

UNIVERSAL HEALTH REALTY INCOME TRUST  
Form 10-Q  
November 08, 2016

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 September 30, 2016

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	19406
367 SOUTH GULPH ROAD	

Edgar Filing: UNIVERSAL HEALTH REALTY INCOME TRUST - Form 10-Q

KING OF PRUSSIA, PENNSYLVANIA

(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, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated Filer

Non-accelerated filer Smaller reporting company

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 October 31, 2016—13,598,144

## UNIVERSAL HEALTH REALTY INCOME TRUST

## INDEX

	PAGE NO.
<b><u>PART I. FINANCIAL INFORMATION</u></b>	
Item 1. <b><u>Financial Statements</u></b>	
<u>Condensed Consolidated Statements of Income—Three and Nine Months Ended September 30, 2016 and 2015</u>	3
<u>Condensed Consolidated Statements of Comprehensive Income—Three and Nine Months Ended September 30, 2016 and 2015</u>	4
<u>Condensed Consolidated Balance Sheets—September 30, 2016 and December 31, 2015</u>	5
<u>Condensed Consolidated Statements of Cash Flows—Nine Months Ended September 30, 2016 and 2015</u>	6
<u>Notes to Condensed Consolidated Financial Statements</u>	7 through 16
Item 2.	17 through
<u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	26
Item 3. <b><u>Quantitative and Qualitative Disclosures About Market Risk</u></b>	27
Item 4. <b><u>Controls and Procedures</u></b>	27
<b><u>PART II. Other Information</u></b>	28
Item 6. <b><u>Exhibits</u></b>	28
<b><u>Signatures</u></b>	29
<b><u>EXHIBIT INDEX</u></b>	30

This Quarterly Report on Form 10-Q is for the quarter ended September 30, 2016. 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 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, including one under construction, or free-standing emergency departments, that are either wholly or jointly-owned by us, 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 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 and Nine Months Ended September 30, 2016 and 2015

(amounts in thousands, except per share amounts)

(unaudited)

	Three Months Ended September 30, 2016		2015		Nine Months Ended September 30, 2016		2015	
<b>Revenues:</b>								
Base rental - UHS facilities	\$4,066	\$4,019	\$12,226	\$11,916				
Base rental - Non-related parties	9,273	8,763	27,118	26,438				
Bonus rental - UHS facilities	1,118	1,085	3,557	3,453				
Tenant reimbursements and other - Non-related parties	2,168	1,620	5,984	5,523				
Tenant reimbursements and other - UHS facilities	176	199	603	607				
	16,801	15,686	49,488	47,937				
<b>Expenses:</b>								
Depreciation and amortization	5,893	5,424	16,872	16,817				
Advisory fees to UHS	832	708	2,380	2,067				
Other operating expenses	4,663	4,461	13,603	13,921				
Transaction costs	331	-	477	204				
	11,719	10,593	33,332	33,009				
Income before equity in income of unconsolidated limited liability								
companies ("LLCs"), interest expense and gain	5,082	5,093	16,156	14,928				
Equity in income of unconsolidated LLCs	1,110	561	3,396	1,826				
Gain on property exchange	-	-	-	8,742				
Interest expense, net	(2,374)	(2,015)	(6,783)	(6,157)				
Net income	\$3,818	\$3,639	\$12,769	\$19,339				
Basic earnings per share	\$0.28	\$0.27	\$0.95	\$1.46				
Diluted earnings per share	\$0.28	\$0.27	\$0.95	\$1.45				
Weighted average number of shares outstanding - Basic								
	13,575	13,298	13,426	13,289				
Weighted average number of share equivalents								
	-	4	5	8				
Weighted average number of shares and equivalents								
outstanding - Diluted	13,575	13,302	13,431	13,297				

See accompanying notes to these condensed consolidated financial statements.

Universal Health Realty Income Trust

Condensed Consolidated Statements of Comprehensive Income

For the Three and Nine Months Ended September 30, 2016 and 2015

(dollar amounts in thousands)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net income	\$3,818	\$3,639	\$12,769	\$19,339
Other comprehensive income/(loss):				
Unrealized losses on interest rate caps	(7 )	(15 )	(75 )	(94 )
Amortization of interest rate cap fees	23	23	69	69
Total other comprehensive income/(loss):	16	8	(6 )	(25 )
Total comprehensive income	\$3,834	\$3,647	\$12,763	\$19,314

See accompanying notes to these condensed consolidated financial statements.

## Universal Health Realty Income Trust

## Condensed Consolidated Balance Sheets

(dollar amounts in thousands)

(unaudited)

	September 30, 2016	December 31, 2015
<b>Assets:</b>		
<b>Real Estate Investments:</b>		
Buildings and improvements and construction in progress	\$ 517,726	\$ 469,933
Accumulated depreciation	(133,929 )	(121,161 )
	383,797	348,772
Land	48,615	41,724
Net Real Estate Investments	432,412	390,496
Investments in and advances to limited liability companies ("LLCs")	36,765	31,597
<b>Other Assets:</b>		
Cash and cash equivalents	3,982	3,894
Base and bonus rent receivable from UHS	2,256	2,116
Rent receivable - other	4,649	4,292
Intangible assets (net of accumulated amortization of \$25.8 million and \$25.1 million at September 30, 2016 and December 31, 2015, respectively)	23,014	19,757
Deferred charges and other assets, net	7,311	6,351
<b>Total Assets</b>	<b>\$ 510,389</b>	<b>\$ 458,503</b>
<b>Liabilities:</b>		
Line of credit borrowings	\$ 192,250	\$ 142,150
Mortgage notes payable, non-recourse to us, net	107,660	110,156
Accrued interest	551	504
Accrued expenses and other liabilities	10,037	6,807
Tenant reserves, deposits and prepaid rents	4,548	3,844
<b>Total Liabilities</b>	<b>315,046</b>	<b>263,461</b>
<b>Equity:</b>		
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: 2016 - 13,598,082; 2015 - 13,327,020	136	133
Capital in excess of par value	255,466	241,700
Cumulative net income	568,055	555,286
Cumulative dividends	(628,214 )	(601,983 )
Accumulated other comprehensive loss	(100 )	(94 )
<b>Total Equity</b>	<b>195,343</b>	<b>195,042</b>
<b>Total Liabilities and Equity</b>	<b>\$ 510,389</b>	<b>\$ 458,503</b>



See accompanying notes to these condensed consolidated financial statements.

5

---

## Universal Health Realty Income Trust

## Condensed Consolidated Statement of Cash Flows

(dollar amounts in thousands)

(unaudited)

	Nine months ended September 30,	
	2016	2015
<b>Cash flows from operating activities:</b>		
Net income	\$12,769	\$19,339
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>		
Depreciation and amortization	16,920	16,884
Amortization of debt premium	(166 )	(169 )
Stock-based compensation expense	354	316
Gain on property exchange	—	(8,742 )
<b>Changes in assets and liabilities:</b>		
Rent receivable	(497 )	(311 )
Accrued expenses and other liabilities	203	(278 )
Tenant reserves, deposits and prepaid rents	604	869
Accrued interest	47	(75 )
Other, net	(482 )	(533 )
Net cash provided by operating activities	29,752	27,300
<b>Cash flows from investing activities:</b>		
Investments in LLCs	(5,454 )	(418 )
Repayments of advances made to LLC	634	—
Cash distributions in excess of income from LLCs	318	168
Cash distribution of refinancing proceeds from LLCs	—	1,045
Additions to real estate investments, net	(7,104 )	(3,667 )
Cash received for property exchange	—	2,000
Deposit on real estate assets	(420 )	—
Net cash paid for acquisition of properties	(52,193)	(16,765)
Cash paid to acquire minority interests in majority-owned LLCs	—	(2,250 )
Net cash used in investing activities	(64,219)	(19,887)
<b>Cash flows from financing activities:</b>		
Net borrowings on line of credit	50,100	24,600
Repayments of mortgages and other notes payable	(2,407 )	(7,383 )
Financing costs paid	(307 )	(1,000 )
Dividends paid	(26,231)	(25,494)
Partial settlement of dividend equivalent rights	(30 )	(17 )
Issuance of shares of beneficial interest, net	13,430	1,671
Net cash provided by (used in) financing activities	34,555	(7,623 )
Increase/(decrease) in cash and cash equivalents	88	(210 )
Cash and cash equivalents, beginning of period	3,894	3,861
Cash and cash equivalents, end of period	\$3,982	\$3,651

Supplemental disclosures of cash flow information:

Interest paid	\$6,491	\$6,052
Property Exchange Transaction:		
Net assets acquired in property exchange	\$—	\$9,886
Net assets relinquished in property exchange	—	(3,144 )

See accompanying notes to these condensed consolidated financial statements.

UNIVERSAL HEALTH REALTY INCOME TRUST

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2016

(unaudited)

(1) General

This Quarterly Report on Form 10-Q is for the quarter ended September 30, 2016. 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 limited liability companies (“LLCs”) in which we have various non-controlling equity interests ranging from 33% to 95%. As of September 30, 2016, we had investments in five 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, 2015.

(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. These 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 23% and 25% of our consolidated revenues for the three months ended September 30, 2016 and 2015, respectively, and approximately 24% and 25% of our consolidated revenues for the nine months ended September 30, 2016 and 2015,

respectively. 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 19% and 20% of the combined consolidated and unconsolidated revenue for the three months ended September 30, 2016 and 2015, respectively, and approximately 20% of the combined consolidated and unconsolidated revenue for each of the nine months ended September 30, 2016 and 2015. In addition, we have seventeen medical office buildings (“MOBs”), including one currently under construction, or free-standing emergency departments (“FEDs”), that are either wholly or jointly-owned by us, and include or will include tenants which are subsidiaries of UHS.

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 leases related to the hospital facilities of UHS are guaranteed by UHS and cross-defaulted with one another.

In June, 2016, three wholly-owned subsidiaries of UHS provided the required notice to us, exercising the 5-year renewal options on the leases related to our acute care hospitals noted in the table below. The renewals extended the lease terms on these facilities, at

existing lease rates, to December, 2021. 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		Renewal	
	Minimum	End of	Term	
	Rent	Lease 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 and 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 these leases.

During the first quarter of 2016, we committed to invest up to \$21.1 million in the development and construction of the Henderson Medical Plaza, an MOB located on the campus of the Henderson Hospital Medical Center which is owned by a UHS subsidiary and opened in late October, 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 \$4.6 million in this MOB as of September 30, 2016. The MOB is scheduled to be completed and opened during the first quarter of 2017.

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 2015, 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 2016 pursuant to the same terms as the Advisory Agreement in place during 2015.

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 nine months of 2016 or 2015 since the incentive fee requirements were not achieved. Advisory fees incurred and paid (or payable) to UHS amounted to \$832,000 and \$708,000 for the three months ended September 30, 2016 and 2015, respectively, and were based upon average invested real estate assets of \$475 million and \$405 million for the three-month periods ended September 30, 2016 and 2015, respectively. Advisory fees incurred and paid (or payable) to UHS amounted to \$2.4 million and \$2.1 million for the nine months ended September 30, 2016 and 2015, respectively, and were based upon average invested real estate assets of \$453 million and \$394 million for the nine-month periods ended September 30, 2016 and 2015, respectively.

Officers and Employees: Our officers are all employees of a wholly-owned subsidiary of UHS and although as of September 30, 2016 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: As of September 30, 2016 and December 31, 2015, UHS owned 5.8% and 5.9%, respectively, 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 23% and 25% of our consolidated revenues during the three month periods ended September 30, 2016 and 2015, respectively, and comprised approximately 24% and 25% of our consolidated revenues during the nine months ended September 30, 2016 and 2015, respectively, 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 and Equity Issuance Program

#### Dividends:

We declared and paid dividends of \$8.8 million, or \$.65 per share, during the third quarter of 2016 and \$8.5 million, or \$.64 per share, during the third quarter of 2015. We declared and paid dividends of \$26.2 million, or \$1.945 per share, during the nine-month period ended September 30, 2016 and \$25.5 million, or \$1.915 per share, during the nine-month period ended September 30, 2015.

#### Equity Issuance Program:

During the second quarter of 2016, we recommenced our at-the-market ("ATM") equity issuance program, pursuant to the terms of which we may sell, from time-to-time, common shares of our beneficial interest up to an aggregate sales price of approximately \$23.3 million to or through Merrill Lynch, Pierce, Fenner and Smith, Incorporated ("Merrill Lynch"), as sales agent and/or principal. The common shares were offered pursuant to the Registration Statement filed with the Securities and Exchange Commission, which became effective during the fourth quarter of 2015.

Pursuant to the ATM Program, during the first nine months of 2016, there were 249,016 shares issued at an average price of \$55.30 per share (all of which were issued during the second quarter), which generated approximately \$13.2 million of cash net proceeds (net of approximately \$558,000, consisting of compensation of \$344,000 to Merrill Lynch, as well as \$214,000 of other various fees and expenses). Since inception of this ATM program, we have issued 829,916 shares at an average price of \$48.77 per share, which generated approximately \$38.8 million of net proceeds (net of approximately \$1.7 million, consisting of compensation of \$1.0 million to Merrill Lynch as well as \$680,000 of other various fees and expenses).



(4) Acquisitions, Dispositions and New Construction

Nine Months Ended September 30, 2016:

Acquisition:

During the nine months ended September 30, 2016, we spent \$52.2 million to:

- purchase the Frederick Memorial Hospital Crestwood, an MOB located in Frederick, Maryland, during the third quarter for approximately \$24.3 million. The property, which consists of approximately 62,300 rentable square feet, is fully occupied pursuant to the terms of triple-net leases with an average remaining lease term of approximately twelve years at the time of acquisition.
- purchase the Chandler Corporate Center III located in Chandler, Arizona, during the second quarter for approximately \$18.0 million. The property, which consists of 82,000 rentable square feet, is currently 92% occupied by one tenant pursuant to the terms of a twelve year escalating triple-net lease, with a ten year fair-market value renewal option. The lease had a remaining lease term of approximately 11.3 years at the time of acquisition.
- purchase the Madison Professional Office Building located in Madison, Alabama, during the first quarter for approximately \$10.1 million (including \$150,000 deposit made in 2015). This multi-tenant property consists of approximately 30,100 rentable square feet and is fully occupied with an average remaining lease term of approximately 6.2 years at the time of acquisition.

The aggregate purchase price for these acquisitions was allocated to the assets acquired and liabilities assumed consisting of tangible property and intangible assets and liabilities, based on the fair value estimated or finalized at acquisition as detailed in the table below. Final allocations of the total purchase price for allocations currently estimated will be recorded during the fourth quarter of 2016, pursuant to a third-party appraisal and will be based upon the fair value at acquisition. While they are not expected to be materially different than those shown, any material adjustments to the estimates will be reflected, retroactively, as of the date of acquisition. Previous reported estimated purchase price allocations that have been finalized in the third quarter did not have a material impact on our consolidated financial statements. The intangible assets include the value of in-place leases at the properties at the time of acquisition as well as the above market lease values. The value of the in-place leases will be amortized over the average remaining lease terms of approximately 6 to 12 years at the time of acquisition. The above/below market leases, which are reflected below as intangible assets/below-market intangibles will be amortized over the remaining term of the respective leases. The estimated aggregate allocation is as follows:

Land	\$6,891
Buildings and improvements	39,647
Intangible assets	7,094
Below-market intangibles	(1,289)
Deposit.....	(150).....
Net cash paid	\$52,193

For these properties acquired during 2016, we recorded aggregate net revenue of approximately \$723,000 and \$1.1 million during the three and nine month periods ended September 30, 2016, respectively, since the date of acquisition. The aggregate net losses generated by these properties since the date of acquisition, including the cost of borrowings and advisory fee expenses was approximately \$47,000 and \$134,000 during the three and nine month periods ended

September 30, 2016, respectively.

Assuming the 2016 acquisitions occurred on January 1, 2015, our pro forma net revenues for the three and nine months ended September 30, 2015, would have been approximately \$16.4 million and \$50.1 million, respectively, and our pro forma net income for the three and nine months ended September 30, 2015, would have been approximately \$3.4 million, or \$.25 per diluted share, and \$18.7 million, or \$1.40 per diluted share, respectively. The Chandler Corporate Center III was not operational during the first nine months of 2015. Assuming these acquisitions occurred on January 1, 2016, our pro forma net revenues for the three and nine months ended September 30, 2016, would have been approximately \$17.2 million and \$51.7 million, respectively, and the aggregate effect on our net income for the three and nine months ended September 30, 2016 was not material.

#### New Construction:

During the first quarter of 2016, we committed to invest up to \$21.1 million in the development and construction of the Henderson Medical Plaza, an MOB located on the campus of the Henderson Hospital Medical Center which is owned by a UHS subsidiary and opened in late October, 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 \$4.6 million on the development and construction for this MOB as of September 30, 2016. The MOB is scheduled to be completed and opened during the first quarter of 2017.

Dispositions:

There were no divestitures during the first nine months of 2016.

Nine Months Ended September 30, 2015:

Property Exchange Transaction:

In May, 2015, in exchange for the real property of Sheffield Medical Building (“Sheffield”), a 73,446 square foot medical office building (“MOB”) located in Atlanta, Georgia, we received \$2 million in cash and the real property of two MOBs located in Sandy Springs and Vinings, Georgia, from an unrelated third party. In connection with the two MOBs acquired in this transaction, triple net, master lease agreements applicable to 100% of the combined 36,700 rentable square feet of these properties were executed with the counterparty. These master lease agreements have initial terms of 15 years and provide for 3% annual rent increases. We recorded an \$8.7 million gain which is included in our Condensed Consolidated Statements of Income for the nine-month period ended September 30, 2015, representing the difference between recorded net book value of Sheffield and the fair values of the properties exchanged, combined with the cash proceeds received.

Acquisitions:

In February, 2015, we purchased the Haas Medical Office Park, two single story buildings having an aggregate of approximately 16,000 rentable square feet, located in Ottumwa, Iowa, for approximately \$4.1 million.

In January and February of 2015, we purchased from wholly-owned subsidiaries of UHS, the real property of two newly-constructed and recently opened FEDs located in Weslaco and Mission, Texas, for an aggregate acquisition cost of approximately \$12.8 million. Each FED consists of approximately 13,600 square feet and is operated by wholly-owned subsidiaries of UHS. In connection with these acquisitions, ten-year lease agreements with six 5-year renewal terms were executed with UHS for each FED. In connection with the lease agreements, the lessee shall have the option to purchase the leased property upon the expiration of the fixed term and each five-year extended term at the fair market value at that time.

Dispositions:

There were no divestitures during the first nine months of 2015.

(5) Summarized Financial Information of Equity Affiliates

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/LPs 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 September 30, 2016, we have non-controlling equity investments or commitments in five jointly-owned LLCs/LPs which own MOBs. As of September 30, 2016, we accounted for these LLCs/LPs on an unconsolidated basis pursuant to the equity method since they are not variable interest entities and we do not have a controlling voting interest. The majority of these entities are joint-ventures between us and non-related parties that manage and hold minority ownership interests in the entities. Each entity 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 member loans. These entities maintain property insurance on the properties.

Effective February 1, 2016, we purchased an additional 10% ownership interest in the Arlington Medical Properties, LLC from the third-party minority member, subject to certain agreed upon terms and conditions. Including this additional ownership interest, we currently own 85% of this LLC which is accounted for on an unconsolidated basis pursuant to the equity method.

The following property table represents the five LLCs in which we own a noncontrolling interest and were accounted for under the equity method as of September 30, 2016:

Name of LLC/LP	Ownership	Property Owned by LLC
Suburban Properties	33 %	St. Matthews Medical Plaza II
Brunswick Associates (a.)	74 %	Mid Coast Hospital MOB
Arlington Medical Properties (b.)	85 %	Saint Mary's Professional Office Building
Grayson Properties (c.)	95 %	Texoma Medical Plaza
FTX MOB Phase II (d.)	95 %	Forney Medical Plaza II

- (a.) This LLC has a third-party term loan, which is non-recourse to us, of \$8.7 million outstanding as of September 30, 2016.
- (b.) We have funded \$5.2 million in equity as of September 30, 2016 and are committed to invest an additional \$623,000. During the fourth quarter of 2015, we advanced this LLC a member loan, the funds of which were utilized to repay its \$22.8 million outstanding third-party mortgage loan on its scheduled maturity date. The terms of the member loan are similar to those in place pursuant to the third-party mortgage loan that was repaid. Additionally, pursuant to the terms and conditions of an agreement executed in February, 2016, we purchased an additional 10% of the ownership interest in this LLC from the existing third-party member for approximately \$4.8 million in cash, thereby increasing our ownership interest to 85%.
- (c.) We have funded \$2.8 million in equity as of September 30, 2016, and are committed to fund an additional \$100,000. This building is on the campus of a UHS hospital and has tenants that include subsidiaries of UHS. This LLC has a third-party term loan, which is non-recourse to us, of \$14.5 million outstanding as of September 30, 2016.
- (d.) We have committed to invest up to \$2.5 million in equity and debt financing, of which \$2.1 million has been funded as of September 30, 2016. This LLC has a third-party term loan, which is non-recourse to us, of \$5.3 million outstanding as of September 30, 2016.

Below are the condensed combined statements of income (unaudited) for the LLCs accounted for under the equity method at September 30, 2016 and 2015.

	Three Months Ended		Nine Months Ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
	(amounts in thousands)		(amounts in thousands)	
Revenues	\$3,776	\$3,638	\$11,437	\$10,799
Operating expenses	1,329	1,461	4,025	4,194
Depreciation and amortization	646	634	1,910	1,788
Interest, net	636	656	1,928	1,907
Net income	\$1,165	\$887	\$3,574	\$2,910
Our share of net income (a.)	\$1,110	\$561	\$3,396	\$1,826

- (a.) Our share of net income for the three and nine months ended September 30, 2016 includes approximately \$291,000 and \$880,000, respectively, of interest income earned by us on an advance made to Arlington Medical Properties, LLC (advance balance payable to us is approximately \$21.8 million as of September 30, 2016). There were no advances outstanding during the first nine months of 2015, therefore there was no interest income earned by us for the three and nine months ended September 30, 2015. Also, as mentioned above, effective February 1, 2016, we purchased an additional 10% of the ownership interest in Arlington Medical Properties, LLC thereby increasing our ownership interest to 85%, from 75% previously.

Edgar Filing: UNIVERSAL HEALTH REALTY INCOME TRUST - Form 10-Q

Below are the condensed combined balance sheets (unaudited) for the five above-mentioned LLCs in which we hold noncontrolling ownership interests and that were accounted for under the equity method as of September 30, 2016 and December 31, 2015:

	September 30, 2016 December 31, 2015	
	(amounts in thousands)	
Net property, including CIP	\$61,317	\$ 61,668
Other assets	5,343	5,264
<b>Total assets</b>	<b>\$66,660</b>	<b>\$ 66,932</b>
<b>Liabilities</b>	<b>\$2,832</b>	<b>\$ 2,538</b>
Mortgage notes payable, non-recourse to us	28,497	28,895
Advances payable to us	21,855	22,489
Equity	13,476	13,010
<b>Total liabilities and equity</b>	<b>\$66,660</b>	<b>\$ 66,932</b>
<b>Our share of equity in and advances to LLCs reflected as:</b>		
Investments in LLCs	\$14,910	\$ 9,108
Advances to LLCs	21,855	22,489
Investments in and advances to LLCs before		
amounts included in accrued expenses and other liabilities	36,765	31,597
Amounts included in accrued expenses and other liabilities	(1,771 )	(1,105 )
<b>Our share of equity in and advances to LLCs, net</b>	<b>\$34,994</b>	<b>\$ 30,492</b>

As of September 30, 2016, and December 31, 2015, 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):

Name of LLC/LP	Mortgage Loan		Maturity Date
	Balance (a.)		
	9/30/2016	12/31/2015	
FTX MOB Phase II	\$5,333	\$ 5,427	August, 2017
Grayson Properties	14,496	14,670	September, 2021
Brunswick Associates	8,668	8,798	December, 2024
	<b>\$28,497</b>	<b>\$ 28,895</b>	

(a.) All mortgage loans require monthly principal payments through maturity and include a balloon principal payment upon maturity.

Pursuant to the operating and/or partnership agreements of the five LLCs/LPs in which we continue to hold non-controlling ownership interests, the third-party member and/or the Trust, at any time, potentially subject to certain conditions, 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 to 90 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 to 90 days of the acceptance by the Non-Offering Member.

#### (6) Recent Accounting Pronouncements

In August, 2016, the Financial Accounting Standards Board (“FASB”) issued ASU No. 2016-15, Classification of Certain Cash Receipts and Cash Payments, which adds or clarifies guidance of the classification of certain cash receipts and payments in the statement of cash flows with the intent to alleviate diversity in practice for classifying various types of cash flows. This ASU is effective for annual and interim reporting periods beginning after December 15, 2017, with early adoption permitted. We are currently evaluating the impact of this ASU on our statement of cash flows.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract (i.e., lessees and lessors). The new standard requires lessees to apply a dual approach, classifying leases as either finance or operating leases based on the principle of whether or not the lease is effectively



a financed purchase by the lessee. This classification will determine whether lease expense is recognized based on an effective interest method or on a straight-line basis over the term of the lease. A lessee is also required to record a right-of-use asset and a lease liability for all leases with a term of greater than 12 months regardless of their classification. Leases with a term of 12 months or less will be accounted for similar to existing guidance for operating leases today. The new standard requires lessors to account for leases using an approach that is substantially equivalent to existing guidance for sales-type leases, direct financing leases and operating leases. ASU 2016-02 supersedes the previous leases standard, Leases (Topic 840). The standard is effective on January 1, 2019, with early adoption permitted. We are currently in the process of evaluating the impact the adoption of ASU 2016-02 will have on our financial position or results of operations.

In April 2015, the FASB issued ASU No. 2015-03, Simplifying the Presentation of Debt Issuance Costs, an update to the accounting standard relating to the presentation of debt issuance costs. Under the new guidance, debt issuance costs related to a recognized debt liability will be presented on the balance sheet as a direct deduction from the debt liability. In the event that there is not an associated debt liability recorded in the consolidated financial statements, the debt issuance costs will continue to be recorded on the consolidated balance sheet as an asset until the debt liability is recorded. The new standard became effective for the Trust on January 1, 2016. The adoption of this guidance did not have a material impact on our consolidated financial position or results of operations as the update only related to changes in financial statement presentation.

In February 2015, the FASB issued ASU No. 2015-02, Consolidation – Amendments to the Consolidation Analysis, which amends the current consolidation guidance affecting both the variable interest entity (“VIE”) and voting interest entity (“VOE”) consolidation models. The standard does not add or remove any of the characteristics in determining if an entity is a VIE or VOE, but rather enhances the way the Company assesses some of these characteristics. The new standard became effective for the Trust on January 1, 2016 and did not have a material impact on our consolidated financial position or results of operations as none of its existing consolidation conclusions were changed.

In 2014, the FASB issued ASU 2014-09, Revenue From Contracts With Customers (“ASU 2014-09”), which outlines a comprehensive model for entities to use in accounting for revenue arising from contracts with customers. ASU 2014-09 states that “an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.” While ASU 2014-09 specifically references contracts with customers, it may apply to certain other transactions such as the sale of real estate or equipment. In 2015, the FASB provided for a one-year deferral of the effective date for ASU 2014-09, which is now effective for us beginning January 1, 2018. We are continuing to evaluate ASU 2014-09 (and related clarifying guidance issued by the FASB); however, we do not expect its adoption to have a significant impact on our consolidated financial statements, as a substantial portion of our revenue consists of rental income from leasing arrangements, which is specifically excluded from ASU 2014-09.

## (7) Debt and Financial Instruments

Debt:

Management routinely monitors and analyzes the Trust's capital structure in an effort to maintain the targeted balance among capital resources including the level of borrowings pursuant to our \$250 million revolving credit facility, the level of borrowings pursuant to non-recourse mortgage debt secured by the real property of our properties and our level of equity including consideration of additional equity issuances pursuant to our ATM equity issuance program. This ongoing analysis considers factors such as the current debt market and interest rate environment, the current/projected occupancy and financial performance of our properties, the current loan-to-value ratio of our properties, the Trust's current stock price, the capital resources required for anticipated acquisitions and the expected capital to be generated by anticipated divestitures. This analysis, together with consideration of the Trust's current balance of revolving credit facility borrowings, non-recourse mortgage borrowings and equity, assists management in deciding which capital resource to utilize when events such as refinancing of specific debt components occur or additional funds are required to finance the Trust's growth.

On March 27, 2015, we entered into a \$185 million revolving credit agreement ("Credit Agreement") which was amended on May 24, 2016 to, among other things, increase the borrowing capacity to \$250 million. The amended Credit Agreement, which is scheduled to mature in March, 2019, includes a \$40 million sub limit for letters of credit and a \$20 million sub limit for swingline/short-term loans. The Credit Agreement also provides a one-time option to extend the maturity date for an additional one year period, and an option to increase the total facility borrowing capacity up to an additional \$50 million, subject to lender agreement. Borrowings under the Credit Agreement are guaranteed by certain subsidiaries of the Trust. In addition, borrowings under the Credit Agreement are secured by first priority security interests in and liens on all equity interests in the Trust's wholly-owned subsidiaries. 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 1.50% to 2.00% or at the Base Rate plus an applicable margin ranging from 0.50% to 1.00%. 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 commitment fee of 0.20% to 0.40% (depending on our total leverage ratio) will be charged on the average

unused portion of the revolving credit commitments. The margins over LIBOR, Base Rate and the commitment fee are based upon our ratio of debt to total capital. At September 30, 2016, the applicable margin over the LIBOR rate was 1.625%, the margin over the Base Rate was 0.625%, and the commitment fee was 0.25%.

At September 30, 2016, we had \$192.3 million of outstanding borrowings and \$2.7 million of letters of credit outstanding under our Credit Agreement. We had \$55.0 million of available borrowing capacity, net of the outstanding borrowings and letters of credit outstanding as of September 30, 2016. There are no compensating balance requirements.

The Credit Agreement contains customary affirmative and negative covenants, including limitations on certain indebtedness, liens, acquisitions and other investments, fundamental changes, asset dispositions and dividends and other distributions. The Credit Agreement also contains restrictive covenants regarding the Trust's ratio of total debt to total assets, the fixed charge coverage ratio, the ratio of total secured debt to total asset value, the ratio of total unsecured debt to total unencumbered asset value, and minimum tangible net worth, as well as customary events of default, the occurrence of which may trigger an acceleration of amounts outstanding under the Credit Agreement. We are in compliance with all of the covenants at September 30, 2016. 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):

	September 30,		
	Covenant	2016	
Tangible net worth	\$125,000	\$ 172,329	
Total leverage	< 60%	47.8	%
Secured leverage	< 30%	17.6	%
Unencumbered leverage	< 60%	48.7	%
Fixed charge coverage	> 1.50x	3.7x	

As indicated on the following table, we have fourteen mortgages, all of which are non-recourse to us, included on our condensed consolidated balance sheet as of September 30, 2016, with a combined outstanding balance of \$107.8 million, excluding net debt premium of \$132,000 and net of net financing fees of \$321,000 (amounts in thousands):

Facility Name	Outstanding		
	Balance	Interest	Maturity
	(in thousands)(a)	Rate	Date
Summerlin Hospital Medical Office Building III			
floating rate mortgage loan (b.)	\$ 10,462	3.77 %	December, 2016
Peace Health fixed rate mortgage loan (b.)	20,434	5.64 %	April, 2017
Auburn Medical II floating rate mortgage loan (b.)	6,783	3.27 %	April, 2017

Edgar Filing: UNIVERSAL HEALTH REALTY INCOME TRUST - Form 10-Q

Medical Center of Western Connecticut fixed rate

mortgage loan (b.)	4,568	6.00	% June, 2017
--------------------	-------	------	--------------

Summerlin Hospital Medical Office Building II fixed

rate mortgage loan (b.)	11,175	5.50	% October, 2017
-------------------------	--------	------	-----------------

Phoenix Children's East Valley Care Center fixed rate

mortgage loan	6,239	5.88	% December, 2017
---------------	-------	------	------------------

Centennial Hills Medical Office Building floating rate

mortgage loan	10,116	3.77	% January, 2018
---------------	--------	------	-----------------

Sparks Medical Building/Vista Medical Terrace

floating rate mortgage loan	4,260	3.77	% February, 2018
-----------------------------	-------	------	------------------

Rosenberg Children's Medical Plaza fixed rate

mortgage loan	8,190	4.85	% May, 2018
---------------	-------	------	-------------

Vibra Hospital-Corpus Christi fixed rate mortgage loan	2,746	6.50	% July, 2019
--	-------	------	--------------

700 Shadow Lane and Goldring MOB's fixed rate

mortgage loan	6,294	4.54	% June, 2022
---------------	-------	------	--------------

BRB Medical Office Building fixed rate mortgage loan	6,362	4.27	% December, 2022
--	-------	------	------------------

Desert Valley Medical Center fixed rate mortgage loan	5,114	3.62	% January, 2023
---	-------	------	-----------------

Tuscan Professional Building fixed rate mortgage loan	5,106	5.56	% June, 2025
---	-------	------	--------------

Total	\$ 107,849		
-------	------------	--	--

- (a.) All mortgage loans require monthly principal payments through maturity and either fully amortize or include a balloon principal payment upon maturity.
- (b.) This loan is scheduled to mature within the next twelve months, at which time we will decide whether to refinance pursuant to a new mortgage loan or by utilizing borrowings under our Credit Agreement.

The mortgages are secured by the real property of the buildings as well as property leases and rents. The mortgages have a combined fair value of approximately \$110 million as of September 30, 2016. Changes in market rates on our fixed rate debt impacts the fair value of debt, but it has no impact on interest incurred or cash flow.

At December 31, 2015, we had fourteen mortgages, all of which were non-recourse to us, included in our consolidated balance sheet. The combined outstanding balance of these fourteen mortgages was \$110.3 million (excluding net debt premium of \$298,000 and net of net financing fees of \$398,000), and had a combined fair value of approximately \$112 million.

#### Financial Instruments:

During the third quarter of 2013, we entered into an interest rate cap on a total notional amount of \$10 million whereby we paid a premium of \$136,000. During the first quarter of 2014, we entered into two additional interest rate cap agreements on a total notional amount of \$20 million whereby we paid premiums of \$134,500. In exchange for the premium payments, the counterparties agreed to pay us the difference between 1.50% and one-month LIBOR if one-month LIBOR rises above 1.50% during the term of the cap. From inception through September 30, 2016, no payments have been made to us by the counterparties pursuant to the terms of these caps which expire in January, 2017.

During the second quarter of 2016, we entered into an interest rate cap on the total notional amount of \$30 million whereby we paid a premium of \$115,000. In exchange for the premium payment, the counterparties agreed to pay us the difference between 1.50% and one-month LIBOR if one-month LIBOR rises above 1.50% during the term of the cap. This interest rate cap becomes effective in January, 2017, coinciding with the expiration of the above-mentioned interest rate caps and expires in March, 2019. During the third quarter of 2016, we entered into an additional interest rate cap agreement on a total notional amount of \$30 million whereby we paid a premium of \$55,000. In exchange for the premium payment, the counterparties agreed to pay us the difference between 1.5% and one-month LIBOR if one-month LIBOR rises above 1.5% during the term of the cap. This interest rate cap became effective in October, 2016 and expires in March, 2019.

#### (8) Segment Reporting

Our primary business is investing in and leasing healthcare and human service facilities through direct ownership or through joint ventures, which aggregate into a single reportable segment. We actively manage our portfolio of healthcare and human service facilities and may from time to time make decisions to sell lower performing properties not meeting our long-term investment objectives. The proceeds of sales are typically reinvested in new developments or acquisitions, which we believe will meet our planned rate of return. It is our intent that all healthcare and human service facilities will be owned or developed for investment purposes. Our revenue and net income are generated from the operation of our investment portfolio.

Our portfolio is located throughout the United States, however, we do not distinguish or group our operations on a geographical basis for purposes of allocating resources or measuring performance. We review operating and financial data for each property on an individual basis; therefore, we define an operating segment as our individual properties. Individual properties have been aggregated into one reportable segment based upon their similarities with regard to

both the nature and economics of the facilities, tenants and operational processes, as well as long-term average financial performance.

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

### Overview

We are a real estate investment trust ("REIT") that commenced operations in 1986. We invest in healthcare and human service related facilities currently including acute care hospitals, rehabilitation hospitals, sub-acute facilities, surgery centers, free-standing emergency departments, childcare centers and medical office buildings ("MOBs"). As of September 30, 2016, we have sixty-five real estate investments located in twenty states consisting of:

- six hospital facilities consisting of three acute care, one rehabilitation and two sub-acute;
- three free-standing emergency departments ("FEDs");
- fifty-two medical/office buildings, including five owned by unconsolidated limited liability companies ("LLCs"), and;
- four pre-school and childcare centers.

### Forward Looking Statements and Certain Risk Factors

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," "expects," "anticipates," "intends," "plans," "believes," "estimates," "appears," "projects" and similar expressions, as well as statements in future tense. You should be aware 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, 2015 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.

Forward-looking statements should not be read as a guarantee of future performance or results, and will not necessarily be accurate indications of the times at, or by which, such performance or results will be achieved. Forward-looking information is based on information available at the time and/or our good faith belief with respect to future events, and is subject to risks and uncertainties that could cause actual performance or results to differ materially from those expressed in the statements. Such factors include, among other things, the following:

- a substantial portion of our revenues are dependent upon one operator, Universal Health Services, Inc. ("UHS"). We cannot assure you that subsidiaries of UHS will renew the leases on our three acute care hospitals (which are scheduled to expire in December, 2021) and two FEDs at existing lease rates or fair market value lease rates. In addition, if subsidiaries of UHS exercise their options to purchase the respective leased hospital facilities upon expiration of the lease terms, our future revenues and results of operations 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 these leases;
- in certain of our markets, the general real estate market has been unfavorably impacted by increased competition/capacity and decreases in occupancy and rental rates which may adversely impact our operating results and the underlying value of our properties;
- a number of legislative initiatives have recently been passed into law that may result in major changes in the health care delivery system on a national or state level to the operators of our facilities, including UHS. No assurances can be given that the implementation of these new laws will not have a material adverse effect on the business, financial condition or results of operations of our operators;
- a subsidiary of UHS is our Advisor and our officers are all employees of a wholly-owned subsidiary of UHS, which may create the potential for conflicts of interest;

lost revenues resulting from the exercise of purchase options, lease expirations and renewals, loan repayments and other restructuring;

our ability to continue to obtain capital on acceptable terms, including borrowed funds, to fund future growth of our business;

the outcome of known and unknown litigation, government investigations, and liabilities and other claims asserted against us or the operators of our facilities;

17

---



failure of the operators of our hospital facilities to comply with governmental regulations related to the Medicare and Medicaid licensing and certification requirements could have a material adverse impact on our future revenues and the underlying value of the property;

the potential unfavorable impact on our business of deterioration in national, regional and local economic and business conditions, including a worsening of credit and/or capital market conditions, which may adversely affect, our ability to obtain capital which may be required to fund the future growth of our business and refinance existing debt with near term maturities;

a deterioration in general economic conditions which could result in increases in the number of people unemployed and/or insured and likely increase the number of individuals without health insurance; as a result, the operators of our facilities may experience decreases in patient volumes which could result in decreased occupancy rates at our medical office buildings;

a worsening of the economic and employment conditions in the United States could materially affect the business of our operators, including UHS, which may unfavorably impact our future bonus rentals (on the UHS hospital facilities) and may potentially have a negative impact on the future lease renewal terms and the underlying value of the hospital properties;

real estate market factors, including without limitation, the supply and demand of office space and market rental rates, changes in interest rates as well as an increase in the development of medical office condominiums in certain markets;

government regulations, including changes in the reimbursement levels under the Medicare and Medicaid program resulting from, among other things, the various health care reform initiatives being implemented;

there have been several attempts in Congress to repeal or modify various provisions of the Patient Protection and Affordable Care Act (the "PPACA"). We cannot predict whether or not any of these proposed changes to the PPACA will become law and therefore can provide no assurance that changes to the PPACA, as currently implemented, will not have a material adverse effect on the future operating results of the tenants/operators of our properties and, thus, our business;

the issues facing the health care industry that affect the operators of our facilities, including UHS, such as: changes in, or the ability to comply with, existing laws and government regulations; unfavorable changes in the levels and terms of reimbursement by third party payors or government programs, including Medicare (including, but not limited to, the potential unfavorable impact of future reductions to Medicare reimbursements resulting from the Budget Control Act of 2011, as discussed below) and Medicaid (most states have reported significant budget deficits that have, in the past, resulted in the reduction of Medicaid funding to the operators of our facilities, including UHS); demographic changes; the ability to enter into managed care provider agreements on acceptable terms; an increase in uninsured and self-pay patients which unfavorably impacts the collectability of patient accounts; decreasing in-patient admission trends; technological and pharmaceutical improvements that may increase the cost of providing, or reduce the demand for, health care, and; the ability to attract and retain qualified medical personnel, including physicians;

in August, 2011, the Budget Control Act of 2011 (the "2011 Act") was enacted into law. The 2011 Act imposed annual spending limits for most federal agencies and programs aimed at reducing budget deficits by \$917 billion between 2012 and 2021, according to a report released by the Congressional Budget Office. The 2011 Act provides for new spending on program integrity initiatives intended to reduce fraud and abuse under the Medicare program. Among its other provisions, the law established a bipartisan Congressional committee, known as the Joint Select Committee on Deficit Reduction (the "Joint Committee"), which was tasked with making recommendations aimed at reducing future federal budget deficits by an additional \$1.5 trillion over 10 years. The Joint Committee was unable to reach an agreement by the November 23, 2011 deadline and, as a result, across-the-board cuts to discretionary, national defense and Medicare spending were implemented on March 1, 2013 resulting in Medicare payment reductions of up to 2% per fiscal year with a uniform percentage reduction across all Medicare programs. The Bipartisan Budget Act of 2015, enacted on November 2, 2015, continued the 2% reductions to Medicare reimbursement imposed under the 2011 Act. We cannot predict whether Congress will restructure the implemented Medicare payment reductions or what federal other deficit reduction initiatives may be proposed by Congress going forward. We also cannot predict

the effect these enactments will have on operators (including UHS), and, thus, our business;

- in March, 2010, the Health Care and Education Reconciliation Act of 2010 and the Patient Protection and Affordable Care Act were enacted into law and created significant changes to health insurance coverage for U.S. citizens as well as material revisions to the federal Medicare and state Medicaid programs. The two combined primary goals of these acts are to provide for increased access to coverage for healthcare and to reduce healthcare-related expenses. Medicare, Medicaid and other health care industry changes are scheduled to be implemented at various times during this decade. We cannot predict the effect, if any, these enactments will have on operators (including UHS) and, thus, our business;

• competition for our operators from other REITs;

• the operators of our facilities face competition from other health care providers, including physician owned facilities and other competing facilities, including certain facilities operated by UHS but the real property of which is not owned by us. Such competition is experienced in markets including, but not limited to, McAllen, Texas, the site of our McAllen Medical Center, a 430-bed acute care hospital, and Riverside County, California, the site of our Southwest Healthcare System-Inland Valley Campus, a 132-bed acute care hospital;

• changes in, or inadvertent violations of, tax laws and regulations and other factors than can affect REITs and our status as a REIT;

• should we be unable to comply with the strict income distribution requirements applicable to REITs, utilizing only cash generated by operating activities, we would be required to generate cash from other sources which could adversely affect our financial condition;

• our ownership interests in five LLCs/LPs in which we hold non-controlling equity interests. In addition, pursuant to the operating and/or partnership agreements of the five entities in which we continue to hold non-controlling ownership interests, the third-party member and/or the Trust, at any time, potentially subject to certain conditions, 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 to 90 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 to 90 days of the acceptance by the Non-Offering Member;

• fluctuations in the value of our common stock, and;

• other factors referenced herein or in our other filings with the Securities and Exchange Commission.

Given these uncertainties, risks and assumptions, you are cautioned not to place undue reliance on such forward-looking statements. Our actual results and financial condition, including the operating results of our lessees and the facilities leased to subsidiaries of UHS, could differ materially from those expressed in, or implied by, the forward-looking statements.

Forward-looking statements speak only as of the date the statements are made. We assume no obligation to publicly update any forward-looking statements to reflect actual results, changes in assumptions or changes in other factors affecting forward-looking information, except as may be required by law. All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by this cautionary statement.

#### Critical Accounting Policies and Estimates

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.

We consider our critical accounting policies to be those that require us to make significant judgments and estimates when we prepare our financial statements, including the following:

**Revenue Recognition:** Our revenues consist primarily of rentals received from tenants, which are comprised of minimum rent (base rentals), bonus rentals and reimbursements from tenants for their pro-rata share of expenses such as common area maintenance costs, real estate taxes and utilities.

The minimum rent for all hospital facilities is fixed over the initial term or renewal term of the respective leases. Rental income recorded by our properties, including our consolidated and unconsolidated MOBs, relating to leases in excess of one year in length, is recognized 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, stipulated rent increases under existing leases, as well as the acquisitions 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. Bonus rents are recognized when earned based upon increases in each facility's net revenue in excess of stipulated amounts. Bonus rentals are determined and paid each quarter based upon a computation

that compares the respective facility's current quarter's net revenue to the corresponding quarter in the base year. Tenant reimbursements for operating expenses are accrued as revenue in the same period the related expenses are incurred.

**Real Estate Investments:** On the date of acquisition, the purchase price of a property is allocated to the property's land, buildings and intangible assets based upon our estimates of their fair values. Depreciation is computed using the straight-line method over the useful lives of the buildings and capital improvements. The value of intangible assets is amortized over the remaining lease term.

**Asset Impairment:** Real estate investments and related intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the property might not be recoverable. A property to be held and used is considered impaired only if management's estimate of the aggregate future cash flows, less estimated capital expenditures, to be generated by the property, undiscounted and without interest charges, are less than the carrying value of the property. This estimate takes into consideration factors such as expected future operating income, trends and prospects, as well as the effects of demand, competition, local market conditions and other factors.

The determination of undiscounted cash flows requires significant estimates by management, including the expected course of action at the balance sheet date that would lead to such cash flows. Subsequent changes in estimated undiscounted cash flows arising from changes in anticipated action to be taken with respect to the property could impact the determination of whether an impairment exists and whether the effects could materially impact our net income. To the extent estimated undiscounted cash flows are less than the carrying value of the property, the loss will be measured as the excess of the carrying amount of the property over the fair value of the property.

Assessment of the recoverability by us of certain lease related costs must be made when we have reason to believe that a tenant might not be able to perform under the terms of the lease as originally expected. This requires us to make estimates as to the recoverability of such costs. If we determine that the intangible assets are not recoverable from future cash flows, the excess of carrying value of the intangible asset over its estimated fair value is charged to income.

An other than temporary impairment of an investment in an LLC is recognized when the carrying value of the investment is not considered recoverable based on evaluation of the severity and duration of the decline in value, including projected declines in cash flow. To the extent impairment has occurred, the excess carrying value of the asset over its estimated fair value is charged to income.

**Federal Income Taxes:** No provision has been made for federal income tax purposes since we qualify as a REIT under Sections 856 to 860 of the Internal Revenue Code of 1986, and intend to continue to remain so qualified. As such, we are exempt from federal income taxes and we are required to distribute at least 90% of our real estate investment taxable income to our shareholders.

We are subject to a federal excise tax computed on a calendar year basis. The excise tax equals 4% of the amount by which 85% of our ordinary income plus 95% of any capital gain income for the calendar year exceeds cash distributions during the calendar year, as defined. No provision for excise tax has been reflected in the financial statements as no tax is expected to be due.

Earnings and profits, which determine the taxability of dividends to shareholders, will differ from net income reported for financial reporting purposes due to the differences for federal tax purposes in the cost basis of assets and in the estimated useful lives used to compute depreciation and the recording of provision for investment losses.

Relationship with Universal Health Services, Inc. (“UHS”) and Related Party Transactions—UHS is our principal tenant and through UHS of Delaware, Inc., a wholly owned subsidiary of UHS, serves as our advisor (the “Advisor”) under an Advisory Agreement dated December 24, 1986 between the Advisor and us (the “Advisory Agreement”). Our officers are all employees of UHS (through UHS of Delaware, Inc.) and although as of September 30, 2016 we had no salaried employees, our officers do receive stock-based compensation from time-to-time.

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 2015, 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 2016 pursuant to the same terms as the Advisory Agreement in place during 2015.

The combined revenues generated from the leases on the UHS hospital facilities comprised approximately 23% and 25% of our consolidated revenues for the three months ended September 30, 2016 and 2015, respectively, and approximately 24% and 25% of our consolidated revenues for the nine months ended September 30, 2016 and 2015, respectively. 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 19% and 20% of the combined consolidated and unconsolidated revenue for the three months ended September 30, 2016 and 2015, respectively, and approximately 20% of the combined consolidated and unconsolidated revenue for each of the nine months ended September 30, 2016 and 2015. In addition, seventeen MOBs, including one currently under construction, and FEDs, that are either wholly or jointly-owned by UHT, include or will include tenants which are subsidiaries of UHS.

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 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 leases related to the hospital facilities of UHS are guaranteed by UHS and cross-defaulted with one another.

In June, 2016, three wholly-owned subsidiaries of UHS provided the required notice to us, exercising the 5-year renewal options on the leases related to our acute care hospitals (McAllen Medical Center, Wellington Regional Medical Center and Southwest Healthcare System, Inland Valley Campus). The renewals extended the lease terms on these facilities, at existing lease rates, to December, 2021. Please see Footnote 2, "Relationship with Universal Health Services, Inc. ("UHS") and Related Party Transactions" for additional information.

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 and 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.

Officers and Employees: Our officers are all employees of a wholly-owned subsidiary of UHS and although as of September 30, 2016 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.

For additional disclosure related to our relationship with UHS, please refer to Note 2 to the condensed consolidated financial statements, Relationship with Universal Health Services, Inc. ("UHS") and Related Party Transactions.

Results of Operations

Edgar Filing: UNIVERSAL HEALTH REALTY INCOME TRUST - Form 10-Q

During the three-month period ended September 30, 2016, net income increased to \$3.8 million, as compared to \$3.6 million during the third quarter of 2015. The \$179,000 net increase was attributable to \$510,000 of combined favorable changes partially offset by the \$331,000 of transaction costs incurred during the third quarter of 2016.

During the nine-month period ended September 30, 2016, net income decreased \$6.6 million to \$12.8 million, as compared to \$19.3 million during the first nine months of 2015. The net decrease was primarily attributable to:

- an \$8.7 million decrease due to the gain on property exchange recorded during the first nine months of 2015;
- a decrease caused by increased transaction costs;
- a decrease caused by an increase in interest expense due in part to the borrowings utilized to finance the acquisitions in 2016;

21

---



an increase due to increased net income generated at various properties, including the favorable impact resulting from the property-exchange transaction completed during the second quarter of 2015, and;  
 increased net income resulting from the above-mentioned repayment during the fourth quarter of 2015 of a previously outstanding third-party mortgage of an unconsolidated LLC utilizing funds borrowed under our revolving credit facility.

Included in our other operating expenses are expenses related to the consolidated medical office buildings, which totaled \$4.1 million and \$3.9 million for the three-month periods ended September 30, 2016 and 2015, respectively, and \$12.1 million and \$12.6 million for the nine-month periods ended September 30, 2016 and 2015, respectively. A large portion of the expenses associated with our consolidated medical office buildings is passed on directly to the tenants either directly as tenant reimbursements of common area maintenance expenses or included in base rental amounts. Tenant reimbursements for operating expenses are accrued as revenue in the same period the related expenses are incurred and are included as tenant reimbursement revenue in our condensed consolidated statements of income.

Funds from operations (“FFO”) is a widely recognized measure of performance for Real Estate Investment Trusts (“REITs”). We believe that FFO and FFO per diluted share, which are non-GAAP financial measures (“GAAP” is Generally Accepted Accounting Principles in the United States of America), are helpful to our investors as measures of our operating performance. We compute FFO, as reflected below, in accordance with standards established by the National Association of Real Estate Investment Trusts (“NAREIT”), which may not be comparable to FFO reported by other REITs that do not compute FFO in accordance with the NAREIT definition, or that interpret the NAREIT definition differently than we interpret the definition. FFO do not represent cash generated from operating activities in accordance with GAAP and should not be considered to be an alternative to net income determined in accordance with GAAP. In addition, FFO should not be used as: (i) an indication of our financial performance determined in accordance with GAAP; (ii) an alternative to cash flow from operating activities determined in accordance with GAAP; (iii) a measure of our liquidity, or; (iv) an indicator of funds available for our cash needs, including our ability to make cash distributions to shareholders.

Below is a reconciliation of our reported net income to FFO for the three and nine-month periods ended September 30, 2016 and 2015 (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Net income	\$3,818	\$3,639	\$12,769	\$19,339
Depreciation and amortization expense on consolidated investments	5,781	5,332	16,549	16,520
Depreciation and amortization expense on unconsolidated affiliates	463	433	1,378	1,261
Gain on property exchange	-	-	-	(8,742)
Funds From Operations	\$10,062	\$9,404	\$30,696	\$28,378
Weighted average number of shares and equivalents outstanding - Diluted	13,575	13,302	13,431	13,297
Funds From Operations per diluted share	\$0.74	\$0.71	\$2.29	\$2.13



Our FFO increased to \$10.1 million during the three-month period ended September 30, 2016, as compared to \$9.4 million during the comparable quarter of 2015. The \$658,000 increase in FFO during the third quarter of 2016, as compared to the third quarter of 2015, was attributable to: (i) a \$179,000 increase in net income, as discussed above, plus; (ii) \$479,000 net increase in the add back of depreciation and amortization expense incurred at our properties on a consolidated and unconsolidated basis.

Our FFO increased to \$30.7 million during the nine-month period ended September 30, 2016, as compared to \$28.4 million during the comparable period of 2015. The \$2.3 million increase in FFO during the nine-month period ended September 30, 2016, as compared to the comparable period of 2015, was attributable to: (i) a \$6.6 million decrease in net income, as discussed above, offset by; (ii) the \$8.7 million gain recorded during the second quarter of 2015, which was deducted for FFO purposes, less; (iii) \$146,000 net increase in the add back of depreciation and amortization expense incurred at our properties on a consolidated and unconsolidated basis.

### Liquidity and Capital Resources

#### Net cash provided by operating activities

Net cash provided by operating activities was \$29.8 million during the nine-month period ended September 30, 2016 as compared to \$27.3 million during the comparable period of 2015. The \$2.5 million net increase was attributable to:

- a favorable change of \$2.2 million due to an increase in net income plus/minus the adjustments to reconcile net income to net cash provided by operating activities (depreciation and amortization, amortization of debt premium, stock-based compensation and gain on property exchange), as discussed above in Results of Operations, and;
- other combined net favorable changes of \$266,000.

#### Net cash used in investing activities

Net cash used in investing activities was \$64.2 million during the nine months ended September 30, 2016 as compared to \$19.9 million during the nine months ended September 30, 2015.

During the nine-month period ended September 30, 2016, we funded: (i) \$5.5 million in equity investments in various unconsolidated LLCs, including \$4.8 million to purchase an additional 10% equity interest in the Arlington Medical Plaza LLC, as discussed above; (ii) \$7.1 million in capital additions to real estate investments primarily related to tenant improvements at various MOBs as well as construction in progress costs for the Henderson Medical Plaza MOB, as discussed above; (iii) \$420,000 consisting of a deposit on real estate assets, and; (iv) \$52.2 million to acquire the real estate assets of three properties, as discussed above. In addition, during the nine-month period ended September 30, 2016, we received: (i) \$634,000 of installment repayments of an outstanding member loan advanced to an unconsolidated LLC, and; (ii) \$318,000 of cash distributions in excess of income received from our unconsolidated LLCs.

During the nine-month period ended September 30, 2015, we funded: (i) \$418,000 in equity investments in various unconsolidated LLCs; (ii) \$3.7 million in capital additions to real estate investments primarily for tenant improvements at various MOBs; (iii) \$16.8 million to acquire the real estate assets of a medical office building and two free-standing emergency departments, and; (iv) \$2.3 million payment of a note payable related to the purchase of third-party minority ownership interests in six majority-owned LLCs during the third quarter of 2014. In addition, during the nine-month period ended September 30, 2015, we received: (i) \$168,000 of cash distributions in excess of income from our unconsolidated LLCs; (ii) \$1.1 million of cash proceeds in connection with the refinancing of third-party debt by a majority-owned LLC in which we hold a noncontrolling ownership interest, and; (iii) \$2.0

million of cash proceeds in connection with the property exchange with an unrelated third party.

Net cash provided by/(used in) financing activities

Net cash provided by financing activities was \$34.6 million during the nine months ended September 30, 2016, as compared to \$7.6 million of net cash used in financing activities during the nine months ended September 30, 2015.

During the nine-month period ended September 30, 2016, we: (i) received \$50.1 million of additional net borrowings on our revolving line of credit, and; (ii) received \$13.4 million of net cash from the issuance of shares of beneficial interest (as discussed below). Additionally, during the nine months ended September 30, 2016, we paid: (i) \$2.4 million on mortgages and other notes payable that are non-recourse to us; (ii) \$307,000 of financing costs paid related to the amendment of our revolving credit facility; (iii) \$26.2 million of dividends, and (iv) \$30,000 of partial settlements of dividend equivalent rights.

During the nine-month period ended September 30, 2015, we: (i) received \$24.6 million of additional net borrowings on our revolving line of credit, and; (ii) received \$1.7 million of net cash from the issuance of shares of beneficial interest (\$1.1 million relates to shares

issued in late December, 2014, as discussed below). Additionally, during the nine months ended September 30, 2015, we paid: (i) \$7.4 million on mortgages and other notes payable that are non-recourse to us, (including the pay-off of the \$4.9 million outstanding mortgage on the Spring Valley Medical Office Building utilizing funds borrowed under our revolving credit facility); (ii) \$1.0 million of financing costs paid on the revolving credit facility; (iii) \$25.5 million of dividends, and (iv) \$17,000 of partial settlements of dividend equivalent rights.

During the second quarter of 2016, we recommenced an at-the-market (“ATM”) equity issuance program, pursuant to the terms of which we may sell, from time-to-time, common shares of our beneficial interest up to an aggregate sales price of approximately \$23.3 million to or through Merrill Lynch, Pierce, Fenner and Smith, Incorporated (“Merrill Lynch”), as sales agent and/or principal. The common shares were offered pursuant to the Registration Statement filed with the Securities and Exchange Commission, which became effective during the fourth quarter of 2015.

During the first nine months of 2016, pursuant to the ATM Program, we issued 249,016 shares at an average price of \$55.30 per share (all of which were issued during the second quarter) which generated approximately \$13.2 million of net cash proceeds (net of approximately \$558,000, consisting of compensation of approximately \$344,000 to Merrill Lynch as well as \$214,000 of other various fees and expenses). As of September 30, 2016, we had approximately \$9.5 million of gross proceeds still available for issuance under the program. Since inception of the program through September, 2016, we have issued 829,916 shares at an average price of \$48.77 per share, which generated approximately \$38.8 million of net proceeds (net of approximately \$1.7 million, consisting of compensation of \$1.0 million to Merrill Lynch as well as \$680,000 of other various fees and expenses). We have, and intend, to use the proceeds generated pursuant to the ATM program to reduce amounts outstanding under our revolving credit agreement. After such repayment of debt, we may re-borrow funds under our revolving credit agreement for general operating purposes, including working capital, capital expenditures, acquisitions, dividend payments and the refinancing of third-party debt.

Additional cash flow and dividends paid information for the nine-month periods ended September 30, 2016 and 2015:

As indicated on our condensed consolidated statement of cash flows, we generated net cash provided by operating activities of \$29.8 million and \$27.3 million during the nine-month periods ended September 30, 2016 and 2015, respectively. As also indicated on our statement of cash flows, noncash expenses including depreciation and amortization, amortization of debt premium, stock-based compensation and the gain recorded during the first nine months of 2015 are the primary differences between our net income and net cash provided by operating activities during each period. In addition, as reflected in the cash flows from investing activities section, we received \$318,000 and \$168,000 during the nine-month periods ended September 30, 2016 and 2015, respectively, of cash distributions in excess of income from various unconsolidated LLCs which represents our share of the net cash flow distributions from these entities. The cash distributions in excess of income represent operating cash flows net of capital expenditures and debt repayments made by the LLCs.

We generated \$30.1 million and \$27.5 million of net cash during the nine months ended September 30, 2016 and 2015, respectively, related to the operating activities of our properties recorded on a consolidated and an unconsolidated basis. We paid dividends of \$26.2 million and \$25.5 million during the nine months ended September 30, 2016 and 2015, respectively. During the first nine months of 2016, the \$30.1 million of net cash generated related to the operating activities of our properties was approximately \$3.8 million greater than the \$26.2 million of dividends paid during the nine-month period. During the first nine months of 2015, the \$27.5 million of net cash generated related to the operating activities of our properties was approximately \$2.0 million greater than the \$25.5 million of dividends paid during the nine-month period.

As indicated in the cash flows from investing activities and cash flows from financing activities sections of the statements of cash flows, there were various other sources and uses of cash during the nine months ended

September 30, 2016 and 2015. From time to time, various other sources and uses of cash may include items such as investments and advances made to/from LLCs, additions to real estate investments, acquisitions/divestiture of properties, net borrowings/repayments of debt, and proceeds generated from the issuance of equity. Therefore, in any given period, the funding source for our dividend payments is not wholly dependent on the operating cash flow generated by our properties. Rather, our dividends as well as our capital reinvestments into our existing properties, acquisitions of real property and other investments are funded based upon the aggregate net cash inflows or outflows from all sources and uses of cash from the properties we own either in whole or through LLCs, as outlined above.

In determining and monitoring our dividend level on a quarterly basis, our management and Board of Trustees consider many factors in determining the amount of dividends to be paid each period. These considerations primarily include: (i) the minimum required amount of dividends to be paid in order to maintain our REIT status; (ii) the current and projected operating results of our properties, including those owned in LLCs, and; (iii) our future capital commitments and debt repayments, including those of our LLCs. Based upon the information discussed above, as well as consideration of projections and forecasts of our future operating cash flows, management and the Board of Trustees have determined that our operating cash flows have been sufficient to fund our dividend

payments. Future dividend levels will be determined based upon the factors outlined above with consideration given to our projected future results of operations.

We expect to finance all capital expenditures and acquisitions and pay dividends utilizing internally generated and additional funds. Additional funds may be obtained through: (i) borrowings under our existing \$250 million revolving credit facility agreement (which has \$55.0 million of available borrowing capacity, net of outstanding borrowings and letters of credit, as of September 30, 2016); (ii) the issuance of equity pursuant to an ATM equity issuance program; (iii) borrowings under or refinancing of existing third-party debt pursuant to mortgage loan agreements entered into by our LLCs, and/or; (iv) the issuance of other long-term debt.

We believe that our operating cash flows, cash and cash equivalents, available borrowing capacity under our revolving credit facility and access to the capital markets provide us with sufficient capital resources to fund our operating, investing and financing requirements for the next twelve months, including providing sufficient capital to allow us to make distributions necessary to enable us to continue to qualify as a REIT under Sections 856 to 860 of the Internal Revenue Code of 1986. In the event we need to access the capital markets or other sources of financing, there can be no assurance that we will be able to obtain financing on acceptable terms or within an acceptable time. Our inability to obtain financing on terms acceptable to us could have a material unfavorable impact on our results of operations, financial condition and liquidity.

#### Credit facilities and mortgage debt

Management routinely monitors and analyzes the Trust's capital structure in an effort to maintain the targeted balance among capital resources including the level of borrowings pursuant to our \$250 million revolving credit facility, the level of borrowings pursuant to non-recourse mortgage debt secured by the real property of our properties and our level of equity including consideration of additional equity issuances pursuant to our ATM equity issuance program. This ongoing analysis considers factors such as the current debt market and interest rate environment, the current/projected occupancy and financial performance of our properties, the current loan-to-value ratio of our properties, the Trust's current stock price, the capital resources required for anticipated acquisitions and the expected capital to be generated by anticipated divestitures. This analysis, together with consideration of the Trust's current balance of revolving credit facility borrowings, non-recourse mortgage borrowings and equity, assists management in deciding which capital resource to utilize when events such as refinancing of specific debt components occur or additional funds are required to finance the Trust's growth.

On March 27, 2015, we entered into a \$185 million revolving credit agreement ("Credit Agreement") which was amended on May 24, 2016 to, among other things, increase the borrowing capacity to \$250 million. The amended Credit Agreement, which is scheduled to mature in March, 2019, includes a \$40 million sub limit for letters of credit and a \$20 million sub limit for swingline/short-term loans. The Credit Agreement also provides a one-time option to extend the maturity date for an additional one year period, and an option to increase the total facility borrowing capacity up to an additional \$50 million, subject to lender agreement. Borrowings under the Credit Agreement are guaranteed by certain subsidiaries of the Trust. In addition, borrowings under the Credit Agreement are secured by first priority security interests in and liens on all equity interests in the Trust's wholly-owned subsidiaries. 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 1.50% to 2.00% or at the Base Rate plus an applicable margin ranging from 0.50% to 1.00%. 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 commitment fee of 0.20% to 0.40% (depending on our total leverage ratio) will be charged on the average unused portion of the revolving credit commitments. The margins over LIBOR, Base Rate and the commitment fee are based upon our ratio of debt to total

capital. At September 30, 2016, the applicable margin over the LIBOR rate was 1.625%, the margin over the Base Rate was 0.625%, and the commitment fee was 0.25%.

At September 30, 2016, we had \$192.3 million of outstanding borrowings and \$2.7 million of letters of credit outstanding under our Credit Agreement. We had \$55.0 million of available borrowing capacity, net of the outstanding borrowings and letters of credit outstanding as of September 30, 2016. There are no compensating balance requirements.

The Credit Agreement contains customary affirmative and negative covenants, including limitations on certain indebtedness, liens, acquisitions and other investments, fundamental changes, asset dispositions and dividends and other distributions. The Credit Agreement also contains restrictive covenants regarding the Trust's ratio of total debt to total assets, the fixed charge coverage ratio, the ratio of total secured debt to total asset value, the ratio of total unsecured debt to total unencumbered asset value, and minimum tangible net worth, as well as customary events of default, the occurrence of which may trigger an acceleration of amounts outstanding under the Credit Agreement. We are in compliance with all of the covenants at September 30, 2016. 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):

	September 30,		
	Covenant	2016	
Tangible net worth	\$125,000	\$172,329	
Total leverage	< 60%	47.8	%
Secured leverage	< 30%	17.6	%
Unencumbered leverage	< 60%	48.7	%
Fixed charge coverage	> 1.50x	3.7x	

As indicated on the following table, we have fourteen mortgages, all of which are non-recourse to us, included on our condensed consolidated balance sheet as of September 30, 2016, with a combined outstanding balance of \$107.8 million, excluding net debt premium of \$132,000 and net of net financing fees of \$321,000 (amounts in thousands):

Facility Name	Outstanding		
	Balance	Interest	Maturity
	(in thousands)(a)	Rate	Date
Summerlin Hospital Medical Office Building III			
floating rate mortgage loan (b.)	\$ 10,462	3.77 %	December, 2016
Peace Health fixed rate mortgage loan (b.)	20,434	5.64 %	April, 2017
Auburn Medical II floating rate mortgage loan (b.)	6,783	3.27 %	April, 2017
Medical Center of Western Connecticut fixed rate			
mortgage loan (b.)	4,568	6.00 %	June, 2017
Summerlin Hospital Medical Office Building II fixed			
rate mortgage loan (b.)	11,175	5.50 %	October, 2017
Phoenix Children's East Valley Care Center fixed rate			
mortgage loan	6,239	5.88 %	December, 2017
Centennial Hills Medical Office Building floating rate			
mortgage loan	10,116	3.77 %	January, 2018
Sparks Medical Building/Vista Medical Terrace			
floating rate mortgage loan	4,260	3.77 %	February, 2018
Rosenberg Children's Medical Plaza fixed rate			
mortgage loan	8,190	4.85 %	May, 2018
Vibra Hospital-Corpus Christi fixed rate mortgage loan	2,746	6.50 %	July, 2019
700 Shadow Lane and Goldring MOBs fixed rate	6,294	4.54 %	June, 2022

mortgage loan			
BRB Medical Office Building fixed rate mortgage loan	6,362	4.27	% December, 2022
Desert Valley Medical Center fixed rate mortgage loan	5,114	3.62	% January, 2023
Tuscan Professional Building fixed rate mortgage loan	5,106	5.56	% June, 2025
<b>Total</b>	<b>\$ 107,849</b>		

- (a.) All mortgage loans require monthly principal payments through maturity and either fully amortize or include a balloon principal payment upon maturity.
- (b.) This loan is scheduled to mature within the next twelve months, at which time we will decide whether to refinance pursuant to a new mortgage loan or by utilizing borrowings under our Credit Agreement.

#### Off Balance Sheet Arrangements

As of September 30, 2016, we are party to certain off balance sheet arrangements consisting of standby letters of credit and equity and debt financing commitments. Our outstanding letters of credit at September 30, 2016 totaled \$2.7 million consisting of: (i) \$1.7 million related to Centennial Hills Medical Properties; (ii) \$380,000 related to FTX MOB Phase II, LP, and; (iii) \$650,000 related to Banburry Medical Properties.

#### Acquisition and Divestiture Activity

Please see Note 4 to the condensed consolidated financial statements for completed transactions.

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

Reference is made to Item 7A in our Annual Report on Form 10-K for the year ended December 31, 2015. There have been no material changes in the quantitative and qualitative disclosures during the first nine months of 2016.

### Item 4. Controls and Procedures

As of September 30, 2016, under the supervision and with the participation of our management, including the Trust's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), we performed an evaluation of the effectiveness of our disclosure controls and procedures as defined in Rule 13a-15(e) or Rule 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "1934 Act").

Based on this evaluation, the CEO and CFO have concluded that our disclosure controls and procedures are effective to ensure that material information is recorded, processed, summarized and reported by management on a timely basis in order to comply with our disclosure obligations under the 1934 Act and the SEC rules thereunder.

There have been no changes in our internal control over financial reporting or in other factors during the first nine months of 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

UNIVERSAL HEALTH REALTY INCOME TRUST

Item 1A. Risk Factors

Our Annual Report on Form 10-K for the year ended December 31, 2015 includes a listing of risk factors to be considered by investors in our securities. There have been no material changes in our risk factors from those set forth in our Annual Report on Form 10-K for the year ended December 31, 2015.

Item 6. Exhibits

(a.) Exhibits:

31.1 Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)/15(d)-14(a) under the Securities Exchange Act of 1934, as amended.

31.2 Certification of the Chief Financial Officer pursuant to Rule 13a-14(a)/15(d)-14(a) under the Securities Exchange Act of 1934, as amended.

32.1 Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101.INS XBRL Instance Document

101.SCH XBRL Taxonomy Extension Schema Document

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document

101.DEF XBRL Taxonomy Extension Definition Linkbase Document

101.LAB XBRL Taxonomy Extension Label Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

Signatures

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

Date: November 8, 2016 UNIVERSAL HEALTH REALTY INCOME TRUST

(Registrant)

/s/ Alan B. Miller  
Alan B. Miller,  
Chairman of the Board,

President and Chief Executive Officer

(Principal Executive Officer)

/s/ Charles F. Boyle  
Charles F. Boyle, Vice President and Chief Financial Officer

(Principal Financial Officer)

EXHIBIT INDEX

Exhibit

No.	Description
31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)/15(d)-14(a) under the Securities Exchange Act of 1934, as amended.
31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a)/15(d)-14(a) under the Securities Exchange Act of 1934, as amended.
32.1	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document