COHEN & STEERS QUALITY INCOME REALTY FUND INC
Form N-CSRS
September 04, 2015

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 811-10481

Cohen & Steers Quality Income Realty Fund, Inc.
(Exact name of registrant as specified in charter)

| | |
|---|---|
| 280 Park Avenue, New York, NY<br>(Address of principal executive offices) | 10017<br>(Zip code) |

Tina M. Payne

Cohen & Steers Capital Management, Inc.

280 Park Avenue

New York, New York 10017
(Name and address of agent for service)

Registrant s telephone number, including area code: (212) 832-3232

Date of fiscal year end: December 31

Date of reporting period: June 30, 2015

**Item 1. Reports to Stockholders.**

**COHEN & STEERS QUALITY INCOME REALTY FUND, INC.**

To Our Shareholders:

We would like to share with you our report for the six months ended June 30, 2015. The net asset value (NAV) at that date was $12.34 per common share. The Fund's common stock is traded on the New York Stock Exchange (NYSE) and its share price can differ from its NAV; at period end, the Fund's closing price on the NYSE was $10.69.

The total returns, including income, for the Fund and its comparative benchmarks were:

| | Six Months Ended June 30, 2015 |
|---|---|
| Cohen & Steers Quality Income Realty Fund at NAV[a] | 5.13% |
| Cohen & Steers Quality Income Realty Fund at Market Value[a] | 8.64% |
| FTSE NAREIT Equity REIT Index[b] | 5.67% |
| Blended Benchmark 80% FTSE NAREIT Equity REIT Index/ 20% BofA Merrill Lynch REIT Preferred Securities Index[b] | 4.15% |
| S&P 500 Index[b] | 1.23% |

*The performance data quoted represent past performance. Past performance is no guarantee of future results. The investment return and the principal value of an investment will fluctuate and shares, if sold, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. Performance results reflect the effects of leverage, resulting from borrowings under a credit agreement. Current total returns of the Fund can be obtained by visiting our website at cohenandsteers.com. The Fund's returns assume the reinvestment of all dividends and distributions at prices obtained under the Fund's dividend reinvestment plan. Index performance does not reflect the deduction of any fees, taxes or expenses. An investor cannot invest directly in an index. Performance figures for periods shorter than one year are not annualized.*

Managed Distribution Policy

Cohen & Steers Quality Income Realty Fund, Inc. (the Fund), acting in accordance with an exemptive order received from the Securities and Exchange Commission and with approval of its Board of Directors (the Board), adopted a managed distribution policy under which the Fund intends to include long-term capital gains, where applicable, as part of the regular quarterly cash distributions to its shareholders (the Plan). The Plan will give the Fund greater flexibility to realize long-term capital gains

[a] As a closed-end investment company, the price of the Fund's NYSE-traded shares will be set by market forces and can deviate from the NAV per share of the Fund.

[b] The FTSE NAREIT Equity REIT Index is an unmanaged, market-capitalization-weighted index of all publicly traded REITs that invest predominantly in the equity ownership of real estate. The index is designed to reflect the performance of all publicly traded equity REITs as a whole. The BofA Merrill Lynch REIT Preferred Securities Index is a subset of the BofA Merrill Lynch Fixed-Rate Preferred Securities Index including all real estate investment trust issued preferred securities. The S&P 500 Index is an unmanaged index of 500 large-capitalization stocks that is frequently used as a general measure of U.S. stock market performance.

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and to distribute those gains on a regular quarterly basis. In accordance with the Plan, the Fund currently distributes $0.24 per share on a quarterly basis.

The Fund may pay distributions in excess of the Fund's investment company taxable income and net realized gains. This excess would be a return of capital distributed from the Fund's assets. Distributions of capital decrease the Fund's total assets and, therefore, could have the effect of increasing the Fund's expense ratio. In addition, in order to make these distributions, the Fund may have to sell portfolio securities at a less than opportune time.

Shareholders should not draw any conclusions about the Fund's investment performance from the amount of these distributions or from the terms of the Fund's Plan. The Fund's total return based on net asset value is presented in the table above as well as in the Financial Highlights table.

The Plan provides that the Board may amend or terminate the Plan at any time without prior notice to Fund shareholders; however, at this time, there are no reasonably foreseeable circumstances that might cause the termination. The termination of the Plan could have the effect of creating a trading discount (if the Fund's stock is trading at or above net asset value) or widening an existing trading discount.

Market Review

Following a strong start to the year, U.S. real estate investment trusts (REITs) fell back in the second quarter to post negative returns for the six-month period. The group came under pressure amid a difficult combination of mixed economic signals and rising bond yields. Gross domestic product (GDP) contracted at an annualized rate of 0.2% in the first quarter, a sharp contrast with the previous quarter's 2.2% growth. However, other aspects of the U.S. economy were relatively healthy, including job growth, housing activity, bank lending, and consumer confidence and spending.

Sovereign bond yields moved higher in response to generally improving global economic conditions. Better economic data in Europe and Japan helped lift bond yields off record lows reached earlier in the year, and U.S. bond yields rose in tandem, but also in anticipation of a possible Federal Reserve interest-rate hike in 2015. Although rate concerns often weigh on REIT returns in the short term, over longer periods REIT performance has been positively associated with rising rates, both of which tend to be propelled by stronger economic growth.

Returns were negative for most property types, despite continued strong fundamentals for U.S. commercial real estate, as reflected in earnings that generally met high expectations. Health care property REITs ( 11.7% total return) were among the poorest performers in the quarter. The sector underperformed due to its perceived bond-like characteristics in a period of rising yields, even as health care REITs have been transitioning to more economically sensitive business models over the years.

The shopping center and regional mall sectors ( 8.1% and 6.2%, respectively) underperformed, even as tenants continued to exhibit strong interest in proven assets. Self storage companies (3.7%) were top performers, drawing support from strong earnings, with year-over-year rental growth running as high as 10%. Apartment landlords (0.8%) also outperformed with a gain, amid sustained household formation that has kept demand ahead of supply. Even apartments in markets vulnerable to lower oil prices, such as Houston, have so far shown a fair degree of resilience.

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Despite heightened volatility, the REIT market continued to see mergers and acquisitions, including the sale of apartment owner Associated Estates to Brookfield Asset Management, and Blackstone's acquisition of shopping center REIT Excel Trust, both at double-digit premiums to the prevailing share prices. Also of note, Equinix, a data center REIT, announced a $3.6 billion takeover of the U.K.'s Telecity Group. In the office sector ( 5.3%), SL Green Realty said that it would purchase a New York City tower for $2.6 billion, in one of New York's largest-ever property deals.

*REIT Preferred Securities Advanced*

Preferred securities issued by commercial real estate companies had a total return of 1.9% in the period as measured by the BofA Merrill Lynch REIT Preferred Securities Index. Good and improving real estate fundamentals continued to enhance REITs' financial profiles, while favorable technical factors low new supply of REIT preferreds combined with steady demand also supported the group's performance.

Fund Performance

The Fund had a negative total return for the period and underperformed its blended benchmark on a NAV and market price basis. Stock selection in the office sector detracted from relative return, as it did in the industrial ( 11.3% total return in the index) and shopping center sectors. Our overweight and stock selection in the apartment sector helped relative performance. Our underweight and stock selection in health care REITs also contributed to relative performance. Security selection among REIT preferred securities was favorable, although the effect was countered by our underweight in REIT preferreds compared with the blended benchmark.

*Impact of Derivatives on Fund Performance*

The Fund engaged in the buying and selling of single stock options with the intention of enhancing total returns and reducing overall volatility. These contracts did not have a material effect on the Fund's total return during the six-month period ended June 30, 2015.

*Impact of Leverage on Fund Performance*

The Fund employs leverage as part of a yield-enhancement strategy. Leverage, which can increase total return in rising markets (just as it can have the opposite effect in declining markets), significantly detracted from the Fund's performance for the six-month period ended June 30, 2015.

Investment Outlook

We expect U.S. economic activity to accelerate after a slow start to the year, with GDP expanding nearly 2.5% in 2015. Continued employment and wage growth should support further strength in consumer confidence, in our view, and we expect to see a more-pronounced benefit from lower gasoline prices in the coming months. These potentially favorable demand trends should be met with continued low levels of new supply in most sectors.

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Based on our view of a resumed expansion in the U.S. economy, we believe commercial real estate fundamentals will continue to strengthen, driving further increases in cash flows, net asset values and dividend distributions. This top-down perspective has led us to prefer cyclically sensitive short-lease sectors. However, our bottom-up analysis has also identified companies offering compelling relative value in traditionally noncyclical sectors. We believe that one area of potential opportunity at present is health care, where certain stocks are trading at discounts to underlying property values for the first time in years.

Sincerely,

| | |
|---|---|
| ROBERT H. STEERS<br>*Chairman* | JOSEPH M. HARVEY<br>*Portfolio Manager* |
| WILLIAM F. SCAPELL<br>*Portfolio Manager* | THOMAS N. BOHJALIAN<br>*Portfolio Manager* |

JASON YABLON

*Portfolio Manager*

**COHEN & STEERS QUALITY INCOME REALTY FUND, INC.**

*The views and opinions in the preceding commentary are subject to change without notice and are as of the date of the report. There is no guarantee that any market forecast set forth in the commentary will be realized. This material represents an assessment of the market environment at a specific point in time, should not be relied upon as investment advice and is not intended to predict or depict performance of any investment.*

Visit Cohen & Steers online at cohenandsteers.com

For more information about the Cohen & Steers family of mutual funds, visit cohenandsteers.com. Here you will find fund net asset values, fund fact sheets and portfolio highlights, as well as educational resources and timely market updates.

Our website also provides comprehensive information about Cohen & Steers, including our most recent press releases, profiles of our senior investment professionals and their investment approach to each asset class. The Cohen & Steers family of mutual funds invests in major real asset categories including real estate, infrastructure, commodities and natural resource equities, as well as preferred securities and other income solutions.

**COHEN & STEERS QUALITY INCOME REALTY FUND, INC.**

Our Leverage Strategy
(Unaudited)

Our current leverage strategy utilizes borrowings up to the maximum permitted by the Investment Company Act of 1940 to provide additional capital for the Fund, with an objective of increasing the net income available for shareholders. As of June 30, 2015, leverage represented 25% of the Fund's managed assets.

Through a combination of variable and fixed rate financing, the Fund has locked in interest rates on a significant portion of this additional capital for periods expiring in 2017, 2018 and 2019[c] (where we effectively reduce our variable rate obligation and lock in our fixed rate obligation over various terms). Locking in a significant portion of our leveraging costs is designed to protect the dividend-paying ability of the Fund. The use of leverage increases the volatility of the Fund's net asset value in both up and down markets. However, we believe that locking in portions of the Fund's leveraging costs for the various terms partially protects the Fund's expenses from an increase in short-term interest rates.

Leverage Facts[a,b]

| | |
|---|---|
| Leverage (as a % of managed assets) | 25% |
| % Fixed Rate | 85% |
| % Variable Rate | 15% |
| Weighted Average Rate on Financing | 1.9%[c] |
| Weighted Average Term on Financing | 3.2 years[c] |

The Fund seeks to enhance its dividend yield through leverage. The use of leverage is a speculative technique and there are special risks and costs associated with leverage. The net asset value of the Fund's shares may be reduced by the issuance and ongoing costs of leverage. So long as the Fund is able to invest in securities that produce an investment yield that is greater than the total cost of leverage, the leverage strategy will produce higher current net investment income for shareholders. On the other hand, to the extent that the total cost of leverage exceeds the incremental income gained from employing such leverage, shareholders would realize lower net investment income. In addition to the impact on net income, the use of leverage will have an effect of magnifying capital appreciation or depreciation for shareholders. Specifically, in an up market, leverage will typically generate greater capital appreciation than if the Fund were not employing leverage. Conversely, in down markets, the use of leverage will generally result in greater capital depreciation than if the Fund had been unlevered. To the extent that the Fund is required or elects to reduce its leverage, the Fund may need to liquidate investments, including under adverse economic conditions which may result in capital losses potentially reducing returns to shareholders. There can be no assurance that a leveraging strategy will be successful during any period in which it is employed.

[a] Data as of June 30, 2015. Information is subject to change.

[b] See Note 7 in Notes to Financial Statements.

[c] On February 24, 2015, the Fund amended its credit agreement to extend the fixed rate financing terms by three years expiring in 2020, 2021 and 2022. If the amendment was reflected, the weighted average term on financing would be 5.7 years and the weighted average rate on financing will increase as the extended fixed-rate tranches become effective.

**COHEN & STEERS QUALITY INCOME REALTY FUND, INC.**

June 30, 2015

Top Ten Holdings[a]
(Unaudited)

| Security | Value | % of Managed Assets |
|---|---|---|
| Simon Property Group | $115,431,850 | 6.4 |
| Equity Residential | 98,995,204 | 5.5 |
| Vornado Realty Trust | 62,514,633 | 3.5 |
| SL Green Realty Corp. | 58,934,886 | 3.3 |
| UDR | 55,369,204 | 3.1 |
| Host Hotels & Resorts | 46,577,160 | 2.6 |
| Ventas | 45,431,812 | 2.5 |
| Essex Property Trust | 42,369,100 | 2.3 |
| Extra Space Storage | 39,281,419 | 2.2 |
| General Growth Properties | 39,172,915 | 2.2 |

[a] Top ten holdings are determined on the basis of the value of individual securities held. The Fund may also hold positions in other types of securities issued by the companies listed above. See the Schedule of Investments for additional details on such other positions.

Sector Breakdown

(Based on Managed Assets)
(Unaudited)

**COHEN & STEERS QUALITY INCOME REALTY FUND, INC.**

SCHEDULE OF INVESTMENTS

June 30, 2015 (Unaudited)

| | | Number of Shares | Value |
|---|---|---|---|
| COMMON STOCK | | | |
| REAL ESTATE | 107.1% | | |
| DIVERSIFIED | 7.0% | | |
| American Assets Trust[a,b] | | 387,981 | $ 15,212,735 |
| BGP Holdings PLC (Australia) (EUR)[c,d,e] | | 3,927,678 | 0 |
| Gramercy Property Trust | | 717,958 | 16,778,678 |
| Vornado Realty Trust[a,b] | | 658,534 | 62,514,633 |
| | | | 94,506,046 |
| HEALTH CARE | 10.7% | | |
| Health Care REIT[a] | | 561,221 | 36,832,934 |
| Healthcare Trust of America, Class A | | 944,650 | 22,624,368 |
| Omega Healthcare Investors | | 874,743 | 30,029,927 |
| Physicians Realty Trust | | 617,890 | 9,490,790 |
| Ventas[a,b] | | 731,709 | 45,431,812 |
| | | | 144,409,831 |
| HOTEL | 8.1% | | |
| Extended Stay America[a,b] | | 816,698 | 15,329,422 |
| Host Hotels & Resorts[a,b] | | 2,348,823 | 46,577,160 |
| Strategic Hotels & Resorts[a,e] | | 1,491,784 | 18,080,422 |
| Sunstone Hotel Investors | | 1,916,269 | 28,763,198 |
| | | | 108,750,202 |
| INDUSTRIALS | 4.4% | | |
| Prologis[a,b] | | 490,520 | 18,198,292 |
| QTS Realty Trust, Class A | | 470,387 | 17,145,606 |
| STAG Industrial | | 1,172,542 | 23,450,840 |
| | | | 58,794,738 |
| OFFICE | 17.0% | | |
| BioMed Realty Trust[a] | | 1,654,486 | 31,997,759 |
| Boston Properties[a,b] | | 192,744 | 23,329,734 |
| Brandywine Realty Trust[a] | | 1,066,603 | 14,164,488 |
| Douglas Emmett[a,b] | | 828,297 | 22,314,321 |
| Empire State Realty Trust, Class A[a,b] | | 667,962 | 11,395,432 |
| Kilroy Realty Corp. | | 514,830 | 34,570,834 |
| Liberty Property Trust[a,b] | | 1,002,327 | 32,294,976 |
| SL Green Realty Corp.[a,b] | | 536,308 | 58,934,886 |
| | | | 229,002,430 |

See accompanying notes to financial statements.

**COHEN & STEERS QUALITY INCOME REALTY FUND, INC.**

SCHEDULE OF INVESTMENTS (Continued)

June 30, 2015 (Unaudited)

| | | Number of Shares | Value |
|---|---|---|---|
| RESIDENTIAL | 21.7% | | |
| APARTMENT | 19.5% | | |
| American Homes 4 Rent, Class A[a,b] | | 1,394,435 | $ 22,366,737 |
| Apartment Investment & Management Co.[a,b] | | 591,704 | 21,851,629 |
| AvalonBay Communities[a,b] | | 136,572 | 21,833,766 |
| Equity Residential[a,b] | | 1,410,791 | 98,995,204 |
| Essex Property Trust[a,b] | | 199,384 | 42,369,100 |
| UDR[a,b] | | 1,728,667 | 55,369,204 |
| | | | 262,785,640 |
| MANUFACTURED HOME | 2.2% | | |
| Sun Communities | | 474,661 | 29,348,290 |
| TOTAL RESIDENTIAL | | | 292,133,930 |
| SELF STORAGE | 9.2% | | |
| CubeSmart[a,b] | | 838,238 | 19,413,592 |
| Extra Space Storage[a] | | | |