

UNIVERSAL HEALTH REALTY INCOME TRUST

Form 10-Q

November 07, 2014

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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

(MARK ONE)

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

**For the quarterly period ended September 30, 2014**

**OR**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number 1-9321**

**UNIVERSAL HEALTH REALTY INCOME TRUST**

**(Exact name of registrant as specified in its charter)**

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

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

**UNIVERSAL CORPORATE CENTER**

**367 SOUTH GULPH ROAD**

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

**19406**  
**(Zip Code)**

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

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

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

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

Large accelerated filer  Accelerated Filer

Non-accelerated filer  Smaller reporting company

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

Number of common shares of beneficial interest outstanding at October 31, 2014 12,931,354

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This Quarterly Report on Form 10-Q is for the quarter ended September 30, 2014. In this Quarterly Report, we, us, our and the Trust refer to Universal Health Realty Income Trust and its subsidiaries.

As disclosed in this Quarterly Report, including in *Part I, Item 1. Relationship with Universal Health Services, Inc. ( UHS ) and Related Party Transactions*, a wholly-owned subsidiary of UHS (UHS of Delaware, Inc.) serves as our Advisor pursuant to the terms of an annually renewable Advisory Agreement dated December 24, 1986. Our officers are all employees of UHS through UHS of Delaware, Inc. In addition, four of our hospital facilities are leased to subsidiaries of UHS and twelve medical office buildings, including one property owned by a limited liability company in which we hold 95% of the non-controlling, majority ownership interest, include or will include tenants which are subsidiaries of UHS. Any reference to UHS or UHS facilities in this report is referring to Universal Health Services, Inc.'s subsidiaries, including UHS of Delaware, Inc.

In this Quarterly Report, the term revenues does not include the revenues of the unconsolidated limited liability companies ( LLCs ) in which we have various non-controlling equity interests ranging from 33% to 95%. We currently account for our share of the income/loss from these investments by the equity method (see Note 5 to the Consolidated Financial Statements included herein).

Table of Contents**Part I. Financial Information****Item I. Financial Statements****Universal Health Realty Income Trust**

## Condensed Consolidated Statements of Income

For the Three and Nine Months Ended September 30, 2014 and 2013

(amounts in thousands, except per share amounts)

(unaudited)

	<b>Three Months</b>		<b>Nine Months</b>	
	<b>Ended September 30,</b>		<b>Ended September 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
<b>Revenues:</b>				
Base rental - UHS facilities	\$ 3,864	\$ 3,587	\$ 11,694	\$ 11,181
Base rental - Non-related parties	8,235	6,905	22,506	20,979
Bonus rental - UHS facilities	1,157	1,075	3,529	3,214
Tenant reimbursements and other - Non-related parties	1,804	1,782	5,585	5,091
Tenant reimbursements and other - UHS facilities	198	99	549	370
	15,258	13,448	43,863	40,835
<b>Expenses:</b>				
Depreciation and amortization	5,247	4,577	14,855	14,113
Advisory fees to UHS	653	603	1,883	1,759
Other operating expenses	4,462	3,636	12,529	11,045
Transaction costs	198	39	301	170
	10,560	8,855	29,568	27,087
Income before equity in income of unconsolidated limited liability companies ( LLCs ), interest expense and gains	4,698	4,593	14,295	13,748
Equity in income of unconsolidated LLCs	499	515	1,771	1,545
Gains on fair value recognition resulting from the purchase of minority interests in majority-owned LLCs	25,093	0	25,409	0
Interest expense, net	(2,149)	(1,805)	(6,152)	(5,622)
Net income	\$ 28,141	\$ 3,303	\$ 35,323	\$ 9,671

Basic earnings per share	\$ 2.18	\$ 0.26	\$ 2.74	\$ 0.76
Diluted earnings per share	\$ 2.18	\$ 0.26	\$ 2.74	\$ 0.76
Weighted average number of shares outstanding - Basic	12,911	12,681	12,887	12,676
Weighted average number of share equivalents	7	13	6	14
Weighted average number of shares and equivalents outstanding - Diluted	12,918	12,694	12,893	12,690

See the accompanying notes to these condensed consolidated financial statements.

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## Condensed Consolidated Statements of Comprehensive Income

For the Three and Nine Months Ended September 30, 2014 and 2013

(dollar amounts in thousands)

(unaudited)

	<b>Three Months</b>		<b>Nine Months</b>	
	<b>Ended September 30,</b>		<b>Ended September 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
Net Income	\$ 28,141	\$ 3,303	\$ 35,323	\$ 9,671
Other comprehensive loss:				
Unrealized derivative gains/(losses) on interest rate caps	18	0	(74)	0
Amortization of interest rate cap fees	23	0	61	0
Total other comprehensive income:	41	0	(13)	0
Total comprehensive income	\$ 28,182	\$ 3,303	\$ 35,310	\$ 9,671

See the accompanying notes to these condensed consolidated financial statements.

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## Condensed Consolidated Balance Sheets

(dollar amounts in thousands)

(unaudited)

	September 30, 2014	December 31, 2013
<b>Assets:</b>		
<b>Real Estate Investments:</b>		
Buildings and improvements	\$ 459,773	\$ 368,295
Accumulated depreciation	(108,374)	(97,921)
	351,399	270,374
Land	35,734	27,374
Net Real Estate Investments	387,133	297,748
Investments in and advances to limited liability companies ( LLCs )	8,531	39,201
<b>Other Assets:</b>		
Cash and cash equivalents	3,739	3,337
Base and bonus rent receivable from UHS	2,165	2,053
Rent receivable - other	4,207	3,310
Intangible assets (net of accumulated amortization of \$17.9 million and \$13.7 million at September 30, 2014 and December 31, 2013, respectively)	25,116	20,782
Deferred charges, goodwill and other assets, net	5,971	6,714
Total Assets	\$ 436,862	\$ 373,145
<b>Liabilities:</b>		
Line of credit borrowings	\$ 120,450	\$ 93,700
Mortgage and other notes payable, non-recourse to us (including net debt premium of \$584,000 and \$834,000 at September 30, 2014 and December 31, 2013, respectively)	124,321	106,287
Accrued interest	576	491
Accrued expenses and other liabilities	9,478	5,156
Tenant reserves, escrows, deposits and prepaid rents	2,608	1,881
Total Liabilities	257,433	207,515
<b>Equity:</b>		

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Preferred shares of beneficial interest, \$.01 par value; 5,000,000 shares authorized; none issued and outstanding		
Common shares, \$.01 par value; 95,000,000 shares authorized; issued and outstanding: 2014 - 12,931,065 2013 -12,858,643	129	128
Capital in excess of par value	223,519	220,691
Cumulative net income	515,368	480,044
Cumulative dividends	(559,517)	(535,176)
Accumulated other comprehensive loss	(70)	(57)
Total Equity	179,429	165,630
Total Liabilities and Equity	\$ 436,862	\$ 373,145

See the accompanying notes to these condensed consolidated financial statements.



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## Condensed Consolidated Statement of Cash Flows

(dollar amounts in thousands)

(unaudited)

	<b>Nine Months Ended September 30,</b>	
	<b>2014</b>	<b>2013</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 35,323	\$ 9,671
<i>Adjustments to reconcile net income to net cash provided by operating activities:</i>		
Depreciation and amortization	14,922	14,181
Amortization on debt premium	(251)	(325)
Restricted/stock-based compensation expense	298	287
Gains on purchase of minority interests in majority-owned LLCs	(25,409)	0
<i>Changes in assets and liabilities:</i>		
Rent receivable	(622)	(555)
Accrued expenses and other liabilities	(439)	75
Tenant reserves, escrows, deposits and prepaid rents	242	64
Accrued interest	(31)	(43)
Other, net	(144)	(352)
<b>Net cash provided by operating activities</b>	<b>23,889</b>	<b>23,003</b>
<b>Cash flows from investing activities:</b>		
Investments in LLCs	(1,243)	(2,593)
Repayments of advances made to LLCs	0	109
Advances made to LLCs	0	(4,431)
Cash distribution of refinancing proceeds from LLC	2,280	0
Cash distributions in excess of income from LLCs	1,011	1,775
Additions to real estate investments, net	(2,033)	(2,322)
Net cash paid for acquisition of medical office buildings	(15,600)	(4,675)
Cash paid to acquire minority interests in majority-owned LLCs	(3,494)	0
<b>Net cash used in investing activities</b>	<b>(19,079)</b>	<b>(12,137)</b>
<b>Cash flows from financing activities:</b>		
Net borrowings on line of credit	26,750	15,350
Proceeds from mortgages and other notes payable	0	11,150
Repayments of mortgages and other notes payable	(11,472)	(13,694)
Financing costs paid on mortgage and other notes payable	0	(95)
Dividends paid	(24,341)	(23,742)

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Issuance of shares of beneficial interest, net	3,074	194
<b>Net cash used in financing activities</b>	<b>(5,989)</b>	<b>(10,837)</b>
(Decrease)/increase in cash and cash equivalents	(1,179)	29
Increase in cash due to recording of LLCs on a consolidated basis	1,581	0
Decrease in cash due to recording of LLC on an unconsolidated basis	0	(141)
Cash and cash equivalents, beginning of period	3,337	3,048
<b>Cash and cash equivalents, end of period</b>	<b>\$ 3,739</b>	<b>\$ 2,936</b>

**Supplemental disclosures of cash flow information:**

Interest paid	\$ 6,075	\$ 5,680
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**Supplemental disclosures of non-cash transactions:**

<b>Consolidation of LLCs:</b>		
Net real estate investments	\$ 84,064	\$ 0
Cash and cash equivalents	1,581	0
Intangible assets	6,490	0
Rent receivable - other	388	0
Deferred charges, goodwill and other assets, net	100	0
Investment in LLCs	(28,616)	0
Mortgage and other notes payable, non-recourse to us	(29,758)	0
Accrued interest	(116)	0
Accrued expenses and other liabilities	(1,245)	0
Tenant reserves, escrows, deposits and prepaid rents	(485)	0
Note payable to previous third party member	(3,500)	0
Gains on purchases of minority interests in majority-owned LLCs	(25,409)	0
Cash paid for purchase of minority interests in majority-owned LLCs	\$ 3,494	\$ 0

<b>Deconsolidation of LLC:</b>		
Net real estate investments	\$ 0	\$ 11,597
Cash and cash equivalents	0	141
Rent receivable - other	0	207
Deferred charges, goodwill and other assets, net	0	135
Mortgage and other notes payable, non-recourse to us	0	(6,215)
Accrued interest	0	(26)
Accrued expenses and other liabilities	0	(342)
Third-party equity interest	0	(54)
Investment in LLC	\$ 0	\$ 5,443

See accompanying notes to these condensed consolidated financial statements.

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**UNIVERSAL HEALTH REALTY INCOME TRUST**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2014**

(unaudited)

**(1) General**

This Quarterly Report on Form 10-Q is for the Quarterly Period ended September 30, 2014. In this Quarterly Report, we, us, our and the Trust refer to Universal Health Realty Income Trust.

You should carefully review all of the information contained in this Quarterly Report, and should particularly consider any risk factors that we set forth in this Quarterly Report and in other reports or documents that we file from time to time with the Securities and Exchange Commission (the SEC). In this Quarterly Report, we state our beliefs of future events and of our future financial performance. In some cases, you can identify those so-called forward-looking statements by words such as may, will, should, could, would, predicts, potential, continue, expects, intends, plans, believes, estimates, appears, projects and similar expressions, as well as statements in future tense. You should be aware that those statements are only our predictions. Actual events or results may differ materially. In evaluating those statements, you should specifically consider various factors, including the risks outlined herein and in our Annual Report on Form 10-K for the year ended December 31, 2013 in *Item 1A Risk Factors* and in *Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations - Forward Looking Statements*. Those factors may cause our actual results to differ materially from any of our forward-looking statements.

In certain of our markets, the general real estate market has been unfavorably impacted by increased competition/capacity and decreases in occupancy and rental rates which may adversely impact our operating results and the underlying value of our properties. In addition, although credit markets conditions and the instability in certain banking and financial institutions over the past several years has not had a material impact on us, there can be no assurance that unfavorable changes in credit market conditions, should they occur, will not materially increase our cost of borrowings and/or have a material adverse impact on our ability to finance our future growth through borrowed funds.

In this Quarterly Report on Form 10-Q, the term revenues does not include the revenues of the unconsolidated limited liability companies (LLCs) in which we have various non-controlling equity interests ranging from 33% to 95%. We currently account for our share of the income/loss from these investments by the equity method (see Note 5). As of September 30, 2014, we had investments in five jointly-owned LLCs, all of which are accounted for by the equity method as of September 30, 2014. Palmdale Medical Properties was consolidated in our financial statements through June 30, 2013 as a result of a master lease arrangement with a wholly-owned subsidiary of UHS. As previously disclosed, the master lease expired effective as of July 1, 2013 and, as of that date, we began accounting for Palmdale Medical Properties under the equity method through December 31, 2013. Effective January 1, 2014, we purchased the third-party minority ownership interests in Palmdale Medical Properties and Sparks Medical Properties in which we formerly held non-controlling majority ownership interests. As a result of our purchase of the minority ownership interests, we now hold 100% of the ownership interests in these LLCs which own MOB's and we began accounting for them on a consolidated basis effective January 1, 2014. Additionally, effective August 1, 2014, we purchased the third-party minority ownership interests in the six LLCs listed below in which we formerly held non-controlling majority ownership interests ranging from 85% to 95%. As a result of our purchase of the minority ownership

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interests, we now hold 100% of the ownership interests in these LLCs which own MOB's and we began accounting for them on a consolidated basis effective August 1, 2014. At the effective date of the purchase of the minority interests, each of the property's assets and liabilities (Palmdale Medical Properties, Sparks Medical Properties and the six LLCs listed below) are recorded at their fair values. (See Note 4 to the consolidated financial statements for additional disclosure).

<b>Name of LLC/LP</b>	<b>Ownership prior to minority interest purchase</b>	<b>Property Owned by LLC</b>
DVMC Properties	90%	Desert Valley Medical Center
Santa Fe Scottsdale	90%	Santa Fe Professional Plaza
PCH Medical Properties	85%	Rosenberg Children's Medical Plaza
Sierra Medical Properties	95%	Sierra San Antonio Medical Plaza
PCH Southern Properties	95%	Phoenix Children's East Valley Care Center
3811 Bell Medical Properties	95%	3811 E. Bell Medical Building Medical Plaza

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The financial statements included herein have been prepared by us, without audit, pursuant to the rules and regulations of the SEC and reflect all normal and recurring adjustments which, in our opinion, are necessary to fairly present results for the interim periods. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although we believe that the accompanying disclosures are adequate to make the information presented not misleading. It is suggested that these financial statements be read in conjunction with the financial statements, the notes thereto and accounting policies included in our Annual Report on Form 10-K for the year ended December 31, 2013.

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

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

The combined revenues generated from the leases on the UHS hospital facilities comprised approximately 27% and 30% of our consolidated revenues for the three months ended September 30, 2014 and 2013, respectively, and approximately 29% and 30% of our consolidated revenues for the nine months ended September 30, 2014 and 2013, respectively. Including 100% of the revenues generated at the unconsolidated LLCs in which we have various non-controlling equity interests ranging from 33% to 95%, the leases on the UHS hospital facilities accounted for approximately 22% of the combined consolidated and unconsolidated revenue for each of the three and nine-month periods ended September 30, 2014 and 2013. In addition, twelve MOBs, that are either wholly or jointly-owned, include or will include tenants which are subsidiaries of UHS.

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

During the third quarter of 2014, a wholly-owned subsidiary of UHS provided notification to us that, upon expiration of The Bridgeway's current lease term in December, 2014, it intends to exercise its option to purchase the real property of the facility. We anticipate that the sale of The Bridgeway, a 103-bed behavioral health facility located in North Little Rock, Arkansas, will occur on December 31, 2014. Our revenues, net cash provided by operating activities and funds from operations have included approximately \$1.1 million earned annually in connection with The Bridgeway's lease. Pursuant to the terms of the lease, we and the wholly-owned subsidiary of UHS are both required to obtain appraisals of the property to determine its fair market value. Based upon the preliminary property appraisals obtained by each party, we estimate that the sales proceeds in connection with the divestiture of The Bridgeway will

approximate \$17.0 million to \$17.5 million. Should the divestiture of The Bridgeway occur as outlined above, we estimate that our results of operations for the three and twelve-month periods ended December 31, 2014 will include a gain on divestiture of approximately \$12.6 million to \$13.1 million.

In addition, UHS is currently negotiating with us regarding our potential ownership of the real property of two free-standing emergency departments located in Texas which are currently under construction and scheduled to be completed during the first quarter of 2015. Since these potential transactions are contingent upon the completion and execution of acquisition and lease agreements (subsidiaries of UHS are expected to operate the facilities), we can provide no assurance that these transactions will ultimately occur. Should they occur, pursuant to the terms of acquisition and lease agreements as currently contemplated, we estimate that the aggregate acquisition cost of these facilities will approximate \$12.5 million to \$13.0 million, and the aggregate rental revenues earned at the commencement of the leases will approximate \$850,000 to \$900,000 annually.

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The table below details the existing lease terms and renewal options for each of the UHS hospital facilities:

<b>Hospital Name</b>	<b>Type of Facility</b>	<b>Annual Minimum Rent</b>	<b>End of Lease Term</b>	<b>Renewal Term (years)</b>
McAllen Medical Center	Acute Care	\$5,485,000	December, 2016	15(a)
Wellington Regional Medical Center	Acute Care	\$3,030,000	December, 2016	15(b)
Southwest Healthcare System, Inland Valley Campus	Acute Care	\$2,648,000	December, 2016	15(b)
The Bridgeway	Behavioral Health	\$930,000	December, 2014	10(c)

- (a) UHS has three 5-year renewal options at existing lease rates (through 2031).  
 (b) UHS has one 5-year renewal option at existing lease rates (through 2021) and two 5-year renewal options at fair market value lease rates (2022 through 2031).  
 (c) UHS provided notification to us that, upon expiration of The Bridgeway's current lease term in December, 2014, it intends to exercise its option to purchase the real property of the facility, as discussed above.

As discussed above, Palmdale Medical Plaza, which is located in Palmdale, California, on the campus of a UHS hospital, had a master lease commitment by a wholly-owned subsidiary of UHS which expired effective as of July 1, 2013. This MOB, tenants of which include subsidiaries of UHS, was completed and opened during the third quarter of 2008 at which time the master lease commenced. The LLC that owns this MOB was deemed to be a variable interest entity during the term of the master lease and was therefore consolidated in our financial statements through June 30, 2013 since we were the primary beneficiary through that date. Effective July 1, 2013, this LLC was no longer deemed a variable interest entity and is accounted for in our financial statements on an unconsolidated basis pursuant to the equity method from July 1, 2013 through December 31, 2013.

Effective January 1, 2014, we purchased the third-party minority ownership interests in two LLCs (Palmdale Medical Properties and Sparks Medical Properties) in which we formerly held non-controlling majority ownership interest. As a result of our purchase of the minority ownership interests, we now hold 100% of the ownership interests in these LLCs (which own MOB) and began accounting for them on a consolidated basis.

We have funded \$2.5 million in equity as of September 30, 2014, and are committed to fund an additional \$500,000, in exchange for a 95% non-controlling equity interest in an LLC (Texoma Medical Properties) that developed, constructed, owns and operates the Texoma Medical Plaza located in Denison, Texas, which was completed and opened during the first quarter of 2010. This MOB is located on the campus of a UHS acute care hospital which is owned and operated by Texoma Medical Center (Texoma Hospital), a wholly-owned subsidiary of UHS. This MOB has tenants that include subsidiaries of UHS. This LLC has a third-party term loan of \$14.9 million, which is non-recourse to us, outstanding as of September 30, 2014. As this LLC is not considered to be a variable interest entity and does not meet the other criteria requiring consolidation of an investment, it is accounted for pursuant to the equity method.

*Advisory Agreement:* UHS of Delaware, Inc. (the Advisor), a wholly-owned subsidiary of UHS, serves as Advisor to us under an Advisory Agreement (the Advisory Agreement) dated December 24, 1986. Pursuant to the Advisory Agreement, the Advisor is obligated to present an investment program to us, to use its best efforts to obtain investments suitable for such program (although it is not obligated to present any particular investment opportunity to us), to provide administrative services to us and to conduct our day-to-day affairs. All transactions between us and

UHS must be approved by the Trustees who are unaffiliated with UHS (the Independent Trustees ). In performing its services under the Advisory Agreement, the Advisor may utilize independent professional services, including accounting, legal, tax and other services, for which the Advisor is reimbursed directly by us. The Advisory Agreement may be terminated for any reason upon sixty days written notice by us or the Advisor. The Advisory Agreement expires on December 31 of each year; however, it is renewable by us, subject to a determination by the Independent Trustees, that the Advisor's performance has been satisfactory. In December of 2013, based upon a review of our advisory fee and other general and administrative expenses, as compared to an industry peer group, the Advisory agreement was renewed for 2014 pursuant to the same terms as the Advisory Agreement in place during 2013.

The Advisory Agreement provides that the Advisor is entitled to receive an annual advisory fee equal to 0.70% of our average invested real estate assets, as derived from our condensed consolidated balance sheet. The average real estate assets for advisory fee calculation purposes exclude certain items from our condensed consolidated balance sheet such as, among other things, accumulated depreciation, cash and cash equivalents, base and bonus rent receivables, deferred charges and other assets. The advisory fee is payable quarterly, subject to adjustment at year-end based upon our audited financial statements. In addition, the Advisor is entitled to an annual incentive fee equal to 20% of the amount by which cash available for distribution to shareholders for each year, as defined in the Advisory Agreement, exceeds 15% of our equity as shown on our condensed consolidated balance sheet, determined in accordance with generally accepted accounting principles without reduction for return of capital dividends. The Advisory Agreement defines cash available for distribution to shareholders as net cash flow from operations less deductions for, among other things,



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amounts required to discharge our debt and liabilities and reserves for replacement and capital improvements to our properties and investments. No incentive fees were paid during the first nine months of 2014 or 2013 since the incentive fee requirements were not achieved. Advisory fees incurred and paid (or payable) to UHS amounted to \$653,000 and \$603,000 for the three months ended September 30, 2014 and 2013, respectively, and were based upon average invested real estate assets of \$373 million and \$345 million for the three-month periods ended September 30, 2014 and 2013, respectively. Advisory fees incurred and paid (or payable) to UHS amounted to \$1.9 million and \$1.8 million for the nine months ended September 30, 2014 and 2013, respectively, and were based upon average invested real estate assets of \$359 million and \$335 million for the nine-month periods ended September 30, 2014 and 2013, respectively.

*Officers and Employees:* Our officers are all employees of a wholly-owned subsidiary of UHS and although as of September 30, 2014 we had no salaried employees, our officers do typically receive annual stock-based compensation awards in the form of restricted stock. In special circumstances, if warranted and deemed appropriate by the Compensation Committee of the Board of Trustees, our officers may also receive one-time special compensation awards in the form of restricted stock and/or cash bonuses.

*Share Ownership:* As of September 30, 2014 and December 31, 2013, UHS owned 6.1% of our outstanding shares of beneficial interest.

*SEC reporting requirements of UHS:* UHS is subject to the reporting requirements of the SEC and is required to file annual reports containing audited financial information and quarterly reports containing unaudited financial information. Since the leases on the hospital facilities leased to wholly-owned subsidiaries of UHS comprised approximately 27% and 30% of our consolidated revenues during the three month periods ended September 30, 2014 and 2013, respectively, and comprised approximately 29% and 30% of our consolidated revenues during the nine months ended September 30, 2014 and 2013, respectively, and since a subsidiary of UHS is our Advisor, you are encouraged to obtain the publicly available filings for Universal Health Services, Inc. from the SEC's website at [www.sec.gov](http://www.sec.gov). These filings are the sole responsibility of UHS and are not incorporated by reference herein.

**(3) Dividends and Equity Issuance Program**

We declared and paid dividends of \$8.1 million, or \$.63 per share, during the third quarter of 2014 and \$7.9 million, or \$.625 per share, during the third quarter of 2013. We declared and paid dividends of \$24.3 million, or \$1.885 per share, during the nine-month period ended September 30, 2014 and \$23.7 million, or \$1.87 per share, during the nine-month period ended September 30, 2013.

During the fourth quarter of 2013, we entered into an ATM Equity Offering Sales Agreement ( *Sales Agreement* ) with Merrill Lynch, Pierce, Fenner and Smith Incorporated ( *Merrill Lynch* ), under which we may offer and sell our common shares of beneficial interest, up to an aggregate sales price of \$50 million. The common shares will be offered pursuant to the Registration Statement filed with the Securities and Exchange Commission, which became effective in November, 2012, under which we can offer up to \$50 million of our securities pursuant to supplemental prospectuses which we may file from time to time.

Pursuant to this ATM program, during the first nine months of 2014, we issued 57,410 shares at an average price of \$42.67 per share (all issued during the first quarter of 2014). Including the shares issued at the end of the fourth quarter of 2013, which settled during the first quarter of 2014, the ATM program generated approximately \$2.9 million of net cash proceeds, (net of approximately \$182,000, consisting of compensation of approximately \$76,000 to Merrill Lynch, as well as approximately \$106,000 of other various fees and expenses) during the first nine months of 2014. Approximately \$592,000 of net cash proceeds (net of approximately \$15,000 of compensation to Merrill Lynch)

related to the shares issued late in the fourth quarter of 2013 and were received by us during the first quarter of 2014. Since inception of this program through September 30, 2014, we have issued 212,123 shares at an average price of \$41.97 per share, which generated approximately \$8.4 million of cash proceeds (net of approximately \$537,000, consisting of compensation of approximately \$222,000 to Merrill Lynch, as well as approximately \$315,000 of other various fees and expenses).

**(4) Acquisitions, Dispositions and New Construction**

**Nine Months Ended September 30, 2014:**

*Acquisitions:*

On August 27, 2014, we purchased the Hanover Emergency Center, a 22,000 rentable square feet, free-standing, full service emergency and imaging center, located in Mechanicsville, VA, for approximately \$8.6 million. The single-tenant property is occupied pursuant to the terms of a 10-year lease with HCA Health Services of Virginia, Inc.

The aggregate purchase price for this clinic was allocated to the assets and liabilities acquired consisting of tangible property and identified intangible assets, based on their respective fair values at acquisition as detailed in the table below. Substantially all of the intangible assets include the value of the in-place lease at the clinic at the time of acquisition which will be amortized over the average remaining lease term of approximately 9.8 years at the time of acquisition.

Land	\$ 1,300
Buildings and improvements	6,224
Intangible assets	1,026
Net cash paid	\$ 8,550

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Additionally, effective August 1, 2014, we paid an aggregate of \$6.8 million (consisting of \$3.3 million in cash and \$3.5 million in the form of a note payable to the previous third-party member, with a maturity date of January 5, 2015 and reflected in Accrued expenses and other liabilities on our Condensed Consolidated Balance Sheet at September 30, 2014 ) to purchase the minority ownership interests held by third-party members in six LLCs (as noted in the table below) in which we previously held various noncontrolling, majority ownership interests ranging from 85% to 95%. As a result of these minority ownership purchases, we now own 100% of each of these LLCs, which own medical office buildings and a clinic, and began accounting for each on a consolidated basis effective August 1, 2014. Pursuant to current accounting standards, during the third quarter of 2014, we were required to record each property's assets and liabilities at their fair values which resulted in the recording of a \$25.1 million non-cash gain, which is included in our Condensed Consolidated Statement of Income for the three and nine months ended September 30, 2014, representing the difference between the fair values and the equity method carrying value of each investment. The calculated fair value, utilizing the income capitalization approach, is based upon the basis of capitalization of the net estimated earnings expectancy of the property, assuming continued use similar to the existing use of the acquired property. Each property's continued cash flow analysis was also utilized in estimating the fair value of the property, whereby cash flows from the various tenants are calculated based upon lease commencement and termination dates.

<b>Name of LLC/LP</b>	<b>Ownership prior to minority interest purchase</b>	<b>Property Owned by LLC</b>
DVMC Properties	90%	Desert Valley Medical Center
Santa Fe Scottsdale	90%	Santa Fe Professional Plaza
PCH Medical Properties	85%	Rosenberg Children's Medical Plaza
Sierra Medical Properties	95%	Sierra San Antonio Medical Plaza
PCH Southern Properties	95%	Phoenix Children's East Valley Care Center
3811 Bell Medical Properties	95%	3811 E. Bell Medical Building Medical Plaza

The aggregate fair values of these MOB's was preliminarily allocated to estimated net tangible property (\$64.5 million), identified intangible assets (\$3.7 million), and long term debt (\$19.0 million), and may be adjusted based upon final valuations determined pursuant to third-party appraisals. Substantially all of the intangible assets include the value of the in-place leases at these MOB's at the time of acquisition which will be amortized over the combined average remaining lease term of approximately 4.7 years at the time of acquisition. Other than the increased depreciation and amortization expense resulting from the amortization of the intangible assets recorded in connection with these transactions, there was no material impact on our net income as a result of the consolidation of these LLC's.

Additionally, we paid an aggregate of \$7.2 million to purchase the following in January, 2014 in a single transaction:

The Children's Clinic at Springdale a 9,800 square foot, single-tenant medical office building located in Springdale, Arkansas, and;

The Northwest Medical Center at Sugar Creek a 16,700 square foot, multi-tenant medical office building located in Bentonville, Arkansas.

The aggregate purchase price for these MOBs was allocated to the assets and liabilities acquired consisting of tangible property and identified intangible assets, based on their respective fair values at acquisition as detailed in the table below. Substantially all of the intangible assets include the value of the in-place leases at the MOBs at the time of acquisition which will be amortized over the average remaining lease term of approximately 9.7 years at the time of acquisition.

Land	\$ 1,710
Buildings and improvements	4,440
Intangible assets	1,050
Deposit paid in 2013	(150)
Net cash paid	\$ 7,050

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The acquisition was preliminarily valued utilizing the income capitalization approach. The calculated fair value, utilizing the income capitalization approach, is based upon the basis of capitalization of the net estimated earnings expectancy of the property, assuming continued use similar to the existing use of the acquired property. The property's continued cash flow analysis were also utilized in estimating the fair value of the property, whereby cash flows from the various tenants are calculated based upon lease commencement and termination dates.

Additionally, effective January 1, 2014, we paid an aggregate of \$170,000 to purchase the 5% minority ownership interests held by third-party members in two LLCs in which we previously held noncontrolling, 95% majority ownership interests (Palmdale Medical Properties and Sparks Medical Properties). As a result of these minority ownership purchases, we now own 100% of each of these LLCs and began accounting for each property on a consolidated basis effective January 1, 2014. Pursuant to current accounting standards, during the first quarter of 2014, we were required to record each property's assets and liabilities at their fair values which resulted in the recording of a \$316,000 non-cash gain, which is included in our Condensed Consolidated Statement of Income for the nine months ended September 30, 2014, representing the difference between the fair values and the equity method carrying value of each investment. The calculated fair value, utilizing the income capitalization approach, is based upon the basis of capitalization of the net estimated earnings expectancy of the property, assuming continued use similar to the existing use of the acquired property. The property's continued cash flow analysis were also utilized in estimating the fair value of the property, whereby cash flows from the various tenants are calculated based upon lease commencement and termination dates.

The aggregate fair values of these MOB's were allocated to net tangible property (\$19.5 million), identified intangible assets (\$2.8 million), and long term debt (\$10.7 million). Substantially all of the intangible assets include the value of the in-place leases at these MOB's at the time of acquisition which will be amortized over the combined average remaining lease term of approximately 5.3 years at the time of acquisition. Other than the increased depreciation and amortization expense resulting from the amortization of the intangible assets recorded in connection with these transactions, there was no material impact on our net income as a result of the consolidation of these LLCs.

### *Divestitures:*

There were no divestitures during the first nine months of 2014.

### **Nine Months Ended September 30, 2013:**

#### *Acquisition:*

On August 22, 2013, we purchased the Ward Eagle Office Village, a medical office building located in Farmington Hills, Michigan. This multi-tenant MOB, which was purchased for approximately \$4.1 million, consists of approximately 16,282 rentable square feet. The net tangible and intangible property asset allocation of the total purchase price was recorded during the third quarter of 2013.

On June 6, 2013, we purchased the 5004 Poole Road medical office building located in Denison, Texas, on the campus of Texoma Medical Center, a wholly-owned subsidiary of UHS. This single-tenant MOB, which was purchased for approximately \$625,000, consists of approximately 4,400 rentable square feet and is located adjacent to our Texoma Medical Plaza MOB.

#### *New Construction:*

The newly constructed Forney Medical Plaza II located in Forney, Texas was completed and opened in April, 2013. This multi-tenant medical office building, consisting of 30,000 rentable square feet, is owned by a limited partnership in which we hold a 95% non-controlling ownership interest. As this LLC is not considered to be a variable interest entity, it is accounted for pursuant to the equity method.

*Divestitures:*

There were no divestitures during the first nine months of 2013.

**(5) Summarized Financial Information of Equity Affiliates**

Our condensed consolidated financial statements include the consolidated accounts of our controlled investments and those investments that meet the criteria of a variable interest entity where we are or were the primary beneficiary. In accordance with the Financial Accounting Standards Board's (FASB) standards and guidance relating to accounting for investments and real estate ventures, we account for our unconsolidated investments in LLCs which we do not control using the equity method of accounting. The third-party members in these investments have equal voting rights with regards to issues such as, but not limited to: (i) divestiture of

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property; (ii) annual budget approval, and; (iii) financing commitments. These investments, which represent 33% to 95% non-controlling ownership interests, are recorded initially at our cost and subsequently adjusted for our net equity in the net income, cash contributions to, and distributions from, the investments. Pursuant to certain agreements, allocations of sales proceeds and profits and losses of some of the LLC investments may be allocated disproportionately as compared to ownership interests after specified preferred return rate thresholds have been satisfied.

At September 30, 2014, we have non-controlling equity investments or commitments in five jointly-owned LLCs which own MOBs. As of September 30, 2014, we accounted for these LLCs on an unconsolidated basis pursuant to the equity method since they are not variable interest entities. The majority of these LLCs are joint-ventures between us and non-related parties that manage and hold minority ownership interests in the entities. Each LLC is generally self-sustained from a cash flow perspective and generates sufficient cash flow to meet its operating cash flow requirements and service the third-party debt (if applicable) that is non-recourse to us. Although there is typically no ongoing financial support required from us to these entities since they are cash-flow sufficient, we may, from time to time, provide funding for certain purposes such as, but not limited to, significant capital expenditures, leasehold improvements and debt financing. Although we are not obligated to do so, if approved by us at our sole discretion, additional cash fundings are typically advanced as equity or member loans.

Effective August 1, 2014, we purchased the minority ownership interests, ranging from 5% to 15%, held by third-party members in six LLCs in which we previously held noncontrolling majority ownership interests, as noted in the table below. As a result of these minority ownership purchases, we now own 100% of each of these LLCs and began to account for them on a consolidated basis effective August 1, 2014. Prior to August 1, 2014, these LLCs were accounted for on an unconsolidated basis pursuant to the equity method.

<b>Name of LLC/LP</b>	<b>Ownership prior to minority interest purchase</b>	<b>Property Owned by LLC</b>
DVMC Properties	90%	Desert Valley Medical Center
Santa Fe Scottsdale	90%	Santa Fe Professional Plaza
PCH Medical Properties	85%	Rosenberg Children's Medical Plaza
Sierra Medical Properties	95%	Sierra San Antonio Medical Plaza
PCH Southern Properties	95%	Phoenix Children's East Valley Care Center
3811 Bell Medical Properties	95%	3811 E. Bell Medical Building Medical Plaza

Effective January 1, 2014, we purchased the 5% minority ownership interests held by third-party members in two LLCs in which we previously held noncontrolling majority ownership interests (Palmdale Medical Properties and Sparks Medical Properties). As a result of these minority ownership purchases, we now own 100% of each of these LLCs and account for them on a consolidated basis. Prior to January 1, 2014, these LLCs were accounted for on an unconsolidated basis pursuant to the equity method. Previously, Palmdale Medical Properties ( Palmdale ) was included in our financial statements on a consolidated basis through June 30, 2013 as a result of a master lease arrangement with a wholly-owned subsidiary of UHS, which expired on July 1, 2013.

At September 30, 2014, the LLCs in which we hold various non-controlling ownership interests are not variable interest entities and therefore are not subject to consolidation. As a result of master lease arrangements between UHS and various LLCs in which we hold majority non-controlling ownership interests, we have consolidated or deconsolidated these LLCs as required in accordance with the FASB's standards and guidance.

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

The following property table represents the five LLCs in which we own a noncontrolling interest and were accounted for under the equity method as of September 30, 2014:

<b>Name of LLC/LP</b>	<b>Ownership</b>	<b>Property Owned by LLC</b>
Suburban Properties	33%	Suburban Medical Plaza II
Brunswick Associates	74%	Mid Coast Hospital MOB



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<b>Name of LLC/LP</b>	<b>Ownership</b>	<b>Property Owned by LLC</b>
Arlington Medical Properties (b.)	75%	Saint Mary's Professional Office Building
Grayson Properties (a.)(c.)	95%	Texoma Medical Plaza
FTX MOB Phase II (d.)	95%	Forney Medical Plaza II

- (a.) Tenants of this medical office building include subsidiaries of UHS.
- (b.) We have funded \$5.2 million in equity as of September 30, 2014 and are committed to invest an additional \$1.2 million. This LLC has a third-party term loan of \$23.5 million, which is non-recourse to us, outstanding as of September 30, 2014.
- (c.) We have funded \$2.5 million in equity as of September 30, 2014, and are committed to fund an additional \$500,000. This building is on the campus of a UHS hospital and has tenants that include subsidiaries of UHS. This LLC has a third-party term loan of \$14.9 million, which is non-recourse to us, outstanding as of September 30, 2014.
- (d.) During the third quarter of 2012, this limited partnership entered into an agreement to develop, construct, own and operate the Forney Medical Plaza II, which opened on April 1, 2013. We have committed to invest up to \$2.5 million in equity and debt financing, of which \$1.4 million has been funded as of September 30, 2014. This LLC has a third-party term loan of \$5.6 million, which is non-recourse to us, outstanding as of September 30, 2014.

Below are the condensed combined statements of income (unaudited) for the LLCs accounted for under the equity method at September 30, 2014 and 2013. The combined statements of income for the three and nine months ended September 30, 2014 include the financial results through July 31, 2014, for the six LLCs (Desert Valley Medical Center, Santa Fe Professional Plaza, Rosenberg Children's Medical Plaza, Sierra San Antonio Medical Plaza, Phoenix Children's East Valley Care Center and 3811 E. Bell Medical Building Medical Plaza) that we began to account for on a consolidated basis as of August 1, 2014, as discussed above.

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>	<b>September 30,</b>	<b>September 30,</b>	<b>September 30,</b>
	<b>2014(c.)</b>	<b>2013 (b.)</b>	<b>2014(c.)</b>	<b>2013 (b.)</b>
	<b>(amounts in thousands)</b>			
Revenues	\$ 3,905	\$ 5,320	\$ 13,828	\$ 15,566
Operating expenses	1,691	2,099	5,826	6,499
Depreciation and amortization	626	985	2,401	2,969
Interest, net	862	1,716	3,541	4,714
<b>Net income</b>	<b>\$ 726</b>	<b>\$ 520</b>	<b>\$ 2,060</b>	<b>\$ 1,384</b>
Our share of net income (a.)	\$ 499	\$ 515	\$ 1,771	\$ 1,545

- (a.) Our share of net income includes interest income earned by us on various advances made to LLCs of approximately \$122,000 and \$511,000 for the three months ended September 30, 2014 and 2013, respectively, and \$834,000 and \$1.4 million for the nine months ended September 30, 2014 and 2013, respectively.
- (b.) As mentioned above, we began to account for Sparks Medical Properties on a consolidated basis as of January 1, 2014. Prior to January 1, 2014, the financial results of this entity were accounted for under the equity method on

an unconsolidated basis. These amounts include the financial results for Sparks Medical Properties for the three and nine months ended September 30, 2013. As also mentioned above, we began to account for Palmdale Medical Properties on a consolidated basis as of January 1, 2014. Prior thereto, as a result of a master lease commitment with a wholly-owned subsidiary of UHS which expired effective as of July 1, 2013, Palmdale Medical Properties was accounted for on a consolidated basis through the six-month period ended June 30, 2013 and is therefore reflected in the table above for only the three-month period of July 1, 2013 through September 30, 2013.

- (c.) As mentioned above, we began to account for six LLCs (Desert Valley Medical Center, Santa Fe Professional Plaza, Rosenberg Children's Medical Plaza, Sierra San Antonio Medical Plaza, Phoenix Children's East Valley Care Center and 3811 E. Bell Medical Building Medical Plaza) on a consolidated basis as of August 1, 2014. Prior to August 1, 2014, the financial results of these entities were accounted for under the equity method on an unconsolidated basis. The three months ended September 30, 2014, include the financial results of the six mentioned LLCs for July, 2014, and the nine months ended September 30, 2014, include the financial results of the six mentioned LLCs for seven months ended July 31, 2014.

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

	September 30, 2014(a.)	December 31, 2013(a.)(b.)
	(amounts in thousands)	
Net property, including CIP	\$ 61,919	\$ 119,547
Other assets	6,013	9,479
<b>Total assets</b>	<b>\$ 67,932</b>	<b>\$ 129,026</b>
Liabilities	\$ 2,490	\$ 5,336
Mortgage notes payable, non-recourse to us	51,829	80,112
Advances payable to us		22,911
Equity	13,613	20,667
<b>Total liabilities and equity</b>	<b>\$ 67,932</b>	<b>\$ 129,026</b>
<b>Our share of equity and advances to LLCs</b>	<b>\$ 8,531</b>	<b>\$ 39,201</b>

- (a.) The amounts presented include the balance sheet amounts for each of the five entities that are accounted for on an unconsolidated basis as of September 30, 2014.
- (b.) As mentioned above, we began to account for Palmdale Medical Properties and Sparks Medical Properties on a consolidated basis effective January 1, 2014. As also mentioned above, we began to account for six LLCs (Desert Valley Medical Center, Santa Fe Professional Plaza, Rosenberg Children's Medical Plaza, Sierra San Antonio Medical Plaza, Phoenix Children's East Valley Care Center and 3811 E. Bell Medical Building Medical Plaza) on a consolidated basis as of August 1, 2014. The amounts reflected for December 31, 2013, include the balance sheet amounts for each of these entities since they were accounted for on an unconsolidated basis pursuant to the equity method as of December 31, 2013.

As of September 30, 2014, aggregate principal amounts due on mortgage notes payable by unconsolidated LLCs, which are accounted for under the equity method and are non-recourse to us, are as follows (amounts in thousands):

2014	\$ 317
2015	31,414
2016	358
2017	5,547
2018	259
2019 and After	13,934
<b>Total</b>	<b>\$ 51,829</b>

<b>Name of LLC</b>	<b>Mortgage/ Construction Loan Balance (a.)</b>	<b>Maturity Date</b>
Brunswick Associates (b.)	7,825	January, 2015
Arlington Medical Properties	23,481	October, 2015
FTX MOB Phase II (c.)	5,577	August, 2017
Grayson Properties (d.)	14,946	September, 2021
	<b>\$ 51,829</b>	

- (a.) All mortgage loans, other than construction loans, require monthly principal payments through maturity and include a balloon principal payment upon maturity.
- (b.) We expect to refinance this loan during 2014 (matures in January, 2015) at the then current market interest rates. In the unexpected event that we are unable to refinance this loan on reasonable terms, we will explore other financing alternatives, including, among other things, utilizing funds borrowed under our revolving credit agreement.
- (c.) This loan was converted from a construction loan to a term loan in August, 2014, pursuant to the terms of the loan agreement.
- (d.) This loan was refinanced in September, 2014 for a seven year term at a fixed rate of 5.034%. This loan includes two one-year extension options.

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

The LLCs in which we have invested maintain property insurance on all properties. Although we believe that generally our properties are adequately insured, two of the wholly-owned LLCs own properties in California that are located in earthquake zones. These properties are not covered by earthquake insurance since earthquake insurance is no longer available at rates which are economical in relation to the risks covered.

### **(6) Recent Accounting Pronouncements**

In August 2014, the FASB issued changes to the disclosure of uncertainties about an entity's ability to continue as a going concern. Under GAAP, continuation of a reporting entity as a going concern is presumed as the basis for preparing financial statements unless and until the entity's liquidation becomes imminent. Even if an entity's liquidation is not imminent, there may be conditions or events that raise substantial doubt about the entity's ability to continue as a going concern. Because there is no guidance in GAAP about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern or to provide related note disclosures, there is diversity in practice whether, when, and how an entity discloses the relevant conditions and events in its financial statements. As a result, these changes require an entity's management to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that financial statements are issued. Substantial doubt is defined as an indication that it is probable that an entity will be unable to meet its obligations as they become due within one year after the date that financial statements are issued. If management has concluded that substantial doubt exists, then the following disclosures should be made in the financial statements: (i) principal conditions or events that raised the substantial doubt, (ii) management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations, (iii) management's plans that alleviated the initial substantial doubt or, if substantial doubt was not alleviated, management's plans that are intended to at least mitigate the conditions or events that raise substantial doubt, and (iv) if the latter in (iii) is disclosed, an explicit statement that there is substantial doubt about the entity's ability to continue as a going concern. These changes become effective for the 2016 annual period. Management has determined that the adoption of these changes will not have an impact on the Consolidated Financial Statements. Subsequent to adoption, this guidance will need to be applied by management at the end of each annual period and interim period therein to determine what, if any, impact there will be on the Consolidated Financial Statements in a given reporting period.

In April 2014, the Financial Accounting Standards Board updated the accounting guidance related to the definition of a discontinued operation and the related disclosures. The updated accounting guidance defines a discontinued operation as a disposal of a component or a group of components that is to be disposed of or is classified as held for sale and represents a strategic shift that has or will have a major effect on an entity's operations and financial results. The updated guidance is applicable to us effective January 1, 2015 with early adoption permitted. We do not expect the adoption of this update to have a material impact on our condensed consolidated financial statements.

### **(7) Debt and Financial Instruments**

*Debt:*

In July, 2011, we entered into a \$150 million revolving credit agreement ( Credit Agreement ) which is scheduled to expire on July 24, 2015. We are in the early stages of renegotiating our Credit Agreement and expect to complete a replacement credit facility within the next three months. We can provide no assurance that a replacement credit facility will be obtained on acceptable terms. The Credit Agreement includes a \$50 million sub limit for letters of credit and