

HEALTHCARE REALTY TRUST INC

Form 10-Q

November 04, 2014

Table of Contents

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

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FORM 10-Q

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(Mark One)

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

For the quarterly period ended: September 30, 2014

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

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HEALTHCARE REALTY TRUST INCORPORATED

(Exact name of Registrant as specified in its charter)

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Maryland

(State or other jurisdiction of  
incorporation or organization)

62 – 1507028

(I.R.S. Employer  
Identification No.)

3310 West End Avenue

Suite 700

Nashville, Tennessee 37203

(Address of principal executive offices)

(615) 269-8175

(Registrant's telephone number, including area  
code)

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

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

Smaller reporting company

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(Do not check if a smaller reporting  
company)

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

As of October 31, 2014, the Registrant had 98,177,187 shares of Common Stock outstanding.

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Table of Contents

HEALTHCARE REALTY TRUST INCORPORATED  
FORM 10-Q  
September 30, 2014

TABLE OF CONTENTS

|                                     | Page  |
|-------------------------------------|---|
| <u>Part I—Financial Information</u> |   |
| <u>Item 1.</u>                      | <u>Financial Statements</u>   |
|                                     | <u>Condensed Consolidated Balance Sheets</u> 1  |
|                                     | <u>Condensed Consolidated Statements of Operations</u> 2  |
|                                     | <u>Condensed Consolidated Statements of Comprehensive Income (Loss)</u> 3                       |
|                                     | <u>Condensed Consolidated Statements of Cash Flows</u> 4  |
|                                     | <u>Notes to Condensed Consolidated Financial Statements</u> 5                                   |
| <u>Item 2.</u>                      | <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u> 16 |
| <u>Item 3.</u>                      | <u>Quantitative and Qualitative Disclosures about Market Risk</u> 26                            |
| <u>Item 4.</u>                      | <u>Controls and Procedures</u> 26   |
| <u>Part II—Other Information</u>    |   |
| <u>Item 1.</u>                      | <u>Legal Proceedings</u> 28   |
| <u>Item 1A.</u>                     | <u>Risk Factors</u> 28  |
| <u>Item 5</u>                       | <u>Other Information</u> 28   |
| <u>Item 6.</u>                      | <u>Exhibits</u> 29  |
| <u>Signature</u>                    | 30  |

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Table of Contents

## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

Healthcare Realty Trust Incorporated

Condensed Consolidated Balance Sheets

(Amounts in thousands, except per share data)

|   | (Unaudited)           |                      |
|---|-----------------------|----------------------|
|   | September 30,<br>2014 | December 31,<br>2013 |
| <b>ASSETS</b>   |                       |                      |
| Real estate properties:   |                       |                      |
| Land  | \$ 183,991            | \$ 178,931           |
| Buildings, improvements and lease intangibles   | 3,030,960             | 2,861,935            |
| Personal property   | 9,535                 | 9,267                |
| Land held for development   | 17,054                | 17,054               |
|   | 3,241,540             | 3,067,187            |
| Less accumulated depreciation   | (693,517 )            | (632,109 )           |
| Total real estate properties, net   | 2,548,023             | 2,435,078            |
| Cash and cash equivalents   | 1,684                 | 8,671                |
| Mortgage notes receivable   | 1,900                 | 125,547              |
| Assets held for sale and discontinued operations, net   | 11,479                | 6,852                |
| Other assets, net   | 178,238               | 153,514              |
| Total assets  | \$ 2,741,324          | \$ 2,729,662         |
| <b>LIABILITIES AND EQUITY</b>   |                       |                      |
| Liabilities:  |                       |                      |
| Notes and bonds payable   | \$ 1,403,379          | \$ 1,348,459         |
| Accounts payable and accrued liabilities  | 60,017                | 73,741               |
| Liabilities of discontinued operations  | 508                   | 1,112                |
| Other liabilities   | 57,913                | 61,064               |
| Total liabilities   | 1,521,817             | 1,484,376            |
| Commitments and contingencies   |                       |                      |
| Equity:   |                       |                      |
| Preferred stock, \$.01 par value; 50,000 shares authorized; none issued and outstanding   | —                     | —                    |
| Common stock, \$.01 par value; 150,000 shares authorized; 98,119 and 95,924 shares issued and outstanding at September 30, 2014 and December 31, 2013, respectively | 981                   | 959                  |
| Additional paid-in capital  | 2,374,345             | 2,325,228            |
| Accumulated other comprehensive income  | 51                    | 51                   |
| Cumulative net income attributable to common stockholders   | 822,176               | 808,362              |
| Cumulative dividends  | (1,978,046 )          | (1,891,123 )         |
| Total stockholders' equity  | 1,219,507             | 1,243,477            |
| Noncontrolling interest   | —                     | 1,809                |
| Total equity  | 1,219,507             | 1,245,286            |
| Total liabilities and equity  | \$ 2,741,324          | \$ 2,729,662         |

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, 2013, are an integral part of these financial statements.

Table of Contents

Healthcare Realty Trust Incorporated  
Condensed Consolidated Statements of Operations  
For the Three and Nine Months Ended September 30, 2014 and 2013  
(Amounts in thousands, except per share data)  
(Unaudited)

|  | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |            |
|--|-------------------------------------|-----------|------------------------------------|------------|
|  | 2014                                | 2013      | 2014                               | 2013       |
| <b>REVENUES</b>  |                                     |           |                                    |            |
| Rental income  | \$92,987                            | \$78,161  | \$270,513                          | \$230,094  |
| Mortgage interest  | 44                                  | 3,926     | 3,634                              | 10,290     |
| Other operating  | 1,475                               | 1,579     | 4,349                              | 4,542      |
|  | 94,506                              | 83,666    | 278,496                            | 244,926    |
| <b>EXPENSES</b>  |                                     |           |                                    |            |
| Property operating   | 34,678                              | 32,244    | 102,077                            | 92,742     |
| General and administrative                                       | 5,190                               | 5,582     | 16,834                             | 17,961     |
| Depreciation   | 25,660                              | 21,716    | 74,408                             | 63,970     |
| Amortization   | 2,656                               | 2,595     | 8,190                              | 7,819      |
| Bad debt, net of recoveries                                      | 3                                   | 109       | 123                                | 116        |
|  | 68,187                              | 62,246    | 201,632                            | 182,608    |
| <b>OTHER INCOME (EXPENSE)</b>                                    |                                     |           |                                    |            |
| Loss on extinguishments of debt                                  | —                                   | —         | —                                  | (29,638 )  |
| Interest expense   | (18,192 )                           | (17,043 ) | (54,176 )                          | (55,738 )  |
| Interest and other income, net                                   | 410                                 | 237       | 2,545                              | 686        |
|  | (17,782 )                           | (16,806 ) | (51,631 )                          | (84,690 )  |
| <b>INCOME (LOSS) FROM CONTINUING OPERATIONS</b>                  | 8,537                               | 4,614     | 25,233                             | (22,372 )  |
| <b>DISCONTINUED OPERATIONS</b>                                   |                                     |           |                                    |            |
| Income (loss) from discontinued operations                       | 121                                 | 1,241     | (75 )                              | 4,818      |
| Impairments  | (4,505 )                            | (6,259 )  | (11,034 )                          | (9,889 )   |
| Gain on sales of real estate properties                          | —                                   | 20,187    | 3                                  | 21,970     |
| <b>INCOME (LOSS) FROM DISCONTINUED OPERATIONS</b>                | (4,384 )                            | 15,169    | (11,106 )                          | 16,899     |
| <b>NET INCOME (LOSS)</b>   | 4,153                               | 19,783    | 14,127                             | (5,473 )   |
| Less: Net (income) loss attributable to noncontrolling interests | (162 )                              | (18 )     | (313 )                             | 34         |
| <b>NET INCOME (LOSS) ATTRIBUTABLE TO COMMON STOCKHOLDERS</b>     | \$3,991                             | \$19,765  | \$13,814                           | \$(5,439 ) |
| <b>BASIC EARNINGS (LOSS) PER COMMON SHARE:</b>                   |                                     |           |                                    |            |
| Income (loss) from continuing operations                         | \$0.09                              | \$0.05    | \$0.27                             | \$(0.25 )  |
| Discontinued operations  | (0.05 )                             | 0.16      | (0.12 )                            | 0.19       |
| Net income (loss) attributable to common stockholders            | \$0.04                              | \$0.21    | \$0.15                             | \$(0.06 )  |
| <b>DILUTED EARNINGS (LOSS) PER COMMON SHARE:</b>                 |                                     |           |                                    |            |
| Income (loss) from continuing operations                         | \$0.09                              | \$0.05    | \$0.26                             | \$(0.25 )  |
| Discontinued operations  | (0.05 )                             | 0.16      | (0.12 )                            | 0.19       |
| Net income (loss) attributable to common stockholders            | \$0.04                              | \$0.21    | \$0.14                             | \$(0.06 )  |
|  | 95,858                              | 93,443    | 94,846                             | 89,871     |

|  |        |        |        |        |
|--|--------|--------|--------|--------|
| WEIGHTED AVERAGE COMMON SHARES<br>OUTSTANDING—BASIC        |        |        |        |        |
| WEIGHTED AVERAGE COMMON SHARES<br>OUTSTANDING—DILUTED      | 97,329 | 94,836 | 96,310 | 89,871 |
| DIVIDENDS DECLARED, PER COMMON SHARE,<br>DURING THE PERIOD | \$0.30 | \$0.30 | \$0.90 | \$0.90 |

The accompanying notes, together with the Notes to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013, are an integral part of these financial statements.

Table of Contents

Healthcare Realty Trust Incorporated  
 Condensed Consolidated Statements of Comprehensive Income (Loss)  
 For the Three and Nine Months Ended September 30, 2014 and 2013  
 (Dollars in thousands)  
 (Unaudited)

|  | Three Months Ended |          | Nine Months Ended |           |
|--|--------------------|----------|-------------------|-----------|
|  | September 30,      |          | September 30,     |           |
|  | 2014               | 2013     | 2014              | 2013      |
| NET INCOME (LOSS)  | \$4,153            | \$19,783 | \$14,127          | \$(5,473) |
| Less: Comprehensive (income) loss attributable to noncontrolling interests | (162)              | ) (18)   | ) (313)           | ) 34      |
| COMPREHENSIVE INCOME (LOSS)  | \$3,991            | \$19,765 | \$13,814          | \$(5,439) |
| ATTRIBUTABLE TO COMMON STOCKHOLDERS  |                    |          |                   |           |

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, 2013, are an integral part of these financial statements.

Table of Contents

Healthcare Realty Trust Incorporated  
Condensed Consolidated Statements of Cash Flows  
For the Nine Months Ended September 30, 2014 and 2013  
(Dollars in thousands)  
(Unaudited)

|  | Nine Months Ended<br>September 30, |            |
|--|------------------------------------|------------|
|  | 2014                               | 2013       |
| <b>OPERATING ACTIVITIES</b>  |                                    |            |
| Net income (loss)  | \$ 14,127                          | \$(5,473 ) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: |                                    |            |
| Depreciation and amortization  | 86,349                             | 77,728     |
| Stock-based compensation   | 3,400                              | 4,131      |
| Straight-line rent receivable  | (7,907 )                           | (5,654 )   |
| Straight-line rent liability   | 522                                | 311        |
| Gain on sales of real estate properties  | (3 )                               | (21,970 )  |
| Loss on extinguishment of debt   | —                                  | 29,907     |
| Impairments  | 11,034                             | 9,889      |
| Provision for bad debt, net  | 126                                | 119        |
| Changes in operating assets and liabilities:   |                                    |            |
| Other assets   | (16,231 )                          | (5,988 )   |
| Accounts payable and accrued liabilities   | (10,644 )                          | (10,273 )  |
| Other liabilities  | (3,123 )                           | (788 )     |
| Net cash provided by operating activities  | 77,650                             | 71,939     |
| <b>INVESTING ACTIVITIES</b>  |                                    |            |
| Acquisitions of real estate  | (37,694 )                          | (104,451 ) |
| Additional long-lived assets   | (54,899 )                          | (52,199 )  |
| Funding of mortgages and notes receivable  | (1,244 )                           | (57,780 )  |
| Proceeds from acquisition of real estate upon mortgage note receivable default           | 204                                | —          |
| Proceeds from sales of real estate   | 6,134                              | 75,855     |
| Proceeds from mortgages and notes receivable repayments                                  | 5,618                              | 643        |
| Net cash used in investing activities  | (81,881 )                          | (137,932 ) |
| <b>FINANCING ACTIVITIES</b>  |                                    |            |
| Net borrowings (repayments) on unsecured credit facility                                 | (154,000 )                         | 75,000     |
| Borrowings on term loan  | 200,000                            | —          |
| Borrowings on notes and bonds payable  | —                                  | 247,948    |
| Repayments on notes and bonds payable  | (4,415 )                           | (18,655 )  |
| Redemption of notes and bonds payable  | —                                  | (371,839 ) |
| Dividends paid   | (86,923 )                          | (82,815 )  |
| Net proceeds from issuance of common stock   | 52,712                             | 220,045    |
| Common stock redemptions   | (382 )                             | (247 )     |
| Capital contributions received from noncontrolling interest                              | —                                  | 1,749      |
| Distributions to noncontrolling interest holders   | (380 )                             | (32 )      |
| Purchase of noncontrolling interest  | (8,189 )                           | —          |
| Debt issuance and assumption costs   | (1,179 )                           | (4,777 )   |
| Net cash provided by (used in) financing activities                                      | (2,756 )                           | 66,377     |
| Increase (decrease) in cash and cash equivalents   | (6,987 )                           | 384        |
| Cash and cash equivalents, beginning of period   | 8,671                              | 6,776      |
| Cash and cash equivalents, end of period   | \$ 1,684                           | \$ 7,160   |



Supplemental Cash Flow Information:

|  |          |          |
|--|----------|----------|
| Interest paid  | \$59,227 | \$62,326 |
| Company-financed real estate property sales  | \$1,900  | \$4,241  |
| Invoices accrued for construction, tenant improvement and other capitalized costs          | \$4,662  | \$6,291  |
| Mortgage notes payable assumed upon acquisition (adjusted to fair value)                   | \$12,618 | \$12,678 |
| Capitalized interest   | \$—      | \$183    |
| Elimination of construction mortgage note receivable upon acquisition real estate property | \$—      | \$97,203 |

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, 2013, are an integral part of these financial statements.

Table of Contents

Healthcare Realty Trust Incorporated

Notes to Condensed Consolidated Financial Statements

September 30, 2014

(Unaudited)

Note 1. Summary of Significant Accounting Policies

Business Overview

Healthcare Realty Trust Incorporated (the "Company") is a real estate investment trust 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 \$3.2 billion in 201 real estate properties and mortgages as of September 30, 2014. The Company's 200 owned real estate properties are located in 30 states and total approximately 14.3 million square feet. The Company provided property management services to approximately 9.7 million square feet nationwide.

Basis of Presentation

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. They do not include all of the information and footnotes required by GAAP for complete financial statements. However, except as disclosed herein, management believes there has been no material change in the information disclosed in the Notes to Consolidated Financial Statements included in the Annual Report on Form 10-K for the year ended December 31, 2013. 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, 2013. Management believes that all adjustments of a normal, recurring nature considered necessary for a fair presentation have been included. In addition, the interim financial information does not necessarily represent or indicate what the operating results will be for the year ending December 31, 2014 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.

Use of Estimates in the Condensed Consolidated Financial Statements

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

Interest and Other Income, Net

Included in "Interest and other income, net" for the nine months ended September 30, 2014 is \$1.9 million recognized for a cash reimbursement received by the Company for certain operating expenses paid by the Company for years 2006 through 2013 and a gain recognized from insurance proceeds of approximately \$0.3 million.

New Accounting Pronouncements

Accounting Standards Update No. 2014-09

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2014-09, "Revenue from Contracts with Customers", a comprehensive new revenue recognition standard that supersedes most all existing revenue recognition guidance, including sales of real estate. This standard's core principle is that a company will recognize revenue when it transfers goods or services to customers in amounts that reflect the consideration to which the company expects to be entitled in exchange for those goods and services. However, leasing

contracts, representing the major source of the Company's revenues, are not within the scope of the new standard and will continue to be accounted for under existing standards.

This new standard is effective for the Company for annual and interim periods beginning on January 1, 2017 with early adoption prohibited. The Company has not yet determined the effects on the Consolidated Financial Statements and related notes resulting from the adoption of this new standard.

Table of Contents

Notes to Condensed Consolidated Financial Statements - Continued

Accounting Standards Update No. 2014-08

In April 2014, the FASB issued Accounting Standards Update No. 2014-08, "Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity." This standard changes the requirements for reporting discontinued operations by raising the threshold for a disposal to qualify as a discontinued operation and requires new disclosures of both discontinued operations and certain other disposals that do not meet the definition of a discontinued operation. The standard limits discontinued operations reporting to disposals of components of an entity that represent strategic shifts that have (or will have) a major effect on an entity's operations and financial results.

This standard is effective for the Company on a prospective basis for annual periods beginning on January 1, 2015 and interim periods within that year. Early adoption is permitted but only for disposals (or classifications as held for sale) that have not been reported in financial statements previously issued. The Company is still evaluating the impact of this new standard but does not expect it to have a material effect on the Consolidated Financial Statements, when adopted.

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 held for sale, and related liabilities, have been reclassified in the Company's Condensed Consolidated Balance Sheets, and the operating results of those net assets, including assets sold, have been reclassified from continuing to discontinued operations for all periods presented.

Note 2. Real Estate Investments

2014 Acquisitions

Third Quarter

In July 2014, the Company purchased a 60,476 square foot medical office building located in Minnesota for a purchase price of \$19.8 million including cash consideration of \$8.4 million and the assumption of debt of \$11.4 million (excluding a \$1.2 million fair value adjustment premium recorded upon acquisition). The mortgage notes payable assumed by the Company bear a weighted average contractual interest rate of 6.67% with maturities from 2017 to 2040. See Note 3 for more information on the debt assumed. The property was constructed in 2010 and is 100% leased with expirations through 2025. The building is connected to Unity Hospital, a 220-bed hospital operated by Allina Health.

In September 2014, the Company purchased a 47,962 square foot medical office building located in Florida for a purchase price and cash consideration of \$7.9 million. The property is 89% leased with expirations through 2019. The building is adjacent to Tampa General Hospital, a 1,018-bed hospital.

Second Quarter

In May 2014, the Company purchased a 200,000 square foot medical office building in Oklahoma for a purchase price of approximately \$85.4 million that is 100% leased to Mercy Health, based in Missouri, through 2028 under a single-tenant net lease. The Company funded the development of the facility through a construction mortgage loan of approximately \$81.2 million that upon purchase was eliminated in the Company's Condensed Consolidated Financial Statements. At the closing of the purchase, the outstanding loan balance was credited to the purchase price and the Company paid an additional \$4.2 million in cash consideration. Subsequent to the purchase, the Company funded an additional \$4.0 million and anticipates funding approximately \$1.8 million to complete the \$91.2 million development during the fourth quarter of 2014.

In June 2014, the Company purchased a 56.9% equity interest in a limited liability company that owns a medical office building and related land in Texas. The Company paid \$8.8 million in cash consideration including closing costs of \$0.1 million. Based on the nature of the transaction, the Company has accounted for the acquisition as an

asset acquisition and has recorded the amounts in real estate assets on the Company's Condensed Consolidated Balance Sheet. The building is adjacent to Seton Medical Center, a 534-bed hospital.

Also in June 2014, the Company purchased a 35,292 square foot medical office building located in North Carolina for a purchase price and cash consideration of \$6.5 million. The property is 100% leased with expirations through 2024. The building is adjacent to Wesley Long Hospital, a 175-bed hospital.

Table of Contents

## Notes to Condensed Consolidated Financial Statements - Continued

## First Quarter

In March 2014, the Company acquired ownership of a multi-tenanted office building in Iowa in satisfaction of a \$40.0 million mortgage note receivable that matured on January 10, 2014. The cash flows from the operations of the property were sufficient to pay the Company interest from the maturity date through the date of the transfer of ownership to the Company at the 7.7% fixed interest rate plus an additional 3% of interest for the default interest rate. The Company has accounted for this transaction as a business combination and recorded the acquisition of the property at its estimated fair value based primarily on Level 3 inputs. The Company did not recognize any of the \$1.5 million exit fee receivable that was due upon maturity of the mortgage note receivable. The following table details the purchase price accounting for this transaction.

|   | Estimated<br>Fair Value<br>(In millions) | Estimated<br>Useful Life<br>(In years) |
|---|--|--|
| Building  | \$38.1                                   | 11.5-33.0                              |
| Intangibles:  |  |  |
| At-market lease intangibles   | 2.1                                      | 5.8                                    |
| Below-market ground lease intangibles                               | (0.1)                                    | ) 91.3                                 |
| Below-market lease intangibles                                      | (0.4)                                    | ) 3.8-6.5                              |
| Total intangibles   | 1.6                                      |  |
| Foreclosed mortgage note receivable                                 | (40.0)                                   | )                                      |
| Other assets acquired   | 1.8                                      |  |
| Accounts payable, accrued liabilities and other liabilities assumed | (1.7)                                    | )                                      |
| Cash acquired   | 0.2                                      |  |
| Total cash paid   | \$—                                      |  |

The following table details the Company's acquisitions for the nine months ended September 30, 2014:

| (Dollars in millions)    | Date Acquired | Purchase Price | Elimination of Mortgage Note Receivable | Mortgage Notes Payable Assumed | Cash Consideration | Real Estate | Other   | Square Footage |
|--------------------------|---------------|----------------|---|--------------------------------|--------------------|-------------|---------|----------------|
| Real estate acquisitions |               |                |   |                                |                    |             |         |                |
| Iowa                     | 3/28/14       | \$—            | \$(40.0)                                | ) \$—                          | \$—                | \$40.2      | \$(0.2) | ) 152,655      |
| Oklahoma                 | 5/22/14       | 85.4           | (81.2)                                  | ) —                            | 4.2                | 85.4        | —       | ) 200,000      |
| Texas                    | 6/4/14        | 8.7            | —                                       | —                              | 8.8                | 8.8         | —       | ) 48,048       |
| North Carolina           | 6/6/14        | 6.5            | —                                       | —                              | 6.5                | 6.5         | —       | ) 35,292       |
| Minnesota <sup>(1)</sup> | 7/28/14       | 19.8           | —                                       | (11.4)                         | ) 8.4              | 21.0        | (1.2)   | ) 60,476       |
| Florida                  | 9/16/14       | 7.9            | —                                       | —                              | 7.9                | 7.9         | —       | ) 47,962       |
|                          |               | \$128.3        | \$(121.2)                               | ) \$(11.4)                     | ) \$35.8           | \$169.8     | \$(1.4) | ) 544,433      |

(1) The mortgage note payable assumed in the acquisition does not reflect the fair value adjustment of \$1.2 million recorded by the Company upon acquisition (included in Other).

## Subsequent Acquisition

In October 2014, the Company acquired a 68,860 square foot medical office building in Oklahoma for a purchase price of \$17.4 million, including cash consideration of \$10.6 million and the assumption of debt of \$6.8 million. The mortgage note payable, assumed by the Company, bears a contractual interest rate of 6.1% and matures on August 1, 2020. The property is 96.7% leased with expirations through 2027. The building is located on the Norman Regional

Healthplex campus, a 152-bed specialty hospital.

2014 Dispositions

Third Quarter

In September 2014, the Company disposed of an on-campus 31,026 square foot medical office building located in Nevada in which the Company had a \$4.9 million net investment. The sales price was approximately \$2.3 million, comprised of net cash proceeds of approximately \$0.2 million, a seller-financed mortgage note of \$1.9 million, and closing costs of \$0.2 million. The

7

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Table of Contents

## Notes to Condensed Consolidated Financial Statements - Continued

Company recognized a \$2.8 million impairment on the disposal of this property that was not previously classified as held for sale.

## Second Quarter

In April 2014, the Company disposed of an off-campus, medical office building located in Florida that was previously classified as held for sale and in which the Company had a \$1.7 million net investment, including a \$0.9 million impairment charge recorded in the first quarter of 2014 as a result of the pending sale and previously recorded impairment charges of \$2.4 million. The sales price was \$1.8 million, comprised of \$1.7 million in net cash proceeds and closing costs of \$0.1 million.

Also in April 2014, the Company disposed of an off-campus, medical office building located in Texas that was classified as held for sale and in which the Company had a \$4.1 million net investment, including a \$2.6 million impairment charge recorded in the first quarter of 2014 as a result of the pending sale. The sales price was \$4.4 million, comprised of \$4.2 million in net cash proceeds and closing costs of \$0.2 million.

A summary of the Company's 2014 dispositions are as follows:

| (Dollars in millions)    | Date Disposed | Sales Price | Closing Adjustments | Company-financed Mortgage Notes | Net Proceeds | Net Real Estate Investment | Other (including receivables) | Gain/ (Impairment) | Square Footage |
|--------------------------|---------------|-------------|---------------------|---------------------------------|--------------|----------------------------|-------------------------------|--------------------|----------------|
| Real estate dispositions |               |             |                     |                                 |              |                            |                               |                    |                |
| Florida <sup>(1)</sup>   | 4/11/2014     | \$ 1.8      | \$ (0.1 )           | \$ —                            | \$ 1.7       | \$ 1.7                     | \$ —                          | \$ —               | 52,608         |
| Texas <sup>(1)</sup>     | 4/23/2014     | 4.4         | (0.2 )              | —                               | 4.2          | 4.1                        | 0.1                           | —                  | 58,365         |
| Nevada                   | 9/12/2014     | 2.3         | (0.2 )              | (1.9 )                          | 0.2          | 4.9                        | —                             | (2.8 )             | 31,026         |
| Total dispositions       |               | 8.5         | (0.5 )              | (1.9 )                          | 6.1          | 10.7                       | 0.1                           | (2.8 )             | 141,999        |
| Mortgage note repayments |               | —           | —                   | 4.9                             | 4.9          | —                          | —                             | —                  | —              |
|                          |               | \$ 8.5      | \$ (0.5 )           | \$ 3.0                          | \$ 11.0      | \$ 10.7                    | \$ 0.1                        | \$ (2.8 )          | 141,999        |

(1) Previously included in assets held for sale.

## Potential Disposition

In September 2014, the Company received notice from a tenant of its intent to purchase a medical office building in Pennsylvania pursuant to a purchase option contained in its lease with the Company. The Company's net investment in the building is \$7.7 million at September 30, 2014, including straight-line rent receivables. The purchase price for the property will be the greater of a fair market value or approximately \$15.0 million. The appraisal process is on-going and the sale will result in a potential gain of at least \$7.3 million. The Company preliminarily expects the sale to occur during the first quarter of 2015. The property was reclassified as held for sale as of September 30, 2014.

## Company-Financed Mortgage Notes

During the third quarter of 2014, two mortgage notes receivable were repaid generating an aggregate of \$4.9 million in net proceeds.



Table of Contents

## Notes to Condensed Consolidated Financial Statements - Continued

In September 2014, the Company originated a \$1.9 million seller-financed mortgage note receivable with the purchaser of a medical office building located in Nevada that was sold by the Company as discussed in "2014 Dispositions" above.

Noncontrolling Interest Purchase

In April 2014, the Company purchased the outstanding 40% noncontrolling equity interest in a consolidated partnership that owns a medical office building and parking garage in Texas, which were developed by the partnership, for an aggregate purchase price and cash consideration of \$8.2 million. The book value of the noncontrolling interest prior to the equity purchase was \$1.6 million. The Company held a term loan that was secured by the property and was payable from the partnership. Upon acquisition of the noncontrolling interest, the term loan, which was previously eliminated in the Company's Condensed Consolidated Financial Statements, was extinguished.

Discontinued Operations and Assets Held for Sale

During the third quarter of 2014, the Company reclassified one property to held for sale. See "Potential Dispositions" above for more information.

Also, during the third quarter of 2014, the Company received an offer and is in negotiations regarding the purchase one of its buildings that was classified as held for sale. The offer is less than the Company's net investment resulting in an impairment charge of \$1.8 million which was recorded in the third quarter of 2014. The fair value amount used to calculate the impairment was based on the expected sales price less costs to sell, which is a Level 3 input.

At September 30, 2014 and December 31, 2013, the Company had four and three properties classified as held for sale, respectively.

The tables below reflect the assets and liabilities of the properties classified as held for sale and discontinued operations as of September 30, 2014 and December 31, 2013 and the results of operations of the properties included in discontinued operations on the Company's Consolidated Statements of Operations for three and nine months ended September 30, 2014 and 2013.

| (Dollars in thousands)                                | September 30,<br>2014 | December 31,<br>2013 |
|---|-----------------------|----------------------|
| Balance Sheet data:                                   |                       |                      |
| Land  | \$1,674               | \$1,578              |
| Buildings, improvements and lease intangibles         | 22,232                | 15,400               |
| Personal property                                     | 14                    | —                    |
|   | 23,920                | 16,978               |
| Accumulated depreciation                              | (12,901               | ) (10,211            |
| Assets held for sale, net                             | 11,019                | 6,767                |
| Other assets, net (including receivables)             | 460                   | 85                   |
| Assets of discontinued operations, net                | 460                   | 85                   |
| Assets held for sale and discontinued operations, net | \$11,479              | \$6,852              |
| Accounts payable and accrued liabilities              | \$482                 | \$1,091              |
| Other liabilities                                     | 26                    | 21                   |
| Liabilities of discontinued operations                | \$508                 | \$1,112              |

Table of Contents

## Notes to Condensed Consolidated Financial Statements - Continued

| (Dollars in thousands)                     | Three Months Ended    |          | Nine Months Ended     |          |
|--|-----------------------|----------|-----------------------|----------|
|  | September 30,<br>2014 | 2013     | September 30,<br>2014 | 2013     |
| Statements of Operations data:             |                       |          |                       |          |
| Revenues                                   |                       |          |                       |          |
| Rental income                              | \$465                 | \$2,608  | \$1,689               | \$9,771  |
| Other Operating Income                     | —                     | —        | —                     | 1        |
|  | 465                   | 2,608    | 1,689                 | 9,772    |
| Expenses                                   |                       |          |                       |          |
| Property operating                         | 251                   | 724      | 1,223                 | 2,221    |
| General and administrative                 | 1                     | 1        | 3                     | 4        |
| Depreciation                               | 104                   | 649      | 544                   | 2,390    |
| Amortization                               | —                     | 12       | —                     | 55       |
| Bad debt, net of recoveries                | (4                    | ) 3      | 3                     | 3        |
|  | 352                   | 1,389    | 1,773                 | 4,673    |
| Other Income (Expense)                     |                       |          |                       |          |
| Loss on extinguishment of debt             | —                     | —        | —                     | (270 )   |
| Interest expense                           | —                     | —        | —                     | (40 )    |
| Interest and other income, net             | 8                     | 22       | 9                     | 29       |
|  | 8                     | 22       | 9                     | (281 )   |
| Discontinued Operations                    |                       |          |                       |          |
| Income (loss) from discontinued operations | 121                   | 1,241    | (75 )                 | 4,818    |
| Impairments                                | (4,505 )              | (6,259 ) | (11,034 )             | (9,889 ) |
| Gain on sales of real estate properties    | —                     | 20,187   | 3                     | 21,970   |
| Income (Loss) from Discontinued Operations | \$(4,384 )            | \$15,169 | \$(11,106 )           | \$16,899 |

## Note 3. Notes and Bonds Payable

## Third Quarter

In July 2014, upon the acquisition of a real estate property, the Company assumed a series 2010B Bond due 2017 totaling \$0.5 million, a Series 2010A Bond due 2022 totaling \$1.2 million, a Series 2010A Bond due 2030 totaling \$2.8 million and a Series 2010A Bond due 2040 totaling \$7.0 million. The aggregate outstanding balance of these bonds is approximately \$11.4 million excluding a fair value adjustment premium recorded upon acquisition of approximately \$1.2 million. The mortgage notes payable have a weighted average contractual interest rate of 6.67% (effective rate of 4.79%). The Series 2010A Bonds can be repaid without penalty on or after May 1, 2020. See Note 2 of the Condensed Consolidated Financial Statements for more information regarding this transaction.

## First Quarter

In February 2014, the Company entered into a \$200.0 million unsecured term loan facility ("Term Loan due 2019") with a syndicate of nine lenders that matures on February 26, 2019. The Term Loan due 2019 bears interest at a rate equal to (x) LIBOR plus (y) a margin ranging from 1.00% to 1.95% (currently 1.45%) based upon the Company's unsecured debt ratings. Payments under the Term Loan due 2019 are interest only, with the full amount of the principal due at maturity. The Term Loan due 2019 may be prepaid at any time, without penalty. The proceeds from the Term Loan due 2019 were used by the Company to repay borrowings on its unsecured revolving credit facility due 2017 ("Unsecured Credit Facility"). The Term Loan due 2019 has various financial covenant provisions that are required to be met on a quarterly and annual basis that are equivalent to those of the Unsecured Credit Facility. The Company was in compliance with the financial covenant provisions at September 30, 2014.

## Subsequent Activity

In October 2014, the Company repaid three mortgage notes payable totaling \$6.3 million bearing a weighted average contractual interest rate of 6.08% (effective rate of 4.06%) that encumbered two medical office buildings in Virginia.

Table of Contents

## Note 4. Commitments and Contingencies

## Legal Proceedings

The Company is, from time to time, involved in litigation arising in the ordinary course of business or which is expected to be covered by insurance. The Company is not aware of any 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.

## Note 5. Equity

The following table provides a reconciliation of total equity for the nine months ended September 30, 2014:

| (Dollars in thousands, except per share data)                   | Common Stock | Additional Paid-In Capital | Accumulated Other Comprehensive Income | Cumulative                                     |                      | Total Stockholders' Equity | Non-controlling Interests | Total Equity |
|---|--------------|----------------------------|--|--|----------------------|----------------------------|---------------------------|--------------|
|   |              |                            |  | Net Income Attributable to Common Stockholders | Cumulative Dividends |                            |                           |              |
| Balance at December 31, 2013                                    | \$ 959       | \$2,325,228                | \$ 51                                  | \$ 808,362                                     | \$(1,891,123)        | \$1,243,477                | \$ 1,809                  | \$ 1,245,286 |
| Issuance of common stock  | 21           | 52,677                     | —                                      | —  | —                    | 52,698                     | —                         | 52,698       |
| Common stock redemptions  | —            | (382)                      | —                                      | —  | —                    | (382)                      | —                         | (382)        |
| Stock-based compensation  | 1            | 3,399                      | —                                      | —  | —                    | 3,400                      | —                         | 3,400        |
| Net income  | —            | —                          | —                                      | 13,814   | —                    | 13,814                     | 313                       | 14,127       |
| Dividends to common stockholders (\$0.90 per share)             | —            | —                          | —                                      | —  | (86,923)             | (86,923)                   | —                         | (86,923)     |
| Distributions to non-controlling interests                      | —            | —                          | —                                      | —  | —                    | —                          | (510)                     | (510)        |
| Purchase of noncontrolling interest in consolidated partnership | —            | (6,577)                    | —                                      | —  | —                    | (6,577)                    | (1,612)                   | (8,189)      |
| Balance at September 30, 2014                                   | \$ 981       | \$2,374,345                | \$ 51                                  | \$ 822,176                                     | \$(1,978,046)        | \$1,219,507                | \$ —                      | \$ 1,219,507 |

The following schedule discloses the effects of changes in the Company's ownership interest in its less-than-wholly-owned subsidiary on the Company's stockholders' equity (in thousands):

|  | Nine Months<br>Ended September<br>30, 2014 |
|--|--|
| Net income attributable to common stockholders   | \$13,814                                   |
| Transfers to noncontrolling interest:  |  |
| Net decrease in the Company's additional paid-in capital for purchase of subsidiary partnership interest | (6,577)                                    |
| Net transfers to the noncontrolling interest   | (6,577)                                    |
|  | \$7,237                                    |

Change to the Company's total stockholders' equity from net income attributable to common stockholders and transfers to noncontrolling interest

11

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Table of Contents

## Notes to Condensed Consolidated Financial Statements - Continued

## Common Stock

The following table provides a reconciliation of the beginning and ending shares of common stock outstanding for the nine months ended September 30, 2014 and the year ended December 31, 2013:

|                                   | September 30,<br>2014 | December 31,<br>2013 |
|-----------------------------------|-----------------------|----------------------|
| Balance, beginning of period      | 95,924,339            | 87,514,336           |
| Issuance of common stock          | 2,149,976             | 8,293,369            |
| Nonvested share-based awards, net | 44,231                | 116,634              |
| Balance, end of period            | 98,118,546            | 95,924,339           |

## At-The-Market Equity Offering Program

During the nine months ended September 30, 2014, the Company sold 2,099,380 shares of common stock under its at-the-market equity offering program, generating \$51.8 million in net proceeds at prices ranging from \$24.35 to \$25.84 per share (weighted average of \$25.05 per share). Of this amount, the Company sold 999,080 shares of common stock during the third quarter of 2014 generating \$24.5 million in net proceeds at prices ranging from \$24.35 to \$25.50 per share (weighted average of \$24.93 per share). In October 2014, the Company sold 58,504 shares of common stock, generating \$1.5 million in net proceeds at prices ranging from \$25.00 to \$25.35 per share (weighted average of \$25.32 per share).

The Company's existing sales agreements with four investment banks allow sales under this program of up to 9,000,000 shares of common stock, with 3,233,516 authorized shares remaining available to be sold under the these agreements as of November 4, 2014.

## Common Stock Dividends

During the first nine months of 2014, the Company declared and paid common stock dividends totaling \$0.90 per share.

On November 4, 2014, the Company declared a quarterly common stock dividend in the amount of \$0.30 per share payable on November 28, 2014 to stockholders of record on November 14, 2014.

Table of Contents

## Notes to Condensed Consolidated Financial Statements - Continued

## 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 nine months ended September 30, 2014 and 2013.

| (Dollars in thousands, except per share data)                                | Three Months Ended<br>September 30, |              | Nine Months Ended<br>September 30, |              |
|--|-------------------------------------|--------------|------------------------------------|--------------|
|  | 2014                                | 2013         | 2014                               | 2013         |
| Weighted average Common Shares outstanding                                   |                                     |              |                                    |              |
| Weighted average Common Shares outstanding                                   | 97,651,673                          | 95,220,031   | 96,677,774                         | 91,665,703   |
| Nonvested shares   | (1,793,639 )                        | (1,777,203 ) | (1,832,242 )                       | (1,794,606 ) |
| Weighted average Common Shares outstanding—Basic                             | 95,858,034                          | 93,442,828   | 94,845,532                         | 89,871,097   |
| Weighted average Common Shares—Basic   | 95,858,034                          | 93,442,828   | 94,845,532                         | 89,871,097   |
| Dilutive effect of restricted stock  | 1,369,047                           | 1,278,902    | 1,346,032                          | —            |
| Dilutive effect of employee stock purchase plan                              | 101,963                             | 114,264      | 118,854                            | —            |
| Weighted average Common Shares outstanding—Diluted                           | 97,329,044                          | 94,835,994   | 96,310,418                         | 89,871,097   |
| Net Income (Loss)  |                                     |              |                                    |              |
| Income (loss) from continuing operations                                     | \$8,537                             | \$4,614      | \$25,233                           | \$(22,372 )  |
| Noncontrolling interests' share in net (income) loss                         | (162 )                              | (18 )        | (313 )                             | 34           |
| Income (loss) from continuing operations attributable to common stockholders | 8,375                               | 4,596        | 24,920                             | (22,338 )    |
| Discontinued operations  | (4,384 )                            | 15,169       | (11,106 )                          | 16,899       |
| Net income (loss) attributable to common stockholders                        | \$3,991                             | \$19,765     | \$13,814                           | \$(5,439 )   |
| Basic Earnings (Loss) Per Common Share                                       |                                     |              |                                    |              |
| Income (loss) from continuing operations                                     | \$0.09                              | \$0.05       | \$0.27                             | \$(0.25 )    |
| Discontinued operations  | (0.05 )                             | 0.16         | (0.12 )                            | 0.19         |
| Net income (loss) attributable to common stockholders                        | \$0.04                              | \$0.21       | \$0.15                             | \$(0.06 )    |
| Diluted Earnings (Loss) Per Common Share                                     |                                     |              |                                    |              |
| Income (loss) from continuing operations                                     | \$0.09                              | \$0.05       | \$0.26                             | \$(0.25 )    |
| Discontinued operations  | (0.05 )                             | 0.16         | (0.12 )                            | 0.19         |
| Net income (loss) attributable to common stockholders                        | \$0.04                              | \$0.21       | \$0.14                             | \$(0.06 )    |

The effect of 1,294,953 nonvested shares and options to purchase 164,418 shares of the Company's common stock for the nine months ended September 30, 2013 were excluded from the calculation of diluted loss per common share 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 nonvested common stock issued to employees and the Company's directors. During the nine months ended September 30, 2014 and 2013, the Company issued 128,199 and 87,043 shares of nonvested common stock, respectively, to participants under these incentive plans and withheld 16,170 and 9,433 shares of common stock, respectively, from participants to pay estimated withholding taxes related to shares that vested.

Table of Contents

## Notes to Condensed Consolidated Financial Statements - Continued

A summary of the activity under the stock-based incentive plans for the three and nine months ended September 30, 2014 and 2013 is included in the table below.

|   | Three Months Ended September 30, |           | Nine Months Ended September 30, |           |
|---|----------------------------------|-----------|---------------------------------|-----------|
|   | 2014                             | 2013      | 2014                            | 2013      |
| Stock-based awards, beginning of period | 1,837,855                        | 1,778,083 | 1,788,168                       | 1,770,061 |
| Granted                                 | —                                | —         | 128,199                         | 87,043    |
| Vested                                  | (4,911                           | ) (890    | ) (83,423                       | ) (79,911 |
| Forfeited                               | (67,798                          | ) —       | (67,798                         | ) —       |
| Stock-based awards, end of period       | 1,765,146                        | 1,777,193 | 1,765,146                       | 1,777,193 |

The Company recorded approximately \$0.2 million in general and administrative expenses during the first quarter of 2014 relating to the annual grant of options to its employees under the Employee Stock Purchase Plan based on the Company's estimate of option exercises.

A summary of the activity under the Employee Stock Purchase Plan for the three and nine months ended September 30, 2014 and 2013 is included in the table below.

|  | Three Months Ended September 30, |           | Nine Months Ended September 30, |            |
|--|----------------------------------|-----------|---------------------------------|------------|
|  | 2014                             | 2013      | 2014                            | 2013       |
| Outstanding and exercisable, beginning of period | 440,471                          | 433,801   | 391,108                         | 433,452    |
| Granted  | —                                | —         | 275,655                         | 246,717    |
| Exercised  | (11,668                          | ) (7,478  | ) (40,988                       | ) (60,483  |
| Forfeited  | (5,219                           | ) (14,007 | ) (44,316                       | ) (36,819  |
| Expired  | —                                | —         | (157,875                        | ) (170,551 |
| Outstanding and exercisable, end of period       | 423,584                          | 412,316   | 423,584                         | 412,316    |

**Note 6. Defined Benefit Pension Plan**

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 \$0.9 million, subject to cost-of-living adjustments. As of September 30, 2014, 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 plan for the three and nine months ended September 30, 2014 and 2013 is detailed in the following table.

| (Dollars in thousands)                        | Three Months Ended September 30, |        | Nine Months Ended September 30, |        |
|---|----------------------------------|--------|---------------------------------|--------|
|   | 2014                             | 2013   | 2014                            | 2013   |
| Service cost                                  | \$22                             | \$22   | \$66                            | \$64   |
| Interest cost                                 | 172                              | 149    | 515                             | 448    |
| Amortization of net gain/loss                 | 117                              | 344    | 352                             | 1,035  |
| Amortization of prior service cost            | (297                             | ) (297 | ) (892                          | ) (892 |
| Total recognized in net periodic benefit cost | \$14                             | \$218  | \$41                            | \$655  |





Table of Contents

## Notes to Condensed Consolidated Financial Statements - Continued

## Note 7. Fair Value of Financial Instruments

The carrying amounts of cash and cash equivalents, receivables and payables are reasonable estimates of their fair value as of September 30, 2014 and December 31, 2013 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 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. The table below details the fair value and carrying values for notes and bonds payable and mortgage notes receivable at September 30, 2014 and December 31, 2013.

| (Dollars in millions)                    | September 30, 2014 |            | December 31, 2013 |            |
|--|--------------------|------------|-------------------|------------|
|  | Carrying Value     | Fair Value | Carrying Value    | Fair Value |
| Notes and bonds payable <sup>(1)</sup>   | \$1,403.4          | \$1,426.5  | \$1,348.5         | \$1,380.6  |
| Mortgage notes receivable <sup>(2)</sup> | \$1.9              | \$1.9      | \$125.5           | \$124.5    |

(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.

Table of Contents

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 management of the Company, contain, or will contain, disclosures that are "forward-looking statements." Forward-looking statements include all statements that do not relate solely to historical or current facts and can be identified by the use of words such as "may," "will," "expect," "believe," "anticipate," "target," "intend," "plan," "estimate," "project," "continue," "should," 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, 2013, 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, 2013.

The purpose of this Management's Discussion and Analysis ("MD&A") is to provide an understanding of the Company's consolidated financial condition, results of operations and cash flows by focusing on the changes in certain key measures from year to year. MD&A is provided as a supplement to, and should be read in conjunction with, the Company's Condensed Consolidated Financial Statements and accompanying notes. MD&A is organized in the following sections:

**Liquidity and Capital Resources**

- Trends and Matters Impacting Operating Results

**Results of Operations**

**Liquidity and Capital Resources**

**Sources and Uses of Cash**

The Company's primary sources of cash include rent and interest receipts from its real estate and mortgage portfolio based on contractual arrangements with its tenants, sponsors and borrowers, borrowings under the Unsecured Credit Facility, proceeds from the sales of real estate properties, the repayments of mortgage notes receivable, and proceeds from public or private debt or equity offerings.

The Company expects to continue to meet its liquidity needs, including funding additional investments, paying dividends, and funding debt service through cash on hand, cash flows from operations, and the cash flow sources addressed above. The Company also had unencumbered real estate assets with a gross book value of approximately \$2.9 billion at September 30, 2014, of which a portion could serve as collateral for secured mortgage financing. The Company believes that its liquidity and sources of capital are adequate to satisfy its cash requirements. The Company cannot, however, be certain that these sources of funds will be available at a time and upon terms acceptable to the Company in sufficient amounts to meet its liquidity needs.

Dividends paid by the Company for the nine months ended September 30, 2014 were funded from cash flows from operations and the Unsecured Credit Facility, as cash flows from operations were not adequate to fully fund dividends

paid at the rate per quarter of \$0.30 per common share. The Company expects that additional cash flows from existing properties, acquisitions and continued lease-up of the development conversion properties will generate sufficient cash flows from operations such that dividends for the full year 2014 can be funded by cash flows from operations.

#### Investing Activities

Cash flows used in investing activities for the nine months ended September 30, 2014 were approximately \$81.9 million. Below is a summary of the significant investing activities. See Note 2 to the Condensed Consolidated Financial Statements for more detailed information on these activities.

During the nine months ended September 30, 2014, the Company funded \$1.2 million on the outstanding construction mortgage note for a build-to-suit facility in Oklahoma leased to Mercy Health, based in Missouri, bringing cumulative fundings to date to \$81.2 million. This project was completed in May 2014 and was purchased by the Company for a purchase price of approximately \$85.4 million. The outstanding loan balance was credited to the purchase price and the Company paid an additional \$4.2 million in cash consideration. Subsequent to the purchase, the Company funded an additional \$4.0 million to fund construction costs through September 30, 2014 and anticipates funding an additional

## Table of Contents

\$1.8 million to complete the \$91.2 million development during the fourth quarter of 2014. The building is 100% leased to Mercy Health through 2028.

The Company acquired five real estate properties during the nine months ended September 30, 2014 as listed below:

In March 2014, the Company acquired ownership of a multi-tenanted office building in Iowa in satisfaction of a \$40.0 million mortgage note receivable that matured on January 10, 2014.

In June 2014, the Company purchased a 56.9% equity interest in a limited liability company that owns a medical office building and related land in Texas. The Company paid \$8.8 million in cash consideration including closing costs of \$0.1 million. The Company accounted for the transaction as an asset acquisition that is recorded in real estate assets on the Company's Condensed Consolidated Balance Sheet. The building is adjacent to Seton Medical Center, a 534-bed hospital.

In June 2014, the Company purchased a 35,292 square foot medical office building located in North Carolina for a purchase price and cash consideration of \$6.5 million. The property is 100% leased with expirations through 2024. The building is adjacent to Wesley Long Hospital, a 175-bed hospital.

In July 2014, the Company purchased a 60,476 square foot medical office building located in Minnesota for a purchase price of \$19.8 million including cash consideration of \$8.4 million and the assumption of debt of \$11.4 million (excluding a \$1.2 million fair value adjustment premium recorded upon acquisition). The mortgage note payables assumed by the Company bear a weighted average contractual interest rate of 6.67% with maturities from 2017 to 2040. See Note 3 to the Company's Condensed Consolidated Financial Statements accompanying this report for more information on the debt assumed. The property was constructed in 2010 and is 100% leased with expirations through 2025. The building is connected to Unity Hospital, a 220-bed hospital operated by Allina Health.

In September 2014, the Company purchased a 47,962 square foot medical office building located in Florida for a purchase price and cash consideration of \$7.9 million. The property is 89% leased with expirations through 2019. The building is adjacent to Tampa General Hospital, a 1,018-bed hospital.

The Company disposed of two off-campus, medical office buildings located in Florida and Texas and an on-campus medical office building in Nevada in which the Company had an aggregate net investment of \$10.7 million, generating net cash proceeds of \$6.1 million and the origination of a \$1.9 million Company-financed mortgage note receivable.

During the third quarter of 2014, two mortgage notes receivable were repaid generating an aggregate of \$4.9 million in net proceeds.

### Subsequent Acquisition

In October 2014, the Company acquired a 68,860 square foot medical office building in Oklahoma for a purchase price of \$17.4 million, including cash consideration of \$10.6 million and the assumption of debt of \$6.8 million. The mortgage note payable, assumed by the Company, bears a contractual interest rate of 6.1% and matures on August 1, 2020. The property is 96.7% leased with expirations through 2027. The building is located on the Norman Regional Healthplex campus, a 152-bed specialty hospital.

### Potential Disposition

In September 2014, the Company received notice from a tenant of its intent to purchase a medical office building in Pennsylvania pursuant to a purchase option contained in its lease with the Company. The Company's net investment in the building is \$7.7 million at September 30, 2014, including straight-line rent receivables. The purchase price for the property will be the greater of a fair market value or approximately \$15.0 million. The appraisal process is on-going and the sale will result in a potential gain of at least \$7.3 million. The Company preliminarily expects the sale to occur during the first quarter of 2015. The property was reclassified as held for sale as of September 30, 2014.

### Financing Activities

Cash flows used in financing activities for the nine months ended September 30, 2014 were approximately \$2.8 million. Inflows from accessing the debt and equity markets totaled \$252.7 million, net of costs incurred. Aggregate cash outflows totaled approximately \$255.5 million primarily associated with net repayments of indebtedness and dividends paid to common stockholders. Below is a summary of the significant financing activities. See Notes 3 and 5 to the Condensed Consolidated Financial Statements for more information on the capital markets and financing activities.

## Table of Contents

### Changes in Debt Structure

In February 2014, the Company entered into a \$200.0 million Term Loan due 2019 with a syndicate of nine lenders that matures on February 26, 2019. The Term Loan due 2019 bears interest at a rate equal to (x) LIBOR plus (y) a margin ranging from 1.00% to 1.95% (currently 1.45%) based upon the Company's unsecured debt ratings. Payments under the Term Loan due 2019 are interest only, with the full amount of the principal due at maturity. The Term Loan due 2019 may be prepaid at any time, without penalty. The proceeds from the Term Loan due 2019 were used by the Company to repay borrowings on the Unsecured Credit Facility.

In July 2014, upon the acquisition of a real estate property, the Company assumed a series 2010B Bond due 2017 totaling \$0.5 million, a Series 2010A Bond due 2022 totaling \$1.2 million, a Series 2010A Bond due 2030 totaling \$2.8 million and a Series 2010A Bond due 2040 totaling \$7.0 million. The aggregate outstanding balance of the bonds is approximately \$11.4 million excluding a fair value adjustment premium recorded upon acquisition of approximately \$1.2 million. The mortgage notes payable have a weighted average contractual interest rate of 6.67% (effective rate of 4.79%). The Series 2010A Bonds can be repaid without penalty on or after May 1, 2020. See Note 2 to the Company's Condensed Consolidated Financial Statements accompanying this report for more information regarding this transaction.

In October 2014, the Company repaid three mortgage notes payable totaling \$6.3 million bearing a weighted average contractual interest rate of 6.08% (effective rate of 4.06%) that encumbered two medical office buildings in Virginia. As of September 30, 2014, the Company's outstanding balance on the Unsecured Credit Facility was \$84.0 million, with a remaining borrowing capacity of approximately \$616.0 million. The Company's leverage ratio [debt divided by (debt plus stockholders' equity less intangible assets plus accumulated depreciation)] was approximately 42.4%. The Company's various debt agreements contain certain representations, warranties, and financial and other covenants customary in such debt agreements. Among other things, these provisions require the Company to maintain certain financial ratios and minimum tangible net worth and impose certain limits on the Company's ability to incur indebtedness and create liens or encumbrances. At September 30, 2014, the Company was in compliance with the financial covenant provisions under all of its various debt instruments.

### Common Stock Issuances

During the nine months ended September 30, 2014, the Company sold 2,099,380 shares of common stock under its at-the-market equity offering program, generating \$51.8 million in net proceeds at prices ranging from \$24.35 to \$25.84 per share (weighted average of \$25.05 per share). Of this amount, the Company sold 999,080 shares of common stock during the third quarter of 2014 generating \$24.5 million in net proceeds at prices ranging from \$24.35 to \$25.50 per share (weighted average of \$24.93 per share). In October 2014, the Company sold 58,504 shares of common stock, generating \$1.5 million in net proceeds at prices ranging from \$25.00 to \$25.35 per share (weighted average of \$25.32 per share).

The Company's existing sales agreements with four investment banks allow sales under this program of up to 9,000,000 shares of common stock, with 3,233,516 authorized shares remaining available to be sold under the these agreements as of November 4, 2014.

### Noncontrolling Interest Purchase

In April 2014, the Company purchased the outstanding 40% noncontrolling equity interest in a consolidated partnership that owned a medical office building and parking garage in Texas, which were developed by the partnership, for an aggregate purchase price and cash consideration of \$8.2 million. The book value of the noncontrolling interest prior to the equity purchase was \$1.6 million.

### Operating Activities

Cash flows provided by operating activities increased from \$71.9 million for the nine months ended September 30, 2013 to \$77.7 million for the nine months ended September 30, 2014. Several items impact cash flows from

operations including, but not limited to, cash generated from property operations, interest payments and the timing related to the payment of invoices and other expenses and receipts of tenant rent.

In May 2014, the Company modified the ground leases and property operating agreements of five on-campus medical office buildings, totaling 424,000 square feet, associated with the sponsoring health system. The Company paid the health system \$12.0 million to modify these agreements and eliminate exercisable purchase options that would have resulted in a purchase price below estimated fair market value. As a result of this transaction, the Company maintained its long-term investment at a yield above current reinvestment rates. As of September 30, 2014, the Company has approximately \$131.0 million of real estate properties with exercisable purchase options and \$486.4 million of real estate properties that are subject to purchase options that will become exercisable after December 31, 2014. Approximately \$104.3 million of these properties have



## Table of Contents

purchase option prices that could be less than fair market value, but greater than the Company's gross investment. The two recently completed Mercy Health properties representing a total gross investment of approximately \$201.4 million have purchase options with stated purchase prices equal to an average premium of approximately 20% of the Company's gross investment.

In June 2014, the Company received a net \$1.9 million cash reimbursement for certain operating expenses paid by the Company for years 2006 through 2013 that is included in the "Interest and other income, net" line item on the Company's Condensed Consolidated Statements of Operations accompanying this report.

The Company may from time to time sell additional properties and redeploy cash from property sales and mortgage repayments into new investments. To the extent revenues related to the properties being sold and the mortgages being repaid exceed income from these new investments, the Company's results of operations and cash flows could be adversely affected.

### Off-Balance Sheet Arrangements

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

### New Accounting Pronouncements

See Note 1 to the Company's Condensed Consolidated Financial Statements accompanying this report for information on new accounting standards not yet adopted. The Company is still evaluating the impact of these new standards.

### 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, 2013, below are some of the factors and trends that management believes may impact future operations of the Company.

### Expiring Leases

The Company expects that approximately 10% to 20% of the leases in its multi-tenanted portfolio will expire each year in the ordinary course of business. There are 499 leases that have expired or will expire during 2014. Approximately 88% of the leases expiring in 2014 are located in buildings on hospital campuses, are distributed throughout the portfolio and are not concentrated with any one tenant, health system or market area. The Company typically expects 75% to 85% of multi-tenant property leases to renew upon expiration, and the renewals for the first nine months of the year are within this range.

There were eight single tenant net leases with expiration dates in 2014. Of these, six leases with respect to senior living facilities in Michigan and Indiana associated with a single operator have been renewed. Additionally, one lease with respect to an on-campus, inpatient facility has also been renewed. The remaining lease relates to an on-campus medical office building occupied by subtenants. The Company is currently in negotiations with the subtenants regarding their lease renewals. There are no single tenant net leases with expiration dates in 2015.

### Operating Expenses

The Company has experienced and expects continued increases in property taxes throughout its portfolio as a result of increasing assessments and tax rates levied across the country. The Company continues its efforts to vigorously appeal all property tax increases and manage the impact of the increases. In addition, the Company has historically incurred variability in portfolio utilities expense based on seasonality with the first and third quarters usually reflecting greater amounts. The effects of these operating expense increases are mitigated in leases that have provisions for operating expense reimbursement. As of September 30, 2014, 83% of the Company's multi-tenant leased square footage allows for some recovery of operating expenses, with 47% recovering all allowable expenses. This is an increase from

September 30, 2013, when 80% of the Company's leased square footage allowed some recovery of operating expenses, with 39% recovering all allowable expenses.

#### Non-GAAP Financial 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.

Table of Contents

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 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 report.

Funds from Operations

Funds from operations ("FFO") and FFO per share are operating performance measures adopted by the National Association of Real Estate Investment Trusts, Inc. ("NAREIT"). NAREIT defines FFO as the most commonly accepted and reported measure of a REIT's operating performance equal to "net income (computed in accordance with GAAP), excluding gains (or losses) from sales of property, plus depreciation and amortization related to real estate properties, and after adjustments for unconsolidated partnerships and joint ventures." The Company follows the NAREIT definition in calculating and presenting FFO and FFO per share.

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

FFO for the three and nine months ended September 30, 2014 compared to the same period in 2013 was primarily impacted by the various acquisitions and dispositions during the period, the effects of capital market transactions and the results of operations of the portfolio from period to period. FFO for the nine months ended September 30, 2014 was also positively impacted by \$1.9 million, or \$0.02 per common share, by a cash reimbursement for certain operating expenses paid by the Company for years 2006 through 2013 and the nine months ended September 30, 2013 was negatively impacted by \$29.9 million, or \$0.33 per common share, charges incurred as a result of the early repayment of debt.

Table of Contents

The table below reconciles FFO to net income (loss) attributable to common stockholders for the three and nine months ended September 30, 2014 and 2013:

| (Amounts in thousands, except per share data)         | Three Months Ended |          | Nine Months Ended |           |
|---|--------------------|----------|-------------------|-----------|
|   | September 30,      |          | September 30,     |           |
|   | 2014               | 2013     | 2014              | 2013      |
| Net Income (Loss) Attributable to Common Stockholders | \$3,991            | \$19,765 | \$13,814          | \$(5,439) |
| Gain on sales of real estate properties               | —                  | (20,187) | (3)               | (21,970)  |
| Impairments   | 4,505              | 6,259    | 11,034            | 9,889     |
| Real estate depreciation and amortization             | 27,697             | 24,214   | 80,963            | 72,175    |
| Total adjustments                                     | 32,202             | 10,286   | 91,994            | 60,094    |
| Funds from Operations                                 | \$36,193           | \$30,051 | \$105,808         | \$54,655  |
| Funds from Operations per Common Share—Basic          | \$0.38             | \$0.32   | \$1.12            | \$0.61    |
| Funds from Operations per Common Share—Diluted        | \$0.37             | \$0.32   | \$1.10            | \$0.60    |
| Weighted Average Common Shares Outstanding—Basic      | 95,858             | 93,443   | 94,846            | 89,871    |
| Weighted Average Common Shares Outstanding—Diluted    | 97,329             | 94,836   | 96,310            | 91,330    |

## Same Store Net Operating Income

Net operating income ("NOI") and same store NOI 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 NOI 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. NOI 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. NOI 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.

The following table reflects the Company's same store NOI for the three months ended September 30, 2014 and 2013. The Company does not measure same store NOI and related growth rate on a year-to-date basis. In a year-to-date period the pool of same store properties would be different than the pool used in any individual quarter resulting in same store NOI information that is not indicative of the earnings from the current same store portfolio.

| (Dollars in thousands)             | Number of Properties <sup>(1)</sup> | Investment at September 30, 2014 | Same Store NOI for the Three Months Ended September 30, |          |
|------------------------------------|-------------------------------------|----------------------------------|---|----------|
|                                    |                                     |                                  | 2014  | 2013     |
| Multi-tenant Properties            | 121                                 | \$1,606,109                      | \$31,420  | \$30,171 |
| Single-tenant Net Lease Properties | 34                                  | 517,243                          | 12,827  | 12,554   |
| Total                              | 155                                 | \$2,123,352                      | \$44,247  | \$42,725 |

(1) Mortgage notes receivable, reposition properties, corporate property and assets classified as held for sale are excluded.

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 from stabilization are excluded from the same store analysis. In addition, the Company excludes properties that meet the following Company-defined criteria to be included in the reposition property group:

• Properties having less than 60% occupancy;

• Anticipated significant or material changes to a particular property or its market environment;

• Conversions between the single-tenant net lease and multi-tenant portfolios; or

• Condemnations, if any.

Table of Contents

The following tables reconcile same store NOI to the respective line items in the Condensed Consolidated Statements of Operations and the same store property count to the total owned real estate portfolio:

## Reconciliation of Same Store NOI:

| (Dollars in thousands)                      | Three Months Ended September 30, |           |
|---|----------------------------------|-----------|
|   | 2014                             | 2013      |
| Rental income                               | \$92,987                         | \$78,161  |
| Rental lease guaranty income <sup>(a)</sup> | 1,100                            | 1,383     |
| Property operating expense                  | (34,678                          | ) (32,244 |
| Exclude Straight-line rent revenue          | (3,055                           | ) (2,353  |
| NOI   | 56,354                           | 44,947    |
| NOI not included in same store              | (12,107                          | ) (2,222  |
| Same store NOI                              | \$44,247                         | \$42,725  |

## (a) Other operating income reconciliation:

|                              |         |         |
|------------------------------|---------|---------|
| Rental lease guaranty income | \$1,100 | \$1,383 |
| Interest income              | 247     | 102     |
| Management fee income        | 72      | 40      |
| Other                        | 56      | 54      |
|                              | \$1,475 | \$1,579 |

## Reconciliation of Same Store Property Count:

|                                    | Property Count as of September 30, 2014 |
|------------------------------------|---|
| Same Store Properties              | 155                                     |
| Acquisitions                       | 14                                      |
| Reposition                         | 19                                      |
| Development Conversions            | 12                                      |
| Total Owned Real Estate Properties | 200                                     |

## Restricted Stock Vesting

The Company's Chairman and Chief Executive Officer, David R. Emery, has received multiple grants of restricted stock in prior years, 838,886 shares of which will vest by their terms on December 31, 2014. The Company expects that approximately 352,000 of these shares will be forfeited by Mr. Emery upon vesting and redeemed by the Company to satisfy the Company's income tax withholding requirements. Together with his other holdings, Mr. Emery will continue to retain approximately 749,000 shares of the Company's common stock, 52,073 of which will continue to be restricted and subject to future vesting requirements.

Table of Contents

## Results of Operations

Three Months Ended September 30, 2014 Compared to Three Months Ended September 30, 2013

The Company's results of operations for the three months ended September 30, 2014 compared to the same period in 2013 were significantly impacted by acquisitions, dispositions, development conversions, impairments recorded, gains on sales of real estate and capital markets transactions.

## Revenues

Rental income increased \$14.8 million, or 19.0%, to approximately \$93.0 million for the three months ended September 30, 2014 compared to \$78.2 million in the prior year period and is comprised of the following:

| (Dollars in thousands)  | Three Months Ended |          | Change   |      |   |
|-------------------------|--------------------|----------|----------|------|---|
|                         | September 30,      |          |          |      |   |
|                         | 2014               | 2013     | \$       | %    |   |
| Property operating      | \$72,730           | \$63,119 | \$9,611  | 15.2 | % |
| Single-tenant net lease | 17,202             | 12,689   | 4,513    | 35.6 | % |
| Straight-line rent      | 3,055              | 2,353    | 702      | 29.8 | % |
| Total rental income     | \$92,987           | \$78,161 | \$14,826 | 19.0 | % |

Property operating income increased \$9.6 million, or 15.2%, from the prior year period as a result of the following activity:

- ▲ Acquisitions in 2013 and 2014 contributed \$5.8 million.
- ▲ Additional leasing activity at development conversion properties contributed \$2.3 million.
- ▲ Net leasing activity including contractual rent increases and renewals contributed \$1.5 million.

Single-tenant net lease revenue increased \$4.5 million, or 35.6%, from the prior year period as a result of the following activity:

- The Company's 2013 and 2014 acquisitions contributed \$4.2 million.
- New leasing activity including contractual rent increases contributed \$0.3 million.

Straight-line rent increased \$0.7 million, or 29.8%, from the prior year period as a result of the Company's 2013 and 2014 acquisitions.

Mortgage interest income decreased \$3.9 million, or 98.9%, from the prior year period as a result of the following activity:

• The Company's 2013 acquisition of a property in Missouri affiliated with Mercy Health previously funded under a construction mortgage note receivable resulted in a decrease of \$1.7 million.

Mortgage interest income decreased approximately \$0.8 million related to a mortgage note receivable that the Company received a deed in lieu of foreclosure during the first quarter of 2014. See "Liquidity and Capital Resources" for additional information.

• The Company's 2014 acquisition of a property in Oklahoma affiliated with Mercy Health previously funded under a construction mortgage note receivable resulted in a decrease of \$1.3 million.

## Expenses

Property operating expenses increased \$2.4 million, or 7.5%, for the three months ended September 30, 2014 compared to the prior year period primarily as a result of the Company's 2013 and 2014 acquisitions.

General and administrative expenses decreased approximately \$0.4 million, or 7.0%, for the three months ended September 30, 2014 compared to the prior year period primarily because of a one-time reversal of restricted stock amortization as the result of an officer's resignation.

Depreciation expense increased \$3.9 million, or 18.2%, for the three months ended September 30, 2014 compared to the prior year period. Properties acquired in 2013 and 2014 and developments completed and commencing operations during 2013



Table of Contents

contributed a combined increase of \$2.8 million. The remaining \$1.1 million increase is related to various building and tenant improvement expenditures.

Other income (expense)

Interest expense increased \$1.1 million for the three months ended September 30, 2014 compared to the prior year period. The components of interest expense are as follows:

| (Dollars in thousands)                | 2014     | 2013     | Change  | Percentage Change |    |
|---------------------------------------|----------|----------|---------|-------------------|----|
| Contractual interest                  | \$17,178 | \$16,034 | \$1,144 | 7.1               | %  |
| Net discount accretion                | 220      | 305      | (85)    | (27.9)            | )% |
| Deferred financing costs amortization | 794      | 716      | 78      | 10.9              | %  |
| Interest cost capitalization          | —        | (12)     | ) 12    | (100.0)           | )% |
| Total interest expense                | \$18,192 | \$17,043 | \$1,149 | 6.7               | %  |

Contractual interest increased \$1.1 million as a result of the following activity:

• The Unsecured Credit Facility and Term Loan due 2019 accounted for a net increase of \$0.5 million.

• Mortgage notes payable assumed upon acquisition of real estate properties accounted for an increase of \$0.6 million.

Included in interest and other income, net for the three months ended September 30, 2014 is a gain recognized on insurance proceeds of approximately \$0.3 million.

#### Discontinued Operations

Results from discontinued operations for the three months ended September 30, 2014 were losses of \$4.4 million compared to income of \$15.2 million for the three months ended September 30, 2013. These amounts include the results of operations and impairments related to assets classified as held for sale or disposed of as of September 30, 2014. See Note 2 to the Company's Condensed Consolidated Financial Statements accompanying this report for more detail.

#### Results of Operations

Nine Months Ended September 30, 2014 Compared to Nine Months Ended September 30, 2013

The Company's results of operations for the nine months ended September 30, 2014 compared to the same period in 2013 were significantly impacted by acquisitions, dispositions, development conversions, impairments recorded, gains on sales of real estate, extinguishments of debt and capital market transactions.

#### Revenues

Rental income increased \$40.4 million, or 17.6%, to approximately \$270.5 million compared to \$230.1 million in the prior year period and is comprised of the following:

| (Dollars in thousands)  | Nine Months Ended September 30, |           | Change   |      |   |
|-------------------------|---------------------------------|-----------|----------|------|---|
|                         | 2014                            | 2013      | \$       | %    |   |
| Property operating      | \$214,827                       | \$187,026 | \$27,801 | 14.9 | % |
| Single-tenant net lease | 47,879                          | 36,596    | 11,283   | 30.8 | % |
| Straight-line rent      | 7,807                           | 6,472     | 1,335    | 20.6 | % |
| Total rental income     | \$270,513                       | \$230,094 | \$40,419 | 17.6 | % |

Property operating income increased \$27.8 million, or 14.9%, from the prior year period as a result of the following activity:

• Acquisitions in 2013 and 2014 contributed \$16.7 million.

• Additional leasing activity at development conversion properties contributed \$7.3 million.

• Net leasing activity including contractual rent increases and renewals contributed \$3.9 million.



Table of Contents

Single-tenant net lease revenue increased \$11.3 million, or 30.8%, from the prior year period as a result of the following activity:

- The Company's 2013 and 2014 acquisitions contributed \$10.0 million.
- New leasing activity including contractual rent increases contributed \$1.3 million.

Straight-line rent increased \$1.3 million, or 20.6%, from the prior year period as a result of the following activity:

- The Company's 2013 and 2014 acquisitions contributed \$2.4 million.
- Net leasing activity including contractual rent increases and the effects of prior year rent abatements that expired resulted in a decrease of \$1.1 million.

Mortgage interest income decreased \$6.7 million, or 64.7%, from the prior year period as a result of the following activity:

- The Company's 2013 acquisition of a property in Missouri affiliated with Mercy Health previously funded under a construction mortgage note receivable resulted in a decrease of \$4.2 million.
- Mortgage interest income decreased approximately \$1.3 million related to a mortgage note receivable that the Company received a deed in lieu of foreclosure during the first quarter of 2014. See "Liquidity and Capital Resources" for additional information.
- The Company's 2014 acquisition of a property in Oklahoma affiliated with Mercy Health previously funded under a construction mortgage note receivable resulted in a decrease of \$1.1 million.

Expenses

Property operating expenses increased \$9.3 million, or 10.1%, for the nine months ended September 30, 2014 compared to the prior year period as a result of the following activity:

- The Company's 2013 and 2014 acquisitions accounted for an increase of \$6.8 million.
- The Company experienced overall increases in utilities of approximately \$0.5 million, leasing commissions of approximately \$0.7 million and maintenance costs of approximately \$1.2 million.

General and administrative expenses decreased approximately \$1.1 million, or 6.3%, for the nine months ended September 30, 2014 compared to the prior year period as a result of the following activity:

- The Company incurred a one-time severance charge in the first quarter of 2013 of approximately \$0.6 million.
- The Company recorded a one-time reversal of restricted stock amortization as the result of an officer's resignation of approximately \$0.4 million.
- Reduction in expenses related to potential acquisitions and developments of \$0.5 million.
- Professional and legal fee expenses increased approximately \$0.3 million.

Depreciation expense increased \$10.4 million, or 16.3%, for the nine months ended September 30, 2014 compared to the prior year period. Properties acquired in 2013 and 2014 and developments completed and commencing operations during 2013 contributed a combined increase of \$7.5 million. The remaining \$2.9 million increase is related to various building and tenant improvement expenditures.

Table of Contents

## Other income (expense)

In the second quarter of 2013, the Company recorded a loss on extinguishments of debt associated with the redemption of the Senior Notes due 2014 of approximately \$12.3 million and the payoff of a secured loan of approximately \$17.4 million.

Interest expense decreased \$1.6 million for the nine months ended September 30, 2014 compared to the prior year period. The components of interest expense are as follows:

| (Dollars in thousands)                | 2014     | 2013     | Change    | Percentage Change |    |
|---------------------------------------|----------|----------|-----------|-------------------|----|
| Contractual interest                  | \$51,117 | \$52,568 | \$(1,451) | (2.8)             | )% |
| Net discount accretion                | 717      | 842      | \$(125)   | (14.8)            | )% |
| Deferred financing costs amortization | 2,342    | 2,511    | \$(169)   | (6.7)             | )% |
| Interest cost capitalization          | —        | (183)    | ) \$183   | (100.0)           | )% |
| Total interest expense                | \$54,176 | \$55,738 | \$(1,562) | (2.8)             | )% |

Contractual interest decreased \$1.5 million as a result of the following activity:

• The Unsecured Credit Facility and Term Loan due 2019 accounted for a net increase of \$1.5 million.

• Senior Notes due 2023 were issued in the first quarter of 2013 and accounted for an increase of \$2.2 million.

• Senior Notes due 2014 were repaid in the second quarter of 2013 and accounted for a decrease of \$4.0 million.

• Mortgage notes assumed upon acquisition of real estate properties accounted for an increase of \$1.9 million, and a mortgage note repayment accounted for a decrease of \$2.9 million.

Deferred financing costs amortization decreased \$0.2 million as a result of the Unsecured Credit Facility amendment in the first quarter of 2013 and related write-off of unamortized financing costs.

Included in interest and other income, net for the nine months ended September 30, 2014 is \$1.9 million recognized for a reimbursement received by the Company for certain operating expense paid by the Company for years 2006 through 2013 and a gain recognized on insurance proceeds of approximately \$0.3 million.

## Discontinued Operations

Results from discontinued operations for the nine months ended September 30, 2014 were losses of \$11.1 million compared to income of \$16.9 million for the nine months ended September 30, 2013. These amounts include the results of operations and impairments related to assets classified as held for sale or disposed of as of September 30, 2014. See Note 2 to the Company's Condensed Consolidated Financial Statements accompanying this report for more detail.

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

The Company is exposed to market risk in the form of changing interest rates on its debt and mortgage notes and other notes receivable. Management uses regular monitoring of market conditions and analysis techniques to manage this risk. During the nine months ended September 30, 2014, there were no material changes in the quantitative and qualitative disclosures about market risks presented in the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

## Item 4. Controls and Procedures

## Disclosure Controls and Procedures

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



Table of Contents

Changes in Internal Control over Financial Reporting

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

27

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Table of Contents

PART II—OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

In addition to the other information set forth in this report, an investor should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2013, which could materially affect the Company's business, financial condition or future results. The risks, as described in the Company's Annual Report on Form 10-K for the year ended December 31, 2013, are not the only risks facing the Company. Additional risks and uncertainties not currently known to management or that management currently deems immaterial also may materially, adversely affect the Company's business, financial condition, operating results or cash flows.

Item 5. Other Information

On November 3, 2014, Batey M. Gresham, Jr. tendered his resignation from the Board of Directors of the Company to be effective November 5, 2014. Mr. Gresham has served as a member of the Board of Directors since the Company's initial public offering in May 1993. His resignation was not the result of any disagreement with the Board of Directors or management of the Company.

Table of Contents

Item 6. Exhibits

| Exhibit         | Description  |
|-----------------|--|
| Exhibit 3.1     | Second Articles of Amendment and Restatement of the Company <sup>(1)</sup>   |
| Exhibit 3.2     | Amended and Restated Bylaws of the Company, as amended <sup>(2)</sup>  |
| Exhibit 4.1     | Specimen Stock Certificate <sup>(1)</sup>  |
| Exhibit 4.2     | Indenture, dated as of May 15, 2001, by and between the Company and Regions Bank, as trustee <sup>(3)</sup>  |
| Exhibit 4.3     | Third Supplemental Indenture, dated December 4, 2009, by and between the Company and Regions Bank, as Trustee <sup>(4)</sup>   |
| Exhibit 4.4     | Form of 6.50% Senior Notes due 2017 (set forth in Exhibit B to the Third Supplemental Indenture filed as Exhibit 4.5 thereto) <sup>(4)</sup>   |
| Exhibit 4.5     | Fourth Supplemental Indenture, dated December 13, 2010, by and between the Company and Regions Bank, as Trustee <sup>(5)</sup>   |
| Exhibit 4.6     | Form of 5.750% Senior Notes due 2021 (set forth in Exhibit B to the Fourth Supplemental Indenture filed as Exhibit 4.7 thereto) <sup>(5)</sup>   |
| Exhibit 4.7     | Fifth Supplemental Indenture, dated March 26, 2013, by and between the Company and Regions Bank, as Trustee <sup>(6)</sup>   |
| Exhibit 4.8     | Form of 3.75% Senior Notes due 2023 (set forth in Exhibit B to the Fifth Supplemental Indenture filed as Exhibit 4.9 thereto) <sup>(6)</sup>   |
| Exhibit 11      | Statement re: Computation of per share earnings (filed herewith in Note 5 to the Condensed Consolidated Financial Statements)  |
| Exhibit 31.1    | Certification of the Chief Executive Officer of Healthcare Realty Trust Incorporated pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith) |
| Exhibit 31.2    | Certification of the Chief Financial Officer of Healthcare Realty Trust Incorporated pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith) |
| Exhibit 32      | Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith)   |
| Exhibit 101.INS | XBRL Instance Document (filed herewith)  |
| Exhibit 101.SCH | XBRL Taxonomy Extension Schema Document (filed herewith)   |
| Exhibit 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document (filed herewith)   |



|                    |   |
|--------------------|---|
| Exhibit<br>101.LAB | XBRL Taxonomy Extension Labels Linkbase Document (filed herewith)       |
| Exhibit<br>101.DEF | XBRL Taxonomy Extension Definition Linkbase Document (filed herewith)   |
| Exhibit<br>101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document (filed herewith) |

- 
- (1) Filed as an exhibit to the Company's Registration Statement on Form S-11 (Registration No. 33-60506) previously filed pursuant to the Securities Act of 1933 and hereby incorporated by reference.
- (2) Filed as an exhibit to the Company's Form 10-Q for the quarter ended September 30, 2007 and hereby incorporated by reference.
- (3) Filed as an exhibit to the Company's Form 8-K filed May 17, 2001 and hereby incorporated as reference.
- (4) Filed as an exhibit to the Company's Form 8-K filed December 4, 2009 and hereby incorporated by reference.
- (5) Filed as an exhibit to the Company's Form 8-K filed December 13, 2010 and hereby incorporated by reference.
- (6) Filed as an exhibit to the Company's Form 8-K filed March 26, 2013 and hereby incorporated by reference.

Table of Contents

SIGNATURE

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

HEALTHCARE REALTY TRUST INCORPORATED

By: /s/ SCOTT W. HOLMES

Scott W. Holmes

Executive Vice President and Chief Financial  
Officer

Date: November 4, 2014

Table of Contents

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