

HEALTHCARE REALTY  
TRUST

ANNUAL REPORT TO SHAREHOLDERS  
**1997**

**COMPANY PROFILE:** Healthcare Realty Trust is a self-managed and self-administered Real Estate Investment Trust that integrates owning, managing and developing income-producing real estate properties associated with the delivery of healthcare services throughout the United States. The Company's portfolio is comprised of seven facility types, located in 44 markets nationwide, and operated pursuant to contractual arrangements with 18 healthcare providers.

Since commencing operations in June 1993, the Company has invested or committed to invest over \$525 million in 87 income-producing real estate properties, totaling over 4.4 million square feet. The Company currently provides property management services for 130 properties, totaling over 3.9 million square feet, and third-party asset management services for 251 properties, totaling over 1.3 million square feet.

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

*Corporate Performance &  
Selected Financial  
HIGHLIGHTS*

**INVESTMENT:** Healthcare Realty Trust acquired, developed, funded or committed to fund \$73.7 million in healthcare-related real estate, including properties in Los Angeles, California; Kansas City, Missouri; Nashville, Tennessee; Cleveland, Tennessee; Greeley, Colorado; and Globe, Arizona.

**MANAGEMENT:** The Company added over 2.7 million square feet to its management portfolio, including property and asset management agreements with the South Florida and Southwest Florida divisions of Columbia/HCA Healthcare Corporation. The two engagements encompass 311 properties or leasehold interests, affiliated with 26 hospitals, totaling approximately 2.4 million square feet of ancillary and medical office space.

**RELATIONSHIPS:** The Company recently acquired, and will manage, four physician clinics under a long-term agreement with Vanderbilt University Medical Center. This investment marks the beginning of a relationship that will assist the Medical Center in expanding its integrated delivery network in Nashville and Middle Tennessee.

**SELECTED FINANCIAL HIGHLIGHTS**

<i>(in thousands, except per share data)</i>	Year Ended December 31,				
	1997	1996	1995	1994	1993 <sup>(1)</sup>
Revenues					
Master lease rental income	\$ 40,298	\$ 35,329	\$ 32,402	\$ 23,231	\$ 7,067
Property operating income	14,631	1,338	-	-	-
Management fees	1,499	1,111	466	-	-
Interest and other income	3,368	796	493	995	68
	<b>\$ 59,796</b>	<b>\$ 38,574</b>	<b>\$ 33,361</b>	<b>\$ 24,226</b>	<b>\$ 7,135</b>
Net income	\$ 31,212	\$ 19,732	\$ 18,258	\$ 15,716	\$ 3,950
Net income per share - Basic	\$ 1.71	\$ 1.52	\$ 1.41	\$ 1.33	\$ 0.64
Net income per share - Diluted	\$ 1.68	\$ 1.49	\$ 1.41	\$ 1.33	\$ 0.63
Funds from operations	\$ 42,337	\$ 28,036	\$ 25,490	\$ 20,919	\$ 5,774
Funds from operations per share - Basic	\$ 2.32	\$ 2.15	\$ 1.97	\$ 1.77	\$ 0.93
Funds from operations per share - Diluted	\$ 2.28	\$ 2.11	\$ 1.97	\$ 1.76	\$ 0.93
Weighted average shares outstanding - Basic	18,222,243	13,014,286	12,931,082	11,806,864	6,185,600
Weighted average shares outstanding - Diluted	18,572,492	13,261,291	12,970,326	11,859,714	6,237,053

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

*Letter*  
*to*  
S H A R E H O L D E R S

I am pleased to report Healthcare Realty Trust's fifth outstanding year and 18th consecutive profitable quarter as a public company. Our portfolio of quality healthcare properties, coupled with the achievements of our property management group, generated solid revenue and earnings growth. The Company's performance continues to provide increasing value for our shareholders.

Revenues for 1997 totaled \$59.8 million, compared with \$38.6 million for the prior year. Net income was \$31.2 million or \$1.68 per diluted share (\$1.71 per basic share), compared with \$19.7 million or \$1.49 per diluted share (\$1.52 per basic share) for the year ended December 31, 1996. Funds from operations, composed of net income and depreciation from real estate, totaled \$42.3 million or \$2.28 per diluted share (\$2.32 per basic share) for the 12-month period. This compares with \$28.0 million or \$2.11 per diluted share (\$2.15 per basic share) for the same period in 1996.

In the fourth quarter of 1997, revenues totaled \$16.8 million, a 54% increase over the prior year's \$10.9 million. Net income for the period was \$8.4 million or \$0.44 per diluted and basic share, compared with \$5.1 million or \$0.38 per diluted and basic share for the same quarter 1996.

Since its formation in June 1993, the Company has increased the dividend paid to its shareholders every quarter. Total dividend payments for the calendar year 1997 were \$1.99 per share, compared with \$1.91 per share for the calendar year 1996, an increase of 4.2%. The dividend payout, as a percentage of funds from operations, decreased to 86%. Dividend and share price growth have provided our shareholders a total return averaging 17.6% per year since the founding of the Company.

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

**A SOUND AND GROWING INDUSTRY** Change has shaped the healthcare industry over the last 15 years as nearly every aspect of healthcare delivery – from diagnostic technology to reimbursement methods – has been retooled and enhanced. The number and volume of outpatient treatments continues to grow, and

consolidation persists as hospitals form integrated delivery networks to realize the economic efficiency of service continuums. Even as the industry realigns, the aging of the population, advances in technology and heightened focus on preventive medicine continue to increase demand for healthcare services. Expenditures for healthcare services and products are now estimated to total more than \$1 trillion annually – 13% of the Gross Domestic Product. Most hospital-based providers are posting record profits on increasing revenues, with operating margins at an all-time high. The industry is fundamentally sound.

The value of real estate related to healthcare services is immense – estimated to exceed \$900 billion – yet to date, real estate investment trusts have funded only slightly more than 1% of these properties. These circumstances present the Company with considerable growth potential, still we continue to grow conservatively, focusing on investments that exhibit sound real estate fundamentals in expanding sectors of healthcare delivery.

By the year 2000, outpatient revenues are expected to exceed 50% of total hospital revenues. Of the estimated \$12 billion in new healthcare facilities developed annually, approximately 75% are outpatient facilities.



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

Outpatient facilities currently comprise 79% of the Company's investment portfolio. As anticipated, transformations in the healthcare services industry continue to enhance investment and growth opportunities for Healthcare Realty Trust.

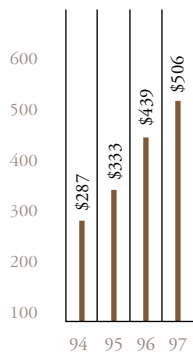
**INTEGRATED REAL ESTATE SOLUTIONS** Recent healthcare industry developments – integrated delivery networks, enhanced technology, physician practice acquisition and merger activity – have forced healthcare providers to look beyond traditional sources of funding and view real estate assets from a portfolio perspective. Innovative equity co-investment and asset management strategies allow providers to preserve control of their real estate, while affording increased financial flexibility and enhancing their mission to provide quality healthcare services.

Healthcare providers are focusing on their core business in the wake of the recent fraud-and-abuse investigations. In 1997, compliance became a priority of government investigators, making providers increasingly aware that implementing voluntary, self-compliance programs is a key component of risk management. Concerned that their ownership of physician-tenanted real estate could raise compliance issues, healthcare providers are forming strategic relationships with third-party real estate professionals in order to alleviate their fraud-and-abuse concerns. As an integrated real estate company, focused exclusively on the healthcare industry, the Company has positioned itself to benefit from the increasing demand for implementation of compliance programs.

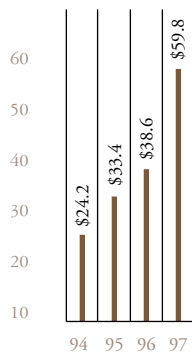
This year marked the relocation to our corporate office of the real estate services arm of the Company, Healthcare Realty Management. Consolidating our team of healthcare real estate specialists has improved collaboration, efficiency and the continuity of client services, which currently range from initial strategic market assessments and asset valuations to development services and property and asset management. The Company's strategy of combining capital resources with management and development expertise adds value for our clients, enhances shareholder return and differentiates the Company from other healthcare-focused real estate companies.

**HEALTHCARE REALTY TRUST AT A GLANCE:**

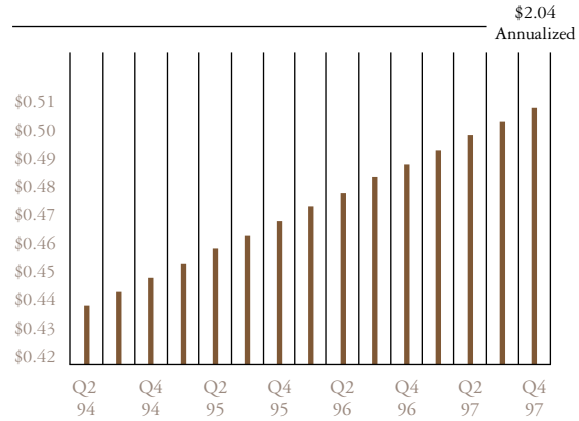
**INVESTMENTS**  
(\$ in millions)



**REVENUES**  
(\$ in millions)



**DIVIDENDS PER SHARE**



**STRATEGIC PARTNERSHIPS**

Healthcare Realty Trust continues to benefit from its integrated services strategy, as healthcare providers seek real estate partners – not just sources of capital. Our strategy is to build relationships with leading healthcare providers that establish market presence, align financial incentives and ensure long-term engagements. Such relationships tend to foster additional investments and the opportunity to provide related services on the same campus or within the market area. Notable events in 1997 that highlight this strategy include:

Healthcare Realty Trust’s \$15 million acquisition of an ancillary hospital facility adjacent to the 413-bed Fountain Valley Regional Hospital and Medical Center, operated by Tenet Healthcare Corporation. This most recent acquisition accompanies five other Tenet facilities which were purchased in 1994 and are located on the same Los Angeles campus.

A real estate property and asset management agreement with the South Florida Division of Columbia/HCA Healthcare Corporation. The engagement encompasses 129 properties, affiliated with 19 hospitals and totaling approximately 1.7 million square feet of ancillary and medical office space. The Company subsequently entered into a second real estate asset management agreement with the Southwest Florida Division of Columbia/HCA, covering 182 properties affiliated with seven hospitals and totaling over 736,000 square feet.

The acquisition of an 80,000 square foot, ancillary hospital facility currently under development and additional building sites adjacent to not-for-profit Bradley Memorial Hospital in Cleveland, Tennessee.

The Company continues to benefit from its exclusive agreement with VHA Inc., the national alliance of 1,550 not-for-profit healthcare organizations. In October, Healthcare Realty Trust announced an agreement

to develop and provide property management for an 83,000 square foot, medical office building located adjacent to Liberty Hospital in Kansas City, Missouri. The Company provided feasibility services to assist the hospital and its board in assessing physician interest, market conditions, and appropriate size and siting for the project. At year end, the Company was engaged in similar real estate assessments with several other VHA members.

In February of 1998, Healthcare Realty Trust acquired, and will manage, four physician clinic properties under a long-term agreement with Vanderbilt University Medical Center, which will utilize these facilities to expand its integrated delivery network in Nashville and Middle Tennessee. The Company expects to establish similar relationships as university-based healthcare systems adapt to the evolving marketplace.

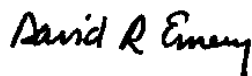
**CONSERVATIVE FINANCIAL MANAGEMENT** Healthcare Realty Trust's conservative capital structure and ample resources allow it to readily take advantage of worthy investment opportunities. Utilizing the relationships, expertise and experience that we have developed over many years in the industry, the management team employs a disciplined real estate investment strategy. We believe quality growth is achieved by focusing only on investments that sustain long-term performance and add economic value, rather than investments made solely for short-term growth.

The Company intends to maintain a low-risk profile through conservative use of debt leverage. At year-end, the ratio of debt to total book capitalization was 21%. In the first quarter of 1998, to enhance its capital base, Healthcare Realty Trust raised net proceeds of \$33.3 million through the sale of shares in two separate unit investment trust offerings by investment banks.

Healthcare Realty Trust's strategy is rooted in its intent to deliver superior returns to its shareholders. In calendar 1997, the Company's shareholders realized an annual return of 17.2%. At year-end, total cumulative shareholder return since the Company's Initial Public Offering in May 1993 had reached 111% – an average annual total return of approximately 17.6%.

We are pleased with Healthcare Realty Trust's progress and achievements during 1997 and are grateful to the Board of Directors and our employees for their diligence and dedication. We are also appreciative of our shareholders, whose support and involvement provide the foundation for the continued growth of the Company. I look forward to keeping you informed of our progress during 1998.

Sincerely yours,



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

*Representative*  
PROPERTIES



**CANDLER REGIONAL HEART & LUNG CENTER**  
*Savannah, Georgia*



**CHIPPENHAM MEDICAL OFFICES**  
*Richmond, Virginia*



**CORAL GABLES MEDICAL CENTER**  
*Coral Gables, Florida*



**GULF COAST MEDICAL CENTRE**  
*Ft. Myers, Florida*



**HUEBNER MEDICAL CENTER**  
*San Antonio, Texas*



**JOHNSTON-WILLIS MEDICAL OFFICES**  
*Richmond, Virginia*



**LEWIS-GALE CLINIC**  
*Roanoke, Virginia*



**OREGON MEDICAL BUILDING**  
*El Paso, Texas*



**PALM BEACH MEDICAL GROUP**  
*Palm Beach, Florida*



**ST. ANDREW'S SURGERY CENTER**  
*Venice, Florida*



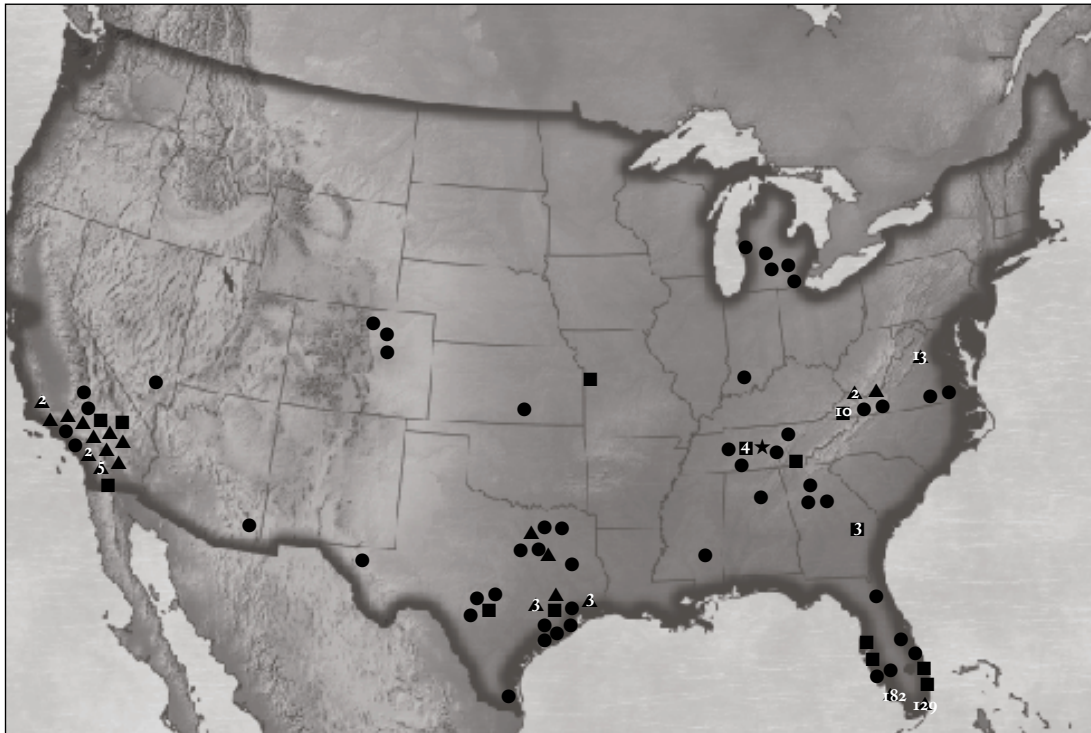
**ORANGE COUNTY REGIONAL  
CANCER CENTER**  
*Fountain Valley, California*



**VALLEY VIEW SURGERY CENTER**  
*Las Vegas, Nevada*



*Property*  
LOCATIONS



★ CORPORATE OFFICE      ● OWNED PROPERTIES      ▲ MANAGED PROPERTIES      ■ OWNED & MANAGED

*Healthcare Realty Trust's portfolio is comprised of seven facility types, located in 45 markets nationwide, and operated pursuant to contractual arrangements with 19 healthcare providers. Since commencing operations in June 1993, the Company has invested or committed to invest, over \$532 million in 91 income producing real estate properties containing over 4.5 million square feet related to the delivery of healthcare services.*

*The Company currently provides property management services for 134 properties, totaling over 4.0 million square feet, and third-party asset management services for 251 properties, totaling over 1.3 million square feet.*

Alabama	1	Georgia	6	Nevada	1
Arizona	2	Indiana	1	Virginia	16
California	10	Kansas	2	Tennessee	9
Colorado	3	Michigan	5	Texas	19
Florida	15	Mississippi	1		

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

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

	Years Ended December 31,					June 3,1993 (commencement of operations) through December 31,
	1997	1996	1995	1994	1993	
<b>Statement of Income Data:</b>						
Total revenues	\$ 59,796	\$ 38,574	\$ 33,361	\$ 24,226	\$ 7,135	
Interest expense	\$ 7,969	\$ 7,344	\$ 5,083	\$ 1,116	\$ 314	
Net income	\$ 31,212	\$ 19,732	\$ 18,258	\$ 15,716	\$ 3,950	
Net income per share - Basic	\$ 1.71	\$ 1.52	\$ 1.41	\$ 1.33	\$ 0.64	
Net income per share - Diluted	\$ 1.68	\$ 1.49	\$ 1.41	\$ 1.33	\$ 0.63	
Weighted average shares outstanding - Basic	18,222,243	13,014,286	12,931,082	11,806,864	6,185,600	
Weighted average shares outstanding - Diluted	18,572,492	13,261,291	12,970,326	11,859,714	6,237,053	
<b>Balance Sheet Data (as of the end of the period):</b>						
Real estate properties, net	\$ 470,981	\$ 416,034	\$ 318,480	\$ 280,767	\$ 133,393	
Total Assets	\$ 488,514	\$ 427,505	\$ 336,778	\$ 283,190	\$ 134,070	
Notes and bonds payable	\$ 101,300	\$ 168,618	\$ 92,970	\$ 40,375	\$ 21,000	
Total stockholders' equity	\$ 376,472	\$ 245,964	\$ 234,448	\$ 236,340	\$ 108,190	
<b>Other Data:</b>						
Funds from operations <sup>(1)</sup>	\$ 42,337	\$ 28,036	\$ 25,490	\$ 20,919	\$ 5,774	
Funds from operations per share - Basic <sup>(1)</sup>	\$ 2.32	\$ 2.15	\$ 1.97	\$ 1.77	\$ 0.93	
Funds from operations per share - Diluted <sup>(1)</sup>	\$ 2.28	\$ 2.11	\$ 1.97	\$ 1.76	\$ 0.93	
Dividends declared and paid per share	\$ 1.99	\$ 1.91	\$ 1.83	\$ 1.75	\$ 0.55	

<sup>(1)</sup> See Note 11 to Consolidated Financial Statements

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

## OVERVIEW

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

Since commencing operations in June, 1993, through December 31, 1997, the Company has invested or committed to invest, directly and indirectly, over \$525 million in 87 income-producing properties related to the delivery of healthcare services, containing over 4.4 million square feet. The Company's portfolio is comprised of seven facility types, located in 44 markets nationwide, and operated pursuant to contractual arrangements with 18 healthcare providers. As of December 31, 1997, the Company was managing 130 healthcare-related properties nationwide totaling over 3.9 million square feet, and was providing third-party asset management services for 251 properties nationwide, totaling over 1.3 million square feet.

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

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

## RESULTS OF OPERATIONS

### *1997 Compared to 1996*

For the year ended December 31, 1997, net income was \$31.2 million, or \$1.71 per basic share of common stock (\$1.68 per diluted share), on total revenues of \$59.8 million compared to net income of \$19.7 million, or \$1.52 per basic share of common stock (\$1.49 per diluted share), on total revenues of \$38.6 million, for the year ended December 31, 1996. Funds from operations ("FFO") was \$42.3 million, or \$2.32 per basic share (\$2.28 per diluted share), for the year ended December 31, 1997 compared to \$28.0 million, or \$2.15 per basic share (\$2.11 per diluted share), in 1996.

*(Dollars in thousands)*

	1997	1996
<b>REVENUES</b>		
Master lease rental income	\$ 40,298	\$ 35,329
Property operating income	14,631	1,338
Total rental income	54,929	36,667
Management fees	1,499	1,111
Interest and other income	3,368	796
	59,796	38,574
<b>EXPENSES</b>		
General and administrative	3,807	2,233
Property operating expenses	5,008	269
Interest	7,969	7,344
Depreciation	11,468	8,652
Amortization	332	344
	28,584	18,842
Net Income	\$ 31,212	\$ 19,732

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

Total revenues for the year ended December 31, 1997 compared to the year ended December 31, 1996, increased \$21.2 million or 55%. The increase is primarily due to master lease rental income and property operating income from 18 properties acquired and two developments completed during the latter part of the fourth quarter of 1996 and the year ended December 31, 1997, representing an investment of approximately \$102.3 million. Third party property management fees for the year ended December 31, 1997, compared to the year ended December 31, 1996, increased \$0.4 million or 35%, due to the net effect of adding third party management contracts in Florida and Virginia and converting six master leased properties (accounted for as third party management) to Company owned and managed properties. Interest and other income for the year ended December 31, 1997 was \$3.4 million compared to \$0.8 million for the year ended December 31, 1996. During the first quarter of 1997, the Company completed a secondary offering and maintained an average cash and short-term investment balance of \$26.1 million during the year ended December 31, 1997 compared to a \$2.2 million average cash balance during the year ended December 31, 1996.

Total expenses for the year ended December 31, 1997 were \$28.6 million compared to \$18.8 million for the year ended December 31, 1996, an increase of \$9.8 million or 52%. General and administrative expenses increased \$1.6 million, primarily due to an increase in payroll associated with the large increase in property management and other service based activities. Property operating expenses for the year ended December 31, 1997, compared to the year ended December 31, 1996, increased \$4.7 million due to the conversion from master leased or acquisition of 19 Company owned and managed properties during the latter part of the fourth quarter of 1996 and the year ended December 31, 1997. Interest expense for the year ended December 31, 1997 compared to the year ended December 31, 1996 increased \$0.6 million due to the net effect of a decrease in average outstanding debt balance and a decrease in average construction in progress, which reduced capitalized interest by approximately \$1.4 million. Depreciation expense increased \$2.8 million due to the acquisition of 18 properties and completion of two properties discussed in the preceding paragraph.

*1996 Compared to 1995*

For the year ended December 31, 1996, net income was \$19.7 million, or \$1.52 per basic share and \$1.49 per diluted share of common stock, on total revenues of \$38.6 million compared to net income of \$18.3 million, or \$1.41 per basic and diluted share of common stock, on total revenues of \$33.4 million, for the year ended December 31, 1995. Funds from operations ("FFO") was \$28.0 million, or \$2.15 per basic share (\$2.11 per diluted share), for the year ended December 31, 1996 compared to \$25.5 million, or \$1.97 per basic and diluted share, in 1995.

<i>(Dollars in thousands)</i>	1996	1995
<b>REVENUES</b>		
Master lease rental income	\$ 35,329	\$ 32,402
Property operating income	1,338	-
Total rental income	36,667	32,402
Management fees	1,111	466
Interest and other income	796	493
	<b>38,574</b>	<b>33,361</b>
<b>EXPENSES</b>		
General and administrative	2,233	2,143
Property operating expenses	269	-
Interest	7,344	5,083
Depreciation	8,652	7,693
Amortization	344	184
	<b>18,842</b>	<b>15,103</b>
Net Income	<b>\$ 19,732</b>	<b>\$ 18,258</b>

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

Total revenues for the year ended December 31, 1996 compared to the year ended December 31, 1995 increased \$5.2 million or 15.6%. The increase is primarily due to base rent derived from investment of approximately \$45.4 million in six completed development properties in 1996. In addition, total rental income for the year ended December 31, 1996 includes a partial year of base rent derived from investment of approximately \$58.4 million in 14 acquisitions during 1996. Revenues during 1996 also reflect an increase of \$0.6 million (138.5%) in property management fees. At December 31, 1996, the Company managed 83 properties compared to 26 properties at December 31, 1995. Interest and other income increased from \$0.5 million for the year ended December 31, 1995 to \$0.8 million for the year ended December 31, 1996 primarily due to the short-term refinancing of approximately \$30.8 million of mortgage notes for a current healthcare client.

Total expenses for the year ended December 31, 1996 were \$18.8 million compared to \$15.1 million for the year ended December 31, 1995, an increase of \$3.7 million or 24.8%. Depreciation expense increased \$1.0 million due to the acquisition of additional properties and the completion of properties under construction which were discussed in the preceding paragraph. General and administrative expenses increased \$90,000, primarily due to an increase in total employees. Interest expense increased from \$5.0 million for the year ended December 31, 1995 to \$7.3 million for the year ended December 31, 1996. During the year ended December 31, 1996, the Company had an average outstanding total debt balance of approximately \$122.4 million compared to approximately \$70.9 million in 1995. On September 18, 1995, the Company privately placed \$90.0 million of unsecured notes (the "Unsecured Notes") with 16 credit institutions which also had the effect of increasing 1996 interest expense since the Unsecured Notes were outstanding for a full year in 1996 compared to 3.5 months in 1995. Amortization expense increased from \$0.2 million for the year ended December 31, 1995 to \$0.3 million for the year ended December 31, 1996 due to amortization of acquired revenue-producing management contracts and other intangible assets.

#### *Liquidity and Capital Resources*

Effective December 26, 1996, the Company is a party to a \$100.0 million unsecured bank credit facility (the "Unsecured Credit Facility") with four commercial banks having a maturity date of December 1999, with two one-year extensions. Interest on borrowed funds pursuant to the Unsecured Credit Facility is at LIBOR plus 1.125% or the base rate of NationsBank, N. A. The Company pays a commitment fee of .225 of one percent per annum on the unused portion of funds available for borrowing under the Unsecured Credit Facility. The Unsecured Credit Facility contains certain representations, warranties and financial and other covenants customary in such loan agreements. As of March 1, 1998, the entire Unsecured Credit Facility borrowing capacity is available to the Company.

The Unsecured Notes bear interest at 7.41%, payable semi-annually, and mature on September 1, 2002. Beginning on September 1, 1998 and on each September 1 through 2002, the Company must repay \$18.0 million of principal under the Unsecured Notes.

On February 14, 1997, the Company sold 5,175,000 shares of its common stock in a secondary offering (the "Secondary Offering") under its currently effective registration statement pertaining to \$250.0 million of equity securities, debt securities and warrants. The Company received \$133.4 million in net proceeds, which were used to repay indebtedness outstanding under the Unsecured Credit Facility, fund the Company's acquisitions and developments and for general corporate purposes.

In February, 1998, the Company participated in two unit investment trust offerings and sold an aggregate of 1,224,026 shares of its common stock. The Company received an aggregate of \$33.3 million in net proceeds from these transactions. The proceeds of these unit investment trust offerings were applied to fully pay the outstanding borrowings under the Unsecured Credit Facility, leaving approximately \$10.0 million for acquisitions, development and general corporate uses. As of March 1, 1998, the Company had stockholders' equity of \$405.5 million. The debt to total capitalization ratio was approximately 18.2% at March 1, 1998.

As of March 1, 1998, the Company can issue an aggregate of approximately \$108.0 million of securities remaining under currently effective registration statements and intends to continue to offer securities under such registration statements from time to time to finance future acquisitions and build-to-suit developments as they occur. The Company may borrow additional amounts in connection with the renovation or expansion of its properties, the acquisition or development of additional properties or, as necessary, to meet distribution requirements for real estate investment trusts under the Code. The Company may raise additional capital or make investments by issuing, in public or private transactions, its equity and debt securities, but the availability and terms of any such issuance will depend upon market and other conditions.

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

The Company generated net cash from operations in 1997 of \$40.4 million, an increase of \$10.9 million over 1996 and \$13.7 million over 1995. The funds were used in 1997, along with proceeds from the secondary offering, to pay dividends to stockholders of \$35.8 million, to make additional investments in income-producing assets and real estate properties totaling approximately \$66.5 million and to repay net long-term indebtedness of \$67.3 million.

At December 31, 1997, the Company, in the normal course of business, had received a fully executed contract to purchase four properties for approximately \$7.4 million. In addition, as of December 31, 1997, the Company had a net investment of approximately \$19.2 million for three lessee developments and one expansion of an existing property in progress with a total remaining funding commitment of approximately \$19.3 million. The Company intends to fund these commitments with the funds available from operations and proceeds from the Unsecured Credit Facility.

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

On January 27, 1998, the Company declared an increase in its quarterly dividend from \$0.505 per share (\$2.02 annualized) to \$0.51 per share (\$2.04 annualized) payable to stockholders of record on February 4, 1998. This dividend was paid on February 17, 1998. The Company presently plans to continue to pay its quarterly dividends, with increases consistent with its current practice. In the event that the Company cannot make additional investments in 1998 because of an inability to obtain new capital by issuing equity and debt securities, the Company will continue to be able to pay its dividends in a manner consistent with its current practice. No assurance can be made as to the effect upon the Company's ability to increase its quarterly dividends during periods subsequent to 1998, should access to new capital not be available to the Company.

***Business Outlook***

A significant challenge facing the Company is the expansion of the REIT industry. REITs have had increasing access to the capital markets, with the result that there has been an acceleration in growth of the number of REITs and the amount of funds REITs have available for investment. A REIT is required to make dividend distributions and has little retained capital for growth; therefore, it is required to grow through the steady investment of new capital in real estate assets. The expansion of available capital to the REIT industry has resulted in significant investment pressure, with the consequence that many transactions undertaken by competitors of the Company do not meet the standards that the Company requires of its investments, in terms of the present and future internal rate of return, credit and financial support, weighted average cost of capital and real estate investment fundamentals. The Company intends to adhere to its established standards and anticipates that it will be able to maintain steady conservative growth through the acquisition of quality real estate investments; however, the increased competition for such assets from other REITs and traditional and non-traditional equity and debt capital sources may affect the growth of the Company and its financial return in a manner and to a degree that the Company cannot, at this time, predict.

The healthcare service industry continues to be a profitable, growing segment of the economy, supported by fundamentals that ensure continued growth. The industry is undergoing substantial changes in the method of delivery of healthcare services, rising competition among healthcare providers for patients, continuing pressure by private and governmental payors and increased scrutiny by federal and state authorities. These changes create uncertainties which can present the Company with the opportunity to assist in providing solutions to the issues created by these changes; however, the economic performance of some or all of the providers who provide financial support, as tenants and sponsors, to the Company's investments can be affected. The degree to which these changes may affect the economic performance of the Company, positively or negatively, cannot be predicted at this time.

The Company is engaged on its own behalf, and for the benefit of third-party property owners, in asset and property management, day-to-day property management and leasing of multi-tenanted healthcare properties and supervision of the development of new

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

healthcare properties. The Company has experienced net gains in both the number of, and square footage subject to, its service engagements. The terms of these engagements can vary in duration from 15 years to month-to-month. Additionally, engagements are regularly terminated as a result of completion of the engagement assignment or as a result of the sale of managed properties by the Company or third-party owners. Termination of engagements must be charged against current revenues or established reserves. The Company is also subject to significant uncertainties because of the dynamic nature of the healthcare service industry, and increased competition from other real estate management companies entering the healthcare services industry. The degree to which these uncertainties may affect the economic performance of the Company cannot be predicted at this time.

#### *Impact of Inflation*

During the past three years, inflation has not significantly affected the earnings of the Company because of the moderate inflation rate and the fact that most of the Company's leases and financial support arrangements require tenants and sponsors to pay all or some portion of the increases in operating expenses, thereby reducing the risk of any adverse effects of inflation to the Company. In addition, inflation will have the effect of increasing the gross revenue the Company is to receive under the terms of the leases and financial support arrangements. Leases and financial support arrangements vary in the remaining terms of obligations from three to 20 years, further reducing the risk of any adverse effects of inflation to the Company. The Unsecured Credit Facility bears interest at a variable rate; therefore, the amount of interest payable under the Unsecured Credit Facility will be influenced by changes in short-term rates, which tend to be sensitive to inflation.

#### *Real Estate Investment Trust Tax Proposals*

On February 2, 1998, the Clinton Administration released proposals for changes in tax rules governing the operations of REITs. If enacted, the proposals would among other items, limit the Company's future ability to engage indirectly in certain business activities that cannot be conducted directly by the Company and tax the built-in gains of C corporations prospectively electing tax-free reorganizations, thus affecting an acquisition format employed by the Company in the past. There is no way to predict the outcome of these proposals or the eventual economic effect of these proposals on the Company if these proposals are enacted.

#### *Year 2000*

Some of the Company's older computer programs were written using two digits rather than four digits to define the applicable year. As a result, those computer programs have time-sensitive software that recognize a date using "00" as the year 1900 rather than the year 2000. This could cause a system failure or miscalculation causing disruptions of operations, including, among other things, a temporary inability to process transactions, send invoices, or engage in similar normal business activities.

The Company has completed an assessment and will have to modify or replace portions of its software so that its computer systems will function properly with respect to dates in the year 2000 and thereafter. The bulk of the software employed by the Company is commercially developed applications which are year 2000 compliant. Replacement software represents upgrades that would have been undertaken by the Company in the ordinary course of events; and, all of the Company's software is expected to be year 2000 compliant not later than December 31, 1998. The cost of becoming year 2000 compliant is not expected to be material to the Company.

#### *Forward-Looking Statements*

This annual report to shareholders of the Company includes forward-looking statements, including, without limitation, statements containing the words "believes," "anticipates," "expects" and words of similar nature, within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. For a more detailed discussion of these factors, see Item 1 of the Company's Form 10-K for the fiscal year ended December 31, 1997.



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

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

We have audited the accompanying consolidated balance sheets of Healthcare Realty Trust Incorporated as of December 31, 1997 and 1996, and the related consolidated statements of income, stockholders of equity, and cash flows for each of the three years in the period ended December 31, 1997. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Healthcare Realty Trust Incorporated at December 31, 1997 and 1996, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1997 in conformity with generally accepted accounting principles.

Nashville, Tennessee  
January 30, 1998, except for the  
2nd paragraph of Note 13, as to  
which the date is February 27, 1998.

*Consolidated*  
BALANCE SHEETS

<i>(Dollars in thousands)</i>	December 31,	
	1997	1996
<b>ASSETS</b>		
Real estate properties:		
Land	\$ 58,424	\$ 53,028
Buildings and improvements	423,618	369,188
Personal property	4,492	3,099
Construction in progress	19,165	13,863
	505,699	439,178
Less accumulated depreciation	(34,718)	(23,144)
Total real estate properties, net	470,981	416,034
Cash and cash equivalents	5,325	1,354
Other assets, net	12,208	10,117
Total assets	<u>\$ 488,514</u>	<u>\$ 427,505</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Liabilities:		
Notes and bonds payable	\$ 101,300	\$ 168,619
Accounts payable and accrued liabilities	6,879	8,197
Other liabilities	3,863	4,725
Total liabilities	112,042	181,541
Commitments	-	-
Stockholders' equity:		
Preferred stock, \$.01 par value; 50,000,000 shares authorized; none outstanding	-	-
Common stock, \$.01 par value; 150,000,000 shares authorized; issued and outstanding, 1997 - 19,285,927; 1996 - 13,898,777	193	139
Additional paid-in capital	402,607	264,614
Deferred compensation	(7,689)	(4,702)
Cumulative net income	88,867	57,655
Cumulative dividends	(107,506)	(71,742)
Total stockholders' equity	376,472	245,964
Total liabilities and stockholders' equity	<u>\$ 488,514</u>	<u>\$ 427,505</u>

*See accompanying notes.*

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

<i>(Dollars in thousands, except per share data)</i>	Year Ended December 31,		
	1997	1996	1995
<b>REVENUES</b>			
Master lease rental income	\$ 40,298	\$ 35,329	\$ 32,402
Property operating income	14,631	1,338	-
Management fees	1,499	1,111	466
Interest and other income	3,368	796	493
	59,796	38,574	33,361
<b>EXPENSES</b>			
General and administrative	3,807	2,233	2,143
Property operating expenses	5,008	269	-
Interest	7,969	7,344	5,083
Depreciation	11,468	8,652	7,693
Amortization	332	344	184
	28,584	18,842	15,103
Net income	\$ 31,212	\$ 19,732	\$ 18,258
Net income per share - Basic	\$ 1.71	\$ 1.52	\$ 1.41
Net income per share - Diluted	\$ 1.68	\$ 1.49	\$ 1.41
Shares outstanding - Basic	18,222,243	13,014,286	12,931,082
Shares outstanding - Diluted	18,572,492	13,261,291	12,970,326

*Consolidated*  
STATEMENTS OF STOCKHOLDERS' EQUITY

<i>(Dollars in thousands, except per share data)</i>	Common Stock		Additional	Deferred	Cumulative	Cumulative	Total
	Shares	Amount	Paid-In Capital	Compensation	Net Income	Dividends	Stockholder's Equity
Balance at December 31, 1994	12,803,397	\$ 128	\$ 239,961	\$ (595)	\$ 19,665	\$ (22,819)	\$ 236,340
Issuance of stock	172,349	2	3,436	-	-	-	3,438
Shares awarded as deferred stock compensation	1,050	-	22	(22)	-	-	-
Deferred stock compensation amortization	-	-	-	139	-	-	139
Net income	-	-	-	-	18,258	-	18,258
Dividends (\$1.83 per share)	-	-	-	-	-	(23,727)	(23,727)
Balance at December 31, 1995	12,976,796	130	243,419	(478)	37,923	(46,546)	234,448
Issuance of stock	707,952	7	16,396	-	-	-	16,403
Shares awarded as deferred stock compensation	203,897	2	4,611	(4,613)	-	-	-
Deferred stock compensation amortization	-	-	-	389	-	-	389
Employee stock purchase plan	10,132	-	188	-	-	-	188
Net income	-	-	-	-	19,732	-	19,732
Dividends (\$1.91 per share)	-	-	-	-	-	(25,196)	(25,196)
Balance at December 31, 1996	13,898,777	139	264,614	(4,702)	57,655	(71,742)	245,964
Issuance of stock	5,195,130	52	133,322	-	-	-	133,374
Shares awarded as deferred stock compensation	143,716	2	3,880	(3,882)	-	-	-
Shares issued from warrants	7,673	-	-	-	-	-	-
Deferred stock compensation amortization	-	-	-	895	-	-	895
Employee stock purchase plan	40,631	-	791	-	-	-	791
Net income	-	-	-	-	31,212	-	31,212
Dividends (\$1.99 per share)	-	-	-	-	-	(35,764)	(35,764)
Balance at December 31, 1997	19,285,927	\$ 193	\$ 402,607	\$ (7,689)	\$ 88,867	\$ (107,506)	\$ 376,472

*See accompanying notes.*

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

<i>(In thousands)</i>	Year Ended December 31,		
	1997	1996	1995
<b>OPERATING ACTIVITIES</b>			
Net income	\$ 31,212	\$ 19,732	\$ 18,258
Adjustments to reconcile net income to cash provided by operating activities:			
Depreciation and amortization	12,073	9,017	8,124
Gain on sale of property	-	-	(220)
Deferred compensation	672	377	1
Increase (decrease) in deferred income	114	(29)	314
Increase in other assets	(2,346)	(933)	(921)
Increase (decrease) in accounts payable and accrued liabilities	(1,318)	1,391	1,181
Net cash provided by operating activities	40,407	29,555	26,737
<b>INVESTING ACTIVITIES</b>			
Acquisition and development of real estate properties	(66,521)	(63,069)	(50,417)
Proceeds from sale of real estate	-	-	4,800
Receipt Disbursement of security deposits	(976)	(390)	(258)
Net cash used in investing activities	(67,497)	(63,459)	(45,875)
<b>FINANCING ACTIVITIES</b>			
Borrowings on notes and bonds payable	35,300	101,899	121,700
Repayments on notes and bonds payable	(102,618)	(50,903)	(69,105)
Deferred financing and organization costs paid	(22)	(169)	(1,245)
Dividends paid	(35,764)	(25,196)	(23,727)
Proceeds from issuance of common stock	134,165	484	161
Net cash provided by financing activities	31,061	26,115	27,784
Increase (decrease) in cash and cash equivalents	3,971	(7,789)	8,646
Cash and cash equivalents, beginning of period	1,354	9,143	497
Cash and cash equivalents, end of period	\$ 5,325	\$ 1,354	\$ 9,143

*Notes to*  
CONSOLIDATED FINANCIAL STATEMENTS

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### *Organization*

The Company invests in healthcare-related properties located throughout the United States, including ancillary hospital facilities, medical office buildings, physician clinics, long-term care facilities, comprehensive ambulatory care centers, clinical laboratories and ambulatory surgery centers. The Company provides management, leasing and build-to-suit development, and capital for the construction of new facilities as well as for the acquisition of existing properties. As of December 31, 1997, the Company had invested or committed to invest in 87 properties (the "Properties") located in 44 markets in 14 states, affiliated with 18 healthcare-related entities.

### *Basis of Presentation*

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

### *Use of Estimates in Financial Statements*

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

### *Real Estate Properties*

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

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

### *Cash and Cash Equivalents*

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

### *Federal Income Taxes*

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

### *Other Assets*

Included in other assets are receivables, deferred costs and intangible assets. Deferred financing costs are amortized over the term of the related credit facility using the interest method. Intangible assets are amortized straight-line over the applicable lives of the assets which range from four to forty years. Accumulated amortization was \$1.5 million and \$1.1 million at December 31, 1997 and 1996, respectively.

### *Revenue Recognition*

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

### *Stock Issued to Employees*

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

*Notes to*  
CONSOLIDATED FINANCIAL STATEMENTS

*Net Income Per Share*

Earnings per share have been restated for Financial Accounting Standards Board Statement No. 128, Earnings per Share ("FAS 128") and the Securities and Exchange Commission Staff Accounting Bulletin No. 98 ("SAB 98").

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

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

**2. REAL ESTATE PROPERTY LEASES**

The Company's properties are generally leased or supported pursuant to noncancelable, fixed-term operating leases and other financial support arrangements with expiration dates from 1998 to 2013. Some leases and financial support arrangements provide for fixed rent renewal terms of five years, or multiples thereof, in addition to market rent renewal terms. The leases generally provide the lessee, during the term of the lease and for a short period thereafter, with an option and a right of first refusal to purchase the leased property.

Each lease generally requires the lessee to pay minimum rent, additional rent based upon increases in the Consumer Price Index or increases in net patient revenues (as defined in the lease agreements), and all taxes (including property tax), insurance, maintenance and other operating costs associated with the leased property.

Amounts of rental and guaranty income received from lessees, physicians and other affiliated parties who accounted for more than 10% of the Company's rental and guaranty income for the three years in the period ended December 31, 1997 were (in thousands):

	1997	1996	1995
Columbia/HCA Healthcare Corporation	\$ 13,297	\$ 11,539	\$ 11,048
Tenet Healthcare	13,899	8,761	8,217
PhyCor	8,218	2,160	1,106

Future minimum lease and guaranty payments under the noncancelable operating leases and financial support arrangements as of December 31, 1997 are as follows (in thousands):

1998	\$ 60,399
1999	53,971
2000	54,279
2001	53,803
2002	52,364
2003 and thereafter	303,203
	\$ 578,019

*Notes to*  
CONSOLIDATED FINANCIAL STATEMENTS

### 3. REAL ESTATE PROPERTIES

The following table summarizes the Company's real estate properties by type of facility and by state as of December 31, 1997 (dollars in thousands).

	Number of Facilities <sup>(1)</sup>	Land	Buildings and Improvements and CIP	Personal Property	Total	Accumulated Depreciation
<i>Ancillary hospital facilities:</i>						
Arizona	1	308	4,966	0	5,274	716
California	8	15,169	46,116	39	61,324	3,327
Florida	8	577	44,757	0	45,334	3,567
Georgia	5	1,965	34,606	38	36,609	2,767
Kansas	1	0	10,091	0	10,091	268
Tennessee	2	3,581	5,583	0	9,164	252
Texas	11	7,102	54,147	260	61,509	5,975
Virginia	6	4,285	47,663	0	51,948	2,599
	42	32,987	247,929	337	281,253	19,471
<i>Ambulatory surgery centers:</i>						
California	1	209	829	8	1,046	125
Nevada	1	940	2,860	0	3,800	254
Texas	1	510	1,514	15	2,039	228
	3	1,659	5,203	23	6,885	607
<i>Comprehensive ambulatory care:</i>						
Florida	2	4,136	15,218	0	19,354	375
Texas	2	1,643	19,890	60	21,593	2,160
	4	5,779	35,108	60	40,947	2,535
<i>Clinical laboratories:</i>						
Alabama	1	181	8,601	8	8,790	1,245
Mississippi	1	538	3,718	30	4,286	419
	2	719	12,319	38	13,076	1,664
<i>Long-term care facilities:</i>						
Arizona	1	267	2,607	0	2,874	55
California	1	1,362	11,326	0	12,688	980
Colorado	3	1,984	20,850	0	22,834	518
Florida	1	1,350	8,856	0	10,206	311
Indiana	1	96	3,512	32	3,640	527
Kansas	1	1,013	6,579	0	7,592	171
Michigan	5	193	12,134	183	12,510	1,694
Tennessee	3	228	12,814	0	13,042	121
Texas	2	1,881	17,670	0	19,551	434
	18	8,374	96,348	215	104,937	4,811
<i>Medical office buildings:</i>						
Texas	1	166	1,810	0	1,976	156
Virginia	4	1,927	11,774	127	13,828	631
	5	2,093	13,584	127	15,804	787
<i>Physician clinics:</i>						
Florida	3	3,559	15,514	51	19,124	1,857
Georgia	1	586	2,087	0	2,673	203
Texas	2	1,654	10,931	385	12,970	1,478
California	1	393	332	0	725	22
Virginia	6	621	2,977	0	3,598	89
	13	6,813	31,841	436	39,090	3,649
Corporate property		0	0	3,256	3,256	1,194
Third party developments		0	451	0	451	0
Total property	87	58,424	442,783	4,492	505,699	34,718

<sup>(1)</sup> Includes three lessee developments.



*Notes to*  
CONSOLIDATED FINANCIAL STATEMENTS

**4. NOTES AND BONDS PAYABLE**

Notes and bonds payable at December 31, 1997 and 1996 consisted of the following (in thousands):

	December 31,	
	1997	1996
Unsecured notes	\$ 90,000	\$ 90,000
Unsecured credit facility	11,300	71,900
Serial and term bonds payable	-	6,719
	<b>\$ 101,300</b>	<b>\$ 168,619</b>

*Unsecured Notes*

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

*Unsecured Credit Facility*

On December 26, 1996, the Company's \$75.0 million unsecured credit facility (the "Unsecured Credit Facility") with four commercial banks was increased to \$100.0 million and extended to December 30, 1999. At the option of the Company, borrowings bear interest at one of the banks' base rate or LIBOR plus 1.125%. In addition, the Company pays a commitment fee of .225 of 1% per annum on the unused portion of funds available for borrowings under the Unsecured Credit Facility. The Unsecured Credit Facility contains certain representations, warranties and financial and other covenants customary in such loan agreements. At December 31, 1997, the Company had available borrowing capacity of \$88.7 million under the Unsecured Credit Facility.

*Serial and Term Bonds Payable*

In conjunction with the acquisition of certain facilities, the Company assumed serial and term bonds payable, totaling \$7.2 million. These bonds payable were repaid or defeased during 1996 and 1997. The Company placed funds in an irrevocable trust to defease \$2.9 million of serial and term bonds, which paid interest semi-annually at interest rates ranging from 6.9% to 8.1%. The resulting loss from the defeasance was not material.

*Other Long-Term Debt Information*

During the years ended December 31, 1997, 1996 and 1995, interest paid totaled \$9.0 million, \$8.4 million and \$3.9 million, and capitalized interest totaled \$0.7 million, \$2.2 million and \$0.9 million, respectively.

**5. NON-CASH ACQUISITIONS OF REAL ESTATE**

During November 1996, the Company acquired ten properties, in exchange for an aggregate of 687,692 shares of the Company's common stock (valued at \$16.1 million) and the assumption of \$20.6 million of notes payable, \$4.1 million of bonds payable and \$3.0 million of accounts payable and accrued liabilities, and incurred \$0.5 million in acquisition costs. In addition to the properties, representing an aggregate investment of \$44.1 million, the Company acquired \$0.2 million of other assets. The Company has repaid the notes and bonds payable assumed in the acquisition.

**6. SECONDARY OFFERING**

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

*Notes to*  
CONSOLIDATED FINANCIAL STATEMENTS

## 7. BENEFIT PLANS

### *Executive Retirement Plan*

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

### *Retirement Plan for Outside Directors*

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

### *Retirement Plan Information*

Net expense for both the Executive Retirement Plan and the Retirement Plan for Outside Directors (the "Plans") for the three years in the period ended December 31, 1997 is comprised of the following (in thousands):

	1997	1996	1995
Service cost	\$ 218	\$ 201	\$ 368
Interest cost	73	59	40
Other	(10)	(21)	(219)
	<u>\$ 281</u>	<u>\$ 239</u>	<u>\$ 189</u>

The Plans are unfunded and benefits will be paid from earnings of the Company. The following table sets forth the benefit obligations at December 31, 1997 and 1996 (in thousands).

	1997	1996
Actuarial present value of benefit obligations:		
Vested	\$ -	\$ -
Accumulated	<u>\$ 997</u>	<u>\$ 620</u>
Actual present value of projected benefit obligations for services rendered to date	\$ 1,213	\$ 744
Unrecognized net gain	90	278
Net pension liability in accrued liabilities	<u>\$ 1,303</u>	<u>\$ 1,022</u>

Accounting for the Executive Retirement Plan for the years ended December 31, 1997 and 1996 assumes discount rates of 7.6% and 8.5%, respectively, and compensation increase rates of 2.7% and 2.7%, respectively. Accounting for the Retirement Plan for Outside Directors assumes discount rates of 7.6% and 9%, respectively.

## 8. STOCK PLANS AND WARRANTS

### *1993 Employees Stock Incentive Plan*

The Company is authorized to issue stock representing up to 7.5% of its outstanding shares of common stock, (the "Employee Plan Shares") under the 1993 Employees Stock Incentive Plan (the "Employee Plan"). As of December 31, 1997 and 1996, the Company had a total of 1,073,735 and 812,364 Employee Plan Shares authorized, respectively, that had not been issued. Unless terminated earlier, the Employee Plan will terminate on January 1, 2003. As of December 31, 1997 and 1996, the Company had issued a total of 372,710 and 230,044, and had specifically reserved, but not issued, a total of 141,668 and 283,334 Employee Plan Shares (the "Reserved Stock"), respectively, for performance-based awards to employees under the Employee Plan. The issue of Reserved Stock to eligible employees is contingent upon the achievement of specific performance criteria. The Reserved Stock awards are subject to fixed vesting periods varying from four to twelve years beginning on the

*Notes to*  
CONSOLIDATED FINANCIAL STATEMENTS

date of issue. If an employee voluntarily terminates employment with the Company before the end of the vesting period, the shares are forfeited, at no cost to the Company. Once the Reserved Stock has been issued, the employee has the right to receive dividends and the right to vote the shares. For 1997 and 1996, compensation expense resulting from the amortization of the value of these shares was \$0.6 million and \$0.3 million, respectively.

*Non-Employee Directors' Stock Plans*

Prior to May 1995, the Company was authorized to issue stock options for up to 2% of its outstanding shares of common stock under the 1993 Outside Directors Stock Incentive Plan (the "1993 Director Plan"). During 1996 the Company canceled all unexercised options granted pursuant to the 1993 Director Plan. Effective May 1995, the Company enacted the 1995 Restricted Stock Plan for Non-Employee Directors (the "1995 Directors' Plan"). The Directors' stock vests in each Director upon the date three years from the date of issue and is subject to forfeiture prior to such date upon termination of the Director's service, at no cost to the Company. As of December 31, 1997 and 1996, the Company had a total of 96,850 and 97,900 shares under the 1995 Directors' Plan authorized, respectively, that had not been issued. As of December 31, 1997 and 1996, the Company had issued a total of 12,423 and 11,373 shares, respectively, pursuant to the Non-Employee Directors' Stock Plans. For 1997 and 1996, compensation expense resulting from the amortization of the value of these shares was \$79,345 and \$70,672 respectively.

*1995 Employee Stock Purchase Plan*

Effective May 1995, the Company adopted an Employee Stock Purchase Plan (the "Employee Purchase Plan") pursuant to which the Company is authorized to issue shares of common stock (the "Employee Purchase Plan Shares"). As of December 31, 1997 and 1996, the Company had a total of 883,664 and 918,795 shares authorized under the Employee Purchase Plan, respectively, that had not been issued or optioned. Under the Employee Purchase Plan, each eligible employee as of May 1995 and each subsequent January 1 has been or shall be granted an option to purchase up to \$25,000 of common stock at the lesser of 85% of the market price on the date of grant or 85% of the market price on the date of exercise of such option (the "Exercise Date"), but at not less than book value per share as of the December 31 immediately preceding the date of grant. The number of shares subject to each year's option becomes fixed on the date of grant. Eligible employees include those employees who were employed by the Company or a subsidiary on a full-time basis as of May 1995 and those employees with six months of service who are so employed by the Company or subsidiary as of each subsequent January 1. Options granted under the Employee Purchase Plan expire if not exercised 27 months after each such option's date of grant.

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

	Options		
	1997	1996	1995
Outstanding, beginning of year	71,073	47,268	-
Granted	69,930	47,564	47,268
Exercised	(40,631)	(10,132)	-
Forfeited	(23,723)	(13,627)	-
Expired	(11,076)	-	-
Outstanding and exercisable at end of year	65,573	71,073	47,268
Weighted-average fair value of options granted during the year (calculated as of the grant date)	\$ 3.12	\$ 2.70	\$ 2.56
Weighted-average exercise price of options exercised during the year	\$ 19.48	\$ 18.59	-
Weighted-average exercise price of options outstanding (calculated as of December 31)	\$ 21.58	\$ 19.09	\$ 18.46
Range of exercise prices of options outstanding (calculated as of December 31)	\$19.71- \$22.47	\$18.46-\$19.71	\$ 18.46
Weighted-average contractual life of outstanding options (calculated as of December 31, in years)	0.9	0.9	1.6

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The fair value for these options was estimated at the date of grant using a Black-Scholes options pricing model with the following assumptions for 1997, 1996 and 1995; risk-free interest rates of 6.00%, 6.30% and 6.30%; a dividend yield of 8.02%, 8.60% and 8.90%; a volatility factor of the expected market price of the Company's Common Stock of .096, .121 and .121; and an expected life of the option of 1.13 years, respectively. The Company has determined that the pro forma effect on net income and earnings per share for the three years in the period ended December 31, 1997 of adopting Statement of Financial Accounting Standards No. 123 "Accounting for Stock-Based Compensation" is not material.

*Other*

In 1993, the Company issued warrants to purchase up to 188,712 shares of common stock (the "Warrants") to certain individuals. The Warrants are exercisable for a period of four years commencing July 1, 1994 at a price of \$19.50 per share, the then current fair market value, subject to adjustment under applicable antidilution provisions. The holders of the Warrants have the right to require the Company to include the common stock underlying such Warrants in any registration statement filed by the Company at the Company's expense. At December 31, 1997 and 1996, the Company had a total of 162,712 and 188,712 shares, respectively, eligible for purchase pursuant to the Warrants. As of December 31, 1997 and 1996, the Company had issued a total of 7,673 and zero shares, respectively, and had cancelled 18,327 and zero shares, respectively, pursuant to the Warrants.

At December 31, 1997 and 1996, the Company had reserved 2,216,961 and 2,017,771 shares, respectively, for future issuance.

## 9. NET INCOME PER SHARE

The table below sets forth the computation of basic and diluted earnings per share as required by FASB Statement No. 128 for the three years in the period ended December 31, 1997.

	Year Ended Dec. 31, 1997	Year Ended Dec. 31, 1996	Year Ended Dec. 31, 1995
<b>Basic EPS</b>			
Average Shares Outstanding	18,605,876	13,254,233	12,967,132
Actual Restricted Stock Shares	(383,633)	(239,947)	(36,050)
Denominator	18,222,243	13,014,286	12,931,082
Numerator	\$ 31,212,289	\$ 19,731,623	\$ 18,257,616
Per share amount	\$ 1.71	\$ 1.52	\$ 1.41
<b>Diluted EPS</b>			
Denominator for Basic EPS	18,222,243	13,014,286	12,931,082
Restricted Shares - Treasury	276,890	205,097	23,772
Dilution For Employee Stock Purchase Plan	25,032	13,981	2,447
Dilution For Warrants	48,327	27,927	13,025
Denominator	18,572,492	13,261,291	12,970,326
Numerator	\$ 31,212,289	\$ 19,731,623	\$ 18,257,616
Per share amount	\$ 1.68	\$ 1.49	\$ 1.41

## 10. COMMITMENTS

At December 31, 1997, the Company, in the normal course of business, had received a fully executed letter of intent to purchase four properties for approximately \$7.4 million. In addition, as of December 31, 1997, the Company had a net investment of approximately \$19.2 million for three lessee developments and one expansion of an existing property in progress with a total remaining funding commitment of approximately \$19.3 million.

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CONSOLIDATED FINANCIAL STATEMENTS

**11. OTHER DATA**

*Funds From Operations (Unaudited)*

Funds from operations, as defined by the National Association of Real Estate Investment Trusts, Inc. ("NAREIT") 1995 White Paper, means net income (computed in accordance with generally accepted accounting principles), excluding gains (or losses) from debt restructuring and sales of property, plus depreciation from real estate assets. NAREIT encourages REITs to make reporting changes consistent with the 1995 NAREIT White Paper on Funds from Operations no later than fiscal year 1996. Beginning with the first quarter 1996 operations, the Company's policy has been to report funds from operations calculated on the NAREIT 1995 White Paper while providing supplemental information based upon previous methodology. Funds from operations does not represent cash generated from operating activities in accordance with generally accepted accounting principles, is not necessarily indicative of cash available to fund cash needs, and should not be considered as an alternative to net income as an indicator of the Company's operating performance or as an alternative to cash flow as a measure of liquidity.

	Year Ended Dec. 31, 1997		Year Ended Dec. 31, 1996	
	(Unaudited)		(Unaudited)	
	NAREIT White Paper As Reported	Previous Methodology	NAREIT White Paper As Reported	Previous Methodology
<i>(Dollars in thousands, except per share data)</i>				
<b>Net Income</b> <sup>(1)</sup>	\$ 31,212	\$ 31,212	\$ 19,732	\$ 19,732
<b>Non-recurring items</b> <sup>(4)</sup>	112	112	-	-
<b>Gain or loss on dispositions</b>	-	-	-	-
<b>Straight line rents</b>	-	-	-	-
<b>ADD:</b>				
<b>Depreciation</b>				
Real estate	11,013	11,012	8,304	8,305
Office F,F&E	-	255	-	168
Leasehold improvements	-	120	-	140
Other non-revenue producing assets	-	82	-	38
	11,013	11,469	8,304	8,651
<b>Amortization</b>				
Acquired property contracts <sup>(2)</sup>	-	194	-	338
Other non-revenue producing assets	-	131	-	-
Organization costs	-	7	-	7
	-	332	-	345
<b>Deferred financing costs</b> <sup>(3)</sup>	-	273	-	360
<b>Total Adjustments</b>	11,125	12,186	8,304	9,356
Funds From Operations	\$ 42,337	\$ 43,398	\$ 28,036	\$ 29,088
Shares Outstanding - Basic	18,222,243	18,222,243	13,014,286	13,014,286
Shares Outstanding - Diluted	18,572,492	18,572,492	13,261,291	13,261,291
Funds From Operations Per Share - Basic	\$ 2.32	\$ 2.38	\$ 2.15	\$ 2.24
Funds From Operations Per Share - Diluted	\$ 2.28	\$ 2.34	\$ 2.11	\$ 2.19

<sup>(1)</sup> 1997 and 1996 amounts include \$0.7 million and \$0.4 million, respectively, of stock-based, long-term, incentive compensation expense, a non-cash expense.

<sup>(2)</sup> Amortization of the acquisition cost of revenue producing property management contracts.

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

<sup>(4)</sup> Represents a loss from a debt restructuring.

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CONSOLIDATED FINANCIAL STATEMENTS

### *Return of Capital*

Distributions in excess of earnings and profits generally constitute a return of capital. For the years ended December 31, 1997, 1996 and 1995, dividends paid per share were \$1.99, \$1.91 and \$1.83, respectively, which consisted of ordinary income per share of \$1.72, \$1.65 and \$1.42 and return of capital per share of \$0.27, \$.26 and \$.41, respectively.

### **12. FAIR VALUE OF FINANCIAL INSTRUMENTS**

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

### **13. SUBSEQUENT EVENTS**

On January 27, 1998, the Company declared an increase in its quarterly dividend from \$.505 per share (\$2.02 annualized) to \$.51 per share (\$2.04 annualized) payable on February 16, 1998 to shareholders of record on February 4, 1998.

In February 1998, the Company participated in two unit investment trust offerings and sold an aggregate of 1,224,026 shares of its common stock. The Company received an aggregate of \$33.3 million in net proceeds from these transactions. The proceeds of these unit investment trust offerings were applied to fully pay the outstanding borrowings under the Unsecured Credit Facility, leaving approximately \$10.0 million for acquisitions, development and general corporate uses.

### **14. SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)**

Quarterly financial information for the years ended December 31, 1997 and 1996 is summarized below:

<i>(In thousands, except per share data)</i>	Quarter Ended			
	March 31	June 30	September 30	December 31
<b>1997</b>				
Total revenue	\$ 12,842	\$ 14,265	\$ 15,865	\$ 16,824
Net income	\$ 6,339	\$ 8,170	\$ 8,328	\$ 8,375
Funds from operations	\$ 9,056	\$ 10,873	\$ 11,122	\$ 11,286
Net income per share - Basic	\$ 0.39	\$ 0.43	\$ 0.44	\$ 0.44
Net income per share - Diluted	\$ 0.38	\$ 0.42	\$ 0.43	\$ 0.44
Funds from operations per share - Basic	\$ 0.56	\$ 0.58	\$ 0.59	\$ 0.60
Funds from operations per share - Diluted	\$ 0.55	\$ 0.57	\$ 0.58	\$ 0.59
<b>1996</b>				
Total revenue	\$ 8,983	\$ 9,136	\$ 9,509	\$ 10,946
Net income	\$ 4,758	\$ 4,952	\$ 4,914	\$ 5,108
Funds from operations	\$ 6,736	\$ 6,930	\$ 6,937	\$ 7,434
Net income per share - Basic	\$ 0.37	\$ 0.38	\$ 0.38	\$ 0.38
Net income per share - Diluted	\$ 0.36	\$ 0.38	\$ 0.37	\$ 0.38
Funds from operations per share - Basic	\$ 0.52	\$ 0.54	\$ 0.54	\$ 0.56
Funds from operations per share - Diluted	\$ 0.51	\$ 0.52	\$ 0.53	\$ 0.55

*Management*  
 BOARD OF DIRECTORS & CORPORATE OFFICERS



*Board of Directors (L-R)*  
**David R. Emery**,  
*Chairman of the Board and Chief Executive Officer*  
**Edwin B. Morris III**  
*Managing Director, Morris & Morse Company Inc.*  
**C. Raymond Fernandez, M.D.**,  
*Medical Director, Nalle Clinic*  
**Errol L. Biggs, Ph.D.**,  
*Director, Center for Health Administration, University of Colorado*  
**Thompson S. Dent**  
*Executive Vice President and Chief Operating Officer, PhyCor, Inc.*  
**Marliese E. Mooney**  
*Consultant, Hospital Operations*  
**Batey M. Gresham, Jr., AIA**  
*Founder, Gresham Smith & Partners*  
**J. Knox Singleton**,  
*President and Chief Executive Officer, INOVA Health Systems*



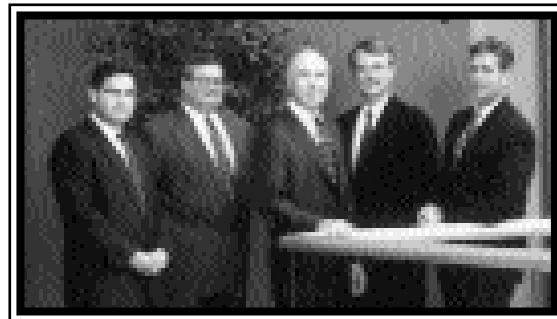
**Fredrick M. Langreck**  
*Senior Vice President, Treasurer*  
**Leigh Ann Bertram**  
*Vice President, Controller*  
**Michael W. Crisler**  
*Vice President, Financial Planning*  
**Rita H. Todd**  
*Corporate Secretary*



**Timothy G. Wallace**  
*Executive Vice President and Chief Financial Officer*  
**David R. Emery**  
*Chairman of the Board and Chief Executive Officer*  
**Roger O. West**  
*Executive Vice President and General Counsel*



**J. D. Carter Steele**  
*Vice President, Real Estate Investment*  
**Keith A. Harville**  
*Vice President, Real Estate Investment*  
**Kenneth D. Stach**  
*Vice President, Asset Administration*



**Eric W. Fischer**  
*Vice President, Development, Healthcare Realty Management*  
**Robert L. Watkins**  
*Senior Vice President, Development, Healthcare Realty Management*  
**B. Bart Starr**  
*Chairman, Healthcare Realty Management*  
**Ronald H. Hart**  
*President, Healthcare Realty Management*  
**James P. Tainter**  
*Vice President, Asset and Real Estate Management Services, Healthcare Realty Management*

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

**CORPORATE ADDRESS**

*Healthcare Realty Trust Incorporated*  
3310 West End Avenue, Suite 700  
Nashville, Tennessee 37203  
Phone: (615) 269-8175  
Fax: (615) 269-8461

*Corporate Internet Site:* www.healthcarerealty.com  
*Corporate Email Address:* hrinfo@healthcarerealty.com

**INDEPENDENT PUBLIC AUDITORS**

*Ernst & Young LLP*  
NationsBank Plaza  
414 Union Street  
Nashville, Tennessee 37219-1779

**TRANSFER AGENT**

*Transfer of Shares*  
BankBoston  
c/o Boston EquiServe, L.P.  
Investor Services  
P.O. Box 8040  
Boston, Massachusetts 02266-8040  
Phone: (781) 575-3400  
CUSIP #: 421946104

*Internet Site:* www.equiserve.com

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

**DIVIDEND REINVESTMENT PLAN**

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

**FORM 10-K**

The Company has filed an Annual Report on Form 10-K for the year ended December 31, 1997 with the Securities and Exchange Commission. Shareholders may obtain a copy of this report, without charge, by writing: Investor Relations, Healthcare Realty Trust Inc., 3310 West End Avenue, Suite 700, Nashville, Tennessee 37203. Or, via e-mail: hrinfo@healthcarerealty.com

**COMMON STOCK**

Healthcare Realty Trust Incorporated common stock is traded on The New York Stock Exchange under the symbol HR. As of March 11, 1998, there were approximately 1,109 shareholders of record. The following table shows, for the fiscal periods indicated, the quarterly range of high and low closing sales prices of the common stock.

	High	Low
<b>1997</b>		
First Quarter	\$ 29.125	\$ 26.000
Second Quarter	27.875	25.500
Third Quarter	29.000	27.375
Fourth Quarter	29.875	27.813
<b>1996</b>		
First Quarter	23.125	20.875
Second Quarter	23.750	21.500
Third Quarter	24.125	21.500
Fourth Quarter	26.875	23.000
<b>1995</b>		
First Quarter	29.000	19.000
Second Quarter	20.500	18.500
Third Quarter	20.750	19.375
Fourth Quarter	23.000	20.000
<b>1994</b>		
First Quarter	22.500	19.375
Second Quarter	21.375	19.500
Third Quarter	22.125	19.875
Fourth Quarter	21.125	19.375

**ANNUAL SHAREHOLDERS MEETING**

The annual meeting of shareholders will be held on May 11, 1998, at 10:00 a.m. at the Cumberland Club, 511 Union Street, Nashville, Tennessee.