HEALTHCARE REALTY TRUST INC
Form 10-Q
August 02, 2018
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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: June 30, 2018
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number: 001-11852

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

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

3310 West End Avenue
Suite 700
Nashville, Tennessee 37203
(Address of principal executive offices)

(615) 269-8175
(Registrant’s telephone number, including area code)

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

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

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

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. o

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

As of July 27, 2018, the Registrant had 125,232,465 shares of Common Stock outstanding.

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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) June 30, 2018	December 31, 2017
ASSETS		
Real estate properties:		
Land	$214,755	$201,283
Buildings, improvements and lease intangibles	3,668,938	3,601,460
Personal property	10,355	10,314
Construction in progress	23,102	5,458
Land held for development	24,633	20,123
	3,941,783	3,838,638
Less accumulated depreciation and amortization	(959,732)	(897,430)
Total real estate properties, net	2,982,051	2,941,208
Cash and cash equivalents	7,414	6,215
Assets held for sale, net	8,788	33,147
Other assets, net	216,437	213,015
Total assets	$3,214,690	$3,193,585
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Notes and bonds payable	$1,335,732	$1,283,880
Accounts payable and accrued liabilities	66,490	70,995
Liabilities of properties held for sale	340	93
Other liabilities	44,072	48,734
Total liabilities	1,446,634	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; 125,234 and 125,132 shares issued and outstanding at June 30, 2018 and December 31, 2017, respectively	1,252	1,251
Additional paid-in capital	3,178,514	3,173,429
Accumulated other comprehensive income (loss)	5	(1,299)
Cumulative net income attributable to common stockholders	1,065,256	1,018,348
Cumulative dividends	(2,476,971)	(2,401,846)
Total stockholders' equity	1,768,056	1,789,883
Total liabilities and stockholders' equity	$3,214,690	$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 and Six Months Ended June 30, 2018 and 2017
(Amounts in thousands, except per share data)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
REVENUES				
Rental income	$109,566	$103,384	$219,795	$206,093
Other operating	2,068	1,934	3,963	3,869
	111,634	105,318	223,758	209,962
EXPENSES				
Property operating	41,737	38,184	83,556	76,035
General and administrative	8,373	8,005	17,473	16,699
Acquisition and pursuit costs	120	785	397	1,371
Depreciation and amortization	40,130	34,823	79,703	69,274
Bad debts, net of recoveries	104	105	104	171
	90,464	81,902	181,233	163,550
OTHER INCOME (EXPENSE)				
Gain on sales of real estate assets	29,590	16,124	29,590	39,532
Interest expense	(13,069)	(14,315)	(25,737)	(28,587)
Impairment of real estate assets	—	(5)	—	(328)
Interest and other income, net	38	4	530	41
	16,559	1,808	4,383	10,658
NET INCOME	$37,729	$25,224	$46,908	$57,070
Basic earnings per common share - Net income	$0.30	$0.22	$0.37	$0.50
Diluted earnings per common share - Net income	$0.30	$0.22	$0.37	$0.49
Weighted average common shares outstanding - basic	123,285	114,721	123,271	114,698
Weighted average common shares outstanding - diluted	123,321	115,674	123,324	115,597
Dividends declared, per common share, during the period	$0.30	$0.30	$0.60	$0.60

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Healthcare Realty Trust Incorporated
Condensed Consolidated Statements of Comprehensive Income
For the Three and Six Months Ended June 30, 2018 and 2017
(Dollars in thousands)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
NET INCOME	$37,729	$25,224	$46,908	$57,070
Other comprehensive income:				
Interest rate swaps:				
Reclassification adjustments for losses included in net income (interest expense)	127	42	274	85
Gains arising during the period on interest rate swaps	517	—	1,030	—
Total other comprehensive income	644	42	1,304	85
COMPREHENSIVE INCOME	$38,373	$25,266	$48,212	$57,155

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 Income (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	—	351	—	—	—	351
Common stock redemptions	—	(680)	—	—	—	(680)
Share-based compensation	1	5,414	—	—	—	5,415
Net income	—	—	—	46,908	—	46,908
Reclassification adjustments for losses included in net income (interest expense)	—	—	274	—	—	274
Gains arising during the period on interest rate swaps	—	—	1,030	—	—	1,030
Dividends to common stockholders ($0.60 per share)	—	—	—	—	(75,125)	(75,125)
Balance at June 30, 2018	$ 1,252	$3,178,514	$ 5	$1,065,256	$(2,476,971)	$1,768,056

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 Six Months Ended June 30, 2018 and 2017
(Dollars in thousands)
(Unaudited)

	Six Months Ended June 30,	
	2018	2017
OPERATING ACTIVITIES		
Net income	$46,908	$57,070
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	79,703	69,274
Other amortization	1,344	2,230
Share-based compensation	5,415	5,067
Amortization of straight-line rent receivable	(2,797)	(3,534)
Amortization of straight-line rent liability	766	316
Gain on sales of real estate assets	(29,590)	(39,532)
Impairment of real estate assets	—	328
Equity in losses from unconsolidated joint ventures	2	—
Distributions from unconsolidated joint ventures	99	—
Provision for bad debts, net	104	171
Changes in operating assets and liabilities:		
Other assets	(778)	536
Accounts payable and accrued liabilities	(4,227)	(10,236)
Other liabilities	279	2,281
Net cash provided by operating activities	97,228	83,971
INVESTING ACTIVITIES		
Acquisitions of real estate	(62,977)	(53,536)
Development of real estate	(16,377)	(10,098)
Additional long-lived assets	(37,592)	(36,329)
Proceeds from sales of real estate	55,001	117,010
Proceeds from notes receivable repayments	8	10
Net cash provided by (used in) investing activities	(61,937)	17,057
FINANCING ACTIVITIES		
Net borrowings (repayments) on unsecured credit facility	46,000	(72,000)
Repayments of notes and bonds payable	(2,556)	(2,249)
Dividends paid	(75,125)	(69,898)
Net proceeds from issuance of common stock	347	1,005
Common stock redemptions	(2,633)	(1,125)
Debt issuance and assumption costs	(125)	(84)
Net cash used in financing activities	(34,092)	(144,351)
Increase (decrease) in cash, cash equivalents and restricted cash	1,199	(43,323)
Cash, cash equivalents and restricted cash at beginning of period	6,215	54,507
Cash, cash equivalents and restricted cash at end of period	$7,414	$11,184
Supplemental Cash Flow Information:		
Interest paid	$18,706	$27,570
Invoices accrued for construction, tenant improvements and other capitalized costs	$9,877	$6,355
Mortgage notes payable assumed upon acquisition (adjusted to fair value)	$7,995	$12,460

Capitalized interest	$471	$484

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
June 30, 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 June 30, 2018, the Company had gross investments of approximately $3.9 billion in 201 real estate properties located in 27 states totaling approximately 14.9 million square feet. The Company provided leasing and property management services to approximately 11.2 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. This requires an entity to 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 Statements 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		For the Six Months Ended	
Type of Revenue	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017

Parking income	$1,819	$1,669	$3,445	$3,238
Rental lease guaranty	146	153	321	377
Management fee income	69	68	137	167
Miscellaneous	34	44	60	87
	$2,068	$1,934	$3,963	$3,869

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.

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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 discontinued operations. The Company had some residual impact from properties that were identified as discontinued operations prior to the adoption of ASU 2014-08. These amounts are considered immaterial and have been reclassified for the prior year presentation on the Company's Condensed Consolidated Statements of Income.

	For the Three Months Ended June 30, 2017		For the Six Months Ended June 30, 2017	
(in thousands)	As Previously Reported	As Reclassified	As Previously Reported	As Reclassified
EXPENSES				
Property operating expense	$38,184	$ 38,184	$76,018	$ 76,035
OTHER INCOME (EXPENSE)				
Gain on sales of properties	16,124	16,124	39,527	39,532
INCOME FROM CONTINUING OPERATIONS	$25,224	$ 25,224	$57,082	$ 57,070
DISCONTINUED OPERATIONS				
Loss from discontinued operations	$—	$ —	$(17)	$ —
Gain on sales of properties	—	—	5	—
LOSS FROM DISCONTINUED OPERATIONS	$—	$ —	$(12)	$ —

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 determined 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 Condensed 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 Condensed Consolidated Statements of Income for the three and six months ended June 30, 2017:

(in thousands)	For the Three Months Ended June 30, 2017		For the Six Months Ended June 30, 2017	
	As Reported	As Reclassified	As Reported	As Reclassified
REVENUES				
Rental income	$104,869	$ 103,384	$208,957	$ 206,093
Other operating	376	1,934	857	3,869
	$105,245	$ 105,318	$209,814	$ 209,962
OTHER INCOME (EXPENSE)				
Interest and other income, net	$77	$ 4	$189	$ 41
NET INCOME	$25,224	$ 25,224	$57,070	$ 57,070

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 continuing to evaluate 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 exceptions 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

2018 Acquisitions
The following table details the Company's acquisitions for the six months ended June 30, 2018:

(Dollars in millions)	Type [1]	Date Acquired	Purchase Price	Mortgage Notes Payable Assumed [2]	Cash Consideration[3]	Real Estate	Other [4]	Square Footage (Unaudited)
Seattle, Washington	MOB	5/4/18	$ 7.8	$ —				