UNIVERSAL HEALTH REALTY INCOME TRUST
Form 10-Q
May 09, 2006
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FORM 10-Q

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

(MARK ONE)

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

For the quarterly period ended March 31, 2006

OR

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

For the transition period from ______ to ______

Commission file number 1-9321

UNIVERSAL HEALTH REALTY INCOME TRUST

(Exact name of registrant as specified in its charter)

MARYLAND	**23-6858580**
(State or other jurisdiction of Incorporation or Organization)	**(I. R. S. Employer Identification No.)**

UNIVERSAL CORPORATE CENTER

367 SOUTH GULPH ROAD

KING OF PRUSSIA, PENNSYLVANIA 19406

(Address of principal executive offices) (Zip Code)

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

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

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

Large accelerated filer ¨ Accelerated Filer x Non-accelerated filer ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act) **Yes ¨ No x**

Number of common shares of beneficial interest outstanding at April 30, 2006 11,781,532

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PART I. FINANCIAL INFORMATION

Universal Health Realty Income Trust

Condensed Consolidated Statements of Income

For the Three Months Ended March 31, 2006 and 2005

(amounts in thousands, except per share amounts)

(unaudited)

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005
Revenues:		
Base rental - UHS facilities	$ 3,092	$ 3,157
Base rental - Non-related parties	3,067	3,011
Bonus rental - UHS facilities	1,151	1,223
Tenant reimbursements and other - Non-related parties	946	974
Tenant reimbursements and other - UHS facilities	103	126
	8,359	8,491
Expenses:		
Depreciation and amortization	1,416	1,408
Advisory fees to UHS	347	355
Other operating expenses	1,698	1,574
	3,461	3,337
Income before equity in unconsolidated limited liability companies (LLCs), property damage recovered from UHS and interest expense	4,898	5,154
Equity in income of unconsolidated LLCs (including gain on sale of real property of $1,061 during the three month period ended March 31, 2005)	725	1,981
Property damage recovered from UHS		1,528
Interest expense	(675)	(1,083)
Net income	$ 4,948	$ 7,580
Basic earnings per share	$ 0.42	$ 0.64
Diluted earnings per share	$ 0.42	$ 0.64
Weighted average number of shares outstanding - Basic	11,778	11,756
Weighted average number of share equivalents	78	74
Weighted average number of shares and equivalents outstanding - Diluted	11,856	11,830

See accompanying notes to condensed consolidated financial statements.

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Universal Health Realty Income Trust

Condensed Consolidated Balance Sheets

(dollar amounts in thousands)

(unaudited)

	March 31, 2006	December 31, 2005
Assets:		
Real Estate Investments:		
Buildings and improvements	$ 187,925	$ 187,451
Accumulated depreciation	(59,072)	(57,729)
	128,853	129,722
Land	23,143	23,143
Net Real Estate Investments	151,996	152,865
Investments in and advances to limited liability companies (LLCs)	32,345	29,572
Other Assets:		
Cash and cash equivalents	1,784	1,717
Bonus rent receivable from UHS	1,306	1,088
Rent receivable - other	750	1,000
Note receivable from sale of property	3,102	3,102
Property damage receivable from UHS - Chalmette	6,259	6,259
Deferred charges and other assets, net	1,397	1,286
Total Assets	$ 198,939	$ 196,889
Liabilities and Shareholders Equity:		
Liabilities:		
Line of credit borrowings	$ 13,800	$ 10,000
Mortgage note payable, non-recourse to us	3,941	3,972
Mortgage notes payable of consolidated LLCs, non-recourse to us	21,446	21,576
Deferred gain on sale of property	1,860	1,860
Accrued interest	340	357
Accrued expenses and other liabilities	2,476	2,575
Fair value of derivative instruments	52	100
Tenant reserves, escrows, deposits and prepaid rents	736	697
Total Liabilities	44,651	41,137
Minority interests	302	302
Shareholders Equity:		
Preferred shares of beneficial interest, $.01 par value; 5,000,000 shares authorized; none outstanding		
Common shares, $.01 par value; 95,000,000 shares authorized; issued and outstanding: 2006 - 11,781,367; 2005 -11,777,829	118	118
Capital in excess of par value	187,079	186,943
Cumulative net income	275,125	270,177

Accumulated other comprehensive loss	(52)	(100)
Cumulative dividends	(308,284)	(301,688)
Total Shareholders Equity	153,986	155,450
Total Liabilities and Shareholders Equity	$ 198,939	$ 196,889

See accompanying notes to condensed consolidated financial statements.

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Universal Health Realty Income Trust

Condensed Consolidated Statements of Cash Flows

(amounts in thousands)

	Three months ended March 31, 2006	2005
Cash flows from operating activities:		
Net income	$ 4,948	$ 7,580
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,416	1,408
Gain on sale of property by LLC		(1,061)
Property damage recovered from UHS - Wellington		(1,528)
Net loss on ineffective cash flow hedge		252
Changes in assets and liabilities:		
Rent receivable	32	(171)
Accrued expenses and other liabilities	(99)	(26)
Tenant reserves, escrows, deposits and prepaid rents	39	31
Accrued interest	(17)	(25)
Other, net	(67)	(130)
Net cash provided by operating activities	6,252	6,330
Cash flows from investing activities:		
Investments in limited liability companies (LLCs)	(1,703)	
Repayments of advances made to LLCs		5,880
Advances made to LLCs	(1,099)	
Cash distributions in excess of income from LLCs	29	275
Cash distribution from sale of property by LLC		2,851
Cash distributions of refinancing proceeds from LLCs		2,111
Additions to real estate investments	(474)	(636)
Net cash (used in) provided by investing activities	(3,247)	10,481
Cash flows from financing activities:		
Net borrowings/(repayments) on line of credit	3,800	(7,300)
Repayments of mortgage notes payable of consolidated LLCs	(130)	(44)
Repayments of mortgage notes payable	(31)	(28)
Dividends paid	(6,596)	(5,937)
Issuance of shares of beneficial interest	19	149
Net cash used in financing activities	(2,938)	(13,160)
Increase in cash and cash equivalents	67	3,651
Cash and cash equivalents, beginning of period	1,717	3,588
Cash and cash equivalents, end of period	$ 1,784	$ 7,239
Supplemental disclosures of cash flow information:		
Interest paid	$ 774	$ 856

Supplemental disclosures of non-cash flow information:

Property damage cost capitalized - UHS - Wellington	$	$ 1,528

See the accompanying notes to condensed consolidated financial statements.

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UNIVERSAL HEALTH REALTY INCOME TRUST

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2006

(unaudited)

(1) General

This Report on Form 10-Q is for the Quarterly Period ended March 31, 2006. In this Quarterly Report, we, us, our and the Trust refer to Universal Health Realty Income Trust.

You should carefully review all of the information contained in this Quarterly Report, and should particularly consider any risk factors that we set forth in this Quarterly Report and in other reports or documents that we file from time to time with the SEC. In this Quarterly Report, we state our beliefs of future events and of our future financial performance. In some cases, you can identify those so-called forward-looking statements by words such as may, will, should, could, would, predicts, potential, continue, expects, anticipates, future, i estimates, appears, projects and similar expressions, as well as statements in future tense. You should be aware that those statements are only our predictions. Actual events or results may differ materially. In evaluating those statements, you should specifically consider various factors, including the risks outlined in Item 2, Management s Discussion and Analysis of Financial Condition and Results of Operations, under Forward Looking Statements and Certain Risk Factors. Those factors may cause our actual results to differ materially from any of our forward-looking statements.

In this Quarterly Report on Form 10-Q, the term revenues does not include the revenues of the unconsolidated limited liability companies in which we have various non-controlling equity interests ranging from 33% to 98%. We currently account for our share of the income/loss from these investments by the equity method (see Note 8). As of March 31, 2006, we had investments or commitments in twenty-two limited liability companies (LLCs), nineteen of which are accounted for by the equity method and three that are currently consolidated in the results of operations.

The financial statements included herein have been prepared by us, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission and reflect all normal and recurring adjustments which, in our opinion, are necessary to fairly present results for the interim periods. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although we believe that the accompanying

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disclosures are adequate to make the information presented not misleading. It is suggested that these financial statements be read in conjunction with the financial statements, accounting policies and the notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2005. Certain prior year amounts have been reclassified to conform with current year financial statement presentation.

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

UHS of Delaware, Inc. (the Advisor), a wholly-owned subsidiary of UHS, serves as Advisor to us under an Advisory Agreement (the Advisory Agreement) dated December 24, 1986. Under the Advisory Agreement, the Advisor is obligated to present an investment program to us, to use its best efforts to obtain investments suitable for such program (although it is not obligated to present any particular investment opportunity to us), to provide administrative services to us and to conduct our day-to-day affairs. In performing its services under the Advisory Agreement, the Advisor may utilize independent professional services, including accounting, legal, tax and other services, for which the Advisor is reimbursed directly by us. The Advisory Agreement expires on December 31st of each year, however, it is renewable by us, subject to a determination by the Independent Trustees who are unaffiliated with UHS, that the Advisor s performance has been satisfactory. The Advisory Agreement may be terminated for any reason upon sixty days written notice by us or the Advisor. The Advisory Agreement has been renewed for 2006. All transactions between us and UHS must be approved by the Independent Trustees.

The Advisory Agreement provides that the Advisor is entitled to receive an annual advisory fee equal to .60% of our average invested real estate assets, as derived from our consolidated balance sheet. The Advisory fee is payable quarterly, subject to adjustment at year-end based upon our audited financial statements. Our officers are all employees of the Advisor and although we have no salaried employees, certain officers do receive stock-based compensation from time to time. Advisory fees incurred and paid (or payable) to UHS amounted to $347,000 and $355,000 for the three months ended March 31, 2006 and 2005, respectively.

The Trust commenced operations in 1986 by purchasing certain subsidiaries from UHS and immediately leasing the properties back to the respective subsidiaries. Most of the leases were entered into at the time the Trust commenced operations and provided for initial terms of 13 to 15 years with up to six additional 5-year renewal terms, with the base rents set forth in the leases effective for all but the last two renewal terms. Each lease also provided for additional or bonus rents, as discussed below. In 1998, the lease for McAllen Medical Center was amended to provide that the last two renewal terms would also be fixed at the initial agreed upon rental. This lease amendment was in connection with certain concessions granted by UHS with respect to the renewal of other leases. The base rents are paid monthly and the bonus rents are computed and paid on a quarterly basis, based upon a computation that compares current quarter revenue to a corresponding quarter in the base year. The leases with subsidiaries of UHS are unconditionally guaranteed by UHS and are cross-defaulted with one another.

During the third quarter of 2005, Chalmette Medical Center (Chalmette), our two story, 138-bed acute care hospital located in Chalmette, Louisiana, was severely damaged and closed as a result of Hurricane Katrina. The majority of the real estate assets of Chalmette were leased from us by a subsidiary of UHS and, in accordance with the terms of the lease, and as part of an overall evaluation of the leases between subsidiaries of UHS and us, UHS has elected to offer

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substitution properties rather than exercise its right to rebuild the facility or offer cash for Chalmette. Independent appraisals were obtained by us and UHS which indicated that the pre-hurricane fair market value of the leased facility was $23,965,000 (FMV of Chalmette).

We have agreed, subject to certain closing conditions, to terminate the lease between Chalmette and us and to transfer the real property assets and all rights attendant thereto (including insurance proceeds) of Chalmette to UHS in exchange and substitution for newly constructed real property assets owned by UHS (Capital Additions) at Wellington Regional Medical Center (Wellington), The Bridgeway (Bridgeway) and Southwest Healthcare System-Inland Valley Campus (Inland Valley), in satisfaction of the obligations under the Chalmette lease. The exchange and substitution package includes the following Capital Additions, as defined in the Master Lease Document, by and among us and certain subsidiaries of UHS, dated December 24, 1986 (the Master Lease), which were recently constructed on, or adjacent to, facilities already owned by us as well as a Capital Addition at Inland Valley which is currently under construction and expected to be completed by the end of 2006. UHS is obligated to complete the Inland Valley Capital Addition or, subject to our approval, offer to either provide alternative substitution property or pay to us an amount in cash equal to the substitution value of the Capital Addition.

Wellington Bed Tower	$8,926,000 (Actual construction costs)
Bridgeway 28 bed addition	$4,072,000 (Actual construction costs)
Inland Valley Campus 44 bed and ICU expansion	$12,160,000 (Estimated construction costs)

To accomplish the exchange and substitution, during the second quarter of 2006, we entered into an Asset Exchange and Substitution Agreement with UHS and certain subsidiaries of UHS. The estimated total value of this exchange and substitution package is approximately $25.2 million based upon the combined actual and estimated construction costs of the Capital Additions. Since the estimated total value of the substitution package is expected to exceed the FMV of Chalmette, the excess amount will be paid to UHS in cash upon completion of the Inland Valley Capital Additions.

During 2005, 2004 and 2003, the total rent earned by us under the Chalmette lease was approximately $1.6 million to $1.7 million annually (including base and bonus rental). The total rent payable to us on the Capital Additions included in the substitution package (excluding the rent on the Capital Additions in excess of the FMV of Chalmette) is expected to closely approximate the total rent earned by us under the Chalmette lease. UHS will pay incremental rent on the Capital Additions in excess of the FMV of Chalmette at a rate equal to the prevailing five-year treasury rate plus 200 basis points at the time of funding (minimum rate 6.75%). Below is the estimated rent allocation of the substitution properties, excluding the incremental rent on the Capital Additions in excess of the FMV of Chalmette.

Facility	Base Rent	Bonus Rent	Total Rent
Wellington	$ 534,504	$ 67,744	$ 602,248
Bridgeway	247,800	26,940	274,740
Inland Valley	740,012		740,012
Total:	$ 1,522,316	$ 94,684	$ 1,617,000

The amounts shown in the bonus rent column represent the estimated bonus rent effect of including the revenues generated from the Capital Additions at Wellington and Bridgeway that

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have not been previously included in the bonus rent paid to us pursuant to the terms of the leases since the Capital Additions were financed and owned by UHS. The bonus rent amounts reflected above were based on the net revenues generated at each facility during 2005. Future bonus rents earned by us on the Capital Additions will be based on the actual net revenues of each facility.

During the second quarter of 2006, as part of the overall arrangement, UHS agreed not to exercise its purchase options under the leases at the end of the current lease terms, which would have resulted in a cash payment to us and the termination of the rental stream with respect to the properties, and likely would have adversely affected our ability to maintain the dividend at current levels. Alternatively, UHS rather agreed to early five year renewals of the leases between us and each of Inland Valley, Wellington and McAllen Medical Center, which were scheduled to mature on December 31, 2006, and Bridgeway, which was scheduled to mature on December 31, 2009, on the same economic terms as the current leases. To reflect the lease renewals, during the second quarter of 2006, we and each of the individual lessees entered into amended and restated leases relating to their respective individual properties at the existing lease rates.

After giving effect to the Asset Exchange and Substitution Agreement and the various lease renewals discussed above, subsidiaries of UHS will lease four hospitals facilities owned by us with terms expiring in 2011 through 2014. The table below details the renewal options and terms for each of the four UHS hospital facilities:

Hospital Name	Type of Facility	Annual Minimum Rent	End of Lease Term	Renewal Term (years)