Cogdell Spencer Inc.
Form 10-K
March 15, 2007

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)**
OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2006

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 001-32649

COGDELL SPENCER INC.
(Exact name of registrant as specified in its charter)

Maryland	**20-3126457**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
4401 Barclay Downs Drive, Suite 300 Charlotte, North Carolina	**28209**
(Address of principal executive offices)	*(Zip code)*

Registrant s telephone number, including area code:
(704) 940-2900

Securities Registered Pursuant to Section 12(b) of the Act:

Title of Each Class	**Name of Exchange on Which Registered**
Common Stock, $0.01 par value	**New York Stock Exchange, Inc.**

Securities Registered Pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No þ

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment of this Form 10-K. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filed, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer o Accelerated filer þ Non-accelerated filer o.

Indicate by check mark whether the registrant is a Shell Company (as defined in rule 12b-2 of the Exchange Act). Yes o No þ

Aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant s most recently completed fiscal quarter. $138,009,425

Indicate the number of shares outstanding of each of the issuer s classes of common stock as of the latest practicable date: 7,999,574 shares of common stock, par value $0.01 per share, outstanding as of February 28, 2007.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s definitive proxy statement for the registrant s 2007 Annual Meeting, to be filed within 120 days after the registrant s fiscal year, are incorporated by reference into Part III of this Annual Report on Form 10-K.

COGDELL SPENCER INC.

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Explanatory Note

Note that the financial statements covered in this report for the period from January 1, 2005 to October 31, 2005 and for the year ended December 31, 2004, contain the results of operations and financial condition of Cogdell Spencer Inc. Predecessor, which is not a legal entity, but represents a combination of certain real estate entities based on common management by Cogdell Spencer Advisors, Inc. In addition, the financial statements covered in this report contain the results of operations and financial condition of Cogdell Spencer Inc. for the year ended December 31, 2006 and for the period from November 1, 2005 to December 31, 2005. Due to the timing of the initial public offering and the formation transactions, Cogdell Spencer Inc. (the Company) does not believe that the results of operations set forth in 2005 and 2004 in this document are necessarily indicative of the Company s future operating results as a publicly-held company.

Statements Regarding Forward-Looking Information

When used in this discussion and elsewhere in this Annual Report on Form 10-K, the words believes, anticipates, projects, should, estimates, expects, and similar expressions are intended to identify forward-looking statements wi the meaning of that term in Section 27A of the Securities Act of 1933, as amended, and in Section 21F of the Securities and Exchange Act of 1934, as amended. Actual results may differ materially due to uncertainties including:

- the Company s business strategy;
- the Company s ability to obtain future financing arrangements;
- estimates relating to the Company s future distributions;
- the Company s understanding of the Company s competition;
- the Company s ability to renew the Company s ground leases;
- changes in the reimbursement available to the Company s tenants by government or private payors;
- the Company s tenants ability to make rent payments;
- defaults by tenants;
- market trends; and
- projected capital expenditures.

Forward-looking statements are based on estimates as of the date of this report. The Company disclaims any obligation to publicly release the results of any revisions to these forward-looking statements reflecting new estimates, events or circumstances after the date of this report.

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PART I

Item 1. *Business*

The Company

Cogdell Spencer Inc. (the Company), incorporated in Maryland in 2005, is a fully-integrated, self-administered and self-managed real estate investment trust (REIT) that invests in specialty office buildings for the medical profession, including medical offices, ambulatory surgery and diagnostic centers, in the United States of America. The Company focuses on the ownership, development, redevelopment, acquisition and management of strategically located medical office buildings and other healthcare related facilities. The Company has been built around understanding and addressing the specialized real estate needs of the healthcare industry. The Company s management team has developed long-term and extensive relationships through developing and maintaining modern, customized medical office buildings and healthcare related facilities. The Company has been able to maintain occupancy above market levels and secure strategic hospital campus locations. The Company operates its business through Cogdell Spencer LP, its operating partnership subsidiary (the Operating Partnership), and its subsidiaries.

The Company derives a significant portion of its revenues from rents received from tenants under existing leases in medical office buildings and other healthcare related facilities. The Company s portfolio is stable with an occupancy rate of 94.2% as of December 31, 2006, and favorable leases generally with consumer price index, or CPI, increases and cost pass throughs to the tenants. The Company derives a lesser portion of its revenues from fees that are paid for managing and developing medical office buildings and other healthcare related facilities for third parties. The Company s management believes a strong internal property management capability is a vital component of the Company s business, both for the properties the Company owns and for those that the Company manages. Strong internal property management allows the Company to control costs, increase tenant satisfaction, and reduce tenant turnover, which reduces capital costs.

The Company s management team has developed long-term and extensive relationships through developing and maintaining modern, customized medical office buildings and healthcare related facilities. Approximately 79% of the net rentable square feet of the Company s wholly-owned properties are situated on hospital campuses. As such, the Company believes that its assets occupy a premier franchise location in relation to local hospitals, providing its properties with a distinct competitive advantage over alternative medical office space in an area. The Company believes that its property locations and relationships with hospitals will allow the Company to capitalize on the increasing healthcare trend of outpatient procedures.

The Company s growth strategy includes leveraging strategic relationships for new developments and off-market acquisitions. The Company will also continue to enter into development joint ventures with hospitals and physicians. The Company is active in seeking new client relationships in new markets. During 2006, the Company acquired properties totaling $100.4 million.

As of December 31, 2006, the Company s portfolio consisted of 112 medical office buildings and healthcare related facilities, serving 27 hospital systems in ten states. The Company s aggregate portfolio was comprised of:

- 50 wholly-owned properties;
- four joint venture properties; and

58 properties owned by third parties.

At December 31, 2006, the Company s aggregate portfolio contains approximately 5.3 million net rentable square feet, consisting of approximately 2.6 million net rentable square feet from wholly-owned properties, approximately 0.2 million net rentable square feet from joint venture properties, and approximately 2.5 million net rental square feet from properties owned by third parties and managed by the Company. As of December 31, 2006, the Company s wholly-owned properties were approximately 94.2% occupied, with a weighted average remaining lease term of 3.8 years.

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The Company s Management Companies

The Company elected to be taxed as a REIT for federal income tax purposes. In order to qualify as a REIT, a specified percentage of the Company s gross income must be derived from real property sources, which would generally exclude the Company s income from providing development and management services to third parties. In order to avoid realizing such income in a manner that would adversely affect the Company s ability to qualify as a REIT, some services are provided through the Company s management company, Cogdell Spencer Advisors, LLC (CSA, LLC), electing, together with the Company, to be treated as a taxable REIT subsidiary or TRS. CSA, LLC is wholly-owned and controlled by the Operating Partnership.

During 2006, the Company acquired Consera Healthcare Real Estate, LLC (Consera). Consera provides property management services to third parties and Consera, together with the Company, has elected Consera to be treated as a TRS.

Management

The Company s senior management team has an average of more than 11 years of healthcare real estate experience and has been involved in the development, redevelopment and acquisition of a broad array of medical office space. The Company s Chairman and founder, James W. Cogdell, has been in the healthcare real estate business for more than 34 years, and Frank C. Spencer, Chief Executive Officer, President and a member of the Board of Directors (the Board of Directors), has more than 11 years of experience in the industry. Three members of the senior management team have entered into employment agreements with the Company. At December 31, 2006, the Company s senior management team owned approximately 23.3% of the Operating Partnership units and Company common stock on a fully diluted basis.

Business and Growth Strategies

The Company s primary business objective is to develop and maintain client relationships in order to maximize cash flow available for distribution to the Company s stockholders.

Operating Strategy

The Company s operating strategy consists of the following principal elements:

Strong Relationships with Physicians and Hospitals.

Healthcare is fundamentally a local business. The Company believes it has developed a reputation based on trust and reliability among physicians and hospitals and believes that these relationships position the Company to secure new development projects and new property acquisition opportunities with both new and existing parties. Many of the Company s healthcare system clients have collaborated with the Company on multiple projects, including the Company s five largest healthcare system clients, with whom the Company has an average relationship lasting more than 23 years. The Company s strategy is to continue to grow its portfolio by leveraging these relationships to acquire existing properties and to selectively develop new medical office buildings and healthcare related facilities in communities in need of additional facilities to support the delivery of medical services. The Company believes that physicians particularly value renting space from a trusted and reliable property owner that consistently delivers an office environment that meets their specialized needs.

Active Management of the Company s Properties.

The Company has developed a comprehensive approach to property and operational management to maximize the operating performance of its medical office buildings and healthcare related facilities, leading to high levels of tenant satisfaction. This fully-integrated property and operating management allows the Company to provide high quality seamless services to its tenants on a cost-effective basis. The Company believes that its operating efficiencies, which consistently exceed industry standards, will allow the Company to control costs for its tenants. The Company intends to maximize the Company s stockholders return on their investment and to achieve long-term functionality and appreciation in its medical office buildings and healthcare related facilities through continuing its practice of active management of its properties. The Company manages its properties with a view toward creating an environment that supports successful medical practices. The properties are clean and kept in a condition that is conducive to the delivery of top-quality medical care to patients. The Company understands that in order to maximize the value of its investments, its tenants must prosper as well. Therefore, the Company is committed to maintaining its properties at the highest possible level.

Key On-Campus Locations.

At December 31, 2006, approximately 79% of the net rentable square feet of the wholly-owned properties are situated on hospital campuses. On-campus properties provide the Company s physician-lessees and their patients with a convenient location so that they can move between medical offices and hospitals with ease, which drives revenues for the Company s physician-lessees. Many of these properties occupy a premier franchise location in relation to the local hospital, providing the Company s properties with a distinct competitive advantage over alternative medical office space in the area. The Company has found that the factors most important to physician-lessees when choosing a medical office building or healthcare related facility in which to locate their offices are convenience to a hospital campus, clean and attractive common areas, state-of-the-art amenities and tenant improvements tailored to each practice.

Loyal and Diverse Tenant Base.

The Company s focus on maintaining the Company s physician-lessees loyalty is a key component of the Company s marketing and operating strategy. A focus on physician-lessee loyalty and the involvement of the physician-tenants and hospitals as investors in the Company s properties results in one of the more stable and diversified tenant bases of any medical office company in the United States. As of December 31, 2006, the Company s properties had an average occupancy rate of approximately 94.2%. The Company s tenants are diversified by type of medical practice, medical specialty and sub-specialty. As of December 31, 2006, no single tenant accounted for more than 7.0% of the annualized base rental revenue at the wholly-owned properties. None of the tenants are in default.

Unique Focus.

The Company focuses exclusively on the ownership, development, redevelopment, acquisition and management of medical office buildings and healthcare related facilities in the United States. The focus on medical office buildings and healthcare related facilities allows the Company to own, develop, redevelop, manage and acquire medical office buildings and healthcare related facilities more effectively and profitably than its competition. Unlike many other public companies that simply engage in sale/leaseback arrangements in the healthcare real estate sector, the Company operates its properties. The Company believes that this focus may position the Company to achieve additional cash flow growth.

Acquisition and Development Strategy

The Company s acquisition and development strategy consists of the following principal elements:

Development Expertise.

The Company s development activities are focused on the design, construction and financing of medical office buildings and healthcare related facilities. The Company and Cogdell Spencer Inc. Predecessor (the Predecessor) has completed the development of more than 70 medical office properties, many of which represent repeat business with its clients. The Company has built strong relationships with leading for-profit and non-profit medical institutions who look to it to provide real estate solutions that will support the growth of a medical community built around their hospitals and regional medical centers. The Company focuses exclusively on medical office buildings and healthcare related facilities and believes that its understanding of real estate and healthcare gives it a competitive advantage over less specialized developers. Further, the Company s regional focus has provided extensive local industry knowledge and insight. The Company believes the network of relationships that have been developed in both the real estate and healthcare industries over the past 34 years provides access to a large volume of potential development and acquisition opportunities.

Selective Development and Acquisitions.

The Company s intends to leverage its strong development and acquisition track record to continue to grow its portfolio of medical office buildings and healthcare related facilities by selectively acquiring existing medical office buildings and by developing new projects in communities in need of additional facilities to support the delivery of medical services.

Develop and Maintain Strategic Relationships.

The Company intends to build upon its key strategic relationships with physicians, hospitals, not-for-profit agencies and religious entities that sponsor healthcare services to further enhance the Company s franchise. Historically, the Predecessor financed real property acquisitions through joint ventures in which the physician-lessees, and in some cases local hospitals or regional medical centers, provided the equity capital. The Company expects to continue entering into joint ventures with individual physicians, physician groups and hospitals. These joint ventures have been, and the Company believes will continue to be, a source of development and acquisition opportunities. Of the 54 healthcare properties the management team developed or acquired over the past 11 years, 36 of them represent repeat transactions with an existing client institution. The Company anticipates that it will also continue to offer potential physician-lessees the opportunity to invest in the Company in order that they may continue to feel a strong sense of attachment to the property in which they practice. The Company intends to continue to work closely with its tenants in order to cultivate long-term working relationships and to maximize new business opportunities. From time to time, the Company may make investments or agree to terms that support the objectives of clients without necessarily maximizing the Company s short-term financial return. The Company believes that this philosophy allows the Company to build long-term relationships and obtain franchise locations otherwise unavailable to the Company s competition.

Investment Criteria and Funding.

The Company intends to expand in its existing markets and enter into markets that research indicates will meet its investment strategy in the future. The Company generally will seek to select clients and assets in locations that the Company believes will complement its existing portfolio. The Company may also selectively pursue portfolio opportunities outside of its existing markets that will not only add incremental value, but will also add diversification and economies of scale to the existing portfolio.

In assessing a potential development or acquisition opportunity, the Company focuses on the economics of the medical community and the strength of local hospitals. The analysis focuses on trying to place the project on a hospital campus or in a strategic growth corridor based on demographics.

As an incentive for future development deals, the Company intends to establish a program whereby units of limited partnership interests or common stock can be offered to potential development partners to help finance a project. Historically, the Company has financed real property acquisitions through joint ventures in which the physicians who lease space at the properties, and in some cases, local hospitals or regional medical centers, provided the equity capital. The Company expects to continue this practice of entering into joint ventures with individual physicians, physician groups and hospitals.

On November 1, 2005, the Company, as guarantor, and the Operating Partnership entered into a $100.0 million unsecured revolving credit facility (the Credit Facility). In August 2006, the Credit Facility s borrowing capability increased from $100.0 million to $130.0 million. As of December 31, 2006, the Credit Facility had approximately $50.1 million of available borrowings, which the Company can use to finance development and acquisition opportunities. The Company plans to finance future acquisitions through a combination of borrowings under the Credit Facility, traditional secured mortgage financing, and equity offerings.

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Regulation

The following discussion describes certain material U.S. federal healthcare laws and regulations that may affect the Company s operations and those of the Company s tenants. However, the discussion does not address state healthcare laws and regulations, except as otherwise indicated. These state laws and regulations, like the U.S. federal healthcare laws and regulations, could affect the Company s operations and those of the Company s tenants.

The regulatory environment remains stringent for healthcare providers. Fraud and abuse statutes that regulate hospital and physician relationships continue to broaden the industry s awareness of the need for experienced real estate management.

New requirements for Medicare coding, physician recruitment and referrals, outlier charges to commercial and government payors, and corporate governance have created a difficult operating environment for some hospitals.

Generally, healthcare real estate properties are subject to various laws, ordinances and regulations. Changes in any of these laws or regulations, such as the Comprehensive Environmental Response and Compensation Liability Act, increase the potential liability for environmental conditions or circumstances existing or created by tenants or others on properties. In addition, laws affecting development, construction, operation, upkeep, safety and taxation requirements may result in significant unanticipated expenditures, loss of healthcare real estate property sites or other impairments to operations, which would adversely affect the Company s cash flows from operating activities.

As the Company s properties and entities are not healthcare providers, the healthcare regulatory restrictions that apply to physician investment in healthcare providers are not applicable to the ownership interests held by physicians in the Company s properties. For example, the Stark II law, which prohibits physicians from referring patients to any entity if they have a financial relationship with or ownership interest in the entity and the entity provides certain designated health services, does not apply to physician ownership in the Company s entities because these entities do not own or operate hospitals, nor do they provide any designated health services. In addition, the Federal Anti-Kickback Statute, which generally prohibits payment or solicitation of remuneration in exchange for referrals for items and services covered by federal health care programs to persons in a position to refer such business, also does not apply to ownership in the existing properties as these entities do not provide or bill for medical services of any kind. Similar state laws that prohibit physician self referrals or kickbacks also do not apply for the same reasons. Notwithstanding the foregoing, the Company cannot assure you that regulatory authorities will agree with the Company s interpretation of these laws.

Under the Americans with Disabilities Act of 1990, or the ADA, all places of public accommodation are required to meet certain U.S. federal requirements related to access and use by disabled persons. A number of additional U.S. federal, state and local laws also exist that may require modifications to properties, or restrict certain further renovations thereof, with respect to access thereto by disabled persons. Noncompliance with the ADA could result in the imposition of fines or an award of damages to private litigants and also could result in an order to correct any non-complying feature, and in substantial capital expenditures. To the extent the Company s properties are not in compliance, the Company may incur additional costs to comply with the ADA.

Property management activities are often subject to state real estate brokerage laws and regulations as determined by the particular real estate commission for each state.

In addition, state and local laws regulate expansion, including the addition of new beds or services or acquisition of medical equipment, and the construction of healthcare related facilities, by requiring a certificate of need, which is issued by the applicable state health planning agency only after that agency makes a determination that a need exists in a particular area for a particular service or facility, or other similar approval. New laws and regulations, changes in existing laws and regulations or changes in the interpretation of such laws or regulations could negatively affect the financial condition of the Company s lessees. These changes, in some cases, could apply retroactively. The enactment, timing or effect of legislative or regulatory changes cannot be predicted. In addition, certain of the Company s medical office buildings and healthcare related facilities and their lessees may require licenses or certificates of need to operate. Failure to obtain a license or certificate of need, or loss of a required license would prevent a facility from operating in the manner intended by the lessee.

Environmental Matters

Pursuant to U.S. federal, state and local environmental laws and regulations, a current or previous owner or operator of real property may be required to investigate, remove and/or remediate a release of hazardous substances or other regulated materials at or emanating from such property. Further, under certain circumstances, such owners or operators of real property may be held liable for property damage, personal injury and/or natural resource damage resulting from or arising in connection with such releases. Certain of these laws have been interpreted to be joint and several unless the harm is divisible and there is a reasonable basis for allocation of responsibility. The failure to properly remediate the property may also adversely affect the owner s ability to lease, sell or rent the property or to borrow funds using the property as collateral.

In connection with the ownership, operation and management of the Company s current or past properties and any properties that the Company may acquire and/or manage in the future, the Company could be legally responsible for environmental liabilities or costs relating to a release of hazardous substances or other regulated materials at or emanating from such property. In order to assess the potential for such liability, the Company conducts an environmental assessment of each property prior to acquisition and manages the Company s properties in accordance with environmental laws while the Company owns or operates them. All of the Company s leases contain a comprehensive environmental provision that requires tenants to conduct all activities in compliance with environmental laws and to indemnify the owner for any harm caused by the failure to do so. In addition, the Company has engaged qualified, reputable and adequately insured environmental consulting firms to perform environmental site assessments of all of the Company s properties and is not aware of any environmental issues that are expected to have materially impacted the operations of any property.

Insurance

The Company believes that its properties are covered by adequate fire, flood, earthquake, wind (as deemed necessary or as required by the Company s lenders) and property insurance, as well as commercial liability insurance, provided by reputable companies and with commercially reasonable deductibles and limits. Furthermore, the Company believes that its businesses and assets are likewise adequately insured against casualty loss and third party liabilities. The Company engages a risk management consultant. Changes in the insurance market since September 11, 2001 have caused increases in insurance costs and deductibles, and have led to more active management of the insurance component of the Company s budget for each project; however, most of the Company s leases provide that insurance premiums are considered part of the operating expenses of the respective property, and the tenants are therefore responsible for any increases in the Company s premiums.

Competition

The Company competes in developing and acquiring medical office buildings and healthcare related facilities with financial institutions, institutional pension funds, real estate developers, other REITs, other public and private real estate companies and private real estate investors.

Depending on the characteristics of a specific market, the Company may also face competition in leasing available medical office buildings and healthcare related facilities to prospective tenants. However, the Company believes that it brings a depth of knowledge and experience in working with physicians, hospitals, not-for-profit agencies and religious entities that sponsor healthcare services that makes the Company an attractive real estate partner for both development projects and acquisitions.

Employees

As of December 31, 2006, the Company has 118 employees. The Company s employees perform various property management, maintenance, acquisition, renovation and management functions. The Company believes that the Company s relationships with the Company s employees are good. None of the Company s employees are represented by a union.

Offices

The Company s corporate headquarters are located at 4401 Barclay Downs Drive, Suite 300, Charlotte, North Carolina 28209-4670. The Company has 29 offices located in California, Florida, Georgia, Indiana, Kentucky, Louisiana, Mississippi, North Carolina, Pennsylvania, South Carolina, and Virginia. The Company believes that its current offices are adequate for its present and future operations, although it may add regional offices depending on the volume and nature of future acquisition and development projects.

Available Information

The Company files its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports with the Securities and Exchange Commission (the SEC). You may obtain copies of these documents by visiting the SEC s Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549, by calling the SEC at 1-800-SEC-0330 or by accessing the SEC s Web site at www.sec.gov. The Company s Web site is www.cogdellspencer.com. Its reports on Forms 10-K, 10-Q, and 8-K, and all amendments to those reports are posted on the Company s Web site as soon as reasonably practicable after the reports and amendments are electronically filed with or furnished to the SEC. The contents of the Company s Web site are not incorporated by reference.

Item 1A. ***Risk Factors***

Risks Related to the Company s Properties and Operations

The Company s real estate investments are concentrated in medical office buildings and healthcare related facilities, making the Company more vulnerable economically than if the Company s investments were diversified.

As a REIT, the Company invests primarily in real estate. Within the real estate industry, the Company selectively owns, develops, redevelops, acquires and manages medical office buildings and healthcare related facilities. The Company is subject to risks inherent in concentrating investments in real estate. The risks resulting from a lack of diversification become even greater as a result of the Company s business strategy to invest primarily in medical office buildings and healthcare related facilities. A downturn in the medical office building industry or in the commercial real estate industry generally, could significantly adversely affect the value of the Company s properties. A downturn in the healthcare industry could negatively affect the Company s tenants ability to make rent payments to the Company, which may have a material adverse effect on the Company s business, financial condition and results of operations, the Company s ability to make distributions to the Company s stockholders and the trading price of the Company s common stock. These adverse effects could be more pronounced than if the Company diversified the Company s investments outside of real estate or outside of medical office buildings and healthcare related properties.

The Company depends on significant tenants.

As of December 31, 2006, the Company s five largest tenants represented $12.6 million, or 23.2%, of the annualized rent generated by the Company s properties. The Company s five largest tenants based on annualized rents are Palmetto Health Alliance, NorthEast Medical Center, University Hospital (Augusta, GA), Carolinas HealthCare System, and Gaston Memorial Hospital. The Company s tenants may experience a downturn in their businesses, which may weaken their financial condition and result in their failure to make timely rental payments or their default under their leases. In the event of any tenant default, the Company may experience delays in enforcing the Company s rights as landlord and may incur substantial costs in protecting the Company s investment.

The bankruptcy or insolvency of the Company s tenants under the Company s leases could seriously harm the Company s operating results and financial condition.

The Company will receive substantially all of the Company s income as rent payments under leases of space in the Company s properties. The Company has no control over the success or failure of the Company s tenants businesses and, at any time, any of the Company s tenants may experience a downturn in its business that may weaken its financial condition. As a result, the Company s tenants may delay lease commencement or renewal, fail to make rent payments when due or declare bankruptcy. Any leasing delays, lessee failures to make rent payments when due or tenant bankruptcies could result in the termination of the tenant s lease and, particularly in the case of a large tenant, may have a material adverse effect on the Company s business, financial condition and results of operations, the Company s ability to make distributions to the Company s stockholders and the trading price of the Company s common stock.

If tenants are unable to comply with the terms of the Company s leases, the Company may be forced to modify lease terms in ways that are unfavorable to the Company. Alternatively, the failure of a tenant to perform under a lease or to extend a lease upon expiration of its term could require the Company to declare a default, repossess the property, find a suitable replacement tenant, operate the property or sell the property. There is no assurance that the Company will be able to lease the property on substantially equivalent or better terms than the prior lease, or at all, find another tenant, successfully reposition the property for other uses, successfully operate the property or sell the property on terms that are favorable to the Company.

If any lease expires or is terminated, the Company will be responsible for all of the operating expenses for that vacant space until it is re-let. If the Company experiences high levels of vacant space, the Company s operating expenses may increase significantly. Any significant increase in the Company s operating costs may have a material adverse effect on the Company s business, financial condition and results of operations, the Company s ability to make distributions to the Company s stockholders and the trading price of the Company s common stock.

Any bankruptcy filings by or relating to one of the Company s tenants could bar all efforts by the Company to collect pre-bankruptcy debts from that lessee or seize its property, unless the Company receives an order permitting the Company to do so from the bankruptcy court, which the Company may be unable to obtain. A tenant bankruptcy could also delay the Company s efforts to collect past due balances under the relevant leases and could ultimately preclude full collection of these sums. If a tenant assumes the lease while in bankruptcy, all pre-bankruptcy balances due under the lease must be paid to the Company in full. However, if a tenant rejects the lease while in bankruptcy, the Company would have only a general unsecured claim for pre-petition damages. Any unsecured claim the Company holds may be paid only to the extent that funds are available and only in the same percentage as is paid to all other holders of unsecured claims. It is possible that the Company may recover substantially less than the full value of any unsecured claims the Company holds, if any, which may have a material adverse effect on the Company s business, financial condition and results of operations, the Company s ability to make distributions to the Company s stockholders and the trading price of the Company s common stock. Furthermore, dealing with a tenant bankruptcy or other default may divert management s attention and cause the Company to incur substantial legal and other costs.

Adverse economic or other conditions in the markets in which the Company does business could negatively affect the Company s occupancy levels and rental rates and therefore the Company s operating results.

The Company s operating results are dependent upon its ability to maximize occupancy levels and rental rates in the Company s portfolio. Adverse economic or other conditions in the markets in which the Company operates may lower the Company s occupancy levels and limit the Company s ability to increase rents or require the Company to offer rental discounts. The following factors are primary among those which may adversely affect the operating performance of the Company s properties:

the national economic climate in which the Company operates, which may be adversely impacted by, among other factors, industry slowdowns, relocation of businesses and changing demographics;

periods of economic slowdown or recession, rising interest rates or declining demand for medical office buildings and healthcare related facilities, or the public perception that any of these events may occur, could result in a general decline in rental rates or an increase in tenant defaults;

local or regional real estate market conditions such as the oversupply of medical office buildings and healthcare related facilities or a reduction in demand for medical office buildings and healthcare related facilities in a particular area;

negative perceptions by prospective tenants of the safety, convenience and attractiveness of the Company s properties and the neighborhoods in which they are located;

earthquakes and other natural disasters, terrorist acts, civil disturbances or acts of war which may result in uninsured or underinsured losses; and changes in the tax, real estate and zoning laws.

The failure of the Company s properties to generate revenues sufficient to meet the Company s cash requirements, including operating and other expenses, debt service and capital expenditures, may have a material adverse effect on the Company s business, financial condition and results of operations, the Company s ability to make distributions to the Company s stockholders and the trading price of the Company s common stock.

All of the Company s wholly-owned properties are located in California, Georgia, Indiana, Kentucky, Louisiana, North Carolina, South Carolina, and Virginia, and changes in these markets may materially adversely affect the Company.

The Company s wholly-owned properties located in California, Georgia, Indiana, Kentucky, Louisiana, North Carolina, South Carolina, and Virginia provide approximately 5.4%, 10.0%, 6.7%, 3.4%, 6.0%, 30.1%, 35.6%, and 2.8%, respectively, of the Company s total annualized rent as of December 31, 2006. As a result of the geographic concentration of properties in these markets, the Company is particularly exposed to downturns in these local economies or other changes in local real estate market conditions. In the event of negative economic changes in these markets, the Company s business, financial condition and results of operations, the Company s ability to make distributions to the Company s stockholders and the trading price of the Company s common stock may be materially and adversely affected.

The Company may not be successful in identifying and consummating suitable acquisitions or investment opportunities, which may impede the Company s growth and negatively affect the Company s results of operations.

The Company s ability to expand through acquisitions is integral to its business strategy and requires the Company to identify suitable acquisition candidates or investment opportunities that meet its criteria and are compatible with its growth strategy. The Company may not be successful in identifying suitable properties or other assets that meet the Company s acquisition criteria or in consummating acquisitions or investments on satisfactory terms or at all. Failure to identify or consummate acquisitions or investment opportunities will slow the Company s growth, which could in turn adversely affect the Company s stock price.

The Company s ability to acquire properties on favorable terms and successfully integrate and operate them may be constrained by the following significant risks:

- competition from other real estate investors with significant capital, including other publicly-traded REITs and institutional investment funds;
- competition from other potential acquirers may significantly increase the purchase price for an acquisition property, which could reduce the Company s profitability;
- unsatisfactory results of the Company s due diligence investigations or failure to meet other customary closing conditions;
- failure to finance an acquisition on favorable terms or at all;
- the Company may spend more than the time and amounts budgeted to make necessary improvements or renovations to acquired properties; and
- the Company may acquire properties subject to liabilities and without any recourse, or with only limited recourse, with respect to unknown liabilities such as liabilities for clean-up of undisclosed environmental

contamination, claims by persons in respect of events transpiring or conditions existing before the Company acquired the properties and claims for indemnification by general partners, directors, officers and others indemnified by the former owners of the properties.

If any of these risks are realized, the Company s business, financial condition and results of operations, the Company s ability to make distributions to the Company s stockholders and the trading price of the Company s common stock may be materially and adversely affected.

If the Company is unable to promptly re-let its properties, if the rates upon such re-letting are significantly lower than expected or if the Company is required to undertake significant capital expenditures to attract new tenants, then the Company s business and results of operations would be adversely affected.

Virtually all of the Company s leases are on a multiple year basis. As of December 31, 2006, leases representing 17.5% of the Company s net rentable square feet will expire in 2007, 13.8% in 2008 and 14.3% in 2009. These expirations would account for 17.8%, 12.8% and 15.0% of the Company s annualized rent, respectively. Approximately 74% of the square feet of the Company s properties and 60% of the number of the Company s properties are subject to certain restrictions. These restrictions include limits on the Company s ability to re-let these properties to tenants not affiliated with the healthcare system that own the underlying property, rights of first offer on sales of the property and limits on the types of medical procedures that may be performed. In addition, lower than expected rental rates upon re-letting could impede the Company s growth. The Company cannot assure you that it will be able to re-let space on terms that are favorable to the Company or at all. Further, the Company may be required to make significant capital expenditures to renovate or reconfigure space to attract new tenants. If it is unable to promptly re-let its properties, if the rates upon such re-letting are significantly lower than expected or if the Company is required to undertake significant capital expenditures in connection with re-letting units, the Company s business, financial condition and results of operations, the Company s ability to make distributions to the Company s stockholders and the trading price of the Company s common stock may be materially and adversely affected.

Certain of the Company s properties may not have efficient alternative uses.

Some of the Company s properties, such as the Company s ambulatory surgery centers, are specialized medical facilities. If the Company or the Company s tenants terminate the leases for these properties or the Company s tenants lose their regulatory authority to operate such properties, the Company may not be able to locate suitable replacement tenants to lease the properties for their specialized uses. Alternatively, the Company may be required to spend substantial amounts to adapt the properties to other uses. Any loss of revenues and/or additional capital expenditures occurring as a result may have a material adverse effect on the Company s business, financial condition and results of operations, the Company s ability to make distributions to the Company s stockholders and the trading price of the Company s common stock.

The Company faces increasing competition for the acquisition of medical office buildings and healthcare related facilities, which may impede the Company s ability to make future acquisitions or may increase the cost of these acquisitions.

The Company competes with many other entities engaged in real estate investment activities for acquisitions of medical office buildings and healthcare related facilities, including national, regional and local operators, acquirers and developers of healthcare real estate properties. The competition for healthcare real estate properties may significantly increase the price the Company must pay for medical office buildings and healthcare related facilities or other assets the Company seeks to acquire and the Company s competitors may succeed in acquiring those properties or assets themselves. In addition, the Company s potential acquisition targets may find the Company s competitors to be more attractive because they may have greater resources, may be willing to pay more for the properties or may have a more compatible operating philosophy. In particular, larger healthcare REITs may enjoy significant competitive advantages that result from, among other things, a lower cost of capital and enhanced operating efficiencies. In addition, the number of entities and the amount of funds competing for suitable investment properties may increase. This competition will result in increased demand for these assets and therefore increased prices paid for them. Because of an increased interest in single-property acquisitions among tax-motivated individual purchasers, the Company may pay higher prices if the Company purchases single properties in comparison with portfolio acquisitions. If the Company pays higher prices for medical office buildings and healthcare related facilities or other assets, the Company s business, financial condition and results of operations, the Company s ability to make distributions to the Company s stockholders and the trading price of the Company s common stock may be materially and adversely affected.

The Company may not be successful in integrating and operating acquired properties.

The Company expects to make future acquisitions of medical office buildings and healthcare related facilities. If the Company acquires medical office buildings and healthcare related facilities, the Company will be required to integrate them into the Company s existing portfolio. The acquired properties may turn out to be less compatible with the Company s growth strategy than originally anticipated, may cause disruptions in the Company s operations or may divert management s attention away from day-to-day operations, any or all of which may have a material adverse effect on the Company s business, financial condition and results of operations, the Company s ability to make distributions to the Company s stockholders and the trading price of the Company s common stock.

The Company s medical office buildings and healthcare related facilities, their associated hospitals and the Company s tenants may be unable to compete successfully.

The Company s medical office buildings and healthcare related facilities, and their associated hospitals often face competition from nearby hospitals and other medical office buildings that provide comparable services. Some of those competing facilities are owned by governmental agencies and supported by tax revenues, and others are owned by nonprofit corporations and may be supported to a large extent by endowments and charitable contributions. These types of support are not available to the Company s buildings.

Similarly, the Company s tenants face competition from other medical practices in nearby hospitals and other medical facilities. The Company s tenants failure to compete successfully with these other practices could adversely affect their ability to make rental payments, which could adversely affect the Company s rental revenues. Further, from time to time and for reasons beyond the Company s control, referral sources, including physicians and managed care organizations, may change their lists of hospitals or physicians to which they refer patients. This could adversely affect the Company s tenants ability to make rental payments, which could adversely affect the Company s rental revenues.

Any reduction in rental revenues resulting from the inability of the Company s medical office buildings and healthcare related facilities, their associated hospitals and the Company s tenants to compete successfully may have a material adverse effect on the Company s business, financial condition and results of operations, the Company s ability to make distributions to the Company s stockholders and the trading price of the Company s common stock.

The Company s investments in development and redevelopment projects may not yield anticipated returns, which would harm the Company s operating results and reduce the amount of funds available for distributions.

A key component of the Company s growth strategy is exploring new-asset development and redevelopment opportunities through strategic joint ventures. To the extent that the Company engages in these development and redevelopment activities, they will be subject to the following risks normally associated with these projects:

- the Company may be unable to obtain financing for these projects on favorable terms or at all;
- the Company may not complete development projects on schedule or within budgeted amounts;
- the Company may encounter delays or refusals in obtaining all necessary zoning, land use, building, occupancy and other required governmental permits and authorizations;