

REALTY INCOME CORP

Form 10-Q

November 01, 2018

REALTY INCOME CORP000072672810-QSep 30, 2018false--12-31YesLarge Accelerated

FilerFALSEFALSE2018Q30.010.01370,100,000370,100,000295,145,532284,213,685295,145,532284,213,68514.414.9P6MP

[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 September 30, 2018, 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)

**Maryland**                    **33-0580106**  
(State or Other  
Jurisdiction of  
Incorporation or  
Organization)            (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

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 295,116,368 shares of common stock outstanding as of October 25, 2018.

---

Table of Contents**REALTY INCOME CORPORATION****Index to Form 10-Q****September 30, 2018**

<b><u>PART I.</u></b>	<b><u>FINANCIAL INFORMATION</u></b>	Page
<b><u>Item 1:</u></b>	<u>Financial Statements</u>	
	<u>Consolidated Balance Sheets</u>	<u>2</u>
	<u>Consolidated Statements of Income</u>	<u>3</u>
	<u>Consolidated Statements of Cash Flows</u>	<u>4</u>
	<u>Notes to Consolidated Financial Statements</u>	<u>5</u>
<b><u>Item 2:</u></b>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	
	<u>Forward-Looking Statements</u>	<u>20</u>
	<u>The Company</u>	<u>20</u>
	<u>Recent Developments</u>	<u>23</u>
	<u>Liquidity and Capital Resources</u>	<u>27</u>
	<u>Results of Operations</u>	<u>32</u>
	<u>Funds from Operations Available to Common Stockholders (FFO)</u>	<u>39</u>
	<u>Adjusted Funds from Operations Available to Common</u>	<u>40</u>

	<u>Stockholders</u>	
	<u>(AFFO)</u>	
	<u>Property Portfolio</u>	<u>41</u>
	<u>Information</u>	
	<u>Impact of Inflation</u>	<u>47</u>
	<u>Impact of Recent</u>	
	<u>Accounting</u>	<u>47</u>
	<u>Pronouncements</u>	
	<u>Other Information</u>	<u>47</u>
<b>Item 3:</b>	<u>Quantitative and</u>	
	<u>Qualitative</u>	
	<u>Disclosures About</u>	<u>49</u>
	<u>Market Risk</u>	
<b>Item 4:</b>	<u>Controls and</u>	
	<u>Procedures</u>	<u>50</u>
<b>PART II.</b>	<b><u>OTHER</u></b>	
	<b><u>INFORMATION</u></b>	
<b>Item 2:</b>	<u>Unregistered</u>	
	<u>Sales of Equity</u>	
	<u>Securities and Use</u>	<u>50</u>
	<u>of Proceeds</u>	
<b>Item 6:</b>	<u>Exhibits</u>	<u>50</u>
<b>SIGNATURE</b>		<u>54</u>

Table of Contents**PART 1. FINANCIAL INFORMATION****Item 1. Financial Statements**

## REALTY INCOME CORPORATION AND SUBSIDIARIES

**CONSOLIDATED BALANCE SHEETS**

(dollars in thousands, except per share data)

	<b>September 30, 2018</b>	<b>December 31, 2017</b>
ASSETS	(unaudited)	
Real estate, at cost:		
Land	\$ 4,562,343	\$ 4,080,400
Buildings and improvements	11,666,564	10,936,069
Total real estate, at cost	16,228,907	15,016,469
Less accumulated depreciation and amortization	(2,607,309)	(2,346,644)
Net real estate held for investment	13,621,598	12,669,825
Real estate held for sale, net	65,376	6,674
Net real estate	13,686,974	12,676,499
Cash and cash equivalents	6,666	6,898
Accounts receivable, net	135,866	119,533
Acquired lease intangible assets, net	1,212,679	1,194,930
Goodwill	14,861	14,970
Other assets, net	38,279	45,336
Total assets	\$ 15,095,325	\$ 14,058,166
LIABILITIES AND EQUITY		
Distributions payable	\$ 65,749	\$ 60,799
Accounts payable and accrued expenses	119,144	109,523
Acquired lease intangible liabilities, net	309,665	268,796
Other liabilities	109,854	116,869
Line of credit payable	774,000	110,000
Term loans, net	319,571	445,286

Edgar Filing: REALTY INCOME CORP - Form 10-Q

Mortgages payable, net	310,206	325,941
Notes payable, net	5,375,882	5,230,244
Total liabilities	7,384,071	6,667,458
Commitments and contingencies		
Stockholders' equity:		
Common stock and paid in capital, par value \$0.01 per share, 370,100,000 shares authorized, 295,145,532 shares issued and outstanding as of September 30, 2018 and 284,213,685 shares issued and outstanding as of December 31, 2017	10,220,092	9,624,264
Distributions in excess of net income	(2,543,852)	(2,252,763)
Total stockholders' equity	7,676,240	7,371,501
Noncontrolling interests	35,014	19,207
Total equity	7,711,254	7,390,708
Total liabilities and equity	\$ 15,095,325	\$ 14,058,166

***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**

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

	Three months ended September 30,			Nine months ended September 30,	
	2018	2017	2018	2017	
<b>REVENUE</b>					
Rental	\$ 324,773	\$ 293,455	\$ 945,191	\$ 867,325	
Tenant reimbursements	12,479	11,933	35,174	34,918	
Other	829	1,532	4,897	2,872	
Total revenue	338,081	306,920	985,262	905,115	
<b>EXPENSES</b>					
Depreciation and amortization	136,967	127,569	402,069	371,755	
Interest	69,342	62,951	195,385	185,935	
General and administrative	16,332	13,881	49,970	43,227	
Property (including reimbursable)	15,806	17,267	48,594	52,828	
Income taxes	1,302	1,133	3,733	2,621	
Provisions for impairment	6,862	365	25,034	8,072	
Total expenses	246,611	223,166	724,785	664,438	
Gain on sales of real estate	7,813	4,319	18,818	17,689	
Net income	99,283	88,073	279,295	258,366	
Net income attributable to noncontrolling interests	(284)	(133)	(753)	(420)	
Net income attributable to the Company	98,999	87,940	278,542	257,946	
Preferred stock dividends	—	—	—	(3,911)	
Excess of redemption value over carrying value of preferred shares redeemed	—	—	—	(13,373)	
Net income available to common stockholders	\$ 98,999	\$ 87,940	\$ 278,542	\$ 240,662	
Amounts available to common stockholders per common share:					
Net income, basic and diluted	\$ 0.34	\$ 0.32	\$ 0.97	\$ 0.89	

Edgar Filing: REALTY INCOME CORP - Form 10-Q

Weighted average  
common shares  
outstanding:

Basic	290,664,368	275,511,870	286,599,191	270,584,365
Diluted	291,207,186	276,050,671	287,105,285	271,126,114

***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**

(dollars in thousands) (unaudited)

	<b>Nine months ended September 30,</b>	
	<b>2018</b>	<b>2017</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 279,295	\$ 258,366
Adjustments to net income:		
Depreciation and amortization	402,069	371,755
Amortization of share-based compensation	12,527	10,641
Non-cash revenue adjustments	(5,781)	(2,783)
Amortization of net premiums on mortgages payable	(1,167)	(1,580)
Amortization of deferred financing costs	5,337	6,819
Gain on interest rate swaps	(3,064)	(1,228)
Gain on sales of real estate	(18,818)	(17,689)
Provisions for impairment on real estate	25,034	8,072
Change in assets and liabilities		
Accounts receivable and other assets	(1,540)	(892)
Accounts payable, accrued expenses and other liabilities	(4,050)	10,067
Net cash provided by operating activities	689,842	641,548
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
	(1,437,377)	(964,719)

## Edgar Filing: REALTY INCOME CORP - Form 10-Q

Investment in real estate		
Improvements to real estate, including leasing costs	(22,432)	(11,834)
Proceeds from sales of real estate	83,024	69,486
Insurance proceeds received	7,121	12,746
Collection of loans receivable	5,267	92
Non-refundable escrow deposits for pending acquisitions	(3,275)	—
Net cash used in investing activities	(1,367,672)	(894,229)
CASH FLOWS FROM FINANCING ACTIVITIES		
Cash distributions to common stockholders	(564,747)	(509,987)
Cash dividends to preferred stockholders	—	(6,168)
Borrowings on line of credit	1,670,000	1,189,000
Payments on line of credit	(1,006,000)	(1,651,000)
Principal payment on term loan	(125,866)	—
Proceeds from notes and bonds payable issued	497,500	711,812
Principal payment on notes payable	(350,000)	(175,000)
Principal payments on mortgages payable	(14,608)	(123,524)
Redemption of preferred stock	—	(408,750)
Proceeds from common stock offerings, net	—	704,938
Proceeds from dividend reinvestment	6,966	67,813

Edgar Filing: REALTY INCOME CORP - Form 10-Q

and stock purchase plan		
Proceeds from At-the-Market (ATM) program	588,860	487,998
Distributions to noncontrolling interests	(1,391)	(1,652)
Debt issuance costs	(4,436)	(6,663)
Other items, including shares withheld upon vesting	(14,862)	(11,455)
Net cash provided by financing activities	681,416	267,362
Net increase in cash, cash equivalents and restricted cash	3,586	14,681
Cash, cash equivalents and restricted cash, beginning of period	12,142	15,681
Cash, cash equivalents and restricted cash, end of period	\$ 15,728	\$ 30,362

For supplemental disclosures, see note 17.

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

-4-

---

Table of Contents

REALTY INCOME CORPORATION AND SUBSIDIARIES

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

September 30, 2018

(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, 2017, which are included in our 2017 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 September 30, 2018 we owned 5,694 properties, located in 49 states and Puerto Rico, containing over 92.7 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 subsidiaries for which we make operating and financial decisions (i.e., control), after elimination of all material intercompany balances and transactions. We consolidate entities that we control and record a noncontrolling interest for the portion that we do not own. Noncontrolling interest that was created or assumed as part of a business combination was recognized at fair value as of the date of the transaction (see note 11). 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 and its subsidiaries for city and state income and franchise taxes.

C. 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 analysis of goodwill during the second quarters of 2018 and 2017, we determined there was no impairment on our existing goodwill.

D. In May 2014, the Financial Accounting Standards Board (FASB) issued ASU 2014-09, Revenue from Contracts with Customers. This ASU, as amended by ASU 2015-14, Revenue from Contracts with Customers: Deferral of the Effective Date, 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, which is effective for interim and annual periods beginning after

December 15, 2017, requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services and also to provide certain additional disclosures. We adopted this standard effective as of January 1, 2018 and utilized the cumulative effect transition method of adoption. The adoption of this guidance did not have a material impact on our financial position or results of operations.

E. In February 2016, the FASB issued ASU 2016-02 (Topic 842, *Leases*), as clarified and amended by ASU 2018-01, 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. Although primarily a lessor, we are also a lessee under several ground lease arrangements. Upon adoption, we will recognize lease obligations for ground leases with a

-5-

---

Table of Contents

corresponding right of use asset, and are currently evaluating other impacts this amendment may have on our consolidated financial statements. The amendments included in this topic are effective, for interim and annual periods beginning after December 15, 2018. We plan to adopt this standard when it becomes effective beginning January 1, 2019, and we expect to elect the practical expedients available for implementation under the standard.

### 3. Supplemental Detail for Certain Components of Consolidated Balance Sheets (dollars in thousands)

Acquired lease intangible assets, net, consist of the following at:			
A.		<b>September 30, 2018</b>	<b>December 31, 2017</b>
	Acquired in-place leases	\$ 1,311,676	\$ 1,272,897
	Accumulated amortization of acquired in-place leases	(521,014)	(444,221)
	Acquired above-market leases	571,341	487,933
	Accumulated amortization of acquired above-market leases	(149,324)	(121,679)
		\$ 1,212,679	\$ 1,194,930
Other assets, net, consist of the following at:			
B.		<b>September 30, 2018</b>	<b>December 31, 2017</b>
	Prepaid expenses	\$ 16,250	\$ 12,851
	Impounds related to mortgages payable	7,529	4,565
	Corporate assets, net	5,825	6,074
	Non-refundable escrow deposits for pending acquisitions	3,275	7,500
	Credit facility origination costs	2,206	4,366
	Restricted escrow deposits	1,533	679
	Receivable for property rebuilds	—	3,919
	Notes receivable issued in connection with	—	5,267

Edgar Filing: REALTY INCOME CORP - Form 10-Q

property sales				
Other items	1,661		115	
	\$	38,279	\$	45,336

	Distributions payable consist of the following declared distributions at:			
C.		<b>September 30, 2018</b>		<b>December 31, 2017</b>
	Common stock distributions			
	\$	65,597	\$	60,713
	Noncontrolling interests distributions			
		152		86
	\$	65,749	\$	60,799

	Accounts payable and accrued expenses consist of the following at:			
D.		<b>September 30, 2018</b>		<b>December 31, 2017</b>
	Notes payable - interest payable			
	\$	57,664	\$	64,058
	Property taxes payable			
		23,632		11,718
	Accrued costs on properties under development			
		4,044		2,681
	Mortgages, term loans, credit line - interest payable and interest rate swaps			
		3,859		2,360
	Other items			
		29,945		28,706
	\$	119,144	\$	109,523

	Acquired lease intangible liabilities, net, consist of the following at:			
E.		<b>September 30, 2018</b>		<b>December 31, 2017</b>
	Acquired below-market leases			
	\$	398,011	\$	340,906
	Accumulated amortization of acquired below-market leases			
		(88,346)		(72,110)
	\$	309,665	\$	268,796

F. Other liabilities consist of the following at:	September 30, 2018	December 31, 2017
Rent received in advance and other deferred revenue	\$ 98,085	\$ 105,284
Security deposits	6,211	6,259
Capital lease obligations	5,558	5,326
	\$ 109,854	\$ 116,869

-6-

---



Table of Contents

**4. Investments in Real Estate**

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

*A. Acquisitions During the First Nine Months of 2018 and 2017*

During the first nine months of 2018, we invested \$1.47 billion in 591 new properties and properties under development or expansion with an initial weighted average contractual lease rate of 6.3%. The 591 new properties and properties under development or expansion are located in 37 states, will contain approximately 4.3 million leasable square feet, and are 100% leased with a weighted average lease term of 14.4 years. The tenants occupying the new properties operate in 20 industries and the property types consist of 96.1% retail and 3.9% industrial, based on rental revenue. None of our investments during 2018 caused any one tenant to be 10% or more of our total assets at September 30, 2018.

The \$1.47 billion invested during the first nine months of 2018 was allocated as follows: \$535.7 million to land, \$846.1 million to buildings and improvements, \$112.5 million to intangible assets related to leases, and \$28.9 million to intangible liabilities related to leases and other assumed liabilities. There was no contingent consideration associated with these acquisitions.

The properties acquired during the first nine months of 2018 generated total revenues of \$31.4 million and net income of \$16.8 million during the nine months ended September 30, 2018.

In comparison, during the first nine months of 2017, we invested \$956.9 million in 177 new properties and properties under development or expansion with an initial weighted average contractual lease rate of 6.5%. The 177 new properties and properties under development or expansion were located in 35 states, contained approximately 4.3 million leasable square feet, and were 100% leased with a weighted average lease term of 14.9 years. The tenants occupying the new properties operated in 21 industries and the property types consisted of 96.6% retail and 3.4% industrial, based on rental revenue.

The \$956.9 million invested during the first nine months of 2017 was allocated as follows: \$235.4 million to land, \$582.7 million to buildings and improvements, \$154.3 million to intangible assets related to leases, and \$15.5 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 nine months of 2017 generated total revenues of \$19.7 million and net income of \$9.4 million during the nine months ended September 30, 2017.

The 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 initial weighted average contractual lease rate is computed as follows: estimated net operating income (determined by the lease) for the first full year of each lease, divided by our projected total investment in the property, including land, construction and capitalized interest costs. Of the \$1.47 billion we invested during the first nine months of 2018, \$69.7 million was invested in 11 properties under development or expansion

with an initial weighted average contractual lease rate of 6.8%. Of the \$956.9 million we invested during the first nine months of 2017, \$16.4 million was invested in 13 properties under development or expansion with an initial weighted average contractual lease rate of 7.3%.

*B. Investments in Existing Properties*

During the first nine months of 2018 , we capitalized costs of \$12.3 million on existing properties in our portfolio, consisting of \$2.8 million for re-leasing costs, \$529,000 for recurring capital expenditures and \$8.9 million for non-recurring building improvements. In comparison, during the first nine months of 2017, we capitalized costs of \$9.5 million on existing properties in our portfolio, consisting of \$1.2 million for re-leasing costs, \$536,000 for recurring capital expenditures and \$7.8 million for non-recurring building improvements.

-7-

---

Table of Contents*C. Properties with Existing Leases*

Of the \$1.47 billion we invested during the first nine months of 2018, approximately \$307.5 million was used to acquire 147 properties with existing leases. In comparison, of the \$956.9 million we invested during the first nine months of 2017, approximately \$562.1 million was used to acquire 68 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 nine months of 2018 and 2017 were \$79.8 million and \$79.1 million, respectively.

The values of the above-market and below-market leases are amortized over the term of the respective leases, including any bargain renewal options, as an adjustment to rental revenue on our consolidated statements of income. The amounts amortized as a net decrease to rental revenue for capitalized above-market and below-market leases for the first nine months of 2018 and 2017 were \$12.4 million and \$10.2 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.

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 at September 30, 2018 (in thousands):

	<b>Net decrease to rental revenue</b>	<b>Increase to amortization expense</b>	
2018	\$ (4,388)	\$	26,568
2019	(17,043)	98,078	
2020	(16,314)	92,326	
2021	(15,075)	84,355	
2022	(13,369)	72,765	
Thereafter	(46,164)	416,571	
Totals	\$ (112,352)	\$	790,662

**5. Credit Facility**

At September 30, 2018, we had a \$2.0 billion unsecured revolving credit facility, or our credit facility, with an initial term that expired in June 2019 and included, at our option, two six-month extensions. Our credit facility had a \$1.0 billion accordion expansion option. Under our credit facility, our investment grade credit ratings as of September 30, 2018 provided for financing at the London Interbank Offered Rate, commonly referred to as LIBOR, plus 0.85% with a facility commitment fee of 0.125%, for all-in drawn pricing of 0.975% over LIBOR. The borrowing rate was subject to an interest rate floor and could change if our investment grade credit ratings changed. We also had other interest rate options available to us under our credit facility. Our credit facility was unsecured and, accordingly, we did not pledge any assets as collateral for this obligation.

In October 2018, we entered into a new \$3.25 billion unsecured credit facility to amend and restate our credit facility. For more information, please see note 21.

At September 30, 2018, credit facility origination costs of \$2.2 million are included in other assets, net on

our consolidated balance sheet. These costs were being amortized over the remaining term of our credit facility.

At September 30, 2018, we had a borrowing capacity of approximately \$1.2 billion available on our credit facility (subject to customary conditions to borrowing) and an outstanding balance of \$774.0 million, as compared to an outstanding balance of \$110.0 million at December 31, 2017.

-8-

---

## Table of Contents

The weighted average interest rate on outstanding borrowings under our credit facility was 2.8% during the first nine months of 2018 and 1.9% during the first nine months of 2017. At September 30, 2018 and December 31, 2017, the weighted average interest rate on outstanding borrowings under our credit facility was 3.1% and 4.5%, respectively.

Our credit facility is subject to various leverage and interest coverage ratio limitations, and at September 30, 2018, we were in compliance with the covenants on our credit facility.

## **6. Term Loans**

In December 2017, in conjunction with the acquisition of a portfolio of properties, we entered into a \$125.9 million promissory note, which was paid in full at maturity in January 2018. Borrowings under this note bore interest at 1.52%.

In June 2015, in conjunction with entering into our credit facility, we entered into a \$250.0 million senior unsecured term loan maturing on June 30, 2020. Borrowing under this term loan bears interest at the current one-month LIBOR, plus 0.90%. 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 2.62%.

In January 2013, in conjunction with our acquisition of American Realty Capital Trust, Inc., or ARCT, we entered into a \$70.0 million senior unsecured term loan with an initial maturity date of January 2018. Borrowing under this term loan bore interest at the current one-month LIBOR, plus 1.10%. In conjunction with this term loan, we also entered into an interest rate swap which effectively fixed our per annum interest rate on this term loan at 2.05%. In January 2018, we entered into a six-month extension of this loan, which included, at our option, two additional six-month extensions. In June 2018, we exercised our first six-month extension of this loan, which now matures in January 2019. Borrowing during the extension periods bears interest at the current one-month LIBOR, plus 0.90%. The interest rate swap terminated upon the initial maturity in January 2018.

Deferred financing costs of \$1.2 million incurred in conjunction with the \$250.0 million term loan and \$368,000 incurred in conjunction with the \$70.0 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 \$429,000 at September 30, 2018, and \$580,000 at December 31, 2017, is included within term loans, net on our consolidated balance sheets.

In October 2018, in connection with our entry into our new \$3.25 billion unsecured credit facility, we entered into an additional \$250.0 million senior unsecured term loan. For more information, please see note 21.

## **7. Mortgages Payable**

During the first nine months of 2018, we made \$14.6 million in principal payments, including the repayment of one mortgage in full for \$11.0 million. During the first nine months of 2017, we made \$123.5 million in principal payments, including the repayment of seven mortgages in full for \$118.6 million. No mortgages were assumed during the first nine months of 2018 or 2017. The assumed mortgages are secured by the properties on which the debt was placed and are considered non-recourse debt with limited customary exceptions for items such as solvency, bankruptcy, misrepresentation, fraud, misapplication of payments, environmental liabilities, failure to pay taxes, insurance premiums, liens on the property, violations of the single purpose entity requirements, and uninsured losses. We expect to pay off our outstanding mortgages as soon as prepayment penalties make it economically feasible to do so.

Our 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 September 30, 2018, we were in compliance with these covenants.

The balance of our deferred financing costs, which are classified as part of mortgages payable, net, on our consolidated balance sheets, was \$196,000 at September 30, 2018 and \$236,000 at December 31, 2017. These costs are being amortized over the remaining term of each mortgage.

-9-

---

Table of Contents

The following is a summary of all our mortgages payable as of September 30, 2018 and December 31, 2017, 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 Financing Costs Balance, net	Mortgage Payable Balance
9/30/2018	61	5.0%	4.0%	3.4	\$ 305,674	\$ 4,532	\$ 310,206
12/31/2017	62	5.0%	4.0%	4.0	\$ 320,283	\$ 5,658	\$ 325,941

(1) At September 30, 2018, there were 27 mortgages on 61 properties. At December 31, 2017, there were 28 mortgages on 62 properties. The mortgages require monthly payments with principal payments due at maturity. The mortgages are at fixed interest rates, except for three mortgages on three properties totaling \$29.4 million and \$29.9 million at September 30, 2018 and December 31, 2017, respectively. After factoring in arrangements which limit our exposure to interest rate risk and effectively fix our per annum interest rates, our mortgage debt subject to variable rates totals \$22.1 million at September 30, 2018 and \$22.4 million at December 31, 2017.

(2) Stated interest rates ranged from 3.8% to 6.9% at September 30, 2018, while stated interest rates ranged from 3.4% to 6.9% at December 31, 2017.

(3) Effective interest rates ranged from 1.6% to 6.1% at September 30, 2018, while effective interest rates ranged from 2.6% to 5.5% at December 31, 2017.

The following table summarizes the maturity of mortgages payable, excluding net premiums of \$4.7 million and deferred financing costs of \$196,000, as of September 30, 2018 (dollars in millions):

Year of Maturity	Principal
2018	\$ 7.3
2019	20.7
2020	82.4
2021	67.0
2022	109.7
Thereafter	18.6
Totals	\$ 305.7

**8. Notes Payable***A. General*

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

	September 30, 2018	December 31, 2017
2.000% notes, issued in October 2012 and due in January 2018	\$ —	\$ 350
5.750% notes, issued in June 2010 and due in January 2021	250	250
3.250% notes, \$450 issued in October 2012 and \$500 issued in	950	950

Edgar Filing: REALTY INCOME CORP - Form 10-Q

December 2017, both due in October 2022			
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
3.875% notes, issued in April 2018 and due in April 2025	500		—
4.125% notes, \$250 issued in September 2014 and \$400 issued in March 2017, both due in October 2026	650		650
3.000% notes, issued in October 2016 and due in January 2027	600		600
3.650% notes, issued in December 2017 and due in January 2028	550		550
5.875% bonds, \$100 issued in March 2005 and \$150 issued in June 2011, both due in March 2035	250		250
4.650% notes, \$300 issued in March 2017 and \$250 issued in December 2017, both due in March 2047	550		550
Total principal amount	5,400		5,250
Unamortized net original issuance premiums and deferred financing costs	(24)		(20)
	\$	5,376	\$ 5,230



Table of Contents

The following table summarizes the maturity of our notes and bonds payable as of September 30, 2018, excluding net unamortized original issuance premiums and deferred financing costs (dollars in millions):

<b>Year of Maturity</b>	<b>Principal</b>
2021	\$ 250
2022	950
Thereafter	4,200
Totals	\$ 5,400

As of September 30, 2018, the weighted average interest rate on our notes and bonds payable was 4.0% and the weighted average remaining years until maturity was 9.0 years.

*B. Note Repayment*

In January 2018, we repaid our \$350.0 million of outstanding 2.000% notes, plus accrued and unpaid interest upon maturity.

*C. Note Issuances*

In April 2018, we issued \$500.0 million of 3.875% senior unsecured notes due 2025, or the 2025 Notes. The public offering price for the 2025 Notes was 99.50% of the principal amount, for an effective yield to maturity of 3.957%. The net proceeds of approximately \$493.1 million from this offering were used to repay borrowings outstanding under our credit facility, to fund investment opportunities, and for other general corporate purposes.

In March 2017, we issued \$300.0 million of 4.650% senior unsecured notes due 2047, or the 2047 Notes, and \$400.0 million of 4.125% senior unsecured notes due 2026, or the 2026 Notes. The public offering price for the 2047 Notes was 99.97% of the principal amount for an effective yield to maturity of 4.65%. The public offering price for the 2026 Notes was 102.98% of the principal amount for an effective yield to maturity of 3.75%. The 2026 Notes constituted a further issuance of, and formed a single series with, the \$250.0 million aggregate principal amount of senior notes due 2026, issued in September 2014. The net proceeds of approximately \$705.2 million from the offerings were used to repay borrowings outstanding under our credit facility to fund investment opportunities, and for other general corporate purposes.

**9. Issuances of Common Stock***A. Issuances of Common Stock in an Overnight Offering*

In March 2017, we issued 11,850,000 shares of common stock in an overnight offering. After underwriting discounts and other offering costs of \$29.8 million, the net proceeds of \$704.9 million were used to repay borrowings under our credit facility.

*B. Dividend Reinvestment and Stock Purchase Plan*

Our Dividend Reinvestment and Stock Purchase Plan, or our DRSP, provides our common stockholders, as well as new investors, with a convenient and economical method of purchasing our common stock and reinvesting their distributions. Our DRSP also allows our current common stockholders to buy additional shares of common stock by reinvesting all or a portion of their distributions. Our DRSP authorizes up to 26,000,000 common shares to be issued. During the first nine months of 2018, we issued 131,072 shares and raised approximately \$7.0 million under our DRSP. During the first nine months of 2017, we issued 1,155,883 shares and raised approximately \$67.8 million under our DRSP. From the inception of our DRSP through September 30, 2018, we have issued 14,194,614 shares and raised approximately \$668.8 million.

Our DRSP includes a waiver approval process, allowing larger investors or institutions, per a formal approval process, to purchase shares at a small discount, if approved by us. We did not issue shares under the waiver approval process during the first nine months of 2018. During the first nine months of 2017, we issued 927,695 shares and raised \$54.7 million under the waiver approval process. These shares are included in the total activity for the first nine months of 2017 noted in the preceding paragraph.

*C. At-the-Market (ATM) Programs*

In October 2017, following the issuance and sale of the initial 12,000,000 shares under our prior "at-the-market" equity distribution plan, we established a new "at-the-market" equity distribution plan, or our ATM program, pursuant to which we are permitted to offer and sell up to 17,000,000 additional shares of common stock to, or through, a

-11-

---

Table of Contents

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 nine months of 2018, we issued 10,630,616 shares and raised approximately \$588.9 million under the ATM program. During the first nine months of 2017, we issued 8,506,559 shares and raised approximately \$488.0 million under the ATM program. From the inception of our ATM programs through September 30, 2018, we have issued 25,038,145 shares authorized by our ATM programs and raised approximately \$1.4 billion.

**10. Redemption of Preferred Stock**

In April 2017, we redeemed all of the 16,350,000 shares of our 6.625% Monthly Income Class F Preferred Stock, or the Class F preferred stock, for \$25 per share, plus accrued dividends. We issued an irrevocable notice of redemption with respect to the Class F preferred stock in March 2017, and, as a result, we incurred a non-cash charge of \$13.4 million for the first nine months of 2017, representing the Class F preferred stock original issuance costs that we paid in 2012.

**11. 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. as consideration for the acquisition. Additionally, in March and April 2018, we completed the acquisition of an additional portfolio of properties, by paying both cash and by issuing additional common partnership units in Realty Income, L.P. as consideration for the acquisitions. At September 30, 2018, the remaining units from these issuances represent a 1.5% ownership in Realty Income, L.P. We hold the remaining 98.5% interests in this entity and consolidate the entity.

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

In 2016, we completed the acquisition of two properties by acquiring a controlling interest in two separate entities. We are the managing member of each of these entities, and possess the ability to control the business and manage the affairs of these entities. At September 30, 2018, we and our subsidiaries held 95.0% and 74.0% interests, respectively, and fully consolidated these entities in our consolidated financial statements.

The following table represents the change in the carrying value of all noncontrolling interests through September 30, 2018 (dollars in thousands):

<b>Tau Operating Partnership units<sup>(1)</sup></b>	<b>Realty Income, L.P. units<sup>(2)</sup></b>	<b>Other Noncontrolling Interests</b>	<b>Total</b>
\$ 13,322	\$ 2,160	\$ 3,725	\$ 19,207

Edgar Filing: REALTY INCOME CORP - Form 10-Q

Carrying value at December 31, 2017								
Reallocation of equity	572	(43)	(37)		492			
Redemptions	—	(2,829)	—		(2,829)			
Shares issued in conjunction with acquisition	—	18,848	—		18,848			
Distributions	(627)	(595)	(235)		(1,457)			
Allocation of net income	250	448	55		753			
Carrying value at September 30, 2018	\$	13,517	\$	17,989	\$	3,508	\$	35,014

-12-

---

Table of Contents

(1) 317,022 Tau Operating Partnership units were issued on January 22, 2013 and remained outstanding as of September 30, 2018 and December 31, 2017.

(2) 534,546 Realty Income, L.P. units were issued on June 27, 2013, 242,007 units were issued on March 30, 2018 and 131,790 units were issued on April 30, 2018. 373,797 and 88,182 remained outstanding as of September 30, 2018 and December 31, 2017, respectively.

Tau Operating Partnership, Realty Income, L.P. and the two entities acquired in 2016 are considered variable interest entities, or VIEs, in which we are deemed the primary beneficiary based on our controlling financial interests. Below is a summary of selected financial data of our consolidated VIEs at September 30, 2018 and December 31, 2017 (in thousands):

	<b>September 30, 2018</b>	<b>December 31, 2017</b>
Net real estate	\$ 2,933,150	\$ 2,936,397
Total assets	3,303,585	3,342,443
Total debt	197,960	210,384
Total liabilities	328,573	313,295

**12. Fair Value of Financial Instruments**

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

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

<b>September 30, 2018</b>	<b>Carrying value</b>	<b>Estimated fair value</b>
Mortgages payable assumed in connection with acquisitions <sup>(1)</sup>	\$ 305.7	\$ 310.5
Notes and bonds payable <sup>(2)</sup>	5,400.0	5,397.6
<b>December 31, 2017</b>	<b>Carrying value</b>	<b>Estimated fair value</b>
Notes receivable issued in connection	\$ 5.3	\$ 5.3

with property  
sales

Mortgages  
payable  
assumed in  
connection  
with  
acquisitions  
(1)

320.3	334.2
-------	-------

Notes and  
bonds  
payable (2)

5,250.0	5,475.3
---------	---------

(1) Excludes non-cash net premiums recorded on the mortgages payable. The unamortized balance of these net premiums was \$4.7 million at September 30, 2018, and \$5.9 million at December 31, 2017. Also excludes deferred financing costs of \$196,000 at September 30, 2018 and \$236,000 at December 31, 2017.

(2) Excludes non-cash original issuance premiums and discounts recorded on notes payable. The unamortized balance of the net original issuance premiums was \$10.8 million at September 30, 2018, and \$14.3 million at December 31, 2017. Also excludes deferred financing costs of \$35.0 million at September 30, 2018 and \$34.1 million at December 31, 2017.

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 forward interest rate 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

-13-

---

Table of Contents

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 September 30, 2018, interest rate swaps in a liability position valued at \$162,000 were included in accounts payable and accrued expenses and interest rate swaps in an asset position valued at \$4.6 million were included in other assets, net on the consolidated balance sheet. The fair value of our interest rate swaps are based on valuation techniques including discounted cash flow analysis on the expected cash flows of each swap, using both observable and unobservable market-based inputs, including interest rate curves. Because this methodology uses observable and unobservable inputs, and the unobservable inputs are not significant to the fair value measurement, the measurement of interest rate swaps is categorized as level two on the three-level valuation hierarchy.

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

During the third quarter of 2018, we sold 20 properties for \$35.5 million, which resulted in a gain of \$7.8 million. During the third quarter of 2017, we sold 17 properties for \$25.5 million, which resulted in a gain of \$4.3 million.

During the first nine months of 2018, we sold 60 properties for \$83.0 million, which resulted in a gain of \$18.8 million. During the first nine months of 2017, we sold 46 properties for \$69.5 million, which resulted in a gain of \$17.7 million.

**14. 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 re-leases, 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 third quarter of 2018, we recorded total provisions for impairment of \$6.9 million on 12 properties classified as held for sale and seven sold properties. For the first nine months of 2018, we recorded total provisions for impairment of \$25.0 million on 16 properties classified as held for sale, two properties classified as held for investment, and 21 sold properties.

In comparison, for the third quarter of 2017, we recorded total provisions for impairment of \$365,000 on four sold properties. For the first nine months of 2017, we recorded total provisions for impairment of \$8.1 million on four properties classified as held for investment and 17 sold properties.

**15. 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 nine months of 2018 and 2017:

Month	2018	2017
-------	------	------

Edgar Filing: REALTY INCOME CORP - Form 10-Q

January	\$	0.2125	\$	0.2025
February		0.2190		0.2105
March		0.2190		0.2105
April		0.2195		0.2110
May		0.2195		0.2110
June		0.2195		0.2110
July		0.2200		0.2115
August		0.2200		0.2115
September		0.2200		0.2115
Total	\$	1.9690	\$	1.8910

-14-

---



Table of Contents

At September 30, 2018, a distribution of \$0.2205 per common share was payable and was paid in October 2018.

*B. Class F Preferred Stock*

In April 2017, we redeemed all 16,350,000 shares of our Class F preferred stock. During the first nine months of 2017, we paid three monthly dividends to holders of our Class F preferred stock totaling \$0.414063 per share, or \$3.9 million. In April 2017, we paid a final monthly dividend of \$0.101215 per share, or \$1.7 million, which was recorded as interest expense, since these dividends accrued subsequent to the March 2017 notice of redemption.

**16. Net Income per Common Share**

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

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

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Weighted average shares used for the basic net income per share computation	290,664,368	275,511,870	286,599,191	270,584,365
Incremental shares from share-based compensation	225,796	221,779	189,072	224,727
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	291,207,186	276,050,671	287,105,285	271,126,114
Unvested shares from	261	15,798	1,378	17,719

share-based compensation that were anti-dilutive				
Weighted average partnership common units convertible to common shares that were anti-dilutive	397,690	88,182	271,890	88,182

## 17. Supplemental Disclosures of Cash Flow Information

Cash paid for interest was \$197.2 million in the first nine months of 2018 and \$198.8 million in the first nine months of 2017.

Interest capitalized to properties under development was \$234,000 in the first nine months of 2018 and \$347,000 in the first nine months of 2017.

Cash paid for income taxes was \$4.0 million in the first nine months of 2018 and 2017.

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

A. During the first nine months of 2018, we issued 373,797 common partnership units of Realty Income, L.P. as partial consideration for an acquisition of properties, totaling \$18.8 million.

B. During the first nine months of 2018, we completed the acquisition of a property using \$7.5 million in funds that were held in a non-refundable escrow account. These funds were included in other assets, net, at December 31, 2017.

Table of Contents

Per the requirements of ASU 2016-18 (Topic 230, *Statement of Cash Flows*), the following table provides a reconciliation of cash and cash equivalents reported within the consolidated balance sheets to the total of the cash, cash equivalents and restricted cash reported within the consolidated statements of cash flows:

	September 30, 2018	September 30, 2017
Cash and cash equivalents shown in the consolidated balance sheets	\$ 6,666	\$ 3,199
Restricted escrow deposits <sup>(1)</sup>	1,533	23,698
Impounds related to mortgages payable <sup>(1)</sup>	7,529	3,465
Total cash, cash equivalents, and restricted cash shown in the consolidated statements of cash flows	\$ 15,728	\$ 30,362

(1) Included within other assets, net on the consolidated balance sheets (see note 3). These amounts consist of cash that we are legally entitled to but, that is not immediately available to us. As a result, these amounts were considered restricted as of the dates presented.

**18. Segment Information**

We evaluate performance and make resource allocation decisions on an industry by industry basis. For financial reporting purposes, we have grouped our tenants into 48 activity segments. All of the properties are incorporated into one of the applicable segments. Because almost all of our leases require the tenant to pay operating expenses, rental revenue is the only component of segment profit and loss we measure.

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):

-16-

---

Table of Contents

<b>Assets, as of:</b>	<b>September 30, 2018</b>	<b>December 31, 2017</b>
Segment net real estate:		
Apparel	\$ 158,461	\$ 164,919
Automotive service	208,457	213,156
Automotive tire services	241,093	247,557
Beverages	285,970	289,170
Child care	61,450	61,527
Convenience stores	1,707,566	997,170
Dollar stores	1,123,751	1,105,097
Drug stores	1,499,534	1,518,443
Financial services	421,431	384,867
General merchandise	320,285	313,181
Grocery stores	779,919	793,286
Health and fitness	885,329	896,430
Home improvement	427,500	407,002
Motor vehicle dealerships	199,639	204,651
Restaurants-casual dining	609,032	494,977
Restaurants-quick service	838,911	681,763
Theaters	561,763	566,585
Transportation services	762,752	776,068
Wholesale club	415,452	426,551
Other non-reportable segments	2,178,679	2,134,099
Total segment net real estate	13,686,974	12,676,499
Intangible assets:		
Apparel	33,666	36,600
Automotive service	61,683	64,388
Automotive tire services	9,103	10,383
Beverages	1,830	2,022
Convenience stores	107,535	45,445
Dollar stores	49,700	47,905
Drug stores	168,111	173,893
Financial services	21,474	24,867
General merchandise	44,666	50,184
Grocery stores	146,315	140,780
Health and fitness	73,301	76,276
Home improvement	60,284	61,045
Motor vehicle dealerships	29,046	31,720
Restaurants-casual dining	18,611	20,079
Restaurants-quick service	54,521	51,711
Theaters	26,654	26,448
	76,718	87,162

Edgar Filing: REALTY INCOME CORP - Form 10-Q

Transportation services			
Wholesale club	27,262		29,596
Other non-reportable segments	202,199		214,426
Goodwill:			
Automotive service	437		437
Automotive tire services	862		862
Child care	4,885		4,924
Convenience stores	1,993		2,004
Restaurants-casual dining	2,034		2,062
Restaurants-quick service	1,057		1,064
Other non-reportable segments	3,593		3,617
Other corporate assets	180,811		171,767
Total assets	\$	15,095,325	\$ 14,058,166

-17-

---

Table of Contents

Revenue	Three months ended September 30,			Nine months ended September 30,	
	2018	2017	2018	2017	
Segment rental revenue:					
Apparel	\$ 4,042	\$ 4,718	\$ 12,582	\$ 14,613	
Automotive service	7,120	6,416	21,150	18,257	
Automotive tire services	7,460	7,383	22,607	22,158	
Beverages	7,908	7,829	23,581	23,345	
Child care	5,255	5,062	16,172	15,395	
Convenience stores	39,384	27,874	101,254	83,143	
Dollar stores	23,903	22,738	70,390	68,246	
Drug stores	32,431	31,635	97,206	94,880	
Financial services	7,850	7,058	21,741	21,377	
General merchandise	7,453	6,296	21,613	17,263	
Grocery stores	16,095	13,450	47,433	37,209	
Health and fitness	23,754	22,416	70,812	65,810	
Home improvement	9,678	7,816	28,261	21,826	
Motor vehicle dealerships	5,711	5,749	18,660	18,240	
Restaurants-casual dining	12,355	11,073	34,344	32,853	
Restaurants-quick service	18,673	14,659	52,035	43,337	
Theaters	17,479	14,947	52,814	41,405	
Transportation services	16,105	15,635	47,653	46,656	
Wholesale club	9,345	9,414	28,218	28,241	
Other non-reportable segments	52,772	51,287	156,665	153,071	
Total rental revenue	324,773	293,455	945,191	867,325	
Tenant reimbursements	12,479	11,933	35,174	34,918	
Other revenue	829	1,532	4,897	2,872	
Total revenue	\$ 338,081	\$ 306,920	\$ 985,262	\$ 905,115	

**19. 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 third quarter of 2018, \$3.4 million during the third quarter of 2017, \$12.5 million during the first nine months of 2018 and \$10.6 million during the first nine months of 2017.

*A. Restricted Stock*

During the first nine months of 2018, we granted 147,000 shares of common stock under the 2012 Plan. This included an annual grant of 28,000 shares of common stock to the independent members of our Board of Directors in May 2018, of which 20,000 shares vested immediately, 4,000 shares vest in equal parts over a three-year service period, and 4,000 shares vest in equal parts over a two-year service period. In addition, in July 2018, we granted 8,000 shares of common stock to our two newly appointed independent directors of our Board of Directors, which vest in equal parts over a three-year service period. With the exception of shares granted to our independent directors, shares granted to employees typically vest in equal parts over a four-year service period.

-18-

---

## Table of Contents

As of September 30, 2018, the remaining unamortized share-based compensation expense related to restricted stock totaled \$16.7 million, which is being amortized on a straight-line basis over the service period of each applicable award. The amount of share-based compensation is based on the fair value of the stock at the grant date. We define the grant date as the date the recipient and Realty Income have a mutual understanding of the key terms and conditions 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.

### *B. Performance Shares and Restricted Stock Units*

During the first nine months of 2018, we granted 190,449 performance shares, as well as dividend equivalent rights, to our executive officers. The performance shares are earned based on our Total Shareholder Return (TSR) performance relative to select industry indices and peer groups 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 nine months of 2018, we also granted 8,383 restricted stock units, all of which vest over a four-year service period. These restricted stock units have the same economic rights as shares of restricted stock.

As of September 30, 2018, the remaining share-based compensation expense related to the performance shares and restricted stock units totaled \$13.6 million. The fair value of the performance shares were 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.

## **20. Commitments and Contingencies**

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

At September 30, 2018, we had commitments of \$8.1 million for re-leasing costs, recurring capital expenditures, and non-recurring building improvements. In addition, as of September 30, 2018, we had committed \$26.8 million under construction contracts, which is expected to be paid in the next twelve months.

## **21. Subsequent Events**

In October 2018, we declared a dividend of \$0.2205 per share to our common stockholders, which will be paid in November 2018.

In October 2018, we entered into a new \$3.25 billion unsecured credit facility to amend and restate our previous \$2.25 billion unsecured credit facility, of which \$2.0 billion was due to expire in June 2019. This new credit facility includes a \$3.0 billion unsecured revolving credit facility and a new \$250.0 million unsecured term loan due March 2024. The new revolving credit facility matures in March 2023 and includes two six-month extensions that can be exercised at our option. The new revolving credit facility also has a \$1.0 billion expansion feature. Under the new revolving credit facility, our current investment grade credit ratings provide for financing at LIBOR plus 0.775% with a facility commitment fee of 0.125%, for all-in drawn pricing of 0.90% over LIBOR.



In conjunction with our new revolving credit facility, we entered into a \$250.0 million senior unsecured term loan, which matures in March 2024. Borrowing under this term loan bears interest at the current one-month LIBOR plus 0.85%. In conjunction with this term loan, we also entered into an interest rate swap which effectively fixes our per annum interest on this term loan at 3.89%.

On October 16, 2018, the Board of Directors appointed Sumit Roy, our President and Chief Operating Officer, as Chief Executive Officer and to the Board, replacing John P. Case. Mr. Roy will continue to serve as President. In connection with Mr. Roy's appointment, we increased Mr. Roy's annual base salary and increased Mr. Roy's target annual cash bonus for the remainder of 2018, which will be pro-rated for the remainder of the year. In addition, we granted to Mr. Roy an award of 34,752 restricted shares of our common stock which will vest 50% on on each of the third and fourth anniversaries of the grant date, subject to Mr. Roy's continued employment with us through the applicable vesting date.

-19-

---

Table of Contents

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

**FORWARD-LOOKING STATEMENTS**

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

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

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

- Our continued qualification as a real estate investment trust;
- General business and economic conditions;
- Competition;
- Fluctuating interest rates;
- Access to debt and equity capital markets;
- Continued volatility and uncertainty in the credit markets and broader financial markets;
- 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, 2017.

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

**THE COMPANY**

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

-20-

---

## Table of Contents

Realty Income was founded in 1969, and listed on the New York Stock Exchange (NYSE: O) in 1994. Over the past 49 years, Realty Income has been acquiring and managing freestanding commercial properties that generate rental revenue under long-term net lease agreements. The company is a member of the S&P High Yield Dividend Aristocrats® index for having increased its dividend every year for more than 20 consecutive years.

At September 30, 2018, we owned a diversified portfolio:

- Of 5,694 properties;
- With an occupancy rate of 98.8%, or 5,623 properties leased and 71 properties available for lease;
- Leased to 260 different commercial tenants doing business in 48 separate industries;
- Located in 49 states and Puerto Rico;
- With over 92.7 million square feet of leasable space; and
- With an average leasable space per property of approximately 16,280 square feet; approximately 11,360 square feet per retail property and 228,150 square feet per industrial property.

Of the 5,694 properties in the portfolio, 5,666, or 99.5%, are single-tenant properties, and the remaining are multi-tenant properties. At September 30, 2018, of the 5,666 single-tenant properties, 5,596 were leased with a weighted average remaining lease term (excluding rights to extend a lease at the option of the tenant) of approximately 9.3 years.

## **Investment Philosophy**

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

Diversification is also a key component of our investment philosophy. We believe that diversification of the portfolio by tenant, industry, geography, and, to a certain extent, property type leads to more consistent and predictable income for our stockholders by reducing vulnerability that can come with any single concentration. Our investment activities have led to a diversified property portfolio that, as of September 30, 2018, consisted of 5,694 properties located in 49 states and Puerto Rico, leased to 260 different commercial tenants doing business in 48 industries. Each of the 48 industries represented in our property portfolio individually accounted for no more than 12.1% of our rental revenue for the quarter ended September 30, 2018.

## **Investment Strategy**

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

- Properties that are freestanding, commercially-zoned with a single tenant;
- Properties that are in significant markets or strategic locations critical to generating revenue for regional and national tenants (i.e. they need the property in which they operate in order to conduct their business);

- Properties that we deem to be profitable for the tenants and/or can generally be characterized as important to the successful operations of the company's business;
- Properties that are located within attractive demographic areas relative to the business of our tenants, generally fungible, and have good visibility and easy access to major thoroughfares;
- Properties with real estate valuations that approximate replacement costs;
- Properties with rental or lease payments that approximate market rents; and
- Properties that can be purchased with the simultaneous execution or assumption of long-term, net lease agreements, offering both current income and the potential for future rent increases.

We seek to invest in industries in which several, well-organized, regional and national tenants are capturing market share through the selection of prime real estate locations supported by superior service, quality control, economies

-21-

---

### Table of Contents

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

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

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

From a retail perspective, our investment strategy is to target tenants that have a service, non-discretionary, and/or low-price-point component to their business. We believe these characteristics better position tenants to operate in a variety of economic conditions and to compete more effectively with internet retailers. As a result of the execution of this strategy, over 92% of our annualized retail rental revenue at September 30, 2018 is derived from tenants with a service, non-discretionary, and/or low price point component to their business. From a non-retail perspective, we target industrial properties leased to Fortune 1000, primarily investment grade rated companies. We believe these characteristics enhance the stability of the rental revenue generated from these properties.

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

### **Underwriting Strategy**

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

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

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

Thus, as the property owner, we believe that we will fare better than unsecured creditors of the same tenant in the event of reorganization. If a property is rejected by the tenant during reorganization, we own the property and can either lease it to a new tenant or sell the property. In addition, we believe that the risk of default on real estate leases can be further mitigated by monitoring the performance of the tenants' individual locations and considering whether to proactively sell locations that meet our criteria for

disposition.

Prior to entering into any transaction, our research department conducts a review of a tenant's credit quality. The information reviewed may include reports and filings, including any public credit ratings, financial statements, debt and equity analyst reports, and reviews of corporate credit spreads, stock prices, market capitalization, and other financial metrics. We conduct additional due diligence, including additional financial reviews of the tenant and a more comprehensive review of the business segment and industry in which the tenant operates. We continue to monitor our tenants' credit quality on an ongoing basis by reviewing the available information previously discussed, and providing summaries of these findings to management. Approximately 51% of our annualized rental revenue comes from properties leased to investment grade rated companies or their subsidiaries. At September 30, 2018,

-22-

---

### Table of Contents

our top 20 tenants represent approximately 54% of our annualized revenue and 12 of these tenants have investment grade credit ratings or are subsidiaries of investment grade companies.

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

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

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

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

We continually monitor our portfolio for any changes that could affect the performance of our tenants, our tenants' industries, and the real estate locations in which we have invested. We also regularly analyze our portfolio with a view towards optimizing its returns and enhancing its overall credit quality. Our active portfolio and asset management strategy pursues asset sales when we believe the reinvestment of the sale proceeds will:

- Generate higher returns;
- Enhance the credit quality of our real estate portfolio;
- Extend our average remaining lease term; and/or
- Strategically decrease tenant, industry, or geographic concentration.

At September 30, 2018, we classified 74 properties with a carrying amount of \$65.4 million as held for sale on our balance sheet. For the remainder of 2018, we intend to continue our active disposition efforts to further enhance our real estate portfolio and anticipate approximately \$150.0 million in property sales. We plan to invest these proceeds into new property acquisitions, if there are attractive opportunities available. However, we cannot guarantee that we will sell properties during the remainder of 2018 at our estimated values or be able to invest the property sale proceeds in new properties.

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

### **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 49-year policy of paying monthly dividends. In addition, we increased the dividend five times during 2018. As of October 2018, we have paid 84 consecutive quarterly dividend increases and increased the dividend 98 times since our listing on the NYSE in 1994.

	<b>Month</b>	<b>Month</b>	<b>Dividend</b>	<b>Increase</b>
<b>2018</b>	<b>Declared</b>	<b>Paid</b>	<b>per share</b>	<b>per share</b>
<b>Dividend</b>				
<b>increases</b>				
1st increase	Dec 2017	Jan 2018	\$ 0.2125	\$ 0.0005
2nd increase	Jan 2018	Feb 2018	\$ 0.2190	\$ 0.0065
3rd increase	Mar 2018	Apr 2018	\$ 0.2195	\$ 0.0005
4th increase	Jun 2018	Jul 2018	\$ 0.2200	\$ 0.0005
5th increase	Sep 2018	Oct 2018	\$ 0.2205	\$ 0.0005

## Table of Contents

The dividends paid per share during the first nine months of 2018 totaled approximately \$1.969, as compared to approximately \$1.891 during the first nine months of 2017, an increase of \$0.078, or 4.1%.

The monthly dividend of \$0.2205 per share represents a current annualized dividend of \$2.646 per share, and an annualized dividend yield of approximately 4.7% based on the last reported sale price of our common stock on the NYSE of \$56.89 on September 30, 2018. Although we expect to continue our policy of paying monthly dividends, we cannot guarantee that we will maintain our current level of dividends, that we will continue our pattern of increasing dividends per share, or what our actual dividend yield will be in any future period.

### **Acquisitions During the Third Quarter of 2018**

During the third quarter of 2018, we invested \$608.5 million in 238 new properties and properties under development or expansion, with an initial weighted average contractual lease rate of 6.3%. The 238 new properties and properties under development or expansion are located in 25 states, will contain approximately 1.4 million leasable square feet and are 100% leased with a weighted average lease term of 15.3 years. The tenants occupying the new properties operate in 14 industries and the property types are 99.4% retail and 0.6% industrial, based on rental revenue.

The 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 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 \$608.5 million we invested during the third quarter of 2018, \$5.4 million was invested in six properties under development or expansion with an initial weighted average contractual lease rate of 8.0%. We may continue to pursue development or expansion opportunities under similar arrangements in the future.

### **Acquisitions During the First Nine Months of 2018**

During the first nine months of 2018, we invested \$1.47 billion in 591 new properties and properties under development or expansion with an initial weighted average contractual lease rate of 6.3%. The 591 new properties and properties under development or expansion are located in 37 states, will contain approximately 4.3 million leasable square feet, and are 100% leased with a weighted average lease term of 14.4 years. The tenants occupying the new properties operate in 20 industries and the property types are 96.1% retail and 3.9% industrial, based on rental revenue. None of our investments during 2018 caused any one tenant to be 10% or more of our total assets at September 30, 2018.

Of the \$1.47 billion we invested during the first nine months of 2018, \$69.7 million was invested in 11 properties under development or expansion with an initial weighted average contractual lease rate of 6.8%. We may continue to pursue development or expansion opportunities under similar arrangements in the future.

## Portfolio Discussion

### Leasing Results

At September 30, 2018, we had 71 properties available for lease out of 5,694 properties in our portfolio, which represents a 98.8% occupancy rate based on the number of properties in our portfolio. Since December 31, 2017, when we reported 83 properties available for lease out of 5,172 and a 98.4% occupancy rate, we:

- Had 191 lease expirations;
- Re-leased 166 properties; and
- Sold 37 vacant properties.

-24-

---

### Table of Contents

Of the 166 properties re-leased during the first nine months of 2018, 155 properties were re-leased to existing tenants, three were re-leased to new tenants without vacancy, and eight were re-leased to new tenants after a period of vacancy. The annual rent on these 166 leases was \$38.15 million, as compared to the previous rent on these same properties of \$36.12 million, which represents a rent recapture rate of 105.6% on the properties re-leased during the first nine months of 2018.

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

At September 30, 2018, our average annualized rental revenue was approximately \$14.16 per square foot on the 5,623 leased properties in our portfolio. At September 30, 2018, we classified 74 properties with a carrying amount of \$65.4 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 and is consistent with our existing disposition strategy to further enhance our real estate portfolio and maximize portfolio returns.

### Investments in Existing Properties

In the third quarter of 2018, we capitalized costs of \$6.7 million on existing properties in our portfolio, consisting of \$379,000 for re-leasing costs, \$382,000 for recurring capital expenditures, and \$5.9 million for non-recurring building improvements. In the third quarter of 2017, we capitalized costs of \$2.7 million on existing properties in our portfolio, consisting of \$489,000 for re-leasing costs, \$171,000 for recurring capital expenditures and \$2.0 million for non-recurring building improvements.

In the first nine months of 2018, we capitalized costs of \$12.3 million on existing properties in our portfolio, consisting of \$2.8 million for re-leasing costs, \$529,000 for recurring capital expenditures, and \$8.9 million for non-recurring building improvements. In the first nine months of 2017, we capitalized costs of \$9.5 million on existing properties in our portfolio, consisting of \$1.2 million for re-leasing costs, \$536,000 for recurring capital expenditures, and \$7.8 million for non-recurring building improvements.

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

We define recurring capital expenditures as mandatory and recurring landlord capital expenditure obligations that have a limited useful life. We define non-recurring capital expenditures as property improvements in which we invest additional capital that extend the useful life of the properties.

### **Sumit Roy Appointed Chief Executive Officer (CEO)**

On October 16, 2018, we announced that our Board of Directors had appointed Sumit Roy to the position of our CEO and to our Board of Directors. Mr. Roy, who had previously served as Chief Operating Officer, succeeds John P. Case, our previous CEO. Mr. Roy will continue to serve as our President.

### **New, Expanded Credit Facility**

In October 2018, we entered into a new \$3.25 billion unsecured credit facility to amend and restate our previous \$2.25 billion unsecured credit facility, of which \$2.0 billion was due to expire in June 2019. This new credit facility includes a \$3.0 billion unsecured revolving credit facility and a new \$250.0 million unsecured term loan due March 2024. The new revolving credit facility matures in March 2023 and includes

two six-month extensions that can be exercised at our option. The new revolving credit facility also has a \$1.0 billion expansion feature. Under the new revolving credit facility, our current investment grade credit ratings provide for financing at LIBOR plus 0.775% with a facility commitment fee of 0.125%, for all-in drawn pricing of 0.90% over LIBOR. This compares favorably to our previous \$2.25 billion unsecured credit facility, which had all-in drawn pricing of 0.975% over LIBOR. As of September 30, 2018, we had a balance of \$774.0 million on our previous revolving credit facility.

In conjunction with our new revolving credit facility, we entered into a \$250.0 million senior unsecured term loan, which matures in March 2024. Borrowing under this term loan bears interest at the current one-month LIBOR plus 0.85%. In conjunction with this term loan, we also entered into an interest rate swap which effectively fixes our per annum interest on this term loan at 3.89%.

-25-

---

Table of Contents

**S&P Upgrade to A-**

In August 2018, S&P Global Ratings raised our credit rating to A- with a "stable" outlook from BBB+ with a "positive" outlook.

**Note Issuance**

In April 2018, we issued \$500.0 million of 3.875% senior unsecured notes due 2025, or the 2025 Notes. The public offering price for the 2025 Notes was 99.50% of the principal amount, for an effective yield to maturity of 3.957%. The net proceeds of approximately \$493.1 million from this offering were used to repay borrowings outstanding under our credit facility, to fund investment opportunities, and for other general corporate purposes.

**Capital Raising**

During the third quarter of 2018, we raised \$293.0 million from the sale of common stock at a weighted average price of \$57.53 per share. During the first nine months of 2018, we raised \$595.8 million from the sale of common stock at a weighted average price of \$55.37 per share.

**Net Income Available to Common Stockholders**

Net income available to common stockholders was \$99.0 million in the third quarter of 2018, compared to \$87.9 million in the third quarter of 2017, an increase of \$11.1 million. On a diluted per common share basis, net income available to common stockholders was \$0.34 in the third quarter of 2018, compared to \$0.32 in the third quarter of 2017, an increase of \$0.02, or 6.3%.

Net income available to common stockholders was \$278.5 million in the first nine months of 2018, as compared to \$240.7 million in the first nine months of 2017, an increase of \$37.8 million. On a diluted per common share basis, net income available to common stockholders was \$0.97 in the first nine months of 2018, as compared to \$0.89 in the first nine months of 2017, an increase of \$0.08, or 9.0%.

Net income and funds from operations available to common stockholders for the nine months ended September 30, 2017 were impacted by a \$13.4 million non-cash redemption charge on the Class F preferred stock that were redeemed in April 2017, which represented \$0.05 on a diluted per common share basis. This charge was based on the excess of redemption value over the carrying value of the Class F preferred stock that represents the original issuance cost that was paid in 2012.

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

Gains from the sale of properties during the third quarter of 2018 were \$7.8 million, as compared to gains from the sale of properties of \$4.3 million during the third quarter of 2017. Gains from the sale of properties during the first nine months of 2018 were \$18.8 million, as compared to gains from the sale of properties of \$17.7 million during the first nine months of 2017.

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

In the third quarter of 2018, FFO increased by \$23.4 million, or 11.1%, to \$234.6 million, compared to \$211.2 million in the third quarter of 2017. On a diluted per common share basis, FFO was \$0.81 in the third quarter of 2018, compared to \$0.77 in the third quarter of 2017, an increase of \$0.04, or 5.2%.

In the first nine months of 2018, FFO increased by \$83.8 million, or 13.9%, to \$685.5 million, compared to \$601.7 million in the first nine months of 2017. On a diluted per common share basis, FFO was \$2.39 in

the first nine months of 2018, compared to \$2.22 in the first nine months of 2017, an increase of \$0.17, or 7.7%.

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

In the third quarter of 2018, AFFO increased by \$22.6 million, or 10.6%, to \$236.2 million, compared to \$213.6 million in the third quarter of 2017. On a diluted per common share basis, AFFO was \$0.81 in the third quarter of 2018, compared to \$0.77 in the third quarter of 2017, an increase of \$0.04, or 5.2%.

-26-

---

## Table of Contents

In the first nine months of 2018, AFFO increased by \$64.4 million, or 10.3%, to \$687.7 million, compared to \$623.3 million in the first nine months of 2017. On a diluted per common share basis, AFFO was \$2.40 in the first nine months of 2018, compared to \$2.30 in the first nine months of 2017, an increase of \$0.10, or 4.3%.

See our discussion of FFO and AFFO (which are not financial measures under generally accepted accounting principles, or GAAP), later in the section entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” in this quarterly report, 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 initially financed by our credit facility or debt securities. However, we cannot assure you that we will have access to the capital markets at all times and at terms that are acceptable to us.

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

### **Conservative Capital Structure**

We believe that our stockholders are best served by a conservative capital structure. Therefore, we seek to maintain a conservative debt level on our balance sheet and solid interest and fixed charge coverage ratios. At September 30, 2018, our total outstanding borrowings of senior unsecured notes and bonds, term loans, mortgages payable and credit facility borrowings were \$6.8 billion, or approximately 28.8% of our total market capitalization of \$23.6 billion.

We define our total market capitalization at September 30, 2018 as the sum of:

- Shares of our common stock outstanding of 295,145,532, plus total common units outstanding of 690,819, multiplied by the last reported sales price of our common stock on the NYSE of \$56.89 per share on September 30, 2018, or \$16.8 billion;
- Outstanding borrowings of \$774.0 million on our credit facility;
- Outstanding mortgages payable of \$305.7 million, excluding net mortgage premiums of \$4.7 million and deferred financing costs of \$196,000;
- Outstanding borrowings of \$320.0 million on our term loans, excluding deferred financing costs of \$429,000; and
- Outstanding senior unsecured notes and bonds of \$5.4 billion, excluding net unamortized original issuance premiums of \$10.8 million and deferred financing costs of \$35.0 million.

### **Universal Shelf Registration**



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

-27-

---

Table of Contents

**At-the-Market (ATM) Programs**

In October 2017, following the issuance and sale of the initial 12,000,000 shares under our prior "at-the-market" equity distribution plan, we established a new "at-the-market" equity distribution plan, or our ATM program, pursuant to which we are permitted to offer and sell up to 17,000,000 additional 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 nine months of 2018, we issued 10,630,616 shares and raised approximately \$588.9 million under the ATM program. From the inception of our ATM programs through September 30, 2018, we have issued 25,038,145 shares authorized by our ATM programs and raised approximately \$1.4 billion.

**Dividend Reinvestment and Stock Purchase Plan**

Our Dividend Reinvestment and Stock Purchase Plan, or our DRSP, provides our common stockholders, as well as new investors, with a convenient and economical method of purchasing our common stock and reinvesting their distributions. Our DRSP also allows our current common stockholders to buy additional shares of common stock by reinvesting all or a portion of their distributions. Our DRSP authorizes up to 26,000,000 common shares to be issued. 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 nine months of 2018, we issued 131,072 shares and raised approximately \$7.0 million under our DRSP. We did not issue shares under the waiver approval process during the first nine months of 2018. From the inception of our DRSP through September 30, 2018, we have issued 14,194,614 shares and raised approximately \$668.8 million.

**Revolving Credit Facility**

In October 2018, we entered into a new \$3.25 billion unsecured credit facility to amend and restate our previous \$2.25 billion unsecured credit facility, of which \$2.0 billion was due to expire in June 2019. This new credit facility includes a \$3.0 billion unsecured revolving credit facility and a new \$250.0 million unsecured term loan due March 2024. The new revolving credit facility matures in March 2023 and includes two six-month extensions that can be exercised at our option. The new revolving credit facility also has a \$1.0 billion expansion feature. Under the new revolving credit facility, our current investment grade credit ratings provide for financing at LIBOR plus 0.775% with a facility commitment fee of 0.125%, for all-in drawn pricing of 0.90% over LIBOR.

The borrowing rate under the new revolving credit facility is subject to an interest rate floor and may change if our investment grade credit ratings change. We also have other interest rate options available to us under our credit facility. Our new revolving credit facility is unsecured and, accordingly, we have not pledged any assets as collateral for this obligation.

At September 30, 2018, we had a borrowing capacity of approximately \$1.2 billion available on our previous credit facility and an outstanding balance of \$774.0 million. The weighted average interest rate on borrowings under our previous credit facility during the first nine months of 2018 was 2.8% per annum. We must comply with various financial and other covenants in our previous credit facility. At September 30, 2018, we were in compliance with these covenants. We expect to use our credit facility to acquire additional properties and for other general corporate purposes. Any additional borrowings will increase our exposure to interest rate risk.

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

**Term Loans**

In December 2017, in conjunction with the acquisition of a portfolio of properties, we entered into a \$125.9 million promissory note, which was paid in full at maturity in January 2018. Borrowings under this note bore interest at 1.52%.

In June 2015, in conjunction with entering into our previous credit facility, we entered into a \$250.0 million senior unsecured term loan maturing on June 30, 2020. Borrowing under this term loan bears interest at the current one-month LIBOR plus 0.90%. 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 2.62%.

-28-

---

Table of Contents

In conjunction with our new revolving credit facility and as referenced above, we entered into a \$250.0 million senior unsecured term loan, which matures in March 2024. Borrowing under this term loan bears interest as the current one-month LIBOR plus 0.85%. In conjunction with this term loan, we also entered into an interest rate swap which effectively fixes our per annum interest on this term loan at 3.89%.

In January 2013, in conjunction with our acquisition of American Realty Capital Trust, Inc., or ARCT, we entered into a \$70.0 million senior unsecured term loan with an initial maturity date of January 2018. Borrowing under this term loan bore interest at the current one-month LIBOR plus 1.10%. In conjunction with this term loan, we also entered into an interest rate swap which effectively fixed our per annum interest rate on this term loan at 2.05%. In January 2018, we entered into a six-month extension of this loan, which included, at our option, two additional six-month extensions. In June 2018, we exercised our first six-month extension of this loan, which now matures in January 2019. Borrowing during the extension periods bears interest at the current one-month LIBOR, plus 0.90%. The interest rate swap terminated upon the initial maturity in January 2018.

**Mortgage Debt**

As of September 30, 2018, we had \$305.7 million of mortgages payable, all of which were assumed in connection with our property acquisitions. Additionally, at September 30, 2018, we had net premiums totaling \$4.7 million on these mortgages and deferred financing costs of \$196,000. We expect to pay off the outstanding mortgages payable as soon as prepayment penalties have declined to a level that would make it economically feasible to do so. During the first nine months of 2018, we made \$14.6 million in principal payments, including the repayment of one mortgage in full for \$11.0 million.

**Notes Outstanding**

Our senior unsecured note and bond obligations consist of the following as of September 30, 2018, sorted by maturity date (dollars in millions):

5.750% notes, issued in June 2010 and due in January 2021	\$ 250
3.250% notes, \$450 issued in October 2012 and \$500 issued in December 2017, both due in October 2022	950
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
3.875% notes, issued in April 2018 and due in April 2025	500
4.125% notes, \$250 issued in September 2014	650

and \$400 issued in March 2017, both due in October 2026 3.000% notes, issued in October 2016 and	600
due in January 2027 3.650% notes, issued in December 2017	550
and due in January 2028 5.875% bonds, \$100 issued in March 2005 and \$150 issued in	250
June 2011, both due in March 2035 4.650% notes, \$300 issued in March 2017 and \$250 issued in	550
December 2017, both due in March 2047 Total principal amount	\$ 5,400
Unamortized net original issuance premiums and deferred financing costs	(24)
	\$ 5,376

In April 2018, we issued \$500.0 million of 3.875% senior unsecured notes due 2025, or the 2025 Notes. The public offering price for the 2025 Notes was 99.50% of the principal amount, for an effective yield to maturity of 3.957%. The net proceeds of approximately \$493.1 million from this offering were used to repay borrowings outstanding under our credit facility, to fund investment opportunities, and for other general corporate purposes.

All of our outstanding notes and bonds have fixed interest rates and contain various covenants, with which we remained in compliance as of September 30, 2018. 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 September 30, 2018 are:

Table of Contents

Note Covenants	Required	Actual
Limitation on incurrence of total debt	≤ 60% of adjusted assets	4 <del>1</del> 5
Limitation on incurrence of secured debt	≤ 40% of adjusted assets	1. <del>9</del>
Debt service coverage (trailing 12 months) <sup>(1)</sup>	≥ 1.5x	4.6x
Maintenance of total unencumbered assets	≥ 150% of unsecured debt	24 <del>3</del> .0

(1) Our debt service coverage ratio 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 October 1, 2017, 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 October 1, 2017, nor does it purport to reflect our debt service coverage ratio for any future period. Our fixed charge coverage ratio is calculated in exactly the same manner as our debt service coverage ratio, except that preferred stock dividends are also added to the denominator; since we redeemed our Class F preferred dividends in April 2017, our fixed charge coverage ratio is equivalent to our debt service coverage ratio. The following is our calculation of debt service and fixed charge coverage at September 30, 2018 (in thousands, for trailing twelve months):

Net income attributable to the company	\$	339,394
Plus: interest expense		248,657
Plus: provision for taxes		7,158
Plus: depreciation and amortization		529,102
Plus: provisions for impairment		31,713
Plus: pro forma adjustments		64,129
Plus: charges for early extinguishment of debt		42,426
Less: gain on sales of real estate		(42,027)
Income available for debt service, as defined	\$	1,220,552
Total pro forma debt service charge	\$	267,239
		4.6

Debt service and  
fixed charge  
coverage ratio

### **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 September 30, 2018, we had cash and cash equivalents totaling \$6.7 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 new revolving credit facility are based upon our ratings assigned by credit rating agencies. As of September 30, 2018, we were assigned the following investment grade corporate credit ratings on our senior unsecured notes and bonds: Moody's Investors Service has assigned a rating of A3 with a "stable" outlook, Standard & Poor's Ratings Group has assigned a rating of A- with a "stable" outlook, and Fitch Ratings has assigned a rating of BBB+ with a "stable" outlook.

Based on our ratings as of October 24, 2018, the date upon which we entered into the new revolving credit facility, the facility interest rate was LIBOR plus 0.775% with a facility commitment fee of 0.125%, for all-in drawn pricing of 0.90% over LIBOR. Our credit facility provides that the interest rate can range between: (i) LIBOR plus 1.45% if our credit rating is lower than BBB-/Baa3 or unrated and (ii) LIBOR plus 0.75% if our credit rating is A/A2 or higher. In addition, our credit facility provides for a facility commitment fee based on our credit ratings, which range from: (i) 0.30% for a rating lower than BBB-/Baa3 or unrated, and (ii) 0.10% for a credit rating of A/A2 or higher.

-30-

---

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 September 30, 2018 (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
2018	\$ —	\$ —	\$ —	\$ 7.3	\$ 51.7	\$ 0.4	\$ 3.4	\$ —	\$ 62.8
2019	774.0	—	70.0	20.7	256.6	1.5	13.7	34.9	1,171.4
2020	—	—	250.0	82.4	237.8	1.4	13.5	—	585.1
2021	—	250.0	—	67.0	219.2	1.2	13.2	—	550.6
2022	—	950.0	—	109.7	208.5	1.2	13.1	—	1,282.5
Thereafter	—	4,200.0	—	18.6	1,224.3	20.9	95.0	—	5,558.8
Totals	\$ 774.0	\$ 5,400.0	\$ 320.0	\$ 305.7	\$ 2,198.1	\$ 26.6	\$ 151.9	\$ 34.9	\$ 9,211.2

(1) The initial term of our previous revolving credit facility was scheduled to expire in June 2019. In October 2018, we entered into a new revolving credit facility which expires in March 2023, and includes at our option, two six-month extensions.

(2) Excludes non-cash original issuance discounts and premiums recorded on notes payable. The net unamortized balance of the original issuance premiums at September 30, 2018 is \$10.8 million. Also excludes deferred financing costs of \$35.0 million.

(3) Excludes deferred financing costs of \$429,000. In June 2018, we exercised our first six-month extension of this loan, which now matures in January 2019. As part of our new revolving credit facility, we entered into a new term loan, which matures in March 2024.

(4) Excludes non-cash net premiums recorded on the mortgages payable. The unamortized balance of these net premiums at September 30, 2018, is \$4.7 million. Also excludes deferred financing costs of \$196,000.

(5) Interest on the term loans, notes, bonds, mortgages payable, and credit facility has been calculated based on outstanding balances as of September 30, 2018 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 \$26.8 million of commitments under construction contracts and \$8.1 million of commitments for tenant improvements and leasing costs.

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

**No Unconsolidated Investments**

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

**Dividend Policy**

Distributions are paid monthly to holders of shares of our common stock.

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



In order to maintain our status as a REIT for federal income tax purposes, we generally are required to distribute dividends to our stockholders aggregating annually at least 90% of our taxable income (excluding net capital gains), and we are subject to income tax to the extent we distribute less than 100% of our taxable income (including net capital gains). In 2017, our cash distributions to preferred and common stockholders totaled \$695.5 million, or 133.2% of our taxable income of \$522.2 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

-31-

---

## Table of Contents

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 nine months of 2018 totaled \$564.7 million, representing 82.1% of our adjusted funds from operations available to common stockholders of \$687.7 million. Our 2017 cash distributions to common stockholders totaled \$689.3 million, representing 82.2% of our adjusted funds from operations available to common stockholders of \$838.6 million.

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). However, non-corporate stockholders, including individuals, generally may deduct up to 20% of dividends from a REIT, other than capital gain dividends and dividends treated as qualified dividend income, for taxable years beginning after December 31, 2017 and before January 1, 2026.

Distributions in excess of earnings and profits generally will first be treated as a non-taxable reduction in the stockholders’ basis in their stock, but not below zero. Distributions in excess of that basis generally will be taxable as a capital gain to stockholders who hold their shares as a capital asset. Approximately 21.7% of the distributions to our common stockholders, made or deemed to have been made in 2017, were classified as a return of capital for federal income tax purposes. We estimate that in 2018, between 15% and 25% of the distributions may be classified as a return of capital.

## **RESULTS OF OPERATIONS**

### **Critical Accounting Policies**

Our consolidated financial statements have been prepared in accordance with GAAP, and are the basis for our discussion and analysis of financial condition and results of operations. Preparing our consolidated financial statements requires us to make a number of estimates and assumptions that affect the reported amounts and disclosures in the consolidated financial statements. We believe that we have made these estimates and assumptions in an appropriate manner and in a way that accurately reflects our financial condition. We continually test and evaluate these estimates and assumptions using our historical knowledge of the business, as well as other factors, to ensure that they are reasonable for reporting purposes. However, actual results may differ from these estimates and assumptions. This summary should be read in conjunction with the more complete discussion of our accounting policies and procedures included in note 2 to our consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2017.

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. 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 cost of real estate acquired, inclusive of transaction costs, to: (1) land, (2) building and improvements, and (3) identified intangible assets and liabilities, based in each case on their relative estimated fair values. Intangible assets and liabilities consist of above-market or below-market lease value of in-place leases and the value of in-place leases, 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

-32-

---

Table of Contents

mortgages receivable or payable 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 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 re-leases, 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 nine months ended September 30, 2018, to the three and nine months ended September 30, 2017.***

Total Revenue

The following summarizes our total revenue (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,		Increase (Decrease)	
	2018	2017	2018	2017	Three months	Nine months
REVENUE						
Rental	\$ 324,773	\$ 293,455	\$ 945,191	\$ 867,325	\$ 31,318	\$ 77,866
Tenant reimbursements	12,479	11,933	35,174	34,918	546	256
Other	829	1,532	4,897	2,872	(703)	2,025
Total revenue	\$ 338,081	\$ 306,920	\$ 985,262	\$ 905,115	\$ 31,161	\$ 80,147

Rental Revenue

The increase in rental revenue in the third quarter of 2018 compared to the third quarter of 2017 is primarily attributable to:

- The 582 properties (3.9 million square feet) we acquired in 2018, which generated \$19.7 million of rent in the third quarter of 2018;
- The 287 properties (7.2 million square feet) we acquired in 2017, which generated \$24.1 million of rent in the third quarter of 2018, compared to \$11.6 million in the third quarter of 2017, an increase of \$12.5 million; and
- Same store rents generated on 4,707 properties (78.5 million square feet) during the third quarter of 2018 and 2017, increased by \$2.6 million, or 1.0%, to \$272.9 million from \$270.3 million;

- A net increase in straight-line rent and other non-cash adjustments to rent of \$1.7 million in the third quarter of 2018 as compared to the third quarter of 2017; partially offset by
- A net decrease of \$3.0 million relating to properties sold in the third quarter of 2018 and during 2017; and
- A net decrease of \$2.2 million relating to the aggregate of (i) rental revenue from properties (93 properties comprising 2.3 million square feet) that were available for lease during part of 2018 or 2017, (ii) rental revenue for five properties under development, and (iii) lease termination settlements. In aggregate, the revenues for these items totaled \$3.6 million in the third quarter of 2018, compared to \$5.8 million in the third quarter of 2017.

## Table of Contents

The increase in rental revenue in the first nine months of 2018 compared to the first nine months of 2017 is primarily attributable to:

- The 582 properties (3.9 million square feet) we acquired in the first nine months of 2018, which generated \$29.7 million of rent in the first nine months of 2018;
- The 287 properties (7.2 million square feet) we acquired in 2017, which generated \$71.7 million of rent in the first nine months of 2018, compared to \$19.0 million in the first nine months of 2017, an increase of \$52.7 million;
- Same store rents generated on 4,707 properties (78.5 million square feet) during the first nine months of 2018 and 2017, increased by \$7.6 million or 0.9%, to \$819.8 million from \$812.2 million;
- A net increase in straight-line rent and other non-cash adjustments to rent of \$3.5 million in the first nine months of 2018 as compared to the first nine months of 2017; partially offset by
- A net decrease of \$9.5 million relating to properties sold in the first nine months of 2018 and during 2017 that were reported in continuing operations; and
- A net decrease of \$6.1 million relating to the aggregate of (i) rental revenue from properties (93 properties comprising 2.3 million square feet) that were available for lease during part of 2018 or 2017, (ii) rental revenue for five properties under development, and (iii) lease termination settlements. In aggregate, the revenues for these items totaled \$10.7 million in the first nine months of 2018 compared to \$16.8 million in the first nine months of 2017.

For purposes of determining the same store rent property pool, we include all properties that were owned for the entire year-to-date period, for both the current and prior year, except for properties during the current or prior year that; (i) were vacant at any time, (ii) were under development or redevelopment, or (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 5,694 properties in the portfolio at September 30, 2018, 5,666, or 99.5%, are single-tenant properties and the remaining are multi-tenant properties. Of the 5,666 single-tenant properties, 5,596, or 98.8%, were net leased with a weighted average remaining lease term (excluding rights to extend a lease at the option of the tenant) of approximately 9.3 years at September 30, 2018. Of our 5,596 leased single-tenant properties, 4,854 or 86.7% were under leases that provide for increases in rents through:

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

Percentage rent, which is included in rental revenue, was \$454,000 in the third quarter of 2018 and \$262,000 in the third quarter of 2017. Percentage rent was \$4.3 million in the first nine months of 2018, and \$4.1 million in the first nine months of 2017. We anticipate percentage rent to be less than 1% of rental revenue for the remainder of 2018.

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 September 30, 2018, our portfolio of 5,694 properties was 98.8% leased with 71 properties available for lease, as compared to 98.4% leased, with 83 properties available for lease at December 31, 2017, and 98.3% leased with 86 properties available for lease at September 30, 2017. It has been our experience that approximately 1% to 4% of our property portfolio will be unleased at any given time; however, it is possible that the number of properties available for lease could exceed these levels in

the future.

**Tenant Reimbursements**

A number of our leases provide for contractually obligated reimbursements from tenants for recoverable real estate taxes and operating expenses.

**Other Revenue**

The increase in other revenue for the first nine months of 2018 was primarily related to higher proceeds from property insurance claims, condemnations and interest income from our investments in United States government money market funds, as compared to the first nine months of 2017.

-34-

---

Table of Contents**Total Expenses**

The following summarizes our total expenses (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,		Increase (Decrease)	
	2018	2017	2018	2017	Three months	Nine months
<b>EXPENSES</b>						
Depreciation and amortization	\$ 136,967	\$ 127,569	\$ 402,069	\$ 371,755	\$ 9,398	\$ 30,314
Interest	69,342	62,951	195,385	185,935	6,391	9,450
General and administrative	16,332	13,881	49,970	43,227	2,451	6,743
Property (excluding reimbursable)	3,327	5,334	13,420	17,910	(2,007)	(4,490)
Property (reimbursable)	12,479	11,933	35,174	34,918	546	256
Income taxes	1,302	1,133	3,733	2,621	169	1,112
Provisions for impairment	6,862	365	25,034	8,072	6,497	16,962
Total expenses	\$ 246,611	\$ 223,166	\$ 724,785	\$ 664,438	\$ 23,445	\$ 60,347
Total revenue <sup>(1)</sup>	325,602	294,987	950,088	870,197		
General and administrative expenses as a percentage of total revenue	5.0 %	4.7 %	5.3 %	5.0 %		
Property expenses net of tenant reimbursements as a percentage of total revenue	4.0 %	1.8 %	1.4 %	2.1 %		

<sup>(1)</sup> Excludes tenant reimbursements revenue.

**Depreciation and Amortization**

The increase in depreciation and amortization in the third quarter and first nine months of 2018 was primarily due to the acquisition of properties in 2017 and the first nine months of 2018, 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 September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017



Edgar Filing: REALTY INCOME CORP - Form 10-Q

Interest on our credit facility, term loans, notes, mortgages and interest rate swaps	\$ 67,556	\$ 60,833	\$ 192,517	\$ 177,604
Credit facility commitment fees	639	767	1,896	2,275
Amortization of credit facility origination costs and deferred financing costs	1,792	2,058	5,204	6,722
Gain on interest rate swaps	(265)	(368)	(3,064)	(1,228)
Dividend on preferred shares subject to redemption	—	—	—	2,257
Amortization of net mortgage premiums	(354)	(341)	(1,167)	(1,580)
Capital lease obligation	78	77	233	232
Interest capitalized	(104)	(75)	(234)	(347)
Interest expense	\$ 69,342	\$ 62,951	\$ 195,385	\$ 185,935
<b>Credit facility, term loans, mortgages and notes</b>				
Average outstanding balances (dollars in thousands)	\$6,933,288	\$5,982,843	\$6,604,422	\$5,860,159
Average interest rates	3.89%	4.03 %	3.88 %	4.00 %

The increase in interest expense from 2017 to 2018 for the third quarter and the first nine months is primarily due to the April 2018 issuance of our 3.875% notes due 2025, the December 2017 issuance of our 3.650% notes due 2028, the March 2017 issuance of our 4.650% notes due 2047, the December 2017 further issuance of our 4.650% notes due 2047 and the 2017 further issuances of our 3.250% notes due 2022 and 4.125% notes due 2026. This increase was partially offset by the December 2017 early redemption of our 6.750% notes due 2019 and the

## Table of Contents

September 2017 repayment of our 5.375% notes due 2017, and lower outstanding debt balances on mortgages payable as a result of the payoff of mortgages in 2017 and 2018.

Additionally, each quarter we adjust the carrying value of our interest rate swaps to fair value. Changes in the fair value of our interest rate swaps are recorded directly to interest expense.

At September 30, 2018, the weighted average interest rate on our:

- Term loans outstanding of \$320.0 million (excluding deferred financing costs of \$429,000) was 3.1%;
- Mortgages payable of \$305.7 million (excluding net premiums totaling \$4.7 million and deferred financing costs of \$196,000 on these mortgages) was 5.1%;
- Credit facility outstanding borrowings of \$774.0 million was 3.1%;
- Notes and bonds payable of \$5.4 billion (excluding net unamortized original issue premiums of \$10.8 million and deferred financing costs of \$35.0 million) was 4.0%; and
- Combined outstanding notes, bonds, mortgages, term loans and credit facility borrowings of \$6.8 billion was 3.9%.

## **General and Administrative Expenses**

General and administrative expenses increased during the third quarter and the first nine months of 2018 due to higher compensation costs, related to higher employee headcount, and higher corporate costs. In October 2018, we had 166 employees, as compared to 154 employees in October 2017.

## **Property 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 September 30, 2018, 71 properties were available for lease, as compared to 83 at December 31, 2017 and 86 at September 30, 2017.

The decrease in gross and net property expenses (excluding tenant reimbursable expenses) in the third quarter and the first nine months of 2018 is primarily attributable to lower bad debt expense, and lower utilities, repairs and maintenance costs, partially offset by higher property taxes.

## **Income Taxes**

Income taxes are for city and state income and franchise taxes paid by us and our subsidiaries. The increase in income taxes for the first nine months of 2018 is primarily due to increased activity in our taxable REIT subsidiary.

## **Provisions for Impairment**

During the third quarter of 2018, we recorded total provisions for impairment of \$6.9 million on 12 properties classified as held for sale and seven sold properties. For the first nine months of 2018, we recorded total provisions for impairment of \$25.0 million on 16 properties classified as held for sale, two properties classified as held for investment, and 21 sold properties.

In comparison, for the third quarter of 2017, we recorded total provisions for impairment of \$365,000 on four sold properties. For the first nine months of 2017, we recorded total provisions for impairment of \$8.1 million on four properties classified as held for investment and 17 sold properties.

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

During the third quarter of 2018, we sold 20 properties for \$35.5 million, which resulted in a gain of \$7.8 million. During the third quarter of 2017, we sold 17 properties for \$25.5 million, which resulted in a gain of \$4.3 million.

During the first nine months of 2018, we sold 60 properties for \$83.0 million, which resulted in a gain of \$18.8 million. During the first nine months of 2017, we sold 46 properties for \$69.5 million, which resulted in a gain of \$17.7 million.

Table of Contents

**Preferred Stock Dividends**

We did not pay any preferred stock dividends in the first nine months of 2018. Preferred stock dividends totaled \$3.9 million in the first nine months of 2017. Additionally, in April 2017, we paid a final dividend on our Class F preferred stock of \$1.7 million, which was recorded to interest expense.

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

When we issued the irrevocable notice of redemption on our Class F preferred stock in March 2017, we incurred a non-cash charge of \$13.4 million for the excess of redemption value over the carrying value. The non-cash charge represents the Class F preferred stock original issuance cost that was paid in 2012.

**Net Income Available to Common Stockholders**

Net income available to common stockholders was \$99.0 million in the third quarter of 2018, compared to \$87.9 million in the third quarter of 2017, an increase of \$11.1 million. On a diluted per common share basis, net income available to common stockholders was \$0.34 in the third quarter of 2018, compared to \$0.32 in the third quarter of 2017, an increase of \$0.02, or 6.3%.

Net income available to common stockholders was \$278.5 million in the first nine months of 2018, compared to \$240.7 million in the first nine months of 2017, an increase of \$37.8 million. On a diluted per common share basis, net income available to common stockholders was \$0.97 in the first nine months of 2018, as compared to \$0.89 in the first nine months of 2017, an increase of \$0.08, or 9.0%.

Net income available to common stockholders for the nine months ended September 30, 2017 was impacted by a \$13.4 million non-cash redemption charge on the Class F preferred stock that were redeemed in April 2017, which represented \$0.05 on a diluted per common share basis. This charge was based on the excess of redemption value over the carrying value of the Class F preferred stock that represents the original issuance cost that was paid in 2012.

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

Table of Contents**Adjusted Earnings before Interest, Taxes, Depreciation and Amortization for Real Estate (Adjusted EBITDAre)**

The National Association of Real Estate Investment Trust (NAREIT) came to the conclusion that a NAREIT-defined EBITDA metric for real estate companies (i.e., EBITDA for real estate, or EBITDAre) would provide investors with a consistent measure to help make investment decisions among REITs. Although this update has not changed our calculation, we have re-labeled our Adjusted EBITDA to “Adjusted EBITDAre” in order to be consistent with the NAREIT definition. Adjusted EBITDAre, a non-GAAP financial measure, means, for the most recent quarter, earnings (net income) before (i) interest expense, including non-cash loss (gain) on swaps, (ii) income and franchise taxes, (iii) real estate depreciation and amortization, (iv) impairment losses, and (v) gain on sales of real estate. Our Adjusted EBITDAre is consistent with the National Association of Real Estate Investment Trusts’ definition, but may not be comparable to Adjusted EBITDAre reported by other companies that interpret the definitions of Adjusted EBITDAre differently than we do. Management believes Adjusted EBITDAre to be a meaningful measure of a REIT’s performance because it is widely followed by industry analysts, lenders and investors. Management also believes the use of an annualized quarterly Adjusted EBITDAre metric is meaningful because it represents the company’s current earnings run rate for the period presented. The ratio of our total debt to our annualized quarterly Adjusted EBITDAre is also used to determine vesting of performance share awards granted to our executive officers. Adjusted EBITDAre 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 Adjusted EBITDAre, which is used by management as a measure of leverage, is calculated by annualizing quarterly Adjusted EBITDAre and then dividing by our total debt per the consolidated balance sheet.

	<b>Three Months Ended September 30,</b>	
Dollars in thousands	<b>2018</b>	<b>2017</b>
Net income	\$ 99,283	\$ 88,073
Interest	69,342	62,951
Income taxes	1,302	1,133
Depreciation and amortization	136,967	127,569
Impairment loss	6,862	365
Gain on sales of real estate	(7,813)	(4,319)
Quarterly Adjusted EBITDAre	\$ 305,943	\$ 275,772
Annualized Adjusted EBITDAre (1)	\$ 1,223,772	\$ 1,103,088
Total Debt	\$ 6,779,659	\$ 5,787,027
Debt/Adjusted EBITDAre	5.5	5.2

(1) We calculate Annualized Adjusted EBITDAre by multiplying the Quarterly Adjusted EBITDAre by four.

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

FFO for the third quarter of 2018 increased by \$23.4 million, or 11.1%, to \$234.6 million, compared to \$211.2 million in the third quarter of 2017. On a diluted per common share basis, FFO was \$0.81 in the third quarter of 2018, compared to \$0.77 in the third quarter of 2017, an increase of \$0.04, or 5.2%.

In the first nine months of 2018, our FFO increased by \$83.8 million, or 13.9%, to \$685.5 million, compared to \$601.7 million in the first nine months of 2017. On a diluted per common share basis, FFO was \$2.39 in the first nine months of 2018, compared to \$2.22 in the first nine months of 2017, an increase of \$0.17, or 7.7%. FFO in the first nine months of 2017 includes a non-cash redemption charge of \$13.4 million on the Class F preferred shares that were redeemed in April 2017, which represents \$0.05 on a diluted per common share basis. This charge is for the excess of redemption value over the carrying value and represents the Class F preferred stock original issuance cost that was paid in 2012.

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 September 30,			Nine Months Ended September 30,	
	2018	2017	2018	2017	
Net income available to common stockholders	\$ 98,999	\$ 87,940	\$ 278,542	\$ 240,662	
Depreciation and amortization	136,967	127,569	402,069	371,755	
Depreciation of furniture, fixtures and equipment	(166)	(133)	(493)	(440)	
Provisions for impairment on real estate	6,862	365	25,034	8,072	
Gain on sales of real estate	(7,813)	(4,319)	(18,818)	(17,689)	
FFO adjustments allocable to noncontrolling interests	(299)	(230)	(820)	(683)	
FFO available to common stockholders	\$ 234,550	\$ 211,192	\$ 685,514	\$ 601,677	
FFO allocable to dilutive noncontrolling interests	217	220	667	659	
Diluted FFO	\$ 234,767	\$ 211,412	\$ 686,181	\$ 602,336	
FFO per common share, basic and	\$ 0.81	\$ 0.77	\$ 2.39	\$ 2.22	

diluted

Distributions paid to common stockholders	\$	191,703	\$	174,607	\$	564,747	\$	509,987
FFO available to common stockholders in excess of distributions paid to common stockholders	\$	42,847	\$	36,585	\$	120,767	\$	91,690
Weighted average number of common shares used for computation per share:								
Basic		290,664,368		275,511,870		286,599,191		270,584,365
Diluted		291,207,186		276,050,671		287,105,285		271,126,114

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 third quarter of 2018 increased by \$22.6 million, or 10.6%, to \$236.2 million, compared to \$213.6 million in the third quarter of 2017. On a diluted per common share basis, AFFO was \$0.81 in the third quarter of 2018, compared to \$0.77 in the third quarter of 2017, an increase of \$0.04, or 5.2%.

In the first nine months of 2018, our AFFO increased by \$64.4 million, or 10.3%, to \$687.7 million, compared to \$623.3 million in the first nine months of 2017. On a diluted per common share basis, AFFO was \$2.40 in the first nine months of 2018, compared to \$2.30 in the first nine months of 2017, an increase of \$0.10, or 4.3%.

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 September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income available to common stockholders	\$ 98,999	\$ 87,940	\$ 278,542	\$ 240,662
Cumulative adjustments to calculate FFO <sup>(1)</sup>	135,551	123,252	406,972	361,015
FFO available to common stockholders	234,550	211,192	685,514	601,677
Excess of redemption value over carrying value of Class F preferred share redemption	—	—	—	13,373
Amortization of share-based compensation	3,870	3,426	12,527	10,641
Amortization of deferred financing costs <sup>(2)</sup>	1,014	1,329	2,872	4,133
Amortization of net mortgage premiums	(354)	(341)	(1,167)	(1,580)
Gain on interest rate swaps	(265)	(368)	(3,064)	(1,228)
	(379)	(489)	(2,831)	(1,248)



Edgar Filing: REALTY INCOME CORP - Form 10-Q

Leasing costs and commissions					
Recurring capital expenditures	(382)	(171)	(529)	(536)	
Straight-line rent	(6,575)	(4,778)	(18,207)	(12,331)	
Amortization of above and below-market leases	4,655	3,732	12,426	10,213	
Other adjustments <sup>(3)</sup>	61	69	203	213	
Total AFFO available to common stockholders	\$ 236,195	\$ 213,601	\$ 687,744	\$ 623,327	
AFFO allocable to dilutive noncontrolling interests	227	299	692	885	
Diluted AFFO	\$ 236,422	\$ 213,900	\$ 688,436	\$ 624,212	
AFFO per common share:					
Basic	\$ 0.81	\$ 0.78	\$ 2.40	\$ 2.30	
Diluted	\$ 0.81	\$ 0.77	\$ 2.40	\$ 2.30	
Distributions paid to common stockholders	\$ 191,703	\$ 174,607	\$ 564,747	\$ 509,987	
AFFO available to common stockholders in excess of distributions paid to common stockholders	\$ 44,492	\$ 38,994	\$ 122,997	\$ 113,340	
Weighted average number of common shares used for computation per share:					
Basic	290,664,368	275,511,870	286,599,191	270,584,365	
Diluted	291,207,186	276,138,853	287,105,285	271,214,296	

(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.

## 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 September 30, 2018, we owned a diversified portfolio:

- Of 5,694 properties;
- With an occupancy rate of 98.8%, or 5,623 properties leased and 71 properties available for lease;
- Leased to 260 different commercial tenants doing business in 48 separate industries;
- Located in 49 states and Puerto Rico;
- With over 92.7 million square feet of leasable space; and
- With an average leasable space per property of approximately 16,280 square feet; approximately 11,360 square feet per retail property and 228,150 square feet per industrial property.

At September 30, 2018, of our 5,694 properties, 5,623 were leased under net lease agreements. A net lease typically requires the tenant to be responsible for monthly rent and certain property operating expenses including property taxes, insurance, and maintenance. In addition, our tenants are typically subject to future rent increases based on increases in the consumer price index (typically subject to ceilings), additional rent calculated as a percentage of the tenants' gross sales above a specified level, or fixed increases.

At September 30, 2018, our 260 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 330 additional tenants, representing approximately 5% of our annualized revenue at September 30, 2018, which brings our total tenant count to 590 tenants.

## **Industry Diversification**

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

-41-

---

Table of Contents**Percentage of Rental Revenue by Industry**

	For the Years Ended		For the Quarter Ended			
	September 30, 2018	September 30, 2017	September 30, 2016	September 30, 2015	September 30, 2014	September 30, 2013
Aerospace	0.2	1.0	1.0	1.2	1.2	1.2
Apparel stores	1.6	1.9	2.0	2.0	1.9	1.9
Automotive collision services	1.0	1.0	1.0	0.8	0.8	0.8
Automotive parts	1.3	1.3	1.4	1.3	1.2	1.2
Automotive service	2.2	1.9	1.9	1.8	2.1	2.1
Automotive tire services	2.3	2.7	2.9	3.2	3.6	3.6
Beverages	2.7	2.6	2.7	2.8	3.3	3.3
Book stores	*	*	*	*	*	*
Child care	1.8	1.9	2.0	2.2	2.8	2.8
Consumer appliances	0.5	0.5	0.6	0.5	0.6	0.6
Consumer electronics	0.3	0.3	0.3	0.3	0.3	0.3
Consumer goods	0.7	0.9	0.9	0.9	1.0	1.0
Convenience stores	9.6	8.7	9.2	10.1	11.2	11.2
Crafts and novelties	0.6	0.6	0.6	0.6	0.6	0.6
Diversified industrial	0.9	0.9	0.8	0.5	0.2	0.2
Dollar stores	7.9	8.6	8.9	9.6	6.2	6.2
Drug stores	10.9	11.2	10.6	9.5	8.1	8.1
Education	0.3	0.3	0.3	0.4	0.4	0.4
Electric utilities	0.1	0.1	0.1	0.1	*	*
Entertainment	0.4	0.5	0.5	0.5	0.6	0.6
Equipment services	0.4	0.6	0.5	0.6	0.5	0.5
Financial services	2.4	1.8	1.7	1.8	2.0	2.0
Food processing	0.4	1.1	1.2	1.4	1.5	1.5
General merchandise	2.0	1.8	1.7	1.5	1.1	1.1
Government services	0.8	1.1	1.2	1.3	1.4	1.4
Grocery stores	5.0	3.1	3.0	3.0	2.9	2.9
Health and beauty	0.3	*	*	*	*	*

Edgar Filing: REALTY INCOME CORP - Form 10-Q

Health and fitness	7.5	8.1	7.7	7.0	6.3
Health care	1.4	1.5	1.7	1.8	1.9
Home furnishings	0.9	0.8	0.9	0.9	1.1
Home improvement	2.6	2.5	2.4	1.7	1.6
Insurance	0.1	0.1	0.1	0.1	0.1
Jewelry	0.1	0.1	0.1	0.1	0.1
Machinery	0.1	0.1	0.1	0.2	0.2
Motor vehicle dealerships	2.1	1.9	1.6	1.6	1.6
Office supplies	0.2	0.3	0.3	0.4	0.5
Other manufacturing	0.8	0.8	0.7	0.7	0.6
Packaging	1.0	0.8	0.8	0.8	0.9
Paper	0.1	0.1	0.1	0.1	0.2
Pet supplies and services	0.6	0.6	0.7	0.7	0.8
Restaurants - casual dining	3.8	3.9	3.8	4.3	5.1
Restaurants - quick service	5.1	4.9	4.2	3.7	4.4
Shoe stores	0.6	0.7	0.7	0.9	1.0
Sporting goods	1.4	1.6	1.8	1.6	1.7
Telecommunications	0.6	0.6	0.7	0.7	0.7
Theaters	5.0	4.9	5.1	5.3	6.2
Transportation services	5.4	5.5	5.4	5.2	5.4
Wholesale clubs	3.3	3.6	3.8	4.1	3.9
Other	0.1	0.2	0.2	0.2	0.2
Total	100.0	100.0	100.0	100.0	100.0

\* Less than 0.1%

Table of Contents**Property Type Composition**

The following table sets forth certain property type information regarding our property portfolio as of September 30, 2018 (dollars in thousands):

<b>Property Type</b>	<b>Number of Properties</b>	<b>Approximate Leasable Square Feet</b>	<b>Rental Revenue for the Quarter Ended September 30, 2018</b> (1)	<b>Percentage of Rental Revenue</b>
Retail	5,520	62,734,600	\$ 264,131	81.4
Industrial	117	26,694,100	40,127	12.4
Office	42	3,104,700	13,634	4.2
Agriculture	15	184,500	6,639	2.0
Totals	5,694	92,717,900	\$ 324,531	100.0

(1) Includes rental revenue for all properties owned at September 30, 2018. Excludes revenue of \$242 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 September 30, 2018:

<b>Tenant</b>	<b>Number of Leases</b>	<b>% of Rental Revenue</b>
Walgreens	219	6%
7-Eleven	376	5%
FedEx	42	4%
Dollar General	574	3%
LA Fitness	54	3%
Dollar Tree / Family Dollar	468	3%
AMC Theatres	32	3%
Walmart / Sam's Club	51	2%
Circle K (Couche-Tard)	298	2%
BJ's Wholesale Clubs	15	2%
Treasury Wine Estates	17	2%
CVS Pharmacy	84	1%
Lifetime Fitness	11	1%
Regal Cinemas	24	1%
GPM Investments / Fas Mart	210	1%
Super America / Western Refining	132	1%
TBC Corporation (Sumitomo)	159	1%
Kroger	17	1%
Rite Aid	51	1%

Home Depot 15 1.2

-43-

---

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

The following table sets forth certain information regarding the properties owned at September 30, 2018, classified according to the business types and the level of services they provide (dollars in thousands):

	Retail Rental Revenue for the Quarter Ended September 30, 2018 <sup>(1)</sup>	Percentage of Retail Rental Revenue
<b><u>Tenants Providing Services</u></b>		
Automotive collision services	\$ 2,905	1.%
Automotive service	7,120	2.7
Child care	5,276	2.0
Education	868	0.3
Entertainment	1,285	0.5
Equipment services	113	*
Financial services	6,820	2.6
Health and fitness	23,660	9.0
Health care	1,996	0.8
Telecommunications	67	*
Theaters	17,417	6.6
Transportation services	249	0.1
Other	80	*
	67,856	25.7
<b><u>Tenants Selling Goods and Services</u></b>		
Automotive parts (with installation)	1,647	0.6
Automotive tire services	7,460	2.8
Convenience stores	39,199	14.9
Health and beauty	15	*
Motor vehicle dealerships	5,710	2.2
Pet supplies and services	653	0.3
Restaurants - casual dining	11,696	4.4
Restaurants - quick service	18,579	7.0
Other	*	*
	84,959	32.2
<b><u>Tenants Selling Goods</u></b>		
Apparel stores	3,960	1.5
Automotive parts	3,090	1.2
Book stores	113	*
Consumer electronics	1,055	0.4
Crafts and novelties	1,866	0.7
Dollar stores	23,898	9.0
Drug stores	30,848	11.7
General merchandise	6,276	2.4
Grocery stores	16,102	6.1
Home furnishings	2,225	0.8

Edgar Filing: REALTY INCOME CORP - Form 10-Q

Home improvement	8,351		3.2
Jewelry	175		0.1
Office supplies	615		0.2
Shoe stores	185		0.1
Sporting goods	3,212		1.2
Wholesale clubs	9,345		3.5
	111,316		42.1
Totals	\$	264,131	<del>100.0</del>

\* Less than 0.1%

(1) Includes rental revenue for all retail leases for properties owned at September 30, 2018. Excludes revenue of \$60,400 from non-retail leases and \$242 from sold properties.

-44-

---



Table of Contents**Lease Expirations**

The following table sets forth certain information regarding the timing of the lease term expirations in our portfolio (excluding rights to extend a lease at the option of the tenant) and their contribution to rental revenue for the quarter ended September 30, 2018 (dollars in thousands):

**Total Portfolio<sup>(1)</sup>**

Expiring Leases		Sq. Feet	Approx. Leasable Revenue	Rental Revenue	% of Rental
Retail	Non-Retail				
<del>2018</del>	4	464,400	\$ 2,184	0%	
<del>2019</del>	9	3,178,300	11,468	3.5	
<del>2020</del>	14	4,207,500	12,889	4.0	
<del>2021</del>	15	5,575,400	15,705	4.9	
<del>2022</del>	21	9,923,200	21,429	6.6	
<del>2023</del>	23	9,538,400	29,250	9.0	
<del>2024</del>	12	4,951,500	14,689	4.5	
<del>2025</del>	13	5,242,500	20,277	6.3	
<del>2026</del>	3	4,627,100	15,613	4.8	
<del>2027</del>	5	6,252,000	22,318	6.9	
<del>2028</del>	13	8,836,600	21,956	6.8	
<del>2029</del>	7	7,572,700	22,068	6.8	
<del>2030</del>	14	3,007,800	16,493	5.1	
<del>2031</del>	25	5,968,300	27,308	8.4	
<del>2032</del>	4	3,089,400	11,821	3.6	
<del>2033</del>	4	9,207,800	58,647	18.1	
<del>2034</del>	186	91,642,900	\$ 324,115	100.0	

\* Less than 0.1%

(1) The lease expirations for leases under construction are based on the estimated date of completion of those projects. Excludes revenue of \$416 from 91 expired leases, and \$242 from sold properties at September 30, 2018. Leases on our multi-tenant properties are counted separately in the table above.

Table of Contents**Geographic Diversification**

The following table sets forth certain state-by-state information regarding our property portfolio as of September 30, 2018 (dollars in thousands):

State	Number of Properties	Percent Leased	Approximate Leasable Square Feet	Rental Revenue for the Quarter Ended September 30, 2018 (1)	Percentage of Rental Revenue
Alabama	168	98%	1,587,400	\$ 5,931	1.8%
Alaska	3	100	274,600	522	0.2
Arizona	116	100	1,807,100	6,836	2.1
Arkansas	74	100	887,700	2,217	0.7
California	186	100	5,976,100	28,498	8.8
Colorado	85	98	1,467,400	5,179	1.6
Connecticut	22	95	521,100	2,029	0.6
Delaware	18	100	93,000	748	0.2
Florida	396	99	4,185,900	18,117	5.6
Georgia	268	99	4,293,400	13,324	4.1
Idaho	12	100	87,000	416	0.1
Illinois	260	99	5,798,000	19,614	6.0
Indiana	186	98	2,194,100	8,945	2.8
Iowa	40	95	3,034,800	4,291	1.3
Kansas	98	96	1,888,800	4,937	1.5
Kentucky	79	99	1,687,700	4,588	1.4
Louisiana	111	97	1,574,900	5,091	1.6
Maine	19	100	207,900	1,240	0.4
Maryland	37	97	1,017,500	4,872	1.5
Massachusetts	78	94	726,500	3,607	1.1
Michigan	179	99	1,929,600	6,805	2.1
Minnesota	165	99	2,137,800	10,282	3.2
Mississippi	150	97	1,707,800	4,754	1.5
Missouri	155	98	2,710,200	8,569	2.6
Montana	11	100	87,000	574	0.2
Nebraska	42	98	775,100	2,043	0.6
Nevada	24	100	1,196,600	2,181	0.7
New Hampshire	19	100	315,800	1,576	0.5
New Jersey	73	100	995,800	5,800	1.8
New Mexico	34	100	366,400	1,212	0.4
New York	128	100	2,850,300	15,619	4.8
North Carolina	182	99	2,781,600	8,865	2.7
North Dakota	6	100	117,700	211	0.1
Ohio	306	99	6,957,700	17,166	5.3
Oklahoma	137	100	1,672,800	4,769	1.5
Oregon	28	96	593,300	2,319	0.7
Pennsylvania	228	98	2,294,000	10,704	3.3
Rhode Island	4	100	161,600	841	0.3
South Carolina	173	99	1,667,600	7,477	2.3
South Dakota	15	100	195,200	471	0.1
Tennessee	251	98	3,589,800	10,824	3.3
Texas	693	99	10,520,600	36,104	11.1
Utah	22	100	933,000	2,219	0.7
Vermont	5	100	98,000	489	0.2
Virginia	209	98	3,114,000	9,858	3.0
Washington	44	98	737,400	2,861	0.9
West Virginia	25	100	418,100	1,372	0.4
Wisconsin	120	99	2,399,200	7,098	2.2
Wyoming	6	100	54,700	317	0.1
Puerto Rico	4	100	28,300	149	—
Totals/Average	5,694	99%	92,717,900	\$ 324,531	100%

\* Less than 0.1%

(1) Includes rental revenue for all properties owned at September 30, 2018. Excludes revenue of \$242 from sold properties.



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.

Moreover, our use of net lease agreements tends to reduce our exposure to rising property expenses due to inflation because the tenant is responsible for property expenses. Inflation and increased costs may have an adverse impact on our tenants if increases in their operating expenses exceed increases in revenue

**IMPACT OF RECENT ACCOUNTING PRONOUNCEMENTS**

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

**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.

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

**Corporate Responsibility**

Realty Income is committed to conducting our business according to the highest ethical standards. We are dedicated to providing an engaging, diverse, and safe work environment for our employees, operating our business in an environmentally conscious manner, and upholding our corporate responsibilities as a public company for the benefit of our shareholders. As The Monthly Dividend Company®, our mission is to provide our stockholders with monthly dividends that increase over time. How we manage and use the physical, financial and talent resources that enable us to achieve this mission, demonstrates our commitment to corporate responsibility.

Environmental Practices

Our focus on the environment 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 electronic approval systems;
- Encouraging employees to carpool to our headquarters; and
- Recycling paper waste.

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 2017, we sent more than 32,700 pounds of paper to our offsite partner for recycling.

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. We continue to evaluate our current operations, strive to improve our environmental performance, and implement sustainable business practices.

The properties in our portfolio are primarily 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 work with our tenants to promote environmental responsibility at the properties we own, with some locations achieving LEED (Leadership in Energy and Environmental Design) certification.

-47-

---

### Table of Contents

Our Asset Management team has engaged with a renewable energy development company to identify assets that would maximize energy efficiency initiatives throughout our property portfolio. These initiatives include solar energy arrays, battery storage, and charging stations. In addition, we continue to explore regional opportunities with our tenants in order to qualify for city and county renewable energy or energy efficiency programs to conserve our world's finite resources.

Realty Income also has a Green Team that encourages our employees to focus on environmentally-smart choices to further reduce our environmental impact as a company. The Green Team, which includes executive and officer-level employees, works to positively impact the environment through education and engagement within the company and local communities, focusing on waste, energy, and water management.

### Social Responsibility

We are committed to providing a positive and engaging work environment for our employees and taking an active role in the betterment of the communities in which our employees and shareholders live and work. Our employees are awarded compensation that is in line with those of our peers and competitors, including generous healthcare benefits (medical, dental, vision) for all employees and their families, participation in a 401(k) plan with a matching contribution from Realty Income, restricted stock awards based on company performance, competitive paid time-off benefits, a wellbeing program, continued education and development opportunities, and an infant-at-work program for new parents. We also have a long-standing commitment to being an equal opportunity employer and adhere to all Equal Employer Opportunity Policy guidelines.

We believe that giving back to our community is an extension of our mission to improve the lives of our shareholders, our employees, and their families. Realty Income and its employees have taken an active role in supporting communities through civic involvement with non-profit organizations and corporate donations. Our non-profit activities resulted in approximately 725 company-sponsored employee volunteer hours in 2017, principally through our partnership with San Diego Habitat for Humanity. We are proud of the efforts we have made to date and look forward to continuing to strengthen our impact as part of the successful operations of The Monthly Dividend Company®.

Additional information on Realty Income's commitment to social responsibility may be found on our website.

### Corporate Governance

We believe that nothing is more important than a company's reputation for integrity and serving as a responsible fiduciary for its shareholders. We are committed to managing the company for the benefit of our stockholders and are focused on maintaining good corporate governance. Practices that illustrate this commitment include, but are not limited to:

- Our Board of Directors is currently comprised of ten directors, nine of whom are independent, non-employee directors;
- In accordance with our continued focus on board refreshment, in July 2018, we added two new independent, non-employee directors;
- Our Board of Directors is elected on an annual basis with a majority vote standard;
- Our Directors conduct annual self-evaluations and participate in orientation and continuing education programs;
- An Enterprise Risk Management evaluation is conducted annually to identify and assess company risk;
- Each committee within our Board of Directors is comprised entirely of independent directors;
- We adhere to all other corporate governance principles outlined in our Corporate Governance Guidelines. These guidelines, as well as our bylaws, committee charters and other governance documents may be

found on our website.

**Business Ethics**

We are committed to conducting our business according to the highest ethical standards and upholding our corporate responsibilities as a public company operating for the benefit of our shareholders. Our Board of Directors has adopted a Code of Business Ethics that applies to our directors, officers, and other employees. The Code of Business Ethics includes our commitment to dealing fairly with all of our customers, service providers, suppliers, and competitors. We conduct annual training with our employees regarding ethical behavior and require all employees to acknowledge the terms of, and abide by, our Code of Business Ethics. Our employees have access

-48-

---

Table of Contents

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. Anonymous reporting is always available through the company's whistleblower hotline and reported to our Audit Committee quarterly.

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

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

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

The following table presents by year of expected maturity, the principal amounts, average interest rates and estimated fair values of our fixed and variable rate debt as of September 30, 2018. 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
2018	\$ 1.1	5.51	\$ 6.2	4.79
2019	4.5	5.59	860.2	3.55
2020	82.2	4.99	250.2	3.92
2021	310.1	5.72	6.9	5.34
2022	1,059.7	3.43	—	—
Thereafter	4,218.6	4.12	—	—
Totals <sup>(1)</sup>	\$ 5,676.2	4.79	\$ 1,123.5	3.75
Fair Value <sup>(2)</sup>	\$ 5,678.5		\$ 1,123.6	

(1) Excludes net premiums recorded on mortgages payable, net original issuance premiums recorded on notes payable and deferred financing costs on mortgages payable, notes payable, and term loans. At September 30, 2018, the unamortized balance of net premiums on mortgages payable is \$4.7 million, the unamortized balance of net original issuance premiums on notes payable is \$10.8 million, and the balance of deferred financing costs on mortgages payable is \$196,000, on notes payable is \$35.0 million, and on term loans is \$429,000.

(2) We base the estimated fair value of the fixed rate senior notes and bonds at September 30, 2018 on the indicative market prices and recent trading activity of our senior notes and bonds payable. We base the estimated fair value of our fixed rate and variable rate mortgages at September 30, 2018 on the relevant forward interest rate 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 September 30, 2018.



The table incorporates only those exposures that exist as of September 30, 2018. 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 three mortgages totaling \$29.4 million at September 30, 2018, 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 mortgage debt subject to variable rates totals \$22.1 million at September 30, 2018. 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

-49-

---

Table of Contents

agreements. Based on our credit facility balance of \$774.0 million at September 30, 2018, a 1% change in interest rates would change our interest rate costs by \$7.7 million per year.

**Item 4: Controls and Procedures**

**Evaluation of Disclosure Controls and Procedures**

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

As of and for the quarter ended September 30, 2018, we carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective and were operating at a reasonable assurance level.

**Changes in Internal Controls**

In January 2018, we implemented an enterprise resource planning system and accordingly we have updated our internal controls over financial reporting, as necessary, to accommodate modifications to our business processes and to take advantage of enhanced automated controls provided by the new system. There have been no changes in our internal control over financial reporting that occurred during the quarter ended September 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**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:

- 529 shares of stock, at a weighted average price of \$54.54, in July 2018;
- 1,718 shares of stock, at a weighted average price of \$57.65, in August 2018; and

- 96 shares of stock, at a weighted average price of \$57.95, in September 2018.

Table of Contents

**Item 6: Exhibits**

**Articles of Incorporation and Bylaws**

**Exhibit No. Description**

2.1 Agreement and Plan of Merger, dated as of September 6, 2012, by and among Realty Income Corporation, Tau Acquisition LLC and American Realty Capital Trust, Inc. (filed as exhibit 2.1 to the Company's Form 8-K, filed on September 6, 2012 and incorporated herein by reference).

2.2 First Amendment to Agreement and Plan of Merger, dated as of January 6, 2013, by and among Realty Income Corporation, Tau Acquisition LLC and American Realty Capital Trust, Inc. (filed as exhibit 2.1 to the Company's Form 8-K, filed on January 7, 2013 and incorporated herein by reference).

3.1 Articles of Incorporation of the Company, as amended by amendment No. 1 dated May 10, 2005 and amendment No. 2 dated May 10, 2005 (filed as exhibit 3.1 to the Company's Form 10-Q for the quarter ended June 30, 2005 and incorporated herein by reference), amendment No. 3 dated July 29, 2011 (filed as exhibit 3.1 to the Company's Form 8-K, filed on August 2, 2011 and incorporated herein by reference); and amendment No. 4 dated June 21, 2012 (filed as exhibit 3.1 to the Company's Form 8 - K, filed on June 21, 2012 and incorporated herein by reference).

3.2 Amended and Restated Bylaws of the Company dated March 13, 2018 (filed as exhibit 3.1 to the Company's Form 8-K filed on March 14, 2018 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).

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 5.875% 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).

4.3 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 5.875% 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).

4.4 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).

-51-

---

Table of Contents

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 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).

4.6 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).

4.7 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).

4.8 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).

4.9 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).

4.10 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).

4.11 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).

4.12 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).

4.13 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).

4.14 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).

4.15 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).

4.16 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).

4.17 Form of 3.000% Note due 2027 (filed as exhibit 4.2 to Company's Form 8-K, filed on October 12, 2016 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 "3.000% Notes due

-52-

---

Table of Contents

2027” (filed as exhibit 4.3 to the Company’s Form 8-K, filed on October 12, 2016 and incorporated herein by reference).

4.19 Form of 4.650% Note due 2047 (filed as exhibit 4.2 to Company’s Form 8-K, filed on March 15, 2017 and incorporated herein by reference).

4.20 Form of 4.125% Note due 2026 (filed as exhibit 4.3 to Company’s Form 8-K, filed on March 15, 2017 and incorporated herein by reference).

4.21 Officers’ 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 2047” and re-opening a series of securities entitled “4.125% Notes due 2026” (filed as exhibit 4.4 to Company’s Form 8-K, filed on March 15, 2017 and incorporated herein by reference).

4.22 Form of 3.650% Note due 2028 (filed as exhibit 4.2 to Company’s Form 8-K, filed on December 6, 2017 and incorporated herein by reference).

4.23 Form of 3.250% Note due 2022 (filed as exhibit 4.3 to Company’s Form 8-K, filed on December 6, 2017 and incorporated herein by reference).

4.24 Form of 4.650% Note due 2047 (filed as exhibit 4.4 to Company’s Form 8-K, filed on December 6, 2017 and incorporated herein by reference).

4.25 Officers’ 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 “3.650% Notes due 2028” and re-opening a series of securities entitled “3.250% Notes due 2022” and “4.650% Notes due 2047.” (filed as exhibit 4.5 to the Company’s Form 8-K, filed on December 6, 2017 and incorporated herein by reference).

4.26 Form of 3.875% Note due 2025 (filed as exhibit 4.2 to Company’s Form 8-K, filed on April 4, 2018 and incorporated herein by reference).

4.27 Officers’ 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 2025” and re-opening a series of securities entitled “4.125% Notes due 2026” (filed as exhibit 4.3 to Company’s Form 8-K, filed on April 4, 2018 and incorporated herein by reference).

**Material Contracts**

10.1 Severance Agreement and General Release for John P. Case dated October 16, 2018 (filed as exhibit 10.1 to the Company’s Form 8-K, filed on October 17, 2018 and incorporated herein by reference).

10.2 Credit Agreement dated October 24, 2018 (filed as exhibit 10.1 to the Company’s Form 8-K, filed on October 26, 2018 and incorporated herein by reference).

**Certifications**



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

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

-53-

---

Table of Contents

\*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 September 30, 2018, formatted in Extensible Business Reporting Language: (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Cash Flows, and (iv) Notes to Consolidated Financial Statements.

\*Filed herewith.

**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:  
November 1,  
2018

/s/ SEAN P.  
NUGENT

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