

HEALTHCARE REALTY TRUST
INCORPORATED

1993 ANNUAL REPORT

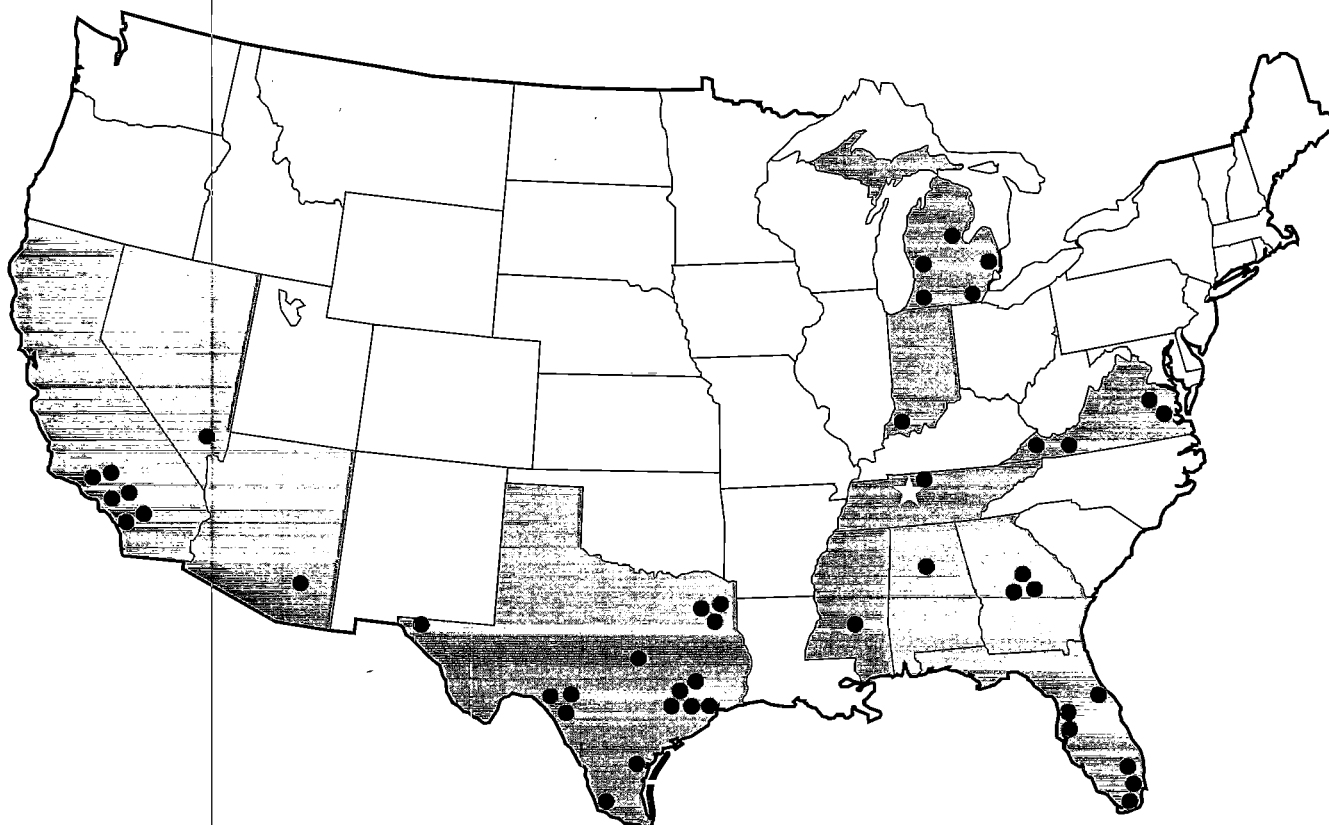


FINANCIAL HIGHLIGHTS

	From Inception Through December 31, 1993*	Quarter Ended December 31, 1993
REVENUES:		
Base rental income	\$7,066,606	\$3,408,255
Interest income	68,398	4,165
	<u>7,135,004</u>	<u>3,412,420</u>
Net income	\$3,950,034	\$1,866,514
Net income per share	\$ 0.64	\$ 0.30
Cash available for distribution	\$6,268,879	\$2,911,087
Cash available for distribution per share	\$ 1.01	\$ 0.47
Dividends paid	\$ 0.551	\$ 0.551
Weighted average shares outstanding	<u>6,185,600</u>	<u>6,185,600</u>

*The Company began operations on June 3, 1993, upon the completion of its initial public offering.

Location of Properties and New Investments*





LETTER TO SHAREHOLDERS

We are pleased to report to you our progress since becoming a public company in June of 1993. During the formative stages of our Company's existence, prior to our initial public offering, we developed a specific strategy for success. Our goal was to become an independent REIT, to own and lease a diversified group of healthcare properties, to concentrate our investments in the growing alternate site and outpatient healthcare businesses, to capitalize the Company with minimal debt, and to pay an attractive dividend to our shareholders. We have achieved all of our formation objectives, and we are on track to enhance this performance in 1994.

For the quarter ended December 31, 1993, revenues totaled \$3.4 million. Net income for the period was \$1.9 million, or \$0.30 per share. Cash available for distribution or reinvestment for the quarter, which consists of net income, depreciation and other non-cash charges, totaled \$2.9 million, or \$0.47 per share.

The Company's year-to-date financial performance in 1993 includes only seven months of operating results because the Company commenced operations on June 3 when our initial public offering was completed. During the period from June 3, 1993, to December 31, 1993, Healthcare Realty Trust achieved revenues of \$7.1 million. Net income for the period was \$4.0 million, or \$0.64 per share. Cash available for

distribution or reinvestment totaled \$6.3 million, or \$1.01 per share.

Healthcare Realty Trust announced the payment of its first dividend for the period ended June 30, 1993, and the quarter ended September 30, 1993. For the holders of common stock as of the close of business on November 1, 1993, the Company paid \$0.126 per share related to the 27 days of its operation in June 1993 and \$0.425 per share for the quarter ended September 30, 1993. Subsequent to year end, the Company increased its dividend to \$0.43 for the quarter ended December 31, 1993. This recent dividend approximates an annual dividend rate of \$1.72 per share.

Healthcare Realty Trust Incorporated began its existence as a public company with the initial public offering of 6,000,000 shares of common stock which were listed on the New York Stock Exchange. The Company raised approximately \$108.8 million; and within three weeks of the closing of our public offering, completed the purchase of all of the initial properties. It is noteworthy that we were able to complete the purchase of our initial properties this quickly, and we are grateful to our employees and professional counsel who worked so diligently to accomplish this task.

Consistent with our strategic plan, the properties acquired with the proceeds of the initial public offering represent a variety of facility types

and diverse healthcare industry segments, including alternate site and outpatient facilities. The lessees include, among others, Columbia/HCA Healthcare Corporation; PhyCor, Inc.; OrNda Healthcorp and Healthtrust, Inc. The quality of these companies as lessees provides dividend security for our shareholders. In addition, the operating success and strength of our lessees provides Healthcare Realty Trust with substantial opportunities to fund additional acquisitions and lessee developments.

Unlike many other healthcare REITs, Healthcare Realty Trust has a highly diversified portfolio independent from any one healthcare provider. We view this independence as a strategic advantage which permits us to diversify more readily, and it enables us to be more flexible in our financing negotiations. In addition, diversification is a strength because it makes us attractive to a large variety of healthcare providers who are not confronted with the possibility of a competitive relationship. An important component of our operating strategy is to focus on the development of sound and mutually beneficial relationships with these providers. We expect the relationships we have developed to foster continued opportunities for growth with our existing lessees and enhance our prospects for developing relationships with other strong, well posi-

tioned healthcare providers.

The underlying principle in the formation of Healthcare Realty Trust was to structure a company that, as a result of its diversification and the quality credit of the lessees, would be a convenient, cost-effective source of funds for well established healthcare providers.

We are intent on offering prominent healthcare providers access to capital at a cost that is competitive with their alternative sources of funds while providing beneficial enhancements to their balance sheets and earnings per share.

Healthcare Realty Trust is different from the traditional REIT that is usually considered a source of expensive debt. Rather, our Company is a REIT that provides funds under terms and conditions which we believe should be considered inexpensive equity.

We believe that our emergence as a new healthcare REIT has occurred at a very opportune time.

The market, social and political forces that are bringing about the restructuring of the healthcare industry have created an environment for Healthcare Realty Trust to become a leader in the REIT industry. Healthcare providers are merging, forming strategic alliances and creating networks to achieve economies of scale and offer one-stop shopping for healthcare services at a time when employers and

insurers are demanding less-expensive coverage. Furthermore, most legislative proposals for health-care reform stress the results achieved from the use of outpatient and alternate site facilities — the types of facilities in which the Company is focusing its investments. The restructuring of the healthcare system will continue to create a substantial demand for funding to meet the real estate financing needs related to mergers, networks and alliances.

We recognize and understand the nature of the demand for real estate capital and have designed funding agreements to advance the business objectives of our existing and prospective lessees.

We also are pleased to report that our Company is in a strong financial position. We emerged from the initial public offering with virtually no debt. At the end of 1993, bank borrowings accounted for only 16 percent of total capital. The Company's ongoing goal is to maintain a debt to total capitalization ratio which does not exceed 40 percent.

Subsequent to the close of the fiscal year, the Company completed the sale of 6,250,000 additional shares of common stock, raising \$126 million in proceeds to be used primarily to purchase additional properties. This secondary offering brings the total amount of equity raised to over \$235 million. The



market's positive reception to this offering was gratifying, and we believe it is a validation of our operating strategy, growth potential and strong capital structure.

Upon completion of the investment of the proceeds from this offering, the Company will own 45 properties located in 12 states that are leased to 14 operators.

We are grateful to the Board of Directors for their leadership, to our employees for their efforts and to our lessees for their participation. We are especially thankful to our shareholders who invested in our Company and believed in our strategy. We appreciate your interest and look forward to keeping you informed of our progress in 1994.

Sincerely,

A handwritten signature in dark ink that reads "David R. Emery". The signature is written in a cursive, slightly slanted style.

David R. Emery
Chairman of the Board
and President



1993 IN REVIEW

The goal of Healthcare Realty Trust is to provide facility funding to a diverse group of quality healthcare providers, geographically dispersed, with an emphasis on alternate care and outpatient services; to strengthen these relationships while expanding our portfolio to include additional healthcare providers with a reputation for high quality, cost-effective service, while generating increasing dividend income for our shareholders.

The Industry

A Real Estate Investment Trust ("REIT") is usually a publicly traded corporation or trust specializing in purchasing and managing real property. REITs derive income from lessees who pay rent to the REIT (Equity REIT) or from interest earned on mortgage loans to real estate owners (Mortgage REIT). In addition, there are hybrid REITs which combine the investment strategies of both Equity and Mortgage REITs. A corporation or trust which qualifies as a REIT generally does not pay corporate income tax to the

Internal Revenue Service and most states do not require REITs to pay state income tax. Thus, nearly all of a REIT's income can be distributed to shareholders and there is no double taxation of the income to the shareholder.

Since the mid-1980s, many new healthcare REITs were formed to enable major healthcare companies to fund capital needs without increasing debt on their balance sheets. Typically, these transactions involved major healthcare companies selling their own properties to a newly created REIT in a captive sale/leaseback transaction. Two challenges encountered by healthcare REITs which are closely linked to their sponsoring healthcare companies are: 1) other healthcare providers are reluctant to affiliate, even indirectly, with a competitor through a REIT transaction; and 2) because of a lack of diversification as to ownership, if the sponsoring healthcare company experiences financial problems, then the REIT

suffers a similar financial fate. Today, many of the healthcare REITs are engaged in diversification efforts to limit their reliance on and involvement in one major healthcare company or industry segment. Clearly, the most ideal solution would be a healthcare REIT which is both diversified and independent of any one major healthcare provider.

The Company

Healthcare Realty Trust Incorporated was organized as an independent real estate investment trust to participate in the growing need for additional funding sources related to the restructuring that is occurring in the healthcare industry. Through its unique portfolio of investments, the Company owns and leases a diversified group of exceptional healthcare properties. The Company is self-administered, and is managed by an experienced executive staff and a very capable Board of Directors — each chosen for their

and real estate. Also, this management team is conservative in credit judgments, working with high-quality healthcare providers that have aggressive growth strategies. The Company is independent because it is not affiliated with any of its lessees. This independence gives the Company a strategic advantage in providing funding to a diverse group of healthcare providers with proven records for strong operating performance.

"Healthcare Realty Trust's investments are diversified in attractive healthcare industry segments, and the Company has an impressive list of tenants which leads us to believe it has sound growth potential for future purchases from existing tenants. Healthcare Realty is a truly independent REIT. In addition, unlike many healthcare REITs, Healthcare Realty Trust began its existence with a strong balance sheet."

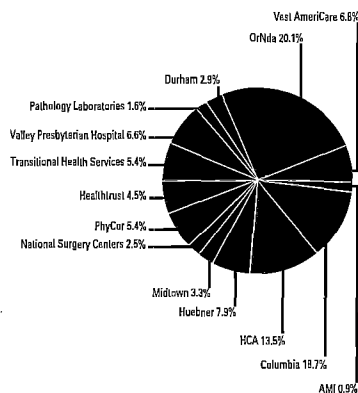
**John Hindelong, Vice President,
Donaldson Lufkin & Jenrette**





The key element of Healthcare Realty Trust's strategy is to focus on quality relationships with lessees which foster the best credits and the greatest opportunity for additional investments. Also, it is the Company's intention to invest in the type of properties which will benefit most from the changes taking place as a result of the restructuring of the healthcare delivery system.

Properties by Lessee



As a result of its strategy to be an independent, non-aligned healthcare REIT with diverse lessees, the Company is assured of a consistent and secure cash flow which allows a conservative dividend pay-out percentage while maintaining an attractive yield. In addition, the Company

anticipates significant growth opportunities because of the relationships that have been developed with leading healthcare providers who are in constant need of capital for expansion. The portfolio of properties which the Company has acquired illustrates the investment opportunities available to a diversified healthcare REIT.

"We are extremely impressed with the level of tenacity and determination exhibited by the executive officers of Healthcare Realty Trust. Within 13 business days of receiving the proceeds from the IPO, the Company had closed on 84 percent of the initial properties, surpassing our projections. The quick closing of the 21 properties with parties not affiliated with the Company reflects the considerable transactional skills that we have observed in the management team."

**James G. Baker III, Research Analyst,
Equitable Securities Corporation**

The Company's acquisition strategy is to position itself to benefit

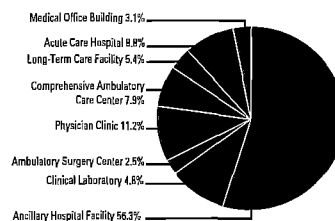
from trends that are emerging in the healthcare services industry. One of the most important of these trends is the effort on the part of third-party payors, managed care companies, and employers to control the rising costs of healthcare by encouraging the transition of patients from expensive acute-care hospitals into less costly alternate site and outpatient facilities. These type facilities are not burdened with the high capital costs and overhead related to acute-care hospitals, thereby, providing medical care at substantially lower rates.

The recent advances in technology related to diagnosis and treatment are unparalleled. These advances along with the aging of the population have created an ever increasing demand for services.

In the early 1970s, outpatient revenues were about three percent of total hospital revenues; today, this amount has grown to approximately thirty-four percent; and by the year 2000, outpatient revenues are expected to exceed fifty percent of total

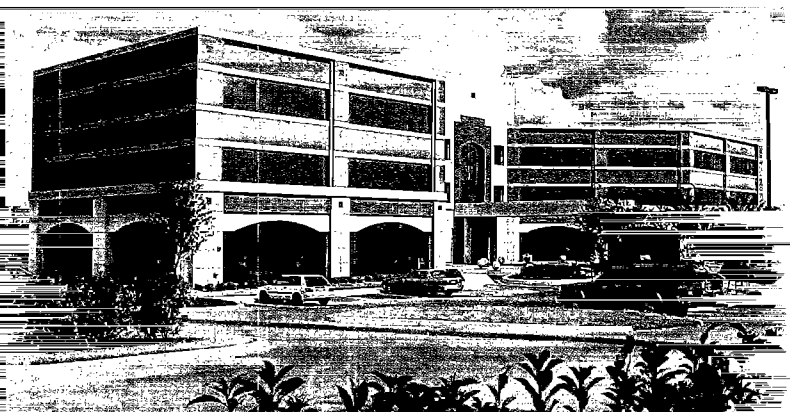
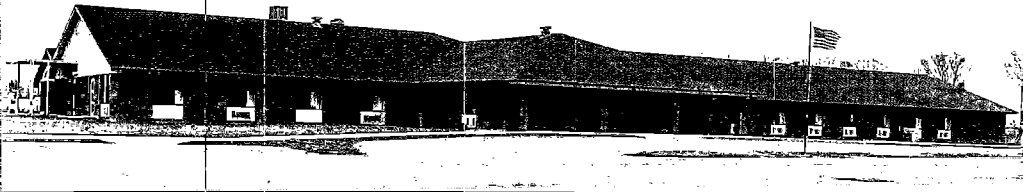
hospital revenues. It is estimated that by 1996 two out of every three hospitals will be aligned with large physician groups using outpatient settings to provide health services in a managed-care environment.

Properties by Type



Modern Healthcare magazine estimates that \$11.8 billion was spent in 1993 by healthcare providers for facility construction — 85 percent of which was for construction related to outpatient and alternate site facilities.

Notwithstanding the emphasis on outpatient and alternate site facilities, the Company will continue to invest in traditional inpatient facilities particularly the long-term care and transitional care sectors.



"We believe that Healthcare Realty Trust represents an attractive investment because the Company offers a high degree of safety as a result of its diversification, the quality of its lessees, and it is a non-captive REIT with an independent and experienced management team. Its flexible financial position will allow it to take advantage of future acquisition opportunities, and its emphasis on outpatient and alternate site facilities will fulfill a demand which is steadily increasing."

Geoffrey E. Harris, CFA, Vice President, Smith Barney Shearson

Healthcare Realty Trust has emerged as a new healthcare REIT at a very auspicious time in the history of our healthcare delivery system. The Company recognizes and understands the increasing demand for capital in today's healthcare environment and is very well positioned to offer healthcare providers convenient, cost-effective capital to facilitate the restructuring of our nation's

healthcare delivery system.

There has been considerable discussion about a crisis in the healthcare system of the United States. Notwithstanding the changes that are being brought about by economic, political and social pressures, it is interesting to note that when the Japanese write the word *crisis*, it is made up of two characters: one from the word *danger* and one from the word *opportunity*. We see the restructuring of our nation's healthcare system as an *opportunity* for Healthcare Realty Trust.

The Company has experienced management, a strong balance sheet and it is unique in the industry as a diversified, independent healthcare REIT. By providing needed capital in an essential industry, the Company expects to continue its positive momentum while being a proactive participant in the transformation of the nation's healthcare system.

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SELECTED FINANCIAL INFORMATION

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

Commencement of
Operations Through
December 31, 1993 (1)

STATEMENT OF INCOME DATA:

Total revenues	\$ 7,135,004
Interest expense	314,167
Net income	3,950,034
Net income per share	\$ 0.64
Weighted average shares outstanding	6,185,600

BALANCE SHEET DATA:

Real estate properties, net	\$133,392,751
Total assets	134,069,694
Bank credit facility	21,000,000
Total shareholders' equity	108,190,254

OTHER DATA:

Cash available for distribution(2)	\$ 6,268,879
Cash available for distribution per Share(2)	\$ 1.01

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

(2) Cash available for distribution is net income plus depreciation, amortization and other non-cash items. Distributions in excess of net income generally constitute a return of capital. Management considers cash available for distribution to be an informative measure of the performance of an equity REIT and consistent with measures used by analysts to evaluate equity REITs. Cash available for distribution 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.

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

Overview

The Company was incorporated in Maryland in May 1992 and operates under the Internal Revenue Code of 1986 as an indefinite life real estate investment trust. Substantially all of the Company's revenues are derived from base and additional rentals received generally under net leases of healthcare real estate property facilities and interest earned from the temporary investment of funds in short-term instruments. The Company incurs operating and administrative expenses, principally compensation expense for its officers and other employees, office rental and related occupancy costs and various expenses incurred in the process of acquiring additional properties.

The Company is "self-administered" and managed by its executives and staff and does not engage a separate advisor or pay an advisory fee for administrative or investment services, although the Company engages legal, accounting, tax and financial advisors from time to time. The Company leverages its portfolio of real estate equity investments and will continue to incur long and short-term indebtedness, and related interest expense, from time to time. The Company intends to continue to declare and pay dividends to its shareholders in amounts not less than the amounts required to maintain REIT status under the Internal Revenue Code of 1986 and, in general, in amounts exceeding taxable income. The Company's ability to pay dividends will depend upon its cash available for distribution.

The Compensation Committee of the Board of Directors has established an executive compensation policy which will rely heavily on at-risk pay and share ownership guidelines. The at-risk pay provides substantial annual incentive opportunities as a percentage of salary, thus leveraging the total cash compensation opportunity. A performance-based restricted stock plan has been approved in concept to promote share ownership, while further leveraging executive total compensation opportunities. Share ownership guidelines will be established for each executive to further link executive and shareholder financial interests.

Results of Operations

For the Period June 3, 1993 (commencement of operations) through December 31, 1993

For the period from commencement of operations (June 3, 1993) through December 31, 1993, net income was \$3,950,034, or \$.64 per share of common stock, on revenues of \$7,135,004. Cash flow available for distribution was \$1.01 per Share.

The Company has had limited operations from June 3, 1993 (the date of the closing of the initial public offering) through the end of the year. The Company's future results of operations will be influenced by the terms of any subsequent investments the Company may make.

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

Liquidity and Capital Resources

The Company closed an offering of 6,250,000 shares (the "Offering") on February 16, 1994 with net proceeds of \$126.2 million. The outstanding balance under the Bank Credit Facility was repaid with a portion of the proceeds of the Offering. Management believes the Company will have sufficient funds from the remaining proceeds of the Offering and under the Bank Credit Facility to meet its liquidity needs.

The Company has a \$25 million Bank Credit Facility from two commercial banks that may be used to finance the acquisition or development of additional properties and for general corporate purposes. Borrowings under the Bank Credit Facility bear interest, at the option of the Company, at the base rate of First Tennessee Bank National Association plus .5% or LIBOR plus 3.5%. The Company pays a commitment fee of one-half of 1% per annum on the unused

portion of funds available for borrowing under the Bank Credit Facility which will be available until September 29, 1996. The Bank Credit Facility is unsecured and contains certain representations, warranties and financial and other covenants customary in such loan agreements. At December 31, 1993, \$21.0 million was outstanding under the Bank Credit Facility.

As of February 9, 1994, the company had commitments to acquire or fund the development of properties aggregating approximately \$135.2 million. Other than those commitments, the Company has no commitments or understandings for capital expenditures. There can be no assurance that the Company will be able to purchase or develop additional properties or to lease to others on suitable terms.

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

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

On November 15, 1993, the Company paid its first dividend for the 27 day period ended June 30, 1993 and the quarter ended September 30, 1993 to the holders of Common Stock as of the close of business on November 1, 1993. On January 18, 1994, the Company declared an increase in its quarterly dividend from \$.425 per share (\$1.70 annualized) to \$.43 per share (\$1.72 annualized) payable to shareholders of record on February 1, 1994. This dividend was paid on February 15, 1994.

REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Stockholders
Healthcare Realty Trust Incorporated

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

We conducted our audit 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 audit provides 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, 1993, and the consolidated results of operations and cash flows for the period from June 3, 1993 (commencement of operations) through December 31, 1993, in conformity with generally accepted accounting principles.

Ernst & Young

Nashville, Tennessee
January 7, 1994, except for Note 7,
and the second paragraph of Note 11,
as to which the date is January 18, 1994

CONSOLIDATED BALANCE SHEET

December 31, 1993

ASSETS

Real estate properties:

Land	\$ 16,949,171
Buildings and improvements	117,068,912
Personal property	1,073,509
Construction in progress	133,841
	<u>135,225,433</u>
Less accumulated depreciation	(1,832,682)
Total real estate properties	<u>133,392,751</u>

Cash and cash equivalents

Receivables	98,456
Deferred costs, net	49,487
Other assets	223,916
	<u>305,084</u>
Total assets	<u>\$134,069,694</u>

LIABILITIES AND STOCKHOLDERS' EQUITY

Liabilities:

Bank notes payable	\$ 21,000,000
Security deposits payable	4,407,658
Accounts payable and accrued liabilities	435,558
Deferred income	36,224
	<u>25,879,440</u>
Total liabilities	

Stockholders' equity:

Preferred stock, \$.01 par value, 50,000,000 shares authorized; none outstanding	—
Common stock, \$.01 par value; 150,000,000 shares authorized; 6,185,600 issued and outstanding	61,856
Additional paid-in capital	107,586,630
Cumulative net income	3,950,034
Cumulative dividends	(3,408,266)
	<u>108,190,254</u>
Total stockholders' equity	
Total liabilities and stockholders' equity	<u>\$134,069,694</u>

CONSOLIDATED STATEMENT OF INCOME

For the period from June 3, 1993 (commencement of operations) through December 31, 1993

REVENUES:

Base rental income	\$7,066,606
Interest income	<u>68,398</u>
	7,135,004

EXPENSES:

General and administrative	551,958
Depreciation	1,832,682
Amortization and other noncash charges	486,163
Interest	<u>314,167</u>
	3,184,970
Net income	<u>\$3,950,034</u>
Net income per share	<u>\$.64</u>
Weighted average shares outstanding	<u>6,185,600</u>

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

For the period from June 3, 1993 (commencement of operations) through December 31, 1993

	Common Stock		Additional	Cumulative	Cumulative	Total
	Shares	Amount	Paid-In Capital	Income	Dividends	Stockholders' Equity
Balance at June 3, 1993	185,600	\$ 1,856	\$ —	\$ —	\$ —	\$ 1,856
Issuance of stock	6,000,000	60,000	\$107,586,630	—	—	107,646,630
Net income	—	—	—	3,950,034	—	3,950,034
Dividends					(3,408,266)	(3,408,266)
Balance at December 31, 1993	6,185,600	\$61,856	\$107,586,630	\$3,950,034	\$(3,408,266)	\$108,190,254

CONSOLIDATED STATEMENT OF CASH FLOWS

For the period from June 3, 1993 (commencement of operations) through December 31, 1993

OPERATING ACTIVITIES

Net income	\$ 3,950,034
Adjustments to reconcile net income to cash provided by operating activities:	
Amortization and depreciation	2,291,865
Increase in deferred income	36,224
Increase in receivables and other assets	(84,214)
Increase in accounts payable and accrued liabilities	<u>156,997</u>
Net cash provided by operating activities	6,350,906

INVESTING ACTIVITIES

Acquisition of real estate properties	(135,116,136)
Receipt of security deposits	<u>4,407,658</u>
Net cash used in investing activities	(130,708,478)

FINANCING ACTIVITIES

Borrowings on short-term notes payable	2,350,000
Borrowings on long-term notes payable	24,000,000
Repayments on short-term notes payable	(2,350,000)
Repayments on long-term notes payable	(3,000,000)
Deferred financing and organization costs	(784,192)
Dividends paid	(3,408,266)
Proceeds from issuance of common stock	<u>107,646,630</u>
Net cash provided by financing activities	<u>124,454,172</u>
Increase in cash and cash equivalents	96,600
Cash and cash equivalents, beginning of period	<u>1,856</u>
Cash and cash equivalents, end of period	<u>\$ 98,456</u>

1. Summary of Significant Accounting Policies

Organization

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

The Company was organized to invest in healthcare related properties located throughout the United States, including ancillary hospital facilities, medical office buildings, physicians' clinics, long-term care facilities, comprehensive ambulatory care centers, clinical laboratories and ambulatory surgery centers. As of December 31, 1993, the Company owns 26 operating properties and one property under development, with a cost of \$135,225,433, located in ten states, which are leased to thirteen healthcare related entities pursuant to long-term leases. These properties include eleven ancillary hospital facilities, two medical office buildings, three physicians' clinics, six long-term care facilities, one comprehensive ambulatory care center, two clinical laboratories, and two ambulatory surgery centers.

Basis of Presentation

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

Real Estate Properties

Real estate properties are recorded at cost. Transaction fees and acquisition costs are netted with the purchase price as appropriate. The cost of real properties acquired is allocated between land, buildings and fixtures, and personal property based upon estimated market values at the time of acquisition. Depreciation is provided for on a straight-line basis over the following estimated useful life:

Buildings and fixtures	31.5 to 39.0 years
Personal property	7.0 years

Cash and Cash Equivalents

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

Federal Income Taxes

No provision has been made for federal income taxes. The Company intends at all times to qualify as a real estate investment trust under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended. The Company must distribute at least 95% of its real estate investment trust taxable income to its stockholders and meet other requirements to continue to qualify as a real estate investment trust.

Deferred Costs

Included in deferred costs are charges incurred in obtaining a standby financing commitment, a revolving credit facility, and organizational costs. Deferred financing costs are amortized over the term of the related debt or commitment. Organizational costs are amortized straight-line over five years. At December 31, 1993, accumulated

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.

Lessee Developments

Under funding arrangements for properties that will be developed by a lessee for the Company, funding fees will be charged the lessee for all funds advanced for the lessee development. The Company will advance the lessee the amounts required to construct the property, including amounts required for the funding fee. The amounts advanced the lessee will be capitalized as construction in progress, as a cost of the lessee development. Because the Company will advance the lessee the funds to pay the funding fee, the receipt of the funding fee by the Company from the lessee will not be accounted for as income, but rather as a reduction of the capitalized cost of the lessee development, thus offsetting the original capitalized funding fee. No such fees were charged during the period June 3, 1993 (commencement of operations) through December 31, 1993. At the completion of the lessee development, the construction in progress will be reclassified to the appropriate real estate property accounts, and the lessee will have the obligation to undertake its responsibilities under the lease.

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%.

2. Real Estate Property Leases

The Company's properties are generally leased pursuant to noncancelable, fixed-term operating leases with expiration dates from 2003 to 2013. Some leases 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 the right of first refusal to purchase the leased property on the same terms and conditions as an acceptable third party offer.

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

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

Future minimum lease payments under the noncancelable operating leases as of December 31, 1993 are as follows:

1994	\$ 14,854,000
1995	15,148,000
1996	15,185,000
1997	15,192,000
1998	15,192,000
1999 and thereafter	134,401,000
	<u>\$209,972,000</u>

3. Bank Notes Payable

The Company has entered into a \$25,000,000 Revolving Credit Facility (the Credit Facility) with two commercial banks (the Banks), which matures September 29, 1996. At the option of the Company, borrowings bear interest at the Banks' base rate plus .5% or LIBOR plus 3.5%.

The Company will pay a commitment fee of one-half of 1% per annum on the unused portion of funds available for borrowings under the Credit Facility. At December 31, 1993, borrowings of \$21,000,000 had been made under this credit facility, and the interest rate at that date was 6.5% (interest of \$216,533 was paid during the period).

Under covenants of the Credit Facility, the Company is generally required to maintain minimum shareholders' equity of \$97,000,000 and certain other financial covenants. The Credit Facility is collateralized by the outstanding common stock of the Company's subsidiaries, which comprise 2.4% of the Company's total stockholders' equity.

4. Security Deposits and Letters of Credit

The Company is currently obligated to certain lessees, under executed sale and purchase agreements, for security and related deposits in an aggregate amount of \$4,407,658. These security deposits are repayable at various times, typically upon expiration of the lease, and generally bear interest, at the First National Bank of Boston prime rate, payable quarterly or annually. The Company has given a \$1,000,000 security interest in a property against one lessee deposit.

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

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

5. Benefit Plans

Executive Retirement Plan

The Company has an Executive Retirement Plan, under which an eligible executive may receive upon normal retirement (defined to be when the participant reaches age 65 and has completed five years of service with the Company) 60% of his final average 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 participant from any basic retirement plan of the Company that covers all employees and social security. Currently, all four of the Company's executive officers are eligible participants.

Retirement Plan for Outside Directors

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

Benefit Plan Information

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

Service cost	\$ 65,300
Amount allocated to property acquisition costs	(38,300)
<u>Net retirement expense</u>	<u>\$ 27,000</u>

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

Actuarial present value of benefit obligations:

Vested	\$ —
Accumulated	\$65,300
<u>Projected</u>	<u>\$77,600</u>

The accumulated benefit obligation has been accrued and included with accrued liabilities on the balance sheet.

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

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

Deferred Compensation Plan

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

6. Stock Incentive Plans

1993 Employees Stock Incentive Plan

The Company may issue incentive awards for up to 5% of its outstanding shares of Common Stock (309,280 shares at December 31, 1993) under the 1993 Employees Stock Incentive Plan ("Employee Plan"). Under the Employee Plan, the Employee Stock Option Committee appointed by the Board of Directors may grant to employees stock awards or nontransferable options to purchase shares of the Company's Common Stock for terms not longer than 10 years, at prices to be determined by the Board of Directors or the Employee Stock Option Committee, which may not be less than 95% of the fair market value of the Common Stock on the date of grant. Options granted under the Employee Plan may be subject to any conditions set by the Employee Stock Option Committee, may be exercised by payment of cash, shares valued at fair market value, or, at the option of the Employee Stock Option Committee, by a note secured by shares. Unless terminated earlier, the Employee Plan will terminate on January 1, 2003.

As of December 31, 1993, options to purchase 225,000 shares, at \$19.50 per share (market price on the date of grant), had been granted to a total of six employees of the Company under the Employee Plan, which may not be exercised for one year from the date of grant. At December 31, 1993, the Plan had 84,280 shares available for future issuance.

1993 Outside Directors Stock Incentive Plan

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

As of December 31, 1993, options to purchase 3,000 shares at \$19.50 per share, had been granted to each of the seven outside directors

under the Director Plan (an aggregate of 21,000 shares), none of which were exercisable. At December 31, 1993, the Plan had 102,712 shares available for future issuance. (See Note 11, "Subsequent Events")

7. Commitments

Through January 18, 1994, in anticipation of a planned public offering of approximately 6,250,000 shares of common stock (see Note 11, "Subsequent Events"), the Company has committed to acquire or fund development of 19 properties for approximately \$135,200,000. The acquisition, or development, of these properties is contingent upon the negotiation of definitive sale and purchase agreements and the availability of acceptable financing sources.

8. Related Party Transaction

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

Two of the Company's properties were purchased for an aggregate of \$14,421,250 from and are leased by the Company to PhyCor, Inc. A director of the Company is a founder and executive Vice President of PhyCor, Inc. The director received no personal benefit as a result of this transaction.

During October, the Company purchased all office furniture from David R. Emery, President, for approximately \$38,000. The amount paid was determined by an independent appraisal of the office furniture.

9. Stockholders' Equity

At December 31, 1993, the Company has reserved 432,992 shares for issuance for the Employee Stock Incentive Plan and the Outside Directors Stock Incentive Plan. In addition, the Company has reserved 100,000 shares for issuance pursuant to the Company's Dividend Reinvestment Plan.

Also, in connection with the acquisition of certain properties, the Company issued warrants to purchase up to 188,712 additional reserved shares of Common Stock (the "Warrants"). The Warrants will be exercisable for a period of four years commencing July 1, 1994 at a price of \$19.50 per share, subject to adjustment under applicable

antidilution provisions. The holders of the Warrants and underlying Common Stock shall have the right to require the Company to include the Common Stock underlying such Warrants in any registration statement filed by the Company at the Company's expense.

10. Other Data—Cash Available for Distribution

Cash available for distribution is net income plus depreciation, amortization and other non-cash items. Distributions in excess of net income generally constitute a return of capital. Due to the timing of actual distributions, however, all of the dividends paid during 1993 will be taxable for federal income tax purposes. Management considers cash available for distribution to be an informative measure of the performance of an equity REIT and consistent with measures used by analysts to evaluate equity REITs. Cash available for distribution 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. Cash available for distribution for the period from June 3, 1993 (commencement of operations) through December 31, 1993 was \$6,268,879 (\$1.01 per Share).

11. Subsequent Events

On January 3, 1994 options to purchase 3,000 shares of Common Stock at \$22.38 per share were granted to each of the seven outside directors (an aggregate of 21,000 shares).

On January 18, 1994, the Company declared an increase in its quarterly dividend from \$.425 per share (\$1.70 annualized) to \$.43 per share (\$1.72 annualized) payable to shareholders of record on February 1, 1994.

Event (Unaudited) Subsequent to Date of Audit Report

On February 16, 1994, the Company completed the sale of 6,250,000 shares of its Common Stock, with net proceeds of approximately \$126 million.

BOARD OF DIRECTORS



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



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



Errol L. Biggs, Ph.D.
Healthcare Academician
 Director
 Programs in Health Administration
 University of Colorado



Marliese E. Mooney
Consultant
 Hospital Operations



Thompson S. Dent
Healthcare Executive
 Executive Vice President
 PHPCOR, Inc.



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



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



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



CORPORATE OFFICERS



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



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



Fredrick M. Langreck
Treasurer & Controller



Kenneth D. Stach
Vice-President Acquisitions



Rita H. Todd
Corporate Secretary



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

Independent Public Accountants

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

Transfer Agent

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

Form 10-K

The Company has filed an Annual Report on Form 10-K for the year ended December 31, 1993, with the Securities and Exchange Commission. Stockholders may obtain a copy of the report, without charge, by writing: Investor Relations, Healthcare Realty Trust Incorporated, 3310 West End Avenue, Suite 400, Nashville, Tennessee 37203.

Dividend Reinvestment Plan

A Dividend Reinvestment Plan is offered as a convenience to stockholders who wish to increase their holdings in the Company. Additional shares may be purchased, without a service or sales charge, through automatic reinvestment of quarterly cash dividends. For information write Fredrick M. Langreck, Treasurer and Controller, Healthcare Realty Trust Incorporated, 3310 West End Avenue, Suite 400, Nashville, Tennessee 37203.

Member

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

Common Stock

The Company's Common Stock is traded on the New York Stock Exchange under the symbol HR. The following table sets forth, for the fiscal periods indicated since the Common Stock began trading, the high and low sales prices for the Common Stock on the New York Stock Exchange.

1993:	High	Low
Second Quarter (beginning May 27)	\$19.88	\$17.75
Third Quarter	23.50	19.25
Fourth Quarter	23.50	19.50

On March 7, 1994, the Company had approximately 6,570 shareholders, including 170 shareholders of record and 6,400 persons or entities holding Common Stock in nominee name.

For the holders of Common Stock as of the close of business on November 1, 1993, the Company paid \$0.126 per share related to the 27 days of its operation in June 1993 and \$0.425 per share for the quarter ended September 30, 1993. Subsequent to year end, the Company increased its dividend to \$0.43 for the quarter ended December 31, 1993, which approximates an annual dividend rate of \$1.72 per share.



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