



*1996*

ANNUAL REPORT

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*Healthcare Realty Trust is an independent, self-managed and self-administered REIT that integrates owning, acquiring, managing and developing income-producing real estate properties related to healthcare services throughout the United States. Since commencing operations in June 1993, the Company has invested or committed to invest over \$460 million in 80 income-producing real estate properties related to the delivery of healthcare services, containing over 3.9 million square feet.*

*The Company's portfolio is comprised of seven facility types, located in 38 markets nationwide, and operated pursuant to contractual arrangements with 16 healthcare providers.*

*The Company intends to maintain a portfolio of properties that are focused predominantly on the outpatient services segment of the healthcare industry and are diversified by tenant, geographic location and facility type.*

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# 1996 Highlights

- ◆ The Company acquired and developed \$104 million in healthcare related real estate, including properties in Roanoke/Salem, Virginia; West Palm Beach, Florida; Coral Gables, Florida; San Antonio, Texas; Fort Worth, Texas; Overland Park, Kansas; and Wichita, Kansas.
- ◆ The Lewis-Gale Building Corporation, comprising ten properties in the Roanoke Valley area, was merged into a subsidiary of Healthcare Realty Trust. The two main clinic properties of 253,644 square feet are contiguous to the 400-bed Columbia/Lewis-Gale Medical Center operated by Columbia/HCA Healthcare Corporation (NYSE:COL). The other eight properties encompass an additional 202,470 square feet of single and multi-tenanted physician and medical office properties in the Roanoke Valley area. Substantially all of the properties are leased to Lewis-Gale Clinic under operating leases and guaranteed by PhyCor, Inc. (Nasdaq/NM:PHYC).
- ◆ Over one million square feet was added to the Company's management portfolio, including a property management agreement with an affiliate of Mary Washington Hospital that includes 15 buildings consisting of 688,000 square feet of ancillary and medical office space located in counties surrounding Fredericksburg, Virginia. The engagement is a property management contract related to Healthcare Realty Trust's real estate services marketing agreement with VHA Inc. VHA is a national alliance of over 1,400 community-owned healthcare organizations. Healthcare Realty Trust provides day-to-day property management and lease administration services for all 15 facilities.
- ◆ The Company negotiated an increase in its unsecured credit facility from \$75 million to \$100 million. Other modifications include a term extension from August 1997 to December 1999, and a pricing reduction from 125 basis points to 112.5 basis points over LIBOR with further reductions indexed to improved credit ratings.
- ◆ In February 1997, Healthcare Realty Trust completed a public offering of 5,175,000 shares of common stock, priced at \$27.25 per share. The net proceeds of the offering were approximately \$133 million. The proceeds of the offering were partially used to repay outstanding indebtedness and will be used to fund the Company's acquisition and development activities, as well as for general corporate purposes.

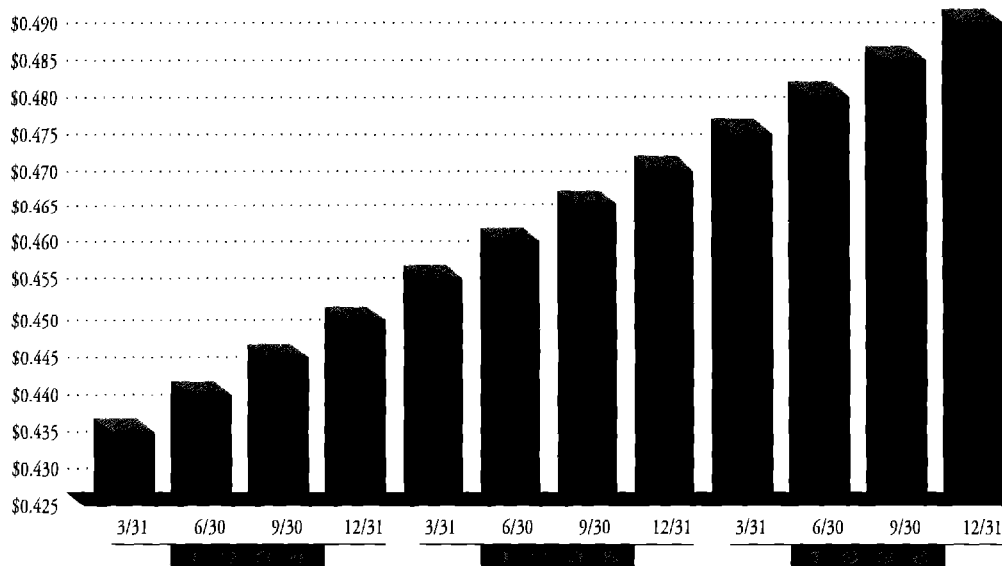
# 1996 CORPORATE Performance

## Notice of Annual Meeting

The annual meeting  
of shareholders will be  
held on May 12, 1997,  
at 10:00 a.m. at  
the Cumberland Club,  
511 Union Street,  
Nashville, Tennessee.

- ◆ 15.6% Increase in Total Revenue
- ◆ 5.7% Increase in Net Income per Share
- ◆ 7.6% Increase in Funds from Operations per Share
- ◆ 31.9% Increase in Portfolio
- ◆ 4.4% Increase in Dividends per Share
- ◆ 14 Consecutive Quarters of Increasing Dividend Payments
- ◆ 25.2% Total Annual Shareholder Return  
(Dividends reinvested plus stock appreciation)

## QUARTERLY DIVIDEND GROWTH



# SELECTED *Financial* HIGHLIGHTS

## SELECTED FINANCIAL HIGHLIGHTS

	Year Ended December 31,			
	1996	1995	1994	1993 <sup>(1)</sup>
Revenues				
Master lease rental income	\$ 35,329,475	\$ 32,402,507	\$ 23,231,345	\$ 7,066,606
Property operating income	1,337,779	—	—	—
Management fees	1,110,943	465,766	—	—
Interest and other income	795,942	492,888	995,078	68,398
	<u>\$ 38,574,139</u>	<u>\$ 33,361,161</u>	<u>\$ 24,226,423</u>	<u>\$ 7,135,004</u>
Net income	\$ 19,731,623	\$ 18,257,616	\$ 15,715,588	\$ 3,950,034
Net income per share	\$ 1.49	\$ 1.41	\$ 1.33	\$ 0.64
Funds from operations	\$ 28,036,395	\$ 25,490,401	\$ 20,918,679	\$ 5,773,571
Funds from operations per share	\$ 2.12	\$ 1.97	\$ 1.77	\$ 0.93
Weighted average shares outstanding	13,254,233	12,967,132	11,830,197	6,185,600

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

## LETTER TO OUR

# Shareholders

I am pleased to report that 1996 represented Healthcare Realty Trust's fourth outstanding year and fourteenth consecutive profitable quarter as a public company. Our portfolio of quality healthcare properties, along with the increasing success of our property management group, generated solid revenue and earnings performance. This growth has continually enabled the Company to provide increasing dividend payments to its shareholders.

For 1996, revenues totaled \$38.6 million, compared with \$33.4 million for the prior year. Net income was \$19.7 million, or \$1.49 per share, compared with \$18.3 million, or \$1.41 per share, for the year ended December 31, 1995. Funds from operations, composed of net income, depreciation and amortization, totaled \$28.0 million, or \$2.12 per share, for the twelve-month period. This compares with \$25.5 million, or \$1.97 per share, for the same period in 1995.

For the fourth quarter of 1996, revenues totaled \$10.9 million, representing a 20% increase over the prior year's \$9.1 million. Net income for the period was \$5.1 million, or \$0.38 per share, compared with \$4.7 million, or \$0.36 per share, for the fourth quarter of 1995. Funds from operations for the quarter totaled \$7.4 million, or \$0.55 per share, compared with \$6.4 million, or \$0.50 per share, for the same quarter 1995.

Since its formation in June 1993, the Company has increased the dividend paid to its shareholders every quarter. Total dividend payments for calendar year 1996 were \$1.91 per share, compared with \$1.83 per share for calendar year 1995, representing an increase of 4.4%. Also, the dividend payout, as a percentage of funds from operations, decreased from 93% to 90%.

We are proud of these accomplishments, and believe them to be a result of a sound investment philosophy and the quality of the portfolio. The Company's distinct competitive advantages have uniquely positioned it as one of the premiere REITs in the country, recognized for its operating strengths and dedication to total shareholder return.

DAVID R. EMERY

CHAIRMAN OF THE BOARD

AND CEO

### SETTING THE STANDARD

Despite all of the political rhetoric surrounding healthcare delivery, the evolving healthcare industry is strong and robust, with revenues totaling more than \$1 trillion annually and profits at an all-time high. The aging of the population, improved technology and preventive medical services continue to generate increased demand for healthcare services. Coupled with this growing demand is the mandate by payors to reduce the costs of services. These conflicting market dynamics have reshaped the delivery of healthcare – not reduced the necessity for healthcare services.

The traditional method of providing care under a fee-for-service and cost-based structure is giving way to a new delivery model – providing a continuum of acute, subacute and preventive healthcare services to a defined population. Providers of healthcare services are responding by offering services in ways not imagined years ago. Under managed care's capitated payment structure, healthcare providers no longer have incentive to incur expensive facility costs. These changes in the healthcare environment have refocused providers' resources

away from large in-patient, brick-and-mortar solutions, to multi-site, physician-based outpatient facilities located throughout communities.

To survive, grow and evolve in this changing healthcare landscape, providers must have access to capital. A survey published in *Modern Healthcare* noted that 90% of the healthcare systems nationwide agree or strongly agree that "... strategic initiatives will, in the future, require greater access to capital." The development of these new initiatives, including physician practice integration, new technology, and merger/acquisition activity, has encouraged healthcare providers to look beyond traditional sources of funding, and to look strategically at their real estate assets and the capital required.

Providers are realizing that various equity co-investment and property management strategies allow them to reserve control of their real estate, while giving them more financial flexibility, and maintaining focus on their core business of providing healthcare services.

#### IMPLEMENTING STRATEGIC INITIATIVES

The transformations in the healthcare marketplace are proving beneficial to Healthcare Realty Trust. As a fully integrated real estate company, Healthcare Realty Trust offers much more than traditional finance companies, by utilizing innovative transaction structures, management experience and client relationships to manage and develop properties that add value and enhance returns. Last year, the Company acquired or completed development of \$104 million in healthcare properties, and doubled the size of the Company's property management portfolio to more than three million square feet.

The Company continues to experience significant opportunities in the investor-owned sector of the healthcare industry. Proprietary hospital companies are using third-party equity funding transactions, to liquefy the investment that is hidden within their facilities. The Company essentially acts as an equity and real estate solutions partner in the strategic planning of new facilities and expansions. Sound relationships with the leading healthcare providers, foster additional business opportunities for Healthcare Realty Trust.

The Company is witnessing opportunities within the tax-exempt or community hospital sector of the healthcare industry, as well. Healthcare providers are paying particularly close attention to the allocation of proceeds received through tax-exempt financing – making sure that this type of funding is spent on ventures that are clearly within the scope of their mission. Many tax-exempt providers are emulating real estate strategies of investor-owned providers to maximize the value of their real estate assets. Healthcare Realty Trust increased its focus on the tax-exempt market in 1995, with the structuring of a marketing agreement with VHA Inc., a purchasing alliance comprised of over 1,400 healthcare providers nationwide.

HEALTHCARE REALTY  
ACQUIRED THE REAL  
ESTATE ASSETS OF THE  
LEWIS GALE CLINIC,  
SALEM, VIRGINIA,  
THROUGH A STOCK-  
FOR-STOCK  
REORGANIZATION.  
THIS TAX ADVANTAGED  
TRANSACTION WAS  
IN CONJUNCTION  
WITH THE OLDEST  
AND LARGEST GROUP  
HEALTH PRACTICE IN  
VIRGINIA. HEALTHCARE  
REALTY MANAGES THE  
FACILITY. THE CLINIC  
IS OPERATED BY  
PHYCOR, INC.

During 1996, the Company announced two notable transactions which validate its strategy and emphasize its ability to add value for clients. The Company completed a \$44 million acquisition of Lewis-Gale Building Corporation, which included ten properties related to a physicians' clinic affiliated with PhyCor, Inc., in the Roanoke/Salem, Virginia area. This unique transaction, which provided significant tax benefits for the physicians, was exclusively attributable to the Company's fully-integrated capabilities. In addition, property management continued to emerge as another avenue for the Company's growth, with Healthcare Realty Trust signing a long-term property management agreement with VHA member Mary Washington Hospital in Fredericksburg, Virginia, for 15 properties totaling 688,000 square feet.

#### **CONSERVATIVE FINANCIAL MANAGEMENT**

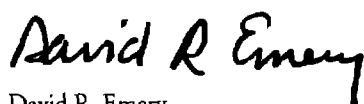
The Company's conservative capital structure and increased resources allow it to take advantage of additional investment opportunities in the market by utilizing the relationships, expertise and experience that it has developed over the past four years of operation. Management continues to employ a conservative approach to real estate investing, focusing on investments that sustain long-term performance. The capital markets have acknowledged these efforts, affording the Company a lower cost of capital, translating into increased investment returns over time.

In the fourth quarter of 1996, Healthcare Realty Trust amended its unsecured credit facility, resulting in improved pricing, increased borrowing capacity and an extension of the terms of the facility. During the first quarter of 1997, Healthcare Realty Trust raised net proceeds of approximately \$133 million in a follow-on equity offering. Debt-to-total capitalization after the equity offering was approximately 24%, giving the Company considerable investment capacity.

Healthcare Realty Trust's strategy is centered around its intent to deliver superior rewards to its shareholders. In calendar 1996, Healthcare Realty Trust's shareholders realized a 25.2% annual return – outperforming both the S&P 500 Index and the Russell 2000. Total cumulative shareholder return has been 80.1% since the Company's Initial Public Offering in May 1993 – an average annual total return of approximately 18%.

We are pleased with the Company's progress and achievements during 1996 and are grateful to the Board of Directors and employees for their diligent efforts and continuing commitment. We are also appreciative of our shareholders, whose support and involvement provide the basis for the continued growth of the Company.

Sincerely yours,

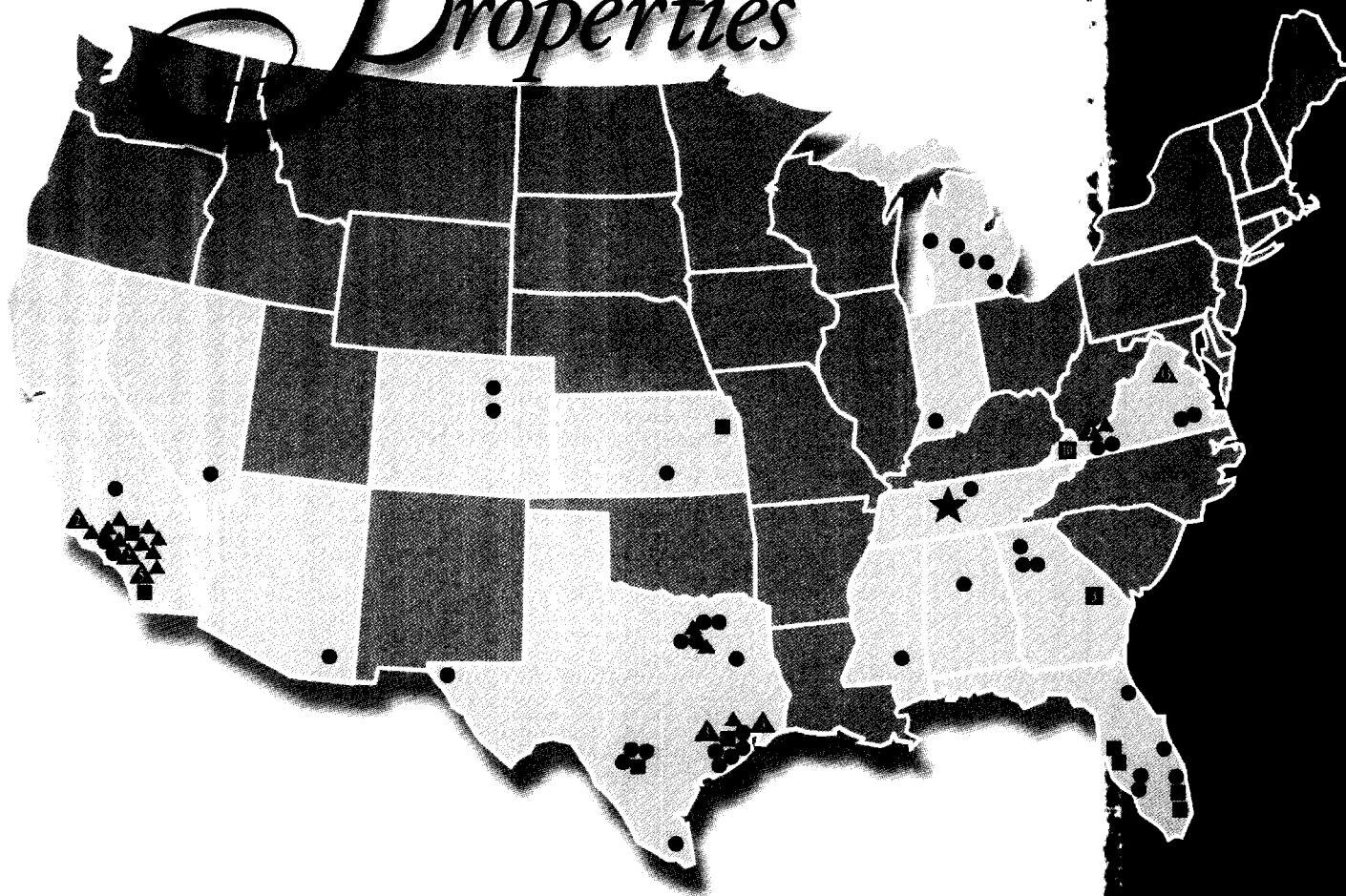


David R. Emery

Chairman of the Board and CEO



# Properties



HEALTHCARE REALTY IS CURRENTLY  
MANAGING 83 HEALTHCARE-RELATED  
PROPERTIES NATIONWIDE TOTALING  
OVER 3.2 MILLION SQUARE FEET,  
INCLUDING 27 WHICH ARE OWNED  
BY THE COMPANY.

- ★ *Corporate Offices*
- *Owned Properties*
- ▲ *Managed Properties*
- *Owned and Managed*

# Financials

IN ADDITION TO PROVIDING  
DEVELOPMENT SERVICES  
FOR AN 80,000 SQUARE  
FOOT ANCILLARY HOSPITAL  
FACILITY AT MARY  
WASHINGTON HOSPITAL  
(MWH MEDICORP)  
IN FREDERICKSBURG,  
VIRGINIA, HEALTHCARE  
REALTY ENTERED INTO  
A LONG-TERM PROPERTY  
MANAGEMENT AGREEMENT  
WITH MWH FOR 15  
PROPERTIES, TOTALING  
688,000 SQUARE FEET.

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# SELECTED FINANCIAL INFORMATION



The following table sets forth financial information for the Company which is derived from the Consolidated Financial Statements of the Company.

	1996	Year Ended December 31, 1995	1994	June 3, 1993 (commencement of operations) through December 31, 1993
<b>Statement of Income Data:</b>				
Total revenues	\$ 38,574,139	\$ 33,361,161	\$ 24,226,423	\$ 7,135,004
Interest expense	\$ 7,344,141	\$ 5,083,172	\$ 1,116,436	\$ 314,167
Net income	\$ 19,731,623	\$ 18,257,616	\$ 15,715,588	\$ 3,950,034
Net income per share	\$ 1.49	\$ 1.41	\$ 1.33	\$ 0.64
Weighted average shares outstanding	13,254,233	12,967,132	11,830,197	6,185,600
<b>Balance Sheet Data (as of the end of the period):</b>				
Real estate properties, net	\$ 416,034,417	\$ 318,480,336	\$ 280,767,098	\$ 133,392,751
Total assets	\$ 427,505,477	\$ 336,777,677	\$ 283,189,771	\$ 134,069,694
Notes and bonds payable	\$ 168,618,000	\$ 92,970,000	\$ 40,375,000	\$ 21,000,000
Total stockholders' equity	\$ 245,964,243	\$ 234,447,793	\$ 236,340,287	\$ 108,190,254
<b>Other Data:</b>				
Funds from operations <sup>(1)</sup>	\$ 28,036,395	\$ 25,490,401	\$ 20,918,679	\$ 5,773,571
Funds from operations per share <sup>(1)</sup>	\$ 2.12	\$ 1.97	\$ 1.77	\$ .93
Dividends declared and paid per share	\$ 1.91	\$ 1.83	\$ 1.75	\$ .55

(1) See Note 10 to Consolidated Financial Statements.

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



**OVERVIEW**

The Company operates under the Internal Revenue Code of 1986 (the "Code") as an indefinite life real estate investment trust ("REIT"). The Company, a self-managed and self-administered REIT, follows a general growth strategy that integrates owning, acquiring, managing, and developing income-producing real estate properties related to healthcare services throughout the United States. Management believes that by providing related real estate services, it can differentiate the Company's competitive market position, acquire needed capital, expand its asset base and increase revenue.

Since commencing operations in June, 1993, through December 31, 1996, the Company has invested or committed to invest, directly and indirectly, over \$460,000,000 in 80 income-producing properties related to the delivery of healthcare services, containing over 3.9 million square feet. The Company's portfolio is comprised of seven facility types, located in 38 markets nationwide, and operated pursuant to contractual arrangements with 16 healthcare providers. The Company is currently managing 83 healthcare-related properties nationwide totaling over 3.2 million square feet, including 27 which are owned by the Company.

Substantially all of the Company's revenues are derived from rentals on its healthcare real estate property facilities, interest earned from the temporary investment of funds in short-term instruments and from management and development services. Leases and other financial support arrangements with respect to its healthcare real estate facilities generally ensure that the costs and expenses incurred with respect to the operation of the facilities will be borne by tenants and healthcare providers related to the facilities. 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.

The Company's strategy is to be a full service provider of integrated real estate solutions to quality healthcare providers. Consistent with this strategy, the Company seeks to provide a spectrum of services needed to own, acquire, manage and develop healthcare properties, including leasing, development, management, market research, budgeting, accounting, collection, construction management, tenant coordination and financial services. The Company's development activities are primarily accomplished through pre-leased build-to-suit projects.

**RESULTS OF OPERATIONS**

*1996 Compared to 1995*

For the year ended December 31, 1996, net income was \$19,731,623, or \$1.49 per share of common stock, on total revenues of \$38,574,139 compared to net income of \$18,257,616, or \$1.41 per share of common stock, on total revenues of \$33,361,161, for the year ended December 31, 1995. Funds from operations ("FFO") was \$28,036,395, or \$2.12 per share, for the year ended December 31, 1996 compared to \$25,490,401, or \$1.97 per share, in 1995.

	1996	1995
<b>Revenues</b>		
Master lease rental income	\$ 35,329,475	\$ 32,402,507
Property operating income	1,337,779	—
Total rental income	36,667,254	32,402,507
Management fees	1,110,943	465,766
Interest and other income	795,942	492,888
	<b>38,574,139</b>	<b>33,361,161</b>
<b>Expenses</b>		
General and administrative	2,232,882	2,143,505
Property operating expenses	269,408	—
Interest	7,344,141	5,083,172
Depreciation	8,651,620	7,693,048
Amortization	344,465	183,820
	<b>18,842,516</b>	<b>15,103,545</b>
Net Income	\$ 19,731,623	\$ 18,257,616

Total revenues for the year ended December 31, 1996 compared to the year ended December 31, 1995 provided an increase of \$5,212,978 or 15.6%. The increase is primarily due to base rent derived from investment of approximately \$45,400,000 in six completed development properties in 1996. In addition, total rental income for the year ended December 31, 1996 includes a partial year of base rent derived from investment of approximately \$58,400,000 in 14 acquisitions during 1996. Revenues during 1996 also reflect an increase of \$645,177 (138.5%) in property management fees. At December 31, 1996, the Company managed 83 properties compared to 26 properties at December 31, 1995. Interest and other income increased from \$492,888 for the year ended December 31, 1995 to \$795,942 for the year ended December 31, 1996 primarily due to the short-term refinancing of approximately \$30,800,000 of mortgage notes for a current healthcare client.

Total expenses for the year ended December 31, 1996 were \$18,842,516 compared to \$15,103,545 for the year ended December 31, 1995, an increase of \$3,738,971 or 24.8%. Depreciation expense increased \$958,572 due to the acquisition of additional properties and the completion of properties under construction which were discussed in the preceding paragraph. General and administrative expenses increased \$89,377, primarily due to an increase in total employees. Interest expense increased from \$5,083,172 for the year ended December 31, 1995 to \$7,344,141 for the year ended December 31, 1996. During the year ended December 31, 1996, the Company had an average outstanding total debt balance of approximately \$122,400,000 compared to approximately \$70,900,000 in 1995. On September 18, 1995, the Company privately placed \$90,000,000 of unsecured notes (the "Unsecured Notes") with 16 credit institutions which also had the effect of increasing 1996 interest expense since the Unsecured Notes were outstanding for a full year in 1996 compared to 3.5 months in 1995. Amortization expense increased from \$183,820 for the year ended December 31, 1995 to \$344,465 for the year ended December 31, 1996 due to amortization of acquired revenue-producing management contracts and other intangible assets.

#### *1995 Compared to 1994*

For the year ended December 31, 1995, net income was \$18,257,616, or \$1.41 per share of common stock, on total revenues of \$33,361,161 compared to net income of \$15,715,588, or \$1.33 per share of common stock, on total revenues of \$24,226,423, for the year ended December 31, 1994. FFO was \$1.97 per share for the year ended December 31, 1995 compared to \$1.77 in 1994.

	1995	1994
<b>Revenues</b>		
Master lease rental income	\$ 32,402,507	\$ 23,231,345
Management fees	465,766	—
Interest and other income	492,888	995,078
	<b>33,361,161</b>	<b>24,226,423</b>
<b>Expenses</b>		
General and administrative	2,143,505	2,095,669
Interest	5,083,172	1,116,436
Depreciation	7,693,048	5,233,474
Amortization	183,820	65,256
	<b>15,103,545</b>	<b>8,510,835</b>
<b>Net Income</b>	<b>\$ 18,257,616</b>	<b>\$ 15,715,588</b>

Total revenues for the year ended December 31, 1995 compared to the year ended December 31, 1994 provided an increase of \$9,134,738 or 37.7%. The increase is primarily due to a full year of rental income derived from the acquisition of 20 properties during the year ended December 31, 1994 and base rent derived from eight completed properties which were transferred from construction in progress subsequent to September 30, 1994. In addition, rental income for the year ended December 31, 1995 includes a partial year of base rent derived from the three acquisitions during 1995. Revenues during 1995 also reflect \$465,766 of property management fees. Interest and other income decreased from \$995,078 for the year ended December 31, 1994 to \$492,888 for the year ended December 31, 1995 primarily due to the Company maintaining lower cash balances. In addition, the 1995 amount reflects \$220,140 of gain from a property disposition.

Total expenses for the year ended December 31, 1995 were \$15,103,545 compared to \$8,510,835 for the year ended December 31, 1994, an increase of \$6,592,710 or 77.5%. Depreciation expense increased \$2,459,574 due to the acquisition of additional properties and the completion of properties under construction which were discussed in the preceding paragraph. General and administrative expenses increased \$47,836, primarily due to an increase in total employees and an increase in the square footage of the Company's office space during March 1994. Interest expense increased from \$1,116,436 for the year ended December 31, 1994 to \$5,083,172 for the year ended December 31, 1995. The Company completed a secondary offering on February 16, 1994 and immediately repaid all \$23,100,000 of outstanding indebtedness under the unsecured credit facility (the "Unsecured Credit Facility"). The Company did not borrow under the Unsecured Credit Facility again until August 9, 1994 since proceeds were available from the secondary offering to fund additional property acquisitions. During the year ended December 31, 1995, the Company had an average outstanding debt balance of \$70,900,000. On September 18, 1995, the Company privately placed \$90,000,000 of Unsecured Notes with 16 credit institutions which also had the effect of increasing 1995 interest expense. Amortization increased from \$65,256 for the year ended December 31, 1994 to \$183,820 for the year ended December 31, 1995 due to amortization of acquired revenue-producing management contracts and other intangible assets.

#### *Liquidity and Capital Resources*

Effective December 26, 1996, the Company amended its \$75,000,000 Unsecured Credit Facility with four commercial banks to increase the Unsecured Credit Facility to \$100,000,000 and to extend the maturity date from August 1997 to December 1999, with two one-year extensions. Other modifications include a reduction in the interest rate to LIBOR plus 1.125% or the base rate of NationsBank, National Association (previously LIBOR

plus 1.25%). The Company pays a commitment fee of .225 of one percent per annum on the unused portion of funds available for borrowing under the Unsecured Credit Facility (previously .250). The Unsecured Credit Facility is unsecured and contains certain representations, warranties and financial and other covenants customary in such loan agreements.

Effective February 14, 1997, the Company sold 5,175,000 shares of its common stock in a secondary offering (the "Secondary Offering") under its currently effective registration statement pertaining to \$250,000,000 of equity securities, debt securities and warrants. The Company received \$133,411,500 in net proceeds. Promptly thereafter, the net proceeds were used, in part, to extinguish all \$71,900,000 of indebtedness outstanding under the Unsecured Credit Facility, which results in a borrowing capacity of \$100,000,000, and repayment or defeasance of secured indebtedness in the total amount of \$6,718,000. Remaining proceeds of the Secondary Offering of approximately \$57,200,000 have been invested short-term and will be available to finance additional property acquisitions, build-to-suit property development and for general corporate purposes. FFO can be negatively affected by delay in the acquisition of, or investment in, healthcare properties. As of December 31, 1996, the Company had stockholders' equity of \$245,964,243; following the Secondary Offering stockholders equity is approximately \$379,375,000. The debt to total capitalization ratio was approximately 40.7% at December 31, 1996 and approximately 24.0% following the Secondary Offering.

The Company can issue an aggregate of approximately \$143,000,000 of securities remaining under currently effective registration statements and intends to continue to offer securities under such registration statements from time to time to finance future acquisitions and build-to-suit developments as they occur. 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 real estate investment trusts 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.

The Company generated net cash from operations in 1996 of \$29,554,897, an increase of \$2,817,979 over 1995 and \$8,271,137 over 1994. The funds were used in 1996, along with net borrowings of approximately \$51,000,000 under the Unsecured Credit Facility, to make additional investments in income-producing assets and real estate properties totaling approximately \$63,000,000. Funds were also used to pay dividends to stockholders of \$25,196,467.

On November 15, 1996, the Company acquired Lewis-Gale Building Corporation, which included two ancillary hospital facilities located adjacent to the Lewis-Gale Medical Center, operated by Columbia/HCA, two medical office buildings and six physician clinics in the Roanoke/Salem, Virginia area. The buildings are either leased to Lewis-Gale Clinic, L.L.C., or are under leases guaranteed by the Clinic, and are managed by the Company. PhyCor, Inc., a physician practice management company, owns the related physician practice assets and has guaranteed the operating lease obligations of the Clinic to the Company. The Company's investment in these properties, which consists of the issuance of 687,692 shares of common stock of the Company and the assumption of liabilities, is approximately \$44,000,000. FFO should be positively affected by the receipts of rentals from these properties for years following 1996.

At December 31, 1996, the Company, in the normal course of business, had received a fully executed letter of intent to purchase upon completion of development, one property for approximately \$15,000,000. In addition, as of December 31, 1996, the Company had a net investment of approximately \$13,900,000 for three lessee developments in progress with a total remaining funding commitment of approximately \$10,100,000. The Company intends to fund these commitments with the funds available from the proceeds of the Secondary Offering.

During 1996, the Company did not sell any properties. Early in 1997, the Company entered into a contract of sale for one property located in Houston, Texas, which if consummated will result in approximate net proceeds of \$3,000,000, an amount approximately equal to the Company's investment. Proceeds from the sale will be available for general corporate purposes. No additional property sales are anticipated in the near future.

Under the terms of the leases and other financial support agreements relating to the properties, tenants or healthcare providers are generally responsible for operating expenses and taxes relating to the properties. As a result of these arrangements, the Company does not believe that it will be responsible for any major expenses in connection with the properties during the respective terms of the agreements. The Company anticipates entering into similar arrangements with respect to additional properties it acquires. After the term of the lease or financial support agreement, or in the event the financial obligations required by the agreement are not met, 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 21, 1997, the Company declared an increase in its quarterly dividend from \$0.485 per share (\$1.94 annualized) to \$0.49 per share (\$1.96 annualized) payable to stockholders of record on January 28, 1997. This dividend was paid on February 17, 1997. 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 1996 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 1997, should access to new capital not be available to the Company.

This annual report to shareholders of the Company includes forward-looking statements which reflect the Company's current views with respect to future events and financial performance. These forward-looking statements are subject to certain risks and uncertainties which would cause actual results to differ materially from historical results or those anticipated. For a more detailed discussion of these factors, see Item 1 of the Company's Form 10K for the fiscal year ended December 31, 1996.

**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, 1996 and 1995, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 1996. 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, 1996 and 1995, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1996 in conformity with generally accepted accounting principles.

*Ernst + Young LLP*

Nashville, Tennessee  
February 4, 1997, except for the disclosures  
with respect to the 1997 Secondary Offering  
of stock referred to in Notes 1, 4, and 12,  
as to which the date is March 10, 1997

# CONSOLIDATED BALANCE SHEETS

	December 31,	
	1996	1995
<b>Assets</b>		
Real estate properties:		
Land	\$ 53,028,292	\$ 41,435,193
Buildings and improvements	369,187,739	273,522,934
Personal property	3,099,382	2,761,458
Construction in progress	13,862,515	15,253,397
	<u>439,177,928</u>	<u>332,972,982</u>
Less accumulated depreciation	(23,143,511)	(14,492,646)
Total real estate properties, net	<u>416,034,417</u>	<u>318,480,336</u>
Cash and cash equivalents	1,354,325	9,142,775
Other assets, net	10,116,735	9,154,566
Total assets	<u>\$ 427,505,477</u>	<u>\$ 336,777,677</u>
<b>Liabilities and Stockholders' Equity</b>		
Liabilities:		
Notes and bonds payable	\$ 168,618,000	\$ 92,970,000
Security deposits payable	4,172,490	4,562,490
Accounts payable and accrued liabilities	8,197,437	4,214,599
Deferred income	553,307	582,795
Total liabilities	<u>181,541,234</u>	<u>102,329,884</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; issued and outstanding, 1996 - 13,898,777; 1995 - 12,976,796	138,988	129,768
Additional paid-in capital	264,614,431	243,418,805
Deferred compensation	(4,701,840)	(478,288)
Cumulative net income	57,654,861	37,923,238
Cumulative dividends	(71,742,197)	(46,545,730)
Total stockholders' equity	<u>245,964,243</u>	<u>234,447,793</u>
Total liabilities and stockholders' equity	<u>\$ 427,505,477</u>	<u>\$ 336,777,677</u>
See accompanying notes		



# CONSOLIDATED STATEMENTS OF INCOME



	1996	Year Ended December 31, 1995	1994
<b>Revenues</b>			
Master lease rental income	\$ 35,329,475	\$ 32,402,507	\$ 23,231,345
Property operating income	1,337,779	—	—
Management fees	1,110,943	465,766	—
Interest and other income	795,942	492,888	995,078
	<b>38,574,139</b>	<b>33,361,161</b>	<b>24,226,423</b>
<b>Expenses</b>			
General and administrative	2,232,882	2,143,505	2,095,669
Property operating expenses	269,408	—	—
Interest	7,344,141	5,083,172	1,116,436
Depreciation	8,651,620	7,693,048	5,233,474
Amortization	344,465	183,820	65,256
	<b>18,842,516</b>	<b>15,103,545</b>	<b>8,510,835</b>
Net income	<b>\$ 19,731,623</b>	<b>\$ 18,257,616</b>	<b>\$ 15,715,588</b>
Net income per share	<b>\$ 1.49</b>	<b>\$ 1.41</b>	<b>\$ 1.33</b>
Weighted average shares outstanding	<b>13,254,233</b>	<b>12,967,132</b>	<b>11,830,197</b>

See accompanying notes.

# CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	Common Stock		Additional	Deferred	Cumulative	Cumulative	Total
	Shares	Amount	Paid-In	Compensation	Net	Dividends	Stockholders'
			Capital		Income		Equity
Balance at January 1, 1994	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
Issuance of stock	172,349	1,724	3,436,547	-	-	-	3,438,271
Shares awarded as deferred stock compensation	1,050	10	21,515	(21,525)	-	-	-
Deferred stock compensation amortization	-	-	-	138,545	-	-	138,545
Net income	-	-	-	-	18,257,616	-	18,257,616
Dividends (\$1.83 per share)	-	-	-	-	-	(23,726,926)	(23,726,926)
Balance at December 31, 1995	12,976,796	129,768	243,418,805	(478,288)	37,923,238	(46,545,730)	234,447,793
Issuance of stock	707,952	7,079	16,396,116	-	-	-	16,403,195
Shares awarded as deferred stock compensation	203,897	2,040	4,611,264	(4,613,304)	-	-	-
Deferred stock compensation amortization	-	-	-	389,752	-	-	389,752
Employee stock purchase plan	10,132	101	188,246	-	-	-	188,347
Net income	-	-	-	-	19,731,623	-	19,731,623
Dividends (\$1.91 per share)	-	-	-	-	-	(25,196,467)	(25,196,467)
Balance at December 31, 1996	13,898,777	\$ 138,988	\$264,614,431	\$ (4,701,840)	\$ 57,654,861	\$ (71,742,197)	\$245,964,243

See accompanying notes.

# CONSOLIDATED STATEMENTS OF CASH FLOWS



	1996	Year Ended December 31, 1995	1994
<b><i>Operating Activities</i></b>			
Net income	\$ 19,731,623	\$ 18,257,616	\$ 15,715,588
Adjustments to reconcile net income to cash provided by operating activities:			
Depreciation and amortization	9,018,430	8,124,374	5,419,702
Gain on sale of property	-	(220,140)	-
Deferred compensation	376,823	1,196	-
Increase (decrease) in deferred income	(29,488)	313,837	232,734
Increase in other assets	(933,355)	(921,243)	(270,425)
Increase in accounts payable and accrued liabilities	1,390,864	1,181,278	186,161
Net cash provided by operating activities	29,554,897	26,736,918	21,283,760
<b><i>Investing Activities</i></b>			
Acquisition and development of real estate properties	(63,069,013)	(50,417,235)	(130,795,615)
Proceeds from sale of real estate	-	4,800,000	-
Receipt (disbursement) of security deposits	(390,000)	(257,282)	412,114
Net cash used in investing activities	(63,459,013)	(45,874,517)	(130,383,501)
<b><i>Financing Activities</i></b>			
Borrowings on notes and bonds payable	101,900,000	121,700,000	40,300,000
Repayments on notes and bonds payable	(50,903,106)	(69,105,000)	(37,018,633)
Deferred financing and organization costs paid	(168,709)	(1,244,980)	(463,884)
Dividends paid	(25,196,467)	(23,726,926)	(19,410,538)
Proceeds from issuance of common stock	483,948	160,428	126,091,192
Net cash provided by financing activities	26,115,666	27,783,522	109,498,137
Increase (decrease) in cash and cash equivalents	(7,788,450)	8,645,923	398,396
Cash and cash equivalents, beginning of period	9,142,775	496,852	98,456
Cash and cash equivalents, end of period	\$ 1,354,325	\$ 9,142,775	\$ 496,852

See accompanying notes.



# 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

## Organization

The Company commenced operations in 1993 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. The Company provides management, leasing and build-to-suit development, and capital for the construction of new facilities as well as for the acquisition of existing properties. As of December 31, 1996, the Company had invested or committed to invest in 80 properties (the "Properties") located in 38 markets in 14 states, which are supported by 17 healthcare-related entities pursuant to long-term leases.

## Basis of Presentation

The audited financial statements include the accounts of the Company, its wholly owned subsidiaries and certain other affiliated corporations with respect to which the Company controls the operating activities and receives substantially all economic benefits. Significant intercompany accounts and transactions have been eliminated.

## Use of Estimates in Financial Statements

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Actual results may differ from those estimates.

## Real Estate Properties

Real estate properties are recorded at cost. Transaction fees and acquisition costs are netted with the purchase price as appropriate. The cost of real properties acquired is allocated between land, buildings, 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 improvements	31.5 to 39.0 years
Personal property	3.0 to 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.

## Other Assets

Included in other assets are receivables, deferred costs and intangible assets. Deferred financing costs are amortized over the term of the related credit facility using the interest method. Intangible assets are amortized straight-line over the applicable lives of the assets which range from four to forty years. Accumulated amortization was \$1,060,811 and \$518,347 at December 31, 1996 and 1995, respectively.

## 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.

## Stock Issued to Employees

The Company has elected to follow Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations in accounting for its stock issued to employees.

## 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 each of the three years in the period ended December 31, 1996.

### *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 and 1996 to reflect the payment during February 1994 of \$23.1 million of outstanding indebtedness using a portion of the proceeds of a secondary offering, and to reflect the payment during the first quarter of 1997 of \$78,618,000 of outstanding indebtedness using a portion of the proceeds from another secondary offering completed February 14, 1997 (see Note 12). For the 1994 computation of supplementary income per common share, 1,080,700 common shares issued in the 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. For the 1996 computation of supplementary income per common share, 3,049,573 common shares issued in the offering whose proceeds were used to retire the debt were assumed to have been issued at the beginning of fiscal 1996, and net income was assumed to have not been reduced by interest expense incurred on the debt. Supplementary income per common share totaled \$1.35 for fiscal 1996.

### *Adoption of New Accounting Rules*

In March 1995, the Financial Accounting Standards Board ("FASB") issued Statement No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of, which requires impairment losses to be recorded on long-lived assets used in operations when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amounts. Statement No. 121 also addresses the accounting for long-lived assets that are expected to be disposed of. The Company adopted Statement No. 121 in the first quarter of fiscal 1995 with no impact.

### *Reclassifications*

Certain reclassifications have been made in the financial statements for the years ended 1995 and 1994 to conform to the 1996 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 1997 to 2013. Some leases provide 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 an option and a right of first refusal to purchase the leased property.

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.

Amounts of rental income received from lessees who accounted for more than 10% of the Company's rental income for the three years in the period ended December 31, 1996 were:

	1996	1995	1994
Columbia/HCA Healthcare Corporation	\$ 11,234,295	\$ 10,713,960	\$ 5,667,948
OrNda Healthcorp	7,634,690	7,257,939	4,086,002

Future minimum lease payments under the noncancelable operating leases as of December 31, 1996 are as follows:

1997	\$ 46,513,544
1998	46,365,714
1999	46,162,819
2000	46,011,237
2001	45,824,755
2002 and thereafter	301,547,167
	<u>\$ 532,425,236</u>

### 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, 1996.

	Number of Facilities <sup>(1)</sup>	Land	Buildings, Improvements and CIP	Personal Property	Total	Accumulated Depreciation
<b>Ancillary Hospital Facilities</b>						
Arizona	1	\$ 308,070	\$ 4,965,923	\$ -	\$ 5,273,993	\$ 558,418
California	7	15,169,012	30,505,657	38,504	45,713,173	2,331,170
Florida	8	577,328	44,504,554	-	45,081,882	2,445,367
Georgia	5	1,965,210	34,144,164	38,409	36,147,783	1,878,449
Kansas	1	-	8,606,501	-	8,606,501	33,461
Tennessee	1	395,056	2,743,834	-	3,138,890	190,450
Texas	10	7,102,169	48,218,718	259,536	55,580,423	4,436,154
Virginia	6	4,239,169	47,621,955	-	51,861,124	1,349,678
	39	29,756,014	221,311,306	336,449	251,403,769	13,223,147
<b>Ambulatory Surgery Centers</b>						
California	1	209,246	828,613	8,370	1,046,229	97,363
Nevada	1	940,000	2,860,571	-	3,800,571	180,308
Texas	1	509,891	1,514,376	15,296	2,039,563	177,942
	3	1,659,137	5,203,560	23,666	6,886,363	455,613
<b>Comprehensive Ambulatory Care</b>						
Florida	2	4,135,536	12,898,835	-	17,034,371	49,017
Texas	2	1,642,773	19,407,604	60,148	21,110,525	1,583,717
	4	5,778,309	32,306,439	60,148	38,144,896	1,632,734
<b>Clinical Laboratories</b>						
Alabama	1	180,633	8,601,151	8,028	8,789,812	971,214
Mississippi	1	537,660	3,718,165	29,660	4,285,485	319,487
	2	718,293	12,319,316	37,688	13,075,297	1,290,701
<b>Long-term Care Facilities</b>						
California	1	1,361,952	11,325,746	-	12,687,698	689,761
Colorado	2	1,651,477	8,934,457	-	10,585,934	278,873
Florida	1	1,203,720	8,388,977	-	9,592,697	85,153
Indiana	1	96,059	3,511,749	32,331	3,640,139	411,065
Kansas	1	1,013,423	5,297,900	-	6,311,323	6,921
Michigan	5	193,096	12,133,668	182,986	12,509,750	1,293,187
Texas	2	690,768	16,656,902	-	17,347,670	28,116
	13	6,210,495	66,249,399	215,317	72,675,211	2,793,076
<b>Medical Office Buildings</b>						
Texas	1	166,123	1,810,249	-	1,976,372	110,248
Virginia	4	1,926,841	11,740,130	126,790	13,793,761	287,504
	5	2,092,964	13,550,379	126,790	15,770,133	397,752
<b>Physician Clinics</b>						
Florida	3	3,558,945	15,504,117	50,781	19,113,843	1,403,271
Georgia	1	586,435	2,087,444	-	2,673,879	149,424
Texas	2	1,654,025	10,930,721	385,104	12,969,850	1,119,463
California	1	392,785	331,685	-	724,470	13,820
Virginia	6	620,890	2,977,392	-	3,598,282	9,543
	13	6,813,080	31,831,359	435,885	39,080,324	2,695,521
<b>Other</b>						
		-	278,496	1,863,439	2,141,935	654,967
<b>Total property</b>	<b>79</b>	<b>\$ 53,028,292</b>	<b>\$ 383,050,254</b>	<b>\$ 3,099,382</b>	<b>\$ 439,177,928</b>	<b>\$ 23,143,511</b>

(1) Includes three properties under construction.

#### 4. NOTES AND BONDS PAYABLE

Notes and bonds payable at December 31, 1996 and 1995 consisted of the following:

	December 31,	
	1996	1995
Unsecured notes	\$ 90,000,000	\$ 90,000,000
Unsecured credit facility	71,900,000	—
Serial and term bonds payable	6,718,000	2,970,000
	<u>\$ 168,618,000</u>	<u>\$ 92,970,000</u>

##### *Unsecured Notes*

On September 18, 1995, the Company privately placed \$90,000,000 of unsecured notes (the "Unsecured Notes") with 16 institutions. The Unsecured Notes bear interest at 7.41%, payable semiannually, and mature on September 1, 2002. Beginning on September 1, 1998 and on each September 1 through 2002, the Company must repay \$18,000,000 of principal. The note agreements pursuant to which the Unsecured Notes were purchased contain certain representations, warranties and financial and other covenants customary in such loan agreements.

##### *Unsecured Credit Facility*

On December 26, 1996, the Company's \$75,000,000 unsecured credit facility (the "Unsecured Credit Facility") with four commercial banks was increased to \$100,000,000 and extended to December 30, 1999. At the option of the Company, borrowings bear interest at one of the banks' base rate or LIBOR plus 1.125% (previously 1.250%). In addition, the Company pays a commitment fee of .225 (previously .250) of 1% per annum on the unused portion of funds available for borrowings under the Unsecured Credit Facility. The Unsecured Credit Facility contains certain representations, warranties and financial and other covenants customary in such loan agreements.

At December 31, 1996, the Company had available borrowing capacity of \$28,100,000 under the Unsecured Credit Facility. Subsequent to December 31, 1996, the Company repaid all \$71,900,000 indebtedness under the Unsecured Credit Facility which results in the maximum borrowing capacity of \$100,000,000.

##### *Serial and Term Bonds Payable*

In conjunction with the acquisition of certain facilities (see Note 6), the Company assumed an obligation for a \$2,496,000 bond issue of the Industrial Development Authority of the City of Salem, Virginia, payable in annual installments of \$208,000 through 2007. Interest on the outstanding principal balance is payable semi-annually at a rate of 75% of the prime rate or 6.1875% at December 31, 1996. The obligation was secured by a deed of trust and guaranteed by Lewis-Gale Clinic, Inc. Subsequent to December 31, 1996, this obligation was repaid.

In conjunction with the acquisition of certain facilities (see Note 6), the Company assumed an obligation for a \$1,575,000 bond issue of the Industrial Development Authority of the City of Roanoke, Virginia, payable in annual installments of \$175,000 through 2005. Interest is payable semi-annually at a rate of approximately 77% of the commercial base rate or 6.3525% at December 31, 1996. The obligation was secured by land and building and guaranteed by Lewis-Gale Clinic, Inc. Subsequent to December 31, 1996, this obligation was repaid.

In conjunction with the acquisition of certain facilities (see Note 6), the Company assumed an obligation for \$1,095,000 of Serial Bonds and \$1,980,000 of Term 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 bonds pay interest semiannually at interest rates ranging from 6.9% to 8.1%. The Serial Bonds mature at annual intervals through 2002 in amounts ranging from \$120,000 to \$320,000; the Term Bonds mature in 2010. The obligation was defeased subsequent to December 31, 1996. The resulting loss was not significant.

### *Other Long-Term Debt Information*

Subsequent to December 31, 1996, the Company repaid \$78,618,000 of indebtedness from proceeds of a secondary offering (see Note 12). The remaining indebtedness of Unsecured Notes is due in five \$18,000,000 annual installments beginning in 1998.

During the years ended December 31, 1996, 1995 and 1994, interest paid totaled \$8,389,712, \$3,932,112 and \$1,268,680, and capitalized interest totaled \$2,175,113, \$888,238 and \$424,675, respectively.

### **5. SECURITY DEPOSITS**

The Company is currently obligated to certain lessees, under executed sale and purchase agreements, for security and related deposits in an aggregate amount of \$4,172,490 and \$4,562,490 at December 31, 1996 and 1995, 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 or NationsBank prime rate, payable annually.

The security deposits 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. ACQUISITIONS AND DISPOSITION OF REAL ESTATE**

During November 1996, the Company acquired ten properties, Lewis Gale Building Corporation, in exchange for an aggregate of 687,692 shares of the Company's common stock (valued at \$16,074,800) and the assumption of \$20,566,106 of notes payable, \$4,071,000 of bonds payable and \$3,037,769 of accounts payable and accrued liabilities, and incurred \$483,328 in acquisition costs. In addition to the properties, representing an aggregate investment of \$44,063,087, the Company acquired cash of \$5,196, accounts receivable of \$58,340, and other assets of \$106,382. During 1996, the Company repaid the notes payable assumed in the acquisition.

On October 31, 1995, the Company sold a 24,189-square-foot ancillary hospital facility in Van Nuys, California for \$4,800,000. The property was sold to the lessee, pursuant to provisions in the Company's lease agreement, due to hidden structural damages suffered in the January 1994 Northridge earthquake that rendered the facility unusable for its intended purpose.

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.

### **7. 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 the 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 the Company's contributions to 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.



### Retirement Plan Information

Net expense for both the Executive Retirement Plan and the Retirement Plan for Outside Directors (the "Plans") for the three years in the period ended December 31, 1996 is comprised of the following:

	1996	1995	1994
Service cost	\$ 201,372	\$ 367,864	\$ 294,528
Interest cost	58,828	40,431	13,099
Other	(21,483)	(219,006)	(137,181)
	<u>\$ 238,717</u>	<u>\$ 189,289</u>	<u>\$ 170,446</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, 1996 and 1995.

	1996	1995
Actuarial present value of benefit obligations:		
Vested	\$ —	\$ —
Accumulated	<u>\$ 619,729</u>	<u>\$ 345,855</u>
Actual present value of projected benefit obligations for services rendered to date	\$ 743,951	\$ 913,682
Unrecognized net gain (loss)	<u>278,211</u>	<u>(112,901)</u>
Net pension liability in accrued liabilities	<u>\$ 1,022,162</u>	<u>\$ 800,781</u>

Accounting for the Executive Retirement Plan for the years ended December 31, 1996 and 1995 assumes discount rates of 8.5% and 8%, respectively, and compensation increase rates of 2.7% and 5%, respectively. Accounting for the Retirement Plan for Outside Directors assumes discount rates of 9% and 8%, respectively.

## **8. STOCK PLANS AND WARRANTS**

### ***1993 Employees Stock Incentive Plan***

The Company is authorized to issue stock representing up to 7.5% of its outstanding shares of common stock, (the "Employee Plan Shares") under the 1993 Employees Stock Incentive Plan (the "Employee Plan"). As of December 31, 1996 and 1995, the Company had a total of 812,364 and 716,260 Employee Plan Shares, respectively, that had not been issued or optioned. Unless terminated earlier, the Employee Plan will terminate on January 1, 2003.

Under the Employee Plan, the Compensation Committee may grant options (the "Options") to purchase shares of the Company's common stock to employees for terms not longer than 10 years at prices that may not be less than 95% of the fair market value of the common stock on the date of grant. The Options may be subject to any conditions set by the Compensation Committee, may be exercised by payment of cash, shares valued at fair market value, or, at the option of the Compensation Committee, by a note secured by shares. As of December 31, 1995, Options to purchase a total of 222,000 of the Employee Plan Shares at \$19.50 per share were outstanding, all of which were exercisable. During 1996 the Company canceled all outstanding Options under the Employee Plan.

Under the Employee Plan, the Compensation Committee may also grant incentive stock awards to employees. Incentive stock awards granted under the Employee Plan may be subject to any conditions set by the Compensation Committee. As of December 31, 1996 and 1995, the Company had specifically reserved, but not issued, a total of 283,334 and 425,000 Employee Plan Shares (the "Reserved Stock"), respectively, for performance-based awards to employees under the Employee Plan. The issue of Reserved Stock to eligible employees is contingent upon the achievement of specific performance criteria. The Reserved Stock awards are subject to fixed vesting periods varying from four to twelve years beginning on the date of issue. If an employee voluntarily terminates employment with the Company before the end of the vesting period, the shares are forfeited, at no cost to the Company. Once the Reserved Stock has been issued, the employee has the right to receive dividends and the right to vote the shares.

As of December 31, 1996 and 1995, performance criteria had been met for the award of, and the Company had issued, a total of 230,044 and 35,000 Employee Plan Shares, respectively. For 1996 and 1995, compensation expense resulting from the amortization of the value of these shares was \$319,120 and \$137,349, respectively.

### ***Non-Employee Directors' Stock Plans***

Prior to May 16, 1995, the Company was authorized to issue stock options for up to 2% of its outstanding shares of common stock under the 1993 Outside Directors Stock Incentive Plan (the "1993 Director Plan"). Under the 1993 Director Plan, each member of the Board of Directors of the Company who was not an employee of the Company, its subsidiaries or affiliates received an option to purchase 3,000 shares on January 1, 1994 at an exercise price equal to the market price of the common stock on the date of grant. As of December 31, 1995, options to purchase a total of 19,530 shares were outstanding under the 1993 Director Plan, all of which were exercisable. During 1996 the Company canceled all unexercised options granted pursuant to the 1993 Director Plan.

Effective May 16, 1995, the Company enacted the 1995 Restricted Stock Plan for Non-Employee Directors (the "1995 Directors' Plan"). As of December 31, 1996 and 1995, the Company had a total of 97,900 and 98,950 shares under the 1995 Directors' Plan, respectively, that had not been issued. Under the 1995 Directors' Plan, each member of the Board of Directors of the Company who is not an employee of the Company, its subsidiaries or affiliates, receives an award of shares of common stock (the "Directors' Stock") at the conclusion of the Company's annual meeting of shareholders. The Directors' Stock vests in each Director upon the date three years from the date of issue and is subject to forfeiture prior to such date upon termination of the Director's service, at no cost to the Company. Once the Directors' Stock has been issued, the Director has the right to receive dividends and the right to vote the shares.

As of December 31, 1996 and 1995, the Company had issued a total of 9,903 and 1,050 shares, respectively, pursuant to the Non-Employee Directors' Stock Plans. For 1996 and 1995, compensation expense resulting from the amortization of the value of these shares was \$70,672 and \$1,196, respectively.

### ***1995 Employee Stock Purchase Plan***

Effective May 16, 1995, the Company adopted an Employee Stock Purchase Plan (the "Employee Purchase Plan") pursuant to which the Company is authorized to issue shares of common stock (the "Employee Purchase Plan Shares"). As of December 31, 1996 and 1995, the Company had a total of 918,795 and 952,732 shares under the Employee Purchase Plan, respectively, that had not been issued or optioned. Under the Employee Purchase Plan, each eligible employee as of May 16, 1995 and each subsequent January 1 (the "Grant Dates") has been or shall be granted an option to purchase up to \$25,000 of common stock at the lesser of 85% of the market price on the Grant Date or 85% of the market price on the date of exercise of such option (the "Exercise Date"), but at not less than book value per share as of the December 31 immediately preceding the Grant Date. The number of shares subject to each year's option becomes fixed on the Grant Date. Eligible employees include those employees who were employed by the Company or a subsidiary on a full-time basis as of May 16, 1995 and those employees with six months of service who are employed by the Company or subsidiary as of each subsequent Grant Date. Options granted under the Employee Purchase Plan expire if not exercised 27 months after each such option's Grant Date.

A summary of Employee Purchase Plan activity and related information for the years ended December 31 is as follows:

	Options	
	1996	1995
Outstanding, beginning of year	47,268	-
Granted	47,564	47,268
Exercised	(10,132)	-
Forfeited	(13,627)	-
Outstanding, end of year	71,073	47,268
Exercisable at end of year	71,073	47,268
Weighted-average fair value of options granted during the year (calculated as of the grant date)	\$ 2.70	\$ 2.56
Weighted-average exercise prices of options exercised during the year	\$ 18.59	\$ -
Weighted-average exercise prices of options outstanding (calculated as of December 31)	\$ 19.09	\$ 18.46
Weighted-average contractual life of outstanding options (calculated as of December 31, in years)	0.9	1.6

The Company has determined that the pro forma effect on net income and earnings per share for the two years in the period ended December 31, 1996 of adopting Statement of Financial Accounting Standards No. 123 "Accounting for Stock-Based Compensation" is not material.

#### *Other*

In 1993, the Company issued warrants to purchase up to 188,712 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, the then current fair market value, subject to adjustment under applicable antidilution provisions. The holders of the Warrants 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.

At December 31, 1996 and 1995, the Company had reserved 2,017,771 and 1,956,654 shares, respectively, for future issuance.

#### **9. COMMITMENTS**

At December 31, 1996, the Company, in the normal course of business, had received a fully executed letter of intent to purchase upon completion of development, one property for approximately \$15,000,000. In addition, as of December 31, 1996, the Company had a net investment of approximately \$13,900,000 for three lessee developments in progress with a total remaining funding commitment of approximately \$10,100,000.

#### **10. OTHER DATA**

##### *Funds From Operations*

Funds from operations, as defined by the National Association of Real Estate Investment Trusts, Inc. ("NAREIT") 1995 White Paper, means net income (computed in accordance with generally accepted accounting principles), excluding gains (or losses) from debt restructuring and sales of property, plus depreciation from real estate assets. NAREIT encourages REITs to make reporting changes consistent with the 1995 NAREIT White Paper on Funds from Operations no later than fiscal year 1996. Beginning with the first quarter 1996 operations, the Company's policy has been to report funds from operations calculated on the NAREIT 1995 White Paper while providing supplemental information based upon previous methodology. Funds from operations does 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.

	Year ended December 31, 1996 (Unaudited)		Year ended December 31, 1995 (Unaudited)	
	1995 NAREIT White Paper As Reported	Previous Methodology	1995 NAREIT White Paper	Previous Methodology As Reported
<b>Net income <sup>(1)</sup></b>	\$ 19,731,623	\$ 19,731,623	\$ 18,257,616	\$ 18,257,616
Non-recurring items	—	—	—	—
Gain on disposition	—	—	(220,140)	(220,140)
Straight line rents	—	—	—	—
<b>ADD</b>				
<b>Depreciation</b>				
Real estate	8,304,772	8,304,772	7,452,925	7,452,925
Other non-revenue producing assets	—	346,848	—	240,123
	8,304,772	8,651,620	7,452,925	7,693,048
<b>Amortization</b>				
Acquired property management contracts <sup>(2)</sup>	—	337,722	—	178,420
Organization costs	—	6,743	—	5,400
	—	344,465	—	183,820
<b>Deferred financing costs <sup>(3)</sup></b>	—	359,744	—	247,506
<b>Total adjustments</b>	8,304,772	9,355,829	7,232,785	7,904,234
<b>Funds from operations</b>	\$ 28,036,395	\$ 29,087,452	\$ 25,490,401	\$ 26,161,850
<b>Weighted average shares outstanding</b>	13,254,233	13,254,233	12,967,132	12,967,132
<b>Funds from operations per share</b>	\$ 2.12	\$ 2.19	\$ 1.97	\$ 2.02

(1) 1996 amounts include \$389,752 (\$0.03 per share) of stock based, long-term, incentive compensation expense, a non-cash expense.

(2) Amortization of the acquisition cost of revenue producing property management contracts.

(3) Amortization of deferred financing costs is reported as part of interest expense on the income statement.

### *Return of Capital*

Distributions in excess of net income generally constitute a return of capital. For the years ended December 31, 1996, 1995 and 1994, dividends paid per share were \$1.91, \$1.83 and \$1.75, respectively, which consisted of ordinary income per share of \$1.65, \$1.42 and \$1.59 and return of capital per share of \$.26, \$.41 and \$.16, respectively.

### 11. FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amounts of cash and receivables are a reasonable estimate of their fair value due to their short-term nature. The fair value of notes and bonds payable is estimated using discounted cash flow analyses, based on the Company's current incremental borrowing rates for similar types of borrowing arrangements. The difference between the carrying amount and the fair value of the Company's notes and bonds payable is not significant.

### 12. SUBSEQUENT EVENTS

On January 21, 1997, the Company declared an increase in its quarterly dividend from \$.485 per share (\$1.94 annualized) to \$.49 per share (\$1.96 annualized) payable on February 17, 1997 to shareholders of record on January 28, 1997.

Effective February 14, 1997, the Company sold 5,175,000 shares of its common stock in a secondary offering (the "Secondary Offering") under its currently effective registration statement pertaining to \$250,000,000 of equity securities, debt securities and warrants. The Company received \$133,411,500 in net proceeds. Promptly thereafter, the net proceeds were used, in part, to extinguish all \$71,900,000 of indebtedness outstanding under the Unsecured Credit Facility, which results in a borrowing capacity under the Unsecured Credit Facility of \$100,000,000, and repayment or defeasance of secured indebtedness in the total amount of \$6,718,000. Remaining proceeds of the Secondary Offering of approximately \$57,200,000 have been invested short-term and will be available to finance additional property acquisitions, build-to-suit property development and for general corporate purposes.

### 13. SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

Quarterly financial information for the years ended December 31, 1996 and 1995 is summarized below:

	March 31	Quarter ended		December 31
		June 30	September 30	
<b>1996</b>				
Total revenue	\$ 8,982,907	\$ 9,135,538	\$ 9,509,019	\$ 10,946,673
Net income	\$ 4,758,183	\$ 4,952,468	\$ 4,913,700	\$ 5,107,272
Funds from operations	\$ 6,735,694	\$ 6,929,979	\$ 6,936,857	\$ 7,433,866
Net income per share	\$ 0.36	\$ 0.38	\$ 0.37	\$ 0.38
Funds from operations per share	\$ 0.52	\$ 0.53	\$ 0.53	\$ 0.55
<b>1995</b>				
Total revenue	\$ 7,894,137	\$ 7,978,111	\$ 8,376,569	\$ 9,112,344
Net income	\$ 4,505,272	\$ 4,519,300	\$ 4,526,268	\$ 4,706,776
Funds from operations	\$ 6,307,622	\$ 6,340,191	\$ 6,413,618	\$ 6,428,970
Net income per share	\$ 0.35	\$ 0.35	\$ 0.35	\$ 0.36
Funds from operations per share	\$ 0.49	\$ 0.49	\$ 0.49	\$ 0.50

**CORPORATE DATA****Corporate Address**

Healthcare Realty Trust Incorporated  
3310 West End Avenue, Suite 400  
Nashville, Tennessee 37203  
Phone: (615) 269-8175  
Fax: (615) 269-8122

**Independent Public Auditors**

Ernst & Young LLP  
NationsBank Plaza  
414 Union St.  
Nashville, Tennessee 37219-1779

**Transfer Agent***Transfer of Shares*

Boston EquiServe  
Stock Transfer Department  
P.O. Box 1865  
Mail Stop 45-02-62  
Boston, Massachusetts 02105-1865  
Phone: (617) 575-3400  
CUSIP #: 421946104

**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, Boston EquiServe, 150 Royall Street, Canton, Massachusetts 02021 or call (617) 575-3400.

**Form 10K**

The Company has filed an Annual Report on Form 10K for the year ended December 31, 1996, with the Securities and Exchange Commission. Shareholders may obtain a copy of this report, without charge, by writing: Investor Relations, Healthcare Realty Trust, Inc., 3310 West End Avenue, Suite 400, Nashville, Tennessee 37203. Or, via e-mail: [hrinfo@healthcarerealty.com](mailto:hrinfo@healthcarerealty.com)

**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. As of March 12, 1997, there were approximately 1,086 shareholders of record. The following table shows, for the fiscal periods indicated, the quarterly range of high and low closing sales prices

Place Stamp Here	1995		1994	
	High	Low	High	Low
75	\$ 21.000	\$ 19.000	\$ 22.500	\$ 19.375
00	20.500	18.500	21.375	19.500
00	20.750	19.375	22.125	19.875
00	23.000	20.000	21.125	19.375

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will be held on May 12, 1997, at 10:00 a.m.  
Street, Nashville, Tennessee.

Investor Relations  
Healthcare Realty Trust Incorporated  
3310 West End Avenue  
Suite 700  
Nashville, Tennessee 37203



## DIVIDEND REINVESTMENT PLAN

A dividend reinvestment plan is offered as a convenience to shareholders who wish to increase their holdings in Healthcare Realty Trust. Additional shares may be purchased by registered shareholders, at a five percent discount, through automatic reinvestment of quarterly dividends. Shareholders may also reinvest a portion of the quarterly dividend. This service is available without a service or sales fee. The Company will pay all administrative costs. Participation in the plan is voluntary and shareholders may begin or withdraw at any time.

To receive a copy of the prospectus relating to the Dividend Reinvestment Plan, please complete the card attached or email your name and address to [hrinfo@healthcarerealty.com](mailto:hrinfo@healthcarerealty.com)

Name \_\_\_\_\_

Address \_\_\_\_\_

City \_\_\_\_\_ State \_\_\_\_\_ Zip \_\_\_\_\_

- ☐ Send me information about the Dividend Reinvestment Plan. I am a current *registered* shareholder.
- ☐ I am not interested in the Dividend Reinvestment Plan, but please add me to your shareholder mailing list.
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