

REALTY INCOME CORP
Form 10-Q
July 28, 2016
[Table of Contents](#)

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 June 30, 2016, 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)

Edgar Filing: REALTY INCOME CORP - Form 10-Q

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 258,569,373 shares of common stock outstanding as of July 21, 2016.

Table of Contents

REALTY INCOME CORPORATION

Index to Form 10-Q

June 30, 2016

<u>PART I.</u>	<u>FINANCIAL INFORMATION</u>	Page
<u>Item 1:</u>	<u>Financial Statements</u>	
	<u>Consolidated Balance Sheets</u>	2
	<u>Consolidated Statements of Income</u>	3
	<u>Consolidated Statements of Cash Flows</u>	4
	<u>Notes to Consolidated Financial Statements</u>	5
<u>Item 2:</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	
	<u>Forward-Looking Statements</u>	19
	<u>The Company</u>	20
	<u>Recent Developments</u>	23
	<u>Liquidity and Capital Resources</u>	26
	<u>Results of Operations</u>	31
	<u>Funds from Operations Available to Common Stockholders (FFO)</u>	38
	<u>Adjusted Funds from Operations Available to Common Stockholders (AFFO)</u>	39
	<u>Property Portfolio Information</u>	40
	<u>Impact of Inflation</u>	47
	<u>Impact of Recent Accounting Pronouncements</u>	47
	<u>Other Information</u>	47
<u>Item 3:</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	48
<u>Item 4:</u>	<u>Controls and Procedures</u>	49
<u>PART II.</u>	<u>OTHER INFORMATION</u>	
<u>Item 2:</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	50
<u>Item 6:</u>	<u>Exhibits</u>	50
<u>SIGNATURE</u>		54

Table of Contents

PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements

REALTY INCOME CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

June 30, 2016 and December 31, 2015

(dollars in thousands, except per share data)

	2016 (unaudited)	2015
ASSETS		
Real estate, at cost:		
Land	\$ 3,436,504	\$ 3,286,004
Buildings and improvements	9,403,441	9,010,778
Total real estate, at cost	12,839,945	12,296,782
Less accumulated depreciation and amortization	(1,841,790)	(1,687,665)
Net real estate held for investment	10,998,155	10,609,117
Real estate held for sale, net	9,991	9,767
Net real estate	11,008,146	10,618,884
Cash and cash equivalents	20,443	40,294
Accounts receivable, net	87,166	81,678
Acquired lease intangible assets, net	1,063,045	1,034,417
Goodwill	15,220	15,321
Other assets, net	55,411	54,785
Total assets	\$ 12,249,431	\$ 11,845,379
LIABILITIES AND EQUITY		
Distributions payable	\$ 54,023	\$ 50,344
Accounts payable and accrued expenses	130,024	115,826
Acquired lease intangible liabilities, net	256,512	250,916
Other liabilities	41,191	53,965
Line of credit payable	512,000	238,000
Term loans, net	318,981	318,835
Mortgages payable, net	496,348	646,187
Notes payable, net	3,620,275	3,617,973
Total liabilities	5,429,354	5,292,046
Commitments and contingencies		
Stockholders' equity:		

Edgar Filing: REALTY INCOME CORP - Form 10-Q

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 June 30, 2016 and December 31, 2015, liquidation preference \$25.00 per share	395,378	395,378
Common stock and paid in capital, par value \$0.01 per share, 370,100,000 shares authorized, 257,954,902 shares issued and outstanding as of June 30, 2016 and 250,416,757 shares issued and outstanding as of December 31, 2015	8,105,229	7,666,428
Distributions in excess of net income	(1,699,966)	(1,530,210)
Total stockholders' equity	6,800,641	6,531,596
Noncontrolling interests	19,436	21,737
Total equity	6,820,077	6,553,333
Total liabilities and equity	\$ 12,249,431	\$ 11,845,379

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

Table of Contents

REALTY INCOME CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

For the three and six months ended June 30, 2016 and 2015

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

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
REVENUE				
Rental	\$ 260,056	\$ 241,431	\$ 516,857	\$ 476,554
Tenant reimbursements	11,112	11,607	20,217	21,570
Other	(129)	822	1,081	2,604
Total revenue	271,039	253,860	538,155	500,728
EXPENSES				
Depreciation and amortization	110,342	101,101	218,275	199,138
Interest	57,409	58,680	118,088	117,148
General and administrative	13,985	12,609	26,304	25,471
Property (including reimbursable)	14,671	14,937	29,776	28,914
Income taxes	953	628	1,917	1,702
Provisions for impairment	6,269	3,230	8,192	5,317
Total expenses	203,629	191,185	402,552	377,690
Gain on sales of real estate	8,658	3,675	10,948	10,893
Net income	76,068	66,350	146,551	133,931
Net income attributable to noncontrolling interests	(253)	(263)	(493)	(581)
Net income attributable to the Company	75,815	66,087	146,058	133,350
Preferred stock dividends	(6,770)	(6,770)	(13,540)	(13,540)
Net income available to common stockholders	\$ 69,045	\$ 59,317	\$ 132,518	\$ 119,810
Amounts available to common stockholders per common share:				
Net income:				
Basic	\$ 0.27	\$ 0.26	\$ 0.53	\$ 0.52
Diluted	\$ 0.27	\$ 0.25	\$ 0.53	\$ 0.52
Weighted average common shares outstanding:				
Basic	253,375,546	232,403,586	251,792,989	228,932,782

Edgar Filing: REALTY INCOME CORP - Form 10-Q

Diluted

253,973,745

232,886,185

252,390,707

229,378,784

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

-3-

Table of Contents

REALTY INCOME CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the six months ended June 30, 2016 and 2015

(dollars in thousands) (unaudited)

	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 146,551	\$ 133,931
Adjustments to net income:		
Depreciation and amortization	218,275	199,138
Amortization of share-based compensation	6,552	5,362
Non-cash rental adjustments	(5,279)	(4,939)
Amortization of net premiums on mortgages payable	(1,855)	(3,824)
Amortization of deferred financing costs	4,384	6,509
Loss on interest rate swaps	7,886	1,958
Gain on sales of real estate	(10,948)	(10,893)
Provisions for impairment on real estate	8,192	5,317
Change in assets and liabilities		
Accounts receivable and other assets	6,946	1,778
Accounts payable, accrued expenses and other liabilities	(19,277)	(12,627)
Net cash provided by operating activities	361,427	321,710
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment in real estate	(618,340)	(924,541)
Improvements to real estate, including leasing costs	(2,934)	(2,470)
Proceeds from sales of real estate	35,020	30,455
Collection of loans receivable	12,457	-
Restricted escrow deposits for Section 1031 tax-deferred exchanges and pending acquisitions	(17,291)	21,313
Net cash used in investing activities	(591,088)	(875,243)
CASH FLOWS FROM FINANCING ACTIVITIES		
Cash distributions to common stockholders	(298,581)	(258,277)
Cash dividends to preferred stockholders	(13,540)	(13,540)
Borrowings on line of credit	2,244,000	957,000
Payments on line of credit	(1,970,000)	(750,000)
Principal payments on mortgages payable	(181,333)	(79,291)
Proceeds from term loans	-	250,000
Proceeds from common stock offerings, net	383,525	276,430
Redemption of preferred units	-	(6,750)
Distributions to noncontrolling interests	(747)	(848)
Debt issuance costs	-	(10,204)
Proceeds from dividend reinvestment and stock purchase plan	5,806	208,033
Proceeds from At-the-Market (ATM) program	44,565	-
Other items, including shares withheld upon vesting	(3,885)	(4,131)
Net cash provided by financing activities	209,810	568,422
Net (decrease) increase in cash and cash equivalents	(19,851)	14,889
Cash and cash equivalents, beginning of period	40,294	3,852
Cash and cash equivalents, end of period	\$ 20,443	\$ 18,741

For supplemental disclosures, see note 16.

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

Table of Contents

REALTY INCOME CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2016

(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, 2015, which are included in our 2015 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 June 30, 2016, we owned 4,646 properties, located in 49 states and Puerto Rico, containing over 79.0 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 10). 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 taxable net income, we generally will not be required to pay federal corporate income taxes on such income. Accordingly, no provision has been made for federal income taxes in the accompanying consolidated financial statements, except for federal income taxes of our taxable REIT subsidiaries. The income taxes recorded on our consolidated statements of income represent amounts paid by Realty

Income 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 receivable and appropriate allowances to record. The allowance for doubtful accounts was \$1.5 million at June 30, 2016 and \$429,000 at December 31, 2015.

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. Based on our analyses of goodwill during the second quarters of 2016 and 2015, we determined there was no impairment on our existing goodwill.

E. In May 2014, the Financial Accounting Standards Board, or FASB, issued ASU 2014-09, *Revenue from Contracts with Customers*. This ASU outlines a comprehensive model for companies to use in accounting for revenue arising from contracts with customers, and will apply to transactions such as the sale of real estate. This ASU is effective for interim and annual periods beginning after December 15, 2017. We have not yet adopted this topic and do not expect it to have a material impact on our consolidated financial statements.

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

Table of Contents

In April 2015, FASB issued ASU 2015-03, which amends Topic 835, *Other Presentation Matters*. The amendments in this ASU require that debt issuance costs be reported on the balance sheet as a direct reduction of the face amount of the debt instrument they relate to, and should not be classified as a deferred charge, as was previously required under the Accounting Standards Codification. We adopted this ASU during the quarter ended March 31, 2016 and, as a result, reclassified deferred financing costs from other assets, net, to the applicable debt caption on the December 31, 2015 balance sheet.

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

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

3. Supplemental Detail for Certain Components of Consolidated Balance Sheets

A. Acquired lease intangible assets, net, consist of the following (dollars in thousands) at:	June 30, 2016	December 31, 2015
Acquired in-place leases	\$ 1,121,112	\$ 1,056,715
Accumulated amortization of acquired in-place leases	(310,141)	(264,399)
Acquired above-market leases	327,050	304,548
Accumulated amortization of acquired above-market leases	(74,976)	(62,447)
	\$ 1,063,045	\$ 1,034,417

B. Other assets, net, consist of the following (dollars in thousands) at:	June 30, 2016	December 31, 2015
Restricted escrow deposits	21,074	4,179
Prepaid expenses	13,694	14,258
Credit facility origination costs, net	8,734	10,226
Notes receivable issued in connection with property sales	5,448	17,905
Impounds related to mortgages payable	2,701	5,860
Corporate assets, net	2,502	2,313
Other items	1,258	44
	\$ 55,411	\$ 54,785

C. Distributions payable consist of the following declared distributions (dollars in thousands) at:	June 30, 2016	December 31, 2015
---	------------------	----------------------

Edgar Filing: REALTY INCOME CORP - Form 10-Q

Common stock distributions	\$	51,657	\$	47,963
Preferred stock dividends		2,257		2,257
Noncontrolling interests distributions		109		124
	\$	54,023	\$	50,344

-6-

Table of Contents

D. Accounts payable and accrued expenses consist of the following (dollars in thousands) at:	June 30, 2016	December 31, 2015
Notes payable - interest payable	\$ 61,486	\$ 61,486
Property taxes payable	14,990	13,354
Mortgages, term loans, credit line - interest payable and interest rate swaps	14,261	6,813
Accrued costs on properties under development	8,865	9,976
Other items	30,422	24,197
	\$ 130,024	\$ 115,826

E. Acquired lease intangible liabilities, net, consist of the following (dollars in thousands) at:	June 30, 2016	December 31, 2015
Acquired below-market leases	\$ 302,342	\$ 288,412
Accumulated amortization of acquired below-market leases	(45,830)	(37,496)
	\$ 256,512	\$ 250,916

F. Other liabilities consist of the following (dollars in thousands) at:	June 30, 2016	December 31, 2015
Rent received in advance	\$ 29,743	\$ 42,840
Security deposits	6,586	6,418
Capital lease obligations	4,862	4,707
	\$ 41,191	\$ 53,965

4. Investments in Real Estate

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

A. *Acquisitions During the First Six Months of 2016 and 2015*

During the first six months of 2016, we invested \$662.9 million in 153 new properties and properties under development or expansion with an initial weighted average contractual lease rate of 6.5%. The 153 new properties and properties under development or expansion are located in 34 states, will contain approximately 3.5 million leasable square feet, and are 100% leased with a weighted average lease term of 14.8 years. The tenants occupying the new properties operate in 23 industries and the property types are 77.6% retail and 22.4% industrial, based on rental revenue. None of our investments during 2016 caused any one tenant to be 10% or more of our total assets at June 30, 2016.

The \$662.9 million invested during the first six months of 2016 was allocated as follows: \$163.0 million to land, \$428.9 million to buildings and improvements, \$85.0 million to intangible assets related to leases, and \$13.3 million to intangible liabilities related to leases and other assumed liabilities. We also recorded mortgage premiums of \$692,000. There was no material contingent consideration associated with these acquisitions.

Edgar Filing: REALTY INCOME CORP - Form 10-Q

The properties acquired during the first six months of 2016 generated total revenues of \$8.0 million and net income of \$3.8 million during the six months ended June 30, 2016.

Of the \$662.9 million we invested during the first six months of 2016, \$300.7 million of the purchase price allocation is based on a preliminary measurement of fair value that is subject to change. The allocation for these properties represents our current best estimate of fair value, and we expect to finalize the valuations and complete the purchase price allocations in 2016. During the first six months of 2016, we finalized the purchase price allocations for \$195.4 million invested in the fourth quarter of 2015. There were no material changes to our consolidated balance sheets or income statements as a result of these purchase price allocations being finalized.

In comparison, during the first six months of 2015, we invested \$931.2 million in 166 new properties and properties under development or expansion with an initial weighted average contractual lease rate of 6.4%. The 166 new properties and properties under development or expansion, were located in 35 states, contained approximately 4.2 million leasable square feet and were 100% leased with a weighted average lease term of 17.5 years. The tenants occupying the new properties operated in 16 industries and the property types are 92.1% retail and 7.9% industrial, based on rental revenue.

Table of Contents

The \$931.2 million invested during the first six months of 2015 was allocated as follows: \$184.2 million to land, \$697.4 million to buildings and improvements, \$64.0 million to intangible assets related to leases, \$5.8 million to other assets, net, and \$20.2 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 six months of 2015 generated total revenues of \$10.0 million and net income of \$4.9 million for the six months ended June 30, 2015.

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

In the case of a property under development or expansion, the contractual lease rate is generally fixed such that rent varies based on the actual total investment in order to provide a fixed rate of return. When the lease does not provide for a fixed rate of return on a property under development or expansion, the estimated initial weighted average contractual lease rate is computed as follows: estimated net operating income (determined by the lease) for the first full year of each lease, divided by our projected total investment in the property, including land, construction and capitalized interest costs. Of the \$662.9 million we invested during the first six months of 2016, \$61.7 million was invested in 27 properties under development or expansion with an estimated initial weighted average contractual lease rate of 7.1%. Of the \$931.2 million we invested during the first six months of 2015, \$30.4 million was invested in 30 properties under development or expansion with an estimated initial weighted average contractual lease rate of 9.3%.

B. Acquisition Transaction Costs

Acquisition transaction costs of \$85,000 and \$298,000 were recorded to general and administrative expense on our consolidated statements of income during the first six months of 2016 and 2015, respectively.

C. Investments in Existing Properties

During the first six months of 2016, we capitalized costs of \$3.7 million on existing properties in our portfolio, consisting of \$277,000 for re-leasing costs, \$246,000 for recurring capital expenditures and \$3.2 million for non-recurring building improvements. In comparison, during the first six months of 2015, we capitalized costs of \$2.5 million on existing properties in our portfolio.

D. Properties with Existing Leases

Of the \$662.9 million we invested during the first six months of 2016, approximately \$411.2 million was used to acquire 51 properties with existing leases. In comparison, of the \$931.2 million we invested during the first six months of 2015, approximately \$209.8 million was used to acquire 34 properties with existing leases. The value of the in-place and above-market leases is recorded to acquired lease intangible assets, net on our consolidated balance sheets, and the value of the below-market leases is

recorded to acquired lease intangible liabilities, net on our consolidated balance sheets.

The values of the in-place leases are amortized as depreciation and amortization expense. The amounts amortized to expense for all of our in-place leases, for the first six months of 2016 and 2015, were \$45.7 million and \$43.5 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 six months of 2016 and 2015 were \$4.2 million and \$3.7 million, respectively. If a lease was to be terminated prior to its stated expiration, all unamortized amounts relating to that lease would be recorded to revenue or expense, as appropriate.

Table of Contents

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 June 30, 2016 (in thousands):

		Net increase (decrease) to rental revenue		Increase to amortization expense
2016	\$	(4,270)	\$	48,008
2017		(8,495)		94,899
2018		(8,247)		92,404
2019		(7,257)		81,720
2020		(6,584)		75,916
Thereafter		39,291		418,024
Totals	\$	4,438	\$	810,971

5. Credit Facility

In June 2015, we entered into a \$2.0 billion unsecured revolving credit facility, or our credit facility, which replaced our \$1.5 billion credit facility that was scheduled to expire in May 2016. The initial term of our credit facility expires in June 2019 and includes, at our option, two six-month extensions. Our credit facility has a \$1.0 billion accordion expansion option. Under our credit facility, our investment grade credit ratings as of June 30, 2016 provide for financing at the London Interbank Offered Rate, commonly referred to as LIBOR, plus 0.90% with a facility commitment fee of 0.15%, for all-in drawn pricing of 1.05% over LIBOR. The borrowing rate is subject to an interest rate floor. We also have other interest rate options available to us under our credit facility. Our credit facility is unsecured and, accordingly, we have not pledged any assets as collateral for this obligation.

At June 30, 2016, credit facility origination costs of \$8.7 million are included in other assets, net on our consolidated balance sheet. This balance includes \$9.1 million of credit facility origination costs incurred during 2015 as a result of entering into our credit facility. These costs, as well as a portion of the costs incurred as a result of entering into our previous credit facilities, are being amortized over the remaining term of our credit facility.

At June 30, 2016, we had a borrowing capacity of \$1.49 billion available on our credit facility (subject to customary conditions to borrowing) and an outstanding balance of \$512.0 million, as compared to an outstanding balance of \$238.0 million at December 31, 2015.

The weighted average interest rate on outstanding borrowings under our credit facility was 1.4% during the first six months of 2016 and 1.3% during the first six months of 2015 under our previous \$1.5 billion credit facility. At June 30, 2016, the weighted average interest rate on borrowings outstanding was 1.5%. Our credit facility is subject to various leverage and interest coverage ratio limitations, and at June 30, 2016, we remain in compliance with the covenants on our credit facility.

6. Term Loans

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

In January 2013, in conjunction with our acquisition of American Realty Capital Trust, Inc., or ARCT, we entered into a \$70 million senior unsecured term loan maturing January 21, 2018. Borrowing under this term loan bears interest at the current one month LIBOR, plus 1.2%. In conjunction with this term loan, we also entered into an interest rate swap which effectively fixes our per annum interest rate on this term loan at 2.15%.

Deferred financing costs of \$1.2 million incurred in conjunction with the \$250 million term loan and \$303,000 incurred in conjunction with the \$70 million term loan are being amortized over the remaining terms of each respective term loan. The net balance of these deferred financing costs, which was \$1.0 million at June 30, 2016, and \$1.2 million at December 31, 2015, is included within term loans, net on our consolidated balance sheets.

Table of Contents**7. Mortgages Payable**

During the first six months of 2016, we made \$181.3 million in principal payments, including the repayment of eight mortgages in full for \$161.5 million. Additionally, we assumed mortgages totaling \$32.5 million, excluding net premiums. The assumed mortgages are secured by the properties on which the debt was placed. Approximately \$9.7 million of the assumed mortgages are considered non-recourse debt with limited customary exceptions for items such as solvency, bankruptcy, misrepresentation, fraud, misapplication of payments, environmental liabilities, failure to pay taxes, insurance premiums, liens on the property, violations of the single purpose entity requirements, and uninsured losses, and the remaining \$22.8 million of the assumed mortgages are non-recourse debt without such exceptions. We expect to pay off our mortgages as soon as prepayment penalties make it economically feasible to do so.

During the first six months of 2016, aggregate net premiums totaling \$692,000 were recorded upon the assumption of a mortgage with an above-market interest rate. 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 June 30, 2016, we remain in compliance with these covenants.

During the first six months of 2015, we made \$79.3 million in principal payments, including the repayment of five mortgages in full for \$75.6 million. No mortgages were assumed during the first six months of 2015.

We did not incur any deferred financing costs on our mortgages assumed in 2016. The balance of our deferred financing costs, which are classified as part of mortgages payable, net, on our consolidated balance sheets, was \$442,000 at June 30, 2016 and \$553,000 at December 31, 2015. These costs are being amortized over the remaining term of each mortgage.

The following is a summary of all our mortgages payable as of June 30, 2016 and December 31, 2015, respectively (dollars in thousands):

As Of	Number of Properties(1)	Weighted Average Stated Interest Rate(2)	Weighted Average Effective Interest Rate(3)	Weighted Average Remaining Years Until Maturity	Remaining Principal Balance	Unamortized Premium and Deferred Finance Costs Balance, net	Mortgage Payable Balance
6/30/16	129	5.0%	4.3%	4.2	\$ 488,870	\$ 7,478	\$ 496,348
12/31/15	183	4.9%	4.1%	3.6	\$ 637,658	\$ 8,529	\$ 646,187

(1) At June 30, 2016, there were 38 mortgages on 129 properties, while at December 31, 2015, there were 44 mortgages on 183 properties. The mortgages require monthly payments, with principal payments due at maturity. The mortgages are at fixed interest rates, except for five mortgages on 14 properties totaling \$58.3 million at June 30, 2016, including net unamortized discounts. At December 31, 2015, four mortgages on 13 properties totaling \$51.1 million, including net unamortized discounts, were at variable interest rates. After factoring in arrangements which limit our

Edgar Filing: REALTY INCOME CORP - Form 10-Q

exposure to interest rate risk and effectively fix our per annum interest rates, our variable rate mortgage debt includes three mortgages totaling \$22.6 million at June 30, 2016, and two mortgages totaling \$15.5 million at December 31, 2015.

(2) Stated interest rates ranged from 2.3% to 6.9% at June 30, 2016, while stated interest rates ranged from 2.0% to 6.9% at December 31, 2015.

(3) Effective interest rates ranged from 2.3% to 8.8% at June 30, 2016, while effective interest rates ranged from 2.2% to 8.9% at December 31, 2015.

Table of Contents

The following table summarizes the maturity of mortgages payable, excluding net premiums of \$7.9 million and deferred finance costs of \$442,000, as of June 30, 2016 (dollars in millions):

Year of Maturity		Principal
2016	\$	4.8
2017		149.7
2018		15.5
2019		26.3
2020		82.4
Thereafter		210.2
Totals	\$	488.9

8. Notes Payable

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

		June 30, 2016		December 31, 2015
5.950% 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
2.000% notes, issued in October 2012 and due in January 2018		350		350
6.750% notes, issued in September 2007 and due in August 2019		550		550
5.750% notes, issued in June 2010 and due in January 2021		250		250
3.250% notes, issued in October 2012 and due in October 2022		450		450
4.650% notes, issued in July 2013 and due in August 2023		750		750
3.875% notes, issued in June 2014 and due in July 2024		350		350
4.125% notes, issued in September 2014 and due in October 2026		250		250
5.875% bonds, \$100 issued in March 2005 and \$150 issued in June 2011, both due in March 2035		250		250
Total principal amount		3,650		3,650
Unamortized original issuance discounts and deferred financing costs		(30)		(32)
	\$	3,620	\$	3,618

The following table summarizes the maturity of our notes and bonds payable as of June 30, 2016, excluding unamortized original issuance discounts and deferred financing costs (dollars in millions):

Year of Maturity		Principal
2016	\$	275
2017		175
2018		350
2019		550

Edgar Filing: REALTY INCOME CORP - Form 10-Q

2020		-
Thereafter		2,300
Totals	\$	3,650

As of June 30, 2016, the weighted average interest rate on our notes and bonds payable was 4.7% and the weighted average remaining years until maturity was 6.0 years. In September 2016, we expect to repay our \$275 million 5.95% notes.

9. Equity

A. *Issuance of Common Stock*

In May 2016, we issued 6,500,000 shares of common stock. After underwriting discounts and other offering costs of \$12.1 million, the net proceeds of \$383.5 million were used to repay borrowings under our credit facility.

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

Table of Contents

B. Dividend Reinvestment and Stock Purchase Plan

Our Dividend Reinvestment and Stock Purchase Plan, or the DRSP, provides our common stockholders, as well as new investors, with a convenient and economical method of purchasing our common stock and reinvesting their distributions. 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 26,000,000 common shares to be issued. During the first six months of 2016, we issued 98,585 shares and raised approximately \$5.8 million under the DRSP. During the first six months of 2015, we issued 4,335,580 shares and raised approximately \$208.3 million under the DRSP. From the inception of the DRSP through June 30, 2016, we have issued 12,798,447 shares and raised approximately \$587.4 million.

We pay for a majority of the plan-related fees related to our DRSP. Additionally, our DRSP includes a waiver approval process, allowing larger investors or institutions, per a formal approval process, to purchase shares at a small discount, if approved by us. During the first six months of 2016, we did not issue shares under the waiver approval process. During the first six months of 2015, we issued 4,239,477 shares and raised \$203.7 million under the waiver approval process. These shares are included in the total activity for the first six months of 2015 noted in the preceding paragraph.

C. At-the-Market (ATM) Program

In September 2015, we established an at-the-market equity distribution program, or our ATM program, pursuant to which we can offer and sell up to 12,000,000 shares of common stock. The shares of common stock may be sold to, or through, a consortium of banks acting as our sales agents either by means of ordinary brokers transactions on the NYSE at prevailing market prices or at negotiated prices. During the first six months of 2016, we issued 710,000 shares and raised approximately \$44.6 million under the ATM program.

10. Noncontrolling Interests

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

In June 2013, we completed the acquisition of a portfolio of properties by issuing common partnership units in Realty Income, L.P. The units were issued as consideration for the acquisition. At June 30, 2016, the remaining units from this issuance represent a 0.9% ownership in Realty Income, L.P. We hold the remaining 99.1% interests in this entity and consolidate 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.

Table of Contents

The following table represents the change in the carrying value of all noncontrolling interests through June 30, 2016 (dollars in thousands):

	Tau Operating Partnership units(1)		Realty Income, L.P. units(2)		Total
Carrying value at December 31, 2015	\$	13,410	\$	8,327	\$ 21,737
Reallocation of equity		491		52	543
Redemptions		-		(2,606)	(2,606)
Distributions		(378)		(353)	(731)
Allocation of net income		128		365	493
Carrying value at June 30, 2016	\$	13,651	\$	5,785	\$ 19,436

(1) 317,022 Tau Operating Partnership units were issued on January 22, 2013 and remained outstanding as of June 30, 2016 and December 31, 2015.

(2) 534,546 Realty Income, L.P. units were issued on June 27, 2013, 331,364 units were outstanding as of December 31, 2015, and 228,182 remain outstanding as of June 30, 2016.

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. In January 2015, we redeemed all 6,750 Tau Operating Partnership preferred units for \$1,000 per unit, plus accrued and unpaid distributions.

C. During the first quarter of 2016, we adopted ASU 2015-02, which amends Topic 810, *Consolidation*. This ASU amended the criteria used to evaluate whether an entity is a variable interest entity, or VIE, resulting in the conclusion that all limited partnerships are considered VIEs, unless substantive kick-out rights or participating rights exist. Accordingly, we determined that both Tau Operating Partnership and Realty Income, L.P. are VIEs. We have also concluded that we are the primary beneficiary of these VIEs, based on our controlling financial interests. We evaluated the minority unitholder rights noting that they do not hold substantive kick-out rights or participating rights. Below is a summary of selected financial data of consolidated VIEs for which we are the primary beneficiary included in the consolidated balance sheets at June 30, 2016 and December 31, 2015 (in thousands):

	June 30, 2016		December 31, 2015	
Net real estate	\$	3,013,607	\$	3,033,180
Total assets		3,497,988		3,529,667
Total debt		232,443		389,105
Total liabilities		325,276		478,955

11. Fair Value of Financial Instruments

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

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

		Carrying value per balance sheet		Estimated fair value
At June 30, 2016				
Notes receivable issued in connection with property sales	\$	5.4	\$	5.7
Mortgages payable assumed in connection with acquisitions, net		496.3		499.2
Notes and bonds payable, net		3,620.3		3,945.7
At December 31, 2015				
Notes receivable issued in connection with property sales	\$	17.9	\$	19.4
Mortgages payable assumed in connection with acquisitions, net		646.2		651.5
Notes and bonds payable, net		3,618.0		3,828.1

Table of Contents

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

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

We record interest rate swaps on the consolidated balance sheet at fair value. At June 30, 2016, interest rate swaps valued at \$11.8 million were included in accounts payable and accrued expenses on the consolidated balance sheet. The fair value of our interest rate swaps are based on valuation techniques including discounted cash flow analysis on the expected cash flows of each swap, using both observable and unobservable market-based inputs, including interest rate curves. Because this methodology uses observable and unobservable inputs, and the unobservable inputs are not significant to the fair value measurement, the measurement of interest rate swaps is categorized as level two on the three-level valuation hierarchy.

12. Gain on Sales of Real Estate

During the second quarter of 2016, we sold 16 properties for \$24.5 million, which resulted in a gain of \$8.7 million. During the first six months of 2016, we sold 27 properties for \$35.5 million, which resulted in a gain of \$10.9 million.

During the second quarter of 2015, we sold five properties for \$8.2 million, which resulted in a gain of \$3.7 million. During the first six months of 2015, we sold 14 properties for \$30.5 million, which resulted in a gain of \$10.9 million.

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

During the second quarter of 2016, we recorded total provisions for impairment of \$6.3 million on five sold properties and six properties classified as held for sale in the following industries: one in the automotive service industry, eight in the

Edgar Filing: REALTY INCOME CORP - Form 10-Q

restaurant-casual dining industry, one in the restaurant-quick service industry and one among the industries we classify as other. For the first six months of 2016, we recorded total provisions for impairment of \$8.2 million on 11 sold properties, six properties classified as held for sale, and one property classified as held for investment in the following industries: one in the automotive parts industry, one in the automotive service industry, one in the convenience store industry, one in the furniture store industry, one in the health and fitness industry, ten in the restaurant-casual dining industry, one in the restaurant-quick service industry and two among the industries we classify as other.

Table of Contents

In comparison, for the second quarter of 2015, we recorded total provisions for impairment of \$3.2 million on three sold properties and two properties classified as held for investment in the following industries: one in the health and fitness industry, three in the restaurant-casual dining industry, and one among the industries we classify as other. For the first six months of 2015, we recorded total provisions for impairment of \$5.3 million on five sold properties, two properties classified as held for investment, and one property disposed of other than by sale in the following industries: one in the health and fitness industry, six in the restaurant-casual dining industry, and one among the industries we classify as other.

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 six months of 2016 and 2015:

Month	2016		2015	
January	\$	0.1910000	\$	0.1834167
February		0.1985000		0.1890000
March		0.1985000		0.1890000
April		0.1990000		0.1895000
May		0.1990000		0.1895000
June		0.1990000		0.1895000
Total	\$	1.1850000	\$	1.1299167

At June 30, 2016, a distribution of \$0.1995 per common share was payable and was paid in July 2016.

B. 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 six months of 2016 and 2015, we paid six monthly dividends to holders of our Class F preferred stock totaling \$0.828126 per share, or \$13.5 million, and at June 30, 2016, a monthly dividend of \$0.138021 per share was payable and was paid in July 2016. We are current in our obligations to pay dividends on our Class F preferred stock.

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

Edgar Filing: REALTY INCOME CORP - Form 10-Q

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.

-15-

Table of Contents

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.

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Weighted average shares used for the basic net income per share computation	253,375,546	232,403,586	251,792,989	228,932,782
Incremental shares from share-based compensation	281,177	165,577	280,696	128,980
Weighted average partnership common units convertible to common shares that were dilutive	317,022	317,022	317,022	317,022
Weighted average shares used for diluted net income per share computation	253,973,745	232,886,185	252,390,707	229,378,784
Unvested shares from share-based compensation that were anti-dilutive	-	115,789	1,978	107,539
Weighted average partnership common units convertible to common shares that were anti-dilutive	280,498	419,546	305,272	429,988

16. Supplemental Disclosures of Cash Flow Information

Cash paid for interest was \$105.6 million in the first six months of 2016 and \$114.6 million in the first six months of 2015.

Interest capitalized to properties under development was \$212,000 in the first six months of 2016 and \$266,000 the first six months of 2015.

Cash paid for income taxes was \$3.4 million in the first six months of 2016 and \$3.1 million in the first six months of 2015.

The following non-cash activity is included in the accompanying consolidated financial statements:

A. During the first six months of 2016, we assumed mortgages payable to third-party lenders of \$32.5 million, and recorded \$692,000 of net premiums. There were no assumed mortgages payable for the first six months of 2015.

17. Segment Information

Edgar Filing: REALTY INCOME CORP - Form 10-Q

We evaluate performance and make resource allocation decisions on an industry by industry basis. For financial reporting purposes, we have grouped our tenants into 47 activity segments. All of the properties are incorporated into one of the applicable segments. Because almost all of our leases require the tenant to pay operating expenses, rental revenue is the only component of segment profit and loss we measure.

-16-

Table of Contents

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

Assets, as of:	June 30, 2016	December 31, 2015
Segment net real estate:		
Apparel	\$ 177,482	\$ 180,175
Automotive service	130,310	129,068
Automotive tire services	242,893	247,200
Beverages	295,585	297,724
Child care	50,965	52,391
Convenience stores	711,270	723,092
Dollar stores	1,139,394	1,158,948
Drug stores	1,406,370	1,386,387
Financial services	250,145	254,022
General merchandise	258,546	195,030
Grocery stores	326,362	331,565
Health and fitness	826,981	839,872
Health care	218,243	220,018
Home improvement	290,763	268,974
Motor vehicle dealerships	195,624	137,315
Restaurants-casual dining	558,588	421,235
Restaurants-quick service	504,888	466,802
Sporting goods	159,223	141,287
Theaters	370,275	371,617
Transportation services	772,749	686,041
Wholesale club	446,060	452,563
27 other non-reportable segments	1,675,430	1,657,558
Total segment net real estate	11,008,146	10,618,884
Intangible assets:		
Apparel	45,951	48,116
Automotive service	18,861	19,131
Automotive tire services	12,367	13,202
Beverages	2,409	2,538
Convenience stores	15,107	15,843
Dollar stores	54,040	56,420
Drug stores	190,449	189,631
Financial services	32,157	34,626
General merchandise	49,764	41,301
Grocery stores	40,747	42,823
Health and fitness	64,731	65,037
Health care	27,585	29,950
Home improvement	43,536	42,630
Motor vehicle dealerships	23,852	13,182
Restaurants-casual dining	22,625	9,392
Restaurants-quick service	34,724	32,612
Sporting goods	16,061	11,871
Theaters	15,748	17,673
Transportation services	103,884	92,602
Wholesale club	34,469	36,215
Other non-reportable segments	213,978	219,622
Goodwill:		
Automotive service	445	448
Automotive tire services	863	865
Child care	4,999	5,034
Convenience stores	2,008	2,009
Restaurants-casual dining	2,175	2,215
Restaurants-quick service	1,075	1,082

Edgar Filing: REALTY INCOME CORP - Form 10-Q

Other non-reportable segments	3,655	3,668
Other corporate assets	163,020	176,757
Total assets	\$ 12,249,431	\$ 11,845,379

-17-

Table of Contents

Revenue	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Segment rental revenue:				
Apparel	\$ 4,879	\$ 4,932	\$ 9,754	\$ 9,863
Automotive service	4,814	4,795	9,491	9,116
Automotive tire services	7,220	7,280	14,484	14,370
Beverages	6,404	6,328	12,809	12,656
Child care	4,845	4,863	9,937	9,884
Convenience stores	22,789	22,557	45,653	45,073
Dollar stores	22,728	21,943	45,324	43,890
Drug stores	28,638	25,885	57,059	48,483
Financial services	4,252	4,263	8,565	8,528
General merchandise	4,301	3,842	8,560	7,866
Grocery stores	7,408	7,527	15,054	14,882
Health and fitness	21,545	17,396	42,849	33,411
Health care	4,049	4,016	8,065	8,032
Home improvement	6,099	5,506	12,153	10,684
Motor vehicle dealerships	5,595	3,945	9,809	7,760
Restaurants-casual dining	10,633	9,463	20,468	18,912
Restaurants-quick service	12,482	9,620	25,276	19,982
Sporting goods	5,316	4,878	9,872	8,577
Theaters	12,708	12,286	26,157	24,476
Transportation services	13,752	12,251	26,842	25,202
Wholesale club	9,369	9,341	18,738	18,683
27 other non-reportable segments	40,230	38,514	79,938	76,224
Total rental revenue	260,056	241,431	516,857	476,554
Tenant reimbursements	11,112	11,607	20,217	21,570
Other revenue	(129)	822	1,081	2,604
Total revenue	\$ 271,039	\$ 253,860	\$ 538,155	\$ 500,728

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

The amount of share-based compensation costs recognized in general and administrative expense on our consolidated statements of income was \$3.9 million during the second quarter of 2016, \$2.8 million during the second quarter of 2015, \$6.6 million during the first six months of 2016 and \$5.4 million during the first six months of 2015.

A. Restricted Stock

During the first six months of 2016, we granted 169,539 shares of common stock under the 2012 Plan. These shares generally vest over a five-year service period, except for the annual grant of shares to our Board of Directors, totaling 28,000 shares, of which 20,000 shares vested immediately and 8,000 shares vest annually, in equal parts, over a three year service period.

As of June 30, 2016, the remaining unamortized share-based compensation expense related to restricted stock totaled \$18.0 million, which is being amortized on a straight-line basis over the service period of each applicable award. The amount of share-based compensation is based on the fair value of the stock at the grant date. We define the grant date as the date the recipient and Realty Income have a mutual understanding of the key terms and condition of the award, and the recipient of the grant begins to benefit from, or be adversely affected by, subsequent changes in the price of the shares.

Table of Contents

B. Performance Shares and Restricted Stock Units

During the first six months of 2016, we granted 58,569 performance shares, as well as dividend equivalent rights, to our executive officers. The performance shares are earned based on our TSR performance relative to select industry indices as well as achievement of certain operating metrics, and vest 50% on the first and second January 1 after the end of the three year performance period, subject to continued service.

During the first six months of 2016, we also granted 11,098 restricted stock units that vest over a five year service period and have the same economic rights as shares of restricted stock.

As of June 30, 2016, the remaining share-based compensation expense related to the performance shares and restricted stock units totaled \$5.6 million. The fair value of the performance share was estimated on the date of grant using a Monte Carlo Simulation model. The performance shares are being recognized on a tranche-by-tranche basis over the service period. The amount of share-based compensation for the restricted stock units is based on the fair value of our common stock at the grant date. The restricted stock units are being recognized on a straight-line basis over the service period.

19. Commitments and Contingencies

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

At June 30, 2016, we had commitments of \$1.4 million for re-leasing costs, recurring capital expenditures, and non-recurring building improvements. In addition, as of June 30, 2016, we had committed \$32.2 million under construction contracts, which is expected to be paid in the next twelve months.

20. Subsequent Events

In July 2016, we declared the following dividends, which will be paid in August 2016:

- \$0.1995 per share to our common stockholders and
- \$0.138021 per share to our Class F preferred stockholders.

In July 2016, we also declared a dividend of \$0.2015 per share to our common stockholders, which will be paid in September 2016.

In July 2016, we issued 602,269 common shares pursuant to our ATM program, at a weighted average price of \$68.43, receiving proceeds of \$40.6 million.

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.

Table of Contents

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

- Our continued qualification as a real estate investment trust;
- General business and economic conditions;
- Competition;
- Fluctuating interest rates;
- Access to debt and equity capital markets;
- Continued volatility and uncertainty in the credit markets and broader financial markets;
- Other risks inherent in the real estate business including tenant defaults, potential liability relating to environmental matters, illiquidity of real estate investments, and potential damages from natural disasters;
- Impairments in the value of our real estate assets;
- Changes in the tax laws of the United States of America;
- The outcome of any legal proceedings to which we are a party or which may occur in the future; and
- Acts of terrorism and war.

Additional factors that may cause risks and uncertainties include those discussed in the sections entitled "Business", "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K, for the fiscal year ended December 31, 2015.

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

Edgar Filing: REALTY INCOME CORP - Form 10-Q

Realty Income, The Monthly Dividend Company®, is an 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 47 years, Realty Income has been acquiring and managing freestanding commercial properties that generate rental revenue under long-term net lease agreements.

Realty Income (NYSE: O) was founded in 1969, and listed on the New York Stock Exchange, or NYSE, in 1994. 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;
- Optimum exposure to certain tenants and markets through re-leasing vacant properties and selectively selling properties;
- Maximum asset-level returns on properties re-leased and/or sold;
- Optimum value of the existing portfolio by enhancing individual properties, pursuing alternative uses, and deriving ancillary revenue; and
- Investment opportunities in new asset classes for the portfolio.

Table of Contents

At June 30, 2016, we owned a diversified portfolio:

- Of 4,646 properties;
- With an occupancy rate of 98.0%, or 4,551 properties leased and 95 properties available for lease;
- Leased to 246 different commercial tenants doing business in 47 separate industries;
- Located in 49 states and Puerto Rico;
- With over 79.0 million square feet of leasable space; and
- With an average leasable space per property of approximately 17,010 square feet; approximately 11,620 square feet per retail property and 220,560 square feet per industrial property.

Of the 4,646 properties in the portfolio, 4,624, or 99.5%, are single-tenant properties, and the remaining are multi-tenant properties. At June 30, 2016, of the 4,624 single-tenant properties, 4,530 were leased with a weighted average remaining lease term (excluding rights to extend a lease at the option of the tenant) of 9.8 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 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 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 June 30, 2016, consisted of 4,646 properties located in 49 states and Puerto Rico, leased to 246 different commercial tenants doing business in 47 industries. Each of the 47 industries represented in our property portfolio individually accounted for no more than 11.0% of our rental revenue for the quarter ended June 30, 2016. 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:

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

Table of Contents

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 e-commerce. As a result of the execution of this strategy, over 90% of our annualized retail rental revenue at June 30, 2016 is derived from tenants with a service, non-discretionary, and/or low price point component to their business. From a non-retail perspective, we target industrial properties leased to Fortune 1000, primarily investment grade rated companies. We believe 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 returns.

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 proactively 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:

- Overall real estate characteristics, including property value and comparative rental rates;

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

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 44% of our annualized rental revenue comes from properties leased to investment grade rated companies or their subsidiaries. At June 30, 2016, our top 20 tenants represent approximately 54% of our annualized revenue and eight of these tenants have investment grade credit ratings or are subsidiaries of investment grade rated companies.

Table of Contents

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 our tenants, our tenants' industries and the locations in which we have invested. We also regularly analyze our portfolio with a view towards optimizing its returns and enhancing its overall credit quality.

We regularly review and analyze:

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

We have an active 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 June 30, 2016, we classified 13 properties with a carrying amount of \$10.0 million as held for sale on our balance sheet. For 2016, we intend to continue our active disposition efforts to further enhance our real estate portfolio and anticipate \$50 to \$75 million in property sales in 2016. 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 2016 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 47-year policy of paying monthly dividends. In addition, we increased the dividend four times during 2016. As of July 2016, we have paid 75 consecutive quarterly dividend increases and increased the dividend 87 times since our listing on the NYSE in 1994.

2016 Dividend increases	Month Declared	Month Paid		Dividend per share		Increase per share
1st increase	Dec 2015	Jan 2016	\$	0.1910	\$	0.0005
2nd increase	Jan 2016	Feb 2016	\$	0.1985	\$	0.0075
3rd increase	Mar 2016	Apr 2016	\$	0.1990	\$	0.0005
4th increase	Jun 2016	Jul 2016	\$	0.1995	\$	0.0005
5th increase	Jul 2016	Sep 2016	\$	0.2015	\$	0.0020

The dividends paid per share during the first six months of 2016 totaled approximately \$1.185, as compared to approximately \$1.130 during the first six months of 2015, an increase of \$0.055, or 4.9%.

The monthly dividend of \$0.1995 per share represents a current annualized dividend of \$2.394 per share, and an annualized dividend yield of approximately 3.5% based on the last reported sale price of our common stock on the NYSE of \$69.36 on June 30, 2016. In July 2016, our Board of Directors declared a 1% increase in our monthly dividend to \$0.2015 per share beginning in September 2016. The new monthly dividend amount represents an annualized dividend of \$2.418 per share. 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.

Table of Contents

Acquisitions During the Second Quarter of 2016

During the second quarter of 2016, we invested \$310.3 million in 57 new properties and properties under development or expansion, with an estimated initial weighted average contractual lease rate of 6.3%. The 57 new properties and properties under development or expansion are located in 22 states, will contain approximately 1.7 million leasable square feet and are 100% leased, with a weighted average lease term of 13.5 years. The tenants occupying the new properties operate in 14 industries and the property types are 68.0% retail and 32.0% industrial, based on rental revenue.

Acquisitions During the First Six Months of 2016

During the first six months of 2016, we invested \$662.9 million in 153 new properties and properties under development or expansion, with an initial weighted average contractual lease rate of 6.5%. The 153 new properties and properties under development or expansion are located in 34 states, will contain approximately 3.5 million leasable square feet, and are 100% leased with a weighted average lease term of 14.8 years. The tenants occupying the new properties operate in 23 industries and the property types are 77.6% retail and 22.4% industrial, based on rental revenue. During the first six months of 2016, none of our real estate investments caused any one tenant to be 10% or more of our total assets at June 30, 2016.

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

In the case of a property under development or expansion, the contractual lease rate is generally fixed such that rent varies based on the actual total investment in order to provide a fixed rate of return. When the lease does not provide for a fixed rate of return on a property under development or expansion, the estimated initial weighted average contractual lease rate is computed as follows: estimated net operating income (determined by the lease) for the first full year of each lease, divided by our projected total investment in the property, including land, construction and capitalized interest costs. Of the \$662.9 million we invested during the first six months of 2016, \$61.7 million was invested in 27 properties under development or expansion with an estimated initial weighted average contractual lease rate of 7.1%. We may continue to pursue development or expansion opportunities under similar arrangements in the future.

Portfolio Discussion

Leasing Results

At June 30, 2016, we had 95 properties available for lease out of 4,646 properties in our portfolio, which represents a 98.0% occupancy rate based on the number of properties in our portfolio. Since December 31, 2015, when we reported 71 properties available for lease out of 4,538 and a 98.4% occupancy rate, we:

- Had 120 lease expirations (including leases rejected in bankruptcy);
- Re-leased 75 properties; and

- Sold 21 vacant properties.

Of the 75 properties re-leased during the first six months of 2016, 58 properties were re-leased to existing tenants, eight were re-leased to the same tenants without vacancy, and nine were re-leased to new tenants after a period of vacancy. The annual rent on these 75 leases was \$9,889,000, as compared to the previous rent on these same properties of \$9,578,000, which represents a rent recapture rate of 103.2%.

At June 30, 2016, our average annualized rental revenue was approximately \$13.44 per square foot on the 4,551 leased properties in our portfolio. At June 30, 2016, we classified 13 properties with a carrying amount of \$10.0 million as held for sale on our balance sheet. The expected sale of these properties does not represent a strategic shift that will have a major effect on our operations and financial results.

Investments in Existing Properties

In the second quarter of 2016, we capitalized costs of \$2.4 million on existing properties in our portfolio, consisting of \$86,000 for re-leasing costs, \$174,000 for recurring capital expenditures, and \$2.2 million for non-recurring building improvements. In the second quarter of 2015, we capitalized costs of \$1.1 million on existing properties in our portfolio.

Table of Contents

In the first six months of 2016, we capitalized costs of \$3.7 million on existing properties in our portfolio, consisting of \$277,000 for re-leasing costs, \$246,000 for recurring capital expenditures, and \$3.2 million for non-recurring building improvements. In the first six months of 2015, we capitalized costs of \$2.5 million on existing properties in our portfolio.

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

Capital Raising

During the quarter ended June 30, 2016, Realty Income issued 6,747,127 common shares at a weighted average price of \$61.06, receiving net proceeds of \$399.6 million. During the six months ended June 30, 2016, Realty Income issued 7,308,585 common shares at a weighted average price of \$61.03, receiving net proceeds of \$433.2 million. In July 2016, Realty Income issued 602,269 common shares at a weighted average price of \$68.43, receiving net proceeds of \$40.6 million.

Net Income Available to Common Stockholders

Net income available to common stockholders was \$69.0 million in the second quarter of 2016, compared to \$59.3 million in the second quarter of 2015, an increase of \$9.7 million. On a diluted per common share basis, net income was \$0.27 in the second quarter of 2016, compared to \$0.25 in the second quarter of 2015, an increase of \$0.02, or 8.0%.

Net income available to common stockholders was \$132.5 million in the first six months of 2016, compared to \$119.8 million in the first six months of 2015, an increase of \$12.7 million. On a diluted per common share basis, net income was \$0.53 in the first six months of 2016, as compared to \$0.52 in the first six months of 2015, an increase of \$0.01, or 1.9%.

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

Gains from the sale of properties during the second quarter of 2016 were \$8.7 million, as compared to gains from the sale of properties of \$3.7 million during the second quarter of 2015. Gains from the sale of properties during the first six months of 2016 and 2015 were \$10.9 million.

Funds from Operations Available to Common Stockholders (FFO)

In the second quarter of 2016, our FFO increased by \$17.1 million, or 10.7%, to \$176.6 million, compared to \$159.5 million in the second quarter of 2015. On a diluted per common share basis, FFO was \$0.70 in the second quarter of 2016 and \$0.69 in the second quarter of 2015, an increase of \$0.01, or 1.4%. FFO for the quarter ended June 30, 2016 was impacted by a non-cash loss of \$2.1 million, or \$0.01 per share, resulting from fair value adjustments on our interest rate swaps. Each quarter we adjust the carrying value of our interest rate swaps to fair value. The changes in the fair value of our interest rate swaps are recorded to interest expense.

In the first six months of 2016, our FFO increased by \$34.9 million, or 11.2%, to \$347.3 million versus \$312.4 million in the first six months of 2015. On a diluted per common share basis, FFO was \$1.38 in the first six months of 2016, compared to \$1.36 in the first six months of 2015, an increase of \$0.02, or 1.5%. FFO for the six months ended June 30, 2016 was impacted by a non-cash loss of \$7.9 million, or \$0.03 per share, resulting from fair value adjustments on our interest rate swaps, as described above.

Table of Contents

Adjusted Funds from Operations Available to Common Stockholders (AFFO)

In the second quarter of 2016, our AFFO increased by \$21.8 million, or 13.7%, to \$180.9 million, compared to \$159.1 million in the second quarter of 2015. On a diluted common share basis, AFFO was \$0.71 in the second quarter of 2016 and \$0.68 in the second quarter of 2015, an increase of \$0.03, or 4.4%.

In the first six months of 2016, our AFFO increased by \$45.6 million, or 14.7%, to \$356.8 million versus \$311.2 million in the first six months of 2015. On a diluted per common share basis, AFFO was \$1.42 in the first six months of 2016, compared to \$1.36 in the first six months of 2015, an increase of \$0.06, or 4.4%.

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

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 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 June 30, 2016, our total outstanding borrowings of senior unsecured notes and bonds, term loans, mortgages payable and credit facility borrowings were \$4.97 billion, or approximately 21.3% of our total market capitalization of \$23.31 billion.

We define our total market capitalization at June 30, 2016 as the sum of:

- Shares of our common stock outstanding of 257,954,902, plus total common units outstanding of 545,204, multiplied by the last reported sales price of our common stock on the NYSE of \$69.36 per share on June 30, 2016, or \$17.93 billion;
- Aggregate liquidation value (par value of \$25.00 per share) of the Class F preferred stock of \$408.8 million;
- Outstanding borrowings of \$512.0 million on our credit facility;
- Outstanding mortgages payable of \$488.9 million, excluding net mortgage premiums of \$7.9 million and deferred financing costs of \$442,000;
- Outstanding borrowings of \$320.0 million on our term loans, excluding deferred financing costs of \$1.0 million; and
- Outstanding senior unsecured notes and bonds of \$3.65 billion, excluding unamortized original issuance discounts of \$12.6 million and deferred financing costs of \$17.1 million.

At-the-Market (ATM) Program

In September 2015, we established an at-the-market equity distribution program, or our ATM program, pursuant to which we can offer and sell up to 12,000,000 shares of common stock to, or through, a consortium of banks acting as our sales agents by means of ordinary brokers transactions on the NYSE at prevailing market prices or at negotiated prices. During the first six months of 2016, we issued 710,000 shares and raised approximately \$44.6 million under the ATM program.

Table of Contents

Dividend Reinvestment and Stock Purchase Plan

Our Dividend Reinvestment and Stock Purchase Plan, or the DRSP, provides our common stockholders, as well as new investors, with a convenient and economical method of purchasing our common stock and reinvesting their distributions. 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 26,000,000 common shares to be issued. In 2013, we revised our DRSP so that we would pay for a majority of the plan-related fees, which were previously paid by investors, and to institute a waiver approval process, allowing larger investors or institutions, per a formal approval process, to purchase shares at a small discount, if approved by us. During the first six months of 2016, we issued 98,585 shares and raised approximately \$5.8 million under the DRSP. During the first six months of 2016, we did not issue shares under the waiver approval process.

Universal Shelf Registration

In December 2015, we filed a shelf registration statement with the SEC, which is effective for a term of three years and will expire in December 2018. In accordance with SEC rules, the amount of securities to be issued pursuant to this shelf registration statement was not specified when it was filed and there is no specific dollar limit. The securities covered by this registration statement include (1) common stock, (2) preferred stock, (3) debt securities, (4) depositary shares representing fractional interests in shares of preferred stock, (5) warrants to purchase debt securities, common stock, preferred stock, or depositary shares, and (6) any combination of these securities. We may periodically offer one or more of these securities in amounts, prices and on terms to be announced when and if these securities are offered. The specifics of any future offerings, along with the use of proceeds of any securities offered, will be described in detail in a prospectus supplement, or other offering materials, at the time of any offering.

Mortgage Debt

As of June 30, 2016, we had \$488.9 million of mortgages payable, all of which were assumed in connection with our property acquisitions. Additionally, at June 30, 2016, we had net premiums totaling \$7.9 million on these mortgages and deferred financing costs of \$442,000. We expect to pay off the mortgages payable as soon as prepayment penalties have declined to a level that would make it economically feasible to do so. During the first six months of 2016, we made \$181.3 million of principal payments, including the repayment of eight mortgages in full for \$161.5 million.

Term Loans

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

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

\$2.0 Billion Revolving Credit Facility

Edgar Filing: REALTY INCOME CORP - Form 10-Q

In June 2015, we entered into a \$2.0 billion unsecured revolving credit facility, which replaced our \$1.5 billion credit facility that was scheduled to expire in May 2016. The initial term of our credit facility expires in June 2019 and includes, at our option, two six-month extensions. Our credit facility has a \$1.0 billion accordion expansion option. Under our credit facility, our investment grade credit ratings as of June 30, 2016 provide for financing at LIBOR, plus 0.9%, with a facility commitment fee of 0.15%, for all-in drawn pricing of 1.05% over LIBOR. The borrowing rate is subject to an interest rate floor. We also have other interest rate options available to us under our credit facility. Our credit facility is unsecured and, accordingly, we have not pledged any assets as collateral for this obligation.

At June 30, 2016, we had a borrowing capacity of \$1.49 billion available on our credit facility and an outstanding balance of \$512.0 million. The interest rate on borrowings outstanding under our credit facility, at June 30, 2016, was 1.5% per annum. We must comply with various financial and other covenants in our credit facility. At June 30, 2016, we remain in compliance with these covenants. We expect to use our credit facility to acquire additional properties and for other general corporate purposes. Any additional borrowings will increase our exposure to interest rate risk.

Table of Contents

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

Notes Outstanding

Our senior unsecured note and bond obligations consist of the following as of June 30, 2016, sorted by maturity date (dollars in millions):

5.950% notes, issued in September 2006 and due in September 2016	\$	275
5.375% notes, issued in September 2005 and due in September 2017		175
2.000% notes, issued in October 2012 and due in January 2018		350
6.750% notes, issued in September 2007 and due in August 2019		550
5.750% notes, issued in June 2010 and due in January 2021		250
3.250% notes, issued in October 2012 and due in October 2022		450
4.650% notes, issued in July 2013 and due in August 2023		750
3.875% notes, issued in June 2014 and due in July 2024		350
4.125% notes, issued in September 2014 and due in October 2026		250
5.875% bonds, \$100 issued in March 2005 and \$150 issued in June 2011, both due in March 2035		250
Total principal amount	\$	3,650
Unamortized original issuance discounts and deferred financing costs		(30)
	\$	3,620

In September 2016, we expect to repay our \$275 million 5.95% notes. All of our outstanding notes and bonds have fixed interest rates and contain various covenants, with which we remain in compliance as of June 30, 2016. Additionally, interest on all of our senior note and bond obligations is paid semiannually.

The following is a summary of the key financial covenants for our senior unsecured notes, as defined and calculated per the terms of our senior notes and bonds. These calculations, which are not based on U.S. GAAP measurements, are presented to investors to show our ability to incur additional debt under the terms of our senior notes and bonds as well as to disclose our current compliance with such covenants, and are not measures of our liquidity or performance. The actual amounts as of June 30, 2016 are:

Note Covenants	Required	Actual
Limitation on incurrence of total debt	≤ 60% of adjusted assets	38.3%
Limitation on incurrence of secured debt	≤ 40% of adjusted assets	3.9%
Debt service coverage (trailing 12 months)(1)	≥ 1.5 x	4.7x
Maintenance of total unencumbered assets	≥ 150% of unsecured debt	270.1%

Table of Contents

(1) This covenant is calculated on a pro forma basis for the preceding four-quarter period on the assumptions that: (i) the incurrence of any Debt (as defined in the covenants) incurred by us since the first day of such four-quarter period and the application of the proceeds therefrom (including to refinance other Debt since the first day of such four-quarter period), (ii) the repayment or retirement of any of our Debt since the first day of such four-quarter period, and (iii) any acquisition or disposition by us of any asset or group since the first day of such four quarters had in each case occurred on July 1, 2015, 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 July 1, 2015, 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 June 30, 2016 (in thousands, for trailing twelve months):

Net income attributable to the Company	\$	296,474
Plus: interest expense		225,450
Plus: provision for taxes		3,384
Plus: depreciation and amortization		428,352
Plus: provisions for impairment		13,434
Plus: pro forma adjustments		41,110
Less: gain on sales of real estate		(22,297)
Income available for debt service, as defined	\$	985,907
Total pro forma debt service charge	\$	208,642
Debt service coverage ratio		4.7

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 June 30, 2016 (in thousands, for the trailing twelve months):

Income available for debt service, as defined	\$	985,907
Pro forma debt service charge plus preferred stock dividends	\$	235,722
Fixed charge coverage ratio		4.2

Cash Reserves

We are organized to operate as an equity REIT that acquires and leases properties and distributes to stockholders, in the form of monthly cash distributions, a substantial portion of our net cash flow generated from leases on our properties. We intend to retain an appropriate amount of cash as working capital. At June 30, 2016, we had cash and cash equivalents totaling \$20.4 million.

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

Credit Agency Ratings

The borrowing interest rates under our credit facility are based upon our ratings assigned by credit rating agencies. As of June 30, 2016, we are assigned the following investment grade corporate credit ratings on our senior unsecured notes and bonds: Moody's Investors Service has assigned a rating of Baa1 with a positive outlook, Standard & Poor's Ratings Group has assigned a rating of BBB+ with a positive outlook, and Fitch Ratings has assigned a rating of BBB+ with a stable outlook.

Based on our current ratings, the facility interest rate as of June 30, 2016 is LIBOR plus 0.9% with a facility commitment fee of 0.15%, for all-in drawn pricing of 1.05% over LIBOR. Our credit facility provides that the interest rate can range between: (i) LIBOR plus 1.55% if our credit rating is lower than BBB-/Baa3 or unrated and (ii) LIBOR plus 0.85% if our credit rating is A-/A3 or higher. In addition, our credit facility provides for a facility commitment fee based on our credit ratings, which range from: (i) 0.3% for a rating lower than BBB-/Baa3 or unrated, and (ii) 0.125% for a credit rating of A-/A3 or higher.

Table of Contents

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 June 30, 2016 (dollars in millions):

Year of Maturity	Credit Facility(1)	Notes and Bonds(2)	Term Loan(3)	Mortgages Payable(4)	Interest(5)	Ground Leases Paid by Realty Income(6)	Ground Leases Paid by Our Tenants(7)	Other(8)	Totals
2016	\$ -	\$ 275.0	\$ -	\$ 4.8	\$ 104.3	\$ 0.7	\$ 6.6	\$ 16.8	\$ 408.2
2017	-	175.0	-	149.7	185.1	1.5	13.4	16.8	541.5
2018	-	350.0	70.0	15.5	166.5	1.6	13.3	-	616.9
2019	512.0	550.0	-	26.3	147.9	1.4	13.2	-	1,250.8
2020	-	-	250.0	82.4	118.3	1.4	13.0	-	465.1
Thereafter	-	2,300.0	-	210.2	452.2	23.2	119.2	-	3,104.8
Totals	\$ 512.0	\$ 3,650.0	\$ 320.0	\$ 488.9	\$ 1,174.3	\$ 29.8	\$ 178.7	\$ 33.6	\$ 6,387.3

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

(2) Excludes non-cash original issuance discounts recorded on the notes payable. The unamortized balance of the original issuance discounts at June 30, 2016, is \$12.6 million. Also excludes deferred financing costs of \$17.1 million.

(3) Excludes deferred financing costs of \$1.0 million.

(4) Excludes non-cash net premiums recorded on the mortgages payable. The unamortized balance of these net premiums at June 30, 2016, is \$7.9 million. Also excludes deferred financing costs of \$442,000.

(5) Interest on the term loans, notes, bonds, mortgages payable, and credit facility has been calculated based on outstanding balances as of June 30, 2016 through their respective maturity dates.

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

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

(8) Other consists of \$32.2 million of commitments under construction contracts and \$1.4 million of commitments for tenant improvements and leasing costs.

Edgar Filing: REALTY INCOME CORP - Form 10-Q

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

Preferred Stock

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

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.

Table of Contents

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 2015, our cash distributions to preferred and common stockholders totaled \$560.3 million, or approximately 136.9% of our estimated taxable income of \$409.4 million. Our estimated taxable income reflects non-cash deductions for depreciation and amortization. Our estimated taxable income is presented to show our compliance with REIT dividend requirements and is not a measure of our liquidity or operating performance. We intend to continue to make distributions to our stockholders that are sufficient to meet this dividend requirement and that will reduce or eliminate our exposure to income taxes. Furthermore, we believe our funds from operations are sufficient to support our current level of cash distributions to our stockholders. Our cash distributions to common stockholders in the first six months of 2016 totaled \$298.6 million, representing 83.7% of our adjusted funds from operations available to common stockholders of \$356.8 million. In comparison, our cash distributions to common stockholders in 2015 totaled \$533.2 million, representing 82.4% of our adjusted funds from operations available to common stockholders of \$647.0 million.

The Class F preferred stockholders receive cumulative distributions at a rate of 6.625% per annum on the \$25.00 per share liquidation preference (equivalent to \$1.65625 per annum per share). 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 under the REIT provisions of the Internal Revenue Code of 1986, as amended, or the Code, our debt service requirements, and any other factors the Board of Directors may deem relevant. In addition, our credit facility contains financial covenants that could limit the amount of distributions payable by us in the event of a default, and which prohibit the payment of distributions on the common or preferred stock in the event that we fail to pay when due (subject to any applicable grace period) any principal or interest on borrowings under our credit facility.

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

Distributions in excess of earnings and profits generally will first be treated as a non-taxable reduction in the stockholders' basis in their stock, but not below zero. Distributions in excess of that basis generally will be taxable as a capital gain to stockholders who hold their shares as a capital asset. Approximately 23.8% of the distributions to our common stockholders, made or deemed to have been made in 2015, were classified as a return of capital for federal income tax purposes. We estimate that in 2016, between 15% and 30% of the distributions may be classified as a return of capital.

RESULTS OF OPERATIONS

Critical Accounting Policies

Edgar Filing: REALTY INCOME CORP - Form 10-Q

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, 2015.

Table of Contents

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

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

Another significant judgment must be made as to if, and when, impairment losses should be taken on our properties when events or a change in circumstances indicate that the carrying amount of the asset may not be recoverable. A provision is made for impairment if estimated future operating cash flows (undiscounted and without interest charges) plus estimated disposition proceeds (undiscounted) are less than the current book value of the property. Key inputs that we utilize in this analysis include projected rental rates, estimated holding periods, historical sales and releases, capital expenditures, and property sales capitalization rates. If a property is held for sale, it is carried at the lower of carrying cost or estimated fair value, less estimated cost to sell. The carrying value of our real estate is the largest component of our consolidated balance sheets. Our strategy of primarily holding properties, long-term, directly decreases the likelihood of their carrying values not being recoverable, thus requiring the recognition of an impairment. However, if our strategy, or one or more of the above assumptions were to change in the future, an impairment may need to be recognized. If events should occur that require us to reduce the carrying value of our real estate by recording provisions for impairment, they could have a material impact on our results of operations.

The following is a comparison of our results of operations for the three and six months ended June 30, 2016, to the three and six months ended June 30, 2015.

Rental Revenue

Rental revenue was \$260.1 million for the second quarter of 2016, as compared to \$241.4 million for the second quarter of 2015, an increase of \$18.7 million, or 7.7%. The increase in rental revenue in the second quarter of 2016 compared to the second quarter of 2015 is primarily attributable to:

- The 128 properties (3.2 million square feet) we acquired in 2016, which generated \$6.2 million of rent in the second quarter of 2016;
- The 254 properties (5.6 million square feet) we acquired in 2015, which generated \$20.0 million of rent in the second quarter of 2016, compared to \$7.8 million in the second quarter of 2015, an increase of \$12.2 million;
- Same store rents generated on 4,093 properties (67.1 million square feet) during the second quarter of 2016 and 2015, increased by \$3.0 million, or 1.4% to \$224.4 million from \$221.4 million;
- A net decrease in straight-line rent and other non-cash adjustments to rent of \$367,000 in the second quarter of 2016 as compared to the second quarter of 2015;

Table of Contents

- A net decrease of \$1.6 million relating to properties sold in the first six months of 2016 and during 2015; and
- A net decrease of \$772,000 relating to the aggregate of (i) rental revenue from properties (133 properties comprising 1.3 million square feet) that were available for lease during part of 2016 or 2015, (ii) rental revenue for 22 properties under development, and (iii) lease termination settlements. In aggregate, the revenues for these items totaled \$6.46 million in the second quarter of 2016, compared to \$7.23 million in the second quarter of 2015.

Rental revenue was \$516.9 million for the first six months of 2016, as compared to \$476.6 million for the first six months of 2015, an increase of \$40.3 million, or 8.5%. The increase in rental revenue in the first six months of 2016 compared to the first six months of 2015 is primarily attributable to:

- The 128 properties (3.2 million square feet) we acquired in the first six months of 2016, which generated \$7.3 million of rent in the first six months of 2016;
- The 254 properties (5.6 million square feet) we acquired in 2015, which generated \$40.0 million of rent in the first six months of 2016, compared to \$9.4 million in the first six months of 2015, an increase of \$30.6 million;
- Same store rents generated on 4,093 properties (67.1 million square feet) during the first six months of 2016 and 2015, increased by \$5.8 million or 1.3%, to \$448.5 million from \$442.7 million;
- A net decrease in straight-line rent and other non-cash adjustments to rent of \$149,000 in the first six months of 2016 as compared to the first six months of 2015;
- A net decrease of \$3.1 million relating to properties sold in the first six months of 2016 and during 2015 that were reported in continuing operations; and
- A net decrease of \$153,000 relating to the aggregate of (i) rental revenue from properties (133 properties comprising 1.3 million square feet) that were available for lease during part of 2016 or 2015, (ii) rental revenue for 22 properties under development, and (iii) lease termination settlements. In aggregate, the revenues for these items totaled \$14.16 million in the first six months of 2016 compared to \$14.31 million in the first six months of 2015.

For purposes of determining the same store rent property pool disclosed above, 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 4,646 properties in the portfolio at June 30, 2016, 4,624, or 99.5%, are single-tenant properties and the remaining are multi-tenant properties. Of the 4,624 single-tenant properties, 4,530, or 98.0%, were net leased with a weighted average remaining lease term (excluding rights to extend a lease at the option of the tenant) of 9.8 years at June 30, 2016. Of our 4,530 leased single-tenant properties, 3,996 or 88.2% were under leases that provide for increases in rents through:

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

Edgar Filing: REALTY INCOME CORP - Form 10-Q

Percentage rent, which is included in rental revenue, was \$1.6 million in the second quarter of 2016, and \$859,000 in the second quarter of 2015. Percentage rent was \$3.2 million in the first six months of 2016, and \$2.3 million in the first six months of 2015. Percentage rent in the first six months of 2016 was less than 1% of rental revenue and we anticipate percentage rent to be less than 1% of rental revenue for the remainder of 2016.

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 June 30, 2016, our portfolio of 4,646 properties was 98.0% leased with 95 properties available for lease, as compared to 98.4% leased, with 71 properties available for lease at December 31, 2015, and 98.2% leased with 81 properties available for lease at June 30, 2015. It has been our experience that approximately 1% to 4% of our property portfolio will be unleased at any given time; however, it is possible that the number of properties available for lease could exceed these levels in the future.

Table of Contents**Tenant Reimbursements**

Contractually obligated reimbursements from tenants for recoverable real estate taxes and operating expenses were \$11.1 million in the second quarter of 2016, compared to \$11.6 million in the second quarter of 2015, and \$20.2 million in the first six months of 2016, compared to \$21.6 million in the first six months of 2015.

Other Revenue

Other revenue, which comprises property-related revenue not included in rental revenue or tenant reimbursements, was \$(129,000) in the second quarter of 2016, compared to \$822,000 in the second quarter of 2015, and \$1.1 million in the six months ended June 30, 2016, compared to \$2.6 million in the same period of 2015. The decrease in the second quarter of 2016 is related to the reclassification of an approximately \$1.0 million payment that was received from a tenant in March 2016, initially recorded to other revenue, and subsequently reclassified to rental revenue on our consolidated statement of income during April 2016 based on additional information received regarding the nature of the payment.

Depreciation and Amortization

Depreciation and amortization was \$110.3 million for the second quarter of 2016, compared to \$101.1 million for the second quarter of 2015. Depreciation and amortization was \$218.3 million for the first six months of 2016, compared to \$199.1 million for the first six months of 2015. The increase in depreciation and amortization in the first six months of 2016 was primarily due to the acquisition of properties in 2015 and the first six months of 2016, which was partially offset by property sales in those same periods. As discussed in the sections entitled Funds from Operations Available to Common Stockholders (FFO) and Adjusted Funds from Operations Available to Common Stockholders (AFFO), depreciation and amortization is a non-cash item that is added back to net income available to common stockholders for our calculation of FFO and AFFO.

Interest Expense

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

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Interest on our credit facility, term loans, notes, mortgages and interest rate swaps	\$ 53,198	\$ 56,828	\$ 106,368	\$ 113,402
Credit facility commitment fees	758	665	1,517	1,321
Amortization of credit facility origination costs and deferred financing costs	2,107	2,246	4,229	4,401
Loss on interest rate swaps	2,109	899	7,886	1,958
Amortization of net mortgage premiums	(754)	(1,862)	(1,855)	(3,823)
Capital lease obligation	77	77	155	155
Interest capitalized	(86)	(173)	(212)	(266)
Interest expense	\$ 57,409	\$ 58,680	\$ 118,088	\$ 117,148
Credit facility, term loans, mortgages and notes				
Average outstanding balances (dollars in thousands)	\$ 4,963,248	\$ 5,092,271	\$ 4,909,826	\$ 5,037,516

Edgar Filing: REALTY INCOME CORP - Form 10-Q

Average interest rates	4.20%	4.43%	4.24%	4.47%
------------------------	-------	-------	-------	-------

The increase in interest expense from the first six months of 2015 to the first six months of 2016 was primarily due to an increase in non-cash losses resulting from fair value adjustments on our interest rate swaps, partially offset by a lower average outstanding debt balance, resulting from the payment of \$150.0 million of notes during November 2015, and the payoff of mortgages during 2015 and first six months of 2016. Each quarter we adjust the carrying value of our interest rate swaps to fair value. Changes in the fair value of our interest rate swaps are recorded to interest expense. We recorded a loss on interest rate swaps of \$7.9 million during the first six months of 2016, compared to a loss of \$2.0 million during the first six months of 2015.

Table of Contents

At June 30, 2016, the weighted average interest rate on our:

- Notes and bonds payable of \$3.65 billion (excluding unamortized original issuance discounts of \$12.6 million and deferred financing costs of \$17.1 million) was 4.7%;
- Mortgages payable of \$488.9 million (excluding net premiums totaling \$7.9 million and deferred financing costs of \$442,000 on these mortgages) was 5.0%;
- Credit facility outstanding borrowings of \$512.0 million was 1.5%;
- Term loans outstanding borrowings of \$320.0 million (excluding deferred financing costs of \$1.0 million) was 1.5%; and
- Combined outstanding notes, bonds, mortgages, term loan and credit facility borrowings of \$4.97 billion was 4.2%.

General and Administrative Expenses

General and administrative expenses increased by \$1.4 million to \$14.0 million in the second quarter of 2016, compared to \$12.6 million in the second quarter of 2015. Included in general and administrative expenses are acquisition transaction costs of \$61,000 in the second quarter of 2016 and \$205,000 in the second quarter of 2015. General and administrative expenses increased by \$833,000 to \$26.3 million for the first six months of 2016, compared to \$25.5 million in the first six months of 2015. Included in general and administrative expenses are acquisition transaction costs of \$85,000 for the first six months of 2016 and \$298,000 for the first six months of 2015. General and administrative costs increased during the first six months of 2016 primarily due to higher stock compensation costs. In July 2016, we had 133 employees, as compared to 127 employees in July 2015.

	Three months ended June 30,			Six months ended June 30,		
	2016	2015		2016	2015	
Dollars in thousands						
General and administrative expenses	\$ 13,985	\$ 12,609	\$	\$ 26,304	\$ 25,471	
Total revenue(1)	259,927	242,253		517,938	479,158	
General and administrative expenses as a percentage of total revenue	5.4%	5.2%		5.1%	5.3%	

(1) Excludes tenant reimbursements revenue.

Property Expenses (including tenant reimbursable expenses)

Property expenses consist of costs associated with unleased properties, non-net-leased properties and general portfolio expenses, as well as contractually obligated reimbursable costs from tenants for recoverable real estate taxes and operating expenses. Expenses related to unleased properties and non-net-leased properties include, but are not limited to, property taxes, maintenance, insurance, utilities, property inspections, bad debt expense and legal fees. General portfolio costs include, but are not limited to, insurance, legal, property inspections, and title search fees. At June 30, 2016, 95 properties were available for lease, as compared to 71 at December 31, 2015 and 81 at June 30, 2015.

Property expenses were \$14.7 million (including \$11.1 million in reimbursable expenses) in the second quarter of 2016, and \$14.9 million (including \$11.6 million in reimbursable expenses) in the second quarter of 2015. Property expenses were \$29.8 million (including \$20.2 million in reimbursable expenses) in the first six months of 2016 and \$28.9 million (including \$21.6 million in reimbursable expenses) in the first six months of 2015. The increase in gross property expenses in the first six months of 2016 is primarily attributable to the increased portfolio size, due to our acquisitions during 2015 and the first six months of 2016.

Edgar Filing: REALTY INCOME CORP - Form 10-Q

	Three months ended		Six months ended	
	June 30,		June 30,	
Dollars in thousands	2016	2015	2016	2015
Property expenses net of tenant reimbursements	\$ 3,559	\$ 3,330	\$ 9,559	\$ 7,344
Total revenue(1)	259,927	242,253	517,938	479,158
Property expenses net of tenant reimbursements as a percentage of total revenue	1.4%	1.4%	1.8%	1.5%

(1) Excludes tenant reimbursements revenue.

Table of Contents

Income Taxes

Income taxes were \$953,000 in the second quarter of 2016, as compared to \$628,000 in the second quarter of 2015. Income taxes were \$1.9 million in the first six months of 2016 and \$1.7 million in the first six months of 2015. These amounts are for city and state income and franchise taxes paid by us and our subsidiaries.

Provisions for Impairment

For the second quarter of 2016, we recorded total provisions for impairment of \$6.3 million on six properties classified as held for sale and five sold properties. For the first six months of 2016, we recorded total provisions for impairment of \$8.2 million on six properties classified as held for sale, one property classified as held for investment, and 11 sold properties. For the second quarter of 2015, we recorded total provisions for impairment of \$3.2 million on two properties classified as held for investment and three sold properties. For the first six months of 2015, we recorded total provisions for impairment of \$5.3 million on two properties classified as held for investment, five sold properties and one property disposed of other than sale.

Gain on Sales of Real Estate

During the second quarter of 2016, we sold 16 properties for \$24.5 million, which resulted in a gain of \$8.7 million. During the first six months of 2016, we sold 27 properties for \$35.5 million, which resulted in a gain of \$10.9 million.

In comparison, during the second quarter of 2015, we sold five properties for \$8.2 million, which resulted in a gain of \$3.7 million. During the first six months of 2015, we sold 14 properties for \$30.5 million, which resulted in a gain of \$10.9 million.

Preferred Stock Dividends

Preferred stock dividends totaled \$6.8 million in the second quarter of 2016 and 2015. Preferred stock dividends totaled \$13.5 million in the first six months of 2016 and 2015.

Net Income Available to Common Stockholders

Net income available to stockholders was \$69.0 million in the second quarter of 2016, compared to \$59.3 million in the second quarter of 2015, an increase of \$9.7 million. On a diluted per common share basis, net income was \$0.27 in the second quarter of 2016, compared to \$0.25 in the second quarter of 2015, an increase of \$0.02, or 8.0%.

Net income available to common stockholders was \$132.5 million in the first six months of 2016, compared to \$119.8 million in the first six months of 2015, an increase of \$12.7 million. On a diluted per common share basis, net income was \$0.53 in the first six months of 2016, as compared to \$0.52 in the first six months of 2015, an increase of \$0.01, or 1.9%.

Edgar Filing: REALTY INCOME CORP - Form 10-Q

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

Gains from the sale of properties during the second quarter of 2016 were \$8.7 million, as compared to gains from the sale of properties of \$3.7 million during the second quarter of 2015. Gains from the sale of properties during the first six months of 2016 and 2015 were \$10.9 million.

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

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

Table of Contents

	Three months ended			
	June 30,			
Dollars in thousands		2016		2015
Net income	\$	76,068	\$	66,350
Interest		57,409		58,680
Income taxes		953		628
Depreciation and amortization		110,342		101,101
Impairment loss		6,269		3,230
Gain on sales		(8,658)		(3,675)
Quarterly EBITDA	\$	242,383	\$	226,314
Annualized EBITDA	\$	969,532	\$	905,256
Total Debt	\$	4,970,870	\$	5,306,720
Debt/EBITDA		5.1		5.9

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

FFO for the second quarter of 2016 increased by \$17.1 million, or 10.7%, to \$176.6 million, compared to \$159.5 million in the second quarter of 2015. On a diluted common share basis, FFO was \$0.70 in the second quarter of 2016, compared to \$0.69 in the second quarter of 2015, an increase of \$0.01, or 1.4%. FFO for the quarter ended June 30, 2016 was impacted by a non-cash loss of \$2.1 million, or \$0.01 per share, resulting from fair value adjustments on our interest rate swaps. Each quarter we adjust the carrying value of our interest rate swaps to fair value. The changes in the fair value of our interest rate swaps are recorded to interest expense.

In the first six months of 2016, our FFO increased by \$34.9 million, or 11.2%, to \$347.3 million, compared to \$312.4 million in the first six months of 2015. On a diluted per common share basis, FFO was \$1.38 in the first six months of 2016, compared to \$1.36 in the first six months of 2015, an increase of \$0.02, or 1.5%. FFO for the six months ended June 30, 2016 was impacted by a non-cash loss of \$7.9 million, or \$0.03 per share, resulting from fair value adjustments on our interest rate swaps, as described above.

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):

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Net income available to common stockholders	\$ 69,045	\$ 59,317	\$ 132,518	\$ 119,810
Depreciation and amortization	110,342	101,101	218,275	199,138
Depreciation of furniture, fixtures and equipment	(195)	(240)	(388)	(425)
Provisions for impairment on investment properties	6,269	3,230	8,192	5,317
Gain on sales of investment properties	(8,658)	(3,675)	(10,948)	(10,893)
FFO adjustments allocable to noncontrolling interests	(155)	(263)	(373)	(577)
FFO available to common stockholders (1)	\$ 176,648	\$ 159,470	\$ 347,276	\$ 312,370
FFO per common share, basic and diluted (2)	\$ 0.70	\$ 0.69	\$ 1.38	\$ 1.36
Distributions paid to common stockholders	\$ 151,236	\$ 131,595	\$ 298,581	\$ 258,277
FFO in excess of distributions paid to common stockholders	\$ 25,412	\$ 27,875	\$ 48,695	\$ 54,093
Weighted average number of common shares used for computation per share:				
Basic	253,375,546	232,403,586	251,792,989	228,932,782
Diluted (2)	254,254,243	232,886,185	252,073,685	229,061,762

Edgar Filing: REALTY INCOME CORP - Form 10-Q

(1) FFO available to common stockholders and dilutive noncontrolling interests for the second quarter of 2016 is \$177,055 after the inclusion of \$407 of FFO allocable to dilutive noncontrolling interests. FFO available to common stockholders and dilutive noncontrolling interests for the second quarter of 2015 is \$159,685 after the inclusion of \$215 of FFO allocable to dilutive noncontrolling interests. Noncontrolling interests were antidilutive for all other periods presented.

(2) The computation of diluted FFO does not assume conversion of securities that are 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 Trusts' definition, as net income available to common stockholders, plus depreciation and amortization of real estate assets, plus impairments of depreciable real estate assets, and reduced by gains on property sales.

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

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

AFFO for the second quarter of 2016 increased by \$21.8 million, or 13.7%, to \$180.9 million, compared to \$159.1 million in the second quarter of 2015. On a diluted common share basis, AFFO was \$0.71 in the second quarter of 2016, compared to \$0.68 in the second quarter of 2015, an increase of \$0.03, or 4.4%.

In the first six months of 2016, our AFFO increased by \$45.6 million, or 14.7%, to \$356.8 million, compared to \$311.2 million in the first six months of 2015. On a diluted per common share basis, AFFO was \$1.42 in the first six months of 2016, compared to \$1.36 in the first six months of 2015, an increase of \$0.06, or 4.4%. 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):

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Net income available to common stockholders	\$ 69,045	\$ 59,317	\$ 132,518	\$ 119,810
Cumulative adjustments to calculate FFO (1)	107,603	100,153	214,758	192,560
FFO available to common stockholders	176,648	159,470	347,276	312,370
Amortization of share-based compensation	3,947	2,811	6,552	5,362
Amortization of deferred financing costs (2)	1,299	1,281	2,598	2,575
Amortization of net mortgage premiums	(754)	(1,862)	(1,855)	(3,824)
Loss on interest rate swaps	2,109	899	7,886	1,958
Leasing costs and commissions	(86)	(149)	(277)	(461)
Recurring capital expenditures	(174)	(977)	(246)	(2,009)
Straight-line rent	(4,323)	(4,444)	(9,474)	(8,635)
Amortization of above and below-market leases	2,143	1,954	4,195	3,696
Other adjustments (3)	67	77	138	152
AFFO available to common stockholders (4)	\$ 180,876	\$ 159,060	\$ 356,793	\$ 311,184
AFFO per common share, basic and diluted (5)	\$ 0.71	\$ 0.68	\$ 1.42	\$ 1.36
Distributions paid to common stockholders	\$ 151,236	\$ 131,595	\$ 298,581	\$ 258,277
AFFO in excess of distributions paid to common stockholders	\$ 29,640	\$ 27,465	\$ 58,212	\$ 52,907
Weighted average number of common shares used for computation per share:				
Basic	253,375,546	232,403,586	251,792,989	228,932,782
Diluted (5)	253,937,221	232,886,185	252,378,957	229,061,762

- (1) See reconciling items for FFO presented under Funds from Operations Available to Common Stockholders (FFO).
- (2) Includes the amortization of costs incurred and capitalized upon issuance of our notes payable, assumption of our mortgages payable and upon issuance of our term loans. The deferred financing costs are being amortized over the lives of the respective mortgages and term loans. No costs associated with our credit facility agreements or annual fees paid to credit rating agencies have been included.
- (3) Includes adjustments allocable to both non-controlling interests and capital lease obligations.
- (4) AFFO available to common stockholders and dilutive noncontrolling interests for the second quarter of 2016 is \$181,065 after the inclusion of \$189 of AFFO allocable to dilutive noncontrolling interests. AFFO available to common stockholders and dilutive noncontrolling interests for the second quarter of 2015 is \$159,275 after the inclusion of \$215 of FFO allocable to dilutive noncontrolling interests. AFFO available to common stockholders and dilutive noncontrolling interests for the six months ended June 30, 2016 is \$357,221 after the inclusion of \$428 of AFFO allocable to dilutive noncontrolling interests. Noncontrolling interests were antidilutive for all other periods presented.
- (5) 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.

Table of Contents

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

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

PROPERTY PORTFOLIO INFORMATION

At June 30, 2016, we owned a diversified portfolio:

- Of 4,646 properties;
- With an occupancy rate of 98.0%, or 4,551 properties leased and 95 properties available for lease;
- Leased to 246 different commercial tenants doing business in 47 separate industries;
- Located in 49 states and Puerto Rico;
- With over 79.0 million square feet of leasable space; and
- With an average leasable space per property of approximately 17,010 square feet; approximately 11,620 square feet per retail property and 220,560 square feet per industrial property.

At June 30, 2016, of our 4,646 properties, 4,551 were leased under net lease agreements. A net lease typically requires the tenant to be responsible for monthly rent and certain property operating expenses including property taxes, insurance, and maintenance. In addition, our tenants are typically subject to future rent increases based on increases in the consumer price index (typically subject to ceilings), additional rent calculated as a percentage of the tenants' gross sales above a specified level, or fixed increases.

Edgar Filing: REALTY INCOME CORP - Form 10-Q

At June 30, 2016, our 246 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 276 additional tenants, representing approximately 5% of our annualized revenue at June 30, 2016, which brings our total tenant count to 522 tenants.

Table of Contents**Industry Diversification**

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

	Percentage of Rental Revenue(1)					
	For the Quarter Ended June 30, 2016	Dec 31, 2015	Dec 31, 2014	For the Years Ended Dec 31, 2013	Dec 31, 2012	Dec 31, 2011
<u>Retail industries</u>						
Apparel stores	1.9%	2.0%	2.0%	1.9%	1.7%	1.4%
Automotive collision services	1.0	1.0	0.8	0.8	1.1	0.9
Automotive parts	1.3	1.4	1.3	1.2	1.0	1.2
Automotive service	1.8	1.9	1.8	2.1	3.1	3.7
Automotive tire services	2.8	2.9	3.2	3.6	4.7	5.6
Book stores	*	*	*	*	0.1	0.1
Child care	1.9	2.0	2.2	2.8	4.5	5.2
Consumer electronics	0.3	0.3	0.3	0.3	0.5	0.5
Convenience stores	8.8	9.2	10.1	11.2	16.3	18.5
Crafts and novelties	0.4	0.5	0.5	0.5	0.3	0.2
Dollar stores	8.7	8.9	9.6	6.2	2.2	-
Drug stores	11.0	10.6	9.5	8.1	3.5	3.8
Education	0.3	0.3	0.4	0.4	0.7	0.7
Entertainment	0.5	0.5	0.5	0.6	0.9	1.0
Equipment services	*	0.1	0.1	0.1	0.1	0.2
Financial services	1.2	1.3	1.4	1.5	0.2	0.2
General merchandise	1.4	1.4	1.2	1.1	0.6	0.6
Grocery stores	2.9	3.0	3.0	2.9	3.7	1.6
Health and fitness	8.2	7.7	7.0	6.3	6.8	6.4
Health care	0.9	1.0	1.1	1.1	-	-
Home furnishings	0.8	0.7	0.7	0.9	1.0	1.1
Home improvement	2.3	2.4	1.7	1.6	1.5	1.7
Jewelry	0.1	0.1	0.1	0.1	-	-
Motor vehicle dealerships	2.2	1.6	1.6	1.6	2.1	2.2
Office supplies	0.3	0.3	0.4	0.5	0.8	0.9
Pet supplies and services	0.7	0.7	0.7	0.8	0.6	0.7
Restaurants - casual dining	4.1	3.8	4.3	5.1	7.3	10.9
Restaurants - quick service	4.8	4.2	3.7	4.4	5.9	6.6
Shoe stores	0.5	0.5	0.1	0.1	0.1	0.2
Sporting goods	2.0	1.8	1.6	1.7	2.5	2.7
Theaters	4.9	5.1	5.3	6.2	9.4	8.8
Transportation services	0.1	0.1	0.1	0.1	0.2	0.2
Wholesale clubs	3.6	3.8	4.1	3.9	3.2	0.7
Other	*	*	*	0.1	0.1	0.1
Retail industries	81.7%	81.1%	80.4%	79.8%	86.7%	88.6%

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

	Percentage of Rental Revenue(1)					
	For the Quarter Ended June 30, 2016	Dec 31, 2015	Dec 31, 2014	For the Years Ended Dec 31, 2013	Dec 31, 2012	Dec 31, 2011
<u>Non-retail industries</u>						
Aerospace	1.0	1.1	1.2	1.2	0.9	0.5
Beverages	2.5	2.7	2.8	3.3	5.1	5.6
Consumer appliances	0.5	0.6	0.5	0.6	0.1	-
Consumer goods	0.9	0.9	0.9	1.0	0.1	-
Crafts and novelties	0.1	0.1	0.1	0.1	-	-
Diversified industrial	0.9	0.8	0.5	0.2	0.1	-
Electric utilities	0.1	0.1	0.1	*	-	-
Equipment services	0.5	0.4	0.5	0.4	0.3	0.2
Financial services	0.4	0.4	0.4	0.5	0.4	0.3
Food processing	1.2	1.2	1.4	1.5	1.3	0.7
General merchandise	0.3	0.3	0.3	-	-	-
Government services	1.1	1.2	1.3	1.4	0.1	0.1
Health care	0.6	0.7	0.7	0.8	*	*
Home furnishings	0.1	0.2	0.2	0.2	-	-
Insurance	0.1	0.1	0.1	0.1	*	-
Machinery	0.1	0.1	0.2	0.2	0.1	-
Other manufacturing	0.8	0.7	0.7	0.6	-	-
Packaging	0.8	0.8	0.8	0.9	0.7	0.4
Paper	0.1	0.1	0.1	0.2	0.1	0.1
Shoe stores	0.2	0.2	0.8	0.9	-	-
Telecommunications	0.6	0.7	0.7	0.7	0.8	0.7
Transportation services	5.2	5.3	5.1	5.3	2.2	1.6
Other	0.2	0.2	0.2	0.1	1.0	1.2
Non-retail industries	18.3%	18.9%	19.6%	20.2%	13.3%	11.4%
Totals	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

* Less than 0.1%

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

Table of Contents**Property Type Composition**

The following table sets forth certain property type information regarding our property portfolio as of June 30, 2016 (dollars in thousands):

Property Type	Number of Properties	Approximate Leasable Square Feet	Rental Revenue for the Quarter Ended June 30, 2016⁽¹⁾	Percentage of Rental Revenue
Retail	4,481	52,074,500	\$ 206,086	79.3%
Industrial	106	23,379,600	33,332	12.8
Office	44	3,403,200	15,045	5.8
Agriculture	15	184,500	5,340	2.1
Totals	4,646	79,041,800	\$ 259,803	100.0%

(1) Includes rental revenue for all properties owned at June 30, 2016. Excludes revenue of \$253 from sold properties.

Tenant Diversification

The following table sets forth the largest tenants in our property portfolio, expressed as a percentage of total rental revenue at June 30, 2016:

Tenant	Number of Properties	% of Rental Revenue
Walgreens	176	6.6%
FedEx	42	5.7%
Dollar General	524	4.5%
LA Fitness	46	4.1%
Dollar Tree / Family Dollar	457	4.0%
Circle K / The Pantry	300	2.8%
AMC Theaters	22	2.8%
BJ's Wholesale Clubs	15	2.5%
Diageo	17	2.4%
CVS Pharmacy	68	2.1%

Edgar Filing: REALTY INCOME CORP - Form 10-Q

SuperAmerica / Western Refining	134	2.1%
GPM Investments / Fas Mart	216	2.0%
Regal Cinemas	22	2.0%
Rite Aid	69	2.0%
Life Time Fitness	9	1.9%
TBC Corporation	149	1.7%
Walmart / Sam's Club	23	1.5%
Freedomroads / Camping World	18	1.2%
NPC International	191	1.2%
Smart & Final	36	1.1%

-43-

Table of Contents**Service Category Diversification for our Retail Properties**

The following table sets forth certain information regarding the 4,481 retail properties included in our 4,646 total properties owned at June 30, 2016, classified according to the business types and the level of services they provide at the property level (dollars in thousands):

	Number of Retail Properties		Retail Rental Revenue for the Quarter Ended June 30, 2016(1)	Percentage of Retail Rental Revenue
<u>Tenants Providing Services</u>				
Automotive collision services	53	\$	2,572	1.3%
Automotive service	235		4,814	2.3
Child care	203		4,845	2.4
Education	14		848	0.4
Entertainment	11		1,303	0.6
Equipment services	2		111	0.1
Financial services	118		3,250	1.6
Health and fitness	85		21,324	10.3
Health care	27		1,129	0.5
Theaters	45		12,708	6.2
Transportation services	2		229	0.1
Other	8		82	*
	803		53,215	25.8
<u>Tenants Selling Goods and Services</u>				
Automotive parts (with installation)	64		1,520	0.7
Automotive tire services	185		7,220	3.5
Convenience stores	758		22,667	11.0
Motor vehicle dealerships	27		5,608	2.7
Pet supplies and services	13		784	0.4
Restaurants - casual dining	337		9,972	4.8
Restaurants - quick service	533		12,468	6.1
	1,917		60,239	29.2
<u>Tenants Selling Goods</u>				
Apparel stores	28		4,952	2.4
Automotive parts	79		1,765	0.9
Book stores	1		104	*
Consumer electronics	8		663	0.3
Crafts and novelties	11		1,142	0.6
Dollar stores	981		22,728	11.0
Drug stores	306		27,177	13.2
General merchandise	75		3,584	1.7
Grocery stores	74		7,343	3.6
Home furnishings	60		1,978	1.0
Home improvement	56		5,431	2.6
Jewelry	4		175	0.1
Office supplies	9		724	0.4
Shoe stores	2		182	0.1
Sporting goods	35		5,316	2.6
Wholesale clubs	32		9,368	4.5
	1,761		92,632	45.0
Total Retail Properties	4,481	\$	206,086	100.0%

* Less than 0.1%

(1) Includes rental revenue for all retail properties owned at June 30, 2016. Excludes revenue of \$53,717 from non-retail properties and \$253 from sold properties.

Table of Contents

Lease Expirations

The following table sets forth certain information regarding our property portfolio regarding the timing of the lease term expirations (excluding rights to extend a lease at the option of the tenant) on our 4,530 net leased, single-tenant properties and their contribution to rental revenue for the quarter ended June 30, 2016 (dollars in thousands):

Year	Total Portfolio(1)					Initial Expirations(3)			Subsequent Expirations(4)		
	Retail	Expiring Leases Non-Retail	Approx. Leasable Sq. Feet	Rental Revenue(2)	% of Rental Revenue	Expiring Leases	Rental Revenue	% of Rental Revenue	Expiring Leases	Rental Revenue	% of Rental Revenue
2016	69	-	441,200	\$ 1,585	0.6%	36	\$ 856	0.3%	33	\$ 729	0.3%
2017	195	1	1,892,700	5,172	2.0	52	1,491	0.6	144	3,681	1.4
2018	280	9	3,689,000	10,817	4.2	153	7,299	2.8	136	3,518	1.4
2019	259	10	3,934,200	13,318	5.2	176	11,073	4.3	93	2,245	0.9
2020	192	12	4,318,500	12,202	4.8	114	9,776	3.9	90	2,426	0.9
2021	279	13	5,669,200	15,978	6.3	178	12,161	4.8	114	3,817	1.5
2022	239	17	7,587,700	15,894	6.2	212	12,606	4.9	44	3,288	1.3
2023	354	20	6,463,500	21,957	8.6	358	21,058	8.2	16	899	0.4
2024	198	12	4,360,000	12,535	4.9	202	12,135	4.7	8	400	0.2
2025	326	15	5,574,700	21,695	8.5	310	20,303	8.0	31	1,392	0.5
2026	256	5	3,776,800	12,798	5.0	242	12,300	4.8	19	498	0.2
2027	494	3	5,581,900	19,840	7.8	472	18,953	7.5	25	887	0.3
2028	288	5	5,989,200	16,422	6.4	286	16,222	6.3	7	200	0.1
2029	398	4	6,531,600	19,919	7.8	360	16,397	6.4	42	3,522	1.4
2030	81	12	2,062,900	12,037	4.7	90	11,933	4.7	3	104	*
2031 - 2043	458	26	9,127,000	43,324	17.0	462	39,666	15.6	22	3,658	1.4
Totals	4,366	164	77,000,100	\$ 255,493	100.0%	3,703	\$ 224,229	87.8%	827	\$ 31,264	12.2%

* Less than 0.1%

(1) Excludes 22 multi-tenant properties and 95 vacant properties, one of which is a vacant, multi-tenant property. The lease expirations for properties under construction are based on the estimated date of completion of those properties.

(2) Excludes revenue of \$4,310 from 22 multi-tenant properties and from 95 vacant properties at June 30, 2016, and \$253 from sold properties.

(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.

Table of Contents**Geographic Diversification**

The following table sets forth certain state-by-state information regarding our property portfolio as of June 30, 2016 (dollars in thousands):

State	Number of Properties	Percent Leased	Approximate Leasable Square Feet	Rental Revenue for the Quarter Ended June 30, 2016(1)	Percentage of Rental Revenue
Alabama	164	98%	1,262,500	\$ 5,216	2.0%
Alaska	3	100	275,900	422	0.2
Arizona	110	99	1,617,100	6,374	2.5
Arkansas	55	100	816,500	1,817	0.7
California	166	100	5,267,900	24,459	9.4
Colorado	72	99	1,015,800	3,989	1.5
Connecticut	24	92	534,900	2,531	1.0
Delaware	18	100	93,000	694	0.3
Florida	332	99	4,047,700	15,166	5.8
Georgia	247	98	3,779,400	11,344	4.4
Hawaii	--	--	--	--	--
Idaho	12	100	87,000	417	0.2
Illinois	167	98	4,661,100	13,500	5.2
Indiana	154	100	1,551,000	6,959	2.7
Iowa	39	90	2,943,200	3,991	1.5
Kansas	94	97	1,845,900	4,505	1.7
Kentucky	63	94	1,035,500	3,586	1.4
Louisiana	98	97	1,196,500	3,367	1.3
Maine	10	90	145,300	889	0.3
Maryland	35	100	861,300	4,509	1.7
Massachusetts	81	98	757,600	3,455	1.3
Michigan	156	97	1,568,900	5,944	2.3
Minnesota	158	99	1,947,500	8,683	3.3
Mississippi	137	95	1,630,600	4,649	1.8
Missouri	139	96	2,825,200	8,459	3.3
Montana	8	100	79,000	191	0.1
Nebraska	37	100	780,400	2,097	0.8
Nevada	22	100	413,000	1,307	0.5
New Hampshire	19	100	315,800	1,477	0.6
New Jersey	70	99	697,400	4,382	1.7
New Mexico	30	100	293,200	858	0.3
New York	91	100	2,434,200	12,507	4.8
North Carolina	163	98	2,224,100	7,250	2.8
North Dakota	7	86	66,000	130	*
Ohio	239	98	6,156,800	14,432	5.6
Oklahoma	130	99	1,553,400	4,226	1.6
Oregon	27	100	590,900	2,091	0.8
Pennsylvania	147	99	1,848,100	7,482	2.9
Rhode Island	4	100	157,200	809	0.3
South Carolina	145	99	1,047,000	5,548	2.1
South Dakota	13	100	156,500	336	0.1
Tennessee	220	96	3,050,500	8,362	3.2
Texas	451	98	8,796,500	23,291	9.0
Utah	18	100	933,400	2,090	0.8
Vermont	5	100	98,000	482	0.2
Virginia	146	97	2,925,700	7,540	2.9
Washington	42	98	690,800	2,711	1.0
West Virginia	14	100	279,100	1,082	0.4
Wisconsin	54	100	1,604,500	3,826	1.5
Wyoming	6	100	54,700	222	0.1
Puerto Rico	4	100	28,300	149	0.1

Edgar Filing: REALTY INCOME CORP - Form 10-Q

Totals\Average	4,646	98%	79,041,800	\$	259,803	100.0%
----------------	-------	-----	------------	----	---------	--------

* Less than 0.1%

(1) Includes rental revenue for all properties owned at June 30, 2016. Excludes revenue of \$253 from sold properties.

-46-

Table of Contents

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 4,646 properties in our portfolio, approximately 97.5% or 4,530 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 **OpF** with a cusip number of 756109-807.

We maintain a corporate website at www.realtyincome.com. On our website we make available, free of charge, copies of our annual report on Form 10-K, quarterly reports on Form 10-Q, 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.

Corporate Responsibility. We are committed to providing an engaging, diverse, and safe work environment for our employees, to upholding our corporate responsibilities as a public company operating for the benefit of our shareholders, and to operating our company in an environmentally conscious manner. As The Monthly Dividend Company®, our mission is to provide our shareholders with monthly dividends that increase over

time. How we manage and use the physical, financial and talent resources that enable us to achieve this mission, demonstrates our commitment to corporate responsibility.

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

Realty Income and our employees have taken an active role in supporting our communities through civic involvement with charitable organizations and corporate donation. Focusing our impact on social and environmentally sustainable areas our non-profit partnerships have resulted in 1,200 employee volunteer hours, employee and corporate donations to fund local affordable housing, educational services to at-risk youth, funding local foodbanks, and toys for under-served children. Our dedication to being a responsible corporate citizen has a direct and positive impact in the communities in which we operate and contributes to the strength of our reputation and our financial performance.

Table of Contents

Corporate Governance. We believe that a company's reputation for integrity and serving its shareholders responsibly is of utmost importance. 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:

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

Environmental Practices. Our focus on conservationism is demonstrated by how we manage our day-to-day activities at our corporate headquarters. At our headquarters, we promote energy efficiency and encourage practices such as powering down office equipment at the end of the day, implementing file-sharing technology and automatic duplex mode to limit paper use, adopting an electronic approval system, and carpooling to our headquarters. With respect to recycling and reuse practices, we encourage the use of recycled products and the recycling of materials during our operations. Cell phones, wireless devices and office equipment are recycled or donated whenever possible. In addition, our headquarters was constructed according to the State of California energy efficiency standards (specifically following California Green Building Standards Code and Title 24 of the California Code of Regulations), with features such as an automatic lighting control system with light-harvesting technology, a Building Management System that monitors and controls energy use, an energy-efficient PVC roof and heating and cooling system, and drought-tolerant landscaping with recycled materials.

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

Item 3: Quantitative and Qualitative Disclosures about Market Risk

Edgar Filing: REALTY INCOME CORP - Form 10-Q

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

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

Table of Contents

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 June 30, 2016. 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 rate on fixed rate debt	Variable rate debt	Weighted average rate on variable rate debt
2016	\$	279.3	5.94%	0.5	2.37%
2017		308.5	5.54	16.2	2.49
2018		365.2	2.15	70.3	1.66
2019		554.5	6.74	533.8	1.39
2020		82.2	4.99	250.2	1.41
Thereafter		2,488.5	4.51	21.7	2.65
Totals (1)	\$	4,078.2	4.79%	892.7	1.47%
Fair Value (2)	\$	4,387.1		\$ 889.8	

Excludes net premiums recorded on mortgages payable and original issuance discounts recorded on notes payable and deferred financing costs on mortgages payable, notes payable, and term loans. At June 30, 2016, the unamortized balance of net premiums on mortgages payable is \$7.9 million, the unamortized balance of original issuance discounts on notes payable is \$12.6 million and the balance of deferred financing costs on mortgages payable is \$442,000, on notes payable is \$17.1 million, and on term loans is \$1.0 million.

We base the estimated fair value of the fixed rate senior notes and bonds at June 30, 2016 on the indicative market prices and recent trading activity of our senior notes and bonds payable.

(2) We base the estimated fair value of our fixed rate and variable rate mortgages at June 30, 2016 on the relevant Treasury yield curve, plus an applicable credit-adjusted spread. We believe that the carrying value of the credit facility balance and term loans balance reasonably approximate their estimated fair values at June 30, 2016.

The table incorporates only those exposures that exist as of June 30, 2016. It does not consider those exposures or positions that could arise after that date. As a result, our ultimate realized gain or loss, with respect to interest rate fluctuations, would depend on the exposures that arise during the period, our hedging strategies at the time, and interest rates.

All of our outstanding notes and bonds have fixed interest rates. All of our mortgages payable, except five mortgages totaling \$58.3 million at June 30, 2016, including net unamortized discounts, have fixed interest rates. After factoring in arrangements that limit our exposure to interest rate risk and effectively fix our per annum interest rates, our variable rate mortgage debt includes three mortgages totaling \$22.6 million at June 30, 2016. Interest on our credit facility and term loan balances is variable. However, the variable interest rate feature on our term loans has been mitigated by interest rate swap agreements. Based on our credit facility balance of \$512.0 million at June 30, 2016, a 1% change in interest rates would change our interest costs by \$5.1 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 June 30, 2016, we carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective and were operating at a reasonable assurance level.

Table of Contents

Changes in Internal Controls

There were no changes to our internal control over financial reporting that occurred during the quarter ended June 30, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. As of June 30, 2016, there were no material weaknesses in our internal controls, and therefore, no corrective actions were taken.

Limitations on the Effectiveness of Controls

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

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:

- 56 shares of stock, at a price of \$62.25, in April 2016;
- 219 shares of stock, at a price of \$62.22, in May 2016; and
- 312 shares of stock, at a price of \$62.64, in June 2016.

Item 6: Exhibits

Articles of Incorporation and By-Laws

<u>Exhibit No.</u>	<u>Description</u>
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 June 16, 2015 (filed as exhibit 3.1 to the Company's Form 8-K filed on June 17, 2015 and incorporated herein by reference)
3.3	Articles 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).
3.4	Certificate 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).

Table of Contents

3.5 Articles 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

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

4.2 Form 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).

4.3 Officer's Certificate pursuant to sections 201, 301 and 303 of the Indenture dated October 28, 1998 between the Company and The Bank of New York, as Trustee, establishing a series of securities entitled 5.50% 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).

4.4 Form 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).

4.5 Officer's Certificate pursuant to sections 201, 301 and 303 of the Indenture dated October 28, 1998 between the Company and The Bank of New York, as Trustee, establishing a series of securities entitled 5.875% 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).

4.6 Form 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).

4.7 Officer's Certificate pursuant to sections 201, 301 and 303 of the Indenture dated October 28, 1998 between the Company and The Bank of New York, as Trustee, establishing a series of

securities entitled 5.375% 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).

4.8 Form 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).

4.9 Officer's Certificate pursuant to sections 201, 301 and 303 of the Indenture dated October 28, 1998 between the Company and The Bank of New York, as Trustee, establishing a series of securities entitled 5.95% 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).

4.10 Form 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).

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).

Table of Contents

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).

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).

Table of Contents

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 period ended June 30, 2016, 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.

Table of Contents

SIGNATURE

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.

REALTY INCOME CORPORATION

Date: July 28, 2016

/s/ SEAN P. NUGENT

Sean P. Nugent
Vice President, Controller
(Principal Accounting Officer)