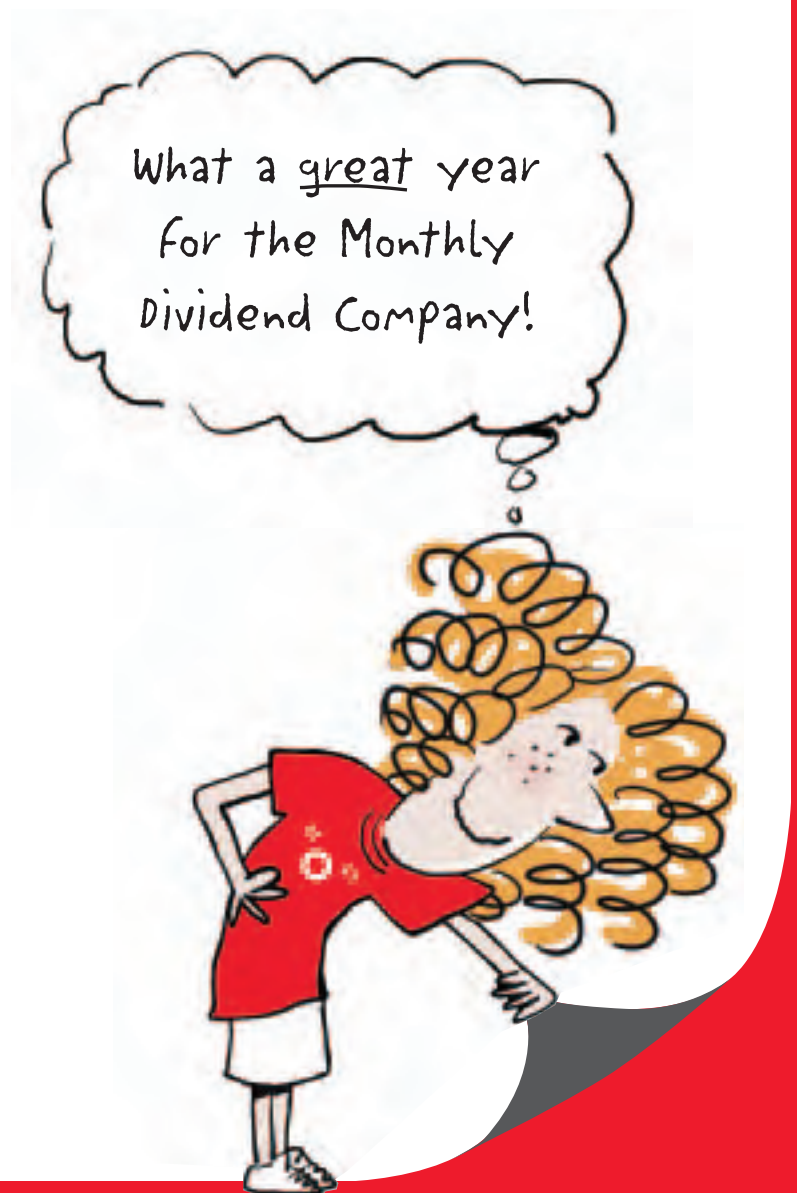


REALTY INCOME

2006 ANNUAL REPORT



To mark the end of a truly great year, we submit “The Monthly Dividend Land Game”, a whimsical way to celebrate the accomplishments of 2006 and remind us that accumulating assets to provide for retirement income is a goal we all share. In the imaginary world of Monthly Dividend Land, you accumulate Realty Income shares at every twist and turn on the road that leads to monthly dividends for life. We hope you enjoy this playful reminder that we understand how important dependable monthly income is to our shareholders—many of whom rely on a monthly dividend check from Realty Income to meet their monthly financial obligations. And, all kidding aside, we’re very serious about continuing to be a solid source of monthly income for our shareholders.

*The more shares you have,
the bigger the monthly check!*





THE MONTHLY DIVIDEND LAND

GAME

INSTRUCTIONS

1. Use 1 die.
2. Person who is youngest at heart goes first.
3. Use the game piece of your choice to proceed around the game board by using the die and instructions along the road.
4. Keep track of the share awards along the way.
5. The one who has the most number of shares at the end of the road wins a lifetime of monthly dividends (Well, not really, it's just a game).
6. All players must reach the finish line to determine who wins.

GAME PIECES

(Push out at perforation and fold ends back to form a stand)



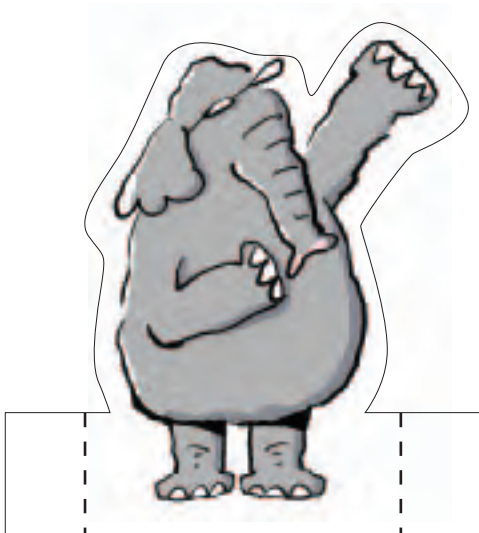
Monthly Dividend Girl



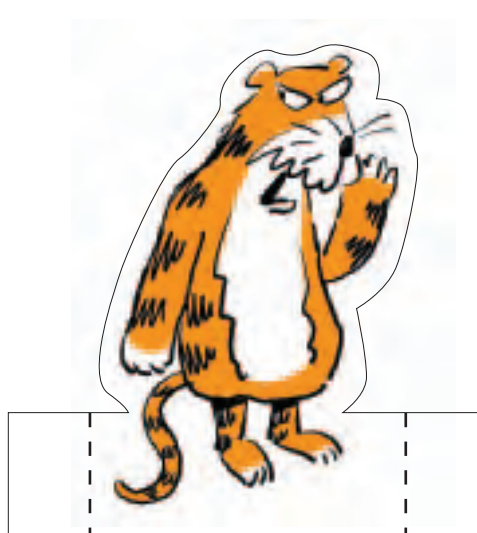
Paycheck



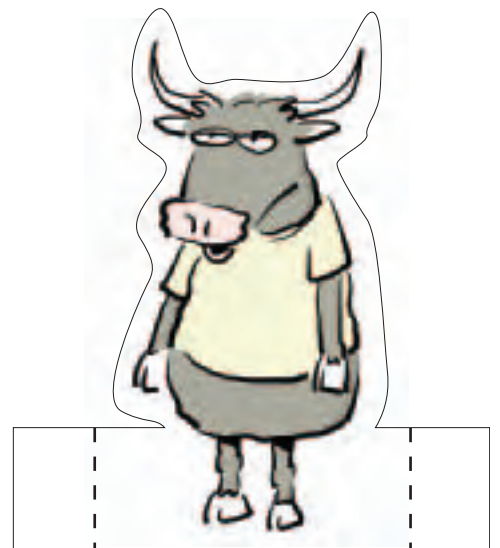
Bear



Elephant



Tiger



Bull



THE MONTHLY DIVIDEND LAND GAME FOR ALL AGES

THE MONTHLY DIVIDEND LAND GAME INSTRUCTIONS



- Reinvest Yourself.
- Engage Others.
- Monthly Dividends
- Give you the Freedom
- To Pursue your Dreams!



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REVIEW (THE SHORT VERSION)

GENERAL COMMENT:

Another terrific year for
The Monthly Dividend Company®



DIVIDEND UPDATE:

- Paid 12 monthly dividends
- Increased the dividend 5 times
- Paid 437 consecutive monthly dividends since 1970

SHARE PRICE GROWTH:

12/31/05 closing price: \$21.62
12/31/06 closing price: \$27.70
28.1% increase

RETURNS TO SHAREHOLDERS:

Dividend yield of 6.7%
Share price appreciation of 28.1%
Total return of 34.8% for 2006

TOTAL MARKET CAPITALIZATION:

\$4.1 billion on 12/31/06

BALANCE SHEET:

Very strong

PROPERTY MORTGAGE DEBT:

Zero (\$0)

REAL ESTATE PORTFOLIO:

1,955 retail properties leased to 103 retailers in
29 retail categories located throughout 48 states

PORTFOLIO OCCUPANCY:

98.7% on 12/31/06

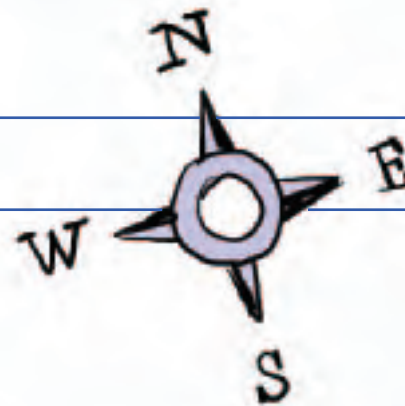
PROPERTY ACQUISITIONS:

Bought 378 properties for \$770 million!



2007

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





RELIABLE FINANCIAL PERFORMANCE

For the Years Ended December 31,	2006	2005	2004
Total revenue ⁽¹⁾	\$ 240,627,000	\$ 197,733,000	\$ 177,606,000
Net income available to common stockholders	99,419,000	89,716,000	90,168,000
Funds from operations ("FFO") ⁽²⁾	155,799,000	129,647,000	118,181,000
Dividends paid to common stockholders	129,667,000	108,575,000	97,420,000
Special dividend paid			
AT YEAR END			
Real estate at cost, before accumulated depreciation ⁽³⁾	\$ 2,743,973,000	\$ 2,096,156,000	\$ 1,691,283,000
Number of properties	1,955	1,646	1,533
Gross leasable square feet	16,740,100	13,448,600	11,986,100
Properties acquired ⁽⁴⁾	378	156	194
Acquisition cost ⁽⁴⁾	\$ 769,900,000	\$ 486,553,000	\$ 215,314,000
Properties sold	13	23	43
Number of retail industries	29	29	30
Number of states	48	48	48
Portfolio occupancy rate	98.7%	98.5%	97.9%
Remaining weighted average lease term in years	12.9	12.4	12.0
PER COMMON SHARE DATA⁽⁵⁾			
Net income (diluted)	\$ 1.11	\$ 1.12	\$ 1.15
Funds from operations ("FFO") ⁽²⁾	1.73	1.62	1.50
Dividends paid	1.437	1.346	1.241
Special dividend			
Annualized dividend amount ⁽⁶⁾	1.518	1.395	1.32
Common shares outstanding	100,746,226	83,696,647	79,301,630
INVESTMENT RESULTS			
Closing price on December 31,	\$ 27.70	\$ 21.62	\$ 25.29
Dividend yield ⁽⁷⁾⁽⁸⁾⁽⁹⁾	6.7%	5.3%	6.2%
Total return to stockholder ⁽⁹⁾⁽¹⁰⁾	34.8%	-9.2%	32.7%

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

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

⁽³⁾ Does not include properties held for sale.

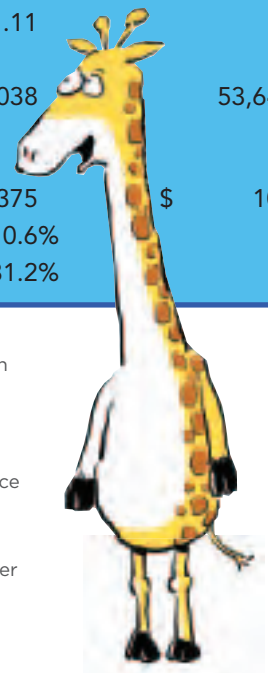
⁽⁴⁾ Includes properties acquired by Realty Income and Crest Net Lease.

⁽⁵⁾ All share and per share amounts reflect the 2-for-1 stock split on December 31, 2004.

⁽⁶⁾ Annualized dividend amount reflects the December declared dividend rate per share multiplied by twelve.



2003	2002	2001	2000	1999
\$ 150,370,000	\$ 137,600,000	\$ 121,081,000	\$ 116,310,000	\$ 104,510,000
76,722,000	68,954,000	57,846,000	45,076,000	41,012,000
103,366,000	93,539,000	76,378,000	67,239,000	65,917,000
83,842,000	78,042,000	64,871,000	58,262,000	55,925,000
\$ 1,533,182,000	\$ 1,285,900,000	\$ 1,178,162,000	\$ 1,073,527,000	\$ 1,017,252,000
1,404	1,197	1,124	1,068	1,076
11,350,800	9,997,700	9,663,000	9,013,200	8,648,000
302	111	117	22	110
\$ 371,642,000	\$ 139,433,000	\$ 156,472,000	\$ 98,559,000	\$ 181,376,000
35	35	35	21	3
28	26	25	24	24
48	48	48	46	45
98.1%	97.7%	98.2%	97.7%	98.4%
11.8	10.9	10.4	9.8	10.7
\$ 1.08	\$ 1.01	\$ 0.99	\$ 0.84	\$ 0.76
1.45	1.38	1.30	1.26	1.23
1.181	1.151	1.121	1.091	1.043
1.20	1.17	1.14	1.11	1.08
75,818,172	69,749,654	65,658,222	53,127,038	53,644,328
\$ 20.00	\$ 17.50	\$ 14.70	\$ 12.4375	\$ 10.3125
6.7%	7.8%	9.0%	10.6%	8.4%
21.0%	26.9%	27.2%	31.2%	-8.7%



⁽⁷⁾ 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.

⁽⁸⁾ Dividend yield excludes special dividends.

⁽⁹⁾ 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.

⁽¹⁰⁾ 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.

	1998	1997	1996	1995	1994
\$	85,132,000	\$ 67,897,000	\$ 56,957,000	\$ 51,555,000	\$ 48,863,000
	41,304,000	34,770,000	32,223,000	25,600,000	15,224,000
	62,799,000	52,188,000	47,139,000	40,414,000	39,050,000
	52,301,000	44,367,000	42,794,000	36,710,000	38,816,000
			5,285,000		5,850,000
\$	889,835,000	\$ 699,797,000	\$ 564,540,000	\$ 515,426,000	\$ 450,703,000
	970	826	740	685	630
	7,824,100	6,302,300	5,226,700	4,673,700	4,064,800
	149	96	62	58	4
\$	193,436,000	\$ 142,287,000	\$ 55,517,000	\$ 65,393,000	\$ 3,273,000
	5	10	7	3	5
	22	14	8	7	5
	45	43	42	42	41
	99.5%	99.2%	99.1%	99.3%	99.4%
	10.2	9.8	9.5	9.2	9.5
\$	0.78	\$ 0.74	\$ 0.70	\$ 0.63	\$ 0.39
	1.18	1.11	1.04	1.00	0.98
	0.983	0.946	0.931	0.913	0.300
			.23		
	1.02	0.96	0.95	0.93	0.90
	53,634,206	51,396,928	45,959,074	45,952,474	39,004,182
\$	12.4375	\$ 12.719	\$ 11.9375	\$ 11.25	\$ 8.5625
	7.7%	7.9%	8.3%	10.7%	9.9%
	5.5%	14.5%	15.4%	42.0%	28.5%

MISSION STATEMENT

Realty Income is a New York Stock Exchange listed company dedicated to providing shareholders with dependable monthly income. The monthly dividend is supported by the cash flow from over 1,950 properties owned under long-term, net-lease agreements with leading regional and national retail chains. The Company is an active buyer of net-leased retail properties nationwide.



CEO LETTER TO SHAREHOLDERS

What a Year!

DEAR FELLOW SHAREHOLDERS,

Company® had an exceptional year in 2006!

During the year we made significant progress in virtually all areas of the Company's business, including strong portfolio performance, outstanding access to capital at attractive rates and a record number of profitable new property acquisitions in both our core real estate portfolio and in our Crest Net Lease, Inc. subsidiary (Crest).

In short, your Company ended 2006 with record revenue, earnings and dividends paid to shareholders. During the year, revenue rose 22.5% to \$240.1 million, funds from operations increased 20.2% to \$155.8 million and common stock dividends paid increased 19.4% to \$129.7 million, as compared to 2005. We also crossed the historical milestone of more than \$1.2 billion in dividends paid to shareholders. Additionally, we substantially increased the size of our real estate portfolio by acquiring 378 new properties for \$770 million and permanently financed these, and other properties acquired in late 2005, by raising over \$900 million in five common stock, preferred stock and senior unsecured bond offerings. We also enjoyed healthy portfolio occupancy at year-end of 98.7%.

During 2006 we paid 12 monthly common stock dividends and increased the dividend five times. The dividend grew from an annualized amount of \$1.395 per share, at the beginning of the year, to an annualized amount of \$1.518 as of December 31, 2006. The share price of our common stock rose from \$21.62, at the end of 2005, to a closing price of \$27.70 on December 31, 2006. Including dividends paid and the share price increase, shareholders received an attractive total return on their investment of 34.8%, for the year ended December 31, 2006.

I am very pleased to report that The Monthly Dividend

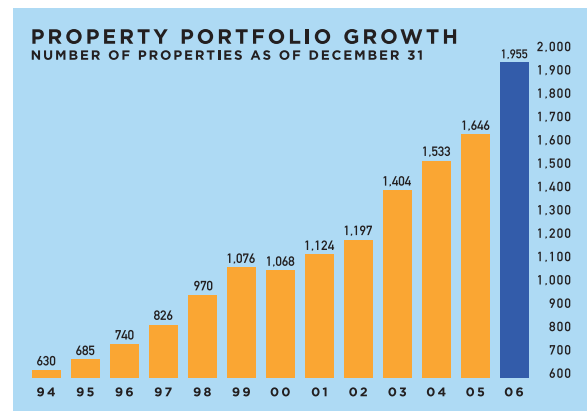


WHY SUCH A GREAT YEAR IN 2006?

A Big Year for Acquisitions—

The Same Underwriting Process

For the year ended December 31, 2006, Realty Income and Crest invested \$769.9 million in 378 new properties and properties under development. Realty Income invested \$656.7 million in 322 new properties with an initial weighted average lease yield of 8.6%. The 322 new properties acquired by Realty Income are located in 30 states and are 100% leased under net-lease agreements with an initial average lease length of 16.7 years. They are leased to 16



different retail chains in 11 separate industries. Crest invested \$113.2 million in 56 properties, all of which are being marketed for sale.

Since \$770 million in property acquisitions is more than 3½ times our average annual property acquisitions over the last ten years, one might surmise that we did something substantially different during 2006. Actually, our investment strategy and underwriting standards remained exactly the same as in the past. As always, our mission for each property acquisition is for the new asset to provide dependable cash flow to support the payment of monthly dividends. In order to do that, we perform extensive analysis on the individual retailer, their overall

DURING THE YEAR, REVENUE ROSE 22.5% TO \$240.1 MILLION, FUNDS FROM OPERATIONS INCREASED 20.2% TO \$155.8 MILLION AND COMMON STOCK DIVIDENDS PAID INCREASED 19.4% TO \$129.7 MILLION AS COMPARED TO 2005.

industry, the profitability of their stores and the individual properties that we will be purchasing. This analysis is critical to determining the appropriateness of each property acquisition we make.

As an active buyer of net lease retail real estate, a very large volume of properties for sale come to our attention each year. We know most of these opportunities won't meet our acquisition requirements and we attempt to quickly let the fine people who bring us these opportunities know that they should look for another buyer. The transactions we see that might fit our requirements are presented to our Research Department for analysis and then to our Investment Committee for consideration. During 2006, our Investment Committee reviewed over \$5 billion of potential transactions and acquired \$770 million in new properties, or about 15% of what we reviewed. We believe we remained disciplined in our review of each acquisition opportunity so that the properties we ultimately acquired will provide us with the consistent cash flow we can use to pay dividends for many years to come. By the way, the 15% purchased this year compares to buying 14%, 8%, 26% and 11% of what we reviewed in each of the previous four years. In other words, during 2006 we ended up seeing a lot more real estate that would potentially meet our needs, while buying about the same percentage of properties we looked at last year and in previous years.

**Additional Market Penetration—
Large Portfolio Transactions**

We believe there are several reasons we were presented with so many potential transactions last year. As an active buyer of net lease properties nationwide, with the ability to write checks for several hundred million dollars, we are a pretty good first stop for people looking to sell net-lease retail properties. Additionally, our staff has worked extremely hard to build a reputation as a buyer, who will

react quickly, who deals with buyers in an honest and straightforward manner, and who, most importantly, shows up on time with cash in hand when it's time to close. I can't say enough about how important these factors are to our long-term success and what a great job our acquisitions, research and legal teams have done in this area.

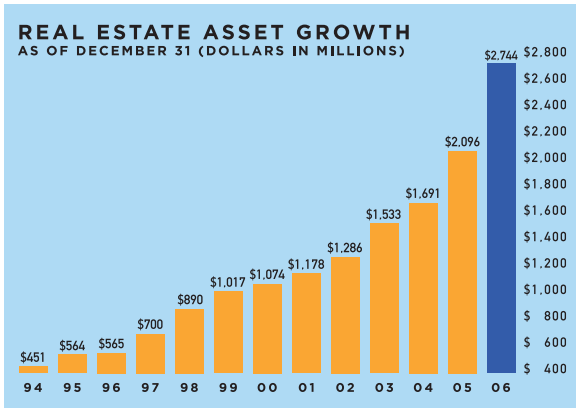
However, I think the primary reason we are seeing so many property acquisition opportunities right now is due to the very high level of retail companies being bought and sold, as well as the financial world's realization that these companies have a hidden treasure chest on their balance sheets. That treasure chest is their real estate. Many of these retailers own a large number of the stores they operate. Often, the value of their real estate, if sold, is worth far more than the retail chain is being given credit for as part of its stock market valuation. Astute management teams at many retail chains have realized that they can add substantial value to their shareholders by selling these properties to us, leasing them back, and then redeploying the capital into other profitable ventures. In addition, potential buyers of these retail chains, such as private equity firms and other retailers, have realized they can use the real estate of the retail chain they are acquiring to help them fund their purchase of the business.

Fortunately, a few years back, we determined that these types of transactions would accelerate and we allocated substantial resources and personnel to working on these large transactions. During 2006, these efforts continued to bear fruit and are primarily responsible for our large volume of property acquisitions.

The net-lease retail market continues to be highly competitive with multiple buyers for individual properties. Because of this competition, the pricing to acquire these individual assets has been higher and their yields lower in recent years. Whenever we acquire a new property, it comes with a long-term lease that requires monthly rent

DURING 2006, WE INVESTED \$770 MILLION IN 378 NEW PROPERTIES.

REAL ESTATE ASSET GROWTH
AS OF DECEMBER 31 (DOLLARS IN MILLIONS)



to be paid, which gives us a return on our investment. For example, let's say that return is about 8½% and increases over time. The money we use to acquire the property is, obviously, not free to us. Let's say it costs us about 7%. The spread between the return from the property (8½%) and our cost of the money to buy it (7%) is how new property acquisitions add to our cash flow. So, if we invest \$100 million in new properties at an 8½% yield (\$8.5 million) and the \$100 million used to purchase the properties costs us 7% (\$7 million), we end up with approximately \$1.5 million in new cash flow (\$8.5 million - \$7 million = \$1.5 million). You get the picture.

Since the size of the spread between our yield and cost of capital contributes to the earnings growth of the Company, it is important for us to be able to purchase real estate with lease yields that are substantially higher than our cost of capital. It has been our experience with these larger, more complicated transactions that there are a variety of parameters that must be analyzed to determine the overall structure, optimal funding required, the source of that funding, and the timing required to finance the final transaction. The sale-leaseback financing that we provide is just one of many factors that must be considered. While the real estate purchase

price and lease yield are an important component of the transaction, often, the most critical factor is the ability of the various parties to arrive at the table with cash and close the transaction on time. Since the focus in these transactions is multi-faceted and not just on yield and price, these larger transactions have offered us more attractive economics than buying properties one at a time in the retail marketplace and have allowed us to maintain profitable margins on new property acquisitions.

The Challenge to Adapt

Our market is always changing. Working with change means that we must be responsive, agile and flexible. We must constantly adapt to change. This requires us to identify new acquisition areas and opportunities so that we remain competitive and obtain good lease yields. We must also accomplish this while remaining conservative and staying true to our mission of providing monthly dividends for life to our shareholders. In the past, our ability to adapt has been the secret to our continued growth and the means for us to acquire good real estate that is reasonably priced, with attractive lease yields.

We strive to adapt to this constantly changing marketplace by trying many new things on a small level. In other words, we slowly and deliberately investigate new industries and retailers. We conceive and test new transaction structures. We survey the marketplace to determine what our focus should be, from year to year, and respond accordingly. Our viewpoint is to always be guided by what will provide the dependable monthly dividends our shareholders require. Our path to integrating new ideas is one of, first crawl, then walk, then run. We believe this purposeful approach has benefited our shareholders in the long run, yet still provided us with a variety of new business areas to pursue.



Opportunistic Acquisitions

Good examples of retail markets that exemplify this adaptive process include restaurants in the 60's, with the birth of the fast food industry, child care in the 70's, as many more women entered the work force, and child care, again, in the 90's, as a wave of consolidation hit the child care industry, auto service stores in the 80's, as the do-it-yourself market grew, and convenience stores in the 90's, as the gasoline service station and convenience store industries realized economies of scale and profitability by combining their goods and services. This process has continued over the last six years with profitable investments in the entertainment, theater, motor vehicle industry, auto collision, education, and a number of other new industries.

Proactive research in a variety of industries provides us with the in-depth analysis necessary to act quickly when markets change and opportunities occur. As mentioned earlier, in larger transactions, such as mergers or private equity transactions, the ability to move quickly and commit to closing is critical to getting the transaction done. This has been an important competitive advantage for us over the past several years.

This proactive analysis will continue to be important for future acquisitions. While never completely clear, our crystal ball is pointing us in the direction of industries that cater to the large baby boomer generation, as well as the continuing consolidation taking place in a number of retail sectors. We will continue to dedicate substantial resources to examining a wide variety of acquisition ideas we may be able to target in the future. You should know, however, that for every idea that has worked for us, there have been four or five ideas we have spent time on that went absolutely nowhere. A primary challenge for our management team, going forward, is to continue to seek out new opportunities and ways to invest that will provide us with additional properties to purchase. The market will continue to change

so we must continue to adapt so we can keep growing.

Invest in Size

We have come to believe that when we find attractive areas in which to invest, we should be prepared to make large commitments to these sectors. For example, in recent years, we have made substantial property acquisitions in both the chain restaurant and convenience store industries to capitalize on certain trends in these sectors. Large investments, like these, from time to time may cause an industry to represent a higher percentage of our lease revenue than we would like to sustain over a prolonged period of time. It is our policy to take advantage of these opportunities by periodically making large commitments and then to focus in other sectors, gradually bringing these concentrations back to more comfortable levels. The diversification of lease revenue will remain an important part of our strategy so that we have multiple sources of funds to support the dividends we pay to our shareholders. Our objective is to keep individual industry levels at no more than 20% of total revenue and individual retail chain levels at no more than 10% of total revenue. (Actually, we prefer about half of these amounts over the long term). While we may slightly exceed these levels at a moment in time, to capitalize on a particular opportunity, rest assured, we will then shift our investment focus so that we maintain appropriate diversification of our revenue.

Research Drives our Efforts

Our research is the primary driver of all of our acquisition efforts. In particular, I cannot overstate the importance of this



OUR VIEWPOINT IS TO ALWAYS BE GUIDED BY WHAT WILL PROVIDE THE
DEPENDABLE MONTHLY DIVIDENDS OUR SHAREHOLDERS REQUIRE.

research effort when we are underwriting larger transactions. Since we rely on the retailers that occupy our properties to pay rent for 15 to 20 years, selecting the right retail chain is crucial. As such, extensive research and due diligence on each chain is undertaken, including: company analysis, interviews with the management team, closely examining the chain's audited financial statements, along with reviewing a variety of internal operating metrics that can give us insight into the operations of the retailer. In addition, a survey of all available external research is completed to augment our internal research expertise. Finally, it is imperative that we have a solid understanding of the historical financial performance of the industry, the outlook for future operating performance, the competitive environment within which the industry operates, as well as some indication of the challenges and opportunities that might impact the industry in the future.

Another critical metric that we use is to analyze the ratio between the cash flow the retailer produces on a particular location, divided by the amount of rent they are going to pay to us. This provides us with a "cash flow coverage" ratio that gives us insight into the property's ability to pay rent over a prolonged period of time. Strong cash flow coverage is fundamental to supporting the payment of monthly dividends and protects the Company in the event that there is a slowdown in a retailer's business. In other words, it creates a "margin of safety" to make sure we receive our rent. Our experience has been that our properties with strong cash flow coverage of rent have been better able to weather the economic ups and downs that are inevitable.

As a final part of our research, our real estate research staff visits every single property under consideration, compiling market analysis, competitor profiles, traffic flows, economic data and comparative purchase price and rent studies for each location. Before we make the final decision to purchase a property, all of this research at the industry, retail chain and property level, is analyzed by our Investment Committee. (As a matter of fact, our 4-person Investment Committee, which includes the CEO, President, CFO and General Counsel spends most Fridays watching hundreds and hundreds and hundreds of videos of the properties we might acquire).

What is almost as important as what we bought this year are the transactions we did not do. Having a large number of opportunities to choose from allows us to select only those properties we wish to hold for the long term and will likely be the key to our continued success. As always, the purpose of additional property acquisitions is to increase the size of our real estate portfolio, thereby increasing lease revenue, which leads to higher funds from operations and makes it possible for us to increase the amount of the monthly dividend on a regular basis.

ACCESS TO CAPITAL

Why Access to Capital is Critical

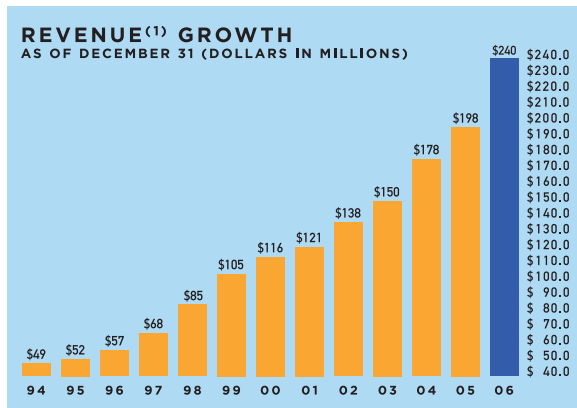
As a Real Estate Investment Trust (REIT), Realty Income is required to pay out the majority of its cash flow as dividends to shareholders. As such, we typically require access to the public markets in order to generate capital to fund the growth in the size of our real estate portfolio. We also seek to strategically time our issuance of new securities to our property purchases so that the funds we raise are promptly put to work and new acquisitions immediately contribute to our cash flow growth.

We initially fund our purchases by utilizing our \$300 million unsecured acquisition credit facility because this allows us to efficiently purchase properties without any financing contingencies. When the credit facility reaches a certain level, we then permanently finance these acquisitions, by issuing common or preferred stock or bonds, and pay down the balance on the short-term credit facility. This tends to minimize the amount of variable rate debt we are exposed to and has been instrumental in minimizing the impact rising interest rates might otherwise have had on our cash flow throughout our operating history.

Great Year in the Capital Markets

During 2006, Realty Income issued 16.8 million common shares, 8.8 million





preferred shares and \$275 million in senior unsecured notes, generating over \$900 million in capital that immediately adds to the Company's earnings.

This capital funded \$770 million in acquisitions during 2006, the redemption of our \$110 million, 7³/₄% unsecured notes due in 2007, and acquisitions made at the end of 2005. There was strong demand for all of these securities offerings and, in the case of the common and preferred stock offerings, strong demand allowed us to issue more shares than originally targeted.

Here is a brief summary of our capital markets activities in 2006:

- In March 2006, we issued 5.2 million shares of common stock priced at \$24.39 per share, generating gross proceeds from the offering of approximately \$126.8 million
- In September 2006, we redeemed our \$110 million, 7³/₄% unsecured notes due May 2007
- In September 2006, we issued \$275 million of 5.95%, 10-year senior unsecured notes
- In September 2006, we issued 4.7 million shares of common stock priced at \$24.32, generating gross proceeds from the offering of approximately \$114.7 million
- In October 2006, we issued 6.0 million shares of common stock priced at \$26.40 per share, generating gross proceeds of approximately \$158.4 million
- In November 2006, our underwriters exercised the over-allotment option to purchase 900,000 shares of additional common stock related to the October 2006 offering, generating gross proceeds of approximately \$23.8 million

⁽¹⁾ Total revenue includes amounts reclassified to income from discontinued operations, but excludes revenue from Crest.

- In December 2006, we issued 8.8 million shares of 6.75% Monthly Income Class E perpetual preferred stock, generating gross proceeds of \$220 million

The capital we raised in 2006 permanently funded all of our property acquisitions and has positioned us well going into 2007. At year end, we have all of our \$300 million acquisition credit facility available to fund acquisitions that we uncover throughout 2007.

We would be remiss if we did not say how much we appreciate the hard work of the underwriters who helped us raise all of this capital. They included: Merrill Lynch as sole book-running manager and A.G. Edwards, Raymond James, and Wachovia as co-lead managers, Robert W. Baird & Co., Banc of America, Credit Suisse and JPMorgan as senior co-managers for our common stock offerings; Citigroup, Merrill Lynch, and Wachovia as co-books, A.G. Edwards and UBS Investment Bank as co-leads, and Banc of America, Credit Suisse, Raymond James and RBC Capital Markets as senior co-managers for our preferred stock offering; and Banc of America, Citigroup and Credit Suisse as joint book-running managers for our senior unsecured notes offering. Other participants in our offerings throughout the year included: BB&T Capital Markets, Bank of Montreal, Stifel Nicolaus, Bank of New York, and Wells Fargo Securities.

A Word about Credit Ratings

We are pleased to report the following credit ratings on our corporate credit and senior unsecured debt: Fitch Ratings Credit Agency: BBB+ stable outlook, Moody's Investors Services: Baa2 positive outlook and Standard & Poor's Ratings Services: BBB positive outlook. During 2006, both Moody's Investors Services and Standard & Poor's Ratings Services revised Realty Income's outlook

to positive from stable. The rating agencies cited our





improved capacity to absorb larger, more concentrated investments without compromising our strong balance

sheet. As part of our capital markets activities, we spend a good deal of time working with the various rating agencies to keep them informed about the latest developments of the Company. This is important as our credit ratings determine the pricing of our preferred stock and notes offerings.

The Importance of Capital Structure

As of December 31, 2006, Realty Income's capital structure consisted of \$2.8 billion, or 69% of common stock, \$347.5 million, or 8% of preferred stock and \$920 million, or 23% of senior unsecured notes, for a total capitalization of approximately \$4.1 billion. We had zero (\$0) borrowings on our \$300 million acquisition credit facility. This conservative capital structure has earned Realty Income the distinction of being one of the top five in the real estate industry for balance sheet strength during all of the years that research analysts have been reviewing and reporting these metrics.

An important consideration in our capital raising activities is maintaining an optimum capital structure that facilitates a low cost-of-capital, while preserving the Company's conservative balance sheet. Since our core objective is to maintain the integrity of the cash flow used to pay dividends, we continue to believe that a conservative capital structure is the best means to achieve this objective. This is why we have a bias towards using common equity to fund acquisitions. However, we attempt to carefully blend in modest amounts of other types of capital when there are clear, cost-of-capital advantages. This balance requires constant monitoring so that we can maintain a conservative capital structure over the long term.

OUR REAL ESTATE PORTFOLIO TODAY

As of December 31, 2006, we owned 1,955 retail properties located in 48 states leased to 103 different retail chains doing business in 29 separate retail industries. Portfolio occupancy as of the end of the year was 98.7% and the average remaining lease term for properties in our portfolio was 12.9 years.

The size of our real estate portfolio increased 19.0%, as compared to the size of the portfolio at the end of 2005. This substantial increase was the result of \$770 million invested in 378 additional properties acquired by Realty Income and its Crest subsidiary during the year. Of the total 378 properties purchased, Realty Income invested \$656.7 million in 322 properties to be held for long-term investment in the Company's core portfolio. These properties are located in 30 states, have an initial weighted average lease rate of 8.6% and an initial average lease term of 16.7 years. They are leased to 16 different retail chains in 11 retail industries.

During 2006, we also continued to proactively manage our real estate portfolio. As part of our active portfolio management, we sold 13 properties for \$10.7 million, for the year ended December 31, 2006.

An important aspect of effectively managing our assets is determining if a particular property we own should be sold. While our primary focus is to hold properties for the income they produce, there are times when it is advantageous to sell a particular property. Property sales occur when we believe the sales 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. All of the property sales completed in 2006 met these criteria.

Lease Expirations

During 2006, 97 properties reached the end of their lease term, 77 properties had their leases renewed, 10 properties were leased to another tenant, 2 properties were sold at the end of the lease term and 8 properties are being marketed for lease or sale.

Fifteen to twenty-year leases, while longer than many real estate leases, eventually do expire. With the real estate portfolio growth we've enjoyed in the past ten years, our lease expirations are likely to increase in future years. We've had a good deal of experience with these

lease expirations, or lease rollovers, as we usually call them. Historically, the majority of leases that have come up for renewal have been in the child care industry, which was one of



our opportunistic acquisition discoveries back in the 80's. If our past experience with lease renewals is a prologue for the future, we can anticipate that:

1. If a property is profitable and performing well, the retailer will likely renew the lease at the existing rate or higher
2. If a property is a more marginal performer, the retailer will likely renew the lease but ask for a slight reduction in rent, or
3. The retailer may opt not to renew the lease, in which case we will either find another tenant or decide to sell the property.

As in the past, our analysis and final decision, as to which path to take, is based upon our desire to hold properties for the long term to generate the highest amount of income possible in order to pay increasing monthly dividends.

Rent Increases

Same store rents on 1,421 properties under lease for the entire year ended December 31, 2006 increased 0.7% to \$175.3 million from \$174.0 million in 2005. To break down the same store rent increase results during 2006, we had 22 industries with increases in rents, five with flat same store rents and two with declining same store rents—so a pretty good result for 2006.

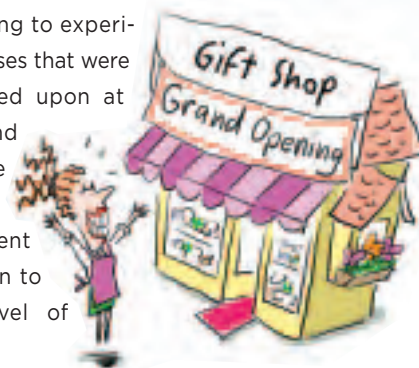
Same store rent increases are comprised of a specific, identical, number of properties that are tracked quarter to quarter and year to year. Generally, we look for same store rents to increase 1% to 2% each year. This year we were obviously below that number. Generally, rent increases on our properties occur every five years. As such, there is usually a considerable lag time between when we purchase a property, when the rent increases occur and when the

property qualifies to be included in the same store rent calculation. Given the

large amount of property acquisitions we have completed in recent years, the vast majority of our properties have now been acquired since 1997. Because of that



we are just beginning to experience the rent increases that were contractually agreed upon at lease origination and we believe, over the next several years, our same store rent increases will return to their historical level of increases.



Retailer Outlook

Our portfolio of retail real estate is currently performing very well. We have no significant issues with the performance of any of our current tenants and their ongoing ability to pay the rent they owe us. From time to time, however, a particular retailer may hit a rough spot and struggle to pay rent. We view these occasional episodes as “business as usual” for an owner of a very large portfolio of single-tenant properties. In each of our 38 years of experience in handling such situations, we have been fortunate to have continually maintained portfolio occupancy above 97%.

In terms of what we see on the horizon for the broader retail market, our crystal ball is a bit cloudy, but our best guess, as of now, is that the retail market could experience some slowing during 2007. However, our long-term leases, strong cash-flow coverages at the store level, and focus on service-oriented retailers providing basic human needs goods and services, should continue to serve us well. Should the economy take a turn for the worse, which is not widely anticipated by most pundits at this point in time, there is always the possibility that some of our retail operators could be impacted. This is something that we diligently monitor and are prepared to proactively manage should such situations arise.

Crest Net Lease

Crest Net Lease, Inc. is Realty Income's wholly-owned subsidiary that was formed in 2000 for the purpose of acquiring properties for resale. The properties are primarily sold in the 1031 tax-deferred exchange market. Crest provides Realty Income with an important competitive advantage since its primary function is to assist Realty

Income in completing large portfolio transactions so that Realty Income can manage tenant level concentrations.

During 2006, Crest acquired 56 properties for \$113.2 million. These properties are being marketed for sale in accordance with Crest's operating strategy. During 2006 Crest sold 13 properties for a gain on sales of \$2.2 million. Crest's inventory at December 31, 2006 was \$137.5 million, which consists of 60 properties that are held for sale.

While Crest helps Realty Income complete large portfolio transactions and does contribute to Realty Income's earnings, its earnings contributions are relatively small and we do not rely on this more volatile income stream to pay our monthly dividends.

HOW WE PERFORMED— FINANCIALLY SPEAKING

Revenue

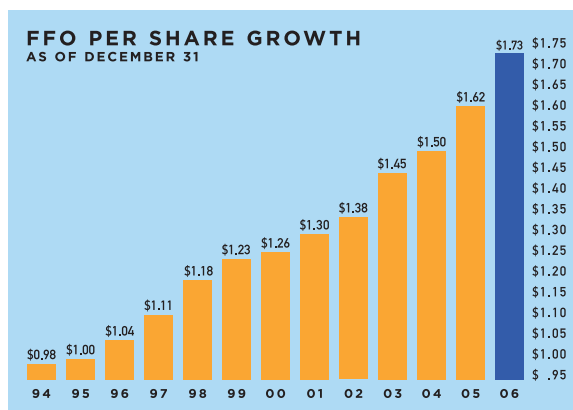
During 2006, revenue increased 22.5% to \$240.1 million, as compared to \$196.0 million during 2005. Revenue growth, driven by portfolio acquisition growth, is an important objective of ours because it is crucial to our ability to increase funds from operations and dividends. This year's revenue growth is primarily attributable to the high level of property acquisitions achieved in both 2005 and 2006.

Funds from Operations (FFO)

In 2006, FFO available to common shareholders also increased 20.2% to \$155.8 million, as compared to \$129.6 million during 2005. On a diluted per common share basis, FFO increased 6.8% to \$1.73 per share, as compared to \$1.62 per share for 2005. This increase in FFO and FFO per share is the result of higher than average acquisition activity throughout the year.



FFO is a common measurement for a REIT. It is an alternative non-GAAP measure that is 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.

Realty Income's subsidiary company, Crest, also contributed to Realty Income's earnings growth during 2006. Crest generated \$1.4 million, or \$0.02 per share, in FFO for Realty Income, in comparison to \$2.8 million, or \$0.03 per share, in FFO for Realty Income in 2005.

Net Income

Net income available to common shareholders, as of December 31, 2006, was \$99.4 million as compared to \$89.7 million in 2005. On a diluted per common share basis, net income was \$1.11 per share in 2006 as compared to \$1.12 per share in 2005. (The calculation to determine net income for a real estate company includes gains from property sales and impairments, which vary from year to year according to the timing of property sales. This variance can significantly impact net income).

INVESTOR RETURNS

Through December 31, 2006, Realty Income had paid a total of 437 consecutive monthly dividends and \$1.2 billion in dividends since 1970. We have also increased the amount of the monthly dividend 42 times, of which 37 have been consecutive quarterly increases. This consistent record of dividend increases has resulted in a total increase in our monthly dividend of 68.7%. In comparison, Realty Income increased the amount of dividends paid from \$1.346 in 2005 to \$1.437 in 2006, a total increase of 6.8%.



In addition, we enjoyed an increase in the price of our shares this year. At the end of 2005, our share price was \$21.62 as compared to the closing price of \$27.70 on December 31, 2006. Based on a share price increase of 28.1% and a 2006 dividend yield of 6.7%, shareholders enjoyed a total return during 2006 of 34.8%.

WHO WE ARE AND WHAT WE FOCUS ON

The most important result of our accomplishments over the course of the year is that we were able to pay 12 monthly dividends and increase the dividend five times during 2006. We know that the majority of our shareholders look to us to provide monthly dividends that increase over time. Equally important is the fact that our efforts during 2006 also bode well for strong operating performance and further dividend increases in 2007, as we receive a full year of lease payments on the newly acquired properties.

Today, investors can choose from a variety of investments that produce income, but few of them are structured to pay dependable monthly dividends. Since we are one of the few remaining purveyors of monthly dividends, we feel a certain responsibility to manage the Company so that we can continue to offer the monthly income upon which so many of you have come to rely. This is always uppermost in our minds as we navigate the competitive

environment in which we operate. Remaining conservative in our operations and capital structure is vitally important to realizing the mission of The Monthly Dividend Company®. We are guided by the need to generate reliable revenue in every decision we make, whether it's a decision to acquire a single property or a portfolio of properties, a decision as to what type of capital we use to fund property acquisitions or a decision as to how to structure lease agreements so that our properties generate increasing lease revenue over the long term. These day-to-day operating decisions are all made with you, the monthly dividend recipient, in mind. You should also gain some comfort in knowing that this is also very much self serving as we own a lot of shares ourselves!

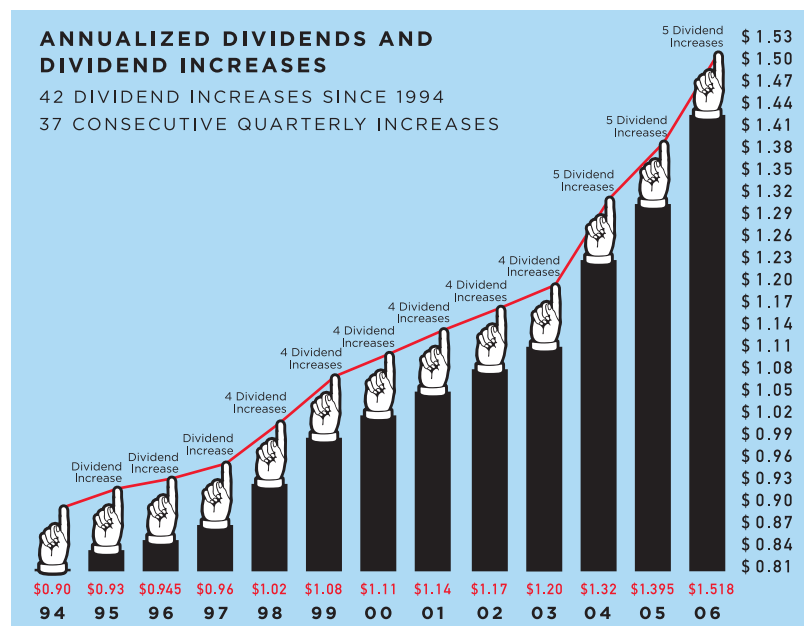


WHERE WE FIT IN THE QUEST FOR INCOME

Conversations on how to produce income are becoming increasingly prevalent as the “Baby Boomer” generation rapidly approaches traditional retirement age. These days, more people are asking how to get income and taking the time to learn about income investments as they begin to shift from growth-oriented investment portfolios to

income-oriented investment portfolios. As The Monthly Dividend Company®, we believe it is important for people to understand the investment characteristics of our particular company, both in comparison to other income vehicles, and within our particular investment type.

Investors can receive income from corporate bonds, preferred stocks, income-focused mutual funds, utility stocks, dividend-paying common stocks, annuities as well as from private real estate ownership and REITs, to mention just a few of the options available. In looking at these various sources of income, we believe that determining the reliability and safety of the source of the income is imperative.





Since we are a REIT, our operating structure is specifically designed to provide dividend income. As a REIT, we are required to pay out 90% of our income as dividends to shareholders. Since all REITs have this dividend requirement, does that mean that all REIT dividends are alike? Not likely.

SHAREHOLDER YIELD ON COST

Name of Company	Ticker Symbol	1,000 Shares Purchase Date	INFORMATION BASED ON ORIGINAL COST		INFORMATION BASED ON CURRENT VALUE 12/31/06	
			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	19.0%	\$1,518
REALTY INCOME	O	12/31/94	10.5%	\$ 900	17.7%	\$1,518
REALTY INCOME	O	12/31/95	8.3%	\$ 930	13.5%	\$1,518
REALTY INCOME	O	12/31/96	7.9%	\$ 945	12.7%	\$1,518
REALTY INCOME	O	12/31/97	7.5%	\$ 960	11.9%	\$1,518
REALTY INCOME	O	12/31/98	8.2%	\$1,020	12.2%	\$1,518
REALTY INCOME	O	12/31/99	10.5%	\$1,080	14.7%	\$1,518
REALTY INCOME	O	12/31/00	8.9%	\$1,110	12.2%	\$1,518
REALTY INCOME	O	12/31/01	7.8%	\$1,140	10.3%	\$1,518
REALTY INCOME	O	12/31/02	6.7%	\$1,170	8.7%	\$1,518
REALTY INCOME	O	12/31/03	6.0%	\$1,200	7.6%	\$1,518
REALTY INCOME	O	12/31/04	5.2%	\$1,320	6.0%	\$1,518
REALTY INCOME	O	12/31/05	6.5%	\$1,395	7.0%	\$1,518
REALTY INCOME	O	12/31/06	5.5%	\$1,518	5.5%	\$1,518

Just as there are many types of real estate that REITs own, there are varying degrees of stability associated with the lease revenue that supports the payment of dividends. In Realty Income's case, we generally have 15 to 20-year lease contracts. Thus, we receive contractually agreed upon, long-term rents, which, if the properties are underwritten properly, tend to provide very stable lease revenue from which to pay dividends. This parallel between stable, long-term leases and dependable dividends is exemplified by the Company's 37-year dividend-paying history. As of the end of 2006, we have paid 437 consecutive monthly dividends.

In addition, Realty Income also has a history of providing shareholders with regular dividend increases. Most of our shareholders consider this to be the main reason to own shares. The metric that is commonly used to demonstrate the power of rising dividends is "Yield on Cost". Simply stated, the longer



someone holds shares of Realty Income (or any other company that regularly increases their dividend), the higher the yield on their original cost will be. This means that regular dividend increases typically motivate long-term ownership because it becomes increasingly difficult to duplicate the income stream at one's current yield on cost. (Example: shares purchased on December 31, 2000

have a yield on cost of 12.2% on December 31, 2006).

Dependable and rising dividends, provided by companies with a dedicated focus on maintaining a low-risk profile, could be of increasing importance to income investors in the coming years. We believe that companies with this focus and a disciplined management style could be in great demand. We also believe that the demand for monthly income is on the rise, based on the rising number of investment products being advertised today that promise dependable monthly income.

While there are very few absolute certainties in life, it is the goal of The Monthly Dividend Company® to provide shareholders with increasing monthly dividends every month, year after year, for the rest of their lives. Our strategy of owning a sizable portfolio of retail properties, operated under long-term lease agreements with large retail chains, is the means to continuing to provide monthly dividends. This rental revenue has been a reliable generator of cash to pay monthly dividends for the past 37 years. In addition, we have never carried a mortgage on any of the properties that we own and we are focused on maintaining a conservative balance sheet. Keeping the amount of debt we carry at a modest amount and our properties



mortgage-free, along with controlling expenses, frees up the majority of our rental revenue for the payment of monthly dividends to shareholders. We believe this operating philosophy distinguishes Realty Income as a conservative provider of monthly dividends.

SUMMARY OF 2006 PERFORMANCE

- Portfolio occupancy remained high at 98.7%
- Same store rents rose 0.7%
- Total acquisitions for Realty Income and Crest, combined, increased to 378 properties purchased for \$769.9 million
 - Realty Income acquired 322 properties for \$656.7 million at an 8.6% weighted average lease yield and an average lease length of 16.7 years
 - Crest acquired 56 properties for \$113.2 million
- Accessed over \$900 million in additional capital in five public market transactions
- Properties continue to be held without mortgage debt
- Property sales provided \$10.7 million in additional proceeds for investment
- Revenue increased 22.5% and FFO per diluted share increased 6.8%
- The monthly dividend was increased five times during the year
- Yield on cost continued to increase
- Dividends paid increased 6.8%
- Share price rose 28.1%
- Total return to shareholders was 34.8%

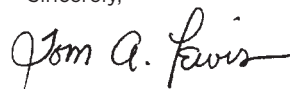
A COUPLE OF LAST THOUGHTS

This has been a very good year for The Monthly Dividend Company®. I'd like to caution you, however, that one year does not a trend make. The type of business transactions we did this year are notoriously difficult to execute, and they tend to be unpredictable and lumpy. We've made good progress in getting our name out to the private equity markets and various investment banking firms, but 2006 was a banner year for such transactions because of the waves of consolidation that are sweeping certain industries. It could be that this was only a moment in time. As such, we are already hard at work identifying new areas for investment. In addition, the record access to capital we enjoyed in 2006 was also a notable event in our Company's history. The popularity of The Monthly Dividend Company® was evident amidst the solid demand for income in the overall marketplace. Our effort to keep the investing public informed about the benefit of monthly dividends (and The Monthly Dividend

Company®) will continue to be an important component of our ability to access capital at attractive prices. We will continue to work hard in this area as well.

As always, we're grateful to the thousands of loyal shareholders who, like us, have enjoyed years of monthly dividend checks. Again, we'd like to caution all investors to remain diversified and rely on us for only a portion of their income needs. We will do our best to operate your Company in a prudent fashion so that the monthly dividend checks keep on coming.

Sincerely,



Tom A. Lewis
Chief Executive Officer



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REALTY INCOME CORPORATION AND SUBSIDIARIES

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 38 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
- Active management of our property portfolio, including re-leasing vacant properties and selectively selling properties.

In acquiring additional properties, we adhere 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, 2006, we owned a diversified portfolio of 1,955 retail properties:

- With an occupancy rate of 98.7%, or 1,929 properties occupied of the 1,955 properties in the portfolio;
- Leased to 103 different retail chains doing business in 29 separate retail industries;
- Located in 48 states;
- With over 16.7 million square feet of leasable space; and
- With an average leasable retail space per property of 8,600 square feet.

Of the 1,955 properties in the portfolio, 1,948, or 99.6%, are single-tenant, retail properties and the remaining seven are multi-tenant, distribution and office properties. At December 31, 2006, 1,923, or 98.7%, of the 1,948 single-tenant properties were leased with a weighted average

remaining lease term (excluding extension options) of approximately 12.9 years.

In addition, at December 31, 2006, our wholly-owned taxable REIT subsidiary, Crest Net Lease, Inc. ("Crest"), had invested \$137.5 million in 60 properties, which are classified as held for sale. Crest was created to buy 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 "Tax 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 retail chains 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 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 eight senior officers of Realty Income owned 1.3% of our outstanding common stock with a market value of \$37.4 million at February 13, 2007. The directors and eight senior officers of Realty Income, as a group, owned 2.5% of our outstanding common stock with a market value of \$72.6 million at February 13, 2007.

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 Class E cumulative redeemable preferred stock is listed on the NYSE under the ticker symbol "OprE" and its cusip number is 756109-708.

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.

In February 2007, we had 70 permanent employees as compared to February 2006 when we had 69 permanent employees and four temporary employees.

We maintain an Internet website at 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 possible 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

Acquisitions during 2006

During 2006, Realty Income and Crest invested \$769.9 million, in aggregate, in 378 new properties and properties under development. These 378 properties are located in 30 states and are 100% leased with an initial average lease term of 17.1 years. As described below, Realty Income acquired 322 properties and Crest acquired 56 properties.

Included in the \$769.9 million is \$656.7 million invested by Realty Income in 322 new properties and properties under development, with an initial weighted average contractual lease rate of 8.6%. These 322 properties are located in 30 states, are 100% leased with an initial average lease term of 16.7 years and will contain over 3.3 million leasable square feet. The 322 new properties acquired by Realty Income are net-leased to 16 different retail chains in the following 11 industries: automotive collision services, automotive tire services, convenience store, drug store, general merchandise, health and fitness, home improvement, motor vehicle dealership, private education, restaurant, and theater. Also included in the \$769.9 million is \$113.2 million invested by Crest in 56 new retail properties.

At December 31, 2006, Realty Income had invested \$15.9 million in four properties that were leased and being developed by the tenant (with development costs funded by Realty Income). Rent on these properties is scheduled to begin at various times during 2007. At December 31, 2006, we had outstanding commitments to pay estimated unfunded development costs totaling approximately \$16.4 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.

Acquisition of \$349 million of Buffets/Ryan's Restaurants on November 1, 2006

The 2006 acquisition amounts include Realty Income and Crest's aggregate investment of \$349 million to acquire 144 Buffets/Ryan's restaurant properties. The properties are leased under 20-year, triple-net lease agreements. These properties were acquired subsequent to a merger between Buffets, Inc. and Ryan's Restaurant Group.

Of the 144 restaurant properties, 116 were acquired by Realty Income and 28 were acquired by Crest. The restaurants have, on average, approximately 10,300 leasable square feet and are situated on an average lot size of approximately 2.86 acres. The properties are existing locations that, on average, have been operating for 11 years.

Investments in Existing Properties

In 2006, we capitalized costs of \$964,000 on existing properties in our portfolio, consisting of \$761,000 for re-leasing costs and \$203,000 for building improvements.

Net Income Available to Common Stockholders

Net income available to common stockholders was \$99.4 million in 2006 versus \$89.7 million in 2005, an increase of \$9.7 million. On a diluted per common share basis, net income was \$1.11 per share in 2006 and \$1.12 per share in 2005.

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 2006 was \$3.0 million as compared to \$6.6 million for 2005.

Funds from Operations (FFO)

In 2006, our FFO increased by \$26.2 million, or 20.2%, to \$155.8 million versus \$129.6 million in 2005. On a diluted per common share basis, FFO was \$1.73 in 2006 compared to \$1.62 for 2005, an increase of \$0.11, or 6.8%.

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.

Issuances of Common Stock

In October and November 2006, we issued an aggregate of 6.9 million shares of common stock at a price of \$26.40 per share. The net proceeds of approximately \$173.2 million were used to fund a portion of the purchase price of the Buffets/Ryan's properties and for other general corporate purposes.

In September 2006, we issued 4.715 million shares of common stock at a price of \$24.32 per share. The net proceeds of approximately \$109 million from this offering were used to

fund new property acquisitions, repay borrowings under our credit facility and for other general corporate purposes.

In March 2006, we issued 5.2 million shares of common stock at a price of \$24.39 per share. The net proceeds of approximately \$120.5 million were used to fund new property acquisitions and for other general corporate purposes.

Issuance of Preferred Stock

In December 2006, we issued 8.8 million shares of 6% Monthly Income Class E cumulative redeemable preferred stock, with a liquidation value of \$25 per share. The net proceeds of \$214 million from this issuance were used to repay borrowings under our credit facility and for other general corporate purposes. Beginning December 7, 2011, the Class E preferred shares are redeemable at our option for \$25 per share. Dividends of \$0.140625 per share are paid monthly in arrears on the Class E preferred stock.

Credit Ratings Upgrades

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

In December 2006, Standard & Poor's Ratings Group affirmed our senior unsecured debt rating of BBB and our preferred stock rating of BBB- and raised the outlook to "positive" from "stable."

Redemption of 2007 Notes

In September 2006, we redeemed all of our outstanding \$110 million, 7%, unsecured notes due May 2007 (the "2007 Notes"). The 2007 Notes were redeemed at a redemption price equal to 100% of the principal amount, plus accrued and unpaid interest of \$3.2 million and a make-whole payment of \$1.6 million. We recorded a loss on extinguishment of debt totaling \$1.6 million related to the make-whole payment associated with the 2007 Notes. For 2006, the make-whole payment represented approximately \$0.017 per share.

Issuance of 10-Year Senior Unsecured Notes

In September 2006, we issued \$275 million, in aggregate principal amount of 5.95% senior unsecured notes due 2016 (the "2016 Notes"). The price to the investor for the 2016 Notes was 99.74% of the principal amount, for an effective yield of 5.985%. The net proceeds of approximately \$271.9 million from this offering were used to redeem the 2007 Notes and for other general corporate purposes. Interest on the 2016 Notes is paid semiannually.

Crest Property Sales

During 2006, Crest sold 13 properties from its inventory for an aggregate of \$22.4 million, which resulted in a gain of \$2.2 million. Crest's gains are included in "income from discontinued operations, real estate acquired for resale by Crest."

Crest Property Inventory

Crest's property inventory at December 31, 2006 and December 31, 2005 totaled \$137.5 million and \$45.7 million, respectively, and is included in "real estate held for sale, net", on our consolidated balance sheets.

Increases in Monthly Distributions to Common Stockholders

We continue our 37-year policy of paying distributions monthly to our common stockholders. Monthly distributions per share were increased in April 2006 by \$0.000625 to \$0.116875, in July 2006 by \$0.000625 to \$0.1175, in September 2006 by \$0.00775 to \$0.12525, in October 2006 by \$0.000625 to \$0.125875 and in January 2007 by \$0.000625 to \$0.1265. The increase in January 2007 was our 37th consecutive quarterly increase and the 42nd increase in the amount of our dividend since our listing on the New York Stock Exchange, or NYSE, in 1994. In 2006, we paid the following monthly cash distributions per share: three in the amount of \$0.11625, three in the amount of \$0.116875, two in the amount of \$0.1175, one in the amount of \$0.12525 and three in the amount of \$0.125875, totaling \$1.43725. In December 2006, January 2007 and February 2007, we declared distributions of \$0.1265 per share, which were paid on January 16, 2007 and February 15, 2007 and will be paid on March 15, 2007, respectively.

The monthly distribution of \$0.1265 per share represents a current annualized distribution of \$1.518 per share, and an annualized distribution yield of approximately 5.2% based on the last reported sale price of our common stock on the NYSE of \$29.09 on February 13, 2007. 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 and Class E preferred stockholders if, and when declared by our Board of Directors.

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 2006, our cash distributions totaled \$139.1 million, or approximately 113.3% of our estimated REIT taxable income of \$122.8 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 2006 cash distributions to common stockholders totaled \$129.7 million, representing 83.2% of our funds from operations available to common stockholders of \$155.8 million.

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). The Class E preferred stockholders receive cumulative distributions at a rate of 6.75% per annum on the \$25 per share liquidation preference (equivalent to \$1.6875 per annum per share).

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 Tax 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 tax rate. 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), 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 9.9% of the distributions to our common stockholders, made or deemed to have been made in 2006, 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. 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 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 underperformance.

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, 2006, approximately 80.9% 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 98.6%, 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.

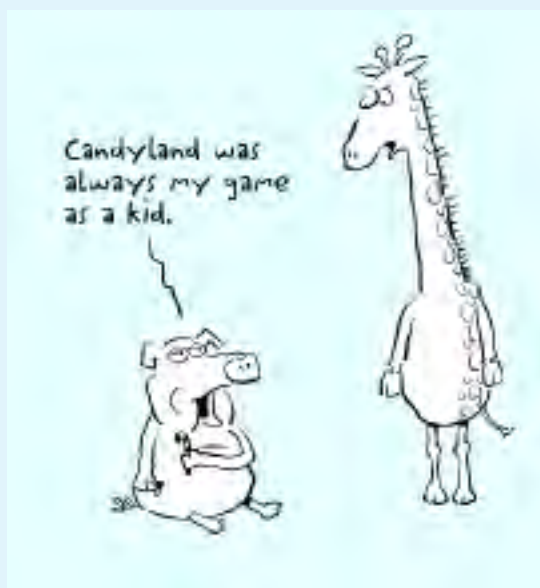
The typical profile of companies whose properties have been approved for acquisition are those with 50 or more retail locations. Generally the properties:

- 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 any 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.

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, 2006, we classified real estate with a carrying amount of \$138 million as held for sale, which includes \$137.5 million in properties owned by Crest. Additionally, we anticipate selling investment properties from our portfolio that have not yet been specifically identified from which we anticipate receiving between \$10 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.

Universal Shelf Registration

In April 2006, we filed a shelf registration statement with the SEC, which is effective for a term of three years. In accordance with the SEC rules, the amount of securities to be issued pursuant to this shelf registration statement was not specified when it was filed. The securities covered by this registration statement include common stock, preferred stock, debt securities, or any combination of such securities. Realty Income may periodically offer one or more of these securities in amounts, prices and on terms to be announced when and if the securities are offered. The specifics of any future offerings, along with the use of proceeds of any securities offered, will be described in detail in a prospectus supplement, or other offering materials, at the time of any offering. As such, there is no specific limit to the dollar amount of new securities that can be issued under this new shelf registration before it expires in April 2009. The common stock issued in September 2006, October 2006 and November 2006, the 2016 Notes issued in September 2006 and the Class E preferred stock issued in December 2006 were issued pursuant to our universal shelf registration statement.

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 13, 2007, our total outstanding credit facility borrowings and outstanding notes were \$920 million or approximately 21.9% of our total market capitalization of \$4.21 billion. We calculate our total market capitalization at February 13, 2007 as the sum of:

- Shares of our common stock outstanding of 101,000,536 multiplied by the last reported sales price of our common stock on the NYSE of \$29.09 per share, or \$2.94 billion;
- Aggregate liquidation value of the Class D preferred stock of \$127.5 million;
- Aggregate liquidation value of the Class E preferred stock of \$220 million; and
- Outstanding notes of \$920 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.

We have a \$300 million revolving, unsecured 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 13, 2007, we had borrowing capacity of \$300 million available on our credit facility and no outstanding balance.

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. We have the right to request an increase in the borrowing capacity of the credit facility by up to \$100 million, to a total borrowing capacity of \$400 million. Any increase in the borrowing capacity is subject to approval by the lending banks of our credit facility.

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 and Standard & Poor's ratings have "positive" outlooks and Fitch has 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 and Standard & Poor's ratings have "positive" outlooks and Fitch has a "stable" outlook.

The credit ratings assigned to us could change based upon, among other things, our results of operations and financial condition. These ratings are subject to ongoing evaluation by credit rating agencies and we cannot assure you that any such rating will not be changed or withdrawn by a rating agency in the future if, in its judgment, circumstances warrant. Moreover, a rating is not a recommendation to buy, sell or hold our debt securities, preferred stock or common stock.

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, 2006, our retail property portfolio consisted of 1,955 properties located in 48 states, leased to 103 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, 2006.

- **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, 2006, we owned a diversified portfolio:

- Of 1,955 retail properties;
- With an occupancy rate of 98.7%, or 1,929 properties occupied of the 1,955 properties in the portfolio;
- Leased to 103 different retail chains doing business in 29 separate retail industries;
- Located in 48 states;
- With over 16.7 million square feet of leasable space; and
- With an average leasable retail space per property of approximately 8,600 square feet.

In addition to our real estate portfolio at December 31, 2006, our subsidiary, Crest had invested \$137.5 million in 60 properties located in 15 states. These properties are classified as held for sale.

At December 31, 2006, 1,923, or 98.4%, of our 1,955 retail properties were leased 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 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, adequate access and proximity to a sufficient population base to constitute a suitable market or trade area for the retailer's business.

Industry Diversification

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

Industries	Percentage of Rental Revenue ⁽¹⁾						
	For the Quarter Ended	For the Years Ended					
	Dec. 31, 2006	Dec. 31, 2006	Dec. 31, 2005	Dec. 31, 2004	Dec. 31, 2003	Dec. 31, 2002	Dec. 31, 2001
Apparel stores	2.3%	1.7%	1.6%	1.8%	2.1%	2.3%	2.4%
Automotive collision services	1.2	1.3	1.3	1.0	0.3	—	—
Automotive parts	2.7	2.8	3.4	3.8	4.5	4.9	5.7
Automotive service	5.4	6.9	7.6	7.7	8.3	7.0	5.7
Automotive tire services	6.2	6.1	7.2	7.8	3.1	2.7	2.6
Book stores	0.2	0.2	0.3	0.3	0.4	0.4	0.4
Business services	*	0.1	0.1	0.1	0.1	0.1	0.1
Child care	8.9	10.3	12.7	14.4	17.8	20.8	23.9
Consumer electronics	1.0	1.1	1.3	2.1	3.0	3.3	4.0
Convenience stores	14.1	16.1	18.7	19.2	13.3	9.1	8.4
Crafts and novelties	0.3	0.4	0.4	0.5	0.6	0.4	0.4
Drug stores	2.8	2.9	2.8	0.1	0.2	0.2	0.2
Entertainment	1.4	1.6	2.1	2.3	2.6	2.3	1.8
Equipment rental services	0.2	0.2	0.4	0.3	0.2	—	—
Financial services	0.1	0.1	0.1	0.1	—	—	—
General merchandise	0.8	0.6	0.5	0.4	0.5	0.5	0.6
Grocery stores	0.8	0.7	0.7	0.8	0.4	0.5	0.6
Health and fitness	4.1	4.3	3.7	4.0	3.8	3.8	3.6
Home furnishings	2.8	3.1	3.7	4.1	4.9	5.4	6.0
Home improvement	4.2	3.4	1.1	1.0	1.1	1.2	1.3
Motor vehicle dealerships	3.4	3.4	2.6	0.6	—	—	—
Office supplies	1.2	1.3	1.5	1.6	1.9	2.1	2.2
Pet supplies and services	0.9	1.1	1.3	1.4	1.7	1.7	1.6
Private education	0.8	0.8	0.8	1.1	1.2	1.3	1.5
Restaurants	17.8	11.9	9.4	9.7	11.8	13.5	12.2
Shoe stores	—	—	0.3	0.3	0.9	0.8	0.7
Sporting goods	2.6	2.9	3.4	3.4	3.8	4.1	0.9
Theaters	9.4	9.6	5.2	3.5	4.1	3.9	4.3
Travel plazas	0.3	0.3	0.3	0.4	0.3	—	—
Video rental	1.8	2.1	2.5	2.8	3.3	3.3	3.7
Other	2.3	2.7	3.0	3.4	3.8	4.4	5.2
Totals	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

*Less than 0.1%

⁽¹⁾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.

Service Category Diversification

The following table sets forth certain information regarding the properties owned by Realty Income (excluding properties owned by Crest) at December 31, 2006, 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, 2006 ⁽¹⁾	Percentage of of Rental Revenue
Tenants Providing Services			
Automotive collision services	13	\$ 825	1.2%
Automotive service	219	3,689	5.4
Child care	268	6,063	8.9
Entertainment	8	970	1.4
Equipment rental services	2	150	0.2
Financial services	4	84	0.1
Health and fitness	16	2,760	4.1
Private education	6	574	0.8
Theaters	31	6,409	9.4
Other	10	1,531	2.3
	577	23,055	33.8
Tenants Selling Goods and Services			
Automotive parts (with installation)	30	583	0.9
Automotive tire services	149	4,229	6.2
Business services	1	32	*
Convenience stores	393	9,611	14.1
Home improvement	1	1,154	1.7
Motor vehicle dealerships	21	2,348	3.4
Pet supplies and services	9	595	0.9
Restaurants	471	12,158	17.8
Travel plazas	1	170	0.3
Video rental	34	1,235	1.8
	1,110	32,115	47.1
Tenants Selling Goods			
Apparel stores	6	1,567	2.3
Automotive parts	73	1,214	1.8
Book stores	2	159	0.2
Consumer electronics	21	678	1.0
Crafts and novelties	4	212	0.3
Drug stores	34	1,943	2.8
General merchandise	25	518	0.8
Grocery stores	7	557	0.8
Home furnishings	40	1,905	2.8
Home improvement	31	1,684	2.5
Office supplies	10	788	1.2
Pet supplies	2	37	*
Sporting goods	13	1,769	2.6
	268	13,031	19.1
Totals	1,955	\$ 68,201	100.0%

*Less than 0.1%

⁽¹⁾Includes rental revenue for all properties owned by Realty Income at December 31, 2006, including revenue from properties reclassified to discontinued operations of \$8.

Lease Expirations

The following table sets forth certain information regarding Realty Income's property portfolio (excluding properties owned by Crest) regarding the timing of the initial lease term expirations (excluding extension options) on our 1,923 net leased, single-tenant retail properties as of December 31, 2006 (dollars in thousands):

Year	Total Portfolio			Initial Expirations ⁽³⁾			Subsequent Expirations ⁽⁴⁾		
	Total Number of Leases Expiring ⁽¹⁾	Rental Revenue for the Quarter Ended 12/31/06 ⁽²⁾	% of Total Rental Revenue	Number of Leases Expiring	Rental Revenue for the Quarter Ended 12/31/06	% of Total Rental Revenue	Number of Leases Expiring	Rental Revenue for the Quarter Ended 12/31/06	% of Total Rental Revenue
2007	139	\$ 2,624	4.0%	92	\$ 1,795	2.7%	47	\$ 829	1.3%
2008	117	2,568	3.9	63	1,551	2.4	54	1,017	1.5
2009	107	2,330	3.5	33	789	1.2	74	1,541	2.3
2010	74	2,680	4.1	36	2,011	3.1	38	669	1.0
2011	81	3,175	4.8	46	1,672	2.5	35	1,503	2.3
2012	47	1,407	2.1	43	1,354	2.0	4	53	0.1
2013	75	3,411	5.1	67	3,196	4.8	8	215	0.3
2014	48	1,996	3.0	36	1,755	2.6	12	241	0.4
2015	90	1,968	3.0	65	1,409	2.2	25	559	0.8
2016	112	1,823	2.8	111	1,796	2.7	1	27	0.1
2017	23	1,638	2.5	19	1,570	2.4	4	68	0.1
2018	23	1,068	1.6	23	1,068	1.6	—	—	—
2019	94	4,651	7.0	93	4,457	6.7	1	194	0.3
2020	82	3,200	4.8	80	3,167	4.8	2	33	*
2021	145	5,977	9.0	144	5,240	7.9	1	737	1.1
2022	97	2,597	3.9	95	2,597	3.9	2	—	—
2023	233	6,453	9.7	232	6,427	9.7	1	26	*
2024	59	1,851	2.8	59	1,851	2.8	—	—	—
2025	68	6,317	9.5	64	6,254	9.4	4	63	0.1
2026	182	6,810	10.3	180	6,771	10.2	2	39	0.1
2027	12	440	0.7	12	440	0.7	—	—	—
2028	5	95	0.1	5	95	0.1	—	—	—
2030	2	240	0.4	2	240	0.4	—	—	—
2033	3	357	0.5	3	357	0.5	—	—	—
2034	2	230	0.4	2	230	0.4	—	—	—
2037	2	325	0.5	2	325	0.5	—	—	—
2043	1	13	*	—	—	—	1	13	*
Totals	1,923	\$ 66,244	100.0%	1,607	\$ 58,417	88.2%	316	\$ 7,827	11.8%

*Less than 0.1%

⁽¹⁾Excludes six multi-tenant properties and 26 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.

⁽²⁾Includes rental revenue of \$8 from properties reclassified to discontinued operations and excludes revenue of \$1,957 from six multi-tenant properties and from 26 vacant unleased properties at December 31, 2006.

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

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

State Diversification

The following table sets forth certain state-by-state information regarding Realty Income's property portfolio (excluding properties owned by Crest) as of December 31, 2006 (dollars in thousands):

State	Number of Properties	Percent Leased	Approximate Leasable Square Feet	Rental Revenue For the Quarter Ended Dec 31, 2006 ⁽¹⁾	Percentage of Rental Revenue
Alabama	61	98%	422,900	\$ 1,255	1.8%
Alaska	2	100	128,500	271	0.4
Arizona	71	100	344,500	1,989	2.9
Arkansas	15	100	94,500	1,041	1.5
California	61	98	1,101,900	3,929	5.8
Colorado	47	96	418,200	1,776	2.6
Connecticut	16	100	245,600	1,019	1.5
Delaware	15	100	27,700	316	0.5
Florida	151	99	1,374,600	5,509	8.1
Georgia	127	99	910,700	3,430	5.0
Idaho	14	100	91,900	369	0.5
Illinois	62	100	769,200	3,501	5.1
Indiana	46	96	471,500	1,878	2.8
Iowa	19	100	138,600	391	0.6
Kansas	29	90	562,200	947	1.4
Kentucky	22	95	111,500	600	0.9
Louisiana	32	100	186,600	757	1.1
Maryland	25	100	230,000	1,197	1.8
Massachusetts	37	100	203,100	999	1.5
Michigan	20	100	158,300	573	0.8
Minnesota	21	100	359,200	1,278	1.9
Mississippi	70	96	353,800	1,317	1.9
Missouri	61	98	634,800	1,919	2.8
Montana	2	100	30,000	77	0.1
Nebraska	17	100	190,100	608	0.9
Nevada	15	100	191,000	849	1.3
New Hampshire	10	100	95,400	383	0.6
New Jersey	25	100	194,500	1,440	2.1
New Mexico	7	100	53,300	159	0.2
New York	28	96	419,400	2,022	3.0
North Carolina	60	100	433,000	1,874	2.8
North Dakota	5	100	31,900	68	0.1
Ohio	109	100	704,900	2,671	3.9
Oklahoma	24	100	133,300	552	0.8
Oregon	19	100	294,800	842	1.2
Pennsylvania	84	100	521,500	2,449	3.6
Rhode Island	1	100	3,500	29	*
South Carolina	59	100	250,700	1,531	2.3
South Dakota	7	100	18,300	76	0.1
Tennessee	126	100	607,800	2,816	4.1
Texas	202	98	2,274,700	9,480	13.9
Utah	6	83	35,100	96	0.1
Vermont	1	100	2,500	22	*
Virginia	67	100	485,900	2,497	3.7
Washington	37	100	243,900	751	1.1
West Virginia	2	50	23,200	30	*
Wisconsin	17	94	157,400	600	0.9
Wyoming	1	100	4,200	18	*
Totals/Average	1,955	99%	16,740,100	\$ 68,201	100.0%

*Less than 0.1%

⁽¹⁾Includes rental revenue for all properties owned by Realty Income at December 31, 2006, including revenue from properties reclassified to discontinued operations of \$8.

Description of Leasing Structure

At December 31, 2006, 1,923 single tenant and certain other retail properties, or 98.4% of our 1,955 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 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. 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 26 properties available for lease or sale at December 31, 2006, all are single-tenant properties except one. At December 31, 2006, 16 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 2006, each of our tenants accounted for less than 10% of our rental revenue.

Certain Properties Under Development

Of the 322 properties Realty Income acquired in 2006, all were occupied at December 31, 2006, except for four 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 building and we fund the costs of that development, or we fund a developer who constructs the building. 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 2006, Realty Income acquired 15 development properties. Crest did not acquire any development property in 2006. Both Realty Income and Crest 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, 2006.



REALTY INCOME CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

December 31, 2006 and 2005 (dollars in thousands, except per share data)

	2006	2005
Assets		
Real estate, at cost:		
Land	\$ 958,770	\$ 746,016
Buildings and improvements	1,785,203	1,350,140
	2,743,973	2,096,156
Less accumulated depreciation and amortization	(396,854)	(341,193)
Net real estate held for investment	2,347,119	1,754,963
Real estate held for sale, net	137,962	47,083
Net real estate	2,485,081	1,802,046
Cash and cash equivalents	10,573	65,704
Accounts receivable	5,953	5,044
Goodwill	17,206	17,206
Other assets, net	27,695	30,988
Total assets	\$ 2,546,508	\$ 1,920,988
Liabilities and Stockholders' Equity		
Distributions payable	\$ 15,096	\$ 10,121
Accounts payable and accrued expenses	27,004	20,391
Other liabilities	8,416	9,562
Line of credit payable	—	136,700
Notes payable	920,000	755,000
Total liabilities	970,516	931,774
Commitments and contingencies		
Stockholders' equity:		
Preferred stock and paid in capital, par value \$1.00 per share, 20,000,000 shares authorized, 13,900,000 and 5,100,000 shares issued and outstanding in 2006 and 2005, respectively	337,781	123,804
Common stock and paid in capital, par value \$1.00 per share, 200,000,000 shares authorized, 100,746,226 and 83,696,647 shares issued and outstanding in 2006 and 2005, respectively	1,540,365	1,134,300
Distributions in excess of net income	(302,154)	(268,890)
Total stockholders' equity	1,575,992	989,214
Total liabilities and stockholders' equity	\$ 2,546,508	\$ 1,920,988

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

REALTY INCOME CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

Years Ended December 31, 2006, 2005 and 2004 (dollars in thousands, except per share data)

	2006	2005	2004
Revenue			
Rental	\$ 238,058	\$ 195,666	\$ 172,033
Other	2,042	354	1,029
	240,100	196,020	173,062
Expenses			
Interest	51,363	40,949	34,132
Depreciation and amortization	59,492	46,206	39,696
General and administrative	17,539	15,421	13,119
Property	3,339	3,731	3,058
Income taxes	747	813	699
Provisions for impairment	—	151	716
Loss on extinguishment of debt	1,555	—	—
	134,035	107,271	91,420
Income from continuing operations	106,065	88,749	81,642
Income from discontinued operations:			
Real estate acquired for resale by Crest	1,402	2,781	7,847
Real estate held for investment	3,314	7,589	13,908
	4,716	10,370	21,755
Net income	110,781	99,119	103,397
Preferred stock cash dividends	(11,362)	(9,403)	(9,455)
Excess of redemption value over carrying value of preferred shares redeemed (see note 7C and 7D)	—	—	(3,774)
Net income available to common stockholders	\$ 99,419	\$ 89,716	\$ 90,168
Amounts available to common stockholders per common share, basic and diluted:			
Income from continuing operations	\$ 1.05	\$ 0.99	\$ 0.87
Net income	\$ 1.11	\$ 1.12	\$ 1.15
Weighted average common shares outstanding:			
Basic	89,766,714	79,950,255	78,518,296
Diluted	89,917,554	80,208,593	78,598,788

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

REALTY INCOME CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

Years Ended December 31, 2006, 2005 and 2004 (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, 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)
Share-based 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
Share-based 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
Net income	—	—	—	—	110,781	110,781
Distributions paid and payable	—	—	—	—	(144,045)	(144,045)
Shares issued in stock offerings, net of offering costs of \$20,911	—	16,815,000	—	402,745	—	402,745
Shares issued in stock offering, net of offering costs of \$6,023	8,800,000	—	213,977	—	—	213,977
Share-based compensation	—	234,579	—	3,320	—	3,320
Balance, December 31, 2006	13,900,000	100,746,226	\$ 337,781	\$ 1,540,365	\$ (302,154)	\$ 1,575,992

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended December 31, 2006, 2005 and 2004 (dollars in thousands)

	2006	2005	2004
Cash Flows from Operating Activities			
Net income	\$ 110,781	\$ 99,119	\$ 103,397
Adjustments to net income:			
Depreciation and amortization	59,492	46,206	39,696
Income from discontinued operations:			
Real estate acquired for resale	(1,402)	(2,781)	(7,847)
Real estate held for investment	(3,314)	(7,589)	(13,908)
Gain on reinstatement of property carrying value	(716)	—	—
Gain on sale of real estate held for investment	—	(18)	(185)
Amortization of stock compensation	2,928	2,155	1,426
Amortization of stock option costs	23	12	14
Provisions for impairment on real estate held for investment	—	151	716
Cash from discontinued operations:			
Real estate acquired for resale	371	(510)	(2,407)
Real estate held for investment	410	1,509	4,184
Investment in real estate acquired for resale	(113,166)	(54,110)	(21,787)
Intangibles acquired in connection with acquisition of real estate acquired for resale	—	(1,780)	—
Proceeds from sales of real estate acquired for resale	22,405	22,195	74,995
Collection of mortgage note receivable by Crest	1,333	—	—
Change in assets and liabilities:			
Accounts receivable and other assets	4,418	(3,292)	1,094
Accounts payable, accrued expenses and other liabilities	3,382	8,290	(1,051)
Net cash provided by operating activities	86,945	109,557	178,337
Cash Flows from Investing Activities			
Proceeds from sales of investment properties:			
Continuing operations	2	109	426
Discontinued operations	9,804	22,191	34,175
Acquisition of and additions to investment properties	(654,149)	(417,347)	(195,470)
Intangibles acquired in connection with acquisitions of investment properties	(937)	(9,494)	—
Net cash used in investing activities	(645,280)	(404,541)	(160,869)
Cash Flows from Financing Activities			
Borrowings from lines of credit	523,200	400,300	280,400
Payments under lines of credit	(659,900)	(287,200)	(283,200)
Proceeds from common stock offerings, net	402,745	92,659	67,918
Proceeds from notes issued, net	271,883	270,266	(28)
Principal payment on notes	(110,000)	—	—
Proceeds from preferred stock offerings, net	213,977	—	123,787
Redemption of preferred stock	—	—	(103,142)
Cash distributions to common stockholders	(129,667)	(108,575)	(97,420)
Cash dividends to preferred stockholders	(9,403)	(9,403)	(9,063)
Proceeds from other common stock issuances	369	500	584
Net cash provided by (used in) financing activities	503,204	358,547	(20,164)
Net increase (decrease) in cash and cash equivalents	(55,131)	63,563	(2,696)
Cash and cash equivalents, beginning of year	65,704	2,141	4,837
Cash and cash equivalents, end of year	\$ 10,573	\$ 65,704	\$ 2,141

For supplemental disclosures, see note 13.

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2006, 2005 and 2004

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, 2006, we owned 1,955 properties, located in 48 states, containing over 16.7 million leasable square feet, along with 60 properties owned by our wholly-owned taxable REIT subsidiary, Crest Net Lease, Inc. ("Crest"). Crest was created to buy 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 "Tax 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.

Information with respect to number of properties, square feet, average initial lease term and weighted average contractual lease rate is unaudited.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND PROCEDURES

Federal Income Taxes. We have elected to be taxed as a Real Estate Investment Trust ("REIT") under the Tax Code. We believe we have qualified and continue to qualify as a REIT. Under the REIT operating structure, we are 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, which totaled \$396,000 in 2006, \$760,000 in 2005 and \$2.8 million in 2004 and are included in "income from discontinued operations, real estate acquired 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 2006 (dollars in thousands) (unaudited):

Net income available to common stockholders	\$ 99,419
Tax loss on the sale of real estate less than book gains	(3,529)
Elimination of net revenue and expenses from Crest	2,440
Dividends received from Crest	500
Preferred dividends not deductible for tax	11,362
Depreciation and amortization timing differences	16,612
Adjustment for straight-line rent	(1,515)
Adjustment for a decrease in prepaid rent	(1,681)
Other adjustments	(816)
Estimated taxable net income, before our dividend paid deduction	\$ 122,792

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 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:

	2006	2005	2004
Weighted average shares used for the basic net income per share computation	89,766,714	79,950,255	78,518,296
Incremental shares from share-based compensation	150,840	258,338	80,492
Adjusted weighted average shares used for diluted net income per share computation	89,917,554	80,208,593	78,598,788

In 2006, 2005 and 2004, no stock options were anti-dilutive. We had nonvested shares from share-based compensation that were anti-dilutive of 235,035 in 2006 and 305,476 in 2005. No nonvested shares were anti-dilutive in 2004.

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 one investment property classified as held for sale at December 31, 2006, plus investment properties sold in 2006, 2005 and 2004, are reported as discontinued operations. Their respective results of operations have been 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 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 as held for sale at the date of acquisition and do not depreciate them. In accordance with SFAS 144, the operations of Crest’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.

We allocate interest expense related to borrowings specifically attributable to Crest’s properties. The interest expense amounts allocated to the Crest properties are included in “income from discontinued operations, real estate acquired for resale by Crest.”

The following is a summary of Crest’s “income from discontinued operations, real estate acquired for resale” for the years ended December 31 (dollars in thousands):

Crest’s income from discontinued operations, real estate acquired for resale	2006	2005	2004
Gain on sales of real estate acquired for resale	\$ 2,219	\$ 3,291	\$ 10,254
Rental revenue	5,080	2,085	2,304
Interest expense	(3,708)	(1,139)	(674)
General and administrative expense	(440)	(453)	(464)
Property expenses	(67)	(60)	(93)
Provisions for impairment	(1,188)	—	—
Income taxes	(494)	(943)	(3,480)
Income from discontinued operations, real estate acquired for resale by Crest	\$ 1,402	\$ 2,781	\$ 7,847

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 (dollars in thousands):

Realty Income’s income from discontinued operations, real estate held for investment	2006	2005	2004
Gain on sales of investment properties	\$ 3,036	\$ 6,573	\$ 12,543
Rental revenue	492	1,729	4,608
Other revenue	34	2	121
Depreciation and amortization	(116)	(458)	(1,162)
Property expenses	(116)	(222)	(545)
Provisions for impairment	(16)	(35)	(1,657)
Income from discontinued operations, real estate held for investment	\$ 3,314	\$ 7,589	\$ 13,908

The following is a summary of our total income from discontinued operations for the years ended December 31 (dollars in thousands, except per share data):

Total income from discontinued operations	2006	2005	2004
Income from discontinued operations:			
Real estate acquired for resale by Crest	\$ 1,402	\$ 2,781	\$ 7,847
Real estate held for investment	3,314	7,589	13,908
Income from discontinued operations	\$ 4,716	\$ 10,370	\$ 21,755
Per common share, basic and diluted	\$ 0.05	\$ 0.13	\$ 0.28

The per share amounts for “income from discontinued operations” above and the “income from continuing operations” and “net income” reported on the consolidated statement of income have each been calculated independently.

Revenue Recognition and Accounts Receivable. 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.

We recognize an allowance for doubtful accounts relating to accounts receivable for amounts deemed uncollectible. We consider tenant specific issues such as financial stability and ability to pay rent when determining collectibility of accounts receivable and appropriate allowances to record. The allowance for doubtful accounts was \$705,000 and \$577,000 at December 31, 2006 and 2005, respectively.

Principles of Consolidation. The accompanying consolidated financial statements include the accounts of Realty Income, Crest and their wholly-owned subsidiaries, after elimination of all material intercompany balances and transactions. All of Realty Income's and Crest'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. Lands, buildings and improvements are recorded at cost and stated at cost. Major replacements and betterments, which improve or extend the life of the asset, are capitalized and depreciated over their estimated useful lives, while ordinary repairs and maintenance are expensed as incurred. Buildings and improvements that are under redevelopment, or are being developed, are carried at cost and no depreciation is recorded on these assets. Additionally, amounts essential to the development of the property, such as pre-construction costs, development costs, construction costs, interest costs and other costs incurred during the period of development are capitalized. We cease capitalization when the property is available for occupancy upon substantial completion of tenant improvements, but in any event no later than one year from the completion of major construction activity.

Properties are depreciated using the straight-line method over the estimated useful lives of the assets. The estimated useful lives are as follows:

Buildings	25 years
Building improvements	4 to 15 years
Tenant improvements and lease commissions	The shorter of the term of the related lease or useful life

Provisions for Impairment. 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 estimated cost to sell.

Realty Income recorded a provision for impairment of \$16,000 in 2006 on one retail investment property in the restaurant industry. The provision for impairment is included in discontinued operations.

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

Realty Income recorded provisions for impairment of \$2.4 million in 2004 on six retail properties, of which five have been sold. 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 recorded on investment properties by Realty Income are included on our consolidated statements of income in "income from discontinued operations, real estate held for investment", except for \$151,000 in 2005 and \$716,000 in 2004 which are included in provisions for impairment.

Crest recorded provisions for impairment of \$1.2 million in 2006 on three retail properties, which are held for resale at December 31, 2006. No provisions for impairment were recorded by Crest in 2005 and 2004. Provisions for impairment recorded by Crest are included in "income from discontinued operations, real estate acquired for resale by Crest" on our consolidated statements of income.

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 consider 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 term of the lease.

Capitalized above-market lease values are amortized as a reduction of rental income over the remaining terms of the respective leases. Capitalized below-market lease values are amortized as an increase to rental income over the remaining 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 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.

Share-Based Compensation. 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. For the years ended December 31, 2006, 2005 and 2004, respectively, there is no difference between the stock option-based compensation expense included in reported net income and that expense determined under the fair value method for all awards.

Effective January 1, 2006, we adopted FASB 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.

Goodwill. Goodwill is tested for impairment during the second quarter of each year 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 2006, 2005 or 2004.

Other Assets. Other assets consist of the following at December 31 (in thousands):

	2006	2005
Deferred bond financing costs	\$ 10,868	\$ 8,999
Value of in-place and		
above-market leases	10,430	9,909
Prepaid expenses	3,271	3,379
Settlements on treasury		
lock agreements	1,629	2,346
Unamortized credit line fees	954	1,473
Corporate assets, net of accumulated		
depreciation and amortization	463	454
Escrow deposits for Section 1031		
tax-deferred exchanges	—	3,070
Other items	80	1,358
	\$ 27,695	\$ 30,988

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 2005 and 2004 balances have been reclassified to conform to the 2006 presentation.

3. RETAIL PROPERTIES ACQUIRED

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

A. During 2006, Realty Income and Crest invested \$769.9 million, in aggregate, in 378 new retail properties and properties under development. These 378 properties are located in 30 states, will contain over 3.8 million leasable square feet, and are 100% leased with an average initial lease term of 17.1 years. Of the \$769.9 million invested in 2006, \$6.0 million was used to acquire one property with an existing lease already in-place with a retail tenant. In accordance with SFAS 141, Realty Income recorded \$1.6 million as the value of the in-place lease and \$628,000 as the value of below-market rents. These amounts are recorded to "other assets" and "other liabilities", respectively, on our consolidated balance sheet and are amortized over the lives of the respective lease.

In comparison, during 2005, Realty Income and Crest invested \$486.6 million, in aggregate, in 156 new retail properties and properties under development. These 156 new retail properties are located in 30 states, contain over 1.9 million leasable square feet and are 100% leased with an average lease term of 15.8 years. Of the \$486.6 million invested in 2005, \$95.1 million was used to acquire 34 properties with

existing leases already in-place with existing retail tenants. In accordance with SFAS 141, Realty Income recorded \$10.1 million and Crest 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 recorded \$66,000 as the value of below-market rents on these leases. These amounts were recorded to "other assets" and "other liabilities", respectively, on our consolidated balance sheet and are amortized over the lives of the respective leases. The amounts recorded by Crest are included in the calculation of gain on sales of real estate when the properties were sold during 2006 and 2005.

B. During 2006, Realty Income invested \$656.7 million in 322 new retail properties and properties under development, with an initial weighted average contractual lease rate of 8.6%. These 322 properties are located in 30 states, will contain over 3.3 million leasable square feet and are 100% leased with an average initial lease term of 16.7 years. The initial weighted average contractual lease rate is computed by dividing the estimated aggregate base rent for the first year of each lease by the estimated total cost of the properties.

In comparison, 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, contain over 1.7 million leasable square feet and are 100% leased with an average initial lease term of 15.6 years.

C. During 2006, Crest invested \$113.2 million in 56 new retail properties and properties under development. In comparison, during 2005, Crest invested \$55.9 million in 21 new retail properties and properties under development.

D. Crest's property inventory at December 31, 2006 consisted of 60 properties with a total investment of \$137.5 million and at December 31, 2005 consisted of 17 properties with a total investment of \$45.7 million. These amounts are included on our consolidated balance sheets in "real estate held for sale, net."

4. CREDIT FACILITY

We have a \$300 million revolving acquisition credit facility that expires in October 2008, unless extended as provided for in the agreement. Under the terms of the credit facility, which commenced in October 2005, the borrowing rate is 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 credit facility offers us other interest rate options as well.

The average borrowing rate on our credit facilities during 2006 was 5.7%, compared to 4.3% in 2005 and 2.4% in 2004 on our previous \$250 million credit facility, which expired in

October 2005. The increase in the average borrowing rate is due to an increase in LIBOR since the beginning of 2005. Our current credit facility is subject to various leverage and interest coverage ratio limitations. The Company is and has been in compliance with these covenants.

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

5. NOTES PAYABLE

In September 2006, we issued \$275 million in aggregate principal amount of 5.95% senior unsecured notes due 2016 (the "2016 Notes"). The price to the investor for the 2016 Notes was 99.74% of the principal amount for an effective yield of 5.985%. Interest on the 2016 Notes is paid semiannually. The net proceeds of approximately \$271.9 million from this offering were used for other general corporate purposes and to redeem the outstanding \$110 million 7¼% unsecured notes due May 2007 (the "2007 Notes"), which were issued in May 1997.

In September 2006, we redeemed all of our outstanding 2007 Notes at a redemption price equal to 100% of the principal amount, plus accrued and unpaid interest of \$3.2 million and a make-whole payment of \$1.6 million. We recorded a loss on extinguishment of debt totaling \$1.6 million related to the make-whole payment associated with the 2007 Notes. For 2006, the make-whole payment represented approximately \$0.017 per share.

In September 2005, we issued \$175 million in aggregate principal amount of 5¾% 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 approximately \$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 5¾% 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 approximately \$97 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 5½% senior unsecured notes due 2015 (the "2015 Notes"). Interest on the 2015 Notes is payable semiannually.

In March 2003, we issued \$100 million of 5¾% senior unsecured notes due 2013 (the "2013 Notes"). 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 8¼% 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.

Interest incurred on the 2016 Notes, 2017 Notes, 2035 Bonds, 2015 Notes, 2013 Notes, 2009 Notes, 2008 Notes and 2007 Notes (redeemed in September 2006) collectively for each of the years ended December 31, 2006, 2005 and 2004 was \$49.6 million, \$39.5 million and \$32.0 million, respectively. In addition, when the 2007 Notes were redeemed, we paid a \$1.6 million make-whole payment, which is classified as "loss on extinguishment of debt" on our consolidated statements of income. 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.

The following table summarizes the maturity of our notes payable as of December 31, 2006 (dollars in millions):

Year of Maturity⁽¹⁾	Notes
2008	\$ 100.0
2009	20.0
After 2011	800.0
Totals	\$ 920.0

⁽¹⁾There are no maturities in 2007, 2010 or 2011.

6. COMMON STOCK OFFERINGS

A. In October and November 2006, we issued an aggregate of 6.9 million shares of common stock at a price of \$26.40 per share. The net proceeds of approximately \$173.2 million were used to fund a portion of the purchase price of the Buffets/Ryan's properties and for other general corporate purposes.

B. In September 2006, we issued 4.715 million shares of common stock at a price of \$24.32 per share. The net proceeds of approximately \$109 million from this offering were used to fund new property acquisitions, repay borrowings under our credit facility and for other general corporate purposes.

C. In March 2006, we issued 5.2 million shares of common stock at a price of \$24.39 per share. The net proceeds of approximately \$120.5 million were used to fund new property acquisitions and for other general corporate purposes.

D. 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.

E. 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.

7. PREFERRED STOCK OFFERINGS AND REDEMPTIONS

A. In December 2006, we issued 8.8 million shares of 6¼% Monthly Income Class E cumulative redeemable preferred stock, with a liquidation value of \$25 per share. The net proceeds of \$214 million from this issuance were used to repay borrowings under our credit facility and for other general corporate purposes. Beginning December 7, 2011, the Class E preferred shares are redeemable at our option for \$25 per share. Dividends of \$0.140625 per share are paid monthly in arrears on the Class E preferred stock.

B. In May 2004, we issued 4.0 million shares of 7¼% Monthly Income Class D cumulative redeemable preferred stock, with a liquidation value of \$25 per share. 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 \$25.00 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.

C. 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. 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. DISTRIBUTIONS PAID AND PAYABLE

A. Common Stock. 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	2006	2005	2004
January	\$ 0.116250	\$ 0.110000	\$ 0.100000
February	0.116250	0.110000	0.100000
March	0.116250	0.110000	0.100000
April	0.116875	0.110625	0.100625
May	0.116875	0.110625	0.100625
June	0.116875	0.110625	0.100625
July	0.117500	0.111250	0.101250
August	0.117500	0.111250	0.101250
September	0.125250	0.115000	0.108750
October	0.125875	0.115625	0.109375
November	0.125875	0.115625	0.109375
December	0.125875	0.115625	0.109375
Total	\$ 1.437250	\$ 1.346250	\$ 1.241250

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

	2006	2005	2004
Ordinary income	\$ 1.2945466	\$ 1.210091	\$ 1.18315
Nontaxable distributions	0.1427034	0.136159	0.05810
Capital gain	—	—	—
Totals	\$ 1.4372500	\$ 1.346250	\$ 1.24125

At December 31, 2006, a distribution of \$0.1265 per common share was payable and was paid in January 2007. At December 31, 2005, a distribution of \$0.11625 per common share was payable and was paid in January 2006.

B. Preferred Stock. Dividends of \$0.140625 per share are paid monthly in arrears on the Class E preferred stock. We declared dividends to holders of our Class E preferred stock totaling \$1.6 million in 2006. The first Class E dividend was paid in January 2007.

Dividends of \$0.1536459 per share are paid monthly in arrears on the Class D preferred stock. We declared dividends to holders of our Class D preferred stock totaling \$9.8 million in 2006, \$9.4 million in 2005 and \$4.8 million in 2004. The dividends paid per share to our Class D preferred stockholders for 2006 and 2005 of \$1.84375 and for 2004 of

\$1.01406 were characterized for federal income tax purposes as ordinary income.

In May 1999, we issued 2.76 million shares of 9% Class B cumulative redeemable preferred stock, of which 2,745,700 shares were outstanding for 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. The dividends paid per share to our Class B preferred stockholders in 2004 of \$1.01563 were characterized for federal income tax purposes as ordinary income.

In July 1999, we issued 1.38 million shares of 9% Class C cumulative redeemable preferred stock, all of which were outstanding 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. The dividends paid per share to our Class C preferred stockholders in 2004 of \$1.37882 were characterized for federal income tax purposes as ordinary income.

9. OPERATING LEASES

A. At December 31, 2006, we owned 1,955 properties in 48 states, excluding 60 properties owned by Crest. Of these 1,955 properties, 1,948, or 99.6%, are single-tenant, retail properties and the remaining seven are multi-tenant, distribution and office properties. At December 31, 2006, 26 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 2006, 2005 and 2004 was \$1.1 million, \$1.2 million and \$1.3 million, respectively, including amounts recorded to discontinued operations.

At December 31, 2006, minimum future annual rents to be received on the operating leases are as follows (dollars in thousands):

For the years ending December 31,

2007	\$ 268,536
2008	257,072
2009	246,422
2010	238,635
2011	231,051
Thereafter	2,252,524
Total	\$ 3,494,240

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, 2006, 2005 or 2004.

10. GAIN ON SALES OF REAL ESTATE ACQUIRED FOR RESALE BY CREST

In 2006, Crest sold 13 properties for \$22.4 million, which resulted in a gain of \$2.2 million. In 2005, Crest sold 12 properties for \$23.5 million, which resulted in a gain of \$3.3 million. As part of one sale in 2005, Crest 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 sold 51 properties for \$75 million, which resulted in a gain of \$10.3 million. Crest's gains on sales are reported before income taxes and are included in discontinued operations.

11. GAIN ON SALES OF INVESTMENT PROPERTIES BY REALTY INCOME

In 2006, we sold or exchanged 13 investment properties for \$10.7 million, which resulted in a gain of \$3.0 million, which is 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, 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 13-H).

12. FAIR VALUE OF FINANCIAL INSTRUMENTS

We believe that the carrying values reflected in the consolidated balance sheets at December 31, 2006 and 2005 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 the balance sheet date. The estimated fair value of the notes payable at December 31, 2006 is \$921.9 million and at December 31, 2005 is \$755.0 million, based upon the closing market price per note, or indicative price per each note, at December 31, 2006 and 2005, respectively.

13. SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Interest paid in 2006 was \$52.4 million, in 2005 was \$36.4 million and in 2004 was \$31.3 million.

Interest capitalized to properties under development in 2006 was \$2.2 million, in 2005 was \$1.9 million and in 2004 was \$531,000.

Income taxes paid by Realty Income and Crest in 2006 were \$775,000, in 2005 were \$1.4 million and in 2004 were \$6.9 million.

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

A. Stock based compensation for 2006 was \$3.0 million, for 2005 was \$2.2 million and for 2004 was \$1.4 million.

B. In 2006, we exchanged one of our properties for a different property that was leased to the same tenant. As part of this transaction, accumulated depreciation was reduced by \$67,000 and a gain of \$67,000 was recorded. The original cost of, and the value received for, the property exchanged was \$900,000. This transaction had no impact to land or building and improvements.

C. In 2006, we received shares of a public company as settlement of a bankruptcy claim associated with a former tenant. We recorded a value of \$207,000, which is in other revenue, based on the closing market price of these shares on December 31, 2006 and included them in other assets on our consolidated balance sheet at December 31, 2006. The shares were sold in January 2007.

D. In 2005, Crest 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 December 31, 2005 consolidated balance sheet.

E. In 2004, we recorded an impairment of \$716,000 on one property to reduce its carrying value to zero. This loss was the result of a dispute with the original owner and tenant in their bankruptcy proceeding. Our title insurance company failed to timely record the deed on this property upon our original acquisition, which resulted in a claim by the bankruptcy trustee that Realty Income did not have legal title to the property. In the second quarter of 2006, this issue was resolved and we obtained title to the property. At that time, we reinstated the original carrying value adjusted for depreciation on our balance sheet and recorded other revenue of \$716,000. We also reversed accrued liabilities and property expenses of \$133,000 associated with this property. As part of the settlement, these costs became the responsibility of the title insurance company.

F. 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.

G. 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.

H. 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.

I. Accrued costs on properties under development resulted in an increase in buildings and accounts payable of \$1.7 million in 2006. In 2005, non-cash additions to properties resulted in an increase in buildings of \$5.4 million and an increase in accounts payable of \$5.1 million.

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

	2006	2005
Common stock distributions	\$ 12,745	\$ 9,729
Preferred stock dividends	2,351	392



14. 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.

15. COMMON STOCK INCENTIVE PLAN

In 2003, our Board of Directors adopted, and our stockholders approved, the 2003 Incentive Award Plan of Realty Income Corporation (the "Stock Plan") 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 Stock Plan was amended and restated by our Board of Directors in February 2006. Under the terms of this plan, the aggregate number of shares of our common stock subject to options, stock purchase rights (SPR), stock appreciation rights (SAR) and other awards will be no more than 3,428,000 shares. The maximum number of shares that 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. To date, we have not issued any SPR or SAR.

The amount of share-based compensation costs charged against income during 2006 were \$3.0 million, during 2005 were \$2.2 million and during 2004 were \$1.4 million.

Stock options were 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 2006, 2005 or 2004.

The following table summarizes our stock option activity for the years ended December 31:

	2006		2005		2004	
	Number of shares	Weighted average exercise price	Number of shares	Weighted average exercise price	Number of shares	Weighted average exercise price
Outstanding options, beginning of year	135,348	\$ 13.02	176,130	\$ 13.01	247,756	\$ 12.53
Options exercised	(28,696)	12.86	(40,352)	12.93	(67,648)	11.16
Options forfeited	(284)	14.70	(430)	14.70	(3,978)	14.70
Outstanding options, end of year	106,368	\$ 13.06	135,348	\$ 13.02	176,130	\$ 13.01
Options exercisable, end of year	106,368	\$ 13.06	119,924	\$ 12.87	153,206	\$ 12.75

At December 31, 2006, the options outstanding and exercisable had exercise prices ranging from \$10.63 to \$14.70, with a weighted average price of \$13.06, and expiration dates ranging from June 2007 to December 2011 with a weighted average remaining term of 2.6 years.

The total intrinsic value of options exercised during the years ended December 31, 2006, 2005 and 2004 was \$268,000, \$377,000 and \$480,000, respectively. The total intrinsic value of options vested during the years ended December 31, 2006, 2005 and 2004 was \$143,000, \$67,000 and \$101,000, respectively. The aggregate intrinsic value of options outstanding was \$1.6 million, \$1.2 million and \$2.2 million at December 31, 2006, 2005 and 2004, respectively. The aggregate intrinsic value of options exercisable at December 31, 2006, 2005 and 2004 was \$1.6 million, \$1.1 million and \$1.9 million, respectively. The intrinsic value of a stock option is the amount by which the market value of the underlying stock at December 31 of each year exceeds the price of the option. The market value of the Company's stock was \$27.70, \$21.62 and \$25.29 at December 31, 2006, 2005 and 2004, respectively.

The following table summarizes our common stock grant activity under our Stock Plan for the years 2006, 2005 and 2004. The grants vest over periods ranging from immediately to 10 years.

	2006		2005		2004	
	Number of shares	Weighted average grant price ⁽¹⁾	Number of shares	Weighted average grant price ⁽¹⁾	Number of shares	Weighted average grant price ⁽¹⁾
Outstanding nonvested shares, beginning of year	788,722	\$ 17.83	626,868	\$ 14.98	475,174	\$ 13.70
Shares granted	210,332	21.72	306,241	25.20	218,180	19.94
Shares vested	(125,879)	20.39	(92,811)	16.69	(64,116)	15.16
Shares forfeited	(4,449)	21.35	(51,576)	17.31	(2,370)	18.65
Outstanding nonvested shares, end of year	868,726	\$ 17.96	788,722	\$ 17.83	626,868	\$ 14.98

⁽¹⁾Grant date fair value.

During 2006, we granted 210,332 shares of common stock under the Stock Plan. These shares vest over the following service periods: 16,000 vested upon issuance, 4,000 vest over a service period of one year, 4,000 vest over a service period of four years, 15,000 vest over a service period of five years and 171,332 vest over a service period of 10 years.

As of December 31, 2006, the remaining unamortized stock compensation expense totaled \$15.6 million, which is being amortized on a straight-line basis over the service period of each applicable award. The amount of share-based compensation is based on the fair value of the stock at the grant date. We define the grant date as the date the recipient and the Company have a mutual understanding of the key terms and conditions of the award and the recipient of the grant begins to benefit from, or be adversely affected by, subsequent changes in the price of the shares.

The effect of pre-vesting forfeitures on our recorded expense has historically been negligible. Any future pre-vesting forfeitures are also expected to be negligible, and we will record the benefit related to such forfeitures as they occur. Under the terms of the Stock Plan, we pay non-refundable dividends to the holders of our nonvested shares. Under Statement No. 123R, the dividends paid to holders of these nonvested shares should be charged as compensation expense to the extent that they relate to nonvested shares that do not, or are not, expected to vest. Given the negligible historical and prospective forfeiture rate determined by us, we did not record any amount to compensation expense, related to dividends paid, for 2006, nor do we expect to record any amounts in future periods.

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 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, 2006 (dollars in thousands):

For the years ended December 31,	Revenue		
	2006	2005	2004
Segment rental revenue:			
Automotive parts	\$ 6,716	\$ 6,750	\$ 6,744
Automotive service	16,495	15,083	13,320
Automotive tire services	14,501	13,821	13,346
Child care	24,649	24,819	24,787
Convenience stores	38,284	36,712	33,409
Drug stores	6,986	5,593	243
Health and fitness	10,212	7,212	6,919
Home furnishings	7,463	7,346	7,327
Home improvement	7,996	2,129	2,115
Motor vehicle dealerships	8,217	5,060	859
Restaurants	28,292	17,988	16,196
Sporting goods	6,829	6,747	5,939
Theaters	22,905	10,139	6,052
17 non-reportable segments ⁽¹⁾	38,513	36,267	34,777
Other revenue	2,042	354	1,029
Total revenue	\$ 240,100	\$ 196,020	\$ 173,062

⁽¹⁾Crest's revenues appear in "income from discontinued operations, real estate acquired for resale by Crest" and is not included in this table.

As of December 31,	Assets	
	2006	2005
Segment net real estate:		
Automotive parts	\$ 37,608	\$ 39,550
Automotive service	104,089	108,036
Automotive tire services	211,784	127,879
Child care	96,263	101,950
Convenience stores	335,169	342,734
Drug stores	78,347	65,846
Health and fitness	102,718	87,426
Home furnishings	54,376	56,218
Home improvement	71,474	17,846
Motor vehicle dealerships	104,122	71,035
Restaurants	540,136	166,231
Sporting goods	56,291	57,913
Theaters	272,135	250,214
Crest	137,439	45,509
17 other non-reportable segments	283,130	263,659
Total segment net real estate	2,485,081	1,802,046
Other intangible assets—		
Drug stores	7,629	8,489
Other intangible assets—		
Theaters	2,801	1,419
Other corporate assets	50,997	109,034
Total assets	\$ 2,546,508	\$ 1,920,988

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 position or results of operations.

At December 31, 2006, we have committed to pay estimated unfunded development costs of \$16.4 million on properties under development. In addition, we have contingent payments for tenant improvements and leasing costs of \$806,000 as well as a \$6.0 million commitment to fund the construction costs of two buildings, which are not currently under construction, and for which construction is dependent upon the tenant's commitment to build the buildings prior to September 30, 2007.

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, 2006 and 2005, 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, 2006. 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, 2006 and 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2006, 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, 2006, 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 20, 2007 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

The logo for KPMG LLP, featuring the letters 'KPMG' in a bold, stylized font followed by 'LLP' in a smaller, simpler font.

San Diego, California

February 20, 2007

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, 2006, 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, 2006, 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, 2006, 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, 2006 and 2005, and for each of the years in the three-year period ended December 31, 2006, and our report dated February 20, 2007 expressed an unqualified opinion on those consolidated financial statements.

The logo for KPMG LLP, featuring the letters 'KPMG' in a large, bold, stylized font, with 'LLP' in a smaller, simpler font to the right.

San Diego, California
February 20, 2007

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 research, real estate research, portfolio management and capital markets expertise. Over the past 38 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, 2006, we owned a diversified portfolio:

- Of 1,955 retail properties;
- With an occupancy rate of 98.7%, or 1,929 properties occupied of the 1,955 properties in the portfolio;
- Leased to 103 different retail chains doing business in 29 separate retail industries;
- Located in 48 states;
- With over 16.7 million square feet of leasable space; and
- With an average leasable retail space per property of approximately 8,600 square feet.

Of the 1,955 properties in the portfolio, 1,948, or 99.6%, are single-tenant, retail properties and the remaining seven are multi-tenant, distribution and office properties. At December 31, 2006, 1,923, or 98.7%, of the 1,948 single-tenant properties were leased with a weighted average remaining lease term (excluding extension options) of approximately 12.9 years.

In addition, at December 31, 2006, our wholly-owned taxable REIT subsidiary, Crest Net Lease, Inc. ("Crest"), had invested \$137.5 million in 60 properties, which are classified as held for sale. Crest was created to buy 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 "Tax Code").

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, 2006, we had cash and cash equivalents totaling \$10.6 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 Acquisition Credit Facility

We have a \$300 million revolving, unsecured 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 13, 2007, we had borrowing capacity of \$300 million available on our credit facility and no outstanding balance.

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. We have the right to request an increase in the borrowing capacity of the credit facility by up to \$100 million, to a total borrowing capacity of \$400 million. Any increase in the borrowing capacity is subject to approval by the lending banks of our credit facility.

Mortgage Debt

We have no mortgage debt on any of our properties.

Universal Shelf Registration

In April 2006, we filed a shelf registration statement with the SEC, which is effective for a term of three years. In accordance with the SEC rules, the amount of securities to be issued pursuant to this shelf registration statement was not specified when it was filed. The securities covered by this registration statement include common stock, preferred stock, debt securities, or any combination of such securities. Realty Income may periodically offer one or more of these securities in amounts, prices and on terms to be announced when and if the securities are offered. The specifics of any

future offerings, along with the use of proceeds of any securities offered, will be described in detail in a prospectus supplement, or other offering materials, at the time of any offering. As such, there is no specific limit to the dollar amount of new securities that can be issued under this new shelf registration before it expires in April 2009.

The common stock issued in September 2006, October 2006 and November 2006, the 2016 Notes issued in September 2006 and the Class E preferred stock issued in December 2006 were issued pursuant to our universal shelf registration statement.

Issuances of Common Stock

In October and November 2006, we issued an aggregate of 6.9 million shares of common stock at a price of \$26.40 per share. The net proceeds of approximately \$173.2 million were used to fund a portion of the purchase price of the Buffets/Ryan's properties and for other general corporate purposes.

In September 2006, we issued 4.715 million shares of common stock at a price of \$24.32 per share. The net proceeds of approximately \$109 million from this offering were used to fund new property acquisitions, repay borrowings under our credit facility and for other general corporate purposes.

In March 2006, we issued 5.2 million shares of common stock at a price of \$24.39 per share. The net proceeds of approximately \$120.5 million were used to fund new property acquisitions and for other general corporate purposes.

Issuance of Preferred Stock

In December 2006, we issued 8.8 million shares of 6¾% Class E cumulative redeemable preferred stock, with a liquidation value of \$25 per share. The net proceeds of \$214 million from this issuance were used to repay borrowings under our credit facility and for other general corporate purposes.

Redemption of 2007 Notes

In September 2006, we redeemed all of our outstanding \$110 million, 7¾%, unsecured notes due May 2007 (the "2007 Notes"). The 2007 Notes were redeemed at a redemption price equal to 100% of the principal amount, plus accrued and unpaid interest of \$3.2 million and a make-whole payment of \$1.6 million. We recorded a loss on extinguishment of debt totaling \$1.6 million related to the make-whole payment associated with the 2007 Notes. For 2006, the make-whole payment represented approximately \$0.017 per share.

Issuance of 10-Year Senior Unsecured Notes

In September 2006, we issued \$275 million in aggregate principal amount of 5.95% senior unsecured notes due 2016 (the "2016 Notes"). The price to the investor for the 2016 Notes was 99.74% of the principal amount for an effective yield of 5.985%. The net proceeds of approximately \$271.9 million from this offering were used to redeem the

2007 Notes and for other general corporate purposes. Interest on the 2016 Notes is paid semiannually.

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 13, 2007, our total outstanding credit facility borrowings and outstanding notes were \$920 million, or approximately 21.9%, of our total market capitalization of \$4.21 billion. We define our total market capitalization at February 13, 2007 as the sum of:

- Shares of our common stock outstanding of 101,000,536 multiplied by the last reported sales price of our common stock on the NYSE of \$29.09 per share, or \$2.94 billion;
- Aggregate liquidation value of the Class D preferred stock of \$127.5 million;
- Aggregate liquidation value of the Class E preferred stock of \$220 million; and
- Outstanding notes of \$920 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 and Standard & Poor's ratings have "positive" outlooks and Fitch has 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 and Standard & Poor's ratings have "positive" outlooks and Fitch has a "stable" outlook.

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

financial condition. These ratings are subject to ongoing evaluation by credit rating agencies, and we cannot assure you that any such rating will not be changed or withdrawn by a rating agency in the future if, in its judgment, circumstances warrant. Moreover, a rating is not a recommendation to buy, sell or hold our debt securities, preferred stock or common stock.

Notes Outstanding

Senior note obligations consist of the following (dollars in thousands), sorted by maturity date:

At December 31, 2006

8¼% senior notes, issued in		
October 1998 and due in 2008	\$ 100,000	
8% senior unsecured notes, issued in		
January 1999 and due in 2009	20,000	
5¾% senior unsecured notes, issued		
in March 2003 and due in 2013	100,000	
5½% senior unsecured notes, issued		
in November 2003 and due in 2015	150,000	
5.95% senior unsecured notes, issued		
in September 2006 and due in 2016	275,000	
5¾% senior unsecured notes, issued		
in September 2005 and due in 2017	175,000	
5¾% senior unsecured bonds, issued		
in March 2005 and due in 2035	100,000	
		\$ 920,000

Interest on all of the senior note obligations is paid semiannually, with the exception of the interest on the 8¼% senior notes issued in October 1998, which is paid monthly. 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, 2006.

Note Covenants	Required	Actual
Limitation on Incurrence of Total Debt	≤ 60%	31.6%
Limitation on Incurrence of Secured Debt	≤ 40%	0.0%
Debt Service Coverage	≥ 1.5 x	4.0 x
Maintenance of Total Unencumbered Assets	≥ 150% of Unsecured Debt	316%

All of our outstanding notes and bonds 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, 2006 (dollars in millions):

Table of Obligations

Year of Maturity	Credit Facility ⁽¹⁾	Notes	Interest ⁽²⁾	Other ⁽³⁾	Totals
2007	\$ —	\$ —	\$ 55.1	\$ 17.2	\$ 72.3
2008	—	100.0	54.1	—	154.1
2009	—	20.0	45.3	—	65.3
2010	—	—	45.3	—	45.3
2011	—	—	45.3	—	45.3
Thereafter	—	800.0	305.5	—	1,105.5
Totals	\$ —	\$ 920.0	\$ 550.6	\$ 17.2	\$ 1,487.8

⁽¹⁾There was no outstanding credit facility balance on December 31, 2006 or February 13, 2007.

⁽²⁾Interest on credit facility and notes has been calculated based on outstanding balances as of December 31, 2006 through their respective maturity dates.

⁽³⁾Other consists of \$16.4 million of estimated unfunded costs on properties under development and \$806,000 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% 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 stock are paid monthly in arrears.

In December 2006, we issued 8.8 million shares of 6% Class E cumulative redeemable preferred stock. Beginning December 7, 2011, shares of Class E preferred stock are redeemable at our option for \$25 per share, plus any accrued and unpaid dividends. Dividends on shares of Class E preferred stock are paid monthly in arrears.

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 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 2006

During 2006, Realty Income and Crest invested \$769.9 million, in aggregate, in 378 new properties and properties under development. These 378 properties are located in 30 states and are 100% leased with an initial average lease term of 17.1 years. As described below, Realty Income acquired 322 properties and Crest acquired 56 properties.

Included in the \$769.9 million is \$656.7 million invested by Realty Income in 322 new properties and properties under development, with an initial weighted average contractual lease rate of 8.6%. These 322 properties are located in 30 states, are 100% leased with an initial average lease term of 16.7 years and will contain over 3.3 million leasable square feet. The 322 new properties acquired by Realty Income are net-leased to 16 different retail chains in the following 11 industries: automotive collision services, automotive tire services, convenience store, drug store, general merchandise, health and fitness, home improvement, motor vehicle dealership, private education, restaurant and theater. Also included in the \$769.9 million is \$113.2 million invested by Crest in 56 new retail properties.

At December 31, 2006, Realty Income had invested \$15.9 million in four properties that were leased and under contract for development by the tenant (with development costs funded by Realty Income). Rent on these properties

is scheduled to begin at various times during 2007. At December 31, 2006, we had outstanding commitments to pay estimated unfunded development costs totaling \$16.4 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.

Acquisition of \$349 million of Buffets/Ryan's Restaurants on November 1, 2006

The 2006 acquisition amounts include Realty Income and Crest's aggregate investment of \$349 million to acquire 144 Buffets/Ryan's restaurant properties. The properties are leased under 20-year, triple-net lease agreements. These properties were acquired subsequent to a merger between Buffets, Inc. and Ryan's Restaurant Group.

Of the 144 restaurant properties, 116 were acquired by Realty Income and 28 were acquired by Crest. The restaurants have, on average, approximately 10,300 leasable square feet and are situated on an average lot size of approximately 2.86 acres. In general, the properties are existing locations that, on average, have been operating for 11 years.

Investments in Existing Properties

In 2006, we capitalized costs of \$964,000 on existing properties in our portfolio, consisting of \$761,000 for re-leasing costs and \$203,000 for building improvements.

Sales of Investment Properties

During 2006, we sold or exchanged 13 properties for \$10.7 million, which resulted in a gain of \$3.0 million. This gain is included in discontinued operations. The 13 properties sold or exchanged consisted of one automotive parts store, one automotive service facility, one child care facility, two convenience stores, and eight restaurants. 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 Property Sales

During 2006, Crest, our wholly-owned subsidiary, sold 13 properties from its inventory for an aggregate of \$22.4 million, which resulted in a gain of \$2.2 million. Crest's gains are included in "income from discontinued operations, real estate acquired for resale by Crest."

Crest Property Inventory

Crest's property inventory at December 31, 2006 and 2005 totaled \$137.5 million and \$45.7 million, respectively, and is included in "real estate held for sale, net", on our consolidated balance sheets.

The financial statements of Crest 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 37-year policy of paying distributions monthly to our common stockholders. Monthly distributions per share were increased in April 2006 by \$0.000625 to \$0.116875, in July 2006 by \$0.000625 to \$0.1175, in September 2006 by \$0.00775 to \$0.12525, in October 2006 by \$0.000625 to \$0.125875 and in January 2007 by \$0.000625 to \$0.1265. The increase in January 2007 was our 37th consecutive quarterly increase and the 42nd increase in the amount of our dividend since our listing on the NYSE in 1994. In 2006, we paid the following monthly cash distributions per share: three in the amount of \$0.11625, three in the amount of \$0.116875, two in the amount of \$0.1175, one in the amount of \$0.12525, and three in the amount of \$0.125875 totaling \$1.43725. In December 2006, January 2007 and February 2007, we declared distributions of \$0.1265 per share, which were paid on January 16, 2007 and February 15, 2007 and will be paid on March 15, 2007, respectively.

The monthly distribution of \$0.1265 per share represents a current annualized distribution of \$1.518 per share, and an annualized distribution yield of approximately 5.2% based on the last reported sale price of our common stock on the NYSE of \$29.09 on February 13, 2007. 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 generally 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's properties because they are held for sale.

Another significant judgment must be made as to if, and when, impairment losses should be taken on our properties when events or a 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 cost 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, 2006, 2005 and 2004.

Rental Revenue

Rental revenue was \$238.1 million for 2006 versus \$195.7 million for 2005, an increase of \$42.4 million, or 21.7%. Rental revenue was \$172 million in 2004. The increase in rental revenue in 2006 compared to 2005 is primarily attributable to:

- The 322 retail properties acquired by Realty Income in 2006, which generated \$15.7 million of rent in 2006;
- The 135 retail properties acquired by Realty Income in 2005, which generated \$33.5 million of rent in 2006 compared to \$12.1 million in 2005, an increase of \$21.4 million;
- Same store rents generated on 1,421 properties leased during the entire years of 2006 and 2005 increased by \$1.3 million, or 0.7%, to \$175.3 million from \$174.0 million.
- An increase in straight-line rent and other non-cash adjustments to rent of \$155,000 in 2006 as compared to 2005; and

- An increase of \$4.0 million relating to the aggregate of (i) development properties acquired before 2005 that started paying rent in 2005, (ii) properties that were vacant during part of 2006 or 2005 and (iii) lease termination settlements. These items totaled \$9.7 million in aggregate in 2006 compared to \$5.7 million in 2005.

Of the 1,955 properties in the portfolio at December 31, 2006, 1,948, or 99.6%, are single-tenant properties and the remaining seven are multi-tenant properties. Of the 1,948 single-tenant properties, 1,923, or 98.7%, were net leased with a weighted average remaining lease term (excluding rights to extend a lease at the option of the tenant) of approximately 12.9 years at December 31, 2006. Of our 1,923 leased single-tenant properties, 1,713, or 89.1%, were under leases that provide for increases in rents through:

- Primarily base rent increases tied to a consumer price index;
- 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 \$1.1 million in 2006, \$1.2 million in 2005 and \$1.3 million in 2004. Percentage rent in 2006 was less than 1% of rental revenue and we anticipate percentage rent to be less than 1% of rental revenue in 2007.

Our portfolio of retail real estate, leased primarily to regional and national chains under net leases, continues to perform well and provide dependable lease revenue supporting the payment of monthly dividends to our stockholders. At December 31, 2006, our portfolio of 1,955 retail properties was 98.7% leased with 26 properties available for lease, one of which is a multi-tenant property.

As of February 13, 2007, transactions to lease or sell four of the 26 properties available for lease at December 31, 2006 were underway 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 \$10.4 million higher in 2006 than in 2005. Interest expense increased in 2006 primarily due to higher average outstanding balances, which was partially offset by slightly lower interest rates related to our average outstanding borrowings. We issued \$275 million of 10-year notes in September 2006, \$175 million of 12-year notes in September 2005 and \$100 million of 30-year bonds in March 2005, which contributed to the increase in average outstanding balances and slightly lower average interest rates on our debt.

The following is a summary of the components of our interest expense (dollars in thousands):

	2006	2005	2004
Interest on our credit facility and notes	\$ 54,068	\$ 40,968	\$ 32,442
Interest included in discontinued operations from real estate acquired for resale by Crest	(3,708)	(1,139)	(674)
Amortization of settlements on treasury lock agreements	717	756	756
Credit facility commitment fees	456	498	508
Amortization of credit facility origination costs and deferred bond financing costs	2,014	1,752	1,631
Interest capitalized	(2,184)	(1,886)	(531)
Interest expense	\$ 51,363	\$ 40,949	\$ 34,132

Credit facilities and notes outstanding	2006	2005	2004
Average outstanding balances (dollars in thousands)	\$ 881,669	\$ 647,301	\$ 498,220
Average interest rates	6.13%	6.33%	6.51%

At February 13, 2007, the weighted average interest rate on our notes payable of \$920 million was 5.99% and the average interest rate on our credit line was 5.97%. There was no balance on our credit line at February 13, 2007.

Interest Coverage Ratio

Our interest coverage ratio for 2006 was 4.1 times, for 2005 was 4.4 times and for 2004 was 5.0 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):

	2006	2005	2004
Net cash provided by operating activities	\$ 86,945	\$ 109,557	\$ 178,337
Interest expense	51,363	40,949	34,132
Interest expense included in discontinued operations ⁽¹⁾	3,708	1,139	674
Income taxes	747	813	699
Income taxes included in discontinued operations ⁽¹⁾	494	943	3,480
Investment in real estate acquired for resale ⁽¹⁾⁽²⁾	113,166	55,890	21,787
Proceeds from sales of real estate acquired for resale ⁽¹⁾	(22,405)	(22,195)	(74,995)
Collection of a mortgage note receivable by Crest ⁽¹⁾	(1,333)	—	—
Crest provisions for impairment losses ⁽¹⁾	(1,188)	—	—
Gain on sales of real estate acquired for resale ⁽¹⁾	2,219	3,291	10,254
Amortization of deferred stock compensation	(2,928)	(2,155)	(1,426)
Amortization of stock option costs	(23)	(12)	(14)
Changes in assets and liabilities:			
Accounts receivable and other assets	(4,418)	3,292	(1,094)
Accounts payable, accrued expenses and other liabilities	(3,208)	(8,290)	1,051
Interest coverage amount	\$ 223,139	\$ 183,222	\$ 172,885
Divided by interest expense ⁽³⁾	\$ 55,071	\$ 42,088	\$ 34,806
Interest coverage ratio	4.1	4.4	5.0

⁽¹⁾Crest activities.

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

⁽³⁾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 2006 was 3.4 times, for 2005 was 3.6 times and for 2004 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):

	2006	2005	2004
Interest coverage amount	\$ 223,139	\$ 183,222	\$ 172,885
Divided by interest expense plus preferred stock dividends ⁽¹⁾⁽²⁾	\$ 66,433	\$ 51,491	\$ 44,261
Fixed charge coverage ratio	3.4	3.6	3.9

⁽¹⁾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.

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

Depreciation and Amortization

Depreciation and amortization was \$59.5 million in 2006 versus \$46.2 million in 2005 and \$39.7 million in 2004. The increases in depreciation and amortization in 2006 and 2005 were due to the acquisition of properties in 2006, 2005 and 2004, which were partially offset by property sales during these years.

General and Administrative Expenses

General and administrative expenses increased by \$2.1 million to \$17.5 million in 2006 versus \$15.4 million in 2005. General and administrative expenses were \$13.1 million in 2004. In 2006, general and administrative expenses as a percentage of total revenue decreased to 7.3% as compared to 7.9% in 2005 and 7.6% in 2004. General and administrative expenses increased in total dollars primarily due to increases in payroll and employee benefit costs.

As our property portfolio has grown and continues to grow, we have increased, and anticipate that we will continue to gradually 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.

In February 2007, we had 70 permanent employees as compared to February 2006 when we had 69 permanent employees and four temporary employees.

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, bad debt expense, property inspections and title search fees. At December 31, 2006, 26 properties were available for lease, as compared to 25 at December 31, 2005 and 32 at December 31, 2004.

Property expenses were \$3.3 million in 2006, \$3.7 million in 2005 and \$3.1 million in 2004. The \$392,000 decrease in property expenses in 2006 is primarily attributable to a decrease in costs associated with bad debt expense, legal fees, and property taxes.

Income Taxes

Income taxes were \$747,000 in 2006 as compared to \$813,000 in 2005 and \$699,000 in 2004. These amounts are for city and state income taxes paid by Realty Income.

In addition, Crest incurred state and federal income taxes of \$494,000 in 2006 as compared to \$943,000 in 2005 and \$3.5 million in 2004. The decrease in Crest's 2006 income taxes over the 2005 and 2004 income taxes 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."

Loss on Extinguishment of Debt

In September 2006, we redeemed all of our outstanding \$110 million, 7 $\frac{3}{4}$ %, unsecured notes due May 2007. The 2007 Notes were redeemed at a redemption price equal to 100% of the principal amount, plus accrued and unpaid interest of \$3.2 million and a make-whole payment of \$1.6 million. We recorded a loss on extinguishment of debt totaling \$1.6 million related to the make-whole payment associated with the 2007 Notes. For 2006, the make-whole payment represented approximately \$0.017 per share.

Discontinued Operations

Crest 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 as held for sale at the date of acquisition and do not depreciate them. The operation of Crest's properties is classified as "income from discontinued operations, real estate acquired for resale by Crest."

The following is a summary of Crest's "income from discontinued operations, real estate acquired for resale" for the years 2006, 2005 and 2004 (dollars in thousands, except per share data):

Crest's income from discontinued operations, real estate acquired for resale	2006	2005	2004
Gain on sales of real estate acquired for resale	\$ 2,219	\$ 3,291	\$ 10,254
Rental revenue	5,080	2,085	2,304
Interest expense	(3,708)	(1,139)	(674)
General and administrative expense	(440)	(453)	(464)
Property expenses	(67)	(60)	(93)
Provisions for impairment	(1,188)	—	—
Income taxes	(494)	(943)	(3,480)
Income from discontinued operations, real estate acquired for resale by Crest	\$ 1,402	\$ 2,781	\$ 7,847
Per common share, basic and diluted	\$ 0.02	\$ 0.03	\$ 0.10

Realty Income's operations from one property listed as held for sale at December 31, 2006, plus properties sold in 2006, 2005 and 2004 have been classified as discontinued operations. The following is a summary of our discontinued operations from real estate held for investment for the years 2006, 2005 and 2004 (dollars in thousands, except per share data):

Realty Income's income from discontinued operations from real estate held for investment	2006	2005	2004
Gain on sales of investment properties	\$ 3,036	\$ 6,573	\$ 12,543
Rental revenue	492	1,729	4,608
Other revenue	34	2	121
Depreciation and amortization	(116)	(458)	(1,162)
Property expenses	(116)	(222)	(545)
Provisions for impairment	(16)	(35)	(1,657)
Income from discontinued operations, real estate held for investment	\$ 3,314	\$ 7,589	\$ 13,908
Per common share, basic and diluted	\$ 0.04	\$ 0.09	\$ 0.18

The following is a summary of our total discontinued operations for the years 2006, 2005 and 2004 (dollars in thousands, except per share data):

Total income from discontinued operations	2006	2005	2004
Real estate acquired for resale by Crest	\$ 1,402	\$ 2,781	\$ 7,847
Real estate held for investment	3,314	7,589	13,908
Income from discontinued operations	\$ 4,716	\$ 10,370	\$ 21,755
Per common share, basic and diluted	\$ 0.05	\$ 0.13	\$ 0.28

The above per share amounts have each been calculated independently.

Gain on Sales of Real Estate Acquired for Resale by Crest

In 2006, Crest sold 13 properties for \$22.4 million, which resulted in a gain of \$2.2 million. In 2005, Crest sold 12 properties for \$23.5 million, which resulted in a gain of \$3.3 million. In 2004, Crest sold 51 properties for \$75 million, which resulted in a gain of \$10.3 million. Crest's gains on sales are reported before income taxes and are included in "income from discontinued operations, real estate acquired for resale by Crest."

At December 31, 2006, Crest had \$137.5 million invested in 60 properties, which are held for sale. Crest generally carries a real estate inventory in excess of \$20 million. Crest 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 without any property sales.

Gain on Sales of Investment Properties by Realty Income

In 2006, we sold or exchanged 13 investment properties for \$10.7 million, which resulted in a gain of \$3.0 million, which is 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, which 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, which is included in discontinued operations, except for \$185,000 that is included in other revenue.

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, 2006, we classified real estate with a carrying amount of \$138 million as held for sale on our balance sheet, which includes properties owned by Crest. Additionally, we anticipate selling investment properties from our portfolio that have not yet been specifically identified, from which we anticipate receiving between \$10 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 Impairment on Real Estate Acquired for Resale by Crest

Provisions for impairment of \$1.2 million were recorded by Crest on three properties in 2006. No provisions for impairment were recorded by Crest in 2005 and 2004. Crest's properties are held for sale and the provisions for impairment recorded in 2006 reduced the carrying costs to the estimated fair-market value of those properties, net of estimated selling costs.

Provisions for Impairment on Realty Income Investment Properties

In 2006, a provision for impairment of \$16,000 was recorded on one property. In 2005, we recorded provisions for impairment totaling \$186,000 on four properties. In 2004, we recorded provisions for impairment totaling \$2.4 million on six properties. These provisions are included in "income from discontinued operations, real estate held for investment" except for \$151,000 in 2005 and \$716,000 in 2004 which are included in "provisions for impairment."

Preferred Stock Cash Dividends and Redemption Charge

Preferred stock cash dividends totaled \$11.4 million in 2006 as compared to \$9.4 million in 2005 and \$9.5 million in 2004.

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 was \$99.4 million in 2006, an increase of \$9.7 million as compared to \$89.7 million in 2005. Net income available to common stockholders in 2004 was \$90.2 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.

During 2006, the gain recognized from the sales of investment properties was \$3.0 million as compared to \$6.6 million during 2005 and \$12.7 million in 2004. Crest's gain recognized from the sale of properties during 2006 was \$2.2 million as compared to \$3.3 million during 2005 and \$10.3 million during 2004.

FUNDS FROM OPERATIONS AVAILABLE TO COMMON STOCKHOLDERS (FFO)

FFO for 2006 increased by \$26.2 million, or 20.2%, to \$155.8 million as compared to \$129.6 million in 2005 and \$118.2 million in 2004. 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. Also presented is information regarding distributions paid to common stockholders and the weighted average number of shares outstanding for the years ended December 31 (dollars in thousands, except per share amounts):

	2006	2005	2004
Net income available to common stockholders	\$ 99,419	\$ 89,716	\$ 90,168
Depreciation and amortization:			
Continuing operations	59,492	46,206	39,696
Discontinued operations	116	458	1,162
Depreciation of furniture, fixtures and equipment	(192)	(142)	(117)
Gain on sales of investment properties:			
Continuing operations	—	(18)	(185)
Discontinued operations	(3,036)	(6,573)	(12,543)
FFO available to common stockholders	\$ 155,799	\$ 129,647	\$ 118,181
FFO per common share:			
Basic	\$ 1.74	\$ 1.62	\$ 1.51
Diluted	\$ 1.73	\$ 1.62	\$ 1.50
Distributions paid to common stockholders	\$ 129,667	\$ 108,575	\$ 97,420
FFO in excess of distributions to common stockholders	\$ 26,132	\$ 21,072	\$ 20,761
Weighted average number of common shares:			
Basic	89,766,714	79,950,255	78,518,296
Diluted	89,917,554	80,208,593	78,598,788

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 noncash 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 December 31 (dollars in thousands)	2006	2005	2004
Provisions for impairment losses	\$ 16	\$ 186	\$ 2,373
Gain on reinstatement of property carrying value	(716)	—	—
Crest provisions for impairment losses	1,188	—	—
Amortization of settlements on treasury lock agreements ⁽¹⁾	717	756	756
Amortization of deferred note financing costs ⁽²⁾	1,287	1,034	913
Amortization of deferred stock compensation and stock option costs	2,951	2,167	1,440
Capitalized leasing costs and commissions	(761)	(570)	(323)
Capitalized building improvements	(203)	(1,017)	(789)
Straight line rent ⁽³⁾	(1,515)	(1,360)	99
Preferred stock origination costs write-off ⁽⁴⁾	—	—	3,774

⁽¹⁾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.

⁽²⁾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, September 2005 and September 2006. 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.

⁽³⁾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.

⁽⁴⁾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 98.4%, or 1,923, of the 1,955 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 September 2006, the FASB issued Statement No. 157, *Fair Value Measurements*. Statement No. 157 sets out a framework for measuring fair value, and requires additional disclosures about fair-value measurements. Statement No. 157 becomes effective for us at the beginning of 2008. The impact of adopting Statement No. 157 is not expected to have a material effect on our financial position or results of operations.

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109*. Interpretation No. 48 applies to all tax positions accounted for under Statement No. 109, including tax positions acquired in a business combination.

Interpretation 48 is effective for us at the beginning of 2007. The impact of adopting Interpretation No. 48 is not expected to have a material effect on 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, 2006. We do not enter into any derivative 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 and fair values as of December 31, 2006. This information is presented to evaluate the expected cash flows and sensitivity to interest rate changes (dollars in millions):

Expected Maturity Data as of December 31, 2006

Year of maturity	Fixed rate debt	Average interest rate on fixed rate debt	Variable rate debt	Average interest rate on variable rate debt
2007	\$ —	—	\$ —	5.98%
2008 ⁽¹⁾⁽²⁾	100.0	8.25%	—	—
2009 ⁽³⁾	20.0	8.00	—	—
2010	—	—	—	—
2011	—	—	—	—
Thereafter ⁽⁴⁾	800.0	5.66	—	—
Totals	\$ 920.0	5.99%	\$ —	5.98%
Fair Value ⁽⁵⁾	\$ 921.9		\$ —	

⁽¹⁾\$100 million matures in November 2008.

⁽²⁾The credit facility expires in October 2008. The credit facility balance as of December 31, 2006 and February 13, 2007 was zero.

⁽³⁾\$20 million matures in January 2009.

⁽⁴⁾\$100 million matures in March 2013, \$150 million matures in November 2015, \$275 million matures in September 2016, \$175 million matures in September 2017 and \$100 million matures in March 2035.

⁽⁵⁾We base the fair value of the fixed rate debt at December 31, 2006 on the closing market price or indicative price per each note.

The table incorporates only those exposures that exist as of December 31, 2006; 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. At December 31, 2006, our credit facility balance was zero; however, we intend to borrow funds on our credit facility in the future. Based on a hypothetical credit facility borrowing of \$50 million, a 1% change in interest rates would change our interest costs by \$500,000 per year.

REALTY INCOME CORPORATION AND SUBSIDIARIES
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,	2006	2005	2004	2003	2002
Total assets (book value)	\$ 2,546,508	\$ 1,920,988	\$ 1,442,315	\$ 1,360,257	\$ 1,080,230
Cash and cash equivalents	10,573	65,704	2,141	4,837	8,921
Lines of credit and notes payable	920,000	891,700	503,600	506,400	339,700
Total liabilities	970,516	931,774	528,580	532,491	357,775
Total stockholders' equity	1,575,992	989,214	913,735	827,766	722,455
Net cash provided by operating activities	86,945	109,557	178,337	73,957	124,807
Net change in cash and cash equivalents	(55,131)	63,563	(2,696)	(4,084)	6,454
Total revenue	240,100	196,020	173,062	142,656	127,337
Income from continuing operations	106,065	88,749	81,642	70,947	63,800
Income from discontinued operations	4,716	10,370	21,755	15,488	14,867
Net income	110,781	99,119	103,397	86,435	78,667
Preferred stock cash dividends	(11,362)	(9,403)	(9,455)	(9,713)	(9,713)
Excess of redemption value over carrying value of preferred shares redeemed	—	—	(3,774)	—	—
Net income available to common stockholders	99,419	89,716	90,168	76,722	68,954
Cash distributions paid to common stockholders	129,667	108,575	97,420	83,842	78,042
Ratio of earnings to fixed charges ⁽¹⁾	2.9 times	3.2 times	3.9 times	4.1 times	4.3 times
Ratio of earnings to combined fixed charges and preferred stock cash dividends ⁽¹⁾	2.4 times	2.6 times	3.1 times	3.0 times	3.0 times
Basic net income per common share	1.11	1.12	1.15	1.08	1.02
Diluted net income per common share	1.11	1.12	1.15	1.08	1.01
Cash distributions paid per common share	1.43725	1.34625	1.24125	1.18125	1.15125
Cash distributions declared per common share	1.44750	1.35250	1.25125	1.18375	1.15375
Basic weighted average number of common shares outstanding	89,766,714	79,950,255	78,518,296	71,128,282	67,867,498
Diluted weighted average number of common shares outstanding	89,917,554	80,208,593	78,598,788	71,222,628	67,976,314

⁽¹⁾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, including the amortization of debt issuance costs and interest classified to discontinued operations. Fixed charges are comprised of interest costs (including capitalized interest), the amortization of debt issuance costs and interest classified to discontinued operations. 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 and Class E 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% Class D preferred stock in May 2004, 1,100,000 shares of our 7% Class D preferred stock in October 2004, and 8,800,000 shares of our 6.75% Class E preferred stock in December 2006.



REALTY INCOME CORPORATION AND SUBSIDIARIES

CONTROLS AND PROCEDURES

CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

We have had no disagreements with our independent registered public accounting firm 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, 2006, 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 and were operating at a reasonable assurance level.

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 20, 2007 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 2006, 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, 2006, 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.



REALTY INCOME CORPORATION AND SUBSIDIARIES

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 ⁽²⁾
2006⁽¹⁾					
Total revenue	\$ 55,156	\$ 56,509	\$ 59,297	\$ 69,139	\$ 240,100
Interest expense	13,198	11,930	12,530	13,706	51,363
Depreciation and amortization expense	13,512	14,791	14,632	16,557	59,492
Other expenses	5,336	5,270	6,521	6,052	23,180
Income from continuing operations	23,110	24,518	25,614	32,824	106,065
Income (loss) from discontinued operations	1,778	2,122	944	(128)	4,716
Net income	24,888	26,640	26,558	32,696	110,781
Net income available to common stockholders	22,537	24,289	24,207	28,386	99,419
Net income per common share:					
Basic	0.27	0.28	0.27	0.29	1.11
Diluted	0.27	0.27	0.27	0.29	1.11
Dividends paid per common share	0.348750	0.350625	0.360250	0.377625	1.437250
2005⁽¹⁾					
Total revenue	\$ 46,431	\$ 47,219	\$ 48,877	\$ 53,492	\$ 196,020
Interest expense	9,058	9,793	10,228	11,869	40,949
Depreciation and amortization expense	10,709	11,146	11,218	13,133	46,206
Other expenses	5,120	4,917	5,370	4,709	20,116
Income from continuing operations	21,544	21,363	22,061	23,781	88,749
Income from discontinued operations	1,959	3,303	1,061	4,047	10,370
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

⁽¹⁾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.

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

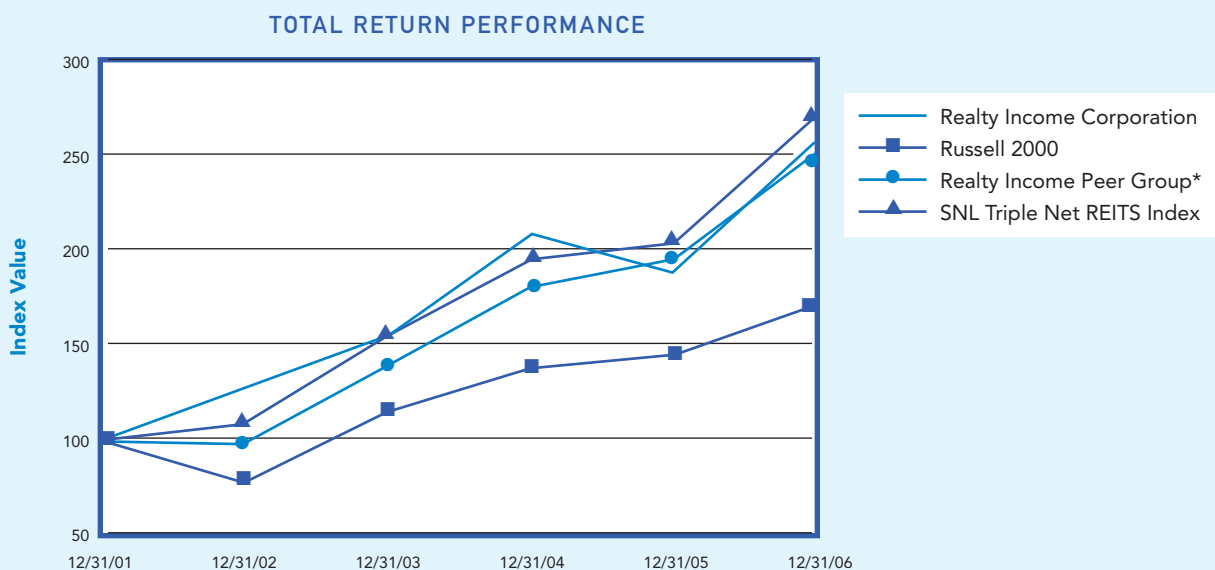
MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

A. 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 ⁽¹⁾
	High	Low	
2006			
First quarter	\$ 24.93	\$ 21.57	\$ 0.349375
Second quarter	24.06	21.25	0.351250
Third quarter	25.10	21.65	0.368625
Fourth quarter	28.43	24.40	0.378250
Total			\$ 1.447500
2005			
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

⁽¹⁾Common stock cash distributions currently are declared monthly by us based on financial results for the prior months. At December 31, 2006, a distribution of \$0.1265 per common share had been declared and was paid in January 2007.

There were 9,737 registered holders of record of our common stock as of January 31, 2007. We estimate that our total number of shareholders is approximately 78,000 when we include both registered and beneficial holders of our common stock.



Index	Period Ending					
	12/31/01	12/31/02	12/31/03	12/31/04	12/31/05	12/31/06
Realty Income Corporation	100.00	127.47	155.01	207.56	187.93	255.60
Russell 2000	100.00	79.52	117.09	138.55	144.86	171.47
Realty Income Peer Group*	100.00	99.70	138.63	179.85	195.10	250.33
SNL Triple Net REITS Index	100.00	109.49	155.72	195.60	203.64	270.09

*Realty Income Peer Group consists of 33 companies (excluding Realty Income) with an implied market capitalization between \$1.5 billion to \$3.0 billion as of September 30, 2006.

REALTY INCOME CORPORATION AND SUBSIDIARIES

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”, “expect”, “believe”, “intend” 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. (“Crest”).

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 proceedings 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 filed with the Securities and Exchange Commission, or SEC. 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.

COMPANY INFORMATION

SENIOR 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

OTHER EXECUTIVE OFFICERS

Robert J. Israel
Senior Vice President,
Research

Kim S. Kundrak
Senior Vice President,
Portfolio Acquisitions

Michael K. Press
Senior Vice President,
Financial Sponsors & Banking

Theresa M. Casey
Vice President,
Information Technologies

Gregory J. Fahey
Vice President,
Controller

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

Tere H. Miller
Vice President,
Corporate Communications

Mitchell N. White
Vice President,
Business Development

Steve D. Burchett
Associate Vice President,
Senior Legal Counsel

Jill M. Cossaboom
Associate Vice President,
Assistant Controller

Kristin K. Ferrell
Associate Vice President,
Portfolio Management

Jenette O'Brien
Associate Vice President,
Senior Legal Counsel

SUBSIDIARY COMPANY

Crest Net Lease, Inc.
Cary J. Wenthur
President

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



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.



The check's been in
the mail for 37 years.
(no kidding!)



REALTY  INCOME

The Monthly Dividend Company®

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LISTED
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