

LMP REAL ESTATE INCOME FUND INC.
Form N-CSR
March 06, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM N-CSR

**CERTIFIED SHAREHOLDER REPORT OF REGISTERED
MANAGEMENT INVESTMENT COMPANIES**

Investment Company Act file number 811-21098

LMP Real Estate Income Fund Inc.
(Exact name of registrant as specified in charter)

125 Broad Street, New York, NY
(Address of principal executive offices)

10004
(Zip code)

Robert I. Frenkel, Esq.
Legg Mason & Co., LLC
300 First Stamford Place, 4th Floor
Stamford, CT 06902
(Name and address of agent for service)

Registrant's telephone number, including area code: (800) 451-2010

Date of fiscal year end: December 31

Date of reporting period: December 31, 2007

ITEM 1. REPORT TO STOCKHOLDERS.

The Annual Report to Stockholders is filed herewith.

**LMP Real Estate
Income Fund Inc.
(RIT)**

ANNUAL REPORT

DECEMBER 31, 2007

INVESTMENT PRODUCTS: NOT FDIC INSURED • NO BANK GUARANTEE • MAY LOSE VALUE

**LMP Real Estate
Income Fund Inc.**

Annual Report • December 31, 2007

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Letter from the Chairman

Dear Shareholder,

While the U.S. economy continued to expand during the 12-month reporting period ended December 31, 2007, it weakened late in the period. In the first quarter of 2007, U.S. gross domestic product (GDP) growth was a tepid 0.6%, according to the U.S. Commerce Department. This was the lowest growth rate since the fourth quarter of 2002. The economy then rebounded, as second quarter 2007 GDP growth was a solid 3.8%. GDP growth accelerated in the third quarter to 4.9%, its strongest showing in four years. A surge in inventory-building and robust exports supported the economy during the third quarter. However, continued weakness in the housing market and an ongoing credit crunch then took their toll on the economy during the last three months of 2007. During this period, the advance estimate for GDP growth was 0.6%.

R. JAY GERKEN, CFA
Chairman, President and
Chief Executive Officer

Ongoing issues related to the housing and subprime mortgage markets and an abrupt tightening in the credit markets prompted the Federal Reserve Board (Fed) to take several actions during the reporting period. The Fed initially responded by lowering the discount rate – the rate the Fed uses for loans it makes directly to banks from 6.25% to 5.75% in mid-August 2007. Then, at its meeting on September 18, the Fed reduced the discount rate to 5.25% and the federal funds rateⁱⁱⁱ from 5.25% to 4.75%. This marked the first reduction in the federal funds rate since June 2003. The Fed again lowered rates in October and December 2007, bringing the federal funds rate to 4.25% at the end of the year. Shortly after the reporting period ended, the Fed continued to ease monetary policy in an attempt to ward off a recession. In a surprise move, the Fed aggressively cut the federal funds rate on January 22, 2008 by 0.75% to 3.50%. The Fed again lowered the federal funds rate during its meeting on January 30, 2008, bringing it to 3.00%. In its statement accompanying its latest rate cut, the Fed stated: Today's policy action,

LMP Real Estate Income Fund Inc.

I

combined with those taken earlier, should help to promote moderate growth over time and to mitigate the risks to economic activity. However, downside risks to growth remain. The Committee will continue to assess the effects of financial and other developments on economic prospects and will act in a timely manner as needed to address those risks.

Despite periods of extreme volatility, the U.S. stock market produced overall positive results during the 12-month reporting period. After rising in four of the first five months of the period, the market reversed course beginning in June 2007. Earlier in the reporting period, U.S. stock prices rose on the back of solid corporate profits, an active merger and acquisition (M&A) environment and hopes that the Fed would lower the federal funds rate in 2007. U.S. equity prices then faltered in June and July 2007 due to troubles in the housing market and expectations that the Fed would not lower short-term interest rates in the foreseeable future. U.S. stock prices then rallied from August through October 2007, as the Fed lowered interest rates and it appeared the credit crunch was easing. However, stock prices then fell sharply in November and modestly in December due to mounting losses related to subprime mortgages and fears of slower economic growth in 2008. All told, the S&P 500 Index^{iv} returned 5.49% during the 12 months ended December 31, 2007.

Looking at the U.S. stock market more closely, large- and mid-cap stocks outperformed their small-cap counterparts, as the Russell 1000^v, Russell Midcap^{vi} and Russell 2000^{vii} Indexes returned 5.77%, 5.60% and -1.57%, respectively, during the 12 months ended December 31, 2007. From an investment style perspective, growth stocks outperformed value stocks, with the Russell 3000 Growth^{viii} and Russell 3000 Value^{ix} Indexes returning 11.40% and -1.01%, respectively. This marked the first calendar year since 1999 that, overall, growth stocks outperformed value stocks.

Please read on for a more detailed look at prevailing economic and market conditions during the Fund's fiscal year and to learn how those conditions have affected Fund performance.

Special Shareholder Notice

Effective as of the close of business on June 30, 2007, the Fund's benchmark is the MSCI U.S. REIT Index.

Auction Rate Cumulative Preferred Stock

Subsequent to the year-end of the Fund, the Auction Rate Preferred Stock (ARPS) market experienced difficulties due to an imbalance between demand for and supply of such securities. This resulted in a large number of failed auctions within this sector, including the outstanding ARPS issued by the Fund. A failed auction occurs when there are not enough buyers to match with sellers. At that point, preferred shareholders who wish to sell may not be able to do so until an auction occurs where a sufficient number of buy orders are submitted. As a result of a failed auction, the issuer pays a rate, called the maximum rate, as compensation to the preferred holders who then typically must wait until the next auction for another attempt to sell securities. At current rates, management believes that maintaining the existing level of leverage is in the best interest of the Fund and its common shareholders; however, the cost of leverage may vary and management continues to evaluate the desirability of maintaining leverage for the Fund.

A failed auction does not constitute an event of default and therefore did not impact the credit ratings of the ARPS issued by the Fund.

The Fund issued a press release on February 19, 2008 and more detailed and current information can be found by visiting www.leggmason.com/cef or by contacting the Fund at 1-888-777-0102.

Information About Your Fund

Important information with regard to recent regulatory and other matters that may affect the Fund is contained in the Notes to Financial Statements included in this report.

As always, thank you for your confidence in our stewardship of your assets.
We look forward to helping you meet your financial goals.

Sincerely,

R. Jay Gerken, CFA
Chairman, President and Chief Executive Officer

February 20, 2008

All index performance reflects no deduction for fees, expenses or taxes. Please note that an investor cannot invest directly in an index.

- i Gross domestic product (GDP) is the market value of all final goods and services produced within a country in a given period of time.
- ii The Federal Reserve Board (Fed) is responsible for the formulation of policies designed to promote economic growth, full employment, stable prices, and a sustainable pattern of international trade and payments.
- iii The federal funds rate is the rate charged by one depository institution on an overnight sale of immediately available funds (balances at the Federal Reserve) to another depository institution; the rate may vary from depository institution to depository institution and from day to day.
- iv The S&P 500 Index is an unmanaged index of 500 stocks that is generally representative of the performance of larger companies in the U.S.
- v The Russell 1000 Index measures the performance of the 1,000 largest companies in the Russell 3000 Index, which represents approximately 92% of the total market capitalization of the Russell 3000 Index.
- vi The Russell Midcap Index measures the performance of the 800 smallest companies in the Russell 1000 Index, which represents approximately 25% of the total market capitalization of the Russell 1000 Index.
- vii The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represents approximately 8% of the total market capitalization of the Russell 3000 Index.
- viii The Russell 3000 Growth Index measures the performance of those Russell 3000 Index companies with higher price-to-book ratios and higher forecasted growth values. (A price-to-book ratio is the price of a stock compared to the difference between a company's assets and liabilities.)
- ix The Russell 3000 Value Index measures the performance of those Russell 3000 Index companies with lower price-to-book ratios and lower forecasted growth values.
- x The MSCI U.S. REIT Index is a free float-adjusted market capitalization weighted index that is comprised of equity Real Estate Investment Trusts (REITs) that are included in the MSCI U.S. Investable Market 2500 Index, with the exception of specialty equity REITs that do not generate a majority of their revenue and income from real estate rental and leasing operations. The Index represents approximately 85% of the U.S. REIT universe.

IV LMP Real Estate Income Fund Inc.

Fund Overview

Q. What were the overall market conditions during the Fund's reporting period?

A. After seven consecutive years of outperforming the overall U.S. stock market, Real Estate Investment Trust (REIT) securities performed poorly on an absolute and relative basis during the fiscal year. For the one-year period ended December 31, 2007, the MSCI U.S. REIT Index (the Index) returned -16.82%. In contrast, the overall stock market, as measured by the S&P 500 Indexⁱⁱⁱ, gained 5.49% over the same period.

The REIT market generated strong results early in the period, with the Index initially rising sharply before peaking in February 2007. REITs were initially buoyed by solid corporate profits, strong demand and continued merger and acquisition (M&A) activity. However, the Index then fell sharply and remained weak during much of the remainder of the period. This reversal of fortune was initially triggered by concerns over REIT valuations, as incoming data pointed to signs of moderating economic growth. In addition, after several years of strong performance, it appeared that investors were eager to lock in profits from their REIT holdings and reallocate their assets to more traditional equities.

The REIT asset class then fell sharply in June and July 2007, as there were fears that the escalating issues in the residential housing and subprime mortgage markets would spill over into the commercial (REIT) real estate market. A severe credit crunch in the summer led to a flight to quality as investors flocked to the relative safety of government-insured Treasuries. As a result, stocks in general, and REITs in particular, suffered. After rallying somewhat as the Federal Reserve Board (Fed) lowered short-term interest rates, REITs again faltered in November 2007 given a resurgence of the summer's credit crunch and another flight to quality.

Performance Review

For the 12 months ended December 31, 2007, LMP Real Estate Income Fund Inc. returned -27.44% based on its net asset value (NAV) and -25.54% based on its New York Stock Exchange (NYSE) market price per share. In comparison, the Fund's benchmark, the MSCI U.S. REIT Index, returned -16.82% for the same period. The Lipper Real Estate Closed-End Funds Category Average^{vi} returned -21.91% over the same time frame. Please note that Lipper performance returns are based on each fund's NAV per share.

During the 12-month period, the Fund made distributions to common shareholders in the amount of \$2.12 per share. The performance table shows the Fund's 12-month total return based on its NAV and market price as of December 31, 2007. **Past performance is no guarantee of future results.**

Performance Snapshot as of December 31, 2007 (unaudited)

Price Per Share	12-Month Total Return
\$16.04 (NAV)	-27.44%
\$14.52 (Market Price)	-25.54%

All figures represent past performance and are not a guarantee of future results.

Total returns are based on changes in NAV or market price, respectively. Total returns assume the reinvestment of all distributions in additional shares.

**Q. What were the most significant factors affecting Fund performance?
What were the leading contributors to performance?**

A. As indicated by the performance of the Index, there were few bright spots in the REIT market during the reporting period. That said, the Fund did benefit on a relative basis from its exposure to shopping center and diversified property REITs. In terms of individual stocks, **Extra Space Storage Inc.**, the country's second largest storage company, enhanced the Fund's relative results. Its stock was trading at a meaningful discount to its largest competitor and Extra Space Storage outperformed its peers during the year. **Primaris Retail Real Estate Investment Trust**, a regional mall company in Canada, also enhanced the Fund's relative performance. The company's sales growth has remained fairly strong and its redevelopment projects have progressed well. In addition, it was helped by the strength of the Canadian dollar over the period.

Not having an exposure to **SL Green Realty Corp.**, which owns and manages office properties in the New York City area, also helped the Fund's relative performance. Its stock price weakened significantly as investors were concerned about the sustainability of rent growth in New York City given the credit crunch and fears of a weakening economy.

What were the leading detractors from performance?

A. As we would expect, given the poor returns in the REIT market, shares of REIT common stocks underperformed their preferred share counterparts over the fiscal year. When the reporting period began, approximately 74% of the Fund's gross assets were in common stocks and 26% were in preferred shares. Compared to preferred shares, the Fund's common stock investments contributed more to Fund performance during the previous several years in which the REIT market performed well. Conversely, over the reporting period during which the REIT market performed poorly, common stock investments detracted more than the preferred shares from the results. At the end of December 2007, the Fund's REIT common stock exposure was reduced to roughly 68% of its gross assets and 32% was in preferred shares.

From a sector perspective, the Fund's exposure to industrial property and office REITs was detrimental to performance. Looking at individual stocks, **iStar Financial Inc.** was the largest detractor to the Fund's performance. We believe the company, which has both leasing and commercial finance operations, has a high-quality management team. However, its stock was punished as investors looked to sell their finance holdings. In addition, investors were disappointed with iStar Financial's acquisition of **Fremont General Corporation's** commercial lending business. We continue to hold the stock and added to the position on weakness. We believe iStar Financial has strong upside potential once the perceived and real risks in the credit and commercial mortgage-backed securities (CMBSⁱⁱ) markets work themselves out. Another holding that hurt the Fund's performance was **Liberty Property Trust**, in the REIT industrial sector. The company made a poor capital allocation decision during the year as it acquired another REIT, **Republic Properties Trust**, at the peak of the market. We maintain our holding in the stock as we are attracted to its dividend, which we believe remains secure.

Q. Were there any significant changes to the Fund during the reporting period?

A. Although there were no significant changes to the Fund's positioning over the period, there was a change to the Fund's benchmark, as described in the Letter from the Chairman. This change, noted under the Special Shareholder Notice, is intended to provide for a more effective benchmark index for the Fund.

Looking for Additional Information?

The Fund is traded under the symbol **RIT** and its closing market price is available in most newspapers under the NYSE listings. The daily NAV is available on-line under the symbol **XRITX** on most financial websites. *Barron's* and *The Wall Street Journal's* Monday edition both carry closed-end fund tables that provide additional information. In addition, the Fund issues a quarterly press release that can be found on most major financial websites, as well as www.leggmason.com/individualinvestors.

In a continuing effort to provide information concerning the Fund, shareholders may call 1-888-777-0102 (toll free), Monday through Friday from 8:00 a.m. to 6:00 p.m. Eastern Time, for the Fund's current NAV, market price and other information.

Thank you for your investment in LMP Real Estate Income Fund Inc. As always, we appreciate that you have chosen us to manage your assets and we remain focused on achieving the Fund's investment goals.

Sincerely,

Portfolio Management
AEW Management and Advisors, L.P.

January 15, 2008

The information provided is not intended to be a forecast of future events, a guarantee of future results or investment advice. Views expressed may differ from those of the firm as a whole.

Portfolio holdings and breakdowns are as of December 31, 2007 and are subject to change and may not be representative of the Fund's current or future investments. The Fund's top ten holdings (as a percentage of net assets) as of that date were: Senior Housing Properties Trust (6.3%), Camden Property Trust (6.0%), Macerich Co. (5.7%), Entertainment Properties Trust (4.8%), Urstadt Biddle Properties Inc. (4.8%), iStar Financial Inc. (4.8%), Kilroy Realty Corp. (4.1%), Realty Income Corp. (4.0%), Healthcare Realty Trust Inc. (4.0%), Liberty Property Trust (3.8%). Please refer to pages 6 through 9 for a list and percentage breakdown of the Fund's holdings.

The mention of sector breakdowns is for informational purposes only and should not be construed as a recommendation to purchase or sell any securities. The information provided regarding such sectors is not a sufficient basis upon which to make an investment decision. Investors seeking financial advice regarding the appropriateness of investing in any securities or investment strategies discussed should consult their financial professional. The Fund's top five sector holdings (as a percentage of net assets) as of December 31, 2007 were: Health Care (24.9%), Office (24.7%), Diversified (18.3%), Shopping Centers (18.3%), Apartments (16.9%). The Fund's portfolio composition is subject to change at any time.

RISKS: Funds that invest in securities related to the real estate industry are subject to the risks of real estate markets, including fluctuating property values, changes in interest rates and other mortgage-related risks. In addition, investment in funds that concentrate their investments in one sector or industry may involve greater risk than more broadly diversified funds.

All index performance reflects no deduction for fees, expenses or taxes. Please note that an investor cannot invest directly in an index.

- i Real Estate Investment Trusts (REITs) invest in real estate or loans secured by real estate and issue shares in such investments, which can be illiquid.
- ii The MSCI U.S. REIT Index is a free float-adjusted market capitalization weighted index that is comprised of equity Real Estate Investment Trusts (REITs) that are included in the MSCI U.S. Investable Market 2500 Index, with the exception of specialty equity REITs that do not generate a majority of their revenue and income from real estate rental and leasing operations. The Index represents approximately 85% of the U.S. REIT universe.
- iii The S&P 500 Index is an unmanaged index of 500 stocks that is generally representative of the performance of larger companies in the U.S.
- iv The Federal Reserve Board (Fed) is responsible for the formulation of policies designed to promote economic growth, full employment, stable prices, and a sustainable pattern of international trade and payments.
- v NAV is calculated by subtracting total liabilities and outstanding preferred stock (if any) from the closing value of all securities held by the Fund (plus all other assets) and dividing the result (total net assets) by the total number of the common shares outstanding. The NAV fluctuates with changes in the market prices of securities in which the Fund has invested. However, the price at which an investor may buy or sell shares of the Fund is at the Fund's market price as determined by supply of and demand for the Fund's shares.
- vi Lipper, Inc. is a major independent mutual-fund tracking organization. Returns are based on the 12-month period ended December 31, 2007, including the reinvestment of all distributions, including returns of capital, if any, calculated among the 23 funds in the Fund's Lipper category.
- vii

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Commercial Mortgage-Backed Securities (CMBS) are a type of mortgage-backed security that are secured by the loan on a commercial property. A CMBS can provide liquidity to real estate investors and to commercial lenders.

4 LMP Real Estate Income Fund Inc. 2007 Annual Report

Fund at a Glance (unaudited)

Investment Breakdown

As a Percent of Total Investments

Schedule of Investments (December 31, 2007)

LMP REAL ESTATE INCOME FUND INC.

Shares	Security	Value
COMMON STOCKS 67.9%		
Apartments 6.5%		
224,000	Camden Property Trust	\$ 10,785,600
100,000	Mid-America Apartment Communities Inc.	4,275,000
140,000	UDR Inc.	2,779,000
	Total Apartments	17,839,600
Diversified 4.0%		
330,000	iStar Financial Inc.	8,596,500
170,000	Lexington Corporate Properties Trust	2,471,800
	Total Diversified	11,068,300
Health Care 14.2%		
174,000	HCP Inc.	6,051,720
281,000	Healthcare Realty Trust Inc.	7,134,590
130,000	Nationwide Health Properties Inc.	4,078,100
380,000	OMEGA Healthcare Investors Inc.	6,099,000
500,000	Senior Housing Properties Trust	11,340,000
92,500	Ventas Inc.	4,185,625
	Total Health Care	38,889,035
Home Financing 0.6%		
108,500	Municipal Mortgage & Equity LLC	1,610,140
Industrial 3.0%		
106,000	EastGroup Properties Inc.	4,436,100
223,000	First Potomac Realty Trust	3,855,670
	Total Industrial	8,291,770
Industrial/Office - Mixed 2.5%		
235,000	Liberty Property Trust	6,770,350
Lodging/Resorts 3.3%		
585,000	Ashford Hospitality Trust	4,206,150
146,000	Hospitality Properties Trust	4,704,120
	Total Lodging/Resorts	8,910,270

See Notes to Financial Statements.

Schedule of Investments (December 31, 2007) (continued)

Office	Shares 12.9%	Security	Value
	290,000	Brandywine Realty Trust	\$ 5,199,700
	179,000	Highwoods Properties Inc.	5,259,020
	873,700	HRPT Properties Trust	6,753,701
	135,000	Kilroy Realty Corp.	7,419,600
	165,400	Mack-Cali Realty Corp.	5,623,600
	134,500	Parkway Properties Inc.	4,973,810
		Total Office	35,229,431
Regional Malls	5.7%		
	115,000	CBL & Associates Properties Inc.	2,749,650
	196,000	Glimcher Realty Trust	2,800,840
	143,200	Macerich Co.	10,175,792
		Total Regional Malls	15,726,282
Retail - Free Standing	4.5%		
	225,000	National Retail Properties Inc.	5,260,500
	265,000	Realty Income Corp.	7,160,300
		Total Retail Free Standing	12,420,800
Self Storage	1.3%		
	250,000	Extra Space Storage Inc.	3,572,500
Shopping Centers	6.2%		
	425,000	Cedar Shopping Centers Inc.	4,347,750
	110,000	Developers Diversified Realty Corp.	4,211,900
	250,000	Primaris Retail Real Estate Investment Trust	4,635,493
	104,000	Tanger Factory Outlet Centers Inc.	3,921,840
		Total Shopping Centers	17,116,983
Specialty	3.2%		
	185,000	Entertainment Properties Trust	8,695,000
		TOTAL COMMON STOCKS	
		(Cost \$150,097,657)	186,140,461

See Notes to Financial Statements.

Schedule of Investments (December 31, 2007) (continued)

Shares	Security	Value
PREFERRED STOCKS 31.8%		
Apartments 4.6%		
75,000	Apartment Investment & Management Co.:	
113,000	Cumulative, Series G, 9.375%	\$ 1,830,000
120,000	Cumulative, Series U, 7.750%	2,363,960
195,000	Cumulative, Series Y, 7.875%	2,403,600
105,000	BRE Properties Inc., Series C, 6.750%	3,771,300
	UDR Inc., 6.750%	2,136,750
	Total Apartments	12,505,610
Diversified 8.0%		
175,000	Duke Realty Corp., 6.950%	3,526,250
90,000	LBA Realty Fund LP, 8.750% (b)(c)	3,735,000
	PS Business Parks Inc.:	
125,000	Cumulative Redeemable, Series O, 7.375%	2,543,750
108,400	Series M, 7.200%	2,184,260
200,000	Public Storage Inc., Cumulative Redeemable, Series L, 6.750%	3,930,000
	Vornado Realty Trust:	
150,000	Cumulative Redeemable, Series G, 6.625%	2,950,500
142,400	Series H, 6.750%	2,937,712
	Total Diversified	21,807,472
Health Care 2.1%		
150,000	HCP Inc., Series F, 7.100%	2,880,000
120,400	OMEGA Healthcare Investors Inc., Cumulative Redeemable, Series D, 8.375%	2,982,308
	Total Health Care	5,862,308
Lodging/Resorts 4.1%		
150,000	Ashford Hospitality Trust, Series D, 8.450%	2,850,000
71,100	Hospitality Properties Trust, Cumulative Redeemable, Series B, 8.875%	1,770,390
90,000	LaSalle Hotel Properties, Cumulative Redeemable, Series G, 7.250%	1,558,125
160,000	Strategic Hotels Capital Inc., 8.250%	3,065,008
100,100	Sunstone Hotel Investors Inc., Cumulative Redeemable, Series A, 8.000%	1,964,462
	Total Lodging/Resorts	11,207,985
Office 3.3%		
196,000	BioMed Realty Trust Inc., Series A, 7.375%	4,008,200
50,000	Brandywine Realty Trust, Series D, 7.375%	990,000
110,000	Corporate Office Properties Trust, Cumulative Redeemable, Series J, 7.625%	2,249,500
76,183	HRPT Properties Trust, Cumulative Redeemable, Series B, 8.750%	1,901,528
	Total Office	9,149,228

See Notes to Financial Statements.