

HEALTHCARE REALTY TRUST INC
Form 10-Q
May 03, 2018
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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, 2018

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: 001-11852

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

Maryland 62 – 1507028
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) 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 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, a smaller reporting company or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

| | | | | |
|-------------------------------------|--------------------------|---|---------------------------|--------------------------|
| Large accelerated filer | Accelerated filer | Non-accelerated filer | Smaller reporting company | Emerging growth |
| <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| | | (Do not check if a smaller reporting company) | | company |

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If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of April 27, 2018, the Registrant had 125,198,489 shares of Common Stock outstanding.

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FORM 10-Q
March 31, 2018

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Healthcare Realty Trust Incorporated

Condensed Consolidated Balance Sheets

(Amounts in thousands, except per share data)

| | (Unaudited) | |
|---|-------------------|----------------------|
| | March 31, 2018 | December 31, 2017 |
| ASSETS | | |
| Real estate properties: | | |
| Land | \$201,090 | \$ 201,283 |
| Buildings, improvements and lease intangibles | 3,600,826 | 3,601,460 |
| Personal property | 10,205 | 10,314 |
| Construction in progress | 14,990 | 5,458 |
| Land held for development | 20,123 | 20,123 |
| | 3,847,234 | 3,838,638 |
| Less accumulated depreciation and amortization | (924,304) | (897,430) |
| Total real estate properties, net | 2,922,930 | 2,941,208 |
| Cash and cash equivalents | 3,796 | 6,215 |
| Assets held for sale, net | 36,118 | 33,147 |
| Other assets, net | 220,576 | 213,015 |
| Total assets | \$3,183,420 | \$ 3,193,585 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Liabilities: | | |
| Notes and bonds payable | \$1,306,951 | \$ 1,283,880 |
| Accounts payable and accrued liabilities | 62,318 | 70,995 |
| Liabilities of properties held for sale | 201 | 93 |
| Other liabilities | 49,402 | 48,734 |
| Total liabilities | 1,418,872 | 1,403,702 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Preferred stock, \$.01 par value per share; 50,000 shares authorized; none issued and outstanding | — | — |
| Common stock, \$.01 par value per share; 300,000 shares authorized; 125,198 and 125,132 shares issued and outstanding at March 31, 2018 and December 31, 2017, respectively | 1,252 | 1,251 |
| Additional paid-in capital | 3,175,809 | 3,173,429 |
| Accumulated other comprehensive loss | (639) | (1,299) |
| Cumulative net income attributable to common stockholders | 1,027,528 | 1,018,348 |
| Cumulative dividends | (2,439,402) | (2,401,846) |
| Total stockholders' equity | 1,764,548 | 1,789,883 |
| Total liabilities and stockholders' equity | \$3,183,420 | \$ 3,193,585 |

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, 2017, are an integral part of these financial statements.

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Healthcare Realty Trust Incorporated
 Condensed Consolidated Statements of Income
 For the Three Months Ended March 31, 2018 and 2017
 (Amounts in thousands, except per share data)
 (Unaudited)

| | Three Months Ended March 31, | |
|--|---------------------------------|-----------------|
| | 2018 | 2017 |
| REVENUES | | |
| Rental income | \$ 110,229 | \$ 102,709 |
| Other operating | 1,895 | 1,935 |
| | 112,124 | 104,644 |
| EXPENSES | | |
| Property operating | 41,818 | 37,852 |
| General and administrative | 9,101 | 8,694 |
| Acquisition and pursuit costs | 277 | 586 |
| Depreciation and amortization | 39,573 | 34,452 |
| Bad debts, net of recoveries | — | 66 |
| | 90,769 | 81,650 |
| OTHER INCOME (EXPENSE) | | |
| Gain on sales of real estate assets | — | 23,408 |
| Interest expense | (12,668) | (14,272) |
| Impairment of real estate asset | — | (323) |
| Interest and other income, net | 493 | 38 |
| | (12,175) | 8,851 |
| NET INCOME | \$9,180 | \$31,845 |
| BASIC EARNINGS PER COMMON SHARE: | | |
| Net income | \$0.07 | \$0.28 |
| DILUTED EARNINGS PER COMMON SHARE: | | |
| Net income | \$0.07 | \$0.28 |
| WEIGHTED AVERAGE COMMON SHARES OUTSTANDING—BASIC | 123,257 | 114,675 |
| WEIGHTED AVERAGE COMMON SHARES OUTSTANDING—DILUTED | 123,348 | 115,507 |
| 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, 2017, are an integral part of these financial statements.

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Healthcare Realty Trust Incorporated
 Condensed Consolidated Statements of Comprehensive Income
 For the Three Months Ended March 31, 2018 and 2017
 (Dollars in thousands)
 (Unaudited)

| | Three Months Ended March 31, | |
|---|------------------------------------|----------|
| | 2018 | 2017 |
| NET INCOME | \$9,180 | \$31,845 |
| Other comprehensive income: | | |
| Interest rate swaps: | | |
| Reclassification adjustments for losses included in net income (interest expense) | 147 | 43 |
| Gains arising during the period on interest rate swaps | 513 | — |
| Total other comprehensive income | 660 | 43 |
| COMPREHENSIVE INCOME | \$9,840 | \$31,888 |

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, 2017, are an integral part of these financial statements.

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Healthcare Realty Trust Incorporated
Condensed Consolidated Statement of Equity
(Dollars in thousands, except per share data)
(Unaudited)

| | Common Stock | Additional Paid-In Capital | Accumulated Other Comprehensive Loss | Cumulative Net Income | Cumulative Dividends | Total Stockholders' Equity |
|---|-----------------|----------------------------------|---|-----------------------------|-------------------------|----------------------------------|
| Balance at December 31, 2017 | \$ 1,251 | \$3,173,429 | \$ (1,299) | \$1,018,348 | \$(2,401,846) | \$1,789,883 |
| Issuance of common stock | — | 239 | — | — | — | 239 |
| Common stock redemptions | — | (680) | — | — | — | (680) |
| Share-based compensation | 1 | 2,821 | — | — | — | 2,822 |
| Net income | — | — | — | 9,180 | — | 9,180 |
| Reclassification adjustments for losses included in net income (interest expense) | — | — | 147 | — | — | 147 |
| Gains arising during the period on interest rate swaps | — | — | 513 | — | — | 513 |
| Dividends to common stockholders (\$0.30 per share) | — | — | — | — | (37,556) | (37,556) |
| Balance at March 31, 2018 | \$ 1,252 | \$3,175,809 | \$ (639) | \$1,027,528 | \$(2,439,402) | \$1,764,548 |

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, 2017, 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, 2018 and 2017
(Dollars in thousands)
(Unaudited)

| | Three Months Ended March 31, | |
|--|---------------------------------|-----------|
| | 2018 | 2017 |
| OPERATING ACTIVITIES | | |
| Net income | \$9,180 | \$31,845 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 39,573 | 34,452 |
| Other amortization | 584 | 1,351 |
| Share-based compensation | 2,822 | 2,614 |
| Amortization of straight-line rent receivable | (1,722) | (1,751) |
| Amortization of straight-line rent liability | 384 | 156 |
| Gain on sales of real estate assets | — | (23,408) |
| Impairment of real estate assets | — | 323 |
| Equity in losses from unconsolidated joint ventures | 10 | — |
| Distributions from unconsolidated joint ventures | 37 | — |
| Provision for bad debts, net | — | 66 |
| Changes in operating assets and liabilities: | | |
| Other assets | (4,193) | (1,662) |
| Accounts payable and accrued liabilities | (6,949) | (14,633) |
| Other liabilities | 1,094 | 19 |
| Net cash provided by operating activities | 40,820 | 29,372 |
| INVESTING ACTIVITIES | | |
| Acquisitions of real estate | (1,756) | (14,143) |
| Development of real estate | (7,573) | (2,804) |
| Additional long-lived assets | (16,764) | (18,997) |
| Proceeds from sales of real estate | — | 79,747 |
| Proceeds from notes receivable repayments | 5 | 3 |
| Net cash provided by (used in) investing activities | (26,088) | 43,806 |
| FINANCING ACTIVITIES | | |
| Net borrowings on unsecured credit facility | 24,000 | 15,000 |
| Repayments of notes and bonds payable | (1,154) | (1,032) |
| Dividends paid | (37,556) | (34,937) |
| Net proceeds from issuance of common stock | 236 | 791 |
| Common stock redemptions | (2,633) | (1,125) |
| Debt issuance and assumption costs | (44) | — |
| Net cash used in financing activities | (17,151) | (21,303) |
| Increase (decrease) in cash, cash equivalents and restricted cash | (2,419) | 51,875 |
| Cash, cash equivalents and restricted cash at beginning of period | 6,215 | 54,507 |
| Cash, cash equivalents and restricted cash at end of period | \$3,796 | \$106,382 |
| Supplemental Cash Flow Information: | | |
| Interest paid | \$3,899 | \$14,536 |
| Invoices accrued for construction, tenant improvements and other capitalized costs | \$8,592 | \$11,394 |
| Capitalized interest | \$186 | \$237 |

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, 2017, are an integral part of these financial statements.

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Healthcare Realty Trust Incorporated

Notes to the Condensed Consolidated Financial Statements
 March 31, 2018
 (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, leases, manages, acquires, finances, develops and redevelops income-producing real estate properties associated primarily with the delivery of outpatient healthcare services throughout the United States. As of March 31, 2018, the Company had gross investments of approximately \$3.8 billion in 196 real estate properties located in 27 states totaling approximately 14.5 million square feet. The Company provided leasing and property management services to approximately 10.9 million square feet nationwide.

Basis of Presentation

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. They do not include all of the information and footnotes required by GAAP for complete financial statements. However, except as disclosed herein, management believes there has been no material change in the information disclosed in the Notes to the Consolidated Financial Statements included in the Annual Report on Form 10-K for the year ended December 31, 2017. All material intercompany transactions and balances have been eliminated in consolidation.

This interim financial information should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2017. Management believes that all adjustments of a normal, recurring nature considered necessary for a fair presentation have been included. In addition, the interim financial information does not necessarily represent or indicate what the operating results will be for the year ending December 31, 2018 for many reasons including, but not limited to, acquisitions, dispositions, capital financing transactions, changes in interest rates and the effects of other trends, risks 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.

Revenue from Contracts with Customers (Topic 606)

The Company recognizes certain revenue under the core principle of Topic 606, as described under new accounting pronouncements. This requires that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve the core principle, the Company applies the five step model specified in the guidance. See the New Accounting Pronouncements section below for additional information.

Revenue that is accounted for under Topic 606 is segregated on the Company's Condensed Consolidated Statement of Income in the Other operating line item. This line item includes parking income, rental lease guaranty income, management fee income and other miscellaneous income. Below is a detail of the amounts by category:

| (in thousands) | For the Three | |
|-----------------|----------------|----------------|
| | Months Ended | |
| Type of Revenue | March 31, 2018 | March 31, 2017 |
| | | |

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| | | |
|-----------------------|---------|---------|
| Parking income | \$1,626 | \$1,568 |
| Rental lease guaranty | 175 | 224 |
| Management fee income | 68 | 99 |
| Miscellaneous | 26 | 44 |
| | \$1,895 | \$1,935 |

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The Company's three major types of revenue that are accounted for under Topic 606 that are listed above are all accounted for as the performance obligation is satisfied. The performance obligations that are identified for each of these items are satisfied over time and the Company recognizes revenue monthly based on this principle.

Reclassifications

Condensed Consolidated Statements of Income

Certain reclassifications have been made on the Company's Condensed Consolidated Statements of Income. After the adoption of Accounting Standards Update ("ASU") 2014-08, "Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity," the Company's dispositions have not met the updated definition to be reported as a discontinued operations. The Company had some residual impact from properties that were identified as a discontinued operation prior to the adoption of ASU 2014-08 that was reported as discontinued operations. These amounts are considered immaterial and have been reclassified for the prior year presentation on the Company's Consolidated Statements of Income.

| (in thousands) | For the Three Months Ended March 31, 2017 | |
|--|--|--------------------|
| | As Previously Reported | As Reclassified |
| EXPENSES | | |
| Property operating expense | \$37,834 | \$ 37,852 |
| OTHER INCOME (EXPENSE) | | |
| Gain on sales of properties | 23,403 | 23,408 |
| INCOME FROM CONTINUING OPERATIONS | \$31,858 | \$ 31,845 |
| DISCONTINUED OPERATIONS | | |
| Loss from discontinued operations | \$(18) | \$ — |
| Gain on sales of properties | 5 | — |
| LOSS FROM DISCONTINUED OPERATIONS | \$(13) | \$ — |

New Accounting Pronouncements

Accounting Standards Update No. 2014-09 and No. 2015-14

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU No. 2014-09, "Revenue from Contracts with Customers," a comprehensive new revenue recognition standard that supersedes most existing revenue recognition guidance, including sales of real estate. This standard's core principle is that a company will recognize revenue when it transfers goods or services to customers in amounts that reflect the consideration to which the company expects to be entitled in exchange for those goods and services. However, leasing contracts, representing the major source of the Company's revenues, are not within the scope of the new standard and will continue to be accounted for under other standards.

In August 2015, the FASB issued ASU No. 2015-14, "Revenue from Contracts with Customers (Topic 606); Deferral of the Effective Date." This standard is effective for the Company for annual and interim periods beginning after December 15, 2017 with early adoption permitted only as of annual reporting periods beginning after December 15, 2016, including interim periods within that year.

The Company adopted this standard by using the full retrospective adoption method beginning on January 1, 2018. The Company's revenue-producing contracts are primarily leases that are not within the scope of this standard. As a result, the adoption of this standard did not have a material impact on the timing and measurement of the Company's

leasing revenues. The Company has identified that parking income, rental lease guaranty income and management fee income are within the scope of Topic 606. However, these items were determined to have the same pattern of revenue recognition that the Company had historically recognized. The Company reclassified these amounts along with all other items that are accounted for within the scope of Topic 606 into the Other operating line item on the Company's Consolidated Statements of Income. This line item historically contained the revenue associated with rental lease guaranty income, management fee income and other non-lease revenue. The Company reclassified parking income from rental income to other operating income.

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The following table represents the impact of the adoption of this standard on the Company's Consolidated Statements of Income for the period ended March 31, 2017:

| (in thousands) | For the Three Months Ended March 31, 2017 | |
|--------------------------------|--|--------------------|
| | As Reported | As Reclassified |
| REVENUES | | |
| Rental income | \$ 104,088 | \$ 102,709 |
| Other operating | 481 | 1,935 |
| | \$ 104,569 | \$ 104,644 |
| OTHER INCOME (EXPENSE) | | |
| Interest and other income, net | \$ 113 | \$ 38 |
| NET INCOME | \$ 31,845 | \$ 31,845 |

Accounting Standards Update No. 2016-02

In February 2016, the FASB issued ASU No. 2016-02, "Leases." For lessees, the new standard establishes a right-of-use ("ROU") model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The Company expects that all of the leases where the Company is the lessee will be recorded on the Company's balance sheet. For lessors, the new standard requires a lessor to classify leases as either sales-type, finance or operating. A lease will be treated as a sale if it transfers all of the risks and rewards, as well as control of the underlying asset, to the lessee. If risks and rewards are conveyed without the transfer of control, the lease is treated as financing. If the lessor doesn't convey risks and rewards or control, then the lease would be classified as an operating lease.

The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years with early adoption permitted. A modified retrospective transition approach is required for lessors for sales-type, direct financing, and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The Company is in the initial stages of evaluating the impact from the adoption of this new standard on the Consolidated Financial Statements and related notes.

Accounting Standards Update No. 2016-13

In June 2016, the FASB issued ASU 2016-13, "Measurement of Credit Losses on Financial Instruments." This update is intended to improve financial reporting by requiring timelier recognition of credit losses on loans and other financial instruments that are not accounted for at fair value through net income, including loans held for investment, held-to-maturity debt securities, trade and other receivables, net investment in leases and other such commitments. This update requires that financial statement assets measured at an amortized cost and certain other financial instruments be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. This standard is effective for annual and interim periods beginning after December 15, 2019 with early adoption permitted. The Company is in the initial stages of evaluating the impact from the adoption of this new standard on the Consolidated Financial Statements and related notes.

Accounting Standards Update No. 2017-04

In January 2017, the FASB issued ASU 2017-04, "Simplifying the Test for Goodwill Impairment." This update eliminates Step 2 of the goodwill impairment test. As such, an entity will perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize a goodwill impairment charge for the amount by which the reporting unit's carrying amount exceeds its fair value. This standard is effective for the Company for annual and interim periods beginning after December 15, 2019. The Company does not expect a material impact on the Consolidated Financial Statements and related notes from the adoption of this standard.

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Accounting Standards Update No. 2017-05

In February 2017, the FASB issued ASU 2017-05, "Other Income - Gains and Losses from the Derecognition of Nonfinancial Assets." This update defines an in-substance nonfinancial asset, unifies guidance related to partial sales of nonfinancial assets, eliminates rules specifically addressing the sales of real estate, removes exception to the financial asset derecognition model and clarifies the accounting for contributions of nonfinancial assets to joint ventures. This standard is effective for the Company for annual and interim periods beginning after December 15, 2017 with early adoption permitted. The adoption of this standard did not have a material impact to the Consolidated Financial Statements and related notes.

Accounting Standards Update No. 2017-09

In May 2017, the FASB issued ASU 2017-09, "Compensation - Stock Compensation - Scope of Modification Accounting." This update provides guidance about which changes to the terms and conditions of share-based awards require an entity to apply modification accounting in Topic 718. This standard is effective for the Company for the annual and interim periods beginning after December 15, 2017 with early adoption permitted. The adoption of this standard did not have a material impact to the Consolidated Financial Statements and related notes.

Note 2. Real Estate Investments

Subsequent Disposition

In October 2017, the Company received notice that a tenant exercised a purchase option on seven properties, comprised of five single-tenant net leased buildings and two multi-tenanted buildings, covered by one purchase option. These properties were classified as held for sale upon receiving notice of the exercise of the purchase option. The Company's aggregate net book value for these properties was approximately \$23.9 million at March 31, 2018. On April 26, 2018, these properties were sold with a stated purchase price of approximately \$46.2 million, pursuant to the terms of the purchase option.

Assets Held for Sale

At March 31, 2018 and December 31, 2017, the Company had 13 and eight properties classified as held for sale, respectively. In March 2018, the Company reclassified five single-tenant net leased properties totaling 121,672 square feet and located in Michigan to held for sale in connection with management's decision to sell the properties. The Company expects to close the sale of these properties by the end of the second quarter of 2018. The table below reflects the assets and liabilities of the properties classified as held for sale as of March 31, 2018 and December 31, 2017:

| (Dollars in thousands) | March 31, 2018 | December 31, 2017 |
|---|-------------------|----------------------|
| Balance Sheet data: | | |
| Land | \$ 4,829 | \$ 4,636 |
| Buildings, improvements and lease intangibles | 76,387 | 63,654 |
| Personal property | 265 | 82 |
| | 81,481 | 68,372 |
| Accumulated depreciation | (45,458) | (35,790) |
| Real estate assets held for sale, net | 36,023 | 32,582 |
| Other assets, net (including receivables) | 95 | 565 |
| Assets held for sale, net | \$ 36,118 | \$ 33,147 |
| Accounts payable and accrued liabilities | \$ 105 | \$ 38 |
| Other liabilities | 96 | 55 |
| Liabilities of properties held for sale | \$ 201 | \$ 93 |

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Note 3. Notes and Bonds Payable

The table below details the Company's notes and bonds payable.

| (Dollars in thousands) | Maturity Dates | Balance as of | | Effective Interest Rate as of | |
|--|----------------|----------------|-------------------|-------------------------------|---|
| | | March 31, 2018 | December 31, 2017 | March 31, 2018 | |
| Unsecured Credit Facility | 7/20 | \$213,000 | \$189,000 | 2.88 | % |
| Unsecured Term Loan Facility, net of issuance costs ⁽¹⁾ | 12/22 | 149,030 | 148,994 | 3.23 | % |
| Senior Notes due 2023, net of discount and issuance costs | 4/23 | 247,806 | 247,703 | 3.95 | % |
| Senior Notes due 2025, net of discount and issuance costs ⁽²⁾ | 5/25 | 248,101 | 248,044 | 4.08 | % |
| Senior Notes due 2028, net of discount and issuance costs | 1/28 | 294,869 | 294,757 | 3.84 | % |
| Mortgage notes payable, net of discounts and issuance costs and including premiums | 12/18-5/40 | 154,145 | 155,382 | 4.82 | % |
| | | \$1,306,951 | \$1,283,880 | | |

⁽¹⁾ The effective interest rate includes the impact of interest rate swaps on \$25.0 million and \$50.0 million of the outstanding balance at a rate of 2.18% and 2.46%, respectively (plus the applicable margin rate, currently 110 basis points).

⁽²⁾ The effective interest rate includes the impact of the \$1.7 million settlement of a forward-starting interest rate swap that is included in accumulated other comprehensive income on the Company's Condensed Consolidated Balance Sheets.

Note 4. Derivative Financial Instruments

Risk Management Objective of Using Derivatives

The Company is exposed to certain risks arising from both its business operations and economic conditions. The Company principally manages its exposures to a wide variety of business and operational risks through management of its core business activities. The Company manages economic risks, including interest rate, liquidity, and credit risk, primarily by managing the amount, sources, and duration of its assets and liabilities and the use of derivative financial instruments. Specifically, the Company enters into derivative financial instruments to manage exposures that arise from business activities that result in the receipt or payment of future known and uncertain cash amounts, the value of which are determined by interest rates. The Company's derivative financial instruments are used to manage differences in the amount, timing, and duration of the Company's known or expected cash receipts and its known or expected cash payments principally related to the Company's borrowings.

Cash Flow Hedges of Interest Rate Risk

The Company's objectives in using interest rate derivatives are to add stability to interest expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company primarily uses interest rate swaps as part of its interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount. Such derivatives were used to hedge the variable cash flows associated with existing variable-rate debt.

For derivatives designated and that qualify as cash flow hedges of interest rate risk, the gain or loss on the derivative is recorded in Accumulated Other Comprehensive Income (Loss) and subsequently reclassified into interest expense

in the same period(s) during which the hedged transaction affects earnings. Amounts reported in accumulated other comprehensive income related to derivatives will be reclassified to interest expense as interest payments are made on the Company's variable-rate debt.

During the three months ended March 31, 2018, the Company entered into two interest rate derivatives totaling \$50.0 million. As of March 31, 2018, the Company had four outstanding interest rate derivatives that were designated as cash flow hedges of interest rate risk:

| Derivative Instrument | Number of Instruments | Notional (in millions) |
|-----------------------|-----------------------|---------------------------|
| Interest rate swaps | 4 | \$75.0 |

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Tabular Disclosure of Fair Values of Derivative Instruments on the Balance Sheet

The table below presents the fair value of the Company's derivative financial instruments, as well as their classification on the Condensed Consolidated Balance Sheet as of March 31, 2018.

| (Dollars in thousands) | Asset Derivatives | |
|---|------------------------|------------|
| | Balance Sheet Location | Fair Value |
| Derivatives designated as hedging instruments | | |
| Interest rate swaps | Other Assets | \$ 551 |
| Total derivatives designated as hedging instruments | | \$ 551 |

Tabular Disclosure of the Effect of Cash Flow Hedge Accounting on Accumulated Other Comprehensive Income (Loss)

The table below presents the effect of cash flow hedge accounting on Accumulated Other Comprehensive Income (Loss) as of March 31, 2018 related to the Company's outstanding interest rate swaps.

| (Dollars in thousands) | Amount of Gain Recognized in OCI on Derivative | | Amount of Loss Reclassified from OCI into Income | |
|-----------------------------|--|------------------------|--|-------|
| | 2018 | 2017 | 2018 | 2017 |
| Interest rate products | \$ 513 | Interest expense | \$ 105 | \$ — |
| Settled interest rate swaps | — | Interest expense | 42 | 43 |
| | \$ 513 | Total interest expense | \$ 147 | \$ 43 |

Credit-risk-related Contingent Features

The Company has agreements with each of its derivative counterparties that contain a provision where the Company could be declared in default on its derivative obligations if repayment of the underlying indebtedness is accelerated by the lender due to the Company's default on the indebtedness.

The Company estimates that an additional \$0.3 million will be reclassified from accumulated other comprehensive loss as an increase to interest expense over the next 12 months.

Note 5. Commitments and Contingencies

Legal Proceedings

The Company is, from time to time, involved in litigation arising in the ordinary course of business. The Company is not aware of any pending or threatened litigation that, if resolved against the Company, would have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

Redevelopment Activity

The Company is redeveloping a medical office building in Charlotte, North Carolina, which includes a 38,000 square foot vertical expansion. As of March 31, 2018, the Company has funded approximately \$5.0 million on the redevelopment of this property. The project is expected to be completed in the first quarter of 2019.

Development Activity

The Company began the development of a 151,000 square foot medical office building in Seattle, Washington during 2017. As of March 31, 2018, the Company has funded approximately \$10.3 million on the development. The Company expects the project to be completed in the second quarter of 2019.

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Note 6. Stockholders' Equity

Common Stock

The following table provides a reconciliation of the beginning and ending shares of common stock outstanding for the three months ended March 31, 2018 and the year ended December 31, 2017:

| | March 31, 2018 | December 31, 2017 |
|--|-------------------|----------------------|
| Balance, beginning of period | 125,131,593 | 116,416,900 |
| Issuance of common stock | 11,158 | 8,395,607 |
| Nonvested share-based awards, net of withheld shares | 55,566 | 319,086 |
| Balance, end of period | 125,198,317 | 125,131,593 |

At-The-Market Equity Offering Program

No shares were sold under this program during the three months ended March 31, 2018. The Company had 5,868,697 authorized shares remaining available to be sold under the current sales agreements as of April 27, 2018.

Common Stock Dividends

During the three months ended March 31, 2018, the Company declared and paid common stock dividends totaling \$0.30 per share. On May 1, 2018, the Company declared a quarterly common stock dividend in the amount of \$0.30 per share payable on May 31, 2018 to stockholders of record on May 16, 2018.

Accumulated Other Comprehensive Loss

During the three months ended March 31, 2018, the Company entered into two interest rate swaps to hedge the variable cash flows associated with variable-rate debt. As of March 31, 2018, the Company had four outstanding interest rate swaps to hedge the variable cash flows associated with existing variable-rate debt. The Company continues to amortize the 2015 settlement of forward-starting interest rate swaps. This amount will be reclassified out of accumulated other comprehensive loss impacting net income over the 10-year term of the associated senior note issuance. See Note 4 for more information regarding the Company's derivative instruments.

The following table represents the changes in balances of each component and the amounts reclassified out of accumulated other comprehensive loss related to the Company during the three months ended March 31, 2018 and 2017:

| (Dollars in thousands) | Forward-starting Interest Rate Swaps | |
|---|--|-----------|
| | 2018 | 2017 |
| Beginning balance | \$(1,299) | \$(1,401) |
| Gains arising during the period related to active interest rate swaps | 513 | — |
| Amounts reclassified from accumulated other comprehensive loss | 147 | 43 |
| Net accumulated other comprehensive income | 660 | 43 |
| Ending balance | \$(639) | \$(1,358) |

The following table represents the details regarding the reclassifications from Accumulated other comprehensive income (loss) during the year ended March 31, 2018:

| Details about accumulated other comprehensive income (loss) components | Amount reclassified from accumulated | Affected line item in the statement where net income is presented |
|--|--------------------------------------|---|
|--|--------------------------------------|---|

other
comprehensive
income (loss)

(Dollars in thousands)

| | | |
|--|--------|------------------|
| Amounts reclassified from accumulated other comprehensive income (loss) related to settled interest rate swaps | \$ 42 | Interest Expense |
| Amounts reclassified from accumulated other comprehensive income (loss) related to current interest rate swaps | 105 | Interest Expense |
| | \$ 147 | |

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Earnings Per Common Share

The Company uses the two-class method of computing net earnings per common shares. Nonvested share-based awards containing non-forfeitable rights to dividends are considered participating securities pursuant to the two-class method. The following table sets forth the computation of basic and diluted earnings per common share for the three months ended March 31, 2018 and 2017.

| (Dollars in thousands, except per share data) | Three Months Ended | |
|--|--------------------|-------------|
| | March 31, | |
| | 2018 | 2017 |
| Weighted average Common Shares outstanding | | |
| Weighted average Common Shares outstanding | 125,167,126 | 126,470,836 |
| Nonvested shares | (1,909,777) | (1,795,752) |
| Weighted average Common Shares outstanding—Basic | 123,257,349 | 124,675,084 |
| Weighted average Common Shares outstanding—Basic | 123,257,349 | 124,675,084 |
| Dilutive effect of nonvested share-based awards | — | 725,346 |
| Dilutive effect of employee stock purchase plan | 90,330 | 106,572 |
| Weighted average Common Shares outstanding—Diluted | 123,347,679 | 125,507,002 |
| Net Income | \$9,180 | \$ 31,845 |
| Dividends paid on nonvested share-based awards | (579) | — |
| Net income applicable to common stockholders | \$8,601 | \$ 31,845 |
| Basic Earnings Per Common Share | | |
| Net income | \$0.07 | \$ 0.28 |
| Diluted Earnings Per Common Share | | |
| Net income | \$0.07 | \$ 0.28 |

Incentive Plans

A summary of the activity under the Company's share-based incentive plans for the three months ended March 31, 2018 and 2017 is included in the table below.

| | Three Months Ended | |
|---|--------------------|-----------|
| | March 31, | |
| | 2018 | 2017 |
| Share-based awards, beginning of period | 1,907,645 | 1,786,497 |
| Granted | 76,762 | 80,384 |
| Vested | (54,065) | (52,842) |
| Share-based awards, end of period | 1,930,342 | 1,814,039 |

During the three months ended March 31, 2018 and 2017, the Company withheld 21,196 and 16,581 shares of common stock, respectively, from participants to pay estimated withholding taxes related to shares that vested.

In addition to the share-based incentive plans, the Company maintains the 2000 Employee Stock Purchase Plan (the "Purchase Plan"). A summary of the activity under the Purchase Plan for the three months ended March 31, 2018 and 2017 is included in the table below.

| | Three Months Ended | |
|--|--------------------|-----------|
| | March 31, | |
| | 2018 | 2017 |
| Outstanding and exercisable, beginning of period | 318,100 | 316,321 |
| Granted | 203,836 | 206,824 |
| Exercised | (8,835) | (11,435) |
| Forfeited | (10,580) | (13,782) |

| | | |
|--|-----------|-----------|
| Expired | (135,790) | (132,310) |
| Outstanding and exercisable, end of period | 366,731 | 365,618 |

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Note 7. Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instrument for which it is practical to estimate that value.

Cash, cash equivalents and restricted cash - The carrying amount approximates fair value due to the short term maturity of these investments.

Borrowings under the unsecured credit facility due 2020 and unsecured term loan facility due 2022 - The carrying amount approximates fair value because the borrowings are based on variable market interest rates.

Senior Notes and Mortgage Notes payable - The fair value of notes and bonds payable is estimated using cash flow analyses, based on the Company's current interest rates for similar types of borrowing arrangements.

Interest rate swap agreements - Interest rate swap agreements are recorded in other liabilities on the Company's Consolidated Balance Sheets at fair value. Fair value is estimated by utilizing pricing models that consider forward yield curves and discount rates.

The table below details the fair values and carrying values for notes and bonds payable at March 31, 2018 and December 31, 2017.

| (Dollars in millions) | March 31, 2018 | | December 31, 2017 | |
|--|----------------|------------|-------------------|------------|
| | Carrying Value | Fair Value | Carrying Value | Fair Value |
| Notes and bonds payable ⁽¹⁾ | \$1,307.0 | \$1,277.6 | \$1,283.9 | \$1,269.7 |

⁽¹⁾ Level 2 – model-derived valuations in which significant inputs and significant value drivers are observable in active markets.

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

Disclosure Regarding Forward-Looking Statements

This report and other materials the Company has filed or may file with the Securities and Exchange Commission, as well as information included in oral statements or other written statements made, or to be made, by management of the Company, contain, or will contain, disclosures that are “forward-looking statements.” Forward-looking statements include all statements that do not relate solely to historical or current facts and can be identified by the use of words such as “may,” “will,” “expect,” “believe,” “anticipate,” “target,” “intend,” “plan,” “estimate,” “project,” “continue,” “should,” and other comparable terms. These forward-looking statements are based on the current plans and expectations of management and are subject to a number of risks and uncertainties, including the risks described in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017, that could significantly affect the Company’s current plans and expectations and future financial condition and results.

The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Stockholders and investors are cautioned not to unduly rely on such forward-looking statements when evaluating the information presented in the Company’s filings and reports, including, without limitation, estimates and projections regarding the performance of development projects the Company is pursuing.

For a detailed discussion of the Company’s risk factors, please refer to the Company’s filings with the Securities and Exchange Commission, including its Annual Report on Form 10-K for the year ended December 31, 2017.

Liquidity and Capital Resources

Sources and Uses of Cash

The Company’s primary sources of cash include rent receipts from its real estate portfolio based on contractual arrangements with its tenants and sponsors, borrowings under the Company’s unsecured credit facility due 2020, proceeds from the sales of real estate properties and proceeds from public or private debt or equity offerings.

The Company expects to continue to meet its liquidity needs, including funding additional investments, paying dividends, and funding debt service through cash on hand and restricted cash, cash flows from operations, and the cash flow sources described above. The Company had unencumbered real estate assets with a gross book value of approximately \$3.5 billion at March 31, 2018, of which a portion could serve as collateral for secured mortgage financing. The Company believes that its liquidity and sources of capital are adequate to satisfy its cash requirements. The Company cannot, however, be certain that these sources of funds will be available at a time and upon terms acceptable to the Company in sufficient amounts to meet its liquidity needs.

Investing Activities

Cash flows used in investing activities for the three months ended March 31, 2018 were approximately \$26.1 million.

Capital items funded during the three months ended March 31, 2018 primarily include the following:

| (Dollars in millions) | Three Months Ended March 31, 2018 |
|--|--|
| Redevelopment and development | \$ 12.7 |
| 1st generation tenant improvements & planned capital expenditures for acquisitions | 1.2 |
| 2nd generation tenant improvements | 5.9 |
| Capital expenditures | 4.1 |
| Total capital funding | \$ 23.9 |

Financing Activities

Cash flows used in financing activities for the three months ended March 31, 2018 were approximately \$17.2 million. Inflows from equity related to the Company's common stock issuances, dividend reinvestment program, and employee stock purchase plan and net borrowings totaled \$24.2 million, net of issuance costs incurred. Aggregate cash outflows totaled approximately \$41.4 million primarily associated with dividends paid to common stockholders. See Notes 3 and 6 to the Condensed Consolidated Financial Statements for more information about capital markets and financing activities.

Operating Activities

Cash flows provided by operating activities increased from \$29.4 million for the three months ended March 31, 2017 to \$40.8 million for the three months ended March 31, 2018. Items impacting cash flows from operations include, but are not limited to, cash generated from property operations, interest payments and the timing related to the payment of invoices and other expenses and receipts of tenant rent.

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The Company may, from time to time, sell additional properties and redeploy cash from property sales and mortgage repayments into new investments. To the extent revenues related to the properties being sold and the mortgages being repaid exceed income from these new investments, the Company's results of operations and cash flows could be adversely affected.

Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements that are reasonably likely to have a current or future material effect on the Company's financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

New Accounting Pronouncements

See Note 1 to the Company's Condensed Consolidated Financial Statements accompanying this report for information on new accounting standards.

Trends and Matters Impacting Operating Results

Management monitors factors and trends important to the Company and the REIT industry to gauge the potential impact on the operations of the Company. In addition to the matters discussed in the Company's Annual Report on Form 10-K for the year ended December 31, 2017, below are some of the factors and trends that management believes may impact future operations of the Company.

Expiring Leases

The Company expects that approximately 15% to 20% of the leases in its multi-tenanted portfolio will expire each year in the ordinary course of business. There are 486 leases totaling 1.6 million square feet in the Company's multi-tenant portfolio that will expire during the remainder of 2018. Approximately 89% of the leases expiring in 2018 are located in buildings on or adjacent to hospital campuses, are distributed throughout the portfolio, and are not concentrated with any one tenant, health system or market area. The Company typically expects to retain 75% to 90% of multi-tenant property tenants upon expiration, and the retention ratio for the first three months of the year has been within this range.

Property Operating Agreement Expirations

One of the Company's owned real estate properties as of March 31, 2018 was covered under a property operating agreement between the Company and a sponsoring health system. This agreement contractually obligates 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 Company calculates and accrues to property lease guaranty revenue, each quarter, any shortfalls due from the sponsoring health systems under the terms of the property operating agreement. This agreement expires in February 2019. The Company recognized \$0.2 million in property operating guaranty revenue during the first quarter of 2018 related to this agreement.

Operating Expenses

The Company has historically experienced increases in property taxes throughout its portfolio as a result of increasing assessments and tax rates levied across the country. The Company continues its efforts to appeal property tax increases and manage the impact of the increases. In addition, the Company has historically incurred variability in portfolio utilities expense based on seasonality, with the first and third quarters usually reflecting greater amounts. The effects of these operating expense increases are mitigated in leases that have provisions for operating expense reimbursement. As of March 31, 2018, leases for 87% of the Company's multi-tenant leased square footage allow for some recovery of operating expenses, with 55% allowing recovery of all expenses.

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Purchase Options

Additional information about the Company's unexercised purchase options (except as otherwise noted) and the amount and basis for determination of the purchase price is detailed in the table below (dollars in thousands):

| Year Exercisable | Number of Properties | Gross Real Estate Investment as of March 31, 2018 | | |
|---------------------|----------------------|--|----------------------------------|-----------|
| | | Fair | Non Fair | Total |
| | | Market Value Method (1) | Market Value Method (2) | |
| Current | 4 | \$95,150 | \$— | \$95,150 |
| 2019 | 1 | 21,355 | — | 21,355 |
| 2020 | — | — | — | — |
| 2021 | 1 | — | 14,984 | 14,984 |
| 2022 | — | — | — | — |
| 2023 | — | — | — | — |
| 2024 | — | — | — | — |
| 2025 | 5 | 18,883 | 221,929 | 240,812 |
| 2026 | — | — | — | — |
| 2027 | — | — | — | — |
| 2028 and thereafter | 5 | 145,482 | — | 145,482 |
| Total | 16 | \$280,870 | \$236,913 | \$517,783 |

(1) The purchase option price includes a fair market value component that is determined by an appraisal process.

(2) Includes properties with stated purchase prices or prices based on fixed capitalization rates. These properties have purchase prices that are on average 17% greater than the Company's current gross investment.

In October 2017, the Company received notice that a tenant exercised a purchase option on seven properties, comprised of five single-tenant net leased buildings and two multi-tenant buildings, covered by one purchase option. The Company's aggregate net book value for these properties was \$23.9 million at March 31, 2018. The Company recognized net operating income of approximately \$1.5 million for the three months ended March 31, 2018 from these properties. On April 26, 2018, these properties were sold with a stated purchase price of approximately \$46.2 million, pursuant to the terms of the purchase option.

Other Potential Dispositions

In March 2018, the Company reclassified five skilled nursing facilities to held for sale. The net investment in these properties was \$3.4 million, and the Company recognized net operating income of \$0.6 million in the quarter related to these properties. The Company has executed a letter of intent to sell the buildings for \$9.5 million to an owner/operator and expects to close by the end of the second quarter of 2018. The Company was previously under contract to sell the properties to a different buyer. However, that contract was terminated, and the Company recognized \$0.5 million of income related to earnest money the buyer forfeited in the first quarter of 2018.

Non-GAAP Financial Measures and Key Performance Indicators

Management believes that net income, as defined by GAAP, is the most appropriate earnings measurement. However, management considers certain non-GAAP financial measures and key performance indicators to be useful supplemental measures of the Company's operating performance. A non-GAAP financial measure is generally defined as one that purports to measure historical or future financial performance, financial position or cash flows, but excludes or includes amounts that would not be so adjusted in the most comparable GAAP measure. Set forth below are descriptions of the non-GAAP financial measures and key performance indicators management considers relevant to the Company's business and useful to investors, as well as reconciliations of these measures to the most directly

comparable GAAP financial measures.

The non-GAAP financial measures and key performance indicators presented herein are not necessarily identical to those presented by other real estate companies due to the fact that not all real estate companies use the same definitions. These measures should not be considered as alternatives to net income (determined in accordance with GAAP), as indicators of the Company's financial performance, or as alternatives to cash flow from operating activities (determined in accordance with GAAP) as measures of the Company's liquidity, nor are these measures necessarily indicative of sufficient cash flow to fund all of the Company's needs. Management believes that in order to facilitate a clear understanding of the Company's consolidated historical operating results, these measures should be examined in conjunction with net income as presented in the Condensed Consolidated Financial Statements and other financial data included elsewhere in this report.

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Funds from Operations ("FFO"), Normalized FFO and Funds Available for Distribution ("FAD")

FFO and FFO per share are operating performance measures adopted by the National Association of Real Estate Investment Trusts ("NAREIT"). NAREIT defines FFO as the most commonly accepted and reported measure of a REIT's operating performance equal to "net income (computed in accordance with GAAP), excluding gains (or losses) from sales of property, plus depreciation and amortization related to real estate properties, leasing commission amortization and after adjustments for unconsolidated partnerships and joint ventures." The Company follows the NAREIT definition in calculating and presenting FFO and FFO per share.

Management believes FFO and FFO per share to be supplemental measures of a REIT's performance because they provide an understanding of the operating performance of the Company's properties without giving effect to certain significant non-cash items, primarily depreciation and amortization expense. Historical cost accounting for real estate assets in accordance with GAAP assumes that the value of real estate assets diminishes predictably over time. However, real estate values instead have historically risen or fallen with market conditions. The Company believes that by excluding the effect of depreciation, amortization and gains or losses from sales of real estate, all of which are based on historical costs and which may be of limited relevance in evaluating current performance, FFO and FFO per share can facilitate comparisons of operating performance between periods. The Company reports FFO and FFO per share because these measures are observed by management to also be the predominant measures used by the REIT industry and by industry analysts to evaluate REITs and because FFO per share is consistently reported, discussed, and compared by research analysts in their notes and publications about REITs. For these reasons, management has deemed it appropriate to disclose and discuss FFO and FFO per share. However, FFO does not represent cash generated from operating activities determined in accordance with GAAP and is not necessarily indicative of cash available to fund cash needs. FFO should not be considered as an alternative to net income attributable to common stockholders as an indicator of the Company's operating performance or as an alternative to cash flow from operating activities as a measure of liquidity.

In addition to FFO and FFO per share, the Company presents Normalized FFO, Normalized FFO per share, and funds available for distribution ("FAD"). Normalized FFO is presented by adding to FFO acquisition-related costs, acceleration of deferred financing costs, debt extinguishment costs and other Company-defined normalizing items to evaluate operating performance. FAD is presented by adding to Normalized FFO non-real estate depreciation and amortization, deferred financing fees amortization, share-based compensation expense and provision for bad debts, net; and subtracting maintenance capital expenditures, including second generation tenant improvements and leasing commissions paid and straight-line rent income, net of expense. The Company's definition of these terms may not be comparable to that of other real estate companies as they may have different methodologies for computing these amounts. Normalized FFO and FAD should not be considered as an alternative to net income as an indicator of the Company's financial performance or to cash flow from operating activities as an indicator of the Company's liquidity. Normalized FFO and FAD should be reviewed in connection with GAAP financial measures.

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The table below reconciles net income to FFO, Normalized FFO and FAD for the three months ended March 31, 2018 and 2017:

| (Amounts in thousands, except per share data) | Three Months | |
|---|-----------------|-----------|
| | Ended March 31, | |
| | 2018 | 2017 |
| Net Income | \$9,180 | \$31,845 |
| Gain on sales of real estate assets | — | (23,408) |
| Impairments of real estate assets | — | 323 |
| Real estate depreciation and amortization | 40,003 | 35,555 |
| Total adjustments | 40,003 | 12,470 |
| Funds from Operations Attributable to Common Stockholders | \$49,183 | \$44,315 |
| Acquisition and pursuit costs ⁽¹⁾ | 277 | 586 |
| Forfeited earnest money received | (466) | — |
| Normalized Funds from Operations Attributable to Common Stockholders | \$48,994 | \$44,901 |
| Non-real estate depreciation and amortization | 1,466 | 1,355 |
| Provision for bad debt, net | — | 66 |
| Straight-line rent, net | (1,330) | (1,595) |
| Stock-based compensation | 2,822 | 2,614 |
| Total non-cash items | 2,958 | 2,440 |
| 2nd generation TI | (5,867) | (5,277) |
| Leasing commissions paid | (1,851) | (1,584) |
| Capital additions | (4,184) | (2,520) |
| Funds Available for Distribution | \$40,050 | \$37,960 |
| Funds from Operations per Common Share—Diluted | \$0.40 | \$0.38 |
| Normalized Funds from Operations per Common Share—Diluted | \$0.40 | \$0.39 |
| FFO weighted average common shares outstanding - Diluted ⁽²⁾ | 123,984 | 115,507 |

(1) Acquisition and pursuit costs include third party and travel costs related to the pursuit of acquisitions and developments.

(2) Diluted weighted average common shares outstanding for the three months ended March 31, 2018 includes the dilutive effect of nonvested share-based awards outstanding of 635,872.

Cash Net Operating Income ("NOI") and Same Store Cash NOI

Cash NOI and Same Store Cash NOI are key performance indicators. Management considers these to be supplemental measures that allow investors, analysts and Company management to measure unlevered property-level operating results. The Company defines cash NOI as rental income and property lease guaranty income less property operating expenses. Cash NOI excludes non-cash items such as above and below market lease intangibles straight-line rent, lease inducements, lease terminations, tenant improvement amortization and leasing commission amortization. Cash NOI is historical and not necessarily indicative of future results.

Same Store Cash NOI compares Cash NOI for stabilized properties. Stabilized properties are properties that have been included in operations for the duration of the year-over-year comparison period presented and include redevelopment projects. Accordingly, stabilized properties exclude properties that were recently acquired or disposed of, properties classified as held for sale, and development conversions. In addition, the Company excludes properties that meet any of the following Company-defined criteria to be included in the reposition property group:

- Properties having less than 60% occupancy that is expected to last at least two quarters;
- Properties that experience a loss of occupancy over 30% in a single quarter; or

Properties with negative net operating income that is expected to last at least two quarters.

Any recently acquired property will be included in the same store pool once the Company has owned the property for eight full quarters. Development properties will be included in the same store pool eight full quarters after substantial completion. Any additional square footage created by redevelopment projects at a same store property is included in the same store pool immediately upon completion. Any property included in the reposition property group will be included in the same store

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analysis once occupancy has increased to 60% or greater with positive net operating income and has remained at that level for eight full quarters.

The following table reflects the Company's same store cash NOI for the three months ended March 31, 2018 and 2017.

| (Dollars in thousands) | Number of Properties | Gross Investment at March 31, 2018 | Same Store Cash NOI for the Three Months Ended March 31, | |
|------------------------------------|----------------------|------------------------------------|--|----------|
| | | | 2018 | 2017 |
| Multi-tenant Properties | 143 | \$2,708,228 | \$48,548 | \$47,649 |
| Single-tenant Net Lease Properties | 14 | 473,636 | 10,685 | 10,465 |
| Total | 157 | \$3,181,864 | \$59,233 | \$58,114 |

The following tables reconcile net income to same store NOI and the same store property count to the total owned real estate portfolio:

Reconciliation of Same Store Cash NOI:

| (Dollars in thousands) | Three Months Ended March 31, | |
|---------------------------------------|------------------------------|----------|
| | 2018 | 2017 |
| Net income | \$9,180 | \$31,845 |
| Other income (expense) | 12,175 | (8,851) |
| General and administrative expense | 9,101 | 8,694 |
| Depreciation and amortization expense | 39,573 | 34,452 |
| Other expenses ⁽¹⁾ | 1,968 | 1,979 |
| Straight-line rent revenue | (1,722) | (1,751) |
| Other revenue ⁽²⁾ | (1,438) | (785) |
| Cash NOI | 68,837 | 65,583 |
| Cash NOI not included in same store | (9,604) | (7,469) |
| Same store cash NOI | \$59,233 | \$58,114 |

(1) Includes acquisition and pursuit costs, bad debt, above and below market ground lease intangible amortization, leasing commission amortization and ground lease straight-line rent expense.

(2) Includes management fee income, interest, mortgage interest income, above and below market lease intangible amortization, lease inducement amortization, lease terminations and tenant improvement overage amortization.

Reconciliation of Same Store Property Count:

Property
Count
as of
March
31,
2018

| | |
|------------------------------------|-----|
| Same Store Properties | 157 |
| Acquisitions | 24 |
| Development Conversion | 2 |
| Reposition | 13 |
| Total Owned Real Estate Properties | 196 |

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Results of Operations

Three Months Ended March 31, 2018 Compared to Three Months Ended March 31, 2017

The Company's results of operations for the three months ended March 31, 2018 compared to the same period in 2017 were impacted by acquisitions, developments, dispositions, gains, impairments recorded and capital markets transactions.

Revenues

Total revenues increased \$7.5 million, or 7.1%, to approximately \$112.1 million for the three months ended March 31, 2018 compared to \$104.6 million in the prior year period and is comprised of the following:

| (Dollars in thousands) | Three Months Ended March 31, | | Change | |
|-------------------------|---------------------------------|-----------|----------|--------|
| | 2018 | 2017 | \$ | % |
| Property operating | \$95,294 | \$86,682 | \$8,612 | 9.9 % |
| Single-tenant net lease | 13,213 | 14,276 | (1,063) | (7.4)% |
| Straight-line rent | 1,722 | 1,751 | (29) | (1.7)% |
| Rental income | 110,229 | 102,709 | 7,520 | 7.3 % |
| Other operating | 1,895 | 1,935 | (40) | (2.1)% |
| Total Revenues | \$112,124 | \$104,644 | \$7,480 | 7.1 % |

Property operating revenue increased \$8.6 million, or 9.9%, from the prior year period primarily as a result of the following activity:

- ▲ Acquisitions and developments in 2017 contributed \$6.6 million.
- ⬇ Leasing activity including contractual rent increases contributed \$2.8 million.
- ◆ Dispositions in 2017 resulted in a decrease of \$0.8 million.

Single-tenant net lease revenue decreased \$1.1 million, or 7.4%, from the prior year period primarily as a result of the following activity:

- ◆ Dispositions in 2017 resulted in a decrease of \$1.6 million.
- ▲ Acquisitions in 2017 resulted in an increase of \$0.3 million.
- ⬇ Leasing activity including contractual rent increases contributed \$0.2 million.

Straight-line rent decreased 1.7% from the prior year period primarily as a result of the following activity:

- ▲ Acquisitions and developments in 2017 resulted in an increase of \$0.3 million.
- ◆ Dispositions in 2017 resulted in a decrease of \$0.3 million.

Expenses

Property operating expenses increased \$4.0 million, or 10.5%, for the three months ended March 31, 2018 compared to the prior year period primarily as a result of the following activity:

- ▲ Acquisitions and developments in 2017 resulted in an increase of \$2.8 million.
- ⬆ Increases in portfolio operating expenses as follows:
 - property tax of approximately \$0.2 million;
 - maintenance and repair expense of approximately \$0.5 million;
 - utilities expense of approximately \$0.2 million;
 - janitorial expense of approximately \$0.2 million;
 - compensation-related expenses of approximately \$0.3 million; and

other expenses of \$0.1 million.

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Dispositions in 2017 resulted in a decrease of \$0.3 million.

General and administrative expenses increased approximately \$0.4 million, or 4.7%, for the three months ended March 31, 2018 compared to the prior year period primarily as a result of the following activity:

- Increase in performance-based compensation expense of \$0.1 million.
- Increase in payroll compensation of \$0.1 million.
- Increase in professional fees and other administrative costs of \$0.2 million.

Depreciation and amortization expense increased \$5.1 million, or 14.9%, for the three months ended March 31, 2018 compared to the prior year period primarily as a result of the following activity:

- Acquisitions and developments in 2017 resulted in an increase of \$4.7 million.
- Various building and tenant improvement expenditures resulted in an increase of \$3.0 million.
- Dispositions in 2017 resulted in a decrease of \$0.9 million.
- Assets that became fully depreciated resulted in a decrease of \$1.2 million.
- Reclassifications to held for sale in 2017 resulted in a decrease of \$0.5 million.

Other income (expense)

In the first quarter of 2017, the Company recorded gains of approximately \$23.4 million on the sale of five properties and an impairment charge of approximately \$0.3 million for one property. There were no such transactions in the first quarter of 2018.

In the first quarter of 2018, the Company recorded \$0.5 million of other income related to the termination fee of a purchase and sale agreement.

Interest expense decreased \$1.6 million for the three months ended March 31, 2018 compared to the prior year period.

The components of interest expense are as follows:

| (Dollars in thousands) | Three Months | | Change | |
|---------------------------------------|-----------------|----------|-----------|----------|
| | Ended March 31, | | \$ | % |
| | 2018 | 2017 | | |
| Contractual interest | \$12,208 | \$13,803 | \$(1,595) | (11.6)% |
| Net discount/premium accretion | (1) | 52 | (53) | (101.9)% |
| Deferred financing costs amortization | 605 | 611 | (6) | (1.0)% |
| Interest rate swap amortization | 42 | 43 | (1) | (2.3)% |
| Interest cost capitalization | (186) | (237) | 51 | (21.5)% |
| Total interest expense | \$12,668 | \$14,272 | \$(1,604) | (11.2)% |

Contractual interest expense decreased \$1.6 million primarily due to the following activity:

- The Senior Notes due 2021 were repaid in the fourth quarter of 2017 and accounted for a decrease of \$5.7 million.
- The Senior Notes due 2028 were issued in the fourth quarter of 2017 and accounted for an increase of \$2.7 million.
- Unsecured Credit Facility balance and interest rate increases accounted for an increase of approximately \$0.7 million.
- Unsecured Term Loan rate increase accounted for an increase of \$0.4 million.
- Mortgage notes assumed upon acquisition of real properties accounted for an increase of \$0.4 million.
- Mortgage notes repayments accounted for a decrease of approximately \$0.1 million.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

The Company is exposed to market risk in the form of changing interest rates on its debt and mortgage notes. Management uses regular monitoring of market conditions and analysis techniques to manage this risk. During the three months ended March 31, 2018, there were no material changes in the quantitative and qualitative disclosures about market risks presented in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

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Item 4. Controls and Procedures

Disclosure Controls and Procedures

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")), as of the end of the period covered by this report. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures were effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the Company in the reports it files or submits under the Exchange Act.

Changes in Internal Control over Financial Reporting

There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II—OTHER INFORMATION

Item 1. Legal Proceedings

The Company is, from time to time, involved in litigation arising in the ordinary course of business. The Company is not aware of any pending or threatened litigation that, if resolved against the Company, would have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

Item 1A. Risk Factors

In addition to the other information set forth in this report, an investor should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2017, which could materially affect the Company's business, financial condition or future results. The risks, as described in the Company's Annual Report on Form 10-K for the year ended December 31, 2017, are not the only risks facing the Company. Additional risks and uncertainties not currently known to management or that management currently deems immaterial also may materially, adversely affect the Company's business, financial condition, operating results or cash flows.

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Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

During the three months ended March 31, 2018, the Company withheld shares of Company common stock to satisfy employee tax withholding obligations payable upon the vesting of nonvested stock, as follows:

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs |
|--------------------------|---|---------------------------------------|--|--|
| January 1 - January 31 | 20,687 | \$ 32.12 | — | — |
| February 1 - February 28 | 509 | 29.36 | — | — |
| March 1 - March 31 | — | — | — | — |
| Total | 21,196 | | | |

Authorized Repurchases of Equity Securities by the Issuer

On May 1, 2018, the Company's Board of Directors authorized the repurchase of up to \$50 million of outstanding shares of the Company's common stock either in the open market or through privately negotiated transactions, subject to market conditions, regulatory constraints, and other customary conditions. The Company is not obligated under this authorization to repurchase any specific number of shares. As of the date of this report, the Company has not repurchased any shares of its common stock.

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Item 6. Exhibits

| Exhibit | Description |
|---------------------|---|
| <u>Exhibit 3.1</u> | <u>Second Articles of Amendment and Restatement of the Company, as amended</u> ⁽¹⁾ |
| <u>Exhibit 3.2</u> | <u>Amended and Restated Bylaws of the Company, as amended</u> ⁽²⁾ |
| Exhibit 4.1 | Specimen Stock Certificate ⁽³⁾ |
| <u>Exhibit 4.2</u> | <u>Indenture, dated as of May 15, 2001, by and between the Company and Branch Banking and Trust Company, as trustee (as successor to the trustee named therein)</u> ⁽⁴⁾ |
| <u>Exhibit 4.3</u> | <u>Fifth Supplemental Indenture, dated March 26, 2013, by and between the Company and Branch Banking and Trust Company, as Trustee (as successor to the trustee named therein)</u> ⁽⁵⁾ |
| <u>Exhibit 4.4</u> | <u>Form of 3.75% Senior Notes due 2023 (set forth in Exhibit B to the Fifth Supplemental Indenture filed as Exhibit 4.7 thereto)</u> ⁽⁵⁾ |
| <u>Exhibit 4.5</u> | <u>Sixth Supplemental Indenture, dated April 24, 2015, by and between the Company and Branch Banking and Trust Company, as Trustee (as successor to the trustee named therein)</u> ⁽⁶⁾ |
| <u>Exhibit 4.6</u> | <u>Form of 3.875% Senior Notes due 2025 (set forth in Exhibit B to the Sixth Supplemental Indenture filed as Exhibit 4.9 thereto)</u> ⁽⁶⁾ |
| <u>Exhibit 4.7</u> | <u>Seventh Supplemental Indenture, dated December 11, 2017, by and between the Company and Branch Banking and Trust Company, as Trustee.</u> ⁽⁷⁾ |
| <u>Exhibit 4.8</u> | <u>Form of 3.625% Senior Note due 2028 (set forth in Exhibit B to the Seventh Supplemental Indenture filed as Exhibit 4.11 hereto).</u> ⁽⁷⁾ |
| <u>Exhibit 10.1</u> | <u>Amendment No. 1, dated February 13, 2018, to Healthcare Realty Trust Incorporated 2000 Employees Stock Purchase Plan (filed herewith).</u> |
| <u>Exhibit 11</u> | <u>Statement re: Computation of per share earnings (filed herewith in Note 6 to the Condensed Consolidated Financial Statements)</u> |
| <u>Exhibit 31.1</u> | <u>Certification of the Chief Executive Officer of Healthcare Realty Trust Incorporated pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)</u> |
| <u>Exhibit 31.2</u> | <u>Certification of the Chief Financial Officer of Healthcare Realty Trust Incorporated pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)</u> |
| <u>Exhibit 32</u> | <u>Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith)</u> |
| Exhibit 101.INS | XBRL Instance Document (furnished electronically herewith) |

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| | |
|--------------------|--|
| Exhibit 101.SCH | XBRL Taxonomy Extension Schema Document (furnished electronically herewith) |
| Exhibit 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document (furnished electronically herewith) |
| Exhibit 101.LAB | XBRL Taxonomy Extension Labels Linkbase Document (furnished electronically herewith) |
| Exhibit 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document (furnished electronically herewith) |
| Exhibit 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document (furnished electronically herewith) |

(1) Filed as an exhibit to the Company's Form 8-K filed May 5, 2017 and hereby incorporated by reference.

(2) Filed as an exhibit to the Company's Form 10-Q for the quarter ended June 30, 2015 and hereby incorporated by reference.

(3) Filed as an exhibit to the Company's Registration Statement on Form S-11 (Registration No. 33-60506) filed April 2, 1993 and hereby incorporated by reference.

(4) Filed as an exhibit to the Company's Form 8-K filed May 17, 2001 and hereby incorporated as reference.

(5) Filed as an exhibit to the Company's Form 8-K filed March 26, 2013 and hereby incorporated by reference.

(6) Filed as an exhibit to the Company's Form 8-K filed April 24, 2015 and hereby incorporated by reference.

(7) Filed as an exhibit to the Company's Form 8-K filed December 11, 2017 and hereby incorporated by reference.

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SIGNATURE

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

HEALTHCARE REALTY TRUST INCORPORATED

By: /s/ J. CHRISTOPHER DOUGLAS

J. Christopher Douglas

Executive Vice President and Chief Financial Officer

Date: May 3, 2018