Physicians Realty Trust
Form 10-Q
November 03, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2016

or

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

For the transition period from to

Commission file number: 001-36007

PHYSICIANS REALTY TRUST
(Exact Name of Registrant as Specified in its Charter)

Maryland	46-2519850
(State of Organization)	(IRS Employer Identification No.)
309 N. Water Street,	
Suite 500	53202
Milwaukee, Wisconsin	(Zip Code)
(Address of Principal Executive Offices)	

(414) 367-5600
(Registrant’s Telephone Number, Including Area Code)

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. x Yes o No

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files).
x Yes o 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 definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer x	Accelerated Filer o
Non-Accelerated Filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

The number of the Registrant’s common shares outstanding as of October 28, 2016 was 135,569,612.

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PHYSICIANS REALTY TRUST

Quarterly Report on Form 10-Q
for the Quarter Ended September 30, 2016

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements made pursuant to safe harbor provisions of the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical facts may be forward-looking statements within the meaning of the federal securities laws. In particular, statements pertaining to our capital resources, property performance and results of operations contain forward-looking statements. Likewise, all of our statements regarding anticipated growth in our funds from operations and anticipated market conditions, demographics and results of operations are forward-looking statements. You can identify forward-looking statements by the use of forward-looking terminology such as "believes," "expects," "may," "will," "should," "seeks," "approximately," " "plans," "pro forma," "estimates" or "anticipates" or the negative of these words and phrases or similar words or phrases which are predictions of or indicate future events or trends and which do not relate solely to historical matters. You can also identify forward-looking statements by discussions of strategy, plans, expectations or intentions.

These forward-looking statements reflect the views of our management regarding current expectations and projections about future events and are based on currently available information. These forward-looking statements are not guarantees of future performance and involve numerous risks and uncertainties and you should not rely on them as predictions of future events. Forward-looking statements depend on assumptions, data or methods which may be incorrect or imprecise and we may not be able to realize them. We do not guarantee that the transactions and events described will happen as described (or that they will happen at all). The following factors, among others, could cause actual results and future events to differ materially from those set forth or contemplated in the forward-looking statements:

- general economic conditions;
- adverse economic or real estate developments, either nationally or in the markets where our properties are located;
- our failure to generate sufficient cash flows to service our outstanding indebtedness;
- fluctuations in interest rates and increased operating costs;
- the availability, terms and deployment of debt and equity capital, including our unsecured revolving credit facility;
- our ability to make distributions on our common shares;
- general volatility of the market price of our common shares;
- our increased vulnerability economically due to the concentration of our investments in healthcare properties;
- our geographic concentrations in Texas and Kentucky cause us to be particularly exposed to downturns in these local economies or other changes in local real estate market conditions;
- changes in our business or strategy;
- our dependence upon key personnel whose continued service is not guaranteed;
- our ability to identify, hire and retain highly qualified personnel in the future;
- the degree and nature of our competition;

- changes in governmental regulations, tax rates and similar matters;
- defaults on or non-renewal of leases by tenants;
- decreased rental rates or increased vacancy rates;
- difficulties in identifying healthcare properties to acquire and completing acquisitions;
- competition for investment opportunities;

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- our failure to successfully develop, integrate, and operate acquired properties and operations, including our ability to integrate the properties in the CHI Portfolio (as defined herein);
- any adverse effects to Catholic Health Initiative's business, financial position or results of operations that impact the ability of affiliates of Catholic Health Initiative to pay us rent;
- the impact of our investment in joint ventures;
- the financial condition and liquidity of, or disputes with, any joint venture and development partners with whom we may make co-investments in the future;
- cybersecurity incidents could disrupt our business and result in the compromise of confidential information;
- our ability to operate as a public company;
- changes in accounting principles generally accepted in the United States (GAAP);
- lack of or insufficient amounts of insurance;
- other factors affecting the real estate industry generally;
- our failure to maintain our qualification as a real estate investment trust (or REIT) for U.S. federal income tax purposes;
- limitations imposed on our business and our ability to satisfy complex rules in order for us to qualify as a REIT for U.S. federal income tax purposes;
- changes in governmental regulations or interpretations thereof, such as real estate and zoning laws and increases in real property tax rates and taxation of REITs; and
- factors that may materially adversely affect us, or the per share trading price of our common shares, including:

- higher market interest rates;
- the number of our common shares available for future issuance or sale;
- our issuance of equity securities or the perception that such issuance might occur;
- future debt;
- failure of securities analysts to publish research or reports about us or our industry; and
- securities analysts' downgrade of our common shares or the healthcare-related real estate sector.

While forward-looking statements reflect our good faith beliefs, they are not guarantees of future performance. We disclaim any obligation to publicly update or revise any forward-looking statement to reflect changes in underlying assumptions or factors, new information, data or methods, future events or other changes after the date of this report, except as required by applicable law. You should not place undue reliance on any forward-looking statements that are based on information currently available to us or the third parties making the forward-looking statements. For a further discussion of these and other factors that could impact our future results, performance or transactions, see Part II, Item 1A (Risk Factors) of this report, Part I, Item 1A (Risk Factors) of our Annual Report on Form 10-K for the fiscal year ended December 31, 2015 (the "Annual Report"), and Part II, Item 1A (Risk Factors) of our Quarterly Reports on Form 10-Q for the quarterly periods ended March 31, 2016 and June 30, 2016.

In this report, the terms "we," "us," "our," "our company," the "Trust," the "Company," and "Physicians Realty" refer to Physi
Realty Trust, a Maryland real estate investment trust, together with its consolidated subsidiaries, including Physicians Realty L.P., a Delaware limited partnership, which we refer to in this report as our "Operating Partnership". In this report, the term "OP Units" refers to partnership interests in the Operating Partnership and the term "Series A Preferred Units" refers to Series A Participating Redeemable Preferred Units of the Operating Partnership, which have priority over the OP Units with respect to distributions and liquidation.

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PART I. Financial Information
Item 1. Financial Statements
Physicians Realty Trust
Consolidated Balance Sheets
(In thousands, except share and per share data)

	September 30, 2016 (unaudited)	December 31, 2015
ASSETS		
Investment properties:		
Land and improvements	$ 172,685	$ 130,788
Building and improvements	2,220,448	1,284,863
Tenant improvements	12,627	9,243
Acquired lease intangibles	282,798	205,168
	2,688,558	1,630,062
Accumulated depreciation	(153,815)	(91,250)
Net real estate property	2,534,743	1,538,812
Real estate loans receivable	43,817	39,349
Investment in unconsolidated entity	1,326	1,322
Net real estate investments	2,579,886	1,579,483
Cash and cash equivalents	8,396	3,143
Tenant receivables, net	9,551	2,977
Other assets	72,814	53,283
Total assets	$ 2,670,647	$ 1,638,886
LIABILITIES AND EQUITY		
Liabilities:		
Credit facility	$ 448,321	$ 389,375
Notes payable	224,339	—
Mortgage debt	113,736	94,240
Accounts payable	2,222	644
Dividends and distributions payable	31,755	20,783
Accrued expenses and other liabilities	46,574	24,473
Acquired lease intangibles, net	9,399	5,950
Total liabilities	876,346	535,465
Redeemable noncontrolling interest - Operating Partnership and partially owned properties	25,891	26,960
Equity:		
Common shares, $0.01 par value, 500,000,000 common shares authorized, 134,620,300 and 86,864,063 common shares issued and outstanding as of September 30, 2016 and December 31, 2015, respectively	1,349	872
Additional paid-in capital	1,893,745	1,129,284
Accumulated deficit	(174,227)	(109,024)
Accumulated other comprehensive income	652	—
Total shareholders' equity	1,721,519	1,021,132
Noncontrolling interests:		
Operating Partnership	46,138	45,451
Partially owned properties	753	9,878

Total noncontrolling interests	46,891	55,329
Total equity	1,768,410	1,076,461
Total liabilities and equity	$ 2,670,647	$ 1,638,886

The accompanying notes are an integral part of these consolidated financial statements.

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Physicians Realty Trust
Consolidated Statements of Income
(In thousands, except share and per share data) (Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Revenues:				
Rental revenues	$53,327	$ 28,145	$130,378	$ 72,111
Expense recoveries	14,361	5,821	31,816	14,265
Interest income on real estate loans and other	2,322	904	5,166	2,661
Total revenues	70,010	34,870	167,360	89,037
Expenses:				
Interest expense	7,300	3,341	15,776	7,244
General and administrative	4,917	4,018	13,964	11,359
Operating expenses	19,159	7,966	43,994	20,979
Depreciation and amortization	23,969	12,476	59,778	31,067
Acquisition expenses	4,398	3,257	11,031	11,764
Total expenses	59,743	31,058	144,543	82,413
Income before equity in income of unconsolidated entity and gain on sale of investment property:	10,267	3,812	22,817	6,624
Equity in income of unconsolidated entity	27	26	85	78
Gain on sale of investment property	—	145	—	130
Net income	10,294	3,983	22,902	6,832
Net income attributable to noncontrolling interests:				
Operating Partnership	(255)	(200)	(629)	(333)
Partially owned properties	(176)	(79)	(553)	(255)
Net income attributable to controlling interest	9,863	3,704	21,720	6,244
Preferred distributions	(436)	(300)	(1,421)	(791)
Net income attributable to common shareholders	$9,427	$ 3,404	$20,299	$ 5,453
Net income per share:				
Basic	$0.07	$ 0.05	$0.17	$ 0.08
Diluted	$0.07	$ 0.05	$0.16	$ 0.08
Weighted average common shares:				
Basic	134,608,396	71,034,747	122,973,862	69,040,121
Diluted	138,880,787	75,104,821	127,395,989	73,040,846
Dividends and distributions declared per common share and OP Unit	$0.225	$ 0.225	$0.675	$ 0.675

The accompanying notes are an integral part of these consolidated financial statements.

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Physicians Realty Trust
Consolidated Statements of Comprehensive Income
(In thousands) (Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net income	$10,294	$3,983	$22,902	$6,832
Other comprehensive income:				
Change in fair value of interest rate swap agreements	652	—	652	—
Total other comprehensive income	652	—	652	—
Comprehensive income	10,946	3,983	23,554	6,832
Comprehensive income attributable to noncontrolling interests	(17)	—	(17)	—
Comprehensive income attributable to common shareholders	$10,929	$3,983	$23,537	$6,832

The accompanying notes are an integral part of these consolidated financial statements.

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Physicians Realty Trust
Consolidated Statement of Equity
(In thousands) (Unaudited)

	Par Value	Additional Paid in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity	Operating Partnership Noncontrolling Interest	Partially Owned Properties Noncontrolling Interest	Total Noncontrolling Interests	Total Equity
Balance at January 1, 2016	$872	$1,129,284	$(109,024)	$—	$1,021,132	$45,451	$9,878	$55,329	$1,076,461
Net proceeds from sale of common shares	472	763,820	—	—	764,292	—	—	—	764,292
Restricted share award grants, net	1	3,496	(294)	—	3,203	—	—	—	3,203
Purchase of OP Units	—	—	—	—	—	(2,999)	—	(2,999)	(2,999)
Conversion of OP Units	4	8,094	—	—	8,098	(8,098)	—	(8,098)	—
Dividends/distributions declared	—	—	(85,208)	—	(85,208)	(2,394)	—	(2,394)	(87,602)
Preferred distributions	—	—	(1,421)	—	(1,421)	—	—	—	(1,421)
Issuance of OP Units in connection with acquisition	—	(3,900)	—	—	(3,900)	6,869	(100)	6,769	2,869
Contributions	—	—	—	—	—	—	50	50	50
Distributions	—	—	—	—	—	—	(450)	(450)	(450)
Change in market value of Redeemable Noncontrolling Interests in Operating Partnership	—	(422)	—	—	(422)	—	—	—	(422)
Reclassification of Noncontrolling Interest - partially owned properties	—	—	—	—	—	—	(8,514)	(8,514)	(8,514)
Buyout of Noncontrolling Interests - partially owned properties	—	53	—	—	53	—	(664)	(664)	(611)
Change in fair value of interest rate cap agreements	—	—	—	652	652	—	—	—	652
Net income	—	—	21,720	—	21,720	629	553	1,182	22,902
Adjustment for Noncontrolling Interests ownership in Operating Partnership	—	(6,680)	—	—	(6,680)	6,680	—	6,680	—
Balance at September 30, 2016	$1,349	$1,893,745	$(174,227)	$652	$1,721,519	$46,138	$753	$46,891	$1,768,410

The accompanying notes are an integral part of this consolidated financial statement.

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Physicians Realty Trust
Consolidated Statements of Cash Flows
(In thousands) (Unaudited)

	Nine Months Ended September 30,	
	2016	2015
Cash Flows from Operating Activities:		
Net income	$22,902	$6,832
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	59,778	31,067
Amortization of deferred financing costs	1,796	953
Amortization of lease inducements and above/below market lease intangibles	2,994	1,559
Straight-line rental revenue/expense	(12,156)	(6,262)
Amortization of above market assumed debt	(177)	(114)
Loss on sale of investment property	—	(130)
Equity in income of unconsolidated entity	(85)	(78)
Distribution from unconsolidated entity	82	79
Change in fair value of derivative	(67)	(116)
Provision for bad debts	152	26
Non-cash share compensation	3,497	2,929
Write-off of contingent consideration	(840)	—
Tenant receivables	(7,543)	(2,448)
Other assets	(6,320)	(1,268)
Accounts payable	1,578	693
Accrued expenses and other liabilities	23,832	7,929
Net cash provided by operating activities	89,423	41,651
Cash Flows from Investing Activities:		
Proceeds on sales of investment property	—	3,039
Acquisition of investment properties, net	(1,044,601)	(629,888)
Capital expenditures on existing investment properties	(8,665)	(3,974)
Real estate loans receivable	(8,153)	(12,404)
Repayment of note receivable	4,118	—
Note receivable	—	(4,123)
Repayment of real estate loan receivable	4,500	—
Leasing commissions	(707)	(278)
Lease inducements	(4,870)	(2,478)
Net cash used in investing activities	(1,058,378)	(650,106)
Cash Flows from Financing Activities:		
Net proceeds from sale of common shares	764,292	318,170
Proceeds from credit facility borrowings	921,000	473,000
Payment on credit facility borrowings	(860,000)	(138,000)
Proceeds from issuance of mortgage debt	21,500	—
Proceeds from issuance of senior unsecured notes	225,000	—
Principal payments on mortgage debt	(1,646)	(1,486)
Debt issuance costs	(4,693)	(3,029)
Dividends paid - shareholders	(74,515)	(47,665)
Distributions to noncontrolling interest - Operating Partnership	(2,410)	(2,374)
Preferred distributions paid - OP Unit holder	(1,115)	(360)

Distributions to noncontrolling interest - partially owned properties	(450)	(158)
Purchase of Series A Preferred Units	(9,756)	—
Purchase of OP Units	(2,999)	(253)
Common shares repurchased and retired	—	(595)
Net cash provided by financing activities	974,208	597,250
Net increase (decrease) in cash and cash equivalents	5,253	(11,205)
Cash and cash equivalents, beginning of period	3,143	15,923
Cash and cash equivalents, end of period	$8,396	$4,718
Supplemental disclosure of cash flow information - interest paid during the period	$6,971	$6,010
Supplemental disclosure of noncash activity - change in fair value of interest rate swap agreements	$652	$—
Supplemental disclosure of noncash activity - assumed debt	$—	$18,690
Supplemental disclosure of noncash activity - issuance of OP Units and Series A Preferred Units in connection with acquisitions	$6,769	$20,677
Supplemental disclosure of noncash activity - contingent consideration	$156	$550

The accompanying notes are an integral part of these consolidated financial statements.

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Physicians Realty Trust
Notes to Consolidated Financial Statements

Note 1. Organization and Business

Physicians Realty Trust (the “Trust” or the “Company”) was organized in the state of Maryland on April 9, 2013. As of September 30, 2016, the Trust was authorized to issue up to 500,000,000 common shares of beneficial interest, par value $0.01 per share (“common shares”). The Trust filed a Registration Statement on Form S-11 with the Securities and Exchange Commission (the “Commission” or the “SEC”) with respect to a proposed underwritten initial public offering (the “IPO”) and completed the IPO of its common shares and commenced operations on July 24, 2013.

The Trust contributed the net proceeds from the IPO to Physicians Realty L.P., a Delaware limited partnership (the “Operating Partnership”), and is the sole general partner of the Operating Partnership. The Trust’s operations are conducted through the Operating Partnership and wholly-owned and majority-owned subsidiaries of the Operating Partnership. The Trust, as the general partner of the Operating Partnership, controls the Operating Partnership and consolidates the assets, liabilities, and results of operations of the Operating Partnership.

The Trust is a self-managed real estate investment trust (“REIT”) formed primarily to acquire, selectively develop, own, and manage healthcare properties that are leased to physicians, hospitals, and healthcare delivery systems.

2016 Follow-On Public Offerings

On January 25, 2016, the Trust completed a follow-on public offering of 21,275,000 common shares of beneficial interest, including 2,775,000 common shares issued upon exercise of the underwriters’ overallotment option, resulting in net proceeds to it of approximately $321.1 million. The Trust contributed the net proceeds of this offering to its Operating Partnership in exchange for 21,275,000 OP Units, and its Operating Partnership used the net proceeds of the public offering to repay borrowings under its unsecured revolving credit facility and for general corporate and working capital purposes and funding acquisitions.

On April 11, 2016, the Trust completed a follow-on public offering of 25,875,000 common shares of beneficial interest, including 3,375,000 common shares issued upon exercise of the underwriters’ overallotment option, resulting in net proceeds to it of approximately $442.8 million. The Trust contributed the net proceeds of this offering to the Operating Partnership in exchange for 25,875,000 OP Units, and the Operating Partnership used the net proceeds of the public offering to repay borrowings under its unsecured revolving credit facility, for general corporate and working capital purposes, for funding acquisitions, and to fund a portion of the purchase price for the acquisition of medical office facilities (the “CHI Portfolio”) from certain subsidiaries and affiliates of Catholic Health Initiatives (the “CHI Acquisition”).

ATM Program

On August 5, 2016, the Trust and the Operating Partnership entered into separate At Market Issuance Sales Agreements (the “Sales Agreements”) with each of KeyBanc Capital Markets Inc., Credit Agricole Securities (USA) Inc., JMP Securities LLC, Raymond James & Associates, Inc., and Stifel Nicolaus & Company, Incorporated (the “Agents”), pursuant to which the Trust may issue and sell, from time to time, its common shares having an aggregate offering price of up to $300 million, through the Agents. The offering of the common shares from time to time were registered pursuant to the Trust’s Registration Statement on Form S-3ASR (File No. 333-205034), which became automatically effective upon filing with the Commission on June 17, 2015, as amended by Post-Effective Amendment No. 1 to the Registration Statement on Form S-3ASR, filed by the Trust with the Commission on January 19, 2016. In accordance with the Sales Agreements, the Trust may offer and sell its common shares through any of the Agents, from time to time, by any method deemed to be an "at the market offering" as defined in Rule 415 under the Securities Act of 1933, as amended, which includes sales made directly on the New York Stock Exchange or other existing trading market, or sales made to or through a market maker. With the Trust's express written consent, sales also may be made in negotiated transactions or any other method permitted by law. During the quarterly period ended September 30, 2016, the Trust did not issue and sell any common shares pursuant to any of the Sales Agreements.

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Note 2. Summary of Significant Accounting Policies

The accompanying unaudited consolidated financial statements reflect all adjustments which are, in the opinion of management, necessary for a fair presentation of the results for the periods ended September 30, 2016 and 2015 pursuant to the instructions to Form 10-Q and Article 10 of Regulation S-X. All such adjustments are of a normal recurring nature. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States ("GAAP") have been condensed or omitted pursuant to such rules and regulations. These financial statements should be read in conjunction with the audited financial statements included in the Trust's Annual Report on Form 10-K for the year ended December 31, 2015, filed with the SEC on February 29, 2016.

Principles of Consolidation

GAAP requires the Trust to identify entities for which control is achieved through means other than voting rights and to determine which business enterprise is the primary beneficiary of variable interest entities ("VIEs"). ASC 810 broadly defines a VIE as an entity in which either (i) the equity investors as a group, if any, lack the power through voting or similar rights to direct the activities of such entity that most significantly impact such entity's economic performance or (ii) the equity investment at risk is insufficient to finance that entity's activities without additional subordinated financial support. The Trust identifies the primary beneficiary of a VIE as the enterprise that has both of the following characteristics: (i) the power to direct the activities of the VIE that most significantly impact the entity's economic performance; and (ii) the obligation to absorb losses or receive benefits of the VIE that could potentially be significant to the entity. The Trust consolidates its investment in a VIE when it determines that the Trust is the VIE's primary beneficiary. The Trust may change its original assessment of a VIE upon subsequent events such as the modification of contractual arrangements that affect the characteristics or adequacy of the entity's equity investments at risk and the disposition of all or a portion of an interest held by the primary beneficiary. The Trust performs this analysis on an ongoing basis.

For property holding entities not determined to be VIEs, the Trust consolidates such entities in which the Trust or the Operating Partnership owns 100% of the equity or has a controlling financial interest evidenced by ownership of a majority voting interest. All intercompany balances and transactions are eliminated in consolidation. For entities in which the Trust owns less than 100% of the equity interest, the Trust consolidates the property if it has the direct or indirect ability to control the entities' activities based upon the terms of the respective entities' ownership agreements. For these entities, the Trust records a noncontrolling interest representing equity held by noncontrolling interests.

Noncontrolling Interests

The Trust presents the portion of any equity it does not own in entities that it controls (and thus consolidates) as noncontrolling interests and classifies such interests as a component of consolidated equity, separate from the Trust's total shareholders' equity, on the consolidated balance sheets.

Operating Partnership: Net income or loss is allocated to noncontrolling interests based on their respective ownership percentage of the Operating Partnership. The ownership percentage is calculated by dividing the number of OP Units held by the noncontrolling interests by the total OP Units held by the noncontrolling interests and the Trust. Issuance of additional Common Shares and OP Units changes the ownership interests of both the noncontrolling interests and the Trust. Such transactions and the related proceeds are treated as capital transactions.

During the three months ended March 31, 2016, the Operating Partnership partially funded a property acquisition by issuing an aggregate of 174,085 OP Units valued at approximately $2.9 million. The acquisition had a total purchase price of approximately $8.5 million.

During the three months ended June 30, 2016, the Operating Partnership funded the acquisition of the remaining non-controlling interest on a property by issuing an aggregate of 217,549 OP Units valued at approximately $4.0 million.

No acquisitions were funded through the issuance of OP units during the three months ended September 30, 2016.

Noncontrolling interests in the Trust represent OP Units held by the Predecessor’s prior investors and other investors. As of September 30, 2016, the Trust held a 97.4% interest in the Operating Partnership. As the sole general partner and the majority interest holder, the Trust consolidates the financial position and results of operation of the Operating Partnership.

Holders of OP Units may not transfer their OP Units without the Trust’s prior written consent, as general partner of the Operating Partnership. Beginning on the first anniversary of the issuance of OP Units, OP Unit holders may tender their OP

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Units for redemption by the Operating Partnership in exchange for cash equal to the market price of the Trust's common shares at the time of redemption or for unregistered common shares on a one-for-one basis. Such selection to pay cash or issue common shares to satisfy an OP Unit holder's redemption request is solely within the control of the Trust. Accordingly, the Trust presents the OP Units of the Operating Partnership held by the Predecessor's prior investors and other investors as noncontrolling interests within equity in the consolidated balance sheet.

Partially Owned Properties: The Trust reflects noncontrolling interests in partially owned properties on the balance sheet for the portion of properties consolidated by the Trust that are not wholly owned by the Trust. The earnings or losses from those properties attributable to the noncontrolling interests are reflected as "net income or loss attributable to noncontrolling interests - partially owned properties" in the consolidated statements of income.

Redeemable Noncontrolling Interests - Operating Partnership and Partially Owned Properties

On February 5, 2015, the Trust entered into a Second Amended and Restated Agreement of Limited Partnership (the "Partnership Agreement") which provides for the designation and issuance of the newly designated Series A Participating Redeemable Preferred Units of the Operating Partnership ("Series A Preferred Units"). Series A Preferred Units have priority over all other partnership interests of the Operating Partnership with respect to distributions and liquidation. Holders of Series A Preferred Units are entitled to a 5% cumulative return and upon redemption, the receipt of one common share and $200. The holders of the Series A Preferred Units have agreed not to cause the Operating Partnership to redeem their Series A Preferred Units prior to one year from the issuance date. In addition, Series A Preferred Units are redeemable at the option of the holder, and redemption obligations may be satisfied, at the Trust's option, in cash or registered common shares. Instruments that require settlement in registered common shares may not be classified in permanent equity as it is not always completely within an issuer's control to deliver registered common shares. Due to the redemption provision, which is outside of the control of the Trust, the Trust classifies the investment in the mezzanine section of its consolidated balance sheet. The Trust records the carrying amount of the redeemable noncontrolling interests at the greater of the carrying value or redemption value. The fair value of the embedded derivative is $6.2 million and is included on the Trust's consolidated balance sheets in accrued expenses and other liabilities.

Effective March 1, 2015, the Trust received a $5 million equity investment from a third party. This investment earns a 15% cumulative preferred return. At any point subsequent to the third anniversary of the investment, the holder can require the Trust to redeem the instrument at a price for which the investor will realize a 15% internal rate of return. Due to the redemption provision, which is outside of the control of the Trust, the Trust classifies the investment in the mezzanine section of its consolidated balance sheet. The Trust records the carrying amount of the redeemable noncontrolling interests at the greater of the carrying value or redemption value.

On April 1, 2016, 44,685 Series A Preferred Units issued in conjunction with the Minnetonka MOB acquisition were redeemed for a total value of $9.8 million. The fair value of the embedded derivative associated with the previously outstanding Series A Preferred Units was $2.7 million.

Dividends and Distributions

On September 26, 2016, the Trust announced that its Board of Trustees authorized and the Trust declared a cash dividend of $0.225 per common share for the quarterly period ended September 30, 2016. The distribution was paid on October 18, 2016 to common shareholders and OP Unit holders of record as of the close of business on October 6, 2016.

Tax Status of Dividends and Distributions

Our distributions of current and accumulated earnings and profits for U.S. federal income tax purposes generally are taxable to shareholders as ordinary income. Distributions in excess of these earnings and profits generally are treated as non-taxable reduction of the shareholders' basis in the shares to the extent thereof (non-dividend distributions) and thereafter as taxable gain.

Any cash distributions received by an OP Unit holder in respect of its OP Units generally will not be taxable to such OP Unit holder for U.S. federal income tax purposes, to the extent that such distribution does not exceed the OP Unit holder's basis in its OP Units. Any such distribution will instead reduce the OP Unit holder's basis in its OP Units (and OP Unit holders will be subject to tax on the taxable income allocated to them by the Operating Partnership in respect of their OP Units when such income is earned by the Operating Partnership, with such income allocation increasing the OP Unit holders' basis in their OP Units).

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Purchase of Investment Properties

A property acquired not subject to an existing lease is treated as an asset acquisition and recorded at its purchase price, inclusive of acquisition costs, allocated between the acquired tangible and intangible assets and assumed liabilities based upon their relative fair values at the date of acquisition. A property acquired with an existing lease is accounted for as a business combination pursuant to the acquisition method in accordance with ASC Topic 805, Business Combinations (“ASC 805”), and assets acquired and liabilities assumed, including identified intangible assets and liabilities, are recorded at fair value.

The determination of fair value involves the use of significant judgment and estimation. The Trust makes estimates of the fair value of the tangible and intangible acquired assets and assumed liabilities using information obtained from multiple sources as a result of pre-acquisition due diligence and may include the assistance of a third party appraiser. The Trust estimates the fair value of buildings acquired on an “as-if-vacant” basis and depreciates the building value over the estimated remaining life of the building. The Trust determines the allocated value of other fixed assets, such as site improvements, based upon the replacement cost and depreciates such value over the assets’ estimated remaining useful lives as determined at the applicable acquisition date. The fair value of land is determined either by considering the sales prices of similar properties in recent transactions or based on internal analyses of recently acquired and existing comparable properties within the Trust’s portfolio.

In recognizing identified intangible assets and liabilities in connection with a business combination, the value of above-or-below market leases is estimated based on the present value (using an interest rate which reflected the risks associated with the leases acquired) of the difference between contractual amounts to be received pursuant to the leases and management’s estimate of market lease rates measured over a period equal to the estimated remaining term of the lease. The capitalized above-market or below-market lease intangibles are amortized as a reduction or addition to rental income over the estimated remaining term of the respective leases plus the term of any renewal options that the lessee would be economically compelled to exercise.

In determining the value of in-place leases, management considers current market conditions and costs to execute similar leases in arriving at an estimate of the carrying costs during the expected lease-up period from vacant to existing occupancy. In estimating carrying costs, management includes real estate taxes, insurance, other operating expenses, estimates of lost rental revenue during the expected lease-up periods, and costs to execute similar leases, including leasing commissions, tenant improvements, legal, and other related costs based on current market demand. The values assigned to in-place leases are amortized to amortization expense over the estimated remaining term of the lease. If a lease terminates prior to its scheduled expiration, all unamortized costs related to that lease are written off, net of any required lease termination payments.

The Trust calculates the fair value of any long-term debt assumed by discounting the remaining contractual cash flows on each instrument at the current market rate for those borrowings, which the Trust approximates based on the rate at which it would expect to incur on a replacement instrument on the date of acquisition, and recognizes any fair value adjustments related to long-term debt as effective yield adjustments over the remaining term of the instrument.

Based on these estimates, the Trust recognizes the acquired assets and assumed liabilities at their estimated fair values, which are generally determined using Level 3 inputs, such as market rental rates, capitalization rates, discount rates, or other available market data. Initial valuations are subject to change until the information is finalized, no later than 12 months from the acquisition date. The Trust expenses transaction costs associated with acquisitions accounted for as business combinations in the period incurred.

Impairment of Intangible and Long-Lived Assets

The Trust periodically evaluates its long-lived assets, primarily consisting of investments in real estate, for impairment indicators or whenever events or changes in circumstances indicate that the recorded amount of an asset may not be fully recoverable. If indicators of impairment are present, the Trust evaluates the carrying value of the related real estate properties in relation to the undiscounted expected future cash flows of the underlying operations. In performing this evaluation, management considers market conditions and current intentions with respect to holding or disposing of the real estate property. The Trust adjusts the net book value of real estate properties to fair value if the sum of the expected future undiscounted cash flows, including sales proceeds, is less than book value. The Trust recognizes an impairment loss at the time it makes any such determination. If the Trust determines that an asset is impaired, the impairment to be recognized is measured as the amount by which the recorded amount of the asset exceeds its fair value. Fair value is typically determined using a discounted future cash flow analysis or other acceptable valuation techniques, which are based, in turn, upon Level 3 inputs, such as revenue and expense growth rates, capitalization rates, discount rates, or other available market data.

The Trust did not record impairment charges in the three and nine month periods ended September 30, 2016 and 2015.

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Investments in Unconsolidated Entities

The Trust reports investments in unconsolidated entities over whose operating and financial policies it has the ability to exercise significant influence under the equity method of accounting. Under this method of accounting, the Trust's share of the investee's earnings or losses is included in its consolidated statements of income. The initial carrying value of investments in unconsolidated entities is based on the amount paid to purchase the equity interest.

Real Estate Loans Receivable

Real estate loans receivable consists of eight mezzanine loans and two term loans. Each mezzanine loan is collateralized by an ownership interest in the respective borrower, while the term loans are secured by equity interests in two medical office building developments. Interest income on the loans are recognized as earned based on the terms of the loans subject to evaluation of collectability risks and are included in the Trust's consolidated statements of income.

Rental Revenue

Rental revenue is recognized on a straight-line basis over the terms of the related leases when collectability is reasonably assured. Recognizing rental revenue on a straight-line basis for leases may result in recognizing revenue for amounts more or less than amounts currently due from tenants. Amounts recognized in excess of amounts currently due from tenants are included in other assets and were approximately $27.9 million and $15.6 million as of September 30, 2016 and December 31, 2015, respectively. If the Trust determines that collectability of straight-line rents is not reasonably assured, the Trust limits future recognition to amounts contractually owed and, where appropriate, establishes an allowance for estimated losses. Rental revenue is adjusted by amortization of lease inducements and above or below market rents on certain leases. Lease inducements and above or below market rents are amortized over the remaining life of the lease.

Expense Recoveries

Expense recoveries relate to tenant reimbursement of real estate taxes, insurance, and other operating expenses that are recognized as expense recovery revenue in the period the applicable expenses are incurred. The reimbursements are recorded at gross, as the Trust is generally the primary obligor with respect to real estate taxes and purchasing goods and services from third-party suppliers, has discretion in selecting the supplier, and bears the credit risk of tenant reimbursement.

The Trust has certain tenants with absolute net leases. Under these lease agreements, the tenant is responsible for operating and building expenses. For absolute net leases, the Trust does not recognize expense recoveries.

Derivative Instruments

When the Trust has derivative instruments embedded in other contracts, it records them either as an asset or a liability measured at their fair value unless they qualify for a normal purchase or normal sales exception. When specific hedge accounting criteria are not met, changes in the Trust's derivative instruments' fair value are recognized currently in earnings. Changes in the fair market values of the Trust's derivative instruments are recorded in the consolidated statements of income if the derivative instruments do not qualify for, or the Trust does not elect to apply for, hedge accounting. If hedge accounting is applied to a derivative instrument, such changes are reported in accumulated other comprehensive income within the consolidated statement of equity, exclusive of ineffectiveness amounts, which are recognized as adjustments to net income.

To manage interest rate risk for certain of its variable-rate debt, the Trust uses interest rate swaps as part of its risk management strategy. These derivatives are designed to mitigate the risk of future interest rate increases by providing a fixed interest rate for a limited, pre-determined period of time. Interest rate swaps designated as cash flow hedges involve the receipt of variable-rate amounts from a counterparty in exchange for the Trust making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount. As of September 30, 2016, the Trust had five outstanding interest rate swap contracts that are designated as cash flow hedges of interest rate risk. For presentational purposes, they are shown as one derivative due to the identical nature of their economic terms. Further detail is provided in Note 7 (Derivatives).

The effective portion of the change in the fair value of derivatives designated and that qualify as cash flow hedges is recorded in accumulated other comprehensive income (“AOCI”) on the consolidated balance sheets and is subsequently reclassified into earnings as interest expense for the period that the hedged forecasted transaction affects earnings. The ineffective portion of the change in fair value of the derivatives is recognized directly in earnings. For the nine months ended September 30, 2016, there was no hedge ineffectiveness. The Trust expects no hedge ineffectiveness in the next 12 months.

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Income Taxes

The Trust elected to be taxed as a REIT for federal tax purposes commencing with the filing of its tax return for the short taxable year ending December 31, 2013. The Trust had no taxable income prior to electing REIT status. To qualify as a REIT, the Trust must meet certain organizational and operational requirements, including a requirement to distribute at least 90% of its annual REIT taxable income to its shareholders (which is computed without regard to the dividends paid deduction or net capital gain and which does not necessarily equal net income as calculated in accordance with GAAP). As a REIT, the Trust generally will not be subject to federal income tax to the extent it distributes qualifying dividends to its shareholders. If the Trust fails to qualify as a REIT in any taxable year, it will be subject to federal income tax (including any applicable alternative minimum tax) on its taxable income at regular corporate income tax rates and generally will not be permitted to qualify for treatment as a REIT for federal income tax purposes for the four taxable years following the year during which qualification is lost, unless the Internal Revenue Service grants the Trust relief under certain statutory provisions. Such an event could materially adversely affect the Trust’s net income and net cash available for distribution to shareholders. However, the Trust intends to continue to operate in such a manner as to continue qualifying for treatment as a REIT. Although the Trust continues to qualify for taxation as a REIT, the Trust may be subject to state and local taxes on its income and property and federal income and excise taxes on its undistributed income.

Management Estimates

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the consolidated financial statements and the amounts of revenue and expenses reported in the period. Significant estimates are made for the fair value assessments with respect to purchase price allocations, impairment assessments, stock-based compensation, and the valuation of financial instruments. Actual results could differ from these estimates.

Contingent Liabilities

The Trust records a liability for contingent consideration (included in accrued expenses and other liabilities on its consolidated balance sheets) at fair value as of the acquisition date and reassesses the fair value at the end of each reporting period, with any changes being recognized in earnings. Increases or decreases in the fair value of contingent consideration can result from changes in discount periods, discount rates, and probabilities that contingencies will be met.

Reclassifications

Certain prior period amounts have been reclassified to conform to the current financial statement presentation, with no effect on the previously reported consolidated balance sheets or consolidated statements of income.

New Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, which creates a new Topic, Accounting Standards Codification Topic 606. The standard is principle-based and provides a five-step model to determine when and how revenue is recognized. The core principle is that a company should recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. This standard is effective for interim or annual periods beginning after December 15, 2017 and allows for either full retrospective or modified retrospective adoption. Early adoption of this standard is permitted for reporting periods beginning after December 15, 2016. The Trust is currently evaluating the impact the adoption of Topic 606 will have on its consolidated financial statements.

In February 2015, the FASB issued ASU 2015-02, Amendments to the Consolidation Analysis. ASU 2015-02 requires entities to evaluate whether they should consolidate certain legal entities. Principally, the new consolidation standard modified the evaluation of whether limited partnerships and similar legal entities are variable interest entities ("VIE") or voting interest entities. The Trust adopted ASU 2015-02 on January 1, 2016. Based on the Trust's review and subsequent analysis of the structure of the Trust's legal entities, the Trust has concluded that the Operating Partnership is a VIE because the limited partners of the Operating Partnership do not have substantive kick-out or participating rights. The Trust is the general partner and controlling owner of approximately 97.4% of the Operating Partnership and will continue to consolidate the Operating Partnership under this new guidance. With respect to the Trust's investment in unconsolidated joint ventures, the new consolidation standard did not have an impact on previous consolidation conclusions.

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In April 2015, the FASB issued ASU 2015-03, Simplifying the Presentation of Debt Issuance Costs, which changes the presentation of debt issuance costs in financial statements. ASU 2015-03 requires an entity to present such costs in the balance sheet as a direct deduction from the related debt liability rather than as an asset. Amortization of the costs will continue to be reported as interest expense. ASU 2015-03 is effective for annual reporting periods beginning after December 15, 2016. Early adoption is permitted. The new guidance has been applied retrospectively to each prior period presented. The Trust adopted ASU 2015-03 on January 1, 2016. As a result of the adoption of ASU 2015-03, the Trust reclassified $6.0 million from net deferred costs to the related liabilities within the December 31, 2015 Consolidated Balance Sheet.

In February 2016, the FASB issued ASU 2016-02, Leases. The update amends the existing accounting standards for lease accounting, including requiring lessees to recognize most leases on their balance sheets and making targeted changes to lessor accounting. The standard requires a modified retrospective transition approach for all leases existing at, or entered into after, the date of initial application, with an option to use certain transition relief. ASU 2016-02 will be effective for annual reporting periods beginning after December 15, 2018. Early adoption is permitted. The Trust is currently evaluating the impact of adopting the new leases standard on its consolidated financial statements.

Note 3. Acquisitions and Dispositions

During the nine months ended September 30, 2016, the Trust completed acquisitions of 84 operating healthcare properties (including the CHI Portfolio), 1 land parcel, and 2 condominium units located in 22 states for an aggregate purchase price of approximately $1.05 billion. In addition, the Trust completed $8.2 million of loan transactions, $1.0 million of redeemable noncontrolling interest buyouts, and $0.6 million of equity buyouts, resulting in total investment activity of approximately $1.06 billion.

This aggregate purchase price does not include near-term capital expenditure commitments of $12.9 million and committed tenant improvement allowances of $8.9 million related to the Company’s acquisition of the CHI Portfolio.

Investment activity for the three months ended September 30, 2016 is summarized below:

Property (1)		Location	Acquisition Date	Purchase Price (in thousands)
Prairie Care MOB	(2)	Maplewood, MN	July 6, 2016	$ 4,886
RE Loan - El Paso		El Paso, TX	July 7, 2016	1,300
Springwoods MOB	(2)(4)	Spring, TX	July 21, 2016	19,925
Equity Buyout - Foundation	(5)	TX / OK	July 26, 2016	611
Mezzanine Loan - Hazelwood		Minnetonka, MN	July 29, 2016	3,375
Jackson, Tennessee Land	(3)	Jackson, TN	August 2, 2016	1,000
Unity Portfolio (4 MOBs)	(2)	Lafayette, IN	August 8, 2016	28,752
Medical Village at Maitland	(2)	Orlando, FL	August 23, 2016	23,211
Tri-State Orthopaedics MOB	(2)	Evansville, IN	August 30, 2016	22,000
Noncontrolling Interest Buyout - Great Falls Clinic	(6)	Great Falls, MT	September 30, 2016	1,015
Maury Regional Healthcare MOB	(2)(7)	Spring Hill, TN	September 30, 2016	18,500
Spring Ridge Medical Center	(2)	Wyomissing, PA	September 30, 2016	6,100
Doctors Community Hospital MOB	(2)	Lanham, MD	September 30, 2016	26,750
Gig Harbor Medical Pavilion	(3)(4)	Gig Harbor, WA	September 30, 2016	4,766
Midlands One Professional Center	(2)(4)	Papillion, NE	September 30, 2016	14,856
				$ 177,047

(1) “MOB” means medical office building.
(2)

The Trust accounted for these acquisitions as business combinations pursuant to the acquisition method and expensed total acquisition costs of $4.4 million.

(3) The Trust accounted for these acquisitions as asset acquisitions and capitalized total acquisition costs of $0.1 million.

(4) These properties are part of the CHI Portfolio.

(5) The Trust acquired the previously outstanding 1% noncontrolling interest retained by the predecessor owner on three properties in El Paso, Texas and Oklahoma City, Oklahoma.

(6) The Trust acquired an additional 3% interest in the Trust's Great Falls Clinic joint venture from the predecessor owner, increasing the Trust's total interest to 77.3%.

(7) The Trust acquired 99.7% of the ownership interest in this property, the remainder of which was retained by the seller.

For the three months ended September 30, 2016, the Trust recorded revenues and net income from its 2016 acquisitions of $25.5 million and $2.3 million, respectively. For the nine months ended September 30, 2016, the Trust recorded revenues and net income from its 2016 acquisitions of $37.7 million and $5.3 million, respectively.

The following table summarizes the acquisition date fair values of the assets acquired and the liabilities assumed, which the Trust determined using Level 2 and Level 3 inputs (in thousands):

	1st Quarter	2nd Quarter	3rd Quarter	Total
Land	$9,240	$19,565	$11,968	$40,773
Building and improvements	168,570	623,247	139,732	931,549
In-place lease intangible	19,158	12,911	13,132	45,201
Above market in-place lease intangible	2,407	1,265	3,037	6,709
Below market in-place lease intangible	(469)	(2,920)	(650)	(4,039)
Above market in-place ground lease	(218)	(348)	(78)	(644)
Below market in-place ground lease	2,057	20,953	3,367	26,377
Lease inducement	1,284	3,586	—	4,870
Contingent consideration	—	(156)	—	(156)
Receivables	—	104	—	104
Issuance of OP Units	(2,869)	—	—	(2,869)
Noncontrolling interest	—	—	(50)	(50)
Net assets acquired	$199,160	$678,207	$170,458	$1,047,825

These preliminary allocations are subject to revision within the measurement period, not to exceed one year from the date of the acquisitions.

Unaudited Pro Forma Financial Information

The following table illustrates the effect on net income and earnings per share - basic and diluted as if the Trust had acquired the above acquisitions as of January 1, 2015 (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Revenue	$72,609	$ 38,643	$219,433	$ 178,785
Net income	11,099	7,078	35,565	24,840
Net income available to common shareholders	10,638	6,845	34,079	23,679
Earnings per share - basic	$0.08	$ 0.05	$0.28	$ 0.19
Earnings per share - diluted	$0.08	$ 0.05	$0.27	$ 0.19
Weighted average number of shares outstanding - basic	134,608,396	134,608,396	122,973,862	122,973,862
Weighted average number of shares outstanding - diluted	138,880,787	138,880,787	127,395,989	127,395,989

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Note 4. Intangibles

The following is a summary of the carrying amount of intangible assets and liabilities as of September 30, 2016 and December 31, 2015 (in thousands):

	September 30, 2016			December 31, 2015		
	Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
Assets						
In-place leases	$208,929	$ (46,557)	$162,372	$163,728	$ (26,702)	$137,026
Above market leases	32,840	(5,840)	27,000	26,787	(3,174)	23,613
Leasehold interest	712	(109)	603	712	(64)	648
Below market ground leases	40,317	(367)	39,950	13,941	(68)	13,873
Total	$282,798	$ (52,873)	$229,925	$205,168	$ (30,008)	$175,160
Liabilities						
Below market lease	$9,914	$ (1,823)	$8,091	$6,068	$ (799)	$5,269
Above market ground leases	1,345	(37)	1,308	701	(20)	681
Total	$11,259	$ (1,860)	$9,399	$6,769	$ (819)	$5,950

The following is a summary of the acquired lease intangible amortization for the three and nine month periods ended September 30, 2016 and 2015, respectively (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Amortization expense related to in-place leases	$7,420	$4,253	$19,855	$10,124
Decrease of rental income related to above-market leases	1,276	742	3,322	1,671
Decrease of rental income related to leasehold interest	15	15	45	44
Increase of rental income related to below-market leases	670	167	1,218	431
Decrease of operating expense related to above market ground leases	8	4	17	12
Increase in operating expense related to below market ground leases	158	32	299	37

For the three and nine months ended September 30, 2016, the Trust wrote-off above market lease intangible assets of approximately $0.7 million with accumulated amortization of approximately $0.5 million, and below market lease intangible liabilities of approximately $0.2 million with accumulated accretion of approximately $0.1 million, for a net recognition of approximately $41,000 loss in rental income from intangible amortization.

Future aggregate net amortization of the acquired lease intangibles as of September 30, 2016, is as follows (in thousands):

	Net Decrease in Revenue	Net Increase in Expenses
2016	$ (554)	$ 7,721
2017	(1,933)	28,761
2018	(2,023)	24,383
2019	(2,145)	20,018
2020	(2,232)	17,640
Thereafter	(10,625)	102,491
Total	$ (19,512)	$ 201,014

As of September 30, 2016, the weighted average amortization period for asset lease intangibles and liability lease intangibles are 18 and 11 years, respectively.

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Note 5. Other Assets

Other assets consisted of the following as of September 30, 2016 and December 31, 2015 (in thousands):

	September 30, 2016	December 31, 2015
Straight line rent receivable	$ 27,875	$ 15,584
Lease inducements, net	9,409	4,970
Escrows	4,733	4,788
Earnest deposits	812	343
Notes receivable	16,618	20,620
Leasing commissions, net	1,601	1,052
Prepaid expenses	8,781	4,181
Other	2,985	1,745
Total	$ 72,814	$ 53,283

Note 6. Debt

The following is a summary of debt as of September 30, 2016 and December 31, 2015 (in thousands):

	September 30, 2016		December 31, 2015	
Fixed interest mortgage notes	$ 80,646	(1)	$ 89,664	(2)
Variable interest mortgage note	33,134	(3)	4,262	(4)
Total mortgage debt	113,780		93,926	
$850 million unsecured revolving credit facility bearing variable interest of LIBOR plus 1.20%, due September 2020	206,000		395,000	
$250 million unsecured term borrowing bearing fixed interest of 2.87%, due June 2023	250,000	(5)	—	
$150 million senior unsecured notes bearing fixed interest of 4.03% to 4.74%, due January 2023 to 2031	150,000		—	
$75 million senior unsecured notes bearing fixed interest of 4.09% to 4.24%, due August 2025 to 2027	75,000		—	
Total principal	794,780		488,926	
Unamortized deferred financing cost	(8,882	)	(5,985	)
Unamortized fair value adjustment	498		674	
Total debt	$ 786,396		$ 483,615	

(1) Fixed interest mortgage notes, bearing interest from 4.71% to 6.58%, with a weighted average interest rate of 5.45%, and due in 2017, 2019, 2020, 2021, and 2022 collateralized by 10 properties with a net book value of $133.4 million.

(2) Fixed interest mortgage notes, bearing interest from 4.71% to 6.58%, with a weighted average interest rate of 5.40%, and due in 2016, 2017, 2019, 2020, 2021, and 2022 collateralized by 11 properties with a net book value of $145.0 million.

(3) Variable interest mortgage notes, bearing variable interest of LIBOR plus 2.25% to 3.25%, with a weighted average interest rate of 3.49% and due in 2017 and 2018, collateralized by four properties with a net book value of $46.1 million.

(4) Variable interest mortgage note bearing variable interest of LIBOR plus 2.75% and due in 2017, collateralized by one property with a net book value of $5.9 million.

(5) The Trust’s borrowings under the term loan feature of the Credit Agreement bear interest at a rate which is determined by the Trust’s credit rating, currently equal to LIBOR + 1.80%. The Trust has entered into a pay-fixed

receive-variable interest rate swap, fixing the LIBOR component of this rate at 1.07%.

On June 10, 2016, the Operating Partnership, as borrower, and the Trust entered into an amended and restated Credit Agreement with KeyBank National Association, as administrative agent, KeyBanc Capital Markets Inc., BMO Capital Markets, and Citizens Bank N.A., as joint lead arrangers and co-book runners, BMO Capital Markets and Citizens Bank N.A., as co-syndication agents, and the lenders party thereto (the "Credit Agreement") which increased the maximum principal amount

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available under an unsecured revolving credit facility from $750 million to $850 million. The Credit Agreement contains a term loan feature allowing the Operating Partnership to borrow in a single drawing up to $250 million, increasing the borrowing capacity to an aggregate $1.1 billion.

On July 7, 2016, the Operating Partnership borrowed $250.0 million under the 7-year term loan feature of the Credit Agreement. Borrowings under the term loan feature of the Credit Agreement bear interest on the outstanding principal amount at a rate which is determined by the Trust's credit rating, currently equal to LIBOR + 1.80%. The Trust simultaneously entered into a pay-fixed receive-variable rate swap for the full borrowing amount, fixing the LIBOR component of the borrowing rate to 1.07%, for an all-in fixed rate of 2.87%. Both the borrowing and pay-fixed receive-variable swap have a maturity date of June 10, 2023.

The Credit Agreement has a maturity date of September 18, 2020 and includes a one year extension option. Borrowings under the revolving credit facility of the Credit Agreement bear interest on the outstanding principal amount at a rate which is determined by the Trust's credit rating, currently equal to LIBOR plus 1.20%. In addition, the Credit Agreement includes a facility fee equal to 0.25% per annum, which is determined by the Trust's investment grade rating under the Credit Agreement.

The Credit Agreement includes a swingline loan commitment for up to 10% of the maximum principal amount and provides an accordion feature allowing the Trust to increase borrowing capacity by up to an additional $500 million, subject to customary terms and conditions, resulting in a maximum borrowing capacity of $1.6 billion.

The Credit Agreement contains financial covenants that, among other things, require compliance with leverage and coverage ratios and maintenance of minimum tangible net worth, as well as covenants that may limit the Trust's and the Operating Partnership's ability to incur additional debt or make distributions. The Trust may, at any time, voluntarily prepay any revolving or swingline loan under the Credit Agreement in whole or in part without premium or penalty. Prepayments of term borrowings require payment of premiums of up to 2.0% of the amount of prepayment, dependent on date of such prepayment. As of September 30, 2016, the Trust was in compliance with all financial covenants.

The Credit Agreement includes customary representations and warranties by the Operating Partnership and the Trust and imposes customary covenants on the Operating Partnership and the Trust. The Credit Agreement also contains customary events of default, and if an event of default occurs and continues, the Operating Partnership is subject to certain actions by the administrative agent, including without limitation, the acceleration of repayment of all amounts outstanding under the Credit Agreement.

The Credit Agreement provides for revolving credit and term loans to the Operating Partnership. Base Rate Loans, Adjusted LIBOR Rate Loans, and Letters of Credit (each, as defined in the Credit Agreement) will be subject to interest rates, based upon the investment grade rating of the Trust and the Operating Partnership as follows:

Credit Rating	Margin for Revolving Loans: Adjusted LIBOR Rate Loans and Letter of Credit Fee	Margin for Revolving Loans: Base Rate Loans		Margin for Term Loans: Adjusted LIBOR Rate Loans and Letter of Credit Fee	Margin for Term Loans: Base Rate Loans	
At Least A- or A3	LIBOR + 0.85%	—	%	LIBOR + 1.40%	0.40	%
At Least BBB+ or BAA1	LIBOR + 0.90%	—	%	LIBOR + 1.45%	0.45	%
At Least BBB or	LIBOR + 1.00%	0.10	%	LIBOR + 1.55%	0.55	%

BAA2						
At Least BBB- or BAA3	LIBOR + 1.20%	0.20	%	LIBOR + 1.80%	0.80	%
Below BBB- or BAA3	LIBOR + 1.55%	0.60	%	LIBOR + 2.25%	1.25	%

As of September 30, 2016, there were $206.0 million of borrowings outstanding under the unsecured revolving credit facility and $643.9 million available for the Trust to borrow without adding additional properties to the unencumbered borrowing base of assets, as defined by the Credit Agreement. As of September 30, 2016 the Trust had $250.0 million of borrowings outstanding under the term loan feature of the Credit Agreement.

On January 7, 2016, the Operating Partnership issued and sold $150.0 million aggregate principal amount of senior notes, comprised of (i) $15.0 million aggregate principal amount of 4.03% Senior Notes, Series A, due January 7, 2023, (ii) $45.0 million aggregate principal amount of 4.43% Senior Notes, Series B, due January 7, 2026, (iii) $45.0 million aggregate principal amount of 4.57% Senior Notes, Series C, due January 7, 2028, and (iv) $45.0 million aggregate principal amount of 4.74% Senior Notes, Series D, due January 7, 2031. On August 11, 2016, the note agreement for these notes was amended to make certain changes to its terms, including certain changes to affirmative covenants, negative covenants and definitions contained therein.

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On August 11, 2016, the Operating Partnership issued and sold $75.0 million aggregate principal amount of senior notes, comprised of (i) $25.0 million aggregate principal amount of 4.09% Senior Notes, Series A, due August 11, 2025, (ii) $25.0 million aggregate principal amount of 4.18% Senior Notes, Series B, due August 11, 2026, and (iii) $25.0 million aggregate principal amount of 4.24% Senior Notes, Series C, due August 11, 2027.

Certain properties have mortgage debt that contain financial covenants. As of September 30, 2016, the Trust was in compliance with all mortgage debt financial covenants.

Scheduled principal payments due on debt as of September 30, 2016, are as follows (in thousands):

2016	$590
2017	40,962
2018	29,973
2019	20,081
2020	211,523
Thereafter	491,651
Total Payments	$794,780

As of September 30, 2016, the Trust had total consolidated indebtedness of approximately $794.8 million. The weighted average interest rate on consolidated indebtedness was 3.30% (based on the 30-day LIBOR rate as of September 30, 2016, of 0.53%).

For the three month periods ended September 30, 2016 and 2015, the Trust incurred interest expense on its debt of $6.5 million and $3.0 million, respectively. For the nine month periods ended September 30, 2016 and 2015, the Trust incurred interest expense on its debt of $14.0 million and $6.3 million, respectively.

Note 7. Derivatives

In the normal course of business, a variety of financial instruments are used to manage or hedge interest rate risk. The Trust has implemented ASC 815, Derivatives and Hedging (ASC 815), which establishes accounting and reporting standards requiring that all derivatives, including certain derivative instruments embedded in other contracts, be recorded as either an asset or a liability measured at their fair value unless they qualify for a normal purchase or normal sales exception.

When specific hedge accounting criteria are not met, ASC 815 requires that changes in a derivative’s fair value be recognized currently in earnings. Changes in the fair market values of the Trust’s derivative instruments are recorded in the consolidated statements of income if such derivatives do not qualify for, or the Trust does not elect to apply for, hedge accounting. If hedge accounting is applied to a derivative instrument, such changes are reported in accumulated other comprehensive income within the consolidated statement of equity, exclusive of ineffectiveness amounts, which are recognized as adjustments to net income.

To manage interest rate risk for certain of its variable-rate debt, the Trust uses interest rate swaps as part of its risk management strategy. These derivatives are designed to mitigate the risk of future interest rate increases by providing a fixed interest rate for a limited, pre-determined period of time. Interest rate swaps designated as cash flow hedges involve the receipt of variable-rate amounts from a counterparty in exchange for the Trust making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount. As of September 30, 2016, the Trust had five outstanding interest rate swap contracts that are designated as cash flow hedges of interest rate risk. For presentational purposes, they are shown as one derivative due to the identical nature of their economic terms.

The effective portion of the change in the fair value of derivatives designated and that qualify as cash flow hedges is recorded in accumulated other comprehensive income (“AOCI”) on the condensed consolidated balance sheets and is subsequently reclassified into earnings as interest expense for the period that the hedged forecasted transaction affects earnings. The ineffective portion of the change in fair value of the derivatives is recognized directly in earnings. For the nine months ended September 30, 2016, there was no hedge ineffectiveness. The Trust expects no hedge ineffectiveness in the next 12 months.

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The following table summarizes the location and aggregate fair value of the interest rate swaps on the Trust's consolidated balance sheets (in thousands):

Total notional amount		$ 250,000
Effective fixed interest rate	(1)	2.87 %
Effective date		7/7/2016
Maturity date		6/10/2023
Asset balance at September 30, 2016 (included in Other assets)		$ 652
Asset balance at December 31, 2015 (included in Other assets)		$ —

(1) 1.07% effective swap rate plus 1.80% spread per Credit Agreement.

Note 8. Accrued Expenses and Other Liabilities

Accrued expenses and other liabilities consisted of the following as of September 30, 2016 and December 31, 2015 (in thousands):

	September 30, 2016	December 31, 2015
Prepaid rent	$ 8,940	$ 2,778
Real estate taxes payable	8,560	2,349
Embedded derivative	6,192	8,149
Security deposits	4,355	4,038
Tenant improvement allowance	4,349	1,184
Contingent consideration	1,235	2,559
Accrued interest	2,363	22
Accrued incentive compensation	3,856	900
Accrued expenses and other	6,724	2,494
Total	$ 46,574	$ 24,473

Note 9. Stock-based Compensation

The Trust follows ASC 718, Compensation - Stock Compensation ("ASC 718"), in accounting for its share-based payments. This guidance requires measurement of the cost of employee services received in exchange for stock compensation based on the grant-date fair value of the employee stock awards. This cost is recognized as compensation expense ratably over the employee's requisite service period. Incremental compensation costs arising from subsequent modifications of awards after the grant date must be recognized when incurred. Share-based payments classified as liability awards are marked to fair value at each reporting period.

Certain of the Trust's employee stock awards vest only upon the achievement of performance targets. ASC 718 requires recognition of compensation cost only when achievement of performance conditions is considered probable. Consequently, the Trust's determination of the amount of stock compensation expense requires a significant level of judgment in estimating the probability of achievement of these performance targets. Additionally, the Trust must make estimates regarding employee forfeitures in determining compensation expense. Subsequent changes in actual experience are monitored and estimates are updated as information is available.

In connection with the IPO, the Trust adopted the 2013 Equity Incentive Plan ("2013 Plan"), which made available 600,000 common shares to be administered by the Compensation and Nominating Governance Committee of the Board of Trustees (the "Committee"). On August 7, 2014, at the Annual Meeting of Shareholders of Physicians Realty Trust, the Trust's shareholders approved an amendment to the 2013 Plan to increase the number of common shares authorized for issuance under the 2013 Plan by 1,850,000 common shares, for a total of 2,450,000 common shares.

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Restricted Common Shares:

The Committee has broad discretion in administering the terms of the 2013 Plan. Restricted common shares granted under the 2013 Plan are eligible for dividends as well as the right to vote. In the nine month period ended September 30, 2016, the Trust granted a total of 155,306 restricted common shares with a total value of $2.8 million to its officers and certain of its employees, which have a one-year vesting period for officer award-recipients and a three-year vesting period for employee award-recipients.

A summary of the status of the Trust's non-vested restricted common shares as of September 30, 2016 and changes during the nine month period then ended follow:

	Common Shares	Weighted Average Grant Date Fair Value
Non-vested at December 31, 2015	311,839	$ 14.17
Granted	155,306	17.96
Vested	(157,878)	14.09
Forfeited	(326)	15.36
Non-vested at September 30, 2016	308,941	$ 16.11

For all service awards, the Trust records compensation expense for the entire award on a straight-line basis over the requisite service period. For the three month periods ended September 30, 2016 and 2015, the Trust recognized non-cash share compensation of $0.9 million and $0.7 million, respectively. For the nine month periods ended September 30, 2016 and 2015, the Trust recognized non-cash share compensation of $2.8 million and $2.2 million, respectively. Unrecognized compensation expense at September 30, 2016 was $2.1 million. The Trust's compensation expense recorded in connection with grants of restricted common shares reflects an initial estimated cumulative forfeiture rate of 0% over the requisite service period of the awards. That estimate will be revised if subsequent information indicates that the actual number of awards expected to vest is likely to differ from previous estimates.

Restricted Share Units:

In March 2016, under the 2013 Plan, the Trust granted restricted share units at a target level of 141,337 to its officers and trustees, which are subject to certain performance, timing, and market conditions and a three-year and two-year service period for officers and trustees, respectively. In addition, each restricted share unit contains one dividend equivalent. The recipient will accrue dividend equivalents on awarded share units equal to the cash dividend that would have been paid on the awarded share unit had the awarded share unit been an issued and outstanding common share on the record date for the dividend.

Approximately 80% of the restricted share units issued to officers vest based on certain market conditions. The market conditions were valued with the assistance of independent valuation specialists. The Trust utilized a Monte Carlo simulation to calculate the weighted average grant date fair value of $28.50 per unit for the March 2016 grant using the following assumptions:

Volatility	20.3 %
Dividend assumption	reinvested
Expected term in years	2.8
Risk-free rate	1.07 %
Share price (per share)	$ 17.67

The remaining 20% of the restricted share units issued to officers, and 100% of restricted share units issued to trustees, vest based upon certain performance or timing conditions. With respect to the performance conditions of the March 2016 grant, the grant date fair value of $17.67 per unit was based on the share price at the date of grant. The combined weighted average grant date fair value of the March 2016 restricted share units issued to officers is $26.33 per unit.

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The following is a summary of the activity in the Trust's restricted share units during the nine months ended September 30, 2016:

	Restricted Share Units	Weighted Average Grant Date Fair Value
Non-vested at December 31, 2015	171,886	$ 18.48
Granted	141,337	24.08
Vested	(20,481)	15.87
Non-vested at September 30, 2016	292,742	$ 21.37

For the three month periods ended September 30, 2016 and 2015, the Trust recognized non-cash share unit compensation expense of $0.6 million and $0.3 million, respectively. For the nine month periods ended September 30, 2016 and 2015, the Trust recognized non-cash share unit compensation expense of $1.5 million and $0.8 million, respectively. Unrecognized compensation expense at September 30, 2016 was $3.4 million.

Note 10. Fair Value Measurements

ASC Topic 820, Fair Value Measurement ("ASC 820"), requires certain assets and liabilities be reported and/or disclosed at fair value in the financial statements and provides a framework for establishing that fair value. The framework for determining fair value is based on a hierarchy that prioritizes the valuation techniques and inputs used to measure fair value.

In general, fair values determined by Level 1 inputs use quoted prices in active markets for identical assets or liabilities that the Trust has the ability to access. Fair values determined by Level 2 inputs use other inputs that are observable, either directly or indirectly. These Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related asset. These Level 3 fair value measurements are based primarily on management's own estimates using pricing models, discounted cash flow methodologies, or similar techniques taking into account the characteristics of the asset or liability. In instances where inputs used to measure fair value fall into different levels of the fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each asset or liability.

The Trust has six derivative instruments at September 30, 2016, consisting of one embedded derivative as detailed in the Redeemable Noncontrolling Interests - Operating Partnership and Partially Owned Properties section of Note 2 (Summary of Significant Accounting Policies) and five interest rate swaps. For presentational purposes, the Trust's interest rate swaps are shown as a single derivative due to the identical nature of their economic terms, as detailed in the Derivative Instruments section of Note 2 (Summary of Significant Accounting Policies) and Note 7 (Derivatives).

Neither the embedded derivative nor the interest rate swaps are traded on an exchange. The Trust's derivative assets and liabilities are recorded at fair value based on a variety of observable inputs including contractual terms, interest rate curves, yield curves, measure of volatility, and correlations of such inputs. The Trust measures its derivatives at fair value on a recurring basis. The fair values are based on Level 2 inputs described above. The Trust considers its own credit risk, as well as the credit risk of its counterparties, when evaluating the fair value of its derivatives.

The Trust also has assets that under certain conditions are subject to measurement at fair value on a non-recurring basis. This generally includes assets subject to impairment. There were no such assets measured at fair value as of September 30, 2016.

The carrying amounts of cash and cash equivalents, tenant receivables, payables, and accrued interest are reasonable estimates of fair value because of the short term maturities of these instruments. Fair values for real estate loans receivable and mortgage debt are estimated based on rates currently prevailing for similar instruments of similar maturities and are based primarily on Level 2 inputs.

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The following table presents the fair value of the Trust's financial instruments (in thousands):

	September 30, 2016		December 31, 2015	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets:				
Real estate loans receivable	$43,817	$43,817	$39,349	$39,349
Notes receivable	$16,618	$16,618	$20,620	$20,620
Derivative assets	$652	$652	$—	$—
Liabilities:				
Credit facility	$(456,000)	$(456,000)	$(395,000)	$(395,000)
Notes payable	$(225,000)	$(232,154)	$—	$—
Mortgage debt	$(114,278)	$(116,413)	$(94,600)	$(95,275)
Derivative liabilities	$(6,192)	$(6,192)	$(8,216)	$(8,216)

Note 11. Tenant Operating Leases

The Trust is lessor of medical office buildings and other healthcare facilities. Leases have expirations from 2016 through 2045. As of September 30, 2016, the future minimum rental payments on non-cancelable leases, exclusive of expense recoveries, were as follows (in thousands):

2016	$50,511
2017	200,692
2018	195,623
2019	190,533
2020	186,085
Thereafter	1,238,856
Total	$2,062,300

Note 12. Rent Expense

The Trust leases the rights to parking structures at three of its properties, the air space above one property, and the land upon which fifty-six of its properties are located from third party land owners pursuant to separate leases. In addition, the Trust leases three individual office spaces. The leases require fixed rental payments and may also include escalation clauses and renewal options. These leases have terms of up to 89 years remaining, excluding extension options. As of September 30, 2016, the future minimum lease obligations under non-cancelable parking, air, ground, and office leases were as follows (in thousands):

2016	$560
2017	2,259
2018	2,314
2019	2,334
2020	2,337
Thereafter	61,738
Total	$71,542

Rent expense for the parking, air, and ground leases of $0.5 million and $0.4 million for the three month periods ended September 30, 2016 and 2015, respectively, and $1.3 million and $1.2 million for the nine month periods ended September 30, 2016 and 2015, respectively, are reported in operating expenses in the consolidated statements of income.

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Note 13. Credit Concentration

The Trust uses annualized base rent (“ABR”) as its credit concentration metric. Annualized base rent is calculated by multiplying contractual base rent for the month ended September 30, 2016 by 12, excluding the impact of concessions and straight-line rent. The following table summarizes certain information about the Company’s top five tenant credit concentrations as of September 30, 2016 (in thousands):

Tenant	Total ABR	Percent of ABR	
CHI - KentuckyOne Health	$12,805	6.31	%
CHI - Nebraska	9,275	4.57	%
CHI - Franciscan (Seattle-Tacoma)	5,420	2.67	%
CHI - St. Alexius (North Dakota)	5,278	2.60	%
Great Falls Hospital	5,145	2.53	%
Remaining portfolio	165,144	81.32	%
Total	203,067	100.00	%

Annualized base rent collected from the Company’s top five tenant relationships comprises 18.68% of its total annualized base rent for the period ending September 30, 2016. Total annualized base rent from CHI affiliated tenants totals 18.89%, including the affiliates disclosed above.

The following table summarizes certain information about the Company’s top five geographic concentrations as of September 30, 2016 (in thousands):

State	Total ABR	Percent of ABR	
Texas	$24,763	12.19	%
Kentucky	15,555	7.66	%
Indiana	12,813	6.31	%
Arizona	12,444	6.13	%
Washington	12,193	6.00	%
Other	125,299	61.71	%
Total	203,067	100.00	%

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Note 14. Earnings Per Share

The following table shows the amounts used in computing the Trust's basic and diluted earnings per share (in thousands, except share and per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Numerator for earnings per share - basic:				
Net income	$10,294	$ 3,983	$22,902	$ 6,832
Net income attributable to noncontrolling interests:				
Operating Partnership	(255)	(200)	(629)	(333)
Partially owned properties	(176)	(79)	(553)	(255)
Preferred distributions	(436)	(300)	(1,421)	(791)
Numerator for earnings per share - basic	$9,427	$ 3,404	$20,299	$ 5,453
Numerator for earnings per share - diluted:				
Numerator for earnings per share - basic	$9,427	$ 3,404	$20,299	$ 5,453
Operating Partnership net income	255	200	629	333
Numerator for earnings per share - diluted	$9,682	$ 3,604	$20,928	$ 5,786
Denominator for earnings per share - basic and diluted:				
Weighted average number of shares outstanding - basic	134,608,396	71,034,747	122,973,862	69,040,121
Effect of dilutive securities:				
Noncontrolling interest - Operating Partnership units	3,618,988	3,829,930	3,778,014	3,676,395
Restricted common shares	208,892	123,343	203,020	194,640
Restricted share units	444,511	116,801	441,093	129,690
Denominator for earnings per share - diluted common shares:	138,880,787	75,104,821	127,395,989	73,040,846
Earnings per share - basic	$0.07	$ 0.05	$0.17	$ 0.08
Earnings per share - diluted	$0.07	$ 0.05	$0.16	$ 0.08

Note 15. Subsequent Events

Since September 30, 2016, the Trust, through subsidiaries of its Operating Partnership, closed on the below acquisitions:

Property		Location	Acquisition Date	Purchase Price (in thousands)
Northwest Michigan Surgery Center	(1)	Traverse City, MI	October 28, 2016	$ 29,448
United Surgical Partners J.V.	(2)	Scottsdale, AZ	October 31, 2016	903
				$ 30,351

(1) The Trust's acquisition of condominium units within the Northwest Michigan Surgery Center was funded through the unregistered issuance of 947,936 common shares of beneficial interest and nominal cash.

(2) The Trust's investment in the United Surgical Partners J.V. represents a 43% ownership interest.

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

The following discussion should be read in conjunction with our unaudited consolidated financial statements, including the notes to those statements, included in Part I, Item 1 of this report, and the Section entitled "Cautionary Statement Regarding Forward-Looking Statements" in this report. As discussed in more detail in the Section entitled "Cautionary Statement Regarding Forward-Looking Statements," this discussion contains forward-looking statements, which involve risks and uncertainties. Our actual results may differ materially from the results discussed in the forward-looking statements. Factors that might cause those differences include those discussed in Part II, Item 1A (Risk Factors) of this report, Part I, Item 1A (Risk Factors) of our Annual Report, and Part II, Item 1A (Risk Factors) of our Quarterly Reports on Form 10-Q for the quarterly periods ended March 31, 2016 and June 30, 2016.

Overview

We are a self-managed healthcare real estate company organized in April 2013 to acquire, selectively develop, own, and manage healthcare properties that are leased to physicians, hospitals, and healthcare delivery systems. We invest in real estate that is integral to providing high quality healthcare services. Our properties are typically located on a campus with a hospital or other healthcare facilities or strategically located and affiliated with a hospital or other healthcare facilities. We believe the impact of government programs and continuing trends in the healthcare industry create attractive opportunities for us to invest in healthcare related real estate. Our management team has significant public healthcare REIT experience and has long established relationships with physicians, hospitals, and healthcare delivery system decision makers that we believe will provide quality investment and growth opportunities. Our principal investments include medical office buildings, outpatient treatment facilities, acute and post-acute care hospitals, as well as other real estate integral to health care providers. We seek to invest in stabilized medical facility assets with initial cash yields of 6% to 9%. We seek to generate attractive risk-adjusted returns for our shareholders through a combination of stable and increasing dividends and potential long-term appreciation in the value of our properties and our common shares.

As of September 30, 2016, our portfolio consisted of 235 properties located in 29 states with approximately 10,233,656 net leasable square feet, which were approximately 95.7% leased with a weighted average remaining lease term of approximately 8.5 years. As of September 30, 2016, approximately 79.2% of the net leasable square footage of our portfolio was affiliated with a healthcare delivery system or located within approximately 1/4 mile of a hospital campus. We expect to acquire between $1.20 billion to $1.30 billion of real estate during 2016, including the approximately $1.06 billion of total investment activity during 2016 through September 30, 2016, subject to favorable capital market conditions.

We receive a cash rental stream from these healthcare providers under our leases. Approximately 86.4% of the annualized base rent payments from our properties as of September 30, 2016 are from triple-net leases, pursuant to which the tenants are responsible for all operating expenses relating to the property, including but not limited to real estate taxes, utilities, property insurance, routine maintenance and repairs, and property management. This structure helps insulate us from increases in certain operating expenses and provides more predictable cash flow. Approximately 10.7% of the annualized base rent payments from our properties as of September 30, 2016 are from modified gross base stop leases which allow us to pass through certain increases in future operating expenses (e.g., property tax and insurance) to tenants for reimbursement, thus protecting us from increases in such operating expenses. We seek to structure our triple-net leases to generate attractive returns on a long-term basis. Our leases typically have initial terms of 5 to 15 years and include annual rent escalators of approximately 1.5% to 3.0%. Our operating results depend significantly upon the ability of our tenants to make required rental payments. We believe that our portfolio of medical office buildings and other healthcare facilities will enable us to generate stable cash flows over time because of the diversity of our tenants, staggered lease expiration schedule, long-term leases, and low historical occurrence of tenants defaulting under their leases. As of September 30, 2016, leases representing 1.0%, 4.0%, and 4.7% of leasable square feet in our portfolio will expire in 2016, 2017, and 2018, respectively.

We have entered into an unsecured credit facility in the maximum principal amount of $1.1 billion and intend to use borrowings under the facility to finance future acquisitions and developments, fund tenant improvements, fund leasing commissions to third parties, fund capital expenditures, provide for working capital, and provide for other general corporate purposes. The unsecured credit facility contains a term loan feature allowing us to borrow in a single drawing up to $250 million, and also includes a swingline loan commitment for up to 10% of the maximum principal amount and provides an accordion feature allowing us to increase borrowing capacity by up to an additional $500 million, subject to customary terms and conditions, resulting in a maximum borrowing capacity of $1.6 billion. As of September 30, 2016, we had approximately $113.8 million of mortgage indebtedness outstanding, secured by first mortgages on certain of our properties, $206.0 million of outstanding borrowings under our unsecured revolving credit facility, $250.0 million of outstanding borrowings under the term loan feature of our unsecured credit facility, and $225.0 million of outstanding notes payable.

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On July 7, 2016, our Operating Partnership borrowed $250.0 million under the 7-year term loan feature of the Credit Agreement. Borrowings under the term loan feature of the Credit Agreement bear interest on the outstanding principal amount at a rate which is determined by the Trust's credit rating, currently equal to LIBOR + 1.80%. We simultaneously entered into a pay-fixed receive-variable rate swap for the full borrowing amount, fixing the LIBOR component of the borrowing rate to 1.07%, for an all-in fixed rate of 2.87%. Both the borrowing and pay-fixed receive-variable swap have a maturity date of June 10, 2023.

On April 5, 2016, we and our Operating Partnership entered into a series of purchase and sale agreements with regional health systems controlled by Catholic Health Initiatives to acquire 52 medical office facilities (which we now treat as 53 medical office facilities because we consider a certain condominium property as being separate from a nearby surgical center) (the "CHI Portfolio") containing 3,159,495 rentable square feet located in 10 states (the "CHI Acquisition"). As of September 30, 2016, we have completed the acquisition of 49 of the properties in the CHI Portfolio representing 3,023,512 net leasable square feet. We elected not to complete the acquisition of 2 of the CHI Portfolio properties and we expect to complete the acquisition of 1 CHI Portfolio facility during the fourth quarter of the 2016 fiscal year and the acquisition of the final CHI Portfolio building by early 2017.

During the quarterly period ended September 30, 2016, we completed acquisitions of 13 operating healthcare properties, located in 9 states with approximately 635,263 net leasable square feet for an aggregate purchase price of approximately $169.7 million.

In addition, we acquired 1 land parcel for $1.0 million, funded loan investments totaling $4.7 million, and completed equity buyouts totaling $1.6 million. Acquisitions are detailed in Note 3 (Acquisitions and Dispositions) to our consolidated financial statements included in Item 1 of this report.

We have grown our portfolio of gross real estate investments from approximately $124 million at the time of our IPO in July 2013 to approximately $2.7 billion as of September 30, 2016. As of October 28, 2016, we have 135,569,612 common shares outstanding.

On January 7, 2016, our Operating Partnership issued and sold $150.0 million aggregate principal amount of senior notes, comprised of (i) $15.0 million aggregate principal amount of 4.03% Senior Notes, Series A, due January 7, 2023, (ii) $45.0 million aggregate principal amount of 4.43% Senior Notes, Series B, due January 7, 2026, (iii) $45.0 million aggregate principal amount of 4.57% Senior Notes, Series C, due January 7, 2028, and (iv) $45.0 million aggregate principal amount of 4.74% Senior Notes, Series D, due January 7, 2031. On August 11, 2016, the note agreement for these notes was amended to make certain changes to its terms, including certain changes to affirmative covenants, negative covenants and definitions contained therein. The proceeds of the notes were used to repay borrowings under our unsecured revolving credit facility, for general corporate and working capital purposes, and for funding acquisitions.

On January 25, 2016, we completed a follow-on public offering of 21,275,000 common shares of beneficial interest, including 2,775,000 common shares issued upon exercise of the underwriters' overallotment option, resulting in net proceeds to us of approximately $321.1 million. We contributed the net proceeds of this offering to our Operating Partnership in exchange for 21,275,000 OP Units, and our Operating Partnership used the net proceeds of the public offering to repay borrowings under our unsecured revolving credit facility, for general corporate and working capital purposes, and for funding acquisitions.

On April 11, 2016, we completed a follow-on public offering of 25,875,000 common shares of beneficial interest, including 3,375,000 common shares issued upon exercise of the underwriters' overallotment option, resulting in net proceeds to us of approximately $442.8 million. We contributed the net proceeds of this offering to our Operating Partnership in exchange for 25,875,000 OP Units, and our Operating Partnership used the net proceeds of the public offering to repay borrowings under our unsecured revolving credit facility, for general corporate and working capital purposes, for funding acquisitions, and to fund a portion of the purchase price for the CHI Acquisition.

On August 5, 2016, we and our Operating Partnership entered into separate At Market Issuance Sales Agreements (the "Sales Agreements") with each of KeyBanc Capital Markets Inc., Credit Agricole Securities (USA) Inc., JMP Securities LLC, Raymond James & Associates, Inc. and Stifel Nicolaus & Company, Incorporated (the "Agents"), pursuant to which we may issue and sell, from time to time, our common shares having an aggregate offering price of up to $300 million, through the Agents. The offering of the common shares from time to time were registered pursuant to our Registration Statement on Form S-3ASR (File No. 333-205034), which became automatically effective upon filing with the Commission on June 17, 2015, as amended by Post-Effective Amendment No. 1 to the Registration Statement on Form S-3ASR, filed by us with the Commission on January 19, 2016 (the "Shelf Registration Statement"). In accordance with the Sales Agreements, we may offer and sell our common shares through any of the Agents, from time to time, by any method deemed to be an "at the market offering" as

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defined in Rule 415 under the Securities Act of 1933, as amended (the "Securities Act"), which includes sales made directly on the New York Stock Exchange or other existing trading market, or sales made to or through a market maker. With our express written consent, sales also may be made in negotiated transactions or any other method permitted by law. During the quarterly period ended September 30, 2016, we did not issue and sell any common shares pursuant to any of the Sales Agreements.

On August 11, 2016, the Operating Partnership issued and sold $75.0 million aggregate principal amount of senior notes, comprised of (i) $25.0 million aggregate principal amount of 4.09% Senior Notes, Series A, due August 11, 2025, (ii) $25.0 million aggregate principal amount of 4.18% Senior Notes, Series B, due August 11, 2026, and (iii) $25.0 million aggregate principal amount of 4.24% Senior Notes, Series C, due August 11, 2027. The proceeds of the notes were used to repay borrowings under our unsecured revolving credit facility, for general corporate and working capital purposes, and for funding acquisitions.

On September 26, 2016, we announced that our Board of Trustees authorized and declared a cash distribution of $0.225 per common share for the quarterly period ended September 30, 2016. The distribution was paid on October 18, 2016 to common shareholders and OP Unit holders of record as of the close of business on October 6, 2016.

We are a Maryland real estate investment trust and elected to be taxed as a REIT for U.S. federal income tax purposes beginning with our short taxable year ended December 31, 2013. We conduct our business through an UPREIT structure in which our properties are owned by our Operating Partnership directly or through limited partnerships, limited liability companies or other subsidiaries. We are the sole general partner of our Operating Partnership and, as of September 30, 2016, own approximately 97.4% of the OP Units.

Recent Developments

Investment Activity

Since September 30, 2016, we completed acquisitions of 2 condominium units with approximately 55,215 net leasable square feet for an aggregate purchase price of approximately $29.4 million. In addition, the Company entered 1 joint venture, representing an investment of $0.9 million, resulting in total subsequent acquisitions of $30.4 million. Investment activity since September 30, 2016 is summarized below:

Property		Location	Acquisition Date	Purchase Price (in thousands)
Northwest Michigan Surgery Center	(1)	Traverse City, MI	October 28, 2016	$ 29,448
United Surgical Partners J.V.	(2)	Scottsdale, AZ	October 31, 2016	903
				$ 30,351

(1) Our acquisition of condominium units within the Northwest Michigan Surgery Center was funded through the unregistered issuance of 947,936 common shares of beneficial interest and nominal cash.
(2) Our investment in the United Surgical Partners J.V. represents a 43% ownership interest.

Revenues

Revenues consist primarily of the rental revenues and property operating expense recoveries we collect from tenants pursuant to our leases. Additionally, we recognize certain cash and non-cash revenues. These cash and non-cash revenues are highlighted below.

Rental revenues. Rental revenues represent rent under existing leases that is paid by our tenants, straight-lining of contractual rents and below-market lease amortization reduced by lease inducements and above-market lease amortization.

Expense recoveries. Certain of our leases require our tenants to make estimated payments to us to cover their proportional share of operating expenses, including but not limited to real estate taxes, property insurance, routine maintenance and repairs, utilities, and property management expenses. We collect these estimated expenses and are reimbursed by our tenants for any actual expenses in excess of our estimates or reimburse tenants if our collected estimates exceed our actual operating expenses. The net reimbursed operating expenses are included in revenues as expense recoveries.

We have certain tenants with absolute net leases. Under these lease agreements, the tenant is responsible for operating and building expenses. For absolute net leases, we do not recognize operating expense or expense recoveries.

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Interest income on real estate loans and other. Represents interest income on mezzanine loans, term loans, notes receivable, income generated on tenant improvements, changes in the fair value of derivative liabilities, and other. Interest income on the loans are recognized as earned based on the terms of the loans subject to evaluation of collectability risks.

Expenses

Expenses consist primarily of interest expense, general and administrative costs associated with operating our properties, operating expenses of our properties, depreciation and amortization, and costs we incur to acquire properties.

Interest expense. We recognize the interest expense we incur on our borrowings as interest expense. Additionally, we incur amortization expense for charges such as legal fees, commitment fees, and arrangement fees that reflect costs incurred with arranging certain debt financings. We generally recognize these costs over the term of the respective debt instrument for which the costs were incurred as a component of interest expense.

General and administrative. General and administrative expenses include certain expenses such as compensation, accounting, legal, and other professional fees as well as certain other administrative and travel costs, and expenses related to bank charges, franchise taxes, corporate filing fees, exchange listing fees, officer and trustee insurance costs, and other costs associated with being a public company.

Operating Expenses. Operating expenses include property operating expenses such as real estate taxes, property insurance, routine maintenance and repairs, utilities, and third party property management expenses, some of which are reimbursed to us by tenants under the terms of triple net leases.

Depreciation and amortization. We incur depreciation and amortization expense on all of our long-lived assets. This non-cash expense is designed under generally accepted accounting principles, or GAAP, to reflect the economic useful lives of our assets.

Acquisition expenses. Acquisition costs are costs we incur in pursuing and closing property acquisitions accounted for as business combinations. These costs include legal, accounting, valuation, other professional or consulting fees, and the compensation of certain employees who dedicate substantially all of their time to acquisition related job functions. We account for acquisition-related costs as expenses in the period in which the costs are incurred and the services are received.

Equity in income of unconsolidated entity. We recognize our 40% share of earnings and losses from the entity that owns the land under Crescent City Surgical Centre.

Cash Flow

Cash flows from operating activities. Cash flows from operating activities are derived largely from net income by adjusting our revenues for those amounts not collected in cash during the period in which the revenue is recognized and for cash collected that was billed in prior periods or will be billed in future periods. Net income is further adjusted by adding back expenses charged in the period that is not paid for in cash during the same period. We expect to make our distributions based largely from cash provided by operations.

Cash flows from investing activities. Cash flows from investing activities consist of cash that is used during a period for making new investments and capital expenditures, offset by cash provided from sales of real estate investments.

Cash flows from financing activities. Cash flows from financing activities consist of cash we receive from debt and equity financings. This cash provides the primary basis for investments in new properties and capital expenditures. While we may invest a portion of our cash from operations into new investments, as a result of the distribution requirements to maintain our REIT status, it is likely that additional debt or equity financings will finance the majority of our investment activity. Cash used in financing activities consists of repayment of debt and distributions paid to shareholders and OP Unit holders.

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Results of Operations

Three Months Ended September 30, 2016 compared to the three months ended September 30, 2015.

The following table summarizes our results of operations for the three months ended September 30, 2016 and the three months ended September 30, 2015 (in thousands):

	2016	2015	Change	%
Revenues:				
Rental revenues	$53,327	$28,145	$25,182	89.5 %
Expense recoveries	14,361	5,821	8,540	146.7 %
Interest income on real estate loans and other	2,322	904	1,418	156.9 %
Total revenues	70,010	34,870	35,140	100.8 %
Expenses:				
Interest expense	7,300	3,341	3,959	118.5 %
General and administrative	4,917	4,018	899	22.4 %
Operating expenses	19,159	7,966	11,193	140.5 %
Depreciation and amortization	23,969	12,476	11,493	92.1 %
Acquisition expenses	4,398	3,257	1,141	35.0 %
Total expenses	59,743	31,058	28,685	92.4 %
Income before equity in income of unconsolidated entity and gain on sale of investment property:	10,267	3,812	6,455	169.3 %
Equity in income of unconsolidated entity	27	26	1	3.8 %
Gain on sale of investment property	—	145	$(145)	(100.0)%
Net income	$10,294	$3,983	$6,311	158.4 %

Revenues

Total revenues increased $35.1 million, or 100.8%, for the three months ended September 30, 2016 as compared to the three months ended September 30, 2015. An analysis of selected revenues follows.

Rental revenues. Rental revenues increased $25.2 million, or 89.5%, from $28.1 million for the three months ended September 30, 2015 to $53.3 million for the three months ended September 30, 2016. The increase in rental revenues primarily resulted from our 2016 and 2015 acquisitions which resulted in additional rental revenue of $19.3 million and $5.9 million, respectively.

Expense recoveries. Expense recoveries increased $8.5 million, or 146.7%, for the three months ended September 30, 2016 as compared to the three months ended September 30, 2015. The increase in expense recoveries primarily resulted from our 2016 and 2015 acquisitions which resulted in additional expense recoveries of $6.0 million and $2.3 million, respectively, partially offset by reduced expenses on other properties.

Interest income on real estate loans and other. Interest income on real estate loans and other increased $1.4 million, or 156.9%, for the three months ended September 30, 2016 as compared to the three months ended September 30, 2015. The increase is attributable to $0.5 million of interest earned on loan transactions completed during the prior twelve months. Additionally, we recognized other income of $0.8 million related to the write-off of an expired contingent liability.

Expenses

Total expenses increased by $28.7 million, or 92.4%, for the three months ended September 30, 2016 as compared to the three months ended September 30, 2015. An analysis of selected expenses follows.

Interest expense. Interest expense for the three months ended September 30, 2016 was $7.3 million compared to $3.3 million for the three months ended September 30, 2015, representing an increase of $4.0 million, or 118.5%. An increase of $2.1 million resulted from the issuance of our senior unsecured notes in January and August. An additional increase of $1.7 million resulted from our borrowings under the term loan provision of our unsecured credit facility.

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General and administrative. General and administrative expenses increased $0.9 million or 22.4%, from $4.0 million during the three months ended September 30, 2015 to $4.9 million during the three months ended September 30, 2016. The increase was driven by increased salaries and benefits of $1.0 million (including increased non-cash share compensation of $0.2 million).

Operating expenses. Operating expenses increased $11.2 million or 140.5%, from $8.0 million during the three months ended September 30, 2015 to $19.2 million during the three months ended September 30, 2016. The increase is primarily due to our 2016 and 2015 property acquisitions which resulted in additional operating expenses of $7.7 million and $2.9 million, respectively.

Depreciation and amortization. Depreciation and amortization increased $11.5 million, or 92.1%, from $12.5 million during the three months ended September 30, 2015 to $24.0 million during the three months ended September 30, 2016. The increase is primarily due to our 2016 and 2015 property acquisitions which resulted in additional depreciation and amortization of $8.8 million and $2.6 million, respectively.

Acquisition expenses. Acquisition expenses increased $1.1 million, or 35.0%, from $3.3 million during the three months ended September 30, 2015 to $4.4 million during the three months ended September 30, 2016. During the three months ended September 30, 2016 and 2015, we acquired $166.6 million and $292.2 million, respectively, of real estate that were considered business combinations and as such, the related acquisition costs were expensed.

Equity in income of unconsolidated entity. The change in equity income from unconsolidated entity for the three months ended September 30, 2016 compared to the three months ended September 30, 2015 is not significant.

Gain on sale of properties. On July 31, 2015, the Trust sold a 26,783 square foot medical office building located in Michigan for approximately $1.5 million, realizing a gain of $0.1 million. We have not disposed of any properties during the three months ended September 30, 2016.

Nine months ended September 30, 2016 compared to the nine months ended September 30, 2015.

The following table summarizes our results of operations for the nine months ended September 30, 2016 and the nine months ended September 30, 2015 (in thousands):

	2016	2015	Change	%
Revenues:				
Rental revenues	$130,378	$72,111	$58,267	80.8 %
Expense recoveries	31,816	14,265	17,551	123.0 %
Interest income on real estate loans and other	5,166	2,661	2,505	94.1 %
Total revenues	167,360	89,037	78,323	88.0 %
Expenses:				
Interest expense	15,776	7,244	8,532	117.8 %
General and administrative	13,964	11,359	2,605	22.9 %
Operating expenses	43,994	20,979	23,015	109.7 %
Depreciation and amortization	59,778	31,067	28,711	92.4 %
Acquisition expenses	11,031	11,764	(733)	(6.2)%
Total expenses	144,543	82,413	62,130	75.4