

LMP REAL ESTATE INCOME FUND INC.
Form N-CSR
March 01, 2013

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

FORM N-CSR

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

Investment Company Act file number 811-21098

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

620 Eighth Avenue, 49th Floor, New York, NY
(Address of principal executive offices)

10018
(Zip code)

Robert I. Frenkel, Esq.

Legg Mason & Co., LLC

100 First Stamford Place

Stamford, CT 06902
(Name and address of agent for service)

Registrant's telephone number, including area code: (888)777-0102

Date of fiscal year end: December 31

Date of reporting period: December 31, 2012

ITEM 1.

REPORT TO STOCKHOLDERS.

The **Annual** Report to Stockholders is filed herewith.

December 31, 2012

Annual Report

LMP Real Estate Income Fund Inc.

(RIT)

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

II LMP Real Estate Income Fund Inc.

Fund objectives

The Fund's primary investment objective is high current income and the Fund's secondary investment objective is capital appreciation.

What's inside

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Letter from the chairman

Dear Shareholder,

We are pleased to provide the annual report of LMP Real Estate Income Fund Inc. for the twelve-month reporting period ended December 31, 2012. Please read on for a detailed look at prevailing economic and market conditions during the Fund's reporting period and to learn how those conditions have affected Fund performance.

Recent regulations adopted by the Commodity Futures Trading Commission (the "CFTC") require operators of registered investment companies, including closed-end funds, to register as commodity pool operators unless the fund limits its investments in commodity interests. Effective December 31, 2012, your Fund's manager has claimed the exclusion from the definition of commodity pool operator. More information about the CFTC rules and their effect on the Fund is included later in this report on page 23.

As always, we remain committed to providing you with excellent service and a full spectrum of investment choices. We also remain committed to supplementing the support you receive from your financial advisor. One way we accomplish this is through our website, www.lmcef.com. Here you can gain immediate access to market and investment information, including:

- Fund prices and performance,
- Market insights and commentaries from our portfolio managers, and
- A host of educational resources.

We look forward to helping you meet your financial goals.

Sincerely,

R. Jay Gerken, CFA

Chairman, President and Chief Executive Officer

January 31, 2013

Investment commentary

Economic review

The U.S. economy continued to grow over the twelve months ended December 31, 2012, but it did so at an uneven pace. U.S. gross domestic product (GDP) growth, as reported by the U.S. Department of Commerce, was 2.0% in the first quarter of 2012. The economy then slowed in the second quarter, as GDP growth was a tepid 1.3%. Economic growth accelerated to 3.1% in the third quarter, partially due to increased private inventory investment, higher federal government spending and moderating imports. However, this was a temporary uptick, as the Commerce Department's initial estimate showed that fourth quarter GDP contracted 0.1%. This was the first negative reading since the second quarter of 2009, and was driven by a reversal of the above factors, as private inventory investment and federal government spending weakened.

While there was some improvement in the U.S. job market, unemployment remained elevated throughout the reporting period. When the period began, unemployment, as reported by the U.S. Department of Labor, was 8.3%. Unemployment then generally declined and was 7.8% in September 2012, the lowest rate since January 2009, but still high by historical standards. The unemployment rate then rose to 7.9% in October, before falling to 7.8% in November, where it remained in December. The number of longer-term unemployed continued to be a headwind for the economy, as roughly 39% of the 12.2 million people without a job have been out of work for more than six months.

Meanwhile, the housing market brightened, as sales generally improved and home prices continued to rebound.

According to the National Association of Realtors (NAR), while existing-home sales dipped 1.0% on a seasonally adjusted basis in December 2012 versus the previous month, they were still 12.8% higher than in December 2011. In addition, the NAR reported that the median existing-home price for all housing types was \$180,800 in December 2012, up 11.5% from December 2011. This marked the tenth consecutive month that home prices rose compared to the same period a year earlier. Furthermore, the inventory of homes available for sale fell 8.5% in December, which represents a 4.4 month supply at the current sales pace. This represents the lowest inventory since May 2005.

The manufacturing sector expanded during much of the reporting period, although it experienced several soft patches. Based on the Institute for Supply Management's PMI (PMI) ii, after expanding 34 consecutive months, the PMI fell to 49.7 in June 2012, which represented the first contraction in the manufacturing sector since July 2009 (a reading below 50 indicates a contraction, whereas a reading above 50 indicates an expansion). Manufacturing continued to contract in July and August before ticking up to 51.5 in September and 51.7 in October. The PMI fell back to contraction territory with a reading of 49.5 in November, its lowest level since July 2009. However, manufacturing again expanded in December, with the PMI increasing to 50.7.

The Federal Reserve Board (Fed) iii took a number of actions as it sought to meet its dual mandate of fostering maximum employment and price stability. As has been the case since December 2008, the Fed kept the

IV LMP Real Estate Income Fund Inc.

Investment commentary (continued)

federal funds rate at a historically low range between zero and 0.25%. In January 2012, the Fed extended the period it expects to keep rates on hold until at least through late 2014. At its June 2012 meeting, the Fed announced that it would continue its program of purchasing longer-term Treasury securities and selling an equal amount of shorter-term Treasury securities (often referred to as "Operation Twist") until the end of 2012. In September, the Fed announced a third round of quantitative easing ("QE3"), which involves purchasing \$40 billion each month of agency mortgage-backed securities on an open-end basis. In addition, the Fed further extended the duration that it expects to keep the federal funds rate on hold, until at least mid-2015. Finally, at its meeting in December, the Fed announced that it would continue purchasing \$40 billion per month of agency mortgage-backed securities, as well as initially purchasing \$45 billion a month of longer-term Treasuries. The Fed also said that it would keep the federal funds rate on hold "...as long as the unemployment rate remains above 6.5%, inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee's 2.0% longer-run goal, and longer-term inflation expectations continue to be well anchored.

As always, thank you for your confidence in our stewardship of your assets.

Sincerely,

R. Jay Gerken, CFA

Chairman, President and
Chief Executive Officer

January 31, 2013

All investments are subject to risk including the possible loss of principal. Past performance is no guarantee of future results.

- i Gross domestic product ("GDP") is the market value of all final goods and services produced within a country in a given period of time.
- ii The Institute for Supply Management's PMI is based on a survey of purchasing executives who buy the raw materials for manufacturing at more than 350 companies. It offers an early reading on the health of the manufacturing sector.
- iii The Federal Reserve Board ("Fed") is responsible for the formulation of policies designed to promote economic growth, full employment, stable prices and a sustainable pattern of international trade and payments.
- iv The federal funds rate is the rate charged by one depository institution on an overnight sale of immediately available funds (balances at the Federal Reserve) to another depository institution; the rate may vary from depository institution to depository institution and from day to

day.

Fund overview

Q. What is the Fund's investment strategy?

A. The Fund's primary investment objective is high current income with capital appreciation as a secondary investment objective. The Fund has a fundamental policy of concentrating its investments in the U.S. real estate industry and not in any other industry. The Fund primarily invests in income-producing common shares, preferred shares, convertible preferred shares and debt securities issued by real estate companies, including real estate investment trusts (REITs). Real estate companies are companies that generally derive at least 50% of their revenue from the ownership, construction, financing, management or sale of commercial, industrial and residential real estate, or have at least 50% of their assets invested in such real estate.

Our investment process focuses on finding securities with sustainable, high or growing distributions that are covered by a company's operating cash flows. We also look for securities that are trading at a discount to what we believe is the intrinsic value of the company. We feel this provides the Fund with additional capital appreciation potential, as well as superior defensive characteristics. Sector allocation is largely an outgrowth of our fundamental securities analysis.

Under normal market conditions, the Fund invests at least 90% of its total assets in income-producing common shares, preferred shares, convertible preferred shares (preferred shares that, upon the passage of time or the happening of certain events, automatically convert into common shares) and debt securities issued by real estate companies, including REITs. At least 80% of the Fund's total assets will be invested, under normal market conditions, in income-producing securities issued by REITs.

It is the Fund's intention to invest approximately 60% to 80% of its total assets in common shares issued by real estate companies and 20% to 40% of its total assets in preferred shares, including convertible preferred shares, issued by real estate companies. The actual percentage of common, preferred and convertible preferred shares and debt securities in the Fund's portfolio may vary over time based on our assessment of market conditions. Our use of leverage is also based on our current view of the risk/return profile of the market. While we do not expect to change the amount of leverage we use frequently, it will be managed in accordance with market conditions and will not be held static if we believe it makes sense to make an adjustment.

Effective September 1, 2012, ClearBridge Investments, LLC (formerly ClearBridge Advisors, LLC) (ClearBridge) is the subadviser to the Fund. Pursuant to a new subadvisory agreement, ClearBridge provides day-to-day portfolio management services to the Fund while the Fund's current investment manager, Legg Mason Partners Fund Advisor, LLC (LMPFA) continues to provide management and administrative services to the Fund and supervise the Fund-related activities of ClearBridge. Mark McAllister serves as senior portfolio manager and John Baldi as co-portfolio manager to the Fund.

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

A. Despite surprisingly resilient performance from stocks, the U.S. REIT

Fund overview (cont'd)

market outperformed the broad U.S. equity market for the fourth consecutive year in 2012. The Fund's benchmark the MSCI U.S. REIT Indexⁱⁱ, returned 17.77% for the year and the FTSE NAREIT All REITs Indexⁱⁱⁱ, which includes both equity and mortgage REITs, produced a 20.14% total return for the same period. In comparison, the S&P 500 Index^{iv} produced a total return for the period of 16.00%.

Q. How did we respond to these changing market conditions?

A. We made some modest changes to the portfolio during the course of the reporting period. The most important changes were to our preferred stock holdings, where we rotated into issues that had longer call protection and/or more favorable yields. In addition, we increased our Mortgage REITs sub-sector holdings as these offered strong dividend yields, low historical leverage levels and attractive valuations. Finally, we participated in two attractively priced REIT initial public offerings, with the companies offering strong dividend yields and stock valuations well below our estimates of their net asset values. We maintained our Fund borrowings constant with 2011's year-end level, reflecting what we believe to be a reasonably, but not excessively, optimistic view of REIT fundamentals and valuations.

Performance review

For the twelve months ended December 31, 2012, LMP Real Estate Income Fund Inc. returned 20.84% based on its NAV and 26.85% based on its New York Stock Exchange (NYSE) market price per share. The Fund's unmanaged benchmark, the MSCI U.S. REIT Index, returned 17.77% for the same period. The Lipper Real Estate Closed-End Funds Category Average^v returned 22.84% 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 shareholders totaling \$0.72 per share. The performance table shows the Fund's twelve-month total return based on its NAV and market price as of December 31, 2012. **Past performance is no guarantee of future results.**

Performance Snapshot as of December 31, 2012

Price Per Share	12-Month Total Return*
\$12.16 (NAV)	20.84%
\$10.97 (Market Price)	26.85%

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

* Total returns are based on changes in NAV or market price, respectively.

Total return assumes the reinvestment of all distributions at NAV. Prior to January 1, 2012, total return assumed the reinvestment of all distributions in additional shares in accordance with the Fund's Dividend Reinvestment Plan.

Total returns assume the reinvestment of all distributions in additional shares in accordance with the Fund's Dividend Reinvestment Plan.

Q. What were the leading contributors to performance?

A. On an absolute basis the Fund had positive returns in all seven REIT industry sub-sectors, with the greatest contributions to returns coming from the Retail REITs, Specialized REITs and Office REITs sub-sectors. Relative to the benchmark, the Fund's overall sector allocation contributed to

performance for the period. In particular, underweights to the Residential REITs and the Specialized REITs sub-sectors and an overweight to the Retail REITs sub-sector helped relative performance. Security selection in the Office REITs sub-sector also helped relative performance for the period.

In terms of individual Fund holdings, leading contributors to performance for the period included positions in Westfield Group, Primaris Retail Real Estate Investment Trust, and Macerich Co. all in the Retail sub-sector, Omega Healthcare Investors Inc. in the Specialized REITs sub-sector and Kilroy Realty Corp. in the Office REITs.

Q. What were the leading detractors from performance?

A. Relative to the benchmark, the Fund's overall security selection had a negative impact on performance for the period. In particular, selection in the Retail REITs, Specialized REITs and Diversified REITs sectors detracted from relative performance. As for allocation, an overweight to the Industrial REITs sub-sector and the Fund's holdings in cash and cash equivalents also detracted from performance.

In terms of individual Fund holdings, leading detractors from performance for the period included positions in Public Storage Series L Preferred in the Specialized REITs sub-sector, American Capital Agency Corp., CYS Investments Inc., and Annaly Capital Management Inc., all in the Mortgage REITs sub-sector, and Retail Properties of America Inc. Series A Preferred in the Retail sub-sector.

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

A. There were a number of specific changes made to the Fund over the course of the reporting period. The majority of these changes were related to the repositioning of our preferred stock holdings to increase the portfolio's call protection. Among the largest additions to the Fund's portfolio were new positions in Spirit Realty Capital Inc., Apartment Investment & Management Co. (both common shares and the Series Z Preferred were purchased), Hersha Hospitality Trust (both the Series B Preferred and the common shares were purchased), Glimcher Realty Trust Series H Preferred and Corporate Office Properties Series L Preferred. Some of the largest existing Fund holdings that were sold over the course of the period were positions in Urstadt Biddle Properties Inc. Series C Preferred, Kimco Realty Corp. Series G Preferred, Public Storage Series L Preferred, Duke Realty Corp. Series M Preferred and Primaris Retail Real Estate Investment Trust.

Looking for additional information?

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

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In a continuing effort to provide information concerning the Fund, shareholders may call 1-888-777-0102 (toll free), Monday through Friday from 8:00 a.m. to 5:30 p.m. Eastern Time, for the Fund's current NAV, market price and other information.

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Fund overview (cont d)

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

Sincerely,

Mark McAllister

Portfolio Manager

ClearBridge Investments, LLC

John Baldi

Portfolio Manager

ClearBridge Investments, LLC

January 22, 2013

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. Leverage may result in greater volatility of NAV and the

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market price of common shares and increases a shareholder's risk of loss. The Fund may make significant investments in derivative instruments. Derivative instruments can be illiquid, may disproportionately increase losses, and have a potentially large impact on Fund performance.

Portfolio holdings and breakdowns are as of December 31, 2012 and are subject to change and may not be representative of the portfolio managers' current or future investments. The Fund's top ten holdings (as a percentage of net assets) as of December 31, 2012 were: Macerich Co. (5.2%), Westfield Group (5.2%), OMEGA Healthcare Investors Inc. (5.1%), Liberty Property Trust (4.5%), HCP Inc. (3.9%), EPR Properties (3.7%), Health Care REIT Inc. (3.7%), Kilroy Realty Corp. (3.6%), Dundee Real Estate Investment Trust (3.4%) and Senior Housing Properties Trust (3.2%). Please refer to pages 6 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. The Fund's top five sector holdings (as a percentage of net assets) as of December 31, 2012 were: Shopping Centers (25.9%), Diversified (22.4%), Health Care (15.9%), Lodging/Resorts (14.1%) and Office (12.2%). The Fund's portfolio composition is subject to change at any time.

All investments are subject to risk including the possible loss of principal. Past performance is no guarantee of future results. All index performance reflects no deduction for fees, expenses or taxes. Please note that an investor cannot invest directly in an index.

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.

- i Real estate investment trusts (REITs) invest in real estate or loans secured by real estate and issue shares in such investments, which can be illiquid.
- ii The MSCI U.S. REIT Index is a free float-adjusted market capitalization weighted index that is comprised of equity Real Estate Investment Trusts (REITs) that are included in the MSCI U.S. Investable Market 2500 Index, with the exception of specialty equity REITs that do not generate a majority of their revenue and income from real estate rental and leasing operations. The Index represents approximately 85% of the U.S. REIT universe. The MSCI U.S. Investable Market 2500 Index represents the investable universe of companies in the U.S. equity market. This index targets for inclusion 2,500 companies and represents, as of October 29, 2004, approximately 98% of capitalization of the U.S. equity market.
- iii The FTSE NAREIT All REITs Index consists of all tax-qualified Real Estate Investment Trusts (REITs) listed on the New York Stock Exchange, American Stock Exchange or NASDAQ National Market List.
- iv The S&P 500 Index is an unmanaged index of 500 stocks and is generally representative of the performance of larger companies in the U.S.
- v Lipper, Inc., a wholly-owned subsidiary of Reuters, provides independent insight on global collective investments. Returns are based on the twelve-month period ended December 31, 2012, including the reinvestment of all distributions, including returns of capital, if any, calculated among the 11 funds in the Fund's Lipper category.

Fund at a glance (unaudited)

Investment breakdown (%) as a percent of total investments

The bar graph above represents the composition of the Fund's investments as of December 31, 2012 and December 31, 2011. The Fund is actively managed. As a result, the composition of the Fund's investments is subject to change at any time.

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Schedule of investments

December 31, 2012

LMP Real Estate Income Fund Inc.

	Shares	Value
Security		
Common Stocks 85.9%		
<i>Apartments 4.6%</i>		
Apartment Investment and Management Co., Class A Shares	98,200	\$ 2,657,292(a)
Campus Crest Communities Inc.	308,220	3,778,777(a)
Total Apartments		6,436,069
<i>Diversified 15.9%</i>		
Digital Realty Trust Inc.		