

HEALTHCARE REALTY TRUST
INCORPORATED



1994 ANNUAL REPORT



COMPANY PROFILE

Healthcare Realty Trust Incorporated, listed on the New York Stock Exchange (HR), is an equity real estate investment trust (REIT) which has invested approximately \$300,000,000 in income-producing healthcare real estate since its formation in June 1993. The Company is the nation's only fully integrated, self-administered, self-managed, independent healthcare REIT with properties diversified by facility type, healthcare provider and geographic location. The Company's current portfolio consists of 57 properties, comprised of 7 facility types, leased to 16 healthcare providers in 32 markets in 13 states nationwide.

The Company acquires existing healthcare facilities, provides property management, leasing and build-to-suit development services, and capital for the construction of new facilities.

The Company has investments with some of the largest publicly traded healthcare companies in the industry, including Columbia/HCA Healthcare Corporation, HealthTrust, Inc., OrNda HealthCorp, PhyCor, Inc. and Tenet Healthcare Corporation (formerly National Medical Enterprises and AMI). Other investments include facilities operated by Life Care Centers of America, National Surgery Centers and Transitional Health Services, Inc. In the not-for-profit sector, the Company owns ancillary hospital facilities related to Valley Presbyterian Hospital, Van Nuys, California, and Candler Health Systems, Savannah, Georgia.

Healthcare Realty Trust provides funding and a full range of real estate services to the rapidly growing alternate-site and outpatient segments of the healthcare industry.

Notice of Annual Meeting

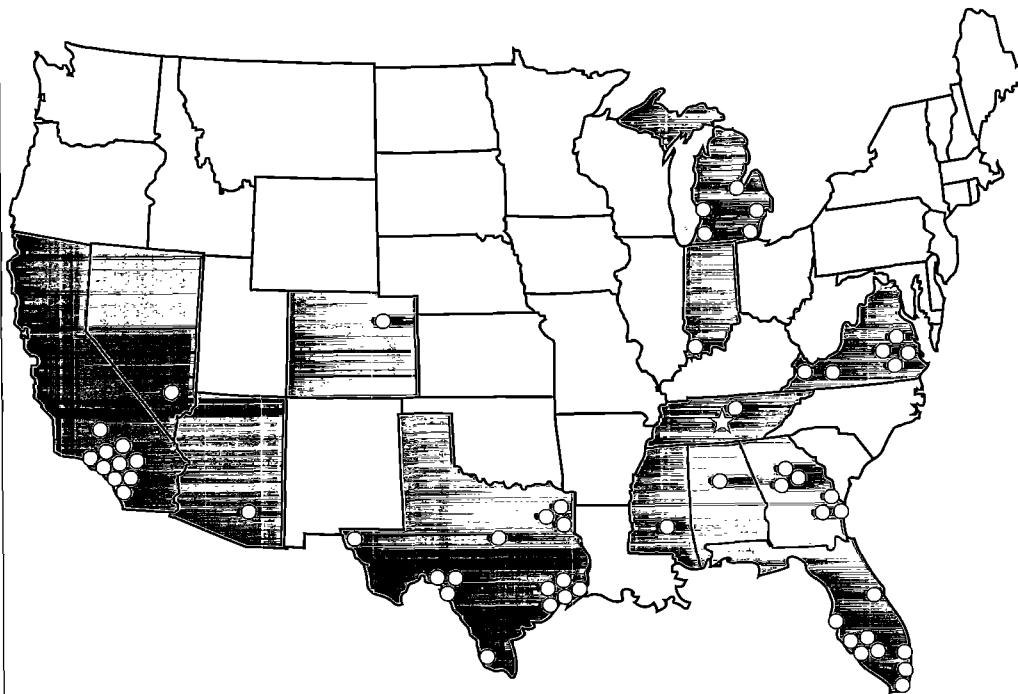
The annual meeting of stockholders will be held on May 16, 1995, at 10:00 a.m. at the Cumberland Club, 511 Union Street, Nashville, Tennessee.

FINANCIAL HIGHLIGHTS

	Year Ended December 31,	
	1994	1993*
Revenues:		
Base rental income	\$ 23,231,345	\$ 7,066,606
Interest income	995,078	68,398
	<u>24,226,423</u>	<u>7,135,004</u>
Net income	\$ 15,715,588	\$ 3,950,034
Net income per share	\$ 1.33	\$ 0.64
Funds from operations	\$ 21,135,302	\$ 6,268,879
Funds from operations per share	\$ 1.79	\$ 1.01
Dividends paid	\$ 1.75	\$ 0.551
Weighted average shares outstanding	\$ 11,830,197	\$ 6,185,600

**Represents operations from June 3, 1993, when the Company completed its initial public offering, to December 31, 1993.*

PROPERTIES



The Company's 57 properties are located in 32 markets in 13 states.

LETTER TO SHAREHOLDERS

In 1994, our second year of operation as a public company, we are pleased to report that Healthcare Realty Trust Incorporated has continued the growth momentum initiated last year. The Company has expanded its portfolio of healthcare properties, increased dividends, and achieved record revenues and earnings. This financial performance has enabled the Company to increase its funds from operations and pay to its shareholders six dividend payments, each representing an increase over the previous quarter. We believe these achievements confirm our investment strategy and operating success.

There is a growing trend among healthcare providers to concentrate more of their resources on healthcare delivery systems and less on property development and management. In response to this trend and to better serve its clients' needs, the Company (through a wholly owned subsidiary, Healthcare Realty Management) recently acquired a leading provider of real estate services to the healthcare industry. This company, Starr Sanders Johnson, Inc., was founded in 1989 by Chairman, Bart Starr, and President, Rance M. Sanders. Services include the day-to-day management and leasing of multi-tenanted healthcare properties, as well as supervision of the development of new facilities. With the addition of Healthcare Realty Management, the Company became

value-added real estate services to clients — further differentiating itself from other healthcare REITs.

The services provided by Healthcare Realty Management are not a redirection of the Company's core business of long-term net-leased investments, but are instead intended to strategically expand the scope of revenue sources to generate increased shareholder value while maintaining a conservative business risk profile. These additional sources of revenues are expected to broaden the Company's growth opportunities beyond the traditional business of "spread investing" by healthcare REITs.

Revenues for the fourth quarter totaled \$7.8 million, a 129% increase over the prior year's \$3.4 million. Net income for the period was \$4.8 million, or \$0.37 per share, compared with \$1.9 million, or \$0.30 per share, for the fourth quarter of 1993. Funds from operations for the quarter, which is composed of net income, depreciation and amortization, totaled \$6.4 million, or \$0.50 per share, compared with \$2.9 million, or \$0.47 per share, for the fourth quarter ended December 31, 1993.

For 1994, revenues totaled \$24.2 million. Net income for the period was \$15.7 million, or \$1.33 per share. Funds from operations for the twelve month period totaled \$21.1 million, or \$1.79 per share. Comparative results

December 31, 1993, are not meaningful since the Company commenced operations on June 3, 1993.

The Company's financial performance enabled our successful return to the equity and credit markets for additional growth capital. The Company completed an equity offering early in 1994 in which it sold 6,250,000 shares resulting in net proceeds of \$125.2 million. To support the Company's portfolio growth and working capital needs, a \$75 million unsecured, revolving credit facility was arranged with a group of four banks.

At year end, the Company had invested more than \$287 million to expand its portfolio of healthcare properties to 56 facilities in 32 markets in 13 states. The Company's investment capital affords healthcare providers access to funding at a cost that is competitive with their alternative sources of funds. Moreover, such funding provides beneficial enhancements to their balance sheets and earnings per share. We believe that Healthcare Realty Trust is unlike traditional REITs which are usually considered a source of expensive debt. The Company provides real estate services and capital under terms and conditions that our clients regard as low-cost equity.

Notable investments during 1994, that reflect our strategies of focusing on outpatient and alternate-site facilities, using creative acquisition struc-

tures, and building relationships with leading not-for-profit and proprietary healthcare systems, included:

- The acquisition of two ancillary hospital facilities, valued at \$21.8 million, located in Richmond, Virginia. The properties, master-leased to Columbia/HCA, were acquired from a group of 204 physicians in a tax-free stock swap which facilitated both hospital and physician objectives.

- The acquisition of an ancillary hospital facility connected to Candler Health System, an investment grade, 335-bed acute-care, not-for-profit hospital in Savannah, Georgia. In addition, the Company will purchase, upon completion, a comprehensive heart center and parking structure, bringing the total value of the transaction to \$20.4 million.

- The purchase of four ancillary hospital facilities and one long-term care facility, valued at \$41 million, located on the campus of the 413-bed Fountain Valley Regional Hospital and Medical Center in Fountain Valley, California. These facilities were acquired simultaneously as an integral part of OrNda HealthCorp's acquisition of the medical center.

- The major expansion of an existing portfolio property, Huebner Medical Center, a comprehensive ambulatory care center in San Antonio, Texas. The \$9.4 million expansion will include outpatient

surgery, outpatient rehabilitation, outpatient diagnostic imaging, skilled nursing beds, special spinal injury care beds and an array of primary care and specialized healthcare services. Columbia/ HCA and HealthSouth Rehabilitation are the major tenants.

During 1994, the Company implemented the Healthcare Realty Trust Dividend Reinvestment Plan. This plan gives shareholders of the Company a convenient way to purchase additional shares of the Company at a modest discount while avoiding the payment of brokerage fees.

Our management team is pleased with the Company's progress during 1994. The additional investments made this past year have enhanced the quality and diversity of the portfolio which contribute to the financial strength and long-term viability of the Company. As we close additional transactions and begin the development of several new properties, we are confident that the Company will continue its record of growth and increased shareholder value. The Company's strong balance sheet and recognition for innovation and teamwork place it in an excellent position to be selective in its investments. Given the consolidation activity in the healthcare field, the constant need for capital and the increasing demand for property management services, we expect qualified investment opportunities will continue to



enable the Company to execute its strategy and realize its full potential.

Since the Company began operations approximately 18 months ago, we have achieved many of our goals. We appreciate the Board of Directors for their leadership, our employees for their dedication and our clients for their participation. In particular, we are thankful to our shareholders who have invested in the Company and continue to have confidence in our strategy. We look forward to keeping you informed of our progress during 1995.

Sincerely yours,

David R. Emery

David R. Emery

Chairman of the Board and President

1994 IN REVIEW

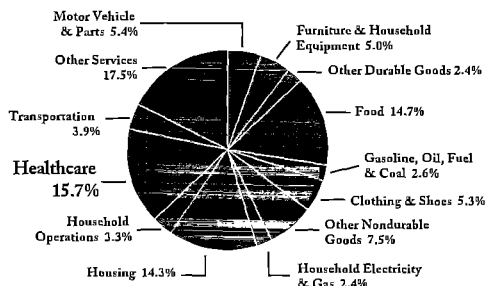
The goals of Healthcare Realty Trust are to: provide real estate services and facility funding to a diverse group of quality healthcare providers, geographically and market dispersed, with an emphasis on alternate site and outpatient services; strengthen these relationships while expanding our portfolio to include additional healthcare providers with a reputation for high quality, cost-effective services; and generate increasing cash flow and dividend income for our shareholders.

The Healthcare Industry

The healthcare industry is undergoing dramatic changes; many have likened it to a revolution. Absent legislated healthcare reform, extraordinary, market-driven, payer-directed, healthcare reform is well underway nationwide. Major consolidations, the emergence of managed care, physicians unifying in groups, increased emphasis on outpatient care, integrated delivery systems and the development of strategic alliances are daily occurrences. In 1994, there were 43

greater than \$200 million — totaling approximately \$60 billion.

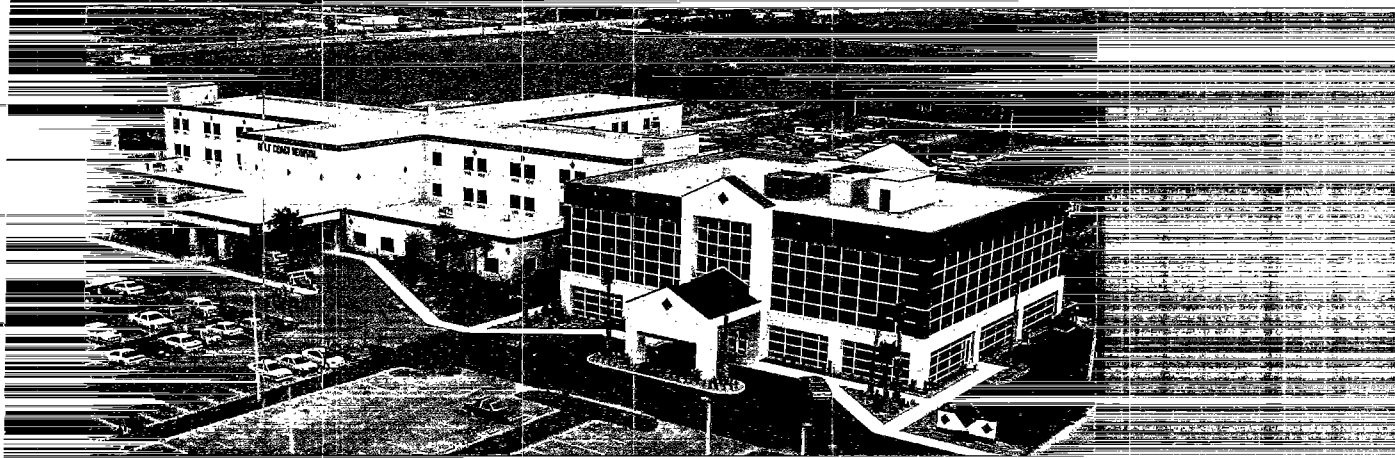
1994 Personal Consumption Expenditures
(US Bureau of Economic Analysis)



The healthcare services industry continues to be one of the largest industries in the United States, representing 13.9% of Gross Domestic Product (GDP). Even though the healthcare industry is undergoing dramatic change, there is no less demand for services. In fact, the aging of the population and improved technology continue to substantially increase demand for healthcare services. Yet, ever-increasing demand is confronted by the need to reduce the cost of services. These opposing market dynamics are changing the way healthcare is delivered - not diminishing its vital importance.

In 1994, medical care led all categories of personal consumption at 15.7%, or \$726.8 billion, accounting for a greater percentage of spending than that required for such basic necessities as food or housing.

The restructuring of the healthcare delivery system has created an ideal climate for creative financing of the care provided by healthcare REITs.



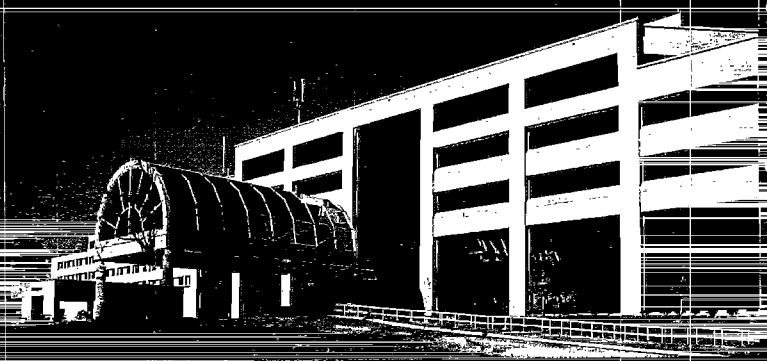
Gulf Coast Medical Center, Fort Myers, Florida (Columbia/HCA)

Hooks Medical Office Building, Richmond, Virginia (Columbia/HCA)

Candler Professional Office Building, Savannah, Georgia (Candler Health Systems)

Coral Gables Medical Plaza, Coral Gables, Florida (Orlando Health Corp.)

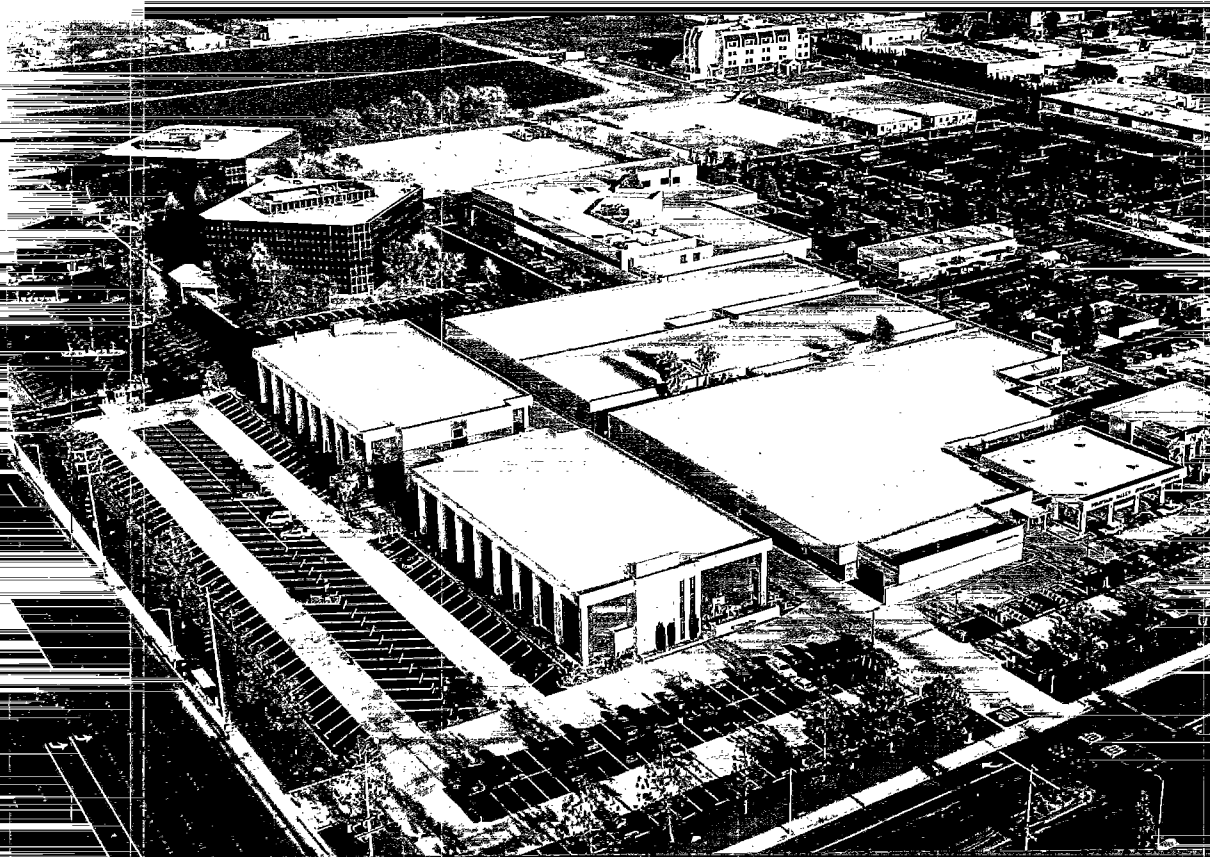




Oregon Medical Building, El Paso, Texas (Columbia/HCA)

The Atrium, Richmond, Virginia (Columbia/HCA)

Fountain Valley Ancillary Facilities, Fountain Valley, California (OrNda HealthCorp)



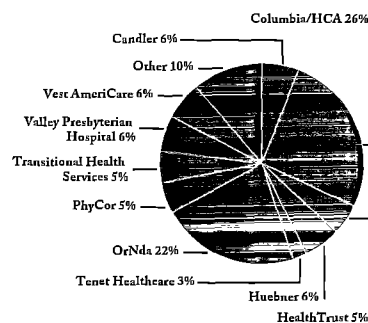
An indication of the future opportunities to provide capital and management services is the fact that healthcare REITs currently finance less than 1% of the estimated \$900 billion of existing properties that relate to the delivery of healthcare services. The growth of the healthcare REIT industry is expected to continue since it is being increasingly recognized as a viable source of long-term financing. In addition, REITs have gained wide market acceptance among investors who are providing capital to the industry. Stock market capitalization of the healthcare REIT industry now totals approximately \$5.7 billion. REITs will continue to be a major source of financing for healthcare providers as capital requirements become even more intense through the remainder of the decade, and market forces continue to shape the healthcare system.

Healthcare will continue to be a dominant industry touching the lives of every U. S. citizen. This time of revolutionary change presents an unprecedented opportunity for innovative healthcare firms. We believe that Healthcare Realty Trust, with its ability to provide a variety of real estate services and capital to finance the growth of healthcare providers, is ideally positioned to benefit from the reshaping of the healthcare delivery system.

The Company

Healthcare Realty Trust is a New York Stock Exchange listed real estate investment trust (REIT) which has invested approximately \$300,000,000 in income-producing real estate since June 1993. It is pursuing an objective of building a diversified portfolio of high-quality healthcare real estate assets. The Company is the only fully integrated, self-administered, self-managed, independent healthcare REIT with properties diversified by facility type, healthcare provider and geographic market location. The Company's current portfolio consists of 57 properties, comprised of 7 facility types, leased to 16 healthcare providers in 32 markets in 13 states nationwide.

Investment By Operator



In addition to acquisitions of existing facilities, the Company also provides property management, leasing and build-to-suit development services and capital for the construction of new facilities. Unlike other healthcare REITs which focus on financing inpatient healthcare facilities such as

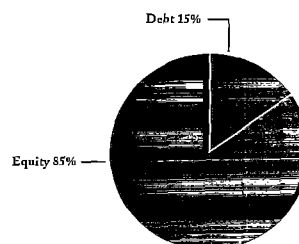
nursing homes and acute care hospitals, Healthcare Realty Trust provides capital and a full range of real estate services to the rapidly growing alternate-site and outpatient segments of the healthcare industry.

The Company is independent from its lessees and is self-administered and self-managed by an experienced executive staff and board of directors. Each has been chosen for their particular expertise in both healthcare and real estate. This independence gives the Company a strategic advantage in providing funding to a diverse group of healthcare providers. Management follows a conservative investment strategy of investing in high-quality, strategic properties operated by well-established and rapidly expanding healthcare companies that present relatively low risk. At the end of 1994, over 72% of the Company's revenue base was represented by publicly traded or investment grade credit healthcare operators including Columbia/HCA Healthcare Corporation, HealthTrust, Inc., ORNda HealthCorp, PhyCor, Inc. and Tenet Healthcare Corporation (formerly National Medical Enterprises and AMI). Other investments include facilities operated by Life Care Centers of America, National Surgery Centers and Transitional Health Services, Inc. In the not-for-profit sector, the Company owns ancil-

Valley Presbyterian Hospital, Van Nuys, California, and Candler Health Systems, Savannah, Georgia.

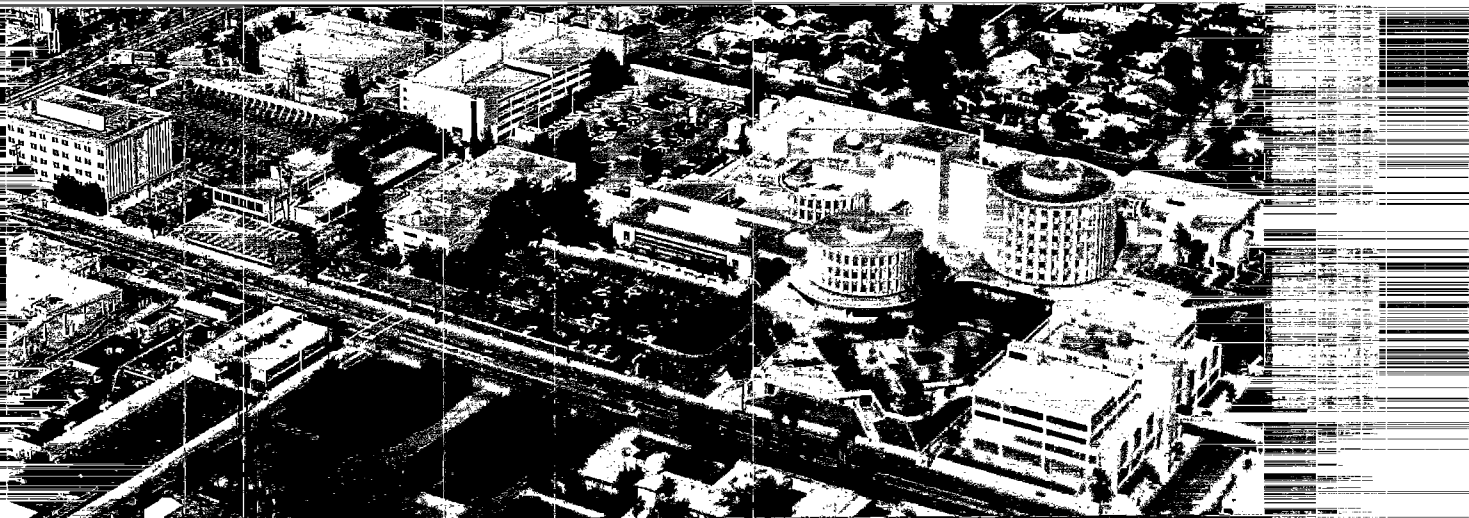
The Company's portfolio growth has been financed substantially by using equity capital to establish a stable income stream to support future cash flow requirements. It is the intent of the Company to continue its strategic focus on outpatient and alternate-site healthcare facilities. This conservative capital structure allows the Company to be selective in its asset acquisitions and in its goal to secure profitable alliances with financially sound healthcare providers.

Capitalization of the Company
December 31, 1994

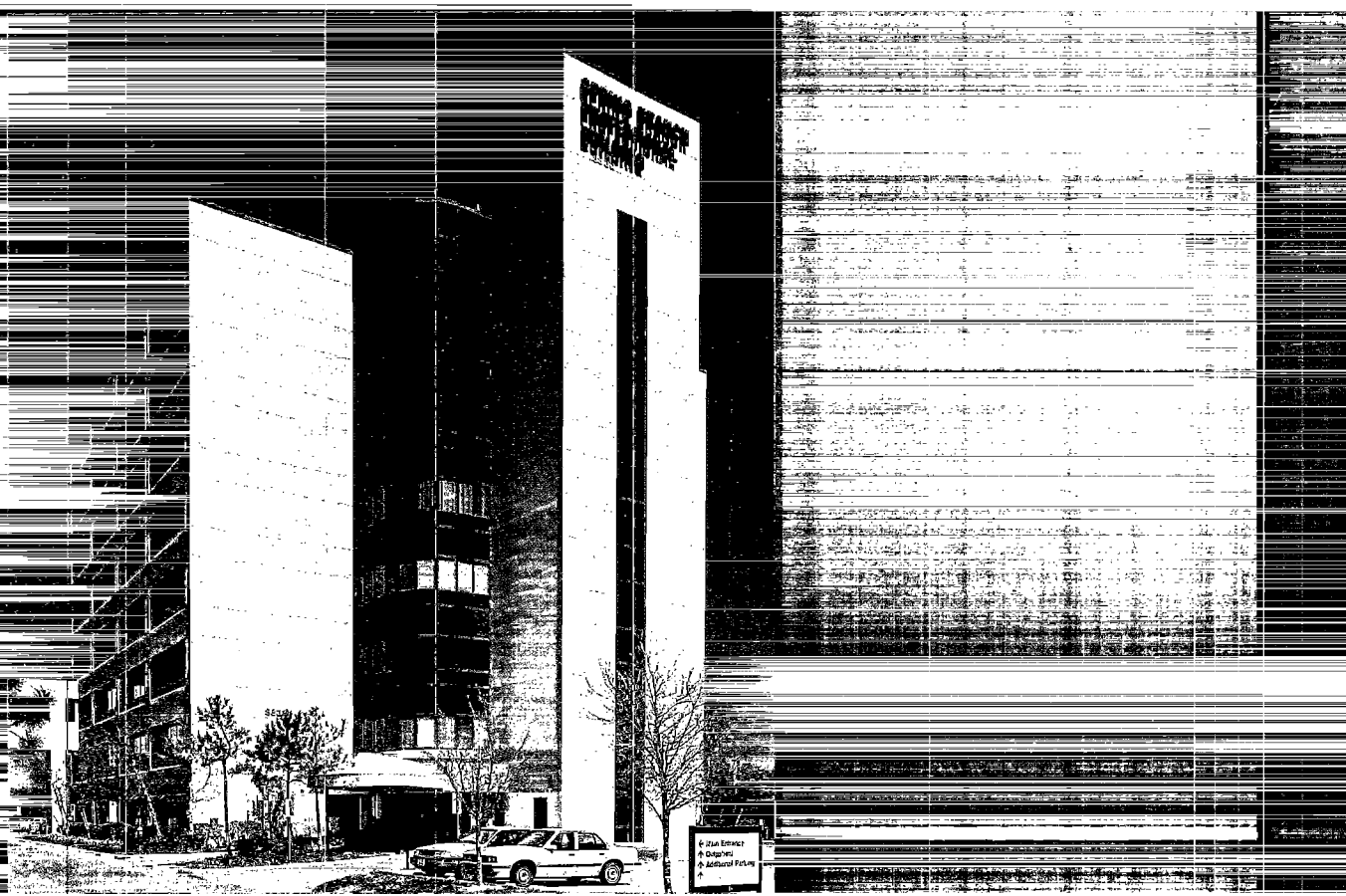


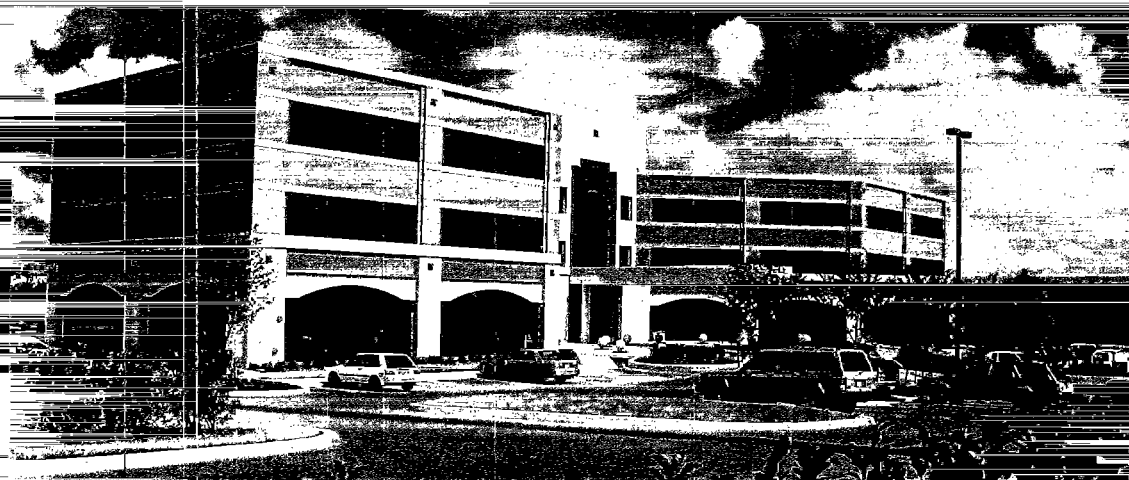
Business Focus

The Company's primary focus is to provide portfolio and cash flow growth through the development of quality relationships with financially stable, well-positioned healthcare providers. The Company believes very strongly in developing client relationships as opposed to being known as just another source of financing. This focus is proving beneficial as existing clients continue to provide additional



Valley Presbyterian Ancillary Facilities, Van Nuys, California (Valley Presbyterian)
Valley View Surgery Center, Las Vegas, Nevada (National Surgery Centers)
Spring Branch Professional Building, Houston, Texas (Columbia/HCA)



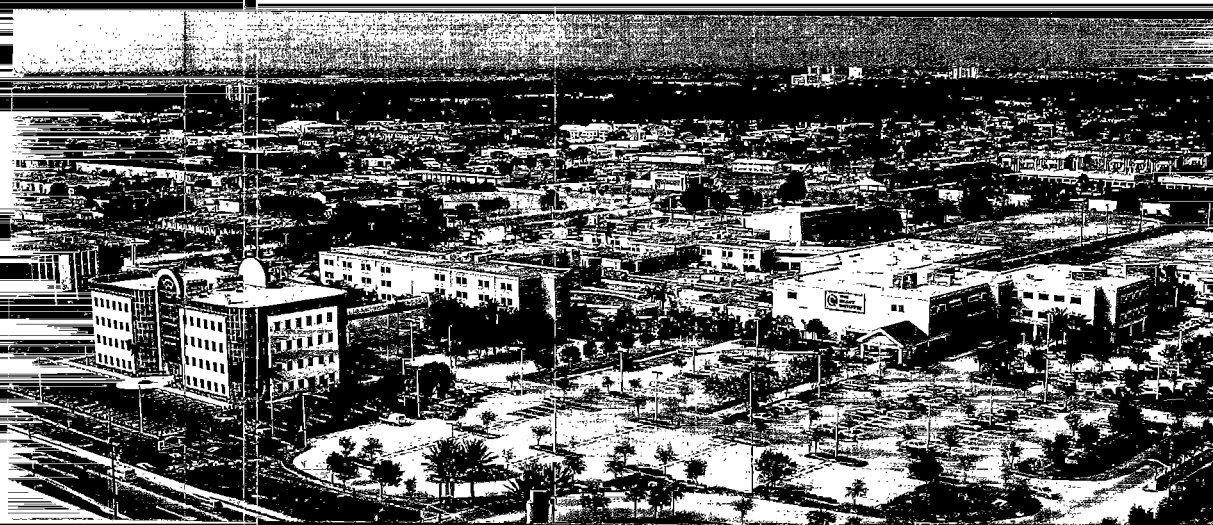
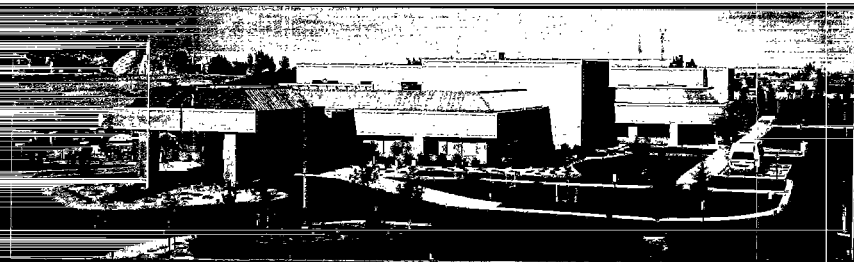


Valley Diagnostic Medical and Surgical Center, Harlingen, Texas (PhyCor)

Huebner Medical Center, San Antonio, Texas (Huebner)

Life Care Center of Aurora, Aurora, Colorado (Life Care Centers of America)

Southwest Medical Center Plaza, Fort Myers, Florida (Columbia/HCA)

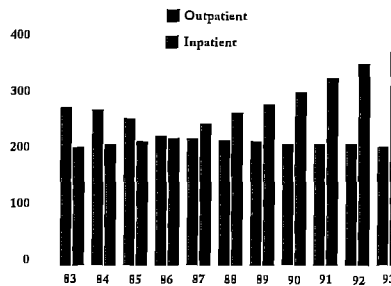


these relationships to foster continued growth and enhance our prospects for developing relationships with other strong, well-positioned healthcare providers.

The Company invests primarily in the most capital intensive and rapidly expanding sectors. The evolution in today's healthcare marketplace encourages the transition of patients from the more expensive inpatient environment into less costly alternate-site and outpatient facilities. These facilities are not burdened with the high cost structure and overhead of their inpatient counterparts, thereby providing medical care at substantially lower costs.

In the early 1970s, outpatient revenues were about three percent of total hospital revenues. Today, this amount has grown to approximately 36 percent; and by the year 2000, outpatient revenues are expected to exceed 50 percent of total hospital revenues. It is estimated that healthcare providers spent \$12 billion last year on remodeling, expansion or construction of new facilities. Importantly, approximately 85% of the funds expended were for alternate-site and outpatient service facilities. With a majority of the Company's investments in outpatient and alternate-site facilities, the Company is clearly positioned to participate in and benefit from the fastest growing sector of the healthcare industry.

**Inpatient Days / Outpatient Visits
1983-1993**



A major focus of the Company is to capitalize on its success in the not-for-profit sector. Of approximately 5,300 hospitals operating in the United States today, nearly 3,900 are not-for-profit facilities. The Company considers this sector to represent enormous opportunities. The cost containment and consolidation forces which are impacting proprietary healthcare providers are similarly affecting the not-for-profit providers. These same forces are driving all providers to consider alternative funding sources in order to conserve capital and survive in the emerging managed care environment.

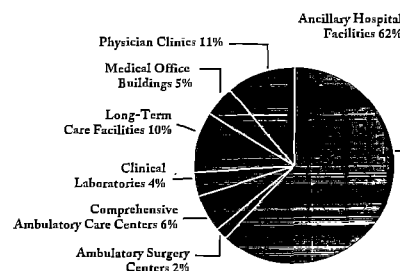
Since its inception, the Company has pursued a strategy of diversification across markets, healthcare providers and facility type. To maintain the residual values of its healthcare facilities, the Company purchases properties which are a critical part of the healthcare delivery system. In the selection of specific properties, the Company's focus is on properties which enhance diversity, have inherent franchise value and are vital to major healthcare providers' delivery of services in their local communities.

markets. It is the Company's intent to maintain market and healthcare provider diversity to avoid narrow market concentration or predominant provider reliance.

Investment Criteria

Prior to making an investment, the Company initiates a comprehensive survey of each facility being considered for inclusion in its portfolio. The due diligence process includes a thorough understanding of property franchise values and the healthcare provider's business plan. It includes the review of the financial status and the creditworthiness of the lessee. Healthcare and real estate market research and analysis are undertaken along with a thorough assessment of the growth potential of the property. In addition, an independent replacement cost analysis is conducted on every facility, along with an independent engineering report. Other investment criteria include: the opportunity for additional investments with the same lessee; sufficiency of certain lease coverage ratios; industry segment and operator diversification; alternative healthcare use of the facility; and whether the purchase of the property represents a co-investment with a major hospital operator or healthcare provider.

Investment By Facility Type



Growth Strategy

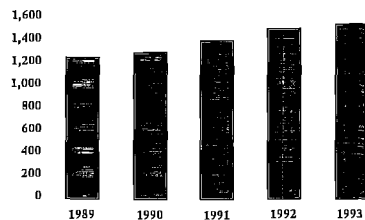
A core component of the Company's strategy is to develop sound and mutually beneficial relationships with healthcare providers in sectors which have the highest propensity for mergers, formation of strategic alliances, and the creation of service networks to achieve economies of scale. The Company's success to date has been largely based on the rapidly growing demand for alternative funding sources in the healthcare industry and its ability to meet those demands.

The Company believes that it will continue to be an attractive source of funding as the trend toward alternate-site and outpatient care continues to drive demand for capital to acquire and develop such facilities. Healthcare providers will continue to find the Company's financing attractive due to its positive impact on their earnings per share and the fact that the return objectives on their equity are considerably higher than the Company's lease rates.

There are opportunities beyond simply funding the acquisition of

providers are in need of property management and development services to allow their management and staff to focus on their core business of delivering healthcare services — not the management of real estate.

Hospitals' Admissions/Visits per 1,000 Persons



With Healthcare Realty Management, the Company will capitalize on its integration of real estate funding, management and build-to-suit development capabilities. Integrated services allow the Company to become a more valued partner in its relationships.

Due to the role conflicts inherent in physician and hospital relationships, coupled with governmental "fraud and abuse" issues, many healthcare providers are seeking independent third parties to provide professional property management. By providing these services, the Company can capture accretive income and enhance its cash flow without the investment of significant additional capital.

Given the cost-containment pressures in the healthcare industry, the need for additional liquidity and the demands for capital, there is a decline

in real estate. In a managed care/capitated payment environment, healthcare providers must have solid, meaningful information to determine the true cost of real estate assets. Real estate is the single largest asset class on most healthcare provider's balance sheets and, in most cases, is the least understood.

The Company is committed to innovation in its use of information systems. Its management information and property operational outcomes are structured to provide clients with topical and meaningful data, formulated to answer strategic queries. This dedication to providing real time information to healthcare providers is key to our strategy to advance long-term, mutually beneficial relationships.

The Company intends to continue cross-selling its property management services to existing master lease tenants. Likewise, we will seek opportunities to purchase existing facilities and provide development services to our property management customers.

As hospitals and other healthcare providers continue to form integrated market networks, new facilities are being constructed to house the various components. We expect the increasing need for new facilities will provide the Company with many build-to-suit opportunities. By constructing these strategic facilities, the Company acquires new, pre-leased, state-of-the-

its yield with development fees. In providing capital, development, leasing and management services from a single source, the Company has significant competitive advantages.

The Company will continue to focus its management resources and financial capability on those healthcare sectors which hold the greatest promise for continued growth. With the addition of Healthcare Realty Management, the Company is ideally positioned to prosper in the future of a vital industry.

The Future

During the past year, the healthcare industry has been a hotly debated subject. Concern about healthcare has ranked near the top of the opinion polls and has been a highly politicized topic. Today, most healthcare analysts believe that because market-driven forces are dictating change, the need for comprehensive governmental legislation appears remote.

Despite the national attention, healthcare is still considered to be a local issue. In the many communities across the U. S., both proprietary and not-for-profit healthcare providers require capital to continue to grow and meet the challenges of a dynamic healthcare marketplace. In this changing environment, we believe that healthcare providers will focus an increasing amount of their attention and resources on developing links

between providers, patients and payers. Hospitals, physician groups and other healthcare providers will be developing integrated networks with emphasis on alternate-site and outpatient facilities.

The Company is confident that the resurgence of the U. S. economy and the gradual strengthening of real estate values will further enhance the Company's growth and viability. Consolidation activity in the healthcare sector will increase the strength and stability of healthcare providers as they attain critical mass.

Our strategy of selectively choosing high quality healthcare providers - participants in vertically integrated healthcare delivery systems with strong positions in their markets - will enable the Company to grow and continue to provide additional value to its shareholders. Whenever there is change, there is also opportunity, and the market-driven healthcare revolution now underway enhances the Company's expectations for growth.

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SELECTED FINANCIAL INFORMATION

The following table sets forth financial information for the Company which is derived from the Financial Statements included elsewhere in this Report.

	Year Ended December 31, 1994	Commencement of Operations Through December 31, 1993 ⁽¹⁾
STATEMENT OF INCOME DATA:		
Total revenues	\$ 24,226,423	\$ 7,135,004
Interest expense	1,116,436	314,167
Net income	15,715,588	3,950,034
Net income per share	1.33	0.64
Weighted average shares outstanding	11,830,197	6,185,600

BALANCE SHEET DATA:

Real estate properties, net	\$ 280,767,098	\$ 133,392,751
Total assets	283,189,771	134,069,694
Bank credit facility	37,300,000	21,000,000
Total shareholders' equity	236,340,287	108,190,254

OTHER DATA:

Funds from operations ⁽²⁾	\$ 21,135,302	\$ 6,268,879
Funds from operations per share ⁽²⁾	\$ 1.79	\$ 1.01

(1) The Company commenced operations on June 3, 1993.

(2) Funds from operations, as defined by the National Association of Real Estate Investment Trusts, Inc., are net income (computed in accordance with generally accepted accounting principles), excluding gains (or losses) from debt restructuring and sales of property, plus depreciation and amortization. Management considers funds from operations to be an informative measure of the performance of an equity REIT and consistent with measures used by analysts to evaluate equity REITs. Funds from operations do not represent cash generated from operating activities in accordance with generally accepted accounting principles, is not necessarily indicative of cash available to fund cash needs and should not be considered as an alternative to net income as an indicator of the Company's operating performance or as an alternative to cash flow as a measure of liquidity.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

The Company was incorporated in Maryland in May 1992 and operates under the Internal Revenue Code of 1986 as an indefinite life real estate investment trust. Substantially all of the Company's revenues are derived from base and additional rentals received generally under net leases of healthcare real estate property facilities and interest earned from the temporary investment of funds in short-term instruments. The Company incurs operating and administrative expenses, principally compensation expense for its officers and other employees, office rental and related occupancy costs and various expenses incurred in the process of acquiring additional properties. As of December 31, 1994, the Company had purchased, developed or had under development 56 properties (the "Properties") for \$287,893,106 located in 32 markets within 13 states, which are leased to 16 healthcare related entities pursuant to long-term leases. The Properties include 31 ancillary hospital facilities, 4 medical office buildings, 6 physician clinics, 8 long-term care facilities, 2 comprehensive ambulatory care centers, 2 clinical laboratories, and 3 ambulatory surgery centers.

Effective January 1, 1995, the Company, through its wholly owned subsidiary, Healthcare Realty Management, acquired the assets of Starr Sanders Johnson, Inc., a leading provider of management and build-to-suit development real estate services to healthcare providers. The \$3,800,000 purchase price consisted of \$650,000 cash and 156,239 shares of the Company's common stock (valued at approximately \$3,150,000). Pending the satisfaction of certain contingencies, \$270,000 cash and 99,507 shares of common stock of the purchase price will be in escrow until December 31, 1995. The assets purchased include existing management contracts and development agreements, as well as operational assets, relating to the day-to-day management and leasing of multi-tenanted healthcare properties and to the supervision of the development of new healthcare facilities. The Company intends to derive additional revenues from these activities.

The Company is self-administered and self-managed by its executives and staff and does not engage a separate advisor or pay an advisory fee for administrative or investment services, although the Company engages legal, accounting, tax and financial advisors from time to time. The Company leverages its portfolio of real estate equity investments and will continue to incur long and short-term indebtedness and related interest expense from time to time. The Company intends to continue to declare and pay dividends to its stockholders in amounts not less than the amounts required to maintain its status as a REIT under the Internal Revenue Code and, in general, in amounts exceeding taxable income. The Company's ability to pay dividends will depend upon its funds from operations.

The Compensation Committee of the Board of Directors has established an executive compensation policy which relies substantially on at-risk pay, alignment of management and shareholder interests, and share ownership guidelines. The at-risk pay provides substantial

annual incentive opportunities as a percentage of salary which are awarded based upon the achievement of short-term goals established by the Compensation Committee. A performance-based restricted stock plan has been established, with awards based upon cumulative returns to the stockholders of the Company. Share ownership guidelines will be established for each executive to further link executive and shareholder financial interests.

Results of Operations

For the Period January 1, 1994 through December 31, 1994

For the period from January 1, 1994 through December 31, 1994, net income was \$15,715,588, or \$1.33 per share of common stock, on revenues of \$24,226,423. Funds from operations were \$1.79 per share. The Company was organized to qualify as an indefinite life real estate investment trust ("REIT") and commenced operations on June 3, 1993 with the receipt of proceeds from the sale of 6,000,000 shares of common stock. Accordingly, the Company has a limited history, and comparative operating results for the year ended December 31, 1994, and the interim period ended December 31, 1993, are not meaningful.

The Company's future results of operations will be influenced by the terms of any subsequent investments the Company may make, as well as its ability to generate revenues from the management and development services performed by Healthcare Realty Management. There can be no assurance that the Company will be able to purchase or develop additional properties or to lease to others on suitable terms or to successfully market the services offered by Healthcare Realty Management.

Management believes that inflation should not have a materially adverse effect on the Company. The majority of the leases contain some provision for additional rent payments based on increases in various economic measures.

Liquidity and Capital Resources

On February 16, 1994, the Company completed a secondary offering of 6,250,000 shares of its common stock. The proceeds from the secondary offering, net of underwriting discounts and commissions and securities issuance expenses, were approximately \$125,200,000. Additionally, effective June 30, 1994, the Company acquired two ancillary hospital facility complexes in exchange for an aggregate of 328,322 shares of the Company's common stock (valued at \$6,898,944 as of the date of closing) and retained debt secured by the properties of \$3,075,000.

The Company has a \$75 million Bank Credit Facility from four commercial banks that may be used to finance the acquisition or development of additional properties and for general corporate purposes. Borrowings under the Bank Credit Facility bear interest, at the option of the Company, at the base rate of NationsBank, National Association plus one-half of one percent (.5%) or at LIBOR plus 2%.

The Company pays a commitment fee of one-half of one percent (.5%) per annum on the unused portion of funds available for borrowing under the Bank Credit Facility which will be available until August 2, 1997. The Bank Credit Facility is unsecured and contains certain representations, warranties and financial and other covenants customary in such loan agreements. At December 31, 1994, \$37.3 million was outstanding under the Bank Credit Facility. As of December 31, 1994, the Company had stockholders' equity of \$236,340,287. Its ratio of long-term debt to equity was .17 as of December 31, 1994.

As of December 31, 1994, the Company, in the normal course of business, has received fully executed non-binding letters of intent to acquire or fund development of six properties for approximately \$25,600,000. The acquisition of these properties is contingent upon the negotiation of definitive sale and purchase documents and the availability of acceptable financing sources. The Company has also entered into a definitive agreement to purchase two facilities, upon completion, for \$12,600,000, which are under construction and are being financed in the interim by a bank. In addition, as of December 31, 1994, the Company had a net investment of \$3,400,000 for lessee developments in progress with a total funding commitment of approximately \$11,100,000.

The Company may, under certain circumstances, borrow additional amounts in connection with the renovation or expansion of its properties, the acquisition or development of additional properties or, as necessary, to meet distribution requirements for REITs under the Code. The Company may raise additional capital or make investments by issuing, in public or private transactions, its equity and debt securities, but the availability and terms of any such issuance will depend upon market and other conditions. Although management believes that the Company will be able to obtain additional financing or capital on terms acceptable to the Company in sufficient amounts to meet its liquidity needs, there can be no assurance that such additional financing or capital will be available on terms acceptable to the Company.

Under the terms of the leases relating to the properties, the lessees are responsible for all operating expenses and taxes. As a result of these arrangements, the Company does not believe it will be responsible for any major expenses in connection with the properties during the lease term. The Company anticipates entering into similar leases with respect to any additional properties. After the lease term, or in the event a lessee is unable to meet its obligations, the Company anticipates that any expenditures it might become responsible for in maintaining the properties will be funded by cash from operations and, in the case of major expenditures, possibly by borrowings. To the extent that unanticipated expenditures or significant borrowings are required, the Company's cash available for distribution and liquidity may be adversely affected.

On January 24, 1995, the Company declared an increase in its quarterly dividend from \$.445 per share (\$1.78 annualized) to \$.45 per share (\$1.80 annualized) payable to stockholders of record on February 1, 1995. This dividend was paid on February 15, 1995. The Company presently plans to continue to pay its quarterly dividends, with increases consistent with its current practice. In the event that the Company cannot make additional investments in 1995 because of an inability to obtain new capital by issuing equity and debt securities, the Company will continue to be able to pay its dividends in a manner consistent with its current practice. No assurance can be made as to the effect upon the Company's ability to increase its quarterly dividends during periods subsequent to 1995, should access to new capital not be available to the Company.

The Company generated net cash from operations in 1994 of \$21,348,037. The funds were used in 1994, along with the net proceeds of the secondary offering of approximately \$125,200,000 and financings of \$40,300,000, to make additional investments in income producing assets and real estate properties totaling \$130,795,615. Funds were also used to retire debt of \$37,018,633 and to pay dividends to stockholders of \$19,410,538.

REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Stockholders
Healthcare Realty Trust Incorporated

We have audited the accompanying consolidated balance sheets of Healthcare Realty Trust Incorporated as of December 31, 1994 and 1993, and the related consolidated statements of income, stockholders' equity, and cash flows for the year ended December 31, 1994 and the period from June 3, 1993 (commencement of operations) through December 31, 1993. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Healthcare Realty Trust Incorporated at December 31, 1994 and 1993, and the consolidated results of operations and cash flows for the year ended December 31, 1994 and the period from June 3, 1993 (commencement of operations) through December 31, 1993, in conformity with generally accepted accounting principles.

Ernst & Young LLP

Nashville, Tennessee
January 24, 1995

CONSOLIDATED BALANCE SHEETS

	December 31,	
	1994	1993
ASSETS		
Real estate properties:		
Land	\$ 39,606,239	\$ 16,949,171
Buildings and improvements	243,450,248	117,068,912
Personal property	1,437,217	1,073,509
Construction in progress	3,399,402	133,841
	<u>287,893,106</u>	<u>135,225,433</u>
Less accumulated depreciation	(7,126,008)	(1,832,682)
Total real estate properties	<u>280,767,098</u>	<u>133,392,751</u>
Cash and cash equivalents	496,852	98,456
Restricted cash	520,187	—
Receivables	637,100	49,487
Deferred costs, net	504,969	223,916
Other assets	263,565	305,084
Total assets	<u>\$ 283,189,771</u>	<u>\$ 134,069,694</u>

LIABILITIES AND STOCKHOLDERS' EQUITY

Liabilities:		
Notes and bonds payable	\$ 40,375,000	\$ 21,000,000
Security deposits payable	4,819,772	4,407,658
Accounts payable and accrued liabilities	1,385,754	435,558
Deferred income	268,958	36,224
Total liabilities	<u>46,849,484</u>	<u>25,879,440</u>
Commitments and contingencies	—	—
Stockholders' equity:		
Preferred stock, \$.01 par value, 50,000,000 shares authorized; none outstanding	—	—
Common stock, \$.01 par value; 150,000,000 shares authorized; 12,803,397 issued and outstanding at December 31, 1994 and 6,185,600 at December 31, 1993	128,034	61,856
Additional paid-in capital	239,960,743	107,586,630
Deferred compensation	(595,308)	—
Cumulative net income	19,665,622	3,950,034
Cumulative dividends	(22,818,804)	(3,408,266)
Total stockholders' equity	<u>236,340,287</u>	<u>108,190,254</u>
Total liabilities and stockholders' equity	<u>\$ 283,189,771</u>	<u>\$ 134,069,694</u>

CONSOLIDATED STATEMENTS OF INCOME

	Year ended December 31, 1994	Period from June 3, 1993 (commencement of operations) through December 31, 1993
REVENUES:		
Base rental income	\$ 23,231,345	\$ 7,066,606
Interest income	995,078	68,398
	<u>24,226,423</u>	<u>7,135,004</u>
EXPENSES:		
General and administrative	1,923,782	551,958
Depreciation	5,233,474	1,832,682
Amortization and other noncash charges	237,143	486,163
Interest	1,116,436	314,167
	<u>8,510,835</u>	<u>3,184,970</u>
Net income	\$ 15,715,588	\$ 3,950,034
Net income per share	\$ 1.33	\$ 0.64
Weighted average shares outstanding	<u>11,830,197</u>	<u>6,185,600</u>

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	Common Stock		Additional	Deferred	Cumulative	Cumulative	Total
	Shares	Amount	Paid-In Capital	Compensation	Net Income	Dividends	Stockholders' Equity
Balance at June 3, 1993	185,600	\$ 1,856	\$ —	\$ —	\$ —	\$ —	\$ 1,856
Issuance of stock	6,000,000	60,000	107,586,630	—	—	—	107,646,630
Net income	—	—	—	—	3,950,034	—	3,950,034
Dividends (\$.55 per share)	—	—	—	—	—	(3,408,266)	(3,408,266)
Balance at December 31, 1993	6,185,600	61,856	107,586,630	—	3,950,034	(3,408,266)	108,190,254
Issuance of stock	6,582,797	65,828	131,687,588	—	—	—	131,753,416
Shares awarded as deferred stock compensation	35,000	350	686,525	(686,875)	—	—	—
Deferred stock compensation amortization	—	—	—	91,567	—	—	91,567
Net income	—	—	—	—	15,715,588	—	15,715,588
Dividends (\$1.75 per share)	—	—	—	—	—	(19,410,538)	(19,410,538)
Balance at December 31, 1994	12,803,397	\$ 128,034	\$ 239,960,743	\$ (595,308)	\$ 19,665,622	\$ (22,818,804)	\$ 236,340,287

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year ended December 31, 1994	Period from June 3, 1993 (commencement of operations) through December 31, 1993
OPERATING ACTIVITIES		
Net income	\$ 15,715,588	\$ 3,950,034
Adjustments to reconcile net income to cash provided by operating activities:		
Amortization and depreciation	5,419,702	2,291,865
Increase in deferred income	232,734	36,224
Increase in receivables	(579,894)	(49,487)
(Increase) decrease in other assets	373,746	(34,727)
Increase in accounts payable and accrued liabilities	186,161	156,997
Net cash provided by operating activities	21,348,037	6,350,906
INVESTING ACTIVITIES		
Acquisition of real estate properties	(130,795,615)	(135,116,136)
Receipt of security deposits	412,114	4,407,658
Net cash used in investing activities	(130,383,501)	(130,708,478)
FINANCING ACTIVITIES		
Borrowings on short-term notes payable	-	2,350,000
Borrowings on long-term notes payable	40,300,000	24,000,000
Repayments on short-term notes payable	-	(2,350,000)
Repayments on long-term notes payable	(37,018,633)	(3,000,000)
Increase in restricted cash	(64,277)	-
Deferred financing and organization costs paid	(463,884)	(784,192)
Dividends paid	(19,410,538)	(3,408,266)
Proceeds from issuance of common stock	126,091,192	107,646,630
Net cash provided by financing activities	109,433,860	124,454,172
Increase in cash and cash equivalents	398,396	96,600
Cash and cash equivalents, beginning of period	98,456	1,856
Cash and cash equivalents, end of period	\$ 496,852	\$ 98,456

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Organization

Healthcare Realty Trust Incorporated (the "Company") was incorporated on May 13, 1992, in the state of Maryland. The Company completed an initial public offering of 6,000,000 shares of common stock (the "Offering") and commenced operations on June 3, 1993, with the receipt of proceeds from the Offering.

The Company was organized to invest in healthcare related properties located throughout the United States, including ancillary hospital facilities, medical office buildings, physician clinics, long-term care facilities, comprehensive ambulatory care centers, clinical laboratories and ambulatory surgery centers. As of December 31, 1994, the Company had purchased, developed or had under development, 56 properties (the "Properties") for \$287,893,106 located in 13 states, which are leased to 16 healthcare related entities pursuant to long-term leases. The Properties include 31 ancillary hospital facilities, 4 medical office buildings, 6 physician clinics, 8 long-term care facilities, 2 comprehensive ambulatory care center, 2 clinical laboratories, and 3 ambulatory surgery centers.

Basis of Presentation

The audited financial statements include the accounts of the Company and its wholly owned subsidiaries. Significant intercompany accounts and transactions have been eliminated.

Real Estate Properties

Real estate properties are recorded at cost. Transaction fees and acquisition costs are netted with the purchase price as appropriate. No allowance for investment losses is considered necessary. The cost of real properties acquired is allocated between land, buildings and fixtures, and personal property based upon estimated market values at the time of acquisition. Depreciation is provided for on a straight-line basis over the following estimated useful lives:

Buildings and fixtures	31.5 or 39.0 years
Personal property	7.0 years

Cash and Cash Equivalents

Short-term investments with maturities of three months or less at date of purchase are classified as cash equivalents.

Federal 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 95% 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.

Deferred Costs

Included in deferred costs are charges incurred in obtaining financing and organizational costs. Deferred financing costs are amortized over the term of the credit facility. Organizational costs are amortized straight-line over five years. Accumulated amortization of deferred costs was \$148,065 and \$459,183 at December 31, 1994 and 1993, respectively. During 1994, the Company wrote off \$437,500 in deferred costs which became fully amortized in 1993.

Revenue Recognition

Rental income is recognized as earned over the life of the lease agreements. Any additional rent, as defined in each lease agreement, is recognized as earned.

Net Income Per Share

Net income per share is computed using the weighted average number of shares outstanding during the period, exclusive of common stock equivalents, which resulted in dilution of less than 3% for both the year ended December 31, 1994, and the period from June 3, 1993, through December 31, 1993.

Supplementary Income Per Common Share

As required by APB Opinion No. 15, "Earnings per Share," supplementary income per common share data is presented for fiscal 1994 to reflect the payment during February 1994 of \$23.1 million of outstanding indebtedness using a portion of the proceeds of a offering (see Note 10). For the computation of the supplementary income per common share, 1,080,700 common shares issued in the public offering whose proceeds were used to retire the debt were assumed to have been issued at the beginning of fiscal 1994 and net income was assumed to have not been reduced by interest expense incurred on the debt. Supplementary income per common share totaled \$1.33 for fiscal 1994.

Reclassifications

Certain reclassifications have been made in the financial statements for the period from June 3, 1993, to December 31, 1993, to conform to the 1994 presentation. These reclassifications had no effect on the results of operations as previously reported.

2. Real Estate Property Leases

The Company's properties are generally leased pursuant to noncancelable, fixed-term operating leases with expiration dates from 2003 to 2013. Some leases provided for fixed rent renewal terms of five years, or multiples thereof, in addition to market rent renewal terms. The leases generally provide the lessee, during the term of the lease and for a short period thereafter, with the right of first refusal to purchase the leased property on the same terms and conditions as an acceptable third party offer.

Each lease generally requires the lessee to pay minimum rent, additional rent based upon increases in the Consumer Price Index or increases in net patient revenues (as defined in the lease agreements), and all taxes (including property tax), insurance, maintenance and other operating costs associated with the leased property. During the year ended December 31, 1994, \$65,354 in additional rents were earned. During the period from June 3, 1993, through December 31, 1993, no additional rents were earned.

Amounts of rental income received from lessees who accounted for more than 10% of the Company's rental income for the year ended December 31, 1994, were: Columbia/HCA Healthcare Corporation--\$5,667,948, and OrNda HealthCorp--\$4,086,002. Amounts of rental income received from lessees who accounted for more than 10% of the Company's rental income for the period from June 3, 1993, through December 31, 1993, were: Columbia Healthcare Corporation--\$1,083,771; HCA-Hospital Corporation of America--\$750,646; PhyCor, Inc.--\$844,282; Valley Presbyterian Hospital--\$1,028,037; Transitional Health Services, Inc.--\$984,339; and Huebner Medical Center--\$713,000.

Future minimum lease payments under the noncancelable operating leases as of December 31, 1994 are as follows:

1995	\$ 31,049,680
1996	31,148,876
1997	31,226,105
1998	31,300,671
1999	31,363,759
2000 and thereafter	250,452,950
	<u>\$ 406,542,041</u>

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3. Real Estate Properties

The following table summarizes the Company's real estate properties by type of facility and by state as of December 31, 1994.

	Number of Facilities (1)	Land	Buildings and Improvements and CIP	Personal Property	Total	Accumulated Depreciation
<i>Ancillary hospital facilities:</i>						
Arizona	1	\$ 308,070	\$ 4,965,923	\$ -	\$ 5,273,993	\$ 243,082
California	7	14,847,288	31,236,745	56,788	46,140,821	840,658
Florida	5	532,112	28,264,620	-	28,796,732	330,049
Georgia	5	1,965,210	20,929,926	38,409	22,933,545	377,022
Tennessee	1	395,056	2,643,834	-	3,038,890	42,369
Texas	8	6,371,655	42,579,011	259,534	49,210,200	1,711,509
Virginia	4	2,787,142	20,301,080	-	23,088,222	225,541
	31	27,206,533	150,921,139	354,731	178,482,403	3,770,230
<i>Ambulatory surgery centers:</i>						
California	1	209,246	828,613	8,370	1,046,229	42,354
Nevada	1	940,000	2,760,263	-	3,700,263	33,618
Texas	1	509,891	1,514,376	15,296	2,039,563	77,407
	3	1,659,137	5,103,252	23,666	6,786,055	153,379
<i>Comprehensive ambulatory care:</i>						
Texas	2	601,475	13,424,174	60,147	14,085,796	554,626

Continued from previous page.

	Number of Facilities (1)	Land	Buildings and Improvements and CIP	Personal Property	Total	Accumulated Depreciation
<i>Clinical laboratories:</i>						
Alabama	1	180,633	8,601,151	8,028	8,789,812	422,747
Mississippi	1	537,660	3,718,165	29,660	4,285,485	120,346
	2	718,293	12,319,316	37,688	13,075,297	543,093
<i>Long-term care facilities:</i>						
California	1	1,361,952	11,325,746	—	12,687,698	108,901
Colorado	1	1,651,477	4,579,039	—	6,230,516	44,029
Indiana	1	96,059	3,511,750	32,332	3,640,141	178,829
Michigan	5	193,096	10,493,466	182,986	10,869,548	552,870
	8	3,302,584	29,910,001	215,318	33,427,903	884,629
<i>Medical office buildings:</i>						
Florida	1	45,216	4,395,234	—	4,440,450	15,823
Texas	1	166,123	1,544,798	—	1,710,921	17,406
Virginia	2	107,473	1,706,875	126,790	1,941,138	110,723
	4	318,812	7,646,907	126,790	8,092,509	143,952
<i>Physician clinics:</i>						
Florida	3	3,558,945	14,833,318	50,781	18,443,044	506,078
Georgia	1	586,435	2,087,444	—	2,673,879	42,358
Texas	2	1,654,025	10,604,099	74,882	12,333,006	428,283
	6	5,799,405	27,524,861	125,663	33,449,929	976,719
Corporate property		—	—	493,214	493,214	99,380
Total property	56	\$ 39,606,239	\$ 246,849,650	\$ 1,437,217	\$ 287,893,106	\$ 7,126,008

(1) Includes four properties under construction.

During June 1994, the Company acquired two ancillary hospital facility complexes in exchange for an aggregate of 328,322 shares of the Company's common stock (valued at \$6,898,944) and the assumption of \$13,018,633 of notes payable, \$3,075,000 of bonds payable and \$623,465 of accounts payable and accrued liabilities. In addition to the facilities, representing an aggregate investment of \$21,774,433, the Company acquired cash of \$1,258,910, accounts receivable of \$7,719, restricted cash of \$455,910, and other assets of \$119,071. During the first week of July 1994, the Company repaid the \$13,018,633 of notes payable assumed in the acquisitions.

4. Notes and Bonds Payable

Notes and bonds payable at December 31 consisted of the following:

	December 31	
	1994	1993
Revolving line of credit	\$ 37,300,000	\$ 21,000,000
Serial and term bonds payable	3,075,000	—
	<u>\$ 40,375,000</u>	<u>\$ 21,000,000</u>

Revolving Line of Credit

Effective in September 1993, the Company entered into a \$25,000,000 Revolving Credit Facility (the Credit Facility) with two commercial banks, which was amended in August 1994 to include two additional commercial banks as lenders and to increase the maximum borrowing amount to \$75,000,000.

The Credit Facility matures August 2, 1997. At the option of the Company, borrowings bear interest at the Banks' base rate plus one-half of 1% or LIBOR plus 2.0%. In addition, the Company will pay a commitment fee of one-half of 1% per annum on the unused portion of funds available for bor-

rowings under the Credit Facility. Under covenants of the Credit Facility, the Company is generally required to maintain minimum shareholders' equity of \$200,000,000 and meet certain other financial covenants.

At December 31, 1994, the Company had \$37,700,000 available under the Credit Facility, with an effective interest rate of 8.2%.

Serial and Term Bonds Payable

In conjunction with the acquisition of certain facilities (see Note 3), the Company assumed an obligation for \$1,095,000 of Serial Bonds and \$1,980,000 of Term Bonds (collectively, the "Bonds"). The obligation is secured by a deed of trust and security agreement granting the issuer a first mortgage lien and security interest in these properties and by assignment of and a security interest in the tenant leases of these properties.

The Serial Bonds pay interest semiannually on October 1 and April 1 at interest rates ranging from 6.90% to 7.50% and mature at annual intervals from April 1, 1995, to April 1, 2002, in amounts ranging from \$105,000 to \$175,000. The Term Bonds pay interest semiannually on October 1 and April 1 at an 8.10% interest rate and are subject to mandatory redemption, without premium, at annual intervals from April 1, 2003, to April 1, 2010, in amounts ranging from \$185,000 to \$320,000. Bonds maturing on or after April 1, 1999, are subject to optional redemption at the discretion of the Company from April 1, 1998, to March 31, 2000, from 101% to 102% of principal amount and thereafter without premium.

The Company is obligated to pay the principal due each April 1 in equal, monthly installments over the 12-month periods ending on such date and to pay the interest due each October 1 and April 1 in equal, monthly installments over the six-month periods ending on such dates. These payments are accumulated in a Bond Fund established pursuant to an indenture of trust (the "Indenture"). Amounts held in the Bond Fund are restricted to payment of the principal of and interest and premium on the Bonds. At December 31, 1994, the balance in the Bond Fund was \$158,670.

A Debt Service Reserve Fund is maintained pursuant to the Indenture for the purpose of replenishing the Bond Fund should amounts held therein be insufficient to pay principal of and interest and premium on the Bonds as such amounts become due. To the extent that amounts held in the Debt Service Reserve Fund drop below the level prescribed by the Indenture, the Company is obligated under the Note to restore these amounts to that level. At December 31, 1994, the balance in the Debt Service Reserve Fund was \$361,517.

Other Long-Term Debt Information

Future maturities of long-term debt are as follows:

1995	\$ 105,000
1996	115,000
1997	37,420,000
1998	130,000
1999	140,000
2000 and thereafter	2,465,000
	<u>\$ 40,375,000</u>

During the year ended December 31, 1994, and the period from June 3, 1993, through December 31, 1993, interest paid totaled \$1,268,680 and \$216,533, and capitalized interest totaled \$424,675 and \$-0-, respectively.

5. Security Deposits and Letters of Credit

The Company is currently obligated to certain lessees, under executed sale and purchase agreements, for security and related deposits in an aggregate amount of \$4,819,772 and \$4,407,658 at December 31, 1994 and 1993, respectively. These security deposits are repayable at various times, typically upon expiration of the lease, and generally bear interest at the First National Bank of Boston prime rate, payable quarterly or annually.

In addition, the Company is currently holding letters of credit, from lessees, in the aggregate amount of \$1,309,219.

The security deposits and letters of credit were negotiated with lessees as part of the terms of the sale and purchase agreements as collateral for lessee performance for future rental payments and property maintenance in accordance with the lease agreements. These funds are unrestricted according to the terms of the lease contracts and may be used at the Company's discretion.

6. Benefit Plans

Executive Retirement Plan

The Company has an Executive Retirement Plan, under which an executive designated by the Compensation Committee of the Board of Directors may receive upon normal retirement (defined to be when the executive reaches age 65 and has completed five years of service with the Company) 60% of that executive's final average earnings (defined as the average of the executive's highest three years' earnings) plus 6% of final average earnings times years of service after age 60 (but not more than five years), less 100% of benefits paid to the executive from any basic retirement plan of the Company that covers all employees and from social security.

Retirement Plan for Outside Directors

The Company has a retirement plan for outside directors, which upon retirement will pay annually, for a period not to exceed 15 years, an amount equal to the director's pay immediately preceding retirement from the Board.

Benefit Plan Information

Net expense for both the Executive Retirement Plan and the Retirement Plan for Outside Directors (the "Plans") for the year ended December 31, 1994, and the period from June 3, 1993, through December 31, 1993, was \$170,446 and \$27,000, respectively. The net retirement expense for the periods is comprised of the following:

	1994	1993
Service cost	\$ 294,528	\$ 65,300
Interest cost	13,099	—
Other cost	3,389	—
Amount allocated to property acquisition costs	(140,570)	(38,300)
	<u>\$ 170,446</u>	<u>\$ 27,000</u>

The Plans are unfunded and benefits will be paid from earnings of the Company. The following table sets forth the benefit obligations at December 31, 1994 and 1993.

	1994	1993
Actuarial present value of benefit obligations:		
Vested	\$ —	\$ —
Accumulated	\$ 205,827	\$ 65,300
Actual present value of projected benefit obligations for services rendered to date	\$ 469,929	\$ 77,600
Unrecognized net loss	(81,313)	—
Net pension liability in accrued liabilities	<u>\$ 388,616</u>	<u>\$ 77,600</u>

Assumptions used in accounting for the retirement plans were as follows:

	Executive Retirement Plan	Retirement Plan for Outside Directors
Discount rates	8%	8%
Compensation increase rate	5%	Not Applicable

Deferred Compensation Plan

The Company has a Deferred Compensation Plan, under which eligible participants may elect to defer and invest a portion of their compensation. One-half of the deferred amount will be matched by the Company up to 4% of a participant's gross compensation for the plan year. All amounts in an account of a participant are fully vested at all times and may be withdrawn by a participant 30 days following such participant's termination of employment. No expense was incurred with respect to this plan for either the year ended December 31, 1994, or the period from June 3, 1993, to December 31, 1993.

7. Stock Incentive Plans

1993 Employees Stock Incentive Plan

The Company may issue stock representing up to 5% of its outstanding shares of Common Stock (640,170 and 309,280 shares at December 31, 1994 and 1993, respectively, under the 1993 Employees Stock Incentive Plan ("Employee Plan"). Under the Employee Plan, the Employee Stock Option Committee appointed by the Board of Directors may grant to employees incentive stock awards or options to purchase shares of the Company's Common Stock for terms not longer than 10 years, at prices to be determined by the Board of Directors or the Employee Stock Option Committee, which may not be less than 95% of the fair market value of the Common Stock on the date of grant. Incentive stock awards or options granted under the Employee Plan may be subject to any conditions set by the Employee Stock Option Committee, may be exercised by payment of cash, shares

valued at fair market value, or, at the option of the Employee Stock Option Committee, by a note secured by shares. Unless terminated earlier, the Employee Plan will terminate on January 1, 2003.

As of December 31, 1994 and 1993, options to purchase 225,000 shares (at \$19.50 per share) were outstanding under the Employee Plan, all of which were exercisable as of December 31, 1994. No options were exercisable at December 31, 1993. Options available for future issuance under the plan covered 415,170 and 84,280 shares at December 31, 1994 and 1993, respectively.

1993 Outside Directors Stock Incentive Plan

The Company may issue stock options for up to 2% of its outstanding shares of Common Stock (256,068 and 123,712 shares at December 31, 1994 and 1993, respectively) under the 1993 Outside Directors Stock Incentive Plan (the "Director Plan"). The Director Plan became effective as of June 3, 1993. Under the Director Plan, members of the Board of Directors of the Company who are not employees of the Company or its subsidiaries or affiliates received an option to purchase 3,000 shares of Common Stock at an exercise price equal to the Offering price. Such directors will also receive an option to purchase an additional 3,000 shares on the first trading date of each year beginning in January 1994 at an exercise price equal to the market price of the Common Stock on the date of grant. The options, which may not be exercised for one year from the date of grant, terminate ten years from the date of grant.

As of December 31, 1994 and 1993, options to purchase 40,530 shares (at \$19.50 to \$23.38 per share) and 21,000 shares (at \$19.50 per share), respectively, were outstanding under the Director Plan, 19,530 of which were exercisable as of December 31, 1994, at \$19.50 per share. Options available for future issuance under the plan covered 214,068 and 102,712 shares at December 31, 1994 and 1993, respectively. During 1994, the Company issued 1,470 shares (at \$19.50 per share) for options exercised.

8. Commitments

At December 31, 1994, the Company, in the normal course of business, has received fully executed letters of intent to acquire or fund development of six properties for approximately \$25,600,000. The Company has also entered into a definitive agreement to purchase two facilities upon completion for \$12,600,000 which are under construction and are being financed in the interim by a bank. The acquisition of these properties is contingent upon the negotiation of definitive sale and purchase documents and the availability of acceptable financing sources. In addition, as of December 31, 1994, the Company had a net investment of \$3,400,000 for lessee developments in progress with a total funding commitment of approximately \$11,100,000.

9. Related Party Transactions

In June 1993, the Company reimbursed approximately \$1,825,000 of actual costs incurred by The Emery Partnership (a partnership controlled by the President of the Company) and its affiliates on behalf of the Company in connection with the Company's initial public offering, including salaries of \$227,000 accrued from January 1, 1993, through May 31, 1993, for David R. Emery, Timothy G. Wallace, Kenneth D. Stach, and Fredrick M. Langreck. Such reimbursement also included a consultant's fee that Mr. Langreck was paid for services performed in 1992 on behalf of the Company, reimbursement to The Emery Partnership for a portion of its rent and office expenses, and \$1,464,000 for payments to unaffiliated third parties for services rendered on behalf of the Company.

Two of the Company's properties were purchased in June 1993 for an aggregate of \$14,421,250 from and are leased by the Company to PhyCor, Inc. The amount of rental income received from Phycor was \$1,623,091 and \$844,282 for the year ended December 31, 1994, and the period from June 3, 1993, through December 31, 1993, respectively. A director of the Company is a founder and Executive Vice President of PhyCor, Inc. The director received no personal benefit as a result of this transaction.

10. Stockholders' Equity

On February 16, 1994, the Company completed a secondary offering of 6,250,000 shares of common stock. Proceeds from the secondary offering, net of underwriting discounts and commissions and securities issuance expenses, were approximately \$125,200,000.

At December 31, 1994, the Company has reserved 894,768 shares for issuance under the Employee Stock Incentive Plan and the Outside Directors Stock Incentive Plan. In addition, during 1994, the Company issued 3,005 shares for proceeds of \$56,959, pursuant to the Company's Dividend Reinvestment Plan. At December 31, 1994, the Company has 996,995 shares reserved for future issuance under the Dividend Reinvestment Plan.

In connection with the acquisition of certain properties, the Company issued warrants to purchase up to 188,712 additional reserved shares of Common Stock (the "Warrants"). The Warrants are exercisable for a period of four years commencing July 1, 1994, at a price of \$19.50 per share, subject to adjustment under applicable antidilution provisions. The holders of the Warrants and underlying Common Stock shall have the right to require the Company to include the Common Stock underlying such Warrants in any registration statement filed by the Company at the Company's expense.

In May 1994, the Company issued 35,000 shares of restricted common stock to an officer of the Company as compensation. The restricted shares were awarded with a fixed restriction period of five years. The officer has the right to receive cash dividends and the right to vote the restricted shares. If the officer voluntarily terminates his employment with the Company before the end of the five-year restriction period the shares will be forfeited to the Company at no cost.

11. Other Data--Funds From Operations

Funds from operations, as defined by the National Association of Real Estate Investment Trusts, Inc., are net income (computed in accordance with generally accepted accounting principles), excluding gains (or losses) from debt restructuring and sales of property, plus depreciation and amortization. Management considers funds from operations to be an informative measure of the performance of an equity REIT and consistent with measures used by analysts to evaluate equity REITs. Funds from operations do not represent cash generated from operating activities in accordance with generally accepted accounting principles, is not necessarily indicative of cash available to fund cash needs and should not be considered as an alternative to net income as an indicator of the Company's operating performance or as an alternative to cash flow as a measure of liquidity. Funds from operations for the year ended December 31, 1994, and for the period from June 3, 1993, (commencement of operations) through December 31, 1993, were \$21,135,302 (\$1.79 per share) and \$6,268,879 (\$1.01 per share), respectively.

Distributions in excess of net income generally constitute a return of capital. For the year ended December 31, 1994, dividends paid per share was \$1.75, which consisted of ordinary income per share of \$1.59 and return of capital per share of \$.16. Due to the timing of actual distributions, all of the dividends paid during the period from June 3, 1993, to December 31, 1993, were taxable as ordinary income.

12. Subsequent Events

On January 24, 1995, the Company declared an increase in its quarterly dividend from \$.445 per share (\$1.78 annualized) to \$.45 per share (\$1.80 annualized) payable on February 15, 1995, to shareholders of record on February 1, 1995.

On January 1, 1995, the Company purchased Starr Sanders Johnson, a provider of property management and development services to healthcare companies, for approximately \$3,800,000. The purchase price, which consists of \$650,000 cash and 156,239 shares of the Company's common stock (valued at approximately \$3,150,000), includes \$270,000 cash and 99,507 shares of common stock that are being held in escrow until December 31, 1995, pending the determination of certain purchase contingencies.

BOARD OF DIRECTORS



David R. Emery
Chairman of the Board
President
Healthcare Realty Trust Incorporated



Batey M. Gresham, Jr., AIA
Healthcare Architect
Founder
Gresham Smith & Partners



Errol L. Biggs, Ph.D.
Healthcare Academician
Director
Center for Health Administration
University of Colorado



Marliese E. Mooney
Consultant
Hospital Operations



Thompson S. Dent
Physician Group Practice
Executive Vice President
PHYCOR, Inc.



Edwin B. Morris III
Real Estate Financial Executive
Managing Director
Morris & Morse



C. Raymond Fernandez, M.D.
Physician
Medical Director
Nalle Clinic



J. Knox Singleton
Healthcare Provider Executive
Chief Executive Officer
INOVA Health Systems

HEALTHCARE REALTY TRUST

C O R P O R A T E O F F I C E R S



David R. Emery
*Chairman of the Board and
President*



Timothy G. Wallace
*Vice-President Finance and
Chief Financial Officer*



Fredrick M. Langreck
Treasurer & Controller



Kenneth D. Stach
Vice-President Acquisitions



Rita H. Todd
Corporate Secretary



Roger O. West
*Senior Vice-President Acquisitions
General Counsel*

HEALTHCARE REALTY MANAGEMENT

CORPORATE OFFICERS



Bart Starr
Chairman of the Board



Rance M. Sanders
President



Roland H. Hart, CPM
Senior Vice President / Management



Robert L. Watkins
Senior Vice President / Development



T. Lynn Adams
Vice President / Administration



David M. Baylot
Vice President / Development



Emilio N. Cerice, CPA
Controller

Independent Public Auditors

Ernst & Young LLP
 NationsBank Plaza
 414 Union Street
 Nashville, TN 37219-1779

Transfer Agent

First National Bank of Boston
 150 Royall Street
 Canton, MA 02021

Form 10-K

The Company has filed an Annual Report on Form 10K for the year ended December 31, 1994, with the Securities and Exchange Commission. Shareholders may obtain a copy of this report, without charge, by writing: Investor Relations, Healthcare Realty Trust Incorporated, 3310 West End Avenue, Suite 400, Nashville, TN 37203.

Dividend Reinvestment Plan

A Dividend Reinvestment Plan is offered as a convenience to stockholders who wish to increase their holdings in the Company. Additional shares may be purchased, without a service or sales charge, through automatic reinvestment of quarterly cash dividends. For information write Investor Relations, First National Bank of Boston, 150 Royall Street, Canton MA 02021 or call (617) 575-3400.

Member

National Association of Real Estate Investment Trusts, Inc. (NAREIT)

Common Stock

Healthcare Realty Trust Incorporated common stock is traded on The New York Stock Exchange under the symbol HR. The following tables show, for the fiscal periods indicated since the Common Stock began trading, the quarterly range of high and low closing sales prices of the common stock.

	1993		1994	
	High	Low	High	Low
First Quarter	\$	\$	\$ 22.125	\$ 19.625
Second Quarter	19.88	17.75	21.375	19.625
Third Quarter	23.50	19.25	22	19.875
Fourth Quarter	23.50	19.50	21.125	18.375

As of March 15, 1995, The Company had approximately 10,897 shareholders, including persons or entities holding Common Stock in nominee name, and 474 shareholders of record.

