REALTY INCOME CORP
Form 10-K
February 21, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended December 31, 2006

Commission File Number 1-13374

REALTY INCOME CORPORATION

(Exact name of registrant as specified in its charter)

Maryland (State or Other Jurisdiction of Incorporation or Organization)	**33-0580106** (IRS Employer Identification Number)

220 West Crest Street, Escondido, California 92025

(Address of Principal Executive Offices)

Registrant s telephone number, including area code: **(760)741-2111**

Securities registered pursuant to Section 12 (b) of the Act:

Title of Each Class	Name of Each Exchange On Which Registered
Common Stock, $1.00 Par Value	New York Stock Exchange
Class D Preferred Stock, $1.00 Par Value	New York Stock Exchange
Class E Preferred Stock, $1.00 Par Value	New York Stock Exchange
8.25% Monthly Income Senior Notes, due 2008	New York Stock Exchange

Securities registered pursuant to Section 12 (g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Exchange Act Rule 12b-2).

Large accelerated filer x Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

At June 30, 2006, the aggregate market value of the Registrant s shares of common stock, $1.00 par value, held by non-affiliates of the Registrant was $1.9 billion, at the New York Stock Exchange (NYSE) closing price of $21.90.

At February 13, 2007, the number of shares of common stock outstanding was 101,005,867, the number of Class D preferred shares outstanding was 5,100,000, the number of Class E preferred shares outstanding was 8,800,000 and the number of Monthly Income Senior Notes, due 2008, outstanding was 4,000,000.

Documents incorporated by reference: Part III, Item 10, 11, 12, 13 and Part IV, Item 14 incorporate by reference certain specific portions of the definitive proxy statement for Realty Income Corporation s Annual Meeting to be held on May 15, 2007, to be filed pursuant to Regulation 14A. Only those portions of the proxy statement which are specifically incorporated by reference herein shall constitute a part of this Annual Report.

Forward-Looking Statements

This annual report on Form 10-K, including documents incorporated by reference, contains forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. When used in this annual report, the words estimated , anticipated , expect , believe , intend and similar expressions are intended to identify forward-looking statements. Forward-looking statements are subject to risks, uncertainties, and assumptions about Realty Income Corporation, including, among other things:

Our anticipated growth strategies;

Our intention to acquire additional properties and the timing of these acquisitions;

Our intention to sell properties and the timing of these property sales;

Our intention to re-lease vacant properties;

Anticipated trends in our business, including trends in the market for long-term net-leases of freestanding, single-tenant retail properties;

Future expenditures for development projects; and

Profitability of our subsidiary, Crest Net Lease, Inc. (Crest).

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

Our continued qualification as a real estate investment trust;

General business and economic conditions;

Competition;

Fluctuating interest rates;

Access to debt and equity capital markets;

Other risks inherent in the real estate business including tenant defaults, potential liability relating to environmental matters, illiquidity of real estate investments and potential damages from natural disasters;

Impairments in the value of our real estate assets;

Changes in the tax laws of the United States of America;

The outcome of any legal proceedings to which we are a party; and

Acts of terrorism and war.

Additional factors that may cause risks and uncertainties include those discussed in the sections entitled Business , 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. 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.

REALTY INCOME CORPORATION

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PART I

Item 1: **Business**

THE COMPANY

Realty Income Corporation, The Monthly Dividend Company®, is a Maryland corporation organized to operate as an equity real estate investment trust, or REIT. Our primary business objective is to generate dependable monthly cash distributions from a consistent and predictable level of funds from operations, or FFO per share. The monthly distributions are supported by the cash flow from our portfolio of retail properties leased to regional and national retail chains. We have in-house acquisition, leasing, legal, retail and real estate research, portfolio management and capital markets expertise. Over the past 38 years, Realty Income and its predecessors have been acquiring and owning freestanding retail properties that generate rental revenue under long-term lease agreements (primarily 15- to 20-years).

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

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

In acquiring additional properties, we adhere to a focused strategy of primarily acquiring properties that are:

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

At December 31, 2006, we owned a diversified portfolio:

- Of 1,955 retail properties;

With an occupancy rate of 98.7%, or 1,929 properties occupied of the 1,955 properties in the portfolio;

Leased to 103 different retail chains doing business in 29 separate retail industries;

Located in 48 states;

With over 16.7 million square feet of leasable space; and

With an average leasable retail space per property of 8,600 square feet.

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

In addition, at December 31, 2006, our wholly-owned taxable REIT subsidiary, Crest Net Lease, Inc. (Crest), had invested $137.5 million in 60 properties, which are classified as held for sale. Crest was created to buy and sell properties, primarily to individual investors, many of whom are involved in tax-deferred exchanges under Section 1031 of the Internal Revenue Code of 1986, as amended (the Tax Code).

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

Our net-lease agreements generally:

Are for initial terms of 15 to 20 years;

Require the tenant to pay minimum monthly rents and property operating expenses (taxes, insurance and maintenance); and

Provide for future rent increases based on increases in the consumer price index, fixed increases, or to a lesser degree, additional rent calculated as a percentage of the tenants gross sales above a specified level.

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

The eight senior officers of Realty Income owned 1.3% of our outstanding common stock with a market value of $37.4 million at February 13, 2007. The directors and eight senior officers of Realty Income, as a group, owned 2.5% of our outstanding common stock with a market value of $72.6 million at February 13, 2007.

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

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

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

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

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

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

RECENT DEVELOPMENTS

Acquisitions during 2006

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

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

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

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

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

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

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

Investments in Existing Properties

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

Net Income Available to Common Stockholders

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

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

The gain recognized from the sales of investment properties during 2006 was $3.0 million as compared to $6.6 million for 2005.

Funds from Operations (FFO)

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

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

Issuances of Common Stock

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

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

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

Issuance of Preferred Stock

In December 2006, we issued 8.8 million shares of 6-3/4% Monthly Income Class E cumulative redeemable preferred stock, with a liquidation value of $25 per share. The net proceeds of $214 million from this issuance were used to repay borrowings under our credit facility and for other general corporate purposes. Beginning December 7, 2011, the Class E preferred shares are redeemable at our option for $25 per share. Dividends of $0.140625 per share are paid monthly in arrears on the Class E preferred stock.

Credit Ratings Upgrades

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

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

Redemption of 2007 Notes

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

Issuance of 10-Year Senior Unsecured Notes

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

Crest Property Sales

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

Crest Property Inventory

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

Increases in Monthly Distributions to Common Stockholders

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

The monthly distribution of $0.1265 per share represents a current annualized distribution of $1.518 per share, and an annualized distribution yield of approximately 5.2% based on the last reported sale price of our common stock on the NYSE of $29.09 on February 13, 2007. Although we expect to continue our policy of paying monthly distributions, we cannot guarantee that we will maintain the current level of distributions, that we will continue our pattern of increasing distributions per share, or what the actual distribution yield will be in any future period.

DISTRIBUTION POLICY

Distributions are paid monthly to our common stockholders and Class D and Class E preferred stockholders if, and when declared by our Board of Directors.

In order to maintain our tax status as a REIT for federal income tax purposes, we generally are required to distribute dividends to our stockholders aggregating annually at least 90% of our REIT taxable income (determined without regard to the dividends paid deduction and by excluding net capital gains) and we are subject to income tax to the extent we distribute less than 100% of our REIT taxable income (including net capital gains). In 2006, our cash distributions totaled $139.1 million, or approximately 113.3% of our estimated REIT taxable income of $122.8 million. Our estimated REIT taxable income reflects non-cash deductions for depreciation and amortization. We intend to continue to make distributions to our stockholders that are sufficient to meet this distribution requirement and that will reduce our exposure to income taxes. Our 2006 cash distributions to common stockholders totaled $129.7 million, representing 83.2% of our funds from operations available to common stockholders of $155.8 million.

The Class D preferred stockholders receive cumulative distributions at a rate of 7.375% per annum on the $25 per share liquidation preference (equivalent to $1.84375 per annum per share). The Class E preferred stockholders receive cumulative distributions at a rate of 6.75% per annum on the $25 per share liquidation preference (equivalent to $1.6875 per annum per share).

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

Distributions of our current and accumulated earnings and profits for federal income tax purposes, generally will be taxable to stockholders as ordinary income, except to the extent that we recognize capital gains and declare a capital gains dividend or that such amounts constitute qualified dividend income subject to a reduced tax rate. The maximum tax rate of non-corporate taxpayers for qualified dividend income has generally been reduced to 15% (for taxable years beginning after December 31, 2002). In general, dividends payable by REITs are not eligible for the reduced tax rate on corporate dividends, except to the extent the REIT s dividends are attributable to dividends received from taxable corporations (such as our taxable REIT subsidiary, Crest), to income that was subject to tax at the corporate or REIT level (for example, if we distribute taxable income that we retained and paid tax on in the prior taxable year) or, as discussed above, dividends properly designated by us as capital gain dividends. Distributions in excess of earnings and profits generally will be treated as a non-taxable reduction in the stockholders basis in the stock. Distributions above that basis, generally, will be taxable as a capital gain. Approximately 9.9% of the distributions to our common stockholders, made or deemed to have been made in 2006, were classified as a return of capital for federal income tax purposes. We are unable to predict the portion of future distributions that may be classified as a return of capital.

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BUSINESS PHILOSOPHY AND STRATEGY

Investment Philosophy

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

Investment Strategy

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

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

They generally have overcome many of the operational and managerial obstacles that can adversely affect venture retailers;

They typically require capital to fund expansion but have more limited financing options;

They generally have provided us with attractive risk-adjusted returns over time since their financial strength has, in many cases, tended to improve as their businesses have matured;

Their relatively large size allows them to spread corporate expenses across a greater number of stores; and

Middle market retailers typically have the critical mass to survive if a number of locations are closed due to underperformance.

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

They typically are of a higher credit quality;

They usually are larger public and private retailers with more commonly recognized brand names;

They utilize a larger building ranging in size from 10,000 to 50,000 square feet; and

They are able to grow because access to capital facilitates larger transaction sizes.

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

Historically, our investment focus has been on retail industries that have a service component because we believe the lease revenue from these types of businesses is more stable. Because of this investment focus, for the quarter ended December 31, 2006, approximately 80.9% of our rental revenue was derived from retailers with a service component in their business. Furthermore, we believe these service-oriented businesses would be difficult to duplicate over the Internet and that our properties continue to perform well relative to competition from Internet businesses.

Credit Strategy

We generally provide sale-leaseback financing to less than investment grade retail chains. We typically acquire and lease back properties to regional and national retail chains and believe that within this market we can achieve an attractive risk-adjusted return on the financing we provide to retailers. Since 1970, our overall weighted average occupancy rate at the end of each year has been 98.6%, and the occupancy rate at the end of each year has never been below 97.5%.

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

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

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

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

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

Acquisition Strategy

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

Freestanding, commercially-zoned property with a single tenant;

Properties that are important retail locations for regional and national retail chains;

Properties that are located within attractive demographic areas relative to the business of their tenants, with high visibility and easy access to major thoroughfares; and

Properties that can be purchased with the simultaneous execution or assumption of long-term, net-lease agreements, offering both current income and the potential for rent increases.

Portfolio Management Strategy

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

The performance of various retail industries; and

The operation, management, business planning and financial condition of the tenants.

We have an active portfolio management program that incorporates the sale of assets when we believe the reinvestment of the sales proceeds will generate higher returns, enhance the credit quality of our real estate portfolio, or extend our average remaining lease term. At December 31, 2006, we classified real estate with a carrying amount of $138 million as held for sale, which includes $137.5 million in properties owned by Crest. Additionally, we anticipate selling investment properties from our portfolio that have not yet been specifically identified from which we anticipate receiving between $10 million and $35 million in proceeds during the next 12 months. We intend to invest these proceeds into new property acquisitions. However, we cannot guarantee that we will sell properties during the next 12 months.

Universal Shelf Registration

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

Conservative Capital Structure

We believe that our stockholders are best served by a conservative capital structure. Therefore, we seek to maintain a conservative debt level on our balance sheet and solid interest and fixed charge coverage ratios. At February 13, 2007, our total outstanding credit facility borrowings and outstanding notes were $920 million or approximately 21.9% of our total market capitalization of $4.21 billion. We calculate our total market capitalization at February 13, 2007 as the sum of:

Shares of our common stock outstanding of 101,000,536 multiplied by the last reported sales price of our common stock on the NYSE of $29.09 per share, or $2.94 billion;

Aggregate liquidation value of the Class D preferred stock of $127.5 million;

Aggregate liquidation value of the Class E preferred stock of $220 million; and

Outstanding notes of $920 million.

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

We have a $300 million revolving, unsecured credit facility that expires in October 2008. Realty Income s current investment grade credit ratings provide for financing under the credit facility at the London Interbank Offered Rate, commonly referred to as LIBOR, plus 65 basis points with a facility fee of 15 basis points, for all-in drawn pricing of 80 basis points over LIBOR. At February 13, 2007, we had borrowing capacity of $300 million available on our credit facility and no outstanding balance.

The credit facility is expected to be used to acquire additional retail properties and for other corporate purposes. Any additional borrowings will increase our exposure to interest rate risk. We have the right to request an increase in the borrowing capacity of the credit facility by up to $100 million, to a total borrowing capacity of $400 million. Any increase in the borrowing capacity is subject to approval by the lending banks of our credit facility.

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

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

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

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

We have no mortgage debt on any of our properties.

No Off-Balance Sheet Arrangements or Unconsolidated Investments

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

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

Competitive Strategy

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

Size and Type of Investment Properties: We believe smaller ($500,000 to $10,000,000) net-leased retail properties represent an attractive investment opportunity in today s real estate environment. Due to the complexities of acquiring and managing a large portfolio of relatively small assets, we believe these types of properties have not experienced significant institutional ownership interest or the corresponding yield reduction experienced by larger income-producing properties. We believe the less intensive day-to-day property management required by net-lease agreements, coupled with the active management of a large portfolio of smaller properties, is an effective investment strategy. The tenants of our freestanding retail properties generally provide goods and services that satisfy basic consumer needs. In order to grow and expand, they generally need capital. Since the acquisition of real estate is typically the single largest capital expenditure of many of these retailers, our method of purchasing the property and then leasing it back, under a net-lease arrangement, allows the retail chain to free up capital.

Investment in New Retail Industries: Though we specialize in single-tenant properties, we will seek to further diversify our portfolio among a variety of retail industries. We believe diversification will allow us to invest in retail industries that currently are growing and have characteristics we find attractive. These characteristics include, but are not limited to, retail industries that are dominated by local store operators where regional and national chain store operators can increase market share and dominance by consolidating local operators and streamlining their operations, as well as capitalizing on major demographic shifts in a population base.

Diversification: Diversification of the portfolio by retail industry type, tenant, and geographic location is key to our objective of providing predictable investment results for our stockholders, therefore further diversification of our portfolio is a continuing objective. At December 31, 2006, our retail property portfolio consisted of 1,955 properties located in 48 states, leased to 103 retail chains doing business in 29 industry segments. Each of the 29 industry segments, represented in our property portfolio, individually accounted for no more than 17.8% of our rental revenue for the quarter ended December 31, 2006.

Management Specialization: We believe that our management s specialization in single-tenant retail properties, operated under net-lease agreements, is important to meeting our objectives. We plan to maintain this specialization and will seek to employ and train high-quality professionals in this specialized area of real estate ownership, finance and management.

Technology: We intend to stay at the forefront of technology in our efforts to efficiently and economically carry out our operations. We maintain sophisticated information systems that allow us to analyze our portfolio s performance and actively manage our investments. We believe that technology and information-based systems will play an increasingly important role in our competitiveness as an investment manager and source of capital to a variety of industries and tenants.

PROPERTIES

At December 31, 2006, we owned a diversified portfolio:

Of 1,955 retail properties;

With an occupancy rate of 98.7%, or 1,929 properties occupied of the 1,955 properties in the portfolio;

Leased to 103 different retail chains doing business in 29 separate retail industries;

Located in 48 states;

With over 16.7 million square feet of leasable space; and

With an average leasable retail space per property of approximately 8,600 square feet.

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

At December 31, 2006, 1,923, or 98.4%, of our 1,955 retail properties were leased under net-lease agreements. Net leases typically require the tenant to be responsible for minimum monthly rent and property operating expenses including property taxes, insurance and maintenance. In addition, tenants are typically responsible for future rent increases based on increases in the consumer price index, fixed increases or, to a lesser degree, additional rent calculated as a percentage of the tenants gross sales above a specified level.

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

Industry Diversification

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

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

* Less than 0.1%

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

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Service Category Diversification

The following table sets forth certain information regarding the properties owned by Realty Income (excluding properties owned by Crest) at December 31, 2006, classified according to the retail business types and the level of services they provide (dollars in thousands):

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

* Less than 0.1%

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

Lease Expirations

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

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

*Less than 0.1%

(1) Excludes six multi-tenant properties and 26 vacant unleased properties, one of which is a multi-tenant property. The lease expirations for properties under construction are based on the estimated date of completion of those properties.

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

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

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

State Diversification

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

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

West Virginia	2	50	23,200		30	*
Wisconsin	17	94	157,400		600	0.9
Wyoming	1	100	4,200		18	*
Totals/Average	1,955	99%	16,740,100	$	68,201	100.0%

* Less than 0.1%

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

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Description of Leasing Structure

At December 31, 2006, 1,923 single tenant and certain other retail properties or 98.4% of our 1,955 properties were net leased. In most cases, the leases:

Are for initial terms of 15 to 20 years;

Require the tenants to pay minimum monthly rents and property operating expenses (taxes, insurance and maintenance); and

Provide for future rent increases based on increases in the consumer price index, fixed increases, or to a lesser degree, additional rent calculated as a percentage of the tenants gross sales above a specified level. Where leases provide for rent increases based on increases in the consumer price index, generally these increases become part of the new permanent base rent. Where leases provide for percentage rent, this additional rent is typically payable only if the tenants gross sales, for a given period (usually one year), exceed a specified level and is then typically calculated as a percentage of only the amount of gross sales in excess of that level.

Matters Pertaining to Certain Properties and Tenants

Of the 26 properties available for lease or sale at December 31, 2006, all are single-tenant properties except one. At December 31, 2006, 16 of our properties under lease were unoccupied and available for sublease by the tenants, all of which were current with their rent and other obligations. During 2006, each of our tenants accounted for less than 10% of our rental revenue.

Certain Properties Under Development

Of the 322 properties Realty Income acquired in 2006, all were occupied at December 31, 2006, except for four properties that were leased and being developed. In the case of development properties, we either enter into an agreement with a retail chain where the retailer retains a contractor to construct the building and we fund the costs of that development, or we fund a developer who constructs the building. In either case, there is an executed lease with a retail tenant at the time of the land purchase (with a fixed rent commencement date) and there is a requirement to complete the construction in a timely basis and within a specific budget, typically within eight months after we purchase the land. The tenant or developer generally is required to pay construction cost overruns to the extent that they exceed the construction budget by more than a predetermined amount. We also enter into a lease with the tenant at the time we purchase the land, which generally requires the tenant to begin paying base rent when the store opens for business. The base rent is calculated by multiplying a predetermined capitalization rate by our total investment in the property including the land cost for the property, construction costs and capitalized interest. In 2006, Realty Income acquired 15 development properties. Crest did not acquire any development property in 2006. Both Realty Income and Crest will continue to pursue development opportunities under similar arrangements in the future.

Item 1A: **Risk Factors**

As used under this caption Risk Factors, references to our capital stock include our common stock and any class or series of our preferred stock and references to our stockholders include holders of our common stock or any class or series of our preferred stock, in each case unless otherwise expressly stated or the context otherwise requires.

In order to grow we need to continue to acquire investment properties which may be subject to competitive pressures.

We face competition in the acquisition, operation and sale of property. We expect competition from:

- Businesses;
- Individuals;
- Fiduciary accounts and plans; and
- Other entities engaged in real estate investment and financing.

Some of these competitors are larger than we are and have greater financial resources. This competition may result in a higher cost for properties we wish to purchase.

Our tenants creditworthiness and ability to pay rent may be affected by competition within their industries from other operators.

The tenants leasing our properties can face significant competition from other operators. This competition may adversely impact:

- That portion, if any, of the rental stream to be paid to us based on a tenant s revenues; and
- The tenants results of operations or financial condition.

As a property owner, we may be subject to unknown environmental liabilities.

Investments in real property can create a potential for environmental liability. An owner of property can face liability for environmental contamination created by the presence or discharge of hazardous substances on the property. We can face such liability regardless of:

- Our knowledge of the contamination;
- The timing of the contamination;
- The cause of the contamination; or
- The party responsible for the contamination of the property.

There may be environmental problems of which we are unaware associated with our properties. In that regard, a number of our properties are leased to operators of convenience stores that sell petroleum-based fuels, as well as to operators of oil change and tune-up facilities. These facilities, and some other of our properties, use, or may have used in the past, underground lifts or underground tanks for the storage of petroleum-based or waste products, which could create a potential for release of hazardous substances.

The presence of hazardous substances on a property may adversely affect our ability to sell that property and we may incur substantial remediation costs. Although our leases generally require our tenants to operate in compliance with all applicable federal, state and local environmental laws, ordinances and regulations, and to indemnify us against any environmental liabilities arising from the tenants activities on the property, we could nevertheless be subject to strict liability by virtue of our ownership interest. There also can be no assurance that our tenants could or would satisfy their indemnification obligations under their leases. The discovery of environmental liabilities attached to our properties could have an adverse effect on our results of operations, our financial condition or our ability to make distributions to stockholders and to pay the principal of and interest on our debt securities and other indebtedness.

In addition, several of our properties were built during the period when asbestos was commonly used in building construction and other buildings with asbestos may be acquired by the Company in the future. Environmental laws govern the presence, maintenance and removal of asbestos-containing materials, or ACMs, and require that owners or operators of buildings containing asbestos properly manage and maintain the asbestos, that they adequately inform or train those who may come into contact with asbestos and that they undertake special precautions, including removal or other abatement in the event that asbestos is disturbed during renovation or demolition of a building. These laws may impose fines and penalties on building owners or operators for failure to comply with these requirements and may allow third parties to seek recovery from owners or operators for personal injury associated with exposure to asbestos fibers.

Compliance. We have not been notified by any governmental authority, and are not otherwise aware, of any material noncompliance, liability or claim relating to hazardous substances, toxic substances, or petroleum products in connection with any of our present properties. Nevertheless, if environmental contamination should exist, we could be subject to strict liability by virtue of our ownership interest. In addition, we believe we are in compliance in all material respects with all present federal, state and local laws relating to ACMs.

Insurance and Indemnity. In June 2005, we entered into a seven-year environmental insurance policy on our property portfolio which replaced the previous five-year environmental insurance policy. The limits on our current policy are $10 million per occurrence, and $50 million in the aggregate, subject to a $40,000 self insurance retention, per occurrence, for properties with underground storage tanks and a $100,000 self insurance retention, per occurrence, for all other properties. It is possible that our insurance could be insufficient to address any particular environmental situation and that, in the future, we could be unable to obtain insurance for environmental matters at a reasonable cost, or at all.

Our tenants are generally responsible for and indemnify us against liabilities for environmental matters that occur on our properties. For properties that have underground storage tanks, in addition to providing an indemnity in our favor, the tenants generally obtain environmental insurance or rely upon the state funds in the states where these properties are located.

If we fail to qualify as a real estate investment trust, the amount of dividends we are able to pay would decrease, which could adversely affect the market price of our capital stock and could adversely affect the value of our debt securities.

Commencing with our taxable year ended December 31, 1994, we believe that we have been organized and have operated, and we intend to continue to operate, so as to qualify as a REIT under Sections 856 through 860 of the Code. However, we cannot assure you that we have been organized or have operated in a manner that has satisfied the requirements for qualification as a REIT, or that we will continue to be organized or operate in a manner that will allow us to continue to qualify as a REIT.

Qualification as a REIT involves the satisfaction of numerous requirements under highly technical and complex Code provisions, for which there are only limited judicial and administrative interpretations, and the determination of various factual matters and circumstances not entirely within our control.

For example, in order to qualify as a REIT, at least 95% of our gross income in each year must be derived from qualifying sources, and we must pay distributions to stockholders aggregating annually at least 90% of our REIT taxable income (as defined in the Code and determined without regard to the dividends paid deduction and by excluding net capital gains).

In the future, it is possible that legislation, new regulations, administrative interpretations or court decisions will change the tax laws with respect to qualification as a REIT, or the federal income tax consequences of such qualification.

If we fail to satisfy all of the requirements for qualifications as a REIT, we may be subject to certain penalty taxes or, in some circumstances, we may fail to qualify as a REIT. If we were to fail to qualify as a REIT in any taxable year:

We would be required to pay federal income tax (including any applicable alternative minimum tax) on our taxable income at regular corporate rates;

We would not be allowed a deduction in computing our taxable income for amounts distributed to our stockholders;

We could be disqualified from treatment as a REIT for the four taxable years following the year during which qualification is lost;

We would no longer be required to make distributions to stockholders; and

This treatment would substantially reduce amounts available for investment or distribution to stockholders because of the additional tax liability for the years involved, which could have a material adverse effect on the market price of our capital stock and the value of our debt securities.

Even if we qualify for and maintain our REIT status, we may be subject to certain federal, state and local taxes on our income and property. For example, if we have net income from a prohibited transaction, that income will be subject to a 100% tax. Our subsidiary Crest is subject to federal and state taxes at the applicable tax rates on its income and property.

Distributions requirements imposed by law limit our flexibility.

To maintain our status as a REIT for federal income tax purposes, we generally are required to distribute to our stockholders at least 90% of our REIT taxable income, determined without regard to the dividends paid deduction and by excluding net capital gains each year. We also are subject to tax at regular corporate rates to the extent that we distribute less than 100% of our REIT taxable income (including net capital gains) each year.

In addition, we are subject to a 4% nondeductible excise tax to the extent that we fail to distribute during any calendar year at least the sum of 85% of our ordinary income for that calendar year, 95% of our capital gain net income for the calendar year, and any amount of that income that was not distributed in prior years.

We intend to continue to make distributions to our stockholders to comply with the distribution requirements of the Code as well as to reduce our exposure to federal income taxes and the nondeductible excise tax. Differences in timing between the receipt of income and the payment of expenses to arrive at taxable income, along with the effect of required debt amortization payments, could require us to borrow funds on a short-term basis to meet the distribution requirements that are necessary to achieve the tax benefits associated with qualifying as a REIT.

Future issuances of equity securities could dilute the interest of holders of our common stock.

Our future growth will depend, in large part, upon our ability to raise additional capital. If we were to raise additional capital through the issuance of equity securities, we could dilute the interests of holders of our common stock. The interests of our common stockholders could also be diluted by the issuance of shares of common stock upon the exercise of outstanding options or pursuant to stock incentive plans. Likewise, our Board of Directors is authorized to cause us to issue preferred stock of any class or series (with dividend, voting and other rights as determined by the Board of Directors). Accordingly, the Board of Directors may authorize the issuance of preferred stock with voting, dividend and other similar rights that could dilute, or otherwise adversely affect, the interests of holders of our common stock.

We are subject to risks associated with debt and capital stock financing.

We intend to incur additional indebtedness in the future, including borrowings under our $300 million acquisition credit facility. At February 13, 2007, we had no borrowings outstanding under our $300 million acquisition credit facility and a total of $920 million aggregate principal amount of outstanding unsecured senior debt securities. To the extent that new indebtedness is added to our current debt levels, the related risks that we now face would increase. As a result, we are and will be subject to risks associated with debt financing, including the risk that our cash flow could be insufficient to meet required payments on our debt. We also face variable interest rate risk as the interest rate on our $300 million credit facility is variable and could therefore increase over time. We also face the risk that we may be unable to refinance or repay our debt as it comes due. In addition, our $300 million credit facility contains financial covenants that could limit the amount of distributions payable by us on our common stock and preferred stock in the event of deterioration in our results of operations or financial condition, and our $300 million credit facility provides that, in the event of a failure to pay principal of or interest on borrowings there under when due (subject to any applicable grace period), we and our subsidiaries may not pay any dividends on our capital stock, including our outstanding common and preferred stock. If this were to occur, it would likely have an adverse effect on the market price of our outstanding common and preferred stock and on the value of our debt securities.

Our indebtedness could also have other important consequences to holders of our common and preferred stock, including:

Increasing our vulnerability to general adverse economic and industry conditions;

Limiting our ability to obtain additional financing to fund future working capital, capital expenditures and other general corporate requirements;

Requiring the use of a substantial portion of our cash flow from operations for the payment of principal, and interest on our indebtedness, thereby reducing our ability to use our cash flow to fund working capital, capital expenditures and general corporate requirements;

Limiting our flexibility in planning for, or reacting to, changes in our business and our industry; and

Putting us at a disadvantage compared to our competitors with less indebtedness.

Our business operations may not generate the cash needed to make distributions on our capital stock or to service our indebtedness.

Our ability to make distributions on our common stock and preferred stock and payments on our indebtedness and to fund planned capital expenditures will depend on our ability to generate cash in the future. We cannot assure you that our business will generate sufficient cash flow from operations or that future borrowings will be available to us in an amount sufficient to enable us to make distributions on our common stock and preferred stock, to pay our indebtedness or to fund our other liquidity needs.

The market value of our capital stock and debt securities could be substantially affected by various factors.

The market value of our capital stock and debt securities will depend on many factors, which may change from time to time, including:

- Prevailing interest rates, increases in which may have an adverse effect on the market value of our capital stock and our debt securities;
- The market for similar securities issued by REITs;
- General economic and financial market conditions;
- The financial condition, performance and prospects of us and our competitors;
- Changes in financial estimates or recommendations by securities analysts with respect to us, our competitors or our industry;
- Changes in our credit ratings; and
- Actual or anticipated variations in quarterly operating results.

As a result of these and other factors, investors who purchase our capital stock and debt securities may experience a decrease, which could be substantial, in the market value of our capital stock and debt securities, including decreases unrelated to our operating performance or prospects.

Real estate ownership is subject to particular economic conditions that may have a negative impact on our revenue.

We are subject to all of the general risks associated with the ownership of real estate. In particular, we face the risk that rental revenue from our properties may be insufficient to cover all corporate operating expenses, debt service payments on indebtedness we incur and distributions on our stock. Additional real estate ownership risks include:

- Adverse changes in general or local economic conditions;
- Changes in supply of, or demand for, similar or competing properties;
- Changes in interest rates and operating expenses;
- Competition for tenants;
- Changes in market rental rates;

Inability to lease properties upon termination of existing leases;

Renewal of leases at lower rental rates;

Inability to collect rents from tenants due to financial hardship, including bankruptcy;

Changes in tax, real estate, zoning and environmental laws that may have an adverse impact upon the value of real estate;

Uninsured property liability;

Property damage or casualty losses;

Unexpected expenditures for capital improvements or to bring properties into compliance with applicable federal, state and local laws;

Acts of terrorism and war; and

Acts of God and other factors beyond the control of our management.

An uninsured loss or a loss that exceeds the policy limits on our properties could subject us to lost capital or revenue on those properties.

Under the terms and conditions of the leases currently in force on our properties, tenants generally are required to indemnify and hold us harmless from liabilities resulting from injury to persons, air, water, land or property, due to activities conducted on the properties, except for claims arising from the negligence or intentional misconduct of us or our agents. Additionally, tenants are generally required, at the tenant s expense, to obtain and keep in full force during the term of the lease, liability and property damage insurance policies. The insurance policies our tenants are required to maintain for property damage are generally in amounts not less than the full replacement cost of the improvements less slab, foundations, supports and other customarily excluded improvements. Our tenants are generally required to maintain general liability coverage varying between $1,000,000 and $10,000,000 depending on the tenant and the industry in which it operates.

In addition to the indemnities and required insurance policies identified above, many of our properties are also covered by flood and earthquake insurance policies (subject to substantial deductibles) obtained and paid for by the tenants as part of their risk management programs. Additionally, we have obtained blanket liability, flood and earthquake (subject to substantial deductibles) and property damage insurance policies to protect us and our properties against loss should the indemnities and insurance policies provided by the tenants fail to restore the properties to their condition prior to a loss. However, should a loss occur that is uninsured or in an amount exceeding the combined aggregate limits for the policies noted above, or in the event of a loss that is subject to a substantial deductible under an insurance policy, we could lose all or part of our capital invested in, and anticipated revenue from, one or more of the properties, which could have a material adverse effect on our results of operations or financial condition and on our ability to pay the principal of and interest on our debt securities and other indebtedness and to make distributions to our stockholders.

Compliance with the Americans With Disabilities Act of 1990 and fire, safety, and other regulations may require us to make unintended expenditures that could adversely impact our results of operation.

Our properties are generally required to comply with the Americans with Disabilities Act of 1990, or the ADA. The ADA has separate compliance requirements for public accommodations and commercial facilities, but generally requires that buildings be made accessible to people with disabilities. Compliance with the ADA requirements could require removal of access barriers and non-compliance could result in imposition of fines by the U.S. government or an award of damages to private litigants. The retailers to whom we lease properties are obligated by law to comply with the ADA provisions, and we believe that these retailers may be obligated to cover costs associated with compliance. If required changes involve greater expenditures than anticipated, or if the changes must be made on a more accelerated basis than anticipated, the ability of these retailers to cover costs could be adversely affected and we could be required to expend our own funds to comply with the provisions of the ADA, which could materially adversely affect our results of operations or financial condition and our ability to pay the principal of and interest on our debt securities and other indebtedness and to make distributions to our stockholders. In addition, we are required to operate our properties in compliance with fire and safety regulations, building codes and other land use regulations, as they may be adopted by governmental agencies and bodies and become applicable to our properties. We may be required to make substantial capital expenditures to comply with those requirements and these expenditures could materially adversely affect our results of operations or financial condition and our ability to pay the principal of and interest on our debt securities and other indebtedness and to make distributions to our stockholders.

Property taxes may increase without notice.

The real property taxes on our properties and any other properties that we develop or acquire in the future may increase as property tax rates change and as those properties are assessed or reassessed by tax authorities.

Matters pertaining to certain properties and tenants.

Twenty-six of our properties were available for lease or sale at December 31, 2006, of which all but one were single-tenant properties. As of February 13, 2007, transactions to lease or sell four of the 26 properties available for lease at December 31, 2006 were underway or completed. At December 31, 2006, 16 of our properties under lease were unoccupied and available for sublease by the tenants, all of which were current with their rent and other obligations.

For 2006, our tenants in the convenience store, restaurant and child care industries accounted for approximately 16.1%, 11.9% and 10.3%, respectively, of our rental revenue. A downturn in any of these industries, whether nationwide or limited to specific sectors of the United States, could adversely affect tenants in these industries, which in turn could have a material adverse affect on our financial position, results of operations and our ability to pay the principal of and interest on our debt securities and other indebtedness and to make distributions on our common stock and preferred stock. Individually, each of the other industries in our property portfolio accounted for less than 10% of our rental revenue for 2006.

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

We depend on key personnel.

We depend on the efforts of our executive officers and key employees. The loss of the services of our executive officers and key employees could have a material adverse effect on our results of operations or financial condition and on our ability to pay the principal and interest on our debt securities and other indebtedness and to make distributions to our stockholders. It is possible that we will not be able to recruit additional personnel with equivalent experience in the retail, net-lease industry.

Terrorist attacks and other acts of violence or war may affect the value of our debt and equity securities, the markets in which we operate and our results of operations.

Terrorist attacks may negatively affect our operations and your investment. There can be no assurance that there will not be further terrorist attacks against the United States or United States businesses. These attacks, or armed conflicts, may directly impact our physical facilities or the businesses of our tenants.

Such events could cause consumer confidence and spending to decrease or result in increased volatility in the U.S. and worldwide financial markets and economy. They also could result in or prolong an economic recession in the U.S. or abroad. Any of these occurrences could have a significant adverse impact on our operating results and revenues and on the market price of our capital stock and on the value of our debt securities. It could also have an adverse effect on our ability to pay principal and interest on our debt securities or other indebtedness and to make distributions to our stockholders.

Item 1B: **Unresolved Staff comments**

There are no unresolved staff comments.

Item 2: **Properties**

Information pertaining to our properties can be found under Item 1.

Item 3: **Legal Proceedings**

We are subject to certain claims and lawsuits in the ordinary course of business, the outcome of which cannot be determined at this time. In the opinion of management, any liability we might incur upon the resolution of these claims and lawsuits will not, in the aggregate, have a material adverse effect on our consolidated financial position or results of operations.

Item 4: **Submission of Matters to a Vote of Security Holders**

No matters were submitted to stockholders during the fourth quarter of the fiscal year.

PART II

Item 5: Market For Registrant s Common Equity And Related Stockholder Matters

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

	Price Per Share of Common Stock					
		High		**Low**		**Distributions Declared(1)**
2006						
First quarter	$	24.93	$	21.57	$	0.349375
Second quarter		24.06		21.25		0.351250
Third quarter		25.10		21.65		0.368625
Fourth quarter		28.43		24.40		0.378250
Total					$	1.447500
2005						
First quarter	$	25.61	$	22.00	$	0.330625
Second quarter		25.69		22.50		0.332500
Third quarter		25.65		22.00		0.341875
Fourth quarter		23.97		21.08		0.347500
Total					$	1.352500

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

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

Item 6: **Selected Financial Data**

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

As of or for the years ended December 31, (dollars in thousands, except for per share data)	**2006**	**2005**	**2004**	**2003**	**2002**
Total assets (book value)	$ 2,546,508	$ 1,920,988	$ 1,442,315	$ 1,360,257	$ 1,080,230
Cash and cash equivalents	10,573	65,704	2,141	4,837	8,921
Lines of credit and notes payable	920,000	891,700	503,600	506,400	339,700
Total liabilities	970,516	931,774	528,580	532,491	357,775
Total stockholders equity	1,575,992	989,214	913,735	827,766	722,455
Net cash provided by operating activities	86,945	109,557	178,337	73,957	124,807
Net change in cash and cash equivalents	(55,131)	63,563	(2,696)	(4,084)	6,454
Total revenue	240,100	196,020	173,062	142,656	127,337
Income from continuing operations	106,065	88,749	81,642	70,947	63,800
Income from discontinued operations	4,716	10,370	21,755	15,488	14,867
Net income	110,781	99,119	103,397	86,435	78,667
Preferred stock cash dividends	(11,362)	(9,403)	(9,455)	(9,713)	(9,713)
Excess of redemption value over carrying value of preferred shares redeemed			(3,774)		
Net income available to common stockholders	99,419	89,716	90,168	76,722	68,954
Cash distributions paid to common stockholders	129,667	108,575	97,420	83,842	78,042
Ratio of earnings to fixed charges (1)	2.9 times	3.2 times	3.9 times	4.1 times	4.3 times
Ratio of earnings to combined fixed charges and preferred stock cash dividends (1)	2.4 times	2.6 times	3.1 times	3.0 times	3.0 times
Basic net income per common share	1.11	1.12	1.15	1.08	1.02
Diluted net income per common share	1.11	1.12	1.15	1.08	1.01
Cash distributions paid per common share	1.43725	1.34625	1.24125	1.18125	1.15125
Cash distributions declared per common share	1.44750	1.35250	1.25125	1.18375	1.15375
Basic weighted average number of common shares outstanding	89,766,714	79,950,255	78,518,296	71,128,282	67,867,498
Diluted weighted average number of common shares outstanding	89,917,554	80,208,593	78,598,788	71,222,628	67,976,314

(1) Ratio of Earnings to Fixed Charges is calculated by dividing earnings by fixed charges. For this purpose, earnings consist of net income before interest expense, including the amortization of debt issuance costs and interest classified to discontinued operations. Fixed charges are comprised of interest costs (including capitalized interest), the amortization of debt issuance costs and interest classified to discontinued operations. In computing the ratio of earnings to combined fixed charges and preferred stock cash dividends, preferred stock cash dividends consist of dividends on our Class B preferred stock, Class C preferred stock and our outstanding Class D and Class E preferred stock. We redeemed our Class B preferred stock in June 2004 and our Class C preferred stock in July 2004. We issued 4,000,000 shares of our 7-3/8% Class D preferred stock in May 2004, 1,100,000 shares of our 7-3/8% Class D preferred stock in October 2004, and 8,800,000 shares of our 6.75% Class E preferred stock in December 2006.

Item 7: **Management s Discussion and Analysis of Financial Condition and Results of Operations**

GENERAL

Realty Income Corporation, The Monthly Dividend Company®, is a Maryland corporation organized to operate as an equity real estate investment trust, or REIT. Our primary business objective is to generate dependable monthly cash distributions from a consistent and predictable level of funds from operations, or FFO per share. The monthly distributions are supported by the cash flow from our portfolio of retail properties leased to regional and national retail chains. We have in-house acquisition, leasing, legal, retail research, real estate research, portfolio management and capital markets expertise. Over the past 38 years, Realty Income and its predecessors have been acquiring and owning freestanding retail properties that generate rental revenue under long-term lease agreements (primarily 15- to 20-years).

In addition, we seek to increase distributions to stockholders and FFO per share through both active portfolio management and the acquisition of additional properties. At December 31, 2006, we owned a diversified portfolio:

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

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

In addition, at December 31, 2006, our wholly-owned taxable REIT subsidiary, Crest Net Lease, Inc. (Crest), had invested $137.5 million in 60 properties, which are classified as held for sale. Crest was created to buy and sell properties, primarily to individual investors, many of whom are involved in tax-deferred exchanges under Section 1031 of the Internal Revenue Code of 1986, as amended (the Tax Code).

LIQUIDITY AND CAPITAL RESOURCES

Cash Reserves

Realty Income is organized to operate as an equity REIT that acquires and leases properties and distributes to stockholders, in the form of monthly cash distributions, a substantial portion of its net cash flow generated from leases on its retail properties. We intend to retain an appropriate amount of cash as working capital. At December 31, 2006, we had cash and cash equivalents totaling $10.6 million.

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

$300 Million Acquisition Credit Facility

We have a $300 million revolving, unsecured credit facility that expires in October 2008. Realty Income s current investment grade credit ratings provide for financing under the credit facility at the London Interbank Offered Rate, commonly referred to as LIBOR, plus 65 basis points with a facility fee of 15 basis points, for all-in drawn pricing of 80 basis points over LIBOR. At February 13, 2007, we had borrowing capacity of $300 million available on our credit facility and no outstanding balance.

The credit facility is expected to be used to acquire additional retail properties and for other corporate purposes. Any additional borrowings will increase our exposure to interest rate risk. We have the right to request an increase in the borrowing capacity of the credit facility by up to $100 million, to a total borrowing capacity of $400 million. Any increase in the borrowing capacity is subject to approval by the lending banks of our credit facility.

Mortgage Debt

We have no mortgage debt on any of our properties.

Universal Shelf Registration

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

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

Issuances of Common Stock

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

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

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

Issuance of Preferred Stock

In December 2006, we issued 8.8 million shares of 6-$^{3}/_{4}$% Class E cumulative redeemable preferred stock, with a liquidation value of $25 per share. The net proceeds of $214 million from this issuance were used to repay borrowings under our credit facility and for other general corporate purposes.

Redemption of 2007 Notes

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

Issuance of 10-Year Senior Unsecured Notes

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

Conservative Capital Structure

We believe that our stockholders are best served by a conservative capital structure. Therefore, we seek to maintain a conservative debt level on our balance sheet and solid interest and fixed charge coverage ratios. At February 13, 2007, our total outstanding credit facility borrowings and outstanding notes were $920 million or approximately 21.9% of our total market capitalization of $4.21 billion. We define our total market capitalization at February 13, 2007 as the sum of:

Shares of our common stock outstanding of 101,000,536 multiplied by the last reported sales price of our common stock on the NYSE of $29.09 per share, or $2.94 billion;

Aggregate liquidation value of the Class D preferred stock of $127.5 million;

Aggregate liquidation value of the Class E preferred stock of $220 million; and

Outstanding notes of $920 million.

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

Credit Agency Ratings

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

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

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

Notes Outstanding

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

		At December 31, 2006
8-$^{1}/_{4}$% senior notes, issued in October 1998 and due in 2008	$	100,000
8% senior unsecured notes, issued in January 1999 and due in 2009		20,000
5-$^{3}/_{8}$% senior unsecured notes, issued in March 2003 and due in 2013		100,000
5-$^{1}/_{2}$% senior unsecured notes, issued in November 2003 and due in 2015		150,000
5.95% senior unsecured notes, issued in September 2006 and due in 2016		275,000
5-$^{3}/_{8}$% senior unsecured notes, issued in September 2005 and due in 2017		175,000
5-$^{7}/_{8}$% senior unsecured bonds, issued in March 2005 and due in 2035		100,000
	$	920,000

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Interest on all of the senior note obligations is paid semiannually, with the exception of the interest on the 8-$^{1}/_{4}$ % senior notes issued in October 1998, which is paid monthly. All of these notes contain various covenants, including: (i) a limitation on incurrence of any debt which would cause our debt to total adjusted assets ratio to exceed 60%; (ii) a limitation on incurrence of any secured debt which would cause our secured debt to total adjusted assets ratio to exceed 40%; (iii) a limitation on incurrence of any debt which would cause our debt service coverage ratio to be less than 1.5 times; and (iv) the maintenance at all times of total unencumbered assets not less than 150% of our outstanding unsecured debt. We have been in compliance with these covenants since each of the notes were issued.

The following is a summary of the key financial covenants to our senior unsecured notes. The actual amounts are as of December 31, 2006.

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

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

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

<u>Table of Obligations</u>

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

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

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

(3) Other consists of $16.4 million of estimated unfunded costs on properties under development and $806,000 of contingent payments for tenant improvements and leasing costs.

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

Preferred Stock Outstanding

In May and October 2004, we issued an aggregate of 5.1 million shares of 7-$^{3}/_{8}$ % Class D cumulative redeemable preferred stock. Beginning May 27, 2009, shares of Class D preferred stock are redeemable at our option for $25.00 per share, plus any accrued and unpaid dividends. Dividends on shares of Class D preferred stock are paid monthly in arrears.

In December 2006, we issued 8.8 million shares of 6-$^{3}/_{4}$% Class E cumulative redeemable preferred stock. Beginning December 7, 2011, shares of Class E preferred stock are redeemable at our option for $25 per share, plus any accrued and unpaid dividends. Dividends on shares of Class E preferred stock are paid monthly in arrears.

No Off-Balance Sheet Arrangements or Unconsolidated Investment

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

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

Acquisitions During 2006

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

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

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

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

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

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

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

Investments in Existing Properties

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

Sales of Investment Properties

During 2006, we sold or exchanged 13 properties for $10.7 million, which resulted in a gain of $3.0 million. This gain is included in discontinued operations. The 13 properties sold or exchanged consisted of one automotive parts store, one automotive service facility, one child care facility, two convenience stores, and eight restaurants. The net proceeds from the sale of these properties were used to repay outstanding indebtedness on our credit facility and to invest in new properties.

Crest Property Sales

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

Crest Property Inventory

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

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

Increases in Monthly Cash Distributions to Common Stockholders

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

The monthly distribution of $0.1265 per share represents a current annualized distribution of $1.518 per share, and an annualized distribution yield of approximately 5.2% based on the last reported sale price of our common stock on the NYSE of $29.09 on February 13, 2007. Although we expect to continue our policy of paying monthly distributions, we cannot guarantee that we will maintain the current level of distributions, that we will continue our pattern of increasing distributions per share, or what the actual distribution yield will be in any future period.

RESULTS OF OPERATIONS

Critical Accounting Policies

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

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

Another significant judgment must be made as to if, and when, impairment losses should be taken on our properties when events or a change in circumstances indicate that the carrying amount of the asset may not be recoverable. Generally, a provision is made for impairment loss if estimated future operating cash flows (undiscounted and without interest charges) plus estimated disposition proceeds (undiscounted) are less than the current book value. Impairment losses are measured as the amount by which the current book value of the asset exceeds the fair value of the asset. If a property is held for sale, it is carried at the lower of carrying cost or estimated fair value, less cost to sell. The carrying value of our real estate is the largest component of our consolidated balance sheet. If events should occur that require us to reduce the carrying value of our real estate by recording provisions for impairment losses, it could have a material impact on our results of operations.

The following is a comparison of our results of operations for the years ended December 31, 2006, 2005 and 2004.

Rental Revenue

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

The 322 retail properties acquired by Realty Income in 2006, which generated $15.7 million of rent in 2006;

The 135 retail properties acquired by Realty Income in 2005, which generated $33.5 million of rent in 2006 compared to $12.1 million in 2005, an increase of $21.4 million;

Same store rents generated on 1,421 properties leased during the entire years of 2006 and 2005 increased by $1.3 million, or 0.7%, to $175.3 million from $174.0 million.

An increase in straight-line rent and other non-cash adjustments to rent of $155,000 in 2006 as compared to 2005; and

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

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

Primarily base rent increases tied to a consumer price index;

Fixed increases;

To a lesser degree, overage rent based on a percentage of the tenants gross sales; or

A combination of two or more of the above rent provisions.

Percentage rent, which is included in rental revenue, was $1.1 million in 2006, $1.2 million in 2005 and $1.3 million in 2004. Percentage rent in 2006 was less than 1% of rental revenue and we anticipate percentage rent to be less than 1% of rental revenue in 2007.

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

As of February 13, 2007, transactions to lease or sell four of the 26 properties available for lease at December 31, 2006 were underway or completed. We anticipate these transactions will be completed during the next several months, although we cannot guarantee that all of these properties can be leased or sold within this period. It has been our experience that approximately 1% to 3% of our property portfolio will be unleased at any given time; however, we cannot assure you that the number of properties available for lease will not exceed these levels.

Interest Expense

Interest expense was $10.4 million higher in 2006 than in 2005. Interest expense increased in 2006 primarily due to higher average outstanding balances, which was partially offset by slightly lower interest rates related to our average outstanding borrowings. We issued $275 million of 10-year notes in September 2006, $175 million of 12-year notes in September 2005 and $100 million of 30-year bonds in March 2005, which contributed to the increase in average outstanding balances and slightly lower average interest rates on our debt.

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

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

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

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

Interest Coverage Ratio

Our interest coverage ratio for 2006 was 4.1 times, for 2005 was 4.4 times and for 2004 was 5.0 times. Interest coverage ratio is calculated as: the interest coverage amount (as calculated in the following table) divided by interest expense, including interest recorded to discontinued operations. We consider interest coverage ratio to be an appropriate supplemental measure of a company s ability to meet its interest expense obligations. Our calculation of interest coverage ratio may be different from the calculation used by other companies and, therefore, comparability may be limited. This information should not be considered as an alternative to any GAAP liquidity measures.

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

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

(1) Crest activities.

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

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

Fixed Charge Coverage Ratio

Our fixed charge coverage ratio for 2006 was 3.4 times, for 2005 was 3.6 times and for 2004 was 3.9 times. Fixed charge coverage ratio is calculated in exactly the same manner as interest coverage ratio, except that preferred stock dividends are also added to the denominator. We consider fixed charge coverage ratio to be an appropriate supplemental measure of a company s ability to make its interest and preferred stock dividend payments. Our calculation of the fixed charge coverage ratio may be different from the calculation used by other companies and, therefore, comparability may be limited. This information should not be considered as an alternative to any GAAP liquidity measures.

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

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

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

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

Depreciation and Amortization

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

General and Administrative Expenses

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

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

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

Property Expenses

Property expenses are broken down into costs associated with non-net leased multi-tenant properties, unleased single-tenant properties and general portfolio expenses. Expenses related to the multi-tenant and unleased single-tenant properties include, but are not limited to, property taxes, maintenance, insurance, utilities, property inspections, bad debt expense and legal fees. General portfolio costs include, but are not limited to, insurance, legal, bad debt expense, property inspections and title search fees. At December 31, 2006, 26 properties were available for lease, as compared to 25 at December 31, 2005 and 32 at December 31, 2004.

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

Income Taxes

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

In addition, Crest incurred state and federal income taxes of $494,000 in 2006 as compared to $943,000 in 2005 and $3.5 million in 2004. The decrease in Crest s 2006 income taxes over the 2005 and 2004 income taxes are due to lower taxable income, primarily attributable to lower gain on sales of real estate acquired for re-sale. These amounts are included in income from discontinued operations, from real estate acquired for resale by Crest.

Loss on Extinguishment of Debt

In September 2006, we redeemed all of our outstanding $110 million, 7-¾%, unsecured notes due May 2007. The 2007 Notes were redeemed at a redemption price equal to 100% of the principal amount, plus accrued and unpaid interest of $3.2 million and a make-whole payment of $1.6 million. We recorded a loss on extinguishment of debt totaling $1.6 million related to the make-whole payment associated with the 2007 Notes. For 2006, the make-whole payment represented approximately $0.017 per share.

Discontinued Operations

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

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

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

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

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

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

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

The above per share amounts have each been calculated independently.

Gain on Sales of Real Estate Acquired for Resale by Crest

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

At December 31, 2006, Crest had $137.5 million invested in 60 properties, which are held for sale. Crest generally carries a real estate inventory in excess of $20 million. Crest generates an earnings spread on the difference between the lease payments it receives on the properties held in inventory and the cost of capital used to acquire properties. It is our belief that at this level of inventory, rental revenue will exceed the ongoing operating expenses of Crest without any property sales.

Gain on Sales of Investment Properties by Realty Income

In 2006, we sold or exchanged 13 investment properties for $10.7 million, which resulted in a gain of $3.0 million, which is included in discontinued operations. In 2005, we sold 23 investment properties and sold a portion of the land from two properties for $23.4 million and recognized a gain on sales of $6.6 million, which is included in discontinued operations, except for $18,000 that is included in other revenue. In 2004, we sold or exchanged 43 investment properties and sold a portion of the land from four properties for a total of $35.4 million and recognized a gain of $12.7 million, which is included in discontinued operations, except for $185,000 that is included in other revenue.

We have an active portfolio management program that incorporates the sale of assets when we believe the reinvestment of the sale proceeds will generate higher returns, enhance the credit quality of our real estate portfolio or extend our average remaining lease term. At December 31, 2006, we classified real estate with a carrying amount of $138 million as held for sale on our balance sheet, which includes properties owned by Crest. Additionally, we anticipate selling investment properties from our portfolio that have not yet been specifically identified, from which we anticipate receiving between $10 million and $35 million in proceeds during the next 12 months. We intend to invest these proceeds into new property acquisitions. However, we cannot guarantee that we will sell properties during the next 12 months.

Provisions for Impairment on Real Estate Acquired for Resale by Crest

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

Provisions for Impairment on Realty Income Investment Properties

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

Preferred Stock Cash Dividends and Redemption Charge

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

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

Net Income Available to Common Stockholders

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

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

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

FUNDS FROM OPERATIONS

AVAILABLE TO COMMON STOCKHOLDERS (FFO)

FFO for 2006 increased by $26.2 million, or 20.2%, to $155.8 million as compared to $129.6 million in 2005 and $118.2 million in 2004. The following is a reconciliation of net income available to common stockholders (which we believe is the most comparable Generally Accepted Accounting Principles (GAAP) measure) to FFO. Also presented is information regarding distributions paid to common stockholders and the weighted average number of shares outstanding for the years ended December 31 (dollars in thousands, except per share amounts):

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

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

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

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

Other Non-cash Items and Capitalized Expenditures

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

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

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

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

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

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

IMPACT OF INFLATION

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

Approximately 98.4%, or 1,923, of the 1,955 properties in the portfolio are leased to tenants under net leases where the tenant is responsible for property costs and expenses. Net leases tend to reduce our exposure to rising property expenses due to inflation. Inflation and increased costs may have an adverse impact on our tenants if increases in their operating expenses exceed increases in revenue.

IMPACT OF ACCOUNTING PRONOUNCEMENTS

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

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109.* Interpretation No. 48 applies to all tax positions accounted for under Statement 109, including tax positions acquired in a business combination. Interpretation 48 is effective for us at the beginning of 2007. The impact of adopting Interpretation No. 48 is not expected to have a material effect on our financial position or results of operations.

Item 7A: Quantitative and Qualitative Disclosures about Market Risk

We are exposed to interest rate changes primarily as a result of our credit facility and long-term notes used to maintain liquidity and expand our real estate investment portfolio and operations. Our interest rate risk management objective is to limit the impact of interest rate changes on earnings and cash flow and to lower our overall borrowing costs. To achieve these objectives we issue long-term notes, primarily at fixed rates, and may selectively enter into derivative financial instruments, such as interest rate lock agreements, interest rate swaps and caps in order to mitigate our interest rate risk on a related financial instrument. We were not a party to any derivative financial instruments at December 31, 2006. We do not enter into any derivative transactions for speculative or trading purposes.

Our interest rate risk is monitored using a variety of techniques. The following table presents by year of expected maturity, the principal amounts, average interest rates and fair values as of December 31, 2006. This information is presented to evaluate the expected cash flows and sensitivity to interest rate changes (dollars in millions):

Expected Maturity Data as of December 31, 2006

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

(1) $100 million matures in November 2008.

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

(3) $20 million matures in January 2009.

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

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

The table incorporates only those exposures that exist as of December 31, 2006; it does not consider those exposures or positions that could arise after that date. As a result, our ultimate realized gain or loss, with respect to interest rate fluctuations, would depend on the exposures that arise during the period, our hedging strategies at the time, and interest rates.

All of our outstanding notes and bonds have fixed interest rates. Our credit facility interest rate is variable. At December 31, 2006, our credit facility balance was zero; however, we intend to borrow funds on our credit facility in the future. Based on a hypothetical credit facility borrowing of $50 million, a 1% change in interest rates would change our interest costs by $500,000 per year.

Item 8: Financial Statements and Supplementary Data

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A. Reports of Independent Registered Public Accounting Firm

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Years ended December 31, 2006, 2005 and 2004

D. Consolidated Statements of Stockholders Equity,
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E. Consolidated Statements of Cash Flows,
Years ended December 31, 2006, 2005 and 2004

F. Notes to Consolidated Financial Statements

G. Consolidated Quarterly Financial Data
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H. Schedule III Real Estate and Accumulated Depreciation

Schedules not filed: All schedules, other than that indicated in the Table of Contents, have been omitted as the required information is either not material, inapplicable or the information is presented in the financial statements or related notes.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

Realty Income Corporation:

We have audited the accompanying consolidated financial statements of Realty Income Corporation and subsidiaries as listed in the accompanying table of contents. In connection with our audits of the consolidated financial statements, we also have audited the financial statement Schedule III as listed in the accompanying table of contents. 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, 2006 and 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Realty Income Corporation s internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 20, 2007 expressed an unqualified opinion on management s assessment of, and the effective operation of, internal control over financial reporting.

/s/ KPMG

San Diego, California
February 20, 2007

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

Realty Income Corporation:

We have audited management s assessment, included in the accompanying Management s Report on Internal Control Over Financial Reporting, that Realty Income Corporation maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Realty Income Corporation s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management s assessment and an opinion on the effectiveness of Realty Income Corporation s internal control over financial reporting based on our audit.

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

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

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

In our opinion, management s assessment that Realty Income Corporation maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, Realty Income Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of Realty Income Corporation and subsidiaries as listed in the accompanying table of contents and our report dated February 20, 2007 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG

San Diego, California
February 20, 2007

REALTY INCOME CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

December 31, 2006 and 2005

(dollars in thousands, except per share data)

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

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

REALTY INCOME CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

Years Ended December 31, 2006, 2005 and 2004

(dollars in thousands, except per share data)

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

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

REALTY INCOME CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

Years Ended December 31, 2006, 2005 and 2004

(dollars in thousands)

	Shares of Preferred stock	Shares of Common stock	Preferred stock and paid in capital	Common stock and paid in capital	Distributions in excess of net income	Total
Balance, December 31, 2003	4,125,700	75,818,172	$ 99,368	$ 969,030	$ (240,632)	$ 827,766
Net income					103,397	103,397
Distributions paid and payable					(108,016)	(108,016)
Shares issued in stock offerings, net of offering costs of $3,682		3,200,000		67,918		67,918
Shares issued in stock offerings, net of offering costs of $4,187	5,100,000		123,787			123,787
Preferred shares redeemed	(4,125,700)		(99,368)		(3,774)	(103,142)
Share-based compensation		283,458		2,025		2,025
Balance, December 31, 2004	5,100,000	79,301,630	123,787	1,038,973	(249,025)	913,735
Net income					99,119	99,119
Distributions paid and payable					(118,984)	(118,984)
Shares issued in stock offerings, net of offering costs of $4,980		4,100,000	17	92,659		92,676
Share-based compensation		295,017		2,668		2,668
Balance, December 31, 2005	5,100,000	83,696,647	123,804	1,134,300	(268,890)	989,214
Net income					110,781	110,781
Distributions paid and payable					(144,045)	(144,045)
Shares issued in stock offerings, net of offering costs of $20,911		16,815,000		402,745		402,745
Shares issued in stock offering, net of offering costs of $6,023	8,800,000		213,977			213,977
Share-based compensation		234,579		3,320		3,320
Balance, December 31, 2006	13,900,000	100,746,226	$ 337,781	$ 1,540,365	$ (302,154)	$ 1,575,992

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

REALTY INCOME CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended December 31, 2006, 2005 and 2004

(dollars in thousands)

	2006	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	$ 110,781	$ 99,119	$ 103,397
Adjustments to net income:			
Depreciation and amortization	59,492	46,206	39,696
Income from discontinued operations:			
Real estate acquired for resale	(1,402)	(2,781)	(7,847)
Real estate held for investment	(3,314)	(7,589)	(13,908)
Gain on reinstatement of property carrying value	(716)		
Gain on sale of real estate held for investment		(18)	(185)
Amortization of stock compensation	2,928	2,155	1,426
Amortization of stock option costs	23	12	14
Provisions for impairment on real estate held for investment		151	716
Cash from discontinued operations:			
Real estate acquired for resale	371	(510)	(2,407)
Real estate held for investment	410	1,509	4,184
Investment in real estate acquired for resale	(113,166)	(54,110)	(21,787)
Intangibles acquired in connection with acquisition of real estate acquired for resale		(1,780)	
Proceeds from sales of real estate acquired for resale	22,405	22,195	74,995
Collection of mortgage note receivable by Crest	1,333		
Change in assets and liabilities:			
Accounts receivable and other assets	4,418	(3,292)	1,094
Accounts payable, accrued expenses and other liabilities	3,382	8,290	(1,051)
Net cash provided by operating activities	86,945	109,557	178,337
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from sales of investment properties:			
Continuing operations	2	109	426
Discontinued operations	9,804	22,191	34,175
Acquisition of and additions to investment properties	(654,149)	(417,347)	(195,470)
Intangibles acquired in connection with acquisitions of investment properties	(937)	(9,494)	
Net cash used in investing activities	(645,280)	(404,541)	(160,869)
CASH FLOWS FROM FINANCING ACTIVITIES			
Borrowings from lines of credit	523,200	400,300	280,400
Payments under lines of credit	(659,900)	(287,200)	(283,200)
Proceeds from common stock offerings, net	402,745	92,659	67,918
Proceeds from notes issued, net	271,883	270,266	(28)
Principal payment on notes	(110,000)		
Proceeds from preferred stock offerings, net	213,977		123,787

Redemption of preferred stock			(103,142)
Cash distributions to common stockholders	(129,667)	(108,575)	(97,420)
Cash dividends to preferred stockholders	(9,403)	(9,403)	(9,063)
Proceeds from other common stock issuances	369	500	584
Net cash provided by (used in) financing activities	503,204	358,547	(20,164)
Net increase (decrease) in cash and cash equivalents	(55,131)	63,563	(2,696)
Cash and cash equivalents, beginning of year	65,704	2,141	4,837
Cash and cash equivalents, end of year	$ 10,573	$ 65,704	$ 2,141

For supplemental disclosures, see note 13.

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

REALTY INCOME CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2006, 2005 and 2004

1. Organization and Operation

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

At December 31, 2006, we owned 1,955 properties, located in 48 states, containing over 16.7 million leasable square feet, along with 60 properties owned by our wholly-owned taxable REIT subsidiary, Crest Net Lease, Inc. (Crest). Crest was created to buy and sell properties, primarily to individual investors, many of whom are involved in tax-deferred exchanges, under Section 1031 of the Internal Revenue Code of 1986, as amended (the Tax Code).

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

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

2. Summary of Significant Accounting Policies and Procedures

Federal Income Taxes. We have elected to be taxed as a Real Estate Investment Trust (REIT) under the Tax Code. We believe we have qualified and continue to qualify as a REIT. Under the REIT operating structure, we are permitted to deduct distributions paid to our stockholders and generally will not be required to pay federal corporate income taxes on such income. Accordingly, no provision has been made for federal income taxes in the accompanying consolidated financial statements, except for federal income taxes of Crest, which totaled $396,000 in 2006, $760,000 in 2005 and $2.8 million in 2004 and are included in income from discontinued operations, real estate acquired by Crest.

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

The following reconciles our net income available to common stockholders to taxable income for 2006 (dollars in thousands) (unaudited):

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

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

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

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

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

Discontinued Operations. In accordance with Financial Accounting Standards Board Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS 144)*, Realty Income s operations from one investment property classified as held for sale at December 31, 2006, plus investment properties sold in 2006, 2005 and 2004, are reported as discontinued operations. Their respective results of operations have been reclassified to income from discontinued operations, real estate held for investment. We classify properties as held for sale in accordance with SFAS 144. We do not depreciate properties that are classified as held for sale.

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

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

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

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

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

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

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

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

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

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

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

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

Principles of Consolidation. The accompanying consolidated financial statements include the accounts of Realty Income, Crest and their wholly owned subsidiaries, after elimination of all material intercompany balances and transactions. All of Realty Income s and Crest s subsidiaries are wholly-owned.

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

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

Depreciation and Amortization. Lands, buildings and improvements are recorded at cost and stated at cost. Major replacements and betterments, which improve or extend the life of the asset, are capitalized and depreciated over their estimated useful lives, while ordinary repairs and maintenance are expensed as incurred.

Buildings and improvements that are under redevelopment, or are being developed, are carried at cost and no depreciation is recorded on these assets. Additionally, amounts essential to the development of the property, such as pre-construction costs, development costs, construction costs, interest costs and other costs incurred during the period of development are capitalized. We cease capitalization when the property is available for occupancy upon substantial completion of tenant improvements, but in any event no later than one year from the completion of major construction activity.

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

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

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

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

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

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

Provisions for impairment recorded on investment properties by Realty Income are included on our consolidated statements of income in income from discontinued operations, real estate held for investment , except for $151,000 in 2005 and $716,000 in 2004 which are included in provisions for impairment.

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

Acquired In-place Leases. In accordance with Financial Accounting Standards Board Statement No. 141, *Business*

Combinations (SFAS 141), the fair value of the real estate acquired with in-place operating leases is allocated to the acquired tangible assets, consisting of land, building and improvements, and identified intangible assets and liabilities, consisting of the value of above-market and below-market leases, the value of in-place leases and tenant relationships, based in each case on their fair values.

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

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

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

Share-Based Compensation

Effective January 1, 2002, we adopted the fair value recognition provisions of FASB Statement No. 123, Accounting for Stock-Based Compensation, and starting January 1, 2002, expensed costs for all stock option awards granted, modified, or settled. Stock option awards under the plan vest over periods ranging from one to five years. For the years ended December 31, 2006, 2005 and 2004, respectively, there is no difference between the stock option-based compensation expense included in reported net income and that expense determined under the fair value method for all awards.

Effective January 1, 2006, we adopted FASB Statement No. 123R, Share-Based Payments. Statement No. 123R requires companies to recognize in the income statement the grant-date fair value of stock options and other equity-based compensation issued to employees.

Goodwill. Goodwill is tested for impairment during the second quarter of each year as well as when events or circumstances occur indicating that our goodwill might be impaired. We did not record any new goodwill or impairment on our existing goodwill during 2006, 2005 or 2004.

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

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

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

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

3. Retail Properties Acquired

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

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

In comparison, during 2005, Realty Income and Crest invested $486.6 million, in aggregate, in 156 new retail properties and properties under development. These 156 new retail properties are located in 30 states, contain over 1.9 million leasable square feet and are 100% leased with an average lease term of 15.8 years. Of the $486.6 million invested in 2005, $95.1 million was used to acquire 34 properties with existing leases already in-place with existing retail tenants. In accordance with SFAS 141, Realty Income recorded $10.1 million and Crest recorded $1.8 million as the value of in-place leases and Realty Income recorded $183,000 as the value of above-market rents. In addition, Realty Income recorded $756,000 and Crest recorded $66,000 as the value of below-market rents on these leases. These amounts were recorded to other assets and other liabilities, respectively, on our consolidated balance sheet and are amortized over the lives of the respective leases. The amounts recorded by Crest are included in the calculation of gain on sales of real estate when the properties were sold during 2006 and 2005.

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

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

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

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

4. Credit Facility

We have a $300 million revolving acquisition credit facility that expires in October 2008, unless extended as provided for in the agreement. Under the terms of the credit facility, which commenced in October 2005, the borrowing rate is LIBOR (London Interbank Offered Rate) plus 65 basis points with a facility fee of 15 basis points, for all-in drawn pricing of 80 basis points over LIBOR, based on our current credit ratings. The credit facility offers us other interest rate options as well.

The average borrowing rate on our credit facilities during 2006 was 5.7%, compared to 4.3% in 2005 and 2.4% in 2004 on our previous $250 million credit facility, which expired in October 2005. The increase in the average borrowing rate is due to an increase in LIBOR since the beginning of 2005. Our current credit facility is subject to various leverage and interest coverage ratio limitations. The Company is and has been in compliance with these covenants.

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

5. Notes Payable

In September 2006, we issued $275 million in aggregate principal amount of 5.95% senior unsecured notes due 2016 (the 2016 Notes). The price to the investor for the 2016 Notes was 99.74% of the principal amount for an effective yield of 5.985%. Interest on the 2016 Notes is paid semiannually. The net proceeds of approximately $271.9 million from this offering were used for other general corporate purposes and to redeem the outstanding $110 million 7-3/4% unsecured notes due May 2007 (the 2007 Notes), which were issued in May 1997.

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

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

In March 2005, we issued $100 million in aggregate principal amount of 5-7/8% senior unsecured bonds due 2035 (the 2035 Bonds). The price to the investor for the 2035 Bonds was 98.296% of the principal amount for an effective yield of 5.998%. The net proceeds of approximately $97 million from this offering were used to repay borrowings under our acquisition credit facility and for other general corporate purposes. Interest on the 2035 Bonds is paid semiannually.

In November 2003, we issued $150 million of 5-1/2% senior unsecured notes due 2015 (the 2015 Notes). Interest on the 2015 Notes is payable semiannually.

In March 2003, we issued $100 million of 5-3/8% senior unsecured notes due 2013 (the 2013 Notes). Interest on the 2013 Notes is payable semiannually.

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

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

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

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

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

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

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

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

6. Common Stock Offerings

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

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

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

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

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

7. Preferred Stock Offerings and Redemptions

A. In December 2006, we issued 8.8 million shares of 6-3/4% Monthly Income Class E cumulative redeemable preferred stock, with a liquidation value of $25 per share. The net proceeds of $214 million from this issuance were used to repay borrowings under our credit facility and for other general corporate purposes. Beginning December 7, 2011, the Class E preferred shares are redeemable at our option for $25 per share. Dividends of $0.140625 per share are paid monthly in arrears on the Class E preferred stock.

B. In May 2004, we issued 4.0 million shares of 7-3/8% Monthly Income Class D cumulative redeemable preferred stock, with a liquidation value of $25 per share. The net proceeds of $96.4 million from this issuance were used to redeem a portion of the outstanding Class B and Class C preferred stock, repay borrowings outstanding under our $250 million acquisition credit facility and for other general corporate purposes. Beginning May 27, 2009, the Class D preferred shares are redeemable at our option for $25.00 per share. Dividends of $0.1536459 per share are paid monthly in arrears on the Class D preferred stock.

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

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

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

8. Distributions Paid and Payable

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

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

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

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

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

B. **Preferred Stock.**

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

Dividends of $0.1536459 per share are paid monthly in arrears on the Class D preferred stock. We declared dividends to holders of our Class D preferred stock totaling $9.8 million in 2006, $9.4 million in 2005 and $4.8 million in 2004. The dividends paid per share to our Class D preferred stockholders for 2006 and 2005 of $1.84375 and for 2004 of $1.01406 were characterized for federal income tax purposes as ordinary income.

In May 1999, we issued 2.76 million shares of 9-3/8% Class B cumulative redeemable preferred stock, of which 2,745,700 shares were outstanding for a portion of 2004. On June 6, 2004, all of the outstanding Class B preferred shares were redeemed. We paid dividends to holders of our Class B preferred stock totaling $2.8 million during the first two quarters of 2004. The dividends paid per share to our Class B Preferred stockholders in 2004 of $1.01563 were characterized for federal income tax purposes as ordinary income.

In July 1999, we issued 1.38 million shares of 9-1/2% Class C cumulative redeemable preferred stock, all of which were outstanding for a portion of 2004. On July 30, 2004, all of the outstanding Class C preferred shares were redeemed. We paid monthly dividends to holders of our Class C preferred stock totaling $1.9 million during the first seven months of 2004. The dividends paid per share to our Class C Preferred stockholders in 2004 of $1.37882 were characterized for federal income tax purposes as ordinary income.

9. Operating Leases

A. At December 31, 2006, we owned 1,955 properties in 48 states, excluding 60 properties owned by Crest. Of these 1,955 properties, 1,948, or 99.6%, are single-tenant, retail properties and the remaining seven are multi-tenant, distribution and office properties. At December 31, 2006, 26 properties were vacant and available for lease or sale.

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

Percentage rent for 2006, 2005 and 2004 was $1.1 million, $1.2 million and $1.3 million, respectively, including amounts recorded to discontinued operations.

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

For the years ending December 31,		
2007	$	268,536
2008		257,072
2009		246,422
2010		238,635
2011		231,051
Thereafter		2,252,524
Total	$	3,494,240

B. Major Tenants No individual tenant s rental revenue, including percentage rents, represented more than 10% of our total revenue for each of the years ended December 31, 2006, 2005 or 2004.

10. Gain on Sales of Real Estate Acquired for Resale by Crest

In 2006, Crest sold 13 properties for $22.4 million, which resulted in a gain of $2.2 million. In 2005, Crest sold 12 properties for $23.5 million, which resulted in a gain of $3.3 million. As part of one sale in 2005, Crest provided buyer financing in the form of a $1.3 million promissory note. This note was paid in full in February 2006. In 2004, Crest sold 51 properties for $75 million, which resulted in a gain of $10.3 million. Crest s gains on sales are reported before income taxes and are included in discontinued operations.

11. Gain on Sales of Investment Properties by Realty Income

In 2006, we sold or exchanged 13 investment properties for $10.7 million, which resulted in a gain of $3.0 million, which is included in discontinued operations.

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

In 2004, we sold or exchanged 43 investment properties and sold a portion of the land from four properties for $35.4 million, which resulted in a gain of $12.7 million. Of this gain, $12.5 million is included in discontinued operations and $185,000 is included in other revenue. Included in the 43 properties was one property leased by one of our tenants that we exchanged for another property owned by that tenant (see note 13-H).

12. Fair Value of Financial Instruments

We believe that the carrying values reflected in the consolidated balance sheets at December 31, 2006 and 2005 reasonably approximate the fair values for cash and cash equivalents, accounts receivable, and all liabilities, due to their short-term nature, except for the line of credit payable and notes payable. In making these assessments, we used estimates. The fair value of the line of credit payable approximates its carrying value because its terms are similar to those available in the market place at the balance sheet date. The estimated fair value of the notes payable at December 31, 2006 is $921.9 million and at December 31, 2005 is $755.0 million, based upon the closing market price per note or indicative price per each note at December 31, 2006 and 2005, respectively.

13. Supplemental Disclosures of Cash Flow Information

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

14. Employee Benefit Plan

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

15. Common Stock Incentive Plan

In 2003, our Board of Directors adopted and our stockholders approved the 2003 Incentive Award Plan of Realty Income Corporation (the Stock Plan) to enable us to attract and retain the services of directors, employees and consultants, considered essential to our long-term success, by offering them an opportunity to own stock in Realty Income and/or rights that will reflect our growth, development and financial success. The

Stock Plan was amended and restated by our Board of Directors in February 2006. Under the terms of this plan, the aggregate number of shares of our common stock subject to options, stock purchase rights (SPR), stock appreciation rights (SAR) and other awards will be no more than 3,428,000 shares. The maximum number of shares that may be subject to options, stock purchase rights, stock appreciation rights and other awards granted under the plan to any individual in any calendar year may not exceed 1,600,000 shares. This plan has a term of 10 years from the date it was adopted by our Board of Directors, which was March 12, 2003. To date, we have not issued any SPR or SAR.

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

Stock options were granted with an exercise price equal to the underlying stock s fair market value at the date of grant. Stock options expire ten years from the date they are granted and vest over service periods of one, three, four and five years. No stock options were granted in 2006, 2005 or 2004.

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

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

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

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

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

	2006		2005		2004	
	Number of shares	Weighted average grant price(1)	Number of shares	Weighted average grant price(1)	Number of shares	Weighted average grant price(1)
Outstanding nonvested shares, beginning of year	788,722	$ 17.83	626,868	$ 14.98	475,721	$ 13.70

Shares granted	210,332		21.72	306,241		25.20	218,180		19.94
Shares vested	(125,879)		20.39	(92,811)		16.69	(64,116)		15.16
Shares forfeited	(4,449)		21.35	(51,576)		17.31	(2,370)		18.65
Outstanding nonvested shares, end of year	868,726	$	17.96	788,722	$	17.83	626,868	$	14.98

(1) Grant date fair value.

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

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

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

16. Segment Information

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

The following tables set forth certain information regarding the properties owned by us, classified according to the business of the respective tenants as of December 31, 2006 (dollars in thousands):

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

17 non-reportable segments(1)		38,513		36,267		34,777
Other revenue		2,042		354		1,029
Total revenue	$	240,100	$	196,020	$	173,062

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

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

17. Commitments and Contingencies

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

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

REALTY INCOME CORPORATION AND SUBSIDIARIES

CONSOLIDATED QUARTERLY FINANCIAL DATA

(dollars in thousands, except per share data)

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

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year (2)
2006 (1)					
Total revenue	$ 55,156	$ 56,509	$ 59,297	$ 69,139	$ 240,100
Interest expense	13,198	11,930	12,530	13,706	51,363
Depreciation and amortization expense	13,512	14,791	14,632	16,557	59,492
Other expenses	5,336	5,270	6,521	6,052	23,180
Income from continuing operations	23,110	24,518	25,614	32,824	106,065
Income (loss) from discontinued operations	1,778	2,122	944	(128)	4,716
Net income	24,888	26,640	26,558	32,696	110,781
Net income available to common stockholders	22,537	24,289	24,207	28,386	99,419
Net income per common share:					
Basic	0.27	0.28	0.27	0.29	1.11
Diluted	0.27	0.27	0.27	0.29	1.11
Dividends paid per common share	0.348750	0.350625	0.360250	0.377625	1.437250
2005 (1)					
Total revenue	$ 46,431	$ 47,219	$ 48,877	$ 53,492	$ 196,020
Interest expense	9,058	9,793	10,228	11,869	40,949
Depreciation and amortization expense	10,709	11,146	11,218	13,133	46,206
Other expenses	5,120	4,917	5,370	4,709	20,116
Income from continuing operations	21,544	21,363	22,061	23,781	88,749
Income from discontinued operations	1,959	3,303	1,061	4,047	10,370
Net income	23,503	24,666	23,122	27,828	99,119
Net income available to common stockholders	21,152	22,315	20,771	25,477	89,716
Basic and diluted net income Per common share	0.27	0.28	0.26	0.31	1.12
Dividends paid per common share	0.330000	0.331875	0.337500	0.346875	1.346250

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

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

Item 9: **Changes In and Disagreements With Accountants on Accounting and Financial Disclosure**

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

Item 9A: **Controls and Procedures**

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

As of and for the year ended December 31, 2006, we carried out an evaluation, under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective and were operating at a reasonable assurance level.

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

(1) Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company;

(2) Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and

(3) Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company s assets that could have a material effect on the financial statements.

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

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

Submitted on February 20, 2007 by,

Thomas A Lewis, Chief Executive Officer and Vice Chairman

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

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

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

Item 9B: Other Information

None.

PART III

Item 10: Directors, Executive Officers and Corporate Governance

The information set forth under the captions Director Nominees and Officers of the Company and Compliance with Federal Securities Laws will be included in the definitive proxy statement for the 2007 Annual Meeting of Stockholders, to be filed pursuant to Regulation 14A. The Annual Meeting of Stockholders is presently scheduled to be held on May 15, 2007.

Item 11: Executive Compensation

The information set forth under the caption Executive Compensation will be included in the definitive proxy statement for the 2007 Annual Meeting of Stockholders, to be filed pursuant to Regulation 14A.

Item 12: Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information set forth under the caption Security Ownership of Certain Beneficial Owners and Management will be included in the definitive proxy statement for the 2007 Annual Meeting of Stockholders, to be filed pursuant to Regulation 14A.

Item 13: **Certain Relationships and Related Transactions**

The information set forth under the caption Certain Transactions will be included in the definitive proxy statement for the 2007 Annual Meeting of Stockholders, to be filed pursuant to Regulation 14A.

Item 14: **Principal Accountant Fees and Services**

The information set forth under the caption Principal Accountant Fees and Services will be included in the definitive proxy statement for the 2007 Annual Meeting of Stockholders, to be filed pursuant to Regulation 14A.

PART IV

Item 15: **Exhibits and Financial Statement Schedules**

A. The following documents are filed as part of this report.

1. Financial Statements (see Item 8)

a. Reports of Independent Registered Public Accounting Firm

b. Consolidated Balance Sheets,
December 31, 2006 and 2005

c. Consolidated Statements of Income,
Years ended December 31, 2006, 2005 and 2004

d. Consolidated Statements of Stockholders Equity,
Years ended December 31, 2006, 2005 and 2004

e. Consolidated Statements of Cash Flows,
Years ended December 31, 2006, 2005 and 2004

f. Notes to Consolidated Financial Statements

g. Consolidated Quarterly Financial Data,
(unaudited) for 2006 and 2005

2. Financial Statement Schedule. Reference is made to page F-1 of this report for Schedule III Real Estate and Accumulated Depreciation (electronically filed with the Securities and Exchange Commission, but not included herein).

Schedules not Filed: All schedules, other than those indicated in the Table of Contents, have been omitted as the required information is either not material, inapplicable or the information is presented in the financial statements or related notes.

3. Exhibits

Articles of Incorporation and By-Laws

3.1 Articles of Incorporation of the Company, as amended by amendment No. 1 dated May 10, 2005 and amendment No. 2 dated May 10, 2005 (filed as exhibit 3.1 to the Company s Form 10-Q dated June 30, 2005, and incorporated herein by reference).

3.2 Bylaws of the Company, as amended by amendment No. 1 dated March 20, 2000 and amendment No. 2 dated June 15, 2005 (filed as exhibit 3.2 to the Company s Form 10-Q dated June 30, 2005, and incorporated herein by reference).

3.3 Articles Supplementary to the Articles of Incorporation of the Company classifying and designating the 7.375% Monthly Income Class D Cumulative Redeemable Preferred Stock (filed as exhibit 3.8 to the Company s Form 8-A filed on May 25, 2004 and incorporated herein by reference).

3.4 Articles Supplementary to the Articles of Incorporation of the Company classifying and designating additional shares of the 7.375% Monthly Income Class D Cumulative Redeemable Preferred Stock (filed as exhibit 3.2 to the Company s Form 8-K filed on October 19, 2004 and incorporated herein by reference).

3.5 Articles Supplementary to the Articles of Incorporation of the Company classifying and designating the 6.75% Class E Cumulative Redeemable Preferred Stock (filed as exhibit 3.5 to the Company s Form 8-A filed on December 5, 2006 and incorporated herein by reference).

Instruments defining the rights of security holders, including indentures

4.1 Pricing Committee Resolutions (filed as exhibit 4.2 the Company s Form 8-K, dated October 27, 1998 and incorporated herein by reference).

4.2 Form of 8.25% Notes due 2008 (filed as exhibit 4.3 to Company s Form 8-K, dated October 27, 1998 and incorporated herein by reference).

4.3 Indenture dated as of October 28, 1998 between the Company and The Bank of New York (filed as exhibit 4.1 to the Company s Form 8-K, dated October 27, 1998 and incorporated herein by reference).

4.4 Pricing Committee Resolutions and Form of 8% Notes due 2009 (filed as exhibit 4.2 to the Company s Form 8-K, dated January 21, 1999 and incorporated herein by reference).

4.5 Form of 5-3/8% Senior Notes due 2013 (filed as exhibit 4.2 to the Company s Form 8-K, dated March 5, 2003 and incorporated herein by reference).

4.6 Officer s Certificate pursuant to sections 201, 301 and 303 of the Indenture dated October 28, 1998 between the Company and The Bank of New York, as Trustee, establishing a series of securities entitled 5-3/8% Senior Notes due 2013 (filed as exhibit 4.3 to the Company s Form 8-K, dated March 5, 2003 and incorporated herein by reference).

4.7 Form of 5-1/2% Senior Notes due 2015 (filed as exhibit 4.2 to the Company s Form 8-K, dated November 19, 2003 and incorporated herein by reference).

4.8 Officer s Certificate pursuant to sections 201, 301 and 303 of the Indenture dated October 28, 1998 between the Company and The Bank of New York, as Trustee, establishing a series of securities entitled 5-1/2% Senior Notes due 2015 (filed as exhibit 4.3 to the Company s Form 8-K, dated November 19, 2003 and incorporated herein by reference).

4.9 Form of 5-7/8% Senior Notes due 2035 (filed as exhibit 4.2 to the Company s Form 8-K, dated March 8, 2005 and incorporated herein by reference).

4.10 Officer s Certificate pursuant to section 301 of the Indenture dated October 28, 1998 between the Company and The Bank of New York, as Trustee, establishing a series of securities entitled 5-7/8% Senior Debentures due 2035 (filed as exhibit 4.3 to the Company s Form 8-K, dated March 8, 2005 and incorporated herein by reference).

4.11 Form of 5-3/8% Senior Notes due 2017 (filed as exhibit 4.2 to the Company s Form 8-K, dated September 8, 2005 and incorporated herein by reference).

4.12 Officer s Certificate pursuant to section 301 of the Indenture dated October 28, 1998 between the Company and The Bank of New York, as Trustee, establishing a series of securities entitled 5-3/8% Senior Notes due 2017 (filed as exhibit 4.3 to the Company s Form 8-K, dated September 8, 2005 and incorporated herein by reference).

4.13 Form of 5.95% Senior Notes due 2016 (filed as exhibit 4.2 to the Company s Form 8-K, dated September 6, 2006 and incorporated herein by reference).

4.14 Officer s Certificate pursuant to section 301 of the Indenture dated October 28, 1998 between the Company and The Bank of New York, as Trustee, establishing a series of securities entitled 5.95% Senior Notes due 2016 (filed as exhibit 4.3 to the Company s Form 8-K, dated September 6, 2006 and incorporated herein by reference).

Material Contracts

10.1 $300 million Credit Agreement dated June 17, 2005 (filed as exhibit 10.1 to the Company s Form 8-K filed on June 20, 2005 and incorporated herein by reference).

10.2 Form indemnification agreement between the Company and each executive officer and each director of the Board of Directors of the Company (filed as exhibit 10.1 to the Company s Form 8-K filed on August 26, 2005 and incorporated herein by reference).

10.3 1994 Stock Option and Incentive Plan (filed as Exhibit 4.1 to the Company s Registration Statement on Form S-8 (registration number 33-95708) and incorporated herein by reference).

10.4 First Amendment to the 1994 Stock Option and Incentive Plan, dated June 12, 1997 (filed as Exhibit 10.9 to the Company s Form 8-B and incorporated herein by reference).

10.5 Second Amendment to the 1994 Stock Option and Incentive Plan, dated December 16, 1997, (filed as Exhibit 10.9 to the Company s Form 10-K dated December 31, 1997 and incorporated herein by reference).

10.6 Management Incentive Plan, (filed as Exhibit 10.10 to the Company s Form 10-K dated December 31, 1997 and incorporated herein by reference).

10.7 Form of Nonqualified Stock Option Agreement for Independent Directors, (filed as Exhibit 10.11 to the Company s Form 10-K dated December 31, 1997 and incorporated herein by reference).

10.8 Form of Employment Agreement between the Company and its Executive Officers (incorporated by reference to the Company s Form 8-B12B dated July 29, 1997 and incorporated herein by reference).

10.9 Form of Restricted Stock Agreement between the Company and Executive Officers (filed as exhibit 10.11 to the Company s Form 8-K dated January 1, 2005 and incorporated herein by reference).

10.10 2003 Stock Incentive Award Plan of Realty Income Corporation, as amended and restated February 21, 2006 (filed as exhibit 10.10 to the Company s Form 10-K dated December 31, 2005 and incorporated herein by reference).

10.20 First Amendment to Credit Agreement dated October 16, 2006 to the $300 million Credit Agreement dated June 17, 2005 (filed as exhibit 10.1 to the Company s Form 8-K filed on November 3, 2006 and incorporated herein by reference).

Statement of Ratios

*12.1 Statements re computation of ratios.

Subsidiaries and Consent

*21.1 Subsidiaries of the Company as of January 1, 2007.

*23.1 Consent of Independent Registered Public Accounting Firm.

Certifications

*31.1 Section 302 Certifications as filed by the Chief Executive Officer pursuant to SEC release No. 33-8212 and 34-47551.

*31.2 Section 302 Certifications as filed by the Chief Financial Officer pursuant to SEC release No. 33-8212 and 34-47551.

*32 Section 906 Certifications as furnished by the Chief Executive Officer and the Chief Financial Officer pursuant to SEC release No. 33-8212 and 34-47551.

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* Filed herewith.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

REALTY INCOME CORPORATION

By:	/s/THOMAS A. LEWIS Thomas A. Lewis Vice Chairman of the Board of Directors, Chief Executive Officer	Date: February 20, 2007

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

By:	/s/WILLIAM E. CLARK William E. Clark Chairman of the Board of Directors	Date: February 20, 2007
By:	/s/THOMAS A. LEWIS Thomas A. Lewis Vice Chairman of the Board of Directors, Chief Executive Officer (Principal Executive Officer)	Date: February 20, 2007
By:	/s/KATHLEEN R. ALLEN, Ph.D. Kathleen R. Allen, Ph.D. Director	Date: February 20, 2007
By:	/s/DONALD R. CAMERON Donald R. Cameron Director	Date: February 20, 2007
By:	/s/ROGER P. KUPPINGER Roger P. Kuppinger Director	Date: February 20, 2007

By:	/s/MICHAEL D. MCKEE Michael D. McKee Director	Date: February 20, 2007
By:	/s/RONALD L. MERRIMAN Ronald L. Merriman Director	Date: February 20, 2007
By:	/s/WILLARD H. SMITH JR Willard H. Smith Jr Director	Date: February 20, 2007
By:	/s/PAUL M. MEURER Paul M. Meurer Executive Vice President, Chief Financial Officer and Treasurer (Principal Financial Officer)	Date: February 20, 2007
By:	/s/GREGORY J. FAHEY Gregory J. Fahey Vice President, Controller (Principal Accounting Officer)	Date: February 20, 2007

REALTY INCOME CORPORATION AND SUBSIDIARIES

SCHEDULE III REAL ESTATE AND ACCUMULATED DEPRECIATION

		Initial Cost to Company		Cost Capitalized Subsequent to Acquisition		Gross Amount at Which Carried at Close of Period (Notes 2, 3, 5, 6, 7 and 8)						
Description (Note 1)		Land	Buildings, Improvements and Acquisition Fees	Improvements	Carrying Costs	Land	Buildings, Improvements and Acquisition Fees	Total	Accumulated Depreciation (Note 4)	Date of Construction	Date Acquired	Life on which depreciation in latest Income Statement is Computed (in Months)
Apparel Stores												
Little Rock	AR	1,079,232	2,594,956	34,285	52,746	1,079,232	2,681,987	3,761,219	885,968		07/21/98	300
Mesa	AZ	619,035	867,013	None	43,447	619,035	910,460	1,529,495	294,481		02/11/99	300
Danbury	CT	1,083,296	6,217,688	40,544	6	1,083,296	6,258,238	7,341,534	2,328,749		09/30/97	300
Manchester	CT	1,250,464	5,917,037	3,555	None	1,250,464	5,920,592	7,171,056	2,080,867		03/26/98	300
Manchester	CT	771,660	3,653,539	1,661	None	771,660	3,655,200	4,426,860	1,284,775		03/26/98	300
Staten Island	NY	4,202,093	3,385,021	None	898	4,202,093	3,385,919	7,588,012	1,190,804		03/26/98	300
Automotive Collision Services												
Highlands Ranch	CO	583,289	2,139,057	None	None	583,289	2,139,057	2,722,346	231,020	03/25/04	08/11/03	300
Littleton	CO	601,388	2,169,898	None	None	601,388	2,169,898	2,771,286	87,584	02/02/06	11/12/04	300
Parker	CO	678,768	2,100,854	None	None	678,768	2,100,854	2,779,622	233,641	02/20/04	07/03/03	300
Thornton	CO	693,323	1,896,616	None	None	693,323	1,896,616	2,589,939	152,916	10/05/04	10/15/03	300
Cumming	GA	661,624	1,822,363	None	None	661,624	1,822,363	2,483,987	235,201	09/18/03	12/31/02	300
Douglasville	GA	679,868	1,935,515	None	None	679,868	1,935,515	2,615,383	255,549	08/11/03	12/30/02	300
Morrow	GA	725,948	1,846,315	None	None	725,948	1,846,315	2,572,263	249,187	07/07/03	08/30/02	300
Peachtree City	GA	1,190,380	689,284	None	None	1,190,380	689,284	1,879,664	109,979	12/16/02	09/19/02	300
Ham Lake	MN	192,610	1,930,958	None	None	192,610	1,930,958	2,123,568	157,907	07/01/04	10/31/03	300
Cary	NC	610,389	1,492,235	None	None	610,389	1,492,235	2,102,624	37,306		05/25/06	300
Durham	NC	680,969	1,323,140	None	None	680,969	1,323,140	2,004,109	33,079		05/25/06	300
Wilmington	NC	378,813	1,150,679	None	None	378,813	1,150,679	1,529,492	66,170	07/15/05	12/21/04	300
Bartlett	TN	648,526	1,960,733	None	None	648,526	1,960,733	2,609,259	160,348	08/03/04	10/27/03	300
Automotive Parts												
Millbrook	AL	108,000	518,741	None	65	108,000	518,806	626,806	165,029	12/10/98	01/21/99	300
Montgomery	AL	254,465	502,350	None	None	254,465	502,350	756,815	171,634		06/30/98	300
Blytheville	AR	137,913	509,447	6,000	None	137,913	515,447	653,360	180,060		06/30/98	300
Osceola	AR	88,759	520,047	None	None	88,759	520,047	608,806	177,681		06/30/98	300
Wynne	AR	70,000	547,576	26,595	None	70,000	574,171	644,171	192,983	11/10/98	02/24/99	300
Phoenix	AZ	231,000	513,057	None	88	231,000	513,145	744,145	383,234		11/09/87	300
Phoenix	AZ	71,750	159,359	None	88	71,750	159,447	231,197	119,061		11/19/87	300
Phoenix	AZ	222,950	495,178	None	88	222,950	495,266	718,216	333,752		11/02/89	300
Tucson	AZ	194,250	431,434	None	176	194,250	431,610	625,860	323,752		10/30/87	300
Grass Valley	CA	325,000	384,955	None	None	325,000	384,955	709,955	279,128		05/20/88	300
Jackson	CA	300,000	390,849	None	None	300,000	390,849	690,849	281,709		05/17/88	300
Sacramento	CA	210,000	466,419	None	None	210,000	466,419	676,419	348,361		11/25/87	300
Turlock	CA	222,250	493,627	None	None	222,250	493,627	715,877	367,056		12/30/87	300
Canon City	CO	66,500	147,699	None	146	66,500	147,845	214,345	110,339		11/12/87	300
Denver	CO	141,400	314,056	None	146	141,400	314,202	455,602	234,587		11/18/87	300
Denver	CO	315,000	699,623	None	None	315,000	699,623	1,014,623	508,766		05/16/88	300
Denver	CO	283,500	629,666	None	None	283,500	629,666	913,166	457,893		05/27/88	300
Littleton	CO	252,925	561,758	None	146	252,925	561,904	814,829	414,049		02/12/88	300
Smyrna	DE	232,273	472,855	None	None	232,273	472,855	705,128	158,407		08/07/98	300

Council Bluffs	IA	194,355	431,668	None	6	194,355	431,674	626,029	313,914		05/19/88	300
Boise	ID	158,400	351,812	None	131	158,400	351,943	510,343	255,905		05/06/88	300
Boise	ID	190,080	422,172	None	131	190,080	422,303	612,383	307,070		05/06/88	300
Coeur D Alene	ID	165,900	368,468	None	None	165,900	368,468	534,368	277,638		09/21/87	300

Description (Note 1)		Initial Cost to Company		Cost Capitalized Subsequent to Acquisition		Gross Amount at Which Carried at Close of Period (Notes 2, 3, 5, 6, 7 and 8)						Life on which depreciation in latest Income Statement is Computed (in Months)
		Land	Buildings, Improvements and Acquisition Fees	Improvements	Carrying Costs	Land	Buildings, Improvements and Acquisition Fees	Total	Accumulated Depreciation (Note 4)	Date of Construction	Date Acquired	
Lewiston	ID	138,950	308,612	None	None	138,950	308,612	447,562	232,537		09/16/87	300
Moscow	ID	117,250	260,417	None	None	117,250	260,417	377,667	196,222		09/14/87	300
Nampa	ID	183,743	408,101	None	250	183,743	408,351	592,094	296,933		05/06/88	300
Twin Falls	ID	190,080	422,172	None	131	190,080	422,303	612,383	307,070		05/06/88	300
Peoria	IL	193,868	387,737	None	230	193,868	387,967	581,835	157,190		11/26/96	300
Brazil	IN	183,952	453,831	None	None	183,952	453,831	637,783	141,438		03/31/99	300
Muncie	IN	148,901	645,235	None	645	148,901	645,880	794,781	261,492		11/26/96	300
Princeton	IN	134,209	560,113	None	None	134,209	560,113	694,322	174,563		03/31/99	300
Vincennes	IN	185,312	489,779	None	None	185,312	489,779	675,091	152,642		03/31/99	300
Kansas City	KS	185,955	413,014	None	None	185,955	413,014	598,969	300,345		05/13/88	300
Kansas City	KS	222,000	455,881	None	None	222,000	455,881	677,881	331,479		05/16/88	300
Alma	MI	155,000	600,282	None	None	155,000	600,282	755,282	183,025	04/29/99	02/10/99	300
Lansing	MI	265,000	574,931	23,134	None	265,000	598,065	863,065	185,184	04/30/99	12/03/98	300
Sturgis	MI	109,558	550,274	None	None	109,558	550,274	659,832	176,982		12/30/98	300
Independence	MO	210,643	467,844	None	93	210,643	467,937	678,580	319,132		07/31/89	300
Kansas City	MO	210,070	466,571	None	93	210,070	466,664	676,734	339,338		05/13/88	300
Kansas City	MO	168,350	373,910	None	93	168,350	374,003	542,353	271,955		05/26/88	300
Batesville	MS	190,124	485,670	None	None	190,124	485,670	675,794	164,318		07/27/98	300
Horn Lake	MS	142,702	514,779	None	None	142,702	514,779	657,481	175,881		06/30/98	300
Jackson	MS	248,483	572,522	None	None	248,483	572,522	821,005	163,180		11/16/99	300
Richland	MS	243,565	558,645	None	None	243,565	558,645	802,210	157,366		12/21/99	300
Missoula	MT	163,100	362,249	None	None	163,100	362,249	525,349	271,755		10/30/87	300
Kearney	NE	173,950	344,393	None	None	173,950	344,393	518,343	223,972		05/01/90	300
Omaha	NE	196,000	435,321	None	None	196,000	435,321	631,321	316,566		05/26/88	300
Omaha	NE	199,100	412,042	None	6	199,100	412,048	611,148	298,850		05/27/88	300
Albuquerque	NM	80,500	178,794	None	None	80,500	178,794	259,294	134,129		10/29/87	300
Rio Rancho	NM	211,577	469,923	None	None	211,577	469,923	681,500	346,341		02/26/88	300
Santa Fe	NM	70,000	155,473	None	32	70,000	155,505	225,505	116,641		10/29/87	300
Las Vegas	NV	161,000	357,585	260,000	None	161,000	617,585	778,585	311,589		10/29/87	300
Reno	NV	456,000	562,344	None	None	456,000	562,344	1,018,344	408,885		05/26/88	300
Canton	OH	396,560	597,553	None	None	396,560	597,553	994,113	200,181		08/14/98	300
Hamilton	OH	183,000	515,727	None	None	183,000	515,727	698,727	159,135	04/07/99	12/03/98	300
Hubbard	OH	147,043	481,217	None	None	147,043	481,217	628,260	164,415		06/30/98	300
Albany	OR	152,250	338,153	None	218	152,250	338,371	490,621	255,934		08/24/87	300
Beaverton	OR	210,000	466,419	None	218	210,000	466,637	676,637	353,006		08/26/87	300
Oak Grove	OR	180,250	400,336	None	218	180,250	400,554	580,804	302,994		08/06/87	300
Portland	OR	190,750	423,664	None	218	190,750	423,882	614,632	320,649		08/12/87	300
Portland	OR	147,000	326,493	None	218	147,000	326,711	473,711	247,109		08/26/87	300
Portland	OR	210,000	466,412	None	218	210,000	466,630	676,630	351,456		09/01/87	300
Salem	OR	136,500	303,170	None	218	136,500	303,388	439,888	229,458		08/20/87	300
Butler	PA	339,929	633,078	5,684	None	339,929	638,762	978,691	217,766		08/07/98	300
Dover	PA	265,112	593,341	None	None	265,112	593,341	858,453	202,724		06/30/98	300
Enola	PA	220,228	546,026	None	None	220,228	546,026	766,254	177,465		11/10/98	300
Hanover	PA	132,500	719,511	None	None	132,500	719,511	852,011	212,415	07/26/99	05/13/99	300
Harrisburg	PA	327,781	608,291	None	None	327,781	608,291	936,072	207,831		06/30/98	300
Harrisburg	PA	283,417	352,473	None	None	283,417	352,473	635,890	116,908		09/30/98	300
Lancaster	PA	199,899	774,838	10,913	None	199,899	785,751	985,650	263,270		08/14/98	300
New Castle	PA	180,009	525,774	3,860	None	180,009	529,634	709,643	183,498		06/30/98	300
Reading	PA	379,000	658,722	10,100	None	379,000	668,822	1,047,822	201,217	06/09/99	12/04/98	300

Description (Note 1)		Initial Cost to Company Land	Initial Cost to Company Buildings, Improvements and Acquisition Fees	Cost Capitalized Subsequent to Acquisition Improvements	Cost Capitalized Subsequent to Acquisition Carrying Costs	Gross Amount at Which Carried at Close of Period (Notes 2, 3, 5, 6, 7 and 8) Land	Gross Amount at Which Carried at Close of Period (Notes 2, 3, 5, 6, 7 and 8) Buildings, Improvements and Acquisition Fees	Total	Accumulated Depreciation (Note 4)	Date of Construction	Date Acquired	Life on which depreciation in latest Income Statement is Computed (in Months)
Columbia	TN	273,120	431,716	None	None	273,120	431,716	704,836	130,233		06/30/99	300
Memphis	TN	197,708	507,647	None	248	197,708	507,895	705,603	168,396		09/30/98	300
Amarillo	TX	140,000	419,734	None	None	140,000	419,734	559,734	299,636		09/12/88	300
El Paso	TX	66,150	146,922	None	None	66,150	146,922	213,072	110,219		10/27/87	300
El Paso	TX	56,350	125,156	None	None	56,350	125,156	181,506	93,890		10/27/87	300
Lubbock	TX	42,000	93,284	None	98	42,000	93,382	135,382	70,035		10/26/87	300
Lubbock	TX	49,000	108,831	None	None	49,000	108,831	157,831	81,644		10/29/87	300
Midland	TX	45,500	101,058	None	4	45,500	101,062	146,562	75,814		10/27/87	300
Provo	UT	125,395	278,507	None	523	125,395	279,030	404,425	184,824		01/25/90	300
Bellevue	WA	185,500	411,997	None	225	185,500	412,222	597,722	311,894		08/06/87	300
Bellingham	WA	168,000	373,133	None	117	168,000	373,250	541,250	282,395		08/20/87	300
Hazel Dell	WA	168,000	373,135	None	None	168,000	373,135	541,135	269,569		05/23/88	300
Kenmore	WA	199,500	443,098	None	225	199,500	443,323	642,823	335,432		08/20/87	300
Kennewick	WA	161,350	358,365	None	131	161,350	358,496	519,846	271,280		08/26/87	300
Kent	WA	199,500	443,091	None	117	199,500	443,208	642,708	335,340		08/06/87	300
Lacey	WA	171,150	380,125	None	117	171,150	380,242	551,392	287,687		08/13/87	300
Lakewood	WA	191,800	425,996	None	225	191,800	426,221	618,021	322,489		08/18/87	300
Marysville	WA	168,000	373,135	None	117	168,000	373,252	541,252	282,398		08/20/87	300
Moses Lake	WA	138,600	307,831	None	None	138,600	307,831	446,431	232,969		08/12/87	300
Pasco	WA	161,700	359,142	None	131	161,700	359,273	520,973	271,868		08/18/87	300
Puyallup	WA	173,250	384,795	None	249	173,250	385,044	558,294	290,036		09/15/87	300
Redmond	WA	196,000	435,317	None	225	196,000	435,542	631,542	328,101		09/17/87	300
Renton	WA	185,500	412,003	None	225	185,500	412,228	597,728	310,533		09/15/87	300
Richland	WA	161,700	359,142	None	131	161,700	359,273	520,973	271,868		08/13/87	300
Seattle	WA	162,400	360,697	None	225	162,400	360,922	523,322	273,071		08/20/87	300
Silverdale	WA	183,808	419,777	None	117	183,808	419,894	603,702	316,305		09/16/87	300
Spokane	WA	66,150	146,921	None	None	66,150	146,921	213,071	109,733		11/18/87	300
Tacoma	WA	189,000	419,777	None	117	189,000	419,894	608,894	317,696		08/25/87	300
Tacoma	WA	196,000	435,324	None	117	196,000	435,441	631,441	326,580		10/15/87	300
Vancouver	WA	180,250	400,343	None	215	180,250	400,558	580,808	302,997		08/20/87	300
Walla Walla	WA	170,100	377,793	None	None	170,100	377,793	547,893	285,917		08/06/87	300
Wenatchee	WA	148,400	329,602	None	None	148,400	329,602	478,002	249,446		08/25/87	300
<u>Automotive Service</u>												
Flagstaff	AZ	144,821	417,485	None	None	144,821	417,485	562,306	139,442	04/11/02	08/29/97	300
Mesa	AZ	210,620	475,072	None	None	210,620	475,072	685,692	87,884		05/14/02	300
Phoenix	AZ	189,341	546,984	None	None	189,341	546,984	736,325	101,192		05/14/02	300
Phoenix	AZ	384,608	279,824	None	None	384,608	279,824	664,432	51,765		05/14/02	300
Sierra Vista	AZ	175,114	345,508	None	None	175,114	345,508	520,622	63,917		05/14/02	300
Tucson	AZ	226,596	437,972	None	None	226,596	437,972	664,568	81,023		05/14/02	300
Bakersfield	CA	65,165	206,927	None	None	65,165	206,927	272,092	38,280		05/14/02	300
Chula Vista	CA	313,293	409,654	None	16	313,293	409,670	722,963	174,116	05/01/96	01/19/96	300
Dublin	CA	415,620	1,153,928	None	None	415,620	1,153,928	1,569,548	213,475		05/14/02	300
Folsom	CA	471,813	325,610	None	None	471,813	325,610	797,423	60,236		05/14/02	300
Indio	CA	264,956	265,509	None	None	264,956	265,509	530,465	49,117		05/14/02	300
Los Angeles	CA	580,446	158,876	None	None	580,446	158,876	739,322	29,390		05/14/02	300
Oxnard	CA	186,980	198,236	None	None	186,980	198,236	385,216	36,672		05/14/02	300
Simi Valley	CA	213,920	161,012	None	None	213,920	161,012	374,932	29,785		05/14/02	300
Vacaville	CA	358,067	284,931	None	None	358,067	284,931	642,998	52,710		05/14/02	300

Description (Note 1)		Initial Cost to Company: Land	Initial Cost to Company: Buildings, Improvements and Acquisition Fees	Cost Capitalized Subsequent to Acquisition: Improvements	Cost Capitalized Subsequent to Acquisition: Carrying Costs	Gross Amount at Which Carried at Close of Period (Notes 2, 3, 5, 6, 7 and 8): Land	Gross Amount at Which Carried at Close of Period (Notes 2, 3, 5, 6, 7 and 8): Buildings, Improvements and Acquisition Fees	Gross Amount at Which Carried at Close of Period (Notes 2, 3, 5, 6, 7 and 8): Total	Accumulated Depreciation (Note 4)	Date of Construction	Date Acquired	Life on which depreciation in latest Income Statement is Computed (in Months)
Broomfield	CO	154,930	503,626	None	450	154,930	504,076	659,006	209,365	08/22/96	03/15/96	300
Denver	CO	79,717	369,587	None	41	79,717	369,628	449,345	324,446		10/08/85	300
Thornton	CO	276,084	415,464	None	205	276,084	415,669	691,753	165,500	12/31/96	10/31/96	300
Hartford	CT	248,540	482,460	None	None	248,540	482,460	731,000	198,613		09/30/96	300
Southington	CT	225,882	672,910	None	None	225,882	672,910	898,792	256,716		06/06/97	300
Vernon	CT	81,529	300,518	None	None	81,529	300,518	382,047	54,594		06/27/02	300
Carol City	FL	163,239	262,726	None	None	163,239	262,726	425,965	47,729		06/27/02	300
Jacksonville	FL	76,585	355,066	6,980	124	76,585	362,170	438,755	309,474		12/23/85	300
Lauderdale Lakes	FL	65,987	305,931	None	None	65,987	305,931	371,918	264,370		02/19/86	300
Orange City	FL	99,613	139,008	None	None	99,613	139,008	238,621	25,714		05/14/02	300
Seminole	FL	68,000	315,266	None	124	68,000	315,390	383,390	274,493		12/23/85	300
Sunrise	FL	80,253	372,070	None	None	80,253	372,070	452,323	321,938		02/14/86	300
Tampa	FL	70,000	324,538	None	162	70,000	324,700	394,700	282,572		12/27/85	300
Tampa	FL	67,000	310,629	None	124	67,000	310,753	377,753	270,457		12/27/85	300
Tampa	FL	86,502	401,041	None	141	86,502	401,182	487,684	340,178		07/23/86	300
Atlanta	GA	55,840	258,889	None	130	55,840	259,019	314,859	226,242		11/27/85	300
Bogart	GA	66,807	309,733	None	None	66,807	309,733	376,540	269,619		12/20/85	300
Douglasville	GA	214,771	129,519	None	None	214,771	129,519	344,290	23,959		05/14/02	300
Duluth	GA	222,275	316,925	None	151	222,275	317,076	539,351	114,122	10/24/97	06/20/97	300
Duluth	GA	290,842	110,056	None	None	290,842	110,056	400,898	20,358		05/14/02	300
Gainesville	GA	53,589	248,452	None	None	53,589	248,452	302,041	216,274		12/19/85	300
Kennesaw	GA	266,865	139,425	None	None	266,865	139,425	406,290	25,792		05/14/02	300
Marietta	GA	60,900	293,461	None	124	60,900	293,585	354,485	255,521		12/26/85	300
Marietta	GA	69,561	346,024	None	356	69,561	346,380	415,941	295,106		06/03/86	300
Norcross	GA	244,124	151,831	None	None	244,124	151,831	395,955	28,087		05/14/02	300
Riverdale	GA	58,444	270,961	None	None	58,444	270,961	329,405	235,011		01/15/86	300
Rome	GA	56,454	261,733	None	None	56,454	261,733	318,187	227,835		12/19/85	300
Snellville	GA	253,316	132,124	None	None	253,316	132,124	385,440	24,441		05/14/02	300
Tucker	GA	78,646	364,625	None	5,237	78,646	369,862	448,508	318,360		12/18/85	300
Arlington Hts	IL	441,437	215,983	None	None	441,437	215,983	657,420	39,955		05/14/02	300
Chicago	IL	329,076	255,294	None	None	329,076	255,294	584,370	47,227		05/14/02	300
Round Lake Beach	IL	472,132	236,585	None	None	472,132	236,585	708,717	43,766		05/14/02	300
Westchester	IL	421,239	184,812	None	None	421,239	184,812	606,051	34,188		05/14/02	300
Anderson	IN	232,170	385,661	None	163	232,170	385,824	617,994	139,487		12/19/97	300
Indianapolis	IN	231,384	428,307	None	None	231,384	428,307	659,691	176,320		09/27/96	300
Michigan City	IN	392,638	297,650	(3,065)	None	392,638	294,585	687,223	55,064		05/14/02	300
Warsaw	IN	140,893	228,116	None	None	140,893	228,116	369,009	42,200		05/14/02	300
Olathe	KS	217,995	367,055	None	None	217,995	367,055	585,050	141,313	04/22/97	11/11/96	300
Louisville	KY	56,054	259,881	None	64	56,054	259,945	315,999	226,240		12/17/85	300
Newport	KY	323,511	289,017	None	None	323,511	289,017	612,528	107,363		09/17/97	300
Billerica	MA	399,043	462,240	None	None	399,043	462,240	861,283	179,405		04/02/97	300
East Falmouth	MA	191,302	340,539	None	None	191,302	340,539	531,841	62,998		05/14/02	300
East Wareham	MA	149,680	278,669	None	None	149,680	278,669	428,349	51,551		05/14/02	300
Fairhaven	MA	138,957	289,294	None	None	138,957	289,294	428,251	53,517		05/14/02	300
Gardner	MA	138,990	289,361	None	None	138,990	289,361	428,351	53,529		05/14/02	300
Hyannis	MA	180,653	458,522	None	None	180,653	458,522	639,175	83,298		06/27/02	300
Lenox	MA	287,769	535,273	None	None	287,769	535,273	823,042	166,815		03/31/99	300
Newburyport	MA	274,698	466,449	None	None	274,698	466,449	741,147	84,738		06/27/02	300
North Reading	MA	180,546	351,161	None	None	180,546	351,161	531,707	64,962		05/14/02	300

Description (Note 1)		Initial Cost to Company: Land	Initial Cost to Company: Buildings, Improvements and Acquisition Fees	Cost Capitalized Subsequent to Acquisition: Improvements	Cost Capitalized Subsequent to Acquisition: Carrying Costs	Gross Amount at Which Carried at Close of Period (Notes 2, 3, 5, 6, 7 and 8): Land	Gross Amount at Which Carried at Close of Period (Notes 2, 3, 5, 6, 7 and 8): Buildings, Improvements and Acquisition Fees	Gross Amount at Which Carried at Close of Period (Notes 2, 3, 5, 6, 7 and 8): Total	Accumulated Depreciation (Note 4)	Date of Construction	Date Acquired	Life on which depreciation in latest Income Statement is Computed (in Months)
Orleans	MA	138,212	394,065	None	None	138,212	394,065	532,277	72,900		05/14/02	300
Aberdeen	MD	223,617	225,605	None	None	223,617	225,605	449,222	40,985		06/27/02	300
Capitol Heights	MD	547,173	219,979	(12,319)	None	547,173	207,660	754,833	40,692		05/14/02	300
Clinton	MD	70,880	328,620	None	459	70,880	329,079	399,959	287,620		11/15/85	300
Lexington Park	MD	111,396	335,288	(7,600)	None	111,396	327,688	439,084	62,025		05/14/02	300
Kalamazoo	MI	391,745	296,975	(2,196)	None	391,745	294,779	686,524	54,939		05/14/02	300
Portage	MI	402,409	286,441	(2,112)	None	402,409	284,329	686,738	52,990		05/14/02	300
Southfield	MI	275,952	350,765	None	None	275,952	350,765	626,717	64,890		05/14/02	300
Troy	MI	214,893	199,299	None	None	214,893	199,299	414,192	36,869		05/14/02	300
Minneapolis	MN	58,000	268,903	None	333	58,000	269,236	327,236	234,245		12/18/85	300
St. Cloud	MN	203,338	258,626	None	None	203,338	258,626	461,964	46,984		06/27/02	300
Independence	MO	297,641	233,152	None	None	297,641	233,152	530,793	93,649		12/20/96	300
Asheville	NC	441,746	242,565	None	None	441,746	242,565	684,311	44,872		05/14/02	300
Charlotte	NC	508,100	457,295	None	None	508,100	457,295	965,395	66,308		05/27/03	300
Concord	NC	237,688	357,976	None	5,668	237,688	363,644	601,332	123,718		11/05/97	300
Durham	NC	354,676	361,203	3,400	351	354,676	364,954	719,630	135,582	08/29/97	03/31/97	300
Durham	NC	55,074	255,336	None	121	55,074	255,457	310,531	223,398		11/13/85	300
Fayetteville	NC	224,326	257,733	None	None	224,326	257,733	482,059	93,196		12/03/97	300
Greensboro	NC	286,068	244,606	None	None	286,068	244,606	530,674	45,244		05/14/02	300
Matthews	NC	295,580	338,472	10,000	16,251	295,580	364,723	660,303	125,452	08/28/98	02/27/98	300
Pineville	NC	254,460	355,630	None	151	254,460	355,781	610,241	132,255	08/28/97	04/16/97	300
Raleigh	NC	218,294	319,334	3,905	1,156	218,294	324,395	542,689	117,447	08/01/02	06/20/97	300
Raleigh	NC	89,145	413,301	None	94	89,145	413,395	502,540	362,418		10/28/85	300
Raleigh	NC	398,694	263,621	None	None	398,694	263,621	662,315	97,065		10/01/97	300
Salisbury	NC	235,614	150,592	None	None	235,614	150,592	386,206	27,857		05/14/02	300
Lincoln	NE	337,138	316,958	None	None	337,138	316,958	654,096	58,634		05/14/02	300
Edison	NJ	448,936	238,773	None	None	448,936	238,773	687,709	44,169		05/14/02	300
Glassboro	NJ	182,013	312,480	None	None	182,013	312,480	494,493	56,767		06/27/02	300
Hamilton Square	NJ	422,477	291,555	None	None	422,477	291,555	714,032	53,934		05/14/02	300
Hamilton Township	NJ	265,238	298,167	None	None	265,238	298,167	563,405	55,157		05/14/02	300
Randolph	NJ	452,629	390,163	None	None	452,629	390,163	842,792	72,178		05/14/02	300
Westfield	NJ	705,337	288,720	None	None	705,337	288,720	994,057	53,409		05/14/02	300
Woodbury	NJ	212,788	320,283	None	None	212,788	320,283	533,071	59,249		05/14/02	300
Las Vegas	NV	326,879	359,101	None	None	326,879	359,101	685,980	66,432		05/14/02	300
Las Vegas	NV	316,441	369,768	None	None	316,441	369,768	686,209	68,405		05/14/02	300
Las Vegas	NV	252,169	562,715	None	None	252,169	562,715	814,884	104,100		05/14/02	300
Sparks	NV	326,813	306,311	None	None	326,813	306,311	633,124	56,665		05/14/02	300
Albany	NY	170,589	317,424	None	None	170,589	317,424	488,013	98,922		03/31/99	300
Dansville	NY	181,664	337,991	None	None	181,664	337,991	519,655	105,332		03/31/99	300
East Amherst	NY	260,708	484,788	None	None	260,708	484,788	745,496	151,084		03/31/99	300
East Syracuse	NY	250,609	466,264	None	None	250,609	466,264	716,873	145,308		03/31/99	300
Johnson City	NY	242,863	451,877	None	None	242,863	451,877	694,740	140,824		03/31/99	300
Wellsville	NY	161,331	300,231	None	None	161,331	300,231	461,562	93,564		03/31/99	300
West Amherst	NY	268,692	499,619	None	None	268,692	499,619	768,311	155,706		03/31/99	300

Akron	OH	139,126	460,334	None	None	139,126	460,334	599,460	171,053		09/18/97	300
Beaver Creek	OH	349,091	251,127	None	None	349,091	251,127	600,218	23,020		09/17/04	300
Beavercreek	OH	205,000	492,538	None	None	205,000	492,538	697,538	192,910	02/13/97	09/09/96	300
Canal Winchester	OH	443,751	825,491	None	None	443,751	825,491	1,269,242	131,748		08/21/02	300
Centerville	OH	305,000	420,448	None	None	305,000	420,448	725,448	175,888	07/24/96	06/28/96	300

Description (Note 1)		Initial Cost to Company: Land	Initial Cost to Company: Buildings, Improvements and Acquisition Fees	Cost Capitalized Subsequent to Acquisition: Improvements	Cost Capitalized Subsequent to Acquisition: Carrying Costs	Gross Amount at Which Carried at Close of Period (Notes 2, 3, 5, 6, 7 and 8): Land	Gross Amount at Which Carried at Close of Period (Notes 2, 3, 5, 6, 7 and 8): Buildings, Improvements and Acquisition Fees	Gross Amount at Which Carried at Close of Period (Notes 2, 3, 5, 6, 7 and 8): Total	Accumulated Depreciation (Note 4)	Date of Construction	Date Acquired	Life on which depreciation in latest Income Statement is Computed (in Months)
Cincinnati	OH	211,185	392,210	None	None	211,185	392,210	603,395	49,026		11/03/03	300
Cincinnati	OH	305,556	244,662	None	None	305,556	244,662	550,218	22,427		09/17/04	300
Cincinnati	OH	589,286	160,932	None	None	589,286	160,932	750,218	14,752		09/17/04	300
Cincinnati	OH	159,375	265,842	None	None	159,375	265,842	425,217	24,368		09/17/04	300
Cincinnati	OH	350,000	300,217	None	None	350,000	300,217	650,217	24,518		12/20/04	300
Cinncinati	OH	293,005	201,340	None	None	293,005	201,340	494,345	74,761		09/17/97	300
Cleveland	OH	215,111	216,517	None	None	215,111	216,517	431,628	39,334		06/27/02	300
Columbus	OH	71,098	329,627	None	195	71,098	329,822	400,920	289,470		10/02/85	300
Columbus	OH	75,761	351,247	None	168	75,761	351,415	427,176	308,075		10/24/85	300
Columbus	OH	190,000	260,162	None	None	190,000	260,162	450,162	23,848		09/17/04	300
Columbus	OH	214,737	85,425	None	None	214,737	85,425	300,162	7,830		09/17/04	300
Columbus	OH	432,110	386,553	None	None	432,110	386,553	818,663	56,049		05/27/03	300
Columbus	OH	466,696	548,133	None	None	466,696	548,133	1,014,829	79,478		05/27/03	300
Columbus	OH	337,679	272,484	None	None	337,679	272,484	610,163	24,977		09/17/04	300
Columbus	OH	371,429	278,734	None	None	371,429	278,734	650,163	25,550		09/17/04	300
Columbus	OH	245,036	470,468	None	None	245,036	470,468	715,504	207,790		12/22/95	300
Cuyahoga Falls	OH	253,750	271,400	None	None	253,750	271,400	525,150	24,878		09/17/04	300
Dayton	OH	70,000	324,538	None	271	70,000						