

UNIVERSAL HEALTH REALTY INCOME TRUST
Form 10-K
March 14, 2007
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2006

OR

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

For the transition period from to .

Commission File No. 1-9321

UNIVERSAL HEALTH REALTY INCOME TRUST

(Exact name of registrant as specified in its charter)

Maryland
(State or other jurisdiction of
incorporation or organization)
Universal Corporate Center

367 South Gulph Road

P.O. Box 61558

King of Prussia, Pennsylvania

(Address of principal executive offices)

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

23-6858580
(I.R.S. Employer

Identification Number)

19406-0958

(Zip Code)

Securities registered pursuant to Section 12(b) of the Act:

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Title of each Class	Name of each exchange on which registered
Shares of beneficial interest, \$.01 par value	New York Stock Exchange
<u>Securities registered pursuant to Section 12(g) of the Act: None</u>	

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.

Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act (check one): **Large accelerated filer** **Accelerated filer** **Non-accelerated filer**

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

Aggregate market value of voting shares and non-voting shares held by non-affiliates as of June 30, 2006: \$367,363,752. Number of shares of beneficial interest outstanding of registrant as of January 31, 2007: 11,792,049

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement for our 2007 Annual Meeting of Shareholders, which will be filed with the Securities and Exchange Commission within 120 days after December 31, 2006 (incorporated by reference under Part III).

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UNIVERSAL HEALTH REALTY INCOME TRUST

2006 FORM 10-K ANNUAL REPORT

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This Annual Report on Form 10-K is for the year ended December 31, 2006. This Annual Report modifies and supersedes documents filed prior to this Annual Report. Information that we file with the SEC in the future will automatically update and supersede information contained in this Annual Report. In this Annual Report, we, us, our and the Trust refer to Universal Health Realty Income Trust. In this Annual Report on Form 10-K, the term revenues does not include the revenues of the unconsolidated limited liability companies in which we have various non-controlling equity interests ranging from 33% to 99%. We currently account for our share of the income/loss from these investments by the equity method (see Note 9).

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We are a real estate investment trust (REIT) which commenced operations in 1986. We invest in health care and human service related facilities including acute care hospitals, behavioral healthcare facilities, rehabilitation hospitals, sub-acute facilities, surgery centers, childcare centers and medical office buildings (MOB s). As of December 31, 2006 we have forty-five real estate investments or commitments located in fifteen states in the United States consisting of: (i) six hospital facilities including three acute care, one behavioral healthcare, one rehabilitation and one sub-acute; (ii) thirty-five medical office buildings (including five being constructed), and; (iii) four preschool and childcare centers.

Available Information

We have our principal executive offices at Universal Corporate Center, 367 South Gulph Road, King of Prussia, PA 19406. Our telephone number is (610) 265-0688. Our website is located at <http://www.uhrit.com>. Copies of the annual, quarterly and current reports we file with the SEC, and any amendments to those reports, are available free of charge on our website. Additionally, we have adopted governance guidelines, a Code of Business Conduct and Ethics applicable to all of our officers and directors, a Code of Ethics for Senior Officers and charters for each of the Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee of the Board of Trustees. These documents are also available free of charge on our website. Copies of such reports and charters are available in print to any shareholder who makes a request. Such requests should be made to our Secretary at our King of Prussia, PA corporate headquarters. We intend to satisfy the disclosure requirement under Item 10 of Form 8-K relating to amendments to or waivers of any provision of our Code of Ethics for Senior Officers by promptly posting this information on our website. The information posted on our website is not incorporated into this Annual Report.

In accordance with Section 303A.12(a) of The New York Stock Exchange Listed Company Manual, we submitted our CEO s Certification to the New York Stock Exchange in 2006. Additionally, contained in Exhibits 31.1 and 31.2 of this Annual Report are our CEO s and CFO s certifications regarding the quality of our public disclosure under Section 302 of the Sarbanes-Oxley Act of 2002.

Overview of Facilities

As of December 31, 2006, we have investments or commitments in forty-five facilities, including five new MOBs being constructed, located in fifteen states and consisting of the following:

Facility Name	Location	Type of Facility	Ownership	Guarantor
Southwest Healthcare System, Inland Valley Campus (A)	Wildomar, CA	Acute Care	100%	Universal Health Services, Inc.
McAllen Medical Center (A)	McAllen, TX	Acute Care	100%	Universal Health Services, Inc.

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The Bridgeway (A)	N.Little Rock, AR	Behavioral Health	100%	Universal Health Services, Inc.
Wellington Regional Medical Center (A)	W. Palm Beach, FL	Acute Care	100%	Universal Health Services, Inc.
Kindred Hospital Chicago Central (B)	Chicago, IL	Sub-Acute Care	100%	Kindred Healthcare, Inc.
Tri-State Regional Rehabilitation Hospital (E)	Evansville, IN	Rehabilitation	100%	HealthSouth Corporation
Fresno-Herndon Medical Plaza (B)	Fresno, CA	MOB	100%	
Family Doctor s Medical Office Bldg. (B)	Shreveport, LA	MOB	100%	HCA Inc.
Kelsey-Seybold Clinic at Kings Crossing (B)	Kingwood, TX	MOB	100%	St. Lukes Episcopal Health Sys.
Professional Bldgs. at Kings Crossing (B)	Kingwood, TX	MOB	100%	
Chesterbrook Academy (B)	Audubon, PA	Preschool & Childcare	100%	Nobel Learning Comm. & Subs.
Chesterbrook Academy (B)	New Britain, PA	Preschool & Childcare	100%	Nobel Learning Comm. & Subs.
Chesterbrook Academy (B)	Newtown, PA	Preschool & Childcare	100%	Nobel Learning Comm. & Subs.
Chesterbrook Academy (B)	Uwchlan, PA	Preschool & Childcare	100%	Nobel Learning Comm. & Subs.
Southern Crescent Center I (B)	Riverdale, GA	MOB	100%	
Southern Crescent Center, II (B)	Riverdale, GA	MOB	100%	
Desert Samaritan Hospital MOBs (C)	Mesa, AZ	MOB	76%	
Suburban Medical Plaza II (C)	Louisville, KY	MOB	33%	
Desert Valley Medical Center (C,K)	Phoenix, AZ	MOB	90%	
Thunderbird Paseo Medical Plaza I & II (C)	Glendale, AZ	MOB	75%	
Cypresswood Professional Center (B)	Spring, TX	MOB	100%	

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Facility Name	Location	Type of Facility	Ownership	Guarantor
Papago Medical Park (C)	Phoenix, AZ	MOB	89%	
Edwards Medical Plaza (C,K)	Phoenix, AZ	MOB	90%	
Desert Springs Medical Plaza (D)	Las Vegas, NV	MOB	99%	Triad Hospitals, Inc.
Rio Rancho Medical Center (P)	Rio Rancho, NM	MOB	80%	
Orthopaedic Specialists of Nevada Bldg. (B)	Las Vegas, NV	MOB	100%	
Santa Fe Professional Plaza (C,K)	Scottsdale, AZ	MOB	90%	
Sheffield Medical Building (B)	Atlanta, GA	MOB	100%	
Centinela Medical Building Complex (C,K)	Inglewood, CA	MOB	90%	
Summerlin Hospital MOB (L,D)	Las Vegas, NV	MOB	95%	
Summerlin Hospital MOB II (G)	Las Vegas, NV	MOB	98%	
Medical Center of Western Connecticut (B)	Danbury, CT	MOB	100%	
Mid Coast Hospital MOB (C)	Brunswick, ME	MOB	74%	
Deer Valley Medical Office II (C)	Phoenix, AZ	MOB	90%	
Rosenberg Children's Medical Plaza (C)	Phoenix, AZ	MOB	85%	
700 Shadow Lane & Goldring MOB's (D)	Las Vegas, NV	MOB	98%	
St. Mary's Professional Office Building (F)	Reno, NV	MOB	75%	
Apache Junction Medical Plaza (C)	Apache Junction, AZ	MOB	85%	
Spring Valley Medical Office Building (D)	Las Vegas, NV	MOB	95%	
Spring Valley Hospital Medical Office Building II (I)	Las Vegas, NV	MOB	95%	
Sierra San Antonio Medical Plaza (H)	Fontana, CA	MOB	95%	
Phoenix Children's East Valley Care Center (J)	Phoenix, AZ	MOB	95%	
Centennial Hills Medical Office Building I (M)	Las Vegas, NV	MOB	95%	
Canyon Springs Medical Plaza (N)	Gilbert, AZ	MOB	95%	
Palmdale Medical Plaza (O)	Palmdale, CA	MOB	95%	

- (A) Real estate assets owned by us and leased to subsidiaries of Universal Health Services, Inc. (UHS).
- (B) Real estate assets owned by us and leased to an unaffiliated third-party or parties.
- (C) Real estate assets owned by a LLC in which we have a non-controlling interest as indicated above.
- (D) Real estate assets owned by a LLC in which we have a non-controlling interest as indicated above and include tenants who are unaffiliated third-parties or subsidiaries of UHS.
- (E) The lessee on the Tri-State Rehabilitation Hospital (Tri-State) is HealthSouth/Deaconess L.L.C., a joint venture between HealthSouth Properties Corporation and Deaconess Hospital, Inc. The lease with Tri-State is scheduled to expire in June of 2009.
- (F) We have committed to invest up to \$8.0 million in equity, of which \$5.2 million has been funded, in exchange for a 75% non-controlling interest in a LLC that constructed and owns the St. Mary's Professional Office Building located in Reno, Nevada. As of December 31, 2006, the LLC has an outstanding mortgage balance of \$28.4 million from a third party, which is non-recourse to us. This medical office building opened in March of 2005.
- (G) Tenants of this medical office building include subsidiaries of UHS. Pursuant to FIN 46R, as a result of our related party relationship with UHS and a master lease agreement between UHS and this property in which we own a 98% non-controlling ownership interest, this LLC is considered to be a variable interest entity. Consequently, we began to consolidate the results of operations of this LLC in our consolidated financial statements.
- (H) We have committed to invest up to a total of \$3.5 million in exchange for a 95% non-controlling interest in a LLC that will develop, construct, own and operate the Sierra San Antonio Medical Plaza located in Fontana, California. As of December 31, 2006, we have invested \$2.6 million in equity and \$485,000 in debt financing in connection with this project. The LLC has a \$7.5 million total construction loan commitment from a third-party, which is non-recourse to us. This medical office building opened during the first quarter of 2006.
- (I) We have committed to invest a total of up to \$12.3 million (\$3.4 million in equity, of which \$79,000 has been funded as of December 31, 2006 and \$8.9 million in debt financing, of which \$5.3 million has been funded as of December 31, 2006) in exchange for a 95% non-controlling interest in a LLC that will develop, construct, own and operate the Spring Valley Hospital Medical Office Building II, located in Las Vegas, Nevada on the campus of a UHS facility. This project, tenants of which may include subsidiaries of UHS, is scheduled to be completed and opened during the second quarter of 2007.
- (J) We have committed to invest up to \$3.5 million in equity, \$1.5 million of which has been funded as of December 31, 2006 as well as \$363,000 in debt financing, in exchange for a 95% non-controlling ownership interest in a LLC that will develop, construct, own and operate the Phoenix Children's East Valley Care Center located in Gilbert, Arizona. This project is scheduled to be completed and opened during the fourth quarter of 2007.
- (K) The membership interests of this entity are held by a master LLC in which we hold a 90% non-controlling ownership interest.
- (L) The membership interests of this entity are held by a master LLC in which we hold a 95% non-controlling ownership interest.
- (M) We have committed to invest up to \$6.6 million (\$250,000 in equity of which \$53,000 has been funded as of December 31, 2006, and \$6.3 million in equity or debt financing, none of which has been funded as of December 31, 2006) in exchange for a 95% non-controlling interest in a LLC that will develop, construct, own and operate the Centennial Hills Medical Office Building I, located in Las Vegas, Nevada. The LLC has a \$15.7 million construction loan commitment from a third-party, which is non-recourse to us. This project, tenants of which may include subsidiaries of UHS, is scheduled to be completed and opened during the third quarter of 2007.
- (N) We have committed to invest up to \$6.0 million (\$5.5 million in equity of which \$67,000 has been funded as of December 31, 2006, and \$500,000 in either equity and/or debt financing, none of which has been funded as of December 31, 2006) in exchange for a 95% non-controlling interest in a LLC that will develop, construct, own and operate the Canyon Springs Medical Plaza in Gilbert, Arizona. The LLC has a \$14.2 million construction loan commitment from a third party, which is non-recourse to us. This project is scheduled to be completed and opened during the third quarter of 2007.

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- (O) We have committed to invest up to \$4.3 million in equity, of which \$86,000 has been funded as of December 31, 2006, in exchange for a 95% non-controlling interest in a LLC that will develop, construct, own and operate the Palmdale Medical Plaza in Palmdale, California. The LLC has a \$9.9 million construction loan commitment from a third-party, which is non-recourse to us. This project, tenants of which may include subsidiaries of UHS, is scheduled to be completed and opened during the fourth quarter of 2007.
- (P) Subsequent to December 31, 2006, the real estate assets owned by this LLC were sold.

See our consolidated financial statements and accompanying Notes included in this Annual Report for our total assets, revenues, income and operating information.

Included in our portfolio are six hospital facilities with an aggregate investment of \$131.4 million. The leases with respect to the hospital facilities comprised approximately 56%, 55% and 58% of our revenues in 2006, 2005 and 2004, respectively, and as of December 31, 2006, these leases have fixed terms with an average of 5.75 years remaining and include renewal options ranging from two to four, five-year terms.

We believe a facility's earnings before interest, taxes, depreciation, amortization and lease rental expense (EBITDAR) and a facility's EBITDAR divided by the sum of minimum rent plus additional rent payable to us (Coverage Ratio), which are non-GAAP financial measures, are helpful to us and our investors as a measure of the operating performance of a hospital facility. EBITDAR, which is used as an indicator of a facility's estimated cash flow generated from operations (before rent expense, capital additions and debt service), is used by us in evaluating a facility's financial viability and its ability to pay rent. For the current hospital facilities owned by us, the combined Coverage Ratio was approximately 5.5 (ranging from 3.8 to 8.3) during 2006, 7.2 (ranging from 5.0 to 13.6) during 2005 and 7.8 (ranging from 3.1 to 14.9) during 2004. The Coverage Ratio for individual facilities varies. See Relationship with Universal Health Services, Inc. below for Coverage Ratio information related to the four hospital facilities leased to subsidiaries of UHS.

Pursuant to the terms of our leases for our six hospital facilities, each lessee, including subsidiaries of UHS, is responsible for building operations, maintenance, renovations and property insurance. We, or the LLCs in which we have invested, are responsible for the building operations, maintenance and renovations of the preschool and childcare centers and the MOBs, however, a portion, or in some cases all, of the expenses associated with the MOBs are passed on directly to the tenants. Cash reserves have been established to fund required building maintenance and renovations at the multi-tenant MOBs. Lessees are required to maintain all risk, replacement cost and commercial property insurance policies on the leased properties and we, or the LLC in which we have invested, are also named insureds on these policies. In addition, we, UHS or the LLCs in which we have invested, maintain property insurance on all properties. For additional information on the terms of our leases, see Relationship with Universal Health Services, Inc.

Relationship with Universal Health Services, Inc.

Leases: We commenced operations in 1986 by purchasing certain subsidiaries from UHS and immediately leasing the properties back to the respective subsidiaries. Most of the leases were entered into at the time we commenced operations and provided for initial terms of 13 to 15 years with up to six additional 5-year renewal terms, with base rents set forth in the leases effective for all but the last two renewal terms. In 1998, the lease for McAllen Medical Center was amended to provide that the last two renewal terms would also be fixed at the initial agreed upon base rental. This lease amendment was in connection with certain concessions granted by UHS with respect to the renewal of other leases. The base rents are paid monthly and each lease also provides for additional or bonus rents which are computed and paid on a quarterly basis based upon a computation that compares current quarter revenue to a corresponding quarter in the base year. The leases with subsidiaries of UHS are unconditionally guaranteed by UHS and are cross-defaulted with one another.

Pursuant to the Master Lease Document by and among us and certain subsidiaries of UHS, dated December 24, 1986 (the Master Lease), which governs all leases of properties with subsidiaries of UHS, UHS has the option to renew the leases at the lease terms described below by

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providing notice to us at least 90 days prior to the termination of the then current term. In addition, UHS has rights of first refusal to: (i) purchase the respective leased facilities during and for 180 days after the lease terms at the same price, terms and conditions of any third-party offer, or; (ii) renew the lease on the respective leased facility at the end of, and for 180 days after,

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the lease term at the same terms and conditions pursuant to any third-party offer. UHS also has the right to purchase the respective leased facilities at the end of the lease terms or any renewal terms at the appraised fair market value. In addition, as part of the overall exchange and substitution proposal relating to Chalmette Medical Center (Chalmette), as discussed below, as well as the early five year lease renewals on Southwest Healthcare System-Inland Valley Campus (Inland Valley), Wellington Regional Medical Center (Wellington), McAllen Medical Center (McAllen) and The Bridgeway (Bridgeway), we agreed to amend the Master Lease to include a change of control provision. The change of control provision grants UHS the right, upon one month's notice should a change of control of the Trust occur, to purchase any or all of the four leased hospital properties at their appraised fair market value purchase price.

During the third quarter of 2005, Chalmette, a 138-bed acute care hospital located in Chalmette, Louisiana, was severely damaged and closed as a result of Hurricane Katrina. At that time, the majority of the real estate assets of Chalmette were leased from us by a subsidiary of UHS and, in accordance with the terms of the lease, and as part of an overall evaluation of the leases between subsidiaries of UHS and us, UHS offered substitution properties rather than exercise its right to rebuild the facility or offer cash for Chalmette. Independent appraisals were obtained by us and UHS which indicated that the pre-hurricane fair market value of the leased facility was \$24.0 million.

During the third quarter of 2006, we completed the previously disclosed asset exchange and substitution pursuant to the Asset Exchange and Substitution Agreement with UHS that we entered into on April 24, 2006 whereby we agreed to terminate the lease between us and Chalmette and to transfer the real property assets and all rights attendant thereto (including insurance proceeds) of Chalmette to UHS in exchange and substitution for newly constructed real property assets owned by UHS (Capital Additions) at Wellington, Bridgeway and Inland Valley, in satisfaction of the obligations under the Chalmette lease. The Capital Additions consist of properties which were recently constructed on, or adjacent to, facilities already owned by us as well as a Capital Addition at Inland Valley which is currently under construction and expected to be completed during 2007. UHS is obligated to complete the Inland Valley Capital Addition or, subject to our approval, offer to either provide alternative substitution property or pay to us an amount in cash equal to the substitution value of the Capital Addition. Pursuant to section 1033(a)(1) of the Internal Revenue Code of 1986, as amended (the IRC), we will recognize no gain for federal income tax purposes based upon the transaction as agreed upon in the Asset Exchange and Substitution Agreement.

The properties included in the Asset Exchange and Substitution Agreement consists of (amounts in thousands):

Wellington Bed Tower	\$ 8,926	Fair value
Bridgeway 28 bed addition	4,072	Fair value
Inland Valley 44 bed and ICU expansion currently under construction	10,967	Estimated minimum fair value
Total fair value of exchanged and substituted assets	\$ 23,965	

In the event the ultimate construction costs related to the Inland Valley Capital Addition exceed \$11.0 million, the excess will be paid in cash by us to UHS and UHS will pay incremental rent on the excess at a rate equal to the prevailing five-year treasury rate plus 200 basis points at the time of funding (minimum rate 6.75%).

During 2005, 2004 and 2003, the total rent earned by us under the Chalmette lease was approximately \$1.6 million to \$1.7 million annually (including \$960,000 of base rental and approximately \$700,000 of bonus rental). The total rent payable to us on the Capital Additions included in the substitution package (excluding the rent on the Inland Valley Capital Addition in excess of \$11.0 million, if any) is expected to closely approximate the total rent earned by us under the Chalmette lease. Below is the estimated rent allocation of the substitution properties.

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<u>Facility</u>	<u>Base Rent</u>	<u>Bonus Rent</u>	<u>Total Rent</u>
Wellington	\$ 534,504	\$ 67,744	\$ 602,248
Bridgeway	247,800	26,940	274,740
Inland Valley	740,012		740,012
	<u> </u>	<u> </u>	<u> </u>
Total:	\$ 1,522,316	\$ 94,684	\$ 1,617,000
	<u> </u>	<u> </u>	<u> </u>

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The amounts shown in the bonus rent column represent the estimated bonus rent effect of including the revenues generated from the Capital Additions at Wellington and Bridgeway that have not been previously included in the bonus rent paid to us pursuant to the terms of the leases since the Capital Additions were financed and owned by UHS. The bonus rent amounts reflected above were based on the net revenues generated at each facility during 2005. Future bonus rents earned by us on the Capital Additions will be based on the actual net revenues of each facility.

Also during the second quarter of 2006, as part of the overall arrangement with UHS, UHS agreed to early renewals of the leases between us and each of Inland Valley, Wellington and McAllen which were scheduled to mature on December 31, 2006, and Bridgeway, which was scheduled to mature on December 31, 2009. These leases were renewed on the same economic terms as the current leases.

Included in our consolidated statement of income during 2005 was a property write-down charge of \$6.3 million representing the book value of the Chalmette property damaged by the hurricane. Included in our 2005 net income was an equal amount representing the property damage recoverable from UHS. Prior to the completion of the Asset Exchange and Substitution Agreement, Chalmette had a combined asset value of \$8.3 million on our consolidated balance sheet consisting of \$2.0 million of land held for exchange and \$6.3 million of property damage receivable from UHS. Included in our net income during 2006 was a gain of \$14.0 million representing the total property transferred to us from UHS as of December 31, 2006 (\$22.2 million) in excess of the \$8.3 million book value of Chalmette. Upon the completion of the asset exchange and substitution during the third quarter of 2006, we received the above mentioned Capital Additions from Wellington and Bridgeway which had a combined fair value of \$13.0 million. In addition, the construction costs related to the completed Capital Addition at Inland Valley amounted to \$9.2 million as of December 31, 2006 (\$11.0 million is total minimum estimated cost of Inland Valley's Capital Addition). Our future net income will include an additional \$1.8 million of property recovered from UHS as the additional construction costs are incurred by UHS related to the Inland Valley Capital Addition, up to the \$11.0 million of estimated total cost of construction. See Item 7-*Management's Discussion and Analysis of Financial Condition and Results of Operations* for additional disclosure.

After giving effect to the exchange and substitution, and the various lease renewals discussed above, subsidiaries of UHS lease four hospital facilities owned by us with terms expiring in 2011 through 2014. The table below details the renewal options and terms for each of the four UHS hospital facilities:

<u>Hospital Name</u>	<u>Type of Facility</u>	<u>Annual</u>	<u>End of</u>	<u>Renewal</u>
		<u>Minimum</u>	<u>Lease Term</u>	<u>Term</u>
		<u>Rent</u>		<u>(years)</u>
McAllen Medical Center	Acute Care	\$ 5,485,000	December, 2011	20(a)
Wellington Regional Medical Center	Acute Care	\$ 3,030,000	December, 2011	20(b)
Southwest Healthcare System, Inland Valley Campus	Acute Care	\$ 2,597,000(d)	December, 2011	20(b)
The Bridgeway	Behavioral Health	\$ 930,000	December, 2014	10(c)

- (a) UHS has four 5-year renewal options at existing lease rates (through 2031).
 (b) UHS has two 5-year renewal options at existing lease rates (through 2021) and two 5-year renewal options at fair market value lease rates (2022 through 2031).
 (c) UHS has two 5-year renewal options at fair market value lease rates (2015 through 2024).
 (d) Excludes potential incremental rent, if any, on Capital Addition in excess of \$11.0 million.

We cannot predict whether the leases with subsidiaries of UHS, which have renewal options at existing lease rates, or any of our other leases, will be renewed at the end of their lease terms. If the leases are not renewed at their current rates, we would be required to find other operators for those facilities and/or enter into leases on terms potentially less favorable to us than the current leases.

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The combined revenues generated from the leases on the UHS hospital facilities accounted for approximately 53% of our total revenue for the five years ended December 31, 2006 (approximately 49% for the

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year ended December 31, 2006). Including 100% of the revenues generated at the unconsolidated LLCs in which we have various non-controlling equity interests ranging from 33% to 99%, the leases on the UHS hospital facilities accounted for approximately 26% of the combined consolidated and unconsolidated revenue for the five years ended December 31, 2006 (approximately 24% for the year ended December 31, 2006). In addition, five MOBs (plus three additional MOBs currently under construction) owned by LLCs in which we hold various non-controlling equity interests, include tenants which are subsidiaries of UHS. For the four hospital facilities currently owned by us and leased to subsidiaries of UHS, the combined Coverage Ratio was approximately 5.7, 7.4 and 8.1 for the years ended December 31, 2006, 2005 and 2004, respectively. The Coverage Ratio for individual facilities vary and range from 3.8 to 8.3 in 2006, 5.0 to 13.6 in 2005 and 4.0 to 14.9 in 2004.

During 2006, we committed to invest up to \$6.6 million (\$250,000 in equity, \$53,000 of which has been funded as of December 31, 2006 and \$6.3 million in debt financing or equity, none of which has been funded as of December 31, 2006) in exchange for a 95% non-controlling equity interest in a limited liability company that will develop, construct, own and operate the Centennial Hills Medical Office Building I, located in Las Vegas, Nevada, on the campus of a UHS hospital. This MOB will be 60% master leased by Valley Health System (VHS), a majority-owned subsidiary of UHS, on a triple net basis. The master lease for each suite will be cancelled at such time that the suite is leased to another tenant acceptable to the LLC and VHS for a minimum term of five years. The LLC has a \$15.7 million construction loan commitment from a third-party, which is non-recourse to us. This building, tenants of which may include subsidiaries of UHS, is scheduled to be completed and opened during the third quarter of 2007.

Additionally, during 2006, we committed to invest up to \$4.3 million in equity, of which \$86,000 has been funded as of December 31, 2006, in exchange for a 95% non-controlling equity interest in a limited liability company that will develop, construct, own and operate the Palmdale Medical Plaza, located in Palmdale, California, on the campus of a UHS hospital currently under construction. This MOB will be 75% master leased by UHS of Palmdale, Inc., a subsidiary of UHS, on a triple net basis. The master lease for each suite will be cancelled at such time that the suite is leased to another tenant acceptable to the LLC and UHS of Palmdale for a minimum term of five years. This building, tenants of which may include subsidiaries of UHS, is scheduled to be completed and opened during the fourth quarter of 2007.

During 2005, we committed to invest up to \$12.3 million (\$3.4 million in equity and \$8.9 million in debt financing, \$5.4 million of which has been funded as of December 31, 2006) in exchange for a 95% non-controlling interest in a limited liability company that will develop, construct, own and operate the Spring Valley Medical Office Building II, a second MOB on the campus of Spring Valley Hospital in Las Vegas, Nevada. This MOB will be 50% master leased by VHS on a triple net basis. The master lease for each suite will be cancelled at such time that the suite is leased to another tenant acceptable to the LLC and VHS for a minimum term of five years. This MOB is scheduled to be completed and opened during the second quarter of 2007.

Upon the December, 2004 lease expiration on the Virtue Street Pavilion, the former lessee (a wholly-owned subsidiary of UHS), exercised its option pursuant to the terms of the lease and purchased the facility at its appraised fair market value of \$7,320,000. The sale resulted in a gain of \$833,000 which is reflected as Income from discontinued operations, net in the consolidated statements of income for the year ended December 31, 2004. Prior to the transaction, the annual minimum rent payable to us under the lease was \$1,261,000 and no bonus rent was earned on this facility during 2004. As a result of this transaction, our cash flows from operating activities were adversely affected during 2006 and 2005 since calculated using our average incremental borrowing rates during each year, the reduction to annual interest expense resulting from repayment of borrowings using the \$7.3 million of sale proceeds was approximately \$700,000 less during 2006, and \$900,000 less during 2005, than the annual rental payments earned by us pursuant to the terms of the lease.

During the third quarter of 2004, Wellington, our 121-bed acute care facility located in West Palm Beach, Florida, sustained storm damage caused by a hurricane. This facility is leased by a wholly-owned subsidiary of UHS and pursuant to the terms of the lease, UHS is responsible for maintaining replacement cost property

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insurance for the facility, a substantial portion of which is insured by a commercial carrier. The facility did not experience significant business interruption. Our consolidated statements of income for the year ended December 31, 2004, included a property write-down charge of \$1.9 million representing the estimated net book value of the damaged assets. This property charge was offset at that time by an equal amount recoverable from UHS. During 2004, UHS incurred approximately \$1.9 million in replacement costs in connection with this property and that amount was included as construction in progress on our consolidated balance sheet as of December 31, 2004. During the twelve months ended December 31, 2005, UHS incurred an additional \$4.7 million in replacement costs and since these additional costs have also been recovered from UHS, \$4.7 million has been included in net income during the year ended December 31, 2005. The repairs to the facility were completed as of December 31, 2005. UHS spent a total of approximately \$6.6 million to replace the damaged property at this facility and this amount is reflected as buildings and improvements on our consolidated balance sheet.

UHS Legal Proceedings: We have been advised by UHS that UHS, together with its South Texas Health System affiliates, which operate McAllen Medical Center, were served with a subpoena dated November 21, 2005, issued by the Office of Inspector General of the Department of Health and Human Services. At that time, the Civil Division of the U.S. Attorney's office in Houston, Texas indicated that the subpoena was part of an investigation under the False Claims Act of compliance with Medicare and Medicaid rules and regulations pertaining to the employment of physicians and the solicitation of patient referrals from physicians from January 1, 1999 to the date of the subpoena related to the South Texas Health System. UHS has informed us that it is cooperating in the investigation. On February 16, 2007, UHS's South Texas Health System affiliates were served with a search warrant in connection with what UHS has been advised is a related criminal investigation concerning the production of documents. UHS has advised us that, at this time, it is unable to evaluate the existence or extent of any potential financial exposure in connection with this matter.

UHS has advised us that it monitors all aspects of its business and that it has developed a comprehensive ethics and compliance program that is designed to meet or exceed applicable federal guidelines and industry standards. Because the law in this area is complex and constantly evolving, governmental investigation or litigation may result in interpretations that are inconsistent with industry practices, including UHS's. Although UHS believes their policies, procedures and practices comply with governmental regulations, no assurance can be given that UHS will not be subjected to further inquiries or actions, or that UHS will not be faced with sanctions, fines or penalties in connection with the investigation of our South Texas Health System affiliates. Even if UHS were to ultimately prevail, the government's inquiry and/or action in connection with this matter could have a material adverse effect on UHS's future operating results and on the future operating results of McAllen Medical Center. While the base rentals are guaranteed by UHS through the end of the lease term, should this matter adversely impact on the future revenues and/or operating results of McAllen Medical Center, the future bonus rental earned by us on this facility may be materially, adversely impacted. Bonus rental revenue earned by us from McAllen Medical Center amounted to \$1.9 million during each of 2006 and 2005 and \$2.2 million during 2004. We can provide no assurance that this matter will not have a material adverse impact on underlying value of McAllen Medical Center or on the future base rental earned on this facility after the December, 2011 scheduled expiration of the existing lease term.

Advisory Agreement: UHS of Delaware, Inc. (the *Advisor*), a wholly-owned subsidiary of UHS, serves as Advisor to us under an Advisory Agreement (the *Advisory Agreement*) dated December 24, 1986. Under the Advisory Agreement, the Advisor is obligated to present an investment program to us, to use its best efforts to obtain investments suitable for such program (although it is not obligated to present any particular investment opportunity to us), to provide administrative services to us and to conduct our day-to-day affairs. In performing its services under the Advisory Agreement, the Advisor may utilize independent professional services, including accounting, legal, tax and other services, for which the Advisor is reimbursed directly by us. The Advisory Agreement expires on December 31 of each year; however, it is renewable by us, subject to a determination by the Trustees who are unaffiliated with UHS (the *Independent Trustees*), that the Advisor's performance has

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been satisfactory. The Advisory Agreement may be terminated for any reason upon sixty days written notice by us or the Advisor. The Advisory Agreement has been renewed for 2007. All transactions between us and UHS must be approved by the Independent Trustees.

The Advisory Agreement provides that the Advisor is entitled to receive an annual advisory fee equal to 0.60% of our average invested real estate assets, as derived from our consolidated balance sheet. The advisory fee is payable quarterly, subject to adjustment at year-end based upon our audited financial statements. In addition, the Advisor is entitled to an annual incentive fee equal to 20% of the amount by which cash available for distribution to shareholders for each year, as defined in the Advisory Agreement, exceeds 15% of our equity as shown on our consolidated balance sheet, determined in accordance with generally accepted accounting principles without reduction for return of capital dividends. The Advisory Agreement defines cash available for distribution to shareholders as net cash flow from operations less deductions for, among other things, amounts required to discharge our debt and liabilities and reserves for replacement and capital improvements to our properties and investments. No incentive fees were paid during 2006, 2005 or 2004.

Officers and Employees: Our officers are all employees of UHS and although as of December 31, 2006 we had no salaried employees, our officers do receive stock-based compensation from time-to-time.

Share Purchase Option: As of December 31, 2006, UHS owned 6.7% of our outstanding shares of beneficial interest.

SEC reporting requirements of UHS: UHS is subject to the reporting requirements of the SEC and is required to file annual reports containing audited financial information and quarterly reports containing unaudited financial information. Since the leases on the hospital facilities leased to wholly-owned subsidiaries of UHS comprised approximately 49% of our consolidated revenues for the year ended December 31, 2006, and since UHS is our Advisor, you are encouraged to obtain the publicly available filings for Universal Health Services, Inc. from the SEC's website at www.sec.gov.

Taxation

We believe we have operated in such a manner as to qualify for taxation as a REIT under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended, and we intend to continue to operate in such a manner. If we qualify for taxation as a REIT, we will generally not be subject to federal corporate income taxes on our net income that is currently distributed to shareholders. This treatment substantially eliminates the double taxation, e.g. at the corporate and shareholder levels, that usually results from investment in the stock of a corporation. Please see the heading *If we fail to maintain our REIT status, we will become subject to federal income tax on our taxable income at regular corporate rates* under Risk Factors for more information.

Competition

We compete for the acquisition, leasing and financing of health care related facilities. Our competitors include, but are not limited to, other REITs, banks and other companies, including UHS. Some of these competitors are larger and have a lower cost of capital than we do. Additionally, the potential for consolidation at the REIT or operator level appears to have increased. These developments could result in fewer investment opportunities for us and lower spreads over our cost of our capital, which would hurt our growth.

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In most geographical areas in which our facilities operate, there are other facilities that provide services comparable to those offered by our facilities. In addition, some competing facilities are owned by tax-supported governmental agencies or by nonprofit corporations and may be supported by endowments and charitable

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contributions and exempt from property, sale and income taxes. Such exemptions and support are not available to our facilities. In some markets, certain competing facilities may have greater financial resources, be better equipped and offer a broader range of services than those available at our facilities. Certain hospitals that are located in the areas served by our facilities are specialty hospitals that provide medical, surgical and behavioral health services, facilities and equipment that are not available at our hospitals. The increase in outpatient treatment and diagnostic facilities, outpatient surgical centers and freestanding ambulatory surgical centers also increases competition for us.

In McAllen, Texas, the location of our largest facility, McAllen Medical Center (which is operated by a subsidiary of UHS), intense competition has continued from other healthcare providers, including physician owned facilities. As a result, the facility has experienced significant declines in patient volume and profitability. In response to these competitive pressures, UHS has, among other things, undertaken significant capital investment in the market including a new dedicated 120-bed children's facility, which was completed and opened during the first quarter of 2006, as well as a 134-bed replacement behavioral health facility, which was completed and opened during the second quarter of 2006. We do not have an ownership interest in the real estate assets of either of these newly constructed UHS facilities. A continuation of the increased provider competition in this market, as well as the additional capacity currently under construction, or recently completed by UHS and others, could result in additional erosion of the net revenues and financial operating results of McAllen Medical Center which may negatively impact the bonus rentals earned by us on this facility and may potentially have a negative impact on the future lease renewal terms (current lease expires in December, 2011) and the underlying value of the property.

In addition, the number and quality of the physicians on a hospital's staff are important factors in determining a hospital's competitive advantage. Typically, physicians are responsible for making hospital admissions decisions and for directing the course of patient treatment. The operators of our facilities also compete with other health care providers in recruiting and retaining qualified hospital management, nurses and other medical personnel. The operators of our acute care and behavioral health care facilities are experiencing the effects of a shortage of skilled nursing staff nationwide, which has caused and may continue to cause an increase in salaries, wages and benefits expense in excess of the inflation rate. Our operators may experience difficulties attracting and retaining qualified physicians, nurses and medical support personnel. We anticipate that our operators, including UHS, will continue to encounter increased competition in the future that could lead to a decline in patient volumes and harm their businesses, which in turn, could harm our business.

A large portion of our non-hospital properties consist of MOB's which are located either close to or on the campuses of hospital facilities. These properties are either directly or indirectly affected by the factors discussed above as well as general real estate factors such as the supply and demand of office space and market rental rates. To improve our competitive position, we anticipate that we will continue investing in additional healthcare related facilities and leasing the facilities to qualified operators, perhaps including UHS and subsidiaries of UHS.

Regulation and Other Factors

During 2006, 2005 and 2004, 47%, 46% and 48%, respectively, of our revenues were earned pursuant to leases with operators of acute care services hospitals, all of which are subsidiaries of UHS. A significant portion of the revenue earned by the operators of our acute care hospitals is derived from federal and state healthcare programs, including Medicare and Medicaid (excluding managed Medicare and Medicaid programs).

The health care industry is subject to numerous laws, regulations and rules including, among others, those related to government healthcare participation requirements, various licensure and accreditations, reimbursement for patient services, health information privacy and security rules, and Medicare and Medicaid fraud and abuse provisions (including, but not limited to, federal statutes and regulations prohibiting kickbacks and other illegal inducements to potential referral sources, false claims submitted to federal health care programs and self-referrals by physicians). Providers that are found to have violated any of these laws and regulations may be excluded from

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participating in government healthcare programs, subjected to significant fines or penalties and/or required to repay amounts received from government for previously billed patient services. This government regulation of the healthcare industry affects us because:

- (i) The financial ability of lessees to make rent payments to us may be affected by governmental regulations such as licensure, certification for participation in government programs, and government reimbursement, and;
- (ii) Our bonus rents are based on our lessees' net revenues which in turn are affected by the amount of reimbursement such lessees receive from the government.

Although UHS and the other operators of our acute care facilities believe that their policies, procedures and practices comply with governmental regulations, no assurance can be given that they will not be subjected to governmental inquiries or actions, or that they would not be faced with sanctions, fines or penalties if so subjected. Because many of these laws and regulations are relatively new, in many cases, our operators do not have the benefit of regulatory or judicial interpretation. In the future, it is possible that different interpretations or enforcement of these laws and regulations could subject their current or past practices to allegations of impropriety or illegality or could require them to make changes in the facilities, equipment, personnel, services, capital expenditure programs and operating expenses. Even if they were to ultimately prevail, a significant governmental inquiry or action under one of the above laws, regulations or rules could have a material adverse effect upon them, and in turn, us. See *Relationship with Universal Health Services, Inc.-UHS Legal Proceedings* for disclosure related to McAllen Medical Center.

A significant portion of the revenue earned by the operators of our acute care hospitals is derived from federal and state healthcare programs, including Medicare and Medicaid. Under the statutory framework of the Medicare and Medicaid programs, many of the general acute care operations are subject to administrative rulings, interpretations and discretion that may affect payments made under either or both of such programs as well as by other third party payors. The federal government makes payments to participating hospitals under its Medicare program based on various formulas. For inpatient services, the operators of our acute care hospitals are subject to a prospective payment system (PPS). Under inpatient PPS, hospitals are paid a predetermined fixed payment amount for each hospital discharge. The fixed payment amount is based upon each patient's diagnosis related group (DRG). Every DRG is assigned a payment rate based upon the estimated intensity of hospital resources necessary to treat the average patient with that particular diagnosis. These rates are based upon historical national average costs and do not consider the actual costs incurred by a hospital in providing care. The DRG rates are adjusted annually based on geographic region.

For outpatient services, both general acute and behavioral health hospitals are paid under an outpatient PPS according to ambulatory procedure codes (APC) that group together services that are clinically related and use similar resources. Medicare pays a set price or rate for each group, regardless of the actual costs incurred in providing care. Medicare sets the payment rate for each APC based on historical median cost data, subject to geographic modification.

DRG rates are adjusted by an update factor each federal fiscal year, which begins on October 1. The index used to adjust the DRG rates, known as the hospital market basket index, gives consideration to the inflation experienced by hospitals in purchasing goods and services. Generally, however, the percentage increases in the DRG payments have been lower than the projected increase in the cost of goods and services purchased by hospitals. For federal fiscal years 2006, 2005 and 2004, the update factors were 3.7%, 3.3% and 3.4%, respectively. For 2007, the update factor is 3.4%. Hospitals are allowed to receive the full basket update if they provide the Centers for Medicare and Medicaid Services (CMS) with specific data relating to the quality of services provided. The operators of our acute care hospital facilities have complied fully with this requirement and intend to comply fully in future periods. The APC payment rates are updated each federal fiscal year as well. For 2006, 2005 and 2004, the payment rate update factors were 3.7%, 3.3% and 3.4%, respectively. For 2007, the update factor is 3.4%.

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Medicaid is a joint federal-state funded health care benefit program that is administered by the states to provide benefits to qualifying individuals who are unable to afford care. Most state Medicaid payments are made under a PPS-like system, or under programs that negotiate payment levels with individual hospitals. Amounts received under the Medicaid program are generally significantly less than a hospital's customary charges for services provided. In addition to revenues received pursuant to the Medicare program, our operators receive a large portion of their revenues either directly from Medicaid programs or from managed care companies managing Medicaid.

In addition to Medicare and Medicaid, our operators, including UHS, receive payments from private payors, including managed care companies, commercial insurance providers and individuals. The ability of our operators to negotiate favorable service contracts with purchasers of group health care services significantly affects the revenues and operating results of our facilities. A primary collection risk for our operators relates to uninsured patients and the portion of the bill that is the patient's responsibility, which primarily includes co-payments and deductibles.

Given increasing budget deficits, the federal government and many states are currently considering additional ways to limit increases in levels of Medicare and Medicaid funding, which could also adversely affect future payments received by operators of our facilities. In addition to statutory and regulatory changes to the Medicare and each of the state Medicaid programs, our operators' operations and reimbursement may be affected by administrative rulings, new or novel interpretations and determinations of existing laws and regulations, post-payment audits, requirements for utilization review and new governmental funding restrictions, all of which may materially increase or decrease program payments as well as affect the cost of providing services and the timing of payments to our facilities.

In addition, we cannot predict whether other legislation or regulations at the federal or state level will be adopted, what form such legislation or regulations may take or what their impact may be. An increasing number of legislative initiatives have been introduced or proposed in recent years that would result in major changes in the health care delivery system on a national or a state level. Among the proposals that have been introduced are price controls on hospitals, insurance market reforms to increase the availability of group health insurance to small businesses, requirements that all businesses offer health insurance coverage to their employees and the creation of government health insurance plans that would cover all citizens and increase payments by beneficiaries. We cannot predict whether any proposals will be adopted or, if adopted, what effect, if any, these proposals would have on operators and, thus, our business.

Executive Officers of the Registrant

<u>Name</u>	<u>Age</u>	<u>Position</u>
Alan B. Miller	69	Chairman of the Board, Chief Executive Officer and President
Charles F. Boyle	47	Vice President and Chief Financial Officer
Cheryl K. Ramagano	44	Vice President, Treasurer and Secretary
Timothy J. Fowler	51	Vice President, Acquisition and Development

Mr. Alan B. Miller has been our Chairman of the Board and Chief Executive Officer since our inception in 1986 and was appointed President in February of 2003. He had previously served as our President until March, 1990. Mr. Miller has been Chairman of the Board, President and Chief Executive Officer of UHS since its inception in 1978. Mr. Miller also serves as a Director of Penn Mutual Life Insurance Company and Broadlane, Inc. (an e-commerce marketplace for healthcare supplies, equipment and services).

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Mr. Charles F. Boyle was appointed Chief Financial Officer in February of 2003 and has served as our Vice President and Controller since 1991. Mr. Boyle, who has held various positions at UHS since 1983, was promoted to Controller of UHS in November, 2003 and has served as its Assistant Vice President - Corporate Accounting since 1994.

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Ms. Cheryl K. Ramagano was appointed Secretary in February of 2003 and served as our Vice President and Treasurer since 1992. Ms. Ramagano, who has held various positions at UHS since 1983, was promoted to Treasurer of UHS in November, 2003 and has served as its Assistant Treasurer since 1994.

Mr. Timothy J. Fowler was elected as our Vice President of Acquisition and Development upon the commencement of his employment with UHS in 1993. Prior thereto, he served as a Vice President of The Chase Manhattan Bank, N.A. since 1986.

ITEM 1A. Risk Factors

We are subject to numerous known and unknown risks, many of which are described below and elsewhere in this Annual Report. Any of the events described below could have a material adverse effect on our business, financial condition and results of operations. Additional risks and uncertainties that we are not aware of, or that we currently deem to be immaterial, could also impact our business and results of operations.

A substantial portion of our revenues are dependent upon one operator. If UHS experiences financial difficulties, or otherwise fails to make payments to us, our revenues will significantly decline.

For the year ended December 31, 2006, UHS accounted for 49% of our revenues. In addition, as of December 31, 2006, subsidiaries of UHS leased four of the six hospital facilities owned by us with terms expiring in 2011 or 2014. We cannot assure you that UHS will continue to satisfy its obligations to us. The failure or inability of UHS to satisfy its obligations to us could materially reduce our revenues and net income, which could in turn reduce the amount of dividends we pay and cause our stock price to decline.

Our relationship with UHS may create conflicts of interest.

In addition to being dependent upon UHS for a substantial portion of our revenues and leases, since 1986, UHS of Delaware, Inc. (the Advisor), a wholly-owned subsidiary of UHS, has served as our Advisor. Pursuant to our Advisory Agreement, the Advisor is obligated to present an investment program to us, to use its best efforts to obtain investments suitable for such program (although it is not obligated to present any particular investment opportunity to us), to provide administrative services to us and to conduct our day-to-day affairs. Further, all of our officers are all employees of UHS. As of December 31, 2006, we had no employees. We believe that the quality and depth of the management and advisory services provided to us by our Advisor and UHS could not be replicated by contracting with unrelated third parties or by being self-advised without considerable cost increases. We believe that these relationships have been beneficial to us in the past, but we cannot guarantee that will not become detrimental to us in the future.

All transactions with UHS must be approved by a majority of our Independent Trustees. We believe that our current leases and business dealings with UHS have been entered into on commercially reasonable terms. However, because of our historical and continuing relationship with UHS and its subsidiaries, in the future, our business dealings may not be on the same or as favorable terms as we might achieve with a third party with whom we do not have such a relationship. Disputes may arise between us and UHS that we are unable to resolve or the resolution of these disputes may not be as favorable to us as a resolution we might achieve with a third party.

We hold significant, non-controlling equity ownership interests in various LLCs.

For the year ended December 31, 2006, 61% of our consolidated and unconsolidated revenues were generated by LLCs in which we hold a majority, non-controlling equity ownership interest. Our level of investment and lack of control exposes us to potential losses of our investments and revenues. Although our ownership arrangements have been beneficial to us in the past, we cannot guarantee that they will continue to be beneficial in the future.

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We cannot be certain of the availability and terms of external sources of capital to fund the growth of our business when needed.

To retain our status as a REIT, we are required to distribute 90% of our taxable income to shareholders and, therefore, we generally cannot use income from operations to fund our growth. Accordingly, our growth strategy depends, in part, upon our ability to raise additional capital at reasonable costs to fund new investments. We believe we will be able to raise additional debt and equity capital at reasonable costs to refinance our debts at or prior to their maturities and to invest at yields which exceed our cost of capital. We cannot predict, however, whether financing will be available to us on satisfactory terms when needed, which could harm our business. Our growth strategy is not assured and may fail.

In addition, the degree to which we are, or in the future may become, leveraged, our ability to obtain financing could be adversely impacted and could make us more vulnerable to competitive pressures. Our ability to meet existing and future debt obligations, depends upon our future performance and our ability to secure additional financing on satisfactory terms, each of which is subject to financial, business and other factors that are beyond our control. Any failure by us to meet our financial obligations would harm our business.

The bankruptcy, default, insolvency or financial deterioration of our tenants could significantly delay our ability to collect unpaid rents or require us to find new operators.

Our financial position and our ability to make distributions to our shareholders may be adversely affected by financial difficulties experienced by any of our major tenants, including bankruptcy, insolvency or a general downturn in the business. We are exposed to the risk that our operators may not be able to meet their obligations, which may result in their bankruptcy or insolvency. Although our leases and loans provide us the right to terminate an investment, evict an operator, demand immediate repayment and other remedies, the bankruptcy laws afford certain rights to a party that has filed for bankruptcy or reorganization. An operator in bankruptcy may be able to restrict our ability to collect unpaid rents or interest during the bankruptcy proceeding.

Real estate ownership creates risks and liabilities that may result in unanticipated losses or expenses.

Our business is subject to risks associated with real estate acquisitions and ownership, including:

general liability, property and casualty losses, some of which may be uninsured;

the illiquid nature of real estate and the real estate market that impairs our ability to purchase or sell our assets rapidly to respond to changing economic conditions;

real estate market factors, such as the supply and demand of office space and market rental rates, changes in interest rates as well as an increase in the development of medical office condominiums in certain markets;

costs that may be incurred relating to maintenance and repair, and the need to make expenditures due to changes in governmental regulations, including the Americans with Disabilities Act;

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environmental hazards at our properties for which we may be liable, including those created by prior owners or occupants, existing tenants, mortgagors or other persons, and;

defaults and bankruptcies by our tenants.

In addition to the foregoing risks, we cannot predict whether the leases on our properties, including the leases on the properties leased to subsidiaries of UHS, which have options to purchase the respective leased facilities at the end of the lease or renewal terms at the appraised fair market value, will be renewed at their current rates at the end of the lease terms in 2011 or 2014. If the leases are not renewed, we may be required to find other operators for these facilities and/or enter into leases with less favorable terms. The exercise of purchase options for our facilities may result in a less favorable rate of return for us than the rental revenue currently earned on such facilities. Further, the purchase options and rights of first refusal granted to the

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respective lessees to purchase or lease the respective leased facilities, after the expiration of the lease term, may adversely affect our ability to sell or lease a facility, and may present a potential conflict of interest between us and UHS since the price and terms offered by a third-party are likely to be dependent, in part, upon the financial performance of the facility during the final years of the lease term.

Significant potential liabilities and rising insurance costs and availability may have an adverse effect on the operations of our operators, which may negatively impact their ability to meet their obligations to us.

As is typical in the healthcare industry, in the ordinary course of business, our operators, including UHS, are subject to medical malpractice lawsuits, product liability lawsuits and other legal actions. Some of these actions may involve large claims, as well as significant defense costs. If their ultimate liability for professional and general liability claims could change materially from current estimates, if such policy limitations should be partially or fully exhausted in the future, or payments of claims exceed estimates or are not covered by insurance, it could have a material adverse effect on the operations of our operators.

In addition, the malpractice expenses of our operators, including UHS, have increased in recent years and they continue to experience unfavorable pricing and availability trends in the professional and general liability insurance markets. There can be no assurance that insurance will continue to be available at reasonable prices that allow them to maintain adequate coverage. If these trends continue, they could have a material adverse effect on their operations. Property insurance rates, particularly for earthquake insurance in California, have also continued to increase. Two LLCs that own properties in California, in which we have various non-controlling equity interests, could not obtain earthquake insurance at rates which are economically beneficial in relation to the risks covered.

Our tenants and operators, including UHS, may be unable to fulfill their insurance, indemnification and other obligations to us under their leases and mortgages and thereby potentially expose us to those risks. In addition, our tenants and operators may be unable to pay their lease or mortgage payments, which could potentially decrease our revenues and increase our collection and litigation costs. Moreover, to the extent we are required to foreclose on the affected facilities, our revenues from those facilities could be reduced or eliminated for an extended period of time. In addition, we may in some circumstances be named as a defendant in litigation involving the actions of our operators. Although we have no involvement in the activities of our operators and our standard leases generally require our operators to carry insurance to cover us in certain cases, a significant judgment against us in such litigation could exceed our and our operators' insurance coverage, which would require us to make payments to cover the judgment.

Increased competition in the health care industry has resulted in lower revenues and higher costs for our operators, including UHS, and may affect our revenues, property values and lease renewal terms.

The health care industry is highly competitive and competition among hospitals and other health care providers for patients has intensified in recent years. In most geographical areas in which our facilities are operated, there are other facilities that provide services comparable to those offered by our facilities. In addition, some competing facilities are owned by tax-supported governmental agencies or by nonprofit corporations and may be supported by endowments and charitable contributions and exempt from property, sale and income taxes. Such exemptions and support are not available to our operators. In some markets, certain competing facilities may have greater financial resources, be better equipped and offer a broader range of services than those available at our facilities. Certain hospitals that are located in the areas served by our operators facilities are specialty or large hospitals that provide medical, surgical and behavioral health services, facilities and equipment that are not available at our operators' hospitals. The increase in outpatient treatment and diagnostic facilities, outpatient surgical centers and freestanding ambulatory surgical centers also increases competition for our operators.

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In McAllen, Texas, the location of our largest facility, McAllen Medical Center (which is operated by a subsidiary of UHS), intense competition has continued from other healthcare providers, including physician

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owned facilities. As a result, the facility has experienced significant declines in patient volume and profitability. In response to these competitive pressures, UHS has, among other things, undertaken significant capital investment in the market including a new dedicated 120-bed children's facility, which was completed and opened during the first quarter of 2006, as well as a 134-bed replacement behavioral health facility, which was completed and opened during the second quarter of 2006. We do not have an ownership interest in the real estate assets of either of these newly constructed UHS facilities. A continuation of the increased provider competition in this market, as well as the additional capacity currently under construction, or recently completed by UHS and others, could result in additional erosion of the net revenues and financial operating results of McAllen Medical Center which may negatively impact the bonus rentals earned by us on this facility and may potentially have a negative impact on the future lease renewal terms (current lease expires in December, 2011) and the underlying value of the property.

In addition, the number and quality of the physicians on a hospital's staff are important factors in determining a hospital's competitive advantage. Typically, physicians are responsible for making hospital admissions decisions and for directing the course of patient treatment. The operators of our facilities also compete with other health care providers in recruiting and retaining qualified hospital management, nurses and other medical personnel. The operators of our acute care and behavioral health care facilities are experiencing the effects of a shortage of skilled nursing staff nationwide, which has caused and may continue to cause an increase in salaries, wages and benefits expense in excess of the inflation rate. Our operators may experience difficulties attracting and retaining qualified physicians, nurses and medical support personnel. We anticipate that our operators, including UHS, will continue to encounter increased competition in the future that could lead to a decline in patient volumes and harm their businesses, which in turn, could harm our business.

Operators that fail to comply with governmental reimbursement programs such as Medicare or Medicaid, licensing and certification requirements, fraud and abuse regulations or new legislative developments may be unable to meet their obligations to us.

Our operators, including UHS and its subsidiaries, are subject to numerous federal, state and local laws and regulations that are subject to frequent and substantial changes (sometimes applied retroactively) resulting from legislation, adoption of rules and regulations, and administrative and judicial interpretations of existing law. The ultimate timing or effect of these changes cannot be predicted. Government regulation may have a dramatic effect on our operators' costs of doing business and the amount of reimbursement received by both government and other third-party payors. The failure of any of our operators to comply with these laws, requirements and regulations could adversely affect their ability to meet their obligations to us. These regulations include, among other items:

hospital billing practices;

relationships with physicians and other referral sources;

adequacy of medical care;

quality of medical equipment and services;

qualifications of medical and support personnel;

confidentiality, maintenance and security issues associated with health-related information and patient medical records;

the screening, stabilization and transfer of patients who have emergency medical conditions;

licensure and accreditation of our facilities;

hospital rate or budget review;

operating policies and procedures, and;

construction or expansion of facilities and services.

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If our operators fail to comply with applicable laws and regulations, they could be subjected to liabilities, including criminal penalties, civil penalties (including the loss of their licenses to operate one or more facilities), and exclusion of one or more facilities from participation in the Medicare, Medicaid and other federal and state health care programs. The imposition of such penalties could jeopardize that operator's ability to make lease or mortgage payments to us or to continue operating its facility. In addition, our bonus rents are based on our operators' net revenues, which in turn are affected by the amount of reimbursement that such lessees receive from the government.

Although UHS and the other operators of our acute care facilities believe that their policies, procedures and practices comply with governmental regulations, no assurance can be given that they will not be subjected to governmental inquiries or actions, or that they would not be faced with sanctions, fines or penalties if so subjected. Because many of these laws and regulations are relatively new, in many cases, our operators do not have the benefit of regulatory or judicial interpretation. In the future, it is possible that different interpretations or enforcement of these laws and regulations could subject their current or past practices to allegations of impropriety or illegality or could require them to make changes in the facilities, equipment, personnel, services, capital expenditure programs and operating expenses. Even if they were to ultimately prevail, a significant governmental inquiry or action under one of the above laws, regulations or rules could have a material adverse effect upon them, and in turn, us.

UHS Legal Proceedings: We have been advised by UHS that UHS, together with its South Texas Health System affiliates, which operate McAllen Medical Center, were served with a subpoena dated November 21, 2005, issued by the Office of Inspector General of the Department of Health and Human Services. At that time, the Civil Division of the U.S. Attorney's office in Houston, Texas indicated that the subpoena was part of an investigation under the False Claims Act of compliance with Medicare and Medicaid rules and regulations pertaining to the employment of physicians and the solicitation of patient referrals from physicians from January 1, 1999 to the date of the subpoena related to the South Texas Health System. UHS has informed us that it is cooperating in the investigation. On February 16, 2007, UHS's South Texas Health System affiliates were served with a search warrant in connection with what UHS has been advised is a related criminal investigation concerning the production of documents. UHS has advised us that, at this time, it is unable to evaluate the existence or extent of any potential financial exposure in connection with this matter.

UHS has advised us that it monitors all aspects of its business and that it has developed a comprehensive ethics and compliance program that is designed to meet or exceed applicable federal guidelines and industry standards. Because the law in this area is complex and constantly evolving, governmental investigation or litigation may result in interpretations that are inconsistent with industry practices, including UHS's. Although UHS believes their policies, procedures and practices comply with governmental regulations, no assurance can be given that UHS will not be subjected to further inquiries or actions, or that UHS will not be faced with sanctions, fines or penalties in connection with the investigation of our South Texas Health System affiliates. Even if UHS were to ultimately prevail, the government's inquiry and/or action in connection with this matter could have a material adverse effect on UHS's future operating results and on the future operating results of McAllen Medical Center. While the base rentals are guaranteed by UHS through the end of the lease term, should this matter adversely impact on the future revenues and/or operating results of McAllen Medical Center, the future bonus rental earned by us on this facility may be materially, adversely impacted. Bonus rental revenue earned by us from McAllen Medical Center amounted to \$1.9 million during each of 2006 and 2005 and \$2.2 million during 2004. We can provide no assurance that this matter will not have a material adverse impact on underlying value of McAllen Medical Center or on the future base rental earned on this facility after the December, 2011 scheduled expiration of the existing lease term.

Medicare, Medicaid and Private Payor Reimbursement: A significant portion of the revenue earned by the operators of our acute care hospitals is derived from federal and state healthcare programs, including Medicare and Medicaid. Given increasing budget deficits, the federal government and many states are currently considering additional ways to limit increases in levels of Medicare and Medicaid funding, which could also

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adversely affect future payments received by operators of our facilities. In addition to statutory and regulatory changes to the Medicare and each of the state Medicaid programs, our operators' operations and reimbursement may be affected by administrative rulings, new or novel interpretations and determinations of existing laws and regulations, post-payment audits, requirements for utilization review and new governmental funding restrictions, all of which may materially increase or decrease program payments as well as affect the cost of providing services and the timing of payments to our facilities.

In addition to changes in government reimbursement programs, our operators' ability to negotiate favorable service contracts with purchasers of group health services, including managed care providers, significantly affects the revenues and operating results of our facilities. Further, a primary collection risk for our operators relates to uninsured patients and the portion of the bill that is the patient's responsibility, which primarily includes co-payments and deductibles.

Health Care Reform: An increasing number of legislative initiatives have been introduced or proposed in recent years that would result in major changes in the health care delivery system on a national or a state level. Among the proposals that have been introduced are price controls on hospitals, insurance market reforms to increase the availability of group health insurance to small businesses, requirements that all businesses offer health insurance coverage to their employees and the creation of government health insurance plans that would cover all citizens and increase payments by beneficiaries. We cannot predict whether any proposals will be adopted or, if adopted, what effect, if any, these proposals would have on operators and, thus, our business.

If we fail to maintain our REIT status, we will become subject to federal income tax on our taxable income at regular corporate rates.

In order to qualify as a REIT, we must comply with certain highly technical and complex Internal Revenue Code provisions. Although we believe we have been qualified as a REIT since our inception, there can be no assurance that we have been so qualified or will remain qualified in the future. Failure to qualify as a REIT may subject us to income tax liabilities, including federal income tax at regular corporate rates. The additional income tax incurred may significantly reduce the cash flow available for distribution to shareholders and for debt service. In addition, if disqualified, we might be barred from qualification as a REIT for four years following disqualification.

The market value of our common stock could be substantially affected by various factors.

Many factors, certain of which are outside of our control, could have an adverse effect on the share price of our common stock. These factors include certain of the risks discussed herein, our financial condition, performance and prospects, the market for similar securities issued by REITs, demographic changes, operating results of our operators and other hospital companies, changes in our financial estimates or recommendations of securities analysts, speculation in the press or investment community, the possible effects of war, terrorist and other hostilities, adverse weather conditions, the level of seasonal illnesses, changes in general conditions in the economy or the financial markets, or other developments affecting the health care industry.

Ownership limitations and anti-takeover provisions in our declaration of trust and bylaws and under Maryland law may delay, defer or prevent a change in control or other transactions that could provide shareholders with a take-over premium. We are subject to significant anti-takeover provisions.

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In order to protect us against the risk of losing our REIT status for federal income tax purposes, our declaration of trust permits our Trustees to redeem shares acquired or held in excess of 9.8% of the issued and outstanding shares of our voting stock and, which in the opinion of the Trustees would jeopardize our REIT status. In addition, any acquisition of our common or preferred shares that would result in our disqualification as a REIT is null and void. The right of redemption may have the effect of delaying, deferring or preventing a change in control of our company and could adversely affect our shareholders' ability to realize a premium over the market price for the shares of our common stock.

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Our declaration of trust authorizes our Board of Trustees to issue additional shares of common and preferred stock and to establish the preferences, rights and other terms of any series of preferred stock that we issue. Although our Board of Trustees has no intention to do so at the present time, it could establish a series of preferred stock that could delay, defer or prevent a transaction or a change in control that might involve the payment of a premium over the market price for our common stock or otherwise be in the best interests of our shareholders.

These provisions could discourage unsolicited acquisition proposals or make it more difficult for a third-party to gain control of us, which could adversely affect the market price of our securities and prevent shareholders from receiving a take-over premium.

We depend heavily on key management personnel and the departure of one or more of our key executives or a significant portion of our operators' local hospital management personnel could harm our business.

The expertise and efforts of our senior executives and key members of our operators' local hospital management personnel are critical to the success of our business. The loss of the services of one or more of our senior executives or of a significant portion of our operators' local hospital management personnel could significantly undermine our management expertise and our operators' ability to provide efficient, quality health care services at our facilities, which could harm their business, and in turn, harm our business.

Increasing investor interest in our sector and consolidation at the operator or REIT level could increase competition and reduce our profitability.

Our business is highly competitive and we expect that it may become more competitive in the future. We compete for the acquisition, leasing and financing of health care related facilities. Our competitors include, but are not limited to, other REITs, banks and other companies, including UHS, some of which are larger and have a lower cost of capital than we do. Additionally, the potential for consolidation at the REIT or operator level appears to have increased. These developments could result in fewer investment opportunities for us and lower spreads over our cost of our capital, which would hurt our growth.

We are subject to significant corporate regulation as a public company and failure to comply with all applicable regulations could subject us to liability or negatively affect our stock price.

As a publicly traded company, we are subject to a significant body of regulation, including the Sarbanes-Oxley Act of 2002. While we have developed and instituted a corporate compliance program based on what we believe are the current best practices in corporate governance and continue to update this program in response to newly implemented or changing regulatory requirements, we cannot provide assurance that we are or will be in compliance with all potentially applicable corporate regulations. For example, we cannot provide assurance that in the future our management will not find a material weakness in connection with its annual review of our internal control over financial reporting pursuant to Section 404 of the Sarbanes-Oxley Act. We also cannot provide assurance that we could correct any such weakness to allow our management to assess the effectiveness of our internal control over financial reporting as of the end of our fiscal year in time to enable our independent registered public accounting firm to state that such assessment will have been fairly stated in our Annual Report on Form 10-K or state that we have maintained effective internal control over financial reporting as of the end of our fiscal year. If we fail to comply with any of these regulations, we could be subject to a range of regulatory actions, fines or other sanctions or litigation. If we must disclose any material weakness in our internal control over financial reporting, our stock price could decline.

Item 1B. *Unresolved Staff Comments*

None.

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The following table shows our investments in hospital facilities leased to UHS and other non-related parties. The table on the next page provides information related to various properties in which we have significant investments, some of which are accounted for by the equity method. The capacity in terms of beds (for the hospital facilities) and the five-year occupancy levels are based on information provided by the lessees.

Hospital Facility Name and Location	Type of facility	Number of available beds @ 12/31/06	Average Occupancy(1)					Lease Term		
			2006	2005	2004	2003	2002	Minimum rent	End of initial or renewed term	Renewal term (years)
Southwest Healthcare System:										
Inland Valley Campus(2)										
Wildomar, California	Acute Care	124	85%	87%	78%	74%	71%	\$ 2,597,000	2011	20
McAllen Medical Center(3)										
McAllen, Texas	Acute Care	490	52%	59%	68%	72%	73%	5,485,000	2011	20
Wellington Regional Medical Center										
West Palm Beach, Florida	Acute Care	143	77%	73%	72%	68%	58%	3,030,000	2011	20
The Bridgeway										
North Little Rock, Arkansas	Behavioral Health	98	92%	96%	98%	98%	97%	930,000	2014	10
Tri-State Rehabilitation Hospital										
Evansville, Indiana	Rehabilitation	80	53%	74%	74%	75%	74%	885,000	2009	15
Kindred Hospital Chicago Central										
Chicago, Illinois	Sub-Acute Care	84	46%	47%	47%	71%	78%	1,326,000	2011	15

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ITEM 2. Properties (continued)

Facility Name and Location	Type of facility	Average Occupancy(1)					Lease Term		
		2005	2005	2004	2003	2002	Minimum rent	End of initial or renewed term(4)	Renewal term (years)
Fresno Herndon Medical Plaza Fresno, California	MOB	67%	67%	67%	73%	92%	\$ 528,000	2007-2008	various
Kelsey-Seybold Clinic at Kings Crossing Kingwood, Texas	MOB	100%	100%	100%	100%	100%	339,000	2008	none
Professional Bldgs. at Kings Crossing Kingwood, Texas	MOB	90%	90%	91%	82%	83%	280,000	2007-2015	various
Southern Crescent Center Riverdale, Georgia	MOB	36%	49%	64%	70%	77%	176,000	2007-2012	various
Southern Crescent Center, II Riverdale, Georgia	MOB	94%	94%	98%	98%	88%	1,099,000	2010	10
Cypresswood Professional Center Spring, Texas	MOB	92%	100%	100%	97%	96%	465,000	2007-2009	various
Desert Springs Medical Plaza(5) Las Vegas, Nevada	MOB	96%	100%	100%	100%	100%	1,136,000	2007-2016	various
Orthopaedic Specialists of Nevada Building Las Vegas, Nevada	MOB	100%	100%	100%	100%	100%	224,000	2009	20
Summerlin Hospital MOB(5) Las Vegas, Nevada	MOB	98%	100%	100%	100%	100%	1,425,000	2007-2014	various
Summerlin Hospital MOB II(5) Las Vegas, Nevada	MOB	100%	100%	100%	100%	100%	1,566,000	2007-2013	various
Sheffield Medical Building Atlanta, Georgia	MOB	86%	85%	88%	99%	98%	1,370,000	2007-2012	various
Medical Center of Western Connecticut Danbury, Connecticut	MOB	85%	100%	100%	94%	94%	787,000	2008-2017	various
Chesterbrook Academy Audubon, New Britain, Newtown and Uwchlan, Pennsylvania	Preschool and Childcare Centers	N/A	N/A	N/A	N/A	N/A	593,000	2010	10
Family Doctor s Medical Office Building Shreveport, Louisiana	MOB	100%	100%	100%	100%	100%	303,000	2011	10
700 Shadow Lane and Goldring MOB(5)	MOB	90%	99%	99%	99%		2,028,000	2007-2016	various

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Las Vegas, Nevada

St. Mary s Professional Office Building Reno, Nevada	MOB	92%	77%	3,612,000	2007- 2025	various
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N/A - Not Applicable

- (1) Average occupancy rate for the hospital facilities is based on the average number of available beds occupied during each of the five years ended December 31, 2006. Average available beds is the number of beds which are actually in service at any given time for immediate patient use with the necessary equipment and staff available for patient care. A hospital may have appropriate licenses for more beds than are in service for a number of reasons, including lack of demand, incomplete construction and anticipation of future needs. The average occupancy rate of a hospital is affected by a number of factors, including the number of physicians using the hospital, changes in the number of beds, the composition and size of the population of the community in which the hospital is located, general and local economic conditions, variations in local medical and surgical practices and the degree of outpatient use of the hospital services. Average occupancy rate for the multi-tenant medical office buildings is based on the occupied square footage of each building, including any applicable master leases.
- (2) In July, 2002, the operations of Inland Valley Regional Medical Center (Inland Valley) were merged with the operations of Rancho Springs Medical Center (Rancho Springs), an acute care hospital located in California and also operated by UHS, the real estate assets of which are not owned by us. Inland Valley, our lessee, was merged into Universal Health Services of Rancho Springs, Inc. The merged entity is now doing business as Southwest Healthcare System (Southwest Healthcare). As a result of merging the operations of the two facilities, the revenues of Southwest Healthcare include the revenues of both Inland Valley and Rancho Springs. Although we do not own the real estate assets of the Rancho Springs facility, Southwest Healthcare became the lessee on the lease relating to the real estate assets of the Inland Valley facility. Since the bonus rent calculation for the Inland Valley campus is based on net revenues and the financial results of the two facilities are no longer separable, the lease was amended during 2002 to exclude from the bonus rent calculation the estimated net revenues generated at the Rancho Springs campus (as calculated pursuant to a percentage based allocation determined at the time of the merger). The average occupancy rates shown for this facility for all years were based on the combined number of beds occupied at the Inland Valley and Rancho Springs campuses.
- (3) During the first quarter of 2001, UHS purchased the assets and operations of the 60-bed McAllen Heart Hospital located in McAllen, Texas. Upon the acquisition by UHS, the Heart Hospital began operating under the same license as an integrated department of McAllen Medical Center. As a result of combining the operations of the two facilities, the revenues of McAllen Medical Center include revenues generated by the Heart Hospital, the real property of which is not owned by us. Accordingly, since the bonus rent calculation for McAllen Medical Center is based on net revenues and the financial results of the two facilities are no longer separable, the McAllen Medical Center lease was amended during 2001 to exclude from the bonus rent calculation, the estimated net revenues generated at the Heart Hospital (as calculated pursuant to a percentage based allocation determined at the time of the merger). During 2000, UHS purchased the South Texas Behavioral Health Center, a behavioral health care facility located in McAllen, Texas. The license for this facility, the real property of which was not owned by us, was merged with the license for McAllen Medical Center and the financial results of the facilities are no longer separable. During the second quarter of 2006, UHS opened a newly constructed behavioral health care facility and the operations of South Texas Behavioral Health Center were transferred into this new facility. We do not own the real property of this newly constructed building. There was no amendment to the McAllen Medical Center lease related to the operations of the South Texas Behavioral Health Center. No assurance can be given as to the effect, if any, the consolidation of the facilities as mentioned above, had on the underlying value of McAllen Medical Center. Base rental commitments and the guarantee by UHS under the original lease continue for the remainder of the lease terms. The average occupancy rates shown for this facility in all years presented were based on the combined number of beds at McAllen Medical Center, McAllen Heart Hospital and South Texas Behavioral Health Center.
- (4) Properties are multi-tenant MOBs which have various lease maturity dates.
- (5) The real estate assets of this facility are owned by a LLC in which we own a non-controlling equity interest and include tenants who are unaffiliated third-parties or subsidiaries of UHS.

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Set forth is information detailing the rentable square feet (RSF) associated with each of our investments and the percentage of RSF on which leases expire during the next five years and thereafter:

	Available for Lease	Percentage of RSF with lease expirations						
								2012
		Jan. 1, 2007	2007	2008	2009	2010	2011	and later
Total RSF								
Hospital Investments								
McAllen Medical Center	532,403	0%	0%	0%	0%	0%	100%	0%
Wellington Regional Medical Center	121,015	0%	0%	0%	0%	0%	100%	0%
Kindred Hospital Chicago Central	115,554	0%	0%	0%	0%	0%	100%	0%
Southwest Healthcare System, Inland Valley Campus	108,499	0%	0%	0%	0%	0%	100%	0%
The Bridgeway	77,901	0%	0%	0%	0%	0%	0%	100%
Tri-State Regional Rehabilitation Hospital	77,440	0%	0%	0%	100%	0%	0%	0%
Subtotal Hospitals	1,032,812	0%	0%	0%	7%	0%	85%	8%
Other Investments								
Medical Office Buildings:								
Desert Samaritan Hospital MOBs (a.)	200,755	3%	30%	31%	10%	9%	12%	5%
Saint Mary's Professional Office Building	190,268	5%	0%	0%	0%	0%	0%	95%
Edwards Medical Plaza	141,945	13%	19%	22%	12%	9%	0%	25%
700 Shadow Lane & Goldring MOBs	114,042	9%	19%	18%	11%	3%	2%	38%
Desert Springs Medical Plaza	106,474	25%	7%	7%	21%	12%	7%	21%
Centinela Medical Building Complex	103,353	7%	20%	4%	47%	2%	14%	6%
Suburban Medical Plaza II	102,818	0%	2%	2%	12%	0%	34%	50%
Thunderbird Paseo Medical Plaza I & II	96,569	0%	20%	43%	10%	10%	17%	0%
Summerlin Hospital MOB II (b.)	92,110	0%	17%	9%	7%	6%	25%	36%
Summerlin Hospital MOB	89,636	7%	8%	16%	40%	9%	10%	10%
Papago Medical Park	79,251	17%	0%	28%	47%	8%	0%	0%
Deer Valley Medical Office II	77,264	0%	5%	0%	6%	5%	0%	84%
Mid Coast Hospital MOB	73,762	0%	0%	0%	0%	0%	44%	56%
Sheffield Medical Building	71,940	17%	8%	18%	15%	14%	2%	26%
Rosenberg Children's Medical Plaza	66,231	8%	0%	21%	0%	24%	7%	40%
Sierra San Antonio Medical Plaza (c.)	59,160	41%	0%	0%	0%	0%	25%	34%
Spring Valley Medical Office Building	57,830	7%	0%	0%	47%	11%	11%	24%
Southern Crescent Center, II (d.)	53,680	6%	0%	0%	8%	86%	0%	0%
Desert Valley Medical Center	53,625	8%	18%	23%	14%	10%	22%	5%
Southern Crescent Center, I	41,400	72%	6%	0%	0%	0%	0%	22%
Cypresswood Professional Center	40,082	9%	51%	33%	7%	0%	0%	0%
Medical Center of Western Connecticut	37,522	1%	0%	4%	15%	62%	0%	18%
Fresno-Herndon Medical Plaza	36,417	33%	47%	20%	0%	0%	0%	0%
Apache Junction Medical Plaza	26,901	0%	26%	17%	4%	9%	9%	35%
Santa Fe Professional Plaza	25,294	0%	15%	50%	18%	12%	5%	0%
Rio Rancho Medical Center	22,956	0%	0%	0%	0%	0%	0%	100%
Kelsey-Seybold Clinic at Kings Crossing	20,470	0%	0%	100%	0%	0%	0%	0%
Professional Bldgs. at Kings Crossing	20,447	10%	22%	14%	0%	0%	24%	30%
Orthopaedic Specialists of Nevada Bldg.	11,000	0%	0%	0%	100%	0%	0%	0%
Family Doctor's MOB	9,155	0%	0%	0%	0%	0%	100%	0%
Preschool and Childcare Centers:								

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Chesterbrook Academy	8,300	0%	0%	0%	0%	0%	100%	0%
Chesterbrook Academy	8,163	0%	0%	0%	0%	0%	100%	0%
Chesterbrook Academy	8,100	0%	0%	0%	0%	0%	100%	0%
Chesterbrook Academy	7,998	0%	0%	0%	0%	0%	100%	0%
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Sub-total Other Investments	2,154,918	9%	12%	15%	14%	9%	12%	29%
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total	3,187,730	6%	8%	10%	12%	6%	36%	22%
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>

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- (a.) The Desert Samaritan Hospital MOB is composed of three different MOB buildings, the first of which contains a master lease provision that covers all vacancies through March 31, 2008. The remaining two MOB buildings do not have a master lease provision.
- (b.) The Summerlin Hospital Medical Office Building II has a master lease provision that expires on September 30, 2010 which covers all vacancies.
- (c.) The Sierra San Antonio Medical Plaza has a master lease provision that expires when 45,000 RSF of the building has been occupied or the expiration term of 2011, whichever occurs first.
- (d.) The Southern Crescent Center II has a master lease agreement that covers 46,300 RSF of space until June 30, 2010.

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ITEM 3. *Legal Proceedings*

None

ITEM 4. *Submission of Matters to a Vote of Security Holders*

No matter was submitted during the fourth quarter of the year ended December 31, 2006 to a vote of security holders.

PART II

ITEM 5. *Market for Registrant's Common Equity and Related Stockholder Matters*

Market Information

Our shares of beneficial interest are listed on the New York Stock Exchange. The high and low closing sales prices for our shares of beneficial interest for each quarter in the two years ended December 31, 2006 and 2005 are summarized below:

	2006		2005	
	High Price	Low Price	High Price	Low Price
First Quarter	\$ 37.35	\$ 32.08	\$ 32.15	\$ 28.06
Second Quarter	\$ 35.95	\$ 29.72	\$ 39.25	\$ 27.47
Third Quarter	\$ 36.65	\$ 31.12	\$ 40.80	\$ 33.15
Fourth Quarter	\$ 40.24	\$ 35.09	\$ 34.39	\$ 31.15

Holders

As of January 31, 2007, there were approximately 569 shareholders of record of our shares of beneficial interest.

Dividends

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It is our intention to declare quarterly dividends to the holders of our shares of beneficial interest so as to comply with applicable sections of the Internal Revenue Code governing REITs. Our revolving credit facility limits our ability to increase dividends in excess of 95% of cash available for distribution, as defined in our revolving credit agreement, unless additional distributions are required to be made so as to comply with applicable sections of the Internal Revenue Code and related regulations governing REITs. In each of the past two years, dividends per share were declared as follows:

	<u>2006</u>	<u>2005</u>
First Quarter	\$.560	\$.505
Second Quarter	.565	.555
Third Quarter	.565	.555
Fourth Quarter	.570	.560
	<u>\$ 2.260</u>	<u>\$ 2.175</u>

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Securities Authorized for Issuance Under Equity Compensation Plans

The table below provides information, as of December 31, 2006, concerning securities authorized for issuance under our equity compensation plans.

Equity Compensation Plan Information

<u>Plan category</u>	<u>Number of securities to be issued upon exercise of outstanding options, warrants and rights(a)</u>	<u>Weighted-average exercise price of outstanding options, warrants and rights</u>	<u>Number of securities remaining available for future issuance under equity compensation plans (excluding column(a))</u>
Equity compensation plans approved by security holders	218,000	\$ 7.58	166,000
Equity compensation plans not approved by security holders			
TOTAL	218,000	\$ 7.58	166,000

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Stock Price Performance Graph

The following graph compares our performance with that of the S&P 500 and a group of peer companies, where performance has been weighted based on market capitalization. Companies in our peer group are as follows: Health Care Property Investors, Inc., Nationwide Health Properties, Inc., Omega Healthcare Investors, Inc., Health Care REIT, Inc., Healthcare Realty Trust, Inc., LTC Properties, Inc., National Health Investors, Inc. and National Health Realty, Inc.

The Stock Price Performance Graph shall not be deemed incorporated by reference by any general statement incorporating by reference in this Form 10-K into any filing under the Securities Act of 1933 or under the Securities Exchange Act of 1934, except to the extent we specifically incorporate this information by reference, and shall not otherwise be deemed filed under such Acts.

The total cumulative return on investment (change in the year-end stock price plus reinvested dividends) for each of the periods for us, the peer group and the S&P 500 Composite is based on the stock price or composite index at the end of fiscal 2001.

Company Name / Index	Base	INDEXED RETURNS				
	Period	Years Ending				
		Dec01	Dec02	Dec03	Dec04	Dec05
Universal Health Realty Income Trust	\$ 100	\$ 120.31	\$ 148.07	\$ 168.47	\$ 175.69	\$ 232.79
S&P 500 Index	\$ 100	\$ 77.90	\$ 100.25	\$ 111.15	\$ 116.61	\$ 135.03
Peer Group	\$ 100	\$ 109.64	\$ 162.08	\$ 195.07	\$ 188.82	\$ 271.05

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The following table contains our selected financial data for, or at the end of, each of the five years ended December 31, 2006. You should read this table in conjunction with our consolidated financial statements and related notes contained elsewhere in this Annual Report and in Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

	(000s, except per share amounts)				
	2006(1)	2005(1)	2004(1)	2003	2002
Operating Results:					
Total revenue(2)	\$ 32,509	\$ 33,338	\$ 31,777	\$ 27,052	\$ 27,168
Income from continuing operations	34,697	25,423	21,712	23,433	20,631
Income from discontinued operations, net (including gain on sale of real property of \$833 during 2004)			1,959	992	992
Net income	\$ 34,697	\$ 25,423	\$ 23,671	\$ 24,425	\$ 21,623
Balance Sheet Data:					
Real estate investments, net of accumulated depreciation(2)	\$ 143,363	\$ 152,865	\$ 157,601	\$ 130,298	\$ 134,375
Investments in LLCs(2)	47,223	29,572	40,523	61,001	48,314
Total assets(2)	194,139	196,889	204,583	194,291	185,117
Total indebtedness(2)(3)	26,337	35,548	46,210	37,242	30,493
Other Data:					
Funds from operations(4)	\$ 28,930	\$ 29,202	\$ 31,149	\$ 30,101	\$ 28,527
Cash provided by (used in):					
Operating activities	24,702	25,303	26,967	26,218	25,059
Investing activities	(2,045)	8,408	11,905	(10,194)	(199)
Financing activities	(23,217)	(35,582)	(36,387)	(15,994)	(24,891)
Per Share Data:					
Basic earnings per share:					
From continuing operations	\$ 2.94	\$ 2.16	\$ 1.85	\$ 2.00	\$ 1.77
From discontinued operations			0.17	0.09	0.08
Total basic earnings per share	\$ 2.94	\$ 2.16	\$ 2.02	\$ 2.09	\$ 1.85
Diluted earnings per share:					
From continuing operations	\$ 2.92	\$ 2.15	\$ 1.84	\$ 1.99	\$ 1.76
From discontinued operations			0.16	0.08	0.08
Total diluted earnings per share	\$ 2.92	\$ 2.15	\$ 2.00	\$ 2.07	\$ 1.84
Dividends per share	\$ 2.260	\$ 2.175	\$ 2.000	\$ 1.960	\$ 1.920
Other Information (in thousands)					
Weighted average number of shares outstanding basic	11,784	11,764	11,744	11,713	11,687
Weighted average number of shares and share equivalents outstanding diluted	11,866	11,841	11,813	11,779	11,750

(1) See Management's Discussion and Analysis of Financial Condition and Results of Operations.

(2)

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During the first quarter of 2004, pursuant to the terms of FASB Interpretation No. 46R, *Consolidation of Variable Interest Entities*, and *Interpretation of ARB No. 51*, we began recording the operating results of three LLCs, in which we hold majority, non-controlling ownership interests, on a consolidated basis. At that time, these LLCs were recorded on a consolidated basis due to certain master lease, lease assurance or lease guarantee agreement between UHS and the properties owned by the LLCs. As a result of the expiration of

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- the master lease arrangements between UHS and two of these LLCs, during the fourth quarter of 2006, we began recording the financial results of these LLCs on an unconsolidated basis. There was no impact on our net income as a result of recording these LLCs on an unconsolidated or a consolidated basis.
- (3) Excludes \$180.9 million as of December 31, 2006 and \$152.3 million as of December 31, 2005, of third-party debt, that is non-recourse to us, incurred by unconsolidated LLCs in which we hold various non-controlling equity interests (see Note 9 to the consolidated financial statements).
- (4) Funds from operations, is a widely recognized measure of REIT performance. Although FFO is a non-GAAP financial measure, we believe that information regarding FFO is helpful to shareholders and potential investors. We compute FFO in accordance with standards established by the National Association of Real Estate Investment Trusts (NAREIT), which may not be comparable to FFO reported by other REITs that do not compute FFO in accordance with the NAREIT definition, or that interpret the NAREIT definition differently than we interpret the definition. To facilitate a clear understanding of our historical operating results, FFO should be examined in conjunction with net income, determined in accordance with GAAP. FFO does not represent cash generated from operating activities in accordance with GAAP and should not be considered to be an alternative to net income determined in accordance with GAAP. In addition, FFO should not be used as: (i) an indication of our financial performance determined in accordance with GAAP; (ii) as an alternative to cash flow from operating activities determined in accordance with GAAP; (iii) as a measure of our liquidity; (iv) nor is FFO an indicator of funds available for our cash needs, including our ability to make cash distributions to shareholders. A reconciliation of our reported net income to FFO is shown below.

FFO shown above is calculated as follows:

	(000s)				
	2006	2005	2004	2003	2002
Net income	\$ 34,697	\$ 25,423	\$ 23,671	\$ 24,425	\$ 21,623
Depreciation expense:					
Consolidated investments	5,438	5,503	5,038	4,361	4,333
Unconsolidated affiliates	4,613	4,012	4,282	4,146	3,791
Less gains:					
Previously deferred gain on sale of our interest in an unconsolidated LLC	(1,860)				
Gain on asset exchange and substitution agreement with UHS Chalmette	(13,958)				
Property damage recovered from UHS-Wellington		(4,693)			
Gains recorded by unconsolidated affiliates		(1,043)	(1,009)	(2,831)	(1,220)
Gain on sale of real property, included in income from discontinued operations			(833)		
FFO	\$ 28,930	\$ 29,202	\$ 31,149	\$ 30,101	\$ 28,527

ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

We are a real estate investment trust (REIT) that commenced operations in 1986. We invest in healthcare and human service related facilities including acute care hospitals, behavioral healthcare facilities, rehabilitation hospitals, sub-acute facilities, surgery centers, childcare centers and medical office buildings. As of December 31, 2006, we have forty-five real estate investments or commitments in fifteen states consisting of:

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six hospital facilities including three acute care, one behavioral healthcare, one rehabilitation and one sub-acute;

thirty-five medical office buildings (including five being constructed), and;

four preschool and childcare centers.

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Forward Looking Statements

This Annual Report contains forward-looking statements that reflect our current estimates, expectations and projections about our future results, performance, prospects and opportunities. Forward-looking statements include, among other things, the information concerning our possible future results of operations, business and growth strategies, financing plans, expectations that regulatory developments or other matters will not have a material adverse effect on our business or financial condition, our competitive position and the effects of competition, the projected growth of the industry in which we operate, and the benefits and synergies to be obtained from our completed and any future acquisitions, and statements of our goals and objectives, and other similar expressions concerning matters that are not historical facts. Words such as may, will, should, could, would, predicts, potential, continue, expects, anticipates, future, intends, plans, believes, estimates, and other similar expressions, as well as statements in future tense, identify forward-looking statements.

Forward-looking statements should not be read as a guarantee of future performance or results, and will not necessarily be accurate indications of the times at, or by which, such performance or results will be achieved. Forward-looking information is based on information available at the time and/or our good faith belief with respect to future events, and is subject to risks and uncertainties that could cause actual performance or results to differ materially from those expressed in the statements. Such factors include, among other things, the following:

a substantial portion of our revenues are dependent upon one operator, Universal Health Services, Inc., (UHS);

a subsidiary of UHS is our Advisor and our officers are all employees of UHS, which may create the potential for conflicts of interest;

lost revenues from purchase option exercises and lease expirations and renewals, loan repayments and other restructuring;

the availability and terms of capital to fund the growth of our business;

the outcome of known and unknown litigation, government investigations, and liabilities and other claims asserted against us or the operators of our facilities, including the investigation of UHS's South Texas Health Systems affiliates, which includes McAllen Medical Center, as described herein;

our majority ownership interests in various LLCs in which we hold non-controlling equity interests;

real estate market factors, including without limitation the supply and demand of office space and market rental rates, changes in interest rates as well as an increase in the development of medical office condominiums in certain markets;

government regulations, including changes in the reimbursement levels under the Medicare and Medicaid program;

the issues facing the health care industry that affect the operators of our facilities, including UHS, such as: changes in, or the ability to comply with, existing laws and government regulations; unfavorable changes in the levels and terms of reimbursement for our charges by third party payors or government programs, including Medicare or Medicaid; demographic changes; the ability to enter into managed care provider agreements on acceptable terms; an increase in uninsured and self-pay patients which unfavorably impacts the collectibility of patient accounts; decreasing in-patient admission trends; technological and pharmaceutical improvements that may increase the cost of providing, or reduce the demand for, health care; the ability to attract and retain qualified medical personnel,

including physicians;

the ability of operators of our facilities, particularly UHS, to obtain adequate levels of general and professional liability insurance;

two LLCs that own properties in California, in which we have various non-controlling equity interests, could not obtain earthquake insurance at rates which are economically beneficial in relation to the risks covered;

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competition for our operators from other REITs;

competition from other health care providers, including physician owned facilities and other facilities owned by UHS, including, but not limited to, McAllen, Texas, the site of our largest acute care facility;

changes in, or inadvertent violations of, tax laws and regulations and other factors than can affect REITs and our status as a REIT;

fluctuations in the value of our common stock, and;

other factors referenced herein or in our other filings with the Securities and Exchange Commission.

Given these uncertainties, risks and assumptions, you are cautioned not to place undue reliance on such forward-looking statements. Our actual results and financial condition, including the operating results of our lessees and the facilities leased to subsidiaries of UHS, could differ materially from those expressed in, or implied by, the forward-looking statements.

Forward-looking statements speak only as of the date the statements are made. We assume no obligation to publicly update any forward-looking statements to reflect actual results, changes in assumptions or changes in other factors affecting forward-looking information, except as may be required by law. All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by this cautionary statement.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions that affect the amounts reported in our consolidated financial statements and accompanying notes.

A summary of our significant accounting policies is outlined in Note 1 to the consolidated financial statements. We consider our critical accounting policies to be those that require us to make significant judgments and estimates when we prepare our financial statements, including the following:

Revenue Recognition Our revenues consist primarily of rentals received from tenants, which are comprised of minimum rent (base rentals), bonus rentals and reimbursements from tenants for their pro-rata share of expenses such as common area maintenance costs, real estate taxes and utilities.

The minimum rent for all hospital facilities is fixed over the initial term or renewal term of the respective leases. Rental income recorded by our consolidated and unconsolidated MOBs relating to leases in excess of one year in length, is recognized using the straight-line method under which contractual rents are recognized evenly over the lease term regardless of when payments are due. The amount of rental revenue resulting from straight-line rent adjustments is dependent on many factors including the nature and amount of any rental concessions granted to new tenants, scheduled rent increases under existing leases, as well as the acquisitions and sales of properties that have existing in-place leases with

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terms in excess of one year. As a result, the straight-line adjustments to rental revenue may vary from period-to-period. Bonus rents are recognized when earned based upon increases in each facility's net revenue in excess of stipulated amounts. Bonus rentals are determined and paid each quarter based upon a computation that compares the respective facility's current quarter's net revenue to the corresponding quarter in the base year. Tenant reimbursements for operating expenses are accrued as revenue in the same period the related expenses are incurred.

Investments in Limited Liability Companies (LLCs) Our consolidated financial statements include the consolidated accounts of our controlled investments and those investments that meet the criteria of a variable interest entity where we are the primary beneficiary. In accordance with the American Institute of Certified Public Accountants' Statement of Position 78-9 Accounting for Investments in Real Estate Ventures as amended by FASB Staff Position SOP 78-9-1 *Interaction of AICPA Statement of Position 78-9 and EITF Issue*

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No. 04-5, Emerging Issues Task Force Issue (EITF) 96-16, *Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights* and EITF 04-5 *Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights* we account for our unconsolidated investments in LLCs which we do not control using the equity method of accounting. The third-party members in these investments have equal voting rights with regards to issues such as, but not limited to: (i) divestiture of property; (ii) annual budget approval, and; (iii) financing commitments. These investments, which represent 33% to 99% non-controlling ownership interests, are recorded initially at our cost and subsequently adjusted for our net equity in the net income, cash contributions to, and distributions from, the investments. Pursuant to certain agreements, allocations of profits and losses of some of the LLC investments may be allocated disproportionately as compared to ownership interests after specified preferred return rate thresholds have been satisfied.

In January 2003, the FASB issued Interpretation No. 46, *Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51*. This Interpretation, as revised (FIN 46R), addresses the consolidation by business enterprises of variable interest entities as defined in the Interpretation. As a result of our related party relationship with UHS, and certain master lease, lease assurance or lease guarantee arrangements between UHS and various properties owned by three LLCs in which we own non-controlling ownership interests ranging from 95% to 99%, these LLCs were considered to be variable interest entities (see Note 9 to the consolidated financial statements). In addition, we were the primary beneficiary of these LLC investments. Upon the adoption of FIN 46R on March 31, 2004, we began consolidating the results of operations of these three LLC investments in our consolidated financial statements.

As a result of the expiration of the master lease arrangements between subsidiaries of UHS and two of these three LLCs, during the fourth quarter of 2006, we began recording the financial results of two LLCs on an unconsolidated basis in our consolidated financial statements. During the fourth quarter of 2006, the revenues and expenses of these two LLCs are no longer included in our consolidated revenues and expenses; instead, our share of the net income generated from each of these LLCs is included in our consolidated statements of income as *Equity in income of unconsolidated LLCs*. The revenues and expenses for these LLCs related to the periods prior to the fourth quarter are included in our revenues and expenses in our consolidated statements of income. There was no impact on our net income as a result of the change in accounting for these LLCs.

The other LLCs in which we hold various non-controlling ownership interests are not variable interest entities and therefore are not subject to the consolidation requirements of FIN 46R.

Federal Income Taxes No provision has been made for federal income tax purposes since we qualify as a REIT under Sections 856 to 860 of the Internal Revenue Code of 1986, and intend to continue to remain so qualified. As such, we are exempt from federal income taxes and we are required to distribute at least 90% of our real estate investment taxable income to our shareholders.

We are subject to a federal excise tax computed on a calendar year basis. The excise tax equals 4% of the amount by which 85% of our ordinary income plus 95% of any capital gain income for the calendar year exceeds cash distributions during the calendar year, as defined. No provision for excise tax has been reflected in the financial statements as no tax was due.

Earnings and profits, which determine the taxability of dividends to shareholders, will differ from net income reported for financial reporting purposes due to the differences for federal tax purposes in the cost basis of assets and in the estimated useful lives used to compute depreciation and the recording of provision for investment losses.

Relationship with UHS and Related Party Transactions

UHS is our principal tenant and through UHS of Delaware, Inc., a wholly owned subsidiary of UHS, serves as our advisor (the Advisor) under an Advisory Agreement dated December 24, 1986 between the Advisor and

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us (the Advisory Agreement). Our officers are all employees of UHS and although as of December 31, 2006 we had no salaried employees, our officers do receive stock-based compensation from time-to-time.

Under the Advisory Agreement, the Advisor is obligated to present an investment program to us, to use its best efforts to obtain investments suitable for such program (although it is not obligated to present any particular investment opportunity to us), to provide administrative services to us and to conduct our day-to-day affairs. In performing its services under the Advisory Agreement, the Advisor may utilize independent professional services, including accounting, legal, tax and other services, for which the Advisor is reimbursed directly by us. The Advisory Agreement expires on December 31 of each year; however, it is renewable by us, subject to a determination by the Independent Trustees who are unaffiliated with UHS, that the Advisor's performance has been satisfactory. The Advisory Agreement may be terminated for any reason upon sixty days written notice by us or the Advisor. The Advisory Agreement has been renewed for 2007. All transactions between us and UHS must be approved by the Independent Trustees.

The Advisor is entitled to certain advisory and incentive fees for its services. No incentive fees were paid during 2006, 2005 and 2004. The advisory fee is payable quarterly, subject to adjustment at year end, based upon our audited financial statements. See Relationship with Universal Health Services, Inc. in Item 1 and Note 2 to the consolidated financial statements for additional information on the Advisory Agreement and related fees.

The leases on the hospital facilities leased to wholly-owned subsidiaries of UHS comprised approximately 49%, 48% and 51% of our revenues for the years ended December 31, 2006, 2005 and 2004, respectively. Including 100% of the revenues generated at the unconsolidated LLCs in which we have various non-controlling equity interests ranging from 33% to 99%, the leases with wholly-owned UHS hospital facilities accounted for 24%, 25% and 27% of the combined consolidated and unconsolidated revenues for the years ended December 31, 2006, 2005 and 2004, respectively. The leases to the hospital facilities of UHS are guaranteed by UHS and cross-defaulted with one another.

Recent Accounting Pronouncements

In July 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement No. 109*. The statement provides a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. In accordance with the statement, before a tax benefit can be recognized, a tax position is evaluated using a threshold that it is more likely than not that the tax position will be sustained upon examination. When evaluating the more-likely-than-not recognition threshold, the interpretation provides that a company should presume the tax position will be examined by the appropriate taxing authority that has full knowledge of all relevant information. If the tax position meets the more-likely-than-not recognition threshold, it is initially and subsequently measured as the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement. The interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. This statement is effective on January 1, 2007. Since we believe we have operated in such a manner as to qualify for taxation as a REIT under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended, and we intend to continue to operate in such a manner, we do not expect the adoption of this statement to have a material impact on our financial position or results of operations.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108). This guidance was issued to resolve diversity in current practice among registrants. The bulletin establishes that registrants must quantify the impact of correcting all misstatements on the financial statements by using both the rollover and iron curtain approaches to evaluate the errors. The rollover approach quantifies the misstatement based on the amount of the error originating in the current year income statement and the iron curtain approach quantifies a misstatement based on the amount of the error existing in the balance sheet at the end of the fiscal year. The bulletin contains guidance on

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correcting errors under the dual approach and transition guidance. The adoption of SAB 108 did not have a material impact on our financial position or results of operations.

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In September, 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS 157), which clarifies the definition of fair value, establishes a framework for measuring fair value in U.S. GAAP, and expands the disclosures regarding fair value measurements. SFAS 157 does not require any new fair value measurements and eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We do not anticipate the adoption of SFAS 157 will have a material effect on our financial position or results of operations.

Results of Operations**Year ended December 31, 2006 as compared to the year ended December 31, 2005:**

As a result of the expiration of the master lease arrangements between subsidiaries of UHS and two LLCs in which we own non-controlling ownership interests of 95% and 99%, during the fourth quarter of 2006, we began recording the financial results of these LLCs on an unconsolidated basis. Prior to the fourth quarter of 2006, these LLCs were included in our financial results on a consolidated basis in accordance with Financial Interpretation No. 46R, *Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51*, (FIN 46R). Accordingly, commencing with the fourth quarter of 2006, the revenues and expenses of these LLCs are no longer included in our consolidated revenues and expenses, but instead, our share of the net income generated from each of these LLCs is included in our consolidated statements of income as Equity in income of unconsolidated LLCs . There was no impact on our net income as a result of the change in accounting for these two LLCs. The following table shows the combined operating results for these two LLCs during the period the results were recorded on an unconsolidated basis. The As Adjusted column on the table below presents our consolidated income statement for the twelve month period ended December 31, 2006 as if we continued to consolidate these two LLCs through December 31, 2006. For comparative purposes, the amounts in the As Adjusted column are used in the discussions below (amounts in thousands).

Twelve Months Ended December 31, 2006	As Reported in 2006 Consolidated Statement of Income	Combined results for two LLCs during period they were recorded on an unconsolidated basis	2006 As Adjusted	As Reported in 2005 Consolidated Statement of Income
Revenues	\$ 32,509	\$ 834	\$ 33,343	\$ 33,338
Expenses:				
Depreciation and amortization	5,757	172	5,929	5,825
Advisory fee to UHS	1,424		1,424	1,420
Other operating expenses	6,547	377	6,924	6,667
	<u>13,728</u>	<u>549</u>	<u>14,277</u>	<u>13,912</u>
Income before equity in unconsolidated LLCs, property damage recovered from UHS and interest expense	18,781	285	19,066	19,426
Equity in income of unconsolidated LLCs (including recognition of previously deferred gain of \$1,860 during 2006 and gain on sale of real property of \$1,043 during 2005)	4,241	(93)	4,148	4,602
Replacement property recovered from UHS Chalmette	13,958		13,958	

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Property damage recovered from UHS Wellington				4,693
Interest expense	(2,283)	(192)	(2,475)	(3,298)
Net income	\$ 34,697		\$ 34,697	\$ 25,423

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Total revenue decreased \$829,000 during 2006, as compared to 2005, due primarily to the recording of the two LLCs on an unconsolidated basis during the fourth quarter of 2006, as indicated above. Income from continuing operations and net income increased \$9.3 million to \$34.7 million, or \$2.92 per diluted share, during 2006 as compared to \$25.4 million, or \$2.15 per diluted share, during 2005. The \$9.3 million, or \$.77 per diluted share, increase in income from continuing operations and net income during 2006, as compared to 2005, was primarily attributable to:

a favorable change of \$14.0 million, or \$1.18 per diluted share, resulting from the Chalmette asset exchange and substitution transaction with UHS, as discussed herein;

an unfavorable change of \$1.3 million, or \$.10 per diluted share, resulting from a decrease in our equity in unconsolidated LLCs, as discussed below (excluding gains recorded by LLCs during 2006 and 2005 and after adjusting for \$93,000 LLC impact, as indicated above);

a favorable change of \$1.9 million, or \$.16 per diluted share, resulting from the 2006 recognition of a deferred gain recorded in connection with the sale of our interest in an unconsolidated LLC during 2005;

an unfavorable change of \$1.0 million, or \$.09 per diluted share, resulting from a gain on the sale of real property recorded by an unconsolidated LLC during 2005;

an unfavorable change of \$4.7 million, or \$.40 per diluted share, resulting from property damage recovered from UHS during 2005 related to hurricane damage sustained at Wellington Regional Medical Center;

a favorable change of \$823,000, or \$.07 per diluted share, resulting from a decrease in interest expense, as discussed below (after adjusting for the \$192,000 LLC impact, as indicated above);

an unfavorable change of \$257,000, or \$.02 per diluted share, resulting from an increase in other operating expenses (after adjusting for the \$377,000 LLC impact, as indicated above), and;

an unfavorable change of approximately \$200,000, or \$.02 per diluted share, resulting from other combined unfavorable changes including a \$104,000 increase in depreciation and amortization expense, as discussed below (after adjusting for the \$172,000 LLC impact, as indicated above).

Included in our consolidated statement of income during 2005 was a property write-down charge of \$6.3 million representing the book value of the Chalmette property damaged by the hurricane. Included in our 2005 net income was an equal amount representing the property damage recoverable from UHS. Prior to the completion of the Asset Exchange and Substitution Agreement, Chalmette had a combined asset value of \$8.3 million on our consolidated balance sheet consisting of \$2.0 million of land held for exchange and \$6.3 million of property damage receivable from UHS. Included in our net income during 2006 was a gain of \$14.0 million representing the total property transferred to us from UHS as of December 31, 2006 (\$22.2 million) in excess of the \$8.3 million book value of Chalmette. Upon the completion of the asset exchange and substitution during the third quarter of 2006, we received the above mentioned Capital Additions from Wellington and Bridgeway which had a combined fair value of \$13.0 million. In addition, the construction costs related to the completed Capital Addition at Inland Valley amounted to \$9.2 million as of December 31, 2006 (\$11.0 million is total minimum estimated cost of Inland Valley's Capital Addition). Our future net income will include an additional \$1.8 million of property recovered from UHS as the additional construction costs are incurred by UHS related to the Inland Valley Capital Addition, up to \$11.0 million estimated total cost of construction.

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FASB Interpretation No. 30 (FIN 30), *Accounting for Involuntary Conversion of Nonmonetary Assets to Monetary Assets, an Interpretation of APB No. 29 (APB29)*, provides guidance on the accounting for involuntary conversions of nonmonetary assets (such as property) to monetary assets (such as insurance proceeds). Although the damage to Chalmette did not directly result in the conversion of a nonmonetary asset to a monetary asset, we do not believe that the receipt of a nonmonetary asset is in substance different than the receipt of a monetary asset in the context of an involuntary conversion. The guidance in FIN 30 would result in recognition of the assets received upon the involuntary conversion at their fair values with gain or loss

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recognized for the difference between the fair value of the assets received and the carrying value of the assets converted. Because it is not clear that the loss of Chalmette and related recovery from UHS represented a monetary conversion as described by FIN 30, we also considered the guidance in SFAS No. 153 (SFAS No. 153), *Exchanges of Nonmonetary Assets, as Amendment of APB 29*, which is effective for nonmonetary asset exchanges occurring in the fiscal year beginning after June 15, 2005. SFAS No. 153 is based upon the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged, unless the exchange lacks commercial substance, as defined in paragraph 21 of APB 29, as amended by SFAS 153. After evaluating the provisions of SFAS No. 153, we concluded that the exchange of these assets had commercial substance since, as indicated above, the base or minimum rent component of the total rental earned on the substituted assets has increased (by \$562,000) over the base rental amount earned pursuant to the terms of the Chalmette lease. As a result, the risk component of the future lease stream has been significantly and favorably impacted. In addition, the future bonus rental earned on the substituted assets at Wellington, Bridgeway and Inland Valley will be impacted (either favorably or unfavorably) by the distinct operating characteristics of those facilities such as the nature of the healthcare care services provided, the geographic markets serviced and patient and payor mix, among other things. As a result of the facts and conclusions detailed above, and pursuant to the contingent gain guidance in SFAS No. 5, *Accounting for Contingencies*, we recorded the \$14.0 million gain during 2006 which reflects the fair value of the assets transferred from UHS to us as of December 31, 2006, net of the \$6.3 million recoverable from UHS recorded during 2005 and the \$2.0 million of Chalmette land relinquished.

Included in our financial results was equity in income of unconsolidated LLCs of \$4.2 million during 2006 and \$4.6 million during 2005. After giving effect to the \$93,000 LLC impact, as indicated above, the equity in income of unconsolidated LLCs decreased by approximately \$500,000 during 2006, as compared to 2005, as follows: (i) an increase of \$1.9 million resulting from the 2006 recognition of a deferred gain recorded in connection with the sale of our interest in an unconsolidated LLC during 2005; (ii) a decrease of \$1.0 million resulting from a gain on the sale of real property recorded by an unconsolidated LLC during 2005; (iii) a combined decrease of approximately \$500,000 due to our share of the increased interest expense incurred by two LLCs during 2006, as compared to 2005, as a result of increased borrowings from refinancing of third-party debt, that is non-recourse to us; (iv) a decrease of approximately \$300,000 due to the losses incurred by a newly constructed MOB that was completed and opened in March of 2006; (v) a decrease of approximately \$200,000 due to the recording of our share of a charge incurred by a LLC to write-off unamortized financing costs in connection with the refinancing of third-party debt, and; (vi) approximately \$400,000 of other combined decreases.

After giving effect to the \$192,000 LLC impact, as indicated above, interest expense decreased \$823,000 during 2006, as compared to 2005, due primarily to: (i) a \$369,000 decrease due to the expiration of two interest-rate swaps that expired during 2005 and 2006; (ii) a \$252,000 decrease due to a net charge recorded during 2005 related to an interest-rate swap agreement that became ineffective based upon the forecasted borrowings under our revolving credit facility; (iii) a decrease of \$145,000 due to interest earned during 2006 on a note receivable related to the sale of our ownership interest in a LLC, and; (iv) \$57,000 of other combined decreases.

After giving effect to the \$377,000 LLC impact, as indicated above, other operating expenses increased \$257,000 during 2006, as compared to 2005, as follows: (i) \$175,000 of combined increases in expense resulting primarily from increased operating expenses at our MOBs, and; (ii) \$82,000 of expense recorded during 2006 in connection with the adoption of SFAS No. 123R. Included in our other operating expenses are expenses related to the consolidated MOBs, a portion of which are passed on directly to the tenants. During 2006, the operating expenses associated with our consolidated MOBs totaled \$5.2 million (without giving effect to the \$377,000 LLC impact, as indicated above) of which, \$3.8 million or 73% were passed on directly to the tenants. During 2005, the operating expenses associated with our MOBs totaled \$5.4 million, of which \$4.0 million or 75% were passed on directly to the tenants. Building expenses allocated to tenants for reimbursement are dependent upon various factors such as overall building occupancy levels and terms of individual leases.

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After giving effect to the \$172,000 LLC impact, as indicated above, depreciation and amortization expense increased \$104,000 during 2006, as compared to 2005. The majority of the increase resulted from the increased depreciation expense recorded during 2006 on the Wellington and Bridgeway assets received in connection with the asset exchange and substitution agreement with UHS (related to the damage sustained at Chalmette from Hurricane Katrina) and replacement property at Wellington (related to hurricane damage sustained during 2004).

Funds from operations (FFO), is a widely recognized measure of REIT performance. Although FFO is a non-GAAP financial measure, we believe that information regarding FFO is helpful to shareholders and potential investors. We compute FFO in accordance with standards established by the National Association of Real Estate Investment Trusts (NAREIT), which may not be comparable to FFO reported by other REITs that do not compute FFO in accordance with the NAREIT definition, or that interpret the NAREIT definition differently than we interpret the definition. To facilitate a clear understanding of our historical operating results, FFO should be examined in conjunction with net income, determined in accordance with GAAP. FFO does not represent cash generated from operating activities in accordance with GAAP and should not be considered to be an alternative to net income determined in accordance with GAAP. In addition, FFO should not be used as: (i) an indication of our financial performance determined in accordance with GAAP; (ii) as an alternative to cash flow from operating activities determined in accordance with GAAP; (iii) as a measure of our liquidity; (iv) nor is FFO an indicator of funds available for our cash needs, including our ability to make cash distributions to shareholders.

Below is a reconciliation of our reported net income to FFO for 2006 and 2005 (in thousands):

	<u>2006</u>	<u>2005</u>
Net income	\$ 34,697	\$ 25,423
Depreciation expense:		
Consolidated investments	5,438	5,503
Unconsolidated affiliates	4,613	4,012
Less gains:		
Previously deferred gain on sale of our interest in an unconsolidated LLC	(1,860)	
Gain on asset exchange and substitution agreement with UHS - Chalmette	(13,958)	
Property damage recovered from UHS-Wellington		(4,693)
Gains recorded by unconsolidated affiliates		(1,043)
Gain on sale of real property, included in income from discontinued operations		
	<u> </u>	<u> </u>
Funds From Operations	<u>\$ 28,930</u>	<u>\$ 29,202</u>

Our FFO decreased 0.9% or \$272,000 to \$28.9 million during 2006 as compared to \$29.2 million during 2005. This decrease in FFO was due primarily to:

an unfavorable change of approximately \$900,000 of FFO generated from our unconsolidated LLCs. This decrease, which excludes depreciation and amortization expense recorded at the LLCs, resulted primarily from a \$1.3 million decrease in our equity in unconsolidated LLCs, as discussed above (excluding gains recorded by LLCs during 2006 and 2005 and after adjusting for \$93,000 LLC impact, as indicated above);

a favorable change of \$823,000 resulting from a decrease in interest expense, as discussed above (after adjusting for the \$192,000 LLC impact, as indicated above), and;

other combined unfavorable changes of approximately \$200,000.

Year ended December 31, 2005 as compared to the year ended December 31, 2004:

Income from continuing operations increased \$3.7 million to \$25.4 million, or \$2.15 per diluted share, during 2005 as compared to \$21.7 million, or \$1.84 per diluted share, during 2004. For the 2004 year, income from discontinued operations totaled \$2.0 million, including a \$833,000 gain on sale of real property. Net income increased \$1.7 million to \$25.4 million, or \$2.15 per diluted share, during 2005 as compared to \$23.7 million, or \$2.00 per diluted share, during 2004.

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The \$1.7 million, or \$.15 per diluted share, increase in net income during 2005, as compared to 2004, was primarily attributable to:

a favorable change of \$4.7 million, or \$.40 per diluted share, resulting from the property damage recovered from UHS during 2005 in connection with replacement of hurricane-damaged property at Wellington;

an unfavorable change of approximately \$1.2 million, or \$.10 per diluted share, from an increase in other operating expenses (excluding the impact of FIN 46R) resulting primarily from increased operating expenses related to our MOBs, increased administrative costs, including insurance expense, and an asset write-off charge recorded during 2005 in connection with building renovations at one of our MOBs;

an unfavorable change of \$700,000, or \$.06 per diluted share, resulting from the purchase of Virtue Street Pavilion by UHS in December of 2004 (net of interest expense savings on the \$7.3 million of sale proceeds received and the depreciation expense decrease);

an unfavorable change of \$833,000, or \$.07 per diluted share, resulting from the gain recorded during 2004 on the purchase of Virtue Street Pavilion by UHS during 2004, and;

other unfavorable changes of approximately \$300,000, or \$.02 per diluted share, including increased depreciation expense recorded in connection with the replacement of hurricane-damaged property at Wellington.

Total revenues increased by \$1.6 million to \$33.3 million in 2005 as compared to \$31.8 million in 2004. The increase was due primarily to the consolidation of the results of operations of the three LLCs as of April 1, 2004 pursuant to FIN 46R, as discussed below.

Other operating expenses increased \$1.7 million to \$6.7 million during 2005 as compared to \$5.0 million during 2004. Approximately \$500,000 of the increase in operating expenses is due to the consolidation of the three LLCs pursuant to FIN 46R, as discussed below. Also contributing to the increase in other operating expense during 2005, as compared to 2004, was increased administrative costs, including increased insurance expense, and an asset write-off charge of approximately \$100,000 recorded during 2005 in connection with building renovations at one of our MOBs. Included in our other operating expenses are expenses related to the consolidated medical office buildings, which totaled \$5.3 million during 2005 and \$4.3 million during 2004. A portion of the expenses associated with our consolidated medical office buildings is passed on directly to the tenants. Tenant reimbursements for operating expenses are accrued as revenue in the same period the related expenses are incurred and are included as tenant reimbursement revenue in our statements of income. Approximately \$4.0 million or 75% in 2005, and \$3.3 million or 75% in 2004, of the operating expenses related to the medical office buildings were passed on directly to the tenants. Building expenses allocated to tenants for reimbursement are dependent upon various factors such as overall building occupancy levels and terms of individual leases.

Depreciation and amortization increased \$648,000 during 2005, as compared to 2004, due primarily to the consolidation of the LLCs pursuant to FIN 46R, as discussed below, as well as an increase resulting from the depreciation expense recorded on the replacement of hurricane-damaged property at Wellington.

Interest expense decreased \$59,000 during 2005 as compared to 2004, due primarily to: (i) an increase of \$426,000 resulting from the consolidation of the LLCs pursuant to FIN 46R, as discussed below; (ii) a net charge of \$252,000 related to an interest-rate swap agreement that became ineffective based upon the forecasted borrowings under our revolving credit facility, and; (iii) a decrease of approximately \$737,000 due primarily to a decrease in our average outstanding borrowings, partially offset by an increase in our average cost of funds. Contributing to the decrease in our average outstanding borrowing during 2005, as compared to 2004, is the repayment of debt using the \$7.3 million of proceeds

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received related to UHS' s purchase of Virtue Street Pavilion in December of 2004.

Included in our financial results was \$4.6 million during 2005 and \$5.0 million during 2004, of operating income generated from our ownership of equity interests in limited liability companies which own medical office

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buildings in Arizona, California, Kentucky, New Mexico, Nevada and Maine (see Note 9 to the consolidated financial statements). Included in our financial results during each of the years ended December 31, 2005 and 2004 were gains of \$1.0 million resulting from the sale of real property by unconsolidated LLCs. The \$400,000 decrease during 2005, as compared to 2004, is due primarily to the consolidation of the three LLCs pursuant to FIN 46R, as discussed below.

As of December 31, 2005, we had investments or commitments in twenty-two limited liability companies (LLCs), nineteen of which were accounted for by the equity method and three that were consolidated in the results of operations as of April 1, 2004. Effective March 31, 2004, we adopted FASB Interpretation No. 46R (FIN 46R), Consolidation of Variable Interest Entities (VIEs), an Interpretation of ARB No. 51. As a result of our related party relationship with UHS, and certain master lease, lease assurance or lease guarantee arrangements between UHS and various properties owned by three LLCs in which we own non-controlling ownership interests ranging from 95% to 99%, these LLCs were considered to be variable interest entities. In addition, we are primary beneficiary of these LLC investments as a result of our level of investment in the entities. Consequently, we began consolidating the results of operations of these three LLC investments. The remaining LLCs were not variable interest entities and therefore were not subject to the consolidation requirements of FIN 46R. As a result of the expiration of the master lease arrangements between subsidiaries of UHS and two LLCs in which we own non-controlling ownership interests of 95% and 99%, during the fourth quarter of 2006, we began recording the financial results of these two LLCs on an unconsolidated basis again.

Our consolidated statements of income for the three and twelve month periods ended December 31, 2005 include the revenue and expenses associated with the three consolidated LLCs. The revenue and expenses associated with these properties were also included in our consolidated statements of income for the nine month period of April 1, 2004 through December 31, 2004. Prior to April 1, 2004, the operations of these LLCs were recorded in our consolidated statements of income using the equity method of accounting and, therefore, the revenue and expenses of these three LLCs were not consolidated in our consolidated statements of income. As detailed in the table below, during the three month period ended March 31, 2004, these properties generated approximately \$1.6 million of revenue, \$300,000 of depreciation and amortization expense, \$500,000 of other operating expenses and \$400,000 of interest expense. The As Adjusted column in the table below presents the effect this three month period ended March 31, 2004 would have had on our consolidated statement of income for the twelve month period ended December 31, 2004, had we consolidated these three VIEs for the three month period ended March 31, 2004. There was no impact on our net income as a result of the consolidation of these LLCs (amounts in thousands).

Twelve Months Ended December 31, 2004	As reported in Consolidated Statements of Income	Jan Mar, 2004	
		Combined Statements of Income for LLCs	As Adjusted
Revenues	\$ 31,777	\$ 1,646	\$ 33,423
Expenses:			
Depreciation and amortization	5,177	292	5,469
Advisory fee to UHS	1,498		1,498
Other operating expenses	5,000	559	5,559
Property write-down - hurricane damage Wellington	1,863		1,863
Property damage recoverable from UHS Wellington	(1,863)		(1,863)
	11,675	851	12,526
Income before equity in unconsolidated LLCs, hurricane recoveries in excess of expense and interest expense	20,102	795	20,897
Equity in income of unconsolidated LLCs (including gain on sale of real property of \$1,009)	4,967	(360)	4,607
Interest expense	(3,357)	(435)	(3,792)
Income from discontinued operations	1,959		1,959

Net Income	<u>\$ 23,671</u>	<u></u>	<u>\$ 23,671</u>
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During the fourth quarter of 2005, we sold our 48% non-controlling ownership interest in West Highland Holdings, a LLC which owned the St. Jude Heritage Health Complex, located in California, in exchange for a \$3.1 million note receivable which is collateralized by the entire ownership interest of the LLC. This transaction resulted in a deferred gain of \$1.9 million which we recognized as income during 2006 when the cash proceeds to repay the note receivable were received by us.

During the third quarter of 2005, Chalmette Medical Center, a 138-bed acute care hospital located in Chalmette, Louisiana, was severely damaged and closed as a result of Hurricane Katrina. At that time, the majority of the real estate assets of Chalmette were leased from us by a subsidiary of UHS and, in accordance with the terms of the lease, and as part of an overall evaluation of the leases between subsidiaries of UHS and us, UHS offered substitution properties rather than exercise its right to rebuild the facility or offer cash for Chalmette. During 2006, we executed an asset exchange and substitution agreement with UHS whereby we received, or are scheduled to receive, additional assets at Wellington, Bridgeway and Inland Valley in replacement of the Chalmette assets. See Note 2 to the consolidated financial statements for additional disclosure.

During the first quarter of 2005, Bayway properties, a LLC in which we owned a 73% non-controlling ownership interest, sold the real estate assets of the East Mesa Medical Center, located in Mesa, Arizona. Our share of the net sale proceeds resulting from this transaction was \$2.9 million. The transaction resulted in a gain of which our share was approximately \$1.0 million, which is included in our results of operations for 2005.

During the third quarter of 2004, Wellington Regional Medical Center, our 121-bed acute care facility located in West Palm Beach, Florida, sustained storm damage caused by a hurricane. This facility is leased by a wholly-owned subsidiary of UHS and pursuant to the terms of the lease, UHS is responsible for maintaining replacement cost property insurance for the facility, a substantial portion of which is insured by a commercial carrier. The facility did not experience significant business interruption. Our Consolidated Statements of Income for the year ended December 31, 2004, included a property write-down charge of \$1.9 million representing the estimated net book value of the damaged assets. This property charge was offset at that time by an equal amount recoverable from UHS. During 2004, UHS incurred approximately \$1.9 million in replacement costs in connection with this property and that amount was included as construction in progress on our Consolidated Balance Sheet as of December 31, 2004. During the twelve months ended December 31, 2005, UHS incurred an additional \$4.7 million in replacement costs and since these additional costs were also recovered from UHS, \$4.7 million was included in net income during the year ended December 31, 2005. As of December 31, 2005, UHS spent a total of approximately \$6.6 million to replace the damaged property at this facility and this amount is reflected as buildings and improvements on our Consolidated Balance Sheet. During the first quarter of 2004, the lessee of this facility completed and financed an \$8.5 million expansion to the facility in order to meet patient demand. Accordingly, since the bonus rent calculation on this facility is based on net revenues, the lease was amended at that time to exclude from the bonus rent calculation the estimated net revenues generated from the UHS-owned real estate assets (as calculated pursuant to a percentage based allocation determined at the time of expansion).

During the second quarter of 2004, Parkvale Properties sold the real property of the Parkvale Medical Building which is located in Phoenix, Arizona. Our share of the net sale proceeds resulting from this transaction was \$950,000 which is included as a gain on sale of real property in our results of operations for 2004, since the carrying value of this investment was reduced to zero in a prior year.

Upon the December, 2004 lease expiration on the Virtue Street Pavilion, the former lessee (a wholly-owned subsidiary of UHS), exercised its option pursuant to the terms of the lease and purchased the facility at its appraised fair market value of \$7,320,000. Prior to the transaction, the annual minimum rent payable to us under the lease was \$1,261,000 and no bonus rent was earned on this facility during 2004. As a result of this transaction, our cash flows from operating activities were adversely affected since calculated using our average incremental borrowing rate during 2005, the reduction in annual interest expense resulting from repayment of borrowings using the \$7.3 million of sale proceeds was approximately \$900,000 less than the annual rental

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payments earned by us pursuant to the terms of the lease. After adjusting for the decreased depreciation expense resulting from this transaction, our net income decreased approximately \$700,000 during 2005, as compared to 2004.

The following table shows the results of operations for the Virtue Street Pavilion which were reflected as Income from discontinued operations, net in the consolidated statements of income for the year ended December 31, 2004 (in thousands):

	Year Ended December 31,
	2004
Revenues	\$ 1,261
Depreciation expense	(135)
Income from operations	1,126
Gain on sale	833
Income from discontinued operations, net	\$ 1,959

Below is a reconciliation of our reported net income to FFO for 2005 and 2004 (in thousands):

	2005	2004
Net income	\$ 25,423	\$ 23,671
Depreciation expense:		
Consolidated investments	5,503	5,038
Unconsolidated affiliates	4,012	4,282
Less gains:		
Property damage recovered from UHS-Wellington	(4,693)	
Gains recorded by unconsolidated affiliates	(1,043)	(1,009)
Gain on sale of real property, included in income from discontinued operations		(833)
FFO	\$ 29,202	\$ 31,149

Our FFO decreased 6.3% or \$1.9 million to \$29.2 million 2005 as compared to \$31.1 million in 2004. This decrease in FFO was due primarily to:

an unfavorable change caused by an increase in other operating expenses of approximately \$1.2 million (excluding the impact of FIN 46R) resulting primarily from increased operating expenses related to our MOBs, increased administrative costs, including insurance expense, and an asset write-off charge recorded during 2005 in connection with building renovations at one of our MOBs;

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an unfavorable change of approximately \$900,000 resulting from the purchase of Virtue Street Pavilion by UHS in December of 2004 (net of interest expense savings on the \$7.3 million of sale proceeds received), and;

other combined favorable changes of approximately \$200,000.

Effects of Inflation

Although inflation has not had a material impact on our results of operations over the last three years, the healthcare industry is very labor intensive and salaries and benefits are subject to inflationary pressures as are rising supply costs which tend to escalate as vendors pass on the rising costs through price increases. Operators of our hospital facilities are experiencing the effects of the tight labor market, including a shortage of nurses which has caused and may continue to cause an increase, in excess of the inflation rate, in salaries, wages and benefits expense. In addition, due to unfavorable pricing and availability trends in the professional and general liability insurance markets, the cost of commercial professional and general liability insurance coverage has risen significantly. As a result, certain operators of our hospital facilities, including all of the facilities leased to subsidiaries of UHS, assumed a greater portion of the hospital professional and general liability risk. We cannot

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predict the ability of the operators of our facilities to continue to cover future cost increases. Therefore, there can be no assurance that a continuation of these trends will not have a material adverse effect on the future results of operations of the operators of our facilities which may affect their ability to make lease payments to us.

Most of our leases contain provisions designed to mitigate the adverse impact of inflation. Our hospital leases require all building operating expenses, including maintenance, real estate taxes and other costs, to be paid by the lessee. In addition, certain of the hospital leases contain bonus rental provisions, which require the lessee to pay additional rent to us based on increases in the revenues of the facility over a base year amount. In addition, most of our MOB leases require the tenant to pay an allocable share of operating expenses, including common area maintenance costs, insurance and real estate taxes. These provisions may reduce our exposure to increases in operating costs resulting from inflation. To the extent that some leases do not contain such provisions, our future operating results may be adversely impacted by the effects of inflation.

Liquidity and Capital Resources

Year ended December 31, 2006 as compared to December 31, 2005:

Net cash provided by operating activities

Net cash provided by operating activities was \$24.7 million during 2006 as compared to \$25.3 million during 2005. The \$601,000 net decrease was attributable to:

an unfavorable change of \$1.1 million due to a decrease in net income plus or minus the adjustments to reconcile net income to net cash provided by operating activities (depreciation and amortization, gain on sales of properties by LLCs, gain on sale of our interest in a LLC, property write-down from hurricane damage-Chalmette, property damage recoverable from UHS-Chalmette, property damage recovered from UHS (Chalmette and Wellington) and net loss on ineffective cash flow hedge);

a favorable change of \$574,000 in rent receivable;

a favorable change of \$140,000 in tenant reserves, escrows, deposits and prepaid rents;

an unfavorable change of \$136,000 in accrued interest, and;

\$79,000 of other unfavorable changes.

The \$1.1 million unfavorable change in net income plus or minus the adjustments to reconcile net income to net cash provided by operating activities was due to: (i) a \$1.3 million unfavorable change resulting from a decrease in equity in income of unconsolidated LLCs, as discussed above (excludes the gains from both periods); (ii) an \$823,000 favorable change resulting from a decrease in interest expense, as discussed above; (iii) an unfavorable change of \$257,000 due to an increase in other operating expenses, as discussed above, and; (iv) other combined

unfavorable changes of \$366,000.

Net cash (used in)/provided by investing activities

Net cash (used in)/provided by investing activities was (\$2.0 million) during 2006 as compared to \$8.4 million during 2005.

2006:

During 2006, we used \$2.0 million of net cash in investing activities as follows:

spent \$7.6 million to fund advances to unconsolidated LLCs;

spent \$5.3 million to fund equity investments in unconsolidated LLCs;

spent \$1.3 million to fund capital additions at certain of our consolidated real estate investments;

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received \$5.7 million of cash proceeds in connection with refinancing of third-party debt by an unconsolidated LLC;

received \$3.1 million of cash proceeds related to the sale of our interest in a LLC;

received \$1.9 million of repayments of advances made to unconsolidated LLCs, and;

received \$1.4 million of cash distributions in excess of income from our unconsolidated LLCs.

During 2006, we spent \$7.6 million to fund advances to unconsolidated LLCs as follows:

\$5.3 million advance made to a LLC that will develop, construct, own and operate the Spring Valley Hospital Medical Office Building II, located in Las Vegas, Nevada on the campus of a UHS facility, in which we have a 95% non-controlling equity interest. We have committed to a total of \$8.9 million of debt financing to this LLC, of which \$5.3 million has been funded as of December 31, 2006. This project is scheduled to be completed and opened during the second quarter of 2007;

\$630,000 advance made to the LLC that owns Rio Rancho Medical Center, an existing LLC in which we have a 80% non-controlling equity interest (subsequent to December 31, 2006, the real estate assets of this LLC were sold) ;

\$540,000 advance (which was fully repaid during the third quarter) made to a master LLC which governs four unconsolidated LLCs in which we have a 90% non-controlling equity interest;

\$485,000 advance made to the LLC that constructed and owns the Sierra San Antonio Medical Plaza, located in Fontana, California, in which we have a 95% non-controlling equity interest. The LLC also obtained a \$7.5 million third-party construction loan, which is non-recourse to us. This project was completed and opened during the first quarter of 2006;

\$363,000 advance made to the LLC that will develop, construct, own and operate the Phoenix Children's East Valley Care Center, located in Gilbert, Arizona, in which we have a 95% non-controlling equity interest. This project is scheduled to be completed and opened during the third quarter of 2007, and;

\$259,000 of advances made to various LLCs in which we own a non-controlling equity interest.

During 2006, we spent \$5.3 million spent to fund equity investments in unconsolidated LLCs as follows:

\$1.6 million of equity funded to the LLC that constructed and owns the Sierra San Antonio Medical Plaza, located in Fontana, California, in which we have a 95% non-controlling equity interest. We have committed to invest a total of up to \$3.5 million in equity in this LLC, of which \$2.6 million has been funded to date. The LLC also obtained a \$7.5 million third-party construction loan, which is non-recourse to us. This project was completed and opened during the first quarter of 2006;

\$1.5 million of equity funded to the LLC that will develop, construct, own and operate the Phoenix Children's East Valley Care Center, located in Gilbert, Arizona, in which we have a 95% non-controlling equity interest. We have committed to invest a total of up to \$3.5

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million in equity in this LLC. This project is scheduled to be completed and opened during the third quarter of 2007;

\$637,000 of additional equity funded to the LLC that constructed and owns the Saint Mary's Professional Office Building located in Reno, Nevada, in which we have a 75% non-controlling equity interest. We have committed to invest a total of \$8.0 million in equity in this LLC, of which \$5.0 million has been funded as of December 31, 2006. The LLC also obtained a \$29 million third-party mortgage that is non-recourse to us;

\$532,000 of additional equity funded to the LLC that owns the Desert Samaritan Hospital MOBs located in Mesa, Arizona, in which we have a 76% non-controlling equity interest;

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\$329,000 of additional equity funded to the LLC that owns the 700 Shadow Lane & Goldring MOBs located in Las Vegas, Nevada, in which we have a 98% non-controlling equity interest;

\$214,000 of additional equity funded to the LLC that owns the Spring Valley Medical Office Building located in Las Vegas, Nevada, on the campus of a UHS facility, in which we have a 95% non-controlling equity interest, and;

\$562,000 of additional investments in various LLCs in which we own a non-controlling equity interest.

Also during 2006, the \$1.9 million of cash received in connection with repayments of advances previously made to LLCs, was as follows:

\$1.2 million received from the LLC that owns the Suburban Medical Plaza II, located in Louisville, Kentucky, in which we have a 33% non-controlling equity interest;

\$540,000 received from the master LLC which governs four unconsolidated LLCs in which we have a 90% non-controlling equity interest, and;

\$160,000 received from various LLCs in which we own non-controlling equity interests.

2005:

During 2005, we generated \$8.4 million of net cash provided by investing activities as follows:

spent \$8.3 million to fund equity investments in unconsolidated LLCs;

spent \$2.9 million to fund advances to unconsolidated LLCs;

spent \$2.4 million to fund capital additions at certain of our consolidated real estate investments;

received \$9.6 million of repayments of advances made to unconsolidated LLCs;

received \$8.5 million of cash proceeds in connection with refinancing of third-party debt by unconsolidated LLCs;

received \$2.9 million of cash proceeds related to sales of properties by unconsolidated LLCs;

received \$1.0 million of cash distributions in excess of income from our unconsolidated LLCs.

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Included in the \$8.3 million of equity investments in unconsolidated LLCs and the \$2.9 million of advances made to unconsolidated LLCs during 2005 (\$11.2 million in total) was the following:

\$4.5 million of equity funded in connection with the purchase of a 75% non-controlling interest in a LLC that constructed and owns the Saint Mary's Center for Health located in Reno, Nevada, which opened in March, 2005;

\$2.5 million paid to an unrelated third-party member as net consideration in connection with the restructure of the ownership interests in five existing unconsolidated LLCs (see Note 9 to the consolidated financial statements);

\$1.0 million funded in exchange for a 95% non-controlling interest in a LLC that constructed and owns the Sierra San Antonio Medical Plaza, located in Fontana, California. This project was completed and opened during 2006;

\$235,000 of additional equity funded during the third quarter of 2005 to the LLC that owns the 700 Shadow Lane & Goldring MOBs located in Las Vegas, Nevada, in which we have a 98% non-controlling equity interest;

\$400,000 additional advance to a LLC that owns the Saint Mary's Center for Health, in connection with the purchase of a 75% non-controlling interest in the LLC (which was fully repaid during 2005);

\$680,000 advance made to Desert Samaritan Hospital MOBs, an existing LLC which we have a 76% non-controlling equity interest (which was fully repaid during 2005);

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\$425,000 advance made to Edwards Medical Plaza, an existing LLC in which we have a 90% non-controlling equity interest;

\$1.3 million advance made to Suburban Medical Plaza II, an existing LLC in which we have a 33% non-controlling equity interest, and;

\$85,000 advance made to Rio Rancho Medical Center, an existing LLC in which we have a 80% non-controlling equity interest (subsequent to December 31, 2006, the real estate assets of this LLC were sold).

Also during 2005, the \$9.6 million of cash received in connection with repayments of advances previously made to LLCs, was as follows:

\$6.5 million received as repaid advances previously provided to a LLC that owns the 700 Shadow Lane & Goldring MOBs located in Las Vegas, Nevada, in which we have a 98% non-controlling equity interest;

\$2.5 million received as repaid advances previously provided to a LLC that owns the Saint Mary's Center for Health located in Reno, Nevada, in which we have a 75% non-controlling equity interest, and;

\$680,000 received as repaid advances previously provided to a LLC that owns the Desert Samaritan Hospital MOBs located in Mesa, Arizona, in which we have a 76% non-controlling equity interest.

Net cash used in financing activities

Net cash used in financing activities was \$23.2 million during 2006 and \$35.6 million during 2005.

During 2006, we had net debt borrowings of \$3.6 million on our revolving line of credit, paid \$26.6 million of dividends, paid \$577,000 on mortgage notes payable that are non-recourse to us and generated \$391,000 of net cash from the issuance of shares of beneficial interest.

During 2005, we had net debt repayments of \$10.0 million on our revolving line of credit, paid \$25.6 million in dividends, paid \$662,000 on mortgage notes payable that are non-recourse to us and generated \$668,000 of cash from the issuance of shares of beneficial interest.

We expect to meet our short-term liquidity requirements generally through our available working capital and net cash provided by operations. We believe that our net cash provided by operations will be sufficient to allow us to make any distributions necessary to enable us to continue to qualify as a REIT under Sections 856 to 860 of the Internal Revenue Code of 1986.

Year ended December 31, 2005 as compared to December 31, 2004:

Net cash provided by operating activities

Net cash provided by operating activities was \$25.3 million during 2005 as compared to \$27.0 million during 2004.

The \$1.7 million net unfavorable change during 2005, as compared to 2004, was primarily attributable to: (i) a \$1.4 million unfavorable change in net income plus or minus the adjustments to reconcile net income to net cash provided by operating activities (depreciation and amortization, gains on sales of properties by LLCs, gain on sale of real property, property write-down from hurricane damage at Wellington, property write-down from hurricane damage at Chalmette, property damage recovered from UHS-Wellington, property damage recoverable from UHS-Chalmette and net loss on ineffective cash flow hedge); (ii) a \$537,000 unfavorable change in rent receivable, and; (iii) \$264,000 favorable change in accrued expenses and other liabilities.

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The \$1.4 million unfavorable change in net income plus or minus the adjustments to reconcile net income to net cash provided by operating activities was due primarily to: (i) an unfavorable change of approximately \$1.2 million resulting from an increase in other operating expenses, as mentioned above (excluding the impact of FIN 46R); (ii) an unfavorable change of approximately \$900,000 resulting from the purchase of the Virtue Street Pavilion by UHS in December of 2004 (net of interest expense savings on the \$7.3 million of sale proceeds received); (iii) a favorable change of approximately \$300,000 resulting from the add-back of additional depreciation and amortization expense incurred by three LLCs that we began including in our financial statements, on a consolidated basis, on April 1, 2004 as a result of FIN 46R, and; (iv) \$400,000 of other favorable changes including a decrease in interest expense.

Net cash provided by investing activities

Net cash provided by investing activities was \$8.4 million during 2005, as discussed above, as compared to \$11.9 million during 2004.

During 2004, we generated \$11.9 million of net cash provided by investing activities as follows:

spent \$2.8 million to fund equity investments in unconsolidated LLCs;

spent \$1.4 million to fund advances to unconsolidated LLCs;

spent \$528,000 to fund capital additions at certain of our consolidated real estate investments;

received \$7.3 million of cash proceeds in connection with the sale of Virtue Street Pavilion;

received \$6.4 million of cash proceeds in connection with the 2003 sales by two LLCs that owned the real estate assets of Skypark Professional Medical Office Building and Pacifica Palms Medical Plaza;

received \$800,000 of cash proceeds in connection with refinancing of third-party debt by unconsolidated LLCs;

received \$1.0 million of cash proceeds related to sale of property by an unconsolidated LLC, and;

received \$1.0 million of cash distributions in excess of income from our unconsolidated LLCs.

During 2004, we invested a total of \$4.2 million in the following (consisting of \$2.8 million of investments in LLCs and \$1.4 million of advances made to LLCs):

\$2.1 million funded in connection with the purchase of a 95% non-controlling equity interest in a LLC that owns the Spring Valley Medical Office Building located in Las Vegas, Nevada;

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\$830,000 additional net loan funded in connection our 75% non-controlling equity interest in a LLC that owns the St. Mary's Center for Health located in Reno, Nevada;

\$600,000 additional net loan funded in connection with 98% non-controlling equity interest in the Gold Shadow Properties LLC;

\$700,000 of additional investments in various LLCs in which we own a non-controlling equity interest.

Net cash used in financing activities

Net cash used in financing activities was \$35.6 million during 2005, as discussed above, and \$36.4 million during 2004.

During 2004, we: (i) paid dividends of \$23.5 million; (ii) repaid \$13.0 million of revolving credit facility borrowings; (iii) repaid \$435,000 of mortgage notes payable, and; (iv) received \$593,000 of proceeds from the issuance of shares of beneficial interest during 2004.

Table of Contents**Credit facilities and mortgage debt**

In January 2007, we entered into a new unsecured \$100 million revolving credit agreement (the Agreement) which expires on January 19, 2012. We have a one time option, which can be exercised at any time, subject to bank approval, to increase the amount by \$50 million for a total commitment of \$150 million. The Agreement provides for interest at our option, at the Eurodollar rate plus .75% to 1.125%, or the prime rate plus zero to .125%. A fee of .15% to .225% is paid on the unused portion of the commitment. The margins over the Eurodollar, prime rate and commitment fee are based upon our debt to total capital ratio as defined by the Agreement. As of January 2007, the applicable margin over the Eurodollar rate was .75%, the prime rate was zero, and the commitment fee was .15%

At December 31, 2006, we had \$13.6 million of outstanding borrowings and \$18.9 million of letters of credit outstanding against the previous revolving credit agreement. After giving effect to the increased borrowing capacity in the Agreement entered into in January of 2007, we had \$67.5 million of available borrowing capacity, net of the outstanding borrowings and letters of credit outstanding as of December 31, 2006. There are no compensating balance requirements. The Agreement contains a provision whereby the commitments will be reduced by 50% of the proceeds generated from any new equity offering. The average amounts outstanding under our previous revolving credit agreement were \$11.9 million in 2006, \$12.0 million in 2005, and \$26.4 million in 2004 with corresponding effective interest rates, including commitment fees and interest rate swap expense, of 7.9% in 2006, 9.0% in 2005, and 7.0% in 2004. The carrying value of the amounts borrowed approximates fair market value.

Covenants relating to the Agreement require the maintenance of a minimum tangible net worth and specified financial ratios, limit our ability to incur additional debt, limit the aggregate amount of mortgage receivables and limit our ability to increase dividends in excess of 95% of cash available for distribution, unless additional distributions are required to comply with the applicable section of the Internal Revenue Code and related regulations governing real estate investment trusts. We were in compliance with all of the covenants at the time we entered the Agreement. The carrying value of this instrument approximates fair value.

We have two mortgages, which are non-recourse to us, included on our consolidated balance sheet as of December 31, 2006, with a combined outstanding balance of \$12.7 million. Both mortgages carry an interest rate of 8.3% and both have maturity dates in 2010. The mortgages are secured by the real property of the buildings as well as property leases and rents. These two mortgages have a combined fair value of approximately \$13.7 million as of December 31, 2006. Changes in market rates on our fixed rate debt impacts the fair value of debt, but it has no impact on interest incurred or cash flow.

The following represents the scheduled maturities of our contractual obligations as of December 31, 2006:

<u>Contractual Obligation</u>	<u>Payments Due by Period (dollars in thousands)</u>				
	<u>Total</u>	<u>Less than 1 Year</u>	<u>2-3 years</u>	<u>4-5 years</u>	<u>After 5 years</u>
Long-term debt fixed(a)	\$ 12,737	\$ 332	\$ 755	\$ 11,650	\$
Long-term debt-variable(b)	13,600				13,600
Estimated future interest payments on debt outstanding as of December 31, 2006(c)	8,131	1,953	3,739	2,394	45
Equity and debt financing commitments(d)	28,415	28,415			
Total contractual cash obligations	\$ 62,883	\$ 30,700	\$ 4,494	\$ 14,044	\$ 13,645

- (a) Consists of two mortgages, which are non-recourse to us, included on our consolidated balance sheet as of December 31, 2006. Excluded from the table above is the \$180.9 million of combined third-party debt outstanding as of December 31, 2006, that is non-recourse to us, at the unconsolidated LLCs in which we hold various non-controlling ownership interests (see Note 9 to the consolidated financial statements).

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- (b) Consists of borrowings outstanding under the terms of our new \$100 million revolving credit agreement entered into in January of 2007.
- (c) Assumes that all debt outstanding as of December 31, 2006, including borrowings under our revolving credit agreement and two mortgage notes payable which are non-recourse to us, remain outstanding until the final maturity of the debt agreements at the same interest rates which were in effect as of December 31, 2006. We have the right to repay borrowings under the revolving credit agreement at any time during the term of the agreement, without penalty.
- (d) As of December 31, 2006, we have equity investment and debt financing commitments remaining in connection with our investments in various LLCs, as follows (in thousands):

	Amount
Arlington Medical Properties	\$ 2,800
Sierra Medical Properties	400
Spring Valley Medical Properties II	6,921
PCH Southern Properties	1,600
Centennial Hills Medical Properties	6,547
Canyon Healthcare Properties	5,933
Palmdale Medical Properties	4,214
	<hr/>
Total	\$ 28,415
	<hr/>

Off Balance Sheet Arrangements

As of December 31, 2006, we are party to certain off balance sheet arrangements consisting of standby letters of credit and equity and debt financing commitments as detailed on the above Contractual Obligations table. Our outstanding letters of credit at December 31, 2006 totaled \$18.9 million consisting of: (i) \$600,000 related to 653 Town Center, Phase II; (ii) \$900,000 related to Arlington Medical Properties, (iii) \$600,000 related to Spring Valley Medical Properties; (iv) \$1.3 million related to Sierra Medical Properties; (v) \$200,000 related to Gold Shadow Properties; (vi) \$6.0 million related to Centennial Hills Medical Properties, (vii) \$5.4 million related to Canyon Healthcare Properties, (viii) \$3.9 million related to Palmdale Medical Properties.

ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk**Market Risks Associated with Financial Instruments**

Our interest expense is sensitive to changes in the general level of interest rates. To mitigate the impact of fluctuations in interest rates, we have, from time to time, fixed the rate on a portion of our debt by entering into interest rate swap agreements. Interest rate swap agreements are contracts that require us to pay a fixed rate and receive a floating interest rate over the life of the agreements. The floating-rates are based on LIBOR and the fixed-rates are determined upon commencement of the swap agreements. We do not hold or issue derivative instruments for trading purposes and we are not a party to any instruments with leverage features. We are exposed to credit losses in the event of nonperformance by the counterparties to our financial instruments.

As of December 31, 2006, we had no outstanding interest rate swap agreements. As of December 31, 2005 we had one outstanding swap agreement having a total notional principal amount of \$10 million which matured in July, 2006. As of December 31, 2004, we had two outstanding swap agreements having a total notional principal amount of \$20 million, one which, as previously mentioned, had a notional principal amount of \$10 million that matured in July, 2006 and one that had a notional principal amount of \$10 million that was terminated

during 2005.

Additional interest expense recorded as a result of our hedging activity, was \$62,000, \$431,000 and \$1,106,000 in 2006, 2005 and 2004, respectively. For the years ended December 31, 2006, 2005 and 2004, we received a weighted average rate of 4.8%, 3.2% and 1.4%, respectively, and paid a weighted average rate on our interest rate swap agreements of 6.9%, 6.1% and 7.0% in 2006, 2005 and 2004, respectively (including the revolver spread of 1.00% in 2006, 2005 and 2004).

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The sensitivity analysis related to our fixed-rate debt assumes an immediate 100 basis point move in interest rates from their 2005 levels, with all other variables held constant. A 100 basis point increase in market interest rates would result in an decrease in the fair value of our fixed-rate debt by approximately \$105,000. A 100 basis point decrease in market interest rates would result in an increase in the fair value of our fixed-rate debt by approximately \$109,000.

The table below presents information about our derivative financial instruments that are sensitive to changes in interest rates, including debt obligations as of December 31, 2006. For debt obligations, the table presents principal cash flows and related weighted average interest rates by contractual maturity dates.

(Dollars in thousands)	Maturity Date, Year Ending December 31						Total
	2007	2008	2009	2010	2011	Thereafter	
Long-term debt:							
Fixed rate	\$ 332	\$ 361	\$ 394	\$ 11,650			\$ 12,737
Weighted average interest rates	8.3%	8.3%	8.3%	8.3%			
Variable rate long-term debt (a)						\$ 13,600	\$ 13,600

(a) Consists of borrowings outstanding under the terms of our \$100 million revolving credit agreement, as amended in January of 2007.

ITEM 8. Financial Statements and Supplementary Data

Our Consolidated Balance Sheets, Consolidated Statements of Income, Shareholders' Equity and Cash Flows, together with the report of KPMG LLP, independent public accountants, are included elsewhere herein. Reference is made to the Index to Financial Statements and Schedule.

ITEM 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

ITEM 9A. Controls and Procedures**Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures**

As of December 31, 2006, under the supervision and with the participation of our management, including our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), we performed an evaluation of the effectiveness of our disclosure controls and procedures as defined in Rule 13a-15(e) or Rule 15d-15(e) under the Securities and Exchange Act of 1934, as amended (the 1934 Act). Based on this evaluation, the CEO and CFO have concluded that our disclosure controls and procedures are effective to ensure that material information is recorded, processed, summarized and reported by management on a timely basis in order to comply with our disclosure obligations under the Securities and Exchange Act of 1934 and the SEC rules thereunder.

Changes in Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting or in other factors during the fourth quarter of 2006 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Management's Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining an adequate system of internal control over our financial reporting. In order to evaluate the effectiveness of internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act, management has conducted an assessment, including testing, using the criteria in *Internal Control - Integrated Framework*, issued by the Committee of Sponsoring Organizations of

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the Treadway Commission (COSO). Our system of internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation and fair presentation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness of internal control over financial reporting to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Based on its assessment, management has concluded that we maintained effective internal control over financial reporting as of December 31, 2006, based on criteria in *Internal Control – Integrated Framework*, issued by the COSO. Management’s assessment of the effectiveness of our internal control over financial reporting as of December 31, 2006, has been audited by KPMG LLP, an independent registered public accounting firm, as stated in their report which is included herein.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Shareholders and Board of Trustees

Universal Health Realty Income Trust:

We have audited management's assessment, included in the accompanying *Management's Report on Internal Control over Financial Reporting*, that Universal Health Realty Income Trust maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Universal Health Realty Income Trust's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Universal Health Realty Income Trust maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, Universal Health Realty Income Trust maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Universal Health Realty Income Trust and subsidiaries as of December 31, 2006 and 2005, and the related consolidated

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statements of income, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2006, and our report dated March 14, 2007, expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Philadelphia, Pennsylvania

March 14, 2007

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ITEM 9B. *Other Information*

None.

PART III

ITEM 10. *Directors and Executive Officers of the Registrant*

The information requested by this item is hereby incorporated herein by reference to our definitive Proxy Statement to be filed with the Securities and Exchange Commission within 120 days after December 31, 2006. See also *Executive Officers of the Registrant* appearing in Part I hereof.

ITEM 11. *Executive Compensation*

The information requested by this item is hereby incorporated herein by reference to our definitive Proxy Statement to be filed with the Securities and Exchange Commission within 120 days after December 31, 2006.

ITEM 12. *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters*

The information requested by this item is hereby incorporated herein by reference to our definitive Proxy Statement to be filed with the Securities and Exchange Commission within 120 days after December 31, 2006.

ITEM 13. *Certain Relationships and Related Transactions*

The information requested by this item is hereby incorporated herein by reference to our definitive Proxy Statement to be filed with the Securities and Exchange Commission within 120 days after December 31, 2006.

ITEM 14. *Principal Accounting Fees and Services*

There is hereby incorporated herein by reference the information to appear under the caption *Relationship with Independent Auditor* in our Proxy Statement, to be filed with the Securities and Exchange Commission within 120 days after December 31, 2006.

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PART IV

ITEM 15. *Exhibits, Financial Statement Schedules*

(a) Documents filed as part of this report:

- (1) Financial Statements: See Index to Financial Statements and Financial Statement Schedules.
- (2) Financial Statement Schedules: See Index to Financial Statements and Financial Statement Schedules.
- (3) Exhibits:

3.1 Declaration of Trust, dated as of August 1986, previously filed as Exhibit 4.1 to the Trust's Registration Statement on Form S-3 (File No. 333-60638) is incorporated herein by reference.

3.2 Amendment to Declaration of Trust, dated as of June 15, 1993, previously filed as Exhibit 4.2 to the Trust's Registration Statement on Form S-3 (File No. 333-60638) is incorporated herein by reference.

3.3 Amended and restated bylaws previously filed as Exhibit 4.3 to the Trust's registration statement on Form S-3 (File No. 333-60638) is incorporated herein by reference.

10.1 Advisory Agreement, dated as of December 24, 1986, between UHS of Delaware, Inc. and the Trust, previously filed as Exhibit 10.2 to the Trust's Current Report on Form 8-K dated December 24, 1986, is incorporated herein by reference.

10.2 Agreement dated December 29, 2006, to renew Advisory Agreement dated as of December 24, 1986 between Universal Health Realty Income Trust and UHS of Delaware, Inc.

10.3 Contract of Acquisition, dated as of August 1986, between the Trust and certain subsidiaries of Universal Health Services, Inc., previously filed as Exhibit 10.2 to Amendment No. 3 of the Registration Statement on Form S-11 and S-2 of Universal Health Services, Inc. and the Trust (File No. 33-7872), is incorporated herein by reference.

10.4 Form of Leases, including Form of Master Lease Document Leases, between certain subsidiaries of Universal Health Services, Inc. and the Trust, previously filed as Exhibit 10.3 to Amendment No. 3 of the Registration Statement on Form S-11 and Form S-2 of Universal Health Services, Inc. and the Trust (File No. 33-7872), is incorporated herein by reference.

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10.5 Corporate Guaranty of Obligations of Subsidiaries Pursuant to Leases and Contract of Acquisition, dated December 1986, issued by Universal Health Services, Inc. in favor of the Trust, previously filed as Exhibit 10.5 to the Trust's Current Report on Form 8-K dated December 24, 1986, is incorporated herein by reference.

10.6* Share Compensation Plan for Outside Trustees, previously filed as Exhibit 10.12 to the Trust's Annual Report on Form 10-K for the year ended December 31, 1991, is incorporated herein by reference.

10.7 Lease, dated December 22, 1993, between the Trust and THC-Chicago, Inc., as lessee, previously filed as Exhibit 10.14 to the Trust's Annual Report on Form 10-K for the year ended December 31, 1993, is incorporated herein by reference.

10.8* Universal Health Realty Income Trust 1997 Incentive Plan, previously filed as Exhibit 10.1 to the Trust's Form 10-Q for the quarter ended September 30, 1997, is incorporated herein by reference.

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10.9 Credit Agreement, dated as of January 19, 2007, by and among the Trust, the financial institutions from time to time party thereto and Wachovia Bank, National Association, as Administrative Agent, previously filed as Exhibit 10.1 to the Trust's Current Report on Form 8-K dated January 24, 2007, is incorporated herein by reference.

10.10 Dividend Reinvestment and Share Purchase Plan included in the Trust's Registration Statement Form S-3 (Registration No. 333-81763) filed on June 28, 1999, is incorporated herein by reference.

10.11 Asset Exchange and Substitution Agreement, dated as of April 24, 2006, by and among the Trust and Universal Health Services, Inc. and certain of its subsidiaries, previously filed as Exhibit 10.1 to the Trust's Current Report on Form 8-K dated April 25, 2006, is incorporated herein by reference.

10.12 Amendment No. 1 to the Master Lease Document, between certain subsidiaries of Universal Health Services, Inc. and the Trust, previously filed as Exhibit 10.2 to the Trust's Current Report on Form 8-K dated April 25, 2006, is incorporated herein by reference.

11 Statement re computation of per share earnings is set forth on the Consolidated Statements of Income.

21 Subsidiaries of Registrant.

23.1 Consent of Independent Registered Public Accounting Firm.

31.1 Certification from the Trust's Chief Executive Officer Pursuant to Rule 13a-14(a)/15(d)-14(a) of the Securities Exchange Act of 1934.

31.2 Certification from the Trust's Chief Financial Officer Pursuant to Rule 13a-14(a)/15(d)-14(a) of the Securities Exchange Act of 1934.

32.1 Certification from the Trust's Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as Adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification from the Trust's Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as Adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Management contract or compensatory plan or arrangement.

Exhibits, other than those incorporated by reference, have been included in copies of this Annual Report filed with the Securities and Exchange Commission. Shareholders of the Trust will be provided with copies of those exhibits upon written request to the Company.

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Charles F. Boyle

(Principal Financial and Accounting Officer)

/s/ CHERYL K. RAMAGANO

Vice President, Treasurer and Secretary

March 14, 2007

Cheryl K. Ramagano

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Shareholders and Board of Trustees

Universal Health Realty Income Trust:

We have audited the consolidated balance sheets of Universal Health Realty Income Trust and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2006. In connection with our audits of the consolidated financial statements, we also have audited financial statement schedule III. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Universal Health Realty Income Trust and subsidiaries as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the related financial statement schedule referred to above, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Universal Health Realty Income Trust's internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 14, 2007, expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

/s/ KPMG LLP

Philadelphia, Pennsylvania

March 14, 2007

Table of Contents**UNIVERSAL HEALTH REALTY INCOME TRUST****CONSOLIDATED BALANCE SHEETS**

(dollar amounts in thousands)

	<u>December 31,</u> <u>2006</u>	<u>December 31,</u> <u>2005</u>
ASSETS:		
Real Estate Investments:		
Buildings and improvements	\$ 171,761	\$ 187,451
Accumulated depreciation	(56,935)	(57,729)
	<u>114,826</u>	<u>129,722</u>
Land	19,317	23,143
Construction in progress	9,220	
	<u>143,363</u>	<u>152,865</u>
Net Real Estate Investments	143,363	152,865
Investments in and advances to limited liability companies (LLCs)	47,223	29,572
Other Assets:		
Cash and cash equivalents	798	1,717
Bonus rent receivable from UHS	1,025	1,088
Rent receivable-other	814	1,000
Note receivable from sale of property		3,102
Property replacement receivable from UHS Chalmette		6,259
Deferred charges and other assets, net	916	1,286
	<u>194,139</u>	<u>196,889</u>
Total Assets	\$ 194,139	\$ 196,889
LIABILITIES AND SHAREHOLDERS' EQUITY:		
Liabilities:		
Line of credit borrowings	\$ 13,600	\$ 10,000
Mortgage note payable, non-recourse to us	3,849	3,972
Mortgage notes payable of consolidated LLCs, non-recourse to us	8,888	21,576
Deferred gain on sale of our interest in an unconsolidated LLC		1,860
Accrued interest	84	357
Accrued expenses and other liabilities	2,857	2,575
Fair value of derivative instruments		100
Tenant reserves, escrows, deposits and prepaid rents	595	697
	<u>29,873</u>	<u>41,137</u>
Total Liabilities	29,873	41,137
Minority interests	69	302
Shareholders' Equity:		
Preferred shares of beneficial interest, \$.01 par value; 5,000,000 shares authorized; none issued and outstanding		
Common shares, \$.01 par value; 95,000,000 shares authorized; issued and outstanding: 2006 11,791,950; 2005 11,777,829	118	118

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Capital in excess of par value	187,524	186,943
Cumulative net income	304,874	270,177
Accumulated other comprehensive loss		(100)
Cumulative dividends	(328,319)	(301,688)
	<u> </u>	<u> </u>
Total Shareholders' Equity	164,197	155,450
	<u> </u>	<u> </u>
Total Liabilities and Shareholders' Equity	\$ 194,139	\$ 196,889
	<u> </u>	<u> </u>

See the accompanying notes to these consolidated financial statements.

Table of Contents**UNIVERSAL HEALTH REALTY INCOME TRUST****CONSOLIDATED STATEMENTS OF INCOME**

(amounts in thousands, except per share amounts)

	Year ended December 31,		
	2006	2005	2004
Revenues (Note 1):			
Base rental UHS facilities	\$ 12,448	\$ 12,567	\$ 12,481
Base rental Non-related parties	11,860	12,237	11,275
Bonus rental UHS facilities	4,317	4,509	4,668
Tenant reimbursements and other Non-related parties	3,584	3,622	2,962
Tenant reimbursements and other UHS facilities	300	403	391
	<u>32,509</u>	<u>33,338</u>	<u>31,777</u>
Expenses:			
Depreciation and amortization	5,757	5,825	5,177
Advisory fees to UHS (Note 2)	1,424	1,420	1,498
Other operating expenses	6,547	6,667	5,000
Property write-down hurricane damage Chalmette		6,259	
Property write-down hurricane damage Wellington			1,863
Property replacement recoverable from UHS Chalmette		(6,259)	
Property damage recoverable from UHS Wellington			(1,863)
	<u>13,728</u>	<u>13,912</u>	<u>11,675</u>
Income before equity in unconsolidated limited liability companies (LLCs), property damage recovered from UHS, and interest expense	18,781	19,426	20,102
Equity in income of unconsolidated LLCs (including recognition of previously deferred gain of \$1,860 on sale of our interest in an unconsolidated LLC during 2006 and gains on sales of real properties of \$1,043 and \$1,009 during 2005 and 2004, respectively)	4,241	4,602	4,967
Replacement property recovered from UHS Chalmette	13,958		
Property damage recovered from UHS Wellington		4,693	
Interest expense, net	(2,283)	(3,298)	(3,357)
	<u>34,697</u>	<u>25,423</u>	<u>21,712</u>
Income from discontinued operations, net (including gain on sale of real property of \$833 during 2004)			1,959
Net Income	<u>\$ 34,697</u>	<u>\$ 25,423</u>	<u>\$ 23,671</u>
Basic earnings per share:			
From continuing operations	\$ 2.94	\$ 2.16	\$ 1.85
From discontinued operations			\$ 0.17
	<u>\$ 2.94</u>	<u>\$ 2.16</u>	<u>\$ 2.02</u>

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Diluted earnings per share:			
From continuing operations	\$ 2.92	\$ 2.15	\$ 1.84
From discontinued operations			\$ 0.16
	<u> </u>	<u> </u>	<u> </u>
Total diluted earnings per share	\$ 2.92	\$ 2.15	\$ 2.00
	<u> </u>	<u> </u>	<u> </u>
Weighted average number of shares outstanding Basic	11,784	11,764	11,744
Weighted average number of share equivalents	82	77	69
	<u> </u>	<u> </u>	<u> </u>
Weighted average number of shares and equivalents outstanding Diluted	11,866	11,841	11,813
	<u> </u>	<u> </u>	<u> </u>

See the accompanying notes to these consolidated financial statements.

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UNIVERSAL HEALTH REALTY INCOME TRUST

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

For the Years Ended December 31, 2006, 2005 and 2004

(amounts in thousands, except per share amounts)

	Common Shares		Capital in excess of par value	Cumulative net income	Cumulative dividends	Accumulated Other comprehensive (loss)/income	Total
	Number of Shares	Amount					
January 1, 2004	11,736	\$ 117	\$ 185,675	\$ 221,083	(\$ 252,612)	(\$ 2,065)	\$ 152,198
Issuance of shares of beneficial interest	20	1	600				601
Dividends (\$2.00/share)					(23,488)		(23,488)
Comprehensive income:							
Net income				23,671			23,671
Adjustment for settlement amounts reclassified into income						1,106	1,106
Unrealized derivative losses on cash flow hedges						(35)	(35)
Total comprehensive income				23,671		1,071	24,742
December 31, 2004	11,756	118	186,275	244,754	(276,100)	(994)	154,053
Issuance of shares of beneficial interest	22		668				668
Dividends (\$2.175/share)					(25,588)		(25,588)
Comprehensive income:							
Net income				25,423			25,423
Adjustment for settlement amounts reclassified into income						863	863
Unrealized derivative gains on cash flow hedges						31	31
Total comprehensive income				25,423		894	26,317
December 31, 2005	11,778	118	186,943	270,177	(301,688)	(100)	155,450
Issuance of shares of beneficial interest	14		499				499
Dividends (\$2.26/share)					(26,631)		(26,631)
Stock-based compensation expense			82				82
Comprehensive income:							
Net income				34,697			34,697
Adjustment for settlement amounts reclassified into income						62	62
Unrealized derivative gains on cash flow hedges						38	38

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Total comprehensive income				34,697		100	34,797
December 31, 2006	11,792	\$ 118	\$ 187,524	\$ 304,874	(\$ 328,319)	\$	\$ 164,197

See the accompanying notes to these consolidated financial statements.

Table of Contents**UNIVERSAL HEALTH REALTY INCOME TRUST****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(amounts in thousands)

	Year ended December 31,		
	2006	2005	2004
Cash flows from operating activities:			
Net income	\$ 34,697	\$ 25,423	\$ 23,671
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	5,757	5,825	5,312
Gains on sales of properties by LLCs		(1,043)	(1,009)
Gain on sale of our interest in a LLC	(1,860)		
Gain on sale of real property			(833)
Property write-down from hurricane damage Wellington			1,863
Property write-down from hurricane damage Chalmette		6,259	
Property damage recoverable from UHS Chalmette		(6,259)	
Property damage recovered from UHS Chalmette	(13,958)		
Property damage recovered from UHS Wellington		(4,693)	(1,863)
Net loss on ineffective cash flow hedge		254	
Changes in assets and liabilities:			
Rent receivable	6	(568)	(31)
Accrued expenses and other liabilities	386	354	90
Tenant reserves, escrows, deposits and prepaid rents	134	(6)	22
Accrued interest	(196)	(60)	(101)
Other, net	(264)	(183)	(154)
Net cash provided by operating activities	24,702	25,303	26,967
Cash flows from investing activities:			
Investments in limited liability companies (LLCs)	(5,332)	(8,281)	(2,764)
Repayments of advances made to LLCs	1,949	9,631	
Advances made to LLCs	(7,573)	(2,902)	(1,375)
Cash distributions in excess of income from LLCs	1,399	954	1,038
Cash escrow account distributions/(deposits) from LLC sale proceeds			6,405
Proceeds received from sale of our interest in a LLC	3,102		
Cash distributions from sales of properties by LLCs		2,851	1,009
Cash distributions of refinancing proceeds from LLCs	5,704	8,499	800
Cash received from sale of real property			7,320
Additions to real estate investments	(1,294)	(2,391)	(528)
Proceeds received from sale of minority ownership interest in LLC		47	
Net cash (used in) provided by investing activities	(2,045)	8,408	11,905
Cash flows from financing activities:			
Net borrowings/(repayments) on line of credit	3,600	(10,000)	(13,057)
Repayments of mortgage notes payable of consolidated LLCs	(454)	(551)	(333)
Repayments of mortgage notes payable	(123)	(111)	(102)
Dividends paid	(26,631)	(25,588)	(23,488)
Issuance of shares of beneficial interest	499	668	593
Dividend reinvestment receivable	(108)		

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Net cash used in financing activities	(23,217)	(35,582)	(36,387)
(Decrease) increase in cash	(560)	(1,871)	2,485
(Decrease) increase in cash due to recording of LLCs on unconsolidated/consolidated basis	(359)		475
Cash and cash equivalents, beginning of year	1,717	3,588	628
Cash and cash equivalents, end of year	\$ 798	\$ 1,717	\$ 3,588
Supplemental disclosures of cash information:			
Interest paid	\$ 2,661	\$ 3,104	\$ 3,582
Supplemental disclosures of non-cash information:			
Replacement property capitalized UHS Wellington	\$ 8,923		
Replacement property capitalized UHS Bridgeway	4,072		
Replacement property CIP UHS Inland Valley	9,219		
Assets exchanged Chalmette	(8,259)		
Property damage costs capitalized UHS Wellington		4,693	1,863
(Decrease) increase in net property due to recording of LLCs on unconsolidated/consolidated basis	(25,571)		38,299
(Decrease) increase in debt due to recording of LLCs on unconsolidated/consolidated basis	(12,234)		22,460

See the accompanying notes to these consolidated financial statements.

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UNIVERSAL HEALTH REALTY INCOME TRUST
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2006

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Universal Health Realty Income Trust and subsidiaries (the Trust) is organized as a Maryland real estate investment trust. We invest in healthcare and human service related facilities including acute care hospitals, behavioral healthcare facilities, rehabilitation hospitals, sub-acute facilities, surgery centers, childcare centers and medical office buildings. As of December 31, 2006, we have forty-five real estate investments or commitments located in fifteen states consisting of:

six hospital facilities including three acute care, one behavioral healthcare, one rehabilitation and one sub-acute;

thirty-five medical office buildings (including five being constructed), and;

four pre-school and childcare centers.

Since we have significant investments in six hospital facilities, which comprised 56%, 55% and 58% of net revenues in 2006, 2005 and 2004, respectively, we are subject to certain industry risk factors which directly impact the operating results of our lessees. In recent years, an increasing number of legislative initiatives have been introduced or proposed in Congress and in state legislatures that would effect major changes in the healthcare system, either nationally or at the state level. In addition, the healthcare industry has been characterized in recent years by increased competition and consolidation. Four of our six hospital facilities and all or a portion of seven medical office buildings are or may be leased to subsidiaries of Universal Health Services, Inc., (UHS).

Management is unable to predict the effect, if any, that the industry factors discussed above will have on the operating results of our lessees or on their ability to meet their obligations under the terms of their leases with us. Management's estimate of future cash flows from our leased properties could be materially affected in the near term, if certain of the leases are not renewed at the end of their lease terms.

Revenue Recognition

Our revenues consist primarily of rentals received from tenants, which are comprised of minimum rent (base rentals), bonus rentals and reimbursements from tenants for their pro-rata share of expenses such as common area maintenance costs, real estate taxes and utilities.

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The minimum rent for all hospital facilities is fixed over the initial term or renewal term of the respective leases. Rental income recorded by our consolidated and unconsolidated medical office buildings (MOBs) relating to leases in excess of one year in length, is recognized using the straight-line method under which contractual rents are recognized evenly over the lease term regardless of when payments are due. The amount of rental revenue resulting from straight-line rent adjustments is dependent on many factors including the nature and amount of any rental concessions granted to new tenants, scheduled rent increases under existing leases, as well as the acquisitions and sales of properties that have existing in-place leases. As a result, the straight-line adjustments to rental revenue may vary from period-to-period. Bonus rents are recognized when earned based upon increases in each facility's net revenue in excess of stipulated amounts. Bonus rentals are determined and paid each quarter based upon a computation that compares the respective facility's current quarter's revenue to the corresponding quarter in the base year. Tenant reimbursements for operating expenses are accrued as revenue in the same period the related expenses are incurred.

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Cash and Cash Equivalents

We consider all highly liquid investment instruments with original maturities of three months or less to be cash equivalents.

Real Estate Properties

We record acquired real estate at cost and use the straight-line method to calculate depreciation expense for buildings and improvements over their estimated useful lives of 25 to 45 years.

We follow the provisions of FASB Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. The Statement establishes a single accounting model for long-lived assets to be disposed of by sale. It requires companies to report separately discontinued operations, and extends that reporting for all periods presented to a component of an entity that either has been disposed of or is classified as held for sale. Additionally, SFAS No. 144 requires that assets and liabilities of components held for sale, if material, be disclosed separately in the balance sheet.

It is our policy to review the carrying value of long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. Measurement of the impairment loss is based on the fair value of the asset. Generally, the estimated fair value will be determined using valuation techniques such as the present value of expected future cash flows. In assessing the carrying value of our real estate investments for possible impairment, management reviews estimates of future cash flows expected from each of our facilities and evaluates the creditworthiness of our lessees based on their current operating performance and on current industry conditions.

Investments in Limited Liability Companies (LLCs)

Our consolidated financial statements include the consolidated accounts of our controlled investments and those investments that meet the criteria of a variable interest entity where we are the primary beneficiary. In accordance with the American Institute of Certified Public Accountants Statement of Position 78-9 Accounting for Investments in Real Estate Ventures, as amended by FASB Staff Position SOP 78-9-1 Interaction of AICPA Statement of Position 78-9 and EITF Issue No. 04-5 , and Emerging Issues Task Force Issue (EITF) 96-16, Investor s Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights and EITF 04-5 Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights , we account for our unconsolidated investments in LLCs, which we do not control, using the equity method of accounting. The third-party members in these investments have equal voting rights with regards to issues such as, but not limited to: (i) divestiture of property; (ii) annual budget approval, and; (iii) financing commitments. These investments, which represent 33% to 99% non-controlling ownership interests, are recorded initially at our cost and subsequently adjusted for our net equity in the net income, cash contributions to, and distributions from, the investments. Pursuant to certain agreements, allocations of profits and losses of some of the LLC investments may be allocated disproportionately as compared to ownership interests after specified preferred return rate thresholds have been satisfied.

In January 2003, the FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51. This Interpretation, as revised (FIN 46R), addresses the consolidation by business enterprises of variable interest entities as defined in the Interpretation. As a result of our related party relationship with UHS, and certain master lease, lease assurance or lease guarantee arrangements

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between UHS and various properties owned by three LLCs in which we own non-controlling ownership interests ranging from 95% to 99%, these LLCs were considered to be variable interest entities (see note 9 to the consolidated financial statements). In addition, we were the primary beneficiary of these LLC investments. Upon the adoption of FIN 46R on March 31, 2004, we began consolidating the results of operations of these three LLC investments in our consolidated financial statements.

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As a result of the expiration of the master lease arrangements between subsidiaries of UHS and two of the three LLCs, during the fourth quarter of 2006, we began recording the financial results of two LLCs on an unconsolidated basis in our consolidated financial statements. Commencing in the fourth quarter of 2006, the revenues and expenses of these two LLCs are no longer included in our consolidated revenues and expenses; instead, our share of the net income generated from each of these LLCs is included in our consolidated statements of income as Equity in income of unconsolidated LLCs. The revenues and expenses for these LLCs related to the periods prior to the fourth quarter are included in our revenues and expenses in our consolidated statements of income. There was no impact on our net income as a result of recording of the financial results of these LLCs on a consolidated or an unconsolidated basis.

The other LLCs in which we hold various non-controlling ownership interests are not variable interest entities and therefore are not subject to the consolidation requirements of FIN 46R.

Federal Income Taxes

No provision has been made for federal income tax purposes since we qualify as a real estate investment trust under Sections 856 to 860 of the Internal Revenue Code of 1986, and intend to continue to remain so qualified. As such, we are exempt from federal income taxes and we are required to distribute at least 90% of our real estate investment taxable income to our shareholders.

We are subject to a federal excise tax computed on a calendar year basis. The excise tax equals 4% of the amount by which 85% of our ordinary income plus 95% of any capital gain income for the calendar year exceeds cash distributions during the calendar year, as defined. No provision for excise tax has been reflected in the financial statements as no tax was due.

Earnings and profits, which determine the taxability of dividends to shareholders, will differ from net income reported for financial reporting purposes due to the differences for federal tax purposes in the cost basis of assets and in the estimated useful lives used to compute depreciation and the recording of provision for impairment losses.

The aggregate gross cost basis and net book value of the properties for federal income tax purposes are approximately \$170 million and \$111 million respectively, at December 31, 2006 and \$202 million and \$140 million, respectively, at December 31, 2005.

Stock-Based Compensation

At December 31, 2006, we have two stock-based compensation plans. Effective January 1, 2006, we adopted SFAS No. 123R, Share-Based Payment and related interpretations and began expensing the grant-date fair value of stock options. SFAS No. 123R requires companies to recognize the grant-date fair value of stock options and other equity-based compensation. SFAS 123R generally requires that a company account for these transactions using the fair-value based method and eliminates a company's ability to account for share-based compensation transactions using the intrinsic value method of accounting provided in Accounting Principles Board, (APB) Opinion No. 25, Accounting for Stock Issued to Employees, which was permitted under Statement No. 123, as originally issued. Prior to January 1, 2006, we accounted for these plans under the recognition and measurement principles of APB Opinion No. 25, and related interpretations. Accordingly, no compensation expense was reflected in net income for stock option grants, as all options granted under the plan had an original exercise price equal to the market value of the underlying shares on the date of grant. The impact of adopting SFAS No. 123R for the year ended December 31, 2006, is a reduction in net income of \$82,000. In accordance with SFAS No. 123, the pro forma impact of expensing stock options for the years ended December 31, 2005

and 2004 would have been a reduction in net income of \$9,000 and \$11,000, respectively.

We adopted SFAS No. 123R using the modified prospective transition method and; therefore, we have not restated prior periods. Under this transition method, compensation costs associated with stock options recognized

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in 2006 includes amortization related to the remaining unvested portion of stock option and dividend equivalent rights awards granted prior to January 1, 2006, and will include amortization expense related to new awards granted after January 1, 2006. We use the Black-Scholes model as our option pricing model for applying SFAS 123R.

The expense associated with share-based compensation arrangements is a non-cash charge. In the consolidated statements of cash flows, share-based compensation expense is an adjustment to reconcile net income to cash provided by operating activities.

For stock options and DERs granted prior to the adoption of SFAS No. 123R, the effect on net income and earnings per share if we had applied the fair value recognition provisions of SFAS No. 123R to our stock option and DER plans for 2005 and 2004 is shown in the table below. We recognize compensation cost related to restricted share awards over the respective vesting periods. As of December 31, 2006, there were no unvested restricted share awards outstanding.

	Twelve Months Ended December 31,	
	2005	2004
	(in thousands, except per share data)	
Income from continuing operations	\$ 25,423	\$ 21,712
Income from discontinued operations, net (including gain on sale during 2004)		1,959
Net income	\$ 25,423	\$ 23,671
Income from continuing operations	\$ 25,423	\$ 21,712
Add: total stock-based compensation expenses included in net income	227	192
Deduct: total stock-based employee compensation expenses determined under fair value based methods for all awards:	(236)	(203)
Pro forma net income from continuing operations	\$ 25,414	\$ 21,701
Income from discontinued operations, net (including gain on sale during 2004)		1,959
Total pro forma net income	\$ 25,414	\$ 23,660
Basic earnings per share, as reported:		
From continuing operations	\$ 2.16	\$ 1.85
From discontinued operations		0.17
Total basic earnings per share, as reported	\$ 2.16	\$ 2.02
Basic earnings per share, pro forma:		
From continuing operations	\$ 2.16	\$ 1.84
From discontinued operations		0.17
Total basic earnings per share, pro forma	\$ 2.16	\$ 2.01
Diluted earnings per share, as reported:		

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From continuing operations	\$ 2.15	\$ 1.84
From discontinued operations		0.16
	<u> </u>	<u> </u>
Total diluted earnings per share, as reported	\$ 2.15	\$ 2.00
	<u> </u>	<u> </u>
Diluted earnings per share, pro forma:		
From continuing operations	\$ 2.15	\$ 1.84
From discontinued operations		0.16
	<u> </u>	<u> </u>
Diluted earnings per share	\$ 2.15	\$ 2.00
	<u> </u>	<u> </u>

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Fair Value of Financial Instruments

From time to time, we may enter into interest rate swap agreements and the fair value of such interest rate swap agreements would be based on quoted market prices. The carrying amounts reported in the balance sheet for cash, receivables, and short-term borrowings would approximate their fair values due to the short-term nature of these instruments. Accordingly, these items are excluded from the fair value disclosures included elsewhere in these notes to consolidated financial statements.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Accounting for Derivative Instruments and Hedging Activities

At December 31, 2006, we had no outstanding swap agreements.

SFAS No. 133, *Accounting for Derivative Instruments and Certain Hedging Activities* and SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activity*, an Amendment of SFAS 133, require that all derivative instruments be recorded on the balance sheet at their respective fair values.

On the date a derivative contract is entered into, we designate the derivative as either a hedge of a forecasted transaction or the variability of cash flows to be paid related to a recognized liability. For all hedging relationships we formally document the hedging relationship and our risk-management objective and strategy for undertaking the hedge, the hedging instrument, the item, the nature of the risk being hedged, how the hedging instrument's effectiveness in offsetting the hedged risk will be assessed, and a description of the method of measuring ineffectiveness. This process includes linking all derivatives that are designated as cash-flow hedges to specific liabilities on the balance sheet or to specific firm commitments or forecasted transactions. We also formally assess, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in the cash flows of hedged items. When it is determined that a derivative is not highly effective as a hedge or that it has ceased to be a highly effective hedge, we discontinue hedge accounting prospectively.

Changes in the fair value of a derivative that is highly effective and that is designated and qualifies as a cash-flow hedge are recorded in other comprehensive income to the extent that the derivative is effective as a hedge, until earnings are affected by the variability in cash flows of the designated hedged item. The ineffective portion of the change in fair value of a derivative instrument that qualifies as a cash-flow hedge is reported in earnings.

We discontinue hedge accounting prospectively when it is determined that the derivative is no longer effective in offsetting changes in the cash flows of the hedged item, the derivative expires or is sold or terminated, the derivative is de-designated as a hedging instrument because it is

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unlikely that a forecasted transaction will occur, a hedged firm commitment no longer meets the definition of a firm commitment, or management determines that designation of the derivative as a hedging instrument is no longer appropriate.

When hedge accounting is discontinued because it is probable that a forecasted transaction will not occur, we continue to carry the derivative on the balance sheet at its fair value with subsequent changes in fair value included in earnings, and gains and losses that were accumulated in other comprehensive income are recognized immediately in earnings.

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We manage our ratio of fixed to floating rate debt with the objective of achieving a mix that management believes is appropriate. To manage this mix in a cost-effective manner, from time to time, we enter into interest rate swap agreements, in which we agree to exchange various combinations of fixed and/or variable interest rates based on agreed upon notional amounts.

Recent Accounting Pronouncements

In July 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement No. 109*. The statement provides a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. In accordance with the interpretation, before a tax benefit can be recognized, a tax position is evaluated using a threshold that it is more likely than not that the tax position will be sustained upon examination. When evaluating the more-likely-than-not recognition threshold, the interpretation provides that a company should presume the tax position will be examined by the appropriate taxing authority that has full knowledge of all relevant information. If the tax position meets the more-likely-than-not recognition threshold, it is initially and subsequently measured as the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement. The interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. This interpretation is effective on January 1, 2007. Since we believe we have operated in such a manner as to qualify for taxation as a REIT under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended, and we intend to continue to operate in such a manner, we do not expect the adoption of this interpretation to have a material impact on our financial position or results of operations.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108). This guidance was issued to resolve diversity in current practice among registrants. The bulletin establishes that registrants must quantify the impact of correcting all misstatements on the financial statements by using both the rollover and iron curtain approaches to evaluate the errors. The rollover approach quantifies the misstatement based on the amount of the error originating in the current year income statement and the iron curtain approach quantifies a misstatement based on the amount of the error existing in the balance sheet at the end of the fiscal year. The bulletin contains guidance on correcting errors under the dual approach and transition guidance. The adoption of SAB 108 did not have a material impact on our financial position or results of operations.

In September, 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS 157), which clarifies the definition of fair value, establishes a framework for measuring fair value in U.S. GAAP, and expands the disclosures regarding fair value measurements. SFAS 157 does not require any new fair value measurements and eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We do not anticipate the adoption of SFAS 157 will have a material effect on our financial position or results of operations.

(2) RELATIONSHIP WITH UHS AND RELATED PARTY TRANSACTIONS

Leases: We commenced operations in 1986 by purchasing certain subsidiaries from UHS and immediately leasing the properties back to the respective subsidiaries. Most of the leases were entered into at the time we commenced operations and provided for initial terms of 13 to 15 years with up to six additional 5-year renewal terms, with base rents set forth in the leases effective for all but the last two renewal terms. In 1998, the lease for McAllen Medical Center was amended to provide that the last two renewal terms would also be fixed at the initial agreed upon base rental. This lease amendment was in connection with certain concessions granted by UHS with respect to the renewal of other leases. The base rents are paid monthly and each lease also provides for additional or bonus rents which are computed and paid on a quarterly basis based upon a computation that compares current quarter revenue to a corresponding quarter in the base year. The leases with subsidiaries of UHS are unconditionally guaranteed by UHS and are cross-defaulted with one another.

Pursuant to the Master Lease Document by and among us and certain subsidiaries of UHS, dated December 24, 1986 (the Master Lease), which governs all leases of properties with subsidiaries of UHS, UHS

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has the option to renew the leases at the lease terms described below by providing notice to us at least 90 days prior to the termination of the then current term. In addition, UHS has rights of first refusal to: (i) purchase the respective leased facilities during and for 180 days after the lease terms at the same price, terms and conditions of any third-party offer, or; (ii) renew the lease on the respective leased facility at the end of, and for 180 days after, the lease term at the same terms and conditions pursuant to any third-party offer. UHS also has the right to purchase the respective leased facilities at the end of the lease terms or any renewal terms at the appraised fair market value. In addition, as part of the overall exchange and substitution proposal relating to Chalmette Medical Center (Chalmette), as discussed below, as well as the early five year lease renewals on Southwest Healthcare System-Inland Valley Campus (Inland Valley), Wellington Regional Medical Center (Wellington), McAllen Medical Center (McAllen) and The Bridgeway (Bridgeway), we agreed to amend the Master Lease to include a change of control provision. The change of control provision grants UHS the right, upon one month's notice should a change of control of the Trust occur, to purchase any or all of the four leased hospital properties at their appraised fair market value purchase price.

During the third quarter of 2005, Chalmette, a 138-bed acute care hospital located in Chalmette, Louisiana, was severely damaged and closed as a result of Hurricane Katrina. At that time, the majority of the real estate assets of Chalmette were leased from us by a subsidiary of UHS and, in accordance with the terms of the lease, and as part of an overall evaluation of the leases between subsidiaries of UHS and us, UHS offered substitution properties rather than exercise its right to rebuild the facility or offer cash for Chalmette. Independent appraisals were obtained by us and UHS which indicated that the pre-hurricane fair market value of the leased facility was \$24.0 million.

During the third quarter of 2006, we completed the previously disclosed asset exchange and substitution pursuant to the Asset Exchange and Substitution Agreement with UHS that we entered into on April 24, 2006 whereby we agreed to terminate the lease between us and Chalmette and to transfer the real property assets and all rights attendant thereto (including insurance proceeds) of Chalmette to UHS in exchange and substitution for newly constructed real property assets owned by UHS (Capital Additions) at Wellington, Bridgeway and Inland Valley, in satisfaction of the obligations under the Chalmette lease. The Capital Additions consist of properties which were recently constructed on, or adjacent to, facilities already owned by us as well as a Capital Addition at Inland Valley which is currently under construction and expected to be completed during 2007. UHS is obligated to complete the Inland Valley Capital Addition or, subject to our approval, offer to either provide alternative substitution property or pay to us an amount in cash equal to the substitution value of the Capital Addition. Pursuant to section 1033(a)(1) of the Internal Revenue Code of 1986, as amended (the IRC), we will recognize no gain for federal income tax purposes based upon the transaction as agreed upon in the Asset Exchange and Substitution Agreement.

The properties included in the Asset Exchange and Substitution Agreement consists of (amounts in thousands):

Wellington Bed Tower	\$ 8,926	Fair value
Bridgeway 28 bed addition	4,072	Fair value
Inland Valley 44 bed and ICU expansion currently under construction	10,967	Estimated minimum fair value
Total fair value of exchanged and substituted assets	\$ 23,965	

In the event the ultimate construction costs related to the Inland Valley Capital Addition exceed \$11.0 million, the excess will be paid in cash by us to UHS and UHS will pay incremental rent on the excess at a rate equal to the prevailing five-year treasury rate plus 200 basis points at the time of funding (minimum rate 6.75%).

During 2005, 2004 and 2003, the total rent earned by us under the Chalmette lease was approximately \$1.6 million to \$1.7 million annually (including \$960,000 of base rental and approximately \$700,000 of bonus rental). The total rent payable to us on the Capital Additions included in the substitution package (excluding the rent

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on the Inland Valley Capital Addition in excess of \$11.0 million, if any) is expected to closely approximate the total rent earned by us under the Chalmette lease. Below is the estimated rent of the substitution properties.

Facility	Base Rent	Bonus Rent	Total Rent
Wellington	\$ 534,504	\$ 67,744	\$ 602,248
Bridgeway	247,800	26,940	274,740
Inland Valley	740,012		740,012
Total:	\$ 1,522,316	\$ 94,684	\$ 1,617,000

The amounts shown in the bonus rent column represent the estimated bonus rent effect of including the revenues generated from the Capital Additions at Wellington and Bridgeway that have not been previously included in the bonus rent paid to us pursuant to the terms of the leases since the Capital Additions were financed and owned by UHS. The bonus rent amounts reflected above were based on the net revenues generated at each facility during 2005. Future bonus rents earned by us on the Capital Additions will be based on the actual net revenues of each facility.

During the second quarter of 2006, as part of the overall arrangement with UHS, UHS agreed to early renewals of the leases between us and each of Inland Valley, Wellington and McAllen which were scheduled to mature on December 31, 2006, and Bridgeway, which was scheduled to mature on December 31, 2009. These leases were renewed on the same economic terms as the current leases.

Included in our consolidated statement of income during 2005 was a property write-down charge of \$6.3 million representing the book value of the Chalmette property damaged by the hurricane. Included in our 2005 net income was an equal amount representing the property damage recoverable from UHS. Prior to the completion of the Asset Exchange and Substitution Agreement, Chalmette had a combined asset value of \$8.3 million on our consolidated balance sheet consisting of \$2.0 million of land held for exchange and \$6.3 million of property damage receivable from UHS. Included in our net income during 2006 was a gain of \$14.0 million representing the total property transferred to us from UHS as of December 31, 2006 (\$22.2 million) in excess of the \$8.3 million book value of Chalmette. Upon the completion of the asset exchange and substitution during the third quarter of 2006, we received the above mentioned Capital Additions from Wellington and Bridgeway which had a combined fair value of \$13.0 million. In addition, the construction costs related to the completed Capital Addition at Inland Valley amounted to \$9.2 million as of December 31, 2006 (\$11.0 million is total minimum estimated cost of Inland Valley's Capital Addition). Our future net income will include an additional \$1.8 million of property recovered from UHS as the additional construction costs are incurred by UHS related to the Inland Valley Capital Addition, up to \$11.0 million estimated total cost of construction.

FASB Interpretation No. 30 (FIN 30), *Accounting for Involuntary Conversion of Nonmonetary Assets to Monetary Assets, an Interpretation of APB No. 29 (APB29)*, provides guidance on the accounting for involuntary conversions of nonmonetary assets (such as property) to monetary assets (such as insurance proceeds). Although the damage to Chalmette did not directly result in the conversion of a nonmonetary asset to a monetary asset, we do not believe that the receipt of a nonmonetary asset is in substance different than the receipt of a monetary asset in the context of an involuntary conversion. The guidance in FIN 30 would result in recognition of the assets received upon the involuntary conversion at their fair values with gain or loss recognized for the difference between the fair value of the assets received and the carrying value of the assets converted. Because it is not clear that the loss of Chalmette and related recovery from UHS represented a monetary conversion as described by FIN 30, we also considered the guidance in SFAS No. 153 (SFAS No. 153), *Exchanges of Nonmonetary Assets, as Amendment of APB 29*, which is effective for nonmonetary asset exchanges occurring in the fiscal year beginning after June 15, 2005. SFAS No. 153 is based upon the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged, unless the exchange lacks commercial substance, as defined in paragraph 21 of APB 29, as amended by SFAS 153. After evaluating the provisions of SFAS No. 153, we concluded that the exchange of

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these assets had commercial substance since, as indicated above, the base or minimum rent component of the total rental earned on the substituted assets has increased (by \$562,000) over the base rental amount earned pursuant to the terms of the Chalmette lease. As a result, the risk component of the future lease stream has been significantly and favorably impacted. In addition, the future bonus rental earned on the substituted assets at Wellington, Bridgeway and Inland Valley will be impacted (either favorably or unfavorably) by the distinct operating characteristics of those facilities such as the nature of the healthcare care services provided, the geographic markets serviced and patient and payor mix, among other things. As a result of the facts and conclusions detailed above, and pursuant to the contingent gain guidance in SFAS No. 5, *Accounting for Contingencies*, we recorded the \$14.0 million gain during 2006 which reflects the fair value of the assets transferred from UHS to us as of December 31, 2006, net of the \$6.3 million recoverable from UHS recorded during 2005 and the \$2.0 million of Chalmette land relinquished.

After giving effect to the exchange and substitution, and the various lease renewals discussed above, subsidiaries of UHS lease four hospital facilities owned by us with terms expiring in 2011 through 2014. The table below details the renewal options and terms for each of the four UHS hospital facilities:

<u>Hospital Name</u>	<u>Type of Facility</u>	<u>Annual</u>	<u>End of</u>	<u>Renewal</u>
		<u>Minimum</u>	<u>Lease Term</u>	<u>Term</u>
		<u>Rent</u>		<u>(years)</u>
McAllen Medical Center	Acute Care	\$ 5,485,000	December, 2011	20(a)
Wellington Regional Medical Center	Acute Care	\$ 3,030,000	December, 2011	20(b)
Southwest Healthcare System, Inland Valley Campus	Acute Care	\$ 2,597,000(d)	December, 2011	20(b)
The Bridgeway	Behavioral Health	\$ 930,000	December, 2014	10(c)

- (a) UHS has four 5-year renewal options at existing lease rates (through 2031).
- (b) UHS has two 5-year renewal options at existing lease rates (through 2021) and two 5-year renewal options at fair market value lease rates (2022 through 2031).
- (c) UHS has two 5-year renewal options at fair market value lease rates (2015 through 2024).
- (d) Excludes potential incremental rent, if any, on Capital Addition in excess of \$11.0 million.

We cannot predict whether the leases with subsidiaries of UHS, which have renewal options at existing lease rates, or any of our other leases, will be renewed at the end of their lease terms. If the leases are not renewed at their current rates, we would be required to find other operators for those facilities and/or enter into leases on terms potentially less favorable to us than the current leases.

The combined revenues generated from the leases on the UHS hospital facilities accounted for approximately 49% of our consolidated revenues for the year ended December 31, 2006. Including 100% of the revenues generated at the unconsolidated LLCs in which we have various non-controlling equity interests ranging from 33% to 99%, the leases on the UHS hospital facilities accounted for approximately 24% for the year ended December 31, 2006. In addition, five MOB's (plus three additional MOB's currently under construction) owned by LLCs in which we hold various non-controlling equity interests, include tenants which are subsidiaries of UHS.

During 2006, we committed to invest up to \$6.6 million (\$250,000 in equity, \$53,000 of which has been funded as of December 31, 2006 and \$6.3 million in debt financing or equity, none of which has been funded as of December 31, 2006) in exchange for a 95% non-controlling equity interest in a limited liability company that will develop, construct, own and operate the Centennial Hills Medical Office Building I, located in Las Vegas, Nevada, on the campus of a UHS hospital. This MOB will be 60% master leased by Valley Health System (VHS), a majority-owned subsidiary of UHS, on a triple net basis. The master lease for each suite will be cancelled at such time that the suite is leased to another tenant acceptable to the LLC and VHS for a minimum term of five years. The LLC has a \$15.7 million construction loan commitment from a

third-party, which is non-recourse to us. This building, tenants of which may include subsidiaries of UHS, is scheduled to be completed and opened during the third quarter of 2007.

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Additionally, during 2006, we committed to invest up to \$4.3 million in equity, of which \$86,000 has been funded as of December 31, 2006, in exchange for a 95% non-controlling equity interest in a limited liability company that will develop, construct, own and operate the Palmdale Medical Plaza, located in Palmdale, California, on the campus of a UHS hospital currently under construction. This MOB will be 75% master leased by UHS of Palmdale, Inc., a subsidiary of UHS, on a triple net basis. The master lease for each suite will be cancelled at such time that the suite is leased to another tenant acceptable to the LLC and UHS of Palmdale, Inc. for a minimum term of five years. This building, tenants of which may include subsidiaries of UHS, is scheduled to be completed and opened during the fourth quarter of 2007.

During 2005, we committed to invest up to \$12.3 million (\$3.4 million in equity and \$8.9 million in debt financing, \$5.4 million of debt has been funded as of December 31, 2006) in exchange for a 95% non-controlling interest in a limited liability company that will develop, construct, own and operate the Spring Valley Medical Office Building II, a second MOB on the campus of Spring Valley Hospital in Las Vegas, Nevada. This MOB will be 50% master leased by VHS on a triple net basis. The master lease for each suite will be cancelled at such time that the suite is leased to another tenant acceptable to the LLC and VHS for a minimum term of five years. This MOB is scheduled to be completed and opened during the second quarter of 2007.

Upon the December, 2004 lease expiration on the Virtue Street Pavilion, the former lessee (a wholly-owned subsidiary of UHS), exercised its option pursuant to the terms of the lease and purchased the facility at its appraised fair market value of \$7,320,000. The sale resulted in a gain of \$833,000 which is reflected as Income from discontinued operations, net in the consolidated statements of income for the year ended December 31, 2004. Prior to the transaction, the annual minimum rent payable to us under the lease was \$1,261,000 and no bonus rent was earned on this facility during 2004. As a result of this transaction, our cash flows from operating activities were adversely affected during 2006 and 2005 since calculated using our average incremental borrowing rates during each year, the reduction to annual interest expense resulting from repayment of borrowings using the \$7.3 million of sale proceeds was approximately \$700,000 less during 2006, and \$900,000 less during 2005, than the annual rental payments earned by us pursuant to the terms of the lease.

The following table summarizes the results of operations for the Virtue Street Pavilion during 2004 (in thousands):

	Year Ended
	December 31,
	2004
Revenues	\$ 1,261
Depreciation expense	(135)
Income from operations	1,126
Gain on sale	833
Income from discontinued operations, net	\$ 1,959

During the third quarter of 2004, Wellington, our 121-bed acute care facility located in West Palm Beach, Florida, sustained storm damage caused by a hurricane. This facility is leased by a wholly-owned subsidiary of UHS and pursuant to the terms of the lease, UHS is responsible for maintaining replacement cost property insurance for the facility, a substantial portion of which is insured by a commercial carrier. The facility did not experience significant business interruption. Our consolidated statements of income for the year ended December 31, 2004,

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included a property write-down charge of \$1.9 million representing the estimated net book value of the damaged assets. This property charge was offset at that time by an equal amount recoverable from UHS. During 2004, UHS incurred approximately \$1.9 million in replacement costs in connection with this property and that amount was included as construction in progress on our consolidated balance sheet as of December 31, 2004. During the twelve months ended December 31, 2005, UHS incurred an additional \$4.7 million in replacement costs and since these additional costs have also been recovered from UHS,

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\$4.7 million has been included in net income during the year ended December 31, 2005. The repairs to the facility were completed as of December 31, 2005. UHS spent a total of approximately \$6.6 million to replace the damaged property at this facility and this amount is reflected as buildings and improvements on our consolidated balance sheet.

During 2004 we invested an additional \$2.1 million in exchange for a 95% non-controlling interest in a limited liability company that acquired the Spring Valley Medical Office Building, a 60,000 square foot medical office building on the campus of Spring Valley Hospital in Las Vegas, Nevada. This medical office building has tenants which are subsidiaries of UHS.

During the fourth quarter of 2004 we invested an additional \$600,000 (for a total of \$3.0 million in equity and \$6.5 million of debt financing, which was repaid to us during the first quarter of 2005) for the purchase of a 98% non-controlling equity interest in a limited liability company that simultaneously purchased the 700 Shadow Lane & Goldring MOBs, consisting of three medical office buildings on the campus of Valley Hospital Medical Center in Las Vegas, Nevada. These medical office buildings were purchased from VHS and have tenants which are subsidiaries of UHS.

UHS Legal Proceedings: We have been advised by UHS that UHS, together with its South Texas Health System affiliates, which operate McAllen Medical Center, were served with a subpoena dated November 21, 2005, issued by the Office of Inspector General of the Department of Health and Human Services. At that time, the Civil Division of the U.S. Attorney's office in Houston, Texas indicated that the subpoena was part of an investigation under the False Claims Act of compliance with Medicare and Medicaid rules and regulations pertaining to the employment of physicians and the solicitation of patient referrals from physicians from January 1, 1999 to the date of the subpoena related to the South Texas Health System. UHS has informed us that it is cooperating in the investigation. On February 16, 2007, UHS's South Texas Health System affiliates were served with a search warrant in connection with what UHS has been advised is a related criminal investigation concerning the production of documents. UHS has advised us that, at this time, it is unable to evaluate the existence or extent of any potential financial exposure in connection with this matter.

UHS has advised us that it monitors all aspects of its business and that it has developed a comprehensive ethics and compliance program that is designed to meet or exceed applicable federal guidelines and industry standards. Because the law in this area is complex and constantly evolving, governmental investigation or litigation may result in interpretations that are inconsistent with industry practices, including UHS's. Although UHS believes their policies, procedures and practices comply with governmental regulations, no assurance can be given that UHS will not be subjected to further inquiries or actions, or that UHS will not be faced with sanctions, fines or penalties in connection with the investigation of our South Texas Health System affiliates. Even if UHS were to ultimately prevail, the government's inquiry and/or action in connection with this matter could have a material adverse effect on UHS's future operating results and on the future operating results of McAllen Medical Center. While the base rentals are guaranteed by UHS through the end of the lease term, should this matter adversely impact on the future revenues and/or operating results of McAllen Medical Center, the future bonus rental earned by us on this facility may be materially, adversely impacted. Bonus rental revenue earned by us from McAllen Medical Center amounted to \$1.9 million during each of 2006 and 2005 and \$2.2 million during 2004. We can provide no assurance that this matter will not have a material adverse impact on underlying value of McAllen Medical Center or on the future base rental earned on this facility after the December, 2011 scheduled expiration of the existing lease term.

Advisory Agreement: UHS of Delaware, Inc. (the Advisor), a wholly-owned subsidiary of UHS, serves as Advisor to us under an Advisory Agreement (the Advisory Agreement) dated December 24, 1986. Under the Advisory Agreement, the Advisor is obligated to present an investment program to us, to use its best efforts to obtain investments suitable for such program (although it is not obligated to present any particular investment opportunity to us), to provide administrative services to us and to conduct our day-to-day affairs. In performing its services under the Advisory Agreement, the Advisor may utilize independent professional services, including accounting, legal, tax and other services, for which the Advisor is reimbursed directly by us. The Advisory

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Agreement expires on December 31 of each year; however, it is renewable by us, subject to a determination by the Trustees who are unaffiliated with UHS (the Independent Trustees), that the Advisor's performance has been satisfactory. The Advisory Agreement may be terminated for any reason upon sixty days written notice by us or the Advisor. The Advisory Agreement has been renewed for 2007. All transactions between us and UHS must be approved by the Independent Trustees.

The Advisory Agreement provides that the Advisor is entitled to receive an annual advisory fee equal to 0.60% of our average invested real estate assets, as derived from our consolidated balance sheet. The advisory fee is payable quarterly, subject to adjustment at year-end based upon our audited financial statements. In addition, the Advisor is entitled to an annual incentive fee equal to 20% of the amount by which cash available for distribution to shareholders for each year, as defined in the Advisory Agreement, exceeds 15% of our equity as shown on our consolidated balance sheet, determined in accordance with generally accepted accounting principles without reduction for return of capital dividends. The Advisory Agreement defines cash available for distribution to shareholders as net cash flow from operations less deductions for, among other things, amounts required to discharge debt and liabilities of the Trust and reserves for replacement and capital improvements to the Trust's properties and investments. No incentive fees were paid during 2006, 2005 or 2004. Advisory fees incurred and paid (or payable) to UHS amounted to \$1.4 million during each of 2006 and 2005 and \$1.5 million for 2004.

Officers and Employees: Our officers are all employees of UHS and although as of December 31, 2006 we had no salaried employees, our officers do receive stock-based compensation from time-to-time.

Share Purchase Option: As of December 31, 2006, UHS owned 6.7% of our outstanding shares of beneficial interest.

(3) ACQUISITIONS AND DISPOSITIONS

2007 Subsequent to December 31, 2006, Rio Med Investments, a LLC in which we owned a 80% non-controlling ownership interest, sold the real estate assets of the Rio Rancho Medical Center, located in Rio Rancho, New Mexico. Our share of the net sale proceeds resulting from this transaction is \$1.1 million. The transaction resulted in a gain of approximately \$250,000 which will be included in our results of operations during the first quarter of 2007.

2006 We invested \$5.3 million in the following LLCs:

\$1.6 million of equity funded to the LLC that constructed and owns the Sierra San Antonio Medical Plaza, located in Fontana, California, in which we have a 95% non-controlling equity interest. We have committed to invest a total of up to \$3.5 million in equity in this LLC, of which \$2.6 million has been funded as of December 31, 2006. The LLC also obtained a \$7.5 million third-party construction loan, which is non-recourse to us. This project was completed and opened during the first quarter of 2006;

\$1.5 million of equity funded to the LLC that will develop, construct, own and operate the Phoenix Children's East Valley Care Center, located in Gilbert, Arizona, in which we have a 95% non-controlling equity interest. We have committed to invest a total of up to \$3.5 million in equity in this LLC, of which \$1.5 million has been funded as of December 31, 2006. This project is scheduled to be completed and opened during the third quarter of 2007;

\$637,000 of additional equity funded to the LLC that constructed and owns the Saint Mary's Professional Office Building located in Reno, Nevada, in which we have a 75% non-controlling equity interest. We have committed to invest a total of \$8.0 million in equity

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in this LLC, of which \$5.2 million has been funded as of December 31, 2006. The LLC also obtained a \$29 million third-party mortgage that is non-recourse to us;

\$532,000 of additional equity funded to the LLC that owns the Desert Samaritan Hospital MOBs located in Mesa, Arizona, in which we have a 76% non-controlling equity interest;

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\$329,000 of additional equity funded to the LLC that owns the 700 Shadow Lane & Goldring MOBs located in Las Vegas, Nevada, in which we have a 98% non-controlling equity interest;

\$214,000 of additional equity funded to the LLC that owns the Spring Valley Medical Office Building located in Las Vegas, Nevada, on the campus of a UHS facility, in which we have a 95% non-controlling equity interest, and;

\$562,000 of additional investments in various LLCs in which we own a non-controlling equity interest.

We advanced \$7.6 million to the following LLCs:

\$5.3 million advance made to a LLC that will develop, construct, own and operate the Spring Valley Hospital Medical Office Building II, located in Las Vegas, Nevada on the campus of a UHS facility, in which we have a 95% non-controlling equity interest. We have committed to a total of \$8.9 million of debt financing to this LLC, of which \$5.3 million has been funded as of December 31, 2006. This project is scheduled to be completed and opened during the second quarter of 2007;

\$630,000 advance made to the LLC that owns Rio Rancho Medical Center, an existing LLC in which we have a 80% non-controlling equity interest (subsequent to December 31, 2006, the real estate assets of this LLC were sold);

\$540,000 advance (which was fully repaid during the third quarter) made to a master LLC which governs four unconsolidated LLCs in which we have a 90% non-controlling equity interest;

\$485,000 advance made to the LLC that constructed and owns the Sierra San Antonio Medical Plaza, located in Fontana, California, in which we have a 95% non-controlling equity interest. The LLC also obtained a \$7.5 million third-party construction loan, which is non-recourse to us. This project was completed and opened during the first quarter of 2006;

\$363,000 advance made to the LLC that will develop, construct, own and operate the Phoenix Children's East Valley Care Center, located in Gilbert, Arizona, in which we have a 95% non-controlling equity interest. This project is scheduled to be completed and opened during the third quarter of 2007, and;

\$259,000 of advances made to various LLCs in which we own a non-controlling equity interest.

We received \$1.9 million of repayments of advances from the following LLCs:

\$1.2 million received as repayments of advances provided to a LLC that owns the Suburban Medical Plaza II, located in Louisville, Kentucky, in which we have a 33% non-controlling equity interest;

\$540,000 received as repayments of advances provided to a master LLC which governs four unconsolidated LLCs in which we have a 90% non-controlling equity interest, and;

\$160,000 received as repayments of advances provided to various LLCs in which we own a non-controlling equity interest.

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Additionally, during 2006, we received \$3.1 million as repayment of a note receivable relating to the 2005 sale of our interest in a LLC which owned the St. Jude Heritage Health Complex. This transaction resulted in a \$1.9 million gain which was deferred in 2005 and recognized during the second quarter of 2006 when the cash proceeds were received by us.

2005 We invested \$8.3 million in the following LLCs:

\$4.5 million of equity funded in connection with the purchase of a 75% non-controlling interest in a LLC that constructed and owns the Saint Mary's Center for Health located in Reno, Nevada, which opened in March, 2005. We committed to invest a total of \$10.5 million (\$8.0 million in equity and \$2.5 million in debt financing, which was repaid to us during 2005). The LLC also obtained a \$29 million third-party mortgage that is non-recourse to us;

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\$2.5 million paid to an unrelated third-party member as net consideration in connection with the restructure of the ownership interests in five existing unconsolidated LLCs (see note 9);

\$1.0 million funded in exchange for a 95% non-controlling interest in a LLC that owns the Sierra San Antonio Medical Plaza, located in Fontana, California. We committed to invest a total of up to \$3.5 million in equity in this LLC. The LLC also obtained a \$7.5 million third-party construction loan, which is non-recourse to us. This project was completed and opened during the first quarter of 2006, and;

\$235,000 of additional equity funded during the third quarter of 2005 to the LLC that owns the 700 Shadow Lane & Goldring MOBs located in Las Vegas, Nevada, in which we have a 98% non-controlling equity interest.

We advanced \$2.9 million to the following LLCs:

\$400,000 additional advance to a LLC that owns the Saint Mary's Center for Health, in connection with the purchase of a 75% non-controlling interest in the LLC (which was fully repaid during 2005);

\$680,000 advance made to Desert Samaritan Hospital MOBs, an existing LLC which we have a 76% non-controlling equity interest (which was fully repaid during 2005);

\$425,000 advance made to Edwards Medical Plaza, an existing LLC in which we have a 90% non-controlling equity interest;

\$1.3 million advance made (which was repaid to us during 2006) to Suburban Medical Plaza II, an existing LLC in which we have a 33% non-controlling equity interest, and;

\$85,000 advance made to Rio Rancho Medical Center, an existing LLC in which we have a 80% non-controlling equity interest (subsequent to December 31, 2006, the real estate assets of this LLC were sold).

We received \$9.6 million of repayments of advances from the following LLCs:

\$6.5 million received as repayments of advances provided to a LLC that owns the 700 Shadow Lane & Goldring MOBs located in Las Vegas, Nevada, in which we have a 98% non-controlling equity interest;

\$2.5 million received as repayments of advances provided to a LLC that owns the Saint Mary's Center for Health located in Reno, Nevada, in which we have a 75% non-controlling equity interest, and;

\$680,000 received as repayments of advances provided to a LLC that owns the Desert Samaritan Hospital MOBs located in Mesa, Arizona, in which we have a 76% non-controlling equity interest.

During the fourth quarter of 2005, we sold our non-controlling equity interest in West Highland Holdings, a LLC which owned the St. Jude Heritage Health Complex, located in California, in exchange for a \$3.1 million note receivable which was collateralized by the entire ownership interest of the LLC. This transaction resulted in a deferred gain of \$1.9 million which was recognized as income during 2006 when the cash

proceeds to repay the note receivable were received by us.

During the first quarter of 2005, Bayway Properties, a LLC in which we owned a 73% non- controlling ownership interest, sold the real estate assets of the East Mesa Medical Center, which is located in Mesa, Arizona. Our share of the net sale proceeds resulting from this transaction was \$2.9 million. The transaction resulted in a gain of approximately \$1.0 million which is included in our results of operations for 2005.

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2004 We invested \$2.8 million in the following LLCs:

\$2.1 million funded in connection with the purchase of a 95% non-controlling equity interest in a LLC that owns the Spring Valley Medical Office Building located in Las Vegas, Nevada (the LLC also obtained a \$4.0 million third-party mortgage that is non-recourse to us), and;

\$700,000 of additional investments in various LLCs in which we own a non-controlling equity interest.

We advanced \$1.4 million to the following LLCs:

\$830,000 additional net loan funded (which was repaid to us during 2005) in connection with a total commitment of up to \$10.5 million by us (consisting of \$8.0 million in equity and \$2.5 million in debt financing) in exchange for a 75% non-controlling equity interest in a LLC that constructed and owns the St. Mary's Center for Health located in Reno, Nevada, which opened in the first quarter of 2005 (the LLC also obtained a \$29 million third-party mortgage that is non-recourse to us), and;

\$600,000 additional net loan funded (which was repaid to us during 2005) in connection with the purchase of a 98% non-controlling equity interest in a LLC that simultaneously purchased three medical office buildings on the campus of Valley Hospital Medical Center in Las Vegas, Nevada.

During the fourth quarter of 2004, we committed to invest a total of up to \$3.5 million in exchange for a 95% non-controlling interest in a LLC that will developed, constructed, owns and operates the Sierra San Antonio Medical Plaza located in Fontana, California. This LLC, which was completed and opened during the first quarter of 2006, also obtained a \$7.5 million third-party construction loan.

On December 31, 2004, we completed the sale of the real estate assets of Virtue Street Pavilion, located in Chalmette, Louisiana, to the former lessee of the facility, a wholly-owned subsidiary of UHS. Pursuant to the terms of the lease on the facility, the lessee exercised its option to purchase the facility at its fair market value upon the December, 2004 lease expiration. Accordingly, pursuant to the terms of the lease, independent appraisals were obtained by us and the lessee, which indicated that the fair market value of the property, and therefore the sale price, was \$7,320,000. The sale resulted in a gain of \$833,000 which is reflected as Income from discontinued operations, net in the Consolidated Statements of Income for the twelve months ended December 31, 2004.

During the second quarter of 2004, Parkvale Properties, a LLC in which we had a 60% non-controlling equity interest, sold the real property of Parkvale Medical Building which is located in Phoenix, Arizona. Our share of the net sale proceeds resulting from this transaction was \$950,000 which is included as a gain on sale of real property in our results of operations for 2004, since the carrying value of this investment was reduced to zero in a prior year.

(4) LEASES

All of our leases are classified as operating leases with initial terms ranging from 3 to 20 years with up to four additional, five-year renewal options. Under the terms of the leases, we earn fixed monthly base rents and pursuant to the leases with subsidiaries of UHS, we may earn periodic bonus rents (see note 1). The bonus rents from the subsidiaries of UHS, which are based upon each facility's net revenue in excess of base amounts, are computed and paid on a quarterly basis based upon a computation that compares current quarter revenue to the corresponding

quarter in the base year.

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Minimum future base rents from non-cancelable leases, excluding increases resulting from changes in the consumer price index and bonus rents, are as follows (amounts in thousands):

2007	\$ 21,984
2008	20,983
2009	20,155
2010	17,345
2011	15,219
Thereafter	5,011
	<hr/>
Total minimum base rents	\$ 100,697
	<hr/>

Under the terms of the hospital leases, the lessees are required to pay all operating costs of the properties including property insurance and real estate taxes. Tenants of the medical office buildings generally are required to pay their pro-rata share of the property's operating costs.

(5) DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

We use variable-rate debt to finance a portion of our operations and investments. These variable-rate debt obligations expose us to variability in interest payments due to changes in interest rates. Management believes that it is prudent to limit the variability of a portion of our interest payments. To meet this objective, from time to time, management enters into interest rate swap agreements to manage fluctuations in cash flows resulting from interest rate risk. These swaps change the variable-rate cash flow exposure on the debt obligations to fixed cash flows. Under the terms of the interest rate swaps, we receive variable interest rate payments and make fixed interest rate payments, thereby creating the equivalent of fixed-rate debt. At December 31, 2006, we had no outstanding swap agreements.

Changes in the fair value of interest rate swap designated as a hedging instrument that effectively offset the variability of cash flows associated with variable-rate debt obligations are reported in accumulated other comprehensive income. These amounts subsequently are reclassified into interest expense in the same period in which the underlying hedged item affects earnings. For the years ended December 31, 2006, 2005 and 2004, we recorded additional interest expense of \$62,000, \$431,000 and \$1,106,000, respectively, as a result of our hedging activity.

During 2005, based on revised borrowing forecasts, one of our interest rate swap agreements was deemed to be ineffective. In connection with this ineffective interest rate swap agreement, we recorded a net loss of \$252,000 which was included in interest expense during 2005 and consisted of the following: (i) a loss of \$515,000 representing the amount recorded in accumulated other comprehensive income (AOCI) as of January 1, 2005, and; (ii) a gain of \$263,000 to recognize the change in fair value of this derivative during 2005. This swap was terminated during 2005 and a termination fee of \$319,000 was paid.

Operating results for the years ended December 31, 2005 and 2004 include net losses/(gains) of \$252,000 and (\$124,000), respectively. The \$252,000 loss recorded during 2005 was in connection with the terminated swap, as discussed above. The gain recorded during 2004 represents cash flow hedge ineffectiveness arising from differences between the critical terms of the interest rate swap and the hedged debt obligation when it affects earnings.

(6) DEBT

In January 2007, we entered into a new unsecured \$100 million revolving credit agreement (the Agreement) which expires on January 19, 2012. We have a one time option, which can be exercised at any time, subject to bank approval, to increase the amount by \$50 million for a total commitment of \$150 million. The Agreement provides for interest at our option, at the Eurodollar rate plus .75% to 1.125%, or the prime rate

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plus zero to .125%. A fee of .15% to .225% is paid on the unused portion of the commitment. The margins over the Eurodollar, prime rate and commitment fee are based upon our debt to total capital ratio as defined by the Agreement. As of January 19, 2007, the applicable margin over the Eurodollar rate was .75%, the prime rate was zero, and the commitment fee was .15%

At December 31, 2006, we had \$13.6 million of outstanding borrowings under our then existing revolving credit agreement and \$18.9 million of outstanding letters of credit. After giving effect to the increased borrowing capacity in the Agreement entered into in January of 2007, we had \$67.5 million of available borrowing capacity, net of the outstanding borrowings and letters of credit outstanding as of December 31, 2006. There are no compensating balance requirements. The Agreement contains a provision whereby the commitments will be reduced by 50% of the proceeds generated from any new equity offering. The average amounts outstanding under our revolving credit agreement were \$11.9 million in 2006, \$12.0 million in 2005, and \$26.4 million in 2004 with corresponding effective interest rates, including commitment fees and interest rate swap expense, of 7.9% in 2006, 9.0% in 2005, and 7.0% in 2004. The carrying value of the amounts borrowed approximates fair market value.

Covenants relating to the revolving credit facility require the maintenance of a minimum tangible net worth and specified financial ratios, limit our ability to incur additional debt, limit the aggregate amount of mortgage receivables and limit our ability to increase dividends in excess of 95% of cash available for distribution, unless additional distributions are required to comply with the applicable section of the Internal Revenue Code and related regulations governing real estate investment trusts. We are in compliance with all their covenants at December 31, 2006.

We have two mortgages, which are non-recourse to us, included on our consolidated balance sheet as of December 31, 2006, with a combined outstanding balance of \$12.7 million. Both mortgages carry an interest rate of 8.3% and both have maturity dates in 2010. The mortgages are secured by the real property of the buildings as well as property leases and rents. These two mortgages have a combined fair value of approximately \$13.7 million as of December 31, 2006. Changes in market rates on our fixed rate debt impacts the fair value of debt, but it has no impact on interest incurred or cash flow.

The following table summarizes our outstanding mortgages at December 31, 2006 (amounts in thousands):

<u>Facility Name / Secured by</u>	<u>Outstanding Balance</u> (in thousands)	<u>Interest Rate</u>	<u>Maturity Date</u>
Medical Center of Western Connecticut	\$ 3,849	8.3%	2010
Summerlin Hospital MOB II	8,888	8.3%	2010
Total	\$ 12,737		

As of December 31, 2006, our aggregate consolidated scheduled debt repayments (including mortgages) are as follows (amounts in thousands):

2007	\$ 332
2008	361
2009	394
2010	11,650

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2011	
Later(a)	13,600
Total	<u>\$ 26,337</u>

(a) Consists of borrowings outstanding under the terms of our new \$100 million revolving credit agreement entered into in January of 2007.

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Dividends of \$2.260 per share were declared and paid in 2006, of which \$1.831 per share was ordinary income, \$0.160 per share was a capital gain distribution and \$0.269 per share was a return of capital distribution. Dividends of \$2.175 per share were declared and paid in 2005, of which \$1.754 per share was ordinary income, \$0.093 per share was a capital gain distribution and \$0.328 per share was a return of capital distribution. Dividends of \$2.000 per share were declared and paid in 2004, of which \$1.753 per share was ordinary income and \$0.247 per share was a capital gain distribution.

(8) INCENTIVE PLANS

As discussed in note 1, effective January 1, 2006, we adopted SFAS No. 123R and related interpretations and began expensing the grant-date fair value of stock options. Prior to January 1, 2006, we accounted for these plans under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Accordingly, no compensation expense was reflected in net income for stock option grants, as all options granted under the plan had an original exercise price equal to the market value of the underlying shares on the date of grant. As a result of adopting SFAS No. 123R, during 2006 we recognized compensation cost in our financial statements on the unvested portion of existing options that were granted prior to the effective date and the cost of stock options granted after the effective date based on the fair value of the stock options at grant date.

During 1997, our Board of Trustees approved the Universal Health Realty Income Trust 1997 Incentive Plan (The Plan), a stock option and dividend equivalent rights plan for employees of the Trust, including officers and trustees. A combined total of 400,000 shares and dividend equivalent rights have been reserved for issuance under The Plan. From inception through December 31, 2006, there have been 137,000 stock options with dividend equivalent rights granted to eligible individuals, including officers and trustees. All stock options were granted with an exercise price equal to the fair market value on the date of the grant. The options granted vest ratably at 25% per year beginning one year after the date of grant, and expire in ten years. Dividend equivalent rights effectively reduce the exercise price of the 1997 Incentive Plan options by an amount equal to the cash or stock dividends distributed subsequent to the date of grant. We recorded expenses relating to the dividend equivalent rights of \$195,000 in 2006, \$227,000 in 2005 and \$192,000 in 2004. As of December 31, 2006, there were 94,750 options exercisable under The Plan with an average exercise price of \$19.62 per share (average exercise price, adjusted to give effect to the dividend equivalent rights is \$4.29 per share).

In 1991, the Trustees adopted a share compensation plan for Trustees who are neither employees nor officers of the Trust (Outside Trustees). There are 40,000 shares reserved for issuance under this plan. Pursuant to the plan, each Outside Trustee may elect to receive, in lieu of all or a portion of the quarterly cash compensation for services as a Trustee, shares of the Trust based on the closing price of the shares on the date of issuance. As of December 31, 2006, no shares have been issued under this plan.

Compensation cost related to stock options is recognized under the straight-line method over the stated vesting period of the award. The fair value of each option grant was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions used for the one option grant that occurred in 2004, and the two option grants that occurred in 2005; the 2006 weighted average assumption ranges were based upon the seven option grants that occurred between 2002 and 2006 that were granted or vesting on or after January 1, 2006:

Year Ended December 31,	2006	2005	2004
Volatility	17%	18% - 19%	18%
Interest rate	4%	4%	3%

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Expected life (years)	9.2	9.2	9.2
Forfeiture rate	2%	3%	0%
Dividend yield(a.)	0%	6.5%	6.5%

(a.) Fair value calculated at 0% expected dividend yield to provide for effect of DERs.

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Stock options to purchase shares of beneficial interest have been granted to eligible individuals, including our officers and trustees, under various plans. Information with respect to these options, before adjustment to the option price to give effect to the dividend equivalent rights, is summarized as follows:

Outstanding Options	Number of Shares	Exercise Weighted-Average Price	Grant Price Range (High-Low)
Balance, January 1, 2004	95,500	\$ 18.92	\$ 29.44/\$14.75
Granted	5,000	\$ 34.07	\$ 34.07/\$34.07
Balance, January 1, 2005	100,500	\$ 19.67	\$ 34.07/\$14.75
Granted	14,000	\$ 34.55	\$ 34.90/\$30.06
Exercised	(4,500)	\$ 20.13	\$ 34.07/\$14.75
Cancelled	(1,000)	\$ 32.47	\$ 34.07/\$27.65
Balance, January 1, 2006	109,000	\$ 21.45	\$ 34.90/\$14.75
Balance, December 31, 2006	109,000	\$ 21.45	\$ 34.90/\$14.75

There were no options granted, exercised or cancelled during 2006.

The following table provides information about options outstanding and exercisable options at December 31, 2006:

	Options Outstanding	Options Exercisable
Number	109,000	94,750
Weighted average exercise price	\$ 21.45	\$ 19.62
Aggregate intrinsic value	\$ 1,911,000	\$ 1,835,000
Weighted average remaining contractual life	3.1	2.3

The weighted average remaining contractual life and weighted average exercise price for options outstanding and the weighted average exercise prices per share for exercisable and expected to vest options at December 31, 2006 were as follows:

Exercise Price	Options Outstanding			Exercisable Options		Expected to Vest Options (a.)	
	Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life (in Years)	Shares	Weighted Average Exercise Price Per Share	Shares	Weighted Average Exercise Price Per Share

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\$14.75 - \$14.75	24,000	\$ 14.75	3.2	24,000	\$ 14.75	N/A	N/A
\$18.625 - \$19.625	52,500	18.67	.5	52,500	18.67	N/A	N/A
\$21.4375 - \$26.25	7,500	24.62	4.5	6,500	24.37	983	\$ 26.25
\$27.65 - \$29.44	7,000	28.42	6.2	6,250	28.29	737	29.44
\$30.06 - \$34.90	18,000	34.45	8.5	5,500	34.38	12,285	34.48
Total	109,000	\$ 21.45	3.1	94,750	\$ 19.62	14,005	\$ 33.63

(a.) Assumes a weighted average forfeiture rate of 1.7%

(9) SUMMARIZED FINANCIAL INFORMATION OF EQUITY AFFILIATES

Our consolidated financial statements include the consolidated accounts of our controlled investments and those investments that meet the criteria of a variable interest entity where we are the primary beneficiary as a result of our level of investment in the entity. In accordance with the American Institute of Certified Public Accountants' Statement of Position 78-9 Accounting for Investments in Real Estate Ventures and Emerging Issues Task Force Issue 96-16, Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights, we

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account for our unconsolidated investments in LLCs which we do not control using the equity method of accounting. The third-party members in these investments have equal voting rights with regards to issues such as, but not limited to: (i) divestiture of property; (ii) annual budget approval, and; (iii) financing commitments. These investments, which represent 33% to 99% non-controlling ownership interests, are recorded initially at our cost and subsequently adjusted for our net equity in the net income, cash contributions to, and distributions from, the investments. Pursuant to certain agreements, allocations of profits and losses of some of the LLC investments may be allocated disproportionately as compared to ownership interests after specified preferred return rate thresholds have been satisfied.

In January 2003, the FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51. This Interpretation, as revised (FIN 46R), addresses the consolidation by business enterprises of variable interest entities as defined in the Interpretation. As a result of our related party relationship with UHS, and certain master lease, lease assurance or lease guarantee arrangements between UHS and various properties owned by three LLCs in which we own non-controlling ownership interests ranging from 95% to 99%, these LLCs were considered to be variable interest entities (see note 9). In addition, we were the primary beneficiary of these LLC investments. Upon the adoption of FIN 46R on March 31, 2004, we began consolidating the results of operations of these three LLC investments in our consolidated financial statements.

As a result of the expiration of the master lease arrangements between subsidiaries of UHS and two of these three LLCs, during the fourth quarter of 2006, we began recording the financial results of two LLCs on an unconsolidated basis in our consolidated financial statements. Commencing in the fourth quarter of 2006, the revenues and expenses of these two LLCs are no longer included in our consolidated revenues and expenses; instead, the net income generated from each of these LLCs is included in our consolidated statements of income as Equity in income of unconsolidated LLCs. The revenues and expenses for these LLCs related to the periods prior to the fourth quarter are included in our revenues and expenses in our consolidated statements of income. There was no impact on our net income as a result of recording of the financial results of these LLCs on a consolidated or an unconsolidated basis. The other LLCs in which we hold various non-controlling ownership interests are not variable interest entities and therefore are not subject to the consolidation requirements of FIN 46R.

Rental income is recorded by our consolidated and unconsolidated MOBs relating to leases in excess of one year in length using the straight-line method under which contractual rents are recognized evenly over the lease term regardless of when payments are due. The amount of rental revenue resulting from straight-line rent adjustments is dependent on many factors, including the nature and amount of any rental concessions granted to new tenants, scheduled rent increases under existing leases, as well as the acquisition and sales of properties that have existing in-place leases with terms in excess of one year. As a result, the straight-line adjustments to rental revenue may vary from period-to-period. Pursuant to certain agreements, allocations of profits and losses of some of the LLC investments may be allocated disproportionately as compared to ownership interest after specified preferred return rate thresholds have been satisfied.

Since January 1, 1995 through December 31, 2006, we have invested \$61.9 million of cash (including advances to various LLCs) in LLCs in which we own various non-controlling equity interests ranging from 33% to 99% (consolidated and unconsolidated), before reductions for cash distributions received from the LLCs. As of December 31, 2006, short-term unsecured advances aggregated \$7.2 million due from six LLCs. Including the cumulative adjustments for our share of equity in the net income of the LLCs and cash contributions to and distributions from these investments, our net investment in LLCs was \$47.2 million, (including the investments in two LLCs that were consolidated prior to the fourth quarter of 2006, as discussed above), as reflected on our consolidated balance sheet as of December 31, 2006.

As of December 31, 2006, we had investments or commitments to invest in twenty-five LLCs. Three of these LLCs were consolidated into the results of operations through the third quarter of 2006. During the fourth quarter of 2006, as discussed above, we began recording the financial results of two LLCs on an unconsolidated basis, and continued accounting for one LLC on a consolidated basis. The following tables represent summarized

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financial and other information related to the twenty-four LLCs which were accounted for under the equity method as of December 31, 2006:

Name of LLC	Ownership	Property Owned by LLC
DSMB Properties	76%	Desert Samaritan Hospital MOBs
DVMC Properties(f.)	90%	Desert Valley Medical Center
Suburban Properties	33%	Suburban Medical Plaza II
Litchvan Investments	89%	Papago Medical Park
Paseo Medical Properties II	75%	Thunderbird Paseo Medical Plaza I & II
Willetta Medical Properties(f.)	90%	Edwards Medical Plaza
RioMed Investments(k.)	80%	Rio Rancho Medical Center
Santa Fe Scottsdale(f.)	90%	Santa Fe Professional Plaza
575 Hardy Investors(f.)	90%	Centinela Medical Building Complex
Brunswick Associates	74%	Mid Coast Hospital MOB
Deerval Properties	90%	Deer Valley Medical Office II
PCH Medical Properties	85%	Rosenberg Children s Medical Plaza
Gold Shadow Properties(a.)	98%	700 Shadow Lane & Goldring MOBs
Arlington Medical Properties(b.)	75%	Saint Mary s Professional Office Building
ApaMed Properties	85%	Apache Junction Medical Plaza
Spring Valley Medical Properties(a.)	95%	Spring Valley Medical Office Building
Sierra Medical Properties(c.)	95%	Sierra San Antonio Medical Plaza
Spring Valley Medical Properties II(d.)	95%	Spring Valley Medical Office Building II
PCH Southern Properties(e.)	95%	Phoenix Children s East Valley Care Center
Centennial Medical Properties(g.)	95%	Centennial Hills Medical Office Building I
Canyon Healthcare Properties(h.)	95%	Canyon Springs Medical Plaza
Palmdale Medical Properties(i.)	95%	Palmdale Medical Plaza
653 Town Center Drive(j.)	95%	Summerlin Hospital Medical Office Building
DesMed(l.)	99%	Desert Springs Medical Plaza

- (a.) Tenants of this medical office building include subsidiaries of UHS.
- (b.) We have committed to invest a total of up to \$8.0 million in equity, of which \$5.2 million has been funded in exchange for a 75% non-controlling interest in a LLC that constructed and owns the Saint Mary s Professional Office Building located in Reno, Nevada. As of December 31, 2006, the LLC has an outstanding mortgage balance of \$28.4 million from a third party, which is non-recourse to us. This medical office building opened in March of 2005.
- (c.) We have committed to invest a total of up to \$3.5 million in equity in exchange for a 95% non-controlling interest in a LLC that will develop, construct, own and operate the Sierra San Antonio Medical Plaza located in Fontana, California. As of December 31, 2006, we have invested \$2.6 million in equity and \$485,000 in debt financing in connection with this project. The LLC has a \$7.5 million total construction loan commitment from a third-party, which is non-recourse to us. This project was completed and opened during the first quarter of 2006.
- (d.) We have committed to invest a total of up to \$12.3 million (\$3.4 million in equity, \$79,000 of which was funded as of December 31, 2006, and \$8.9 million in debt financing, of which \$5.3 million has been funded as of December 31, 2006) in exchange for a 95% non-controlling interest in a LLC that will develop, construct, own and operate the Spring Valley Hospital Medical Office Building II, located in Las Vegas, Nevada on the campus of a UHS facility. This project, tenants of which may include subsidiaries of UHS, is scheduled to be completed and opened during the second quarter of 2007.
- (e.) We have committed to invest up to \$3.5 million in equity, of which \$1.5 million has been funded as of December 31, 2006; additionally, \$363,000 in debt financing has been funded as of December 31, 2006, in exchange for a 95% non-controlling ownership interest in a LLC that will develop, construct, own and operate the Phoenix Children s East Valley Care Center located in Gilbert, Arizona. The LLC has a \$6.8 million total construction loan commitment from a third-party, which is non-recourse to us. This project is scheduled to be completed and opened during the fourth quarter of 2007.

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- (f.) The membership interests of this entity are held by a master LLC in which we hold a 90% non-controlling ownership interest.
- (g.) We have committed to invest up to \$6.6 million (\$250,000 in equity, \$53,000 of which has been funded as of December 31, 2006 and \$6.3 million in debt financing or equity, none of which has been funded as of December 31, 2006) in exchange for a 95% non-controlling interest in a LLC that will develop, construct, operate and own the Centennial Hills Medical Office Building I, located in Las Vegas, Nevada. The LLC has a \$15.7 million construction loan agreement with a third party, which is non-recourse to us, under which \$2.8 million has been drawn as of December 31, 2006. This project is scheduled to be completed and opened during the third quarter of 2007.
- (h.) We have committed to invest up to \$6.0 million (\$5.5 million in equity, \$67,000 of which has been funded as of December 31, 2006, and \$500,000 in either equity and/or debt financing, none of which has been funded as of December 31, 2006) in exchange for a 95% non-controlling equity interest in a LLC that will develop, construct, own and operate the Canyon Springs Medical Plaza in Gilbert, Arizona. The LLC has a \$14.2 million construction loan agreement with a third party, which is non-recourse to us, under which \$2.9 million has been drawn as of December 31, 2006. This project is scheduled to be completed and opened during the third quarter of 2007.
- (i.) We have committed to invest up to \$4.3 million in equity of which \$86,000 has been funded as of December 31, 2006 in exchange for a 95% non-controlling interest in a LLC that will develop, construct, own, and operate the Palmdale Medical Plaza in Palmdale, California. The LLC has a \$9.9 million construction loan agreement with a third party, which is non-recourse to us, under which \$1.6 million has been drawn as of December 31, 2006. This project, tenants of which may include subsidiaries of UHS, is scheduled to be completed and opened during the fourth quarter of 2007.
- (j.) Tenants of these medical office buildings include subsidiaries of UHS. As discussed above, we began recording these LLCs on an unconsolidated basis during the fourth quarter of 2006.
- (k.) Subsequent to December 31, 2006, the real estate assets of this LLC were sold.
- (l.) The membership interest of this entity is held by a master LLC in which we hold a 95% non-controlling ownership interest.

During the fourth quarter of 2005, we sold our non-controlling equity interest in West Highland Holdings, a LLC which owned the St. Jude Heritage Health Complex, located in California, in exchange for a \$3.1 million note receivable which was collateralized by the entire ownership interest of the LLC. This transaction resulted in a deferred gain of \$1.9 million which we recognized as income during 2006 when the cash proceeds to repay the note receivable were received by us.

During the first quarter of 2005, Bayway properties, a LLC in which we owned a 73% non-controlling ownership interest, sold the real estate assets of the East Mesa Medical Center, located in Mesa, Arizona. Our share of the net sale proceeds resulting from this transaction was \$2.9 million. The transaction resulted in a gain of approximately \$1.0 million, which is included in our results of operations for 2005.

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Below are the combined statements of income for the LLCs accounted for under the equity method:

	For the Year Ended December 31,		
	2006	2005	2004
	(amounts in thousands)		
Revenues	\$ 34,524	\$ 31,689	\$ 28,961
Operating expenses	14,853	13,993	12,069
Depreciation and amortization	6,213	5,484	5,006
Interest, net	10,021	9,033	7,600
Net income before gain	3,437	3,179	4,286
Gains on sales		1,693	1,192
Net income	\$ 3,437	\$ 4,872	\$ 5,478
Our share of net income before gains on sales(a.)	\$ 2,381	\$ 3,559	\$ 3,958
Our share of gains on sales	1,860(a.)	1,043	1,009
Our share of net income	\$ 4,241	\$ 4,602	\$ 4,967

(a.) Consists of a previously deferred gain of \$1.9 million resulting from the sale of our interest in an unconsolidated LLC during the fourth quarter of 2005.

Included in the 2006 information presented above was the combined income statement information for two above-mentioned LLCs that we began accounting for on an unconsolidated basis during the fourth quarter of 2006, pursuant to the provisions of FIN 46R. The combined revenue amounts included in the table above for the fourth quarter of 2006 for these two properties were \$834,000, the combined operating expenses were \$377,000, the combined depreciation and amortization expenses were \$172,000 and the combined net interest expense was \$192,000. For the year ended December 31, 2006, the amount of combined revenue reflected on our consolidated income statement for these two LLCs while accounted for on a consolidated basis, and therefore not included in the table above, totaled \$3.8 million, the amount of combined operating expenses were \$1.6 million, the combined depreciation and amortization expenses were \$736,000 and the combined net interest expense was \$715,000. There was no impact on our net income as a result of recording these two LLCs on an unconsolidated basis.

Included in the information presented above for the three months ended March 31, 2004 was the combined income statement information for three LLCs that we began including in our consolidated statements of income on April 1, 2004, pursuant to the provisions of FIN 46R. For the nine month period from April 1, 2004 to December 31, 2004, these three LLCs had combined revenues of \$4.8 million, operating expenses of \$1.7 million, depreciation and amortization expense of \$900,000 and interest expense of \$1.3 million. During the three month period ended March 31, 2004, these properties generated approximately \$1.6 million of revenue, \$300,000 of depreciation and amortization expense, \$500,000 of other operating expenses and \$400,000 of interest expense. There was no impact on our net income as a result of the consolidation of these LLCs.

Below are the combined balance sheets for the LLCs accounted for under the equity method:

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	December 31,	
	2006(a.)	2005
	(amounts in thousands)	
Net property, including CIP	\$ 210,241	\$ 163,942
Other assets	16,840	19,685
Total assets	\$ 227,081	\$ 183,627
Liabilities	\$ 3,930	\$ 6,086
Mortgage notes payable, non-recourse to us	180,928	152,301
Notes payable to us	7,238	1,859
Equity	34,985	23,381
Total liabilities and equity	\$ 227,081	\$ 183,627
Our share of equity and notes receivable from LLCs	\$ 47,223	\$ 29,572

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- (a.) Includes the assets, liabilities and equity related to the two LLCs discussed above which we began accounting for on an unconsolidated basis during the fourth quarter of 2006.

As of December 31, 2006, aggregate maturities of mortgage notes payable by unconsolidated LLCs, which are accounted for under the equity method and are non-recourse to us, are as follows (amounts in thousands):

2007	\$ 18,299
2008	24,077
2009	9,688
2010	23,216
2011	11,245
Later	94,403
	<hr/>
Total	\$ 180,928

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

On May 1, 2005, we entered into an agreement with the unrelated third-party member to twenty-five of the LLCs in which we hold various ownership interests, whereby we agreed to restructure our ownership interests in five existing LLCs with the third-party member. During the second quarter of 2005, we paid approximately \$2.5 million in cash to the third-party member as net consideration for these transactions based on an agreed upon fair market valuation for the properties. In connection with this agreement, we also established two master limited liability companies to hold certain of the jointly-owned LLCs and entered into a new ventures agreement that will govern all our future joint investments with this third-party member.

The LLCs in which we have invested maintain property insurance on all properties. Although we believe that generally our properties are adequately insured, two of the LLCs in which we own various non-controlling equity interests, own properties in California that are located in earthquake zones. These properties, in which we have invested a total of \$5.6 million, are no longer covered by earthquake insurance since earthquake insurance is no longer available at rates which are economical in relation to the risks covered.

(10) SEGMENT REPORTING

Our primary business is investing in and leasing healthcare and human service facilities through direct ownership or through joint ventures, which aggregate into a single reportable segment under SFAS 131. We actively manage our portfolio of healthcare and human service facilities and may from time to time make decisions to sell lower performing properties not meeting our long-term investment objectives. The proceeds of sales are typically reinvested in new developments or acquisitions, which we believe will meet our planned rate of return. It is our intent that all healthcare and human service facilities will be owned or developed for investment purposes. Our revenue and net income are generated from the operation of our investment portfolio.

Our portfolio is located throughout the United States; however, we do not distinguish or group our operations on a geographical basis for purposes of allocating resources or measuring performance. We review

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operating and financial data for each property on an individual basis, therefore we define an operating segment as our individual properties. Individual properties have been aggregated into one reportable segment based upon their similarities with regard to both the nature and economics of the facilities, tenants and operational processes, as well as long-term average financial performance.

(11) QUARTERLY RESULTS (unaudited)

	2006				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
	(amounts in thousands, except per share amounts)				
Revenues	\$ 8,359	\$ 8,328	\$ 8,395	\$ 7,427	\$ 32,509
Net Income	\$ 4,948	\$ 6,892	\$ 15,725	\$ 7,132	\$ 34,697
Total basic earnings per share	\$ 0.42	\$ 0.58	\$ 1.33	\$ 0.60	\$ 2.94
Total diluted earnings per share	\$ 0.42	\$ 0.58	\$ 1.32	\$ 0.60	\$ 2.92

Included in net income during the third and fourth quarters of 2006 are gains on the asset exchange and substitution agreement with UHS of \$11.3 million and \$2.7 million, respectively. Revenues during the fourth quarter of 2006 exclude the \$834,000 of combined revenues generated by two LLCs that we began recording on an unconsolidated basis during the fourth quarter of 2006.

	2005				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
	(amounts in thousands, except per share amounts)				
Revenues	\$ 8,491	\$ 8,345	\$ 8,217	\$ 8,285	\$ 33,338
Net Income	\$ 7,580	\$ 6,205	\$ 6,408	\$ 5,230	\$ 25,423
Total basic earnings per share	\$ 0.64	\$ 0.53	\$ 0.54	\$ 0.44	\$ 2.16
Total diluted earnings per share	\$ 0.64	\$ 0.52	\$ 0.54	\$ 0.44	\$ 2.15

Included in net income during the first quarter of 2005 is a gain on the sale of real property by a LLC of \$1.0 million, or \$.09 per diluted share. Included in net income during all four quarters of 2005 is \$1.5 million, \$1.2 million, \$1.2 million and \$750,000, respectively, related to the recovery of replacement costs of real estate assets at Wellington Regional Medical Center that were damaged by hurricanes during 2004.

Table of Contents**Schedule III****Universal Health Realty Income Trust****Real Estate and Accumulated Depreciation December 31, 2006**

(amounts in thousands)

Description	Initial Cost to Universal Health Realty Income Trust		Net cost capitalized/ divested subsequent to acquisition	Gross amount at which carried at close of period			Accumulated Depreciation as of Dec. 31, 2006	Date of construction, acquisition or most recent significant expansion or renovation	Date Acquired	Average Depreciable Life	
	Land	Building & Improv.		Land	Building & Improvements	CIP					Total
Inland Valley Regional Medical Center <i>Wildomar, California</i>	\$ 2,050	\$ 10,701	\$ 12,088(c.)	\$ 2,050	\$ 13,569	\$ 9,220	\$ 24,839	\$ 5,704	2006	1986	43 Years
McAllen Medical Center <i>McAllen, Texas</i>	4,720	31,442	10,188	6,281	40,069		46,350	16,823	1994	1986	42 Years
Wellington Regional Medical Center <i>West Palm Beach, Florida</i>	1,190	14,652	17,370(c.)	1,663	31,549		33,212	7,652(a.)	2006	1986	42 Years
The Bridgeway <i>North Little Rock, Arkansas</i>	150	5,395	4,571(c.)	150	9,966		10,116	3,419	2006	1986	35 Years
Tri-State Rehabilitation Hospital <i>Evansville, Indiana</i>	500	6,945	1,062	500	8,007		8,507	3,444	1993	1989	40 Years
Kindred Hospital Chicago Central <i>Chicago, Illinois</i>	158	6,404	1,837	158	8,241		8,399	6,309	1993	1986	25 Years
Fresno-Herndon Medical Plaza <i>Fresno, California</i>	1,073	5,266	95	1,073	5,361		6,434	1,438	1992	1994	45 Years
Family Doctor's Medical Office Building <i>Shreveport, Louisiana</i>	54	1,526	494	54	2,020		2,074	521	1991	1995	45 Years
Kelsey-Seybold Clinic at King's Crossing <i>Kingwood, Texas</i>	439	1,618	232	439	1,850		2,289	444	1995	1995	45 Years
Professional Center at King's Crossing <i>Kingwood, Texas</i>	439	1,837	93	439	1,930		2,369	478	1995	1995	45 Years
Chesterbrook Academy <i>Audubon, Pennsylvania</i>	307	996		307	996		1,303	236	1996	1996	45 Years
Chesterbrook Academy <i>New Britain, Pennsylvania</i>	250	744		250	744		994	176	1991	1996	45 Years
	180	815		180	815		995	193	1992	1996	45 Years

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Chesterbrook Academy <i>Uwchlan, Pennsylvania</i>										
Chesterbrook Academy <i>Newtown, Pennsylvania</i>	195	749		195	749	944	178	1992	1996	45 Years
The Southern Crescent Center										
	1,130	5,092	173	1,130	5,265	6,395	1,232	1994	1996	45 Years
The Southern Crescent Center II <i>Riverdale, Georgia</i>										
			5,095	806	4,289	5,095	800	2000	1998	35 Years
The Cypresswood Professional Center <i>Spring, Texas</i>										
	573	3,842	197	573	4,039	4,612	1,097	1997	1997	35 Years
Orthopaedic Specialists of Nevada Building <i>Las Vegas, Nevada</i>										
		1,579		1,579		1,579	458	1999	1999	25 Years
Sheffield Medical Building <i>Atlanta, Georgia</i>										
	1,760	9,766	1,663	1,760	11,429	13,189	3,121	1999	1999	25 Years
Medical Center of Western Connecticut Bldg. 73 (a.) <i>Danbury, Connecticut</i>										
	1,151	5,176	190	1,151	5,366	6,517	1,235	2000	2000	30 Years
Summerlin Hospital MOB II (b.) <i>Las Vegas, Nevada</i>										
	158	13,073	855	158	13,928	14,086	1,977	2000	2000	40 Years
TOTALS										
	\$ 16,477	\$ 127,618	\$ 56,203	\$ 19,317	\$ 171,761	\$ 9,220	\$ 200,298	\$ 56,935		

- At December 31, 2006 this property had an outstanding mortgage balance of \$3.8 million. The mortgage carries a 8.3% interest rate and matures on February 1, 2010. The mortgage is non-recourse to us and is secured by the Medical Center of Western Connecticut.
- At December 31, 2006 this property had an outstanding mortgage balance of \$8.9 million. The mortgage carries a 8.3% interest rate and matures on December 10, 2010. The mortgage is non-recourse to us and is secured by the Summerlin Hospital MOB II.
- Includes Asset Exchange and Substitution Agreement transaction completed during the third quarter of 2006.

Table of Contents**UNIVERSAL HEALTH REALTY INCOME TRUST****NOTES TO SCHEDULE III****DECEMBER 31, 2006****(amounts in thousands)****(1) RECONCILIATION OF REAL ESTATE PROPERTIES**

The following table reconciles the Real Estate Properties from January 1, 2004 to December 31, 2006:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Balance at January 1,	\$ 210,594	\$ 214,254	\$ 182,417
Initial consolidation of variable interest entities			43,592
Impact of deconsolidating two LLCs	(31,804)		
Property write-down due to hurricane damage		(10,621)	(2,931)
Sale of real property			(11,215)
Construction in progress	9,220		1,863
Other		(123)	
Additions(a.)	12,288	7,084	528
	<u> </u>	<u> </u>	<u> </u>
Balance at December 31,	<u>\$ 200,298</u>	<u>\$ 210,594</u>	<u>\$ 214,254</u>

(2) RECONCILIATION OF ACCUMULATED DEPRECIATION

The following table reconciles the Accumulated Depreciation from January 1, 2004 to December 31, 2006:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Balance at January 1,	\$ 57,729	\$ 56,609	\$ 52,075
Initial consolidation of variable interest entities			5,292
Impact of deconsolidating two LLCs	(6,232)		
Property write-down due to hurricane damage		(4,362)	(1,068)
Sale of real property			(4,728)
Other		(21)	
Current year depreciation expense	5,438	5,503	5,038
	<u> </u>	<u> </u>	<u> </u>
Balance at December 31,	<u>\$ 56,935</u>	<u>\$ 57,729</u>	<u>\$ 56,609</u>

(a.) 2006 and 2005 amounts include replacement property recovered from UHS.

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Exhibit No.	Exhibit
3.1	Declaration of Trust, dated as of August 1986, previously filed as Exhibit 4.1 to the Trust's Registration Statement on Form S-3 (File No. 333-60638) is incorporated herein by reference.
3.2	Amendment to Declaration of Trust, dated as of June 15, 1993, previously filed as Exhibit 4.2 to the Trust's Registration Statement on Form S-3 (File No. 333-60638) is incorporated herein by reference.
3.3	Amended and restated bylaws previously filed as Exhibit 4.3 to the Trust's registration statement on Form S-3 (File No. 333-60638) is incorporated herein by reference.
10.1	Advisory Agreement, dated as of December 24, 1986, between UHS of Delaware, Inc. and the Trust, previously filed as Exhibit 10.2 to the Trust's Current Report on Form 8-K dated December 24, 1986, is incorporated herein by reference.
10.2	Agreement dated December 29, 2006, to renew Advisory Agreement dated as of December 24, 1986 between Universal Health Realty Income Trust and UHS of Delaware, Inc.
10.3	Contract of Acquisition, dated as of August 1986, between the Trust and certain subsidiaries of Universal Health Services, Inc., previously filed as Exhibit 10.2 to Amendment No. 3 of the Registration Statement on Form S-11 and S-2 of Universal Health Services, Inc. and the Trust (File No. 33-7872), is incorporated herein by reference.
10.4	Form of Leases, including Form of Master Lease Document Leases, between certain subsidiaries of Universal Health Services, Inc. and the Trust, previously filed as Exhibit 10.3 to Amendment No. 3 of the Registration Statement on Form S-11 and Form S-2 of Universal Health Services, Inc. and the Trust (File No. 33-7872), is incorporated herein by reference.
10.5	Corporate Guaranty of Obligations of Subsidiaries Pursuant to Leases and Contract of Acquisition, dated December 1986, issued by Universal Health Services, Inc. in favor of the Trust, previously filed as Exhibit 10.5 to the Trust's Current Report on Form 8-K dated December 24, 1986, is incorporated herein by reference.
10.6*	Share Compensation Plan for Outside Trustees, previously filed as Exhibit 10.12 to the Trust's Annual Report on Form 10-K for the year ended December 31, 1991, is incorporated herein by reference.
10.7	Lease, dated December 22, 1993, between the Trust and THC-Chicago, Inc., as lessee, previously filed as Exhibit 10.14 to the Trust's Annual Report on Form 10-K for the year ended December 31, 1993, is incorporated herein by reference.
10.8*	Universal Health Realty Income Trust 1997 Incentive Plan, previously filed as Exhibit 10.1 to the Trust's Form 10-Q for the quarter ended September 30, 1997, is incorporated herein by reference.
10.9	Credit Agreement, dated as of January 19, 2007, by and among the Trust, the financial institutions from time to time party thereto and Wachovia Bank, National Association, as Administrative Agent, previously filed as Exhibit 10.1 to the Trust's Current Report on Form 8-K dated January 24, 2007, is incorporated herein by reference.
10.10	Dividend Reinvestment and Share Purchase Plan included in the Trust's Registration Statement Form S-3 (Registration No. 333-81763) filed on June 28, 1999, is incorporated herein by reference.
10.11	Asset Exchange and Substitution Agreement, dated as of April 24, 2006, by and among the Trust and Universal Health Services, Inc. and certain of its subsidiaries, previously filed as Exhibit 10.1 to the Trust's Current Report on Form 8-K dated April 25, 2006, is incorporated herein by reference.

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<u>Exhibit No.</u>	<u>Exhibit</u>
10.12	Amendment No. 1 to the Master Lease Document, between certain subsidiaries of Universal Health Services, Inc. and the Trust, previously filed as Exhibit 10.2 to the Trust's Current Report on Form 8-K dated April 25, 2006, is incorporated herein by reference.
11	Statement re computation of per share earnings is set forth on the Consolidated Statements of Income.
21	Subsidiaries of Registrant.
23.1	Consent of Independent Registered Public Accounting Firm.
31.1	Certification from the Trust's Chief Executive Officer Pursuant to Rule 13a-14(a)/15(d)-14(a) of the Securities Exchange Act of 1934.
31.2	Certification from the Trust's Chief Financial Officer Pursuant to Rule 13a-14(a)/15(d)-14(a) of the Securities Exchange Act of 1934.
32.1	Certification from the Trust's Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as Adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification from the Trust's Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as Adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Management contract or compensatory plan or arrangement.