UNIVERSAL HEALTH REALTY INCOME TRUST
Form 10-Q
May 09, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(MARK ONE)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2018

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 No

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

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

Large accelerated filer	Accelerated Filer
Non-accelerated filer	Smaller reporting company
	Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Number of common shares of beneficial interest outstanding at April 30, 2018—13,735,629

UNIVERSAL HEALTH REALTY INCOME TRUST

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This Quarterly Report on Form 10-Q is for the quarter ended March 31, 2018. 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 Note 2 to the Condensed Consolidated Financial Statements—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 its wholly-owned subsidiary, UHS of Delaware, Inc. In addition, three of our hospital facilities are leased to subsidiaries of UHS and seventeen medical office buildings or free-standing emergency departments, that are either wholly or jointly-owned by us, 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 four 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 Condensed Consolidated Financial Statements included herein).

Part I. Financial Information

Item I. Financial Statements

Universal Health Realty Income Trust

Condensed Consolidated Statements of Income

For the Three Months Ended March 31, 2018 and 2017

(amounts in thousands, except per share amounts)

(unaudited)

	Three Months Ended March 31, 2018	2017
Revenues:		
Base rental - UHS facilities	$4,176	$4,080
Base rental - Non-related parties	10,327	9,970
Bonus rental - UHS facilities	1,326	1,288
Tenant reimbursements and other - Non-related parties	2,415	2,193
Tenant reimbursements and other - UHS facilities	295	219
	18,539	17,750
Expenses:		
Depreciation and amortization	6,287	6,145
Advisory fees to UHS	904	866
Other operating expenses	5,208	4,705
Transaction costs	-	70
	12,399	11,786
Income before equity in income of unconsolidated limited liability companies ("LLCs"), interest expense, hurricane insurance recovery proceeds and gain	6,140	5,964
Equity in income of unconsolidated LLCs	429	1,077
Hurricane insurance recovery proceeds in excess of damaged property write-downs	4,535	-
Hurricane business interruption insurance recovery proceeds	968	-
Gain on Arlington transaction	-	27,196
Interest expense, net	(2,468)	(2,675)
Net income	$9,604	$31,562
Basic earnings per share	$0.70	$2.32
Diluted earnings per share	$0.70	$2.32
Weighted average number of shares outstanding - Basic and Diluted	13,718	13,580

See accompanying notes to these condensed consolidated financial statements.

Universal Health Realty Income Trust

Condensed Consolidated Statements of Comprehensive Income

For the Three Months Ended March 31, 2018 and 2017

(dollar amounts in thousands)

(unaudited)

	Three Months Ended March 31, 2018	2017
Net income	$9,604	$31,562
Other comprehensive income/(loss):		
Unrealized derivative gain/(loss) on interest rate caps	148	(18)
Total other comprehensive income/(loss):	148	(18)
Total comprehensive income	$9,752	$31,544

See accompanying notes to these condensed consolidated financial statements.

Universal Health Realty Income Trust

Condensed Consolidated Balance Sheets

(dollar amounts in thousands)

(unaudited)

	March 31, 2018	December 31, 2017
Assets:		
Real Estate Investments:		
Buildings and improvements and construction in progress	$549,465	$ 546,634
Accumulated depreciation	(158,382)	(153,379)
	391,083	393,255
Land	53,142	53,142
Net Real Estate Investments	444,225	446,397
Investments in limited liability companies ("LLCs")	4,643	4,671
Other Assets:		
Cash and cash equivalents	4,209	3,387
Base and bonus rent and other receivables from UHS	2,817	2,680
Rent receivable - other	6,690	6,422
Intangible assets (net of accumulated amortization of $25.7 million and $28.7 million at March 31, 2018 and December 31, 2017, respectively)	19,376	20,559
Deferred charges and other assets, net	7,625	5,892
Total Assets	$489,585	$ 490,008
Liabilities:		
Line of credit borrowings	$175,000	$ 181,050
Mortgage notes payable, non-recourse to us, net	70,781	75,359
Accrued interest	358	540
Accrued expenses and other liabilities	12,270	12,188
Dividends payable	9,134	-
Tenant reserves, deposits and deferred and prepaid rents	10,686	10,310
Total Liabilities	278,229	279,447
Equity:		
Preferred shares of beneficial interest, $.01 par value; 5,000,000 shares authorized; none issued and outstanding	-	-
Common shares, $.01 par value; 95,000,000 shares authorized; issued and outstanding: 2018 - 13,735,611; 2017 - 13,735,369	137	137
Capital in excess of par value	265,511	265,335

Cumulative net income	627,724	618,120
Cumulative dividends	(682,309)	(673,175)
Accumulated other comprehensive income	293	144
Total Equity	211,356	210,561
Total Liabilities and Equity	$489,585	$ 490,008

See accompanying notes to these condensed consolidated financial statements.

Universal Health Realty Income Trust

Condensed Consolidated Statement of Cash Flows

(dollar amounts in thousands)

(unaudited)

	Three months ended March 31,	
	2018	2017
Cash flows from operating activities:		
Net income	$9,604	$31,562
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	6,231	6,167
Amortization of debt premium	(10)	(68)
Stock-based compensation expense	119	127
Hurricane insurance recovery proceeds in excess of damaged property write-downs	(4,535)	—
Gain on Arlington transaction	—	(27,196)
Changes in assets and liabilities:		
Rent receivable	(405)	(461)
Accrued expenses and other liabilities	(367)	(230)
Tenant reserves, deposits and deferred and prepaid rents	296	64
Accrued interest	(182)	(63)
Leasing costs paid	(209)	(250)
Other, net	217	(158)
Net cash provided by operating activities	10,759	9,494
Cash flows from investing activities:		
Investments in LLCs	(369)	(371)
Repayments of advances made to LLC	—	216
Cash distributions in excess of income from LLCs	193	557
Additions to real estate investments, net	(1,987)	(4,181)
Cash proceeds received from divestiture of property	—	53,967
Restricted cash proceeds from divestiture of property	—	11,253
Hurricane insurance recovery proceeds in excess of damaged property write-downs	4,535	—
Hurricane remediation payments	(192)	—
Cash paid to acquire minority interests in majority-owned LLCs	—	(7,890)
Net cash provided by investing activities	2,180	53,551
Cash flows from financing activities:		
Net repayments on line of credit	(6,050)	(31,600)
Repayments of mortgage notes payable	(4,596)	(11,174)
Financing costs paid	(1,527)	(35)
Dividends paid	—	(8,907)
Issuance of shares of beneficial interest, net	56	61
Net cash used in financing activities	(12,117)	(51,655)
Increase in cash, cash equivalents and restricted cash	822	11,390
Cash, cash equivalents and restricted cash, beginning of period	3,387	3,930

Cash, cash equivalents and restricted cash, end of period	$4,209	$15,320
Supplemental disclosures of cash flow information:		
Interest paid	$2,525	$2,673

See accompanying notes to these condensed consolidated financial statements.

UNIVERSAL HEALTH REALTY INCOME TRUST

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2018

(unaudited)

(1) General

This Quarterly Report on Form 10-Q is for the quarter ended March 31, 2018. In this Quarterly Report, “we,” “us,” “our” and the “Trust” refer to Universal Health Realty Income Trust and its subsidiaries.

In this Quarterly Report on Form 10-Q, the term “revenues” does not include the revenues of the unconsolidated LLCs in which we have various non-controlling equity interests ranging from 33% to 95%. As of March 31, 2018, we had investments in four jointly-owned LLCs/LPs which own medical office buildings, all of which are accounted for by the equity method (see Note 5). These LLCs are included in our financial statements for all periods presented on an unconsolidated basis since they are not variable interest entities for which we are the primary beneficiary, nor do we hold a controlling voting interest.

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, 2017.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the amounts reported in our consolidated financial statements and accompanying notes. Certain prior period amounts on our statement of cash flows have been reclassified to conform to the current period presentation in connection with our adoption of ASU No. 2016-18, Restricted Cash.

(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 of the three hospital facilities leased to subsidiaries of UHS 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 three hospital 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 accounted for approximately 22% and 23% of our consolidated revenues for the three months ended March 31, 2018 and 2017, respectively. In addition, we have seventeen medical office buildings ("MOBs"), or free-standing emergency departments ("FEDs"), that are either wholly or jointly-owned by us, that include tenants which are subsidiaries of UHS. The aggregate revenues generated from UHS-related tenants comprised approximately 31% of our consolidated revenues during each of the three-month periods ended March 31, 2018 and 2017.

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. 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 three leased hospital properties listed below at their appraised fair market value. Additionally, 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.

The table below details the existing lease terms and renewal options for our three acute care hospitals operated by wholly-owned subsidiaries of UHS:

Hospital Name	Annual Minimum Rent	End of Lease Term	Renewal Term (years)	
McAllen Medical Center	$5,485,000	December, 2021	10	(a)
Wellington Regional Medical Center	$3,030,000	December, 2021	10	(b)
Southwest Healthcare System, Inland Valley Campus	$2,648,000	December, 2021	10	(b)

(a) UHS has two 5-year renewal options at existing lease rates (through 2031).
(b) UHS has two 5-year renewal options at fair market value lease rates (2022 through 2031).

Management cannot predict whether the leases with subsidiaries of UHS, which have renewal options at existing lease rates or fair market value lease rates, or any of our other leases, will be renewed at the end of their lease term. If the leases are not renewed at their current rates or the fair market value lease rates, we would be required to find other operators for those facilities and/or enter into leases on terms potentially less favorable to us than the current leases. In addition, if subsidiaries of UHS exercise their options to purchase the respective leased hospital or FED facilities upon expiration of the lease terms, our future revenues could decrease if we were unable to earn a favorable rate of return on the sale proceeds received, as compared to the rental revenue currently earned pursuant to the these leases.

In April, 2017, the recently constructed Henderson Medical Plaza MOB received its certificate of occupancy. Henderson Medical Plaza is located on the campus of the Henderson Hospital Medical Center, a newly constructed acute care hospital that is owned and operated by a subsidiary of UHS and was completed and opened during the fourth quarter of 2016. A ground lease has been executed between the limited liability company that owns the MOB and a subsidiary of UHS, the terms of which include a seventy-five year lease term with two, ten-year renewal options at the lessee’s option at an adjusting lease rate. We have invested net cash of approximately $12.8 million on the development and construction of this MOB as of March 31, 2018.

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. Our advisory fee is 0.70% of our average invested real estate assets, as derived from our consolidated balance sheet. In December of 2017, 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 2018 pursuant to the same terms as the Advisory Agreement in place since 2013.

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 at any time since our inception since the incentive fee requirements were not achieved. Advisory fees incurred and paid (or payable) to UHS amounted to $904,000 and $866,000 for the three months ended March 31, 2018 and 2017, respectively, and were based upon average invested real estate assets of $517 million and $495 million for the three-month periods ended March 31, 2018 and 2017, respectively.

Officers and Employees: Our officers are all employees of a wholly-owned subsidiary of UHS and although as of March 31, 2018 we had no salaried employees, our officers do typically receive annual stock-based compensation awards in the form of restricted stock. In special circumstances, if warranted and deemed appropriate by the Compensation Committee of the Board of Trustees, our officers may also receive one-time special compensation awards in the form of restricted stock and/or cash bonuses.

Share Ownership: At each of March 31, 2018 and December 31, 2017, UHS owned 5.7%, 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 aggregate revenues generated from the UHS-related tenants comprised 31% of our consolidated revenues during each of the three-month periods ended March 31, 2018 and 2017, 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. These filings are the sole responsibility of UHS and are not incorporated by reference herein.

(3) Dividends

Dividends:

We declared dividends of $9.1 million, or $.665 per share, during the first quarter of 2018, which were paid on April 2, 2018. We declared and paid dividends of $8.9 million, or $.655 per share, during the first quarter of 2017.

(4) Acquisitions and Dispositions

Three Months Ended March 31, 2018:

Acquisitions:

There were no acquisitions during the first three months of 2018.

Disposition:

There were no dispositions during the first three months of 2018.

Three Months Ended March 31, 2017:

Acquisitions:

There were no acquisitions during the first three months of 2017.

Disposition:

During March, 2017, Arlington Medical Properties, LLC, a formerly jointly-owned limited liability company in which we held an 85% noncontrolling ownership interest, sold the real estate assets of St. Mary's Professional Office Building ("St. Mary's") as part of a series of planned tax deferred like-kind exchange transactions pursuant to Section 1031 of the Internal Revenue Code. St. Mary's is a multi-tenant medical office building located in Reno, Nevada. A third party member owned the remaining 15% of Arlington Medical Properties LLC, which we acquired prior to the divestiture of St. Mary's for a purchase price of $7.9 million. The divestiture of St. Mary's generated an aggregate of approximately $57.3 million of net cash proceeds to us (approximately $11.3 million of which was held as restricted cash by a qualified 1031 exchange intermediary until the third quarter of 2017). These proceeds, which were net of closing costs and the purchase price paid for the minority member's ownership interest in the LLC, include repayment to us of a $21.4 million member loan. Our results of operations for the three-month period ended March 31, 2017 included a net gain of $27.2 million (net of related transaction costs) recorded in connection with this transaction.