

HEALTHCARE REALTY TRUST INC

Form 10-K

February 23, 2009

Table of Contents

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

Form 10-K

(Mark One)

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended: December 31, 2008
- 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: 1-11852

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

Maryland
(State or other jurisdiction of incorporation or organization)

62-1507028
(I.R.S. Employer Identification No.)

**3310 West End Avenue
Suite 700
Nashville, Tennessee 37203**
(Address of principal executive offices)
(615) 269-8175
(Registrant's telephone number, including area code)

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, \$.01 par value per share	New York Stock Exchange
Securities Registered Pursuant to Section 12(g) of the Act:	
None	
(Title of Class)	

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

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

Indicate by check mark whether the Registrant (1) has filed all reports 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

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

The aggregate market value of the shares of Common Stock (based upon the closing price of these shares on the New York Stock Exchange, Inc. on June 30, 2008) of the Registrant held by non-affiliates on June 30, 2008 was approximately \$1,166,970,059.

As of January 31, 2009, 59,295,426 shares of the Registrant's Common Stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's definitive Proxy Statement relating to the Annual Meeting of Stockholders to be held on May 19, 2009 are incorporated into Part III of this Report.

TABLE OF CONTENTS

	Page	
<u>Item 1.</u>	<u>Business</u>	3
<u>Item 1A.</u>	<u>Risk Factors</u>	23
<u>Item 1B.</u>	<u>Unresolved Staff Comments</u>	26
<u>Item 2.</u>	<u>Properties</u>	26
<u>Item 3.</u>	<u>Legal Proceedings</u>	26
<u>Item 4.</u>	<u>Submission of Matters to a Vote of Security Holders</u>	27
<u>Item 5.</u>	<u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	28
<u>Item 6.</u>	<u>Selected Financial Data</u>	29
<u>Item 7.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	30
<u>Item 7A.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	52
<u>Item 8.</u>	<u>Financial Statements and Supplementary Data</u>	53
<u>Item 9.</u>	<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	98
<u>Item 9A.</u>	<u>Controls and Procedures</u>	98
<u>Item 9B.</u>	<u>Other Information</u>	100
<u>Item 10.</u>	<u>Directors, Executive Officers and Corporate Governance</u>	100
<u>Item 11.</u>	<u>Executive Compensation</u>	101
<u>Item 12.</u>	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	101
<u>Item 13.</u>	<u>Certain Relationships and Related Transactions, and Director Independence</u>	101
<u>Item 14.</u>	<u>Principal Accountant Fees and Services</u>	101
<u>Item 15.</u>	<u>Exhibits and Financial Statement Schedules</u>	102
<u>SIGNATURES</u>		105
<u>EX-21</u>		
<u>EX-23</u>		
<u>EX-31.1</u>		
<u>EX-31.2</u>		
<u>EX-32</u>		

Table of Contents**PART I****ITEM 1. BUSINESS****Overview**

Healthcare Realty Trust Incorporated (Healthcare Realty or the Company) was incorporated in Maryland in 1993 and is a self-managed and self-administered real estate investment trust (REIT) that owns, acquires, manages, finances and develops income-producing real estate properties associated primarily with the delivery of outpatient healthcare services throughout the United States.

The Company operates so as to qualify as a REIT for federal income tax purposes. As a REIT, the Company is not subject to corporate federal income tax with respect to net income distributed to its stockholders. See Federal Income Tax Information in Item 1 of this report.

As of December 31, 2008, the Company had invested in real estate properties, excluding assets held for sale and including investments in two unconsolidated joint ventures, as shown in the table below:

<i>(Dollars and square feet in thousands)</i>	Number of	Investments	Investment	Square Feet
Owned properties:				
<i>Long-term net master leases</i>				
Medical office	13	\$ 116,400	5.6%	718
Physician clinics	20	136,143	6.7%	786
Ambulatory care/surgery	7	40,166	1.9%	160
Specialty outpatient	7	29,856	1.4%	127
Specialty inpatient	12	218,611	10.7%	864
Other	10	44,222	2.1%	498
	69	585,398	28.4%	3,153
<i>Financial support agreements</i>				
Medical office	14	151,367	7.3%	1,048
	14	151,367	7.3%	1,048
<i>Multi-tenanted with occupancy leases</i>				
Medical office	94	1,136,526	55.1%	7,047
Physician clinics	11	37,591	1.8%	233
Ambulatory care/surgery	4	59,191	2.9%	268
	109	1,233,308	59.8%	7,548
<i>Land held for development</i>				
		17,301	0.8%	
<i>Corporate property</i>				
		14,350	0.7%	
		31,651	1.5%	

Total owned properties	192	2,001,724	97.0%	11,749
Mortgage loans:				
Medical office	1	34,160	1.6%	
Physician clinics	2	16,845	0.8%	
Ambulatory care/surgery	1	7,996	0.4%	
	4	59,001	2.8%	
Unconsolidated joint venture investment:				
Medical office	1	1,702	0.1%	
Other	1	1,082	0.1%	
	2	2,784	0.2%	
Total real estate investments	198	\$ 2,063,509	100.0%	11,749

Table of Contents

The Company also provided property management services for 131 healthcare-related properties nationwide, totaling approximately 8.5 million square feet at December 31, 2008. The Company's portfolio of properties is focused predominantly on the outpatient services and medical office segments of the healthcare industry and is diversified by tenant, geographic location and facility type.

As of December 31, 2008, the weighted average remaining years to maturity pursuant to the Company's long-term master leases, financial support agreements, and multi-tenanted occupancy leases was approximately 4.4 years, with expiration dates ranging from 2009 to 2025.

Business Strategy

Healthcare Realty's strategy is to own and operate quality medical office and other outpatient-related facilities that produce stable and growing rental income. Consistent with this strategy, the Company selectively seeks acquisition and development opportunities located on or near the campuses of large, stable healthcare systems. Additionally, the Company provides a broad spectrum of services needed to own, develop, lease, finance and manage its portfolio of healthcare properties.

Management has streamlined the Company's portfolio to focus on medical office and other outpatient-related facilities associated with large acute care hospitals and leading health systems because it views these facilities as the most stable, lowest-risk real estate investments. Inpatient hospitals and outpatient-related facility tenants have historically received more than half of the nation's healthcare spending each year, totaling \$2.2 trillion in 2007. Healthcare spending is projected to increase yearly, comprising an estimated 19.5% of the nation's GDP by 2017. In addition, management believes that the diversity of tenants in the Company's medical office and other outpatient-related facilities, which includes physicians of nearly two-dozen specialties, as well as surgery, imaging, and diagnostic centers, lowers the Company's financial and operational risk. In 2008, the Company had only one healthcare provider that accounted for 10% or more of the Company's revenues, including revenues of discontinued operations, HealthSouth Corporation at 11%.

Over the last few years, the market for quality medical office and other outpatient-related facilities attracted many non-traditional and/or highly-leveraged buyers, which resulted in a significant increase in the competition for these assets. The recent and ongoing turmoil in the credit markets, however, has resulted in the Company seeing fewer buyers competing for such properties, which has provided more opportunities to acquire real estate properties with attractive risk-adjusted returns. While management has observed only a slight decrease in asset prices, the Company's relatively conservative capital structure positions it well to take advantage of the current credit market dislocation and any resulting future decline in asset prices. In 2008, the Company acquired approximately \$335.6 million in real estate assets and funded \$8.0 million in a new mortgage note receivable. In January 2009, the Company acquired the remaining membership interest in a joint venture in which it previously held a minority interest for approximately \$4.4 million and assumed related debt of approximately \$12.8 million. The entity owns a 62,246 square foot on-campus medical office building. See Note 4 to the Consolidated Financial Statements for more details on these acquisitions.

The Company believes that its construction projects will provide solid, long-term investment returns and high quality buildings. As of December 31, 2008, the Company had four construction projects underway with budgets totaling approximately \$174.0 million. The Company expects completion of the core and shell of three of the projects with budgets totaling approximately \$88.0 million during 2009 and expects completion of the core and shell of the fourth project with a budget totaling approximately \$86.0 million in the first quarter of 2010. In addition to the projects currently under construction, the Company is financing an on-campus medical office development of an outpatient campus comprised of six facilities, with a total budget of approximately \$72 million, of which the Company has already advanced \$42.2 million. The Company expects to finance the remaining \$29.8 million during 2009 and 2010.

With respect to five of the six facilities, the Company will have an option to purchase each such facility at a market cap rate upon its completion and full occupancy. The sixth facility is being acquired by the tenant.

The Company plans to continue to meet its liquidity needs, including funding additional investments in 2009, paying dividends and funding debt service, with cash flows from operations, borrowings under the

Table of Contents

Unsecured Credit Facility, proceeds from mortgage notes receivable repayments, proceeds from sales of real estate investments, proceeds from secured debt borrowings, or additional capital market financings. The Company also had unencumbered real estate assets of approximately \$1.9 billion at December 31, 2008, which could serve as collateral for secured mortgage financing. Furthermore, the Company anticipates renewing its Unsecured Credit Facility during 2009. Management believes that sufficient funding commitments will be available to the Company, but that the interest rate upon renewal will likely be higher than the Company's current interest rate (LIBOR + 0.90%). At December 31, 2008, the Company's leverage ratio [debt divided by (debt plus stockholders' equity less intangible assets plus accumulated depreciation)] was approximately 45.0% with 64.6% of its debt portfolio maturing after 2010. Also, at December 31, 2008, the Company had borrowings outstanding of \$329.0 million under its \$400 million Unsecured Credit Facility with a capacity remaining of \$71.0 million. See Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources in Item 7 and Risk Factors in Item 1A of this report for more discussion concerning the Company's liquidity and capital resources.

Acquisitions and Dispositions

2008 Acquisitions

During 2008, the Company acquired 27 real estate properties and funded a mortgage note receivable for approximately \$294.5 million and assumed related debt of approximately \$43.4 million, net of fair value adjustments, including an 80% interest in a joint venture that concurrently acquired four buildings for an investment of \$28.8 million. These acquisitions were funded with net proceeds from an equity offering in September 2008 totaling \$196.0 million, borrowings under the Unsecured Credit Facility, and proceeds from real estate dispositions. See Note 4 to the Consolidated Financial Statements for more information on these acquisitions.

2008 Dispositions

During 2008, the Company disposed of seven real estate properties for approximately \$27.1 million and disposed of two parcels of land for approximately \$9.8 million. Also, a portion of the Company's preferred equity investment in a joint venture was redeemed for \$5.5 million and one mortgage note receivable totaling approximately \$2.5 million was repaid. These dispositions were used to repay amounts under the Unsecured Credit Facility and to fund additional real estate investments. See Note 4 to the Consolidated Financial Statements for more information on these dispositions.

2009 Acquisition

In January 2009, the Company acquired the remaining membership interest in a joint venture which owns a 62,246 square foot on-campus medical office building in Oregon for approximately \$4.4 million and assumed outstanding indebtedness of approximately \$12.8 million bearing interest at 5.91% with maturities beginning in 2021. The building is approximately 97% occupied with lease terms ranging from 2009 through 2025. Prior to the acquisition, the Company had an equity investment in the joint venture of approximately \$1.7 million and accounted for its investment under the equity method.

Potential Dispositions

As discussed in more detail in Note 4 to the Consolidated Financial Statements, included in the 12 assets held for sale at December 31, 2008, are 10 properties that were pending disposition at December 31, 2008 which, if sold, would result in additional net proceeds of approximately \$80 million.

Purchase Options

At December 31, 2008, the Company had approximately \$94.0 million in real estate properties that were subject to exercisable purchase options held by the respective operators and lessees that had not been exercised. On a probability-weighted basis, the Company estimates that approximately \$19.4 million of these options might be exercised in the future. During 2009, additional purchase options become exercisable on

Table of Contents

properties in which the Company had a gross investment of approximately \$16.9 million at December 31, 2008. The Company anticipates, on a probability-weighted basis, that approximately \$8.4 million of these options might be exercised in the future. Though other properties may have purchase options exercisable in 2010 and beyond, the Company does not believe it can reasonably estimate the probability of exercise of these purchase options in the future.

Construction in Progress and Other Commitments

As of December 31, 2008, the Company had four medical office buildings under construction with estimated completion dates ranging from the third quarter of 2009 through the first quarter of 2010. At December 31, 2008, the Company had \$84.8 million invested in construction in progress, including land held for development, and expects to fund \$82.4 million and \$10.1 million in 2009 and 2010, respectively, on the projects currently under construction. Included in construction in progress are two parcels of land held for future development totaling approximately \$17.3 million at December 31, 2008. See Note 14 to the Consolidated Financial Statements for more details on the Company's construction in progress at December 31, 2008.

The Company also had various remaining first-generation tenant improvement obligations budgeted as of December 31, 2008 totaling approximately \$17.0 million related to properties that were developed by the Company and a tenant improvement obligation totaling approximately \$0.4 million related to a project developed by a joint venture acquired by the Company in 2008.

In addition to the projects currently under construction, the Company is financing an on-campus medical office development of an outpatient campus comprised of six facilities, with a total budget of approximately \$72 million, of which the Company has already advanced \$42.2 million. The Company expects to finance the remaining \$29.8 million during 2009 and 2010. With respect to five of the six facilities, the Company will have an option to purchase each such facility at a market cap rate upon its completion and full occupancy. The sixth facility is being acquired by the tenant.

Contractual Obligations

As of December 31, 2008, the Company had long-term contractual obligations of approximately \$1.5 billion, consisting primarily of \$1.1 billion of long-term debt obligations. For a more detailed description of these contractual obligations, see Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Contractual Obligations, in Item 7 of this report.

Competition

The Company competes for the acquisition and development of real estate properties with private investors, healthcare providers, other healthcare-related REITs, real estate partnerships and financial institutions, among others. The business of acquiring and constructing new healthcare facilities is highly competitive and is subject to price, construction and operating costs, and other competitive pressures.

The financial performance of all of the Company's properties is subject to competition from similar properties. Certain operators of other properties may have capital resources in excess of those of the Company or the operators of the Company's properties. In addition, the extent to which the Company's properties are utilized depends upon several factors, including the number of physicians using the healthcare facilities or referring patients there, healthcare employment, competitive systems of healthcare delivery, and the area's population, size and composition. Private, federal and state payment programs and other laws and regulations may also have an effect on the utilization of the properties. Virtually all of the Company's properties operate in a competitive environment, and patients and referral

sources, including physicians, may change their preferences for a healthcare facility from time to time.

Government Regulation

The healthcare industry continues to face rising costs in the delivery of healthcare services, increased competition for patients, an economy struggling with rising unemployment and a growing population of

Table of Contents

uninsured patients, higher bad debt expense, changes in reimbursement levels by private and governmental payors, and scrutiny by federal and state legislative and administrative authorities, thus presenting the industry and its individual participants with uncertainty. These various changes can affect the economic performance of some or all of the Company's tenants and clients. The Company cannot predict the degree to which these changes may affect the economic performance of the Company, positively or negatively.

The facilities owned by the Company and the manner in which they are operated are affected by changes in the reimbursement, licensing and certification policies of federal, state and local governments. Facilities may also be affected by changes in accreditation standards or procedures of accrediting agencies that are recognized by governments in the certification process. In addition, expansion (including the addition of new beds or services or acquisition of medical equipment) and occasionally the discontinuation of services of healthcare facilities are, in some states, subjected to state regulatory approval through certificate of need laws and regulations. Loss by a facility of its ability to participate in government-sponsored programs because of licensing, certification or accreditation deficiencies or because of program exclusion resulting from violations of law would have a material adverse effect on facility revenues.

Although the Company is not a healthcare provider or in a position to refer patients or order services reimbursable by the federal government, to the extent that a healthcare provider leases space from the Company and, in turn, subleases space to physicians or other referral sources at less than a fair market value rental rate, or otherwise arrange for remuneration to such a referral source, the Anti-Kickback Statute (a provision of the Social Security Act addressing illegal remuneration) and the Stark Law (the federal physician self-referral law) could be implicated. The Company's leases require the lessees to agree to comply with all applicable laws.

A significant portion of the revenue of healthcare providers is derived from government reimbursement programs, such as the federal Medicare program and the joint federal and state Medicaid program. Although lease payments to the Company are not directly affected by government reimbursement, changes in these programs could adversely affect healthcare providers and tenants' ability to make payments to the Company.

The Medicare and Medicaid programs are highly regulated and subject to frequent evaluation and change. Government healthcare spending has increased over time; however, changes from year to year in reimbursement methodology, rates and other regulatory requirements have resulted in a challenging operating environment for healthcare providers. Spending on government reimbursement programs is expected to continue to rise significantly over the next 20 years, particularly as the government seeks to expand public insurance programs for the uninsured. While government proposals for achieving universal healthcare coverage and other costly initiatives could benefit healthcare providers by decreasing the level of uninsured patients and bad debt expense, Congress could select to slow the growth in healthcare spending by limiting reimbursement rates to healthcare providers. Reductions in the growth of Medicare and Medicaid payments could have an adverse impact on healthcare providers' financial condition and, therefore, could adversely affect the ability of providers to make rental payments. However, the Company expects healthcare providers to continue to adjust to new operating challenges, as they have in the past, by increasing operating efficiency and modifying their strategies for profitable operations and growth.

The Company believes its strategic focus on the medical office and outpatient sector of the healthcare industry mitigates risk from changes in public healthcare spending and reimbursement because physician practices generally derive a large portion of their revenue from private insurance and out-of-pocket patient expense. The diversity of the Company's multi-tenant medical office facilities also provides lower reimbursement risk as payor mix varies from physician to physician, depending on location, specialty, patients, and physician preferences.

Legislative Developments

Each year, legislative proposals for health policy are introduced in Congress and state legislatures, and regulatory changes are enacted by government agencies. These proposals, individually or in the aggregate,

Table of Contents

could significantly change the delivery of healthcare services, either nationally or at the state level, if implemented. Among the matters under consideration or recently implemented are:

cost containment, quality control and payment system refinements for Medicaid, Medicare and other governmental and commercial payors;

prohibitions on more types of contractual relationships between physicians and the healthcare facilities and providers to which they refer, and related information-collection activities;

universal healthcare coverage through tax subsidies and reform, expanded federal health insurance programs, heightened regulations on insurance companies, individual and employer mandates, and other initiatives;

reform of the Medicare physician fee-for-service reimbursement formula that dictates annual updates in payment rates for physician services;

pay-for-performance and other quality-based payment system implementation;

efforts to increase transparency with respect to pricing and financial relationships among healthcare providers and drug/device manufacturers;

universal healthcare coverage;

increased scrutiny of medical errors and conditions acquired inside health facilities;

patient and drug safety efforts;

Medicare Advantage reforms;

pharmaceutical drug pricing and compliance activities under Medicare Part D;

tax law changes affecting non-profit providers;

immigration reform and related healthcare mandates;

modifications to increase requirements for facility accessibility by persons with disabilities;

facility requirements related to earthquakes and other disasters, including structural retrofitting;

re-importation of pharmaceuticals; and

The Company cannot predict whether any proposals will be adopted or what effect, whether positive or negative, such proposals would have on the Company's business.

Environmental Matters

Under various federal, state and local environmental laws, ordinances and regulations, an owner of real property (such as the Company) may be liable for the costs of removal or remediation of certain hazardous or toxic substances at, under or disposed of in connection with such property, as well as certain other potential costs relating to hazardous or toxic substances (including government fines and injuries to persons and adjacent property). Most, if not all, of these

laws, ordinances and regulations contain stringent enforcement provisions including, but not limited to, the authority to impose substantial administrative, civil and criminal fines and penalties upon violators. Such laws often impose liability without regard to whether the owner knew of, or was responsible for, the presence or disposal of such substances and may be imposed on the owner in connection with the activities of an operator of the property. The cost of any required remediation, removal, fines or personal or property damages and the owner's liability therefore could exceed the value of the property and/or the aggregate assets of the owner. In addition, the presence of such substances, or the failure to properly dispose of or remediate such substances, may adversely affect the owner's ability to sell or lease such property or to borrow using such property as collateral. A property can also be negatively impacted either through physical contamination or by virtue of an adverse effect on value, from contamination that has or may have emanated from other properties.

Operations of the properties owned, developed or managed by the Company are and will continue to be subject to numerous federal, state, and local environmental laws, ordinances and regulations, including those

Table of Contents

relating to the following: the generation, segregation, handling, packaging and disposal of medical wastes; air quality requirements related to operations of generators, incineration devices, or sterilization equipment; facility siting and construction; disposal of non-medical wastes and ash from incinerators; and underground storage tanks. Certain properties owned, developed or managed by the Company contain, and others may contain or at one time may have contained, underground storage tanks that are or were used to store waste oils, petroleum products or other hazardous substances. Such underground storage tanks can be the source of releases of hazardous or toxic materials. Operations of nuclear medicine departments at some properties also involve the use and handling, and subsequent disposal of, radioactive isotopes and similar materials, activities which are closely regulated by the Nuclear Regulatory Commission and state regulatory agencies. In addition, several of the properties were built during the period that asbestos was commonly used in building construction and other such facilities may be acquired by the Company in the future. The presence of such materials could result in significant costs in the event that any asbestos-containing materials requiring immediate removal and/or encapsulation are located in or on any facilities or in the event of any future renovation activities.

The Company has had environmental site assessments conducted on substantially all of the properties currently owned. These site assessments are limited in scope and provide only an evaluation of potential environmental conditions associated with the property, not compliance assessments of ongoing operations. The Company is not aware of any environmental condition or liability that management believes would have a material adverse effect on the Company's financial position, earnings, expenditures or continuing operations. While it is the Company's policy to seek indemnification relating to environmental liabilities or conditions, even where leases and sale and purchase agreements do contain such provisions, there can be no assurances that the tenant or seller will be able to fulfill its indemnification obligations. In addition, the terms of the Company's leases or financial support agreements do not give the Company control over the operational activities of its lessees or healthcare operators, nor will the Company monitor the lessees or healthcare operators with respect to environmental matters.

Insurance

The Company generally requires its tenants to maintain comprehensive liability and property insurance that covers the Company as well as the tenants. The Company also carries comprehensive liability insurance and property insurance covering its owned and managed properties. In addition, tenants under long-term net master leases are required to carry property insurance covering the Company's interest in the buildings. The Company has also obtained title insurance with respect to each of the properties it owns, insuring that the Company holds title to each of the properties free and clear of all liens and encumbrances except those approved by the Company.

Employees

As of December 31, 2008, the Company employed 223 people. The employees are not members of any labor union, and the Company considers its relations with its employees to be excellent.

Federal Income Tax Information

The Company is and intends to remain qualified as a REIT under the Internal Revenue Code of 1986, as amended (the Code). As a REIT, the Company's net income will be exempt from federal taxation to the extent that it is distributed as dividends to stockholders. Distributions to the Company's stockholders generally will be includable in their income; however, dividends distributed that are in excess of current and/or accumulated earnings and profits will be treated for tax purposes as a return of capital to the extent of a stockholder's basis and will reduce the basis of the stockholder's shares.

Introduction

The Company is qualified and intends to remain qualified as a REIT for federal income tax purposes under Sections 856 through 860 of the Code. The following discussion addresses the material tax

Table of Contents

considerations relevant to the taxation of the Company and summarizes certain federal income tax consequences that may be relevant to certain stockholders. However, the actual tax consequences of holding particular securities issued by the Company may vary in light of a securities holder's particular facts and circumstances. Certain holders, such as tax-exempt entities, insurance companies and financial institutions, are generally subject to special rules. In addition, the following discussion does not address issues under any foreign, state or local tax laws. The tax treatment of a holder of any of the securities issued by the Company will vary depending upon the terms of the specific securities acquired by such holder, as well as the holder's particular situation, and this discussion does not attempt to address aspects of federal income taxation relating to holders of particular securities of the Company. This summary is qualified in its entirety by the applicable Code provisions, rules and regulations promulgated thereunder, and administrative and judicial interpretations thereof. The Code, rules, regulations, and administrative and judicial interpretations are all subject to change at any time (possibly on a retroactive basis).

The Company is organized and is operating in conformity with the requirements for qualification and taxation as a REIT and intends to continue operating so as to enable it to continue to meet the requirements for qualification and taxation as a REIT under the Code. The Company's qualification and taxation as a REIT depend upon its ability to meet, through actual annual operating results, the various income, asset, distribution, stock ownership and other tests discussed below. Accordingly, the Company cannot guarantee that the actual results of operations for any one taxable year will satisfy such requirements.

If the Company were to cease to qualify as a REIT, and the statutory relief provisions were found not to apply, the Company's income that it distributed to stockholders would be subject to the double taxation on earnings (once at the corporate level and again at the stockholder level) that generally results from an investment in the equity securities of a corporation. The distributions would then qualify for the reduced dividend rates created by the Jobs and Growth Tax Relief Reconciliation Act of 2003. However, the reduced dividend rates are scheduled to expire for taxable years beginning after December 31, 2010. Failure to maintain qualification as a REIT would force the Company to significantly reduce its distributions and possibly incur substantial indebtedness or liquidate substantial investments in order to pay the resulting corporate taxes. In addition, the Company, once having obtained REIT status and having thereafter lost such status, would not be eligible to reelect REIT status for the four subsequent taxable years, unless its failure to maintain its qualification was due to reasonable cause and not willful neglect and certain other requirements were satisfied. In order to elect again to be taxed as a REIT, just as with its original election, the Company would be required to distribute all of its earnings and profits accumulated in any non-REIT taxable year.

Taxation of the Company

As long as the Company remains qualified to be taxed as a REIT, it generally will not be subject to federal income taxes on that portion of its ordinary income or capital gain that is currently distributed to stockholders.

However, the Company will be subject to federal income tax as follows:

The Company will be taxed at regular corporate rates on any undistributed real estate investment trust taxable income, including undistributed net capital gains.

Under certain circumstances, the Company may be subject to the alternative minimum tax on its items of tax preference, if any.

If the Company has (i) net income from the sale or other disposition of foreclosure property that is held primarily for sale to customers in the ordinary course of business, or (ii) other non-qualifying income from foreclosure property, it will be subject to tax on such income at the highest regular corporate rate.

Any net income that the Company has from prohibited transactions (which are, in general, certain sales or other dispositions of property, other than foreclosure property, held primarily for sale to customers in the ordinary course of business) will be subject to a 100% tax.

Table of Contents

If the Company should fail to satisfy either the 75% or 95% gross income test (as discussed below), and has nonetheless maintained its qualification as a REIT because certain other requirements have been met, it will be subject to a percentage tax calculated by the ratio of REIT taxable income to gross income with certain adjustments multiplied by the gross income attributable to the greater of the amount by which the Company fails the 75% or 95% gross income test.

If the Company fails to distribute during each year at least the sum of (i) 85% of its REIT ordinary income for such year, (ii) 95% of its REIT capital gain net income for such year, and (iii) any undistributed taxable income from preceding periods, then the Company will be subject to a 4% excise tax on the excess of such required distribution over the amounts actually distributed.

In the event of a more than de minimis failure of any of the asset tests, as described below under Asset Tests, as long as the failure was due to reasonable cause and not to willful neglect, the Company files a description of each asset that caused such failure with the Internal Revenue Service (IRS), and disposes of the assets or otherwise complies with the asset tests within six months after the last day of the quarter in which the Company identifies such failure, the Company will pay a tax equal to the greater of \$50,000 or 35% of the net income from the nonqualifying assets during the period in which the Company failed to satisfy the asset tests.

In the event the Company fails to satisfy one or more requirements for REIT qualification, other than the gross income tests and the asset tests, and such failure is due to reasonable cause and not to willful neglect, the Company will be required to pay a penalty of \$50,000 for each such failure.

To the extent that the Company recognizes gain from the disposition of an asset with respect to which there existed built-in gain upon its acquisition by the Company from a Subchapter C corporation in a carry-over basis transaction and such disposition occurs within a maximum ten-year recognition period beginning on the date on which it was acquired by the Company, the Company will be subject to federal income tax at the highest regular corporate rate on the amount of its net recognized built-in gain.

To the extent that the Company has net income from a taxable REIT subsidiary (TRS), the TRS will be subject to federal corporate income tax in much the same manner as other non-REIT Subchapter C corporations, with the exceptions that the deductions for interest expense on debt and rental payments made by the TRS to the Company will be limited and a 100% excise tax may be imposed on transactions between the TRS and the Company or the Company's tenants that are not conducted on an arm's length basis. A TRS is a corporation in which a REIT owns stock, directly or indirectly, and for which both the REIT and the corporation have made TRS elections.

Requirements for Qualification as a REIT

To qualify as a REIT for a taxable year, the Company must have no earnings and profits accumulated in any non-REIT year. The Company also must elect or have in effect an election to be taxed as a REIT and must meet other requirements, some of which are summarized below, including percentage tests relating to the sources of its gross income, the nature of the Company's assets and the distribution of its income to stockholders. Such election, if properly made and assuming continuing compliance with the qualification tests described herein, will continue in effect for subsequent years.

Organizational Requirements and Share Ownership Tests

Section 856(a) of the Code defines a REIT as a corporation, trust or association:

- (1) that is managed by one or more trustees or directors;
- (2) the beneficial ownership of which is evidenced by transferable shares or by transferable certificates of beneficial interest;
- (3) that would be taxable, but for Sections 856 through 860 of the Code, as a domestic corporation;

Table of Contents

- (4) that is neither a financial institution nor an insurance company subject to certain provisions of the Code;
- (5) the beneficial ownership of which is held by 100 or more persons, determined without reference to any rules of attribution (the share ownership test);
- (6) that during the last half of each taxable year not more than 50% in value of the outstanding stock of which is owned, directly or indirectly, by five or fewer individuals (as defined in the Code to include certain entities) (the five or fewer test); and
- (7) that meets certain other tests, described below, regarding the nature of its income and assets.

Section 856(b) of the Code provides that conditions (1) through (4), inclusive, must be met during the entire taxable year and that condition (5) must be met during at least 335 days of a taxable year of 12 months, or during a proportionate part of a taxable year of fewer than 12 months. The five or fewer test and the share ownership test do not apply to the first taxable year for which an election is made to be treated as a REIT.

The Company is also required to request annually (within 30 days after the close of its taxable year) from record holders of specified percentages of its shares written information regarding the ownership of such shares. A list of stockholders failing to fully comply with the demand for the written statements is required to be maintained as part of the Company's records required under the Code. Rather than responding to the Company, the Code allows the stockholder to submit such statement to the IRS with the stockholder's tax return.

The Company has issued shares to a sufficient number of people to allow it to satisfy the share ownership test and the five or fewer test. In addition, to assist in complying with the five or fewer test, the Company's Articles of Incorporation contain provisions restricting share transfers where the transferee (other than specified individuals involved in the formation of the Company, members of their families and certain affiliates, and certain other exceptions) would, after such transfer, own (a) more than 9.9% either in number or value of the outstanding Common Stock of the Company or (b) more than 9.9% either in number or value of any outstanding preferred stock of the Company. Pension plans and certain other tax-exempt entities have different restrictions on ownership. If, despite this prohibition, stock is acquired increasing a transferee's ownership to over 9.9% in value of either the outstanding Common Stock or any preferred stock of the Company, the stock in excess of this 9.9% in value is deemed to be held in trust for transfer at a price that does not exceed what the purported transferee paid for the stock, and, while held in trust, the stock is not entitled to receive dividends or to vote. In addition, under these circumstances, the Company also has the right to redeem such stock.

For purposes of determining whether the five or fewer test (but not the share ownership test) is met, any stock held by a qualified trust (generally, pension plans, profit-sharing plans and other employee retirement trusts) is, generally, treated as held directly by the trust's beneficiaries in proportion to their actuarial interests in the trust and not as held by the trust.

Income Tests

In order to maintain qualification as a REIT, two gross income requirements must be satisfied annually.

First, at least 75% of the Company's gross income (excluding gross income from certain sales of property held as inventory or primarily for sale in the ordinary course of business) must be derived from rents from real property; interest on obligations secured by mortgages on real property or on interests in real property; gain (excluding gross income from certain sales of property held as inventory or primarily for sale in the ordinary course of business) from the sale or other disposition of, and certain other gross income related to, real property

(including interests in real property and in mortgages on real property); and income received or accrued within one year of the Company's receipt of, and attributable to the temporary investment of, new capital (any amount received in exchange for stock other than through a dividend reinvestment plan or in a public offering of debt obligations having maturities of at least five years).

Table of Contents

Second, at least 95% of the Company's gross income (excluding gross income from certain sales of property held as inventory or primarily for sale in the ordinary course of business) must be derived from dividends; interest; rents from real property; gain (excluding gross income from certain sales of property held as inventory or primarily for sale in the ordinary course of business) from the sale or other disposition of, and certain other gross income related to, real property (including interests in real property and in mortgages on real property); and gain from the sale or other disposition of stock and securities.

The Company may temporarily invest its working capital in short-term investments. Although the Company will use its best efforts to ensure that income generated by these investments will be of a type that satisfies the 75% and 95% gross income tests, there can be no assurance in this regard (see the discussion above of the new capital rule under the 75% gross income test).

For an amount received or accrued to qualify for purposes of an applicable gross income test as rents from real property or interest on obligations secured by mortgages on real property or on interests in real property, the determination of such amount must not depend in whole or in part on the income or profits derived by any person from such property (except that such amount may be based on a fixed percentage or percentages of receipts or sales). In addition, for an amount received or accrued to qualify as rents from real property, such amount may not be received or accrued directly or indirectly from a person in which the Company owns directly or indirectly 10% or more of, in the case of a corporation, the total voting power of all voting stock or the total value of all stock, and, in the case of an unincorporated entity, the assets or net profits of such entity (except for certain amounts received or accrued from a TRS in connection with property substantially rented to persons other than a TRS of the Company and other 10%-or-more owned persons or with respect to certain healthcare facilities, if certain conditions are met). The Company leases and intends to lease property only under circumstances such that substantially all, if not all, rents from such property qualify as rents from real property. Although it is possible that a tenant could sublease space to a sublessee in which the Company is deemed to own directly or indirectly 10% or more of the tenant, the Company believes that as a result of the provisions of the Company's Articles of Incorporation that limit ownership to 9.9%, such occurrence would be unlikely. Application of the 10% ownership rule is, however, dependent upon complex attribution rules provided in the Code and circumstances beyond the control of the Company. Ownership, directly or by attribution, by an unaffiliated third party of more than 10% of the Company's stock and more than 10% of the stock of any tenant or subtenant would result in a violation of the rule.

In addition, the Company must not manage its properties or furnish or render services to the tenants of its properties, except through an independent contractor from whom the Company derives no income or through a TRS unless (i) the Company is performing services that are usually or customarily furnished or rendered in connection with the rental of space for occupancy only and the services are of the sort that a tax-exempt organization could perform without being considered in receipt of unrelated business taxable income or (ii) the income earned by the Company for other services furnished or rendered by the Company to tenants of a property or for the management or operation of the property does not exceed a de minimis threshold generally equal to 1% of the income from such property. The Company self-manages some of its properties, but does not believe it provides services to tenants that are outside the exception.

If rent attributable to personal property leased in connection with a lease of real property is greater than 15% of the total rent received under the lease, then the portion of rent attributable to such personal property will not qualify as rents from real property. Generally, this 15% test is applied separately to each lease. The portion of rental income treated as attributable to personal property is determined according to the ratio of the fair market value of the personal property to the total fair market value of the property that is rented. The determination of what fixtures and other property constitute personal property for federal tax purposes is difficult and imprecise. The Company does not have 15% by value of any of its properties classified as personal property. If, however, rent payments do not qualify, for reasons discussed above, as rents from real property for purposes of Section 856 of the Code, it will be more difficult

for the Company to meet the 95% and 75% gross income tests and continue to qualify as a REIT.

Table of Contents

The Company is and expects to continue performing third-party management and development services. If the gross income to the Company from this or any other activity producing disqualified income for purposes of the 95% or 75% gross income tests approaches a level that could potentially cause the Company to fail to satisfy these tests, the Company intends to take such corrective action as may be necessary to avoid failing to satisfy the 95% or 75% gross income tests.

The Company may enter into hedging transactions with respect to one or more of its assets or liabilities. The Company's hedging activities may include entering into interest rate swaps, caps and floors, options to purchase such items, and futures and forward contracts. Income and gain from hedging transactions will be excluded from gross income for purposes of the 95% and 75% gross income tests. A hedging transaction includes any transaction entered into in the normal course of the Company's trade or business primarily to manage the risk of interest rate, price changes or currency fluctuations with respect to borrowings made or to be made, or ordinary obligations incurred or to be incurred, to acquire or carry real estate assets. The Company will be required to clearly identify any such hedging transaction before the close of the day on which it was acquired, originated or entered into. The Company intends to structure any hedging or similar transactions so as not to jeopardize its status as a REIT.

If the Company were to fail to satisfy one or both of the 75% or 95% gross income tests for any taxable year, it may nevertheless qualify as a REIT for such year if it is entitled to relief under certain provisions of the Code. These relief provisions would generally be available if (i) the Company's failure to meet such test or tests was due to reasonable cause and not to willful neglect and (ii) following its identification of its failure to meet these tests, the Company files a description of each item of income that fails to meet these tests in a schedule in accordance with Treasury Regulations. It is not possible, however, to know whether the Company would be entitled to the benefit of these relief provisions since the application of the relief provisions is dependent on future facts and circumstances. If these provisions were to apply, the Company would be subjected to tax equal to a percentage tax calculated by the ratio of REIT taxable income to gross income with certain adjustments multiplied by the gross income attributable to the greater of the amount by which the Company failed either of the 75% or the 95% gross income tests.

Asset Tests

At the close of each quarter of its taxable year, the Company must also satisfy four tests relating to the nature of its assets.

At least 75% of the value of the Company's total assets must consist of real estate assets (including interests in real property and interests in mortgages on real property as well as its allocable share of real estate assets held by joint ventures or partnerships in which the Company participates), cash, cash items and government securities.

Not more than 25% of the Company's total assets may be represented by securities other than those includable in the 75% asset class.

Not more than 25% of the Company's total assets may be represented by securities of one or more TRS.

Of the investments included in the 25% asset class, except for TRS, (i) the value of any one issuer's securities owned by the Company may not exceed 5% of the value of the Company's total assets, (ii) the Company may not own more than 10% of any one issuer's outstanding voting securities and (iii) the Company may not hold securities having a value of more than 10% of the total value of the outstanding securities of any one issuer. Securities issued by affiliated qualified REIT subsidiaries (QRS), which are corporations wholly owned by the Company, either directly or indirectly, that are not TRS, are not subject to the 25% of total assets limit, the 5% of total assets limit or the 10% of a single issuer's voting securities limit or the 10% of a single issuer's value

limit. Additionally, straight debt and certain other exceptions are not securities for purposes of the 10% of a single issuer's value test. The existence of QRS are ignored, and the assets, income, gain, loss and other attributes of the QRS are treated as being owned or generated by the Company, for federal income tax purposes. The Company currently has 57 subsidiaries and other affiliates that it employs in the conduct of its business.

Table of Contents

If the Company meets the asset tests described above at the close of any quarter, it will not lose its status as a REIT because of a change in value of its assets unless the discrepancy exists immediately after the acquisition of any security or other property that is wholly or partly the result of an acquisition during such quarter. Where a failure to satisfy the asset tests results from an acquisition of securities or other property during a quarter, the failure can be cured by disposition of sufficient nonqualifying assets within 30 days after the close of such quarter. The Company maintains adequate records of the value of its assets to maintain compliance with the asset tests and to take such action as may be required to cure any failure to satisfy the test within 30 days after the close of any quarter. Nevertheless, if the Company were unable to cure within the 30-day cure period, the Company may cure a violation of the 5% asset test or the 10% asset test so long as the value of the asset causing such violation does not exceed the lesser of 1% of the Company's assets at the end of the relevant quarter or \$10 million and the Company disposes of the asset causing the failure or otherwise complies with the asset tests within six months after the last day of the quarter in which the failure to satisfy the asset test is discovered. For violations due to reasonable cause and not due to willful neglect that are larger than this amount, the Company is permitted to avoid disqualification as a REIT after the 30-day cure period by (i) disposing of an amount of assets sufficient to meet the asset tests, (ii) paying a tax equal to the greater of \$50,000 or the highest corporate tax rate times the taxable income generated by the non-qualifying asset and (iii) disclosing certain information to the IRS.

Distribution Requirement

In order to qualify as a REIT, the Company is required to distribute dividends (other than capital gain dividends) to its stockholders in an amount equal to or greater than the excess of (a) the sum of (i) 90% of the Company's real estate investment trust taxable income (computed without regard to the dividends paid deduction and the Company's net capital gain) and (ii) 90% of the net income (after tax on such income), if any, from foreclosure property, over (b) the sum of certain non-cash income (from certain imputed rental income and income from transactions inadvertently failing to qualify as like-kind exchanges). These requirements may be waived by the IRS if the Company establishes that it failed to meet them by reason of distributions previously made to meet the requirements of the 4% excise tax described below. To the extent that the Company does not distribute all of its net long-term capital gain and all of its real estate investment trust taxable income, it will be subject to tax thereon. In addition, the Company will be subject to a 4% excise tax to the extent it fails within a calendar year to make required distributions to its stockholders of 85% of its ordinary income and 95% of its capital gain net income plus the excess, if any, of the grossed up required distribution for the preceding calendar year over the amount treated as distributed for such preceding calendar year. For this purpose, the term grossed up required distribution for any calendar year is the sum of the taxable income of the Company for the taxable year (without regard to the deduction for dividends paid) and all amounts from earlier years that are not treated as having been distributed under the provision. Dividends declared in the last quarter of the year and paid during the following January will be treated as having been paid and received on December 31 of such earlier year. The Company's distributions for 2008 were adequate to satisfy its distribution requirement.

It is possible that the Company, from time to time, may have insufficient cash or other liquid assets to meet the 90% distribution requirement due to timing differences between the actual receipt of income and the actual payment of deductible expenses or dividends on the one hand and the inclusion of such income and deduction of such expenses or dividends in arriving at real estate investment trust taxable income on the other hand. The problem of not having adequate cash to make required distributions could also occur as a result of the repayment in cash of principal amounts due on the Company's outstanding debt, particularly in the case of balloon repayments or as a result of capital losses on short-term investments of working capital. Therefore, the Company might find it necessary to arrange for short-term, or possibly long-term, borrowing or new equity financing. If the Company were unable to arrange such borrowing or financing as might be necessary to provide funds for required distributions, its REIT status could be jeopardized.

Under certain circumstances, the Company may be able to rectify a failure to meet the distribution requirement for a year by paying deficiency dividends to stockholders in a later year, which may be included in the Company's deduction for dividends paid for the earlier year. The Company may be able to avoid being

Table of Contents

taxed on amounts distributed as deficiency dividends; however, the Company might in certain circumstances remain liable for the 4% excise tax described above.

Federal Income Tax Treatment of Leases

The availability to the Company of, among other things, depreciation deductions with respect to the facilities owned and leased by the Company depends upon the treatment of the Company as the owner of the facilities and the classification of the leases of the facilities as true leases, rather than as sales or financing arrangements, for federal income tax purposes. The Company has not requested nor has it received an opinion that it will be treated as the owner of the portion of the facilities constituting real property and that the leases will be treated as true leases of such real property for federal income tax purposes.

Other Issues

With respect to property acquired from and leased back to the same or an affiliated party, the IRS could assert that the Company realized prepaid rental income in the year of purchase to the extent that the value of the leased property exceeds the purchase price paid by the Company for that property. In litigated cases involving sale-leasebacks which have considered this issue, courts have concluded that buyers have realized prepaid rent where both parties acknowledged that the purported purchase price for the property was substantially less than fair market value and the purported rents were substantially less than the fair market rentals. Because of the lack of clear precedent and the inherently factual nature of the inquiry, the Company cannot give complete assurance that the IRS could not successfully assert the existence of prepaid rental income in such circumstances. The value of property and the fair market rent for properties involved in sale-leasebacks are inherently factual matters and always subject to challenge.

Additionally, it should be noted that Section 467 of the Code (concerning leases with increasing rents) may apply to those leases of the Company that provide for rents that increase from one period to the next. Section 467 provides that in the case of a so-called disqualified leaseback agreement, rental income must be accrued at a constant rate. If such constant rent accrual is required, the Company would recognize rental income in excess of cash rents and, as a result, may fail to have adequate funds available to meet the 90% dividend distribution requirement. Disqualified leaseback agreements include leaseback transactions where a principal purpose of providing increasing rent under the agreement is the avoidance of federal income tax. Since the Section 467 regulations provide that rents will not be treated as increasing for tax avoidance purposes where the increases are based upon a fixed percentage of lessee receipts, additional rent provisions of leases containing such clauses should not result in these leases being disqualified leaseback agreements. In addition, the Section 467 regulations provide that leases providing for fluctuations in rents by no more than a reasonable percentage, which is 15% for long-term real property leases, from the average rent payable over the term of the lease will be deemed to not be motivated by tax avoidance. The Company does not believe it has rent subject to the disqualified leaseback provisions of Section 467.

Subject to a safe harbor exception for annual sales of up to seven properties (or properties with a basis of up to 10% of the REIT's assets) that have been held for at least four years, gain from sales of property held for sale to customers in the ordinary course of business is subject to a 100% tax. The simultaneous exercise of options to acquire leased property that may be granted to certain tenants or other events could result in sales of properties by the Company that exceed this safe harbor. However, the Company believes that in such event, it will not have held such properties for sale to customers in the ordinary course of business.

Depreciation of Properties

For federal income tax purposes, the Company's real property is being depreciated over 31.5, 39 or 40 years using the straight-line method of depreciation and its personal property over various periods utilizing accelerated and

straight-line methods of depreciation.

Table of Contents***Failure to Qualify as a REIT***

If the Company were to fail to qualify for federal income tax purposes as a REIT in any taxable year, and the relief provisions were found not to apply, the Company would be subject to tax on its taxable income at regular corporate rates (plus any applicable alternative minimum tax). Distributions to stockholders in any year in which the Company failed to qualify would not be deductible by the Company nor would they be required to be made. In such event, to the extent of current and/or accumulated earnings and profits, all distributions to stockholders would be taxable as qualified dividend income, including, presumably, subject to the 15% maximum rate on dividends created by the Jobs and Growth Tax Relief Reconciliation Act of 2003, and, subject to certain limitations in the Code, eligible for the 70% dividends received deduction for corporations that are REIT stockholders. However, this reduced rate for dividend income is set to expire for taxable years beginning after December 31, 2010. Unless entitled to relief under specific statutory provisions, the Company would also be disqualified from taxation as a REIT for the following four taxable years. It is not possible to state whether in all circumstances the Company would be entitled to statutory relief from such disqualification. Failure to qualify for even one year could result in the Company's incurring substantial indebtedness (to the extent borrowings were feasible) or liquidating substantial investments in order to pay the resulting taxes.

Taxation of Tax-Exempt Stockholders

The IRS has issued a revenue ruling in which it held that amounts distributed by a REIT to a tax-exempt employee pension trust do not constitute unrelated business taxable income, even though the REIT may have financed certain of its activities with acquisition indebtedness. Although revenue rulings are interpretive in nature and are subject to revocation or modification by the IRS, based upon the revenue ruling and the analysis therein, distributions made by the Company to a U.S. stockholder that is a tax-exempt entity (such as an individual retirement account (IRA) or a 401(k) plan) should not constitute unrelated business taxable income unless such tax-exempt U.S. stockholder has financed the acquisition of its shares with acquisition indebtedness within the meaning of the Code, or the shares are otherwise used in an unrelated trade or business conducted by such U.S. stockholder.

Special rules apply to certain tax-exempt pension funds (including 401(k) plans but excluding IRAs or government pension plans) that own more than 10% (measured by value) of a pension-held REIT. Such a pension fund may be required to treat a certain percentage of all dividends received from the REIT during the year as unrelated business taxable income. The percentage is equal to the ratio of the REIT's gross income (less direct expenses related thereto) derived from the conduct of unrelated trades or businesses determined as if the REIT were a tax-exempt pension fund (including income from activities financed with acquisition indebtedness), to the REIT's gross income (less direct expenses related thereto) from all sources. The special rules will not require a pension fund to recharacterize a portion of its dividends as unrelated business taxable income unless the percentage computed is at least 5%.

A REIT will be treated as a pension-held REIT if the REIT is predominantly held by tax-exempt pension funds and if the REIT would otherwise fail to satisfy the five or fewer test discussed above. A REIT is predominantly held by tax-exempt pension funds if at least one tax-exempt pension fund holds more than 25% (measured by value) of the REIT's stock or beneficial interests, or if one or more tax-exempt pension funds (each of which owns more than 10% (measured by value) of the REIT's stock or beneficial interests) own in the aggregate more than 50% (measured by value) of the REIT's stock or beneficial interests. The Company believes that it will not be treated as a pension-held REIT. However, because the shares of the Company will be publicly traded, no assurance can be given that the Company is not or will not become a pension-held REIT.

Taxation of Non-U.S. Stockholders

The rules governing United States federal income taxation of any person other than (i) a citizen or resident of the United States, (ii) a corporation or partnership created in the United States or under the laws of the United States or of any state thereof, (iii) an estate whose income is includable in income for U.S. federal income tax purposes regardless of its source or (iv) a trust if a court within the United States is able to exercise primary

Table of Contents

supervision over the administration of the trust and one or more United States fiduciaries have the authority to control all substantial decisions of the trust (Non-U.S. Stockholders) are highly complex, and the following discussion is intended only as a summary of such rules. Prospective Non-U.S. Stockholders should consult with their own tax advisors to determine the impact of United States federal, state, and local income tax laws on an investment in stock of the Company, including any reporting requirements.

In general, Non-U.S. Stockholders are subject to regular United States income tax with respect to their investment in stock of the Company in the same manner as a U.S. stockholder if such investment is effectively connected with the Non-U.S. Stockholder's conduct of a trade or business in the United States. A corporate Non-U.S. Stockholder that receives income with respect to its investment in stock of the Company that is (or is treated as) effectively connected with the conduct of a trade or business in the United States also may be subject to the 30% branch profits tax imposed by the Code, which is payable in addition to regular United States corporate income tax. The following discussion addresses only the United States taxation of Non-U.S. Stockholders whose investment in stock of the Company is not effectively connected with the conduct of a trade or business in the United States.

Ordinary Dividends

Distributions made by the Company that are not attributable to gain from the sale or exchange by the Company of United States real property interests (USRPI) and that are not designated by the Company as capital gain dividends will be treated as ordinary income dividends to the extent made out of current or accumulated earnings and profits of the Company. Generally, such ordinary income dividends will be subject to United States withholding tax at the rate of 30% on the gross amount of the dividend paid unless reduced or eliminated by an applicable United States income tax treaty. The Company expects to withhold United States income tax at the rate of 30% on the gross amount of any such dividends paid to a Non-U.S. Stockholder unless a lower treaty rate applies and the Non-U.S. Stockholder has filed an IRS Form W-8BEN with the Company, certifying the Non-U.S. Stockholder's entitlement to treaty benefits.

Non-Dividend Distributions

Distributions made by the Company in excess of its current and accumulated earnings and profits to a Non-U.S. Stockholder who holds 5% or less of the stock of the Company (after application of certain ownership rules) will not be subject to U.S. income or withholding tax. If it cannot be determined at the time a distribution is made whether or not such distribution will be in excess of the Company's current and accumulated earnings and profits, the distribution will be subject to withholding at the rate applicable to a dividend distribution. However, the Non-U.S. Stockholder may seek a refund from the IRS of any amount withheld if it is subsequently determined that such distribution was, in fact, in excess of the Company's then current and accumulated earnings and profits.

Capital Gain Dividends

As long as the Company continues to qualify as a REIT, distributions made by the Company after December 31, 2005, that are attributable to gain from the sale or exchange by the Company of any USRPI will not be treated as effectively connected with the conduct of a trade or business in the United States. Instead, such distributions will be treated as REIT dividends that are not capital gains and will not be subject to the branch profits tax as long as the Non-U.S. Stockholder does not hold greater than 5% of the stock of the Company at any time during the one-year period ending on the date of the distribution. Non-U.S. Stockholders who hold more than 5% of the stock of the Company will be treated as if such gains were effectively connected with the conduct of a trade or business in the United States and generally subject to the same capital gains rates applicable to U.S. stockholders. In addition, corporate Non-U.S. Stockholders may also be subject to the 30% branch profits tax and to withholding at the rate of 35% of the gross distribution.

Table of Contents

Disposition of Stock of the Company

Generally, gain recognized by a Non-U.S. Stockholder upon the sale or exchange of stock of the Company will not be subject to United States taxation unless such stock constitutes a USRPI within the meaning of the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA). The stock of the Company will not constitute a USRPI so long as the Company is a domestically controlled REIT. A domestically controlled REIT is a REIT in which at all times during a specified testing period less than 50% in value of its stock or beneficial interests are held directly or indirectly by Non-U.S. Stockholders. The Company believes that it will be a domestically controlled REIT, and therefore that the sale of stock of the Company will generally not be subject to taxation under FIRPTA. However, because the stock of the Company is publicly traded, no assurance can be given that the Company is or will continue to be a domestically controlled REIT.

Under recently enacted wash sale rules applicable to certain dispositions of interests in domestically controlled REITs, a Non-U.S. Stockholder could be subject to taxation under FIRPTA on the disposition of stock of the Company if certain conditions are met. If the Company is a domestically controlled REIT, a Non-U.S. Stockholder will be treated as having disposed of USRPI, if such Non-U.S. Stockholder disposes of an interest in the Company in an applicable wash sale transaction. An applicable wash sale transaction is any transaction in which a Non-U.S. Stockholder avoids receiving a distribution from a REIT by (i) disposing of an interest in a domestically controlled REIT during the 30 day period preceding a distribution, any portion of which distribution would have been treated as gain from the sale of a USRPI if it had been received by the Non-U.S. Stockholder and (ii) acquiring, or entering into a contract or option to acquire, a substantially identical interest in the REIT during the 61 day period beginning the first day of the 30 day period preceding the distribution. The wash sale rule does not apply to a Non-U.S. Stockholder who actually receives the distribution from the Company or, so long as the Company is publicly traded, to any Non-U.S. Stockholder holding greater than 5% of the outstanding stock of the Company at any time during the one year period ending on the date of the distribution.

If the Company did not constitute a domestically controlled REIT, gain arising from the sale or exchange by a Non-U.S. Stockholder of stock of the Company would be subject to United States taxation under FIRPTA as a sale of a USRPI unless (i) the stock of the Company is regularly traded (as defined in the applicable Treasury regulations) and (ii) the selling Non-U.S. Stockholder's interest (after application of certain constructive ownership rules) in the Company is 5% or less at all times during the five years preceding the sale or exchange. If gain on the sale or exchange of the stock of the Company were subject to taxation under FIRPTA, the Non-U.S. Shareholder would be subject to regular United States income tax with respect to such gain in the same manner as a U.S. stockholder (subject to any applicable alternative minimum tax, a special alternative minimum tax in the case of nonresident alien individuals and the possible application of the 30% branch profits tax in the case of foreign corporations), and the purchaser of the stock of the Company (including the Company) would be required to withhold and remit to the IRS 10% of the purchase price. Additionally, in such case, distributions on the stock of the Company to the extent they represent a return of capital or capital gain from the sale of the stock of the Company, rather than dividends, would be subject to a 10% withholding tax.

Capital gains not subject to FIRPTA will nonetheless be taxable in the United States to a Non-U.S. Stockholder in two cases:

if the Non-U.S. Stockholder's investment in the stock of the Company is effectively connected with a U.S. trade or business conducted by such Non-U.S. Stockholder, the Non-U.S. Stockholder will be subject to the same treatment as a U.S. stockholder with respect to such gain, or

if the Non-U.S. Stockholder is a nonresident alien individual who was present in the United States for 183 days or more during the taxable year and has a tax home in the United States, the nonresident alien individual will

be subject to a 30% tax on the individual's capital gain.

Table of Contents

Information Reporting Requirements and Backup Withholding Tax

The Company will report to its U.S. stockholders and to the IRS the amount of dividends paid during each calendar year and the amount of tax withheld, if any, with respect thereto. Under the backup withholding rules, a U.S. stockholder may be subject to backup withholding, currently at a rate of 28% on dividends paid unless such U.S. stockholder

is a corporation or falls within certain other exempt categories and, when required, can demonstrate this fact, or

provides a taxpayer identification number, certifies as to no loss of exemption from backup withholding, and otherwise complies with applicable requirements of the backup withholding rules. A U.S. stockholder who does not provide the Company with his correct taxpayer identification number also may be subject to penalties imposed by the IRS. Any amount paid as backup withholding will be creditable against the U.S. stockholder's federal income tax liability. In addition, the Company may be required to withhold a portion of any capital gain distributions made to U.S. stockholders who fail to certify their non-foreign status to the Company.

Additional issues may arise pertaining to information reporting and backup withholding with respect to Non-U.S. Stockholders, and Non-U.S. Stockholders should consult their tax advisors with respect to any such information reporting and backup withholding requirements.

State and Local Taxes

The Company and its stockholders may be subject to state or local taxation in various state or local jurisdictions, including those in which it or they transact business or reside. The state and local tax treatment of the Company and its stockholders may not conform to the federal income tax consequences discussed above. Consequently, prospective holders should consult their own tax advisors regarding the effect of state and local tax laws on an investment in the stock of the Company.

Real Estate Investment Trust Tax Proposals

Investors must recognize that the present federal income tax treatment of the Company may be modified by future legislative, judicial or administrative actions or decisions at any time, which may be retroactive in effect, and, as a result, any such action or decision may affect investments and commitments previously made. The rules dealing with federal income taxation are constantly under review by persons involved in the legislative process and by the IRS and the Treasury Department, resulting in statutory changes as well as promulgation of new, or revisions to existing, regulations and revised interpretations of established concepts. No prediction can be made as to the likelihood of the passage of any new tax legislation or other provisions either directly or indirectly affecting the Company or its stockholders.

Other Legislation

The Jobs and Growth Tax Relief Reconciliation Act of 2003 reduced the maximum individual tax rate for long-term capital gains generally from 20% to 15% (for sales occurring after May 6, 2003 through December 31, 2008) and for dividends generally from 38.6% to 15% (for tax years from 2003 through 2008). These provisions have been extended through the 2010 tax year. Without future congressional action, the maximum tax rate on long-term capital gains will return to 20% in 2011, and the maximum rate on dividends will move to 39.6% in 2011. Because a REIT is not generally subject to federal income tax on the portion of its REIT taxable income or capital gains distributed to its stockholders, distributions of dividends by a REIT are generally not eligible for the new 15% tax rate on dividends. As

a result, the Company's ordinary REIT dividends will continue to be taxed at the higher tax rates (currently, a maximum of 35%) applicable to ordinary income.

ERISA Considerations

The following is a summary of material considerations arising under ERISA and the prohibited transaction provisions of Section 4975 of the Code that may be relevant to a holder of stock of the Company.

Table of Contents

This discussion does not propose to deal with all aspects of ERISA or Section 4975 of the Code or, to the extent not preempted, state law that may be relevant to particular employee benefit plan stockholders (including plans subject to Title I of ERISA, other employee benefit plans and IRAs subject to the prohibited transaction provisions of Section 4975 of the Code, and governmental plans and church plans that are exempt from ERISA and Section 4975 of the Code but that may be subject to state law requirements) in light of their particular circumstances.

A fiduciary making the decision to invest in stock of the Company on behalf of a prospective purchaser which is an ERISA plan, a tax-qualified retirement plan, an IRA or other employee benefit plan is advised to consult its own legal advisor regarding the specific considerations arising under ERISA, Section 4975 of the Code, and (to the extent not preempted) state law with respect to the purchase, ownership or sale of stock by such plan or IRA.

Employee Benefit Plans, Tax-Qualified Retirement Plans and IRAs

Each fiduciary of an employee benefit plan subject to Title I of ERISA (an ERISA Plan) should carefully consider whether an investment in stock of the Company is consistent with its fiduciary responsibilities under ERISA. In particular, the fiduciary requirements of Part 4 of Title I of ERISA require (i) an ERISA Plan s investments to be prudent and in the best interests of the ERISA Plan, its participants and beneficiaries, (ii) an ERISA Plan s investments to be diversified in order to reduce the risk of large losses, unless it is clearly prudent not to do so, (iii) an ERISA Plan s investments to be authorized under ERISA and the terms of the governing documents of the ERISA Plan and (iv) that the fiduciary not cause the ERISA Plan to enter into transactions prohibited under Section 406 of ERISA. In determining whether an investment in stock of the Company is prudent for purposes of ERISA, the appropriate fiduciary of an ERISA Plan should consider all of the facts and circumstances, including whether the investment is reasonably designed, as a part of the ERISA Plan s portfolio for which the fiduciary has investment responsibility, to meet the objectives of the ERISA Plan, taking into consideration the risk of loss and opportunity for gain (or other return) from the investment, the diversification, cash flow and funding requirements of the ERISA Plan and the liquidity and current return of the ERISA Plan s portfolio. A fiduciary should also take into account the nature of the Company s business, the length of the Company s operating history and other matters described below under Risk Factors.

The fiduciary of an IRA or of an employee benefit plan not subject to Title I of ERISA because it is a governmental or church plan or because it does not cover common law employees (a Non-ERISA Plan) should consider that such an IRA or Non-ERISA Plan may only make investments that are authorized by the appropriate governing documents, not prohibited under Section 4975 of the Code and permitted under applicable state law.

Status of the Company under ERISA

A prohibited transaction may occur if the assets of the Company are deemed to be assets of the investing Plans and parties in interest or disqualified persons as defined in ERISA and Section 4975 of the Code, respectively, deal with such assets. In certain circumstances where a Plan holds an interest in an entity, the assets of the entity are deemed to be Plan assets (the look-through rule). Under such circumstances, any person that exercises authority or control with respect to the management or disposition of such assets is a Plan fiduciary. Plan assets are not defined in ERISA or the Code, but the United States Department of Labor issued regulations in 1987 (the Regulations) that outline the circumstances under which a Plan s interest in an entity will be subject to the look-through rule.

The Regulations apply only to the purchase by a Plan of an equity interest in an entity, such as common stock or common shares of beneficial interest of a REIT. However, the Regulations provide an exception to the look-through rule for equity interests that are publicly-offered securities.

Under the Regulations, a publicly-offered security is a security that is (i) freely transferable, (ii) part of a class of securities that is widely-held and (iii) either (a) part of a class of securities that is registered under section 12(b) or 12(g) of the Securities Exchange Act of 1934, as amended (the Exchange Act), or (b) sold to a Plan as part of an offering of securities to the public pursuant to an effective registration statement under

Table of Contents

the Securities Act and the class of securities of which such security is a part is registered under the Exchange Act within 120 days (or such longer period allowed by the Securities and Exchange Commission) after the end of the fiscal year of the issuer during which the offering of such securities to the public occurred. Whether a security is considered freely transferable depends on the facts and circumstances of each case. Generally, if the security is part of an offering in which the minimum investment is \$10,000 or less, any restriction on or prohibition against any transfer or assignment of such security for the purposes of preventing a termination or reclassification of the entity for federal or state tax purposes will not of itself prevent the security from being considered freely transferable. A class of securities is considered widely-held if it is a class of securities that is owned by 100 or more investors independent of the issuer and of one another.

Management believes that the stock of the Company will meet the criteria of the publicly-offered securities exception to the look-through rule in that the stock of the Company is freely transferable, the minimum investment is less than \$10,000 and the only restrictions upon its transfer are those required under federal income tax laws to maintain the Company's status as a REIT. Second, stock of the Company is held by 100 or more investors and at least 100 or more of these investors are independent of the Company and of one another. Third, the stock of the Company has been and will be part of offerings of securities to the public pursuant to an effective registration statement under the Securities Act and will be registered under the Exchange Act within 120 days after the end of the fiscal year of the Company during which an offering of such securities to the public occurs. Accordingly, management believes that if a Plan purchases stock of the Company, the Company's assets should not be deemed to be Plan assets and, therefore, that any person who exercises authority or control with respect to the Company's assets should not be treated as a Plan fiduciary for purposes of the prohibited transaction rules of ERISA and Section 4975 of the Code.

Available Information

The Company makes available to the public free of charge through its internet website the Company's Proxy Statement, Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after the Company electronically files such reports with, or furnishes such reports to, the Securities and Exchange Commission. The Company's internet website address is www.healthcarerealty.com.

The public may read and copy any materials that the Company files with the SEC at the SEC's Public Reference Room located at 100 F Street, NE, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains electronic versions of the Company's reports on its website at www.sec.gov.

Corporate Governance Principles

The Company has adopted Corporate Governance Principles relating to the conduct and operations of the Board of Directors. The Corporate Governance Principles are posted on the Company's website (www.healthcarerealty.com) and are available in print to any stockholder who requests a copy.

Committee Charters

The Board of Directors has an Audit Committee, Compensation Committee, Corporate Governance Committee and Executive Committee. The Board of Directors has adopted written charters for each committee except for the Executive Committee, which are posted on the Company's website (www.healthcarerealty.com) and are available in print to any stockholder who requests a copy.

Executive Officers

Information regarding the executive officers of the Company is set forth in Part III, Item 10 of this report and is incorporated herein by reference.

Table of Contents**ITEM 1A. RISK FACTORS**

The following are some of the risks and uncertainties that could cause the Company's actual financial condition, results of operations, business and prospects to differ materially from those contemplated by the forward-looking statements contained in this report or the Company's other filings with the SEC. These risks, as well as the risks described in Item 1 under the headings "Competition," "Government Regulation," and "Federal Income Tax Information" and in Item 7 under the heading "Disclosure Regarding Forward-Looking Statements" should be carefully considered before making an investment decision regarding the Company. The risks and uncertainties described below are not the only ones facing the Company, and there may be additional risks that the Company does not presently know of or that the Company currently considers not likely to have a significant impact. If any of the events underlying the following risks actually occurred, the Company's business, financial condition and operating results could suffer, and the trading price of its Common Stock could decline.

The unavailability of equity and debt capital, volatility in the credit markets, changes in interest rates, or changes in the Company's debt ratings could harm its financial position.

A REIT is required by IRS regulations to make dividend distributions, thereby retaining less of its capital for growth. As a result, a REIT typically grows through steady investments of new capital in real estate assets. Presently, the Company has sufficient capital availability. However, there may be times when the Company will have limited access to capital from the equity and/or debt markets. Recently, the capital and credit markets have become increasingly volatile as a result of adverse conditions that have caused the failure or near failure of large financial services companies. If the capital and credit markets continue to experience volatility and the availability of funds remains limited, it is possible that the Company's ability to access the capital and credit markets may be limited by these or other factors, which could have an impact on its ability to refinance maturing debt, fund dividend payments and operations, acquire healthcare properties and complete construction projects.

Changes in the Company's debt ratings could have a material adverse effect on its interest costs and financing sources. The Company's debt rating can be materially influenced by a number of factors including, but not limited to, acquisitions, investment decisions, and capital management activities.

The Company's revenues depend on the ability of its tenants and sponsors under its financial support agreements to generate sufficient income from their operations to make loan, rent and support payments to the Company.

The Company's revenues are subject to the financial strength of its tenants and sponsors. The Company has no operational control over the business of these tenants and sponsors who face a wide range of economic, competitive and regulatory pressures and constraints. Such pressures and constraints could materially impair these tenants and sponsors and prevent them from making their loan, rent and support payments to the Company which could have a negative effect on the Company's cash flows and results of operations and its ability to make dividend payments.

If a healthcare tenant loses its licensure or certification, becomes unable to provide healthcare services, cannot meet its financial obligations to the Company or otherwise vacates the facility, the Company would have to obtain another tenant for the affected facility.

If the Company loses a tenant or sponsor and is unable to attract another healthcare provider on a timely basis and on acceptable terms, the Company's cash flows and results of operations could suffer. In addition, many of the Company's properties are special purpose healthcare facilities that may not be easily adaptable to other uses. Transfers of operations of healthcare facilities are often subject to regulatory approvals not required for transfers of other types of commercial operations and real estate.

Table of Contents

If lenders under the Company's Unsecured Credit Facility fail to meet their funding commitments, the Company's financial position would be negatively impacted.

Access to external capital on favorable terms is critical to the Company's success in growing and maintaining its portfolio. If financial institutions within the Company's Unsecured Credit Facility were unwilling or unable to meet their respective funding commitments to the Company, any such failure would have a negative impact on the Company's operations, financial condition and ability to meet its obligations, including the payment of dividends to stockholders.

The Company is subject to risks associated with the development of properties.

The Company is subject to certain risks associated with the development of properties including the following:

The construction of properties generally require various government and other approvals which may not be received when expected, or at all, which could delay or preclude commencement of construction;

Unsuccessful development opportunities could result in the recognition of direct expenses which could impact the Company's results of operations;

Construction costs could exceed original estimates, which would impact its profitability to the Company;

Time required to initiate and complete the construction of a property and lease up a completed development property may be greater than originally anticipated, thereby adversely affecting the Company's cash flow and liquidity;

Occupancy rates and rents of a completed development property may not be sufficient to make the property profitable to the Company; and

Favorable capital sources to fund the Company's development activities may not be available when needed.

The Company may be unsuccessful in operating new and existing real estate properties.

The Company's acquired, developed and existing real estate properties may not perform in accordance with management's expectations because of many factors including the following:

The Company's purchase price for acquired facilities may be based upon a series of market judgments which may be incorrect;

The costs of any improvements required to bring an acquired facility up to standards necessary to establish the market position intended for that facility might exceed budgeted costs;

The Company may incur unexpected costs in the acquisition, construction or maintenance of real estate assets that could impact its expected returns on such assets; and

Leasing of real estate properties may not occur within expected timeframes or at expected rental rates.

Further, the Company can give no assurance that acquisition and development opportunities that will meet management's investment criteria will be available when needed or anticipated.

The Company's long-term master leases and financial support agreements may expire and not be extended.

Long-term master leases and financial support agreements that are expiring may not be extended. With respect to master leased properties, the Company may not be able to re-let those properties at rental rates that are as high as the former master lease rate. With respect to properties with financial support agreements that are not extended at expiration, the property operating income generated from those properties may decline.

Table of Contents

The market price of the Company's stock may be affected adversely by changes in the Company's dividend policy.

The ability of the Company to pay dividends is dependent upon its ability to maintain funds from operations and cash flow, to make accretive new investments and to access capital. A failure to maintain dividend payments at current levels could result in a reduction of the market price of the Company's stock.

Adverse trends in the healthcare service industry may negatively affect the Company's lease revenues and the values of its investments.

The healthcare service industry is currently experiencing:

- Changing trends in the method of delivery of healthcare services;
- Increased expense for uninsured patients and uncompensated care;
- Increased competition among healthcare providers;
- Continuing pressure by private and governmental payors to contain costs and reimbursements while increasing patients' access to healthcare services;
- Lower operating profit margins in an uncertain economy;
- Investment losses;
- Constrained availability of capital;
- Credit downgrades;
- Increased liability insurance expense; and
- Increased scrutiny and formal investigations by federal and state authorities.

These changes, among others, can adversely affect the economic performance of some or all of the tenants and sponsors who provide financial support to the Company's investments and, in turn, negatively affect the lease revenues and the value of the Company's property investments.

The Company is exposed to risks associated with entering new geographic markets.

The Company's acquisition and development activities may involve entering geographic markets where the Company has not previously had a presence. The construction and/or acquisition of properties in new geographic areas involves risks, including the risk that the property will not perform as anticipated and the risk that any actual costs for site development and improvements identified in the pre-construction or pre-acquisition due diligence process will exceed estimates. There is, and it is expected that there will continue to be, significant competition for investment opportunities that meet management's investment criteria, as well as risks associated with obtaining financing for acquisition activities, if necessary.

The Company may experience uninsured or underinsured losses related to casualty or liability.

The Company generally requires its tenants to maintain comprehensive liability and property insurance that covers the Company as well as the tenants. The Company also carries comprehensive liability insurance and property insurance covering its owned and managed properties. In addition, tenants under long-term master leases are required to carry property insurance covering the Company's interest in the buildings. Some types of losses, however, either may be uninsurable or too expensive to insure against. Should an uninsured loss or a loss in excess of insured limits occur, the Company could lose all or a portion of the capital it has invested in a property, as well as the anticipated future revenue from the property. In such an event, the Company might remain obligated for any mortgage debt or other financial obligation related to the property. The Company cannot give assurance that material losses in excess of insurance proceeds will not occur in the future.

Table of Contents

The Company owns facilities that are operated by companies that may experience regulatory and legal problems.

The Company's tenants and sponsors are subject to a complex system of federal and state regulations relating to the delivery of healthcare services. If a tenant or sponsor experiences regulatory or legal problems, the Company could be at risk for amounts owed to it by the tenant under leases or financial support agreements.

Failure to maintain its status as a REIT, even in one taxable year, could cause the Company to reduce its dividends dramatically.

The Company intends to qualify at all times as a REIT under the Code. If in any taxable year the Company does not qualify as a REIT, it would be taxed as a corporation. As a result, the Company could not deduct its distributions to the stockholders in computing its taxable income. Depending upon the circumstances, a REIT that loses its qualification in one year may not be eligible to re-qualify during the four succeeding years. Further, certain transactions or other events could lead to the Company being taxed at rates ranging from four to 100 percent on certain income or gains. For more information about the Company's status as a REIT, see "Federal Income Tax Information" in Item 1 of this Annual Report on Form 10-K.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

In addition to the properties described under Item 1, "Business" and in Schedule III of Item 15 hereto, the Company leases office space for its headquarters.

The Company's headquarters, located in offices at 3310 West End Avenue in Nashville, Tennessee, are leased from an unrelated third party. The Company's current lease agreement, which commenced on November 1, 2003, covers approximately 30,934 square feet of rented space and expires on October 31, 2010, with two five-year renewal options. Annual base rent was approximately \$636,312 in 2008 with increases of approximately 3.25% annually.

ITEM 3. LEGAL PROCEEDINGS

On October 9, 2003, HR Acquisition I Corporation (f/k/a Capstone Capital Corporation, "Capstone"), a wholly owned affiliate of the Company, was served with the Third Amended Verified Complaint in a stockholder derivative suit which was originally filed on August 28, 2002 in the Jefferson County, Alabama Circuit Court by a stockholder of HealthSouth Corporation. The suit alleges that certain officers and directors of HealthSouth, who were also officers and directors of Capstone, sold real estate properties from HealthSouth to Capstone and then leased the properties back to HealthSouth at artificially high values, in violation of their fiduciary obligations to HealthSouth. The Company acquired Capstone in a merger transaction in October 1998. None of the Capstone officers and directors remained in their positions following the Company's acquisition of Capstone. The complaint seeks unspecified compensatory and punitive damages. Following the settlement of a number of claims unrelated to the claims against Capstone, the court lifted a lengthy stay on discovery in April 2007. Discovery is substantially complete and a trial is scheduled in May 2009. In late 2008, the Company reached an agreement in principle with HealthSouth Corporation to develop and lease a new inpatient rehabilitation hospital in Arizona and to modify the terms of several existing leases. The transactions between the Company and HealthSouth are expected to be completed in the first quarter of 2009. The derivative plaintiff has agreed to settle and dismiss its claims against Capstone upon the conclusion of the transactions and the payment by the Company and HealthSouth of approximately \$0.6 million each to the derivative plaintiff's counsel. The settlement and dismissal of the case are subject to a fairness hearing and court approval. The

Company believes the new development and business transactions are favorable to it and to HealthSouth and continues to deny any liability for the claims presented by the derivative plaintiff.

Table of Contents

In connection with the stockholder derivative suit discussed above, Capstone filed a claim with its directors and officers liability insurance carrier, Twin City Fire Insurance Company (Twin City), an affiliate of the Hartford family of insurance companies, for indemnity against legal and other expenses incurred by Capstone related to the suit and any judgment rendered. Twin City asserted that the Company's claim was not covered under the D&O policy and refused to reimburse Capstone's defense expenses. In September 2005, Capstone filed suit against Twin City for coverage and performance under its insurance policy. In late 2007, the federal district judge in Birmingham, Alabama entered partial summary judgment on Capstone's claim for advancement of defense costs under the policy under which Capstone and Twin City agreed to an interim plan for Twin City's payment of defense costs, fees and expenses, subject to Twin City's appeal of the partial summary judgment ruling. During 2007 and 2008, Capstone received \$2.2 million from Twin City which was recorded as an offset to property operating expense on the Company's Consolidated Statements of Income. On November 3, 2008, Capstone accepted Twin City's oral offer to settle the dispute over coverage which provided that Capstone would retain monies received to date from Twin City of \$2.2 million, and Twin City would pay Capstone an additional \$0.3 million for additional incurred but unreimbursed expenses. Also on November 3, 2008, the 11th Circuit Court of Appeals issued a written opinion reversing the lower court's ruling and ruled that the Twin City policy did not provide coverage to Capstone. Given the outcome of the appellate court's ruling, Twin City asserted that no enforceable contract to settle existed. Capstone filed suit against Twin City on January 20, 2009 in the federal district court for the Middle District of Tennessee for breach of contract and to enforce the terms of the November 2008 oral agreement to settle. Capstone and Twin City reached an agreement to settle and dismiss the breach of contract action on February 13, 2009. The terms of the settlement require Capstone to refund \$950,000 of the \$2.2 million in legal fees and expenses Twin City previously reimbursed. As a result, the Company accrued the \$950,000 refund to property operating expense in its 2008 operating results.

In October 2008, the Company and Methodist Health System Foundation, Inc. (the Foundation) agreed to settle a lawsuit filed against the Company by the Foundation. In May 2006, the Foundation filed suit against a wholly owned affiliate of the Company in the Civil District Court for Orleans Parish, Louisiana. The Foundation is the sponsor under property operating agreements which support two of the Company's medical office buildings adjoining the Methodist Hospital in east New Orleans, which has remained closed since Hurricane Katrina struck in August 2005. Since Hurricane Katrina, the Foundation had ceased making payments to the Company under its property operating agreements. In connection with the settlement, the Foundation agreed to pay to the Company approximately \$8.6 million, of which \$3.0 million was paid on December 31, 2008, and granted the Company an option to purchase the Foundation's interest in the associated land and related ground leases for \$50,000. The Foundation will pay the remaining \$5.6 million in quarterly installments of approximately \$0.5 million, beginning on March 31, 2009 and continuing through and including September 30, 2011. The Foundation will have no further guaranty payment obligations under the modified property operating agreements beyond the amounts payable under the settlement agreement.

The Company is not aware of any other pending or threatened litigation that, if resolved against the Company, would have a material adverse effect on the Company's financial condition or results of operations.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matter was submitted to a vote of stockholders during the fourth quarter of 2008.

Table of Contents**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Shares of the Company's Common Stock are traded on the New York Stock Exchange under the symbol HR. As of December 31, 2008, there were approximately 1,394 stockholders of record. The following table sets forth the high and low sales prices per share of Common Stock and the distributions declared and paid per share of Common Stock related to the periods indicated.

	High	Low	Distributions Declared and Paid per Share
<u>2008</u>			
First Quarter	\$ 27.07	\$ 22.02	\$ 0.385
Second Quarter	29.89	23.55	0.385
Third Quarter	32.00	23.45	0.385
Fourth Quarter (Payable on March 5, 2009)	29.75	14.29	0.385
<u>2007</u>			
Special Dividend			\$ 4.750
First Quarter	\$ 44.19	\$ 34.96	0.660
Second Quarter	39.26	27.20	0.385
Third Quarter	29.07	18.00	0.385
Fourth Quarter	27.76	22.72	0.385

Future distributions will be declared and paid at the discretion of the Board of Directors. The Company's ability to pay dividends is dependent upon its ability to generate funds from operations, cash flows, and to make accretive new investments.

Equity Compensation Plan Information

The following table provides information as of December 31, 2008 about the Company's Common Stock that may be issued upon grants of restricted stock and the exercise of options, warrants and rights under all of the Company's existing compensation plans, including the 2007 Employees Stock Incentive Plan, the 2000 Employee Stock Purchase Plan, the 1994 Dividend Reinvestment Plan, and the 1995 Restricted Stock Plan for Non-Employee Directors.

Number of Securities to be Issued upon Exercise of Outstanding Options,	Weighted-Average Exercise Price of Outstanding Options,	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected
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Plan Category	Warrants and Rights(1)	Warrants and Rights(1)	in the First Column)
Equity compensation plans approved by security holders	250,868		2,685,609
Equity compensation plans not approved by security holders			
Total	250,868		2,685,609

- (1) The Company is unable to ascertain with specificity the number of securities to be issued upon exercise of outstanding rights under the 2000 Employee Stock Purchase Plan or the weighted average exercise price of outstanding rights under that plan. The 2000 Employee Stock Purchase Plan provides that shares of Common Stock may be purchased at a per share price equal to 85% of the fair market value of the Common Stock at the beginning of the offering period or a purchase date applicable to such offering period, whichever is lower.

Table of Contents**ITEM 6. SELECTED FINANCIAL DATA**

The following table sets forth financial information for the Company, which is derived from the Consolidated Financial Statements of the Company:

<i>(Dollars in thousands, except per share data)</i>	Years Ended December 31,				
	2008	2007(1)(2)	2006(2)	2005(2)	2004(2)
Statement of Income Data:					
Total revenues	\$ 214,241	\$ 197,371	\$ 198,219	\$ 192,211	\$ 168,532
Total expenses	\$ 160,499	\$ 139,294	\$ 137,859	\$ 133,221	\$ 104,025
Other income (expense)	\$ (35,584)	\$ (46,848)	\$ (49,747)	\$ (44,906)	\$ (40,823)
Income from continuing operations	\$ 18,158	\$ 11,229	\$ 10,613	\$ 14,084	\$ 23,684
Discontinued operations	\$ 23,534	\$ 48,833	\$ 29,106	\$ 38,584	\$ 31,849
Net income	\$ 41,692	\$ 60,062	\$ 39,719	\$ 52,668	\$ 55,533
Per Share Data:					
Basic:					
Income from continuing operations per common share	\$ 0.35	\$ 0.24	\$ 0.23	\$ 0.30	\$ 0.54
Discontinued operations per common share	\$ 0.46	\$ 1.02	\$ 0.62	\$ 0.83	\$ 0.73
Net income per common share	\$ 0.81	\$ 1.26	\$ 0.85	\$ 1.13	\$ 1.27
Diluted:					
Income from continuing operations per common share	\$ 0.35	\$ 0.23	\$ 0.22	\$ 0.30	\$ 0.53
Discontinued operations per common share	\$ 0.44	\$ 1.01	\$ 0.62	\$ 0.81	\$ 0.71
Net income per common share	\$ 0.79	\$ 1.24	\$ 0.84	\$ 1.11	\$ 1.24
Weighted average common shares outstanding Basic	51,547,279	47,536,133	46,527,857	46,465,215	43,706,528
Weighted average common shares outstanding Diluted	52,564,944	48,291,330	47,498,937	47,406,798	44,627,475
Balance Sheet Data (as of the end of the period):					
Real estate properties, net	\$ 1,634,364	\$ 1,351,173	\$ 1,554,620	\$ 1,513,247	\$ 1,558,794
Mortgage notes receivable	\$ 59,001	\$ 30,117	\$ 73,856	\$ 105,795	\$ 40,321
Assets held for sale and discontinued operations, net	\$ 90,233	\$ 15,639	\$	\$ 21,415	\$ 61,246
Total assets	\$ 1,864,780	\$ 1,495,492	\$ 1,736,603	\$ 1,747,652	\$ 1,750,810
Notes and bonds payable	\$ 940,186	\$ 785,289	\$ 849,982	\$ 778,446	\$ 719,264

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Total stockholders' equity	\$	794,820	\$	631,995	\$	825,672	\$	912,468	\$	980,616
Other Data:										
Funds from operations - Basic and Diluted(3)	\$	85,437	\$	73,156	\$	101,106	\$	107,943	\$	110,172
Funds from operations per common share										
Basic(3)	\$	1.66	\$	1.54	\$	2.17	\$	2.32	\$	2.52
Funds from operations per common share										
Diluted(3)	\$	1.63	\$	1.51	\$	2.13	\$	2.28	\$	2.47
Quarterly dividends declared and paid per										
common share	\$	1.54	\$	2.09	\$	2.64	\$	2.63	\$	2.55
Special dividend declared and paid per										
common share	\$		\$	4.75	\$		\$		\$	

(1) The Company completed the sale of its senior living assets in 2007 and paid a \$4.75 per share special dividend with a portion of the proceeds. See Note 4 to the Consolidated Financial Statements for more information on this transaction.

Table of Contents

- (2) The years ended December 31, 2007, 2006, 2005 and 2004 are restated to conform to the discontinued operations presentation for 2008. See Note 5 to the Consolidated Financial Statements for more information on the Company's discontinued operations at December 31, 2008.
- (3) See Management's Discussion and Analysis of Financial Condition and Results of Operations for a discussion of funds from operations (FFO), including why the Company presents FFO and a reconciliation of net income to FFO.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Disclosure Regarding Forward-Looking Statements

This report and other materials Healthcare Realty has filed or may file with the Securities and Exchange Commission, as well as information included in oral statements or other written statements made, or to be made, by senior management of the Company, contain, or will contain, disclosures that are forward-looking statements. Forward-looking statements include all statements that do not relate solely to historical or current facts and can be identified by the use of words such as may, will, expect, believe, anticipate, target, intend, plan, estimate, continue, should, could and other comparable terms. These forward-looking statements are based on the current plans and expectations of management and are subject to a number of risks and uncertainties, including those set forth below, that could significantly affect the Company's current plans and expectations and future financial condition and results.

Such risks and uncertainties include, among other things, the following:

The unavailability of equity and debt capital, volatility in the credit markets, changes in interest rates, or changes in the Company's debt ratings;

The financial health of the Company's tenants and sponsors and their ability to make loan and rent payments to the Company;

The ability and willingness of the Company's lenders to make their funding commitments to the Company;

The Company's long-term master leases and financial support agreements may expire and not be extended;

The construction of properties generally requires various government and other approvals which may not be received;

Unsuccessful development opportunities could result in the recognition of direct expenses which could impact the Company's results of operations;

Construction costs of a development property may exceed original estimates, which could impact its profitability to the Company;

Time required to lease up a completed development property may be greater than originally anticipated, thereby adversely affecting the Company's cash flow and liquidity;

Occupancy rates and rents of a completed development property may not be sufficient to make the property profitable to the Company;

Favorable capital sources to fund the Company's development activities may not be available when needed;

Changes in the financial condition or corporate strategy of the Company's tenants and sponsors;

Adverse trends in the healthcare service industry that could negatively affect the Company's lease revenues and the values of its investments; and

Changes in the Company's dividend policy.

Table of Contents

Other risks, uncertainties and factors that could cause actual results to differ materially from those projected are detailed in Item 1A "Risk Factors" of this report and in other reports filed by the Company with the SEC from time to time.

The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Stockholders and investors are cautioned not to unduly rely on such forward-looking statements when evaluating the information presented in the Company's filings and reports.

Overview

Business Overview

The Company, a self-managed and self-administered REIT, integrates owning, managing and developing income-producing real estate properties associated primarily with the delivery of outpatient healthcare services throughout the United States. Management believes that by providing a complete spectrum of real estate services, the Company can differentiate its competitive market position, expand its asset base and increase revenues over time.

The Company's revenues are generally derived from rentals on its healthcare real estate properties. The Company incurs operating and administrative expenses, including compensation, office rent and other related occupancy costs, as well as various expenses incurred in connection with managing its existing portfolio and acquiring additional properties. The Company also incurs interest expense on its various debt instruments and depreciation and amortization expense on its real estate portfolio.

Executive Overview

Over the last few years, the market for quality medical office and other outpatient-related facilities attracted many non-traditional and/or highly-leveraged buyers, which resulted in a significant increase in the competition for these assets. The recent and ongoing turmoil in the credit markets, however, has resulted in the Company seeing fewer buyers competing for such properties, which has provided more opportunities to acquire real estate properties with attractive risk-adjusted returns. While management has observed only a slight decrease in asset prices, the Company's relatively conservative capital structure positions it well to take advantage of the current credit market dislocation and any resulting future decline in asset prices. In 2008, the Company acquired approximately \$335.6 million in real estate assets and funded \$8.0 million in a new mortgage note receivable. In January 2009, the Company acquired the remaining membership interest in a joint venture in which it previously held a minority interest for approximately \$4.4 million and assumed related debt of approximately \$12.8 million. The entity acquired by the Company owns a 62,246 square foot on-campus medical office building. See Note 4 to the Consolidated Financial Statements for more details on these acquisitions.

The Company believes that its construction projects will provide solid, long-term investment returns and high quality buildings. As of December 31, 2008, the Company had four construction projects underway with budgets totaling approximately \$174.0 million. The Company expects completion of the core and shell of three of the projects with budgets totaling approximately \$88.0 million during 2009 and expects completion of the fourth project with a budget totaling approximately \$86.0 million in the first quarter of 2010. In addition to the projects currently under construction, the Company is financing an on-campus medical office development of an outpatient campus comprised of six facilities, with a total budget of approximately \$72 million, of which the Company has already advanced \$42.2 million. The Company expects to finance the remaining \$29.8 million during 2009 and 2010. With respect to five of the six facilities, the Company will have an option to purchase each such facility at a market cap rate upon its completion and full occupancy. The sixth facility is being acquired by the tenant.

The Company's real estate portfolio, diversified by facility type, geography, tenant and payor mix, helps mitigate its exposure to fluctuating economic conditions, tenant and sponsor credit risks, and changes in clinical practice patterns. At December 31, 2008, the Company's leverage ratio [debt divided by (debt plus

Table of Contents

stockholders' equity less intangible assets plus accumulated depreciation)] was approximately 45.0% with 64.6% of its debt portfolio maturing after 2010. The Company had borrowings outstanding under its Unsecured Credit Facility totaling \$329.0 million at December 31, 2008, with a capacity remaining of \$71.0 million.

Capital and Credit Market Conditions

The capital and credit markets have become increasingly volatile as a result of adverse conditions that have caused the failure or near failure of a number of large financial institutions. The Company believes its conservative capital structure will foster stable operations throughout this time with no debt maturities in 2009, its \$400 million Unsecured Credit Facility maturing in January 2010 and its two \$300 million Senior Notes maturing in 2011 and 2014. However, continued volatility in the markets could limit the Company's ability to access debt or equity markets when needed which, in turn, could impact the Company's ability to invest in real estate assets, refinance maturing debt and react to changing economic and business conditions. The Company's debt ratings could also be affected, adversely impacting its interest costs and financing sources. The Company also had unencumbered real estate assets of approximately \$1.9 billion at December 31, 2008, which could serve as collateral for secured mortgage financing. Furthermore, the Company anticipates renewing its Unsecured Credit Facility during 2009 and believes that sufficient commitments will be available to the Company, but believes that the interest rate upon renewal will likely be higher than its current rate (LIBOR + 0.90%).

Trends and Matters Impacting Operating Results

Management monitors factors and trends important to the Company and REIT industry in order to gauge the potential impact on the operations of the Company. Discussed below are some of the factors and trends that management believes may impact future operations of the Company.

As of December 31, 2008, approximately 35.7% of the Company's real estate investments consisted of properties leased to unaffiliated lessees pursuant to long-term net lease agreements or subject to financial support agreements; approximately 59.8% were multi-tenanted properties with shorter-term occupancy leases; and the remaining 4.5% of investments were related to land held for development, corporate property, mortgage notes receivable and investments in unconsolidated joint ventures which are invested in real estate properties. The Company's long-term net leases and financial support agreements are generally designed to ensure the continuity of revenues and coverage of costs and expenses relating to the properties by the tenants and the sponsoring healthcare operators. There is no assurance that the Company's leases and financial support agreements will be extended past their expiration dates which could impact the Company's operating results as described in more detail below in *Expiring Leases and Financial Support Agreements*.

Acquisition Activity

During 2008, the Company acquired 27 real estate properties and funded a mortgage note receivable for approximately \$294.5 million and assumed related debt of approximately \$43.4 million, net of fair value adjustments, including an 80% interest in a joint venture that concurrently acquired four buildings for an investment of \$28.8 million. These acquisitions were funded with net proceeds from an equity offering in September 2008 totaling \$196.0 million, the assumption of existing mortgage debt, borrowings on the Unsecured Credit Facility, and proceeds from real estate dispositions. See Note 4 to the Consolidated Financial Statements for more information on these acquisitions.

Development Activity

During 2008, five buildings that were previously under construction commenced operations and one construction project was reclassified to land held for development, resulting in four construction projects remaining that were underway at December 31, 2008 with budgets totaling approximately \$174.0 million. The Company expects completion of the core and shell of three of the four projects with budgets totaling approximately \$88.0 million during 2009 and expects the core and shell of the fourth project with a budget totaling approximately \$86.0 million to be completed during the first quarter of 2010. In addition to the

Table of Contents

projects currently under construction, the Company is financing an on-campus medical office development of an outpatient campus comprised of six facilities, with a total budget of approximately \$72 million, of which the Company has already advanced \$42.2 million. The Company expects to finance the remaining \$29.8 million during 2009 and 2010. With respect to five of the six facilities, the Company will have an option to purchase each such facility at a market cap rate upon its completion and full occupancy. The sixth facility is being acquired by the tenant. The Company's ability to complete, lease-up and operate these facilities in a given period of time will impact the Company's results of operations and cash flows. More favorable completion dates, lease-up periods and rental rates will result in improved results of operations and cash flows, while lagging completion dates, lease-up periods and rental rates will likely result in less favorable results of operations and cash flows. The Company's disclosures regarding projections or estimates of completion dates and leasing may not reflect actual results. See Note 14 to the Consolidated Financial Statements for more information on the Company's development activities.

Dispositions

During 2008, the Company disposed of seven real estate properties for approximately \$27.1 million and disposed of two parcels of land for approximately \$9.8 million. Also, a portion of the Company's preferred equity investment in a joint venture was redeemed for \$5.5 million and one mortgage note receivable totaling approximately \$2.5 million was repaid. Proceeds from these dispositions were used to repay amounts under the Unsecured Credit Facility and to fund additional real estate investments. See Note 4 to the Consolidated Financial Statements for more information on these dispositions.

2009 Potential Acquisitions and Dispositions

As discussed in Note 4 to the Consolidated Financial Statements, the Company had several acquisitions and dispositions pending at December 31, 2008 that will impact the Company's operating results for 2009 when or if those transactions are completed.

Purchase Option Provisions

As discussed in Liquidity and Capital Resources, certain of the Company's leases include purchase option provisions, which if exercised, could require the Company to sell a property to a lessee or operator, which could have a negative impact on the Company's future results of operations and cash flows.

Expiring Leases and Financial Support Agreements

Master leases on 14 of the Company's properties will expire in 2009. The Company has decided not to extend the master leases relating to about one-half of these properties. The master leases the Company has decided not to extend are multi-tenanted properties on or near hospital campuses and in locations where the Company already has existing management capabilities. With respect to the remaining properties, the Company believes that either the current tenants will extend their leases or the Company will lease the property to another single tenant.

Approximately 440 of the Company's leases in its multi-tenanted buildings will expire in 2009, with each tenant lessee occupying an average of approximately 3,188 square feet. Approximately 60% of the multi-tenant leases expiring in 2009 relate to buildings acquired in 2004, in which each lessee occupies approximately 3,200 square feet. About 43% of the 2004 leases expiring were signed with hospital-related entities upon closing of the real estate property acquisitions, and the remainder of the leases are related to non-hospital tenants. Historically, hospital-related tenants who occupy space in on-campus buildings have a high probability of renewal. Also, management expects that the majority of the non-hospital tenants will renew at favorable rates.

One of the Company's financial support agreements also expires in 2009. The Company does not expect the sponsor to extend its agreement with the Company.

Table of Contents

With the expirations discussed above, the Company expects there could be a short-term negative impact to its results of operations, but anticipates that over time it will be able to re-lease the properties or increase tenant rents to offset any short-term decline in revenue.

Discontinued Operations

In accordance with Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS No. 144), discussed in more detail in Note 1 to the Consolidated Financial Statements, a company must present the results of operations of real estate assets disposed of or held for sale as discontinued operations. Therefore, the results of operations from such assets are classified as discontinued operations for the current period, and all prior periods presented are restated to conform to the current period presentation. Readers of the Company s Consolidated Financial Statements should be aware that each future disposal will result in a change to the presentation of the Company s operations in the historical Consolidated Statements of Income as previously filed. Such reclassifications to the Consolidated Statements of Income will have no impact on previously reported net income.

Amortization of In-Place Leases

As discussed in Application of Critical Accounting Policies to Accounting Estimates and in Note 1 to the Consolidated Financial Statements, when a building is acquired with in-place leases, SFAS No. 141, Business Combinations (SFAS No. 141), requires that the cost of the acquisition be allocated between the tangible real estate and the intangible assets related to in-place leases based on their fair values. Where appropriate, the intangible assets recorded could include goodwill, ground leases or customer relationship assets. The value of above- or below-market in-place leases is amortized against rental income or property operating expense over the average remaining term of the leases in-place upon acquisition. The amortization periods of the intangibles may be relatively short, such as with a short-term tenant lease, or may be longer, such as with a long-term ground lease. The value of at-market in-place leases and other intangible assets is amortized and reflected in amortization expense in the Company s Consolidated Statements of Income. Amortization expense related to these in-place leases may increase or decrease because of new in-place leases recorded related to new real estate acquisitions or because of in-place leases becoming fully amortized.

Funds from Operations

Funds from operations (FFO) and FFO per share are operating performance measures adopted by the National Association of Real Estate Investment Trusts, Inc. (NAREIT). NAREIT defines FFO as the most commonly accepted and reported measure of a REIT s operating performance equal to net income (computed in accordance with GAAP), excluding gains (or losses) from sales of property, plus depreciation and amortization, and after adjustments for unconsolidated partnerships and joint ventures. Impairment charges may not be added back to net income in calculating FFO, which have the effect of decreasing FFO in the period recorded. In 2008, the Company recognized additional income for certain items which increased FFO, including net gains on repurchases of the Company s Senior Notes due 2011 and 2014 of approximately \$4.1 million, termination fees of approximately \$8.0 million and the recognition of straight-line rent income for prior years related to a joint venture of approximately \$0.8 million, which were partially offset by a reserve recorded on an outstanding receivable of approximately \$1.4 million and a \$1.0 million accrual recorded related to a litigation settlement. These items had the net effect of increasing FFO by approximately \$0.20 per share for the year ended December 31, 2008. Also, for the years ended 2008, 2007 and 2006, the Company recorded impairment charges totaling \$2.5 million, \$7.1 million and \$5.7 million, respectively, which reduced FFO per diluted share by approximately \$0.05, \$0.15 and \$0.12, respectively. The comparability of FFO for the three years ending December 31, 2008 is also impacted by the senior living asset dispositions during 2007, because of the elimination of the operations of the divested assets. FFO and FFO per share generated by the senior living assets disposed of during 2007 totaled approximately \$10.2 million, or \$0.22 per basic common share (\$0.21

per diluted common share), for the year ended December 31, 2007 and approximately \$29.1 million, or \$0.63 per basic common share (\$0.61 per diluted common share), for the year ended December 31, 2006.

Table of Contents

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

The table below reconciles net income to FFO for the three years ended December 31, 2008.

<i>(Dollars in thousands, except per share data)</i>	Year Ended December 31,		
	2008	2007	2006
Net income	\$ 41,692	\$ 60,062	\$ 39,719
Gain on sales of real estate properties	(10,227)	(40,405)	(3,275)
Real estate depreciation and amortization	53,972	53,499	64,662
Total adjustments	43,745	13,094	61,387
Funds from operations Basic and Diluted	\$ 85,437	\$ 73,156	\$ 101,106
Weighted average common shares outstanding Basic	51,547,279	47,536,133	46,527,857
Weighted average common shares outstanding Diluted	52,564,944	48,291,330	47,498,937
Funds from operations per common share Basic	\$ 1.66	\$ 1.54	\$ 2.17
Funds from operations per common share Diluted	\$ 1.63	\$ 1.51	\$ 2.13

Results of Operations***2008 Compared to 2007***

The Company's net income for 2008 compared to 2007 was impacted by senior living asset dispositions in 2007 and the resulting gain on sale. However, the comparability of revenues and income from continuing operations for 2007 and 2006 was not impacted by the disposition because the results of operations of the assets disposed of are included in discontinued operations for both periods. Included in the sale were 56 real estate properties in which the Company

had investments totaling approximately \$328.4 million (\$259.9 million, net), 16 mortgage notes and notes receivable in which the Company had investments totaling approximately \$63.2 million, and certain other assets and liabilities related to the assets. The Company received cash proceeds from the sale of approximately \$369.4 million, recorded a deferred gain of approximately \$5.7 million and recognized a net gain of approximately \$40.2 million. The proceeds were used to pay a special dividend to the Company's stockholders of approximately \$227.2 million, or \$4.75 per share, to repay amounts outstanding on the Company's Unsecured Credit Facility, to pay transaction costs and were used for general corporate purposes. The transaction also included the sale of all 21 of the properties associated with the

Table of Contents

Company's variable interest entities (VIEs), including the six VIEs the Company had previously consolidated. Revenues, including the revenues from the VIEs, were approximately \$27.4 million and net income was approximately \$8.4 million for the senior living assets for the year ended December 31, 2007, which are included in discontinued operations on the Consolidated Statement of Income.

For the year ended December 31, 2008, net income was \$41.7 million, or \$0.81 per basic common share (\$0.79 per diluted common share), compared to net income of \$60.1 million, or \$1.26 per basic common share (\$1.24 per diluted common share), for the year ended December 31, 2007. Revenues from continuing operations were \$214.2 million for the year ended December 31, 2008 compared to revenues from continuing operations of \$197.4 million for the year ended December 31, 2007. FFO was \$85.4 million, or \$1.66 per basic common share (\$1.63 per diluted common share), for the year ended December 31, 2008 compared to \$73.2 million, or \$1.54 per basic common share (\$1.51 per diluted common share), in 2007.

<i>(Dollars in thousands)</i>	2008	2007	Change	
			\$	%
Revenues				
Master lease rent	\$ 58,412	\$ 56,401	\$ 2,011	3.6%
Property operating	136,745	121,644	15,101	12.4%
Straight-line rent	622	934	(312)	(33.4)%
Mortgage interest	2,207	1,752	455	26.0%
Other operating	16,255	16,640	(385)	(2.3)%
	214,241	197,371	16,870	8.5%
Expenses				
General and administrative	23,514	20,619	2,895	14.0%
Property operating	82,420	71,671	10,749	15.0%
Impairment	1,600		1,600	
Bad debts, net of recoveries	1,833	222	1,611	725.7%
Depreciation	48,283	42,254	6,029	14.3%
Amortization	2,849	4,528	(1,679)	(37.1)%
	160,499	139,294	21,205	15.2%
Other Income (Expense)				
Gain on extinguishment of debt, net	4,102		4,102	
Interest expense	(42,126)	(48,307)	6,181	(12.8)%
Interest and other income, net	2,440	1,459	981	67.2%
	(35,584)	(46,848)	11,264	(24.0)%
Income From Continuing Operations	18,158	11,229	6,929	61.7%
Discontinued Operations				
Income from discontinued operations	14,577	15,517	(940)	(6.1)%
Impairments	(886)	(7,089)	6,203	(87.5)%
Gain on sales of real estate properties	9,843	40,405	(30,562)	(75.6)%
Income From Discontinued Operations	23,534	48,833	(25,299)	(51.8)%

Net Income	\$ 41,692	\$ 60,062	\$ (18,370)	(30.6)%
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Total revenues from continuing operations for the year ended December 31, 2008 increased \$16.9 million, or 8.5%, compared to 2007 for primarily the following reasons:

Master lease rental income increased \$2.0 million, or 3.6%, from 2007 to 2008. The majority of the increase was due to annual contractual rent increases from 2007 to 2008 of approximately \$1.3 million. During 2008, the Company also recognized additional master lease rental income totaling

Table of Contents

approximately \$0.2 million related to its 2008 acquisitions and an \$0.8 million lease termination fee, offset partially by prior year rental income of the property of approximately \$0.3 million.

Property operating income increased \$15.1 million, or 12.4%, from 2007 to 2008. The Company's acquisitions of real estate properties during 2008 and 2007 resulted in additional property operating income in 2008 compared to 2007 of approximately \$6.7 million. Also, properties previously under construction that commenced operations during 2007 and 2008 resulted in approximately \$2.9 million in additional property operating income from 2007 to 2008. The remaining increase of approximately \$5.5 million was related generally to annual contractual rent increases, rental increases related to lease renewals and new leases executed with various tenants.

Mortgage interest income increased \$0.5 million, or 26.0%, from 2007 to 2008 due mainly to additional fundings on construction mortgage notes.

Total expenses for the year ended December 31, 2008 compared to the year ended December 31, 2007 increased \$21.2 million, or 15.2%, for primarily the following reasons:

General and administrative expenses increased \$2.9 million, or 14.0%, from 2007 to 2008. This increase was attributable mainly to higher compensation-related expenses in 2008 of approximately \$2.3 million related to annual salary increases and amortization on restricted shares, an increase in pension expense recorded of approximately \$0.7 million and expenses recognized related to acquisition and development efforts of approximately \$1.8 million. These amounts were partially offset by the voluntary resignation of an officer, resulting in a net reduction to expense of \$0.5 million related to the forfeiture of outstanding share-based payment awards and the lump-sum payment of the officer's pension benefit under the Executive Retirement Plan. See Note 12 to the Consolidated Financial Statements for more details. Also, the Company recorded a charge in 2007 of approximately \$1.5 million related to the retirement of an officer and the termination of five employees.

Property operating expenses increased \$10.7 million, or 15.0%, from 2007 to 2008. The Company recognized expense of approximately \$2.7 million related to properties that were previously under construction and commenced operations during 2007 and 2008. Also, the Company's acquisitions of real estate properties during 2008 and 2007 resulted in additional property operating expense in 2008 compared to 2007 of approximately \$2.7 million. In addition, legal expense increased approximately \$3.5 million in 2008 compared to 2007 mainly due to legal fee reimbursements received in 2007 and a litigation settlement of \$1.0 million in 2008. Also, utility and real estate tax rate increases in 2008 resulted in additional expenses of approximately \$1.3 million and \$0.6 million, respectively.

An impairment charge totaling \$1.6 million was recognized in 2008 on patient accounts receivable assigned to the Company as part of a lease termination and debt restructuring in late 2005 related to a physician clinic owned by the Company. See Note 6 to the Consolidated Financial Statements.

Bad debt expense increased \$1.6 million from 2007 to 2008 mainly due to a reserve recorded by the Company in 2008 related to additional rental income due from an operator on four properties.

Depreciation expense increased \$6.0 million, or 14.3%, from 2007 to 2008 mainly due to increases related to the acquisitions of real estate properties of approximately \$1.4 million, the commencement of operations of buildings during 2007 and 2008 that were previously under construction of approximately \$1.0 million, as well as additional building and tenant improvement expenditures during 2007 and 2008 of approximately \$3.6 million.

Table of Contents

Amortization expense decreased \$1.7 million, or 37.1%, from 2007 to 2008, mainly due to a decrease in amortization of lease intangibles related to properties acquired during 2003 and 2004 which are becoming fully amortized, offset partially by amortization of lease intangibles related to properties acquired during 2007 and 2008.

Other income (expense) for the year ended December 31, 2008 compared to the year ended December 31, 2007 decreased \$11.3 million, or 24.0%, for primarily the following reasons:

The Company recognized a net gain on extinguishment of debt of approximately \$4.1 million related to repurchases of the Company's Senior Notes due 2011 and 2014 which is discussed in more detail in Note 9 to the Consolidated Financial Statements.

Interest expense decreased \$6.2 million, or 12.8%, from 2007 to 2008. The decrease was mainly attributable to an increase in the capitalization of interest of approximately \$2.7 million related to the Company's construction projects, interest savings of approximately \$1.0 million related to repurchases of the Company's Senior Notes due 2011 and 2014 and a reduction of interest expense of approximately \$3.1 million related to the Unsecured Credit Facility due mainly to a decrease in interest rates in 2008 compared to 2007.

Interest and other income increased \$1.0 million, or 67.2%, from 2007 to 2008. In connection with the Company's acquisition of the remaining interest in a joint venture in which it previously had an equity interest and the related transition of accounting from the joint venture to the Company, the joint venture recorded an adjustment to straight-line rent on the properties. As such, the Company recognized its portion of the adjustment through equity income on the joint venture of approximately \$1.1 million (of which \$0.8 million is related to prior years). Also, the Company recorded a gain on the sale of a land parcel of approximately \$0.4 million. These amounts are partially offset by a reduction in income recognized on one joint venture of approximately \$0.4 million due to the partial repurchase of the Company's preferred equity investment.

Income from discontinued operations totaled \$23.5 million and \$48.8 million for the years ended December 31, 2008 and 2007, respectively, which includes the results of operations, net gains and impairments related to property disposals during 2008 and 2007 and properties held for sale as of December 31, 2008. The Company disposed of seven properties and two parcels of land in 2008, 59 properties in 2007, and had 12 properties classified as held for sale at December 31, 2008. Income from discontinued operations for 2008 also included a \$7.2 million fee received from an operator to terminate its financial support agreement with the Company in connection with the disposition of the property.

2007 Compared to 2006

The comparability of net income and net income per share for 2007 and 2006 was impacted by senior living asset dispositions in 2007 and the resulting gain on sale. However, the comparability of revenues and income from continuing operations for 2007 and 2006 was not impacted by the disposition because the results of operations of the assets disposed of are included in discontinued operations for both periods. See Note 4 to the Company's Consolidated Financial Statements for more information on the sale of the senior living assets.

For the year ended December 31, 2007, net income was \$60.1 million, or \$1.26 per basic common share (\$1.24 per diluted common share), compared to net income of \$39.7 million, or \$0.85 per basic common share (\$0.84 per diluted common share), for the year ended December 31, 2006. Revenues from continuing operations were \$197.4 million for the year ended December 31, 2007 compared to revenues from continuing operations of \$198.2 million for the year ended December 31, 2006. FFO was \$73.2 million, or \$1.54 per

Table of Contents

basic common share (\$1.51 per diluted common share), for the year ended December 31, 2007 compared to \$101.1 million, or \$2.17 per basic common share (\$2.13 per diluted common share), in 2006.

<i>(Dollars in thousands)</i>	2007	2006	Change	
			\$	%
Revenues				
Master lease rent	\$ 56,401	\$ 52,676	\$ 3,725	7.1%
Property operating	121,644	118,389	3,255	2.7%
Straight-line rent	934	2,228	(1,294)	(58.1)%
Mortgage interest	1,752	5,101	(3,349)	(65.7)%
Other operating	16,640	19,825	(3,185)	(16.1)%
	197,371	198,219	(848)	(0.4)%
Expenses				
General and administrative	20,619	16,856	3,763	22.3%
Property operating	71,671	65,894	5,777	8.8%
Other operating		173	(173)	
Impairments		4,111	(4,111)	
Bad debts, net of recoveries	222	861	(639)	(74.2)%
Depreciation	42,254	40,088	2,166	5.4%
Amortization	4,528	9,876	(5,348)	(54.2)%
	139,294	137,859	1,435	1.0%
Other Income (Expense)				
Interest expense	(48,307)	(50,760)	2,453	(4.8)%
Interest and other income, net	1,459	1,013	446	44.0%
	(46,848)	(49,747)	2,899	(5.8)%
Income From Continuing Operations	11,229	10,613	616	5.8%
Discontinued Operations				
Income from discontinued operations	15,517	27,404	(11,887)	43.4%
Impairments	(7,089)	(1,573)	(5,516)	350.7%
Gain on sales of real estate properties	40,405	3,275	37,130	1133.7%
Income From Discontinued Operations	48,833	29,106	19,727	67.8%
Net Income	\$ 60,062	\$ 39,719	\$ 20,343	51.2%

Total revenues from continuing operations for the year ended December 31, 2007 decreased \$0.8 million, or 0.4%, compared to 2006 for primarily the following reasons:

Master lease rental income increased \$3.7 million, or 7.1%, from 2006 to 2007. During 2007, the Company recognized additional master lease rental income of approximately \$2.5 million from its 2006 acquisitions and recognized approximately \$0.5 million in master lease rental income from a \$7.3 million acquisition in 2007. The Company also recognized additional master lease rental income of approximately \$0.4 million related to

new master lease agreements executed during 2006 on properties whose income was previously reported in property operating income. Annual rent increases also attributed to an approximate \$1.2 million increase from 2006 and 2007. These increases were offset partially by a decrease of approximately \$0.9 million in master lease rental income related to properties whose master lease agreements expired during 2007. As such, subsequent to the expiration of the master lease, rather than recording rental income under a master lease, the underlying tenant rents were reported in property operating income.

Table of Contents

Property operating income increased \$3.3 million, or 2.7%, from 2006 to 2007. During 2007, two properties previously under construction commenced operations resulting in approximately \$1.4 million in rental income. Also, the Company's real estate acquisitions in 2007 resulted in additional property operating income of approximately \$0.6 million, and the Company began recognizing in property operating income the underlying tenant rents totaling approximately \$0.4 million relating to properties whose master lease agreements had expired. The Company also received a lump sum payment during 2007 of approximately \$0.3 million related to a bankruptcy settlement with one tenant. The remaining \$0.6 million increase was generally related to revenue generated from new tenant leases and from annual rent increases.

Straight-line rent decreased \$1.3 million, or 58.1%, from 2006 to 2007. Straight-line rent decreased approximately \$0.7 million from 2006 to 2007 due to a positive adjustment recorded in 2006 on several leases related to one operator. Also, during 2006, the Company recorded positive adjustments to straight-line rent totaling approximately \$0.5 million related to amendments to certain leases which extended the maturity dates of the leases.

Mortgage interest income decreased \$3.3 million, or 65.7%, from 2006 to 2007 mainly due to a \$4.0 million decrease in interest income related to the repayment of seven mortgage notes receivable in 2006, offset partially by the addition of two mortgage notes receivable during 2006 and two mortgage notes receivable during 2007 resulting in an increase in interest income during 2007 compared to 2006 of approximately \$0.6 million.

Other operating income decreased \$3.2 million, or 16.1%, from 2006 to 2007. During 2006, the Company recognized prepayment fees related to the repayment of two mortgage notes receivable totaling approximately \$2.2 million and recognized approximately \$1.1 million more in lease guaranty income than in 2007. These decreases were offset partially by the recognition of an additional \$0.6 million during 2007 related to replacement rent received from one operator.

Total expenses for the year ended December 31, 2007 compared to the year ended December 31, 2006 increased \$1.4 million, or 1.0%, for primarily the following reasons:

General and administrative expenses increased \$3.8 million, or 22.3%, from 2006 to 2007. This increase was attributable mainly to higher compensation-related expenses in 2007 of approximately \$2.4 million related to a \$1.5 million charge recorded in 2007 upon retirement of an officer and termination of five employees and \$0.9 million due to annual increases in the executive retirement plan liability, annual salary increases and amortization expense recognized on the vesting of restricted shares. Also, the Company accrued approximately \$0.7 million in additional state taxes as discussed in Note 15 to the Consolidated Financial Statements.

Property operating expenses increased \$5.8 million, or 8.8%, from 2006 to 2007. Additional expenses of approximately \$1.2 million were recognized in 2008 for properties that commenced operations during 2007 that were previously under construction. The Company began recognizing expenses in 2008 for properties whose triple-net master lease agreements had expired totaling approximately \$0.8 million. The Company's 2007 acquisitions resulted in additional property operating expenses of approximately \$0.3 million, and utility and real estate tax rates increased in 2007 resulting in additional expenses of approximately \$0.9 million and \$1.2 million, respectively. Also, during 2007, the Company recorded straight-line rent expense of approximately \$0.8 million (of which \$0.6 million was related to prior years) associated with ground leases where the Company is the lessee.

Impairment charges totaling \$4.1 million were recognized in 2006 on patient accounts receivable assigned to the Company as part of a lease termination and debt restructuring in late 2005 related to a physician clinic owned by the Company. See Note 6 to the Consolidated Financial Statements.

Depreciation expense increased \$2.2 million, or 5.4%, from 2006 to 2007 mainly due to the acquisitions of real estate properties, the commencement of operations of buildings during 2007 that were previously under construction, as well as additional building and tenant improvement expenditures during 2006 and 2007.

Table of Contents

Amortization expense decreased \$5.3 million, or 54.2%, from 2006 to 2007, mainly due to a decrease in amortization expense recognized on lease intangibles recorded for properties acquired during 2003 and 2004 which are becoming fully amortized.

Other income (expense) for the year ended December 31, 2007 compared to the year ended December 31, 2006 decreased \$2.9 million, or 5.8%, for primarily the following reasons:

Interest expense decreased \$2.5 million, or 4.8%, from 2006 to 2007. The decrease in interest expense was mainly attributable to an increase in the capitalization of interest of approximately \$2.7 million related to the Company's construction projects and a decrease of approximately \$0.7 million related to the repayment of the Company's 9.49% Senior Notes due 2006. These decreases in interest expense were offset partially by an increase in interest expense of approximately \$1.2 million on the Unsecured Credit Facility due mainly to an increase in the weighted average balance outstanding in 2007 compared to 2006.

Interest and other income increased \$0.4 million, or 44.0%, from 2006 to 2007. The increase in interest and other income is mainly attributable to equity income of approximately \$0.2 million recognized in 2006 from the acquisition of a membership equity interest in a joint venture, as well as additional interest income recorded in 2007 compared to 2006 of approximately \$0.2 million.

Income from discontinued operations totaled \$48.8 million and \$29.1 million for the years ended December 31, 2007 and 2006, respectively, which includes the results of operations, net gains and impairments related to property disposals during the three-year period ended December 31, 2008 and properties classified as held for sale at December 31, 2008. The Company disposed of seven properties and two parcels of land in 2008, 59 properties in 2007, and eight properties in 2006, and had 12 properties classified as held for sale at December 31, 2008.

Liquidity and Capital Resources

The Company derives most of its revenues from its real estate property portfolio based on contractual arrangements with its tenants and sponsors. The Company may, from time to time, also generate funds from capital market financings, sales of real estate properties or mortgages, borrowings under its Unsecured Credit Facility, secured debt borrowings, or from other private debt or equity offerings. For the year ended December 31, 2008, the Company generated approximately \$106.6 million in cash from operations and used \$111.0 million in total cash from investing and financing activities as detailed in the Company's Consolidated Statements of Cash Flows.

Capital and Credit Market Conditions

The Company may from time to time raise additional capital by issuing equity and debt securities under its currently effective shelf registration statement or by private offerings. Access to capital markets impacts the Company's ability to refinance existing indebtedness as it matures and fund future acquisitions and development through the issuance of additional securities. The Company's ability to access capital on favorable terms is dependent on various factors, including general market conditions, interest rates, credit ratings on its debt, perception of its potential future earnings and cash distributions, and the market price of its capital stock. Recently, the capital and credit markets have become increasingly volatile as a result of adverse conditions that have caused the failure or near failure of a number of large financial institutions. Continued volatility in the markets could limit the Company's ability to access debt or equity markets when it needs or wants access to those markets which, in turn, could impact the Company's cost of capital, ability to invest in real estate assets, pay its dividend at current levels, refinance maturing debt and react to changing economic and business conditions. Further, the Company's debt ratings could be affected which could have an adverse effect on its interest costs and financing sources. The Company had unencumbered real estate assets of approximately

\$1.9 billion at December 31, 2008, which could serve as collateral for secured mortgage financing. Furthermore, the Company anticipates renewing its Unsecured Credit Facility during 2009 and believes that sufficient commitments will be available to the Company, but anticipates that the interest rate will likely be higher than its current rate (LIBOR + 0.90%).

Table of Contents***Key Indicators***

The Company monitors its liquidity and capital resources and relies on several key indicators in its assessment of capital markets for financing acquisitions and other operating activities as needed, including the following:

Debt metrics;

Dividend payout percentage; and

Interest rates, underlying treasury rates, debt market spreads and equity markets.

The Company uses these indicators and others to compare its operations to its peers and to help identify areas in which the Company may need to focus its attention.

Contractual Obligations

The Company monitors its contractual obligations to ensure funds are available to meet obligations when due. The following table represents the Company's long-term contractual obligations for which the Company was making payments as of December 31, 2008, including interest payments due where applicable. As of December 31, 2008, the Company had no long-term capital lease or purchase obligations. The following table includes the Company's contractual obligations as of December 31, 2008.

<i>(Dollars in thousands)</i>	Total	Payments Due by Period			
		Less than 1 Year	1 - 3 Years	3 - 5 Years	More than 5 Years
Long-term debt obligations, including interest(1)	\$ 1,108,391	\$ 43,325	\$ 689,754	\$ 37,127	\$ 338,185
Operating lease commitments(2)	271,951	3,901	7,179	6,729	254,142
Construction in progress(3)	106,519	82,403	18,408	5,708	
Tenant improvements(4)	440	440			
Deferred gain(5)	2,769	2,769			
Pension obligations(6)	2,300	2,300			
Construction loan obligations(7)	15,619	15,619			
Total contractual obligations	\$ 1,507,989	\$ 150,757	\$ 715,341	\$ 49,564	\$ 592,327

- (1) The amounts shown include estimated interest on total debt other than the Unsecured Credit Facility. Excluded from the table above are the premium on the Senior Notes due 2011 of \$0.6 million and the discount on the Senior Notes due 2014 of \$0.8 million which are included in notes and bonds payable on the Company's Consolidated Balance Sheet as of December 31, 2008. Also excluded from the table above are discounts on four mortgage notes payable totaling \$7.4 million. The table above does not include contractual obligations relating to four mortgage notes payable classified as liabilities of discontinued operations. If these four mortgage notes are not repaid, the Company would have additional contractual obligations for 2009 of approximately \$4.3 million. The Company's long-term debt principal obligations are presented in more detail in the table below.

<i>(Dollars in millions)</i>	Principal Balance at December 31, 2008	Principal Balance at December 31, 2007	Maturity Date	Contractual Interest Rates at December 31, 2008	Interest Payments	Principal Payments
				LIBOR +		
Unsecured credit facility(a)	\$ 329.0	\$ 136.0	1/10	0.90%	Quarterly	At maturity
Senior notes due 2011	286.3	300.0	5/11	8.125%	Semi-Annual	At maturity
Senior notes due 2014	264.7	300.0	4/14	5.125%	Semi-Annual	At maturity
Mortgage notes payable	67.7	49.4	5/11-10/32	5.00%-7.625%	Monthly	Monthly
	\$ 947.7					