

HEALTHCARE REALTY TRUST INC  
Form 10-Q  
November 01, 2011  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended: September 30, 2011

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from            to

Commission File Number: 001-11852

**HEALTHCARE REALTY TRUST INCORPORATED**

(Exact name of Registrant as specified in its charter)

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**Maryland**  
(State or other jurisdiction of  
incorporation or organization)

**62 1507028**  
(I.R.S. Employer  
Identification No.)

**3310 West End Avenue**

**Suite 700**

**Nashville, Tennessee 37203**

(Address of principal executive offices)

**(615) 269-8175**

(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of October 25, 2011, 77,838,388 shares of the Registrant's Common Stock were outstanding.

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**HEALTHCARE REALTY TRUST INCORPORATED**

**FORM 10-Q**

**September 30, 2011**

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(Dollars in thousands, except per share data)

|                                                                                                                                                                                 | (Unaudited)<br>September 30,<br>2011 | December 31,<br>2010 |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------|----------------------|
| <b>ASSETS</b>                                                                                                                                                                   |                                      |                      |
| Real estate properties:                                                                                                                                                         |                                      |                      |
| Land                                                                                                                                                                            | \$ 164,768                           | \$ 163,020           |
| Buildings, improvements and lease intangibles                                                                                                                                   | 2,432,968                            | 2,310,404            |
| Personal property                                                                                                                                                               | 17,516                               | 17,919               |
| Construction in progress                                                                                                                                                        | 155,489                              | 80,262               |
|                                                                                                                                                                                 | 2,770,741                            | 2,571,605            |
| Less accumulated depreciation                                                                                                                                                   | (506,344)                            | (484,641)            |
| Total real estate properties, net                                                                                                                                               | 2,264,397                            | 2,086,964            |
| Cash and cash equivalents                                                                                                                                                       | 4,054                                | 113,321              |
| Mortgage notes receivable                                                                                                                                                       | 94,588                               | 36,599               |
| Assets held for sale and discontinued operations, net                                                                                                                           | 16,519                               | 23,915               |
| Other assets, net                                                                                                                                                               | 108,015                              | 96,510               |
| Total assets                                                                                                                                                                    | \$ 2,487,573                         | \$ 2,357,309         |
| <b>LIABILITIES AND EQUITY</b>                                                                                                                                                   |                                      |                      |
| Liabilities:                                                                                                                                                                    |                                      |                      |
| Notes and bonds payable                                                                                                                                                         | \$ 1,349,882                         | \$ 1,407,855         |
| Accounts payable and accrued liabilities                                                                                                                                        | 65,202                               | 62,652               |
| Liabilities of discontinued operations                                                                                                                                          | 249                                  | 423                  |
| Other liabilities                                                                                                                                                               | 49,662                               | 43,639               |
| Total liabilities                                                                                                                                                               | 1,464,995                            | 1,514,569            |
| Commitments and contingencies                                                                                                                                                   |                                      |                      |
| Equity:                                                                                                                                                                         |                                      |                      |
| Preferred stock, \$.01 par value; 50,000,000 shares authorized; none issued and outstanding                                                                                     |                                      |                      |
| Common stock, \$.01 par value; 150,000,000 shares authorized; 77,839,098 and 66,071,424 shares issued and outstanding at September 30, 2011 and December 31, 2010, respectively | 779                                  | 661                  |
| Additional paid-in capital                                                                                                                                                      | 1,893,878                            | 1,641,379            |
| Accumulated other comprehensive loss                                                                                                                                            | (5,269)                              | (5,269)              |

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|                                                           |              |              |
|-----------------------------------------------------------|--------------|--------------|
| Cumulative net income attributable to common stockholders | 793,034      | 796,165      |
| Cumulative dividends                                      | (1,659,844)  | (1,593,926)  |
| Total stockholders' equity                                | 1,022,578    | 839,010      |
| Noncontrolling interests                                  |              | 3,730        |
| Total equity                                              | 1,022,578    | 842,740      |
| Total liabilities and equity                              | \$ 2,487,573 | \$ 2,357,309 |

The accompanying notes, together with the Notes to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010, are an integral part of these financial statements.

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**Healthcare Realty Trust Incorporated**  
**Condensed Consolidated Statements of Operations**  
**For the Three Months Ended September 30, 2011 and 2010**

(Dollars in thousands, except per share data)

(Unaudited)

|                                                                  | 2011      | 2010       |
|------------------------------------------------------------------|-----------|------------|
| <b>REVENUES</b>                                                  |           |            |
| Master lease rent                                                | \$ 14,049 | \$ 13,303  |
| Property operating                                               | 57,078    | 47,716     |
| Straight-line rent                                               | 1,109     | 639        |
| Mortgage interest                                                | 1,776     | 601        |
| Other operating                                                  | 2,067     | 2,128      |
|                                                                  | 76,079    | 64,387     |
| <b>EXPENSES</b>                                                  |           |            |
| General and administrative                                       | 5,530     | 4,243      |
| Property operating                                               | 30,851    | 26,681     |
| Impairment                                                       |           | 1,259      |
| Bad debt, net                                                    | (353)     | 39         |
| Depreciation                                                     | 19,959    | 16,975     |
| Amortization                                                     | 2,214     | 1,237      |
|                                                                  | 58,201    | 50,434     |
| <b>OTHER INCOME (EXPENSE)</b>                                    |           |            |
| Interest expense                                                 | (17,928)  | (15,923)   |
| Interest and other income, net                                   | 205       | 187        |
|                                                                  | (17,723)  | (15,736)   |
| <b>INCOME (LOSS) FROM CONTINUING OPERATIONS</b>                  | 155       | (1,783)    |
| <b>DISCONTINUED OPERATIONS</b>                                   |           |            |
| Income from discontinued operations                              | 690       | 485        |
| Impairments                                                      | (1,551)   | (6,102)    |
| Gain on sales of real estate properties                          | 1,357     | 4,092      |
| <b>INCOME (LOSS) FROM DISCONTINUED OPERATIONS</b>                | 496       | (1,525)    |
| <b>NET INCOME (LOSS)</b>                                         | 651       | (3,308)    |
| Less: Net (income) loss attributable to noncontrolling interests | (4)       | 60         |
| <b>NET INCOME (LOSS) ATTRIBUTABLE TO COMMON STOCKHOLDERS</b>     | \$ 647    | \$ (3,248) |
| <b>BASIC EARNINGS (LOSS) PER COMMON SHARE:</b>                   |           |            |
| Income (loss) from continuing operations                         | \$        | \$ (0.03)  |
| Discontinued operations                                          | 0.01      | (0.02)     |

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|                                                                |    |            |    |            |
|----------------------------------------------------------------|----|------------|----|------------|
| Net income (loss) attributable to common stockholders          | \$ | 0.01       | \$ | (0.05)     |
| <b>DILUTED EARNINGS (LOSS) PER COMMON SHARE:</b>               |    |            |    |            |
| Income (loss) from continuing operations                       | \$ |            | \$ | (0.03)     |
| Discontinued operations                                        |    | 0.01       |    | (0.02)     |
| Net income (loss) attributable to common stockholders          | \$ | 0.01       | \$ | (0.05)     |
| <b>WEIGHTED AVERAGE COMMON SHARES OUTSTANDING - BASIC</b>      |    | 76,139,055 |    | 62,369,773 |
| <b>WEIGHTED AVERAGE COMMON SHARES OUTSTANDING - DILUTED</b>    |    | 77,177,114 |    | 62,369,773 |
| <b>DIVIDENDS DECLARED, PER COMMON SHARE, DURING THE PERIOD</b> | \$ | 0.30       | \$ | 0.30       |

The accompanying notes, together with the Notes to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010, are an integral part of these financial statements.

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**Healthcare Realty Trust Incorporated**  
**Condensed Consolidated Statements of Operations**  
**For the Nine Months Ended September 30, 2011 and 2010**

(Dollars in thousands, except per share data)

(Unaudited)

|                                                              | 2011              | 2010            |
|--------------------------------------------------------------|-------------------|-----------------|
| <b>REVENUES</b>                                              |                   |                 |
| Master lease rent                                            | \$ 43,312         | \$ 41,056       |
| Property operating                                           | 163,280           | 140,008         |
| Straight-line rent                                           | 3,536             | 1,989           |
| Mortgage interest                                            | 5,250             | 1,708           |
| Other operating                                              | 6,425             | 6,399           |
|                                                              | 221,803           | 191,160         |
| <b>EXPENSES</b>                                              |                   |                 |
| General and administrative                                   | 16,469            | 12,513          |
| Property operating                                           | 87,423            | 75,116          |
| Impairment                                                   |                   | 1,259           |
| Bad debt, net                                                | (80)              | (438)           |
| Depreciation                                                 | 57,928            | 49,582          |
| Amortization                                                 | 5,753             | 3,869           |
|                                                              | 167,493           | 141,901         |
| <b>OTHER INCOME (EXPENSE)</b>                                |                   |                 |
| Loss on extinguishment of debt                               | (1,986)           | (480)           |
| Interest expense                                             | (57,546)          | (47,803)        |
| Interest and other income, net                               | 636               | 1,799           |
|                                                              | (58,896)          | (46,484)        |
| <b>INCOME (LOSS) FROM CONTINUING OPERATIONS</b>              | <b>(4,586)</b>    | <b>2,775</b>    |
| <b>DISCONTINUED OPERATIONS</b>                               |                   |                 |
| Income from discontinued operations                          | 1,791             | 2,878           |
| Impairments                                                  | (1,698)           | (6,102)         |
| Gain on sales of real estate properties                      | 1,393             | 8,313           |
| <b>INCOME FROM DISCONTINUED OPERATIONS</b>                   | <b>1,486</b>      | <b>5,089</b>    |
| <b>NET INCOME (LOSS)</b>                                     | <b>(3,100)</b>    | <b>7,864</b>    |
| Less: Net income attributable to noncontrolling interests    | (31)              | (44)            |
| <b>NET INCOME (LOSS) ATTRIBUTABLE TO COMMON STOCKHOLDERS</b> | <b>\$ (3,131)</b> | <b>\$ 7,820</b> |
| <b>BASIC EARNINGS (LOSS) PER COMMON SHARE:</b>               |                   |                 |
| Income (loss) from continuing operations                     | \$ (0.06)         | \$ 0.05         |
| Discontinued operations                                      | 0.02              | 0.08            |



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|                                                                |            |            |
|----------------------------------------------------------------|------------|------------|
| Net income (loss) attributable to common stockholders          | \$ (0.04)  | \$ 0.13    |
| <b>DILUTED EARNINGS (LOSS) PER COMMON SHARE:</b>               |            |            |
| Income (loss) from continuing operations                       | \$ (0.06)  | \$ 0.05    |
| Discontinued operations                                        | 0.02       | 0.08       |
| Net income (loss) attributable to common stockholders          | \$ (0.04)  | \$ 0.13    |
| <b>WEIGHTED AVERAGE COMMON SHARES OUTSTANDING - BASIC</b>      | 71,478,463 | 61,232,810 |
| <b>WEIGHTED AVERAGE COMMON SHARES OUTSTANDING - DILUTED</b>    | 71,478,463 | 62,269,413 |
| <b>DIVIDENDS DECLARED, PER COMMON SHARE, DURING THE PERIOD</b> | \$ 0.90    | \$ 0.90    |

The accompanying notes, together with the Notes to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010, are an integral part of these financial statements.

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**Healthcare Realty Trust Incorporated**  
**Condensed Consolidated Statements of Cash Flows**  
**For the Nine Months Ended September 30, 2011 and 2010**

(Dollars in thousands)

(Unaudited)

|                                                                                      | 2011       | 2010      |
|--------------------------------------------------------------------------------------|------------|-----------|
| <b>OPERATING ACTIVITIES</b>                                                          |            |           |
| Net income (loss)                                                                    | \$ (3,100) | \$ 7,864  |
| Adjustments to reconcile net income (loss) to cash provided by operating activities: |            |           |
| Depreciation and amortization                                                        | 67,384     | 57,484    |
| Stock-based compensation                                                             | 2,272      | 1,845     |
| Straight-line rent receivable                                                        | (3,493)    | (1,923)   |
| Straight-line rent liability                                                         | 369        | 309       |
| Gain on sales of real estate properties                                              | (1,393)    | (8,313)   |
| Loss on extinguishment of debt                                                       | 1,986      | 480       |
| Impairments                                                                          | 1,698      | 7,361     |
| Provision for bad debt, net                                                          | (65)       | (418)     |
| Payment of partial pension settlement                                                |            | (342)     |
| Changes in operating assets and liabilities:                                         |            |           |
| Other assets                                                                         | (4,532)    | (6,923)   |
| Accounts payable and accrued liabilities                                             | (1,380)    | 9,358     |
| Other liabilities                                                                    | 7,500      | 2,193     |
| Net cash provided by operating activities                                            | 67,246     | 68,975    |
| <b>INVESTING ACTIVITIES</b>                                                          |            |           |
| Acquisition and development of real estate properties                                | (179,851)  | (183,653) |
| Funding of mortgages and notes receivable                                            | (91,978)   | (13,921)  |
| Proceeds from sales of real estate                                                   | 4,993      | 33,321    |
| Proceeds from mortgages and notes receivable repayments                              | 14,988     | 7,385     |
| Net cash used in investing activities                                                | (251,848)  | (156,868) |
| <b>FINANCING ACTIVITIES</b>                                                          |            |           |
| Net borrowings on unsecured credit facility                                          | 175,000    | 81,000    |
| Repayments on notes and bonds payable                                                | (2,537)    | (1,759)   |
| Repurchase of notes payable                                                          | (280,201)  | (8,556)   |
| Dividends paid                                                                       | (65,918)   | (56,481)  |
| Proceeds from issuance of common stock                                               | 251,836    | 79,444    |
| Common stock redemptions                                                             | (51)       |           |
| Capital contributions received from noncontrolling interests                         |            | 686       |
| Distributions to noncontrolling interest holders                                     | (281)      | (399)     |
| Purchase of noncontrolling interests                                                 | (1,591)    |           |
| Debt issuance and assumption costs                                                   | (922)      | (716)     |
| Net cash provided by financing activities                                            | 75,335     | 93,219    |
| Increase (decrease) in cash and cash equivalents                                     | (109,267)  | 5,326     |
| Cash and cash equivalents, beginning of period                                       | 113,321    | 5,851     |

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|                                          |          |           |
|------------------------------------------|----------|-----------|
| Cash and cash equivalents, end of period | \$ 4,054 | \$ 11,177 |
|------------------------------------------|----------|-----------|

**Supplemental Cash Flow Information:**

|                                                                                   |           |           |
|-----------------------------------------------------------------------------------|-----------|-----------|
| Interest paid                                                                     | \$ 61,253 | \$ 40,048 |
| Capitalized interest                                                              | \$ 6,402  | \$ 7,729  |
| Company-financed real estate property sales                                       | \$ 2,700  | \$        |
| Invoices accrued for construction, tenant improvement and other capitalized costs | \$ 17,075 | \$ 11,914 |
| Mortgage notes payable assumed upon acquisition (adjusted to fair value)          | \$ 46,832 | \$        |
| Mortgage note payable disposed of upon sale of joint venture interest             | \$        | \$ 19,880 |
| Elimination of mortgage note upon consolidation of VIE                            | \$ 21,939 | \$        |

The accompanying notes, together with the Notes to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010, are an integral part of these financial statements.

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**Healthcare Realty Trust Incorporated**

**Notes to Condensed Consolidated Financial Statements**

**September 30, 2011**

(Unaudited)

**Note 1. Summary of Significant Accounting Policies**

*Business Overview*

Healthcare Realty Trust Incorporated (the Company) is a real estate investment trust (REIT) that owns, acquires, manages, finances, and develops income-producing real estate properties associated primarily with the delivery of outpatient healthcare services throughout the United States. The Company had investments of approximately \$2.9 billion in 219 real estate properties and mortgages as of September 30, 2011, excluding assets classified as held for sale and including an investment in one unconsolidated joint venture. The Company's 208 owned real estate properties, excluding assets classified as held for sale, are comprised of three facility types, located in 29 states, totaling approximately 13.9 million square feet. As of September 30, 2011, the Company provided property management services to approximately 10.0 million square feet nationwide.

*Principles of Consolidation*

The Condensed Consolidated Financial Statements include the accounts of the Company, its wholly-owned subsidiaries, joint ventures, partnerships and variable interest entities (VIE) where the Company controls the operating activities.

In accordance with consolidations accounting standards, the Company must evaluate each contractual relationship to determine whether or not it creates a VIE. Furthermore, the Company must evaluate each VIE to determine whether or not it is the primary beneficiary, resulting in consolidation of the VIE. A primary beneficiary has the power to direct the activities of the VIE that most significantly impacts the entity's economic performance and has the obligation to absorb the losses of, or receive the benefits from, the entity. During the third quarter of 2011, the Company concluded that it had become the primary beneficiary of a VIE in which the Company held a variable interest through one of its construction mortgage loans when the Company began overseeing and managing the construction project. As a result of its conclusion, the Company consolidated the VIE (borrower) which held the mortgage note payable to the Company. Upon consolidation, the Company eliminated the VIE's mortgage note payable and interest against the Company's mortgage note receivable and interest and reclassified the costs incurred on the project to construction in progress at fair value, which the Company determined to approximate the carrying value of the mortgage note plus accrued but unpaid construction-related invoices. The mortgage note receivable/payable eliminated on the Company's Condensed Consolidated Financial Statements was approximately \$28.4 million at September 30, 2011 and the construction in progress asset (including accrued invoices) totaled approximately \$32.7 million at September 30, 2011. The creditors of the VIE (borrower) have no recourse against the general credit of the Company.

The Company also concluded that it had two other construction mortgage loans aggregating approximately \$31.0 million at September 30, 2011 in which each borrower has been identified as a VIE, but the Company had determined that it was not the primary beneficiary. The Company's maximum exposure to loss related to these two unconsolidated VIEs at September 30, 2011 equaled the Company's related aggregate loan investment.

During the first quarter of 2011, the Company purchased the remaining noncontrolling equity interest in its two consolidated joint ventures. The noncontrolling interest holder in both joint ventures was an affiliate of Ladco Development Inc. Prior to the purchase, the noncontrolling interests were reported as equity and the related net income (loss) attributable to the noncontrolling interests as part of consolidated net income in the Company's Condensed Consolidated Financial Statements. The Company's investment in its one unconsolidated joint venture, which is carried at cost, is included in other assets with its related income recognized in other income (expense) in the Company's Condensed Consolidated Financial Statements.

The Condensed Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements that are included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010. Management believes, however, that all adjustments of a normal, recurring nature considered necessary for a fair presentation have been included. All material intercompany transactions and balances

have been eliminated in consolidation.

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**Notes to Condensed Consolidated Financial Statements-Continued**

This interim financial information should be read in conjunction with the financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations included in this report and in the Company's Annual Report on Form 10-K for the year ended December 31, 2010. This interim financial information does not necessarily represent or indicate what the operating results will be for the year ending December 31, 2011 for many reasons including, but not limited to, acquisitions, dispositions, capital financing transactions, changes in interest rates and the effects of other trends and uncertainties.

*Use of Estimates in the Condensed Consolidated Financial Statements*

Preparation of the Condensed Consolidated Financial Statements in accordance with GAAP requires management to make estimates and assumptions that affect amounts reported in the Condensed Consolidated Financial Statements and accompanying notes. Actual results may differ from those estimates.

*Segment Reporting*

The Company owns, acquires, manages, finances, and develops outpatient and other healthcare-related properties. The Company is managed as one operating segment, rather than multiple operating segments, for internal reporting purposes and for internal decision-making. Therefore, the Company discloses its operating results in a single segment.

*Reclassifications*

Certain amounts in the Company's Condensed Consolidated Financial Statements for prior periods have been reclassified to conform to the current period presentation. Assets sold or held for sale, and related liabilities, have been reclassified in the Company's Condensed Consolidated Balance Sheets, and the operating results of those assets have been reclassified from continuing to discontinued operations for all periods presented. The Company also reclassified one property from discontinued operations to continuing operations in the first quarter of 2011 as discussed in Note 3. The related impairment on this property recorded in the third quarter of 2010 was also reclassified from discontinued operations to continuing operations.

*Revenue Recognition*

General

The Company recognizes revenue when it is realized or realizable and earned. There are four criteria that must be met before a company may recognize revenue, including: persuasive evidence that an arrangement exists; delivery has occurred or services have been rendered (i.e., the tenant has taken possession of and controls the physical use of the leased asset); the price has been fixed or is determinable; and collectability is reasonably assured. Income received but not yet earned is deferred until such time it is earned. Deferred revenue is included in other liabilities in the Company's Condensed Consolidated Balance Sheets.

The Company derives most of its revenues from its real estate and mortgage notes receivable portfolio. The Company's rental and mortgage interest income is recognized based on contractual arrangements with its tenants, sponsors or borrowers. These contractual arrangements generally fall into three categories: leases, mortgage notes receivable, and property operating agreements as described in the following paragraphs. The Company may accrue late fees based on the contractual terms of a lease or note. Such fees, if accrued, are included in master lease rent, property operating income, or mortgage interest income in the Company's Condensed Consolidated Statements of Operations, based on the type of contractual agreement.

Rental Income

Rental income related to non-cancelable operating leases is recognized as earned over the life of the lease agreements on a straight-line basis. The Company's lease agreements generally include provisions for stated annual increases or increases based on a Consumer Price Index. The Company's multi-tenant office lease arrangements also generally allow for operating expense recoveries which the Company calculates and bills to its tenants. Rental income from properties under master lease arrangements with tenants is included in master lease rent and rental income from properties with multi-tenant office lease arrangements is included in property operating income in the Company's Condensed Consolidated

Statements of Operations.

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**Notes to Condensed Consolidated Financial Statements-Continued**

**Interest Income**

Mortgage interest income and notes receivable interest income are recognized based on the interest rates and maturity date or amortization period specific to each note. Loan origination fees received are deferred and are recognized in mortgage interest income over the estimated life of the loan.

**Property Operating Income**

At September 30, 2011, the Company had eight real estate properties subject to property operating agreements that obligate the sponsoring health system to provide to the Company a minimum return on the Company's investment in the property in exchange for the right to be involved in the operating decisions of the property, including tenancy. If the minimum return is not achieved through normal operations of the property, the sponsor is responsible to the Company for the shortfall under the terms of these agreements. The Company recognizes any shortfall income in other operating income in the Company's Condensed Consolidated Statements of Operations. Property operating agreement payments totaling approximately \$0.5 million per quarter on two of the Company's properties in New Orleans expired on September 30, 2011.

**Accumulated Other Comprehensive Loss**

A company must include certain items in comprehensive income (loss), such as foreign currency translation adjustments, minimum pension liability adjustments, and unrealized gains or losses on available-for-sale securities. The Company's accumulated other comprehensive loss includes pension liability adjustments, which are generally recognized in the fourth quarter of each year.

**Income Taxes**

The Company intends at all times to qualify as a REIT under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended. Accordingly, no provision has been made for federal income taxes. The Company must distribute at least 90% of its REIT taxable income per annum to its stockholders and meet other requirements to continue to qualify as a REIT.

The Company must pay certain state income taxes which are generally included in general and administrative expense in the Company's Condensed Consolidated Statements of Operations.

The Company classifies interest and penalties related to uncertain tax positions, if any, in its Condensed Consolidated Financial Statements as a component of general and administrative expense.

**Incentive Plans**

The Company has various outstanding employee and non-employee stock-based awards, including restricted stock issued under its incentive plans, and options granted to employees pursuant to its employee stock purchase plan (the Employee Stock Purchase Plan). The Company recognizes compensation expense for these awards based on the grant date fair value of the awards ratably over the requisite service period.

**Accounting for Defined Benefit Pension Plans**

The Company has a retirement plan (the Executive Retirement Plan) under which three of the Company's founding officers may receive certain benefits upon retirement. The plan is unfunded and benefits will be paid from cash flows of the Company. The maximum annual benefits payable to each individual under the Executive Retirement Plan have been frozen at \$896,000, subject to cost-of-living adjustments. The Company recognizes pension expense on an accrual basis over an estimated service period. The Company calculates pension expense and the corresponding liability annually on the measurement date (December 31) which requires certain assumptions, such as a discount rate and the recognition of actuarial gains and losses.

The Company also had a pension plan under which the Company's non-employee directors would receive certain retirement benefits. That plan was terminated and lump sum payments totaling \$2.6 million were made during 2010 (\$0.3 million in the second quarter of 2010 and \$2.3 million in the fourth quarter of 2010) to those directors who participated in the plan.





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### **Notes to Condensed Consolidated Financial Statements-Continued**

#### *Operating Leases*

As described in more detail in the Company's Annual Report on Form 10-K for the year ended December 31, 2010, the Company is obligated under operating lease agreements consisting primarily of its corporate office lease and various ground leases related to the Company's real estate investments where the Company is the lessee.

#### *Discontinued Operations and Assets Held for Sale*

The Company sells properties from time to time due to a variety of factors, including among other things, market conditions or the exercise of purchase options by tenants. The operating results of properties that have been sold or are held for sale are reported as discontinued operations in the Company's Condensed Consolidated Statements of Operations. A company must report discontinued operations when a component of an entity has either been disposed of or is deemed to be held for sale if (i) both the operations and cash flows of the component have been or will be eliminated from ongoing operations as a result of the disposal transaction, and (ii) the entity will not have any significant continuing involvement in the operations of the component after the disposal transaction. Long-lived assets classified as held for sale in the Company's Condensed Consolidated Balance Sheets are reported at the lower of their carrying amount or their estimated fair value less cost to sell. Further, depreciation of these assets ceases at the time the assets are classified as discontinued operations. Losses resulting from the sale or anticipated sale of such properties are characterized as impairment losses relating to discontinued operations in the Company's Condensed Consolidated Statements of Operations. See Note 3 for a detail of the Company's assets held for sale and discontinued operations.

#### *Land Held for Development*

Land held for development, which is included in construction in progress in the Company's Condensed Consolidated Balance Sheets, includes parcels of land owned by the Company, upon which the Company intends to develop and own outpatient healthcare facilities.

#### *Fair Value Measurements*

Fair value is defined as the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants. In calculating fair value, a company must maximize the use of observable market inputs, minimize the use of unobservable market inputs and disclose in the form of an outlined hierarchy the details of such fair value measurements.

A hierarchy of valuation techniques is defined to determine whether the inputs to a fair value measurement are considered to be observable or unobservable in a marketplace. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions. This hierarchy requires the use of observable market data when available. These inputs have created the following fair value hierarchy:

*Level 1* quoted prices for identical instruments in active markets;

*Level 2* quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which significant inputs and significant value drivers are observable in active markets; and

*Level 3* fair value measurements derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

In connection with the sale of a medical office building in the third quarter of 2011, the Company recorded an impairment charge based on the contractual sales price, a level one input.

#### *Real Estate Properties*

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Real estate properties are recorded at cost or fair value, if acquired. Cost or fair value at the time of acquisition is allocated between land, buildings, tenant improvements, lease and other intangibles, and personal property.

Periodically, the Company will eliminate fully-depreciated assets that are no longer in use against the respective accumulated depreciation balances. During the second quarter of 2011, the Company eliminated approximately \$40.0 million of fully amortized real estate lease intangibles that were initially recorded as part of certain real estate acquisitions against the respective accumulated depreciation balances. Also, during the third quarter of 2011, the Company eliminated approximately \$1.1 million of personal property and equipment against the respective accumulated depreciation balances.

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**Table of Contents****Notes to Condensed Consolidated Financial Statements-Continued**

The Company also capitalizes direct construction and development costs, including interest, to all consolidated real estate properties that are under construction and substantive activities are ongoing to prepare the asset for its intended use. The Company considers a building as substantially complete and held available for occupancy upon the completion of tenant improvements, but no later than one year from cessation of major construction activity. Development costs incurred after a project is substantially complete and ready for its intended use, or after development activities have ceased, are expensed as incurred.

*Mortgage Loans*

Loans receivable may be classified as held-for-investment or held-for-sale based on a lender's intent and ability to hold the loans. Loans held-for-investment are carried at amortized cost and are reduced by valuation allowances for estimated credit losses as necessary. Loans held-for-sale are carried at the lower of cost or fair value. All of the Company's loans receivable are classified as held-for-investment.

*Allowance for Doubtful Accounts and Credit Losses*

Management monitors the aging and collectibility of its accounts receivable balances on an ongoing basis. Whenever deterioration in the timeliness of payment from a tenant or sponsor is noted, management investigates and determines the reason(s) for the delay. Considering all information gathered, management's judgment is exercised in determining whether a receivable is potentially uncollectible and, if so, how much or what percentage may be uncollectible. Among the factors management considers in determining collectibility are: the type of contractual arrangement under which the receivable was recorded (e.g., a triple net lease, a gross lease, a sponsor guaranty agreement, or some other type of agreement); the tenant's reason for slow payment; industry influences under which the tenant operates; evidence of willingness and ability of the tenant to pay the receivable; credit-worthiness of the tenant; collateral, security deposit, letters of credit or other monies held as security; tenant's historical payment pattern; other contractual agreements between the tenant and the Company; relationship between the tenant and the Company; the state in which the tenant operates; and the existence of a guarantor and the willingness and ability of the guarantor to pay the receivable. Considering these factors and others, management concludes whether all or some of the aged receivable balance is likely uncollectible. Upon determining that some portion of the receivable is likely uncollectible, the Company records a provision for bad debts for the amount it expects will be uncollectible. When efforts to collect a receivable are exhausted, the receivable amount is charged off against the allowance.

The Company also evaluates collectibility of its mortgage notes and notes receivable and records an allowance on the notes as necessary. A loan is impaired when it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan as scheduled, including both contractual interest and principal payments. If a mortgage loan or note receivable becomes past due, the Company will review the specific circumstances and may discontinue the accrual of interest on the loan. The loan is not returned to accrual status until the debtor has demonstrated the ability to continue debt service in accordance with the contractual terms. Loans placed on non-accrual status will be accounted for either on a cash basis, in which income is recognized only upon receipt of cash, or on a cost-recovery basis, in which all cash receipts reduce the carrying value of the loan, based on the Company's expectation of future collectibility.

*New Pronouncements*

In September 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-08, Intangibles Goodwill and Other (Topic 350), Testing Goodwill for Impairment. This standard simplifies the process a company must go through to test goodwill for impairment. Companies will have an option to first assess qualitative factors of a reporting unit being tested before having to assess quantitative factors. If a company believes no impairment exists based on qualitative factors, then it will no longer be required to perform the two-step quantitative impairment test. The standard will be effective for the Company on January 1, 2012 although early adoption is permitted. The adoption will not have a material impact on the Company's results of operations or financial position.

In June 2011, the FASB issued ASU 2011-05, Presentation of Comprehensive Income. This standard requires companies to retrospectively present comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements, and eliminates the current option of presenting components of comprehensive income as part of the statement of changes in stockholders' equity. The standard will be effective for the Company on January 1, 2012 although early adoption is permitted. The adoption of will not have a material impact on the Company's results of operations or financial position.



**Table of Contents****Notes to Condensed Consolidated Financial Statements-Continued****Note 2. Real Estate and Mortgage Notes Receivable Investments**

The Company had investments of approximately \$2.9 billion in 219 real estate properties and mortgage notes receivable as of September 30, 2011, excluding assets classified as held for sale and including an investment in one unconsolidated joint venture. The Company's 208 owned real estate properties, excluding assets classified as held for sale, are located in 29 states and comprise approximately 13.9 million total square feet. The table below details the Company's investments.

| <i>(Dollars and Square Feet in thousands)</i>         | Number<br>of<br>Investments | Gross Investment<br>Amount | %            | Square Feet<br>Footage | %             |
|-------------------------------------------------------|-----------------------------|----------------------------|--------------|------------------------|---------------|
| <b>Owned properties:</b>                              |                             |                            |              |                        |               |
| <i>Master leases</i>                                  |                             |                            |              |                        |               |
| Medical office/outpatient                             | 24                          | \$ 211,882                 | 7.4%         | 1,167                  | 8.4%          |
| Inpatient                                             | 14                          | 329,924                    | 11.5%        | 1,072                  | 7.7%          |
| Other                                                 | 2                           | 9,545                      | 0.3%         | 91                     | 0.7%          |
|                                                       | 40                          | 551,351                    | 19.2%        | 2,330                  | 16.8%         |
| <i>Property operating agreements</i>                  |                             |                            |              |                        |               |
| Medical office/outpatient                             | 8                           | 83,089                     | 2.9%         | 624                    | 4.5%          |
|                                                       | 8                           | 83,089                     | 2.9%         | 624                    | 4.5%          |
| <i>Multi-tenanted with occupancy leases</i>           |                             |                            |              |                        |               |
| Medical office/outpatient                             | 145                         | 1,709,708                  | 59.7%        | 9,308                  | 66.9%         |
| Medical office/outpatient - stabilization in progress | 8                           | 237,192                    | 8.3%         | 808                    | 5.8%          |
| Other                                                 | 2                           | 19,648                     | 0.7%         | 256                    | 1.8%          |
|                                                       | 155                         | 1,966,548                  | 68.7%        | 10,372                 | 74.5%         |
| <i>Construction in progress</i>                       |                             |                            |              |                        |               |
| Medical office/outpatient                             | 4                           | 101,970                    | 3.6%         | 474                    | 3.4%          |
| Inpatient                                             | 1                           | 32,746                     | 1.1%         | 114                    | 0.8%          |
| Land held for development                             |                             | 20,773                     | 0.7%         |                        |               |
|                                                       | 5                           | 155,489                    | 5.4%         | 588                    | 4.2%          |
| <i>Corporate property</i>                             |                             |                            |              |                        |               |
|                                                       |                             | 14,264                     | 0.5%         |                        |               |
| <b>Total owned properties</b>                         | <b>208</b>                  | <b>2,770,741</b>           | <b>96.7%</b> | <b>13,914</b>          | <b>100.0%</b> |
| <b>Mortgage notes receivable:</b>                     |                             |                            |              |                        |               |
| Medical office/outpatient                             | 8                           | 39,611                     | 1.4%         |                        |               |
| Inpatient                                             | 1                           | 14,977                     | 0.5%         |                        |               |
| Other                                                 | 1                           | 40,000                     | 1.4%         |                        |               |
|                                                       | 10                          | 94,588                     | 3.3%         |                        |               |
| <b>Unconsolidated joint venture:</b>                  |                             |                            |              |                        |               |
| Other                                                 | 1                           | 1,266                      | %            |                        |               |
|                                                       | 1                           | 1,266                      | %            |                        |               |

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|                                      |     |              |        |
|--------------------------------------|-----|--------------|--------|
| <b>Total real estate investments</b> | 219 | \$ 2,866,595 | 100.0% |
|--------------------------------------|-----|--------------|--------|

*Mortgage Notes Receivable*

All of the Company's mortgage notes receivable are classified as held-for-investment based on management's intent and ability to hold the loans until maturity. As such, the loans are carried at amortized cost. A summary of the Company's mortgage notes receivable is shown in the table below:

**Table of Contents****Notes to Condensed Consolidated Financial Statements-Continued**

| <i>(Dollars in thousands)</i> | September 30, 2011 |                  |           | December 31, 2010 |                  |           |
|-------------------------------|--------------------|------------------|-----------|-------------------|------------------|-----------|
|                               | Principal Balance  | Unamortized Fees | Total     | Principal Balance | Unamortized Fees | Total     |
| Construction mortgage notes   | \$ 48,202          | \$               | \$ 48,202 | \$ 18,409         | \$ 430           | \$ 17,979 |
| Other mortgage loans          | 46,386             |                  | 46,386    | 18,620            |                  | 18,620    |
|                               | \$ 94,588          | \$               | \$ 94,588 | \$ 37,029         | \$ 430           | \$ 36,599 |

As of September 30, 2011, approximately \$51.8 million, or 54.7%, of the Company's mortgage notes receivable were due from affiliates of Ladco. Except as otherwise described below, Ladco was performing under each of these loans in accordance with the respective loan agreements as of September 30, 2011. At September 30, 2011, the Company had two construction mortgage notes receivable with principal balances totaling \$4.4 million on nonaccrual status with recorded allowances on the interest receivables totaling approximately \$0.3 million. In October 2011, the Company took ownership of the two parcels of land that secured these two construction mortgage loans and plans to eventually construct outpatient facilities on the two sites. On October 21, 2011, a Ladco-affiliated construction mortgage note with \$2.2 million outstanding at September 30, 2011 was repaid in full by the borrower with proceeds from the sale of the property securing the loan. Also, on October 21, 2011, another Ladco-affiliated property securing a \$3.7 million mortgage loan was sold and the mortgage was assumed by the buyer. As part of the assignment of the note, the buyer made a \$0.5 million principal payment on the note.

As of September 30, 2011, approximately \$31.0 million, or 32.8%, of the Company's mortgage notes receivable were due from affiliates of the United Trust Fund, which is developing two build-to-suit facilities that are fully leased to Mercy Health, as described in Note 3 below.

**Note 3. Acquisitions and Dispositions***Real Estate Acquisitions*

On October 26, 2011, the Company acquired the final two outpatient buildings in the Richmond, Virginia portfolio transaction from affiliates of Woolfolk Medical Group, LLC. These two buildings comprise 73,325 square feet and were acquired for approximately \$19.7 million, including the assumption of debt with principal balances of approximately \$7.2 million and the prepayment of ground rent of approximately \$1.8 million. The two buildings were 100% leased at the time of closing.

Five of the seven property acquisitions in the portfolio were completed by the end of the third quarter of 2011. These five properties comprise approximately 475,000 square feet and were approximately 95% leased at September 30, 2011.

The aggregate purchase price for the seven-building portfolio was approximately \$161.8 million, including the assumption of debt with principal balances of \$52.5 million and the prepayment of ground rent of approximately \$12.8 million. Upon acquisition, Bon Secours Health System (BSHS) and its affiliates leased approximately 35% of the total square footage of the portfolio. BSHS is a not-for-profit, A-rated, health system, based in Marriottsville, Maryland, that generated \$2.8 billion in revenue and operated 18 acute care hospitals with approximately 2,938 beds throughout 15 markets in seven states as of December 31, 2010.

The portfolio, as previously announced by the Company, originally included eight outpatient buildings. The Company elected not to purchase the eighth building, which was the only off-campus building in the portfolio.

During the three and nine months ended September 30, 2011, the Company expensed approximately \$0.4 million and \$1.1 million in project costs related to the acquisition of this portfolio, with an additional \$0.3 million expensed in previous periods. The table below details the preliminary purchase price allocation of the five properties acquired as of September 30, 2011.



**Table of Contents****Notes to Condensed Consolidated Financial Statements-Continued**

|                                                                     | <b>Estimated<br/>Fair Value (1)<br/>(In millions)</b> | <b>Estimated<br/>Useful Life<br/>(In years)</b> |
|---------------------------------------------------------------------|-------------------------------------------------------|-------------------------------------------------|
| Buildings                                                           | \$ 122.8                                              | 26.0-33.0                                       |
| Prepaid ground leases                                               | 11.0                                                  | 93.3-93.5                                       |
| Mortgage notes payable assumed, including fair value adjustments    | (46.8)                                                |                                                 |
| Accounts receivable and other assets acquired                       | 0.3                                                   |                                                 |
| Accounts payable, accrued liabilities and other liabilities assumed | (0.5)                                                 |                                                 |
| Prorated rent, net of expenses paid                                 | 0.4                                                   |                                                 |
| <b>Intangibles:</b>                                                 |                                                       |                                                 |
| At-market lease intangibles                                         | 9.2                                                   | 2.4-5.0                                         |
| Above-market lease intangibles                                      | 0.3                                                   | 0.9-4.7                                         |
| Below-market lease intangibles                                      | (0.1)                                                 | 2.7-6.3                                         |
| <b>Total intangibles</b>                                            | <b>9.4</b>                                            |                                                 |
| <br>Total cash consideration                                        | <br>\$ 96.6                                           |                                                 |

- (1) The purchase price allocation reflected in the table above is preliminary and certain amounts could change at a later date if new or better information is received.

*Mortgage Note Financings*

In the second quarter of 2011, the Company advanced \$24.0 million to begin funding the development of two build-to-suit facilities, affiliated with Mercy Health, with an aggregate budget of approximately \$202.6 million. The two projects include a 200,000 square foot medical office building in Oklahoma with a construction budget of approximately \$91.2 million and a 186,000 square foot orthopedic surgical facility in Missouri with a construction budget of approximately \$111.4 million. The loans have stated interest rates of 6.75% and are scheduled to mature upon substantial completion, which is estimated to be in the latter half of 2013. The Company has agreed to acquire the facilities upon substantial completion of construction at a price equal to the amount outstanding under the mortgage notes. The facilities are leased by affiliates of Mercy Health under 14-year absolute net leases with options to purchase the buildings contingent on certain provisions in the lease agreements. Mercy Health, based in St. Louis, Missouri, is the eighth largest Catholic healthcare system in the U.S., has a net worth of more than \$2 billion, and maintains a AA- credit rating. Mercy Health operates 26 acute care hospitals and two heart hospitals in a seven-state area.

In the first quarter of 2011, the Company originated the following mortgage notes receivable:

a \$40.0 million mortgage loan that is secured by a multi-tenanted office building located in Iowa that was 94% leased at the time the mortgage was originated. The mortgage loan requires interest only payments through maturity, has a stated fixed interest rate of 7.7% and matures in January 2014;

a \$2.7 million mortgage note receivable with the purchaser in conjunction with the disposal of a medical office building located in Florida as discussed in *Asset Dispositions* below. The loan has a stated fixed interest rate of 7.0% and matures in March 2016; and

a \$3.7 million loan for the construction of a medical office building located in Missouri. The loan has a stated interest rate of 11.0% and matures in 2012. The Company had funded \$2.2 million on the loan as of September 30, 2011. This loan was repaid on October 21, 2011.

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In addition to the amounts discussed above, the Company funded approximately \$8.1 million and \$18.7 million, respectively, on construction mortgage loans during the three and nine months ended September 30, 2011.

### *Purchase of Noncontrolling Interests*

During the first quarter of 2011, the Company purchased from Ladco the remaining noncontrolling equity interests in two consolidated joint ventures for a total aggregate purchase price of \$5.1 million. The book value of the noncontrolling interests prior to the equity purchase was \$3.6 million. Concurrent with these purchases, the noncontrolling interest holder repaid a loan due to the Company totaling \$3.5 million that had been secured by the noncontrolling joint venture equity interests. The Company had previously consolidated these joint ventures in its financial statements. One of the joint

**Table of Contents****Notes to Condensed Consolidated Financial Statements-Continued**

ventures owns nine 100% leased outpatient facilities located in Iowa with an aggregate investment of approximately \$87.6 million and 369,000 square feet. The second joint venture is constructing two medical office buildings and a parking garage located in Colorado with an aggregate budget of approximately \$54.9 million.

The following table details the Company's acquisitions for the nine months ended September 30, 2011:

| <i>(Dollars in millions)</i>                | Date Acquired | Cash Consideration | Real Estate | Note Receivable Repayment | Mortgage Note Financing | Mortgage Notes Payable Assumed | Non-controlling interests | APIC   | Other   | Square Footage |
|---------------------------------------------|---------------|--------------------|-------------|---------------------------|-------------------------|--------------------------------|---------------------------|--------|---------|----------------|
| <b>Real estate acquisitions</b>             |               |                    |             |                           |                         |                                |                           |        |         |                |
| Virginia                                    | 06/30/2011    | \$ 34.8            | \$ 31.9     | \$                        | \$                      | \$                             | \$                        | \$     | \$ 2.9  | 142,015        |
| Virginia (1)                                | 08/04/2011    | 16.2               | 26.4        |                           |                         | (12.5)                         |                           |        | 2.3     | 87,816         |
| Virginia (1)                                | 08/04/2011    | 28.3               | 43.8        |                           |                         | (19.0)                         |                           |        | 3.5     | 142,855        |
| Virginia (1)                                | 08/30/2011    | 8.6                | 14.6        |                           |                         | (7.5)                          |                           |        | 1.5     | 59,240         |
| Virginia (1)                                | 09/30/2011    | 8.7                | 15.3        |                           |                         | (7.8)                          |                           |        | 1.2     | 42,957         |
|                                             |               | 96.6               | 132.0       |                           |                         | (46.8)                         |                           |        | 11.4    | 474,883        |
| <b>Purchase of noncontrolling interests</b> |               | 1.3                |             | (3.5)                     |                         |                                | 3.6                       | 1.5    | (0.3)   |                |
| <b>Mortgage note financings (2)</b>         |               |                    |             |                           |                         |                                |                           |        |         |                |
| Iowa                                        | 01/03/2011    | 40.0               |             |                           | 40.0                    |                                |                           |        |         |                |
| Florida                                     | 02/03/2011    | 2.7                |             |                           | 2.7                     |                                |                           |        |         |                |
| Missouri (3)(4)                             | 03/24/2011    | 2.2                |             |                           | 2.2                     |                                |                           |        |         |                |
| Missouri (4)                                | 06/30/2011    | 15.0               |             |                           | 15.0                    |                                |                           |        |         |                |
| Oklahoma (4)                                | 06/30/2011    | 16.1               |             |                           | 16.1                    |                                |                           |        |         |                |
|                                             |               | 76.0               |             |                           | 76.0                    |                                |                           |        |         |                |
|                                             |               | \$ 173.9           | \$ 132.0    | \$ (3.5)                  | \$ 76.0                 | \$ (46.8)                      | \$ 3.6                    | \$ 1.5 | \$ 11.1 | 474,883        |

- (1) The mortgage notes payable assumed in these acquisitions reflect fair value adjustments totaling \$1.6 million recorded by the Company upon acquisition.
- (2) Amounts in table include fundings through September 30, 2011.
- (3) The loan was repaid in full on October 21, 2011.
- (4) These are construction mortgage notes and the amounts in the table include amounts funded since the acquisition date.

**Table of Contents****Notes to Condensed Consolidated Financial Statements-Continued***Asset Dispositions*

During the third quarter of 2011, the Company disposed of the following:

a 16,256 square foot medical office building in Florida in which the Company had an aggregate net investment of approximately \$2.8 million. The Company received approximately \$1.2 million in net cash proceeds and recognized a \$1.6 million impairment on the disposition; and

a mortgage note receivable totaling approximately \$14.9 million was repaid. Upon repayment, the Company recognized a gain of \$1.4 million that had been deferred from the original sale of the building in 2006.

During the first quarter of 2011, the Company disposed of the following:

a 35,761 square foot medical office building in Maryland in which the Company had a net investment of approximately \$3.5 million. The Company received approximately \$3.4 million in net proceeds and recorded a \$0.1 million impairment charge on the disposal; and

a 28,861 square foot physician clinic in Florida in which the Company had a net investment of approximately \$3.1 million. The Company received approximately \$0.4 million in net cash proceeds and financed the remainder of the sale with a \$2.7 million mortgage note receivable as discussed above in Real Estate Acquisitions.

The following table details the Company's dispositions for the nine months ended September 30, 2011:

| <i>(Dollars in millions)</i>             | Date<br>Disposed | Net<br>Proceeds | Net Real<br>Estate<br>Investment | Mortgage<br>Note<br>Receivable | Gain/<br>Impairment | Square<br>Footage |
|------------------------------------------|------------------|-----------------|----------------------------------|--------------------------------|---------------------|-------------------|
| <b>Real estate dispositions</b>          |                  |                 |                                  |                                |                     |                   |
| Maryland                                 | 01/19/2011       | \$ 3.4          | \$ 3.5                           | \$                             | \$ (0.1)            | 35,761            |
| Florida                                  | 02/03/2011       | 0.4             | 3.1                              | (2.7)                          |                     | 28,861            |
| Florida                                  | 08/09/2011       | 1.2             | 2.8                              |                                | (1.6)               | 16,256            |
|                                          |                  | 5.0             | 9.4                              | (2.7)                          | (1.7)               | 80,878            |
| <b>Mortgage note repayments</b>          |                  | 14.9            |                                  | 14.9                           | 1.4                 |                   |
| <b>Total dispositions and repayments</b> |                  | \$ 19.9         | \$ 9.4                           | \$ 12.2                        | \$ (0.3)            | 80,878            |

*Potential Dispositions*

In the fourth quarter of 2010, the Company received notice from a tenant of its intent to purchase six skilled nursing facilities in Michigan and Indiana pursuant to purchase options contained in its leases with the Company. The Company's aggregate net investment in the buildings, which are classified as held for sale, was approximately \$8.2 million at September 30, 2011 and the aggregate contractual rent on the facilities is approximately \$0.7 million per quarter. The aggregate purchase price for the properties is expected to be approximately \$17.3 million, resulting in an expected net aggregate gain of approximately \$9.1 million. The Company previously reported that it expected the sales to close during the third quarter of 2011; however, the Company now expects that these sales will close in 2012.

*Discontinued Operations and Assets Held for Sale*

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During the first quarter of 2011, the Company sold one property in Florida and one property in Maryland and reclassified one property located in Tennessee that was previously classified as held for sale to held for use upon execution of a long-term lease. The Company's gross investment in the Tennessee property was approximately \$1.1 million (\$0.5 million, net) at September 30, 2011. During the third quarter of 2011, the Company sold one property in Florida that was not previously classified as held for sale.

The tables below detail the assets, liabilities, and results of operations included in discontinued operations on the Company's Condensed Consolidated Statements of Operations and in assets and liabilities of discontinued operations on the

**Table of Contents****Notes to Condensed Consolidated Financial Statements-Continued**

Company's Condensed Consolidated Balance Sheets. At September 30, 2011 and December 31, 2010, the Company had eight and 11 properties, respectively, classified as held for sale, including the six properties discussed above in Potential Dispositions. Of the 11 properties classified as held for sale at December 31, 2010, two of the properties were sold and one was reclassified to held for use during the first quarter of 2011.

| <i>(Dollars in thousands)</i>                                | September 30,<br>2011 | December 31,<br>2010 |
|--------------------------------------------------------------|-----------------------|----------------------|
| <b>Balance Sheet data (as of the period ended):</b>          |                       |                      |
| Land                                                         | \$ 4,766              | \$ 7,099             |
| Buildings, improvements and lease intangibles                | 27,119                | 35,424               |
| Personal property                                            | 427                   | 429                  |
|                                                              | 32,312                | 42,952               |
| Accumulated depreciation                                     | (15,883)              | (19,447)             |
| <b>Assets held for sale, net</b>                             | <b>16,429</b>         | <b>23,505</b>        |
| Other assets, net (including receivables)                    | 90                    | 410                  |
| <b>Assets of discontinued operations, net</b>                | <b>90</b>             | <b>410</b>           |
| <b>Assets held for sale and discontinued operations, net</b> | <b>\$ 16,519</b>      | <b>\$ 23,915</b>     |
| Accounts payable and accrued liabilities                     | \$ 138                | \$ 229               |
| Other liabilities                                            | 111                   | 194                  |
| <b>Liabilities of discontinued operations</b>                | <b>\$ 249</b>         | <b>\$ 423</b>        |

| <i>(Dollars in thousands, except per share data)</i>         | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |          |
|--------------------------------------------------------------|-------------------------------------|--------|------------------------------------|----------|
|                                                              | 2011                                | 2010   | 2011                               | 2010     |
| <b>Statements of Operations data (for the period ended):</b> |                                     |        |                                    |          |
| <b>Revenues</b>                                              |                                     |        |                                    |          |
| Master lease rent                                            | \$ 823                              | \$ 913 | \$ 2,350                           | \$ 3,846 |
| Property operating                                           | 145                                 | 581    | 519                                | 1,787    |
| Straight-line rent                                           | (11)                                | (34)   | (43)                               | (66)     |
| Other operating                                              |                                     |        |                                    | 1        |
|                                                              | 957                                 | 1,460  | 2,826                              | 5,568    |
| <b>Expenses</b>                                              |                                     |        |                                    |          |
| General and administrative                                   | 1                                   | 2      | 4                                  | 8        |
| Property operating                                           | 249                                 | 581    | 954                                | 1,686    |
| Bad debt, net                                                | 1                                   |        | 15                                 | 20       |
| Depreciation                                                 | 16                                  | 391    | 62                                 | 1,199    |
|                                                              | 267                                 | 974    | 1,035                              | 2,913    |
| <b>Other Income (Expense)</b>                                |                                     |        |                                    |          |
| Interest and other income, net                               |                                     | (1)    |                                    | 223      |
|                                                              |                                     | (1)    |                                    | 223      |

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| <b>Discontinued Operations</b>                                               |                |                   |                 |                 |
|------------------------------------------------------------------------------|----------------|-------------------|-----------------|-----------------|
| Income from discontinued operations                                          | 690            | 485               | 1,791           | 2,878           |
| Impairments                                                                  | (1,551)        | (6,102)           | (1,698)         | (6,102)         |
| Gain on sales of real estate properties                                      | 1,357          | 4,092             | 1,393           | 8,313           |
| <b>Income (Loss) from Discontinued Operations</b>                            | <b>\$ 496</b>  | <b>\$ (1,525)</b> | <b>\$ 1,486</b> | <b>\$ 5,089</b> |
| <b>Income (Loss) from Discontinued Operations per Common Share - Basic</b>   | <b>\$ 0.01</b> | <b>\$ (0.02)</b>  | <b>\$ 0.02</b>  | <b>\$ 0.08</b>  |
| <b>Income (Loss) from Discontinued Operations per Common Share - Diluted</b> | <b>\$ 0.01</b> | <b>\$ (0.02)</b>  | <b>\$ 0.02</b>  | <b>\$ 0.08</b>  |

**Table of Contents****Notes to Condensed Consolidated Financial Statements-Continued****Note 4. Notes and Bonds Payable**

The table below details the Company's notes and bonds payable as of September 30, 2011 and December 31, 2010.

| <i>(Dollars in thousands)</i>                                  | Sept. 30,<br>2011 | Dec. 31,<br>2010 | Maturity<br>Dates | Contractual<br>Interest Rates | Principal<br>Payments | Interest<br>Payments |
|----------------------------------------------------------------|-------------------|------------------|-------------------|-------------------------------|-----------------------|----------------------|
| Unsecured Credit Facility due 2012                             | \$ 175,000        | \$               | 9/12              | LIBOR + 2.80%                 | At maturity           | Quarterly            |
| Senior Notes due 2011, including premium                       |                   | 278,311          |                   | 8.125%                        | At maturity           | Semi-Annual          |
| Senior Notes due 2014, net of discount                         | 264,334           | 264,227          | 4/14              | 5.125%                        | At maturity           | Semi-Annual          |
| Senior Notes due 2017, net of discount                         | 298,402           | 298,218          | 1/17              | 6.500%                        | At maturity           | Semi-Annual          |
| Senior Notes due 2021, net of discount                         | 396,991           | 396,812          | 1/21              | 5.750%                        | At maturity           | Semi-Annual          |
| Mortgage notes payable, net of discount and including premiums | 215,155           | 170,287          | 4/13-10/30        | 5.000%-7.625%                 | Monthly               | Monthly              |
|                                                                | \$ 1,349,882      | \$ 1,407,855     |                   |                               |                       |                      |

The Company's various debt agreements contain certain representations, warranties, and financial and other covenants customary in such loan agreements. Among other things, these provisions require the Company to maintain certain financial ratios and minimum tangible net worth and impose certain limits on the Company's ability to incur indebtedness and create liens or encumbrances. At September 30, 2011, the Company was in compliance with the financial covenant provisions under all of its various debt instruments.

*Unsecured Credit Facility due 2012*

On October 14, 2011, the Company's \$550.0 million unsecured credit facility due 2012 (the "Unsecured Credit Facility due 2012") was repaid with proceeds from the Company's new \$700.0 million unsecured credit facility due 2015 (the "Unsecured Credit Facility"). Amounts outstanding under the Unsecured Credit Facility due 2012 bore interest at a rate equal to LIBOR plus 2.80% at September 30, 2011. In addition, the Company paid a facility fee of 0.40% per annum on the aggregate amount of commitments. At September 30, 2011, the Company had \$175.0 million outstanding under the Unsecured Credit Facility due 2012 with a weighted average interest rate of approximately 3.03% and a borrowing capacity remaining, under its financial covenants, of approximately \$375.0 million.

*Unsecured Credit Facility due 2015*

On October 14, 2011, the Company entered into a \$700.0 million Unsecured Credit Facility with a syndicate of 17 lenders that matures on October 14, 2015. The Company has the option to extend the maturity of the Unsecured Credit Facility for one additional year for an extension fee of 0.20% of the aggregate commitments. Amounts outstanding under the Unsecured Credit Facility bear interest at LIBOR plus the applicable margin rate (defined as a range of 1.075% to 1.900% depending on the Company's unsecured debt ratings, currently 1.50%). In addition, the Company pays a 0.35% facility fee per annum on the aggregate amount of commitments. The facility fee ranges from 0.175% per annum to 0.45% per annum, based on the Company's unsecured debt ratings. At October 15, 2011, the Company had \$187.0 million outstanding under the Unsecured Credit Facility with a weighted average interest rate of approximately 1.74% and a remaining borrowing capacity of approximately \$513.0 million.

In conjunction with the closing of the Unsecured Credit Facility in October 2011, the Company will expense in the fourth quarter of 2011 approximately \$0.4 million of unamortized deferred financing costs related to the Unsecured Credit Facility due 2012 with the remaining \$2.2 million of deferred costs related to the prior credit facility amortized through the maturity date of the new Unsecured Credit Facility.



**Table of Contents****Notes to Condensed Consolidated Financial Statements-Continued***Senior Notes due 2011*

On March 28, 2011, the Company redeemed its unsecured senior notes due 2011 (the Senior Notes due 2011) at a redemption price equal to an aggregate of \$289.4 million, consisting of outstanding principal of \$278.2 million, accrued interest as of the redemption date of \$9.2 million, and a make-whole amount of approximately \$2.0 million for the early extinguishment of the debt, which was approximately equal to the interest that would have been paid between the redemption date and the maturity date. The Senior Notes due 2011, issued in 2001, bore interest at 8.125% per annum, payable semi-annually on May 1 and November 1, and were due to mature on May 1, 2011. The unamortized net gain on these notes was fully amortized upon redemption.

*Senior Notes due 2014*

In 2004, the Company issued \$300.0 million of unsecured senior notes due 2014 (the Senior Notes due 2014) that bear interest at 5.125% per annum, payable semi-annually on April 1 and October 1, and are due on April 1, 2014, unless redeemed earlier by the Company. The Senior Notes due 2014 were issued at a discount of approximately \$1.5 million, yielding an effective interest rate of 5.19% per annum. In previous years, the Company repurchased approximately \$35.3 million of the Senior Notes due 2014 and amortized a pro-rata portion of the discount upon the repurchases. The following table reconciles the balance of the Senior Notes due 2014 on the Company's Condensed Consolidated Balance Sheets.

| <i>(Dollars in thousands)</i>                | September 30,<br>2011 | December 31,<br>2010 |
|----------------------------------------------|-----------------------|----------------------|
| Senior Notes due 2014 face value             | \$ 264,737            | \$ 264,737           |
| Unaccreted discount                          | (403)                 | (510)                |
| <b>Senior Notes due 2014 carrying amount</b> | <b>\$ 264,334</b>     | <b>\$ 264,227</b>    |

*Senior Notes due 2017*

In 2009, the Company issued \$300.0 million of unsecured senior notes due 2017 (the Senior Notes due 2017) that bear interest at 6.50% per annum, payable semi-annually on January 17 and July 17, and are due on January 17, 2017, unless redeemed earlier by the Company. The Senior Notes due 2017 were issued at a discount of approximately \$2.0 million, yielding an effective interest rate of 6.618% per annum. The following table reconciles the balance of the Senior Notes due 2017 on the Company's Condensed Consolidated Balance Sheets.

| <i>(Dollars in thousands)</i>                | September 30,<br>2011 | December 31,<br>2010 |
|----------------------------------------------|-----------------------|----------------------|
| Senior Notes due 2017 face value             | \$ 300,000            | \$ 300,000           |
| Unaccreted discount                          | (1,598)               | (1,782)              |
| <b>Senior Notes due 2017 carrying amount</b> | <b>\$ 298,402</b>     | <b>\$ 298,218</b>    |

*Senior Notes due 2021*

In December 2010, the Company issued \$400.0 million of unsecured senior notes due 2021 (the Senior Notes due 2021) that bear interest at 5.75%, payable semi-annually on January 15 and July 15, beginning July 15, 2011, and are due on January 15, 2021, unless redeemed earlier by the Company. The Senior Notes due 2021 were issued at a discount of approximately \$3.2 million, which yielded a 5.855% interest rate per annum upon issuance. The following table reconciles the balance of the Senior Notes due 2021 on the Company's Condensed Consolidated Balance Sheets.

| <i>(Dollars in thousands)</i>    | September 30,<br>2011 | December 31,<br>2010 |
|----------------------------------|-----------------------|----------------------|
| Senior Notes due 2021 face value | \$ 400,000            | \$ 400,000           |
| Unaccreted discount              | (3,009)               | (3,188)              |

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|                                       |            |            |
|---------------------------------------|------------|------------|
| Senior Notes due 2021 carrying amount | \$ 396,991 | \$ 396,812 |
|---------------------------------------|------------|------------|

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**Table of Contents****Notes to Condensed Consolidated Financial Statements-Continued***Mortgage Notes Payable*

The following table reconciles the Company's aggregate mortgage notes principal balance with the Company's Condensed Consolidated Balance Sheets.

| <i>(Dollars in thousands)</i>            | September 30,<br>2011 | December 31,<br>2010 |
|------------------------------------------|-----------------------|----------------------|
| Mortgage notes payable principal balance | \$ 219,381            | \$ 176,638           |
| Unaccreted discount, net of premium      | (4,226)               | (6,351)              |
| Mortgage notes payable carrying amount   | \$ 215,155            | \$ 170,287           |

**Table of Contents****Notes to Condensed Consolidated Financial Statements-Continued**

The following table further details the Company's mortgage notes payable, with related collateral, at September 30, 2011.

| <i>(Dollars in millions)</i> | Original<br>Balance | Effective<br>Interest<br>Rate<br>(17) | Maturity<br>Date | Collateral (18) | Investment                                   | Balance at        |                     |
|------------------------------|---------------------|---------------------------------------|------------------|-----------------|----------------------------------------------|-------------------|---------------------|
|                              |                     |                                       |                  |                 | in<br>Collateral at<br>September 30,<br>2011 | Sept. 30,<br>2011 | Dec.<br>31,<br>2010 |
| Life Insurance Co. (1)       | \$ 4.7              | 7.765%                                | 1/17             | MOB             | \$ 11.6                                      | \$ 2.0            | \$ 2.2              |
| Commercial Bank (2)          | 1.8                 | 5.550%                                | 10/30            | OTH             | 7.9                                          | 1.6               | 1.7                 |
| Life Insurance Co. (3)       | 15.1                | 5.490%                                | 1/16             | MOB             | 32.7                                         | 13.2              | 13.5                |
| Commercial Bank (4)          | 17.4                | 6.480%                                | 5/15             | MOB             | 19.9                                         | 14.5              | 14.5                |
| Commercial Bank (5)          | 12.0                | 6.110%                                | 7/15             | 2 MOBs          | 19.4                                         | 9.8               | 9.7                 |
| Commercial Bank (6)          | 15.2                | 7.650%                                | 7/20             | MOB             | 20.2                                         | 12.8              | 12.8                |
| Life Insurance Co. (7)       | 1.5                 | 6.810%                                | 7/16             | MOB             | 2.2                                          | 1.1               | 1.2                 |
| Commercial Bank (8)          | 12.9                | 6.430%                                | 2/21             | MOB             | 20.5                                         | 11.4              | 11.5                |
| Investment Fund (9)          | 80.0                | 7.250%                                | 12/16            | 15 MOBs         | 154.7                                        | 78.6              | 79.2                |
| Life Insurance Co. (10)      | 7.0                 | 5.530%                                | 1/18             | MOB             | 14.5                                         | 3.7               | 4.0                 |
| Investment Co. (11)          | 15.9                | 6.550%                                | 4/13             | MOB             | 23.3                                         | 15.4              | 15.6                |
| Investment Co. (12)          | 4.6                 | 5.250%                                | 9/15             | MOB             | 6.9                                          | 4.3               | 4.4                 |
| Life Insurance Co. (13)      | 13.9                | 4.700%                                | 1/16             | MOB             | 26.4                                         | 12.5              |                     |
| Life Insurance Co. (14)      | 21.5                | 4.700%                                | 8/15             | MOB             | 43.8                                         | 19.0              |                     |
| Insurance Co. (15)           | 7.3                 | 5.100%                                | 12/18            | MOB             | 14.6                                         | 7.5               |                     |
| Commercial Bank (16)         | 8.1                 | 4.540%                                | 8/16             | MOB             | 15.3                                         | 7.8               |                     |
|                              |                     |                                       |                  |                 | \$ 433.9                                     | \$ 215.2          | \$ 170.3            |

- (1) Payable in monthly installments of principal and interest based on a 20-year amortization with the final payment due at maturity.
- (2) Payable in monthly installments of principal and interest based on a 27-year amortization with the final payment due at maturity.
- (3) Payable in monthly installments of principal and interest based on a 10-year amortization with the final payment due at maturity.
- (4) Payable in monthly installments of principal and interest based on a 10-year amortization with the final payment due at maturity. The unaccreted portion of the \$2.7 million discount recorded on this note upon acquisition is included in the balance above.
- (5) Payable in monthly installments of principal and interest based on a 10-year amortization with the final payment due at maturity. The unaccreted portion of the \$2.1 million discount recorded on this note upon acquisition is included in the balance above.
- (6) Payable in monthly installments of interest only for 24 months and then installments of principal and interest based on an 11-year amortization with the final payment due at maturity. The unaccreted portion of the \$2.4 million discount recorded on this note upon acquisition is included in the balance above.
- (7) Payable in monthly installments of principal and interest based on a 9-year amortization with the final payment due at maturity. The unaccreted portion of the \$0.2 million discount recorded on this note upon acquisition is included in the balance above.
- (8) Payable in monthly installments of principal and interest based on a 12-year amortization with the final payment due at maturity. The unaccreted portion of the \$1.0 million discount recorded on this note upon acquisition is included in the balance above.
- (9) Payable in monthly installments of principal and interest based on a 30-year amortization with a 7-year initial term (maturity 12/01/16) and the option to extend the initial term for two, one-year floating rate extension terms.
- (10) Payable in monthly installments of principal and interest based on a 15-year amortization with the final payment due at maturity. The Company acquired this mortgage note in an acquisition during the third quarter 2010.
- (11) Payable in monthly installments of principal and interest based on a 30-year amortization with the option to extend for three years at a fixed rate of 6.75%. The unamortized portion of the \$0.5 million premium recorded on this note upon acquisition is included in the balance above.
- (12) Payable in monthly installments of principal and interest with a balloon payment of \$4.0 million due at maturity.
- (13) Payable in monthly installments of principal and interest based on a 25-year amortization with the final payment due at maturity. The unamortized portion of the \$0.3 million premium recorded on this note upon acquisition is included in the balance above. The Company assumed this mortgage note in an acquisition during the third quarter 2011.

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- (14) Payable in monthly installments of principal and interest based on a 25-year amortization with the final payment due at maturity. The unamortized portion of the \$0.4 million premium recorded on this note upon acquisition is included in the balance above. The Company assumed this mortgage note in an acquisition during the third quarter 2011.
- (15) Payable in monthly installments of principal and interest based on a 25-year amortization with the final payment due at maturity. The unamortized portion of the \$0.6 million premium recorded on this note upon acquisition is included in the balance above. The Company assumed this mortgage note in an acquisition during the third quarter 2011.
- (16) Payable in monthly installments of principal and interest based on a 10-year amortization with the final payment due at maturity. The unamortized portion of the \$0.2 million premium recorded on this note upon acquisition is included in the balance above. The Company assumed this mortgage note in an acquisition during the third quarter 2011.
- (17) The contractual interest rates ranged from 5.00% to 7.625% at September 30, 2011.
- (18) MOB-Medical office building; OTH-Other.

**Table of Contents****Notes to Condensed Consolidated Financial Statements-Continued***Long-Term Debt Maturities*

Future contractual maturities of the Company's notes and bonds payable as of September 30, 2011 were:

| <i>(Dollars in thousands)</i> | Principal<br>Maturities | Net Accretion/<br>Amortization (1) | Notes and<br>Bonds Payable | %      |
|-------------------------------|-------------------------|------------------------------------|----------------------------|--------|
| 2011 (remaining)              | \$ 1,130                | \$ (283)                           | \$ 847                     | 0.1%   |
| 2012 (2)                      | 179,721                 | (1,148)                            | 178,573                    | 13.2%  |
| 2013                          | 19,540                  | (1,392)                            | 18,148                     | 1.3%   |
| 2014                          | 269,692                 | (1,522)                            | 268,170                    | 19.9%  |
| 2015                          | 49,775                  | (1,216)                            | 48,559                     | 3.6%   |
| 2016 and thereafter           | 839,260                 | (3,675)                            | 835,585                    | 61.9%  |
|                               | \$ 1,359,118            | \$ (9,236)                         | \$ 1,349,882               | 100.0% |

- (1) Includes discount accretion and premium amortization related to the Company's Senior Notes due 2014, Senior Notes due 2017, Senior Notes due 2021 and ten mortgage notes payable.
- (2) Includes \$175.0 million outstanding on the Company's Unsecured Credit Facility due 2012 which was repaid on October 14, 2011 with proceeds from the Unsecured Credit Facility that matures in October 2015.

**Note 5. Other Assets**

Other assets consist primarily of prepaid assets, straight-line rent receivables, intangible assets and receivables. Items included in other assets on the Company's Condensed Consolidated Balance Sheets are detailed in the table below.

| <i>(Dollars in millions)</i>                     | September 30,<br>2011 | December 31,<br>2010 |
|--------------------------------------------------|-----------------------|----------------------|
| Prepaid assets                                   | \$ 42.0               | \$ 27.9              |
| Straight-line rent receivables                   | 30.5                  | 27.0                 |
| Above-market intangible assets, net              | 13.4                  | 13.4                 |
| Deferred financing costs, net                    | 9.6                   | 12.0                 |
| Accounts receivable                              | 5.4                   | 6.1                  |
| Goodwill                                         | 3.5                   | 3.5                  |
| Equity investment in joint venture - cost method | 1.3                   | 1.3                  |
| Customer relationship intangible assets, net     | 1.1                   | 1.2                  |
| Notes receivable                                 | 0.3                   | 3.8                  |
| Allowance for uncollectible accounts             | (0.8)                 | (1.2)                |
| Other                                            | 1.7                   | 1.5                  |
|                                                  | \$ 108.0              | \$ 96.5              |

*Equity Investment in Joint Venture*

At September 30, 2011, the Company had an investment in one unconsolidated joint venture, which the Company accounts for under the cost method since the Company does not exert significant influence. The joint venture, which invests in real estate properties, is included in other assets on the Company's Condensed Consolidated Balance Sheets, and the related distributions received are included in interest and other income, net on the Company's Condensed Consolidated Statements of Operations.

**Note 6. Commitments and Contingencies**

*Development Activity*

The Company had several ongoing development projects at September 30, 2011 with aggregate project budgets totaling approximately \$668.2 million, including five construction projects, seven construction mortgage loans and eight properties in the process of stabilization subsequent to construction as detailed in the table below.

**Table of Contents****Notes to Condensed Consolidated Financial Statements-Continued**

|                               | Number of Properties | Amount Funded                            |                                            | Estimated Remaining Fundings | Estimated Total Investment | Approximate Square Feet |
|-------------------------------|----------------------|------------------------------------------|--------------------------------------------|------------------------------|----------------------------|-------------------------|
|                               |                      | During Three Months Ended Sept. 30, 2011 | Total Amount Funded Through Sept. 30, 2011 |                              |                            |                         |
| <i>(Dollars in thousands)</i> |                      |                                          |                                            |                              |                            |                         |
| Construction in progress      | 5                    | \$ 28,809                                | \$ 134,716                                 | \$ 63,424                    | \$ 198,140                 | 587,758                 |
| Mortgage construction loans   | 7                    | 8,836                                    | 48,202                                     | 177,097                      | 225,299                    | 489,931                 |
| Stabilization in progress     | 8                    | 2,166                                    | 237,192                                    | 7,608                        | 244,800                    | 808,140                 |
| Land held for development     |                      |                                          | 20,773                                     |                              |                            |                         |
| <b>Total</b>                  | <b>20</b>            | <b>\$ 39,811</b>                         | <b>\$ 440,883</b>                          | <b>\$ 248,129</b>            | <b>\$ 668,239</b>          | <b>1,885,829</b>        |

*Construction in Progress*

As of September 30, 2011, the Company had four medical office buildings and one inpatient facility under construction with estimated completion dates ranging from the fourth quarter of 2011 to the third quarter of 2012. In July 2011, the Company initiated development of a 96,433 square foot, on-campus medical office building and parking garage with significant pre-leasing in The Woodlands, Texas for an estimated total budget of approximately \$18.1 million and an estimated completion date in the third quarter of 2012. This building is adjacent to a medical office building that the Company purchased in late 2010 as part of a five building portfolio. Also, in July 2011, the Company took control of a construction project in South Dakota and began consolidating the construction in progress that the Company was funding through a mortgage note agreement. The total budget for the South Dakota project is approximately \$43.6 million with an estimated completion date of March 31, 2012. The South Dakota building is 100% leased to a AA- rated health system, with the lease commencing upon completion. The lease also provides the tenant with an option to purchase the project at completion. Further, in October 2011, a medical office building in Washington, with an estimated total budget of \$92.2 million, was substantially completed and placed into service.

The table below details the Company's construction in progress and land held for development as of September 30, 2011. The information included in the table below represents management's estimates and expectations at September 30, 2011, which are subject to change. The Company's disclosures regarding certain projections or estimates of completion dates may not reflect actual results.

| State                             | Estimated Completion Date | Property Type (1) | Properties | Approximate Square Feet | CIP at September 30, 2011 | Estimated Remaining Funding | Estimated Total Investment |
|-----------------------------------|---------------------------|-------------------|------------|-------------------------|---------------------------|-----------------------------|----------------------------|
| <i>(Dollars in thousands)</i>     |                           |                   |            |                         |                           |                             |                            |
| <i>Under construction:</i>        |                           |                   |            |                         |                           |                             |                            |
| Washington (2)                    | 4Q 2011                   | MOB               | 1          | 191,051                 | \$ 69,932                 | \$ 22,268                   | \$ 92,200                  |
| Colorado                          | 4Q 2011                   | MOB               | 1          | 96,093                  | 14,173                    | 8,485                       | 22,658                     |
| Colorado                          | 1Q 2012                   | MOB               | 1          | 90,579                  | 12,883                    | 8,714                       | 21,597                     |
| South Dakota                      | 1Q 2012                   | Inpatient         | 1          | 113,602                 | 32,746                    | 10,854                      | 43,600                     |
| Texas                             | 3Q 2012                   | MOB               | 1          | 96,433                  | 4,982                     | 13,103                      | 18,085                     |
| <i>Land held for development:</i> |                           |                   |            |                         |                           |                             |                            |
| Texas                             |                           |                   |            |                         | 20,773                    |                             |                            |
|                                   |                           |                   | 5          | 587,758                 | \$ 155,489                | \$ 63,424                   | \$ 198,140                 |

(1) MOB-Medical office building.

(2) Substantially completed construction in October 2011.

*Construction Mortgage Loans*

The Company expects that the remaining funding commitments totaling \$177.1 million on the seven construction loans at September 30, 2011, of which \$171.6 million related to the two mortgage notes affiliated with Mercy Health, will be funded through 2013.





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**Table of Contents****Notes to Condensed Consolidated Financial Statements-Continued***Stabilization in Progress*

At September 30, 2011, the Company had eight properties that it had previously developed that are in the process of stabilization. In the aggregate, the properties were approximately 33% leased and 19% occupied at September 30, 2011, with tenant improvement activities occurring in suites that were leased but not yet occupied by the tenants. The Company's remaining funding commitments on these properties at September 30, 2011 related to tenant improvements. Because these properties are not stabilized, they generated a net operating loss of approximately \$0.9 million and \$2.7 million, respectively, for the three and nine months ended September 30, 2011. Also, one of the properties in stabilization, with an investment of approximately \$85.7 million as of September 30, 2011, has been open and in service for twelve months as of August 2011. Accordingly, the Company ceased capitalizing interest which resulted in higher interest expense in the third quarter of 2011 of approximately \$0.7 million as compared to the second quarter of 2011. Additionally, the Company expects that interest expense in the fourth quarter of 2011 will be approximately \$0.4 million higher as compared to the third quarter of 2011 from not capitalizing interest on the project.

*Other Construction Matters*

In late June 2011, the Company became aware of the financial instability of the general contractor on a development project in South Dakota with Ladco that the Company was funding under a construction mortgage loan to an affiliate of the general contractor. The building under construction is 100% leased to a AA- rated health system, with the lease commencing upon completion. The lease also provides the tenant with an option to purchase the project at completion. In July 2011, the Company exercised its rights as lender to take control of the project, engaged an unrelated third-party contractor and has continued to fund the development. The Company has a variable interest in the borrower (VIE) and upon the change in control in July 2011, the Company concluded that it was the primary beneficiary of the VIE. Therefore, the Company began consolidating the VIE in July 2011, which resulted in a reclassification of the project from a mortgage note receivable to construction in progress on the Company's Condensed Consolidated Financial Statements. Upon consolidation, the Company was also required to record the construction project at fair value, which the Company determined to approximate the carrying value of its mortgage note receivable plus accrued but unpaid construction-related invoices.

Ladco also served as developer on two wholly-owned medical office buildings that are being constructed by the Company. During the third quarter, the Company engaged an unrelated third-party contractor when it became aware of the financial instability of the general contractor, an affiliate of Ladco. The Company continues to fund the construction of these two projects, which are included in construction in progress on the Company's Condensed Consolidated Balance Sheets.

The Company does not expect an adverse financial impact from the consolidation of the South Dakota construction project or from the transitions to the new contractor.

*Legal Proceedings*

Two affiliates of the Company, HR Acquisition of Virginia Limited Partnership and HRT Holdings, Inc., were defendants in a lawsuit brought by Fork Union Medical Investors Limited Partnership, Goochland Medical Investors Limited Partnership, and Life Care Centers of America, Inc., as plaintiffs, in the Circuit Court of Davidson County, Tennessee. The plaintiffs alleged that they overpaid rent between 1991 and 2003 under leases for two skilled nursing facilities in Virginia and sought a refund of such overpayments. Plaintiffs were seeking up to \$2.0 million, plus pre- and post-judgment interest and attorneys' fees. The two leases were terminated by agreement in 2003. The Company denied that it was liable to the plaintiffs and filed a motion for summary judgment seeking dismissal of the case. The court granted the Company's motion for summary judgment and the case was dismissed with prejudice by order entered on July 20, 2011. On August 11, 2011, the plaintiffs filed a notice of appeal with the Tennessee Court of Appeals. No schedule for briefing or oral arguments has yet been established. The Company believes the trial court's dismissal of the case should be affirmed but can provide no assurance as to the outcome of the appeal.

The Company is, from time to time, involved in litigation arising out of the ordinary course of business or which is expected to be covered by insurance. The Company is not aware of any other pending or threatened litigation that, if resolved against the Company, would have a material adverse effect on the Company's consolidated financial position, results of operations, or cash flows.

**Table of Contents****Notes to Condensed Consolidated Financial Statements-Continued****Note 7. Stockholders Equity**

The following table provides a reconciliation of total equity:

*(Dollars in thousands, except per share data)*

|                                                                       | Common<br>Stock | Additional<br>Paid-In<br>Capital | Accumulated<br>Other<br>Comprehensive<br>Loss | Cumulative<br>Net<br>Income | Cumulative<br>Dividends | Total<br>Stockholders<br>Equity | Non<br>controlling<br>Interests | Total<br>Equity |
|-----------------------------------------------------------------------|-----------------|----------------------------------|-----------------------------------------------|-----------------------------|-------------------------|---------------------------------|---------------------------------|-----------------|
| Balance at Dec. 31, 2010                                              | \$ 661          | \$ 1,641,379                     | \$ (5,269)                                    | \$ 796,165                  | \$ (1,593,926)          | \$ 839,010                      | \$ 3,730                        | \$ 842,740      |
| Issuance of common stock                                              | 117             | 251,748                          |                                               |                             |                         | 251,865                         |                                 | 251,865         |
| Common stock redemption                                               |                 | (51)                             |                                               |                             |                         | (51)                            |                                 | (51)            |
| Stock-based compensation                                              | 1               | 2,271                            |                                               |                             |                         | 2,272                           |                                 | 2,272           |
| Net income (loss)                                                     |                 |                                  |                                               | (3,131)                     |                         | (3,131)                         | 31                              | (3,100)         |
| Other comprehensive loss                                              |                 |                                  |                                               |                             |                         |                                 |                                 |                 |
| Comprehensive loss                                                    |                 |                                  |                                               |                             |                         |                                 |                                 | (3,100)         |
| Dividends to common stockholders<br>(\$0.90 per share)                |                 |                                  |                                               |                             | (65,918)                | (65,918)                        |                                 | (65,918)        |
| Distributions to noncontrolling<br>interests                          |                 |                                  |                                               |                             |                         |                                 | (251)                           | (251)           |
| Proceeds from noncontrolling<br>interests                             |                 |                                  |                                               |                             |                         |                                 | 76                              | 76              |
| Purchase of noncontrolling interest in<br>consolidated joint ventures |                 | (1,469)                          |                                               |                             |                         | (1,469)                         | (3,586)                         | (5,055)         |
| Balance at September 30, 2011                                         | \$ 779          | \$ 1,893,878                     | \$ (5,269)                                    | \$ 793,034                  | \$ (1,659,844)          | \$ 1,022,578                    | \$                              | \$ 1,022,578    |

*Common Stock*

The following table provides a reconciliation of the beginning and ending common stock outstanding for the nine months ended September 30, 2011 and the year ended December 31, 2010:

|                                                   | Nine Months Ended<br>September 30,<br>2011 | Year Ended<br>December<br>31,<br>2010 |
|---------------------------------------------------|--------------------------------------------|---------------------------------------|
| Balance, beginning of period                      | 66,071,424                                 | 60,614,931                            |
| Issuance of common stock                          | 11,674,599                                 | 5,287,098                             |
| Restricted stock-based awards, net of forfeitures | 93,075                                     | 169,395                               |
| Balance, end of period                            | 77,839,098                                 | 66,071,424                            |

*At-The-Market Equity Offering Program*

Since December 2008, the Company has had in place an at-the-market equity offering program to sell shares of its common stock from time to time in at-the-market sales transactions. During the nine months ended September 30, 2011, the Company sold 11,648,700 shares of common stock under this program at prices ranging from \$20.27 to \$23.63 per share, generating approximately \$251.6 million in net proceeds. No shares have been sold under this program since July 31, 2011, with 2,791,300 authorized shares remaining to be sold under the current sales agreements.

*Common Stock Dividends*

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During the first nine months of 2011, the Company declared and paid common stock dividends aggregating \$0.90 per share.

On November 1, 2011, the Company declared a quarterly common stock dividend in the amount of \$0.30 per share payable on December 1, 2011 to stockholders of record on November 17, 2011.

**Table of Contents****Notes to Condensed Consolidated Financial Statements-Continued***Earnings (Loss) Per Common Share*

The table below sets forth the computation of basic and diluted earnings (loss) per common share for the three and nine months ended September 30, 2011 and 2010.

| <i>(Dollars in thousands, except per share data)</i>                         | Three Months Ended<br>September 30, |             | Nine Months Ended<br>September 30, |             |
|------------------------------------------------------------------------------|-------------------------------------|-------------|------------------------------------|-------------|
|                                                                              | 2011                                | 2010        | 2011                               | 2010        |
| <b>Weighted average Common Shares outstanding</b>                            |                                     |             |                                    |             |
| Weighted average Common Shares outstanding                                   | 77,570,090                          | 63,681,224  | 72,915,791                         | 62,540,743  |
| Unvested restricted stock                                                    | (1,431,035)                         | (1,311,451) | (1,437,328)                        | (1,307,933) |
| Weighted average Common Shares Outstanding - Basic                           | 76,139,055                          | 62,369,773  | 71,478,463                         | 61,232,810  |
| Weighted average Common Shares - Basic                                       | 76,139,055                          | 62,369,773  | 71,478,463                         | 61,232,810  |
| Dilutive effect of restricted stock                                          | 971,887                             |             |                                    | 970,737     |
| Dilutive effect of employee stock purchase plan                              | 66,172                              |             |                                    | 65,866      |
| Weighted average Common Shares Outstanding - Diluted                         | 77,177,114                          | 62,369,773  | 71,478,463                         | 62,269,413  |
| <b>Net income (Loss)</b>                                                     |                                     |             |                                    |             |
| Income (loss) from continuing operations                                     | \$ 155                              | \$ (1,783)  | \$ (4,586)                         | \$ 2,775    |
| Noncontrolling interests share in net income                                 | (4)                                 | 60          | (31)                               | (44)        |
| Income (loss) from continuing operations attributable to common shareholders | 151                                 | (1,723)     | (4,617)                            | 2,731       |
| Discontinued operations                                                      | 496                                 | (1,525)     | 1,486                              | 5,089       |
| Net income (loss) attributable to common stockholders                        | \$ 647                              | \$ (3,248)  | \$ (3,131)                         | \$ 7,820    |
| <b>Basic Earnings (Loss) Per Common Share</b>                                |                                     |             |                                    |             |
| Income (loss) from continuing operations                                     | \$                                  | \$ (0.03)   | \$ (0.06)                          | \$ 0.05     |
| Discontinued operations                                                      | 0.01                                | (0.02)      | 0.02                               | 0.08        |
| Net income (loss) attributable to common stockholders                        | \$ 0.01                             | \$ (0.05)   | \$ (0.04)                          | \$ 0.13     |
| <b>Diluted Earnings (Loss) Per Common Share</b>                              |                                     |             |                                    |             |
| Income (loss) from continuing operations                                     | \$                                  | \$ (0.03)   | \$ (0.06)                          | \$ 0.05     |
| Discontinued operations                                                      | 0.01                                | (0.02)      | 0.02                               | 0.08        |
| Net income (loss) attributable to common stockholders                        | \$ 0.01                             | \$ (0.05)   | \$ (0.04)                          | \$ 0.13     |

The dilutive effect of restricted stock totaling 1,015,470 and 993,051 shares, respectively, and options under the Employee Stock Purchase Plan to purchase the Company's stock totaling 76,622 shares and 61,882 shares, respectively, were excluded from the calculation of diluted loss per common share for the nine months ended September 30, 2011 and the three months ended September 30, 2010 because the effect was anti-dilutive due to the net loss from continuing operations incurred during those periods.

*Incentive Plans*

The Company has various stock-based incentive plans for its employees and directors. Awards under these plans include restricted stock issued to employees and the Company's directors and options granted to employees pursuant to its Employee Stock Purchase Plan.

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A summary of the activity under the incentive plans for the three and nine months ended September 30, 2011 and 2010 is included in the table below.

**Table of Contents****Notes to Condensed Consolidated Financial Statements-Continued**

|                                         | Three Months Ended |           | Nine Months Ended |           |
|-----------------------------------------|--------------------|-----------|-------------------|-----------|
|                                         | September 30,      |           | September 30,     |           |
|                                         | 2011               | 2010      | 2011              | 2010      |
| Stock-based awards, beginning of period | 1,448,211          | 1,311,451 | 1,379,243         | 1,224,779 |
| Granted                                 |                    |           | 106,569           | 107,620   |
| Vested                                  | (2,200)            |           | (28,875)          | (20,948)  |
| Forfeited                               |                    |           | (10,926)          |           |
| Stock-based awards, end of period       | 1,446,011          | 1,311,451 | 1,446,011         | 1,311,451 |

Under the Company's Employee Stock Purchase Plan, in January of each year each eligible employee is granted an option to purchase up to \$25,000 of Common Stock at the lesser of 85% of the market price on the date of grant or 85% of the market price on the date of exercise of such option. The number of shares subject to each year's option becomes fixed on the date of grant. Options granted under the Employee Stock Purchase Plan expire if not exercised within 27 months after each such option's date of grant.

A summary of the activity under the Employee Stock Purchase Plan for the nine months ended September 30, 2011 and 2010 is included in the table below.

|                                                  | Three Months Ended |          | Nine Months Ended |           |
|--------------------------------------------------|--------------------|----------|-------------------|-----------|
|                                                  | September 30,      |          | September 30,     |           |
|                                                  | 2011               | 2010     | 2011              | 2010      |
| Outstanding and exercisable, beginning of period | 448,243            | 430,231  | 392,517           | 335,608   |
| Granted                                          |                    |          | 261,960           | 256,080   |
| Exercised                                        | (5,230)            | (1,724)  | (12,475)          | (7,166)   |
| Forfeited                                        | (11,703)           | (25,013) | (44,485)          | (44,492)  |
| Expired                                          |                    |          | (166,207)         | (136,536) |
| Outstanding and exercisable, end of period       | 431,310            | 403,494  | 431,310           | 403,494   |

**Note 8. Defined Benefit Pension Plans**

The Company's Executive Retirement Plan provides benefits upon retirement for three of the Company's founding officers. The plan is unfunded and benefits will be paid from cash flows of the Company. The maximum annual benefits payable to each individual under the Executive Retirement Plan have been frozen at \$896,000, subject to cost-of-living adjustments. As of September 30, 2011 only the Company's Chief Executive Officer was eligible to retire under the Executive Retirement Plan.

Net periodic benefit cost recorded related to the Company's pension plans for the three and nine months ended September 30, 2011 and 2010 is detailed in the following table.

|                                               | Three Months Ended |        | Nine Months Ended |          |
|-----------------------------------------------|--------------------|--------|-------------------|----------|
|                                               | September 30,      |        | September 30,     |          |
|                                               | 2011               | 2010   | 2011              | 2010     |
| <i>(Dollars in thousands)</i>                 |                    |        |                   |          |
| Service costs                                 | \$ 17              | \$ 13  | \$ 51             | \$ 39    |
| Interest costs                                | 218                | 253    | 644               | 724      |
| Amortization of net gain/loss                 | 232                | 159    | 696               | 491      |
| Effect of settlement                          |                    |        |                   | (35)     |
| Total recognized in net periodic benefit cost | \$ 467             | \$ 425 | \$ 1,391          | \$ 1,219 |

**Note 9. Other Operating Income**

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Other operating income on the Company's Condensed Consolidated Statements of Operations generally includes guaranty revenue recognized under its property operating agreements, interest income on notes receivable, and other items as detailed in the table below.



**Table of Contents****Notes to Condensed Consolidated Financial Statements-Continued**

| <i>(Dollars in thousands)</i>                 | Three Months Ended |          | Nine Months Ended |          |
|-----------------------------------------------|--------------------|----------|-------------------|----------|
|                                               | September 30,      |          | September 30,     |          |
|                                               | 2011               | 2010     | 2011              | 2010     |
| Property operating agreement guaranty revenue | \$ 1,841           | \$ 1,823 | \$ 5,640          | \$ 5,533 |
| Interest income on notes receivable           | 138                | 223      | 518               | 600      |
| Management fee income                         | 38                 | 36       | 115               | 127      |
| Other                                         | 50                 | 46       | 152               | 139      |
|                                               | \$ 2,067           | \$ 2,128 | \$ 6,425          | \$ 6,399 |

**Note 10. Taxable Income***Taxable Income*

The Company has elected to be taxed as a REIT, as defined under the Internal Revenue Code of 1986, as amended. To qualify as a REIT, the Company must meet a number of organizational and operational requirements, including a requirement that it distribute at least 90% of its annual taxable income to its stockholders.

As a REIT, the Company generally will not be subject to federal income tax on taxable income it distributes currently to its stockholders. Accordingly, no provision for federal income taxes has been made in the accompanying Condensed Consolidated Financial Statements. If the Company fails to qualify as a REIT for any taxable year, then it will be subject to federal income taxes at regular corporate rates, including any applicable alternative minimum tax, and may not be able to qualify as a REIT for four subsequent taxable years. Even if the Company qualifies as a REIT, it may be subject to certain state and local taxes on its income and property and to federal income and excise tax on its undistributed taxable income.

Earnings and profits, the current and accumulated amounts of which determine the taxability of distributions to stockholders, vary from net income (loss) attributable to common stockholders and taxable income because of different depreciation recovery periods and methods, and other items.

The following table reconciles the Company's consolidated net income (loss) attributable to common stockholders to taxable income for the three and nine months ended September 30, 2011 and 2010.

| <i>(Dollars in thousands)</i>                         | Three Months Ended |            | Nine Months Ended |           |
|-------------------------------------------------------|--------------------|------------|-------------------|-----------|
|                                                       | September 30,      |            | September 30,     |           |
|                                                       | 2011               | 2010       | 2011              | 2010      |
| Net income (loss) attributable to common stockholders | \$ 647             | \$ (3,248) | \$ (3,131)        | \$ 7,820  |
| Reconciling items to taxable income:                  |                    |            |                   |           |
| Depreciation and amortization                         | 6,187              | 4,898      | 15,706            | 15,038    |
| Gain or loss on disposition of depreciable assets     | (562)              | 1          | (2,660)           | 7,085     |
| Straight-line rent                                    | (975)              | (502)      | (3,124)           | (1,614)   |
| Receivable allowances                                 | (465)              | (2,806)    | 255               | (3,400)   |
| Stock-based compensation                              | 1,727              | 1,502      | 4,411             | 2,861     |
| Other                                                 | (1,968)            | 8,093      | 5,076             | 7,031     |
| Taxable income (1)                                    | \$ 4,591           | \$ 7,938   | \$ 16,533         | \$ 34,821 |
| Dividends paid                                        | \$ 23,348          | \$ 19,111  | \$ 65,918         | \$ 56,481 |

(1) Before REIT dividend paid deduction.



**Table of Contents****Notes to Condensed Consolidated Financial Statements-Continued***State Income Taxes*

State income tax expense and payments for the three and nine months ended September 30, 2011 and 2010 are detailed in the table below.

| <i>(Dollars in thousands)</i>             | Three Months Ended |                    | Nine Months Ended  |                    |
|-------------------------------------------|--------------------|--------------------|--------------------|--------------------|
|                                           | September 30, 2011 | September 30, 2010 | September 30, 2011 | September 30, 2010 |
| State income tax expense:                 |                    |                    |                    |                    |
| Texas gross margin tax                    | \$ 116             | \$ 146             | \$ 342             | \$ 374             |
| Other                                     | 54                 | (1)                | (28)               | 95                 |
| Total state income tax expense            | \$ 170             | \$ 145             | \$ 314             | \$ 469             |
| State income tax payments, net of refunds | \$ 25              | \$ 12              | \$ 528             | \$ 503             |

The Texas gross margin tax is a tax on gross receipts from operations in Texas. The Company understands that the Securities and Exchange Commission views this tax as an income tax. As such, the Company has disclosed the Texas gross margin tax in the table above. The Company does not necessarily agree with the Securities and Exchange Commission's position concerning the Texas gross margin tax.

In the second quarter of 2011, the Michigan Business Tax was replaced with a flat corporate income tax effective for January 1, 2012. Management believes that the new tax will incorporate the dividends paid deduction and thus is expected to eliminate its tax liability in Michigan effective for 2012. Additionally, this legislation repeals the tax associated with the Company's deferred tax liability previously recorded, which resulted in a \$0.2 million reduction of state income tax expense recognized in general and administrative expenses during the second quarter of 2011.

**Note 11. Fair Value of Financial Instruments**

The carrying amounts of cash and cash equivalents, receivables and payables are reasonable estimates of their fair value as of September 30, 2011 and December 31, 2010 due to their short-term nature. The fair value of notes and bonds payable is estimated using cash flow analyses, based on the Company's current interest rates for similar types of borrowing arrangements. The fair value of mortgage notes and notes receivable is estimated either based on cash flow analyses at an assumed market rate of interest or at a rate consistent with the rates on mortgage notes acquired by the Company recently or notes receivable entered into by the Company recently. The table below details the fair value and carrying values for notes and bonds payable, mortgage notes receivable and notes receivable at September 30, 2011 and December 31, 2010.

| <i>(Dollars in millions)</i>        | September 30, 2011 |            | December 31, 2010 |            |
|-------------------------------------|--------------------|------------|-------------------|------------|
|                                     | Carrying value     | Fair value | Carrying value    | Fair value |
| Notes and bonds payable             | \$ 1,349.9         | \$ 1,466.2 | \$ 1,407.9        | \$ 1,460.2 |
| Mortgage notes receivable           | \$ 94.6            | \$ 92.6    | \$ 36.6           | \$ 35.9    |
| Notes receivable, net of allowances | \$ 0.3             | \$ 0.3     | \$ 3.8            | \$ 3.8     |

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

#### **Disclosure Regarding Forward-Looking Statements**

*This report and other materials the Company has filed or may file with the Securities and Exchange Commission, as well as information included in oral statements or other written statements made, or to be made, by senior management of the Company, contain, or will contain, disclosures that are forward-looking statements. Forward-looking statements include all statements that do not relate solely to historical or current facts and can be identified by the use of words such as may, will, expect, believe, anticipate, target, intend, plan, estimate, project, continue, should, could and other comparable terms. These forward-looking statements are based on the current plans and expectations of management and are subject to a number of risks and uncertainties, including the risks, as described in the Company's Annual Report on Form 10-K for the year ended December 31, 2010 that could significantly affect the Company's current plans and expectations and future financial condition and results.*

*The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Stockholders and investors are cautioned not to unduly rely on such forward-looking statements when evaluating the information presented in the Company's filings and reports, including, without limitation, estimates and projections regarding the performance of development projects the Company is pursuing.*

*For a detailed discussion of the Company's risk factors, please refer to the Company's filings with the Securities and Exchange Commission, including its Annual Report on Form 10-K for the year ended December 31, 2010.*

#### **Business Overview**

Healthcare Realty's strategy is to own and operate medical office and other medical-related facilities that produce stable and growing rental income. Additionally, the Company provides a broad spectrum of services to own, develop, lease, finance and manage its portfolio of healthcare properties. The Company focuses its portfolio on outpatient-related facilities located on or near the campuses of large acute care hospitals and associated with leading health systems because management views these facilities as stable, lower-risk real estate investments. The Company's diversity of geography and tenants, which includes physicians of two-dozen physician specialties, as well as surgery, imaging, and diagnostic centers, helps mitigate exposure to credit risk, changes in tenant clinical practice, reimbursement levels, and fluctuating economic conditions.

Substantially all of the Company's revenues are derived from operating lease rentals on its real estate properties and interest earned on outstanding notes receivable. These sources of revenue represent the Company's primary source of liquidity to fund its dividends and its operating expenses, including interest incurred on debt, general and administrative costs such as compensation and office rent, as well as other expenses incurred in connection with managing its existing portfolio and acquiring additional properties. To the extent additional investments are not funded by these sources, the Company will fund its investment activity generally through equity or debt issuances either in the public or private markets or through proceeds from its Unsecured Credit Facility.

#### **Executive Overview**

During the third quarter of 2011, the Company acquired \$100.1 million in real estate properties, funded \$28.8 million related to its construction projects, and funded \$8.8 million in existing mortgage notes which are described in more detail below.

At September 30, 2011, the Company's leverage ratio [debt divided by (debt plus stockholders' equity less intangible assets plus accumulated depreciation)] was approximately 47.0% and its borrowings outstanding under the Unsecured Credit Facility due 2012 totaled \$175.0 million with a capacity remaining under its financial covenants of approximately \$375.0 million.

On October 14, 2011, the Unsecured Credit Facility due 2012 was replaced with a new \$700 million unsecured credit facility due 2015 (the Unsecured Credit Facility). The new Unsecured Credit Facility is currently priced approximately 135 basis points lower than the previous facility, which would result in over \$2 million in reduced interest payments per annum, based on the outstanding balance at September 30, 2011. At October 15, 2011, the Company had \$187.0 million outstanding under the Unsecured Credit Facility, with a weighted average interest rate of approximately 1.74% and a remaining borrowing capacity of approximately \$513.0 million. The additional capacity on the Unsecured Credit Facility, at more favorable rates, also provides the Company with more flexibility in funding its acquisition and development activities.

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### **Trends and Matters Impacting Operating Results**

Management monitors factors and trends important to the Company and the REIT industry in order to gauge the potential impact on the operations of the Company. In addition to the matters discussed in the Company's Annual Report on Form 10-K for the year ended December 31, 2010, below are some of the factors and trends that management believes may impact future operations of the Company.

#### *Acquisitions*

On October 26, 2011, the Company completed the acquisition of the final two buildings in a seven outpatient building portfolio in Virginia for an aggregate purchase price of approximately \$161.8 million, including the assumption of debt of approximately \$52.5 million and the prepayment of ground rent of approximately \$12.8 million. As of September 30, 2011, the Company had acquired five of the buildings for cash consideration of approximately \$96.6 million, including prepaid ground rent of approximately \$11.0 million and the assumption of debt of approximately \$45.3 million.

During the first quarter of 2011, the Company acquired from Ladco the remaining noncontrolling equity interest in its two consolidated joint ventures for a total purchase price of \$5.1 million. Concurrent with these purchases, the noncontrolling interest holder repaid a loan receivable to the Company totaling \$3.5 million. The loan receivable had been secured by the noncontrolling interests.

During the first nine months of 2011, the Company funded \$76.0 million in mortgage notes receivable with interest rates ranging from 6.75% to 11.00% and funded approximately \$18.7 million on existing construction mortgage loans.

The cash outlays for these acquisitions and mortgage notes were funded primarily from proceeds from the Company's at-the-market equity offering program, proceeds from borrowings under the unsecured credit facilities, and proceeds from the disposition of real estate assets. See Note 3 to the Condensed Consolidated Financial Statements for more information on these acquisitions.

#### *Dispositions*

During the first nine months of 2011, the Company disposed of three medical office buildings in which the Company had an aggregate net investment of approximately \$9.4 million. Net cash proceeds from these dispositions were used to repay outstanding balances on the Unsecured Credit Facility due 2012. See Note 3 to the Condensed Consolidated Financial Statements for more details on these dispositions.

#### *Potential Dispositions*

In the fourth quarter of 2010, the Company received notice from a tenant of its intent to purchase six skilled nursing facilities in Michigan and Indiana pursuant to purchase options contained in its leases with the Company. The Company's aggregate net investment in the buildings, which are classified as held for sale, was approximately \$8.2 million at September 30, 2011 and the aggregate contractual rent on the facilities is approximately \$0.7 million per quarter. The aggregate purchase price for the properties is expected to be approximately \$17.3 million, resulting in an expected net aggregate gain of approximately \$9.1 million. The Company previously reported that it expected the sales to close during the third quarter of 2011; however, the Company now expects that these sales will close in 2012.

Additionally, the Company expects to redeploy cash from other property sales and mortgage repayments into new investments. To the extent revenues related to these property sales or mortgage repayments exceed revenues from these new investments, the Company's results of operations and cash flows could be adversely affected.

#### *Development Activity*

The Company had several ongoing development projects at September 30, 2011 with aggregate project budgets totaling approximately \$668.2 million, including five construction projects, seven construction mortgage loans and eight properties in the process of stabilization subsequent to construction as detailed in the table below.

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|                               | Number<br>of<br>Properties | Amount Funded                                     |                                                     | Estimated<br>Remaining<br>Fundings | Estimated<br>Total<br>Investment | Approximate<br>Square<br>Feet |
|-------------------------------|----------------------------|---------------------------------------------------|-----------------------------------------------------|------------------------------------|----------------------------------|-------------------------------|
|                               |                            | During Three<br>Months<br>Ended<br>Sept. 30, 2011 | Total Amount<br>Funded<br>Through<br>Sept. 30, 2011 |                                    |                                  |                               |
| <i>(Dollars in thousands)</i> |                            |                                                   |                                                     |                                    |                                  |                               |
| Construction in progress      | 5                          | \$ 28,809                                         | \$ 134,716                                          | \$ 63,424                          | \$ 198,140                       | 587,758                       |
| Mortgage construction loans   | 7                          | 8,836                                             | 48,202                                              | 177,097                            | 225,299                          | 489,931                       |
| Stabilization in progress     | 8                          | 2,166                                             | 237,192                                             | 7,608                              | 244,800                          | 808,140                       |
| Land held for development     |                            |                                                   | 20,773                                              |                                    |                                  |                               |
| <b>Total</b>                  | <b>20</b>                  | <b>\$ 39,811</b>                                  | <b>\$ 440,883</b>                                   | <b>\$ 248,129</b>                  | <b>\$ 668,239</b>                | <b>1,885,829</b>              |

As of September 30, 2011, the Company had four medical office buildings and one inpatient facility under construction with estimated completion dates ranging from the fourth quarter of 2011 to the third quarter of 2012. One of the four medical office buildings, with an estimated budget of \$92.2 million, was substantially completed in October 2011 and placed into service. Earlier completion dates, shorter stabilization periods and higher rental rates will result in improved results of operations and cash flows, while lagging completion dates, longer stabilization periods and lower rental rates will result in less favorable results of operations and cash flows.

The Company expects that the remaining funding commitments totaling \$177.1 million on the seven construction loans at September 30, 2011, of which \$171.6 million related to the two mortgage notes affiliated with Mercy Health, will be funded during the remainder of 2011 through 2013.

At September 30, 2011, the Company had eight properties that it had previously developed that are in the process of stabilization. In the aggregate, the properties were approximately 33% leased and 19% occupied at September 30, 2011, with tenant improvement activities occurring in suites that were leased but not yet occupied by the tenants. The Company's remaining funding commitments on these properties at September 30, 2011 related to tenant improvements. Because these properties are not stabilized, they generated a net operating loss of approximately \$0.9 million and \$2.7 million, respectively, for the three and nine months ended September 30, 2011. Also, one of the properties in stabilization, with an investment of approximately \$85.7 million as of September 30, 2011, has been open and in service for twelve months as of August 2011. Accordingly, the Company ceased capitalizing interest which resulted in higher interest expense in the third quarter of 2011 of approximately \$0.7 million as compared to the second quarter of 2011. Additionally, the Company expects that interest expense in the fourth quarter of 2011 will be approximately \$0.4 million higher as compared to the third quarter 2011 from not capitalizing interest on the project.

*At-The-Market Equity Offering Program*

Since December 2008, the Company has had in place an at-the-market equity offering program to sell shares of its common stock from time to time in at-the-market sales transactions. During the nine months ended September 30, 2011, the Company sold 11,648,700 shares of common stock under this program at prices ranging from \$20.27 per share to \$23.63 per share, generating approximately \$251.6 million in net proceeds. No shares have been sold under this program since July 31, 2011, with 2,791,300 authorized shares remaining to be sold under the current sales agreements.

The proceeds from these sales were generally used to fund the Company's investment activities, redeem the 8.125% Senior Notes due 2011 and repay balances outstanding under the Unsecured Credit Facility due 2012.

*New Unsecured Credit Facility*

On October 14, 2011, the Company replaced the Unsecured Credit Facility due 2012 with a new \$700 million Unsecured Credit Facility that matures in October 2015 and may be extended for one additional year at the Company's option. The new Unsecured Credit Facility is currently priced approximately 135 basis points lower than the previous facility, which would result in over \$2 million in reduced interest payments per annum, based on the outstanding balance at September 30, 2011.

*Expiring Leases and Financial Support Agreements*

Master leases on five of the Company's properties expired during the first nine months of 2011. Three of the tenants renewed their leases, and, on the remaining two buildings, the Company assumed the subtenant leases and management of the properties' operations. The aggregate net operating income on the five buildings is expected to be approximately \$0.8 million per quarter lower



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than under the previous master leases. In addition to these five properties, one other master leased property, whose lease was set to expire during the fourth quarter of 2011, was sold in the third quarter of 2011, as discussed in more detail in Note 3 to the Condensed Consolidated Financial Statements.

Five master leases, relating to single tenant properties, are scheduled to expire during 2012 as follows:

During the third quarter of 2011, a lease on one 48,000 square foot property was extended for 10 years. The terms of the 10 year extension, which begins upon expiration of the current lease in June 2012, includes a lease rate reduction of approximately \$28,000 per month, with annual lease rate increases;

An agreement has been reached but not executed on an 81,000 square foot property whose master lease expires in August 2012. The amended lease will extend the maturity of the lease for an additional 10 years and will include a lease rate reduction of approximately \$51,000 per month upon execution of the amended lease with lease rate increases every three years;

An agreement has been reached but not executed on a 12,000 square foot property whose master lease expires in February 2012. The amended lease will extend the maturity of the lease for an additional two years at the same lease rate with annual lease rate increases; and

Negotiations are on-going relating to the renewal of the remaining two master leased properties. One property is 14,000 square feet with a lease that matures in July 2012 and the other property is 110,000 square feet with a lease that matures in July 2012.

Financial support payments totaling approximately \$0.5 million per quarter on two of the Company's properties in New Orleans expired on September 30, 2011. This concludes the series of payments totaling \$8.6 million received by the Company since Hurricane Katrina struck in August 2005. The Company's total investment in the two buildings was approximately \$10.8 million (\$6.3 million, net) at September 30, 2011. The buildings, which aggregate approximately 136,155 square feet, are adjacent to the former Methodist Hospital in East New Orleans which has remained closed since Hurricane Katrina struck in August 2005. The City of New Orleans purchased the hospital and formed a partnership with a health system to open and operate the hospital in the future, which the Company expects will provide additional occupancy in the buildings.

The Company generally expects 15-20% of the leases in the multi-tenanted portfolio to expire each year. During the first nine months of 2011, 238 of the leases in the Company's multi-tenanted buildings expired. Approximately 88% of these leases were renewed or the tenants continue to occupy the space. In the aggregate, the Company expects that the operations on these multi-tenanted properties will not be significantly impacted by these expirations.

### *Ladco*

Regarding its relationship with Ladco, the Company has terminated all contractual relationships with Ladco, other than as a lender, and all property management, leasing, administration, and accounting functions have been transitioned from Ladco to the Company. As of September 30, 2011, the Company had six mortgage notes with outstanding principal balances of approximately \$51.8 million remaining with Ladco, excluding the mortgage note receivable related to the construction in progress consolidated by the Company during the third quarter as discussed in Notes 1 and 6 of the Company's Condensed Consolidated Financial Statements. In October 2011, the Company took ownership of two land parcels in Des Moines, Iowa which secured approximately \$4.4 million in mortgage notes. These land parcels will be consolidated by the Company in the fourth quarter and classified as land held for development on the Company's Condensed Consolidated Balance Sheet. Further, on October 21, 2011, a Ladco-affiliated construction mortgage note with \$2.2 million outstanding at September 30, 2011 was repaid in full by the borrower with proceeds from the sale of the property securing the loan. Also, on October 21, 2011, another Ladco-affiliated property securing a \$3.7 million mortgage loan was sold and the mortgage was assigned to the buyer. As part of the assignment of the note, the buyer made a \$0.5 million principal payment on the note.

As discussed in more detail in Note 6 to the Company's Condensed Consolidated Financial Statements, the Company took control of a construction project with Ladco under a mortgage loan arrangement when the Company became aware of the financial instability of the general contractor, an affiliate of Ladco. The Company engaged an unrelated third-party contractor and began consolidating the project during the third quarter of 2011. The building under construction is 100% leased to a AA- rated health system, with the lease commencing upon completion. The



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lease also provides the tenant with an option to purchase the project at completion.

Ladco also served as developer on two wholly-owned medical office buildings that are being constructed by the Company. During the third quarter of 2011, the Company engaged an unrelated third-party contractor when it became aware of the financial instability of the general contractor, an affiliate of Ladco. The Company continues to fund the construction of these two projects, which are included in construction in progress on the Company's Consolidated Balance Sheets.

The Company does not expect an adverse financial impact from the consolidation of the South Dakota construction project or from the transitions to the new contractor.

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**Funds from Operations**

Funds from Operations ( FFO ) and FFO per share are operating performance measures adopted by the National Association of Real Estate Investment Trusts, Inc. ( NAREIT ). NAREIT defines FFO as the most commonly accepted and reported measure of a REIT 's operating performance equal to net income (computed in accordance with GAAP), excluding gains (or losses) from sales of property, plus depreciation and amortization, and after adjustments for unconsolidated partnerships and joint ventures. Impairment charges may not be added back to net income in calculating FFO, which has the effect of decreasing FFO in the period recorded.

Management believes FFO and FFO per share to be supplemental measures of a REIT 's performance because they provide an understanding of the operating performance of the Company 's properties without giving effect to certain significant non-cash items, primarily depreciation and amortization expense. Historical cost accounting for real estate assets in accordance with GAAP assumes that the value of real estate assets diminishes predictably over time. However, real estate values instead have historically risen or fallen with market conditions. The Company believes that by excluding the effect of depreciation, amortization, and gains from sales of real estate, all of which are based on historical costs and which may be of limited relevance in evaluating current performance, FFO and FFO per share can facilitate comparisons of operating performance between periods. The Company reports FFO and FFO per share because these measures are observed by management to also be the predominant measures used by the REIT industry and by industry analysts to evaluate REITs and because FFO per share is consistently reported, discussed, and compared by research analysts in their notes and publications about REITs. For these reasons, management has deemed it appropriate to disclose and discuss FFO and FFO per share. However, FFO does not represent cash generated from operating activities determined in accordance with GAAP and is not necessarily indicative of cash available to fund cash needs. FFO should not be considered as an alternative to net income as an indicator of the Company 's operating performance or as an alternative to cash flow from operating activities as a measure of liquidity.

The comparability of FFO for the three and nine months ended September 30, 2011 to the same periods in 2010 was affected by the various acquisitions and dispositions of the Company 's real estate portfolio and the results of operations of the portfolio from period to period. Other items that impacted the comparability of FFO are discussed below:

impairment charges recognized for the three and nine months ended September 30, 2011 totaled \$1.6 million and \$1.7 million, respectively, or \$0.02 per diluted share, related to two properties sold during 2011, compared to impairment charges totaling \$7.4 million, or \$0.12 per diluted share, recognized for the three and nine months ended September 30, 2010 related to a property sold and a property classified as held for sale during 2010;

increased interest expense for the three and nine months ended September 30, 2011 compared to the same period in 2010 of approximately \$2.0 million, or \$0.03 per diluted common share, and \$9.7 million, or \$0.13 per diluted common share, respectively, due primarily to the issuance of the Senior Notes due 2021 in the fourth quarter of 2010;

a decrease in interest and other income, net for the nine months ended September 30, 2011 compared to the same period in 2010 due to proceeds received in the second quarter of 2010 from the settlement of disputes with former tenants of approximately \$1.2 million, or \$0.02 per diluted common share;

losses on the extinguishment of debt of approximately \$2.0 million, or \$0.03 per diluted common share, recognized during the nine months ended September 30, 2011, compared to \$0.5 million, or \$0.01 per diluted common share, recognized during the nine months ended September 30, 2010 from the redemption of the Senior Notes due 2011 during the first quarter of 2011 and the partial redemption of the Senior Notes due 2011 during 2010; and

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the effect of issuing common shares under the at-the-market equity offering program resulted in a reduction of FFO per share for 2011 compared to 2010. The Company issued 1,360,900 and 11,648,700 common shares, respectively, under the at-the-market equity offering program for the three and nine months ended September 30, 2011 and issued 852,000 and 3,411,200 common shares, respectively, under the at-the-market equity offering program for the three and nine months ended September 30, 2010. The Company also issued 1,847,500 common shares under the at-the-market equity offering program in the fourth quarter of 2010.

The table below reconciles FFO to net income (loss) attributable to common stockholders for the three and nine months ended September 30, 2011 and 2010:

| <i>(Dollars in thousands, except per share data)</i>         | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|--------------------------------------------------------------|-------------------------------------|------------|------------------------------------|------------|
|                                                              | 2011                                | 2010       | 2011                               | 2010       |
| <b>Net Income (Loss) Attributable to Common Stockholders</b> | \$ 647                              | \$ (3,248) | \$ (3,131)                         | \$ 7,820   |
| Gain on sales of real estate properties                      | (1,357)                             | (4,092)    | (1,393)                            | (8,313)    |
| Real estate depreciation and amortization                    | 21,709                              | 18,075     | 62,173                             | 52,843     |
| Total adjustments                                            | 20,352                              | 13,983     | 60,780                             | 44,530     |
| <b>Funds from Operations</b>                                 | \$ 20,999                           | \$ 10,735  | \$ 57,649                          | \$ 52,350  |
| <b>Funds from Operations per Common Share - Basic</b>        | \$ 0.28                             | \$ 0.17    | \$ 0.81                            | \$ 0.85    |
| <b>Funds from Operations per Common Share - Diluted</b>      | \$ 0.27                             | \$ 0.17    | \$ 0.79                            | \$ 0.84    |
| <b>Weighted Average Common Shares Outstanding - Basic</b>    | 76,139,055                          | 62,369,773 | 71,478,463                         | 61,232,810 |
| <b>Weighted Average Common Shares Outstanding - Diluted</b>  | 77,177,114                          | 63,424,706 | 72,570,555                         | 62,269,413 |

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Three Months Ended September 30, 2011 Compared to Three Months Ended September 30, 2010

The Company's results of operations for the three months ended September 30, 2011 compared to the same period in 2010 were significantly impacted by acquisitions, dispositions and impairments of properties, as well as higher interest expense.

| <i>(Dollars in thousands, except per share data)</i>             | Three Months Ended    |                       | Change   |          |
|------------------------------------------------------------------|-----------------------|-----------------------|----------|----------|
|                                                                  | September 30,<br>2011 | September 30,<br>2010 | \$       | %        |
| <b>REVENUES</b>                                                  |                       |                       |          |          |
| Master lease rent                                                | \$ 14,049             | \$ 13,303             | \$ 746   | 5.6%     |
| Property operating                                               | 57,078                | 47,716                | 9,362    | 19.6%    |
| Straight-line rent                                               | 1,109                 | 639                   | 470      | 73.6%    |
| Mortgage interest                                                | 1,776                 | 601                   | 1,175    | 195.5%   |
| Other operating                                                  | 2,067                 | 2,128                 | (61)     | -2.9%    |
|                                                                  | 76,079                | 64,387                | 11,692   | 18.2%    |
| <b>EXPENSES</b>                                                  |                       |                       |          |          |
| General and administrative                                       | 5,530                 | 4,243                 | 1,287    | 30.3%    |
| Property operating                                               | 30,851                | 26,681                | 4,170    | 15.6%    |
| Impairment                                                       |                       | 1,259                 | (1,259)  | -100.0%  |
| Bad debt, net                                                    | (353)                 | 39                    | (392)    | -1005.1% |
| Depreciation                                                     | 19,959                | 16,975                | 2,984    | 17.6%    |
| Amortization                                                     | 2,214                 | 1,237                 | 977      | 79.0%    |
|                                                                  | 58,201                | 50,434                | 7,767    | 15.4%    |
| <b>OTHER INCOME (EXPENSE)</b>                                    |                       |                       |          |          |
| Interest expense                                                 | (17,928)              | (15,923)              | (2,005)  | -12.6%   |
| Interest and other income, net                                   | 205                   | 187                   | 18       | 9.6%     |
|                                                                  | (17,723)              | (15,736)              | (1,987)  | 12.6%    |
| <b>INCOME (LOSS) FROM CONTINUING OPERATIONS</b>                  | 155                   | (1,783)               | 1,938    | 108.7%   |
| <b>DISCONTINUED OPERATIONS</b>                                   |                       |                       |          |          |
| Income from discontinued operations                              | 690                   | 485                   | 205      | 42.3%    |
| Impairments                                                      | (1,551)               | (6,102)               | 4,551    | -74.6%   |
| Gain on sales of real estate properties                          | 1,357                 | 4,092                 | (2,735)  | -66.8%   |
| <b>INCOME (LOSS) FROM DISCONTINUED OPERATIONS</b>                | 496                   | (1,525)               | 2,021    | 132.5%   |
| <b>NET INCOME (LOSS)</b>                                         | 651                   | (3,308)               | 3,959    | 119.7%   |
| Less: Net (income) loss attributable to noncontrolling interests | (4)                   | 60                    | (64)     | -106.7%  |
| <b>NET INCOME (LOSS) ATTRIBUTABLE TO COMMON STOCKHOLDERS</b>     | \$ 647                | \$ (3,248)            | \$ 3,895 | 119.9%   |
| <b>EARNINGS (LOSS) PER COMMON SHARE</b>                          |                       |                       |          |          |
| Net income (loss) attributable to common stockholders - Basic    | \$ 0.01               | \$ (0.05)             | \$ 0.06  | 120.0%   |
| Net income (loss) attributable to common stockholders - Diluted  | \$ 0.01               | \$ (0.05)             | \$ 0.06  | 120.0%   |



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Total revenues from continuing operations for the three months ended September 30, 2011 increased \$11.7 million, or 18.2%, compared to the same period in 2010, mainly for the reasons discussed below:

Master lease rental income increased \$0.7 million, or 5.6%. Master lease rental income increased approximately \$1.7 million as a result of the Company's 2010 acquisitions and approximately \$0.3 million from contractual rent increases. These increases were partially offset by reductions of approximately \$0.7 million related to properties whose master leases had expired and the Company began recognizing the underlying tenant rents and approximately \$0.5 million from the expiration of replacement rent from an operator.

Property operating income increased \$9.4 million, or 19.6%, due mainly to the recognition of additional revenue of approximately \$8.0 million from the Company's 2010 and 2011 real estate acquisitions and approximately \$0.1 million from properties that were previously under construction that commenced operations during 2010. Also, the Company began recognizing the underlying tenant rental income on properties whose master leases had expired, resulting in approximately \$0.4 million in additional income in 2011 compared to 2010, with the remainder of the increase of approximately \$0.9 million resulting mainly from new leasing activity and annual rent increases.

Straight-line rent increased \$0.5 million, or 73.6%, due mainly to leases subject to straight-lining on properties acquired in 2010 and 2011.

Mortgage interest increased \$1.2 million, or 195.5%, due mainly to interest earned on new mortgage notes and additional fundings on existing mortgage notes.

Total expenses for the three months ended September 30, 2011 increased \$7.8 million, or 15.4%, compared to the same period in 2010, mainly for the reasons discussed below:

General and administrative expenses increased \$1.3 million, or 30.3%, due mainly to additional compensation costs of approximately \$0.7 million and project costs of approximately \$0.5 million.

Property operating expense increased \$4.2 million, or 15.6%, due mainly to the recognition of additional expenses totaling approximately \$3.8 million related to the Company's 2010 and 2011 real estate acquisitions and \$0.4 million from properties that were previously under construction that commenced operations during 2010.

An impairment charge totaling \$1.3 million was recognized in 2010 related to one property that was classified as held for sale and subsequently reclassified to held for use.

Depreciation expense increased \$3.0 million, or 17.6%, due mainly to approximately \$2.3 million in additional depreciation recognized related to the Company's 2010 and 2011 real estate acquisitions and \$0.2 million related to properties previously under construction that commenced operations during 2010. The remaining \$0.5 million increase was due mainly to additional depreciation expense recognized related to various building and tenant improvement expenditures.

Amortization expense increased \$1.0 million, or 79.0%, due mainly to lease intangibles of properties acquired in 2010 and 2011.

Other income (expense) for the three months ended September 30, 2011 changed unfavorably by \$2.0 million, or 12.6%, compared to the same period in 2010 due to an increase in interest expense relating mainly to the issuance of the Senior Notes due 2021 in December 2010 and additional interest related to debt assumed as part of the Company's 2011 acquisitions, offset partially by a reduction of interest expense in 2011

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from the repayment of the Senior Notes due 2011 in March 2011.

Income from discontinued operations for the three months ended September 30, 2011 totaled \$0.5 million compared to a loss from discontinued operations for the three months ended September 30, 2010 of \$1.5 million, which includes the results of operations, impairments and gains on sale related to assets classified as held for sale or disposed of as of September 30, 2011.

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*Nine Months Ended September 30, 2011 Compared to Nine Months Ended September 30, 2010*

The Company's results of operations for the nine months ended September 30, 2011 compared to the same period in 2010 were significantly impacted by acquisitions, dispositions and impairments of properties during the period, higher interest expense, and losses recognized related to the redemption of the Senior Notes due 2011.

| <i>(Dollars in thousands, except per share data)</i>            | Nine Months Ended     |                       | Change             |                |
|-----------------------------------------------------------------|-----------------------|-----------------------|--------------------|----------------|
|                                                                 | September 30,<br>2011 | September 30,<br>2010 | \$                 | %              |
| <b>REVENUES</b>                                                 |                       |                       |                    |                |
| Master lease rent                                               | \$ 43,312             | \$ 41,056             | \$ 2,256           | 5.5%           |
| Property operating                                              | 163,280               | 140,008               | 23,272             | 16.6%          |
| Straight-line rent                                              | 3,536                 | 1,989                 | 1,547              | 77.8%          |
| Mortgage interest                                               | 5,250                 | 1,708                 | 3,542              | 207.4%         |
| Other operating                                                 | 6,425                 | 6,399                 | 26                 | 0.4%           |
|                                                                 | 221,803               | 191,160               | 30,643             | 16.0%          |
| <b>EXPENSES</b>                                                 |                       |                       |                    |                |
| General and administrative                                      | 16,469                | 12,513                | 3,956              | 31.6%          |
| Property operating                                              | 87,423                | 75,116                | 12,307             | 16.4%          |
| Impairment                                                      |                       | 1,259                 | (1,259)            | -100.0%        |
| Bad debt, net                                                   | (80)                  | (438)                 | 358                | 81.7%          |
| Depreciation                                                    | 57,928                | 49,582                | 8,346              | 16.8%          |
| Amortization                                                    | 5,753                 | 3,869                 | 1,884              | 48.7%          |
|                                                                 | 167,493               | 141,901               | 25,592             | 18.0%          |
| <b>OTHER INCOME (EXPENSE)</b>                                   |                       |                       |                    |                |
| Loss on extinguishment of debt                                  | (1,986)               | (480)                 | (1,506)            | 313.8%         |
| Interest expense                                                | (57,546)              | (47,803)              | (9,743)            | 20.4%          |
| Interest and other income, net                                  | 636                   | 1,799                 | (1,163)            | -64.6%         |
|                                                                 | (58,896)              | (46,484)              | (12,412)           | 26.7%          |
| <b>INCOME (LOSS) FROM CONTINUING OPERATIONS</b>                 | <b>(4,586)</b>        | <b>2,775</b>          | <b>(7,361)</b>     | <b>-265.3%</b> |
| <b>DISCONTINUED OPERATIONS</b>                                  |                       |                       |                    |                |
| Income from discontinued operations                             | 1,791                 | 2,878                 | (1,087)            | -37.8%         |
| Impairments                                                     | (1,698)               | (6,102)               | 4,404              | 72.2%          |
| Gain on sales of real estate properties                         | 1,393                 | 8,313                 | (6,920)            | -83.2%         |
| <b>INCOME FROM DISCONTINUED OPERATIONS</b>                      | <b>1,486</b>          | <b>5,089</b>          | <b>(3,603)</b>     | <b>-70.8%</b>  |
| <b>NET INCOME (LOSS)</b>                                        | <b>(3,100)</b>        | <b>7,864</b>          | <b>(10,964)</b>    | <b>-139.4%</b> |
| Less: Net income attributable to noncontrolling interests       | (31)                  | (44)                  | 13                 | -29.5%         |
| <b>NET INCOME (LOSS) ATTRIBUTABLE TO COMMON STOCKHOLDERS</b>    | <b>\$ (3,131)</b>     | <b>\$ 7,820</b>       | <b>\$ (10,951)</b> | <b>-140.0%</b> |
| <b>EARNINGS (LOSS) PER COMMON SHARE</b>                         |                       |                       |                    |                |
| Net income (loss) attributable to common stockholders - Basic   | \$ (0.04)             | \$ 0.13               | \$ (0.17)          | -130.8%        |
| Net income (loss) attributable to common stockholders - Diluted | \$ (0.04)             | \$ 0.13               | \$ (0.17)          | -130.8%        |





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Total revenues from continuing operations for the nine months ended September 30, 2011 increased \$30.6 million, or 16.0%, compared to the same period in 2010, mainly for the reasons discussed below:

Master lease income increased \$2.3 million, or 5.5%. Master lease rental income increased approximately \$5.0 million as a result of the Company's 2010 acquisitions and increased approximately \$0.7 million from contractual rent increases. These increases to master lease rent were partially offset by reductions of approximately \$2.7 million related to properties whose master leases had expired and the Company began recognizing the underlying tenant rents and approximately \$0.7 million from the expiration of replacement rent from an operator.

Property operating income increased \$23.3 million, or 16.6%, due mainly to the recognition of additional revenue of approximately \$20.5 million from the Company's 2010 and 2011 real estate acquisitions and approximately \$0.2 million from properties that were previously under construction that commenced operations during 2010. Also, the Company began recognizing the underlying tenant rental income on properties whose master leases had expired, resulting in approximately \$1.4 million in additional property operating income in 2011 compared to 2010, with the remainder of the increase of approximately \$1.2 million mainly resulting from new leasing activity and annual rent increases.

Straight-line rent increased \$1.5 million, or 77.8%, due mainly to straight-line rent recognized on leases subject to straight-lining from properties acquired in 2010 and 2011 of approximately \$2.0 million, partially offset by a decrease in straight-line rent due to leases that are recognizing straight-line rent expense of \$0.5 million.

Mortgage interest increased \$3.5 million, or 207.4%, due mainly to interest earned on new mortgage notes and additional fundings on existing mortgage notes of approximately \$4.3 million, partially offset by a reduction in interest of approximately \$0.8 million from the repayment of mortgage notes.

Total expenses for the nine months ended September 30, 2011 increased \$25.6 million, or 18.0%, compared to the same period in 2010, mainly for the reasons discussed below:

General and administrative expenses increased \$4.0 million, or 31.6%. Compensation-related costs increased approximately \$2.1 million, travel costs increased approximately \$0.6 million and pursuit costs increased approximately \$0.9 million. Also, expenses for 2011 compared to 2010 increased due to a one-time reversal of expense recorded in 2010 of approximately \$0.5 million relating to a change in the named executive officer benefit arrangement upon retirement.

Property operating expense increased \$12.3 million, or 16.4%, due mainly to the recognition of additional expenses totaling approximately \$9.3 million related to the Company's 2010 and 2011 real estate acquisitions and \$1.1 million from properties that were previously under construction that commenced operations during 2010. Property operating expense also increased approximately \$0.5 million for properties whose master leases expired and the Company began incurring the underlying operating expenses of the buildings, increased approximately \$0.6 million related to higher general maintenance and repair expense and increased approximately \$0.5 million due to higher utility expenses.

An impairment charge totaling \$1.3 million was recognized in 2010 related to one property that was classified as held for sale and subsequently reclassified to held for use.

Depreciation expense increased \$8.3 million, or 16.8%, due mainly to approximately \$6.0 million in additional depreciation recognized related to the Company's 2010 and 2011 real estate acquisitions and \$1.2 million related to properties previously under construction that commenced operations during 2010. The remaining \$1.1 million increase was due mainly to additional depreciation

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expense recognized related to various building and tenant improvement expenditures.

Amortization expense increased \$1.9 million, or 48.7%, due mainly to additional amortization expense recognized related to lease intangibles acquired with the Company's 2010 and 2011 real estate acquisitions.

Other income (expense) for the nine months ended September 30, 2011 changed unfavorably by \$12.4 million, or 26.7%, compared to the same period in 2010, mainly for the reasons discussed below:

The Company recognized a \$2.0 million loss from the early extinguishment of the Senior Notes due 2011 in March 2011 and recognized a \$0.5 million loss from the early extinguishment of a portion of the Senior Notes due 2011 in 2010.

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Interest expense increased \$9.7 million, or 20.4%, due to the following:

approximately \$17.7 million from the issuance of the Senior Notes due 2021 in December 2010;

approximately \$1.3 million from the mortgage notes assumed as part of the real estate acquisitions in 2010 and 2011;

approximately \$1.3 million from a reduction in capitalized interest; and

approximately \$1.2 million due to a higher weighted average balance on the Unsecured Credit Facility due 2012; offset by

a decrease of approximately \$11.6 million due mainly to the redemption of the Senior Notes due 2011 in March 2011.

Interest and other income, net decreased approximately \$1.2 million, or 64.6%, due mainly to proceeds received in 2010 of approximately \$1.1 million related to the cash settlement of disputes with former tenants.

Income from discontinued operations totaled \$1.5 million and \$5.1 million, respectively, for the nine months ended September 30, 2011 and 2010, which includes the results of operations, impairments, and gains on sale related to assets classified as held for sale or disposed of as of September 30, 2011.

**Liquidity and Capital Resources***Sources and Uses of Cash*

The Company's primary sources of cash include rent and interest receipts from its real estate and mortgage portfolio based on contractual arrangements with its tenants and sponsors, borrowings under its credit facilities, proceeds from the sales of real estate properties or the repayments of mortgage notes receivable or proceeds from public or private debt or equity offerings, including the at-the-market equity offering program. The Company's primary uses of cash include dividend distributions, debt service payments, including principal and interest, real estate investments, including acquisitions and construction advances, as well as property operating and general and administrative expenses. These sources and uses of cash are detailed in the table below, as well as in the Company's Condensed Consolidated Statements of Cash Flows.

|                                                | Nine Months Ended |                   | Change     |         |
|------------------------------------------------|-------------------|-------------------|------------|---------|
|                                                | Sept. 30,<br>2011 | Sept. 30,<br>2010 | \$         | %       |
| <i>(Dollars in thousands)</i>                  |                   |                   |            |         |
| Cash and cash equivalents, beginning of period | \$ 113,321        | \$ 5,851          | \$ 107,470 | 1836.8% |
| Cash provided by operating activities          | 67,246            | 68,975            | (1,729)    | -2.5%   |
| Cash used in investing activities              | (251,848)         | (156,868)         | (94,980)   | 60.5%   |
| Cash provided by financing activities          | 75,335            | 93,219            | (17,884)   | -19.2%  |
| Cash and cash equivalents, end of period       | \$ 4,054          | \$ 11,177         | \$ (7,123) | -63.7%  |

*Operating Activities*

Cash flows provided by operating activities remained fairly consistent for the nine months ended September 30, 2011 compared to the same period in 2010 with a slight decrease from \$69.0 million in 2010 to \$67.2 million in 2011. Several items impact cash flows from operations including, but not limited to, cash generated from property operations, interest payments and the timing related to the payment of invoices.

*Investing Activities*

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Cash flows used in investing activities increased during the nine months ended September 30, 2011 compared to the same period in 2010 primarily due to the origination and funding of mortgage notes receivables.

**Table of Contents***Financing Activities*

Cash flows provided by financing activities decreased during the nine months ended September 30, 2011 compared to the same period in 2010 primarily due to the redemption of the Senior Notes due 2011.

*Contractual Obligations*

The Company monitors its contractual obligations to ensure funds are available to meet obligations when due. The following table represents the Company's long-term contractual obligations for which the Company was making payments as of September 30, 2011, including interest payments due where applicable. The Company is also required to pay dividends to its stockholders at least equal to 90% of its taxable income in order to maintain its qualification as a real estate investment trust under the Internal Revenue Code of 1986, as amended. The Company's material contractual obligations for the remainder of 2011 through 2012 are included in the table below. At September 30, 2011, the Company had no purchase or long-term capital lease obligations.

| <i>(Dollars in thousands)</i>                      | 2011             | 2012              | Total             |
|----------------------------------------------------|------------------|-------------------|-------------------|
| Long-term debt obligations, including interest (1) | \$ 11,004        | \$ 248,367        | \$ 259,371        |
| Operating lease commitments (2)                    | 1,072            | 4,335             | 5,407             |
| Construction in progress (3)                       | 42,533           | 17,746            | 60,279            |
| Tenant improvements (4)                            |                  |                   |                   |
| Construction loan obligations (5)                  | 24,464           | 92,837            | 117,301           |
| Pension obligations (6)                            |                  |                   |                   |
| <b>Total contractual obligations</b>               | <b>\$ 79,073</b> | <b>\$ 363,285</b> | <b>\$ 442,358</b> |

- (1) Includes estimated interest due on total debt other than on the Unsecured Credit Facility due 2012. Note 4 to the Company's Condensed Consolidated Financial Statements provides more detail on the Company's notes and bonds payable.
- (2) Includes primarily the corporate office lease and ground leases related to various properties for which the Company is currently making payments.
- (3) The table above includes cash flow projections for the remainder of 2011 and 2012 related to the construction of the five buildings currently in construction in progress but does not include budgeted amounts on those projects that are designated for tenant improvements which the Company is not obligated to fund until tenant leases are executed.
- (4) The Company has various first-generation tenant improvement budgeted amounts remaining as of September 30, 2011 of approximately \$27.7 million related to properties developed by the Company that the Company may fund for tenant improvements as leases are signed. The Company cannot predict when or if these amounts will be expended and, therefore, has not included estimated fundings in the table above.
- (5) The Company's remaining funding commitment as of September 30, 2011 on seven construction loans. Not included in the table above is an additional \$59.8 million that the Company expects will be funded in 2013 on two of the construction loans.
- (6) At December 31, 2010, the last measurement date, one employee, the Company's chief executive officer, was eligible to retire under the Executive Retirement Plan. If the chief executive officer retired and received full retirement benefits based upon the terms of the plan, the future benefits to be paid are estimated to be approximately \$29.9 million as of December 31, 2010. However, because the Company's chief executive officer has no present intention to retire, the Company has not projected when the retirement benefits would be paid to the officer in this table. At September 30, 2011, the Company had recorded a \$16.9 million liability, included in other liabilities, related to its pension plan obligations.

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As of September 30, 2011, the Company's leverage ratio [debt divided by (debt plus stockholders' equity less intangible assets plus accumulated depreciation)] was approximately 47.0%. The Company's fixed charge ratio, calculated in accordance with Item 503 of Regulation S-K, includes only income from continuing operations which is reduced by depreciation and amortization and the operating results of properties currently classified as held for sale, as well as other income from discontinued operations. In accordance with this definition, the Company's earnings from continuing operations for the nine months ended September 30, 2011 were insufficient to cover its fixed charges by approximately \$11.0 million, with a ratio of 0.83 to 1.00. However, the Company's earnings calculated in accordance with its fixed charge covenant ratio under its Unsecured Credit Facility due 2012, which is based on a rolling four quarter calculation, covered its fixed charges by 2.0 times.

The Company's various debt agreements contain certain representations, warranties, and financial and other covenants customary in such debt agreements. Among other things, these provisions require the Company to maintain certain financial ratios and minimum tangible net worth and impose certain limits on the Company's ability to incur indebtedness and create liens or encumbrances. At September 30, 2011, the Company was in compliance with the financial covenant provisions under all of its various debt instruments.

*New Unsecured Credit Facility*

On October 14, 2011, the Company replaced its Unsecured Credit Facility due 2012 with a new \$700 million Unsecured Credit Facility that matures in October 2015. The new Unsecured Credit Facility is currently priced approximately 135 basis points lower than the previous facility, which would result in over \$2 million in reduced interest payments per annum, based on the outstanding balance at September 30, 2011. At October 15, 2011, the Company had \$187.0 million outstanding under the Unsecured Credit Facility, with a weighted average interest rate of approximately 1.74% and a remaining borrowing capacity of approximately \$513.0 million.

*Security Deposits and Letters of Credit*

As of September 30, 2011, the Company had approximately \$6.5 million in letters of credit, security deposits, debt service reserves or capital replacement reserves for the benefit of the Company in the event the obligated lessee or operator fails to make payments under the terms of their respective lease or mortgage. Generally, the Company may, at its discretion and upon notification to the operator or tenant, draw upon these instruments if there are any defaults under the leases or mortgage notes.

*Development Activity*

The Company had several ongoing development projects at September 30, 2011, including five construction projects, seven mortgage construction loans and eight properties in the process of stabilization subsequent to construction. A summary of these development projects is detailed in the table below.

|                               | Number of Properties | Amount Funded                            | Total Amount                  | Estimated Remaining Fundings | Estimated Total Investment | Approximate Square Feet |
|-------------------------------|----------------------|------------------------------------------|-------------------------------|------------------------------|----------------------------|-------------------------|
|                               |                      | During Three Months Ended Sept. 30, 2011 | Funded Through Sept. 30, 2011 |                              |                            |                         |
| <i>(Dollars in thousands)</i> |                      |                                          |                               |                              |                            |                         |
| Construction in progress      | 5                    | \$ 28,809                                | \$ 134,716                    | \$ 63,424                    | \$ 198,140                 | 587,758                 |
| Mortgage construction loans   | 7                    | 8,836                                    | 48,202                        | 177,097                      | 225,299                    | 489,931                 |
| Stabilization in progress     | 8                    | 2,166                                    | 237,192                       | 7,608                        | 244,800                    | 808,140                 |
| Land held for development     |                      |                                          | 20,773                        |                              |                            |                         |
| <b>Total</b>                  | <b>20</b>            | <b>\$ 39,811</b>                         | <b>\$ 440,883</b>             | <b>\$ 248,129</b>            | <b>\$ 668,239</b>          | <b>1,885,829</b>        |

As of September 30, 2011, the Company had four medical office buildings and one inpatient facility under construction with estimated completion dates ranging from the fourth quarter of 2011 to the third quarter of 2012. One of the four medical office buildings, with an estimated budget of \$92.2 million, was substantially completed in October 2011 and placed into service. Earlier completion dates, shorter stabilization periods and higher rental rates will result in improved results of operations and cash flows, while lagging completion dates, longer stabilization periods and lower rental rates will result in less favorable results of operations and cash flows.





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The Company expects that the remaining funding commitments totaling \$177.1 million on the seven construction loans at September 30, 2011, of which \$171.6 million related to the two mortgage notes affiliated with Mercy Health, will be funded during the remainder of 2011 through 2013.

At September 30, 2011, the Company had eight properties that it had previously developed that are in the process of stabilization. In the aggregate, the properties were approximately 33% leased and 19% occupied at September 30, 2011, with tenant improvement activities occurring in suites that were leased but not yet occupied by the tenants. The Company's remaining funding commitments on these properties at September 30, 2011 related to tenant improvements. Because these properties are not stabilized, they generated a net operating loss of approximately \$0.9 million and \$2.7 million, respectively, for the three and nine months ended September 30, 2011. Also, one of the properties in stabilization, with an investment of approximately \$85.7 million as of September 30, 2011, has been open and in service for twelve months as of August 2011. Accordingly, the Company ceased capitalizing interest which resulted in higher interest expense in the third quarter of 2011 of approximately \$0.7 million as compared to the second quarter of 2011. Additionally, the Company expects that interest expense in the fourth quarter of 2011 will be approximately \$0.4 million higher as compared to the third quarter of 2011 from not capitalizing interest on the project.

### *At-The-Market Equity Offering Program*

Since December 2008, the Company has had in place an at-the-market equity offering program to sell shares of its common stock from time to time in at-the-market sales transactions. During the nine months ended September 30, 2011, the Company sold 11,648,700 shares of common stock under this program at prices ranging from \$20.27 per share to \$23.63 per share, generating approximately \$251.6 million in net proceeds. No shares have been sold under this program since July 31, 2011, with 2,791,300 authorized shares remaining to be sold under the current sales agreements.

The proceeds from these sales were generally used to fund the Company's investment activities, redeem the 8.125% Senior Notes due 2011 and repay balances outstanding under the Unsecured Credit Facility due 2012.

### *Dividends*

The Company paid quarterly dividends during the first nine months of 2011 of \$0.30 per share per quarter. On November 1, 2011, the Company's Board of Directors declared a common stock cash dividend for the three months ended September 30, 2011 of \$0.30 per share, payable on December 1, 2011 to shareholders of record on November 17, 2011. As described in the Company's Annual Report on Form 10-K for the year ended December 31, 2010 under the heading "Risk Factors," the ability of the Company to pay dividends is dependent upon its ability to generate funds from operations and cash flows and to make accretive new investments.

### *Liquidity*

Net cash provided by operating activities was \$67.2 million and \$69.0 million for the nine months ended September 30, 2011 and 2010, respectively. The Company's cash flows are dependent upon rental rates on leases, occupancy levels of the multi-tenanted buildings, acquisition and disposition activity during the year, and the level of operating expenses, among other factors. The Company's leases, which provide its main source of income and cash flow have terms of approximately one to 20 years and generally have annual fixed rate increases or annual increases based on consumer price indices.

The Company plans to continue to meet its liquidity needs, including funding additional investments, paying dividends, and funding debt service, with cash flows from operations, borrowings under the Unsecured Credit Facility, proceeds from sales of real estate investments, proceeds from debt borrowings, or additional capital market financings. The Company believes that its liquidity and sources of capital are adequate to satisfy its cash requirements. The Company cannot, however, be certain that these sources of funds will continue to be available at a time and upon terms acceptable to the Company in sufficient amounts to meet its liquidity needs.

### *Impact of Inflation*

Inflation has not significantly affected the Company's earnings due to the moderate inflation rate in recent years and the fact that approximately 75% of the Company's leases and property operating agreements require tenants and sponsors to pay all or some portion of the increases in operating expenses, thereby reducing the Company's risk of the adverse effects of inflation. In addition, inflation has the effect of increasing gross revenue the Company is to receive under the terms of certain leases and property operating agreements. Leases and property operating agreements vary in the remaining terms of obligations, further reducing the Company's risk of any adverse effects of inflation. Interest payable



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under the Unsecured Credit Facility is calculated at a variable rate; therefore, the amount of interest payable under the Unsecured Credit Facility is influenced by changes in short-term rates, which tend to be sensitive to inflation. During periods where interest rate increases outpace inflation, the Company's operating results should be negatively impacted. Conversely, when increases in inflation outpace increases in interest rates, the Company's operating results should be positively impacted.

*Off-Balance Sheet Arrangements*

The Company has no off-balance sheet arrangements that are reasonably likely to have a current or future material effect on the Company's financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

*New Accounting Pronouncements*

See Note 1 to the Condensed Consolidated Financial Statements for the impact of new accounting standards. The adoption of these new standards will not have a material impact on the Company's results of operations or financial position.

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

The Company is exposed to market risk in the form of changing interest rates on its debt and mortgage notes and other notes receivable. Management uses regular monitoring of market conditions and analysis techniques to manage this risk. During the three months ended September 30, 2011, there were no material changes in the quantitative and qualitative disclosures about market risks presented in the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

**Item 4. Controls and Procedures.**

*Disclosure Controls and Procedures.* The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)), as of the end of the period covered by this report. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures were effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the Company in the reports it files or submits under the Exchange Act.

*Changes in Internal Control over Financial Reporting.* There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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**PART II - OTHER INFORMATION**

**Item 1. Legal Proceedings.**

Two affiliates of the Company, HR Acquisition of Virginia Limited Partnership and HRT Holdings, Inc., were defendants in a lawsuit brought by Fork Union Medical Investors Limited Partnership, Goochland Medical Investors Limited Partnership, and Life Care Centers of America, Inc., as plaintiffs, in the Circuit Court of Davidson County, Tennessee. The plaintiffs alleged that they overpaid rent between 1991 and 2003 under leases for two skilled nursing facilities in Virginia and sought a refund of such overpayments. Plaintiffs were seeking up to \$2.0 million, plus pre- and post-judgment interest and attorneys' fees. The two leases were terminated by agreement in 2003. The Company denied that it was liable to the plaintiffs and filed a motion for summary judgment seeking dismissal of the case. The court granted the Company's motion for summary judgment and the case was dismissed with prejudice by order entered on July 20, 2011. On August 11, 2011, the plaintiffs filed a notice of appeal with the Tennessee Court of Appeals. No schedule for briefing or oral arguments has yet been established. The Company believes the trial court's dismissal of the case should be affirmed but can provide no assurance as to the outcome of the appeal.

The Company is, from time to time, involved in litigation arising out of the ordinary course of business or which is expected to be covered by insurance. The Company is not aware of any other pending or threatened litigation that, if resolved against the Company, would have a material adverse effect on the Company's consolidated financial position, results of operations, or cash flows.

**Item 1A. Risk Factors.**

In addition to the other information set forth in this report, an investor should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in the Company's Annual Report on Form 10-K for the year ended December 31, 2010, which could materially affect the Company's business, financial condition or future results. The risks, as described in the Company's Annual Report on Form 10-K for the year ended December 31, 2010, are not the only risks facing the Company. Additional risks and uncertainties not currently known to management or that management currently deems immaterial also may materially, adversely affect the Company's business, financial condition, operating results or cash flows.

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**Item 6. Exhibits.**

| <b>Exhibit</b> | <b>Description</b>                                                                                                                                                                                                                                     |
|----------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Exhibit 3.1    | Second Articles of Amendment and Restatement of the Company (1)                                                                                                                                                                                        |
| Exhibit 3.2    | Amended and Restated Bylaws of the Company, as amended (2)                                                                                                                                                                                             |
| Exhibit 4.1    | Specimen Stock Certificate (1)                                                                                                                                                                                                                         |
| Exhibit 4.2    | Second Supplemental Indenture, dated as of March 30, 2004, by the Company to HSBC Bank USA, National Association, as Trustee, (formerly Wachovia Bank, National Association, as Trustee) (3)                                                           |
| Exhibit 4.3    | Form of 5.125% Senior Note Due 2014 (3)                                                                                                                                                                                                                |
| Exhibit 4.4    | Third Supplemental Indenture, dated December 4, 2009, by and between the Company and Regions Bank, as Trustee (4)                                                                                                                                      |
| Exhibit 4.5    | Form of 6.50% Senior Notes due 2017 (set forth in Exhibit B to the Third Supplemental Indenture filed as Exhibit 4.2 thereto) (4)                                                                                                                      |
| Exhibit 4.6    | Fourth Supplemental Indenture, dated December 13, 2010, by and between the Company and Regions Bank, as Trustee (5)                                                                                                                                    |
| Exhibit 4.7    | Form of 5.750% Senior Notes due 2021 (set forth in Exhibit B to the Fourth Supplemental Indenture filed as Exhibit 4.2 thereto) (5)                                                                                                                    |
| Exhibit 10.1   | Credit Agreement, dated as of October 14, 2011, by and among the Company, Wells Fargo Bank, National Association, as Administrative Agent, and the other lenders named therein (6)                                                                     |
| Exhibit 11     | Statement re: Computation of per share earnings (filed herewith in Note 7 to the Condensed Consolidated Financial Statements)                                                                                                                          |
| Exhibit 31.1   | Certification of the Chief Executive Officer of Healthcare Realty Trust Incorporated pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith) |
| Exhibit 31.2   | Certification of the Chief Financial Officer of Healthcare Realty Trust Incorporated pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith) |
| Exhibit 32     | Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith)                                                                                                           |

- (1) Filed as an exhibit to the Company's Registration Statement on Form S-11 (Registration No. 33-60506) previously filed pursuant to the Securities Act of 1933 and hereby incorporated by reference.
- (2) Filed as an exhibit to the Company's Form 10-Q for the quarter ended September 30, 2007 and hereby incorporated by reference.
- (3) Filed as an exhibit to the Company's Form 8-K filed March 29, 2004 and hereby incorporated by reference.
- (4) Filed as an exhibit to the Company's Form 8-K filed December 4, 2009 and hereby incorporated by reference.
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- (6) Filed as an exhibit to the Company's Form 8-K filed October 19, 2011 and hereby incorporated by reference.

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**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

HEALTHCARE REALTY TRUST INCORPORATED

By: /s/ SCOTT W. HOLMES  
Scott W. Holmes  
Executive Vice President and Chief Financial  
Officer

Date: November 1, 2011

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**Exhibit Index**

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