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REAL ESTATE INCOME FUND INC
Form N-CSR
March 13, 2006
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM N-CSR

CERTIFIED SHAREHOLDER REPORT OF REGISTERED MANAGEMENT INVESTMENT COMPANIES

Investment Company Act file number **811-21098**

Real Estate Income Fund Inc.

(Exact name of registrant as specified in charter)

125 Broad Street, New York, NY 10004
(Address of principal executive offices) (Zip code)

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

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

Date of fiscal year end: **December 31**

Date of reporting period: **December 31, 2005**

ITEM 1. REPORT TO STOCKHOLDERS.

The Annual Report to Stockholders is filed herewith.

Real Estate Income Fund Inc.

EXPERIENCE

A N N U A L R E P O R T

DECEMBER 31, 2005

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

Real Estate Income Fund Inc.

Annual Report December 31, 2005

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All Citi Marks are owned by Citigroup, and are licensed for use until no later than one year after the date of the licensing agreement.

Letter from the Chairman

Dear Shareholder,

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

Despite numerous obstacles, including rising short-term interest rates, surging oil prices, a destructive hurricane season, and geopolitical issues, the U.S. economy continued to expand at a healthy pace during the reporting period. After a 3.8% advance in the first quarter of 2005, gross domestic product (GDP) growth was 3.3% during the second quarter and 4.1% in the third quarter. While fourth quarter figures have not yet been released, another slight gain is anticipated.

Given the strength of the economy and inflationary pressures, the Federal Reserve Board (Fed) continued to raise interest rates throughout the period. After raising rates five times from June 2004 through December 2004, the Fed increased its target for the federal funds rateⁱⁱⁱ in 0.25% increments eight additional times over the reporting period. This represents the longest sustained Fed tightening cycle since the 1970s. All told, the Fed's thirteen rate hikes have brought the target for the federal funds rate from 1.00% to 4.25%. After the end of the Fund's reporting period, at its January meeting, the Fed once again raised its target for the federal funds rate by 0.25% to 4.50%.

For the one-year period ended December 31, 2005, the U.S. stock market generated positive results, with the S&P 500 Index^{iv} returning 4.91%. While corporate profits remained strong during the year, they were often over-shadowed by rising interest rates and higher oil prices.

Looking at the fiscal year as a whole, mid-cap stocks out-performed their large- and small-cap counterparts, with the Russell Midcap^v, Russell 1000^{vi}, and Russell 2000^{vii} Indexes returning 12.65%, 6.27%, and 4.55%, respectively. From an investment style perspective, value stocks outperformed growth stocks for the sixth consecutive calendar year, with

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the Russell 3000 Value^{viii} and Russell 3000 Growth^{ix} Indexes returning 6.85% and 5.17%, respectively, in 2005.

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

Special Shareholder Notice

On December 1, 2005, Citigroup Inc. (Citigroup) completed the sale of substantially all of its asset management business, Citigroup Asset Management (CAM), to Legg Mason, Inc. (Legg Mason). As a result, the Fund's investment adviser (the Manager), previously an indirect wholly-owned subsidiary of Citigroup, has become a wholly-owned subsidiary of Legg Mason. Completion of the sale caused the Fund's existing investment management contract to terminate. The Fund's shareholders previously approved a new investment management contract between the Fund and the Manager which became effective on December 1, 2005.

Information About Your Fund

As you may be aware, several issues in the mutual fund industry have recently come under the scrutiny of federal and state regulators. The Fund's Manager and some of its affiliates have received requests for information from various government regulators regarding market timing, late trading, fees, and other mutual fund issues in connection with various investigations. While these issues do not directly affect your Fund, the Fund has been informed that the Manager and its affiliates are responding to those information requests, but are not in a position to predict the outcome of these requests and investigations.

Important information concerning the Fund and its Manager with regard to recent regulatory developments is contained in the Notes to Financial Statements included in this report.

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

Sincerely,

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

February 2, 2006

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

- i Gross domestic product is a market value of goods and services produced by labor and property in a given country.
- ii The Federal Reserve Board is responsible for the formulation of a policy designed to promote economic growth, full employment, stable prices, and a sustainable pattern of international trade and payments.
- iii The federal funds rate is the interest rate that banks with excess reserves at a Federal Reserve district bank charge other banks that need overnight loans.
- iv The S&P 500 Index is an unmanaged index of 500 stocks that is generally representative of the performance of larger companies in the U.S.
- v The Russell Midcap Index measures the performance of the 800 smallest companies in the Russell 1000 Index whose average market capitalization was approximately \$4.7 billion as of 6/24/05.
- vi The Russell 1000 Index measures the performance of the 1,000 largest companies in the Russell 3000 Index, which represents approximately 92% of the total market capitalization of the Russell 3000 Index.
- vii The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represents approximately 8% of the total market capitalization of the Russell 3000 Index.
- viii

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- The Russell 3000 Value Index measures the performance of those Russell 3000 Index companies with lower price-to-book ratios and lower forecasted growth values. (A price-to-book ratio is the price of a stock compared to the difference between a company's assets and liabilities.)
- ix The Russell 3000 Growth Index measures the performance of those Russell 3000 Index companies with higher price-to-book ratios and higher forecasted growth values.

Real Estate Income Fund Inc.

III

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Manager Overview

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

A. Demand for real estate as an investment class remained strong through 2005 against the backdrop of low long-term interest rates, improving commercial real estate fundamentals, and modest stock market returns. This strong demand contributed to another solid year for the U.S. real estate income trust (REIT) market, with each of the major U.S. REIT indexes posting gains in excess of 10% for the year. This marks the sixth consecutive year that REITs have outperformed the broader U.S. equities market. We remain somewhat cautious, however, about REIT returns as we head into 2006, particularly in light of perceived high REIT stock valuations, and the extended outperformance of the sector relative to the overall stock market. Despite this, we continue to believe that the returns expected from real estate can be competitive and that the portfolio diversification benefits provided by real estate should continue to be a positive for investors.

Performance Review

For the twelve months ended December 31, 2005, the Real Estate Income Fund Inc. returned 7.35%, based on its net asset value (NAVⁱ) and 10.69% based on its New York Stock Exchange (NYSE) market price per share. In comparison, the Lipper Sector Equity Closed-End Funds Category Averageⁱⁱⁱ increased 9.18% over the same time frame. Please note that Lipper performance returns are based on each Fund 's NAV.

During the twelve-month period, the Fund made distributions to common stock shareholders totaling \$1.708 per share, (which may have included a return of capital). The performance table shows the Fund 's twelve-month total return based on its NAV and market price as of December 31, 2005. **Past performance is no guarantee of future results.**

Price Per Share

\$20.58 (NAV)

\$18.62 (Market Price)

12-Month

Total Return

7.35%

10.69%

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

Management has agreed to waive a portion of its fees through 8/01/09. Absent this waiver, the total returns would have been lower.

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

Q. What were the most significant factors affecting Fund performance?

What were the leading contributors to performance?

A. The Fund's positive performance for the year was primarily driven by strong results in the apartment, office, and industrial sectors. **Camden Property Trust** in the apartment sector was one of the strongest contributors to performance during the year, posting a return of over 19%. The company's shares have benefited from strong operating results and a solid development pipeline. In the office sector, **Kilroy Realty Corp.** was among the Fund's most solid performers, generating a total return of over 50% for the year. Kilroy has benefited from the recovery in Southern California's real estate market, which is among the strongest in the nation. **EastGroup Properties Inc.** within the industrial sector was another strong performer, posting a return of over 23%. The company, which focuses on the management of warehouse properties in high-growth Sunbelt market, has benefited from solid occupancy gains and a growing development pipeline.

What were the leading detractors from performance?

A. The areas that detracted the most from performance during the period were the triple net lease and health care sectors. Within the triple net lease sector, **iStar Financial Inc.** was the Fund's worst performer, losing over 15% during the year. The company has been spending capital to build platforms in several new business lines, which has led to reduce earnings growth, as well as lowered earnings estimates from its prior pace. Also, during the year iStar Financial Inc. received a larger than normal amount of prepayments on loans, which hurt earnings growth. **Healthcare Realty Trust Inc.** was the weakest performer in the health care sector, losing over 12%. The company underperformed primarily due to an accounting change that arose at a small portion of their portfolio, which resulted in a delayed restatement of the company's earnings. The issue appears to have been resolved.

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

A. There were no significant changes made to the Fund during the year that had a major impact, either positively or negatively, on its performance. In July 2005, the Fund issued 1,200 additional shares of its Series M Taxable Auction Market Preferred Stock for an aggregate offering price of \$30 million.

Looking for Additional Information?

The Fund is traded under the symbol **RIT** and its closing market price is available in most newspapers under the NYSE listings. The daily NAV is available on-line under symbol **XRITX**. *Barron's* and *The Wall Street Journal's* Monday editions carry closed-end fund tables that will provide additional information. In addition, the Fund issues a

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quarterly press release that can be found on most major financial websites as well as www.citigroupam.com.

In a continuing effort to provide information concerning the Fund, shareholders may call 1-888-735-6507, Monday through Friday from 8:00 a.m. to 6:00 p.m. Eastern Time, for the Fund's current net asset value, market price, and other information.

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

Sincerely,

Matthew A. Troxell, CFA
Investment Officer
February 2, 2006

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

Portfolio holdings and breakdowns are as of December 31, 2005 and are subject to change and may not be representative of the Fund's current or future investments. The Fund's top ten holdings (as a percentage of net assets) as of this date were: Camden Property Trust (6.8%), iStar Financial Inc. (4.7%), Healthcare Realty Trust Inc. (4.5%), Macerich Co. (4.4%), Liberty Property Trust (4.3%), Arden Realty Inc. (4.0%), HRPT Properties Trust (3.9%), Senior Housing Properties Trust (3.8%), Prentiss Properties Trust (3.7%) and Heritage Property Investment Trust (3.7%). Please refer to pages 5 through 8 for a list and percentage breakdown of the Fund's holdings.

The mention of sector breakdowns is for informational purposes only and should not be construed as a recommendation to purchase or sell any securities. The information provided regarding such sectors is not a sufficient basis upon which to make an investment decision. Investors seeking financial advice regarding the appropriateness of investing in any securities or investment strategies discussed should consult their financial professional. Portfolio holdings are subject to change at any time and may not be representative of the Fund's current or future investments. The Fund's top five sector holdings (as a percentage of net assets) as of December 31, 2005 were: Office (34.0%), Shopping Centers (20.5%), Apartments (18.7%), Health Care (16.3%) and Regional Malls (11.6%). The Fund's portfolio composition is subject to change at any time.

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

- i Real Estate Investment Trusts invest in real estate or loans secured by real estate and issue shares in such investments, which can be illiquid.
- ii NAV is calculated by subtracting total liabilities and outstanding preferred stock from the closing value of all securities held by the Fund (plus all other assets) and dividing the result (total net assets) by the total number of the common shares outstanding. The NAV fluctuates with changes in the market prices of securities in which the Fund has invested. However, the price at which an investor may buy or sell shares of the Fund is at the Fund's market price as determined by supply of and demand for the Fund's shares.
- iii Lipper, Inc. is a major independent mutual-fund tracking organization. Returns are based on the 12-month period ended December 31, 2005, including the reinvestment of distributions, including returns of capital, if any, calculated among the 40 funds in the Fund's Lipper category, and excluding sales charges.

Fund at a Glance (unaudited)

Investment Breakdown

As a Percent of Total Investments

Office

Apartments

Shopping Centers

Health Care

Regional Malls

Diversified

Lodging/Resorts

Industrial/Office-Mixed

Industrial

Retail-Free Standing

Specialty

Home Financing

Self Storage

Short-Term Investment

0.0%

5.0%

10.0%

15.0%

20.0%

25.0%

24.2%

14.6%

13.3%

11.6%

8.3%

6.7%

5.1%

4.5%

4.0%

3.9%

2.4%

0.9%

0.3%

0.2%

December 31, 2005

REAL ESTATE INCOME FUND INC.

Shares	Security	Value
COMMON STOCKS 70.6%		
Apartments 8.8%		
36,500	Archstone-Smith Trust	\$ 1,528,985
269,000	Camden Property Trust	15,580,480
185,000	GMH Communities Trust	2,869,350
100,000	Mid-America Apartment Communities Inc.	4,850,000
140,000	United Dominion Realty Trust Inc.	3,281,600
	Total Apartments	28,110,415
Diversified 4.6%		
300,000	iStar Financial Inc.	10,695,000
190,000	Lexington Corporate Properties Trust	4,047,000
	Total Diversified	14,742,000
Health Care 9.5%		
174,000	Health Care Property Investors Inc.	4,447,440
305,000	Healthcare Realty Trust Inc.	10,147,350
187,700	OMEGA Healthcare Investors Inc.	2,363,143
511,700	Senior Housing Properties Trust	8,652,847
150,000	Ventas Inc.	4,803,000
	Total Health Care	30,413,780
Home Financing 0.9%		
108,500	Municipal Mortgage & Equity LLC	2,802,555
Industrial 4.0%		
185,000	EastGroup Properties Inc. (a)	8,354,600
161,700	First Potomac Realty Trust	4,301,220
	Total Industrial	12,655,820
Industrial/Office Mixed 3.1%		
230,000	Liberty Property Trust	9,855,500
Lodging/Resorts 1.8%		
146,000	Hospitality Properties Trust	5,854,600
Office 19.2%		
203,000	Arden Realty Inc.	9,100,490
163,000	Brandywine Realty Trust	4,549,330
160,000	CarrAmerica Realty Corp.	5,540,800
72,000	Glenborough Realty Trust Inc.	1,303,200
290,000	Highwoods Properties Inc.	8,250,500
848,700	HRPT Properties Trust	8,784,045
135,000	Kilroy Realty Corp.	8,356,500
161,000	Mack-Cali Realty Corp.	6,955,200
210,000	Prentiss Properties Trust	8,542,800
	Total Office	61,382,865

See Notes to Financial Statements.

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Shares	Security	Value
Regional Malls	4.6%	
196,000	Glimcher Realty Trust	\$ 4,766,720
148,100	Macerich Co.	9,943,434
	Total Regional Malls	14,710,154
Retail Free Standing	3.0%	
171,900	Commercial Net Lease Realty Inc.	3,501,603
140,000	Realty Income Corp.	3,026,800
218,000	Truststreet Properties Inc.	3,187,160
	Total Retail Free Standing	9,715,563
Shopping Centers	8.7%	
385,000	Cedar Shopping Centers Inc.	5,416,950
171,100	Equity One Inc.	3,955,832
252,000	Heritage Property Investment Trust	8,416,800
250,000	Primaris Retail Real Estate Investment Trust	3,503,581
135,000	Ramco-Gershenson Properties Trust	3,597,750
104,000	Tanger Factory Outlet Centers Inc.	2,988,960
	Total Shopping Centers	27,879,873
Specialty	2.4%	
185,000	Entertainment Properties Trust	7,538,750
	TOTAL COMMON STOCKS	
	(Cost \$153,744,749)	225,661,875
PREFERRED STOCKS	29.2%	
Apartments	4.5%	
	Apartment Investment & Management Co.:	
75,000	Cumulative, Series G, 9.375%	1,953,750
115,000	Cumulative, Series R, 10.000%	2,934,800
113,000	Cumulative, Series U, 7.750%	2,806,920
120,000	Cumulative, Series Y, 7.875%	3,012,000
150,000	BRE Properties Inc., Series C, 6.750%	3,708,000
	Total Apartments	14,415,470
Diversified	2.1%	
109,400	Crescent Real Estate Equities Co., Cumulative Redeemable, Series B, 9.500%	2,877,220
67,000	PS Business Parks Inc., Series M, 7.200%	1,648,200
100,000	Vornado Realty Trust, Series H, 6.750%	2,370,000
	Total Diversified	6,895,420
Health Care	2.1%	
150,000	Health Care Property Investors Inc., Cumulative Redeemable, Series F, 7.100%	3,765,000
120,400	Omega Healthcare Investors Inc., Cumulative Redeemable, Series D, 8.375%	3,036,488
	Total Health Care	6,801,488
Industrial/Office	Mixed 1.4%	
90,000	Bedford Property Investors Inc., Cumulative Redeemable, Series A, 8.750% (b)	4,401,567

See Notes to Financial Statements.

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Shares	Security	Value
Lodging/Resorts	3.3%	
220,000	Boykin Lodging Co., Cumulative, Class A, 10.500%	\$ 5,753,000
71,100	Hospitality Properties Trust, Cumulative Redeemable, Series B, 8.875%	1,829,403
26,000	LaSalle Hotel Properties, Cumulative Redeemable, Series A, 10.250%	676,000
90,000	Sunstone Hotel Investors Inc., Cumulative Redeemable, Series A, 8.000%	2,258,442
	Total Lodging/Resorts	10,516,845
Office	5.0%	
50,000	Brandywine Realty Trust, Series D, 7.375%	1,254,500
275,000	CarrAmerica Realty Corp., Cumulative Redeemable, Series E, 7.500%	6,943,750
	HRPT Properties Trust:	
50,000	Cumulative Redeemable, Series A, 9.875%	1,271,500
255,600	Cumulative Redeemable, Series B, 8.750%	6,620,040
	Total Office	16,089,790
Regional Malls	3.7%	
85,000	Glimcher Realty Trust, Cumulative Redeemable, Series F, 8.750%	2,188,750
	Mills Corp.:	
91,700	Cumulative Redeemable, Series B, 9.000%	2,341,101
35,000	Cumulative Redeemable, Series E, 8.750%	896,000
6,000	Pennsylvania Real Estate Investment Trust, Cumulative, 11.000%	335,400
32,700	Simon Property Group Inc., Cumulative, Series C, step bond to yield 3.043%	1,700,400
169,600	Taubman Centers Inc., Cumulative Redeemable, Series H, 7.625%	4,314,200
	Total Regional Malls	11,775,851
Retail Free Standing	0.9%	
85,000	Commercial Net Lease Realty Inc., Cumulative, Series A, 9.000%	2,219,775
25,200	Realty Income Corp., Cumulative Redeemable, Series D, 7.375%	646,380
	Total Retail Free Standing	2,866,155
Self Storage	0.3%	
35,000	Public Storage Inc., Cumulative, Series R, 8.000%	885,850
Shopping Centers	5.9%	
73,000	Cedar Shopping Centers Inc., Cumulative Redeemable, Series A, 8.875%	1,923,915
	Developers Diversified Realty Corp.:	
21,200	Cumulative Redeemable, Class F, 8.000%	543,780
130,000	Cumulative Redeemable, Class G, 8.600%	3,338,400
131,000	Federal Realty Investment Trust, Cumulative Redeemable, Series B, 8.500%	3,375,870
75,000	New Plan Excel Realty Trust Inc., Cumulative Redeemable, Series E, 7.625%	1,886,250
34,800	Ramco-Gershenson Properties Trust, Cumulative Redeemable, Series B, 9.500%	918,720
63,000	Urstadt Biddle Properties Inc., Cumulative, Series C, 8.500%	6,751,710
	Total Shopping Centers	18,738,645
	TOTAL PREFERRED STOCKS	
	(Cost \$91,981,056)	93,387,081
	TOTAL INVESTMENTS BEFORE SHORT-TERM INVESTMENT	
	(Cost \$245,725,805)	319,048,956

See Notes to Financial Statements.

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Face Amount	Security	Value
SHORT-TERM INVESTMENT	0.2%	
Repurchase Agreement	0.2%	
\$ 730,000	Interest in \$972,036,000 joint tri-party repurchase agreement dated 12/30/05 with Goldman, Sachs & Co., 4.270% due 1/3/06; Proceeds at maturity \$730,346; (Fully collateralized by various U.S. Treasury obligations, 2.375% to 3.875% due 1/15/08 to 4/15/32; Market value \$774,094) (Cost \$730,000)	\$ 730,000
TOTAL INVESTMENTS	100.0% (Cost \$246,455,805#)	\$ 319,778,956

(a) All or a portion of this security is segregated for swap transactions.

(b) Security is exempt from registration under Rule 144A of the Securities Act of 1933. This security may be resold in transactions that are exempt from registration, normally to qualified institutional buyers. This security has been deemed liquid pursuant to guidelines approved by the Board of Directors, unless otherwise noted.

Aggregate cost for federal income tax purposes is \$246,484,466.

See Notes to Financial Statements.

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ASSETS:

Investments, at value (Cost \$246,455,805)	\$	319,778,956
Cash		602
Dividends and interest receivable		2,039,629
Unrealized appreciation on swaps (Notes 1 and 3)		1,514,807
Prepaid expenses		7,408

Total Assets

323,341,402

LIABILITIES:

Management fee payable		162,155
Interest payable for open swap contracts (Note 3)		85,247
Dividends payable to Taxable Auction Rate Cumulative Preferred Stockholders		58,358
Directors' fees payable		20,534
Accrued expenses		178,328

Total Liabilities

504,622

Series M Taxable Auction Rate Cumulative Preferred Stock (3,800 shares authorized and issued at \$25,000 per share) (Note 4)

95,000,000

Total Net Assets

\$ 227,836,780

NET ASSETS:

Par value (\$0.001 par value; 11,069,242 shares issued and outstanding; 100,000,000 shares authorized)	\$	11,069
Paid-in capital in excess of par value		151,258,291
Undistributed net investment income		761,402
Accumulated net realized gain on investments, swap contracts and foreign currency transactions		968,093
Net unrealized appreciation on investments, swap contracts and foreign currencies		74,837,925

Total Net Assets

\$ 227,836,780

Shares Outstanding

11,069,242

Net Asset Value

\$20.58

See Notes to Financial Statements.

INVESTMENT INCOME:

Dividends	\$ 12,197,659
Interest	73,783
Less: Foreign taxes withheld	(34,385)
Total Investment Income	12,237,057

EXPENSES:

Management fee (Note 2)	2,775,871
Auction participation fees (Note 4)	196,834
Legal fees	88,920
Audit and tax	87,640
Shareholder reports	82,849
Directors fees	80,764
Custody fees	27,128
Listing fees	21,809
Transfer agent fees	18,325
Insurance	17,661
Rating agency fees	11,966
Miscellaneous expenses	16,659
Total Expenses	3,426,426

Less: Management fee waiver (Note 2)	(986,976)
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Net Expenses **2,439,450**

Net Investment Income **9,797,607**

REALIZED AND UNREALIZED GAIN (LOSS) ON INVESTMENTS, SWAP CONTRACTS AND FOREIGN CURRENCY TRANSACTIONS (NOTES 1 AND 3):

Net Realized Gain (Loss) From:	
Investments	8,041,427
REIT distributions	4,911,346
Swap contracts	(307,439)
Foreign currency transactions	1,177
Net Realized Gain	12,646,511

Change in Net Unrealized Appreciation/Depreciation From:	
Investments	(7,365,702)
Swap contracts	1,788,530
Foreign currencies	(238)

Change in Net Unrealized Appreciation/Depreciation **(5,577,410)**

Net Gain on Investments, Swap Contracts and Foreign Currency Transactions **7,069,101**

Distributions Paid to Taxable Auction Rate Cumulative Preferred Stockholders **(2,680,306)**

Increase in Net Assets From Operations **\$ 14,186,402**

See Notes to Financial Statements.

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	2005	2004
OPERATIONS:		
Net investment income	\$ 9,797,607	\$ 10,414,200
Net realized gain	12,646,511	2,590,642
Change in net unrealized appreciation/depreciation	(5,577,410)	34,009,653
Distributions paid to Taxable Auction Rate Cumulative Preferred Stockholders (Note 5)	(2,680,306)	(1,004,412)
Increase in Net Assets From Operations	14,186,402	46,010,083
DISTRIBUTIONS PAID TO COMMON STOCK SHAREHOLDERS FROM (NOTES 1 AND 5):		
Net investment income	(8,496,527)	(8,305,866)
Net realized gains	(10,409,739)	(3,556,810)
Return of capital		(2,615,893)
Decrease in Net Assets From Distributions to Common Stock Shareholders	(18,906,266)	(14,478,569)
FUND SHARE TRANSACTIONS:		
Underwriting commissions and offering expenses for the issuance of Taxable Auction Rate Cumulative Preferred Stock (Note 4)	(497,532)	
Decrease in Net Assets From Fund Share Transactions	(497,532)	
Increase (Decrease) in Net Assets	(5,217,396)	31,531,514
NET ASSETS:		
Beginning of year	233,054,176	201,522,662
End of year*	\$ 227,836,780	\$ 233,054,176
*Includes undistributed net investment income of:	\$761,402	\$900,610

See Notes to Financial Statements.

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For a share of capital stock outstanding throughout each year ended December 31, unless otherwise noted:

	2005(1)	2004(1)	2003	2002(2)
Net Asset Value, Beginning of Year	\$21.05	\$18.21	\$13.95	\$14.30
Income (Loss) From Operations:				
Net investment income	0.89	0.94	1.04	0.38
Net realized and unrealized gain (loss)	0.63	3.30	4.96	(0.18)
Distributions paid to Taxable Auction Rate Cumulative Preferred Stockholders	(0.24)	(0.09)	(0.08)	(0.03)
Total Income From Operations	1.28	4.15	5.92	0.17
Underwriting Commissions and Offering Expenses for the Issuance of Taxable Auction Rate Cumulative Preferred Stock Less Distributions Paid to Common Stock Shareholders From:				
Net investment income	(0.77)	(0.75)	(0.80)	(0.31)
Net realized gains	(0.94)	(0.32)	(0.62)	(0.07)
Return of capital		(0.24)	(0.24)	(0.05)
Total Distributions	(1.71)	(1.31)	(1.66)	(0.43)
Net Asset Value, End of Year	\$20.58	\$21.05	\$18.21	\$13.95
Market Price, End of Year	\$18.62	\$18.47	\$17.57	\$14.01
Total Return, Based on Net Asset Value⁽⁴⁾	7.35 %	24.75 %	45.12 %	0.69 %
Total Return, Based on Market Price Per Share⁽⁴⁾	10.69 %	13.45 %	39.42 %	(3.59)%
Net Assets, End of Year (millions)	\$228	\$233	\$202	\$150
Ratios to Average Net Assets:⁽⁵⁾				
Gross expenses	1.49 %	1.44 %	1.55 %	1.55 % ⁽⁷⁾
Net expenses ⁽⁶⁾	1.06	1.02	1.11	1.11 ⁽⁷⁾
Net investment income	4.27	5.00	6.60	6.66 ⁽⁷⁾
Portfolio Turnover Rate	12 %	6 %	27 %	13 %
Taxable Auction Rate Cumulative Preferred Stock:⁽⁸⁾				
Total Amount Outstanding (000s)	\$95,000	\$65,000	\$65,000	\$65,000
Asset Coverage Per Share	84,957	114,636	102,509	82,841
Involuntary Liquidating Preference Per Share ⁽⁹⁾	25,000	25,000	25,000	25,000
Average Market Value Per Share ⁽⁹⁾	25,000	25,000	25,000	25,000

(1) Per share amounts have been calculated using the average shares method.

(2) For the period July 31, 2002 (commencement of operations) to December 31, 2002.