HEALTHCARE REALTY TRUST INC
Form 10-Q
May 09, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended: March 31, 2011

OR

o **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: 001-11852

HEALTHCARE REALTY TRUST INCORPORATED
(Exact name of Registrant as specified in its charter)

Maryland	**62 1507028**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

3310 West End Avenue
Suite 700
Nashville, Tennessee 37203
(Address of principal executive offices)
(615) 269-8175
(Registrant s telephone number, including area code)

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 Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes þ No o

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 þ No o

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 þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

As of April 30, 2011, 72,742,110 shares of the Registrant s Common Stock were outstanding.

HEALTHCARE REALTY TRUST INCORPORATED
FORM 10-Q
March 31, 2011
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Part I. FINANCIAL INFORMATION
Item 1. Financial Statements.

Healthcare Realty Trust Incorporated
Condensed Consolidated Balance Sheets
(Dollars in thousands, except per share data)

	(Unaudited) **March 31, 2011**	**December 31, 2010**
ASSETS		
Real estate properties:		
Land	$ 163,598	$ 163,020
Buildings, improvements and lease intangibles	2,317,702	2,310,404
Personal property	18,073	17,919
Construction in progress	98,590	80,262
	2,597,963	2,571,605
Less accumulated depreciation	(505,784)	(484,641)
Total real estate properties, net	2,092,179	2,086,964
Cash and cash equivalents	3,007	113,321
Mortgage notes receivable	88,171	36,599
Assets held for sale and discontinued operations, net	16,694	23,915
Other assets, net	96,661	96,510
Total assets	$ 2,296,712	$ 2,357,309
LIABILITIES AND EQUITY		
Liabilities:		
Notes and bonds payable	$ 1,293,086	$ 1,407,855
Accounts payable and accrued liabilities	55,822	62,652
Liabilities of discontinued operations	145	423
Other liabilities	45,212	43,639
Total liabilities	1,394,265	1,514,569
Commitments and contingencies		
Equity:		

Preferred stock, $.01 par value; 50,000,000 shares authorized; none issued and outstanding		
Common stock, $.01 par value; 150,000,000 shares authorized; 70,265,262 and 66,071,424 shares issued and outstanding at March 31, 2011 and December 31, 2010, respectively	703	661
Additional paid-in capital	1,730,808	1,641,379
Accumulated other comprehensive loss	(5,269)	(5,269)
Cumulative net income attributable to common stockholders	790,376	796,165
Cumulative dividends	(1,614,171)	(1,593,926)
Total stockholders equity	902,447	839,010
Noncontrolling interests		3,730
Total equity	902,447	842,740
Total liabilities and equity	$ 2,296,712	$ 2,357,309

The accompanying notes, together with the Notes to the Consolidated Financial Statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2010, are an integral part of these financial statements.

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Healthcare Realty Trust Incorporated
Condensed Consolidated Statements of Operations
For the Three Months Ended March 31, 2011 and 2010
(Dollars in thousands, except per share data)
(Unaudited)

	2011	2010
REVENUES		
Master lease rent	$ 15,019	$ 14,059
Property operating	52,353	45,531
Straight-line rent	1,286	600
Mortgage interest	1,649	638
Other operating	2,305	2,169
	72,612	62,997
EXPENSES		
General and administrative	5,781	4,728
Property operating	28,095	24,199
Bad debt, net	180	(199)
Depreciation	18,895	16,203
Amortization	1,770	1,301
	54,721	46,232
OTHER INCOME (EXPENSE)		
Loss on extinguishment of debt	(1,986)	(480)
Interest expense	(22,274)	(16,311)
Interest and other income, net	228	437
	(24,032)	(16,354)
INCOME (LOSS) FROM CONTINUING OPERATIONS	(6,141)	411
DISCONTINUED OPERATIONS		
Income from discontinued operations	490	1,551
Impairment	(147)	
Gain on sales of real estate properties	36	2,696
INCOME FROM DISCONTINUED OPERATIONS	379	4,247
NET INCOME (LOSS)	(5,762)	4,658
Less: Net income attributable to noncontrolling interests	(27)	(64)
	$ (5,789)	$ 4,594

NET INCOME (LOSS) ATTRIBUTABLE TO COMMON STOCKHOLDERS				
BASIC EARNINGS (LOSS) PER COMMON SHARE:				
Income (loss) from continuing operations	$	(0.09)	$	0.01
Discontinued operations				0.07
Net income (loss) attributable to common stockholders	$	(0.09)	$	0.08
DILUTED EARNINGS (LOSS) PER COMMON SHARE:				
Income (loss) from continuing operations	$	(0.09)	$	0.01
Discontinued operations				0.07
Net income (loss) attributable to common stockholders	$	(0.09)	$	0.08
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING BASIC		66,151,426		59,961,455
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING DILUTED		66,151,426		60,969,730
DIVIDENDS DECLARED, PER COMMON SHARE, DURING THE PERIOD	$	0.30	$	0.30

The accompanying notes, together with the Notes to the Consolidated Financial Statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2010, are an integral part of these financial statements.

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Healthcare Realty Trust Incorporated
Condensed Consolidated Statements of Cash Flows
For the Three Months Ended March 31, 2011 and 2010
(Dollars in thousands)
(Unaudited)

	2011	2010
OPERATING ACTIVITIES		
Net income (loss)	$ (5,762)	$ 4,658
Adjustments to reconcile net income (loss) to cash provided by operating activities:		
Depreciation and amortization	21,855	18,848
Stock-based compensation	941	754
Straight-line rent receivable	(1,286)	(584)
Straight-line rent liability	97	103
Gain on sales of real estate properties	(36)	(2,696)
Loss on extinguishment of debt	1,986	480
Impairment	147	
Provision for bad debt, net	195	(199)
Changes in operating assets and liabilities:		
Other assets	(3,721)	488
Accounts payable and accrued liabilities	(6,418)	5,052
Other liabilities	1,676	1,433
Net cash provided by operating activities	9,674	28,337
INVESTING ACTIVITIES		
Acquisition and development of real estate properties	(25,537)	(25,268)
Funding of mortgages and notes receivable	(48,780)	(2,090)
Proceeds from sales of real estate	3,775	19,588
Proceeds from mortgages and notes receivable repayments	18	36
Net cash used in investing activities	(70,524)	(7,734)
FINANCING ACTIVITIES		
Net borrowings (repayments) on unsecured credit facility	164,000	(3,000)
Repayments on notes and bonds payable	(806)	(524)
Repurchase of notes payable	(280,201)	(8,556)
Quarterly dividends paid	(20,245)	(18,417)
Proceeds from issuance of common stock	90,073	15,044
Common stock redemptions	(51)	
Capital contributions received from noncontrolling interests		633
Distributions to noncontrolling interest holders	(226)	(115)
Purchase of noncontrolling interests	(1,591)	
Equity issuance costs	(61)	
Debt issuance costs	(356)	(474)
Net cash used in financing activities	(49,464)	(15,409)

Increase (decrease) in cash and cash equivalents	(110,314)	5,194
Cash and cash equivalents, beginning of year	113,321	5,851
Cash and cash equivalents, end of year	$ 3,007	$ 11,045
Supplemental Cash Flow Information:		
Interest paid	$ 22,374	$ 3,238
Capitalized interest	$ 1,969	$ 2,197
Company-financed real estate property sales	$ 2,700	$
Invoices accrued for construction, tenant improvement and other capitalized costs	$ 13,223	$ 15,052

The accompanying notes, together with the Notes to the Consolidated Financial Statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2010, are an integral part of these financial statements.

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Healthcare Realty Trust Incorporated
Notes to Condensed Consolidated Financial Statements
March 31, 2011
(Unaudited)

Note 1. Summary of Significant Accounting Policies

Business Overview

Healthcare Realty Trust Incorporated (the Company) is a real estate investment trust (REIT) that owns, acquires, manages, finances, and develops income-producing real estate properties associated primarily with the delivery of outpatient healthcare services throughout the United States. The Company had investments of approximately $2.7 billion in 213 real estate properties and mortgages as of March 31, 2011, excluding assets classified as held for sale and including an investment in one unconsolidated joint venture. The Company s 202 owned real estate properties, excluding assets classified as held for sale, are comprised of six facility types, located in 28 states, totaling approximately 13.3 million square feet. As of March 31, 2011, the Company provided property management services to approximately 9.2 million square feet nationwide.

Principles of Consolidation

The Condensed Consolidated Financial Statements include the accounts of the Company, its wholly-owned subsidiaries, joint ventures, and partnerships where the Company controls the operating activities. During the first quarter of 2011, the Company purchased the remaining noncontrolling interest in its two consolidated joint ventures: (1) HR Ladco Holdings, LLC in which the Company held an 80% interest and (2) Lakewood MOB, LLC in which the Company held a 98.75% interest. The noncontrolling interest holder in both joint ventures was Ladco MPF I, LLC. Prior to the purchase, the noncontrolling interests were reported as equity and the related net income (loss) attributable to the noncontrolling interests as part of consolidated net income in the Company s Condensed Consolidated Financial Statements. The Company s investment in its one unconsolidated joint venture, which is carried at cost, is included in other assets with its related income recognized in other income (expense) in the Company s Condensed Consolidated Financial Statements.

The Condensed Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements that are included in the Company s Annual Report on Form 10-K for the year ended December 31, 2010. Management believes, however, that all adjustments of a normal, recurring nature considered necessary for a fair presentation have been included. All material intercompany transactions and balances have been eliminated in consolidation.

This interim financial information should be read in conjunction with the financial statements and Management s Discussion and Analysis of Financial Condition and Results of Operations included in this report and in the Company s Annual Report on Form 10-K for the year ended December 31, 2010. This interim financial information does not necessarily represent or indicate what the operating results will be for the year ending December 31, 2011 for many reasons including, but not limited to, acquisitions, dispositions, capital financing transactions, changes in interest rates and the effects of other trends and uncertainties.

Use of Estimates in the Condensed Consolidated Financial Statements

Preparation of the Condensed Consolidated Financial Statements in accordance with GAAP requires management to make estimates and assumptions that affect amounts reported in the Condensed Consolidated Financial Statements and accompanying notes. Actual results may differ from those estimates.

Segment Reporting

The Company owns, acquires, manages, finances, and develops outpatient, healthcare-related properties. The Company is managed as one operating segment, rather than multiple operating segments, for internal reporting purposes and for internal decision-making. Therefore, the Company discloses its operating results in a single segment.

Notes to Condensed Consolidated Financial Statements-Continued

Reclassifications

Certain amounts in the Company s Condensed Consolidated Financial Statements for prior periods have been reclassified to conform to the current period presentation. Assets sold or held for sale, and related liabilities, have been reclassified in the Company s Condensed Consolidated Balance Sheets, and the operating results of those assets have been reclassified from continuing to discontinued operations for all periods presented. The Company also reclassified one property from discontinued operations to continuing operations as discussed in Note 3.

Revenue Recognition

General

The Company recognizes revenue when it is realized or realizable and earned. There are four criteria that must be met before a company may recognize revenue, including: persuasive evidence that an arrangement exists; delivery has occurred or services have been rendered (i.e., the tenant has taken possession of and controls the physical use of the leased asset); the price has been fixed or is determinable; and collectability is reasonably assured. Income received but not yet earned is deferred until such time it is earned. Deferred revenue is included in other liabilities in the Company s Condensed Consolidated Balance Sheets.

The Company derives most of its revenues from its real estate and mortgage notes receivable portfolio. The Company s rental and mortgage interest income is recognized based on contractual arrangements with its tenants, sponsors or borrowers. These contractual arrangements generally fall into three categories: leases, mortgage notes receivable, and property operating agreements as described in the following paragraphs. The Company may accrue late fees based on the contractual terms of a lease or note. Such fees, if accrued, are included in master lease rent, property operating income, or mortgage interest income in the Company s Condensed Consolidated Statements of Operations, based on the type of contractual agreement.

Rental Income

Rental income related to non-cancelable operating leases is recognized as earned over the life of the lease agreements on a straight-line basis. The Company s lease agreements generally include provisions for stated annual increases or increases based on a Consumer Price Index. The Company s multi-tenant office lease arrangements also generally allow for operating expense recoveries which the Company calculates and bills to its tenants. Rental income from properties under master lease arrangements with tenants is included in master lease rent and rental income from properties with multi-tenant office lease arrangements is included in property operating income in the Company s Condensed Consolidated Statements of Operations.

Interest Income

Mortgage interest income and notes receivable interest income are recognized based on the interest rates and maturity date or amortization period specific to each note. Loan origination fees received are deferred and are recognized in mortgage interest income over the estimated life of the loan.

Property Operating Income

The Company has eight real estate properties subject to property operating agreements that obligate the sponsoring health system to provide to the Company a minimum return on the Company s investment in the property in exchange for the right to be involved in the operating decisions of the property, including tenancy. If the minimum return is not achieved through normal operations of the property, the sponsor is responsible to the Company for the shortfall under the terms of these agreements. The Company recognizes any shortfall income in other operating income in the Company s Condensed Consolidated Statements of Operations.

Accumulated Other Comprehensive Loss

A company must include certain items in comprehensive income (loss), such as foreign currency translation adjustments, minimum pension liability adjustments, and unrealized gains or losses on available-for-sale securities. The Company s accumulated other comprehensive loss includes pension liability adjustments, which are generally recognized in the fourth quarter of each year.

Income Taxes

The Company intends at all times to qualify as a REIT under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended. Accordingly, no provision has been made for federal income taxes. The Company must

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Notes to Condensed Consolidated Financial Statements-Continued

distribute at least 90% per annum of its REIT taxable income to its stockholders and meet other requirements to continue to qualify as a REIT.

The Company must pay certain state income taxes which are generally included in general and administrative expense in the Company s Condensed Consolidated Statements of Operations.

The Company classifies interest and penalties related to uncertain tax positions, if any, in its Condensed Consolidated Financial Statements as a component of general and administrative expense.

Incentive Plans

The Company has various outstanding employee and non-employee stock-based awards, including restricted stock issued under its incentive plans, and options granted to employees pursuant to its employee stock purchase plan (the Employee Stock Purchase Plan). The Company recognizes compensation expense for these awards based on the grant date fair value of the awards ratably over the requisite service period.

Accounting for Defined Benefit Pension Plans

The Company has a retirement plan (the Executive Retirement Plan) under which three of the Company s founding officers may receive certain benefits upon retirement. The plan is unfunded and benefits will be paid from cash flows of the Company. The maximum annual benefits payable under the Executive Retirement Plan have been frozen at $896,000, subject to cost-of-living adjustments. The Company recognizes pension expense on an accrual basis over an estimated service period. The Company calculates pension expense and the corresponding liability annually on the measurement date (December 31) which requires certain assumptions, such as a discount rate and the recognition of actuarial gains and losses.

The Company also had a pension plan under which the Company s non-employee directors would receive certain retirement benefits. That plan was terminated in 2009 and during 2010 lump sum payments were made to those directors who participated in the plan. See Note 8 for further discussion.

Operating Leases

As described in more detail in the Company s Annual Report on Form 10-K for the year ended December 31, 2010, the Company is obligated under operating lease agreements consisting primarily of its corporate office lease and various ground leases related to the Company s real estate investments where the Company is the lessee.

Discontinued Operations and Assets Held for Sale

The Company sells properties from time to time due to a variety of factors, including among other things, market conditions or the exercise of purchase options by tenants. The operating results of properties that have been sold or are held for sale are reported as discontinued operations in the Company s Condensed Consolidated Statements of Operations. A company must report discontinued operations when a component of an entity has either been disposed of or is deemed to be held for sale if (i) both the operations and cash flows of the component have been or will be eliminated from ongoing operations as a result of the disposal transaction, and (ii) the entity will not have any significant continuing involvement in the operations of the component after the disposal transaction. Long-lived assets classified as held for sale in the Company s Condensed Consolidated Balance Sheets are reported at the lower of their carrying amount or their estimated fair value less cost to sell. Further, depreciation of these assets ceases at the time the assets are classified as discontinued operations. Losses resulting from the sale or anticipated sale of such properties are characterized as impairment losses relating to discontinued operations in the Company s Condensed Consolidated Statements of Operations. See Note 3 for a detail of the Company s assets held for sale and discontinued operations.

Land Held for Development

Land held for development, which is included in construction in progress in the Company s Condensed Consolidated Balance Sheets, includes parcels of land owned by the Company, upon which the Company intends to develop and own outpatient healthcare facilities.

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Notes to Condensed Consolidated Financial Statements-Continued

Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants. In calculating fair value, a company must maximize the use of observable market inputs, minimize the use of unobservable market inputs and disclose in the form of an outlined hierarchy the details of such fair value measurements.

A hierarchy of valuation techniques is defined to determine whether the inputs to a fair value measurement are considered to be observable or unobservable in a marketplace. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company s market assumptions. This hierarchy requires the use of observable market data when available. These inputs have created the following fair value hierarchy:

o *Level 1* quoted prices for identical instruments in active markets;

o *Level 2* quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which significant inputs and significant value drivers are observable in active markets; and

o *Level 3* fair value measurements derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

Real Estate Properties

Real estate properties are recorded at cost. Cost at the time of the acquisition is allocated between land, buildings, tenant improvements, lease and other intangibles, and personal property based upon estimated fair values at the time of acquisition.

The Company also capitalizes direct construction and development costs, including interest, to all consolidated real estate properties that are under construction and substantive activities are ongoing to prepare the asset for its intended use. The Company considers a building as substantially complete and held available for occupancy upon the completion of tenant improvements, but no later than one year from cessation of major construction activity. Costs incurred after a project is substantially complete and ready for its intended use, or after development activities have ceased, are expensed as incurred.

Mortgage Loans

Loans receivable may be classified as held-for-investment or held-for-sale based on a lender s intent and ability to hold the loans. Loans held-for-investment are carried at amortized cost and are reduced by valuation allowances for estimated credit losses as necessary. Loans held-for-sale are carried at the lower of cost or fair value. All of the Company s loans receivable are classified as held-for-investment.

Allowance for Doubtful Accounts and Credit Losses

Management monitors the aging and collectibility of its accounts receivable balances on an ongoing basis. Whenever deterioration in the timeliness of payment from a tenant or sponsor is noted, management investigates and determines the reason(s) for the delay. Considering all information gathered, management s judgment is exercised in determining whether a receivable is potentially uncollectible and, if so, how much or what percentage may be uncollectible. Among the factors management considers in determining collectibility are: the type of contractual arrangement under which the receivable was recorded (e.g., a triple net lease, a gross lease, a sponsor guaranty agreement, or some other type of agreement); the tenant s reason for slow payment; industry influences under which the tenant operates; evidence of willingness and ability of the tenant to pay the receivable; credit-worthiness of the tenant; collateral, security deposit, letters of credit or other monies held as security; tenant s historical payment pattern; other contractual agreements between the tenant and the Company; relationship between the tenant and the Company; the state in which the tenant operates; and the existence of a guarantor and the willingness and ability of the guarantor to pay the receivable. Considering these factors and others, management concludes whether all or some of the aged receivable balance is likely uncollectible. Upon determining that some portion of the receivable is likely uncollectible, the Company records a provision for bad debts for the amount it expects will be uncollectible. When efforts to collect a receivable are exhausted, the receivable amount is charged off against the allowance.

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Notes to Condensed Consolidated Financial Statements-Continued

The Company also evaluates collectibility of its mortgage notes and notes receivable and records an allowance on the notes as necessary. A loan is impaired when it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan as scheduled, including both contractual interest and principal payments. If a mortgage loan or note receivable becomes past due, the Company will review the specific circumstances and may discontinue the accrual of interest on the loan. The loan is not returned to accrual status until the debtor has demonstrated the ability to continue debt service in accordance with the contractual terms.

Note 2. Real Estate and Mortgage Notes Receivable Investments

The Company had investments of approximately $2.7 billion in 213 real estate properties and mortgage notes receivable as of March 31, 2011, excluding assets classified as held for sale and including an investment in one unconsolidated joint venture. The Company s 202 owned real estate properties, excluding assets classified as held for sale, are located in 28 states and comprise approximately 13.3 million total square feet. The table below details the Company s investments.

(Dollars and Square Feet in thousands)	Number of Investments	Gross Investment Amount	Gross Investment %	Square Feet Footage	Square Feet %
Owned properties:					
Master leases					
Medical office	11	$ 100,242	3.5%	548	4.1%
Physician clinics	13	106,063	3.9%	602	4.6%
Surgical facilities	6	162,631	6.1%	382	2.9%
Specialty outpatient	2	4,852	0.2%	23	0.1%
Inpatient rehab	11	178,755	6.7%	735	5.5%
Other	4	31,726	1.2%	284	2.1%
	47	584,269	21.6%	2,574	19.3%
Property operating agreements					
Medical office	8	84,062	3.1%	624	4.7%
	8	84,062	3.1%	624	4.7%
Multi-tenanted with occupancy leases					
Medical office	115	1,487,288	55.4%	8,196	61.8%
Medical office stabilization in progress	8	233,366	8.7%	808	6.1%
Medical office construction in progress	3	77,818	2.9%	405	3.1%
Physician clinics	14	46,295	1.7%	296	2.2%
Surgical facilities	4	35,303	1.3%	212	1.6%
Specialty outpatient	1	2,562	0.1%	10	0.1%
Other	2	11,210	0.4%	144	1.1%
	147	1,893,842	70.5%	10,071	76.0%
Land held for development		20,772	0.8%		
Corporate property		15,018	0.6%		
		35,790	1.4%		

Total owned properties	202	2,597,963