

UNIVERSAL HEALTH REALTY INCOME TRUST

Form 10-Q

August 08, 2012

[Table of Contents](#)

**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 June 30, 2012

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 1-9321

**UNIVERSAL HEALTH REALTY INCOME TRUST**

(Exact name of registrant as specified in its charter)

Edgar Filing: UNIVERSAL HEALTH REALTY INCOME TRUST - Form 10-Q

**MARYLAND**  
(State or other jurisdiction of

incorporation or organization)

**23-6858580**  
(I. R. S. Employer

Identification No.)

**UNIVERSAL CORPORATE CENTER**

**367 SOUTH GULPH ROAD**

**KING OF PRUSSIA, PENNSYLVANIA**  
(Address of principal executive offices)

**19406**  
(Zip Code)

**Registrant's telephone number, including area code (610) 265-0688**

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 the 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  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

Number of common shares of beneficial interest outstanding at July 31, 2012 - 12,683,970

**Table of Contents**

UNIVERSAL HEALTH REALTY INCOME TRUST

INDEX

|  | <b>PAGE N O.</b> |
|--|------------------|
| <b><u>PART I. FINANCIAL INFORMATION</u></b>  |                  |
| Item 1. <u>Financial Statements</u>  |                  |
| <u>Condensed Consolidated Statements of Income - Three and Six Months Ended June 30, 2012 and 2011</u> | 3                |
| <u>Condensed Consolidated Balance Sheets - June 30, 2012 and December 31, 2011</u>                     | 4                |
| <u>Condensed Consolidated Statements of Cash Flows - Six Months Ended June 30, 2012 and 2011</u>       | 5                |
| <u>Notes to Condensed Consolidated Financial Statements</u>  | 6 through 14     |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>   | 15 through 27    |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>                              | 28               |
| Item 4. <u>Controls and Procedures</u>   | 28               |
| <b><u>PART II. Other Information</u></b>   | 29               |
| Item 6. <u>Exhibits</u>  | 29               |
| <u>Signatures</u>  | 30               |
| <b><u>EXHIBIT INDEX</u></b>  | 31               |

**Table of Contents****Part I. Financial Information****Item I. Financial Statements****Universal Health Realty Income Trust**

## Condensed Consolidated Statements of Income

For the Three and Six Months Ended June 30, 2012 and 2011

(amounts in thousands, except per share amounts)

(unaudited)

|  | <b>Three Months Ended<br/>June 30,</b> |             | <b>Six Months Ended<br/>June 30,</b> |             |
|--|--|-------------|--------------------------------------|-------------|
|  | <b>2012</b>                            | <b>2011</b> | <b>2012</b>                          | <b>2011</b> |
| <b>Revenues:</b>   |  |             |                                      |             |
| Base rental - UHS facilities   | \$ 3,732                               | \$ 3,261    | \$ 7,488                             | \$ 6,522    |
| Base rental - Non-related parties  | 6,910                                  | 2,064       | 13,642                               | 4,051       |
| Bonus rental - UHS facilities  | 1,038                                  | 1,092       | 2,154                                | 2,204       |
| Tenant reimbursements and other - Non-related parties  | 1,875                                  | 332         | 3,525                                | 638         |
| Tenant reimbursements and other - UHS facilities   | 111                                    | 17          | 208                                  | 27          |
|  | 13,666                                 | 6,766       | 27,017                               | 13,442      |
| <b>Expenses:</b>   |  |             |                                      |             |
| Depreciation and amortization  | 5,001                                  | 1,539       | 10,221                               | 3,042       |
| Advisory fees to UHS   | 521                                    | 480         | 1,054                                | 951         |
| Other operating expenses   | 4,196                                  | 1,414       | 7,666                                | 2,385       |
| Transaction costs  | 129                                    | 0           | 649                                  | 0           |
|  | 9,847                                  | 3,433       | 19,590                               | 6,378       |
| Income before equity in income of unconsolidated limited liability companies ( LLCs ),<br>interest expense and gain, net | 3,819                                  | 3,333       | 7,427                                | 7,064       |
| Equity in income of unconsolidated LLCs  | 604                                    | 727         | 1,158                                | 1,502       |
| Gain on divestiture of property owned by an unconsolidated LLC, net  | 0                                      | 0           | 7,375                                | 0           |
| Interest expense, net  | (1,956)                                | (368)       | (3,979)                              | (746)       |
| Net income   | \$ 2,467                               | \$ 3,692    | \$ 11,981                            | \$ 7,820    |
| Basic earnings per share   | \$ 0.19                                | \$ 0.29     | \$ 0.95                              | \$ 0.62     |
| Diluted earnings per share   | \$ 0.19                                | \$ 0.29     | \$ 0.95                              | \$ 0.62     |
| Weighted average number of shares outstanding - Basic  | 12,658                                 | 12,642      | 12,655                               | 12,640      |
| Weighted average number of share equivalents   | 6                                      | 9           | 5                                    | 7           |
| Weighted average number of shares and equivalents outstanding - Diluted  | 12,664                                 | 12,651      | 12,660                               | 12,647      |

See accompanying notes to these condensed consolidated financial statements.



**Table of Contents****Universal Health Realty Income Trust**

## Condensed Consolidated Balance Sheets

(dollar amounts in thousands)

(unaudited)

|   | June 30,<br>2012 | December 31,<br>2011 |
|---|------------------|----------------------|
| <b>Assets:</b>  |                  |                      |
| <b>Real Estate Investments:</b>   |                  |                      |
| Buildings and improvements  | \$ 365,667       | \$ 338,648           |
| Accumulated depreciation  | (81,043)         | (74,865)             |
|   | 284,624          | 263,783              |
| Land  | 27,058           | 24,850               |
| Net Real Estate Investments   | 311,682          | 288,633              |
| Investments in and advances to limited liability companies ( LLCs )   | 38,257           | 33,057               |
| <b>Other Assets:</b>  |                  |                      |
| Cash and cash equivalents   | 3,211            | 11,649               |
| Base and bonus rent receivable from UHS   | 2,046            | 1,982                |
| Rent receivable - other   | 2,479            | 2,056                |
| Intangible assets (net of accumulated amortization of \$5.2 million and \$1.2 million at June 30, 2012 and December 31, 2011, respectively)                           | 27,717           | 28,081               |
| Deferred charges, notes receivable and other assets, net  | 5,386            | 5,471                |
| Total Assets  | \$ 390,778       | \$ 370,929           |
| <b>Liabilities:</b>   |                  |                      |
| Line of credit borrowings   | \$ 81,150        | \$ 77,150            |
| Mortgage and other notes payable, non-recourse to us (including net debt premium of \$867,000 and \$1.1 million at June 30, 2012 and December 31, 2011, respectively) | 116,273          | 97,686               |
| Accrued interest  | 578              | 473                  |
| Accrued expenses and other liabilities  | 4,824            | 4,984                |
| Tenant reserves, escrows, deposits and prepaid rents  | 2,214            | 1,691                |
| Total Liabilities   | 205,039          | 181,984              |
| <b>Equity:</b>  |                  |                      |
| Preferred shares of beneficial interest, \$.01 par value; 5,000,000 shares authorized; none issued and outstanding  |                  |                      |
| Common shares, \$.01 par value; 95,000,000 shares authorized; issued and outstanding: 2012 - 12,683,428<br>2011 - 12,666,824  | 127              | 127                  |
| Capital in excess of par value  | 213,912          | 213,566              |
| Cumulative net income   | 459,379          | 447,398              |
| Cumulative dividends  | (487,757)        | (472,230)            |
| Total Universal Health Realty Income Trust Shareholders' Equity   | 185,661          | 188,861              |
| Non-controlling equity interest   | 78               | 84                   |

Edgar Filing: UNIVERSAL HEALTH REALTY INCOME TRUST - Form 10-Q

|                              |            |            |
|------------------------------|------------|------------|
| Total Equity                 | 185,739    | 188,945    |
| Total Liabilities and Equity | \$ 390,778 | \$ 370,929 |

See the accompanying notes to these condensed consolidated financial statements.

**Table of Contents****Universal Health Realty Income Trust**

## Condensed Consolidated Statements of Cash Flows

(amounts in thousands)

(unaudited)

|  | Six months ended<br>June 30, |                 |
|--|------------------------------|-----------------|
|  | 2012                         | 2011            |
| <b>Cash flows from operating activities:</b>   |                              |                 |
| Net income   | \$ 11,981                    | \$ 7,820        |
| <i>Adjustments to reconcile net income to net cash provided by operating activities:</i> |                              |                 |
| Depreciation and amortization  | 10,221                       | 3,042           |
| Restricted/stock-based compensation expense  | 147                          | 140             |
| Gain on divestiture of property owned by an unconsolidated LLC                           | (7,375)                      | 0               |
| <i>Changes in assets and liabilities:</i>  |                              |                 |
| Rent receivable  | (563)                        | (241)           |
| Accrued expenses and other liabilities   | (305)                        | (503)           |
| Tenant reserves, escrows, deposits and prepaid rents                                     | 523                          | 45              |
| Accrued interest   | 105                          | (14)            |
| Other, net   | (118)                        | 17              |
| <b>Net cash provided by operating activities</b>   | <b>14,616</b>                | <b>10,306</b>   |
| <b>Cash flows from investing activities:</b>   |                              |                 |
| Investments in LLCs  | (705)                        | (3,134)         |
| Repayments of advances made to LLCs  | 473                          | 6,599           |
| Advances made to LLCs  | (8,000)                      | (11,099)        |
| Cash distributions in excess of income from LLCs   | 2,318                        | 3,288           |
| Cash distributions of refinancing proceeds from LLCs                                     | 0                            | 2,111           |
| Additions to real estate investments   | (2,171)                      | 4               |
| Deposit on real estate assets  | 100                          | (300)           |
| Net cash paid for acquisition of medical office building                                 | (7,324)                      | (11,782)        |
| Payment of assumed liabilities on acquired properties                                    | (553)                        | 0               |
| Cash proceeds received from divestiture of property owned by an unconsolidated LLC, net  | 8,077                        | 0               |
| <b>Net cash used in investing activities</b>   | <b>(7,785)</b>               | <b>(14,313)</b> |
| <b>Cash flows from financing activities:</b>   |                              |                 |
| Net borrowings on line of credit   | 4,000                        | 19,100          |
| Proceeds from mortgage notes payable   | 7,000                        | 0               |
| Repayments of mortgage and other notes payable   | (10,597)                     | (140)           |
| Financing costs paid on mortgage and other notes payable                                 | (347)                        | 0               |
| Dividends paid   | (15,527)                     | (15,315)        |
| Issuance of shares of beneficial interest, net   | 202                          | 115             |
| <b>Net cash (used in)/ provided by financing activities</b>                              | <b>(15,269)</b>              | <b>3,760</b>    |
| Decrease in cash and cash equivalents  | (8,438)                      | (247)           |
| Cash and cash equivalents, beginning of period   | 11,649                       | 987             |
| <b>Cash and cash equivalents, end of period</b>  | <b>\$ 3,211</b>              | <b>\$ 740</b>   |



**Supplemental disclosures of cash flow information:**

|               |          |        |
|---------------|----------|--------|
| Interest paid | \$ 3,970 | \$ 762 |
|---------------|----------|--------|

See accompanying notes to these condensed consolidated financial statements.

**Table of Contents**

**UNIVERSAL HEALTH REALTY INCOME TRUST**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**June 30, 2012**

(unaudited)

**(1) General**

This Quarterly Report on Form 10-Q is for the Quarterly Period ended June 30, 2012. In this Quarterly Report, we, us, our and the Trust refer to Universal Health Realty Income Trust.

You should carefully review all of the information contained in this Quarterly Report, and should particularly consider any risk factors that we set forth in this Quarterly Report and in other reports or documents that we file from time to time with the Securities and Exchange Commission (the SEC). In this Quarterly Report, we state our beliefs of future events and of our future financial performance. In some cases, you can identify those so-called forward-looking statements by words such as may, will, should, could, would, predicts, potential, continue, expect, future, intends, plans, believes, estimates, appears, projects and similar expressions, as well as statements in future tense. You should be aware that those statements are only our predictions. Actual events or results may differ materially. In evaluating those statements, you should specifically consider various factors, including the risks outlined herein and in our Annual Report on Form 10-K for the year ended December 31, 2011 in *Item 1A Risk Factors* and in *Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations -Forward Looking Statements*. Those factors may cause our actual results to differ materially from any of our forward-looking statements.

Our future results of operations could be unfavorably impacted by continued deterioration in general economic conditions which could result in increases in the number of people unemployed and/or uninsured. Should that occur, it may result in decreased occupancy rates at our medical office buildings as well as a reduction in the revenues earned by the operators of our hospital facilities which would unfavorably impact our future bonus rentals (on the Universal Health Services, Inc. hospital facilities) and may potentially have a negative impact on the future lease renewal terms and the underlying value of the hospital properties. Additionally, the general real estate market has been unfavorably impacted by the deterioration in economic and credit market conditions which may adversely impact the underlying value of our properties. The tightening in the credit markets and the instability in certain banking and financial institutions over the past several years has not had a material impact on us. However, there can be no assurance that unfavorable credit market conditions will not materially increase our cost of borrowings and/or have a material adverse impact on our ability to finance our future growth through borrowed funds.

In this Quarterly Report on Form 10-Q, the term revenues does not include the revenues of the unconsolidated limited liability companies (LLCs) in which we have various non-controlling equity interests ranging from 33% to 95%. We currently account for our share of the income/loss from these investments by the equity method (see Note 5). As of June 30, 2012, we had investments or commitments in thirteen LLCs, twelve of which are accounted for by the equity method and one that is currently consolidated in our financial statements. Additionally, as previously disclosed, during the fourth quarter of 2011, we purchased the third-party minority ownership interests in eleven LLCs of which we previously held non-controlling, majority ownership interests ranging from 85% to 99%. As a result, we now own 100% of each of these entities and began recording their financial results in our financial statements on a consolidated basis during the fourth quarter of 2011.

The financial statements included herein have been prepared by us, without audit, pursuant to the rules and regulations of the SEC and reflect all normal and recurring adjustments which, in our opinion, are necessary to fairly present results for the interim periods. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although we believe that the accompanying disclosures are adequate to make the information presented not misleading. It is suggested that these financial statements be read in conjunction with the financial statements, the notes thereto and accounting policies included in our Annual Report on Form 10-K for the year ended December 31, 2011.

**(2) Relationship with Universal Health Services, Inc. ( UHS ) and Related Party Transactions**

*Leases:* We commenced operations in 1986 by purchasing properties of certain subsidiaries from UHS and immediately leasing the properties back to the respective subsidiaries. Most of the leases were entered into at the time we commenced operations and provided for initial terms of 13 to 15 years with up to six additional 5-year renewal terms. The current base rentals and lease and rental terms for each facility are provided below. The base rents are paid monthly and each lease also provides for additional or bonus rents which are computed and paid on a quarterly basis based upon a computation that compares current quarter revenue to a corresponding quarter in the base year. The leases with subsidiaries

Edgar Filing: UNIVERSAL HEALTH REALTY INCOME TRUST - Form 10-Q

of UHS are unconditionally guaranteed by UHS and are cross-defaulted with one another.

**Table of Contents**

The combined revenues generated from the leases on the UHS hospital facilities comprised approximately 30% of our consolidated revenues during each of the three and six months ended June 30, 2012 and 61% of our consolidated revenues during each of the three and six months ended June 30, 2011. The decreases during the second quarter and the first six months of 2012, as compared to the comparable quarter and six months of the prior year, were due primarily to the December, 2011 purchase of the third-party minority ownership interests in eleven LLCs in which we previously held noncontrolling majority ownership interests (we began recording the financial results of these entities in our financial statements on a consolidated basis at that time) and various acquisitions of medical office buildings ( MOBs ) and clinics completed during 2011 and the first quarter of 2012. Including 100% of the revenues generated at the unconsolidated LLCs in which we have various non-controlling equity interests ranging from 33% to 95%, the leases on the UHS hospital facilities accounted for approximately 21% and 19% of the combined consolidated and unconsolidated revenue for the three month periods ended June 30, 2012 and 2011, respectively, and 22% and 19% of the combined consolidated and unconsolidated revenue for the six months ended June 30, 2012 and 2011, respectively. In addition, twelve MOBs owned by LLCs in which we hold either 100% of the ownership interest or various non-controlling, majority ownership interests, include or will include tenants which are subsidiaries of UHS. The leases to the hospital facilities of UHS are guaranteed by UHS and cross-defaulted with one another.

Pursuant to the Master Lease Document by and among us and certain subsidiaries of UHS, dated December 24, 1986 (the Master Lease ), which governs the leases of all hospital properties with subsidiaries of UHS, UHS has the option to renew the leases at the lease terms described below by providing notice to us at least 90 days prior to the termination of the then current term. In addition, UHS has rights of first refusal to: (i) purchase the respective leased facilities during and for 180 days after the lease terms at the same price, terms and conditions of any third-party offer, or; (ii) renew the lease on the respective leased facility at the end of, and for 180 days after, the lease term at the same terms and conditions pursuant to any third-party offer. UHS also has the right to purchase the respective leased facilities at the end of the lease terms or any renewal terms at the appraised fair market value. In addition, the Master Lease, as amended during 2006, includes a change of control provision whereby UHS has the right, upon one month s notice should a change of control of the Trust occur, to purchase any or all of the four leased hospital properties listed below at their appraised fair market value.

The table below details the existing lease terms and renewal options for each of the UHS hospital facilities, giving effect to the above-mentioned renewals:

| Hospital Name                                     | Type of Facility  | Annual Minimum Rent | End of Lease Term | Renewal Term (years) |
|---|-------------------|---------------------|-------------------|----------------------|
| McAllen Medical Center                            | Acute Care        | \$ 5,485,000        | December, 2016    | 15(a)                |
| Wellington Regional Medical Center                | Acute Care        | \$ 3,030,000        | December, 2016    | 15(b)                |
| Southwest Healthcare System, Inland Valley Campus | Acute Care        | \$ 2,648,000        | December, 2016    | 15(b)                |
| The Bridgeway                                     | Behavioral Health | \$ 930,000          | December, 2014    | 10(c)                |

- (a) UHS has three 5-year renewal options at existing lease rates (through 2031).
- (b) UHS has one 5-year renewal option at existing lease rates (through 2021) and two 5-year renewal options at fair market value lease rates (2022 through 2031).
- (c) UHS has two 5-year renewal options at fair market value lease rates (2015 through 2024).

We are committed to invest up to a total of \$8.9 million in equity and debt financing, of which \$5.0 million has been funded as of June 30, 2012, in exchange for a 95% non-controlling equity interest in an LLC (Palmdale Medical Properties) that constructed, owns, and operates the Palmdale Medical Plaza, located in Palmdale, California, on the campus of a UHS hospital. This MOB has a triple net, 75% master lease commitment by UHS of Palmdale, Inc., a wholly-owned subsidiary of UHS, pursuant to the terms of which the master lease for each suite will be cancelled at such time that the suite is leased to another tenant acceptable to the LLC and UHS of Palmdale, Inc. This MOB, tenants of which include subsidiaries of UHS, was completed and opened during the third quarter of 2008 at which time the master lease commenced. As of June 30, 2012, the master lease threshold of 75% has not been met. The LLC has a third-party term loan of \$6.4 million, which is non-recourse to us, outstanding as of June 30, 2012. This LLC, which is deemed to be a variable interest entity, is consolidated in our financial statements since we are the primary beneficiary.

We are committed to invest up to \$6.4 million in equity and debt financing, of which \$5.6 million has been funded as of June 30, 2012, in exchange for a 95% non-controlling equity interest in an LLC (Sparks Medical Properties) that owns and operates the Vista Medical Terrace and The Sparks Medical Building, located in Sparks, Nevada, on the campus of a UHS hospital. This LLC has a third-party term loan of \$5.3 million, which is non-recourse to us, outstanding as of June 30, 2012. As this LLC is not considered to be a variable interest entity, it is accounted for pursuant to the equity method.



---

**Table of Contents**

We are committed to invest up to a total of \$4.4 million in equity and debt financing, of which \$1.4 million has been funded as of June 30, 2012, in exchange for a 95% non-controlling equity interest in an LLC (Texoma Medical Properties) that developed, constructed, owns and operates the Texoma Medical Plaza located in Denison, Texas, which was completed and opened during the first quarter of 2010. This MOB is located on the campus of a newly constructed and recently opened replacement UHS acute care hospital owned and operated by Texoma Medical Center (Texoma Hospital), a wholly-owned subsidiary of UHS. Texoma Hospital has committed to lease 75% of this building, pursuant to which the master lease for each suite will be cancelled at such time that the suite is leased to another tenant acceptable to the LLC and Texoma Hospital. It is anticipated that the master lease threshold on this MOB will be met in the near future. This MOB will have tenants that include subsidiaries of UHS. This LLC has a third-party term loan of \$13.0 million, which is non-recourse to us, outstanding as of June 30, 2012. As this LLC is not considered to be a variable interest entity, it is accounted for pursuant to the equity method.

*Advisory Agreement:* UHS of Delaware, Inc. (the Advisor), a wholly-owned subsidiary of UHS, serves as Advisor to us under an Advisory Agreement (the Advisory Agreement) dated December 24, 1986. Pursuant to the Advisory Agreement, the Advisor is obligated to present an investment program to us, to use its best efforts to obtain investments suitable for such program (although it is not obligated to present any particular investment opportunity to us), to provide administrative services to us and to conduct our day-to-day affairs. All transactions between us and UHS must be approved by the Trustees who are unaffiliated with UHS (the Independent Trustees). In performing its services under the Advisory Agreement, the Advisor may utilize independent professional services, including accounting, legal, tax and other services, for which the Advisor is reimbursed directly by us. The Advisory Agreement may be terminated for any reason upon sixty days written notice by us or the Advisor. The Advisory Agreement expires on December 31 of each year; however, it is renewable by us, subject to a determination by the Independent Trustees, that the Advisor's performance has been satisfactory. The Advisory Agreement was renewed for 2012 at the same terms and conditions as 2011.

The Advisory Agreement provides that the Advisor is entitled to receive an annual advisory fee equal to 0.65% of our average invested real estate assets, as derived from our consolidated balance sheet. The average real estate assets for advisory fee calculation purposes exclude certain items from our consolidated balance sheet such as, among other things, accumulated depreciation, cash and cash equivalents, base and bonus rent receivables, deferred charges and other assets. The advisory fee is payable quarterly, subject to adjustment at year-end based upon our audited financial statements. In addition, the Advisor is entitled to an annual incentive fee equal to 20% of the amount by which cash available for distribution to shareholders for each year, as defined in the Advisory Agreement, exceeds 15% of our equity as shown on our consolidated balance sheet, determined in accordance with generally accepted accounting principles without reduction for return of capital dividends. The Advisory Agreement defines cash available for distribution to shareholders as net cash flow from operations less deductions for, among other things, amounts required to discharge our debt and liabilities and reserves for replacement and capital improvements to our properties and investments. No incentive fees were paid during the first six months of 2012 or 2011 since the incentive fee requirements were not achieved. Advisory fees incurred and paid (or payable) to UHS amounted to \$521,000 and \$480,000 for the three months ended June 30, 2012 and 2011, respectively, and were based upon average invested real estate assets of \$321 million and \$295 million for the three-month periods ended June 30, 2012 and 2011, respectively. Advisory fees incurred and paid (or payable) to UHS amounted to \$1.1 million and \$951,000 for the six months ended June 30, 2012 and 2011, respectively, and were based upon average invested real estate assets of \$324 million and \$293 million for the six-month periods ended June 30, 2012 and 2011, respectively.

*Officers and Employees:* Our officers are all employees of UHS and although as of June 30, 2012 we had no salaried employees, our officers do receive stock-based compensation from time-to-time. As previously disclosed on our Current Report on Form 8-K as filed on June 11, 2012, in recognition of the efforts and contributions of our executive officers in connection with the various previously disclosed acquisitions, divestitures and purchases of third-party minority ownership interests in certain majority-owned limited liability companies, as completed at various times during 2011 and the first quarter of 2012, the Compensation Committee of the Board of Trustees of the Trust recommended, and the Board of Trustees of the Trust approved, one-time, special compensation awards to our executive officers in the form of a cash bonus and/or shares of restricted stock. The cash bonuses were paid and the restricted shares were granted during the second quarter of 2012. The restricted shares are scheduled to vest on the second anniversary of the date of grant. For additional disclosure, please refer to our Current Report on Form 8-K as filed on June 11, 2012.

*Share Ownership:* As of June 30, 2012 and December 31, 2011, UHS owned 6.2% of our outstanding shares of beneficial interest.

*SEC reporting requirements of UHS:* UHS is subject to the reporting requirements of the SEC and is required to file annual reports containing audited financial information and quarterly reports containing unaudited financial information. Since the leases on the hospital facilities leased to wholly-owned subsidiaries of UHS comprised approximately 30% of our consolidated revenues during each of the three and six months ended June 30, 2012 and 61% of our consolidated revenues during each of the three and six months ended June 30, 2011, and since a subsidiary of UHS is our Advisor, you are encouraged to obtain the publicly available filings for Universal Health Services, Inc. from the SEC's website at [www.sec.gov](http://www.sec.gov). These filings are the sole responsibility of UHS and are not incorporated by reference herein.



**Table of Contents****(3) Dividends**

We declared and paid dividends of \$7.8 million, or \$.615 per share, during the second quarter of 2012 and \$7.7 million, or \$.605 per share, during the second quarter of 2011. We declared and paid dividends of \$15.5 million, or \$1.225 per share, during the six-month period ended June 30, 2012 and \$15.3 million, or \$1.210 per share, during the six-month period ended June 30, 2011.

**(4) Acquisitions and Dispositions****Six Months Ended June 30, 2012:***Acquisition:*

In January, 2012, we purchased, as part of a planned, like-kind exchange transaction pursuant to Section 1031 of the Internal Revenue Code, the PeaceHealth Medical Clinic, a single-tenant medical office building consisting of approximately 99,000 rentable square feet, located in Bellingham, Washington. The property was purchased for approximately \$30.4 million, including the assumption of approximately \$22.4 million of third-party financing. The aggregate purchase price of this MOB was allocated to the assets and liabilities acquired consisting of tangible property (\$26.8 million) and identified intangible assets (\$3.6 million), based on the respective fair values at acquisition, as determined by an appraisal. Intangible assets include the value of the in-place lease at the time of acquisition and will be amortized over the average remaining lease term of approximately ten years.

|                            |          |
|----------------------------|----------|
| Land                       | \$ 1,900 |
| Buildings and improvements | 24,910   |
| Intangible assets          | 3,600    |
| <br>                       |          |
| Total purchase price       | 30,410   |
| Liabilities, net           | (111)    |
| Deposit funded in 2011     | (534)    |
| Debt                       | (22,441) |
| <br>                       |          |
| Net cash paid in 2012      | \$ 7,324 |

In connection with this MOB, during the three months ended June 30, 2012 we recorded revenue of \$703,000 and a net loss of approximately \$11,000 (excluding transaction expenses of \$129,000). During the six months ended June 30, 2012 we recorded revenue of \$1.2 million and net income of approximately \$52,000 (excluding transaction expenses of \$649,000).

*Divestiture:*

In February, 2012, Canyon Healthcare Properties, a limited liability company ( LLC ) in which we owned a 95% noncontrolling ownership interest, completed the divestiture of the Canyon Springs Medical Plaza. As partial consideration for the transaction, the buyer has assumed an existing third-party mortgage related to this property. The divestiture by this LLC generated approximately \$8.1 million of cash proceeds to us, net of closing costs and the minority members' share of the proceeds. This divestiture resulted in a gain of approximately \$7.4 million which is included in our consolidated statement of income for the six months ended June 30, 2012 (recorded during the first quarter of 2012).

**Six Months Ended June 30, 2011:***Acquisition:*

In June, 2011, utilizing a qualified third-party intermediary in connection with a planned like-kind exchange transaction pursuant to Section 1031 of the Internal Revenue Code, we purchased the Lake Pointe Medical Arts, a multi-tenant medical office building located in Rowlett, Texas. The purchase price for this 50,974 square foot MOB was approximately \$12.2 million and was allocated to the assets acquired consisting of tangible property (\$10.1 million) and identified intangible assets (\$2.1 million), based on the respective fair values at acquisition, as determined by an appraisal. Intangible assets include the value of the in-place leases at the time of acquisition and are being amortized over the average remaining lease term at the time of acquisition of 6.5 years.



## Edgar Filing: UNIVERSAL HEALTH REALTY INCOME TRUST - Form 10-Q

There were no divestitures during the first six months of 2011.

Assuming the 2012 acquisition and divestiture, as well as the 2011 acquisitions and divestitures as previously disclosed, occurred on January 1, 2011, our 2011 pro forma net revenues for the three and six months ended June 30, 2011 would have been approximately \$13.2 million and \$26.3 million, respectively, and our 2011 proforma net income for the three and six months ended June 30, 2011 would have been approximately \$2.4 million, or \$0.19 per diluted share, and \$5.9 million, or \$0.46 per diluted share, respectively, without giving effect to the gains and transaction costs recorded during 2011. Assuming the 2012 acquisition and divestiture occurred on January 1, 2012, our net revenues and net income for the three month period ended June 30, 2012 would have remained unchanged from the actual net revenues and net income as reported, and our pro forma net revenues and net income for the six months ended June 30, 2012 would have been approximately \$27.2 million and \$5.3 million, or \$.42 per diluted share, respectively, without giving effect to the gains and transaction costs recorded during 2012.

---

**Table of Contents**

**(5) Summarized Financial Information of Equity Affiliates**

Our consolidated financial statements include the consolidated accounts of our controlled investments and those investments that meet the criteria of a variable interest entity where we are the primary beneficiary. In accordance with the Financial Accounting Standards Board's (FASB) standards and guidance relating to accounting for investments and real estate ventures, we account for our unconsolidated investments in LLCs which we do not control using the equity method of accounting. The third-party members in these investments have equal voting rights with regards to issues such as, but not limited to: (i) divestiture of property; (ii) annual budget approval, and; (iii) financing commitments. These investments, which represent 33% to 95% non-controlling ownership interests, are recorded initially at our cost and subsequently adjusted for our net equity in the net income, cash contributions to, and distributions from, the investments. Pursuant to certain agreements, allocations of sales proceeds and profits and losses of some of the LLC investments may be allocated disproportionately as compared to ownership interests after specified preferred return rate thresholds have been satisfied.

In December, 2011, as previously disclosed on our Annual Report on Form 10-K for the year ended December 31, 2011, we purchased the third-party minority ownership interests in eleven LLCs of which we previously held non-controlling, majority ownership interests ranging from 85% to 99%. As a result, we now own 100% of each of these entities and began recording their financial results in our financial statements on a consolidated basis. Prior to December, 2011, the financial results of these LLCs were included in our financial statements on an unconsolidated basis under the equity method of accounting. With the exception of no longer providing for the third-party's share of the operating results of these entities, there was no material impact on our net income as a result of the consolidation of these entities.

At June 30, 2012, we have non-controlling equity investments or commitments in thirteen LLCs which own MOBs. As of June 30, 2012, we accounted for: (i) twelve of these LLCs on an unconsolidated basis pursuant to the equity method since they are not variable interest entities, and; (ii) one of these LLCs (Palmdale Medical Properties) on a consolidated basis, as discussed below, since it is considered to be a variable interest entity where we are the primary beneficiary by virtue of its master lease with a subsidiary of Universal Health Services, Inc. (UHS), a related party to us. The majority of these LLCs are joint-ventures between us and a non-related party that manages and holds minority ownership interests in the entities. Each LLC is generally self-sustained from a cash flow perspective and generates sufficient cash flow to meet its operating cash flow requirements and service the third-party debt (if applicable) that is non-recourse to us. Although there is typically no ongoing financial support required from us to these entities since they are cash-flow sufficient, we may, from time to time, provide funding for certain purposes such as, but not limited to, significant capital expenditures, leasehold improvements and debt financing. Although we are not obligated to do so, if approved by us at our sole discretion, additional cash fundings are typically advanced as equity or short to intermediate term loans.

Palmdale Medical Properties has a master lease with a subsidiary of UHS. Additionally, UHS of Delaware, a wholly-owned subsidiary of UHS, serves as advisor to us under the terms of an advisory agreement and manages our day-to-day affairs. All of our officers are officers or employees of UHS. As a result of our related-party relationship with UHS and the master lease, lease assurance or lease guarantee arrangements with subsidiaries of UHS, we account for this LLC on a consolidated basis, since the fourth quarter of 2007, since it is a variable interest entity and we are deemed to be the primary beneficiary. The master lease threshold on this MOB has not yet been met.

The other LLCs in which we hold various non-controlling ownership interests are not variable interest entities and therefore are not subject to consolidation. As a result of master lease arrangements between UHS and various LLCs in which we hold majority non-controlling ownership interests, we have consolidated or deconsolidated these LLCs as required in accordance with the FASB's standards and guidance.

Rental income is recorded by our consolidated and unconsolidated MOBs relating to leases in excess of one year in length using the straight-line method under which contractual rents are recognized evenly over the lease term regardless of when payments are due. The amount of rental revenue resulting from straight-line rent adjustments is dependent on many factors, including the nature and amount of any rental concessions granted to new tenants, scheduled rent increases under existing leases, as well as the acquisition and sales of properties that have existing in-place leases with terms in excess of one year. As a result, the straight-line adjustments to rental revenue may vary from period-to-period.

**Table of Contents**

The following property table represents the twelve LLCs in which we own a noncontrolling interest and were accounted for under the equity method as of June 30, 2012:

| Name of LLC                   | Ownership | Property Owned by LLC                               |
|-------------------------------|-----------|---|
| DVMC Properties               | 90%       | Desert Valley Medical Center                        |
| Suburban Properties           | 33%       | Suburban Medical Plaza II                           |
| Santa Fe Scottsdale           | 90%       | Santa Fe Professional Plaza                         |
| 575 Hardy Investors           | 90%       | Centinela Medical Building Complex                  |
| Brunswick Associates          | 74%       | Mid Coast Hospital MOB                              |
| PCH Medical Properties        | 85%       | Rosenberg Children's Medical Plaza                  |
| Arlington Medical Properties  | 75%       | Saint Mary's Professional Office Building           |
| Sierra Medical Properties     | 95%       | Sierra San Antonio Medical Plaza                    |
| PCH Southern Properties       | 95%       | Phoenix Children's East Valley Care Center          |
| Sparks Medical Properties(a.) | 95%       | Vista Medical Terrace & The Sparks Medical Building |
| Grayson Properties(a.)        | 95%       | Texoma Medical Plaza                                |
| 3811 Bell Medical Properties  | 95%       | North Valley Medical Plaza                          |

(a.) Tenants of this medical office building include or will include subsidiaries of UHS.

Below are the combined statements of income (unaudited) for the LLCs accounted for under the equity method at June 30, 2012 and 2011:

|                               | Three Months Ended<br>June 30, |               | Six Months Ended<br>June 30, |               |
|-------------------------------|--------------------------------|---------------|------------------------------|---------------|
|                               | 2012(b.)                       | 2011          | 2012(b.)                     | 2011          |
|                               | (amounts in thousands)         |               |                              |               |
| Revenues                      | \$ 5,347                       | \$ 14,828     | \$ 10,985                    | \$ 29,581     |
| Operating expenses            | 2,247                          | 6,532         | 4,665                        | 13,104        |
| Depreciation and amortization | 942                            | 3,436         | 2,058                        | 6,725         |
| Interest, net                 | 1,616                          | 4,546         | 3,171                        | 9,020         |
| <b>Net income</b>             | <b>\$ 542</b>                  | <b>\$ 314</b> | <b>\$ 1,091</b>              | <b>\$ 732</b> |
| Our share of net income (a.)  | \$ 604                         | \$ 727        | \$ 1,158                     | \$ 1,502      |

(a.) Our share of net income includes interest income earned by us on various advances made to LLCs of approximately \$434,000 and \$655,000 for the three months ended June 30, 2012 and 2011, respectively, and \$817,000 and \$1.3 million for the six months ended June 30, 2012 and 2011, respectively.

(b.) As previously disclosed, during the fourth quarter of 2011, eleven of our previously unconsolidated investments in LLCs are now owned 100% by us and are therefore included in our financial results on a consolidated basis. Additionally, during the fourth quarter of 2011 and the first quarter of 2012, nine LLCs, in which we previously owned various noncontrolling, majority ownership interests, completed divestitures of medical office buildings and related real property. Our share of the financial results of the divested entities were previously accounted for on an unconsolidated basis under the equity method.

Below are the combined balance sheets (unaudited) for the LLCs accounted for under the equity method:

|                             | June 30,<br>2012       | December 31,<br>2011 |
|-----------------------------|------------------------|----------------------|
|                             | (amounts in thousands) |                      |
| Net property, including CIP | \$ 110,190             | \$ 127,755           |

Edgar Filing: UNIVERSAL HEALTH REALTY INCOME TRUST - Form 10-Q

|   |                   |                   |
|---|-------------------|-------------------|
| Other assets                                    | 9,446             | 12,719            |
| <b>Total assets</b>                             | <b>\$ 119,636</b> | <b>\$ 140,474</b> |
| Liabilities                                     | \$ 5,865          | \$ 4,949          |
| Mortgage notes payable, non-recourse to us      | 75,141            | 101,839           |
| Advances payable to us                          | 20,534            | 12,692            |
| Equity  | 18,096            | 20,994            |
| <b>Total liabilities and equity</b>             | <b>\$ 119,636</b> | <b>\$ 140,474</b> |
| <b>Our share of equity and advances to LLCs</b> | <b>\$ 38,257</b>  | <b>\$ 33,057</b>  |

**Table of Contents**

As of June 30, 2012, aggregate principal amounts due on mortgage notes payable by unconsolidated LLCs, which are accounted for under the equity method and are non-recourse to us, are as follows (amounts in thousands):

|              |                  |
|--------------|------------------|
| 2012         | \$ 4,625         |
| 2013         | 6,766            |
| 2014         | 13,854           |
| 2015         | 35,231           |
| 2016         | 316              |
| Later        | 14,349           |
| <b>Total</b> | <b>\$ 75,141</b> |

| Name of LLC                   | Mortgage Balance(b.) | Maturity Date |
|-------------------------------|----------------------|---------------|
| Sierra Medical Properties(a.) | \$ 3,828             | 12/31/2012    |
| Sparks Medical Properties     | 5,273                | 02/12/2013    |
| Grayson Properties(c.)        | 12,985               | 07/01/2014    |
| Brunswick Associates          | 8,158                | 01/01/2015    |
| Arlington Medical Properties  | 25,127               | 10/10/2015    |
| DVMC Properties               | 4,123                | 11/01/2015    |
| PCH Southern Properties       | 6,795                | 12/01/2017    |
| PCH Medical Properties        | 8,852                | 05/01/2018    |
|                               | <b>\$ 75,141</b>     |               |

- (a.) We believe the terms of this loan are within current market underwriting criteria. At this time, we expect to refinance this loan on or before the 2012 maturity date for three to ten year terms at the then current market interest rates. In the unexpected event that we are unable to refinance this loan on reasonable terms, we will explore other financing alternatives, including, among other things, potentially increasing our equity investment in the property utilizing funds borrowed under our revolving credit facility.
- (b.) All mortgage loans, other than construction loans, require monthly principal payments through maturity and include a balloon principal payment upon maturity.
- (c.) This original construction loan automatically converted to a term loan commencing July 1, 2011, with a maturity date of July 1, 2014. Pursuant to the operating agreements of the LLCs, the third-party member and the Trust, at any time, have the right to make an offer ( Offering Member ) to the other member(s) ( Non-Offering Member ) in which it either agrees to: (i) sell the entire ownership interest of the Offering Member to the Non-Offering Member ( Offer to Sell ) at a price as determined by the Offering Member ( Transfer Price ), or; (ii) purchase the entire ownership interest of the Non-Offering Member ( Offer to Purchase ) at the equivalent proportionate Transfer Price. The Non-Offering Member has 60 days to either: (i) purchase the entire ownership interest of the Offering Member at the Transfer Price, or; (ii) sell its entire ownership interest to the Offering Member at the equivalent proportionate Transfer Price. The closing of the transfer must occur within 60 days of the acceptance by the Non-Offering Member.

The LLCs in which we have invested maintain property insurance on all properties. Although we believe that generally our properties are adequately insured, three of the LLCs in which we own various non-controlling equity interests, own properties in California that are located in earthquake zones. These properties are not covered by earthquake insurance since earthquake insurance is no longer available at rates which are economical in relation to the risks covered.

**(6) Recent Accounting Pronouncements**

There were no new accounting pronouncements during the first six months of 2012 that impacted, or are expected to impact us.

In May 2011, the FASB issued an update to the accounting standard for measuring and disclosing fair value. The update modifies the wording used to describe the requirements for fair value measuring and for disclosing information about fair value measurements to improve consistency between U.S. GAAP and International Financial Reporting Standards ( IFRS ). This update is effective for the annual and interim periods

## Edgar Filing: UNIVERSAL HEALTH REALTY INCOME TRUST - Form 10-Q

beginning after December 15, 2011. The adoption of this guidance in 2012 did not have a material impact on our consolidated financial position or results of operations as its impact was limited to disclosure requirements.

### **(7) Long-term debt**

Our previous unsecured \$100 million revolving credit agreement (the Agreement ) was terminated by us on July 25, 2011 and replaced with a new revolving credit facility. The Agreement provided for interest at our option, at the Eurodollar rate plus 0.75% to 1.125%, or the prime rate plus zero to 0.125%. A fee of 0.15% to 0.225% was payable on the unused portion of the commitment. The margins over the Eurodollar, prime rate and the commitment fee were based upon our debt to total capital ratio as defined by the Agreement.

**Table of Contents**

On July 25, 2011, we entered into a new \$150 million revolving credit agreement ( Credit Agreement ). The Credit Agreement, which is scheduled to expire on July 24, 2015, replaced our previous revolving credit facility which was scheduled to mature in January, 2012 and increased our borrowing capacity from \$100 million to \$150 million. The Credit Agreement includes a \$50 million sub limit for letters of credit and a \$20 million sub limit for swingline/short-term loans. The Credit Agreement also provides an option to increase the total facility borrowing capacity by an additional \$50 million, subject to lender agreement. Borrowings made pursuant to the Credit Agreement will bear interest, at our option, at one, two, three, or six month LIBOR plus an applicable margin ranging from 1.75% to 2.50% or at the Base Rate plus an applicable margin ranging from 0.75% to 1.50%. The Credit Agreement defines Base Rate as the greatest of: (a) the administrative agent's prime rate, (b) the federal funds effective rate plus 1/2 of 1%, and; (c) one month LIBOR plus 1%. A fee of 0.30% to 0.50% will be charged on the unused portion of the commitment. The margins over LIBOR, Base Rate and the commitment fee are based upon our ratio of debt to total capital. At June 30, 2012, the applicable margin over the LIBOR rate was 1.75%, the margin over the Base Rate was 0.75%, and the commitment fee was 0.30%.

At June 30, 2012, we had \$81.2 million of outstanding borrowings and \$12.0 million of letters of credit outstanding against our revolving credit agreement. We had \$56.8 million of available borrowing capacity, net of the outstanding borrowings and letters of credit outstanding as of June 30, 2012. There are no compensating balance requirements.

Covenants relating to the Agreement require the maintenance of a minimum tangible net worth and specified financial ratios, limit our ability to incur additional debt, limit the aggregate amount of mortgage receivables and limit our ability to increase dividends in excess of 95% of cash available for distribution, unless additional distributions are required to comply with the applicable section of the Internal Revenue Code of 1986 and related regulations governing real estate investment trusts. We are in compliance with all of the covenants at June 30, 2012. We also believe that we would remain in compliance if the full amount of our commitment was borrowed.

The following table includes a summary of the required compliance ratios, giving effect to the new covenants contained in the Credit Agreement (dollar amounts in thousands):

|                             | Covenant   | June 30,<br>2012 |
|-----------------------------|------------|------------------|
| Tangible net worth          | \$ 125,000 | \$ 157,944       |
| Debt to total capital       | < 55%      | 30.4%            |
| Debt service coverage ratio | > 5.00x    | 28.21x           |
| Debt to cash flow ratio     | < 3.50x    | 1.32x            |

We have thirteen mortgages, all of which are non-recourse to us, included on our consolidated balance sheet as of June 30, 2012, with a combined outstanding balance of \$115.4 million (excluding net debt premium, resulting from fair value recognition of third-party debt related to majority-owned LLCs in which we purchased the minority ownership interests, of \$867,000 at June 30, 2012). The following table summarizes our outstanding mortgages at June 30, 2012 (amounts in thousands):

| Facility Name   | Outstanding<br>Balance<br>(in thousands) | Interest<br>Rate | Maturity<br>Date |
|---|--|------------------|------------------|
| BRB Medical Office Building mortgage loan(b)                      | \$ 6,180                                 | 6.25%            | 2012             |
| Centennial Hills Medical Office Building I mortgage loan(a)       | 11,751                                   | 6.00%            | 2013             |
| Palmdale Medical Plaza fixed rate mortgage loan(a)                | 6,363                                    | 5.10%            | 2013             |
| Summerlin Hospital Medical Office Building I mortgage loan(a)     | 9,491                                    | 6.55%            | 2014             |
| Spring Valley Medical Office Building mortgage loan(a)            | 5,406                                    | 5.50%            | 2015             |
| Summerlin III Medical Office Building III mortgage loan(a) (c)    | 11,801                                   | Floating         | 2016             |
| Auburn Medical II mortgage loan (a)(d)                            | 7,726                                    | Floating         | 2017             |
| Medical Center of Western Connecticut fixed rate mortgage loan(a) | 5,057                                    | 6.00%            | 2017             |
| PeaceHealth Medical Clinic fixed rate mortgage loan(a)            | 22,282                                   | 5.64%            | 2017             |
| Summerlin Hospital Medical Office Building II mortgage loan(a)    | 12,432                                   | 5.50%            | 2017             |
| Kindred Hospital-Corpus Christi fixed rate mortgage loan(a)       | 3,095                                    | 6.50%            | 2019             |
| 700 Shadow Lane and Goldring MOB mortgage loan (a)                | 7,000                                    | 4.54%            | 2022             |
| Tuscan Professional Building fixed rate mortgage loan(a)          | 6,822                                    | 5.56%            | 2025             |

Total

\$ 115,406



**Table of Contents**

- (a) Amortized principal payments made on a monthly basis.
  - (b) We believe the terms of this loan are within current market underwriting criteria. At this time, we expect to refinance this loan on or before the 2012 maturity date for three to ten year terms at the then current market interest rates. In the unexpected event that we are unable to refinance this loan on reasonable terms, we will explore other financing alternatives, including, among other things, potentially repaying the mortgage loan utilizing funds borrowed under our revolving credit facility.
  - (c) This loan was amended and extended in April, 2012, with a floating rate of 1, 6 or 12 month Libor plus 3.25% at the borrower's option.
  - (d) This loan was amended and extended in April, 2012, with a floating rate of 1, 6 or 12 month Libor plus 2.75% at the borrower's option.
- The mortgages are secured by the real property of the buildings as well as property leases and rents. The mortgages have a combined fair value of approximately \$117.6 million as of June 30, 2012. Changes in market rates on our fixed rate debt impacts the fair value of debt, but it has no impact on interest incurred or cash flow.

**(8) Segment Reporting**

Our primary business is investing in and leasing healthcare and human service facilities through direct ownership or through joint ventures, which aggregate into a single reportable segment. We actively manage our portfolio of healthcare and human service facilities and may from time to time make decisions to sell lower performing properties not meeting our long-term investment objectives. The proceeds of sales are typically reinvested in new developments or acquisitions, which we believe will meet our planned rate of return. It is our intent that all healthcare and human service facilities will be owned or developed for investment purposes. Our revenue and net income are generated from the operation of our investment portfolio.

Our portfolio is located throughout the United States, however, we do not distinguish or group our operations on a geographical basis for purposes of allocating resources or measuring performance. We review operating and financial data for each property on an individual basis; therefore, we define an operating segment as our individual properties. Individual properties have been aggregated into one reportable segment based upon their similarities with regard to both the nature and economics of the facilities, tenants and operational processes, as well as long-term average financial performance.

---

**Table of Contents**

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

**Overview**

We are a real estate investment trust ( REIT ) that commenced operations in 1986. We invest in healthcare and human service related facilities including acute care hospitals, behavioral healthcare facilities, rehabilitation hospitals, sub-acute facilities, surgery centers, childcare centers and medical office buildings ( MOBs ). As of June 30, 2012, we have fifty-four real estate investments or commitments located in fifteen states consisting of:

seven hospital facilities consisting of three acute care, one behavioral healthcare, one rehabilitation and two sub-acute;

forty-three medical office buildings, including thirteen owned by various jointly-owned LLCs, the majority of which are unconsolidated, and;

four pre-school and childcare centers.

**Forward Looking Statements and Certain Risk Factors**

This report contains forward-looking statements that reflect our current estimates, expectations and projections about our future results, performance, prospects and opportunities. Forward-looking statements include, among other things, the information concerning our possible future results of operations, business and growth strategies, financing plans, expectations that regulatory developments or other matters will not have a material adverse effect on our business or financial condition, our competitive position and the effects of competition, the projected growth of the industry in which we operate, and the benefits and synergies to be obtained from our completed and any future acquisitions, and statements of our goals and objectives, and other similar expressions concerning matters that are not historical facts. Words such as may, will, should, could, would, predicts, potential, continue, expects, anticipates, future, intends, plans, believes, estimates, a expressions, as well as statements in future tense, identify forward-looking statements.

Forward-looking statements should not be read as a guarantee of future performance or results, and will not necessarily be accurate indications of the times at, or by which, such performance or results will be achieved. Forward-looking information is based on information available at the time and/or our good faith belief with respect to future events, and is subject to risks and uncertainties that could cause actual performance or results to differ materially from those expressed in the statements. Such factors include, among other things, the following:

a substantial portion of our revenues are dependent upon one operator, Universal Health Services, Inc. ( UHS );

a number of legislative initiatives have recently been passed into law that may result in major changes in the health care delivery system on a national or state level to the operators of our facilities, including UHS. No assurances can be given that the implementation of these new laws will not have a material adverse effect on the business, financial condition or results of operations of our operators;

a subsidiary of UHS is our Advisor and our officers are all employees of UHS, which may create the potential for conflicts of interest;

lost revenues from purchase option exercises and lease expirations and renewals, loan repayments and other restructuring;

the availability and terms of capital to fund the growth of our business;

## Edgar Filing: UNIVERSAL HEALTH REALTY INCOME TRUST - Form 10-Q

the outcome of known and unknown litigation, government investigations, and liabilities and other claims asserted against us or the operators of our facilities;

failure of the operators of our hospital facilities to comply with governmental regulations related to the Medicare and Medicaid licensing and certification requirements could have a material adverse impact on our future revenues and the underlying value of the property;

the potential unfavorable impact on our business of deterioration in national, regional and local economic and business conditions, including a continuation or worsening of unfavorable credit and/or capital market conditions, which may adversely affect, on acceptable terms, our access to sources of capital which may be required to fund the future growth of our business and refinance existing debt with near term maturities;

further deterioration in general economic conditions which could result in increases in the number of people unemployed and/or insured and likely increase the number of individuals without health insurance; as a result, the operators of our facilities may experience decreases in patient volumes which could result in decreased occupancy rates at our medical office buildings;

**Table of Contents**

a worsening of the economic and employment conditions in the United States could materially affect the business of our operators, including UHS, which may unfavorably impact our future bonus rentals (on the UHS hospital facilities) and may potentially have a negative impact on the future lease renewal terms and the underlying value of the hospital properties;

real estate market factors, including without limitation, the supply and demand of office space and market rental rates, changes in interest rates as well as an increase in the development of medical office condominiums in certain markets;

government regulations, including changes in the reimbursement levels under the Medicare and Medicaid program resulting from, among other things, the various health care reform initiatives being implemented;

the issues facing the health care industry that affect the operators of our facilities, including UHS, such as: changes in, or the ability to comply with, existing laws and government regulations; unfavorable changes in the levels and terms of reimbursement by third party payors or government programs, including Medicare (including, but not limited to, the potential unfavorable impact of future reductions to Medicare reimbursements resulting from the recently passed Budget Control Act of 2011, as discussed below) and Medicaid (most states have reported significant budget deficits that have resulted in the reduction of Medicaid funding to the operators of our facilities, including UHS, during each of the last several years, and many states may effectuate further reductions in the level of Medicaid funding due to continued projected state budget deficits); demographic changes; the ability to enter into managed care provider agreements on acceptable terms; an increase in uninsured and self-pay patients which unfavorably impacts the collectability of patient accounts; decreasing in-patient admission trends; technological and pharmaceutical improvements that may increase the cost of providing, or reduce the demand for, health care, and; the ability to attract and retain qualified medical personnel, including physicians;

in August, 2011, the Budget Control Act of 2011 (the 2011 Act ) was enacted into law. The 2011 Act imposed annual spending limits for most federal agencies and programs aimed at reducing budget deficits by \$917 billion between 2012 and 2021, according to a report released by the Congressional Budget Office. The 2011 Act provides for new spending on program integrity initiatives intended to reduce fraud and abuse under the Medicare program. Among its other provisions, the law established a bipartisan Congressional committee, known as the Joint Select Committee on Deficit Reduction (the Joint Committee ), which was tasked with making recommendations aimed at reducing future federal budget deficits by an additional \$1.5 trillion over 10 years. The Joint Committee was unable to reach an agreement by the November 23, 2011 deadline and, as a result, across-the-board cuts to discretionary, national defense and Medicare spending were implemented which, if triggered, would result in Medicare payment reductions of up to 2% per fiscal year with a uniform percentage reduction across all Medicare programs starting in 2013. We cannot predict whether Congress will attempt to suspend or restructure the automatic budget cuts or what other deficit reduction initiatives may be proposed by Congress. We also cannot predict the effect this enactment will have on operators (including UHS), and, thus, our business;

three LLCs that own properties in California, in which we have various non-controlling equity interests, could not obtain earthquake insurance at rates which are economically beneficial in relation to the risks covered;

competition for our operators from other REITs;

the operators of our facilities face competition from other health care providers, including physician owned facilities and other competing facilities, including certain facilities operated by UHS but the real property of which is not owned by us. Such competition is experienced in markets including, but not limited to, McAllen, Texas, the site of our McAllen Medical Center, a 428-bed acute care hospital, and Riverside County, California, the site of our Southwest Healthcare System-Inland Valley Campus, a 130-bed acute care hospital;

changes in, or inadvertent violations of, tax laws and regulations and other factors than can affect REITs and our status as a REIT;

should we be unable to comply with the strict income distribution requirements applicable to REITs, utilizing only cash generated by operating activities, we would be required to generate cash from other sources which could adversely affect our financial condition;

our majority ownership interests in various LLCs in which we hold non-controlling equity interests. In addition, pursuant to the operating agreements of most of the LLCs (consisting of substantially all of the LLCs that own MOBs in Arizona, Nevada and California), the third-party member and the Trust, at any time, have the right to make an offer ( Offering Member ) to the other member(s) ( Non-Offering Member ) in which it either agrees to: (i) sell the entire ownership interest of the Offering Member to the Non-Offering Member ( Offer to Sell ) at a price as determined by the Offering Member ( Transfer Price ), or; (ii) purchase the entire ownership interest of the Non-Offering Member ( Offer to

---

## Table of Contents

Purchase ) at the equivalent proportionate Transfer Price. The Non-Offering Member has 60 days to either: (i) purchase the entire ownership interest of the Offering Member at the Transfer Price, or; (ii) sell its entire ownership interest to the Offering Member at the equivalent proportionate Transfer Price. The closing of the transfer must occur within 60 days of the acceptance by the Non-Offering Member;

UHS's 2010 acquisition of Psychiatric Solutions, Inc. has required UHS to substantially increase its level of indebtedness, which will be further increased by UHS's planned acquisition of Ascend Health Corporation later in 2012, which could, among other things, adversely affect its ability to raise additional capital to fund operations, limit its ability to react to changes in the economy or its industry and could potentially prevent it from meeting its obligations under the agreements related to its indebtedness. If UHS experiences financial difficulties and, as a result, operations of its existing facilities suffer, or UHS otherwise fails to make payments to us, our revenues will significantly decline;

fluctuations in the value of our common stock, and;

other factors referenced herein or in our other filings with the Securities and Exchange Commission.

Given these uncertainties, risks and assumptions, you are cautioned not to place undue reliance on such forward-looking statements. Our actual results and financial condition, including the operating results of our lessees and the facilities leased to subsidiaries of UHS, could differ materially from those expressed in, or implied by, the forward-looking statements.

Forward-looking statements speak only as of the date the statements are made. We assume no obligation to publicly update any forward-looking statements to reflect actual results, changes in assumptions or changes in other factors affecting forward-looking information, except as may be required by law. All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by this cautionary statement.

## Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the amounts reported in our consolidated financial statements and accompanying notes. We consider our critical accounting policies to be those that require us to make significant judgments and estimates when we prepare our financial statements, including the following:

**Revenue Recognition:** Our revenues consist primarily of rentals received from tenants, which are comprised of minimum rent (base rentals), bonus rentals and reimbursements from tenants for their pro-rata share of expenses such as common area maintenance costs, real estate taxes and utilities.

The minimum rent for all hospital facilities is fixed over the initial term or renewal term of the respective leases. Rental income recorded by our consolidated and unconsolidated medical office buildings ( MOBs ) relating to leases in excess of one year in length is recognized using the straight-line method under which contractual rents are recognized evenly over the lease term regardless of when payments are due. The amount of rental revenue resulting from straight-line rent adjustments is dependent on many factors including the nature and amount of any rental concessions granted to new tenants, scheduled rent increases under existing leases, as well as the acquisitions and sales of properties that have existing in-place leases with terms in excess of one year. As a result, the straight-line adjustments to rental revenue may vary from period-to-period. Bonus rents are recognized when earned based upon increases in each facility's net revenue in excess of stipulated amounts. Bonus rentals are determined and paid each quarter based upon a computation that compares the respective facility's current quarter's net revenue to the corresponding quarter in the base year. Tenant reimbursements for operating expenses are accrued as revenue in the same period the related expenses are incurred.

**Real Estate Investments:** On the date of acquisition, the purchase price of a property is allocated to the property's land, buildings and intangible assets based upon our estimates of their fair values. Depreciation is computed using the straight-line method over the useful lives of the buildings and capital improvements. The value of intangible assets is amortized over the remaining lease term.

**Asset Impairment:** Real estate investments and related intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the property might not be recoverable. A property to be held and used is considered impaired only if management's estimate of the aggregate future cash flows, less estimated capital expenditures, to be generated by the property,

## Edgar Filing: UNIVERSAL HEALTH REALTY INCOME TRUST - Form 10-Q

undiscounted and without interest charges, are less than the carrying value of the property. This estimate takes into consideration factors such as expected future operating income, trends and prospects, as well as the effects of demand, competition, local market conditions and other factors.

The determination of undiscounted cash flows requires significant estimates by management, including the expected course of action at the balance sheet date that would lead to such cash flows. Subsequent changes in estimated undiscounted cash flows arising from changes in anticipated action to be taken with respect to the property could impact the determination of whether an impairment exists and whether the effects could materially impact our net income. To the extent estimated undiscounted cash flows are less than the

carrying value of the property, the loss will be measured as the excess of the carrying amount of the property over the fair value of the property.

---

## Table of Contents

Assessment of the recoverability by us of certain lease related costs must be made when we have reason to believe that a tenant might not be able to perform under the terms of the lease as originally expected. This requires us to make estimates as to the recoverability of such costs.

An other than temporary impairment of an investment/advance in an LLC is recognized when the carrying value of the investment is not considered recoverable based on evaluation of the severity and duration of the decline in value, including projected declines in cash flow. To the extent impairment has occurred, the excess carrying value of the asset over its estimated fair value is charged to income.

**Investments in Limited Liability Companies ( LLCs ):** Our consolidated financial statements include the consolidated accounts of our controlled investments and those investments that meet the criteria of a variable interest entity where we are the primary beneficiary. In accordance with the FASB's standards and guidance relating to accounting for investments and real estate ventures, we account for our unconsolidated investments in LLCs which we do not control using the equity method of accounting. The third-party members in these investments have equal voting rights with regards to issues such as, but not limited to: (i) divestiture of property; (ii) annual budget approval, and; (iii) financing commitments. These investments, which represent 33% to 95% non-controlling ownership interests, are recorded initially at our cost and subsequently adjusted for our net equity in the net income, cash contributions to, and distributions from, the investments. Pursuant to certain agreements, allocations of sales proceeds and profits and losses of some of the LLC investments may be allocated disproportionately as compared to ownership interests after specified preferred return rate thresholds have been satisfied.

At June 30, 2012, we have non-controlling equity investments or commitments in thirteen LLCs which own medical office buildings ( MOBs ). As of June 30, 2012, we accounted for: (i) twelve of these LLCs on an unconsolidated basis pursuant to the equity method since they are not variable interest entities, and; (ii) one of these LLCs (Palmdale Medical Properties) on a consolidated basis, as discussed below, since it is considered to be a variable interest entity where we are the primary beneficiary by virtue of its master lease with a subsidiary of Universal Health Services, Inc. ( UHS ), a related party to us.

The majority of these LLCs are joint-ventures between us and a non-related party that manages and holds minority ownership interests in the entities. Each LLC is generally self-sustained from a cash flow perspective and generates sufficient cash flow to meet its operating cash flow requirements and service the third-party debt (if applicable) that is non-recourse to us. Although there is typically no ongoing financial support required from us to these entities since they are cash-flow sufficient, we may, from time to time, provide funding for certain purposes such as, but not limited to, significant capital expenditures and/or leasehold improvements. Although we are not obligated to do so, if approved by us at our sole discretion, additional cash fundings are typically advanced as equity or short to intermediate term loans.

In addition, at December 31, 2011 and June 30, 2012, as a result of our purchases of third-party minority ownership interests in eleven LLCs in which we formerly held non-controlling majority ownership interests, we now hold 100% of the ownership interest in these LLCs which own MOBs and are accounted for on a consolidated basis, as previously disclosed.

Palmdale Medical Properties has a master lease with a subsidiary of UHS. Additionally, UHS of Delaware, a wholly-owned subsidiary of UHS, serves as advisor to us under the terms of an advisory agreement and manages our day-to-day affairs. All of our officers are officers or employees of UHS. As a result of our related-party relationship with UHS and the master lease, lease assurance or lease guarantee arrangements with subsidiaries of UHS, we account for this LLC on a consolidated basis, since the fourth quarter of 2007, since it is a variable interest entity and we are deemed to be the primary beneficiary. The master lease threshold on this MOB has not yet been met and is not expected to be met in the near future.

The other LLCs in which we hold various non-controlling ownership interests are not variable interest entities and therefore are not subject to consolidation.

**Federal Income Taxes:** No provision has been made for federal income tax purposes since we qualify as a REIT under Sections 856 to 860 of the Internal Revenue Code of 1986, and intend to continue to remain so qualified. As such, we are exempt from federal income taxes and we are required to distribute at least 90% of our real estate investment taxable income to our shareholders.

We are subject to a federal excise tax computed on a calendar year basis. The excise tax equals 4% of the amount by which 85% of our ordinary income plus 95% of any capital gain income for the calendar year exceeds cash distributions during the calendar year, as defined. No provision for excise tax has been reflected in the financial statements as no tax is expected to be due.



## Table of Contents

Earnings and profits, which determine the taxability of dividends to shareholders, will differ from net income reported for financial reporting purposes due to the differences for federal tax purposes in the cost basis of assets and in the estimated useful lives used to compute depreciation and the recording of provision for investment losses.

**Relationship with Universal Health Services, Inc. ( UHS ) and Related Party Transactions** UHS is our principal tenant and through UHS of Delaware, Inc., a wholly owned subsidiary of UHS, serves as our advisor (the Advisor ) under an Advisory Agreement dated December 24, 1986 between the Advisor and us (the Advisory Agreement ). Our officers are all employees of UHS and although as of June 30, 2012 we had no salaried employees, our officers do receive stock-based compensation from time-to-time. As previously disclosed on our Current Report on Form 8-K as filed on June 11, 2012, in recognition of the efforts and contributions of our executive officers in connection with the various previously disclosed acquisitions, divestitures and purchases of third-party minority ownership interests in certain majority-owned limited liability companies, as completed at various times during 2011 and the first quarter of 2012, the Compensation Committee of the Board of Trustees of the Trust recommended, and the Board of Trustees of the Trust approved, one-time, special compensation awards to our executive officers in the form of a cash bonus and/or shares of restricted stock. The cash bonuses were paid and the restricted shares were granted during the second quarter of 2012. The restricted shares are scheduled to vest on the second anniversary of the date of grant. Please see additional details and disclosure included on our Current Report on Form 8-K as filed on June 11, 2012.

Pursuant to the Advisory Agreement, the Advisor is obligated to present an investment program to us, to use its best efforts to obtain investments suitable for such program (although it is not obligated to present any particular investment opportunity to us), to provide administrative services to us and to conduct our day-to-day affairs. All transactions between us and UHS must be approved by the Trustees who are unaffiliated with UHS (the Independent Trustees ). In performing its services under the Advisory Agreement, the Advisor may utilize independent professional services, including accounting, legal, tax and other services, for which the Advisor is reimbursed directly by us. The Advisory Agreement may be terminated for any reason upon sixty days written notice by us or the Advisor. The Advisory Agreement expires on December 31 of each year; however, it is renewable by us, subject to a determination by the Independent Trustees, that the Advisor's performance has been satisfactory. The Advisor is entitled to certain advisory fees for its services. See Relationship with Universal Health Services, Inc. ( UHS ) and Related Party Transactions in Note 2 to the condensed consolidated financial statements for additional information on the Advisory Agreement and related fees. In December of 2011, based upon a review of our advisory fee and other general and administrative expenses, as compared to an industry peer group, the Advisory Agreement was renewed for 2012 at the same terms and conditions as 2011.

The combined revenues generated from the leases on the UHS hospital facilities comprised approximately 30% of our consolidated revenue during each of the three and six months ended June 30, 2012 and 61% of our consolidated revenues during each of the three and six months ended June 30, 2011. The decreases during the second quarter and the first six months of 2012, as compared to the comparable quarter and six months of the prior year, were due primarily to the December, 2011 purchase of the third-party minority ownership interests in eleven LLCs in which we previously held noncontrolling majority ownership interests (we began recording the financial results of these entities in our financial statements on a consolidated basis at that time) and various acquisitions of medical office buildings and clinics completed during 2011 and the first quarter of 2012. Including 100% of the revenues generated at the unconsolidated LLCs in which we have various non-controlling equity interests ranging from 33% to 95%, the leases on the UHS hospital facilities accounted for approximately 21% and 19% of the combined consolidated and unconsolidated revenue for the three month periods ended June 30, 2012 and 2011, respectively, and 22% and 19% of the combined consolidated and unconsolidated revenue for the six months ended June 30, 2012 and 2011, respectively. In addition, twelve medical office buildings ( MOBs ), owned by LLCs in which we hold either 100% of the ownership interest or various non-controlling, majority ownership interests, include or will include tenants which are subsidiaries of UHS. The leases to the hospital facilities of UHS are guaranteed by UHS and cross-defaulted with one another. For additional disclosure related to our relationship with UHS, please refer to Note 2 to the condensed consolidated financial statements Relationship with Universal Health Services, Inc. ( UHS ) and Related Party Transactions.

## Results of Operations

Our Consolidated Statement of Income for the three and six months ended June 30, 2012 includes the revenue and expenses associated with the previously disclosed LLCs in which we purchased the third-party minority ownership interests during the fourth quarter of 2011. As a result of the purchases of the minority ownership interests, we now own 100% of these entities and therefore began consolidating the financial data of each effective December 12, 2011. Prior to these minority ownership interest purchases, we previously held noncontrolling majority ownership interests in these LLCs and they were therefore accounted for on an unconsolidated basis.

The tables below reflect the As Adjusted Statement of Income for the three and six months ended June 30, 2011, reflecting the revenue and expense impact of the consolidation of these various LLCs as if they had been consolidated for the three and six-month periods ended June 30, 2011. The As Adjusted amounts are used for comparison discussions in the Results of Operations, as they present both periods on a comparable basis. There was no material impact on our net income as a result of the consolidation of these LLCs.



**Table of Contents****Three Months Ended June 30, 2011:**

|  | As reported<br>in<br>Consolidated<br>Statements<br>of Income for<br>the Three<br>Months Ended<br>June 30, 2012 | As reported<br>in<br>Consolidated<br>Statements<br>of Income for<br>the Three<br>Months Ended<br>June 30, 2011 | Three<br>months<br>2011<br>Statements<br>of Income<br>for LLCs<br>in which<br>we<br>purchased<br>third-party<br>minority<br>interests | As<br>Adjusted<br>Three<br>Months<br>Ended<br>June 30,<br>2011 | As<br>Adjusted<br>Variance |
|--|--|--|---|--|----------------------------|
| Revenues   | \$ 13,666  | \$ 6,766   | \$ 4,468  | \$ 11,234  | \$ 2,432                   |
| <b>Expenses:</b>   |  |  |   |  |                            |
| Depreciation and amortization  | 5,001  | 1,539  | 899   | 2,438  | (2,563)                    |
| Advisory fees to UHS   | 521  | 480  |   | 480  | (41)                       |
| Other operating expenses   | 4,196  | 1,414  | 1,856   | 3,270  | (926)                      |
| Transaction costs  | 129  |  |   |  | (129)                      |
|  | 9,847  | 3,433  | 2,755   | 6,188  | (3,659)                    |
| Income before equity in income of unconsolidated LLCs,<br>interest expense and gain, net | 3,819  | 3,333  | 1,713   | 5,046  | (1,227)                    |
| Equity in income of unconsolidated LLCs  | 604  | 727  | (518)   | 209  | 395                        |
| Gain on divestiture of property owned by an unconsolidated<br>LLC                        |  |  |   |  |                            |
| Interest expense, net  | (1,956)  | (368)  | (1,195)   | (1,563)  | (393)                      |
| Net income   | \$ 2,467   | \$ 3,692   | \$  | \$ 3,692   | (\$ 1,225)                 |

**Six Months Ended June 30, 2011:**

|                               | As reported<br>in<br>Consolidated<br>Statements<br>of Income for<br>the Six<br>Months Ended<br>June 30, 2012 | As reported<br>in<br>Consolidated<br>Statements<br>of Income for<br>the Six<br>Months Ended<br>June 30, 2011 | Six<br>months<br>2011<br>Statements<br>of Income<br>for LLCs<br>in which<br>we<br>purchased<br>third-party<br>minority<br>interests | As<br>Adjusted<br>Six<br>Months<br>Ended<br>June 30,<br>2011 | As<br>Adjusted<br>Variance |
|-------------------------------|--|--|---|--|----------------------------|
| Revenues                      | \$ 27,017  | \$ 13,442  | \$ 8,820  | \$ 22,262  | \$ 4,755                   |
| <b>Expenses:</b>              |  |  |   |  |                            |
| Depreciation and amortization | 10,221   | 3,042  | 1,895   | 4,937  | (5,284)                    |
| Advisory fees to UHS          | 1,054  | 951  |   | 951  | (103)                      |
| Other operating expenses      | 7,666  | 2,385  | 3,731   | 6,116  | (1,550)                    |
| Transaction costs             | 649  |  |   |  | (649)                      |

Edgar Filing: UNIVERSAL HEALTH REALTY INCOME TRUST - Form 10-Q

|  |           |          |         |          |          |
|--|-----------|----------|---------|----------|----------|
|  | 19,590    | 6,378    | 5,626   | 12,004   | (7,586)  |
| Income before equity in income of unconsolidated LLCs,<br>interest expense and gain, net | 7,427     | 7,064    | 3,194   | 10,258   | (2,831)  |
| Equity in income of unconsolidated LLCs  | 1,158     | 1,502    | (938)   | 564      | 594      |
| Gain on divestiture of property owned by an unconsolidated<br>LLC                        | 7,375     |          |         |          | 7,375    |
| Interest expense, net  | (3,979)   | (746)    | (2,256) | (3,002)  | (977)    |
| Net income   | \$ 11,981 | \$ 7,820 | \$      | \$ 7,820 | \$ 4,161 |

**Table of Contents**

For the quarter ended June 30, 2012, net income was \$2.5 million, or \$0.19 per diluted share, as compared to \$3.7 million, or \$0.29 per diluted share, during the comparable prior year quarter. For the six-month period ended June 30, 2012, net income was \$12.0 million, or \$0.95 per diluted share, as compared to \$7.8 million, or \$0.62 per diluted share, during the comparable six-month period of the prior year.

The decrease in net income of \$1.2 million during the second quarter of 2012, as compared to the comparable prior year quarter, was primarily attributable to:

an unfavorable change of \$2.6 million (As Adjusted) in depreciation and amortization expense primarily due to a \$1.6 million increase incurred during the second quarter of 2012 resulting from the increased basis recorded in connection with the fair value recognition of the assets and liabilities related to the eleven LLCs of which we purchased the third-party minority ownership interests during the fourth quarter of 2011, as well as a \$900,000 increase during the second quarter of 2012 at five MOBs and clinics acquired during 2011 and the first quarter of 2012;

an unfavorable change of \$129,000 resulting from transaction costs;

an unfavorable change of \$393,000 (As Adjusted) in interest expense, as discussed below;

a favorable change of approximately \$1.6 million from the net operating income (before depreciation and amortization and interest expenses) generated during the second quarter of 2012 at five MOBs and clinics acquired during 2011 and the first quarter of 2012;

a favorable change of \$395,000 (As Adjusted) resulting from an increase in equity in income of unconsolidated LLCs resulting primarily from increased income generated at a number of our LLCs, and;

other combined net unfavorable changes of approximately \$100,000.

The increase in net income of \$4.2 million during the first six months of 2012, as compared to the first six months in 2011, was primarily attributable to:

a favorable change of \$7.4 million resulting from the net gain on the divestiture of property owned by an unconsolidated LLC, as discussed above and herein;

an unfavorable change of \$649,000 primarily resulting from the transaction costs incurred in connection with the acquisition of the PeaceHealth Medical Clinic, as discussed herein;

an unfavorable change of \$5.3 million (As Adjusted) in depreciation and amortization expense primarily due to a \$3.3 million increase incurred during the first six months of 2012 resulting from the increased basis recorded in connection with the fair value recognition of the assets and liabilities related to the eleven LLCs of which we purchased the third-party minority ownership interests during the fourth quarter of 2011, as well as a \$1.8 million increase during the first six months of 2012 at five MOBs and clinics acquired during 2011 and the first quarter of 2012;

an unfavorable change of \$977,000 (As Adjusted) in interest expense, as discussed below;

## Edgar Filing: UNIVERSAL HEALTH REALTY INCOME TRUST - Form 10-Q

a favorable change of approximately \$3.1 million from the net operating income (before depreciation and amortization and interest expenses) generated during the first six months of 2012 at five MOB's and clinics acquired during 2011 and the first quarter of 2012, and;

a favorable change of \$594,000 (As Adjusted) resulting from an increase in equity in income of unconsolidated LLCs resulting primarily from increased income generated at a number of our LLCs.

During the first quarter of 2012, we recorded a net gain of \$7.4 million in connection with the sale of a medical office building by an LLC in which the Trust formerly held a noncontrolling majority ownership interest, as discussed above and herein. See Note 4 to the consolidated financial statements for additional disclosure related to this divestiture.

Interest expense, net of interest income, increased \$393,000 and \$977,000 (As Adjusted) during the three and six month periods of 2012 as compared to the same periods in 2011, respectively. The increase was due primarily to: (i) an increase in our average outstanding borrowings as well as an increase in the average effective interest rate pursuant to the terms of our \$150 million revolving credit agreement that commenced in July, 2011; (ii) interest expense incurred on the combined \$29.4 million of third-party debt assumed as part of the acquisitions of PeaceHealth Medical Clinic in January, 2012 (\$22.4 million of assumed third-party financing) and the Tuscan Professional Building in December, 2011 (\$7.0 million of assumed third-party financing) partially offset by; (iii) a decrease in interest expense related to the previously unconsolidated LLCs which are now consolidated in our financial statements, as discussed above. The increased borrowings were used primarily to: (i) fund the purchases of the five newly acquired MOB's during

**Table of Contents**

2011 and the first quarter of 2012; (ii) fund the fourth quarter of 2011 purchases of the third-party minority ownership interests in various LLCs in which we formerly held noncontrolling majority ownership interests; (iii) fund investments in, and advances to, various LLCs, partially offset by; (iv) our share of the cash proceeds generated during the fourth quarter of 2011 and the first quarter of 2012 in connection with the sale of MOBs by various LLCs in which we formerly held noncontrolling majority ownership interests, as previously disclosed.

During the second quarter of 2012, the five MOBs and clinics acquired during 2011 and the first quarter of 2012 generated approximately \$2.3 million of revenue and incurred approximately \$750,000 of other operating expenses, \$925,000 of depreciation and amortization expense and \$410,000 of interest expense. During the six months ended June 30, 2012, these five MOBs and clinics generated approximately \$4.4 million of revenue and incurred approximately \$1.3 million of other operating expenses, \$1.8 million of depreciation and amortization expense and \$750,000 of interest expense.

During the three month period ended June 30, 2012, total revenue increased by \$2.4 million (As Adjusted). The net increase during the three months ended June 30, 2012, as compared to the comparable prior year period, resulted primarily from: (i) \$2.3 million of revenue generated during the second quarter of 2012 at the five newly acquired MOBs as discussed above (acquired during 2011 and the first quarter of 2012), and; (ii) approximately \$100,000 increase in revenues generated at the eleven LLCs which, effective December, 2011 when we purchased the third-party minority ownership interests, we began recording on a consolidated basis in our financial statements. During the six month period ended June 30, 2012, total revenue increased by \$4.8 million (As Adjusted). The net increase during the six months ended June 30, 2012, as compared to the comparable prior year period, resulted primarily from: (i) \$4.4 million of revenue generated during the six month period at the five newly acquired MOBs as discussed above, and; (ii) approximately \$300,000 increase in revenues generated at the eleven LLCs which, effective December, 2011 when we purchased the third-party minority ownership interests, we began recording on a consolidated basis in our financial statements.

Included in our other operating expenses are expenses related to the consolidated medical office buildings, which totaled \$3.7 million and \$2.8 million (As Adjusted basis), for the three-month periods ended June 30, 2012 and 2011, respectively, and \$6.8 million and \$5.4 million (As Adjusted basis) for the six month periods ended June 30, 2012 and 2011, respectively. The increases in other operating expenses for the three and six-month periods ended June 30, 2012 as compared to the same periods during 2011 are primarily attributable to the expenses related to the five recently acquired MOBs, as previously discussed, as well as reserves established in connection with certain tenant receivables at various consolidated properties. A portion of the expenses associated with our consolidated medical office buildings is passed on directly to the tenants. Tenant reimbursements for operating expenses are accrued as revenue in the same period the related expenses are incurred and are included as tenant reimbursement revenue in our condensed consolidated statements of income.

Funds from operations ( FFO ) is a widely recognized measure of performance for Real Estate Investment Trusts ( REITs ). We believe that FFO and FFO per diluted share, and adjusted funds from operations ( AFFO ) and AFFO per diluted share, which are non-GAAP financial measures ( GAAP is Generally Accepted Accounting Principles in the United States of America), are helpful to our investors as measures of our operating performance. We compute FFO, as reflected below, in accordance with standards established by the National Association of Real Estate Investment Trusts ( NAREIT ), which may not be comparable to FFO reported by other REITs that do not compute FFO in accordance with the NAREIT definition, or that interpret the NAREIT definition differently than we interpret the definition. AFFO was also computed for the three and six-month period ended June 30, 2012, as reflected below, since we believe it is helpful to our investors since it adjusts for the effect of a gain on divestiture of property owned by an unconsolidated LLC and transaction costs related to an acquisition. FFO/AFFO do not represent cash generated from operating activities in accordance with GAAP and should not be considered to be an alternative to net income determined in accordance with GAAP. In addition, FFO/AFFO should not be used as: (i) an indication of our financial performance determined in accordance with GAAP; (ii) an alternative to cash flow from operating activities determined in accordance with GAAP; (iii) a measure of our liquidity, or; (iv) an indicator of funds available for our cash needs, including our ability to make cash distributions to shareholders. A reconciliation of our reported net income to FFO/AFFO is reflected on the Supplemental Schedules included below.

Below is a reconciliation of our reported net income to FFO and AFFO for the three and six-month periods ended June 30, 2012 and 2011 (in thousands):

|  | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |          |
|--|--------------------------------|----------|------------------------------|----------|
|  | 2012                           | 2011     | 2012                         | 2011     |
| Net income   | \$ 2,467                       | \$ 3,692 | \$ 11,981                    | \$ 7,820 |
| Depreciation and amortization expense on consolidated investments  | 4,956                          | 1,503    | 10,138                       | 2,969    |
| Depreciation and amortization expense on unconsolidated affiliates | 822                            | 2,718    | 1,680                        | 5,405    |
| Gain on divestiture of property owned by an unconsolidated LLC     |                                |          | (7,375)                      |          |

Edgar Filing: UNIVERSAL HEALTH REALTY INCOME TRUST - Form 10-Q

|                                |          |          |           |           |
|--------------------------------|----------|----------|-----------|-----------|
| Funds From Operations          | \$ 8,245 | \$ 7,913 | \$ 16,424 | \$ 16,194 |
| Transaction costs              | 129      |          | 649       |           |
| Adjusted Funds From Operations | \$ 8,374 | \$ 7,913 | \$ 17,073 | \$ 16,194 |



---

## **Table of Contents**

Our FFO increased \$332,000 to \$8.2 million during the second quarter of 2012 as compared to \$7.9 million during the second quarter of 2011. The increase was primarily due to: (i) an unfavorable change of \$1.2 million resulting from the decrease in net income, as discussed above; (ii) plus a \$1.6 million increase in the add-back of depreciation and amortization expense (including consolidated investments and unconsolidated affiliates) due primarily to the increased basis recorded in connection with the fair value recognition of the assets and liabilities related to the eleven LLCs of which we purchased the third-party minority ownership interests during the fourth quarter of 2011 (the above-mentioned \$925,000 increase in depreciation and amortization expense resulting from the acquisition of five MOBs and clinics during 2011 and the first quarter of 2012 was substantially offset by the decreased depreciation and amortization expense resulting from the divestiture, during 2011 and the first quarter of 2012, of nine MOBs and related property by LLCs in which we previously held noncontrolling ownership interests).

Our FFO increased \$230,000 to \$16.4 million during the first six months of 2012 as compared to \$16.2 million during the first six months of 2011. The increase was primarily due to: (i) a favorable change of \$4.2 million resulting from the increase in net income, as discussed above; (ii) plus a \$3.4 million increase in the add-back of depreciation and amortization expense (including consolidated investments and unconsolidated affiliates) due primarily to the increased basis recorded in connection with the fair value recognition of the assets and liabilities related to the eleven LLCs of which we purchased the third-party minority ownership interests during the fourth quarter of 2011 (the above-mentioned \$1.8 million increase in depreciation and amortization expense resulting from the acquisition of five MOBs and clinics during 2011 and the first quarter of 2012 was substantially offset by the decreased depreciation and amortization expense resulting from the divestiture, during 2011 and the first quarter of 2012, of nine MOBs and related property by LLCs in which we previously held noncontrolling ownership interests), and; (iii) less the \$7.4 million gain recorded during the first quarter of 2012 on divestiture of property owned by an unconsolidated LLC.

Our AFFO increased \$461,000 to \$8.4 million during the second quarter of 2012 as compared to \$7.9 million during the comparable quarter of 2011. The increase in AFFO during the second quarter of 2012, as compared to the comparable quarter of 2011, was attributable to: (i) the above-mentioned \$332,000 increase in FFO, plus; (ii) the \$129,000 add-back of the transaction costs incurred during the second quarter of 2012.

Our AFFO increased \$879,000 to \$17.1 million during the first six months of 2012 as compared to \$16.2 million during the comparable period of 2011. The increase in AFFO during the first six months of 2012 as compared to the comparable period in 2011 was attributable to: (i) the above-mentioned \$230,000 increase in FFO, plus; (ii) the \$649,000 add-back of the transaction costs incurred during the first six months of 2012.

## **Liquidity and Capital Resources**

### **Net cash provided by operating activities**

Net cash provided by operating activities was \$14.6 million and \$10.3 million during the six-month periods ended June 30, 2012 and 2011, respectively.

The \$4.3 million net increase was attributable to:

a favorable change of \$4.0 million due to an increase in net income net of the adjustments to reconcile net income to net cash provided by operating activities (depreciation and amortization, restricted/stock-based compensation and gain on divestiture of property owned by an unconsolidated LLC), as discussed above in Results of Operations;

an unfavorable change of \$322,000 in rent receivable, primarily resulting from an increase in receivables at various MOBs, including the five acquired during 2011 and the first quarter of 2012;

a favorable change of \$198,000 in accrued expenses and other liabilities, and;

a favorable change of \$478,000 in tenant reserves, escrows, deposits and prepaid rents resulting primarily from increased prepaid rents collected from various MOBs, including the medical clinic acquired during the first quarter of 2012.

**Net cash used in investing activities**

Net cash used in investing activities was \$7.8 million during the six months ended June 30, 2012 as compared to \$14.3 million during the six months ended June 30, 2011.

During the six-month period ended June 30, 2012, we funded: (i) an \$8.0 million advance in the form of a member loan to an unconsolidated LLC to retire its third-party debt; (ii) \$7.3 million (net of certain acquired liabilities, third-party debt and prepaid deposit) to acquire the real estate assets of the PeaceHealth Medical Clinic, as discussed above; (iii) \$2.2 million on additions to real estate investments primarily for tenant improvements at various MOB's; (iv) \$553,000 for settlement of assumed liabilities related to newly acquired MOB's, and; (v) \$705,000 in equity investments in various unconsolidated LLC's. In addition, during the six-month period ended June 30, 2012, we received: (i) \$473,000 in repayments of advances previously made to unconsolidated LLC's; (ii) \$2.3

**Table of Contents**

million of cash distributions in excess of income from our unconsolidated LLCs; (iii) \$100,000 of refunded real estate deposits, and; (iv) \$8.1 million, net, of cash in connection with our share of the proceeds received from the divestiture of an MOB owned by an unconsolidated LLC, as discussed above.

During the six-month period ended June 30, 2011, we funded: (i) \$11.8 million (net of certain acquired liabilities) to acquire the real estate assets of the Lake Pointe Medical Arts MOB; (ii) \$11.1 million of advances to LLCs; (iii) \$3.1 million of equity investments in LLCs, and; (iv) \$300,000 of deposits on real estate assets related to the acquisitions of Forney Medical Plaza which was acquired during the third quarter of 2011 and Tuscan Professional Building which was acquired during the fourth quarter of 2011. Also during the six-month period ended June 30, 2011, we received: (i) \$6.6 million in repayments of advances to LLCs; (ii) \$3.3 million of cash distributions in excess of income from our unconsolidated LLCs, and; (iii) \$2.1 million of cash distributions of refinancing proceeds from our unconsolidated LLCs.

**Net cash (used in)/provided by financing activities**

Net cash used in financing activities was \$15.3 million during the six months ended June 30, 2012 as compared to \$3.8 million of net cash provided by financing activities during the six months ended June 30, 2011.

During the six-month period ended June 30, 2012, we: (i) received \$4.0 million of additional net borrowings on our revolving line of credit; (ii) received \$7.0 million of proceeds related to a new mortgage note payable that is non-recourse to us, and; (iii) generated \$202,000 of net cash from the issuance of shares of beneficial interest. Additionally, during the six months ended June 30, 2012, we paid: (i) \$10.6 million on mortgage and other notes payable that are non-recourse to us (including the pay-off of a mortgage note payable that was refinanced during the second quarter of 2012, resulting in the \$7.0 million of proceeds, as mentioned above, as well as a \$600,000 mortgage principal pay-down); (ii) \$347,000 of financing costs on mortgage notes payable that are non-recourse to us, and; (iii) \$15.5 million of dividends.

During the six-month period ended June 30, 2011, we: (i) received \$19.1 million of additional net borrowings on our revolving line of credit, and; (ii) generated \$115,000 of net cash from the issuance of shares of beneficial interest. Additionally, during the six months ended June 30, 2011, we paid: (i) \$80,000 on mortgage notes payable that are non-recourse to us; (ii) \$60,000 on a loan payable of a consolidated LLC that is non-recourse to us, and; (iii) \$15.3 million of dividends.

During the fourth quarter of 2009, we commenced an at-the-market ( ATM ) equity issuance program pursuant to the terms of which we may sell, from time-to-time, common shares of our beneficial interest up to an aggregate sales price of \$50 million to or through Merrill Lynch, Pierce, Fenner and Smith Incorporated, as sales agent and/or principal. There were no shares issued pursuant to our ATM Program during the first six months of 2012. Since inception of this program, we have issued 733,500 shares at an average price of \$32.90 per share, which generated approximately \$22.9 million of net cash proceeds (net of approximately \$1.2 million, consisting of compensation of approximately \$725,000 to Merrill Lynch as well as \$515,000 of various other fees and expenses). As of June 30, 2012, we generated approximately \$24.1 million of gross cash proceeds, excluding all fees and expenses, and had \$25.9 million of gross proceeds still available for issuance under the program.

**Additional cash flow and dividends paid information for the six-month periods ended June 30, 2012 and 2011:**

As indicated on our consolidated statement of cash flows, we generated net cash provided by operating activities of \$14.6 million and \$10.3 million during the six-month periods ended June 30, 2012 and 2011, respectively. As also indicated on our statement of cash flows, noncash expenses such as depreciation and amortization expense, restricted/stock-based compensation expense as well as the gain recorded during the first six months of 2012, are the primary differences between our net income and net cash provided by operating activities during each period. In addition, as reflected in the cash flows from investing activities section, we received \$2.3 million and \$3.3 million during the six months ended June 30, 2012 and 2011, respectively, of cash distributions in excess of income from various unconsolidated LLCs which represents our share of the net cash flow distributions from these entities. These cash distributions in excess of income represent operating cash flows net of capital expenditures and debt repayments made by the LLCs.

We generated \$16.9 million and \$13.6 million of net cash during the six months ended June 30, 2012 and 2011, respectively, related to the operating activities of our properties recorded on a consolidated and an unconsolidated basis. We paid dividends of \$15.5 million and \$15.3 million during the six months ended June 30, 2012 and 2011, respectively. During the first six months of 2012, the cash generated from the operating activities of our properties (\$16.9 million) exceeded the dividends paid (\$15.5 million) by approximately \$1.4 million. During the first six months of 2011, the \$13.6 million of net cash generated related to operating activities was approximately \$1.7 million less than the \$15.3 million of dividends paid during the prior year six month period. The shortfall experienced during the first six months of 2011 was attributable to certain operating factors being experienced at that time.

## Edgar Filing: UNIVERSAL HEALTH REALTY INCOME TRUST - Form 10-Q

As indicated in the cash flows from investing activities and cash flows from financing activities sections of the statements of cash flows, there were various other sources and uses of cash during the six months ended June 30, 2012 and 2011. Therefore, the funding source for our dividend payments is not wholly dependent on the operating cash flow generated by our properties in any given period. Rather, our dividends, as well as our capital reinvestments into our existing properties, acquisitions of real property and other investments are funded based upon the aggregate net cash inflows or outflows from all sources and uses of cash from the properties we own either in whole or through LLCs, as outlined above.

**Table of Contents**

In determining and monitoring our dividend level on a quarterly basis, our management and Board of Trustees consider many factors in determining the amount of dividends to be paid each period. These considerations primarily include: (i) the minimum required amount of dividends to be paid in order to maintain our REIT status; (ii) the current and projected operating results of our properties, including those owned in LLCs, and; (iii) our future capital commitments and debt repayments, including those of our LLCs. Based upon the information discussed above, as well as consideration of projections and forecasts of our future operating cash flows, management and the Board of Trustees have determined that our operating cash flows have been sufficient to fund our dividend payments. Future dividend levels will be determined based upon the factors outlined above with consideration given to our projected future results of operations.

Included in the various sources of cash were: (i) funds generated from the repayments of advances made from us to LLCs (\$473,000 and \$6.6 million for the six months ended June 30, 2012 and 2011, respectively); (ii) cash distributions of refinancing proceeds from LLCs (\$2.1 million for the six months ended June 30, 2011); (iii) refunds/(deposits) on real estate assets (\$100,000 and (\$300,000) for the six months ended June 30, 2012 and 2011, respectively); (iv) net borrowings on our revolving credit agreement (\$4.0 million and \$19.1 million for the six months ended June 30, 2012 and 2011, respectively); (v) proceeds from mortgage notes payable (\$7.0 million for the six months ended June 30, 2012), and; (vi) net cash generated in connection with the issuance of shares of beneficial interest (\$202,000 and \$115,000 for the six months ended June 30, 2012 and 2011, respectively). In addition, during the first six months of 2012, we generated \$8.1 million from the divestiture of an MOB owned by an unconsolidated LLC.

In addition to the dividends paid, the following were also included in the various uses of cash: (i) investments in LLCs (\$705,000 and \$3.1 million for the six months ended June 30, 2012 and 2011, respectively); (ii) advances made to LLCs (\$8.0 million and \$11.1 million for the six months ended June 30, 2012 and 2011, respectively); (iii) net real estate additions/(reductions) (\$2.2 million and (\$4,000) for the six months ended June 30, 2012 and 2011, respectively); (iv) repayments of mortgage and other notes payable (\$10.6 million and \$140,000 for the six months ended June 30, 2012 and 2011, respectively), and; (v) financing costs paid on mortgage and other notes payable (\$347,000 for the six months ended June 30, 2012). Additionally, during the first six months of 2012, we had additional uses of cash consisting of: (i) \$7.3 million for the acquisition of a medical clinic located in Bellingham, Washington, and; (ii) \$553,000 of payment of assumed liabilities on acquired properties.

We expect to finance all capital expenditures and acquisitions and pay dividends utilizing internally generated and additional funds. Additional funds may be obtained through: (i) the issuance of equity pursuant to our at-the-market equity issuance program (which has \$25.9 million of gross proceeds remaining for issuance as of June 30, 2012); (ii) borrowings under our existing \$150 million revolving credit facility agreement (which has \$56.8 million of available borrowing capacity, net of outstanding borrowings and letters of credit, as of June 30, 2012); (iii) borrowings under or refinancing of existing third-party debt pursuant to mortgage and construction loan agreements entered into by our LLCs, and/or; (iv) the issuance of other long-term debt.

We believe that our operating cash flows, cash and cash equivalents, available borrowing capacity under our revolving credit facility and equity issuance capacity pursuant to the terms of the ATM program, and access to the capital markets provide us with sufficient capital resources to fund our operating, investing and financing requirements for the next twelve months, including providing sufficient capital to allow us to make distributions necessary to enable us to continue to qualify as a REIT under Sections 856 to 860 of the Internal Revenue Code of 1986. In the event we need to access the capital markets or other sources of financing, there can be no assurance that we will be able to obtain financing on acceptable terms or within an acceptable time. Our inability to obtain financing on terms acceptable to us could have a material unfavorable impact on our results of operations, financial condition and liquidity.

**Credit facilities and mortgage debt**

Our previous unsecured \$100 million revolving credit agreement (the Agreement) was terminated by us on July 25, 2011 and replaced with a new revolving credit facility. The Agreement provided for interest at our option, at the Eurodollar rate plus 0.75% to 1.125%, or the prime rate plus zero to 0.125%. A fee of 0.15% to 0.225% was payable on the unused portion of the commitment. The margins over the Eurodollar, prime rate and the commitment fee were based upon our debt to total capital ratio as defined by the Agreement.

On July 25, 2011, we entered into a new \$150 million revolving credit agreement (Credit Agreement). The Credit Agreement, which is scheduled to expire on July 24, 2015, replaced our previous revolving credit facility which was scheduled to mature in January, 2012 and increased our borrowing capacity from \$100 million to \$150 million. The Credit Agreement includes a \$50 million sub limit for letters of credit and a \$20 million sub limit for swingline/short-term loans. The Credit Agreement also provides an option to increase the total facility borrowing capacity by an additional \$50 million, subject to lender agreement. Borrowings made pursuant to the Credit Agreement will bear interest, at our option, at one, two, three, or six month LIBOR plus an applicable margin ranging from 1.75% to 2.50% or at the Base Rate plus an applicable margin ranging from 0.75% to 1.50%. The Credit Agreement defines



**Table of Contents**

Base Rate as the greatest of: (a) the administrative agent's prime rate, (b) the federal funds effective rate plus 1/2 of 1%, and; (c) one month LIBOR plus 1%. A fee of 0.30% to 0.50% will be charged on the unused portion of the commitment. The margins over LIBOR, Base Rate and the commitment fee are based upon our ratio of debt to total capital. At June 30, 2012, the applicable margin over the LIBOR rate was 1.75%, the margin over the Base Rate was 0.75%, and the commitment fee was 0.30%.

At June 30, 2012, we had \$81.2 million of outstanding borrowings and \$12.0 million of letters of credit outstanding against our revolving credit agreement. We had \$56.8 million of available borrowing capacity, net of the outstanding borrowings and letters of credit outstanding as of June 30, 2012. There are no compensating balance requirements.

Covenants relating to the Credit Agreement require the maintenance of a minimum tangible net worth and specified financial ratios, limit our ability to incur additional debt, limit the aggregate amount of mortgage receivables and limit our ability to increase dividends in excess of 95% of cash available for distribution, unless additional distributions are required to comply with the applicable section of the Internal Revenue Code of 1986 and related regulations governing real estate investment trusts. We are in compliance with all of the covenants at June 30, 2012. We also believe that we would remain in compliance if the full amount of our commitment was borrowed.

The following table includes a summary of the required compliance ratios, giving effect to the new covenants contained in the Credit Agreement (dollar amounts in thousands):

|                             | Covenant   | June 30,<br>2012 |
|-----------------------------|------------|------------------|
| Tangible net worth          | \$ 125,000 | \$ 157,944       |
| Debt to total capital       | < 55%      | 30.4%            |
| Debt service coverage ratio | > 5.00 x   | 28.21 x          |
| Debt to cash flow ratio     | < 3.50 x   | 1.32x            |

We have thirteen mortgages, all of which are non-recourse to us, included on our consolidated balance sheet as of June 30, 2012, with a combined outstanding balance of \$115.4 million (excluding net debt premium, resulting from fair value recognition of third-party debt related to majority-owned LLCs in which we purchased the minority ownership interests, of \$867,000 at June 30, 2012). The following table summarizes our outstanding mortgages at June 30, 2012 (amounts in thousands):

| Facility Name   | Outstanding<br>Balance<br>(in thousands) | Interest<br>Rate | Maturity<br>Date |
|---|--|------------------|------------------|
| BRB Medical Office Building mortgage loan(b)                      | \$ 6,180                                 | 6.25%            | 2012             |
| Centennial Hills Medical Office Building I mortgage loan(a)       | 11,751                                   | 6.00%            | 2013             |
| Palmdale Medical Plaza fixed rate mortgage loan(a)                | 6,363                                    | 5.10%            | 2013             |
| Summerlin Hospital Medical Office Building I mortgage loan(a)     | 9,491                                    | 6.55%            | 2014             |
| Spring Valley Medical Office Building mortgage loan(a)            | 5,406                                    | 5.50%            | 2015             |
| Summerlin III Medical Office Building III mortgage loan(a) (c)    | 11,801                                   | Floating         | 2016             |
| Auburn Medical II mortgage loan (a)(d)                            | 7,726                                    | Floating         | 2017             |
| Medical Center of Western Connecticut fixed rate mortgage loan(a) | 5,057                                    | 6.00%            | 2017             |
| PeaceHealth Medical Clinic fixed rate mortgage loan(a)            | 22,282                                   | 5.64%            | 2017             |
| Summerlin Hospital Medical Office Building II mortgage loan(a)    | 12,432                                   | 5.50%            | 2017             |
| Kindred Hospital-Corpus Christi fixed rate mortgage loan(a)       | 3,095                                    | 6.50%            | 2019             |
| 700 Shadow Lane and Goldring MOB mortgage loan (a)                | 7,000                                    | 4.54%            | 2022             |
| Tuscan Professional Building fixed rate mortgage loan(a)          | 6,822                                    | 5.56%            | 2025             |
| Total   | \$ 115,406                               |                  |                  |

## Edgar Filing: UNIVERSAL HEALTH REALTY INCOME TRUST - Form 10-Q

- (a) Amortized principal payments made on a monthly basis.
- (b) We believe the terms of this loan are within current market underwriting criteria. At this time, we expect to refinance this loan on or before the 2012 maturity date for three to ten year terms at the then current market interest rates. In the unexpected event that we are unable to refinance this loan on reasonable terms, we will explore other financing alternatives, including, among other things, potentially repaying the mortgage loan utilizing funds borrowed under our revolving credit facility.
- (c) This loan was amended and extended in April, 2012, with a floating rate of 1, 6 or 12 month Libor plus 3.25% at the borrower's option.
- (d) This loan was amended and extended in April, 2012, with a floating rate of 1, 6 or 12 month Libor plus 2.75% at the borrower's option.



**Table of Contents**

The mortgages are secured by the real property of the buildings as well as property leases and rents. The mortgages have a combined fair value of approximately \$117.6 million as of June 30, 2012. Changes in market rates on our fixed rate debt impacts the fair value of debt, but it has no impact on interest incurred or cash flow.

## **Table of Contents**

### **Off Balance Sheet Arrangements**

As of June 30, 2012, we are party to certain off balance sheet arrangements consisting of standby letters of credit and equity and debt financing commitments. Our outstanding letters of credit at June 30, 2012 totaled \$12.0 million consisting of: (i) \$3.1 million related to Grayson Properties; (ii) \$2.5 million related to Centennial Hills Medical Properties; (iii) \$2.0 million related to Palmdale Medical Properties; (iv) \$1.9 million related to Banbury Medical Properties; (v) \$1.0 million related to Sierra Medical Properties; (vi) \$802,000 related to Sparks Medical Properties; (vii) \$478,000 related to Arlington Medical Properties, and; (viii) \$240,000 related to BRB/E Building One.

### **Acquisition and Divestiture Activity**

Please see Note 4 to the condensed consolidated financial statements for completed transactions.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

There have been no material changes in the quantitative and qualitative disclosures during the first six months of 2012. Reference is made to Item 7A in our Annual Report on Form 10-K for the year ended December 31, 2011.

### **Item 4. Controls and Procedures**

As of June 30, 2012, under the supervision and with the participation of our management, including the Trust's Chief Executive Officer ( CEO ) and Chief Financial Officer ( CFO ), we performed an evaluation of the effectiveness of our disclosure controls and procedures as defined in Rule 13a-15(e) or Rule 15d-15(e) under the Securities Exchange Act of 1934, as amended (the 1934 Act ). Based on this evaluation, the CEO and CFO have concluded that our disclosure controls and procedures are effective to ensure that material information is recorded, processed, summarized and reported by management on a timely basis in order to comply with our disclosure obligations under the 1934 Act and the SEC rules thereunder.

There have been no changes in our internal control over financial reporting or in other factors during the second quarter of 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents**

**PART II. OTHER INFORMATION**

**UNIVERSAL HEALTH REALTY INCOME TRUST**

**Item 6. Exhibits**

(a.) Exhibits:

- 31.1 Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)/15(d)-14(a) under the Securities Exchange Act of 1934, as amended.
- 31.2 Certification of the Chief Financial Officer pursuant to Rule 13a-14(a)/15(d)-14(a) under the Securities Exchange Act of 1934, as amended.
- 32.1 Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.INS\*\* XBRL Instance Document
- 101.SCH\*\* XBRL Taxonomy Extension Schema Document
- 101.CAL\*\* XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF\*\* XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB\*\* XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE\*\* XBRL Taxonomy Extension Presentation Linkbase Document

\*\* XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

**Table of Contents**

**Signatures**

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.

Date: August 8, 2012

UNIVERSAL HEALTH REALTY INCOME TRUST

(Registrant)

/s/ Alan B. Miller

Alan B. Miller, Chairman of the Board,  
President and Chief Executive Officer

(Principal Executive Officer)

/s/ Charles F. Boyle

Charles F. Boyle,

Vice President and Chief Financial Officer  
(Principal Financial Officer)

**Table of Contents****EXHIBIT INDEX**

| <b>Exhibit No.</b> | <b>Description</b>   |
|--------------------|--|
| 31.1               | Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)/15(d)-14(a) under the Securities Exchange Act of 1934, as amended.             |
| 31.2               | Certification of the Chief Financial Officer pursuant to Rule 13a-14(a)/15(d)-14(a) under the Securities Exchange Act of 1934, as amended.             |
| 32.1               | Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2               | Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS**          | XBRL Instance Document   |
| 101.SCH**          | XBRL Taxonomy Extension Schema Document  |
| 101.CAL**          | XBRL Taxonomy Extension Calculation Linkbase Document  |
| 101.DEF**          | XBRL Taxonomy Extension Definition Linkbase Document   |
| 101.LAB**          | XBRL Taxonomy Extension Label Linkbase Document  |
| 101.PRE**          | XBRL Taxonomy Extension Presentation Linkbase Document   |

\*\* XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.