

HEALTHCARE REALTY TRUST INC

Form 10-K

February 22, 2012

[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

(Mark One)

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

For the fiscal year ended: December 31, 2011

OR

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

For the transition period **to**

Commission File Number: 1-11852

HEALTHCARE REALTY TRUST INCORPORATED

(Exact name of Registrant as specified in its charter)

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Maryland
(State or other jurisdiction of

62-1507028
(I.R.S. Employer

Incorporation or organization)

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)

Securities Registered Pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common stock, \$0.01 par value per share	New York Stock Exchange

Securities Registered Pursuant to Section 12(g) of the Act:

None

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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. (Check one):

Large accelerated filer

Accelerated filer

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Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company
Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.) Yes No

The aggregate market value of the shares of common stock (based upon the closing price of these shares on the New York Stock Exchange, Inc. on June 30, 2011) of the Registrant held by non-affiliates on June 30, 2011 was approximately \$1,539,898,933.

As of January 31, 2012, 77,945,225 shares of the Registrant's common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's definitive Proxy Statement relating to the Annual Meeting of Stockholders to be held on May 15, 2012 are incorporated by reference into Part III of this Report.

Table of Contents

TABLE OF CONTENTS

	Page
Item 1.	1
Item 1A.	17
Item 1B.	23
Item 2.	23
Item 3.	23
Item 5.	24
Item 6.	25
Item 7.	27
Item 7A.	48
Item 8.	49
Item 9.	89
Item 9A.	89
Item 9B.	91
Item 10.	92
Item 11.	93
Item 12.	93
Item 13.	93
Item 14.	93
Item 15.	94
<u>SIGNATURES</u>	96

Table of Contents**PART I****ITEM 1. BUSINESS****Overview**

Healthcare Realty Trust Incorporated (Healthcare Realty or the Company) was incorporated in Maryland in 1993 and is a self-managed and self-administered real estate investment trust (REIT) that owns, acquires, manages, finances and develops income-producing real estate properties associated primarily with the delivery of outpatient healthcare services throughout the United States.

The Company operates so as to qualify as a REIT for federal income tax purposes. As a REIT, the Company is not subject to corporate federal income tax with respect to net income distributed to its stockholders. See Federal Income Tax Information in Item 1 of this report.

Real Estate Properties

As of December 31, 2011, the Company's real estate property investments, excluding assets held for sale and including an investment in one unconsolidated joint venture, are shown in the table below. The Company's real estate property investments by geographic area are shown in Note 2 to the Consolidated Financial Statements.

	Number of Investments	Gross Investment		Square Feet	
		Amount	%	Footage	%
<i>(Dollars and Square Feet in thousands)</i>					
Owned properties:					
<i>Multi-tenanted with occupancy leases</i>					
Medical office/outpatient	143	\$ 1,728,610	59.9%	9,363	68.4%
Medical office - stabilization in progress	10	333,370	11.5%	1,095	8.0%
Other	2	19,691	0.7%	256	1.8%
	155	2,081,671	72.1%	10,714	78.2%
<i>Master leases</i>					
Medical office/outpatient	21	188,115	6.5%	1,009	7.4%
Inpatient	14	335,746	11.7%	1,072	7.9%
Other	2	9,545	0.3%	91	0.7%
	37	533,406	18.5%	2,172	16.0%
<i>Property operating agreements</i>					
Medical office/outpatient	6	72,538	2.5%	488	3.6%
	6	72,538	2.5%	488	3.6%
<i>Construction in progress</i>					
Medical office/outpatient	2	23,178	0.8%	187	1.4%
Inpatient (1)	1	37,974	1.3%	114	0.8%
Land held for development		25,176	0.9%		%
	3	86,328	3.0%	301	2.2%
<i>Corporate property</i>					
		14,675	0.5%		%
		14,675	0.5%		%
Total owned properties	201	2,788,618	96.6%	13,675	100.0%

Mortgage loans:

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Medical office/outpatient	5	36,822	1.3%		
Inpatient	1	20,559	0.7%		
Other	1	40,000	1.4%		
	7	97,381	3.4%		
Unconsolidated joint venture:					
Other	1	1,266	%		
	1	1,266	%		
Total real estate investments	209	\$ 2,887,265	100.0%	13,675	100.0%

(1) Includes one project in South Dakota that is a consolidated variable interest entity. See Note 4 to the Consolidated Financial Statements.

Table of Contents

The following table details occupancy of the Company's owned properties by facility type as of December 31, 2011 and 2010.

	Investment at Dec. 31, 2011 (1) (in thousands)	Percentage of Square Feet (1)	Occupancy (1) 2011	2010
Medical office/outpatient	\$ 2,345,811	88.8%	86%	86%
Inpatient	373,720	8.7%	100%	96%
Other	29,236	2.5%	76%	76%
Total	\$ 2,748,767	100.0%	87%	87%

- (1) The investment and percentage of square feet columns include all owned real estate properties. The occupancy columns represent the percentage of total rentable square feet leased (including month-to-month and holdover leases), excluding 10 and 9 properties, respectively, in stabilization, 15 and 11 properties, respectively, classified as held for sale and three properties in construction in progress as of December 31, 2011 and 2010. Properties under financial support or master lease agreements are included at 100% occupancy. Upon expiration of these agreements, occupancy reflects underlying tenant leases in the building.

As of December 31, 2011, the weighted average remaining years to maturity pursuant to the Company's long-term master leases, financial support agreements, and multi-tenanted occupancy leases were approximately 6.9 years, with expirations through 2029. The table below details the Company's lease maturities as of December 31, 2011, excluding 15 properties classified as held for sale.

Expiration Year	Annualized Minimum Rents (1) (in thousands)	Number of Leases		Average Percentage of Revenues	Total Square Feet
		Multi-Tenanted Properties	Master Leased Properties		
2012	\$ 36,083	451	3	14.6%	1,480,717
2013	37,555	306	4	15.3%	1,399,989
2014	42,662	368	5	17.3%	1,715,197
2015	24,531	224		10.0%	1,028,778
2016	23,508	188	6	9.6%	919,638
2017	17,540	69	5	7.1%	819,114
2018	13,318	93		5.4%	622,952
2019	6,107	30	1	2.5%	214,214
2020	9,578	34		3.9%	334,253
2021	7,353	32	3	3.0%	352,011
Thereafter	27,751	44	10	11.3%	1,114,539

- (1) Represents the annualized minimum rents on leases in-place as of December 31, 2011, excluding the impact of potential lease renewals, future step-ups in rent, sponsor support payments under financial support agreements and straight-line rent.

The Company provided property management services for 150 healthcare-related properties nationwide, totaling approximately 10.3 million square feet at December 31, 2011. The Company's portfolio of properties is focused predominantly on the medical office and outpatient sector of the healthcare industry and is diversified by geographic location, tenant and facility type.

Mortgage Notes Receivable

All of the Company's mortgage notes receivable are classified as held-for-investment based on management's intent and ability to hold the loans until maturity. As such, the loans are carried at amortized cost. Also, all of the Company's mortgage notes receivable are secured by existing buildings or buildings under construction.

Table of Contents

A summary of the Company's mortgage notes receivable is shown in the table below:

<i>(Dollars in thousands)</i>	Balance at December 31, 2011	Balance at December 31, 2010
Construction mortgage notes (1)	\$ 51,471	\$ 17,979
Other mortgage notes	45,910	18,620
	\$ 97,381	\$ 36,599

(1) Balance at December 31, 2010 includes unamortized fees of approximately \$0.4 million.

Business Strategy

Healthcare Realty's strategy is to own and operate medical office and other medical-related facilities that produce stable and growing rental income. Additionally, the Company provides a broad spectrum of services needed to own, develop, lease, finance and manage its portfolio of healthcare properties.

The Company focuses its portfolio on outpatient-related facilities located on or near the campuses of large acute care hospitals and associated with leading health systems because management views these facilities as stable, lower-risk real estate investments. According to the Centers for Medicare & Medicaid Services, the nation's overall healthcare spending in 2010 was \$2.6 trillion, representing 17.9% of the nation's gross domestic product (GDP). Total healthcare spending is expected to grow and could reach an estimated 19.8% of GDP by 2020. Historically, more than half of the nation's healthcare spending has been received by hospitals, physicians and other outpatient-related facility tenants. In addition to the consistent growth in demand for outpatient services, management believes that the Company's diversity of tenants, which includes physicians of nearly two-dozen physician specialties, as well as surgery, imaging, and diagnostic centers, lowers the Company's overall financial and operational risk.

The Company plans to continue to meet its liquidity needs, including funding investments in 2012, paying dividends, repaying maturing debt and funding other debt service, with available cash on hand, cash flows from operations, borrowings under its \$700 million unsecured credit facility due 2015 (the Unsecured Credit Facility), proceeds from mortgage notes receivable repayments, proceeds from sales of real estate investments, or additional public capital market transactions. See Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources in Item 7 and Risk Factors in Item 1A of this report for more discussion concerning the Company's liquidity and capital resources.

Acquisitions and Dispositions**2011 Acquisitions**

During 2011, the Company acquired approximately \$155.7 million in real estate assets and funded \$85.5 million in mortgage notes receivable. These acquisitions and mortgage notes were funded with borrowings on the unsecured credit facilities, proceeds from the Senior Notes due 2021 issued in December 2010, proceeds from real estate dispositions and mortgage note repayments, proceeds from the Company's at-the-market equity offering program, and from the assumption of existing mortgage debt related to certain acquired properties. See Note 4 to the Consolidated Financial Statements for more information on these acquisitions.

2011 Dispositions

During 2011, the Company disposed of five real estate properties for approximately \$19.6 million in net proceeds and recognized approximately \$5.7 million in gains and approximately \$1.7 million in impairments from the sale of the properties. Also, two mortgage notes receivable totaling approximately \$17.2 million were repaid. Upon repayment of one of the mortgage notes receivables, the Company recognized a gain of \$1.4 million that had been deferred from the original sale of the building to the borrower in 2006. Proceeds from these dispositions were used to repay amounts due under the Company's unsecured credit facilities, to fund additional real estate investments, and for general corporate purposes. See Note 4 to the Consolidated Financial Statements for more information on these dispositions.

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2012 Acquisitions

In January 2012, the Company purchased a 58,295 square foot medical office building in South Dakota for \$15.0 million. The property is 100% leased under a single absolute net lease with an affiliate of AA- rated Sanford Health, with a parent guarantee, and the lease expires in 2022. The property is connected to a new Sanford Health acute care hospital that is currently under construction.

In February 2012, the Company purchased a 23,312 square foot medical office building in North Carolina for \$6.4 million. The property is 100% leased by two tenants, and the leases expire in 2019.

Table of Contents

2012 Dispositions

In January 2012, the Company disposed of two medical office buildings located in Texas that were classified as held for sale and in which the Company had a \$2.5 million net investment at December 31, 2011. The Company received approximately \$3.4 million in consideration including a seller-financed \$3.0 million mortgage note receivable.

In January 2012, the Company disposed of a medical office building located in Florida that was classified as held for sale and in which the Company had a \$3.1 million net investment at December 31, 2011. The Company received approximately \$7.2 million in proceeds, net of expenses incurred at the time of closing.

In January 2012, an inpatient facility under construction in South Dakota that was being funded by the Company through a mortgage note was sold. As a result, the Company's mortgage note was repaid in full. The Company began consolidating the variable interest entity that owned the ongoing construction project in the third quarter of 2011 when the Company concluded it was the primary beneficiary of the entity, resulting in the elimination of the construction mortgage loan in the Consolidated Financial Statements. The balance in the construction project at December 31, 2011 was approximately \$38.0 million. Amounts outstanding on the mortgage note receivable totaled approximately \$34.9 million at December 31, 2011. The Company does not anticipate a material gain or loss in connection with the deconsolidation of the project.

Potential Dispositions

In the fourth quarter of 2010, the Company received notice from a tenant of its intent to purchase six skilled nursing facilities in Michigan and Indiana pursuant to purchase options contained in its leases with the Company. The Company's aggregate net investment in the buildings, which were classified as held for sale upon receiving notice of the purchase option exercise, was approximately \$8.2 million at December 31, 2011, and the aggregate contractual rent on the facilities is approximately \$0.7 million per quarter. The aggregate purchase price for the properties is expected to be approximately \$17.3 million, resulting in an expected aggregate net gain of approximately \$9.1 million. The Company expects the sales will close in 2012.

During the fourth quarter of 2011, management decided to sell seven properties in the Company's portfolio. In connection with its planned disposal of these properties, the Company determined that the carrying value for four of these properties would not likely be fully recoverable upon sale. Accordingly, the Company recorded an aggregate impairment charge on these properties of approximately \$4.7 million, reducing the aggregate net investment in the properties to approximately \$6.7 million. Of the seven properties identified for disposal, four of the properties are located in Texas and three are located in Florida. Three of the seven properties were sold during January 2012, and the remaining four, two of which are under contract, are expected to be sold during 2012.

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

Purchase Options

In addition to the six skilled nursing facilities in Michigan and Indiana discussed above, the Company had \$108.9 million in real estate properties at December 31, 2011 that were subject to exercisable purchase options that had not been exercised. On a probability-weighted basis, the Company estimates that less than one-third of these options might ever be exercised in the future. Purchase options on four properties in which the Company had an aggregate gross investment of approximately \$68.7 million at December 31, 2011 become exercisable during 2012 and 2013. The Company does not believe it can reasonably estimate at this time the probability that these purchase options will be exercised in the future.

Development Activity

The Company had several development projects ongoing at December 31, 2011, including three construction projects, four construction mortgage loans and 10 properties in the process of stabilization subsequent to construction. See Note 14 to the Consolidated Financial Statements for more detail on these projects.

Table of Contents

<i>(Dollars in thousands)</i>	Number of Properties	Amount Funded During Twelve Months Ended Dec. 31, 2011	Total Amount Funded Through Dec. 31, 2011	Estimated Remaining Fundings	Estimated Total Investment	Approximate Square Feet
Construction in progress (1)	3	\$ 57,547	\$ 61,152	\$ 22,130	\$ 83,282	300,614
Construction mortgage loans	4	48,609	51,472	165,722	217,194	473,431
Stabilization in progress	10	53,550	333,370	26,288	359,658	1,095,284
Land held for development		4,403	25,176			
Total	17	\$ 164,109	\$ 471,170	\$ 214,140	\$ 660,134	1,869,329

(1) Includes one construction mortgage loan that the Company was consolidating under consolidation accounting principles. The building under construction was sold by the owner in January 2012.

Contractual Obligations

As of December 31, 2011, the Company had long-term contractual obligations of approximately \$2.3 billion, consisting primarily of \$1.8 billion of long-term debt obligations (including related interest). For a more detailed description of these contractual obligations, see Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Contractual Obligations, in Item 7 of this report.

Competition

The Company competes for the acquisition and development of real estate properties with private investors, healthcare providers, other healthcare-related REITs, real estate partnerships and financial institutions, among others. The business of acquiring and constructing new healthcare facilities is highly competitive and is subject to price, construction and operating costs, and other competitive pressures.

The financial performance of all of the Company's properties is subject to competition from similar properties. The extent to which the Company's properties are utilized depends upon several factors, including the number of physicians using or referring patients to the healthcare facility, healthcare employment, competitive systems of healthcare delivery, and the area's population, size and composition. Private, federal and state health insurance programs and other laws and regulations may also have an effect on the utilization of the properties. Virtually all of the Company's properties operate in a competitive environment, and patients and referral sources, including physicians, may change their preferences for a healthcare facility from time to time.

Government Regulation

The facilities owned by the Company are utilized by medical tenants which are required to comply with extensive regulation at the federal, state, and local levels, including laws intended to combat fraud and waste such as the Anti-Kickback Statute, Stark Law, False Claims Act, and Health Insurance Portability and Accountability Act of 1996. These laws and regulations establish, among other things, requirements for state licensure and criteria to participate in government-sponsored reimbursement programs, such as the Medicare and Medicaid programs. The Company's leases generally require the tenant to comply with all applicable laws relating to the tenant's use and occupation of the leased premises. Although lease payments to the Company are not directly affected by these laws and regulations, changes in these programs or the loss by a tenant of its license or ability to participate in government-sponsored reimbursement programs would have a material adverse effect on its ability to make lease payments and could impact facility revenues to the Company.

The Medicare and Medicaid programs are highly regulated and subject to frequent evaluation and change. Government healthcare spending has increased over time; however, changes from year to year in reimbursement methodology, rates and other regulatory requirements have resulted in a challenging operating environment for healthcare providers. Aggregate spending on government reimbursement programs for healthcare services is expected to continue to rise significantly over the next 20 years with the anticipated expansion of public insurance programs for the uninsured and senior populations. However, the profitability of providing care to the rising number of Medicare and Medicaid patients may decline, which could adversely affect tenants' ability to make lease payments to the Company.

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In March 2010, the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010 (collectively, the Health Reform Law) were signed into law to provide for comprehensive reform of the United States healthcare system and extend health insurance benefits to the uninsured population, with the potential to alleviate high uncompensated care expense to healthcare providers. However, the law also increases regulatory scrutiny of providers by federal and state administrative authorities; lowers annual increases in Medicare payment rates prior to expanding coverage to the uninsured; and will gradually implement significant cost-saving measures to lower the growth of healthcare spending, while also requiring improved access and quality of care,

Table of Contents

thus presenting the industry and its individual participants with uncertainty. The Health Reform Law has been ruled both constitutional and unconstitutional in whole or in part by certain federal district courts and courts of appeal. The degree to which it is implemented, if at all, will ultimately be decided by the United States Supreme Court, which is expected to issue a decision on the constitutionality of the Health Reform Law in 2012. These varied reforms could affect the economic performance of some or all of the Company's tenants and borrowers. The Company cannot predict the degree to which these changes may affect the economic performance of the Company, positively or negatively.

In November 2011, the Joint Select Committee on Deficit Reduction, created pursuant to the Budget Control Act of 2011, announced that it was unable to reach agreement on \$1.2 trillion in deficit reduction measures. The bipartisan Joint Select Committee had been tasked with agreeing upon the deficit reduction measures in order to avoid automatic \$1.2 trillion across-the-board cuts, including automatic cuts of up to 2% for Medicare and other federal healthcare programs. If implemented, these reductions could result in lower reimbursement rates that may affect the economic performance of some or all of the Company's tenants.

The Company expects healthcare providers to continue to adjust to new operating challenges, as they have in the past, by increasing operating efficiency and modifying their strategies for profitable operations and growth. Furthermore, under comprehensive healthcare reform, the Company could benefit from higher demand for medical office space as the newly insured population would require additional healthcare providers and facilities.

Legislative Developments

Each year, legislative proposals for health policy are introduced in Congress and state legislatures, and regulatory changes are enacted by government agencies. These proposals, individually or in the aggregate, could significantly change the delivery of healthcare services, either nationally or at the state level, if implemented. Examples of significant legislation currently under consideration or recently enacted include:

the Health Reform Law;

proposals to repeal the Health Reform Law in whole or in part;

proposals by individual states to opt out of the Health Reform Law in whole or in part;

cost-saving measures by federal and state governments to reduce budget deficits and lower Medicare and Medicaid spending growth, including federal budget-wide cuts of 2% currently planned for January 2013;

quality control, cost containment, and payment system refinements for Medicaid, Medicare and other public funding, such as expansion of pay-for-performance criteria and value-based purchasing programs, bundled provider payments, accountable care organizations, state health insurance exchanges, increased patient cost-sharing, geographic payment variations, comparative effectiveness research, and lower payments for hospital readmissions;

reform of the Medicare physician fee-for-service reimbursement formula that dictates annual updates in Medicare payment rates for physician services, including significant reductions in the sustainable growth rate. Congress is considering legislation to continue its practice of extending or increasing physician payment rates, whether through a short-term fix or a more long-term solution;

prohibitions on additional types of contractual relationships between physicians and the healthcare facilities and providers to which they refer, and related information-collection activities;

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efforts to increase transparency with respect to pricing and financial relationships among healthcare providers and drug/device manufacturers;

heightened health information technology standards for healthcare providers;

increased scrutiny of medical errors and conditions acquired inside health facilities;

patient and drug safety initiatives;

re-importation of pharmaceuticals;

pharmaceutical drug pricing and compliance activities under Medicare part D;

Table of Contents

tax law changes affecting non-profit providers;

immigration reform and related healthcare mandates;

modifications to increase requirements for facility accessibility by persons with disabilities; and

facility requirements related to earthquakes and other disasters, including structural retrofitting.

The Company cannot predict whether any proposals will be fully implemented, adopted, repealed, or amended, or what effect, whether positive or negative, such proposals would have on the Company's business.

Environmental Matters

Under various federal, state and local environmental laws, ordinances and regulations, an owner of real property (such as the Company) may be liable for the costs of removal or remediation of certain hazardous or toxic substances at, under, or disposed of in connection with such property, as well as certain other potential costs relating to hazardous or toxic substances (including government fines and injuries to persons and adjacent property). Most, if not all, of these laws, ordinances and regulations contain stringent enforcement provisions including, but not limited to, the authority to impose substantial administrative, civil, and criminal fines and penalties upon violators. Such laws often impose liability, without regard to whether the owner knew of, or was responsible for, the presence or disposal of such substances, and may be imposed on the owner in connection with the activities of a tenant or operator of the property. The cost of any required remediation, removal, fines or personal or property damages and the owner's liability therefore could exceed the value of the property and/or the aggregate assets of the owner. In addition, the presence of such substances, or the failure to properly dispose of or remediate such substances, may adversely affect the owner's ability to sell or lease such property or to borrow using such property as collateral. A property can also be negatively impacted either through physical contamination, or by virtue of an adverse effect on value, from contamination that has or may have emanated from other properties.

Operations of the properties owned, developed or managed by the Company are and will continue to be subject to numerous federal, state, and local environmental laws, ordinances and regulations, including those relating to the following: the generation, segregation, handling, packaging and disposal of medical wastes; air quality requirements related to operations of generators, incineration devices, or sterilization equipment; facility siting and construction; disposal of non-medical wastes and ash from incinerators; and underground storage tanks. Certain properties owned, developed or managed by the Company contain, and others may contain or at one time may have contained, underground storage tanks that are or were used to store waste oils, petroleum products or other hazardous substances. Such underground storage tanks can be the source of releases of hazardous or toxic materials. Operations of nuclear medicine departments at some properties also involve the use and handling, and subsequent disposal of, radioactive isotopes and similar materials, activities which are closely regulated by the Nuclear Regulatory Commission and state regulatory agencies. In addition, several of the properties were built during the period that asbestos was commonly used in building construction and other such facilities may be acquired by the Company in the future. The presence of such materials could result in significant costs in the event that any asbestos-containing materials requiring immediate removal and/or encapsulation are located in or on any facilities or in the event of any future renovation activities.

The Company has had environmental site assessments conducted on substantially all of the properties currently owned. These site assessments are limited in scope and provide only an evaluation of potential environmental conditions associated with the property, not compliance assessments of ongoing operations. While it is the Company's policy to seek indemnification relating to environmental liabilities or conditions, even where leases and sale and purchase agreements do contain such provisions, there can be no assurances that the tenant or seller will be able to fulfill its indemnification obligations. In addition, the terms of the Company's leases or financial support agreements do not give the Company control over the operational activities of its lessees or healthcare operators, nor will the Company monitor the lessees or healthcare operators with respect to environmental matters.

Insurance

The Company generally requires its tenants to maintain comprehensive liability and property insurance that covers the Company as well as the tenants. The Company also carries comprehensive liability insurance and property insurance covering its owned and managed properties, including those held under long-term ground leases. In addition, tenants under long-term net master leases are required to carry property insurance covering the Company's interest in the buildings. The Company has also obtained title insurance with respect to each of the properties it owns, insuring that the Company holds title to each of the properties free and clear of all liens and encumbrances except those approved by the Company.

Employees

As of December 31, 2011, the Company employed 260 people. The employees are not members of any labor union, and the Company considers its relations with its employees to be excellent.

Table of Contents

Federal Income Tax Information

The Company is and intends to remain qualified as a REIT under the Internal Revenue Code of 1986, as amended (the Code). As a REIT, the Company's net income attributable to common stockholders will not be subject to federal taxation to the extent that it is distributed as dividends to stockholders. Distributions to the Company's stockholders generally will be includable in their income; however, dividends distributed that are in excess of current and/or accumulated earnings and profits will be treated for tax purposes as a return of capital to the extent of a stockholder's basis and will reduce the basis of the stockholder's shares.

Introduction

The Company is qualified and intends to remain qualified as a REIT for federal income tax purposes under Sections 856 through 860 of the Code. The following discussion addresses the material federal tax considerations relevant to the taxation of the Company and summarizes certain federal income tax consequences that may be relevant to certain stockholders. However, the actual tax consequences of holding particular securities issued by the Company may vary in light of a securities holder's particular facts and circumstances. Certain holders, such as tax-exempt entities, insurance companies and financial institutions, are generally subject to special rules. In addition, the following discussion does not address issues under any foreign, state or local tax laws. The tax treatment of a holder of any of the securities issued by the Company will vary depending upon the terms of the specific securities acquired by such holder, as well as the holder's particular situation, and this discussion does not attempt to address aspects of federal income taxation relating to holders of particular securities of the Company. This summary is qualified in its entirety by the applicable Code provisions, rules and regulations promulgated thereunder, and administrative and judicial interpretations thereof. The Code, rules, regulations, and administrative and judicial interpretations are all subject to change at any time (possibly on a retroactive basis).

The Company is organized and is operating in conformity with the requirements for qualification and taxation as a REIT and intends to continue operating so as to enable it to continue to meet the requirements for qualification and taxation as a REIT under the Code. The Company's qualification and taxation as a REIT depends upon its ability to meet, through actual annual operating results, the various income, asset, distribution, stock ownership and other tests discussed below. Accordingly, the Company cannot guarantee that the actual results of operations for any one taxable year will satisfy such requirements.

If the Company were to cease to qualify as a REIT, and the statutory relief provisions were found not to apply, the Company's income that it distributed to stockholders would be subject to the double taxation on earnings (once at the corporate level and again at the stockholder level) that generally results from an investment in the equity securities of a corporation. The distributions would then qualify for the reduced dividend rates created by the Jobs and Growth Tax Relief Reconciliation Act of 2003. However, the reduced dividend rates are scheduled to expire for taxable years beginning after December 31, 2012. Failure to maintain qualification as a REIT would force the Company to significantly reduce its distributions and possibly incur substantial indebtedness or liquidate substantial investments in order to pay the resulting corporate taxes. In addition, the Company, once having obtained REIT status and having thereafter lost such status, would not be eligible to re-elect REIT status for the four subsequent taxable years, unless its failure to maintain its qualification was due to reasonable cause and not willful neglect and certain other requirements were satisfied. In order to elect again to be taxed as a REIT, just as with its original election, the Company would be required to distribute all of its earnings and profits accumulated in any non-REIT taxable year.

Taxation of the Company

As long as the Company remains qualified to be taxed as a REIT, it generally will not be subject to federal income taxes on that portion of its ordinary income or capital gain that is currently distributed to stockholders.

However, the Company will be subject to federal income tax as follows:

The Company will be taxed at regular corporate rates on any undistributed real estate investment trust taxable income, including undistributed net capital gains.

Under certain circumstances, the Company may be subject to the alternative minimum tax on its items of tax preference, if any.

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If the Company has (i) net income from the sale or other disposition of foreclosure property that is held primarily for sale to customers in the ordinary course of business, or (ii) other non-qualifying income from foreclosure property, it will be subject to tax on such income at the highest regular corporate rate.

Table of Contents

Any net income that the Company has from prohibited transactions (which are, in general, certain sales or other dispositions of property, other than foreclosure property, held primarily for sale to customers in the ordinary course of business) will be subject to a 100% tax.

If the Company should fail to satisfy either the 75% or 95% gross income test (as discussed below), and has nonetheless maintained its qualification as a REIT because certain other requirements have been met, it will be subject to a percentage tax calculated by the ratio of REIT taxable income to gross income with certain adjustments multiplied by the gross income attributable to the greater of the amount by which the Company fails the 75% or 95% gross income test.

If the Company fails to distribute during each year at least the sum of (i) 85% of its REIT ordinary income for such year, (ii) 95% of its REIT capital gain net income for such year, and (iii) any undistributed taxable income from preceding periods, then the Company will be subject to a 4% excise tax on the excess of such required distribution over the amounts actually distributed.

In the event of a more than de minimis failure of any of the asset tests, as described below under **Asset Tests**, as long as the failure was due to reasonable cause and not to willful neglect, the Company files a description of each asset that caused such failure with the Internal Revenue Service (**IRS**), and disposes of the assets or otherwise complies with the asset tests within six months after the last day of the quarter in which the Company identifies such failure, the Company will pay a tax equal to the greater of \$50,000 or 35% of the net income from the nonqualifying assets during the period in which the Company failed to satisfy the asset tests.

In the event the Company fails to satisfy one or more requirements for REIT qualification, other than the gross income tests and the asset tests, and such failure is due to reasonable cause and not to willful neglect, the Company will be required to pay a penalty of \$50,000 for each such failure.

To the extent that the Company recognizes gain from the disposition of an asset with respect to which there existed built-in gain upon its acquisition by the Company from a Subchapter C corporation in a carry-over basis transaction and such disposition occurs within a maximum ten-year recognition period beginning on the date on which it was acquired by the Company, the Company will be subject to federal income tax at the highest regular corporate rate on the amount of its net recognized built-in gain.

To the extent that the Company has net income from a taxable REIT subsidiary (**TRS**), the TRS will be subject to federal corporate income tax in much the same manner as other non-REIT Subchapter C corporations, with the exceptions that the deductions for interest expense on debt and rental payments made by the TRS to the Company will be limited and a 100% excise tax may be imposed on transactions between the TRS and the Company or the Company's tenants that are not conducted on an arm's length basis. A TRS is a corporation in which a REIT owns stock, directly or indirectly, and for which both the REIT and the corporation have made TRS elections.

Requirements for Qualification as a REIT

To qualify as a REIT for a taxable year, the Company must have no earnings and profits accumulated in any non-REIT year. The Company also must elect or have in effect an election to be taxed as a REIT and must meet other requirements, some of which are summarized below, including percentage tests relating to the sources of its gross income, the nature of the Company's assets and the distribution of its income to stockholders. Such election, if properly made and assuming continuing compliance with the qualification tests described herein, will continue in effect for subsequent years.

Organizational Requirements and Share Ownership Tests

Section 856(a) of the Code defines a REIT as a corporation, trust or association:

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- (1) that is managed by one or more trustees or directors;
- (2) the beneficial ownership of which is evidenced by transferable shares or by transferable certificates of beneficial interest;
- (3) that would be taxable, but for Sections 856 through 860 of the Code, as a domestic corporation;
- (4) that is neither a financial institution nor an insurance company subject to certain provisions of the Code;

Table of Contents

- (5) the beneficial ownership of which is held by 100 or more persons, determined without reference to any rules of attribution (the share ownership test);
- (6) that during the last half of each taxable year not more than 50% in value of the outstanding stock of which is owned, directly or indirectly, by five or fewer individuals (as defined in the Code to include certain entities) (the five or fewer test); and
- (7) that meets certain other tests, described below, regarding the nature of its income and assets.

Section 856(b) of the Code provides that conditions (1) through (4), inclusive, must be met during the entire taxable year and that condition (5) must be met during at least 335 days of a taxable year of 12 months, or during a proportionate part of a taxable year of fewer than 12 months. The five or fewer test and the share ownership test do not apply to the first taxable year for which an election is made to be treated as a REIT.

The Company is also required to request annually (within 30 days after the close of its taxable year) from record holders of specified percentages of its shares written information regarding the ownership of such shares. A list of stockholders failing to fully comply with the demand for the written statements is required to be maintained as part of the Company's records required under the Code. Rather than responding to the Company, the Code allows the stockholder to submit such statement to the IRS with the stockholder's tax return.

The Company has issued shares to a sufficient number of people to allow it to satisfy the share ownership test and the five or fewer test. In addition, to assist in complying with the five or fewer test, the Company's Articles of Incorporation contain provisions restricting share transfers where the transferee (other than specified individuals involved in the formation of the Company, members of their families and certain affiliates, and certain other exceptions) would, after such transfer, own (a) more than 9.9% either in number or value of the outstanding common stock of the Company or (b) more than 9.9% either in number or value of any outstanding preferred stock of the Company. Pension plans and certain other tax-exempt entities have different restrictions on ownership. If, despite this prohibition, stock is acquired increasing a transferee's ownership to over 9.9% in value of either the outstanding common stock or any preferred stock of the Company, the stock in excess of this 9.9% in value is deemed to be held in trust for transfer at a price that does not exceed what the purported transferee paid for the stock, and, while held in trust, the stock is not entitled to receive dividends or to vote. In addition, under these circumstances, the Company has the right to redeem such stock.

For purposes of determining whether the five or fewer test (but not the share ownership test) is met, any stock held by a qualified trust (generally pension plans, profit-sharing plans and other employee retirement trusts) is, generally, treated as held directly by the trust's beneficiaries in proportion to their actuarial interests in the trust and not as held by the trust.

Income Tests

In order to maintain qualification as a REIT, two gross income requirements must be satisfied annually.

First, at least 75% of the Company's gross income (excluding gross income from certain sales of property held as inventory or primarily for sale in the ordinary course of business) must be derived from rents from real property ; interest on obligations secured by mortgages on real property or on interests in real property ; gain (excluding gross income from certain sales of property held as inventory or primarily for sale in the ordinary course of business) from the sale or other disposition of, and certain other gross income related to, real property (including interests in real property and in mortgages on real property); and income received or accrued within one year of the Company's receipt of, and attributable to the temporary investment of, new capital (any amount received in exchange for stock other than through a dividend reinvestment plan or in a public offering of debt obligations having maturities of at least five years).

Second, at least 95% of the Company's gross income (excluding gross income from certain sales of property held as inventory or primarily for sale in the ordinary course of business) must be derived from: dividends; interest; rents from real property ; gain (excluding gross income from certain sales of property held as inventory or primarily for sale in the ordinary course of business) from the sale or other disposition of, and certain other gross income related to, real property (including interests in real property and in mortgages on real property); and gain from the sale or other disposition of stock and securities.

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The Company may temporarily invest its working capital in short-term investments. Although the Company will use its best efforts to ensure that income generated by these investments will be of a type that satisfies the 75% and 95% gross income tests, there can be no assurance in this regard (see the discussion above of the new capital rule under the 75% gross income test).

For an amount received or accrued to qualify for purposes of an applicable gross income test as rents from real property or interest on obligations secured by mortgages on real property or on interests in real property, the determination of such amount must not depend in whole or in part on the income or profits derived by any person from such property (except that such amount may be based

Table of Contents

on a fixed percentage or percentages of receipts or sales). In addition, for an amount received or accrued to qualify as rents from real property, such amount may not be received or accrued directly or indirectly from a person in which the Company owns directly or indirectly 10% or more of, in the case of a corporation, the total voting power of all voting stock or the total value of all stock, and, in the case of an unincorporated entity, the assets or net profits of such entity (except for certain amounts received or accrued from a TRS in connection with property substantially rented to persons other than a TRS of the Company and other 10%-or-more owned persons or with respect to certain healthcare facilities, if certain conditions are met). The Company leases and intends to lease property only under circumstances such that substantially all, if not all, rents from such property qualify as rents from real property. Although it is possible that a tenant could sublease space to a sublessee in whom the Company is deemed to own directly or indirectly 10% or more of the tenant, the Company believes that as a result of the provisions of the Company's Articles of Incorporation that limit ownership to 9.9%, such occurrence would be unlikely. Application of the 10% ownership rule is, however, dependent upon complex attribution rules provided in the Code and circumstances beyond the control of the Company. Ownership, directly or by attribution, by an unaffiliated third party of more than 10% of the Company's stock and more than 10% of the stock of any tenant or subtenant would result in a violation of the rule.

In addition, the Company must not manage its properties or furnish or render services to the tenants of its properties, except through an independent contractor from whom the Company derives no income or through a TRS unless (i) the Company is performing services that are usually or customarily furnished or rendered in connection with the rental of space for occupancy only and the services are of the sort that a tax-exempt organization could perform without being considered in receipt of unrelated business taxable income or (ii) the income earned by the Company for other services furnished or rendered by the Company to tenants of a property or for the management or operation of the property does not exceed a de minimis threshold generally equal to 1% of the income from such property. The Company self-manages some of its properties, but does not believe it provides services to tenants that are outside the exception.

If rent attributable to personal property leased in connection with a lease of real property is greater than 15% of the total rent received under the lease, then the portion of rent attributable to such personal property will not qualify as rents from real property. Generally, this 15% test is applied separately to each lease. The portion of rental income treated as attributable to personal property is determined according to the ratio of the fair market value of the personal property to the total fair market value of the property that is rented. The determination of what fixtures and other property constitute personal property for federal tax purposes is difficult and imprecise. The Company does not have 15% by value of any of its properties classified as personal property. If, however, rent payments do not qualify, for reasons discussed above, as rents from real property for purposes of Section 856 of the Code, it will be more difficult for the Company to meet the 95% and 75% gross income tests and continue to qualify as a REIT.

The Company is and expects to continue performing third-party management services, and may also perform third-party development services. If the gross income to the Company from this or any other activity producing disqualified income for purposes of the 95% or 75% gross income tests approaches a level that could potentially cause the Company to fail to satisfy these tests, the Company intends to take such corrective action as may be necessary to avoid failing to satisfy the 95% or 75% gross income tests.

The Company may enter into hedging transactions with respect to one or more of its assets or liabilities. The Company's hedging activities may include entering into interest rate swaps, caps and floors, options to purchase such items, and futures and forward contracts. Income and gain from hedging transactions will be excluded from gross income for purposes of the 95% and 75% gross income tests. A hedging transaction includes any transaction entered into in the normal course of the Company's trade or business primarily to manage the risk of interest rate, price changes or currency fluctuations with respect to borrowings made or to be made, or ordinary obligations incurred or to be incurred, to acquire or carry real estate assets. The Company will be required to clearly identify any such hedging transaction before the close of the day on which it was acquired, originated or entered into. The Company intends to structure any hedging or similar transactions so as not to jeopardize its status as a REIT.

If the Company were to fail to satisfy one or both of the 75% or 95% gross income tests for any taxable year, it may nevertheless qualify as a REIT for such year if it is entitled to relief under certain provisions of the Code. These relief provisions would generally be available if (i) the Company's failure to meet such test or tests was due to reasonable cause and not to willful neglect and (ii) following its identification of its failure to meet these tests, the Company files a description of each item of income that fails to meet these tests in a schedule in accordance with Treasury Regulations. It is not possible, however, to know whether the Company would be entitled to the benefit of these relief provisions since the application of the relief provisions is dependent on future facts and circumstances. If these provisions were to apply, the Company would be subjected to tax equal to a percentage tax calculated by the ratio of REIT taxable income to gross income with certain adjustments multiplied by the gross income attributable to the greater of the amount by which the Company failed either of the 75% or the 95% gross income tests.

Asset Tests

At the close of each quarter of its taxable year, the Company must also satisfy four tests relating to the nature of its assets.

Table of Contents

At least 75% of the value of the Company's total assets must consist of real estate assets (including interests in real property and interests in mortgages on real property as well as its allocable share of real estate assets held by joint ventures or partnerships in which the Company participates), cash, cash items and government securities.

Not more than 25% of the Company's total assets may be represented by securities other than those includable in the 75% asset class.

Not more than 25% of the Company's total assets may be represented by securities of one or more TRS.

Of the investments included in the 25% asset class, except for TRS, (i) the value of any one issuer's securities owned by the Company may not exceed 5% of the value of the Company's total assets, (ii) the Company may not own more than 10% of any one issuer's outstanding voting securities and (iii) the Company may not hold securities having a value of more than 10% of the total value of the outstanding securities of any one issuer. Securities issued by affiliated qualified REIT subsidiaries (QRS), which are corporations wholly owned by the Company, either directly or indirectly, that are not TRS, are not subject to the 25% of total assets limit, the 5% of total assets limit or the 10% of a single issuer's voting securities limit or the 10% of a single issuer's value limit. Additionally, straight debt and certain other exceptions are not securities for purposes of the 10% of a single issuer's value test. The existence of QRS are ignored, and the assets, income, gain, loss and other attributes of the QRS are treated as being owned or generated by the Company, for federal income tax purposes. The Company currently has 76 subsidiaries and other affiliates that it employs in the conduct of its business.

If the Company meets the asset tests described above at the close of any quarter, it will not lose its status as a REIT because of a change in value of its assets unless the discrepancy exists immediately after the acquisition of any security or other property that is wholly or partly the result of an acquisition during such quarter. Where a failure to satisfy the asset tests results from an acquisition of securities or other property during a quarter, the failure can be cured by disposition of sufficient non-qualifying assets within 30 days after the close of such quarter. The Company maintains adequate records of the value of its assets to maintain compliance with the asset tests and to take such action as may be required to cure any failure to satisfy the test within 30 days after the close of any quarter. Nevertheless, if the Company were unable to cure within the 30-day cure period, the Company may cure a violation of the 5% asset test or the 10% asset test so long as the value of the asset causing such violation does not exceed the lesser of 1% of the Company's assets at the end of the relevant quarter or \$10 million and the Company disposes of the asset causing the failure or otherwise complies with the asset tests within six months after the last day of the quarter in which the failure to satisfy the asset test is discovered. For violations due to reasonable cause and not due to willful neglect that are larger than this amount, the Company is permitted to avoid disqualification as a REIT after the 30-day cure period by (i) disposing of an amount of assets sufficient to meet the asset tests, (ii) paying a tax equal to the greater of \$50,000 or the highest corporate tax rate times the taxable income generated by the non-qualifying asset and (iii) disclosing certain information to the IRS.

Distribution Requirement

In order to qualify as a REIT, the Company is required to distribute dividends (other than capital gain dividends) to its stockholders in an amount equal to or greater than the excess of (a) the sum of (i) 90% of the Company's real estate investment trust taxable income (computed without regard to the dividends paid deduction and the Company's net capital gain) and (ii) 90% of the net income (after tax on such income), if any, from foreclosure property, over (b) the sum of certain non-cash income (from certain imputed rental income and income from transactions inadvertently failing to qualify as like-kind exchanges). These requirements may be waived by the IRS if the Company establishes that it failed to meet them by reason of distributions previously made to meet the requirements of the 4% excise tax described below. To the extent that the Company does not distribute all of its net long-term capital gain and all of its real estate investment trust taxable income, it will be subject to tax thereon. In addition, the Company will be subject to a 4% excise tax to the extent it fails within a calendar year to make required distributions to its stockholders of 85% of its ordinary income and 95% of its capital gain net income plus the excess, if any, of the grossed up required distribution for the preceding calendar year over the amount treated as distributed for such preceding calendar year. For this purpose, the term grossed up required distribution for any calendar year is the sum of the taxable income of the Company for the taxable year (without regard to the deduction for dividends paid) and all amounts from earlier years that are not treated as having been distributed under the provision. Dividends declared in the last quarter of the year and paid during the following January will be treated as having been paid and received on December 31 of such earlier year. The Company's distributions for 2011 were adequate to satisfy its distribution requirement.

It is possible that the Company, from time to time, may have insufficient cash or other liquid assets to meet the 90% distribution requirement due to timing differences between the actual receipt of income and the actual payment of deductible expenses or dividends on the one hand and the inclusion of such income and deduction of such expenses or dividends in arriving at real estate investment trust taxable income on the other hand. The problem of not having adequate cash to make required distributions could also occur as a result of the repayment in cash of principal

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amounts due on the Company's outstanding debt, particularly in the case of balloon repayments or as a result of capital losses on short-term investments of working capital. Therefore, the Company might find it necessary to arrange for short-term, or possibly long-term, borrowing or new equity financing. If the Company were unable to arrange such borrowing or financing as might be necessary to provide funds for required distributions, its REIT status could be jeopardized.

Table of Contents

Under certain circumstances, the Company may be able to rectify a failure to meet the distribution requirement for a year by paying deficiency dividends to stockholders in a later year, which may be included in the Company's deduction for dividends paid for the earlier year. The Company may be able to avoid being taxed on amounts distributed as deficiency dividends; however, the Company might in certain circumstances remain liable for the 4% excise tax described above.

Federal Income Tax Treatment of Leases

The availability to the Company of, among other things, depreciation deductions with respect to the facilities owned and leased by the Company depends upon the treatment of the Company as the owner of the facilities and the classification of the leases of the facilities as true leases, rather than as sales or financing arrangements, for federal income tax purposes. The Company has not requested nor has it received an opinion that it will be treated as the owner of the portion of the facilities constituting real property and that the leases will be treated as true leases of such real property for federal income tax purposes.

Other Issues

With respect to property acquired from and leased back to the same or an affiliated party, the IRS could assert that the Company realized prepaid rental income in the year of purchase to the extent that the value of the leased property exceeds the purchase price paid by the Company for that property. In litigated cases involving sale-leasebacks which have considered this issue, courts have concluded that buyers have realized prepaid rent where both parties acknowledged that the purported purchase price for the property was substantially less than fair market value and the purported rents were substantially less than the fair market rentals. Because of the lack of clear precedent and the inherently factual nature of the inquiry, the Company cannot give complete assurance that the IRS could not successfully assert the existence of prepaid rental income in such circumstances. The value of property and the fair market rent for properties involved in sale-leasebacks are inherently factual matters and always subject to challenge.

Additionally, it should be noted that Section 467 of the Code (concerning leases with increasing rents) may apply to those leases of the Company that provide for rents that increase from one period to the next. Section 467 provides that in the case of a so-called disqualified leaseback agreement, rental income must be accrued at a constant rate. If such constant rent accrual is required, the Company would recognize rental income in excess of cash rents and, as a result, may fail to have adequate funds available to meet the 90% dividend distribution requirement.

Disqualified leaseback agreements include leaseback transactions where a principal purpose of providing increasing rent under the agreement is the avoidance of federal income tax. Since the Section 467 regulations provide that rents will not be treated as increasing for tax avoidance purposes where the increases are based upon a fixed percentage of lessee receipts, additional rent provisions of leases containing such clauses should not result in these leases being disqualified leaseback agreements. In addition, the Section 467 regulations provide that leases providing for fluctuations in rents by no more than a reasonable percentage, which is 15% for long-term real property leases, from the average rent payable over the term of the lease will be deemed to not be motivated by tax avoidance. The Company does not believe it has rent subject to the disqualified leaseback provisions of Section 467.

Subject to a safe harbor exception for annual sales of up to seven properties (or properties with a basis of up to 10% of the REIT's assets) that have been held for at least two years, gain from sales of property held for sale to customers in the ordinary course of business is subject to a 100% tax. The simultaneous exercise of options to acquire leased property that may be granted to certain tenants or other events could result in sales of properties by the Company that exceed this safe harbor. However, the Company believes that in such event, it will not have held such properties for sale to customers in the ordinary course of business.

Depreciation of Properties

For federal income tax purposes, the Company's real property is being depreciated over 31.5, 39 or 40 years, using the straight-line method of depreciation and its personal property over various periods utilizing accelerated and straight-line methods of depreciation.

Failure to Qualify as a REIT

If the Company was to fail to qualify for federal income tax purposes as a REIT in any taxable year, and the relief provisions were found not to apply, the Company would be subject to tax on its taxable income at regular corporate rates (plus any applicable alternative minimum tax). Distributions to stockholders in any year in which the Company failed to qualify would not be deductible by the Company nor would they be required to be made. In such event, to the extent of current and/or accumulated earnings and profits, all distributions to stockholders would be taxable as qualified dividend income, including, presumably, subject to the 15% maximum rate on dividends created by the Jobs and Growth Tax Relief Reconciliation Act of 2003, and, subject to certain limitations in the Code, eligible for the 70% dividends received deduction for corporations that are REIT stockholders. However, this reduced rate for qualified dividend income is set to expire for taxable years beginning

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after December 31, 2012. Unless entitled to relief under specific statutory provisions, the Company would also be disqualified from taxation as a REIT for the following four taxable years. It is not possible to state whether in all circumstances the Company would be entitled to statutory relief from such disqualification. Failure to qualify for even one year could result in the Company's incurring substantial indebtedness (to the extent borrowings were feasible) or liquidating substantial investments in order to pay the resulting taxes.

Table of Contents***Taxation of Tax-Exempt Stockholders***

The IRS has issued a revenue ruling in which it held that amounts distributed by a REIT to a tax-exempt employees' pension trust do not constitute unrelated business taxable income, even though the REIT may have financed certain of its activities with acquisition indebtedness. Although revenue rulings are interpretive in nature and are subject to revocation or modification by the IRS, based upon the revenue ruling and the analysis therein, distributions made by the Company to a U.S. stockholder that is a tax-exempt entity (such as an individual retirement account (IRA) or a 401(k) plan) should not constitute unrelated business taxable income unless such tax-exempt U.S. stockholder has financed the acquisition of its shares with acquisition indebtedness within the meaning of the Code, or the shares are otherwise used in an unrelated trade or business conducted by such U.S. stockholder.

Special rules apply to certain tax-exempt pension funds (including 401(k) plans but excluding IRAs or government pension plans) that own more than 10% (measured by value) of a pension-held REIT. Such a pension fund may be required to treat a certain percentage of all dividends received from the REIT during the year as unrelated business taxable income. The percentage is equal to the ratio of the REIT's gross income (less direct expenses related thereto) derived from the conduct of unrelated trades or businesses determined as if the REIT were a tax-exempt pension fund (including income from activities financed with acquisition indebtedness), to the REIT's gross income (less direct expenses related thereto) from all sources. The special rules will not require a pension fund to recharacterize a portion of its dividends as unrelated business taxable income unless the percentage computed is at least 5%.

A REIT will be treated as a pension-held REIT if the REIT is predominantly held by tax-exempt pension funds and if the REIT would otherwise fail to satisfy the five or fewer test discussed above. A REIT is predominantly held by tax-exempt pension funds if at least one tax-exempt pension fund holds more than 25% (measured by value) of the REIT's stock or beneficial interests, or if one or more tax-exempt pension funds (each of which owns more than 10% (measured by value) of the REIT's stock or beneficial interests) own in the aggregate more than 50% (measured by value) of the REIT's stock or beneficial interests. The Company believes that it will not be treated as a pension-held REIT. However, because the shares of the Company will be publicly traded, no assurance can be given that the Company is not or will not become a pension-held REIT.

Taxation of Non-U.S. Stockholders

The rules governing United States federal income taxation of any person other than (i) a citizen or resident of the United States, (ii) a corporation or partnership created in the United States or under the laws of the United States or of any state thereof, (iii) an estate whose income is includable in income for U.S. federal income tax purposes regardless of its source or (iv) a trust if a court within the United States is able to exercise primary supervision over the administration of the trust and one or more United States fiduciaries have the authority to control all substantial decisions of the trust (Non-U.S. Stockholders) are highly complex, and the following discussion is intended only as a summary of such rules. Prospective Non-U.S. Stockholders should consult with their own tax advisors to determine the impact of United States federal, state, and local income tax laws on an investment in stock of the Company, including any reporting requirements.

In general, Non-U.S. Stockholders are subject to regular United States income tax with respect to their investment in stock of the Company in the same manner as a U.S. stockholder if such investment is effectively connected with the Non-U.S. Stockholder's conduct of a trade or business in the United States. A corporate Non-U.S. Stockholder that receives income with respect to its investment in stock of the Company that is (or is treated as) effectively connected with the conduct of a trade or business in the United States also may be subject to the 30% branch profits tax imposed by the Code, which is payable in addition to regular United States corporate income tax. The following discussion addresses only the United States taxation of Non-U.S. Stockholders whose investment in stock of the Company is not effectively connected with the conduct of a trade or business in the United States.

Ordinary Dividends

Distributions made by the Company that are not attributable to gain from the sale or exchange by the Company of United States real property interests (USRPI) and that are not designated by the Company as capital gain dividends will be treated as ordinary income dividends to the extent made out of current or accumulated earnings and profits of the Company. Generally, such ordinary income dividends will be subject to United States withholding tax at the rate of 30% on the gross amount of the dividend paid unless reduced or eliminated by an applicable United States income tax treaty. The Company expects to withhold United States income tax at the rate of 30% on the gross amount of any such dividends paid to a Non-U.S. Stockholder unless a lower treaty rate applies and the Non-U.S. Stockholder has filed an IRS Form W-8BEN with the Company, certifying the Non-U.S. Stockholder's entitlement to treaty benefits.

Table of Contents***Non-Dividend Distributions***

Distributions made by the Company in excess of its current and accumulated earnings and profits to a Non-U.S. Stockholder who holds 5% or less of the stock of the Company (after application of certain ownership rules) will not be subject to U.S. income or withholding tax. If it cannot be determined at the time a distribution is made whether or not such distribution will be in excess of the Company's current and accumulated earnings and profits, the distribution will be subject to withholding at the rate applicable to a dividend distribution. However, the Non-U.S. Stockholder may seek a refund from the IRS of any amount withheld if it is subsequently determined that such distribution was, in fact, in excess of the Company's then current and accumulated earnings and profits.

Capital Gain Dividends

As long as the Company continues to qualify as a REIT, distributions made by the Company after December 31, 2005, that are attributable to gain from the sale or exchange by the Company of any USRPI will not be treated as effectively connected with the conduct of a trade or business in the United States. Instead, such distributions will be treated as REIT dividends that are not capital gains and will not be subject to the branch profits tax as long as the Non-U.S. Stockholder does not hold greater than 5% of the stock of the Company at any time during the one-year period ending on the date of the distribution. Non-U.S. Stockholders who hold more than 5% of the stock of the Company will be treated as if such gains were effectively connected with the conduct of a trade or business in the United States and generally subject to the same capital gains rates applicable to U.S. stockholders but, unless a reduced treaty rate applies, will be subject to withholding at the rate of 35% of the gross distribution. If the 35% withholding exceeds the actual tax due, the Non-U.S. Stockholder may file a claim for a refund with the IRS. In addition, corporate Non-U.S. Stockholders may also be subject to the 30% branch profits tax.

Disposition of Stock of the Company

Generally, gain recognized by a Non-U.S. Stockholder upon the sale or exchange of stock of the Company will not be subject to United States taxation unless such stock constitutes a USRPI within the meaning of the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA). The stock of the Company will not constitute a USRPI so long as the Company is a domestically controlled REIT. A domestically controlled REIT is a REIT in which at all times during a specified testing period less than 50% in value of its stock or beneficial interests are held directly or indirectly by Non-U.S. Stockholders. The Company believes that it will be a domestically controlled REIT, and therefore that the sale of stock of the Company will generally not be subject to taxation under FIRPTA. However, because the stock of the Company is publicly traded, no assurance can be given that the Company is or will continue to be a domestically controlled REIT.

Under wash sale rules applicable to certain dispositions of interests in domestically controlled REITs, a Non-U.S. Stockholder could be subject to taxation under FIRPTA on the disposition of stock of the Company if certain conditions are met. If the Company is a domestically controlled REIT, a Non-U.S. Stockholder will be treated as having disposed of USRPI, if such Non-U.S. Stockholder disposes of an interest in the Company in an applicable wash sale transaction. An applicable wash sale transaction is any transaction in which a Non-U.S. Stockholder avoids receiving a distribution from a REIT by (i) disposing of an interest in a domestically controlled REIT during the 30-day period preceding a distribution, any portion of which distribution would have been treated as gain from the sale of a USRPI if it had been received by the Non-U.S. Stockholder and (ii) acquiring, or entering into a contract or option to acquire, a substantially identical interest in the REIT during the 61-day period beginning the first day of the 30-day period preceding the distribution. The wash sale rule does not apply to a Non-U.S. Stockholder who actually receives the distribution from the Company or, so long as the Company is publicly traded, to any Non-U.S. Stockholder holding greater than 5% of the outstanding stock of the Company at any time during the one-year period ending on the date of the distribution.

If the Company did not constitute a domestically controlled REIT, gain arising from the sale or exchange by a Non-U.S. Stockholder of stock of the Company would be subject to United States taxation under FIRPTA as a sale of a USRPI unless (i) the stock of the Company is regularly traded (as defined in the applicable Treasury regulations) and (ii) the selling Non-U.S. Stockholder's interest (after application of certain constructive ownership rules) in the Company is 5% or less at all times during the five years preceding the sale or exchange. If gain on the sale or exchange of the stock of the Company were subject to taxation under FIRPTA, the Non-U.S. Stockholder would be subject to regular United States income tax with respect to such gain in the same manner as a U.S. stockholder (subject to any applicable alternative minimum tax, a special alternative minimum tax in the case of nonresident alien individuals and the possible application of the 30% branch profits tax in the case of foreign corporations), and the purchaser of the stock of the Company (including the Company) would be required to withhold and remit to the IRS 10% of the purchase price. Additionally, in such case, distributions on the stock of the Company to the extent they represent a return of capital or capital gain from the sale of the stock of the Company, rather than dividends, would be subject to a 10% withholding tax.

Table of Contents

Capital gains not subject to FIRPTA will nonetheless be taxable in the United States to a Non-U.S. Stockholder in two cases:

if the Non-U.S. Stockholder's investment in the stock of the Company is effectively connected with a U.S. trade or business conducted by such Non-U.S. Stockholder, the Non-U.S. Stockholder will be subject to the same treatment as a U.S. stockholder with respect to such gain; or

if the Non-U.S. Stockholder is a nonresident alien individual who was present in the United States for 183 days or more during the taxable year and has a tax home in the United States, the nonresident alien individual will be subject to the same treatment as a U.S. Stockholder with respect to such gain.

Information Reporting Requirements and Backup Withholding Tax

The Company will report to its U.S. stockholders and to the IRS the amount of dividends paid during each calendar year and the amount of tax withheld, if any, with respect thereto. Under the backup withholding rules, a U.S. stockholder may be subject to backup withholding, currently at a rate of 28% on dividends paid unless such U.S. stockholder:

is a corporation or falls within certain other exempt categories and, when required, can demonstrate this fact; or

provides a taxpayer identification number, certifies as to no loss of exemption from backup withholding, and otherwise complies with applicable requirements of the backup withholding rules.

A U.S. stockholder who does not provide the Company with his correct taxpayer identification number also may be subject to penalties imposed by the IRS. Any amount paid as backup withholding will be creditable against the U.S. stockholder's federal income tax liability. In addition, the Company may be required to withhold a portion of any capital gain distributions made to U.S. stockholders who fail to certify their non-foreign status to the Company.

Additional issues may arise pertaining to information reporting and backup withholding with respect to Non-U.S. Stockholders, and Non-U.S. Stockholders should consult their tax advisors with respect to any such information reporting and backup withholding requirements.

State and Local Taxes

The Company and its stockholders may be subject to state or local taxation in various state or local jurisdictions, including those in which it or they transact business or reside. The state and local tax treatment of the Company and its stockholders may not conform to the federal income tax consequences discussed above. Consequently, prospective holders should consult their own tax advisors regarding the effect of state and local tax laws on an investment in the stock of the Company.

Real Estate Investment Trust Tax Proposals

Investors must recognize that the present federal income tax treatment of the Company may be modified by future legislative, judicial or administrative actions or decisions at any time, which may be retroactive in effect, and, as a result, any such action or decision may affect investments and commitments previously made. The rules dealing with federal income taxation are constantly under review by persons involved in the legislative process and by the IRS and the Treasury Department, resulting in statutory changes as well as promulgation of new, or revisions to existing, regulations and revised interpretations of established concepts. No prediction can be made as to the likelihood of the passage of any new tax legislation or other provisions either directly or indirectly affecting the Company or its stockholders.

Other Legislation

The Jobs and Growth Tax Relief Reconciliation Act of 2003 reduced the maximum individual tax rate for long-term capital gains generally from 20% to 15% (for sales occurring after May 6, 2003 through December 31, 2008) and for dividends generally from 38.6% to 15% (for tax years from 2003 through 2008). These provisions have been extended through the 2012 tax year. Without future congressional action, the maximum

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tax rate on long-term capital gains will return to 20% in 2013, and the maximum rate on dividends will move to 39.6% in 2013. Because a REIT is not generally subject to federal income tax on the portion of its REIT taxable income or capital gains distributed to its stockholders, distributions of dividends by a REIT are generally not eligible for the 15% tax rate on dividends. As a result, the Company's ordinary REIT dividends will continue to be taxed at the higher tax rates (currently, a maximum of 35%) applicable to ordinary income.

Available Information

The Company makes available to the public free of charge through its internet website the Company's Proxy Statement, Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after the Company electronically files such reports with, or furnishes such reports to, the SEC. The Company's internet website address is www.healthcarerealty.com.

Table of Contents

The public may read and copy any materials that the Company files with the SEC at the SEC's Public Reference Room located at 100 F Street, NE, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains electronic versions of the Company's reports on its website at www.sec.gov.

Corporate Governance Principles

The Company has adopted Corporate Governance Principles relating to the conduct and operations of the Board of Directors. The Corporate Governance Principles are posted on the Company's website (www.healthcarerealty.com) and are available in print to any stockholder who requests a copy.

Committee Charters

The Board of Directors has an Audit Committee, Compensation Committee, Corporate Governance Committee and Executive Committee. The Board of Directors has adopted written charters for each committee, except for the Executive Committee, which are posted on the Company's website (www.healthcarerealty.com) and are available in print to any stockholder who requests a copy.

Executive Officers

Information regarding the executive officers of the Company is set forth in Part III, Item 10 of this report and is incorporated herein by reference.

ITEM 1A. RISK FACTORS

The following are some of the risks and uncertainties that could negatively affect the Company's financial condition, results of operations, business and prospects. These risks, as well as the risks described in Item 1 under the headings Competition, Government Regulation, Legislative Developments, Environmental Matters, and Federal Income Tax Information and in Item 7 under the heading Disclosure Regarding Forward-Looking Statements should be carefully considered before making an investment decision regarding the Company. The risks and uncertainties described below are not the only ones facing the Company, and there may be additional risks that the Company does not presently know of or that the Company currently considers not likely to have a significant impact. If any of the events underlying the following risks actually occurred, the Company's business, financial condition and operating results could suffer, and the trading price of its common stock could decline.

The Company has incurred significant debt obligations and may incur additional debt and increase leverage in the future.

As of December 31, 2011, the Company had approximately \$1.4 billion of outstanding indebtedness. The Company's leverage ratio [debt divided by (debt plus stockholders' equity less intangible assets plus accumulated depreciation)] was 47.8% at December 31, 2011. Covenants under the Unsecured Credit Facility and the indenture governing the Company's senior notes permit the Company to incur substantial, additional debt, and the Company may borrow additional funds, which may include secured borrowings. A high level of indebtedness would require the Company to dedicate a substantial portion of its cash flow from operations to the payment of indebtedness, thereby reducing the funds available to implement the Company's business strategy and to make distributions to stockholders. A high level of indebtedness could also:

potentially limit the Company's ability to adjust rapidly to changing market conditions in the event of a downturn in general economic conditions or in the real estate and/or healthcare industries;

potentially impair the Company's ability to obtain additional debt financing or require potentially dilutive equity to fund obligations and carry out its business strategy; and

potentially downgrade the rating of the Company's debt securities by one or more rating agencies, which would increase the costs of borrowing under the Unsecured Credit Facility and the cost of issuance of new debt securities, among other things.

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In addition, from time to time the Company mortgages properties to secure payment of indebtedness. If the Company is unable to meet its mortgage payments, then the encumbered properties could be foreclosed upon or transferred to the mortgagee with a consequent loss of income and asset value. A foreclosure on one or more of our properties could have a material adverse effect on the Company's financial condition and results of operations.

Table of Contents

The unavailability of equity and debt capital, volatility in the credit markets, increases in interest rates, or changes in the Company's debt ratings could have an adverse effect on the Company's ability to meet its debt payments, make dividend payments to stockholders or engage in acquisition and development activity.

A REIT is required by IRS regulations to make dividend distributions, thereby retaining less of its capital for growth. As a result, a REIT typically grows through steady investments of new capital in real estate assets. However, there may be times when the Company will have limited access to capital from the equity and/or debt markets. Changes in the Company's debt ratings could have a material adverse effect on its interest costs and financing sources. The Company's debt rating can be materially influenced by a number of factors including, but not limited to, acquisitions, investment decisions, and capital management activities. In recent years, the capital and credit markets have experienced volatility and at times have limited the availability of funds. The Company's ability to access the capital and credit markets may be limited by these or other factors, which could have an impact on its ability to refinance maturing debt, fund dividend payments and operations, acquire healthcare properties and complete construction projects. If the Company is unable to refinance or extend principal payments due at maturity of its various debt instruments, its cash flow may not be sufficient to repay maturing debt and, consequently, make dividend payments to stockholders. If the Company defaults in paying any of its debts or honoring its debt covenants, it could experience cross-defaults among debt instruments, the debts could be accelerated and the Company could be forced to liquidate assets for less than the values it would otherwise receive.

The Company is exposed to increases in interest rates, which could adversely impact its ability to refinance existing debt, sell assets or engage in acquisition and development activity.

The Company receives a significant portion of its revenues by leasing its assets under long-term leases in which the rental rate is generally fixed, subject to annual rent escalators. A significant portion of the Company's debt may be from time to time subject to floating rates, based on LIBOR or other indices. The generally fixed nature of revenues and the variable rate of certain debt obligations create interest rate risk for the Company. Increases in interest rates could make the financing of any acquisition or investment activity more costly. Rising interest rates could limit the Company's ability to refinance existing debt when it matures or cause the Company to pay higher rates upon refinancing. An increase in interest rates also could have the effect of reducing the amounts that third parties might be willing to pay for real estate assets, which could limit the Company's ability to sell assets at times when it might be advantageous to do so.

The Company's business operations may not generate the cash needed to service debt or fund planned capital expenditures.

The Company's ability to make payments on its indebtedness and to fund planned capital expenditures will depend on its ability to generate cash in the future. There can be no assurance that the Company's business will generate sufficient cash flow from operations or that future borrowings will be available in amounts sufficient to enable the Company to pay its indebtedness or to fund other liquidity needs.

Owning real estate and indirect interests in real estate is subject to inherent risks.

The Company's operating performance and the value of its real estate assets are subject to the risk that if its properties do not generate revenues sufficient to meet its operating expenses, including debt service, the Company's cash flow and ability to pay dividends to shareholders will be adversely affected.

The Company may decide or may be required under purchase options to sell certain properties. The Company may not be able to reinvest the proceeds from sale at rates of return equal to the return received on the properties sold.

At December 31, 2011, the Company had approximately \$108.9 million in real estate properties, or 3.9% of the Company's real estate property investments, that were subject to exercisable purchase options held by lessees or financial support agreement sponsors that had not been exercised. Other properties have purchase options that will become exercisable in the future. The exercise of these purchase options exposes the Company to reinvestment risk. Certain properties subject to purchase options are producing returns above the rates of return the Company expects to achieve with new investments. If the Company is unable to reinvest the proceeds of sale at rates of return equal to the return received on the properties that are sold, it may experience a decline in lease revenues and a corresponding material adverse effect on the Company's business and financial condition, the Company's ability to make distributions to its stockholders, and the market price of its common stock.

The Company's real estate investments are illiquid and the Company may not be able to sell properties strategically targeted for disposition.

Because real estate investments are relatively illiquid, the Company's ability to adjust its portfolio promptly in response to economic or other conditions is limited. Certain significant expenditures generally do not change in response to economic or other conditions, including debt service (if any), real estate taxes, and operating and maintenance costs. This combination of variable revenue

Table of Contents

and relatively fixed expenditures may result in reduced earnings and could have an adverse effect on the Company's financial condition. In addition, the Company may not be able to sell properties targeted for disposition, including properties held for sale, due to adverse market conditions. This may negatively affect, among other things, the Company's ability to sell properties on favorable terms, execute its operating strategy, repay debt or pay dividends.

The Company is subject to risks associated with the development of properties.

As of December 31, 2011, the Company had approximately \$471.2 million invested in construction in progress, construction mortgage loans, stabilization in progress and land held for development. The Company's estimated remaining funding obligations on the projects in construction in progress, construction mortgage loans and stabilization in progress was approximately \$214.1 million at December 31, 2011. The Company is subject to certain risks associated with the development of properties including the following:

The construction of properties generally requires various government and other approvals that may not be received when expected, or at all, which could delay or preclude commencement of construction;

Development opportunities that the Company pursued but later abandoned could result in the expensing of pursuit costs, which could impact the Company's results of operations;

Construction costs could exceed original estimates, which could impact the building's profitability to the Company;

Operating expenses could be higher than forecasted;

Time required to initiate and complete the construction of a property and to lease up a completed development property may be greater than originally anticipated, thereby adversely affecting the Company's cash flow and liquidity;

Occupancy rates and rents of a completed development property may not be sufficient to make the property profitable to the Company; and

Favorable capital sources to fund the Company's development activities may not be available when needed.

From time to time the Company may make material acquisitions and developments that may involve the expenditure of significant funds and may not perform in accordance with management's expectations.

The Company regularly pursues potential transactions to acquire or develop additional assets in order to grow stockholder value. Future acquisitions could require the Company to issue equity securities, incur debt or other contingent liabilities or amortize expenses related to other intangible assets, any of which could adversely impact the Company's financial condition or results of operations. In addition, equity or debt financing required for such acquisitions may not be available at favorable times or rates.

The Company's acquired, developed and existing real estate properties may not perform in accordance with management's expectations because of many factors including the following:

The Company's purchase price for acquired facilities may be based upon a series of market or building-specific judgments which may be incorrect;

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The costs of any maintenance or improvements for properties might exceed budgeted costs;

The Company may incur unexpected costs in the acquisition, construction or maintenance of real estate assets that could impact its expected returns on such assets; and

Leasing of real estate properties may not occur within expected time frames or at expected rental rates.

Further, the Company can give no assurance that acquisition and development opportunities that meet management's investment criteria will be available when needed or anticipated.

The Company may incur impairment charges on its real estate properties or other assets.

The Company performs an annual impairment review on its real estate properties in the third quarter of every fiscal year. In addition, the Company assesses the potential for impairment of identifiable intangible assets and long-lived assets, including real estate properties, whenever events occur or a change in circumstances indicates that the recorded value might not be fully recoverable. The decision to sell a property also requires the Company to assess the potential for impairment. At some future date, the Company may determine that an impairment has occurred in the value of one or more of its real estate properties or other assets. In such an event, the Company may be required to recognize an impairment loss which could have a material adverse effect on the Company's financial condition and results of operations.

Table of Contents

The Company's expiring long-term master leases may not be extended.

Long-term master leases that are expiring may not be extended. To the extent these properties have vacancies or subleases at lower rates upon expiration, income may decline if the Company is not able to re-let the properties at rental rates that are as high as the former rates. The Company has three properties under master lease agreements that will expire during 2012 which had an aggregate net operating income of approximately \$2.0 million during 2011.

Covenants in the Company's debt instruments limit its operational flexibility, and a breach of these covenants could materially affect the Company's financial condition and results of operations.

The terms of the Unsecured Credit Facility, the indentures governing the Company's outstanding senior notes and other debt instruments that the Company may enter into in the future are subject to customary financial and operational covenants. These provisions include, among other things: a limitation on the incurrence of additional indebtedness; limitations on mergers, investments, acquisitions, redemptions of capital stock, transactions with affiliates; and maintenance of specified financial ratios. The Company's continued ability to incur debt and operate its business is subject to compliance with these covenants, which limit operational flexibility. Breaches of these covenants could result in defaults under applicable debt instruments, even if payment obligations are satisfied. Financial and other covenants that limit the Company's operational flexibility, as well as defaults resulting from a breach of any of these covenants in its debt instruments, could have a material adverse effect on the Company's financial condition and results of operations.

The Company's revenues depend on the ability of its tenants and sponsors under its leases and financial support agreements to generate sufficient income from their operations to make loan, rent and support payments to the Company.

The Company's revenues are subject to the financial strength of its tenants and sponsors. The Company has no operational control over the business of these tenants and sponsors who face a wide range of economic, competitive, government reimbursement and regulatory pressures and constraints. The slowdown in the economy, decline in the availability of financing from the capital markets, and changes in healthcare regulations have affected, or may in the future adversely affect, the businesses of the Company's tenants and sponsors to varying degrees. Such conditions may further impact such tenants' and sponsors' abilities to meet their obligations to the Company and, in certain cases, could lead to restructurings, disruptions, or bankruptcies of such tenants and sponsors. In turn, these conditions could adversely affect the Company's revenues and could increase allowances for losses and result in impairment charges, which could decrease net income attributable to common stockholders and equity, and reduce cash flows from operations.

If a healthcare tenant loses its licensure or certification, becomes unable to provide healthcare services, cannot meet its financial obligations to the Company or otherwise vacates a facility, the Company would have to obtain another tenant for the affected facility.

If the Company loses a tenant or sponsor and is unable to attract another healthcare provider on a timely basis and on acceptable terms, the Company's cash flows and results of operations could suffer. In addition, many of the Company's properties are special purpose healthcare facilities that may not be easily adaptable to other uses. Transfers of operations of healthcare facilities are often subject to regulatory approvals not required for transfers of other types of commercial operations and real estate.

Many of the Company's properties are held under long-term ground leases. These ground leases contain provisions that may limit the Company's ability to lease, sell, or finance these properties.

As of December 31, 2011, the Company had 105 properties, representing an aggregate net investment of approximately \$1.3 billion that were held under long-term ground leases. The Company's ground lease agreements with hospitals and health systems typically contain restrictions that limit building occupancy to physicians on the medical staff of an affiliated hospital and prohibit physician tenants from providing services that compete with the services provided by the affiliated hospital. Ground leases may also contain consent requirements or other restrictions on sale or assignment of the Company's leasehold interest, including rights of first offer and first refusal in favor of the lessor. These ground lease provisions may limit the Company's ability to lease, sell, or obtain mortgage financing secured by such properties which, in turn, could adversely affect the income from operations or the proceeds received from a sale. As a ground lessee, the Company is also exposed to the risk of reversion of the property upon expiration of the ground lease term, or an earlier breach by the Company of the ground lease, which may have a material adverse effect on the Company's business, financial condition and results of operations, the Company's ability to make distributions to the Company's stockholders and the trading price of the Company's common stock.

Table of Contents

If the Company is unable to promptly re-let its properties, if the rates upon such re-letting are significantly lower than expected or if the Company is required to undertake significant capital expenditures to attract new tenants, then the Company's business, financial condition and results of operations would be adversely affected.

A portion of the Company's leases will mature over the course of any year. For more specific information concerning the Company's expiring leases, see "Expiring Leases" on page 31 of this Annual Report on Form 10-K. The Company may not be able to re-let space on terms that are favorable to the Company or at all. Further, the Company may be required to make significant capital expenditures to renovate or reconfigure space to attract new tenants. If it is unable to promptly re-let its properties, if the rates upon such re-letting are significantly lower than expected, or if the Company is required to undertake significant capital expenditures in connection with re-letting units, the Company's business, financial condition and results of operations, the Company's ability to make distributions to the Company's stockholders and the trading price of the Company's common stock may be materially and adversely affected.

Certain of the Company's properties are special purpose healthcare facilities and may not be easily adaptable to other uses.

Some of the Company's properties are specialized medical facilities. If the Company or the Company's tenants terminate the leases for these properties or the Company's tenants lose their regulatory authority to operate such properties, the Company may not be able to locate suitable replacement tenants to lease the properties for their specialized uses. Alternatively, the Company may be required to spend substantial amounts to adapt the properties to other uses. Any loss of revenues and/or additional capital expenditures occurring as a result may have a material adverse effect on the Company's business, financial condition and results of operations, the Company's ability to make distributions to its stockholders, and the market price of the Company's common stock.

A change to the Company's current dividend payment may have an adverse effect on the market price of the Company's stock.

The ability of the Company to pay dividends is dependent upon its ability to maintain funds from operations and cash flow, to make accretive new investments and to access capital. There can be no assurance that the Company will continue to pay dividends at current amounts, or at all. A failure to maintain dividend payments at current levels could result in a reduction of the market price of the Company's stock.

Adverse trends in the healthcare service industry may negatively affect the Company's lease revenues and the values of its investments.

The healthcare service industry may be affected by the following:

trends in the method of delivery of healthcare services;

competition among healthcare providers;

lower increases in reimbursement rates from government and commercial payors, high uncompensated care expense, investment losses and limited admissions growth pressuring operating profit margins for healthcare providers;

availability of capital;

credit downgrades;

liability insurance expense;

regulatory and government reimbursement uncertainty resulting from the Health Reform Law;

health reform initiatives to address healthcare costs through expanded pay-for-performance criteria, value-based purchasing programs, bundled provider payments, accountable care organizations, state health insurance exchanges, increased patient cost-sharing, geographic payment variations, comparative effectiveness research, and lower payments for hospital readmissions;

federal and state government plans to reduce budget deficits by lowering healthcare provider Medicare and Medicaid payment rates, while requiring increased patient access to care, but prior to expanding public benefits to the uninsured and senior populations;

congressional efforts to reform the Medicare physician fee-for-service formula that dictates annual updates in payment rates for physician services, including significant reductions in the sustainable growth rate, whether through a short-term fix or a more long-term solution;

Table of Contents

scrutiny and formal investigations by federal and state authorities;

prohibitions on additional types of contractual relationships between physicians and the healthcare facilities and providers to which they refer, and related information-collection activities;

efforts to increase transparency with respect to pricing and financial relationships among healthcare providers and drug/device manufacturers;

increased regulation to limit medical errors and conditions acquired inside health facilities and improve patient safety;

heightened health information technology standards for healthcare providers;

potential tax law changes affecting non-profit providers; and

enhanced facility requirements related to accessibility by persons with disabilities, as well as structural retrofitting for earthquakes and other disasters.

These changes, among others, can adversely affect the economic performance of some or all of the tenants and sponsors who provide financial support to the Company's investments and, in turn, negatively affect the lease revenues and the value of the Company's property investments.

The Company is exposed to risks associated with entering new geographic markets.

The Company's acquisition and development activities may involve entering geographic markets where the Company has not previously had a presence. The construction and/or acquisition of properties in new geographic areas involves risks, including the risk that the property will not perform as anticipated and the risk that any actual costs for site development and improvements identified in the pre-construction or pre-acquisition due diligence process will exceed estimates. There is, and it is expected that there will continue to be, significant competition for investment opportunities that meet management's investment criteria, as well as risks associated with obtaining financing for acquisition activities, if necessary.

The Company may experience uninsured or underinsured losses related to casualty or liability.

The Company generally requires its tenants to maintain comprehensive liability and property insurance that covers the Company as well as the tenants. The Company also carries comprehensive liability insurance and property insurance covering its owned and managed properties. In addition, tenants under long-term master leases are required to carry property insurance covering the Company's interest in the buildings. Some types of losses, however, either may be uninsurable or too expensive to insure against. Should an uninsured loss or a loss in excess of insured limits occur, the Company could lose all or a portion of the capital it has invested in a property, as well as the anticipated future revenue from the property. In such an event, the Company might remain obligated for any mortgage debt or other financial obligation related to the property. The Company cannot give assurance that material losses in excess of insurance proceeds will not occur in the future.

Failure to maintain its status as a REIT, even in one taxable year, could cause the Company to reduce its dividends dramatically.

The Company intends to qualify at all times as a REIT under the Code. If in any taxable year the Company does not qualify as a REIT, it would be taxed as a corporation. As a result, the Company could not deduct its distributions to the stockholders in computing its taxable income. Depending upon the circumstances, a REIT that loses its qualification in one year may not be eligible to re-qualify during the four succeeding years. Further, certain transactions or other events could lead to the Company being taxed at rates ranging from four to 100 percent on certain income or gains. For more information about the Company's status as a REIT, see "Federal Income Tax Information" in Item 1 of this Annual Report on Form 10-K.

If lenders under the Unsecured Credit Facility fail to meet their funding commitments, the Company's financial position would be negatively impacted.

Access to external capital on favorable terms is critical to the Company's success in growing and maintaining its portfolio. If financial institutions within the Unsecured Credit Facility were unwilling or unable to meet their respective funding commitments to the Company, any such failure would have a negative impact on the Company's operations, financial condition and ability to meet its obligations, including the payment of dividends to stockholders.

Table of Contents

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

In addition to the properties described under Item 1, Business, in Note 2 to the Consolidated Financial Statements, and in Schedule III of Item 15 of this Annual Report on Form 10-K, the Company leases office space from an unrelated third party for its headquarters, which are located at 3310 West End Avenue in Nashville, Tennessee. The Company's office lease, which expires on October 31, 2020, covers approximately 30,934 square feet of rented space with base rental escalations of approximately 3.25% annually and an additional base rental increase possible beginning in 2015 conditioned on changes in CPI. The lease also provides the Company with a right of first offer to purchase the building if the current landlord were to decide to sell the property. The Company's base rent for 2011 was approximately \$0.7 million.

ITEM 3. LEGAL PROCEEDINGS

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

Table of Contents**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Shares of the Company's common stock are traded on the New York Stock Exchange under the symbol HR. As of December 31, 2011, there were approximately 1,273 stockholders of record. The following table sets forth the high and low sales prices per share of common stock and the dividend declared and paid per share of common stock related to the periods indicated.

	High	Low	Dividends Declared and Paid per Share
2011			
First Quarter	\$23.73	\$20.24	\$0.30
Second Quarter	23.53	19.92	0.30
Third Quarter	21.29	13.83	0.30
Fourth Quarter (Payable on March 1, 2012)	19.39	16.04	0.30
2010			
First Quarter	\$24.57	\$19.61	\$0.30
Second Quarter	25.24	20.47	0.30
Third Quarter	24.69	21.36	0.30
Fourth Quarter	25.00	20.06	0.30

Future dividends will be declared and paid at the discretion of the Board of Directors. The Company's ability to pay dividends is dependent upon its ability to generate funds from operations, cash flows, and to make accretive new investments.

Equity Compensation Plan Information

The following table provides information as of December 31, 2011 about the Company's common stock that may be issued upon grants of restricted stock and the exercise of options, warrants and rights under all of the Company's existing compensation plans, including the 2007 Employees Stock Incentive Plan and the 2000 Employee Stock Purchase Plan.

Plan Category	Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants and Rights (1)		Weighted Average Exercise Price of Outstanding Options, Warrants and Rights (1)	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in the First Column)
	Equity compensation plans approved by security holders	425,196		
Equity compensation plans not approved by security holders				
Total	425,196			1,440,416

- (1) The Company's outstanding rights relate only to its 2000 Employee Stock Purchase Plan. The Company is unable to ascertain with specificity the number of securities to be used upon exercise of outstanding rights under the 2000 Employee Stock Purchase Plan or the weighted average exercise price of outstanding rights under that plan. The 2000 Employee Stock Purchase Plan provides that shares of

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common stock may be purchased at a per share price equal to 85% of the fair market value of the common stock at the beginning of the offering period or a purchase date applicable to such offering period, whichever is lower.

Table of Contents**ITEM 6. SELECTED FINANCIAL DATA**

The following table sets forth financial information for the Company, which is derived from the Consolidated Financial Statements of the Company:

<i>(Dollars in thousands except per share data)</i>	Years Ended December 31,				
	2011	2010 (1)	2009 (1)	2008 (1)	2007 (1) (2)
Statement of Operations Data:					
Total revenues	\$ 296,649	\$ 255,674	\$ 242,801	\$ 201,933	\$ 185,788
Total expenses	\$ 222,502	\$ 189,799	\$ 180,186	\$ 153,180	\$ 133,942
Other income (expense)	\$ (77,204)	\$ (63,787)	\$ (39,351)	\$ (35,586)	\$ (46,850)
Income (loss) from continuing operations	\$ (3,057)	\$ 2,088	\$ 23,264	\$ 13,167	\$ 4,996
Discontinued operations	\$ 2,873	\$ 6,159	\$ 27,884	\$ 28,593	\$ 55,084
Net income (loss)	\$ (184)	\$ 8,247	\$ 51,148	\$ 41,760	\$ 60,080
Less: Net income attributable to noncontrolling interests	\$ (30)	\$ (47)	\$ (57)	\$ (68)	\$ (18)
Net income (loss) attributable to common stockholders	\$ (214)	\$ 8,200	\$ 51,091	\$ 41,692	\$ 60,062
Per Share Data:					
Basic earnings per common share:					
Income (loss) from continuing operations	\$ (0.04)	\$ 0.03	\$ 0.40	\$ 0.26	\$ 0.10
Discontinued operations	\$ 0.04	\$ 0.10	\$ 0.48	\$ 0.55	\$ 1.16
Net income (loss) attributable to common stockholders	\$ 0.00	\$ 0.13	\$ 0.88	\$ 0.81	\$ 1.26
Diluted earnings per common share:					
Income (loss) from continuing operations	\$ (0.04)	\$ 0.03	\$ 0.39	\$ 0.25	\$ 0.10
Discontinued operations	\$ 0.04	\$ 0.10	\$ 0.48	\$ 0.54	\$ 1.14
Net income (loss) attributable to common stockholders	\$ 0.00	\$ 0.13	\$ 0.87	\$ 0.79	\$ 1.24
Weighted average common shares outstanding - Basic	72,720,147	61,722,786	58,199,592	51,547,279	47,536,133
Weighted average common shares outstanding - Diluted	72,720,147	62,770,826	59,047,314	52,564,944	48,291,330
Balance Sheet Data (as of the end of the period):					
Real estate properties, gross	\$ 2,788,618	\$ 2,571,605	\$ 2,225,327	\$ 2,001,724	\$ 1,696,630
Real estate properties, net	\$ 2,271,871	\$ 2,086,964	\$ 1,791,693	\$ 1,634,364	\$ 1,351,173
Mortgage notes receivable	\$ 97,381	\$ 36,599	\$ 31,008	\$ 59,001	\$ 30,117
Assets held for sale and discontinued operations, net	\$ 28,650	\$ 23,915	\$ 17,745	\$ 90,233	\$ 15,639
Total assets	\$ 2,521,022	\$ 2,357,309	\$ 1,935,764	\$ 1,864,780	\$ 1,495,492
Notes and bonds payable	\$ 1,393,537	\$ 1,407,855	\$ 1,046,422	\$ 940,186	\$ 785,289
Total equity	\$ 1,004,806	\$ 842,740	\$ 790,148	\$ 796,247	\$ 631,995
Other Data:					
Funds from operations - Basic and Diluted (3)	\$ 84,682	\$ 79,084	\$ 97,904	\$ 86,323	\$ 80,244
Funds from operations per common share - Basic (3)	\$ 1.16	\$ 1.28	\$ 1.68	\$ 1.67	\$ 1.69
Funds from operations per common share - Diluted (3)	\$ 1.15	\$ 1.26	\$ 1.66	\$ 1.64	\$ 1.66
Cash flows from operations	\$ 105,032	\$ 80,835	\$ 103,214	\$ 105,251	\$ 90,938
Quarterly dividends paid	\$ 89,270	\$ 75,821	\$ 91,385	\$ 81,301	\$ 101,137
Quarterly dividends declared and paid per common share	\$ 1.20	\$ 1.20	\$ 1.54	\$ 1.54	\$ 2.09
Special dividend declared and paid per common share	\$	\$	\$	\$	\$ 4.75

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- (1) The years ended December 31, 2010, 2009, 2008 and 2007 are restated to conform to the discontinued operations presentation for 2011. See Note 5 to the Consolidated Financial Statements for more information on the Company's discontinued operations at December 31, 2011.
- (2) The Company completed the sale of its senior living assets in 2007 and paid a \$4.75 per share special dividend with a portion of the proceeds.

Table of Contents

- (3) See Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) for a discussion of funds from operations (FFO), including why the Company presents FFO and a reconciliation of net income attributable to common stockholders to FFO. FFO and FFO per share for 2010, 2009, 2008, and 2007 have been restated to add back impairments of real estate assets to net income attributable to common stockholders in calculating FFO as discussed in more detail in MD&A.

Table of Contents

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
Disclosure Regarding Forward-Looking Statements

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

Such risks and uncertainties include, among other things, the following:

The Company has incurred significant debt obligations and may incur additional debt and increase leverage in the future;

The unavailability of equity and debt capital, volatility in the credit markets, increases in interest rates, or changes in the Company's debt ratings could have an adverse effect on the Company's ability to meet its debt payments, make dividend payments to stockholders or engage in acquisition and development activity;

The Company's business operations may not generate the cash needed to service debt or fund planned capital expenditures;

Owning real estate and indirect interests in real estate is subject to inherent risks;

The Company may decide or may be required under purchase options to sell certain properties. The Company may not be able to reinvest the proceeds from sale at rates of return equal to the return received on the properties sold;

The Company's real estate investments are illiquid and the Company may not be able to sell properties consistent with its operating strategy;

The Company is subject to risks associated with the development of properties;

From time to time, the Company may make material acquisitions and developments that may involve the expenditure of significant funds and may not perform in accordance with management's expectations;

The Company may incur impairment charges on its real estate properties or other assets;

The Company's long-term master leases and financial support agreements may expire and not be extended;

Covenants in the Company's debt instruments limit its operational flexibility, and a breach of these covenants could materially affect the Company's financial condition and results of operations;

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The Company's revenues depend on the ability of its tenants and sponsors under its leases and financial support agreements to generate sufficient income from their operations to make loan, rent and support payments to the Company;

If a tenant loses its licensure or certification, becomes unable to provide healthcare services, cannot meet its financial obligations to the Company or otherwise vacates a facility, the Company would have to obtain another tenant for the affected facility;

Many of the Company's properties are held under long-term ground leases. These ground leases contain provisions that may limit the Company's ability to lease, sell, or finance these properties;

If the Company is unable to re-let its properties, if the rates upon such re-letting are significantly lower than expected or if the Company is required to undertake significant capital expenditures to attract new tenants, then the Company's business, financial condition and results of operations would be adversely affected;

Certain of the Company's properties are special purpose healthcare facilities and may not be easily adapted to other uses;

Table of Contents

A change to the Company's current dividend payment may have an adverse effect on the market price of the Company's stock;

Adverse trends in the healthcare service industry may negatively affect the Company's lease revenues and the value of its investments;

The Company is exposed to risks associated with entering new geographic markets;

The Company may experience uninsured or underinsured losses related to casualty or liability;

Failure to maintain its status as a REIT, even in one taxable year, could cause the Company to reduce its dividends dramatically; and

If lenders under the Unsecured Credit Facility fail to meet their funding commitments, the Company's financial position would be negatively impacted.

Other risks, uncertainties and factors that could cause actual results to differ materially from those projected are detailed in Item 1A Risk Factors of this report and in other reports filed by the Company with the SEC from time to time.

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.

Overview

Business Overview

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

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

Executive Overview

During 2011, the Company acquired \$155.7 million in real estate properties, acquired or originated \$85.5 million in mortgage loans, funded \$79.4 million related to its construction projects and funded \$19.2 million in existing mortgage loans. Management continues to see investment opportunities across the country, some of which involve healthcare systems seeking outside capital and expertise and others involving third-parties or developers monetizing their holdings or seeking a capital partner. The Company generally expects to see a capitalization rate of 6.5% to 8.5% on new single asset investments. However, capitalization rates can vary greatly due to a variety of factors, including growth prospects, age of the asset, occupancy, location, affiliation with health systems and other factors. In addition, assets that are part of a portfolio will generally result in lower capitalization rates.

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The results of operations for 2011 as compared to 2010 were negatively impacted by interest expense which increased \$10.3 million in 2011 compared to 2010. In advance of the May 2011 repayment of its outstanding \$278.2 million of senior notes (the Senior Notes due 2011), the Company took advantage of the low interest rate environment in December 2010 to issue \$400 million in 5.75% Senior Notes due 2021 which were used to repay the outstanding balance on the unsecured credit facility due 2012 and pre-fund the repayment of the Senior Notes due 2011. As a result of this opportunistic issuance of the Senior Notes due 2021, the Company effectively paid approximately four months of interest on both the Senior Notes due 2021 and the Senior Notes due 2011 during 2011 that otherwise would not have been paid.

Table of Contents

At December 31, 2011, the Company's leverage ratio [debt divided by (debt plus stockholders' equity less intangible assets plus accumulated depreciation)] was approximately 47.8% and its borrowings outstanding under the Unsecured Credit Facility totaled \$212.0 million with a capacity remaining under its financial covenants of approximately \$488.0 million.

Trends and Matters Impacting Operating Results

Management monitors factors and trends important to the Company and REIT industry in order to gauge the potential impact on the operations of the Company. Discussed below are some of the factors and trends that management believes may impact future operations of the Company.

2011 Acquisitions

During 2011, the Company acquired approximately \$155.7 million in real estate assets and funded \$85.5 million in mortgage notes receivable. These acquisitions and mortgage notes were funded with borrowings on the unsecured credit facilities, proceeds from the Senior Notes due 2021 issued in December 2010, proceeds from real estate dispositions and mortgage note repayments, proceeds from the Company's at-the-market equity offering program, and from the assumption of existing mortgage debt related to certain acquired properties. See Note 4 to the Consolidated Financial Statements for more information on these acquisitions.

Development Activity

The Company had several development projects ongoing at December 31, 2011, including three construction projects, four construction mortgage loans and 10 properties in the process of stabilization subsequent to construction. See Note 14 to the Consolidated Financial Statements for more detail on these projects.

The Company's ability to complete and stabilize these facilities in a given period of time will impact the Company's results of operations and cash flows. More favorable completion dates, stabilization periods and rental rates will result in improved results of operations and cash flows, while lagging completion dates, stabilization periods and rental rates will result in less favorable results of operations and cash flows. The Company's disclosures regarding projections or estimates of completion dates and leasing may not reflect actual results. See Note 14 to the Consolidated Financial Statements for more information on the Company's development activities.

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

Dispositions and Impairments

During 2011, the Company disposed of five real estate properties for approximately \$19.6 million in net proceeds and recognized approximately \$5.7 million in gains and approximately \$1.7 million in impairments from the sale of the properties. Also, two mortgage notes receivable totaling approximately \$17.2 million were repaid. Upon repayment of one of the mortgage notes receivables, the Company recognized a gain of \$1.4 million that had been deferred from the original sale of the building to the borrower in 2006. Proceeds from these dispositions were used to repay amounts due under the Company's unsecured credit facilities, to fund additional real estate investments, and for general corporate purposes. See Note 4 to the Consolidated Financial Statements for more information on these dispositions.

In addition to the \$1.7 million in impairments recorded during 2011 from the sales of properties, the Company recorded an additional \$5.0 million in impairments related to properties placed into held for sale during 2011.

2012 Acquisitions

In January 2012, the Company purchased a 58,295 square foot medical office building in South Dakota for \$15.0 million. The property is 100% leased under a single absolute net lease with an affiliate of AA- rated Sanford Health, with a parent guarantee, and the lease expires in 2022. The property is connected to a new Sanford Health acute care hospital that is currently under construction.

In February 2012, the Company purchased a 23,312 square foot medical office building in North Carolina for \$6.4 million. The property is 100% leased by two tenants, and the leases expire in 2019.

Table of Contents

2012 Dispositions

In January 2012, the Company disposed of two medical office buildings located in Texas that were classified as held for sale and in which the Company had a \$2.5 million net investment at December 31, 2011. The Company received approximately \$3.4 million in consideration including a seller-financed \$3.0 million mortgage note receivable.

In January 2012, the Company disposed of a medical office building located in Florida that was classified as held for sale and in which the Company had a \$3.1 million net investment at December 31, 2011. The Company received approximately \$7.2 million in proceeds, net of expenses incurred at the time of closing.

In January 2012, an inpatient facility under construction in South Dakota that was being funded by the Company through a mortgage note was sold. As a result, the Company's mortgage note was repaid in full. The Company began consolidating the variable interest entity that owned the ongoing construction project in the third quarter of 2011 when the Company concluded it was the primary beneficiary of the entity, resulting in the elimination of the construction mortgage loan in the Consolidated Financial Statements. The balance in the construction project at December 31, 2011 was approximately \$38.0 million. Amounts outstanding on the mortgage note receivable totaled approximately \$34.9 million at December 31, 2011. The Company does not anticipate a material gain or loss in connection with the deconsolidation of the project.

Potential Dispositions

In the fourth quarter of 2010, the Company received notice from a tenant of its intent to purchase six skilled nursing facilities in Michigan and Indiana pursuant to purchase options contained in its leases with the Company. The Company's aggregate net investment in the buildings, which were classified as held for sale upon receiving notice of the purchase option exercise, was approximately \$8.2 million at December 31, 2011, and the aggregate contractual rent on the facilities is approximately \$0.7 million per quarter. The aggregate purchase price for the properties is expected to be approximately \$17.3 million, resulting in an expected aggregate net gain of approximately \$9.1 million. The Company expects the sales will close in 2012.

During the fourth quarter of 2011, management decided to sell seven properties in the Company's portfolio. In connection with its planned disposal of these properties, the Company determined that the carrying value for four of these properties would not likely be fully recoverable upon sale. Accordingly, the Company recorded an aggregate impairment charge on these properties of approximately \$4.7 million, reducing the aggregate net investment in the properties to approximately \$6.7 million. Of the seven properties identified for disposal, four of the properties are located in Texas and three are located in Florida. Three of the seven properties were sold during January 2012, and the remaining four, two of which are under contract, are expected to be sold during 2012.

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

Purchase Options

As discussed in *Liquidity and Capital Resources*, certain of the Company's leases include purchase option provisions, which if exercised, could require the Company to sell a property to a lessee or operator, which could have a negative impact on the Company's future results of operations and cash flows.

Table of Contents

Leasing Trends

Expiring Leases

Overall, the Company expects approximately 15%-20% of the leases in its multi-tenanted portfolio will expire each year. During 2011, 320 of the leases in the Company's multi-tenanted buildings expired of which approximately 89% were renewed or the tenants continue to occupy the space. An additional 369 leases in the Company's multi-tenanted portfolio will expire during 2012. Approximately 85% of the leases expiring in 2012 are located in buildings on hospital campuses. The 2012 expirations are distributed throughout the portfolio and are not concentrated with any one tenant, health system or location.

Master leases on five of the Company's properties expired during 2011. Three of the tenants renewed their leases, and the Company assumed the subtenant leases and management of the other two properties' operations. The aggregate net operating income on the five buildings is expected to be approximately \$0.9 million per quarter lower than under the previous master leases. In addition to these five properties, one other master-leased property, whose lease was set to expire during the year, was sold.

Master leases on three, single-tenanted properties are scheduled to expire during 2012. An agreement (in principle) has been reached but not executed on one of the properties whose master lease expires in February 2012. The terms of the amended lease on this 12,000 square foot property will extend the expiration of the lease for an additional two years at the same lease rate with annual increases in the lease rate. Negotiations are on-going relating to the renewal of the remaining two master-leased properties. The properties include a 13,500 square foot property with a lease expiration in July 2012 and a 110,000 square foot property with a lease expiration in July 2012.

Financial support payments totaling approximately \$0.5 million per quarter expired on September 30, 2011 on two of the Company's properties in New Orleans. Since Hurricane Katrina struck in August 2005, the Company received a series of payments totaling \$8.6 million under the financial support agreements. The Company's total investment in the two buildings was approximately \$11.0 million (\$6.2 million, net) at December 31, 2011. The buildings, which aggregate approximately 136,155 square feet, are adjacent to the former Methodist Hospital in East New Orleans which has remained closed since Hurricane Katrina. The City of New Orleans purchased the hospital and formed a partnership with a health system to open and operate the hospital in the future, which the Company expects will provide additional occupancy in the buildings.

Lease Renewal Rates

Due to the non-fungible nature and high occupancy of the Company's principal asset type—on-campus, medical office buildings—the Company continues to see positive re-leasing spreads across its portfolio. For newly executed leases in 2011, the quarterly weighted average rent increases ranged from 1.7% to 2.5%. The Company has seen these positive leasing spreads every quarter for several years and has been able to increase rents throughout the economic downturn.

Tenant Improvements

In most markets, subject to the terms of the lease, the Company may provide a tenant improvement allowance in the lease rental rate for the purpose of refurbishing or renovating second generation tenant space. Shorter-term leases (one to two years) generally do not involve a tenant improvement allowance. Where a tenant improvement allowance is offered, the typical allowance is approximately \$1.00 per square foot per year of term. Tenant improvement allowances for first generation tenant space are approximately \$40.00 to \$50.00 per square foot.

If tenants spend more than the allowance, the Company generally offers the tenant the option to either amortize the overage over the lease term, with interest, or reimburse the overage to the Company in a lump sum. In either case, such overage reimbursements are amortized by the Company as rent over the term of the lease. Interest earned on tenant overages is included in other operating income in the Company's Statement of Operations and totaled approximately \$0.5 million in 2011. The tenant overage amount amortized to rent in 2011 totaled approximately \$2.9 million.

Leasing Commissions

The Company manages the majority of its real estate portfolio and handles most of its leasing in-house. In certain markets, the Company may pay leasing commissions to real estate brokers who represent either the Company's properties or prospective tenants. Where the Company does pay leasing commissions, the commission will generally equate to 4%-6% of the gross lease value for new leases. In 2011, the Company paid approximately \$2.0 million in leasing commissions, which will be amortized to rent over the term of the lease.

Table of Contents

Rent Concessions

Rent concessions are sometimes used to help induce a potential tenant or renewing tenant to lease space in the Company's properties. In most cases, rent concessions are only offered with respect to currently vacant space. Concessions generally take the form of deferred rent. Such concessions, when made, are amortized by the Company on a straight-line basis against rental income over the lease term. Some markets have experienced softening in rates as general office and retail landlords seek medical tenants to help solve their vacancy issues. Driven also by reimbursement uncertainty and the introduction of tenant-representative real estate brokers, in recent quarters the Company has seen increased interest in rent concessions from its existing and prospective tenants. Rent concessions on the multi-tenant and stabilizing portfolio totaled approximately \$1.3 million in 2011 and \$0.6 million in 2010.

Discontinued Operations

As discussed in more detail in Note 1 to the Consolidated Financial Statements, a company must present the results of operations of real estate assets disposed of or held for sale as discontinued operations. Therefore, the results of operations from such assets are classified as discontinued operations for the current period, and all prior periods presented are restated to conform to the current period presentation. Readers of the Company's Consolidated Financial Statements should be aware that each future disposal will result in a change to the presentation of the Company's operations in the historical Consolidated Statements of Operations as previously filed. Such reclassifications to the Consolidated Statements of Operations will have no impact on previously reported net income attributable to common stockholders.

Other Items Impacting Operations

Several events that occurred in the fourth quarter of 2011 or will occur in the first quarter of 2012 may impact the Company's operations and financial results in 2012:

The Company typically has higher general and administrative costs in the first quarter of every year as a result of the publication of its annual report and proxy. In addition, the Company records an expense related to the grant of employee stock purchase plan options every January. These items will likely increase general and administrative expenses by approximately \$0.5 million in the first quarter.

Renewals of three master leases during the fourth quarter of 2011 were executed at slightly lower base lease rates. The impact of these renewals will initially lower master lease income and straight line rent by approximately \$0.2 million per quarter.

In December 2011, the Company sold two properties in Massachusetts for \$14.6 million and recorded a gain of \$5.7 million. The sale of these two properties will reduce master lease income by nearly \$0.4 million per quarter.

The Company's utility costs are a large component of property operating expense and can vary widely quarter to quarter depending on weather conditions in areas where the Company owns and manages properties. For 2011, the average utility expense per quarter for the properties included in the Company's same store analysis was approximately \$5.1 million. Because of milder temperatures experienced throughout much of the country in the fourth quarter, the Company's utility expense for those same properties was only \$4.6 million. The Company cannot predict if these weather conditions will continue, so property operating expense in the first quarter of 2012 may be higher than the previous quarter's results.

Fourth quarter 2011 results included partially reserved revenue that was recovered through a settlement with a former tenant. The settlement totaling approximately \$0.4 million increased property operating income by approximately \$0.3 million and reduced bad debt expense by approximately \$0.1 million in the fourth quarter of 2011.

At-The-Market Equity Offering Program

Since December 2008, the Company has had in place an at-the-market equity offering program to sell shares of the Company's common stock from time to time in at-the-market sales transactions. The Company has not sold any shares under this program since July 2011. The following

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table details the shares sold under this program.

Year	Shares Sold	Sales Price Per Share	Net Proceeds <i>(in millions)</i>
2011	11,648,700	\$ 20.27 - \$23.63	\$ 251.6
2010	5,258,700	\$ 20.23 - \$25.16	\$ 117.7
2009	1,201,600	\$ 21.62 - \$22.50	\$ 25.7

Unsecured Credit Facility

During the fourth quarter of 2011, the Company entered into a \$700 million Unsecured Credit Facility that replaced its \$550 million unsecured credit facility. The new facility matures in October 2015 and may be extended for one additional year at the Company's option. The Unsecured Credit Facility is currently priced at 150 basis points over 30-day LIBOR on outstanding

Table of Contents

borrowings, with a 35 basis point annual facility fee on the total amount of commitments.

Funds from Operations

Funds from operations (FFO) and FFO per share are operating performance measures adopted by the National Association of Real Estate Investment Trusts, Inc. (NAREIT). NAREIT defines FFO as the most commonly accepted and reported measure of a REIT's operating performance equal to net income (computed in accordance with GAAP), excluding gains (or losses) from sales of property, plus depreciation and amortization, and after adjustments for unconsolidated partnerships and joint ventures. The SEC indicated in 2003 that impairment charges (losses) could not be added back to net income attributable to common stockholders in calculating FFO. However, in late October 2011, NAREIT issued an alert indicating that the SEC staff recently advised NAREIT that it currently takes no position on the matter of whether impairment charges should be added back to net income to compute FFO, and NAREIT affirmed its original definition of FFO. For 2011, the Company is following the NAREIT definition to exclude impairment charges and has restated all prior periods to exclude impairment charges in calculating FFO and FFO per share to agree with the 2011 presentation.

The comparability of FFO for the year ended December 31, 2011 compared to 2010 was affected by the various acquisitions and dispositions of the Company's real estate portfolio and the results of operations of the portfolio from period to period, as well as from the commencement of operations of properties that were previously under construction. Also, interest expense increased \$10.3 million, or \$0.14 per diluted common share, in 2011 compared to 2010 largely due to interest incurred from the issuance in December 2010 of the \$400 million of Senior Notes due 2021 whose proceeds were partially used to pre-fund the redemption of the Senior Notes due 2011. The Company incurred interest on both senior note issuances for effectively four months of 2011. Other items that impacted the comparability of FFO are discussed below in Results of Operations.

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 generally accepted accounting principles (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.

The table below reconciles net income attributable to common stockholders to FFO for the three years ended December 31, 2011.

	Year Ended December 31,		
	2011	2010	2009
<i>(Dollars in thousands, except per share data)</i>			
Net income (loss) attributable to common stockholders	\$ (214)	\$ 8,200	\$ 51,091
Gain on sales of real estate properties	(7,035)	(8,352)	(20,136)
Impairments	6,697	7,511	22
Real estate depreciation and amortization	85,234	71,725	66,927
Total adjustments	84,896	70,884	46,813
Funds from Operations - Basic and Diluted	\$ 84,682	\$ 79,084	\$ 97,904
Funds from Operations per Common Share - Basic	\$ 1.16	\$ 1.28	\$ 1.68
Funds from Operations per Common Share - Diluted	\$ 1.15	\$ 1.26	\$ 1.66
Weighted Average Common Shares Outstanding - Basic	72,720,147		