

REALTY INCOME CORP  
Form 10-Q  
April 30, 2015  
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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, DC 20549**

**FORM 10-Q**

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended March 31, 2015, or

Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934

**Commission File Number 1-13374**

**REALTY INCOME CORPORATION**

(Exact name of registrant as specified in its charter)

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**Maryland**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**33-0580106**  
(IRS Employer Identification  
Number)

**11995 El Camino Real, San Diego, California 92130**

(Address of Principal Executive Offices)

Registrant's telephone number, including area code: **(858) 284-5000**

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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

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

There were 232,538,873 shares of common stock outstanding as of April 23, 2015.

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## REALTY INCOME CORPORATION AND SUBSIDIARIES

**CONSOLIDATED BALANCE SHEETS**

March 31, 2015 and December 31, 2014

(dollars in thousands, except per share data)

|                                                                                                                                                                                                                                | 2015<br>(unaudited) | 2014          |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------|---------------|
| <b>ASSETS</b>                                                                                                                                                                                                                  |                     |               |
| Real estate, at cost:                                                                                                                                                                                                          |                     |               |
| Land                                                                                                                                                                                                                           | \$ 3,081,468        | \$ 3,046,372  |
| Buildings and improvements                                                                                                                                                                                                     | 8,221,599           | 8,107,199     |
| Total real estate, at cost                                                                                                                                                                                                     | 11,303,067          | 11,153,571    |
| Less accumulated depreciation and amortization                                                                                                                                                                                 | (1,459,320)         | (1,386,871)   |
| Net real estate held for investment                                                                                                                                                                                            | 9,843,747           | 9,766,700     |
| Real estate held for sale, net                                                                                                                                                                                                 | 9,394               | 14,840        |
| Net real estate                                                                                                                                                                                                                | 9,853,141           | 9,781,540     |
| Cash and cash equivalents                                                                                                                                                                                                      | 12,190              | 3,852         |
| Accounts receivable, net                                                                                                                                                                                                       | 66,831              | 64,386        |
| Acquired lease intangible assets, net                                                                                                                                                                                          | 1,056,845           | 1,039,724     |
| Goodwill                                                                                                                                                                                                                       | 15,425              | 15,470        |
| Other assets, net                                                                                                                                                                                                              | 87,721              | 107,650       |
| Total assets                                                                                                                                                                                                                   | \$ 11,092,153       | \$ 11,012,622 |
| <b>LIABILITIES AND EQUITY</b>                                                                                                                                                                                                  |                     |               |
| Distributions payable                                                                                                                                                                                                          | \$ 45,466           | \$ 43,675     |
| Accounts payable and accrued expenses                                                                                                                                                                                          | 77,594              | 123,287       |
| Acquired lease intangible liabilities, net                                                                                                                                                                                     | 228,191             | 220,469       |
| Other liabilities                                                                                                                                                                                                              | 41,404              | 53,145        |
| Line of credit payable                                                                                                                                                                                                         | 370,000             | 223,000       |
| Term loan                                                                                                                                                                                                                      | 70,000              | 70,000        |
| Mortgages payable, net                                                                                                                                                                                                         | 799,318             | 852,575       |
| Notes payable, net                                                                                                                                                                                                             | 3,785,718           | 3,785,372     |
| Total liabilities                                                                                                                                                                                                              | 5,417,691           | 5,371,523     |
| Commitments and contingencies                                                                                                                                                                                                  |                     |               |
| Stockholders' equity:                                                                                                                                                                                                          |                     |               |
| Preferred stock and paid in capital, par value \$0.01 per share, 69,900,000 shares authorized, 16,350,000 shares issued and outstanding as of March 31, 2015 and December 31, 2014                                             | 395,378             | 395,378       |
| Common stock and paid in capital, par value \$0.01 per share, 370,100,000 shares authorized, 227,031,104 shares issued and outstanding as of March 31, 2015 and 224,881,192 shares issued and outstanding at December 31, 2014 | 6,569,610           | 6,464,987     |
| Distributions in excess of net income                                                                                                                                                                                          | (1,314,952)         | (1,246,964)   |
| Total stockholders' equity                                                                                                                                                                                                     | 5,650,036           | 5,613,401     |
| Noncontrolling interests                                                                                                                                                                                                       | 24,426              | 27,698        |
| Total equity                                                                                                                                                                                                                   | 5,674,462           | 5,641,099     |
| Total liabilities and equity                                                                                                                                                                                                   | \$ 11,092,153       | \$ 11,012,622 |

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



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## REALTY INCOME CORPORATION AND SUBSIDIARIES

**CONSOLIDATED STATEMENTS OF INCOME**

For the three months ended March 31, 2015 and 2014

(dollars in thousands, except per share data) (unaudited)

|                                                            | <b>2015</b> | <b>2014</b> |
|------------------------------------------------------------|-------------|-------------|
| <b>REVENUE</b>                                             |             |             |
| Rental                                                     | \$ 235,122  | \$ 214,122  |
| Tenant reimbursements                                      | 9,963       | 6,427       |
| Other                                                      | 1,782       | 1,023       |
| Total revenue                                              | 246,867     | 221,572     |
| <b>EXPENSES</b>                                            |             |             |
| Depreciation and amortization                              | 98,037      | 89,970      |
| Interest                                                   | 58,468      | 51,720      |
| General and administrative                                 | 12,862      | 12,886      |
| Property (including reimbursable)                          | 13,976      | 10,577      |
| Income taxes                                               | 1,074       | 1,091       |
| Provisions for impairment                                  | 2,087       | 1,683       |
| Total expenses                                             | 186,504     | 167,927     |
| Gain on sales of real estate                               | 7,218       | 1,271       |
| Income from continuing operations                          | 67,581      | 54,916      |
| Income from discontinued operations                        | -           | 3,077       |
| Net income                                                 | 67,581      | 57,993      |
| Net income attributable to noncontrolling interests        | (317)       | (332)       |
| Net income attributable to the Company                     | 67,264      | 57,661      |
| Preferred stock dividends                                  | (6,770)     | (10,482)    |
| Net income available to common stockholders                | \$ 60,494   | \$ 47,179   |
| Amounts available to common stockholders per common share: |             |             |
| Income from continuing operations, basic and diluted       | \$ 0.27     | \$ 0.21     |
| Net income, basic and diluted                              | \$ 0.27     | \$ 0.23     |
| Weighted average common shares outstanding:                |             |             |
| Basic                                                      | 225,346,407 | 207,003,950 |
| Diluted                                                    | 225,825,854 | 207,324,363 |

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

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## REALTY INCOME CORPORATION AND SUBSIDIARIES

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

For the three months ended March 31, 2015 and 2014

(dollars in thousands) (unaudited)

|                                                                                             | <b>2015</b> |    | <b>2014</b> |
|---------------------------------------------------------------------------------------------|-------------|----|-------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                                                 |             |    |             |
| Net income                                                                                  | \$ 67,581   | \$ | 57,993      |
| Adjustments to net income:                                                                  |             |    |             |
| Depreciation and amortization                                                               | 98,037      |    | 89,970      |
| Income from discontinued operations                                                         | -           |    | (3,077)     |
| Amortization of share-based compensation                                                    | 2,552       |    | 2,697       |
| Non-cash rental adjustments                                                                 | (2,449)     |    | (1,942)     |
| Amortization of net premiums on mortgages payable                                           | (1,962)     |    | (2,385)     |
| Amortization of deferred financing costs                                                    | 2,228       |    | 2,585       |
| Gain on sales of real estate                                                                | (7,218)     |    | (1,271)     |
| Provisions for impairment on real estate                                                    | 2,087       |    | 1,683       |
| Cash provided by discontinued operations                                                    | -           |    | 1,290       |
| Change in assets and liabilities                                                            |             |    |             |
| Accounts receivable and other assets                                                        | 892         |    | 9,600       |
| Accounts payable, accrued expenses and other liabilities                                    | (43,896)    |    | (42,947)    |
| Net cash provided by operating activities                                                   | 117,852     |    | 114,196     |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                                                 |             |    |             |
| Investment in real estate                                                                   | (202,781)   |    | (603,980)   |
| Improvements to real estate, including leasing costs                                        | (1,345)     |    | (1,369)     |
| Proceeds from sales of real estate:                                                         |             |    |             |
| Continuing operations                                                                       | 22,274      |    | 5,772       |
| Discontinued operations                                                                     | -           |    | 6,918       |
| Restricted escrow deposits for Section 1031 tax-deferred exchanges and pending acquisitions | 18,083      |    | (460)       |
| Net cash used in investing activities                                                       | (163,769)   |    | (593,119)   |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                                                 |             |    |             |
| Cash distributions to common stockholders                                                   | (126,682)   |    | (113,414)   |
| Cash dividends to preferred stockholders                                                    | (6,770)     |    | (10,482)    |
| Borrowings on line of credit                                                                | 282,000     |    | 732,800     |
| Payments on line of credit                                                                  | (135,000)   |    | (120,700)   |
| Principal payments on mortgages payable                                                     | (51,296)    |    | (1,797)     |
| Redemption of preferred units                                                               | (6,750)     |    | -           |
| Distributions to noncontrolling interests                                                   | (428)       |    | (466)       |
| Proceeds from dividend reinvestment and stock purchase plan, net                            | 102,162     |    | 2,126       |
| Other items, including shares withheld upon vesting                                         | (2,981)     |    | (5,259)     |
| Net cash provided by financing activities                                                   | 54,255      |    | 482,808     |
| Net increase in cash and cash equivalents                                                   | 8,338       |    | 3,885       |
| Cash and cash equivalents, beginning of period                                              | 3,852       |    | 10,257      |
| Cash and cash equivalents, end of period                                                    | \$ 12,190   | \$ | 14,142      |

For supplemental disclosures, see note 16.

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

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REALTY INCOME CORPORATION AND SUBSIDIARIES

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

March 31, 2015

(unaudited)

**1. Management Statement**

The consolidated financial statements of Realty Income Corporation ( Realty Income , the Company , we , our or us ) were prepared from our books and records without audit and include all adjustments (consisting of only normal recurring accruals) necessary to present a fair statement of results for the interim periods presented. Readers of this quarterly report should refer to our audited consolidated financial statements for the year ended December 31, 2014, which are included in our 2014 Annual Report on Form 10-K, as certain disclosures that would substantially duplicate those contained in the audited financial statements have not been included in this report.

At March 31, 2015, we owned 4,378 properties, located in 49 states and Puerto Rico, containing over 71.6 million leasable square feet.

**2. Summary of Significant Accounting Policies and Procedures and Recent Accounting Pronouncements**

A. The accompanying consolidated financial statements include the accounts of Realty Income and other entities for which we make operating and financial decisions (i.e., control), after elimination of all material intercompany balances and transactions. We consolidate entities that we control and record a noncontrolling interest for the portion that we do not own. Noncontrolling interest that was created or assumed as part of a business combination was recognized at fair value as of the date of the transaction (see note 9). We have no unconsolidated investments.

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

C. 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 collectability of accounts



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receivable and appropriate allowances to record. The allowance for doubtful accounts was \$409,000 at March 31, 2015 and \$765,000 at December 31, 2014.

D. We assign a portion of goodwill to our applicable property sales, which results in a reduction of the carrying amount of our goodwill. In order to allocate goodwill to the carrying amount of properties that we sell, we utilize a relative fair value approach based on the original methodology for assigning goodwill. As we sell properties, our goodwill will likely continue to gradually decrease over time.

E. In April 2015, the Financial Accounting Standards Board, or FASB, issued ASU 2015-03, which amends Topic 835, *Other Presentation Matters*. The amendments in the ASU require that debt issuance costs be reported on the balance sheet as a direct reduction of the face amount of the debt instrument they relate to, and should not be classified as a deferred charge, as was previously required under the Accounting Standards Codification. ASU 2015-03 is effective, on a retrospective basis, for interim and annual periods beginning after December 15, 2015; early adoption is permitted. We do not expect the adoption of this ASU to have a material impact on our consolidated financial statements.

Table of Contents**3. Supplemental Detail for Certain Components of Consolidated Balance Sheets**

|                                                                                                     |    |                   |                      |
|-----------------------------------------------------------------------------------------------------|----|-------------------|----------------------|
| A. Acquired lease intangible assets, net, consist of the following (dollars in thousands) at:       |    | March 31,<br>2015 | December 31,<br>2014 |
| Acquired in-place leases                                                                            | \$ | 1,021,247         | \$ 1,005,244         |
| Accumulated amortization of acquired in-place leases                                                |    | (198,976)         | (177,722)            |
| Acquired above-market leases                                                                        |    | 279,650           | 252,581              |
| Accumulated amortization of acquired above-market leases                                            |    | (45,076)          | (40,379)             |
|                                                                                                     | \$ | 1,056,845         | \$ 1,039,724         |
| B. Other assets, net, consist of the following (dollars in thousands) at:                           |    | March 31,<br>2015 | December 31,<br>2014 |
| Deferred financing costs, net                                                                       | \$ | 22,295            | \$ 23,274            |
| Restricted escrow deposits                                                                          |    | 18,300            | 36,540               |
| Notes receivable issued in connection with property sales                                           |    | 18,243            | 18,342               |
| Prepaid expenses                                                                                    |    | 15,166            | 14,137               |
| Impounds related to mortgages payable                                                               |    | 4,868             | 5,789                |
| Credit facility origination costs, net                                                              |    | 3,403             | 4,171                |
| Corporate assets, net                                                                               |    | 2,492             | 2,600                |
| Other items                                                                                         |    | 2,954             | 2,797                |
|                                                                                                     | \$ | 87,721            | \$ 107,650           |
| C. Distributions payable consist of the following declared distributions (dollars in thousands) at: |    | March 31,<br>2015 | December 31,<br>2014 |
| Common stock distributions                                                                          | \$ | 43,069            | \$ 41,268            |
| Preferred stock dividends                                                                           |    | 2,257             | 2,257                |
| Noncontrolling interests distributions                                                              |    | 140               | 150                  |
|                                                                                                     | \$ | 45,466            | \$ 43,675            |
| D. Accounts payable and accrued expenses consist of the following (dollars in thousands) at:        |    | March 31,<br>2015 | December 31,<br>2014 |
| Notes payable - interest payable                                                                    | \$ | 34,617            | \$ 63,919            |
| Accrued costs on properties under development                                                       |    | 11,498            | 18,011               |
| Property taxes payable                                                                              |    | 9,641             | 11,634               |
| Other items                                                                                         |    | 21,838            | 29,723               |
|                                                                                                     | \$ | 77,594            | \$ 123,287           |
| E. Acquired lease intangible liabilities, net, consist of the following (dollars in thousands) at:  |    | March 31,<br>2015 | December 31,<br>2014 |
| Acquired below-market leases                                                                        | \$ | 254,381           | \$ 243,025           |
| Accumulated amortization of acquired below-market leases                                            |    | (26,190)          | (22,556)             |
|                                                                                                     | \$ | 228,191           | \$ 220,469           |
| F. Other liabilities consist of the following (dollars in thousands) at:                            |    | March 31,<br>2015 | December 31,<br>2014 |
| Rent received in advance                                                                            | \$ | 30,933            | \$ 36,122            |
| Security deposits                                                                                   |    | 5,996             | 5,876                |
| Capital lease obligation                                                                            |    | 4,475             | 4,397                |
| Preferred units issued upon entity acquisition                                                      |    | -                 | 6,750                |
|                                                                                                     | \$ | 41,404            | \$ 53,145            |

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**4. Investments in Real Estate**

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

*A. Acquisitions during the First Three Months of 2015 and 2014*

During the first three months of 2015, we invested \$209.9 million in 83 new properties and properties under development or expansion with an initial weighted average contractual lease rate of 6.9%. The 83 new properties and properties under development or expansion are located in 24 states, will contain approximately 1.6 million leasable square feet, and are 100% leased with a weighted average lease term of 15.5 years. The tenants occupying the new properties operate in 12 industries and the property types consist of 74.2% retail, and 25.8% industrial and distribution, based on rental revenue. None of our investments during 2015 caused any one tenant to be 10% or more of our total assets at March 31, 2015.

The \$209.9 million invested during the first three months of 2015 was allocated as follows: \$39.8 million to land, \$121.2 million to buildings and improvements, \$41.6 million to intangible assets related to leases, \$14.1 million to other assets, net, and \$6.8 million to intangible liabilities related to leases and other assumed liabilities. There was no contingent consideration associated with these acquisitions.

The properties acquired during the first three months of 2015 generated total revenues of \$1.5 million and income from continuing operations of \$712,000.

The purchase price allocation for \$197.7 million of the \$209.9 million we invested in during the first three months of 2015 is based on a preliminary measurement of fair value that is subject to change. The allocation for these properties represents our current best estimate of fair value and we expect to finalize the valuations and complete the purchase price allocations in 2015. During the first three months of 2015, we finalized the purchase price allocations for \$147.1 million invested in the fourth quarter of 2014. There were no material changes to our consolidated balance sheets or income statements as a result of these purchase price allocation adjustments.

In comparison, during the first three months of 2014, we invested \$656.7 million in 337 new properties and properties under development or expansion with an initial weighted average contractual lease rate of 7.0%. The 337 new properties and properties under development or expansion, were located in 35 states, contained over 4.5 million leasable square feet and were 100% leased with a weighted average lease term of 14.2 years. The tenants occupying the new properties operate in 15 industries and the property types consist of 87.6% retail, 7.8% industrial and distribution, and 4.6% office, based on rental revenue.

The \$656.7 million invested during the first three months of 2014 was allocated as follows: \$132.2 million to land, \$455.3 million to buildings and improvements, \$74.0 million to intangible assets related to leases, \$901,000 to other assets, net, and \$8.5 million to intangible liabilities related to leases and other assumed liabilities. We also recorded mortgage discounts of \$2.8 million associated with the \$45.9 million of mortgages acquired during the first three months of 2014. There was no contingent consideration associated with these acquisitions.

The properties acquired during the first three months of 2014 contributed total revenues of \$7.9 million and income from continuing operations of \$3.2 million for the three months ended March 31, 2014.

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

In the case of a property under development or expansion, the contractual lease rate is generally fixed such that rent varies based on the actual total investment in order to provide a fixed rate of return. When the lease does not provide for a fixed rate of return on a property under development or expansion, the estimated initial weighted average contractual lease rate is computed as follows: estimated net operating income (determined by the lease) for the first full year of each lease, divided by our projected total investment in the property, including land, construction and capitalized interest costs. Of the \$209.9 million we invested during the first three months of 2015, \$15.3 million was invested in 25 properties under development or expansion with an estimated initial weighted average contractual lease rate of 9.0%. Of the \$656.7 million we invested during the first three months of 2014, \$13.4 million was invested in 13 properties under development or expansion with an estimated initial weighted average contractual lease rate of 8.4%.

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*B. Acquisition Transaction Costs*

Acquisition transaction costs of \$94,000 and \$454,000 were recorded to general and administrative expense on our consolidated statements of income during the first three months of 2015 and 2014, respectively.

*C. Investments in Existing Properties*

During the first three months of 2015, we capitalized costs of \$1.3 million on existing properties in our portfolio, consisting of \$313,000 for re-leasing costs and \$1.0 million for building and tenant improvements. In comparison, during the first three months of 2014, we capitalized costs of \$1.4 million on existing properties in our portfolio, consisting of \$192,000 for re-leasing costs and \$1.2 million for building and tenant improvements.

*D. Properties with Existing Leases*

Of the \$209.9 million we invested during the first three months of 2015, approximately \$114.2 million was used to acquire 14 properties with existing leases. In comparison, of the \$656.7 million we invested in the first three months of 2014, approximately \$403.8 million was used to acquire 90 properties with existing leases. The value of the in-place and above-market leases is recorded to acquired lease intangible assets, net on our consolidated balance sheets, and the value of the below-market leases is recorded to acquired lease intangible liabilities, net on our consolidated balance sheets. The values recorded to all of these intangible values for properties acquired during the first quarter of 2015 are based on a preliminary measurement of fair value that is subject to change.

The values of the in-place leases are amortized as depreciation and amortization expense. The amounts amortized to expense for all of our in-place leases, for the first three months of 2015 and 2014, were \$21.6 million and \$20.1 million, respectively.

The values of the above-market and below-market leases are amortized over the term of the respective leases, including any bargain renewal options, as an adjustment to rental revenue on our consolidated statements of income. The amounts amortized as a net decrease to rental revenue for capitalized above-market and below-market leases for the first three months of 2015 and 2014 were \$1.7 million and \$2.0 million, respectively. If a lease were to be terminated prior to its stated expiration, all unamortized amounts relating to that lease would be recorded to revenue or expense as appropriate.

The following table presents the estimated impact during the next five years and thereafter related to the amortization of the acquired above-market and below-market lease intangibles and the amortization of the in-place lease intangibles for properties held for investment at March 31, 2015 (in thousands):

|      |    | <b>Net increase<br/>(decrease) to<br/>rental revenue</b> |    | <b>Increase to<br/>amortization<br/>expense</b> |
|------|----|----------------------------------------------------------|----|-------------------------------------------------|
| 2015 | \$ | (5,889)                                                  | \$ | 65,083                                          |
| 2016 |    | (7,864)                                                  |    | 86,533                                          |
| 2017 |    | (7,809)                                                  |    | 85,333                                          |
| 2018 |    | (7,549)                                                  |    | 82,889                                          |
| 2019 |    | (6,563)                                                  |    | 72,831                                          |

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|            |    |         |    |         |
|------------|----|---------|----|---------|
| Thereafter |    | 29,291  |    | 429,602 |
| Totals     | \$ | (6,383) | \$ | 822,271 |

**5. Credit Facility**

We have a \$1.5 billion unsecured acquisition credit facility with an initial term that expires in May 2016 and includes, at our election, a one-year extension option. Under this credit facility, our current investment grade credit ratings provide for financing at the London Interbank Offered Rate, commonly referred to as LIBOR, plus 1.075% with a facility commitment fee of 0.175%, for all-in drawn pricing of 1.25% over LIBOR. The borrowing rate is not subject to an interest rate floor or ceiling. We also have other interest rate options available to us under this credit facility. Our credit facility is unsecured and, accordingly, we have not pledged any assets as collateral for this obligation.

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At March 31, 2015, credit facility origination costs of \$3.4 million are included in other assets, net, on our consolidated balance sheet. These costs are being amortized over the remaining term of our \$1.5 billion credit facility.

At March 31, 2015, we had a borrowing capacity of \$1.13 billion available on our credit facility (subject to customary conditions to borrowing) and an outstanding balance of \$370.0 million, as compared to an outstanding balance of \$223.0 million at December 31, 2014.

The weighted average interest rate on outstanding borrowings under our credit facilities was 1.2% during the first three months of 2015 and 2014. At March 31, 2015, the effective interest rate was 1.2%. Our current credit facility is subject to various leverage and interest coverage ratio limitations, and at March 31, 2015, we remain in compliance with these covenants. We regularly review our credit facility and may seek to extend, renew or replace our credit facility, to the extent we deem appropriate.

## **6. Mortgages Payable**

During the first three months of 2015, we made \$51.3 million in principal payments, including the repayment of three mortgages in full for \$49.4 million. No mortgages were assumed during the first three months of 2015.

During the first three months of 2014, we made \$1.8 million in principal payments and assumed mortgages totaling \$45.9 million, excluding net discounts. The mortgages are secured by the properties on which the debt was placed. We expect to pay off the mortgages as soon as prepayment penalties make it economically feasible to do so.

During the first three months of 2014, aggregate net discounts totaling \$2.8 million were recorded upon assumption of mortgages with below-market interest rates. Amortization of our net premiums is recorded as a reduction to interest expense over the remaining term of the respective mortgages, using a method that approximates the effective-interest method.

These mortgages contain customary covenants, such as limiting our ability to further mortgage each applicable property or to discontinue insurance coverage without the prior consent of the lender. At March 31, 2015, we remain in compliance with these covenants.

We did not incur any deferred financing costs on our mortgages assumed in 2014. The balance of our deferred financing costs, which are classified as part of other assets, net, on our consolidated balance sheets, was \$750,000 at March 31, 2015 and \$827,000 at December 31, 2014. These costs are being amortized over the remaining term of each mortgage.

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The following is a summary of all our mortgages payable as of March 31, 2015 and December 31, 2014, respectively (dollars in thousands):

| <b>As Of</b> | <b>Number of Properties(1)</b> | <b>Weighted Average Stated Interest Rate(2)</b> | <b>Weighted Average Effective Interest Rate(3)</b> | <b>Weighted Average Remaining Years Until Maturity</b> | <b>Remaining Principal Balance</b> | <b>Unamortized Premium Balance, net</b> | <b>Mortgage Payable Balance</b> |
|--------------|--------------------------------|-------------------------------------------------|----------------------------------------------------|--------------------------------------------------------|------------------------------------|-----------------------------------------|---------------------------------|
| 3/31/15      | 238                            | 5.0%                                            | 4.0%                                               | 3.7                                                    | \$ 784,715                         | \$ 14,603                               | \$ 799,318                      |
| 12/31/14     | 241                            | 5.0%                                            | 4.0%                                               | 3.7                                                    | \$ 836,011                         | \$ 16,564                               | \$ 852,575                      |

(1) At March 31, 2015, there were 54 mortgages on the 238 properties, while at December 31, 2014, there were 57 mortgages on the 241 properties. The mortgages require monthly payments, with principal payments due at maturity. The mortgages are at fixed interest rates, except for four mortgages on 13 properties totaling \$50.9 million at March 31, 2015, including net unamortized discounts. At December 31, 2014, five mortgages on 14 properties totaling \$74.5 million, including net unamortized discounts, were at variable interest rates. All of these variable rate mortgages were acquired with arrangements which limit our exposure to interest rate risk.

(2) Stated interest rates ranged from 2.0% to 6.9% at March 31, 2015 and December 31, 2014.

(3) Effective interest rates ranged from 2.2% to 9.0% at March 31, 2015 and December 31, 2014.



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The following table summarizes the maturity of mortgages payable, excluding net premiums of \$14.6 million, as of March 31, 2015 (dollars in millions):

| <b>Year of Maturity</b> |    |       |
|-------------------------|----|-------|
| 2015                    | \$ | 68.4  |
| 2016                    |    | 248.4 |
| 2017                    |    | 142.5 |
| 2018                    |    | 15.1  |
| 2019                    |    | 26.0  |
| Thereafter              |    | 284.3 |
| Totals                  | \$ | 784.7 |

**7. Term Loan**

In January 2013, in conjunction with our acquisition of American Realty Capital Trust, Inc., or ARCT, we entered into a \$70 million senior unsecured term loan maturing January 21, 2018. Borrowing under the term loan bears interest at the current one month LIBOR, plus 1.2%. In conjunction with this term loan, we also acquired an interest rate swap which essentially fixes our per annum interest rate on the term loan at 2.15%. Deferred financing costs of \$303,000 are being amortized over the remaining term of the term loan. The net balance of these deferred financing costs, which was \$172,000 at March 31, 2015, and \$187,000 at December 31, 2014, is included in other assets, net on our consolidated balance sheets.

**8. Notes Payable**

*A. General*

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

|                                                                                                |    | March 31,<br>2015 |    | December 31,<br>2014 |
|------------------------------------------------------------------------------------------------|----|-------------------|----|----------------------|
| 5.5% notes, issued in November 2003 and due in November 2015                                   | \$ | 150               | \$ | 150                  |
| 5.95% notes, issued in September 2006 and due in September 2016                                |    | 275               |    | 275                  |
| 5.375% notes, issued in September 2005 and due in September 2017                               |    | 175               |    | 175                  |
| 2.0% notes, issued in October 2012 and due in January 2018                                     |    | 350               |    | 350                  |
| 6.75% notes, issued in September 2007 and due in August 2019                                   |    | 550               |    | 550                  |
| 5.75% notes, issued in June 2010 and due in January 2021                                       |    | 250               |    | 250                  |
| 3.25% notes, issued in October 2012 and due in October 2022                                    |    | 450               |    | 450                  |
| 4.65% notes, issued in July 2013 and due in August 2023                                        |    | 750               |    | 750                  |
| 3.875% notes, issued in June 2014 and due in July 2024                                         |    | 350               |    | 350                  |
| 4.125% notes, issued in September 2014 and due in October 2026                                 |    | 250               |    | 250                  |
| 5.875% bonds, \$100 issued in March 2005 and \$150 issued in June 2011, both due in March 2035 |    | 250               |    | 250                  |

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|                                         |    |       |    |       |
|-----------------------------------------|----|-------|----|-------|
| Total principal amount                  |    | 3,800 |    | 3,800 |
| Unamortized original issuance discounts |    | (14)  |    | (15)  |
|                                         | \$ | 3,786 | \$ | 3,785 |

The following table summarizes the maturity of our notes and bonds payable as of March 31, 2015, excluding unamortized original issuance discounts (dollars in millions):

| Year of Maturity |    | Notes and<br>Bonds |
|------------------|----|--------------------|
| 2015             | \$ | 150                |
| 2016             |    | 275                |
| 2017             |    | 175                |
| 2018             |    | 350                |
| 2019             |    | 550                |
| Thereafter       |    | 2,300              |
| Totals           | \$ | 3,800              |

As of March 31, 2015, the weighted average interest rate on our notes and bonds payable was 4.8% and the weighted average remaining years until maturity was 7.0 years.

Table of Contents**9. Noncontrolling Interests**

In January 2013, we completed our acquisition of ARCT. Equity issued as consideration for this transaction included common and preferred partnership units issued by Tau Operating Partnership, L.P., or Tau Operating Partnership, the consolidated subsidiary which owns properties acquired through the ARCT acquisition. Realty Income and its subsidiaries hold a 99.3% interest in Tau Operating Partnership, and consolidate the entity.

In June 2013, we completed the acquisition of a portfolio of properties by issuing common partnership units in a newly formed entity, Realty Income, L.P. The units were issued as consideration for the acquisition. At March 31, 2015, the remaining units from this issuance represent a 1.7% ownership in Realty Income, L.P. Realty Income holds the remaining 98.3% interests in this entity, and consolidates the entity.

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

The following table represents the change in the carrying value of all noncontrolling interests through March 31, 2015 (dollars in thousands):

|                                     |    | <b>Tau Operating<br/>Partnership units(1)</b> |    | <b>Realty Income, L.P.<br/>units(2)</b> |    | <b>Total</b> |
|-------------------------------------|----|-----------------------------------------------|----|-----------------------------------------|----|--------------|
| Carrying value at December 31, 2014 | \$ | 13,067                                        | \$ | 14,631                                  | \$ | 27,698       |
| Reallocation of equity              |    | 836                                           |    | (1,887)                                 |    | (1,051)      |
| Redemptions                         |    | -                                             |    | (2,120)                                 |    | (2,120)      |
| Distributions                       |    | (180)                                         |    | (238)                                   |    | (418)        |
| Allocation of net income            |    | 73                                            |    | 244                                     |    | 317          |
| Carrying value at March 31, 2015    | \$ | 13,796                                        | \$ | 10,630                                  | \$ | 24,426       |
|                                     |    |                                               |    |                                         |    |              |
|                                     |    | <b>Tau Operating<br/>Partnership units(1)</b> |    | <b>Realty Income, L.P.<br/>units(2)</b> |    | <b>Total</b> |
| Carrying value at December 31, 2013 | \$ | 13,489                                        | \$ | 22,422                                  | \$ | 35,911       |
| Reallocation of equity              |    | -                                             |    | (6,647)                                 |    | (6,647)      |
| Redemptions                         |    | -                                             |    | (1,032)                                 |    | (1,032)      |
| Distributions                       |    | (695)                                         |    | (1,144)                                 |    | (1,839)      |
| Allocation of net income            |    | 273                                           |    | 1,032                                   |    | 1,305        |
| Carrying value at December 31, 2014 | \$ | 13,067                                        | \$ | 14,631                                  | \$ | 27,698       |

(1) 317,022 Tau Operating Partnership units were issued on January 22, 2013 and remained outstanding as of March 31, 2015 and December 31, 2014.

(2) 534,546 Realty Income, L.P. units were issued on June 27, 2013, 499,546 units were outstanding as of December 31, 2014 and 419,546 remain outstanding as of March 31, 2015.

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During the first three months of 2015, we recorded net equity reclassification adjustments of \$1.1 million between noncontrolling interests and additional paid in capital to adjust the carrying value of noncontrolling interests to be in-line with their equity ownership interests in the entities. During the first three months of 2014, we recorded an equity reclassification adjustment of \$6.6 million between noncontrolling interests and additional paid in capital to adjust the carrying value of the Realty Income, L.P. noncontrolling interests to be in-line with their equity ownership interest in the entity.

B. The Tau Operating Partnership preferred units were recorded at fair value as of the date of acquisition. Since they were redeemable at a fixed price on a determinable date, we initially classified them in other liabilities on our consolidated balance sheets. Payments on these preferred units were made monthly at a rate of 2% per annum and were included in interest expense. As of December 31, 2014, the preferred units had a carrying value of \$6.75 million. In January 2015, we redeemed all 6,750 Tau Operating Partnership preferred units for \$1,000 per unit, plus accrued and unpaid distributions.

Table of Contents**10. Fair Value of Financial Instruments**

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

We believe that the carrying values reflected in our consolidated balance sheets reasonably approximate the fair values for cash and cash equivalents, accounts receivable, escrow deposits, loans receivable, line of credit payable, term loan and all other liabilities, due to their short-term nature or interest rates and terms that are consistent with market, except for our notes receivable issued in connection with property sales, mortgages payable and our senior notes and bonds payable, which are disclosed below (dollars in millions):

|                                                                         |    | <b>Carrying value per<br/>balance sheet</b> |    | <b>Estimated fair<br/>value</b> |
|-------------------------------------------------------------------------|----|---------------------------------------------|----|---------------------------------|
| <b>At March 31, 2015</b>                                                |    |                                             |    |                                 |
| Notes receivable issued in connection with property sales               | \$ | 18.2                                        | \$ | 20.1                            |
| Mortgages payable assumed in connection with acquisitions, net          |    | 799.3                                       |    | 809.8                           |
| Notes and bonds payable, net of unamortized original issuance discounts |    | 3,785.7                                     |    | 4,121.5                         |
| <b>At December 31, 2014</b>                                             |    |                                             |    |                                 |
| Notes receivable issued in connection with property sales               | \$ | 18.3                                        | \$ | 20.1                            |
| Mortgages payable assumed in connection with acquisitions, net          |    | 852.6                                       |    | 857.9                           |
| Notes and bonds payable, net of unamortized original issuance discounts |    | 3,785.4                                     |    | 4,092.8                         |

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

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

**11. Gain on Sales of Real Estate**

During the first three months of 2015, we sold nine investment properties for \$22.3 million, which resulted in a gain of \$7.2 million. The results of operations for these properties are presented within continuing operations.

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During the first three months of 2014, Realty Income sold 11 investment properties for \$12.7 million, which resulted in a gain of \$3.9 million. Only the results of operations specifically related to the properties classified as held for sale at December 31, 2013 and sold during the first three months of 2014 have been reclassified as discontinued operations, which was \$2.6 million.

During the first three months of 2015, Crest Net Lease, Inc., or Crest, did not sell any properties. During the first three months of 2014, Crest sold one property for \$820,000, which did not result in a gain. The results of operations for this property were reclassified as discontinued operations.

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**12. Discontinued Operations**

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

Starting with the first quarter of 2014, the results of operations for all qualifying disposals and properties classified as held for sale that were not previously reported in discontinued operations in our 2013 Annual Report on Form 10-K are presented within income from continuing operations on our consolidated statements of income. Prior to the date of adoption of ASU 2014-08, we reported, in discontinued operations, the results of operations of properties that had either been disposed of or classified as held for sale in financial statements issued. For the three months ended March 31, 2014, we recorded income from discontinued operations of \$3.1 million, or \$0.01 per common share, basic and diluted.

**13. Impairments**

We review long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. A provision is made for impairment if estimated future operating cash flows (undiscounted and without interest charges) plus estimated disposition proceeds (undiscounted) are less than the current book value of the property. Key factors that we estimate in this analysis include projected rental rates, estimated holding periods, capital expenditures and property sales capitalization rates. If a property is classified as held for sale, it is carried at the lower of carrying cost or estimated fair value, less estimated cost to sell, and depreciation of the property ceases.

For the first three months of 2015, we recorded total provisions for impairment of \$2.1 million on the following properties in the restaurant-casual dining industry: one sold property, one property classified as held for sale, and one property disposed of other than by sale. For the first three months of 2014, we recorded total provisions for impairment of \$1.7 million on four sold properties in the following industries: one in the consumer electronics industry, one in the home furnishings industry, and two in the restaurant-casual dining industry. These properties were not previously classified as held for sale in financial statements issued prior to the date of adoption of ASU 2014-08; accordingly, the provisions for impairment are included in income from continuing operations on our consolidated statement of income for the three months ended March 31, 2015 and March 31, 2014, respectively.

**14. Distributions Paid and Payable**

A. *Common Stock*

We pay monthly distributions to our common stockholders. The following is a summary of monthly distributions paid per common share for the first three months of 2015 and 2014:

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| Month    |    | 2015      |    | 2014      |
|----------|----|-----------|----|-----------|
| January  | \$ | 0.1834167 | \$ | 0.1821667 |
| February |    | 0.1890000 |    | 0.1821667 |
| March    |    | 0.1890000 |    | 0.1821667 |
| Total    | \$ | 0.5614167 | \$ | 0.5465001 |

At March 31, 2015, a distribution of \$0.1895 per common share was payable and was paid in April 2015.

*B. Class E Preferred Stock*

Prior to the redemption of the Class E preferred stock in October 2014, dividends of \$0.140625 per share were paid monthly in arrears on the Class E preferred stock. During the first three months of 2014, we paid three monthly dividends to holders of our Class E preferred stock totaling \$0.421875 per share, or \$3.7 million.

*C. Class F Preferred Stock*

Dividends of \$0.138021 per share are paid monthly in arrears on the Class F preferred stock. During each of the first three months of 2015 and 2014, we paid three monthly dividends to holders of our Class F preferred stock totaling \$0.414063 per share, or \$6.8 million, and at March 31, 2015, a monthly dividend of \$0.138021 per share was payable and was paid in April 2015.



Table of Contents**15. Net Income Per Common Share**

Basic net income per common share is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during each period. Diluted net income per common share is computed by dividing net income available to common stockholders, plus income attributable to dilutive shares and convertible common units, for the period by the weighted average number of common shares that would have been outstanding assuming the issuance of common shares for all potentially dilutive common shares outstanding during the reporting period.

The following is a reconciliation of the denominator of the basic net income per common share computation to the denominator of the diluted net income per common share computation.

|                                                                                                | <b>Three months ended</b> |             |
|------------------------------------------------------------------------------------------------|---------------------------|-------------|
|                                                                                                | <b>March 31,</b>          |             |
|                                                                                                | <b>2015</b>               | <b>2014</b> |
| Weighted average shares used for the basic net income per share computation                    | 225,346,407               | 207,003,950 |
| Incremental shares from share-based compensation                                               | 162,425                   | 3,391       |
| Weighted average partnership common units convertible to common shares that were dilutive      | 317,022                   | 317,022     |
| Weighted average shares used for diluted net income per share computation                      | 225,825,854               | 207,324,363 |
| Unvested shares from share-based compensation that were anti-dilutive                          | 111,338                   | 194,933     |
| Weighted average partnership common units convertible to common shares that were anti-dilutive | 440,546                   | 534,546     |

**16. Supplemental Disclosures of Cash Flow Information**

Cash paid for interest was \$85.9 million in the first three months of 2015 and \$79.9 million in the first three months of 2014.

Interest capitalized to properties under development was \$94,000 in the first three months of 2015 and \$95,000 in the first three months of 2014.

Cash paid for income taxes was \$1.8 million in the first three months of 2015 and \$942,000 in the first three months of 2014.

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

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- A. See note 13 for a discussion of impairments recorded by Realty Income for the first three months of 2015 and 2014.
- B. During the first three months of 2014, we assumed mortgages payable to third-party lenders of \$45.9 million, recorded \$2.8 million of net discounts, and recorded \$901,000 of interest rate swap value to other assets, net, related to property acquisitions.
- C. During the first three months of 2014, we applied \$48.9 million of loans receivable to the purchase price of five acquired properties.
- D. Accrued costs on properties under development resulted in an increase of \$7.1 million at March 31, 2014.

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**17. 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 48 activity segments. All of the properties are incorporated into one of the applicable segments. Because almost all of our leases require the tenant to pay operating expenses, rental revenue is the only component of segment profit and loss we measure.

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The following tables set forth certain information regarding the properties owned by us, classified according to the business of the respective tenants, as of March 31, 2015 (dollars in thousands):

| <b>Assets, as of:</b>            | <b>March 31,<br/>2015</b> | <b>December 31,<br/>2014</b> |
|----------------------------------|---------------------------|------------------------------|
| Segment net real estate:         |                           |                              |
| Apparel                          | \$ 187,016                | \$ 188,387                   |
| Automotive service               | 131,420                   | 119,684                      |
| Automotive tire services         | 252,785                   | 254,857                      |
| Beverages                        | 300,932                   | 302,001                      |
| Child care                       | 53,647                    | 54,523                       |
| Convenience stores               | 746,209                   | 752,047                      |
| Dollar stores                    | 1,156,416                 | 1,165,560                    |
| Drug stores                      | 1,057,256                 | 1,036,697                    |
| Financial services               | 260,145                   | 262,095                      |
| Grocery stores                   | 336,052                   | 338,624                      |
| Health and fitness               | 541,941                   | 546,583                      |
| Health care                      | 224,982                   | 227,084                      |
| Home improvement                 | 229,131                   | 226,577                      |
| Restaurants-casual dining        | 444,247                   | 450,337                      |
| Restaurants-quick service        | 376,562                   | 336,753                      |
| Theaters                         | 375,636                   | 375,982                      |
| Transportation services          | 659,753                   | 661,053                      |
| Wholesale club                   | 462,317                   | 465,569                      |
| 30 other non-reportable segments | 2,056,694                 | 2,017,127                    |
| Total segment net real estate    | 9,853,141                 | 9,781,540                    |
| Intangible assets:               |                           |                              |
| Apparel                          | 51,580                    | 52,680                       |
| Automotive service               | 20,111                    | 2,909                        |
| Automotive tire services         | 14,453                    | 14,871                       |
| Beverages                        | 2,732                     | 2,797                        |
| Convenience stores               | 17,161                    | 17,535                       |
| Dollar stores                    | 57,352                    | 58,691                       |
| Drug stores                      | 197,445                   | 194,905                      |
| Financial services               | 38,330                    | 39,564                       |
| Grocery stores                   | 45,719                    | 46,729                       |
| Health and fitness               | 65,189                    | 66,460                       |
| Health care                      | 33,750                    | 35,017                       |
| Home improvement                 | 36,946                    | 35,726                       |
| Restaurants-casual dining        | 10,335                    | 10,649                       |
| Restaurants-quick service        | 21,623                    | 16,415                       |
| Theaters                         | 20,561                    | 21,601                       |
| Transportation services          | 97,902                    | 101,040                      |
| Wholesale club                   | 38,834                    | 39,707                       |
| Other non-reportable segments    | 286,822                   | 282,428                      |
| Goodwill:                        |                           |                              |
| Automotive service               | 448                       | 452                          |
| Automotive tire services         | 865                       | 865                          |
| Child care                       | 5,064                     | 5,095                        |
| Convenience stores               | 2,023                     | 2,023                        |
| Restaurants-casual dining        | 2,269                     | 2,279                        |
| Restaurants-quick service        | 1,085                     | 1,085                        |
| Other non-reportable segments    | 3,671                     | 3,671                        |
| Other corporate assets           | 166,742                   | 175,888                      |
| Total assets                     | \$ 11,092,153             | \$ 11,012,622                |



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| <b>Revenue for the three months ended March 31,</b> | <b>2015</b> |         | <b>2014</b> |         |
|-----------------------------------------------------|-------------|---------|-------------|---------|
| Segment rental revenue:                             |             |         |             |         |
| Apparel                                             | \$          | 5,004   | \$          | 3,800   |
| Automotive service                                  |             | 4,232   |             | 3,994   |
| Automotive tire services                            |             | 7,069   |             | 7,052   |
| Beverages                                           |             | 6,328   |             | 6,253   |
| Child care                                          |             | 5,019   |             | 4,988   |
| Convenience stores                                  |             | 22,545  |             | 22,105  |
| Dollar stores                                       |             | 21,947  |             | 19,523  |
| Drug stores                                         |             | 22,568  |             | 20,264  |
| Financial services                                  |             | 4,264   |             | 4,122   |
| Grocery stores                                      |             | 7,283   |             | 5,891   |
| Health and fitness                                  |             | 16,015  |             | 14,848  |
| Health care                                         |             | 4,017   |             | 3,987   |
| Home improvement                                    |             | 5,178   |             | 2,771   |
| Restaurants-casual dining                           |             | 9,506   |             | 9,757   |
| Restaurants-quick service                           |             | 10,395  |             | 8,729   |
| Theaters                                            |             | 12,190  |             | 11,529  |
| Transportation services                             |             | 12,951  |             | 11,282  |
| Wholesale club                                      |             | 9,341   |             | 8,751   |
| 30 other non-reportable segments                    |             | 49,270  |             | 44,476  |
| Total rental revenue                                |             | 235,122 |             | 214,122 |
| Tenant reimbursements                               |             | 9,963   |             | 6,427   |
| Other revenue                                       |             | 1,782   |             | 1,023   |
| Total revenue                                       | \$          | 246,867 | \$          | 221,572 |

**18. Common Stock Incentive Plan**

In 2012, our Board of Directors adopted and stockholders approved the Realty Income Corporation 2012 Incentive Award Plan, or the 2012 Plan, to enable us to motivate, attract and retain the services of directors, employees and consultants considered essential to our long-term success. The 2012 Plan offers our directors, employees and consultants an opportunity to own stock in Realty Income or rights that will reflect our growth, development and financial success. Under the terms of the 2012 plan, the aggregate number of shares of our common stock subject to options, restricted stock, stock appreciation rights, restricted stock units and other awards, will be no more than 3,985,734 shares. The 2012 Plan has a term of 10 years from the date it was adopted by our Board of Directors.

The amount of share-based compensation costs recognized in general and administrative expense on our consolidated statements of income was \$2.6 million during the first three months of 2015 and \$2.7 million during the first three months of 2014.

Table of Contents*A. Restricted Stock*

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

|                                                     | For the three months ended<br>March 31, 2015 |                                 | For the year ended<br>December 31, 2014 |                                 |
|-----------------------------------------------------|----------------------------------------------|---------------------------------|-----------------------------------------|---------------------------------|
|                                                     | Number of<br>shares                          | Weighted<br>average<br>price(1) | Number of<br>shares                     | Weighted<br>average<br>price(1) |
| Outstanding nonvested<br>shares, beginning of year  | 527,176                                      | \$ 29.02                        | 722,263                                 | \$ 23.37                        |
| Shares granted                                      | 123,585                                      | \$ 51.86                        | 262,655                                 | \$ 39.87                        |
| Shares vested                                       | (118,630)                                    | \$ 35.20                        | (440,348)                               | \$ 36.88                        |
| Shares forfeited                                    | (21,810)                                     | \$ 45.13                        | (17,394)                                | \$ 39.07                        |
| Outstanding nonvested<br>shares, end of each period | 510,321                                      | \$ 36.07                        | 527,176                                 | \$ 29.02                        |

(1) Grant date fair value.

During the first three months of 2015, we issued 123,585 shares of common stock under the 2012 Plan. These shares vest over a five year service period. Not included in the table above are 10,269 restricted share units granted during the first three months of 2015 that vest over a five year service period and have the same economic rights as shares of restricted stock.

As of March 31, 2015, the remaining unamortized share-based compensation expense related to restricted stock totaled \$18.4 million, which is being amortized on a straight-line basis over the service period of each applicable award.

Due to a historically low turnover rate, we do not estimate a forfeiture rate for our nonvested shares. Accordingly, unexpected forfeitures will lower share-based compensation expense during the applicable period. Under the terms of our 2012 Plan, we pay non-refundable dividends to the holders of our nonvested shares. Applicable accounting guidance requires that the dividends paid to holders of these nonvested shares be charged as compensation expense to the extent that they relate to nonvested shares that do not or are not expected to vest. However, since we do not estimate forfeitures given our historical trends, we did not record any compensation expense related to dividends paid in the first three months of 2015 or 2014.

*B. Performance Shares*

During the first three month of 2015, and the year ended December 31, 2014, we granted performance share awards, as well as dividend equivalent rights. The number of performance shares that vest is based on the achievement of the following performance goals:

*2015 Performance Awards*

| Metrics                                                         | Weighting |
|-----------------------------------------------------------------|-----------|
| Total shareholder return ( TSR ) relative to MSCI US REIT Index | 50%       |
| TSR relative to NAREIT Freestanding Index                       | 20%       |

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|                                |     |
|--------------------------------|-----|
| Dividend per share growth rate | 20% |
| Debt-to-EBITDA ratio           | 10% |

### *2014 Performance Awards*

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

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



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

|                                                     | For the three months ended<br>March 31, 2015 |                                 | For the year ended<br>December 31, 2014 |                                 | Weighted<br>average<br>price(1) |
|-----------------------------------------------------|----------------------------------------------|---------------------------------|-----------------------------------------|---------------------------------|---------------------------------|
|                                                     | Number of<br>performance<br>shares           | Weighted<br>average<br>price(1) | Number of<br>performance<br>shares      | Weighted<br>average<br>price(1) |                                 |
| Outstanding nonvested<br>shares, beginning of year  | 59,405                                       | \$ 41.46                        | -                                       | \$ -                            | -                               |
| Shares granted                                      | 55,716                                       | \$ 52.78                        | 71,705                                  | \$ 41.46                        | 41.46                           |
| Shares vested                                       | -                                            | \$ -                            | (4,067)                                 | \$ 41.46                        | 41.46                           |
| Shares forfeited                                    | -                                            | \$ -                            | (8,233)                                 | \$ 41.46                        | 41.46                           |
| Outstanding nonvested<br>shares, end of each period | 115,121                                      | \$ 46.94                        | 59,405                                  | \$ 41.46                        | 41.46                           |

(1) Grant date fair value.

As of March 31, 2015, the remaining share-based compensation expense related to the performance shares totaled \$4.6 million. The portion related to the market-based awards is being recognized on a straight-line basis over the service period, and the portion related to the performance-based awards is being recognized on a tranche-by-tranche basis over the service period.

## 19. Dividend Reinvestment and Stock Purchase Plan

We have a Dividend Reinvestment and Stock Purchase Plan, or the DRSP, to provide our common stockholders, as well as new investors, with a convenient and economical method of purchasing our common stock and reinvesting their distributions. The DRSP also allows our current stockholders to buy additional shares of common stock by reinvesting all or a portion of their distributions. The DRSP authorizes up to 11,000,000 common shares to be issued. During the first three months of 2015, we issued 2,023,276 shares and raised approximately \$102.2 million under the DRSP. During the first three months of 2014, we issued 55,870 shares and raised approximately \$2.3 million under the DRSP. From the inception of the DRSP through March 31, 2015, we have issued 7,114,784 shares and raised approximately \$320.8 million.

In 2013, we revised our DRSP to pay for a majority of the plan-related fees, which were previously paid by investors, and to institute a waiver approval process, allowing larger investors or institutions, per a formal approval process, to purchase shares at a small discount, if approved by us. During the first three months of 2015, we issued 1,980,994 shares and raised \$100.0 million under the waiver approval process. These shares are included in the total activity for the first three months of 2015 noted in the preceding paragraph.

## 20. Commitments and Contingencies

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

consolidated financial position or results of operations.

At March 31, 2015, we had commitments of \$2.0 million for tenant improvements and leasing costs. In addition, as of March 31, 2015, we had committed \$54.5 million under construction contracts, which is expected to be paid in the next twelve months.

## 21. Subsequent Events

In April 2015, we declared the following dividends, which will be paid in May 2015:

- \$0.1895 per share to our common stockholders and
- \$0.138021 per share to our Class F preferred stockholders.

In April 2015, we issued 5,500,000 shares of common stock. After underwriting discounts and other offering costs of \$1.5 million, the net proceeds of \$276.3 million were used to repay borrowings under our acquisition credit facility.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

**FORWARD-LOOKING STATEMENTS**

This Quarterly Report on Form 10-Q, including the documents incorporated by reference, contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Exchange Act of 1934, as amended. When used in this quarterly report, the words estimated, anticipated, expect, believe, intend and similar expressions are intended to identify forward-looking statements. Forward-looking statements include discussions of strategy, plans, or intentions of management. Forward-looking statements are subject to risks, uncertainties, and assumptions about Realty Income Corporation, including, among other things:

- Our anticipated growth strategies;
- Our intention to acquire additional properties and the timing of these acquisitions;
- Our intention to sell properties and the timing of these property sales;
- Our intention to re-lease vacant properties;
- Anticipated trends in our business, including trends in the market for long-term, net leases of freestanding, single-tenant properties; and
- Future expenditures for development projects.

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

- Our continued qualification as a real estate investment trust;
- General business and economic conditions;
- Competition;
- Fluctuating interest rates;
- Access to debt and equity capital markets;
- Continued volatility and uncertainty in the credit markets and broader financial markets;

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- Other risks inherent in the real estate business including tenant defaults, potential liability relating to environmental matters, illiquidity of real estate investments, and potential damages from natural disasters;
- Impairments in the value of our real estate assets;
- Changes in the tax laws of the United States of America;
- The outcome of any legal proceedings to which we are a party or which may occur in the future; and
- Acts of terrorism and war.

Additional factors that may cause risks and uncertainties include those discussed in the sections entitled Business , Risk Factors and Management s Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K, for the fiscal year ended December 31, 2014.

Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date that this quarterly report was filed with the Securities and Exchange Commission, or SEC. While forward-looking statements reflect our good faith beliefs, they are not guarantees of future performance. We undertake no obligation to publicly release the results of any revisions to these forward-looking statements that may be made to reflect events or circumstances after the date of this quarterly report or to reflect the occurrence of unanticipated events. In light of these risks and uncertainties, the forward-looking events discussed in this quarterly report might not occur.

### THE COMPANY

Realty Income, The Monthly Dividend Company®, is a S&P 500 real estate company with the primary business objective of generating dependable monthly cash dividends from a consistent and predictable level of cash flow from operations. Our monthly dividends are supported by the cash flow from our property portfolio. We have in-house acquisition, portfolio management, asset management, credit research, real estate research, legal, finance and accounting, information technology, and capital markets capabilities. Over the past 46 years, Realty Income has been acquiring and managing freestanding commercial properties that generate rental revenue under long-term net lease agreements.

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Realty Income (NYSE: O) was founded in 1969, and listed in 1994 on the New York Stock Exchange, or NYSE. We elected to be taxed as a real estate investment trust, or REIT, requiring us to distribute dividends to our stockholders aggregating at least 90% of our taxable income (excluding net capital gains).

We seek to increase earnings and distributions to stockholders through active portfolio management, asset management and the acquisition of additional properties.

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

- Contractual rent increases on existing leases;
- Rent increases at the termination of existing leases, when market conditions permit;
- Active management of our property portfolio, including re-leasing vacant properties, and selectively selling properties, thereby mitigating our exposure to certain tenants and markets;
- Maximized asset-level returns on sold properties;
- Optimized value on existing portfolio by enhancing individual properties, pursuing alternative uses, and deriving ancillary revenue; and
- Investment opportunities in new asset classes for the portfolio.

At March 31, 2015, we owned a diversified portfolio:

- Of 4,378 properties;
- With an occupancy rate of 98.0%, or 4,292 properties leased and 86 properties available for lease;
- Leased to 236 different commercial tenants doing business in 47 separate industries;
- Located in 49 states and Puerto Rico;
- With over 71.6 million square feet of leasable space; and
- With an average leasable space per property of approximately 16,360 square feet, including approximately 11,250 square feet per retail property and 200,580 square feet per industrial and distribution property.

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Of the 4,378 properties in the portfolio, 4,359, or 99.6%, are single-tenant properties, and the remaining are multi-tenant properties. At March 31, 2015, of the 4,359 single-tenant properties, 4,273 were leased with a weighted average remaining lease term (excluding rights to extend a lease at the option of the tenant) of approximately 10.1 years.

### **Investment Philosophy**

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

Diversification is also a key component of our investment philosophy. We believe that diversification of the portfolio by tenant, industry, geography, and, to a certain extent, property type leads to more predictable investment results for our shareholders by reducing vulnerability that can come with any single concentration. Our investment efforts have led to a diversified property portfolio that, as of March 31, 2015, consisted of 4,378 properties located in 49 states and Puerto Rico, leased to 236 different commercial tenants doing business in 47 industry segments. Each of the 47 industry segments, represented in our property portfolio, individually accounted for no more than 10% of our rental revenue for the quarter ended March 31, 2015. Since 1970, our occupancy rate at the end of each year has never been below 96%. However, we cannot assure you that our future occupancy levels will continue to equal or exceed 96%.

### **Investment Strategy**

Our investment strategy is to act as a source of capital to regional and national tenants by acquiring and leasing back their real estate locations. When identifying new properties for investment, we generally focus on acquiring the real estate tenants consider important to the successful operation of their business. We generally seek to acquire real estate that has the following characteristics:

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

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

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

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

From a retail perspective, our investment strategy is to target tenants that have a service, non-discretionary, and/or low-price-point component to their business. We believe these characteristics better position tenants to operate in a variety of economic conditions and to compete more effectively with internet retailers. As a result of the execution of this strategy, over 90% of our retail rental revenue for the first three months of 2015 is derived from tenants with a service, non-discretionary, and/or low price point component to their business. From a non-retail perspective, we target industrial and distribution properties leased to Fortune 1000, primarily investment grade rated companies. We believe rental revenue generated from businesses with these

characteristics is generally more durable and stable.

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

### **Underwriting Strategy**

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

In order to be considered for acquisition, properties must meet stringent investment and credit requirements. The properties must generate attractive current yields and the tenant must meet our credit criteria. We have established a four-part analysis that examines each potential investment based on:



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- Industry, company, market conditions, and credit profile;
- Store profitability for retail locations, if profitability data is available;
- Overall real estate characteristics, including property value and comparative rental rates; and
- The importance of the real estate location to the operations of the tenants' business.

Prior to entering into any transaction, our research department conducts a review of a tenant's credit quality. The information reviewed may include reports and filings, including any public credit ratings, financial statements, debt and equity analyst reports, and reviews of corporate credit spreads, stock prices, market capitalization, and other financial metrics. We conduct additional due diligence, including additional financial reviews of the tenant and a more comprehensive review of the business segment and industry in which the tenant operates. We continue to monitor our tenants' credit quality on an ongoing basis by reviewing the available information previously discussed, and providing summaries of these findings to management. We estimate that approximately 48% of our annualized rental revenue comes from properties leased to investment grade rated companies or their subsidiaries. At March 31, 2015, our top 20 tenants represent approximately 54% of our annualized revenue and ten of these tenants have investment grade credit ratings.

**Asset Management Strategy**

The active management of the property portfolio is an essential component of our long-term strategy. We continually monitor our portfolio for any changes that could affect the performance of the industries, tenants and locations in which we have invested. We also regularly analyze our portfolio with a view toward optimizing its returns and enhancing the credit quality of our portfolio.

We regularly review and analyze:

- The performance of the various industries of our tenants;
- The operation, management, business planning, and financial condition of our tenants; and
- The quality of the underlying real estate locations.

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

- Generate higher returns;
- Enhance the credit quality of our real estate portfolio;

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

At March 31, 2015, we classified real estate with a carrying amount of \$9.4 million as held for sale on our balance sheet. For the remainder of 2015, we intend to continue our active disposition efforts to further enhance our real estate portfolio and anticipate approximately \$50 million in property sales for all of 2015. We intend to invest these proceeds into new property acquisitions, if there are attractive opportunities available. However, we cannot guarantee that we will sell properties during the next 12 months at our estimated values or be able to invest the property sale proceeds in new properties.

### Impact of Real Estate and Credit Markets

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

## RECENT DEVELOPMENTS

### Increases in Monthly Dividends to Common Stockholders

We have continued our 46-year policy of paying monthly dividends. In addition, we increased the dividend three times during 2015. As of April 2015, we have paid 70 consecutive quarterly dividend increases and increased the dividend 80 times since our listing on the NYSE in 1994.

| <b>2015 Dividend increases</b> | <b>Month Declared</b> | <b>Month Paid</b> | <b>Dividend per share</b> | <b>Increase per share</b> |
|--------------------------------|-----------------------|-------------------|---------------------------|---------------------------|
| 1st increase                   | Dec 2014              | Jan 2015          | \$ 0.1834167              | \$ 0.0003125              |
| 2nd increase                   | Jan 2015              | Feb 2015          | 0.1890000                 | 0.0055833                 |
| 3rd increase                   | Mar 2015              | Apr 2015          | 0.1895000                 | 0.0005000                 |

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The dividends paid per share during the first three months of 2015 as compared to the first three months of 2014 increased 2.6%. The dividends paid per share during the first three months of 2015 totaled approximately \$0.561, as compared to approximately \$0.547 during the first three months of 2014, an increase of \$0.014.

The monthly dividend of \$0.1895 per share represents a current annualized dividend of \$2.274 per share, and an annualized dividend yield of approximately 4.4% based on the last reported sale price of our common stock on the NYSE of \$51.60 on March 31, 2015. Although we expect to continue our policy of paying monthly dividends, we cannot guarantee that we will maintain our current level of dividends, that we will continue our pattern of increasing dividends per share, or what our actual dividend yield will be in any future period.

**Acquisitions during the First Three Months of 2015**

During the first three months of 2015, we invested \$209.9 million in 83 new properties and properties under development or expansion, with an initial weighted average contractual lease rate of 6.9%. The 83 new properties and properties under development or expansion are located in 24 states, will contain approximately 1.6 million leasable square feet, and are 100% leased with a weighted average lease term of 15.5 years. The tenants occupying the new properties operate in 12 industries and the property types consist of 74.2% retail and 25.8% industrial and distribution, based on rental revenue. During the first three months of 2015, none of our real estate investments caused any one tenant to be 10% or more of our total assets at March 31, 2015.

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

In the case of a property under development or expansion, the contractual lease rate is generally fixed such that rent varies based on the actual total investment in order to provide a fixed rate of return. When the lease does not provide for a fixed rate of return on a property under development or expansion, the estimated initial weighted average contractual lease rate is computed as follows: estimated net operating income (determined by the lease) for the first full year of each lease, divided by our projected total investment in the property, including land, construction and capitalized interest costs. Of the \$209.9 million we invested during the first three months of 2015, \$15.3 million was invested in 25 properties under development or expansion with an estimated initial weighted average contractual lease rate of 9.0%. We may continue to pursue development or expansion opportunities under similar arrangements in the future.

**Portfolio Discussion**

Leasing Results

At March 31, 2015, we had 86 properties available for lease out of 4,378 properties in our portfolio, which represents a 98.0% occupancy rate. Since December 31, 2014, when we reported 70 properties available for lease out of 4,327 and a 98.4% occupancy rate, we:

- Had 64 lease expirations;
- Re-leased 43 properties; and
- Sold five vacant properties.

Of the 43 properties re-leased during the first three months of 2015, 30 properties were re-leased to existing tenants, two were re-leased to new tenants without vacancy, and 11 were re-leased to new tenants after a period of vacancy. The annual rent on these 43 leases was \$11.7 million, as compared to the previous rent on these same properties of \$11.8 million, which represents a rent recapture rate of 99.2%.

At March 31, 2015, our average annualized rental revenue was approximately \$13.20 per square foot on the 4,292 leased properties in our portfolio. At March 31, 2015, we classified seven properties with a carrying amount of \$9.4 million as held for sale on our balance sheet. The disposal of these properties does not represent a strategic shift that will have a major effect on our operations and financial results.

#### Investments in Existing Properties

In the first three months of 2015, we capitalized costs of \$1.3 million on existing properties in our portfolio, consisting of \$313,000 for re-leasing costs and \$1.0 million for building and tenant improvements. In the first three months of 2014, we capitalized costs of \$1.4 million on existing properties in our portfolio, consisting of \$192,000 for re-leasing costs and \$1.2 million for building and tenant improvements.

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As part of our re-leasing costs, we typically pay leasing commissions and sometimes provide tenant rent concessions. Leasing commissions are paid based on the commercial real estate industry standard and any rent concessions provided are minimal. We do not consider the collective impact of the leasing commissions or tenant rent concessions to be material to our financial position or results of operations.

The majority of our building and tenant improvements relate to roof repairs, HVAC improvements, and parking lot resurfacing and replacements. It is not customary for us to offer significant tenant improvements on our properties as tenant incentives. The amounts of our capital expenditures can vary significantly, depending on the rental market, tenant credit worthiness, the lease term and the willingness of tenants to pay higher rents over the terms of the leases.

**Inclusion in S&P Indices**

In January 2015, we were added to the S&P High Yield Dividend Aristocrats® index. In April 2015, we were added to the S&P 500 index and are one of 24 REITs, and the only net lease REIT included in this index.

**Issuance of Common Stock**

In April 2015, we issued 5,500,000 shares of common stock. After underwriting discounts and other offering costs of \$1.5 million, the net proceeds of \$276.3 million were used to repay borrowings under our acquisition credit facility.

**Dividend Reinvestment and Stock Purchase Plan**

We have established a Dividend Reinvestment and Stock Purchase Plan, or the DRSP, to provide our common stockholders, as well as new investors, with a convenient and economical method of purchasing our common stock and reinvesting their distributions. The DRSP also allows our current stockholders to buy additional shares of common stock by reinvesting all or a portion of their distributions. The DRSP authorizes up to 11,000,000 common shares to be issued. During the first three months of 2015, we issued 2,023,276 shares and raised approximately \$102.2 million under the DRSP.

**Net Income Available to Common Stockholders**

Net income available to common stockholders was \$60.5 million in the first three months of 2015, compared to \$47.2 million in the first three months of 2014, an increase of \$13.3 million. On a diluted per common share basis, net income was \$0.27 in the first three months of 2015, as compared to \$0.23 in the first three months of 2014, an increase of \$0.04, or 17.4%.

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

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Gains from the sale of properties during the first three months of 2015 were \$7.2 million, as compared to gains from the sale of properties of \$3.9 million during the first three months of 2014.

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

In the first three months of 2015, our FFO increased by \$18.4 million, or 13.7%, to \$152.9 million versus \$134.5 million in the first three months of 2014. On a diluted per common share basis, FFO was \$0.68 in the first three months of 2015, compared to \$0.65 in the first three months of 2014, an increase of \$0.03, or 4.6%.

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

In the first three months of 2015, our AFFO increased by \$19.4 million, or 14.6%, to \$152.1 million versus \$132.7 million in the first three months of 2014. On a diluted per common share basis, AFFO was \$0.67 in the first three months of 2015, compared to \$0.64 in the first three months of 2014, an increase of \$0.03, or 4.7%.

See our discussion of FFO and AFFO (which are not financial measures under GAAP), later in this Management's Discussion and Analysis of Financial Condition and Results of Operations, which includes a reconciliation of net income available to common stockholders to FFO and AFFO.

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## LIQUIDITY AND CAPITAL RESOURCES

### Capital Philosophy

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

Our primary cash obligations, for the current year and subsequent years, are included in the Table of Obligations, which is presented later in this section. We expect to fund our operating expenses and other short-term liquidity requirements, including property acquisitions and development costs, payment of principal and interest on our outstanding indebtedness, property improvements, re-leasing costs and cash distributions to common and preferred stockholders, primarily through cash provided by operating activities, borrowing on our \$1.5 billion credit facility and periodically through public securities offerings.

### Conservative Capital Structure

We believe that our stockholders are best served by a conservative capital structure. Therefore, we seek to maintain a conservative debt level on our balance sheet and solid interest and fixed charge coverage ratios. At March 31, 2015, our total outstanding borrowings of senior unsecured notes and bonds, term loan, mortgages payable and credit facility borrowings were \$5.02 billion, or approximately 29.2% of our total market capitalization of \$17.19 billion.

We define our total market capitalization at March 31, 2015 as the sum of:

- Shares of our common stock outstanding of 227,031,104, plus total common units outstanding of 736,568, multiplied by the last reported sales price of our common stock on the NYSE of \$51.60 per share on March 31, 2015, or \$11.75 billion;
- Aggregate liquidation value (par value of \$25.00 per share) of the Class F preferred stock of \$408.8 million;
- Outstanding borrowings of \$370.0 million on our credit facility;
- Outstanding mortgages payable of \$784.7 million, excluding net mortgage premiums of \$14.6 million;
- Outstanding borrowings of \$70.0 million on our term loan; and
- Outstanding senior unsecured notes and bonds of \$3.8 billion, excluding unamortized original issuance discounts of \$14.3 million.

### **Universal Shelf Registration**

In February 2013, we filed a shelf registration statement with the SEC, which is effective for a term of three years and will expire in February 2016. This replaced our prior shelf registration statement. In accordance with SEC rules, the amount of securities to be issued pursuant to this shelf registration statement was not specified when it was filed and there is no specific dollar limit. The securities covered by this registration statement include (1) common stock, (2) preferred stock, (3) debt securities, (4) depository shares representing fractional interests in shares of preferred stock, (5) warrants to purchase debt securities, common stock, preferred stock, or depository shares, and (6) any combination of these securities. We may periodically offer one or more of these securities in amounts, prices and on terms to be announced when and if these securities are offered. The specifics of any future offerings, along with the use of proceeds of any securities offered, will be described in detail in a prospectus supplement, or other offering materials, at the time of any offering.

### **Mortgage Debt**

As of March 31, 2015, we had \$784.7 million of mortgages payable, all of which were assumed in connection with our property acquisitions. Additionally, at March 31, 2015, we had net premiums totaling \$14.6 million on these mortgages. We expect to pay off the mortgages payable as soon as prepayment penalties have declined to a level that will make it economically feasible to do so. During the first three months of 2015, we made \$51.3 million of principal payments, including the repayment of three mortgages in full for \$49.4 million.



Table of Contents**Term Loan**

In January 2013, in conjunction with our acquisition of ARCT, we entered into a \$70 million senior unsecured term loan maturing in January 2018. Borrowing under the term loan bears interest at the London Interbank Offered Rate, commonly referred to as LIBOR, plus 1.20%. In conjunction with this term loan, we also acquired an interest rate swap which essentially fixes our per annum interest rate on the term loan at 2.15%.

**\$1.5 Billion Acquisition Credit Facility**

We have a \$1.5 billion unsecured acquisition credit facility with an initial term that expires in May 2016 and includes, at our election, a one-year extension option. Under this credit facility, our current investment grade credit ratings provide for financing at LIBOR, plus 1.075% with a facility commitment fee of 0.175%, for all-in drawn pricing of 1.25% over LIBOR. The borrowing rate is not subject to an interest rate floor or ceiling. We also have other interest rate options available to us under this credit facility. Our credit facility is unsecured and, accordingly, we have not pledged any assets as collateral for this obligation.

At March 31, 2015, we had a borrowing capacity of \$1.13 billion available on our credit facility (subject to customary conditions to borrowing) and an outstanding balance of \$370.0 million. As of April 10, 2015, we had a borrowing capacity of approximately \$1.4 billion available on our credit facility after using proceeds from our April common stock offering to repay borrowings on our credit facility. The interest rate on borrowings outstanding under our credit facility, at March 31, 2015, was 1.2% per annum. We must comply with various financial and other covenants in our credit facility. At March 31, 2015, we remain in compliance with these covenants. We expect to use our credit facility to acquire additional properties and for other corporate purposes. Any additional borrowings will increase our exposure to interest rate risk. We regularly review our credit facility and may seek to extend or replace our credit facility, to the extent we deem appropriate.

We generally use our credit facility for the short-term financing of new property acquisitions. Thereafter, when capital is available on acceptable terms, we generally seek to refinance those borrowings with the net proceeds of long-term or permanent financing, which may include the issuance of common stock, preferred stock or debt securities. We cannot assure you, however, that we will be able to obtain any such refinancing, or that market conditions prevailing at the time of the refinancing will enable us to issue equity or debt securities at acceptable terms.

**Notes Outstanding**

Our senior unsecured note and bond obligations consist of the following as of March 31, 2015, sorted by maturity date (dollars in millions):

|                                                                  |    |     |
|------------------------------------------------------------------|----|-----|
| 5.5% notes, issued in November 2003 and due in November 2015     | \$ | 150 |
| 5.95% notes, issued in September 2006 and due in September 2016  |    | 275 |
| 5.375% notes, issued in September 2005 and due in September 2017 |    | 175 |
| 2.0% notes, issued in October 2012 and due in January 2018       |    | 350 |
| 6.75% notes, issued in September 2007 and due in August 2019     |    | 550 |
| 5.75% notes, issued in June 2010 and due in January 2021         |    | 250 |
| 3.25% notes, issued in October 2012 and due in October 2022      |    | 450 |
| 4.65% notes, issued in July 2013 and due in August 2023          |    | 750 |
| 3.875% notes, issued in June 2014 and due in July 2024           |    | 350 |

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|                                                                                                   |    |       |
|---------------------------------------------------------------------------------------------------|----|-------|
| 4.125% notes, issued in September 2014 and due in October 2026                                    |    | 250   |
| 5.875% bonds, \$100 issued in March 2005 and \$150 issued in<br>June 2011, both due in March 2035 |    | 250   |
| Total principal amount                                                                            | \$ | 3,800 |
| Unamortized original issuance discounts                                                           |    | (14)  |
|                                                                                                   | \$ | 3,786 |

All of our outstanding notes and bonds have fixed interest rates and contain various covenants, which we remain in compliance with at March 31, 2015. Additionally, interest on all of our senior note and bond obligations is paid semiannually.

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The following is a summary of the key financial covenants for our senior unsecured notes, as defined and calculated per the terms of our senior notes and bonds. These calculations, which are not based on U.S. generally accepted accounting principles, or GAAP, measurements, are presented to investors to show our ability to incur additional debt under the terms of our senior notes and bonds as well as to disclose our current compliance with such covenants, and are not measures of our liquidity or performance. The actual amounts as of March 31, 2015 are:

| Note Covenants                                | Required                 | Actual |
|-----------------------------------------------|--------------------------|--------|
| Limitation on incurrence of total debt        | ≤ 60% of adjusted assets | 43.6%  |
| Limitation on incurrence of secured debt      | ≤ 40% of adjusted assets | 6.9%   |
| Debt service coverage (trailing 12 months)(1) | ≥ 1.5 x                  | 3.9x   |
| Maintenance of total unencumbered assets      | ≥ 150% of unsecured debt | 237.2% |

(1) This covenant is calculated on a pro forma basis for the preceding four-quarter period on the assumption that: (i) the incurrence of any Debt (as defined in the covenants) incurred by us since the first day of such four-quarter period and the application of the proceeds therefrom (including to refinance other Debt since the first day of such four-quarter period), (ii) the repayment or retirement of any of our Debt since the first day of such four-quarter period, and (iii) any acquisition or disposition by us of any asset or group since the first day of such four-quarters had in each case occurred on April 1, 2014, and subject to certain additional adjustments. Such pro forma ratio has been prepared on the basis required by that debt service covenant, reflects various estimates and assumptions and is subject to other uncertainties, and therefore does not purport to reflect what our actual debt service coverage ratio would have been had transactions referred to in clauses (i), (ii) and (iii) of the preceding sentence occurred as of April 1, 2014, nor does it purport to reflect our debt service coverage ratio for any future period. The following is our calculation of debt service coverage at March 31, 2015 (in thousands, for trailing twelve months):

|                                               |    |          |
|-----------------------------------------------|----|----------|
| Net income attributable to the Company        | \$ | 280,237  |
| Plus: interest expense                        |    | 214,673  |
| Plus: provision for taxes                     |    | 3,445    |
| Plus: depreciation and amortization           |    | 382,729  |
| Plus: provisions for impairment               |    | 5,041    |
| Plus: pro forma adjustments                   |    | 27,334   |
| Less: gain on sales of real estate            |    | (45,427) |
| Income available for debt service, as defined | \$ | 868,032  |
| Total pro forma debt service charge           | \$ | 225,022  |
| Debt service coverage ratio                   |    | 3.9      |

*Fixed Charge Coverage Ratio*

Fixed charge coverage ratio is calculated in exactly the same manner as the debt service coverage ratio, except that preferred stock dividends are also added to the denominator. Similar to debt service coverage ratio, we consider fixed charge coverage ratio to be an appropriate supplemental measure of a company's ability to make its interest and preferred stock dividend payments. Our calculations of both debt service and fixed charge coverage ratios may be different from the calculations used by other companies and, therefore, comparability may be limited. The presentation of debt service and fixed charge coverage ratios should not be considered as alternatives to any U.S. GAAP operating performance measures. Below is our calculation of fixed charges at March 31, 2015 (in thousands, for the trailing twelve months):

|                                                              |    |         |
|--------------------------------------------------------------|----|---------|
| Income available for debt service, as defined                | \$ | 868,032 |
| Pro forma debt service charge plus preferred stock dividends | \$ | 252,102 |
| Fixed charge coverage ratio                                  |    | 3.4     |

**Cash Reserves**

We are organized to operate as an equity REIT that acquires and leases properties and distributes to stockholders, in the form of monthly cash distributions, a substantial portion of our net cash flow generated from leases on our properties. We intend to retain an appropriate amount of cash as working capital. At March 31, 2015, we had cash and cash equivalents totaling \$12.2 million.

We believe that our cash and cash equivalents on hand, cash provided from operating activities, and borrowing capacity is sufficient to meet our liquidity needs for the next twelve months. We intend, however, to use permanent or long-term capital to fund property acquisitions and to repay future borrowings under our credit facility.

Table of Contents**Credit Agency Ratings**

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

Based on our current ratings, the current facility interest rate is LIBOR plus 1.075% with a facility commitment fee of 0.175%, for all-in drawn pricing of 1.25% over LIBOR. The credit facility provides that the interest rate can range between: (i) LIBOR plus 1.85% if our credit rating is lower than BBB-/Baa3 and (ii) LIBOR plus 1.00% if our credit rating is A-/A3 or higher. In addition, our credit facility provides for a facility commitment fee based on our credit ratings, which range from: (i) 0.45% for a rating lower than BBB-/Baa3, and (ii) 0.15% for a credit rating of A-/A3 or higher.

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

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

**Table of Obligations**

The following table summarizes the maturity of each of our obligations as of March 31, 2015 (dollars in millions):

| Year of Maturity | Credit Facility(1) | Notes and Bonds(2) | Term Loan | Mortgages Payable(3) | Interest(4) | Ground           | Ground         | Other(7) | Totals     |
|------------------|--------------------|--------------------|-----------|----------------------|-------------|------------------|----------------|----------|------------|
|                  |                    |                    |           |                      |             | Leases           | Leases         |          |            |
|                  |                    |                    |           |                      |             | Paid by          | Paid by        |          |            |
|                  |                    |                    |           |                      |             | Realty Income(5) | Our Tenants(6) |          |            |
| 2015             | \$ -               | \$ 150.0           | \$ -      | \$ 68.4              | \$ 168.7    | \$ 0.7           | \$ 9.5         | \$ 56.5  | \$ 453.8   |
| 2016             | -                  | 275.0              | -         | 248.4                | 200.4       | 1.0              | 12.8           | -        | 737.6      |
| 2017             | 370.0              | 175.0              | -         | 142.5                | 175.3       | 1.1              | 12.9           | -        | 876.8      |
| 2018             | -                  | 350.0              | 70.0      | 15.1                 | 155.4       | 1.0              | 12.9           | -        | 604.4      |
| 2019             | -                  | 550.0              | -         | 26.0                 | 140.2       | 0.9              | 12.8           | -        | 729.9      |
| Thereafter       | -                  | 2,300.0            | -         | 284.3                | 567.9       | 8.5              | 131.9          | -        | 3,292.6    |
| Totals           | \$370.0            | \$ 3,800.0         | \$ 70.0   | \$ 784.7             | \$ 1,407.9  | \$ 13.2          | \$ 192.8       | \$ 56.5  | \$ 6,695.1 |

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- (1) The initial term of the credit facility expires in May 2016 and includes, at our option, a one-year extension, which has been assumed to occur in the table above.
- (2) Excludes non-cash original issuance discounts recorded on the notes payable. The unamortized balance of the original issuance discounts at March 31, 2015, is \$14.3 million.
- (3) Excludes non-cash net premiums recorded on the mortgages payable. The unamortized balance of these net premiums at March 31, 2015, is \$14.6 million.
- (4) Interest on the term loan, notes, bonds, mortgages payable, and credit facility has been calculated based on outstanding balances as of March 31, 2015 through their respective maturity dates.
- (5) Realty Income currently pays the ground lessors directly for the rent under the ground leases.
- (6) Our tenants, who are generally sub-tenants under ground leases, are responsible for paying the rent under these ground leases. In the event a tenant fails to pay the ground lease rent, we are primarily responsible.
- (7) Other consists of \$54.5 million of commitments under construction contracts and \$2.0 million of commitments for tenant improvements and leasing costs.

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

### **Preferred Stock and Preferred Units Outstanding**

In 2006, we issued 8,800,000 shares of Class E preferred stock at a price of \$25.00 per share. In October 2014, we redeemed all of the 8,800,000 shares of our Class E preferred stock for \$25.00 per share, plus accrued dividends. In the third quarter of 2014, we incurred a charge of \$6.0 million, representing the Class E preferred stock original issuance costs that we paid in 2006.

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

As part of our acquisition of ARCT in January 2013, we issued 6,750 partnership units, with a carrying value of \$6.75 million. Payments on these preferred units were made monthly in arrears at rate of 2% per annum, or \$135,000, and are included in interest expense. In January 2015, we redeemed all 6,750 Tau Operating Partnership preferred units for \$1,000 per unit, plus accrued and unpaid distributions.

**No Unconsolidated Investments**

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

**Dividend Policy**

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

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

In order to maintain our status as a REIT for federal income tax purposes, we generally are required to distribute dividends to our stockholders aggregating annually at least 90% of our taxable income (excluding net capital gains), and we are subject to income tax to the extent we distribute less than 100% of our taxable income (including net capital gains). In 2014, our cash distributions to preferred and common stockholders totaled \$519.1 million, or approximately 154.6% of our estimated taxable income of \$335.7 million. Our estimated taxable income reflects non-cash deductions for depreciation and amortization. Our estimated taxable income is presented to show our compliance with REIT dividend requirements and is not a measure of our liquidity or operating performance. We intend to continue to make distributions to our stockholders that are sufficient to meet this dividend requirement and that will reduce or eliminate our exposure to income taxes. Furthermore, we believe our funds from operations are more than sufficient to support our current level of cash distributions to our stockholders. Our cash distributions to common stockholders, for the first three months of 2015, totaled \$126.7 million, representing 83.3% of our adjusted funds from operations available to common stockholders of \$152.1 million. In comparison, our 2014 cash distributions to common stockholders totaled \$479.3 million, representing 85.3% of our adjusted funds from operations available to common stockholders of \$561.7 million.

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

Future distributions will be at the discretion of our Board of Directors and will depend on, among other things, our results of operations, FFO, AFFO, cash flow from operations, financial condition, capital requirements, the annual distribution requirements

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under the REIT provisions of the Internal Revenue Code of 1986, as amended, our debt service requirements, and any other factors the Board of Directors may deem relevant. In addition, our credit facility contains financial covenants that could limit the amount of distributions payable by us in the event of a default, and which prohibit the payment of distributions on the common or preferred stock in the event that we fail to pay when due (subject to any applicable grace period) any principal or interest on borrowings under our credit facility.

Distributions of our current and accumulated earnings and profits for federal income tax purposes generally will be taxable to stockholders as ordinary income, except to the extent that we recognize capital gains and declare a capital gains dividend, or that such amounts constitute qualified dividend income subject to a reduced rate of tax. The maximum tax rate of non-corporate taxpayers for qualified dividend income is generally 20%. In general, dividends payable by REITs are not eligible for the reduced tax rate on qualified dividend income, except to the extent that certain holding requirements have been met with respect to the REIT's stock and the REIT's dividends are attributable to dividends received from certain taxable corporations (such as our taxable REIT subsidiaries) or to income that was subject to tax at the corporate or REIT level (for example, if we distribute taxable income that we retained and paid tax on in the prior taxable year).



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Distributions in excess of earnings and profits generally will first be treated as a non-taxable reduction in the stockholders' basis in their stock, but not below zero. Distributions in excess of that basis generally will be taxable as a capital gain to stockholders who hold their shares as a capital asset. Approximately 24.8% of the distributions to our common stockholders, made or deemed to have been made in 2014, were classified as a return of capital for federal income tax purposes. We estimate that in 2015, between 20% and 35% of the distributions may be classified as a return of capital.

## RESULTS OF OPERATIONS

### Critical Accounting Policies

Our consolidated financial statements have been prepared in accordance with GAAP, and are the basis for our discussion and analysis of financial condition and results of operations. Preparing our consolidated financial statements requires us to make a number of estimates and assumptions that affect the reported amounts and disclosures in the consolidated financial statements. We believe that we have made these estimates and assumptions in an appropriate manner and in a way that accurately reflects our financial condition. We continually test and evaluate these estimates and assumptions using our historical knowledge of the business, as well as other factors, to ensure that they are reasonable for reporting purposes. However, actual results may differ from these estimates and assumptions. This summary should be read in conjunction with the more complete discussion of our accounting policies and procedures included in note 2 to our consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2014.

In order to prepare our consolidated financial statements according to the rules and guidelines set forth by GAAP, many subjective judgments must be made with regard to critical accounting policies. One of these judgments is our estimate for useful lives in determining depreciation expense for our properties. Depreciation on a majority of our buildings and improvements is computed using the straight-line method over an estimated useful life of 25 to 35 years for buildings and 4 to 20 years for improvements, which we believe are appropriate estimates of useful life. If we use a shorter or longer estimated useful life, it could have a material impact on our results of operations.

Management must make significant assumptions in determining the fair value of assets acquired and liabilities assumed. When acquiring a property for investment purposes, we typically allocate the fair value of real estate acquired to: (1) land, (2) building and improvements, and (3) identified intangible assets and liabilities, based in each case on their estimated fair values. Intangible assets and liabilities consist of above-market or below-market lease value of in-place leases, the value of in-place leases, and tenant relationships, as applicable. In an acquisition of multiple properties, we must also allocate the purchase price among the properties. The allocation of the purchase price is based on our assessment of estimated fair value and is often based upon the expected future cash flows of the property and various characteristics of the market where the property is located. In addition, any assumed mortgages receivable or payable and any assumed or issued noncontrolling interests are recorded at their estimated fair values. The estimated fair values of our mortgages payable have been calculated by discounting the future cash flows using applicable interest rates that have been adjusted for factors, such as industry type, tenant investment grade, maturity date, and comparable borrowings for similar assets. The initial allocation of the purchase price is based on management's preliminary assessment, which may differ when final information becomes available. Subsequent adjustments made to the initial purchase price allocation are made within the allocation period, which does not exceed one year. The use of different assumptions in the allocation of the purchase price of the acquired properties and liabilities assumed could affect the timing of recognition of the related revenue and expenses.

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Another significant judgment must be made as to if, and when, impairment losses should be taken on our properties when events or a change in circumstances indicate that the carrying amount of the asset may not be recoverable. A provision is made for impairment if estimated future operating cash flows (undiscounted and without interest charges) plus estimated disposition proceeds (undiscounted) are less than the current book value of the property. Key inputs that we estimate in this analysis include projected rental rates, estimated holding periods, capital expenditures, and property sales capitalization rates. If a property is held for sale, it is carried at the lower of carrying cost or estimated fair value, less estimated cost to sell. The carrying value of our real estate is the largest component of our consolidated balance sheets. Our strategy of primarily holding

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properties, long-term, directly decreases the likelihood of their carrying values not being recoverable, thus requiring the recognition of an impairment. However, if our strategy, or one or more of the above assumptions were to change in the future, an impairment may need to be recognized. If events should occur that require us to reduce the carrying value of our real estate by recording provisions for impairment, they could have a material impact on our results of operations.

***The following is a comparison of our results of operations for the three months ended March 31, 2015, to the three months ended March 31, 2014.***

**Rental Revenue**

Rental revenue was \$235.1 million for the first three months of 2015, as compared to \$214.1 million for the first three months of 2014, an increase of \$21.0 million, or 9.8%. The increase in rental revenue in the first three months of 2015 compared to the first three months of 2014 is primarily attributable to:

- The 60 properties (1.0 million square feet) we acquired in the first three months of 2015, which generated \$1.5 million of rent in the first three months of 2015;
- The 479 properties (9.3 million square feet) we acquired in 2014, which generated \$24.0 million of rent in the first three months of 2015 compared to \$7.3 million in the first three months of 2014, an increase of \$16.7 million;
- Same store rents generated on 3,695 properties (59.0 million square feet) during the first three months of 2015 and 2014, increased by \$2.7 million, or 1.4%, to \$201.1 million from \$198.4 million;
- A net increase in straight-line rent and other non-cash adjustments to rent of \$1.2 million in the first three months of 2015 as compared to the first three months of 2014;
- A net decrease of \$2.2 million relating to properties sold in the first three months of 2015 and during 2014 that were reported in continuing operations; and
- A net increase of \$1.1 million relating to the aggregate of (i) rental revenue from properties (117 properties comprising 1.2 million square feet) that were available for lease during part of 2015 or 2014, (ii) rental revenue for twelve properties under development, and (iii) lease termination settlements. In aggregate, the revenues for these items totaled \$5.2 million in the first three months of 2015 compared to \$4.1 million in the first three months of 2014.

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

Of the 4,378 properties in the portfolio at March 31, 2015, 4,359, or 99.6%, are single-tenant properties and the remaining are multi-tenant properties. Of the 4,359 single-tenant properties, 4,273, or 98.0%, were net leased with a weighted average remaining

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lease term (excluding rights to extend a lease at the option of the tenant) of approximately 10.1 years at March 31, 2015. Of our 4,273 leased single-tenant properties, 3,832 or 89.7% were under leases that provide for increases in rents through:

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

Percentage rent, which is included in rental revenue, was \$1.4 million in the first three months of 2015 and 2014, respectively. Percentage rent in the first three months of 2015 was less than 1% of rental revenue and we anticipate percentage rent to be less than 1% of rental revenue for the remainder of 2015.

Our portfolio of real estate, leased primarily to regional and national tenants under net leases, continues to perform well and provides dependable lease revenue supporting the payment of monthly dividends to our stockholders. At March 31, 2015, our portfolio of 4,378 properties was 98.0% leased with 86 properties available for lease, as compared to 98.4% occupancy, or 70 properties available for lease at December 31, 2014, and 98.3% occupancy, or 73 properties available for lease at March 31, 2014. It has been our experience that approximately 2% to 4% of our property portfolio will be unleased at any given time; however, it is possible that the number of properties available for lease could exceed these levels in the future.

Table of Contents**Tenant Reimbursements**

Contractually obligated reimbursements from tenants for recoverable real estate taxes and operating expenses were \$10.0 million in the first three months of 2015, compared to \$6.4 million in the first three months of 2014. The increase in tenant reimbursements is primarily due to our acquisitions during 2014 and the first three months of 2015. Our tenant reimbursements approximate our reimbursable property expenses for any given period.

**Other Revenue**

Other revenue, which comprises property-related revenue not included in rental revenue or tenant reimbursements, was \$1.8 million in the first three months of 2015, compared to \$1.0 million in the first three months of 2014.

**Depreciation and Amortization**

Depreciation and amortization was \$98.0 million for the first three months of 2015, compared to \$90.0 million for the first three months of 2014. The increases in depreciation and amortization in the first three months of 2015 was primarily due to the acquisition of properties in 2014 and the first three months of 2015, which was partially offset by property sales in those same periods. As discussed in the sections entitled Funds from Operations Available to Common Stockholders (FFO) and Adjusted Funds from Operations Available to Common Stockholders (AFFO), depreciation and amortization is a non-cash item that is added back to net income available to common stockholders for our calculation of FFO and AFFO.

**Interest Expense**

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

|                                                                                         | <b>Three months ended<br/>March 31,</b> |              |
|-----------------------------------------------------------------------------------------|-----------------------------------------|--------------|
|                                                                                         | <b>2015</b>                             | <b>2014</b>  |
| Interest on our credit facility, term loan, notes,<br>mortgages and interest rate swaps | \$ 56,576                               | \$ 51,523    |
| Credit facility commitment fees                                                         | 656                                     | 656          |
| Amortization of credit facility origination costs and<br>deferred financing costs       | 2,156                                   | 1,963        |
| Loss on interest rate swaps                                                             | 1,058                                   | 57           |
| Amortization of net mortgage premiums                                                   | (1,961)                                 | (2,384)      |
| Capital lease obligation                                                                | 77                                      | -            |
| Interest capitalized                                                                    | (94)                                    | (95)         |
| Interest expense                                                                        | \$ 58,468                               | \$ 51,720    |
| <b>Credit facility, term loan, mortgages and notes</b>                                  | <b>2015</b>                             | <b>2014</b>  |
| Average outstanding balances (dollars in thousands)                                     | \$ 4,982,170                            | \$ 4,539,423 |
| Average interest rates                                                                  | 4.52%                                   | 4.51%        |

The increase in interest expense from the first three months of 2014 to the first three months of 2015 was primarily due to the June 2014 issuance of our 3.88% senior unsecured notes due July 2024 and the September 2014 issuance of our 4.125% senior unsecured notes due October 2026.

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At March 31, 2015, the weighted average interest rate on our:

- Notes and bonds payable of \$3.8 billion (excluding unamortized original issuance discounts of \$14.3 million) was 4.8%;
- Mortgages payable of \$784.7 million (excluding net premiums totaling \$14.6 million on these mortgages) was 5.0%;
- Credit facility outstanding borrowings of \$370.0 million was 1.2%;
- Term loan outstanding borrowings of \$70.0 million was 1.4%; and
- Combined outstanding notes, bonds, mortgages, term loan and credit facility borrowings of \$5.02 billion was 4.5%.

Table of Contents**General and Administrative Expenses**

General and administrative expenses remained at \$12.9 million for the first three months of 2015 and 2014. Included in general and administrative expenses are acquisition transaction costs of \$94,000 for the first three months of 2015 and \$454,000 for the first three months of 2014. In April 2015, we had 131 employees, as compared to 118 employees in April 2014.

| Dollars in thousands                                                 | Three months ended |           |
|----------------------------------------------------------------------|--------------------|-----------|
|                                                                      | March 31,          |           |
|                                                                      | 2015               | 2014      |
| General and administrative expenses                                  | \$ 12,862          | \$ 12,886 |
| Total revenue, including discontinued operations(1)                  | 236,904            | 215,216   |
| General and administrative expenses as a percentage of total revenue | 5.4%               | 6.0%      |

(1) Excludes all tenant reimbursements revenue, as well as revenue included in discontinued operations and gain on sales.

**Property Expenses (including tenant reimbursable expenses)**

Property expenses consist of costs associated with unleased properties, non-net leased properties and general portfolio expenses, as well as contractually obligated reimbursements from tenants for recoverable real estate taxes and operating expenses. Expenses related to unleased properties and non-net leased properties include, but are not limited to, property taxes, maintenance, insurance, utilities, property inspections, bad debt expense and legal fees. General portfolio costs include, but are not limited to, insurance, legal, property inspections, and title search fees. At March 31, 2015, 86 properties were available for lease, as compared to 70 at December 31, 2014 and 73 at March 31, 2014.

Property expenses were \$14.0 million (including \$10.0 million reimbursable) in the first three months of 2015 and \$10.6 million (including \$6.4 million reimbursable) in the first three months of 2014. The increase in property expenses in the first three months of 2015 is primarily attributable to the increased portfolio size, which contributed to higher property taxes, maintenance and utilities, and bad debt expense along with higher contractually obligated reimbursements primarily due to our acquisitions during 2014 and the first three months of 2015.

**Income Taxes**

Income taxes were \$1.1 million in the first three months of 2015 and 2014, respectively. These amounts are for city and state income and franchise taxes paid by Realty Income and its subsidiaries.

**Discontinued Operations**

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

statements of income

Operations from seven properties were classified as held for sale at March 31, 2015, and are included in income from continuing operations. For the three months ended March 31, 2014, we recorded income from discontinued operations of \$3.1 million, or \$0.01 per basic and diluted common share.

**Provisions for Impairment**

For the first three months of 2015, we recorded total provisions for impairment of \$2.1 million on one sold property, one property classified as held for sale, and one property disposed of other than by sale. For the first three months of 2014, we recorded total provisions for impairment of \$1.7 million on four sold properties. These properties were not previously classified as held for sale in financial statements issued prior to the date of adoption of ASU 2014-08; accordingly, the provisions for impairment are included in income from continuing operations on our consolidated statement of income for the three months ended March 31, 2015 and March 31, 2014, respectively.



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**Gain on Sales of Real Estate**

During the first three months of 2015, we sold nine investment properties for \$22.3 million, which resulted in a gain of \$7.2 million. The results of operations for these properties are presented within continuing operations.

During the first three months of 2014, Realty Income sold 11 investment properties for \$12.7 million, which resulted in a gain of \$3.9 million. Only the results of operations specifically related to the properties classified as held for sale at December 31, 2013 and sold during the first three months of 2014 have been reclassified as discontinued operations.

During the first three months of 2015, Crest did not sell any properties. During the first three months of 2014, Crest sold one property for \$820,000, which did not result in a gain. The results of operations for this property have been reclassified as discontinued operations.

**Preferred Stock Dividends**

Preferred stock dividends totaled \$6.8 million in the first three months of 2015 and \$10.5 million in the first three months of 2014.

**Net Income Available to Common Stockholders**

Net income available to common stockholders was \$60.5 million in the first three months of 2015, compared to \$47.2 million in the first three months of 2014, an increase of \$13.3 million. On a diluted per common share basis, net income available to common stockholders was \$0.27 in the first three months of 2015, as compared to \$0.23 in the first three months of 2014, an increase of \$0.04, or 17.4%.

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.

Gains from the sale of properties during the first three months of 2015 were \$7.2 million, as compared to gains from the sale of properties of \$3.9 million during the first three months of 2014.

Table of Contents**FUNDS FROM OPERATIONS AVAILABLE TO COMMON STOCKHOLDERS (FFO)**

In the first three months of 2015, our FFO increased by \$18.4 million, or 13.7%, to \$152.9 million, compared to \$134.5 million in the first three months of 2014. On a diluted per common share basis, FFO was \$0.68 in the first three months of 2015, compared to \$0.65 in the first three months of 2014, an increase of \$0.03, or 4.6%.

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

|                                                                           | <b>Three months ended<br/>March 31,</b> |             |
|---------------------------------------------------------------------------|-----------------------------------------|-------------|
|                                                                           | <b>2015</b>                             | <b>2014</b> |
| Net income available to common stockholders                               | \$ 60,494                               | \$ 47,179   |
| Depreciation and amortization, continuing operations                      | 98,037                                  | 89,970      |
| Depreciation of furniture, fixtures and equipment                         | (185)                                   | (91)        |
| Provisions for impairment on investment properties, continuing operations | 2,087                                   | 1,683       |
| Gain on sales of investment properties:                                   |                                         |             |
| Continuing operations                                                     | (7,218)                                 | (1,271)     |
| Discontinued operations                                                   | -                                       | (2,607)     |
| FFO adjustments allocable to noncontrolling interests                     | (315)                                   | (343)       |
| FFO available to common stockholders                                      | \$ 152,900                              | \$ 134,520  |
| FFO per common share, basic and diluted (1)                               | \$ 0.68                                 | \$ 0.65     |
| Distributions paid to common stockholders                                 | \$ 126,682                              | \$ 113,414  |
| FFO in excess of distributions paid to common stockholders                | \$ 26,218                               | \$ 21,106   |
| Weighted average number of common shares used for computation per share:  |                                         |             |
| Basic                                                                     | 225,346,407                             | 207,003,950 |
| Diluted (1)                                                               | 225,508,832                             | 207,007,341 |

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

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

We consider FFO to be an appropriate supplemental measure of a REIT's operating performance as it is based on a net income analysis of property portfolio performance that adds back items such as depreciation and impairments for FFO. The historical accounting convention used for real estate assets requires straight-line depreciation of buildings and improvements, which implies that the value of real estate assets diminishes predictably over time. Since real estate values historically rise and fall with market

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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.

Table of Contents**ADJUSTED FUNDS FROM OPERATIONS AVAILABLE TO COMMON STOCKHOLDERS (AFFO)**

In the first three months of 2015, our AFFO increased by \$19.4 million, or 14.6%, to \$152.1 million versus \$132.7 million in the first three months of 2014. On a diluted per common share basis, AFFO was \$0.67 in the first three months of 2015, compared to \$0.64 in the first three months of 2014, an increase of \$0.03, or 4.7%. We consider AFFO to be an appropriate supplemental measure of our performance. Most companies in our industry use a similar measurement, but they may use the term CAD (for Cash Available for Distribution), FAD (for Funds Available for Distribution) or other terms.

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

|                                                                          |    | <b>Three months ended</b> |             |
|--------------------------------------------------------------------------|----|---------------------------|-------------|
|                                                                          |    | <b>March 31,</b>          |             |
|                                                                          |    | <b>2015</b>               | <b>2014</b> |
| Net income available to common stockholders                              | \$ | 60,494                    | \$ 47,179   |
| Cumulative adjustments to calculate FFO (1)                              |    | 92,406                    | 87,341      |
| FFO available to common stockholders                                     |    | 152,900                   | 134,520     |
| Amortization of share-based compensation                                 |    | 2,552                     | 2,697       |
| Amortization of deferred financing costs (2)                             |    | 1,293                     | 1,076       |
| Amortization of net mortgage premiums                                    |    | (1,884)                   | (2,361)     |
| Gain on early extinguishment of mortgage debt                            |    | (78)                      | (24)        |
| Loss on interest rate swaps                                              |    | 1,058                     | 57          |
| Capitalized leasing costs and commissions                                |    | (313)                     | (192)       |
| Capitalized building improvements                                        |    | (1,032)                   | (1,177)     |
| Straight-line rent                                                       |    | (4,191)                   | (3,936)     |
| Amortization of above and below-market leases                            |    | 1,742                     | 1,994       |
| Other adjustments (3)                                                    |    | 74                        | 6           |
| Total AFFO available to common stockholders                              | \$ | 152,121                   | \$ 132,660  |
| AFFO per common share:                                                   |    |                           |             |
| Basic                                                                    | \$ | 0.68                      | \$ 0.64     |
| Diluted (4)                                                              | \$ | 0.67                      | \$ 0.64     |
| Distributions paid to common stockholders                                | \$ | 126,682                   | \$ 113,414  |
| AFFO in excess of distributions paid to common stockholders              | \$ | 25,439                    | \$ 19,246   |
| Weighted average number of common shares used for computation per share: |    |                           |             |
| Basic                                                                    |    | 225,346,407               | 207,003,950 |
| Diluted (4)                                                              |    | 225,508,832               | 207,007,341 |

(1) See reconciling items for FFO presented under Funds from Operations Available to Common Stockholders (FFO).

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- (2) Includes the amortization of costs incurred and capitalized when our notes were issued in March 2003, November 2003, March 2005, September 2005, September 2006, September 2007, June 2010, June 2011, October 2012, July 2013, June 2014 and September 2014. Additionally, this includes the amortization of deferred financing costs incurred and capitalized in connection with our assumption of the mortgages payable and the issuance of our term loan. The deferred financing costs are being amortized over the lives of the respective mortgages and term loan. No costs associated with our credit facility agreements or annual fees paid to credit rating agencies have been included.
- (3) Includes adjustments allocable to both non-controlling interests and capital lease obligations.
- (4) The computation of diluted AFFO does not assume conversion of securities that are convertible to common shares if the conversion of those securities would increase diluted AFFO per share in a given period.

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

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

### **PROPERTY PORTFOLIO INFORMATION**

At March 31, 2015, we owned a diversified portfolio:

- Of 4,378 properties;
- With an occupancy rate of 98.0%, or 4,292 properties leased and 86 properties available for lease;
- Leased to 236 different commercial tenants doing business in 47 separate industries;
- Located in 49 states and Puerto Rico;
- With over 71.6 million square feet of leasable space; and
- With an average leasable space per property of approximately 16,360 square feet, including approximately 11,250 square feet per retail property and 200,580 square feet per industrial and distribution property.

At March 31, 2015, of our 4,378 properties, 4,292 were leased under net lease agreements. A net lease typically requires the tenant to be responsible for minimum monthly rent and certain property operating expenses including property taxes, insurance, and maintenance. In addition, our tenants are typically subject to future rent increases based on increases in the consumer price index (typically subject to ceilings), additional rent calculated as a percentage of the tenants' gross sales above a specified level, or fixed increases.

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At March 31, 2015, our 236 commercial tenants, which we define as retailers with over 50 locations and non-retailers with over \$500 million in annual revenues, represented approximately 95% of our annualized revenue. We had 272 additional tenants, representing approximately 5% of our annualized revenue at March 31, 2015, which brings our total tenant count to 508 tenants.

Table of Contents**Industry Diversification**

The following table sets forth certain information regarding Realty Income's property portfolio 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<br>Quarter Ended<br>March 31,<br>2015 | Dec 31,<br>2014 | Dec 31,<br>2013 | For the Years Ended |       | Dec 31,<br>2010 | Dec 31,<br>2009 |
|                               | Dec 31,<br>2012                               | Dec 31,<br>2011 |                 |                     |       |                 |                 |
| <u>Retail industries</u>      |                                               |                 |                 |                     |       |                 |                 |
| Apparel stores                | 2.1%                                          | 2.0%            | 1.9%            | 1.7%                | 1.4%  | 1.2%            | 1.1%            |
| Automotive collision services | 0.9                                           | 0.8             | 0.8             | 1.1                 | 0.9   | 1.0             | 1.1             |
| Automotive parts              | 1.3                                           | 1.3             | 1.2             | 1.0                 | 1.2   | 1.4             | 1.5             |
| Automotive service            | 1.8                                           | 1.8             | 2.1             | 3.1                 | 3.7   | 4.7             | 4.8             |
| Automotive tire services      | 3.0                                           | 3.2             | 3.6             | 4.7                 | 5.6   | 6.4             | 6.9             |
| Book stores                   | *                                             | *               | *               | 0.1                 | 0.1   | 0.1             | 0.2             |
| Child care                    | 2.1                                           | 2.2             | 2.8             | 4.5                 | 5.2   | 6.5             | 7.3             |
| Consumer electronics          | 0.3                                           | 0.3             | 0.3             | 0.5                 | 0.5   | 0.6             | 0.7             |
| Convenience stores            | 9.6                                           | 10.1            | 11.2            | 16.3                | 18.5  | 17.1            | 16.9            |
| Crafts and novelties          | 0.5                                           | 0.5             | 0.5             | 0.3                 | 0.2   | 0.3             | 0.3             |
| Dollar stores                 | 9.3                                           | 9.6             | 6.2             | 2.2                 | -     | -               | -               |
| Drug stores                   | 9.6                                           | 9.5             | 8.1             | 3.5                 | 3.8   | 4.1             | 4.3             |
| Education                     | 0.4                                           | 0.4             | 0.4             | 0.7                 | 0.7   | 0.8             | 0.9             |
| Entertainment                 | 0.5                                           | 0.5             | 0.6             | 0.9                 | 1.0   | 1.2             | 1.3             |
| Equipment services            | 0.1                                           | 0.1             | 0.1             | 0.1                 | 0.2   | 0.2             | 0.2             |
| Financial services            | 1.4                                           | 1.4             | 1.5             | 0.2                 | 0.2   | 0.2             | 0.2             |
| General merchandise           | 1.4                                           | 1.2             | 1.1             | 0.6                 | 0.6   | 0.8             | 0.8             |
| Grocery stores                | 3.1                                           | 3.0             | 2.9             | 3.7                 | 1.6   | 0.9             | 0.7             |
| Health and fitness            | 6.8                                           | 7.0             | 6.3             | 6.8                 | 6.4   | 6.9             | 5.9             |
| Health care                   | 1.0                                           | 1.1             | 1.1             | -                   | -     | -               | -               |
| Home furnishings              | 0.7                                           | 0.7             | 0.9             | 1.0                 | 1.1   | 1.3             | 1.3             |
| Home improvement              | 2.2                                           | 1.7             | 1.6             | 1.5                 | 1.7   | 2.0             | 2.2             |
| Jewelry                       | 0.1                                           | 0.1             | 0.1             | -                   | -     | -               | -               |
| Motor vehicle dealerships     | 1.6                                           | 1.6             | 1.6             | 2.1                 | 2.2   | 2.6             | 2.7             |
| Office supplies               | 0.3                                           | 0.4             | 0.5             | 0.8                 | 0.9   | 0.9             | 1.0             |
| Pet supplies and services     | 0.7                                           | 0.7             | 0.8             | 0.6                 | 0.7   | 0.9             | 0.9             |
| Restaurants - casual dining   | 4.0                                           | 4.3             | 5.1             | 7.3                 | 10.9  | 13.4            | 13.7            |
| Restaurants - quick service   | 4.4                                           | 3.7             | 4.4             | 5.9                 | 6.6   | 7.7             | 8.3             |
| Shoe stores                   | 0.1                                           | 0.1             | 0.1             | 0.1                 | 0.2   | 0.1             | -               |
| Sporting goods                | 1.6                                           | 1.6             | 1.7             | 2.5                 | 2.7   | 2.7             | 2.6             |
| Theaters                      | 5.2                                           | 5.3             | 6.2             | 9.4                 | 8.8   | 8.9             | 9.2             |
| Transportation services       | 0.1                                           | 0.1             | 0.1             | 0.2                 | 0.2   | 0.2             | 0.2             |
| Wholesale clubs               | 4.0                                           | 4.1             | 3.9             | 3.2                 | 0.7   | -               | -               |
| Other                         | *                                             | *               | 0.1             | 0.1                 | 0.1   | 0.3             | 1.1             |
| Retail industries             | 80.2%                                         | 80.4%           | 79.8%           | 86.7%               | 88.6% | 95.4%           | 98.3%           |



Table of Contents**Industry Diversification (continued)**

|                              | Percentage of Rental Revenue(1) |                     |                 |                 |                 |                 |                 |
|------------------------------|---------------------------------|---------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
|                              | For the<br>Quarter<br>Ended     | For the Years Ended |                 |                 |                 |                 |                 |
|                              | March 31,<br>2015               | Dec 31,<br>2014     | Dec 31,<br>2013 | Dec 31,<br>2012 | Dec 31,<br>2011 | Dec 31,<br>2010 | Dec 31,<br>2009 |
| <u>Non-retail industries</u> |                                 |                     |                 |                 |                 |                 |                 |
| Aerospace                    | 1.2                             | 1.2                 | 1.2             | 0.9             | 0.5             | -               | -               |
| Beverages                    | 2.7                             | 2.8                 | 3.3             | 5.1             | 5.6             | 3.0             | -               |
| Consumer appliances          | 0.5                             | 0.5                 | 0.6             | 0.1             | -               | -               | -               |
| Consumer goods               | 0.9                             | 0.9                 | 1.0             | 0.1             | -               | -               | -               |
| Crafts and novelties         | 0.1                             | 0.1                 | 0.1             | -               | -               | -               | -               |
| Diversified industrial       | 0.7                             | 0.5                 | 0.2             | 0.1             | -               | -               | -               |
| Electric utilities           | 0.1                             | 0.1                 | *               | -               | -               | -               | -               |
| Equipment services           | 0.5                             | 0.5                 | 0.4             | 0.3             | 0.2             | -               | -               |
| Financial services           | 0.4                             | 0.4                 | 0.5             | 0.4             | 0.3             | -               | -               |
| Food processing              | 1.3                             | 1.4                 | 1.5             | 1.3             | 0.7             | -               | -               |
| General merchandise          | 0.3                             | 0.3                 | -               | -               | -               | -               | -               |
| Government services          | 1.2                             | 1.3                 | 1.4             | 0.1             | 0.1             | 0.1             | 0.1             |
| Health care                  | 0.7                             | 0.7                 | 0.8             | *               | *               | -               | -               |
| Home furnishings             | 0.2                             | 0.2                 | 0.2             | -               | -               | -               | -               |
| Insurance                    | 0.1                             | 0.1                 | 0.1             | *               | -               | -               | -               |
| Machinery                    | 0.2                             | 0.2                 | 0.2             | 0.1             | -               | -               | -               |
| Other manufacturing          | 0.7                             | 0.7                 | 0.6             | -               | -               | -               | -               |
| Packaging                    | 0.9                             | 0.8                 | 0.9             | 0.7             | 0.4             | -               | -               |
| Paper                        | 0.1                             | 0.1                 | 0.2             | 0.1             | 0.1             | -               | -               |
| Shoe stores                  | 0.7                             | 0.8                 | 0.9             | -               | -               | -               | -               |
| Telecommunications           | 0.7                             | 0.7                 | 0.7             | 0.8             | 0.7             | -               | -               |
| Transportation services      | 5.4                             | 5.1                 | 5.3             | 2.2             | 1.6             | -               | -               |
| Other                        | 0.2                             | 0.2                 | 0.1             | 1.0             | 1.2             | 1.5             | 1.6             |
| Non-retail industries        | 19.8%                           | 19.6%               | 20.2%           | 13.3%           | 11.4%           | 4.6%            | 1.7%            |
| 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 as discontinued operations. Excludes revenue from properties owned by Crest Net Lease, Inc., or Crest.

Table of Contents**Property Type Diversification**

The following table sets forth certain property type information regarding Realty Income's property portfolio as of March 31, 2015 (dollars in thousands):

| <b>Property Type</b>        | <b>Number of Properties</b> | <b>Approximate Leasable Square Feet</b> | <b>Rental Revenue for the Quarter Ended March 31, 2015(1)</b> | <b>Percentage of Rental Revenue</b> |
|-----------------------------|-----------------------------|-----------------------------------------|---------------------------------------------------------------|-------------------------------------|
| Retail                      | 4,222                       | 47,512,200                              | \$ 183,804                                                    | 78.2%                               |
| Industrial and distribution | 83                          | 16,648,200                              | 25,229                                                        | 10.7                                |
| Office                      | 44                          | 3,403,200                               | 15,044                                                        | 6.4                                 |
| Manufacturing               | 14                          | 3,875,200                               | 5,616                                                         | 2.4                                 |
| Agriculture                 | 15                          | 184,500                                 | 5,274                                                         | 2.3                                 |
| Totals                      | 4,378                       | 71,623,300                              | \$ 234,967                                                    | 100.0%                              |

(1) Includes rental revenue for all properties owned by Realty Income at March 31, 2015. Excludes revenue of \$41 from properties owned by Crest and \$114 from sold properties that were included in continuing operations.

**Tenant Diversification**

The largest tenants based on percentage of total portfolio rental revenue at March 31, 2015 include the following:

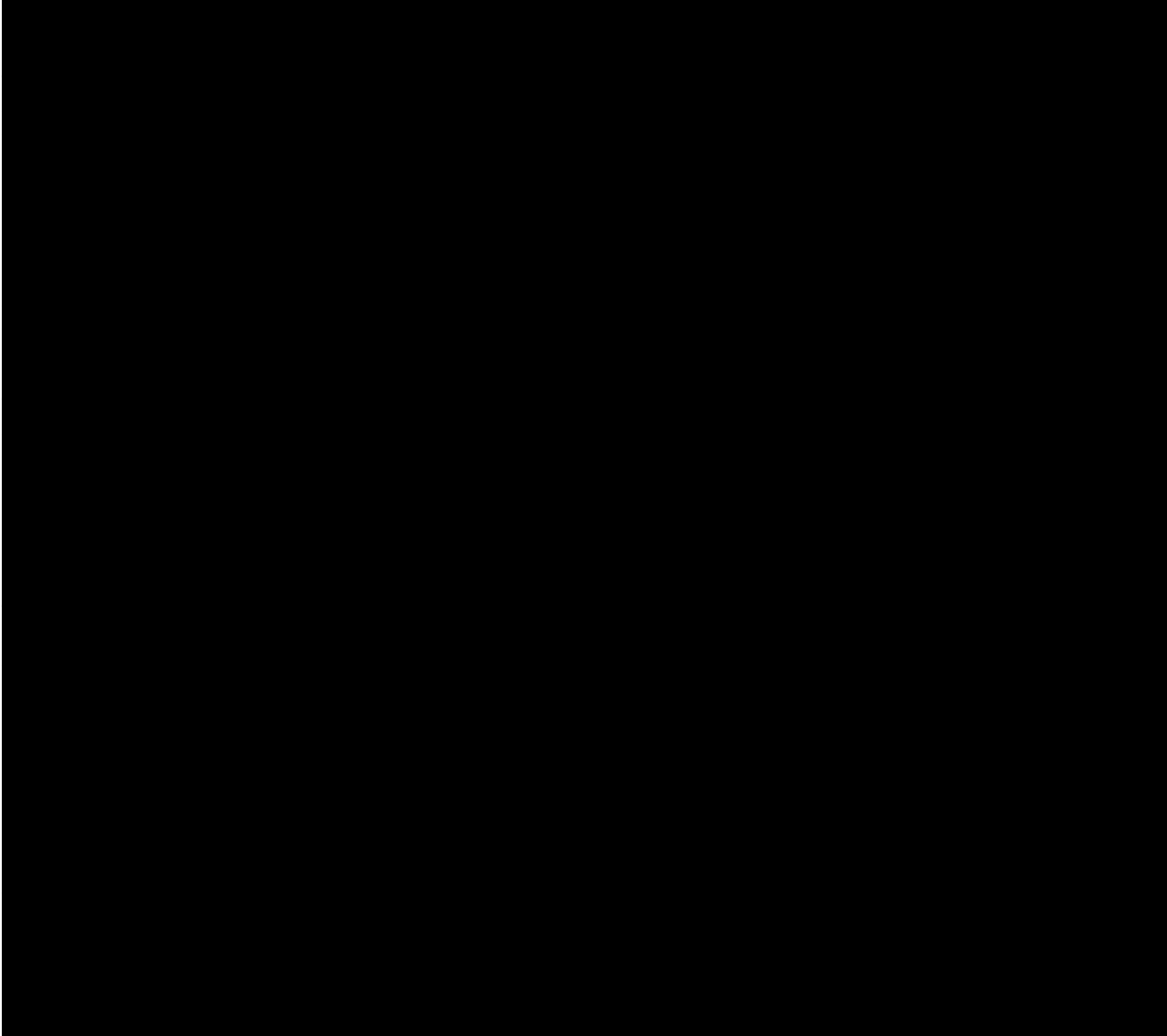
| <b>Tenant</b>                      | <b>Number of Properties</b> | <b>% of Revenue</b> |
|------------------------------------|-----------------------------|---------------------|
| Walgreens                          | 124                         | 5.5%                |
| FedEx                              | 38                          | 5.2%                |
| Dollar General                     | 502                         | 4.8%                |
| LA Fitness                         | 46                          | 4.5%                |
| Family Dollar                      | 454                         | 4.4%                |
| Circle K / The Pantry              | 312                         | 3.3%                |
| BJ's Wholesale Clubs               | 15                          | 2.8%                |
| AMC Theatres                       | 20                          | 2.7%                |
| Diageo                             | 17                          | 2.6%                |
| Regal Cinemas                      | 23                          | 2.2%                |
| Northern Tier Energy/Super America | 134                         | 2.2%                |
| CVS Pharmacy                       | 55                          | 2.1%                |
| Rite Aid                           | 58                          | 1.9%                |
| TBC Corporation                    | 149                         | 1.9%                |
| GPM Investments/Fas Mart           | 136                         | 1.5%                |
| Walmart/Sam's Club                 | 19                          | 1.4%                |
| NPC International                  | 202                         | 1.4%                |
| FreedomRoads/Camping World         | 18                          | 1.2%                |
| Smart & Final                      | 36                          | 1.2%                |
| U. S. Government                   | 15                          | 1.2%                |



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**Service Category Diversification for our Retail Properties**

The following table sets forth certain information regarding the 4,222 retail properties, included in the 4,378 total properties, owned by Realty Income at March 31, 2015, classified according to the business types and the level of services they provide at the property level (dollars in thousands):



\* Less than 0.1%

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(1) Includes rental revenue for all retail properties owned by Realty Income at March 31, 2015. Excludes revenue of \$51,163 from non-retail properties, \$41 from properties owned by Crest and \$114 from sold properties that were included in continuing operations.

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**Lease Expirations**

The following table sets forth certain information regarding Realty Income's property portfolio regarding the timing of the lease term expirations (excluding rights to extend a lease at the option of the tenant) on our 4,273 net leased, single-tenant properties as of March 31, 2015 (dollars in thousands):

| Year        | Total Portfolio(1) |                     |                           | Initial Expirations(3)               |                |                           | Subsequent Expirations(4)            |              |                           |                                      |            |
|-------------|--------------------|---------------------|---------------------------|--------------------------------------|----------------|---------------------------|--------------------------------------|--------------|---------------------------|--------------------------------------|------------|
|             | Number of Leases   |                     | Approx. Leasable Sq. Feet | Rental Revenue for the Quarter Ended | % of Total     | Number of Leases Expiring | Rental Revenue for the Quarter Ended | % of Total   | Number of Leases Expiring | Rental Revenue for the Quarter Ended | % of Total |
|             | Expiring Retail    | Expiring Non-Retail |                           | Mar 31, 2015(2)                      | Rental Revenue | Mar 31, 2015              | Rental Revenue                       | Mar 31, 2015 | Rental Revenue            |                                      |            |
| 2015        | 108                | -                   | 577,300                   | \$ 2,359                             | 1.0%           | 57                        | \$ 1,282                             | 0.6%         | 51                        | \$ 1,077                             | 0.4%       |
| 2016        | 206                | 1                   | 1,257,100                 | 5,039                                | 2.2            | 123                       | 2,860                                | 1.2          | 84                        | 2,179                                | 1.0        |
| 2017        | 214                | 1                   | 2,185,300                 | 6,557                                | 2.8            | 49                        | 2,954                                | 1.3          | 166                       | 3,603                                | 1.5        |
| 2018        | 279                | 9                   | 3,787,200                 | 11,803                               | 5.1            | 157                       | 8,297                                | 3.6          | 131                       | 3,506                                | 1.5        |
| 2019        | 240                | 11                  | 3,954,400                 | 13,515                               | 5.8            | 170                       | 11,321                               | 4.9          | 81                        | 2,194                                | 0.9        |
| 2020        | 151                | 12                  | 4,004,300                 | 11,238                               | 4.9            | 107                       | 9,392                                | 4.1          | 56                        | 1,846                                | 0.8        |
| 2021        | 176                | 12                  | 5,166,300                 | 14,238                               | 6.1            | 177                       | 13,660                               | 5.9          | 11                        | 578                                  | 0.2        |
| 2022        | 225                | 18                  | 7,441,700                 | 15,181                               | 6.6            | 221                       | 14,517                               | 6.3          | 22                        | 664                                  | 0.3        |
| 2023        | 350                | 20                  | 6,409,700                 | 22,186                               | 9.6            | 357                       | 21,518                               | 9.3          | 13                        | 668                                  | 0.3        |
| 2024        | 183                | 10                  | 3,384,000                 | 10,138                               | 4.4            | 188                       | 9,975                                | 4.3          | 5                         | 163                                  | 0.1        |
| 2025        | 314                | 12                  | 4,420,600                 | 18,166                               | 7.8            | 302                       | 17,492                               | 7.5          | 24                        | 674                                  | 0.3        |
| 2026        | 233                | 3                   | 2,959,000                 | 11,233                               | 4.8            | 231                       | 11,031                               | 4.7          | 5                         | 202                                  | 0.1        |
| 2027        | 468                | 3                   | 5,301,700                 | 19,362                               | 8.3            | 468                       | 18,865                               | 8.1          | 3                         | 497                                  | 0.2        |
| 2028        | 285                | 5                   | 6,051,200                 | 16,327                               | 7.1            | 288                       | 16,273                               | 7.1          | 2                         | 54                                   | *          |
| 2029        | 323                | 4                   | 5,538,700                 | 14,040                               | 6.1            | 321                       | 13,431                               | 5.8          | 6                         | 609                                  | 0.3        |
| 2030 - 2043 | 363                | 34                  | 7,237,200                 | 40,227                               | 17.4           | 393                       | 40,078                               | 17.3         | 4                         | 149                                  | 0.1        |
| Totals      | 4,118              | 155                 | 69,675,700                | \$ 231,609                           | 100.0%         | 3,609                     | \$ 212,946                           | 92.0%        | 664                       | \$ 18,663                            | 8.0%       |

\* Less than 0.1%

(1) Excludes 19 multi-tenant properties and 86 vacant properties. The lease expirations for properties under construction are based on the estimated date of completion of those properties.

(2) Excludes revenue of \$3,358 from 19 multi-tenant properties and from 86 vacant properties at March 31, 2015, \$114 from sold properties included in continuing operations and \$41 from properties owned by Crest.

(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.

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The following table sets forth certain state-by-state information regarding Realty Income's property portfolio as of March 31, 2015 (dollars in thousands):

| <b>State</b>          | <b>Number of Properties</b> | <b>Percent Leased</b> | <b>Approximate Leasable Square Feet</b> | <b>Rental Revenue for the Quarter Ended March 31, 2015(1)</b> | <b>Percentage of Rental Revenue</b> |
|-----------------------|-----------------------------|-----------------------|-----------------------------------------|---------------------------------------------------------------|-------------------------------------|
| Alabama               | 129                         | 98%                   | 1,117,500                               | \$ 3,487                                                      | 1.5%                                |
| Alaska                | 3                           | 100                   | 275,900                                 | 541                                                           | 0.2                                 |
| Arizona               | 112                         | 97                    | 1,527,000                               | 6,000                                                         | 2.6                                 |
| Arkansas              | 53                          | 100                   | 782,600                                 | 1,660                                                         | 0.7                                 |
| California            | 164                         | 100                   | 5,221,400                               | 24,052                                                        | 10.2                                |
| Colorado              | 71                          | 96                    | 1,013,000                               | 3,814                                                         | 1.6                                 |
| Connecticut           | 25                          | 96                    | 536,900                                 | 2,460                                                         | 1.0                                 |
| Delaware              | 17                          | 100                   | 78,300                                  | 633                                                           | 0.3                                 |
| Florida               | 322                         | 99                    | 3,842,000                               | 13,684                                                        | 5.8                                 |
| Georgia               | 237                         | 98                    | 3,362,400                               | 10,178                                                        | 4.3                                 |
| Hawaii                | --                          | --                    | --                                      | --                                                            | --                                  |
| Idaho                 | 12                          | 100                   | 87,000                                  | 853                                                           | 0.4                                 |
| Illinois              | 163                         | 99                    | 4,590,800                               | 13,078                                                        | 5.6                                 |
| Indiana               | 142                         | 100                   | 1,413,600                               | 6,491                                                         | 2.8                                 |
| Iowa                  | 35                          | 91                    | 2,751,700                               | 3,390                                                         | 1.4                                 |
| Kansas                | 84                          | 95                    | 1,467,400                               | 3,437                                                         | 1.5                                 |
| Kentucky              | 56                          | 98                    | 915,700                                 | 3,193                                                         | 1.4                                 |
| Louisiana             | 90                          | 99                    | 1,025,900                               | 3,097                                                         | 1.3                                 |
| Maine                 | 10                          | 90                    | 145,300                                 | 889                                                           | 0.4                                 |
| Maryland              | 34                          | 100                   | 791,100                                 | 4,709                                                         | 2.0                                 |
| Massachusetts         | 81                          | 95                    | 751,100                                 | 3,337                                                         | 1.4                                 |
| Michigan              | 137                         | 99                    | 1,254,300                               | 4,125                                                         | 1.8                                 |
| Minnesota             | 155                         | 98                    | 1,209,600                               | 8,106                                                         | 3.4                                 |
| Mississippi           | 121                         | 98                    | 1,560,700                               | 3,895                                                         | 1.7                                 |
| Missouri              | 137                         | 97                    | 2,776,000                               | 8,342                                                         | 3.6                                 |
| Montana               | 1                           | 100                   | 5,400                                   | 13                                                            | *                                   |
| Nebraska              | 31                          | 100                   | 708,700                                 | 1,815                                                         | 0.8                                 |
| Nevada                | 22                          | 100                   | 413,000                                 | 1,291                                                         | 0.5                                 |
| New Hampshire         | 20                          | 100                   | 320,100                                 | 1,507                                                         | 0.6                                 |
| New Jersey            | 67                          | 96                    | 577,300                                 | 3,588                                                         | 1.5                                 |
| New Mexico            | 31                          | 97                    | 302,500                                 | 870                                                           | 0.4                                 |
| New York              | 85                          | 98                    | 2,184,600                               | 11,039                                                        | 4.7                                 |
| North Carolina        | 152                         | 99                    | 1,534,400                               | 5,949                                                         | 2.5                                 |
| North Dakota          | 7                           | 86                    | 66,000                                  | 123                                                           | 0.1                                 |
| Ohio                  | 218                         | 98                    | 5,258,100                               | 12,634                                                        | 5.4                                 |
| Oklahoma              | 125                         | 99                    | 1,492,600                               | 3,745                                                         | 1.6                                 |
| Oregon                | 25                          | 100                   | 525,400                                 | 1,844                                                         | 0.8                                 |
| Pennsylvania          | 147                         | 99                    | 1,792,400                               | 7,261                                                         | 3.1                                 |
| Rhode Island          | 4                           | 100                   | 157,200                                 | 808                                                           | 0.3                                 |
| South Carolina        | 133                         | 99                    | 971,900                                 | 4,517                                                         | 1.9                                 |
| South Dakota          | 11                          | 100                   | 133,500                                 | 244                                                           | 0.1                                 |
| Tennessee             | 210                         | 96                    | 2,634,100                               | 6,312                                                         | 2.7                                 |
| Texas                 | 438                         | 97                    | 8,136,100                               | 23,026                                                        | 9.8                                 |
| Utah                  | 15                          | 100                   | 760,000                                 | 1,482                                                         | 0.6                                 |
| Vermont               | 5                           | 100                   | 98,000                                  | 480                                                           | 0.2                                 |
| Virginia              | 141                         | 98                    | 2,872,700                               | 7,368                                                         | 3.1                                 |
| Washington            | 38                          | 97                    | 415,300                                 | 1,583                                                         | 0.7                                 |
| West Virginia         | 12                          | 100                   | 261,200                                 | 984                                                           | 0.4                                 |
| Wisconsin             | 43                          | 98                    | 1,456,200                               | 2,827                                                         | 1.2                                 |
| Wyoming               | 3                           | 67                    | 21,100                                  | 57                                                            | *                                   |
| Puerto Rico           | 4                           | 100                   | 28,300                                  | 149                                                           | 0.1                                 |
| <b>Totals/Average</b> | <b>4,378</b>                | <b>98%</b>            | <b>71,623,300</b>                       | <b>\$ 234,967</b>                                             | <b>100.0%</b>                       |

\* Less than 0.1%

(1) Includes rental revenue for all properties owned by Realty Income at March 31, 2015. Excludes revenue of \$41 from properties owned by Crest and \$114 from sold properties that were included in continuing operations.



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**IMPACT OF INFLATION**

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

Of our 4,378 properties in our portfolio, approximately 97.6% or 4,273 are leased to tenants under net leases where the tenant is responsible for property expenses. Net leases tend to reduce our exposure to rising property expenses due to inflation. Inflation and increased costs may have an adverse impact on our tenants if increases in their operating expenses exceed increases in revenue.

**IMPACT OF RECENT ACCOUNTING PRONOUNCEMENTS**

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

**OTHER INFORMATION**

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

Our 6.625% Monthly Income Class F Cumulative Redeemable Preferred Stock is listed on the NYSE under the ticker symbol **OprF** with a cusip number of 756109-807.

We maintain a corporate website at [www.realtyincome.com](http://www.realtyincome.com). On our website we make available, free of charge, copies of our annual report on Form 10-K, quarterly reports on Form 10-Q, Form 3s, Form 4s, Form 5s, current reports on Form 8-K, and amendments to those reports, as soon as reasonably practicable after we electronically file these reports with the SEC. None of the information on our website is deemed to be a part of this report.

We are committed to providing an enjoyable, diverse, and safe working atmosphere for our employees, to upholding our responsibilities as a public company operating for the benefit of our shareholders, and to being mindful of the environment. As The Monthly Dividend Company®, we believe our primary responsibility is to provide monthly dividends to our shareholders. How we manage and use the physical, human, and financial resources that enable us to acquire and own the real estate, which provides us

with the lease revenue to pay monthly dividends, demonstrates our commitment to corporate responsibility.

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

We apply the principles of full and fair disclosure in all of our business dealings, as outlined in our Corporate Code of Business Ethics. We are also committed to dealing fairly with all of our customers, suppliers, and competitors.

*Corporate Governance.* We believe that nothing is more important than a company's reputation for integrity and serving as a responsible fiduciary for its shareholders. We are committed to managing the company for the benefit of our shareholders and are focused on maintaining good corporate governance. Practices that illustrate this commitment include:

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

*Environmental Practices.* Our focus on energy related matters is demonstrated by how we manage our day-to-day activities in our corporate headquarters. In our headquarters, we promote energy conservation and encourage the following practices:

- Powering down office equipment at the end of the day;
- Setting copier machines to energy saver mode;
- Encouraging employees to reduce paper usage whenever possible, by storing documents electronically and using duplex copy mode;
- Employing an automated lights out system that is activated 24/7;
- Programming HVAC to only operate during normal business operating hours; and
- Encouraging employees to carpool to our headquarters.

In addition, our headquarters was constructed according to the State of California energy standards, specifically following California Green Building Standards Code and Title 24 of the California Code of Regulations, with features including high efficiency lighting and heating and cooling systems.

With respect to recycling and reuse practices, we encourage the use of recycled products and the recycling of materials during our operations. Recycling bins are placed in all areas where materials are regularly disposed of and at the individual desks of our employees. Cell phones, wireless devices and office equipment are recycled or donated whenever possible.

With respect to the properties that we own, these properties are net-leased to our tenants who are responsible for maintaining the buildings and are in control of their energy usage and environmental sustainability practices.

**Item 3: Quantitative and Qualitative Disclosures about Market Risk**

We are exposed to interest rate changes primarily as a result of our credit facility, term loan, mortgages payable, and long-term notes and bonds used to maintain liquidity and expand our real estate investment portfolio and operations. Our interest rate risk management objective is to limit the impact of interest rate changes on earnings and cash flow and to lower our overall borrowing costs. To achieve these objectives we issue long-term notes and bonds, primarily at fixed rates.

In order to mitigate and manage the effects of interest rate risks on our operations, we may utilize a variety of financial instruments, including interest rate swaps and caps. The use of these types of instruments to hedge our exposure to changes in interest rates carries additional risks, including counterparty credit risk, the enforceability of hedging contracts and the risk that unanticipated and significant changes in interest rates will cause a significant loss of basis in the contract. To limit counterparty credit risk we will seek to enter into such agreements with major financial institutions with favorable credit ratings. There can be no assurance that we will be able to adequately protect against the foregoing risks or realize an economic benefit that exceeds the related amounts incurred in connection with engaging in such hedging activities. We do not enter into any derivative transactions for speculative or trading purposes.

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The following table presents by year of expected maturity, the principal amounts, average interest rates and estimated fair values of our fixed and variable rate debt as of March 31, 2015. This information is presented to evaluate the expected cash flows and sensitivity to interest rate changes (dollars in millions):

Expected Maturity Data

| Year of maturity | Fixed rate debt | Weighted average interest rate on fixed rate debt | Variable rate debt | Weighted average interest rate on variable rate debt |
|------------------|-----------------|---------------------------------------------------|--------------------|------------------------------------------------------|
| 2015             | \$ 218.3        | 5.39 %                                            | \$ 0.1             | 2.52 %                                               |
| 2016             | 523.2           | 5.39                                              | 0.2                | 2.52                                                 |
| 2017             | 307.9           | 5.63                                              | 379.6              | 1.28                                                 |
| 2018             | 364.9           | 2.14                                              | 70.2               | 1.38                                                 |
| 2019             | 554.1           | 6.74                                              | 21.8               | 2.03                                                 |
| Thereafter       | 2,562.4         | 4.52                                              | 22.0               | 2.39                                                 |
| Totals (1)       | \$ 4,530.8      | 4.82 %                                            | \$ 493.9           | 1.37 %                                               |
| Fair Value (2)   | \$ 4,881.1      |                                                   | \$ 490.2           |                                                      |

(1) Excludes net premiums recorded on mortgages payable and original issuance discounts recorded on notes payable. At March 31, 2015, the unamortized balance of net premiums on mortgages payable is \$14.6 million, and the unamortized balance of original issuance discounts on notes payable is \$14.3 million.

(2) We base the estimated fair value of the fixed rate senior notes and bonds at March 31, 2015 on the indicative market prices and recent trading activity of our senior notes and bonds payable. We base the estimated fair value of our fixed rate and variable rate mortgages at March 31, 2015 on the relevant Treasury yield curve, plus an applicable credit-adjusted spread. We believe that the carrying value of the credit facility balance and term loan balance reasonably approximate their estimated fair values at March 31, 2015.

The table incorporates only those exposures that exist as of March 31, 2015. It does not consider those exposures or positions that could arise after that date. As a result, our ultimate realized gain or loss, with respect to interest rate fluctuations, would depend on the exposures that arise during the period, our hedging strategies at the time, and interest rates.

All of our outstanding notes and bonds have fixed interest rates. All of our mortgages payable, except four with an outstanding principal balance of \$53.9 million at March 31, 2015, have fixed interest rates. All of these variable rate mortgages have arrangements that limit our exposure to interest rate risk. Interest on our credit facility and term loan balance is variable. However, the variable interest rate feature on our term loan has been mitigated by an interest rate swap agreement. Based on our credit facility balance of \$370.0 million at March 31, 2015, a 1% change in interest rates would change our interest costs by \$3.7 million per year.

**Item 4: Controls and Procedures**

**Evaluation of Disclosure Controls and Procedures**

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

As of and for the quarter ended March 31, 2015, we carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective and were operating at a reasonable assurance level.

**Changes in Internal Controls**

There were no changes to our internal control over financial reporting that occurred during the quarter ended March 31, 2015 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. As of March 31, 2015, there were no material weaknesses in our internal controls, and therefore, no corrective actions were taken.

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**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.

**PART II. OTHER INFORMATION**

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

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

- 54,254 shares of stock, at a price of \$47.71, during January 2015;
- 469 shares of stock, at a price of \$51.97, during February 2015; and
- 416 shares of stock, at a price of \$51.60, during March 2015.

**Item 6: Exhibits**

**Articles of Incorporation and By-Laws**

**Exhibit No. Description**

- 2.1 Agreement and Plan of Merger, dated as of September 6, 2012, by and among Realty Income Corporation, Tau Acquisition LLC and American Realty Capital Trust, Inc. (filed as exhibit 2.1 to the Company's Form 8-K, filed on September 6, 2012 and incorporated herein by reference).
- 2.2 First Amendment to Agreement and Plan of Merger, dated as of January 6, 2013, by and among Realty Income Corporation, Tau Acquisition LLC and American Realty Capital Trust, Inc. (filed as exhibit 2.1 to the Company's Form 8-K, filed on January 7, 2013 and incorporated herein by reference).
- 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 for the quarter ended June 30, 2005 and incorporated herein by reference), amendment No. 3

dated July 29, 2011 (filed as exhibit 3.1 to the Company's Form 8-K, filed on August 2, 2011 and incorporated herein by reference); and amendment No. 4 dated June 21, 2012 (filed as exhibit 3.1 to the Company's Form 8-K, filed on June 21, 2012 and incorporated herein by reference).

3.2 Amended and Restated Bylaws of the Company dated December 12, 2007 (filed as exhibit 3.1 to the Company's Form 8-K, filed on December 13, 2007 and incorporated herein by reference), as amended on May 13, 2008 (filed as exhibit 3.1 to the Company's Form 8-K, filed on May 14, 2008 and incorporated herein by reference), February 7, 2012 (filed as exhibit 3.1 to the Company's Form 8-K, filed on February 13, 2012 and incorporated herein by reference), February 21, 2012 (filed as exhibit 3.1 to the Company's Form 8-K, filed on February 22, 2012 and incorporated herein by reference), March 13, 2013 (filed as exhibit 3.1 to the Company's Form 8-K, filed on March 14, 2013 and incorporated herein by reference), September 3, 2013 (filed as exhibit 3.1 to the Company's Form 8-K, filed on September 6, 2013 and incorporated herein by reference), and April 15, 2014 (filed as exhibit 3.1 to the Company's Form 8-K filed on April 17, 2014 and incorporated herein by reference).



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- 3.3Articles Supplementary to the Articles of Incorporation of the Company classifying and designating the 6.625% Monthly Income Class F Cumulative Redeemable Preferred Stock, dated February 3, 2012 (the First Class F Articles Supplementary ) (filed as exhibit 3.1 to the Company s Form 8-K, filed on February 3, 2012 and incorporated herein by reference).
- 3.4Certificate of Correction to the First Class F Articles Supplementary, dated April 11, 2012 (filed as exhibit 3.2 to the Company s Form 8-K, filed on April 17, 2012 and incorporated herein by reference).
- 3.5Articles Supplementary to the Articles of Incorporation of the Company classifying and designating additional shares of the 6.625% Monthly Income Class F Cumulative Redeemable Preferred Stock, dated April 17, 2012 (filed as exhibit 3.3 to the Company s Form 8-K, filed on April 17, 2012 and incorporated herein by reference).

**Instruments defining the rights of security holders, including indentures**

- 4.1Indenture 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, filed on October 28, 1998 and incorporated herein by reference).
- 4.2Form of 5.50% Senior Notes due 2015 (filed as exhibit 4.2 to the Company s Form 8-K, filed on November 24, 2003 and incorporated herein by reference).
- 4.3Officer 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 5.50% Senior Notes due 2015 (filed as exhibit 4.3 to the Company s Form 8-K, filed on November 24, 2003 and incorporated herein by reference).
- 4.4Form of 5.875% Senior Notes due 2035 (filed as exhibit 4.2 to the Company s Form 8-K, filed on March 11, 2005 and incorporated herein by reference).
- 4.5Officer 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 5.875% Senior Debentures due 2035 (filed as exhibit 4.3 to the Company s Form 8-K, filed on March 11, 2005 and incorporated herein by reference).
- 4.6Form of 5.375% Senior Notes due 2017 (filed as exhibit 4.2 to the Company s Form 8-K, filed on September 16, 2005 and incorporated herein by reference).
- 4.7Officer 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 5.375% Senior Notes due 2017 (filed as exhibit 4.3 to the Company s Form 8-K, filed on September 16, 2005 and incorporated herein by reference).
- 4.8Form of 5.95% Senior Notes due 2016 (filed as exhibit 4.2 to the Company s Form 8-K, filed on September 18, 2006 and incorporated herein by reference).
- 4.9Officer 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 5.95% Senior Notes due 2016 (filed as exhibit 4.3 to the Company s Form 8-K, filed on September 18, 2006 and incorporated herein by reference).
- 4.10Form of 6.75% Notes due 2019 (filed as exhibit 4.2 to Company s Form 8-K, filed on September 5, 2007 and incorporated herein by reference).



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- 4.11 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 Trust Company, N.A., as Trustee, establishing a series of securities entitled 6.75% Senior Notes due 2019 (filed as exhibit 4.3 to the Company's Form 8-K, filed on September 5, 2007 and incorporated herein by reference).
- 4.12 Form of 5.750% Notes due 2021 (filed as exhibit 4.2 to Company's Form 8-K, filed on June 29, 2010 and incorporated herein by reference).
- 4.13 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 Mellon Trust Company, N.A., as Successor Trustee, establishing a series of securities entitled 5.750% Notes due 2021 (filed as exhibit 4.3 to the Company's Form 8-K, filed on June 29, 2010 and incorporated herein by reference).
- 4.14 Form of Common Stock Certificate (filed as exhibit 4.16 to the Company's Form 10-Q for the quarter ended September 30, 2011 and incorporated herein by reference).
- 4.15 Form of Preferred Stock Certificate representing the 6.625% Monthly Income Class F Cumulative Redeemable Preferred Stock (filed as exhibit 4.1 to the Company's Form 8-K, filed on February 3, 2012 and incorporated herein by reference).
- 4.16 Form of 2.000% Note due 2018 (filed as exhibit 4.2 to Company's Form 8-K, filed on October 10, 2012 and incorporated herein by reference).
- 4.17 Form of 3.250% Note due 2022 (filed as exhibit 4.3 to Company's Form 8-K, filed on October 10, 2012 and incorporated herein by reference).
- 4.18 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 Mellon Trust Company, N.A., as successor trustee, establishing a series of securities entitled 2.000% Notes due 2018 and establishing a series of securities entitled 3.250% Notes due 2022 (filed as exhibit 4.4 to the Company's Form 8-K, filed on October 10, 2012 and incorporated herein by reference).
- 4.19 Form of 4.650% Note due 2023 (filed as exhibit 4.2 to Company's Form 8-K, filed on July 16, 2013 and incorporated herein by reference).
- 4.20 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 Mellon Trust Company, N.A., as successor trustee, establishing a series of securities entitled 4.650% Notes due 2023 (filed as exhibit 4.3 to the Company's Form 8-K, filed on July 16, 2013 and incorporated herein by reference).
- 4.21 Form of 3.875% Note due 2024 (filed as exhibit 4.2 to Company's Form 8-K, filed on June 25, 2014 and incorporated herein by reference).
- 4.22 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 Mellon Trust Company, N.A., as successor trustee, establishing a series of securities entitled 3.875% Notes due 2024 (filed as exhibit 4.3 to the Company's Form 8-K, filed on June 25, 2014 and incorporated herein by reference).
- 4.23 Form of 4.125% Note due 2026 (filed as exhibit 4.2 to Company's Form 8-K, filed on September 23, 2014 and incorporated herein by reference).

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4.24 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 Mellon Trust Company, N.A., as successor trustee, establishing a series of securities entitled 4.125% Notes due 2026 (filed as exhibit 4.3 to the Company's Form 8-K, filed on September 23, 2014 and incorporated herein by reference).

**Material Contracts**

\*10.1 Form of Performance Share Award Agreement

10.2 Dividend Reinvestment and Stock Purchase Plan (filed pursuant to Rule 424(b)(5) under the Securities Act of 1933, as amended, on February 23, 2015, as a prospectus supplement to the Company's prospectus dated February 22, 2013 (File No. 333-186788) and incorporated herein by reference).

**Certifications**

\*31.1 Rule 13a-14(a) Certifications as filed by the Chief Executive Officer pursuant to SEC release No. 33-8212 and 34-47551.

\*31.2 Rule 13a-14(a) Certifications as filed by the Chief Financial Officer pursuant to SEC release No. 33-8212 and 34-47551.

\*32 Section 1350 Certifications as furnished by the Chief Executive Officer and the Chief Financial Officer pursuant to SEC release No. 33-8212 and 34-47551.

**Interactive Data Files**

\*101 The following materials from Realty Income Corporation's Quarterly Report on Form 10-Q for the year period ended March 31, 2015, formatted in Extensible Business Reporting Language: (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Cash Flows, (iv) Notes to Consolidated Financial Statements.

\* Filed herewith.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: April 30, 2015

REALTY INCOME CORPORATION  
/s/ SEAN P. NUGENT  
Sean P. Nugent  
Vice President, Controller  
(Principal Accounting Officer)

