

UNIVERSAL HEALTH REALTY INCOME TRUST
Form 10-Q
August 08, 2017

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 June 30, 2017

OR

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

For the transition period from _____ to _____

Commission file number 1-9321

UNIVERSAL HEALTH REALTY INCOME TRUST

(Exact name of registrant as specified in its charter)

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

UNIVERSAL CORPORATE CENTER

367 SOUTH GULPH ROAD

KING OF PRUSSIA, PENNSYLVANIA 19406

Edgar Filing: UNIVERSAL HEALTH REALTY INCOME TRUST - Form 10-Q

(Address of principal executive offices) (Zip Code)

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated Filer

Non-accelerated filer Smaller reporting company
Emerging growth company

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

Number of common shares of beneficial interest outstanding at July 31, 2017—13,606,901

UNIVERSAL HEALTH REALTY INCOME TRUST

INDEX

	PAGE NO.
<u>PART I. FINANCIAL INFORMATION</u>	
Item 1. <u>Financial Statements</u>	
<u>Condensed Consolidated Statements of Income—Three and Six Months Ended June 30, 2017 and 2016</u>	3
<u>Condensed Consolidated Statements of Comprehensive Income—Three and Six Months Ended June 30, 2017 and 2016</u>	4
<u>Condensed Consolidated Balance Sheets—June 30, 2017 and December 31, 2016</u>	5
<u>Condensed Consolidated Statements of Cash Flows—Six Months Ended June 30, 2017 and 2016</u>	6
<u>Notes to Condensed Consolidated Financial Statements</u>	7 through 17
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	18 through 28
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	28
Item 4. <u>Controls and Procedures</u>	28
<u>PART II. OTHER INFORMATION</u>	
Item 6. <u>Exhibits</u>	29
<u>Signatures</u>	30
<u>EXHIBIT INDEX</u>	31

This Quarterly Report on Form 10-Q is for the quarter ended June 30, 2017. In this Quarterly Report, “we,” “us,” “our” and the “Trust” refer to Universal Health Realty Income Trust and its subsidiaries.

As disclosed in this Quarterly Report, including in Note 2 to the Condensed Consolidated Financial Statements—Relationship with Universal Health Services, Inc. (“UHS”) and Related Party Transactions, a wholly-owned subsidiary of UHS (UHS of Delaware, Inc.) serves as our Advisor pursuant to the terms of an annually renewable Advisory Agreement dated December 24, 1986. Our officers are all employees of UHS through its wholly-owned subsidiary, UHS of Delaware, Inc. In addition, three of our hospital facilities are leased to subsidiaries of UHS and seventeen medical office buildings or free-standing emergency departments, that are either wholly or jointly-owned by us that include tenants which are subsidiaries of UHS. Any reference to “UHS” or “UHS facilities” in this report is referring to Universal Health Services, Inc.’s subsidiaries, including UHS of Delaware, Inc.

In this Quarterly Report, the term “revenues” does not include the revenues of the unconsolidated limited liability companies (“LLCs”) in which we have various non-controlling equity interests ranging from 33% to 95%. We currently account for our share of the income/loss from these investments by the equity method (see Note 5 to the Condensed Consolidated Financial Statements included herein).

Part I. Financial Information

Item I. Financial Statements

Universal Health Realty Income Trust

Condensed Consolidated Statements of Income

For the Three and Six Months Ended June 30, 2017 and 2016

(amounts in thousands, except per share amounts)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Revenues:				
Base rental - UHS facilities	\$4,303	\$4,079	\$8,383	\$8,160
Base rental - Non-related parties	10,116	9,030	20,086	17,845
Bonus rental - UHS facilities	1,242	1,193	2,530	2,439
Tenant reimbursements and other - Non-related parties	2,239	1,943	4,432	3,816
Tenant reimbursements and other - UHS facilities	245	216	464	427
	18,145	16,461	35,895	32,687
Expenses:				
Depreciation and amortization	6,295	5,543	12,440	10,979
Advisory fees to UHS	874	781	1,740	1,548
Other operating expenses	4,923	4,540	9,628	8,940
Transaction costs	56	64	126	146
	12,148	10,928	23,934	21,613
Income before equity in income of unconsolidated limited liability companies ("LLCs"), interest expense and gain	5,997	5,533	11,961	11,074
Equity in income of unconsolidated LLCs	498	1,227	1,575	2,286
Gain on fair value recognition resulting from purchase of minority interest in majority-owned LLC, net	-	-	27,196	-
Interest expense, net	(2,462)	(2,237)	(5,137)	(4,409)
Net income	\$4,033	\$4,523	\$35,595	\$8,951
Basic earnings per share	\$0.30	\$0.34	\$2.62	\$0.67
Diluted earnings per share	\$0.30	\$0.34	\$2.62	\$0.67
Weighted average number of shares outstanding - Basic	13,583	13,397	13,581	13,352
Weighted average number of share equivalents	-	7	-	7
Weighted average number of shares and equivalents outstanding - Diluted	13,583	13,404	13,581	13,359

See accompanying notes to these condensed consolidated financial statements.

3

Universal Health Realty Income Trust

Condensed Consolidated Statements of Comprehensive Income

For the Three and Six Months Ended June 30, 2017 and 2016

(dollar amounts in thousands)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net income	\$4,033	\$4,523	\$35,595	\$8,951
Other comprehensive loss:				
Unrealized derivative losses on interest rate caps	(75)	(43)	(93)	(22)
Total other comprehensive loss:	(75)	(43)	(93)	(22)
Total comprehensive income	\$3,958	\$4,480	\$35,502	\$8,929

See accompanying notes to these condensed consolidated financial statements.

Universal Health Realty Income Trust

Condensed Consolidated Balance Sheets

(dollar amounts in thousands)

(unaudited)

	June 30, 2017	December 31, 2016
Assets:		
Real Estate Investments:		
Buildings and improvements and construction in progress	\$ 539,729	\$ 534,190
Accumulated depreciation	(148,279)	(138,588)
	391,450	395,602
Land	51,645	51,638
Net Real Estate Investments	443,095	447,240
Investments in and advances to limited liability companies ("LLCs")	4,718	35,593
Other Assets:		
Cash and cash equivalents	4,109	3,930
Restricted cash	11,253	-
Base and bonus rent and other receivables from UHS	3,630	2,321
Rent receivable - other	5,697	5,291
Intangible assets (net of accumulated amortization of \$28.4 million and \$27.1 million at June 30, 2017 and December 31, 2016, respectively)	21,460	23,815
Deferred charges and other assets, net	5,863	6,560
Total Assets	\$ 499,825	\$ 524,750
Liabilities:		
Line of credit borrowings	\$ 182,850	\$ 201,500
Mortgage notes payable, non-recourse to us, net	90,649	114,217
Accrued interest	564	626
Accrued expenses and other liabilities	10,283	11,809
Tenant reserves, deposits and prepaid rents	6,432	5,321
Total Liabilities	290,778	333,473
Equity:		
Preferred shares of beneficial interest, \$0.01 par value; 5,000,000 shares authorized; none issued and outstanding	-	-
Common shares, \$0.01 par value; 95,000,000 shares authorized; issued and outstanding: 2017 - 13,606,889; 2016 - 13,599,055	136	136
Capital in excess of par value	255,811	255,656

Edgar Filing: UNIVERSAL HEALTH REALTY INCOME TRUST - Form 10-Q

Cumulative net income	608,096	572,501
Cumulative dividends	(655,008)	(637,121)
Accumulated other comprehensive income	12	105
Total Equity	209,047	191,277
Total Liabilities and Equity	\$499,825	\$ 524,750

See accompanying notes to these condensed consolidated financial statements.

Universal Health Realty Income Trust

Condensed Consolidated Statement of Cash Flows

(dollar amounts in thousands)

(unaudited)

	Six months ended June 30,	
	2017	2016
Cash flows from operating activities:		
Net income	\$35,595	\$8,951
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	12,476	11,027
Amortization of debt premium	(100)	(111)
Stock-based compensation expense	252	228
Gain on fair value recognition resulting from purchase of minority interest in majority-owned LLC, net	(27,196)	—
Changes in assets and liabilities:		
Rent receivable	(683)	(400)
Accrued expenses and other liabilities	(398)	(446)
Tenant reserves, deposits and prepaid rents	79	593
Accrued interest	(62)	10
Leasing costs paid	(403)	(297)
Other, net	783	454
Net cash provided by operating activities	20,343	20,009
Cash flows from investing activities:		
Investments in LLCs	(532)	(5,454)
Repayments of advances made to LLC	216	421
Cash distributions in excess of income from LLCs	734	104
Additions to real estate investments, net	(6,537)	(4,143)
Cash proceeds received from divestiture of property, net of restricted cash	53,967	—
Deposit on real estate assets	(150)	—
Net cash paid for acquisition of properties	—	(27,943)
Cash paid to acquire minority interests in majority-owned LLCs	(7,890)	—
Net cash provided by/(used in) investing activities	39,808	(37,015)
Cash flows from financing activities:		
Net (repayments)/borrowings on line of credit	(18,650)	24,850
Repayments of mortgage notes payable	(36,473)	(1,596)
Proceeds from mortgage notes payable	13,200	—
Financing costs paid	(284)	(307)
Dividends paid	(17,887)	(17,393)
Partial settlement of dividend equivalent rights	—	(1)
Issuance of shares of beneficial interest, net	122	12,266
Net cash (used in)/provided by financing activities	(59,972)	17,819
Increase in cash and cash equivalents	179	813

Edgar Filing: UNIVERSAL HEALTH REALTY INCOME TRUST - Form 10-Q

Cash and cash equivalents, beginning of period	3,930	3,894
Cash and cash equivalents, end of period	\$4,109	\$4,707
Supplemental disclosures of cash flow information:		
Interest paid	\$5,039	\$4,251

See accompanying notes to these condensed consolidated financial statements.

UNIVERSAL HEALTH REALTY INCOME TRUST

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017

(unaudited)

(1) General

This Quarterly Report on Form 10-Q is for the quarter ended June 30, 2017. In this Quarterly Report, “we,” “us,” “our” and the “Trust” refer to Universal Health Realty Income Trust and its subsidiaries.

In this Quarterly Report on Form 10-Q, the term “revenues” does not include the revenues of the unconsolidated LLCs in which we have various non-controlling equity interests ranging from 33% to 95%. As of June 30, 2017, we had investments in four jointly-owned LLCs/LPs which own medical office buildings, all of which are accounted for by the equity method (see Note 5). These LLCs are included in our financial statements for all periods presented on an unconsolidated basis since they are not variable interest entities for which we are the primary beneficiary, nor do we hold a controlling voting interest.

The financial statements included herein have been prepared by us, without audit, pursuant to the rules and regulations of the SEC and reflect all normal and recurring adjustments which, in our opinion, are necessary to fairly present results for the interim periods. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although we believe that the accompanying disclosures are adequate to make the information presented not misleading. It is suggested that these financial statements be read in conjunction with the financial statements, the notes thereto and accounting policies included in our Annual Report on Form 10-K for the year ended December 31, 2016.

(2) Relationship with Universal Health Services, Inc. (“UHS”) and Related Party Transactions

Leases: We commenced operations in 1986 by purchasing properties of certain subsidiaries from UHS and immediately leasing the properties back to the respective subsidiaries. Most of the leases were entered into at the time we commenced operations and provided for initial terms of 13 to 15 years with up to six additional 5-year renewal terms. The current base rentals and lease and rental terms for each of the three hospital facilities leased to subsidiaries of UHS are provided below. The base rents are paid monthly and each lease also provides for additional or bonus rents which are computed and paid on a quarterly basis based upon a computation that compares current quarter revenue to a corresponding quarter in the base year. The three hospital leases with subsidiaries of UHS are unconditionally guaranteed by UHS and are cross-defaulted with one another.

The combined revenues generated from the leases on the UHS hospital facilities accounted for approximately 22% and 24% of our consolidated revenues for the three months ended June 30, 2017 and 2016, respectively, and approximately 23% and 25% of our consolidated revenues for the six months ended June 30, 2017 and 2016,

respectively. Including 100% of the revenues generated at the unconsolidated LLCs in which we have various non-controlling equity interests ranging from 33% to 95%, the leases on the UHS hospital facilities accounted for approximately 20% of the combined consolidated and unconsolidated revenue for each of the three months ended June 30, 2017 and 2016, and approximately 19% and 20% of the combined consolidated and unconsolidated revenue for the six months ended June 30, 2017 and 2016, respectively. In addition, we have seventeen medical office buildings (“MOBs”), or free-standing emergency departments (“FEDs”), that are either wholly or jointly-owned by us, that include tenants which are subsidiaries of UHS.

Pursuant to the Master Lease Document by and among us and certain subsidiaries of UHS, dated December 24, 1986 (the “Master Lease”), which governs the leases of all hospital properties with subsidiaries of UHS, UHS has the option to renew the leases at the lease terms described below by providing notice to us at least 90 days prior to the termination of the then current term. UHS also has the right to purchase the respective leased facilities at the end of the lease terms or any renewal terms at the appraised fair market value. In addition, the Master Lease, as amended during 2006, includes a change of control provision whereby UHS has the right, upon one month’s notice should a change of control of the Trust occur, to purchase any or all of the three leased hospital properties listed below at their appraised fair market value. Additionally, UHS has rights of first refusal to: (i) purchase the respective leased facilities during and for 180 days after the lease terms at the same price, terms and conditions of any third-party offer, or; (ii) renew the lease on the respective leased facility at the end of, and for 180 days after, the lease term at the same terms and conditions pursuant to any third-party offer.

In June, 2016, three wholly-owned subsidiaries of UHS provided the required notice to us, exercising the 5-year renewal options on the leases related to our acute care hospitals. The renewals extended the lease terms on these facilities, at existing lease rates, to December, 2021.

The table below details the existing lease terms and renewal options for our three acute care hospitals operated by wholly-owned subsidiaries of UHS:

Hospital Name	Annual		Renewal	
	Minimum	End of	Term	
	Rent	Lease Term	(years)	
McAllen Medical Center	\$5,485,000	December, 2021	10	(a)
Wellington Regional Medical Center	\$3,030,000	December, 2021	10	(b)
Southwest Healthcare System, Inland Valley Campus	\$2,648,000	December, 2021	10	(b)

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

(b) UHS has two 5-year renewal options at fair market value lease rates (2022 through 2031).

Management cannot predict whether the leases with subsidiaries of UHS, which have renewal options at existing lease rates or fair market value lease rates, or any of our other leases, will be renewed at the end of their lease term. If the leases are not renewed at their current rates or the fair market value lease rates, we would be required to find other operators for those facilities and/or enter into leases on terms potentially less favorable to us than the current leases. In addition, if subsidiaries of UHS exercise their options to purchase the respective leased hospital or FED facilities upon expiration of the lease terms, our future revenues could decrease if we were unable to earn a favorable rate of return on the sale proceeds received, as compared to the rental revenue currently earned pursuant to these leases.

In April, 2017, the recently constructed Henderson Medical Plaza MOB received its certificate of occupancy. Henderson Medical Plaza is located on the campus of the Henderson Hospital, a newly constructed, 130-bed acute care hospital that is owned and operated by a subsidiary of UHS and was completed and opened during the fourth quarter of 2016. A ground lease has been executed between the limited liability company that owns the MOB and a subsidiary of UHS, the terms of which include a seventy-five year lease term with two, ten-year renewal options at the lessee's option at an adjusting lease rate. We have invested \$10.7 million on the development and construction of this MOB as of June 30, 2017.

Advisory Agreement: UHS of Delaware, Inc. (the "Advisor"), a wholly-owned subsidiary of UHS, serves as Advisor to us under an Advisory Agreement (the "Advisory Agreement") dated December 24, 1986. Pursuant to the Advisory Agreement, the Advisor is obligated to present an investment program to us, to use its best efforts to obtain investments suitable for such program (although it is not obligated to present any particular investment opportunity to us), to provide administrative services to us and to conduct our day-to-day affairs. All transactions between us and UHS must be approved by the Trustees who are unaffiliated with UHS (the "Independent Trustees"). In performing its services under the Advisory Agreement, the Advisor may utilize independent professional services, including accounting, legal, tax and other services, for which the Advisor is reimbursed directly by us. The Advisory Agreement may be terminated for any reason upon sixty days written notice by us or the Advisor. The Advisory Agreement expires on December 31 of each year; however, it is renewable by us, subject to a determination by the Independent Trustees, that the Advisor's performance has been satisfactory. Our advisory fee is 0.70% of our average invested real estate assets, as derived from our consolidated balance sheet. In December of 2016, based upon a review of our advisory fee and other general and administrative expenses as compared to an industry peer group, the Advisory Agreement was renewed for 2017 pursuant to the same terms as the Advisory Agreement in place during 2016.

The average real estate assets for advisory fee calculation purposes exclude certain items from our consolidated balance sheet such as, among other things, accumulated depreciation, cash and cash equivalents, restricted cash, base and bonus rent receivables, deferred charges and other assets. The advisory fee is payable quarterly, subject to adjustment at year-end based upon our audited financial statements. In addition, the Advisor is entitled to an annual incentive fee equal to 20% of the amount by which cash available for distribution to shareholders for each year, as defined in the Advisory Agreement, exceeds 15% of our equity as shown on our consolidated balance sheet, determined in accordance with generally accepted accounting principles without reduction for return of capital dividends. The Advisory Agreement defines cash available for distribution to shareholders as net cash flow from operations less deductions for, among other things, amounts required to discharge our debt and liabilities and reserves for replacement and capital improvements to our properties and investments. No incentive fees were paid during the first six months of 2017 or 2016 since the incentive fee requirements were not achieved. Advisory fees incurred and paid (or payable) to UHS amounted to \$874,000 and \$781,000 for the three months ended June 30, 2017 and 2016, respectively, and were based upon average invested real estate assets of \$499 million and \$446 million for the three-month periods ended June 30, 2017 and 2016, respectively. Advisory fees incurred and paid (or payable) to UHS amounted to \$1.7 million and \$1.5 million for the six months ended June 30, 2017 and 2016, respectively, and were based upon average invested real estate assets of \$497 million and \$442 million for the six-month periods ended June 30, 2017 and 2016, respectively.

Officers and Employees: Our officers are all employees of a wholly-owned subsidiary of UHS and although as of June 30, 2017 we had no salaried employees, our officers do typically receive annual stock-based compensation awards in the form of restricted stock.

In special circumstances, if warranted and deemed appropriate by the Compensation Committee of the Board of Trustees, our officers may also receive one-time special compensation awards in the form of restricted stock and/or cash bonuses.

Share Ownership: As of June 30, 2017 and December 31, 2016, UHS owned 5.8% of our outstanding shares of beneficial interest.

SEC reporting requirements of UHS: UHS is subject to the reporting requirements of the SEC and is required to file annual reports containing audited financial information and quarterly reports containing unaudited financial information. Since the leases on the hospital facilities leased to wholly-owned subsidiaries of UHS comprised approximately 22% and 24% of our consolidated revenues during the three-month periods ended June 30, 2017 and 2016, respectively, and comprised approximately 23% and 25% of our consolidated revenues during the six-month periods ended June 30, 2017 and 2016, respectively, and since a subsidiary of UHS is our Advisor, you are encouraged to obtain the publicly available filings for Universal Health Services, Inc. from the SEC's website. These filings are the sole responsibility of UHS and are not incorporated by reference herein.

(3) Dividends and Equity Issuance Program

Dividends:

We declared and paid dividends of \$9.0 million, or \$.66 per share, during the second quarter of 2017 and \$8.8 million, or \$.65 per share, during the second quarter of 2016. We declared and paid dividends of \$17.9 million, or \$1.315 per share, during the six-month period ended June 30, 2017 and \$17.4 million, or \$1.295 per share, during the six-month period ended June 30, 2016.

Equity Issuance Program:

During the second quarter of 2016, we recommenced our at-the-market ("ATM") equity issuance program, pursuant to the terms of which we may sell, from time-to-time, common shares of our beneficial interest up to an aggregate sales price of approximately \$23.3 million to or through Merrill Lynch, Pierce, Fenner and Smith, Incorporated ("Merrill Lynch"), as sales agent and/or principal. The common shares were offered pursuant to the Registration Statement filed with the Securities and Exchange Commission, which became effective during the fourth quarter of 2015.

There were no shares issued pursuant to the ATM Program during the first six months of 2017. Since inception of this ATM program, we have issued 829,916 shares at an average price of \$48.77 per share, which generated approximately \$38.8 million of net proceeds (net of approximately \$1.7 million, consisting of compensation of \$1.0 million to Merrill Lynch as well as \$680,000 of other various fees and expenses).

(4) Acquisitions, Dispositions and New Construction

Subsequent Events:

Acquisitions:

During July, 2017, we acquired The Health Center at Hamburg located in Hamburg, Pennsylvania for a purchase price of approximately \$4.7 million. This medical office building is 100% leased under the terms of a triple net lease and has a remaining lease term of approximately 8.5 years at the time of purchase. This acquisition was planned and executed in accordance with the provisions of Section 1031 of the Internal Revenue Code and therefore we believe it qualifies as tax deferred like-kind exchange transactions, as discussed below, in connection with the below-mentioned divestiture of St. Mary's Professional Office Building in March, 2017.

Six Months Ended June 30, 2017:

Acquisitions:

There were no acquisitions during the first six months of 2017.

Disposition:

During March, 2017, Arlington Medical Properties, LLC, a formerly jointly-owned limited liability company in which we held an 85% noncontrolling ownership interest, sold the real estate assets of St. Mary's Professional Office Building ("St. Mary's") as part of a series of planned tax deferred like-kind exchange transactions pursuant to Section 1031 of the Internal Revenue Code. St. Mary's is a multi-tenant medical office building located in Reno, Nevada. A third party member owned the remaining 15% of Arlington Medical Properties LLC, which we acquired prior to the divestiture of St. Mary's for a purchase price of \$7.9 million.

In connection with the divestiture of St. Mary's, we are entitled to an aggregate of approximately \$57.3 million of net cash proceeds. These proceeds, which are net of closing costs and the purchase price paid for the minority member's ownership interest in the LLC, include repayment to us of a \$21.4 million member loan previously extended to Arlington Medical Properties, LLC by us when we held an 85% noncontrolling ownership interest in the LLC. As of June 30, 2017, approximately \$11.3 million of the net sale proceeds due to us are being held as restricted cash by a qualified 1031 exchange intermediary, approximately \$4.7 million of which was

utilized to finance the purchase of The Health Center of Hamburg in July, 2017, as discussed above. Our results of operations for the six-month period ended June 30, 2017 include a net gain of \$27.2 million (net of related transaction costs) recorded in connection with this transaction.

Tax Deferred Like-Kind Exchange Transactions Under Section 1031 of the Internal Revenue Code:

As part of a series of planned tax deferred like-kind exchange transactions pursuant to Section 1031 of the Internal Revenue Code in connection with the divestiture of St. Mary's, in addition to the above-mentioned July, 2017 acquisition of the Health Center at Hamburg, we completed two previously announced 2016 acquisitions, as outlined below, and may complete another potential 2017 acquisition, as discussed below.

Acquisitions Previously Completed in 2016:

2704 North Tenaya Way, located in Las Vegas, Nevada. This MOB was acquired in November, 2016 for a total purchase price of approximately \$15.3 million, including the assumption of approximately \$7.1 million of third-party debt that is non-recourse to us.

Frederick Crestwood Medical Office Building, located in Frederick, Maryland. This MOB was acquired in September, 2016 for a purchase price of approximately \$24.3 million.

Both of these 2016 acquisitions were planned and executed in accordance with the provisions of Section 1031 of the Internal Revenue Code and therefore we believe they qualify as tax deferred like-kind exchange transactions in connection with the divestiture of St. Mary's in March, 2017.

Other Potential 2017 Acquisitions:

- In addition to the above-mentioned 2016 and 2017 acquisitions, we may purchase one additional property during 2017, as part of the planned like-kind exchange transaction. We can provide no assurance that we will complete an additional acquisition during 2017, and any additional acquisition completed during 2017 would need to be finalized by mid-September, 2017, in order to qualify as a tax-deferred like-kind exchange transaction under the provisions of Section 1031 of the Internal Revenue Code in connection with the divestiture of St. Mary's.

New Construction:

During the first quarter of 2016, we committed to invest up to \$21.1 million in the development and construction of the Henderson Medical Plaza, an MOB located on the campus of the Henderson Hospital Medical Center which is owned by a UHS subsidiary and opened in late October, 2016. The MOB was completed and opened during April, 2017. We have invested \$10.7 million on the development and construction for this MOB as of June 30, 2017.

Six Months Ended June 30, 2016:

Acquisition:

During the six months ended June 30, 2016, we spent \$28.1 million to:

purchase the Chandler Corporate Center III located in Chandler, Arizona, during the second quarter of 2016 for approximately \$18.0 million. The property was 92% occupied by one tenant pursuant to the terms of a twelve year escalating triple-net lease, with a ten year fair-market value renewal option at the time of acquisition. The lease had a remaining lease term of approximately 11.3 years at the time of acquisition.

purchase the Madison Professional Office Building located in Madison, Alabama, during the first quarter of 2016 for approximately \$10.1 million (including \$150,000 deposit made in 2015). This multi-tenant property was fully

occupied with an average remaining lease term of approximately 6.2 years at the time of acquisition.

10

The aggregate purchase price for these acquisitions was allocated to the assets acquired and liabilities assumed consisting of tangible property and intangible assets and liabilities, based on the fair value at acquisition as detailed in the table below. Previous reported estimated purchase price allocations that have been finalized did not have a material impact on our consolidated financial statements. The intangible assets include the value of in-place leases at the properties at the time of acquisition as well as the above market lease values, if applicable. The value of the in-place leases will be amortized over the average remaining lease terms of approximately 6 to 11 years at the time of acquisition. The above/below market leases, which are reflected below as intangible assets/below-market intangibles will be amortized over the remaining term of the respective leases. The estimated aggregate allocation is as follows:

Land	\$4,624
Buildings and improvements	20,542
Intangible assets	3,746
Below-market intangibles	(819)
Deposit	(150)
Net cash paid	\$27,943

Dispositions:

There were no divestitures during the first six months of 2016.

(5) Summarized Financial Information of Equity Affiliates

In accordance with the Financial Accounting Standards Board's ("FASB") standards and guidance relating to accounting for investments and real estate ventures, we account for our unconsolidated investments in LLCs/LPs which we do not control using the equity method of accounting. The third-party members in these investments have equal voting rights with regards to issues such as, but not limited to: (i) divestiture of property; (ii) annual budget approval, and; (iii) financing commitments. These investments, which represent 33% to 95% non-controlling ownership interests, are recorded initially at our cost and subsequently adjusted for our net equity in the net income, cash contributions to, and distributions from, the investments. Pursuant to certain agreements, allocations of sales proceeds and profits and losses of some of the LLC investments may be allocated disproportionately as compared to ownership interests after specified preferred return rate thresholds have been satisfied.

In the Consolidated Statements of Cash Flows, distributions and equity in net income are presented net as cash flows from operating activities. Cumulative distributions received exceeding cumulative equity in earnings represent returns of investments and are classified as cash flows from investing activities in the Consolidated Statements of Cash Flows.

At June 30, 2017, we have non-controlling equity investments or commitments in four jointly-owned LLCs/LPs which own MOBs. As of June 30, 2017, we accounted for these LLCs/LPs on an unconsolidated basis pursuant to the equity method since they are not variable interest entities and we do not have a controlling voting interest. The majority of

these entities are joint-ventures between us and non-related parties that manage and hold minority ownership interests in the entities. Each entity is generally self-sustained from a cash flow perspective and generates sufficient cash flow to meet its operating cash flow requirements and service the third-party debt (if applicable) that is non-recourse to us. Although there is typically no ongoing financial support required from us to these entities since they are cash-flow sufficient, we may, from time to time, provide funding for certain purposes such as, but not limited to, significant capital expenditures, leasehold improvements and debt financing. Although we are not obligated to do so, if approved by us at our sole discretion, additional cash fundings are typically advanced as equity or member loans. These entities maintain property insurance on the properties.

During March, 2017, Arlington Medical Properties, LLC, a formerly jointly-owned limited liability company in which we held an 85% noncontrolling ownership interest, sold the real estate assets of St. Mary's Professional Office Building ("St. Mary's") as part of a series of planned tax deferred like-kind exchange transactions pursuant to Section 1031 of the Internal Revenue Code. A third party member owned the remaining 15% of Arlington Medical Properties LLC, which we acquired prior to the divestiture of St. Mary's.

The following property table represents the four LLCs in which we own a noncontrolling interest and were accounted for under the equity method as of June 30, 2017:

Name of LLC/LP	Ownership	Property Owned by LLC
Suburban Properties	33 %	St. Matthews Medical Plaza II
Brunswick Associates (a.)	74 %	Mid Coast Hospital MOB
Grayson Properties (b.)	95 %	Texoma Medical Plaza
FTX MOB Phase II (c.)	95 %	Forney Medical Plaza II

(a.) This LLC has a third-party term loan, which is non-recourse to us, of \$8.5 million outstanding as of June 30, 2017.

(b.) This building is on the campus of a UHS hospital and has tenants that include subsidiaries of UHS. This LLC has a third-party term loan, which is non-recourse to us, of \$14.3 million outstanding as of June 30, 2017.

(c.) We have committed to invest up to \$2.5 million in equity and debt financing, of which \$2.1 million has been funded as of June 30, 2017. This LLC has a third-party term loan, which is non-recourse to us, of \$5.2 million outstanding as of June 30, 2017.

Below are the condensed combined statements of income (unaudited) for the LLCs accounted for under the equity method during the three and six months ended June 30, 2017 and 2016. The six months ended June 30, 2017 include the financial results of Arlington Medical Properties, LLC, through the March 13, 2017 divestiture date. The three and six months ended June 30, 2016, include the financial results of Arlington Medical Properties, LLC for the entire three and six months ended June 30, 2016.

	Three Months Ended		Six Months Ended	
	June 30, 2017	June 30, 2016	June 30, 2017	June 30, 2016
	(amounts in thousands)		(amounts in thousands)	
Revenues	\$2,410	\$3,925	\$5,993	\$7,661
Operating expenses	939	1,343	2,189	2,696
Depreciation and amortization	421	651	1,064	1,264
Interest, net	337	635	899	1,292
Net income	\$713	\$1,296	\$1,841	\$2,409
Our share of net income (a.)	\$498	\$1,227	\$1,575	\$2,286

(a.)

Our share of net income for the three months ended June 30, 2016 includes approximately \$293,000 of interest income earned by us on an advance made to Arlington Medical Properties, LLC. This advance was repaid to us effective with the previously mentioned Arlington Medical Properties, LLC transaction during March, 2017, therefore there was no interest income earned by us on this advance during the three months ended June 30, 2017. Our share of net income for the six months ended June 30, 2017 and 2016 includes approximately \$284,000 and \$589,000, respectively, of interest income earned by us on the advance made to Arlington Medical Properties, LLC.

Edgar Filing: UNIVERSAL HEALTH REALTY INCOME TRUST - Form 10-Q

Below are the condensed combined balance sheets (unaudited) for the four above-mentioned LLCs that were accounted for under the equity method as of June 30, 2017 and the five LLCs (including Arlington Medical Properties, LLC, which was divested during the first quarter of 2017) that were accounted for under the equity method as of December 31, 2016:

	June 30, December 31,	
	2017	2016
	(amounts in thousands)	
Net property, including CIP	\$33,485	\$ 60,970
Other assets	3,735	4,598
Total assets	\$37,220	\$ 65,568
Liabilities	\$2,671	\$ 3,334
Mortgage notes payable, non-recourse to us	28,082	28,367
Advances payable to us	-	21,638
Equity	6,467	12,229
Total liabilities and equity	\$37,220	\$ 65,568
Our share of equity in and advances to LLCs reflected as:		
Investments in LLCs	\$4,718	\$ 13,955
Advances to LLCs	-	21,638
Investments in and advances to LLCs before		
amounts included in accrued expenses and other liabilities	4,718	35,593
Amounts included in accrued expenses and other liabilities	(1,487)	(1,862)
Our share of equity in and advances to LLCs, net	\$3,231	\$ 33,731

As of June 30, 2017, and December 31, 2016, aggregate principal amounts due on mortgage notes payable by unconsolidated LLCs, which are accounted for under the equity method and are non-recourse to us, are as follows (amounts in thousands):

Name of LLC/LP	Mortgage Loan		Maturity Date
	Balance (a.)		
	6/30/2017	12/31/2016	
FTX MOB Phase II	\$5,234	\$ 5,301	August, 2017 (b.)
Grayson Properties	14,313	14,438	September, 2021
Brunswick Associates	8,535	8,628	December, 2024
	\$28,082	\$ 28,367	

- (a.) All mortgage loans require monthly principal payments through maturity and include a balloon principal payment upon maturity.
- (b.) Subsequent to June 30, 2017, this loan has been extended to mature on October 1, 2017, at which time it will be refinanced pursuant to: (i) a new or renewed third-party mortgage loan; (ii) a member loan extended from us to

the LLC, or; (iii) equity contributions to the LLC by us and the third-party member. Funds required from us to the LLC for either the member loan or our share of an equity contribution would likely be borrowed under our Credit Agreement.

Pursuant to the operating and/or partnership agreements of the four LLCs/LPs in which we continue to hold non-controlling ownership interests, the third-party member and/or the Trust, at any time, potentially subject to certain conditions, have the right to make an offer (“Offering Member”) to the other member(s) (“Non-Offering Member”) in which it either agrees to: (i) sell the entire ownership interest of the Offering Member to the Non-Offering Member (“Offer to Sell”) at a price as determined by the Offering Member (“Transfer Price”), or; (ii) purchase the entire ownership interest of the Non-Offering Member (“Offer to Purchase”) at the equivalent proportionate Transfer Price. The Non-Offering Member has 60 to 90 days to either: (i) purchase the entire ownership interest of the Offering Member at the Transfer Price, or; (ii) sell its entire ownership interest to the Offering Member at the equivalent proportionate Transfer Price. The closing of the transfer must occur within 60 to 90 days of the acceptance by the Non-Offering Member.

(6) Recent Accounting Pronouncements

In August, 2016, the Financial Accounting Standards Board (“FASB”) issued ASU No. 2016-15, Classification of Certain Cash Receipts and Cash Payments, which adds or clarifies guidance of the classification of certain cash receipts and payments in the statement of cash flows with the intent to alleviate diversity in practice for classifying various types of cash flows. This ASU is

effective for annual and interim reporting periods beginning after December 15, 2017, with early adoption permitted. We are currently evaluating the impact of this ASU on our statement of cash flows.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract (i.e., lessees and lessors). The new standard requires lessees to apply a dual approach, classifying leases as either finance or operating leases based on the principle of whether or not the lease is effectively a financed purchase by the lessee. This classification will determine whether lease expense is recognized based on an effective interest method or on a straight-line basis over the term of the lease. A lessee is also required to record a right-of-use asset and a lease liability for all leases with a term of greater than 12 months regardless of their classification. Leases with a term of 12 months or less will be accounted for similar to existing guidance for operating leases today. The new standard requires lessors to account for leases using an approach that is substantially equivalent to existing guidance for sales-type leases, direct financing leases and operating leases. ASU 2016-02 supersedes the previous leases standard, Leases (Topic 840). The standard is effective on January 1, 2019, with early adoption permitted. We are currently in the process of evaluating the impact the adoption of ASU 2016-02 will have on our financial position or results of operations.

In 2014, the FASB issued ASU 2014-09, Revenue From Contracts With Customers (“ASU 2014-09”), which outlines a comprehensive model for entities to use in accounting for revenue arising from contracts with customers. ASU 2014-09 states that “an entity recognizes 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.” While ASU 2014-09 specifically references contracts with customers, it may apply to certain other transactions such as the sale of real estate or equipment. In 2015, the FASB provided for a one-year deferral of the effective date for ASU 2014-09, which is now effective for us beginning January 1, 2018. A reporting entity may apply the new standard using either a modified retrospective approach by recording a cumulative-effect adjustment to equity as of the beginning of the fiscal year of adoption or a full retrospective approach. We have not yet determined the method by which we will adopt the new standard; however, we do not expect its adoption to have a significant impact on our consolidated financial statements, as a substantial portion of our revenue consists of rental income from leasing arrangements, which is specifically excluded from ASU 2014-09.

In January, 2017, the FASB issued ASU 2017-01, “Business Combinations (Topic 805) - Clarifying the Definition of a Business” to clarify the definition of a business in order to allow for the evaluation of whether transactions should be accounted for as acquisitions or disposals of assets or businesses. ASU 2017-01 will be effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. We expect that future property acquisitions will generally qualify as asset acquisitions under the standard, which permits the capitalization of acquisition costs to the underlying assets. We adopted this new guidance effective January 1, 2017. This new guidance is not expected to have a significant impact on our financial statements.

(7) Debt and Financial Instruments

Debt:

Management routinely monitors and analyzes the Trust's capital structure in an effort to maintain the targeted balance among capital resources including the level of borrowings pursuant to our \$250 million revolving credit facility, the level of borrowings pursuant to non-recourse mortgage debt secured by the real property of our properties and our level of equity including consideration of additional equity issuances pursuant to our ATM equity issuance program. This ongoing analysis considers factors such as the current debt market and interest rate environment, the current/projected occupancy and financial performance of our properties, the current loan-to-value ratio of our properties, the Trust's current stock price, the capital resources required for anticipated acquisitions and the expected capital to be generated by anticipated divestitures. This analysis, together with consideration of the Trust's current balance of revolving credit facility borrowings, non-recourse mortgage borrowings and equity, assists management in deciding which capital resource to utilize when events such as refinancing of specific debt components occur or additional funds are required to finance the Trust's growth.

On March 27, 2015, we entered into a \$185 million revolving credit agreement ("Credit Agreement") which was amended on May 24, 2016 to, among other things, increase the borrowing capacity to \$250 million. The amended Credit Agreement, which is scheduled to mature in March, 2019, includes a \$40 million sub limit for letters of credit and a \$20 million sub limit for swingline/short-term loans. The Credit Agreement also provides a one-time option to extend the maturity date for an additional one year period, and an option to increase the total facility borrowing capacity up to an additional \$50 million, subject to lender agreement. Borrowings under the Credit Agreement are guaranteed by certain subsidiaries of the Trust. In addition, borrowings under the Credit Agreement are secured by first priority security interests in and liens on all equity interests in the Trust's wholly-owned subsidiaries. Borrowings made pursuant to the Credit Agreement will bear interest, at our option, at one, two, three, or six month LIBOR plus an applicable margin ranging from 1.50% to 2.00% or at the Base Rate plus an applicable margin ranging from 0.50% to 1.00%. The Credit Agreement defines "Base Rate" as the greatest of: (a) the administrative agent's prime rate; (b) the federal funds effective rate plus 1/2 of 1%, and; (c) one

month LIBOR plus 1%. A commitment fee of 0.20% to 0.40% (depending on our total leverage ratio) will be charged on the average unused portion of the revolving credit commitments. The margins over LIBOR, Base Rate and the commitment fee are based upon our ratio of debt to total capital. At June 30, 2017, the applicable margin over the LIBOR rate was 1.625%, the margin over the Base Rate was 0.625%, and the commitment fee was 0.25%.

At June 30, 2017, we had \$182.9 million of outstanding borrowings and \$2.1 million of letters of credit outstanding under our Credit Agreement. We had \$65.1 million of available borrowing capacity, net of the outstanding borrowings and letters of credit outstanding as of June 30, 2017. There are no compensating balance requirements.

The Credit Agreement contains customary affirmative and negative covenants, including limitations on certain indebtedness, liens, acquisitions and other investments, fundamental changes, asset dispositions and dividends and other distributions. The Credit Agreement also contains restrictive covenants regarding the Trust's ratio of total debt to total assets, the fixed charge coverage ratio, the ratio of total secured debt to total asset value, the ratio of total unsecured debt to total unencumbered asset value, and minimum tangible net worth, as well as customary events of default, the occurrence of which may trigger an acceleration of amounts outstanding under the Credit Agreement. We are in compliance with all of the covenants at June 30, 2017. We also believe that we would remain in compliance if the full amount of our commitment was borrowed.

The following table includes a summary of the required compliance ratios, giving effect to the covenants contained in the Credit Agreement (dollar amounts in thousands):

	June 30,	
	Covenant	2017
Tangible net worth	\$131,607	\$187,587
Total leverage	< 60%	44.1 %
Secured leverage	< 30%	14.1 %
Unencumbered leverage	< 60%	41.5 %
Fixed charge coverage	> 1.50x	3.6x

Edgar Filing: UNIVERSAL HEALTH REALTY INCOME TRUST - Form 10-Q

As indicated on the following table, we have thirteen mortgages, all of which are non-recourse to us, included on our condensed consolidated balance sheet as of June 30, 2017, with a combined outstanding balance of \$90.9 million, excluding net debt premium of \$336,000 and net financing fees of \$577,000 (amounts in thousands):

Facility Name	Outstanding		
	Balance (in thousands)(a)	Interest Rate	Maturity Date
Auburn Medical II floating rate mortgage loan (b.)	\$ 6,615	3.80 %	July, 2017
Summerlin Hospital Medical Office Building II fixed rate mortgage loan (c.)	10,921	5.50 %	October, 2017
Phoenix Children's East Valley Care Center fixed rate mortgage loan (c.)	6,126	5.88 %	December, 2017
Centennial Hills Medical Office Building floating rate mortgage loan (c.)	9,897	4.33 %	January, 2018
Sparks Medical Building/Vista Medical Terrace floating rate mortgage loan (c.)	4,177	4.33 %	February, 2018
Rosenberg Children's Medical Plaza fixed rate mortgage loan (c.)	8,058	4.85 %	May, 2018
Vibra Hospital-Corpus Christi fixed rate mortgage loan	2,674	6.50 %	July, 2019
700 Shadow Lane and Goldring MOB's fixed rate mortgage loan	6,154	4.54 %	June, 2022
BRB Medical Office Building fixed rate mortgage loan	6,222	4.27 %	December, 2022
Desert Valley Medical Center fixed rate mortgage loan	5,014	3.62 %	January, 2023
2704 North Tenaya Way fixed rate mortgage loan	7,073	4.95 %	November, 2023
Summerlin Hospital Medical Office Building III fixed rate mortgage loan	13,200	4.03 %	April, 2024
Tuscan Professional Building fixed rate mortgage loan	4,759	5.56 %	June, 2025
Total, excluding net debt premium and net financing fees	90,890		
Less net financing fees	(577))	
Plus net debt premium	336		
Total mortgages notes payable, non-recourse to us, net	\$ 90,649		

- (a.) All mortgage loans require monthly principal payments through maturity and either fully amortize or include a balloon principal payment upon maturity.
- (b.) During July, 2017, upon its maturity, this \$6.7 million floating rate mortgage loan was fully repaid utilizing borrowings under our Credit Agreement.
- (c.)

This loan is scheduled to mature within the next twelve months, at which time we will decide whether to refinance pursuant to a new mortgage loan or repay utilizing borrowings under our Credit Agreement. On June 1, 2017, upon its maturity, the \$4.5 million fixed rate mortgage loan on the Medical Center of Western Connecticut was fully repaid utilizing borrowings under our Credit Agreement.

On April 3, 2017, upon its maturity, the \$20.2 million fixed rate mortgage loan on the Peace Health Medical Clinic was fully repaid utilizing borrowings under our Credit Agreement.

On March 31, 2017, upon its maturity, a \$10.3 million floating rate mortgage loan on Summerlin Hospital Medical Office Building III was fully repaid. In April, 2017, we refinanced this property with a \$13.2 million fixed rate mortgage, as shown above.

The mortgages are secured by the real property of the buildings as well as property leases and rents. The mortgages have a combined fair value of approximately \$92.1 million as of June 30, 2017. Changes in market rates on our fixed rate debt impacts the fair value of debt, but it has no impact on interest incurred or cash flow.

At December 31, 2016, we had fifteen mortgages, all of which were non-recourse to us, included in our consolidated balance sheet. The combined outstanding balance of these fifteen mortgages was \$114.2 million (excluding net debt premium of \$436,000 and net financing fees of \$381,000), and had a combined fair value of approximately \$115.7 million.

Financial Instruments:

During the third quarter of 2013, we entered into an interest rate cap on a total notional amount of \$10 million whereby we paid a premium of \$136,000. During the first quarter of 2014, we entered into two additional interest rate cap agreements on a total notional amount of \$20 million whereby we paid premiums of \$134,500. In exchange for the premium payments, the counterparties agreed to pay us the difference between 1.50% and one-month LIBOR if one-month LIBOR rises above 1.50% during the term of the cap. From inception through the January, 2017 expiration, no payments were made to us by the counterparties pursuant to the terms of these caps.

During the second quarter of 2016, we entered into an interest rate cap on the total notional amount of \$30 million whereby we paid a premium of \$115,000. In exchange for the premium payment, the counterparties agreed to pay us the difference between 1.50% and one-month LIBOR if one-month LIBOR rises above 1.50% during the term of the cap. This interest rate cap became effective in January, 2017, coinciding with the expiration of the above-mentioned interest rate caps and expires in March, 2019.

During the third quarter of 2016, we entered into an additional interest rate cap agreement on a total notional amount of \$30 million whereby we paid a premium of \$55,000. In exchange for the premium payment, the counterparties agreed to pay us the difference between 1.5% and one-month LIBOR if one-month LIBOR rises above 1.5% during the term of the cap. This interest rate cap became effective in October, 2016 and expires in March, 2019.

(8) Segment Reporting

Our primary business is investing in and leasing healthcare and human service facilities through direct ownership or through joint ventures, which aggregate into a single reportable segment. We actively manage our portfolio of healthcare and human service facilities and may from time to time make decisions to sell lower performing properties not meeting our long-term investment objectives. The proceeds of sales are typically reinvested in new developments or acquisitions, which we believe will meet our planned rate of return. It is our intent that all healthcare and human service facilities will be owned or developed for investment purposes. Our revenue and net income are generated from the operation of our investment portfolio.

Our portfolio is located throughout the United States, however, we do not distinguish or group our operations on a geographical basis for purposes of allocating resources or measuring performance. We review operating and financial data for each property on an individual basis; therefore, we define an operating segment as our individual properties. Individual properties have been aggregated into one reportable segment based upon their similarities with regard to both the nature and economics of the facilities, tenants and operational processes, as well as long-term average financial performance.

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

Overview

We are a real estate investment trust ("REIT") that commenced operations in 1986. We invest in healthcare and human service related facilities currently including acute care hospitals, rehabilitation hospitals, sub-acute facilities, medical office buildings ("MOBs"), free-standing emergency departments and childcare centers. As of July 31, 2017, we have sixty-seven real estate investments located in twenty states consisting of:

- six hospital facilities consisting of three acute care, one rehabilitation and two sub-acute;
- fifty-four medical/office buildings, including four owned by unconsolidated limited liability companies ("LLCs")/limited liability partnerships ("LPs");
- three free-standing emergency departments ("FEDs"), and;
- four pre-school and childcare centers.

Forward Looking Statements and Certain Risk Factors

You should carefully review all of the information contained in this Quarterly Report, and should particularly consider any risk factors that we set forth in this Quarterly Report and in other reports or documents that we file from time to time with the Securities and Exchange Commission (the "SEC"). In this Quarterly Report, we state our beliefs of future events and of our future financial performance. In some cases, you can identify those so-called "forward-looking statements" by words such as "may," "will," "should," "could," "would," "predicts," "potential," "continue," "expects," "anticipates," "intends," "plans," "believes," "estimates," "appears," "projects" and similar expressions, as well as statements in future tense. You should be aware that those statements are only our predictions. Actual events or results may differ materially. In evaluating those statements, you should specifically consider various factors, including the risks outlined herein and in our Annual Report on Form 10-K for the year ended December 31, 2016 in Item 1A Risk Factors and in Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations—Forward Looking Statements. Those factors may cause our actual results to differ materially from any of our forward-looking statements.

Forward-looking statements should not be read as a guarantee of future performance or results, and will not necessarily be accurate indications of the times at, or by which, such performance or results will be achieved. Forward-looking information is based on information available at the time and/or our good faith belief with respect to future events, and is subject to risks and uncertainties that could cause actual performance or results to differ materially from those expressed in the statements. Such factors include, among other things, the following:

- a substantial portion of our revenues are dependent upon one operator, Universal Health Services, Inc. ("UHS"). We cannot assure you that subsidiaries of UHS will renew the leases on our three acute care hospitals (which are scheduled to expire in December, 2021) and two FEDs at existing lease rates or fair market value lease rates. In addition, if subsidiaries of UHS exercise their options to purchase the respective leased hospital facilities and FEDs upon expiration of the lease terms, our future revenues and results of operations could decrease if we were unable to earn a favorable rate of return on the sale proceeds received, as compared to the rental revenue currently earned pursuant to these leases;
- in certain of our markets, the general real estate market has been unfavorably impacted by increased competition/capacity and decreases in occupancy and rental rates which may adversely impact our operating results and the underlying value of our properties;
- a number of legislative initiatives have recently been passed into law that may result in major changes in the health care delivery system on a national or state level to the operators of our facilities, including UHS. No assurances can be given that the implementation of these new laws will not have a material adverse effect on the business, financial condition or results of operations of our operators;

-

a subsidiary of UHS is our Advisor and our officers are all employees of a wholly-owned subsidiary of UHS, which may create the potential for conflicts of interest;

lost revenues resulting from the exercise of purchase options, lease expirations and renewals, loan repayments and other restructuring;

our ability to continue to obtain capital on acceptable terms, including borrowed funds, to fund future growth of our business;

18

the outcome of known and unknown litigation, government investigations, and liabilities and other claims asserted against us, UHS or the other operators of our facilities. UHS and its subsidiaries are subject to pending legal actions, purported shareholder class actions and shareholder derivative cases, governmental investigations and regulatory actions. Since UHS comprised approximately 32% and 33% of our consolidated revenues for the six-month period ended June 30, 2017 and the year ended December 31, 2016, respectively, and since a subsidiary of UHS is our Advisor, you are encouraged to obtain and review the disclosures contained in the Legal Proceedings section of Universal Health Services, Inc.'s Forms 10-Q and 10-K, as publicly filed with the Securities and Exchange Commission. Those filings are the sole responsibility of UHS and are not incorporated by reference herein;

failure of UHS or the other operators of our hospital facilities to comply with governmental regulations related to the Medicare and Medicaid licensing and certification requirements could have a material adverse impact on our future revenues and the underlying value of the property;

the potential unfavorable impact on our business of deterioration in national, regional and local economic and business conditions, including a worsening of credit and/or capital market conditions, which may adversely affect our ability to obtain capital which may be required to fund the future growth of our business and refinance existing debt with near term maturities;

a deterioration in general economic conditions which could result in increases in the number of people unemployed and/or insured and likely increase the number of individuals without health insurance; as a result, the operators of our facilities may experience decreases in patient volumes which could result in decreased occupancy rates at our medical office buildings;

a worsening of the economic and employment conditions in the United States could materially affect the business of our operators, including UHS, which may unfavorably impact our future bonus rentals (on the UHS hospital facilities) and may potentially have a negative impact on the future lease renewal terms and the underlying value of the hospital properties;

real estate market factors, including without limitation, the supply and demand of office space and market rental rates, changes in interest rates as well as an increase in the development of medical office condominiums in certain markets;

government regulations, including changes in the reimbursement levels under the Medicare and Medicaid programs;

the issues facing the health care industry that affect the operators of our facilities, including UHS, such as: changes in, or the ability to comply with, existing laws and government regulations; unfavorable changes in the levels and terms of reimbursement by third party payors or government programs, including Medicare (including, but not limited to, the potential unfavorable impact of future reductions to Medicare reimbursements resulting from the Budget Control Act of 2011, as discussed below) and Medicaid (most states have reported significant budget deficits that have, in the past, resulted in the reduction of Medicaid funding to the operators of our facilities, including UHS); demographic changes; the ability to enter into managed care provider agreements on acceptable terms; an increase in uninsured and self-pay patients which unfavorably impacts the collectability of patient accounts; decreasing in-patient admission trends; technological and pharmaceutical improvements that may increase the cost of providing, or reduce the demand for, health care, and; the ability to attract and retain qualified medical personnel, including physicians;

in August, 2011, the Budget Control Act of 2011 (the "2011 Act") was enacted into law. The 2011 Act imposed annual spending limits for most federal agencies and programs aimed at reducing budget deficits by \$917 billion between 2012 and 2021, according to a report released by the Congressional Budget Office. The 2011 Act provides for new spending on program integrity initiatives intended to reduce fraud and abuse under the Medicare program. Among its other provisions, the law established a bipartisan Congressional committee, known as the Joint Select Committee on Deficit Reduction (the "Joint Committee"), which was tasked with making recommendations aimed at reducing future federal budget deficits by an additional \$1.5 trillion over 10 years. The Joint Committee was unable to reach an agreement by the November 23, 2011 deadline and, as a result, across-the-board cuts to discretionary, national defense and Medicare spending were implemented on March 1, 2013 resulting in Medicare payment reductions of up to 2% per fiscal year with a uniform percentage reduction across all Medicare programs. The Bipartisan Budget Act of 2015, enacted on November 2, 2015, continued the 2% reductions to Medicare reimbursement imposed under the

2011 Act. We cannot predict whether Congress will restructure the implemented Medicare payment reductions or what federal other deficit reduction initiatives may be proposed by Congress going forward. We also cannot predict the effect these enactments will have on operators (including UHS), and, thus, our business;

in March, 2010, the Health Care and Education Reconciliation Act of 2010 and the Patient Protection and Affordable Care Act (the "ACA") were enacted into law and created significant changes to health insurance coverage for U.S. citizens as well as material revisions to the federal Medicare and state Medicaid programs. The two combined primary goals of these acts are to provide for increased access to coverage for healthcare and to reduce healthcare-related expenses. Medicare,

Medicaid and other health care industry changes are scheduled to be implemented at various times during this decade. Initiatives to repeal the ACA, in whole or in part, to delay elements of implementation or funding, and to offer amendments or supplements to modify its provisions, have been persistent and may increase as a result of the 2016 election.

In May, 2017, the U.S. House of Representatives voted to adopt legislation (the “ACHA”) to replace portions of the ACA. The legislation featured provisions that would, in material part (i) eliminate the individual and large employer mandates to obtain or provide health insurance coverage, respectively; (ii) permit insurers to impose a surcharge up to 30 percent on individuals who go uninsured for more than two months and then purchase coverage; (iii) provide tax credits towards the purchase of health insurance, with a phase-out of tax credits according to income level; (iv) expand health savings accounts; (v) impose a per capita cap on federal funding of state Medicaid programs, or, if elected by a state, transition federal funding to a block grant; and (vi) permit states to seek a waiver of certain federal requirements that would allow such states to define essential health benefits differently from federal standards and that would allow certain commercial health plans to take health status, including pre-existing conditions, into account in setting premiums. In June, 2017, The Better Care Reconciliation Act (“BCRA”) was introduced in the U.S. Senate. The BCRA as originally introduced or modified was similar to the AHCA and would have generally eliminated the employer mandate, imposed a waiting period for individuals who voluntarily allow their health insurance coverage to lapse, provide varying insurance subsidies for individuals with income below 350% of the federal poverty level, begin phasing out the Enhanced FMAP in 2021, converted Medicaid funding to a block grant or per capita formula, allow health savings accounts to be used to pay for premiums for high-deductible health plans, and allow insurers to offer non-Affordable Care Act compliant plans in certain markets. However, as of the date of this report, the Senate has not passed the BCRA as originally introduced or any of the proposed amended forms of the legislation. It is uncertain when or if any other bills similar to the ACHA or BCRA or other bills amending or repealing all of portions of the ACA will be enacted. If the provisions of the AHCA or BCRA are ultimately implemented along with other proposed amendments to the ACA, there can be no assurance that any such legislation will not have a negative financial impact on the operators or tenants of our facilities which in turn could have a negative impact on our results of operations and financial condition.

• competition for our operators from other REITs;

• the operators of our facilities face competition from other health care providers, including physician owned facilities and other competing facilities, including certain facilities operated by UHS but the real property of which is not owned by us. Such competition is experienced in markets including, but not limited to, McAllen, Texas, the site of our McAllen Medical Center, a 370-bed acute care hospital, and Riverside County, California, the site of our Southwest Healthcare System-Inland Valley Campus, a 132-bed acute care hospital;

• changes in, or inadvertent violations of, tax laws and regulations and other factors than can affect REITs and our status as a REIT;

• should we be unable to comply with the strict income distribution requirements applicable to REITs, utilizing only cash generated by operating activities, we would be required to generate cash from other sources which could adversely affect our financial condition;

• our ownership interest in four LLCs/LPs in which we hold non-controlling equity interests. In addition, pursuant to the operating and/or partnership agreements of the four LLCs/LPs in which we continue to hold non-controlling ownership interests, the third-party member and the Trust, at any time, potentially subject to certain conditions, have the right to make an offer (“Offering Member”) to the other member(s) (“Non-Offering Member”) in which it either agrees to: (i) sell the entire ownership interest of the Offering Member to the Non-Offering Member (“Offer to Sell”) at a price as determined by the Offering Member (“Transfer Price”), or; (ii) purchase the entire ownership interest of the Non-Offering Member (“Offer to Purchase”) at the equivalent proportionate Transfer Price. The Non-Offering Member has 60 to 90 days to either: (i) purchase the entire ownership interest of the Offering Member at the Transfer Price, or; (ii) sell its entire ownership interest to the Offering Member at the equivalent proportionate Transfer Price. The closing of the transfer must occur within 60 to 90 days of the acceptance by the Non-Offering Member.

• fluctuations in the value of our common stock, and;

• other factors referenced herein or in our other filings with the Securities and Exchange Commission.

Given these uncertainties, risks and assumptions, you are cautioned not to place undue reliance on such forward-looking statements. Our actual results and financial condition, including the operating results of our lessees and the facilities leased to subsidiaries of UHS, could differ materially from those expressed in, or implied by, the forward-looking statements.

Forward-looking statements speak only as of the date the statements are made. We assume no obligation to publicly update any forward-looking statements to reflect actual results, changes in assumptions or changes in other factors affecting forward-looking information, except as may be required by law. All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by this cautionary statement.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the amounts reported in our consolidated financial statements and accompanying notes.

We consider our critical accounting policies to be those that require us to make significant judgments and estimates when we prepare our financial statements, including the following:

Revenue Recognition: Our revenues consist primarily of rentals received from tenants, which are comprised of minimum rent (base rentals), bonus rentals and reimbursements from tenants for their pro-rata share of expenses such as common area maintenance costs, real estate taxes and utilities.

The minimum rent for our six hospital facilities, which is paid monthly, is fixed over the term of the respective leases which are scheduled to expire in 2019 (2 hospitals) or 2021 (4 hospitals). In addition, for the three hospital facilities leased to subsidiaries of UHS, bonus rents are paid on a quarterly basis, based upon a computation that compares the hospitals' current quarter net revenues to the corresponding quarter in the base year. Rental income recorded by our other properties, including our consolidated and unconsolidated MOBs, relating to leases in excess of one year in length, is recognized using the straight-line method under which contractual rents are recognized evenly over the lease term regardless of when payments are due. The amount of rental revenue resulting from straight-line rent adjustments is dependent on many factors including the nature and amount of any rental concessions granted to new tenants, stipulated rent increases under existing leases, as well as the acquisitions and sales of properties that have existing in-place leases with terms in excess of one year. As a result, the straight-line adjustments to rental revenue may vary from period-to-period. Tenant reimbursements for operating expenses are accrued as revenue in the same period the related expenses are incurred.

Real Estate Investments: Land, buildings and capital improvements are recorded at cost and stated at cost less accumulated depreciation. Expenditures for maintenance and repairs are charged to operations as incurred. Renovations or replacements, which improve or extend the life of an asset, are capitalized and depreciated over their estimated useful lives.

Purchase Accounting for Acquisition of Investments in Real Estate: Purchase accounting is applied to the assets and liabilities related to all real estate investments acquired from third parties. In accordance with current accounting guidance, the fair value of the real estate acquired is allocated to the acquired tangible assets, consisting primarily of land, building and tenant improvements, and identified intangible assets and liabilities, consisting of the value of above-market and below-market leases, and acquired ground leases, based in each case on their fair values. Loan premiums, in the case of above market rate loans, or loan discounts, in the case of below market loans, are recorded based on the fair value of any loans assumed in connection with acquiring the real estate.

The fair values of the tangible assets of an acquired property are determined based on comparable land sales for land and replacement costs adjusted for physical and market obsolescence for the improvements. The fair values of the tangible assets of an acquired property are also determined by valuing the property as if it were vacant, and the

“as-if-vacant” value is then allocated to land, building and tenant improvements based on management’s determination of the relative fair values of these assets. Management determines the as-if-vacant fair value of a property based on assumptions that a market participant would use, which is similar to methods used by independent appraisers. In addition, there is intangible value related to having tenants leasing space in the purchased property, which is referred to as in-place lease value. Such value results primarily from the buyer of a leased property avoiding the costs associated with leasing the property and also avoiding rent losses and unreimbursed operating expenses during the hypothetical lease-up period. Factors considered by management in performing these analyses include an estimate of carrying costs during the expected lease-up periods considering current market conditions and costs to execute similar leases. In estimating carrying costs, management includes real estate taxes, insurance and other operating expenses and estimates of lost rental revenue during the expected lease-up periods based on current market demand. Management also estimates costs to execute similar leases including leasing commissions, tenant improvements, legal and other related costs. The value of in-place leases are amortized to expense over the remaining initial terms of the respective leases.

In allocating the fair value of the identified intangible assets and liabilities of an acquired property, above-market and below-market in-place lease values are recorded based on the present value (using an interest rate which reflects the risks associated with the leases

acquired) of the difference between (i) the contractual amounts to be paid pursuant to the in-place leases and (ii) estimated fair market lease rates from the perspective of a market participant for the corresponding in-place leases, measured, for above-market leases, over a period equal to the remaining non-cancelable term of the lease and, for below-market leases, over a period equal to the initial term plus any below market fixed rate renewal periods. The capitalized above-market lease values are amortized as a reduction of rental income over the remaining non-cancelable terms of the respective leases. The capitalized below-market lease values, also referred to as acquired lease obligations, are amortized as an increase to rental income over the initial terms of the respective leases.

Asset Impairment: We review each of our properties for indicators that its carrying amount may not be recoverable. Examples of such indicators may include a significant decrease in the market price of the property, a change in the expected holding period for the property, a significant adverse change in how the property is being used or expected to be used based on the underwriting at the time of acquisition, an accumulation of costs significantly in excess of the amount originally expected for the acquisition or development of the property, or a history of operating or cash flow losses of the property. When such impairment indicators exist, we review an estimate of the future undiscounted net cash flows (excluding interest charges) expected to result from the real estate investment's use and eventual disposition and compare that estimate to the carrying value of the property. We consider factors such as future operating income, trends and prospects, as well as the effects of leasing demand, competition and other factors. If our future undiscounted net cash flow evaluation indicates that we are unable to recover the carrying value of a real estate investment, an impairment loss is recorded to the extent that the carrying value exceeds the estimated fair value of the property. These losses have a direct impact on our net income because recording an impairment loss results in an immediate negative adjustment to net income. The evaluation of anticipated cash flows is highly subjective and is based in part on assumptions regarding future occupancy, rental rates and capital requirements that could differ materially from actual results in future periods. Since cash flows on properties considered to be long-lived assets to be held and used are considered on an undiscounted basis to determine whether the carrying value of a property is recoverable, our strategy of holding properties over the long-term directly decreases the likelihood of their carrying values not being recoverable and therefore requiring the recording of an impairment loss. If our strategy changes or market conditions otherwise dictate an earlier sale date, an impairment loss may be recognized and such loss could be material. If we determine that the asset fails the recoverability test, the affected assets must be reduced to their fair value.

We generally estimate the fair value of rental properties utilizing a discounted cash flow analysis that includes projections of future revenues, expenses and capital improvement costs that a market participant would use based on the highest and best use of the asset, which is similar to the income approach that is commonly utilized by appraisers. In certain cases, we may supplement this analysis by obtaining outside broker opinions of value or third party appraisals.

In considering whether to classify a property as held for sale, we consider factors such as whether management has committed to a plan to sell the property, the property is available for immediate sale in its present condition for a price that is reasonable in relation to its current value, the sale of the property is probable, and actions required for management to complete the plan indicate that it is unlikely that any significant changes will be made to the plan. If all the criteria are met, we classify the property as held for sale. Upon being classified as held for sale, depreciation and amortization related to the property ceases and it is recorded at the lower of its carrying amount or fair value less cost to sell. The assets and related liabilities of the property are classified separately on the consolidated balance sheets for the most recent reporting period. Only those assets held for sale that constitute a strategic shift or that will have a major effect on our operations are classified as discontinued operations.

An other than temporary impairment of an investment in an LLC is recognized when the carrying value of the investment is not considered recoverable based on evaluation of the severity and duration of the decline in value, including projected declines in cash flow. To the extent impairment has occurred, the excess carrying value of the asset over its estimated fair value is charged to income.

Federal Income Taxes: No provision has been made for federal income tax purposes since we qualify as a REIT under Sections 856 to 860 of the Internal Revenue Code of 1986, and intend to continue to remain so qualified. As such, we are exempt from federal income taxes and we are required to distribute at least 90% of our real estate investment taxable income to our shareholders.

We are subject to a federal excise tax computed on a calendar year basis. The excise tax equals 4% of the amount by which 85% of our ordinary income plus 95% of any capital gain income for the calendar year exceeds cash distributions during the calendar year, as defined. No provision for excise tax has been reflected in the financial statements as no tax was due.

Earnings and profits, which determine the taxability of dividends to shareholders, will differ from net income reported for financial reporting purposes due to the differences for federal tax purposes in the cost basis of assets and in the estimated useful lives used to compute depreciation and the recording of provision for investment losses.

Results of Operations

During the three-month period ended June 30, 2017, net income decreased to \$4.0 million, as compared to \$4.5 million during the second quarter of 2016. The \$490,000 decrease was primarily attributable to:

- \$225,000 decrease due to increased interest expense resulting primarily from increased net borrowings under our revolving credit facility utilized to finance various 2016 acquisitions as well as an increase in our average cost of funds, partially offset by the repayment of borrowings under our revolving credit facility utilizing a portion of the proceeds generated from the divestiture of St. Mary's in March, 2017;

- \$729,000 decrease in equity in income of LLCs, due primarily to the March, 2017 divestiture of St. Mary's, and;

- \$464,000 of other combined net increases due to the increased net income generated at various properties, including the properties acquired during 2016.

During the six-month period ended June 30, 2017, net income increased to \$35.6 million, as compared to \$9.0 million during the first six months of 2016. The \$26.6 million increase was primarily attributable to:

- \$27.2 million increase due to the gain on fair value recognition resulting from the purchase of minority interest in a majority-owned LLC and subsequent divestiture of St. Mary's recorded during the first quarter of 2017 (in connection with the March, 2017 Arlington Medical Properties, LLC transaction, as discussed herein);

- \$728,000 decrease due to increased interest expense resulting primarily from increased net borrowings under our revolving credit facility utilized to finance various 2016 acquisitions as well as an increase in our average cost of funds, partially offset by the repayment of borrowings under our revolving credit facility utilizing a portion of the proceeds generated from the divestiture of St. Mary's in March, 2017;

- \$176,000 of other combined net increases due to the increased net income generated at various properties, including the properties acquired during 2016.

Included in our other operating expenses are expenses related to the consolidated medical office buildings, which totaled \$4.4 million and \$4.1 million for the three-month periods ended June 30, 2017 and 2016, respectively, and \$8.6 million and \$8.0 million for the six-month periods ended June 30, 2017 and 2016, respectively. The increase in operating expenses during the three and six month periods ended June 30, 2017 as compared to the prior year periods is primarily due to new acquisitions as discussed above. A large portion of the expenses associated with our consolidated medical office buildings is passed on directly to the tenants either directly as tenant reimbursements of common area maintenance expenses or included in base rental amounts. Tenant reimbursements for operating expenses are accrued as revenue in the same period the related expenses are incurred and are included as tenant reimbursement revenue in our condensed consolidated statements of income.

Funds from operations ("FFO") is a widely recognized measure of performance for REITs. We believe that FFO and FFO per diluted share, which are non-GAAP financial measures ("GAAP" is Generally Accepted Accounting Principles in the United States of America), are helpful to our investors as measures of our operating performance. We compute FFO, as reflected below, in accordance with standards established by the National Association of Real Estate Investment Trusts ("NAREIT"), which may not be comparable to FFO reported by other REITs that do not compute FFO in accordance with the NAREIT definition, or that interpret the NAREIT definition differently than we interpret the definition. FFO do not represent cash generated from operating activities in accordance with GAAP and should

not be considered to be an alternative to net income determined in accordance with GAAP. In addition, FFO should not be used as: (i) an indication of our financial performance determined in accordance with GAAP; (ii) an alternative to cash flow from operating activities determined in accordance with GAAP; (iii) a measure of our liquidity, or; (iv) an indicator of funds available for our cash needs, including our ability to make cash distributions to shareholders.

Edgar Filing: UNIVERSAL HEALTH REALTY INCOME TRUST - Form 10-Q

Below is a reconciliation of our reported net income to FFO for the three and six-month periods ended June 30, 2017 and 2016 (in thousands):

	Three Months Ended		Six Months Ended	
	June 30, 2017	2016	June 30, 2017	2016
Net income	\$4,033	\$4,523	\$35,595	\$8,951
Depreciation and amortization expense on consolidated investments	6,167	5,435	12,189	10,768
Depreciation and amortization expense on unconsolidated affiliates	253	465	679	915
Gain on fair value recognition resulting from purchase of minority interest in majority-owned LLC, net	-	-	(27,196)	-
Funds From Operations	\$10,453	\$10,423	\$21,267	\$20,634
Weighted average number of shares and equivalents outstanding - Diluted	13,583	13,404	13,581	13,359
Funds From Operations per diluted share	\$0.77	\$0.78	\$1.57	\$1.54

Our FFO was \$10.5 million, or \$.77 per diluted share, during the three-month period ended June 30, 2017, as compared to \$10.4 million, or \$.78 per diluted share, during the comparable quarter of 2016. Our FFO increased to \$21.3 million, or \$1.57 per diluted share, during the first six-month period ended June 30, 2017, as compared to \$20.6 million, or \$1.54 per diluted share, during the comparable period of 2016. The \$633,000 increase in FFO during the first six months of 2017, as compared to the first six months of 2016, was primarily attributable to a net increase in the income (before depreciation and amortization expense) generated our properties, including the properties acquired at various times during 2016.

Liquidity and Capital Resources

Net cash provided by operating activities

Net cash provided by operating activities was \$20.3 million during the six-month period ended June 30, 2017 as compared to \$20.0 million during the comparable period of 2016. The \$334,000 net increase was attributable to:

- a favorable net change of \$932,000 due to an increase in net income plus/minus the adjustments to reconcile net income to net cash provided by operating activities (depreciation and amortization, amortization of debt premium, stock-based compensation and gain on fair value recognition resulting from purchase of minority interest in majority-owned LLC), as discussed above in Results of Operations;
- an unfavorable change of \$514,000 in tenant reserves, deposits and prepaid rents resulting primarily from the timing of prepaid rents;
- an unfavorable change of \$283,000 in rent receivable, and;
- other combined net favorable changes of \$199,000.

Net cash provided by/(used in) investing activities

Net cash provided by investing activities was \$39.8 million during the six months ended June 30, 2017 as compared to \$37.0 million of net cash used in investing activities during the six months ended June 30, 2016.

During the six-month period ended June 30, 2017, we funded: (i) \$532,000 in equity investments in various unconsolidated LLCs; (ii) \$6.5 million in capital additions to real estate investments including construction costs for the Henderson Medical Plaza MOB (this MOB opened in April, 2017), as well as tenant improvements at various MOBs; (iii) \$7.9 million paid to acquire the minority interest in a majority-owned LLC (Arlington Medical Properties, LLC), and; (iv) \$150,000 deposit on real estate assets in connection with the July, 2017 acquisition of the Health Center of Hamburg. In addition, during the six-month period ended June 30, 2017, we received: (i) \$54.0 million of net cash proceeds generated in connection with the divestiture of St. Mary's Professional Office Building, as discussed herein (net of closing costs and \$11.3 million of restricted cash held by a qualified 1031 exchange intermediary as of June 30, 2017); (ii) \$216,000 of installment repayments of member loan advanced to an LLC, and; (iii) \$734,000 of cash distributions in excess of income received from our unconsolidated LLCs. The \$54.0 million of net cash proceeds generated in connection with the divestiture of St. Mary's Professional Office Building includes repayment of a \$21.4 million previously extended member loan that was provided by us to Arlington Medical Properties, LLC when we held an 85% noncontrolling ownership interest in the LLC.

During the six-month period ended June 30, 2016, we funded: (i) \$5.5 million in equity investments in various unconsolidated LLCs; (ii) \$4.1 million in capital additions to real estate investments primarily related to tenant improvements at various MOBs as well as construction costs for Henderson Medical Plaza, and; (iii) \$27.9 million to acquire the real estate assets of two properties, as discussed above. In addition, during the six-month period ended June 30, 2016, we received: (i) \$421,000 of installment repayments of an outstanding member loan that was provided by us to Arlington Medical Properties, LLC, and; (ii) \$104,000 of cash distributions in excess of income received from our unconsolidated LLCs.

Net cash (used in)/provided by financing activities

Net cash used in financing activities was \$60.0 million during the six months ended June 30, 2017, as compared to \$17.8 million of net cash provided by financing activities during the six months ended June 30, 2016.

During the six-month period ended June 30, 2017, we paid: (i) \$18.7 million of net borrowings on our revolving credit facility; (ii) \$36.5 million on mortgage notes payable that are non-recourse to us, including the repayment of an aggregate of \$35.0 million related to previously outstanding mortgage notes payable on three properties that were funded utilizing borrowings under our revolving credit facility; (iii) \$284,000 of financing costs related to the revolving credit facility and a new mortgage note payable that is non-recourse to us, and; (iv) \$17.9 million of dividends. Additionally, during the six months ended June 30, 2017, we received: (i) \$13.2 million of proceeds from a new mortgage note payable that is non-recourse to us (these proceeds were utilized to repay outstanding borrowings under our revolving credit facility), and; (ii) \$122,000 of net cash from the issuance of shares of beneficial interest.

During the six-month period ended June 30, 2016, we: (i) received \$24.9 million of additional net borrowings on our revolving credit facility, and; (ii) received \$12.3 million of net cash from the issuance of shares of beneficial interest, including cash proceeds generated pursuant to the ATM program. Additionally, during the six months ended June 30, 2016, we paid: (i) \$1.6 million on mortgage notes payable that are non-recourse to us; (ii) \$307,000 of financing costs paid related to the amendment of our revolving credit facility, and; (iii) \$17.4 million of dividends.

Additional cash flow and dividends paid information for the six-month periods ended June 30, 2017 and 2016:

As indicated on our condensed consolidated statement of cash flows, we generated net cash provided by operating activities of \$20.3 million and \$20.0 million during the six-month periods ended June 30, 2017 and 2016, respectively. As also indicated on our statement of cash flows, noncash expenses including depreciation and amortization expense, amortization of debt premium, stock-based compensation expense and the gain recorded during the first six months of 2017 are the primary differences between our net income and net cash provided by operating activities during each period. In addition, as reflected in the cash flows from investing activities section, we received \$734,000 and \$104,000 during the six-month periods ended June 30, 2017 and 2016, respectively, of cash distributions in excess of income from various unconsolidated LLCs which represents our share of the net cash flow distributions from these entities. The cash distributions in excess of income represent operating cash flows net of capital expenditures and debt repayments made by the LLCs.

We therefore generated \$21.1 million and \$20.1 million of net cash during the six months ended June 30, 2017 and 2016, respectively, related to the operating activities of our properties recorded on a consolidated and an unconsolidated basis. We paid dividends of \$17.9 million and \$17.4 million during the six months ended June 30, 2017 and 2016, respectively. During the first six months of 2017, the \$21.1 million of net cash generated related to the operating activities of our properties was approximately \$3.2 million greater than the \$17.9 million of dividends paid during the first six months of 2017. During the first six months of 2016, the \$20.1 million of net cash generated related to the operating activities of our properties was \$2.7 million greater than the \$17.4 million of dividends paid during the first six months of 2016.

As indicated in the cash flows from investing activities and cash flows from financing activities sections of the statements of cash flows, there were various other sources and uses of cash during the six months ended June 30, 2017 and 2016. From time to time, various other sources and uses of cash may include items such as investments and advances made to/from LLCs, additions to real estate investments, acquisitions/divestiture of properties, net borrowings/repayments of debt, and proceeds generated from the issuance of equity. Therefore, in any given period, the funding source for our dividend payments is not wholly dependent on the operating cash flow generated by our properties. Rather, our dividends as well as our capital reinvestments into our existing properties, acquisitions of real property and other investments are funded based upon the aggregate net cash inflows or outflows from all sources and uses of cash from the properties we own either in whole or through LLCs, as outlined above.

In determining and monitoring our dividend level on a quarterly basis, our management and Board of Trustees consider many factors in determining the amount of dividends to be paid each period. These considerations primarily include: (i) the minimum required amount of dividends to be paid in order to maintain our REIT status; (ii) the current and projected operating results of our properties,

including those owned in LLCs, and; (iii) our future capital commitments and debt repayments, including those of our LLCs. Based upon the information discussed above, as well as consideration of projections and forecasts of our future operating cash flows, management and the Board of Trustees have determined that our operating cash flows have been sufficient to fund our dividend payments. Future dividend levels will be determined based upon the factors outlined above with consideration given to our projected future results of operations.

We expect to finance all capital expenditures and acquisitions and pay dividends utilizing internally generated and additional funds. Additional funds may be obtained through: (i) borrowings under our existing \$250 million revolving credit facility agreement (which has \$65.1 million of available borrowing capacity, net of outstanding borrowings and letters of credit, as of June 30, 2017); (ii) the issuance of equity pursuant to our at-the-market equity issuance program; (iii) borrowings under or refinancing of existing third-party debt pursuant to mortgage loan agreements entered into by our consolidated and unconsolidated LLCs/LPs, and/or; (iv) the issuance of other long-term debt.

We believe that our operating cash flows, cash and cash equivalents, available borrowing capacity under our revolving credit facility and access to the capital markets provide us with sufficient capital resources to fund our operating, investing and financing requirements for the next twelve months, including providing sufficient capital to allow us to make distributions necessary to enable us to continue to qualify as a REIT under Sections 856 to 860 of the Internal Revenue Code of 1986. In the event we need to access the capital markets or other sources of financing, there can be no assurance that we will be able to obtain financing on acceptable terms or within an acceptable time. Our inability to obtain financing on terms acceptable to us could have a material unfavorable impact on our results of operations, financial condition and liquidity.

Credit facilities and mortgage debt

Management routinely monitors and analyzes the Trust's capital structure in an effort to maintain the targeted balance among capital resources including the level of borrowings pursuant to our \$250 million revolving credit facility, the level of borrowings pursuant to non-recourse mortgage debt secured by the real property of our properties and our level of equity including consideration of additional equity issuances pursuant to our ATM equity issuance program. This ongoing analysis considers factors such as the current debt market and interest rate environment, the current/projected occupancy and financial performance of our properties, the current loan-to-value ratio of our properties, the Trust's current stock price, the capital resources required for anticipated acquisitions and the expected capital to be generated by anticipated divestitures. This analysis, together with consideration of the Trust's current balance of revolving credit facility borrowings, non-recourse mortgage borrowings and equity, assists management in deciding which capital resource to utilize when events such as refinancing of specific debt components occur or additional funds are required to finance the Trust's growth.

On March 27, 2015, we entered into a \$185 million revolving credit agreement ("Credit Agreement") which was amended on May 24, 2016 to, among other things, increase the borrowing capacity to \$250 million. The amended Credit Agreement, which is scheduled to mature in March, 2019, includes a \$40 million sub limit for letters of credit and a \$20 million sub limit for swingline/short-term loans. The Credit Agreement also provides a one-time option to extend the maturity date for an additional one year period, and an option to increase the total facility borrowing capacity up to an additional \$50 million, subject to lender agreement. Borrowings under the Credit Agreement are guaranteed by certain subsidiaries of the Trust. In addition, borrowings under the Credit Agreement are secured by first priority security interests in and liens on all equity interests in the Trust's wholly-owned subsidiaries. Borrowings made pursuant to the Credit Agreement will bear interest, at our option, at one, two, three, or six month LIBOR plus

an applicable margin ranging from 1.50% to 2.00% or at the Base Rate plus an applicable margin ranging from 0.50% to 1.00%. The Credit Agreement defines “Base Rate” as the greatest of: (a) the administrative agent’s prime rate; (b) the federal funds effective rate plus 1/2 of 1%, and; (c) one month LIBOR plus 1%. A commitment fee of 0.20% to 0.40% (depending on our total leverage ratio) will be charged on the average unused portion of the revolving credit commitments. The margins over LIBOR, Base Rate and the commitment fee are based upon our ratio of debt to total capital. At June 30, 2017, the applicable margin over the LIBOR rate was 1.625%, the margin over the Base Rate was 0.625%, and the commitment fee was 0.25%.

At June 30, 2017, we had \$182.9 million of outstanding borrowings and \$2.1 million of letters of credit outstanding under our Credit Agreement. We had \$65.1 million of available borrowing capacity, net of the outstanding borrowings and letters of credit outstanding as of June 30, 2017. There are no compensating balance requirements.

The Credit Agreement contains customary affirmative and negative covenants, including limitations on certain indebtedness, liens, acquisitions and other investments, fundamental changes, asset dispositions and dividends and other distributions. The Credit Agreement also contains restrictive covenants regarding the Trust’s ratio of total debt to total assets, the fixed charge coverage ratio, the ratio of total secured debt to total asset value, the ratio of total unsecured debt to total unencumbered asset value, and minimum tangible net worth, as well as customary events of default, the occurrence of which may trigger an acceleration of amounts outstanding

under the Credit Agreement. We are in compliance with all of the covenants at June 30, 2017. We also believe that we would remain in compliance if the full amount of our commitment was borrowed.

The following table includes a summary of the required compliance ratios, giving effect to the covenants contained in the Credit Agreement (dollar amounts in thousands):

	June 30,		
	Covenant	2017	
Tangible net worth	\$131,607	\$187,587	
Total leverage	< 60%	44.1	%
Secured leverage	< 30%	14.1	%
Unencumbered leverage	< 60%	41.5	%
Fixed charge coverage	> 1.50x	3.6x	

As indicated on the following table, we have thirteen mortgages, all of which are non-recourse to us, included on our condensed consolidated balance sheet as of June 30, 2017, with a combined outstanding balance of \$90.9 million, excluding net debt premium of \$336,000 and net financing fees of \$577,000 (amounts in thousands):

Facility Name	Outstanding		
	Balance (in thousands)(a)	Interest Rate	Maturity Date
Auburn Medical II floating rate mortgage loan (b.)	\$ 6,615	3.80 %	July, 2017
Summerlin Hospital Medical Office Building II fixed rate mortgage loan (c.)	10,921	5.50 %	October, 2017
Phoenix Children's East Valley Care Center fixed rate mortgage loan (c.)	6,126	5.88 %	December, 2017
Centennial Hills Medical Office Building floating rate mortgage loan (c.)	9,897	4.33 %	January, 2018
Sparks Medical Building/Vista Medical Terrace floating rate mortgage loan (c.)	4,177	4.33 %	February, 2018
Rosenberg Children's Medical Plaza fixed rate mortgage loan (c.)	8,058	4.85 %	May, 2018
Vibra Hospital-Corpus Christi fixed rate mortgage loan	2,674	6.50 %	July, 2019
700 Shadow Lane and Goldring MOB's fixed rate mortgage loan	6,154	4.54 %	June, 2022

Edgar Filing: UNIVERSAL HEALTH REALTY INCOME TRUST - Form 10-Q

BRB Medical Office Building fixed rate mortgage loan	6,222	4.27	% December, 2022
Desert Valley Medical Center fixed rate mortgage loan	5,014	3.62	% January, 2023
2704 North Tenaya Way fixed rate mortgage loan	7,073	4.95	% November, 2023
Summerlin Hospital Medical Office Building III fixed			
rate mortgage loan	13,200	4.03	% April, 2024
Tuscan Professional Building fixed rate mortgage loan	4,759	5.56	% June, 2025
Total, excluding net debt premium and net financing fees	90,890		
Less net financing fees	(577)	
Plus net debt premium	336		
Total mortgages notes payable, non-recourse to us, net	\$ 90,649		

- (a.) All mortgage loans require monthly principal payments through maturity and either fully amortize or include a balloon principal payment upon maturity.
- (b.) During July, 2017, upon its maturity, this \$6.7 million floating rate mortgage loan was fully repaid utilizing borrowings under our Credit Agreement.
- (c.) This loan is scheduled to mature within the next twelve months, at which time we will decide whether to refinance pursuant to a new mortgage loan or repay utilizing borrowings under our Credit Agreement.

On June 1, 2017, upon its maturity, the \$4.5 million fixed rate mortgage loan on the Medical Center of Western Connecticut was fully repaid utilizing borrowings under our Credit Agreement.

On April 3, 2017, upon its maturity, the \$20.2 million fixed rate mortgage loan on the Peace Health Medical Clinic was fully repaid utilizing borrowings under our Credit Agreement.

On March 31, 2017, upon its maturity, a \$10.3 million floating rate mortgage loan on Summerlin Hospital Medical Office Building III was fully repaid. In April, 2017, we refinanced the property with a \$13.2 million fixed rate mortgage, as shown above.

Off Balance Sheet Arrangements

As of June 30, 2017, we are party to certain off balance sheet arrangements consisting of standby letters of credit and equity and debt financing commitments. Our outstanding letters of credit at June 30, 2017 totaled \$2.1 million consisting of: (i) \$1.7 million related to Centennial Hills Medical Properties, and; (ii) \$375,000 related to FTX MOB Phase II, LP.

Acquisition and Divestiture Activity

Please see Note 4 to the condensed consolidated financial statements for completed transactions.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Reference is made to Item 7A in our Annual Report on Form 10-K for the year ended December 31, 2016. There have been no material changes in the quantitative and qualitative disclosures during the first six months of 2017.

Item 4. Controls and Procedures

As of June 30, 2017, under the supervision and with the participation of our management, including the Trust's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), we performed an evaluation of the effectiveness of our disclosure controls and procedures as defined in Rule 13a-15(e) or Rule 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "1934 Act").

Based on this evaluation, the CEO and CFO have concluded that our disclosure controls and procedures are effective to ensure that material information is recorded, processed, summarized and reported by management on a timely basis in order to comply with our disclosure obligations under the 1934 Act and the SEC rules thereunder.

There have been no changes in our internal control over financial reporting or in other factors during the first six months of 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

UNIVERSAL HEALTH REALTY INCOME TRUST

Item 1A. Risk Factors

Our Annual Report on Form 10-K for the year ended December 31, 2016 includes a listing of risk factors to be considered by investors in our securities. There have been no material changes in our risk factors from those set forth in our Annual Report on Form 10-K for the year ended December 31, 2016.

Item 6. Exhibits

(a.) Exhibits:

31.1 Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)/15(d)-14(a) under the Securities Exchange Act of 1934, as amended.

31.2 Certification of the Chief Financial Officer pursuant to Rule 13a-14(a)/15(d)-14(a) under the Securities Exchange Act of 1934, as amended.

32.1 Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101.INS XBRL Instance Document

101.SCH XBRL Taxonomy Extension Schema Document

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document

101.DEF XBRL Taxonomy Extension Definition Linkbase Document

101.LAB XBRL Taxonomy Extension Label Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

Signatures

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.

Date: August 8, 2017 UNIVERSAL HEALTH REALTY INCOME TRUST

(Registrant)

/s/ Alan B. Miller
Alan B. Miller,
Chairman of the Board,

President and Chief Executive Officer

(Principal Executive Officer)

/s/ Charles F. Boyle
Charles F. Boyle, Vice President and Chief Financial Officer

(Principal Financial Officer)

EXHIBIT INDEX

Exhibit

No.	Description
31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)/15(d)-14(a) under the Securities Exchange Act of 1934, as amended.
31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a)/15(d)-14(a) under the Securities Exchange Act of 1934, as amended.
32.1	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document