

Edgar Filing: Physicians Realty Trust - Form 10-Q

Physicians Realty Trust  
Form 10-Q  
May 04, 2018

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2018-04-03 doc:instruments doc:properties doc:states iso4217:USD xbrli:shares doc:portfolio xbrli:pure  
doc:disposition\_group doc:buildings doc:land xbrli:shares doc:segment iso4217:USD doc:mezzanine\_loan  
doc:healthcareproperty utreg:Rate

### UNITED STATES

### SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

## FORM 10-Q

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

For the quarterly period ended March 31, 2018

or

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

For the transition period from to

Commission file number: 001-36007 (Physicians Realty Trust)

Commission file number: 333-205034-01 (Physicians Realty L.P.)

## PHYSICIANS REALTY TRUST PHYSICIANS REALTY L.P.

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(Exact Name of Registrant as Specified in its Charter)

**Maryland (Physicians Realty Trust)**      **46-2519850**  
**Delaware (Physicians Realty L.P.)**      **80-0941870**  
(State of Organization)      (IRS Employer Identification No.)

**309 N. Water Street,**  
**Suite 500**      **53202**  
**Milwaukee, Wisconsin**      (Zip Code)  
(Address of Principal Executive Offices)

**(414) 367-5600**  
(Registrant's Telephone Number, Including Area Code)

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.

Physicians Realty Trust      Yes ☒ No ☐      Physicians Realty L.P.      Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Physicians Realty Trust      Yes ☒ No ☐      Physicians Realty L.P.      Yes ☒ No ☐

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

Physicians Realty Trust      Large accelerated filer ☒      Accelerated filer ☐      Non-accelerated filer ☐ (Do not check if a smaller reporting company)      Smaller reporting company ☐      Emerging growth company ☐

Physicians Realty L.P.      Large accelerated filer ☐      Accelerated filer ☐      Non-accelerated filer ☒ (Do not check if a smaller reporting company)      Smaller reporting company ☐      Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Physicians Realty Trust      ☐ Physicians Realty L.P. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Physicians Realty Trust      Yes ☐ No ☒      Physicians Realty L.P.      Yes ☐ No ☒

The number of Physicians Realty Trust's common shares outstanding as of April 30, 2018 was 182,004,287.

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## EXPLANATORY NOTE

This Quarterly Report on Form 10-Q combines the Quarterly Reports on Form 10-Q for the quarter ended March 31, 2018 of Physicians Realty Trust (the “Trust”), a Maryland real estate investment trust, and Physicians Realty L.P. (the “Operating Partnership”), a Delaware limited partnership. Unless otherwise indicated or unless the context requires otherwise, all references in this report to “we,” “us,” “our,” and the “Company,” refer to the Trust, together with its consolidated subsidiaries, including the Operating Partnership. References to the “Operating Partnership” mean collectively the Operating Partnership, together with its consolidated subsidiaries. In this report, all references to “common shares” refer to the common shares of the Trust and references to “our shareholders” refer to shareholders of the common shares of the Trust, the term “OP Units” refers to partnership interests of the Operating Partnership and the term “Series A Preferred Units” refers to Series A Participating Redeemable Preferred Units of the Operating Partnership.

The Trust is a self-managed real estate investment trust (“REIT”) formed primarily to acquire, selectively develop, own, and manage healthcare properties that are leased to physicians, hospitals, and healthcare delivery systems. The Trust’s operations are conducted through the Operating Partnership and wholly-owned and majority-owned subsidiaries of the Operating Partnership. The Trust, as the general partner of the Operating Partnership, controls the Operating Partnership and consolidates the assets, liabilities, and results of operations of the Operating Partnership.

The Trust conducts substantially all of its operations through the Operating Partnership. As of March 31, 2018, the Trust held a 97.1% interest in the Operating Partnership and owns no Series A Preferred Units. Apart from this ownership interest, the Trust has no independent operations.

Noncontrolling interests in the Operating Partnership, shareholders’ equity of the Trust and partners’ capital of the Operating Partnership are the primary areas of difference between the consolidated financial statements of the Trust and those of the Operating Partnership. OP Units not owned by the Trust are accounted for as limited partners’ capital in the Operating Partnership’s consolidated financial statements and as noncontrolling interests in the Trust’s consolidated financial statements. The differences between the Trust’s shareholders’ equity and the Operating Partnership’s partners’ capital are due to the differences in the equity issued by the Trust and the Operating Partnership, respectively.

The Company believes combining the Quarterly Reports of the Trust and the Operating Partnership, including the notes to the consolidated financial statements, into this single report results in the following benefits:

- a combined report enhances investors’ understanding of the Trust and the Operating Partnership by enabling investors to view the business as a whole in the same manner as management views and operates the business;
- a combined report eliminates duplicative disclosure and provides a more streamlined and readable presentation, as a substantial portion of the Company’s disclosure applies to both the Trust and the Operating Partnership; and
- a combined report creates time and cost efficiencies through the preparation of one combined report instead of two separate reports.

To help investors understand the significant differences between the Trust and the Operating Partnership, this report presents the following separate sections for each of the Trust and the Operating Partnership:

- the consolidated financial statements in Part I, Item 1 of this report;
- certain accompanying notes to the consolidated financial statements, including Note 3 (Acquisitions and Dispositions) and Note 14 (Earnings Per Share and Earnings Per Unit);
- controls and procedures in Part I, Item 4 of this report; and
- the certifications of the Chief Executive Officer and the Chief Financial Officer included as Exhibits 31 and 32 to this report.



Table of Contents

**PHYSICIANS REALTY TRUST AND PHYSICIANS REALTY L.P.**

**Quarterly Report on Form 10-Q  
for the Quarter Ended March 31, 2018**

**Table of Contents**

|                                                                                                            | Page<br>Number |
|------------------------------------------------------------------------------------------------------------|----------------|
| <b><u>Part I Financial Information</u></b>                                                                 |                |
| <b><u>Item 1 Financial Statements (Unaudited)</u></b>                                                      |                |
| <b>Financial Statements of Physicians Realty Trust</b>                                                     |                |
| <u>Consolidated Balance Sheets as of March 31, 2018 and December 31, 2017</u>                              | <u>3</u>       |
| <u>Consolidated Statements of Income for the Three Months Ended March 31, 2018 and 2017</u>                | <u>4</u>       |
| <u>Consolidated Statements of Comprehensive Income for the Three Months Ended March 31, 2018 and 2017</u>  | <u>5</u>       |
| <u>Consolidated Statement of Equity for the Three Months Ended March 31, 2018</u>                          | <u>6</u>       |
| <u>Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2018 and 2017</u>            | <u>7</u>       |
| <b>Financial Statements of Physicians Realty L.P.</b>                                                      |                |
| <u>Consolidated Balance Sheets as of March 31, 2018 and December 31, 2017</u>                              | <u>8</u>       |
| <u>Consolidated Statements of Income for the Three Months Ended March 31, 2018 and 2017</u>                | <u>9</u>       |
| <u>Consolidated Statements of Comprehensive Income for the Three Months Ended March 31, 2018 and 2017</u>  | <u>10</u>      |
| <u>Consolidated Statement of Changes in Capital for the Three Months Ended March 31, 2018</u>              | <u>11</u>      |
| <u>Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2018 and 2017</u>            | <u>12</u>      |
| <b>Notes for Physicians Realty Trust and Physicians Realty L.P.</b>                                        |                |
| <u>Notes to Consolidated Financial Statements</u>                                                          | <u>13</u>      |
| <b><u>Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b> | <u>35</u>      |
| <b><u>Item 3 Quantitative and Qualitative Disclosures About Market Risk</u></b>                            | <u>50</u>      |
| <b><u>Item 4 Controls and Procedures</u></b>                                                               | <u>51</u>      |
| <b><u>Part II Other Information</u></b>                                                                    |                |
| <b><u>Item 1 Legal Proceedings</u></b>                                                                     | <u>52</u>      |
| <b><u>Item 1A Risk Factors</u></b>                                                                         | <u>52</u>      |
| <b><u>Item 2 Unregistered Sales of Equity Securities and Use of Proceeds</u></b>                           | <u>53</u>      |
| <b><u>Item 6 Exhibits</u></b>                                                                              | <u>55</u>      |
| <b><u>SIGNATURES</u></b>                                                                                   | <u>56</u>      |

Table of Contents

**CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS**

This Quarterly Report on Form 10-Q contains forward-looking statements made pursuant to safe harbor provisions of the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical facts may be forward-looking statements within the meaning of the federal securities laws. In particular, statements pertaining to our capital resources, property performance and results of operations contain forward-looking statements. Likewise, all of our statements regarding anticipated growth in our funds from operations and anticipated market conditions, demographics and results of operations are forward-looking statements. You can identify forward-looking statements by the use of forward-looking terminology such as “believe,” “expect,” “outlook,” “continue,” “project,” “may,” “will,” “should,” “approximately,” “intend,” “plan,” “pro forma,” “estimate” or “anticipate” or the negative of these words and phrases or similar words or phrases which are predictions of or indicate future events or trends and which do not relate solely to historical matters. You can also identify forward-looking statements by discussions of strategy, plans, expectations or intentions.

These forward-looking statements reflect the views of our management regarding current expectations and projections about future events and are based on currently available information. These forward-looking statements are not guarantees of future performance and involve numerous risks and uncertainties and you should not rely on them as predictions of future events. Forward-looking statements depend on assumptions, data or methods which may be incorrect or imprecise and we may not be able to realize them. We do not guarantee that the transactions and events described will happen as described (or that they will happen at all). The following factors, among others, could cause actual results and future events to differ materially from those set forth or contemplated in the forward-looking statements:

- general economic conditions;
- adverse economic or real estate developments, either nationally or in the markets where our properties are located;
- our failure to generate sufficient cash flows to service our outstanding indebtedness, or our ability to pay down or refinance our indebtedness;
- fluctuations in interest rates and increased operating costs;
- the availability, terms and deployment of debt and equity capital, including our unsecured revolving credit facility;
- our ability to make distributions on our common shares;
- general volatility of the market price of our common shares;
- our increased vulnerability economically due to the concentration of our investments in healthcare properties;
- our geographic concentration in Texas causes us to be particularly exposed to downturns in the Texas economy or other changes in Texas market conditions;
- changes in our business or strategy;
- our dependence upon key personnel whose continued service is not guaranteed;
- our ability to identify, hire and retain highly qualified personnel in the future;

- the degree and nature of our competition;
- changes in governmental regulations, tax rates, and similar matters;
- defaults on or non-renewal of leases by tenants;
- decreased rental rates or increased vacancy rates;
- difficulties in identifying healthcare properties to acquire and completing acquisitions;
- competition for investment opportunities;

Table of Contents

any adverse effects to the business, financial position or results of Catholic Health Initiatives' ("CHI"), or one or more of the CHI-affiliated tenants, that impact the ability of CHI-affiliated tenants to pay us rent;

the impact of our investments in joint ventures;

the financial condition and liquidity of, or disputes with, any joint venture and development partners with whom we may make co-investments in the future;

cybersecurity incidents could disrupt our business and result in the compromise of confidential information;

our ability to operate as a public company;

changes in accounting principles generally accepted in the United States (GAAP);

- lack of or insufficient amounts of insurance;

other factors affecting the real estate industry generally;

our failure to maintain our qualification as a REIT for U.S. federal income tax purposes;

limitations imposed on our business and our ability to satisfy complex rules in order for us to qualify as a REIT for U.S. federal income tax purposes;

changes in governmental regulations or interpretations thereof, such as real estate and zoning laws and increases in real property tax rates and taxation of REITs; and

factors that may materially adversely affect us, or the per share trading price of our common shares, including:

higher market interest rates;

the number of our common shares available for future issuance or sale;

our issuance of equity securities or the perception that such issuance might occur;

future debt;

failure of securities analysts to publish research or reports about us or our industry; and

securities analysts' downgrade of our common shares or the healthcare-related real estate sector.

While forward-looking statements reflect our good faith beliefs, they are not guarantees of future performance. We disclaim any obligation to publicly update or revise any forward-looking statement to reflect changes in underlying assumptions or factors, new information, data or methods, future events or other changes after the date of this report, except as required by applicable law. You should not place undue reliance on any forward-looking statements that are based on information currently available to us or the third parties making the forward-looking statements. For a further discussion of these and other factors that could impact our future results, performance or transactions, see Part II, Item 1A (Risk Factors) of this report and, Part I, Item 1A (Risk Factors) of our Annual Report on Form 10-K for the fiscal year ended December 31, 2017 (the "2017 Annual Report").

Table of Contents**PART I. Financial Information****Item 1. Financial Statements****Physicians Realty Trust****Consolidated Balance Sheets***(In thousands, except share and per share data)*

|                                                                                                                                                                                                  | March 31,<br>2018<br>(unaudited) | December 31,<br>2017 |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------|----------------------|
| <b><u>ASSETS</u></b>                                                                                                                                                                             |                                  |                      |
| Investment properties:                                                                                                                                                                           |                                  |                      |
| Land and improvements                                                                                                                                                                            | \$214,476                        | \$217,695            |
| Building and improvements                                                                                                                                                                        | 3,570,056                        | 3,568,858            |
| Tenant improvements                                                                                                                                                                              | 19,121                           | 23,056               |
| Acquired lease intangibles                                                                                                                                                                       | 459,836                          | 458,713              |
|                                                                                                                                                                                                  | 4,263,489                        | 4,268,322            |
| Accumulated depreciation                                                                                                                                                                         | (318,393 )                       | (300,458 )           |
| Net real estate property                                                                                                                                                                         | 3,945,096                        | 3,967,864            |
| Real estate held for sale                                                                                                                                                                        | 93,289                           | —                    |
| Real estate loans receivable                                                                                                                                                                     | 71,529                           | 76,195               |
| Investments in unconsolidated entities                                                                                                                                                           | 1,331                            | 1,329                |
| Net real estate investments                                                                                                                                                                      | 4,111,245                        | 4,045,388            |
| Cash and cash equivalents                                                                                                                                                                        | 6,550                            | 2,727                |
| Tenant receivables, net                                                                                                                                                                          | 4,293                            | 9,966                |
| Other assets                                                                                                                                                                                     | 134,919                          | 106,302              |
| Total assets                                                                                                                                                                                     | \$4,257,007                      | \$4,164,383          |
| <b><u>LIABILITIES AND EQUITY</u></b>                                                                                                                                                             |                                  |                      |
| Liabilities:                                                                                                                                                                                     |                                  |                      |
| Credit facility                                                                                                                                                                                  | \$466,828                        | \$324,394            |
| Notes payable                                                                                                                                                                                    | 966,387                          | 966,603              |
| Mortgage debt                                                                                                                                                                                    | 154,373                          | 186,471              |
| Accounts payable                                                                                                                                                                                 | 2,562                            | 11,023               |
| Dividends and distributions payable                                                                                                                                                              | 43,388                           | 43,804               |
| Accrued expenses and other liabilities                                                                                                                                                           | 56,706                           | 56,405               |
| Acquired lease intangibles, net                                                                                                                                                                  | 15,767                           | 15,702               |
| Total liabilities                                                                                                                                                                                | 1,706,011                        | 1,604,402            |
| Redeemable noncontrolling interest - Series A Preferred Units (2018) and partially owned properties                                                                                              | 23,736                           | 12,347               |
| Equity:                                                                                                                                                                                          |                                  |                      |
| Common shares, \$0.01 par value, 500,000,000 common shares authorized, 181,943,725 and 181,440,051 common shares issued and outstanding as of March 31, 2018 and December 31, 2017, respectively | 1,819                            | 1,814                |
| Additional paid-in capital                                                                                                                                                                       | 2,778,616                        | 2,772,823            |
| Accumulated deficit                                                                                                                                                                              | (345,571 )                       | (315,417 )           |
| Accumulated other comprehensive income                                                                                                                                                           | 18,250                           | 13,952               |
| Total shareholders' equity                                                                                                                                                                       | 2,453,114                        | 2,473,172            |
| Noncontrolling interests:                                                                                                                                                                        |                                  |                      |
| Operating Partnership                                                                                                                                                                            | 73,527                           | 73,844               |

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|                                |             |             |
|--------------------------------|-------------|-------------|
| Partially owned properties     | 619         | 618         |
| Total noncontrolling interests | 74,146      | 74,462      |
| Total equity                   | 2,527,260   | 2,547,634   |
| Total liabilities and equity   | \$4,257,007 | \$4,164,383 |

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**Physicians Realty Trust****Consolidated Statements of Income***(In thousands, except share and per share data) (Unaudited)*

|                                                                                                             | Three Months Ended<br>March 31, |             |
|-------------------------------------------------------------------------------------------------------------|---------------------------------|-------------|
|                                                                                                             | 2018                            | 2017        |
| <b>Revenues:</b>                                                                                            |                                 |             |
| Rental revenues                                                                                             | \$78,887                        | \$ 59,092   |
| Expense recoveries                                                                                          | 24,308                          | 16,354      |
| Interest income on real estate loans and other                                                              | 2,028                           | 1,220       |
| Total revenues                                                                                              | 105,223                         | 76,666      |
| <b>Expenses:</b>                                                                                            |                                 |             |
| Interest expense                                                                                            | 16,494                          | 9,815       |
| General and administrative                                                                                  | 8,459                           | 4,736       |
| Operating expenses                                                                                          | 30,459                          | 22,089      |
| Depreciation and amortization                                                                               | 38,576                          | 27,933      |
| Acquisition expenses                                                                                        | —                               | 5,405       |
| Total expenses                                                                                              | 93,988                          | 69,978      |
| <b>Income before equity in income of unconsolidated entities and gain on sale of investment properties:</b> | 11,235                          | 6,688       |
| Equity in income of unconsolidated entities                                                                 | 28                              | 28          |
| Gain on sale of investment properties                                                                       | 69                              | —           |
| Net income                                                                                                  | 11,332                          | 6,716       |
| Net income attributable to noncontrolling interests:                                                        |                                 |             |
| Operating Partnership                                                                                       | (313 )                          | (147 )      |
| Partially owned properties (1)                                                                              | (111 )                          | (167 )      |
| Net income attributable to controlling interests                                                            | 10,908                          | 6,402       |
| Preferred distributions                                                                                     | (487 )                          | (211 )      |
| <b>Net income attributable to common shareholders:</b>                                                      | \$10,421                        | \$ 6,191    |
| Net income per share:                                                                                       |                                 |             |
| Basic                                                                                                       | \$0.06                          | \$ 0.04     |
| Diluted                                                                                                     | \$0.06                          | \$ 0.04     |
| Weighted average common shares:                                                                             |                                 |             |
| Basic                                                                                                       | 181,809,570                     | 188,986,629 |
| Diluted                                                                                                     | 187,317,243                     | 192,605,930 |
| Dividends and distributions declared per common share and OP Unit                                           | \$0.230                         | \$ 0.225    |

(1) An adjustment of \$0.1 million was required for net income attributable to redeemable noncontrolling interests for the three months ended March 31, 2018 and March 31, 2017.

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

**Physicians Realty Trust**  
**Consolidated Statements of Comprehensive Income**  
*(In thousands) (Unaudited)*

|                                                                                            | <b>Three Months Ended</b> |             |
|--------------------------------------------------------------------------------------------|---------------------------|-------------|
|                                                                                            | <b>March 31,</b>          |             |
|                                                                                            | <b>2018</b>               | <b>2017</b> |
| Net income                                                                                 | \$11,332                  | \$6,716     |
| Other comprehensive income:                                                                |                           |             |
| Change in fair value of interest rate swap agreements                                      | 4,298                     | 825         |
| Total other comprehensive income                                                           | 4,298                     | 825         |
| Comprehensive income                                                                       | 15,630                    | 7,541       |
| Comprehensive income attributable to noncontrolling interests - Operating Partnership      | (438 )                    | (201 )      |
| Comprehensive income attributable to noncontrolling interests - partially owned properties | (111 )                    | (167 )      |
| Comprehensive income attributable to common shareholders                                   | \$15,081                  | \$7,173     |

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

**Physicians Realty Trust**  
**Consolidated Statement of Equity**  
*(In thousands) (Unaudited)*

|                                                                                       | Par Value | Additional Paid in Capital | Accumulated Deficit | Accumulated Other Comprehensive Income | Total Shareholders' Equity | Operating Partnership Noncontrolling Interest | Partially Owned Properties Noncontrolling Interest | Total Noncontrolling Interests | Total Equity |
|---------------------------------------------------------------------------------------|-----------|----------------------------|---------------------|----------------------------------------|----------------------------|-----------------------------------------------|----------------------------------------------------|--------------------------------|--------------|
| Balance at January 1, 2018                                                            | \$ 1,814  | \$ 2,772,823               | \$ (315,417 )       | \$ 13,952                              | \$ 2,473,172               | \$ 73,844                                     | \$ 618                                             | \$ 74,462                      | \$ 2,547,634 |
| Net proceeds from sale of common shares                                               | 3         | 5,313                      | —                   | —                                      | 5,316                      | —                                             | —                                                  | —                              | 5,316        |
| Restricted share award grants, net                                                    | 2         | 872                        | 59                  | —                                      | 933                        | —                                             | —                                                  | —                              | 933          |
| Conversion of OP Units                                                                | —         | 126                        | —                   | —                                      | 126                        | (126 )                                        | —                                                  | (126 )                         | —            |
| Dividends/distributions declared                                                      | —         | —                          | (41,910 )           | —                                      | (41,910 )                  | (1,216 )                                      | —                                                  | (1,216 )                       | (43,126 )    |
| Preferred distributions                                                               | —         | —                          | (487 )              | —                                      | (487 )                     | —                                             | —                                                  | —                              | (487 )       |
| Distributions                                                                         | —         | —                          | —                   | —                                      | —                          | —                                             | (43 )                                              | (43 )                          | (43 )        |
| Change in market value of Redeemable Noncontrolling Interest in Operating Partnership | —         | 194                        | 1,276               | —                                      | 1,470                      | —                                             | —                                                  | —                              | 1,470        |
| Change in fair value of interest rate swap agreements                                 | —         | —                          | —                   | 4,298                                  | 4,298                      | —                                             | —                                                  | —                              | 4,298        |
| Net income                                                                            | —         | —                          | 10,908              | —                                      | 10,908                     | 313                                           | 44                                                 | 357                            | 11,265       |
| Adjustment for Noncontrolling Interests ownership in Operating Partnership            | —         | (712 )                     | —                   | —                                      | (712 )                     | 712                                           | —                                                  | 712                            | —            |
| Balance at March 31, 2018                                                             | \$ 1,819  | \$ 2,778,616               | \$ (345,571 )       | \$ 18,250                              | \$ 2,453,114               | \$ 73,527                                     | \$ 619                                             | \$ 74,146                      | \$ 2,527,260 |

The accompanying notes are an integral part of this consolidated financial statements.

Table of Contents

**Physicians Realty Trust**  
**Consolidated Statements of Cash Flows**  
*(In thousands) (Unaudited)*

|                                                                                  | <b>Three Months<br/>Ended<br/>March 31,</b> |                   |
|----------------------------------------------------------------------------------|---------------------------------------------|-------------------|
|                                                                                  | <b>2018</b>                                 | <b>2017</b>       |
| <b>Cash Flows from Operating Activities:</b>                                     |                                             |                   |
| Net income                                                                       | \$ 11,332                                   | \$ 6,716          |
| Adjustments to reconcile net income to net cash provided by operating activities |                                             |                   |
| Depreciation and amortization                                                    | 38,576                                      | 27,933            |
| Amortization of deferred financing costs                                         | 618                                         | 549               |
| Amortization of lease inducements and above/below-market lease intangibles       | 1,190                                       | 1,307             |
| Straight-line rental revenue/expense                                             | (6,450 )                                    | (4,508 )          |
| Amortization of discount on unsecured senior notes                               | 142                                         | 20                |
| Amortization of above market assumed debt                                        | (16 )                                       | (59 )             |
| Gain on sale of investment properties                                            | (69 )                                       | —                 |
| Equity in income of unconsolidated entities                                      | (28 )                                       | (28 )             |
| Distributions from unconsolidated entities                                       | 26                                          | 55                |
| Change in fair value of derivative                                               | 2                                           | 165               |
| Provision for bad debts                                                          | (141 )                                      | (127 )            |
| Non-cash share compensation                                                      | 2,605                                       | 1,490             |
| Net change in fair value of contingent consideration                             | —                                           | (70 )             |
| Change in operating assets and liabilities:                                      |                                             |                   |
| Tenant receivables                                                               | 5,437                                       | 2,703             |
| Other assets                                                                     | (222 )                                      | (287 )            |
| Accounts payable                                                                 | (8,461 )                                    | (1,297 )          |
| Accrued expenses and other liabilities                                           | (3,651 )                                    | (676 )            |
| <b>Net cash provided by operating activities</b>                                 | <b>40,890</b>                               | <b>33,886</b>     |
| <b>Cash Flows from Investing Activities:</b>                                     |                                             |                   |
| Proceeds on sales of investment properties                                       | 2,440                                       | —                 |
| Acquisition of investment properties, net                                        | (84,202 )                                   | (174,737 )        |
| Escrowed cash - acquisition deposits / earnest deposits                          | (2,720 )                                    | 1,375             |
| Capital expenditures on existing investment properties                           | (5,608 )                                    | (3,434 )          |
| Issuance of real estate loans receivable                                         | (2,000 )                                    | (2,279 )          |
| Repayment of real estate loan receivable                                         | 6,717                                       | 1,507             |
| Issuance of note receivable                                                      | (20,385 )                                   | —                 |
| Repayment of note receivable                                                     | —                                           | 16,423            |
| Leasing commissions                                                              | (664 )                                      | (552 )            |
| Lease inducements                                                                | —                                           | (2,050 )          |
| <b>Net cash used in investing activities</b>                                     | <b>(106,422)</b>                            | <b>(163,747 )</b> |
| <b>Cash Flows from Financing Activities:</b>                                     |                                             |                   |
| Net proceeds from sale of common shares                                          | 5,316                                       | 301,572           |
| Proceeds from credit facility borrowings                                         | 166,000                                     | 128,000           |
| Payment on credit facility borrowings                                            | (24,000 )                                   | (529,000 )        |
| Proceeds from issuance of senior unsecured notes                                 | —                                           | 396,108           |
| Principal payments on mortgage debt                                              | (32,157 )                                   | (5,823 )          |
| Debt issuance costs                                                              | (412 )                                      | (651 )            |
| Dividends paid - shareholders                                                    | (42,251 )                                   | (30,945 )         |
| Distributions to noncontrolling interest - Operating Partnership                 | (1,232 )                                    | (703 )            |
| Preferred distributions paid - OP Unit holder                                    | (81 )                                       | (480 )            |

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|                                                                                                                                 |                |                  |
|---------------------------------------------------------------------------------------------------------------------------------|----------------|------------------|
| Contributions from noncontrolling interest                                                                                      | —              | 47               |
| Distributions to noncontrolling interest - partially owned properties                                                           | (127 )         | (154 )           |
| Payments of employee taxes for withheld stock based compensation shares                                                         | (1,701 )       | (2,431 )         |
| Purchase of Series A Preferred Units                                                                                            | —              | (19,961 )        |
| Purchase of OP Units                                                                                                            | —              | (3,725 )         |
| <b>Net cash provided by financing activities</b>                                                                                | <b>69,355</b>  | <b>231,854</b>   |
| Net increase in cash and cash equivalents                                                                                       | 3,823          | 101,993          |
| Cash and cash equivalents, beginning of period                                                                                  | 2,727          | 15,491           |
| <b>Cash and cash equivalents, end of period</b>                                                                                 | <b>\$6,550</b> | <b>\$117,484</b> |
| Supplemental disclosure of cash flow information - interest paid during the period                                              | \$19,230       | \$10,764         |
| Supplemental disclosure of noncash activity - change in fair value of interest rate swap agreements                             | \$4,298        | \$825            |
| Supplemental disclosure of noncash activity - assumed debt                                                                      | \$—            | \$26,379         |
| Supplemental disclosure of noncash activity - issuance of OP Units and Series A Preferred Units in connection with acquisitions | \$22,651       | \$44,978         |

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**Physicians Realty L.P.****Consolidated Balance Sheets***(In thousands, except unit and per unit data)*

|                                                                                                                                              | March 31,<br>2018<br>(unaudited) | December 31,<br>2017 |
|----------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------|----------------------|
| <b><u>ASSETS</u></b>                                                                                                                         |                                  |                      |
| Investment properties:                                                                                                                       |                                  |                      |
| Land and improvements                                                                                                                        | \$214,476                        | \$217,695            |
| Building and improvements                                                                                                                    | 3,570,056                        | 3,568,858            |
| Tenant improvements                                                                                                                          | 19,121                           | 23,056               |
| Acquired lease intangibles                                                                                                                   | 459,836                          | 458,713              |
|                                                                                                                                              | 4,263,489                        | 4,268,322            |
| Accumulated depreciation                                                                                                                     | (318,393)                        | (300,458)            |
| Net real estate property                                                                                                                     | 3,945,096                        | 3,967,864            |
| Real estate held for sale                                                                                                                    | 93,289                           | —                    |
| Real estate loans receivable                                                                                                                 | 71,529                           | 76,195               |
| Investments in unconsolidated entities                                                                                                       | 1,331                            | 1,329                |
| Net real estate investments                                                                                                                  | 4,111,245                        | 4,045,388            |
| Cash and cash equivalents                                                                                                                    | 6,550                            | 2,727                |
| Tenant receivables, net                                                                                                                      | 4,293                            | 9,966                |
| Other assets                                                                                                                                 | 134,919                          | 106,302              |
| Total assets                                                                                                                                 | \$4,257,007                      | \$4,164,383          |
| <b><u>LIABILITIES AND CAPITAL</u></b>                                                                                                        |                                  |                      |
| Liabilities:                                                                                                                                 |                                  |                      |
| Credit facility                                                                                                                              | \$466,828                        | \$324,394            |
| Notes payable                                                                                                                                | 966,387                          | 966,603              |
| Mortgage debt                                                                                                                                | 154,373                          | 186,471              |
| Accounts payable                                                                                                                             | 2,562                            | 11,023               |
| Dividends and distributions payable                                                                                                          | 43,388                           | 43,804               |
| Accrued expenses and other liabilities                                                                                                       | 56,706                           | 56,405               |
| Acquired lease intangibles, net                                                                                                              | 15,767                           | 15,702               |
| Total liabilities                                                                                                                            | 1,706,011                        | 1,604,402            |
| Redeemable noncontrolling interest - Series A Preferred Units (2018) and partially owned properties                                          | 23,736                           | 12,347               |
| Capital:                                                                                                                                     |                                  |                      |
| Partners' capital:                                                                                                                           |                                  |                      |
| General partners' capital, 181,943,725 and 181,440,051 units issued and outstanding as of March 31, 2018 and December 31, 2017, respectively | 2,434,864                        | 2,459,220            |
| Limited partners' capital, 5,464,217 and 5,364,632 units issued and outstanding as of March 31, 2018 and December 31, 2017, respectively     | 73,527                           | 73,844               |
| Accumulated other comprehensive income                                                                                                       | 18,250                           | 13,952               |
| Total partners' capital                                                                                                                      | 2,526,641                        | 2,547,016            |
| Noncontrolling interest - partially owned properties                                                                                         | 619                              | 618                  |
| Total capital                                                                                                                                | 2,527,260                        | 2,547,634            |
| Total liabilities and capital                                                                                                                | \$4,257,007                      | \$4,164,383          |

The accompanying notes are an integral part of these consolidated financial statements.



Table of Contents**Physicians Realty L.P.****Consolidated Statements of Income***(In thousands, except unit and per unit data) (Unaudited)*

|                                                                                                             | <b>Three Months Ended<br/>March 31,</b> |                 |
|-------------------------------------------------------------------------------------------------------------|-----------------------------------------|-----------------|
|                                                                                                             | <b>2018</b>                             | <b>2017</b>     |
| <b>Revenues:</b>                                                                                            |                                         |                 |
| Rental revenues                                                                                             | \$78,887                                | \$ 59,092       |
| Expense recoveries                                                                                          | 24,308                                  | 16,354          |
| Interest income on real estate loans and other                                                              | 2,028                                   | 1,220           |
| Total revenues                                                                                              | 105,223                                 | 76,666          |
| <b>Expenses:</b>                                                                                            |                                         |                 |
| Interest expense                                                                                            | 16,494                                  | 9,815           |
| General and administrative                                                                                  | 8,459                                   | 4,736           |
| Operating expenses                                                                                          | 30,459                                  | 22,089          |
| Depreciation and amortization                                                                               | 38,576                                  | 27,933          |
| Acquisition expenses                                                                                        | —                                       | 5,405           |
| Total expenses                                                                                              | 93,988                                  | 69,978          |
| <b>Income before equity in income of unconsolidated entities and gain on sale of investment properties:</b> | 11,235                                  | 6,688           |
| Equity in income of unconsolidated entities                                                                 | 28                                      | 28              |
| Gain on sale of investment properties                                                                       | 69                                      | —               |
| Net income                                                                                                  | 11,332                                  | 6,716           |
| Net income attributable to noncontrolling interests - partially owned properties (1)                        | (111 )                                  | (167 )          |
| Net income attributable to controlling interests                                                            | 11,221                                  | 6,549           |
| Preferred distributions                                                                                     | (487 )                                  | (211 )          |
| <b>Net income attributable to common unitholders</b>                                                        | <b>\$10,734</b>                         | <b>\$ 6,338</b> |
| Net income per common unit:                                                                                 |                                         |                 |
| Basic                                                                                                       | \$0.06                                  | \$ 0.04         |
| Diluted                                                                                                     | \$0.06                                  | \$ 0.04         |
| Weighted average common units:                                                                              |                                         |                 |
| Basic                                                                                                       | 187,264,064                             | 187,172,746     |
| Diluted                                                                                                     | 187,317,243                             | 187,605,930     |
| Distributions declared per common unit                                                                      | \$0.230                                 | \$ 0.225        |

(1) An adjustment of \$0.1 million was required for net income attributable to redeemable noncontrolling interests for the three months ended March 31, 2018 and March 31, 2017.

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

**Physicians Realty L.P.**

**Consolidated Statements of Comprehensive Income**

*(In thousands) (Unaudited)*

|                                                                                            | Three Months Ended<br>March 31, |         |
|--------------------------------------------------------------------------------------------|---------------------------------|---------|
|                                                                                            | 2018                            | 2017    |
| Net income                                                                                 | \$11,332                        | \$6,716 |
| Other comprehensive income:                                                                |                                 |         |
| Change in fair value of interest rate swap agreements                                      | 4,298                           | 825     |
| Total other comprehensive income                                                           | 4,298                           | 825     |
| Comprehensive income                                                                       | 15,630                          | 7,541   |
| Comprehensive income attributable to noncontrolling interests - partially owned properties | (111 )                          | (167 )  |
| Comprehensive income attributable to common unitholders                                    | \$15,519                        | \$7,374 |

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**Physicians Realty L.P.****Consolidated Statement of Changes in Capital***(In thousands) (Unaudited)*

|                                                                     | General<br>Partner | Limited<br>Partner | Accumulated<br>Other<br>Comprehensive<br>Income | Total<br>Partners'<br>Capital | Partially<br>Owned<br>Properties<br>Noncontrolling<br>Interest | Total<br>Partners'<br>Capital |
|---------------------------------------------------------------------|--------------------|--------------------|-------------------------------------------------|-------------------------------|----------------------------------------------------------------|-------------------------------|
| Balance at January 1, 2018                                          | 2,459,220          | 73,844             | 13,952                                          | 2,547,016                     | 618                                                            | 2,547,634                     |
| Net proceeds from sale of common shares                             | 5,316              | —                  | —                                               | 5,316                         | —                                                              | 5,316                         |
| Restricted share award grants, net                                  | 933                | —                  | —                                               | 933                           | —                                                              | 933                           |
| Conversion of OP Units                                              | 126                | (126 )             | —                                               | —                             | —                                                              | —                             |
| OP Units - distributions                                            | (41,910 )          | (1,216 )           | —                                               | (43,126 )                     | —                                                              | (43,126 )                     |
| Preferred distributions                                             | (487 )             | —                  | —                                               | (487 )                        | —                                                              | (487 )                        |
| Distributions                                                       | —                  | —                  | —                                               | —                             | (43 )                                                          | (43 )                         |
| Change in market value of Redeemable Limited Partners               | 194                | —                  | —                                               | 194                           | —                                                              | 194                           |
| Buyout of Noncontrolling Interest - partially owned properties      | 1,276              | —                  | —                                               | 1,276                         | —                                                              | 1,276                         |
| Change in fair value of interest rate swap agreements               | —                  | —                  | 4,298                                           | 4,298                         | —                                                              | 4,298                         |
| Net income                                                          | 10,908             | 313                | —                                               | 11,221                        | 44                                                             | 11,265                        |
| Adjustments for Limited Partners ownership in Operating Partnership | (712 )             | 712                | —                                               | —                             | —                                                              | —                             |
| Balance at March 31, 2018                                           | \$ 2,434,864       | \$ 73,527          | \$ 18,250                                       | \$ 2,526,641                  | \$ 619                                                         | \$ 2,527,260                  |

The accompanying notes are an integral part of this consolidated financial statements.

Table of Contents

**Physicians Realty L.P.**  
**Consolidated Statements of Cash Flows**  
*(In thousands) (Unaudited)*

|                                                                                  | <b>Three Months<br/>Ended<br/>March 31,</b> |                   |
|----------------------------------------------------------------------------------|---------------------------------------------|-------------------|
|                                                                                  | <b>2018</b>                                 | <b>2017</b>       |
| <b>Cash Flows from Operating Activities:</b>                                     |                                             |                   |
| Net income                                                                       | \$ 11,332                                   | \$ 6,716          |
| Adjustments to reconcile net income to net cash provided by operating activities |                                             |                   |
| Depreciation and amortization                                                    | 38,576                                      | 27,933            |
| Amortization of deferred financing costs                                         | 618                                         | 549               |
| Amortization of lease inducements and above/below-market lease intangibles       | 1,190                                       | 1,307             |
| Straight-line rental revenue/expense                                             | (6,450 )                                    | (4,508 )          |
| Amortization of discount on unsecured senior notes                               | 142                                         | 20                |
| Amortization of above market assumed debt                                        | (16 )                                       | (59 )             |
| Gain on sale of investment properties                                            | (69 )                                       | —                 |
| Equity in income of unconsolidated entities                                      | (28 )                                       | (28 )             |
| Distributions from unconsolidated entities                                       | 26                                          | 55                |
| Change in fair value of derivative                                               | 2                                           | 165               |
| Provision for bad debts                                                          | (141 )                                      | (127 )            |
| Non-cash share compensation                                                      | 2,605                                       | 1,490             |
| Net change in fair value of contingent consideration                             | —                                           | (70 )             |
| Change in operating assets and liabilities:                                      |                                             |                   |
| Tenant receivables                                                               | 5,437                                       | 2,703             |
| Other assets                                                                     | (222 )                                      | (287 )            |
| Accounts payable                                                                 | (8,461 )                                    | (1,297 )          |
| Accrued expenses and other liabilities                                           | (3,651 )                                    | (676 )            |
| <b>Net cash provided by operating activities</b>                                 | <b>40,890</b>                               | <b>33,886</b>     |
| <b>Cash Flows from Investing Activities:</b>                                     |                                             |                   |
| Proceeds on sales of investment properties                                       | 2,440                                       | —                 |
| Acquisition of investment properties, net                                        | (84,202 )                                   | (174,737 )        |
| Escrowed cash - acquisition deposits / earnest deposits                          | (2,720 )                                    | 1,375             |
| Capital expenditures on existing investment properties                           | (5,608 )                                    | (3,434 )          |
| Issuance of real estate loans receivable                                         | (2,000 )                                    | (2,279 )          |
| Repayment of real estate loan receivable                                         | 6,717                                       | 1,507             |
| Issuance of note receivable                                                      | (20,385 )                                   | —                 |
| Repayment of note receivable                                                     | —                                           | 16,423            |
| Leasing commissions                                                              | (664 )                                      | (552 )            |
| Lease inducements                                                                | —                                           | (2,050 )          |
| <b>Net cash used in investing activities</b>                                     | <b>(106,422)</b>                            | <b>(163,747 )</b> |
| <b>Cash Flows from Financing Activities:</b>                                     |                                             |                   |
| Net proceeds from sale of common shares                                          | 5,316                                       | 301,572           |
| Proceeds from credit facility borrowings                                         | 166,000                                     | 128,000           |
| Payment on credit facility borrowings                                            | (24,000 )                                   | (529,000 )        |
| Proceeds from issuance of senior unsecured notes                                 | —                                           | 396,108           |
| Principal payments on mortgage debt                                              | (32,157 )                                   | (5,823 )          |
| Debt issuance costs                                                              | (412 )                                      | (651 )            |
| OP Unit distributions - General Partner                                          | (42,251 )                                   | (30,945 )         |
| OP Unit distributions - Limited Partner                                          | (1,232 )                                    | (703 )            |

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|                                                                                                                                 |          |           |
|---------------------------------------------------------------------------------------------------------------------------------|----------|-----------|
| Preferred OP Units distributions - Limited Partner                                                                              | (81 )    | (480 )    |
| Contributions from noncontrolling interest                                                                                      | —        | 47        |
| Distributions to noncontrolling interest - partially owned properties                                                           | (127 )   | (154 )    |
| Payments of employee taxes for withheld stock based compensation shares                                                         | (1,701 ) | (2,431 )  |
| Purchase of Series A Preferred Units                                                                                            | —        | (19,961 ) |
| Purchase of Limited Partner Units                                                                                               | —        | (3,725 )  |
| <b>Net cash provided by financing activities</b>                                                                                | 69,355   | 231,854   |
| Net increase in cash and cash equivalents                                                                                       | 3,823    | 101,993   |
| Cash and cash equivalents, beginning of period                                                                                  | 2,727    | 15,491    |
| <b>Cash and cash equivalents, end of period</b>                                                                                 | \$6,550  | \$117,484 |
| Supplemental disclosure of cash flow information - interest paid during the period                                              | \$19,230 | \$10,764  |
| Supplemental disclosure of noncash activity - change in fair value of interest rate swap agreements                             | \$4,298  | \$825     |
| Supplemental disclosure of noncash activity - assumed debt                                                                      | \$—      | \$26,379  |
| Supplemental disclosure of noncash activity - issuance of OP Units and Series A Preferred Units in connection with acquisitions | \$22,651 | \$44,978  |

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

**Physicians Realty Trust and Physicians Realty L.P.  
Notes to Consolidated Financial Statements**

*Unless otherwise indicated or unless the context requires otherwise the use of the words “we,” “us,” “our,” and the “Company,” refer to Physicians Realty Trust, together with its consolidated subsidiaries, including Physicians Realty L.P.*

**Note 1. Organization and Business**

Physicians Realty Trust (the “Trust”) was organized in the state of Maryland on April 9, 2013. As of March 31, 2018, the Trust was authorized to issue up to 500,000,000 common shares of beneficial interest, par value \$0.01 per share (“common shares”). The Trust filed a Registration Statement on Form S-11 with the Securities and Exchange Commission (the “Commission”) with respect to a proposed underwritten initial public offering (the “IPO”) and completed the IPO of its common shares and commenced operations on July 24, 2013.

The Trust contributed the net proceeds from the IPO to Physicians Realty L.P., a Delaware limited partnership, (the “Operating Partnership”), and is the sole general partner of the Operating Partnership. The Trust and the Operating Partnership are managed and operated as one entity. The Trust has no significant assets other than its investment in the Operating Partnership. The Trust’s operations are conducted through the Operating Partnership and wholly-owned and majority-owned subsidiaries of the Operating Partnership. The Trust, as the general partner of the Operating Partnership, controls the Operating Partnership and consolidates the assets, liabilities, and results of operations of the Operating Partnership. Therefore, the assets and liabilities of the Trust and the Operating Partnership are the same.

The Trust is a self-managed real estate investment trust (“REIT”) formed primarily to acquire, selectively develop, own, and manage healthcare properties that are leased to physicians, hospitals, and healthcare delivery systems.

**ATM Program**

On August 5, 2016, the Trust and the Operating Partnership entered into separate At Market Issuance Sales Agreements (the “Sales Agreements”) with each of KeyBanc Capital Markets Inc., Credit Agricole Securities (USA) Inc., JMP Securities LLC, Raymond James & Associates, Inc., and Stifel Nicolaus & Company, Incorporated (the “Agents”), pursuant to which the Trust may issue and sell, from time to time, its common shares having an aggregate offering price of up to \$300.0 million, through the Agents (the “ATM Program”). In accordance with the Sales Agreements, the Trust may offer and sell its common shares through any of the Agents, from time to time, by any method deemed to be an “at the market offering” as defined in Rule 415 under the Securities Act of 1933, as amended, which includes sales made directly on the New York Stock Exchange or other existing trading market, or sales made to or through a market maker. With the Trust’s express written consent, sales may also be made in negotiated transactions or any other method permitted by law.

During the quarterly period ended March 31, 2018, the Trust sold 311,786 common shares pursuant to the ATM Program, at a weighted average price of \$17.85 per share, resulting in total net proceeds of approximately \$5.5 million.

As of April 30, 2018, the Trust has \$168.2 million remaining available under the ATM Program.

**Note 2. Summary of Significant Accounting Policies**

The accompanying unaudited consolidated financial statements reflect all adjustments which are, in the opinion of management, necessary for a fair presentation of the results for the periods ended March 31, 2018 and 2017 pursuant

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to the instructions to Form 10-Q and Article 10 of Regulation S-X. All such adjustments are of a normal recurring nature. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) have been condensed or omitted pursuant to such rules and regulations. These financial statements should be read in conjunction with the audited financial statements included in the Trust’s and the Operating Partnership’s combined Annual Report on Form 10-K for the year ended December 31, 2017, filed with the Commission on March 1, 2018.

## Table of Contents

### *Principles of Consolidation*

GAAP requires us to identify entities for which control is achieved through means other than voting rights and to determine which business enterprise is the primary beneficiary of variable interest entities (“VIEs”). ASC 810 broadly defines a VIE as an entity in which either (i) the equity investors as a group, if any, lack the power through voting or similar rights to direct the activities of such entity that most significantly impact such entity’s economic performance or (ii) the equity investment at risk is insufficient to finance that entity’s activities without additional subordinated financial support. We identify the primary beneficiary of a VIE as the enterprise that has both of the following characteristics: (i) the power to direct the activities of the VIE that most significantly impact the entity’s economic performance, and (ii) the obligation to absorb losses or receive benefits of the VIE that could potentially be significant to the entity. We consolidate our investment in a VIE when we determine that we are the VIE’s primary beneficiary. We may change our original assessment of a VIE upon subsequent events such as the modification of contractual arrangements that affect the characteristics or adequacy of the entity’s equity investments at risk and the disposition of all or a portion of an interest held by the primary beneficiary. We perform this analysis on an ongoing basis.

For property holding entities not determined to be VIEs, we consolidate such entities in which the Operating Partnership owns 100% of the equity or has a controlling financial interest evidenced by ownership of a majority voting interest. All intercompany balances and transactions are eliminated in consolidation. For entities in which the Operating Partnership owns less than 100% of the equity interest, the Operating Partnership consolidates the property if it has the direct or indirect ability to control the entities’ activities based upon the terms of the respective entities’ ownership agreements. For these entities, the Operating Partnership records a noncontrolling interest representing equity held by noncontrolling interests.

### *Noncontrolling Interests*

The Company presents the portion of any equity it does not own in entities that it controls (and thus consolidates) as noncontrolling interests and classifies such interests as a component of consolidated equity, separate from the Company’s total shareholders’ equity, on the consolidated balance sheets.

Operating Partnership: Net income or loss is allocated to noncontrolling interests (limited partners) based on their respective ownership percentage of the Operating Partnership. The ownership percentage is calculated by dividing the number of OP Units held by the noncontrolling interests by the total OP Units held by the noncontrolling interests and the Trust. Issuance of additional common shares and OP Units changes the ownership interests of both the noncontrolling interests and the Trust. Such transactions and the related proceeds are treated as capital transactions.

Noncontrolling interests in the Company include OP Units held by other investors. As of March 31, 2018, the Trust held a 97.1% interest in the Operating Partnership. As the sole general partner and the majority interest holder, the Trust consolidates the financial position and results of operations of the Operating Partnership.

Holders of OP Units may not transfer their OP Units without the Trust’s prior written consent, as general partner of the Operating Partnership. Beginning on the first anniversary of the issuance of OP Units, OP Unit holders may tender their units for redemption by the Operating Partnership in exchange for cash equal to the market price of the Trust’s common shares at the time of redemption or for unregistered common shares on a one-for-one basis. Such selection to pay cash or issue common shares to satisfy an OP Unit holder’s redemption request is solely within the control of the Trust. Accordingly, the Trust presents the OP Units of the Operating Partnership held by investors other than the Trust as noncontrolling interests within equity in the consolidated balance sheets.

Partially Owned Properties: The Trust and Operating Partnership reflect noncontrolling interests in partially owned properties on the balance sheet for the portion of consolidated properties that are not wholly owned by the Company.

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The earnings or losses from those properties attributable to the noncontrolling interests are reflected as noncontrolling interests in partially owned properties in the consolidated statements of income.

Table of Contents

*Redeemable Noncontrolling Interests - Series A Preferred Units and Partially Owned Properties*

On February 5, 2015, the Company entered into a Second Amended and Restated Agreement of Limited Partnership (the “Partnership Agreement”) which provides for the designation and issuance of the newly designated Series A Participating Redeemable Preferred Units of the Operating Partnership (“Series A Preferred Units”). Series A Preferred Units have priority over all other partnership interests of the Operating Partnership with respect to distributions and liquidation. Holders of Series A Preferred Units are entitled to a 5% cumulative return and upon redemption, the receipt of one common share and \$200. The holders of the Series A Preferred Units have agreed not to cause the Operating Partnership to redeem their Series A Preferred Units prior to one year from the issuance date. In addition, Series A Preferred Units are redeemable at the option of the holders which redemption obligation may be satisfied, at the Trust’s option, in cash or registered common shares. Instruments that require settlement in registered common shares may not be classified in permanent equity as it is not always completely within an issuer’s control to deliver registered common shares. Due to the redemption rights associated with the Series A Preferred Units, the Company classifies the Series A Preferred Units in the mezzanine section of the consolidated balance sheets.

The Series A Preferred Units were evaluated for embedded features that should be bifurcated and separately accounted for as a freestanding derivative. The Company determined that the Series A Preferred Units contained features that require bifurcation. The Company records the carrying amount of the redeemable noncontrolling interests, less the value of the embedded derivative, at the greater of the carrying value or redemption value in the consolidated balance sheets.

On January 9, 2018, the acquisition of the HealthEast Clinic & Specialty Center (“Hazelwood Medical Commons”) was partially funded with the issuance of 104,172 Series A Preferred Units with a value of \$22.7 million. Due to the redemption rights associated with the Series A Preferred Units the Trust classifies the Series A Preferred Units in the mezzanine section of its consolidated balance sheet. As of March 31, 2018, the value of the embedded derivative is \$3.8 million and is classified in accrued expenses and other liabilities on the consolidated balance sheet.

As of March 31, 2018, there were 104,172 Series A Preferred Units outstanding.

In connection with the acquisition of a medical office portfolio in Minnesota (the “Minnesota portfolio”), the Trust received a \$5 million equity investment from a third party, effective March 1, 2015. This investment earns a 15% cumulative preferred return. At any point subsequent to the third anniversary of the investment, the holder can require the Trust to redeem the instrument at a price for which the investor will realize a 15% internal rate of return. Due to the redemption provision, which is outside of the control of the Trust, the Trust classifies the investment in the mezzanine section of its consolidated balance sheet. The Trust records the carrying amount of the redeemable noncontrolling interests at the greater of the carrying value or redemption value. As of March 1, 2018, holders redeemed a portion of their noncontrolling interest for \$6.4 million.

In connection with the acquisition on December 29, 2015 of a medical office building located on the campus of the Great Falls Clinic and Hospital in Great Falls, Montana, physicians affiliated with the seller retained a noncontrolling interest which may, at the holders’ option, be redeemed at any time. Due to the redemption provision, which is outside of the control of the Trust, the Trust classifies the investment in the mezzanine section of its consolidated balance sheet. The Trust records the carrying amount of the redeemable noncontrolling interests at the greater of the carrying value or redemption value.

*Dividends and Distributions*

On March 23, 2018, the Trust announced that its Board of Trustees authorized and the Trust declared a cash dividend of \$0.23 per common share for the quarterly period ended March 31, 2018. The distribution was paid on April 18,

2018 to common shareholders and OP Unit holders of record as of the close of business on April 3, 2018.

All distributions paid by the Operating Partnership are declared and paid at the same time as dividends are distributed by the Trust to common shareholders. It has been the Operating Partnership's policy to declare quarterly distributions so as to allow the Trust to comply with applicable provisions of the Internal Revenue Code of 1986, as amended (the "Code"), governing REITs. The declaration and payment of quarterly distributions remains subject to the review and approval of the Trust's Board of Trustees.

Our shareholders are entitled to reinvest all or a portion of any cash distribution on their common shares by participating in our Dividend Reinvestment and Share Purchase Plan ("DRIP"), subject to the terms of the plan.

## Table of Contents

### *Tax Status of Dividends and Distributions*

Our distributions of current and accumulated earnings and profits for U.S. federal income tax purposes generally are taxable to shareholders as ordinary income. Distributions in excess of these earnings and profits generally are treated as a non-taxable reduction of the shareholders' basis in the shares to the extent thereof (non-dividend distributions) and thereafter as taxable gain.

Any cash distributions received by an OP Unit holder in respect of its OP Units generally will not be taxable to such OP Unit holder for U.S. federal income tax purposes, to the extent that such distribution does not exceed the OP Unit holder's basis in its OP Units. Any such distribution will instead reduce the OP Unit holder's basis in its OP Units (and OP Unit holders will be subject to tax on the taxable income allocated to them by the Operating Partnership in respect of their OP Units when such income is earned by the Operating Partnership, with such income allocation increasing the OP Unit holders' basis in their OP Units).

### *Purchases of Investment Properties*

With the adoption of ASU 2017-01 in January 2018 we expect the majority of our future investments in real estate investments will be accounted for as asset acquisitions and to record the purchase price to tangible and intangible assets and liabilities based on their relative fair values. Tangible assets primarily consist of land and buildings and improvements. Additionally, the purchase price includes acquisition related expenses, above- or below-market leases, in place leases, above- or below-market debt assumed, and any contingent consideration recorded when the contingency is resolved. The determination of the fair value requires us to make certain estimates and assumptions.

The determination of fair value involves the use of significant judgment and estimation. The Company makes estimates of the fair value of the tangible and intangible acquired assets and assumed liabilities using information obtained from multiple sources as a result of pre-acquisition due diligence and generally includes the assistance of a third party appraiser. The Company estimates the fair value of an acquired asset on an "as-if-vacant" basis and its value is depreciated in equal amounts over the course of its estimated remaining useful life. The Company determines the allocated value of other fixed assets, such as site improvements, based upon the replacement cost and depreciates such value over the assets' estimated remaining useful lives as determined at the applicable acquisition date. The fair value of land is determined either by considering the sales prices of similar properties in recent transactions or based on internal analyses of recently acquired and existing comparable properties within the Company's portfolio.

The value of above- or below-market leases is estimated based on the present value (using an interest rate which reflected the risks associated with the leases acquired) of the difference between contractual amounts to be received pursuant to the leases and management's estimate of market lease rates measured over a period equal to the estimated remaining term of the lease. The capitalized above-market or below-market lease intangibles are amortized as a reduction or addition to rental income over the estimated remaining term of the respective leases plus the term of any renewal options that the lessee would be economically compelled to exercise.

In determining the value of in-place leases, management considers current market conditions and costs to execute similar leases in arriving at an estimate of the carrying costs during the expected lease-up period from vacant to existing occupancy. In estimating carrying costs, management includes real estate taxes, insurance, other operating expenses, estimates of lost rental revenue during the expected lease-up periods, and costs to execute similar leases, including leasing commissions, tenant improvements, legal, and other related costs based on current market demand. The values assigned to in-place leases are amortized to amortization expense over the estimated remaining term of the lease. If a lease terminates prior to its scheduled expiration, all unamortized costs related to that lease are written off, net of any required lease termination payments.

The Company calculates the fair value of any long-term debt assumed by discounting the remaining contractual cash flows on each instrument at the current market rate for those borrowings, which the Company approximates based on the rate it would expect to incur on a replacement instrument on the date of acquisition, and recognizes any fair value adjustments related to long-term debt as effective yield adjustments over the remaining term of the instrument.

Based on these estimates, the Company recognizes the acquired assets and assumed liabilities at their estimated fair values, which are generally determined using Level 3 inputs, such as market rental rates, capitalization rates, discount rates, or other available market data. Initial valuations are subject to change until the information is finalized, no later than 12 months from the acquisition date.

## Table of Contents

### *Impairment of Intangible and Long-Lived Assets*

The Company periodically evaluates its long-lived assets, primarily consisting of investments in real estate, for impairment indicators or whenever events or changes in circumstances indicate that the recorded amount of an asset may not be fully recoverable. If indicators of impairment are present, the Company evaluates the carrying value of the related real estate properties in relation to the undiscounted expected future cash flows of the underlying operations. In performing this evaluation, management considers market conditions and current intentions with respect to holding or disposing of the real estate property. The Company adjusts the net book value of real estate properties to fair value if the sum of the expected future undiscounted cash flows, including sales proceeds, is less than book value. The Company recognizes an impairment loss at the time it makes any such determination. If the Company determines that an asset is impaired, the impairment to be recognized is measured as the amount by which the recorded amount of the asset exceeds its fair value. Fair value is typically determined using a discounted future cash flow analysis or other acceptable valuation techniques, which are based, in turn, upon Level 3 inputs, such as revenue and expense growth rates, capitalization rates, discount rates, or other available market data.

The Company did not record any impairment charges in the three month periods ended March 31, 2018 and 2017.

### *Assets Held for Sale*

The Company may sell properties from time to time for various reasons, including favorable market conditions. The Company classifies certain long-lived assets as held for sale once the criteria, as defined by GAAP, has been met. The Company classifies a real estate property, or portfolio, as held for sale when: (i) management has approved the disposal, (ii) the property is available for sale in its present condition, (iii) an active program to locate a buyer has been initiated, (iv) it is probable that the property will be disposed of within one year, (v) the property is being marketed at a reasonable price relative to its fair value, and (vi) it is unlikely that the disposal plan will significantly change or be withdrawn. Following the classification of a property as “held for sale,” no further depreciation is recorded on the assets, and the asset is written down to the lower of carrying value or fair market value, less cost to sell. As of March 31, 2018, the Company classified one disposition group as held for sale which includes 15 medical office buildings.

### *Investments in Unconsolidated Entities*

The Company reports investments in unconsolidated entities over whose operating and financial policies it has the ability to exercise significant influence under the equity method of accounting. Under this method of accounting, the Company’s share of the investee’s earnings or losses is included in its consolidated statements of income. The initial carrying value of investments in unconsolidated entities is based on the amount paid to purchase the equity interest.

### *Real Estate Loans Receivable*

Real estate loans receivable consists of ten mezzanine loans and two term loans as of March 31, 2018. Generally, each mezzanine loan is collateralized by an ownership interest in the respective borrower, while each term loan is secured by a mortgage of a related medical office building. Interest income on the loans is recognized as earned based on the terms of the loans, subject to evaluation of collectability risks, and is included in the Company’s consolidated statements of income. On a quarterly basis, the Company evaluates the collectability of its loan portfolio, including related interest income receivable, and establishes a reserve for loan losses, if necessary. No such losses have been recognized to date.

### *Rental Revenue*

Rental revenue is recognized on a straight-line basis over the terms of the related leases when collectability is reasonably assured. Recognizing rental revenue on a straight-line basis for leases may result in recognizing revenue for amounts more or less than amounts currently due from tenants. Amounts recognized in excess of amounts currently due from tenants, excluding assets classified as held for sale, net of related allowances, are included in other assets and were approximately \$51.0 million and \$47.6 million as of March 31, 2018 and December 31, 2017, respectively. If the Company determines that collectability of straight-line rents is not reasonably assured, the Company limits future recognition to amounts contractually owed and, where appropriate, establishes an allowance for estimated losses. Allowance for doubtful accounts was approximately \$0.3 million and \$4.9 million as of March 31, 2018 and December 31, 2017, respectively. Rental revenue is adjusted by amortization of lease inducements and above or below market rents on certain leases. Lease inducements and above or below market rents are amortized over the remaining life of the lease.

## Table of Contents

### *Expense Recoveries*

Expense recoveries relate to tenant reimbursement of real estate taxes, insurance, and other operating expenses that are recognized as expense recovery revenue in the period the applicable expenses are incurred. The reimbursements are recorded at gross, as the Company is generally the primary obligor with respect to real estate taxes and purchasing goods and services from third-party suppliers, has discretion in selecting the supplier, and bears the credit risk of tenant reimbursement.

The Company has certain tenants with absolute net leases. Under these lease agreements, the tenant is responsible for operating and building expenses. For absolute net leases, the Company does not recognize expense recoveries.

### *Derivative Instruments*

When the Company has derivative instruments embedded in other contracts, it records them either as an asset or a liability measured at their fair value unless they qualify for a normal purchase or normal sale exception. When specific hedge accounting criteria are not met, changes in the Company's derivative instruments' fair value are recognized currently in earnings. Changes in the fair market values of the Company's derivative instruments are recorded in the consolidated statements of income if the derivative instruments do not qualify for, or the Company does not elect to apply for, hedge accounting. If hedge accounting is applied to a derivative instrument, such changes are reported in accumulated other comprehensive income within the consolidated statement of equity, exclusive of ineffectiveness amounts, which are recognized as adjustments to net income.

To manage interest rate risk for certain of its variable-rate debt, the Company uses interest rate swaps as part of its risk management strategy. These derivatives are designed to mitigate the risk of future interest rate increases by providing a fixed interest rate for a limited, pre-determined period of time. Interest rate swaps designated as cash flow hedges involve the receipt of variable-rate amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount. As of March 31, 2018, the Company had five outstanding interest rate swap contracts that are designated as cash flow hedges of interest rate risk. For presentational purposes, they are shown as one derivative due to the identical nature of their economic terms. Further detail is provided in Note 7 (Derivatives).

The effective portion of the change in the fair value of derivatives designated and that qualify as cash flow hedges is recorded in accumulated other comprehensive income ("AOCI") on the consolidated balance sheets and is subsequently reclassified into earnings as interest expense for the period that the hedged forecasted transaction affects earnings. The ineffective portion of the change in fair value of the derivatives is recognized directly in earnings. For the three months ended March 31, 2018, hedge ineffectiveness was insignificant. For the three months ended March 31, 2017, the Company recorded a \$0.2 million loss as a result of hedge ineffectiveness. The Company expects hedge ineffectiveness to be insignificant in the next 12 months.

### *Income Taxes*

The Trust elected to be taxed as a REIT for federal tax purposes commencing with the filing of its tax return for the short taxable year ending December 31, 2013. The Trust had no taxable income prior to electing REIT status. To qualify as a REIT, the Trust must meet certain organizational and operational requirements, including a requirement to distribute at least 90% of its annual REIT taxable income to its shareholders (which is computed without regard to the dividends paid deduction or net capital gain and which does not necessarily equal net income as calculated in accordance with GAAP). As a REIT, the Trust generally will not be subject to federal income tax to the extent it distributes qualifying dividends to its shareholders. If the Trust fails to qualify as a REIT in any taxable year, it will be subject to federal income tax (including any applicable alternative minimum tax) on its taxable income at regular

corporate income tax rates and generally will not be permitted to qualify for treatment as a REIT for federal income tax purposes for the four taxable years following the year during which qualification is lost, unless the Internal Revenue Service grants the Trust relief under certain statutory provisions. Such an event could materially adversely affect the Trust's net income and net cash available for distribution to shareholders. However, the Trust intends to continue to operate in such a manner as to continue qualifying for treatment as a REIT. Although the Trust continues to qualify for taxation as a REIT, in various instances, the Trust is subject to state and local taxes on its income and property, and federal income and excise taxes on its undistributed income.

As discussed in Note 1 (Organization and Business), the Trust conducts substantially all of its operations through the Operating Partnership. As a partnership, the Operating Partnership generally is not liable for federal income taxes. The income and loss from the operations of the Operating Partnership is included in the tax returns of its partners, including the Trust, who are responsible for reporting their allocable share of the partnership income and loss. Accordingly, no provision for income taxes has been made on the accompanying consolidated financial statements.

## Table of Contents

### *Tenant Receivables, Net*

Tenant accounts receivable are stated net of the applicable allowance. Rental payments under these contracts are primarily due monthly. The Company assesses the collectability of tenant receivables, including straight-line rent receivables, and defers recognition of revenue if collectability is not reasonably assured. The Company bases its assessment of the collectability of rent receivables on several factors, including, among other things, payment history, the financial strength of the tenant, and current economic conditions. If management's evaluation of these factors indicates it is probable that the Company will be unable to recover the full value of the receivable, the Company provides a reserve against the portion of the receivable that it estimates may not be recovered. At March 31, 2018 and December 31, 2017, the allowance for doubtful accounts was \$0.8 million and \$1.6 million, respectively.

### *Management Estimates*

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the consolidated financial statements and the amounts of revenue and expenses reported in the period. Significant estimates are made for the fair value assessments with respect to purchase price allocations, impairment assessments, and the valuation of financial instruments. Actual results could differ from these estimates.

### *Contingent Liabilities*

Certain of our acquisitions provide for additional consideration to the seller in the form of an earn-out associated with lease-up contingencies. The Company recognizes the contingent liabilities only if certain parameters or other substantive contingencies are met, at which time the consideration becomes payable. Resolved contingent liabilities increase our acquired assets, and reduce our liability.

In January 2017, the FASB issued ASU No. 2017-01, *Clarifying the Definition of a Business*, which changes the definition of a business to assist entities with evaluating when a set of transferred assets and activities is a business. Prior to January 1, 2018, the Company recorded certain contingent liabilities which are included in accrued expenses and other liabilities on its consolidated balance sheets. These were recorded at fair value as of the acquisition date and until they expire, the Company reassesses the fair value at the end of each reporting period, with any changes being recognized in earnings.

### *Reclassifications*

Certain prior period amounts have been reclassified to conform to the current financial statement presentation, with no effect on the previously reported consolidated balance sheets or consolidated statements of income.

### *Segment Reporting*

Under the provision of Codification Topic 280, *Segment Reporting*, the Company has determined that it has one reportable segment with activities related to leasing and managing healthcare properties.

### *New Accounting Pronouncements*

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*, which creates a new Topic, Accounting Standards Codification Topic 606. The standard is principle-based and provides a five-step model to determine when and how revenue is recognized. The core principle is that a company should recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company

expects to be entitled in exchange for those goods or services. We adopted ASU 2014-09 as of January 1, 2018 under the modified retrospective approach. Based on our assessment, we have identified all of our revenue streams and concluded rental income from leasing arrangements represents a substantial portion of our revenue. Income from leasing arrangements is specifically excluded from Topic 606 and will be evaluated with the anticipated adoption of ASU 2016-02, *Leases*. Therefore, the impact of adopting ASU 2014-09 was minimal on our current recognition and presentation of non-lease revenue. Upon adoption of ASU 2016-02, Topic 606 may apply to executory costs and other components of revenue due under leases that are deemed to be non-lease components (such as common area maintenance and other reimbursement revenue), even when the revenue for such activities is not separately stipulated in the lease. In that case, the revenue from these items previously recognized on a straight-line basis under the current lease guidance would be recognized under the new revenue guidance as the related services are delivered.

## Table of Contents

In February 2016, the FASB issued ASU 2016-02, *Leases*. The update amends the existing accounting standards for lease accounting, including requiring lessees to recognize most leases on their balance sheets and making targeted changes to lessor accounting. The standard provides the option of a modified retrospective transition approach or a cumulative effect for all leases existing at, or entered into after, the date of initial application, with an option to use certain transition relief. The FASB also issued an Exposure Draft on January 5, 2018 proposing to amend ASU 2016-02, which would provide lessors with a practical expedient, by class of underlying assets, to not separate non-lease components from the related lease components and, instead, to account for those components as a single lease component, if certain criteria are met. ASU 2016-02 and the related Exposure Draft are not effective for us until January 1, 2019, with early adoption permitted. We are continuing to evaluate this guidance and the impact to us, as both lessor and lessee, on our Consolidated Financial Statements. We expect to utilize the practical expedients proposed in the Exposure Draft as part of our adoption of ASU 2016-02. As a result of adopting the practical expedients, the Company will recognize all of its operating leases for which it is the lessee, including ground leases, on its consolidated balance sheets. The Company is evaluating the impact of the adoption of ASU 2016-02 on January 1, 2019 to its consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments-Credit Losses*, which changes the impairment model for most financial instruments by requiring companies to recognize an allowance for expected losses, rather than incurred losses as required currently by the other-than-temporary impairment model. ASU 2016-13 will apply to most financial assets measured at amortized cost and certain other instruments, including trade and other receivables, loans, held-to-maturity debt securities, net investments in leases, and off-balance-sheet credit exposures (e.g., loan commitments). ASU 2016-13 is effective for reporting periods beginning after December 15, 2019, with early adoption permitted, and will be applied as a cumulative adjustment to retained earnings as of the effective date. We are currently assessing the potential effect the adoption of ASU 2016-13 will have on our consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payment*. ASU 2016-15 clarifies the guidance on the classification of certain cash receipts and payments in the statement of cash flows to reduce diversity in practice with respect to: (i) debt prepayment or debt extinguishment costs; (ii) settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; (iii) contingent consideration payments made after a business combination; (iv) proceeds from the settlement of insurance claims; (v) proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies; (vi) distributions received from equity method investees; (vii) beneficial interests in securitization transactions; and (viii) separately identifiable cash flows and application of the predominance principle. ASU 2016-15 is effective for fiscal years beginning after December 15, 2017 with early adoption permitted. The Company adopted ASU 2016-15 on January 1, 2018, with no material effect on its consolidated financial statements and no adjustments made to prior periods.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows: Restricted Cash*, which will require companies to include restricted cash with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown in the statement of cash flows. ASU 2016-18 will require disclosure of a reconciliation between the balance sheet and the statement of cash flows when the balance sheet includes more than one line item for cash, cash equivalents, restricted cash, and restricted cash equivalents. An entity with material restricted cash and restricted cash equivalents balances will be required to disclose the nature of the restrictions. ASU 2016-18 is effective for reporting periods beginning after December 15, 2017, and is required to be applied retrospectively to all periods presented. The Company adopted ASU 2016-18 on January 1, 2018, with no material effect on its consolidated financial statements and no adjustments made to prior periods.

In January 2017, the FASB issued ASU No. 2017-01, *Clarifying the Definition of a Business*, which changes the definition of a business to assist entities with evaluating when a set of transferred assets and activities is a business.

ASU 2017-01 states that when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or group of similar identifiable assets, the set is not a business. If this initial test is not met, a set cannot be considered a business unless it includes an acquired input and a substantive process that together significantly contribute to the ability to create outputs. In addition, ASU 2017-01 clarifies the requirements for a set of activities to be considered a business and narrows the definition of an output. This ASU is to be applied prospectively and is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017. The Company adopted ASU 2017-01 on January 1, 2018 and as a result, have classified our real estate acquisitions completed during the three months ended March 31, 2018 as asset acquisitions rather than business combinations due to the fact that substantially all of the fair value of the gross assets acquired were concentrated in a single asset or group of similar identifiable assets. The Company has recorded identifiable assets acquired, liabilities assumed and any noncontrolling interests associated with any asset acquisitions at cost on a relative fair value basis and has capitalized transaction costs incurred.

Table of Contents

In August 2017, the FASB issued ASU 2017-12, *Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities*, which expands and refines hedge accounting for both nonfinancial and financial risk components and aligns the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements. It also includes certain targeted improvements to simplify the application of current guidance related to hedge accounting. The standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018, with early adoption permitted. The Company is currently in the process of evaluating the effects this standard will have on its consolidated financial statements.

**Note 3. Acquisitions and Dispositions**

During the three months ended March 31, 2018, the Company completed acquisitions of 2 operating healthcare properties and 1 land parcel located in 3 states for an aggregate purchase price of approximately \$99.4 million. In addition, the Company completed a noncontrolling interest buyout for \$6.4 million and a \$2.0 million loan transaction, resulting in total investment activity of approximately \$107.8 million.

Effective January 1, 2018, with our adoption of ASU 2017-01, transaction costs incurred for asset acquisitions are capitalized as a component of purchase price and all other non-capitalizable costs are reflected in "Operating Expenses" on our consolidated statement of operations. Certain acquisitions that occurred prior to January 1, 2018, were accounted for as business combinations.

Investment activity for the three months ended March 31, 2018 is summarized below:

| Property                                             | Location           | Acquisition Date  | Purchase Price<br>(in thousands) |
|------------------------------------------------------|--------------------|-------------------|----------------------------------|
| Hazelwood Medical Commons                            | (1) Maplewood, MN  | January 9, 2018   | \$ 70,702                        |
| Lee's Hill Medical Plaza                             | Fredericksburg, VA | January 23, 2018  | 28,000                           |
| Scottsdale, Arizona Land                             | (2) Scottsdale, AZ | February 16, 2018 | 700                              |
| Loan Investment                                      | (3) Pensacola, FL  | February 16, 2018 | 2,000                            |
| Noncontrolling Interest Buyout - Minnesota portfolio | (4)                | March 1, 2018     | 6,406                            |
|                                                      |                    |                   | \$ 107,808                       |

- (1) The Company partially funded the purchase price of this acquisition by issuing a total of 104,172 Series A Preferred Units valued at approximately \$22.7 million in the aggregate on the date of issuance.
- (2) The Company acquired the land beneath a previously acquired facility.
- (3) Has an interest rate of 8.9%.
- (4) The Company acquired an additional 4.2% interest in the Minnesota portfolio joint venture, increasing the Company's total interest in the joint venture to 99.6%.

For the three months ended March 31, 2018, the Company recorded revenues and net income from its 2018 acquisitions of \$1.9 million and \$0.6 million, respectively.

The following table summarizes the acquisition date fair values of the assets acquired and the liabilities assumed, which the Company determined using Level 2 and Level 3 inputs (in thousands):

|                                        |           |
|----------------------------------------|-----------|
| Land                                   | \$7,684   |
| Building and improvements              | 82,180    |
| In-place lease intangible              | 13,202    |
| Above market in-place lease intangible | 969       |
| Below market in-place lease intangible | (959 )    |
| Prepaid Expenses                       | (2,628 )  |
| Issuance of Series A Preferred Units   | (22,651 ) |
| Net assets acquired                    | \$77,797  |



## Table of Contents

### Dispositions

During the three months ended March 31, 2018, the Company sold two medical office buildings located in Michigan and Florida for approximately \$2.5 million and recognized a net gain on the sale of approximately \$0.1 million.

The following table summarizes revenues and net income related to the two disposed properties for the periods presented (in thousands):

|                                                             | Three Months Ended<br>March 31, |       |
|-------------------------------------------------------------|---------------------------------|-------|
|                                                             | 2018                            | 2017  |
| Revenues                                                    | \$48                            | \$142 |
| Income (loss) before gain on sale of investment properties: | (46 )                           | 29    |
| Gain on sale of investment properties, net                  | 69                              | —     |
| Net income                                                  | \$23                            | \$29  |

### Assets Held for Sale

As of March 31, 2018, the Company classified one portfolio comprised of 15 properties, as held for sale. In accordance with this classification, the following assets are classified as held for sale in the accompanying consolidated balance sheets at March 31, 2018.

|                                                           |           |
|-----------------------------------------------------------|-----------|
| Land and improvements                                     | \$10,166  |
| Building and improvements                                 | 80,517    |
| Tenant improvements                                       | 6,046     |
| Acquired lease intangibles                                | 12,967    |
| Other Assets                                              | 3,898     |
| Real estate held for sale before accumulated depreciation | 113,594   |
| Accumulated depreciation                                  | (20,305 ) |
| Real estate held for sale                                 | \$93,289  |

### Unaudited Pro Forma Financial Information

#### Physicians Realty Trust

The following table illustrates the pro forma consolidated revenue, net income, and earnings per share as if the Company had acquired the 2018 acquisitions as of January 1, 2017 (in thousands, except share and per share amounts):

|                                                         | Three Months Ended<br>March 31, |             |
|---------------------------------------------------------|---------------------------------|-------------|
|                                                         | 2018                            | 2017        |
| Revenue                                                 | \$106,047                       | \$ 79,183   |
| Net income                                              | 12,009                          | 7,298       |
| Net income available to common shareholders             | 11,065                          | 6,756       |
| Earnings per share - basic                              | \$0.06                          | \$ 0.04     |
| Earnings per share - diluted                            | \$0.06                          | \$ 0.04     |
| Weighted average number of shares outstanding - basic   | 181,809,570                     | 181,809,570 |
| Weighted average number of shares outstanding - diluted | 187,317,243                     | 187,317,243 |



Table of Contents*Physicians Realty L.P.*

The following table illustrates the pro forma consolidated revenue, net income, and earnings per unit as if the Company had acquired the 2018 acquisitions as of January 1, 2017 (in thousands, except unit and per unit amounts):

|                                                        | Three Months Ended<br>March 31, |             |
|--------------------------------------------------------|---------------------------------|-------------|
|                                                        | 2018                            | 2017        |
| Revenue                                                | \$ 106,047                      | \$ 79,183   |
| Net income                                             | 12,009                          | 7,298       |
| Net income available to common unitholders             | 11,411                          | 6,920       |
| Earnings per unit - basic                              | \$0.06                          | \$ 0.04     |
| Earnings per unit - diluted                            | \$0.06                          | \$ 0.04     |
| Weighted average number of units outstanding - basic   | 187,264,064                     | 187,264,064 |
| Weighted average number of units outstanding - diluted | 187,317,243                     | 187,317,243 |

**Note 4. Intangibles**

The following is a summary of the carrying amount of intangible assets and liabilities, excluding 15 assets classified as held for sale, as of March 31, 2018 and December 31, 2017 (in thousands):

|                            | March 31, 2018 |                             |           | December 31, 2017 |                             |           |
|----------------------------|----------------|-----------------------------|-----------|-------------------|-----------------------------|-----------|
|                            | Cost           | Accumulated<br>Amortization | Net       | Cost              | Accumulated<br>Amortization | Net       |
| <b>Assets</b>              |                |                             |           |                   |                             |           |
| In-place leases            | \$345,495      | \$(90,633 )                 | \$254,862 | \$343,429         | \$(85,424 )                 | \$258,005 |
| Above-market leases        | 53,205         | (12,680 )                   | 40,525    | 54,148            | (11,968 )                   | 42,180    |
| Leasehold interest         | 712            | (198 )                      | 514       | 712               | (183 )                      | 529       |
| Below-market ground leases | 60,424         | (1,588 )                    | 58,836    | 60,424            | (1,344 )                    | 59,080    |
| Total                      | \$459,836      | \$(105,099 )                | \$354,737 | \$458,713         | \$(98,919 )                 | \$359,794 |
| <b>Liabilities</b>         |                |                             |           |                   |                             |           |
| Below-market leases        | \$15,225       | \$(5,261 )                  | \$9,964   | \$14,344          | \$(4,479 )                  | \$9,865   |
| Above-market ground leases | 5,965          | (162 )                      | 5,803     | 5,965             | (128 )                      | 5,837     |
| Total                      | \$21,190       | \$(5,423 )                  | \$15,767  | \$20,309          | \$(4,607 )                  | \$15,702  |

The following is a summary of the acquired lease intangible amortization for the three month periods ended March 31, 2018 and 2017, respectively (in thousands):

|                                                                     | Three Months Ended<br>March 31, |         |
|---------------------------------------------------------------------|---------------------------------|---------|
|                                                                     | 2018                            | 2017    |
| Amortization expense related to in-place leases                     | \$11,002                        | \$8,740 |
| Decrease of rental income related to above-market leases            | 1,480                           | 1,389   |
| Decrease of rental income related to leasehold interest             | 15                              | 14      |
| Increase of rental income related to below-market leases            | 843                             | 569     |
| Decrease of operating expense related to above-market ground leases | 35                              | 8       |
| Increase in operating expense related to below-market ground leases | 244                             | 185     |



Table of Contents

Future aggregate net amortization of the acquired lease intangibles as of March 31, 2018, is as follows (in thousands):

|            | Net Decrease in<br>Revenue | Net Increase in<br>Expenses |
|------------|----------------------------|-----------------------------|
| 2018       | \$ (2,267 )                | \$ 30,661                   |
| 2019       | (3,219 )                   | 36,279                      |
| 2020       | (3,320 )                   | 33,480                      |
| 2021       | (3,264 )                   | 31,142                      |
| 2022       | (2,772 )                   | 26,841                      |
| Thereafter | (16,233 )                  | 149,492                     |
| Total      | \$ (31,075 )               | \$ 307,895                  |

As of March 31, 2018, the weighted average amortization period for asset lease intangibles and liability lease intangibles are 19 and 20 years, respectively.

**Note 5. Other Assets**

Other assets, excluding 15 assets classified as held for sale, consisted of the following as of March 31, 2018 and December 31, 2017 (in thousands):

|                                    | March 31,<br>2018 | December 31,<br>2017 |
|------------------------------------|-------------------|----------------------|
| Straight line rent receivable, net | \$50,952          | \$47,599             |
| Note receivable                    | 20,606            | —                    |
| Interest rate swap                 | 18,976            | 14,693               |
| Prepaid expenses                   | 15,510            | 18,103               |
| Lease inducements, net             | 13,943            | 14,232               |
| Earnest deposits                   | 5,500             | 2,780                |
| Leasing commissions, net           | 4,420             | 4,128                |
| Escrows                            | 1,475             | 1,996                |
| Other                              | 3,537             | 2,771                |
| Total                              | \$134,919         | \$106,302            |

Table of Contents**Note 6. Debt**

The following is a summary of debt as of March 31, 2018 and December 31, 2017 (in thousands):

|                                                                                                                     | March 31,<br>2018 | December 31,<br>2017 |     |
|---------------------------------------------------------------------------------------------------------------------|-------------------|----------------------|-----|
| Fixed interest mortgage notes                                                                                       | \$147,607         | (1)\$158,171         | (2) |
| Variable interest mortgage notes                                                                                    | 6,915             | (3)28,509            | (4) |
| Total mortgage debt                                                                                                 | 154,522           | 186,680              |     |
| \$850 million unsecured revolving credit facility bearing variable interest of LIBOR plus 1.20%, due September 2020 | 222,000           | 80,000               |     |
| \$400 million senior unsecured notes bearing fixed interest of 4.30%, due March 2027                                | 400,000           | 400,000              |     |
| \$350 million senior unsecured notes bearing fixed interest of 3.95%, due January 2028                              | 350,000           | 350,000              |     |
| \$250 million unsecured term borrowing bearing fixed interest of 2.87%, due June 2023 (5)                           | 250,000           | 250,000              |     |
| \$150 million senior unsecured notes bearing fixed interest of 4.03% to 4.74%, due January 2023 to 2031             | 150,000           | 150,000              |     |
| \$75 million senior unsecured notes bearing fixed interest of 4.09% to 4.24%, due August 2025 to 2027               | 75,000            | 75,000               |     |
| Total principal                                                                                                     | 1,601,522         | 1,491,680            |     |
| Unamortized deferred financing costs                                                                                | (7,657 )          | (7,808 )             |     |
| Unamortized discount                                                                                                | (6,521 )          | (6,663 )             |     |
| Unamortized fair value adjustment                                                                                   | 244               | 259                  |     |
| Total debt                                                                                                          | \$1,587,588       | \$1,477,468          |     |

Fixed interest mortgage notes, bearing interest from 3.00% to 5.50%, with a weighted average interest rate (1) of 4.39%, and due in 2019, 2020, 2021, 2022, and 2024 collateralized by eight properties with a net book value of \$240.8 million.

Fixed interest mortgage notes, bearing interest from 3.00% to 5.50%, with a weighted average interest rate (2) of 4.45%, and due in 2018, 2019, 2020, 2021, 2022, and 2024 collateralized by nine properties with a net book value of \$267.7 million.

(3) Variable interest mortgage note bearing variable interest of LIBOR plus 2.25% and due in 2018, collateralized by one property with a net book value of \$8.3 million.

Variable interest mortgage notes, bearing variable interest of LIBOR plus 2.25% to 3.25%, with a weighted (4) average interest rate of 4.50% and due 2018 collateralized by three properties with a net book value of \$39.2 million.

The Trust's borrowings under the term loan feature of the Credit Agreement bear interest at a rate which is (5) determined by the Trust's credit rating, currently equal to LIBOR + 1.80%. The Trust has entered into a pay-fixed receive-variable interest rate swap, fixing the LIBOR component of this rate at 1.07%.

On June 10, 2016, the Operating Partnership, as borrower, and the Trust entered into an amended and restated Credit Agreement with KeyBank National Association, as administrative agent, KeyBanc Capital Markets Inc., BMO Capital Markets, and Citizens Bank N.A., as joint lead arrangers and co-book runners, BMO Capital Markets and Citizens Bank N.A., as co-syndication agents, and the lenders party thereto (the "Credit Agreement") which increased the maximum principal amount available under an unsecured revolving credit facility from \$750 million to \$850 million. The Credit Agreement contains a 7-year term loan feature allowing the Operating Partnership to borrow in a single drawing up to \$250 million, increasing the borrowing capacity to an aggregate \$1.1 billion. The Credit Agreement also includes a swingline loan commitment for up to 10% of the maximum principal amount and provides an accordion feature allowing the Trust to increase borrowing capacity by up to an additional \$500 million, subject to customary terms and conditions, resulting in a maximum borrowing capacity of \$1.6 billion.



Table of Contents

On July 7, 2016, the Operating Partnership borrowed \$250.0 million under the 7-year term loan feature of the Credit Agreement. Borrowings under the term loan feature of the Credit Agreement bear interest on the outstanding principal amount at a rate which is determined by the Trust's credit rating, currently equal to LIBOR + 1.80%. The Trust simultaneously entered into a pay-fixed receive-variable rate swap for the full borrowing amount, fixing the LIBOR component of the borrowing rate to 1.07%, for an all-in fixed rate of 2.87%. Both the borrowing and pay-fixed receive-variable swap have a maturity date of June 10, 2023.

The Credit Agreement has a maturity date of September 18, 2020 and includes a one year extension option. Borrowings under the Credit Agreement bear interest on the outstanding principal amount at an adjusted LIBOR rate, which is based on the Trust's investment grade rating under the Credit Agreement. As of March 31, 2018, the Trust had an investment grade rating of Baa3 from Moody's and BBB- from S&P. As such, borrowings under the revolving credit facility of the Credit Agreement accrued interest on the outstanding principal at a rate of LIBOR plus 1.20%. The Credit Agreement includes a facility fee equal to 0.25% per annum, which is also determined by the Trust's investment grade rating.

The Credit Agreement contains financial covenants that, among other things, require compliance with leverage and coverage ratios and maintenance of minimum tangible net worth, as well as covenants that may limit the Trust's and the Operating Partnership's ability to incur additional debt or make distributions. The Company may, at any time, voluntarily prepay any revolving or swingline loan under the Credit Agreement in whole or in part without premium or penalty. Prepayments of term borrowings require payment of premiums of up to 2.0% of the amount of prepayment, dependent on the date of such prepayment. As of March 31, 2018, the Company was in compliance with all financial covenants related to the Credit Agreement.

The Credit Agreement includes customary representations and warranties by the Trust and the Operating Partnership, and imposes customary covenants on the Operating Partnership and the Trust. The Credit Agreement also contains customary events of default, and if an event of default occurs and continues, the Operating Partnership is subject to certain actions by the administrative agent, including without limitation, the acceleration of repayment of all amounts outstanding under the Credit Agreement.

The Credit Agreement provides for revolving credit and term loans to the Trust and the Operating Partnership. Base Rate Loans, Adjusted LIBOR Rate Loans, and Letters of Credit (each, as defined in the Credit Agreement) will be subject to interest rates, based upon the Trust's investment grade rating as follows:

| Credit Rating         | Margin for Revolving Loans:<br>Adjusted LIBOR Rate Loans<br>and Letter of Credit Fee | Margin for<br>Revolving<br>Loans:<br>Base Rate Loans | Margin for Term Loans:<br>Adjusted LIBOR Rate Loans<br>and Letter of Credit Fee | Margin for<br>Term Loans:<br>Base Rate Loans |
|-----------------------|--------------------------------------------------------------------------------------|------------------------------------------------------|---------------------------------------------------------------------------------|----------------------------------------------|
| At Least A- or A3     | LIBOR + 0.85%                                                                        | — %                                                  | LIBOR + 1.40%                                                                   | 0.40 %                                       |
| At Least BBB+ or Baa1 | LIBOR + 0.90%                                                                        | — %                                                  | LIBOR + 1.45%                                                                   | 0.45 %                                       |
| At Least BBB or Baa2  | LIBOR + 1.00%                                                                        | 0.10 %                                               | LIBOR + 1.55%                                                                   | 0.55 %                                       |
| At Least BBB- or Baa3 | LIBOR + 1.20%                                                                        | 0.20 %                                               | LIBOR + 1.80%                                                                   | 0.80 %                                       |
| Below BBB- or Baa3    | LIBOR + 1.55%                                                                        | 0.60 %                                               | LIBOR + 2.25%                                                                   | 1.25 %                                       |

As of March 31, 2018, the company had \$222.0 million of borrowings outstanding under its unsecured revolving credit facility, and \$250.0 million of borrowings outstanding under the term loan feature of the Credit Agreement. The

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Company has also issued a letter of credit for \$17.0 million with no outstanding balance as of March 31, 2018. As defined by the Credit Agreement, \$611.0 million is available to borrow without adding additional properties to the unencumbered borrowing base of assets.

On January 7, 2016, the Operating Partnership issued and sold \$150.0 million aggregate principal amount of senior notes, comprised of (i) \$15.0 million aggregate principal amount of 4.03% Senior Notes, Series A, due January 7, 2023, (ii) \$45.0 million aggregate principal amount of 4.43% Senior Notes, Series B, due January 7, 2026, (iii) \$45.0 million aggregate principal amount of 4.57% Senior Notes, Series C, due January 7, 2028, and (iv) \$45.0 million aggregate principal amount of 4.74% Senior Notes, Series D, due January 7, 2031. On August 11, 2016, the note agreement for these notes was amended to make certain changes to its terms, including certain changes to affirmative covenants, negative covenants and definitions contained therein. Interest on each respective series of the January 2016 Senior Notes is payable semi-annually.

On August 11, 2016, the Operating Partnership issued and sold \$75.0 million aggregate principal amount of senior notes, comprised of (i) \$25.0 million aggregate principal amount of 4.09% Senior Notes, Series A, due August 11, 2025, (ii) \$25.0 million aggregate principal amount of 4.18% Senior Notes, Series B, due August 11, 2026, and (iii) \$25.0 million

## Table of Contents

aggregate principal amount of 4.24% Senior Notes, Series C, due August 11, 2027. Interest on each respective series of the August 2016 Senior Notes is payable semi-annually.

On March 7, 2017, the Operating Partnership issued and sold \$400.0 million aggregate principal amount of 4.30% Senior Notes which will mature on March 15, 2027. The Senior Notes began accruing interest on March 7, 2017 and began paying interest semi-annually beginning September 15, 2017. The Senior Notes were sold at an issue price of 99.68% of their face value, before the underwriters' discount. Our net proceeds from the offering, after deducting underwriting discounts and expenses, were approximately \$396.1 million.

On December 1, 2017, the Operating Partnership issued and sold \$350.0 million aggregate principal amount of 3.95% Senior Notes which will mature on January 15, 2028. The Senior Notes began accruing interest on December 1, 2017 and will begin paying interest semi-annually beginning July 15, 2018. The Senior Notes were sold at an issue price of 99.78% of their face value, before the underwriters' discount. Our net proceeds from the offering, after deducting underwriting discounts and expenses, were approximately \$347.0 million.

Certain properties have mortgage debt that contains financial covenants. As of March 31, 2018, the Trust was in compliance with all mortgage debt financial covenants.

Scheduled principal payments due on debt as of March 31, 2018, are as follows (in thousands):

|                |             |
|----------------|-------------|
| 2018           | \$22,618    |
| 2019           | 44,631      |
| 2020           | 252,121     |
| 2021           | 8,718       |
| 2022           | 24,708      |
| Thereafter     | 1,248,726   |
| Total Payments | \$1,601,522 |

As of March 31, 2018, the Company had total consolidated indebtedness of approximately \$1.6 billion. The weighted average interest rate on consolidated indebtedness was 3.84% (based on the 30-day LIBOR rate as of March 31, 2018, of 1.80%).

For the three month periods ended March 31, 2018 and 2017, the Company incurred interest expense on its debt, exclusive of deferred financing cost amortization, of \$16.0 million and \$9.3 million, respectively.

## **Note 7. Derivatives**

In the normal course of business, a variety of financial instruments are used to manage or hedge interest rate risk. The Company has implemented ASC 815, *Derivatives and Hedging* (ASC 815), which establishes accounting and reporting standards requiring that all derivatives, including certain derivative instruments embedded in other contracts, be recorded as either an asset or a liability measured at their fair value unless they qualify for a normal purchase or normal sales exception.

When specific hedge accounting criteria are not met, ASC 815 requires that changes in a derivative's fair value be recognized currently in earnings. Changes in the fair market values of the Company's derivative instruments are recorded in the consolidated statements of income if such derivatives do not qualify for, or the Company does not elect to apply for, hedge accounting. If hedge accounting is applied to a derivative instrument, such changes are reported in accumulated other comprehensive income within the consolidated statement of equity, exclusive of ineffectiveness amounts, which are recognized as adjustments to net income.

To manage interest rate risk for certain of its variable-rate debt, the Company uses interest rate swaps as part of its risk management strategy. These derivatives are designed to mitigate the risk of future interest rate increases by providing a fixed interest rate for a limited, pre-determined period of time. Interest rate swaps designated as cash flow hedges involve the receipt of variable-rate amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount. As of March 31, 2018, the Company had five outstanding interest rate swap contracts that are designated as cash flow hedges of interest rate risk. For presentational purposes, they are shown as one derivative due to the identical nature of their economic terms.

Table of Contents

The effective portion of the change in the fair value of derivatives designated and that qualify as cash flow hedges is recorded in accumulated other comprehensive income (“AOCI”) on the consolidated balance sheets and is subsequently reclassified into earnings as interest expense for the period that the hedged forecasted transaction affects earnings. The ineffective portion of the change in fair value of the derivatives is recognized directly in earnings. Hedge ineffectiveness was insignificant for the three months ended March 31, 2018. For the three months ended March 31, 2017 the Company recognized a \$0.2 million loss as a result of hedge ineffectiveness. The Company expects hedge ineffectiveness to be insignificant in the next 12 months.

The following table summarizes the location and aggregate fair value of the interest rate swaps on the Company’s consolidated balance sheets (in thousands):

|                                                                      |            |
|----------------------------------------------------------------------|------------|
| Total notional amount                                                | \$ 250,000 |
| Effective fixed interest rate                                        | (1)2.87 %  |
| Effective date                                                       | 7/7/2016   |
| Maturity date                                                        | 6/10/2023  |
| Asset balance at March 31, 2018 (included in Other assets)           | \$ 18,976  |
| Asset balance at December 31, 2017 (included in Other assets)        | \$ 14,693  |
| (1)1.07% effective swap rate plus 1.80% spread per Credit Agreement. |            |

**Note 8. Accrued Expenses and Other Liabilities**

Accrued expenses and other liabilities consisted of the following as of March 31, 2018 and December 31, 2017 (in thousands):

|                                | March 31,<br>2018 | December 31,<br>2017 |
|--------------------------------|-------------------|----------------------|
| Prepaid rent                   | \$ 16,701         | \$ 10,496            |
| Real estate taxes payable      | 14,054            | 16,103               |
| Accrued interest               | 7,711             | 11,107               |
| Accrued expenses               | 4,590             | 8,751                |
| Embedded derivative            | 3,776             | —                    |
| Security deposits              | 2,810             | 2,882                |
| Tenant improvement allowance   | 2,678             | 3,065                |
| Accrued incentive compensation | 860               | 1,625                |
| Contingent consideration       | 803               | 1,454                |
| Other                          | 2,723             | 922                  |
| Total                          | \$ 56,706         | \$ 56,405            |

**Note 9. Stock-based Compensation**

The Company follows ASC 718, *Compensation - Stock Compensation* (“ASC 718”), in accounting for its share-based payments. This guidance requires measurement of the cost of employee services received in exchange for stock compensation based on the grant-date fair value of the employee stock awards. This cost is recognized as compensation expense ratably over the employee’s requisite service period. Incremental compensation costs arising from subsequent modifications of awards after the grant date must be recognized when incurred. Share-based payments classified as liability awards are marked to fair value at each reporting period. Any common shares issued pursuant to the Company's incentive equity compensation and employee stock purchase plans will result in the Operating Partnership issuing OP Units to the Trust on a one-for-one basis, with the Operating Partnership receiving the net cash proceeds of such issuances.

Certain of the Company's employee stock awards vest only upon the achievement of performance targets. ASC 718 requires recognition of compensation cost only when achievement of performance conditions is considered probable. Consequently, the Company's determination of the amount of stock compensation expense requires a significant level of judgment in estimating the probability of achievement of these performance targets. Subsequent changes in actual experience are monitored and estimates are updated as information is available.

Table of Contents

In connection with the IPO, the Trust adopted the 2013 Equity Incentive Plan (“2013 Plan”), which made available 600,000 common shares to be administered by the Compensation and Nominating Governance Committee of the Board of Trustees. On August 7, 2014, at the Annual Meeting of Shareholders of Physicians Realty Trust, the Trust’s shareholders approved an amendment to the 2013 Plan to increase the number of common shares authorized for issuance under the 2013 Plan by 1,850,000 common shares, for a total of 2,450,000 common shares authorized for issuance.

*Restricted Common Shares*

Restricted common shares granted under the 2013 Plan are eligible for dividends as well as the right to vote. In the three month period ended March 31, 2018, the Trust granted a total of 178,700 restricted common shares with a total value of \$2.6 million to its officers and certain of its employees, which have a vesting period of one year.

A summary of the status of the Trust’s non-vested restricted common shares as of March 31, 2018 and changes during the three month period then ended follow:

|                                 | <b>Common<br/>Shares</b> | <b>Weighted<br/>Average Grant<br/>Date Fair Value</b> |
|---------------------------------|--------------------------|-------------------------------------------------------|
| Non-vested at December 31, 2017 | 173,276                  | \$ 19.36                                              |
| Granted                         | 178,700                  | 14.78                                                 |
| Vested                          | (133,052)                | 19.63                                                 |
| Non-vested at March 31, 2018    | 218,924                  | \$ 15.45                                              |

For all service awards, the Company records compensation expense for the entire award on a straight-line basis over the requisite service period. For the three month periods ended March 31, 2018 and 2017, the Company recognized non-cash share compensation of \$0.7 million and \$0.8 million, respectively. Unrecognized compensation expense at March 31, 2018 was \$2.9 million.

*Restricted Share Units*

In March 2018, under the 2013 Plan, the Trust granted restricted share units at a target level of 254,282 to its officers and certain employees and 50,745 to its trustees, which are subject to certain performance, timing, and market conditions and three-year and two-year service periods for officers/employees and trustees, respectively. In addition, each restricted share unit contains one dividend equivalent. The recipient will accrue dividend equivalents on awarded share units equal to the cash dividend that would have been paid on the awarded share unit had the awarded share unit been an issued and outstanding common share on the record date for the dividend.

Approximately 40% of the restricted share units issued to officers and certain employees vest based on certain market conditions. The market conditions were valued with the assistance of independent valuation specialists. The Company utilized a Monte Carlo simulation to calculate the weighted average grant date fair value of \$19.28 per unit for the March 2018 grant using the following assumptions:

|                         |            |   |
|-------------------------|------------|---|
| Volatility              | 21.7       | % |
| Dividend assumption     | reinvested |   |
| Expected term in years  | 2.8 years  |   |
| Risk-free rate          | 2.40       | % |
| Share price (per share) | \$ 14.78   |   |

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The remaining 60% of the restricted share units issued to officers and certain employees, and 100% of restricted share units issued to trustees, vest based upon certain performance or timing conditions. With respect to the performance conditions of the March 2018 grant, the grant date fair value of \$14.78 per unit was based on the share price at the date of grant. The combined weighted average grant date fair value of the March 2018 restricted share units issued to officers and certain employees is \$16.58 per unit.

Table of Contents

The following is a summary of the activity in the Trust's restricted share units during the three months ended March 31, 2018:

|                                 | Executive Awards          |                                              | Trustee Awards            |                                              |
|---------------------------------|---------------------------|----------------------------------------------|---------------------------|----------------------------------------------|
|                                 | Restricted Share<br>Units | Weighted<br>Average Grant<br>Date Fair Value | Restricted Share<br>Units | Weighted<br>Average Grant<br>Date Fair Value |
| Non-vested at December 31, 2017 | 354,123                   | \$ 26.30                                     | 51,220                    | \$ 19.04                                     |
| Granted                         | 254,282                   | 16.58                                        | 50,745                    | 14.78                                        |
| Vested                          | (75,250 )                 | (1) 21.16                                    | (34,807 )                 | 18.67                                        |
| Non-vested at March 31, 2018    | 533,155                   | \$ 22.66                                     | 67,158                    | \$ 16.01                                     |

(1) Restricted units vested by Company executives in 2018 resulted in the issuance of 126,108 common shares, less 56,502 common shares withheld to cover minimum withholding tax obligations, for multiple employees.

For the three month periods ending March 31, 2018 and 2017, the Trust recognized non-cash share restricted unit compensation expense of \$1.8 million and \$0.7 million, respectively. Unrecognized compensation expense at March 31, 2018 was \$8.5 million.

**Note 10. Fair Value Measurements**

ASC Topic 820, *Fair Value Measurement* ("ASC 820"), requires certain assets and liabilities be reported and/or disclosed at fair value in the financial statements and provides a framework for establishing that fair value. The framework for determining fair value is based on a hierarchy that prioritizes the valuation techniques and inputs used to measure fair value.

In general, fair values determined by Level 1 inputs use quoted prices in active markets for identical assets or liabilities that the Company has the ability to access. Fair values determined by Level 2 inputs use other inputs that are observable, either directly or indirectly. These Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related asset. These Level 3 fair value measurements are based primarily on management's own estimates using pricing models, discounted cash flow methodologies, or similar techniques taking into account the characteristics of the asset or liability. In instances where inputs used to measure fair value fall into different levels of the fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each asset or liability.

The Company's derivative instruments as of March 31, 2018 consist of five interest rate swaps. For presentational purposes, the Company's interest rate swaps are shown as a single derivative due to the identical nature of their economic terms, as detailed in the Derivative Instruments section of Note 2 (Summary of Significant Accounting Policies) and Note 7 (Derivatives).

The Company's interest rate swaps are not traded on an exchange. The Company's derivative assets and liabilities are recorded at fair value based on a variety of observable inputs including contractual terms, interest rate curves, yield curves, measure of volatility, and correlations of such inputs. The Company measures its derivatives at fair value on a recurring basis. The fair values are based on Level 2 inputs described above. The Company considers its own credit risk, as well as the credit risk of its counterparties, when evaluating the fair value of its derivatives.

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The Company also has assets that under certain conditions are subject to measurement at fair value on a non-recurring basis. This generally includes assets subject to impairment. There were no such assets measured at fair value as of March 31, 2018.

The carrying amounts of cash and cash equivalents, tenant receivables, payables, and accrued interest are reasonable estimates of fair value because of the short term maturities of these instruments. Fair values for real estate loans receivable and mortgage debt are estimated based on rates currently prevailing for similar instruments of similar maturities and are based primarily on Level 2 inputs.

Table of Contents

As of March 31, 2018, the Company classified one portfolio, comprised of 15 properties, as held for sale. Upon classification as held for sale, we record the portfolio at the lower of its carrying amount or fair value, less costs to sell. Fair value is generally based on discounted cash flow analyses, which involved management's best estimate of market participants' holding period, market comparables, future occupancy levels, rental rates, capitalization rates, lease-up periods and capital requirements. As of March 31, 2018, fair value exceeds carrying value of our assets classified as held for sale and therefore, are recorded at respective carrying value.

The following table presents the fair value of the Company's financial instruments (in thousands):

|                              | March 31,<br>2018  | Fair<br>Value | December 31,<br>2017 | Fair<br>Value |
|------------------------------|--------------------|---------------|----------------------|---------------|
|                              | Carrying<br>Amount |               | Carrying<br>Amount   |               |
| Assets:                      |                    |               |                      |               |
| Real estate loans receivable | \$71,529           | \$70,587      | \$76,195             | \$75,288      |
| Notes receivable             | \$20,606           | \$20,606      | \$—                  | \$—           |
| Derivative assets            | \$18,976           | \$18,976      | \$14,693             | \$14,693      |
| Liabilities:                 |                    |               |                      |               |
| Credit facility              | \$(472,000)        | \$(472,000)   | \$(330,000)          | \$(330,000)   |
| Notes payable                | \$(975,000)        | \$(946,079)   | \$(975,000)          | \$(970,975)   |
| Mortgage debt                | \$(154,766)        | \$(155,241)   | \$(186,939)          | \$(185,743)   |

**Note 11. Tenant Operating Leases**

The Company is lessor of medical office buildings and other healthcare facilities. Leases have expirations from 2018 through 2045. As of March 31, 2018, the future minimum rental payments on non-cancelable leases, exclusive of expense recoveries and 15 assets classified as held for sale, were as follows (in thousands):

|            |             |
|------------|-------------|
| 2018       | \$212,756   |
| 2019       | 283,265     |
| 2020       | 277,287     |
| 2021       | 270,694     |
| 2022       | 258,579     |
| Thereafter | 1,261,540   |
| Total      | \$2,564,121 |

**Note 12. Rent Expense**

The Company leases the rights to parking structures at two of its properties, the air space above one property, and the land upon which 77 of its properties are located from third party land owners pursuant to separate leases. In addition, the Company leases four individual office spaces.

The Company's leases require fixed rental payments and may also include escalation clauses and renewal options. These leases have terms of up to 87 years remaining, excluding extension options.

Table of Contents

As of March 31, 2018, the future minimum lease obligations under non-cancelable parking, air, ground, and office leases were as follows (in thousands):

|            |           |
|------------|-----------|
| 2018       | \$1,938   |
| 2019       | 2,577     |
| 2020       | 2,522     |
| 2021       | 2,537     |
| 2022       | 2,558     |
| Thereafter | 116,728   |
| Total      | \$128,860 |

Rent expense for the parking, air, and ground leases of \$0.6 million and \$0.6 million for the three month periods ended March 31, 2018 and 2017, respectively, are reported in operating expenses in the consolidated statements of income. Rent expense for office leases was insignificant for the three month periods ended March 31, 2018 and 2017, and is reported within general and administrative expenses in the consolidated statements of income.

**Note 13. Credit Concentration**

The Company uses annualized base rent (“ABR”) as its credit concentration metric. Annualized base rent is calculated by multiplying contractual base rent for the month ended March 31, 2018 by 12, excluding the impact of concessions and straight-line rent. The following table summarizes certain information about the Company’s top five tenant credit concentrations as of March 31, 2018, excluding assets classified as held for sale (in thousands):

| Tenant                        | Total ABR | Percent of ABR |
|-------------------------------|-----------|----------------|
| CHI - Nebraska                | \$15,959  | 5.6 %          |
| CHI - KentuckyOne Health      | 13,122    | 4.6 %          |
| Baylor Scott and White Health | 7,583     | 2.7 %          |
| US Oncology                   | 6,706     | 2.4 %          |
| Northside Hospital (GA)       | 6,363     | 2.3 %          |
| Remaining portfolio           | 232,409   | 82.4 %         |
| Total                         | \$282,142 | 100.0 %        |

Annualized base rent collected from the Company’s top five tenant relationships comprises 17.6% of its total annualized base rent for the period ending March 31, 2018. Total annualized base rent from CHI affiliated tenants totals 18.9%, including the affiliates disclosed above. Consolidated financial statements of CHI, the parent of the subsidiaries and affiliates of the entities party to master lease agreements, are publicly available on the Catholic Health Initiatives website ([www.catholichealthinitiatvies.org/](http://www.catholichealthinitiatvies.org/)). Information included on the CHI website is not incorporated by reference within this Quarterly Report on Form 10-Q.

The following table summarizes certain information about the Company’s top five geographic concentrations as of March 31, 2018, excluding 15 assets classified as held for sale (in thousands):

| State     | Total ABR | Percent of ABR |
|-----------|-----------|----------------|
| Texas     | \$47,121  | 16.7 %         |
| Georgia   | 21,909    | 7.8 %          |
| Indiana   | 18,103    | 6.4 %          |
| Nebraska  | 17,361    | 6.2 %          |
| Minnesota | 16,706    | 5.9 %          |
| Other     | 160,942   | 57.0 %         |

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|       |           |        |
|-------|-----------|--------|
| Total | \$282,142 | 100.0% |
|-------|-----------|--------|

32

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Table of Contents**Note 14. Earnings Per Share and Earnings Per Unit**

The following table shows the amounts used in computing the Trust's basic and diluted earnings per share (in thousands, except share and per share data):

|                                                                | <b>Three Months Ended<br/>March 31,</b> |             |
|----------------------------------------------------------------|-----------------------------------------|-------------|
|                                                                | <b>2018</b>                             | <b>2017</b> |
| <b>Numerator for earnings per share - basic:</b>               |                                         |             |
| Net income                                                     | \$11,332                                | \$ 6,716    |
| Net income attributable to noncontrolling interests:           |                                         |             |
| Operating Partnership                                          | (313 )                                  | (147 )      |
| Partially owned properties                                     | (111 )                                  | (167 )      |
| Preferred distributions                                        | (487 )                                  | (211 )      |
| Numerator for earnings per share - basic                       | \$10,421                                | \$ 6,191    |
| <b>Numerator for earnings per share - diluted:</b>             |                                         |             |
| Numerator for earnings per share - basic                       | \$10,421                                | \$ 6,191    |
| Operating Partnership net income                               | 313                                     | 147         |
| Numerator for earnings per share - diluted                     | \$10,734                                | \$ 6,338    |
| <b>Denominator for earnings per share - basic and diluted:</b> |                                         |             |
| Weighted average number of shares outstanding - basic          | 181,809,570                             | 188,986,629 |
| Effect of dilutive securities:                                 |                                         |             |
| Noncontrolling interest - Operating Partnership units          | 5,454,494                               | 3,186,117   |
| Restricted common shares                                       | 53,179                                  | 96,643      |
| Restricted share units                                         | —                                       | 336,541     |
| <b>Denominator for earnings per share - diluted:</b>           | 187,317,243                             | 192,605,930 |
| <b>Earnings per share - basic</b>                              | \$0.06                                  | \$ 0.04     |
| <b>Earnings per share - diluted</b>                            | \$0.06                                  | \$ 0.04     |

For the three months ended March 31, 2018, total restricted share units of 600,313 were excluded from the computation of diluted earnings per share and diluted earnings per unit as their impact would have been anti-dilutive.

The following table shows the amounts used in computing the Operating Partnership's basic and diluted earnings per unit (in thousands, except unit and per unit data):

|                                                                                  | <b>Three Months Ended<br/>March 31,</b> |             |
|----------------------------------------------------------------------------------|-----------------------------------------|-------------|
|                                                                                  | <b>2018</b>                             | <b>2017</b> |
| <b>Numerator for earnings per unit - basic and diluted:</b>                      |                                         |             |
| Net income                                                                       | \$11,332                                | \$ 6,716    |
| Net income attributable to noncontrolling interests - partially owned properties | (111 )                                  | (167 )      |
| Preferred distributions                                                          | (487 )                                  | (211 )      |
| Numerator for earnings per unit - basic and diluted                              | \$10,734                                | \$ 6,338    |
| <b>Denominator for earnings per unit - basic and diluted:</b>                    |                                         |             |
| Weighted average number of units outstanding - basic                             | 187,264,064                             | 142,172,746 |
| Effect of dilutive securities:                                                   |                                         |             |
| Restricted common shares                                                         | 53,179                                  | 96,643      |
| Restricted share units                                                           | —                                       | 336,541     |
| <b>Denominator for earnings per unit - diluted</b>                               | 187,317,243                             | 192,605,930 |
| <b>Earnings per unit - basic</b>                                                 | \$0.06                                  | \$ 0.04     |
| <b>Earnings per unit - diluted</b>                                               | \$0.06                                  | \$ 0.04     |



Table of Contents

**Note 15. Subsequent Events**

On April 3, 2018, the Trust, through a subsidiary of its Operating Partnership, closed on the acquisition of a medical office facility in Kingsport, Tennessee for approximately \$71.3 million.

Table of Contents

**Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations**

*The following discussion should be read in conjunction with our unaudited consolidated financial statements, including the notes to those statements, included in Part I, Item 1 of this report, and the Section entitled “Cautionary Statement Regarding Forward-Looking Statements” in this report. As discussed in more detail in the Section entitled “Cautionary Statement Regarding Forward-Looking Statements,” this discussion contains forward-looking statements, which involve risks and uncertainties. Our actual results may differ materially from the results discussed in the forward-looking statements. Factors that might cause those differences include those discussed in Part II, Item 1A (Risk Factors) of this report, and Part I, Item A (Business), and Part I, Item 1A (Risk Factors) of our 2017 Annual Report.*

**Overview**

We are a self-managed healthcare real estate company organized in April 2013 to acquire, selectively develop, own, and manage healthcare properties that are leased to physicians, hospitals, and healthcare delivery systems. We invest in real estate that is integral to providing high quality healthcare services. Our properties are typically located on a campus with a hospital or other healthcare facilities or strategically located and affiliated with a hospital or other healthcare facilities. We believe the impact of government programs and continuing trends in the healthcare industry create attractive opportunities for us to invest in healthcare related real estate. In particular, we believe the demand for healthcare will continue to increase as a result of the aging population as older persons generally utilize healthcare services at a rate well in excess of younger people. Our management team has significant public healthcare REIT experience and has long established relationships with physicians, hospitals, and healthcare delivery system decision makers that we believe will provide quality investment and growth opportunities. Our principal investments include medical office buildings, outpatient treatment facilities, acute and post-acute care hospitals, as well as other real estate integral to health care providers. We seek to invest in stabilized medical facility assets with initial cash yields of 5.0% to 9.0%, although we invested in certain medical facility assets in 2017 with anticipated initial cash yields below 5.0% and we may invest in other medical facility assets with initial cash yields outside of this range. We seek to generate attractive risk-adjusted returns for our shareholders through a combination of stable and increasing dividends and potential long-term appreciation in the value of our properties and our common shares.

We have grown our portfolio of gross real estate investments from approximately \$124 million at the time of our IPO in July 2013 to approximately \$4.4 billion as of March 31, 2018. Since the date of our IPO through to March 31, 2018, our compounded annual growth rate was 115%. While we expect to continue to grow through property acquisitions and investments as our asset base continues to increase, we expect our annual growth rate to decelerate in the future.

As of March 31, 2018, our portfolio consisted of 265 healthcare properties (which excludes one portfolio comprised of 15 assets, representing approximately 560,234 leasable square feet in three states, classified as held for sale) located in 31 states with approximately 13,625,726 net leasable square feet, which were approximately 96.6% leased with a weighted average remaining lease term of approximately 8.2 years. As of March 31, 2018, approximately 85.0% of the net leasable square footage of our portfolio was either on campus with a hospital or other healthcare facility or strategically located and affiliated with a hospital or other healthcare facility.

We receive a cash rental stream from these healthcare providers under our leases. Approximately 92.2% of the annualized base rent payments from our properties as of March 31, 2018 are from triple-net leases, less assets held for sale, pursuant to which the tenants are responsible for all operating expenses relating to the property, including but not limited to real estate taxes, utilities, property insurance, routine maintenance and repairs, and property management. This structure helps insulate us from increases in certain operating expenses and provides more predictable cash flow. Approximately 6.3% of the annualized base rent payments from our properties as of March 31, 2018 are from modified gross base stop leases which allow us to pass through certain increases in future operating expenses (e.g.,

property tax and insurance) to tenants for reimbursement, thus protecting us from increases in such operating expenses.

We seek to structure our triple-net leases to generate attractive returns on a long-term basis. Our leases typically have initial terms of 5 to 15 years and include annual rent escalators of approximately 1.5% to 3.0%. Our operating results depend significantly upon the ability of our tenants to make required rental payments. We believe that our portfolio of medical office buildings and other healthcare facilities will enable us to generate stable cash flows over time because of the diversity of our tenants, staggered lease expiration schedule, long-term leases, and low historical occurrence of tenants defaulting under their leases. As of March 31, 2018, leases representing 1.9%, 3.8%, and 3.6% of leasable square feet in our portfolio will expire in 2018, 2019, and 2020, respectively.

We intend to grow our portfolio of high-quality healthcare properties leased to physicians, hospitals, healthcare delivery systems and other healthcare providers primarily through acquisitions of existing healthcare facilities that provide

## Table of Contents

stable revenue growth and predictable long-term cash flows. We may also selectively finance the development of new healthcare facilities through joint venture or fee arrangements with premier healthcare real estate developers. Generally, we only expect to make investments in new development properties when approximately 70% or more of the development property has been pre-leased before construction commences. We seek to invest in properties where we can develop strategic alliances with financially sound healthcare providers and healthcare delivery systems that offer need-based healthcare services in sustainable healthcare markets. We focus our investment activity on the following types of healthcare properties:

- medical office buildings;
  - outpatient treatment and diagnostic facilities;
- physician group practice clinics;
- ambulatory surgery centers; and
- specialty hospitals and treatment centers.

We believe that shifting consumer preferences, limited space in hospitals, the desire of patients and healthcare providers to limit non-essential services provided in a hospital setting, and cost considerations, among other trends, continue to drive the industry trend of performing procedures in outpatient facilities that have traditionally been performed in hospitals, such as surgeries and other invasive medical procedures. As these trends continue, we believe that demand for medical office buildings and similar healthcare properties will continue to rise, and that our investment strategy accounts for these trends.

We may invest opportunistically in life science facilities, assisted living, and independent senior living facilities and in the longer term, senior housing properties, including skilled nursing. Consistent with our qualification as a REIT, we may also opportunistically invest in companies that provide healthcare services, and in joint venture entities with operating partners, structured to comply with the REIT Investment Diversification Act of 2007 (“RIDEA”).

One of the factors that influences the market price of our common shares is the dividend yield on common shares (as a percentage of the price of our common shares) relative to market interest rates. In response to the global financial crisis, the U.S. Federal Reserve took actions which resulted in low interest rates prevailing in the marketplace for a historically long period of time. Since December 2015, the U.S. Federal Reserve has raised its benchmark interest rate by a quarter of a percentage point six times to a range of 1.50% to 1.75% and is projected to raise its benchmark interest rate a couple more times in 2018. Further increases in market interest rates may lead prospective purchasers of our common shares to expect a higher dividend yield (with a resulting decline in the market price of our common shares) and higher interest rates would likely increase our borrowing costs for both our existing and future indebtedness and potentially decrease funds available for distribution. Thus, higher market interest rates could cause the market price of our common shares to decrease.

The Trust is a Maryland real estate investment trust and elected to be taxed as a REIT for U.S. federal income tax purposes. We conduct our business through an UPREIT structure in which our properties are owned by our Operating Partnership directly or through limited partnerships, limited liability companies or other subsidiaries. The Trust is the sole general partner of our Operating Partnership and, as of March 31, 2018, owned approximately 97.1% of the OP Units. As of April 30, 2018, there were 182,004,287 common shares outstanding.

## **Key Transactions in First Quarter 2018**

### *Investment Activity*

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During the three months ended March 31, 2018, we completed acquisitions of 2 operating healthcare properties and 1 land parcel located in 3 states with approximately 220,140 net leasable square feet for an aggregate purchase price of approximately \$99.4 million. In addition, we completed a noncontrolling interest buyout for \$6.4 million and a \$2.0 million loan transaction, resulting in total investment activity of approximately \$107.8 million. Acquisitions are detailed in Note 3 (Acquisitions and Dispositions) to our consolidated financial statements included in Part I, Item 1 of this report.

### *Disposition Activity*

Since January 1, 2018, the Trust sold two medical office buildings, representing an aggregate 29,733 square feet, in Michigan and Florida for approximately \$2.5 million and recognized a net gain on the sale of approximately \$0.1 million.

Table of Contents

**Assets Slated for Disposition**

We consider 23 properties in six states, representing an aggregate of approximately 921,515 square feet of gross leasable area, to be slated for disposition as of March 31, 2018. These assets consist of one portfolio comprised of 15 assets representing approximately 560,234 leasable square feet in three states classified as held for sale, five assets affiliated with Foundation Healthcare, Inc. (OTC: FDNH) (“Foundation Healthcare”), and three additional properties which we believe no longer meet our core business strategy from a size, age, geography or line of business perspective.

**Recent Developments**

*Quarterly Distribution*

On March 23, 2018, we announced that our Board of Trustees authorized and declared a cash distribution of \$0.23 per common share for the quarterly period ended March 31, 2018. The distribution was paid on April 18, 2018 to common shareholders and OP Unit holders of record as of the close of business on April 3, 2018.

*Investment Activity*

Since March 31, 2018, the Trust, through subsidiaries of its Operating Partnership, completed the acquisition of one healthcare property with approximately 231,486 net leasable square feet for an aggregate purchase price of approximately \$71.3 million.

**Components of Our Revenues, Expenses, and Cash Flow**

***Revenues***

Revenues consist primarily of the rental revenues and property operating expense recoveries we collect from tenants pursuant to our leases. Additionally, we recognize certain cash and non-cash revenues. These cash and non-cash revenues are highlighted below.

*Rental revenues.* Rental revenues represent rent under existing leases that is paid by our tenants, straight-lining of contractual rents and below-market lease amortization reduced by lease inducements and above-market lease amortization.

*Expense recoveries.* Certain of our leases require our tenants to make estimated payments to us to cover their proportional share of operating expenses, including but not limited to real estate taxes, property insurance, routine maintenance and repairs, utilities, and property management expenses. We collect these estimated expenses and are reimbursed by our tenants for any actual expenses in excess of our estimates or reimburse tenants if our collected estimates exceed our actual operating expenses. The net reimbursed operating expenses are included in revenues as expense recoveries.

We have certain tenants with absolute net leases. Under these lease agreements, the tenant is responsible for operating and building expenses. For absolute net leases, we do not recognize operating expense or expense recoveries.

*Interest income on real estate loans and other.* Represents interest income on mezzanine loans, term loans, notes receivable, income generated on tenant improvements, changes in the fair value of derivative instruments, and other. Interest income on the loans are recognized as earned based on the terms of the loans subject to evaluation of collectability risks.

***Expenses***

Expenses consist primarily of interest expense, general and administrative costs associated with operating our properties, operating expenses of our properties, depreciation and amortization, and prior to adoption of ASU 2017-01, costs we incur to acquire properties.

*Interest expense.* We recognize the interest expense we incur on our borrowings as interest expense. Additionally, we incur amortization expense for charges such as legal fees, commitment fees, and arrangement fees that reflect costs incurred with arranging certain debt financings. We generally recognize these costs over the term of the respective debt instrument for which the costs were incurred as a component of interest expense.

*General and administrative.* General and administrative expenses include certain expenses such as compensation, accounting, legal, and other professional fees as well as certain other administrative and travel costs, and expenses related to

## Table of Contents

bank charges, franchise taxes, corporate filing fees, exchange listing fees, officer and trustee insurance costs, and other costs associated with being a public company.

*Operating Expenses.* Operating expenses include property operating expenses such as real estate taxes, property insurance, routine maintenance and repairs, utilities, and third party property management expenses, some of which are reimbursed to us by tenants under the terms of triple net and modified gross base stop leases.

*Depreciation and amortization.* We incur depreciation and amortization expense on all of our long-lived assets. This non-cash expense is designed under generally accepted accounting principles, or GAAP, to reflect the economic useful lives of our assets.

*Acquisition expenses.* Acquisition costs are costs we incur in pursuing and closing property acquisitions accounted for as business combinations. These costs include legal, accounting, valuation, other professional or consulting fees, and the compensation of certain employees who dedicate substantially all of their time to acquisition related job functions. We account for acquisition-related costs as expenses in the period in which the costs are incurred and the services are received.

*Equity in income of unconsolidated entities.* We recognize our share of earnings and losses from unconsolidated joint venture investments in Louisiana.

## **Cash Flow**

*Cash flows from operating activities.* Cash flows from operating activities are derived largely from net income by adjusting our revenues for those amounts not collected in cash during the period in which the revenue is recognized and for cash collected that was billed in prior periods or will be billed in future periods. Net income is further adjusted by adding back expenses charged in the period that are not paid for in cash during the same period. We expect to make our distributions based largely from cash provided by operations.

*Cash flows from investing activities.* Cash flows from investing activities consist of cash that is used during a period for making new investments and capital expenditures, offset by cash provided from sales of real estate investments.

*Cash flows from financing activities.* Cash flows from financing activities consist of cash we receive from debt and equity financings. This cash provides the primary basis for investments in new properties and capital expenditures. While we may invest a portion of our cash from operations into new investments, as a result of the distribution requirements to maintain our REIT status, it is likely that additional debt or equity financings will finance the majority of our investment activity. Cash used in financing activities consists of repayment of debt and distributions paid to shareholders and OP Unit holders.

Table of Contents

**Results of Operations**

*Three Months Ended March 31, 2018 compared to the three months ended March 31, 2017.*

The following table summarizes our results of operations for the three months ended March 31, 2018 and 2017 (in thousands):

|                                                | 2018     | 2017     | Change   | %      |
|------------------------------------------------|----------|----------|----------|--------|
| <b>Revenues:</b>                               |          |          |          |        |
| Rental revenues                                | \$78,887 | \$59,092 | \$19,795 | 33.5 % |
| Expense recoveries                             | 24,308   | 16,354   | 7,954    | 48.6 % |
| Interest income on real estate loans and other | 2,028    | 1,220    | 808      | 66.2 % |
| Total revenues                                 | 105,223  | 76,666   | 28,557   | 37.2 % |
| <b>Expenses:</b>                               |          |          |          |        |