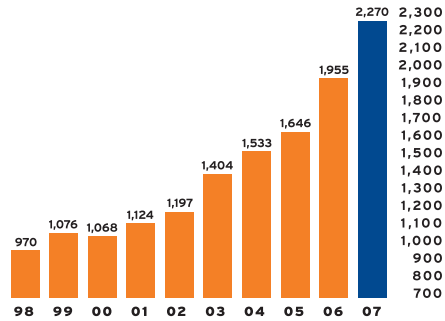
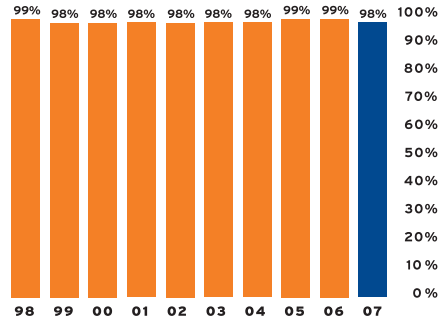


# THE MONTHLY DIVIDEND COMPANY®

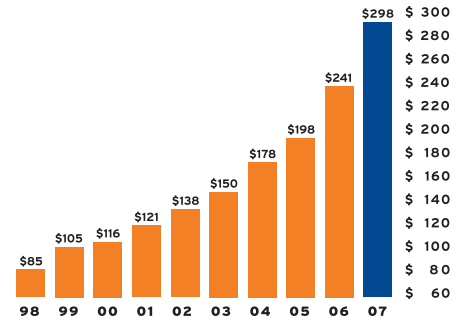
**NUMBER OF PROPERTIES**



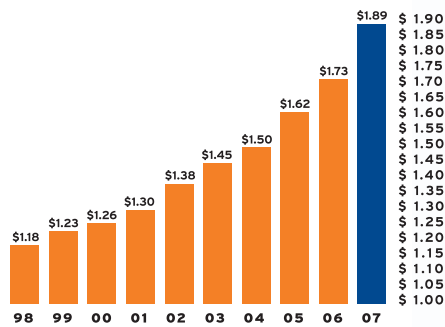
**PORTFOLIO OCCUPANCY**



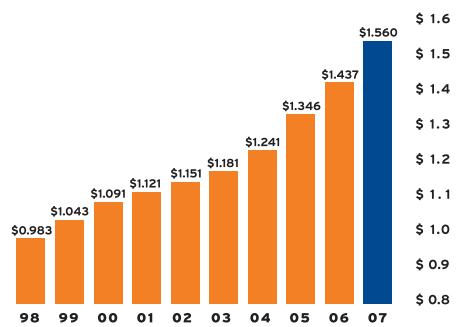
**TOTAL REVENUE**



**FFO PER SHARE**



**DIVIDENDS PAID PER SHARE**



AS THE CHARTS ON THE COVER ILLUSTRATE, 2007 WAS AN EXTREMELY POSITIVE YEAR FOR THE OPERATIONS OF YOUR COMPANY. DURING THE YEAR WE MADE SUBSTANTIAL PROGRESS IN INCREASING THE SIZE OF THE REAL ESTATE PORTFOLIO, MAINTAINED HIGH PORTFOLIO OCCUPANCY, AND GENERATED RECORD INCREASES IN OUR FUNDS FROM OPERATIONS, WHICH ALLOWED US TO SUBSTANTIALLY RAISE THE AMOUNT OF THE MONTHLY DIVIDEND. GENERATING ADDITIONAL CASH FLOW TO PAY INCREASING DIVIDENDS HAS BEEN THE GOAL OF "THE MONTHLY DIVIDEND COMPANY®" SINCE ITS FOUNDING BACK IN 1969. WE ARE PLEASED WITH THE PROGRESS WE'VE MADE IN ACHIEVING THAT GOAL OVER THE PAST 38 YEARS.

## MISSION STATEMENT

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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 2,270 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.

## 2007 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 449 consecutive monthly dividends since 1970
SHARE PRICE PERFORMANCE:	12/31/06 closing price: \$27.70 12/31/07 closing price: \$27.02 2.4% decrease
RETURNS TO SHAREHOLDERS:	Dividend yield of 5.6% Share price decrease of 2.4% Total return of 3.2% for 2007
TOTAL MARKET CAPITALIZATION:	\$4.55 billion on 12/31/07
BALANCE SHEET:	Very strong
PROPERTY MORTGAGE DEBT:	Zero (\$0)
REAL ESTATE PORTFOLIO:	2,270 retail properties leased to 115 retailers in 30 retail industries located throughout 49 states
PORTFOLIO OCCUPANCY:	97.9% on 12/31/07
PROPERTY ACQUISITIONS:	Bought 357 properties for \$534 million

## 2008 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 OVER TIME

For the Years Ended December 31,	2007	2006	2005	2004
Total revenue <sup>(1)</sup>	\$ 297,396,000	\$ 240,626,000	\$ 197,751,000	\$ 177,606,000
Net income available to common stockholders	116,156,000	99,419,000	89,716,000	90,168,000
Funds from operations ("FFO") <sup>(2)</sup>	189,675,000	155,799,000	129,647,000	118,181,000
Dividends paid to common stockholders	157,659,000	129,667,000	108,575,000	97,420,000
Special dividend paid				
<b>AT YEAR END</b>				
Real estate at cost, before accumulated depreciation <sup>(3)</sup>	\$ 3,238,794,000	\$ 2,743,973,000	\$ 2,096,156,000	\$ 1,691,283,000
Number of properties	2,270	1,955	1,646	1,533
Gross leasable square feet	18,504,800	16,740,100	13,448,600	11,986,100
Properties acquired <sup>(4)</sup>	357	378	156	194
Cost of properties acquired <sup>(4)</sup>	\$ 533,726,000	\$ 769,900,000	\$ 486,553,000	\$ 215,314,000
Properties sold	10	13	23	43
Number of retail industries	30	29	29	30
Number of states	49	48	48	48
Portfolio occupancy rate	97.9%	98.7%	98.5%	97.9%
Remaining weighted average lease term in years	13.0	12.9	12.4	12.0
<b>PER COMMON SHARE DATA<sup>(5)</sup></b>				
Net income (diluted)	\$ 1.16	\$ 1.11	\$ 1.12	\$ 1.15
Funds from operations ("FFO") <sup>(2)</sup>	1.89	1.73	1.62	1.50
Dividends paid	1.560	1.437	1.346	1.241
Special dividend				
Annualized dividend amount <sup>(6)</sup>	1.641	1.518	1.395	1.32
Common shares outstanding	101,082,717	100,746,226	83,696,647	79,301,630
<b>INVESTMENT RESULTS</b>				
Closing price on December 31,	\$ 27.02	\$ 27.70	\$ 21.62	\$ 25.29
Dividend yield <sup>(7)(8)(9)</sup>	5.6%	6.7%	5.3%	6.2%
Total return to stockholders <sup>(9)(10)</sup>	3.2%	34.8%	-9.2%	32.7%

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

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

<sup>(3)</sup> Does not include properties held for sale.

<sup>(4)</sup> Includes properties acquired by Realty Income and Crest Net Lease.

	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%

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

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

<sup>(7)</sup> Dividend yield was calculated by dividing the dividend paid per share, during the year, by the closing share price on December 31 of the previous year.

<sup>(8)</sup> Dividend yield excludes special dividends.

	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
	1.02	0.96	.23	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%

<sup>(9)</sup> The 1994 dividend yield is based on the annualized dividends for the period from August 15, 1994 (the date of the consolidation of the predecessors to the Company) to December 31, 1994. The 1994 total return is based on the price change from the closing on October 18, 1994 (the Company's first day of trading) to December 31, 1994 plus the annualized dividend yield.

<sup>(10)</sup> Total return was calculated by dividing the net change in the share price, during the year, plus the dividends paid per share, during the year, by the closing share price on December 31 of the preceding year.



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# CEO LETTER TO SHAREHOLDERS

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Dear Shareholders,

I am very pleased to report to you that during 2007 your Company had the best operating performance in its 38-year history. During the year we made excellent progress in all areas of the Company's business, including strong real estate portfolio performance, access to attractively priced capital, substantial progress in our real estate acquisition program, and solid financial performance that allowed us to raise the dividend five times. We believe our continued success is the result of a business strategy that has proven to be resilient through many years of varying economic conditions. As we begin 2008, we believe we are well positioned to achieve continued operating success and to pursue our mission of providing dependable monthly income that increases over time.

## HIGHLIGHTS OF 2007 (as compared to 2006)

- Revenue rose 23.8% to \$296.5 million
- Funds from operations (FFO) increased 21.8% to \$189.7 million
- Common stock dividends paid increased 21.6% to \$157.7 million
- Portfolio occupancy of 97.9% at year end
- Large and diverse portfolio of 2,270 properties located in 49 states occupied by 115 different retailers in 30 different industries
- Same store rents increased 1.4%
- 357 new properties acquired for \$533.7 million
- Issued \$550 million of senior unsecured notes issued in September of 2007
- Zero balance on our credit facility and \$193.1 million in cash to pursue 2008 acquisitions
- No mortgages on any of our properties



## INVESTOR RETURNS

During 2007, we paid 12 monthly dividends on our common stock and increased the amount of the dividend five times. Dividends paid per share increased 8.6% and shareholders who owned our stock for the entire year received \$1.56 per share in dividends during 2007.

Investors who have owned Realty Income for many years also benefited from the regular payment of dividends and dividend increases. For example, shareholders who purchased shares ten years ago (12/31/97), now enjoy a current yield on the original cost of their shares of 12.9% and have received back 95.6% of their original dollars invested because of consistent and increasing payments of dividends. (See "The Magic of

Rising Dividends Over Time" table below).

The price of Realty Income's shares was \$27.02 at December 31, 2007, a decrease of \$0.68, as compared to the closing price of \$27.70 on December 31, 2006. As sometimes happens in the financial markets, the closing price of our shares, at year end, did not reflect the record operating results we achieved in 2007. While this may be somewhat disappointing, it is important to realize that neither our fundamental business nor our operations were the cause of this modest share price decrease during the year.

As for total return in 2007, combining the dividends paid of 5.6% with the share price decrease of 2.4%, shareholders achieved a total return of 3.2% for 2007.

### The Magic of Rising Dividends Over Time

\* Based on 12/31/07 Annualized Dividend Per Share Amount of \$1.641.

Yield on Cost					The Cumulative Dividend Effect	
1,000 Shares Purchase Date	Original Investment	Original Dividends	Original Yield	Current Yield on Cost*	Dividends Received to Date	% of Original Investment Paid Back
10/18/94	\$ 8,000.00	\$ 900.00	11.3%	20.5%	\$ 15,360.00	192.0%
12/31/94	\$ 8,562.50	\$ 900.00	10.5%	19.2%	\$ 15,060.00	175.9%
12/31/95	\$ 11,250.00	\$ 930.00	8.3%	14.6%	\$ 14,147.50	125.8%
12/31/96	\$ 11,937.50	\$ 945.00	7.9%	13.7%	\$ 13,101.25	109.7%
12/31/97	\$ 12,719.00	\$ 960.00	7.5%	12.9%	\$ 12,155.00	95.6%
12/31/98	\$ 12,437.50	\$ 1,020.00	8.2%	13.2%	\$ 11,172.50	89.8%
12/31/99	\$ 10,312.50	\$ 1,080.00	10.5%	15.9%	\$ 10,130.00	98.2%
12/31/00	\$ 12,437.50	\$ 1,110.00	8.9%	13.2%	\$ 9,038.75	72.7%
12/31/01	\$ 14,700.00	\$ 1,140.00	7.8%	11.2%	\$ 7,917.50	53.9%
12/31/02	\$ 17,500.00	\$ 1,170.00	6.7%	9.4%	\$ 6,766.25	38.7%
12/31/03	\$ 20,000.00	\$ 1,200.00	6.0%	8.2%	\$ 5,585.00	27.9%
12/31/04	\$ 25,290.00	\$ 1,320.00	5.2%	6.5%	\$ 4,343.75	17.2%
12/31/05	\$ 21,620.00	\$ 1,395.00	6.5%	7.6%	\$ 2,997.50	13.9%
12/31/06	\$ 27,700.00	\$ 1,518.00	5.5%	5.9%	\$ 1,560.25	5.6%
12/31/07	\$ 27,020.00	\$ 1,641.00	6.1%	6.1%		

## IT'S ABOUT FUNDS FROM OPERATIONS AND DIVIDENDS

Different people look for different things from an investment. Some look for earnings growth. Some look for dividend growth (these people generally need increasing income to replace the salaries they no longer receive). And some look for stock price growth (these more risk tolerant people generally look to achieve sizable capital gains).

What we look for as a company is funds from operations and dividend growth. Our view is that if we pay attention to the quality and growth of our funds from operations, then regular dividend payments and dividend increases should be a natural outcome. As a company, we have the most in common with investors who are looking for earnings growth and dividend growth. In the long run, we believe that our shareholders are best served when we keep our eye on what we can control (the operations of the

every year has not necessarily correlated to the movement of our stock price over the short term. Since 1999, Realty Income's FFO per share growth rate was: 4.2% in 1999, 2.4% in 2000, 3.2% in 2001, 6.2% in 2002, 5.1% in 2003, 3.4% in 2004, 8.0% in 2005, 6.8% in 2006, and 9.2% in 2007. In comparison, the Company's stock price percentage change during the same years has been: -17.1% in 1999, 20.6% in 2000, 18.2% in 2001, 19.1% in 2002, 14.3% in 2003, 26.5% in 2004, -14.5% in 2005, 28.1% in 2006 and -2.4% in 2007. You can see this more clearly in the table below that compares our dividend per share growth, FFO per share growth (our earnings or cash flow metric) and share price growth over the past 9 years. The numbers reveal historical operating performance and dividend payments that have consistently increased while share price performance has been somewhat erratic.

### Annual Per Share Comparisons

	2007	2006	2005	2004	2003	2002	2001	2000	1999
Dividend Growth	8.6%	6.8%	8.5%	5.1%	2.6%	2.7%	2.7%	4.7%	6.1%
FFO Growth	9.2%	6.8%	8.0%	3.4%	5.1%	6.2%	3.2%	2.4%	4.2%
Share Price Growth	-2.4%	28.1%	-14.5%	26.5%	14.3%	19.1%	18.2%	20.6%	-17.1%

business and our dividends) rather than on what we can't control (the day to day price of our shares).

By this, we mean that we view stock market performance in much the same way as the well-known investor, Warren Buffet, who has sometimes commented that, in the short run, the market is a voting machine that reflects people's current hopes, fears and emotions. However, in the long run, the market is more of a weighing machine, measuring a company's growth in revenue, earnings and dividends. To illustrate this, it is very interesting to note that strong performance in our operations

The point of this is that if we are income investors, what we care most about is a company's track record of consistent and increasing funds from operations and dividends and not particularly how the shares traded on any given day, week, month or year. True, we also want to protect our principal, but as most savvy investors know, if we pay attention to our operations and manage for cash flow and dividend growth, then, over the long term, the price of our shares should usually reflect our positive long term performance.

## WHAT MORE DO YOU NEED TO KNOW ABOUT YOUR COMPANY?

There are six things we think you should know about Realty Income, and I'll address them in order throughout the rest of this letter.

- I. We need to reiterate why we are in business and what we're trying to accomplish for all of us as shareholders.
- II. We should explain what our strategy is and how our business works.
- III. We need to let you know what kind of shape your company is in and how well we executed our business strategy this past year.
- IV. We need to provide insight into how we underwrite real estate acquisitions and discuss our financial and operating performance in 2007.
- V. We should give you our take on what might happen in 2008 (our crystal ball is never quite clear, but we have a few ideas).
- VI. Finally we should share our thoughts about what you ought to expect from us as an owner of Realty Income.

### I. WHY WE'RE IN BUSINESS

Realty Income is "The Monthly Dividend Company®". The mission of The Monthly Dividend Company® is to provide dependable monthly income that increases over time. This is both the reason we exist and our primary goal year after year.

The Company was founded in 1969 to invest in quality commercial properties, leased to regional and national retail chains, under long-term leases that produce consistent lease revenue. The goal then and now is to preserve capital, to produce monthly income by owning these types of properties and to increase that income over time.

Because we are dedicated to producing reliable income that rises over time, our activities and decisions are guided by the need to generate an enduring stream of lease revenue that generates the cash flow to support the regular payment of

increasing dividends. 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 on how to structure a lease agreement, the quality of the lease revenue that will be produced by the investment is front and center in our analysis. Our goal is to grow your Company and maintain a real estate portfolio that is a reliable generator of income for the long haul.

Our track record in accomplishing our mission includes:

- 449 consecutive monthly dividends paid since 1970
- 47 increases in the amount of the monthly dividend, of which 41 have been consecutive quarterly increases since 1994, and
- \$1.4 billion in dividends paid.

This dividend-paying track record is the result of the following operating performance from 1994 (when we were listed on the NYSE) until December 31, 2007:

- Increase in the number of properties that we own from 630 to 2,270
- Increase in the value of the real estate at original cost from \$451 million to \$3.2 billion
- Increase in the diversification of lease revenue from approximately 15 retail chains and 5 industries to 115 retail chains and 30 industries today
- Increase of 608% in our revenue
- Increase of 486% in our funds from operations
- Maintaining portfolio occupancy in excess of 97.5% since 1970
- Increase in the total capitalization of the company from \$325 million to \$4.55 billion.

These results indicate the importance we've placed on meeting our goal of providing dividend income that increases over time and our commitment to performing in accordance with the mission of The Monthly Dividend Company®. Producing consistent operating results and

achieving the goals set by a company is not a given in any business. It requires a workable strategy, good execution of that strategy and a consistency of commitment to the overriding mission of the company. Fundamental to Realty Income's historical success is the simplicity of its operating strategy.

## II. WHAT IS OUR STRATEGY AND HOW DOES OUR BUSINESS WORK?

### Proven Strategy

Our strategy is to acquire properties with three particular characteristics:

First, they are single-tenant, freestanding, retail properties with 15 to 20-year net leases. Second, we focus on retail chains that provide basic human needs goods and services used by consumers almost every day. And third, the properties we acquire generally provide for additional portfolio diversification by retail industry, retail chain and/or geographic location. We do our best to acquire and own these types of properties because they generate consistent, long-term lease revenue.

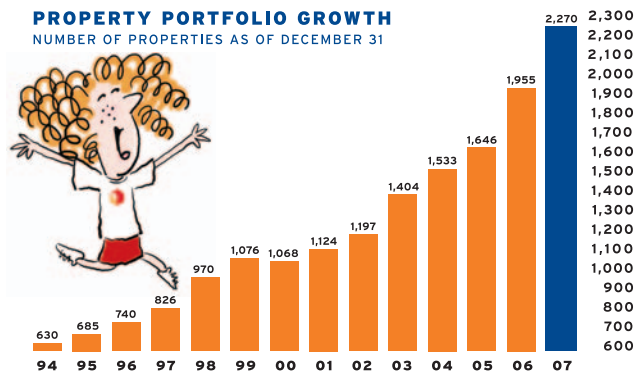
The benefit of owning real estate under net lease agreements is that the tenant (retail chain) is responsible for the payment of taxes, insurance and the maintenance of the property, rather than us. We've also said that consistency of lease revenue is important to our shareholders, so purchasing properties from retailers selling "basic human needs goods and services" offers us some degree of protection against the usual ups and downs of retail trends. (Some examples of retailers that provide these types of services are: auto parts and service stores, convenience stores, and child care centers.) A focus on acquiring freestanding retail locations provides us with real estate that is accessible and attractively located. Diversifying the source of our lease revenue by retail industry and chain, as well as by geographic

location, is also a priority because it means our lease revenue isn't overly dependent on any single retail industry, chain or area of the country.

This strategy, as simple as it is, still requires consistent execution. To acquire \$533.7 million in properties in 2007, as well as to consistently achieve a high level of acquisition success year after year is hard work (much harder than it may look). It takes a great deal of planning and organization to uncover property acquisition opportunities, decide which ones will pay us over the long term, raise attractively priced capital to purchase the properties and then monitor the properties once we own them. Making all of this work year after year is most certainly not a given, so let's take a look at the processes we have in place that have allowed us to generate real estate portfolio growth, earnings growth and dividend growth in recent years.

### How We Work

We uncover property acquisitions through the efforts of a staff of acquisition officers who have relationships with, and call on, individual retail chains, real estate developers, brokers, private equity firms, and investment banks. This requires diligence, experience, consistent contact with these firms, a good reputation for timely performance, as well as being in the right place at the right time. Since there is generally a great deal of competition for net-leased retail real estate, the advantages we



## Our business strategy is to acquire and own freestanding retail properties under 15 to 20-year leases that generate consistent long-term lease revenue from which we pay dividends.

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bring to the table are ready access to capital, solid experience in financing a variety of industries, a track record of closing transactions on time and a reputation for being reasonably easy to work with.

Once an opportunity has been identified as viable for Realty Income to review, the due diligence, or underwriting process begins. There are many real estate transactions identified that don't make it past an initial analysis, but the ones that do, go through a rigorous review process by our in-house research team, which culminates in intense discussion and analysis by the four most senior level executives who comprise our Investment Committee. (An in-depth look at our underwriting process comes later in this letter.)

If a potential transaction is approved by the Investment Committee, we then have to determine how to fund the acquisition. It's important to note that the capital funding aspect of our process does not necessarily proceed in a linear fashion with the rest of the acquisition process. The majority of the time, when a transaction is approved by the Investment Committee, we have already identified how it will be funded. Generally, we use our \$300 million acquisition credit facility to fund acquisitions for the short term. When the credit facility gets to a certain level, we typically look to permanently fund acquisitions by issuing common or preferred stock or long-term bonds. We do this because permanent funding provides us with capital at a long-term fixed cost rather than the short-term variable rate funding that is available through our acquisition credit facility.

### **Funding Acquisitions**

The Company's long-term capital structure is an important strategic discussion for our Board of Directors and senior management team. Our goal is to consistently maintain a conservative capital structure while employing the lowest cost of capital available. Achieving this optimal capital structure at any given point in time is a bit challenging and requires us to always be aware of the market environment in which we're operating so that we can access attractively priced capital given the ebb and flow of ever-changing market conditions. This often requires a great deal of patience to time capital issuances appropriately so that the capital we access meets our goals. Our bias, generally, is to issue common stock so that we minimize debt levels. We believe that this delivers a certain degree of comfort to our shareholders and also provides us with significant balance sheet flexibility so we have access to capital when attractive investment opportunities present themselves.

### **How We Increase Earnings and Funds from Operations**

Realty Income generates earnings growth in two primary ways, by increasing the size of our real estate portfolio and through regular rent increases on the real estate that we already own. We generate increasing cash flow from our new property acquisitions based on the spread, or difference, we achieve between the cost of the capital we use to acquire a property and the return, or lease yield, we receive from the property we buy. In short, the lower the cost of our capital and the higher the

lease yield on the property acquired, the greater the spread. Sounds simple, however, our ability to achieve this spread is determined by conditions in the capital markets on the one hand and conditions in the real estate market on the other.

For example, from time to time our share price increases to a level where we are able to achieve a very attractive spread between the cost of the capital we've generated for new investments and the return, or lease yield, on the properties we acquire. The timing of stock issuance is challenging, however, because share price movement is based on a variety of factors over which we have little control as well as stock market conditions that are difficult to predict. Thus, constant monitoring of market conditions is required in order to maximize our returns when we issue additional common stock.

On the other hand, there are times when we can achieve a more attractive spread, and greater earnings growth, by issuing long-term bonds or preferred stock. Our decision to issue additional long-term bonds is not totally dependent on cost of capital issues, however. Another objective is to operate with a conservative balance sheet. As such, we are constantly monitoring our capital structure so that the ratio between common stock, preferred stock and long-term bonds matches our desire for a conservative capital structure and, at the same time, we are still able to generate the earnings growth that supports regular dividend increases.

Earnings growth is also achieved through rent increases in our property portfolio that generally occur on a regular basis throughout the duration of our 15 to 20-year leases. Typically we look for annual increases, though there are many properties in our portfolio that have contractual rent increases every five years. In general, we target annual rent increases of around 1% to 2%, though this depends on the number of properties scheduled for rent increases in any given year. The foundation for reliable rent growth, however, is a consistent,

high level of occupancy arising from proactive portfolio management.

### **Staying on Top of Portfolio Performance**

To the extent that our properties and tenants have passed a rigorous due diligence process, we enjoy a certain degree of confidence that our tenants will meet their 15 to 20-year contractual lease agreements. Behind the scenes, however, there are many aspects to the consistent portfolio performance that supports the payment of monthly dividends. The research that goes into acquiring properties with good tenants in the first place is one aspect, but monitoring the month to month collection of rents and staying on top of the operations of 115 retailers and 2,270 retail stores is also critical to realizing dependable lease revenue. Realty Income's retail research group follows economic and industry trends on over 30 different retail industries and scrutinizes the operations of the retail chains in our portfolio. We monitor tenant financial health and perform tenant financial analysis with a goal to realize the consistent payment of rent every month.

Another aspect is the proactive management of the portfolio. Instead of waiting for a lease to expire to discover a retailer's intentions, our portfolio management team enters into discussions, considerably in advance of the lease expiration date, to determine our options. The markets where we own properties with leases scheduled to expire are also closely monitored to gauge whether or not it would be better to re-lease a property to the same tenant, to a new tenant, or to sell the property when the lease expires.

Finally, we must manage our real estate assets with respect to the property sales that may occur from time to time. Ascertaining whether or not to sell a particular property is not just a strategic decision, it can also represent a potential source of capital for Realty Income. Property sales occur



when we believe that the sale proceeds can be reinvested at higher returns, or when the sale of the property will enhance portfolio credit quality, or when selling the property will likely increase the average remaining lease term in the portfolio.

### III. WERE WE SUCCESSFUL IN DELIVERING ON OUR STRATEGY?

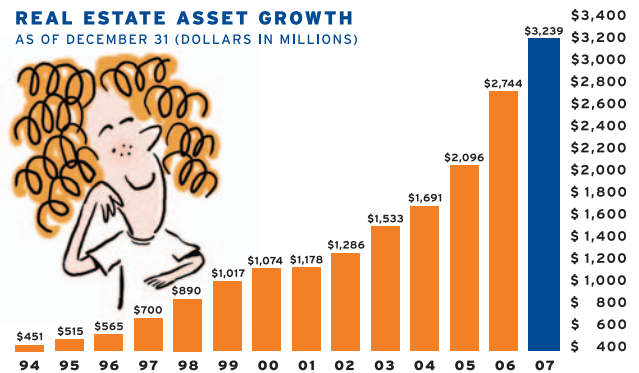
So how well did our strategy, planning and processes work for us this past year?

#### Another Very Good Acquisitions Year

During 2007, we enjoyed continued success in uncovering and acquiring the types of properties that are our strategic focus. For the year ended December 31, 2007, Realty Income and its subsidiary company, Crest Net Lease, Inc. (Crest) invested \$533.7 million in 357 new properties and properties under development. Realty Income invested \$503.8 million in 325 new properties with an initial weighted average lease yield of 8.6%. The 325 new properties, acquired by Realty Income, are located in 38 states and are 100% leased under net-lease agreements with an initial average lease length of 19.2 years. They are leased to 16 different retail chains in 9 separate industries. Crest invested \$29.9 million in 32 properties, all of which are being marketed for sale.

We achieved strong 2007 acquisitions in the face of an increasingly competitive operating environment. We would note, however, that we could have done nearly twice or more of the volume in acquisitions if we had relaxed our tenant or industry concentration standards and given just a little on our underwriting standards. But since we are The Monthly Dividend Company®, we are always mindful of the fact that we are investing dollars that provide thousands of retired people (and people nearing retirement) with much needed income.

On the other hand, there is a great deal of competition for every transaction, which puts



pressure on the lease yield that can be realized. In Investment Committee we walk a fine line between pricing and credit quality to acquire properties that we believe will be able to provide attractive long-term lease revenue. This past year proved to be somewhat more challenging with respect to what we were able to approve based on credit. The volume of acquisition opportunities remained strong, but a great many of the transactions we reviewed were a bit challenging from a credit perspective. To summarize how this played out during 2007, the Investment Committee reviewed nearly \$4 billion of potential transactions in order to acquire \$533.7 million in new properties, or about 13% of what we reviewed. This completed transaction ratio is generally consistent with the results of the past five years where we purchased 15%, 14%, 8%, 26% and 12% of what we reviewed.

While it appears that we spent a great deal of time and effort to uncover the properties we acquired, we believe that the income needs of our shareholders are best served by maintaining strict due diligence and credit underwriting standards. We believe shareholders look to us to compete based on our ability to uncover new markets and industries in which to do transactions, and based on our track record of getting deals done, rather than solely on pricing. That's why we spend a great deal of time investigating new ways to approach our business. The growth in the number of our retail industries from 5 to 30 and in the

number of our retail chains from 15 to 115 since 1994 demonstrates our ability to creatively pursue new opportunities and compete in this way. But it's important to emphasize that our approach to new ideas is to start small and then see if there is opportunity for growth. Some of the areas we've investigated don't work out so we try not to invest a large amount of capital into business areas that have not proven themselves. It is a process of first crawl, then walk, then run rather than jumping in with both feet. Nevertheless we aim to remain agile, vigilant and well capitalized in order to pursue new opportunities as they arise.

### **Access to Capital**

In terms of financing 2007 acquisitions, capital raised at the end of 2006 funded acquisitions made early in the year. Then, in September 2007, we issued \$550 million of 6.75%, senior unsecured notes, due in 2019, in an offering that was underwritten by: Joint-book running managers, Banc of America Securities LLC and Citigroup Global Markets Inc., as well as Co-managers, BMO Capital Markets Corp., BNY Capital Markets, Inc., Morgan Keegan & Company, Inc., Piper Jaffray & Co. and Wells Fargo Securities LLC.

We were pleased to have been able to access credit during a capital-constrained environment for the majority of American businesses. Demand for the 2019 notes was extremely strong and we doubled the size of the offering so that our capital requirements for 2008 would largely be met in what we believed would be a very difficult financing market in 2008. As of December 31, 2007, we had no borrowings on our \$300 million acquisition credit facility and \$193 million in cash. Our \$4.55 billion total capitalization consisted of, \$2.73 billion in common stock, \$348 million in preferred stock, and \$1.47 billion in senior unsecured notes outstanding. Our corporate credit and senior unsecured debt ratings are as follows:

Fitch Ratings, BBB+ stable outlook, Moody's Investors Services, Baa1 stable outlook, and Standard & Poor's Ratings Group, BBB positive outlook. Maintaining solid credit ratings is important as they determine the rate of interest we pay for our preferred stock and notes offerings.

### **Crest Performance**

Crest 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 has been an important strategic addition for us as it assists us in competing for large portfolio transactions so that we can manage tenant level concentrations in Realty Income's core portfolio by selling off the properties Crest acquires. During 2007, Crest acquired 32 properties for \$29.9 million. These properties are being marketed for sale in accordance with Crest's operating strategy. During 2007, Crest sold 62 properties for a gain on sales of \$12.3 million. Crest's inventory, at December 31, 2007, was \$56.2 million, which consists of 30 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 don't rely on this more volatile income stream to pay monthly dividends.

### **Portfolio Performance**

Realty Income's real estate portfolio is in excellent shape. As of December 31, 2007, we owned 2,270 retail properties located in 49 states leased to 115 retail chains doing business in 30 separate retail industries. Portfolio occupancy, as of the end of the year, was 97.9% with just 48 properties available for lease or sale. The average remaining lease term for properties in our portfolio was 13 years.

Maintaining strong portfolio occupancy year after year is largely the result of good initial underwriting and then proactively managing lease expirations. In 2007 we successfully managed 139 lease expirations and in 2008 we anticipate that our portfolio management group will work with 144 leases that come up for renewal. Our track record of effectively managing the lease expirations in the portfolio year after year is demonstrated by the consistently high portfolio occupancy we've experienced since the Company was founded 38 years ago.

In terms of properties that were identified for sale in the core portfolio, during 2007, we sold 10 properties for \$7.0 million, all of which met the strategic requirements to qualify for sale.

Finally, same store rent increases for Realty Income's portfolio were 1.4%, which is consistent with the 1% to 2% increase in rental income we hope to achieve every year.

#### **IV. CAREFUL UNDERWRITING AND RECORD FINANCIAL PERFORMANCE** **Underwriting Analysis and Process**

Our ability to rely on a tenant's property level cash flow to meet their contractual lease obligations, for the 15 to 20-year lease term, is another reason we've achieved historically high levels of occupancy. We know that finding good tenants and good properties with profitable operations can potentially neutralize portfolio performance issues in the future.

In general, our underwriting process is a three-part analysis that examines the:

1. Retail chain (tenant) and retail industry
2. Unit profitability of the stores we are acquiring
3. Real estate location

When we underwrite a particular retail chain and/or industry, we ascertain the competitive conditions of the industry, how the particular retail chain we are considering fits within the industry, the historical financial performance of the industry, the outlook for future operating performance, as

well as some indication of the challenges and opportunities that might impact the industry in the future. In addition, we meet with the management team of the individual retail chain, review audited financial statements at the corporate level and review a variety of internal operating metrics that can give us insight into the retailer's performance. Additionally, a review of available external research is completed to augment our internal research expertise.

A second important analysis is the unit profitability, or the operating results, for each individual store we are considering for purchase. This is particularly important information when we are considering the purchase of properties that are part of a large portfolio of properties. In general we seek to purchase only the most profitable stores of the retail chains, with whom we do business.

Finally, we send out real estate research people to visit every property that we are considering. Each individual property is analyzed along with the trade area in which it operates. Typically we obtain data on property values and we review area demographics, as well as analyze traffic flow, economic data and prepare comparative purchase price and rent studies for each location.

Once we've obtained all of the data that comprise the three-part analysis, the information is compiled into a report for our Investment Committee to review. The Investment Committee consists of the chief executive officer, chief operating officer, chief financial officer and general counsel. Most Fridays (and many other days) are spent reviewing research on new opportunities, watching property videos and research presentations, reviewing financial information on properties we are considering for purchase, and discussing the merits of each opportunity and each individual property.

A key metric we use in analyzing every transaction is an individual property's "cash flow coverage" ratio. To arrive at this number we divide the cash flow from the operations of each retail

location by the amount of rent that is to be paid (Cash flow or EBITDA ÷ rent). Generally speaking, we're looking for cash flow coverage of 1.75 to 4 times the required rent. This coverage ratio requirement, however, can vary according to the particular retail industry, individual retail chain, and the specific property being considered. So this useful metric tells us what, exactly?

In the simplest terms, it helps us to determine how bad things have to get before the operations of a particular retail location won't be able to support the payment of rent. Since the majority of our recent acquisitions have been large portfolio transactions, strong cash flow coverage for individual store locations is critical to the underlying stability of the overall lease revenue we receive and is one of the most important factors in determining whether we accept or reject a transaction.

### What Happens if a Tenant Gets into Financial Trouble?

Despite all of the careful due diligence and time spent reviewing every aspect of a potential transaction, there have been times when certain retail chains in our portfolio have encountered financial difficulty. In fact, we have underwritten transactions where the retail chain was already under financial pressure and we have moved forward with these transactions because both the real estate and the store level operations were strong. Our ability to successfully do business with less than investment grade retail chains and acquire properties from retail chains that are looking for alternative financing to pay

down debt, or otherwise work through their financial issues, provides us with an important competitive advantage. We have concentrated our efforts on less than investment grade tenants, for the past 38 years, because of attractive price and lease yield advantages. We believe a historical occupancy rate in excess of 97.5% (in every year since our founding in 1969) has generally indicated the effectiveness of our ability to underwrite such transactions and the soundness of our approach.

### Management Experience with Financially Challenged Tenants

When we enter into any transaction, an important part of our analysis is how we would fare if the tenant runs into financial difficulty. Generally, tenants can run into a couple of different problems that could cause them to file for bankruptcy. The first is an absolute failure of the operations of the business to generate positive cash flow. If a

business cannot generate cash flow it usually files for Chapter 7 bankruptcy and is liquidated. We believe this is pretty good public policy as a business that cannot generate positive cash flow should probably not exist.

The second is where a business generates a lot of cash flow from its operations, but management has borrowed a great deal of money to capitalize the business. As a result, the company cannot make the required interest payments. In this case, the problem isn't business operations or cash flow generation, but that the management borrowed too much money. In such a situation, the company would generally file for Chapter 11 reorganization rather than liquidation. This allows

Portfolio Occupancy (as of the end of each year)	
2007	97.9%
2006	98.7%
2005	98.5%
2004	97.9%
2003	98.1%
2002	97.7%
2001	98.2%
2000	97.7%
1999	98.4%
1998	99.5%
1997	99.2%
1996	99.1%
1995	99.3%
1994	99.4%
1969-1993	>99.0%

the company to reduce its borrowings and still continue to operate. We believe this is pretty good public policy too, by the way, as the business actually works pretty well, generates cash flow and, through the reorganization process, employees can keep their jobs and consumers can continue to do business with the company.

When we underwrite a business, our first series of questions address whether or not we believe the business could become a candidate for a Chapter 7 filing in the future. If we believe the business will not generate consistent cash flow over the long term, and could potentially become a candidate for Chapter 7 liquidation, we walk away from the transaction because there is too much risk to us as a landlord. However, if we believe it is a good business that will consistently generate positive cash flow in the future, we usually ASSUME that at some point the company could borrow too much money and perhaps become a candidate for a Chapter 11 reorganization. We then structure the transaction in a manner that would tend to minimize the risk to our rent in the event of financial difficulties.

Since our listing on the New York Stock Exchange in 1994, we've worked with about 15 tenants who have faced such financial difficulty and filed for Chapter 11 reorganization. One tenant filed for Chapter 7 liquidation. At the same time, our portfolio occupancy never dropped below 97.5%. How can this be? We have already talked about how we underwrite transactions, focusing on the ability of each store to generate more cash flow for the retail chain, than the rent it pays, and also focusing on the real estate itself. These are part of our underwriting processes for very important reasons. Let's start with the Chapter 11 reorganization. Again, the business generates a lot of cash, but not enough to pay the interest on its borrowings. So what usually happens is, the shareholders or equity owners lose all or a majority of their investment in the company during the

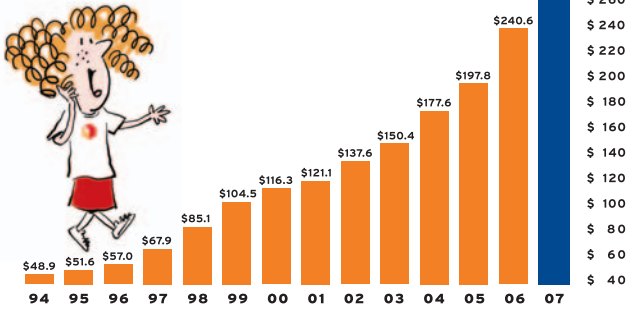
Chapter 11. That is bad for all of them, but, generally, not for us, as we are the property owners and not the shareholders. Next, the debt holders generally have all or part of their debt converted to equity. They now become the new owners or shareholders. These former debt holders, generally, no longer receive interest payments but they do have the opportunity to recoup their investment as the new equity owners. Through this process, the company decreases the amount of interest it has to pay, which was the problem to begin with. Again, not great for the debt holders, as this was not what they signed up for, but not necessarily bad for us because we are the property owners, not the debt holders.

What about our position as property owners? In the reorganization, the retail chain can either "reject" or "accept" our leases. If they reject a lease, the chain gets out of its obligation to pay us rent. We get the keys back to our property and then seek to re-lease the property to another chain. Our risk in this situation is the difference between the rent we received from the former tenant versus what we can get from a new tenant.

If they accept the lease on our property our tenant must continue to pay us rent. We've had no credit event and we continue to receive our rent from a chain that now, in general, has a lot less debt.

So how does the retail chain make the decision whether to accept or reject a lease? Well, obviously the one thing the retail chain HAS TO HAVE coming out of the reorganization is the store where they generate their cash flow. No store, no customers, no sales and no cash flow, right? Obviously, they cannot operate the stores without accepting our lease and paying rent to us as the landlord. So, during the Chapter 11, the retailer looks at each of its stores and asks a very simple question: does this store generate cash flow to the chain after paying the property owner the rent? If the store does generate good cash flow after rent, the retail

**TOTAL REVENUE<sup>(1)</sup> GROWTH**  
FOR THE YEARS ENDED  
DECEMBER 31, (DOLLARS IN MILLIONS)



chain will usually accept the lease and keep operating the store and paying rent since this is how they generate their cash flow. If not, they will reject the lease and stop operating the store. Either way, we are usually in much better shape than the other creditors, as we either keep getting our rent when the lease is accepted, or we have our asset back and can immediately seek to lease it to another retail chain if the lease is rejected.

This brings us back to our discussion about how we underwrite transactions:

1. We undergo substantial research on the retail chain's industry and on its operations and financials. The purpose of this is to assess whether it will generate reliable cash flow over the long term and, if it does run into trouble, it will likely be a Chapter 11 reorganization rather than a Chapter 7 liquidation.
2. We look carefully at the profitability of each store after it pays our rent. We seek to own properties that are very profitable to the retailers so that, even after a downturn in the business, we will own the stores they would want to accept in the event of a Chapter 11 filing.
3. We focus carefully on how much we pay for a property, its market rents and alternative uses, so that, if a property were rejected in a Chapter 11, we would seek to replicate the majority of the rent the property had previously been receiving.

We believe this is why, in the past, we have fared pretty well when one of our tenants ran into problems. However, this method of underwriting is not foolproof (us being the fools here). So, in addition, by diversifying our portfolio by industry, tenant, and geographic location, we seek to minimize the overall impact to the portfolio from a financial problem with any single tenant. We have experienced tenant difficulties many times in our 38-year history, while continuing to generate consistent performance, and we believe there will be many more such occurrences in the future. We also believe that by adhering to these underwriting standards and operating principals we should continue to prosper in the future.

**Record Financial Performance**

We enjoyed record financial performance in 2007. Revenue increased 23.8% to \$296.5 million, as compared to \$239.5 million during 2006. This year's revenue growth is primarily attributable to the high level of property acquisitions achieved in 2006 and 2007.

FFO available to common shareholders also increased 21.8% to \$189.7 million, as compared to \$155.8 million in 2006. On a diluted per common share basis, FFO increased 9.2% to \$1.89 per share as compared to \$1.73 per share in 2006. This increase in FFO and FFO per share is the result of higher than average acquisition activity throughout the year.

Realty Income's subsidiary company, Crest, also contributed to Realty Income's earnings growth during 2007. Crest generated \$10.7 million, or \$0.11 per share, in FFO for Realty Income, in comparison to \$1.4 million, or \$0.02 per share, in FFO for Realty Income in 2006.

FFO is a common financial operating 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.

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

**Our portfolio of properties is well diversified and provides us with reliable revenue that allows us to pay the consistent monthly dividends we all depend upon.**

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A reconciliation of net income available to common stockholders to FFO available to common stockholders, is included in Management's Discussion and Analysis of Financial Condition and Results of Operations on page 66.

Net income available to common stockholders, as of December 31, 2007, was \$116.2 million as compared to \$99.4 million in 2006. On a diluted per common share basis, net income was \$1.16 per share in 2007 as compared to \$1.11 per share in 2006. 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.

Same store rent increases on 1,505 properties under lease for the entire year ended December 31, 2007, increased 1.4% to \$204.2 million from \$201.3 million in 2006. To break down the same store rent increases during 2007, we had 24 industries with increases in rents, 5 with flat same store rents and one with declining same store rents, so a pretty good result in 2007.

## **V. LOOKING AHEAD—OPPORTUNITIES AND CHALLENGES IN 2008**

We believe that many companies (us included) have had a fairly easy operating environment in recent years. Interest rates have been historically low, which has allowed businesses, consumers and investors to finance their purchases of assets with higher levels of debt. This has led to increased values in the stock market, bond market, residential real estate, commercial real estate and almost all

other asset classes. At the same time, we have seen historically low default rates on mortgages, bonds, consumer loans, and virtually all other types of credit. It has been our experience that all "good runs" eventually end, asset values get a bit overdone and, at some point, things slow down. We wouldn't be surprised if 2008 is a year that, at best, we all move towards a more normal operating environment, and, at worst, we face more challenging conditions throughout the economy.

We believe we are prepared for such an environment and should be able to make progress in our operations in 2008. Our portfolio of properties has long term leases, is well diversified, and provides us with the reliable revenue that allows us to pay the consistent monthly dividends we all depend upon. Our balance sheet is extremely strong and we have limited debt maturities over the next few years, which should allow us to weather what could be a potentially challenging financing environment in 2008. At year end, we have substantial cash on hand and no balance on our \$300 million acquisition credit facility, which should allow us to capitalize on the opportunities that could present themselves in such an environment. Indeed, we believe 2008 will be a most interesting year and, once again, a profitable year for the operations of your Company.

## **VI. WHAT YOU MIGHT EXPECT FROM US**

As always, we will work hard to perform in a manner consistent with our mission. That is, we will strive to, not only pay twelve monthly dividends, but to regularly increase the amount of the monthly

dividend. To do that we will continue to work prudently to increase the size of your real estate portfolio and strive to manage the properties that you own so that they continue to perform well. We will also report our results to you so that they are both easy to understand and are communicated to you in a timely fashion.

We also think it's important to bear in mind that share prices go up and down because of a great variety of factors over which we have little control. Investor sentiment towards the market in general is a factor, people's perceptions of the consumer also weigh on the market, and research analysts are typically paid to provide opinions about which companies are likely to provide the highest return over various periods of time. All of this can impact the movement of share prices, however, not much of it has to do with the fact that we're looking to receive a dividend check in the mail every month. So our responsibility is to see that we continually build our cash flow so we can keep paying the monthly dividend and increase it on a regular basis. Our general goal is to "dividend" the stock price into submission over the long term. By that we mean that if we increase our cash flow, increase the dividend and perform according to plan, over the long term our share price should tend to reflect that performance.

As you know, in all of this there are absolutely no guarantees of success every year and all of us should be sure to diversify so that no one single security represents too much of our investment capital. You've seen, hopefully, how important diversification is to Realty Income's lease revenue stream. It is equally important to an individual investor. We will continue to attempt to stay conservative in our approach and operate within our level of competency. Hopefully, this means that the mistakes we make (and we will make some) will be small and that we learn something in the process that helps us in the future.

## A FEW LAST WORDS

We've accomplished a great deal during 2007 and believe we've operated your Company in a manner that is consistent with our mission to generate increasing monthly dividends. We also have attempted to build a company that will endure over time. There will always be challenges in accomplishing our mission. The ebb and flow of the economy, gyrations in the financial markets, and the operations of our tenants can all weigh on our results. However, we continue to believe that our proven business strategy, coupled with a conservative balance sheet, will continue to provide a firm foundation for generating increasing monthly income over time.

As always, we're grateful to the thousands of loyal shareholders, who, like us, have enjoyed years of monthly dividend checks. We look forward to reporting the progress of your Monthly Dividend Company® throughout 2008.



Sincerely,

A handwritten signature in black ink that reads "Tom A. Lewis". The signature is written in a cursive, flowing style.

Tom A. Lewis  
Chief Executive Officer





**REALTY INCOME CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**

(dollars in thousands, except per share data)

As of December 31,	2007	2006
<b>Assets</b>		
Real estate, at cost:		
Land	\$ 1,110,897	\$ 958,770
Buildings and improvements	2,127,897	1,785,203
	3,238,794	2,743,973
Less accumulated depreciation and amortization	(470,695)	(396,854)
Net real estate held for investment	2,768,099	2,347,119
Real estate held for sale, net	56,156	137,962
Net real estate	2,824,255	2,485,081
Cash and cash equivalents	193,101	10,573
Accounts receivable	7,142	5,953
Goodwill	17,206	17,206
Other assets, net	35,648	27,695
Total assets	\$ 3,077,352	\$ 2,546,508
<b>Liabilities and Stockholders' Equity</b>		
Distributions payable	\$ 15,844	\$ 15,096
Accounts payable and accrued expenses	38,112	27,004
Other liabilities	15,304	8,416
Line of credit payable	—	—
Notes payable	1,470,000	920,000
Total liabilities	1,539,260	970,516
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 shares issued and outstanding in 2007 and 2006	337,790	337,781
Common stock and paid in capital, par value \$1.00 per share, 200,000,000 shares authorized, 101,082,717 and 100,746,226 shares issued and outstanding in 2007 and 2006, respectively	1,545,037	1,540,365
Distributions in excess of net income	(344,735)	(302,154)
Total stockholders' equity	1,538,092	1,575,992
Total liabilities and stockholders' equity	\$ 3,077,352	\$ 2,546,508

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

**REALTY INCOME CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME**

(dollars in thousands, except per share data)

Years Ended December 31,	2007	2006	2005
<b>Revenue</b>			
Rental	\$ 290,159	\$ 237,487	\$ 195,099
Other	6,354	2,042	354
	296,513	239,529	195,453
<b>Expenses</b>			
Depreciation and amortization	77,192	59,288	46,002
Interest	64,331	51,363	40,949
General and administrative	22,694	17,539	15,421
Property	3,521	3,319	3,865
Income taxes	1,392	747	813
Loss on extinguishment of debt	—	1,555	—
	169,130	133,811	107,050
Income from continuing operations	127,383	105,718	88,403
Income from discontinued operations:			
Real estate acquired for resale by Crest	10,703	1,402	2,781
Real estate held for investment	2,323	3,661	7,935
	13,026	5,063	10,716
Net income	140,409	110,781	99,119
Preferred stock cash dividends	(24,253)	(11,362)	(9,403)
Net income available to common stockholders	\$ 116,156	\$ 99,419	\$ 89,716
Amounts available to common stockholders per common share:			
Income from continuing operations:			
Basic	\$ 1.03	\$ 1.05	\$ 0.99
Diluted	\$ 1.03	\$ 1.05	\$ 0.98
Net income, basic and diluted	\$ 1.16	\$ 1.11	\$ 1.12
Weighted average common shares outstanding:			
Basic	100,195,031	89,766,714	79,950,255
Diluted	100,333,966	89,917,554	80,208,593

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

**REALTY INCOME CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**

(dollars in thousands)

For the Years 2005, 2006 and 2007	Shares of Preferred stock	Shares of Common stock	Preferred stock and paid in capital	Common stock and paid in capital	Distributions in excess of net income	Total
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
Net income	—	—	—	—	140,409	140,409
Distributions paid and payable	—	—	—	—	(182,990)	(182,990)
Preferred stock issuance cost	—	—	9	—	—	9
Share-based compensation	—	336,491	—	4,672	—	4,672
Balance, December 31, 2007	13,900,000	101,082,717	\$ 337,790	\$ 1,545,037	\$ (344,735)	\$ 1,538,092

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

REALTY INCOME CORPORATION AND SUBSIDIARIES  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(dollars in thousands)

Years Ended December 31,	2007	2006	2005
<b>Cash Flows from Operating Activities</b>			
Net income	\$ 140,409	\$ 110,781	\$ 99,119
Adjustments to net income:			
Depreciation and amortization	77,192	59,288	46,002
Income from discontinued operations:			
Real estate acquired for resale	(10,703)	(1,402)	(2,781)
Real estate held for investment	(2,323)	(3,661)	(7,935)
Gain on sales of land and improvements	(1,835)	—	(18)
Gain on reinstatement of property carrying value	—	(716)	—
Amortization of share-based compensation	3,857	2,951	2,167
Provisions for impairment on real estate held for investment	138	—	151
Cash provided by (used in) discontinued operations:			
Real estate acquired for resale	(1,610)	371	(510)
Real estate held for investment	863	961	2,059
Investment in real estate acquired for resale	(29,886)	(113,166)	(54,110)
Intangibles acquired in connection with acquisition of real estate acquired for resale	—	—	(1,780)
Proceeds from sales of real estate acquired for resale	119,790	22,405	22,195
Collection of notes receivable by Crest	651	1,333	—
Change in assets and liabilities:			
Accounts receivable and other assets	(49)	4,418	(3,292)
Accounts payable, accrued expenses and other liabilities	21,675	3,382	8,290
Net cash provided by operating activities	318,169	86,945	109,557
<b>Cash Flows from Investing Activities</b>			
Proceeds from sales of investment properties:			
Continuing operations	4,370	2	109
Discontinued operations	7,014	9,804	22,191
Acquisition of and improvements to investment properties	(506,360)	(654,149)	(417,347)
Restricted escrow funds acquired in connection with acquisitions of investment properties	(2,648)	—	—
Intangibles acquired in connection with acquisitions of investment properties	(997)	(937)	(9,494)
Net cash used in investing activities	(498,621)	(645,280)	(404,541)
<b>Cash Flows from Financing Activities</b>			
Borrowings from lines of credit	407,800	523,200	400,300
Payments under lines of credit	(407,800)	(659,900)	(287,200)
Proceeds from common stock offerings, net	—	402,745	92,659
Proceeds from notes issued, net	544,397	271,883	270,266
Principal payment on notes	—	(110,000)	—
Proceeds from preferred stock offerings, net	9	213,977	—
Cash distributions to common stockholders	(157,659)	(129,667)	(108,575)
Cash dividends to preferred stockholders	(24,583)	(9,403)	(9,403)
Proceeds from other stock issuances	816	369	500
Net cash provided by financing activities	362,980	503,204	358,547
Net increase (decrease) in cash and cash equivalents	182,528	(55,131)	63,563
Cash and cash equivalents, beginning of year	10,573	65,704	2,141
Cash and cash equivalents, end of year	\$ 193,101	\$ 10,573	\$ 65,704

For supplemental disclosures, see note 13.

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

REALTY INCOME CORPORATION AND SUBSIDIARIES  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2007, 2006 and 2005

**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, 2007, we owned 2,270 properties, located in 49 states, containing over 18.5 million leasable square feet, along with 30 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 who are involved in tax-deferred exchanges under Section 1031 of the Internal Revenue Code of 1986, as amended (the “Tax Code”).

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 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 \$2.5 million in 2007, \$396,000 in 2006 and \$760,000 in 2005 and are included in discontinued operations.

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 2007 (dollars in thousands) (unaudited):

Net income available to common stockholders	\$ 116,156
Tax loss on the sale of real estate less than book gains	(3,839)
Elimination of net revenue and expenses from Crest	(6,677)
Dividends received from Crest	3,300
Preferred dividends not deductible for tax	24,583
Depreciation and amortization timing differences	22,668
Adjustment for straight-line rent	(1,217)
Adjustment for an increase in prepaid rent	5,608
Other adjustments	(164)
Estimated taxable net income, before our dividends paid deduction	\$ 160,418

In June 2006, the Financial Accounting Standards Board (“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 and clarifies the accounting for uncertainty in income taxes by defining criteria that a tax position on an individual matter must meet before that position is recognized in the financial statements. The adoption of Interpretation No. 48 in January 2007 did not impact our financial position or results of operations and we do not have any material unrecognized tax benefits or liabilities.

Absent an election to the contrary, if a REIT acquires property that is or has been owned by a C corporation in a transaction in which the tax basis of the property in the hands of the REIT is determined by reference to the tax basis of the property in the hands of the C corporation, and the REIT recognizes a gain on the disposition of such property during the 10 year period beginning on the date on which it acquired the property, then the REIT will be required to pay tax at the highest regular corporate tax rate on this gain to the extent of the excess of the fair market value of the property over the REIT’s adjusted basis in the property, in each case determined as of the date the REIT acquired the property. In August 2007, we acquired 100% of the stock of a C corporation that owned real property. At the time of acquisition, the C corporation became a Qualified REIT Subsidiary, was deemed to be liquidated for Federal income tax purposes, and the real property was deemed to be transferred to us with a carryover tax basis. As of December 31, 2007, we have built-in

gains of \$59 million with respect to such property. We do not expect that we will be required to pay income tax on the built-in gains on these properties during the ten-year period ending August 28, 2017. It is our intent, and we have the ability, to defer any dispositions of these properties to periods when the related gains would not be subject to the built-in gain income tax or otherwise to defer the recognition of the built-in gain related to these properties. However, our plans could change and it may be necessary to dispose of one or more of these properties in a taxable transaction before August 28, 2017, in which case we would be required to pay corporate level tax with respect to the built-in gains on these properties as described above.

**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 weighted average 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:

	2007	2006	2005
Weighted average shares used for the basic net income per share computation	100,195,031	89,766,714	79,950,255
Incremental shares from share-based compensation	138,935	150,840	258,338
Adjusted weighted average shares used for diluted net income per share computation	100,333,966	89,917,554	80,208,593
Nonvested shares from share-based compensation that were anti-dilutive	243,631	235,035	305,476

No stock options were anti-dilutive in 2007, 2006 or 2005.

**Discontinued Operations** In accordance with FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* ("SFAS 144"), Realty Income's operations from investment properties sold in 2007, 2006 and 2005 are reported as discontinued operations. Their respective results of operations have been reclassified to "income from discontinued operations, real estate held for investment" on our consolidated statements of income. We do not depreciate properties that are classified as held for sale. No investment properties were classified as held for sale at December 31, 2007.

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" on our consolidated statements of income.

No debt was assumed by buyers of our investment properties or repaid as a result of our investment property sales and we do not 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" on our consolidated statements of income.

The following is a summary of Crest's "income from discontinued operations, real estate acquired for resale" on our consolidated statements of income (dollars in thousands):

Crest's income from discontinued operations, real estate acquired for resale	2007	2006	2005
Gain on sales of real estate acquired for resale	\$ 12,319	\$ 2,219	\$ 3,291
Rental revenue	8,165	5,065	2,083
Other revenue	190	15	2
Interest expense	(6,201)	(3,708)	(1,139)
General and administrative expense	(691)	(440)	(453)
Property expenses	(40)	(67)	(60)
Provisions for impairment	—	(1,188)	—
Income taxes	(3,039)	(494)	(943)
Income from discontinued operations, real estate acquired for resale by Crest	\$ 10,703	\$ 1,402	\$ 2,781

The following is a summary of Realty Income's "income from discontinued operations, from real estate held for investment" on our consolidated statements of income (dollars in thousands):

Realty Income's income from discontinued operations, real estate held for investment	2007	2006	2005
Gain on sales of investment properties	\$ 1,724	\$ 3,036	\$ 6,573
Rental revenue	881	1,063	2,296
Other revenue	2	34	2
Depreciation and amortization	(130)	(320)	(662)
Property expenses	(20)	(136)	(239)
Provisions for impairment	(134)	(16)	(35)
Income from discontinued operations, real estate held for investment	\$ 2,323	\$ 3,661	\$ 7,935

The following is a summary of our total income from discontinued operations (dollars in thousands, except per share data):

	2007	2006	2005
Real estate acquired for resale by Crest	\$ 10,703	\$ 1,402	\$ 2,781
Real estate held for investment	2,323	3,661	7,935
Income from discontinued operations	\$ 13,026	\$ 5,063	\$ 10,716
Per common share, basic and diluted	\$ 0.13	\$ 0.06	\$ 0.13

The per share amounts for "income from discontinued operations" above and the "income from continuing operations" and "net income" reported on the consolidated statements 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 \$795,000 at December 31, 2007 and \$705,000 at December 31, 2006.

Other revenue includes non operating interest earned from investments in money market funds and other notes of \$3.6 million in 2007, \$1.2 million in 2006 and \$171,000 in 2005.

**Principles of Consolidation** The accompanying consolidated financial statements include the accounts of Realty Income, Crest and other entities for which we make operating and financial decisions (control), after elimination of all material intercompany balances and transactions. All of Realty Income's and Crest's subsidiaries are wholly-owned. We have no unconsolidated or off-balance sheet investments in variable interest entities.

**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. Our cash equivalents are primarily investments in United States Treasury or government money market funds.

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

**Depreciation and Amortization** Land, buildings and improvements are recorded 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, development, construction, interest and any 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
Acquired in-place operating leases	Remaining terms of the respective leases

**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.

In 2007, we recorded a provision for impairment of \$134,000 on one retail investment property in the motor vehicle industry. This provision for impairment is included in "income from discontinued operations, real estate held for investment" on our consolidated statement of income ("Discontinued Operations"). In 2007, we also recorded a provision for impairment of \$138,000 on one retail investment property in the consumer electronics industry. This provision for impairment is included in property expense on our consolidated statements of income.

In 2006, we recorded a provision for impairment of \$16,000 on one retail investment property in the restaurant industry. In 2005, we recorded provisions for impairment of \$186,000 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.

The provisions for impairment recorded on investment properties in 2006 and 2005 are included in Discontinued Operations, except for \$151,000 in 2005 which is included in property expense on our consolidated statements of income.

In 2006, Crest recorded provisions for impairment of \$1.2 million on three retail properties, which were held for resale at December 31, 2006. One of the three properties was sold in 2007. No provision for impairment was recorded by Crest in 2007 or 2005. 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 FASB 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, and 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, 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. 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.

**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 2007, 2006 or 2005.

**Other Assets** Other assets consist of the following (in thousands):

December 31,	2007	2006
Deferred bond financing costs, net	\$ 14,940	\$ 10,868
Value of in-place and above-market leases, net	11,211	10,430
Prepaid expenses	3,803	3,271
Corporate assets, net of accumulated depreciation and amortization	1,356	463
Settlements on treasury lock agreements	759	1,629
Unamortized credit line fees, net	434	954
Other items	3,145	80
	\$ 35,648	\$ 27,695

**Accounts Payable and Accrued Expenses** Accounts payable and accrued expenses consist of the following (in thousands):

December 31,	2007	2006
Bond interest payable	\$ 24,987	\$ 12,888
Other items	13,125	14,116
	\$ 38,112	\$ 27,004

**Other Liabilities.** Other liabilities consist of the following (in thousands):

December 31,	2007	2006
Rent received in advance	\$ 10,626	\$ 4,878
Security deposits	2,818	2,291
Value of in-place below-market leases, net	1,860	1,247
	\$ 15,304	\$ 8,416

**Sales Taxes** We collect and remit sales taxes assessed by different governmental authorities that are both imposed on and concurrent with a revenue-producing transaction between us and our tenants. We report the collection of these taxes on a net basis (excluded from revenues). The amounts of these taxes are not significant to our financial position or results of operations.

**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.

**Impact of Recent 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 February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities—including an Amendment of FASB Statement No. 115*. Statement No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. We have elected not to use the fair value measurement provisions of Statement No. 159.

In December 2007, the FASB issued Statement No. 141R (revised 2007), *Business Combinations*. Statement No. 141R will change the accounting for business combinations. Under Statement No. 141R, an acquiring entity will be required to

recognize all the assets acquired and liabilities assumed in a transaction at the acquisition-date fair value with limited exceptions. Statement No. 141R will change the accounting treatment and disclosures for certain specific items in a business combination. Statement No. 141R becomes effective for us at the beginning of 2009. We are still evaluating the impact of Statement No. 141R on our financial position or results of operations.

In December 2007, the FASB issued Statement No. 160, *Noncontrolling Interest in Consolidated Financial Statements*. Statement No. 160 clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. This statement also requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the noncontrolling interest and requires disclosure, on the face of the consolidated statement of income, of the amounts of consolidated net income attributable to the parent and to the noncontrolling interest. In addition, this statement establishes a single method of accounting for changes in a parent's ownership interest in a subsidiary that does not result in deconsolidation and requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated. Statement No. 160 is effective for us at the beginning of 2009. This statement will be applied prospectively, except for the presentation and disclosure requirements, which will be applied retrospectively for all periods presented. We currently do not have any minority or noncontrolling interest in a subsidiary, and we do not expect Statement No. 160 to have an impact on our consolidated financial statements; however, transactions between now and the adoption date of Statement No. 160 could have an impact on our consolidated financial statements.

**Reclassifications** Certain of the 2006 and 2005 balances have been reclassified to conform to the 2007 presentation.

### 3. RETAIL PROPERTIES ACQUIRED

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

**A.** During 2007, Realty Income and Crest invested \$533.7 million, in aggregate, in 357 new retail properties and properties under development. These 357 properties are located in 38 states, will contain over 1.9 million leasable square feet, and are 100% leased with an average lease term of 19.3 years.

In comparison, during 2006, Realty Income and Crest invested \$769.9 million, in aggregate, in 378 new retail properties and properties under development. These 378 retail properties are located in 30 states, contain over 3.8 million leasable square feet, and are 100% leased with an average lease term of 17.1 years.

**B.** Of the \$533.7 million invested during 2007, Realty Income invested \$503.8 million in 325 new retail properties and properties under development with an initial weighted average contractual lease rate of 8.6%. These 325 properties are located

in 38 states, will contain over 1.8 million leasable square feet, and are 100% leased with an average lease term of 19.2 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 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, contain over 3.3 million leasable square feet and are 100% leased with an average lease term of 16.7 years.

**C.** During 2007, Crest invested \$29.9 million in 32 new retail properties. In comparison, during 2006, Crest invested \$113.2 million in 56 retail properties.

**D.** Crest's property inventory at December 31, 2007 consisted of 30 properties with a total investment of \$56.2 million and at December 31, 2006 consisted of 60 properties with a total investment of \$137.5 million. These amounts are included on our consolidated balance sheets in "real estate held for sale, net."

**E.** Of the \$533.7 million invested in 2007, \$14.7 million was used to acquire five properties with existing leases already in-place with retail tenants. In accordance with SFAS 141, Realty Income recorded \$1.8 million as the intangible value of the in-place leases and \$784,000 as the intangible value of below-market rents. These amounts are recorded to "other assets" and "other liabilities," respectively, on our consolidated balance sheet at December 31, 2007 and are amortized over the life of the respective leases.

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 intangible value of the in-place lease and \$628,000 as the intangible value of below-market rents. These amounts were recorded to "other assets" and "other liabilities", respectively, on our consolidated balance sheet and are amortized over the life of the respective lease.

#### 4. CREDIT FACILITY

We have a \$300 million acquisition credit facility that expires in October 2008, unless extended as provided for in the credit facility agreement. We have the right to extend the credit facility for an additional term of one year (to October 2009). Since May 2007, our investment grade credit ratings provided for financing under the credit facility at LIBOR (London Interbank Offered Rate) plus 60 basis points with a facility commitment fee of 15 basis points, for all-in drawn pricing of 75 basis points over LIBOR.

The average borrowing rate on our credit facilities during 2007 was 6.0%, compared to 5.7% in 2006 and 4.3% in 2005 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. The effective borrowing rate at December 31, 2007 was 5.2% and at December 31, 2006 was 6.0%. Our current credit facility is subject to various leverage and interest coverage ratio limitations. We are and have been in compliance with these covenants.

Our credit facility is unsecured and accordingly, we have not pledged any assets as collateral for this obligation. We regularly review our credit facility and may seek to extend, renew or replace our credit facility, to the extent we deem appropriate.

#### 5. NOTES PAYABLE

Our senior unsecured note obligations consist of the following as of December 31, 2007, sorted by maturity date (dollars in millions):

8.25% notes, issued in October 1998 and due in November 2008	\$ 100.0
8% notes, issued in January 1999 and due in January 2009	20.0
5.375% notes, issued in March 2003 and due in March 2013	100.0
5.5% notes, issued in November 2003 and due in November 2015	150.0
5.95% notes, issued in September 2006 and due in September 2016	275.0
5.375% notes, issued in September 2005 and due in September 2017	175.0
6.75% notes, issued in September 2007 and due in August 2019	550.0
5.875% bonds, issued in March 2005 and due in March 2035	100.0
	\$ 1,470.0

Interest incurred on all of the notes for 2007 was \$67.1 million, for 2006 was \$49.6 million and for 2005 was \$39.5 million. In addition, when our 7.75% senior unsecured notes due 2007 were redeemed in September 2006, 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. Interest on all of the senior note obligations is paid semiannually, with the exception of the interest on the 8.25% 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.

In September 2007, we issued \$550 million in aggregate principal amount of 6.75% senior unsecured notes due 2019 (the "2019 Notes"). The price to the investor for the 2019 Notes was 99.827% of the principal amount for an effective yield of 6.772%. The net proceeds of approximately \$544.4 million from this offering were used to fund certain property acquisitions, repay borrowings under our acquisition credit facility and for general corporate purposes. The remaining net proceeds, which are included in "cash and cash equivalents" on our 2007 consolidated balance sheet, will be used for general corporate purposes, which include additional property acquisitions.

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 for general corporate purposes and to redeem the outstanding \$110 million 7.75% 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 5.375% 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.

In March 2005, we issued \$100 million in aggregate principal amount of 5.875% 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.

In May 1998, we entered into a treasury interest rate lock agreement associated with the 8.25% senior notes issued in October 1998 (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 notes) as a yield adjustment to interest expense. After taking into effect the results of the treasury lock settlement, the effective rate to us on the 2008 Notes is 9.12%.

The following table summarizes the maturity of our notes payable as of December 31, 2007 (dollars in millions):

Year of Maturity <sup>(1)</sup>	Notes
2008	\$ 100.0
2009	20.0
After 2012	1,350.0
<b>Totals</b>	<b>\$ 1,470.0</b>

<sup>(1)</sup> There are no maturities in 2010, 2011 and 2012.

We anticipate paying off the notes due in 2008 and 2009 by one or more of the following; using cash on hand, utilizing our credit facility or issuing new securities.

## 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 new property acquisitions 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.

## 7. PREFERRED STOCK

**A.** In December 2006, we issued 8.8 million shares of 6.75% Monthly Income Class E cumulative redeemable preferred stock. 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. During 2007, we paid twelve monthly dividends to holders of our Class E preferred stock totaling \$1.725 per share, or \$15.2 million, and at December 31, 2007 a monthly dividend of \$0.140625 per share was payable and was paid in January 2008. In January 2007, we paid the first Class E preferred dividend of \$0.178125, which covered a period of 38 days.

**B.** In 2004, we issued 5.1 million shares of 7.375% Monthly Income Class D cumulative redeemable preferred stock. The net proceeds of \$123.8 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 acquisition credit facility and for other general corporate purposes. Beginning May 27, 2009, the Class D preferred shares are redeemable, at our option, for \$25 per share. During 2007, 2006 and 2005, we paid twelve monthly dividends to holders of our Class D preferred stock totaling \$1.8437508, or \$9.4 million, and at December 31, 2007 a monthly dividend of \$0.1536459 was payable and was paid in January 2008.

## 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:

Month	2007	2006	2005
January	\$ 0.126500	\$ 0.116250	\$ 0.110000
February	0.126500	0.116250	0.110000
March	0.126500	0.116250	0.110000
April	0.127125	0.116875	0.110625
May	0.127125	0.116875	0.110625
June	0.127125	0.116875	0.110625
July	0.127750	0.117500	0.111250
August	0.127750	0.117500	0.111250
September	0.135500	0.125250	0.115000
October	0.136125	0.125875	0.115625
November	0.136125	0.125875	0.115625
December	0.136125	0.125875	0.115625
Total	\$ 1.560250	\$ 1.437250	\$ 1.346250

The following presents the federal income tax characterization of distributions paid or deemed to be paid per common share for the years (unaudited):

	2007	2006	2005
Ordinary income	\$ 1.3847719	\$ 1.2945466	\$ 1.210091
Nontaxable distributions	0.1754781	0.1427034	0.136159
Capital gain	—	—	—
Totals	\$ 1.5602500	\$ 1.4372500	\$ 1.346250

At December 31, 2007, a distribution of \$0.13675 per common share was payable and was paid in January 2008. At

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

### B. Preferred Stock

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 \$9.4 million in 2007, \$9.8 million in 2006, and \$9.4 million in 2005. The dividends paid per share to our Class D preferred stockholders for 2007, 2006 and 2005 of \$1.84375 were characterized for federal income tax purposes as ordinary income.

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 \$14.9 million in 2007 and \$1.6 million in 2006. The first Class E dividend was paid in January 2007. The dividends paid per share to our Class E preferred stockholders for 2007 of \$1.725 were characterized for federal income tax purposes as ordinary income.

## 9. OPERATING LEASES

**A.** At December 31, 2007, we owned 2,270 properties in 49 states, excluding 30 properties owned by Crest. Of these 2,270 properties, 2,259, or 99.5%, are single-tenant, retail properties and the remaining 11 are multi-tenant, distribution and office properties. At December 31, 2007, 48 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.

Rent based on a percentage of a tenants' gross sales (percentage rents) for 2007 was \$851,000, for 2006 was \$1.1 million and for 2005 was \$1.2 million, including amounts recorded to discontinued operations.

At December 31, 2007, minimum future annual rents to be received on the operating leases for the next five years and thereafter are as follows (dollars in thousands):

2008	\$ 307,983
2009	295,745
2010	286,809
2011	279,163
2012	269,310
Thereafter	2,668,430
Total	\$ 4,107,440

**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, 2007, 2006 or 2005.

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

In 2007, Crest sold 62 properties for \$123.6 million, which resulted in a gain of \$12.3 million. For two property sales during 2007, Crest provided the buyers partial financing for a total of \$3.8 million, of which \$619,000 was paid in full in November 2007. 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 2005, Crest provided a buyer partial financing of \$1.3 million for one property, which was paid in full in February 2006. Crest's gains on sales are reported before income taxes and are included in discontinued operations.

## 11. GAIN ON SALES OF INVESTMENT PROPERTIES, IMPROVEMENTS AND LAND BY REALTY INCOME

In 2007, we sold ten investment properties for \$7.0 million, which resulted in a gain of \$1.7 million. This gain is included in discontinued operations. In addition, we sold excess land and improvements from five properties for an aggregate of \$4.4 million, which resulted in a gain of \$1.8 million. This gain from the land and improvements sales is reported in "other revenue" on our consolidated statements of income because these improvements and excess land were associated with properties that continue to be owned as part of our core operations.

In 2006, we sold or exchanged 13 investment properties for \$10.7 million, which resulted in a gain of \$3.0 million that 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" on our consolidated statements of income.

## 12. FAIR VALUE OF FINANCIAL INSTRUMENTS

We believe that the carrying values reflected in the consolidated balance sheets at December 31, 2007 and 2006 reasonably approximate the fair values for cash and cash equivalents, accounts receivable, and all liabilities, due to their short-term nature, except for notes payable. In making these assessments, we used estimates. The estimated fair value of the notes payable at December 31, 2007 is \$1.413 billion and at December 31, 2006 is \$921.9 million, based upon the closing market price per note or indicative price per each note at December 31, 2007 and 2006, respectively.

## 13. SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Interest paid in 2007 was \$56.7 million, in 2006 was \$52.4 million and in 2005 was \$36.4 million.

Interest capitalized to properties under development in 2007 was \$993,000, in 2006 was \$2.2 million and in 2005 was \$1.9 million.

Income taxes paid by Realty Income and Crest in 2007 were \$4.3 million, in 2006 were \$775,000 and in 2005 were \$1.4 million.

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

**A.** Share-based compensation expense for 2007 was \$3.9 million, for 2006 was \$3.0 million and for 2005 was \$2.2 million.

**B.** See "Provisions for Impairment" in note 2 for a discussion of impairments recorded by Realty Income and Crest.

**C.** In 2007, Crest sold two properties for an aggregate of \$5.5 million and received notes totaling \$3.8 million from the buyers, of which \$619,000 was paid in full in November 2007. The remaining note is included in "other assets" on our December 31, 2007 consolidated balance sheet.

**D.** In connection with the acquisition of seven properties during 2007, we acquired restricted escrow funds totaling \$2.6 million. During 2007, all of these funds were invested in improvements to these properties.

**E.** In accordance with FASB Statement No. 143, *Accounting for Asset Retirement Obligations*, we recorded an additional \$239,000 of estimated legal obligations related to asset retirement obligations on two land leases in 2007. In 2005, an asset retirement obligation was originally established for \$402,000 to account for the difference between our obligations to the landlord under the two land leases and our subtenant's obligations to us under the subleases.

**F.** 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 on land or building and improvements.

**G.** 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” on our consolidated income statement, 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.

**H.** In 2005, Crest sold a property for \$2.8 million and issued a note of \$1.3 million, which was paid in full in 2006 and is included in “other assets” on our December 31, 2005 consolidated balance sheet.

**I.** Accrued costs on properties under development resulted in an increase in buildings and improvements 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):

	12/31/07	12/31/06
Common stock distributions	\$ 13,823	\$ 12,745
Preferred stock dividends	2,021	2,351

**K.** 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.

#### **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 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 and in May 2007. 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 2007 were \$3.9 million, during 2006 were \$3.0 million and during 2005 were \$2.2 million.

No stock options were granted after January 1, 2002 and all outstanding options were fully vested as of December 31, 2006. 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 vested over service periods of one, three, four or five years.

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

	2007		2006		2005	
	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	106,368	\$ 13.06	135,348	\$ 13.02	176,130	\$ 13.01
Options exercised	(61,361)	13.32	(28,696)	12.86	(40,352)	12.93
Options forfeited	—	—	(284)	14.7	(430)	14.70
Outstanding options, end of year	45,007	\$ 12.71	106,368	\$ 13.06	135,348	\$ 13.02
Options exercisable, end of year	45,007	\$ 12.71	106,368	\$ 13.06	119,924	\$ 12.87

At December 31, 2007, the options outstanding and exercisable had exercise prices ranging from \$10.63 to \$14.70, with a weighted average price of \$12.71, and expiration dates ranging from May 2008 to December 2011 with a weighted average remaining term of 3.1 years.

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 exercise price of the option. The market value of the Company's stock was \$27.02, \$27.70 and \$21.62 at December 31, 2007, 2006 and 2005, respectively. The total intrinsic value of options exercised during the years ended December 31, 2007, 2006 and 2005 was \$904,000, \$268,000 and \$377,000, respectively. The total intrinsic value of options vested during the years ended December 31, 2006 and 2005 was \$143,000 and \$67,000, respectively. The aggregate intrinsic value of options outstanding was \$644,000, \$1.6 million and \$1.2 million at December 31, 2007, 2006 and 2005, respectively. The aggregate intrinsic value of options exercisable at December 31, 2007, 2006 and 2005 was \$644,000, \$1.6 million and \$1.1 million, respectively.

The following table summarizes our common stock grant activity under our Stock Plan for the years 2007, 2006 and 2005. Our common stock grants vest over periods ranging from immediately to 10 years.

	2007		2006		2005	
	Number of shares	Weighted average price <sup>(1)</sup>	Number of shares	Weighted average price <sup>(1)</sup>	Number of shares	Weighted average price <sup>(1)</sup>
Outstanding nonvested shares, beginning of year	868,726	\$ 17.96	788,722	\$ 17.83	626,868	\$ 14.98
Shares granted	276,631	27.64	210,332	21.72	306,241	25.20
Shares vested	(149,284)	20.94	(125,879)	20.39	(92,811)	16.69
Shares forfeited	(1,501)	24.81	(4,449)	21.35	(51,576)	17.31
Outstanding nonvested shares, end of year	994,572	\$ 19.46	868,726	\$ 17.96	788,722	\$ 17.83

<sup>(1)</sup> Grant date fair value.



During 2007, we issued 276,631 shares of common stock under our Stock Plan. These shares vest over the following service periods: 20,000 vested upon issuance, 4,000 vest over a service period of one year, 12,000 vest over a service period of three years, 19,000 vest over a service period of five years and 221,631 vest over a service period of 10 years.

Our Stock Plan was amended on May 15, 2007. For grants made on or after May 15, 2007 the vesting schedule for shares granted to non-employee directors was amended to the following schedule:

- Shares vest in 33.33% increments on each of the first three anniversaries of the date the shares of stock are granted to directors with less than five years of service at the date of grant;
- Shares vest in 50% increments on each of the first two anniversaries of the date the shares of stock are granted to directors with six years of service at the date of grant;
- Shares are 100% vested on the first anniversary of the date the shares of stock are granted to directors with seven years of service at the date of grant; and
- There is immediate vesting as of the date the shares of stock are granted to directors with eight or more years of service at the date of grant.

On May 15, 2007, our Board of Directors also approved a new vesting schedule for shares granted to employees on or after May 15, 2007, which is as follows:

- For employees age 49 and below at the grant date, shares vest in 10% increments on each of the first ten anniversaries of the grant date;
- For employees age 50 through 55 at the grant date, shares vest in 20% increments on each of the first five anniversaries of the grant date;
- For employees age 56 at the grant date, shares vest in 25% increments on each of the first four anniversaries of the grant date;

- For employees age 57 at the grant date, shares vest in 33.33% increments on each of the first three anniversaries of the grant date;
- For employees age 58 at the grant date, shares vest in 50% increments on each of the first two anniversaries of the grant date;
- For employees age 59 at the grant date, shares are 100% vested on the first anniversary of the grant date; and
- For employees age 60 and above at the grant date, shares vest immediately on the grant date.

In addition, after they have been employed for six full months, all non-executive employees receive 200 shares of nonvested stock which vests over a five-year period.

As of December 31, 2007, the remaining unamortized share-based compensation expense totaled \$19.4 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 condition 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 our 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 in 2007, 2006 or 2005, 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 31 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, 2007 (dollars in thousands):

For the years ended December 31,	Revenue		
	2007	2006	2005
Segment rental revenue <sup>(1)</sup> :			
Automotive parts	\$ 6,347	\$ 6,066	\$ 6,077
Automotive service	14,849	16,495	15,083
Automotive tire services	21,235	14,501	13,821
Child care	24,323	24,649	24,819
Convenience stores	40,727	38,283	36,711
Drug stores	7,830	6,986	5,593
Health and fitness	14,874	10,212	7,212
Home furnishings	7,797	7,623	7,552
Home improvement	6,116	7,127	2,152
Motor vehicle dealerships	9,540	7,890	4,747
Restaurants	60,908	28,191	17,888
Sporting goods	7,443	6,829	6,747
Theaters	26,120	22,906	10,139
17 non-reportable segments	42,050	39,729	36,558
Total rental revenue	290,159	237,487	195,099
Other revenue	6,354	2,042	354
Total revenue	\$ 296,513	\$ 239,529	\$ 195,453

<sup>(1)</sup> Crest's revenue appears in "income from discontinued operations, real estate acquired for resale by Crest" and is not included in this table, which covers revenue but does not include revenue classified as part of income from discontinued operations.

Assets, as of December 31:	2007	2006
Segment net real estate:		
Automotive parts	\$ 42,555	\$ 36,026
Automotive service	101,238	104,089
Automotive tire services	212,746	211,760
Child care	91,219	96,263
Convenience stores	408,119	334,839
Drug stores	100,154	78,347
Health and fitness	169,109	102,718
Home furnishings	54,508	56,286
Home improvement	59,497	61,301
Motor vehicle dealerships	101,886	104,122
Restaurants	776,973	540,093
Sporting goods	57,135	56,291
Theaters	267,423	272,135
Crest	56,156	137,506
17 other non-reportable segments	325,537	293,305
Total segment net real estate	2,824,255	2,485,081
Other intangible assets—		
Drug stores	6,988	7,629
Other intangible assets—Theaters	2,496	2,801
Other intangible assets—		
Automotive tire services	765	—
Other intangible assets—		
Grocery stores	962	—
Other corporate assets	241,886	50,997
Total assets	\$ 3,077,352	\$ 2,546,508

## 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, 2007, we have committed \$7.9 million under construction contracts. These costs are expected to be paid in the next 12 months. In addition, we also have contingent payments for tenant improvements and leasing costs of \$743,000.

We have certain properties that are subject to ground leases which are accounted for as operating leases. At December 31, 2007, minimum future rental payments for the next five years and thereafter are as follows (dollars in thousands):

	<b>Ground leases paid by Realty Income<sup>(1)</sup></b>	<b>Ground leases paid by our tenants<sup>(2)</sup></b>	<b>Total</b>
2008	\$ 137	\$ 1,844	\$ 1,981
2009	92	1,778	1,870
2010	82	1,701	1,783
2011	69	1,668	1,737
2012	69	1,591	1,660
Thereafter	969	16,485	17,454
<b>Total</b>	<b>\$ 1,418</b>	<b>\$ 25,067</b>	<b>\$ 26,485</b>

<sup>(1)</sup> Realty Income currently pays the ground lessor directly for the rent under the ground lease. A majority of this rent is reimbursed to Realty Income as additional rent from our tenant.

<sup>(2)</sup> Our tenants, who are generally sub-tenants under the ground leases, are responsible for paying the rent under these ground leases. In the event a tenant fails to pay the ground lease rent, we are primarily responsible.

**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 <sup>(2)</sup>
<b>2007<sup>(1)</sup></b>					
Total revenue	\$ 71,198	\$ 70,589	\$ 74,080	\$ 80,646	\$ 296,513
Depreciation and amortization expense	18,083	18,475	19,559	21,075	77,192
Interest expense	12,420	13,029	16,163	22,719	64,331
Other expenses	6,207	7,151	7,458	6,791	27,607
Income from continuing operations	34,488	31,934	30,900	30,061	127,383
Income from discontinued operations	1,835	5,002	3,073	3,115	13,026
Net income	36,323	36,936	33,973	33,176	140,409
Net income available to common stockholders	30,260	30,873	27,910	27,113	116,156
Net income per common share:					
Basic	0.30	0.31	0.28	0.27	1.16
Diluted	0.30	0.31	0.28	0.27	1.16
Dividends paid per common share	0.379500	0.381375	0.391000	0.408375	1.56025
<b>2006<sup>(1)</sup></b>					
Total revenue	\$ 55,015	\$ 56,366	\$ 59,154	\$ 68,995	\$ 239,529
Depreciation and amortization expense	13,461	14,740	14,581	16,505	59,288
Interest expense	13,198	11,930	12,530	13,706	51,363
Other expenses	5,335	5,268	6,520	6,037	23,160
Income from continuing operations	23,021	24,428	25,523	32,747	105,718
Income (loss) from discontinued operations	1,867	2,212	1,035	(51)	5,063
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

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

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

REALTY INCOME CORPORATION AND SUBSIDIARIES  
REPORT 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, 2007 and 2006, 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, 2007. We also have audited Realty Income Corporation's internal control over financial reporting as of December 31, 2007, 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 these consolidated financial statements, for maintaining effective internal control over financial reporting, and for their assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on these consolidated financial statements and on Realty Income Corporation's internal control over financial reporting 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the consolidated financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

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, 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, 2007 and 2006, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles. Also in our opinion, Realty Income Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

**KPMG LLP**

San Diego, California  
February 12, 2008

## 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. Our 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 common stockholders and FFO per share through both active portfolio management and the acquisition of additional properties. Our portfolio management focus includes:

- Contractual rent increases on existing leases;
- Rent increases at the termination of existing leases, when market conditions permit; and
- The active management of our property portfolio, including re-leasing 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, 2007, we owned a diversified portfolio:

- Of 2,270 retail properties;
- With an occupancy rate of 97.9%, or 2,222 properties occupied of the 2,270 properties in the portfolio;
- With only 48 properties available for lease;
- Leased to 115 different retail chains doing business in 30 separate retail industries;
- Located in 49 states;
- With over 18.5 million square feet of leasable space; and
- With an average leasable retail space per property of approximately 8,150 square feet.

Of the 2,270 properties in the portfolio, 2,259, or 99.5%, are single-tenant, retail properties and the remaining 11 are multi-tenant, distribution and office properties. At December 31, 2007, 2,212 of the 2,259 single-tenant properties were leased with a weighted average remaining lease term (excluding extension options) of approximately 13.0 years.

In addition, at December 31, 2007, our wholly-owned taxable REIT subsidiary, Crest Net Lease, Inc. ("Crest"), had invested \$56.2 million in 30 properties, which are classified as held for sale. Crest was created to buy and sell properties, primarily to individual investors who 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 rent 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.

We commenced operations as a REIT on August 15, 1994 through the merger of 25 public and private real estate limited partnerships with and into us. 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 \$33.2 million at February 1, 2008. 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 \$64.6 million at February 1, 2008.

Our common stock is listed on The New York Stock Exchange ("NYSE") under the ticker symbol "O" with a cusip number of 756109-104. Our central index key number is 726728.

Our Class D cumulative redeemable preferred stock is listed on the NYSE under the ticker symbol "OprD" with a cusip number of 756109-609.

Our Class E cumulative redeemable preferred stock is listed on the NYSE under the ticker symbol "OprE" with a cusip number of 756109-708.

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

In February 2008, we had 75 permanent employees as compared to 70 permanent employees in February 2007.

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

## RECENT DEVELOPMENTS

### Increases in Monthly Distributions to Common Stockholders

We continue our 38-year policy of paying distributions monthly. Monthly distributions per share were increased in April 2007 by \$0.000625 to \$0.127125, in July 2007 by \$0.000625 to \$0.12775, in September 2007 by \$0.00775 to \$0.1355, in October 2007 by \$0.000625 to \$0.136125 and in January 2008 by \$0.000625 to \$0.13675. The increase in January 2008 was our 41st consecutive quarterly increase and the 47th increase in the amount of our dividend since our listing on the New York Stock Exchange, or NYSE, in 1994. In 2007, we paid the following monthly cash distributions per share: three in the amount of \$0.1265, three in the amount of \$0.127125, two in the amount of \$0.12775, one in the amount of \$0.1355 and three in the amount of \$0.136125, totaling \$1.56025. In December 2007 and January 2008, we declared distributions of \$0.13675 per share, which were paid in January 2008 and will be paid in February 2008, respectively.

The monthly distribution of \$0.13675 per share represents a current annualized distribution of \$1.641 per share, and an annualized distribution yield of approximately 6.5% based on the last reported sale price of our common stock on the NYSE of \$25.15 on February 1, 2008. Although we expect to continue our policy of paying monthly distributions, we cannot guarantee that we will maintain our current level of distributions, that we will continue our pattern of increasing distributions per share, or what our actual distribution yield will be in any future period.

### Acquisitions During 2007

During 2007, Realty Income and Crest invested \$533.7 million, in aggregate, in 357 new retail properties and properties under development. These 357 new properties are located in 38 states, will contain over 1.9 million leasable square feet, and are 100% leased with an average lease term of 19.3 years. As described below, Realty Income acquired 325 properties and Crest acquired 32 properties.

Included in the \$533.7 million is \$503.8 million invested by Realty Income in 325 new properties and properties under development, with an initial weighted average contractual lease rate of 8.6%. These 325 properties are located in 38 states, will contain over 1.8 million leasable square feet and are 100% leased with an average lease term of 19.2 years. The 325 new properties acquired by Realty Income are net-leased to 16 different retail chains in the following nine industries: automotive service, automotive tire service, convenience store, distribution and office, drug store, grocery, health and fitness, restaurant, and sporting

goods. Also included in the \$533.7 million is \$29.9 million invested by Crest in 32 new restaurant properties.

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

### Investments in Existing Properties

In 2007, we capitalized costs of \$1.9 million on existing properties in our portfolio, consisting of \$614,000 for re-leasing costs and \$1.3 million for building improvements.

### Issuance of 12-Year Senior Unsecured Notes

In September 2007, we issued \$550 million in aggregate principal amount of 6.75% senior unsecured notes due 2019 (the "2019 Notes"). The price to the investor for the 2019 Notes was 99.827% of the principal amount for an effective yield of 6.772%. The net proceeds of approximately \$544.4 million from this offering were used to fund certain acquisitions, repay borrowings under our acquisition credit facility and for general corporate purposes. The remaining net proceeds, which are included in "cash and cash equivalents" on our 2007 consolidated balance sheet, will be used for general corporate purposes, which include additional property acquisitions. Interest on the 2019 Notes is paid semiannually.

### Credit Ratings Upgrade

In April 2007, Moody's Investors Service upgraded our senior unsecured debt rating to Baa1 from Baa2 and our preferred stock rating to Baa2 from Baa3, with a stable outlook.

### Standard & Poor's MidCap 400 Index

In November 2007, we were added to the Standard & Poor's ("S&P") MidCap 400 Index. The S&P MidCap 400 stock index covers companies with market capitalizations in the range of \$1.5 billion to \$5.5 billion and is part of a series of S&P indices.

### Net Income Available to Common Stockholders

Net income available to common stockholders was \$116.2 million in 2007 versus \$99.4 million in 2006, an increase of \$16.8 million. On a diluted per common share basis, net income was \$1.16 per share in 2007 as compared to \$1.11 per share in 2006.

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

The gain recognized from the sales of investment properties during 2007 was \$3.6 million, as compared to \$3.0 million for 2006.

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

In 2007, our FFO increased by \$33.9 million, or 21.8%, to \$189.7 million versus \$155.8 million in 2006. On a diluted per common share basis, FFO was \$1.89 in 2007 compared to \$1.73 for 2006, an increase of \$0.16, or 9.2%.

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

### **Crest's Property Sales**

During 2007, Crest sold 62 properties from its inventory for an aggregate of \$123.6 million, which resulted in a gain of \$12.3 million. Crest's gains are included in "income from discontinued operations, real estate acquired for resale by Crest" on our consolidated statements of income.

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

Crest's property inventory at December 31, 2007 totaled \$56.2 million. These properties are included in "real estate held for sale, net" on our consolidated balance sheets.

## **DISTRIBUTION POLICY**

Distributions are paid monthly to our common, Class D preferred 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 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 2007, our cash distributions totaled \$182.2 million, or approximately 113.6% of our estimated REIT taxable income of \$160.4 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 2007 cash distributions to common stockholders totaled \$157.7 million, representing 83.1% of our funds from operations available to common stockholders of \$189.7 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% (until it "sunset" or reverts to the provisions of prior law, which under current law will occur with respect to taxable years beginning after December 31, 2010). 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 their stock. Distributions above that basis, generally, will be taxable as a capital gain to stockholders who hold their shares as a capital asset. Approximately 11.2% of the distributions to our common stockholders, made or deemed to have been made in 2007, 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 than upper market retail chains;
- They generally have provided us with attractive risk-adjusted returns over time since their financial strength has, in many cases, tended to improve as their businesses have matured;
- Their relatively large size allows them to spread corporate expenses across a greater number of stores; and
- Middle market retailers typically have the critical mass to survive if a number of locations are closed due to under-performance.

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

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

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

Historically, our investment focus has been on retail industries that have a service component because we believe the lease revenue from these types of businesses is more stable. Because of this investment focus, for the quarter ended December 31, 2007, approximately 84.5% of our rental revenue was derived from retailers with a service component in their business. Furthermore, we believe these service-oriented businesses would be difficult to duplicate over the Internet and that our properties continue to perform well relative to competition from Internet businesses.

### **Credit Strategy**

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

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

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

- Industry, company, market conditions and credit profile;
- Store profitability, if profitability data is available; and
- Overall real estate characteristics, including property 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 retail 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 we deem to be profitable for the retailers;
- 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. We also regularly analyze our portfolio 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, 2007, we classified real estate owned by Crest with a carrying amount of \$56.2 million as held for sale on our balance sheet. Additionally, we anticipate selling investment properties in 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. We 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. 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, and our common stock, preferred stock and notes issued after April 2006 were all issued pursuant to this 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 1, 2008, our total outstanding credit facility borrowings and outstanding notes were \$1.47 billion, or approximately 33.7% of our total market capitalization of \$4.36 billion.

We define our total market capitalization at February 1, 2008 as the sum of:

- Shares of our common stock outstanding of 101,286,217 multiplied by the last reported sales price of our common stock on the NYSE of \$25.15 per share on February 1, 2008, or \$2.55 billion;
- Aggregate liquidation value (par value of \$25 per share) of the Class D preferred stock of \$127.5 million;
- Aggregate liquidation value (par value of \$25 per share) of the Class E preferred stock of \$220 million; and
- Outstanding notes of \$1.47 billion.

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 common stock should be the majority of our capital structure, 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.

### **\$300 Million Acquisition Credit Facility**

We have a \$300 million revolving, unsecured credit facility that expires in October 2008. In April 2007, Moody's Investors Service upgraded our credit ratings. Effective May 2007, our investment grade credit ratings provided for financing under the credit facility at the London Interbank Offered Rate, commonly referred to as LIBOR, plus 60 basis points with a facility commitment fee of 15 basis points, for all-in drawn pricing of 75 basis points over LIBOR. At February 1, 2008, we had a borrowing capacity of \$300 million available on our credit facility and no outstanding balance.

We expect to use the credit facility 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 regularly review our credit facility and may seek to extend, renew or replace our credit facility, to the extent we deem appropriate. We have the right to extend the credit facility for an additional term of one year (to October 2009).

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.

### **Credit Agency Ratings**

We are currently assigned investment grade corporate credit ratings, on our senior unsecured notes. Fitch Ratings has assigned a rating of BBB+, Moody's Investors Service has assigned a rating of Baa1 and Standard & Poor's Ratings Group has assigned a rating of BBB to our senior notes. The rating by Standard & Poor's has a "positive" outlook and the ratings by Fitch and Moody's have "stable" outlooks.

We have also been assigned investment grade credit ratings on our preferred stock. 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 preferred stock. The rating by Standard & Poor's has a "positive" outlook and the ratings by Fitch and Moody's have "stable" outlooks.

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.

### **Mortgage Debt**

We have no mortgage debt on any of our properties.

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

We 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 current financial position or results of operations are 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, 2007, our retail property portfolio consisted of 2,270 properties located in 49 states, leased to 115 retail chains doing business in 30 industry segments. Each of the 30 industry segments, represented in our property portfolio, individually accounted for no more than 24.2% of our rental revenue for the quarter ended December 31, 2007.
- **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, 2007, we owned a diversified portfolio:

- Of 2,270 retail properties;
- With an occupancy rate of 97.9%, or 2,222 properties occupied of the 2,270 properties in the portfolio;
- With only 48 properties available for lease;
- Leased to 115 different retail chains doing business in 30 separate retail industries;
- Located in 49 states;
- With over 18.5 million square feet of leasable space; and
- With an average leasable retail space per property of approximately 8,150 square feet.

In addition to our real estate portfolio, our subsidiary, Crest had invested \$56.2 million in 30 properties located in 14 states at December 31, 2007. These properties are classified as held for sale.

At December 31, 2007, 2,212, or 97.4%, of our 2,270 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 <sup>(1)</sup>						
	For the Quarter Ended December 31, 2007	For the Years Ended					
		Dec 31, 2007	Dec 31, 2006	Dec 31, 2005	Dec 31, 2004	Dec 31, 2003	Dec 31, 2002
Apparel stores	1.1%	1.2%	1.7%	1.6%	1.8%	2.1%	2.3%
Automotive collision services	1.1	1.1	1.3	1.3	1.0	0.3	—
Automotive parts	2.0	2.1	2.8	3.4	3.8	4.5	4.9
Automotive service	5.0	5.2	6.9	7.6	7.7	8.3	7.0
Automotive tire services	6.9	7.3	6.1	7.2	7.8	3.1	2.7
Book stores	0.2	0.2	0.2	0.3	0.3	0.4	0.4
Business services	*	0.1	0.1	0.1	0.1	0.1	0.1
Child care	7.7	8.4	10.3	12.7	14.4	17.8	20.8
Consumer electronics	0.9	0.9	1.1	1.3	2.1	3.0	3.3
Convenience stores	14.1	14.0	16.1	18.7	19.2	13.3	9.1
Crafts and novelties	0.3	0.3	0.4	0.4	0.5	0.6	0.4
Distribution and office	1.1	0.6	—	—	—	—	—
Drug stores	2.6	2.7	2.9	2.8	0.1	0.2	0.2
Entertainment	1.3	1.4	1.6	2.1	2.3	2.6	2.3
Equipment rental services	0.2	0.2	0.2	0.4	0.3	0.2	—
Financial services	0.2	0.2	0.1	0.1	0.1	—	—
General merchandise	0.7	0.7	0.6	0.5	0.4	0.5	0.5
Grocery stores	0.7	0.7	0.7	0.7	0.8	0.4	0.5
Health and fitness	5.3	5.1	4.3	3.7	4.0	3.8	3.8
Home furnishings	2.4	2.6	3.1	3.7	4.1	4.9	5.4
Home improvement	2.0	2.1	3.4	1.1	1.0	1.1	1.2
Motor vehicle dealerships	3.0	3.1	3.4	2.6	0.6	—	—
Office supplies	1.0	1.1	1.3	1.5	1.6	1.9	2.1
Pet supplies and services	0.8	0.9	1.1	1.3	1.4	1.7	1.7
Private education	0.7	0.8	0.8	0.8	1.1	1.2	1.3
Restaurants	24.2	21.2	11.9	9.4	9.7	11.8	13.5
Shoe stores	—	—	—	0.3	0.3	0.9	0.8
Sporting goods	2.4	2.6	2.9	3.4	3.4	3.8	4.1
Theaters	8.4	9.0	9.6	5.2	3.5	4.1	3.9
Travel plazas	0.2	0.2	0.3	0.3	0.4	0.3	—
Video rental	1.4	1.7	2.1	2.5	2.8	3.3	3.3
Other	2.1	2.3	2.7	3.0	3.4	3.8	4.4
<b>Totals</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

\* Less than 0.1%

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

## 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, 2007, 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 December 31, 2007	Percentage of Rental Revenue
<b>Tenants Providing Services</b>			
Automotive collision services	13	\$ 825	1.1%
Automotive service	237	3,921	5.0
Child care	265	5,970	7.7
Entertainment	8	999	1.3
Equipment rental services	2	150	0.2
Financial services	8	132	0.2
Health and fitness	26	4,105	5.3
Private education	6	576	0.7
Theaters	31	6,578	8.4
Other	13	1,652	2.1
	609	24,908	32.0
<b>Tenants Selling Goods and Services</b>			
Automotive parts (with installation)	30	583	0.7
Automotive tire services	153	5,387	6.9
Business services	2	37	*
Convenience stores	489	11,000	14.1
Distribution and office	3	827	1.1
Home improvement	1	57	0.1
Motor vehicle dealerships	19	2,323	3.0
Pet supplies and services	9	607	0.8
Restaurants	663	18,847	24.2
Travel plazas	1	170	0.2
Video rental	34	1,102	1.4
	1,404	40,940	52.5
<b>Tenants Selling Goods</b>			
Apparel stores	6	883	1.1
Automotive parts	59	1,004	1.3
Book stores	2	156	0.2
Consumer electronics	15	683	0.9
Crafts and novelties	4	215	0.3
Drug stores	39	2,007	2.6
General merchandise	25	556	0.7
Grocery stores	8	552	0.7
Home furnishings	42	1,897	2.4
Home improvement	31	1,451	1.9
Office supplies	10	789	1.0
Pet supplies	2	37	*
Sporting goods	14	1,874	2.4
	257	12,104	15.5
Totals	2,270	\$ 77,952	100.0%

\* Less than 0.1%

## 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 lease term expirations (excluding extension options) on our 2,212 net leased, single-tenant retail properties as of December 31, 2007 (dollars in thousands):

	Total Portfolio			Initial Expirations <sup>(3)</sup>			Subsequent Expirations <sup>(4)</sup>		
	Number of Leases Expiring <sup>(1)</sup>	Rental Revenue for the Quarter Ended 12/31/07 <sup>(2)</sup>	% of Total Rental Revenue	Number of Leases Expiring	Rental Revenue for the Quarter Ended 12/31/07	% of Total Rental Revenue	Number of Leases Expiring	Rental Revenue for the Quarter Ended 12/31/07	% of Total Rental Revenue
2008	144	\$ 3,023	4.0%	70	\$ 1,594	2.1%	74	\$ 1,429	1.9%
2009	120	2,664	3.5	37	880	1.1	83	1,784	2.4
2010	78	1,553	2.1	34	789	1.1	44	764	1.0
2011	80	2,377	3.2	36	1,368	1.8	44	1,009	1.4
2012	101	2,425	3.2	80	2,011	2.7	21	414	0.5
2013	77	3,456	4.6	67	3,205	4.3	10	251	0.3
2014	47	1,968	2.6	34	1,714	2.3	13	254	0.3
2015	90	1,810	2.4	65	1,250	1.7	25	560	0.7
2016	112	1,909	2.5	111	1,883	2.5	1	26	*
2017	50	1,956	2.6	45	1,870	2.5	5	86	0.1
2018	24	1,093	1.5	24	1,093	1.5	—	—	—
2019	95	4,675	6.2	94	4,481	5.9	1	194	0.3
2020	82	2,980	4.0	79	2,916	3.9	3	64	0.1
2021	149	5,843	7.8	148	5,788	7.7	1	55	0.1
2022	104	3,033	4.0	103	2,985	4.0	1	48	*
2023	240	6,760	9.0	239	6,735	9.0	1	25	*
2024	64	1,919	2.5	64	1,919	2.5	—	—	—
2025	76	6,329	8.4	72	6,264	8.3	4	65	0.1
2026	217	11,719	15.6	215	11,664	15.5	2	55	0.1
2027	159	3,903	5.2	159	3,903	5.2	—	—	—
2028	44	1,262	1.7	43	1,260	1.7	1	2	*
2029	35	858	1.1	35	858	1.1	—	—	—
2030	14	714	0.9	14	714	0.9	—	—	—
2031	1	51	0.1	1	51	0.1	—	—	—
2032	1	17	*	1	17	*	—	—	—
2033	3	357	0.5	3	357	0.5	—	—	—
2034	2	230	0.3	2	230	0.3	—	—	—
2037	2	354	0.5	2	354	0.5	—	—	—
2043	1	13	*	—	—	—	1	13	*
Totals	2,212	\$ 75,251	100.0%	1,877	\$ 68,153	90.7%	335	\$ 7,098	9.3%

\* Less than 0.1%

<sup>(1)</sup> Excludes ten multi-tenant properties and 48 vacant unleased properties, one of which is a multi-tenant property. The lease expirations for properties under construction are based on the estimated date of completion of those properties.

<sup>(2)</sup> Excludes revenue of \$2,701 from ten multi-tenant properties and from 48 vacant and unleased properties at December 31, 2007.

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

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

## 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, 2007 (dollars in thousands):

State (49)	Number of Properties	Percent Leased	Approximate Leasable Square Feet	Rental Revenue for the Quarter Ended December 31, 2007	Percentage of Rental Revenue
Alabama	61	98%	413,700	\$ 1,885	2.4%
Alaska	2	100	128,500	277	0.4
Arizona	79	99	394,100	2,426	3.1
Arkansas	18	100	98,500	436	0.6
California	63	98	1,124,700	4,072	5.2
Colorado	54	98	451,000	1,943	2.5
Connecticut	26	100	282,300	1,324	1.7
Delaware	17	100	33,300	372	0.5
Florida	168	98	1,450,800	6,706	8.6
Georgia	132	98	926,900	3,972	5.1
Idaho	14	100	91,900	373	0.5
Illinois	74	99	867,600	4,076	5.2
Indiana	82	98	694,400	2,971	3.8
Iowa	20	95	140,900	439	0.6
Kansas	33	97	573,500	1,109	1.4
Kentucky	22	100	111,500	701	0.9
Louisiana	33	100	190,400	970	1.2
Maine	3	100	22,500	54	0.1
Maryland	28	100	256,500	1,470	1.9
Massachusetts	69	100	587,900	2,586	3.3
Michigan	51	100	246,200	1,235	1.6
Minnesota	21	100	392,100	1,328	1.7
Mississippi	72	97	359,600	1,482	1.9
Missouri	62	98	640,100	2,121	2.7
Montana	2	100	30,000	77	0.1
Nebraska	19	100	196,300	630	0.8
Nevada	15	100	191,000	847	1.1
New Hampshire	14	100	109,900	544	0.7
New Jersey	36	100	266,100	1,905	2.4
New Mexico	8	100	56,400	193	0.2
New York	44	95	508,100	2,544	3.3
North Carolina	63	98	454,400	2,098	2.7
North Dakota	6	100	36,600	71	0.1
Ohio	128	97	813,900	3,044	3.9
Oklahoma	25	100	145,900	609	0.8
Oregon	18	94	289,100	858	1.1
Pennsylvania	97	100	630,000	2,940	3.8
Rhode Island	4	100	14,500	87	0.1
South Carolina	59	98	250,700	1,569	2.0
South Dakota	9	100	24,900	100	0.1
Tennessee	135	99	635,500	3,018	3.9
Texas	215	94	2,282,500	7,950	10.2
Utah	6	83	35,100	91	0.1
Vermont	4	100	12,700	122	0.1
Virginia	103	100	622,400	3,085	4.0
Washington	36	89	235,100	756	1.0
West Virginia	2	50	23,200	45	0.1
Wisconsin	17	94	157,400	409	0.5
Wyoming	1	100	4,200	32	*
Totals/Average	2,270	98%	18,504,800	\$ 77,952	100.0%

\* Less than 0.1%



### **Description of Leasing Structure**

At December 31, 2007, 2,212 single tenant and certain other retail properties, or 97.4%, of our 2,270 properties were net leased. In most cases, the leases:

- 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. 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 48 properties available for lease or sale at December 31, 2007, all are single-tenant properties except one. As of February 1, 2008, transactions to lease or sell 17 of the 48 properties were underway or completed. At December 31, 2007, 25 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 2007, each of our tenants accounted for less than 10% of our rental revenue.

For 2007, our tenants in the convenience store and restaurant industries accounted for approximately 14.0% and 21.2%, respectively, of our rental revenue. A downturn in any of these industries, whether nationwide or limited to specific sectors of the United States, could adversely affect tenants in these industries, which in turn could have a material adverse affect on our financial position, results of operations and our ability to pay the principal of and interest on our debt securities and other indebtedness and to make distributions on our common stock and preferred stock. Individually, each of the other industries in our property portfolio accounted for less than 10% of our rental revenue for 2007.

In addition, a substantial number of our properties are leased to middle-market retail chains that generally have more limited financial and other resources than certain upper-market retail chains, and therefore they are more likely to be adversely affected by a downturn in their respective businesses or in the regional or national economy. Some of our tenants have incurred substantial debt and therefore are more likely to be adversely affected by a downturn in their respective businesses.

Realty Income owns 116 properties and Crest owns three properties, all leased to subsidiaries of Buffets, Inc. (Buffets) and guaranteed by Buffets. Buffets is a subsidiary of Buffets Holding, Inc. ("Buffets Holdings"). On January 22, 2008, Buffets Holdings, together with each of its subsidiaries, filed voluntary petitions for reorganization under Chapter 11 of the U.S. Bankruptcy Code. As of February 12, 2008, Buffets' lease payments to us are current. Based on our analysis of the Buffets' locations owned by Realty Income, we believe that the Chapter 11 filing will not have a material adverse affect on our operations or financial position.

### **Certain Properties Under Development**

Of the 325 properties Realty Income acquired in 2007, four were development properties, all of which were occupied at December 31, 2007. 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. Crest did not acquire any development property in 2007. Both Realty Income and Crest will continue to pursue development opportunities under similar arrangements in the future.

## 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;
- Continued uncertainty in the credit 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”, “Risk Factors” 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 our Form 10-K for the fiscal year ended December 31, 2007 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.

### 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, 2007.

### Unresolved Staff Comments

There are no unresolved staff comments.

REALTY INCOME CORPORATION AND SUBSIDIARIES  
**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, 2007, we owned a diversified portfolio:

- Of 2,270 retail properties;
- With an occupancy rate of 97.9%, or 2,222 properties occupied of the 2,270 properties in the portfolio;
- With only 48 properties available for lease;
- Leased to 115 different retail chains doing business in 30 separate retail industries;
- Located in 49 states;
- With over 18.5 million square feet of leasable space; and
- With an average leasable retail space per property of approximately 8,150 square feet.

Of the 2,270 properties in the portfolio, 2,259, or 99.5%, are single-tenant, retail properties and the remaining 11 are multi-tenant, distribution and office properties. At December 31, 2007, 2,212, or 97.9%, of the 2,259 single-tenant properties were leased with a weighted average remaining lease term (excluding extension options) of approximately 13.0 years.

In addition, at December 31, 2007, our wholly-owned taxable REIT subsidiary, Crest Net Lease, Inc. ("Crest"), had invested \$56.2 million in 30 properties, which are classified as held for sale. Crest was created to buy and sell properties, primarily to individual investors who 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**

We are 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 our net cash flow generated from leases on our retail properties. We intend to retain an appropriate amount of cash as working capital. At December 31, 2007, we had cash and cash equivalents totaling \$193.1 million, which represents a portion of the proceeds from the September 2007 issuance of \$550 million of 6.75% senior unsecured notes.

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 future borrowings under our credit facility.

### **\$300 Million Acquisition Credit Facility**

We have a \$300 million revolving, unsecured credit facility that expires in October 2008. In April 2007, Moody's Investors Service upgraded our credit ratings. Since May 2007, our investment grade credit ratings provided for financing under the credit facility at the London Interbank Offered Rate, commonly referred to as LIBOR, plus 60 basis points with a facility fee of 15 basis points, for all-in drawn pricing of 75 basis points over LIBOR. At February 1, 2008, we had a borrowing capacity of \$300 million available on our credit facility and no outstanding balance.

We expect to use the credit facility 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 on our credit facility.

We regularly review our credit facility and may seek to extend, renew or replace our credit facility, to the extent we deem appropriate. We have the right to extend the credit facility for an additional term of one year (to October 2009).

### **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. We 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. 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, and our common stock, preferred stock and notes issued after April 2006 were all issued pursuant to this 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 1, 2008, our total outstanding credit facility borrowings and outstanding notes were \$1.47 billion or approximately 33.7% of our total market capitalization of \$4.36 billion.

We define our total market capitalization at February 1, 2008 as the sum of:

- Shares of our common stock outstanding of 101,286,217 multiplied by the last reported sales price of our common stock on the NYSE of \$25.15 per share on February 1, 2008, or \$2.55 billion;
- Aggregate liquidation value (par value of \$25 per share) of the Class D preferred stock of \$127.5 million;
- Aggregate liquidation value (par value of \$25 per share) of the Class E preferred stock of \$220 million; and
- Outstanding notes of \$1.47 billion.

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 common stock may be the majority of our capital structure; 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. Fitch Ratings has assigned a rating of BBB+, Moody's Investors Service has assigned a rating of Baa1 and Standard & Poor's Ratings Group has assigned a rating of BBB to our senior notes. The rating by Standard & Poor's has a "positive" outlook and the ratings by Fitch and Moody's have "stable" outlooks.

We have also been assigned investment grade credit ratings on our preferred stock. 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 preferred stock. The rating by Standard & Poor's has a "positive" outlook and the ratings by Fitch and Moody's have "stable" outlooks.

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

Our senior unsecured note obligations consist of the following as of December 31, 2007, sorted by maturity date (dollars in millions):

8.25% notes, issued in October 1998 and due in November 2008	\$ 100.0
8% notes, issued in January 1999 and due in January 2009	20.0
5.375% notes, issued in March 2003 and due in March 2013	100.0
5.5% notes, issued in November 2003 and due in November 2015	150.0
5.95% notes, issued in September 2006 and due in September 2016	275.0
5.375% notes, issued in September 2005 and due in September 2017	175.0
6.75% notes, issued in September 2007 and due in August 2019	550.0
5.875% bonds, issued in March 2005 and due in March 2035	100.0
	<hr/> <b>\$ 1,470.0</b> <hr/>

All of our outstanding notes and bonds have fixed interest rates.

Interest on all of the senior note obligations is paid semi-annually, with the exception of the interest on the 8.25% 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, as defined and calculated per the

terms of our notes. These calculations, which are not based on GAAP measurements, are presented to investors to show our ability to incur additional debt under the terms of our notes only and are not measures of our liquidity or performance. The actual amounts as of December 31, 2007 are:

Note Covenants	Required	Actual
Limitation on incurrence of total debt	≤ 60%	41.9%
Limitation on incurrence of secured debt	≤ 40%	0.0%
Debt service coverage	≥ 1.5 x	4.2 x
Maintenance of total unencumbered assets	≥ 150% of unsecured debt	239%

The following table summarizes the maturity of each of our obligations as of December 31, 2007 (dollars in millions):

#### Table of Obligations

Year of Maturity	Credit Facility <sup>(1)</sup>	Notes	Interest <sup>(2)</sup>	Ground Leases Paid by Realty Income <sup>(3)</sup>	Ground Leases Paid by Our Tenants <sup>(4)</sup>	Other <sup>(5)</sup>	Totals
2008	\$ —	\$ 100.0	\$ 91.2	\$ 0.1	\$ 1.8	\$ 8.6	\$ 201.7
2009	—	20.0	82.5	0.1	1.8	—	104.4
2010	—	—	82.4	0.1	1.7	—	84.2
2011	—	—	82.4	0.1	1.7	—	84.2
2012	—	—	82.4	0.1	1.6	—	84.1
Thereafter	—	1,350.0	505.9	1.0	16.5	—	1,873.4
Totals	\$ —	\$ 1,470.0	\$ 926.8	\$ 1.5	\$ 25.1	\$ 8.6	\$ 2,432.0

<sup>(1)</sup> There was no outstanding credit facility balance on February 1, 2008.

<sup>(2)</sup> Interest on the credit facility and notes has been calculated based on outstanding balances as of December 31, 2007 through their respective maturity dates.

<sup>(3)</sup> Realty Income currently pays the ground lessor directly for the rent under the ground lease. A majority of this rent is reimbursed to Realty Income as additional rent from our tenant.

<sup>(4)</sup> Our tenants, who are generally sub-tenants under the ground leases, are responsible for paying the rent under these ground leases. In the event a tenant fails to pay the ground lease rent, we are primarily responsible.

<sup>(5)</sup> Other consists of \$7.9 million of commitments under construction contracts and \$743,000 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. We anticipate paying off the notes due in 2008 and 2009 by one or more of the following: using cash on hand, utilizing our credit facility or issuing new securities.

### **Preferred Stock Outstanding**

In 2004, we issued 5.1 million shares of 7.375% Class D cumulative redeemable preferred stock. Beginning May 27, 2009, shares of Class D preferred stock are redeemable at our option for \$25 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 6.75% 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**

We 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 2007**

During 2007, Realty Income and Crest invested \$533.7 million, in aggregate, in 357 new retail properties and properties under development. These 357 new properties are located in 38 states, will contain over 1.9 million leasable square feet, and are 100% leased with an average lease term of 19.3 years. As described below, Realty Income acquired 325 properties and Crest acquired 32 properties.

Included in the \$533.7 million is \$503.8 million invested by Realty Income in 325 new properties and properties under development, with an initial weighted average contractual lease rate of 8.6%. These 325 properties are located in 38 states, will contain over 1.8 million leasable square feet and are 100% leased with an average lease term of 19.2 years. The 325 new properties acquired by Realty Income are net-leased to 16 different retail chains in the following nine industries: automotive service, automotive tire service, convenience store, distribution and office, drug store, grocery, health and fitness, restaurant and sporting goods. Also included in the \$533.7 million is \$29.9 million invested by Crest in 32 new restaurant properties.

The initial weighted average contractual lease rate is computed as estimated contractual net operating income (in a net-leased property that 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.

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

We continue our 38-year policy of paying distributions monthly. Monthly distributions per share were increased in April 2007 by \$0.000625 to \$0.127125, in July 2007 by \$0.000625 to \$0.12775, in September 2007 by \$0.00775 to \$0.1355, in October 2007 by \$0.000625 to \$0.136125 and in January 2008 by \$0.000625 to \$0.13675. The increase in January 2008 was our 41st consecutive quarterly increase and the 47th increase in the amount of our dividend since our listing on the New York Stock Exchange, or NYSE, in 1994. In 2007, we paid the following monthly cash distributions per share: three in the amount of \$0.1265, three in the amount of \$0.127125, two in the amount of \$0.12775, one in the amount of \$0.1355 and three in the amount of \$0.136125, totaling \$1.56025. In December 2007 and January 2008, we declared distributions of \$0.13675 per share, which were paid in January 2008 and will be paid in February 2008, respectively.

The monthly distribution of \$0.13675 per share represents a current annualized distribution of \$1.641 per share, and an annualized distribution yield of approximately 6.5% based on the last reported sale price of our common stock on the NYSE of \$25.15 on February 1, 2008. Although we expect to continue our policy of paying monthly distributions, we cannot guarantee that we will maintain our current level of distributions, that we will continue our pattern of increasing distributions per share, or what our 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, 2007, 2006 and 2005.**

#### **Rental Revenue**

Rental revenue was \$290.2 million for 2007 versus \$237.5 million for 2006, an increase of \$52.7 million, or 22.2%. Rental revenue was \$195.1 million in 2005. The increase in rental revenue in 2007 compared to 2006 is primarily attributable to:

- The 325 retail properties acquired by Realty Income in 2007, which generated \$13.6 million of rent in 2007;
- The 322 retail properties acquired by Realty Income in 2006, which generated \$53.4 million of rent in 2007 compared to \$15.7 million in 2006, an increase of \$37.7 million;
- Same store rents generated on 1,505 properties during the entire years of 2007 and 2006 increased by \$2.9 million, or 1.4%, to \$204.2 million from \$201.3 million; net of
- A decrease of \$1.2 million relating to the aggregate of (i) development properties acquired before 2006 that started paying rent in 2006, (ii) properties that were vacant during part of 2007 or 2006 and (iii) lease termination settlements. These items totaled \$17.74 million in aggregate in 2007 compared to \$18.96 million in 2006; and
- A decrease in straight-line rent and other non-cash adjustments to rent of \$274,000 in 2007 as compared to 2006.

Of the 2,270 properties in the portfolio at December 31, 2007, 2,259, or 99.5%, are single-tenant properties and the remaining 11 are multi-tenant properties. Of the 2,259 single-tenant properties, 2,212, or 97.9%, were net leased with a weighted average remaining lease term (excluding rights to extend a lease at the option of the tenant) of approximately 13.0 years at December 31, 2007. Of our 2,212 leased single-tenant properties, 1,999 or 90.4%, 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 \$836,000 in 2007, \$1.1 million in 2006 and \$1.1 million in 2005. Percentage rent in 2007 was less than 1% of rental revenue and we anticipate percentage rent to be less than 1% of rental revenue in 2008.

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, 2007, our portfolio of 2,270 retail properties was 97.9% leased with 48 properties available for lease, one of which is a multi-tenant property.

As of February 1, 2008, transactions to lease or sell 17 of the 48 properties available for lease at December 31, 2007 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.

#### **Depreciation and Amortization**

Depreciation and amortization was \$77.2 million in 2007 versus \$59.3 million in 2006 and \$46.0 million in 2005. The increases in depreciation and amortization in 2007 and 2006 were due to the acquisition of properties in 2007, 2006 and 2005, which were partially offset by property sales in these years. As discussed in the section entitled "Funds from Operations Available to Common Stockholders," depreciation and amortization is a non-cash item that is excluded from our calculation of FFO.

#### **Interest Expense**

Interest expense was \$13.0 million higher in 2007 than in 2006. Interest expense increased in 2007 primarily due to higher average outstanding balances, which were partially offset by slightly lower interest rates related to our average outstanding borrowings, and Crest's larger investment in real estate, which contributed to the increase in interest expense included in discontinued operations. We issued \$550 million of 12-year

notes in September 2007 and \$275 million of 10-year notes in September 2006, 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):

	2007	2006	2005
Interest on our credit facility and notes	\$ 67,964	\$ 54,068	\$ 40,968
Interest included in discontinued operations from real estate acquired for resale by Crest	(6,201)	(3,708)	(1,139)
Amortization of settlements on treasury lock agreement	870	717	756
Credit facility commitment fees	456	456	498
Amortization of credit facility origination costs and deferred bond financing costs	2,235	2,014	1,752
Interest capitalized	(993)	(2,184)	(1,886)
<b>Interest expense</b>	<b>\$ 64,331</b>	<b>\$ 51,363</b>	<b>\$ 40,949</b>
<b>Credit facility and notes outstanding</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>
Average outstanding balances (dollars in thousands)	\$ 1,111,914	\$ 881,669	\$ 647,301
Average interest rates	6.11%	6.13%	6.33%

At February 1, 2008, the weighted average interest rate on our notes payable of \$1.47 billion was 6.28% and the average interest rate on our credit line was 3.78%. There was no outstanding balance on our credit line at February 1, 2008.

### Interest Coverage Ratio

Our interest coverage ratio for 2007 was 4.1 times, for 2006 was 4.1 times and for 2005 was 4.4 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 on our consolidated statements of cash flow to our interest coverage amount (dollars in thousands):

	2007	2006	2005
Net cash provided by operating activities	\$ 318,169	\$ 86,945	\$ 109,557
Interest expense	64,331	51,363	40,949
Interest expense included in discontinued operations <sup>(1)</sup>	6,201	3,708	1,139
Income taxes	1,392	747	813
Income taxes included in discontinued operations <sup>(1)</sup>	3,039	494	943
Investment in real estate acquired for resale <sup>(1)(2)</sup>	29,886	113,166	55,890
Proceeds from sales of real estate acquired for resale <sup>(1)</sup>	(119,790)	(22,405)	(22,195)
Collection of a note receivable by Crest <sup>(1)</sup>	(651)	(1,333)	—
Crest provisions for impairment <sup>(1)</sup>	—	(1,188)	—
Gain on sales of real estate acquired for resale <sup>(1)</sup>	12,319	2,219	3,291
Amortization of share-based compensation	(3,857)	(2,951)	(2,167)
Changes in assets and liabilities:			
Accounts receivable and other assets	49	(4,418)	3,292
Accounts payable, accrued expenses and other liabilities	(21,675)	(3,208)	(8,290)
<b>Interest coverage amount</b>	<b>\$ 289,413</b>	<b>\$ 223,139</b>	<b>\$ 183,222</b>
Divided by interest expense <sup>(3)</sup>	\$ 70,532	\$ 55,071	\$ 42,088
<b>Interest coverage ratio</b>	<b>4.1</b>	<b>4.1</b>	<b>4.4</b>

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

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

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



### Fixed Charge Coverage Ratio

Our fixed charge coverage ratio for 2007 was 3.1 times, for 2006 was 3.4 times and for 2005 was 3.6 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 or information presented in Exhibit 12.1 to our Form 10-K.

Interest coverage amount divided by interest expense plus preferred stock dividends (dollars in thousands):

	2007	2006	2005
Interest coverage amount	\$ 289,413	\$ 223,139	\$ 183,222
Divided by interest expense plus preferred stock dividends <sup>(1)</sup>	\$ 94,785	\$ 66,433	\$ 51,491
Fixed charge coverage ratio	3.1	3.4	3.6

<sup>(1)</sup> Includes interest expense recorded to "income from discontinued operations, real estate acquired for resale by Crest" on our consolidated statements of income.

### General and Administrative Expenses

General and administrative expenses increased by \$5.2 million to \$22.7 million in 2007 versus \$17.5 million in 2006. General and administrative expenses were \$15.4 million in 2005. In 2007, general and administrative expenses as a percentage of total revenue were 7.7% as compared to 7.3% in 2006 and 7.9% in 2005. General and administrative expenses increased in 2007 primarily due to increases in employee and director compensation costs. During 2007, we added two new directors to our board of directors. We anticipate that in 2008, general and administrative expenses as a percentage of total revenue will be flat or decrease.

In February 2008, we had 75 permanent employees as compared to 70 permanent employees in February 2007. 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.

### 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, 2007, 48 properties were available for lease, as compared to 26 at December 31, 2006 and 25 at December 31, 2005.

Property expenses were \$3.5 million in 2007, \$3.3 million in 2006 and \$3.9 million in 2005. Property expenses include provisions for impairment of \$138,000 recorded for one property in 2007 and \$151,000 recorded for two properties in 2005.

### Income Taxes

Income taxes were \$1.4 million in 2007 as compared to \$747,000 in 2006 and \$813,000 in 2005. These amounts are for city and state income taxes paid by Realty Income. The increase in 2007 is due primarily to an increase in rental revenue resulting in higher city and state income tax expense and higher state tax rates.

In addition, Crest incurred state and federal income taxes of \$3.0 million in 2007 as compared to \$494,000 in 2006 and \$943,000 in 2005. The increase in Crest's 2007 income taxes over the 2006 and 2005 income taxes is due to higher taxable income, primarily attributable to higher rental revenue and higher gain on sales of real estate acquired for resale. These amounts are included in "income from discontinued operations, real estate acquired for resale by Crest" on our consolidated statements of income.

### Loss on Extinguishment of Debt

In September 2006, we redeemed all of our outstanding \$110 million, 7.75%, unsecured notes due May 2007 (the "2007 Notes"). The 2007 Notes were redeemed at a redemption price equal to 100% of the principal amount of the 2007 Notes, plus accrued and unpaid interest of \$3.2 million, as well as 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" on our consolidated statements of income.

The following is a summary of Crest's "income from discontinued operations, real estate acquired for resale" on our consolidated statements of income (dollars in thousands, except per share data):

<b>Crest's income from discontinued operations, real estate acquired for resale</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>
Gain on sales of real estate acquired for resale	\$ 12,319	\$ 2,219	\$ 3,291
Rental revenue	8,165	5,065	2,083
Other revenue	190	15	2
Interest expense	(6,201)	(3,708)	(1,139)
General and administrative expense	(691)	(440)	(453)
Property expenses	(40)	(67)	(60)
Provisions for impairment	—	(1,188)	—
Income taxes	(3,039)	(494)	(943)
<b>Income from discontinued operations, real estate acquired for resale by Crest</b>	<b>\$ 10,703</b>	<b>\$ 1,402</b>	<b>\$ 2,781</b>
<b>Per common share, basic and diluted</b>	<b>\$ 0.11</b>	<b>\$ 0.02</b>	<b>\$ 0.03</b>

Realty Income's operations from properties sold in 2007, 2006 and 2005 have been classified as discontinued operations. No investment properties were classified as held for sale at December 31, 2007. The following is a summary of Realty Income's "income from discontinued operations, real estate held for investment" on our consolidated statements of income (dollars in thousands, except per share data):

<b>Realty Income's income from discontinued operations, real estate held for investment</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>
Gain on sales of investment properties	\$ 1,724	\$ 3,036	\$ 6,573
Rental revenue	881	1,063	2,296
Other revenue	2	34	2
Depreciation and amortization	(130)	(320)	(662)
Property expenses	(20)	(136)	(239)
Provisions for impairment	(134)	(16)	(35)
<b>Income from discontinued operations, real estate held for investment</b>	<b>\$ 2,323</b>	<b>\$ 3,661</b>	<b>\$ 7,935</b>
<b>Per common share, basic and diluted</b>	<b>\$ 0.02</b>	<b>\$ 0.04</b>	<b>\$ 0.10</b>

The following is a summary of our total income from discontinued operations (dollars in thousands, except per share data):

	<b>2007</b>	<b>2006</b>	<b>2005</b>
Real estate acquired for resale by Crest	\$ 10,703	\$ 1,402	\$ 2,781
Real estate held for investment	2,323	3,661	7,935
<b>Income from discontinued operations</b>	<b>\$ 13,026</b>	<b>\$ 5,063</b>	<b>\$ 10,716</b>
<b>Per common share, basic and diluted</b>	<b>\$ 0.13</b>	<b>\$ 0.06</b>	<b>\$ 0.13</b>

### **Crest's Property Sales**

In 2007, Crest sold 62 properties for \$123.6 million, which resulted in a gain of \$12.3 million. For two property sales during 2007, Crest provided the buyers partial financing for a total of \$3.8 million, of which \$619,000 was paid in full in November 2007. 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 2005, Crest provided a buyer partial financing of \$1.3 million for one property sale, which was paid in full in February 2006. Crest's gains on sales are reported before income taxes and are included in discontinued operations.

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

At December 31, 2007, Crest had \$56.2 million invested in 30 properties, which are held for sale. At December 31, 2006, Crest's property inventory totaled \$137.5 million in 60 properties. Crest generally carries 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, Improvements and Land by Realty Income**

In 2007, we sold ten investment properties for \$7.0 million, which resulted in a gain of \$1.7 million. This gain is included in discontinued operations. In addition, we sold excess land and improvements from five properties for an aggregate of \$4.4 million, which resulted in a gain of \$1.8 million. This gain from the land and improvements sales is reported in “other revenue” on our consolidated statements of income because these improvements and excess land were associated with properties that continue to be owned as part of our core operations. 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” on our consolidated statements of income.

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, 2007, we classified real estate owned by Crest with a carrying amount of \$56.2 million as held for sale on our balance sheet. 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**

In 2007 and 2005, no provisions for impairment were recorded by Crest. In 2006, provisions for impairment of \$1.2 million were recorded by Crest on three properties. One of the three properties was sold in 2007. 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 2007, we recorded a provision for impairment of \$134,000 on one property, which is included in “income from discontinued operations, real estate held for investment” on our consolidated statement of income, as the property was subsequently sold. Additionally, we recorded a provision for impairment of \$138,000 on one property in 2007, which is included in property expense on our consolidated statement of income. In 2006, we recorded a provision for impairment of \$16,000 on one property. In 2005, we recorded provisions for impairment totaling \$186,000 on four properties. The 2006 and 2005 provisions are included in “income from discontinued operations, real estate held for investment” except for \$151,000 in 2005, which is included in property expense on our consolidated statement of income.

### **Preferred Stock Dividends**

Preferred stock cash dividends totaled \$24.3 million in 2007 as compared to \$11.4 million in 2006 and \$9.4 million in 2005.

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

Net income available to common stockholders was \$116.2 million in 2007, an increase of \$16.8 million as compared to \$99.4 million in 2006. Net income available to common stockholders in 2005 was \$89.7 million.

The calculation to determine net income available to common stockholders includes gains from the sales 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 2007, the gain recognized from the sales of investment properties was \$3.6 million as compared to \$3.0 million during 2006 and \$6.6 million in 2005. Crest's gain recognized from the sale of properties during 2007 was \$12.3 million as compared to \$2.2 million during 2006 and \$3.3 million during 2005.

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

FFO for 2007 increased by \$33.9 million, or 21.8%, to \$189.7 million as compared to \$155.8 million in 2006 and \$129.6 million in 2005. The following is a reconciliation of net income available to common stockholders (which we believe is the most comparable GAAP measure) to FFO. Also presented is information regarding distributions paid to common stockholders and the weighted average number of shares used for the basic and diluted computation per share (dollars in thousands, except per share amounts):

	2007	2006	2005
Net income available to common stockholders	\$ 116,156	\$ 99,419	\$ 89,716
Depreciation and amortization:			
Continuing operations	77,192	59,288	46,002
Discontinued operations	130	320	662
Depreciation of furniture, fixtures and equipment	(244)	(192)	(142)
Gain on sales of land and investment properties:			
Continuing operations	(1,835)	—	(18)
Discontinued operations	(1,724)	(3,036)	(6,573)
FFO available to common stockholders	\$ 189,675	\$ 155,799	\$ 129,647
FFO per common share:			
Basic	\$ 1.89	\$ 1.74	\$ 1.62
Diluted	\$ 1.89	\$ 1.73	\$ 1.62
Distributions paid to common stockholders	\$ 157,659	\$ 129,667	\$ 108,575
FFO in excess of distributions paid to common stockholders	\$ 32,016	\$ 26,132	\$ 21,072
Weighted average number of common shares used for computation per share:			
Basic	100,195,031	89,766,714	79,950,255
Diluted	100,333,966	89,917,554	80,208,593

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 properties 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 our 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.

(dollars in thousands)	2007	2006	2005
Amortization of settlements on treasury lock agreements <sup>(1)</sup>	\$ 870	\$ 717	\$ 756
Amortization of deferred note financing costs <sup>(2)</sup>	1,494	1,287	1,034
Amortization of share-based compensation	3,857	2,951	2,167
Capitalized leasing costs and commissions	(614)	(761)	(570)
Capitalized building improvements	(1,258)	(203)	(1,017)
Straight-line rent <sup>(3)</sup>	(1,217)	(1,515)	(1,360)
Provisions for impairment	272	16	186
Crest provisions for impairment	—	1,188	—
Crest gain on sale, previously reported as impairment	(271)	—	—
Gain on reinstatement of property carrying value	—	(716)	—

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

<sup>(2)</sup> Amortization of deferred note financing costs includes the amortization of costs incurred and capitalized when our notes were issued in May 1997, October 1998, January 1999, March 2003, November 2003, March 2005, September 2005, September 2006 and September 2007. These costs are being amortized over the lives of these notes. No costs associated with our credit facility agreements or annual fees paid to credit rating agencies have been included.

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

### 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 97.4%, or 2,212, of the 2,270 properties in the portfolio are leased to tenants under net leases where the tenant is responsible for property 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 RECENT ACCOUNTING PRONOUNCEMENTS

For information on the impact of recent accounting pronouncements on our business, see note 2 of the Notes to Consolidated Financial Statements.

### Item 7A: 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, 2007. 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, 2007. This information is presented to evaluate the expected cash flows and sensitivity to interest rate changes (dollars in millions):

### Expected Maturity Data

Year of maturity	Fixed rate debt	Average interest rate on fixed rate debt	Variable rate debt	Average interest rate on variable rate debt
2008 <sup>(1)(2)</sup>	\$ 100.0	8.25%	\$ —	—%
2009 <sup>(3)</sup>	20.0	8.00	—	—
2010	—	—	—	—
2011	—	—	—	—
2012	—	—	—	—
Thereafter <sup>(4)</sup>	1,350.0	6.10	—	—
Totals	\$ 1,470.0	6.28%	\$ —	—%
Fair Value <sup>(5)</sup>	\$ 1,412.5		\$ —	

<sup>(1)</sup> \$100 million matures in November 2008.

<sup>(2)</sup> The credit facility expires in October 2008. There was no outstanding credit facility balance as of February 1, 2008.

<sup>(3)</sup> \$20 million matures in January 2009.

<sup>(4)</sup> \$100 million matures in March 2013, \$150 million matures in November 2015, \$275 million matures in September 2016, \$175 million matures in September 2017, \$550 million matures in August 2019 and \$100 million matures in March 2035.

<sup>(5)</sup> We base the fair value of the fixed rate debt at December 31, 2007 on the closing market price or indicative price per each note.

The table incorporates only those exposures that exist as of December 31, 2007. 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, 2007, 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)

As of or for the years ended December 31, (dollars in thousands, except for per share data)	2007	2006	2005	2004	2003
Total assets (book value)	\$ 3,077,352	\$ 2,546,508	\$ 1,920,988	\$ 1,442,315	\$ 1,360,257
Cash and cash equivalents	193,101	10,573	65,704	2,141	4,837
Lines of credit and notes payable	1,470,000	920,000	891,700	503,600	506,400
Total liabilities	1,539,260	970,516	931,774	528,580	532,491
Total stockholders' equity	1,538,092	1,575,992	989,214	913,735	827,766
Net cash provided by operating activities	318,169	86,945	109,557	178,337	73,957
Net change in cash and cash equivalents	182,528	(55,131)	63,563	(2,696)	(4,084)
Total revenue	296,513	239,529	195,453	172,711	142,296
Income from continuing operations	127,383	105,718	88,403	81,400	70,685
Income from discontinued operations	13,026	5,063	10,716	21,997	15,750
Net income	140,409	110,781	99,119	103,397	86,435
Preferred stock cash dividends	(24,253)	(11,362)	(9,403)	(9,455)	(9,713)
Excess of redemption value over carrying value of preferred shares redeemed	—	—	—	(3,774)	—
Net income available to common stockholders	116,156	99,419	89,716	90,168	76,722
Cash distributions paid to common stockholders	157,659	129,667	108,575	97,420	83,842
Ratio of earnings to fixed charges <sup>(1)</sup>	2.9 times	2.9 times	3.2 times	3.9 times	4.1 times
Ratio of earnings to combined fixed charges and preferred stock cash dividends <sup>(1)</sup>	2.2 times	2.4 times	2.6 times	3.1 times	3.0 times
Basic and diluted net income per common share	1.16	1.11	1.12	1.15	1.08
Cash distributions paid per common share	1.56025	1.43725	1.34625	1.24125	1.18125
Cash distributions declared per common share	1.57050	1.44750	1.35250	1.25125	1.18375
Basic weighted average number of common shares outstanding	100,195,031	89,766,714	79,950,255	78,518,296	71,128,282
Diluted weighted average number of common shares outstanding	100,333,966	89,917,554	80,208,593	78,598,788	71,222,628

<sup>(1)</sup> Ratio of Earnings to Fixed Charges is calculated by dividing earnings by fixed charges. For this purpose, earnings consist of net income before interest expense, 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 7.375% Class D preferred stock in May 2004, 1,100,000 shares of our 7.375% 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, 2007, we carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer. 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 the effectiveness of the Company's internal control over financial reporting.

Submitted on February 12, 2008 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 in our internal controls, 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 2007, 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, 2007, 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.

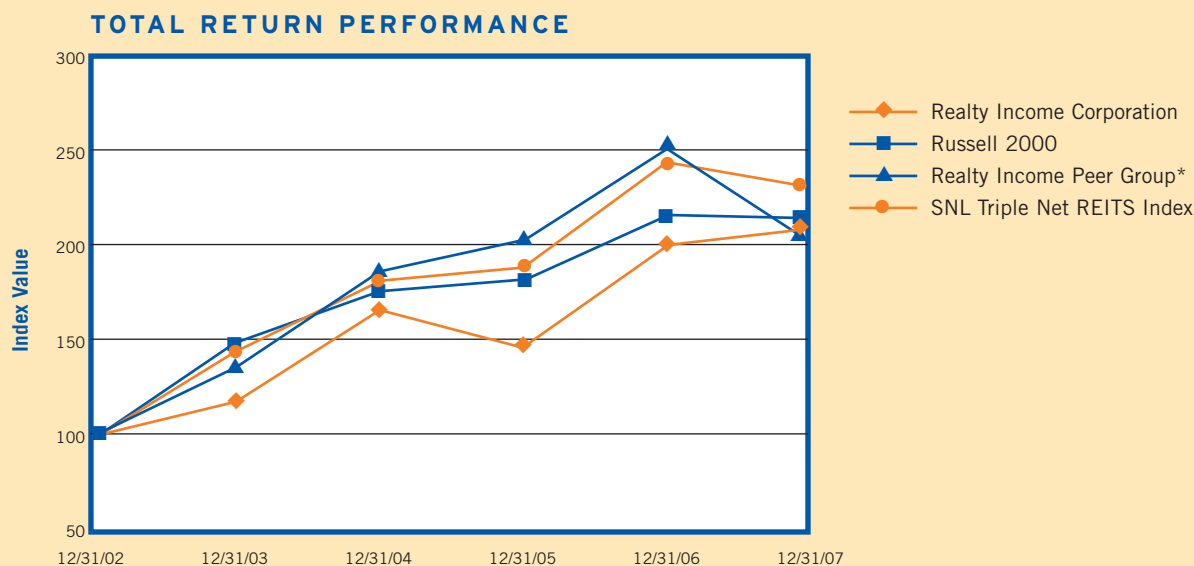
## MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

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 <sup>(1)</sup>
	High	Low	
<b>2007</b>			
First quarter	\$ 30.36	\$ 26.02	\$ 0.380125
Second quarter	29.13	24.53	0.382000
Third quarter	28.79	22.87	0.399375
Fourth quarter	30.70	26.31	0.409000
Total			\$ 1.570500
<b>2006</b>			
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

<sup>(1)</sup> Common stock cash distributions currently are declared monthly by us based on financial results for the prior months. At December 31, 2007, a distribution of \$0.13675 per common share had been declared and was paid in January 2008.

There were 9,356 registered holders of record of our common stock as of December 31, 2007. We estimate that our total number of shareholders is approximately 80,000 when we include both registered and beneficial holders of our common stock.



Index	Period Ending					
	12/31/02	12/31/03	12/31/04	12/31/05	12/31/06	12/31/07
Realty Income Corporation	100.00	121.61	162.83	147.43	200.52	207.11
Russell 2000	100.00	147.25	174.24	182.18	215.64	212.26
Realty Income Peer Group*	100.00	135.71	182.56	201.78	253.28	206.46
SNL Triple Net REITS Index	100.00	142.22	178.65	185.99	246.69	228.87

\* Realty Income Peer Group consists of thirty-five companies (excluding Realty Income) with an implied market capitalization between \$1.5 billion to \$3 billion as of September 30, 2007.

# COMPANY INFORMATION



## BOARD OF DIRECTORS

Front row: Donald R. Cameron, Dr. Kathleen R. Allen, Thomas A. Lewis, Priya Cherian Huskins, Roger P. Kuppinger, William E. Clark, Jr. Back row: Gregory T. McLaughlin, Ronald L. Merriman, Michael D. McKee, Willard H. Smith, Jr.



## MANAGEMENT TEAM

### 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 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

Dawn Nguyen  
Vice President,  
Portfolio Management

MDG (Monthly Dividend Girl)  
Vice President,  
Corporate Cheerleader

Steve D. Burchett  
Associate Vice President,  
Senior Legal Counsel

Elizabeth Cate  
Associate Vice President,  
Portfolio Management

Jill M. Cossaboom  
Associate Vice President,  
Assistant Controller

Kristin K. Ferrell  
Associate Vice President,  
Portfolio Management

Teresa M. Glenn  
Associate Vice President,  
Human Resources & Operations

Mark Manheimer  
Associate Vice President,  
Research

Jenette S. O'Brien  
Associate Vice President,  
Senior Legal Counsel

### SUBSIDIARY COMPANY

Crest Net Lease, Inc.  
Cary J. Wenthur  
President and Chief Operating Officer

### DIRECTORS

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

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

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

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

Priya Cherian Huskins  
Partner,  
Woodruff-Sawyer & Co.

Roger P. Kuppinger  
Private Investment Banker  
and Financial Advisor

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

Gregory T. McLaughlin  
President,  
Tiger Woods Foundation

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

BNY Mellon Shareholder Services  
For shareholder administration  
and account information please  
visit BNY Mellon's website to  
manage your account online at:  
[www.bnymellon.com/shareowner/isd](http://www.bnymellon.com/shareowner/isd)  
or call this toll-free number:  
1-877-218-2434  
or email your question to:  
[shrrelations@bnymellon.com](mailto:shrrelations@bnymellon.com)  
or write to:  
Shareholder Relations Department  
P.O. Box 358015  
Pittsburgh, PA 15252-8015

### 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](http://www.realtyincome.com)

Contact your financial advisor or  
Realty Income at:  
telephone: 760-741-2111  
email: [ir@realtyincome.com](mailto:ir@realtyincome.com)

Copies of Realty Income's Annual  
Report on Form 10-K are available  
upon written request to:

Realty Income Corporation  
Attention: Investor Relations  
600 La Terraza Boulevard  
Escondido, CA 92025



The Monthly Dividend Company®

600 La Terraza Boulevard  
Escondido, CA 92025