LMP REAL ESTATE INCOME FUND INC.
Form N-CSR
March 02, 2010

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)

55 Water Street, New York, NY	10041
(Address of principal executive offices)	(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, 2009

ITEM 1. REPORT TO STOCKHOLDERS.

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

ANNUAL REPORT / DECEMBER 31, 2009

LMP Real Estate Income Fund Inc.

(RIT)

Managed by **AEW CAPITAL MANAGEMENT**

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

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

Legg Mason Partners Fund Advisor, LLC (LMPFA) is the Fund s investment manager. AEW Capital Management, L.P. (AEW) is the Fund s subadviser. LMPFA is a wholly-owned subsidiary of Legg Mason, Inc.

Letter from the chairman

Dear Shareholder,

While the U.S. economy was weak during the first half of the twelve-month reporting period ended December 31, 2009, the lengthiest recession since the Great Depression finally appeared to have ended during the second half of the year.

Looking back, the U.S. Department of Commerce reported that first quarter 2009 U.S. gross domestic product (GDP)i contracted 6.4%. The economic environment then started to get relatively better during the second quarter, as GDP fell 0.7%. The economy s more modest contraction was due, in part, to smaller declines in both exports and business spending. After contracting four consecutive quarters, the Commerce Department reported that third quarter 2009 GDP growth was 2.2%. A variety of factors helped the economy to expand, including the government s $787 billion stimulus program, its Cash for Clunkers car rebate program, which helped spur an increase in car sales, and tax credits for first-time home buyers. Economic growth then accelerated during the fourth quarter of 2009, as the advance estimate for GDP growth was 5.7%. The Commerce Department cited a slower drawdown in business inventories and consumer spending as contributing factors spurring the economy s higher growth rate.

Even before GDP advanced in the third quarter, there were signs that the economy was starting to regain its footing. The manufacturing sector, as measured by the Institute for Supply Management s PMIii, rose to 52.9 in August 2009, the first time it surpassed 50 since January 2008 (a reading below 50 indicates a contraction, whereas a reading above 50 indicates an expansion). PMI data subsequently showed that manufacturing expanded from September through December as well. In addition, December s PMI reading of 55.9 was the highest since April 2006.

The housing market also saw some improvement during the reporting period. According to its most recent data, the S&P/Case-Shiller Home Price Indexiii indicated that home prices rose for the fifth straight month in October. In addition, the National Association of Realtors reported that existing home sales rose 7.4% in November.

Letter from the chairman *continued*

One area that remained weak and could hamper the magnitude of economic recovery was the labor market. While monthly job losses have moderated compared to earlier in the year, the unemployment rate remained elevated during the reporting period. After reaching a twenty-six-year high of 10.1% in October 2009, the unemployment rate fell to 10.0% in November and remained unchanged the following month. Since December 2007, the unemployment rate has more than doubled and the number of unemployed workers has risen by more than eight million.

The Federal Reserve Board (Fed)[iv] continued to pursue an accommodative monetary policy during the reporting period. After reducing the federal funds rate[v] from 5.25% in August 2007 to a range of 0 to 1/4 percent in December 2008 a historic low the Fed maintained this stance through the end of 2009 and during its first meeting in January 2010. In conjunction with its January 2010 meeting, the Fed said that it will maintain the target range for the federal funds rate at 0 to 1/4 percent and continues to anticipate that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels of the federal funds rate for an extended period.

After falling nearly 30% from September through November 2008 (before the reporting period began), the U.S. stock market, as measured by the S&P 500 Index[vi] (the Index), rallied and, overall, generated strong results during the twelve-month reporting period. Stock prices fell during the first two months of the reporting period, due to the rapidly weakening global economy, an ongoing credit crisis and plunging corporate profits. Stock prices continued to decline in early March, reaching a twelve-year low on March 9th. Stocks then moved sharply and posted positive returns during nine of the last ten months of the year. From its March trough through the end of December, the Index gained approximately 67%, its fastest rebound since 1933. The market s rally was attributed to a number of factors, including optimism that the economy was gaining traction and that corporate profits would continue to improve. All told, the Index returned 26.46% over the twelve-month reporting period ended December 31, 2009, its best calendar year since 2003.

Looking at the U.S. stock market more closely, in terms of market capitalizations, large-, mid- and small-cap stocks, as measured by the Russell 1000[vii], Russell Midcap[viii] and Russell 2000[ix] Indices, returned 28.43%, 40.48% and 27.17%, respectively, during the twelve-month period ended December 31, 2009. From an investment style perspective, growth and value stocks, as measured by the Russell 3000 Growth[x] and Russell 3000 Value[xi] Indices, returned 37.01% and 19.76%, respectively.

A special note regarding increased market volatility

Dramatically higher volatility in the financial markets has been very challenging for many investors. Market movements have been rapid sometimes in reaction to economic news, and sometimes creating the news.

In the midst of this evolving market environment, we at Legg Mason want to do everything we can to help you reach your financial goals. Now, as always, we remain committed to providing you with excellent service and a full spectrum of investment choices. Rest assured, we will continue to work hard to ensure that our investment managers make every effort to deliver strong long-term results.

We also remain committed to supplementing the support you receive from your financial advisor. One way we accomplish this is through our enhanced website, www.leggmason.com/cef. Here you can gain immediate access to many special features to help guide you through difficult times, including:

- Fund prices and performance,

- Market insights and commentaries from our portfolio managers, and

- A host of educational resources.

During periods of market unrest, it is especially important to work closely with your financial advisor and remember that reaching one s investment goals unfolds over time and through multiple market cycles. Time and again, history has shown that, over the long run, the markets have eventually recovered and grown.

Information about your fund

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

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

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

Sincerely,

R. Jay Gerken, CFA

Chairman, President and Chief Executive Officer

January 29, 2010

Letter from the chairman *continued*

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

i Gross domestic product (GDP) is the market value of all final goods and services produced within a country in a given period of time.
ii The 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 S&P/Case-Shiller Home Price Index measures the residential housing market, tracking changes in the value of the residential real estate market in twenty metropolitan regions across the United States.
iv The Federal Reserve Board (Fed) is responsible for the formulation of policies designed to promote economic growth, full employment, stable prices, and a sustainable pattern of international trade and payments.
v 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.
vi 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.
vii 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. The Russell 3000 Index measures the performance of the 3,000 largest U.S. companies based on total market capitalization, which represents approximately 98% of the U.S. equity market.
viii The Russell Midcap Index measures the performance of the 800 smallest companies in the Russell 1000 Index, which represents approximately 25% of the total market capitalization of the Russell 1000 Index.
ix 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.
x The Russell 3000 Growth Index measures the performance of those Russell 3000 Index companies with higher price-to-book ratios and higher forecasted growth values. (A price-to-book ratio is the price of a stock compared to the difference between a company s assets and liabilities.)
xi 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.

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. At AEW Capital Management, L.P., the Fund s subadviser, we employ a value-oriented investment strategy designed to identify securities that are priced below what we believe is their intrinsic value. We believe that the performance of real estate securities is ultimately dependent upon the performance of the underlying real estate assets and company management, as well as the overall influence of capital markets. Consequently, when selecting securities for the Fund, we draw upon the combined expertise of our real estate, research and securities professionals.

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 real estate investment trusts (REITs)[i]. 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.

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

A. On the heels of their worst-ever annual performance in 2008, REITs, as measured by the MSCI U.S. REIT Index[ii], started 2009 in dismal fashion losing over 40% from January 1st through early March, as worries over the economy and banking system took a particularly heavy toll on real estate securities as did the continued struggles in the credit markets and deteriorating property fundamentals. The sector began to rally in March, however, and the rally continued largely unabated through the final three quarters of the year with U.S. REITs up 28.61% for the twelve-month period. The sector s rebound was catalyzed by several factors including the positive impact of new equity raise activity which helped to improve the financial condition of several REITs and reverse some of the negative sentiment facing the sector, improving capital market conditions as the year progressed, solid gains in the financial sector, which was also up strongly during the year, and a general perception that most REITs have successfully weathered the worst of the recession.

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

A. Our bottom-up value-oriented investment approach remained the same during 2009. Against the backdrop of uncertainty in the economy and increased volatility in the equity market, we continued to focus on security selection within each property sector, with the goal of constructing a

Fund overview *continued*

diversified portfolio of income-producing real estate securities that we believe will provide the best risk-adjusted returns for the Fund.

The Fund continued to maintain its exposure to interest rate swaps during the reporting period. These positions were used to manage the Fund s exposure to interest rate fluctuations. Overall, these positions had a minimal impact on performance during the period.

Performance review

For the twelve months ended December 31, 2009, LMP Real Estate Income Fund Inc. returned 63.57% based on its net asset value (NAV)iii and 97.75% based on its New York Stock Exchange (NYSE) market price per share. The Fund s unmanaged benchmark, the MSCI U.S. REIT Index, returned 28.61% for the same period. The Lipper Real Estate Closed-End Funds Category Averageiv returned 47.73% 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 $0.94 per share, which includes a return of capital of $0.50 per share. The performance table shows the Fund s twelve-month total return based on its NAV and market price as of December 31, 2009. **Past performance is no guarantee of future results.**

PERFORMANCE SNAPSHOT as of December 31, 2009 (unaudited)

PRICE PER SHARE	12-MONTH TOTAL RETURN*
$8.98 (NAV)	63.57%
$8.05 (Market Price)	97.75%

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

***Total returns are based on changes in NAV or market price, respectively. Total returns assume the reinvestment of all distributions in additional shares in accordance with the Fund s Dividend Reinvestment Plan.**

Q. What were the leading contributors to performance?

A. On an individual stock basis, top contributors to the Fund s performance during the period included Regional Malls REIT **Macerich Co**. and Office REIT **HRPT Properties Trust**. The performance of Macerich Co., which was among the weakest performers in the Regional Malls sector for the six-month period from September 30, 2008 through March 31, 2009, was attributable in large part to the company s efforts to deleverage and remove much of its near-term balance sheet risks. HRPT Properties Trust s strong performance for the year was largely attributable to the company facing minimal financial risk due to a largely stable balance sheet, as well as a lack of development property exposure.

From a sector perspective, the Fund s underweights to the Health Care and Storage sectors, which underperformed on a relative basis, also contributed positively to performance. The performance of the Fund s preferred stock portfolio generally outperformed its common share segment due in large part to the positive impact of the stabilization of the credit markets.

Q. What were the leading detractors from performance?

A. Top individual Fund detractors during 2009 included holdings in Shopping Centers company **Kimco Realty Corp.** and Office REIT **Kilroy Realty Corp.** Consistent with the rest of the REIT sector, Kimco Realty suffered significant erosion in its share price early in 2009 due to concerns over the company s exposure to development, pending debt maturities and potential write-downs of non-core investments. The company s price has rebounded somewhat since that time, however, as a result of an improving balance sheet through debt repayment and an overall perception that the company has managed its portfolio well through the downturn, thus positioning itself to benefit as the economy recovers. The performance of Kilroy Realty suffered in large part during the first quarter due to market concerns over the company s exposure to markets in Southern California, which have suffered considerably during the recession, and some scheduled lease expirations. Kilroy Realty s shares have also bounced back considerably since the first quarter due largely to the strength of its balance sheet, which compares favorably to many of its Office REIT peers, and positive sentiment towards the company s limited exposure to new development and the fact that it has addressed most of its funding requirements for the near term.

On a sector basis, the Fund s overweight to the Shopping Centers sector, which underperformed on a relative basis, and underweight to the Regional Malls sector, which outperformed on a relative basis, also detracted from Fund performance for the period.

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

A. There were no significant changes made to the Fund s portfolio during the twelve months ended December 31, 2009. We made marginal changes to the Fund s holdings based on our ongoing assessment of the relative value of each company in the Fund s investment universe consistent with the Fund s investment objective of high current income. At the end of the reporting period, the Fund s REIT common stock exposure was approximately 59% of its total investments, with 41% in preferred shares. This compares to 55% and 45%, respectively, as of year end 2008.

Looking for additional information?

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

Fund overview *continued*

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 Standard Time, for the Fund s current NAV, market price and other information.

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

Sincerely,

Portfolio Management
AEW Capital Management, L.P.

January 19, 2010

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, 2009 and are subject to change and may not be representative of the portfolio manager s current or future investments. The Fund s top ten holdings (as a percentage of total investments) as of this date were: Urstadt Biddle Properties Inc., Cumulative, Series C, 8.500% (4.6%), Macerich Co. (4.3%), Camden Property Trust (4.1%), Mack-Cali Realty Corp. (4.0%), Kimco Realty Corp., Series G 7.750% (3.8%), Kilroy Realty Corp. (3.5%), Public Storage Inc., Cumulative Redeemable, Series L, 6.750% (3.4%), First Potomac Realty Trust (3.4%), OMEGA Healthcare Investors Inc. (3.4%) and National Retail Properties Inc. (3.3%). 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 total investments) as of December 31, 2009 were: Office (17.2%), Shopping Centers (15.6%), Health Care (12.8%), Apartments (10.6%) and Retail Free Standing (7.7%). 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. 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.

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

i Real estate investment trusts (REITs) invest in real estate or loans secured by real estate and issue shares in such investments, which can be illiquid.

ii The MSCI U.S. REIT Index is a free float-adjusted market capitalization weighted index that is comprised of equity Real Estate Investment Trusts (REITs) that are included in the MSCI U.S. Investable Market 2500 Index, with the exception of specialty equity REITs that do not generate a majority of their revenue and income from real estate rental and leasing operations. The Index represents approximately 85% of the U.S. REIT universe.

iii Net asset value (NAV) is calculated by subtracting total liabilities and outstanding preferred stock (if any) from the closing value of all securities held by the Fund (plus all other assets) and dividing the result (total net assets) by the total number of the common shares outstanding. The NAV fluctuates with changes in the market prices of securities in which the Fund has invested. However, the price at which an investor may buy or sell shares of the Fund is the Fund s market price as determined by supply of and demand for the Fund s shares.

iv 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, 2009, including the reinvestment of all distributions, including returns of capital, if any, calculated among the 19 funds in the Fund s Lipper category.

Fund at a glance (unaudited)

INVESTMENT BREAKDOWN (%) As a percent of total investments

The bar graphs above represent the composition of the Fund s investments as of December 31, 2009 and December 31, 2008 and do not include derivatives. The Fund is actively managed. As a result, the composition of the Fund s investments is subject to change at any time.

Schedule of investments

December 31, 2009

LMP REAL ESTATE INCOME FUND INC.

SHARES	SECURITY	VALUE
COMMON STOCKS 58.4%		
	Apartments 7.3%	
129,800	Camden Property Trust	$ 5,499,626
60,000	Equity Residential	2,026,800
141,059	UDR Inc.	2,319,010
	Total Apartments	*9,845,436*
	Health Care 10.1%	
130,000	HCP Inc.	3,970,200
90,300	Nationwide Health Properties Inc.	3,176,754
235,000	OMEGA Healthcare Investors Inc.	4,570,750
90,000	Senior Housing Properties Trust	1,968,300
	Total Health Care	*13,686,004*
	Industrial 4.8%	
375,000	DCT Industrial Trust Inc.	1,882,500
365,000	First Potomac Realty Trust	4,588,050
	Total Industrial	*6,470,550*
	Industrial/Office - Mixed 2.5%	
105,000	Liberty Property Trust	*3,361,050*
	Lodging/Resorts 0.5%	
29,600	Hospitality Properties Trust	*701,816*
	Office 12.6%	
112,000	BioMed Realty Trust Inc.	1,767,360
60,400	Highwoods Properties Inc.	2,014,340
500,000	HRPT Properties Trust	3,235,000
155,000	Kilroy Realty Corp.	4,753,850
155,600	Mack-Cali Realty Corp.	5,379,092
	Total Office	*17,149,642*
	Regional Malls 4.7%	
172,800	Glimcher Realty Trust	466,560
163,731	Macerich Co.	5,886,129
	Total Regional Malls	*6,352,689*
	Retail - Free Standing 5.0%	
209,400	National Retail Properties Inc.	4,443,468
93,000	Realty Income Corp.	2,409,630
	Total Retail - Free Standing	*6,853,098*
	Self Storage 1.8%	
215,000	Extra Space Storage Inc.	*2,483,250*
	Shopping Centers 6.2%	
130,000	Kimco Realty Corp.	1,758,900
415,000	Kite Realty Group Trust	1,689,050

See Notes to Financial Statements.

LMP REAL ESTATE INCOME FUND INC.

SHARES	SECURITY	VALUE
	Shopping Centers 6.2% *continued*	
205,000	Primaris Retail Real Estate Investment Trust	$ 3,163,647
50,000	Regency Centers Corp.	1,753,000
	Total Shopping Centers	*8,364,597*
	Specialty 2.9%	
110,000	Entertainment Properties Trust	*3,879,700*
	TOTAL COMMON STOCKS (Cost $74,340,031)	79,147,832
PREFERRED STOCKS 41.0%		
	Apartments 3.3%	
	Apartment Investment & Management Co., Cumulative:	
70,000	Series U, 7.750%	1,561,000
70,000	Series Y, 7.875%	1,565,900
60,000	BRE Properties Inc., Series C, 6.750%	1,344,600
	Total Apartments	*4,471,500*
	Diversified 7.7%	
175,000	Duke Realty Corp., Series M, 6.950%	3,531,500
90,000	LBA Realty Fund LP, 8.750%(a)	1,980,000
	PS Business Parks Inc.:	
45,000	Cumulative Redeemable, Series O, 7.375%	1,050,975
75,000	Series M, 7.200%	1,642,500
100,000	Vornado Realty Trust, Cumulative Redeemable, Series G, 6.625%	2,165,000
	Total Diversified	*10,369,975*
	Health Care 2.7%	
100,000	HCP Inc., Series F, 7.100%	2,288,000
55,000	OMEGA Healthcare Investors Inc., Cumulative Redeemable, Series D, 8.375%	1,388,200
	Total Health Care	*3,676,200*
	Lodging/Resorts 4.8%	
71,100	Hospitality Properties Trust, Cumulative Redeemable, Series B, 8.875%	1,745,505
52,900	LaSalle Hotel Properties, Cumulative Redeemable, Series G, 7.250%	1,127,431
94,300	Strategic Hotels Capital Inc., Series B, 8.250%	1,286,488
100,100	Sunstone Hotel Investors Inc., Cumulative Redeemable, Series A, 8.000%	2,323,571
	Total Lodging/Resorts	*6,482,995*
	Office 4.6%	
130,000	BioMed Realty Trust Inc., Series A, 7.375%	3,016,000
46,400	Brandywine Realty Trust, Series D, 7.375%	1,035,648
40,000	Corporate Office Properties Trust, Cumulative Redeemable, Series J, 7.625%	950,000
51,183	HRPT Properties Trust, Cumulative Redeemable, Series B, 8.750%	1,248,865
	Total Office	*6,250,513*

See Notes to Financial Statements.

Schedule of investments ***continued***

December 31, 2009

LMP REAL ESTATE INCOME FUND INC.

SHARES	SECURITY	VALUE
	Regional Malls 2.4%	
85,000	Glimcher Realty Trust, Cumulative Redeemable, Series F, 8.750%	$ 1,560,600
70,000	Taubman Centers Inc., Cumulative Redeemable, Series H, 7.625%	1,664,691
	Total Regional Malls	*3,225,291*
	Retail - Free Standing 2.7%	
85,000	National Retail Properties Inc., Cumulative Redeemable, Series C, 7.375%	2,045,313
70,000	Realty Income Corp., Cumulative Redeemable, Series E, 6.750%	1,674,400
	Total Retail - Free Standing	*3,719,713*
	Shopping Centers 9.4%	
50,000	Cedar Shopping Centers Inc., Cumulative Redeemable, Series A, 8.875%	1,198,500
13,300	Developers Diversified Realty Corp., Cumulative Redeemable, Class G, 8.000%	266,000
209,100	Kimco Realty Corp. Series G, 7.750%	5,133,405
63,800	Urstadt Biddle Properties Inc., Cumulative, Series C, 8.500%	6,204,550
	Total Shopping Centers	*12,802,455*
	Storage 3.4%	
200,000	Public Storage Inc., Cumulative Redeemable, Series L, 6.750%	*4,656,000*
	TOTAL PREFERRED STOCKS (Cost $63,670,170)	55,654,642
	TOTAL INVESTMENTS BEFORE SHORT-TERM INVESTMENT (Cost $138,010,201)	134,802,474
FACE AMOUNT		
SHORT-TERM INVESTMENT 0.6%		
	Repurchase Agreement 0.6%	
$ 810,000	Interest in $283,704,000 joint tri-party repurchase agreement dated 12/31/09 with Barclays Capital Inc., 0.000% due 1/4/10; Proceeds at maturity $810,000; (Fully collateralized by various U.S. government obligations, 1.875% to 3.125% due 2/28/14 to 10/31/16; Market value $826,200) (Cost $810,000)	810,000
	TOTAL INVESTMENTS 100.0% (Cost $138,820,201#)	$ 135,612,474

(a) 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 $139,284,739.

See Notes to Financial Statements.

Statement of assets and liabilities

December 31, 2009

ASSETS:	
Investments, at value (Cost $138,820,201)	$ 135,612,474
Cash	172
Dividends and interest receivable	906,018
Cash deposits with brokers for swap contracts	823,345
Unrealized appreciation on swaps	228,355
Prepaid expenses	1,730
Total Assets	*137,572,094*
LIABILITIES:	
Loan payable (Note 5)	34,000,000
Unrealized depreciation on swaps	516,997
Interest payable (Note 5)	104,174
Investment management fee payable	101,155
Interest payable for open swap contracts	23,533
Directors fees payable	5,621
Accrued expenses	135,514
Total Liabilities	*34,886,994*
TOTAL NET ASSETS	$ 102,685,100
NET ASSETS:	
Par value ($0.001 par value; 11,431,201 shares issued and outstanding; 100,000,000 shares authorized)	$ 11,431
Paid-in capital in excess of par value	139,979,893
Undistributed net investment income	518,440
Accumulated net realized loss on investments, swap contracts and foreign currency transactions	(34,328,226)
Net unrealized depreciation on investments, swap contracts and foreign currencies	(3,496,438)
TOTAL NET ASSETS	$ 102,685,100
Shares Outstanding	11,431,201
Net Asset Value	$8.98

See Notes to Financial Statements.

Statement of operations

For the Year Ended December 31, 2009

INVESTMENT INCOME:	
Dividends	$ 6,988,975
Interest	1,917
Less: Foreign taxes withheld	(25,660)
Total Investment Income	*6,965,232*
EXPENSES:	
Investment management fee (Note 2)	930,663
Interest expense (Note 5)	373,814
Commitment fees (Note 5)	211,063
Legal fees	100,902
Shareholder reports	95,130
Transfer agent fees	58,239
Audit and tax	53,785
Stock exchange listing fees	21,593
Directors fees	16,445
Custody fees	9,935
Insurance	4,810
Miscellaneous expenses	8,274
Total Expenses	*1,884,653*
Less: Fee waivers and/or expense reimbursements (Note 2)	(51,185)
Net Expenses	*1,833,468*
NET INVESTMENT INCOME	5,131,764
REALIZED AND UNREALIZED GAIN (LOSS) ON INVESTMENTS, REIT DISTRIBUTIONS, SWAP CONTRACTS AND FOREIGN CURRENCY TRANSACTIONS (NOTES 1, 3 AND 4):	
Net Realized Loss From:	
Investment transactions	(23,148,432)
REIT distributions	916,318
Swap contracts	(1,056,112)
Foreign currency transactions	(1,570)
Net Realized Loss	*(23,289,796)*
Change in Net Unrealized Appreciation/Depreciation From:	
Investments	56,460,022
Swap contracts	1,108,872
Foreign currencies	56
Change in Net Unrealized Appreciation/Depreciation	*57,568,950*
NET GAIN ON INVESTMENTS, REIT DISTRIBUTIONS, SWAP CONTRACTS AND FOREIGN CURRENCY TRANSACTIONS	34,279,154
INCREASE IN NET ASSETS FROM OPERATIONS	$ 39,410,918

See Notes to Financial Statements.

Statements of changes in net assets

FOR THE YEARS ENDED DECEMBER 31,	2009	2008
OPERATIONS:		
Net investment income	$ 5,131,764	$ 10,121,573
Net realized loss	(23,289,796)	(10,120,365)
Change in net unrealized appreciation/depreciation	57,568,950	(81,595,578)
Distributions paid to taxable auction rate preferred stockholders		(2,336,449)
Increase (Decrease) in Net Assets From Operations	*39,410,918*	*(83,930,819)*
DISTRIBUTIONS TO SHAREHOLDERS FROM (NOTE 1):		
Net investment income	(5,005,137)	(7,976,386)
Net realized gains		(5,481,194)
Return of capital	(5,686,906)	(11,039,452)
Decrease in Net Assets From Distributions to Shareholders	*(10,692,043)*	*(24,497,032)*
FUND SHARE TRANSACTIONS (NOTE 7):		
Proceeds from shares issued on reinvestments of distributions (85,193 and 136,353 shares issued, respectively)	628,877	2,001,570
Increase in Net Assets From Fund Share Transactions	*628,877*	*2,001,570*
INCREASE (DECREASE) IN NET ASSETS	29,347,752	(106,426,281)
NET ASSETS:		
Beginning of year	73,337,348	179,763,629
End of year*	$102,685,100	$ 73,337,348
* Includes undistributed net investment income of:	$ 518,440	$ 643,184

See Notes to Financial Statements.

Statement of cash flows

For the Year Ended December 31, 2009

CASH FLOWS PROVIDED (USED) BY OPERATING ACTIVITIES:	
Interest and dividends received	$ 9,129,776
Operating expenses paid	(1,335,375)
Interest paid	(278,397)
Net sales and maturities of short-term investments	224,000
Realized loss on swap contracts	(1,056,112)
Realized loss on foreign currency transactions	(1,570)
Net change in unrealized appreciation on foreign currencies	56
Purchases of long-term investments	(23,658,962)
Proceeds from disposition of long-term investments	20,046,731
Change in cash deposits with brokers for swap contracts	588,500
Change in payable on swap contracts	3,850
Net Cash Provided by Operating Activities	*3,662,497*
CASH FLOWS PROVIDED (USED) BY FINANCING ACTIVITIES:	
Cash distributions paid on Common Stock	(10,063,166)
Proceeds from loan	6,400,000
Net Cash Used by Financing Activities	*(3,663,166)*
NET DECREASE IN CASH	(669)
Cash, beginning of year	841
Cash, end of year	$ 172
RECONCILIATION OF INCREASE IN NET ASSETS FROM OPERATIONS TO NET CASH FLOWS PROVIDED (USED) BY OPERATING ACTIVITIES:	
Increase in Net Assets From Operations	$ 39,410,918
Increase in investments, at value	(35,594,275)
Increase in swaps, at value	(1,108,872)
Decrease in payable for securities purchased	(132,922)
Decrease in interest and dividends receivable	275,602
Increase in swap contracts payable	3,850
Decrease in deposits with brokers for swap contracts	588,500
Decrease in prepaid expenses	92,012
Increase in interest payable	95,417
Increase in accrued expenses	32,267
Total Adjustments	*(35,748,421)*
NET CASH FLOWS PROVIDED BY OPERATING ACTIVITIES	$ 3,662,497
NON-CASH FINANCING ACTIVITIES:	
Proceeds from reinvestment of dividends	$ 628,877

See Notes to Financial Statements.

Financial highlights

FOR A SHARE OF CAPITAL STOCK OUTSTANDING THROUGHOUT EACH YEAR ENDED DECEMBER 31:

	2009	2008	2007	2006	2005
NET ASSET VALUE, BEGINNING OF YEAR[1]	$6.46	$16.04	$24.53	$20.58	$21.05
INCOME (LOSS) FROM OPERATIONS:					
Net investment income	0.45	0.90	1.13	0.99	0.89
Net realized and unrealized gain (loss)	3.01	(8.10)	(7.04)	5.92	0.63
Distributions paid to taxable auction rate preferred stockholders		(0.21)	(0.46)	(0.42)	(0.24)
Total income (loss) from operations	*3.46*	*(7.41)*	*(6.37)*	*6.49*	*1.28*
Underwriting commissions and offering expenses for the issuance of taxable auction rate cumulative preferred stock					*(0.04)*
LESS DISTRIBUTIONS PAID TO COMMON STOCK SHAREHOLDERS FROM:					
Net investment income	(0.44)	(0.71)	(0.97)	(0.92)	(0.77)
Net realized gains		(0.48)	(1.15)	(1.62)	(0.94)
Return of capital	(0.50)	(0.98)			
Total distributions	*(0.94)*	*(2.17)*	*(2.12)*	*(2.54)*	*(1.71)*
NET ASSET VALUE, END OF YEAR	$8.98	$6.46	$16.04	$24.53	$20.58
MARKET PRICE, END OF YEAR	$8.05	$4.79	$14.52	$21.64	$18.62
Total return, based on NAV[2,3]	*63.57%*	*(49.80)%*	*(27.44)%*	*34.39%*	*7.35%*
Total return, based on Market Price[3]	*97.75%*	*(58.88)%*	*(25.54)%*	*31.04%*	*10.69%*
NET ASSETS, END OF YEAR (MILLIONS)	$103	$73	$180	$272	$228
RATIOS TO AVERAGE NET ASSETS:[4]					
Gross expenses	2.48%	2.27%	1.55%	1.57%[5]	1.49%
Gross expenses, excluding interest expense	1.99	1.89	1.55	1.57[5]	1.49
Net expenses[6,7]	2.42	2.01[8]	1.17	1.09[5]	1.06
Net expenses, excluding interest expense[6,7]	1.92	1.63[8]	1.17	1.09[5]	1.06
Net investment income	6.76	6.83	5.18	4.31	4.27
PORTFOLIO TURNOVER RATE	19%	14%	13%	18%	12%
TAXABLE AUCTION RATE PREFERRED STOCK:[9]					
Total Amount Outstanding (000s)			$95,000	$95,000	$95,000
Asset Coverage Per Share			72,306	96,459	84,957
Involuntary Liquidating Preference Per Share[10]			25,000	25,000	25,000
SUPPLEMENTAL DATA:					
Loans Outstanding, End of Year (000s)	$34,000	$27,600			
Asset Coverage for Loan Outstanding	402%	366%			
Weighted Average Loan (000s)	$27,499	$46,502[11]			
Weighted Average Interest Rate on Loans	1.38%	3.43%			

See Notes to Financial Statements.

Financial highlights *continued*

1 Per share amounts have been calculated using the average shares method.
2 Performance figures may reflect fee waivers and/or expense reimbursements. In the absence of fee waivers and/or expense reimbursements, the total return would have been lower. Past performance is no guarantee of future results.
3 The total return calculation assumes that distributions are reinvested in accordance with the Fund s dividend reinvestment plan. Past performance is no guarantee of future results.
4 Calculated on the basis of average net assets of common stock shareholders. Ratios do not reflect the effect of dividend payments to preferred stockholders.
5 Included in the expense ratios are certain non-recurring restructuring (and reorganization, if applicable) fees that were incurred by the Fund during the period. Without these fees, the gross and net expense ratios would have been 1.49% and 1.05%, respectively.
6 Reflects fee waivers and/or expense reimbursements.
7 LMPFA has contractually agreed to waive a portion of its management fee in the amount of 0.32% of the Fund s average daily managed assets from inception through July 31, 2007, 0.20% of the Fund s average daily Managed Assets fror the 12-month period ended July 31, 2008, and 0.10% of the Fund s average daily Managed Assets for the 12-month period ended July 31, 2009. The waiver was eliminated August 1, 2009.
8 The impact to the expense ratio was less than 0.01% as a result of compensating balance agreements.
9 On September 30, 2002 and July 18, 2005, the Fund issued 2,600 and 1,200 shares, respectively, of Taxable Auction Rate Cumulative Preferred Stock at $25,000 per share. On August 26, 2008, the Fund fully redeemed the 3,800 shares of Taxable Auction Rate Cumulative Preferred Stock.
10 Excludes accrued interest or accumulated undeclared distributions.
11 For the period August 26 through December 31, 2008.

See Notes to Financial Statements.

Notes to financial statements

1. Organization and significant accounting policies

LMP Real Estate Income Fund Inc. (the Fund) was incorporated in Maryland and is registered as a non-diversified, closed-end management investment company under the Investment Company Act of 1940, as amended (the 1940 Act). The Fund s primary investment objective is high current income and the Fund s secondary objective is capital appreciation.

The following are significant accounting policies consistently followed by the Fund and are in conformity with U.S. generally accepted accounting principles (GAAP). Estimates and assumptions are required to be made regarding assets, liabilities and changes in net assets resulting from operations when financial statements are prepared. Changes in the economic environment, financial markets and any other parameters used in determining these estimates could cause actual results to differ. Subsequent events have been evaluated through February 23, 2010, the issuance date of the financial statements.

(a) Investment valuation. Equity securities for which market quotations are available are valued at the last reported sales price or official closing price on the primary market or exchange on which they trade. Debt securities are valued at the mean between the last quoted bid and asked prices provided by an independent pricing service, which are based on transactions in debt obligations, quotations from bond dealers, market transactions in comparable securities and various other relationships between securities. When prices are not readily available, or are determined not to reflect fair value, such as when the value of a security has been significantly affected by events after the close of the exchange or market on which the security is principally traded, but before the Fund calculates its net asset value, the Fund values these securities at fair value as determined in accordance with procedures approved by the Fund s Board of Directors. Short-term obligations with maturities of 60 days or less are valued at amortized cost, which approximates fair value.

The Fund has adopted Financial Accounting Standards Board Codification Topic 820 (formerly, Statement of Financial Accounting Standards No. 157) (ASC Topic 820). ASC Topic 820 establishes a single definition of fair value, creates a three-tier hierarchy as a framework for measuring fair value based on inputs used to value the Fund s investments, and requires additional disclosure about fair value. The hierarchy of inputs is summarized below.

- Level 1 quoted prices in active markets for identical investments
- Level 2 other significant observable inputs (including quoted prices for similar investments, interest rates, prepayment speeds, credit risk, etc.)
- Level 3 significant unobservable inputs (including the Fund s own assumptions in determining the fair value of investments)

The inputs or methodology used for valuing securities are not necessarily an indication of the risk associated with investing in those securities.

Notes to financial statements *continued*

The Fund uses valuation techniques to measure fair value that are consistent with the market approach and/or income approach, depending on the type of the security and the particular circumstance. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable securities. The income approach uses valuation techniques to convert future amounts to a single present amount.

The following is a summary of the inputs used in valuing the Fund s assets carried at fair value:

DESCRIPTION	QUOTED PRICES (LEVEL 1)	OTHER SIGNIFICANT OBSERVABLE INPUTS (LEVEL 2)	SIGNIFICANT UNOBSERVABLE INPUTS (LEVEL 3)	TOTAL
Long-term investments :				
Common stocks	$ 79,147,832			$ 79,147,832
Preferred stocks				
Diversified	8,389,975	1,980,000		10,369,975
Lodging/resorts	1,745,505	4,737,490		6,482,995
Regional malls	1,560,600	1,664,691		3,225,291
Retail-free stading	1,674,400	2,045,313		3,719,713
Other preferred stocks	31,856,668			31,856,668
Total long-term investments	124,374,980	10,427,494		134,802,474
Short-term investment		810,000		810,000
Total investments	$124,374,980	$11,237,494		$135,612,474
Other financial instruments:				
Interest rate swaps		(288,642)		(288,642)
Total other financial instruments		$ (288,642)		$ (288,642)
Total	$124,374,980	$10,948,852		$135,323,832

See Schedule of Investments for additional detailed categorizations.

(b) Repurchase agreements. The Fund may enter into repurchase agreements with institutions that its investment adviser has determined are creditworthy. Each repurchase agreement is recorded at cost. Under the terms of a typical repurchase agreement, a fund takes possession of an underlying debt obligation subject to an obligation of the seller to repurchase, and of the fund to resell, the obligation at an agreed-upon price and time, thereby determining the yield during a fund s holding period. When entering into repurchase agreements, it is the Fund s policy that its custodian or a third party custodian, acting on the Fund s behalf, take possession of the underlying collateral securities, the market value of which, at all times, at least equals the principal amount of the repurchase transaction, including accrued interest. To the extent that any repurchase transaction maturity exceeds one business day, the value of the collateral is marked to market and measured against the value of the agreement to ensure the adequacy of the collateral. If the counterparty defaults, the Fund generally has the right to use the collateral to satisfy the terms of the repurchase transaction. However, if the market value of the collateral declines during the period in which the Fund seeks to assert its rights or if bankruptcy proceedings are commenced with respect to the seller of the security, realization of the collateral by the Fund may be delayed or limited.

(c) Swap agreements. The Fund may invest in swaps for the purpose of managing its exposure to interest rate, credit or market risk, or for other purposes. The use of swaps involves risks that are different from those associated with ordinary portfolio transactions.

Swap contracts are marked to market daily and changes in value are recorded as unrealized appreciation/(depreciation). Gains or losses are realized upon termination of the swap agreement. Periodic payments and premiums received or made by the Fund are recognized in the Statement of Operations as realized gains or losses, respectively. Collateral, in the form of restricted cash or securities, may be required to be held in segregated accounts with the Fund s custodian in compliance with the terms of the swap contracts. Securities held as collateral for swap contracts are identified in the Schedule of Investments and restricted cash, if any, is identified on the Statement of Assets and Liabilities. Risks may exceed amounts recorded in the Statement of Assets and Liabilities. These risks include changes in the returns of the underlying instruments, failure of the counterparties to perform under the contracts terms, and the possible lack of liquidity with respect to the swap agreements.

Payments received or made at the beginning of the measurement period are reflected as a premium or deposit, respectively, on the Statement of Assets and Liabilities. These upfront payments are amortized over the life of the swap and are recognized as realized gain or loss in the Statement of Operations. A liquidation payment received or made at the termination of the swap is recognized as realized gain or loss in the Statement of Operations. Net periodic payments received or paid by the Fund are recognized as realized gain or loss at the time of receipt or payment in the Statement of Operations.

Interest rate swaps. The Fund may enter into interest rate swap contracts. Interest rate swaps are agreements between two parties to exchange cash flows based on a notional principal amount. The Fund may elect to pay a fixed rate and receive a floating rate, or, receive a fixed rate and pay a floating rate on a notional principal amount. The net interest received or paid on interest rate swap agreements is accrued daily as interest income. Interest rate swaps are marked to market daily based upon quotations from market makers and the change, if any, is recorded as an unrealized gain or loss in the Statement of Operations. When a swap contract is terminated early, the Fund records a realized gain or loss equal to the difference between the original cost and the settlement amount of the closing transaction.

The risks of interest rate swaps include changes in market conditions that will affect the value of the contract or changes in the present value of the future

Notes to financial statements *continued*

cash flow streams and the possible inability of the counterparty to fulfill its obligations under the agreement. The Fund s maximum risk of loss from counterparty credit risk is the discounted net value of the cash flows to be received from the counterparty over the contract s remaining life, to the extent that that amount is positive. This risk is mitigated by the posting of collateral by the counterparty to the Fund to cover the Fund s exposure to the counterparty.

(d) Net asset value. The net asset value (NAV) of the Fund s Common Stock is determined on each day the exchange is open for business. It is determined by dividing the value of the net assets available to Common Stock by the total number of shares of Common Stock outstanding. For the purpose of determining the NAV per share of the Common Stock, the value of the Fund s net assets shall be deemed to equal the value of the Fund s assets less the Fund s liabilities.

(e) Foreign currency translation. Investment securities and other assets and liabilities denominated in foreign currencies are translated into U.S. dollar amounts based upon prevailing exchange rates on the date of valuation. Purchases and sales of investment securities and income and expense items denominated in foreign currencies are translated into U.S. dollar amounts based upon prevailing exchange rates on the respective dates of such transactions.

The Fund does not isolate that portion of the results of operations resulting from fluctuations in foreign exchange rates on investments from the fluctuations arising from changes in market prices of securities held. Such fluctuations are included with the net realized and unrealized gain or loss on investments.

Net realized foreign exchange gains or losses arise from sales of foreign currencies, including gains and losses on forward foreign currency contracts, currency gains or losses realized between the trade and settlement dates on securities transactions, and the difference between the amounts of dividends, interest, and foreign withholding taxes recorded on the Fund s books and the U.S. dollar equivalent of the amounts actually received or paid. Net unrealized foreign exchange gains and losses arise from changes in the fair values of assets and liabilities, other than investments in securities, on the date of valuation, resulting from changes in exchange rates.

Foreign security and currency transactions may involve certain considerations and risks not typically associated with those of U.S. dollar denominated transactions as a result of, among other factors, the possibility of lower levels of governmental supervision and regulation of foreign securities markets and the possibility of political or economic instability.

(f) Concentration risk. The Fund invests in securities related to the real estate industry and is subject to the risks of real estate markets, including fluctuating property values, changes in interest rates and other mortgage- related risks.

(g) Security transactions and investment income. Security transactions are accounted for on a trade date basis. Interest income, adjusted for amortization of premium and accretion of discount, is recorded on the accrual basis. Dividend income is recorded on the ex-dividend date. Foreign dividend income is recorded on the ex-dividend date or as soon as practicable after the Fund determines the existence of a dividend declaration after exercising reasonable due diligence. The cost of investments sold is determined by use of the specific identification method. To the extent any issuer defaults or credit event occurs by the issuer, the Fund may halt any additional interest income accruals and consider the realizability of interest accrued up to the date of default or credit event.

(h) Distributions to shareholders. Dividends and distributions to shareholders are recorded monthly by the Fund on the ex-dividend date for the shareholders of common stock. The Fund s policy is to pass through to its shareholders substantially all Real Estate Investment Trust (REIT) distributions and other income it receives, less operating expenses. The character of REIT distributions received from portfolio securities held by the Fund is generally comprised of investment income, long-term capital gains, and return of capital. The Fund reclassifies amounts within the Statement of Operations primarily based on information provided by REITs after the Fund s fiscal year end. In those instances where such information is not available, the Fund estimates the amounts based on amounts reported by the REITs in the prior year. After all remaining REITs report the actual character of distributions paid during the year, the Fund adjusts estimates previously recorded to actual. The character of distributions paid to shareholders disclosed within the Statements of Changes in Net Assets is based on these reclassifications.

Pursuant to its Managed Distribution Policy, the Fund intends to make regular monthly distributions to shareholders at a fixed rate per common share, which rate may be adjusted from time to time by the Fund s Board of Directors. Under Fund s Managed Distribution Policy, if, for any monthly distribution, net investment income and net realized capital gain is less than the amount of the distribution, the difference will be distributed from the Fund s assets (and constitute a return of capital). The Board of Directors may terminate the Managed Distribution Policy at any time, including when certain events would make part of the return of capital taxable to shareholders. Any such termination could have an adverse effect on the market price for Fund s shares.

(i) Cash flow information. The Fund invests in securities and distributes dividends from net investment income and net realized gains, which are paid in cash and may be reinvested at the discretion of shareholders. These activities are reported in the Statement of Changes in Net Assets and additional information on cash receipts and cash payments are presented in the Statement of Cash Flows.

Notes to financial statements *continued*

(j) Compensating balance agreements. The Fund has an arrangement with its custodian bank whereby a portion of the custodian s fees is paid indirectly by credits earned on the Fund s cash deposit with the bank.

(k) Federal and other taxes. It is the Fund s policy to comply with the federal income and excise tax requirements of the Internal Revenue Code of 1986 (the Code), as amended, applicable to regulated investment companies. Accordingly, the Fund intends to distribute its taxable income and net realized gains, if any, to shareholders in accordance with timing requirements imposed by the Code. Therefore, no federal income tax provision is required in the Fund s financial statements.

Management has analyzed the Fund s tax positions taken on federal income tax returns for all open tax years and has concluded that as of December 31, 2009, no provision for income tax is required in the Fund s financial statements. The Fund s federal and state income and federal excise tax returns for tax years for which the applicable statutes of limitations have not expired are subject to examination by Internal Revenue Service and state departments of revenue.

Under the applicable foreign tax laws, a withholding tax may be imposed on interest, dividends and capital gains at various rates.

(l) Reclassification. GAAP requires that certain components of net assets be adjusted to reflect permanent differences between financial and tax reporting. These reclassifications have no effect on net assets or net asset values per share. During the current year, the following reclassifications have been made:

	UNDISTRIBUTED NET INVESTMENT INCOME	ACCUMULATED NET REALIZED LOSS	PAID-IN CAPITAL
(a)	$ 145,963		$(145,963)
(b)	(397,334)	$397,334	

(a) Reclassifications are primarily due to book/tax differences in the treatment of a prior year return of capital.

(b) Reclassifications are primarily due to foreign currency transactions treated as ordinary income for tax purposes, book/tax differences in the treatment of distributions and book/tax differences in the treatment of swap contracts.

2. Investment management agreement and other transactions with affiliates

Legg Mason Partners Fund Advisor, LLC (LMPFA) is the Fund s investment manager and AEW Capital Management, L.P. (AEW) is the Fund s subadviser. LMPFA is a wholly-owned subsidiary of Legg Mason, Inc. (Legg Mason).

LMPFA provides administrative and certain oversight services to the Fund. The Fund pays LMPFA an investment management fee, calculated daily and paid monthly, at an annual rate of 0.90% of the Fund s average daily net assets plus assets attributable to any borrowings used for leverage (Managed Assets).

In addition, LMPFA has contractually agreed to waive a portion of its management fee in the amount of 0.10% of the average daily Managed Assets for the period ended July 31, 2009. The waiver was eliminated August 1, 2009.

During the year ended December 31, 2009, LMPFA waived a portion of its management fee in the amount of $51,185.

LMPFA has delegated to AEW the day-to-day portfolio management of the Fund, except for the management of cash and short-term instruments. For its services, LMPFA pays AEW a fee at an annual rate equal to 50% of the management fee paid by the Fund to LMPFA, net of waivers.

Certain officers and one Director of the Fund are employees of Legg Mason or its affiliates and do not receive compensation from the Fund.

3. Investments

During the year ended December 31, 2009, the aggregate cost of purchases and proceeds from sales of investments (excluding short-term investments) were as follows:

Purchases	$23,526,040
Sales	19,604,288

At December 31, 2009, the aggregate gross unrealized appreciation and depreciation of investments for federal income tax purposes were as follows:

Gross unrealized appreciation	$ 12,784,052
Gross unrealized depreciation	(16,456,317)
Net unrealized depreciation	$ (3,672,265)

At December 31, 2009, the Fund had the following open swap contracts:

SWAP COUNTERPARTY *(REFERENCE ENTITY)*	NOTIONAL AMOUNT	TERMINATION DATE	PERIODIC PAYMENTS MADE BY THE FUND	PERIODIC PAYMENTS RECEIVED BY THE FUND	UPFRONT PREMIUMS PAID/ (RECEIVED)	UNREALIZED APPRECIATION/ (DEPRECIATION)
Interest Rate Swaps:						
Wachovia Bank, N.A.	$ 5,000,000	7/22/12	4.500%	1-Month LIBOR		$(362,067)

Wachovia Bank, N.A.	5,000,000	12/5/10	3.840%	1-Month LIBOR	(154,930)
Wachovia Bank, N.A.	5,000,000	11/25/14	2.395%	1-Month LIBOR	92,428
Wachovia Bank, N.A.	5,000,000	11/25/16	2.915%	1-Month LIBOR	135,927
Total	$20,000,000				$(288,642)

Percentage shown is an annual percentage rate.

Notes to financial statements ***continued***

4. Derivative instruments and hedging activities

Financial Accounting Standards Board Codification Topic 815 (formerly, Statement of Financial Accounting Standards No. 161) (ASC Topic 815) requires enhanced disclosure about an entity s derivative and hedging activities.

Below is a table, grouped by derivative type that provides information about the fair value and the location of derivatives within the Statement of Assets and Liabilities at December 31, 2009.

ASSET DERIVATIVES1

	INTEREST RATE CONTRACTS RISK	OTHER CONTRACTS RISK	TOTAL
Swap contracts	$228,355		$228,355

LIABILITY DERIVATIVES1

	INTEREST RATE CONTRACTS RISK	OTHER CONTRACTS RISK	TOTAL
Swap contracts	$516,997		$516,997

1 Generally, the balance sheet location for asset derivatives is receivables/net unrealized appreciation(depreciation) and for liability derivatives is payables/net unrealized appreciation(depreciation).

The following tables provide information about the effect of derivatives and hedging activities on the Fund s Statement of Operations for the year ended December 31, 2009. The first table provides additional detail about the amounts and sources of gains/(losses) realized on derivatives during the period. The second table provides additional information about the changes in unrealized appreciation/(depreciation) resulting from the Fund s derivatives and hedging activities during the period.

AMOUNT OF REALIZED GAIN OR (LOSS) ON DERIVATIVES RECOGNIZED

	INTEREST RATE CONTRACTS RISK	OTHER CONTRACTS RISK	TOTAL
Swap contracts	$(1,056,112)		$(1,056,112)

CHANGE IN UNREALIZED APPRECIATION/DEPRECIATION ON DERIVATIVES RECOGNIZED

	INTEREST RATE	OTHER CONTRACTS	TOTAL

	CONTRACTS RISK	RISK	
Swap contracts	$1,108,872		$1,108,872

During the year ended December 31, 2009, the Fund had an average notional balance in interest rate swap contracts of $16,923,077.

The Fund has several credit related contingent features that if triggered would allow its derivatives counterparties to close out and demand payment or additional collateral to cover their exposure from the Fund. Credit related contingent features are established between the Fund and its derivatives counterparties to reduce the risk that the Fund will not fulfill its payment obligations to its counterparties. These triggering features include, but are not limited to, a percentage decrease in the Fund s net assets and or percentage decrease in the Fund s Net Asset Value or NAV.

As of December 31, 2009, the total value of derivative positions with credit related contingent features in a net liability position was $516,997. If a contingent feature would have been triggered as of December 31, 2009, the Fund would have been required to pay this amount in cash to its counterparties. The Fund did not hold or post collateral for its swap transactions.

5. Loan

The Fund has a 364-day revolving credit agreement with a financial institution, which allows the Fund to borrow up to an aggregate amount of $75,000,000. Unless renewed, this agreement terminates on August 9, 2010. The Fund pays a quarterly facility fee at an annual rate of 0.20%, on the unutilized portion of the loan. The interest on the loan is calculated at a variable rate based on the LIBOR, Fed Funds or Prime Rates plus any applicable margin. Interest expense related to the loan for the year ended December 31, 2009 was $373,814. For the year ended December 31, 2009, the Fund incurred a commitment fee in the amount of $211,063. For the year ended December 31, 2009 the Fund had an average daily loan balance outstanding of $27.5 million and the weighted average interest rate was 1.38%. At December 31, 2009 the Fund had $34,000,000 of borrowings outstanding per this credit agreement.

6. Taxable auction rate cumulative preferred stock

As of December 31, 2009, the Fund did not have any outstanding shares of Taxable Auction Rate Cumulative Preferred Stock (TARPS). The TARPS was fully redeemed on August 26, 2008.

7. Common stock

Common stock transactions were as follows:

	YEAR ENDED DECEMBER 31, 2009		YEAR ENDED DECEMBER 31, 2008	
	SHARES	AMOUNT	SHARES	AMOUNT
Shares issued on reinvestment	85,193	$628,877	136,353	$2,001,570

Notes to financial statements *continued*

8. Distributions subsequent to December 31, 2009

On February 16, 2010, the Fund s Board declared three distributions, each in the amount of $0.06 per share, payable on April 30, 2010, May 28, 2010 and June 25, 2010 to shareholders of record on April 23, 2010, May 21, 2010 and June 18, 2010, respectively.

On November 16, 2009, the Fund s Board declared three distributions, each in the amount of $0.06 per share, payable on January 29, 2010, February 26, 2010 and March 26, 2010 to shareholders of record on January 22, 2009, February 19, 2010 and March 19, 2010, respectively.

9. Income tax information and distributions to shareholders

The tax character of distributions paid during the fiscal years ended December 31, were as follows:

	2009	2008
Distributions Paid From:		
Ordinary income to common shareholders	$ 5,005,137	$ 7,976,386
Ordinary income to taxable auction rate cumulative preferred stockholders		1,941,866
Net long-term capital gains to common shareholders		5,481,194
Net long-term capital gains to taxable auction rate cumulative preferred stockholders		394,583
Total taxable distributions	$ 5,005,137	$15,794,029
Tax return of capital	5,686,906	11,039,452
Total distributions paid	$10,692,043	$26,833,481

As of December 31, 2009, the components of accumulated earnings on a tax basis were as follows:

Capital loss carryforward*	$(33,863,688)
Other book/tax temporary differences(a)	518,440
Unrealized appreciation/(depreciation)(b)	(3,960,976)
Total accumulated earnings / (losses) net	$(37,306,224)

* As of December 31, 2009, the Fund had the following net capital loss carryforward remaining:

Year of Expiration	Amount
12/31/2017	$(33,863,688)

This amount will be available to offset any future taxable capital gains.

(a) Other book/tax temporary differences are attributable primarily to book/tax differences from real estate investment trusts and book/tax differences in the timing of the deductibility of various expenses.

(b) The differences between book-basis and tax-basis unrealized appreciation / (depreciation) is attributable primarily to the tax deferral of losses on wash sales.

Report of independent registered public accounting firm

The Board of Directors and Shareholders
LMP Real Estate Income Fund Inc.:

We have audited the accompanying statement of assets and liabilities, including the schedule of investments, of LMP Real Estate Income Fund Inc. as of December 31, 2009, and the related statements of operations and cash flows for the year then ended, the statements of changes in net assets for each of the years in the two-year period then ended, and the financial highlights for each of the years in the five-year period then ended. These financial statements and financial highlights are the responsibility of the Fund s management. Our responsibility is to express an opinion on these financial statements and financial highlights based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and financial highlights are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our procedures included confirmation of securities owned as of December 31, 2009, by correspondence with the custodian and broker. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements and financial highlights referred to above present fairly, in all material respects, the financial position of LMP Real Estate Income Fund Inc. as of December 31, 2009, and the results of its operations and its cash flows for the year then ended, the changes in its net assets for each of the years in the two-year period then ended, and the financial highlights for each of the years in the five-year period then ended, in conformity with U.S. generally accepted accounting principles.

New York, New York

February 23, 2010

Board approval of management and subadvisory agreements (unaudited)

Background

The Investment Company Act of 1940 (the 1940 Act) requires that the Board of Directors (the Board) of LMP Real Estate Income Fund Inc. (the Fund), including a majority of its members that are not considered to be interested persons under the 1940 Act (the Independent Directors) voting separately, approve on an annual basis the continuation of the investment management contract (the Management Agreement) with the Fund s manager, Legg Mason Partners Fund Advisor, LLC (the Manager), and the sub-advisory agreement (the Sub-Advisory Agreement) with AEW Capital Management, L.P. (the Sub-Adviser). At a meeting (the Contract Renewal Meeting) held in-person on November 11 and 12, 2009, the Board, including the Independent Directors, considered and approved continuation of each of the Management Agreement and Sub-Advisory Agreement for an additional one-year term. To assist in its consideration of the renewals of the Management Agreement and the Sub-Advisory Agreement, the Board received and considered a variety of information (together with the information provided at the Contract Renewal Meeting, the Contract Renewal Information) about the Manager and Sub-Adviser, as well as the management and sub-advisory arrangements for the Fund and other closed-end funds in the same complex under the Board s supervision (collectively, the Legg Mason Closed-end Funds), certain portions of which are discussed below. A presentation made by the Manager to the Board at the Contract Renewal Meeting in connection with its evaluations of the Management Agreement and the Sub-Advisory Agreement encompassed the Fund and other Legg Mason Closed-end Funds. The Sub-Adviser also made a presentation to the Board at the Contract Renewal Meeting regarding its sub-advisory services to the Fund. In addition to the Contract Renewal Information, the Board received performance and other information throughout the year related to the respective services rendered by the Manager and the Sub-Adviser to the Fund. The Board s evaluation took into account the information received throughout the year and also reflected the knowledge and familiarity gained as members of the Board of the Fund and the other Legg Mason Closed-end Funds with respect to the services provided to the Fund by the Manager.

The Manager provides the Fund with investment advisory and administrative services pursuant to the Management Agreement and the Sub-Adviser provides the Fund with investment sub-advisory services pursuant to the Sub-Advisory Agreement. The discussion below covers both advisory and administrative functions being rendered by the Manager, each such function being encompassed by the Management Agreement, and the investment sub-advisory function being rendered by the Sub-Adviser.

Board approval of management agreement and sub-advisory agreement

In its deliberations regarding renewal of the Management Agreement and the Sub-Advisory Agreement, the Board, including the Independent Directors, considered the factors below.