTIVE PLAN

In 2003, our Board of Directors adopted and our stockholders approved the 2003 Incentive Award Plan of Realty Income Corporation to enable us to attract and retain the services of directors, employees and consultants considered essential to our long-term success, by offering them an opportunity to own stock in Realty Income and/or rights that will reflect our growth, development and financial success. The 2003 Incentive Award Plan of Realty Income Corporation was amended and restated by our Board of Directors on February 21, 2006. Under the terms of this plan, the aggregate number of shares of our common stock subject to options, stock purchase rights, stock appreciation rights and other awards will be no more than 3,428,000 shares. The maximum number of shares, which may be subject to options, stock purchase rights, stock appreciation rights and other awards granted under the plan to any individual in any calendar year may not exceed 1,600,000 shares. This plan has a term of 10 years from the date it was adopted by our Board of Directors, which was March 12, 2003.

In 1993, our Board of Directors approved a stock incentive plan (the "Stock Plan"), which expired in 2004.

Stock options are granted with an exercise price equal to the underlying stock's fair market value at the date of grant. Stock options expire ten years from the date they are granted and vest over service periods of one, three, four and five years. No stock options were granted in 2005, 2004 or 2003.



The following table summarizes our stock option activity for the years 2005, 2004 and 2003:

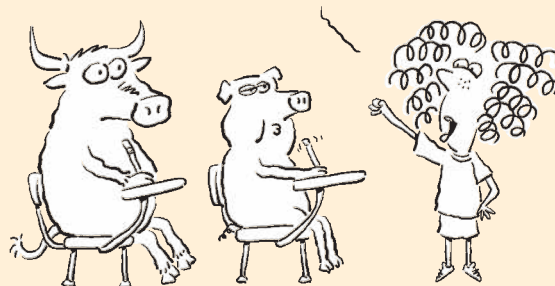
	2005		2004		2003	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Outstanding, beginning of year	176,130	\$ 13.01	247,756	\$ 12.53	380,480	\$ 12.01
Options granted	—	—	—	—	—	—
Options exercised	(40,352)	12.93	(67,648)	11.16	(130,126)	10.97
Options canceled	(430)	14.70	(3,978)	14.70	(2,598)	14.70
Outstanding, end of year	135,348	\$ 13.02	176,130	\$ 13.01	247,756	\$ 12.53
Options exercisable, end of year	119,924		153,206		207,324	

At December 31, 2005, the options outstanding under the Stock Plan had exercise prices ranging from \$10.63 to \$14.70, with a weighted average price of \$13.02, and expiration dates ranging from June 2007 to December 2011 with a weighted average remaining term of 3.3 years. At December 31, 2005, the options exercisable under the Stock Plan had exercise prices ranging from \$10.63 to \$14.70 with a weighted average price of \$12.87. Cash received from the exercise of options is included in deferred stock compensation on our consolidated statements of stockholders' equity.

The following table summarizes our nonvested common stock grant activity for the years 2005, 2004 and 2003. The grants vest over periods ranging from five to 10 years.

	2005		2004		2003	
	Number of Shares	Weighted Average Grant Price	Number of Shares	Weighted Average Grant Price	Number of Shares	Weighted Average Grant Price
Outstanding nonvested shares, beginning of year	626,868	\$ 14.98	475,174	\$ 13.70	332,584	\$ 12.43
Shares granted	306,241	25.20	218,180	19.94	189,732	17.59
Shares vested	(92,811)	16.69	(64,116)	15.16	(45,802)	13.69
Shares forfeited	(51,576)	17.31	(2,370)	18.65	(1,340)	16.92
Outstanding nonvested shares, end of year	788,722	\$ 17.83	626,868	\$ 14.98	475,174	\$ 13.70

What is the stock price doing?  
That is the wrong question. You should be asking me what the dividend is doing. If you bought a milk cow for the milk, why would you keep asking what the price of beef is?





## 15. STOCKHOLDER RIGHTS PLAN

In 1998, our Board of Directors adopted a Stockholder Rights Plan (the "Rights Plan") that was to expire in July 2008. The Rights Plan was canceled by the Board of Directors in February 2005.

## 16. SEGMENT INFORMATION

We evaluate performance and make resource allocation decisions on an industry by industry basis. For financial reporting purposes, we have grouped our tenants into 30 industry and activity segments (including properties owned by Crest Net that are grouped together). All of the properties are incorporated into one of the applicable segments. Because almost all of our leases require the tenant to pay operating expenses, revenue is the only component of segment profit and loss we measure.

The following tables set forth certain information regarding the properties owned by us, classified according to the business of the respective tenants as of December 31, 2005 (dollars in thousands):

For the years ended December 31,	Revenue		
	2005	2004	2003
Segment rental revenue:			
Apparel stores	\$ 3,100	\$ 3,100	\$ 3,158
Automotive parts	6,718	6,716	6,694
Automotive service	14,970	13,329	12,085
Automotive tire services	14,112	13,510	4,528
Child care	24,918	24,898	24,664
Consumer electronics	2,606	3,176	3,364
Convenience stores	36,624	33,293	18,492
Drug stores	5,593	243	243
Entertainment	4,081	3,997	3,869
Health and fitness	7,212	6,919	5,638
Home furnishings	7,346	7,276	7,378
Home improvement	2,130	2,115	2,265
Motor vehicle dealerships	5,060	859	51
Office supplies	2,996	2,868	2,865
Pet supplies and services	2,587	2,511	2,564
Restaurants	18,329	16,466	16,264
Sporting goods	6,747	5,939	5,664
Theaters	10,139	6,052	6,015
Video rental	4,942	4,959	4,806
11 other non-reportable segments	16,112	14,488	12,281
Reconciling items— Interest and other	354	1,033	590
Total revenue	\$ 196,676	\$ 173,747	\$ 143,478

As of December 31,	Assets	
	2005	2004
Segment net real estate:		
Apparel stores	\$ 21,688	\$ 22,492
Automotive parts	39,319	41,153
Automotive service	106,833	109,836
Automotive tire services	129,314	133,296
Child care	102,228	109,523
Consumer electronics	23,408	25,320
Convenience stores	342,404	321,746
Drug stores	65,846	2,320
Entertainment	35,402	35,400
Health and fitness	87,426	58,647
Home furnishings	55,728	57,588
Home improvement	17,846	18,156
Motor vehicle dealerships	71,035	40,786
Office supplies	22,852	22,305
Pet supplies and services	17,152	16,795
Restaurants	163,811	116,534
Sporting goods	57,913	59,535
Theaters	250,214	51,837
Video rental	33,163	34,277
11 other non-reportable segments	158,464	129,164
Total segment net real estate	1,802,046	1,406,710
Other intangible assets— Drug stores	8,489	—
Other intangible assets— Theaters	1,419	—
Other corporate assets	109,034	35,605
Total assets	\$ 1,920,988	\$ 1,442,315

## 17. COMMITMENTS AND CONTINGENCIES

In the ordinary course of our business, we are party to various legal actions which we believe are routine in nature and incidental to the operation of our business. We believe that the outcome of the proceedings will not have a material adverse effect upon our consolidated financial statements taken as a whole.

At December 31, 2005, we have committed to pay estimated unfunded development costs of \$42.2 million on properties under development. We also have contingent payments for tenant improvements and leasing costs of \$456,000.

In 2004, we recorded impairment of \$716,000 on one property to reduce its carrying value to zero. This property is classified as held for sale. This impairment was the result of a title insurance company failing to timely record a deed on this property. It is likely that through our tenant's bankruptcy proceedings, our title to this property will be divested. We believe that we have a strong claim against the title insurance company and others for the loss of the current fair market value of the property, rent which we may be required to repay to the tenant, and direct and incidental costs incurred. Our claim against the title insurance company and others is estimated to be between \$750,000 and \$1.3 million, which is not reflected in our consolidated financial statements as this represents a contingent gain.

## REPORTS OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

### The Board of Directors and Stockholders

#### Realty Income Corporation:

We have audited the accompanying consolidated balance sheets of Realty Income Corporation and subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2005. These consolidated financial statements are the responsibility of Realty Income Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Realty Income Corporation and subsidiaries as of December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Realty Income Corporation's internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 21, 2006 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

**KPMG LLP**

San Diego, California  
February 21, 2006

## The Board of Directors and Stockholders

### Realty Income Corporation:

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that Realty Income Corporation maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Realty Income Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of Realty Income Corporation's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Realty Income Corporation maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, Realty Income Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of Realty Income Corporation and subsidiaries as of December 31, 2005 and 2004, and for each of the years in the three-year period ended December 31, 2005, and our report dated February 21, 2006 expressed an unqualified opinion on those consolidated financial statements.

**KPMG LLP**

San Diego, California

February 21, 2006

# MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

## GENERAL

Realty Income Corporation, The Monthly Dividend Company®, is a Maryland corporation organized to operate as an equity real estate investment trust, or REIT. Our primary business objective is to generate dependable monthly cash distributions from a consistent and predictable level of funds from operations, or FFO per share. The monthly distributions are supported by the cash flow from our portfolio of retail properties leased to regional and national retail chains. We have in-house acquisition, leasing, legal, retail and real estate research, portfolio management and capital markets expertise. Over the past 37 years, Realty Income and its predecessors have been acquiring and owning freestanding retail properties that generate rental revenue under long-term lease agreements (primarily 15- to 20-years).

In addition, we seek to increase distributions to stockholders and FFO per share through both active portfolio management and the acquisition of additional properties. At December 31, 2005, we owned a diversified portfolio:

- Of 1,646 retail properties;
- With an occupancy rate of 98.5%, or 1,621 properties occupied of the 1,646 properties in the portfolio;
- Leased to 101 different retail chains doing business in 29 separate retail industries;
- Located in 48 states;
- With over 13.4 million square feet of leasable space; and
- With an average leasable retail space per property of 8,200 square feet.

Of the 1,646 properties in the portfolio, 1,641, or 99.7%, are single-tenant, retail properties and the remaining five are multi-tenant, distribution and office properties. At December 31, 2005, 1,617, or 98.5%, of the 1,641 single-tenant properties were leased with a weighted average remaining lease term (excluding extension options) of approximately 12.4 years.

In addition, our wholly-owned taxable REIT subsidiary, Crest Net Lease, Inc., owned 17 properties with a total investment of \$45.7 million at December 31, 2005, which are classified as held for sale. Crest Net was created to buy, own and sell properties, primarily to individual investors, many of whom are involved in tax-deferred exchanges under Section 1031 of the Internal Revenue Code of 1986, as amended.

## LIQUIDITY AND CAPITAL RESOURCES

### Cash Reserves

Realty Income is organized to operate as an equity REIT that acquires and leases properties and distributes to stockholders, in the form of monthly cash distributions, a substantial portion of its net cash flow generated from leases on its retail properties. We

intend to retain an appropriate amount of cash as working capital. At December 31, 2005, we had cash and cash equivalents totaling \$65.7 million.

We believe that our cash and cash equivalents on hand, cash provided from operating activities and borrowing capacity is sufficient to meet our liquidity needs for the foreseeable future. We intend, however, to use additional sources of capital to fund property acquisitions and to repay our credit facility.

### \$300 Million Credit Facility

We have a \$300 million revolving, unsecured acquisition credit facility that expires in October 2008. Realty Income's current investment grade credit ratings provide for financing under the credit facility at the London Interbank Offered Rate, commonly referred to as LIBOR, plus 65 basis points with a facility fee of 15 basis points, for all-in drawn pricing of 80 basis points over LIBOR. At February 10, 2006, we had a borrowing capacity of \$168.4 million available on our credit facility and an outstanding balance of \$131.6 million at an effective interest rate of 5.2%.

The credit facility is expected to be used to acquire additional retail properties and for other corporate purposes. Any additional borrowings will increase our exposure to interest rate risk.

### Mortgage Debt

We have no mortgage debt on any of our properties.

### Universal Shelf Registration of \$800 Million

In February 2004, we filed a universal shelf registration statement with the SEC registering the issuance, from time to time, of up to \$800 million in aggregate value of common stock, preferred stock and debt securities. At February 10, 2006, \$227.9 million remained available for issuance under our universal shelf registration statement.

### Issuance of Common Stock in 2005

In September 2005, Realty Income issued 4.1 million shares of common stock. The net proceeds of approximately \$92.7 million from this offering were used to fund new property acquisitions and for other general corporate purposes.

### Issuance of 12-Year Senior Unsecured Notes

In September 2005, Realty Income issued \$175 million in aggregate principal amount of 12-year, 5<sup>3</sup>/<sub>8</sub>% senior unsecured notes due 2017. The price to the public for the notes was 99.974% of the principal amount for an effective yield of 5.378%. The net proceeds from the offering were used to repay borrowings under the Company's unsecured acquisition credit facility, for property acquisitions and for other general corporate purposes.

### Issuance of 30-Year Senior Unsecured Bonds

In March 2005, Realty Income issued \$100 million in aggregate principal amount of 30-year, 5<sup>7</sup>/<sub>8</sub>% senior unsecured bonds due 2035. The price to the investor for the bonds was 98.296% of the principal amount for an effective yield of 5.998%. The net proceeds from the offering were used to repay borrowings under our unsecured acquisition credit facility and for other general corporate purposes.

### Conservative Capital Structure

We believe that our stockholders are best served by a conservative capital structure. Therefore, we seek to maintain a conservative debt level on our balance sheet and solid interest and fixed charge coverage ratios. At February 10, 2006, our total outstanding credit facility borrowings and outstanding notes were \$886.6 million or approximately 30.3% of our total market capitalization of \$2.92 billion. We calculate our total market capitalization at February 10, 2006 as the sum of:

- Shares of our common stock outstanding of 83,880,873 multiplied by the last reported sales price of our common stock on the NYSE of \$22.78 per share, or \$1.91 billion;
- Aggregate liquidation value of the Class D preferred stock of \$127.5 million;
- Outstanding borrowings of \$131.6 million on our credit facility; and
- Outstanding notes of \$755.0 million.

Historically, we have met our long-term capital needs through the issuance of common stock, preferred stock and long-term unsecured notes and bonds. Over the long term, we believe that the majority of our future securities issuances should be in the form of common stock, however, we may issue additional preferred stock or debt securities from time to time. We may issue common stock when we believe that our share price is at a level that allows for the proceeds of any offering to be accretively invested into additional properties. In addition, we may issue common stock to permanently finance properties that were financed by our credit facility or debt securities. However, we cannot assure you that we will have access to the capital markets at terms that are acceptable to us.

### Credit Agency Ratings

We are currently assigned investment grade corporate credit ratings, on our senior unsecured notes, from Fitch Ratings, Moody's Investors Service, Inc. and Standard & Poor's Ratings Group. Currently, Fitch Ratings has assigned a rating of BBB+, Moody's has assigned a rating of Baa2 and Standard & Poor's has assigned a rating of BBB to our senior notes. Moody's rating has a "positive" outlook and the other ratings have a "stable" outlook.

We have also been assigned investment grade credit ratings from the same rating agencies on our preferred stock. Fitch Ratings has assigned a rating of BBB, Moody's has assigned a rating of Baa3 and Standard & Poor's has assigned a rating of

BBB- to our preferred stock. Moody's rating has a "positive" outlook and the other ratings have a "stable" outlook.

The credit ratings assigned to us could change based upon, among other things, our results of operations and financial condition.

### Notes Outstanding

In September 2005, we issued \$175 million of 5<sup>3</sup>/<sub>8</sub>%, 12-year, senior unsecured notes due 2017. Interest on these notes is paid semiannually.

In March 2005, we issued \$100 million of 5<sup>7</sup>/<sub>8</sub>%, 30-year, senior unsecured bonds due 2035. Interest on these bonds is paid semiannually.

In November 2003, we issued \$150 million of 5<sup>1</sup>/<sub>2</sub>%, 12-year, senior unsecured notes due 2015 (the "2015 Notes"). Interest on the 2015 Notes is paid semiannually.

In March 2003, we issued \$100 million of 5<sup>3</sup>/<sub>8</sub>%, 10-year, senior unsecured notes due 2013 (the "2013 Notes"). Interest on the 2013 Notes is paid semiannually.

In January 1999, we issued \$20 million of 8% senior unsecured notes due 2009 (the "2009 Notes"). Interest on the 2009 Notes is payable semiannually.

In October 1998, we issued \$100 million of 8<sup>1</sup>/<sub>4</sub>% Monthly Income Senior Notes due 2008 (the "2008 Notes"). Interest on the 2008 Notes is payable monthly. The 2008 Notes are unsecured.

In May 1997, we issued \$110 million of 7<sup>3</sup>/<sub>4</sub>% senior unsecured notes due 2007 (the "2007 Notes"). Interest on the 2007 Notes is payable semiannually.

All of these notes contain various covenants, including: (i) a limitation on incurrence of any debt which would cause our debt to total adjusted assets ratio to exceed 60%; (ii) a limitation on incurrence of any secured debt which would cause our secured debt to total adjusted assets ratio to exceed 40%; (iii) a limitation on incurrence of any debt which would cause our debt service coverage ratio to be less than 1.5 times; and (iv) the maintenance at all times of total unencumbered assets not less than 150% of our outstanding unsecured debt. We have been in compliance with these covenants since each of the notes were issued.

The following is a summary of the key financial covenants to our senior unsecured notes. The actual amounts are as of December 31, 2005.

Note Covenants	Required	Actual
Limitation on Incurrence of Total Debt	≤ 60%	40.0%
Limitation on Incurrence of Secured Debt	≤ 40%	0.0%
Debt Service Coverage	≥ 1.5 x	4.4 x
Maintenance of Total Unencumbered Assets	≥ 150% of Unsecured Debt	250%

All of our outstanding notes have fixed interest rates. Our credit facility interest rate is variable.

The following table summarizes the maturity of each of our obligations as of December 31, 2005 (dollars in millions):

#### Table of Obligations

Year of Maturity	Credit Facility <sup>(1)</sup>	Notes	Interest <sup>(2)</sup>	Other <sup>(3)</sup>	Totals
2006	\$ —	\$ —	\$ 54.2	\$ 42.7	\$ 96.9
2007	—	110.0	48.6	—	158.6
2008	136.7	100.0	43.5	—	280.2
2009	—	20.0	29.0	—	49.0
2010	—	—	28.9	—	28.9
Thereafter	—	525.0	257.3	—	782.3
Totals	\$ 136.7	\$ 755.0	\$ 461.5	\$ 42.7	\$ 1,395.9

<sup>(1)</sup>The credit facility balance was \$131.6 million as of February 10, 2006.

<sup>(2)</sup>Interest on credit facility and notes has been calculated based on outstanding balances as of December 31, 2005 through their respective maturity dates.

<sup>(3)</sup>Other consists of \$42.2 million of estimated unfunded costs on properties under development and \$456,000 of contingent payments for tenant improvements and leasing costs.

Our credit facility and note obligations are unsecured. Accordingly, we have not pledged any assets as collateral for these obligations.

#### Preferred Stock Outstanding

In May and October 2004, we issued an aggregate of 5.1 million shares of 7.375% Class D cumulative redeemable preferred stock. Beginning May 27, 2009, shares of Class D preferred stock are redeemable at our option for \$25.00 per share, plus any accrued and unpaid dividends. Dividends on shares of Class D preferred are paid monthly in arrears.

#### No Off-Balance Sheet Arrangements or Unconsolidated Investment

Realty Income and its subsidiaries have no unconsolidated or off-balance sheet investments in "variable interest entities" or off-balance sheet financing, nor do we engage in trading activities involving energy or commodity contracts or other derivative instruments.

As we have no joint ventures, off-balance sheet entities, or mandatory redeemable preferred stock, our financial position or results of operations are currently not affected by Financial Accounting Standard Board Interpretation No. 46R, *Consolidation of Variable Interest Entities* and Statement of Financial Accounting Standard No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*.

#### Acquisitions During 2005

During 2005, Realty Income and Crest Net invested, in aggregate, \$486.6 million in 156 new properties and properties under development. These 156 properties are located in 30 states and are 100% leased with an initial average lease term of 15.8 years. As described below, Realty Income acquired 135 properties and Crest Net acquired 21 properties.

Included in the \$486.6 million is \$430.7 million invested by Realty Income in 135 new properties and properties under development with an initial weighted average contractual lease rate of 8.4%. These 135 properties are located in 28 states, are 100% leased with an initial average lease term of 15.6 years and will contain over 1.7 million leasable square feet. The 135 new properties acquired by Realty Income are net-leased to 13 different retail chains in the convenience store, drug store, financial services, health and fitness, motor vehicle dealership, restaurant and theater industries. At December 31, 2005, 10 new properties acquired during 2005 were leased and under contract for development by the tenant (with development costs funded by Realty Income) with rent scheduled to begin at various times during the next 12 months.

Included in the \$486.6 million is \$55.9 million invested by Crest Net in 21 new retail properties and properties under development.

Of the \$430.7 million Realty Income invested in real estate during 2005, \$43.9 million was invested in properties under development with rent scheduled to begin at various times during 2006. At December 31, 2005, we also had committed to pay estimated unfunded development costs totaling \$42.2 million.

The initial weighted average contractual lease rate is computed as estimated contractual net operating income (in a net-leased property this is equal to the base rent or, in the case of properties under development, the estimated base rent under the lease) for the first year of each lease, divided by the estimated total costs. Since it is possible that a tenant could default on the payment of contractual rent, we cannot assure you that the actual return on the funds invested will remain at the percentages listed above.

#### Investments in Existing Properties

In 2005, we capitalized costs of \$1.6 million on existing properties in our portfolio, consisting of \$570,000 for re-leasing costs and \$1.0 million for building improvements.

### Sales of Investment Properties

During 2005, we sold 23 properties and sold a portion of land from two properties for an aggregate of \$23.4 million, which resulted in a gain on sales of \$6.6 million. This gain is included in discontinued operations, except for \$18,000 that is included in other revenue. The 23 properties sold consisted of one automotive service store, two automotive tire service locations, seven child care facilities, two consumer electronics stores, one convenience store, one motor vehicle dealership, one private education facility, seven restaurants, and one property classified as "other." The net proceeds from the sale of these properties were used to repay outstanding indebtedness on our credit facility and to invest in new properties.

### Crest Net Property Sales

During 2005, Crest Net, our wholly-owned subsidiary, sold 12 properties from its inventory for \$23.5 million, which resulted in a gain of \$3.3 million.

### Crest Net's Property Inventory

Crest Net's property inventory totaled \$45.7 million at December 31, 2005 as compared to \$10.1 million at December 31, 2004. Crest Net's properties are included in "real estate held for sale, net", on our consolidated balance sheets.

The financial statements of Crest Net are consolidated into Realty Income's financial statements. All material intercompany transactions have been eliminated in consolidation.

### Increases in Monthly Cash Distributions to Common Stockholders

We continue our 36-year policy of paying distributions monthly. Monthly distributions per share were increased in April 2005 by \$0.000625 to \$0.110625, in July 2005 by \$0.000625 to \$0.11125, in September 2005 by \$0.00375 to \$0.115, in October 2005 by \$0.000625 to \$0.115625 and in January

2006 by \$0.000625 to \$0.11625. The increase in January 2006 was our 33rd consecutive quarterly increase and the 37th increase in the amount of our dividend since our listing on the NYSE in 1994. In 2005, we paid the following monthly cash distributions per share: three in the amount of \$0.11, three in the amount of \$0.110625, two in the amount of \$0.11125, one in the amount of \$0.115, and three in the amount of \$0.115625 totaling \$1.34625. In December 2005, January 2006 and February 2006, we declared distributions of \$0.11625 per share, which were paid on January 17, 2006 and February 15, 2006 and will be paid on March 15, 2006, respectively.

The monthly distribution of \$0.11625 per share represents a current annualized distribution of \$1.395 per share, and an annualized distribution yield of approximately 6.1% based on the last reported sale price of our common stock on the NYSE of \$22.78 on February 10, 2006. Although we expect to continue our policy of paying monthly distributions, we cannot guarantee that we will maintain the current level of distributions, that we will continue our pattern of increasing distributions per share, or what the actual distribution yield will be in any future period.

## RESULTS OF OPERATIONS

### Critical Accounting Policies

Our consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP"). Our consolidated financial statements are the basis for our discussion and analysis of financial condition and results of operations. Preparing our consolidated financial statements requires us to make a number of estimates and assumptions that affect the reported amounts and disclosures in the consolidated financial statements. We believe that we have made these estimates and assumptions in an appropriate manner and in a way that accurately reflects our financial condition. We continually test and evaluate these estimates and assumptions using our historical knowledge of the business, as well as other factors, to ensure that they are reasonable for reporting purposes. However, actual results may differ from these estimates and assumptions.

In order to prepare our consolidated financial statements according to the rules and guidelines set forth by GAAP, many subjective judgments must be made with regard to critical accounting policies. One of these judgments is our estimate for useful lives in determining depreciation expense for our properties. Depreciation of buildings and improvements is computed using the straight-line method over an estimated useful life of 25 years. If we use a shorter or longer estimated useful life it could have a material impact on our results of operations. We believe that 25 years is an appropriate estimate of useful life. No depreciation has been recorded on Crest Net's properties because they are held for sale.

Another significant judgment that must be made is, if and when the impairment losses should be taken on our properties when events or change in circumstances indicate that the carrying amount of the asset may not be recoverable. Generally, a provision is made for impairment loss if estimated future operating cash flows (undiscounted and without interest charges) plus estimated



disposition proceeds (undiscounted) are less than the current book value. Impairment losses are measured as the amount by which the current book value of the asset exceeds the fair value of the asset. If a property is held for sale, it is carried at the lower of carrying cost or estimated fair value, less costs to sell. The carrying value of our real estate is the largest component of our consolidated balance sheet. If events should occur that require us to reduce the carrying value of our real estate by recording provisions for impairment losses, it could have a material impact on our results of operations.

**The following is a comparison of our results of operations for the years ended December 31, 2005, 2004 and 2003.**

### Rental Revenue

Rental revenue was \$196.3 million for 2005 versus \$172.7 million for 2004, an increase of \$23.6 million, or 13.7%. Rental revenue was \$142.9 million in 2003. The increase in rental revenue in 2005 compared to 2004 is primarily attributable to:

- The 135 retail properties acquired by Realty Income in 2005, which generated \$12.1 million in 2005;
- The 172 retail properties acquired by Realty Income in 2004, which generated \$17.1 million in 2005 compared to \$9.4 million in 2004, an increase of \$7.7 million;
- Same store rents generated on 1,269 properties during 2005 and 2004 increased by \$1.3 million, or 0.8%, to \$158.1 million from \$156.8 million. These properties were leased during all of both 2005 and 2004;
- An increase in straight-line rent and other non-cash adjustments to rent of \$1.5 million in 2005 as compared to 2004; and
- An increase of \$807,000 relating to the aggregate of (i) development properties acquired before 2004 that started paying rent in 2004, (ii) properties that were vacant during part of 2005 or 2004 and (iii) lease termination settlements. These items in aggregate totaled \$5.2 million in 2005 and \$4.4 million in 2004.

Realty Income acquired 135 retail properties in 2005, excluding Crest Net acquisitions, and as a result, our 2005 operating results included less than a full year of rental revenue from these properties. Accordingly, we anticipate that the contribution to rental revenue from these 135 properties will increase in 2006, because there will be a full year of rent from these properties.

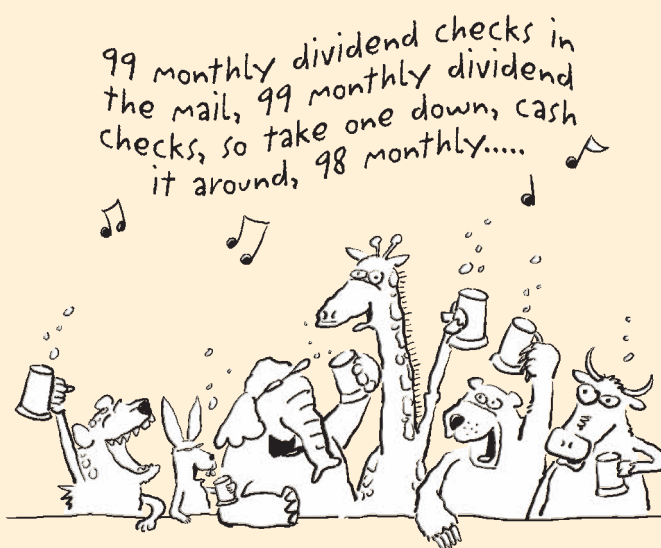
Our portfolio of retail real estate, leased primarily to regional and national chains under net leases, continues to perform well and provides dependable lease revenue supporting the payment of monthly dividends to our stockholders. At December 31, 2005, our portfolio of 1,646 retail properties was 98.5% leased with 25 properties available for lease, one of which is a multi-tenant property.

Of the 1,646 properties in the portfolio at December 31, 2005, 1,641, or 99.7%, are single-tenant properties and the remaining properties are multi-tenant, distribution and office properties. Of the 1,641 single-tenant properties, 1,617, or 98.5%, were net leased with a weighted average remaining lease term (excluding rights to extend a lease at the option of the tenant) of approximately 12.4 years at December 31, 2005. Of our 1,617 leased single-tenant and certain other properties, 1,488, or 92.0%, were under leases that provide for increases in rents through:

- Base rent increases tied to a consumer price index with adjustment ceilings;
- Fixed increases;
- To a lesser degree, overage rent based on a percentage of the tenants' gross sales; or
- A combination of two or more of the above rent provisions.

Percentage rent, which is included in rental revenue, was \$1.2 million in 2005, \$1.3 million in 2004 and \$1.1 million in 2003. Percentage rent in 2005 was less than 1% of rental revenue and we anticipate percentage rent to be less than 1% of rental revenue in 2006.

As of February 10, 2006, transactions to lease or sell 6 of the 25 properties available for lease at December 31, 2005 were under way or completed. We anticipate these transactions will be completed during the next several months, although we cannot guarantee that all of these properties can be leased or sold within this period. It has been our experience that approximately 1% to 3% of our property portfolio will be unleased at any given time, however, we cannot assure you that the number of properties available for lease will not exceed these levels.





## Interest Expense

Interest expense was \$6.8 million higher in 2005 than in 2004 primarily due to higher average outstanding balances. Interest expense was \$26.4 million in 2003. The following is a summary of the five components of our interest expense (dollars in thousands):

	2005	2004	2003
Interest on our credit facility and notes	\$ 40,968	\$ 32,442	\$ 24,962
Interest included in discontinued operations from real estate acquired for resale by Crest	(1,139)	(674)	(561)
Amortization of settlements on treasury lock agreements	756	756	756
Credit facility commitment fees	498	508	507
Amortization of credit facility origination costs and deferred bond financing costs	1,752	1,631	1,446
Interest capitalized	(1,886)	(531)	(697)
<b>Interest expense</b>	<b>\$ 40,949</b>	<b>\$ 34,132</b>	<b>\$ 26,413</b>

Credit facilities and notes outstanding	2005	2004	2003
Average outstanding balances (in thousands)	\$ 647,301	\$ 498,220	\$ 389,517
Average interest rates	6.33%	6.51%	6.41%

Interest on outstanding credit facilities and notes increased by \$8.5 million in 2005 as compared to 2004 primarily due to higher average outstanding note balances in 2005.

At February 10, 2006 the weighted average interest rate on our:

- Credit facility borrowings of \$131.6 million was 5.2%;
- Notes payable of \$755.0 million was 6.3%; and
- Combined outstanding credit facility and notes of \$886.6 million was 6.1%.

## Interest Coverage Ratio

Our interest coverage ratio for 2005 was 4.4 times, for 2004 was 5.0 times and for 2003 was 5.3 times. Interest coverage ratio is calculated as: the interest coverage amount (as calculated in the following table) divided by interest expense, including interest recorded to discontinued operations. We consider interest coverage ratio to be an appropriate supplemental measure of a company's ability to meet its interest expense obligations. Our calculation of interest coverage ratio may be different from the

calculation used by other companies and, therefore, comparability may be limited. This information should not be considered as an alternative to any GAAP liquidity measures.

The following is a reconciliation of net cash provided by operating activities to our interest coverage amount (dollars in thousands):

	2005	2004	2003
Net cash provided by operating activities	\$ 109,557	\$ 178,337	\$ 73,957
Interest expense	40,949	34,132	26,413
Interest expense included in discontinued operations <sup>(1)</sup>	1,139	674	561
Income taxes	813	699	501
Income taxes included in discontinued operations <sup>(1)</sup>	943	3,480	2,202
Investment in real estate acquired for resale <sup>(1)(2)</sup>	55,890	21,787	87,384
Proceeds from sales of real estate acquired for resale <sup>(1)</sup>	(22,195)	(74,995)	(45,226)
Gain on sales of real estate acquired for resale <sup>(1)</sup>	3,291	10,254	6,217
Amortization of deferred stock compensation	(2,155)	(1,426)	(940)
Amortization of stock option costs	(12)	(14)	(11)
Changes in assets and liabilities:			
Accounts receivable and other assets	3,292	(1,094)	(1,751)
Accounts payable, accrued expenses and other liabilities	(8,290)	1,050	(5,194)
<b>Interest coverage amount</b>	<b>\$ 183,222</b>	<b>\$ 172,884</b>	<b>\$ 144,113</b>
Divided by interest expense <sup>(3)</sup>	\$ 42,088	\$ 34,806	\$ 26,974
<b>Interest coverage ratio</b>	<b>4.4</b>	<b>5.0</b>	<b>5.3</b>

<sup>(1)</sup>Crest Net activities.

<sup>(2)</sup>The 2005 amount includes intangibles recorded in connection with acquisitions of real estate acquired for resale.

<sup>(3)</sup>Includes interest expense recorded to "income from discontinued operations, real estate acquired for resale by Crest."

### Fixed Charge Coverage Ratio

Our fixed charge coverage ratio for 2005 was 3.6 times, for 2004 was 3.9 times and for 2003 was 3.9 times. Fixed charge coverage ratio is calculated in exactly the same manner as interest coverage ratio, except that preferred stock dividends are also added to the denominator. We consider fixed charge coverage ratio to be an appropriate supplemental measure of a company's ability to make its interest and preferred stock dividend payments. Our calculation of the fixed charge coverage ratio may be different from the calculation used by other companies and, therefore, comparability may be limited. This information should not be considered as an alternative to any GAAP liquidity measures.

Interest coverage amount divided by interest expense plus preferred stock dividends (dollars in thousands)	2005	2004	2003
Interest coverage amount	\$ 183,222	\$ 172,884	\$ 144,113
Divided by interest expense plus preferred stock dividends <sup>(1)(2)</sup>	\$ 51,491	\$ 44,261	\$ 36,687
Fixed charge coverage ratio	3.6	3.9	3.9

<sup>(1)</sup>Excludes the Class B and Class C preferred stock non-cash charge of \$3,774 in 2004 for excess of redemption value over carrying value of preferred shares redeemed.

<sup>(2)</sup>Includes interest expense recorded to "income from discontinued operations, real estate acquired for resale by Crest."

### Depreciation and Amortization

Depreciation and amortization was \$46.4 million in 2005 versus \$39.9 million in 2004 and \$32.2 million in 2003. The increases in depreciation and amortization in 2005 and 2004 are due to the acquisition of properties in 2005, 2004 and 2003, which was partially offset by property sales in these years.

### General and Administrative Expenses

General and administrative expenses increased by \$2.3 million to \$15.4 million in 2005 versus \$13.1 million in 2004. General and administrative expenses were \$10.6 million in 2003. In 2005, general and administrative expenses as a percentage of total revenue increased to 7.8% as compared to 7.6% in 2004 and 7.4% in 2003. General and administrative expenses increased primarily due to increases in costs of corporate insurance, payroll, employee benefits, corporate governance and Sarbanes-Oxley Act of 2002 compliance costs.

As our property portfolio has grown and continues to grow, we have increased, and anticipate that we will continue to increase, the level of our staffing. We expect general and administrative expenses to moderately increase due to costs attributable to payroll, staffing costs and corporate governance.

At February 10, 2006, we had 69 permanent employees and four temporary employees as compared to February 15, 2005 when we had 64 permanent employees and six temporary employees. The temporary employees have been working on a record retention project that is expected to conclude in 2006.

### Property Expenses

Property expenses are broken down into costs associated with non-net leased multi-tenant properties, unleased single-tenant properties and general portfolio expenses. Expenses related to the multi-tenant and unleased single-tenant properties include, but are not limited to, property taxes, maintenance, insurance, utilities, property inspections, bad debt expense and legal fees. General portfolio costs include, but are not limited to, insurance, legal, property inspections and title search fees. At December 31, 2005, 25 properties were available for lease, as compared to 32 at December 31, 2004 and 26 at December 31, 2003.

Property expenses were \$3.8 million in 2005, \$3.1 million in 2004 and \$2.4 million in 2003. The \$769,000 increase in property expenses in 2005 is primarily attributable to an increase in costs associated with vacant properties and bad debt expense.

### Income Taxes

Income taxes were \$813,000 in 2005 as compared to \$699,000 in 2004 and \$501,000 in 2003. These amounts are for city and state income taxes paid by Realty Income. The increases in 2005 and 2004 are due to an increase in rental revenue causing higher city and state income tax expense.

In addition, Crest Net incurred state and federal income taxes of \$943,000 in 2005 as compared to \$3.5 million in 2004 and \$2.2 million in 2003. The decrease in 2005 over the 2004 and 2003 amounts are due to lower taxable income, primarily attributable to lower gain on sales of real estate acquired for re-sale. These amounts are included in "income from discontinued operations from real estate acquired for resale by Crest."

### Discontinued Operations

Crest Net acquires properties with the intention of reselling them rather than holding them as investments and operating the properties. Consequently, we classify properties acquired by Crest Net as held for sale at the date of acquisition and do not depreciate them. The operations of Crest Net's properties are classified as "income from discontinued operations, real estate acquired for resale by Crest."

The following is a summary of Crest Net's "income from discontinued operations, real estate acquired for resale" for the years ended December 31, 2005, 2004 and 2003 (dollars in thousands):

Crest Net's income from discontinued operations, real estate acquired for resale	2005	2004	2003
Gain on sales of real estate acquired for resale	\$ 3,291	\$ 10,254	\$ 6,217
Rental revenue	2,085	2,304	1,724
Interest expense	(1,139)	(674)	(561)
General and administrative expense	(453)	(464)	(566)
Property expenses	(60)	(93)	(24)
Income taxes	(943)	(3,480)	(2,202)
Income from discontinued operations, real estate acquired for resale by Crest	\$ 2,781	\$ 7,847	\$ 4,588
Per common share, basic and diluted	\$ 0.03	\$ 0.10	\$ 0.06

Realty Income's operations from four properties listed as held for sale at December 31, 2005, plus properties sold in 2005, 2004 and 2003 have been classified as discontinued operations. The following is a summary of our discontinued operations from real estate held for investment for the years ended December 31, 2005, 2004 and 2003 (dollars in thousands):

Realty Income's income from discontinued operations from real estate held for investment	2005	2004	2003
Gain on sales of investment properties	\$ 6,573	\$ 12,543	\$ 7,156
Rental revenue	1,073	3,927	6,845
Other revenue	2	117	46
Depreciation and amortization	(226)	(984)	(1,684)
Property expenses	(266)	(534)	(552)
Provisions for impairments	(35)	(2,373)	(1,242)
Income from discontinued operations, real estate held for investment	\$ 7,121	\$ 12,696	\$ 10,569
Per common share, basic and diluted	\$ 0.09	\$ 0.16	\$ 0.15

The following is a summary of our total discontinued operations for the years ended December 31, 2005, 2004 and 2003 (dollars in thousands):

Total income from discontinued operations	2005	2004	2003
Income from discontinued operations:			
Real estate acquired for resale by Crest	\$ 2,781	\$ 7,847	\$ 4,588
Real estate held for investment	7,121	12,696	10,569
Income from discontinued operations	\$ 9,902	\$ 20,543	\$ 15,157
Per common share, basic and diluted	\$ 0.12	\$ 0.26	\$ 0.21

#### Gain on Sales of Real Estate Acquired for Resale by Crest Net (included in discontinued operations)

In 2005 Crest Net sold 12 properties for \$23.5 million, which resulted in a gain of \$3.3 million. In 2004, Crest Net sold 51 properties for \$75.0 million, which resulted in a gain of \$10.3 million. In 2003, Crest Net sold 27 properties for \$45.2 million, which resulted in a gain of \$6.2 million. All gains on sales of real estate acquired for resale are reported before income taxes.

At December 31, 2005, Crest Net had \$45.7 million invested in 17 properties, which are held for sale. Our goal is for Crest Net to carry an average inventory of approximately \$20 to \$25 million in real estate. Crest Net generates an earnings spread on the difference between the lease payments it receives on the properties held in inventory and the cost of capital used to acquire properties. It is our belief that at this level of inventory, rental revenue will exceed the ongoing operating expenses of Crest Net without any property sales.

### **Gain on Sales of Investment Properties by Realty Income (included in discontinued operations)**

In 2005, we sold 23 investment properties and sold a portion of the land from two properties for \$23.4 million and recognized a gain on sales of \$6.6 million. This gain is included in discontinued operations, except for \$18,000 that is included in other revenue. In 2004, we sold or exchanged 43 investment properties and sold a portion of the land from four properties for a total of \$35.4 million and recognized a gain of \$12.7 million. This gain is included in discontinued operations, except for \$185,000 that is included in other revenue. In 2003, we sold or exchanged 35 properties and exchanged three excess land parcels (from three properties) for \$23.1 million and recognized a gain of \$7.2 million, which is included in discontinued operations.

We have an active portfolio management program that incorporates the sale of assets when we believe the reinvestment of the sale proceeds will generate higher returns, enhance the credit quality of our real estate portfolio or extend our average remaining lease term. At December 31, 2005, we classified real estate with a carrying amount of \$47.1 million as held for sale, which includes \$45.5 million in properties owned by Crest Net. In addition, \$219,000 invested by Crest Net in real estate is included in other assets and was classified as intangible assets. Additionally, we anticipate selling investment properties from our portfolio that have not yet been specifically identified from which we anticipate receiving between \$15 million and \$35 million in proceeds during the next 12 months. We intend to invest these proceeds into new property acquisitions. However, we cannot guarantee that we will sell properties during the next 12 months.

### **Provisions for Impairments**

Provisions for impairments of \$186,000 were recorded in 2005 on four properties as compared to \$2.4 million in 2004 on six properties and \$1.2 million on 11 properties in 2003. These provisions are included in "income from discontinued operations, real estate held for investment", except for \$151,000 in 2005, which is included in property expenses.

### **Preferred Stock Cash Dividends and Redemption Charge**

We had preferred stock cash dividends of \$9.4 million in 2005 as compared to \$9.5 million in 2004 and \$9.7 million in 2003.

When we redeemed our Class B preferred stock in June 2004 and our Class C preferred stock in July 2004, we incurred non-cash charges of \$2.4 million and \$1.4 million, respectively, for the excess of redemption value over the carrying value. These non-cash charges represent the Class B and Class C preferred stock original issuance costs that were paid in 1999 and recorded as a reduction to net income available to common stockholders when the shares were redeemed. These non-cash charges equated to \$0.05 per common share in 2004.

### **Net Income Available to Common Stockholders**

Net income available to common stockholders in 2005 decreased by \$452,000 to \$89.7 million as compared to \$90.2 million in 2004. Net income available to common stockholders in 2003 was \$76.7 million.

The calculation to determine net income available to common stockholders includes gains from the sale of properties. The amount of gains varies from period to period based on the timing of property sales and can significantly impact net income available to common stockholders.

The gain recognized from the sales of investment properties during 2005 was \$6.6 million as compared to \$12.7 million during 2004 and \$7.2 million in 2003. The gain recognized from the sale of properties acquired for re-sale during 2005 was \$3.3 million as compared to \$10.3 million during 2004 and \$6.2 million during 2003.

At least our  
monthly  
dividends are  
going up as fast  
as the tuition.



**FUNDS FROM OPERATIONS (FFO)  
AVAILABLE TO COMMON STOCKHOLDERS**

FFO for 2005 increased by \$11.4 million, or 9.6%, to \$129.6 million as compared to \$118.2 million in 2004 and \$103.4 million in 2003. The following is a reconciliation of net income available to common stockholders (which we believe is the most comparable Generally Accepted Accounting Principles (“GAAP”) measure) to FFO, information regarding cash distributions paid and the diluted weighted average number of shares outstanding for 2005, 2004 and 2003 (dollars in thousands):

	2005	2004	2003
Net income available to common stockholders	\$ 89,716	\$ 90,168	\$ 76,722
Depreciation and amortization:			
Continuing operations	46,438	39,874	32,231
Discontinued operations	226	984	1,683
Depreciation of furniture, fixtures and equipment	(142)	(117)	(114)
Gain on sales of investment properties:			
Continuing operations	(18)	(185)	—
Discontinued operations	(6,573)	(12,543)	(7,156)
<b>Total funds from operations</b>	<b>\$ 129,647</b>	<b>\$ 118,181</b>	<b>\$ 103,366</b>
FFO per common share, basic	\$ 1.62	\$ 1.51	\$ 1.45
FFO per common share, diluted	\$ 1.62	\$ 1.50	\$ 1.45
Cash distributions paid to common stockholders	\$ 108,575	\$ 97,420	\$ 83,842
FFO in excess of distributions to common stockholders	\$ 21,072	\$ 20,761	\$ 19,524
Basic weighted average number of shares outstanding	79,950,255	78,518,296	71,128,282
Diluted weighted average number of shares outstanding	80,208,593	78,598,788	71,222,628

We define FFO, a non-GAAP measure, consistent with the National Association of Real Estate Investment Trust’s definition, as net income available to common stockholders, plus depreciation and amortization of real estate assets, reduced by gains on sales of investment property and extraordinary items.

We consider FFO to be an appropriate supplemental measure of a REIT’s operating performance as it is based on a net income analysis of property portfolio performance that excludes non-cash items such as depreciation. The historical accounting convention used for real estate assets requires straight-line depreciation of buildings and improvements, which implies that the value of real estate assets diminishes predictably over time. Since real estate values historically rise and fall with market conditions, presentations of operating results for a REIT, using historical accounting for depreciation, could be less informative. The use of FFO is recommended by the REIT industry as a supplemental performance measure. In addition, FFO is used as a measure of our compliance with the financial covenants of our credit facility.

Presentation of this information is intended to assist the reader in comparing the operating performance of different REITs, although it should be noted that not all REITs calculate FFO the same way, so comparisons with other REITs may not be meaningful. Furthermore, FFO is not necessarily indicative of cash flow available to fund cash needs and should not be considered as an alternative to net income as an indication of Realty Income’s performance. In addition, FFO should not be considered as an alternative to reviewing our cash flows from operating, investing and financing activities as a measure of liquidity, of our ability to make cash distributions or of our ability to pay interest payments.



### Other Non-Cash Items and Capitalized Expenditures

The following information includes non-cash items and capitalized expenditures on existing properties in our portfolio. These items are not included in the adjustments to net income available to common stockholders to arrive at FFO. Analysts and investors often request this supplemental information.

For the years ended (dollars in thousands)	2005	2004	2003
Provisions for impairments	\$ 186	\$ 2,373	\$ 1,242
Amortization of settlements on treasury lock agreements <sup>(1)</sup>	756	756	756
Amortization of deferred note financing costs <sup>(2)</sup>	1,034	913	725
Amortization of deferred stock compensation and stock option costs	2,167	1,440	951
Capitalized leasing costs and commissions	(570)	(323)	(392)
Capitalized building improvements	(1,017)	(789)	(264)
Straight line rent <sup>(3)</sup>	(1,360)	99	275
Preferred stock origination costs write-off <sup>(4)</sup>	—	3,774	—

<sup>(1)</sup>The settlements on the treasury lock agreements resulted from an interest rate risk prevention strategy that was used by the Company in 1997 and 1998, which correlated to pending issuances of senior note securities. We have not employed this strategy since 1998.

<sup>(2)</sup>Amortization of deferred note financing costs includes the amortization of costs incurred and capitalized when our notes were issued in May 1997, October 1998, January 1999, March 2003, November 2003, March 2005 and September 2005. These costs are being amortized over the lives of these notes. No costs associated with our credit facility agreements or annual fees paid to credit rating agencies have been included.

<sup>(3)</sup>A negative amount indicates that our straight-line rent was greater than our actual cash rent collected. A positive amount indicates that our straight-line rent was less than our actual cash rent collected.

<sup>(4)</sup>Represents the Class B and Class C preferred stock non-cash charges for the excess of redemption value over the carrying value.

### IMPACT OF INFLATION

Tenant leases generally provide for limited increases in rent as a result of increases in the tenants' sales volumes, increases in the consumer price index, and/or fixed increases. We expect that inflation will cause these lease provisions to result in rent increases over time. During times when inflation is greater than increases in rent, as provided for in the leases, rent increases may not keep up with the rate of inflation.

Approximately 98.2%, or 1,617, of the 1,646 properties in the portfolio are leased to tenants under net leases where the tenant is responsible for property costs and expenses. Net leases tend to reduce our exposure to rising property expenses due to inflation. Inflation and increased costs may have an adverse impact on our tenants if increases in their operating expenses exceed increases in revenue.

### IMPACT OF ACCOUNTING PRONOUNCEMENTS

In December 2004, the FASB issued Statement No. 123R, *Share-Based Payments*. Statement No. 123R requires companies to recognize in the income statement the grant-date fair value of stock options and other equity-based compensation issued to employees. We adopted Statement No. 123R on January 1, 2006. The impact of adopting Statement No. 123R was not material to our financial position or results of operations.

In December 2004, the FASB issued Statement No. 153, *Exchanges of Nonmonetary Assets*, an Amendment of APB No. 29. Statement No. 153 amends APB Opinion No. 29 and states that companies will no longer be permitted to use the "similar productive assets" concept to account for nonmonetary exchanges at book value with no gain being recognized. An exchange must be accounted for at fair value if the exchange has commercial substance and fair value is determinable. We adopted Statement No. 153 on January 1, 2006. The impact of adopting Statement No. 153 was not material to our financial position or results of operations.

In March 2005, the FASB issued Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations*, an interpretation of Statement No. 143, *Accounting for Asset Retirement Obligations*. Interpretation No. 47 requires companies to recognize a liability for the fair value of a legal obligation to perform asset-retirement activities that are conditional on a future event if the amount can be reasonably estimated. We adopted Interpretation No. 47 in the fourth quarter of 2005. The impact of adopting Interpretation No. 47 was not material to our financial position or results of operations.

## QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to interest rate changes primarily as a result of our credit facility and long-term notes used to maintain liquidity and expand our real estate investment portfolio and operations. Our interest rate risk management objective is to limit the impact of interest rate changes on earnings and cash flow and to lower our overall borrowing costs. To achieve these objectives we issue long-term notes, primarily at fixed rates, and may selectively enter into derivative financial instruments, such as interest rate lock agreements, interest rate swaps and caps in order to mitigate our interest rate risk on a related financial instrument. We were not a party to any derivative financial instruments at December 31, 2005. We do not enter into any transactions for speculative or trading purposes.

Our interest rate risk is monitored using a variety of techniques. The following table presents by year of expected maturity, the principal amounts, average interest rates, fair values as of December 31, 2005. This information is presented to evaluate the expected cash flows and sensitivity to interest rate changes (dollars in millions):

### Expected Maturity Data

Year of maturity	Fixed rate debt	Average interest rate on fixed rate debt	Variable rate debt	Average interest rate on variable rate debt
2006	\$ —	—	\$ —	—
2007 <sup>(1)</sup>	110.0	7.75%	—	—
2008 <sup>(2)(3)</sup>	100.0	8.25%	136.7	5.03%
2009 <sup>(4)</sup>	20.0	8.00%	—	—
2010	—	—	—	—
Thereafter <sup>(5)</sup>	525.0	5.51%	—	—
Totals	\$ 755.0	6.26%	\$ 136.7	5.03%
Fair Value <sup>(6)</sup>	\$ 755.0		\$ 136.7	

<sup>(1)</sup> \$110 million matures in May 2007.

<sup>(2)</sup> \$100 million matures in October 2008.

<sup>(3)</sup> The credit facility expires in October 2008. The credit facility balance as of February 10, 2006 was \$131.6 million.

<sup>(4)</sup> \$20 million matures in January 2009.

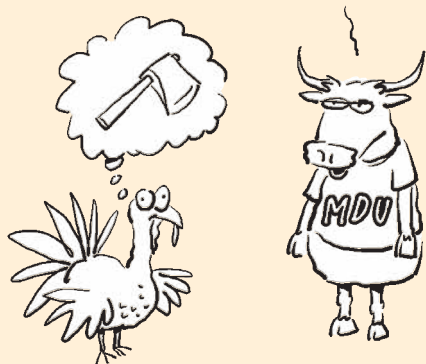
<sup>(5)</sup> \$100 million matures in March 2013, \$150 million matures in November 2015, \$175 million matures in September 2017 and \$100 million matures in March 2035.

<sup>(6)</sup> We base the fair value of the fixed rate debt at December 31, 2005 on the closing market price or indicative price per each note. The fair value of the variable rate debt approximates its carrying value because its terms are similar to those available in the market place at December 31, 2005.

The table incorporates only those exposures that exist as of December 31, 2005; it does not consider those exposures or positions that could arise after that date. As a result, our ultimate realized gain or loss, with respect to interest rate fluctuations, would depend on the exposures that arise during the period, our hedging strategies at the time, and interest rates.

All of our outstanding notes and bonds have fixed interest rates. Our credit facility interest rate is variable. Based on our credit facility balance at December 31, 2005, a 1% change in interest rates would change our interest costs by \$1.4 million per year.

No, no, no... the turkey drop refers to the tendency of the freshman girls to drop their old high school boyfriends by Thanksgiving.



**SELECTED FINANCIAL DATA**

(not covered by Report of Independent Registered Public Accounting Firm)

(dollars in thousands, except for per share data)

As of or for the years ended December 31,	2005	2004	2003	2002	2001
Total assets (book value)	\$ 1,920,988	\$ 1,442,315	\$ 1,360,257	\$ 1,080,230	\$ 1,003,708
Cash and cash equivalents	65,704	2,141	4,837	8,921	2,467
Lines of credit and notes payable	891,700	503,600	506,400	339,700	315,300
Total liabilities	931,774	528,580	532,491	357,775	331,915
Total stockholders' equity	989,214	913,735	827,766	722,455	671,793
Net cash provided by operating activities	109,557	178,337	73,957	124,807	90,035
Net change in cash and cash equivalents	63,563	(2,696)	(4,084)	6,454	(1,348)
Total revenue	196,676	173,747	143,478	128,145	109,807
Income from continuing operations	89,217	82,854	71,278	64,373	56,892
Income from discontinued operations	9,902	20,543	15,157	14,294	10,666
Net income	99,119	103,397	86,435	78,667	67,558
Preferred stock cash dividends	(9,403)	(9,455)	(9,713)	(9,713)	(9,712)
Excess of redemption value over carrying value of preferred shares redeemed	—	(3,774)	—	—	—
Net income available to common stockholders	89,716	90,168	76,722	68,954	57,846
Cash distributions paid to common stockholders	108,575	97,420	83,842	78,042	64,871
Ratio of earnings to fixed charges <sup>(1)</sup>	3.2 times	3.9 times	4.1 times	4.3 times	3.5 times
Ratio of earnings to combined fixed charges and preferred stock cash dividends <sup>(1)</sup>	2.6 times	3.1 times	3.0 times	3.0 times	2.6 times
Basic net income per common share	1.12	1.15	1.08	1.02	0.99
Diluted net income per common share	1.12	1.15	1.08	1.01	0.99
Cash distributions paid per common share	1.346250	1.24125	1.18125	1.15125	1.12125
Cash distributions declared per common share	1.352500	1.25125	1.18375	1.15375	1.12375
Basic weighted average number of common shares outstanding	79,950,255	78,518,296	71,128,282	67,867,498	58,450,718
Diluted weighted average number of common shares outstanding	80,208,593	78,598,788	71,222,628	67,976,314	58,562,240

<sup>(1)</sup>Ratio of Earnings to Fixed Charges is calculated by dividing earnings by fixed charges. For this purpose, earnings consist of net income before interest expense. Fixed charges are comprised of interest costs (including capitalized interest) and the amortization of debt issuance costs. In computing the ratio of earnings to combined fixed charges and preferred stock cash dividends, preferred stock cash dividends consist of dividends on our Class B preferred stock, Class C preferred stock and our outstanding Class D preferred stock. We redeemed our Class B preferred stock in June 2004 and our Class C preferred stock in July 2004, we issued 4,000,000 shares of our 7<sup>3</sup>/<sub>8</sub>% Class D preferred stock in May 2004 and we issued 1,100,000 shares of our 7<sup>3</sup>/<sub>8</sub>% Class D preferred stock in October 2004.



## CONTROLS AND PROCEDURES

### CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

We have had no disagreements with our independent auditors on accountancy or financial disclosure, nor have we changed accountants in the two most recent fiscal years.

### CONTROLS AND PROCEDURES

**Evaluation of Disclosure Controls and Procedures.** We maintain disclosure controls and procedures (as defined in Securities Exchange Act 1934 Rules 13a-14(c) and 15d-14(c)) that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As of and for the year ended December 31, 2005, we carried out an evaluation, under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective.

*We've had a report of illegal substances being used on dorm premises...*



### Management's Report on Internal Control Over Financial Reporting

Internal control over financial reporting refers to the process designed by, or under the supervision of, our Chief Executive Officer and Chief Financial Officer, and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles, and includes those policies and procedures that:

- (1) Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- (2) Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and
- (3) Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company.

Management has used the framework set forth in the report entitled "Internal Control—Integrated Framework" published by the Committee of Sponsoring Organizations ("COSO") of the Treadway Commission to evaluate the effectiveness of the Company's internal control over financial reporting. Management has concluded that the Company's internal control over financial reporting was effective as of the end of the most recent fiscal year. KPMG LLP has issued an attestation report on management's assessment of the Company's internal control over financial reporting.

Submitted on February 21, 2006 by,  
Thomas A Lewis, Chief Executive Officer and Vice Chairman  
Paul M. Meurer, Chief Financial Officer,  
Executive Vice President and Treasurer

**Changes in Internal Controls.** There have not been any significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation. There were no material weaknesses, and therefore no corrective actions were taken.

**Limitations on the Effectiveness of Controls.** Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

**Certifications.** Tom Lewis, Realty Income's Chief Executive Officer, Certified to the NYSE in 2005, pursuant to Section 303A. 12(a) of the NYSE's Listing Standards, that he was not aware of any violation of the NYSE corporate governance listing standards by Realty Income. Furthermore, Realty Income filed with the SEC, as exhibits to its Annual Report on Form 10-K for the year ended December 31, 2005, the certifications by Tom Lewis and Paul Meurer, Realty Income's Chief Executive Officer and Chief Financial Officer, respectively, required under Section 302 of the Sarbanes-Oxley Act.



## CONSOLIDATED QUARTERLY FINANCIAL DATA

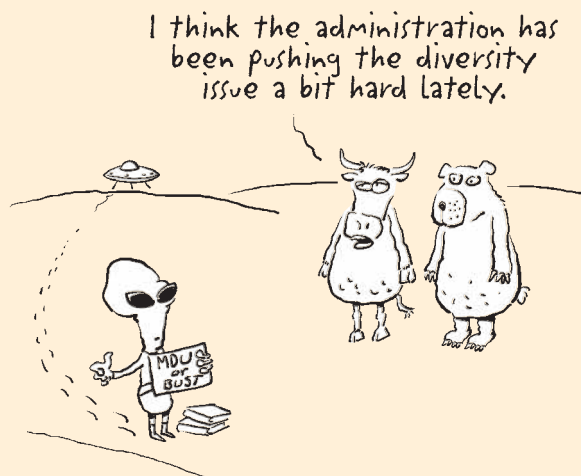
(dollars in thousands, except per share data)

(not covered by Report of Independent Registered Public Accounting Firm)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year <sup>(2)</sup>
<b>2005<sup>(1)</sup></b>					
Total revenue	\$ 46,579	\$ 47,367	\$49,080	\$ 53,650	\$ 196,676
Interest expense	9,058	9,793	10,228	11,869	40,949
Depreciation and amortization expense	10,760	11,194	11,266	13,218	46,438
Other expenses	5,117	4,900	5,386	4,670	20,072
Income from continuing operations	21,644	21,480	22,200	23,893	89,217
Income from discontinued operations	1,859	3,186	922	3,935	9,902
Net income	23,503	24,666	23,122	27,828	99,119
Net income available to common stockholders	21,152	22,315	20,771	25,477	89,716
Basic and diluted net income					
per common share	0.27	0.28	0.26	0.31	1.12
Dividends paid per common share	0.330000	0.331875	0.337500	0.346875	1.346250
<b>2004<sup>(1)</sup></b>					
Total revenue	\$ 41,232	\$ 43,646	\$ 43,563	\$ 45,306	\$ 173,747
Interest expense	8,476	8,505	8,553	8,599	34,132
Depreciation and amortization expense	9,504	9,968	10,120	10,283	39,874
Other expenses	4,003	4,190	4,118	4,573	16,887
Income from continuing operations	19,249	20,983	20,772	21,851	82,854
Income from discontinued operations	5,602	5,805	4,431	4,705	20,543
Net income	24,851	26,788	25,203	26,556	103,397
Net income available to common stockholders	22,423	21,446	21,988	24,312	90,168
Basic and diluted net income					
per common share	0.29	0.27	0.28	0.31	1.15
Dividends paid per common share	0.300000	0.301875	0.311250	0.328125	1.241250

<sup>(1)</sup>The consolidated quarterly financial data includes revenues and expenses from our continuing and discontinued operations. The results of operations related to certain properties, that have been classified as held for sale or have been disposed of, have been reclassified to income from discontinued operations. Therefore, some of the information may not agree to our previously filed 10-Qs.

<sup>(2)</sup>Amounts for each period are calculated independently. The sum of the quarters may differ from the annual amount.



## MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our common stock is traded on the NYSE under the ticker symbol "O." The following table shows the high and low sales prices per share for our common stock as reported by the NYSE, and distributions declared per share of common stock for the periods indicated.

	Price Per Share of Common Stock		Distributions Declared <sup>(1)</sup>
	High	Low	
<b>2005</b>			
First quarter	\$ 25.61	\$ 22.00	\$ 0.330625
Second quarter	25.69	22.50	0.332500
Third quarter	25.65	22.00	0.341875
Fourth quarter	23.97	21.08	0.347500
Total			\$ 1.352500
<b>2004</b>			
First quarter	\$ 22.48	\$ 19.70	\$ 0.300625
Second quarter	22.33	17.69	0.302500
Third quarter	22.70	19.71	0.319375
Fourth quarter	26.08	22.48	0.328750
Total			\$ 1.251250

Common stock cash distributions currently are declared monthly by us based on financial results for the prior months. At December 31, 2005 a distribution of \$0.11625 per common share had been declared and was paid in January 2006.

A 2-for-1 stock split was declared in November 2004 and became effective after the market close on December 31, 2004. Common stockholders received a dividend of an additional share of common stock for each share they owned. The increase in the number of common shares outstanding after the stock split is reflected for all periods presented and all per share data has been adjusted for the stock split.

There were 10,179 registered holders of record of our common stock as of January 31, 2006. We estimate that our total number of shareholders is approximately 65,000 when we include both registered and beneficial holders of our common stock.



## FORWARD-LOOKING STATEMENTS

This annual report contains forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. When used in this annual report, the words “estimated”, “anticipated” and similar expressions are intended to identify forward-looking statements. Forward-looking statements are subject to risks, uncertainties, and assumptions about Realty Income Corporation, including, among other things:

- Our anticipated growth strategies;
- Our intention to acquire additional properties and the timing of these acquisitions;
- Our intention to sell properties and the timing of these property sales;
- Our intention to re-lease vacant properties;
- Anticipated trends in our business, including trends in the market for long-term net-leases of freestanding, single-tenant retail properties;
- Future expenditures for development projects; and
- Profitability of our subsidiary, Crest Net Lease, Inc.

Future events and actual results, financial and otherwise, may differ materially from the results discussed in the forward-looking statements. In particular, some of the factors that could cause actual results to differ materially are:

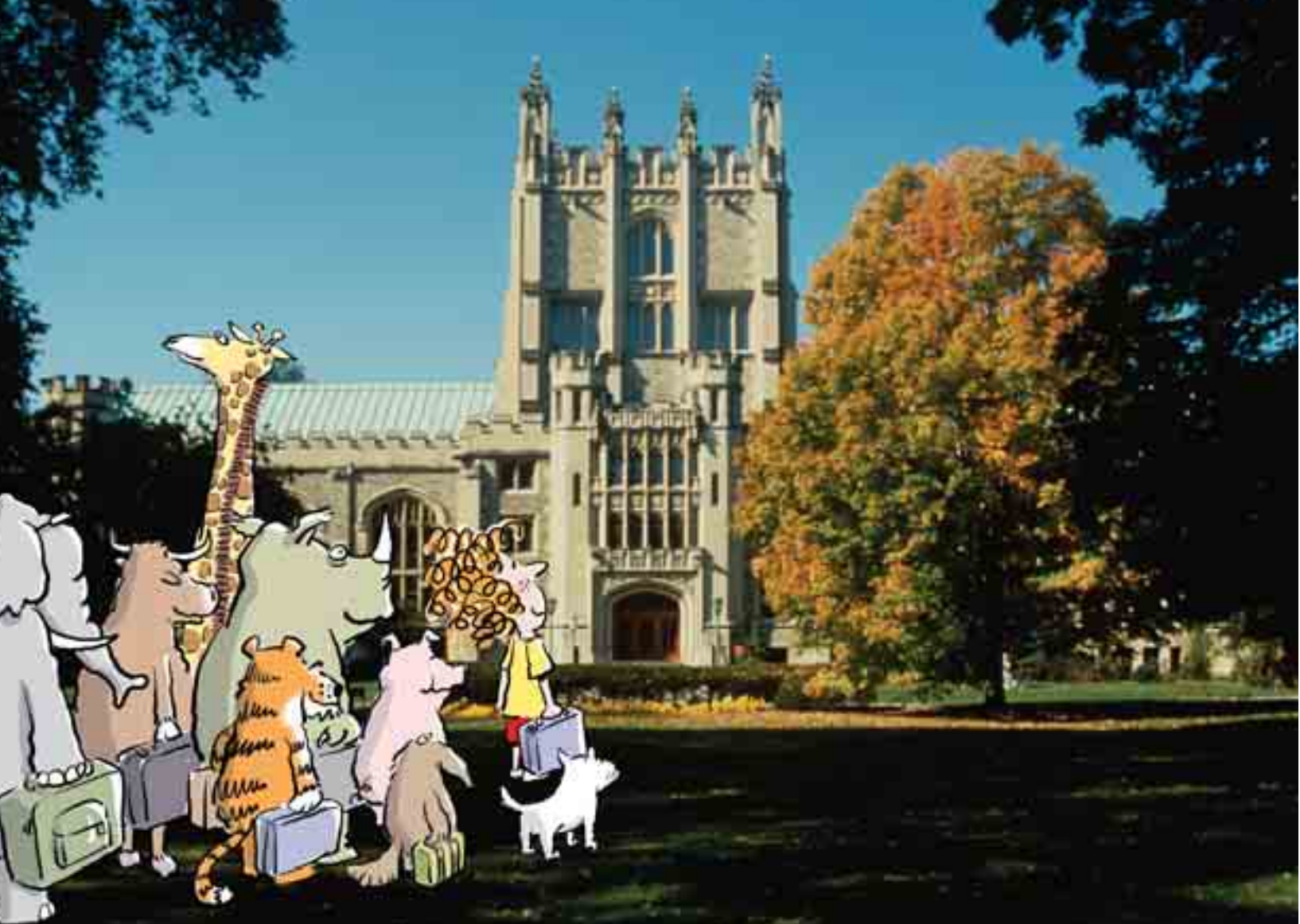
- Our continued qualification as a real estate investment trust;
- General business and economic conditions;
- Competition;
- Fluctuating interest rates;
- Access to debt and equity capital markets;
- Other risks inherent in the real estate business including tenant defaults, potential liability relating to environmental matters, illiquidity of real estate investments and potential damages from natural disasters;
- Impairments in the value of our real estate assets;
- Changes in the tax laws of the United States of America;
- The outcome of any legal proceeding to which we are a party; and
- Acts of terrorism and war.

Additional factors that may cause risks and uncertainties include those discussed in the sections entitled “Business” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in this annual report.

Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date that this annual report was prepared. We undertake no obligation to publicly release the results of any revisions to these forward-looking statements that may be made to reflect events or circumstances after the date of this annual report or to reflect the occurrence of unanticipated events. In light of these risks and uncertainties, the forward-looking events discussed in this annual report might not occur.

You're listening to radio MDU. This hour's program is brought to you by Realty Income, the Monthly Dividend Company.... Come to think of it, all our shows are brought to you by Realty.....





## WELCOME TO MONTHLY DIVIDEND UNIVERSITY!



### Monthly Dividend Girl and Friends Visit Monthly Dividend University

Designed and Produced by Patera, San Diego, CA; Illustrations by Tom Klare

## COMPANY INFORMATION

### EXECUTIVE OFFICERS

Thomas A. Lewis  
Vice Chairman  
of the Board of Directors,  
Chief Executive Officer

Gary M. Malino  
President and  
Chief Operating Officer

Paul M. Meurer  
Executive Vice President,  
Chief Financial Officer  
and Treasurer

Michael R. Pfeiffer  
Executive Vice President,  
General Counsel and Secretary

Richard G. Collins  
Executive Vice President,  
Portfolio Management

Kim S. Kandrak  
Senior Vice President,  
Portfolio Acquisitions

Gregory J. Fahey  
Vice President,  
Controller

Robert J. Israel  
Vice President,  
Research

Laura S. King  
Vice President,  
Assistant General Counsel  
and Assistant Secretary

Tere H. Miller  
Vice President,  
Corporate Communications

Michael K. Press  
Vice President,  
Financial Institutions

Mitchell N. White  
Vice President,  
Business Development

Cary J. Wenthur  
Vice President,  
Acquisitions Director

Theresa M. Casey  
Associate Vice President,  
Information Technologies

Jill M. Cossaboom  
Associate Vice President,  
Assistant Controller

Kristin K. Ferrell  
Associate Vice President,  
Portfolio Management

### SUBSIDIARY COMPANY

Crest Net Lease, Inc.  
Richard G. Collins  
President

Pete L. Oakley  
Senior Vice President,  
Chief Operating Officer

### DIRECTORS

William E. Clark, Jr.  
Chairman of the Board of Directors

Thomas A. Lewis  
Vice Chairman of the  
Board of Directors  
and Chief Executive Officer,  
Realty Income Corporation

Kathleen R. Allen, Ph.D.  
Director, Center of Technology  
Commercialization,  
Marshall School of Business  
University of Southern California

Donald R. Cameron  
Lead Independent Director  
President,  
Cameron, Murphy & Spangler, Inc.

Roger P. Kuppinger  
Private Investment Banker  
and Financial Advisor

Michael D. McKee  
Vice Chairman,  
Chief Operating Officer,  
The Irvine Company

Ronald L. Merriman  
Consultant,  
Merriman Partners

Willard H. Smith, Jr.  
Retired Managing Director,  
Merrill Lynch & Co.

**INDEPENDENT REGISTERED  
PUBLIC ACCOUNTING FIRM**  
KPMG LLP  
San Diego, California

### TRANSFER AGENT

The Bank of New York  
For shareholder administration and  
account information please call this  
toll-free number:  
1-877-218-2434

or email your question to:  
shareowner-svcs@bankofny.com

or write to:  
Shareholder Relations Department  
P.O. Box 11258  
Church Street Station  
New York, NY 10286

### FOR ADDITIONAL CORPORATE INFORMATION

Call the Realty Income Investor Hotline:  
For automated shareholder information  
please call:  
888-811-2001

Visit the Realty Income Corporate  
web site at:  
www.realtyincome.com

Contact your financial advisor or contact  
Realty Income at:  
telephone: 760-741-2111  
email: ir@realtyincome.com

Copies of Realty Income's 10-K report are  
available upon written request to:

**REALTY INCOME CORPORATION**  
Attention: Investor Relations  
220 West Crest Street  
Escondido, CA 92025-1707



### SENIOR MANAGEMENT TEAM

Back row, left to right: Richard G. Collins, Kim S. Kandrak,  
Tere H. Miller, Paul M. Meurer, Michael R. Pfeiffer

Front row, left to right: Thomas A. Lewis, Gary M. Malino



### BOARD OF DIRECTORS

Back row, left to right: Roger P. Kuppinger, Kathleen R. Allen, Ph.D.,  
Willard H. Smith, Jr., Michael D. McKee, Ronald L. Merriman

Front row, left to right: Donald R. Cameron, Thomas A. Lewis,  
William E. Clark, Jr.

