

# HIGH-QUALITY GROWTH



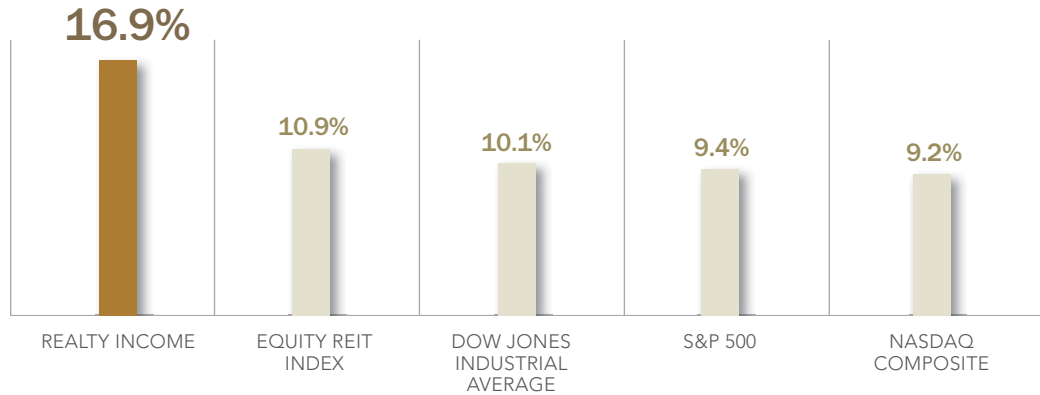
REALTY  INCOME

The Monthly Dividend Company®

2016 ANNUAL REPORT

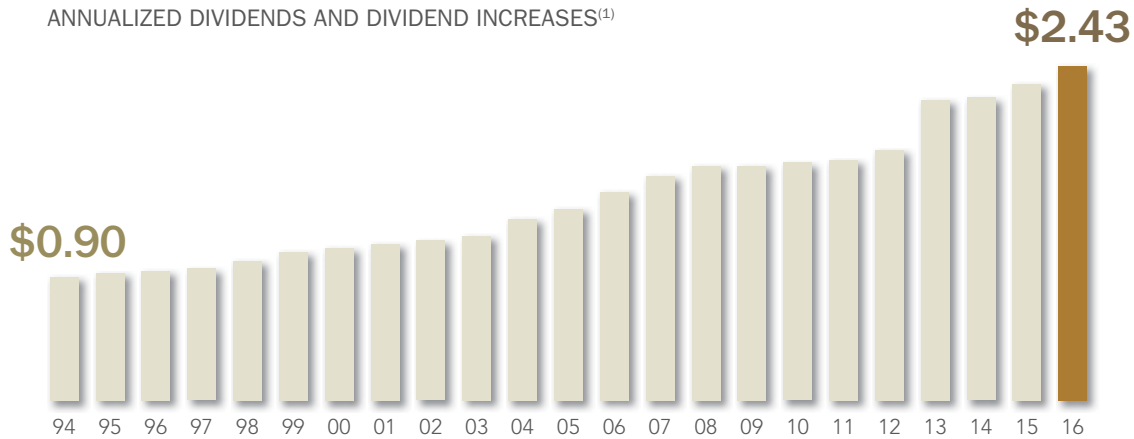
# HIGH-QUALITY RESULTS

## COMPOUND AVERAGE ANNUAL TOTAL SHAREHOLDER RETURN SINCE 1994 NYSE LISTING



## SUPPORTED BY CONSISTENT COMPOUND AVERAGE ANNUAL DIVIDEND GROWTH OF 4.6%

ANNUALIZED DIVIDENDS AND DIVIDEND INCREASES<sup>(1)</sup>



(1) Annualized dividend amount reflects the December declared dividend rate per share multiplied by 12

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# 2016 PERFORMANCE HIGHLIGHTS

16.0%

TOTAL SHAREHOLDER  
RETURN

5.1%

AFFO PER SHARE  
GROWTH

5.3%

DIVIDEND PER  
SHARE GROWTH

\$1.86 Billion

INVESTED IN HIGH-QUALITY  
REAL ESTATE

98.3%

PORTFOLIO  
OCCUPANCY

\$1.2 Billion

ATTRACTIVELY PRICED  
CAPITAL RAISED



# HISTORICAL FINANCIAL PERFORMANCE

(DOLLARS IN MILLIONS, EXCEPT PER SHARE DATA)

For the Years Ended December 31,	2016	2015	2014	2013	2012	2011	2010	2009
<b>Total revenue<sup>(1)</sup></b>	<b>\$1,060</b>	<b>\$980</b>	<b>\$895</b>	<b>\$760</b>	<b>\$484</b>	<b>\$422</b>	<b>\$346</b>	<b>\$329</b>
Net income available to common stockholders	\$288	\$257	\$228	\$204	\$115	\$133	\$107	\$107
Funds from operations (“FFO”) <sup>(2)</sup>	\$735	\$652	\$563	\$462	\$269	\$249	\$194	\$191
Adjusted funds from operations (“AFFO”) <sup>(2)</sup>	\$736	\$647	\$562	\$463	\$274	\$253	\$197	\$193
Dividends paid to common stockholders	\$611	\$533	\$479	\$409	\$236	\$219	\$183	\$178
<b>AT YEAR END</b>								
Real estate at cost, before accumulated depreciation <sup>(3)</sup>	\$13,864	\$12,297	\$11,154	\$9,899	\$5,921	\$4,972	\$4,113	\$3,439
Number of properties	4,944	4,538	4,327	3,896	3,013	2,634	2,496	2,339
Gross leasable square feet (millions)	83	76	71	63	38	27	21	19
Properties acquired <sup>(4)</sup>	505	286	506	974	423	164	186	16
<b>Cost of properties acquired<sup>(4)</sup></b>	<b>\$1,859</b>	<b>\$1,259</b>	<b>\$1,402</b>	<b>\$4,670</b>	<b>\$1,165</b>	<b>\$1,016</b>	<b>\$714</b>	<b>\$58</b>
Properties sold	77	38	46	75	44	26	28	25
Net proceeds from sale of properties	\$91	\$66	\$107	\$134	\$51	\$24	\$27	\$20
Number of commercial tenants <sup>(5)</sup>	248	240	234	205	150	136	122	118
Number of industries	47	47	47	47	44	38	32	30
Number of states	49	49	49	49	49	49	49	49
<b>Portfolio occupancy rate</b>	<b>98.3%</b>	<b>98.4%</b>	<b>98.4%</b>	<b>98.2%</b>	<b>97.2%</b>	<b>96.7%</b>	<b>96.6%</b>	<b>96.8%</b>
Remaining weighted average lease term (years)	9.8	10.0	10.2	10.8	11.0	11.3	11.4	11.2
<b>PER COMMON SHARE DATA<sup>(6)</sup></b>								
Net income (diluted)	<b>\$1.13</b>	\$1.09	\$1.04	\$1.06	\$0.86	\$1.05	\$1.01	\$1.03
Funds from operations (“FFO”) <sup>(2)</sup>	\$2.88	\$2.77	\$2.58	\$2.41	\$2.02	\$1.98	\$1.83	\$1.84
<b>Adjusted funds from operations (“AFFO”)<sup>(2)</sup></b>	<b>\$2.88</b>	<b>\$2.74</b>	<b>\$2.57</b>	<b>\$2.41</b>	<b>\$2.06</b>	<b>\$2.01</b>	<b>\$1.86</b>	<b>\$1.86</b>
<b>Dividends paid</b>	<b>\$2.392</b>	<b>\$2.271</b>	<b>\$2.192</b>	<b>\$2.147</b>	<b>\$1.772</b>	<b>\$1.737</b>	<b>\$1.722</b>	<b>\$1.707</b>
Annualized dividend amount <sup>(7)</sup>	\$2.43	\$2.29	\$2.20	\$2.19	\$1.82	\$1.75	\$1.73	\$1.72
Common shares outstanding (millions)	260	250	225	207	133	133	118	104
<b>INVESTMENT RESULTS</b>								
Closing price on December 31,	\$57.48	\$51.63	\$47.71	\$37.33	\$40.21	\$34.96	\$34.20	\$25.91
Dividend yield <sup>(8)(9)</sup>	4.6%	4.4%	5.9%	5.3%	5.1%	5.1%	6.6%	7.4%
<b>Total return to stockholders<sup>(10)</sup></b>	<b>16.0%</b>	<b>13.0%</b>	<b>33.7%</b>	<b>(1.8%)</b>	<b>20.1%</b>	<b>7.3%</b>	<b>38.6%</b>	<b>19.3%</b>

<sup>(1)</sup> For years prior to 2016, total revenue includes amounts reclassified to income from discontinued operations, but excludes gain on sales, tenant reimbursements, and revenue from Crest Net Lease, a subsidiary of Realty Income. Consistent with Realty Income’s financial reporting methodology changes, 2016 total revenue includes approximately \$2.3 million of revenue from Crest Net Lease

<sup>(2)</sup> Refer to Management’s Discussion and Analysis for FFO and AFFO definition and reconciliation to net income available to common stockholders in the 2016 Form 10-K section. For 2012 and 2013, FFO has been adjusted to add back American Realty Capital Trust merger-related costs

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

<sup>(4)</sup> Includes new properties acquired by Realty Income and Crest Net Lease and properties under development or expansion

<sup>(5)</sup> Commercial tenants are defined as retailers with over 50 locations and non-retailers with over \$500 million in annual revenues

2008	2007	2006	2005	2004	2003	2002	2001	2000	1999	1998	1997	1996	1995	1994
\$331	\$296	\$241	\$198	\$178	\$150	\$138	\$121	\$116	\$105	\$85	\$68	\$57	\$52	\$49
\$108	\$116	\$99	\$90	\$90	\$77	\$69	\$58	\$45	\$41	\$41	\$35	\$32	\$26	\$15
\$186	\$190	\$156	\$130	\$121	\$105	\$95	\$78	\$67	\$66	\$63	\$52	\$48	\$40	\$39
\$192	\$193	\$159	\$131	\$126	\$107	\$96	\$79	\$68	\$66	\$62	\$52	\$47	\$40	\$39
\$170	\$158	\$130	\$109	\$97	\$84	\$78	\$65	\$58	\$56	\$52	\$44	\$43	\$37	\$39
\$3,409	\$3,239	\$2,744	\$2,096	\$1,691	\$1,533	\$1,286	\$1,178	\$1,074	\$1,017	\$890	\$700	\$565	\$515	\$451
2,348	2,270	1,955	1,646	1,533	1,404	1,197	1,124	1,068	1,076	970	826	740	685	630
19	19	17	13	12	11	10	10	9	9	8	6	5	5	4
108	357	378	156	194	302	111	117	22	110	149	96	62	58	4
\$190	\$534	\$770	\$487	\$215	\$372	\$139	\$156	\$99	\$181	\$193	\$142	\$56	\$65	\$3
29	10	13	23	43	35	35	35	21	3	5	10	7	3	5
\$28	\$7	\$11	\$23	\$35	\$23	\$20	\$40	\$45	\$9	\$3	\$4	\$4	\$1	\$4
119	115	103	101	93	85	79	78	72	72	65	40	24	22	23
30	30	29	29	30	28	26	25	24	24	22	14	8	7	5
49	49	48	48	48	48	48	48	46	45	45	43	42	42	41
97.0%	97.9%	98.7%	98.5%	97.9%	98.1%	97.7%	98.2%	97.7%	98.4%	99.5%	99.2%	99.1%	99.3%	99.4%
11.9	13.0	12.9	12.4	12.0	11.8	10.9	10.4	9.8	10.7	10.2	9.8	9.5	9.2	9.5
\$1.06	\$1.16	\$1.11	\$1.12	\$1.15	\$1.08	\$1.01	\$0.99	\$0.84	\$0.76	\$0.78	\$0.74	\$0.70	\$0.63	\$0.39
\$1.83	\$1.89	\$1.73	\$1.62	\$1.53	\$1.47	\$1.40	\$1.33	\$1.26	\$1.23	\$1.18	\$1.11	\$1.04	\$1.00	\$0.98
\$1.90	\$1.92	\$1.77	\$1.63	\$1.61	\$1.50	\$1.41	\$1.34	\$1.27	\$1.24	\$1.17	\$1.10	\$1.03	\$0.98	\$0.98
\$1.662	\$1.560	\$1.437	\$1.346	\$1.241	\$1.181	\$1.151	\$1.121	\$1.091	\$1.043	\$0.983	\$0.946	\$0.931	\$0.913	\$0.300
\$1.70	\$1.64	\$1.52	\$1.40	\$1.32	\$1.20	\$1.17	\$1.14	\$1.11	\$1.08	\$1.02	\$0.96	\$0.95	\$0.93	\$0.90
104	101	101	84	79	76	70	66	53	54	54	51	46	46	39
\$23.15	\$27.02	\$27.70	\$21.62	\$25.29	\$20.00	\$17.50	\$14.70	\$12.44	\$10.31	\$12.44	\$12.72	\$11.94	\$11.25	\$8.56
6.1%	5.6%	6.7%	5.3%	6.2%	6.7%	7.8%	9.0%	10.6%	8.4%	7.7%	7.9%	8.3%	10.7%	9.9%
(8.2%)	3.2%	34.8%	(9.2%)	32.7%	21.0%	26.9%	27.2%	31.2%	(8.7%)	5.5%	14.5%	15.4%	42.0%	28.5%

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

<sup>(7)</sup> Annualized dividend amount reflects the December declared dividend rate per share multiplied by 12

<sup>(8)</sup> Dividend yield was calculated by dividing the dividend paid per share, during the year, by the closing share price on December 31 or the last trading day of the preceding year. 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

<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 or the last trading day of the preceding year



# DEAR FELLOW SHAREHOLDERS,

Since our founding in 1969, we have remained dedicated to our mission of providing our shareholders with dependable monthly dividends that increase over time. Accomplishing this mission is made possible by our unwavering focus on *quality*, which is reflected by the composition of our real estate portfolio, the strength of our balance sheet, and the talents of our team members. By operating our company in this manner, we strive to achieve consistent, positive performance year after year.



**2016 was another year of high-quality growth for our company.**

We surpassed the milestone of \$1 billion in rental revenues. Our efficient operations continued to allow us to deliver more of this revenue to our shareholders in the form of earnings and dividends. In 2016, earnings per share, as measured by Adjusted Funds from Operations (AFFO), grew by 5.1% to \$2.88. We paid 12 monthly dividends, increased the dividend six times and grew it by 5.3%, which contributed to a total annual return to our shareholders of 16.0%.

**MISSION**

Our mission of providing dependable monthly dividends to our shareholders has remained constant throughout our 48-year operating history and consistently positions us for favorable results.

Achieving our mission involves effectively executing our business plan. That plan is to:

- Pay 12 monthly dividends
- Raise the dividend
- Remain disciplined in our acquisitions underwriting approach

- Acquire additional properties according to our selective investment strategy
- Maintain high occupancy through active portfolio management
- Maintain a conservative balance sheet
- Continue to grow investor interest in The Monthly Dividend Company®

During 2016, we successfully executed on all aspects of this plan. We completed the highest volume of property acquisitions in the company’s history, maintained consistently high portfolio occupancy, and accessed the public capital markets at favorable terms to position our balance sheet for future growth. This business plan has served us well throughout our history and provides us with the flexibility to react to ongoing changes in the economy and real estate markets which is crucial to our continued successful operations.

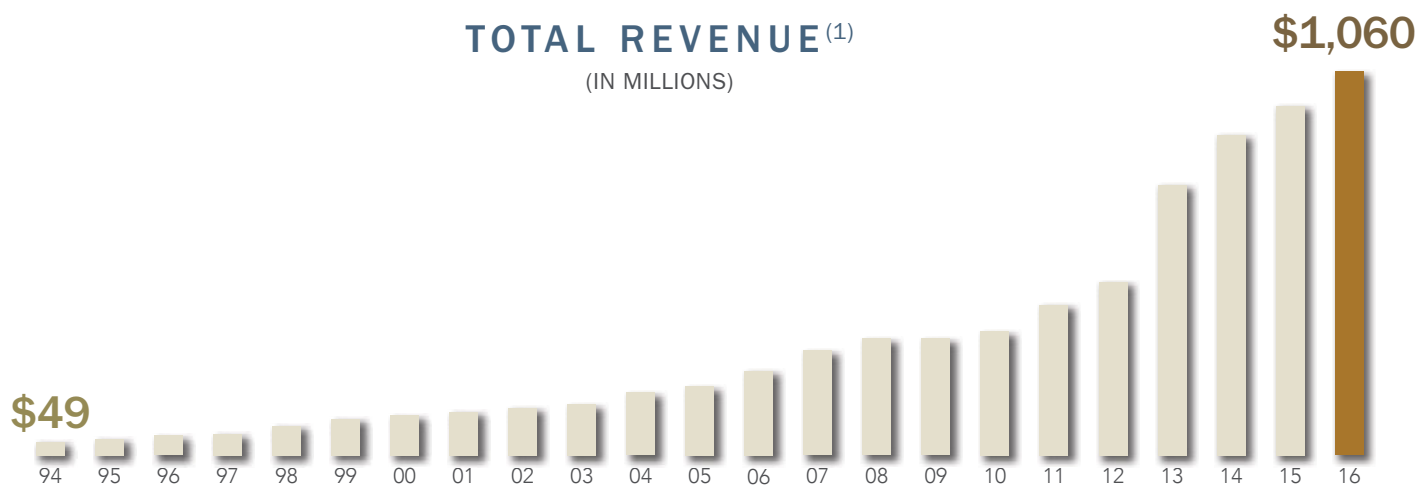
**SHAREHOLDER RETURN**

Our focus on providing dependable monthly dividends that increase over time helps drive attractive total shareholder returns. In 2016, the shareholders who owned

our common stock for the full calendar year realized a total return of 16.0%, which reflects the 11.3% increase in our stock price as well as the dividends paid throughout the year.

We always like to remind our shareholders that our company’s total return results do not always move in parallel with its operating performance in any given year. Other factors beyond our company’s operating performance can impact the price of our shares including, but not limited to, macroeconomic events, interest rate trends, and conditions in the broader stock market.

Over the long term, however, our positive and consistent operating performance has led to advances in our stock price and dividends, resulting in a compound average annual total shareholder return of 16.9% since our public listing in 1994, as shown in the table on page 6. Additionally, our stock price has experienced lower market volatility than the major stock indices over this time period. We are pleased by these results and our goal is to continue managing the company



(1) See page 2 for the definition of total revenue

## REALTY INCOME PERFORMANCE VS. MAJOR STOCK INDICES

	Realty Income		Equity REIT Index <sup>(1)</sup>		Dow Jones Industrial Average		S&P 500		NASDAQ Composite	
	DIVIDEND YIELD	TOTAL RETURN <sup>(2)</sup>	DIVIDEND YIELD	TOTAL RETURN <sup>(3)</sup>	DIVIDEND YIELD	TOTAL RETURN <sup>(3)</sup>	DIVIDEND YIELD	TOTAL RETURN <sup>(3)</sup>	DIVIDEND YIELD	TOTAL RETURN <sup>(4)</sup>
10/18–12/31 1994	10.5%	10.8%	7.7%	0.0%	2.9%	(1.6%)	2.9%	(1.2%)	0.5%	(1.7%)
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%
2011	5.0%	7.3%	3.8%	8.3%	2.8%	8.3%	2.3%	2.1%	1.3%	(1.8%)
2012	4.5%	20.1%	3.5%	19.7%	3.0%	10.2%	2.5%	16.0%	2.6%	15.9%
2013	5.8%	(1.8%)	3.9%	2.9%	2.3%	29.6%	2.0%	32.4%	1.4%	38.3%
2014	4.6%	33.7%	3.6%	28.0%	2.3%	10.0%	2.0%	13.7%	1.3%	13.4%
2015	4.4%	13.0%	3.9%	2.8%	2.6%	0.2%	2.2%	1.4%	1.4%	5.7%
2016	4.2%	16.0%	4.0%	8.6%	2.5%	16.5%	2.1%	12.0%	1.4%	7.5%
<b>COMPOUND AVERAGE ANNUAL TOTAL RETURN<sup>(5)</sup></b>		<b>16.9%</b>		<b>10.9%</b>		<b>10.1%</b>		<b>9.4%</b>		<b>9.2%</b>

Note: All of these dividend yields are calculated as annualized dividends based on the last dividend paid in applicable time period divided by the closing price as of period end. Dividend yield sources: NAREIT website and Bloomberg, except for the 1994 NASDAQ dividend yield which was sourced from Datastream / Thomson Financial.

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

<sup>(2)</sup> Calculated as the difference between the closing stock price as of period end less the closing stock price as of previous period, plus dividends paid in period, divided by closing stock price as of end of previous period. Does not include reinvestment of dividends for the annual percentages.

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

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

<sup>(5)</sup> All of these Compound Average Annual Total Return rates are calculated in the same manner: from Realty Income's NYSE listing on October 18, 1994 through December 31, 2016, and (except for NASDAQ) assuming reinvestment of dividends. 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.



in a manner that supports sustainable, long-term value creation for our shareholders.

## ACQUISITIONS

Our high-quality real estate acquisitions continue to be the primary driver of our earnings growth. During 2016, we completed \$1.86 billion in acquisitions which represented our most active year for property-level acquisitions in our company's history. We remained quite selective in what we pursued, acquiring just 6.5% of the \$29 billion in real estate acquisition opportunities that were generated and reviewed.

While the flow of opportunities continued to be abundant, we remained committed to our investment strategy, targeting only those opportunities with attractive real estate locations, high-quality tenants, and favorably structured lease terms. We believe this measured approach is a prudent one. As fiduciaries of your investment, we are committed to responsibly acquiring

properties that preserve the stability and growth of the dividend.

The \$1.86 billion in property acquisitions were purchased at an average initial yield of 6.3%, which resulted in very attractive investment spreads relative to our first-year weighted average cost of capital.

We continue to maintain investment spreads well above our historical average while acquiring high-quality real estate properties.

Beyond increasing earnings, our acquisitions activity strengthened the company by further diversifying the portfolio and improving our tenant credit quality.

Diversification continues to be central to our investment strategy as it enhances the stability of our revenues by limiting the amount of rent we receive from any single tenant, industry, or market. The 505 properties acquired in 2016 are leased to tenants that operate in 28 different industries located in 40 states. Retail properties continue to be our principal property type and comprised 86% of the

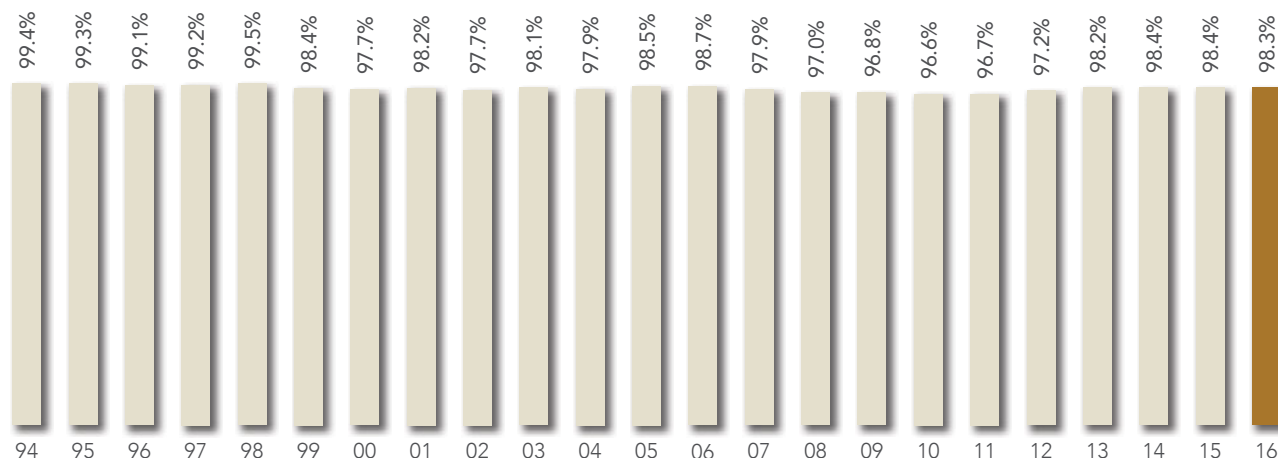
acquisitions as a percentage of rental revenue with the balance represented by industrial properties. Additionally, approximately 64% of the rental revenue from our acquisitions was from tenants with investment-grade credit ratings.

## PORTFOLIO AND ASSET MANAGEMENT

The quality of our real estate portfolio as well as the caliber and experience of our team led to another successful year for our portfolio and asset management activities. Our portfolio of 4,944 properties performed well with high occupancy and positive re-leasing results.

We ended 2016 with occupancy of 98.3% which continues to remain at a high level. We re-leased 186 properties to either existing or new tenants, achieving rental rates that were approximately 105% of the expiring rent. We are pleased to grow the cash flow generated from our properties that we re-leased, and believe our positive 2016 results reflect our proven, disciplined, and selective underwriting approach based

## PORTFOLIO OCCUPANCY<sup>(1)</sup>



(1) Calculated at the end of each year by the number of properties

on many years of investing in net lease properties. This experience has enabled us to assemble a high-quality real estate portfolio that has produced favorable long-term, risk-adjusted returns for our shareholders.

We continue to strive for additional value creation opportunities through our asset management efforts. In 2016, we selectively invested \$23 million in properties with expiring leases, generating a 13.0% yield on this invested capital. Additionally, we identified and sold properties that no longer met our investment criteria, further enhancing the value of our portfolio. In 2016, we sold 77 properties for \$91 million and realized attractive returns on these investments. These activities collectively ensure the quality of our portfolio and support the stability and growth of the dividend.

## CAPITAL MARKETS ACTIVITY

We continue to enjoy excellent access to attractively priced capital to fund our business. Within the net lease sector, we view our low cost of capital as a distinct competitive advantage as it allows us to grow earnings while acquiring the highest-quality real estate properties in the marketplace.

In 2016, we took advantage of the favorable demand for our shares to raise \$573 million in common equity capital at an average price of \$60.61, higher than any price achieved in a prior year. Additionally, with one of the highest credit ratings in the REIT industry, we raised \$600 million in 10-year unsecured, fixed-rate debt at a yield of 3.15%, the lowest yield for debt we have issued with this term in our company's history.

Since the beginning of 2015, we have raised over \$2.6 billion of permanent and long-term capital. Approximately 70% of this capital has been equity, allowing us to grow our business while maintaining a high-quality and conservative balance sheet. By primarily utilizing equity to fund our liquidity needs, and by borrowing capital with long-term maturity dates, we have preserved our financial flexibility and limited future refinancing risks.

As we entered 2017, common equity represented 70% of our total market capitalization and our fixed charge coverage ratio was a healthy 4.2x. While these levels will fluctuate from year-to-year, we remain committed to managing our balance sheet in a conservative manner with approximately two-thirds equity and one-third long-term, primarily fixed-rate debt.



The strength of our balance sheet and track record of financial discipline is reflected by our investment-grade credit ratings of Baa1/BBB+/BBB+. In 2016, Moody's and S&P raised their outlook on our ratings to "Positive," recognizing the continued strengthening of our credit profile. Our improved credit rating has further widened our cost-of-capital advantage relative to our peers in the net lease sector, allowing us to continue growing our earnings with the highest-quality real estate acquisitions.

## RESOURCES

The continued success of our company is made possible by the quality of our team members. The breadth and depth of our team includes an experienced leadership team that has guided the company throughout a variety of market conditions. The average tenure of our officers exceeds 11 years, and I am confident that this collective experience will continue to serve us well into the future.

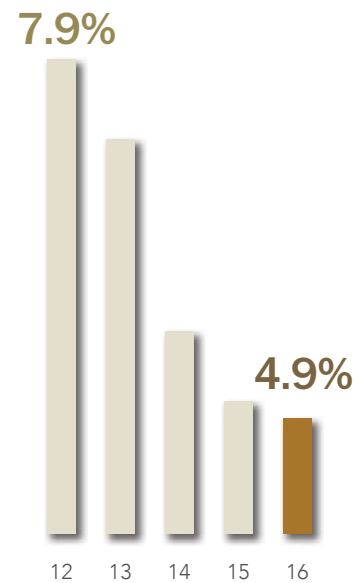
Our goal is always to maximize our operational efficiency by ensuring that

we have the right people, processes, and systems in place. In 2016, our general and administrative expenses as a percentage of revenue were 4.9%, the lowest in our history and the lowest amongst our peers in the net lease sector. We continue to capitalize on the scalability and efficiency of our business platform, delivering the highest percentage of our revenue to our earnings of any publicly-traded net lease company.

An extension of our mission as The Monthly Dividend Company® is to take an active role in the betterment of our community. As part of our Corporate Responsibility Program, this past year we devoted over 700 employee volunteer hours to charitable organizations including partnering with San Diego Habitat for Humanity. Our team members helped paint, landscape, and install roofing for several local homes. We also made a corporate donation to the organization. We have had a significant presence in San Diego County since our founding in 1969 and we believe it is

## GENERAL AND ADMINISTRATIVE EXPENSES

AS % OF TOTAL REVENUE



important for us to continue to impact our local community positively as a responsible corporate citizen.



San Diego Habitat for Humanity Day of Service - July 2016



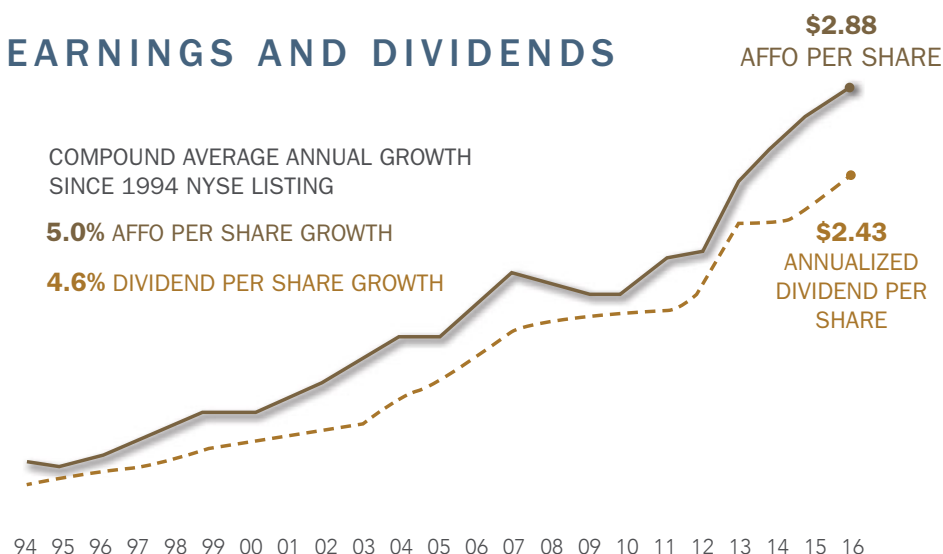
## EARNINGS AND DIVIDENDS

Our activities collectively contributed to our healthy 2016 earnings growth. We continued to grow our AFFO, or the cash earnings available to pay the dividend, while remaining committed to our conservative balance sheet. In 2016, we grew our AFFO per share by 5.1% to \$2.88, which exceeds our 22-year annual average as a public company. This growth allowed us to increase the dividend six times throughout the year, and again in February 2017, growing the dividend by 6% as compared to February 2016. We are pleased that the continued strength in our operations allowed us to increase the dividend while maintaining a payout ratio of approximately 83%, providing a comfortable margin of safety for our shareholders.

## MACROECONOMIC ENVIRONMENT AND OUR POSITION

As I write this letter, we are operating in a domestic economy characterized by continued modest GDP growth, a relatively low but increasingly volatile interest rate environment, and the prospect of new economic policies as a result of changes in the political landscape. While we cannot control these external macroeconomic factors or predict how they might change in the future, we believe our continued focus on quality has created a strong real estate portfolio and well-capitalized balance sheet that should, by design, perform in virtually any economic environment.

## EARNINGS AND DIVIDENDS



Over our 48-year operating history, we have taken deliberate steps to position our portfolio to be diversified by tenant, industry, geography, and to a certain extent, property type, enhancing the stability of our revenue. Our tenant credit profile remains strong with 47% of our revenue today derived from investment-grade rated tenants. We have also conservatively underwritten non-investment grade retail tenants who have demonstrated resiliency throughout varying economic environments during our company's history.

Over 90% of our rental revenue from our retail properties is generated from tenants with a service, non-discretionary, and/or low price point component to their business. We believe these characteristics better position our tenants to operate in a variety of economic environments and to compete effectively with e-commerce. Our track record of maintaining high occupancy, which has never been below 96% in our company's history, reflects the overall health of our tenant base and the reliability

of our revenue that supports the monthly dividend.

Prioritizing quality in all facets of our business helps ensure that the decisions we make today protect our dividend in the future. Specifically, we continue to monitor the impact of disruptive technologies and changing demographics on our business and strive to make adjustments to our investment strategy well in advance of emerging trends. In 2016, we completed an in-depth strategic review of each facet of our business with our Board of Directors, focusing on the long-term vision for our company. We remain confident in our strategy and believe our business plan positions us to continue to perform well in the future.

## OUTLOOK

We are proud to have surpassed \$1 billion in annual rental revenues in 2016 and are committed to continuing to grow your company responsibly. As we enter 2017, we remain positive regarding our outlook.



We continue to source ample acquisition opportunities and remain disciplined and selective in our underwriting approach. Given the opportunities we are seeing that meet our investment parameters, we anticipate completing approximately \$1 billion in high-quality acquisitions in 2017 at attractive investment spreads and favorable risk-adjusted returns.

To fund our acquisition activities, we maintain a \$2 billion line of credit and continue to enjoy excellent access to favorably-priced permanent and long-term capital. Our leverage metrics remain within our target range, providing us with the flexibility to fund the growth of our portfolio while maintaining a conservative balance sheet.

We are optimistic that our existing portfolio will continue to perform well. We expect occupancy in 2017 to remain around 98%, with same store rent growing by 1.0%–1.2%, consistent with our 2016 results. Additionally, we are committed to maximizing the revenue generated from our existing real estate properties through our active portfolio and asset management

activities. These aforementioned activities collectively contribute to what we believe will be another year of favorable operating results for the company.

### CONCLUSION

We are pleased with our accomplishments in 2016. We had another successful year of operating performance that led to solid earnings and dividend growth, as well as attractive shareholder returns. As we move into 2017 and beyond, we will continue to manage the business for the long term with the same degree of discipline and dedication to the dividend.

Our mission as The Monthly Dividend Company® is to provide our shareholders with dependable monthly dividends that increase over time. This mission has served us well throughout our 48-year operating history, and will continue to drive the quality of properties we acquire, the types of capital we raise, and the talents required of our team. As your CEO, I am committed to continuing to guide our company towards the execution of our business plan and the achievement of our mission.

While we remain confident in our ability to operate the company in a manner that supports our mission, we cannot guarantee that we will be as successful in 2017 as we have been in the past. Therefore, we always remind our shareholders how important it is to rely on Realty Income for only a portion of their income needs. We thank you for your continued support of our company and will keep you apprised of our progress throughout the year.

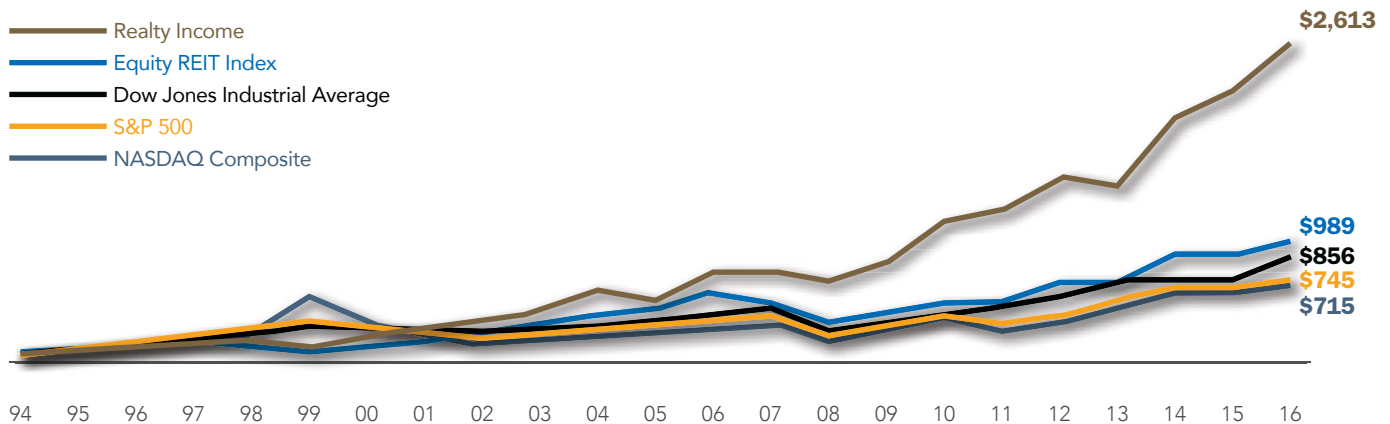
Sincerely,



John P. Case  
Chief Executive Officer



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



# HIGH-QUALITY PORTFOLIO

Our real estate portfolio consists of 4,944 freestanding, single-tenant commercial properties that are diversified by tenant, industry, geography, and to a certain extent, property type. At the end of 2016, our properties were leased to 248 commercial tenants operating across 47 industries and located in 49 states and Puerto Rico. The majority of our properties continue to be retail, with the largest component outside of retail being industrial properties representing 13.2% of revenue. Our tenant base remains healthy, with approximately 47% of the revenue generated from properties leased to tenants with investment-grade credit ratings. Maintaining a diversified portfolio leased to strong tenants helps ensure the stability of our revenue that supports the payment of monthly dividends.

The strength of our portfolio is further enhanced by the experience of our portfolio and asset management teams in maximizing the revenue generated from our properties. As one of the most seasoned net lease companies, we have re-leased or sold over 2,300 properties with expiring leases throughout our history as a public company. This is unprecedented in our industry, and through our active re-leasing activities and selective property sales, we have achieved stable occupancy that has never been below 96% in our company's history.



## TENANT DIVERSIFICATION

% of Revenue <sup>(1)</sup>	Number of Properties	Tenant
7.0%	203	Walgreens*
5.5%	43	FedEx*
4.2%	524	Dollar General*
4.0%	48	LA Fitness
3.8%	457	Dollar Tree / Family Dollar
2.6%	299	Circle K (Couche-Tard)*
2.6%	22	AMC Theatres
2.4%	15	BJ's Wholesale Clubs
2.2%	17	Diageo*
2.0%	70	CVS Pharmacy*
2.0%	134	Super America / Western Refining
1.9%	31	Walmart / Sam's Club*
1.9%	22	Regal Cinemas
1.9%	216	GPM Investments / Fas Mart
1.9%	69	Rite Aid
1.8%	111	7-Eleven*
1.8%	9	Life Time Fitness
1.6%	149	TBC Corporation (Sumitomo)*
1.2%	18	FreedomRoads / Camping World
1.1%	10	Home Depot*

(1) Based on annualized rental revenue as of 12/31/16

\*Investment-grade rated

## PROPERTY TYPE DIVERSIFICATION

Property Type	Number of Properties	% of Revenue <sup>(1)</sup>
Retail	4,774	78.9%
Industrial	111	13.2%
Office	44	5.5%
Agriculture	15	2.4%

(1) Based on rental revenue for the quarter ended 12/31/16





## INDUSTRY DIVERSIFICATION

% of Revenue <sup>(1)</sup>	Industry
11.4%	Drug Stores
8.5%	Convenience Stores
8.3%	Dollar Stores
7.9%	Health & Fitness
5.7%	Transportation Services
5.2%	Restaurants - quick service
4.7%	Theaters
3.9%	Restaurants - casual dining
3.4%	Wholesale Clubs
3.4%	Grocery Stores

(1) Based on rental revenue for the quarter ended 12/31/16

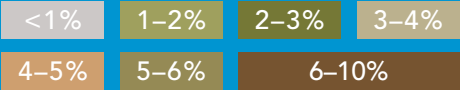




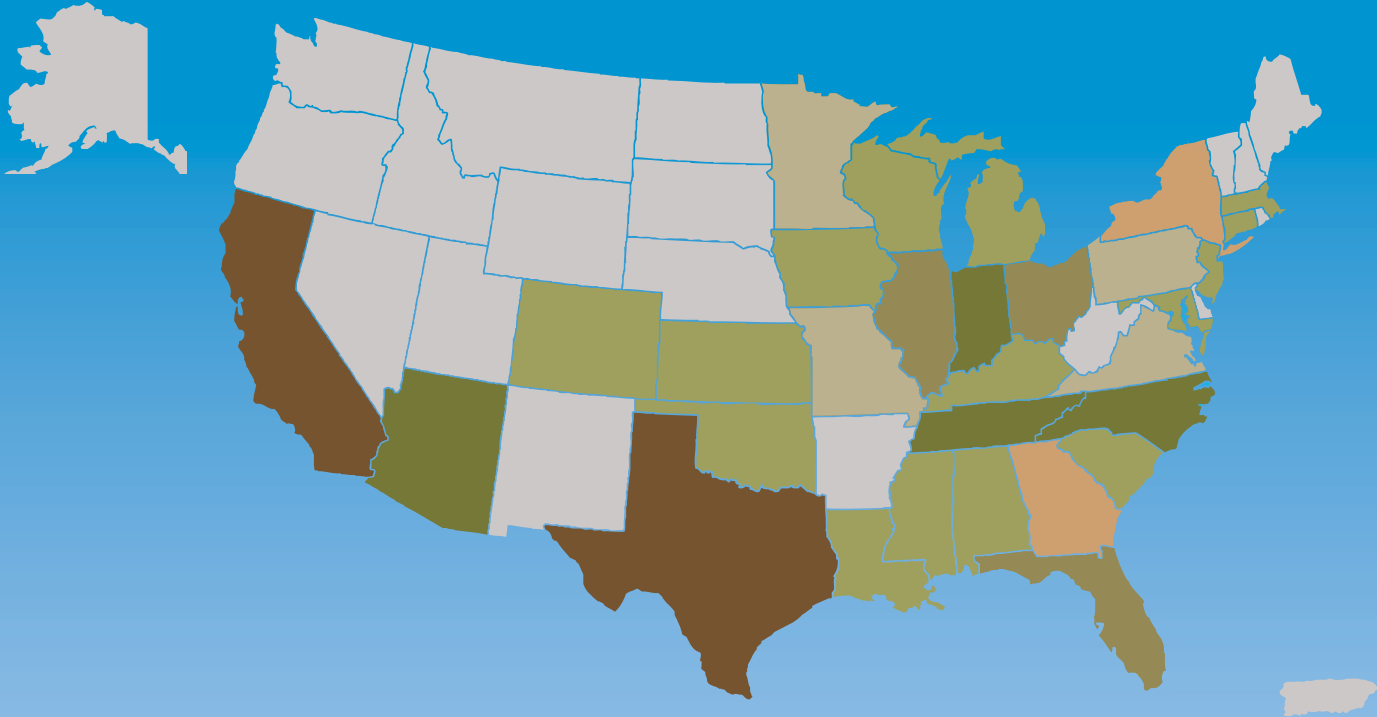
# GEOGRAPHIC DIVERSIFICATION

AS A % OF REVENUE<sup>(1)</sup>

CALIFORNIA 9.6% | FLORIDA 5.4% | ILLINOIS 5.3%  
 TEXAS 9.4% | OHIO 5.4% | NEW YORK 4.5%



(1) Based on rental revenue for the quarter ended 12/31/16



ALASKA AND PUERTO RICO NOT TO SCALE



DISCIPLINED

# INVESTMENT PROCESS

FOCUSED ON HIGH-QUALITY GROWTH

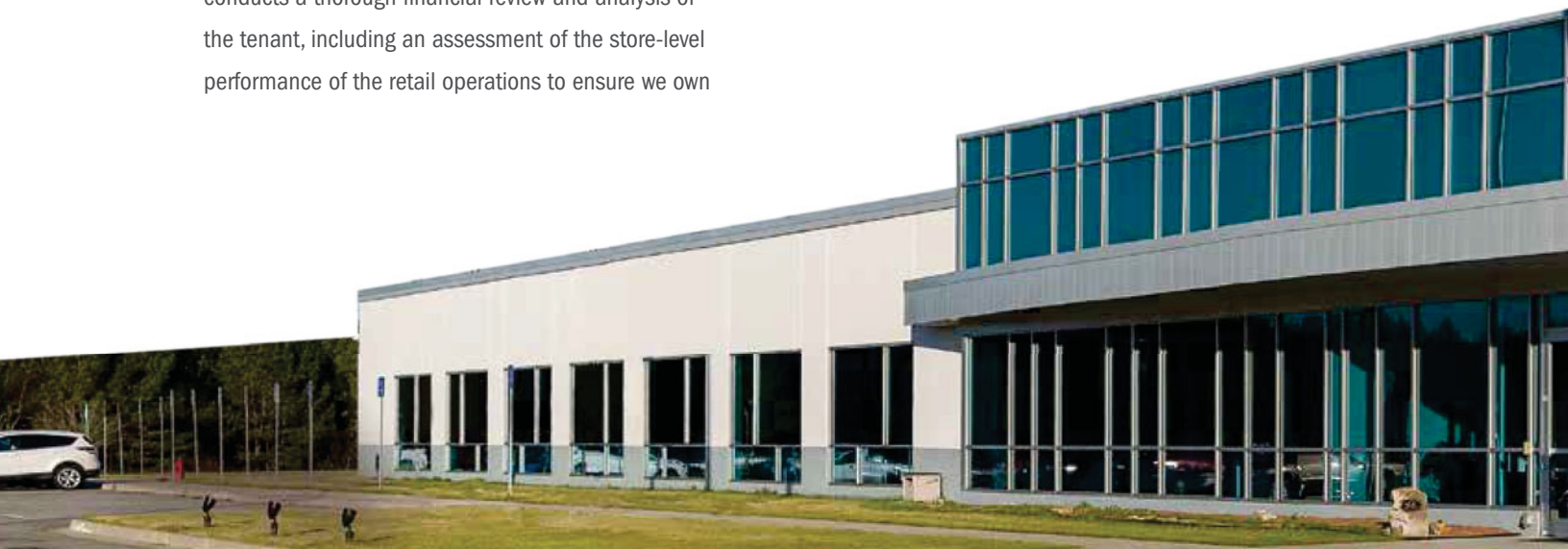
We focus on acquiring freestanding, single-tenant commercial properties leased to high-quality tenants under long-term, net lease agreements, typically in excess of 10 years. During 2016, we reviewed approximately \$29 billion of investment opportunities that generally satisfied one or more of these criteria. These opportunities went through a rigorous, multi-step internal underwriting process, resulting in the selection of \$1.86 billion in properties that were ultimately acquired.

The process begins with a review of the real estate. We target properties located in significant markets or strategic locations critical to generating revenue for the tenant. We examine the property-level attributes such as access and signage, demographic trends relative to the property's intended use, and overall viability of the market.

In addition to the real estate, we also carefully review the characteristics and financial strength of the tenant and its industry. Our team of research professionals conducts a thorough financial review and analysis of the tenant, including an assessment of the store-level performance of the retail operations to ensure we own

the tenant's highest-performing locations. Our team stays abreast of trends in the various industries relative to the economic environment and frequently meets with management representatives within these industries to better understand the tenant's operations.

The information gathered on the real estate, tenant, and industry determines the appropriate price for an investment. Our cost of capital remains the lowest in the net lease sector, so we have the advantage of achieving the widest investment spreads while offering competitive pricing for high-quality properties. However, we ensure the real estate is appropriately priced relative to replacement cost, and leased at rental rates that are generally in-line with market rent in order to support strong long-term investment returns generated by each asset. Our Investment Committee collectively reviews these characteristics and metrics to decide which properties to acquire. This rigorous selection process maintains the quality of our investment portfolio and supports the stability of our cash flow over time.



## ACQUISITIONS SELECTIVITY

FOR THE YEARS (DOLLARS IN BILLIONS)

	<b>Amount Sourced</b>	<b>Amount Acquired</b>	<b>Selectivity<sup>(1)</sup></b>
2016	\$28.5	\$1.86	7%
2015	\$31.7	\$1.26	4%
2014	\$24.3	\$1.40	6%
2013	\$39.4	\$4.67	12%
2012	\$17.0	\$1.16	7%
2011	\$13.3	\$1.02	8%
2010	\$5.7	\$0.71	12%

(1) Selectivity is calculated as the amount of acquisitions acquired divided by the amount of acquisitions sourced



# CONSERVATIVE CAPITAL STRUCTURE

## HIGH-QUALITY BALANCE SHEET

Our commitment to the dividend is demonstrated by the way we manage our balance sheet. We believe it is important to maintain a conservative capital structure that is primarily equity-focused in order to protect the dividend. At the end of 2016, our total market capitalization was \$21.3 billion, of which \$15.0 billion, or 70%, was common equity.

When we use debt to fund our growth, we structure it in a conservative manner. Over the life of the company, over 92% of the bond volume we have issued has been for terms of 10 years or longer, and 100% of our outstanding bonds are fixed-rate and unsecured. As of December 31, 2016, our debt-to-EBITDA ratio was a healthy 5.7x. We maintain a \$2.0 billion line of credit, which provides us flexibility to close on acquisitions quickly and then opportunistically raise equity and/or long-term debt when capital market dynamics are most advantageous to us. Our investment-grade credit ratings of Baa1/BBB+/BBB+ (Moody's/S&P/Fitch), with "Positive" outlooks by both Moody's and S&P, continue to provide us with a low cost of public unsecured debt.

	Debt + Preferred Equity to Total Market Capitalization	Fixed Charge Coverage Ratio
2016	30%	4.2x
2015	29%	4.0x
2014	33%	3.4x
2013	38%	3.0x
2012	40%	2.7x

## CONSERVATIVE CAPITAL STRUCTURE <sup>(1)</sup>

(DOLLARS IN BILLIONS)

	Common Equity	Debt	Preferred Stock	Total Capitalization
Amount in Billions	\$15.0	\$5.9	\$0.4	\$21.3
% of Total	70%	28%	2%	100%

(1) At 12/31/16





# MONTHLY DIVIDENDS

## SUPPORTED BY HIGH-QUALITY CASH FLOW

As The Monthly Dividend Company®, we remain committed to operating our company in a manner that provides our shareholders with dependable monthly dividends that increase over time. At the core of every business decision we make is the focus on protecting and growing the dividend. Our commitment is evidenced by our track record of dividend performance. Since our company's listing on the NYSE in 1994, we have increased the dividend every year at a compound average annual growth rate of approximately 5% and have never cut the dividend. We are one of only five REITs in the S&P High Yield Dividend Aristocrats® index, which includes companies that have increased their dividend every year for at least 20 years.

To quantify the benefit to our shareholders of what we often refer to as the “magic” of rising dividends over time, we consider a shareholder's hypothetical investment in 1,000 Realty Income shares 10 years ago. As a result of the dividends received and the dividend increases on these shares over time, the shareholder's yield on cost grows. **Today, that shareholder would receive:**



8.8%

Dividend yield on  
the original investment  
(vs. original yield of 5.5%)

69%

of the original investment  
received in dividends

60%

Increase in the amount of  
annual dividends paid



# 2016

## FORM 10-K

Certain exhibits and schedules to the Form 10-K are not reproduced here, but can be obtained from our website at [www.realtyincome.com](http://www.realtyincome.com). The Form 10-K includes the section 302 certifications filed with the SEC.

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**Consolidated Balance Sheets**

At December 31, 2016 and 2015

(DOLLARS IN THOUSANDS, EXCEPT PER SHARE DATA)

	2016	2015
<b>ASSETS</b>		
Real estate, at cost:		
Land	\$ 3,752,204	\$ 3,286,004
Buildings and improvements	10,112,212	9,010,778
Total real estate, at cost	13,864,416	12,296,782
Less accumulated depreciation and amortization	(1,987,200)	(1,687,665)
Net real estate held for investment	11,877,216	10,609,117
Real estate held for sale, net	26,575	9,767
Net real estate	11,903,791	10,618,884
Cash and cash equivalents	9,420	40,294
Accounts receivable, net	104,584	81,678
Acquired lease intangible assets, net	1,082,320	1,034,417
Goodwill	15,067	15,321
Other assets, net	37,689	54,785
Total assets	\$ 13,152,871	\$ 11,845,379
<b>LIABILITIES AND EQUITY</b>		
Distributions payable	\$ 55,235	\$ 50,344
Accounts payable and accrued expenses	121,156	115,826
Acquired lease intangible liabilities, net	264,206	250,916
Other liabilities	85,616	53,965
Line of credit payable	1,120,000	238,000
Term loans, net	319,127	318,835
Mortgages payable, net	466,045	646,187
Notes payable, net	3,934,433	3,617,973
Total liabilities	6,365,818	5,292,046
Commitments and contingencies		
Stockholders' equity:		
Preferred stock and paid in capital, par value \$0.01 per share, 69,900,000 shares authorized, 16,350,000 shares issued and outstanding as of December 31, 2016 and December 31, 2015, liquidation preference \$25.00 per share	395,378	395,378
Common stock and paid in capital, par value \$0.01 per share, 370,100,000 shares authorized, 260,168,259 shares issued and outstanding as of December 31, 2016 and 250,416,757 shares issued and outstanding as of December 31, 2015	8,228,594	7,666,428
Distributions in excess of net income	(1,857,168)	(1,530,210)
Total stockholders' equity	6,766,804	6,531,596
Noncontrolling interests	20,249	21,737
Total equity	6,787,053	6,553,333
Total liabilities and equity	\$ 13,152,871	\$ 11,845,379

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



**Consolidated Statements of Income**

Years ended December 31, 2016, 2015 and 2014

(DOLLARS IN THOUSANDS, EXCEPT PER SHARE DATA)

	2016	2015	2014
<b>REVENUE</b>			
Rental	\$ 1,057,413	\$ 976,865	\$ 893,457
Tenant reimbursements	43,104	42,015	37,118
Other	2,655	4,405	2,930
<b>Total revenue</b>	<b>1,103,172</b>	<b>1,023,285</b>	<b>933,505</b>
<b>EXPENSES</b>			
Depreciation and amortization	449,943	409,215	374,661
Interest	219,974	233,079	216,366
General and administrative	51,966	49,298	51,085
Property (including reimbursable)	62,865	55,352	53,871
Income taxes	3,262	3,169	3,461
Provisions for impairment	20,664	10,560	4,126
<b>Total expenses</b>	<b>808,674</b>	<b>760,673</b>	<b>703,570</b>
Gain on sales of real estate	21,979	22,243	39,205
Income from continuing operations	316,477	284,855	269,140
Income from discontinued operations	-	-	2,800
<b>Net income</b>	<b>316,477</b>	<b>284,855</b>	<b>271,940</b>
Net income attributable to noncontrolling interests	(906)	(1,089)	(1,305)
<b>Net income attributable to the Company</b>	<b>315,571</b>	<b>283,766</b>	<b>270,635</b>
Preferred stock dividends	(27,080)	(27,080)	(37,062)
Excess of redemption value over carrying value of preferred shares redeemed	-	-	(6,015)
<b>Net income available to common stockholders</b>	<b>\$ 288,491</b>	<b>\$ 256,686</b>	<b>\$ 227,558</b>
Amounts available to common stockholders per common share:			
Income from continuing operations, basic and diluted	\$ 1.13	\$ 1.09	\$ 1.03
Net income, basic and diluted	\$ 1.13	\$ 1.09	\$ 1.04
Weighted average common shares outstanding:			
Basic	255,066,500	235,767,932	218,390,885
Diluted	255,624,250	236,208,390	218,767,885

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

**Consolidated Statements of Equity**

Years ended December 31, 2016, 2015, and 2014

(DOLLARS IN THOUSANDS)

	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 stockholders' equity	Noncontrolling interests	Total equity
Balance, December 31, 2013	25,150,000	207,485,073	\$ 609,363	\$ 5,767,878	\$ (991,794)	\$ 5,385,447	\$ 35,911	\$ 5,421,358
Net income	-	-	-	-	270,635	270,635	1,305	271,940
Distributions paid and payable	-	-	-	-	(519,790)	(519,790)	(1,839)	(521,629)
Share issuances, net of costs	-	17,327,166	-	685,877	-	685,877	-	685,877
Redemption of common units	-	35,000	-	1,032	-	1,032	(1,032)	-
Reallocation of equity	-	-	-	6,647	-	6,647	(6,647)	-
Preferred shares redeemed	(8,800,000)	-	(213,985)	-	(6,015)	(220,000)	-	(220,000)
Share-based compensation, net	-	33,953	-	3,553	-	3,553	-	3,553
Balance, December 31, 2014	16,350,000	224,881,192	\$ 395,378	\$ 6,464,987	\$ (1,246,964)	\$ 5,613,401	\$ 27,698	\$ 5,641,099
Net income	-	-	-	-	283,766	283,766	1,089	284,855
Distributions paid and payable	-	-	-	-	(567,012)	(567,012)	(1,652)	(568,664)
Share issuances, net of costs	-	25,322,655	-	1,190,006	-	1,190,006	-	1,190,006
Redemption of common units	-	168,182	-	4,347	-	4,347	(4,347)	-
Reallocation of equity	-	-	-	1,051	-	1,051	(1,051)	-
Share-based compensation, net	-	44,728	-	6,037	-	6,037	-	6,037
Balance, December 31, 2015	16,350,000	250,416,757	\$ 395,378	\$ 7,666,428	\$ (1,530,210)	\$ 6,531,596	\$ 21,737	\$ 6,553,333
Net income	-	-	-	-	315,571	315,571	906	316,477
Distributions paid and payable	-	-	-	-	(642,529)	(642,529)	(12,682)	(655,211)
Share issuances, net of costs	-	9,449,167	-	557,636	-	557,636	-	557,636
Contributions by noncontrolling interests	-	-	-	-	-	-	15,906	15,906
Redemption of common units	-	103,182	-	(2,865)	-	(2,865)	(6,161)	(9,026)
Reallocation of equity	-	-	-	(543)	-	(543)	543	-
Share-based compensation, net	-	199,153	-	7,938	-	7,938	-	7,938
Balance, December 31, 2016	16,350,000	260,168,259	\$ 395,378	\$ 8,228,594	\$ (1,857,168)	\$ 6,766,804	\$ 20,249	\$ 6,787,053

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

**Consolidated Statements of Cash Flows**

Years ended December 31, 2016, 2015 and 2014

(DOLLARS IN THOUSANDS)

	2016	2015	2014
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net income	\$ 316,477	\$ 284,855	\$ 271,940
Adjustments to net income:			
Depreciation and amortization	449,943	409,215	374,661
Income from discontinued operations	-	-	(2,800)
Amortization of share-based compensation	12,007	10,391	11,959
Non-cash rental adjustments	(10,154)	(8,607)	(6,848)
Amortization of net premiums on mortgages payable	(3,414)	(7,482)	(12,891)
Amortization of deferred financing costs	8,904	9,044	8,335
(Gain) loss on interest rate swaps	(1,639)	3,043	1,349
Gain on sales of real estate	(21,979)	(22,243)	(39,205)
Provisions for impairment on real estate	20,664	10,560	4,126
Change in assets and liabilities			
Accounts receivable and other assets	(1,232)	(2,641)	(3,064)
Accounts payable, accrued expenses and other liabilities	34,468	6,168	20,130
Net cash provided by operating activities	804,045	692,303	627,692
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Investment in real estate	(1,798,892)	(1,266,885)	(1,228,243)
Improvements to real estate, including leasing costs	(13,426)	(11,541)	(6,032)
Proceeds from sales of real estate			
Continuing operations	99,096	65,817	88,688
Discontinued operations	-	-	6,918
Collection of loans receivable	12,515	-	350
Restricted escrow deposits for Section 1031 tax-deferred exchanges and pending acquisitions	(404)	33,554	(36,540)
Net cash used in investing activities	(1,701,111)	(1,179,055)	(1,174,859)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Cash distributions to common stockholders	(610,516)	(533,238)	(479,256)
Cash dividends to preferred stockholders	(27,080)	(27,080)	(38,300)
Borrowings on line of credit	3,879,000	1,448,000	1,672,321
Payments on line of credit	(2,997,000)	(1,433,000)	(1,577,321)
Proceeds from notes and bonds payable issued	592,026	-	598,594
Principal payment on notes payable	(275,000)	(150,000)	-
Proceeds from mortgages payable	9,963	-	-
Principal payments on mortgages payable	(231,743)	(198,353)	(85,208)
Proceeds from term loans	-	250,000	-
Proceeds from common stock offerings, net	383,572	793,559	528,615
Proceeds from dividend reinvestment and stock purchase plan	10,252	363,029	158,462
Proceeds from At-the-Market (ATM) program	166,781	36,348	-
Redemption of preferred stock	-	-	(220,000)
Redemption of preferred units	-	(6,750)	-
Redemption of common units	(9,026)	-	-
Distributions to noncontrolling interests	(12,725)	(1,679)	(1,844)
Debt issuance costs	(5,274)	(10,259)	(5,505)
Other items, including shares withheld upon vesting	(7,038)	(7,383)	(9,796)
Net cash provided by financing activities	866,192	523,194	540,762
Net (decrease) increase in cash and cash equivalents	(30,874)	36,442	(6,405)
Cash and cash equivalents, beginning of period	40,294	3,852	10,257
Cash and cash equivalents, end of period	\$ 9,420	\$ 40,294	\$ 3,852

For supplemental disclosures, see note 15.

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

**Notes to Consolidated Financial Statements**

December 31, 2016, 2015 and 2014

**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, 2016, we owned 4,944 properties, located in 49 states and Puerto Rico, containing over 83.0 million leasable square feet.

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**

**Federal Income Taxes.** We have elected to be taxed as a REIT, as defined above, under the Internal Revenue Code of 1986, as amended, or the Code. We believe we have qualified and continue to qualify as a REIT. Under the REIT operating structure, we are permitted to deduct dividends paid to our stockholders in determining our taxable income. Assuming our dividends equal or exceed our taxable net income, we generally will not be required to pay federal corporate income taxes on such income. Accordingly, no provision has been made for federal income taxes in the accompanying consolidated financial statements, except for federal income taxes of our taxable REIT subsidiaries. The income taxes recorded on our consolidated statements of income represent amounts paid by Realty Income and its subsidiaries 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.

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 provisions for uncertain income tax positions have been recorded in our financial statements.

**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, plus income attributable to dilutive shares and convertible common units, 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.

	2016	2015	2014
Weighted average shares used for the basic net income per share computation	255,066,500	235,767,932	218,390,885
Incremental shares from share-based compensation	240,728	123,436	59,978
Weighted average partnership common units convertible to common shares that were dilutive	317,022	317,022	317,022
Weighted average shares used for diluted net income per share computation	255,624,250	236,208,390	218,767,885
Unvested shares from share-based compensation that were anti-dilutive	475	106,103	51,749
Weighted average partnership common units convertible to common shares that were anti-dilutive	198,429	417,060	523,847



**Discontinued Operations.** During the first quarter of 2014, the Financial Accounting Standards Board issued guidance that changed the definition of discontinued operations by limiting discontinued operations reporting to disposals of components of an entity that represent strategic shifts that have, or will have, a major effect on an entity's operations and financial results. We early adopted the requirements of this accounting pronouncement in the first quarter of 2014.

Starting with the first quarter of 2014, the results of operations for all qualifying disposals and properties classified as held for sale that were not previously reported in discontinued operations in our 2013 Annual Report on Form 10-K are presented within income from continuing operations on our consolidated statements of income. Prior to the date of adoption of Accounting Standards Update 2014-08 (ASU 2014-08), which amends Topic 205, *Presentation of Financial Statements*, and Topic 360, *Property, Plant, and Equipment*, we reported, in discontinued operations, the results of operations of properties that had either been disposed of or classified as held for sale in financial statements issued.

Operations from 15 properties were classified as held for sale at December 31, 2016, and are included in income from continuing operations. We do not depreciate properties that are classified as held for sale.

If the property was previously reclassified as held for sale but the applicable criteria for this classification are no longer met, the property is reclassified to 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.

No debt was assumed by buyers of our properties, or repaid as a result of our property sales.

For the year ended December 31, 2014, we recorded income from discontinued operations of \$2.8 million, or \$0.01 per common share, basic and diluted.

**Revenue Recognition and Accounts Receivable.** All leases are accounted for as operating leases. Under this method, leases 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. Contractually obligated reimbursements from tenants for recoverable real estate taxes and operating expenses are included in tenant reimbursements in the period when such costs are incurred.

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 collectability of accounts receivable and appropriate allowances to record. The allowance for doubtful accounts was \$74,000 at December 31, 2016 and \$429,000 at December 31, 2015.

Other revenue, which comprises property-related revenue not included in rental revenue or tenant reimbursements, was \$2.7 million in 2016, \$4.4 million in 2015 and \$2.9 million in 2014

**Principles of Consolidation.** The accompanying consolidated financial statements include the accounts of Realty Income and other subsidiaries for which we make operating and financial decisions (i.e. control), after elimination of all material intercompany balances and transactions. We consolidate entities that we control and record a noncontrolling interest for the portion that we do not own. Noncontrolling interest that was created or assumed as part of a business combination was recognized at fair value as of the date of the transaction (see note 10). We have no unconsolidated investments.

**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 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 typically allocate the fair value of real estate acquired 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 or below-market lease value of in-place leases, the value of in-place leases, and tenant relationships, as applicable. In an acquisition of multiple properties, we must also allocate the purchase price among the properties. The allocation of the purchase price is based on our assessment of estimated fair value and is often based upon the expected future cash flows of the property and various characteristics of the markets where the property is located. In addition, any assumed mortgages receivable or payable and any assumed or issued noncontrolling interests are recorded at their estimated fair values. The estimated fair values of our mortgages payable have been calculated by discounting the future cash flows using applicable interest rates that have been adjusted for factors, such as industry type, tenant investment grade, maturity date, and comparable borrowings for similar assets. The initial allocation of the purchase price is based on management's preliminary assessment, which may differ when final information becomes available. Subsequent adjustments made to the initial purchase price allocation are made within the allocation period, which does not exceed one year. The use of different assumptions in the allocation of the purchase price of the acquired properties and liabilities assumed could affect the timing of recognition of the related revenue and expenses.

Our estimated fair value determinations are based on management's judgment, utilizing various factors, including: (1) market conditions, (2) industry that the 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 valuations, prepared either internally or by an independent valuation firm. Our methodologies for measuring fair value related to the allocation of the purchase price of real estate acquisitions include both observable market data (and thus should be categorized as level 2 on the Financial Accounting Standards Board, or FASB's, three-level valuation hierarchy) and 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 with an in-place operating lease (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 fair value of these assets. Our fair value determinations are based primarily on internally prepared real estate valuations for each property, 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 the remaining term of the lease.

The values of the above-market and below-market leases are amortized over the term of the respective leases, including any bargain renewal options, as an adjustment to rental revenue on our consolidated statements of income.

The aggregate value of other acquired intangible assets consists of the fair value of in-place leases and tenant relationships, as applicable. The value of in-place leases, exclusive of the value of above-market and below-market in-place leases, is amortized to depreciation and amortization expense over the remaining periods of the respective leases.

If a lease was terminated prior to its stated expiration, all unamortized amounts relating to that lease would be recorded to revenue or expense as appropriate.

In allocating the fair value to assumed mortgages, amounts are recorded to debt premiums or discounts based on the present value of the estimated cash flows, which is calculated to account for either above or below-market interest rates. Our assumed net debt premiums are amortized as a reduction to interest expense over the remaining term of the respective mortgages.

In allocating noncontrolling interests, amounts are recorded based on the fair value of units issued or contributions made at the date of acquisition, as determined by the terms of the applicable agreement.

**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 other costs incurred during the period of development are capitalized. We cease capitalization when the property is available for occupancy upon substantial completion of tenant improvements, but in any event no later than one year from the completion of major construction activity.

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

Buildings	25 years or 35 years
Building improvements	4 to 20 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

**Provision 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. 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 factors that we utilize in this analysis include projected rental rates, estimated holding periods, historical sales and releases, capital expenditures and property sales capitalization rates. If a property is classified as held for sale, it is carried at the lower of carrying cost or estimated fair value, less estimated cost to sell, and depreciation of the property ceases.

In 2016, we recorded total provisions for impairment of \$20.7 million on six properties classified as held for sale, two properties classified as held for investment, and 31 sold properties in the following industries: one in the automotive parts industry, two in the automotive services industry, one in the automotive tire services industry, one in the convenience stores industry, one in the financial services industry, one in the general merchandise industry, one in the health and fitness industry, two in the home furnishings industry, 24 in the restaurant-casual dining industry, two in the restaurant-quick service industry, and three among the industry we classify as "other." These properties were not previously classified as held for sale in financial statements issued prior to the date of adoption of ASU 2014-08; accordingly, the provisions for impairment are included in income from continuing operations on our consolidated statement of income.

In 2015, we recorded total provisions for impairment of \$10.6 million on three properties classified as held for investment, 11 sold properties, and one property disposed of other than by sale in the following industries: one in the convenience stores industry, one in the health and fitness industry, one in the pet supplies and services industry, 11 in the restaurant-casual dining industry, and one among the industry we classify as "other." These properties were not previously classified as held for sale in financial statements issued prior to the date of adoption of ASU 2014-08; accordingly, the provisions for impairment are included in income from continuing operations on our consolidated statement of income.

In 2014, we recorded total provisions for impairment of \$4.6 million. Provisions for impairment of \$4.1 million are included in income from continuing operations on 10 sold properties and one property classified as held for sale in the following industries: one in the consumer electronics industry, one in the convenience stores industry, one in the home furnishings industry, two in the home improvement industry, and six in the restaurant-casual dining industry. These properties were not previously classified as held for sale in financial statements issued prior to the date of adoption of ASU 2014-08; accordingly, these provisions for impairment are included in income from continuing operations on our consolidated statements of income. Additionally, a provision for impairment of \$510,000 is included in income from discontinued operations on one sold property that was classified as held for sale as of December 31, 2013.

**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 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. Under the amendments issued in conjunction with ASU No. 2011-08, *Intangibles – Goodwill and Other* (Topic 350), an entity, through an assessment of qualitative factors, is not required to calculate the estimated fair value of a reporting unit, in connection with the two-step goodwill impairment test, unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. During our tests for impairment of goodwill during the second quarters of 2016, 2015 and 2014, we determined that the fair values of our reporting units are not more likely than not to be less than their respective carrying amounts and that no impairment was recorded on our goodwill during 2016, 2015 or 2014.

**Equity Offering Costs.** Underwriting commissions and offering costs have been reflected as a reduction of additional paid-in-capital on our consolidated balance sheets.

**Noncontrolling Interests.** Noncontrolling interests are reflected on our consolidated balance sheets as a component of equity. Noncontrolling interests are recorded initially at fair value based on the price of the applicable units issued or contributions made, and subsequently adjusted each period for distributions, additional contributions and the allocation of net income attributable to the noncontrolling interests.

As consideration for two separate acquisitions during 2013, partnership units of Tau Operating Partnership, L.P. and Realty Income, L.P. were issued to third parties. These common units (discussed in footnote 10) do not have voting rights, are entitled to monthly distributions equal to the amount paid to our common stockholders, and are redeemable in cash or our common stock, at our option and at a conversion ratio of one to one, subject to certain exceptions. As the general partner for each of these partnerships, we have operating and financial control over these entities, consolidate them in our financial statements, and record the partnership units held by third parties as noncontrolling interests.

**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.

**Recent Accounting Pronouncements.** In May 2014, FASB issued ASU 2014-09, *Revenue from Contracts with Customers*. This ASU outlines a comprehensive model for companies to use in accounting for revenue arising from contracts with customers, and will apply to transactions such as the sale of real estate. This ASU is effective for interim and annual periods beginning after December 15, 2017. The standard permits the use of either the retrospective or cumulative effect transition method. We plan to use the cumulative effect transition method upon adoption of the standard on January 1, 2018, and do not expect this topic to have a material impact on our consolidated financial statements or the related notes.

In February 2015, FASB issued ASU 2015-02, which amends Topic 810, *Consolidation*. This ASU amended the criteria used to evaluate whether an entity is a variable interest entity, or VIE, resulting in the conclusion that all limited partnerships are considered VIEs, unless substantive kick-out rights or participating rights exist. We adopted this ASU during the quarter ended March 31, 2016 and evaluated our applicable entities. The evaluation did not result in changes to our conclusions regarding consolidation of these entities (see note 10).

In April 2015, FASB issued ASU 2015-03, which amends Topic 835, *Other Presentation Matters*. The amendments in this ASU require that debt issuance costs be reported on the balance sheet as a direct reduction of the face amount of the debt instrument they relate to, and should not be classified as a deferred charge, as was previously required under the Accounting Standards Codification. We adopted this ASU during the quarter



ended March 31, 2016 and, as a result, reclassified deferred financing costs from other assets, net, to the applicable debt caption on the December 31, 2015 balance sheet.

In February 2016, FASB issued Topic 842, *Leases*, which amended Topic 840, *Leases*. Under this amended topic, the accounting applied by a lessor is largely unchanged from that applied under Topic 840, *Leases*. The large majority of operating leases should remain classified as operating leases, and lessors should continue to recognize lease income for those leases on a generally straight-line basis over the lease term. The amendments included in this topic are effective, on a retrospective or modified retrospective basis, for interim and annual periods beginning after December 15, 2018. We have not yet adopted this topic and are currently evaluating the impact this amendment will have on our consolidated financial statements.

In March 2016, FASB issued ASU 2016-09, which amends Topic 718, *Compensation – Stock Compensation*. FASB issued this ASU to simplify several aspects of the accounting for share-based payment transactions, including classification of awards as either equity or liabilities, estimation of forfeitures, and classification on the statement of cash flows. The ASU is effective for interim and annual periods beginning after December 15, 2016, and early adoption is permitted. We early adopted this ASU during the quarter ended March 31, 2016 and it did not have a material impact on our consolidated financial statements.

In January 2017, FASB issued ASU 2017-01, which amends Topic 805, *Business Combinations*. FASB issued this ASU to clarify the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The ASU is effective for interim and annual periods beginning after December 15, 2017. We have not yet adopted this topic and are currently evaluating the impact this amendment will have on our consolidated financial statements.

### 3. Supplemental Detail for Certain Components of Consolidated Balance Sheets

A. Acquired lease intangible assets, net, consist of the following (dollars in thousands) at:	December 31, 2016	December 31, 2015
Acquired in-place leases	\$ 1,164,075	\$ 1,056,715
Accumulated amortization of acquired in-place leases	(358,040)	(264,399)
Acquired above-market leases	365,005	304,548
Accumulated amortization of acquired above-market leases	(88,720)	(62,447)
	<u>\$ 1,082,320</u>	<u>\$ 1,034,417</u>
B. Other assets, net, consist of the following (dollars in thousands) at:	December 31, 2016	December 31, 2015
Prepaid expenses	14,406	14,258
Credit facility origination costs, net	7,303	10,226
Notes receivable issued in connection with property sales	5,390	17,905
Restricted escrow deposits	4,246	4,179
Corporate assets, net	3,585	2,313
Impounds related to mortgages payable	2,015	5,860
Other items	744	44
	<u>\$ 37,689</u>	<u>\$ 54,785</u>
C. Distributions payable consist of the following declared distributions (dollars in thousands) at:	December 31, 2016	December 31, 2015
Common stock distributions	\$ 52,896	\$ 47,963
Preferred stock dividends	2,257	2,257
Noncontrolling interests distributions	82	124
	<u>\$ 55,235</u>	<u>\$ 50,344</u>

D. Accounts payable and accrued expenses consist of the following (dollars in thousands) at:	December 31, 2016	December 31, 2015
Notes payable - interest payable	\$ 60,668	\$ 61,486
Property taxes payable	16,949	13,354
Accrued costs on properties under development	9,049	9,976
Mortgages, term loans, credit line - interest payable and interest rate swaps	5,432	6,813
Other items	29,058	24,197
	<u>\$ 121,156</u>	<u>\$ 115,826</u>
E. Acquired lease intangible liabilities, net, consist of the following (dollars in thousands) at:	December 31, 2016	December 31, 2015
Acquired below-market leases	\$ 318,926	\$ 288,412
Accumulated amortization of acquired below-market leases	(54,720)	(37,496)
	<u>\$ 264,206</u>	<u>\$ 250,916</u>
F. Other liabilities consist of the following (dollars in thousands) at:	December 31, 2016	December 31, 2015
Rent received in advance and other deferred revenue <sup>(1)</sup>	\$ 74,098	\$ 42,840
Security deposits	6,502	6,418
Capital lease obligations	5,016	4,707
	<u>\$ 85,616</u>	<u>\$ 53,965</u>

#### 4. Investments in Real Estate

We acquire land, buildings and improvements necessary for the successful operations of commercial tenants.

##### A. Acquisitions during 2016 and 2015

During 2016, we invested \$1.86 billion in 505 new properties and properties under development or expansion with an initial weighted average contractual lease rate of 6.3%. The 505 new properties and properties under development or expansion are located in 40 states, will contain approximately 8.2 million leasable square feet, and are 100% leased with a weighted average lease term of 14.7 years. The tenants occupying the new properties operate in 28 industries and the property types consist of 86.4% retail and 13.6% industrial, based on rental revenue. None of our investments during 2016 caused any one tenant to be 10% or more of our total assets at December 31, 2016.

The \$1.86 billion invested during 2016 was allocated as follows: \$515.5 million to land, \$1.21 billion to buildings and improvements, \$168.0 million to intangible assets related to leases, and \$30.6 million to intangible liabilities related to leases and other assumed liabilities. There was no contingent consideration associated with these acquisitions.

The properties acquired during 2016 generated total revenues of \$44.6 million and income from continuing operations of \$22.0 million during the year ended December 31, 2016.

Of the \$1.86 billion we invested during 2016, \$761.8 million of the purchase price allocation is based on a preliminary measurement of fair value that is subject to change. The allocation for these properties represents our current best estimate of fair value, and we expect to finalize the valuations and complete the purchase price allocations in 2017. During 2016, we finalized the purchase price allocations for \$195.4 million invested in the fourth quarter of 2015. There were no material changes to our consolidated balance sheets or income statements as a result of these purchase price allocations being finalized.

In comparison, during 2015, we invested \$1.26 billion in 286 new properties and properties under development or expansion with an initial weighted average contractual lease rate of 6.6%. The 286 new properties and properties under development or expansion are located in 40 states, contain approximately 6.2 million leasable square feet, and are 100% leased with a weighted average lease term of 16.5 years. The tenants occupying the new properties operate in 21 industries and the property types consist of 87.3% retail and 12.7% industrial, based on rental revenue.

The \$1.26 billion invested during 2015 was allocated as follows: \$257.1 million to land, \$937.1 million to buildings and improvements, \$105.8 million to intangible assets related to leases, and \$40.9 million to intangible

liabilities related to leases and other assumed liabilities. There was no contingent consideration associated with these acquisitions.

The properties acquired during 2015 generated total revenues of \$43.4 million and income from continuing operations of \$21.1 million during the year ended December 31, 2015.

The estimated initial weighted average contractual lease rate for a property is generally computed as estimated contractual net operating income, which, in the case of a net leased property, is equal to the aggregate base rent for the first full year of each lease, divided by the total cost of the property. Since it is possible that a tenant could default on the payment of contractual rent, we cannot provide assurance that the actual return on the funds invested will remain at the percentages listed above.

In the case of a property under development or expansion, the contractual lease rate is generally fixed such that rent varies based on the actual total investment in order to provide a fixed rate of return. When the lease does not provide for a fixed rate of return on a property under development or expansion, the estimated initial weighted average contractual lease rate is computed as follows: estimated net operating income (determined by the lease) for the first full year of each lease, divided by our projected total investment in the property, including land, construction and capitalized interest costs. Of the \$1.86 billion we invested during 2016, \$103.8 million was invested in 33 properties under development or expansion with an estimated initial weighted average contractual lease rate of 7.1%. Of the \$1.26 billion we invested during 2015, \$45.8 million was invested in 35 properties under development or expansion with an estimated initial weighted average contractual lease rate of 9.7%.

#### *B. Acquisition Transaction Costs*

Acquisition transaction costs of \$346,000 and \$913,000 were recorded to general and administrative expense on our consolidated statements of income during 2016 and 2015, respectively.

#### *C. Investments in Existing Properties*

During 2016, we capitalized costs of \$16.3 million on existing properties in our portfolio, consisting of \$797,000 for re-leasing costs, \$679,000 for recurring capital expenditures and \$14.9 million for non-recurring building improvements. In comparison, during 2015, we capitalized costs of \$11.5 million on existing properties in our portfolio, consisting of \$748,000 for re-leasing costs, \$7.6 million for recurring capital expenditures and \$3.2 million for non-recurring building improvements.

#### *D. Properties with Existing Leases*

Of the \$1.86 billion we invested during 2016, approximately \$741.2 million was used to acquire 90 properties with existing leases. In comparison, of the \$1.26 billion we invested during 2015, approximately \$391.4 million was used to acquire 86 properties with existing leases. The value of the in-place and above-market leases is recorded to acquired lease intangible assets, net on our consolidated balance sheets, and the value of the below-market leases is recorded to acquired lease intangible liabilities, net on our consolidated balance sheets.

The values of the in-place leases are amortized as depreciation and amortization expense. The amounts amortized to expense for all of our in-place leases, for 2016, 2015, and 2014 were \$94.0 million, \$87.9 million, and \$83.6 million, respectively.

The values of the above-market and below-market leases are amortized over the term of the respective leases, including any bargain renewal options, as an adjustment to rental revenue on our consolidated statements of income. The amounts amortized as a net decrease to rental revenue for capitalized above-market and below-market leases for 2016, 2015, and 2014 were \$9.3 million, \$7.9 million, and \$8.0 million, respectively. 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.



The following table presents the estimated impact during the next five years and thereafter related to the amortization of the acquired above-market and below-market lease intangibles and the amortization of the in-place lease intangibles for properties held for investment at December 31, 2016 (in thousands):

	<b>Net increase (decrease) to rental revenue</b>	<b>Increase to amortization expense</b>
2017	\$ (10,076)	\$ 97,299
2018	(9,834)	94,801
2019	(8,880)	84,477
2020	(8,119)	78,972
2021	(6,842)	70,783
Thereafter	31,672	379,703
<b>Totals</b>	<b>\$ (12,079)</b>	<b>\$ 806,035</b>

## 5. Credit Facility

In June 2015, we entered into a \$2.0 billion unsecured revolving credit facility, or our credit facility, which replaced our \$1.5 billion credit facility that was scheduled to expire in May 2016. The initial term of our credit facility expires in June 2019 and includes, at our option, two six-month extensions. Our credit facility has a \$1.0 billion accordion expansion option. Under our credit facility, our investment grade credit ratings as of December 31, 2016 provide for financing at the London Interbank Offered Rate, commonly referred to as LIBOR, plus 0.90% with a facility commitment fee of 0.15%, for all-in drawn pricing of 1.05% over LIBOR. The borrowing rate is subject to an interest rate floor and may change if our investment grade credit ratings change. We also have other interest rate options available to us under our credit facility. Our credit facility is unsecured and, accordingly, we have not pledged any assets as collateral for this obligation.

At December 31, 2016, credit facility origination costs of \$7.3 million are included in other assets, net on our consolidated balance sheet. This balance includes \$9.1 million of credit facility origination costs incurred during 2015 as a result of entering into our credit facility. These costs, as well as a portion of the costs incurred as a result of entering into our previous credit facilities, are being amortized over the remaining term of our credit facility.

At December 31, 2016, we had a borrowing capacity of \$880.0 million available on our credit facility (subject to customary conditions to borrowing) and an outstanding balance of \$1.12 billion, as compared to an outstanding balance of \$238.0 million at December 31, 2015.

The weighted average interest rate on outstanding borrowings under our credit facility was 1.4% during 2016 and 1.2% during 2015. At December 31, 2016, the weighted average interest rate on borrowings outstanding was 1.7%. Our credit facility is subject to various leverage and interest coverage ratio limitations, and at December 31, 2016, we remain in compliance with the covenants on our credit facility.

## 6. Term Loans

In June 2015, in conjunction with entering into our credit facility, we entered into a \$250 million senior unsecured term loan maturing on June 30, 2020. Borrowing under this term loan bears interest at the current one-month LIBOR, plus 0.95%. In conjunction with this term loan, we also entered into an interest rate swap which effectively fixes our per annum interest rate on this term loan at 2.67%.

In January 2013, in conjunction with our acquisition of American Realty Capital Trust, Inc., or ARCT, we entered into a \$70 million senior unsecured term loan maturing January 2018. Borrowing under this term loan bears interest at the current one-month LIBOR, plus 1.20%. In conjunction with this term loan, we also entered into an interest rate swap which effectively fixes our per annum interest rate on this term loan at 2.15%. Deferred financing costs of \$1.2 million incurred in conjunction with the \$250 million term loan and \$303,000 incurred in conjunction with the \$70 million term loan are being amortized over the remaining terms of each respective term loan. The net balance of these deferred financing costs, which was \$873,000 at December 31, 2016, and \$1.2 million at December 31, 2015, is included within term loans, net on our consolidated balance sheets.

## 7. Mortgages Payable

During 2016, we made \$231.7 million in principal payments, including the repayment of 11 mortgages in full for \$201.8 million, and we assumed mortgages totaling \$44.1 million, excluding net premiums. During 2016, we refinanced one of these assumed mortgages and received an additional \$10.0 million in proceeds. The assumed mortgages are secured by the properties on which the debt was placed and are considered non-recourse debt with limited customary exceptions for items such as solvency, bankruptcy, misrepresentation, fraud, misapplication of payments, environmental liabilities, failure to pay taxes, insurance premiums, liens on the property, violations of the single purpose entity requirements, and uninsured losses. We expect to pay off our mortgages as soon as prepayment penalties make it economically feasible to do so.

During 2016, a premium of \$692,000 was recorded upon the assumption of one mortgage with an above-market interest rate. The interest rates on the remaining mortgages assumed were at market. Amortization of our net premiums is recorded as a reduction to interest expense over the remaining term of the respective mortgages, using a method that approximates the effective-interest method. These mortgages contain customary covenants, such as limiting our ability to further mortgage each applicable property or to discontinue insurance coverage without the prior consent of the lender. At December 31, 2016, we remain in compliance with these covenants.

During 2015, we made \$198.4 million in principal payments, including the repayment of 13 mortgages in full for \$191.0 million. No mortgages were assumed during 2015.

We did not incur any deferred financing costs on our mortgages assumed in 2016. The balance of our deferred financing costs, which are classified as part of mortgages payable, net, on our consolidated balance sheets, was \$324,000 at December 31, 2016 and \$553,000 at December 31, 2015. These costs are being amortized over the remaining term of each mortgage.

The following is a summary of all our mortgages payable as of December 31, 2016 and 2015, respectively (dollars in thousands):

As Of	Number of Properties <sup>(1)</sup>	Weighted Average Stated Interest Rate <sup>(2)</sup>	Weighted Average Effective Interest Rate <sup>(3)</sup>	Weighted Average Remaining Years Until Maturity	Remaining Principal Balance	Unamortized Premium and Deferred Finance Costs Balance, net	Mortgage Payable Balance
12/31/16	127	4.9%	4.3%	4.0	\$ 460,008	\$ 6,037	\$ 466,045
12/31/15	183	4.9%	4.1%	3.6	\$ 637,658	\$ 8,529	\$ 646,187

<sup>(1)</sup> At December 31, 2016, there were 36 mortgages on 127 properties, while at December 31, 2015, there were 44 mortgages on 183 properties. The mortgages require monthly payments, with principal payments due at maturity. The mortgages are at fixed interest rates, except for six mortgages on 15 properties totaling \$74.0 million at December 31, 2016, including net unamortized discounts. At December 31, 2015, four mortgages on 13 properties totaling \$51.1 million, including net unamortized discounts, were at variable interest rates. After factoring in arrangements which limit our exposure to interest rate risk and effectively fix our per annum interest rates, our variable rate mortgage debt includes four mortgages totaling \$38.2 million at December 31, 2016, and two mortgages totaling \$15.5 million at December 31, 2015.

<sup>(2)</sup> Stated interest rates ranged from 2.4% to 6.9% at December 31, 2016, while stated interest rates ranged from 2.0% to 6.9% at December 31, 2015.

<sup>(3)</sup> Effective interest rates ranged from 2.5% to 8.8% at December 31, 2016, while effective interest rates ranged from 2.2% to 8.9% at December 31, 2015.

The following table summarizes the maturity of mortgages payable, excluding net premiums of \$6.4 million and deferred finance costs of \$324,000, as of December 31, 2016 (dollars in millions):

Year of Maturity	Principal
2017	\$ 103.2
2018	21.9
2019	42.3
2020	82.4
2021	66.9
Thereafter	143.3
Totals	\$ 460.0

## 8. Notes Payable

### A. General

Our senior unsecured notes and bonds consisted of the following, sorted by maturity date (dollars in millions):

	December 31, 2016	December 31, 2015
5.950% notes, issued in September 2006 and due in September 2016	\$ -	\$ 275
5.375% notes, issued in September 2005 and due in September 2017	175	175
2.000% notes, issued in October 2012 and due in January 2018	350	350
6.750% notes, issued in September 2007 and due in August 2019	550	550
5.750% notes, issued in June 2010 and due in January 2021	250	250
3.250% notes, issued in October 2012 and due in October 2022	450	450
4.650% notes, issued in July 2013 and due in August 2023	750	750
3.875% notes, issued in June 2014 and due in July 2024	350	350
4.125% notes, issued in September 2014 and due in October 2026	250	250
3.000% notes, issued in October 2016 and due in January 2027	600	-
5.875% bonds, \$100 issued in March 2005 and \$150 issued in June 2011, both due in March 2035	250	250
Total principal amount	3,975	3,650
Unamortized original issuance discounts and deferred financing costs	(41)	(32)
	<u>\$ 3,934</u>	<u>\$ 3,618</u>

The following table summarizes the maturity of our notes and bonds payable as of December 31, 2016, excluding unamortized original issuance discounts and deferred financing costs (dollars in millions):

<u>Year of Maturity</u>	<u>Principal</u>
2017	\$ 175
2018	350
2019	550
2020	-
2021	250
Thereafter	2,650
<u>Totals</u>	<u>\$ 3,975</u>

As of December 31, 2016, the weighted average interest rate on our notes and bonds payable was 4.4% and the weighted average remaining years until maturity was 6.6 years.

Interest incurred on all of the notes and bonds was \$171.5 million for 2016, \$179.5 million for 2015 and \$166.5 million for 2014. The interest rate on each of these notes and bonds is fixed.

Our outstanding notes and bonds are unsecured; accordingly, we have not pledged any assets as collateral for these or any other obligations. Interest on all of the 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. At December 31, 2016, we remain in compliance with these covenants.

### B. Note Issuances

In October 2016, we issued \$600 million of 3.000% senior unsecured notes due January 2027. The public offering price for the notes was 98.671% of the principal amount for an effective yield to maturity of 3.153%. The net proceeds of approximately \$586.7 million from the offering were used to repay borrowings outstanding under our credit facility.

In September 2014, we issued \$250 million of 4.125% senior unsecured notes due October 2026, or the 2026 Notes. The price to the investors for the 2026 Notes was 99.499% of the principal amount for an effective yield of 4.178% per annum. A portion of the total net proceeds of \$246.4 million from this offering were used to repay



all outstanding borrowings under our credit facility, and the remaining proceeds were used for other general corporate purposes, including additional property acquisitions.

In June 2014, we issued \$350 million of 3.875% senior unsecured notes due July 2024, or the 2024 Notes. The price to the investors for the 2024 Notes was 99.956% of the principal amount for an effective yield of 3.88% per annum. The total net proceeds of \$346.7 million from these offerings were used to repay a portion of the outstanding borrowings under our credit facility.

#### *C. Note Repayment*

In September 2016, we repaid all \$275 million of outstanding 5.950% notes, plus accrued and unpaid interest.

In November 2015, we repaid \$150 million of outstanding 5.500% notes, plus accrued and unpaid interest, using proceeds from our October 2015 common stock offering and our credit facility

## **9. Equity**

#### *A. Issuance of Common Stock*

In May 2016, we issued 6,500,000 shares of common stock. After underwriting discounts and other offering costs of \$12.1 million, the net proceeds of \$383.6 million were used to repay borrowings under our credit facility.

In October 2015, we issued 11,500,000 shares of common stock. After underwriting discounts and other offering costs of \$22.0 million, a portion of the net proceeds of \$517.1 million was used to repay borrowings under our credit facility and the remaining portion was used for other general corporate purposes, including acquisitions.

In April 2015, we issued 5,500,000 shares of common stock. After underwriting discounts and other offering costs of \$1.4 million, the net proceeds of \$276.4 million were used to repay borrowings under our credit facility.

In April 2014, we issued 13,800,000 shares of common stock. After underwriting discounts and other offering costs of \$22.8 million, the net proceeds of \$528.6 million were used to repay borrowings under our previous credit facility.

#### *B. Redemption of Preferred Stock*

In September 2014, we issued an irrevocable notice of redemption for all 8.8 million shares of our 6.75% Monthly Income Class E Preferred Stock for \$25 per share, plus accrued dividends. The redemption occurred in October 2014. We incurred a charge of \$6.0 million, representing the Class E preferred stock original issuance costs that we paid in 2006.

#### *C. Dividend Reinvestment and Stock Purchase Plan*

Our Dividend Reinvestment and Stock Purchase Plan, or our DRSP, provides our common stockholders, as well as new investors, with a convenient and economical method of purchasing our common stock and reinvesting their distributions. Our DRSP also allows our current stockholders to buy additional shares of common stock by reinvesting all or a portion of their distributions. Our DRSP authorizes up to 26,000,000 common shares to be issued. During 2016, we issued 170,027 shares and raised approximately \$10.3 million under our DRSP. During 2015, we issued 7,608,354 shares and raised approximately \$363.0 million under our DRSP. From the inception of our DRSP through December 31, 2016, we have issued 12,869,889 shares and raised \$591.9 million.

Our DRSP includes a waiver approval process, allowing larger investors or institutions, per a formal approval process, to purchase shares at a small discount, if approved by us. During 2016, we did not issue shares under the waiver approval process. During 2015, we issued 7,413,207 shares and raised \$353.7 million under the waiver approval process. These shares are included in the total activity for 2015 noted in the preceding paragraph.

#### *D. At-the-Market (ATM) Program*

In September 2015, we established an "at-the-market" equity distribution program, or our ATM program, pursuant to which we can offer and sell up to 12,000,000 shares of common stock. The shares of common stock may be sold to, or through, a consortium of banks acting as our sales agents either by means of ordinary brokers' transactions on the NYSE at prevailing market prices or at negotiated prices. During 2016, we issued

2,779,140 shares and raised \$166.8 million under the ATM program. During 2015, we issued 714,301 shares and raised \$36.3 million under the ATM program. From the inception of our ATM program through December 31, 2016, we have issued 3,493,441 shares and raised \$203.1 million.

## 10. Noncontrolling Interests

In January 2013, we completed our acquisition of ARCT. Equity issued as consideration for this transaction included common and preferred partnership units issued by Tau Operating Partnership, L.P., or Tau Operating Partnership, the consolidated subsidiary which owns properties acquired through the ARCT acquisition. We and our subsidiaries hold a 99.4% interest in Tau Operating Partnership, and consolidate the entity.

In June 2013, we completed the acquisition of a portfolio of properties by issuing common partnership units in Realty Income, L.P. The units were issued as consideration for the acquisition. At December 31, 2016, the remaining units from this issuance represent a 0.4% ownership in Realty Income, L.P. We hold the remaining 99.6% interests in this entity and consolidate the entity.

Neither of the common partnership units have voting rights. Both common partnership units are entitled to monthly distributions equal to the amount paid to common stockholders of Realty Income, and are redeemable in cash or Realty Income common stock, at our option, and at a conversion ratio of one to one, subject to certain exceptions. Noncontrolling interests with redemption provisions that permit the issuer to settle in either cash or common stock, at the option of the issuer, were evaluated to determine whether temporary or permanent equity classification on the balance sheet was appropriate. We determined that the units meet the requirements to qualify for presentation as permanent equity.

In 2016, we completed the acquisition of two properties by acquiring a controlling interest in two separate joint ventures. We are the managing member of each of these joint ventures, and possess the ability to control the business and manage the affairs of these entities. At December 31, 2016, we and our subsidiaries held 90.5% and 74% interests, and fully consolidated these entities in our consolidated financial statements.

The following table represents the change in the carrying value of all noncontrolling interests through December 31, 2016 (dollars in thousands):

	Tau Operating Partnership units <sup>(1)</sup>	Realty Income, L.P. units <sup>(2)</sup>	Other Noncontrolling Interests	Total
Carrying value at December 31, 2015	\$ 13,410	\$ 8,327	\$ -	\$ 21,737
Reallocation of equity	491	52	-	543
Redemptions	-	(6,161)	-	(6,161)
Contributions	-	-	15,906	15,906
Distributions	(762)	(459)	(11,461)	(12,682)
Allocation of net income	266	457	183	906
Carrying value at December 31, 2016	\$ 13,405	\$ 2,216	4,628	\$ 20,249

	Tau Operating Partnership units <sup>(1)</sup>	Realty Income, L.P. units <sup>(2)</sup>	Total
Carrying value at December 31, 2014	\$ 13,067	\$ 14,631	\$ 27,698
Reallocation of equity	836	(1,887)	(1,051)
Redemptions	-	(4,347)	(4,347)
Distributions	(722)	(930)	(1,652)
Allocation of net income	229	860	1,089
Carrying value at December 31, 2015	\$ 13,410	\$ 8,327	\$ 21,737

<sup>(1)</sup> 317,022 Tau Operating Partnership units were issued on January 22, 2013 and remained outstanding as of December 31, 2016 and December 31, 2015.

<sup>(2)</sup> 534,546 Realty Income, L.P. units were issued on June 27, 2013, 331,364 units were outstanding as of December 31, 2015, and 88,182 remain outstanding as of December 31, 2016.

The Tau Operating Partnership preferred units were recorded at fair value as of the date of acquisition. Since they were redeemable at a fixed price on a determinable date, we initially classified them in other liabilities on

our consolidated balance sheets. Payments on these preferred units were made monthly at a rate of 2% per annum and were included in interest expense. In January 2015, we redeemed all 6,750 Tau Operating Partnership preferred units for \$1,000 per unit, plus accrued and unpaid distributions.

During the first quarter of 2016, we adopted ASU 2015-02, which amends Topic 810, *Consolidation*. This ASU amended the criteria used to evaluate whether an entity is a variable interest entity, or VIE, resulting in the conclusion that all limited partnerships are considered VIEs, unless substantive kick-out rights or participating rights exist. Accordingly, we determined that both Tau Operating Partnership and Realty Income, L.P. are VIEs. We have also concluded that we are the primary beneficiary of these VIEs, based on our controlling financial interests. We evaluated the minority unitholder rights noting that they do not hold substantive kick-out rights or participating rights. These conclusions did not result in changes to our historical accounting for these partnerships. Below is a summary of selected financial data of consolidated VIEs, including the joint ventures acquired during 2016, for which we are the primary beneficiary included in the consolidated balance sheets at December 31, 2016 and 2015 (in thousands):

	<b>2016</b>		<b>2015</b>	
Net real estate	\$	3,040,903	\$	3,082,025
Total assets		3,499,481		3,586,239
Total debt		251,047		393,812
Total liabilities		364,797		511,476

## 11. 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 2016, 2015 and 2014:

<b>Month</b>	<b>2016</b>		<b>2015</b>		<b>2014</b>	
January	\$	0.1910000	\$	0.1834167	\$	0.1821667
February		0.1985000		0.1890000		0.1821667
March		0.1985000		0.1890000		0.1821667
April		0.1990000		0.1895000		0.1824792
May		0.1990000		0.1895000		0.1824792
June		0.1990000		0.1895000		0.1824792
July		0.1995000		0.1900000		0.1827917
August		0.1995000		0.1900000		0.1827917
September		0.2015000		0.1900000		0.1827917
October		0.2020000		0.1905000		0.1831042
November		0.2020000		0.1905000		0.1831042
December		0.2020000		0.1905000		0.1831042
<b>Total</b>	<b>\$</b>	<b>2.3915000</b>	<b>\$</b>	<b>2.2714167</b>	<b>\$</b>	<b>2.1916254</b>

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

	<b>2016</b>		<b>2015</b>		<b>2014</b>	
Ordinary income	\$	1.8771975	\$	1.7307023	\$	1.6483522
Nontaxable distributions		0.5143025		0.5407144		0.5432732
<b>Totals</b>	<b>\$</b>	<b>2.3915000</b>	<b>\$</b>	<b>2.2714167</b>	<b>\$</b>	<b>2.1916254</b>

At December 31, 2016, a distribution of \$0.2025 per common share was payable and was paid in January 2017. At December 31, 2015, a distribution of \$0.191 per common share was payable and was paid in January 2016.

### B. Class E Preferred Stock

Prior to the redemption of the Class E preferred stock in October 2014, dividends of \$0.140625 per share were paid monthly in arrears on the Class E preferred stock. We paid distributions to holders of our Class E preferred stock totaling \$12.7 million in 2014. For 2014, dividends paid per share in the amount of \$1.4484375 were characterized as ordinary income for federal income tax purposes.

### C. *Class F Preferred Stock*

Dividends of \$0.138021 per share are paid monthly in arrears on the Class F preferred stock. We declared dividends to holders of our Class F preferred stock totaling \$27.1 million in 2016, 2015 and 2014. For 2016, 2015 and 2014, dividends paid per share of \$1.656252 were characterized as ordinary income for federal income tax purposes. At December 31, 2016, a monthly dividend of \$0.138021 per share was payable and was paid in January 2017. We are current in our obligations to pay dividends on our Class F preferred stock.

## 12. Operating Leases

A. At December 31, 2016, we owned 4,944 properties in 49 states and Puerto Rico. Of the 4,944 properties, 4,920, or 99.5%, are single-tenant properties, and the remaining are multi-tenant properties. At December 31, 2016, 84 properties were available for lease or sale.

Substantially all leases are net leases where the tenant pays or reimburses us for 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) was \$5.3 million for 2016, \$4.5 million for 2015 and \$3.6 million for 2014.

At December 31, 2016, minimum future annual rents to be received on the operating leases for the next five years and thereafter are as follows (dollars in thousands):

2017	\$	1,146,053
2018		1,092,071
2019		1,042,068
2020		992,192
2021		940,379
Thereafter		6,043,472
Total	\$	11,256,235

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, 2016, 2015 or 2014.

## 13. Gain on Sales of Real Estate

During 2016, we sold 77 properties for \$90.5 million, which resulted in a gain of \$22.0 million.

During 2015, we sold 38 properties for \$65.8 million, which resulted in a gain of \$22.2 million.

These property sales in 2016 and 2015 do not represent a strategic shift that will have a major effect on our operations and financial results, and therefore do not require presentation as discontinued operations.

During 2014, we sold 47 properties for \$108.1 million, which resulted in a gain of \$42.1 million. Only the results of operations specifically related to the properties classified as held for sale at December 31, 2013 and sold during the year were reclassified as discontinued operations.

Additionally, during 2016 we sold our former corporate headquarters building for \$8.6 million.

## 14. 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, escrow deposits, loans receivable, line of credit



payable, term loans and all other liabilities, due to their short-term nature or interest rates and terms that are consistent with market, except for our notes receivable issued in connection with property sales, mortgages payable and our senior notes and bonds payable, which are disclosed as follows (dollars in millions):

<b>At December 31, 2016</b>	<b>Carrying value per balance sheet</b>	<b>Estimated fair value</b>
Notes receivable issued in connection with property sales	\$ 5.4	\$ 5.5
Mortgages payable assumed in connection with acquisitions, net	466.0	468.7
Notes and bonds payable, net	3,934.4	4,143.3

<b>At December 31, 2015</b>	<b>Carrying value per balance sheet</b>	<b>Estimated fair value</b>
Notes receivable issued in connection with property sales	\$ 17.9	\$ 19.4
Mortgages payable assumed in connection with acquisitions, net	646.2	651.5
Notes and bonds payable, net	3,618.0	3,828.1

The estimated fair values of our notes receivable issued in connection with property sales and our mortgages payable have been calculated by discounting the future cash flows using an interest rate based upon the relevant Treasury yield curve, plus an applicable credit-adjusted spread. Because this methodology includes unobservable inputs that reflect our own internal assumptions and calculations, the measurement of estimated fair values related to our notes receivable and mortgages payable is categorized as level three on the three-level valuation hierarchy.

The estimated fair values of our senior notes and bonds payable are based upon indicative market prices and recent trading activity of our senior notes and bonds payable. Because this methodology includes inputs that are less observable by the public and are not necessarily reflected in active markets, the measurement of the estimated fair values, related to our notes and bonds payable, is categorized as level two on the three-level valuation hierarchy.

We record interest rate swaps on the consolidated balance sheet at fair value. At December 31, 2016, interest rate swaps in a liability position valued at \$2.3 million were included in accounts payable and accrued expenses and interest rate swaps in an asset position valued at \$66,000 were included in other assets, net on the consolidated balance sheet. The fair value of our interest rate swaps are based on valuation techniques including discounted cash flow analysis on the expected cash flows of each swap, using both observable and unobservable market-based inputs, including interest rate curves. Because this methodology uses observable and unobservable inputs, and the unobservable inputs are not significant to the fair value measurement, the measurement of interest rate swaps is categorized as level two on the three-level valuation hierarchy.

## **15. Supplemental Disclosures of Cash Flow Information**

Cash paid for interest was \$214.3 million in 2016, \$229.5 million in 2015, and \$207.3 million in 2014.

Interest capitalized to properties under development was \$469,000 in 2016, \$594,000 in 2015, and \$444,000 in 2014.

Cash paid for income taxes was \$3.6 million in 2016, \$3.1 million in 2015, and \$3.7 million in 2014.

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

- A. During 2016, we assumed mortgages payable to third-party lenders of \$44.1 million and recorded a premium of \$692,000. During 2014, we assumed mortgages payable to third-party lenders of \$166.7 million, recorded \$604,000 of net premiums, and recorded \$901,000 of interest rate swap value to other assets, net, related to property acquisitions.
- B. During 2016, consolidated joint venture members made real estate contributions of \$15.9 million, net of contributed mortgages payable included in the figures disclosed above in 15.A.
- C. See note 9 for a discussion of the \$6.0 million excess of redemption value over carrying value of preferred shares subject to redemption charge recorded during 2014.
- D. During 2014, we applied \$48.9 million of loans receivable to the purchase price of five acquired properties.

E. During 2014, we acquired real estate for \$11.6 million via exchanges of our properties.

F. Accrued costs on properties under development resulted in an increase in buildings and improvements and accounts payable of \$2.6 million and \$4.0 million at December 31, 2016 and 2014, respectively.

## 16. 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 each of our employee's salary deferrals up to the first 6% of the employee's eligible compensation. Our aggregate matching contributions each year have been immaterial to our results of operations.

## 17. Common Stock Incentive Plan

In 2012, our Board of Directors adopted and stockholders approved the Realty Income Corporation 2012 Incentive Award Plan, or the 2012 Plan, to enable us to motivate, attract and retain the services of directors and employees considered essential to our long-term success. The 2012 Plan offers our directors and employees an opportunity to own our stock or rights that will reflect our growth, development and financial success. Under the terms of the 2012 plan, the aggregate number of shares of our common stock subject to options, restricted stock, stock appreciation rights, restricted stock units and other awards, will be no more than 3,985,734 shares. The 2012 Plan has a term of ten years from the date it was adopted by our Board of Directors.

The amount of share-based compensation costs recognized in general and administrative expense on our consolidated statements of income was \$12.0 million during 2016, \$10.4 million during 2015, and \$12.0 million during 2014.

### A. Restricted Stock

The following table summarizes our common stock grant activity under our 2012 Plan. Our outstanding restricted stock vests over periods ranging from immediately to five years.

	2016		2015		2014	
	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	456,282	\$ 30.46	527,176	\$ 29.02	722,263	\$ 23.37
Shares granted	260,171	\$ 54.14	161,949	\$ 50.87	262,655	\$ 39.87
Shares vested	(200,066)	\$ 43.26	(205,248)	\$ 37.70	(440,348)	\$ 36.88
Shares forfeited	(2,864)	\$ 48.15	(27,595)	\$ 45.58	(17,394)	\$ 39.07
Outstanding nonvested shares, end of each period	<u>513,523</u>	\$ 48.33	<u>456,282</u>	\$ 30.46	<u>527,176</u>	\$ 29.02

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

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.

During 2016, 28,000 shares were granted to our Board of Directors, of which 20,000 vested immediately and 8,000 shares vest annually in equal parts over a three-year service period.

For shares granted on or after January 1, 2015, shares granted to employees typically vest in 20% increments on each of the first five anniversaries of the grant date. For shares granted prior to December 2014, the typical vesting schedule for shares granted to employees was 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.

Of the 232,171 shares granted to employees during 2016, 143,739 will vest over a five-year service period and 88,432 will vest over a four-year service period.

As of December 31, 2016, the remaining unamortized share-based compensation expense related to restricted stock totaled \$18.7 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.

As of December 31, 2016, 2015 and 2014, there were no common stock options outstanding for any of the periods presented.

#### *B. Performance Shares*

During 2016, 2015 and 2014, we granted performance share awards, as well as dividend equivalent rights, to our executive officers. The number of performance shares that vest is based on the achievement of the following performance goals:

##### *2016 & 2015 Performance Awards*

Metrics	Weighting
Total shareholder return ("TSR") relative to MSCI US REIT Index	50%
TSR relative to NAREIT Freestanding Index	20%
Dividend per share growth rate	20%
Debt-to-EBITDA ratio	10%

##### *2014 Performance Awards*

Metrics	Weighting
TSR relative to MSCI US REIT Index	60%
TSR relative to NAREIT Freestanding Index	20%
Debt-to-EBITDA ratio	20%

The performance shares are earned based on our performance, and vest 50% on the first and second January 1 after the end of the three year performance period, subject to continued service. The performance period for the 2014 performance awards began on January 1, 2014 and ended on December 31, 2016. The performance period for the 2015 performance awards began on January 1, 2015 and will end on December 31, 2017. The performance period for the 2016 performance awards began on January 1, 2016 and will end on December 31, 2018.

The fair value of the performance shares was estimated on the date of grant using a Monte Carlo Simulation model. The following table summarizes our performance share grant activity:

	<b>2016</b>		<b>2015</b>		<b>2014</b>	
	Number of performance shares	Weighted average price <sup>(1)</sup>	Number of performance shares	Weighted average price <sup>(1)</sup>	Number of performance shares	Weighted average price <sup>(1)</sup>
Outstanding nonvested shares, beginning of year	115,121	\$ 46.94	59,405	\$ 41.46	-	\$ -
Shares granted	58,575	\$ 55.07	55,716	\$ 52.78	71,705	\$ 41.46
Shares vested	(10,454)	\$ 44.54	-	\$ -	(4,067)	\$ 41.46
Shares forfeited	<u>(3,491)</u>	\$ 52.55	<u>-</u>	\$ -	<u>(8,233)</u>	\$ 41.46
Outstanding nonvested shares, end of each period	<u>159,751</u>	\$ 49.95	<u>115,121</u>	\$ 46.94	<u>59,405</u>	\$ 41.46

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

As of December 31, 2016, the remaining share-based compensation expense related to the performance shares totaled \$3.7 million and is being recognized on a tranche-by-tranche basis over the service period.

### C. Restricted Stock Units

During 2016 and 2015 we also granted restricted stock units that vest over a five-year service period and have the same economic rights as shares of restricted stock.

	<b>2016</b>		<b>2015</b>	
	Number of restricted stock units	Weighted average price <sup>(1)</sup>	Number of restricted stock units	Weighted average price <sup>(1)</sup>
Outstanding nonvested shares, beginning of year	10,136	\$ 52.21	-	\$ -
Shares granted	14,783	\$ 52.76	10,136	\$ 52.21
Shares vested	(6,459)	\$ 52.21	-	\$ -
Shares forfeited	<u>-</u>	\$ -	<u>-</u>	\$ -
Outstanding nonvested shares, end of each period	<u>18,460</u>	\$ 52.65	<u>10,136</u>	\$ 52.21

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

As of December 31, 2016, the remaining share-based compensation expense related to the restricted stock units totaled \$752,000 and is being recognized on a straight-line basis over the service period.



## 18. 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 47 activity segments. 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, rental revenue is the only component of segment profit and loss we measure.

<b>Assets, as of December 31:</b>	<b>2016</b>	<b>2015</b>
Segment net real estate:		
Apparel	\$ 175,418	\$ 180,175
Automotive service	152,220	129,328
Automotive tire services	238,151	247,200
Beverages	293,447	297,724
Child care	49,584	52,392
Convenience stores	1,050,285	724,972
Dollar stores	1,120,896	1,158,948
Drug stores	1,541,846	1,384,506
Financial services	408,228	254,022
General merchandise	248,040	195,030
Grocery stores	464,359	331,565
Health and fitness	823,697	839,872
Health care	214,971	220,018
Home improvement	311,459	268,974
Motor vehicle dealerships	197,713	137,315
Restaurants-casual dining	511,863	419,455
Restaurants-quick service	574,532	467,643
Theaters	370,732	371,617
Transportation services	796,717	686,041
Wholesale club	439,557	452,563
27 other non-reportable segments	1,920,076	1,799,524
<b>Total segment net real estate</b>	<b>11,903,791</b>	<b>10,618,884</b>
Intangible assets:		
Apparel	43,786	48,116
Automotive service	33,160	19,131
Automotive tire services	11,533	13,202
Beverages	2,280	2,538
Convenience stores	14,372	16,040
Dollar stores	51,249	56,420
Drug stores	182,981	189,433
Financial services	29,749	34,626
General merchandise	43,248	41,301
Grocery stores	65,412	42,823
Health and fitness	63,574	65,037
Health care	25,039	29,950
Home improvement	49,932	42,630
Motor vehicle dealerships	25,032	13,182
Restaurants-casual dining	22,058	9,392
Restaurants-quick service	43,356	32,612
Theaters	13,822	17,673
Transportation services	101,664	92,602
Wholesale club	32,723	36,215
Other non-reportable segments	227,350	231,494
Goodwill:		
Automotive service	440	448
Automotive tire services	862	865
Child care	4,945	5,034
Convenience stores	2,008	2,009
Restaurants-casual dining	2,107	2,215
Restaurants-quick service	1,068	1,082
Other non-reportable segments	3,637	3,668
<b>Other corporate assets</b>	<b>151,693</b>	<b>176,757</b>
<b>Total assets</b>	<b>\$ 13,152,871</b>	<b>\$ 11,845,379</b>

Revenue for the years ended December 31,	2016	2015	2014
Segment rental revenue:			
Apparel	\$ 19,975	\$ 19,819	\$ 17,674
Automotive service	20,212	18,632	16,548
Automotive tire services	28,754	28,627	28,222
Beverages	27,587	25,451	25,147
Child care	19,712	19,949	20,022
Convenience stores	91,784	90,093	89,754
Dollar stores	90,746	88,126	85,049
Drug stores	117,758	103,324	84,625
Financial services	18,769	17,044	16,828
General merchandise	18,976	16,411	13,550
Grocery stores	32,815	29,506	27,270
Health and fitness	85,901	75,881	62,086
Health care	16,168	16,057	16,039
Home improvement	25,695	23,112	15,593
Motor vehicle dealerships	20,329	15,332	13,909
Restaurants-casual dining	42,312	37,645	38,473
Restaurants-quick service	52,674	41,407	33,388
Theaters	51,926	49,456	47,102
Transportation services	57,694	51,745	46,287
Wholesale club	37,531	37,391	36,588
27 other non-reportable segments	180,095	171,857	159,303
Total rental revenue	1,057,413	976,865	893,457
Tenant reimbursements	43,104	42,015	37,118
Other revenue	2,655	4,405	2,930
Total revenue	\$ 1,103,172	\$ 1,023,285	\$ 933,505

## 19. Commitments and Contingencies

In the ordinary course of 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, 2016, we had commitments of \$7.0 million for re-leasing costs, recurring capital expenditures, and non-recurring building improvements. In addition, as of December 31, 2016, we had committed \$21.9 million under construction contracts, which is expected to be paid in the next twelve months.

We have certain properties that are subject to ground leases which are accounted for as operating leases. At December 31, 2016, minimum future rental payment for the next five years and thereafter are as follows (dollars in millions):

	Ground Leases Paid by Realty Income <sup>(1)</sup>	Ground Leases Paid by Our Tenants <sup>(2)</sup>	Total
2017	\$ 1.6	\$ 13.4	\$ 15.0
2018	1.6	13.5	15.1
2019	1.5	13.3	14.8
2020	1.4	13.1	14.5
2021	1.2	12.8	14.0
Thereafter	22.1	106.6	128.7
Total	\$ 29.4	\$ 172.7	\$ 202.1

<sup>(1)</sup> Realty Income currently pays the ground lessors directly for the rent under the ground leases.

<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.

## 20. Subsequent Events

In January and February 2017, we declared the following dividends, which will be paid in February 2017 and March 2017, respectively:

- \$0.2105 per share to our common stockholders and
- \$0.138021 per share to our Class F preferred stockholders.

REALTY INCOME CORPORATION AND SUBSIDIARIES

### Consolidated Quarterly Financial Data

(DOLLARS IN THOUSANDS, EXCEPT PER SHARE DATA)  
(NOT COVERED BY REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year <sup>(1)</sup>
<b>2016</b>					
Total revenue	\$ 267,116	\$ 271,039	\$ 277,174	\$ 287,843	\$ 1,103,172
Depreciation and amortization expense	107,933	110,342	113,917	117,752	449,943
Interest expense	60,678	57,409	52,952	48,935	219,974
Other expenses	30,310	35,878	37,438	35,128	138,757
Net income	70,484	76,068	77,202	92,724	316,477
Net income available to common stockholders	63,473	69,045	70,302	85,671	288,491
Net income per common share					
Basic	0.25	0.27	0.27	0.33	1.13
Diluted	0.25	0.27	0.27	0.33	1.13
Dividends paid per common share	0.5880000	0.5970000	0.6005000	0.6060000	2.3915000
<b>2015</b>					
Total revenue	\$ 246,867	\$ 253,860	\$ 258,889	\$ 263,668	\$ 1,023,285
Depreciation and amortization expense	98,037	101,101	104,338	105,739	409,215
Interest expense	58,468	58,680	63,950	51,982	233,079
Other expenses	29,999	31,404	29,012	27,962	118,379
Net income	67,581	66,350	67,813	83,111	284,855
Net income available to common stockholders	60,494	59,317	60,705	76,171	256,686
Net income per common share					
Basic	0.27	0.26	0.26	0.31	1.09
Diluted	0.27	0.25	0.26	0.31	1.09
Dividends paid per common share	0.5614167	0.5685000	0.5700000	0.5715000	2.2714167

<sup>(1)</sup> Amounts for each period are calculated independently. The sum of the quarters may differ from the annual amount.

## Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders  
Realty Income Corporation:

We have audited the accompanying consolidated balance sheets of Realty Income Corporation and subsidiaries as of December 31, 2016 and 2015, and the related consolidated statements of income, equity, and cash flows for each of the years in the three-year period ended December 31, 2016. These consolidated financial statements and financial statement schedule are the responsibility of Realty Income Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule 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, 2016 and 2015, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2016, 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, 2016, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 23, 2017 expressed an unqualified opinion on the effectiveness of Realty Income Corporation's internal control over financial reporting.

**KPMG LLP**

San Diego, California  
February 23, 2017



## Report of Independent Registered Public Accounting Firm, Continued

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, 2016, based on criteria established in *Internal Control – Integrated Framework (2013)* 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 Realty Income Corporation's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, 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, 2016, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Realty Income Corporation and subsidiaries as of December 31, 2016 and 2015, and the related consolidated statements of income, equity, and cash flows for each of the years in the three-year period ended December 31, 2016, and our report dated February 23, 2017 expressed an unqualified opinion on those consolidated financial statements.

**KPMG LLP**

San Diego, California  
February 23, 2017

## Business Description

### THE COMPANY

Realty Income, The Monthly Dividend Company<sup>®</sup>, is an S&P 500 company dedicated to providing stockholders with dependable monthly dividends that increase over time. The company is structured as a real estate investment trust, or REIT, requiring it annually to distribute at least 90% of its taxable income (excluding net capital gains) in the form of dividends to its stockholders. The monthly dividends are supported by the cash flow generated from real estate owned under long-term, net lease agreements with regional and national commercial tenants. The company has in-house acquisition, portfolio management, asset management, real estate research, credit research, legal, finance and accounting, information technology, and capital markets capabilities.

Realty Income was founded in 1969, and listed on the New York Stock Exchange (NYSE: O) in 1994. Over the past 48 years, Realty Income has been acquiring and managing freestanding commercial properties that generate rental revenue under long-term net lease agreements. The company is a member of the S&P High Yield Dividend Aristocrats<sup>®</sup> index for having increased its dividend every year for more than 20 consecutive years.

At December 31, 2016, we owned a diversified portfolio:

- Of 4,944 properties;
- With an occupancy rate of 98.3%, or 4,860 properties leased and 84 properties available for lease;
- Leased to 248 different commercial tenants doing business in 47 separate industries;
- Located in 49 states and Puerto Rico;
- With over 83.0 million square feet of leasable space; and
- With an average leasable space per property of approximately 16,800 square feet; approximately 11,520 square feet per retail property and 220,290 square feet per industrial property.

Of the 4,944 properties in the portfolio, 4,920, or 99.5%, are single-tenant properties, and the remaining are multi-tenant properties. At December 31, 2016, of the 4,920 single-tenant properties, 4,836 were leased with a weighted average remaining lease term (excluding rights to extend a lease at the option of the tenant) of approximately 9.8 years.

Our 11 senior officers owned 0.2% of our outstanding common stock with a market value of \$24.6 million at January 31, 2017. Our directors and 11 senior officers, as a group, owned 0.3% of our outstanding common stock with a market value of \$42.4 million at January 31, 2017.

Our common stock is listed on the NYSE under the ticker symbol "O" with a CUSIP number of 756109-104. Our central index key number is 726728.

Our 6.625% Monthly Income Class F Cumulative Redeemable Preferred Stock, or the Class F preferred stock, is listed on the NYSE under the ticker symbol "OprF" with a CUSIP number of 756109-807.

In January 2017, we had 146 employees, as compared to 132 employees in January 2016.

We maintain a corporate 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, Form 3s, Form 4s, Form 5s, 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 Dividends to Common Stockholders

We have continued our 48-year policy of paying monthly dividends. In addition, we increased the dividend six times during 2016 and twice during 2017. As of February 2017, we have paid 77 consecutive quarterly dividend increases and increased the dividend 90 times since our listing on the NYSE in 1994.

<b>2016 Dividend increases</b>	<b>Month Declared</b>	<b>Month Paid</b>	<b>Dividend per share</b>	<b>Increase per share</b>
1st increase	Dec 2015	Jan 2016	\$ 0.1910	\$ 0.0005
2nd increase	Jan 2016	Feb 2016	\$ 0.1985	\$ 0.0075
3rd increase	Mar 2016	Apr 2016	\$ 0.1990	\$ 0.0005
4th increase	Jun 2016	Jul 2016	\$ 0.1995	\$ 0.0005
5th increase	Jul 2016	Sep 2016	\$ 0.2015	\$ 0.0020
6th increase	Sep 2016	Oct 2016	\$ 0.2020	\$ 0.0005
<b>2017 Dividend increases</b>				
1st increase	Dec 2016	Jan 2017	\$ 0.2025	\$ 0.0005
2nd increase	Jan 2017	Feb 2017	\$ 0.2105	\$ 0.0080

The dividends paid per share during 2016 totaled approximately \$2.392, as compared to approximately \$2.271 during 2015, an increase of \$0.121, or 5.3%.

The monthly dividend of \$0.2105 per share represents a current annualized dividend of \$2.526 per share, and an annualized dividend yield of approximately 4.2% based on the last reported sale price of our common stock on the NYSE of \$59.63 on January 31, 2017. Although we expect to continue our policy of paying monthly dividends, we cannot guarantee that we will maintain our current level of dividends, that we will continue our pattern of increasing dividends per share, or what our actual dividend yield will be in any future period.

#### **Acquisitions During 2016**

During 2016, we invested \$1.86 billion in 505 new properties and properties under development or expansion, with an initial weighted average contractual lease rate of 6.3%. The 505 new properties and properties under development or expansion are located in 40 states, will contain approximately 8.2 million leasable square feet, and are 100% leased with a weighted average lease term of 14.7 years. The tenants occupying the new properties operate in 28 industries and the property types are 86.4% retail and 13.6% industrial, based on rental revenue. During 2016, none of our real estate investments caused any one tenant to be 10% or more of our total assets at December 31, 2016.

The estimated initial weighted average contractual lease rate for a property is generally computed as estimated contractual net operating income, which, in the case of a net leased property, is equal to the aggregate base rent for the first full year of each lease, divided by the total cost of the property. Since it is possible that a tenant could default on the payment of contractual rent, we cannot provide assurance that the actual return on the funds invested will remain at the percentages listed above.

In the case of a property under development or expansion, the contractual lease rate is generally fixed such that rent varies based on the actual total investment in order to provide a fixed rate of return. When the lease does not provide for a fixed rate of return on a property under development or expansion, the estimated initial weighted average contractual lease rate is computed as follows: estimated net operating income (determined by the lease) for the first full year of each lease, divided by our projected total investment in the property, including land, construction and capitalized interest costs. Of the \$1.86 billion we invested during 2016, \$103.8 million was invested in 33 properties under development or expansion with an estimated initial weighted average contractual lease rate of 7.1%. We may continue to pursue development or expansion opportunities under similar arrangements in the future.

## PORTFOLIO DISCUSSION

### Leasing Results

At December 31, 2016, we had 84 properties available for lease out of 4,944 properties in our portfolio, which represents a 98.3% occupancy rate based on the number of properties in our portfolio. Since December 31, 2015, when we reported 71 properties available for lease out of 4,538 and a 98.4% occupancy rate, we:

- Had 256 lease expirations (including leases rejected in bankruptcy);
- Re-leased 186 properties; and
- Sold 57 vacant properties.

Of the 186 properties re-leased during 2016, 144 properties were re-leased to existing tenants, 21 were re-leased to the same tenants without vacancy, and 21 were re-leased to new tenants after a period of vacancy. The annual rent on these 186 leases was \$28.57 million, as compared to the previous rent on these same properties of \$27.33 million, which represents a rent recapture rate of 104.5% on the properties re-leased during 2016.

As part of our re-leasing costs, we pay leasing commissions to unrelated, third party real estate brokers consistent with the commercial real estate industry standard, and sometimes provide tenant rent concessions. We do not consider the collective impact of the leasing commissions or tenant rent concessions to be material to our financial position or results of operations.

At December 31, 2016, our average annualized rental revenue was approximately \$13.64 per square foot on the 4,860 leased properties in our portfolio. At December 31, 2016, we classified 15 properties with a carrying amount of \$26.6 million as held for sale on our balance sheet. The expected sale of these properties does not represent a strategic shift that will have a major effect on our operations and financial results.

### Investments in Existing Properties

In 2016, we capitalized costs of \$16.3 million on existing properties in our portfolio, consisting of \$797,000 for re-leasing costs, \$679,000 for recurring capital expenditures, and \$14.9 million for non-recurring building improvements. In 2015, we capitalized costs of \$11.5 million on existing properties in our portfolio, consisting of \$748,000 for re-leasing costs, \$7.6 million for recurring capital expenditures and \$3.2 million for non-recurring building improvements.

The majority of our building improvements relate to roof repairs, HVAC improvements, and parking lot resurfacing and replacements. The amounts of our capital expenditures can vary significantly, depending on the rental market, tenant credit worthiness, the lease term and the willingness of tenants to pay higher rents over the terms of the lease.

### Note Issuance

In October 2016, we issued \$600 million of 3.000% senior unsecured notes due January 2027. The public offering price for the notes was 98.671% of the principal amount for an effective yield to maturity of 3.153%. The net proceeds of approximately \$586.7 million from the offering were used to repay borrowings outstanding under our credit facility.

### Capital Raising

During 2016, Realty Income issued 9,449,167 common shares at a weighted average price of \$60.61, receiving gross proceeds of \$572.7 million.

### Net Income Available to Common Stockholders

Net income available to common stockholders was \$288.5 million in 2016, as compared to \$256.7 million in 2015, an increase of \$31.8 million. On a diluted per common share basis, net income was \$1.13 in 2016, as compared to \$1.09 in 2015, an increase of \$0.04, or 3.7%.

The calculation to determine net income available to common stockholders includes impairments, gains from the sale of properties and/or fair value adjustments on our interest rate swaps. These items vary from period to period based on the timing of property sales and the interest rate environment, and can significantly impact net income available to common stockholders.



Gains from the sale of properties during 2016 were \$22.0 million, as compared to gains from the sale of properties of \$22.2 million during 2015.

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

In 2016, our FFO increased by \$83.0 million, or 12.7%, to \$735.4 million, as compared to \$652.4 million in 2015. On a diluted per common share basis, FFO was \$2.88 in 2016, compared to \$2.77 in 2015, an increase of \$0.11, or 4.0%.

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

In 2016, our AFFO increased by \$89.4 million, or 13.8%, to \$736.4 million versus \$647.0 million in 2015. On a diluted per common share basis, our AFFO was \$2.88 in 2016, compared to \$2.74 in 2015, an increase of \$0.14, or 5.1%.

See our discussion of FFO and AFFO (which are not financial measures under generally accepted accounting principles, or GAAP), later 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.

#### **DIVIDEND POLICY**

Distributions are paid monthly to holders of shares of our common stock and Class F preferred stock if, and when, declared by our Board of Directors.

Distributions are paid monthly to the limited partners holding common units of Tau Operating Partnership, L.P. and Realty Income, L.P., each on a per unit basis that is generally equal to the amount paid per share to our common stockholders.

In order to maintain our 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 taxable income (excluding net capital gains), and we are subject to income tax to the extent we distribute less than 100% of our taxable income (including net capital gains). In 2016, our cash distributions to preferred and common stockholders totaled \$637.6 million, or approximately 129.2% of our estimated taxable income of \$493.4 million. Our estimated taxable income reflects non-cash deductions for depreciation and amortization. Our estimated taxable income is presented to show our compliance with REIT dividend requirements and is not a measure of our liquidity or operating performance. We intend to continue to make distributions to our stockholders that are sufficient to meet this dividend requirement and that will reduce or eliminate our exposure to income taxes. Furthermore, we believe our funds from operations are sufficient to support our current level of cash distributions to our stockholders. Our cash distributions to common stockholders in 2016 totaled \$610.5 million, representing 82.9% of our adjusted funds from operations available to common stockholders of \$736.4 million. In comparison, our 2015 cash distributions to common stockholders totaled \$533.2 million, representing 82.4% of our adjusted funds from operations available to common stockholders of \$647.0 million.

The Class F preferred stockholders receive cumulative distributions at a rate of 6.625% per annum on the \$25.00 per share liquidation preference (equivalent to \$1.65625 per annum per share).

Future distributions will be at the discretion of our Board of Directors and will depend on, among other things, our results of operations, FFO, AFFO, cash flow from operations, financial condition, capital requirements, the annual distribution requirements under the REIT provisions of the Internal Revenue Code of 1986, as amended, or 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" is generally 20%. In general, dividends payable by REITs are not eligible for the reduced tax rate on qualified dividend income,

except to the extent that certain holding requirements have been met with respect to the REIT's stock and the REIT's dividends are attributable to dividends received from certain taxable corporations (such as our taxable REIT subsidiaries) or 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).

Distributions in excess of earnings and profits generally will first be treated as a non-taxable reduction in the stockholders' basis in their stock, but not below zero. Distributions in excess of that basis generally will be taxable as a capital gain to stockholders who hold their shares as a capital asset. Approximately 21.5% of the distributions to our common stockholders, made or deemed to have been made in 2016, were classified as a return of capital for federal income tax purposes. We estimate that in 2017, between 15% and 25% of the distributions may be classified as a return of capital.

## **BUSINESS PHILOSOPHY AND STRATEGY**

We believe that owning an actively managed, diversified portfolio of commercial properties under long-term, net lease agreements produces consistent and predictable income. A net lease typically requires the tenant to be responsible for monthly rent and certain property operating expenses including property taxes, insurance, and maintenance. In addition, tenants of our properties typically pay rent increases based on: (1) increases in the consumer price index (typically subject to ceilings), (2) fixed increases, or (3) additional rent calculated as a percentage of the tenants' gross sales above a specified level. We believe that a portfolio of properties under long-term, net lease agreements 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.

Diversification is also a key component of our business philosophy. We believe that diversification of the portfolio by tenant, industry, geography, and, to a certain extent, property type leads to more consistent and predictable income for our stockholders by reducing vulnerability that can come with any single concentration. Our investment activities have led to a diversified property portfolio that, as of December 31, 2016, consisted of 4,944 properties located in 49 states and Puerto Rico, leased to 248 different commercial tenants doing business in 47 industries. Each of the 47 industries represented in our property portfolio individually accounted for no more than 11.4% of our rental revenue for the quarter ended December 31, 2016.

### **Investment Strategy**

Our investment strategy is to acquire real estate leased to regional and national tenants. When identifying new properties for investment, we generally focus on acquiring high-quality real estate that tenants consider important to the successful operation of their business. We generally seek to acquire real estate that has the following characteristics:

- Properties that are freestanding, commercially-zoned with a single tenant;
- Properties that are in significant markets or strategic locations critical to generating revenue for regional and national tenants (i.e. they need the property in which they operate in order to conduct their business);
- Properties that we deem to be profitable for the tenants and/or can generally be characterized as important to the successful operations of the company's business;
- Properties that are located within attractive demographic areas relative to the business of our tenants, generally fungible, and have good visibility and easy access to major thoroughfares;
- Properties with real estate valuations that approximate replacement costs;
- Properties with rental or lease payments that approximate market rents; 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 future rent increases.

We seek to invest in industries in which several, well-organized, regional and national tenants are capturing market share through the selection of prime real estate locations supported by superior service, quality control, economies of scale, consumer branding, and advertising. In addition, we frequently acquire large portfolios of single-tenant properties net leased to different tenants operating in a variety of industries. We have an internal team dedicated to sourcing such opportunities, often using our relationships with various tenants, owners/developers, and advisers to uncover and secure transactions. We also undertake thorough research and analysis to identify what we consider to be appropriate property locations, tenants, and industries for investment. This research expertise is instrumental to uncovering net lease opportunities in markets where we believe we can add value.

In selecting potential investments, we look for tenants with the following attributes:

- Tenants with reliable and sustainable cash flow;
- Tenants with revenue and cash flow from multiple sources;
- Tenants that are willing to sign a long-term lease (10 or more years); and
- Tenants that are large owners and users of real estate.

From a retail perspective, our investment strategy is to target tenants that have a service, non-discretionary, and/or low-price-point component to their business. We believe these characteristics better position tenants to operate in a variety of economic conditions and to compete more effectively with internet retailers. As a result of the execution of this strategy, over 90% of our annualized retail rental revenue is derived from tenants with a service, non-discretionary, and/or low price point component to their business. From a non-retail perspective, we target industrial properties leased to Fortune 1000, primarily investment grade rated companies. We believe these characteristics enhance the stability of the rental revenue generated from these properties.

After applying this investment strategy, we pursue those transactions where we can achieve an attractive investment spread over our cost of capital and favorable risk-adjusted returns.

### **Underwriting Strategy**

In order to be considered for acquisition, properties must meet stringent underwriting requirements. We have established a four-part analysis that examines each potential investment based on:

- The aforementioned overall real estate characteristics, including demographics, replacement cost and comparative rental rates;
- Industry, tenant (including credit profile), and market conditions;
- Store profitability for retail locations if profitability data is available; and
- The importance of the real estate location to the operations of the tenants' business.

We believe the principal financial obligations for most of our tenants 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 or which are critical to the tenant's ability to generate revenue, we believe the risk of default on a tenant's lease obligation is less than the tenant's unsecured general obligations. It has been our experience that tenants must retain their profitable and critical locations in order to survive. Therefore, in the event of reorganization, they are less likely to reject a lease of a profitable or critical location because this would terminate their right to use the property.

Thus, as the property owner, we believe that 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 real estate leases can be further mitigated by monitoring the performance of the tenants' individual locations and considering whether to proactively sell locations that meet our criteria for disposition.

Prior to entering into any transaction, our research department conducts a review of a tenant's credit quality. The information reviewed may include reports and filings, including any public credit ratings, financial statements, debt and equity analyst reports, and reviews of corporate credit spreads, stock prices, market capitalization, and other financial metrics. We conduct additional due diligence, including additional financial reviews of the tenant and a more comprehensive review of the business segment and industry in which the tenant operates. We continue to monitor our tenants' credit quality on an ongoing basis by reviewing the available information previously discussed, and providing summaries of these findings to management. We estimate that approximately 47% of our annualized rental revenue comes from properties leased to investment grade rated companies or their subsidiaries. At December 31, 2016, our top 20 tenants represent approximately 53% of our annualized revenue and ten of these tenants have investment grade credit ratings or are subsidiaries of investment grade companies.

### **Portfolio and Asset Management Strategy**

In addition to pursuing new properties for investment, we seek to increase earnings and distributions to stockholders through active portfolio and asset management.

Generally, our portfolio and asset management efforts seek to achieve:

- Rent increases at the expiration of existing leases, when market conditions permit;
- Optimum exposure to certain tenants, industries, and markets through re-leasing vacant properties and selectively selling properties;
- Maximum asset-level returns on properties that are re-leased or sold;
- Additional value creation from the existing portfolio by enhancing individual properties, pursuing alternative uses, and deriving ancillary revenue; and
- Investment opportunities in new asset classes for the portfolio.

We continually monitor our portfolio for any changes that could affect the performance of our tenants, our tenants' industries, and the real estate locations in which we have invested. We also regularly analyze our portfolio with a view towards optimizing its returns and enhancing its overall credit quality. Our active portfolio and asset management strategy pursues asset sales 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; and/or
- Decrease tenant, industry, or geographic concentration.

At December 31, 2016, we classified 15 properties with a carrying amount of \$26.6 million as held for sale on our balance sheet. For 2017, we intend to continue our active disposition efforts to further enhance our real estate portfolio and anticipate \$75 to \$100 million in property sales. We plan to invest these proceeds into new property acquisitions, if there are attractive opportunities available. However, we cannot guarantee that we will sell properties during 2017 at our estimated values or be able to invest the property sale proceeds in new properties.

The active management of the portfolio is an essential component of our long-term strategy of maintaining high occupancy. Since 1970, our occupancy rate at the end of each year has never been below 96%. However, we cannot assure you that our future occupancy levels will continue to equal or exceed 96%.

### **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. 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 initially financed by our credit facility or debt securities. However, we cannot assure you that we will have access to the capital markets at all times and at terms that are acceptable to us.

Our primary cash obligations, for the current year and subsequent years, are included in the "Table of Obligations," which is presented later in this section. We expect to fund our operating expenses and other short-term liquidity requirements, including property acquisitions and development costs, payment of principal and interest on our outstanding indebtedness, property improvements, re-leasing costs and cash distributions to common and preferred stockholders, primarily through cash provided by operating activities, borrowing on our credit facility and periodically through public securities offerings.

### **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, 2016, our total outstanding borrowings of senior unsecured notes and bonds, term loans, mortgages payable and credit facility borrowings were \$5.875 billion, or approximately 27.6% of our total market capitalization of \$21.26 billion.

We define our total market capitalization at December 31, 2016 as the sum of:

- Shares of our common stock outstanding of 260,168,259, plus total common units outstanding of 405,204, multiplied by the last reported sales price of our common stock on the NYSE of \$57.48 per share on December 31, 2016, or \$14.98 billion;
- Aggregate liquidation value (par value of \$25.00 per share) of the Class F preferred stock of \$408.8 million;



- Outstanding borrowings of \$1.12 billion on our credit facility;
- Outstanding mortgages payable of \$460.0 million, excluding net mortgage premiums of \$6.4 million and deferred financing costs of \$324,000;
- Outstanding borrowings of \$320.0 million on our term loans, excluding deferred financing costs of \$873,000; and
- Outstanding senior unsecured notes and bonds of \$3.98 billion, excluding unamortized original issuance discounts of \$19.8 million and deferred financing costs of \$20.8 million.

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

In the commercial real estate market, property prices generally continue to fluctuate. Likewise, during certain periods, the U.S. credit markets have experienced significant price volatility, dislocations, and liquidity disruptions, which may impact our access to and cost of capital. We continually monitor the commercial real estate and U.S. credit markets carefully and, if required, will make decisions to adjust our business strategy accordingly.

### **Universal Shelf Registration**

In December 2015, we filed a shelf registration statement with the SEC, which is effective for a term of three years and will expire in December 2018. In accordance with 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 (1) common stock, (2) preferred stock, (3) debt securities, (4) depositary shares representing fractional interests in shares of preferred stock, (5) warrants to purchase debt securities, common stock, preferred stock, or depositary shares, and (6) 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 these 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.

### **\$2.0 Billion Revolving Credit Facility**

In June 2015, we entered into a \$2.0 billion unsecured revolving credit facility, or our credit facility, that expires in June 2019 and includes, at our option, two six-month extensions. Our credit facility has a \$1.0 billion accordion expansion option. Under our credit facility, our investment grade credit ratings as of December 31, 2016 provide for financing at the London Interbank Offered Rate, commonly referred to as LIBOR, plus 0.90%, with a facility commitment fee of 0.15%, for all-in drawn pricing of 1.05% over LIBOR. The borrowing rate is subject to an interest rate floor and may change if our investment grade credit ratings change. We also have other interest rate options available to us under our credit facility. Our credit facility is unsecured and, accordingly, we have not pledged any assets as collateral for this obligation.

At December 31, 2016, we had a borrowing capacity of \$880.0 million available on our credit facility and an outstanding balance of \$1.12 billion. The weighted average interest rate on borrowings outstanding under our credit facility, at December 31, 2016, was 1.7% per annum. We must comply with various financial and other covenants in our credit facility. At December 31, 2016, we remain in compliance with these covenants. We expect to use our credit facility to acquire additional properties and for other general corporate purposes. Any additional borrowings will increase our exposure to interest rate risk.

We generally use our credit facility for the short-term financing of new property acquisitions. Thereafter, 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 the refinancing will enable us to issue equity or debt securities at acceptable terms.

### **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, 2016, we had cash and cash equivalents totaling \$9.4 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 next twelve months. We intend, however, to use

permanent or long-term capital to fund property acquisitions and to repay future borrowings under our credit facility.

### **Credit Agency Ratings**

The borrowing interest rates under our credit facility are based upon our ratings assigned by credit rating agencies. As of December 31, 2016, we were assigned the following investment grade corporate credit ratings on our senior unsecured notes and bonds: Moody's Investors Service has assigned a rating of Baa1 with a "positive" outlook, Standard & Poor's Ratings Group has assigned a rating of BBB+ with a "positive" outlook, and Fitch Ratings has assigned a rating of BBB+ with a "stable" outlook.

Based on our ratings as of December 31, 2016, the facility interest rate as of December 31, 2016 was LIBOR plus 0.90% with a facility commitment fee of 0.15%, for all-in drawn pricing of 1.05% over LIBOR. Our credit facility provides that the interest rate can range between: (i) LIBOR plus 1.55% if our credit rating is lower than BBB-/Baa3 or unrated and (ii) LIBOR plus 0.85% 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 range from: (i) 0.30% for a rating lower than BBB-/Baa3 or unrated, and (ii) 0.125% 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.

### **Term Loans**

In June 2015, in conjunction with entering into our credit facility, we entered into a \$250 million senior unsecured term loan maturing June 30, 2020. Borrowing under this term loan bears interest at LIBOR, plus 0.95%. In conjunction with this term loan, we also entered into an interest rate swap which effectively fixes our per annum interest rate on this term loan at 2.67%.

In January 2013, in conjunction with our acquisition of American Realty Capital Trust, ARCT, we entered into a \$70 million senior unsecured term loan maturing in January 2018. Borrowing under the term loan bears interest at LIBOR, plus 1.20%. In conjunction with this term loan, we also acquired an interest rate swap which effectively fixes our per annum interest rate on this term loan at 2.15%.

### **Mortgage Debt**

As of December 31, 2016, we had \$460.0 million of mortgages payable, all of which were assumed in connection with our property acquisitions. Additionally, at December 31, 2016, we had net premiums totaling \$6.4 million on these mortgages and deferred financing costs of \$324,000. We expect to pay off the mortgages payable as soon as prepayment penalties have declined to a level that would make it economically feasible to do so. During 2016, we made \$231.7 million of principal payments, including the repayment of 11 mortgages in full for \$201.8 million, and refinanced one of our assumed mortgages whereby we received an additional \$10.0 million in proceeds.

### **Notes Outstanding**

As of December 31, 2016, we had \$3.98 billion of senior unsecured note and bond obligations, excluding unamortized original issuance discounts of \$19.8 million and deferred financing costs of \$20.8 million. All of our outstanding notes and bonds have fixed interest rates. Interest on all of our senior note and bond obligations is paid semiannually.

### **No Unconsolidated Investments**

We have no unconsolidated investments, nor do we engage in trading activities involving energy or commodity contracts.

### **Corporate Responsibility**

We are committed to providing an engaging, diverse, and safe work environment for our employees, to upholding our corporate responsibilities as a public company operating for the benefit of our stockholders, and

to operating our company in an environmentally conscious manner. As The Monthly Dividend Company®, our mission is to provide our stockholders with monthly dividends that increase over time. How we manage and use the physical, financial and talent resources that enable us to achieve this mission, demonstrates our commitment to corporate responsibility.

*Social Responsibility and Ethics.* An extension of our mission is our commitment to being socially responsible and conducting our business according to the highest ethical standards. Our employees are awarded compensation that is in line with those of our peers and competitors, including generous healthcare benefits for employees and their families; participation in a 401(k) plan with a matching contribution by Realty Income; competitive paid time-off benefits; and an infant-at-work program for new parents. Our employees have access to members of our Board of Directors to report anonymously, if desired, any suspicion of misconduct by any member of our senior management or executive team. We also have a longstanding commitment to equal employment opportunity and adhere to all Equal Employer Opportunity Policy guidelines. We apply the principles of full and fair disclosure in all of our business dealings, as outlined in our Corporate Code of Business Ethics. We are also committed to dealing fairly with all of our customers, suppliers, and competitors.

Realty Income and our employees have taken an active role in supporting our communities through civic involvement with charitable organizations, including our partnership with San Diego Habitat for Humanity, and corporate donations. Focusing our impact on social and environmentally sustainable areas our non-profit partnerships have resulted in approximately 700 employee volunteer hours during 2016, employee and corporate donations to fund local affordable housing, educational services to at-risk youth, funding local foodbanks, and toys for under-served children. Our dedication to being a responsible corporate citizen has a direct and positive impact in the communities in which we operate and contributes to the strength of our reputation and our financial performance.

*Corporate Governance.* We believe that a company's reputation for integrity and serving its stockholders responsibly is of utmost importance. We are committed to managing the company for the benefit of our stockholders and are focused on maintaining good corporate governance. Practices that illustrate this commitment include:

- Our Board of Directors is comprised of eight directors, seven of which are independent, non-employee directors;
- Our Board of Directors is elected on an annual basis;
- We employ a majority vote standard for uncontested elections;
- Our Compensation Committee of the Board of Directors works with independent consultants in conducting annual compensation reviews for our key executives, and compensates each individual primarily based on reaching certain performance metrics that determine the success of our company; and
- We adhere to all other corporate governance principles outlined in our "Corporate Governance Guidelines" document on our website.

*Environmental Practices.* Our focus on conservationism is demonstrated by how we manage our day-to-day activities at our corporate headquarters. At our headquarters, we promote energy efficiency and encourage practices such as powering down office equipment at the end of the day, implementing file-sharing technology and automatic "duplex mode" to limit paper use, adopting an electronic approval system, carpooling to our headquarters, and recycling paper waste. In 2016, we sent more than 29,500 pounds of paper to our off-site partner for recycling.

With respect to recycling and reuse practices, we encourage the use of recycled products and the recycling of materials during our operations. Cell phones, wireless devices and office equipment are recycled or donated whenever possible.

In addition, our headquarters was retrofitted according to the State of California energy efficiency standards (specifically following California Green Building Standards Code and Title 24 of the California Code of Regulations), with features such as an automatic lighting control system with light-harvesting technology, a Building Management System that monitors and controls energy use, an energy-efficient PVC roof and heating and cooling system, LED lighting, and drought-tolerant landscaping with recycled materials.

The properties in our portfolio are net leased to our tenants who are responsible for maintaining the buildings and are in control of their energy usage and environmental sustainability practices. We remain active in working with our tenants to promote environmental responsibility at the properties we own and to promote the importance of energy efficient facilities.

Our Asset Management team has engaged with a renewable energy development company to identify assets that would maximize energy efficiency initiatives throughout our property portfolio. These initiatives include solar energy arrays, battery storage, and charging stations. In addition, we continue to explore regional opportunities with our tenants, bringing our properties into compliance to qualify for city and county programs.

REALTY INCOME CORPORATION AND SUBSIDIARIES

## Property Portfolio Information

At December 31, 2016, we owned a diversified portfolio:

- Of 4,944 properties;
- With an occupancy rate of 98.3%, or 4,860 properties leased and 84 properties available for lease;
- Leased to 248 different commercial tenants doing business in 47 separate industries;
- Located in 49 states and Puerto Rico;
- With over 83.0 million square feet of leasable space; and
- With an average leasable space per property of approximately 16,800 square feet; approximately 11,520 square feet per retail property and 220,290 square feet per industrial property.

At December 31, 2016, of our 4,944 properties, 4,860 were leased under net lease agreements. A net lease typically requires the tenant to be responsible for monthly rent and certain property operating expenses including property taxes, insurance, and maintenance. In addition, our tenants are typically subject to 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.

At December 31, 2016, our 248 commercial tenants, which we define as retailers with over 50 locations and non-retailers with over \$500 million in annual revenues, represented approximately 95% of our annualized revenue. We had 277 additional tenants, representing approximately 5% of our annualized revenue at December 31, 2016, which brings our total tenant count to 525 tenants.



## Industry Diversification

The following table sets forth certain information regarding our property portfolio classified according to the business of the respective tenants, expressed as a percentage of our total rental revenue:

	Percentage of Rental Revenue <sup>(1)</sup>					
	For the	For the Years Ended				
	Quarter Ended	Dec 31,	Dec 31,	Dec 31,	Dec 31,	Dec 31,
	December 31,	2016	2015	2014	2013	2012
	2016	2016	2015	2014	2013	2012
<u>Retail industries</u>						
Apparel stores	1.8%	1.9%	2.0%	2.0%	1.9%	1.7%
Automotive collision services	1.0	1.0	1.0	0.8	0.8	1.1
Automotive parts	1.4	1.3	1.4	1.3	1.2	1.0
Automotive service	1.9	1.9	1.9	1.8	2.1	3.1
Automotive tire services	2.6	2.7	2.9	3.2	3.6	4.7
Book stores	*	*	*	*	*	0.1
Child care	1.8	1.9	2.0	2.2	2.8	4.5
Consumer electronics	0.3	0.3	0.3	0.3	0.3	0.5
Convenience stores	8.5	8.7	9.2	10.1	11.2	16.3
Crafts and novelties	0.5	0.5	0.5	0.5	0.5	0.3
Dollar stores	8.3	8.6	8.9	9.6	6.2	2.2
Drug stores	11.4	11.2	10.6	9.5	8.1	3.5
Education	0.3	0.3	0.3	0.4	0.4	0.7
Entertainment	0.5	0.5	0.5	0.5	0.6	0.9
Equipment services	*	0.1	0.1	0.1	0.1	0.1
Financial services	1.8	1.4	1.3	1.4	1.5	0.2
General merchandise	1.7	1.5	1.4	1.2	1.1	0.6
Grocery stores	3.4	3.1	3.0	3.0	2.9	3.7
Health and fitness	7.9	8.1	7.7	7.0	6.3	6.8
Health care	0.9	0.9	1.0	1.1	1.1	-
Home furnishings	0.8	0.7	0.7	0.7	0.9	1.0
Home improvement	2.5	2.5	2.4	1.7	1.6	1.5
Jewelry	0.1	0.1	0.1	0.1	0.1	-
Motor vehicle dealerships	1.9	1.9	1.6	1.6	1.6	2.1
Office supplies	0.3	0.3	0.3	0.4	0.5	0.8
Pet supplies and services	0.6	0.6	0.7	0.7	0.8	0.6
Restaurants - casual dining	3.9	3.9	3.8	4.3	5.1	7.3
Restaurants - quick service	5.2	4.9	4.2	3.7	4.4	5.9
Shoe stores	0.5	0.5	0.5	0.1	0.1	0.1
Sporting goods	1.3	1.6	1.8	1.6	1.7	2.5
Telecommunications	*	*	-	-	-	-
Theaters	4.7	4.9	5.1	5.3	6.2	9.4
Transportation services	0.1	0.1	0.1	0.1	0.1	0.2
Wholesale clubs	3.4	3.6	3.8	4.1	3.9	3.2
Other	*	*	*	*	0.1	0.1
Retail industries	81.3%	81.5%	81.1%	80.4%	79.8%	86.7%

## Industry Diversification (continued)

	Percentage of Rental Revenue <sup>(1)</sup>					
	For the	For the Years Ended				
	Quarter Ended	Dec 31,	Dec 31,	Dec 31,	Dec 31,	Dec 31,
	December 31,	2016	2015	2014	2013	2012
	2016	2016	2015	2014	2013	2012
<u>Non-retail industries</u>						
Aerospace	1.0	1.0	1.1	1.2	1.2	0.9
Beverages	2.8	2.6	2.7	2.8	3.3	5.1
Consumer appliances	0.4	0.5	0.6	0.5	0.6	0.1
Consumer goods	0.9	0.9	0.9	0.9	1.0	0.1
Crafts and novelties	0.1	0.1	0.1	0.1	0.1	-
Diversified industrial	0.9	0.9	0.8	0.5	0.2	0.1
Electric utilities	0.1	0.1	0.1	0.1	*	-
Equipment services	0.4	0.5	0.4	0.5	0.4	0.3
Financial services	0.4	0.4	0.4	0.4	0.5	0.4
Food processing	1.1	1.1	1.2	1.4	1.5	1.3
General merchandise	0.3	0.3	0.3	0.3	-	-
Government services	1.0	1.1	1.2	1.3	1.4	0.1
Health care	0.6	0.6	0.7	0.7	0.8	*
Home furnishings	0.1	0.1	0.2	0.2	0.2	-
Insurance	0.1	0.1	0.1	0.1	0.1	*
Machinery	0.1	0.1	0.1	0.2	0.2	0.1
Other manufacturing	0.7	0.8	0.7	0.7	0.6	-
Packaging	0.9	0.8	0.8	0.8	0.9	0.7
Paper	0.1	0.1	0.1	0.1	0.2	0.1
Shoe stores	0.2	0.2	0.2	0.8	0.9	-
Telecommunications	0.7	0.6	0.7	0.7	0.7	0.8
Transportation services	5.6	5.4	5.3	5.1	5.3	2.2
Other	0.2	0.2	0.2	0.2	0.1	1.0
Non-retail industries	18.7%	18.5%	18.9%	19.6%	20.2%	13.3%
Totals	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

\* Less than 0.1%

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

### Property Type Composition

The following table sets forth certain property type information regarding our property portfolio as of December 31, 2016 (dollars in thousands):

Property Type	Number of Properties	Approximate Leasable Square Feet	Rental Revenue for the Quarter Ended December 31, 2016 <sup>(1)</sup>	Percentage of Rental Revenue
Retail	4,774	55,005,900	\$ 216,904	78.9%
Industrial	111	24,452,100	36,383	13.2
Office	44	3,403,200	15,111	5.5
Agriculture	15	184,500	6,503	2.4
<b>Totals</b>	<b>4,944</b>	<b>83,045,700</b>	<b>\$ 274,901</b>	<b>100.0%</b>

<sup>(1)</sup> Includes rental revenue for all properties owned at December 31, 2016. Excludes revenue of \$323 from sold properties.

### Tenant Diversification

The following table sets forth the largest tenants in our property portfolio, expressed as a percentage of total rental revenue at December 31, 2016:

Tenant	Number of Properties	% of Rental Revenue
Walgreens	203	7.0%
FedEx	43	5.5%
Dollar General	524	4.2%
LA Fitness	48	4.0%
Dollar Tree / Family Dollar	457	3.8%
Circle K (Couche-Tard)	299	2.6%
AMC Theatres	22	2.6%
BJ's Wholesale Club	15	2.4%
Diageo	17	2.2%
CVS Pharmacy	70	2.0%
Super America / Western Refining	134	2.0%
Walmart / Sam's Club	31	1.9%
Regal Cinemas	22	1.9%
GPM Investments / Fas Mart	216	1.9%
Rite Aid	69	1.9%
7-Eleven	111	1.8%
Life Time Fitness	9	1.8%
TBC Corporation (Sumitomo)	149	1.6%
FreedomRoads / Camping World	18	1.2%
Home Depot	10	1.1%

### Service Category Diversification for our Retail Properties

The following table sets forth certain information regarding the 4,774 retail properties included in our 4,944 total properties owned at December 31, 2016, classified according to the business types and the level of services they provide at the property level (dollars in thousands):

	Number of Retail Properties	Retail Rental Revenue for the Quarter Ended December 31, 2016 <sup>(1)</sup>	Percentage of Retail Rental Revenue
<b><u>Tenants Providing Services</u></b>			
Automotive collision services	54	\$ 2,705	1.2%
Automotive service	241	5,342	2.5
Child care	199	4,862	2.2
Education	14	824	0.4
Entertainment	11	1,310	0.6
Equipment services	2	111	0.1
Financial services	227	4,930	2.3
Health and fitness	87	21,608	10.0
Health care	27	1,133	0.5
Telecommunications	1	-	*
Theaters	45	13,080	6.0
Transportation services	2	229	0.1
Other	7	82	*
	917	56,216	25.9
<b><u>Tenants Selling Goods and Services</u></b>			
Automotive parts (with installation)	68	1,589	0.7
Automotive tire services	184	7,136	3.3
Convenience stores	866	23,253	10.7
Motor vehicle dealerships	28	5,304	2.5
Pet supplies and services	12	722	0.3
Restaurants - casual dining	323	10,128	4.7
Restaurants - quick service	566	14,330	6.6
	2,047	62,462	28.8
<b><u>Tenants Selling Goods</u></b>			
Apparel stores	29	5,147	2.4
Automotive parts	83	2,363	1.1
Book stores	1	104	*
Consumer electronics	9	916	0.4
Crafts and novelties	13	1,274	0.6
Dollar stores	981	22,770	10.5
Drug stores	335	29,922	13.8
General merchandise	76	4,223	2.0
Grocery stores	84	9,291	4.3
Home furnishings	58	2,065	1.0
Home improvement	58	6,142	2.8
Jewelry	4	175	0.1
Office supplies	9	724	0.3
Shoe stores	2	182	0.1
Sporting goods	36	3,503	1.6
Wholesale clubs	32	9,425	4.3
	1,810	98,226	45.3
<b>Total Retail Properties</b>	<b>4,774</b>	<b>\$ 216,904</b>	<b>100.0%</b>

\* Less than 0.1%

<sup>(1)</sup> Includes rental revenue for all retail properties owned at December 31, 2016. Excludes revenue of \$57,997 from non-retail properties and \$323 from sold properties.

## Lease Expirations

The following table sets forth certain information regarding our property portfolio regarding the timing of the lease term expirations in our portfolio (excluding rights to extend a lease at the option of the tenant) on our 4,836 net leased, single-tenant properties and their contribution to rental revenue for the quarter ended December 31, 2016 (dollars in thousands):

Year	Expiring Leases		Approx. Leasable Sq. Feet	Rental Revenue <sup>(2)</sup>	% of Rental Revenue
	Retail	Non-Retail			
	Total Portfolio <sup>(1)</sup>				
2017	156	2	1,752,600	\$ 4,239	1.6%
2018	279	9	3,661,200	11,542	4.3
2019	264	10	3,912,700	13,556	5.0
2020	198	11	4,345,800	12,688	4.7
2021	295	13	5,355,200	15,227	5.6
2022	280	17	7,843,300	16,939	6.3
2023	378	20	6,640,300	22,434	8.3
2024	198	12	4,360,000	12,533	4.6
2025	326	14	5,227,100	20,452	7.5
2026	317	5	4,451,500	14,598	5.4
2027	504	3	5,698,000	20,861	7.7
2028	289	6	6,296,600	16,426	6.1
2029	400	5	6,986,800	20,650	7.7
2030	80	13	2,439,100	14,568	5.3
2031	269	25	5,110,000	18,527	6.8
2032 - 2043	434	4	6,869,300	35,456	13.1
Totals	4,667	169	80,949,500	\$ 270,696	100.0%

\* Less than 0.1%

<sup>(1)</sup> Excludes 24 multi-tenant properties and 84 vacant properties. The lease expirations for properties under construction are based on the estimated date of completion of those properties.

<sup>(2)</sup> Excludes revenue of \$4,205 from 24 multi-tenant properties and from 84 vacant properties at December 31, 2016, and \$323 from sold properties.



## Geographic Diversification

The following table sets forth certain state-by-state information regarding our property portfolio as of December 31, 2016 (dollars in thousands):

State	Number of Properties	Percent Leased	Approximate Leasable Square Feet	Rental Revenue for the Quarter Ended December 31, 2016 <sup>(1)</sup>	Percentage of Rental Revenue
Alabama	159	97%	1,367,700	\$ 5,112	1.9%
Alaska	3	67	275,900	475	0.2
Arizona	109	99	1,626,300	6,422	2.3
Arkansas	55	100	816,500	1,828	0.7
California	178	99	5,292,400	26,423	9.6
Colorado	81	100	1,097,400	4,375	1.6
Connecticut	24	92	535,300	2,571	0.9
Delaware	18	100	93,000	717	0.3
Florida	367	99	4,039,500	14,950	5.4
Georgia	250	98	4,154,400	12,150	4.4
Idaho	12	100	87,000	419	0.1
Illinois	229	99	5,144,000	14,597	5.3
Indiana	171	99	2,105,400	8,406	3.1
Iowa	40	95	2,970,600	4,089	1.5
Kansas	93	98	1,846,400	4,834	1.8
Kentucky	62	98	1,368,400	4,026	1.5
Louisiana	99	97	1,353,200	3,863	1.4
Maine	16	94	178,500	928	0.3
Maryland	36	94	864,400	4,412	1.6
Massachusetts	80	98	751,600	3,498	1.3
Michigan	163	98	1,651,900	6,398	2.3
Minnesota	158	99	1,951,100	9,772	3.5
Mississippi	134	95	1,623,600	4,552	1.7
Missouri	140	97	2,851,300	8,846	3.2
Montana	11	100	87,000	483	0.2
Nebraska	38	100	806,500	2,255	0.8
Nevada	22	100	413,000	1,309	0.5
New Hampshire	19	100	315,800	1,481	0.5
New Jersey	71	99	834,400	4,388	1.6
New Mexico	30	100	293,200	887	0.3
New York	94	100	2,505,300	12,331	4.5
North Carolina	173	98	2,258,100	7,387	2.7
North Dakota	8	88	123,000	206	0.1
Ohio	247	98	6,247,100	14,936	5.4
Oklahoma	133	99	1,652,200	4,549	1.6
Oregon	28	100	593,300	2,378	0.9
Pennsylvania	148	99	1,855,000	7,528	2.7
Rhode Island	3	100	153,300	809	0.3
South Carolina	148	99	1,105,100	5,157	1.9
South Dakota	14	100	170,700	416	0.1
Tennessee	224	97	3,174,400	8,781	3.2
Texas	490	99	9,176,400	25,756	9.4
Utah	22	100	956,400	2,170	0.8
Vermont	5	100	98,000	484	0.2
Virginia	153	97	2,991,200	7,597	2.8
Washington	43	98	687,200	2,941	1.1
West Virginia	15	100	284,300	1,098	0.4
Wisconsin	118	100	2,136,000	5,473	2.0
Wyoming	6	100	54,700	289	0.1
Puerto Rico	4	100	28,300	149	*
<b>Totals/Average</b>	<b>4,944</b>	<b>98%</b>	<b>83,045,700</b>	<b>\$ 274,901</b>	<b>100.0%</b>

\* Less than 0.1%

<sup>(1)</sup> Includes rental revenue for all properties owned at December 31, 2016. Excludes revenue of \$323 from sold properties.

## Forward-Looking Statements

This Annual Report on Form 10-K, including the documents incorporated by reference, 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; and
- Future expenditures for development projects.

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 or which may occur in the future; 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 Securities and Exchange Commission, or 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, The Monthly Dividend Company®, is an S&P 500 company dedicated to providing stockholders with dependable monthly dividends that increase over time. The company is structured as a real estate investment trust, or REIT, requiring it annually to distribute at least 90% of its taxable income (excluding net capital gains) in the form of dividends to its stockholders. The monthly dividends are supported by the cash flow generated from real estate owned under long-term, net lease agreements with regional and national commercial tenants. The company has in-house acquisition, portfolio management, asset management, real estate research, credit research, legal, finance and accounting, information technology and capital markets capabilities.

Realty Income was founded in 1969, and listed on the New York Stock Exchange (NYSE: O) in 1994. Over the past 48 years, Realty Income has been acquiring and managing freestanding commercial properties that generate rental revenue under long-term net lease agreements. The company is a member of the S&P High Yield Dividend Aristocrats® index for having increased its dividend every year for more than 20 consecutive years.

At December 31, 2016, we owned a diversified portfolio:

- Of 4,944 properties;
- With an occupancy rate of 98.3%, or 4,860 properties leased and 84 properties available for lease;
- Leased to 248 different commercial tenants doing business in 47 separate industries;
- Located in 49 states and Puerto Rico;
- With over 83.0 million square feet of leasable space; and
- With an average leasable space per property of approximately 16,800 square feet; approximately 11,520 square feet per retail property and 220,290 square feet per industrial property.

Of the 4,944 properties in the portfolio, 4,920, or 99.5%, are single-tenant properties, and the remaining are multi-tenant properties. At December 31, 2016, of the 4,920 single-tenant properties, 4,836 were leased with a weighted average remaining lease term (excluding rights to extend a lease at the option of the tenant) of approximately 9.8 years.

### 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. 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 initially financed by our credit facility or debt securities. However, we cannot assure you that we will have access to the capital markets at all times and at terms that are acceptable to us.

Our primary cash obligations, for the current year and subsequent years, are included in the "Table of Obligations," which is presented later in this section. We expect to fund our operating expenses and other short-term liquidity requirements, including property acquisitions and development costs, payment of principal and interest on our outstanding indebtedness, property improvements, re-leasing costs and cash distributions to common and preferred stockholders, primarily through cash provided by operating activities, borrowing on our credit facility and periodically through public securities offerings.

#### 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, 2016, our total outstanding borrowings of senior unsecured notes and bonds, term loans, mortgages payable and credit facility borrowings were \$5.875 billion, or approximately 27.6% of our total market capitalization of \$21.26 billion.

We define our total market capitalization at December 31, 2016 as the sum of:

- Shares of our common stock outstanding of 260,168,259, plus total common units outstanding of 405,204, multiplied by the last reported sales price of our common stock on the NYSE of \$57.48 per share on December 31, 2016, or \$14.98 billion;
- Aggregate liquidation value (par value of \$25.00 per share) of the Class F preferred stock of \$408.8 million;
- Outstanding borrowings of \$1.12 billion on our credit facility;
- Outstanding mortgages payable of \$460.0 million, excluding net mortgage premiums of \$6.4 million and deferred financing costs of \$324,000;
- Outstanding borrowings of \$320.0 million on our term loans, excluding deferred financing costs of \$873,000; and
- Outstanding senior unsecured notes and bonds of \$3.98 billion, excluding unamortized original issuance discounts of \$19.8 million and deferred financing costs of \$20.8 million.

### **Universal Shelf Registration**

In December 2015, we filed a shelf registration statement with the SEC, which is effective for a term of three years and will expire in December 2018. In accordance with 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 (1) common stock, (2) preferred stock, (3) debt securities, (4) depositary shares representing fractional interests in shares of preferred stock, (5) warrants to purchase debt securities, common stock, preferred stock, or depositary shares, and (6) 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 these 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.

### **At-the-Market (ATM) Program**

In September 2015, we established an “at-the-market” equity distribution program, or our ATM program, pursuant to which we can offer and sell up to 12,000,000 shares of common stock to, or through, a consortium of banks acting as our sales agents by means of ordinary brokers’ transactions on the NYSE at prevailing market prices or at negotiated prices. During 2016, we issued 2,779,140 shares and raised gross proceeds of \$166.8 million under the ATM program.

### **Issuance of Common Stock**

In May 2016, we issued 6,500,000 shares of common stock. After underwriting discounts and other offering costs of \$12.1 million, the net proceeds of \$383.6 million were used to repay borrowings under our credit facility.

### **Dividend Reinvestment and Stock Purchase Plan**

Our Dividend Reinvestment and Stock Purchase Plan, or our DRSP, provides our common stockholders, as well as new investors, with a convenient and economical method of purchasing our common stock and reinvesting their distributions. Our DRSP also allows our current stockholders to buy additional shares of common stock by reinvesting all or a portion of their distributions. Our DRSP authorizes up to 26,000,000 common shares to be issued. In 2013, we revised our DRSP so that we would pay for a majority of the plan-related fees, which were previously paid by investors, and to institute a waiver approval process, allowing larger investors or institutions, per a formal approval process, to purchase shares at a small discount, if approved by us. During 2016, we issued 170,027 shares and raised approximately \$10.3 million under our DRSP. During 2016, we did not issue shares under the waiver approval process.

### **Preferred Stock**

In February 2012, we issued 14,950,000 shares of our Class F preferred stock at \$25.00 per share. In April 2012, we issued an additional 1,400,000 shares of Class F preferred stock at \$25.2863 per share. Beginning February 15, 2017, shares of our Class F preferred stock are redeemable at our option for \$25.00 per share, plus any accrued and unpaid dividends. Dividends on the shares of our Class F preferred stock are paid monthly in arrears. We are current on our obligations to pay dividends on our Class F preferred stock.

### **\$2.0 Billion Revolving Credit Facility**

In June 2015, we entered into a \$2.0 billion unsecured revolving credit facility, or our credit facility, that expires in June 2019 and includes, at our option, two six-month extensions. Our credit facility has a \$1.0 billion accordion expansion option. Under our credit facility, our investment grade credit ratings as of

December 31, 2016 provide for financing at the London Interbank Offered Rate, commonly referred to as LIBOR, plus 0.90%, with a facility commitment fee of 0.15%, for all-in drawn pricing of 1.05% over LIBOR. The borrowing rate is subject to an interest rate floor and may change if our investment grade credit ratings were to change. We also have other interest rate options available to us under our credit facility. Our credit facility is unsecured and, accordingly, we have not pledged any assets as collateral for this obligation.

At December 31, 2016, we had a borrowing capacity of \$880.0 million available on our credit facility and an outstanding balance of \$1.12 billion. The weighted average interest rate on borrowings outstanding under our credit facility, at December 31, 2016, was 1.7% per annum. We must comply with various financial and other covenants in our credit facility. At December 31, 2016, we were in compliance with these covenants. We expect to use our credit facility to acquire additional properties and for other general corporate purposes. Any additional borrowings will increase our exposure to interest rate risk.

We generally use our credit facility for the short-term financing of new property acquisitions. Thereafter, 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 the refinancing will enable us to issue equity or debt securities at acceptable terms.

### Term Loans

In June 2015, in conjunction with entering into our credit facility, we entered into a \$250 million senior unsecured term loan maturing June 30, 2020. Borrowing under this term loan bears interest at LIBOR, plus 0.95%. In conjunction with this term loan, we also entered into an interest rate swap which effectively fixes our per annum interest rate on this term loan at 2.67%.

In January 2013, in conjunction with our acquisition of American Realty Capital Trust, or ARCT, we entered into a \$70 million senior unsecured term loan maturing in January 2018. Borrowing under the term loan bears interest at LIBOR, plus 1.20%. In conjunction with this term loan, we also acquired an interest rate swap which effectively fixes our per annum interest rate on this term loan at 2.15%.

### Mortgage Debt

As of December 31, 2016, we had \$460.0 million of mortgages payable, all of which were assumed in connection with our property acquisitions. Additionally, at December 31, 2016, we had net premiums totaling \$6.4 million on these mortgages and deferred financing costs of \$324,000. We expect to pay off the mortgages payable as soon as prepayment penalties have declined to a level that would make it economically feasible to do so. During 2016, we made \$231.7 million of principal payments, including the repayment of 11 mortgages in full for \$201.8 million, and refinanced one of our assumed mortgages whereby we received an additional \$10.0 million in proceeds.

### Notes Outstanding

Our senior unsecured note and bond obligations consist of the following as of December 31, 2016, sorted by maturity date (dollars in millions):

5.375% notes, issued in September 2005 and due in September 2017	\$	175
2.000% notes, issued in October 2012 and due in January 2018		350
6.750% notes, issued in September 2007 and due in August 2019		550
5.750% notes, issued in June 2010 and due in January 2021		250
3.250% notes, issued in October 2012 and due in October 2022		450
4.650% notes, issued in July 2013 and due in August 2023		750
3.875% notes, issued in June 2014 and due in July 2024		350
4.125% notes, issued in September 2014 and due in October 2026		250
3.000% notes, issued in October 2016 and due in January 2027		600
5.875% bonds, \$100 issued in March 2005 and \$150 issued in June 2011, both due in March 2035		250
Total principal amount	\$	3,975
Unamortized original issuance discounts and deferred financing costs		(41)
	\$	<u>3,934</u>



In October 2016, we issued \$600 million of 3.000% senior unsecured notes due January 2027. The public offering price for the notes was 98.671% of the principal amount for an effective yield to maturity of 3.153%. The net proceeds of approximately \$586.7 million from the offering were used to repay borrowings outstanding under our credit facility.

In September 2016, we repaid \$275 million of outstanding 5.950% notes, plus accrued and unpaid interest.

All of our outstanding notes and bonds have fixed interest rates and contain various covenants, with which we remained in compliance as of December 31, 2016. Additionally, interest on all of our senior note and bond obligations is paid semiannually.

The following is a summary of the key financial covenants for our senior unsecured notes, as defined and calculated per the terms of our senior notes and bonds. These calculations, which are not based on U.S. GAAP measurements, are presented to investors to show our ability to incur additional debt under the terms of our senior notes and bonds as well as to disclose our current compliance with such covenants, and are not measures of our liquidity or performance. The actual amounts as of December 31, 2016 are:

Note Covenants	Required	Actual
Limitation on incurrence of total debt	≤ 60% of adjusted assets	41.9%
Limitation on incurrence of secured debt	≤ 40% of adjusted assets	3.4%
Debt service coverage (trailing 12 months) <sup>(1)</sup>	≥ 1.5 x	4.8 x
Maintenance of total unencumbered assets	≥ 150% of unsecured debt	243.7%

<sup>(1)</sup> This covenant is calculated on a pro forma basis for the preceding four-quarter period on the assumptions that: (i) the incurrence of any Debt (as defined in the covenants) incurred by us since the first day of such four-quarter period and the application of the proceeds therefrom (including to refinance other Debt since the first day of such four-quarter period), (ii) the repayment or retirement of any of our Debt since the first day of such four-quarter period, and (iii) any acquisition or disposition by us of any asset or group since the first day of such four quarters had in each case occurred on January 1, 2016, and subject to certain additional adjustments. Such pro forma ratio has been prepared on the basis required by that debt service covenant, reflects various estimates and assumptions and is subject to other uncertainties, and therefore does not purport to reflect what our actual debt service coverage ratio would have been had transactions referred to in clauses (i), (ii) and (iii) of the preceding sentence occurred as of January 1, 2016, nor does it purport to reflect our debt service coverage ratio for any future period. The following is our calculation of debt service coverage at December 31, 2016 (in thousands, for trailing twelve months):

Net income attributable to the Company	\$	315,571
Plus: interest expense		211,379
Plus: provision for taxes		3,262
Plus: depreciation and amortization		449,943
Plus: provisions for impairment		20,664
Plus: pro forma adjustments		71,979
Less: gain on sales of real estate		(21,979)
Income available for debt service, as defined	\$	<u>1,050,819</u>
Total pro forma debt service charge	\$	<u>220,921</u>
Debt service coverage ratio		4.8

#### *Fixed Charge Coverage Ratio*

Fixed charge coverage ratio is calculated in exactly the same manner as the debt service coverage ratio, except that preferred stock dividends are also added to the denominator. Similar to debt service coverage ratio, 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 calculations of both debt service and fixed charge coverage ratios may be different from the calculations used by other companies and, therefore, comparability may be limited. The presentation of debt service and fixed charge coverage ratios should not be considered as alternatives to any U.S. GAAP operating performance measures. Below is our calculation of fixed charges at December 31, 2016 (in thousands, for the trailing twelve months):

Income available for debt service, as defined	\$	1,050,819
Pro forma debt service charge plus preferred stock dividends	\$	248,001
Fixed charge coverage ratio		4.2

## 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, 2016, we had cash and cash equivalents totaling \$9.4 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 next twelve months. We intend, however, to use permanent or long-term capital to fund property acquisitions and to repay future borrowings under our credit facility.

## Credit Agency Ratings

The borrowing interest rates under our credit facility are based upon our ratings assigned by credit rating agencies. As of December 31, 2016, we were assigned the following investment grade corporate credit ratings on our senior unsecured notes and bonds: Moody's Investors Service has assigned a rating of Baa1 with a "positive" outlook, Standard & Poor's Ratings Group has assigned a rating of BBB+ with a "positive" outlook, and Fitch Ratings has assigned a rating of BBB+ with a "stable" outlook.

Based on our ratings as of December 31, 2016, the facility interest rate as of December 31, 2016 was LIBOR plus 0.90% with a facility commitment fee of 0.15%, for all-in drawn pricing of 1.05% over LIBOR. Our credit facility provides that the interest rate can range between: (i) LIBOR plus 1.55% if our credit rating is lower than BBB-/Baa3 or unrated and (ii) LIBOR plus 0.85% 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 range from: (i) 0.30% for a rating lower than BBB-/Baa3 or unrated, and (ii) 0.125% 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.

## Table of Obligations

The following table summarizes the maturity of each of our obligations as of December 31, 2016 (dollars in millions):

Year of Maturity	Credit Facility <sup>(1)</sup>	Notes and Bonds <sup>(2)</sup>	Term Loan <sup>(3)</sup>	Mortgages Payable <sup>(4)</sup>	Interest <sup>(5)</sup>	Ground Leases	Ground Leases	Other <sup>(6)</sup>	Totals
						Paid by Realty Income <sup>(6)</sup>	Paid by Our Tenants <sup>(7)</sup>		
2017	\$ -	\$ 175.0	\$ -	\$ 103.2	\$ 218.6	\$ 1.6	\$ 13.4	\$ 28.9	\$ 540.7
2018	-	350.0	70.0	21.9	197.2	1.6	13.5	-	654.2
2019	1,120.0	550.0	-	42.3	172.6	1.5	13.3	-	1,899.7
2020	-	-	250.0	82.4	136.7	1.4	13.1	-	483.6
2021	-	250.0	-	66.9	115.2	1.2	12.8	-	446.1
Thereafter	-	2,650.0	-	143.3	445.8	22.1	106.6	-	3,367.8
<b>Totals</b>	<b>\$ 1,120.0</b>	<b>\$ 3,975.0</b>	<b>\$ 320.0</b>	<b>\$ 460.0</b>	<b>\$ 1,286.1</b>	<b>\$ 29.4</b>	<b>\$ 172.7</b>	<b>\$ 28.9</b>	<b>\$ 7,392.1</b>

(1) The initial term of the credit facility expires in June 2019 and includes, at our option, two six-month extensions.

(2) Excludes non-cash original issuance discounts recorded on notes payable. The unamortized balance of the original issuance discounts at December 31, 2016 is \$19.8 million. Also excludes deferred financing costs of \$20.8 million.

(3) Excludes deferred financing costs of \$873,000.

(4) Excludes non-cash net premiums recorded on the mortgages payable. The unamortized balance of these net premiums at December 31, 2016, is \$6.4 million. Also excludes deferred financing costs of \$324,000.

(5) Interest on the term loans, notes, bonds, mortgages payable, and credit facility has been calculated based on outstanding balances as of December 31, 2016 through their respective maturity dates.

(6) Realty Income currently pays the ground lessors directly for the rent under the ground leases.

(7) Our tenants, who are generally sub-tenants under 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.

(8) "Other" consists of \$21.9 million of commitments under construction contracts and \$7.0 million of commitments for tenant improvements and leasing costs.

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

### **No Unconsolidated Investments**

We have no unconsolidated investments, nor do we engage in trading activities involving energy or commodity contracts.

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

In the commercial real estate market, property prices generally continue to fluctuate. Likewise, during certain periods, the U.S. credit markets have experienced significant price volatility, dislocations, and liquidity disruptions, which may impact our access to and cost of capital. We continually monitor the commercial real estate and U.S. credit markets carefully and, if required, will make decisions to adjust our business strategy accordingly.

### **Acquisitions During 2016**

During 2016, we invested \$1.86 billion in 505 new properties and properties under development or expansion, with an initial weighted average contractual lease rate of 6.3%. The 505 new properties and properties under development or expansion are located in 40 states, will contain approximately 8.2 million leasable square feet, and are 100% leased with a weighted average lease term of 14.7 years. The tenants occupying the new properties operate in 28 industries and the property types are 86.4% retail and 13.6% industrial, based on rental revenue. During 2016, none of our real estate investments caused any one tenant to be 10% or more of our total assets at December 31, 2016.

The estimated initial weighted average contractual lease rate for a property is generally computed as estimated contractual net operating income, which, in the case of a net leased property, is equal to the aggregate base rent for the first full year of each lease, divided by the total cost of the property. Since it is possible that a tenant could default on the payment of contractual rent, we cannot provide assurance that the actual return on the funds invested will remain at the percentages listed above.

In the case of a property under development or expansion, the contractual lease rate is generally fixed such that rent varies based on the actual total investment in order to provide a fixed rate of return. When the lease does not provide for a fixed rate of return on a property under development or expansion, the estimated initial weighted average contractual lease rate is computed as follows: estimated net operating income (determined by the lease) for the first full year of each lease, divided by our projected total investment in the property, including land, construction and capitalized interest costs. Of the \$1.86 billion we invested during 2016, \$103.8 million was invested in 33 properties under development or expansion with an estimated initial weighted average contractual lease rate of 7.1%. We may continue to pursue development or expansion opportunities under similar arrangements in the future.

### **Portfolio Discussion**

#### Leasing Results

At December 31, 2016, we had 84 properties available for lease out of 4,944 properties in our portfolio, which represents a 98.3% occupancy rate based on the number of properties in our portfolio. Since December 31, 2015, when we reported 71 properties available for lease out of 4,538 and a 98.4% occupancy rate, we:

- Had 256 lease expirations (including leases rejected in bankruptcy);
- Re-leased 186 properties; and
- Sold 57 vacant properties.

Of the 186 properties re-leased during 2016, 144 properties were re-leased to existing tenants, 21 were re-leased to new tenants without vacancy, and 21 were re-leased to new tenants after a period of vacancy. The annual rent on these 186 leases was \$28.57 million, as compared to the previous rent on these same properties of \$27.33 million, which represents a rent recapture rate of 104.5% on the properties re-leased during 2016.

As part of our re-leasing costs, we pay leasing commissions to unrelated, 3<sup>rd</sup> party real estate brokers consistent with the commercial real estate industry standard, and sometimes provide tenant rent concessions. We do not consider the collective impact of the leasing commissions or tenant rent concessions to be material to our financial position or results of operations.

At December 31, 2016, our average annualized rental revenue was approximately \$13.64 per square foot on the 4,860 leased properties in our portfolio. At December 31, 2016, we classified 15 properties with a carrying amount of \$26.6 million as held for sale on our balance sheet. The expected sale of these properties does not represent a strategic shift that will have a major effect on our operations and financial results. The expected sale of these properties is consistent with our active disposition efforts to further enhance our real estate portfolio and maximize portfolio returns

#### Investments in Existing Properties

In 2016, we capitalized costs of \$16.3 million on existing properties in our portfolio, consisting of \$797,000 for re-leasing costs, \$679,000 for recurring capital expenditures and \$14.9 million for non-recurring building improvements. In 2015, we capitalized costs of \$11.5 million on existing properties in our portfolio, consisting of \$748,000 for re-leasing costs, \$7.6 million for recurring capital expenditures and \$3.2 million for non-recurring building improvements.

The majority of our building improvements relate to roof repairs, HVAC improvements, and parking lot resurfacing and replacements. The amounts of our capital expenditures can vary significantly, depending on the rental market, tenant credit worthiness, the lease term and the willingness of tenants to pay higher rents over the terms of the leases.

With the increasing size and aging of our portfolio, overall investments in existing properties increased in 2016 and we refined our definition of recurring versus non-recurring capital expenditures. We define recurring capital expenditures as mandatory and repetitive landlord capital expenditure obligations that have a limited useful life. We define non-recurring capital expenditures as property improvements where we invest additional capital that extend the useful life of the property.

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

We have continued our 48-year policy of paying monthly dividends. In addition, we increased the dividend six times during 2016 and twice in 2017. As of February 2017, we have paid 77 consecutive quarterly dividend increases and increased the dividend 90 times since our listing on the NYSE in 1994.

<b>2016 Dividend increases</b>	<b>Month Declared</b>	<b>Month Paid</b>	<b>Dividend per share</b>	<b>Increase per share</b>
1st increase	Dec 2015	Jan 2016	\$ 0.1910	\$ 0.0005
2nd increase	Jan 2016	Feb 2016	\$ 0.1985	\$ 0.0075
3rd increase	Mar 2016	Apr 2016	\$ 0.1990	\$ 0.0005
4th increase	Jun 2016	Jul 2016	\$ 0.1995	\$ 0.0005
5th increase	Jul 2016	Sep 2016	\$ 0.2015	\$ 0.0020
6th increase	Sep 2016	Oct 2016	\$ 0.2020	\$ 0.0005
<b>2017 Dividend increases</b>				
1st increase	Dec 2016	Jan 2017	\$ 0.2025	\$ 0.0005
2nd increase	Jan 2017	Feb 2017	\$ 0.2105	\$ 0.0080

The dividends paid per share during 2016 totaled approximately \$2.392, as compared to approximately \$2.271 during 2015, an increase of \$0.121, or 5.3%.

The monthly dividend of \$0.2105 per share represents a current annualized dividend of \$2.526 per share, and an annualized dividend yield of approximately 4.2% based on the last reported sale price of our common stock on the NYSE of \$59.63 on January 31, 2017. Although we expect to continue our policy of paying monthly dividends, we cannot guarantee that we will maintain our current level of dividends, that we will continue our pattern of increasing dividends per share, or what our actual dividend yield will be in any future period.

## **RESULTS OF OPERATIONS**

### **Critical Accounting Policies**

Our consolidated financial statements have been prepared in accordance with GAAP, and 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 to 35 years for buildings and 4 to 20 years for improvements, which we believe are appropriate estimates of useful life. If we use a shorter or longer estimated useful life, it could have a material impact on our results of operations.

Management must make significant assumptions in determining the fair value of assets acquired and liabilities assumed. When acquiring a property for investment purposes, we typically allocate the fair value of real estate acquired 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 or below-market lease value of in-place leases, the value of in-place leases, and tenant relationships, as applicable. In an acquisition of multiple properties, we must also allocate the purchase price among the properties. The allocation of the purchase price is based on our assessment of estimated fair value and is often based upon the expected future cash flows of the property and various characteristics of the market where the property is located. In addition, any assumed mortgages receivable or payable and any assumed or issued noncontrolling interests are recorded at their estimated fair values. The estimated fair values of our mortgages payable have been calculated by discounting the future cash flows using applicable interest rates that have been adjusted for factors, such as industry type, tenant investment grade, maturity date, and comparable borrowings for similar assets. The initial allocation of the purchase price is based on management's preliminary assessment, which may differ when final information becomes available. Subsequent adjustments made to the initial purchase price allocation are made within the allocation period, which does not exceed one year. The use of different assumptions in the allocation of the purchase price of the acquired properties and liabilities assumed could affect the timing of recognition of the related revenue and expenses.

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 utilize in this analysis include projected rental rates, estimated holding periods, historical sales and releases, 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 sheets. Our strategy of primarily holding properties, long-term, directly decreases the likelihood of their carrying values not being recoverable, thus requiring the recognition of an impairment. However, if our strategy, or one or more of the above assumptions were to change in the future, an impairment may need to be recognized. If events should occur that require us to reduce the carrying value of our real estate by recording provisions for impairment, they 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, 2015, 2014 and 2013.***

#### **Rental Revenue**

Rental revenue was \$1.057 billion for 2016, as compared to \$976.9 million for 2015, an increase of \$80.5 million, or 8.2%. Rental revenue was \$893.5 million for 2014. The increase in rental revenue in 2016 compared to 2015 is primarily attributable to:

- The 475 properties (7.6 million square feet) we acquired in 2016, which generated \$39.7 million of rent in 2016;
- The 254 properties (5.6 million square feet) we acquired in 2015, which generated \$80.3 million of rent in 2016, compared to \$41.9 million in 2015, an increase of \$38.4 million;
- Same store rents generated on 4,045 properties (66.5 million square feet) during 2016 and 2015,



increased by \$10.15 million, or 1.2%, to \$888.51 million from \$878.36 million; and

- A net increase in straight-line rent and other non-cash adjustments to rent of \$959,000 in 2016 as compared to 2015; partially offset by
- A net decrease of \$7.1 million relating to properties sold in 2016 and during 2015; and
- A net decrease of \$1.6 million relating to the aggregate of (i) rental revenue from properties (131 properties comprising 1.5 million square feet) that were available for lease during part of 2016 or 2015, (ii) rental revenue for 24 properties under development, and (iii) lease termination settlements. In aggregate, the revenues for these items totaled \$33.3 million in 2016, compared to \$34.9 million in 2015.

For purposes of determining the same store rent property pool, we include all properties that were owned for the entire year-to-date period, for both the current and prior year, except for properties during the current or prior year that; (i) were vacant at any time, (ii) were under development or redevelopment, and (iii) were involved in eminent domain and rent was reduced. Each of the exclusions from the same store pool are separately addressed within the applicable sentences above, explaining the changes in rental revenue for the period.

Of the 4,944 properties in the portfolio at December 31, 2016, 4,920, or 99.5%, are single-tenant properties and the remaining are multi-tenant properties. Of the 4,920 single-tenant properties, 4,836, or 98.3%, were net leased with a weighted average remaining lease term (excluding rights to extend a lease at the option of the tenant) of approximately 9.8 years at December 31, 2016. Of our 4,836 leased single-tenant properties, 4,310 or 89.1% were under leases that provide for increases in rents through:

- Base rent increases tied to a consumer price index (typically subject to ceilings);
- Percentage 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 \$5.3 million in 2016, \$4.5 million in 2015, and \$3.6 million in 2014. Percentage rent in 2016 was less than 1% of rental revenue and we anticipate percentage rent to be less than 1% of rental revenue in 2017.

Our portfolio of real estate, leased primarily to regional and national tenants under net leases, continues to perform well and provides dependable lease revenue supporting the payment of monthly dividends to our stockholders. At December 31, 2016, our portfolio of 4,944 properties was 98.3% leased with 84 properties available for lease, as compared to 98.4% leased, with 71 properties available for lease at December 31, 2015. It has been our experience that approximately 1% to 4% of our property portfolio will be unleased at any given time; however, it is possible that the number of properties available for lease could exceed these levels in the future.

### **Tenant Reimbursements**

Contractually obligated reimbursements from tenants for recoverable real estate taxes and operating expenses were \$43.1 million in 2016, compared to \$42.0 million in 2015 and \$37.1 million in 2014. The increase in tenant reimbursements is primarily due to our increase in acquisitions.

### **Other Revenue**

Other revenue, which comprises property-related revenue not included in rental revenue or tenant reimbursements, was \$2.7 million in 2016, compared to \$4.4 million in 2015 and \$2.9 million in 2014.

### **Depreciation and Amortization**

Depreciation and amortization was \$449.9 million for 2016, compared to \$409.2 million for 2015 and \$374.7 million for 2014. The increase in depreciation and amortization in 2016 and 2015 was primarily due to the acquisition of properties in 2015 and 2016, which was partially offset by property sales in those same periods. As discussed in the sections entitled "Funds from Operations Available to Common Stockholders (FFO)" and "Adjusted Funds from Operations Available to Common Stockholders (AFFO)," 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

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

	2016	2015	2014
Interest on our credit facility, term loans, notes, mortgages and interest rate swaps	\$ 213,540	\$ 226,207	\$ 215,830
Credit facility commitment fees	3,050	2,854	2,661
Amortization of credit facility origination costs and deferred financing costs	8,596	8,741	8,219
(Gain) loss on interest rate swaps	(1,639)	3,043	1,349
Dividend on preferred shares subject to redemption	-	-	1,526
Amortization of net mortgage premiums	(3,414)	(7,482)	(12,891)
Capital lease obligation	310	310	116
Interest capitalized	(469)	(594)	(444)
Interest expense	\$ 219,974	\$ 233,079	\$ 216,366

### Credit facility, term loans, mortgages and notes

Average outstanding balances (dollars in thousands)	\$ 5,081,663	\$ 5,030,532	\$ 4,628,438
Average interest rates	4.11%	4.43%	4.62%

The decrease in interest expense from 2015 to 2016 was primarily due to lower outstanding debt balances on our notes payable and mortgages payable, resulting from the payoff of \$150.0 million of notes during November 2015 and \$275.0 million of notes during September 2016, as well as the payoff of mortgages throughout 2015 and 2016. This decrease was slightly offset by an increase in interest expense related to the issuance of a \$600 million note in October 2016.

The increase in interest expense from 2014 to 2015 was primarily due to the June 2014 issuance of our 3.88% senior unsecured notes due July 2024, the September 2014 issuance of our 4.125% senior unsecured notes due October 2026, the interest expense on the \$250 million term loan that was entered into during June 2015, and the payoff of mortgages during 2015 which reduced the amortization of net mortgage premiums.

Additionally, each quarter we adjust the carrying value of our interest rate swaps to fair value. Changes in the fair value of our interest rate swaps are recorded directly to interest expense. We recorded a gain on interest rate swaps of \$1.6 million during 2016 and a loss on interest rate swaps of \$3.0 million and \$1.3 million during 2015 and 2014, respectively.

At December 31, 2016, the weighted average interest rate on our:

- Credit facility outstanding borrowings of \$1.12 billion was 1.7%;
- Term loans outstanding of \$320.0 million (excluding deferred financing costs of \$873,000) was 1.7%;
- Mortgages payable of \$460.0 million (excluding net premiums totaling \$6.4 million and deferred financing costs of \$324,000 on these mortgages) was 4.9%;
- Notes and bonds payable of \$3.98 billion (excluding unamortized original issue discounts of \$19.8 million and deferred financing costs of \$20.8 million) was 4.4%; and
- Combined outstanding notes, bonds, mortgages, term loan and credit facility borrowings of \$5.88 billion was 3.8%.

### General and Administrative Expenses

General and administrative expenses increased by \$2.7 million to \$52.0 million for 2016, compared to \$49.3 million in 2015 and \$51.1 million in 2014. Included in general and administrative expenses are acquisition transaction costs of \$346,000 for 2016, \$913,000 for 2015, and \$453,000 for 2014. General and administrative costs increased during 2016 primarily due to higher compensation costs. General and administrative expenses decreased during 2015 primarily due to lower compensation costs, lower corporate insurance premiums, and lower proxy costs. In January 2017, we had 146 employees, as compared to 132 employees in January 2016 and 125 employees in January 2015.

Dollars in thousands	2016		2015		2014	
General and administrative expenses	\$	51,966	\$	49,298	\$	51,085
Total revenue <sup>(1)</sup>		1,060,068		981,270		896,499
General and administrative expenses as a percentage of total revenue		4.9%		5.0%		5.7%

<sup>(1)</sup> Excludes tenant reimbursements revenue, as well as revenue included in discontinued operations and gain on sales.

### Property Expenses (including tenant reimbursable expenses)

Property expenses consist of costs associated with unleased properties, non-net-leased properties and general portfolio expenses, as well as contractually obligated reimbursable costs from tenants for recoverable real estate taxes and operating expenses. Expenses related to unleased properties and non-net-leased properties include, but are not limited to, property taxes, maintenance, insurance, utilities, property inspections, bad debt expense and legal fees. General portfolio costs include, but are not limited to, insurance, legal, property inspections, and title search fees. At December 31, 2016, 84 properties were available for lease, as compared to 71 at December 31, 2015 and 70 at December 31, 2014.

Property expenses were \$62.9 million (including \$43.1 million in reimbursable expenses) in 2016, \$55.4 million (including \$42.0 million in reimbursable expenses) in 2015 and \$53.9 million (including \$37.1 million in reimbursable expenses) in 2014. The increase in gross property expenses in 2016 is primarily attributable to the increased portfolio size, which contributed to higher contractually obligated reimbursements primarily due to our acquisitions during 2015 and 2016. We also incurred higher gross property expenses as a result of maintenance and utilities, property taxes, ground rent expenses, legal costs, and bad debt expense on vacant properties.

Dollars in thousands	2016		2015		2014	
Property expenses net of tenant reimbursements	\$	19,761	\$	13,337	\$	16,753
Total revenue <sup>(1)</sup>		1,060,068		981,270		896,499
Property expenses net of tenant reimbursements as a percentage of total revenue		1.9%		1.4%		1.9%

<sup>(1)</sup> Excludes tenant reimbursements revenue, as well as revenue included in discontinued operations and gain on sales.

### Income Taxes

Income taxes were \$3.3 million in 2016, compared to \$3.2 million in 2015 and \$3.5 million in 2014. These amounts are for city and state income and franchise taxes paid by us and our subsidiaries.

### Provisions for Impairment

In 2016, we recorded total provisions for impairment of \$20.7 million on six properties classified as held for sale, two properties classified as held for investment, and 31 sold properties. These properties were not previously classified as held for sale in financial statements issued prior to the date of adoption of ASU 2014-08; accordingly, these provisions for impairment are included in income from continuing operations on our consolidated statements of income.

In 2015, we recorded total provisions for impairment of \$10.6 million on three properties classified as held for investment, 11 sold properties, and one property disposed of other than by sale. These properties were not previously classified as held for sale in financial statements issued prior to the date of adoption of ASU 2014-08; accordingly, these provisions for impairment are included in income from continuing operations on our consolidated statements of income.

In 2014, we recorded total provisions for impairment of \$4.6 million. Provisions for impairment of \$4.1 million are included in income from continuing operations on 10 sold properties and one property classified as held for sale. These properties were not previously classified as held for sale in financial statements issued prior to the date of adoption of Accounting Standards Update (ASU) 2014-08 which amends Topic 205, *Presentation of Financial Statements*, and Topic 360, *Property, Plant, and Equipment*; accordingly, these provisions for impairment are included in income from continuing operations on our consolidated statements of income. Additionally, a provision for impairment of \$510,000 is included in income from discontinued operations on one sold property that was classified as held for sale as of December 31, 2013.

### **Gain on Sales of Real Estate**

During 2016, we sold 77 properties for \$90.5 million, which resulted in a gain of \$22.0 million. Additionally, during 2016 we sold our former corporate headquarters building for \$8.6 million.

During 2015, we sold 38 properties for \$65.8 million, which resulted in a gain of \$22.2 million.

These property sales in 2016 and 2015 do not represent a strategic shift that will have a major effect on our operations and financial results, and therefore do not require presentation as discontinued operations.

During 2014, we sold 47 properties for \$108.1 million, which resulted in a gain of \$42.1 million. Only the results of operations specifically related to the properties classified as held for sale at December 31, 2013 and sold during 2014 were reclassified as discontinued operations.

At December 31, 2016, we classified real estate with a carrying amount of \$26.6 million as held for sale on our balance sheet. In 2017, we intend to continue our active disposition efforts to further enhance our real estate portfolio and anticipate approximately \$75 to \$100 million in yet to be identified property sales for all of 2017. 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 at our estimated values or be able to invest the property sale proceeds in new properties.

### **Preferred Stock Dividends**

Preferred stock dividends totaled \$27.1 million in 2016 and 2015, and \$37.1 million in 2014.

### **Excess of Redemption Value over Carrying Value of Preferred Shares Redeemed**

In October 2014, we redeemed all 8,800,000 shares of our 6.75% Monthly Income Class E Cumulative Redeemable Preferred Stock, or the Class E preferred stock, for \$25.00 per share, plus accrued dividends. We incurred a non-cash charge of \$6.0 million. This charge is for the excess of redemption value over the carrying value of the Class E preferred stock and represents the original issuance cost that was paid in 2006.

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

Net income available to common stockholders was \$288.5 million in 2016, compared to \$256.7 million in 2015, an increase of \$31.8 million. On a diluted per common share basis, net income was \$1.13 in 2016, as compared to \$1.09 in 2015, an increase of \$0.04, or 3.7%. Net income available to common stockholders was \$227.6 million in 2014, or \$1.04 on a diluted per common share basis. Net income available to common stockholders for 2014 includes a non-cash redemption charge of \$6.0 million on the shares of Class E preferred stock that were redeemed in October 2014, which represents \$0.03 on a diluted per common share basis. This charge is for the excess of redemption value over the carrying value of the Class E preferred stock and represents the original issuance cost that was paid in 2006.

The calculation to determine net income available to common stockholders includes impairments, gains from the sale of properties and/or fair value adjustments on our interest rate swaps. These items vary from period to period based on the timing of property sales and the interest rate environment, and can significantly impact net income available to common stockholders.

Gains from the sale of properties during 2016 were \$22.0 million, as compared to gains from the sale of properties of \$22.2 million during 2015, and \$42.1 million during 2014.

### **Discontinued Operations**

During the first quarter of 2014, the Financial Accounting Standards Board issued guidance that changed the definition of discontinued operations by limiting discontinued operations reporting to disposals of components of an entity that represent strategic shifts that have, or will have, a major effect on an entity's operations and financial results. We early adopted the requirements of this accounting pronouncement in the first quarter of 2014. Starting with the first quarter of 2014, the results of operations for all qualifying disposals and properties classified as held for sale that were not previously reported in discontinued operations in our 2013 Annual Report on Form 10-K are presented within income from continuing operations on our consolidated statements of income. For 2014, we recorded income from discontinued operations of \$2.8 million, or \$0.01 per common share, basic and diluted.

### Earnings before Interest, Taxes, Depreciation and Amortization (EBITDA)

EBITDA, a non-GAAP financial measure, means, for the most recent quarter, earnings (net income) before (i) interest expense, including non-cash loss (gain) on swaps, (ii) income and franchise taxes, (iii) real estate depreciation and amortization, (iv) impairment losses, and (v) gain on sales of real estate. Our EBITDA may not be comparable to EBITDA reported by other companies that interpret the definitions of EBITDA differently than we do. Management believes EBITDA to be a meaningful measure of a REIT's performance because it is widely followed by industry analysts, lenders and investors. The ratio of our total debt to EBITDA is also used to determine vesting of performance share awards granted to our executive officers. EBITDA should be considered along with, but not as an alternative to net income as a measure of our operating performance. Our ratio of debt to EBITDA, which is used by management as a measure of leverage, is calculated by annualizing quarterly EBITDA and then dividing by our total debt per the consolidated balance sheet.

#### Three months ended December 31,

Dollars in thousands	2016	2015	2014
Net income	\$ 92,724	\$ 83,111	\$ 78,077
Interest	48,935	51,982	59,120
Income taxes	449	721	1,103
Depreciation and amortization	117,752	105,739	96,537
Impairment loss	3,709	1,378	1,450
Gain on sales of real estate	(6,696)	(5,126)	(24,994)
Discontinued Operations (EBITDA component)	-	-	234
Quarterly EBITDA	\$ 256,873	\$ 237,805	\$ 211,527
Annualized EBITDA <sup>(1)</sup>	\$ 1,027,492	\$ 951,220	\$ 846,108
Total Debt <sup>(2)</sup>	\$ 5,839,605	\$ 4,820,995	\$ 4,907,673
Debt/EBITDA	5.7	5.1	5.8

<sup>(1)</sup> We calculate Annualized EBITDA by multiplying the Quarterly EBITDA by four.

<sup>(2)</sup> Total debt is consistent with its definition under market capitalization as described in "Liquidity and Capital Resources – Conservative Capital Structure" earlier in this "Management's Discussion and Analysis of Financial Condition and Results of Operations."

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

In 2016, our FFO increased by \$83.0 million, or 12.7%, to \$735.4 million, compared to \$652.4 million in 2015. On a diluted per common share basis, FFO was \$2.88 in 2016, compared to \$2.77 in 2015, an increase of \$0.11, or 4.0%. In 2014, FFO was \$562.9 million, or \$2.58 on a diluted per common share basis. Our FFO in 2014 included a non-cash redemption charge of \$6.0 million on the shares of Class E preferred stock that were redeemed in October 2014, which represents \$0.03 on a diluted per common share basis. This charge is for the excess of redemption value over the carrying value of the Class E preferred stock and represents the original issuance cost that was paid in 2006.

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):



	2016	2015	2014
Net income available to common stockholders	\$ 288,491	\$ 256,686	\$ 227,558
Depreciation and amortization	449,943	409,215	374,661
Depreciation of furniture, fixtures and equipment	(747)	(811)	(482)
Provisions for impairment:			
Continuing operations	20,664	10,560	4,126
Discontinued operations	-	-	510
Gain on sales of real estate:			
Continuing operations	(21,979)	(22,243)	(39,205)
Discontinued operations	-	-	(2,883)
FFO adjustments allocable to noncontrolling interests	(977)	(970)	(1,396)
<b>FFO available to common stockholders <sup>(1)</sup></b>	<b>\$ 735,395</b>	<b>\$ 652,437</b>	<b>\$ 562,889</b>
FFO allocable to dilutive noncontrolling interests	1,435	-	-
<b>Diluted FFO</b>	<b>\$ 736,830</b>	<b>\$ 652,437</b>	<b>\$ 562,889</b>
FFO per common share, basic and diluted <sup>(2)</sup>	\$ 2.88	\$ 2.77	\$ 2.58
Distributions paid to common stockholders	\$ 610,516	\$ 533,238	\$ 479,256
FFO available to common stockholders in excess of distributions paid to common stockholders	\$ 124,879	\$ 119,199	\$ 83,633
Weighted average number of common shares used for computation per share:			
Basic	255,066,500	235,767,932	218,390,885
Diluted <sup>(2)</sup>	255,822,679	235,891,368	218,450,863

(1) FFO available to common stockholders and dilutive noncontrolling interests for 2016 is \$736,830 after the inclusion of \$1,435 of FFO allocable to dilutive noncontrolling interests. Noncontrolling interests were antidilutive for all other periods presented.

(2) The computation of diluted FFO does not assume conversion of securities that are exchangeable for common shares if the conversion of those securities would increase diluted FFO per share in a given period.

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

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 items such as depreciation and impairments for FFO. 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.

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

In 2016, our AFFO increased by \$89.4 million, or 13.8%, to \$736.4 million, compared to \$647.0 million in 2015. On a diluted per common share basis, AFFO was \$2.88 in 2016, compared to \$2.74 in 2015, an increase of \$0.14, or 5.1%. In 2014, AFFO was \$561.7 million, or \$2.57 on a diluted per common share basis. We consider AFFO to be an appropriate supplemental measure of our performance. Most companies in our industry use a similar measurement, but they may use the term "CAD" (for Cash Available for Distribution), "FAD" (for Funds Available for Distribution) or other terms.

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):

	2016	2015	2014
Net income available to common stockholders	\$ 288,491	\$ 256,686	\$ 227,558
Cumulative adjustments to calculate FFO <sup>(1)</sup>	446,904	395,751	335,331
FFO available to common stockholders	735,395	652,437	562,889
Amortization of share-based compensation	12,007	10,391	11,959
Amortization of deferred financing costs <sup>(2)</sup>	5,352	5,294	4,804
Amortization of net mortgage premiums	(3,414)	(6,978)	(9,208)
Gain on early extinguishment of debt	-	(504)	(3,428)
(Gain) loss on interest rate swaps	(1,639)	3,043	1,349
Leasing costs and commissions	(797)	(748)	(821)
Recurring capital expenditures	(679)	(7,606)	(5,210)
Straight-line rent	(19,451)	(16,468)	(14,872)
Amortization of above and below-market leases	9,297	7,861	8,024
Excess of redemption value over carrying value of preferred share redemptions	-	-	6,015
Other adjustments <sup>(3)</sup>	303	306	160
<b>Total AFFO available to common stockholders <sup>(4)</sup></b>	<b>\$ 736,374</b>	<b>\$ 647,028</b>	<b>\$ 561,661</b>
AFFO allocable to dilutive noncontrolling interests	1,455	-	-
<b>Diluted AFFO</b>	<b>\$ 737,829</b>	<b>\$ 647,028</b>	<b>\$ 561,661</b>
AFFO per common share:			
Basic	\$ 2.89	\$ 2.74	\$ 2.57
Diluted <sup>(5)</sup>	\$ 2.88	\$ 2.74	\$ 2.57
Distributions paid to common stockholders	\$ 610,516	\$ 533,238	\$ 479,256
AFFO available to common stockholders			
in excess of distributions paid to common stockholders	\$ 125,858	\$ 113,790	\$ 82,405
Weighted average number of common shares used for computation per share:			
Basic	255,066,500	235,767,932	218,390,885
Diluted <sup>(5)</sup>	255,822,679	235,891,368	218,450,863

<sup>(1)</sup> See reconciling items for FFO presented under "Funds from Operations Available to Common Stockholders (FFO)."

<sup>(2)</sup> Includes the amortization of costs incurred and capitalized upon issuance of our notes payable, assumption of our mortgages payable and upon issuance of our term loans. The deferred financing costs are being amortized over the lives of the respective mortgages and term loans. No costs associated with our credit facility agreements or annual fees paid to credit rating agencies have been included.

<sup>(3)</sup> Includes adjustments allocable to both non-controlling interests and capital lease obligations.

<sup>(4)</sup> AFFO available to common stockholders and dilutive noncontrolling interests for 2016 is \$737,829 after the inclusion of \$1,455 of AFFO allocable to dilutive noncontrolling interests.

<sup>(5)</sup> The computation of diluted AFFO does not assume conversion of securities that are convertible to common shares if the conversion of those securities would increase diluted AFFO per share in a given period.

We believe the non-GAAP financial measure AFFO provides useful information to investors because it is a widely accepted industry measure of the operating performance of real estate companies that is used by industry analysts and investors who look at and compare those companies. In particular, AFFO provides an additional measure to compare the operating performance of different REITs without having to account for differing depreciation assumptions and other unique revenue and expense items which are not pertinent to measuring a particular company's on-going operating performance. Therefore, we believe that AFFO is an

appropriate supplemental performance metric, and that the most appropriate GAAP performance metric to which AFFO should be reconciled is net income available to common stockholders.

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 alternatives to net income as an indication of our performance. FFO and AFFO should not be considered as alternatives to reviewing our cash flows from operating, investing, and financing activities. In addition, FFO and AFFO should not be considered as measures of liquidity, our ability to make cash distributions, or our ability to pay interest payments.

### **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), 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.

Moreover, our use of net lease agreements tends to reduce our exposure to rising property expenses due to inflation because the tenant is responsible for property expenses. 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 the 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, term loans, mortgages payable, 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.

In order to mitigate and manage the effects of interest rate risks on our operations, we may utilize a variety of financial instruments, including interest rate swaps and caps. The use of these types of instruments to hedge our exposure to changes in interest rates carries additional risks, including counterparty credit risk, the enforceability of hedging contracts and the risk that unanticipated and significant changes in interest rates will cause a significant loss of basis in the contract. To limit counterparty credit risk we will seek to enter into such agreements with major financial institutions with favorable credit ratings. There can be no assurance that we will be able to adequately protect against the foregoing risks or realize an economic benefit that exceeds the related amounts incurred in connection with engaging in such hedging activities. 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 rate debt as of December 31, 2016. This information is presented to evaluate the expected cash flows and sensitivity to interest rate changes (dollars in millions):

### Expected Maturity Data

<u>Year of maturity</u>	<u>Fixed rate debt</u>	<u>Weighted average rate on fixed rate debt</u>	<u>Variable rate debt</u>	<u>Weighted average rate on variable rate debt</u>
2017	\$ 268.3	5.51%	\$ 9.9	2.73 %
2018	365.3	2.15	76.6	1.95
2019	554.4	6.74	1,157.9	1.70
2020	82.2	4.99	250.2	1.72
2021	310.1	5.72	6.8	2.88
Thereafter	2,778.4	4.05	14.9	2.68
<u>Totals <sup>(1)</sup></u>	<u>\$ 4,358.7</u>	<u>4.46%</u>	<u>\$ 1,516.3</u>	<u>1.73 %</u>
Fair Value <sup>(2)</sup>	\$ 4,538.8		\$ 1,513.3	

(1) Excludes net premiums recorded on mortgages payable, original issuance discounts recorded on notes payable and deferred financing costs on mortgages payable, notes payable, and term loans. At December 31, 2016, the unamortized balance of net premiums on mortgages payable is \$6.4 million, the unamortized balance of original issue discounts on notes payable is \$19.8 million, and the balance of deferred financing costs on mortgages payable is \$324,000, on notes payable is \$20.8 million, and on term loans is \$873,000.

(2) We base the estimated fair value of the fixed rate senior notes and bonds at December 31, 2016 on the indicative market prices and recent trading activity of our senior notes and bonds payable. We base the estimated fair value of our fixed rate and variable rate mortgages at December 31, 2016 on the relevant Treasury yield curve, plus an applicable credit-adjusted spread. We believe that the carrying value of the credit facility balance and term loans balance reasonably approximate their estimated fair values at December 31, 2016.

The table incorporates only those exposures that exist as of December 31, 2016. 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. All of our mortgages payable, except six mortgages totaling \$74.0 million at December 31, 2016, including net unamortized discounts, have fixed interest rates. After factoring in arrangements that limit our exposure to interest rate risk and effectively fix our per annum interest rates, our variable rate mortgage debt includes four mortgages totaling \$38.2 million at December 31, 2016. Interest on our credit facility and term loan balances is variable. However, the variable interest rate feature on our term loans has been mitigated by interest rate swap agreements. Based on our credit facility balance of \$1.12 billion at December 31, 2016, a 1% change in interest rates would change our interest costs by \$11.2 million per year.

**Selected Financial Data**(NOT COVERED BY REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM)  
(DOLLARS IN THOUSANDS, EXCEPT FOR PER SHARE DATA)

<b>As of or for the years ended December 31,</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>
Total assets (book value)	\$ 13,152,871	\$ 11,845,379	\$ 10,989,349	\$ 9,903,118	\$ 5,412,135
Cash and cash equivalents	9,420	40,294	3,852	10,257	5,248
Total debt	5,839,605	4,820,995	4,907,673	4,145,517	2,852,640
Total liabilities	6,365,818	5,292,046	5,348,249	4,481,760	2,999,340
Total equity	6,787,053	6,553,333	5,641,099	5,421,358	2,412,794
Net cash provided by operating activities	804,045	692,303	627,692	518,906	326,469
Net change in cash and cash equivalents	(30,874)	36,442	(6,405)	5,009	1,083
Total revenue	1,103,172	1,023,285	933,505	780,209	484,581
Income from continuing operations	316,477	284,855	269,140	180,613	141,895
Income from discontinued operations	-	-	2,800	65,670	17,257
Net income	316,477	284,855	271,940	246,283	159,152
Preferred stock dividends	(27,080)	(27,080)	(37,062)	(41,930)	(40,918)
Excess of redemption value over carrying value of preferred shares redeemed	-	-	(6,015)	-	(3,696)
Net income available to common stockholders	288,491	256,686	227,558	203,634	114,538
Cash distributions paid to common stockholders	610,516	533,238	479,256	409,222	236,348
Basic and diluted net income per common share	1.13	1.09	1.04	1.06	0.86
Cash distributions paid per common share	2.391500	2.271417	2.191625	2.147459	1.771625
Cash distributions declared per common share	2.403000	2.279000	2.192875	2.177875	1.777875
Basic weighted average number of common shares outstanding	255,066,500	235,767,932	218,390,885	191,754,857	132,817,472
Diluted weighted average number of common shares outstanding	255,624,250	236,208,390	218,767,885	191,781,622	132,884,933

**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 recognizes 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, 2016, 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 (2013)" 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 23, 2017 by,

John P. Case, Chief Executive Officer

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

### Changes in Internal Controls

There were no changes to our internal control over financial reporting that occurred during the quarter ended December 31, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. As of December 31, 2016, 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

John Case, Realty Income's Chief Executive Officer, certified to the NYSE in 2016, 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, 2016, the certifications by John Case and Paul M. Meurer, Realty Income's Chief Executive Officer and Chief Financial Officer, respectively, required under Section 302 of the Sarbanes-Oxley Act.

REALTY INCOME CORPORATION AND SUBSIDIARIES

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

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

	Price Per Share of Common Stock		Distributions Declared <sup>(1)</sup>
	High	Low	
<b>2016</b>			
First Quarter	\$ 62.89	\$ 50.47	\$ 0.5960000
Second Quarter	69.36	58.30	0.5975000
Third Quarter	72.30	63.33	0.6030000
Fourth Quarter	66.75	52.72	0.6065000
Total			\$ 2.4030000
<b>2015</b>			
First Quarter	\$ 55.54	\$ 47.95	\$ 0.5675000
Second Quarter	52.66	44.23	0.5690000
Third Quarter	48.88	43.15	0.5705000
Fourth Quarter	52.41	45.65	0.5720000
Total			\$ 2.2790000

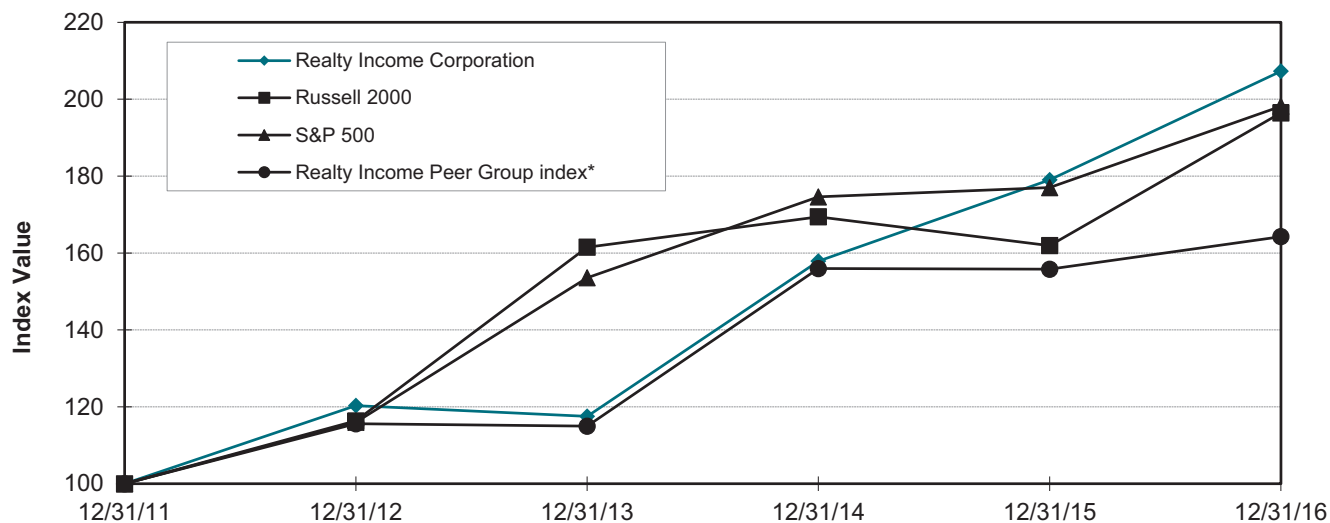
<sup>(1)</sup> Common stock cash distributions are declared monthly by us based on financial results for the prior months. At December 31, 2016, a distribution of \$0.2025 per common share had been declared and was paid in January 2017.

B. There were 9,896 registered holders of record of our common stock as of December 31, 2016. We estimate that our total number of stockholders is over 421,000 when we include both registered and beneficial holders of our common stock.

C. During the fourth quarter of 2016, the following shares of stock were withheld for state and federal payroll taxes on the vesting of employee stock awards, as permitted under the 2012 Incentive Award Plan of Realty Income Corporation:

- 17 shares of stock, at a weighted average price of \$66.93, in October 2016;
- 69 shares of stock, at a weighted average price of \$57.74, in November 2016; and
- 16,922 shares of stock, at a weighted average price of \$57.45, in December 2016

### Total Return Performance



Index	Period Ending					
	12/31/11	12/31/12	12/31/13	12/31/14	12/31/15	12/31/16
Realty Income Corporation	100.00	120.32	117.54	157.90	179.04	207.29
Russell 2000	100.00	116.35	161.52	169.43	161.95	196.45
S&P 500	100.00	116.00	153.57	174.60	177.01	198.18
Realty Income Peer Group index*	100.00	115.61	114.99	155.98	155.79	164.26

\* Realty Income Peer Group index consists of 17 companies with an implied market capitalization between \$2.3 billion and \$24.3 billion as of December 31, 2016.

# COMPANY INFORMATION

## EXECUTIVE OFFICERS



Top row left to right: Neil Abraham, John Case, Michael Pfeiffer | Bottom row left to right: Sumit Roy, Paul Meurer

### John P. Case

Chief Executive Officer

### Sumit Roy

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

### Neil Abraham

Executive Vice President, Chief Investment Officer

## DIRECTORS



Top row left to right: Gregory McLaughlin, Kathleen Allen, Ronald Merriman, Priya Cherian Huskins, Larry Chapman | Bottom row left to right: Michael McKee, John Case, Stephen Sterrett

### Michael D. McKee

Non-Executive Chairman, Executive Chairman, HCP, Inc.

### John P. Case

Chief Executive Officer

### Kathleen R. Allen, Ph.D.

Founding Director, Center for Technology Commercialization, University of Southern California

### A. Larry Chapman

Retired, Executive Vice President, Head of Commercial Real Estate, Wells Fargo Bank

### Priya Cherian Huskins

Partner, Woodruff-Sawyer & Co.

### Gregory T. McLaughlin

President, PGA TOUR Champions

### Ronald L. Merriman

Retired Vice Chair, KPMG LLP

### Stephen E. Sterrett

Retired, Senior Executive Vice President, Chief Financial Officer, Simon Property Group, Inc.

## ADDITIONAL OFFICERS



### Benjamin N. Fox

Senior Vice President, Asset and Portfolio Management



### Robert J. Israel

Senior Vice President, Research



### Dawn Nguyen

Senior Vice President, Portfolio Management



### Sean P. Nugent

Senior Vice President, Controller



### Joel Tomlinson

Senior Vice President, Acquisitions



### Cary J. Wenthur

Senior Vice President, Acquisitions



### Janeen S. Bedard

Vice President, Administration



### Stephen D. Burchett

Vice President, Senior Legal Counsel



### Kyle B. Campbell

Vice President, Senior Legal Counsel, Risk Management



### Nicole A. Carr

Vice President, Assistant Controller, Financial Reporting



### Theresa M. Casey

Vice President, IT Enterprise Software



### Elizabeth Cate

Vice President, Portfolio Management



### T.J. Chun

Vice President, Investments



### Jill M. Cossaboom

Vice President, Assistant Controller, Systems



### Ross Edwards

Vice President, Portfolio Management



### Kristin K. Ferrell

Vice President, Head of Lease Administration



### Shannon C. Jensen

Vice President, Associate General Counsel and Assistant Secretary



### Shannon Kehle

Vice President, Human Resources



### Scott A. Kohnen

Vice President, Research



### Jenette S. O'Brien

Vice President, Asset Management



### Jonathan Pong

Vice President, Head of Capital Markets and Investor Relations



### Lori Satterfield

Vice President, Associate General Counsel, Portfolio Management



### Clint Schmucker

Vice President, Information Technology



### Ashley N. Wells

Vice President, Research

### 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), call toll-free at 1-877-218-2434, or email your questions to [stocktransfer@wellsfargo.com](mailto:stocktransfer@wellsfargo.com)

### Independent Registered

### Public Accounting Firm

KPMG LLP  
San Diego, CA

### For Additional Corporate Information

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

Contact your financial advisor, or contact Realty Income at:  
Telephone: 858-284-5000, 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  
11995 El Camino Real  
San Diego, CA 92130

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