UNIVERSAL HEALTH REALTY INCOME TRUST
Form 10-Q
November 05, 2010


# 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, 2010**

**OR**

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

**For the transition period from to**

**Commission file number 1-9321**

# UNIVERSAL HEALTH REALTY INCOME TRUST

**(Exact name of registrant as specified in its charter)**

| | |
|---|---|
| **MARYLAND** | **23-6858580** |
| **(State or other jurisdiction of** | **(I. R. S. Employer** |
| **incorporation or organization)** | **Identification No.)** |

**UNIVERSAL CORPORATE CENTER**

**367 SOUTH GULPH ROAD**

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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 ¨ 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, 2010 12,492,829

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UNIVERSAL HEALTH REALTY INCOME TRUST

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**Part I. Financial Information**

**Universal Health Realty Income Trust**

**Condensed Consolidated Statements of Income**

**For the Three and Nine Months Ended September 30, 2010 and 2009**

**(amounts in thousands, except per share amounts)**

**(unaudited)**

| | Three Months Ended September 30, 2010 | Three Months Ended September 30, 2009 | Nine Months Ended September 30, 2010 | Nine Months Ended September 30, 2009 |
|---|---|---|---|---|
| **Revenues:** | | | | |
| Base rental - UHS facilities | $ 3,298 | $ 3,640 | $ 9,882 | $ 10,737 |
| Base rental - Non-related parties | 2,332 | 2,566 | 7,515 | 7,720 |
| Bonus rental - UHS facilities | 1,024 | 1,022 | 3,141 | 3,167 |
| Tenant reimbursements and other - Non-related parties | 492 | 639 | 1,651 | 2,064 |
| Tenant reimbursements and other - UHS facilities | 25 | 57 | 99 | 139 |
| | 7,171 | 7,924 | 22,288 | 23,827 |
| **Expenses:** | | | | |
| Depreciation and amortization | 1,599 | 1,623 | 4,778 | 4,747 |
| Advisory fees to UHS | 474 | 412 | 1,377 | 1,191 |
| Other operating expenses | 1,488 | 1,468 | 4,274 | 4,510 |
| | 3,561 | 3,503 | 10,429 | 10,448 |
| Income before equity in income of unconsolidated limited liability companies ( LLCs ) and interest expense | 3,610 | 4,421 | 11,859 | 13,379 |
| Equity in income of unconsolidated LLCs | 335 | 750 | 1,904 | 2,516 |
| Interest expense, net | (558) | (600) | (1,575) | (1,876) |
| **Net income** | $ 3,387 | $ 4,571 | $ 12,188 | $ 14,019 |
| Basic earnings per share | $ 0.27 | $ 0.38 | $ 1.00 | $ 1.18 |
| Diluted earnings per share | $ 0.27 | $ 0.38 | $ 1.00 | $ 1.18 |
| Weighted average number of shares outstanding - Basic | 12,323 | 11,884 | 12,170 | 11,873 |
| Weighted average number of share equivalents | 2 | 4 | 2 | 7 |

| | | | | |
|---|---|---|---|---|
| Weighted average number of shares and equivalents outstanding - Diluted | 12,325 | 11,888 | 12,172 | 11,880 |

See accompanying notes to condensed consolidated financial statements.

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**Universal Health Realty Income Trust**

**Condensed Consolidated Balance Sheets**

**(dollar amounts in thousands, except share amounts)**

**(unaudited)**

| | September 30, 2010 | December 31, 2009 |
|---|---|---|
| **Assets:** | | |
| **Real Estate Investments:** | | |
| Buildings and improvements | $ 195,959 | $ 207,597 |
| Accumulated depreciation | (76,715) | (72,405) |
| | 119,244 | 135,192 |
| Land | 19,348 | 19,348 |
| Net Real Estate Investments | 138,592 | 154,540 |
| Investments in and advances to limited liability companies ( LLCs ) | 78,106 | 61,934 |
| **Other Assets:** | | |
| Cash and cash equivalents | 1,061 | 3,038 |
| Base and bonus rent receivable from UHS | 2,032 | 2,039 |
| Rent receivable - other | 823 | 980 |
| Deferred charges, notes receivable and intangible and other assets, net | 6,561 | 6,294 |
| Total Assets | $ 227,175 | $ 228,825 |
| **Liabilities:** | | |
| Line of credit borrowings | $ 56,600 | $ 48,800 |
| Mortgage notes payable, non-recourse to us | 8,438 | 6,677 |
| Mortgage, construction and other loans payable of consolidated LLCs, non-recourse to us | 15,016 | 28,790 |
| Accrued interest | 159 | 142 |
| Accrued expenses and other liabilities | 2,370 | 2,251 |
| Tenant reserves, escrows, deposits and prepaid rents | 986 | 981 |
| Total Liabilities | 83,569 | 87,641 |
| **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: 2010 - 12,492,535 2009 -12,089,474 | 125 | 121 |
| Capital in excess of par value | 207,686 | 195,209 |
| Cumulative net income | 369,482 | 357,294 |
| Cumulative dividends | (433,877) | (411,662) |

| | | |
|---|---|---|
| Total Universal Health Realty Income Trust Shareholders Equity | 143,416 | 140,962 |
| Third-party equity interests | 190 | 222 |
| Total Equity | 143,606 | 141,184 |
| Total Liabilities and Equity | $ 227,175 | $ 228,825 |

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, 2010 | 2009 |
|---|---|---|
| **Cash flows from operating activities:** | | |
| Net income | $ 12,188 | $ 14,019 |
| *Adjustments to reconcile net income to net cash provided by operating activities:* | | |
| Depreciation and amortization | 4,778 | 4,747 |
| Restricted/stock-based compensation expense | 261 | 214 |
| *Changes in assets and liabilities:* | | |
| Rent receivable | 112 | 156 |
| Accrued expenses and other liabilities | 431 | 26 |
| Tenant reserves, escrows, deposits and prepaid rents | 41 | (101) |
| Accrued interest | 39 | (36) |
| Other, net | (209) | (42) |
| **Net cash provided by operating activities** | 17,641 | 18,983 |
| **Cash flows from investing activities:** | | |
| Investments in LLCs | (12,018) | (8,188) |
| Repayments of advances made to LLCs | 478 | 680 |
| Advances made to LLCs | (9,547) | (2,142) |
| Cash distributions in excess of income from LLCs | 2,582 | 3,020 |
| Cash distributions of refinancing proceeds from LLCs | 2,734 | 2,789 |
| Additions to real estate investments | (801) | (5,838) |
| Decrease in cash and cash equivalents due to recording of LLC on unconsolidated basis | (1,938) | |
| **Net cash used in investing activities** | (18,510) | (9,679) |
| **Cash flows from financing activities:** | | |
| Net borrowings on line of credit | 7,800 | 11,200 |
| Repayments of mortgage notes payable of consolidated LLCs | (191) | (176) |
| (Repayments)/borrowings from loans payable of consolidated LLCs | (118) | 1,873 |
| Repayments of mortgage notes payable | (3,489) | (160) |
| Proceeds from mortgage notes payable | 5,250 | |
| Financing costs on mortgage notes payable | (388) | |
| Dividends paid | (22,215) | (21,158) |
| Partial settlement of dividends equivalent rights | | (213) |
| Issuance of shares of beneficial interest, net | 12,243 | 471 |
| Capital contributions from non-controlling interests | | 59 |
| **Net cash used in financing activities** | (1,108) | (8,104) |
| (Decrease)/Increase in cash and cash equivalents | (1,977) | 1,200 |

| | | |
|---|---|---|
| Cash and cash equivalents, beginning of period | 3,038 | 618 |
| **Cash and cash equivalents, end of period** | $ 1,061 | $ 1,818 |
| **Supplemental disclosures of cash flow information:** | | |
| Interest paid | $ 1,540 | $ 1,853 |
| **Supplemental disclosures of non-cash information:** | | |
| Deconsolidation of LLC: | | |
| Net real estate investments | $ 12,169 | |
| Cash and cash equivalents | 1,938 | |
| Other assets | 144 | |
| Mortgage and note payable | 13,465 | |
| Other liabilities | 370 | |
| Third-party equity interests | 21 | |
| Investment in LLC | $ 395 | $ 0 |

See accompanying notes to these consolidated financial statements.

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## UNIVERSAL HEALTH REALTY INCOME TRUST

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## September 30, 2010

(unaudited)

**(1) General**

This Quarterly Report on Form 10-Q is for the Quarterly Period ended September 30, 2010. 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, 2009 in *Item 1A Risk Factors* and in *Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Forward Looking Statements and Risk Factors* and as set forth in our Report on Form 10-Q for the quarterly period ended June 30, 2010 in *Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations Forward Looking Statements and Risk Factors* and *Item 1A-Risk Factors.* 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.

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, 2010, we had investments or commitments in thirty-two LLCs, thirty of which are accounted for by the equity method and two that are 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, 2009.

**(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 56% and 51% of our consolidated revenue for the three months ended September 30, 2010 and 2009, respectively, and 55% and 51% for the nine months ended September 30, 2010 and 2009, 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 20% of the combined consolidated and unconsolidated revenue for both of the three and nine month periods ended September 30, 2010 and 2009. 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.

The table below details the renewal options and terms for each of the four 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, 2011 | 20(a) |
| Wellington Regional Medical Center | Acute Care | $ 3,030,000 | December, 2011 | 20(b) |
| Southwest Healthcare System, Inland Valley Campus | Acute Care | $ 2,648,000 | December, 2011 | 20(b) |
| The Bridgeway | Behavioral Health | $ 930,000 | December, 2014 | 10(c) |

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

(b) UHS has two 5-year renewal options 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 $4.7 million has been funded as of September 30, 2010, 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, 2010, 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 commitment of $7.4 million, which is non-recourse to us, of which $7.0 million has been borrowed as of September 30, 2010. This LLC, which is deemed to be a variable interest entity, is consolidated in our financial statements as of September 30, 2010 since we are the primary beneficiary.

We are committed to invest up to $5.2 million in debt or equity, of which $523,000 has been funded as of September 30, 2010, 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. Summerlin Hospital Medical Center ( Summerlin Hospital ), a majority-owned subsidiary of UHS, has committed to lease approximately 25% of this building pursuant to the terms of a 10-year flex lease. In addition, Summerlin Hospital has 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. This MOB, tenants of which will include subsidiaries of UHS, was completed and opened during the first quarter of 2009 at which time the master lease commenced. As a result of this master lease agreement, the LLC was considered a variable interest entity and since we were the primary beneficiary, the financial results of this MOB were included in our financial statements on a consolidated basis prior to January 1, 2010. 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 commitment of $13.5 million, which is non-recourse to us, all of which has been borrowed as of September 30, 2010.

We are committed to invest up to $6.4 million in equity and debt financing, of which $4.9 million has been funded as of September 30, 2010, 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. These MOBs were acquired by the LLC during the third quarter of 2008. As this LLC is not considered to be a variable interest entity, it is accounted for pursuant to the equity method. This LLC has a third-party term loan commitment of $5.5 million, which is non-recourse to us, all of which has been borrowed as of September 30, 2010.

We are committed to invest up to a total of $4.8 million in equity and debt financing, of which $65,000 has been funded as of September 30, 2010, 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. The master lease threshold has been met. This MOB will have tenants that include subsidiaries of UHS. This LLC has a third-party construction loan commitment of $13.3 million, which is non-recourse to us, all of which has been borrowed as of September 30, 2010. 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 $4.4 million has been funded as of September 30, 2010, 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, 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 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 commitment of $8.4 million, which is non-recourse to us, all of which has been borrowed as of September 30, 2010. 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. In December, 2009, based upon a review of our advisory fee and other general and administrative expenses, as compared to an industry peer group, the Advisory Agreement was renewed for 2010 and the fee was increased to 0.65% (from 0.60%) 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 2010 or 2009 since the incentive fee requirements were not achieved. Advisory fees incurred and paid (or payable) to UHS amounted to $474,000 and $412,000 for the three months ended September 30, 2010 and 2009, respectively, and were based upon average invested real estate assets of $292 million and $275 million for the three months ended September 30, 2010 and 2009, respectively. Advisory fees incurred and paid (or payable) to UHS amounted to $1.4 million and $1.2 million for the nine month periods ended September 30, 2010 and 2009, respectively, and were based upon average invested real estate assets of $282 million and $265 million for the nine-month periods ended September 30, 2010 and 2009, respectively.

*Officers and Employees:* Our officers are all employees of UHS and although as of September 30, 2010 we had no salaried employees, our officers do receive stock-based compensation from time-to-time.

*Share Ownership:* As of September 30, 2010 and December 31, 2009, UHS owned 6.3% and 6.5% of our outstanding shares of beneficial interest, respectively.

*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 56% and 51% of our consolidated revenues for the three months ended September 30, 2010 and 2009, respectively, and 55% and 51% for the nine month periods ended September 30, 2010 and 2009, 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:* During the third quarter of 2009, UHS advised us that Southwest Healthcare System ( SWHCS ), a wholly-owned subsidiary of UHS which operates Rancho Springs Medical Center (the real property of which is not owned by the Trust) and Inland Valley Regional Medical Center ( Inland Valley , the real property of which is owned by the Trust) located in Riverside County, California, entered into an agreement with the Center for Medicare and Medicaid Services ( CMS ). The agreement required SWHCS to engage an independent quality monitor to assist SWHCS in meeting all CMS conditions of participation. Further, the agreement provided that, during the last 60 days of the agreement, CMS would conduct a full Medicare certification survey. That survey took place the week of January 11, 2010.

In April, 2010, SWHCS received notification from CMS that it intended to effectuate the termination of SWHCS s Medicare provider agreement effective June 1, 2010. In May, 2010, UHS entered into an agreement with CMS which abated the termination action scheduled for June 1, 2010. The agreement is one year in duration and required SWHCS to engage independent experts in various disciplines to analyze and develop implementation plans for SWHCS to meet the Medicare conditions of participation. At the conclusion of the agreement, CMS will conduct a full certification survey to determine if SWHCS has achieved substantial compliance with the Medicare conditions of participation. During the term of the agreement, SWHCS remains eligible to receive reimbursements from Medicare for services rendered to Medicare beneficiaries.

Also in April, 2010, SWHCS received notification from the California Department of Public Health ( CDPH ) indicating that it planned to initiate a process to revoke SWHCS s hospital license. In May, 2010, SWHCS received the formal document related to the revocation action. In September, 2010, SWHCS entered into an agreement with CDPH relating to the license revocation. The terms of the CDPH agreement are substantially similar to those contained in the agreement with CMS. As a result of the agreement, SWHCS s hospital license remains in effect pending the outcome of the CMS full certification survey which will occur at the end of the agreement. Pursuant to the results of the CMS full certification survey, which SWHCS anticipates occurring in mid-year, 2011, should SWHCS be deemed to have achieved substantial compliance with the Medicare conditions of participation, CDPH shall deem SWHCS s license to be in good standing. Failure of SWHCS to achieve substantial compliance with the Medicare conditions of participation, pursuant to CMS s full certification survey, will likely have a material adverse impact on SWHCS s ability to continue to operate the facilities.

As a result of the matters discussed above, SWHCS has not been permitted to open newly constructed capacity at Rancho Springs Medical Center and Inland Valley Medical Center. If SWHCS is able to resolve these regulatory issues and/or open the capacity, the impact on SWHCS s future results of operations should be favorable. At the same time, SWHCS expects a competitor to open a newly constructed acute care hospital during the second quarter of 2011 which may have an unfavorable impact on SWHCS s future results of operations. UHS is unable to predict the net impact of these developments on SWHCS s results of operations in 2011 and beyond.

UHS has advised us that Rancho Springs Medical Center and Inland Valley Regional Medical Center remain fully committed to providing high-quality healthcare to their patients and the communities they serve. UHS therefore intends to work expeditiously and collaboratively with both CMS and CDPH in an effort to resolve these matters, although there can be no assurance they will be able to do so. Failure to resolve these matters could have a material adverse effect on UHS and, in turn, us. While the base rentals on Inland Valley are guaranteed by UHS through the end of the existing lease term (December, 2011), should this matter, or the opening of the above-mentioned newly constructed acute care facility by a competitor, adversely impact the future revenues and/or operating results of SWHCS, the future bonus rental earned by us on Inland Valley, as well as the underlying value of the property, may be materially adversely impacted. At September 30, 2010, the book value of the property was $19.2 million. Bonus rental revenue earned by us from Inland Valley amounted to $273,000 and $847,000 during the three and nine-month periods ended September 30, 2010, respectively, and $1.1 million during the year ended December 31, 2009.

*Psychiatric Solutions, Inc.:* In connection with the agreement to acquire Psychiatric Solutions, Inc. ( PSI ), UHS will be required to substantially increase 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 them from meeting their obligations under the agreements related to their 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 do not expect to be directly impacted by UHS acquisition of PSI, UHS will be 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**

A dividend of $0.605 per share or $7.5 million in the aggregate was declared by the Board of Trustees on September 2, 2010 and was paid on September 30, 2010 to shareholders of record as of September 16, 2010.

**(4) Acquisitions and Dispositions**

**Nine Months Ended September 30, 2010:**

During the 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.

**Nine Months Ended September 30, 2009:**

There were no acquisitions or dispositions during the first nine months of 2009.

**(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 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.

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At September 30, 2010, we have non-controlling equity investments or commitments in thirty-two LLCs which own medical office buildings ( MOBs ). As of September 30, 2010, we accounted for: (i) thirty of these LLCs on an unconsolidated basis pursuant to the equity method since they are not variable interest entities, and; (ii) two of these LLCs on a consolidated basis, as discussed below, since they are considered to be variable interest entities where we are the primary beneficiary by virtue of their master lease, lease assurance or lease guarantee arrangements with subsidiaries 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. 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.

Two of these LLCs have master lease, lease assurance or lease guarantee arrangements with subsidiaries 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 these LLCs on a consolidated basis since they are variable interest entities and we are deemed to be the primary beneficiary.

The two LLCs that we account for on a consolidated basis are as follows:

| LLC | Facility Name | Ownership Interest | Date of Consolidation |
|---|---|---|---|
| 653 Town Center Phase II | Summerlin Hospital MOB II | 98% | First quarter of 2004(a) |
| Palmdale Medical Properties | Palmdale Medical Plaza | 95% | Fourth quarter of 2007(b) |

(a) This MOB has a master lease provision that expired on September 30, 2010; therefore, beginning in the fourth quarter of 2010, this MOB will no longer be deemed a variable interest entity and will be accounted for on an unconsolidated basis pursuant to the equity method.

(b) Newly constructed facility that was completed and opened during the third quarter of 2008. 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.

Summerlin Medical Office Building III, which is located in Las Vegas, Nevada on the campus of Summerlin Hospital Medical Center (a majority-owned subsidiary of Universal Health Services, Inc.), was completed and opened during the first quarter of 2009. In connection with this MOB, which is owned by an LLC (Banburry Medical Properties) 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 January 1, 2010. 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. During the three-month period ended September 30, 2009, this property generated approximately $355,000 of revenue, $125,000 of other operating expenses and $160,000 of combined interest and depreciation and amortization expense. During the nine-month period ended September 30, 2009, this property generated approximately $855,000 of revenue, $325,000 of other operating expenses and $380,000 of combined interest and depreciation and amortization expense. There was no material impact on our net income as a result of the deconsolidation of this LLC.

Below are the combined balance sheets (unaudited) for the two above-mentioned LLCs, as included in our condensed consolidated balance sheets at September 30, 2010 and for the three LLCs (the two above-mentioned LLCs as well as Banburry Medical Properties), as included in our consolidated balance sheet at December 31, 2009:

| | September 30, 2010 | December 31, 2009 |
|---|---|---|
| | (in thousands) | |
| Net property (a.) | $ 23,495 | $ 36,193 |
| Other assets | 1,122 | 2,818 |
| Total assets | $ 24,617 | $ 39,011 |
| Liabilities | $ 917 | $ 1,089 |
| Mortgage notes payable, non-recourse to us | 15,016 | 28,790 |

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| | September 30, 2010 | December 31, 2009 |
|---|---|---|
| | (in thousands) | |
| Equity | 8,684 | 9,132 |
| Total liabilities and equity | $ 24,617 | $ 39,011 |

(a.) Used as collateral for outstanding mortgage notes payable.

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 LLCs which were accounted for under the equity method:

| Name of LLC | Ownership | Property Owned by LLC |
|---|---|---|
| DSMB Properties | 76% | Desert Samaritan Hospital MOBs |
| DVMC Properties (a.) | 90% | Desert Valley Medical Center |
| Suburban Properties | 33% | Suburban Medical Plaza II |
| Litchvan Investments | 89% | Papago Medical Park |
| Paseo Medical Properties II | 75% | Thunderbird Paseo Medical Plaza I & II |
| Willetta Medical Properties (a.) | 90% | Edwards Medical Plaza |
| Santa Fe Scottsdale (a.) | 90% | Santa Fe Professional Plaza |
| 575 Hardy Investors (a.) | 90% | Centinela Medical Building Complex |
| Brunswick Associates | 74% | Mid Coast Hospital MOB |
| Deerval Properties (d.) | 90% | Deer Valley Medical Office II |
| PCH Medical Properties | 85% | Rosenberg Children s Medical Plaza |
| Gold Shadow Properties (b.) | 98% | 700 Shadow Lane & Goldring MOBs |
| Arlington Medical Properties | 75% | Saint Mary s Professional Office Building |
| ApaMed Properties | 85% | Apache Junction Medical Plaza |
| Spring Valley Medical Properties (b.) | 95% | Spring Valley Medical Office Building |
| Sierra Medical Properties | 95% | Sierra San Antonio Medical Plaza |
| Spring Valley Medical Properties II (b.) | 95% | Spring Valley Hospital Medical Office Building II |
| PCH Southern Properties | 95% | Phoenix Children s East Valley Care Center |
| Centennial Medical Properties (b.) | 95% | Centennial Hills Medical Office Building I |
| Canyon Healthcare Properties | 95% | Canyon Springs Medical Plaza |
| 653 Town Center Investments (b.)(c.) | 95% | Summerlin Hospital Medical Office Building |
| DesMed (b.) | 99% | Desert Springs Medical Plaza |
| Deerval Properties II (d.) | 95% | Deer Valley Medical Office Building III |
| Cobre Properties | 95% | Cobre Valley Medical Plaza |
| Sparks Medical Properties (b.) | 95% | Vista Medical Terrace & The Sparks Medical Building |
| Auburn Medical Properties II (b.) | 95% | Auburn Medical Office Building II |
| Texoma Medical Properties (b.)(e.) | 95% | Texoma Medical Plaza |
| BRB/E Building One (f.) | 95% | BRB Medical Office Building |
| Banburry Medical Properties (b.)(g.) | 95% | Summerlin Hospital MOB III |
| 3811 Bell Medical Properties (h.) | 95% | North Valley Medical Plaza |

(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 buildings 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 $65, 000 has been funded as of September 30, 2010. This building, which is on the campus of a replacement 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 commitment of $13.3 million, which is non-recourse to us, all of which has been borrowed as of September 30, 2010.
(f.) We have committed to invest up to $3.0 million in equity and debt financing, $1.1 million of which has been funded as of September 30, 2010, in an LLC that will develop, construct, own and operate this MOB which is scheduled to be completed and

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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, $5.3 million of which has been borrowed as of September 30, 2010.

(g.) We have committed to invest up to $5.2 million in equity and debt financing, of which $523,000 has been funded as of September 30, 2010. The LLC has a third-party term loan commitment of $13.5 million, which is non-recourse to us, all of which has been borrowed as of September 30, 2010. This facility was completed and opened during the first quarter of 2009 and was accounted for on a consolidated basis through December 31, 2009. During the first quarter of 2010, the master lease threshold at this facility was met; 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 January 1, 2010.

(h.) We have committed to invest up to $6.2 million in equity and debt financing, $5.5 million of which has been funded as of September 30, 2010. This MOB was acquired during the first quarter of 2010.

Below are the combined statements of income (unaudited) for the LLCs accounted for under the equity method at September 30, 2010 and 2009:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| | (amounts in thousands) | | | |
| Revenues | $ 13,975 | $ 12,648 | $ 41,040 | $ 37,289 |
| Operating expenses | 6,436 | 5,556 | 18,171 | 16,480 |
| Depreciation and amortization | 3,204 | 2,651 | 9,215 | 7,702 |
| Interest, net | 4,445 | 3,720 | 12,807 | 10,953 |
| Net income | ($ 110) | $ 721 | $ 847 | $ 2,154 |
| Our share of net income (a.) | $ 335 | $ 750 | $ 1,904 | $ 2,516 |

(a.) Our share of net income for the three months ended September 30, 2010 and 2009 includes interest income earned by us on various advances made to LLCs of approximately $615,000 and $405,000, respectively, and $1.7 million and $1.2 million for the nine months ended September 30, 2010 and 2009, respectively.

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

| | September 30, 2010 | December 31, 2009 |
|---|---|---|
| | (in thousands) | |
| Net property, including CIP | $ 321,687 | $ 296,623 |
| Other assets | 27,832 | 21,666 |
| Total assets | $ 349,519 | $ 318,289 |
| Liabilities | $ 13,640 | $ 13,097 |
| Mortgage notes payable, non-recourse to us | 259,887 | 251,406 |
| Notes payable to us | 28,847 | 19,084 |
| Equity | 47,145 | |