UNIVERSAL HEALTH REALTY INCOME TRUST
Form 10-Q
August 08, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(MARK ONE)

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

For the quarterly period ended June 30, 2013

OR

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

For the transition period from _________ to _________

Commission file number 1-9321

UNIVERSAL HEALTH REALTY INCOME TRUST

(Exact name of registrant as specified in its charter)

MARYLAND	**23-6858580**
(State or other jurisdiction of	**(I. R. S. Employer**
incorporation or organization)	**Identification No.)**
UNIVERSAL CORPORATE CENTER	
367 SOUTH GULPH ROAD	
KING OF PRUSSIA, PENNSYLVANIA	**19406**
(Address of principal executive offices)	**(Zip Code)**

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

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

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

Large accelerated filer	¨	Accelerated Filer	x
Non-accelerated filer	¨	Smaller reporting company	¨

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

Number of common shares of beneficial interest outstanding at July 31, 2013 - 12,700,739

Table of Contents

UNIVERSAL HEALTH REALTY INCOME TRUST

INDEX

This Quarterly Report on Form 10-Q is for the quarter ended June 30, 2013. In this Quarterly Report, we, us, our and the Trust refer to Universal Health Realty Income Trust and its subsidiaries.

As disclosed in this Quarterly Report, including in *Part I, Item 1. - Relationship with Universal Health Services, Inc. (UHS) and Related Party Transactions,* a wholly-owned subsidiary of UHS (UHS of Delaware, Inc.) serves as our Advisor pursuant to the terms of an annually renewable Advisory Agreement dated December 24, 1986. Our officers are all employees of UHS through UHS of Delaware, Inc. In addition, four of our hospital facilities are leased to subsidiaries of UHS and eleven medical office buildings, including certain properties owned by limited liability companies in which we either hold 100% of the ownership interest or various non-controlling, majority ownership interests, include or will include tenants which are subsidiaries of UHS. Any reference to UHS or UHS facilities in this report is referring to Universal Health Services, Inc. s subsidiaries, including UHS of Delaware, Inc.

In this Quarterly Report, the term revenues does not include the revenues of the unconsolidated limited liability companies (LLCs) in which we have various non-controlling equity interests ranging from 33% to 95%. We currently account for our share of the income/loss from these investments by the equity method (see Note 5 to the Consolidated Financial Statements included herein).

Table of Contents

Part I. Financial Information

Item I. Financial Statements

Universal Health Realty Income Trust

Condensed Consolidated Statements of Income

For the Three and Six Months Ended June 30, 2013 and 2012

(dollar amounts in thousands, except per share amounts)

(unaudited)

	Three Months Ended June 30, 2013	Three Months Ended June 30, 2012	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
Revenues:				
Base rental - UHS facilities	$ 3,804	$ 3,732	$ 7,594	$ 7,488
Base rental - Non-related parties	7,028	6,910	14,074	13,642
Bonus rental - UHS facilities	1,041	1,038	2,139	2,154
Tenant reimbursements and other - Non-related parties	1,521	1,875	3,309	3,525
Tenant reimbursements and other - UHS facilities	108	111	271	208
	13,502	13,666	27,387	27,017
Expenses:				
Depreciation and amortization	4,722	5,001	9,536	10,221
Advisory fees to UHS	585	521	1,156	1,054
Other operating expenses	3,744	4,196	7,409	7,666
Transaction costs	49	129	131	649
	9,100	9,847	18,232	19,590
Income before equity in income of unconsolidated limited liability companies (LLCs), interest expense and gain, net	4,402	3,819	9,155	7,427
Equity in income of unconsolidated LLCs	461	604	1,030	1,158
Gain on divestiture of property owned by an unconsolidated LLC, net	0	0	0	7,375
Interest expense, net	(1,922)	(1,956)	(3,817)	(3,979)
Net income	$ 2,941	$ 2,467	$ 6,368	$ 11,981
Basic earnings per share	$ 0.23	$ 0.19	$ 0.50	$ 0.95
Diluted earnings per share	$ 0.23	$ 0.19	$ 0.50	$ 0.95

Weighted average number of shares outstanding - Basic	12,675	12,658	12,673	12,655
Weighted average number of share equivalents	13	6	14	5
Weighted average number of shares and equivalents outstanding - Diluted	12,688	12,664	12,687	12,660

See the accompanying notes to these condensed consolidated financial statements.

Table of Contents

Universal Health Realty Income Trust

Condensed Consolidated Balance Sheets

(dollar amounts in thousands)

(unaudited)

	June 30, 2013	December 31, 2012
Assets:		
Real Estate Investments:		
Buildings and improvements	$ 376,530	$ 374,416
Accumulated depreciation	(93,374)	(87,088)
	283,156	287,328
Land	27,154	27,058
Net Real Estate Investments	310,310	314,386
Investments in and advances to limited liability companies (LLCs)	33,180	28,636
Other Assets:		
Cash and cash equivalents	3,097	3,048
Base and bonus rent receivable from UHS	2,049	2,041
Rent receivable - other	3,107	2,783
Intangible assets (net of accumulated amortization of $11.3 million and $8.2 million at June 30, 2013 and December 31, 2012, respectively)	23,136	26,293
Deferred charges, goodwill and other assets, net	5,770	5,851
Total Assets	$ 380,649	$ 383,038
Liabilities:		
Line of credit borrowings	$ 90,350	$ 81,750
Mortgage and other notes payable, non-recourse to us (including net debt premium of $1.0 million and $1.3 million at June 30, 2013 and December 31, 2012, respectively)	114,103	116,186
Accrued interest	516	539
Accrued expenses and other liabilities	5,119	4,920
Tenant reserves, escrows, deposits and prepaid rents	1,962	1,898
Total Liabilities	212,050	205,293
Equity:		
Preferred shares of beneficial interest, $.01 par value; 5,000,000 shares authorized; none issued and outstanding	0	0
Common shares, $.01 par value; 95,000,000 shares authorized; issued and outstanding: 2013 - 12,700,612; 2012 - 12,688,998	127	127
Capital in excess of par value	214,404	214,094
Cumulative net income	473,243	466,875
Cumulative dividends	(519,229)	(503,425)

Total Universal Health Realty Income Trust Shareholders Equity	168,545	177,671
Non-controlling equity interest	54	74
Total Equity	168,599	177,745
Total Liabilities and Equity	$ 380,649	$ 383,038

See the accompanying notes to these condensed consolidated financial statements.

Table of Contents

Universal Health Realty Income Trust

Condensed Consolidated Statement of Cash Flows

(dollar amounts in thousands)

(unaudited)

	Six Months Ended June 30, 2013	2012
Cash flows from operating activities:		
Net income	$ 6,368	$ 11,981
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	9,581	10,221
Amortization on debt premium	(218)	(258)
Restricted/stock-based compensation expense	185	147
Gain on divestiture of property owned by an unconsolidated LLC	0	(7,375)
Changes in assets and liabilities:		
Rent receivable	(332)	(563)
Accrued expenses and other liabilities	(48)	(305)
Tenant reserves, escrows, deposits and prepaid rents	64	523
Accrued interest	(23)	105
Other, net	76	140
Net cash provided by operating activities	15,653	14,616
Cash flows from investing activities:		
Investments in LLCs	(1,816)	(705)
Repayments of advances made to LLCs	67	473
Advances made to LLCs	(4,082)	(8,000)
Cash distributions in excess of income from LLCs	1,282	2,318
Additions to real estate investments, net	(1,393)	(2,171)
Deposits on real estate assets	0	100
Net cash paid for acquisition of medical office buildings	(625)	(7,324)
Payment of assumed liabilities on acquired properties	0	(553)
Cash proceeds received from divestiture of property owned by an unconsolidated LLC, net	0	8,077
Net cash used in investing activities	(6,567)	(7,785)
Cash flows from financing activities:		
Net borrowings on line of credit	8,600	4,000
Proceeds from mortgages and other notes payable	11,150	7,000
Repayments of mortgages and other notes payable	(13,016)	(10,597)
Financing costs paid on mortgage and other notes payable	(95)	(347)
Dividends paid	(15,804)	(15,527)
Issuance of shares of beneficial interest, net	128	202
Net cash used in financing activities	(9,037)	(15,269)
Increase/(decrease) in cash and cash equivalents	49	(8,438)
Cash and cash equivalents, beginning of period	3,048	11,649

Cash and cash equivalents, end of period	$ 3,097	$ 3,211
Supplemental disclosures of cash flow information:		
Interest paid	$ 3,847	$ 3,970

See accompanying notes to these condensed consolidated financial statements.

4

Table of Contents

UNIVERSAL HEALTH REALTY INCOME TRUST

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2013

(unaudited)

(1) General

This Quarterly Report on Form 10-Q is for the Quarterly Period ended June 30, 2013. In this Quarterly Report, we, us, our and the Trust refer t Universal Health Realty Income Trust.

You should carefully review all of the information contained in this Quarterly Report, and should particularly consider any risk factors that we set forth in this Quarterly Report and in other reports or documents that we file from time to time with the Securities and Exchange Commission (the SEC). In this Quarterly Report, we state our beliefs of future events and of our future financial performance. In some cases, you can identify those so-called forward-looking statements by words such as may, will, should, could, would, predicts, potential, continue, exp future, intends, plans, believes, estimates, appears, projects and similar expressions, as well as statements in future tense. You should b that those statements are only our predictions. Actual events or results may differ materially. In evaluating those statements, you should specifically consider various factors, including the risks outlined herein and in our Annual Report on Form 10-K for the year ended December 31, 2012 in *Item 1A Risk Factors* and in *Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations - Forward Looking Statements*. Those factors may cause our actual results to differ materially from any of our forward-looking statements.

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

In this Quarterly Report on Form 10-Q, the term revenues does not include the revenues of the unconsolidated limited liability companies (LLCs) in which we have various non-controlling equity interests ranging from 33% to 95%. We currently account for our share of the income/loss from these investments by the equity method (see Note 5). As of June 30, 2013, we had investments or commitments in thirteen jointly-owned LLCs, twelve of which are accounted for by the equity method and one (Palmdale Medical Properties) that is consolidated in our financial statements through June 30, 2013. As discussed below, the master lease with a wholly-owned subsidiary of UHS related to Palmdale Medical Properties expired effective as of July 1, 2013 and, as of that date, Palmdale Medical Properties will be accounted for under the equity method.

The financial statements included herein have been prepared by us, without audit, pursuant to the rules and regulations of the SEC and reflect all normal and recurring adjustments which, in our opinion, are necessary to fairly present results for the interim periods. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although we believe that the accompanying disclosures are adequate to make the information presented not misleading. It is suggested that these financial statements be read in conjunction with the financial statements, the notes thereto and accounting policies included in our Annual Report on Form 10-K for the year ended December 31, 2012.

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

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

The combined revenues generated from the leases on the UHS hospital facilities comprised approximately 30% of our consolidated revenues for each of the three and six months ended June 30, 2013 and 2012. Including 100% of the revenues generated at the unconsolidated LLCs in which we have various non-controlling equity interests ranging from 33% to 95%, the leases on the UHS hospital facilities accounted for approximately 22% and 21% of the combined consolidated and unconsolidated revenue for the three- month periods ended June 30, 2013 and 2012, respectively, and 22% of the combined consolidated and unconsolidated revenue for

Table of Contents

each of the six months ended June 30, 2013 and 2012. In addition, eleven MOBs, that are either wholly or jointly-owned, include or will include tenants which are subsidiaries of UHS. The leases to the hospital facilities of UHS are guaranteed by UHS and cross-defaulted with one another.

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

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

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

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

We have funded $5.6 million in equity and member loans as of June 30, 2013, and are committed to fund an additional $3.3 million, in exchange for a 95% non-controlling equity interest in an LLC (Palmdale Medical Properties) that constructed, owns, and operates the Palmdale Medical Plaza, located in Palmdale, California, on the campus of a UHS hospital. The LLC has a third-party term loan of $6.2 million, which is non-recourse to us, outstanding as of June 30, 2013. Through June 30, 2013, this MOB had a triple net, 75% master lease commitment by UHS of Palmdale, Inc., a wholly-owned subsidiary of UHS, pursuant to the terms of which the master lease for each suite would be cancelled at such time that the suite was leased to another tenant acceptable to the LLC and UHS of Palmdale, Inc. This MOB, tenants of which include subsidiaries of UHS, was completed and opened during the third quarter of 2008 at which time the master lease commenced. The master lease arrangement expired effective as of July 1, 2013, and although the expiration will have an unfavorable impact on our net income and funds from operations, we do not believe the impact will be material to our financial condition or liquidity. This LLC, which was deemed to be a variable interest entity during the term of the master lease, is consolidated in our financial statements through June 30, 2013 since we were the primary beneficiary through that date. Effective July 1, 2013, this LLC will no longer be deemed a variable interest entity and will be accounted for in our financial statements on an unconsolidated basis pursuant to the equity method.

We have funded $6.5 million in equity and member loans as of June 30, 2013, and are committed to fund an additional $400,000, in exchange for a 95% non-controlling equity interest in an LLC (Sparks Medical Properties) that owns and operates the Vista Medical Terrace and The Sparks Medical Building, located in Sparks, Nevada, on the campus of a UHS hospital. This LLC has a third-party term loan of $4.7 million, which is non-recourse to us, outstanding as of June 30, 2013. As this LLC is not considered to be a variable interest entity, it is accounted for pursuant to the equity method.

We have funded $1.8 million in equity as of June 30, 2013, and are committed to fund an additional $2.6 million, in exchange for a 95% non-controlling equity interest in an LLC (Texoma Medical Properties) that developed, constructed, owns and operates the Texoma Medical Plaza located in Denison, Texas, which was completed and opened during the first quarter of 2010. This MOB is located on the campus of a UHS acute care hospital which is owned and operated by Texoma Medical Center (Texoma Hospital), a wholly-owned subsidiary of UHS. This MOB has tenants that include subsidiaries of UHS. This LLC has a third-party term loan of $12.7 million, which is non-recourse to us, outstanding as of June 30, 2013. As this LLC is not considered to be a variable interest entity, it is accounted for pursuant to the equity method.

Table of Contents

Advisory Agreement: UHS of Delaware, Inc. (the Advisor), a wholly-owned subsidiary of UHS, serves as Advisor to us under an Advisory Agreement (the Advisory Agreement) dated December 24, 1986. Pursuant to the Advisory Agreement, the Advisor is obligated to present an investment program to us, to use its best efforts to obtain investments suitable for such program (although it is not obligated to present any particular investment opportunity to us), to provide administrative services to us and to conduct our day-to-day affairs. All transactions between us and UHS must be approved by the Trustees who are unaffiliated with UHS (the Independent Trustees). In performing its services under the Advisory Agreement, the Advisor may utilize independent professional services, including accounting, legal, tax and other services, for which the Advisor is reimbursed directly by us. The Advisory Agreement may be terminated for any reason upon sixty days written notice by us or the Advisor. The Advisory Agreement expires on December 31 of each year; however, it is renewable by us, subject to a determination by the Independent Trustees, that the Advisor s performance has been satisfactory. In December of 2012, based upon a review of our advisory fee and other general and administrative expenses, as compared to an industry peer group, the Advisory agreement was renewed for 2013 and, effective January 1, 2013, the fee was increased to 0.70% (from 0.65%) of our average invested real estate assets, as derived from our consolidated balance sheet.

The Advisory Agreement provides that the Advisor is entitled to receive an annual advisory fee equal to 0.70% of our average invested real estate assets, as derived from our consolidated balance sheet. The average real estate assets for advisory fee calculation purposes exclude certain items from our consolidated balance sheet such as, among other things, accumulated depreciation, cash and cash equivalents, base and bonus rent receivables, deferred charges and other assets. The advisory fee is payable quarterly, subject to adjustment at year-end based upon our audited financial statements. In addition, the Advisor is entitled to an annual incentive fee equal to 20% of the amount by which cash available for distribution to shareholders for each year, as defined in the Advisory Agreement, exceeds 15% of our equity as shown on our consolidated balance sheet, determined in accordance with generally accepted accounting principles without reduction for return of capital dividends. The Advisory Agreement defines cash available for distribution to shareholders as net cash flow from operations less deductions for, among other things, amounts required to discharge our debt and liabilities and reserves for replacement and capital improvements to our properties and investments. No incentive fees were paid during the first six months of 2013 or 2012 since the incentive fee requirements were not achieved. Advisory fees incurred and paid (or payable) to UHS amounted to $585,000 and $521,000 for the three months ended June 30, 2013 and 2012, respectively, and were based upon average invested real estate assets of $334 million and $321 million for the three-month periods ended June 30, 2013 and 2012, respectively. Advisory fees incurred and paid (or payable) to UHS amounted to $1.2 million and $1.1 million for the six months ended June 30, 2013 and 2012, respectively, and were based upon average invested real estate assets of $330 million and $324 million for the six-month periods ended June 30, 2013 and 2012, respectively.

Officers and Employees: Our officers are all employees of UHS (through UHS of Delaware, Inc.) and although as of June 30, 2013 we had no salaried employees, our officers do receive stock-based compensation.

Share Ownership: As of June 30, 2013 and December 31, 2012, UHS owned 6.2% of our outstanding shares of beneficial interest.

SEC reporting requirements of UHS: UHS is subject to the reporting requirements of the SEC and is required to file annual reports containing audited financial information and quarterly reports containing unaudited financial information. Since the leases on the hospital facilities leased to wholly-owned subsidiaries of UHS comprised approximately 30% of our consolidated revenues during each of the three and six months ended June 30, 2013 and 2012, and since a subsidiary of UHS is our Advisor, you are encouraged to obtain the publicly available filings for Universal Health Services, Inc. from the SEC s website at www.sec.gov. These filings are the sole responsibility of UHS and are not incorporated by reference herein.

(3) Dividends and Equity Issuance Program

We declared and paid dividends of $7.9 million, or $.625 per share, during the second quarter of 2013 and $7.8 million, or $.615 per share, during the second quarter of 2012. We declared and paid dividends of $15.8 million, or $1.245 per share, during the six-month period ended June 30, 2013 and $15.5 million, or $1.225 per share, during the six-month period ended June 30, 2012.

We filed a Registration Statement with the Securities and Exchange Commission which became effective in November 2012, under which we can offer up to an aggregate sales price of $50 million of our securities pursuant to supplemental prospectuses which we may file from time to time. No offering will be made except pursuant to such supplemental prospectuses, and none have been made as of June 30, 2013.

(4) Acquisitions, Dispositions and New Construction

Six Months Ended June 30, 2013:

Acquisition:

On June 6, 2013, we purchased the 5004 Poole Road medical office building (MOB), located in Denison, Texas, on the campus of Texoma Medical Center, a wholly-owned subsidiary of UHS. This single-tenant MOB, which was purchased for approximately $625,000, consists of approximately 4,400 rentable square feet and is located adjacent to our Texoma Medical Plaza MOB.

Table of Contents

New Construction:

As previously announced, the newly constructed Forney Medical Plaza II located in Forney, Texas was completed and opened in April, 2013. This multi-tenant medical office building, consisting of 30,000 rentable square feet, is owned by a limited partnership in which we hold a 95% non-controlling ownership interest. As this LLC is not considered to be a variable interest entity, it is accounted for pursuant to the equity method.

Divestitures:

There were no divestitures during the first six months of 2013.

Six Months Ended June 30, 2012:

Acquisition:

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

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

Divestiture:

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

(5) Summarized Financial Information of Equity Affiliates

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

At June 30, 2013, we have non-controlling equity investments or commitments in thirteen jointly-owned LLCs which own MOBs. As of June 30, 2013, we accounted for: (i) twelve of these LLCs on an unconsolidated basis pursuant to the equity method since they are not variable interest entities, and; (ii) one of these LLCs (Palmdale Medical Properties) on a consolidated basis, as discussed below, since it was considered to be a variable interest entity where we were the primary beneficiary by virtue of its master lease with a subsidiary of Universal Health Services, Inc. (UHS), a related party to us. The master lease with a wholly-owned subsidiary of UHS related to Palmdale Medical Properties expired effective as of July 1, 2013 and, as of that date, this LLC will be accounted for under the equity method since it is no longer considered a variable interest entity. The majority of these LLCs are joint-ventures between us and a non-related party that manages and holds minority ownership interests in the entities. Each LLC is generally self-sustained from a cash flow perspective and generates sufficient cash flow to meet its operating cash flow requirements and service the third-party debt (if applicable) that is non-recourse to us. Although there is typically no ongoing financial support required from us to these entities since they are cash-flow sufficient, we may, from time to time, provide funding for certain purposes such as, but not limited to, significant capital expenditures, leasehold improvements and debt financing. Although we are not obligated to do so, if approved by us at our sole discretion, additional cash fundings are typically advanced as equity or short to intermediate term loans.

As discussed above, Palmdale Medical Properties had a master lease with a subsidiary of UHS through June 30, 2013. Additionally, UHS of Delaware, a wholly-owned subsidiary of UHS, serves as advisor to us under the terms of an advisory agreement and manages our day-to-day affairs. All of our officers are officers or employees of UHS (through UHS of Delaware, Inc.). As a result of our related-party relationship with UHS and the master lease, lease assurance or lease guarantee arrangements with subsidiaries of UHS, we have accounted for this LLC on a consolidated basis, since the fourth quarter of 2007 through June 30, 2013, since it was a variable interest entity and we were deemed to be the primary beneficiary. As of July 1, 2013, the master lease expired and this LLC is no longer considered a variable interest entity and we will therefore begin to account for this LLC on an unconsolidated basis pursuant to the equity method as of July 1, 2013. Although the expiration of the master lease will have an unfavorable impact on our net income and funds from operations, we do not believe the impact will be material to our financial condition or liquidity.

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

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

The following property table represents the twelve LLCs in which we own a noncontrolling interest and were accounted for under the equity method as of June 30, 2013:

Name of LLC/LP	Ownership	Property Owned by LLC
DVMC Properties	90%	Desert Valley Medical Center
Suburban Properties	33%	Suburban Medical Plaza II
Santa Fe Scottsdale	90%	Santa Fe Professional Plaza
Brunswick Associates	74%	Mid Coast Hospital MOB
PCH Medical Properties	85%	Rosenberg Children s Medical Plaza
Arlington Medical Properties	75%	Saint Mary s Professional Office Building
Sierra Medical Properties	95%	Sierra San Antonio Medical Plaza
PCH Southern Properties	95%	Phoenix Children s East Valley Care Center
Sparks Medical Properties(a.)(d.)	95%	Vista Medical Terrace & The Sparks Medical Building
Grayson Properties(a.)(b.)	95%	Texoma Medical Plaza
3811 Bell Medical Properties	95%	North Valley Medical Plaza
FTX MOB Phase II (c.)	95%	Forney Medical Plaza II

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

(b.) We have funded $1.8 million in equity as of June 30, 2013, and are committed to fund an additional $2.6 million. This building, which is on the campus of a UHS hospital and has tenants that include subsidiaries of UHS, was completed and opened during the first quarter of 2010. This LLC has a third-party term loan of $12.7 million, which is non-recourse to us, outstanding as of June 30, 2013.

(c.) During the third quarter of 2012, this limited partnership entered into an agreement to develop, construct, own and operate the Forney Medical Plaza II, which opened on April 1, 2013. We have committed to invest up to $2.5 million in equity and debt financing, of which $1.1 million has been funded as of June 30, 2013. This LLC has a third-party construction loan of $5.6 million, which is non-recourse to us, outstanding as of June 30, 2013.

(d.) We have funded $6.5 million in equity and member loans as of June 30, 2013, and are committed to invest an additional $400,000, in exchange for a 95% non-controlling equity interest in an LLC that owns and operates the Vista Medical Terrace and The Sparks Medical Building, located in Sparks, Nevada, on the campus of a UHS hospital. This LLC has a third-party term loan of $4.7 million, which is non-recourse to us, outstanding as of June 30, 2013.

Table of Contents

Below are the condensed combined statements of income (unaudited) for the LLCs accounted for under the equity method at June 30, 2013 and 2012:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(amounts in thousands)			
Revenues	$ 5,206	$ 5,347	$ 10,246	$ 10,985
Operating expenses	2,398	2,247	4,400	4,665
Depreciation and amortization	1,069	942	2,093	2,058
Interest, net	1,635	1,616	2,889	3,171
Net income	$ 104	$ 542	$ 864	$ 1,091
Our share of net income (a.)	$ 461	$ 604	$ 1,030	$ 1,158

(a.) Our share of net income includes interest income earned by us on various advances made to LLCs of approximately $620,000 and $434,000 for the three months ended June 30, 2013 and 2012, respectively, and $877,000 and $817,000 for the six months ended June 30, 2013 and 2012, respectively.

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

	June 30, 2013	December 31, 2012
	(amounts in thousands)	
Net property, including CIP	$ 107,929	$ 106,150
Other assets	9,705	9,850
Total assets	$ 117,634	$ 116,000
Liabilities	$ 5,128	$ 5,368
Mortgage notes payable, non-recourse to us	74,791	77,511
Advances payable to us	17,278	12,658
Equity	20,437	20,463
Total liabilities and equity	$ 117,634	$ 116,000
Our share of equity and advances to LLCs	$ 33,180	$ 28,636

As of June 30, 2013, aggregate principal amounts due on mortgage notes payable by unconsolidated LLCs, which are accounted for under the equity method and are non-recourse to us, are as follows (amounts in thousands):

2013	$ 842
2014	14,018
2015	35,482
2016	577
2017	11,827
Later	12,045

Total	$ 74,791

Table of Contents

Name of LLC	Mortgage/ Construction Loan Balance(a.)	Maturity Date
Grayson Properties	$ 12,690	2014
Brunswick Associates	8,015	2015
Arlington Medical Properties	24,420	2015
DVMC Properties	4,022	2015
FTX MOB Phase II(b.)	5,596	2017
PCH Southern Properties	6,676	2017
Sparks Medical Properties	4,664	2018
PCH Medical Properties	8,708	2018
	$ 74,791	

(a.) All mortgage loans, other than construction loans, require monthly principal payments through maturity and include a balloon principal payment upon maturity.
(b.) Construction loan.

Pursuant to the operating agreements of the LLCs, the third-party member and the Trust, at any time, have the right to make an offer (Offering Member) to the other member(s) (Non-Offering Member) in which it either agrees to: (i) sell the entire ownership interest of the Offering Member to the Non-Offering Member (Offer to Sell) at a price as determined by the Offering Member (Transfer Price), or; (ii) purchase the entire ownership interest of the Non-Offering Member (Offer to Purchase) at the equivalent proportionate Transfer Price. The Non-Offering Member has 60 days to either: (i) purchase the entire ownership interest of the Offering Member at the Transfer Price, or; (ii) sell its entire ownership interest to the Offering Member at the equivalent proportionate Transfer Price. The closing of the transfer must occur within 60 days of the acceptance by the Non-Offering Member.

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

(6) Recent Accounting Pronouncements

There were no new accounting pronouncements during the first six months of 2013 that impacted, or are expected to impact us.

(7) Debt

In July, 2011, we entered into a $150 million revolving credit agreement (Credit Agreement) which is scheduled to expire on July 24, 2015. The Credit Agreement includes a $50 million sub limit for letters of credit and a $20 million sub limit for swingline/short-term loans. The Credit Agreement also provides an option to increase the total facility borrowing capacity by an additional $50 million, subject to lender agreement. Borrowings made pursuant to the Credit Agreement will bear interest, at our option, at one, two, three, or six month LIBOR plus an applicable margin ranging from 1.75% to 2.50% or at the Base Rate plus an applicable margin ranging from 0.75% to 1.50%. The Credit Agreement defines Base Rate as the greatest of: (a) the administrative agent s prime rate, (b) the federal funds effective rate plus 1/2 of 1%, and; (c) one month LIBOR plus 1%. A fee of 0.30% to 0.50% will be charged on the unused portion of the commitment. The margins over LIBOR, Base Rate and the commitment fee are based upon our ratio of debt to total capital. At June 30, 2013, the applicable margin over the LIBOR rate was 1.75%, the margin over the Base Rate was 0.75%, and the commitment fee was 0.30%.

At June 30, 2013, we had $90.4 million of outstanding borrowings and $10.3 million of letters of credit outstanding against our revolving credit agreement. We had $49.3 million of available borrowing capacity, net of the outstanding borrowings and letters of credit outstanding as of June 30, 2013. There are no compensating balance requirements.

Table of Contents

Covenants relating to the Agreement require the maintenance of a minimum tangible net worth and specified financial ratios, limit our ability to incur additional debt, limit the aggregate amount of mortgage receivables and limit our ability to increase dividends in excess of 95% of cash available for distribution, unless additional distributions are required to comply with the applicable section of the Internal Revenue Code of 1986 and related regulations governing real estate investment trusts. We are in compliance with all of the covenants at June 30, 2013. We also believe that we would remain in compliance if the full amount of our commitment was borrowed.

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

	Covenant	**June 30, 2013**
Tangible net worth	$ 125,000	$ 145,409
Debt to total capital	< 55%	34.9%
Debt service coverage ratio	> 5.00x	20.9x
Debt to cash flow ratio	< 3.50x	2.11x

We have thirteen mortgages, all of which are non-recourse to us, included on our consolidated balance sheet as of June 30, 2013, with a combined outstanding balance of $113.1 million (excluding net debt premium, resulting from fair value recognition of third-party debt related to majority-owned LLCs in which we purchased the minority ownership interests, of $1.0 million at June 30, 2013). The following table summarizes our outstanding mortgages at June 30, 2013 (amounts in thousands):