

HEALTHCARE REALTY TRUST INC

Form 10-Q

August 10, 2009

**Table of Contents**

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

**FORM 10-Q**

(Mark One)

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

**For the quarterly period ended: June 30, 2009  
OR**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File Number: 001-11852**

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

**Maryland**  
(State or other jurisdiction of  
incorporation or organization)

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

**3310 West End Avenue  
Suite 700  
Nashville, Tennessee 37203**  
(Address of principal executive offices)  
**(615) 269-8175**

(Registrant's telephone number, including area code)

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 Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

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

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

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

As of July 31, 2009, 59,355,658 shares of the Registrant's Common Stock were outstanding.



**HEALTHCARE REALTY TRUST INCORPORATED**  
**FORM 10-Q**  
**June 30, 2009**  
**TABLE OF CONTENTS**

	Page
<u>Part I Financial Information</u>	
<u>Item 1. Financial Statements</u>	
<u>Condensed Consolidated Balance Sheets</u>	1
<u>Condensed Consolidated Statements of Income</u>	2
<u>Condensed Consolidated Statements of Cash Flows</u>	4
<u>Notes to Condensed Consolidated Financial Statements</u>	5
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	21
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	32
<u>Item 4. Controls and Procedures</u>	32
<u>Part II Other Information</u>	
<u>Item 1. Legal Proceedings</u>	33
<u>Item 1A. Risk Factors</u>	33
<u>Item 4. Submission of Matters to a Vote of Security Holders</u>	33
<u>Item 6. Exhibits</u>	34
<u>Signature</u>	35
<u>EX-31.1</u>	
<u>EX-31.2</u>	
<u>EX-32</u>	

---

**Table of Contents****Part I. FINANCIAL INFORMATION****Item 1. Financial Statements.**

**Healthcare Realty Trust Incorporated**  
**Condensed Consolidated Balance Sheets**  
(Dollars in thousands, except per share data)  
(Unaudited)

	<b>June 30, 2009</b>	<b>December 31, 2008</b>
<b>ASSETS</b>		
Real estate properties:		
Land	\$ 113,003	\$ 107,555
Buildings, improvements and lease intangibles	1,853,887	1,792,402
Personal property	17,242	16,985
Construction in progress	126,429	84,782
	2,110,561	2,001,724
Less accumulated depreciation	(407,297)	(367,360)
Total real estate properties, net	1,703,264	1,634,364
Cash and cash equivalents	4,707	4,138
Mortgage notes receivable	57,022	59,001
Assets held for sale and discontinued operations, net	1,377	90,233
Other assets, net	78,215	77,044
Total assets	\$ 1,844,585	\$ 1,864,780
<b>LIABILITIES AND EQUITY</b>		
Liabilities:		
Notes and bonds payable	\$ 962,934	\$ 940,186
Accounts payable and accrued liabilities	44,421	45,937
Liabilities held for sale and discontinued operations	17	32,821
Other liabilities	45,859	49,589
Total liabilities	1,053,231	1,068,533
Commitments and contingencies		
Equity:		
Preferred stock, \$.01 par value; 50,000,000 shares authorized; none issued and outstanding		
Common stock, \$.01 par value; 150,000,000 shares authorized; 59,354,883 and 59,246,284 shares issued and outstanding at June 30, 2009 and December 31, 2008, respectively	594	592
Additional paid-in capital	1,493,182	1,490,535
Accumulated other comprehensive loss	(6,461)	(6,461)

Edgar Filing: HEALTHCARE REALTY TRUST INC - Form 10-Q

Cumulative net income	774,491	736,874
Cumulative dividends	(1,472,398)	(1,426,720)
Total stockholders' equity	789,408	794,820
Noncontrolling interests	1,946	1,427
Total equity	791,354	796,247
Total liabilities and equity	\$ 1,844,585	\$ 1,864,780

The accompanying notes, together with the Notes to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008, are an integral part of these financial statements.

**Table of Contents**

**Healthcare Realty Trust Incorporated**  
**Condensed Consolidated Statements of Income**  
**For The Three Months Ended June 30, 2009 and 2008**  
(Dollars in thousands, except per share data)  
(Unaudited)

	<b>2009</b>	<b>2008</b>
<b>REVENUES</b>		
Master lease rent	\$ 14,953	\$ 15,014
Property operating	45,866	32,899
Straight-line rent	328	(126)
Mortgage interest	978	542
Other operating	3,007	4,312
	65,132	52,641
<b>EXPENSES</b>		
General and administrative	5,329	5,863
Property operating	23,587	19,279
Bad debts, net of recoveries	127	115
Depreciation	15,575	11,665
Amortization	1,346	566
	45,964	37,488
<b>OTHER INCOME (EXPENSE)</b>		
Gain on Extinguishment of Debt		9
Interest expense	(10,043)	(10,886)
Interest and other income, net	228	486
	(9,815)	(10,391)
<b>INCOME FROM CONTINUING OPERATIONS</b>	<b>9,353</b>	<b>4,762</b>
<b>DISCONTINUED OPERATIONS</b>		
Income from discontinued operations	18	1,289
Gain on sales of real estate properties	7,443	7,715
<b>INCOME FROM DISCONTINUED OPERATIONS</b>	<b>7,461</b>	<b>9,004</b>
<b>NET INCOME</b>	<b>16,814</b>	<b>13,766</b>
Less: Net income attributable to noncontrolling interests	(62)	
<b>NET INCOME ATTRIBUTABLE TO COMMON STOCKHOLDERS</b>	<b>\$ 16,752</b>	<b>\$ 13,766</b>

**Basic Earnings Per Common Share**

Income from continuing operations	\$	0.16	\$	0.10
Discontinued operations		0.13		0.18
Net income attributable to common stockholders	\$	0.29	\$	0.28

**Diluted Earnings Per Common Share**

Income from continuing operations	\$	0.16	\$	0.09
Discontinued operations		0.12		0.18
Net income attributable to common stockholders	\$	0.28	\$	0.27

<b>Weighted Average Common Shares Outstanding</b>	<b>Basic</b>	58,128,489	49,431,724
---	--------------	------------	------------

<b>Weighted Average Common Shares Outstanding</b>	<b>Diluted</b>	58,899,618	50,474,762
---	----------------	------------	------------

<b>Dividends Declared, per Common Share, During the Period</b>	\$	0.385	\$	0.385
--	----	-------	----	-------

The accompanying notes, together with the Notes to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008, are an integral part of these financial statements.



**Table of Contents**

**Healthcare Realty Trust Incorporated**  
**Condensed Consolidated Statements of Income**  
**For The Six Months Ended June 30, 2009 and 2008**  
(Dollars in thousands, except per share data)  
(Unaudited)

	<b>2009</b>	<b>2008</b>
<b>REVENUES</b>		
Master lease rent	\$ 30,604	\$ 30,703
Property operating	88,776	65,014
Straight-line rent	688	(182)
Mortgage interest	1,468	1,067
Other operating	6,514	8,164
	128,050	104,766
<b>EXPENSES</b>		
General and administrative	12,296	11,908
Property operating	46,950	37,524
Bad debts, net of recoveries	562	260
Depreciation	31,300	23,127
Amortization	2,827	1,150
	93,935	73,969
<b>OTHER INCOME (EXPENSE)</b>		
Gain on Extinguishment of Debt		9
Re-measurement gain of equity interest upon acquisition	2,701	
Interest expense	(20,116)	(21,764)
Interest and other income, net	383	622
	(17,032)	(21,133)
<b>INCOME FROM CONTINUING OPERATIONS</b>	17,083	9,664
<b>DISCONTINUED OPERATIONS</b>		
Income from discontinued operations	582	2,582
Impairments	(22)	(29)
Gain on sales of real estate properties	20,051	8,352
<b>INCOME FROM DISCONTINUED OPERATIONS</b>	20,611	10,905
<b>NET INCOME</b>	37,694	20,569
Less: Net income attributable to noncontrolling interests	(77)	(3)

<b>NET INCOME ATTRIBUTABLE TO COMMON STOCKHOLDERS</b>	\$	37,617	\$	20,566
<b>Basic Earnings Per Common Share</b>				
Income from continuing operations	\$	0.29	\$	0.20
Discontinued operations		0.36		0.22
Net income attributable to common stockholders	\$	0.65	\$	0.42
<b>Diluted Earnings Per Common Share</b>				
Income from continuing operations	\$	0.29	\$	0.19
Discontinued operations		0.35		0.22
Net income attributable to common stockholders	\$	0.64	\$	0.41
<b>Weighted Average Common Shares Outstanding</b>	<b>Basic</b>	58,153,637		49,422,391
<b>Weighted Average Common Shares Outstanding</b>	<b>Diluted</b>	58,897,895		50,442,808
<b>Dividends Declared, per Common Share, During the Period</b>	\$	0.77	\$	0.77

The accompanying notes, together with the Notes to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008, are an integral part of these financial statements.

**Table of Contents****Healthcare Realty Trust Incorporated****Condensed Consolidated Statements of Cash Flows  
For The Six Months Ended June 30, 2009 and 2008**

(Dollars in thousands)

(Unaudited)

	<b>2009</b>	<b>2008</b>
<b>Operating Activities</b>		
Net income	\$ 37,694	\$ 20,569
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	35,218	26,480
Stock-based compensation	2,301	2,403
Straight-line rent receivable	(672)	199
Straight-line rent liability	224	86
Gain on sales of real estate properties	(20,051)	(8,352)
Gain on repurchase of notes payable		(9)
Re-measurement gain of equity interest upon acquisition	(2,701)	
Impairments	22	29
Equity in losses from unconsolidated joint ventures	2	148
Provision for bad debts, net of recoveries	566	331
State income taxes paid, net of refunds	(569)	(621)
Payment of partial pension settlement	(2,300)	
Changes in operating assets and liabilities:		
Other assets	132	5,866
Accounts payable and accrued liabilities	(3,200)	(3,686)
Other liabilities	(872)	(717)
Net cash provided by operating activities	45,794	42,726
<b>Investing Activities</b>		
Acquisition and development of real estate properties	(61,791)	(37,694)
Funding of mortgages and notes receivable	(8,816)	(7,181)
Investment in unconsolidated joint venture	(149)	
Distributions received from unconsolidated joint ventures		867
Proceeds from sales of real estate	82,878	22,040
Proceeds from mortgages and notes receivable repayments	98	79
Net cash provided by (used in) investing activities	12,220	(21,889)
<b>Financing Activities</b>		
Net borrowings on unsecured credit facility	9,000	22,000
Repayments on notes and bonds payable	(21,569)	(1,825)
Repurchase of notes payable		(5,332)
Quarterly dividends paid	(45,678)	(39,067)
Proceeds from issuance of common stock	348	361
Common stock redemption		(282)
Credit facility amendment fee		(326)
Capital contributions received from noncontrolling interests	529	

Edgar Filing: HEALTHCARE REALTY TRUST INC - Form 10-Q

Distributions to noncontrolling interests	(75)	(3)
Net cash used in financing activities	(57,445)	(24,474)
<b>Increase (decrease) in cash and cash equivalents</b>	569	(3,637)
<b>Cash and cash equivalents, beginning of period</b>	4,138	8,519
<b>Cash and cash equivalents, end of period</b>	\$ 4,707	\$ 4,882

**Supplemental Cash Flow Information**

Interest paid	\$ 24,221	\$ 25,201
Capitalized interest	\$ 4,613	\$ 3,110
Capital expenditures accrued	\$ 13,892	\$ 7,370
Mortgage note payable assumed upon acquisition of joint venture interest (adjusted to fair value)	\$ 11,716	\$
Mortgage note payable disposed of upon sale of joint venture interest	\$ 5,425	\$

The accompanying notes, together with the Notes to the Consolidated Financial Statements included in the Company's Annual Report on

Form 10-K for the year ended December 31, 2008, are an integral part of these financial statements.

**Table of Contents**

**Healthcare Realty Trust Incorporated**  
**Notes to Condensed Consolidated Financial Statements**  
**June 30, 2009**  
(Unaudited)

**Note 1. Summary of Significant Accounting Policies**

*Business Overview*

Healthcare Realty Trust Incorporated (the Company) is a real estate investment trust (REIT) that owns, acquires, manages, finances, and develops income-producing real estate properties associated primarily with the delivery of outpatient healthcare services throughout the United States. The Company had investments of approximately \$2.2 billion in 203 real estate properties and mortgages as of June 30, 2009, excluding assets classified as held for sale and including an investment in an unconsolidated joint venture. The Company's 198 owned real estate properties, excluding assets classified as held for sale, are comprised of six facility types, located in 28 states, totaling approximately 12.1 million square feet. As of June 30, 2009, the Company provided property management services to approximately 8.8 million square feet nationwide.

*Principles of Consolidation*

The accompanying Condensed Consolidated Financial Statements include the accounts of the Company, its wholly-owned subsidiaries, and certain other affiliated entities with respect to which the Company controlled or controls the operating activities and receives substantially all of the economic benefits.

The Company accounts for its joint venture investments in accordance with the Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 94, Consolidation of all Majority-Owned Subsidiaries, Accounting Principles Board Standard No. 18, The Equity Method of Accounting for Investments in Common Stock, and the American Institute of Certified Public Accountants Statement of Position 78-9, Accounting for Investments in Real Estate Ventures, which provide guidance on whether an entity should consolidate an investment or account for it under the equity or cost methods. The Company's investments in its unconsolidated joint ventures are included in other assets and the related equity income is recognized in other income (expense) on the Company's Condensed Consolidated Financial Statements. On January 1, 2009, the Company adopted SFAS No. 160, Non-Controlling Interests in Consolidated Financial Statements - An Amendment of ARB No. 51 (SFAS No. 160). SFAS No. 160 requires all entities to report noncontrolling (minority) interests in subsidiaries as equity in the consolidated financial statements and eliminates the diversity that existed in accounting for transactions between an entity and noncontrolling interests by requiring that they be treated as equity transactions. In addition, net income attributable to the noncontrolling interests is included in consolidated net income on the face of the income statement. SFAS No. 160 requires prospective treatment, except for the presentation and disclosure requirements, which require retrospective treatment. The adoption of SFAS No. 160 did not have a significant impact on the Company's consolidated financial position or net income per share.

The Condensed Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements that are included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008. Management believes, however, that all adjustments of a normal, recurring nature considered necessary for a fair presentation have been included. All significant intercompany accounts and transactions have been eliminated in the Condensed Consolidated Financial Statements. The Company evaluated subsequent events for recognition or disclosure through August 10, 2009, which is the date the Condensed Consolidated Financial Statements were issued.

This interim financial information should be read in conjunction with the financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) included in this report and in the Company's Annual Report on Form 10-K for the year ended December 31, 2008. This interim financial information does not necessarily represent or indicate what the operating results will be for the year ending December 31, 2009 for many reasons including, but not limited to, acquisitions, dispositions, capital financing transactions, changes in interest rates and the effects of trends.



## **Table of Contents**

### *Use of Estimates in the Condensed Consolidated Financial Statements*

Preparation of the Condensed Consolidated Financial Statements in accordance with GAAP requires management to make estimates and assumptions that affect amounts reported in the Condensed Consolidated Financial Statements and accompanying notes. Actual results may differ from those estimates.

### *Segment Reporting*

The Company owns, acquires, manages, finances, and develops outpatient, healthcare-related properties. The Company is managed as one reporting unit, rather than multiple reporting units, for internal reporting purposes and for internal decision-making. Therefore, the Company discloses its operating results in a single segment.

### *Reclassifications*

#### Discontinued operations

Certain amounts in the Company's Condensed Consolidated Financial Statements for prior periods have been reclassified to conform to the current period presentation. Assets sold or held for sale, and related liabilities, have been reclassified on the Company's Condensed Consolidated Balance Sheets, and the operating results of those assets have been reclassified from continuing to discontinued operations for all periods presented. Likewise, certain assets and liabilities that were previously classified as held for sale and included in discontinued operations have been reclassified to held for use and included in continuing operations.

#### Noncontrolling interests

All prior period noncontrolling interests on the Company's Condensed Consolidated Balance Sheets have been reclassified from liabilities to equity, and all prior period noncontrolling interests' net income on the Company's Condensed Consolidated Statements of Income have been reclassified to specifically identify net income attributable to the noncontrolling interests.

### *Revenue Recognition*

The Company recognizes revenue in accordance with the Securities and Exchange Commission Staff Accounting Bulletin No. 104, Revenue Recognition (SAB No. 104). SAB No. 104 includes four criteria that must be met before revenue is realized or realizable and earned. The Company begins recognizing revenue when all four criteria have been met, such as persuasive evidence of an arrangement exists, the tenant has taken possession of and controls the physical use of the leased asset, and collectibility is reasonably assured.

The Company derives most of its revenues from its real estate and mortgage notes receivable portfolio. The Company's rental and mortgage interest income is recognized based on contractual arrangements with its tenants, sponsors or borrowers. These contractual arrangements generally fall into three categories: leases, mortgage notes receivable, and property operating agreements as described in the following paragraphs. The Company may accrue late fees based on the contractual terms of a lease or note. Such fees, if accrued, are included in master lease rent, property operating income, or mortgage interest income on the Company's Condensed Consolidated Statements of Income, based on the type of contractual agreement.

#### Rental Income

Rental income related to non-cancelable operating leases is recognized as earned over the life of the lease agreements on a straight-line basis. The Company's lease agreements generally include provisions for stated annual increases or increases based on a Consumer Price Index (CPI). Rental income from properties under master lease arrangements with tenants is included in master lease rent, and rental income from properties with multiple tenant lease arrangements is included in property operating income on the Company's Condensed Consolidated Statements of Income.

#### Interest Income

Mortgage interest income and notes receivable interest income are recognized based on the interest rates and maturity date or amortization period specific to each note.

#### Property operating income

As of June 30, 2009, the Company had eight real estate properties subject to property operating agreements that obligate the sponsoring health system to provide to the Company a minimum return on the Company's investment in the property in return for the right to be involved in the operating decisions of the property, including tenancy. If the minimum return is not achieved through normal operations of the property, the sponsor is responsible to the Company





## **Table of Contents**

for the shortfall under the terms of these agreements. The Company recognizes the shortfall income in other operating income on the Company's Condensed Consolidated Statements of Income.

### *Accumulated Other Comprehensive Loss*

Foreign currency translation adjustments, minimum pension liability adjustments, unrealized gains or losses on available-for-sale securities, as well as other items, are included in comprehensive income (loss). Included in accumulated other comprehensive loss is the cumulative adjustment related to the adoption and subsequent application of SFAS No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of SFAS No. 87, 88, 106 and 132(R), which is generally recognized in the fourth quarter of each year. As such, total comprehensive income for the three and six months ended June 30, 2009 and 2008 was the same as net income.

### *Income Taxes*

No provision has been made for federal income taxes. The Company intends at all times to qualify as a real estate investment trust under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended. The Company must distribute at least 90% per annum of its real estate investment trust taxable income to its stockholders and meet other requirements to continue to qualify as a real estate investment trust.

The Company must pay certain state income taxes which are generally included in general and administrative expense on the Company's Condensed Consolidated Statements of Income.

The Company classifies interest and penalties related to uncertain tax positions, if any, in its Condensed Consolidated Financial Statements as a component of general and administrative expense.

### *Incentive Plans*

The Company follows the provisions of SFAS No. 123(R), Share-Based Payment, for accounting for its stock-based awards. As of June 30, 2009, the Company had issued and outstanding various employee and non-employee stock-based awards. These awards included restricted stock issued to employees pursuant to the Company's employee stock incentive plans, restricted stock issued to its Board of Directors under its non-employee director incentive plan, and options issued to employees pursuant to its employee stock purchase plan.

### *Accounting for Defined Benefit Pension Plans*

The Company accounts for its pension plans in accordance with SFAS No. 158. The Company has pension plans under which the Company's Board of Directors and certain designated employees may receive retirement benefits upon retirement and the completion of five years of service with the Company. The plans are unfunded and benefits will be paid from earnings of the Company.

### *Operating Leases*

As described in more detail in the Company's Annual Report on Form 10-K for the year ended December 31, 2008, the Company is obligated under operating lease agreements consisting primarily of its corporate office lease and various ground leases related to the Company's real estate investments where the Company is the lessee.

### *Discontinued Operations and Assets Held for Sale*

The Company sells properties from time to time due to a variety of factors, including among other things, market conditions or the exercise of purchase options by tenants. The operating results of properties that have been sold or are held for sale are reported as discontinued operations in the Company's Condensed Consolidated Statements of Income in accordance with the criteria established in SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, (SFAS No. 144). Pursuant to SFAS No. 144, a company must report discontinued operations when a component of an entity has either been disposed of or is deemed to be held for sale if (i) both the operations and cash flows of the component have been or will be eliminated from ongoing operations as a result of the disposal transaction, and (ii) the entity will not have any significant continuing involvement in the operations of the component after the disposal transaction. Long-lived assets classified as held for sale on the Company's Condensed Consolidated Balance Sheet are reported at the lower of their carrying amount or their fair value less cost to sell. Further, depreciation of these assets ceases at the time the assets are classified as discontinued operations. Losses resulting from the sale of such properties are characterized as impairment losses relating to discontinued operations in the Condensed Consolidated Statements of Income. As of June 30, 2009, the Company had two real estate properties classified as held for sale.

### *Land Held for Development*

Land held for development, which is included in construction in progress on the Company's Condensed Consolidated Balance Sheets, includes parcels of land owned by the Company, upon which the Company intends to

7

---

**Table of Contents**

develop and own medical office and outpatient healthcare properties. See Note 6 for a detail of the Company's land held for development.

*Fair Value Measurements*

The Company adopted SFAS No. 157, Fair Value Measurements ( SFAS No. 157 ) for its financial assets and liabilities on January 1, 2008 and for its non-financial assets and liabilities on January 1, 2009. The adoption of SFAS No. 157 has not had a significant impact on the Company's financial position or results of operations. SFAS No. 157 defines fair value, expands disclosure requirements about fair value measurements, and establishes specific requirements as well as guidelines for a consistent framework to measure fair value. SFAS No. 157 defines fair value as the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants. SFAS No. 157 requires a company to maximize the use of observable market inputs, minimize the use of unobservable market inputs and disclose in the form of an outlined hierarchy the details of such fair value measurements.

SFAS No. 157 specifies a hierarchy of valuation techniques based on whether the inputs to a fair value measurement are considered to be observable or unobservable in a marketplace. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions. This hierarchy requires the use of observable market data when available. These inputs have created the following fair value hierarchy:

*Level 1* quoted prices for identical instruments in active markets;

*Level 2* quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which significant inputs and significant value drivers are observable in active markets; and

*Level 3* fair value measurements derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

*Real Estate Properties*

Real estate properties are recorded at fair value at the acquisition date. The fair value of real estate properties acquired is allocated between land, buildings, tenant improvements, lease and other intangibles, and personal property based upon estimated fair values at the time of acquisition in accordance with SFAS No. 141(R), Business Combinations, as revised ( SFAS No. 141(R) ) which the Company adopted on January 1, 2009. SFAS No. 141(R) requires an acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose to investors and other users all of the information needed to evaluate and understand the nature and financial effect of the business combination. Prior to the adoption of SFAS No. 141(R), the Company applied SFAS No. 141, Business Combinations.

*New Pronouncements*

In May 2009, the FASB issued SFAS No. 165, Subsequent Events, ( SFAS No. 165 ). This statement provides authoritative accounting literature relating to subsequent events that was previously addressed only in auditing literature. The guidance is virtually the same as guidance included in the auditing literature with some exceptions. First, the two types of subsequent events have been renamed as either recognized or non-recognized rather than Type I and Type II as previously referred to in the auditing literature. Second, the definition of a subsequent event was modified to refer to events or transactions that occur after the balance sheet date, but before the issuance of the financial statements. Lastly, companies are required to disclose the date through which it has evaluated subsequent events and the basis for that date. The adoption of SFAS No. 165, which was effective for the Company for the interim period ended June 30, 2009, has not had a material impact on the Company's financial statements.

In June 2009, the FASB issued SFAS No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles a replacement of FASB Statement No. 162, ( SFAS No. 168 or the Codification ) as the single source of authoritative nongovernmental GAAP. All existing accounting standard documents, such as FASB, American Institute of Certified Public Accountants, Emerging Issues Task Force and other related literature, excluding guidance from the Securities and Exchange Commission ( SEC ), will be superseded by the Codification. All other non-grandfathered, non-SEC accounting literature not included in the Codification will become

nonauthoritative. The Codification is not intended to change GAAP, but instead introduces a new structure that will combine all authoritative standards into a comprehensive, topically organized online database.

8

---