

HEALTHCARE REALTY TRUST INC

Form 10-Q

May 06, 2015

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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: March 31, 2015

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 May 1, 2015, the Registrant had 100,391,509 shares of Common Stock outstanding.

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HEALTHCARE REALTY TRUST INCORPORATED  
FORM 10-Q  
March 31, 2015

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

## Healthcare Realty Trust Incorporated

## Condensed Consolidated Balance Sheets

(Amounts in thousands, except per share data)

|                                                                                                                                                                  | (Unaudited)       |                      |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------|----------------------|
|                                                                                                                                                                  | March 31,<br>2015 | December 31,<br>2014 |
| <b>ASSETS</b>                                                                                                                                                    |                   |                      |
| Real estate properties:                                                                                                                                          |                   |                      |
| Land                                                                                                                                                             | \$ 187,951        | \$ 183,060           |
| Buildings, improvements and lease intangibles                                                                                                                    | 3,077,828         | 3,048,251            |
| Personal property                                                                                                                                                | 10,014            | 9,914                |
| Land held for development                                                                                                                                        | 21,376            | 17,054               |
|                                                                                                                                                                  | 3,297,169         | 3,258,279            |
| Less accumulated depreciation                                                                                                                                    | (723,393 )        | (700,671 )           |
| Total real estate properties, net                                                                                                                                | 2,573,776         | 2,557,608            |
| Cash and cash equivalents                                                                                                                                        | 10,417            | 3,519                |
| Mortgage notes receivable                                                                                                                                        | 1,900             | 1,900                |
| Assets held for sale and discontinued operations, net                                                                                                            | 14,164            | 9,146                |
| Other assets, net                                                                                                                                                | 188,198           | 185,337              |
| Total assets                                                                                                                                                     | \$2,788,455       | \$ 2,757,510         |
| <b>LIABILITIES AND EQUITY</b>                                                                                                                                    |                   |                      |
| Liabilities:                                                                                                                                                     |                   |                      |
| Notes and bonds payable                                                                                                                                          | \$ 1,444,555      | \$ 1,403,692         |
| Accounts payable and accrued liabilities                                                                                                                         | 50,144            | 70,240               |
| Liabilities of discontinued operations                                                                                                                           | 102               | 372                  |
| Other liabilities                                                                                                                                                | 64,469            | 62,152               |
| Total liabilities                                                                                                                                                | 1,559,270         | 1,536,456            |
| Commitments and contingencies                                                                                                                                    |                   |                      |
| Stockholders' Equity:                                                                                                                                            |                   |                      |
| Preferred stock, \$.01 par value; 50,000 shares authorized; none issued and outstanding                                                                          | —                 | —                    |
| Common stock, \$.01 par value; 150,000 shares authorized; 100,087 and 98,828 shares issued and outstanding at March 31, 2015 and December 31, 2014, respectively | 1,001             | 988                  |
| Additional paid-in capital                                                                                                                                       | 2,423,121         | 2,389,830            |
| Accumulated other comprehensive loss                                                                                                                             | (3,242 )          | (2,519 )             |
| Cumulative net income attributable to common stockholders                                                                                                        | 845,631           | 840,249              |
| Cumulative dividends                                                                                                                                             | (2,037,326 )      | (2,007,494 )         |
| Total stockholders' equity                                                                                                                                       | 1,229,185         | 1,221,054            |
| Total liabilities and equity                                                                                                                                     | \$2,788,455       | \$ 2,757,510         |

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, 2014, are an integral part of these financial statements.

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Healthcare Realty Trust Incorporated  
Condensed Consolidated Statements of Operations  
For the Three Months Ended March 31, 2015 and 2014  
(Amounts in thousands, except per share data)  
(Unaudited)

|                                                           | Three Months Ended March 31, |             |
|-----------------------------------------------------------|------------------------------|-------------|
|                                                           | 2015                         | 2014        |
| REVENUES                                                  |                              |             |
| Rental income                                             | \$95,034                     | \$86,502    |
| Mortgage interest                                         | 31                           | 2,621       |
| Other operating                                           | 1,391                        | 1,448       |
|                                                           | 96,456                       | 90,571      |
| EXPENSES                                                  |                              |             |
| Property operating                                        | 34,263                       | 32,831      |
| General and administrative                                | 6,738                        | 5,972       |
| Depreciation                                              | 26,387                       | 23,667      |
| Amortization                                              | 2,667                        | 2,759       |
| Bad debts, net of recoveries                              | (207)                        | ) 47        |
|                                                           | 69,848                       | 65,276      |
| OTHER INCOME (EXPENSE)                                    |                              |             |
| Interest expense                                          | (18,322                      | ) (17,918 ) |
| Impairment                                                | (3,328                       | ) —         |
| Interest and other income, net                            | 91                           | 100         |
|                                                           | (21,559                      | ) (17,818 ) |
| INCOME FROM CONTINUING OPERATIONS                         | 5,049                        | 7,477       |
| DISCONTINUED OPERATIONS                                   |                              |             |
| Income (loss) from discontinued operations                | 333                          | (89 )       |
| Impairments                                               | —                            | (3,425 )    |
| INCOME (LOSS) FROM DISCONTINUED OPERATIONS                | 333                          | (3,514 )    |
| NET INCOME                                                | 5,382                        | 3,963       |
| Less: Net income attributable to noncontrolling interests | —                            | (111 )      |
| NET INCOME ATTRIBUTABLE TO COMMON STOCKHOLDERS            | \$5,382                      | \$3,852     |
| BASIC EARNINGS (LOSS) PER COMMON SHARE:                   |                              |             |
| Income from continuing operations                         | \$0.05                       | \$0.08      |
| Discontinued operations                                   | 0.00                         | (0.04 )     |
| Net income attributable to common stockholders            | \$0.05                       | \$0.04      |
| DILUTED EARNINGS (LOSS) PER COMMON SHARE:                 |                              |             |
| Income from continuing operations                         | \$0.05                       | \$0.08      |
| Discontinued operations                                   | 0.00                         | (0.04 )     |
| Net income attributable to common stockholders            | \$0.05                       | \$0.04      |
| WEIGHTED AVERAGE COMMON SHARES OUTSTANDING—BASIC          | 98,360                       | 94,152      |
| WEIGHTED AVERAGE COMMON SHARES OUTSTANDING—DILUTED        | 99,137                       | 95,585      |
| DIVIDENDS DECLARED, PER COMMON SHARE, DURING THE PERIOD   | \$0.30                       | \$0.30      |

The accompanying notes, together with the Notes to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2014, are an integral part of these financial statements.

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Healthcare Realty Trust Incorporated  
 Condensed Consolidated Statements of Comprehensive Income  
 For the Three Months Ended March 31, 2015 and 2014  
 (Dollars in thousands)  
 (Unaudited)

|                                                          | Three Months Ended March<br>31, |          |
|----------------------------------------------------------|---------------------------------|----------|
|                                                          | 2015                            | 2014     |
| NET INCOME                                               | \$5,382                         | \$3,963  |
| Other comprehensive income (loss):                       |                                 |          |
| Income from noncontrolling interests                     | —                               | (111 )   |
| Unrecognized loss on cash flow hedges                    | (723 )                          | —        |
| Total other comprehensive loss                           | \$(723 )                        | \$(111 ) |
| COMPREHENSIVE INCOME ATTRIBUTABLE TO COMMON STOCKHOLDERS | \$4,659                         | \$3,852  |

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, 2014, are an integral part of these financial statements.

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Healthcare Realty Trust Incorporated  
Condensed Consolidated Statements of Cash Flows  
For the Three Months Ended March 31, 2015 and 2014  
(Dollars in thousands)  
(Unaudited)

|                                                                                   | Three Months Ended March<br>31, |           |
|-----------------------------------------------------------------------------------|---------------------------------|-----------|
|                                                                                   | 2015                            | 2014      |
| <b>OPERATING ACTIVITIES</b>                                                       |                                 |           |
| Net income                                                                        | \$5,382                         | \$3,963   |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                 |           |
| Depreciation and amortization                                                     | 30,214                          | 28,049    |
| Stock-based compensation                                                          | 1,617                           | 1,516     |
| Straight-line rent receivable                                                     | (2,858)                         | (2,303)   |
| Straight-line rent liability                                                      | 195                             | 108       |
| Impairments                                                                       | 3,328                           | 3,425     |
| Provision for bad debts, net                                                      | (208)                           | 47        |
| Changes in operating assets and liabilities:                                      |                                 |           |
| Other assets                                                                      | (2,914)                         | (3,087)   |
| Accounts payable and accrued liabilities                                          | (18,989)                        | (21,577)  |
| Other liabilities                                                                 | 1,337                           | (1,848)   |
| Net cash provided by operating activities                                         | 17,104                          | 8,293     |
| <b>INVESTING ACTIVITIES</b>                                                       |                                 |           |
| Acquisitions of real estate                                                       | (37,139)                        | —         |
| Development of real estate                                                        | (4,320)                         | —         |
| Acquisition of additional long-lived assets                                       | (11,161)                        | (15,882)  |
| Funding of mortgages and notes receivable                                         | —                               | (798)     |
| Proceeds from acquisition of real estate upon mortgage note receivable default    | —                               | 204       |
| Proceeds from mortgages and notes receivable repayments                           | 5                               | 4         |
| Net cash used in investing activities                                             | (52,615)                        | (16,472)  |
| <b>FINANCING ACTIVITIES</b>                                                       |                                 |           |
| Net borrowings (repayments) on unsecured credit facility                          | 57,000                          | (159,000) |
| Borrowings on term loan                                                           | —                               | 200,000   |
| Repayments on notes and bonds payable                                             | (16,468)                        | (1,462)   |
| Dividends paid                                                                    | (29,832)                        | (28,802)  |
| Net proceeds from issuance of common stock                                        | 31,910                          | 374       |
| Common stock redemptions                                                          | (201)                           | (227)     |
| Distributions to noncontrolling interest holders                                  | —                               | (32)      |
| Debt issuance and assumption costs                                                | —                               | (1,174)   |
| Net cash provided by financing activities                                         | 42,409                          | 9,677     |
| Increase in cash and cash equivalents                                             | 6,898                           | 1,498     |
| Cash and cash equivalents, beginning of period                                    | 3,519                           | 8,671     |
| Cash and cash equivalents, end of period                                          | \$10,417                        | \$10,169  |

## Supplemental Cash Flow Information:

|                                                                                   |          |          |
|-----------------------------------------------------------------------------------|----------|----------|
| Interest paid                                                                     | \$25,313 | \$25,153 |
| Invoices accrued for construction, tenant improvement and other capitalized costs | \$4,247  | \$6,988  |

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, 2014, are an integral part of these financial statements.





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Healthcare Realty Trust Incorporated

Notes to Condensed Consolidated Financial Statements

March 31, 2015

(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 \$3.3 billion in 199 real estate properties and mortgages as of March 31, 2015. The Company’s 198 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 9.5 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, 2014. 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, 2014. 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, 2015 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.

Fair Value of Derivative Financial Instruments

Derivative financial instruments are recorded at fair value on the Company's Condensed Consolidated Balance Sheets as other assets or other liabilities. The valuation of derivative instruments requires the Company to make estimates and judgments that affect the fair value of the instruments. Fair values of derivatives are estimated by pricing models that consider the forward yield curves and discount rates. The fair value of the Company's forward exchange contracts are estimated by pricing models that consider foreign trade rates and discount rates. Such amounts and the recognition of such amounts are subject to significant estimates that may change in the future. See Note 4 for additional information.

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Notes to Condensed Consolidated Financial Statements - Continued

New Accounting Pronouncements

Accounting Standards Update No. 2015-03

In April 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2015-03, "Simplifying the Presentation of Debt Issuance Costs." This standard requires debt issuance costs to be reported in the balance sheet as a direct reduction from the face amount of the note in which it is directly related.

This standard is effective for the Company beginning on January 1, 2016 with early adoption permitted, on a retrospective basis, wherein the balance sheet of each individual period presented should be adjusted to reflect the period-specific effects of applying the new guidance. Upon transition, the Company is required to comply with the applicable disclosures for a change in an accounting principle. The Company does not expect the adoption of this standard to have a material impact on the Company's consolidated financial position or cash flows.

Accounting Standards Update No. 2014-08

In April 2014, the FASB issued ASU 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 was permitted but only for disposals (or classifications as held for sale) that had not been reported in financial statements previously issued. The Company adopted this standard on the effective date of January 1, 2015 and does not expect it to have a material impact on the Company's consolidated financial position or cash flows, but it could have a material impact on the presentation of the Consolidated Statement of Operations.

Accounting Standards Update No. 2014-09

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers", a comprehensive new revenue recognition standard that supersedes most 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. However, the FASB issued an exposure draft on April 29, 2015 that would defer the effective date one year. The Company has not yet determined the effects on the Consolidated Financial Statements and related notes resulting from the adoption of this new standard.

Reclassifications

Certain amounts in the Company's Condensed Consolidated Balance Sheets have been reclassified for the current period presentation of assets held for sale and related liabilities.

Note 2. Real Estate Investments

2015 Acquisition

In January 2015, the Company acquired a 110,679 square foot medical office building in California for a purchase price and cash consideration of \$39.3 million. The property is located adjacent to two hospital campuses, Kaiser Permanente, a 106-bed hospital, and Washington Hospital Healthcare System, a 353-bed hospital. Upon acquisition,

this property was 97% leased, with leases to the two hospitals comprising 59% of the rentable square footage.

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## Notes to Condensed Consolidated Financial Statements - Continued

## Assets Held for Sale

During the first quarter of 2015, the Company reclassified one off-campus medical office building to held for sale in connection with management's decision to sell the property. The Company expects that the property will be sold during 2015. The Company recorded an impairment charge of \$3.3 million to record the property at estimated fair value less costs to sell, which was based on a purchase and sale agreement, a level 3 input, that was subsequently terminated. At March 31, 2015 and December 31, 2014, the Company had three and two properties classified as held for sale, respectively.

The table below reflects the assets and liabilities of the properties classified as held for sale as of March 31, 2015 and December 31, 2014.

| (Dollars in thousands)                                | March 31,<br>2015 | December 31,<br>2014 |
|-------------------------------------------------------|-------------------|----------------------|
| Balance Sheet data:                                   |                   |                      |
| Land                                                  | \$2,524           | \$422                |
| Buildings, improvements and lease intangibles         | 21,513            | 12,822               |
| Personal property                                     | 21                | 13                   |
|                                                       | 24,058            | 13,257               |
| Accumulated depreciation                              | (10,322)          | (4,464)              |
| Assets held for sale, net                             | 13,736            | 8,793                |
| Other assets, net (including receivables)             | 428               | 353                  |
| Assets of discontinued operations, net                | 428               | 353                  |
| Assets held for sale and discontinued operations, net | \$14,164          | \$9,146              |
| Accounts payable and accrued liabilities              | \$93              | \$86                 |
| Other liabilities                                     | 9                 | 286                  |
| Liabilities of discontinued operations                | \$102             | \$372                |

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## Notes to Condensed Consolidated Financial Statements - Continued

## Discontinued Operations

The Company adopted Accounting Standards Update No. 2014-08, "Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity" during the first quarter of 2015. As of December 31, 2014, the Company had two properties classified as held for sale and recorded in discontinued operations. These two properties will remain classified as discontinued operations until the properties are sold. During the three months ended March 31, 2015, the Company reclassified a property to held for sale upon management's decision to sell the property that did not meet the amended criteria as a discontinued operation. Therefore, the operating results of the property is not included in the table below which reflects the results of operations of the properties included in discontinued operations on the Company's Condensed Consolidated Statements of Operations for the three months ended March 31, 2015 and 2014.

|                                            | Three Months Ended March 31, |            |
|--------------------------------------------|------------------------------|------------|
| (Dollars in thousands)                     | 2015                         | 2014       |
| Statements of Operations data:             |                              |            |
| Revenues                                   |                              |            |
| Rental income                              | \$341                        | \$1,585    |
| Other Operating Income                     | —                            | 1          |
|                                            | 341                          | 1,586      |
| Expenses                                   |                              |            |
| Property operating                         | 29                           | 1,113      |
| General and administrative                 | —                            | 7          |
| Depreciation                               | —                            | 555        |
| Bad debts, net of recoveries               | (1)                          | —          |
|                                            | 28                           | 1,675      |
| Other Income (Expense)                     |                              |            |
| Interest and other income, net             | 20                           | —          |
|                                            | 20                           | —          |
| Discontinued Operations                    |                              |            |
| Income (loss) from discontinued operations | 333                          | (89 )      |
| Impairments                                | —                            | (3,425 )   |
| Income (Loss) from Discontinued Operations | \$333                        | \$(3,514 ) |

## Note 3. Notes and Bonds Payable

## First Quarter

In January 2015, the Company repaid in full a secured loan from Wells Fargo Commercial Mortgage bearing an interest rate of 5.45% consisting of outstanding principal of \$15.0 million and accrued interest as of the redemption date of \$0.1 million.

## Subsequent Activity

On April 1, 2015, the Company repaid in full a secured loan from Wells Fargo Commercial Mortgage bearing an interest rate of 5.0% consisting of principal of \$10.2 million.

On April 24, 2015, the Company issued \$250.0 million of unsecured senior notes due 2025 (the "Senior Notes due 2025") in a registered public offering. The Senior Notes due 2025 bear interest at 3.875%, payable semi-annually on May 1 and November 1, beginning November 1, 2015, and are due on May 1, 2025, unless redeemed earlier by the Company. The notes were issued at a discount of approximately \$0.2 million, which yielded a 3.885% interest rate per annum upon issuance. The Company incurred approximately \$2.1 million in debt issuance costs that are included in Other assets, which will be amortized to maturity using the effective interest method. See Note 4 for discussion

regarding the concurrent termination of the four forward starting interest rate swaps and related impact. The Senior Notes due 2025 have various financial covenants that are required to be met on a quarterly and annual basis.

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## Notes to Condensed Consolidated Financial Statements - Continued

Also in April 2015, the Company issued a notice of its intent to redeem its unsecured senior notes due 2017 on May 15, 2015 at a redemption price equal to an aggregate of \$333.2 million, consisting of outstanding principal of \$300.0 million, accrued interest of \$6.4 million, and a "make-whole" amount of approximately \$26.8 million for the early extinguishment of debt. The unaccreted discount and unamortized costs on these notes of \$1.2 million will be written off upon redemption. In the second quarter of 2015, the Company expects to recognize a loss on early extinguishment of debt of approximately \$28.0 million related to this redemption.

On May 4, 2015, the Company repaid in full a mortgage note payable bearing an interest rate of 5.41% consisting of outstanding principal of \$16.3 million and accrued interest as of the redemption date of \$0.1 million.

**Note 4. Derivative Financial Instruments****Risk Management Objective of Using Derivatives**

In addition to operational risks which arise in the normal course of business, the Company is exposed to economic risks such as interest rate, liquidity, and credit risk. In certain situations, the Company may enter into derivative financial instruments such as interest rate swap and interest rate cap agreements to manage interest rate risk exposure arising from variable rate debt transactions that result in the receipt or payment of future known and uncertain cash amounts, the value of which are determined by interest rates. The Company's objective in using interest rate derivatives is to manage its exposure to interest rate movements.

**Cash Flow Hedges of Interest Rate Risk**

Interest rate swaps designated as cash flow hedges involve the receipt of variable-rate amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without changing the underlying notional amount.

During the three months ended March 31, 2015, the Company entered into two forward starting interest rate swaps with a total notional value of \$125.0 million to hedge the risk of changes in the interest-related cash flows associated with the potential issuance of long-term debt that was issued in April 2015 as discussed in Note 3. The Company was hedging its exposure to the variability in future cash flows for forecasted transactions. As of March 31, 2015, the Company had hedged \$125.0 million associated with the potential incurrence of long-term debt.

A detail of the Company's interest rate derivatives outstanding as of March 31, 2015 is as follows (in thousands):

| Interest Rate Derivative | Notional Amount |
|--------------------------|-----------------|
| Interest Rate Swaps      | \$ 125,000      |

The Company has elected to present its interest rate derivatives on its Condensed Consolidated Balance Sheets on a gross basis as interest rate swap assets and interest rate swap liabilities. A detail of the Company's fair value of interest rate derivatives on a gross and net basis as of March 31, 2015 is as follows (in thousands):

| Interest Rate Swaps Classified as: | Fair Value of Derivative Instruments |
|------------------------------------|--------------------------------------|
| Gross derivative liabilities       | \$(723 )                             |
| Derivative liability               | \$(723 )                             |

All of the Company's interest rate swap agreements outstanding for the three months ended March 31, 2015 were designated as cash flow hedges of interest rate risk. The effective portion of the changes in fair value of derivatives designated as, and that qualify as, cash flow hedges is recorded in other comprehensive income (loss) ("OCI") and will be reclassified into earnings as interest expense in the period that the hedged forecasted transaction affects earnings.





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## Notes to Condensed Consolidated Financial Statements - Continued

The following presents the impacts of derivative instruments on the Condensed Consolidated Statements of Comprehensive Income for the three months ended March 31, 2015 (in thousands):

|                                                                          | Location | For the Three Months<br>Ended March 31,<br>2015 |
|--------------------------------------------------------------------------|----------|-------------------------------------------------|
| Loss on forward starting interest rate swap agreements recognized in OCI | OCI      | \$723                                           |

The Company estimates that an additional \$0.2 million will be reclassified from accumulated other comprehensive loss as an increase to interest expense over the next 12 months. No gain or loss was recognized related to hedge ineffectiveness or to amounts excluded from effectiveness testing on the Company's cash flow hedges during the three months ended March 31, 2015.

**Credit-risk-related Contingent Features**

The Company has agreements with its derivative counterparties that contain a provision whereby if the Company defaults on any of its indebtedness, including default where repayment of the indebtedness has not been accelerated by the lender, then the Company could also be declared in default on its derivative obligations. If the Company were to breach any of the contractual provisions of the derivative contracts, it would be required to settle its obligations under the agreements at their termination value including accrued interest, or approximately \$0.7 million at March 31, 2015. Additionally, the Company does have rights of set-off under certain of its derivative agreements related to potential termination fees and amounts payable under the agreements, if a termination were to occur.

**Subsequent Activity**

On April 1 and April 3, 2015, the Company entered into two forward starting swap agreements with a total notional value of \$62.5 million and \$37.5 million, respectively.

On April 24, 2015 and in conjunction with the Company's issuance of the Senior Notes due 2025, the Company settled the four previously outstanding forward starting swap agreements for a loss of approximately \$1.7 million. The loss was recorded as accumulated other comprehensive income and is being amortized as additional interest expense over the ten-year term of the Senior Notes due 2025 resulting in an effective interest rate of 3.97%. The Company classifies cash flows from the settlement of hedging derivative instruments in the same category as the underlying exposure which is being hedged. As the cash settlement of approximately \$1.7 million was the result of hedging the Company's exposure to interest rate changes and their effect on interest expense, such cash settlement is classified as an operating cash flow in the accompanying consolidated statements of cash flows. See Note 3 for more information on the bond issuance.

**Note 5. 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.

**Redevelopment Activity**

The Company is in the process of redeveloping two properties in Tennessee and will begin constructing an expansion of one of the buildings beginning in the second quarter of 2015. The Company has spent approximately \$9.4 million toward these projects through March 31, 2015, including the acquisition of a land parcel for \$4.3 million on which the Company intends to build a parking garage. The total estimated budget of the redevelopment of these properties is

expected to be \$47.8 million and the project is expected to be completed near the end of 2016.

The Company will commence redevelopment of a property in Alabama, which will include building a parking garage. Construction is expected to begin in the second quarter of 2015. The total redevelopment budget is \$15.4 million, of which \$1.5 million has been spent as of March 31, 2015. Construction is expected to be completed at the beginning of 2016.

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## Notes to Condensed Consolidated Financial Statements - Continued

## Note 6. Stockholders' Equity

The following table provides a reconciliation of total stockholders' equity for the three months ended March 31, 2015:

| (Dollars in thousands, except per share data)       | Common Stock | Additional Paid-In Capital | Accumulated Other Comprehensive Loss | Cumulative Net Income Attributable to Common Stockholders | Cumulative Dividends | Total Stockholders' Equity |
|-----------------------------------------------------|--------------|----------------------------|--------------------------------------|-----------------------------------------------------------|----------------------|----------------------------|
| Balance at December 31, 2014                        | \$ 988       | \$2,389,830                | \$ (2,519                            | ) \$ 840,249                                              | \$(2,007,494)        | \$1,221,054                |
| Issuance of common stock                            | 12           | 31,876                     | —                                    | —                                                         | —                    | 31,888                     |
| Common stock redemptions                            | —            | (201                       | )—                                   | —                                                         | —                    | (201 )                     |
| Stock-based compensation                            | 1            | 1,616                      | —                                    | —                                                         | —                    | 1,617                      |
| Net income                                          | —            | —                          | —                                    | 5,382                                                     | —                    | 5,382                      |
| Loss on forward starting interest rate swaps        | —            | —                          | (723                                 | ) —                                                       | —                    | (723 )                     |
| Dividends to common stockholders (\$0.30 per share) | —            | —                          | —                                    | —                                                         | (29,832              | )(29,832 )                 |
| Balance at March 31, 2015                           | \$ 1,001     | \$2,423,121                | \$ (3,242                            | ) \$ 845,631                                              | \$(2,037,326)        | \$1,229,185                |

The following table discloses changes in the balances of each component of accumulated comprehensive loss for the three months ended March 31, 2015:

|                                         | Forward-starting Interest Rate Swaps | Defined Benefit Pension Plans | Accumulated Other Comprehensive Loss |
|-----------------------------------------|--------------------------------------|-------------------------------|--------------------------------------|
| Beginning balance                       | \$—                                  | \$(2,519                      | ) \$(2,519 )                         |
| Current-period other comprehensive loss | (723                                 | ) —                           | (723 )                               |
| Ending balance                          | \$(723                               | ) \$(2,519                    | ) \$(3,242 )                         |

## Common Stock

The following table provides a reconciliation of the beginning and ending shares of common stock outstanding for the three months ended March 31, 2015 and the year ended December 31, 2014:

|                                   | March 31, 2015 | December 31, 2014 |
|-----------------------------------|----------------|-------------------|
| Balance, beginning of period      | 98,828,098     | 95,924,339        |
| Issuance of common stock          | 1,176,702      | 3,073,445         |
| Nonvested share-based awards, net | 81,786         | (169,686 )        |
| Balance, end of period            | 100,086,586    | 98,828,098        |

## At-The-Market Equity Offering Program

During the three months ended March 31, 2015, the Company sold 1,140,362 shares of common stock under its at-the-market equity offering program, generating \$31.2 million in net proceeds at prices ranging from \$26.35 to \$29.15 per share (weighted average of \$27.78 per share). In April 2015, the Company sold 304,752 shares of common stock, generating \$8.3 million in net proceeds at prices ranging from \$27.04 to \$28.00 per share (weighted average of \$27.77 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 936,525 authorized shares remaining available to be sold under the these agreements as of May 1, 2015.

#### Common Stock Dividends

During the first three months of 2015, the Company declared and paid common stock dividends totaling \$0.30 per share. On May 5, 2015, the Company declared a quarterly common stock dividend in the amount of \$0.30 per share payable on May 29, 2015 to stockholders of record on May 18, 2015.

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## 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 months ended March 31, 2015 and 2014.

|                                                                       | Three Months Ended March 31, |              |
|-----------------------------------------------------------------------|------------------------------|--------------|
|                                                                       | 2015                         | 2014         |
| (Dollars in thousands, except per share data)                         |                              |              |
| Weighted average Common Shares outstanding                            |                              |              |
| Weighted average Common Shares outstanding                            | 99,467,804                   | 96,009,788   |
| Nonvested shares                                                      | (1,107,846 )                 | (1,857,536 ) |
| Weighted average Common Shares outstanding—Basic                      | 98,359,958                   | 94,152,252   |
| Weighted average Common Shares—Basic                                  | 98,359,958                   | 94,152,252   |
| Dilutive effect of restricted stock                                   | 615,511                      | 1,299,287    |
| Dilutive effect of employee stock purchase plan                       | 161,428                      | 133,893      |
| Weighted average Common Shares outstanding—Diluted                    | 99,136,897                   | 95,585,432   |
| Net Income (Loss)                                                     |                              |              |
| Income from continuing operations                                     | \$5,049                      | \$7,477      |
| Noncontrolling interests' share in net loss                           | —                            | (111 )       |
| Income from continuing operations attributable to common stockholders | 5,049                        | 7,366        |
| Discontinued operations                                               | 333                          | (3,514 )     |
| Net income attributable to common stockholders                        | \$5,382                      | \$3,852      |
| Basic Earnings (Loss) Per Common Share                                |                              |              |
| Income from continuing operations                                     | \$0.05                       | \$0.08       |
| Discontinued operations                                               | 0.00                         | (0.04 )      |
| Net income attributable to common stockholders                        | \$0.05                       | \$0.04       |
| Diluted Earnings (Loss) Per Common Share                              |                              |              |
| Income from continuing operations                                     | \$0.05                       | \$0.08       |
| Discontinued operations                                               | 0.00                         | (0.04 )      |
| Net income attributable to common stockholders                        | \$0.05                       | \$0.04       |

## 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 three months ended March 31, 2015 and 2014, the Company issued 89,068 and 101,522 shares of nonvested common stock, respectively, to participants under these incentive plans and withheld 7,282 and 9,974 shares of common stock, respectively, from participants to pay estimated withholding taxes related to shares that vested.

A summary of the activity under the stock-based incentive plans for the three months ended March 31, 2015 and 2014 is included in the table below.

|                                         | Three Months Ended March 31, |           |
|-----------------------------------------|------------------------------|-----------|
|                                         | 2015                         | 2014      |
| Stock-based awards, beginning of period | 1,057,732                    | 1,788,168 |
| Granted                                 | 89,068                       | 101,522   |
| Vested                                  | (28,386 )                    | (34,365 ) |
| Stock-based awards, end of period       | 1,118,414                    | 1,855,325 |

The Company recorded approximately \$0.2 million in general and administrative expenses during the first quarter of 2015 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.



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## Notes to Condensed Consolidated Financial Statements - Continued

A summary of the activity under the Employee Stock Purchase Plan for the three months ended March 31, 2015 and 2014 is included in the table below.

|                                                  | Three Months Ended March 31, |           |
|--------------------------------------------------|------------------------------|-----------|
|                                                  | 2015                         | 2014      |
| Outstanding and exercisable, beginning of period | 393,902                      | 391,108   |
| Granted                                          | 197,640                      | 275,655   |
| Exercised                                        | (33,046)                     | (18,502)  |
| Forfeited                                        | (20,779)                     | (22,426)  |
| Expired                                          | (158,946)                    | (157,875) |
| Outstanding and exercisable, end of period       | 378,771                      | 467,960   |

## Note 7. 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 March 31, 2015, 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 months ended March 31, 2015 and 2014 is detailed in the following table.

|                                               | Three Months Ended March 31, |       |
|-----------------------------------------------|------------------------------|-------|
| (Dollars in thousands)                        | 2015                         | 2014  |
| Service cost                                  | \$21                         | \$22  |
| Interest cost                                 | 169                          | 172   |
| Amortization of net gain (loss)               | (149)                        | 117   |
| Amortization of prior service cost            | 258                          | (297) |
| Total recognized in net periodic benefit cost | \$299                        | \$14  |

## Subsequent Activity

Effective May 5, 2015, the Company terminated its Executive Retirement Plan. The Company will settle benefits under the plan by paying the plan participants lump sum amounts. In accordance with Section 409A of the Internal Revenue Code, these amounts will be paid no earlier than twelve and no later than twenty-four months following the termination date. The Second Amendment to the Second Amended and Restated Executive Retirement Plan (the "Termination Amendment"), which provides for the termination of the plan, is filed with this Quarterly Report on Form 10-Q as Exhibit 10.1. Additional information regarding the Executive Retirement Plan can be found in the Company's proxy statement filed with the Securities and Exchange Commission in connection with the Company's annual meeting of shareholders to be held on May 12, 2015.

At March 31, 2015, the Company recognized a total benefit obligation of \$16.8 million in connection with the Executive Retirement Plan. The Company expects the total costs associated with the termination of the Executive Retirement Plan to be approximately \$19.6 million and that it will record a current period charge in the second quarter of 2015 of approximately \$5.3 million, inclusive of the acceleration of \$2.5 million recorded in accumulated other comprehensive income (loss) on the consolidated balance sheet that was being amortized. The charge includes amounts resulting from assumed additional years of service for plan participants who have not reached age 65 and payments associated with FICA and other tax obligations.

The Company's chairman and chief executive officer, Mr. David Emery, is the only named executive officer that is a participant under the plan. As a result of the termination, Mr. Emery will receive a lump sum amount equal to his accrued benefit under the plan of approximately \$14.4 million. The Company expects that Mr. Emery and the other officer participants will take the settlement payments in Company stock, but can elect to receive cash.

The preceding summary is qualified in its entirety by the full text of the Termination Amendment and, in the event of any discrepancy, the text of the Termination Amendment shall control.



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## Notes to Condensed Consolidated Financial Statements - Continued

## Note 8. Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instrument for which it is practical to estimate that value.

Cash and cash equivalents - The carrying amount approximates fair value.

Mortgage notes receivable - 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.

Borrowings under the unsecured credit facility due 2017 - The carrying amount approximates fair value because the borrowings are based on variable interest rates.

Senior unsecured notes payable - 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.

Mortgage notes payable - The fair value is estimated using cash flow analyses, based on the Company's current interest rates for similar types of borrowing arrangements.

Interest rate swap agreements - Interest rate swap agreements are recorded in other liabilities on the Company's Condensed Consolidated Balance Sheets at fair value. Fair value is estimated by utilizing pricing models that consider forward yield curves and discount rates.

The table below details the fair values and carrying values for notes and bonds payable, mortgage notes receivable and interest rate swaps at March 31, 2015 and December 31, 2014.

| (Dollars in millions)                    | March 31, 2015 |            | December 31, 2014 |            |
|------------------------------------------|----------------|------------|-------------------|------------|
|                                          | Carrying Value | Fair Value | Carrying Value    | Fair Value |
| Notes and bonds payable <sup>(1)</sup>   | \$1,444.6      | \$1,487.5  | \$1,403.7         | \$1,438.8  |
| Mortgage notes receivable <sup>(2)</sup> | \$1.9          | \$1.9      | \$1.9             | \$1.9      |
| Interest rate swaps <sup>(2)</sup>       | \$0.7          | \$0.7      | \$—               | \$—        |

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

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

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

#### Disclosure Regarding Forward-Looking Statements

This report and other materials the Company has filed or may file with the Securities and Exchange Commission, as well as information included in oral statements or other written statements made, or to be made, by 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, 2014, 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, 2014.

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 due 2017 ("Unsecured Credit Facility"), proceeds from the sales of real estate properties, the repayment 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 described above. The Company had unencumbered real estate assets with a gross book value of approximately \$2.9 billion at March 31, 2015, 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 three months ended March 31, 2015 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 2015 can be funded by cash flows from operations.

#### Investing Activities

Cash flows used in investing activities for the three months ended March 31, 2015 were approximately \$52.6 million. Below is a summary of the significant investing activities.

In January 2015, the Company acquired a 110,679 square foot medical office building in California for a purchase price and cash consideration of \$39.3 million. The property is located adjacent to two hospital campuses, Kaiser Permanente, a 106-bed hospital, and Washington Hospital Healthcare System, a 353-bed hospital. Upon acquisition, this property was 97% leased, with leases to the two hospitals comprising 59% of the rentable square footage.

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The Company is in the process of redeveloping two properties in Tennessee and will begin constructing an expansion of one of the buildings beginning in the second quarter of 2015. The Company has spent approximately \$9.4 million toward these projects through March 31, 2015, including the acquisition of a land parcel for \$4.3 million on which the Company intends to build a parking garage. The total estimated budget of the redevelopment of these properties is expected to be \$47.8 million and the project is expected to be completed near the end of 2016.

The Company is in the process of redeveloping a property in Alabama, which will include building a parking garage. The total redevelopment budget is \$15.4 million, of which \$1.5 million has been spent as of March 31, 2015. Construction is expected to be completed at the beginning of 2016.

### Financing Activities

Cash flows provided by financing activities for the three months ended March 31, 2015 were approximately \$42.4 million. Inflows from accessing the debt and equity markets totaled \$88.9 million, net of costs incurred. Aggregate cash outflows totaled approximately \$46.5 million primarily associated with dividends paid to common stockholders and repayments of indebtedness. See Notes 3 and 6 to the Condensed Consolidated Financial Statements for more information on capital markets and financing activities.

### Changes in Debt Structure

In January 2015, the Company repaid in full a secured loan from Wells Fargo Commercial Mortgage bearing an interest rate of 5.45% consisting of outstanding principal of \$15.0 million and accrued interest as of the redemption date of \$0.1 million.

As of March 31, 2015, the Company's outstanding balance on the Unsecured Credit Facility was \$142.0 million, with a remaining borrowing capacity of approximately \$558.0 million. The Company's leverage ratio [debt divided by (debt plus stockholders' equity less intangible assets plus accumulated depreciation)] was approximately 42.6%.

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 March 31, 2015, the Company was in compliance with the financial covenant provisions under all of its various debt instruments.

### Subsequent Activity

On April 1, 2015, the Company repaid in full a secured loan from Wells Fargo Commercial Mortgage bearing an interest rate of 5.0% consisting of principal of \$10.2 million.

On April 24, 2015, the Company issued \$250.0 million of unsecured senior notes due 2025 (the "Senior Notes due 2025") in a registered public offering. The Senior Notes due 2025 bear interest at 3.875%, payable semi-annually on May 1 and November 1, beginning November 1, 2015, and are due on May 1, 2025, unless redeemed earlier by the Company. The notes were issued at a discount of approximately \$0.2 million, which yielded a 3.885% interest rate per annum upon issuance. The Company incurred approximately \$2.1 million in debt issuance costs that are included in Other assets, which will be amortized to maturity. Concurrent with this transaction, the Company settled four forward starting swap agreements and paid \$1.7 million. The Senior Notes due 2025 have various financial covenants that are required to be met on a quarterly and annual basis.

Also in April 2015, the Company issued a notice of its intent to redeem its unsecured senior notes due 2017 on May 15, 2015 at a redemption price equal to an aggregate of \$333.2 million, consisting of outstanding principal of \$300.0 million, accrued interest of \$6.4 million, and a "make-whole" amount of approximately \$26.8 million for the

early extinguishment of debt. The unaccreted discount and unamortized costs on these notes of \$1.2 million will be written off upon redemption. In the second quarter of 2015, the Company expects to recognize a loss on early extinguishment of debt of approximately \$28.0 million related to this redemption.

On May 4, 2015, the Company repaid in full a mortgage note payable bearing an interest rate of 5.41% consisting of outstanding principal of \$16.3 million and accrued interest as of the redemption date of \$0.1 million.

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### Common Stock Issuances

During the three months ended March 31, 2015, the Company sold 1,140,362 shares of common stock under its at-the-market equity offering program, generating \$31.2 million in net proceeds at prices ranging from \$26.35 to \$29.15 per share (weighted average of \$27.78 per share). In April 2015 the Company sold 304,752 shares of common stock, generating \$8.3 million in net proceeds at prices ranging from \$27.04 to \$28.00 per share (weighted average of \$27.77 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 936,525 authorized shares remaining available to be sold under the these agreements as of May 1, 2015.

### Operating Activities

Cash flows provided by operating activities increased from \$8.3 million for the three months ended March 31, 2014 to \$17.1 million for the three months ended March 31, 2015. 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.

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 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, 2014, 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 15% to 20% of the leases in its multi-tenanted portfolio will expire each year in the ordinary course of business. There are 411 leases that have expired, or will expire during 2015 including those in holdover. Approximately 89% of the leases expiring in 2015 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 90% of multi-tenant property leases to renew upon expiration, and the renewals for the first three months of the year are within this range.

### 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 appeal 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 March 31, 2015, 83% of the Company's multi-tenant leased square footage allows for some

recovery of operating expenses, with 50% recovering all allowable expenses.

#### Termination of Defined Benefit Plan

The Company has had a defined benefit pension plan, referred to elsewhere in this report as the "Executive Retirement Plan" since its inception that provides benefits for three founding officers and the surviving spouse of another founding officer. No participants have been added to the plan since 1994. The plan is subject to non-cash valuation fluctuations each year based on changes in mortality assumptions and changing discount rates. Given these fluctuations and the applicability of the plan to only a small number of Company employees, the Company has decided to terminate the plan to eliminate a level of volatility and uncertainty to the Company's financial results. See Note 7 in this Form 10-Q for additional information regarding the plan termination and the future payments of benefits to the plan participants.

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### 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.

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 months ended March 31, 2015 compared to the same period in 2014 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.





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The table below reconciles FFO to net income attributable to common stockholders for the three months ended March 31, 2015 and 2014:

|                                                    | Three Months Ended March 31, |          |
|----------------------------------------------------|------------------------------|----------|
| (Amounts in thousands, except per share data)      | 2015                         | 2014     |
| Net Income Attributable to Common Stockholders     | \$5,382                      | \$3,852  |
| Impairments                                        | 3,328                        | 3,425    |
| Real estate depreciation and amortization          | 28,532                       | 26,248   |
| Total adjustments                                  | 31,860                       | 29,673   |
| Funds from Operations                              | \$37,242                     | \$33,525 |
| Funds from Operations per Common Share—Basic       | \$0.38                       | \$0.36   |
| Funds from Operations per Common Share—Diluted     | \$0.38                       | \$0.35   |
| Weighted Average Common Shares Outstanding—Basic   | 98,360                       | 94,152   |
| Weighted Average Common Shares Outstanding—Diluted | 99,137                       | 95,585   |

## Same Store Net Operating Income

Net operating income ("NOI") and same store NOI are non-GAAP historical financial measures of performance. Management considers same store NOI a supplemental measure because it allows investors, analysts and Company management to measure unlevered property-level operating results. The Company defines NOI as operating revenues (property operating revenue, single-tenant net lease revenue, and property lease guaranty revenue) 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. Same store NOI is historical and not necessarily indicative of future results.

The following table reflects the Company's same store NOI for the three months ended March 31, 2015 and 2014.

|                                    |                                     |                              | Same Store NOI for the Three Months Ended March 31, |          |
|------------------------------------|-------------------------------------|------------------------------|-----------------------------------------------------|----------|
| (Dollars in thousands)             | Number of Properties <sup>(1)</sup> | Investment at March 31, 2015 | 2015                                                | 2014     |
| Multi-tenant Properties            | 129                                 | \$2,017,988                  | \$35,348                                            | \$33,087 |
| Single-tenant Net Lease Properties | 33                                  | 504,370                      | 12,757                                              | 12,166   |
| Total                              | 162                                 | \$2,522,358                  | \$48,105                                            | \$45,253 |

(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 are 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 are excluded from the same store analysis. In addition, the Company excludes properties that have less than 60% occupancy or that experience a loss of occupancy over 30% in a single quarter that is expected to continue for a period of at least two quarters.



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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 March 31, |           |
|---------------------------------------------------|------------------------------|-----------|
|                                                   | 2015                         | 2014      |
| Rental income                                     | \$95,034                     | \$86,502  |
| Rental lease guaranty income <sup>(a)</sup>       | 1,102                        | 1,141     |
| Property operating expense                        | (34,263                      | ) (32,831 |
| Exclude Straight-line rent revenue <sup>(b)</sup> | (2,832                       | ) (2,297  |
| NOI                                               | 59,041                       | 52,515    |
| NOI not included in same store                    | (10,936                      | ) (7,262  |
| Same store NOI                                    | \$48,105                     | \$45,253  |

## (a) Other operating income reconciliation:

|                              |         |         |
|------------------------------|---------|---------|
| Rental lease guaranty income | \$1,102 | \$1,141 |
| Interest income              | 157     | 192     |
| Management fee income        | 78      | 64      |
| Other                        | 54      | 51      |
|                              | \$1,391 | \$1,448 |

## (b) Rental income reconciliation:

|                         |          |          |
|-------------------------|----------|----------|
| Property operating      | \$74,654 | \$69,274 |
| Single-tenant net lease | 17,548   | 14,931   |
| Straight-line rent      | 2,832    | 2,297    |
|                         | \$95,034 | \$86,502 |

## Reconciliation of Same Store Property Count:

|                                    | Property Count as<br>of March 31, 2015 |
|------------------------------------|----------------------------------------|
| Same Store Properties              | 162                                    |
| Acquisitions                       | 18                                     |
| Reposition                         | 18                                     |
| Total Owned Real Estate Properties | 198                                    |

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## Results of Operations

## Three Months Ended March 31, 2015 Compared to Three Months Ended March 31, 2014

The Company's results of operations for the three months ended March 31, 2015 compared to the same period in 2014 were significantly impacted by acquisitions, dispositions, impairments recorded, gains on sales of real estate, capital markets transactions and changes due to the Company's adoption of Accounting Standards Update ("ASU") No. 2014-08, "Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity."

## Revenues

Rental income increased \$8.5 million, or 9.9%, to approximately \$95.0 million for the three months ended March 31, 2015 compared to \$86.5 million in the prior year period and is comprised of the following:

|                         | Three Months Ended March 31, |          | Change  |      |   |
|-------------------------|------------------------------|----------|---------|------|---|
| (Dollars in thousands)  | 2015                         | 2014     | \$      | %    | % |
| Property operating      | \$74,654                     | \$69,274 | \$5,380 | 7.8  | % |
| Single-tenant net lease | 17,548                       | 14,931   | 2,617   | 17.5 | % |
| Straight-line rent      | 2,832                        | 2,297    | 535     | 23.3 | % |
| Total rental income     | \$95,034                     | \$86,502 | \$8,532 | 9.9  | % |

Property operating income increased \$5.4 million, or 7.8%, from the prior year period as a result of the following activity:

- Acquisitions in 2014 and 2015 contributed \$4.1 million.
- Leasing activity including contractual rent increases contributed \$1.4 million.
- Conversion from single-tenant net lease caused an increase of \$0.2 million.
- Conversion to single-tenant net lease caused a decrease of \$0.3 million.

Single-tenant net lease revenue increased \$2.6 million, or 17.5%, from the prior year period as a result of the following activity:

- The Company's 2014 acquisitions contributed \$1.8 million.
- Leasing activity including contractual rent increases contributed \$0.8 million.
- Conversion to property operating income caused a decrease of \$0.4 million.
- Conversion from property operating income caused an increase of \$0.5 million.

Straight-line rent increased \$0.5 million, or 23.3%, from the prior year period primarily as a result of the Company's 2014 and 2015 acquisitions.

Mortgage interest income decreased \$2.6 million, or 98.8%, from the prior year period as a result of the following activity:

- Mortgage interest income decreased approximately \$1.0 million related to a mortgage note receivable that the Company received a deed in lieu of foreclosure during the first quarter of 2014.
- 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 \$1.5 million.
- Other payoffs, offset by fundings, resulted in a decrease of \$0.1 million.

## Expenses

Property operating expenses increased \$1.4 million, or 4.4%, for the three months ended March 31, 2015 compared to the prior year period primarily as a result of the Company's 2014 and 2015 acquisitions.

General and administrative expenses increased approximately \$0.8 million, or 12.8%, for the three months ended March 31, 2015 compared to the prior year period primarily due to non-cash compensation-related expenses of \$0.7 million.

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Depreciation expense increased \$2.7 million, or 11.5%, for the three months ended March 31, 2015 compared to the prior year period. Properties acquired in 2014 and 2015 contributed an increase of \$1.9 million. The remaining \$0.8 million increase is related to various building and tenant improvement expenditures.

Other income (expense)

Interest expense increased \$0.4 million for the three months ended March 31, 2015 compared to the prior year period.

The components of interest expense are as follows:

| (Dollars in thousands)                | 2015     | 2014     | Change | Percentage Change |   |
|---------------------------------------|----------|----------|--------|-------------------|---|
| Contractual interest                  | \$17,203 | \$16,919 | \$284  | 1.7               | % |
| Net discount/premium accretion        | 331      | 244      | 87     | 35.7              | % |
| Deferred financing costs amortization | 788      | 755      | 33     | 4.4               | % |
| Total interest expense                | \$18,322 | \$17,918 | \$404  | 2.3               | % |

Contractual interest increased \$0.3 million primarily due to the Unsecured Credit Facility and unsecured term loan due 2019.

In 2015, the Company recorded an impairment charge on a property that was reclassified to held for sale due to management's decision to sell to adjust the carrying value to fair value less costs to sell. The impairment charge is included in Income from Continuing Operations in the Company's Condensed Consolidated Statements of Operations. Prior to the Company's January 1, 2015 adoption of ASU No. 2014-08, "Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity," this impairment charge would have been recorded in discontinued operations.

#### Discontinued Operations

Results from discontinued operations for the three months ended March 31, 2015 were income of \$0.3 million compared to losses of \$3.5 million for the three months ended March 31, 2014. These amounts include the results of operations and impairments related to assets classified as held for sale or disposed of as of December 31, 2014. See Note 2 to the Company's Condensed Consolidated Financial Statements accompanying this report for more detail, regarding the impact of the Company's January 1, 2015 adoption of ASU No. 2014-08, "Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity."

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

The Company is exposed to market risk in the form of changing interest rates on its debt and mortgage notes and other notes receivable. Management uses regular monitoring of market conditions and analysis techniques to manage this risk. During the three months ended March 31, 2015, 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, 2014.

#### Item 4. Controls and Procedures

##### Disclosure Controls and Procedures

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

##### Changes in Internal Control over Financial Reporting

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

materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.



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## PART II—OTHER INFORMATION

## Item 1. Legal Proceedings

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, 2014, 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, 2014, 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 2. Unregistered Sales of Equity Securities and Use of Proceeds

During the three months ended March 31, 2015, the Company withheld shares of Company common stock to satisfy employee tax withholding obligations payable upon the vesting of nonvested stock, as follows:

| Period                   | Total Number of<br>Shares Purchased | Average Price<br>Paid per Share | Total Number of<br>Shares Purchased as<br>Part of Publicly<br>Announced Plans or<br>Programs | Maximum Number of<br>Shares that May Yet<br>Be Purchased Under<br>the Plans or Programs |
|--------------------------|-------------------------------------|---------------------------------|----------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------|
| January 1 - January 31   | 6,197                               | 27.32                           | —                                                                                            | —                                                                                       |
| February 1 - February 28 | 1,085                               | 29.65                           | —                                                                                            | —                                                                                       |
| March 1 - March 31       | —                                   | —                               | —                                                                                            | —                                                                                       |
| Total                    | 7,282                               |                                 |                                                                                              |                                                                                         |

## Item 5. Other Information

The information in Note 7 to the Condensed Consolidated Financial Statements included in this Form 10-Q, under the heading "Subsequent Event" regarding the termination of the Company's defined benefit pension plan is incorporated herein by reference.

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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 4.3 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 4.5 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 4.7 thereto) <sup>(6)</sup>                                                                                                           |
| Exhibit 4.9  | Sixth Supplemental Indenture, dated April 24, 2015, by and between the Company and Regions Bank, as Trustee <sup>(7)</sup>                                                                                                                             |
| Exhibit 4.10 | Form of 3.875% Senior Notes due 2025 (set forth in Exhibit B to the Sixth Supplemental Indenture filed as Exhibit 4.9 thereto) <sup>(7)</sup>                                                                                                          |
| Exhibit 10.1 | Second Amendment to Healthcare Realty Trust Incorporated Second Amended and Restated Executive Retirement Plan, dated as of May 5, 2015 (filed herewith)                                                                                               |
| 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   |                                                                                                                                                                                                                                                        |

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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  
101.LAB XBRL Taxonomy Extension Labels Linkbase Document (filed herewith)

Exhibit  
101.DEF XBRL Taxonomy Extension Definition Linkbase Document (filed herewith)

Exhibit  
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.

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SIGNATURE

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

HEALTHCARE REALTY TRUST INCORPORATED

By: /s/ SCOTT W. HOLMES

Scott W. Holmes

Executive Vice President and Chief Financial  
Officer

Date: May 6, 2015

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Exhibit Index

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