UNIVERSAL HEALTH REALTY INCOME TRUST
Form 10-Q
November 07, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(MARK ONE)

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

For the quarterly period ended September 30, 2011

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 incorporation or organization)	**(I. R. S. Employer Identification No.)**

UNIVERSAL CORPORATE CENTER

367 SOUTH GULPH ROAD

KING OF PRUSSIA, PENNSYLVANIA	**19406**
(Address of principal executive offices)	**(Zip Code)**

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

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

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

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

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

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

Number of common shares of beneficial interest outstanding at October 31, 2011 - 12,665,326

UNIVERSAL HEALTH REALTY INCOME TRUST

INDEX

Part I. Financial Information

Universal Health Realty Income Trust

Condensed Consolidated Statements of Income

For the Three and Nine Months Ended September 30, 2011 and 2010

(amounts in thousands, except per share amounts)

(unaudited)

	Three Months Ended September 30, 2011	2010	Nine Months Ended September 30, 2011	2010
Revenues:				
Base rental - UHS facilities	$3,266	$3,298	$9,788	$9,882
Base rental - Non-related parties	2,676	2,332	6,727	7,515
Bonus rental - UHS facilities	1,013	1,024	3,217	3,141
Tenant reimbursements and other - Non-related parties	421	492	1,059	1,651
Tenant reimbursements and other- UHS facilities	18	25	45	99
	7,394	7,171	20,836	22,288
Expenses:				
Depreciation and amortization	1,799	1,599	4,841	4,778
Advisory fees to UHS	525	474	1,476	1,377
Other operating expenses	1,424	1,488	3,674	4,274
Transaction costs	455	0	590	0
	4,203	3,561	10,581	10,429
Income before equity in income of unconsolidated limited liability companies ("LLCs") and interest expense	3,191	3,610	10,255	11,859
Equity in income of unconsolidated LLCs	875	335	2,377	1,904
Interest expense, net	(718)	(558)	(1,464)	(1,575)
Net income	$3,348	$3,387	$11,168	$12,188
Basic earnings per share	$0.26	$0.27	$0.88	$1.00
Diluted earnings per share	$0.26	$0.27	$0.88	$1.00
Weighted average number of shares outstanding - Basic	12,648	12,323	12,643	12,170
Weighted average number of share equivalents	3	2	5	2

Weighted average number of shares and equivalents outstanding - Diluted	12,651	12,325	12,648	12,172

See accompanying notes to condensed consolidated financial statements.

Universal Health Realty Income Trust

Condensed Consolidated Balance Sheets

(dollar amounts in thousands)

(unaudited)

Assets:	September 30, 2011	December 31, 2010
Real Estate Investments:		
Buildings and improvements	$202,257	$180,750
Accumulated depreciation	(79,162)	(74,683)
	123,095	106,067
Land	21,200	19,190
Net Real Estate Investments	144,295	125,257
Investments in and advances to limited liability companies ("LLCs")	82,615	80,442
Other Assets:		
Cash and cash equivalents	787	987
Base and bonus rent receivable from UHS	2,021	1,964
Rent receivable - other	1,226	912
Deferred charges, notes receivable and intangible and other assets, net	11,895	6,573
Total Assets	$242,839	$216,135
Liabilities:		
Line of credit borrowings	$90,400	$52,600
Mortgage notes payable, non-recourse to us	8,279	8,399
Loans payable of consolidated LLC, non-recourse to us	6,470	6,564
Accrued interest	90	113
Accrued expenses and other liabilities	2,766	2,333
Tenant reserves, escrows, deposits and prepaid rents	763	616
Total Liabilities	108,768	70,625
Equity:		
Preferred shares of beneficial interest, $.01 par value; 5,000,000 shares authorized; none issued and outstanding	0	0
Common shares, $.01 par value; 95,000,000 shares authorized; issued and outstanding: 2011 - 12,665,269; 2010 -12,653,169	127	127
Capital in excess of par value	213,597	213,209
Cumulative net income	384,772	373,604
Cumulative dividends	(464,504)	(441,527)

Total Universal Health Realty Income Trust Shareholders' Equity	133,992	145,413
Non-controlling equity interest	79	97
Total Equity	134,071	145,510
Total Liabilities and Equity	$242,839	$216,135

See accompanying notes to condensed consolidated financial statements.

Universal Health Realty Income Trust

Condensed Consolidated Statements of Cash Flows

(amounts in thousands)

(unaudited)

	Nine months ended September 30, 2011	2010
Cash flows from operating activities:		
Net income	$11,168	$12,188
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,841	4,778
Restricted/stock-based compensation expense	210	261
Changes in assets and liabilities:		
Rent receivable	(371)	112
Accrued expenses and other liabilities	(114)	431
Tenant reserves, escrows, deposits and prepaid rents	(1)	41
Accrued interest	(23)	39
Other, net	87	(209)
Net cash provided by operating activities	15,797	17,641
Cash flows from investing activities:		
Investments in LLCs	(3,475)	(12,018)
Repayments of advances made to LLCs	6,664	478
Advances made to LLCs	(11,541)	(9,547)
Cash distributions in excess of income from LLCs	4,066	2,582
Cash distributions of refinancing proceeds from LLCs	2,111	2,734
Additions to real estate investments	(172)	(801)
Deposits on real estate assets	(834)	0
Net cash paid for acquisition of medical office buildings	(26,505)	0
Decrease in cash and cash equivalents due to recording of LLC on unconsolidated basis	0	(1,938)
Net cash used in investing activities	(29,686)	(18,510)
Cash flows from financing activities:		
Net borrowings on line of credit	37,800	7,800
Repayments of mortgage notes payable of consolidated LLCs	0	(191)
Repayments of loans payable of consolidated LLCs	(94)	(118)
Repayments of mortgage notes payable	(120)	(3,489)
Proceeds from mortgage notes payable	0	5,250
Financing costs paid	(1,104)	0
Financing costs of mortgage notes payable	0	(388)
Dividends paid	(22,977)	(22,215)
Issuance of shares of beneficial interest, net	184	12,243
Net cash provided by/(used in) financing activities	13,689	(1,108)
Decrease in cash and cash equivalents	(200)	(1,977)
Cash and cash equivalents, beginning of period	987	3,038

Cash and cash equivalents, end of period	$787	$1,061
Supplemental disclosures of cash flow information:		
Interest paid	$1,297	$1,540
Supplemental disclosures of non-cash information:		
Deconsolidation of LLC:		
Net real estate investments	$0	$12,169
Cash and cash equivalents	0	1,938
Other assets	0	144
Mortgage and note payable	0	13,465
Other liabilities	0	370
Third-party equity interests	0	21
Investment in LLC	$0	$395

See accompanying notes to these consolidated financial statements.

UNIVERSAL HEALTH REALTY INCOME TRUST

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2011

(unaudited)

(1) General

This Quarterly Report on Form 10-Q is for the Quarterly Period ended September 30, 2011. In this Quarterly Report, we, us, our and the Trust refer to Universal Health Realty Income Trust.

You should carefully review all of the information contained in this Quarterly Report, and should particularly consider any risk factors that we set forth in this Quarterly Report and in other reports or documents that we file from time to time with the Securities and Exchange Commission (the SEC). In this Quarterly Report, we state our beliefs of future events and of our future financial performance. In some cases, you can identify those so-called forward-looking statements by words such as may, will, should, could, would, predicts, potential, continue, exp future, intends, plans, believes, estimates, appears, projects and similar expressions, as well as statements in future tense. You should b that those statements are only our predictions. Actual events or results may differ materially. In evaluating those statements, you should specifically consider various factors, including the risks outlined herein and in our Annual Report on Form 10-K for the year ended December 31, 2010 in *Item 1A Risk Factors* and in *Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations - Forward Looking Statements*. Those factors may cause our actual results to differ materially from any of our forward-looking statements.

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

In this Quarterly Report on Form 10-Q, the term revenues does not include the revenues of the unconsolidated limited liability companies (LLCs) in which we have various non-controlling equity interests ranging from 33% to 99%. We currently account for our share of the income/loss from these investments by the equity method (see Note 5). As of September 30, 2011, we had investments or commitments in thirty-two LLCs, thirty-one of which are accounted for by the equity method and one that is currently consolidated in our financial statements.

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, 2010.

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

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

The combined revenues generated from the leases on the UHS hospital facilities accounted for approximately 55% and 56% of our consolidated revenue for the three months ended September 30, 2011 and 2010, respectively and 59% and 55% for the nine months ended September 30, 2011 and 2010, respectively. Including 100% of the revenues generated at the unconsolidated LLCs in which we have various non-controlling equity interests ranging from 33% to 99%, the leases on the UHS hospital facilities accounted for approximately 18% and 20% of the combined consolidated and unconsolidated revenue for the three month periods ended September

30, 2011 and 2010, and 19% and 20% for the nine month periods ended September 30, 2011 and 2010, respectively. In addition, twelve medical office buildings (MOBs), owned by an LLC in which we hold various non-controlling equity interests, 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. In addition, UHS has rights of first refusal to: (i) purchase the respective leased facilities during and for 180 days after the lease terms at the same price, terms and conditions of any third-party offer, or; (ii) renew the lease on the respective leased facility at the end of, and for 180 days after, the lease term at the same terms and conditions pursuant to any third-party offer. UHS also has the right to purchase the respective leased facilities at the end of the lease terms or any renewal terms at the appraised fair market value. In addition, the Master Lease, as amended during 2006, includes a change of control provision whereby UHS has the right, upon one month s notice should a change of control of the Trust occur, to purchase any or all of the four leased hospital properties listed below at their appraised fair market value.

On May 19, 2011, certain subsidiaries of UHS provided the required notice to us exercising the 5-year renewal options on the following hospital facilities which extended the existing lease terms to December, 2016:

- McAllen Medical Center
- Wellington Regional Medical Center
- Southwest Healthcare System - Inland Valley Campus

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

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

(a) UHS has three 5-year renewal options at existing lease rates (through 2031).

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

(c) UHS has two 5-year renewal options at fair market value lease rates (2015 through 2024).

We are committed to invest up to a total of $8.9 million in equity and debt financing, of which $5.0 million has been funded as of September 30, 2011, in exchange for a 95% non-controlling equity interest in an LLC (Palmdale Medical Properties) that constructed, owns, and operates the Palmdale Medical Plaza, located in Palmdale, California, on the campus of a UHS hospital. This MOB has a triple net, 75% master lease commitment by UHS of Palmdale, Inc., a wholly-owned subsidiary of UHS, pursuant to the terms of which the master lease for each suite will be cancelled at such time that the suite is leased to another tenant acceptable to the LLC and UHS of Palmdale, Inc. This MOB, tenants of which will include subsidiaries of UHS, was completed and opened during the third quarter of 2008 at which time the master lease commenced. As of September 30, 2011, the master lease threshold of 75% has not been met and is not expected to be met in the near future. The LLC has a third-party term loan of $6.5 million, which is non-recourse to us, outstanding as of September 30, 2011. This LLC, which is deemed to be a variable interest entity, is consolidated in our financial statements since we are the primary beneficiary.

We are committed to invest up to $5.5 million in debt or equity of which $2.5 million has been funded as of September 30, 2011, in exchange for a 95% non-controlling equity interest in an LLC (Banburry Medical Properties) that developed, constructed, owns and operates the Summerlin Medical Office Building III, located in Las Vegas, Nevada, on the campus of a UHS hospital. This MOB, tenants of which will include subsidiaries of UHS, was completed and opened during the first quarter of 2009. Summerlin Hospital Medical Center (Summerlin Hospital), a majority-owned subsidiary of UHS committed to lease approximately 25% of this building pursuant to the terms of a 10-year flex lease. In addition, Summerlin Hospital committed to a 50% master lease on the remaining 75% of the building (representing 37.5% of the building) pursuant to the terms of which the master lease for each suite was cancelled at such time that the suite was leased to another tenant acceptable to the LLC and Summerlin Hospital. During the first quarter of 2010, the master lease threshold was met and, as a result, this MOB is accounted for as an unconsolidated LLC under the equity method beginning on January 1, 2010. The LLC has a third-party term loan of $12.7 million, which is non-recourse to us, outstanding as of September 30, 2011.

We are committed to invest up to $6.4 million in equity and debt financing, of which $5.6 million has been funded as of September 30, 2011, in exchange for a 95% non-controlling equity interest in an LLC (Sparks Medical Properties) that owns and operates the Vista Medical Terrace and The Sparks Medical Building, located in Sparks, Nevada, on the campus of a UHS hospital. This LLC has a third-party term loan of $5.4 million, which is non-recourse to us, outstanding as of September 30, 2011. As this LLC is not considered to be a variable interest entity, it is accounted for pursuant to the equity method.

We are committed to invest up to $8.4 million in equity and debt financing, of which $6.8 million has been funded as of September 30, 2011, in exchange for a 95% non-controlling equity interest in an LLC that owns and operates the Centennial Hills Medical Office Building I, located in Las Vegas, Nevada, on the campus of a UHS hospital. This MOB was completed and opened during the fourth quarter of 2007. This LLC has a third-party term loan of $11.9 million, which is non-recourse to us, outstanding as of September 30, 2011. As this LLC is not considered to be a variable interest entity, it is accounted for under the equity method.

We are committed to invest up to a total of $4.8 million in equity and debt financing, of which $1.2 million has been funded as of September 30, 2011, in exchange for a 95% non-controlling equity interest in an LLC (Texoma Medical Properties) that developed, constructed, owns and operates the Texoma Medical Plaza located in Denison, Texas, which was completed and opened during the first quarter of 2010. This MOB is located on the campus of a newly constructed and recently opened replacement UHS acute care hospital owned and operated by Texoma Medical Center (Texoma Hospital), a wholly-owned subsidiary of UHS. Texoma Hospital has committed to lease 75% of this building, pursuant to which the master lease for each suite will be cancelled at such time that the suite is leased to another tenant acceptable to the LLC and Texoma Hospital. It is anticipated that the master lease threshold on this MOB will be met in the near future. This MOB will have tenants that include subsidiaries of UHS. This LLC has a third-party construction loan of $13.2 million, which is non-recourse to us, outstanding as of September 30, 2011. As this LLC is not considered to be a variable interest entity, it is accounted for pursuant to the equity method.

We are committed to invest up to a total of $4.7 million in equity and debt financing, of which $3.7 million has been funded as of September 30, 2011, in exchange for a 95% non-controlling equity interest in an LLC (Auburn Medical Properties) that developed, constructed, owns and operates the Auburn Medical Office Building II, located in Auburn, Washington, on the campus of a UHS hospital. Auburn Regional Medical Center (Auburn Hospital), a wholly-owned subsidiary of UHS committed to lease 75% of this building, pursuant to which the master lease for each suite was cancelled at such time that the suite was leased to another tenant acceptable to the LLC and Auburn Hospital. The master lease threshold on this MOB has been met. This MOB, tenants of which include subsidiaries of UHS, was completed and opened in the third quarter of 2009. This LLC has a third-party construction loan of $7.9 million, which is non-recourse to us, outstanding as of September 30, 2011. As this LLC is not considered to be a variable interest entity, it is accounted for pursuant to the equity method.

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. The Advisory Agreement was renewed for 2011 at the same terms and conditions as 2010.

The Advisory Agreement provides that the Advisor is entitled to receive an annual advisory fee equal to 0.65% of our average invested real estate assets, as derived from our consolidated balance sheet. The average real estate assets for advisory fee calculation purposes exclude certain items from our consolidated balance sheet such as, among other things, accumulated depreciation, cash and cash equivalents, base and bonus rent receivables, deferred charges and other assets. The advisory fee is payable quarterly, subject to adjustment at year-end based upon our audited financial statements. In addition, the Advisor is entitled to an annual incentive fee equal to 20% of the amount by which cash available for distribution to shareholders for each year, as defined in the Advisory Agreement, exceeds 15% of our equity as shown on our consolidated balance sheet, determined in accordance with generally accepted accounting principles without reduction for return of capital dividends. The Advisory Agreement defines cash available for distribution to shareholders as net cash flow from operations less deductions for, among other things, amounts required to discharge our debt and liabilities and reserves for replacement and capital improvements to our properties and investments. No incentive fees were paid during the first nine months of 2011 or 2010 since the incentive fee requirements were not achieved. Advisory fees incurred and paid (or payable) to UHS amounted to $525,000 and $474,000 for the three months ended September 30, 2011 and 2010, respectively, and were based upon average invested real estate assets of $323 million and $292 million for the three-month periods ended September 30, 2011 and 2010, respectively. Advisory fees incurred and paid (or payable) to UHS amounted to $1.5 million and

$1.4 million for the nine months ended September 30, 2011 and 2010, respectively, and were based upon average invested real estate assets of $303 million and $282 million for the nine-month periods ended September 30, 2011 and 2010, respectively.

Officers and Employees: Our officers are all employees of UHS and although as of September 30, 2011 we had no salaried employees, our officers do receive stock-based compensation from time-to-time.

Share Ownership: As of September 30, 2011 and December 31, 2010, UHS owned 6.2% of our outstanding shares of beneficial interest.

SEC reporting requirements of UHS: UHS is subject to the reporting requirements of the SEC and is required to file annual reports containing audited financial information and quarterly reports containing unaudited financial information. Since the leases on the hospital facilities leased to wholly-owned subsidiaries of UHS comprised approximately 55% and 56% of our consolidated revenues for the three months ended September 30, 2011 and 2010, respectively, and 59% and 55% of our consolidated revenues for the nine months ended September 30, 2011 and 2010, 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 at www.sec.gov. These filings are the sole responsibility of UHS and are not incorporated by reference herein.

UHS Other Matters:

Southwest Healthcare System: UHS has advised us that in April, 2010, Southwest Healthcare System (SWHCS), which operates Rancho Springs Medical Center (the real property of which is not owned by the Trust) and Inland Valley Regional Medical Center (the real property of which is owned by the Trust) located in Riverside County, California, received notifications from the Centers for Medicare and Medicaid Services (CMS) and the California Department of Public Health (CDPH) that they intended to effectuate the termination of SWHCS s Medicare provider agreement and hospital license. In May and September of 2010, SWHCS entered into agreements with CMS and CDPH which abated the termination actions. The agreements required SWHCS to engage independent experts in various disciplines to analyze and develop implementation plans for SWHCS to meet the Medicare conditions of participation. Pursuant to the agreements, CMS/CDPH would conduct a full certification survey, following the implementation of corrective measures, to determine if SWHCS had achieved substantial compliance with the Medicare conditions of participation.

The certification survey occurred during the last week of July, 2011 and as a result of that survey, CMS requested that an additional, follow-up survey be conducted to address specific items identified in the survey. The follow-up survey was conducted in early November, 2011. On November 4, 2011, SWHCS received notification from CMS that, based upon the results of the November 2, 2011 survey, it has been determined that SWHCS is in compliance with the Medicare conditions of participation for a provider of hospital services and SWHCS has been restored to the deemed status pursuant to its continued accreditation by The Joint Commission.

Psychiatric Solutions, Inc.: In connection with the acquisition of Psychiatric Solutions, Inc. (PSI) by UHS, UHS has substantially increased its level of indebtedness which could, among other things, adversely affect its ability to raise additional capital to fund operations, limit its ability to react to changes in the economy or its industry and could potentially prevent it from meeting its obligations under the agreements related to its indebtedness. If UHS experiences financial difficulties and, as a result, operations of its existing facilities suffer, or UHS otherwise fails to make payments to us, our revenues will significantly decline.

Although we have not been and do not expect to be directly impacted by UHS acquisition of PSI, UHS is substantially more leveraged and we cannot assure you that UHS will continue to satisfy its obligations to us. The failure or inability of UHS to satisfy its obligations to us could materially reduce our revenues and net income, which could in turn reduce the amount of dividends we pay and cause our stock price to decline.

(3) Dividends

We declared and paid dividends of $7.7 million, or $.605 per share, during the third quarter of 2011 and $7.5 million, or $.605 per share, during the third quarter of 2010. We declared and paid dividends of $23.0 million, or $1.815 per share, during the nine-month period ended September 30, 2011 and $22.2 million, or $1.81 per share, during the nine-month period ended September 30, 2010.

(4) Acquisitions and Dispositions

Nine Months Ended September 30, 2011:

In June and July, 2011, utilizing a qualified third-party intermediary in connection with planned like-kind exchange transactions pursuant to Section 1031 of the Internal Revenue Code, we purchased the:

Lake Pointe Medical Arts Building a 50,974 square foot, multi-tenant, medical office building located in Rowlett, Texas, for $12.2 million, and;

Forney Medical Plaza a 50,946 square foot, multi-tenant medical office building located in Forney, Texas, for $15.0 million.

The aggregate purchase price for these MOBs was allocated to the assets acquired consisting of tangible property ($23.0 million) and identified intangible assets ($4.2 million), based on their respective fair values at acquisition, as determined by third-party appraisals. Intangible assets include the value of the in-place leases at the time of acquisition. The intangible assets at each MOB will be amortized over the remaining lease terms which average approximately six years.

For these MOBs acquired during the nine months ended September 30, 2011, we recorded aggregate revenue of $827,000 and aggregate property net income of approximately $200,000, not including transaction expenses.

In addition, as previously disclosed on October 12, 2011 on Form 8-K:

Ten LLCs in which we own various noncontrolling, majority ownership interests, entered into a Purchase and Sale Agreement (the Agreement) with a third-party to sell all of the real property owned by each of the LLCs, together with the related leases, rents, personal property, intangible property and accepted service contracts. As partial consideration for the transaction, the purchaser has agreed to assume certain existing third-party mortgage debt related to these assets. The closing of the transaction is expected to occur on or before December 1, 2011 and is subject to customary closing conditions including, but not limited to, lender consents and receipt of certain tenant and ground lease estoppels. We estimate that the divestitures by the LLCs, as provided for pursuant to the terms of the Agreement, will generate approximately $50 million of cash proceeds to us, net of closing costs and the minority members share of the proceeds.

We have entered into a Membership Interest Purchase Agreement (MI Agreement) pursuant to the terms of which we intend to purchase the minority ownership interests held by the third-party member in eleven LLCs in which we currently hold noncontrolling, majority ownership interests. The closing of the transaction, which is subject to certain closing and other conditions, is expected to occur on or before December 1, 2011. Should the MI Agreement be successfully completed, we will hold 100% of the ownership interest in each of the eleven LLCs. These LLCs also agreed to enter into two-year, annually renewable, management and leasing agreements related to the properties with an affiliate of the existing third-party entity that currently acts as managing member of the LLCs. We estimate that the purchase of the membership interests in the various LLCs, as provided for pursuant to the MI

Agreement, will require an aggregate expenditure by us of approximately $5 million, including closing costs.
See Note 5 for the entity and property specific information related to the above-mentioned Agreement and MI Agreement.

We have executed purchase agreements, which are subject to certain closing and other conditions, in connection with the potential acquisition of two additional MOBs from various other parties. Although we can provide no assurance that we will complete the acquisition of these two properties, if completed, we anticipate finalizing the transactions at various times during the latter part of the fourth quarter of 2011.

It is intended that should all of the above-mentioned transactions be completed pursuant to terms and timing as currently contemplated, based upon various assumptions, our funds from operations and cash available for distribution may not be materially different from those that currently exist. However, the various transactions are complex, involve numerous third parties and are not conditioned on each other occurring at any particular date or upon the contemplated terms. We therefore cannot predict whether we will ultimately complete any or all of the tentatively agreed upon transactions as outlined above. Since all of the uncompleted transactions are subject to terms, conditions and other events that may be beyond our ability to control, we can provide no assurance that our funds from operations will not be affected on a short term or long term basis, or that any or all of the tentative transactions as mentioned above can be successfully completed. If we were to sell our ownership interests in the LLCs as mentioned above, but were not able to redeploy a substantial portion of the proceeds into the potential acquisitions as outlined above, in the time periods contemplated, our funds from operations and cash available for distribution could be materially unfavorably impacted. Should we be unable to defer substantially all of the expected taxable gains resulting from the potential divestitures of our noncontrolling, majority ownership interests in ten LLCs that own the real property of certain medical office buildings and other related real estate properties (pursuant to Section 1031 of the Internal Revenue Code) we may be required to borrow funds to make a special dividend distribution to our shareholders or be subject to federal income and/or excise tax liabilities.

Three were no divestitures during the first nine months of 2011.

Nine Months Ended September 30, 2010:

During the first nine months of 2010, we invested $5.1 million in debt financing and equity for a 95% non-controlling ownership interest in an LLC (3811 Bell Medical Properties) that purchased the North Valley Medical Plaza, a medical office building located in Phoenix, Arizona.

There were no dispositions during the first nine months of 2010.

(5) Summarized Financial Information of Equity Affiliates

Our consolidated financial statements include the consolidated accounts of our controlled investments and those investments that meet the criteria of a variable interest entity where we are the primary beneficiary. In accordance with the FASB s standards and guidance relating to accounting for investments and real estate ventures, we account for our unconsolidated investments in LLCs which we do not control using the equity method of accounting. The third-party members in these investments have equal voting rights with regards to issues such as, but not limited to: (i) divestiture of property; (ii) annual budget approval, and; (iii) financing commitments. These investments, which represent 33% to 99% 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, 2011, we have non-controlling equity investments or commitments in thirty-two LLCs which own medical office buildings (MOBs). As of September 30, 2011, we accounted for: (i) thirty-one of these LLCs on an unconsolidated basis pursuant to the equity method since they are not variable interest entities, and; (ii) one of these LLCs (Palmdale Medical Properties) on a consolidated basis, as discussed below, since it is considered to be variable interest entity where we are the primary beneficiary by virtue of its master lease with a subsidiary of Universal Health Services, Inc. (UHS), a related party to us.

The majority of these LLCs are joint-ventures between us and a non-related party that manages and holds minority ownership interests in the entities. Each LLC is generally self-sustained from a cash flow perspective and generates sufficient cash flow to meet its operating cash flow requirements and service the third-party debt (if applicable) that is non-recourse to us. Although there is typically no ongoing financial support required from us to these entities since they are cash-flow sufficient, we may, from time to time, provide funding for certain purposes such as, but not limited to, significant capital expenditures and/or leasehold improvements and reductions and repayments of third-party debt. Although we are not obligated to do so, if approved by us at our sole discretion, additional cash fundings are typically advanced as equity or short to intermediate term loans.

As a result of master lease arrangements between UHS and various LLCs in which we hold majority non-controlling ownership interests, we have consolidated or deconsolidated these LLCs as required in accordance with the FASB s standards and guidance.

Summerlin Medical Office Building II is located in Las Vegas, Nevada on the campus of Summerlin Hospital Medical Center. In connection with this MOB, which is owned by an LLC in which we hold a majority, non-controlling ownership interest, Summerlin Hospital Medical Center committed to a master lease agreement for a specified portion of the space. As a result of this master lease agreement, the LLC was considered a variable interest entity. Since we were the primary beneficiary, the financial results of this MOB were included in our financial statements on a consolidated basis prior to October 1, 2010. During the fourth quarter of 2010, the master lease arrangement expired and, as a result, this MOB is accounted for as an unconsolidated LLC under the equity method beginning on October 1, 2010. There was no material impact on our net income as a result of the deconsolidation of this LLC.

Palmdale Medical Properties has a master lease with a subsidiary of UHS. Additionally, UHS of Delaware, a wholly-owned subsidiary of UHS, serves as advisor to us under the terms of an advisory agreement and manages our day-to-day affairs. All of our officers are officers or employees of UHS. As a result of our related-party relationship with UHS and the master lease, lease assurance or lease guarantee arrangements with subsidiaries of UHS, we account for this LLC on a consolidated basis, since the fourth quarter of 2007, since it is a variable interest entity and we are deemed to be the primary beneficiary. The master lease threshold on this MOB has not yet been met and is not expected to be met in the near future.

The other LLCs in which we hold various non-controlling ownership interests are not variable interest entities and therefore are not subject to consolidation.

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

The following tables represent summarized financial and other information related to the thirty-one LLCs which were accounted for under the equity method as of September 30, 2011:

Name of LLC	**Ownership**	**Property Owned by LLC**
DSMB Properties(j.)	76%	Desert Samaritan Hospital MOBs
DVMC Properties(a.)	90%	Desert Valley Medical Center
Suburban Properties	33%	Suburban Medical Plaza II
Litchvan Investments(j.)	89%	Papago Medical Park

Paseo Medical Properties II(j.)	75%	Thunderbird Paseo Medical Plaza I & II
Willetta Medical Properties(a.)(j.)	90%	Edwards Medical Plaza
Santa Fe Scottsdale(a.)	90%	Santa Fe Professional Plaza
575 Hardy Investors(a.)	90%	Centinela Medical Building Complex

Name of LLC	Ownership	Property Owned by LLC
Brunswick Associates	74%	Mid Coast Hospital MOB
Deerval Properties(d.)(j.)	90%	Deer Valley Medical Office II
PCH Medical Properties	85%	Rosenberg Children s Medical Plaza
Gold Shadow Properties(b.)(k.)	98%	700 Shadow Lane & Goldring MOBs
Arlington Medical Properties	75%	Saint Mary s Professional Office Building
ApaMed Properties(k.)	85%	Apache Junction Medical Plaza
Spring Valley Medical Properties(b.)(k.)	95%	Spring Valley Medical Office Building
Sierra Medical Properties(j.)	95%	Sierra San Antonio Medical Plaza
Spring Valley Medical Properties II(b.)(k.)	95%	Spring Valley Hospital Medical Office Building II
PCH Southern Properties	95%	Phoenix Children s East Valley Care Center
Centennial Medical Properties(b.)(k.)	95%	Centennial Hills Medical Office Building I
Canyon Healthcare Properties(j.)	95%	Canyon Springs Medical Plaza
653 Town Center Investments(b.)(c.)(k.)	95%	Summerlin Hospital Medical Office Building
DesMed(b.)(k.)	99%	Desert Springs Medical Plaza
Deerval Properties II(d.)(j.)	95%	Deer Valley Medical Office Building III
Cobre Properties(j.)	95%	Cobre Valley Medical Plaza
Sparks Medical Properties(b.)	95%	Vista Medical Terrace & The Sparks Medical Building
Auburn Medical Properties II(b.)(k.)	95%	Auburn Medical Office Building II
Grayson Properties(b.)(e.)	95%	Texoma Medical Plaza
BRB/E Building One(f.)(k.)	95%	BRB Medical Office Building
Banburry Medical Properties(b.)(g.)(k.)	95%	Summerlin Hospital MOB III
3811 Bell Medical Properties(h.)	95%	North Valley Medical Plaza
653 Town Center Phase II(b.)(i.)(k.)	98%	Summerlin Hospital MOB II

(a.) The membership interests of this entity are held by a master LLC in which we hold a 90% non-controlling ownership interest.
(b.) Tenants of this medical office building include or will include subsidiaries of UHS.
(c.) The membership interests of this entity are held by a master LLC in which we hold a 95% non-controlling ownership interest.
(d.) Deerval Parking Company, LLC, which owns the real property of a parking garage located near Deer Valley Medical Office Buildings II and III, is 50% owned by each of Deerval Properties and Deerval Properties II.
(e.) We have committed to invest up to \$4.8 million in equity and debt financing, of which \$1.2 million has been funded as of September 30, 2011. This building, which is on the campus of a UHS hospital and has tenants that include subsidiaries of UHS, was completed and opened during the first quarter of 2010. This LLC has a third-party construction loan of \$13.2 million, which is non-recourse to us, outstanding as of September 30, 2011.
(f.) We have committed to invest up to \$3.0 million in equity and debt financing, \$2.7 million of which has been funded as of September 30, 2011, in an LLC that owns and operates this MOB which was completed and opened during the fourth quarter of 2010. This LLC obtained a third-party construction loan commitment of \$6.2 million, which is non-recourse to us, \$6.1 million of which has been borrowed as of September 30, 2011.
(g.) We have committed to invest up to \$5.5 million in equity and debt financing, of which \$2.5 million has been funded as of September 30, 2011. The LLC has a third-party term loan of \$12.7 million, which is non-recourse to us, outstanding as of September 30, 2011.
(h.) We have committed to invest up to \$6.2 million in equity and debt financing, all of which has been funded as of September 30, 2011. This MOB was acquired during the first quarter of 2010.
(i.) This LLC has a third-party loan of \$12.6 million, which is non-recourse to us, outstanding as of September 30, 2011. This facility was accounted for on a consolidated basis prior to October 1, 2010. During the fourth quarter of 2010, the master lease at this facility expired; therefore, this LLC is no longer deemed to be a variable interest entity and is accounted for on an unconsolidated basis pursuant to the equity method beginning October 1, 2010.
(j.) This entity/property is included in the Purchase and Sale Agreement, as discussed in Note 4.
(k.) This entity/property is included in the Membership Interest Purchase Agreement, as discussed in Note 4.

Below are the combined statements of income (unaudited) for the LLCs accounted for under the equity method at September 30, 2011 and 2010:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010 (b.)	2011	2010 (b.)
	(amounts in thousands)			

Revenues	$ 15,222	$ 13,975	$ 44,803	$ 41,040
Operating expenses	6,882	6,436	19,986	18,171
Depreciation and amortization	3,284	3,204	10,009	9,215
Interest, net	4,599	4,445	13,619	12,807

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010 (b.)	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010 (b.)
	(amounts in thousands)			
Net income	$ 457	($110)	$ 1,189	$ 847
Our share of net income (a.)	$ 875	$ 335	$ 2,377	$ 1,904

(a.) Our share of net income includes interest income earned by us on various advances made to LLCs of approximately $715,000 and $615,000 for the three months ended September 30, 2011 and 2010, respectively, and $2.0 million and $1.7 million for the nine months ended September 30, 2011 and 2010, respectively.

(b.) Excludes Summerlin II MOB which was accounted for on a consolidated basis through September 30, 2010.

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

	September 30, 2011	December 31, 2010
	(amounts in thousands)	
Net property, including CIP	$ 330,863	$ 334,757
Other assets	28,473	27,912
Total assets	$ 359,336	$ 362,669
Liabilities	$ 11,333	$ 12,852
Loans payable, non-recourse to us		