

UNIVERSAL HEALTH REALTY INCOME TRUST

Form 10-Q

August 06, 2010

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(MARK ONE)

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

For the quarterly period ended June 30, 2010

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)

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MARYLAND
(State or other jurisdiction of
incorporation or organization)

23-6858580
(I. R. S. Employer
Identification No.)

UNIVERSAL CORPORATE CENTER

367 SOUTH GULPH ROAD

KING OF PRUSSIA, PENNSYLVANIA
(Address of principal executive offices)

19406
(Zip Code)

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

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

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

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

Large accelerated filer Accelerated Filer
Non-accelerated filer Smaller reporting company
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Number of common shares of beneficial interest outstanding at July 31, 2010 12,260,485

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UNIVERSAL HEALTH REALTY INCOME TRUST

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Table of Contents**Part I. Financial Information****Universal Health Realty Income Trust****Condensed Consolidated Statements of Income****For the Three and Six Months Ended June 30, 2010 and 2009****(amounts in thousands, except per share amounts)****(unaudited)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Revenues:				
Base rental - UHS facilities	\$ 3,292	\$ 3,637	\$ 6,584	\$ 7,097
Base rental - Non-related parties	2,573	2,578	5,183	5,154
Bonus rental - UHS facilities	1,023	1,050	2,117	2,145
Tenant reimbursements and other - Non-related parties	543	711	1,159	1,425
Tenant reimbursements and other - UHS facilities	42	47	74	82
	7,473	8,023	15,117	15,903
Expenses:				
Depreciation and amortization	1,610	1,586	3,179	3,124
Advisory fees to UHS	466	389	903	779
Other operating expenses	1,434	1,536	2,786	3,042
	3,510	3,511	6,868	6,945
Income before equity in income of unconsolidated limited liability companies (LLCs) and interest expense	3,963	4,512	8,249	8,958
Equity in income of unconsolidated LLCs	833	959	1,569	1,766
Interest expense, net	(522)	(669)	(1,017)	(1,276)
Net income	\$ 4,274	\$ 4,802	\$ 8,801	\$ 9,448
Basic earnings per share	\$ 0.35	\$ 0.40	\$ 0.73	\$ 0.80
Diluted earnings per share	\$ 0.35	\$ 0.40	\$ 0.73	\$ 0.80
Weighted average number of shares outstanding - Basic	12,111	11,876	12,094	11,868
Weighted average number of share equivalents	2	4	2	8
Weighted average number of shares and equivalents outstanding - Diluted	12,113	11,880	12,096	11,876

See accompanying notes to condensed consolidated financial statements.

Table of Contents**Universal Health Realty Income Trust****Condensed Consolidated Balance Sheets**

(dollar amounts in thousands, except share amounts)

(unaudited)

	June 30, 2010	December 31, 2009
Assets:		
Real Estate Investments:		
Buildings and improvements	\$ 195,460	\$ 207,597
Accumulated depreciation	(75,175)	(72,405)
	120,285	135,192
Land	19,348	19,348
Net Real Estate Investments	139,633	154,540
Investments in and advances to limited liability companies (LLCs)	75,499	61,934
Other Assets:		
Cash and cash equivalents	1,246	3,038
Base and bonus rent receivable from UHS	2,031	2,039
Rent receivable - other	852	980
Deferred charges, notes receivable and intangible and other assets, net	6,447	6,294
Total Assets	\$ 225,708	\$ 228,825
Liabilities:		
Line of credit borrowings	\$ 58,800	\$ 48,800
Mortgage notes payable, non-recourse to us	8,478	6,677
Mortgage, construction and other loans payable of consolidated LLCs, non-recourse to us	15,105	28,790
Accrued interest	146	142
Accrued expenses and other liabilities	2,038	2,251
Tenant reserves, escrows, deposits and prepaid rents	991	981
Total Liabilities	85,558	87,641
Equity:		
Preferred shares of beneficial interest, \$.01 par value; 5,000,000 shares authorized; none issued and outstanding		
Common shares, \$.01 par value; 95,000,000 shares authorized; issued and outstanding: 2010 - 12,253,756; 2009 -12,089,474	123	121
Capital in excess of par value	200,066	195,209
Cumulative net income	366,095	357,294
Cumulative dividends	(426,329)	(411,662)
Total Universal Health Realty Income Trust Shareholders Equity	139,955	140,962

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Third-party equity interests	195	222
Total Equity	140,150	141,184
Total Liabilities and Equity	\$ 225,708	\$ 228,825

See accompanying notes to condensed consolidated financial statements.

Table of Contents**Universal Health Realty Income Trust****Condensed Consolidated Statements of Cash Flows**

(amounts in thousands)

(unaudited)

	Six months ended June 30,	
	2010	2009
Cash flows from operating activities:		
Net income	\$ 8,801	\$ 9,448
<i>Adjustments to reconcile net income to net cash provided by operating activities:</i>		
Depreciation and amortization	3,179	3,124
Restricted/stock-based compensation expense	162	69
<i>Changes in assets and liabilities:</i>		
Rent receivable	84	167
Accrued expenses and other liabilities	99	(333)
Tenant reserves, escrows, deposits and prepaid rents	46	(162)
Accrued interest	26	(55)
Other, net	(86)	15
Net cash provided by operating activities	12,311	12,273
Cash flows from investing activities:		
Investments in LLCs	(5,221)	(11,352)
Repayments of advances made to LLCs	94	106
Advances made to LLCs	(9,547)	(1,952)
Cash distributions in excess of income from LLCs	1,480	2,258
Cash distributions of refinancing proceeds from LLCs	29	2,789
Additions to real estate investments	(302)	(4,314)
Deposit on building refurbishment		(753)
Decrease in cash and cash equivalents due to recording of LLC on unconsolidated basis	(1,938)	
Net cash used in investing activities	(15,405)	(13,218)
Cash flows from financing activities:		
Net borrowings on line of credit	10,000	13,300
Repayments of mortgage notes payable of consolidated LLCs	(126)	(116)
(Repayments)/borrowings from loans payable of consolidated LLCs	(94)	3,050
Repayments of mortgage notes payable	(3,449)	(107)
Proceeds from mortgage notes payable	5,250	
Financing costs on mortgage notes payable	(308)	
Dividends paid	(14,667)	(14,079)
Partial settlement of dividends equivalent rights		(213)
Issuance of shares of beneficial interest, net	4,696	420
Capital contributions from non-controlling interests		59
Net cash provided by financing activities	1,302	2,314
(Decrease)/Increase in cash and cash equivalents	(1,792)	1,369
Cash and cash equivalents, beginning of period	3,038	618

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Cash and cash equivalents, end of period	\$ 1,246	\$ 1,987
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Supplemental disclosures of cash flow information:

Interest paid	\$ 994	\$ 1,285
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Supplemental disclosures of non-cash information:

Deconsolidation of LLC:		
Net real estate investments	\$ 12,169	
Cash and cash equivalents	1,938	
Other assets	144	
Mortgage and note payable	13,465	
Other liabilities	370	
Third-party equity interests	21	

Investment in LLC	\$ 395	
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See accompanying notes to these consolidated financial statements.

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UNIVERSAL HEALTH REALTY INCOME TRUST

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2010

(unaudited)

(1) General

This Quarterly Report on Form 10-Q is for the Quarterly Period ended June 30, 2010. 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 Securities and Exchange Commission (the SEC). In this Quarterly Report, we state our beliefs of future events and of our future financial performance. In some cases, you can identify those so-called forward-looking statements by words such as may, will, should, could, would, predicts, potential, continue, expect, future, intends, plans, believes, estimates, appears, projects and similar expressions, as well as statements in future tense. You should be aware that those statements are only our predictions. Actual events or results may differ materially. In evaluating those statements, you should specifically consider various factors, including the risks outlined in Item 2- *Management's Discussion and Analysis of Financial Condition and Results of Operations*, under *Forward Looking Statements and Certain Risk Factors* as disclosed in this Quarterly Report on Form 10-Q for the period ended June 30, 2010 and as outlined in Item 1A-*Risk Factors* as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2009. Those factors may cause our actual results to differ materially from any of our forward-looking statements.

Our future results of operations could be unfavorably impacted by continued deterioration in general economic conditions which could result in increases in the number of people unemployed and/or uninsured. Should that occur, it may result in decreased occupancy rates at our medical office buildings as well as a reduction in the revenues earned by the operators of our hospital facilities which would unfavorably impact our future bonus rentals (on the UHS hospital facilities) and may potentially have a negative impact on the future lease renewal terms and the underlying value of the hospital properties. Additionally, the general real estate market has been unfavorably impacted by the deterioration in economic and credit market conditions which may adversely impact the underlying value of our properties.

In this Quarterly Report on Form 10-Q, the term revenues does not include the revenues of the unconsolidated limited liability companies (LLCs) in which we have various non-controlling equity interests ranging from 33% to 99%. We currently account for our share of the income/loss from these investments by the equity method (see Note 5). As of June 30, 2010, we had investments or commitments in thirty-two LLCs, thirty of which are accounted for by the equity method and two that are currently consolidated in our financial statements.

The financial statements included herein have been prepared by us, without audit, pursuant to the rules and regulations of the SEC and reflect all normal and recurring adjustments which, in our opinion, are necessary to fairly present results for the interim periods. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although we believe that the accompanying disclosures are adequate to make the information presented not misleading. It is suggested that these financial statements be read in conjunction with the financial statements, the notes thereto and accounting policies included in our Annual Report on Form 10-K for the year ended December 31, 2009.

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

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

The combined revenues generated from the leases on the UHS hospital facilities accounted for approximately 54% and 51% of our consolidated revenue for the three months ended June 30, 2010 and 2009, respectively, and 54% and 52% for the six months ended June 30, 2010 and 2009, respectively. Including 100% of the revenues generated at the unconsolidated LLCs in which we have various non-controlling equity interests ranging from 33% to 99%, the leases on the UHS hospital facilities accounted for approximately 19% and 20% of the combined consolidated

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and unconsolidated revenue for the three month periods ended June 30, 2010 and 2009, respectively, and 19% and 20% for the six months ended June 30, 2010 and 2009, respectively. In addition, twelve medical office buildings (MOBs), owned by an LLC in which we hold various non-controlling equity interests, include or will include tenants which are subsidiaries of UHS.

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

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)
McAllen Medical Center	Acute Care	\$ 5,485,000	December, 2011	20(a)
Wellington Regional Medical Center	Acute Care	\$ 3,030,000	December, 2011	20(b)
Southwest Healthcare System, Inland Valley Campus	Acute Care	\$ 2,648,000	December, 2011	20(b)
The Bridgeway	Behavioral Health	\$ 930,000	December, 2014	10(c)

- (a) UHS has four 5-year renewal options at existing lease rates (through 2031).
- (b) UHS has two 5-year renewal options at existing lease rates (through 2021) and two 5-year renewal options at fair market value lease rates (2022 through 2031).
- (c) UHS has two 5-year renewal options at fair market value lease rates (2015 through 2024).

We are committed to invest up to a total of \$8.6 million in equity and debt financing, of which \$4.7 million has been funded as of June 30, 2010, in exchange for a 95% non-controlling equity interest in an LLC (Palmdale Medical Properties) that constructed, owns, and operates the Palmdale Medical Plaza, located in Palmdale, California, on the campus of a UHS hospital. This MOB has a triple net, 75% master lease commitment by UHS of Palmdale, Inc., a wholly-owned subsidiary of UHS, pursuant to the terms of which the master lease for each suite will be cancelled at such time that the suite is leased to another tenant acceptable to the LLC and UHS of Palmdale, Inc. This MOB, tenants of which will include subsidiaries of UHS, was completed and opened during the third quarter of 2008 at which time the master lease commenced. As of June 30, 2010, the master lease threshold of 75% has not been met and is not expected to be met in the near future. The LLC has a third-party term loan commitment of \$7.4 million, which is non-recourse to us, of which \$7.0 million has been borrowed as of June 30, 2010. This LLC, which is deemed to be a variable interest entity, is consolidated in our financial statements as of June 30, 2010 since we are the primary beneficiary.

We are committed to invest up to \$5.2 million in debt or equity, of which \$380,000 has been funded as of June 30, 2010, in exchange for a 95% non-controlling equity interest in an LLC (Banburry Medical Properties) that developed, constructed, owns and operates the Summerlin Medical Office Building III, located in Las Vegas, Nevada, on the campus of a UHS hospital. Summerlin Hospital Medical Center (Summerlin Hospital), a majority-owned subsidiary of UHS, has committed to lease approximately 25% of this building pursuant to the terms of a 10-year flex lease. In addition, Summerlin Hospital has committed to a 50% master lease on the remaining 75% of the building (representing 37.5% of the building) pursuant to the terms of which the master lease for each suite was cancelled at such time that the suite was leased to another tenant acceptable to the LLC and Summerlin Hospital. This MOB, tenants of which will include subsidiaries of UHS, was completed and opened during the first quarter of 2009 at which time the master lease commenced. As a result of this master lease agreement, the LLC was considered a variable interest entity and since we were the primary beneficiary, the financial results of this MOB were included in our financial statements on a consolidated basis prior to January 1, 2010. During the first quarter of 2010, the master lease threshold was met and, as a result, this MOB is accounted for as an unconsolidated LLC under the equity method beginning on January 1, 2010. The LLC has a third-party term loan commitment of \$13.5 million, which is non-recourse to us, all of which has been borrowed as of June 30, 2010.

We are committed to invest up to \$6.4 million in equity and debt financing, of which \$4.8 million has been funded as of June 30, 2010, in exchange for a 95% non-controlling equity interest in an LLC (Sparks Medical Properties) that owns and operates the Vista Medical Terrace and The Sparks Medical Building, located in Sparks, Nevada, on the campus of a UHS hospital. These MOB's were acquired by the LLC during the third quarter of 2008. As this LLC is not considered to be a variable interest entity, it is accounted for pursuant to the equity method. This LLC has a third-party term loan commitment of \$5.5 million, which is non-recourse to us, all of which has been borrowed as of June 30, 2010.

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We are committed to invest up to a total of \$4.8 million in equity and debt financing, none of which has been funded as of June 30, 2010, in exchange for a 95% non-controlling equity interest in an LLC (Texoma Medical Properties) that developed, constructed, owns and operates the Texoma Medical Plaza located in Denison, Texas, which was completed and opened during the first quarter of 2010. This MOB is located on the campus of a newly constructed and recently opened replacement UHS acute care hospital owned and operated by Texoma Medical Center (Texoma Hospital), a wholly-owned subsidiary of UHS. Texoma Hospital has committed to lease 75% of this building, pursuant to which the master lease for each suite will be cancelled at such time that the suite is leased to another tenant acceptable to the LLC and

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Texoma Hospital. The master lease threshold has been met. This MOB will have tenants that include subsidiaries of UHS. This LLC has a third-party construction loan commitment of \$13.3 million, which is non-recourse to us, of which \$12.9 million has been borrowed as of June 30, 2010. As this LLC is not considered to be a variable interest entity, it is accounted for pursuant to the equity method.

We are committed to invest up to a total of \$4.7 million in equity and debt financing, of which \$3.9 million has been funded as of June 30, 2010, in exchange for a 95% non-controlling equity interest in an LLC (Auburn Medical Properties) that developed constructed, owns and operates the Auburn Medical Office Building II, located in Auburn, Washington, on the campus of a UHS hospital. Auburn Regional Medical Center (Auburn Hospital), a wholly-owned subsidiary of UHS, has committed to lease 75% of this building, pursuant to which the master lease for each suite will be cancelled at such time that the suite is leased to another tenant acceptable to the LLC and Auburn Hospital. The master lease threshold on this MOB has been met. This MOB, tenants of which include subsidiaries of UHS, was completed and opened in the third quarter of 2009. This LLC has a third-party construction loan commitment of \$8.4 million, which is non-recourse to us, all of which has been borrowed as of June 30, 2010. As this LLC is not considered to be a variable interest entity, it is accounted for pursuant to the equity method.

Advisory Agreement: UHS of Delaware, Inc. (the Advisor), a wholly-owned subsidiary of UHS, serves as Advisor to us under an Advisory Agreement (the Advisory Agreement) dated December 24, 1986. Pursuant to the Advisory Agreement, the Advisor is obligated to present an investment program to us, to use its best efforts to obtain investments suitable for such program (although it is not obligated to present any particular investment opportunity to us), to provide administrative services to us and to conduct our day-to-day affairs. All transactions between us and UHS must be approved by the Trustees who are unaffiliated with UHS (the Independent Trustees). In performing its services under the Advisory Agreement, the Advisor may utilize independent professional services, including accounting, legal, tax and other services, for which the Advisor is reimbursed directly by us. The Advisory Agreement may be terminated for any reason upon sixty days written notice by us or the Advisor. The Advisory Agreement expires on December 31 of each year; however, it is renewable by us, subject to a determination by the Independent Trustees, that the Advisor's performance has been satisfactory. In December, 2009, based upon a review of our advisory fee and other general and administrative expenses, as compared to an industry peer group, the Advisory Agreement was renewed for 2010 and the fee was increased to 0.65% (from 0.60%) of our average invested real estate assets, as derived from our consolidated balance sheet.

The average real estate assets for advisory fee calculation purposes exclude certain items from our consolidated balance sheet such as, among other things, accumulated depreciation, cash and cash equivalents, base and bonus rent receivables, deferred charges and other assets. The advisory fee is payable quarterly, subject to adjustment at year-end based upon our audited financial statements. In addition, the Advisor is entitled to an annual incentive fee equal to 20% of the amount by which cash available for distribution to shareholders for each year, as defined in the Advisory Agreement, exceeds 15% of our equity as shown on our consolidated balance sheet, determined in accordance with generally accepted accounting principles without reduction for return of capital dividends. The Advisory Agreement defines cash available for distribution to shareholders as net cash flow from operations less deductions for, among other things, amounts required to discharge our debt and liabilities and reserves for replacement and capital improvements to our properties and investments. No incentive fees were paid during the first six months of 2010 or 2009 since the incentive fee requirements were not achieved. Advisory fees incurred and paid (or payable) to UHS amounted to \$466,000 and \$389,000 for the three months ended June 30, 2010 and 2009, respectively, and were based upon average invested real estate assets of \$286 million and \$259 million for the three months ended June 30, 2010 and 2009, respectively. Advisory fees incurred and paid (or payable) to UHS amounted to \$903,000 and \$779,000 for the six month periods ended June 30, 2010 and 2009, respectively, and were based upon average invested real estate assets of \$278 million and \$260 million for the six-month periods ended June 30, 2010 and 2009, respectively.

Officers and Employees: Our officers are all employees of UHS and although as of June 30, 2010 we had no salaried employees, our officers do receive stock-based compensation from time-to-time.

Share Ownership: As of June 30, 2010 and December 31, 2009, UHS owned 6.4% and 6.5% of our outstanding shares of beneficial interest, respectively.

SEC reporting requirements of UHS: UHS is subject to the reporting requirements of the SEC and is required to file annual reports containing audited financial information and quarterly reports containing unaudited financial information. Since the leases on the hospital facilities leased to wholly-owned subsidiaries of UHS comprised approximately 54% and 51% of our consolidated revenues for the three months ended June 30, 2010 and 2009, respectively, and 54% and 52% for the six month periods ended June 30, 2010 and 2009, respectively, and since a subsidiary of UHS is our Advisor, you are encouraged to obtain the publicly available filings for Universal Health Services, Inc. from the SEC's website at www.sec.gov. These filings are the sole responsibility of UHS and are not incorporated by reference herein.

UHS Other Matters:

Southwest Healthcare System: During the third quarter of 2009, UHS advised us that, Southwest Healthcare System (SWHCS), a wholly-owned subsidiary of UHS which operates Rancho Springs Medical Center (the real property of which is not owned by the Trust) and Inland Valley Regional Medical Center (Inland Valley), the real property of which is owned by the Trust) located in Riverside County, California, entered into

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an agreement with the Center for Medicare and Medicaid Services (CMS). The agreement required SWHCS to engage an independent quality monitor to assist SWHCS in meeting all CMS conditions of participation. Further, the agreement provided that, during the last 60 days of the agreement, CMS would conduct a full Medicare certification survey. That survey took place the week of January 11, 2010.

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In April, 2010, SWHCS received notification from CMS that it intended to effectuate the termination of SWHCS's Medicare provider agreement effective June 1, 2010. At that time, SWHCS commenced discussions with officials from CMS regarding an agreement in an effort to resolve the provider agreement termination action. In May, 2010, SWHCS entered into an agreement with CMS which abated the termination action scheduled for June 1, 2010. The agreement is up to one year in duration and requires SWHCS to engage independent experts in various disciplines to analyze and develop implementation plans for SWHCS to meet the Medicare conditions of participation. At the conclusion of the agreement, CMS will conduct a full certification survey to determine if SWHCS has achieved substantial compliance with the Medicare conditions of participation. During the term of the agreement, SWHCS will remain eligible to receive reimbursements from Medicare for services rendered to Medicare beneficiaries.

Also in April, 2010, SWHCS received notification from the California Department of Public Health (CDPH) indicating that it planned to initiate a process to revoke SWHCS's hospital license. In May, 2010, SWHCS received the formal document related to the revocation action. CDPH has previously indicated its willingness to rescind this revocation should SWHCS demonstrate its ability to meet all state licensing requirements. SWHCS is currently engaged in pursuing a resolution of this action with CDPH, however, there can be no assurance it will be able to do so. Should SWHCS fail to reach an agreement with CDPH, SWHCS will appeal CDPH's revocation action and SWHCS would remain operational during the appeal process.

UHS has advised us that Rancho Springs Medical Center and Inland Valley Regional Medical Center remain fully committed to providing high-quality healthcare to their patients and the communities they serve. UHS therefore intends to work expeditiously and collaboratively with both CMS and CDPH in an effort to resolve these matters, although there can be no assurance they will be able to do so. Failure to resolve these matters could have a material adverse effect on UHS and, in turn, us. While the base rentals on Inland Valley are guaranteed by UHS through the end of the existing lease term (December, 2011), should this matter adversely impact the future revenues and/or operating results of SWHCS, the future bonus rental earned by us on Inland Valley, as well as the underlying value of the property, may be materially adversely impacted. At June 30, 2010, the book value of the property was \$19.4 million. Bonus rental revenue earned by us from Inland Valley amounted to \$283,000 and \$574,000 during the three and six-month periods ended June 30, 2010, respectively, and \$1.1 million during the year ended December 31, 2009.

(3) Dividends

A dividend of \$0.605 per share or \$7.4 million in the aggregate was declared by the Board of Trustees on June 3, 2010 and was paid on June 30, 2010 to shareholders of record as of June 16, 2010.

(4) Acquisitions and Dispositions

Six Months Ended June 30, 2010:

During the first six months of 2010, we invested \$5.1 million in debt financing and equity for a 95% non-controlling ownership interest in an LLC (3811 Bell Medical Properties) that purchased the North Valley Medical Plaza, a medical office building located in Phoenix, Arizona.

There were no dispositions during the first six months of 2010.

Six Months Ended June 30, 2009:

There were no acquisitions or dispositions during the first six months of 2009.

(5) Summarized Financial Information of Equity Affiliates

Our consolidated financial statements include the consolidated accounts of our controlled investments and those investments that meet the criteria of a variable interest entity where we are the primary beneficiary. In accordance with the FASB's standards and guidance relating to accounting for investments and real estate ventures, we account for our unconsolidated investments in LLCs which we do not control using the equity method of accounting. The third-party members in these investments have equal voting rights with regards to issues such as, but not limited to: (i) divestiture of property; (ii) annual budget approval, and; (iii) financing commitments. These investments, which represent 33% to 99% non-controlling ownership interests, are recorded initially at our cost and subsequently adjusted for our net equity in the net income, cash contributions to, and distributions from, the investments. Pursuant to certain agreements, allocations of profits and losses of some of the LLC investments may be allocated disproportionately as compared to ownership interests after specified preferred return rate thresholds have been satisfied.

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At June 30, 2010, we have non-controlling equity investments or commitments in thirty-two LLCs which own medical office buildings (MOBs). As of June 30, 2010, we accounted for: (i) thirty of these LLCs on an unconsolidated basis pursuant to the equity method since they are not variable interest entities, and; (ii) two of these LLCs on a consolidated basis, as discussed below, since they are considered to be variable interest entities where we are the primary beneficiary by virtue of their master lease, lease assurance or lease guarantee arrangements with subsidiaries of Universal Health Services, Inc. (UHS), a related party to us.

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The majority of these LLCs are joint-ventures between us and a non-related party that manages and holds minority ownership interests in the entities. Each LLC is generally self-sustained from a cash flow perspective and generates sufficient cash flow to meet its operating cash flow requirements and service the third-party debt (if applicable) that is non-recourse to us. Although there is typically no ongoing financial support required from us to these entities since they are cash-flow sufficient, we may, from time to time, provide funding for certain purposes such as, but not limited to, significant capital expenditures and/or leasehold improvements. Although we are not obligated to do so, if approved by us at our sole discretion, additional cash fundings are typically advanced as equity or short to intermediate term loans.

Two of these LLCs have master lease, lease assurance or lease guarantee arrangements with subsidiaries of UHS. Additionally, UHS of Delaware, a wholly-owned subsidiary of UHS, serves as advisor to us under the terms of an advisory agreement and manages our day-to-day affairs. All of our officers are officers or employees of UHS. As a result of our related-party relationship with UHS and the master lease, lease assurance or lease guarantee arrangements with subsidiaries of UHS, we account for these LLCs on a consolidated basis since they are variable interest entities and we are deemed to be the primary beneficiary.

The two LLCs that we account for on a consolidated basis are as follows:

LLC	Facility Name	Ownership Interest	Date of Consolidation
653 Town Center Phase II	Summerlin Hospital MOB II	98%	First quarter of 2004(a)
Palmdale Medical Properties	Palmdale Medical Plaza	95%	Fourth quarter of 2007(b)

- (a) This MOB has a master lease provision that is scheduled to expire on September 30, 2010; therefore, beginning in the fourth quarter of 2010, we anticipate this MOB will no longer be deemed a variable interest entity and will be accounted for on an unconsolidated basis pursuant to the equity method.
- (b) Newly constructed facility that was completed and opened during the third quarter of 2008. The master lease threshold on this MOB has not yet been met and is not expected to be met in the near future.

The other LLCs in which we hold various non-controlling ownership interests are not variable interest entities and therefore are not subject to consolidation.

Summerlin Medical Office Building III, which is located in Las Vegas, Nevada on the campus of Summerlin Hospital Medical Center (a majority-owned subsidiary of Universal Health Services, Inc.), was completed and opened during the first quarter of 2009. In connection with this MOB, which is owned by an LLC (Banburry Medical Properties) in which we hold a majority, non-controlling ownership interest, Summerlin Hospital Medical Center committed to a master lease agreement for a specified portion of the space. As a result of this master lease agreement, the LLC was considered a variable interest entity. Since we were the primary beneficiary, the financial results of this MOB were included in our financial statements on a consolidated basis prior to January 1, 2010. During the first quarter of 2010, the master lease threshold was met and, as a result, this MOB is accounted for as an unconsolidated LLC under the equity method beginning on January 1, 2010. During the three-month period ended June 30, 2009, this property generated approximately \$345,000 of revenue, \$135,000 of other operating expenses and \$160,000 of combined interest and depreciation and amortization expense. During the six-month period ended June 30, 2009, this property generated approximately \$500,000 of revenue, \$200,000 of other operating expenses and \$220,000 of combined interest and depreciation and amortization expense. There was no material impact on our net income as a result of the deconsolidation of this LLC.

Below are the combined balance sheets (unaudited) for the two above-mentioned LLCs, as included in our condensed consolidated balance sheets at June 30, 2010 and for the three LLCs (the two above-mentioned LLCs as well as Banburry Medical Properties), as included in our consolidated balance sheet at December 31, 2009:

	June 30, 2010	December 31, 2009
	(in thousands)	
Net property (a.)	\$ 23,686	\$ 36,193
Other assets	1,047	2,818

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Total assets	\$ 24,733	\$ 39,011
Liabilities	\$ 864	\$ 1,089
Mortgage notes payable, non-recourse to us	15,105	28,790
Equity	8,764	9,132
Total liabilities and equity	\$ 24,733	\$ 39,011

(a.) Used as collateral for outstanding mortgage notes payable.

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Rental income is recorded by our consolidated and unconsolidated MOB's relating to leases in excess of one year in length using the straight-line method under which contractual rents are recognized evenly over the lease term regardless of when payments are due. The amount of rental revenue resulting from straight-line rent adjustments is dependent on many factors, including the nature and amount of any rental concessions granted to new tenants, scheduled rent increases under existing leases, as well as the acquisition and sales of properties that have existing in-place leases with terms in excess of one year. As a result, the straight-line adjustments to rental revenue may vary from period-to-period.

The following tables represent summarized financial and other information related to the thirty LLCs which were accounted for under the equity method:

Name of LLC	Ownership	Property Owned by LLC
DSMB Properties	76%	Desert Samaritan Hospital MOB's
DVMC Properties (a.)	90%	Desert Valley Medical Center
Suburban Properties	33%	Suburban Medical Plaza II
Litchvan Investments	89%	Papago Medical Park
Paseo Medical Properties II	75%	Thunderbird Paseo Medical Plaza I & II
Willetta Medical Properties (a.)	90%	Edwards Medical Plaza
Santa Fe Scottsdale (a.)	90%	Santa Fe Professional Plaza
575 Hardy Investors (a.)	90%	Centinela Medical Building Complex
Brunswick Associates	74%	Mid Coast Hospital MOB
Deerval Properties (d.)	90%	Deer Valley Medical Office II
PCH Medical Properties	85%	Rosenberg Children's Medical Plaza
Gold Shadow Properties (b.)	98%	700 Shadow Lane & Goldring MOB's
Arlington Medical Properties	75%	Saint Mary's Professional Office Building
ApaMed Properties	85%	Apache Junction Medical Plaza
Spring Valley Medical Properties (b.)	95%	Spring Valley Medical Office Building
Sierra Medical Properties	95%	Sierra San Antonio Medical Plaza
Spring Valley Medical Properties II (b.)	95%	Spring Valley Hospital Medical Office Building II
PCH Southern Properties	95%	Phoenix Children's East Valley Care Center
Centennial Medical Properties (b.)	95%	Centennial Hills Medical Office Building I
Canyon Healthcare Properties	95%	Canyon Springs Medical Plaza
653 Town Center Investments (b.)(c.)	95%	Summerlin Hospital Medical Office Building
DesMed (b.)	99%	Desert Springs Medical Plaza
Deerval Properties II (d.)	95%	Deer Valley Medical Office Building III
Cobre Properties	95%	Cobre Valley Medical Plaza
Sparks Medical Properties (b.)	95%	Vista Medical Terrace & The Sparks Medical Building
Auburn Medical Properties II (b.)	95%	Auburn Medical Office Building II
Texoma Medical Properties (b.)(e.)	95%	Texoma Medical Plaza
BRB/E Building One (f.)	95%	BRB Medical Office Building
Banburry Medical Properties (b.)(g.)	95%	Summerlin Hospital MOB III
3811 Bell Medical Properties (h.)	95%	North Valley Medical Plaza

- (a.) The membership interests of this entity are held by a master LLC in which we hold a 90% non-controlling ownership interest.
- (b.) Tenants of this medical office buildings include or will include subsidiaries of UHS.
- (c.) The membership interests of this entity are held by a master LLC in which we hold a 95% non-controlling ownership interest.
- (d.) Deerval Parking Company, LLC, which owns the real property of a parking garage located near Deer Valley Medical Office Buildings II and III, is 50% owned by each of Deerval Properties and Deerval Properties II.
- (e.) We have committed to invest up to \$4.8 million in equity and debt financing, none of which has been funded as of June 30, 2010. This building, which is on the campus of a replacement UHS hospital and will have tenants that will include subsidiaries of UHS, was completed and opened during the first quarter of 2010. This LLC has a third-party construction loan commitment of \$13.3 million, which is non-recourse to us, of which \$12.9 million has been borrowed as of June 30, 2010.
- (f.) We have committed to invest up to \$3.0 million in equity and debt financing, \$867,000 of which has been funded as of June 30, 2010, in an LLC that will develop, construct, own and operate this MOB which is scheduled to be completed and opened during the third quarter of 2010. This LLC obtained a third-party construction loan commitment of \$6.2 million, which is non-recourse to us, \$4.8 million of which has been borrowed as of June 30, 2010.

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- (g.) We have committed to invest up to \$5.2 million in equity and debt financing, of which \$380,000 has been funded as of June 30, 2010. The LLC has a third-party term loan commitment of \$13.5 million, which is non-recourse to us, all of which has been borrowed as of June 30, 2010. This facility was completed and opened during the first quarter of 2009 and was accounted for on a consolidated basis through December 31, 2009. During the first quarter of 2010, the master lease threshold at this facility was met; therefore, this LLC is no longer deemed to be a variable interest entity and is accounted for on an unconsolidated basis pursuant to the equity method beginning January 1, 2010.

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(h.) We have committed to invest up to \$6.2 million in equity and debt financing, \$5.1 million of which has been funded as of June 30, 2010. This MOB was acquired during the first quarter of 2010.

Below are the combined statements of income (unaudited) for the LLCs accounted for under the equity method at June 30, 2010 and 2009:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
	(amounts in thousands)			
Revenues	\$ 14,049	\$ 12,678	\$ 27,065	\$ 24,641
Operating expenses	6,310	5,663	11,735	10,925
Depreciation and amortization	3,017	2,619	6,011	5,050
Interest, net	4,316	3,696	8,362	7,233
Net income	\$ 406	\$ 700	\$ 957	\$ 1,433
Our share of net income (a.)	\$ 833	\$ 959	\$ 1,569	\$ 1,766

(a.) Our share of net income for the three months ended June 30, 2010 and 2009 includes interest income earned by us on various advances made to LLCs of approximately \$600,000 and \$393,000, respectively, and \$1.1 million and \$771,000 for the six months ended June 30, 2010 and 2009, respectively.

Below are the combined balance sheets (unaudited) for the LLCs accounted for under the equity method:

	June 30, 2010	December 31, 2009
	(in thousands)	
Net property, including CIP	\$ 320,284	\$ 296,623
Other assets	27,867	21,666
Total assets	\$ 348,151	\$ 318,289
Liabilities	\$ 13,089	\$ 13,097
Mortgage notes payable, non-recourse to us	267,755	251,406
Notes payable to us	28,952	19,084
Equity	38,355	34,702
Total liabilities and equity	\$ 348,151	\$ 318,289
Our share of equity and notes receivable from LLCs	\$ 75,499	\$ 61,934

As of June 30, 2010, aggregate maturities of mortgage notes payable by the LLCs which are accounted for under the equity method and are non-recourse to us, are as follows (amounts in thousands):

2010	\$ 35,862
2011	51,612
2012	30,225
2013	27,272

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2014	28,822
Thereafter	93,962
Total	\$ 267,755

Name of LLC	Mortgage Balance(a.)	Maturity Date
Deerval Properties(b.)(d.)	\$ 6,891	08/10/2010
Suburban Properties(b.)	9,078	09/15/2010
DVMC Properties(b.)(e.)	4,403	09/30/2010
Banbury Medical Properties(b.)(f.)	13,309	12/31/2010
PCH Medical Properties	6,393	01/31/2011
Deerval Properties II(g.)	18,185	02/15/2011
Auburn Medical Properties	8,376	04/02/2011
Santa Fe Scottsdale	2,599	06/10/2011
Texoma Medical Properties(c.)	12,973	07/01/2011
ApaMed Properties	2,727	01/01/2012

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Name of LLC	Mortgage Balance(a.)	Maturity Date
575 Hardy Investors	9,579	02/01/2012
Gold Shadow Properties	6,622	04/10/2012
BRB/E Building One(c.)	4,751	11/01/2012
Sierra Medical Properties	3,976	12/31/2012
Centennial Medical Properties	12,203	01/31/2013
Sparks Medical Properties	5,483	02/12/2013
Litchvan Investments	7,857	10/01/2013
Paseo Medical Properties II	17,000	06/08/2014
653 Town Center Investments	9,850	07/01/2014
Brunswick Associates	8,418	01/01/2015
Spring Valley Medical Properties	5,749	02/10/2015
DSMB Properties	25,252	09/10/2015
Arlington Medical Properties	26,435	10/10/2015
Willetta Medical Properties	13,171	10/10/2016
Cobre Properties	2,537	11/01/2017
Canyon Healthcare Properties	16,925	12/01/2017
PCH Southern Properties	7,013	12/01/2017

\$ 267,755

- (a.) All mortgage loans, other than construction loans, require monthly principal payments through maturity and include a balloon principal payment upon maturity.
- (b.) We believe the terms of these loans are within current market underwriting criteria. At this time, we expect the LLCs to either refinance these loans on or before their 2010 maturity dates for three to ten year terms at the then current market interest rates, or, we may decide to increase our equity investment in the property utilizing funds borrowed under our revolving credit facility.
- (c.) Construction loans.
- (d.) The Deerval Properties loan was extended by the current lender and a new loan is expected to close during August, 2010.
- (e.) The DVMC Properties loan is scheduled to mature on September 30, 2010, and can be extended, at the LLC's option, for three years to September 30, 2013.
- (f.) The Banburry Medical Properties loan is scheduled to mature on December 31, 2010, and can be extended, at the LLC's option, for one year to December 31, 2011.
- (g.) The Deerval Properties II amount includes one loan for each of Deerval Properties II and Deerval Parking, and are currently under refinancing. Two new loans are expected to close on August 1, 2010 and September 1, 2010.

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

(6) Recent Accounting Pronouncements

In January 2010, the Financial Accounting Standards Board (FASB) issued updated accounting guidance related to fair value measurements and disclosures which amends and clarifies existing disclosure requirements. This updated accounting guidance requires new disclosures related to amounts transferred into and out of Level 1 and 2 fair value measurements as well as separate disclosures of purchases, sales, issuances, and settlements related to amounts reported as Level 3 fair value measurements. This guidance also clarifies existing fair value disclosure requirements related to the level of disaggregation and the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. This guidance is effective for interim and annual periods beginning after December 15, 2009, except for the separate disclosures of purchases, sales, issuances and settlements related to amounts reported as Level 3 fair value measurements which is effective for fiscal years beginning after December 15, 2010. The adoption of this guidance did not have a material impact on our consolidated financial position or results of operations.

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In June 2009, the Financial Accounting Standards Board (FASB) issued an amendment to the accounting and disclosure requirements for transfers of financial assets. This amendment requires greater transparency and additional disclosures for transfers of financial assets and the entity's continuing involvement with them and changes the requirements for derecognizing financial assets. In addition, this amendment eliminates the concept of a qualifying special-purpose entity (QSPE). This amendment became effective for us on January 1, 2010. This amendment did not have a material impact on our consolidated financial position or results of operations.

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In June 2009, the FASB also issued an amendment to the accounting and disclosure requirements for the consolidation of variable interest entities (VIE s). The elimination of the concept of a QSPE, as discussed above, removes the exception from applying the consolidation guidance within this amendment. This amendment requires an enterprise to perform a qualitative analysis when determining whether or not it must consolidate a VIE. The amendment also requires an enterprise to continuously reassess whether it must consolidate a VIE. Additionally, the amendment requires enhanced disclosures about an enterprise s involvement with VIEs and any significant change in risk exposure due to that involvement, as well as how its involvement with VIEs impacts the enterprise s financial statements. Finally, an enterprise will be required to disclose significant judgments and assumptions used to determine whether or not to consolidate a VIE. This amendment became effective for us on January 1, 2010. This amendment did not have a material impact on our consolidated financial position or results of operations.

(7) Long-term debt

In January 2007, we entered into an unsecured \$100 million revolving credit agreement (the Agreement) which expires on January 19, 2012. We have a one-time option, which can be exercised at any time, subject to bank approval, to increase the amount by \$50 million for a total commitment of \$150 million. The Agreement provides for interest at our option, at the Eurodollar rate plus 0.75% to 1.125%, or the prime rate plus zero to 0.125%. A fee of 0.15% to 0.225% is paid on the unused portion of the commitment. The margins over the Eurodollar, prime rate and the commitment fee are based upon our debt to total capital ratio as defined by the Agreement. As of June 30, 2010, the applicable margin over the Eurodollar rate was 0.75%, the margin over the prime rate was zero, and the commitment fee was 0.15%.

The Agreement contained a provision that required the commitments to be reduced by 50% of the net proceeds generated from the issuance of any new equity. As a result of this provision, during the fourth quarter of 2009, we reduced the commitment by \$2.65 million to \$97.35 million. Subsequent to the end of the second quarter of 2010, we retroactively amended our Agreement to reinstate the commitment back to \$100 million and eliminated the provision in the Agreement that required the commitment to be reduced by 50% of the net proceeds from the issuance of equity. At June 30, 2010, we had \$58.8 million of outstanding borrowings and \$20.5 million of letters of credit outstanding against the Agreement. We had \$20.75 million of available borrowing capacity, net of the outstanding borrowings and letters of credit outstanding as of June 30, 2010. There are no compensating balance requirements. The carrying amount and fair value of the outstanding borrowings pursuant to the Agreement were \$58.8 million and \$56.0 million, respectively, at June 30, 2010.

Covenants relating to the Agreement require the maintenance of a minimum tangible net worth and specified financial ratios, limit our ability to incur additional debt, limit the aggregate amount of mortgage receivables and limit our ability to increase dividends in excess of 95% of cash available for distribution, unless additional distributions are required to comply with the applicable section of the Internal Revenue Code and related regulations governing real estate investment trusts. We are in compliance with all of the covenants at June 30, 2010. We also believe that we would remain in compliance if the full amount of our commitment was borrowed.

The following table includes a summary of the required compliance ratios (dollar amounts in thousands):

	Covenant	June 30, 2010
Tangible net worth	>\$ 129,928	\$ 139,955
Debt to total capital	< 55%	30%
Debt service coverage ratio	> 1.25x	3.6x
Debt to cash flow ratio	< 3.50x	1.72x

We have three mortgages and one term loan, all of which are non-recourse to us, included on our consolidated balance sheet as of June 30, 2010, with a combined outstanding carrying balance of \$23.6 million and fair value of \$23.6 million. Changes in market rates on our fixed rate debt impact the fair value of debt, but have no impact on interest incurred or cash flow. The mortgages are secured by the real property of the buildings as well as property leases and rents. The following table summarizes our outstanding mortgages and term loan at June 30, 2010 (amounts in thousands):

Facility Name	Outstanding Balance (in thousands)	Interest Rate	Maturity Date
Medical Center of Western Connecticut fixed rate mortgage loan(b)	\$ 5,250	6.0%	2017
Summerlin Hospital MOB II fixed rate mortgage loan(b)(c)	8,106	8.3%	2010

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Kindred Hospital-Corpus Christi fixed rate mortgage loan(b)	3,228	6.5%	2019
Palmdale Medical Plaza term loan(a)	6,999	3.3%	2010
Total	\$ 23,583		

- (a) This term loan, which carries a fixed interest rate of 3.25%, was scheduled to mature on July 31, 2010. The lender has agreed to extend this term loan for a 3-month period, to October 31, 2010, subject to a \$382,000 principal curtailment due to occur on or before October 15, 2010. This loan can be extended, at our option, for three years to July 31, 2013 at interest rates as provided for in the current loan agreement. We expect to exercise the three-year option, or, since we believe the terms of this loan are within current market underwriting criteria, we could elect to refinance this loan on or before its maturity date for a three to ten year term at the then current market interest rates. In the unexpected event we are unable to refinance this loan on reasonable terms, we would explore other financing alternatives including, among other things, potentially increasing our equity investment in the property utilizing funds borrowed under our revolving credit facility.
- (b) Amortized principal payments made on a monthly basis.
- (c) Since we believe the terms of this loan are within current market underwriting criteria at this time, we expect to refinance this loan on or before its 2010 maturity date for three to ten-year terms at the then current market interest rates. In the unexpected event that we are unable to refinance this loan on reasonable terms, we will explore other financing alternatives, including, among other things, potentially increasing our equity investment in the property utilizing funds borrowed under our revolving credit facility.

(8) Segment Reporting

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

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

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

Overview

We are a real estate investment trust (REIT) that commenced operations in 1986. We invest in healthcare and human service related facilities including acute care hospitals, behavioral healthcare facilities, rehabilitation hospitals, sub-acute facilities, surgery centers, childcare centers and medical office buildings. As of June 30, 2010, we have fifty-two real estate investments or commitments located in fifteen states consisting of:

seven hospital facilities consisting of three acute care, one behavioral healthcare, one rehabilitation and two sub-acute;

forty-one medical office buildings, including thirty-two owned by various LLCs, and;

four pre-school and childcare centers.

Forward Looking Statements and Certain Risk Factors

This report contains forward-looking statements that reflect our current estimates, expectations and projections about our future results, performance, prospects and opportunities. Forward-looking statements include, among other things, the information concerning our possible future results of operations, business and growth strategies, financing plans, expectations that regulatory developments or other matters will not have a material adverse effect on our business or financial condition, our competitive position and the effects of competition, the projected growth of the industry in which we operate, and the benefits and synergies to be obtained from our completed and any future acquisitions, and statements of our goals and objectives, and other similar expressions concerning matters that are not historical facts. Words such as may, will, should, could, would, predicts, potential, continue, expects, anticipates, future, intends, plans, believes, estimates, and other expressions, as well as statements in future tense, identify forward-looking statements.

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

a substantial portion of our revenues are dependent upon one operator, Universal Health Services, Inc. (UHS);

A number of legislative initiatives have recently been passed into law that may result in major changes in the health care delivery system on a national or state level to the operators of our facilities, including UHS. No assurances can be given that the implementation of these new laws will not have a material adverse effect on the business, financial condition or results of operations of our operators;

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

lost revenues from purchase option exercises and lease expirations and renewals, loan repayments and other restructuring;

the availability and terms of capital to fund the growth of our business;

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the outcome of known and unknown litigation, government investigations, and liabilities and other claims asserted against us or the operators of our facilities;

UHS's agreement to acquire Psychiatric Solutions, Inc. will require UHS to substantially increase its level of indebtedness which could, among other things, adversely affect its ability to raise additional capital to fund operations, limit its ability to react to changes in the economy or its industry and could potentially prevent them from meeting their obligations under the agreements related to their indebtedness. If UHS experiences financial difficulties and, as a result, operations of its existing facilities suffer, or UHS otherwise fails to make payments to us, our revenues will significantly decline. See Item 1A. *Risk Factors* for additional disclosure;

failure of the operators of our hospital facilities to comply with governmental regulations related to the Medicare and Medicaid certification requirements and hospital license requirements could have a material adverse impact on our future revenues and the underlying value of our properties (see Note 2, Relationship with Universal Health Services, Inc. (UHS) and Related Party Transactions for disclosure related to Southwest Healthcare System's regulatory matters with the Center for Medicare and Medicaid Services and the California Department of Public Health);

the potential unfavorable impact on our business of continued deterioration in national, regional and local economic and business conditions, including a continuation or worsening of unfavorable credit and/or capital market conditions, which may adversely affect, on acceptable terms, our access to sources of capital which may be required to fund the future growth of our business;

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

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

our majority ownership interests in various LLCs in which we hold non-controlling equity interests;

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

government regulations, including changes in the reimbursement levels under the Medicare and Medicaid program resulting from, among other things, the various health care reform initiatives being implemented;

the issues facing the health care industry that affect the operators of our facilities, including UHS, such as: changes in, or the ability to comply with, existing laws and government regulations; unfavorable changes in the levels and terms of reimbursement for our charges by third party payors or government programs, including Medicare or Medicaid; demographic changes; the ability to enter into managed care provider agreements on acceptable terms; an increase in uninsured and self-pay patients which unfavorably impacts the collectibility of patient accounts; decreasing in-patient admission trends; technological and pharmaceutical improvements that may increase the cost of providing, or reduce the demand for, health care, and; the ability to attract and retain qualified medical personnel, including physicians;

three LLCs that own properties in California, in which we have various non-controlling equity interests, could not obtain earthquake insurance at rates which are economically beneficial in relation to the risks covered;

competition for our operators from other REITs;

competition from other health care providers, including physician owned facilities and other facilities owned by UHS, including, but not limited to, McAllen, Texas, the site of our largest acute care facility;

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

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

fluctuations in the value of our common stock, and;

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

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

Forward-looking statements speak only as of the date the statements are made. We assume no obligation to publicly update any forward-looking statements to reflect actual results, changes in assumptions or changes in other factors affecting forward-looking information, except as may be

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required by law. All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by this cautionary statement.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the amounts reported in our consolidated financial statements and accompanying notes. We consider our critical accounting policies to be those that require us to make significant judgments and estimates when we prepare our financial statements, including the following:

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

The minimum rent for all hospital facilities is fixed over the initial term or renewal term of the respective leases. Rental income recorded by our consolidated and unconsolidated medical office buildings (MOBs) relating to leases in excess of one year in length is recognized using the straight-line method under which contractual rents are recognized evenly over the lease term regardless of

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when payments are due. The amount of rental revenue resulting from straight-line rent adjustments is dependent on many factors including the nature and amount of any rental concessions granted to new tenants, scheduled rent increases under existing leases, as well as the acquisitions and sales of properties that have existing in-place leases with terms in excess of one year. As a result, the straight-line adjustments to rental revenue may vary from period-to-period. Bonus rents are recognized when earned based upon increases in each facility's net revenue in excess of stipulated amounts. Bonus rentals are determined and paid each quarter based upon a computation that compares the respective facility's current quarter's net revenue to the corresponding quarter in the base year. Tenant reimbursements for operating expenses are accrued as revenue in the same period the related expenses are incurred.

Real Estate Investments: On the date of acquisition, the purchase price of a property is allocated to the property's land, buildings and intangible assets based upon our estimates of their fair values. Depreciation is computed using the straight-line method over the useful lives of the buildings and capital improvements. The value of intangible assets is amortized over the remaining lease term.

Asset Impairment: Real estate investments and related intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the property might not be recoverable. A property to be held and used is considered impaired only if management's estimate of the aggregate future cash flows, less estimated capital expenditures, to be generated by the property, undiscounted and without interest charges, are less than the carrying value of the property. This estimate takes into consideration factors such as expected future operating income, trends and prospects, as well as the effects of demand, competition, local market conditions and other factors.

The determination of undiscounted cash flows requires significant estimates by management, including the expected course of action at the balance sheet date that would lead to such cash flows. Subsequent changes in estimated undiscounted cash flows arising from changes in anticipated action to be taken with respect to the property could impact the determination of whether an impairment exists and whether the effects could materially impact our net income. To the extent estimated undiscounted cash flows are less than the carrying value of the property, the loss will be measured as the excess of the carrying amount of the property over the fair value of the property.

Assessment of the recoverability by us of certain lease related costs must be made when we have reason to believe that a tenant might not be able to perform under the terms of the lease as originally expected. This requires us to make estimates as to the recoverability of such costs.

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

Investments in Limited Liability Companies (LLCs): Our consolidated financial statements include the consolidated accounts of our controlled investments and those investments that meet the criteria of a variable interest entity where we are the primary beneficiary. In accordance with the FASB's standards and guidance relating to accounting for investments and real estate ventures, we account for our unconsolidated investments in LLCs which we do not control using the equity method of accounting. The third-party members in these investments have equal voting rights with regards to issues such as, but not limited to: (i) divestiture of property; (ii) annual budget approval, and; (iii) financing commitments. These investments, which represent 33% to 99% non-controlling ownership interests, are recorded initially at our cost and subsequently adjusted for our net equity in the net income, cash contributions to, and distributions from, the investments. Pursuant to certain agreements, allocations of profits and losses of some of the LLC investments may be allocated disproportionately as compared to ownership interests after specified preferred return rate thresholds have been satisfied.

At June 30, 2010, we have non-controlling equity investments or commitments in thirty-two LLCs which own medical office buildings (MOBs). As of June 30, 2010, we accounted for: (i) thirty of these LLCs on an unconsolidated basis pursuant to the equity method since they are not variable interest entities, and; (ii) two of these LLCs on a consolidated basis, as discussed below, since they are considered to be variable interest entities where we are the primary beneficiary by virtue of their master lease, lease assurance or lease guarantee arrangements with subsidiaries of Universal Health Services, Inc. (UHS), a related party to us.

The majority of these LLCs are joint-ventures between us and a non-related party that manages and holds minority ownership interests in the entities. Each LLC is generally self-sustained from a cash flow perspective and generates sufficient cash flow to meet its operating cash flow requirements and service the third-party debt (if applicable) that is non-recourse to us. Although there is typically no ongoing financial support required from us to these entities since they are cash-flow sufficient, we may, from time to time, provide funding for certain purposes such as, but not limited to, significant capital expenditures and/or leasehold improvements. Although we are not obligated to do so, if approved by us at our sole discretion, additional cash fundings are typically advanced as equity or short to intermediate term loans.

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Two of these LLCs have master lease, lease assurance or lease guarantee arrangements with subsidiaries of UHS. Additionally, UHS of Delaware, a wholly-owned subsidiary of UHS, serves as advisor to us under the terms of an advisory agreement and manages our day-to-day affairs. All of our officers are officers or employees of UHS. As a result of our related-party relationship with UHS and the master lease, lease assurance or lease guarantee arrangements with subsidiaries of UHS, we account for these LLCs on a consolidated basis since they are variable interest entities and we are deemed to be the primary beneficiary.

The two LLCs that we account for on a consolidated basis are as follows:

LLC	Facility Name	Ownership Interest	Date of
			Consolidation
653 Town Center Phase II	Summerlin Hospital MOB II	98%	First quarter of 2004(a)
Palmdale Medical Properties	Palmdale Medical Plaza	95%	Fourth quarter of 2007(b)

- (a) This MOB has a master lease provision that is scheduled to expire on September 30, 2010; therefore, beginning in the fourth quarter of 2010, we anticipate this MOB will no longer be deemed a variable interest entity and will be accounted for on an unconsolidated basis pursuant to the equity method.
- (b) Newly constructed facility that was completed and opened during the third quarter of 2008. The master lease threshold on this MOB has not yet been met and is not expected to be met in the near future.

The other LLCs in which we hold various non-controlling ownership interests are not variable interest entities and therefore are not subject to consolidation.

Summerlin Medical Office Building III, which is located in Las Vegas, Nevada on the campus of Summerlin Hospital Medical Center (a majority-owned subsidiary of Universal Health Services, Inc.), was completed and opened during the first quarter of 2009. In connection with this MOB, which is owned by an LLC in which we hold a majority, non-controlling ownership interest, Summerlin Hospital Medical Center committed to a master lease agreement for a specified portion of the space. As a result of this master lease agreement, the LLC was considered a variable interest entity. Since we were the primary beneficiary, the financial results of this MOB were included in our financial statements on a consolidated basis prior to January 1, 2010. During the first quarter of 2010, the master lease threshold was met and, as a result, this MOB is accounted for as an unconsolidated LLC under the equity method beginning on January 1, 2010. During the three-month period ended June 30, 2009, this property generated approximately \$345,000 of revenue, \$135,000 of other operating expenses and \$160,000 of combined interest and depreciation and amortization expense. During the six-month period ended June 30, 2009, this property generated approximately \$500,000 of revenue, \$200,000 of other operating expenses and \$220,000 of combined interest and depreciation and amortization expense. There was no material impact on our net income as a result of the deconsolidation of this LLC.

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

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

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

Relationship with Universal Health Services, Inc. (UHS) UHS is our principal tenant and through UHS of Delaware, Inc., a wholly owned subsidiary of UHS, serves as our advisor (the Advisor) under an Advisory Agreement dated December 24, 1986 between the Advisor and us (the Advisory Agreement). Our officers are all employees of UHS and although as of June 30, 2010 we had no salaried employees, our officers do receive stock-based compensation from time-to-time.

Pursuant to the Advisory Agreement, the Advisor is obligated to present an investment program to us, to use its best efforts to obtain investments suitable for such program (although it is not obligated to present any particular investment opportunity to us), to provide

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administrative services to us and to conduct our day-to-day affairs. All transactions between us and UHS must be approved by the Independent Trustees. In performing its services under the Advisory Agreement, the Advisor may utilize independent professional services, including accounting, legal, tax and other services, for which the Advisor is reimbursed directly by us. The Advisory Agreement may be terminated for any reason upon sixty days written notice by us or the Advisor. The Advisory Agreement expires on December 31 of each year; however, it is renewable by us, subject to a determination by the Trustees who are unaffiliated with UHS (the Independent Trustees), that the Advisor's performance has been satisfactory. The Advisor is entitled to certain advisory fees for its services. See Relationship with Universal Health Services, Inc. and Related Party Transactions in Note 2 to the consolidated financial statements for additional information on the Advisory Agreement and related fees.

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The combined revenues generated from the leases on the UHS hospital facilities accounted for approximately 54% and 51% of our consolidated revenue for the three months ended June 30, 2010 and 2009, respectively, and 54% and 52% for the six months ended June 30, 2010 and 2009, respectively. Including 100% of the revenues generated at the unconsolidated LLCs in which we have various non-controlling equity interests ranging from 33% to 99%, the leases on the UHS hospital facilities accounted for approximately 19% and 20% of the combined consolidated and unconsolidated revenue for the three month periods ended June 30, 2010 and 2009, respectively, and 19% and 20% for the six months ended June 30, 2010 and 2009, respectively. In addition, twelve medical office buildings (MOBs) owned by LLCs in which we hold various non-controlling equity interests, include or will include tenants which are subsidiaries of UHS. The leases to the hospital facilities of UHS are guaranteed by UHS and cross-defaulted with one another. For additional disclosure related to our relationship with UHS, please refer to Note 2 to the condensed consolidated financial statements Relationship with Universal Health Services, Inc. (UHS) and Related Party Transactions.

Results of Operations

Our Consolidated Statement of Income for the three month period ended June 30, 2009 includes the revenue and expenses associated with the three consolidated LLCs, as discussed above. During the first quarter of 2010, the master lease threshold on the Summerlin III MOB was met and, as a result, this MOB is accounted for as an unconsolidated LLC under the equity method beginning on January 1, 2010. During the three-month period ended June 30, 2009, this property generated approximately \$345,000 of revenue, \$135,000 of other operating expenses and \$160,000 of combined interest and depreciation and amortization expense. During the six-month period ended June 30, 2009, this property generated approximately \$500,000 of revenue, \$200,000 of other operating expenses and \$220,000 of combined interest and depreciation and amortization expense. The tables below provide the Statement of Income for this LLC for the three and six month period ended June 30, 2009. The As Adjusted column is used for comparison discussions in the Results of Operations. There was no material impact on our net income as a result of the deconsolidation of this LLC.

(amounts in thousands)

Three Months Ended June 30, 2009	As reported in Consolidated Statements of Income	April June, 2009 Statements of Income for Summerlin III	As Adjusted
Revenues	\$ 8,023	\$ 345	\$ 7,678
<u>Expenses:</u>			
Depreciation and amortization	1,586	82	1,504
Advisory fee to UHS	389		389
Other operating expenses	1,536	135	1,401
	3,511	217	3,294
Income before equity in limited liability companies (LLCs) and interest expense	4,512	128	4,384
Equity in income of unconsolidated LLCs	959	(51)	1,010
Interest expense	(669)	(77)	(592)
Net income	\$ 4,802		\$ 4,802

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Six Months Ended June 30, 2009	As reported in Consolidated Statements of Income	Jan June, 2009 Statements of Income for Summerlin III	As Adjusted
Revenues	\$ 15,903	\$ 503	\$ 15,400
Expenses:			
Depreciation and amortization	3,124	107	3,017
Advisory fee to UHS	779		779
Other operating expenses	3,042	200	2,842
	6,945	307	6,638
Income before equity in limited liability companies (LLCs) and interest expense	8,958	196	8,762
Equity in income of unconsolidated LLCs	1,766	(86)	1,852
Interest expense	(1,276)	(110)	(1,166)
Net income	\$ 9,448		\$ 9,448

For the quarter ended June 30, 2010, net income was \$4.3 million, or \$0.35 per diluted share, as compared to \$4.8 million, or \$0.40 per diluted share, during the comparable prior year quarter. For the six-month period ended June 30, 2010, net income was \$8.8 million, or \$0.73 per diluted share, as compared to \$9.4 million, or \$0.80 per diluted share, during the comparable six-month period of the prior year.

The decrease in net income of \$528,000, or \$.05 per diluted share, during the second quarter of 2010, as compared to the comparable prior year quarter, was primarily attributable to:

an unfavorable change of approximately \$300,000, or \$.03 per diluted share, resulting from the following net favorable items included in our results for the three and six-month periods ended June 30, 2009: (i) the effect of a favorable adjustment resulting from the change in estimate to the operating expenses of an LLC, partially offset by; (ii) the operating losses sustained during the second quarter of 2009 at an LLC that owns a newly constructed medical office building that was completed and opened in April of 2009, and;

other combined net unfavorable changes of \$228,000, or \$.02 per diluted share, due primarily to a \$205,000 reduction in revenues (on an As Adjusted basis), as discussed below.

The decrease in net income of \$647,000, or \$.07 per diluted share, during the six-month period ended June 30, 2010, as compared to the comparable prior year period, was primarily attributable to:

an unfavorable change of approximately \$300,000, or \$.03 per diluted share, resulting from the above-mentioned favorable items included in our results for the three and six-month periods ended June 30, 2009, and;

other combined net unfavorable changes of \$347,000, or \$.03 per diluted share, due primarily to a \$283,000 reduction in revenues (on an As Adjusted basis), as discussed below.

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During the three months ended June 30, 2010 and 2009, we recorded equity in income of unconsolidated LLCs of \$833,000 and \$1.0 million As Adjusted, respectively. During the six months ended June 30, 2010 and 2009, we recorded equity in income of unconsolidated LLCs of \$1.6 million and \$1.9 million As Adjusted, respectively. The decrease during the three and six-month periods ended June 30, 2010, as compared to the comparable 2009 period, was primarily due to the above-mentioned \$300,000 of net favorable items recorded during the three and six-month periods ended June 30, 2009.

During the three and six-month periods ended June 30, 2010, total revenue decreased by \$205,000, or \$0.02 per diluted share As Adjusted, and \$283,000, or \$0.02 per diluted share As Adjusted, respectively. These decreases resulted primarily from decreases in base rental and tenant reimbursements at certain of our MOBs due to decreased occupancy rates.

Depreciation and amortization expense increased \$106,000 and \$162,000 during the three and six months ended June 30, 2010, as compared to the comparable prior year As Adjusted periods, respectively, due primarily to the expense recorded in connection with renovations completed at certain consolidated MOBs.

Interest expense, net of interest income, decreased \$70,000 and \$149,000 during the three and six months ended June 30, 2010 as compared to the comparable prior year As Adjusted periods, respectively, due primarily to a decrease in our average borrowing rate, partially offset by an increase in our average outstanding borrowings. The increased borrowings were used primarily to fund the investments in and advances to LLCs and additions to real estate investments, as discussed herein.

Included in our other operating expenses are expenses related to the consolidated medical office buildings, which totaled \$1.2 million and \$1.1 million (excluding Summerlin III MOB) for the three-month periods ended June 30, 2010 and 2009, respectively, and \$2.2 million (excluding Summerlin III MOB) for each of the six-month periods ended June 30, 2010 and 2009. The increases in other operating expenses for the three-month period ended June 30, 2010 is primarily attributable to an increase in general maintenance expenses at certain MOBs. A portion of the expenses associated with our consolidated medical office buildings is passed on directly to the tenants. Tenant reimbursements for operating expenses are accrued as revenue in the same period the related expenses are incurred and are included as tenant reimbursement revenue in our condensed consolidated statements of income.

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During 2008, we recorded an asset impairment charge of \$4.6 million in connection with two medical office buildings (Southern Crescent Centers I and II) located on a medical campus in Clayton County (Riverdale), Georgia. This asset impairment charge was recorded after evaluation of property and location-specific factors including: (i) the future expiration of a master lease which occurred in June, 2010; (ii) the occupancy and projected occupancy of the buildings, and; (iii) the anticipated unfavorable impact on the region and the properties resulting from the loss of the school district's accreditation during 2008. As expected and previously disclosed, the master lease, which has been in effect since 2000 on one of these properties, was not renewed upon its expiration in June, 2010. The combined fair value of these properties was determined based upon the present value of their expected future cash flows.

Since the master lease was not renewed, we will be required to find other operators for this property and/or enter into leases on terms potentially less favorable to us than the previous master lease. Since inception of this master lease, our historical annual revenues, net income and net cash provided by operating activities included approximately \$1.1 million annually in connection with the terms of this master lease. Although we continue to actively market the available space in these two buildings, and have successfully executed new leases on a portion of the space, our annual revenues, net income and cash provided by operating activities in connection with these properties could be reduced by up to \$1 million annually beginning in July of 2010.

Funds from operations is a widely recognized measure of performance for Real Estate Investment Trusts (REITs). We believe that funds from operations (FFO) and funds from operations per diluted share, which are non-GAAP financial measures (GAAP is Generally Accepted Accounting Principles in the United States of America), are helpful to our investors as measures of our operating performance. We compute FFO in accordance with standards established by the National Association of Real Estate Investment Trusts (NAREIT), which may not be comparable to FFO reported by other REITs that do not compute FFO in accordance with the NAREIT definition, or that interpret the NAREIT definition differently than we interpret the definition. FFO does not represent cash generated from operating activities in accordance with GAAP and should not be considered to be an alternative to net income determined in accordance with GAAP. In addition, FFO should not be used as: (i) an indication of our financial performance determined in accordance with GAAP; (ii) an alternative to cash flow from operating activities determined in accordance with GAAP; (iii) a measure of our liquidity, or; (iv) an indicator of funds available for our cash needs, including our ability to make cash distributions to shareholders.

Below is a reconciliation of our reported net income to FFO for the three and six month periods ended June 30, 2010 and 2009 (in thousands):

	Three Months Ended		Six Months Ended	
	June 30, 2010	2009	June 30, 2010	2009
Net income	\$ 4,274	\$ 4,802	\$ 8,801	\$ 9,448
Plus: Depreciation and amortization expense:				
Consolidated investments	1,573	1,561	3,107	3,076
Unconsolidated affiliates	2,451	2,095	4,882	4,025
Funds from operations (FFO)	\$ 8,298	\$ 8,458	\$ 16,790	\$ 16,549

Liquidity and Capital Resources**Net cash provided by operating activities**

Net cash provided by operating activities was \$12.3 million for each of the six-month periods ended June 30, 2010 and 2009.

The \$38,000 net increase was attributable to:

an unfavorable change of \$499,000 due to a decrease in net income plus or minus the adjustments to reconcile net income to net cash provided by operating activities (depreciation and amortization and restricted/stock-based compensation);

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a favorable change of \$432,000 in accrued expenses and other liabilities;

a favorable change of \$208,000 in tenant reserves, escrows, deposits and prepaid rents related primarily to increases in prepaid rents and deposits at certain MOBs;

a favorable change of \$81,000 in accrued interest;

an unfavorable change of \$83,000 in rent receivable, and;

other net unfavorable changes of \$101,000.

The \$432,000 favorable change in accrued expenses and other liabilities resulted primarily from the partial settlement of accrued dividend rights during the six months ended June 30, 2009, partially offset by various other net unfavorable changes. In order to meet certain recent changes to tax law requirements, the current payment of dividend equivalents will be made in the years in which dividends are declared and paid, or, if later, when the related options become vested. Dividend equivalents that were accrued as of December 31, 2008 with respect to previously vested options, were paid in January, 2009.

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Net cash used in investing activities

Net cash used in investing activities was \$15.4 million during the six months ended June 30, 2010 as compared to \$13.2 million during the six months ended June 30, 2009.

During the six-month period ended June 30, 2010, we funded: (i) \$5.2 million of equity investments in LLCs; (ii) \$9.5 million of advances to LLCs, and; (iii) \$302,000 of capital additions. Additionally, a decrease in cash of \$1.9 million resulted from the previously discussed deconsolidation of the Summerlin Hospital Medical Office Building III during the first quarter of 2010. Also during the six-month period ended June 30, 2010, we received: (i) \$29,000 related to debt refinancing by an LLC; (ii) \$94,000 in repayments of advances to LLCs, and; (iii) \$1.5 million of cash distributions in excess of income from our unconsolidated LLCs.

During the six-month period ended June 30, 2009, we funded: (i) \$11.4 million of equity investments; (ii) \$2.0 million of advances to LLCs; (iii) \$4.3 million of capital additions consisting primarily of construction costs related to the new MOB in Las Vegas, Nevada, which opened during the first quarter of 2009, and a \$753,000 deposit made in connection with the refurbishment of an MOB. Also during the six-month period ended June 30, 2009, we received: (i) \$2.8 million related to debt refinancing by LLCs; (ii) \$106,000 in repayments of advances to LLCs, and; (iii) \$2.3 million of cash distributions in excess of income from our unconsolidated LLCs.

Net cash provided by financing activities

Net cash provided by financing activities was \$1.3 million during the six months ended June 30, 2010 and \$2.3 million during the six months ended June 30, 2009.

During the six-month period ended June 30, 2010, we: (i) received \$10.0 million of additional net borrowings on our revolving line of credit; (ii) received \$5.3 million of proceeds related to a new mortgage note payable that is non-recourse to us, related to a consolidated MOB, and; (iii) generated \$4.7 million of net cash from the issuance of shares of beneficial interest. Additionally, during the six months ended June 30, 2010, we paid: (i) \$3.4 million on mortgage notes payable that are non-recourse to us; (ii) \$126,000 on mortgage notes payable of a consolidated LLC that are non-recourse to us; (iii) \$94,000 on a loan payable of a consolidated LLC that is non-recourse to us; (iv) \$308,000 of financing costs on mortgage notes payable that are non-recourse to us, and; (v) \$14.7 million of dividends.

During the fourth quarter of 2009, we commenced an at-the-market (ATM) equity issuance program pursuant to the terms of which we may sell, from time-to-time, common shares of our beneficial interest up to an aggregate sales price of \$50 million to or through Merrill Lynch, Pierce, Fenner and Smith Incorporated, as sales agent and/or principal. Pursuant to this ATM program, we issued 152,200 shares at an average price of \$32.08 per share during the three and six months ended June 30, 2010, which generated approximately \$4.6 million of net cash proceeds (net of \$325,000, consisting of compensation of approximately \$146,000 to Merrill Lynch as well as \$179,000 of other various fees and expenses). Since inception of this program, we have issued 336,800 shares at an average price of \$31.64 per share, which generated approximately \$9.9 million of net cash proceeds (net of \$762,000, consisting of compensation of approximately \$320,000 to Merrill Lynch as well as \$442,000 of various other fees and expenses).

During the six month period ended June 30, 2009, we received: (i) \$13.3 million of additional net borrowings on our revolving line of credit; (ii) \$2.9 million of additional net borrowings from mortgage, construction and other loans payable of consolidated LLCs, and; (iii) \$420,000 of cash from the issuance of shares of beneficial interest. Additionally, during the six months ended June 30, 2009, we paid: (i) \$107,000 on mortgage notes payable that are non-recourse to us; (ii) \$213,000 as partial settlement of accrued dividend rights, as discussed above, and; (iii) \$14.1 million of dividends.

Additional cash flow and dividends paid information for the six-month periods ended June 30, 2010 and 2009:

As indicated on our consolidated statement of cash flows, we generated net cash provided by operating activities of \$12.3 million during each of the six months ended June 30, 2010 and 2009, respectively. As also indicated on our statement of cash flows, noncash expenses such as depreciation and amortization expense and restricted/stock-based compensation expense are the primary differences between our net income and net cash provided by operating activities during each period. In addition, as reflected in the cash flows from investing activities section, we received \$1.5 million and \$2.3 million during the six months ended June 30, 2010 and 2009, respectively, of cash distributions in excess of income from various unconsolidated LLCs which represents our share of the net cash flow distributions from these entities. These cash distributions in excess of income represent operating cash flows net of capital expenditures and debt repayments made by the LLCs.

We generated \$13.8 million and \$14.6 million of net cash during the six months ended June 30, 2010 and 2009, respectively, related to the operating activities of our properties recorded on a consolidated and an unconsolidated basis. We paid dividends of \$14.7 million and \$14.1

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million during the six months ended June 30, 2010 and 2009, respectively. As indicated on the cash flows from investing activities and cash flows from financing activities sections of the statements of cash flows, there were various sources and uses of cash during the six months ended June 30, 2010 and 2009. Therefore, the funding source for our dividend payments is not wholly dependent on the operating cash flow generated by our properties in any given period. Rather, our dividends, as well as our capital reinvestments into our existing properties, acquisitions of real property and other investments are funded based upon the aggregate net cash inflows or outflows from all sources and uses of cash generated from the properties we own either in whole or through LLCs as outlined above.

Included in the various sources of cash were: (i) funds generated from the repayments of advances, made from us to LLCs (\$94,000 and \$106,000 for the six months ended June 30, 2010 and 2009, respectively); (ii) cash distributions of refinancing proceeds from LLCs (\$29,000 and \$2.8 million during the six months ended June 30, 2010 and 2009, respectively); (iii) net borrowings on our revolving credit agreements (\$10.0 million and \$13.3 million for the six months ended June 30, 2010 and 2009, respectively); (iv) net borrowings from mortgage, construction and other loans payable of consolidated MOBs and LLCs, net of financing costs (\$1.3 million and \$2.8 million for the six months ended June 30, 2010 and 2009, respectively), and; (v) net cash generated in connection with the issuance of shares of beneficial interest (\$4.7 million and \$420,000 for the six months ended June 30, 2010 and 2009, respectively).

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In addition to the dividends paid, the following were also included in the various uses of cash: (i) investments in LLCs (\$5.2 million and \$11.4 million for the six months ended June 30, 2010 and 2009, respectively); (ii) advances made to LLCs (\$9.5 million and \$2.0 million for the six months ended June 30, 2010 and 2009, respectively), and; (iii) additions to real estate investments and deposit on building refurbishment (\$302,000 and \$5.1 million for the six months ended June 30, 2010 and 2009, respectively).

In determining and monitoring our dividend level on a quarterly basis, our management and Board of Trustees consider many factors in determining the amount of dividends to be paid each period. These considerations primarily include: (i) the minimum required amount of dividends to be paid in order to maintain our REIT status; (ii) the projected operating results of our properties, including those owned in LLCs, and; (iii) our future capital commitments and debt repayments, including those of our LLCs. Based upon the information discussed above, as well as consideration of projections and forecasts of our future operating cash flows, management and the Board of Trustees have determined that our operating cash flows have been sufficient to fund our dividend payments.

We expect to finance all capital expenditures and acquisitions and pay dividends utilizing internally generated and additional funds. Additional funds may be obtained through: (i) the issuance of equity pursuant to our at-the-market equity issuance program; (ii) borrowings under our existing revolving credit facility or through refinancing the existing revolving credit agreement; (iii) borrowings under or refinancing of existing third-party debt pursuant to mortgage and construction loan agreements entered into by our LLCs, and/or; (iv) the issuance of other long-term debt.

There can be no assurance that such additional funds will be available in the preferred amounts or from the preferred sources. We believe that our net cash provided by operations will be sufficient to allow us to make distributions necessary to enable us to continue to qualify as a REIT under Sections 856 to 860 of the Internal Revenue Code of 1986.

Credit facilities and mortgage debt

In January 2007, we entered into an unsecured \$100 million revolving credit agreement (the Agreement) which expires on January 19, 2012. We have a one-time option, which can be exercised at any time, subject to bank approval, to increase the amount by \$50 million for a total commitment of \$150 million. The Agreement provides for interest at our option, at the Eurodollar rate plus 0.75% to 1.125%, or the prime rate plus zero to 0.125%. A fee of 0.15% to 0.225% is paid on the unused portion of the commitment. The margins over the Eurodollar, prime rate and the commitment fee are based upon our debt to total capital ratio as defined by the Agreement. As of June 30, 2010, the applicable margin over the Eurodollar rate was 0.75%, the margin over the prime rate was zero, and the commitment fee was 0.15%.

The Agreement contained a provision that required the commitments to be reduced by 50% of the net proceeds generated from the issuance of any new equity. As a result of this provision, during the fourth quarter of 2009, we reduced the commitment by \$2.65 million to \$97.35 million. Subsequent to June 30, 2010, we retroactively amended our Agreement to reinstate the commitment back to \$100 million and eliminated the provision in the Agreement that required the commitment to be reduced by 50% of the net proceeds from the issuance of equity. At June 30, 2010, we had \$58.8 million of outstanding borrowings and \$20.5 million of letters of credit outstanding against the Agreement. We had \$20.75 million of available borrowing capacity, net of the outstanding borrowings and letters of credit outstanding as of June 30, 2010. There are no compensating balance requirements. The carrying amount and fair value of the outstanding borrowings pursuant to the Agreement were \$58.8 million and \$56.0 million, respectively, at June 30, 2010.

Covenants relating to the Agreement require the maintenance of a minimum tangible net worth and specified financial ratios, limit our ability to incur additional debt, limit the aggregate amount of mortgage receivables and limit our ability to increase dividends in excess of 95% of cash available for distribution, unless additional distributions are required to comply with the applicable section of the Internal Revenue Code and related regulations governing real estate investment trusts. We are in compliance with all of the covenants at June 30, 2010. We also believe that we would remain in compliance if the full amount of our commitment was borrowed.

The following table includes a summary of the required compliance ratios (dollar amounts in thousands):

	Covenant	June 30, 2010
Tangible net worth	>\$ 129,928	\$ 139,955
Debt to total capital	< 55%	30%
Debt service coverage ratio	> 1.25x	3.6x
Debt to cash flow ratio	< 3.50x	1.72x

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We have three mortgages and one term loan, all of which are non-recourse to us, included on our consolidated balance sheet as of June 30, 2010, with a combined outstanding carrying balance of \$23.6 million and fair value of \$23.6 million. Changes in market rates on our fixed rate debt impact the fair value of debt, but have no impact on interest incurred or cash flow. The mortgages are secured by the real property of the buildings as well as property leases and rents. The following table summarizes our outstanding mortgages and term loan at June 30, 2010 (amounts in thousands):

Facility Name	Outstanding Balance (in thousands)	Interest Rate	Maturity Date
Medical Center of Western Connecticut fixed rate mortgage loan(b)	\$ 5,250	6.0%	2017
Summerlin Hospital MOB II fixed rate mortgage loan(b)(c)	8,106	8.3%	2010
Kindred Hospital-Corpus Christi fixed rate mortgage loan(b)	3,228	6.5%	2019
Palmdale Medical Plaza term loan(a)	6,999	3.3%	2010
Total	\$ 23,583		

- (a) This term loan, which carries a fixed interest rate of 3.25%, was scheduled to mature on July 31, 2010. The lender has agreed to extend this term loan for a 3-month period, to October 31, 2010, subject to a \$382,000 principal curtailment due to occur on or before October 15, 2010. This loan can be extended, at our option, for three years to July 31, 2013 at interest rates as provided for in the current loan agreement. We expect to exercise the three-year option, or, since we believe the terms of this loan are within current market underwriting criteria, we could elect to refinance this loan on or before its maturity date for a three to ten year term at the then current market interest rates. In the unexpected event we are unable to refinance this loan on reasonable terms, we would explore other financing alternatives including, among other things, potentially increasing our equity investment in the property utilizing funds borrowed under our revolving credit facility.
- (b) Amortized principal payments made on a monthly basis.
- (c) Since we believe the terms of this loan are within current market underwriting criteria at this time, we expect to refinance this loan on or before its 2010 maturity date for three to ten-year terms at the then current market interest rates. In the unexpected event that we are unable to refinance this loan on reasonable terms, we will explore other financing alternatives, including, among other things, potentially increasing our equity investment in the property utilizing funds borrowed under our revolving credit facility.

Off Balance Sheet Arrangements

As of June 30, 2010, we are party to certain off balance sheet arrangements consisting of standby letters of credit and equity and debt financing commitments. Our outstanding letters of credit at June 30, 2010 totaled \$20.5 million consisting of: (i) \$4.4 million related to Banburry Medical Properties; (ii) \$4.4 million related to Texoma Medical Plaza; (iii) \$2.8 million related to Centennial Hills Medical Properties; (iv) \$2.4 million related to Palmdale Medical Properties; (v) \$2.1 million related to BRB/E Building One; (vi) \$808,000 related to Auburn Medical Properties II; (vii) \$1.3 million related to Sparks Medical Properties; (viii) \$908,000 related to Sierra Medical Properties; (ix) \$884,000 related to Deerval Properties II, and; (x) \$478,000 related to Arlington Medical Properties.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes in the quantitative and qualitative disclosures during the first six months of 2010. Reference is made to Item 7A in the Annual Report on Form 10-K for the year ended December 31, 2009.

Item 4. Controls and Procedures

As of June 30, 2010, under the supervision and with the participation of our management, including the Trust's Chief Executive Officer (CEO) and Chief Financial Officer (CFO), we performed an evaluation of the effectiveness of our disclosure controls and procedures as defined in Rule 13a-15(e) or Rule 15d-15(e) under the Securities Exchange Act of 1934, as amended (the 1934 Act). Based on this evaluation, the CEO and CFO have concluded that our disclosure controls and procedures are effective to ensure that material information is recorded, processed, summarized and reported by management on a timely basis in order to comply with our disclosure obligations under the 1934 Act and the SEC rules thereunder.

There have been no changes in our internal control over financial reporting or in other factors during the second quarter of 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

UNIVERSAL HEALTH REALTY INCOME TRUST

Item 1A. Risk Factors

Our Annual Report on Form 10-K for 2009 and our Quarterly Report on Form 10-Q for the quarter ended March 31, 2010 include a listing of risk factors to be considered by investors in our securities. Other than developments related to Southwest Healthcare System, as disclosed in Note 2 to the Financial Statements included in Part 1 of this Report and incorporated herein by reference, and the additional risk related to Universal Health Services, Inc. (UHS) agreement to acquire Psychiatric Solutions, Inc. (PSI), there have been no material changes in our risk factors from those set forth in our Annual Report on Form 10-K for the year ended December 31, 2009 and our Quarterly Report on Form 10-Q for the quarter ended March 31, 2010.

A substantial portion of our revenues are dependent upon UHS. UHS has agreed to acquire PSI which will require UHS to incur substantial indebtedness which could adversely affect UHS's ability to raise additional capital to fund its operations and meet its obligations under agreements related to their indebtedness. If UHS experiences financial difficulties and, as a result, operations of its existing facilities suffer, or UHS otherwise fails to make payments to us, our revenues will significantly decline.

The combined revenues generated from the leases on the UHS hospital facilities accounted for approximately 54% of our consolidated net revenues for the six months ended June 30, 2010 and 59% for the year ended December 31, 2009. As of June 30, 2010, subsidiaries of UHS leased four of the seven hospital facilities owned by us with terms expiring in 2011 or 2014.

In connection with the consummation of UHS's potential acquisition of PSI, UHS has obtained a debt financing commitment of \$3.45 billion consisting of an \$800 million revolving credit agreement, a \$1.05 billion term loan A and a \$1.6 billion term loan B (collectively The Credit Facilities). The Credit Facilities will become effective upon closing of UHS's proposed acquisition of PSI which is expected to occur in the fourth quarter of 2010. The indebtedness under The Credit Facilities will be senior obligations of UHS's and will be guaranteed by substantially all of UHS's material domestic subsidiaries. UHS will use the net proceeds from The Credit Facilities to pay the consideration under the merger agreement with PSI, to refinance certain of its existing indebtedness and the indebtedness of PSI, to pay certain costs and expenses of the transactions and for general corporate uses.

Although we do not expect to be directly impacted by UHS's acquisition of PSI, UHS will be substantially more leveraged and we cannot assure you that UHS will continue to satisfy its obligations to us. The failure or inability of UHS to satisfy its obligations to us could materially reduce our revenues and net income, which could in turn reduce the amount of dividends we pay and cause our stock price to decline.

Item 6. Exhibits

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(a.) Exhibits:

- 31.1 Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)/15(d)-14(a) under the Securities Exchange Act of 1934, as amended.
- 31.2 Certification of the Chief Financial Officer pursuant to Rule 13a-14(a)/15(d)-14(a) under the Securities Exchange Act of 1934, as amended.
- 32.1 Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: August 6, 2010

UNIVERSAL HEALTH REALTY INCOME TRUST
(Registrant)

/s/ Alan B. Miller
Alan B. Miller, Chairman of the Board,
Chief Executive Officer and President
(Principal Executive Officer)

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

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EXHIBIT INDEX

Exhibit No.	Description
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