

HEALTHCARE REALTY
TRUST

ANNUAL REPORT TO SHAREHOLDERS
1999

COMPANY PROFILE: Healthcare Realty Trust is a real estate investment trust that integrates owning, managing, and developing income-producing real estate properties associated with the delivery of healthcare services throughout the United States. The Company's portfolio is comprised of nine facility types, located in 34 states nationwide, and operated pursuant to contractual arrangements with 72 healthcare providers.

Since commencing operations in June 1993, the Company has invested or committed to invest approximately \$1.7 billion in 285 real estate properties or mortgages, totaling more than twelve million square feet. The Company currently provides property or asset management services to approximately ten million square feet nationwide.

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

1999 *Letter to* SHAREHOLDERS

I am pleased to report Healthcare Realty Trust's seventh outstanding year and 26th consecutive profitable quarter as a public company. Our portfolio of high-quality healthcare properties, coupled with the achievements of our services group, generated solid revenue and earnings growth. It is disappointing that, despite a record year for the Company, negative investor sentiment for all REITs depressed our share price.



DAVID R. EMERY
*Chairman of The Board &
Chief Executive Officer*

Healthcare Realty Trust's total revenues and net income for 1999 more than doubled the results of the prior year, due in part to the completed acquisition of Capstone Capital Corporation in Fall, 1998. Revenues for 1999 totaled \$187.3 million, compared with \$92.4 million for 1998. Net income was \$86.0 million, or \$1.99 per diluted common share, compared with \$40.5 million, or \$1.63 per diluted common share, for the prior year. Funds from operations, composed primarily of net income and depreciation of real estate, totaled \$105.7 million on a diluted basis, or \$2.66 per diluted common share, for the 12-month period. This compares with \$59.7 million, or \$2.44 per diluted common share, for the same period in 1998.

Since its formation in June 1993, the Company has increased the dividend paid to common shareholders every quarter. Total dividend payments for the calendar year 1999 were \$2.15 per common share, compared with \$2.07 per common share for the calendar year 1998, an increase of 3.9%. The common dividend payout as a percentage of funds from operations decreased to 80.8%.

We are proud of these accomplishments and believe they affirm our investment standards and reflect the quality of our portfolio. Given our operating strengths, low business-risk profile and dedication to shareholder return, we believe the Company is among the most strategically positioned real estate investment trusts in the country.

HEALTHCARE IN 1999

Despite a year of significant challenges for the healthcare industry related to a combination of changes in Medicare reimbursement, volatile capital markets and misdirected strategies, the latter part of the year suggested signs of recovery. Skilled nursing facilities continued to adapt to the pressures brought by Medicare's implementation of the prospective payment system (PPS). Further consolidation of the healthcare industry, improved efficiency at the operator level and the government's commitment to \$16.4 billion in future relief served to renew confidence that skilled nursing facilities would recover in the same manner that acute and tertiary care hospitals recovered from the introduction of PPS in the mid-1980s.

A VITAL INDUSTRY

Even as REITs and the healthcare industry adapt to the events of 1999, the essential nature of healthcare and the related real estate remains firmly intact. The aging of the population, advances in technology and heightened focus on preventive medicine continue to increase demand for healthcare services. Expenditures for these services and products are now estimated to total more than \$1 trillion annually, or 13% of the Gross Domestic Product, and are projected to grow to \$2.2 trillion, or 16.6% of GDP, by 2007. Healthcare is a demographically need-driven industry with compelling fundamentals that support long-term real estate values.

Healthcare services delivery continues to shift toward outpatient settings. Outpatient revenues currently comprise approximately 43% of gross hospital revenues and are expected to exceed 50% in the near future. As outpatient services account for an increasingly larger portion of system revenues, providers are seeking to

expand and create operating efficiencies throughout their network of affiliated clinics and ambulatory care centers. Of the estimated \$12 billion in new healthcare facilities developed annually, approximately 60% are outpatient. These type properties, including ancillary hospital facilities, physician clinics, ambulatory surgery centers, comprehensive ambulatory care centers and medical office buildings, currently comprise 52% of the Company's investment portfolio.

As anticipated, transformations in the healthcare services industry continue to enhance investment and growth opportunities for Healthcare Realty Trust.

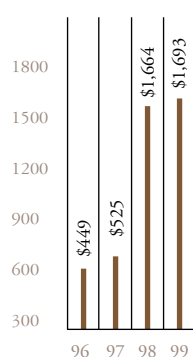
INTEGRATED REAL ESTATE SOLUTIONS

Healthcare industry developments, such as service delivery networks, ongoing enhancement of technology and physician practice alliances, have presented healthcare providers with competing demands for capital. Providers are looking beyond traditional capital sources and recognize that the manner in which real estate needs are funded is crucial to their long-term financial capability. Forming strategic relationships with real estate equity sources and managers has enabled them to monetize their real estate assets and allocate internal funds to more compelling and mission-critical uses. Innovative equity co-investment and asset management strategies allow providers to preserve control of their real estate, while affording increased financial flexibility and enhanced capital formation.

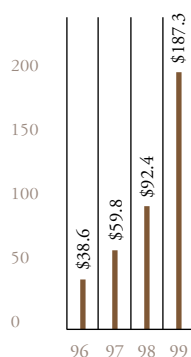
As an integrated real estate company focused exclusively on the healthcare industry, Healthcare Realty Trust is functionally organized to be an attractive partner to address not only the increased demand for capital but also to meet the rising need for real estate management services. As the largest manager of healthcare related real estate in the country, Healthcare Realty Trust furnishes a continuum of client services, ranging from initial strategic market assessments and asset valuations to construction services and property and asset management for approximately 10 million square feet nationwide. The Company's understanding of the healthcare industry and our ability to combine capital resources with management and construction expertise adds value for our clients and differentiates Healthcare Realty Trust from other real estate firms.

HEALTHCARE REALTY TRUST AT A GLANCE:

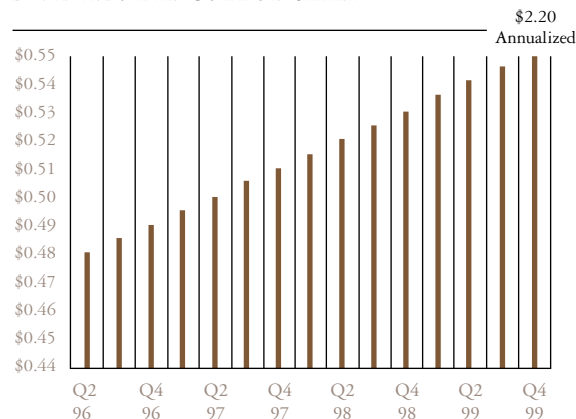
INVESTMENTS & COMMITMENTS
(\$ in millions)



REVENUES
(\$ in millions)



DIVIDENDS PER COMMON SHARE



BUILDING RELATIONSHIPS

Healthcare Realty Trust continues to benefit from its integrated services approach as healthcare providers seek real estate partners, not just sources of capital. Our strategy is to build relationships with leading providers that establish market presence, align financial incentives and ensure long-term associations. Such relationships often foster additional investments and the opportunity to provide related services on the same campus or within the market area.

Healthcare Realty Trust's announcement of an agreement with Baptist Memorial Health Care Corporation of Memphis, Tennessee to construct and own a new medical office facility exemplifies this strategic intent. The initiative marks the first phase of a long-term relationship that we expect to include equity funding for additional on-campus developments, construction management and strategic advisory services.

The Company remains encouraged by the activity generated from its exclusive, business-partner agreement with VHA Inc., a national alliance of more than 1,900 not-for-profit healthcare organizations. Through this agreement, we are establishing mutually beneficial relationships that enhance the financial capabilities of our healthcare provider partners and expand the Company's ability to structure investments that align interests and create long-term value for our clients and shareholders.

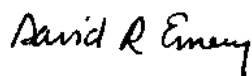
CONSERVATIVE FINANCIAL MANAGEMENT

We believe that Healthcare Realty Trust's conservative capital structure continues to differentiate the Company from other healthcare REITs and strategically position the Company to take advantage of worthy investment opportunities when the capital markets improve. Utilizing the relationships, experience and expertise that we have developed over many years in the industry, the management team employs a disciplined real estate investment strategy. We believe quality growth is achieved by focusing only on investments that sustain long-term performance and add economic value.

The Company continues to maintain a low business-risk profile through conservative use of debt leverage. At year-end, the ratio of debt to total book capitalization was 36%. We believe our investment-grade ratings validate the Company's conservative capital structure and prospects for growth.

The management team is pleased with Healthcare Realty Trust's progress and achievements during 1999 and is grateful to the Board of Directors and our employees for their energy and commitment. We appreciate our shareholders, whose support and involvement provide the foundation for the continued growth of the Company. I look forward to sharing our accomplishments with you during 2000.

Sincerely yours,



David R. Emery

Chairman of the Board and CEO

Selected
P R O P E R T I E S



KERLAN JOBE MEDICAL CENTER
Los Angeles, California



RICHMOND MEDICAL BUILDING II
Richmond, Virginia



CORAL GABLES MEDICAL CENTER
Coral Gables, Florida



SUNRISE MOUNTAIN VIEW
MEDICAL CENTER
Las Vegas, Nevada



HUEBNER MEDICAL CENTER
San Antonio, Texas



OREGON MEDICAL BUILDING
El Paso, Texas



LEWIS-GALE CLINIC
Roanoke, Virginia



SARASOTA MEDICAL CENTER
Sarasota, Florida



KELSEY SEYBOLD CLINIC WEST
Houston, Texas



ST. ANDREW'S SURGERY CENTER
Venice, Florida

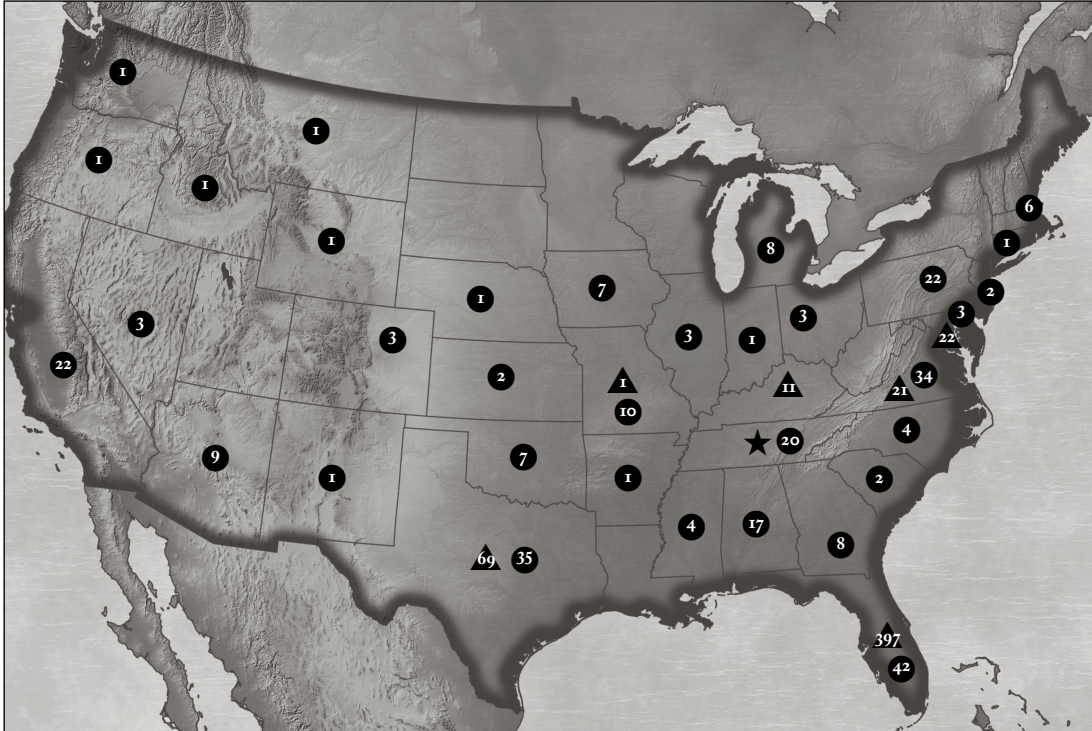


ORANGE COUNTY REGIONAL
CANCER CENTER
Fountain Valley, California



MARY WASHINGTON HOSPITAL
Fredericksburg, Virginia

Property LOCATIONS



★ CORPORATE OFFICE

● INVESTMENTS

▲ MANAGED PROPERTIES

Alabama	17	Kansas	2	North Carolina	4
Arizona	9	Kentucky	11	Ohio	3
Arkansas	1	Maryland	2	Oklahoma	7
California	22	Massachusetts	6	Oregon	1
Colorado	3	Michigan	8	Pennsylvania	22
Connecticut	1	Mississippi	4	South Carolina	2
Florida	439	Missouri	11	Tennessee	20
Georgia	8	Montana	1	Texas	104
Illinois	3	Nevada	3	Virginia	55
Indiana	1	New Jersey	2	Washington	1
Iowa	7	New Mexico	1	Wyoming	1
Idaho	1	Nebraska	1		



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Selected Financial
I N F O R M A T I O N

The following table sets forth financial information for the Company which is derived from the Consolidated Financial Statements of the Company (Dollars in thousands, except per share data):

	Years Ended December 31,				
	1999	1998 ⁽²⁾	1997	1996	1995
Statement of Income Data:					
Total revenues	\$ 187,257	\$ 92,429	\$ 59,796	\$ 38,574	\$ 33,361
Interest expense	\$ 38,603	\$ 13,057	\$ 7,969	\$ 7,344	\$ 5,083
Net income	\$ 86,027	\$ 40,479	\$ 31,212	\$ 19,732	\$ 18,258
Net income per share - Basic	\$ 2.02	\$ 1.66	\$ 1.71	\$ 1.52	\$ 1.41
Net income per share - Diluted	\$ 1.99	\$ 1.63	\$ 1.68	\$ 1.49	\$ 1.41
Weighted average shares outstanding – Basic	39,326,594	24,043,942	18,222,243	13,014,286	12,931,082
Weighted average shares outstanding – Diluted	39,810,306	24,524,600	18,572,492	13,261,291	12,970,326
Balance Sheet Data (as of the end of the period):					
Real estate properties, net	\$ 1,315,150	\$ 1,337,439	\$ 466,273	\$ 416,034	\$ 318,480
Total assets	\$ 1,607,964	\$ 1,612,423	\$ 488,514	\$ 427,505	\$ 336,778
Notes and bonds payable	\$ 563,884	\$ 559,924	\$ 101,300	\$ 168,618	\$ 92,970
Total stockholders' equity	\$ 1,017,903	\$ 1,017,704	\$ 376,472	\$ 245,964	\$ 234,448
Other Data:					
Funds from operations – Basic ⁽¹⁾	\$ 105,727	\$ 59,667	\$ 42,337	\$ 28,036	\$ 25,490
Funds from operations – Diluted ⁽¹⁾	\$ 105,727	\$ 59,731	\$ 42,337	\$ 28,036	\$ 25,490
Funds from operations per share - Basic ⁽¹⁾	\$ 2.69	\$ 2.48	\$ 2.32	\$ 2.15	\$ 1.97
Funds from operations per share - Diluted ⁽¹⁾	\$ 2.66	\$ 2.44	\$ 2.28	\$ 2.11	\$ 1.97
Dividends declared and paid per share	\$ 2.15	\$ 2.07	\$ 1.99	\$ 1.91	\$ 1.83

(1) See Note 11 to Consolidated Financial Statements.

(2) See Note 2 to Consolidated Financial Statements.

Management's Discussion and Analysis of Financial Condition AND RESULTS OF OPERATIONS

OVERVIEW

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

Substantially all of the Company's revenues are derived from rentals on its healthcare real estate property facilities, interest earned on mortgage loans and from the temporary investment of funds in short-term instruments and from management and development services. Leases and other financial support arrangements with respect to the Company's healthcare real estate facilities generally ensure that increased costs and expenses incurred with respect to the operation of the facilities will be borne by tenants and healthcare providers related to the facilities. The Company incurs operating and administrative expenses, principally compensation expense for its officers and other employees, office rental and related occupancy costs and various expenses incurred in the process of acquiring additional properties.

RESULTS OF OPERATIONS

1999 Compared to 1998

On October 15, 1998, the Company acquired by merger Capstone Capital Corporation ("Capstone"). The purchase price is summarized as follows (in thousands):

Common stock	\$ 532,554
Preferred stock	72,052
Cash and cash equivalents	8,330
Liabilities assumed	424,897
Total Purchase Price	<u>\$ 1,037,833</u>

The assets acquired in the Capstone merger are summarized as follows (in thousands):

Real estate properties	\$ 804,178
Mortgage notes receivable	211,590
Cash and cash equivalents	13,767
Other assets	8,298
Total Assets Acquired	<u>\$ 1,037,833</u>

The results of operations of the Company have been significantly affected by the Capstone merger. As a result of this transaction in 1998, the Company acquired 111 properties and 75 mortgages with a fair value of \$804.2 million and \$211.6 million, respectively. The merger was effective October 15, 1998; therefore, 1998 consolidated revenues and expenses of the Company reflect the effect of the Capstone assets acquired and liabilities assumed for only 2.5 months in 1998 versus the entire year for 1999. The Capstone investments, along with commitments acquired in the merger, resulted in additional master lease rent, straight line rent and property operating income, net of operating expenses, for the year ended December 31, 1999, of \$73.5 million, a \$59.0 million or 407.1% increase from 1998. Mortgage interest income in 1999 resulting from these Capstone investments was \$24.2 million, a \$20.4 million or 543.3% increase from 1998. Interest and other income attributed to the Capstone acquisition for the years ended 1999 and 1998 was \$1.4 million and \$0.4 million, respectively, a 286.2% increase. Depreciation and amortization expense for the year ended

Management's Discussion and Analysis of Financial Condition
AND RESULTS OF OPERATIONS

December 31, 1999 attributed to the Capstone acquisition was \$24.8 million compared to \$2.9 million in 1998, a \$21.9 million or 739.0% increase.

For the year ended December 31, 1999, net income was \$86.0 million, or \$2.02 per basic share of common stock (\$1.99 per diluted share), on total revenues of \$187.3 million compared to net income of \$40.5 million, or \$1.66 per basic share of common stock (\$1.63 per diluted share), on total revenues of \$92.4 million, for the year ended December 31, 1998. Funds from operations ("FFO") was \$105.7 million, or \$2.69 per basic share (\$2.66 per diluted share), for the year ended December 31, 1999 compared to \$59.7 million, or \$2.48 per basic share (\$2.44 per diluted share), in 1998.

(Dollars in thousands)

	1999	1998
REVENUES		
Master lease rental income	\$ 92,070	\$ 47,512
Property operating income	57,778	35,269
Straight line rent	6,885	1,265
Total rental income	156,733	84,046
Mortgage interest income	26,254	5,120
Management fees	2,727	2,056
Interest and other income	1,543	1,207
	187,257	92,429
EXPENSES		
General and administrative	7,287	11,126
Property operating expenses	21,077	11,978
Interest	38,603	13,057
Depreciation	38,566	15,965
Amortization	473	499
	106,006	52,625
Net income before net gain on real estate disposals	81,251	39,804
Net gain on real estate disposals	4,776	675
Net income	\$ 86,027	\$ 40,479

Total revenues for the year ended December 31, 1999 compared to the year ended December 31, 1998, increased \$94.8 million or 102.6%.

Master lease rent, straight line rent and property operating income increased \$72.7 million or 86.5%. Excluding the effect of the Capstone merger, master lease rent, straight line rent and property operating income increased \$4.8 million or 7.0%. During 1999, the Company acquired two revenue-producing properties, and 11 properties under construction were completed and began operations.

Mortgage interest income increased \$21.1 million or 412.8% for the year ended December 31, 1999 compared to 1998 substantially due to the Capstone merger.

Interest and other income for the year ended December 31, 1999 was \$1.5 million compared to \$1.2 million for the year ended December 31, 1998. Excluding the effect of the Capstone merger, interest and other income decreased \$0.7 million from 1998 to 1999. In 1998, the Company recognized development fee income from a third party project of \$0.5 million, and the Company's average cash balance was higher in 1998 resulting in more interest income for the year.

Third party management fees for the year ended December 31, 1999 compared to 1998 increased \$0.7 million or 32.6% due primarily to the addition of over 50 buildings with approximately 0.9 million square feet under property management.

Total expenses for the year ended December 31, 1999 were \$106.0 million compared to \$52.6 million for 1998, an increase of \$53.4 million or 101.4%.

Management's Discussion and Analysis of Financial Condition
AND RESULTS OF OPERATIONS - CONTINUED

Interest expense for the year ended December 31, 1999, compared to 1998, increased \$25.5 million or 195.6%. In conjunction with the Capstone merger in 1998, the Company repaid the outstanding balances under both Capstone's and its own unsecured credit facilities and entered into a \$265.0 million unsecured credit facility and a \$200.0 million unsecured term loan. The average outstanding balances under its credit facilities and term loan for the year ended 1999 compared to 1998 was \$368.1 million and \$82.3 million, respectively, increasing interest expense in 1999 by approximately \$18.6 million. The subordinated convertible debentures and mortgage notes payable assumed by the Company in the Capstone merger resulted in an increase of \$8.6 million in interest expense for the year ended December 31, 1999, compared to 1998. These increases to interest expense discussed above were offset by decreases to interest expense due to an increase in capitalized interest of \$0.5 million from 1998 to 1999 and a decrease of \$1.3 million to interest expense on the Company's unsecured notes due to scheduled repayments.

Depreciation expense increased \$22.6 million due substantially to the properties acquired in the Capstone merger. Excluding the effect of the Capstone merger, depreciation expense increased \$0.8 million, resulting primarily from the acquisition of 11 properties during 1998 and 1999.

Property operating expenses for the year ended December 31, 1999, compared to 1998, increased \$9.1 million or 76.0% due mainly to the properties acquired in the Capstone merger.

General and administrative expenses decreased \$3.8 million or 34.5% for the year ended December 31, 1999, compared to 1998. During 1998, the Company recognized a \$6.3 million write-off for certain capitalized software costs, leasehold improvements, organization and other deferred costs which were deemed to have no continuing value and for incremental internal costs incurred in conjunction with the Capstone merger. After consideration of the write-off, the net \$2.5 million increase was primarily due to the increased number of employees for property management, development, and other service-based activities, an increase and expansion of the corporate office lease, and the write-off of certain project costs during 1999.

During 1999, the Company sold five facilities and one partnership interest in a facility resulting in net gains of \$4.8 million, while the Company's 1998 dispositions resulted in net gains of \$0.7 million.

1998 Compared to 1997

The results of operations of the Company were significantly affected by the Capstone merger. For the year ended December 31, 1998, net income increased approximately \$12.3 million due to the Capstone merger. As a result of this transaction, the Company acquired 111 properties and 75 mortgages with a fair value of \$804.2 million and \$211.6 million, respectively. These investments resulted in additional master lease rent, straight line rent, mortgage interest income and property operating income, net of operating expenses, for the year of \$18.2 million, as well as, additional interest and other income of \$0.4 million. The Company also assumed Capstone's 6.55% and 10.5% convertible subordinated debentures and notes payable, with interest rates ranging from 7.625% to 9.0%, with a collective fair value of \$138.0 million, which resulted in interest expense of \$1.4 million for the period October 15, 1998 through December 31, 1998.

For the year ended December 31, 1998, net income was \$40.5 million, or \$1.66 per basic share of common stock (\$1.63 per diluted share), on total revenues of \$92.4 million compared to net income of \$31.2 million, or \$1.71 per basic share of common stock (\$1.68 per diluted share), on total revenues of \$59.8 million, for the year ended December 31, 1997. Funds from operation was \$59.7 million, or \$2.48 per basic share (\$2.44 per diluted share), for the year ended December 31, 1998 compared to \$42.3 million, or \$2.32 per basic share (\$2.28 per diluted share), in 1997.

Management's Discussion and Analysis of Financial Condition
AND RESULTS OF OPERATIONS - CONTINUED

(Dollars in thousands)

	1998	1997
REVENUES		
Master lease rental income	\$ 47,512	\$ 40,298
Property operating income	35,269	14,631
Straight line rent	1,265	0
Total rental income	84,046	54,929
Mortgage interest income	5,120	84
Management fees	2,056	1,499
Interest and other income	1,207	3,284
	92,429	59,796
EXPENSES		
General and administrative	11,126	3,807
Property operating expenses	11,978	5,008
Interest	13,057	7,969
Depreciation	15,965	11,468
Amortization	499	332
	52,625	28,584
Net income before net gain on real estate disposals	39,804	31,212
Net gain on real estate disposals	675	0
Net income	\$ 40,479	\$ 31,212

Total revenues for the year ended December 31, 1998, compared to the year ended December 31, 1997, increased \$32.6 million or 54.6%. Excluding the effect of the Capstone merger, total revenues for the year ended December 31, 1998 compared to the year ended December 31, 1997 increased \$12.9 million. This increase is primarily due to increases in master lease rental income and property operating income. During 1998, the Company acquired nine properties, and two properties under construction were completed and began operations. Certain leases acquired from Capstone contain escalating rental rates over the life of the leases; however, rental income is recognized as earned on a straight line basis over the life of the lease.

Third party property management fees for the year ended December 31, 1998, compared to the year ended December 31, 1997, increased \$0.6 million or 37.2% due primarily to the addition of over 60 buildings with approximately 2.6 million square feet under property management.

Interest and other income for the year ended December 31, 1998 was \$1.2 million compared to \$3.3 million for the year ended December 31, 1997. Excluding the effect of the Capstone merger, interest and other income decreased \$2.4 million from the year ending December 31, 1997 to the year ending December 31, 1998. During the first quarter of 1997, the Company completed a secondary offering and maintained a higher than normal average cash and short-term investment balance.

Total expenses for the year ended December 31, 1998 were \$52.6 million, compared to \$28.6 million for the year ended December 31, 1997, an increase of \$24.0 million or 84.1%. General and administrative expenses increased \$7.3 million. \$6.3 million of this increase represents the write-off of certain capitalized software costs, leasehold improvements, organization and other deferred costs which were deemed to have no continuing value and incremental internal costs incurred in conjunction with the Capstone merger. The remaining \$1.0 million increase is primarily due to the increased number of employees for property management, development, and other service-based activities.

Property operating expenses for the year ended December 31, 1998, compared to the year ended December 31, 1997, increased \$7.0 million. Property operating expenses rose during 1998 for the same reasons property operating income increased.

Interest expense for the year ended December 31, 1998, compared to the year ended December 31, 1997, increased \$5.1 million. At the time of the Capstone merger, the Company repaid the outstanding balances under both Capstone's and its own unsecured credit facilities and entered into a \$265.0 million unsecured credit facility and a \$200.0 million unsecured term loan. During the year ended

Management's Discussion and Analysis of Financial Condition
AND RESULTS OF OPERATIONS - CONTINUED

December 31, 1997, the Company had an average outstanding balance under its unsecured credit facility of \$18.1 million, compared to an average outstanding balance under its unsecured credit facility and term loan during the year ended December 31, 1998 of \$82.3 million. In addition, Capstone's subordinated convertible debentures and notes payable were assumed by the Company in the merger, and capitalized interest increased \$0.7 million from 1997 to 1998.

Depreciation expense increased \$4.5 million due to the significant increase during 1998 in depreciable properties. Excluding the effect of the Capstone merger, depreciation expense increased \$1.6 million. This increase primarily resulted from the acquisition of nine properties during 1998 and the completion in 1998 of two properties under construction at December 31, 1997.

During 1998, the Company sold one facility and a tract of land resulting in net gains of \$0.7 million.

Liquidity and Capital Resources

On October 15, 1998, at the time of the Capstone merger, the Company repaid the outstanding balances under both Capstone's and its own unsecured credit facilities and entered into a \$265.0 million unsecured credit facility (the "Unsecured Credit Facility") with ten commercial banks. The Unsecured Credit Facility bears interest at LIBOR plus 1.05%, payable quarterly, and matures on October 15, 2001. In addition, the Company will pay, quarterly, a commitment fee of 0.225 of 1% on the unused portion of funds available for borrowings. At December 31, 1999, the Company had available borrowing capacity of \$13.0 million under the Unsecured Credit Facility.

At the time of the Capstone merger, the Company entered into a \$200.0 million unsecured term loan (the "Term Loan Facility") with NationsBank (now Bank of America). The Term Loan Facility, as amended, bears interest at LIBOR plus 2.00%, payable quarterly, and matures on April 14, 2000. Effective January 14, 2000, the Company amended its Term Loan Facility agreement with Bank of America. If the balance on the Term Loan Facility exceeds \$25.0 million on March 14, 2000, the interest rate will increase to LIBOR plus 2.50%. Since the Capstone merger, the Company has received proceeds from the sale of assets and from mortgage prepayments and reduced the unpaid balance of the Term Loan Facility from \$200.0 million to \$113.7 million.

In 1995, the Company privately placed \$90.0 million of unsecured notes (the "Unsecured Notes") bearing interest at 7.41%, payable semi-annually (\$3.6 million for 2000), that mature on September 1, 2002. The Company must repay \$18.0 million of principal annually. At December 31, 1999, \$54.0 million was outstanding under the Unsecured Notes.

The Company assumed in the Capstone merger 10.5% Convertible Subordinated Debentures and 6.55% Convertible Subordinated Debentures having an aggregate principal balance of \$78.2 million at December 31, 1999. In 2000, the Company will pay \$5.3 million of interest on these subordinated debentures.

In 1998, the Company sold an aggregate of 1.4 million shares of its common stock. The Company received an aggregate of \$37.1 million in net proceeds from these transactions. The proceeds were used to repay debt and were also used for acquisitions, developments and general corporate purposes.

As of March 1, 2000, the Company can issue an aggregate of approximately \$123.8 million of securities remaining under the currently effective registration statement. Due to the current market price of the Company's stock, the Company does not presently plan to offer stock under its registration statement. The Company may, under certain circumstances, borrow additional amounts in connection with the renovation or expansion of its properties, the acquisition or development of additional properties or, as necessary, to meet distribution requirements for REITs under the Code. The Company may raise additional capital or make investments by issuing, in public or private transactions, debt securities, but the availability and terms of any such issuance will depend upon market and other conditions.

The Company generated net cash from operations in 1999 of \$91.8 million, an increase of \$70.0 million from 1998 and \$51.4 million from 1997. The increase from 1998 results primarily from the increase in net income. The decrease in 1998 from 1997 resulted primarily from the payment of accounts payable and accrued liabilities assumed in the Capstone merger. Other significant sources and uses of cash for investing and financing activities are set forth in the Statement of Cash Flows in the Consolidated Financial Statements.

Management's Discussion and Analysis of Financial Condition
AND RESULTS OF OPERATIONS - CONTINUED

As of December 31, 1999, the Company had an investment of approximately \$20.0 million in six build-to-suit developments in progress, which have a total remaining funding commitment of approximately \$37.6 million. Further, the Company had commitments to purchase or provide funding for the construction of other properties totaling \$12.4 million at December 31, 1999. The Company also had six mortgages under development at December 31, 1999, which have a total remaining funding commitment of approximately \$1.9 million. The Company intends to fund these commitments with internally generated cash flow, proceeds from the sale of additional assets, proceeds from additional prepayments of mortgage notes receivable, and additional capital market financing.

At December 31, 1999, the Company had stockholders' equity of \$1.0 billion. The debt to total capitalization ratio was approximately .352 to 1 at January 31, 2000.

On January 25, 2000, the Company declared an increase in its quarterly common stock dividend from \$.545 per share (\$2.18 annualized) to \$.55 per share (\$2.20 annualized) payable to stockholders of record on February 4, 2000. This dividend was paid on February 16, 2000. The Company presently plans to continue to pay its quarterly common stock dividends, with increases consistent with its current practice. In the event that the Company cannot make additional investments in 2000 because of an inability to obtain new capital by issuing equity and debt securities, the Company will continue to be able to pay its common stock dividends in a manner consistent with its current practice. Should access to new capital not be available, the Company is uncertain of its ability to increase its quarterly common stock dividends beyond 2000.

During 2000, the Company will pay quarterly dividends on its 8 7/8% Series A Cumulative Preferred Stock in the annualized amount of \$2.22 per share.

Under the terms of the leases and other financial support agreements relating to most of the properties, tenants or healthcare providers are generally responsible for operating expenses and taxes relating to the properties. As a result of these arrangements, with limited exceptions not material to the performance of the Company, the Company does not believe that any increases in the property operating expenses or taxes would significantly impact the operating results of the Company during the respective terms of the agreements. The Company anticipates entering into similar arrangements with respect to additional properties it acquires or develops. After the term of the lease or financial support agreement, or in the event the financial obligations required by the agreement are not met, the Company anticipates that any expenditures it might become responsible for in maintaining the properties will be funded by cash from operations and, in the case of major expenditures, possibly by borrowings. To the extent that unanticipated expenditures or significant borrowings are required, the Company's cash available for distribution and liquidity may be adversely affected.

The Company plans to continue to meet its liquidity needs, including funding additional investments in 2000, paying its quarterly dividends (with increases consistent with its current practices) and funding the debt service on the 10.50% Convertible Subordinated Debentures, the 6.55% Convertible Subordinated Debentures, the Unsecured Credit Facility, the Term Loan Facility, and the Unsecured Notes from its cash flows, the proceeds of mortgage loan repayments, sales of real estate investments and mortgage notes receivable, and capital market financings. The Company is presently negotiating additional capital market financing, the proceeds of which are expected to repay the Term Loan Facility, the Unsecured Credit Facility and to fund other general corporate purposes. The Company believes that its liquidity and sources of capital are adequate to satisfy its cash requirements. The Company, however, cannot be certain that these sources of funds will be available at a time and upon terms acceptable to the Company in sufficient amounts to meet its liquidity needs.

Impact of Inflation

Inflation has not significantly affected the earnings of the Company because of the moderate inflation rate and the fact that most of the Company's leases and financial support arrangements require tenants and sponsors to pay all or some portion of the increases in operating expenses, thereby reducing the risk of any adverse effects of inflation to the Company. In addition, inflation will have the effect of increasing gross revenue the Company is to receive under the terms of the leases and financial support arrangements. Leases and financial support arrangements vary in the remaining terms of obligations from one to 23 years, further reducing the risk of any adverse effects of inflation to the Company. The Unsecured Credit Facility bears interest at a variable rate; therefore, the amount of interest payable under the Unsecured Credit Facility will be influenced by changes in short-term rates, which tend to be sensitive to inflation.

Management's Discussion and Analysis of Financial Condition
AND RESULTS OF OPERATIONS - CONTINUED

Year 2000 Issue

During 1999, the Company completed its remediation and testing of systems in connection with the Year 2000 issue. As a result of these efforts, the Company experienced no disruptions or malfunctions at any of its properties. The Company incurred costs of less than \$50,000 in connection with testing and remediation for the Year 2000 issue.

Market Risk

The Company is exposed to market risk, in the form of changing interest rates, on its debt and mortgage notes receivable. The Company has no market risk with respect to derivatives and foreign currency fluctuations. Management uses daily monitoring of market conditions and analytical techniques to manage this risk.

At December 31, 1999 and 1998, the fair value of the Company's variable rate debt approximates its carrying value of \$365.7 million and \$350.2 million, respectively. By definition, because the interest rate is variable, the carrying amount of variable rate debt will always approximate its fair value. Assuming the December 31, 1999 and 1998 carrying value of \$365.7 million and \$350.2 million, respectively, is held constant, the hypothetical increase in interest expense resulting from a one percentage point increase in interest rates, would be \$3.7 million and \$3.5 million, respectively. The interest rate on variable rate debt is based on and variable with European interbank interest rates (LIBOR).

At December 31, 1999 and 1998, the carrying value of the Company's fixed rate debt is \$198.2 million and \$209.7 million, respectively, and the fair value of the Company's fixed rate debt is approximately \$190.9 million and \$209.7 million, respectively. The fair value is based on the present value of future cash flows discounted at the market rate of interest. Market risk, expressed as the hypothetical increase in fair value resulting from a one percentage point increase in interest rates, is \$4.1 million and \$7.2 million, respectively, for aggregate fixed rate debt.

At December 31, 1999 and 1998, the carrying value of the Company's fixed rate mortgage notes receivable is \$253.5 million and \$237.6 million, respectively, and the fair value is approximately \$232.1 million and \$237.6 million, respectively. The fair value is based on the present value of future cash flows discounted at an assumed market rate of interest. Because no market rates of interest are published for these assets, the market rate of interest is assumed to be the same spread to U.S. Treasury yields for comparable maturities that existed when the mortgage notes receivable were acquired in the Capstone merger on October 15, 1998, adjusted to published U.S. Treasury yields. Market risk at December 31, 1999 and 1998, expressed as the hypothetical decrease in fair value resulting from a one percentage point increase in interest rates, is \$10.6 million and \$10.7 million, respectively, on the aggregate portfolio of fixed rate mortgage notes receivable.

Cautionary Language Regarding Forward Looking Statements

Statements in this Annual Report on Form 10-K that are not historical, factual statements are "forward looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. The statements include, among other things, statements regarding the intent, belief or expectations of the Company and its officers and can be identified by the use of terminology such as "may", "will", "expect", "believe", "intend", "plan", "estimate", "should" and other comparable terms. In addition, the Company, through its senior management, from time to time makes forward looking oral and written public statements concerning the Company's expected future operations and other developments. Shareholders and investors are cautioned that, while forward looking statements reflect the Company's good faith beliefs and best judgment based upon current information, they are not guarantees of future performance and are subject to known and unknown risks and uncertainties. Actual results may differ materially from the expectations contained in the forward looking statements as a result of various factors. For a more detailed discussion of these, and other factors, see Item 1 of the Company's Form 10-K for the fiscal year ended December 31, 1999.

Report of
I N D E P E N D E N T A U D I T O R S

**The Board of Directors and Stockholders
Healthcare Realty Trust Incorporated**

We have audited the accompanying consolidated balance sheets of Healthcare Realty Trust Incorporated as of December 31, 1999 and 1998, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 1999. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Healthcare Realty Trust Incorporated at December 31, 1999 and 1998, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1999 in conformity with accounting principles generally accepted in the United States.

Ernst & Young LLP

Nashville, Tennessee
January 25, 2000

Consolidated
BALANCE SHEETS

<i>(Dollars in thousands)</i>	December 31,	
	1999	1998
ASSETS		
Real estate properties:		
Land	\$ 150,591	\$ 140,617
Buildings and improvements	1,223,387	1,169,941
Personal property	5,165	4,825
Construction in progress	20,003	72,172
	1,399,146	1,387,555
Less accumulated depreciation	(83,996)	(50,116)
Total real estate properties, net	1,315,150	1,337,439
Cash and cash equivalents	3,396	12,710
Restricted cash	990	1,701
Mortgage notes receivable	253,459	237,617
Other assets, net	34,969	22,956
Total assets	\$ 1,607,964	\$ 1,612,423
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Notes and bonds payable	\$ 563,884	\$ 559,924
Accounts payable and accrued liabilities	17,658	22,824
Other liabilities	8,519	11,971
Total liabilities	590,061	594,719
Commitments	—	—
Stockholders' equity:		
Preferred stock, \$.01 par value; 50,000,000 shares authorized; issued and outstanding 1999 and 1998 - 3,000,000	30	30
Common stock, \$.01 par value; 150,000,000 shares authorized; issued and outstanding 1999 - 40,004,579; 1998 - 39,792,775	400	398
Additional paid-in capital	1,054,405	1,049,039
Deferred compensation	(9,509)	(10,662)
Cumulative net income	215,373	129,346
Cumulative dividends	(242,796)	(150,447)
Total stockholders' equity	1,017,903	1,017,704
Total liabilities and stockholders' equity	\$ 1,607,964	\$ 1,612,423

See accompanying notes.

Consolidated
S T A T E M E N T S O F I N C O M E

	Year Ended December 31,		
	1999	1998	1997
<i>(Dollars in thousands, except per share data)</i>			
REVENUES			
Master lease rental income	\$ 92,070	\$ 47,512	\$ 40,298
Property operating income	57,778	35,269	14,631
Straight line rent	6,885	1,265	0
Mortgage interest income	26,254	5,120	84
Management fees	2,727	2,056	1,499
Interest and other income	1,543	1,207	3,284
	187,257	92,429	59,796
EXPENSES			
General and administrative	7,287	11,126	3,807
Property operating expenses	21,077	11,978	5,008
Interest	38,603	13,057	7,969
Depreciation	38,566	15,965	11,468
Amortization	473	499	332
	106,006	52,625	28,584
Net income before net gain on real estate disposals	81,251	39,804	31,212
Net gain on real estate disposals	4,776	675	0
Net income	\$ 86,027	\$ 40,479	\$ 31,212
Net income per share - Basic	\$ 2.02	\$ 1.66	\$ 1.71
Net income per share - Diluted	\$ 1.99	\$ 1.63	\$ 1.68
Shares outstanding - Basic	39,326,594	24,043,942	18,222,243
Shares outstanding - Diluted	39,810,306	24,524,600	18,572,492

See accompanying notes.

Consolidated
STATEMENTS OF STOCKHOLDERS' EQUITY

<i>(Dollars in thousands, except per share data)</i>	Preferred Stock	Common Stock	Additional Paid-In Capital	Deferred Compensation	Cumulative Net Income	Cumulative Dividends	Total Stockholders' Equity
Balance at December 31, 1996	\$ —	\$ 139	\$ 264,614	\$ (4,702)	\$ 57,655	\$ (71,742)	\$ 245,964
Issuance of stock	—	52	134,113	—	—	—	134,165
Shares awarded as deferred stock compensation	—	2	3,880	(3,882)	—	—	—
Deferred stock compensation amortization	—	—	—	895	—	—	895
Net income	—	—	—	—	31,212	—	31,212
Dividends (\$1.99 per share)	—	—	—	—	—	(35,764)	(35,764)
Balance at December 31, 1997	—	193	402,607	(7,689)	88,867	(107,506)	376,472
Issuance of common stock	—	202	567,734	—	—	—	567,936
Issuance of preferred stock	30	—	71,956	—	—	—	71,986
Shares awarded as deferred stock compensation	—	2	4,331	(4,274)	—	—	59
Shares issued from warrants	—	1	2,411	—	—	—	2,412
Deferred stock compensation amortization	—	—	—	1,301	—	—	1,301
Net income	—	—	—	—	40,479	—	40,479
Dividends – common (\$2.07 per share)	—	—	—	—	—	(42,386)	(42,386)
Dividends – preferred (\$0.46224 per share)	—	—	—	—	—	(555)	(555)
Balance at December 31, 1998	30	398	1,049,039	(10,662)	129,346	(150,447)	1,017,704
Issuance of common stock	—	2	5,345	—	—	—	5,347
Shares awarded as deferred stock compensation	—	—	21	(21)	—	—	—
Deferred stock compensation amortization	—	—	—	1,174	—	—	1,174
Net income	—	—	—	—	86,027	—	86,027
Dividends – common (\$2.15 per share)	—	—	—	—	—	(85,693)	(85,693)
Dividends – preferred (\$2.22 per share)	—	—	—	—	—	(6,656)	(6,656)
Balance at December 31, 1999	\$ 30	\$ 400	\$ 1,054,405	\$ (9,509)	\$ 215,373	\$ (242,796)	\$ 1,017,903

See accompanying notes.

Consolidated Statements of
C A S H F L O W S

<i>(In thousands)</i>	Year Ended December 31,		
	1999	1998	1997
OPERATING ACTIVITIES			
Net income	\$ 86,027	\$ 40,479	\$ 31,212
Adjustments to reconcile net income to cash provided by operating activities:			
Depreciation and amortization	41,225	17,122	12,073
Deferred compensation	1,153	1,247	672
Increase (decrease) in deferred income	(743)	(907)	114
Decrease in other liabilities	(749)	(2,474)	—
Increase in other assets	(17,638)	(7,957)	(2,346)
Decrease in accounts payable and accrued liabilities	(5,781)	(27,133)	(1,340)
Increase in straight line rent	(6,885)	(1,265)	—
Charge to operations	—	3,373	—
Gain on sales of real estate	(4,776)	(675)	—
Net cash provided by operating activities	91,833	21,810	40,385
INVESTING ACTIVITIES			
Acquisition and development of real estate properties	(55,664)	(94,066)	(61,813)
Acquisition and development of mortgages	(27,475)	(27,851)	(4,708)
Proceeds from mortgage repayments	18,749	8,522	—
Proceeds from sale of real estate	46,929	11,895	—
Receipt (disbursement) of security deposits	(481)	134	(976)
Purchase of Capstone, net of cash acquired	—	5,437	—
Net cash used in investing activities	(17,942)	(95,929)	(67,497)
FINANCING ACTIVITIES			
Borrowings on notes and bonds payable	125,200	425,000	35,300
Repayments on notes and bonds payable	(121,608)	(338,689)	(102,618)
Decrease in notes receivable	350	451	—
Dividends paid	(92,349)	(42,941)	(35,764)
Proceeds from issuance of common stock	5,202	37,683	134,165
Net cash provided by (used in) financing activities	(83,205)	81,504	31,083
Increase (decrease) in cash and cash equivalents	(9,314)	7,385	3,971
Cash and cash equivalents, beginning of period	12,710	5,325	1,354
Cash and cash equivalents, end of period	\$ 3,396	\$ 12,710	\$ 5,325

Notes to CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

The Company invests in healthcare-related properties and mortgages located throughout the United States, including ancillary hospital facilities, physician clinics, ambulatory surgery centers, inpatient rehab facilities, assisted living facilities, skilled nursing facilities, comprehensive ambulatory care centers, and other facilities. The Company provides management, leasing and build-to-suit development, and capital for the construction of new facilities as well as for the acquisition of existing properties. As of December 31, 1999, the Company had invested or committed to invest in 285 properties and mortgages located in 34 states, affiliated with 74 healthcare-related entities.

Basis of Presentation

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

Use of Estimates in Financial Statements

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

Real Estate Properties

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

Buildings and improvements	31.5 or 39.0 years
Personal property	3.0 to 7.0 years

Restricted Cash

Restricted cash includes security deposits and other funds set aside for capital expenditures on certain investments of the Company.

Mortgage Notes Receivable

Mortgage notes receivable, substantially all of which were acquired in the Capstone merger (see Note 2), were recorded at their fair value at the date of acquisition. The mortgage portfolio has a weighted average maturity of approximately 5.9 years. Interest rates, which range from 8% to 13%, are generally adjustable each year to reflect actual increases in the Consumer Price Index subject to a minimum increase of 4% of the current interest rate. Substantially all of the mortgages are subject to a prepayment penalty.

Cash and Cash Equivalents

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

Federal Income Taxes

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

Other Assets

Other assets consist primarily of receivables, deferred costs and intangible assets. Deferred financing costs are amortized over the term of the related credit facility using the interest method. Intangible assets are amortized straight-line over the applicable lives of the assets, which range from four to forty years. Accumulated amortization was \$2.0 million and \$1.1 million at December 31, 1999 and 1998, respectively.

Notes to
CONSOLIDATED FINANCIAL STATEMENTS

Revenue Recognition

Rental income related to noncancelable operating leases is recognized as earned over the life of the lease agreements on a straight-line basis. Any additional rent, as defined in each lease agreement, is recognized as earned.

Stock Issued to Employees

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

Net Income Per Share

Basic earnings per share is calculated using weighted average shares outstanding less issued and outstanding but unvested restricted shares of Common Stock.

Diluted earnings per share is calculated using weighted average shares outstanding plus the dilutive effect of convertible debt and restricted shares of Common Stock and outstanding stock options, using the treasury stock method and the average stock price during the period.

Significant Accounting Pronouncements

In June 1997, the Financial Accounting Standards Board ("FASB") issued Financial Accounting Standards Board Statement No. 130, "Reporting Comprehensive Income" ("FAS 130"), which establishes standards for reporting and displaying comprehensive income and its components in a full set of general purpose financial statements. The Company adopted FAS 130 effective for its fiscal year ended December 31, 1998. Comprehensive income is the same as net income for the Company.

In June 1997, the FASB issued Financial Accounting Standards Board Statement No. 131, "Disclosures about Segments of an Enterprise and Related Information" ("FAS 131"). The Company adopted FAS 131 effective for its fiscal year ended December 31, 1998. The adoption of FAS 131 had no impact on the Company, as the Company operates in only one business segment, consisting of investments in healthcare-related properties and mortgages throughout the United States.

Reclassification

Certain reclassifications have been made in the financial statements for the years ended 1998 and 1997 to conform to the 1999 presentation. These reclassifications had no effect on the results of operations as previously reported.

2. CAPSTONE MERGER

On October 15, 1998, the Company acquired Capstone Capital Corporation ("Capstone") in a stock-for-stock merger in which the stockholders of Capstone received a fixed ratio of .8518 shares of the Company's common stock and the holders of Capstone preferred stock received one share of the Company's voting preferred stock in exchange for each share of Capstone preferred stock. The Company issued 18,906,909 shares of common stock and 3,000,000 shares of preferred stock. The transaction was accounted for as a purchase and resulted in no goodwill.

The purchase price is summarized as follows (in thousands):

Common stock	\$ 532,554
Preferred stock	72,052
Cash and cash equivalents	8,330
Liabilities assumed	424,897
Total Purchase Price	<u>\$ 1,037,833</u>

The assets acquired in the Capstone merger are summarized as follows (in thousands):

Real estate properties	\$ 804,178
Mortgage notes receivable	211,590
Cash and cash equivalents	13,767
Other assets	8,298
Total Assets Acquired	<u>\$ 1,037,833</u>

Notes to
CONSOLIDATED FINANCIAL STATEMENTS

The unaudited proforma results of operations for the two years ended December 31, 1998 and 1997, assuming that the Capstone merger had occurred as of the beginning of each of those periods, are (dollars in thousands, except for per share data):

	1998	1997
Revenues	\$ 168,721	\$ 116,974
Net income	\$ 73,186	\$ 54,234
Net income per share - Basic	\$ 1.74	\$ 1.39
Net income per share - Diluted	\$ 1.72	\$ 1.38

3. REAL ESTATE PROPERTY LEASES

The Company's properties are generally leased or supported pursuant to noncancelable, fixed-term operating leases and other financial support arrangements with expiration dates from 2000 to 2023. Some leases and financial arrangements provide for fixed rent renewal terms of five years, or multiples thereof, in addition to market rent renewal terms. The leases generally provide the lessee, during the term of the lease and for a short period thereafter, with an option and a right of first refusal to purchase the leased property. Each lease generally requires the lessee to pay minimum rent, additional rent based upon increases in the Consumer Price Index or increases in net patient revenues (as defined in the lease agreements), and all taxes (including property tax), insurance, maintenance and other operating costs associated with the leased property.

Amounts of rental income received from lessees who accounted for more than 10% of the Company's rental income for the three years in the period ended December 31, 1999 were (in thousands):

	1999	1998	1997
Healthsouth	\$ 24,060	\$ 4,727	\$ 0
Columbia/HCA Healthcare Corporation	23,211	17,125	13,899
Tenet Healthcare	17,942	13,713	13,297
Phycor	9,228	8,899	8,218

Future minimum lease and guaranty payments under the noncancelable operating leases and financial support arrangements as of December 31, 1999 are as follows (in thousands):

2000	\$ 143,330
2001	141,504
2002	139,479
2003	138,986
2004	143,082
2005 and thereafter	735,816
	<u>\$ 1,442,197</u>

Notes to
CONSOLIDATED FINANCIAL STATEMENTS

4. REAL ESTATE PROPERTIES

The following table summarizes the Company's real estate properties by type of facility and by state as of December 31, 1999 (dollars in thousands).

	Number of Facilities ⁽¹⁾	Land	Buildings and Improvements and CIP	Personal Property	Total	Accumulated Depreciation
<i>Ancillary hospital facilities:</i>						
Alabama	6	\$ 5,792	\$ 37,173	\$ 0	\$ 42,965	\$ 1,405
California	9	18,375	60,556	44	78,975	6,374
Florida	12	6,042	90,627	122	96,791	7,540
Texas	11	8,989	62,760	276	72,025	8,674
Virginia	9	13,832	65,429	94	79,355	5,533
Other states	13	10,545	102,710	67	113,322	6,794
	60	63,575	419,255	603	483,433	36,320
<i>Skilled nursing facilities:</i>						
Michigan	5	193	12,338	183	12,714	2,507
Virginia	5	1,060	22,589	0	23,649	836
Colorado	3	2,886	23,522	0	26,408	1,662
Pennsylvania	3	479	20,138	0	20,617	748
Tennessee	2	228	8,107	0	8,335	537
Texas	2	1,795	17,671	0	19,466	1,340
Other states	7	4,625	39,124	32	43,781	4,001
	27	11,266	143,489	215	154,970	11,631
<i>Physician clinics:</i>						
Florida	10	12,260	43,905	51	56,216	3,816
Virginia	6	621	3,188	0	3,809	244
Maine	5	4,284	26,502	0	30,786	979
Tennessee	5	2,943	7,728	0	10,671	347
Texas	2	5,796	15,581	20	21,397	1,238
Other states	8	4,674	40,733	1	45,408	1,767
	36	30,578	137,637	72	168,287	8,391
<i>Comprehensive ambulatory care centers:</i>						
Florida	6	2,593	36,637	0	39,230	1,437
Texas	2	1,643	20,008	69	21,720	3,351
Other states	5	9,196	54,595	7	63,798	1,746
	13	13,432	111,240	76	124,748	6,534
<i>Ambulatory surgery centers:</i>						
Florida	1	2,200	3,944	0	6,144	8
Missouri	1	1,686	3,621	0	5,307	132
Nevada	1	940	2,861	0	3,801	400
Texas	1	510	1,514	15	2,039	330
Other states	3	558	3,494	9	4,061	286
	7	5,894	15,434	24	21,352	1,156
<i>Inpatient rehabilitation facilities:</i>						
Alabama	1	0	17,722	0	17,722	562
Florida	1	0	11,703	0	11,703	372
Pennsylvania	6	4,718	107,529	0	112,247	3,780
Texas	1	1,117	11,800	0	12,917	436
	9	5,835	148,754	0	154,589	5,150
<i>Assisted living facilities:</i>						
Florida	3	1,171	18,957	0	20,128	78
Missouri	4	206	5,909	0	6,115	219
Pennsylvania	7	1,490	28,908	0	30,398	991
Texas	8	0	70,824	0	70,824	2,603
Virginia	3	889	15,846	0	16,735	586
Other states	7	2,899	43,635	0	46,534	1,437
	32	6,655	184,079	0	190,734	5,914
<i>Other:</i>						
Arizona	1	582	2,952	0	3,534	96
Florida	2	911	3,843	0	4,754	147
Missouri	1	2,040	8,857	0	10,897	343
Texas	3	1,667	14,361	441	16,469	1,913
Virginia	6	2,385	26,314	129	28,828	1,831
Other states	5	5,771	27,173	38	32,982	2,851
	18	13,356	83,500	608	97,464	7,181
Corporate property	0	0	2	3,567	3,569	1,719
Total property	202	\$150,591	\$1,243,390	\$ 5,165	\$1,399,146	\$ 83,996

⁽¹⁾ Includes six lessee developments.

Notes to
CONSOLIDATED FINANCIAL STATEMENTS

5. NOTES AND BONDS PAYABLE

Notes and bonds payable at December 31, 1999 and 1998 consisted of the following (in thousands):

	December 31,	
	1999	1998
Unsecured credit facility	\$ 252,000	\$ 171,000
Term loan facility	113,700	179,200
Unsecured notes	54,000	72,000
6.55% convertible subordinated debentures, net	73,836	73,219
10.50% convertible subordinated debentures, net	3,573	3,823
Mortgage notes payable	59,775	60,682
Other note payable	7,000	—
	<u>\$ 563,884</u>	<u>\$ 559,924</u>

Unsecured Credit Facility

On October 15, 1998, concurrent with the Capstone merger, the Company repaid the outstanding balances under both Capstone and its own unsecured credit facilities and entered into a \$265.0 million unsecured credit facility (the "Unsecured Credit Facility") with ten commercial banks. The Unsecured Credit Facility bears interest at LIBOR plus 1.05%, payable quarterly, and matures on October 15, 2001. In addition, the Company will pay, quarterly, a commitment fee of 0.225 of 1% on the unused portion of funds available for borrowings. The Unsecured Credit Facility contains certain representations, warranties, and financial and other covenants customary in such loan agreements. At December 31, 1999, the Company had available borrowing capacity of \$13.0 million under the Unsecured Credit Facility.

Term Loan Facility

On October 15, 1998, concurrent with the Capstone merger, the Company entered into a \$200.0 million unsecured term loan (the "Term Loan Facility") with Bank of America (formerly NationsBank). Effective January 14, 2000, the Company amended its Term Loan Facility agreement with Bank of America. The Term Loan Facility, as amended, bears interest at LIBOR plus 2.00%, payable quarterly, and matures on April 14, 2000. If the balance on the Term Loan Facility exceeds \$25.0 million on March 14, 2000, the interest rate will increase to LIBOR plus 2.50%. The Term Loan Facility contains certain representations, warranties and financial and other covenants customary in such loan agreements, as well as restrictions on dividend payments if minimum tangible capital requirements are not met. At December 31, 1999, the Company had no additional available borrowing capacity under the Term Loan Facility.

Unsecured Notes

On September 18, 1995, the Company privately placed \$90.0 million of unsecured notes (the "Unsecured Notes") with 16 institutions. The Unsecured Notes bear interest at 7.41%, payable semi-annually, and mature on September 1, 2002. Beginning on September 1, 1998 and on each September 1 through 2002, the Company must repay \$18.0 million of principal. The note agreements pursuant to which the Unsecured Notes were purchased contain certain representations, warranties and financial and other covenants customary in such loan agreements.

Convertible Subordinated Debentures

As part of the Capstone merger, the Company assumed and recorded at fair value \$74.7 million aggregate face amount of 6.55% Convertible Subordinated Debentures (the "6.55% Debentures") of Capstone. At December 31, 1999, the Company had approximately \$73.8 million aggregate principal amount of 6.55% Debentures outstanding with a face amount of \$74.7 million and unaccreted discount of \$0.9 million. Such rate of interest and accretion of discount represents a yield to maturity of 7.5% per annum (computed on a semiannual bond equivalent basis). The 6.55% Debentures are due on March 14, 2002, unless redeemed earlier by the Company or converted by the holder, and are callable on March 16, 2000. Interest on the 6.55% Debentures is payable on March 14 and September 14 in each year. The 6.55% Debentures are convertible into shares of common stock of the Company at the option of the holder at any time prior to redemption or stated maturity, at a conversion price rate of 33.6251 shares per \$1 thousand bond.

Also, as part of the Capstone merger, the Company assumed and recorded at fair value \$3.8 million aggregate face amount of 10.5% Convertible Subordinated Debentures (the "10.5% Debentures") of Capstone. At December 31, 1999, the Company had approximately \$3.6 million aggregate principal amount of 10.5% Debentures outstanding with a face amount of \$3.4 million and unamortized premium of \$0.2 million. Such rate of interest and amortization of premium represents a yield to maturity of 7.5% per annum (computed on a semiannual bond

Notes to
CONSOLIDATED FINANCIAL STATEMENTS

equivalent basis). The 10.5% Debentures are due on April 1, 2002, unless redeemed earlier by the Company or converted by the holder, and are callable on April 5, 2000. Interest on the 10.5% Debentures is payable on April 1 and October 1 in each year. The 10.5% Debentures are convertible into shares of common stock of the Company at the option of the holder at any time prior to redemption or stated maturity at a conversion price rate of 52.8248 shares per \$1 thousand bond.

Mortgage Notes

As part of the Capstone merger, the Company assumed six nonrecourse mortgage notes payable, and the related collateral, as follows (*dollars in millions*):

Mortgagor	Original Balance	Interest Rate	Collateral	Book Value Of Collateral at December 31, 1999	Balance at December 31, 1999
Life Insurance Co.	\$ 23.3	8.500%	Ancillary hospital facility	\$ 41.2	\$ 22.6
Life Insurance Co.	4.7	7.625%	Ancillary hospital facility	10.4	4.4
Life Insurance Co.	17.1	8.125%	Two Ambulatory surgery centers & one ancillary hospital facility	35.7	16.6
Bank	17.0	8.500%	Six skilled nursing facilities	28.8	16.2
	<u>\$ 62.1</u>			<u>\$ 116.1</u>	<u>\$ 59.8</u>

The \$23.3 million note is payable in monthly installments of principal and interest based on a 30 year amortization with the final payment due in July 2026. The \$4.7 million note is payable in monthly installments of principal and interest based on a 20 year amortization with the final payment due in January 2017. The three notes totaling \$17.1 million are payable in monthly installments of principal and interest based on a 25 year amortization with a balloon payment of the unpaid balance in September 2004. The \$17.0 million note bears interest at 50 basis points in excess of the prime rate, and is payable in monthly installments of principal and interest based on a 25 year amortization with a balloon payment of the unpaid balance in June 2000.

Other Notes

On July 31, 1999, the Company entered into a \$7.0 million note with a commercial institution. The note bears interest at 7.53%, is payable in equal semi-annual installments of principal and interest and fully amortizes in July 2005.

Other Long-Term Debt Information

Future maturities of long-term debt are as follows (in thousands):

2000	\$ 149,092
2001	271,653
2002	98,075
2003	1,971
2004	17,061
2005 and thereafter	26,032
	<u>\$ 563,884</u>

During the years ended December 31, 1999, 1998 and the 1997, interest paid totaled \$41.5 million, \$11.1 million and \$9.0 million, and capitalized interest totaled \$1.9 million, \$1.4 million and \$0.7 million, respectively.

Notes to
CONSOLIDATED FINANCIAL STATEMENTS

6. STOCKHOLDERS' EQUITY

The Company had common and preferred shares outstanding as of the three years ended December 31, 1999 as follows:

	Year Ended December 31,		
	1999	1998	1997
Common Shares			
Balance, beginning of period	39,792,775	19,285,927	13,898,777
Issuance of stock	210,754	20,226,981	5,235,761
Shares awarded as deferred stock compensation	1,050	148,357	143,716
Shares issued from warrants	—	131,510	7,673
Balance, end of period	40,004,579	39,792,775	19,285,927
Preferred Shares			
Balance, beginning of period	3,000,000	—	—
Issuance of stock	—	3,000,000	—
Balance, end of period	3,000,000	3,000,000	—

On October 15, 1998, the Company issued 18,906,909 shares of common stock and 3,000,000 shares of 8 7/8% Series A Voting Cumulative preferred stock, par value \$.01 per share, in a stock-for-stock merger with Capstone Capital Corporation (see Note 2). Upon dissolution of the Company, the preferred stock is senior to common stock with respect to dividend rights and rights upon dissolution. Holders of preferred stock are entitled to receive cumulative preferential cash dividends of 8 7/8 % per annum of the liquidation preference of \$25.00 per share payable quarterly, in arrears. Preferred stock is not redeemable prior to September 30, 2002. On or after September 2002, the Company, at its option, may redeem preferred stock, in whole or in part, at any time or from time to time, at the redemption price. The holder of each share of preferred stock has one vote, together with the holders of common stock, on all matters on which stockholders may vote.

In July 1998, warrants for 128,149 shares of common stock were exercised. At December 31, 1999 and 1998, the Company has no warrants outstanding. During April and May 1998, the Company sold an aggregate of 49,953 shares of common stock to a single institutional investor. In February 1998, the Company participated in two unit investment trust offerings and sold an aggregate of 1,224,026 shares of its common stock. The Company received an aggregate of \$37.1 million in proceeds for these transactions. The proceeds were used to repay outstanding borrowings under the Company's previous unsecured credit facility, acquisitions, developments and for general corporate purposes.

Effective February 14, 1997, the Company sold 5,175,000 shares of its common stock in a secondary offering (the "Secondary Offering") under its currently effective registration statement pertaining to \$250.0 million of equity securities, debt securities and warrants. The Company received \$133.4 million in net proceeds. Promptly thereafter, the net proceeds were used, in part, to extinguish \$71.9 million of indebtedness outstanding under the Company's previous unsecured credit facility, and to repay or defease secured indebtedness in the total amount of \$6.7 million. Remaining proceeds of the Secondary Offering of approximately \$57.2 million were invested in additional property acquisitions, build-to-suit property development and for general corporate purposes.

7. BENEFIT PLANS

Executive Retirement Plan

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

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CONSOLIDATED FINANCIAL STATEMENTS

Retirement Plan for Outside Directors

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

Retirement Plan Information

Net expense for both the Executive Retirement Plan and the Retirement Plan for Outside Directors (the "Plans") for the two years ended December 31, 1999 is comprised of the following (in thousands):

	1999	1998
Service cost	\$ 233	\$ 775
Interest cost	141	103
Other	(27)	10
	<u>\$ 347</u>	<u>\$ 888</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, 1999 and 1998 (in thousands).

	1999	1998
Benefit obligation at beginning of year	\$ 2,553	\$ 1,213
Service cost	233	775
Interest cost	141	103
Other	(27)	10
Actuarial gain (loss)	(576)	452
Benefit obligation at end of year	2,324	2,553
Unrecognized net actuarial (gain) loss	214	(362)
Net pension liability in accrued liabilities	<u>\$ 2,538</u>	<u>\$ 2,191</u>

Accounting for the Executive Retirement Plan for the years ended December 31, 1999 and 1998 assumes discount rates of 8.03% and 7.04%, respectively, and a compensation increase rate of 2.7%. Accounting for the Retirement Plan for Outside Directors assumes discount rates of 8.03% and 7.04%, respectively.

8. STOCK PLANS AND WARRANTS

1993 Employees Stock Incentive Plan

The Company is authorized to issue stock representing up to 7.5% of its outstanding shares of common stock, (the "Employee Plan Shares") under the 1993 Employees Stock Incentive Plan (the "Employee Plan"). As of December 31, 1999 and 1998, the Company had a total of 2,480,326 and 2,464,441 Employee Plan Shares authorized, respectively, that had not been issued. Unless terminated earlier, the Employee Plan will terminate on January 1, 2003. As of December 31, 1999 and 1998, the Company had issued a total of 520,017 and 520,017, and had specifically reserved, but not issued, a total of 445,000 and 445,000 Employee Plan Shares (the "Reserved Stock"), respectively, for performance-based awards to employees under the Employee Plan. The issuance of Reserved Stock to eligible employees is contingent upon the achievement of specific performance criteria. The Reserved Stock awards are subject to fixed vesting periods varying from four to twelve years beginning on the date of issue. If an employee voluntarily terminates employment with the Company before the end of the vesting period, the shares are forfeited, at no cost to the Company. Once the Reserved Stock has been issued, the employee has the right to receive dividends and the right to vote the shares. For 1999 and 1998, compensation expense resulting from the amortization of the value of these shares was \$1.1 million and \$1.2 million, respectively.

Notes to CONSOLIDATED FINANCIAL STATEMENTS

Non-Employee Directors' Stock Plan

Pursuant to the 1995 Restricted Stock Plan for Non-Employee Directors (the "1995 Directors' Plan"), the Directors' stock vests in each Director upon the date three years from the date of issue and is subject to forfeiture prior to such date upon termination of the Director's service, at no cost to the Company. As of December 31, 1999 and 1998, the Company had a total of 94,750 and 95,800 authorized shares under the 1995 Directors' Plan, respectively, that had not been issued. As of December 31, 1999 and 1998, the Company had issued a total of 14,523 and 13,473 shares, respectively, pursuant to the 1995 Directors' Plan. For 1999 and 1998, compensation expense resulting from the amortization of the value of these shares was \$30,943 and \$89,792 respectively.

1995 Employee Stock Purchase Plan

As of December 31, 1999 and 1998, the Company had a total of 772,819 and 851,232 shares authorized under the 1995 Employee Stock Purchase Plan (the "Employee Purchase Plan"), respectively, that had not been issued or optioned. Under the Employee Purchase Plan, each eligible employee as of May 1995 and each subsequent January 1 has been or shall be granted an option to purchase up to \$25,000 of common stock at the lesser of 85% of the market price on the date of grant or 85% of the market price on the date of exercise of such option (the "Exercise Date"), but at not less than book value per share as of the December 31 immediately preceding the date of grant. The number of shares subject to each year's option becomes fixed on the date of grant. Eligible employees include those employees who were employed by the Company or a subsidiary on a full-time basis as of May 1995 and those employees with six months of service who are so employed by the Company or subsidiary as of each subsequent January 1. Options granted under the Employee Purchase Plan expire if not exercised 27 months after each such option's date of grant. The Employee Purchase Plan results in no compensation expense to the Company.

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

	All Options		
	1999	1998	1997
Outstanding, beginning of year	85,716	65,573	71,073
Granted	144,886	74,472	69,930
Exercised	(5,524)	(12,289)	(40,631)
Forfeited	(37,775)	(31,799)	(23,723)
Expired	(28,698)	(10,241)	(11,076)
Outstanding and exercisable at end of year	158,605	85,716	65,573
Weighted-average fair value of options granted during the year (calculated as of the grant date)	\$ 0.76	\$ 5.94	\$ 3.12
Weighted-average exercise price of options exercised during the year	\$ 18.00	\$ 20.69	\$ 19.48
Weighted-average exercise price of options outstanding (calculated as of December 31)	\$ 22.57	\$ 19.10	\$ 21.58
Range of exercise prices of options outstanding (calculated as of December 31)	\$19.52-\$23.76	\$18.43-\$19.52	\$19.71-\$22.47
Weighted-average contractual life of outstanding options (calculated as of December 31, in years)	1.0	0.9	0.9

The fair value for these options was estimated at the date of grant using a Black-Scholes options pricing model with the following assumptions for 1999, 1998 and 1997; risk-free interest rates of 6.24%, 5.00% and 6.00%; a dividend yield of 9.87%, 7.13% and 8.02%; a volatility factor of the expected market price of the Company's Common Stock of .178, .139 and .096; and an expected life of the option of 1.13 years, respectively.

The pro forma effect on net income and earnings per share for the three years in the period ended December 31, 1999, calculated in accordance with Statement of Financial Accounting Standards No. 123 "Accounting for Stock-Based Compensation," is as follows (dollars in thousands, except per share data):

	1999	1998	1997
Pro forma net income	\$ 85,917	\$ 40,037	\$ 30,994
Pro forma earnings per share:			
Basic	\$ 2.02	\$ 1.64	\$ 1.70
Assuming dilution	\$ 1.99	\$ 1.61	\$ 1.67

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CONSOLIDATED FINANCIAL STATEMENTS

The Company is proposing a 2000 Employee Stock Purchase Plan which will be voted on at the Company's annual shareholders' meeting in May 2000.

Other

In 1993, the Company issued warrants to purchase up to 188,712 shares of common stock (the "Warrants"). The Warrants were exercisable for a period of four years commencing July 1, 1994 at a price of \$19.50 per share, the then current fair market value, subject to adjustment under applicable antidilution provisions. The holders of the Warrants had 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. As of December 31, 1998, all Warrants had either been exercised or cancelled.

At December 31, 1999 and 1998, the Company had authorized 3,347,895 and 3,430,112 shares, respectively, for future issuance under stock plans.

The Company has revised its discretionary bonus incentive plan to include restricted stock as part of bonuses for employees in management positions. These restricted stock shares will vest over periods ranging from three to five years. If an employee terminates employment with the Company before the end of the vesting period, the shares are forfeited at no cost to the Company. The Company's first bonus under this plan was issued March 1, 2000.

9. NET INCOME PER SHARE

The table below sets forth the computation of basic and diluted earnings per share as required by FASB Statement No. 128 for the three years in the period ended December 31, 1999.

	Year Ended Dec. 31, 1999	Year Ended Dec. 31, 1998	Year Ended Dec. 31, 1997
Basic EPS			
Average Shares Outstanding	39,857,587	24,573,885	18,605,876
Actual Restricted Stock Shares	(530,993)	(529,943)	(383,633)
Denominator – Basic	39,326,594	24,043,942	18,222,243
Net Income	\$ 86,026,559	\$ 40,478,407	\$ 31,312,289
Preferred Stock Dividend	(6,655,726)	(554,688)	0
Numerator – Basic	\$ 79,370,833	\$ 39,923,719	\$ 31,212,289
Per share amount	\$ 2.02	\$ 1.66	\$ 1.71
Diluted EPS			
Average Shares Outstanding	39,857,587	24,573,885	18,605,876
Actual Restricted Stock Shares	(530,993)	(529,943)	(383,633)
Dilution for Convertible Debentures	0	40,017	0
Restricted Shares – Treasury	482,496	405,235	276,890
Dilution For Employee Stock Purchase Plan	1,216	15,597	25,032
Dilution for Warrants	0	19,809	48,327
Denominator – Diluted	39,810,306	24,524,600	18,572,492
Numerator – Basic	\$ 79,370,833	\$ 39,923,719	\$ 31,212,289
Convertible Subordinated Debenture Interest	0	63,638	0
Numerator – Diluted	\$ 79,370,833	\$ 39,987,357	\$ 31,212,289
Per share amount	\$ 1.99	\$ 1.63	\$ 1.68

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CONSOLIDATED FINANCIAL STATEMENTS

10. COMMITMENTS AND CONTINGENCIES

As of December 31, 1999, the Company had a net investment of approximately \$20.0 million in six build-to-suit developments in progress, which have a total remaining funding commitment of approximately \$37.6 million. Further, the Company has commitments to purchase or provide funding for the construction of other properties totaling \$12.4 million at December 31, 1999. The Company also has six mortgages under development at December 31, 1999, which have a total remaining funding commitment of approximately \$1.9 million.

As part of the Capstone merger, agreements were entered into with three individuals affiliated with Capstone that restrict competitive practices and which the Company believes will protect and enhance the value of the real estate properties acquired from Capstone. These agreements provide for the issuance of 150,000 shares per year of common stock of the Company to the individuals on October 15 of the years 1999, 2000, 2001, and 2002, provided all terms of the agreements are met. Upon issuance, these shares are valued at \$28.0714 per share. The Company issued 150,000 shares during 1999 pursuant to these agreements.

On March 22, 1999, HR Acquisition I Corporation, formerly known as Capstone Capital Corporation ("HRT"), a wholly-owned subsidiary of the Company, filed suit against Medistar Corporation and its affiliate, Medix Construction Company in United States District Court for the Northern District of Alabama, Southern Division. HRT is seeking damages in excess of two million dollars arising out of the development and construction of four real estate projects located in different parts of the United States. Medistar and Medix served as the developer and contractor, respectively, for the projects. HRT has asserted claims for damages relating to, among others, alleged breaches of the development and contracting obligations, failure to perform in accordance with contract terms and specifications, and other deficiencies in performance by Medistar and Medix. On June 10, 1999, Medistar and Medix filed its answer and counterclaim asserting a variety of alleged legal theories, claims for damages for alleged deficiencies by HRT and the Company in the performance of alleged obligations, and for damage to their business reputation. Attempts at mediation have not resulted in a settlement of the disputes. The Company's prosecution of its claims and defense of the counterclaims will be vigorous. While the Company cannot predict the range of possible loss or outcome, the Company believes that, even though the asserted cross claims seek substantial monetary damages, the allegations made by Medistar and Medix are not factually or legally meritorious, are subject to sustainable defenses and are, to a significant extent, covered by liability insurance.

11. OTHER DATA

Funds From Operations (Unaudited)

Funds from operations, as defined by the National Association of Real Estate Investment Trusts, Inc. ("NAREIT") 1995 White Paper, means net income (computed in accordance with generally accepted accounting principles), excluding gains (or losses) from debt restructuring and sales of property, plus depreciation from real estate assets. Funds from operations does not represent cash generated from operating activities in accordance with generally accepted accounting principles, is not necessarily indicative of cash available to fund cash needs, and should not be considered as an alternative to net income as an indicator of the Company's operating performance or as an alternative to cash flow as a measure of liquidity.

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CONSOLIDATED FINANCIAL STATEMENTS

	Year Ended Dec. 31, (Unaudited)	
	1999	1998
<i>(Dollars in thousands except per share data)</i>		
Net Income ⁽¹⁾	\$ 86,027	\$ 40,479
Non-recurring items ⁽²⁾	0	6,308
Gain or loss on dispositions ⁽³⁾	(4,776)	(675)
Straight line rents	(6,885)	(1,264)
Preferred stock dividend	(6,656)	(555)
Depreciation		
Real estate	38,017	15,374
Office F, F & E	0	0
Leasehold improvements	0	0
Other non-revenue producing assets	0	0
	38,017	15,374
Amortization		
Acquired property contracts	0	0
Other non-revenue producing assets	0	0
Organization costs	0	0
	0	0
Deferred financing costs	0	0
Total Adjustments	19,700	19,188
Funds From Operations – Basic	\$ 105,727	\$ 59,667
Convertible Subordinated Debenture Interest	0	64
Funds From Operations – Diluted	\$ 105,727	\$ 59,731
Shares Outstanding – Basic	39,326,594	24,043,942
Shares Outstanding – Diluted	39,810,306	24,524,600
Funds From Operations Per Share – Basic	\$ 2.69	\$ 2.48
Funds From Operations Per Share – Diluted	\$ 2.66	\$ 2.44

⁽¹⁾ 1999 and 1998 amounts include \$1.2 million and \$1.3 million, respectively, of stock-based, long-term, incentive compensation expense, a non-cash expense.

⁽²⁾ Represents charges primarily to write off certain capitalized costs, leasehold improvements, organization and other deferred costs in 1998.

⁽³⁾ Represents net gains from sales of real estate properties.

Return of Capital

Distributions in excess of earnings and profits generally constitute a return of capital. For the years ended December 31, 1999, 1998 and 1997, dividends paid per share of common stock were \$2.15, \$2.07 and \$1.99, respectively, which consisted of ordinary income per share of \$2.00, \$2.07 and \$1.72 and return of capital per share of \$0.15, \$0.00 and \$0.27, respectively. For the year ended December 31, 1999 and 1998, dividends paid per share of preferred stock were \$2.22 and \$0.46, all of which was ordinary income.

12. FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amounts of cash, receivables and payables are a reasonable estimate of their fair value at December 31, 1999 and 1998 due to their short term nature. The fair value of notes and bonds payable is estimated using cash flow analyses at December 31, 1999 and 1998, based on the Company's current interest rates for similar types of borrowing arrangements. The carrying amount of the Company's notes and bonds payable at December 31, 1999 is approximately \$7.3 million greater than the fair value. The carrying amount of the Company's mortgage notes receivable at December 31, 1999 is approximately \$21.4 million greater than the fair value. The fair value is based on the present value of future cash flows discounted at an assumed market rate of interest. Because no market rates of interest are published for these assets, the

Notes to
CONSOLIDATED FINANCIAL STATEMENTS

market rate of interest is assumed to be the same spread to U.S. Treasury yields for comparable maturities that existed when the mortgage notes receivable were acquired in the Capstone merger on October 15, 1998, adjusted to published U.S. Treasury yields. At December 31, 1998, the carrying value of notes and bonds payable and mortgage notes receivable approximated fair value.

13. SUBSEQUENT EVENTS

On January 25, 2000, the Company declared an increase in its quarterly common stock dividend from \$.545 per share (\$2.18 annualized) to \$.55 per share (\$2.20 annualized) payable on February 16, 2000 to shareholders of record on February 4, 2000. The Company also announced its quarterly preferred stock dividend of \$.55469 per share (\$2.22 annualized) payable on February 29, 2000 to shareholders of record on February 4, 2000.

14. SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

Quarterly financial information includes certain reclassifications to conform to the December 31, 1999 presentation. This information for the years ended December 31, 1999 and 1998 is summarized below:

(In thousands, except per share data)	Quarter Ended			
	March 31	June 30	September 30	December 31
1999				
Total revenue	\$ 45,148	\$ 46,160	\$ 46,518	\$ 49,431
Net income	\$ 20,742	\$ 20,592	\$ 20,230	\$ 24,463
Funds from operations - Basic	\$ 25,730	\$ 26,362	\$ 26,530	\$ 27,105
Funds from operations - Diluted	\$ 25,730	\$ 26,420	\$ 26,610	\$ 27,105
Net income per share - Basic	\$ 0.49	\$ 0.48	\$ 0.47	\$ 0.58
Net income per share - Diluted	\$ 0.48	\$ 0.48	\$ 0.47	\$ 0.57
Funds from operations per share - Basic	\$ 0.66	\$ 0.67	\$ 0.68	\$ 0.69
Funds from operations per share - Diluted	\$ 0.65	\$ 0.66	\$ 0.67	\$ 0.68
1998				
Total revenue	\$ 17,333	\$ 17,730	\$ 18,325	\$ 39,041
Net income	\$ 8,606	\$ 9,381	\$ 3,050	\$ 19,442
Funds from operations - Basic	\$ 11,604	\$ 12,316	\$ 12,368	\$ 23,379
Funds from operations - Diluted	\$ 11,604	\$ 12,316	\$ 12,368	\$ 23,443
Net income per share - Basic	\$ 0.44	\$ 0.46	\$ 0.15	\$ 0.52
Net income per share - Diluted	\$ 0.43	\$ 0.45	\$ 0.15	\$ 0.51
Funds from operations per share - Basic	\$ 0.60	\$ 0.61	\$ 0.61	\$ 0.65
Funds from operations per share - Diluted	\$ 0.59	\$ 0.60	\$ 0.60	\$ 0.64

Management
BOARD OF DIRECTORS & CORPORATE OFFICERS



Board of Directors (L-R)

David R. Emery

Chairman of the Board and Chief Executive Officer

Edwin B. Morris III

Managing Director, Morris & Morse Company Inc.

C. Raymond Fernandez M.D.

Chief Executive Officer and Chief Medical Officer, Piedmont Clinic

Errol L. Biggs, Ph.D.

Director, Center for Health Administration, University of Colorado

Thompson S. Dent

President and Chief Operating Officer, PhyCor, Inc.

Marliese E. Mooney

Consultant, Hospital Operations

Batey M. Gresham, Jr. AIA

Founder, Gresham Smith & Partners

J. Knox Singleton

President and Chief Executive Officer, INOVA Health Systems



Timothy G. Wallace

Executive Vice President and Chief Financial Officer

David R. Emery

Chairman of the Board and Chief Executive Officer

Roger O. West

Executive Vice President and General Counsel



J. D. Carter Steele

Vice President, Real Estate Investments

Keith A. Harville

Vice President, Real Estate Investments

Eric W. Fischer

Vice President, Real Estate Investments



Fredrick M. Langreck

Senior Vice President, Treasurer

Leigh Ann Stach

Vice President, Controller

Michael W. Crisler

Vice President, Financial Planning

Rita H. Todd

Corporate Secretary

Scott W. Holmes

Senior Vice President, Financial Reporting



Thomas M. Carnell AIA

Vice President, Design and Construction

Roland H. Hart

President, Healthcare Realty Services

Anne C. Sanborn

Director, Marketing and Strategic Advisory Services

B. Bart Starr

Chairman, Healthcare Realty Services

James P. Tainter

Vice President, Management Services

Corporate I N F O R M A T I O N

CORPORATE ADDRESS

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TRANSFER AGENT

Transfer of Shares
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Investor Services
P.O. Box 8040
Boston, Massachusetts 02266-8040
Phone: (781) 575-3400
CUSIP #: 421946104
Preferred CUSIP #: 421946203

Web Site: www.equiserve.com

Street Address for Courier Service
Boston EquiServe, L.P.
Blue Hills Office Park
Attn: Investor Services
150 Royall Street
Canton, Massachusetts 02021-1031

DIVIDEND REINVESTMENT PLAN

A Dividend Reinvestment Plan is offered as a convenience to stockholders who wish to increase their holdings in the Company. Additional shares may be purchased, without a service or sales charge, through automatic reinvestment of quarterly cash dividends. For information write Investor Relations, Boston EquiServe, 150 Royall Street, Canton, Massachusetts 02021 or call (781) 575-3400.

FORM 10-K

The Company has filed an Annual Report on Form 10-K for the year ended December 31, 1999, with the Securities and Exchange Commission. Shareholders may obtain a copy of this report, without charge, by writing: Investor Relations, Healthcare Realty Trust Inc., 3310 West End Avenue, Suite 700, Nashville, Tennessee 37203. Or, via e-mail: hrinfo@healthcarerealty.com.

COMMON STOCK

Healthcare Realty Trust Incorporated common stock is traded on The New York Stock Exchange under the symbol HR. As of March 8, 2000, there were approximately 1,820 shareholders of record. The following table shows, for the fiscal periods indicated, the quarterly range of high and low closing prices of the common stock.

	High	Low
1999		
First Quarter	\$ 22.813	\$ 18.125
Second Quarter	22.125	18.438
Third Quarter	21.875	18.750
Fourth Quarter	19.688	14.688
1998		
First Quarter	\$ 29.938	\$ 27.375
Second Quarter	28.625	26.938
Third Quarter	28.563	21.688
Fourth Quarter	25.313	21.250
1997		
First Quarter	29.125	26.000
Second Quarter	27.875	25.500
Third Quarter	29.000	27.375
Fourth Quarter	29.875	27.813
1996		
First Quarter	23.125	20.875
Second Quarter	23.750	21.500
Third Quarter	24.125	21.500
Fourth Quarter	26.875	23.000

ANNUAL SHAREHOLDERS MEETING

The annual meeting of shareholders will be held on May 16, 2000, at 10:00 a.m. at 3310 West End Avenue, 7th Floor, Nashville, Tennessee.