

UNIVERSAL HEALTH REALTY INCOME TRUST

Form 10-Q

May 07, 2014

[Table of Contents](#)

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(MARK ONE)

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

For the quarterly period ended March 31, 2014

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
(State or other jurisdiction of
incorporation or organization)

23-6858580
(I. R. S. Employer
Identification No.)

UNIVERSAL CORPORATE CENTER

367 SOUTH GULPH ROAD

KING OF PRUSSIA, PENNSYLVANIA
(Address of principal executive offices)

19406
(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 April 30, 2014 12,918,298

Table of Contents

UNIVERSAL HEALTH REALTY INCOME TRUST

INDEX

	PAGE NO.
<u>PART I. FINANCIAL INFORMATION</u>	
Item 1. <u>Financial Statements</u>	
<u>Condensed Consolidated Statements of Income Three Months Ended March 31, 2014 and 2013</u>	3
<u>Condensed Consolidated Statements of Comprehensive Income Three Months Ended March 31, 2014 and 2013</u>	4
<u>Condensed Consolidated Balance Sheets March 31, 2014 and December 31, 2013</u>	5
<u>Condensed Consolidated Statements of Cash Flows Three Months Ended March 31, 2014 and 2013</u>	6
<u>Notes to Condensed Consolidated Financial Statements</u>	7 through 16
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	16 through 26
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	26
Item 4. <u>Controls and Procedures</u>	26 through 27
<u>PART II. Other Information</u>	28
Item 6. <u>Exhibits</u>	28
<u>Signatures</u>	29
<u>EXHIBIT INDEX</u>	30

This Quarterly Report on Form 10-Q is for the quarter ended March 31, 2014. In this Quarterly Report, we, us, our and the Trust refer to Universal Health Realty Income Trust and its subsidiaries.

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

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

Table of Contents**Part I. Financial Information****Item I. Financial Statements****Universal Health Realty Income Trust**

Condensed Consolidated Statements of Income

For the Three Months Ended March 31, 2014 and 2013

(dollar amounts in thousands, except per share amounts)

(unaudited)

	Three Months Ended March 31,	
	2014	2013
Revenues:		
Base rental UHS facilities	\$ 3,914	\$ 3,790
Base rental Non-related parties	7,226	7,046
Bonus rental UHS facilities	1,150	1,098
Tenant reimbursements and other Non-related parties	1,833	1,788
Tenant reimbursements and other UHS facilities	165	163
	14,288	13,885
Expenses:		
Depreciation and amortization	4,826	4,814
Advisory fees to UHS	610	571
Other operating expenses	3,933	3,665
Transaction costs	62	82
	9,431	9,132
Income before equity in income of unconsolidated limited liability companies (LLCs), interest expense and gains	4,857	4,753
Equity in income of unconsolidated LLCs	593	569
Gains on fair value recognition resulting from the purchase of minority interests in majority-owned LLCs	316	0
Interest expense, net	(1,992)	(1,895)
Net income	\$ 3,774	\$ 3,427
Basic earnings per share	\$ 0.29	\$ 0.27
Diluted earnings per share	\$ 0.29	\$ 0.27

Weighted average number of shares outstanding Basic	12,848	12,671
Weighted average number of share equivalents	6	16
Weighted average number of shares and equivalents outstanding Diluted	12,854	12,687

See the accompanying notes to these condensed consolidated financial statements.

Table of Contents

Universal Health Realty Income Trust

Condensed Consolidated Statements of Comprehensive Income

For the Three Months Ended March 31, 2014 and 2013

(dollar amounts in thousands, except per share amounts)

(unaudited)

	Three Months Ended March 31,	
	2014	2013
Net Income	\$ 3,774	\$ 3,427
Other comprehensive income:		
Unrealized derivative gains on interest rate caps	3	0
Amortization of interest rate cap fees	15	0
Total other comprehensive income:	18	0
Total comprehensive income	\$ 3,792	\$ 3,427

See the accompanying notes to these condensed consolidated financial statements.

Table of Contents**Universal Health Realty Income Trust**

Condensed Consolidated Balance Sheets

(dollar amounts in thousands)

(unaudited)

	March 31, 2014	December 31, 2013
Assets:		
Real Estate Investments:		
Buildings and improvements	\$ 392,898	\$ 368,295
Accumulated depreciation	(101,269)	(97,921)
	291,629	270,374
Land	29,083	27,374
Net Real Estate Investments	320,712	297,748
Investments in and advances to limited liability companies (LLCs)	27,842	39,201
Other Assets:		
Cash and cash equivalents	3,844	3,337
Base and bonus rent receivable from UHS	2,157	2,053
Rent receivable other	3,679	3,310
Intangible assets (net of accumulated amortization of \$15.1 million and \$13.7 million at March 31, 2014 and December 31, 2013, respectively)	23,198	20,782
Deferred charges, goodwill and other assets, net	6,582	6,714
Total Assets	\$ 388,014	\$ 373,145
Liabilities:		
Line of credit borrowings	\$ 101,250	\$ 93,700
Mortgage and other notes payable, non-recourse to us (including net debt premium of \$691,000 and \$834,000 at March 31, 2014 and December 31, 2013, respectively)	116,113	106,287
Accrued interest	526	491
Accrued expenses and other liabilities	4,221	5,156
Tenant reserves, escrows, deposits and prepaid rents	1,989	1,881
Total Liabilities	224,099	207,515
Equity:		
Preferred shares of beneficial interest, \$.01 par value; 5,000,000 shares authorized; none issued and outstanding		
Common shares, \$.01 par value; 95,000,000 shares authorized; issued and outstanding: 2014 12,918,287 2013 12,858,643	129	128

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Capital in excess of par value	223,233	220,691
Cumulative net income	483,818	480,044
Cumulative dividends	(543,226)	(535,176)
Accumulated other comprehensive loss	(39)	(57)
Total Equity	163,915	165,630
Total Liabilities and Equity	\$ 388,014	\$ 373,145

See the accompanying notes to these condensed consolidated financial statements.

Table of Contents**Universal Health Realty Income Trust**

Condensed Consolidated Statement of Cash Flows

(dollar amounts in thousands)

(unaudited)

	Three Months Ended March 31,	
	2014	2013
Cash flows from operating activities:		
Net income	\$ 3,774	\$ 3,427
<i>Adjustments to reconcile net income to net cash provided by operating activities:</i>		
Depreciation and amortization	4,849	4,837
Amortization on debt premium	(104)	(109)
Restricted/stock-based compensation expense	96	91
Gains on purchase of minority interests in majority-owned LLCs before transaction costs	(316)	0
<i>Changes in assets and liabilities:</i>		
Rent receivable	(143)	(269)
Accrued expenses and other liabilities	(1,129)	(501)
Tenant reserves, escrows, deposits and prepaid rents	51	143
Accrued interest	2	(52)
Other, net	(114)	55
Net cash provided by operating activities	6,966	7,622
Cash flows from investing activities:		
Investments in LLCs	(442)	(541)
Repayments of advances made to LLCs	0	26
Advances made to LLCs	0	(519)
Cash distributions in excess of income from LLCs	406	763
Additions to real estate investments, net	(641)	(434)
Net cash paid for acquisition of medical office buildings	(7,050)	0
Cash paid to acquire minority interests in majority-owned LLCs	(170)	0
Net cash used in investing activities	(7,897)	(705)
Cash flows from financing activities:		
Net borrowings on line of credit	7,550	2,400
Proceeds from mortgages and other notes payable	0	11,150
Repayments of mortgages and other notes payable	(796)	(12,284)
Financing costs paid on mortgage and other notes payable	0	(95)
Dividends paid	(8,050)	(7,867)
Issuance of shares of beneficial interest, net	2,477	52

Net cash provided by/(used in) financing activities	1,181	(6,644)
Increase in cash and cash equivalents	250	273
Increase in cash due to recording of LLC on a consolidated basis	257	0
Cash and cash equivalents, beginning of period	3,337	3,048
Cash and cash equivalents, end of period	\$ 3,844	\$ 3,321
Supplemental disclosures of cash flow information:		
Interest paid	\$ 1,980	\$ 1,953
Supplemental disclosures of non-cash transactions:		
Consolidation of LLC:		
Net real estate investments	\$ 19,489	\$ 0
Cash and cash equivalents	257	0
Intangible assets	2,820	0
Rent receivable other	330	0
Deferred charges, goodwill and other assets, net	46	0
Investment in LLCs	(11,392)	0
Mortgage and other notes payable, non-recourse to us	(10,726)	0
Accrued interest	(33)	0
Accrued expenses and other liabilities	(248)	0
Tenant reserves, escrows, deposits and prepaid rents	(57)	0
Gains on purchase of minority interests in majority-owned LLCs	(316)	0
Cash Paid for purchase of minority interests in majority-owned LLCs	\$ 170	\$ 0

See accompanying notes to these condensed consolidated financial statements.

Table of Contents

UNIVERSAL HEALTH REALTY INCOME TRUST

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2014

(unaudited)

(1) General

This Quarterly Report on Form 10-Q is for the Quarterly Period ended March 31, 2014. 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, expects, 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, 2013 in *Item 1A Risk Factors* and in *Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations - Forward Looking Statements*. Those factors may cause our actual results to differ materially from any of our forward-looking statements.

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

In this Quarterly Report on Form 10-Q, the term revenues does not include the revenues of the unconsolidated limited liability companies (LLCs) in which we have various non-controlling equity interests ranging from 33% to 95%. We currently account for our share of the income/loss from these investments by the equity method (see Note 5). As of March 31, 2014, we had investments in eleven jointly-owned LLCs, all of which are accounted for by the equity method as of March 31, 2014. Palmdale Medical Properties was consolidated in our financial statements through June 30, 2013 as a result of a master lease arrangement with a wholly-owned subsidiary of UHS. As previously disclosed, the master lease expired effective as of July 1, 2013 and, as of that date, we began accounting for Palmdale Medical Properties under the equity method through December 31, 2013. Effective January 1, 2014, we purchased the third-party minority ownership interests in Palmdale Medical Properties and Sparks Medical Properties in which we formerly held non-controlling majority ownership interests. As a result of our purchase of the minority ownership

interests, we now hold 100% of the ownership interests in these LLCs which own MOB's and we began accounting for them on a consolidated basis effective January 1, 2014. Each of the property's assets and liabilities are recorded at their fair values. (See Note 4 to the consolidated financial statements for additional disclosure).

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, 2013.

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

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

The combined revenues generated from the leases on the UHS hospital facilities comprised approximately 29% and 30% of our consolidated revenues for the three months ended March 31, 2014 and 2013, 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 22% of the combined consolidated and unconsolidated revenue for each of the three-month periods ended March 31, 2014 and 2013. In addition, twelve MOBs, that are either wholly or jointly-owned, 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, 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. 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.

Management cannot predict whether the leases with subsidiaries of UHS, which have renewal options at existing lease rates or fair market value lease rates (as indicated below), will be renewed at the end of their lease term. As indicated below, The Bridgeway's (Bridgeway) lease term is scheduled to expire in December, 2014 and we can provide no assurance that this lease will be renewed at the fair market value lease rate. Our revenues, net cash provided by operating activities and funds from operations include approximately \$1.1 million annually earned in connection with Bridgeway's lease. If UHS exercises its right to purchase the Bridgeway facility, or any of its other hospital facilities, at the end of the current lease terms at the appraised fair market value, we would consider, among other things, redeploying the sale proceeds generated from the divestiture to acquire other real estate property. If we are unable to redeploy the proceeds generated from the divestiture, or if we were unable to generate the same rate of return on the redeployed proceeds, our revenues, cash provided by operating activities and funds from operations could be unfavorably impacted. In the event that The Bridgeway's lease, or the lease on any other hospital leased to a subsidiary of UHS, is not renewed, and UHS does not exercise its right to purchase the facility for the appraised fair market value at the end of the lease term, we will be required to find other operators for the property and/or enter into leases on terms potentially less favorable to us than the current lease.

The table below details the existing lease terms and renewal options for each of the UHS hospital facilities:

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).

As discussed above, Palmdale Medical Plaza, which is located in Palmdale, California, on the campus of a UHS hospital, had a master lease commitment by a wholly-owned subsidiary of UHS which expired effective as of July 1, 2013. This MOB, tenants of which include subsidiaries of UHS, was completed and opened during the third quarter of 2008 at which time the master lease commenced. The LLC that owns this MOB was deemed to be a variable interest entity during the term of the master lease and was therefore consolidated in our financial statements through June 30, 2013 since we were the primary beneficiary through that date. Effective July 1, 2013, this LLC was no longer be deemed a variable interest entity and is accounted for in our financial statements on an unconsolidated basis pursuant to the equity method from July 1, 2013 through December 31, 2013.

Table of Contents

Effective January 1, 2014, we purchased the third-party minority ownership interests in two LLCs (Palmdale Medical Properties and Sparks Medical Properties) in which we formerly held non-controlling majority ownership interest. As a result of our purchase of the minority ownership interests, we now hold 100% of the ownership interests in these LLCs (which own MOB) and began accounting for them on a consolidated basis.

We have funded \$2.3 million in equity as of March 31, 2014, and are committed to fund an additional \$2.1 million, in exchange for a 95% non-controlling equity interest in an LLC (Texoma Medical Properties) that developed, constructed, owns and operates the Texoma Medical Plaza located in Denison, Texas, which was completed and opened during the first quarter of 2010. This MOB is lo