

HEALTHCARE REALTY TRUST INC

Form 10-Q

July 31, 2012

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended: 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: 001-11852

HEALTHCARE REALTY TRUST INCORPORATED

(Exact name of Registrant as specified in its charter)

Maryland	62 – 1507028
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

3310 West End Avenue
Suite 700
Nashville, Tennessee 37203
(Address of principal executive offices)

(615) 269-8175
(Registrant's telephone number, including area code)

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

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

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

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

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

As of July 25, 2012, 78,003,422 shares of the Registrant's Common Stock were outstanding.

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FORM 10-Q
June 30, 2012

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Part I. FINANCIAL INFORMATION

Item 1. Financial Statements.

Healthcare Realty Trust Incorporated
 Condensed Consolidated Balance Sheets
 (Dollars in thousands, except per share data)

	(Unaudited)	
	June 30, 2012	December 31, 2011
ASSETS		
Real estate properties:		
Land	\$ 163,211	\$ 162,843
Buildings, improvements and lease intangibles	2,552,106	2,521,226
Personal property	18,776	18,221
Construction in progress	34,180	86,328
	2,768,273	2,788,618
Less accumulated depreciation	(545,677)	(516,747)
Total real estate properties, net	2,222,596	2,271,871
Cash and cash equivalents	3,103	4,738
Mortgage notes receivable	118,059	97,381
Assets held for sale and discontinued operations, net	12,921	28,650
Other assets, net	115,645	118,382
Total assets	\$ 2,472,324	\$ 2,521,022
LIABILITIES AND EQUITY		
Liabilities:		
Notes and bonds payable	\$ 1,395,600	\$ 1,393,537
Accounts payable and accrued liabilities	57,785	72,217
Liabilities of discontinued operations	174	518
Other liabilities	52,570	49,944
Total liabilities	1,506,129	1,516,216
Commitments and contingencies		
Equity:		
Preferred stock, \$.01 par value; 50,000,000 shares authorized; none issued and outstanding	—	—
Common stock, \$.01 par value; 150,000,000 shares authorized; 78,002,812 and 77,843,883 shares issued and outstanding at June 30, 2012 and December 31, 2011, respectively	780	779
Additional paid-in capital	1,896,735	1,894,604
Accumulated other comprehensive loss	(3,332)	(3,332)
Cumulative net income attributable to common stockholders	801,993	795,951
Cumulative dividends	(1,729,981)	(1,683,196)
Total stockholders' equity	966,195	1,004,806
Total liabilities and equity	\$ 2,472,324	\$ 2,521,022

The accompanying notes, together with the Notes to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011, are an integral part of these financial statements.

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Healthcare Realty Trust Incorporated
 Condensed Consolidated Statements of Operations
 For the Three Months Ended June 30, 2012 and 2011
 (Dollars in thousands, except per share data)
 (Unaudited)

	2012	2011
REVENUES		
Property operating	\$60,948	\$53,320
Single-tenant net lease	12,833	13,459
Straight-line rent	1,542	1,076
Mortgage interest	2,039	1,825
Other operating	1,374	2,047
	78,736	71,727
EXPENSES		
Property operating	29,457	27,773
General and administrative	4,519	5,157
Depreciation	21,311	18,487
Amortization	2,540	1,778
Bad debt, net	149	93
	57,976	53,288
OTHER INCOME (EXPENSE)		
Interest expense	(18,530)	(17,343)
Interest and other income, net	203	196
	(18,327)	(17,147)
INCOME FROM CONTINUING OPERATIONS	2,433	1,292
DISCONTINUED OPERATIONS		
Income from discontinued operations	659	719
Impairments	(167)	—
Gain on sales of real estate properties	3	—
INCOME FROM DISCONTINUED OPERATIONS	495	719
NET INCOME	2,928	2,011
Less: Net income attributable to noncontrolling interests	(20)	—
NET INCOME ATTRIBUTABLE TO COMMON STOCKHOLDERS	\$2,908	\$2,011
BASIC EARNINGS PER COMMON SHARE:		
Income from continuing operations	\$0.03	\$0.02
Discontinued operations	0.01	0.01
Net income attributable to common stockholders	\$0.04	\$0.03
DILUTED EARNINGS PER COMMON SHARE:		
Income from continuing operations	\$0.03	\$0.02
Discontinued operations	0.01	0.01
Net income attributable to common stockholders	\$0.04	\$0.03
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING—BASIC	76,462,266	72,035,154
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING—DILUTED	77,712,493	73,149,232
DIVIDENDS DECLARED, PER COMMON SHARE, DURING THE PERIOD	\$0.30	\$0.30

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Healthcare Realty Trust Incorporated
Condensed Consolidated Statements of Operations
For the Six Months Ended June 30, 2012 and 2011
(Dollars in thousands, except per share data)
(Unaudited)

	2012	2011	
REVENUES			
Property operating	\$ 119,913	\$ 105,141	
Single-tenant net lease	25,092	27,503	
Straight-line rent	3,449	2,364	
Mortgage interest	4,331	3,474	
Other operating	3,146	4,345	
	155,931	142,827	
EXPENSES			
Property operating	58,039	55,210	
General and administrative	9,782	10,938	
Depreciation	42,333	36,756	
Amortization	5,077	3,555	
Bad debt, net	109	271	
	115,340	106,730	
OTHER INCOME (EXPENSE)			
Loss on extinguishment of debt	—	(1,986)
Interest expense	(36,909	)	(39,617
Interest and other income, net	508	418)
	(36,401	)	(41,185
)
INCOME (LOSS) FROM CONTINUING OPERATIONS	4,190	(5,088)
DISCONTINUED OPERATIONS			
Income from discontinued operations	2,777	1,448	
Impairments	(4,336	)	(147
Gain on sales of real estate properties	3,431	36)
INCOME FROM DISCONTINUED OPERATIONS	1,872	1,337	
NET INCOME (LOSS)	6,062	(3,751)
Less: Net income attributable to noncontrolling interests	(20	)	(27
NET INCOME (LOSS) ATTRIBUTABLE TO COMMON STOCKHOLDERS	\$ 6,042	\$ (3,778)
BASIC EARNINGS (LOSS) PER COMMON SHARE:			
Income (loss) from continuing operations	\$ 0.05	\$ (0.07)
Discontinued operations	0.03	0.02	
Net income (loss) attributable to common stockholders	\$ 0.08	\$ (0.05)
DILUTED EARNINGS (LOSS) PER COMMON SHARE:			
Income (loss) from continuing operations	\$ 0.05	\$ (0.07)
Discontinued operations	0.03	0.02	
Net income (loss) attributable to common stockholders	\$ 0.08	\$ (0.05)
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING—BASIC	76,444,487	69,109,543	
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING—DILUTED	77,678,362	69,109,543	
DIVIDENDS DECLARED, PER COMMON SHARE, DURING THE PERIOD	\$ 0.60	\$ 0.60	

The accompanying notes, together with the Notes to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011, are an integral part of these financial statements.

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Healthcare Realty Trust Incorporated
 Condensed Consolidated Statements of Comprehensive Income
 For the Three Months Ended June 30, 2012 and 2011
 (Dollars in thousands)
 (Unaudited)

	2012	2011
COMPREHENSIVE INCOME	\$2,928	\$2,011
Less: Comprehensive income attributable to noncontrolling interests	(20) —
COMPREHENSIVE INCOME ATTRIBUTABLE TO COMMON STOCKHOLDERS	\$2,908	\$2,011

The accompanying notes, together with the Notes to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011, are an integral part of these financial statements.

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Healthcare Realty Trust Incorporated
 Condensed Consolidated Statements of Comprehensive Income (Loss)
 For the Six Months Ended June 30, 2012 and 2011
 (Dollars in thousands)
 (Unaudited)

	2012	2011	
COMPREHENSIVE INCOME (LOSS)	\$6,062	\$(3,751)
Less: Comprehensive income attributable to noncontrolling interests	(20	)	(27
COMPREHENSIVE INCOME (LOSS) ATTRIBUTABLE TO COMMON STOCKHOLDERS	\$6,042	\$(3,778)

The accompanying notes, together with the Notes to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011, are an integral part of these financial statements.

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Healthcare Realty Trust Incorporated
 Condensed Consolidated Statements of Cash Flows
 For the Six Months Ended June 30, 2012 and 2011
 (Dollars in thousands)
 (Unaudited)

	2012	2011	
OPERATING ACTIVITIES			
Net income (loss)	\$6,062	\$(3,751))
Adjustments to reconcile net income (loss) to cash provided by operating activities:			
Depreciation and amortization	49,762	43,919	
Stock-based compensation	1,653	1,602	
Straight-line rent receivable	(3,445)	(2,395))
Straight-line rent liability	202	246	
Gain on sales of real estate properties	(3,431)	(36))
Loss on extinguishment of debt	—	1,986	
Impairments	4,336	147	
Provision for bad debt, net	108	287	
Changes in operating assets and liabilities:			
Other assets	4,050	(5,376))
Accounts payable and accrued liabilities	(9,573)	2,649)
Other liabilities	3,073	7,217	
Net cash provided by operating activities	52,797	46,495	
INVESTING ACTIVITIES			
Acquisition and development of real estate properties	(61,522)	(83,111))
Funding of mortgages and notes receivable	(28,550)	(83,141))
Proceeds from sales of real estate	36,109	3,775	
Proceeds from mortgage repayment by consolidated variable interest entity	35,057	—	
Proceeds from mortgages and notes receivable repayments	9,232	58	
Net cash used in investing activities	(9,674)	(162,419))
FINANCING ACTIVITIES			
Net borrowings on unsecured credit facility	4,000	123,000	
Repayments on notes and bonds payable	(2,436)	(1,616))
Repurchase of notes payable	—	(280,201))
Dividends paid	(46,785)	(42,570))
Proceeds from issuance of common stock	511	224,045	
Common stock redemptions	(45)	(51))
Distributions to noncontrolling interest holders	—	(281))
Purchase of noncontrolling interests	—	(1,591))
Debt issuance costs	(3)	(356))
Net cash provided by (used in) financing activities	(44,758)	20,379)
Decrease in cash and cash equivalents	(1,635)	(95,545))
Cash and cash equivalents, beginning of period	4,738	113,321	
Cash and cash equivalents, end of period	\$3,103	\$17,776	

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Healthcare Realty Trust Incorporated
 Condensed Consolidated Statements of Cash Flows
 For the Six Months Ended June 30, 2012 and 2011
 (Dollars in thousands)
 (Unaudited)

	2012	2011
Supplemental Cash Flow Information:		
Interest paid	\$38,307	\$33,437
Capitalized interest	\$3,469	\$4,194
Company-financed real estate property sales	\$11,200	\$2,700
Invoices accrued for construction, tenant improvement and other capitalized costs	\$5,931	\$15,001
Construction liabilities transferred upon deconsolidation of variable interest entity	\$3,450	\$—

The accompanying notes, together with the Notes to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011, are an integral part of these financial statements.

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Healthcare Realty Trust Incorporated
Notes to Condensed Consolidated Financial Statements
June 30, 2012
(Unaudited)

Note 1. Summary of Significant Accounting Policies

Business Overview

Healthcare Realty Trust Incorporated (the “Company”) is a real estate investment trust (“REIT”) that integrates owning, managing, financing and developing income-producing real estate properties associated primarily with the delivery of outpatient healthcare services throughout the United States. The Company had investments of approximately \$2.9 billion in 205 real estate properties and mortgages as of June 30, 2012. The Company’s 198 owned real estate properties are located in 28 states and total approximately 13.5 million square feet. The Company provided property management services to approximately 10.3 million square feet nationwide.

Principles of Consolidation

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

The Condensed Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements that are included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2011. Management believes, however, that all adjustments of a normal, recurring nature considered necessary for a fair presentation have been included. All material intercompany transactions and balances have been eliminated in consolidation.

This interim financial information should be read in conjunction with the financial statements and Management’s Discussion and Analysis of Financial Condition and Results of Operations included in this report and in the Company’s Annual Report on Form 10-K for the year ended December 31, 2011. This interim financial information does not necessarily represent or indicate what the operating results will be for the year ending December 31, 2012 for many reasons including, but not limited to, acquisitions, dispositions, capital financing transactions, changes in interest rates and the effects of other trends, risks, and uncertainties.

In January 2012, a construction mortgage note receivable totaling approximately \$35.1 million was repaid in full. The construction mortgage note was funding the ongoing development of an inpatient facility in South Dakota that was leased by Sanford Health. In the third quarter of 2011, the Company began consolidating the construction project upon its conclusion that it was the primary beneficiary of the VIE that was constructing the facility. As a result of the consolidation of the VIE, the Company also eliminated the construction mortgage note and related interest on its Condensed Consolidated Financial Statements. Upon repayment of the mortgage note, the Company deconsolidated the VIE and recognized net mortgage interest income of \$0.4 million and overhead expense of \$0.1 million, resulting in a net gain to the Company of \$0.3 million.

The Company also had a variable interest in two unconsolidated VIEs consisting of construction mortgage notes aggregating approximately \$68.7 million at June 30, 2012 in which management concluded that the Company was not currently the primary beneficiary.

The Company had an investment in one unconsolidated joint venture of approximately \$1.3 million at June 30, 2012 which the Company accounts for under the cost method since the Company does not exert significant influence over

the joint venture's operations. The joint venture, which invests in real estate properties, is included in other assets on the Company's Condensed Consolidated Balance Sheets, and the related distributions received are included in interest and other income, net on the Company's Condensed Consolidated Statements of Operations.

Use of Estimates in the Condensed Consolidated Financial Statements

Preparation of the Condensed Consolidated Financial Statements in accordance with GAAP requires management to make estimates and assumptions that affect amounts reported in the Condensed Consolidated Financial Statements and accompanying

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Notes to Condensed Consolidated Financial Statements - Continued

notes. Actual results may differ from those estimates.

Segment Reporting

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

Reclassifications

Certain amounts in the Company's Condensed Consolidated Financial Statements for prior periods have been reclassified to conform to the current period presentation. Assets sold or held for sale, and related liabilities, have been reclassified in the Company's Condensed Consolidated Balance Sheets, and the operating results of those assets have been reclassified from continuing to discontinued operations for all periods presented.

Revenue Recognition

General

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

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

Rental Income

Rental income related to non-cancelable operating leases is recognized as earned over the life of the lease agreements on a straight-line basis. The Company's lease agreements generally include provisions for stated annual increases or increases based on a Consumer Price Index. The Company's multi-tenant office lease arrangements also generally allow for operating expense recoveries which the Company calculates and bills to its tenants. Rental income from properties under single-tenant net lease arrangements (formerly named master leases) is included in single-tenant net lease revenue and rental income from properties with multi-tenant office lease arrangements is included in property operating income in the Company's Condensed Consolidated Statements of Operations. The Company's leases, formerly named as master leases, have over time changed from single tenant leases with underlying sub-tenants occupying the majority of the buildings to buildings that are leased and occupied by a single tenant. As such, the Company has renamed the revenues from these types of agreements to "single-tenant net leases" to describe more fully the nature of these leases.

Interest Income

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

Property Operating Agreements

At June 30, 2012, the Company had six real estate properties with an aggregate gross investment of approximately \$73.6 million subject to property operating agreements that obligate the sponsoring health system to provide to the Company a minimum return on the Company's investment in the property in exchange for the right to be involved in the operating decisions of the property, including tenancy. If the minimum return is not achieved through normal operations of the property, the sponsor is responsible to the Company for the shortfall under the terms of these agreements. The Company recognizes any shortfall income in other operating income in the Company's Condensed Consolidated Statements of Operations. Property operating agreement payments totaling approximately \$0.5 million per quarter on two of the Company's properties in New Orleans expired on

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Notes to Condensed Consolidated Financial Statements - Continued

September 30, 2011. No other property operating agreements are scheduled to expire until 2016.

Accumulated Other Comprehensive Loss

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

Income Taxes

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

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

The Company classifies interest and penalties related to uncertain tax positions, if any, in its Condensed Consolidated Financial Statements as a component of general and administrative expense. No such amounts were recognized during the six months ended June 30, 2012 or 2011.

Incentive Plans

The Company has various employee and non-employee stock-based awards outstanding, including restricted stock issued under its incentive plans, and options granted to employees pursuant to its employee stock purchase plan (the "Employee Stock Purchase Plan"). The Company generally recognizes compensation expense for awards issued under its incentive plans based on the grant date fair value of the awards ratably over the requisite service period. Compensation expense for awards issued under the Employee Stock Purchase Plan is based on fair value, net of estimated forfeitures, using the Black-Scholes model, and is generally recognized when the awards are granted in the first quarter of each year since they immediately vest when granted.

Defined Benefit Pension Plan

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

Operating Leases

As described in more detail in the Company's Annual Report on Form 10-K for the year ended December 31, 2011, the Company is obligated under operating lease agreements consisting primarily of its corporate office lease and various ground leases related to the Company's real estate investments where the Company is the lessee.

Discontinued Operations and Assets Held for Sale

The Company sells properties from time to time due to a variety of factors, including among other things, market conditions or the exercise of purchase options by tenants. The operating results of properties that have been sold or are held for sale are reported as discontinued operations in the Company's Condensed Consolidated Statements of

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

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Notes to Condensed Consolidated Financial Statements - Continued

Land Held for Development

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

Fair Value Measurements

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

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

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

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

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

In connection with the sale of five medical office buildings in the second quarter of 2012, the Company recorded impairment charges totaling approximately \$0.2 million based on the contractual sales prices, a Level 1 input.

Real Estate Properties

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

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

Mortgage Notes

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

Allowance for Doubtful Accounts and Credit Losses

Management monitors the aging and collectibility of its accounts receivable balances on an ongoing basis. Whenever there is deterioration in the timeliness of payment from a tenant or sponsor, management investigates and determines the reason(s) for the delay. Considering all information gathered, management's judgment is exercised in determining

whether a receivable is potentially uncollectible and, if so, how much or what percentage may be uncollectible. Among the factors management considers in determining collectibility are: the type of contractual arrangement under which the receivable was recorded (e.g., a triple net lease, a gross lease, a sponsor guaranty agreement, or some other type of agreement); the tenant's reason for slow payment; industry influences under which the tenant operates; evidence of willingness and ability of the tenant to pay the receivable; credit-worthiness of the tenant; collateral, security deposit, letters of credit or other monies held as security; tenant's historical payment pattern; other contractual agreements between the tenant and the Company; relationship between the tenant and the Company; the state

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Notes to Condensed Consolidated Financial Statements - Continued

in which the tenant operates; and the existence of a guarantor and the willingness and ability of the guarantor to pay the receivable. Considering these factors and others, management concludes whether all or some of the aged receivable balance is likely uncollectible. Upon determining that some portion of the receivable is likely uncollectible, the Company records a provision for bad debts for the amount it expects will be uncollectible. When efforts to collect a receivable are exhausted, the receivable amount is charged off against the allowance.

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

New Pronouncements

On January 1, 2012, the Company adopted the Financial Accounting Standard Board's Accounting Standards Update ("ASU") 2011-08, "Intangibles – Goodwill and Other (Topic 350), Testing Goodwill for Impairment." The standard simplifies the process a company must go through to test goodwill for impairment. Companies have an option to first assess qualitative factors of a reporting unit being tested before having to assess quantitative factors. If a company believes no impairment exists based on qualitative factors, then it will no longer be required to perform the two-step quantitative impairment test. The Company tests its \$3.5 million of goodwill for impairment as of December 31 of each year. The adoption of this new standard did not have a material impact on the Company's financial statements.

Note 2. Real Estate and Mortgage Notes Receivable Investments

The Company had investments of approximately \$2.9 billion in 205 real estate properties and mortgages as of June 30, 2012. The Company's 198 owned real estate properties are located in 28 states and total approximately 13.5 million total square feet. The table below details the Company's investments.

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(Dollars and Square Feet in thousands)	Number of Investments	Gross Investment		Square Feet			
		Amount	%	Footage	%		
Owned properties:							
Multi-tenant leases							
Medical office/outpatient	148	\$1,782,088	61.8	% 9,764	72.4	%	
Medical office—stabilization in progress	11	379,494	13.1	% 1,186	8.8	%	
Other	2	19,767	0.7	% 256	1.9	%	
	161	2,181,349	75.6	% 11,206	83.1	%	
Single-tenant net leases							
Medical office/outpatient	20	190,903	6.6	% 982	7.3	%	
Inpatient	14	337,492	11.7	% 1,103	8.2	%	
Other	2	9,545	0.3	% 91	0.7	%	
	36	537,940	18.6	% 2,176	16.2	%	
Construction in progress							
Medical office/outpatient	1	9,009	0.3	% 96	0.7	%	
Land held for development	—	25,171	0.9	% —	—		
	1	34,180	1.2	% 96	0.7	%	
Corporate property							
	—	14,804	0.5	% —	—		
	—	14,804	0.5	% —	—		
Total owned properties	198	2,768,273	95.9	% 13,478	100.0	%	
Mortgage notes receivable:							
Medical office/outpatient	4	41,801	1.4	% —	—		
Inpatient	1	36,258	1.3	% —	—		
Other	1	40,000	1.4	% —	—		
	6	118,059	4.1	% —	—		
Unconsolidated joint venture:							
Other	1	1,266	—	—	—		
	1	1,266	—	—	—		
Total real estate investments	205	\$2,887,598	100.0	% 13,478	100.0	%	

Mortgage Notes Receivable

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

(Dollars in thousands)	June 30, 2012	December 31, 2011
Construction mortgage notes	\$68,694	\$51,471
Other mortgage loans	49,365	45,910
	\$118,059	\$97,381

As of June 30, 2012, approximately \$68.7 million, or 58.2%, of the Company's mortgage notes receivable were due from affiliates of the United Trust Fund, which is developing two build-to-suit facilities that are fully leased to Mercy Health. Also, approximately \$40.0 million, or 33.9%, of the Company's mortgage notes receivable were due from LB Properties X, LLC.

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Note 3. Acquisitions and Dispositions

Real Estate Acquisitions

In January 2012, the Company purchased a 58,285 square foot medical office building in South Dakota for cash consideration of approximately \$15.0 million. The property is 100% leased under a single-tenant net lease, which expires in 2022, with an affiliate of "AA-" rated Sanford Health, with a parent guarantee. The property is connected to a new Sanford Health acute care hospital that opened in June 2012.

In February 2012, the Company purchased a 23,312 square foot medical office building in North Carolina for cash consideration of approximately \$6.4 million. The building is 100% occupied by two tenants with an affiliate of "AA-" rated Carolinas Healthcare System ("CHS") occupying 93% of the building. The property is adjacent to a CHS hospital campus where the Company currently owns six medical office buildings totaling approximately 187,000 square feet.

In March 2012, the Company acquired the fee simple interest in 9.14 acres of land in Pennsylvania for cash consideration of approximately \$1.2 million. The Company previously held a ground lease interest in this property.

In May 2012, the Company purchased a 76,484 square foot medical office building in Texas for a purchase price of approximately \$10.7 million. Concurrent with the acquisition, the Company's construction mortgage note receivable totaling \$9.9 million, which was secured by the building, was repaid, resulting in a total of an additional \$1.2 million in cash consideration from the Company. The building was 100% leased at the time of the acquisition with lease expirations through 2021.

Mortgage Note Financings

In January 2012, the Company originated a \$3.0 million seller-financed mortgage note receivable with the purchaser of two medical office buildings located in Texas that were sold by the Company as discussed in "Asset Dispositions" below. The note has a stated fixed interest rate of 7.25% and matures in January 2014.

In March 2012, the Company originated a \$4.5 million seller-financed mortgage note receivable with the purchaser of a medical office building located in Texas that was sold by the Company as discussed in "Asset Dispositions" below. This note was repaid in April 2012.

In April 2012, the Company originated a \$3.8 million seller-financed mortgage note receivable with the purchaser of two medical office buildings located in Florida that were sold by the Company as part of a larger disposition as discussed in "Asset Dispositions" below. The note has a stated fixed interest rate of 7.5% and matures in April 2015.

The following table details the Company's acquisitions and mortgage note financings for the six months ended June 30, 2012:

(Dollars in millions)	Date Acquired	Cash Consideration	Real Estate	Mortgage Note Financing	Other	Square Footage
Real estate acquisitions						
South Dakota	1/20/12	\$15.0	\$14.9	\$—	\$0.1	58,285
North Carolina	2/10/12	6.4	6.4	—	—	23,312
Pennsylvania	3/16/12	1.2	1.1	—	0.1	—
Texas	5/23/12	1.2	10.7	(9.9)	) 0.4	76,484
		23.8	33.1	(9.9)) 0.6	158,081
Mortgage note financings						
Texas	1/10/12	3.0	—	3.0	—	—
Texas	3/16/12	4.5	—	4.5	—	—

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Florida	4/18/12	3.8	—	3.8	—	—
		11.3	—	11.3	—	—
		\$35.1	\$33.1	\$1.4	\$0.6	158,081

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Asset Dispositions

During the first quarter of 2012, the Company disposed of the following properties and mortgage notes:

a 14,748 square foot medical office building and an 18,978 square foot medical office building, both in Texas, in which the Company had an aggregate net investment of approximately \$2.5 million, for total consideration of approximately \$3.4 million. The Company received approximately \$0.4 million in net cash proceeds, including prepaid interest, originated a \$3.0 million seller-financed mortgage note receivable as discussed above in "Mortgage Note Financings," and recognized a \$0.9 million net gain on the disposal;

a 35,752 square foot medical office building in Florida, in which the Company had a net investment of approximately \$3.0 million, for total consideration of approximately \$5.7 million. The Company received approximately \$5.7 million in net cash proceeds and a lease termination fee of \$1.5 million which is recorded in income from discontinued operations. The Company also recognized a \$2.5 million net gain on the disposal;

• a 33,895 square foot medical office building in Florida in which the Company had a net investment of approximately \$0.5 million for total consideration of approximately \$0.5 million;

an 82,664 square foot medical office building in Texas, in which the Company had a net investment of approximately \$4.8 million, for a purchase price of approximately \$4.7 million. The Company originated a \$4.5 million seller-financed mortgage note receivable as discussed above in "Mortgage Note Financings" and recognized a \$0.4 million impairment on the disposal, including the write-off of straight-line rent receivables and closing costs; two mortgage notes receivable of \$1.5 million and \$3.2 million for total consideration of approximately \$4.7 million; and

a construction mortgage note receivable totaling approximately \$35.1 million which was repaid in full relating to the ongoing development of an inpatient facility in South Dakota. See Note 1 for more details on this repayment.

During the second quarter of 2012, the Company disposed of the following properties and mortgage notes:

a medical office building in Tennessee in which the Company had a net investment of approximately \$0.8 million. The Company received approximately \$0.8 million in net cash proceeds;

five medical office buildings located in Florida were sold to a single buyer for a purchase price of \$33.3 million in which the Company had a net aggregate investment of approximately \$31.8 million, including \$0.6 million of straight-line rent receivables. The Company received approximately \$32.4 million in consideration from the sale, including the origination of a \$3.8 million seller-financed mortgage note and a \$0.6 million contingent liability. The Company recognized a \$0.2 million impairment on the disposal, including the write-off of straight-line rent receivables and closing costs. These properties were not previously classified as held for sale;

a mortgage note receivable of \$4.5 million was repaid; and

a mortgage note receivable of \$9.9 million was repaid in conjunction with the acquisition of a medical office building in Texas as discussed in "Real Estate Acquisitions" above.

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The following table details the Company's dispositions and mortgage note repayments for the six months ended June 30, 2012:

(Dollars in millions)	Date Disposed	Net Proceeds	Net Real Estate Investment	Other (including receivables)	Mortgage Note Receivable	Gain/ (Impairment)	Square Footage
Real estate dispositions							
Texas (two properties) (1)	1/10/2012	\$0.4	\$2.5	\$—	\$(3.0)	) \$0.9	33,726
Florida (1)	1/19/2012	5.7	3.0	0.2	—	2.5	35,752
Florida (1)	3/2/2012	0.5	0.5	—	—	—	33,895
Texas (1)	3/16/2012	—	4.8	0.1	(4.5)	) (0.4)	82,664
Tennessee (1)	4/13/2012	0.8	0.8	—	—	—	18,476
Florida (five properties)	4/18/2012	28.6	31.2	1.4	(3.8)	) (0.2)	272,571
		36.0	42.8	1.7	(11.3)	) 2.8	477,084
Mortgage note repayments		19.1	—	—	19.1	—	—
Deconsolidation of VIE (2)		35.1	38.2	(3.4)	) —	0.3	113,602
Total dispositions and repayments		\$90.2	\$81.0	\$(1.7)	) \$7.8	\$3.1	590,686

(1) Previously included in assets held for sale.

(2) "Other" includes construction liabilities transferred upon deconsolidation. "Gain" includes \$0.4 million of net mortgage interest income recognized, partially offset by \$0.1 million of general and administrative overhead expense that had been capitalized into the project that was reversed upon deconsolidation.

Discontinued Operations and Assets Held for Sale

During the first quarter of 2012, the Company recorded a \$1.5 million lease termination fee related to the sale of a medical office building in Florida which is included in single-tenant net lease revenue in discontinued operations, recorded \$3.4 million in gains on property sales, recorded a \$0.4 million impairment charge on a property sold, and recorded a \$3.8 million impairment charge on a building that was classified as held for sale.

During the second quarter of 2012, the Company sold five properties that were not previously classified as held for sale and recognized a \$0.2 million impairment on the disposal.

The following tables detail the assets, liabilities, and results of operations included in discontinued operations on the Company's Condensed Consolidated Statements of Operations and in assets and liabilities of discontinued operations on the Company's Condensed Consolidated Balance Sheets. At June 30, 2012 and December 31, 2011, the Company had 9 and 15 properties, respectively, classified as held for sale. Of the 15 properties classified as held for sale at December 31, 2011, three properties in Texas and two properties in Florida were sold during the first quarter of 2012, and one property in Tennessee was sold during the second quarter of 2012.

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(Dollars in thousands)	June 30, 2012	December 31, 2011		
Balance Sheet data (as of the period ended):				
Land	\$5,107	\$8,078		
Buildings, improvements and lease intangibles	23,992	44,299		
Personal property	440	458		
	29,539	52,835		
Accumulated depreciation	(16,675	) (24,557)	
Assets held for sale, net	12,864	28,278		
Other assets, net (including receivables)	57	372		
Assets of discontinued operations, net	57	372		
Assets held for sale and discontinued operations, net	\$12,921	\$28,650		
Accounts payable and accrued liabilities	\$100	\$404		
Other liabilities	74	114		
Liabilities of discontinued operations	\$174	\$518		
	Three Months Ended		Six Months Ended	
(Dollars in thousands, except per share data)	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
Statements of Operations data (for the period ended):				
Revenues				
Property operating	\$269	\$665	\$910	\$1,436
Single-tenant net lease	766	1,643	3,391	3,287
Straight-line rent	3	33	(4	) 31
Other operating	2	6	9	13
	1,040	2,347	4,306	4,767
Expenses				
Property operating	305	1,006	1,111	2,067
General and administrative	1	3	4	5
Depreciation	121	633	487	1,259
Amortization	—	(8	) —	(16
Bad debt, net	1	—	(1	) 16
	428	1,634	1,601	3,331
Other Income (Expense)				
Interest and other income, net	47	6	72	12
	47	6	72	12
Discontinued Operations				
Income from discontinued operations	659	719	2,777	1,448
Impairments	(167	) —	(4,336	) (147
Gain on sales of real estate properties	3	—	3,431	36
Income from Discontinued Operations	\$495	\$719	\$1,872	\$1,337
Income from Discontinued Operations per Common Share—Basic	\$0.01	\$0.01	\$0.03	\$0.02
Income from Discontinued Operations per Common Share—Diluted	\$0.01	\$0.01	\$0.03	\$0.02

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Note 4. Notes and Bonds Payable

The table below details the Company's notes and bonds payable as of June 30, 2012 and December 31, 2011.

(Dollars in thousands)	June 30, 2012	December 31, 2011	Maturity Dates	Contractual Interest Rates	Principal Payments	Interest Payments
Unsecured Credit Facility	\$216,000	\$212,000	10/15	LIBOR + 1.50%	At maturity	Quarterly
Senior Notes due 2014, net of discount	264,445	264,371	4/14	5.125%	At maturity	Semi-Annual
Senior Notes due 2017, net of discount	298,594	298,465	1/17	6.500%	At maturity	Semi-Annual
Senior Notes due 2021, net of discount	397,178	397,052	1/21	5.750%	At maturity	Semi-Annual
Mortgage notes payable, net of discount and including premiums	219,383	221,649	4/13-10/30	5.000%-7.625%	Monthly	Monthly
	\$1,395,600	\$1,393,537				

The Company's various debt agreements contain certain representations, warranties, and financial and other covenants customary in such loan agreements. Among other things, these provisions require the Company to maintain certain financial ratios and minimum tangible net worth and impose certain limits on the Company's ability to incur indebtedness and create liens or encumbrances. At June 30, 2012, the Company was in compliance with the financial covenant provisions under all of its various debt instruments.

Unsecured Credit Facility

On October 14, 2011, the Company entered into a \$700.0 million unsecured credit facility due 2015 (the "Unsecured Credit Facility") with a syndicate of 17 lenders that matures on October 14, 2015 with an option to extend the facility for one additional year for an extension fee of 0.20% of the aggregate commitments. Amounts outstanding under the Unsecured Credit Facility bear interest at LIBOR plus the applicable margin rate (defined as a range of 1.075% to 1.900% depending on the Company's unsecured debt ratings, currently 1.5%). In addition, the Company pays a 0.35% facility fee per annum on the aggregate amount of commitments. The facility fee ranges from 0.175% per annum to 0.45% per annum, based on the Company's unsecured debt ratings. At June 30, 2012, the Company had \$216.0 million outstanding under the Unsecured Credit Facility with a weighted average interest rate of approximately 1.75% and a remaining borrowing capacity of approximately \$484.0 million.

Senior Notes due 2014

On March 30, 2004, the Company issued \$300.0 million of unsecured senior notes due 2014 (the "Senior Notes due 2014"). The Senior Notes due 2014 bear interest at 5.125% per annum, payable semi-annually on April 1 and October 1, and are due on April 1, 2014, unless redeemed earlier by the Company. The notes were issued at a discount of approximately \$1.5 million, which yielded a 5.19% interest rate per annum upon issuance. In previous years, the Company repurchased approximately \$35.3 million of the Senior Notes due 2014 and accreted a pro-rata portion of the discount upon the repurchases. The following table reconciles the balance of the Senior Notes due 2014 on the Company's Condensed Consolidated Balance Sheets.

(Dollars in thousands)	June 30, 2012	December 31, 2011
Senior Notes due 2014 face value	\$264,737	\$264,737
Unaccreted discount	(292)	(366)
Senior Notes due 2014 carrying amount	\$264,445	\$264,371

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Senior Notes due 2017

On December 4, 2009, the Company issued \$300.0 million of unsecured senior notes due 2017 (the “Senior Notes due 2017”). The Senior Notes due 2017 bear interest at 6.50% per annum, payable semi-annually on January 17 and July 17, and are due on January 17, 2017, unless redeemed earlier by the Company. The notes were issued at a discount of approximately \$2.0 million, which yielded a 6.618% interest rate per annum upon issuance. The following table reconciles the balance of the Senior Notes due 2017 on the Company’s Condensed Consolidated Balance Sheets.

(Dollars in thousands)	June 30, 2012	December 31, 2011
Senior Notes due 2017 face value	\$ 300,000	\$ 300,000
Unaccreted discount	(1,406	) (1,535
Senior Notes due 2017 carrying amount	\$ 298,594	\$ 298,465

Senior Notes due 2021

On December 13, 2010, the Company issued \$400.0 million of unsecured senior notes due 2021 (the “Senior Notes due 2021”). The Senior Notes due 2021 bear interest at 5.75% per annum, payable semi-annually on January 15 and July 15, beginning January 15, 2011, and are due on January 15, 2021, unless redeemed earlier by the Company. The notes were issued at a discount of approximately \$3.2 million, which yielded a 5.855% interest rate per annum upon issuance. The following table reconciles the balance of the Senior Notes due 2021 on the Company’s Condensed Consolidated Balance Sheets.

(Dollars in thousands)	June 30, 2012	December 31, 2011
Senior Notes due 2021 face value	\$ 400,000	\$ 400,000
Unaccreted discount	(2,822	) (2,948
Senior Notes due 2021 carrying amount	\$ 397,178	\$ 397,052

Mortgage Notes Payable

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

(Dollars in thousands)	June 30, 2012	December 31, 2011
Mortgage notes payable principal balance	\$ 222,941	\$ 225,377
Unaccreted discount, net of premium	(3,558) (3,728
Mortgage notes payable carrying amount	\$ 219,383	\$ 221,649

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The following table further details the Company's mortgage notes payable, with related collateral, at June 30, 2012.

(Dollars in millions)	Effective Original Balance	Interest Rate (18)	Maturity Date	Collateral(19)	Payments (14)	Investment in Collateral at Balance at		
						June 30, 2012	June 30, 2012	December 31, 2011
Life Insurance Co. Commercial Bank	\$4.7	7.765 %	1/17	MOB	Monthly/20-yr amort.	\$ 11.7	\$ 1.8	\$ 1.9
Life Insurance Co. Commercial Bank (1)	1.8	5.550 %	10/30	OTH	Monthly/27-yr amort.	7.9	1.6	1.6
Life Insurance Co. Commercial Bank (2)	15.1	5.490 %	1/16	MOB	Monthly/10-yr amort.	32.7	12.9	13.1
Commercial Bank (3)	17.4	6.480 %	5/15	MOB	Monthly/10-yr amort.	19.9	14.6	14.5
Commercial Bank (4)	12.0	6.110 %	7/15	2 MOB's	Monthly/10-yr amort.	19.5	9.8	9.8
Commercial Bank (5)	15.2	7.650 %	7/20	MOB	(15)	20.2	12.8	12.8
Life Insurance Co. (4)	1.5	6.810 %	7/16	MOB	Monthly/9-yr amort.	2.1	1.1	1.1
Commercial Bank (5)	12.9	6.430 %	2/21	MOB	Monthly/12-yr amort.	20.6	11.3	11.4
Investment Fund	80.0	7.250 %	12/16	15 MOB's	Monthly/30-yr amort.(16)	155.0	78.0	78.4
Life Insurance Co.	7.0	5.530 %	1/18	MOB	Monthly/15-yr amort.	14.5	3.3	3.5
Investment Co. (6)	15.9	6.550 %	4/13	MOB	Monthly/30-yr amort.(17)	23.3	15.0	15.2
Investment Co.	4.6	5.250 %	9/15	MOB	Monthly/10-yr amort.	6.9	4.3	4.3
Life Insurance Co. (7)	13.9	4.700 %	1/16	MOB	Monthly/25-yr amort.	26.4	12.1	12.4
Life Insurance Co. (8)	21.5	4.700 %	8/15	MOB	Monthly/25-yr amort.	43.8	18.5	18.8
Insurance Co. (9)	7.3	5.100 %	12/18	MOB	Monthly/25-yr amort.	14.6	7.4	7.5
Commercial Bank (10)	8.1	4.540 %	8/16	MOB	Monthly/10-yr amort.	15.1	7.6	7.7
Life Insurance Co. (11) (12)	5.3	4.060 %	11/14	MOB	Monthly/25-yr amort.	11.6	4.6	4.8
Life Insurance Co. (13)	3.1	4.060 %	11/14	MOB	Monthly/25-yr amort.	6.7	2.7	2.8
						\$452.5	\$219.4	\$221.6

(1) The unaccreted portion of a \$2.7 million discount recorded on this note upon acquisition is included in the balance above.

(2) The unaccreted portion of a \$2.1 million discount recorded on this note upon acquisition is included in the balance above.

(3) The unaccreted portion of a \$2.4 million discount recorded on this note upon acquisition is included in the balance above.

(4) The unaccreted portion of a \$0.2 million discount recorded on this note upon acquisition is included in the balance above.

(5) The unaccreted portion of a \$1.0 million discount recorded on this note upon acquisition is included in the balance above.

(6) The unamortized portion of a \$0.5 million premium recorded on this note upon acquisition is included in the balance above.

(7) The unamortized portion of a \$0.3 million premium recorded on this note upon acquisition is included in the balance above.

(8) The unamortized portion of a \$0.4 million premium recorded on this note upon acquisition is included in the balance above.

(9) The unamortized portion of a \$0.6 million premium recorded on this note upon acquisition is included in the balance above.

(10) The unamortized portion of a \$0.2 million premium recorded on this note upon acquisition is included in the balance above.

(11) The balance consists of two notes secured by the same building.

- (12) The unamortized portions of a \$0.3 million premium recorded on these notes upon acquisition are included in the balance above.
- (13) The unamortized portion of a \$0.2 million premium recorded on this note upon acquisition is included in the balance above.
- (14) Payable in monthly installments of principal and interest with the final payment due at maturity (unless otherwise noted).
- (15) Payable in monthly installments of interest only for 24 months and then installments of principal and interest based on an 11-year amortization with the final payment due at maturity.
- (16) The Company has the option to extend the maturity for two, one-year floating rate extension terms.
- (17) The Company has the option to extend the maturity for three years at a fixed rate of 6.75%.
- (18) The contractual interest rates for the 19 outstanding mortgage notes ranged from 5.00% to 7.625% at June 30, 2012.
- (19) MOB-Medical office building; OTH-Other.

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Long-Term Debt Maturities

Future contractual maturities of the Company's notes and bonds payable as of June 30, 2012 were:

(Dollars in thousands)	Principal Maturities	Net Accretion/ Amortization (1)	Notes and Bonds Payable	%	
2012 (remaining)	\$2,512	\$(520)	) \$1,992	0.1	%
2013	19,781	(1,263)	) 18,518	1.3	%
2014	276,349	(1,404)	) 274,945	19.7	%
2015	265,775	(1,215)	) 264,560	19.0	%
2016	106,376	(907)	) 105,469	7.6	%
2017 and thereafter	732,885	(2,769)	) 730,116	52.3	%
	\$1,403,678	\$(8,078)	) \$1,395,600	100.0	%

(1) Includes discount accretion and premium amortization related to the Company's Senior Notes due 2014, Senior Notes due 2017, Senior Notes due 2021 and 13 mortgage notes payable.

Note 5. Other Assets

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

(In thousands)	June 30, 2012	December 31, 2011
Prepaid assets	\$44,548	\$45,054
Straight-line rent receivables	33,177	30,374
Above-market intangible assets, net	13,010	13,263
Deferred financing costs, net	12,202	13,783
Accounts receivable, net	5,035	8,181
Goodwill	3,487	3,487
Customer relationship intangible assets, net	2,070	2,103
Equity investments in joint venture—cost method	1,266	1,266
Notes receivable, net	244	283
Allowance for uncollectible accounts	(625)) (583)
Other	1,231	1,171
	\$115,645	\$118,382

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Note 6. Commitments and Contingencies

Development Activity

The Company had several development projects ongoing at June 30, 2012, including one construction project, two construction mortgage notes and eleven properties in the process of stabilization subsequent to construction as detailed in the following table.

(Dollars in thousands)	Number of Properties	Funded During Three Months Ended June 30, 2012	Total Amount Funded Through June 30, 2012	Estimated Remaining Budget	Estimated Total Budget	Approximate Square Feet
Construction in progress (1)	1	\$2,169	\$9,009	\$4,950	\$13,959	96,433
Construction mortgage notes	2	15,597	68,694	133,920	202,614	386,000
Stabilization in progress (1)	11	6,979	379,494	16,532	396,026	1,185,863
Land held for development	—	—	25,171	—	—	—
Total	14	\$24,745	\$482,368	\$155,402	\$612,599	1,668,296

(1) The estimated total budget for the development properties reflects the original budget including estimated tenant improvement allowances but does not include any estimate of excess tenant improvement cost financing by the Company. To the extent actual amounts funded for the development properties reflect excess tenant improvement costs financed by the Company, the estimated remaining fundings could be greater than the amount budgeted.

Construction in Progress

The Company had one construction project ongoing at June 30, 2012 with an estimated completion date during the third quarter of 2012. The project commenced in July 2011 and consists of a 96,433 square foot, on-campus medical office building in Texas with significant pre-leasing. The project has an estimated total budget of approximately \$14.0 million and is adjacent to a medical office building that the Company acquired in late 2010. A \$4.1 million parking structure associated with this project was completed and was placed into service in the second quarter of 2012.

The table below details the Company's construction in progress and land held for development as of June 30, 2012. The information included in the table represents management's estimates and expectations at June 30, 2012, which are subject to change. The Company's disclosures regarding certain projections or estimates of completion dates may not reflect actual results.

State	Estimated Completion Date	Property Type (2)	Properties	Approximate Square Feet	CIP at June 30, 2012	Estimated Remaining Budget	Estimated Total Budget
(Dollars in thousands)							
Under construction: (1)							
Texas	3Q 2012	MOB	1	96,433	\$9,009	\$4,950	\$13,959
Land held for development:							
Iowa			—		4,399		
Texas			—		20,772		
			1	96,433	\$34,180	\$4,950	\$13,959

(1) The estimated total budget for the development property reflects the original budget including estimated tenant improvement allowances but does not include any estimate of excess tenant improvement cost financing by the Company. To the extent actual amounts funded for the development property reflect excess tenant improvement costs financed by the Company, the estimated remaining fundings could be greater than the amount budgeted.

(2) MOB-Medical office building.

Construction Mortgage Notes

The Company had two construction mortgage notes totaling \$68.7 million at June 30, 2012 due from affiliates of the United Trust Fund, which is developing two build-to-suit facilities that are fully leased to Mercy Health. The Company expects that the remaining funding commitments totaling \$133.9 million on these notes will be funded during the remainder of 2012 and 2013.

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Stabilization in Progress

At June 30, 2012, the Company had 11 properties that it had previously developed that were in the process of stabilization. In the aggregate, the properties were approximately 51% leased and 33% occupied at June 30, 2012, with tenant improvement build-out occurring in suites that are leased but not yet occupied by the tenants. The Company's remaining funding commitments on these properties at June 30, 2012 relates to tenant improvements.

Legal Proceedings

Two affiliates of the Company, HR Acquisition of Virginia Limited Partnership and HRT Holdings, Inc., are defendants in a lawsuit brought by Fork Union Medical Investors Limited Partnership, Goochland Medical Investors Limited Partnership, and Life Care Centers of America, Inc., as plaintiffs. The plaintiffs alleged that they overpaid rent between 1991 and 2003 under leases for two skilled nursing facilities in Virginia and sought a refund of such overpayments. Plaintiffs were seeking up to \$2.0 million, plus pre- and post-judgment interest and attorneys' fees. The two leases were terminated by agreement in 2003. The Company denied that it was liable to the plaintiffs and filed a motion for summary judgment seeking dismissal of the case. The Circuit Court of Davidson County, Tennessee granted the Company's motion for summary judgment and the case was dismissed with prejudice by order entered on July 20, 2011. On August 11, 2011, the plaintiffs filed a notice of appeal with the Tennessee Court of Appeals. Briefs have been filed by all parties and oral arguments were heard before the Court of Appeals on May 23, 2012. The Company believes the trial court's dismissal of the case should be affirmed but can provide no assurance as to the outcome of the appeal.

The Company is a co-defendant in a lawsuit initially filed June 28, 2011 in the District Court of Collin County, Texas captioned James P. Murphy, JPM Realty Property Management, Inc., and Rainier Medical Investments LLC v. LandPlan Development Corp., LandPlan Medical, L.P., Frisco Surgery Center Limited, Frisco POB I Limited, Frisco POB II Limited, Medland L.P., Texas Land Management, L.L.C., Jim Williams, Jr., Reed Williams, and Healthcare Realty Trust, Inc. The original plaintiffs, James P. Murphy and JPM Realty Property Management, Inc. (the "Murphy Plaintiffs") allege they are due a real estate commission arising out of the sale of certain real property in Frisco, Texas ("the Frisco Property"). Certain affiliates of the Company purchased the Frisco Property in December 2010 from Frisco Surgery Center Limited, Frisco POB I Limited, Frisco POB II Limited, and Medland L.P. (collectively, the "Sellers"). The Murphy Plaintiffs assert breach of contract and common law business tort theories in pursuit of their claim for a commission in the amount of \$1.34 million, as well as unspecified punitive damages. The Company denies any liability to the Murphy Plaintiffs and filed a motion for summary judgment with the court as to their claims. The Company's motion for summary judgment was partially granted as to the Murphy Plaintiffs' breach of contract claims and third party beneficiary claims on April 19, 2012. The Murphy Plaintiffs' remaining claims against the Company were dismissed on summary judgment on July 22, 2012. The Company was served with an amended complaint in the case on or about February 28, 2012 in which Rainier Medical Investments LLC ("Rainier") joined as a plaintiff. Rainier alleges breach of contract, unfair competition, breach of fiduciary duty, and various common law business tort and equitable claims against the Company arising out of the Company's alleged exclusion of Rainier from participation as an investor in the Frisco Property acquisition. Rainier seeks compensatory and punitive damages in excess of \$10 million. The Company denies any liability to Rainier and will defend the claims vigorously. Discovery is ongoing and a trial date is expected in late 2012.

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

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Note 7. Stockholders' Equity

The following table provides a reconciliation of total stockholders' equity for the six months ended June 30, 2012:

(Dollars in thousands, except per share data)	Common Stock	Additional Paid-In Capital	Accumulated Other Comprehensive Loss	Cumulative Net Income	Cumulative Dividends	Total Stockholders' Equity
Balance at Dec. 31, 2011	\$779	\$1,894,604	\$(3,332)	) \$795,951	\$(1,683,196)	\$1,004,806
Issuance of common stock	1	523	—	—	—	524
Common stock redemption	—	(45)	) —	—	—	(45)
Stock-based compensation	—	1,653	—	—	—	1,653
Net income attributable to common stockholders	—	—	—	6,042	—	6,042
Dividends to common stockholders (\$0.60 per share)	—	—	—	—	(46,785)	(46,785)
Balance at June 30, 2012	\$780	\$1,896,735	\$(3,332)	) \$801,993	\$(1,729,981)	\$966,195

Common Stock

The following table provides a reconciliation of the beginning and ending common stock outstanding for the six months ended June 30, 2012 and the year ended December 31, 2011:

	Six Months Ended June 30, 2012	Year Ended December 31, 2011
Balance, beginning of period	77,843,883	66,071,424
Issuance of common stock	30,182	11,681,392
Restricted stock-based awards, net of forfeitures	128,747	91,067
Balance, end of period	78,002,812	77,843,883

At-The-Market Equity Offering Program

Since December 2008, the Company has had in place an at-the-market equity offering program to sell shares of its common stock from time to time in at-the-market sales transactions. The Company has not sold any shares under this program since July 2011 and had 2,791,300 authorized shares remaining to be sold under the current sales agreement at June 30, 2012.

Common Stock Dividends

During the first six months of 2012, the Company declared and paid common stock dividends totaling \$0.60 per share.

On July 31, 2012, the Company declared a quarterly common stock dividend in the amount of \$0.30 per share payable on August 31, 2012 to stockholders of record on August 16, 2012.

Earnings (Loss) Per Common Share

The following table sets forth the computation of basic and diluted earnings (loss) per common share for the three and six months ended June 30, 2012 and 2011.

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(Dollars in thousands, except per share data)	Three Months Ended		Six Months Ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
Weighted average Common Shares outstanding				
Weighted average Common Shares outstanding	77,977,278	73,476,473	77,961,391	70,550,070
Unvested restricted stock	(1,515,012)	(1,441,319)	(1,516,904)	(1,440,527)
Weighted average Common Shares Outstanding—Basic	76,462,266	72,035,154	76,444,487	69,109,543
Weighted average Common Shares—Basic	76,462,266	72,035,154	76,444,487	69,109,543
Dilutive effect of restricted stock	1,127,522	1,045,698	1,108,456	—
Dilutive effect of employee stock purchase plan	122,705	68,380	125,419	—
Weighted average Common Shares Outstanding—Diluted	77,712,493	73,149,232	77,678,362	69,109,543
Net income (loss)				
Income (loss) from continuing operations	\$2,433	\$1,292	\$4,190	\$(5,088)
Noncontrolling interests' share in net income	(20)	—	(20)	(27)
Income (loss) from continuing operations attributable to common shareholders	2,413	1,292	4,170	(5,115)
Discontinued operations	495	719	1,872	1,337
Net income (loss) attributable to common stockholders	\$2,908	\$2,011	\$6,042	\$(3,778)
Basic Earnings (Loss) Per Common Share				
Income (loss) from continuing operations	\$0.03	\$0.02	\$0.05	\$(0.07)
Discontinued operations	0.01	0.01	0.03	0.02
Net income (loss) attributable to common stockholders	\$0.04	\$0.03	\$0.08	\$(0.05)
Diluted Earnings (Loss) Per Common Share				
Income (loss) from continuing operations	\$0.03	\$0.02	\$0.05	\$(0.07)
Discontinued operations	0.01	0.01	0.03	0.02
Net income (loss) attributable to common stockholders	\$0.04	\$0.03	\$0.08	\$(0.05)

The dilutive effect of 1,034,520 shares of restricted stock and options to purchase 81,935 shares under the Employee Stock Purchase Plan was excluded from the calculation of diluted loss per common share for the six months ended June 30, 2011 because the effect was anti-dilutive due to the loss from continuing operations incurred during that period.

Incentive Plans

The Company has various stock-based incentive plans for its employees and directors. Awards under these plans include restricted stock issued to employees and the Company's directors and options granted to employees pursuant to its Employee Stock Purchase Plan. In May 2012, an annual restricted stock grant was made to each non-employee director equal to a market value of approximately \$76,000. During the six months ended June 30, 2012 and 2011, the Company issued 103,225 and 79,169 shares of restricted common stock, respectively, to its employees under its stock-based incentive plans and withheld 2,342 shares and 2,568 shares of common stock, respectively, from its officers to pay estimated withholding taxes related to restricted stock that vested, respectively.

A summary of the activity under the restricted stock incentive plans for the three and six months ended June 30, 2012 and 2011 is included in the table below.

	Three Months Ended		Six Months Ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
Stock-based awards, beginning of period	1,518,512	1,436,811	1,430,675	1,379,243
Granted	27,864	27,400	131,089	106,569
Vested	(38,102)	(16,000)	(53,490)	(26,675)

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Forfeited	—	—	—	(10,926)
Stock-based awards, end of period	1,508,274	1,448,211	1,508,274	1,448,211

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Under the Company's Employee Stock Purchase Plan, in January of each year, each eligible employee is granted an option to purchase up to \$25,000 of Common Stock at the lesser of 85% of the market price on the date of grant or 85% of the market price on the date of exercise of such option. The number of shares subject to each year's option becomes fixed on the date of grant. Options granted under the Employee Stock Purchase Plan expire if not exercised within 27 months after each such option's date of grant. The Company recorded approximately \$0.2 million in general and administrative expenses during the first quarter of 2012 relating to the annual grant of options to its employees under the Employee Stock Purchase Plan. On April 1, 2012, options to purchase 182,315 shares of Common Stock expired that had not been exercised.

A summary of the activity under the Employee Stock Purchase Plan for the three and six months ended June 30, 2012 and 2011 is included in the table below.

	Three Months Ended		Six Months Ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
Outstanding and exercisable, beginning of period	712,385	626,480	425,196	392,517
Granted	—	—	327,936	261,960
Exercised	(8,787	) (2,654	) (21,368	) (7,245
Forfeited	(23,547	) (9,376	) (51,713	) (32,782
Expired	(182,315	) (166,207	) (182,315	) (166,207
Outstanding and exercisable, end of period	497,736	448,243	497,736	448,243

Note 8. Defined Benefit Pension Plans

The Company's Executive Retirement Plan provides benefits upon retirement for three of the Company's founding officers. The plan is unfunded and benefits will be paid from cash flows of the Company. The maximum annual benefits payable to each individual under the Executive Retirement Plan is \$896,000, subject to cost-of-living adjustments. As of June 30, 2012, only the Company's Chief Executive Officer was eligible to retire under the Executive Retirement Plan.

Net periodic benefit cost recorded related to the Company's pension plans for the three and six months ended June 30, 2012 and 2011 is detailed in the following table.

(Dollars in thousands)	Three Months Ended		Six Months Ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
Service costs	\$19	\$17	\$38	\$34
Interest costs	181	212	363	426
Amortization of net gain/loss	248	232	496	464
Amortization of prior service cost	(181	) —	(362) —
Total recognized in net periodic benefit cost	\$267	\$461	\$535	\$924

Note 9. Other Operating Income

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

(Dollars in thousands)	Three Months Ended		Six Months Ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
Rental lease guaranty income	\$1,185	\$1,824	\$2,428	\$3,799

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Interest income on notes receivable	100	136	240	371
Management fee income	37	38	79	76
Other	52	49	399	99
	\$1,374	\$2,047	\$3,146	\$4,345

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Note 10. Taxable Income

Taxable Income

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

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

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

The following table reconciles the Company's consolidated net income (loss) attributable to common stockholders to taxable income for the three and six months ended June 30, 2012 and 2011.

(Dollars in thousands)	Three Months Ended		Six Months Ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
Net income (loss) attributable to common stockholders	\$2,908	\$2,011	\$6,042	\$(3,778)
Reconciling items to taxable income:				
Depreciation and amortization	6,557	4,194	13,500	9,519
Gain or loss on disposition of depreciable assets	1,251	78	(4,357)	(2,098)
Straight-line rent	(1,434)	(1,009)	(3,244)	(2,149)
Receivable allowances	109	324	(371)	720
Stock-based compensation	1,443	1,298	2,632	2,684
Other	2,246	5,955	7,505	7,044
Taxable income (1)	\$13,080	\$12,851	\$21,707	\$11,942
Dividends paid	\$23,398	\$22,325	\$46,785	\$42,570

(1) Before REIT dividends paid deduction.

State Income Taxes

State income tax expense and payments for the three and six months ended June 30, 2012 and 2011 are detailed in the table below.

(Dollars in thousands)	Three Months Ended		Six Months Ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
State income tax expense:				
Texas gross margins tax	\$118	\$108	\$261	\$227
Other	29	(126)	(42)	(83)
Total state income tax expense	\$147	\$(18)	\$219	\$144
State income tax payments, net	\$523	\$481	\$547	\$503

The Texas gross margins tax is a tax on gross receipts from operations in Texas. The Company understands that the Securities and Exchange Commission views this tax as an income tax. As such, the Company has disclosed the Texas gross margin tax in

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the table above.

Note 11. Fair Value of Financial Instruments

The carrying amounts of cash and cash equivalents, receivables and payables are reasonable estimates of their fair value as of June 30, 2012 and December 31, 2011 due to their short-term nature. The fair value of notes and bonds payable is estimated using cash flow analyses, based on the Company's current interest rates for similar types of borrowing arrangements. The fair value of mortgage notes and notes receivable is estimated based either on cash flow analyses at an assumed market rate of interest or at a rate consistent with the rates on mortgage notes acquired by the Company recently or notes receivable entered into by the Company recently. The table below details the fair value and carrying values for notes and bonds payable, mortgage notes receivable and notes receivable at June 30, 2012 and December 31, 2011.

(Dollars in millions)	June 30, 2012		December 31, 2011	
	Carrying value	Fair value	Carrying value	Fair value
Notes and bonds payable (1)	\$1,395.6	\$1,550.2	\$1,393.5	\$1,534.3
Mortgage notes receivable (2)	\$118.1	\$117.5	\$97.4	\$95.5
Notes receivable, net of allowances (2)	\$0.2	\$0.2	\$0.3	\$0.3

(1) Level 3 - Fair value derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

(2) Level 2 - Fair value based on quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which significant inputs and significant value drivers are observable in active markets.

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

Disclosure Regarding Forward-Looking Statements

This report and other materials the Company has filed or may file with the Securities and Exchange Commission, as well as information included in oral statements or other written statements made, or to be made, by senior management of the Company, contain, or will contain, disclosures that are "forward-looking statements."

Forward-looking statements include all statements that do not relate solely to historical or current facts and can be identified by the use of words such as "may," "will," "expect," "believe," "anticipate," "target," "intend," "plan," "estimate," "continue," "should," "could" and other comparable terms. These forward-looking statements are based on the current plans and expectations of management and are subject to a number of risks and uncertainties, including the risks, as described in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 that could significantly affect the Company's current plans and expectations and future financial condition and results.

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

For a detailed discussion of the Company's risk factors, please refer to the Company's filings with the Securities and Exchange Commission, including its Annual Report on Form 10-K for the year ended December 31, 2011.

Business Overview

Healthcare Realty's strategy is to own and operate medical office and other medical-related facilities that produce stable and growing rental income. Additionally, the Company provides a broad spectrum of services to develop, lease, finance and manage its portfolio of healthcare properties. The Company focuses its portfolio on outpatient-related facilities located on or near the campuses of large acute care hospitals and associated with leading health systems because management views these facilities as stable, lower-risk real estate investments. The Company's diversity of geography and tenants, which comprises over 30 physician specialties, as well as surgery, imaging, and diagnostic centers, helps mitigate exposure to credit risk, changes in tenant clinical practice, reimbursement levels, and fluctuating economic conditions.

Substantially all of the Company's revenues are derived from operating leases on its real estate properties and interest earned on outstanding notes receivable. These sources of revenue represent the Company's primary source of liquidity to fund its dividends and its operating expenses, including interest incurred on debt, general and administrative costs such as compensation and office rent, as well as other expenses incurred in connection with managing its existing portfolio and acquiring additional properties. To the extent additional investments are not funded by these sources, the Company will fund its investment activity generally through equity or debt issuances either in the public or private markets, proceeds from asset dispositions or through proceeds from its unsecured credit facility due 2015 (the "Unsecured Credit Facility").

Executive Overview

During the second quarter of 2012, the Company acquired \$10.7 million in real estate properties, funded \$2.1 million related to its construction projects, and funded \$15.9 million in existing mortgage notes. The Company also sold six real estate properties in which the Company had a \$32.0 million net investment, generating cash proceeds of approximately \$29.4 million and \$3.8 million of seller-financed mortgage notes.

The Company remains focused on leasing its development properties and expects leasing momentum on these properties to continue based on increased activity in recent periods. The Company also expects that the net proceeds

received from the sale of assets will be used to fund obligations on the development properties.

At June 30, 2012, the Company's leverage ratio [debt divided by (debt plus stockholders' equity less intangible assets plus accumulated depreciation)] was approximately 48.1%, and its borrowings outstanding under the Unsecured Credit Facility totaled \$216.0 million, with a capacity remaining under its financial covenants of approximately \$484.0 million.

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Trends and Matters Impacting Operating Results

Management monitors factors and trends important to the Company and the REIT industry in order to gauge the potential impact on the operations of the Company. In addition to the matters discussed in the Company's Annual Report on Form 10-K for the year ended December 31, 2011, below are some of the factors and trends that management believes may impact future operations of the Company.

Acquisitions

During the first six months of 2012, the Company acquired approximately \$33.1 million in real estate assets. These acquisitions were funded with borrowings on the Unsecured Credit Facility and proceeds from real estate dispositions. See Note 3 to the Condensed Consolidated Financial Statements for more information on these acquisitions.

Development Activity

The Company had several development projects ongoing at June 30, 2012, including one construction project, two construction mortgage notes and 11 properties in the process of stabilization subsequent to construction. See Note 6 to the Condensed Consolidated Financial Statements for more detail on these projects.

The Company's ability to complete and stabilize these facilities in a given period of time will impact the Company's results of operations and cash flows. More favorable completion dates, stabilization periods and rental rates will result in improved results of operations and cash flows, while lagging completion dates, stabilization dates, and rental rates will result in less favorable results of operations and cash flows.

Beyond the current commitments, the Company has no new development starts planned. However, the Company is regularly in discussions with health systems, developers and others that could lead to attractive development opportunities. The Company will consider these projects in light of existing obligations, the acquisition environment, capital availability and cost, among other factors.

Dispositions

During the first six months of 2012, the Company disposed of 11 medical office buildings in which the Company had an aggregate net investment of approximately \$42.8 million. Net cash proceeds from these dispositions were used to repay amounts due under the Unsecured Credit Facility, to fund additional real estate investments, and for general corporate purposes. See Note 3 to the Condensed Consolidated Financial Statements for more information on these dispositions.

At-The-Market Equity Offering Program

Since December 2008, the Company has had in place an at-the-market equity offering program to sell shares of its common stock from time to time in at-the-market sales transactions. The Company has not sold any shares under this program since July 2011 and had 2,791,300 authorized shares remaining to be sold under the current sales agreement at June 30, 2012.

Expiring Leases

Normally, approximately 15%-20% of the leases in the multi-tenanted portfolio will expire each year. There are 369 leases scheduled to expire during 2012. Approximately 85% of the leases expiring in 2012 are located in buildings on hospital campuses, are distributed throughout the portfolio and are not concentrated with any one tenant, health system or location. Of the 197 leases that had expired during the first half of 2012, nearly all of the tenants had renewed, had expressed an intention to renew, or continued to occupy their leased space in a holdover lease arrangement.

Leases on three single tenant net lease properties are scheduled to expire during 2012. During the first quarter of 2012, a lease was signed on a 12,000 square foot property extending the expiration of the lease for an additional eighteen

months to August 2013 at the same lease rate. Leases on the other two properties expired in July 2012. A lease was signed on one of the properties, a 110,000 square foot building, which extended the maturity until July 2013 and increased the rental rate, and the tenant vacated the other building, a 13,500 square foot property, in July 2012.

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Other Items Impacting Operations

Several other events that occurred in the second quarter of 2012 or are expected to occur in the third quarter of 2012 that may impact the Company's operations and financial results are as follows:

The Company typically experiences higher utility costs in the third quarter compared to the second quarter, which results in increased property operating expenses. Over the past five years, the Company has reported the following sequential (Q2 vs. Q3) percentage increases in property operating expenses which includes utility expenses:

	% Increase in Property Operating Expenses	
2007	4.9	%
2008	9.7	%
2009	1.7	%
2010	7.9	%
2011	8.3	%

The median sequential increase has been 7.9%. These increases are calculated using publicly reported property operating expense data and have not been normalized or adjusted.

While the Company cannot predict third quarter of 2012 utility costs or property operating expenses, historical data and the record temperatures experienced by much of the country in June and July would suggest that utility costs will be higher in the third quarter of 2012 compared to the second quarter of 2012.

Property tax adjustments and recoveries for 2011 and prior years reduced property operating expenses by \$0.6 million during the second quarter. These tax adjustments are not expected to recur in the third quarter.

At June 30, 2012, the Company had 11 properties that it had previously developed that were in the process of stabilization. Because these properties are not yet stabilized, they generated net operating income of approximately \$0.1 million (\$0.4 million net operating loss including prior period real estate tax and operating expense billing adjustments recorded in the period) for the three months ended June 30, 2012 and a net operating loss of approximately \$0.6 million (\$1.1 million net operating loss including prior period real estate tax and operating expense billing adjustments recorded in the period) for the six months ended June 30, 2012.

The Company renewed a lease and executed a new ground lease amendment at one of its inpatient rehab hospitals late in the fourth quarter of 2011. Revenue increased by \$0.1 million in the second quarter related to the lease renewal and ground lease amendment but is not expected to recur in the third quarter.

In April 2012, the Company disposed of five medical office buildings located in Florida in which the Company had a net aggregate investment of approximately \$31.8 million. The sale of these properties will reduce property operating income, net of expenses, by approximately \$0.2 million in the third quarter.

The lease at a 13,500 square foot, off-campus single tenant net lease property expired in July 2012. The tenant vacated the property which will impact revenues by approximately \$0.1 million per quarter until the property is re-leased.

Non-GAAP Measures

Management believes that net income, as defined by GAAP, is the most appropriate earnings measurement. However, management considers certain non-GAAP financial measures to be useful supplemental measures of the Company's operating performance. A non-GAAP financial measure is generally defined as one that purports to measure historical or future financial performance, financial position or cash flows, but excludes or includes amounts that would not be

so adjusted in the most comparable GAAP measure. Set forth below are descriptions of the non-GAAP financial measures management considers relevant to the Company's business and useful to investors, as well as reconciliations of these measures to the most directly comparable GAAP financial measures.

The non-GAAP financial measures presented herein are not necessarily identical to those presented by other real estate companies due to the fact that not all real estate companies use the same definitions. These measures should not be considered as alternatives to net income (determined in accordance with GAAP), as indicators of the Company's financial performance, or as

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alternatives to cash flow from operating activities (determined in accordance with GAAP) as measures of the Company's liquidity, nor are these measures necessarily indicative of sufficient cash flow to fund all of the Company's needs. Management believes that in order to facilitate a clear understanding of the Company's consolidated historical operating results, these measures should be examined in conjunction with net income as presented in the Condensed Consolidated Financial Statements and other financial data included elsewhere in this Quarterly Report on Form 10-Q.

Same Store Net Operating Income

Net Operating Income ("NOI") and same store net operating income are non-GAAP financial measures of performance. Management considers same store NOI an important supplemental measure because it allows investors, analysts and Company management to measure unlevered property-level operating results and to compare those results to other real estate companies and between periods on a consistent basis. The Company defines net operating income as operating revenues (property operating revenue, single-tenant net lease revenue, and rental lease guaranty income) less property operating expenses related specifically to the property portfolio. Net operating income excludes straight-line rent, general and administrative expenses, interest expense, depreciation and amortization, gains and losses from property sales, property management fees and other revenues and expenses not specifically related to the property portfolio. Net operating income may also be adjusted for certain expenses that are related to prior periods or are not considered to be part of the operations of the properties. Properties included in the same store analysis are stabilized properties that have been included in operations and were consistently reported as leased and stabilized properties for the duration of the year-over-year comparison period presented. Accordingly, properties that were recently acquired or disposed of, properties classified as held for sale, and properties in stabilization or conversion are excluded from the same store analysis.

The following table reflects the Company's same store NOI for the three months ended June 30, 2012 and 2011.

(dollars in thousands)	Number of Properties ⁽¹⁾	Investment at June 30, 2012	Three Months Ended June 30,	
			2012 ⁽²⁾	2011 ⁽²⁾
Multi-tenant Properties	124	\$1,491,892	\$29,595	\$28,608
Single-tenant Net Lease Properties	35	522,956	12,661	12,771
Total	159	\$2,014,848	\$42,256	\$41,379

⁽¹⁾ Mortgage notes receivable, construction in progress, an investment in one unconsolidated joint venture, corporate property and assets classified as held for sale are excluded.

⁽²⁾ Reconciliation of Same Store NOI:

(dollars in thousands)	Three Months Ended June 30,	
	2012	2011
Property operating revenue	\$60,948	\$53,320