

# Imagine the Possibilities



REALTY  INCOME

The Monthly Dividend Company®

# What have Monthly Dividends

*Explore*



*Learn*



# made possible for you?



*Travel*

*Engage*

## Wish List

- Learn to do something new.
- Travel more.
- Spend more time with family.
- Give back to the community.
- Live comfortably and work part-time.
- Start a new business.
- Get closer to your financial goals.

**We'd love  
to hear  
from you.**

**Let us know how you use  
your monthly dividends by visiting  
[www.realtyincome.com/dividendpossibilities](http://www.realtyincome.com/dividendpossibilities)  
to share your dividend possibilities.**



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**We Are  
The Monthly Dividend  
Company<sup>®</sup>**

**Monthly dividends  
are our mission,  
our passion,  
our reason to be.**

**Monthly dividends  
give our shareholders  
the freedom to  
reinvent themselves,  
engage others and  
pursue their dreams.**

## **OUR LONG-TERM 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**

## **THE RESULTS SO FAR ...**

- **485 Consecutive Monthly Dividends**
- **60 Dividend Increases**
- **\$1.9 Billion in Dividends Paid**

## **2010 RESULTS**

- **2,496 Properties Owned**
- **96.6% Occupancy**
- **186 Properties Acquired for \$713.5 Million**
- **\$182.5 Million in Monthly Dividends Paid**
- **Four Dividend Increases**
- **38.6% Return to Shareholders**

# Historical Financials

For the Years Ended December 31, 2010 2009

Total revenue <sup>(1)</sup>	\$ 346,709,000	\$ 328,794,000
Net income available to common stockholders	\$ 106,531,000	\$ 106,874,000
Funds from operations ("FFO") <sup>(2)</sup>	\$ 193,713,000	\$ 190,444,000
Adjusted funds from operations ("AFFO") <sup>(2)</sup>	\$ 197,256,000	\$ 192,739,000
Dividends paid to common stockholders	\$ 182,500,000	\$ 178,008,000
Special dividend paid		

## AT YEAR END

Real estate at cost, before accumulated depreciation <sup>(3)</sup>	\$ 4,112,862,000	\$ 3,439,456,000
Number of properties	2,496	2,339
Gross leasable square feet	21,215,800	19,182,000
Properties acquired <sup>(4)</sup>	186	16
Cost of properties acquired <sup>(4)</sup>	\$ 713,534,000	\$ 57,937,000
Properties sold	28	25
Number of retail industries	32	30
Number of states	49	49
Portfolio occupancy rate	96.6%	96.8%
Remaining weighted average lease term in years	11.4	11.2

## PER COMMON SHARE DATA<sup>(5)</sup>

Net income (diluted)	\$ 1.01	\$ 1.03
Funds from operations ("FFO") <sup>(2)</sup>	\$ 1.83	\$ 1.84
Adjusted funds from operations ("AFFO") <sup>(2)</sup>	\$ 1.86	\$ 1.86
Dividends paid	\$ 1.722	\$ 1.707
Special dividend		
Annualized dividend amount <sup>(6)</sup>	\$ 1.731	\$ 1.716

Common shares outstanding	118,058,988	104,286,705
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## INVESTMENT RESULTS

Closing price on December 31,	\$ 34.20	\$ 25.91
Dividend yield <sup>(7) (8) (9)</sup>	6.6%	7.4%
Total return to stockholders <sup>(9) (10)</sup>	38.6%	19.3%

<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 and AFFO 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.

<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.



# al Performance

	2008	2007	2006	2005	2004
	\$ 331,701,000	\$ 297,396,000	\$ 240,626,000	\$ 197,751,000	\$ 177,606,000
	\$ 107,588,000	\$ 116,156,000	\$ 99,419,000	\$ 89,716,000	\$ 90,168,000
	\$ 185,524,000	\$ 189,675,000	\$ 155,799,000	\$ 129,647,000	\$ 118,181,000
	\$ 192,003,000	\$ 193,079,000	\$ 158,763,000	\$ 130,843,000	\$ 126,424,000
	\$ 169,655,000	\$ 157,659,000	\$ 129,667,000	\$ 108,575,000	\$ 97,420,000
	\$ 3,408,910,000	\$ 3,238,794,000	\$ 2,743,973,000	\$ 2,096,156,000	\$ 1,691,283,000
	2,348	2,270	1,955	1,646	1,533
	19,106,700	18,504,800	16,740,100	13,448,600	11,986,100
	108	357	378	156	194
	\$ 189,627,000	\$ 533,726,000	\$ 769,900,000	\$ 486,553,000	\$ 215,314,000
	29	10	13	23	43
	30	30	29	29	30
	49	49	48	48	48
	97.0%	97.9%	98.7%	98.5%	97.9%
	11.9	13.0	12.9	12.4	12.0
	\$ 1.06	\$ 1.16	\$ 1.11	\$ 1.12	\$ 1.15
	\$ 1.83	\$ 1.89	\$ 1.73	\$ 1.62	\$ 1.50
	\$ 1.90	\$ 1.92	\$ 1.77	\$ 1.63	\$ 1.61
	\$ 1.662	\$ 1.560	\$ 1.437	\$ 1.346	\$ 1.241
	\$ 1.701	\$ 1.641	\$ 1.518	\$ 1.395	\$ 1.32
	104,211,541	101,082,717	100,746,226	83,696,647	79,301,630
	\$ 23.15	\$ 27.02	\$ 27.70	\$ 21.62	\$ 25.29
	6.1%	5.6%	6.7%	5.3%	6.2%
	-8.2%	3.2%	34.8%	-9.2%	32.7%

<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.

<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 opening on October 18, 1994 (the Company's first day of trading) to December 31, 1994 plus the annualized dividend yield.

	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
	\$ 106,659,000	\$ 95,844,000	\$ 78,504,000	\$ 67,836,000	\$ 66,330,000
	\$ 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
	\$ 1.50	\$ 1.41	\$ 1.34	\$ 1.27	\$ 1.24
	\$ 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>(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.

	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
	\$ 62,364,000	\$ 52,077,000	\$ 47,430,000	\$ 39,668,000	\$ 39,185,000
	\$ 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	\$ 1.03	\$ 1.00	\$ 0.98
	\$ 1.17	\$ 1.10	\$ 1.03	\$ 0.98	\$ 0.98
	\$ 0.983	\$ 0.946	\$ 0.931	\$ 0.913	\$ 0.300
			\$ 0.23		
	\$ 1.02	\$ 0.96	\$ 0.945	\$ 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%

## Dear Fellow Shareholders,

As the introductory pages to this year's report suggest, we would like to hear from you about what you actually do with the monthly dividends generated by our Company.

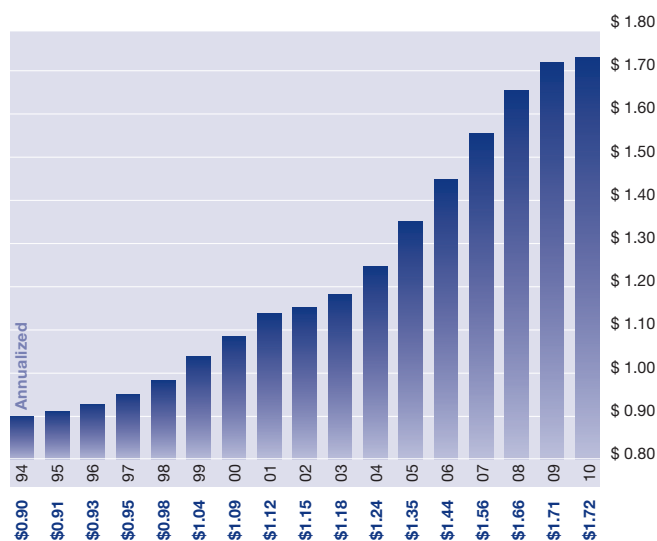
Over the years, investors have sent us letters, or shared stories with us, about their experiences as a shareholder receiving monthly dividends. These stories get passed around to our staff and inspire us to continue to focus our efforts on those activities that will generate the cash flow to pay and increase the monthly dividends we all rely on. Now we've set aside a section of our new, updated, website at [www.realtyincome.com](http://www.realtyincome.com) so that you can easily email us and tell us what monthly dividends do for you. For our part, we'll look forward to hearing all of the ways that monthly dividends from Realty Income are used by our shareholders.

I am pleased to report that, during 2010, your Company continued to collect more rent, maintain stable funds from operations and raise the dividend. Once again, The Monthly Dividend Company's strategy of owning a portfolio of properties under long-term leases that have been carefully underwritten, coupled with a conservative balance sheet, enabled us to deliver consistent results. We also added new employees during the year to assist us with our goal of accelerating our growth. In addition, we widened the net, in terms of the type of industries with which we do business (more on that later). In short, I believe we did a good job of setting the stage for additional earnings and dividend growth during 2011.

To summarize our results for 2010:

- Shareholders received 12 monthly dividends
- Dividends per common share increased 0.9%
- Investors achieved a 38.6% total return
- Revenue grew to over \$346 million
- Funds from operations increased to \$193.7 million
- We maintained a large and diverse portfolio of 2,496 properties located in 49 states occupied by 122 retail and other consumer businesses in 32 different industries
- Portfolio occupancy remained high at 96.6% at year-end
- Same store rents increased 0.6%

### DIVIDENDS PAID PER COMMON SHARE



- 186 new properties were acquired for \$713.5 million
- We raised approximately \$679 million of attractively priced new capital
- We arranged a new \$425 million credit facility for property acquisitions, ended the year with a zero balance on the facility and we had \$18 million in cash on hand

### INVESTOR RETURNS

We increased the amount of the monthly dividend four times during 2010. Dividends paid per common share increased 0.9% and common shareholders, who owned the stock for the entire year, received \$1.722 per share in dividends during 2010, as compared to \$1.707 per share in 2009.

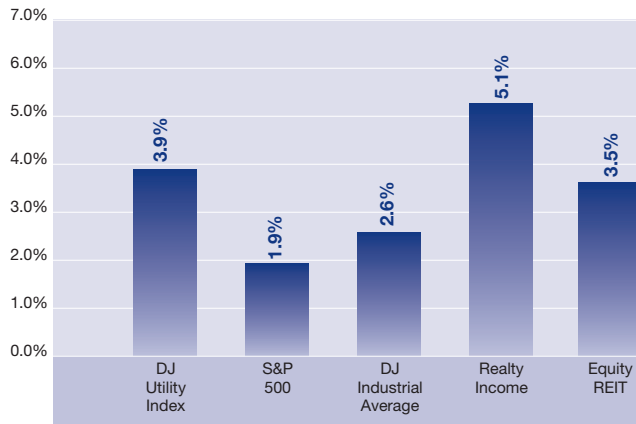
During 2010, the price of our shares rose 32.0% to \$34.20 from \$25.91, largely due, we believe, to the increasing demand for

dividend income in a low interest rate environment. When you add the \$1.722 per common share in dividends we paid last year, this works out to a total return to shareholders of 38.6%, as compared to the Equity REIT Index at 27.9%, the Dow Jones Industrial Average at 14.0%, the Standard & Poor's 500 Index at 15.1%, and the NASDAQ Composite Average at 16.9%.

While our main focus is on providing dependable monthly dividends to shareholders, we know that investors regularly compare Realty Income to other investments in terms of total return. Since the calculation of total return can rely on the whims of stock market pricing, it does not always mirror a company's actual operating results in a given year. With that said, the chart on page 13 shows Realty Income's compounded average annual return since 1994, when we were listed on the New York Stock Exchange, in comparison to other

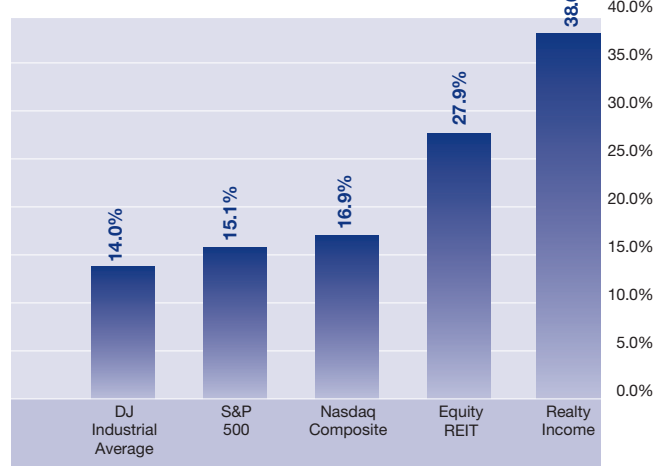
### YIELD COMPARISONS

(as of December 31, 2010)



### TOTAL RETURN COMPARISONS

(as of December 31, 2010)



major stock indices. For that 16-year period, our compounded average annual return to shareholders was 17.9%, as compared to the Equity REIT Index at 10.7%, the Dow Jones Industrial Average at 9.3%, the Standard & Poor's 500 Index at 8.3%, and the NASDAQ Composite Average at 8.0%.

The dividend yield on our shares at December 31, 2010, was 5.1% based on the annualized dividend amount of \$1.731 per common share and a closing share price of \$34.20. This compares favorably to other investments as measured by the various indices. For example, at year end, the yield

on the Dow Jones Industrial Average was 2.6%, Standard & Poor's 500 Index was 1.9%, Dow Jones Utility Index was 3.9% and Equity REIT Index was 3.5% (see Yield Comparisons on page 11).

## 2010 SUMMARY OF OPERATIONS

During 2010, we succeeded in maintaining a healthy and stable company, while positioning ourselves for future earnings growth. Our portfolio of net-leased commercial properties continues to perform well and provide the lease revenue from which we pay monthly dividends. As of December 31, 2010, portfolio

## THE MAGIC OF RISING DIVIDENDS OVER TIME

1000 Shares Purchase Date	Yield on Cost			The Cumulative Dividend Effect		
	Original Investment	Original Dividends <sup>(1)</sup>	Original Yield	Current Yield On Cost <sup>(2)</sup>	Dividends Received to Date	% of Original Investment Paid Back
10/18/94	\$ 8,000.00	\$ 900.00	11.3%	<b>21.6%</b>	\$ 20,450.50	<b>255.6%</b>
12/31/94	8,562.50	900.00	10.5%	<b>20.2%</b>	20,150.50	<b>235.3%</b>
12/31/95	11,250.00	930.00	8.3%	<b>15.4%</b>	19,238.00	<b>171.0%</b>
12/31/96	11,937.50	945.00	7.9%	<b>14.5%</b>	18,191.75	<b>152.4%</b>
12/31/97	12,719.00	960.00	7.5%	<b>13.6%</b>	17,245.50	<b>135.6%</b>
12/31/98	12,437.50	1,020.00	8.2%	<b>13.9%</b>	16,263.00	<b>130.8%</b>
12/31/99	10,312.50	1,080.00	10.5%	<b>16.8%</b>	15,220.50	<b>147.6%</b>
12/31/00	12,437.50	1,110.00	8.9%	<b>13.9%</b>	14,129.25	<b>113.6%</b>
12/31/01	14,700.00	1,140.00	7.8%	<b>11.8%</b>	13,008.00	<b>88.5%</b>
12/31/02	17,500.00	1,170.00	6.7%	<b>9.9%</b>	11,856.75	<b>67.8%</b>
12/31/03	20,000.00	1,200.00	6.0%	<b>8.7%</b>	10,675.50	<b>53.4%</b>
12/31/04	25,290.00	1,320.00	5.2%	<b>6.8%</b>	9,434.25	<b>37.3%</b>
12/31/05	21,620.00	1,395.00	6.5%	<b>8.0%</b>	8,088.00	<b>37.4%</b>
12/31/06	27,700.00	1,518.00	5.5%	<b>6.2%</b>	6,650.75	<b>24.0%</b>
12/31/07	27,020.00	1,641.00	6.1%	<b>6.4%</b>	5,090.50	<b>18.8%</b>
12/31/08	23,150.00	1,701.00	7.3%	<b>7.5%</b>	3,428.25	<b>14.8%</b>
12/31/09	25,910.00	1,716.00	6.6%	<b>6.7%</b>	1,721.63	<b>6.6%</b>
12/31/10	34,200.00	1,731.00	5.1%	<b>5.1%</b>		

<sup>(1)</sup> Based on annualized dividend per share on the purchase date  
<sup>(2)</sup> Based on 12/31/10 annualized dividend per share amount of \$1.731

occupancy was 96.6% with just 84 properties available for lease or sale out of 2,496 properties in the portfolio. The weighted average remaining lease term for properties in our portfolio was 11.4 years, and our portfolio continues to be well diversified by industry, geographic region and individual tenant. We were also able to capitalize on our excellent liquidity and substantially increase the size of our real estate portfolio by

acquiring 186 new properties for \$713.5 million during 2010. We permanently funded these acquisitions through two common stock offerings, generating approximately \$433 million in net proceeds, and a 10-year, senior notes offering of \$250 million, which generated net proceeds of \$246.1 million. In addition, we entered into a new and expanded credit facility that increased our access to short-term acquisition funding

## REALTY INCOME HISTORICAL PERFORMANCE VS. MAJOR STOCK INDICES

	Realty Income		Equity REIT Index <sup>(1)</sup>		Dow Jones Industrial Average		Standard & Poor's 500		NASDAQ Composite	
	Dividend Yield	Total Return <sup>(2)</sup>	Dividend Yield	Total Return <sup>(2)</sup>	Dividend Yield	Total Return <sup>(2)</sup>	Dividend Yield	Total Return <sup>(2)</sup>	Dividend Yield	Total Return <sup>(2)</sup>
1995	8.3%	42.0%	7.4%	15.3%	2.4%	36.9%	2.3%	37.6%	0.6%	39.9%
1996	7.9%	15.4%	6.1%	35.3%	2.2%	28.9%	2.0%	23.0%	0.2%	22.7%
1997	7.5%	14.5%	5.5%	20.3%	1.8%	24.9%	1.6%	33.4%	0.5%	21.6%
1998	8.2%	5.5%	7.5%	(17.5%)	1.7%	18.1%	1.3%	28.6%	0.3%	39.6%
1999	10.5%	(8.7%)	8.7%	(4.6%)	1.3%	27.2%	1.1%	21.0%	0.2%	85.6%
2000	8.9%	31.2%	7.5%	26.4%	1.5%	(4.7%)	1.2%	(9.1%)	0.3%	(39.3%)
2001	7.8%	27.2%	7.1%	13.9%	1.9%	(5.5%)	1.4%	(11.9%)	0.3%	(21.1%)
2002	6.7%	26.9%	7.1%	3.8%	2.6%	(15.0%)	1.9%	(22.1%)	0.5%	(31.5%)
2003	6.0%	21.0%	5.5%	37.1%	2.3%	28.3%	1.8%	28.7%	0.6%	50.0%
2004	5.2%	32.7%	4.7%	31.6%	2.2%	5.6%	1.8%	10.9%	0.6%	8.6%
2005	6.5%	(9.2%)	4.6%	12.2%	2.6%	1.7%	1.9%	4.9%	0.9%	1.4%
2006	5.5%	34.8%	3.7%	35.1%	2.5%	19.0%	1.9%	15.8%	0.8%	9.5%
2007	6.1%	3.2%	4.9%	(15.7%)	2.7%	8.8%	2.1%	5.5%	0.8%	9.8%
2008	7.3%	(8.2%)	7.6%	(37.7%)	3.6%	(31.8%)	3.2%	(37.0%)	1.3%	(40.5%)
2009	6.6%	19.3%	3.7%	28.0%	2.6%	22.6%	2.0%	26.5%	1.0%	43.9%
2010	5.1%	38.6%	3.5%	27.9%	2.6%	14.0%	1.9%	15.1%	1.2%	16.9%
<b>Compounded Average Annual Total Return<sup>(3)</sup></b>	<b>17.9%</b>		<b>10.7%</b>		<b>9.3%</b>		<b>8.3%</b>		<b>8.0%</b>	

Note: All of these Dividend Yields are calculated as annualized dividend based on last dividend paid in applicable time period divided by closing price as of period end. Dividend Yield sources: NAREIT website and Bloomberg.

<sup>(1)</sup> FTSE NAREIT US Equity REIT Index, as per NAREIT website.

<sup>(2)</sup> Calculated as closing stock price as of period end plus dividends paid in period divided by closing stock price as of end of previous period. Does not include reinvestment of dividends.

<sup>(3)</sup> Includes reinvestment of dividends. Sources: NAREIT website and Factset.

<sup>(4)</sup> Price only index, does not include dividends. Source: Factset.

<sup>(5)</sup> All of these Compounded Average Annual Total Return rates are calculated in the same manner: from Realty Income's NYSE listing on October 18, 1994 through December 31, 2010, and assuming reinvestment of dividends, except for NASDAQ. Past performance does not guarantee future performance. Realty Income presents this data for informational purposes only and makes no representation about its future performance or how it will compare in performance to other indices in the future.

from \$355 million to \$425 million (with an additional \$200 million expansion feature). Our ability to access public capital to permanently fund property acquisitions provides us with a healthy balance sheet and plenty of liquidity as we begin 2011. As such, we believe we are well positioned to fund additional property acquisitions during 2011.

### **INVESTMENTS FOR NOW AND THE FUTURE**

New property investments weren't the only investments we made in 2010. We also invested in additional personnel in key areas of the company (research, acquisitions, investor communications) and in company operations to maintain continued access to the high quality tools and resources required to manage a large portfolio of commercial real estate. All of these new associates and operating improvements are in accordance with our strategic plan to increase our property portfolio footprint and enhance revenue growth, to widen our industry net and further diversify the cash flow supporting dividends, and to expand our connection with the individual investor.

In early 2011, we launched a new corporate website and added a dividend reinvestment and direct stock purchase plan. The new website provides a wealth of information that has been organized so investors can get the information they need quickly and efficiently. The new site also provides information about and access to our new dividend reinvestment plan and direct stock purchase plan that is administered by our transfer

agent, Wells Fargo Shareowner Services, a division of Wells Fargo Bank, N.A. The site also features a "Connect" section that allows shareholders to contact us in a variety of ways to share information, get answers to their questions, or to sign up to receive various types of email communications from us. Our goal in launching this new website is to build an online bridge between the Company and its owners that will enhance our communications and enrich the experience of being a Realty Income shareholder.

### **WIDENING THE INVESTMENT NET**

Likely the most important activity we commenced in the past year-and-a-half was our effort to broaden our areas of investment by expanding the types of businesses in which we invest. But, before I get into that, perhaps I should talk a bit about the history of our investment process. Most of you will recall that virtually all of the Company's acquisitions over the last 42 years have been structured as sale-leasebacks. A sale-leaseback is where a retailer, or other business that uses real estate to conduct their business, elects to sell their real estate to a company like ours and then lease it back under a long-term lease agreement. In this transaction, the seller is able to take their cash out of their real estate and reallocate it for additional growth in other areas, while still maintaining the use of the property where they operate their business and generate their profits. For Realty Income, we are able to acquire a property operated



by a large tenant, under a long-term lease agreement, that will generate the cash flow we use to pay monthly dividends. This is very much a win-win situation for Realty Income and the seller of the property, and we believe this will continue to be our focus for many years to come.

#### **Real Estate Investment History Perspective**

Most of the investments we have made over the years have been sale-leasebacks to retail chains where we have acquired the stores in which they sell their goods and services. Acquiring these stores turned out to be a very attractive area of investment as consumer spending continued to increase fairly rapidly over the last 40 years and retailers were constantly opening new stores.

In the Company's first decade, we invested primarily in growing companies in the fast food restaurant business, as that industry was developing in the 1970s. Realty Income's founders, Bill and Joan Clark, identified that these growing companies needed their store locations in order to produce their profits, and they also needed capital to open new stores. They concluded that sale-leaseback was the perfect answer for these growing retailers. The Clarks also focused our business on purchasing properties from companies selling basic consumer goods and services at low price points, which people buy and use regularly, since they felt that these businesses would be more likely to produce stable cash flow and be able to pay rent over the long term.

In the 1980s, the Company expanded its

horizons to include other retail industries that had similar characteristics such as auto parts, auto service and the child day care business. Expanding into these areas fueled the growth of the Company and enabled us to build a track record of consistent dividends to our investors over a prolonged period of time.

Early in our history, we mostly bought the new stores that retailers were opening. This worked out pretty well as we selected the up-and-coming retailers, in growing segments of the retail industry, and the majority of the stores we acquired proved to be profitable to the retailers. Over time, however, we noticed that, at the end of the 15 to 20-year lease term, there were usually a number of the stores that the retailer no longer wanted to use because the stores had proven to be only marginally profitable. Once the initial lease terms expired, on the less profitable stores, we did not do as well since we often had to re-lease the store to another tenant, sometimes at a lower rental rate. As a result, about 15 years ago, we changed our focus to acquiring existing, seasoned stores that were already profitable and stores where profits far exceeded the rent the retailer paid to us. In these more profitable stores, the retailer is making a significant profit and is more likely to want to stay in the property and extend the lease when the initial long-term lease is completed. We believe this adjustment to our acquisitions strategy, many years ago, is a key reason for our real estate portfolio's stability and continued high occupancy.

Another important aspect of our investment history is the fact that, after going public in 1994, we invested in building our research capacity by adding staff in both industry and real estate research. We did this so that we could continue to find new areas in which to invest. In 1994, we owned 630 properties in 5 different industries that generated about \$49 million in revenue. Utilizing our increased research capacity, over the last 16 years, we have grown dramatically to where we are today, with approximately 2,500 properties in 32 different industries and annualized revenue exceeding \$380 million. I think it is fair to say that these adjustments to our investment strategy have been vital to our success and are likely to continue to be important for many years to come.

#### **How We're Thinking about Investments Today**

Last year, in my letter to shareholders, I wrote about “retail consumer shifts” that we are keeping our eyes on, stating that the “decisions we make over the next few years with respect to investment opportunities will be very important.” While our general focus on consumer retail has served us well over the years, I believe we must continue to widen the net and look for new areas of investment to continue to fuel our growth. It is likely that the growth in retail spending, and the resulting growth in new retail stores, will be more muted in the future than over the last decade or two. I think we will continue to find the majority of our acquisition opportunities in the areas in which we have previously

invested, I also believe that we will find new opportunities that will provide us with the consistent cash flow we need to generate in order to pay monthly dividends.

While looking to identify and invest in new industries we are careful to make sure that the core concepts and characteristics of the investments we make should generally remain as follows:

- The acquisition of well located commercial properties under long-term, net-lease agreements where the tenant is responsible for paying the operating expenses of the property and paying increasing rent over time
- The tenant is a significant commercial enterprise with multiple cash flows and revenue sources
- The tenant is a large owner and user of real estate to operate its business
- The real estate is important to the tenant's business and is necessary in the production of its earnings
- The tenant is in a business that we can understand and is in a business we believe will be sustainable over a prolonged period of time
- Our decision to invest will continue to be based on a three-pronged research approach that analyzes:
  1. The tenant's industry, financial strength, competitors and business operations
  2. The real estate attributes of the property
  3. The profitability to the tenant of the property we acquire

Additionally, our approach has generally been to seek areas of investment that aren't being efficiently financed or that aren't on the radar screen of other potential buyers. Often these areas are considered "out of the financial mainstream" by many investors, they may currently be harder to finance than other areas, or they are in a business area that may be new to the use of sale-leaseback transaction to generate capital. If we can manage to be "first to invest" (or at least early) in these areas we are more likely to receive a higher return on investment. History has also shown us that, over time, these "new" types of sale-leaseback financing opportunities tend to become more mainstream, which means competition increases and investment returns tend to decline. As in many things, the early bird often gets the worm (or at least a few bigger ones).

Some examples of new areas of investment that we uncovered in the past that became very profitable for us are:

- Fast food in the 60s and 70s
- Child day care in the 70s and 80s
- Auto service in the 80s and 90s
- Convenience stores and multi-plex theaters 10-12 years ago
- Entertainment venues like family entertainment centers and water parks ten years ago
- Health and fitness centers over the last six years.

Our ability to innovate and find new areas of investment has allowed us to expand our portfolio and grow our earnings and

dividends. It also has allowed us to diversify our real estate portfolio over time. Today we are in 32 different industries, and we would like to continue to expand into new areas with the goal of being in 40 to 50 different industries a decade from now. As always, the objective when we invest in new properties and industries is to generate an ongoing, stable cash flow that will allow us to continue to pay increasing monthly dividends.

#### **Source and Research New Investment Opportunities**

Uncovering new acquisition opportunities is the responsibility of our acquisition calling officers who maintain relationships with a wide variety of private equity firms, commercial and investment banking contacts and over 1,100 retailers throughout the US. Their goal is to generate a constant stream of opportunities for us to analyze for potential investment. The amount of work involved is daunting, but it is absolutely key to our success. To give you an idea of the volume of opportunities we have analyzed, since 2002 the acquisitions department has brought us over 840 transactions, representing 15,426 individual properties with an approximate value of \$27.5 billion. Wow! Out of this, we then acquired 1,808 properties with an approximate value of \$3.5 billion, or about 12.7% of what we evaluated.

Once our calling officers have uncovered a viable opportunity, the important task of underwriting begins. This involves researching 1) the tenant's industry, financial strength

and operations, 2) the specific real estate locations we are being offered and 3) the profitability and cash flow coverage of the properties we are acquiring. When examining a potential tenant and industry, we attempt to ascertain competitive conditions of the industry, how the particular tenant we are considering fits within their industry, the historical 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. We also meet with the prospective tenant's management team, review audited financial statements and a variety of internal operating metrics that can give us insight into the tenant's performance.

The real estate analysis consists of sending our real estate research people to visit every property and review the trade area in which the business operates.

Typically, we obtain data on property values, and we review area demographics, traffic flow, regional economic data, as well as comparative purchase and lease prices for each location.

The final key analysis is the individual unit profitability that is shown by the cash flow coverage metric. This is calculated by dividing the cash flow of a particular location we're considering for purchase by the rent that would have to be paid. This measure helps us figure out how much cushion we have before the tenant may experience difficulty in paying rent. We also call this our "margin of safety."

The research compiled in this underwriting process is reviewed by our investment committee that consists of five senior members of the Company. The path to approval of a potential tenant, generally, goes something like this (see table below):

Initial research to determine a viable opportunity	>	Committee Meeting—Decide whether or not to allocate time and resources to the opportunity
Preliminary credit research report	>	Committee Meeting—Decide whether the potential tenant warrants further due diligence
Meet with management team	>	Trip by research and committee member— More in-depth financial review and assessment of operations expertise
Final credit research report	>	Committee meeting—Decide whether or not the potential tenant is approved based on credit review
Presentation of real estate research	>	Committee meeting—Determine whether or not the real estate meets our investment guidelines
Legal review of potential transaction	>	Legal team meeting—Determine whether lease provisions and property conditions are acceptable
Approve, close and fund transaction	>	The tenant and real estate is approved and transaction is funded and closed

As evidenced by the number of times a potential transaction is analyzed, reviewed and discussed in our investment committee before it is approved, we make every effort to determine that a potential tenant offers the reliable and sustainable cash flow that is required before we make an investment.

Historically, our approach to sourcing tenants that represent new industry opportunities has been that we tend to first crawl, then walk, and occasionally run. This is because new industries require even more research than those in which we have already developed expertise. In addition to the standard research process just described, we also have to do a great deal more research into the competition, the types of properties that are important to a new industry, and to what extent certain demographic profiles are related to the industry. Often, we may conduct a research project on a new industry for a year or more, with no business coming in during that time. However, the initial research has been done and often we have developed a certain amount of expertise in the new industry, as well as some important relationships that may prove useful to us in the future. This legwork sets us up so that when an opportunity does arise, in this new area, we are ready to move forward. We intend to accelerate our efforts to find new investment areas in the years ahead.

### **A New Industry Investment Story**

A very good example of our approach to

investing in a new industry is one of our acquisitions this year. It is a story of how we were able to get comfortable with an investment in the beverage industry (specifically the wine segment), culminating in over \$300 million in investments during 2010.

A few years ago, we undertook a look at investing in the wine industry and set about learning everything we could about the business, but we made no acquisitions at that time. However, this background research was helpful in determining what we would require in order for us to invest in this area. During that research, we identified several potential hurdles to our acquiring properties in this industry. First, there were only a limited number of large owners and operators, with multiple cash flows (one of our requirements for investment). Most winery and vineyard operators are “one-off” operators consisting of a single winery and a few vineyards. Second, we had some difficulty assessing how consistently the earnings, generated from a winemaker’s business of making and selling wine to the consumer, could be tied to the vineyards and wine production, storage and distribution buildings. Third, it was even harder to tie the vineyards themselves to the earnings of the winemaker since, often, the winemakers purchased their grapes from one or more growers, as well as using grapes from their own vineyards. In other words, grapes are easily bought from a variety of growers, so winemakers don’t necessarily have to grow their own grapes.

This could potentially be a problem for

whoever owns the wine company's real estate. Should the winemaker get into financial difficulty and enter Chapter 11, the wine company in bankruptcy could potentially accept the lease on the winery and reject the lease on the vineyards themselves, continuing on in the wine-making business by buying grapes from third parties. This would reduce the amount of rent the landlord could collect and negatively impact the anticipated return on investment.

The possible exception we identified to this scenario was towards the premium end of the wine business, where the winemaker's brand may well be closely tied to estate bottling (growing the grapes on site) or a specific region where the grapes are grown. (For example: the Rutherford, Oakville, Stag's Leap, or Carneros areas in Napa Valley). The premium wine consumer often values and seeks out the wines from these specific regions and the vintners producing wine from grapes in these areas. Thus, the consumer may be willing to pay a higher price for these appellations and it is somewhat easier to tie the premium winemaker's earnings to both the winery operations and the vineyards themselves.

The research also confirmed our knowledge that the prices that can be charged for wine can be heavily impacted by a number of factors: the brand of the wine, the winemaker and, most importantly, where the grapes are grown. California produces approximately 94% of the wine produced in the United States. There are 17 different wine producing

areas in the state and one of those areas, the Napa Valley, produces about 4% of the wine that comes from California. The price differential, for grapes grown in these different areas, can be substantial. For instance, according to the 2010 Crush Report, US Department of Agriculture, the price of a ton of cabernet sauvignon grapes, from the 2010 harvest in California, averaged \$1,025 per ton with the lowest of the sixteen regions getting \$357 per ton and the highest region, the Napa Valley, commanding \$4,478 per ton. Where the grapes are grown matters a great deal when considering the value of the property and the price you can get for the wine.

Finally, wine is a consumer product and analyzing a consumer product involves a wide variety of additional factors that include; the branding of the product, its production, its marketing and, in this particular industry, its distribution through wholesalers and distributors to the stores and restaurants where it is sold. This has been especially true over the last couple of years, during the recession, as many stores and restaurants culled their lists of premium wine offerings and kept those brands that could be the most meaningful to their sales.

Our conclusion, after analyzing the industry, was that there would most likely be a limited number of potential tenants that would meet our criteria, and that it would be unlikely that we would structure transactions in this industry. To reiterate, we felt the tenant would need to meet the following criteria:

- A large entity with multiple cash flows and strong financials
- Premium vineyards in premium areas (Napa Valley)
- Vineyards that are critical to the production of the particular brand and the profitability of the winery
- An excellent track record of good operations
- A well-known, quality brand with a large consumer following
- Strong operations with the ability to market the brand year after year
- Solid relationships with distributors willing to put the winemaker's products on the shelf

As frequently happens, as we look at new industries, there is a lot of work with little to show for it in terms of attractive property acquisitions.

### **DIAGEO – THE TENANT AND THE WINE BUSINESS**

When a transaction with Diageo arose this year, we suspected that this would likely be an investment that met all of our investment criteria since Diageo is the world's leading global premium drinks company. Diageo brands are sold in approximately 180 markets worldwide and include names like: Smirnoff, Johnnie Walker, Captain Morgan, Jose Cuervo, Tanqueray, Gordon's, Crown Royal, (spirit brands); Guinness, Red Stripe, Harp, (beer brands); Sterling and Beaulieu (BV) (wine brands).

The Diageo business model, with a 100% focus on producing, distributing and marketing

premium spirits, beer and wines, satisfied our investment requirement for multiple sources of reliable and sustainable cash flow. In addition, the Sterling and Beaulieu (BV) wine brands proved to be businesses where real estate was tied to the generation of earnings for the wineries. Diageo also has, arguably, the best distribution and marketing in the business. Its impact and/or influence with distributors is unparalleled so that its wine brands generally command prized shelf space at the retail level.

Diageo also represented a high-quality, credit tenant that would enhance the overall credit quality of our real estate portfolio. Based in London, and traded on the London and New York stock exchanges, Diageo has investment grade credit ratings, a market capitalization of \$49 billion, and annual revenue of about \$16 billion.

We were able to become quite comfortable with both Diageo as our tenant and the cash flow sources, so our next step was to learn more about the Sterling and Beaulieu wineries, the competitive landscape for these brands, and the real estate.

Beaulieu Vineyards (BV) is 100 years old. It is located in the heart of the Napa wine region and about 40,000 visitors come to the winery each year. It is known for its Cabernet Sauvignon, Chardonnay and premium wine blends, of which 1.6 million cases of wine are produced annually. BV wines are widely distributed in retail stores, restaurants and hospitality venues throughout the US.

Sterling Vineyards is 39 years old and the winery is as well known for its architecture

and scenic surroundings as it is for its premium Cabernet Sauvignon, Merlot and Chardonnay wines. About 150,000 people visit this winery every year. The 1.4 million cases of wine that Sterling produces every year are also widely distributed in retail stores, restaurants and hospitality venues throughout the US.

These two wineries are among the most visited and recognized destinations in the Napa Valley and feature some of the best real estate locations in the area. As we already noted, the grapes grown in this region command higher prices compared to grapes grown elsewhere in California. The vineyards have been producing the highest quality grapes for 25 to 100 years and the grapes grown on the land are directly tied to the production of the Sterling and BV wines and the premium brand recognition inherent in the region’s appellation. In other words, the fact that Sterling and BV wineries produce wine from grapes that are primarily grown in their own vineyards means that the earnings derived from the wine production are directly related to the grapes grown on their land. You may recall that this was an important criterion for us in order to acquire both the buildings and the land.

What we acquired in this transaction are 11 vineyards on approximately 2,000 acres, of which 68% are plantable land, and the two wineries, consisting of wine production facilities, storage, shipping and tourist properties for \$269 million. We acquired these assets under 20-year, triple-net leases

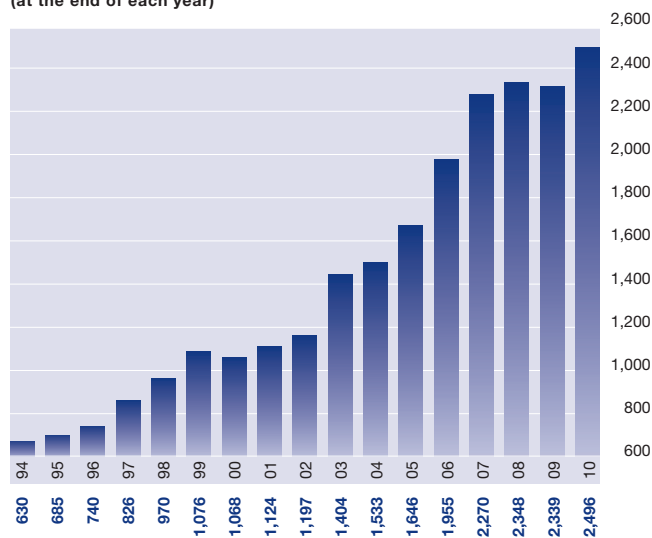
that offer several renewal options, since Diageo intends to operate these wineries into the foreseeable future. The real estate is in the Napa Valley with two vineyards in the Carneros area of the valley, and nine in the Rutherford, Oakville and Calistoga areas of the north valley, some of the premier growing areas in the Napa Valley.

### WHAT WE OWN

This acquisition is a bit different from many of the other real estate assets that we own in that the revenue and earnings are not primarily generated by a “storefront” operation. True, we do own land and buildings, but the revenue and earnings that are generated by Diageo are most closely tied to the consumer brands that they sell at a variety of locations other than the winery. A well-defined, brand-building strategy, superbly executed, has been key to Diageo’s success. The company has great distributors and

### NUMBER OF PROPERTIES

(at the end of each year)





wholesalers and they market the spirits, beer and wine with the same sales force through the same channels. This provides convenient, one-stop shopping for the retailer, restaurant chain, or hotel since they can buy multiple products from a single source.

Bottom line, our analysis and due diligence convinced us that Diageo is an expert in the wine business and they will be a valuable tenant, generating reliable cash flow that should allow them to meet their long-term lease obligations with us. So now we are all owners of two of the largest wineries and vineyards in Napa Valley that are operated by the experts at Diageo.

### WHAT'S NEXT?

This has been a good example of what we will be trying to do as we seek to invest in additional industries now and in the future. What I hope I've conveyed is the methodical, analytical and measured approach we took in order to make the Diageo transaction a reality, and that this is the approach that we will take when venturing into new industry territory. We walk a fine line between remaining flexible about investing in new areas and being disciplined about our approach. It can sometimes be difficult to put a great deal of work into an area and then have to wait for months, or years, for our work to pay off in terms of attractive acquisitions. However, we believe this is the right approach and that it reflects the manner in which our shareholders expect us to go about making investments in new areas.

With that said, we will look to existing areas for our real estate acquisitions in 2011. But, we will remain open to considering new areas and committing the resources to investigate them. If, a few years from now, we have been successful in securing a good piece of our revenue from other areas, that would be fine. But only after we have carefully researched, discussed and analyzed something new, will we make an investment. Again, the expansion into new investment areas has been the key to our growth for over 30 years.

### MORE DETAILS ABOUT OUR 2010 REAL ESTATE AND FINANCIAL PERFORMANCE

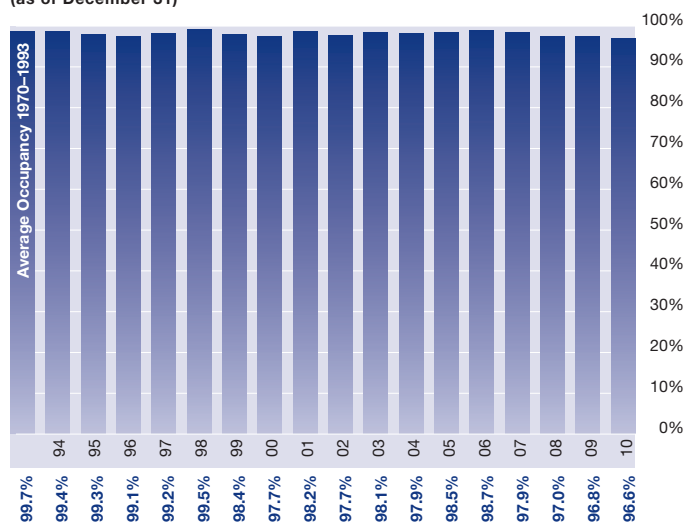
#### Consistent Real Estate Portfolio Performance

At the end of 2010, we owned 2,496 properties located in 49 states leased to 122 different retail chains and other businesses in 32 separate consumer-oriented industries.

Our goal for 2011 and forward is to continue to diversify our sources of lease revenue and

### PORTFOLIO OCCUPANCY

(as of December 31)



increase the credit quality of our portfolio of net-leased real estate assets.

Same store rents on 2,131 properties under lease for 2010 increased 0.6% as compared to 2009. To break down same store rent increases for 2010, we had 23 industries with rent increases, 3 with flat rents, and 3 with declining rents. We think that same store rent increases will probably be a bit higher in 2011 than they were in 2010 given the fact that the economy is improving and we have no tenants on our financial performance watch list.

We also selectively sold 28 properties for \$27.2 million during 2010. These properties had been targeted for sale based on very specific asset sale guidelines. In general, our business model is to hold properties for the long-term cash flow that is generated to pay dividends. However, we will pursue the sale of properties out of the portfolio when we believe that reinvesting the sales proceeds will generate higher returns, that the asset sales will enhance the credit quality of our real estate portfolio, or that specific tenant or industry concentration levels will be reduced.

Looking at lease expirations during 2010, the portfolio management group continued to be diligent in proactively anticipating lease expirations and did a tremendous job of handling 105 leases that expired during the year. Their efforts allowed us to maintain our historical occupancy rate that has never fallen below 96% since the company was founded in 1969. As of December 31, 2010, we had just 84 properties available for lease and

occupancy was 96.6%. As I've said before, keeping the majority of our properties leased, year after year, is the key to generating dependable lease revenue to support your monthly dividend payments.

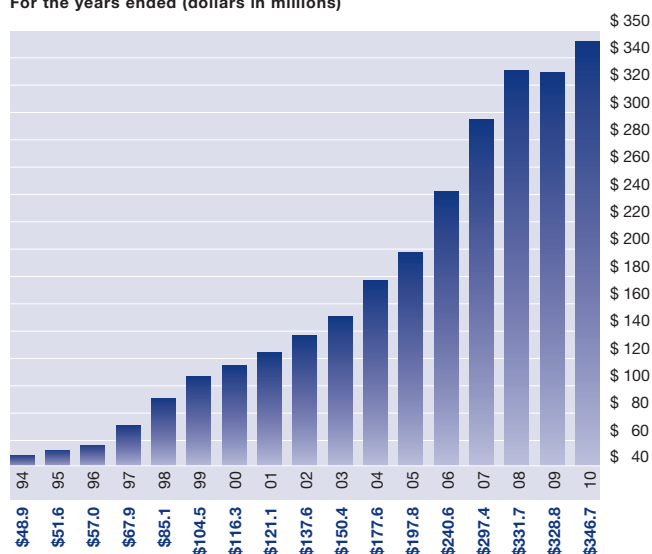
### STABLE FINANCIAL PERFORMANCE AND CONSERVATIVE BALANCE SHEET

Revenue, funds from operations (FFO), and net income results for the year ended December 31, 2010, as compared to the same period in 2009 were as follows:

- Revenue was \$345.0 million as compared to \$325.2 million in 2009
- FFO available to common shareholders was \$193.7 million as compared to \$190.4 million in 2009
- FFO per diluted common share was \$1.83 as compared to \$1.84 in 2009
- Net income available to common

### TOTAL REVENUE<sup>(1)</sup>

For the years ended (dollars in millions)



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

shareholders was \$106.5 million as compared to \$106.9 million in 2009

Funds from operations per share were lower, in comparison to 2009, due to our deliberate cessation of acquisition activities during 2008 and 2009, which means the revenue contributing to our earnings has been essentially flat during this period. Even though we had a very successful year of acquisitions in 2010, the majority of the transactions closed during the third and fourth quarter, limiting the positive contribution the additional revenue might otherwise have had on our earnings. In addition, I already mentioned the fact that we added staff in the acquisitions, research and investor communications areas during the year, which increased our administrative expenses. We anticipate that the high level of acquisition activity in 2010, along with our staff addi-

tions, should continue to contribute to increased productivity and positively impact our 2011 earnings.

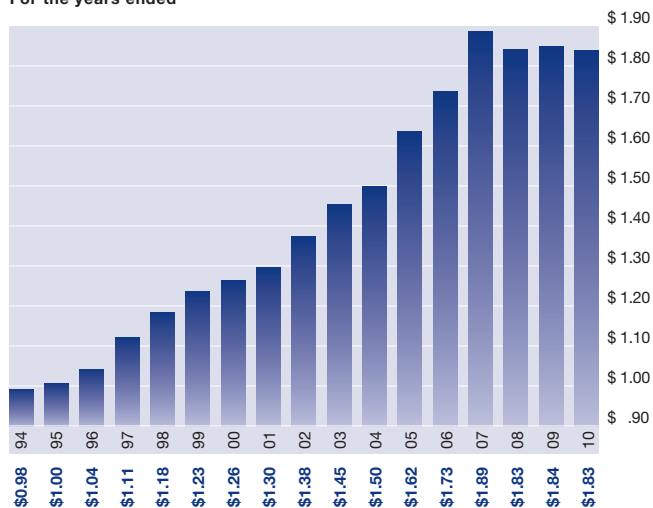
With respect to our capital structure, it remains very conservative and we have one of the strongest balance sheets in our industry, according to many research analysts. Our capital structure consisted of 67.5% in common shares, 5.8% in preferred shares, 26.7% in notes outstanding, and \$17.6 million in cash on hand, and no mortgages on any of our properties, at the end of 2010.

### RENEWING OUR MONTHLY DIVIDEND COMMITMENT

As we begin 2011, we've crossed the threshold for \$1.9 billion in monthly dividends paid. We also celebrated our 42nd birthday on February 28, 2011. During all these years, we've been committed to being The Monthly Dividend Company®. I'm particularly pleased with the fact that, even during the troubled economic times we've all endured in the past two to three years, we've still been able to not only continue paying the monthly dividend, but also increase it a bit each year. Our primary goal is, and always has been, to manage our real estate assets so that they continue to provide the lease revenue to support monthly dividend payments. Secondly, we hope to manage our operations, and effectively plan for the future, so that we also have the resources to increase the number of assets we own and to continue to increase our revenue and the amount of the dividend over time.

### FFO PER COMMON SHARE

For the years ended

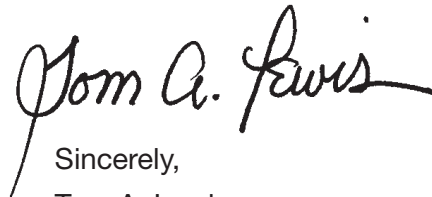


While we're not 100% out of the woods, in terms of the financial challenges that face our nation and the millions of people still unemployed, we are seeing some improvement in the broader economy. Our view is that, as we begin 2011, we have a somewhat improved operating environment as compared to the last few years, and that we should be successful in achieving our objective of paying 12 monthly dividends and increasing the dividend over time.

We remain grateful for the support of thousands of loyal shareholders (nearly 100,000) many of whom, like us, have enjoyed years of monthly dividends. As always, there are no guarantees we will be as successful in our efforts during 2011 as we have been in the past and, for that reason, we recommend that all investors remain diversified and rely on us for only a portion of

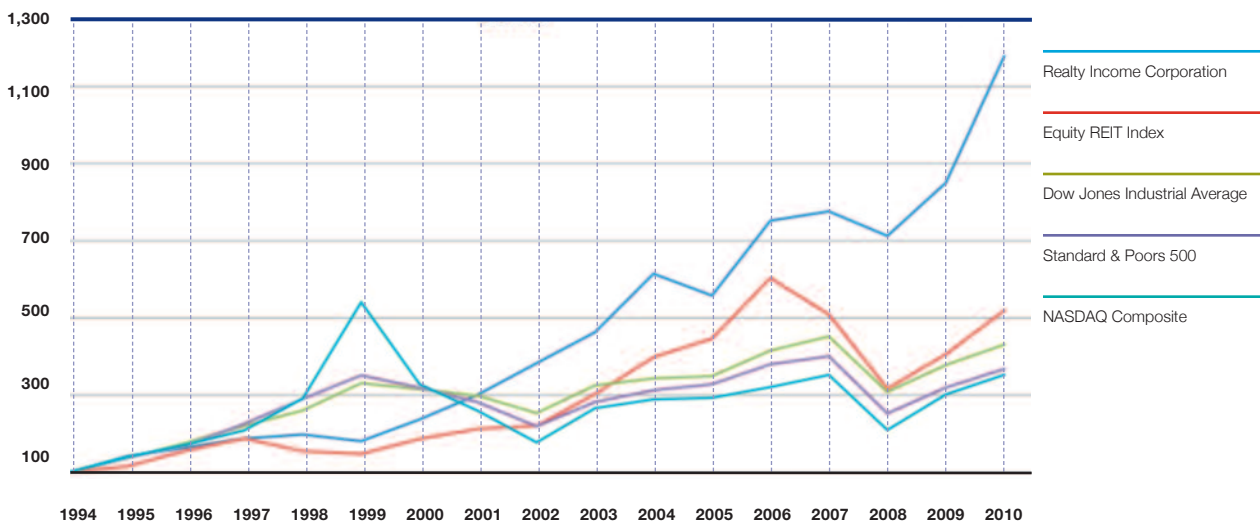
their income. I would also highly recommend that all of you visit the "Risk" section of our new corporate website where you can watch a video that discusses risk and read a helpful summary of the risks involved in owning our shares.

We will do our best, this year, to operate your Company in a prudent fashion so that the monthly dividends just keep on coming. Also, please be sure to go to the new website and, if you care to do so, email us a sentence or two about what monthly dividends do for you. We'd love to hear from you.



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

### COMPARISON OF \$100 INVESTED IN REALTY INCOME IN 1994 VS. MAJOR STOCK INDICES



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# Consolidated Balance Sheets

(dollars in thousands, except per share data)

December 31,	2010	2009
<b>Assets</b>		
Real estate, at cost:		
Land	\$ 1,520,413	\$ 1,169,295
Buildings and improvements	2,592,449	2,270,161
Total real estate, at cost	4,112,862	3,439,456
Less accumulated depreciation and amortization	(711,615)	(630,840)
Net real estate held for investment	3,401,247	2,808,616
Real estate held for sale, net	3,631	8,266
Net real estate	3,404,878	2,816,882
Cash and cash equivalents	17,607	10,026
Accounts receivable, net	11,301	10,396
Goodwill	17,206	17,206
Other assets, net	84,598	60,277
Total assets	\$ 3,535,590	\$ 2,914,787
<b>Liabilities and Stockholders' Equity</b>		
Distributions payable	\$ 19,051	\$ 16,926
Accounts payable and accrued expenses	47,019	38,445
Other liabilities	22,555	16,807
Lines of credit payable	—	4,600
Notes payable	1,600,000	1,350,000
Total liabilities	1,688,625	1,426,778
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 2010 and 2009	337,790	337,790
Common stock and paid in capital, par value \$1.00 per share, 200,000,000 shares authorized, 118,058,988 and 104,286,705 shares issued and outstanding as of December 31, 2010 and 2009, respectively	2,066,287	1,629,237
Distributions in excess of net income	(557,112)	(479,018)
Total stockholders' equity	1,846,965	1,488,009
Total liabilities and stockholders' equity	\$ 3,535,590	\$ 2,914,787

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

# Consolidated Statements of Income

(dollars in thousands, except per share data)

Years Ended December 31,	2010	2009	2008
<b>Revenue</b>			
Rental	\$ 344,080	\$ 323,819	\$ 323,164
Other	929	1,426	1,877
Total revenue	345,009	325,245	325,041
<b>Expenses</b>			
Depreciation and amortization	95,513	90,519	89,104
Interest	93,237	85,528	93,956
General and administrative	25,311	20,946	21,618
Property	7,332	6,601	5,458
Income taxes	1,393	677	1,230
Provisions for impairment	807	199	3,374
Total expenses	223,593	204,470	214,740
Income from continuing operations	121,416	120,775	110,301
Income from discontinued operations:			
Real estate acquired for resale by Crest	946	1,172	3,819
Real estate held for investment	8,422	9,180	17,721
Total income from discontinued operations	9,368	10,352	21,540
Net income	130,784	131,127	131,841
Preferred stock cash dividends	(24,253)	(24,253)	(24,253)
Net income available to common stockholders	\$ 106,531	\$ 106,874	\$ 107,588
Amounts available to common stockholders per common share:			
Income from continuing operations:			
Basic	\$ 0.92	\$ 0.93	\$ 0.85
Diluted	\$ 0.92	\$ 0.93	\$ 0.85
Net income:			
Basic	\$ 1.01	\$ 1.03	\$ 1.06
Diluted	\$ 1.01	\$ 1.03	\$ 1.06
Weighted average common shares outstanding:			
Basic	105,869,637	103,577,507	101,178,191
Diluted	105,942,721	103,581,053	101,209,883

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

# Consolidated Statements of Stockholders' Equity

(dollars in thousands)

Years Ended December 31, 2008, 2009, 2010	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, 2007	13,900,000	101,082,717	\$ 337,790	\$ 1,545,037	\$ (344,735)	\$ 1,538,092
Net income	—	—	—	—	131,841	131,841
Distributions paid and payable	—	—	—	—	(194,857)	(194,857)
Shares issued in stock offering, net of offering costs of \$4,024	—	2,925,000	—	74,425	—	74,425
Share-based compensation	—	203,824	—	5,160	—	5,160
Balance, December 31, 2008	13,900,000	104,211,541	337,790	1,624,622	(407,751)	1,554,661
Net income	—	—	—	—	131,127	131,127
Distributions paid and payable	—	—	—	—	(202,394)	(202,394)
Share-based compensation	—	75,164	—	4,615	—	4,615
Balance, December 31, 2009	13,900,000	104,286,705	337,790	1,629,237	(479,018)	1,488,009
Net income	—	—	—	—	130,784	130,784
Distributions paid and payable	—	—	—	—	(208,878)	(208,878)
Shares issued in stock offerings, net of offering costs of \$22,471	—	13,558,500	—	432,591	—	432,591
Share-based compensation	—	213,783	—	4,459	—	4,459
Balance, December 31, 2010	13,900,000	118,058,988	\$ 337,790	\$ 2,066,287	\$ (557,112)	\$ 1,846,965

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



# Consolidated Statements of Cash Flows

(dollars in thousands)

Years Ended December 31,	2010	2009	2008
<b>Cash Flows From Operating Activities</b>			
Net income	\$ 130,784	\$ 131,127	\$ 131,841
Adjustments to net income:			
Depreciation and amortization	95,513	90,519	89,104
Income from discontinued operations:			
Real estate acquired for resale	(946)	(1,172)	(3,819)
Real estate held for investment	(8,422)	(9,180)	(17,721)
Gain on sales of land	(271)	(15)	(236)
Amortization of share-based compensation	6,166	4,726	5,049
Provisions for impairment on real estate held for investment	807	199	3,374
Cash provided by (used in) discontinued operations:			
Real estate acquired for resale	946	1,250	(52)
Real estate held for investment	866	2,674	6,336
Investment in real estate acquired for resale	—	—	(9)
Proceeds from sales of real estate acquired for resale	—	1,987	31,455
Collection of notes receivable by Crest	138	129	87
Change in assets and liabilities:			
Accounts receivable and other assets	5,270	3,607	(930)
Accounts payable, accrued expenses and other liabilities	12,517	856	1,676
Net cash provided by operating activities	243,368	226,707	246,155
<b>Cash Flows from Investing Activities</b>			
Proceeds from sales of investment properties:			
Continuing operations	—	170	439
Discontinued operations	25,779	19,904	27,365
Restricted escrow deposit for Section 1031 tax-deferred exchange	(6,361)	(4,479)	(3,174)
Acquisition of and improvements to investment properties	(701,391)	(60,459)	(194,106)
Intangibles acquired in connection with acquisitions of investment properties	(15,385)	(860)	(397)
Net cash used in investing activities	(697,358)	(45,724)	(169,873)
<b>Cash Flows from Financing Activities</b>			
Cash distributions to common stockholders	(182,500)	(178,008)	(169,655)
Cash dividends to preferred stockholders	(24,253)	(24,253)	(24,253)
Borrowings from lines of credit	612,200	4,600	—
Payments under lines of credit	(616,800)	—	—
Proceeds from notes issued, net	246,131	—	—
Proceeds from common stock offerings, net	432,591	—	74,425
Debt issuance costs	(4,091)	—	(3,196)
Principal payment on notes payable	—	(20,000)	(100,000)
Other items	(1,707)	(111)	111
Net cash provided by (used in) financing activities	461,571	(217,772)	(222,568)
Net increase (decrease) in cash and cash equivalents	7,581	(36,789)	(146,286)
Cash and cash equivalents, beginning of year	10,026	46,815	193,101
Cash and cash equivalents, end of year	\$ 17,607	\$ 10,026	\$ 46,815

For supplemental disclosures, see note 13.

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

# Notes to Consolidated Financial Statements

December 31, 2010, 2009 and 2008

## 1. ORGANIZATION AND OPERATION

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

At December 31, 2010, we owned 2,496 properties, located in 49 states, containing over 21.2 million leasable square feet, along with three properties owned by our wholly-owned taxable REIT subsidiary, Crest Net Lease, Inc., or 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, or the 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 AND RECENT ACCOUNTING PRONOUNCEMENTS

**Federal Income Taxes.** We have elected to be taxed as a REIT under the Code. We believe we have qualified and continue to qualify as a REIT. 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 the federal income taxes of Crest, which are included in discontinued operations. The income taxes recorded on our consolidated statements of income represent amounts paid by Realty Income for city and state income and franchise taxes.

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) of the investments in properties for tax purposes, among other things.

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

	2010 <sup>(1)</sup>	2009	2008
Net income available to common stockholders	\$ 106,531	\$ 106,874	\$ 107,588
Preferred stock cash dividends	24,253	24,253	24,253
Depreciation and amortization timing differences	22,905	27,094	28,624
Tax gain on the sales of real estate less than book gain	—	(5,436)	(4,518)
Tax loss on the sale of real estate less than book gain	(10,063)	—	—
Dividends received from Crest	—	—	2,500
Elimination of net revenue and expenses from Crest	1,337	378	270
Adjustment for share-based compensation	562	1,824	2,270
Adjustment for straight-line rent	(1,613)	(1,117)	(1,997)
Adjustment for an increase (decrease) in prepaid rent	4,223	1,273	(1,226)
Other adjustments	3,579	(752)	(321)
Taxable net income, before our dividends paid deduction	\$ 151,714	\$ 154,391	\$ 157,443

<sup>(1)</sup> The 2010 information presented is a reconciliation of our net income available to common stockholders to estimated taxable net income.

We regularly analyze our various federal and state filing positions and only recognize the income tax effect in our financial statements when certain criteria regarding uncertain income tax positions have been met. We believe that our income tax positions would more likely than not be sustained upon examination by all relevant taxing authorities. Therefore, no reserves for uncertain income tax positions have been recorded in our financial statements.

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 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 carry-over tax basis. As of December 31, 2010, we have built-in gains of \$60 million with respect to such property. We do not expect that we will be

required to pay income tax on the built-in gains in 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:

	2010	2009	2008
Weighted average shares used for the basic net income per share computation	105,869,637	103,577,507	101,178,191
Incremental shares from share-based compensation	73,084	3,546	31,692
Adjusted weighted average shares used for diluted net income per share computation	105,942,721	103,581,053	101,209,883
Unvested shares from share-based compensation that were anti-dilutive	87,600	542,368	614,917

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

December 31,	2010	2009
Value of in-place and above-market leases, net	\$ 26,221	\$ 10,928
Notes receivable issued in connection with Crest property sales	22,075	22,214
Deferred bond financing costs, net	14,203	11,899
Prepaid expenses	8,431	7,738
Escrow deposits for Section 1031 tax-deferred exchanges	6,361	4,479
Credit facility organization costs, net	4,619	1,470
Corporate assets, net of accumulated depreciation and amortization	827	1,058
Other items	1,861	491
	\$ 84,598	\$ 60,277

**Distributions Payable.** Distributions payable consist of the following declared distributions (dollars in thousands) at:

December 31,	2010	2009
Common stock distributions	\$ 17,030	\$ 14,905
Preferred stock dividends	2,021	2,021
	\$ 19,051	\$ 16,926

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

December 31,	2010	2009
Bond interest payable	\$ 33,240	\$ 25,972
Other items	13,779	12,473
	\$ 47,019	\$ 38,445

Notes to Consolidated Financial Statements, cont'd.

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

December 31,	2010	2009
Rent received in advance	\$ 14,564	\$ 10,341
Security deposits	4,539	4,334
Value of in-place below-market leases, net	3,452	2,132
	<u>\$ 22,555</u>	<u>\$ 16,807</u>

**Discontinued Operations.** Operations from nine of our investment properties were classified as held for sale at December 31, 2010, plus properties sold in 2010, 2009 and 2008, 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.

Crest acquires properties with the intention of reselling them rather than holding them for investment and operating the properties. Consequently, we typically classify Crest's assets as held for sale at the date of acquisition and do not depreciate them. As a result, the operations of Crest's property assets are typically classified as "income from discontinued operations, real estate acquired for resale by Crest" on our consolidated statements of income.

However, if we determine we have no plans to sell a property asset in the near term (i.e. within the next 12 months), and this property was previously classified as held for sale, the property is reclassified as real estate held for investment. A property that is reclassified to held for investment is measured and recorded at the lower of (i) its carrying amount before the property was classified as held for sale, adjusted for any depreciation expense that would have been recognized had the property been continuously classified as held for investment, or (ii) the fair value at the date of the subsequent decision not to sell.

At December 31, 2010, we determined that three property assets, acquired by Crest in 2006, no longer met the held for sale criteria because we decided to lease rather than sell these properties in the near term. As a result, investment in real estate of \$3.0 million was reclassified from real estate held for sale to real estate held for investment on our consolidated balance sheet at December 31, 2010. At December 31, 2009, Crest's property inventory consisted of three properties valued at \$3.8 million, all of which was held for sale and included on our consolidated balance sheet at December 31, 2009, in "real estate held for sale, net." The results of operations for these properties are included in "income from continuing operations" on our consolidated statements of income. As a result of this reclassification, \$911,000, \$214,000 and \$3.2 million in operating loss was reclassified from discontinued operations to continuing operations for 2010, 2009 and 2008, respectively.

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 held for sale 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 by Crest" on our consolidated statements of income (dollars in thousands):

Crest's income from discontinued operations, real estate acquired for resale	2010	2009	2008
Rental revenue	\$ —	\$ 157	\$ 1,595
Interest revenue	1,397	1,403	899
Gain on sales of real estate acquired for resale	—	—	4,642
Interest expense	(557)	(595)	(1,797)
General and administrative expense	(226)	(336)	(511)
Property expenses	(12)	(24)	(13)
Provisions for impairment	—	(78)	—
Depreciation <sup>(1)</sup>	—	—	(771)
Income tax benefit (expense)	344	645	(225)
Income from discontinued operations, real estate acquired for resale by Crest	<u>\$ 946</u>	<u>\$ 1,172</u>	<u>\$ 3,819</u>

<sup>(1)</sup> Depreciation was recorded on one property that was classified as held for investment. This property was sold in 2008.

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):

<b>Realty Income's income from discontinued operations, real estate held for investment</b>	<b>2010</b>	<b>2009</b>	<b>2008</b>
Gain on sales of investment properties	\$ 8,405	\$ 8,044	\$ 13,314
Rental revenue	1,771	3,592	6,813
Other revenue	32	45	96
Depreciation and amortization	(636)	(1,428)	(1,929)
Property expenses	(937)	(963)	(573)
Provisions for impairment	(213)	(110)	—
Income from discontinued operations, real estate held for investment	\$ 8,422	\$ 9,180	\$ 17,721

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

<b>Total discontinued operations</b>	<b>2010</b>	<b>2009</b>	<b>2008</b>
Real estate acquired for resale by Crest	\$ 946	\$ 1,172	\$ 3,819
Real estate held for investment	8,422	9,180	17,721
Income from discontinued operations	\$ 9,368	\$ 10,352	\$ 21,540
Per common share, basic and diluted	\$ 0.09	\$ 0.10	\$ 0.21

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, when determining collectibility of accounts receivable and appropriate allowances to record. Our allowance for doubtful accounts at December 31, 2010 was \$1.1 million and at December 31, 2009 was \$865,000.

Other revenue includes non-operating interest earned from investments in money market funds and other notes of \$96,000 in 2010, \$51,000 in 2009 and \$1.4 million in 2008.

**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 (i.e. control), after elimination of all material intercompany balances and transactions. All of Realty Income'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.** When real estate is sold, the related net book value of the applicable assets is removed and a gain from the sale is recognized in our consolidated statements of income. We record a gain from the sale of real estate provided that various criteria, relating to the terms of the sale and any subsequent involvement by us with the real estate, have been met.

**Allocation of the Purchase Price of Real Estate Acquisitions.** When acquiring a property for investment purposes, we allocate the fair value of real estate acquired to: 1) land and 2) building and improvements, based in each case on their estimated fair values.

Notes to Consolidated Financial Statements, cont'd.

For properties acquired with in-place operating leases, the fair value of real estate is allocated to: 1) land, 2) building and improvements, and 3) identified intangible assets and liabilities, based in each case on their estimated fair values. Intangible assets and liabilities consist of above-market and below-market leases, the value of in-place leases and tenant relationships.

Our estimated fair value determinations are based on management's judgment, which is based on various factors, including: (1) market conditions, (2) industry that tenant operates in, (3) characteristics of the real estate, i.e.: location, size, demographics, value and comparative rental rates, (4) tenant credit profile, (5) store profitability and the importance of the location of the real estate to the operations of the tenant's business, and/or (6) real estate appraisals, prepared by an independent appraisal firm. When real estate appraisals are utilized, the measurement of fair value related to the allocation of the purchase price of real estate acquisitions is derived principally from observable market data that is not readily available to the public (and thus should be categorized as level 2 on FASB's three-level valuation hierarchy). Our other methodologies for measuring fair value related to the allocation of the purchase price of real estate acquisitions (except for independent third-party real estate appraisals) include unobservable inputs that reflect our own internal assumptions and calculations (and thus should be categorized as level 3 on FASB's three-level valuation hierarchy).

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 fair value determinations are based on a real estate appraisal for each property, prepared 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.

**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	Typically 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 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. An impairment is recorded if estimated future operating cash flows (undiscounted and without interest charges) plus estimated disposition proceeds (undiscounted) are less than the current book value of the property. Key factors that we use in this analysis include: projected rental rates, capital expenditures and property sales capitalization rates. Additionally, a property classified as held for sale is carried at the lower of carrying cost or estimated fair value, less estimated cost to sell.

In 2010, Realty Income recorded total provisions for impairment of \$213,000 on three properties in the restaurant industry and one property in the child care industry. These provisions for impairment are included in “income from discontinued operations, real estate held for investment” on our consolidated statement of income for 2010, as three of the properties were subsequently sold and one is anticipated to be sold in the first quarter of 2011. During 2010, Crest recorded total provisions for impairment of \$807,000 on three properties held for investment at December 31, 2010. These provisions for impairment are included in “income from continuing operations” on our consolidated statement of income for 2010.

In 2009, we recorded a provision for impairment of \$110,000 on one property in the convenience store industry, which was sold during 2010. This provision for impairment is included in “income from discontinued operations, real estate held for investment” on our consolidated statement of income for 2009. Additionally, in 2009, Crest recorded total provisions for impairment of \$199,000 on three properties classified as held for investment at December 31, 2010. These provisions for impairment are included in “income from continuing operations” on our consolidated statement of income for 2009. Additionally, Crest recorded total provisions for impairment of \$78,000 on two properties which were sold in 2009. These provisions for impairment are included in “income from discontinued operations, real estate acquired for resale by Crest” on our consolidated statement of income for 2009.

No provisions for impairment were recorded by Realty Income in 2008. In 2008, Crest recorded total provisions for impairment of \$3.4 million on three properties, which were held for investment at December 31, 2010. These provisions for impairment are included in “income from continuing operations” on our consolidated statement of income for 2008.

**Asset Retirement Obligations.** We analyze our future legal obligations associated with the other-than-temporary removal of tangible long-lived assets, also referred to as asset retirement obligations. When we determine that we have a legal obligation to provide services upon the retirement of a tangible long-lived asset, we record a liability for this obligation based on the estimated fair market value of this obligation and adjust the carrying amount of the related long-lived asset by the same amount. This asset is amortized over its estimated useful life. The estimated fair value of the asset retirement obligation is calculated by discounting the future cash flows using a credit-adjusted risk-free interest rate.

**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. During our tests for impairment of goodwill, during the second quarters of 2010, 2009 and 2008, we determined that the estimated fair values of our reporting units exceeded their carrying values. We did not record any new goodwill or impairment on our existing goodwill during 2010, 2009 or 2008.

**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, or GAAP, 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 December 2010, the Financial Accounting Standards Board issued Accounting Standards Update, or ASU, No. 2010-29, Business Combinations (Topic 805), *Disclosure of Supplementary Pro Forma Information for Business Combinations*. Effective for periods beginning after December 15, 2010, ASC No. 2010-29 specifies that if a public entity enters into business combinations that are material on an individual or aggregate basis and presents comparative financial statements, the entity must present pro forma revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. ASU No. 2010-29 only applies to our disclosures in note 3 related to acquisitions and is not expected to have a significant impact on our footnote disclosures.

**Reclassifications.** Certain of the 2009 and 2008 balances have been reclassified to conform to the 2010 presentation.

Notes to Consolidated Financial Statements, cont'd.

3. PROPERTIES ACQUIRED

We acquire the land, buildings and improvements that are necessary for the successful operations of retail and other commercial enterprises.

A. During 2010, Realty Income invested \$713.5 million in 186 new properties with an initial weighted average contractual lease rate of 7.9%. These 186 properties are located in 14 states, contain over 2.2 million leasable square feet, and are 100% leased with an average lease term of 15.7 years. The initial weighted average contractual lease rate is computed by dividing the estimated aggregate base rent for the first year of each lease by the estimated total cost of the properties. In accordance with GAAP, acquisition transaction costs of \$368,000 were recorded to "general and administrative" expense on our consolidated statement of income for 2010.

Included in the \$713.5 million invested during 2010 are the following acquisitions:

- (1) The acquisition and lease-back of approximately \$304.1 million of winery and vineyard properties under 20-year, triple-net lease arrangements with Diageo Chateau & Estates Wine Company, guaranteed by Diageo plc (NYSE: ADR: DEO), or, together with its subsidiaries, Diageo. The properties are primarily located in California's Napa Valley and include two wineries that produce wines for Diageo's Sterling Vineyards, or Sterling, and Beaulieu Vineyards, or BV, brands and 14 vineyards producing grapes for their Sterling, BV and other brands. The properties include approximately 3,600 acres and 426,000 square feet of winery, production, storage, shipping and tourist buildings. Diageo will continue to operate the wineries and vineyards.
- (2) The acquisition of 23 retail properties leased to 13 tenants in six states, for approximately \$126.5 million, under long-term, net lease agreements. The properties are in eight different industries, all of which are already in our portfolio. All of the properties acquired have in-place leases.
- (3) The acquisition of 135 SuperAmerica convenience stores and one support facility, for approximately \$247.6 million, under long-term, triple-net lease agreements. The stores are located in Minnesota and Wisconsin, and average approximately 3,500 leasable square feet on approximately 1.14 acres.
- (4) The remaining 11 properties acquired totaled approximately \$35.3 million.

The 2010 aggregate acquisitions were allocated as follows: \$358.3 million to land, \$339.8 million to buildings and improvements, \$17.0 million to intangible assets and \$1.6 million to intangible liabilities. All of the acquisitions were cash purchases and there were no contingent considerations associated with these acquisitions.

Total revenues of \$16.0 million and income from continuing operations of \$12.1 million are included in the 2010 consolidated income statement for the aggregate 2010 acquisitions.

The following pro forma total revenue and income from continuing operations of the 2010 acquisitions in aggregate, assumes the acquisitions had taken place on January 1, 2010 for the 2010 pro forma information, and on January 1, 2009 for the 2009 pro forma information (in millions):

	Total Revenue	Income from Continuing Operations
Supplemental pro forma for the year ended December 31, 2010 <sup>(1)</sup>	\$ 385.4	\$ 137.7
Supplemental pro forma for the year ended December 31, 2009 <sup>(1)</sup>	\$ 381.6	\$ 142.3

<sup>(1)</sup> This unaudited pro forma supplemental information does not purport to be indicative of what our operating results would have been had the acquisitions occurred on January 1, 2010 or January 1, 2009, and may not be indicative of future operating results.

In comparison, during 2009, Realty Income invested \$57.9 million in 16 new properties with an initial weighted average contractual lease rate of 9.7%. These 16 properties are located in five states, contain over 278,000 leasable square feet, and are 100% leased with an average lease term of 17.9 years. In accordance with GAAP, acquisition transaction costs of \$62,000 were recorded to "general and administrative" expense on our consolidated statement of income for 2009.

B. During 2010 and 2009, Crest did not invest in any new properties.

C. Of the \$713.5 million invested by Realty Income in 2010, approximately \$126.5 million was used to acquire 23 properties with existing leases. Realty Income recorded \$12.6 million as the intangible value of the in-place leases, \$4.4 million as the intangible value of above-market leases and \$1.6 million as the intangible value of below-market leases for 2010. The value of the in-place and above-market leases are recorded to "other



assets” on our consolidated balance sheet, as of December 31, 2010, and the value of the below-market leases are recorded to “other liabilities” on our consolidated balance sheet as of December 31, 2010. All of these amounts are amortized over the life of the respective leases.

Of the \$57.9 million invested by Realty Income in 2009, \$10.5 million was used to acquire three properties with existing leases. Realty Income recorded \$1.4 million as the intangible value of the in-place leases, \$150,000 as the intangible value of above-market leases and \$655,000 as the intangible value of below-market leases for 2009. The value of the in-place and above-market leases are recorded to “other assets” on our consolidated balance sheet, as of December 31, 2009, and the value of the below-market leases are recorded to “other liabilities” on our consolidated balance sheet as of December 31, 2009. All of these amounts are amortized over the life of the respective leases.

#### 4. CREDIT FACILITY

In December 2010, we entered into a new \$425 million revolving, unsecured credit facility that replaced our previous \$355 million acquisition credit facility that was scheduled to expire in May 2011. The initial term of the new credit facility expires in March 2014 and includes two, one-year extension options. Under the new credit facility, our investment grade credit ratings provide for financing at the London Interbank Offered Rate, commonly referred to as LIBOR, plus 185 basis points with a facility commitment fee of 35 basis points, for all-in drawn pricing of 220 basis points over LIBOR. We also have other interest rate options available to us. Our credit facility is unsecured and, accordingly, we have not pledged any assets as collateral for this obligation.

In December 2010, as a result of entering into our current credit facility, we incurred \$4.2 million of credit facility origination costs that were classified as part of “other assets” on our consolidated balance sheet at December 31, 2010 and are being amortized over the term of the credit facility. The remaining credit facility origination costs that were incurred as a result of entering into our previous \$355 million credit facility, which were \$452,000 at December 31, 2010, are included in “other assets” and are being amortized over the remaining term of our current \$425 million credit facility.

The average borrowing rate on our credit facility was 1.3% during 2010. During 2009, we did not utilize our credit facility until December and, during 2008, we did not utilize our credit facility. Our effective borrowing rate at December 31, 2010 was 2.1% and at December 31, 2009 was 1.2%. Our current and prior credit facilities are and were subject to various leverage and interest coverage ratio limitations. We are and have been in compliance with these covenants.

#### 5. NOTES PAYABLE

##### A. General

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

December 31,	2010	2009
5.375% notes, issued in March 2003 and due in March 2013	\$ 100	\$ 100
5.5% notes, issued in November 2003 and due in November 2015	150	150
5.95% notes, issued in September 2006 and due in September 2016	275	275
5.375% notes, issued in September 2005 and due in September 2017	175	175
6.75% notes, issued in September 2007 and due in August 2019	550	550
5.75% notes, issued in June 2010 and due in January 2021	250	—
5.875% bonds, issued in March 2005 and due in March 2035	100	100
	<b>\$ 1,600</b>	<b>\$ 1,350</b>

The following table summarizes the maturity of our notes payable as of December 31, 2010 (dollars in millions):

Year of Maturity	Notes
2011	\$ —
2012	—
2013	100
2014	—
2015	150
Thereafter	1,350
Totals	<b>\$ 1,600</b>

## Notes to Consolidated Financial Statements, cont'd.

Interest incurred on all of the notes for 2010 was \$89.7 million, for 2009 was \$82.5 million and for 2008 was \$91.2 million. The interest rate on each of these notes is fixed.

Our outstanding notes are unsecured; 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.

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.

### B. Note Issuance

In June 2010, we issued \$250 million in aggregate principal amount of 5.75% senior unsecured notes due January 2021, or the 2021 Notes. The price to the investor for the 2021 Notes was 99.404% of the principal amount for an effective yield of 5.826%. The net proceeds of approximately \$246.1 million from this offering were used to repay borrowings under our acquisition credit facility, which were used to finance the acquisition of the Diageo properties in June 2010. Interest is paid semiannually on the 2021 Notes.

### C. Note Redemptions

On their maturity date in January 2009, we redeemed, using cash on hand, all of our outstanding 8.00% notes issued in January 1999 at a redemption price equal to 100% of the principal amount of \$20 million, plus accrued and unpaid interest.

On their maturity date in November 2008, we redeemed, using proceeds from our September 2008 common stock offering and cash on hand, all of our outstanding 8.25% senior notes issued in October 1998, or the 2008 Notes, at a redemption price equal to 100% of the principal amount, plus accrued and unpaid interest.

## 6. COMMON STOCK OFFERINGS

In December 2010, we issued 7,360,000 shares of common stock at a price of \$33.70 per share. The net proceeds of approximately \$235.7 million were used to repay borrowings of \$179.8 million under our acquisition credit facility and to fund property acquisitions during December 2010. The remaining net proceeds were used for general corporate purposes and working capital.

In September 2010, we issued 6,198,500 shares of common stock at a price of \$33.40 per share. The net proceeds of approximately \$196.9 million were used to repay borrowings of \$49.7 million under our acquisition credit facility and to fund \$126.5 million of property acquisitions during October 2010. The remaining net proceeds were used for general corporate purposes and working capital.

In September 2008, we issued 2,925,000 shares of common stock at a price of \$26.82 per share. The net proceeds of approximately \$74.4 million were used, along with our available cash on hand, to redeem the \$100 million outstanding principal amount of our 2008 Notes in November 2008.

## 7. PREFERRED STOCK

**A.** In 2004, we issued 5.1 million shares of 7.375% Monthly Income Class D cumulative redeemable preferred stock. In May 2009, the Class D preferred shares became redeemable, at our option, for \$25 per share. During 2010, 2009 and 2008, we paid twelve monthly dividends to holders of our Class D preferred stock totaling \$1.8437508 per share, or \$9.4 million, and at December 31, 2010, a monthly dividend of \$0.1536459 per share was payable and was paid in January 2011.

**B.** In 2006, we issued 8.8 million shares of 6.75% Monthly Income Class E cumulative redeemable preferred stock. Beginning December 7, 2011, the Class E preferred shares are redeemable, at our option, for \$25 per share. During 2010, 2009 and 2008, we paid twelve monthly dividends to holders of our Class E preferred stock totaling \$1.6875 per share, or \$14.9 million, and at December 31, 2010, a monthly dividend of \$0.140625 per share was payable and was paid in January 2011.

We are current in our obligations to pay dividends on our Class D and Class E preferred stock.

## 8. DISTRIBUTIONS PAID AND PAYABLE

### A. Common Stock

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

Month	2010	2009	2008
January	\$ 0.1430000	\$ 0.1417500	\$ 0.136750
February	0.1430000	0.1417500	0.136750
March	0.1430000	0.1417500	0.136750
April	0.1433125	0.1420625	0.137375
May	0.1433125	0.1420625	0.137375
June	0.1433125	0.1420625	0.137375
July	0.1436250	0.1423750	0.138000
August	0.1436250	0.1423750	0.138000
September	0.1436250	0.1423750	0.140500
October	0.1439375	0.1426875	0.141125
November	0.1439375	0.1426875	0.141125
December	0.1439375	0.1426875	0.141125
Total	\$ 1.7216250	\$ 1.7066250	\$ 1.662250

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

	2010	2009	2008
Ordinary income	\$ 1.2598879	\$ 1.2739214	\$ 1.2681285
Nontaxable distributions	0.4617371	0.4113034	0.3121490
Capital gain	—	0.0214002	0.0819725
Totals	\$ 1.7216250	\$ 1.7066250	\$ 1.6622500

At December 31, 2010, a distribution of \$0.14425 per common share was payable and was paid in January 2011. At December 31, 2009, a distribution of \$0.143 per common share was payable and was paid in January 2010.

### B. Class D 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 2010, 2009 and 2008, respectively.

The following presents the federal income tax characterization of dividends paid per share to our Class D preferred stockholders for the years:

	2010	2009	2008
Ordinary income	\$ 1.8437508	\$ 1.8206316	\$ 1.7528280
Capital gain	—	0.0231192	0.0909228
Totals	\$ 1.8437508	\$ 1.8437508	\$ 1.8437508

### C. Class E Preferred Stock

Dividends of \$0.140625 per share are paid monthly in arrears on the Class E preferred stock. We declared dividends to holders of our Class E preferred stock totaling \$14.9 million in 2010, 2009 and 2008.

The following presents the federal income tax characterization of dividends paid per share to our Class E preferred stockholders for the years:

	2010	2009	2008
Ordinary income	\$ 1.6875000	\$ 1.6663392	\$ 1.6042824
Capital gain	—	0.0211608	0.0832176
Totals	\$ 1.6875000	\$ 1.6875000	\$ 1.6875000

**Notes to Consolidated Financial Statements, cont'd.****9. OPERATING LEASES**

A. At December 31, 2010, we owned 2,496 properties in 49 states, plus an additional three properties owned by Crest. Of the 2,496 properties, 2,485, or 99.6%, are single-tenant, properties and the remaining 11 are multi-tenant, distribution and office properties. At December 31, 2010, 84 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 2010 was \$1.4 million, for 2009 was \$1.3 million and for 2008 was \$1.3 million, including amounts recorded to discontinued operations of \$56,000 in 2010, \$90,000 in 2009 and \$61,000 in 2008.

At December 31, 2010, minimum future annual rents to be received on the operating leases for the next five years and thereafter are as follows (dollars in thousands):

2011	\$ 373,787
2012	360,338
2013	346,073
2014	328,318
2015	314,855
Thereafter	2,637,944
<b>Total</b>	<b>\$ 4,361,315</b>

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, 2010, 2009 or 2008.

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

During 2010, Crest did not sell any properties. During 2009, Crest sold two properties for \$2.0 million, which resulted in no gain. During 2008, Crest sold 25 properties for \$50.7 million, which resulted in a gain of \$4.6 million. In 2008, as part of two sales, Crest provided buyer financing of \$19.2 million. Crest's gains on sales are reported before income taxes and are included in discontinued operations.

**11. GAIN ON SALES OF INVESTMENT PROPERTIES BY REALTY INCOME**

During 2010, we sold 28 investment properties for \$26.6 million, which resulted in a gain of \$8.4 million. The results of operations for these properties have been reclassified as discontinued operations. Additionally, we sold excess land from one property for \$600,000, which resulted in a gain of \$271,000. This gain is included in "other revenue" on our consolidated statement of income for 2010 because this excess land was associated with a property that continues to be owned as part of our core operations.

During 2009, we sold 25 investment properties for \$20.3 million, which resulted in a gain of \$8.0 million. The results of operations for these properties have been reclassified as discontinued operations. Additionally, we received proceeds of \$170,000 from the sale of excess land from one property, which resulted in a gain of \$15,000. This gain is included in "other revenue" on our consolidated statement of income for 2009 because this excess land was associated with a property that continues to be owned as part of our core operations.

During 2008, we sold 29 investment properties for \$27.4 million, which resulted in a gain of \$13.3 million. The results of operations for these properties have been reclassified as discontinued operations. Additionally, we received proceeds of \$439,000 from the sale of excess land from one property, which resulted in a gain of \$236,000. This gain is included in "other revenue" on our consolidated statement of income for 2008 because this excess land was associated with a property that continues to be owned as part of our core operations.

**12. FAIR VALUE OF FINANCIAL INSTRUMENTS**

Fair value is defined as the price that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The disclosure for assets and liabilities measured at fair value requires allocation to a three-level valuation hierarchy. This valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. Categorization within this hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

We believe that the carrying values reflected in our consolidated balance sheets reasonably approximate the fair values for cash and cash equivalents, accounts receivable, and all liabilities, due to their short-term nature, except for our notes receivable issued in connection with property sales and our notes payable, which are disclosed below (dollars in millions):

<b>At December 31, 2010</b>	<b>Carrying value per balance sheet</b>	<b>Estimated fair market value</b>
Notes receivable issued in connection with Crest property sales	\$ 22.1	\$ 23.2
Notes payable	\$ 1,600.0	\$ 1,707.1

<b>At December 31, 2009</b>	<b>Carrying value per balance sheet</b>	<b>Estimated fair market value</b>
Notes receivable issued in connection with Crest property sales	\$ 22.2	\$ 20.0
Notes payable	\$ 1,350.0	\$ 1,276.4

The estimated fair value of our notes receivable, issued in connection with property sales, has been calculated by discounting the future cash flows using an interest rate based upon the current 5-year or 7-year Treasury Yield Curve, plus an applicable credit-adjusted spread. These notes receivable were issued in connection with the sale of three Crest properties. Payments to us on these notes receivable are current and no allowance for doubtful accounts has been recorded for them.

The estimated fair value of our notes payable is based upon indicative market prices and recent trading activity of our notes payable.

### **13. SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION**

Interest paid in 2010 was \$82.6 million, in 2009 was \$83.2 million and in 2008 was \$90.3 million. Interest capitalized to properties under development in 2010 was \$10,000, in 2009 was \$5,000 and in 2008 was \$92,000. Income taxes paid by Realty Income and Crest in 2010 were \$907,000, in 2009 were \$1.2 million and in 2008 were \$1.7 million.

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

- A.** Share-based compensation expense for 2010 was \$6.2 million, for 2009 was \$4.7 million and for 2008 was \$5.0 million.
- B.** See "Provisions for Impairment" in note 2 for a discussion of provisions for impairments recorded by Realty Income and Crest.
- C.** At December 31, 2010, Realty Income had escrow deposits of \$6.4 million held for tax-deferred exchanges under Section 1031 of the Code. The \$6.4 million is included in "other assets" on our consolidated balance sheet at December 31, 2010.
- D.** At December 31, 2009, Realty Income had escrow deposits of \$4.5 million held for tax-deferred exchanges under Section 1031 of the Code. The \$4.5 million is included in "other assets" on our consolidated balance sheet at December 31, 2009.
- E.** At December 31, 2008, Realty Income had escrow deposits of \$3.2 million held for tax-deferred exchanges under Section 1031 of the Code. The \$3.2 million is included in "other assets" on our consolidated balance sheet at December 31, 2008.
- F.** In 2010, Realty Income recorded a \$799,000 receivable for the sale of an investment property as a result of an eminent domain action and recorded a \$600,000 receivable for the sale of excess land from an investment property. These receivables are included in "other assets" on our consolidated balance sheet at December 31, 2010.
- G.** At December 31, 2009, Realty Income recorded \$1.5 million for a new environmental insurance policy, which supplements its primary insurance policy. The \$1.5 million is included in "other assets" and "accounts payable and accrued expenses" on our consolidated balance sheet at December 31, 2009.

Notes to Consolidated Financial Statements, cont'd.

H. In 2009, Realty Income and Crest amended certain prior year state tax returns and determined that it is more-likely-than-not that we will be collecting refunds in the future as a result of these amendments. As a result of this, in 2009, Realty Income recorded a tax receivable of \$454,000 and Crest recorded a tax receivable of \$303,000.

I. In 2008, Crest sold two properties for \$23.5 million and received notes totaling \$19.2 million from the buyers, which are included in "other assets" on our consolidated balance sheets.

J. In accordance with our policy, we recorded adjustments to our estimated legal obligations related to asset retirement obligations on two land leases in the following amounts: an increase of \$82,000 in 2010, a reduction of \$63,000 in 2009 and an increase of \$335,000 in 2008. These asset retirement obligations 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.

K. Accrued costs on properties under development resulted in an increase in buildings and improvements and accounts payable of \$337,000 at December 31, 2010.

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 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, or the Stock Plan, to enable us to attract and retain the services of directors, employees and consultants, considered essential to our long-term success. The Stock Plan offers our directors, employees and consultants 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, or SPR, stock appreciation rights, or SAR, and other awards will be no more than 3,428,000 shares. The maximum number of shares that may be subject to options, SPR, SAR 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 recognized in "general and administrative expense" on our consolidated statements of income during 2010 was \$6.2 million, during 2009 was \$4.7 million and during 2008 was \$5.0 million.

The following table summarizes our common stock grant activity under our Stock Plan. Our common stock grants vest over periods ranging from immediately to 10 years.

	2010		2009		2008	
	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	853,234	\$ 19.14	994,453	\$ 19.70	994,572	\$ 19.46
Shares granted	278,200	28.99	142,860	22.86	249,447	26.63
Shares vested	(206,153)	23.70	(214,521)	23.14	(188,215)	21.96
Shares forfeited	(987)	26.03	(69,558)	25.95	(61,351)	22.13
Outstanding nonvested shares, end of year	924,294	\$ 19.69	853,234	\$ 19.14	994,453	\$ 19.70

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

During 2010, we issued 278,200 shares of common stock under our Stock Plan. These shares vest over the following service periods: 32,000 vested immediately, 5,000 vest over a service period of two years, 12,000 vest over a service period of three years, 50,000 vest over a service period of four years and 179,200 vest over a service period of five years.

The vesting schedule for shares granted to non-employee directors is as follows:

- For directors with less than six years of service at the date of grant, shares vest in 33.33% increments on each of the first three anniversaries of the date the shares of stock are granted;
- For directors with six 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;
- For directors with seven 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; and
- For directors with eight or more years of service at the date of grant, there is immediate vesting as of the date the shares of stock are granted.

The vesting schedule for shares granted to employees is as follows:

- For employees age 55 and below 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, 2010, the remaining unamortized share-based compensation expense totaled \$18.2 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 Realty Income 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.

Due to a historically low turnover rate, we do not estimate a forfeiture rate for our nonvested shares. Accordingly, unexpected forfeitures will lower share-based compensation expense during the applicable period. Under the terms of our Stock Plan, we pay non-refundable dividends to the holders of our nonvested shares. Applicable accounting guidance requires that the dividends paid to holders of these nonvested shares be charged as compensation expense to the extent that they relate to nonvested shares that do not or are not expected to vest. However, since we do not estimate forfeitures given our historical trends, we did not record any amount to compensation expense related to dividends paid in 2010, 2009 or 2008.

No stock options were granted after January 1, 2002, all outstanding options were fully vested as of December 31, 2006, and 2006 represented the last year for which we recorded expense on our stock option awards. Stock options were granted with an exercise price equal to the underlying stock's fair value at the date of grant. The outstanding stock options expire on December 31, 2011, ten years from the date they were granted and have an exercise price of \$14.70.

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

	2010		2009		2008	
	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	5,846	\$ 14.70	21,294	\$ 13.33	45,007	\$ 12.71
Options exercised	(3,392)	14.70	(15,448)	12.81	(23,713)	12.15
Outstanding and exercisable options, end of year	2,454	\$ 14.70	5,846	\$ 14.70	21,294	\$ 13.33

## Notes to Consolidated Financial Statements, cont'd.

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 our stock was \$34.20, \$25.91 and \$23.15 at December 31, 2010, 2009 and 2008, respectively. The total intrinsic value of options exercised during the years ended December 31, 2010, 2009 and 2008 was \$61,000, \$157,000 and \$319,000, respectively. The aggregate intrinsic value of options outstanding and exercisable was \$48,000, \$66,000 and \$209,000 at December 31, 2010, 2009 and 2008, respectively.

**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 33 industry and activity segments (including properties owned by Crest that are grouped together as a segment). 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, 2010 (dollars in thousands):

<b>Assets, as of December 31:</b>	<b>2010</b>	<b>2009</b>
Segment net real estate:		
Automotive service	\$ 106,669	\$ 105,085
Automotive tire services	195,064	201,233
Child care	72,827	77,987
Convenience stores	706,173	477,640
Drug stores	143,739	141,057
Health and fitness	220,296	200,316
Restaurants	709,523	730,460
Theaters	281,072	290,386
Wine and spirits	302,159	—
24 non-reportable segments	667,356	592,718
Total segment net real estate	3,404,878	2,816,882
Other intangible assets - Apparel	3,644	—
Other intangible assets - Automotive tire service	588	647
Other intangible assets - Drug stores	5,938	6,066
Other intangible assets - Grocery stores	6,031	860
Other intangible assets - Health and fitness	1,707	845
Other intangible assets - Office supplies	390	—
Other intangible assets - Theaters	1,579	1,885
Other intangible assets - Sporting goods	5,786	—
Other intangible assets - Other	558	625
Goodwill - Automotive service	1,338	1,338
Goodwill - Child care	5,353	5,353
Goodwill - Convenience stores	2,074	2,074
Goodwill - Home furnishings	1,557	1,557
Goodwill - Restaurants	3,779	3,779
Goodwill - non reportable segments	3,105	3,105
Other corporate assets	87,285	69,771
Total assets	\$ 3,535,590	\$ 2,914,787



For the years ended December 31,	Revenue		
	2010	2009	2008
Segment rental revenue:			
Automotive service	\$ 16,123	\$ 15,797	\$ 15,853
Automotive tire services	21,859	22,616	22,040
Child care	22,417	23,408	23,758
Convenience stores	58,883	55,136	51,971
Drug stores	13,962	13,727	13,125
Health and fitness	23,768	18,787	18,419
Restaurants	69,923	69,181	70,763
Theaters	30,634	30,078	29,640
Wine and spirits	10,292	—	—
24 non-reportable segments	76,219	75,089	77,595
Total rental revenue	344,080	323,819	323,164
Other revenue	929	1,426	1,877
Total revenue	\$ 345,009	\$ 325,245	\$ 325,041

## 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, 2010, we have contingent payments of \$4.2 million for tenant improvements and leasing costs. In addition, we have committed \$420,000 under construction contracts, which is expected to be paid in the next three months.

We have certain properties that are subject to ground leases which are accounted for as operating leases. 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. At December 31, 2010, minimum future rental payments for the next five years and thereafter under these ground leases are as follows (dollars in thousands):

2011	\$ 3,631
2012	3,527
2013	3,385
2014	3,150
2015	3,096
Thereafter	31,933
Total	\$ 48,722

## 18. SUBSEQUENT EVENTS

In January 2011 and February 2011, we declared the following dividends, which will be paid in February 2011 and March 2011, respectively:

- \$0.14425 per share to our common stockholders;
- \$0.1536459 per share to our Class D preferred stockholders; and
- \$0.140625 per share to our Class E preferred stockholders.

# 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>2010<sup>(1)</sup></b>					
Total revenue	\$ 82,725	\$ 83,047	\$ 87,018	\$ 92,219	\$ 345,009
Depreciation and amortization expense	23,060	23,353	24,045	25,055	95,513
Interest expense	21,395	21,576	25,135	25,131	93,237
Other expenses	8,932	8,615	8,276	9,020	34,843
Income from continuing operations	29,338	29,503	29,562	33,013	121,416
Income from discontinued operations	867	1,545	2,092	4,864	9,368
Net income	30,205	31,048	31,654	37,877	130,784
Net income available to common stockholders	24,142	24,985	25,591	31,814	106,531
Net income per common share:					
Basic and diluted	0.23	0.24	0.25	0.28	1.01
Dividends paid per common share	0.4290000	0.4299375	0.4308750	0.4318125	1.7216250
<b>2009<sup>(1)</sup></b>					
Total revenue	\$ 81,906	\$ 80,776	\$ 81,276	\$ 81,286	\$ 325,245
Depreciation and amortization expense	22,578	22,611	22,626	22,704	90,519
Interest expense	21,410	21,367	21,374	21,377	85,528
Other expenses	8,428	7,089	6,537	6,369	28,423
Income from continuing operations	29,490	29,709	30,739	30,836	120,775
Income from discontinued operations	594	2,851	2,413	4,495	10,352
Net income	30,084	32,560	33,152	35,331	131,127
Net income available to common stockholders	24,021	26,497	27,089	29,268	106,874
Net income per common share:					
Basic and diluted	0.23	0.26	0.26	0.28	1.03
Dividends paid per common share	0.4252500	0.4261875	0.4271250	0.4280625	1.7066250

<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, classified as held for sale or 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.

# Reports of Independent Registered Public Accounting Firm

## THE BOARD OF DIRECTORS AND STOCKHOLDERS

### REALTY INCOME CORPORATION:

We have audited the accompanying consolidated balance sheets of Realty Income Corporation and subsidiaries as of December 31, 2010 and 2009, 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, 2010. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Realty Income Corporation and subsidiaries as of December 31, 2010 and 2009, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2010, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Realty Income Corporation's internal control over financial reporting as of December 31, 2010, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 10, 2011 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

**KPMG LLP**

San Diego, California  
February 10, 2011

## Reports of Independent Registered Public Accounting Firm, cont'd.

### THE BOARD OF DIRECTORS AND STOCKHOLDERS

#### REALTY INCOME CORPORATION:

We have audited Realty Income Corporation's internal control over financial reporting as of December 31, 2010, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Realty Income Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying *Management's Report on Internal Control over Financial Reporting*. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, Realty Income Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Realty Income Corporation and subsidiaries as of December 31, 2010 and 2009, 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, 2010, and our report dated February 10, 2011 expressed an unqualified opinion on those consolidated financial statements.

**KPMG LLP**

San Diego, California  
February 10, 2011

# Business Description

## THE COMPANY

Realty Income Corporation, The Monthly Dividend Company<sup>®</sup>, 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 properties leased to retail and other commercial enterprises. We have in-house acquisition, leasing, legal, credit research, real estate research, portfolio management and capital markets expertise. Over the past 42 years, Realty Income and its predecessors have been acquiring and owning freestanding retail and other commercial properties that generate rental revenue under long-term lease agreements (primarily 15 to 20 years).

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

- 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, thereby mitigating our exposure to certain tenants and markets.

In acquiring additional properties, our strategy is primarily to acquire properties that are:

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

At December 31, 2010, we owned a diversified portfolio:

- Of 2,496 properties;
- With an occupancy rate of 96.6%, or 2,412 properties occupied and only 84 properties available for lease;
- Leased to 122 different retail and other commercial enterprises doing business in 32 separate industries;
- Located in 49 states;
- With over 21.2 million square feet of leasable space; and
- With an average leasable space per property of approximately 8,500 square feet.

Of the 2,496 properties in the portfolio, 2,485, or 99.6%, are single-tenant properties, and the remaining 11 are multi-tenant, distribution and office properties. At December 31, 2010, of the 2,485 single-tenant properties, 2,402 were leased with a weighted average remaining lease term (excluding extension options) of approximately 11.4 years.

In addition, at December 31, 2010, our wholly-owned taxable REIT subsidiary, Crest Net Lease, Inc., or Crest, had an inventory of three properties valued at \$3.0 million, which are classified as held for investment. No Crest properties are classified as held for sale at December 31, 2010. 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, or the Code. In addition to the three properties, Crest also holds notes receivable of \$22.1 million at December 31, 2010.

We typically acquire properties under long-term leases with regional and national retailers and other commercial enterprises. Our acquisition and investment activities generally focus on businesses providing goods and services that satisfy basic consumer and business 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 (typically subject to ceilings), additional rent calculated as a percentage of the tenants' gross sales above a specified level, or fixed increases.

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

Our eight senior officers owned 1.1% of our outstanding common stock with a market value of \$44.5 million at February 1, 2011. Our directors and eight senior officers, as a group, owned 1.3% of our outstanding common stock with a market value of \$53.9 million at February 1, 2011.

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

## Business Description, cont'd.

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. In February 2011, we had 79 employees as compared to 72 employees in February 2010.

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, Forms 3, 4, 5, current reports on Form 8-K, and amendments to those reports, as soon as reasonably practicable after we electronically file these reports with the Securities and Exchange Commission, or 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 have continued our 42-year policy of paying distributions monthly. Monthly distributions per share increased in April 2010 by \$0.0003125 to \$0.1433125, in July 2010 by \$0.0003125 to \$0.143625, in October 2010 by \$0.0003125 to \$0.1439375 and in January 2011 by \$0.0003125 to \$0.14425. The increase in January 2011 was our 53<sup>rd</sup> consecutive quarterly increase and the 60<sup>th</sup> increase in the amount of our dividend since our listing on the NYSE in 1994. In 2010, we paid three monthly cash distributions per share in the amount of \$0.143, three in the amount of \$0.1433125, three in the amount of \$0.143625 and three in the amount of \$0.1439375, totaling \$1.721625. In December 2010, January 2011 and February 2011, we declared distributions of \$0.14425 per share, which were paid in January 2011 and will be paid in February 2011 and March 2011, respectively.

The current monthly distribution of \$0.14425 per share represents an annualized distribution of \$1.731 per share, and an annualized distribution yield of approximately 5.1% based on the last reported sale price of our common stock on the NYSE of \$34.20 on December 31, 2010. 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 2010

During 2010, we invested \$713.5 million in 186 new properties with an initial weighted average contractual lease rate of 7.9%. These 186 properties are located in 14 states, contain over 2.2 million leasable square feet, and are 100% leased with an average lease term of 15.7 years. The 186 new properties we acquired are net-leased to commercial enterprises in the following 13 industries: apparel stores, automotive collision services, automotive service, crafts and novelties, consumer electronics, convenience store, drug stores, grocery stores, health and fitness, office supplies, restaurants, sporting goods and wine and spirits. There were no acquisitions by Crest in 2010.

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 aggregate base rent) for the first year of each lease, divided by the estimated total cost of the properties. 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.

Included in the \$713.5 million invested during 2010 are the following acquisitions:

- The acquisition and leaseback of approximately \$304.1 million of winery and vineyard properties under 20-year, triple-net lease agreements with Diageo Chateau & Estates Wine Company, guaranteed by Diageo plc, or, together with its subsidiaries, Diageo. The properties are primarily located in California's Napa Valley and include two wineries that produce wines for Diageo's Sterling Vineyards, or Sterling, and Beaulieu Vineyards, or BV, brands and 14 vineyards producing grapes for their Sterling, BV and other brands. The properties include approximately 3,600 acres and 426,000 square feet of winery, production, storage, shipping and tourist buildings. Diageo will continue to operate the wineries and vineyards. As a result of this acquisition of properties, Diageo has become our largest tenant based on rental revenue. Headquartered in London, Diageo is a global premium drinks company with a well-known portfolio of international brands of spirits, beer and wine. Diageo ordinary shares trade on the London Stock Exchange under the symbol "DGE.L" and on the NYSE under the symbol "DEO."
- The acquisition of 23 retail properties leased to 13 tenants in six states, for approximately \$126.5 million, under long-term, net lease agreements. The properties are in eight different industries, including apparel stores, consumer electronics, crafts and novelties, drug stores, grocery stores, health and fitness, office supplies, and sporting goods. All of the properties acquired have in-place leases.
- The acquisition of 135 SuperAmerica convenience stores and one support facility, for approximately \$247.6 million, under long-term, triple-net lease agreements. The stores are located in Minnesota and Wisconsin, and average approximately 3,500 leasable square feet on approximately 1.14 acres.
- The remaining 11 properties acquired totaled approximately \$35.3 million.

### **Investments in Existing Properties**

In 2010, we capitalized costs of \$3.6 million on existing properties in our portfolio, consisting of \$1.5 million for re-leasing costs and \$2.1 million for building improvements.

### **\$425 Million Acquisition Credit Facility**

In December 2010, we entered into a new \$425 million acquisition credit facility that replaced our previous \$355 million acquisition credit facility that was scheduled to expire in May 2011. The initial term of the new credit facility expires in March 2014 and includes two, one-year extension options. Under the new credit facility, our investment grade credit ratings provide for financing at London Interbank Offered Rate, commonly referred to as LIBOR, plus 185 basis points with a facility commitment fee of 35 basis points, for all-in drawn pricing of 220 basis points over LIBOR. We also have other interest rate options available to us. Our credit facility is unsecured and, accordingly, we have not pledged any assets as collateral for this obligation. At December 31, 2010, there were no borrowings on our credit facility, but if there were, the effective borrowing rate would have been 2.1%.

### **Issuance of Common Stock**

In December 2010, we issued 7,360,000 shares of common stock at a price of \$33.70 per share. The net proceeds of approximately \$235.7 million were used to repay borrowings of \$179.8 million under our acquisition credit facility and to fund property acquisitions during December 2010. The remaining net proceeds were used for general corporate purposes and working capital.

In September 2010, we issued 6,198,500 shares of common stock at a price of \$33.40 per share. The net proceeds of approximately \$196.9 million were used to repay borrowings of \$49.7 million under our acquisition credit facility and to fund \$126.5 million of property acquisitions during October 2010. The remaining net proceeds were used for general corporate purposes and working capital.

### **Note Issuance**

In June 2010, we issued \$250.0 million aggregate principal amount of 5.75% senior unsecured notes due January 2021, or the 2021 Notes. The price to the investor for the 2021 Notes was 99.404% of the principal amount for an effective yield of 5.826%. The net proceeds of approximately \$246.1 million from this offering were used to repay borrowings under our acquisition credit facility, which were used to finance the acquisition of the Diageo properties. Interest is paid semiannually on the 2021 Notes.

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

Net income available to common stockholders was \$106.5 million in 2010 versus \$106.9 million in 2009, a decrease of \$343,000. On a diluted per common share basis, net income was \$1.01 in 2010 as compared to \$1.03 in 2009.

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

The gain from the sale of properties during 2010 was \$8.7 million, as compared to \$8.1 million during 2009.

### **Funds from Operations Available to Common Stockholders (FFO)**

In 2010, our FFO increased by \$3.3 million, or 1.7%, to \$193.7 million versus \$190.4 million in 2009. On a diluted per common share basis, FFO was \$1.83 in 2010 compared to \$1.84 in 2009, a decrease of \$0.01, or 0.5%.

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.

### **Adjusted Funds from Operations Available to Common Stockholders (AFFO)**

In 2010, our AFFO increased by \$4.6 million, or 2.4%, to \$197.3 million versus \$192.7 million in 2009. On a diluted per common share basis, AFFO was \$1.86 in 2010 and 2009.

See our discussion of AFFO 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 and AFFO.

## **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.

## Business Description, cont'd.

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 2010, our cash distributions totaled \$206.8 million, or approximately 136.3% of our estimated REIT taxable income of \$151.7 million. Our estimated REIT taxable income reflects non-cash deductions for depreciation and amortization. Our estimated REIT taxable income is presented to show our compliance with REIT distribution requirements and is not a measure of our liquidity or performance.

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. Furthermore, we believe our funds from operations are more than sufficient to support our current level of cash distributions to our stockholders. Our 2010 cash distributions to common stockholders totaled \$182.5 million, representing 94.2% of our funds from operations available to common stockholders of \$193.7 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). Dividends on our Class D and Class E preferred stock are current.

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

Distributions of our current and accumulated earnings and profits for federal income tax purposes generally will be taxable to stockholders as ordinary income, except to the extent that we recognize capital gains and declare a capital gains dividend, or that such amounts constitute "qualified dividend income" subject to a reduced rate of tax. The maximum tax rate of non-corporate taxpayers for "qualified dividend income" has generally been reduced to 15% (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, 2012). 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 26.8% of the distributions to our common stockholders, made or deemed to have been made in 2010, 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

### Capital Philosophy

Historically, we have met our long-term capital needs by issuing 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 times and at terms that are acceptable to us.

### 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 December 31, 2010, our total outstanding borrowings were \$1.6 billion of senior unsecured notes, or approximately 26.7% of our total market capitalization of \$5.99 billion. There were no outstanding borrowings on our credit facility at December 31, 2010.



We define our total market capitalization at December 31, 2010 as the sum of:

- Shares of our common stock outstanding of 118,058,988 multiplied by the last reported NYSE sales price of \$34.20 per share on December 31, 2010, or \$4.04 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 \$1.6 billion.

### Investment Philosophy

We believe that owning an actively managed, diversified portfolio of commercial properties under long-term, net leases produces consistent and predictable income. Net leases typically require the tenant to be responsible for 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 (typically subject to ceilings), additional rent calculated as a percentage of the tenants' gross sales above a specified level, or fixed increases. 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

When identifying new properties for acquisition, our focus is generally on providing capital to owners and operators of retail and other commercial enterprises by acquiring, then leasing back, the real estate they consider important to the successful operation of their business. We categorize tenants as: 1) venture market, 2) middle market, and 3) upper market. Venture companies typically offer a newer concept, generally in one geographic region of the country and operate between five and 50 locations. Middle market companies typically have 50 to 500 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 tenants typically consist of companies with 500 or more locations, operating a proven, mature concept. Upper market tenants generally have strong operating histories and access to several sources of capital.

We primarily focus on acquiring properties leased to middle market retail and other commercial enterprises that we believe are attractive for investment because:

- They generally have overcome many of the operational and managerial obstacles that can adversely affect new venture companies;
- They typically require capital to fund expansion but have more limited financing options than upper market tenants;
- 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 grown;
- Their relatively large size allows them to spread corporate expenses across a greater number of locations; and
- Middle market tenants typically have the critical mass to survive during economic or market dislocations.

Historically, our investment focus has primarily been on retail and other commercial enterprises 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, 2010, approximately 78% of our rental revenue was derived from tenants with a service component in their business. 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-based businesses.

### Credit Strategy

We primarily provide sale-leaseback financing to less than investment grade tenants. We typically acquire and lease back properties to regional and national commercial enterprises and believe that within this market we can achieve an attractive risk-adjusted return. Since 1970, our overall weighted average occupancy rate at the end of each year has been 98.2%, and our occupancy rate at the end of each year has never been below 96%.

We believe the principal financial obligations of most commercial enterprises 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 business, we believe the risk of default on a tenants' lease obligations is less than the tenants' unsecured general obligations. It has been our experience that since tenants must retain their profitable 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 tenant 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 tenants' individual unit locations and considering whether to sell locations that are weaker performers.

## Business Description, cont'd.

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 the importance of the location of the real estate to the operations of the company's business; 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 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 retailers and other commercial enterprises are capturing market share through service, quality control, economies of scale, strong consumer brands, advertising, and the selection of prime locations. We execute our acquisition strategy by acting as a source of capital to regional and national commercial enterprises by acquiring and leasing back their real estate locations. We undertake thorough research and analysis to identify what we consider to be 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 locations for regional and national commercial enterprises;
- Properties that we deem to be profitable for the tenants and/or can generally be characterized as important to the operations of the company's business;
- Properties that are located within attractive demographic areas relative to the business of our 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.

### Impact of Real Estate and Credit Markets

In the commercial real estate market, property prices generally continue to fluctuate. Likewise, the U.S. credit markets have experienced significant price volatility, dislocations and liquidity disruptions, which sometimes impact our access to and cost of capital. We continue to monitor the commercial real estate and U.S. credit markets carefully and, if required, will make decisions to adjust our business strategy accordingly. See Item 1A entitled "Risk Factors" in our Form 10-K for the fiscal year ended December 31, 2010.

### 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 our credit quality.

Our executives regularly review and analyze:

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

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;
- Extend our average remaining lease term; or
- Decrease tenant or industry concentration.

At December 31, 2010, we classified real estate with a carrying amount of \$3.6 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, if there are attractive opportunities available. However, we cannot guarantee that we will sell properties during the next 12 months or be able to invest the proceeds from the sales of any properties in new properties.

### **Universal Shelf Registration**

In March 2009, we filed a shelf registration statement with the SEC, which expires in March 2012. 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 and there is no specific dollar limit. The securities covered by this registration statement include common stock, preferred stock, debt securities, or any combination of these 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.

### **\$425 Million Acquisition Credit Facility**

In December 2010, we entered into a new \$425 million revolving, unsecured credit facility that replaced our previous \$355 million acquisition credit facility that was scheduled to expire in May 2011. The initial term of the new credit facility expires in March 2014 and includes two, one-year extension options. Under the new credit facility, our investment grade credit ratings provide for financing at LIBOR, plus 185 basis points with a facility commitment fee of 35 basis points, for all-in drawn pricing of 220 basis points over LIBOR. We also have other interest rate options available to us. Our credit facility is unsecured and, accordingly, we have not pledged any assets as collateral for this obligation. At December 31, 2010, we had a borrowing capacity of \$425 million available on our credit facility and no outstanding balance. If there were outstanding borrowings, the effective borrowing rate would have been 2.1%.

We expect to use our credit facility to acquire additional 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, up to \$200 million, to a total borrowing capacity of \$625 million. Any increase in the borrowing capacity is subject to approval by the banks participating in our credit facility.

We generally use our credit facility for the short-term financing of new property acquisitions. Thereafter, when 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 or 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**

The borrowing rates under our credit facility are based upon our credit ratings. We are currently assigned the following investment grade 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. All of these ratings have "stable" outlooks.

Based on our current ratings, the current facility interest rate is LIBOR plus 185 basis points with a facility commitment fee of 35 basis points, for all-in drawn pricing of 220 basis points over LIBOR. The credit facility provides that the interest rate can range between: (i) LIBOR plus 300 basis points if our credit facility is lower than BBB-/Baa3 and (ii) LIBOR plus 175 basis points if our credit rating is A-/A3 or higher. In addition, our credit facility provides for a facility commitment fee based on our credit ratings, which ranges from: (i) 50 basis points for a rating lower than BBB-/Baa3, and (ii) 30 basis points for a credit rating of A-/A3 or higher.

We also issue senior debt securities from time to time and our credit ratings can impact the interest rates charged in those transactions. If our credit ratings or ratings outlook change, our cost to obtain debt financing could increase or decrease.

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 our ratings 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.

## Business Description, cont'd.

### 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. Additionally, we have no joint ventures or mandatorily redeemable preferred stock. As such, our financial position and results of operations are not affected by accounting regulations regarding the consolidation of off-balance sheet entities and classification of 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 properties, whether purchased individually or as part of larger portfolio purchases, 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 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 tenants, our method of purchasing the property and then leasing it back, under a net-lease arrangement, allows the commercial enterprise to free up capital.
- **INVESTMENT IN NEW INDUSTRIES:** We will seek to further diversify our portfolio among a variety of industries. We believe diversification will allow us to invest in industries that currently are growing and have characteristics we find attractive. When analyzing new industries, we seek to acquire properties which are critical to the success of a commercial enterprise, through its distribution of the product or service. Other characteristics may include, but are not limited to, industries that are dominated by local store operators where regional and national store operators and other commercial enterprises 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 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, 2010, we owned a diversified property portfolio that consisted of 2,496 properties located in 49 states, leased to 122 different retail and other commercial enterprises doing business in 32 industry segments. Each of the 32 industry segments, represented in our property portfolio, individually accounted for no more than 19.1% of our rental revenue for the quarter ended December 31, 2010.
- **MANAGEMENT SPECIALIZATION:** We believe that our management's specialization in acquiring and managing single-tenant properties, operated under net-lease agreements, purchased individually or as part of a larger portfolio, 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 carry out our operations efficiently and economically. 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 play an important role in our competitiveness as an investment manager and source of capital to a variety of industries and tenants.

### RISK FACTORS

For 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, 2010.

### UNRESOLVED STAFF COMMENTS

There are no unresolved staff comments.

# Property Portfolio Information

At December 31, 2010, we owned a diversified portfolio:

- Of 2,496 properties;
- With an occupancy rate of 96.6%, or 2,412 properties occupied and only 84 properties available for lease;
- Leased to 122 different retail and other commercial enterprises doing business in 32 separate industries;
- Located in 49 states;
- With over 21.2 million square feet of leasable space; and
- With an average leasable space per property of approximately 8,500 square feet.

In addition to our real estate portfolio, our subsidiary, Crest, had an inventory of three properties located in three states at December 31, 2010. These properties are valued at \$3.0 million and are classified as held for investment. No Crest properties are classified as held for sale at December 31, 2010.

At December 31, 2010, of our 2,496 properties, 2,402 were leased under net-lease agreements. A net lease typically requires the tenant to be responsible for minimum monthly rent and property operating expenses including property taxes, insurance and maintenance. In addition, our tenants are typically responsible for future rent increases based on increases in the consumer price index (typically subject to ceilings), additional rent calculated as a percentage of the tenants' gross sales above a specified level, or fixed increases.

Our net-lease agreements generally:

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

**Property Portfolio Information, cont'd.**
**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, 2010	For the Years Ended					
		Dec 31, 2010	Dec 31, 2009	Dec 31, 2008	Dec 31, 2007	Dec 31, 2006	Dec 31, 2005
Apparel stores	1.5%	1.2%	1.1%	1.1%	1.2%	1.7%	1.6%
Automotive collision services	1.0	1.0	1.1	1.0	1.1	1.3	1.3
Automotive parts	1.5	1.4	1.5	1.6	2.1	2.8	3.4
Automotive service	4.5	4.7	4.8	4.8	5.2	6.9	7.6
Automotive tire services	5.9	6.4	6.9	6.7	7.3	6.1	7.2
Book stores	0.1	0.1	0.2	0.2	0.2	0.2	0.3
Business services	*	*	*	*	0.1	0.1	0.1
Child care	5.9	6.5	7.3	7.6	8.4	10.3	12.7
Consumer electronics	0.6	0.6	0.7	0.8	0.9	1.1	1.3
Convenience stores	17.4	17.1	16.9	15.8	14.0	16.1	18.7
Crafts and novelties	0.3	0.3	0.3	0.3	0.3	0.4	0.4
Distribution and office	1.0	1.0	1.0	1.0	0.6	—	—
Drug stores	3.9	4.1	4.3	4.1	2.7	2.9	2.8
Entertainment	1.1	1.2	1.3	1.2	1.4	1.6	2.1
Equipment rental services	0.2	0.2	0.2	0.2	0.2	0.2	0.4
Financial services	0.2	0.2	0.2	0.2	0.2	0.1	0.1
General merchandise	0.7	0.8	0.8	0.8	0.7	0.6	0.5
Grocery stores	1.5	0.9	0.7	0.7	0.7	0.7	0.7
Health and fitness	6.7	6.9	5.9	5.6	5.1	4.3	3.7
Home furnishings	1.2	1.3	1.3	2.4	2.6	3.1	3.7
Home improvement	1.6	1.7	1.9	1.9	2.1	3.4	1.1
Motor vehicle dealerships	2.4	2.6	2.7	3.1	3.1	3.4	2.6
Office supplies	1.0	0.9	1.0	1.0	1.1	1.3	1.5
Pet supplies and services	0.8	0.9	0.9	0.8	0.9	1.1	1.3
Private education	0.8	0.8	0.9	0.8	0.8	0.8	0.8
Restaurants	19.1	20.4	21.3	21.8	21.2	11.9	9.4
Shoe stores	0.2	0.1	—	—	—	—	0.3
Sporting goods	2.9	2.7	2.6	2.3	2.6	2.9	3.4
Theaters	8.6	8.9	9.2	9.0	9.0	9.6	5.2
Travel plazas	0.2	0.2	0.2	0.2	0.2	0.3	0.3
Video rental	0.0	0.2	1.0	1.1	1.7	2.1	2.5
Wine and spirits	5.6	3.0	—	—	—	—	—
Other	1.6	1.7	1.8	1.9	2.3	2.7	3.0
<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 as 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, 2010, classified according to the business types and the level of services they provide (dollars in thousands):

Industry	Number of Properties	Rental Revenue for the Quarter Ended December 31, 2010 <sup>(1)</sup>	Percentage of Rental Revenue
<b>Tenants Providing Services</b>			
Automotive collision services	14	\$ 893	1.0%
Automotive service	240	4,113	4.5
Child care	250	5,467	5.9
Entertainment	8	1,064	1.1
Equipment rental services	2	150	0.2
Financial services	12	193	0.2
Health and fitness	34	6,182	6.7
Private education	11	730	0.8
Theaters	34	7,944	8.6
Other	13	1,456	1.6
	618	28,192	30.6
<b>Tenants Selling Goods and Services</b>			
Automotive parts (with installation)	25	449	0.5
Automotive tire services	154	5,468	5.9
Business services	1	5	*
Convenience stores	720	16,046	17.4
Distribution and office	4	919	1.0
Home improvement	1	27	*
Motor vehicle dealerships	17	2,228	2.4
Pet supplies and services	12	709	0.8
Restaurants	631	17,601	19.1
Travel plazas	1	187	0.2
Video rental	15	0	0.0
	1,581	43,639	47.3
<b>Tenants Selling Goods</b>			
Apparel stores	11	1,365	1.5
Automotive parts	43	898	1.0
Book stores	1	128	0.1
Consumer electronics	9	521	0.6
Crafts and novelties	5	234	0.3
Drug stores	52	3,619	3.9
General merchandise	33	691	0.7
Grocery stores	21	1,397	1.5
Home furnishings	42	1,149	1.2
Home improvement	28	1,464	1.6
Office supplies	11	880	1.0
Pet supplies	3	33	*
Shoe stores	1	168	0.2
Sporting goods	21	2,650	2.9
Wine and spirits	16	5,134	5.6
	297	20,331	22.1
<b>Totals</b>	<b>2,496</b>	<b>\$ 92,162</b>	<b>100.0%</b>

\* Less than 0.1%

<sup>(1)</sup> Includes rental revenue for all properties owned by Realty Income at December 31, 2010, including revenue from properties reclassified as discontinued operations of \$98. Excludes revenue of \$80 for properties owned by Crest.

**Property Portfolio Information, cont'd.**
**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 2,402 net leased, single-tenant properties as of December 31, 2010 (dollars in thousands):

Year	Total Portfolio			Initial Expirations <sup>(3)</sup>			Subsequent Expirations <sup>(4)</sup>		
	Total Number of Leases Expiring <sup>(1)</sup>	Rental Revenue for the Quarter Ended Dec 31, 2010 <sup>(2)</sup>	% of Total Rental Revenue	Number of Leases Expiring	Rental Revenue for the Quarter Ended Dec 31, 2010	% of Total Rental Revenue	Number of Leases Expiring	Rental Revenue for the Quarter Ended Dec 31, 2010	% of Total Rental Revenue
2011	164	\$ 4,144	4.6%	58	\$ 1,975	2.2%	106	\$ 2,169	2.4%
2012	127	2,908	3.2	37	1,031	1.1	90	1,877	2.1
2013	147	4,947	5.5	65	2,961	3.3	82	1,986	2.2
2014	111	3,489	3.8	41	1,861	2.0	70	1,628	1.8
2015	147	3,768	4.2	78	2,205	2.5	69	1,563	1.7
2016	130	2,516	2.8	111	2,107	2.3	19	409	0.5
2017	51	1,904	2.1	40	1,681	1.9	11	223	0.2
2018	46	2,230	2.5	38	2,027	2.3	8	203	0.2
2019	98	5,089	5.6	90	4,659	5.1	8	430	0.5
2020	86	4,208	4.6	75	3,605	4.0	11	603	0.6
2021	177	7,592	8.4	176	7,538	8.3	1	54	0.1
2022	100	3,072	3.4	99	3,024	3.3	1	48	0.1
2023	253	8,779	9.7	251	8,706	9.6	2	73	0.1
2024	64	2,348	2.6	64	2,348	2.6	—	—	—
2025	208	7,684	8.5	203	7,557	8.4	5	127	0.1
2026	109	6,378	7.1	107	6,319	7.0	2	59	0.1
2027	169	5,572	6.1	168	5,555	6.1	1	17	*
2028	81	4,119	4.5	79	4,069	4.4	2	50	0.1
2029	49	1,290	1.4	48	1,275	1.4	1	15	*
2030	43	6,163	6.8	43	6,163	6.8	—	—	—
2031	27	663	0.7	27	663	0.7	—	—	—
2032	2	655	0.7	2	655	0.7	—	—	—
2033	7	460	0.5	7	460	0.5	—	—	—
2034	3	281	0.3	3	281	0.3	—	—	—
2037	2	354	0.4	2	354	0.4	—	—	—
2043	1	13	*	—	—	—	1	13	*
Totals	2,402	\$ 90,626	100.0%	1,912	\$ 79,079	87.2%	490	\$ 11,547	12.8%

\* Less than 0.1%

<sup>(1)</sup> Excludes ten multi-tenant properties and 84 vacant unleased properties, one of which is a multi-tenant property. The lease expirations for properties under construction are based on the estimated date of completion of those properties.

<sup>(2)</sup> Includes rental revenue of \$98 from properties reclassified as discontinued operations and excludes revenue of \$1,536 from ten multi-tenant properties and from 84 vacant and unleased properties at December 31, 2010. Excludes revenue of \$80 from properties owned by Crest.

<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, 2010 (dollars in thousands):

State	Number of Properties	Percent Leased	Approximate Leasable Square Feet	Rental Revenue for the Quarter Ended December 31, 2010 <sup>(1)</sup>	Percentage of Rental Revenue
Alabama	62	97%	420,200	\$ 1,861	2.0%
Alaska	2	100	128,500	287	0.3
Arizona	82	98	509,300	2,740	3.0
Arkansas	17	94	92,400	380	0.4
California	82	98	1,675,500	9,987	10.8
Colorado	51	94	471,400	1,804	2.0
Connecticut	23	96	269,100	1,156	1.3
Delaware	17	100	33,300	431	0.5
Florida	169	93	1,621,000	6,903	7.5
Georgia	131	95	905,500	3,809	4.1
Hawaii	—	—	—	—	—
Idaho	12	100	80,700	339	0.4
Illinois	84	99	998,500	5,107	5.5
Indiana	81	95	729,900	3,512	3.8
Iowa	21	100	290,600	1,018	1.1
Kansas	31	90	562,500	1,043	1.1
Kentucky	22	95	110,600	647	0.7
Louisiana	32	100	184,900	947	1.0
Maine	3	100	22,500	162	0.2
Maryland	28	100	266,600	1,661	1.8
Massachusetts	64	98	575,400	2,558	2.8
Michigan	52	100	257,300	1,287	1.4
Minnesota	150	99	894,700	3,240	3.5
Mississippi	72	97	360,700	1,563	1.7
Missouri	61	95	634,900	2,174	2.4
Montana	2	100	30,000	77	0.1
Nebraska	19	95	196,300	488	0.5
Nevada	14	93	153,200	720	0.8
New Hampshire	14	100	109,900	588	0.6
New Jersey	33	100	261,300	1,944	2.1
New Mexico	9	100	58,400	211	0.2
New York	39	97	495,000	2,553	2.8
North Carolina	94	99	531,700	2,896	3.1
North Dakota	6	100	36,600	69	0.1
Ohio	136	94	846,200	3,224	3.5
Oklahoma	35	100	755,300	1,305	1.4
Oregon	18	94	297,300	929	1.0
Pennsylvania	98	99	677,200	3,556	3.9
Rhode Island	3	100	11,000	59	0.1
South Carolina	99	100	372,500	2,271	2.5
South Dakota	10	100	89,800	165	0.2
Tennessee	129	95	592,400	2,758	3.0
Texas	213	95	2,357,200	8,074	8.8
Utah	4	100	25,200	94	0.1
Vermont	4	100	12,700	129	0.1
Virginia	104	95	636,500	3,410	3.7
Washington	34	94	276,500	1,036	1.1
West Virginia	2	100	23,000	121	0.1
Wisconsin	27	93	269,200	869	0.9
Wyoming	1	0	5,400	0	0.0
Totals/Average	2,496	97%	21,215,800	\$ 92,162	100.0%

<sup>(1)</sup> Includes rental revenue for all properties owned by Realty Income at December 31, 2010, including revenue from properties reclassified as discontinued operations of \$98. Excludes revenue of \$80 from properties owned by Crest.

# Forward-Looking Statements

This annual report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Exchange Act of 1934, as amended. 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 include discussions of strategy, plans or intentions of management. 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 properties;
- Future expenditures for development projects; and
- Profitability of our subsidiary, 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 volatility and uncertainty in the credit markets and broader financial 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 that this annual report was filed with the SEC. While forward-looking statements reflect our good faith beliefs, they are not guarantees of future performance. 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.

# Management's Discussion and Analysis of Financial Condition and Results of Operations

## GENERAL

Realty Income Corporation, The Monthly Dividend Company<sup>®</sup>, 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 properties leased to retail and other commercial enterprises. We have in-house acquisition, leasing, legal, credit research, real estate research, portfolio management and capital markets expertise. Over the past 42 years, Realty Income and its predecessors have been acquiring and owning freestanding retail and other commercial 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, 2010, we owned a diversified portfolio:

- Of 2,496 properties;
- With an occupancy rate of 96.6%, or 2,412 properties occupied and only 84 properties available for lease;
- Leased to 122 different retail and other commercial enterprises doing business in 32 separate industries;
- Located in 49 states;
- With over 21.2 million square feet of leasable space; and
- With an average leasable space per property of approximately 8,500 square feet.

Of the 2,496 properties in the portfolio, 2,485, or 99.6%, are single-tenant properties, and the remaining 11 are multi-tenant, distribution and office properties. At December 31, 2010, of the 2,485 single-tenant properties, 2,402 were leased with a weighted average remaining lease term (excluding extension options) of approximately 11.4 years.

In addition, at December 31, 2010, our wholly-owned taxable REIT subsidiary, Crest Net Lease, Inc. ("Crest"), had an inventory of three properties valued at \$3.0 million, which are classified as held for investment. No Crest properties are classified as held for sale at December 31, 2010. 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 "Code"). In addition to the three properties, Crest also holds notes receivable of \$22.1 million at December 31, 2010. Crest did not acquire any properties in 2010.

## LIQUIDITY AND CAPITAL RESOURCES

### Capital Philosophy

Historically, we have met our long-term capital needs by issuing 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 invested on an accretive basis 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 times and at terms that are acceptable to us.

### 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 December 31, 2010, our total outstanding borrowings were \$1.6 billion of senior unsecured notes, or approximately 26.7% of our total market capitalization of \$5.99 billion. There were no outstanding borrowings on our credit facility at December 31, 2010.

We define our total market capitalization at December 31, 2010 as the sum of:

- Shares of our common stock outstanding of 118,058,988 multiplied by the last reported NYSE sales price of \$34.20 per share on December 31, 2010, or \$4.04 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 \$1.6 billion.

### Mortgage Debt

We have no mortgage debt on any of our properties.

## Management's Discussion and Analysis of Financial Condition and Results of Operations, cont'd.

### \$425 Million Acquisition Credit Facility

In December 2010, we entered into a new \$425 million acquisition credit facility that replaced our previous \$355 million acquisition credit facility that was scheduled to expire in May 2011. The initial term of the new credit facility expires in March 2014 and includes two, one-year extension options. Under the new credit facility, our investment grade credit ratings provide for financing at the London Interbank Offered Rate, commonly referred to as LIBOR, plus 185 basis points with a facility commitment fee of 35 basis points, for all-in drawn pricing of 220 basis points over LIBOR. The borrowing rate is not subject to a LIBOR floor. We also have other interest rate options available to us. At December 31, 2010, we had a borrowing capacity of \$425 million available on our credit facility and no outstanding balance. If there were outstanding borrowings, the effective borrowing rate would have been 2.1%.

We expect to use our credit facility to acquire additional 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, up to \$200 million, to a total borrowing capacity of \$625 million. Any increase in the borrowing capacity is subject to approval by the lending banks participating in our credit facility.

### 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 properties. We intend to retain an appropriate amount of cash as working capital. At December 31, 2010, we had cash and cash equivalents totaling \$17.6 million.

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

### Acquisitions During 2010

During 2010, we invested \$713.5 million in 186 new properties with an initial weighted average contractual lease rate of 7.9%. These 186 properties are located in 14 states, contain over 2.2 million leasable square feet, and are 100% leased with an average lease term of 15.7 years. The 186 new properties we acquired are net-leased to commercial enterprises in the following 13 industries: apparel stores, automotive collision services, automotive service, crafts and novelties, consumer electronics, convenience stores, drug stores, grocery stores, health and fitness, office supplies, restaurants, sporting goods and wine and spirits. There were no acquisitions by Crest in 2010.

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 aggregate base rent) for the first year of each lease, divided by the estimated total cost of the properties. 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.

Included in the \$713.5 million invested during 2010 are the following acquisitions:

- The acquisition and leaseback of approximately \$304.1 million of winery and vineyard properties under 20-year, triple-net lease agreements with Diageo Chateau & Estates Wine Company, guaranteed by Diageo plc, or, together with its subsidiaries, Diageo. The properties are primarily located in California's Napa Valley and include two wineries that produce wines for Diageo's Sterling Vineyards, or Sterling, and Beaulieu Vineyards, or BV, brands and 14 vineyards producing grapes for their Sterling, BV and other brands. The properties include approximately 3,600 acres and 426,000 square feet of winery, production, storage, shipping and tourist buildings. Diageo will continue to operate the wineries and vineyards. As a result of this acquisition of properties, Diageo has become our largest tenant based on rental revenue. Headquartered in London, Diageo is a global premium drinks company with a well-known portfolio of international brands of spirits, beer and wine. Diageo ordinary shares trade on the London Stock Exchange under the symbol "DGE.L" and on the NYSE under the symbol "DEO."
- The acquisition of 23 retail properties leased to 13 tenants in six states, for approximately \$126.5 million, under long-term, net lease agreements. The properties are in eight different industries, including apparel stores, consumer electronics, crafts and novelties, drug stores, grocery stores, health and fitness, office supplies, and sporting goods. All of the properties acquired have in-place leases.
- The acquisition of 135 SuperAmerica convenience stores and one support facility, for approximately \$247.6 million, under long-term, triple-net lease agreements. The stores are located in Minnesota and Wisconsin, and average approximately 3,500 leasable square feet on approximately 1.14 acres.
- The remaining 11 properties acquired totaled approximately \$35.3 million.

### **Impact of Real Estate and Credit Markets**

In the commercial real estate market, property prices generally continue to fluctuate. Likewise, the U.S. credit markets have experienced significant price volatility, dislocations and liquidity disruptions, which sometimes impact our access to and cost of capital. We continue to monitor the commercial real estate and U.S. credit markets carefully and, if required, will make decisions to adjust our business strategy accordingly. See our discussion of “Risk Factors” in this annual report.

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

We have continued our 42-year policy of paying distributions monthly. Monthly distributions per share increased in April 2010 by \$0.0003125 to \$0.1433125, in July 2010 by \$0.0003125 to \$0.143625, in October 2010 by \$0.0003125 to \$0.1439375 and in January 2011 by \$0.0003125 to \$0.14425. The increase in January 2011 was our 53rd consecutive quarterly increase and the 60th increase in the amount of our dividend since our listing on the New York Stock Exchange, or NYSE, in 1994. In 2010, we paid three monthly cash distributions per share in the amount of \$0.143, three in the amount of \$0.1433125, three in the amount of \$0.143625 and three in the amount of \$0.1439375, totaling \$1.721625. In December 2010, January 2011 and February 2011, we declared distributions of \$0.14425 per share, which were paid in January 2011 and will be paid in February 2011 and March 2011, respectively.

The monthly distribution of \$0.14425 per share represents an annualized distribution of \$1.731 per share, and an annualized distribution yield of approximately 5.1% based on the last reported sale price of our common stock on the NYSE of \$34.20 on December 31, 2010. 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.

### **Issuance of Common Stock**

In December 2010, we issued 7,360,000 shares of common stock at a price of \$33.70 per share. The net proceeds of approximately \$235.7 million were used to repay borrowings of \$179.8 million under our acquisition credit facility and to fund property acquisitions during December 2010. The remaining net proceeds were used for general corporate purposes and working capital.

In September 2010, we issued 6,198,500 shares of common stock at a price of \$33.40 per share. The net proceeds of approximately \$196.9 million were used to repay borrowings of \$49.7 million under our acquisition credit facility and to fund \$126.5 million of property acquisitions during October 2010. The remaining net proceeds were used for general corporate purposes and working capital.

### **Note Issuance**

In June 2010, we issued \$250.0 million aggregate principal amount of 5.75% senior unsecured notes due January 2021 (the “2021 Notes”). The price to the investor for the 2021 Notes was 99.404% of the principal amount for an effective yield of 5.826%. The net proceeds of approximately \$246.1 million from this offering were used to repay borrowings under our acquisition credit facility, which were used to finance the acquisition of the Diageo properties. Interest is paid semiannually on the 2021 Notes.

### **Universal Shelf Registration**

In March 2009, we filed a shelf registration statement with the SEC, which expires in March 2012. In accordance with the SEC rules, the amount of the securities to be issued pursuant to this shelf registration statement was not specified when it was filed and there is no specific dollar limit. 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.

### **Credit Agency Ratings**

The borrowing rates under our credit facility are based upon our credit ratings. We are currently assigned the following investment grade 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. All of these ratings have “stable” outlooks.

## Management's Discussion and Analysis of Financial Condition and Results of Operations, cont'd.

Based on our current ratings, the current facility interest rate is LIBOR plus 185 basis points with a facility commitment fee of 35 basis points, for all-in drawn pricing of 220 basis points over LIBOR. The credit facility provides that the interest rate can range between: (i) LIBOR plus 300 basis points if our credit facility is lower than BBB-/Baa3 and (ii) LIBOR plus 175 basis points if our credit rating is A-/A3 or higher. In addition, our credit facility provides for a facility commitment fee based on our credit ratings, which ranges from: (i) 50 basis points for a rating lower than BBB-/Baa3, and (ii) 30 basis points for a credit rating of A-/A3 or higher.

We also issue senior debt securities from time to time and our credit ratings can impact the interest rates charged in those transactions. If our credit ratings or ratings outlook change, our cost to obtain debt financing could increase or decrease.

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 our ratings 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, 2010, sorted by maturity date (dollars in millions):

5.375% notes, issued in March 2003 and due in March 2013	\$ 100
5.5% notes, issued in November 2003 and due in November 2015	150
5.95% notes, issued in September 2006 and due in September 2016	275
5.375% notes, issued in September 2005 and due in September 2017	175
6.75% notes, issued in September 2007 and due in August 2019	550
5.75% notes, issued in June 2010 and due in January 2021	250
5.875% bonds, issued in March 2005 and due in March 2035	100
	\$ 1,600

All of our outstanding notes and bonds have fixed interest rates. Interest on all of our senior note and bond obligations is paid semiannually. All of these notes and bonds 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 and bonds was issued.

The following is a summary of the key financial covenants for 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, 2010 are:

Note Covenants	Required	Actual
Limitation on incurrence of total debt	≤ 60% of adjusted assets	38.2%
Limitation on incurrence of secured debt	≤ 40% of adjusted assets	0.0%
Debt service coverage (trailing 12 months)	≥ 1.5 x	3.5 x
Maintenance of total unencumbered assets	≥ 150% of unsecured debt	262.0%

The following table summarizes the maturity of each of our obligations as of December 31, 2010 (dollars in millions):

#### Table of Obligations

Year of Maturity	Credit Facility	Notes	Interest <sup>(1)</sup>	Ground Leases Paid by Our Tenants <sup>(2)</sup>	Other <sup>(3)</sup>	Totals
2011	\$ —	\$ —	\$ 96.8	\$ 3.6	\$ 4.6	\$ 105.0
2012	—	—	96.8	3.5	—	100.3
2013	—	100.0	92.5	3.4	—	195.9
2014	—	—	91.4	3.2	—	94.6
2015	—	150.0	90.4	3.1	—	243.5
Thereafter	—	1,350.0	347.5	31.9	—	1,729.4
Totals	\$ —	\$ 1,600.0	\$ 815.4	\$ 48.7	\$ 4.6	\$ 2,468.7

<sup>(1)</sup> Interest on the credit facility and notes has been calculated based on outstanding balances as of December 31, 2010 through their respective maturity dates.

<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.

<sup>(3)</sup> "Other" consists of \$420,000 of commitments under construction contracts and \$4.2 million of contingent payments for tenant improvements and leasing costs.

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

#### Preferred Stock Outstanding

In 2004, we issued 5.1 million shares of 7.375% Class D cumulative redeemable preferred stock. In May 2009, shares of Class D preferred stock became 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 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 become 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.

We are current in our obligations to pay dividends on our Class D and Class E preferred stock.

#### 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. Additionally, we have no joint ventures or mandatorily redeemable preferred stock. As such, our financial position and results of operations are not affected by accounting regulations regarding the consolidation of off-balance sheet entities and classification of financial instruments with characteristics of both liabilities and equity.

## RESULTS OF OPERATIONS

#### Critical Accounting Policies

Our consolidated financial statements have been prepared in accordance with 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. This summary should be read in conjunction with the more complete discussion of our accounting policies and procedures included in note 2 to our consolidated financial statements.

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 on a majority of our buildings and improvements is computed using the straight-line method over an estimated useful life of 25 years. If we use a shorter or longer estimated useful life, it could have a material impact on our results of operations. We believe that 25 years is an appropriate estimate of useful life.

## Management's Discussion and Analysis of Financial Condition and Results of Operations, cont'd.

When acquiring a property for investment purposes, we allocate the fair value of real estate acquired to: 1) land and 2) building and improvements, based in each case on their estimated fair values.

For properties acquired with in-place operating leases, the fair value of real estate is allocated to: (1) land, (2) building and improvements, and (3) identified intangible assets and liabilities, based in each case on their estimated fair values. Intangible assets and liabilities consist of above-market and below-market leases, the value of in-place leases and tenant relationships.

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. 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 of the property. Key inputs that we estimate in this analysis include projected rental rates, capital expenditures, and property sales capitalization rates. If a property is held for sale, it is carried at the lower of carrying cost or estimated fair value, less estimated 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, 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, 2010, 2009 and 2008.

### Rental Revenue

Rental revenue was \$344.1 million for 2010 versus \$323.8 million for 2009, an increase of \$20.3 million, or 6.3%. Rental revenue was \$323.2 million in 2008. The increase in rental revenue in 2010 compared to 2009 is primarily attributable to:

- The 186 properties acquired by Realty Income in 2010, which generated \$15.9 million of rent in 2010;
- The 16 properties acquired by Realty Income in 2009, which generated \$5.6 million of rent in 2010 compared to \$490,000 in 2009, an increase of \$5.1 million;
- Same store rents generated on 2,131 properties during the entire years of 2010 and 2009, increased by \$1.8 million, or 0.6%, to \$313.8 million from \$312.0 million; and
- An increase in straight-line rent and other non-cash adjustments to rent of \$442,000 in 2010 as compared to 2009; net of
- A net decrease of \$3.1 million relating to the aggregate of (i) development properties acquired before 2009 that started paying rent in 2009, (ii) properties that were vacant during part of 2010 or 2009, (iii) properties sold during 2010 and 2009 and (iv) lease termination settlements, which, in aggregate, totaled \$7.16 million in 2010 compared to \$10.23 million in 2009.

Of the 2,496 properties in the portfolio at December 31, 2010, 2,485, or 99.6%, are single-tenant properties and the remaining 11 are multi-tenant, distribution and office properties. Of the 2,485 single-tenant properties, 2,402, or 96.7%, were net leased with a weighted average remaining lease term (excluding rights to extend a lease at the option of the tenant) of approximately 11.4 years at December 31, 2010. Of our 2,402 leased single-tenant properties, 2,217 or 92.3% were under leases that provide for increases in rents through:

- Primarily base rent increases tied to a consumer price index (typically subject to ceilings);
- Overage rent based on a percentage of the tenants' gross sales;
- Fixed increases; or
- A combination of two or more of the above rent provisions.

Percentage rent, which is included in rental revenue, was \$1.3 million in 2010, \$1.3 million in 2009 and \$1.2 million in 2008 (excluding percentage rent reclassified to discontinued operations of \$56,000 in 2010, \$90,000 in 2009 and \$61,000 in 2008). Percentage rent in 2010 was less than 1% of rental revenue, and we anticipate percentage rent to be less than 1% of rental revenue in 2011.

Our portfolio of real estate, leased primarily to regional and national commercial enterprises under net leases, continues to perform well and provides dependable lease revenue supporting the payment of monthly dividends to our stockholders. At December 31, 2010, our portfolio of 2,496 properties was 96.6% leased with 84 properties available for lease as compared to 75 at December 31, 2009. It has been our experience that approximately 2% to 4% 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 \$95.5 million in 2010 versus \$90.5 million in 2009 and \$89.1 million in 2008. The increases in depreciation and amortization in 2010 and 2009 were primarily due to the acquisition of properties in 2010, 2009 and 2008, which was partially offset by property sales in those same years. As discussed in the section entitled "Funds from Operations Available to Common Stockholders," depreciation and amortization is a non-cash item that is added back to net income available to common stockholders for our calculation of FFO and AFFO.

## Interest Expense

Interest expense was \$93.2 million in 2010 versus \$85.5 million in 2009 and \$94.0 million in 2008. The increase in interest expense from 2009 to 2010 was primarily due to an increase in borrowings attributable to the issuance of our \$250 million of 5.75% senior unsecured notes in June 2010 and utilization of our credit facility in 2010, which was partially offset by lower average interest rates. The decrease in interest expense from 2008 to 2009 was primarily due to lower average outstanding balances and, to a lesser extent, lower interest rates. We redeemed, in November 2008, the \$100 million outstanding principal amount of our 8.25% Monthly Income Senior Notes and, in January 2009, the \$20 million outstanding principal amount of our 8% Notes, both of which contributed to the decrease in average outstanding balances and lower average interest rates on our debt in 2009.

In December 2010, as a result of entering into our \$425 million credit facility, we incurred \$4.2 million of credit facility origination costs that were classified in "other assets" on our consolidated balance sheet at December 31, 2010, and are being amortized over the term of the credit facility. The remaining credit facility origination costs that were incurred as a result of entering into our previous \$355 million credit facility, which were \$452,000 at December 31, 2010, are included in "other assets" and are being amortized over the remaining term of our current \$425 million credit facility.

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

	2010	2009	2008
Interest on our credit facility and notes	\$ 89,916	\$ 82,460	\$ 91,213
Interest included in discontinued operations from real estate acquired for resale by Crest	(557)	(595)	(1,797)
Credit facility commitment fees	1,017	990	795
Amortization of credit facility origination costs and deferred bond financing costs	2,871	2,678	3,078
Amortization of settlements on treasury lock agreement	—	—	759
Interest capitalized	(10)	(5)	(92)
Interest expense	\$ 93,237	\$ 85,528	\$ 93,956

<b>Credit facility and notes outstanding</b>	2010	2009	2008
Average outstanding balances (dollars in thousands)	\$ 1,496,150	\$ 1,350,791	\$ 1,457,222
Average interest rates	6.01%	6.10%	6.26%

At December 31, 2010, the weighted average interest rate on our notes payable of \$1.6 billion was 6.05%. There was no outstanding balance on our credit facility at December 31, 2010, but if there was, the effective borrowing rate would have been 2.11%.

## Interest Coverage Ratio

Our interest coverage ratio for 2010 was 3.3 times, for 2009 was 3.5 times and for 2008 was 3.2 times. Interest coverage ratio is calculated as: the interest coverage amount (as calculated in the following table) divided by interest expense, including interest recorded as 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.

## Management's Discussion and Analysis of Financial Condition and Results of Operations, cont'd.

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):

	2010	2009	2008
Net cash provided by operating activities	\$ 243,368	\$ 226,707	\$ 246,155
Interest expense	93,237	85,528	93,956
Interest expense included in discontinued operations <sup>(1)</sup>	557	595	1,797
Income taxes	1,393	677	1,230
Income taxes (benefit) included in discontinued operations <sup>(1)</sup>	(344)	(645)	225
Investment in real estate acquired for resale <sup>(1)</sup>	—	—	9
Proceeds from sales of real estate acquired for resale <sup>(1)</sup>	—	(1,987)	(31,455)
Collection of note receivables by Crest <sup>(1)</sup>	(138)	(129)	(87)
Crest provisions for impairment <sup>(1)</sup>	(807)	(277)	(3,374)
Gain on sales of real estate acquired for resale <sup>(1)</sup>	—	—	4,642
Amortization of share-based compensation	(6,166)	(4,726)	(5,049)
Changes in assets and liabilities:			
Accounts receivable and other assets	(5,270)	(3,607)	930
Accounts payable, accrued expenses and other liabilities	(12,517)	(856)	(1,676)
Interest coverage amount	\$ 313,313	\$ 301,280	\$ 307,303
Divided by interest expense <sup>(2)</sup>	\$ 93,794	\$ 86,123	\$ 95,753
Interest coverage ratio	3.3	3.5	3.2

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

<sup>(2)</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 2010 was 2.7 times, for 2009 was 2.7 times and for 2008 was 2.6 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 this Annual Report.

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

	2010	2009	2008
Interest coverage amount	\$ 313,313	\$ 301,280	\$ 307,303
Divided by interest expense plus preferred stock dividends <sup>(1)</sup>	\$ 118,047	\$ 110,376	\$ 120,006
Fixed charge coverage ratio	2.7	2.7	2.6

<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 \$4.4 million to \$25.3 million in 2010 as compared to \$20.9 million in 2009. General and administrative expenses were \$21.6 million in 2008. In 2010, general and administrative expenses as a percentage of total revenue were 7.3% as compared to 6.4% in 2009 and 6.7% in 2008. General and administrative expenses increased during 2010 primarily because of increases in employee costs, particularly in the acquisitions and research departments. In February 2011, we had 79 employees as compared to 72 employees in February 2010. In accordance with GAAP, 2010 general and administrative expenses also include transaction costs of \$368,000 related to the acquisition of 186 new properties during 2010, as compared to \$62,000 related to the acquisition of 16 new properties during 2009. Prior to 2009, GAAP required these transaction costs to be capitalized as part of the property investments.

### 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, 2010, 84 properties were available for lease, as compared to 75 at December 31, 2009 and 70 at December 31, 2008.

Property expenses were \$7.3 million in 2010, \$6.6 million in 2009 and \$5.5 million in 2008. The increase in property expenses in 2010 is primarily attributable to an increase in maintenance, utilities and property taxes associated with properties available for lease, partially offset by a decrease in bad debt expense.

### Income Taxes

Income taxes were \$1.4 million in 2010 as compared to \$677,000 in 2009 and \$1.2 million in 2008. These amounts are for city and state income and franchise taxes paid by Realty Income. Income taxes for 2009 are lower primarily a result of a prior year review of our state tax filings, where we determined that it was appropriate to amend some prior year tax returns from which we realized a tax benefit of \$308,000 in 2009.

In addition, Crest recorded state and federal income tax benefits of \$344,000 in 2010 as compared to income tax benefits of \$645,000 in 2009 and income tax expense of \$225,000 in 2008. These amounts are included in "income from discontinued operations, real estate acquired for resale by Crest" on our consolidated statements of income. The Crest 2009 tax benefit includes a benefit of \$303,000 attributable to amendments of certain prior year state tax returns.

### Discontinued Operations

Crest acquires properties with the intention of reselling them rather than holding them as investments and operating the properties. Consequently, we typically classify Crest's assets as held for sale at the date of acquisition and do not depreciate them. As a result, the operations of Crest's property assets are typically classified as "income from discontinued operations, real estate acquired for resale by Crest" on our consolidated statements of income.

However, if we determine we have no plans to sell a property asset in the near term (i.e. within the next 12 months), and this property was previously classified as held for sale, the property is reclassified as real estate held for investment. A property that is reclassified as held for investment is measured and recorded at the lower of (i) its carrying amount before the property was classified as held for sale, adjusted for any depreciation expense that would have been recognized had the property been continuously classified as held for investment, or (ii) the fair value at the date of the subsequent decision not to sell.

At December 31, 2010, we determined that three property assets, acquired by Crest in 2006, no longer met the held for sale criteria because we decided to lease rather than sell these properties in the near term. As a result, investment in real estate of \$3.0 million was reclassified from real estate held for sale to real estate held for investment on our consolidated balance sheet at December 31, 2010. The results of operations for these properties are included in income from continuing operations on our consolidated statements of income. As a result of this reclassification, \$911,000, \$214,000 and \$3.2 million in operating loss was reclassified from discontinued operations to continuing operations for 2010, 2009 and 2008, respectively.

## Management's Discussion and Analysis of Financial Condition and Results of Operations, cont'd.

The following is a summary of Crest's "income from discontinued operations, real estate acquired for resale by Crest" 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>2010</b>	<b>2009</b>	<b>2008</b>
Rental revenue	\$ —	\$ 157	\$ 1,595
Interest revenue	1,397	1,403	899
Gain on sales of real estate acquired for resale	—	—	4,642
Interest expense	(557)	(595)	(1,797)
General and administrative expense	(226)	(336)	(511)
Property expenses	(12)	(24)	(13)
Provisions for impairment	—	(78)	—
Depreciation <sup>(1)</sup>	—	—	(771)
Income tax benefit (expense)	344	645	(225)
Income from discontinued operations, real estate acquired for resale by Crest	\$ 946	\$ 1,172	\$ 3,819
Per common share, basic and diluted	\$ 0.01	\$ 0.01	\$ 0.04

<sup>(1)</sup> Depreciation was recorded on one property that was classified as held for investment. This property was sold in 2008.

Operations from nine of our investment properties were classified as held for sale at December 31, 2010, plus properties sold in 2010, 2009 and 2008 have been classified as discontinued operations. 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>2010</b>	<b>2009</b>	<b>2008</b>
Gain on sales of investment properties	\$ 8,405	\$ 8,044	\$ 13,314
Rental revenue	1,771	3,592	6,813
Other revenue	32	45	96
Depreciation and amortization	(636)	(1,428)	(1,929)
Property expenses	(937)	(963)	(573)
Provisions for impairment	(213)	(110)	—
Income from discontinued operations, real estate held for investment	\$ 8,422	\$ 9,180	\$ 17,721
Per common share, basic and diluted	\$ 0.08	\$ 0.09	\$ 0.18

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

<b>Total discontinued operations</b>	<b>2010</b>	<b>2009</b>	<b>2008</b>
Real estate acquired for resale by Crest	\$ 946	\$ 1,172	\$ 3,819
Real estate held for investment	8,422	9,180	17,721
Income from discontinued operations	\$ 9,368	\$ 10,352	\$ 21,540
Per common share, basic and diluted	\$ 0.09	\$ 0.10	\$ 0.21

The above per share amounts have each been calculated independently.

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

During 2010, Crest did not sell any properties. During 2009, Crest sold two properties for \$2.0 million, which resulted in no gain. In 2008, Crest sold 25 properties for \$50.7 million, which resulted in a gain of \$4.6 million. During 2008, as part of two sales, Crest provided buyer financing of \$19.2 million. Crest's gains on sales are reported before income taxes and are included in discontinued operations.

### **Gain on Sales of Investment Properties by Realty Income**

During 2010, we sold 28 investment properties for \$26.6 million, which resulted in a gain of \$8.4 million. The results of operations for these properties have been reclassified as discontinued operations. Additionally, we sold excess land from one property for \$600,000, which resulted in a gain of \$271,000. This gain is included in "other revenue" on our consolidated statement of income for 2010 because this excess land was associated with a property that continues to be owned as part of our core operations.

During 2009, we sold 25 investment properties for \$20.3 million, which resulted in a gain of \$8.0 million. The results of operations for these properties have been reclassified as discontinued operations. Additionally, we received proceeds of \$170,000 from the sale of excess land from one property, which resulted in a gain of \$15,000. This gain is included in "other revenue" on our consolidated statement of income for 2009 because this excess land was associated with a property that continues to be owned as part of our core operations.

During 2008, we sold 29 investment properties for \$27.4 million, which resulted in a gain of \$13.3 million. The results of operations for these properties have been reclassified as discontinued operations. Additionally, we received proceeds of \$439,000 from the sale of excess land from one property, which resulted in a gain of \$236,000. This gain is included in "other revenue" on our consolidated statement of income for 2008 because this excess land was associated with a property that continues to be owned as part of our core operations.

We have an active portfolio management program that incorporates the sale of assets when we believe the reinvestment of the sale proceeds will:

- Generate higher returns;
- Enhance the credit quality of our real estate portfolio;
- Extend our average remaining lease term; or
- Decrease tenant or industry concentration.

At December 31, 2010, we classified real estate with a carrying amount of \$3.6 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, if there are attractive opportunities available. However, we cannot guarantee that we will sell properties during the next 12 months or be able to invest the proceeds from the sales of any properties in new properties.

### **Provisions for Impairment on Real Estate Acquired for Resale by Crest**

During 2010, Crest recorded total provisions for impairment of \$807,000 on three properties held for investment at December 31, 2010. These provisions for impairment are included in continuing operations on our consolidated statement of income for 2010.

During 2009, Crest recorded total provisions for impairment of \$199,000 on three properties classified as held for investment at December 31, 2010. These provisions for impairment are included in continuing operations on our consolidated statement of income for 2009. Additionally, in 2009, Crest recorded total provisions for impairment of \$78,000 on two properties which were sold in 2009. These provisions for impairment are included in "income from discontinued operations, real estate acquired for resale by Crest" on our consolidated statement of income for 2009.

During 2008, Crest recorded total provisions for impairment of \$3.4 million on three properties which were held for investment at December 31, 2010. These provisions for impairment are included in continuing operations on our consolidated statement of income for 2008.

### **Provisions for Impairment on Realty Income Investment Properties**

During 2010, we recorded provisions for impairment of \$213,000 on four properties, three which were sold in 2010 and the other is anticipated to be sold in the first quarter of 2011. These provisions for impairment are included in "income from discontinued operations, real estate held for investment" on our consolidated statement of income for 2010. During 2009, we recorded a provision for impairment of \$110,000 on one property, which is included in "income from discontinued operations, real estate held for investment" on our consolidated statement of income for 2009, and the property was sold in 2010. No provisions for impairment were recorded in 2008.

### **Preferred Stock Dividends**

Preferred stock cash dividends totaled \$24.3 million in 2010, 2009 and 2008.

## Management's Discussion and Analysis of Financial Condition and Results of Operations, cont'd.

### Net Income Available to Common Stockholders

Net income available to common stockholders was \$106.5 million in 2010, a slight decrease of \$343,000 as compared to \$106.9 million in 2009. Net income available to common stockholders in 2008 was \$107.6 million.

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

Gain from the sale of investment properties and the sale of excess land recognized during 2010 was \$8.7 million, as compared to a \$8.1 million gain recognized during 2009 and a \$13.6 million gain recognized during 2008. Crest recognized no gain from the sale of properties during 2010 or 2009 as compared to \$4.6 million during 2008.

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

FFO for 2010 increased by \$3.3 million, or 1.7%, to \$193.7 million, as compared to \$190.4 million in 2009 and \$185.5 million in 2008. 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 common shares used for the basic and diluted computation per share (dollars in thousands, except per share amounts):

	2010	2009	2008
Net income available to common stockholders	\$ 106,531	\$ 106,874	\$ 107,588
Depreciation and amortization:			
Continuing operations	95,513	90,519	89,104
Discontinued operations	636	1,428	2,701
Depreciation of furniture, fixtures and equipment	(291)	(318)	(319)
Gain on sales of land and investment properties:			
Continuing operations	(271)	(15)	(236)
Discontinued operations	(8,405)	(8,044)	(13,314)
FFO available to common stockholders	\$ 193,713	\$ 190,444	\$ 185,524
FFO per common share:			
Basic	\$ 1.83	\$ 1.84	\$ 1.83
Diluted	\$ 1.83	\$ 1.84	\$ 1.83
Distributions paid to common stockholders	\$ 182,500	\$ 178,008	\$ 169,655
FFO in excess of distributions paid to common stockholders	\$ 11,213	\$ 12,436	\$ 15,869
Weighted average number of common shares used for computation per share:			
Basic	105,869,637	103,577,507	101,178,191
Diluted	105,942,721	103,581,053	101,209,883

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 adds back non-cash items such as depreciation. The historical accounting convention used for real estate assets requires straight-line depreciation of buildings and improvements, which implies that the value of real estate assets diminishes predictably over time. Since real estate values historically rise and fall with market conditions, presentations of operating results for a REIT, using historical accounting for depreciation, could be less informative. The use of FFO is recommended by the REIT industry as a supplemental performance measure. In addition, FFO is used as a measure of our compliance with the financial covenants of our credit facility.

Presentation of this information is intended to assist the reader in comparing the operating performance of different REITs, although it should be noted that not all REITs calculate FFO the same way, so comparisons with other REITs may not be meaningful. Furthermore, FFO is not necessarily indicative of cash flow available to fund cash needs and should not be considered as an alternative to net income as an indication of 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.

## ADJUSTED FUNDS FROM OPERATIONS AVAILABLE TO COMMON STOCKHOLDERS (AFFO)

AFFO for 2010 increased by \$4.6 million, or 2.4%, to \$197.3 million as compared to \$192.7 million in 2009 and \$192.0 million in 2008. We consider AFFO to be an appropriate supplemental measure of our performance because it provides analysts and investors with an additional indicator of our ability to pay dividends. Most companies in our industry use a similar measurement, but they may use the term "CAD" (for Cash Available for Distribution) or "FAD" (for Funds Available for Distribution). AFFO further adjusts FFO by adding back non-cash items that reduce net income in accordance with GAAP, and deducting such items as capitalized expenditures and straight-line rent revenue.

The following is a reconciliation of net income available to common stockholders (which we believe is the most comparable GAAP measure) to FFO and AFFO. Also presented is information regarding distributions paid to common stockholders and the weighted average number of common shares used for the basic and diluted computation per share (dollars in thousands, except per share amounts):

	2010	2009	2008
Net income available to common stockholders	\$ 106,531	\$ 106,874	\$ 107,588
Cumulative adjustments to calculate FFO <sup>(1)</sup>	87,182	83,570	77,936
FFO available to common stockholders	193,713	190,444	185,524
Amortization of share-based compensation	6,166	4,726	5,049
Amortization of deferred note financing costs <sup>(2)</sup>	1,548	1,363	1,748
Amortization of settlements on treasury lock agreements <sup>(3)</sup>	—	—	759
Provisions for impairment	1,020	387	3,374
Capitalized leasing costs and commissions	(1,501)	(1,185)	(956)
Capitalized building improvements	(2,077)	(1,879)	(1,498)
Straight-line rent revenue <sup>(4)</sup>	(1,613)	(1,117)	(1,997)
Total AFFO available to common stockholders	\$ 197,256	\$ 192,739	\$ 192,003
AFFO per common share:			
Basic	\$ 1.86	\$ 1.86	\$ 1.90
Diluted	\$ 1.86	\$ 1.86	\$ 1.90
Distributions paid to common stockholders	\$ 182,500	\$ 178,008	\$ 169,655
AFFO in excess of distributions paid to common stockholders	\$ 14,756	\$ 14,731	\$ 22,348
Weighted average number of common shares used for computation per share:			
Basic	105,869,637	103,577,507	101,178,191
Diluted	105,942,721	103,581,053	101,209,883

<sup>(1)</sup> See reconciling items for FFO presented on the previous page.

<sup>(2)</sup> Amortization of deferred note financing costs includes the amortization of costs incurred and capitalized when our notes were issued in January 1999, March 2003, November 2003, March 2005, September 2005, September 2006, September 2007 and June 2010. 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> The settlement 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>(4)</sup> A negative amount indicates that our straight-line rent revenue was greater than our actual cash rent collected.

Presentation of the information regarding FFO and AFFO 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 and AFFO in the same way, so comparisons with other REITs may not be meaningful. Furthermore, FFO and AFFO are 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 and AFFO should not be considered as an alternative to reviewing our cash flows from operating, investing, and financing activities. In addition, FFO and AFFO should not be considered as a measure of liquidity, of our ability to make cash distributions, or of our ability to pay interest payments.

## Management's Discussion and Analysis of Financial Condition and Results of Operations, cont'd.

### 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 (typically subject to ceilings), 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.

Of our 2,496 properties in our portfolio, approximately 96.2% or 2,402 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.

### 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 and bonds 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 and bonds, primarily at fixed rates. We were not a party to any derivative financial instruments at December 31, 2010. We do not enter into any derivative transactions for speculative or trading purposes.

The following table presents by year of expected maturity, the principal amounts, average interest rates and estimated fair values of our fixed and variable debt as of December 31, 2010. 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
2011	\$ —	—%	\$ —	—%
2012	—	—	—	—
2013 <sup>(1)</sup>	100.0	5.38	—	—
2014 <sup>(2)</sup>	—	—	—	—
2015 <sup>(3)</sup>	150.0	5.50	—	—
Thereafter <sup>(4)</sup>	1,350.0	6.16	—	—
Totals/Average	\$ 1,600.0	6.05%	\$ —	—%
Fair Value <sup>(5)</sup>	\$ 1,707.1		\$ —	

<sup>(1)</sup> \$100 million matures in March 2013.

<sup>(2)</sup> The credit facility expires in March 2014.

<sup>(3)</sup> \$150 million matures in November 2015.

<sup>(4)</sup> \$275 million matures in September 2016, \$175 million matures in September 2017, \$550 million matures in August 2019, \$250 million matures in January 2021 and \$100 million matures in March 2035.

<sup>(5)</sup> We base the fair value of the fixed rate debt at December 31, 2010 on indicative market prices and recent trading activity of our notes payable.

The table incorporates only those exposures that exist as of December 31, 2010. 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. Interest on our credit facility balance is variable. At December 31, 2010, 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.



## Selected Financial Data

(not covered by Report of Independent Registered Public Accounting Firm)  
(dollars in thousands, except for per share data)

As of or for the years ended December 31,	2010	2009	2008	2007	2006
Total assets (book value)	\$ 3,535,590	\$ 2,914,787	\$ 2,994,179	\$ 3,077,352	\$ 2,546,508
Cash and cash equivalents	17,607	10,026	46,815	193,101	10,573
Lines of credit and notes payable	1,600,000	1,354,600	1,370,000	1,470,000	920,000
Total liabilities	1,688,625	1,426,778	1,439,518	1,539,260	970,516
Total stockholders' equity	1,846,965	1,488,009	1,554,661	1,538,092	1,575,992
Net cash provided by operating activities	243,368	226,707	246,155	318,169	86,945
Net change in cash and cash equivalents	7,581	(36,789)	(146,286)	182,528	(55,131)
Total revenue	345,009	325,245	325,041	288,650	230,940
Income from continuing operations	121,416	120,775	110,301	121,871	99,551
Income from discontinued operations	9,368	10,352	21,540	18,538	11,230
Net income	130,784	131,127	131,841	140,409	110,781
Preferred stock cash dividends	(24,253)	(24,253)	(24,253)	(24,253)	(11,362)
Net income available to common stockholders	106,531	106,874	107,588	116,156	99,419
Cash distributions paid to common stockholders	182,500	178,008	169,655	157,659	129,667
Basic and diluted net income per common share	1.01	1.03	1.06	1.16	1.11
Cash distributions paid per common share	1.721625	1.706625	1.662250	1.560250	1.437250
Cash distributions declared per common share	1.722875	1.707875	1.667250	1.570500	1.447500
Basic weighted average number of common shares outstanding	105,869,637	103,577,507	101,178,191	100,195,031	89,766,714
Diluted weighted average number of common shares outstanding	105,942,721	103,581,053	101,209,883	100,333,966	89,917,554

# 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 accounting matters 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 Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended) 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, 2010, 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 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 10, 2011 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 in the fourth quarter of 2010. As of December 31, 2010, 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 2010, 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, 2010, the certifications by Tom Lewis and Paul M. Meurer, Realty Income's Chief Executive Officer and Chief Financial Officer, respectively, required under Section 302 of the Sarbanes-Oxley Act.

# Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

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.

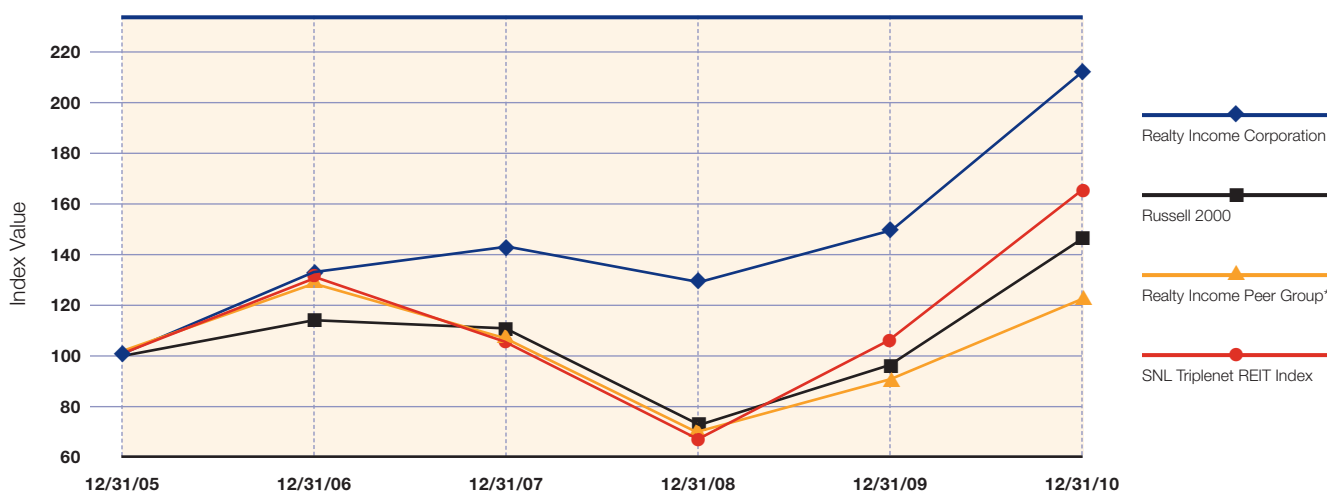
	Price Per Share of Common Stock		Distributions Declared <sup>(1)</sup>
	High	Low	
<b>2010</b>			
First quarter	\$ 31.18	\$ 25.30	\$ 0.4293125
Second quarter	34.53	28.42	0.4302500
Third quarter	34.79	29.12	0.4311875
Fourth quarter	35.97	32.92	0.4321250
Total			\$ 1.7228750
<b>2009</b>			
First quarter	\$ 23.41	\$ 14.26	\$ 0.4255625
Second quarter	23.23	17.90	0.4265000
Third quarter	28.20	19.83	0.4274375
Fourth quarter	27.53	22.17	0.4283750
Total			\$ 1.7078750

<sup>(1)</sup> Common stock cash distributions currently are declared monthly by us based on financial results for the prior months. At December 31, 2010, a distribution of \$0.14425 per common share had been declared and was paid in January 2011.

There were 8,396 registered holders of record of our common stock as of December 31, 2010. We estimate that our total number of shareholders is approximately 100,000 when we include both registered and beneficial holders of our common stock.

During the fourth quarter of 2010, no shares of stock were withheld for state and federal payroll taxes on the vesting of stock awards, as permitted under the 2003 Incentive Award Plan of Realty Income Corporation.

## TOTAL RETURN PERFORMANCE



Index	Period Ending					
	12/31/05	12/31/06	12/31/07	12/31/08	12/31/09	12/31/10
Realty Income Corporation	100.00	136.01	140.48	129.02	155.96	217.26
Russell 2000	100.00	118.37	116.51	77.15	98.11	124.46
Realty Income Peer Group*	100.00	133.17	110.49	67.04	91.85	120.85
SNL Triplanet REIT Index	100.00	132.63	123.05	84.88	113.89	143.30

\* Realty Income Peer Group consists of thirteen companies (excluding Realty Income) with an implied market capitalization between \$3 billion-\$5 billion as of September 30, 2010.

# Company Information



**Realty Income's Senior Management** - front row: Tom Lewis, second row: Rob Israel, Paul Meurer, Laura King, third row: Gary Malino, Richard Collins, top row: John Case and Mike Pfeiffer

## 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

**John P. Case**  
Executive Vice President,  
Chief Investment Officer

**Richard G. Collins**  
Executive Vice President,  
Portfolio Management

## ADDITIONAL OFFICERS

**Robert J. Israel**  
Senior Vice President,  
Research

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

**Theresa M. Casey**  
Vice President,  
Information Technologies

**Elizabeth Cate**  
Vice President,  
Portfolio Management

**Gregory J. Fahey**  
Vice President,  
Controller

**Benjamin N. Fox**  
Vice President,  
Director, Strategic Initiatives

**Tere H. Miller**  
Vice President,  
Corporate Communications

**Dawn Nguyen**  
Vice President,  
Portfolio Management

**Joel Tomlinson**  
Vice President,  
Director of Acquisitions

**Cary J. Wenthur**  
Vice President,  
Acquisitions

**Stephen D. Burchett**  
Associate Vice President,  
Senior Legal Counsel

**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

**Sean P. Nugent**  
Associate Vice President,  
Accounting Manager

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

**Patrick Rea**  
Associate Vice President,  
Property Management

## DIRECTORS

**Donald R. Cameron**  
Chairman of the Board  
of Directors and President,  
Cameron, Murphy & Spangler, Inc.

**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

**Priya Cherian Huskins**  
Partner,  
Woodruff-Sawyer & Co.

**Michael D. McKee**  
Chief Executive Officer,  
Bentall Kennedy

**Gregory T. McLaughlin**  
President,  
Tiger Woods Foundation

**Ronald L. Merriman**  
Retired Vice Chair,  
KPMG, LLP

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

## TRANSFER AGENT

Wells Fargo Shareowner Services  
P.O. Box 64873  
St. Paul, MN 55164

For shareholder administration  
and account information please  
visit Wells Fargo's website at:  
[www.shareowneronline.com](http://www.shareowneronline.com)  
or call this toll-free number:  
1-877-218-2434 or email your  
questions to:  
[stocktransfer@wellsfargo.com](mailto:stocktransfer@wellsfargo.com)

## FOR ADDITIONAL CORPORATE INFORMATION

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

Visit the Realty Income corporate  
website at: [www.realtyincome.com](http://www.realtyincome.com)

Contact your financial advisor, or  
contact 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

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