MEDICAL PROPERTIES TRUST INC
Form 10-Q
November 09, 2007

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**
**WASHINGTON, D.C. 20549**

**FORM 10-Q**

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended September 30, 2007**

**OR**

o **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 001-32559**

**MEDICAL PROPERTIES TRUST, INC.**

**(Exact Name of Registrant as Specified in Its Charter)**

| | |
|---|---|
| **MARYLAND** | **20-0191742** |
| **(State or other jurisdiction of incorporation or organization)** | **(I. R. S. Employer Identification No.)** |
| **1000 URBAN CENTER DRIVE, SUITE 501 BIRMINGHAM, AL** | **35242** |
| **(Address of principal executive offices)** | **(Zip Code)** |

**REGISTRANT S TELEPHONE NUMBER, INCLUDING AREA CODE: (205) 969-3755**

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

Yes þ No o

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

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

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

Yes o No þ

As of November 7, 2007, the registrant had 50,308,812 shares of common stock, par value $.001, outstanding.

**MEDICAL PROPERTIES TRUST, INC.**
**QUARTERLY REPORT ON FORM 10-Q**
**FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2007**
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## PART I FINANCIAL INFORMATION

### Item 1. Financial Statements

### MEDICAL PROPERTIES TRUST, INC. AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

| | September 30, 2007 (Unaudited) | December 31, 2006 |
|---|---|---|
| **Assets** | | |
| Real estate assets | | |
| Land, buildings and improvements, and intangible lease assets | $ 582,365,980 | $ 437,367,722 |
| Construction in progress | 331,949 | 57,432,264 |
| Mortgage loans | 210,000,000 | 105,000,000 |
| Real estate held for sale | | 63,324,381 |
| Gross investment in real estate assets | 792,697,929 | 663,124,367 |
| Accumulated depreciation and amortization | (18,696,023) | (12,056,422) |
| Net investment in real estate assets | 774,001,906 | 651,067,945 |
| Cash and cash equivalents | 7,720,381 | 4,102,873 |
| Interest and rent receivable | 9,573,818 | 11,893,513 |
| Straight-line rent receivable | 21,243,485 | 12,686,976 |
| Other loans | 76,020,911 | 45,172,830 |
| Other assets of discontinued operations | 4,519,835 | 6,890,919 |
| Other assets | 19,438,081 | 12,941,689 |
| **Total Assets** | **$ 912,518,417** | **$ 744,756,745** |
| **Liabilities and Stockholders Equity** | | |
| Liabilities | | |
| Debt | $ 380,387,437 | $ 304,961,898 |
| Debt real estate held for sale | | 43,165,650 |
| Accounts payable and accrued expenses | 22,052,866 | 30,386,858 |
| Deferred revenue | 20,038,859 | 14,615,609 |
| Lease deposits and other obligations to tenants | 15,065,406 | 6,853,759 |
| Total liabilities | 437,544,568 | 399,983,774 |
| Minority interests | 76,394 | 1,051,835 |
| Stockholders equity | | |
| Preferred stock, $0.001 par value. Authorized 10,000,000 shares; no shares outstanding | | |
| Common stock, $0.001 par value. Authorized 100,000,000 shares; issued and outstanding - 49,046,116 shares at September 30, 2007, and 39,585,510 shares at December 31, 2006 | 49,046 | 39,586 |
| Additional paid in capital | 495,394,811 | 356,678,018 |
| Distributions in excess of net income | (20,546,402) | (12,996,468) |
| Total stockholders equity | 474,897,455 | 343,721,136 |

| | | | | |
|---|---|---|---|---|
| **Total Liabilities and Stockholders Equity** | **$** | **912,518,417** | **$** | **744,756,745** |

See accompanying notes to condensed consolidated financial statements.

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**MEDICAL PROPERTIES TRUST, INC. AND SUBSIDIARIES**
Condensed Consolidated Statements of Income
(Unaudited)

| | For the Three Months Ended September 30, 2007 | For the Three Months Ended September 30, 2006 | For the Nine Months Ended September 30, 2007 | For the Nine Months Ended September 30, 2006 |
|---|---|---|---|---|
| **Revenues** | | | | |
| Rent billed | $ 14,342,685 | $ 7,614,441 | $ 37,646,181 | $ 22,536,668 |
| Straight-line rent | 4,517,344 | 1,690,251 | 8,506,996 | 3,686,862 |
| Interest and fee income | 6,818,579 | 3,610,983 | 22,175,070 | 8,359,631 |
| Total revenues | 25,678,608 | 12,915,675 | 68,328,247 | 34,583,161 |
| **Expenses** | | | | |
| Real estate depreciation and amortization | 3,288,419 | 1,640,256 | 8,619,358 | 4,509,609 |
| General and administrative | 3,463,786 | 2,500,740 | 11,122,938 | 7,855,357 |
| Total operating expenses | 6,752,205 | 4,140,996 | 19,742,296 | 12,364,966 |
| Operating income | 18,926,403 | 8,774,679 | 48,585,951 | 22,218,195 |
| **Other income (expense)** | | | | |
| Interest income | 135,145 | 198,442 | 412,865 | 436,989 |
| Interest expense | (6,999,768) | (1,155,623) | (17,394,641) | (820,105) |
| Net other (expense) income | (6,864,623) | (957,181) | (16,981,776) | (383,116) |
| **Income from continuing operations** | 12,061,780 | 7,817,498 | 31,604,175 | 21,835,079 |
| Income (loss) from discontinued operations | (415,134) | 856,049 | 1,758,004 | 2,731,150 |
| **Net income** | **$ 11,646,646** | **$ 8,673,547** | **$ 33,362,179** | **$ 24,566,229** |
| **Net income per common share basic** | | | | |
| Income from continuing operations | $ 0.25 | $ 0.20 | $ 0.67 | $ 0.55 |
| Income (loss) from discontinued operations | (0.01) | 0.02 | 0.04 | 0.07 |
| Net income | $ 0.24 | $ 0.22 | $ 0.71 | $ 0.62 |
| Weighted average shares outstanding basic | 49,071,806 | 39,529,687 | 47,000,508 | 39,453,413 |
| **Net income per share diluted** | | | | |
| Income from continuing operations | $ 0.25 | $ 0.20 | $ 0.67 | $ 0.55 |
| Income (loss) from discontinued operations | (0.01) | 0.02 | 0.04 | 0.07 |

| | | | | |
|---|---|---|---|---|
| Net income | $ 0.24 | $ 0.22 | $ 0.71 | $ 0.62 |
| Weighted average shares outstanding diluted | 49,371,555 | 39,857,355 | 47,211,611 | 39,759,907 |

See accompanying notes to condensed consolidated financial statements.

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**MEDICAL PROPERTIES TRUST, INC. AND SUBSIDIARIES**
Condensed Consolidated Statements of Cash Flows
(Unaudited)

| | For the Nine Months Ended September 30, 2007 | 2006 |
|---|---|---|
| **Operating activities** | | |
| Net income | $ 33,362,179 | $ 24,566,229 |
| Adjustments to reconcile net income to net cash provided by operating activities | | |
| Depreciation and amortization | 9,046,088 | 6,411,232 |
| Straight-line rent revenue | (10,209,097) | (4,520,232) |
| Share-based compensation | 2,674,634 | 2,362,848 |
| Gain on sale of real estate | (4,061,626) | |
| Increase (decrease) in accounts payable and accrued liabilities | (11,083,223) | 4,730,425 |
| Other adjustments | 4,457,918 | (4,412,198) |
| Net cash provided by operating activities | 24,186,873 | 29,138,304 |
| **Investing activities** | | |
| Real estate acquired | (128,083,281) | (44,586,357) |
| Principal received on loans receivable | 49,501,859 | |
| Proceeds from sale of real estate | 67,817,594 | 7,642,332 |
| Investment in loans receivable | (126,708,089) | (66,175,482) |
| Construction in progress and other | (11,912,921) | (87,463,115) |
| Net cash used for investing activities | (149,384,838) | (190,582,622) |
| **Financing activities** | | |
| Additions to debt | 247,053,701 | 181,719,896 |
| Payments of debt | (215,362,008) | (52,428,726) |
| Distributions paid | (39,399,308) | (25,654,886) |
| Sale of common stock | 135,809,396 | |
| Other financing activities | 713,694 | (120,772) |
| Net cash provided by financing activities | 128,815,475 | 103,515,512 |
| Increase (decrease) in cash and cash equivalents for period | 3,617,508 | (57,928,806) |
| Cash and cash equivalents at beginning of period | 4,102,873 | 59,115,832 |
| **Cash and cash equivalents at end of period** | **$ 7,720,381** | **$ 1,187,026** |
| Interest paid, including capitalized interest of $1,335,413 in 2007 and $4,728,153 in 2006 | $ 9,494,105 | $ 5,494,249 |
| Supplemental schedule of non-cash operating activities: | | |
| Tenant deposits recorded as other assets | $ 7,500,000 | $ |
| Supplemental schedule of non-cash investing activities: | | |
| Construction in progress transferred to land and building | $ 67,642,043 | $ 32,374,814 |
| Interest and other receivables recorded as deferred revenue | 3,786,436 | 6,979,015 |

| | | |
|---|---|---|
| Interest and other receivables transferred to loans receivable | 4,621,677 | 3,768,864 |
| Other non-cash investing activities | 1,715,280 | 935,346 |
| Supplemental schedule of non-cash financing activities: | | |
| Distributions declared, unpaid | $ 13,602,033 | $ 10,448,750 |
| Other non-cash financing activities | 42,447 | 2,886,162 |

See accompanying notes to condensed consolidated financial statements.

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**MEDICAL PROPERTIES TRUST, INC. AND SUBSIDIARIES**
Notes to Condensed Consolidated Financial Statements
(Unaudited)

**1. Organization**

Medical Properties Trust, Inc., a Maryland corporation (the Company), was formed on August 27, 2003 under the General Corporation Law of Maryland for the purpose of engaging in the business of investing in and owning commercial real estate. The Company s operating partnership subsidiary, MPT Operating Partnership, L.P. (the Operating Partnership) through which it conducts all of its operations, was formed in September 2003. Through another wholly owned subsidiary, Medical Properties Trust, LLC, the Company is the sole general partner of the Operating Partnership. The Company presently owns directly all of the limited partnership interests in the Operating Partnership.

The Company s primary business strategy is to acquire and develop real estate and improvements, primarily for long term lease to providers of healthcare services such as operators of general acute care hospitals, inpatient physical rehabilitation hospitals, long-term acute care hospitals, surgery centers, centers for treatment of specific conditions such as cardiac, pulmonary, cancer, and neurological hospitals, and other healthcare-oriented facilities. The Company manages its business as a single business segment as defined in Statement of Financial Accounting Standards (SFAS) No. 131, *Disclosures about Segments of an Enterprise and Related Information*.

From the time of the Company s initial capitalization in April 2004 through completion of the follow-on offering in the first quarter of 2007, the Company has sold approximately 48.0 million shares of common stock and realized net proceeds of approximately $494.5 million. The Company has also issued $125.0 million in fixed rate term notes and $138.0 million in fixed rate exchangeable notes. At November 1, 2007, the Company has in place $192.0 million of secured revolving credit facilities with a total available borrowing base of approximately $116.8 million.

**2. Summary of Significant Accounting Policies**

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

*Principles of Consolidation*: Property holding entities and other subsidiaries of which the Company owns 100% of the equity or has a controlling financial interest evidenced by ownership of a majority voting interest are consolidated. All inter-company balances and transactions are eliminated. For entities in which the Company owns less than 100% of the equity interest, the Company consolidates the property if it has the direct or indirect ability to make decisions about the entities activities based upon the terms of the respective entities ownership agreements. For entities in which the Company owns less than 100% and does not have the direct or indirect ability to make decisions but does exert significant influence over the entities activities, the Company records its ownership in the entity using the equity method of accounting.

The Company periodically evaluates all of its transactions and investments to determine if they represent variable interests in a variable interest entity as defined by Financial Accounting Standards Board (FASB) Interpretation No. 46 (revised December 2003) (FIN 46-R), *Consolidation of Variable Interest Entities*, an interpretation of Accounting Research Bulletin No. 51, *Consolidated Financial Statements*. If the Company determines that it has a variable interest in a variable interest entity, the Company determines if it is the primary beneficiary of the variable interest entity. The Company consolidates each variable interest entity in which the Company, by virtue of its transactions with or investments in the entity, is considered to be the primary beneficiary. The Company re-evaluates its status as primary beneficiary when a variable interest entity or potential variable interest entity has a material change in its variable interests.

*Unaudited Interim Condensed Consolidated Financial Statements*: The accompanying unaudited interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information, including rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three month and nine month periods ended September 30, 2007, are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s 2006 Annual Report on Form 10-K filed with the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended.

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*New Accounting Pronouncements*: In June 2006, the FASB issued Interpretation No. 48 *Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109* (FIN No. 48). FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in financial statements in accordance with SFAS No. 109 *Accounting for Income Taxes* and prescribes a recognition threshold and measurement attribute of tax positions taken or expected to be taken on a tax return. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. The Company adopted FIN No. 48 on January 1, 2007. No amounts were recorded for unrecognized tax benefits or related interest expense and penalties as a result of the implementation of FIN No. 48. The taxable periods ending December 31, 2004 through December 31, 2006 remain open to examination by the Internal Revenue Service and the tax authorities of significant jurisdictions in which the Company does business.

On July 25, 2007, the FASB issued Proposed FASB Staff Position FSP APB 14-a (the proposed FSP ) that, if issued, would affect the accounting for the Company s exchangeable notes. The proposed FSP would require that the initial debt proceeds from the sale of the Company s exchangeable notes be allocated between a liability component and an equity component. The resulting debt discount would be amortized over the period the debt is expected to be outstanding as additional interest expense. The equity component would be recorded as additional paid-in capital. The proposed FSP would be effective for fiscal years beginning after December 15, 2007, and require retroactive application. Because the proposed FSP is currently in the comment period and therefore subject to change, the Company has not determined the effect of the proposed FSP on its financial statements.

*Reclassifications:* Certain reclassifications have been made to the consolidated financial statements to conform to the 2007 consolidated financial statement presentation. These reclassifications have no impact on stockholders equity or net income.

**3. Real Estate and Lending Activities**

In August 2007, the Company acquired two general acute care hospitals in Houston, Texas and Redding, California at a cost of $100.0 million and entered into operating leases with the operator. The leases have 15 year fixed terms with three five year renewal options and contain annual rent increases of two percent. The seller/lessees have options to repurchase the real estate under certain limited circumstances.

For the three months ended September 30, 2007 and 2006, revenue from Vibra Healthcare, LLC accounted for 37.2% and 53.8%, respectively, of total revenue. For the nine months ended September 30, 2007 and 2006, revenue from Vibra Healthcare, LLC accounted for 36.8% and 60.2% of total revenue. For the three months ended September 30, 2007 and 2006, revenue from affiliates of Prime Healthcare Services, Inc. accounted for 26.5% and 18.2%, respectively, of total revenue. For the nine months ended September 30, 2007 and 2006, revenue from affiliates of Prime Healthcare Services, Inc. accounted for 24.8% and 18.4%, respectively, of total revenue.

**4. Debt**

The Company s debt is summarized as follows:

| | Balance as of September 30, 2007 | Balance as of December 31, 2006 |
|---|---|---|
| Revolving credit facilities | $ 20,869,599 | $ 45,996,359 |
| Senior unsecured notes fixed rate through July and October, 2011, due July and October, 2016 | 125,000,000 | 125,000,000 |
| Bridge loan | 100,000,000 | |
| Exchangeable senior notes due November, 2011 | 134,517,838 | 133,965,539 |
| | $ 380,387,437 | $ 304,961,898 |

As of September 30, 2007, principal payments due for the senior unsecured notes, bridge loan and exchangeable notes were as follows:

| | |
|---|---|
| 2007 | $ 100,000,000 |
| 2008 | |
| 2009 | |
| 2010 | |
| 2011 | 134,517,838 |
| Thereafter | 125,000,000 |
| Total | $ 359,517,838 |

In July, 2007, the Company signed a credit agreement for a $42.0 million secured revolving credit facility. The agreement has a five year term and has an interest rate of 30-day LIBOR plus 150 basis points. The agreement also requires the payment of certain fees and that the Company comply with certain financial covenants customary for similar credit arrangements. The credit facility is secured by real estate with a book value of $61.1 million at September 30, 2007. The Company may borrow up to 65% of the real estate cost, subject to the appraised value. This agreement requires the payment of interest only during its term. The maximum committed amount is reduced $800,000 per year beginning in 2010.

In August 2007, the Company signed a bridge loan agreement for $100 million, the proceeds of which were used to fund the August 2007 acquisitions. The loan is due on November 30, 2007 and accrues interest at a rate equal to 30-day LIBOR plus 175 basis points. The Company expects to repay the bridge loan with proceeds from a new syndicated term loan and revolving credit facility, the amount and terms of which are being negotiated with a group of banks.

**5. Common Stock**

In the nine months ended September 30, 2007, the Company completed the sale of 12,217,900 shares of common stock at a price of $15.60 per share, less underwriting commissions. Of the 12 million shares sold, the underwriters borrowed from third parties and sold 3,000,000 shares of Company common stock in connection with forward sale agreements between the Company and affiliates of the underwriters (the forward purchasers ). The Company expects to settle the forward sale agreements and receive proceeds, subject to certain adjustments, from the sale of those shares only upon one or more future physical settlements of the forward sale agreements on a date or dates specified by the Company by February 28, 2008.

**6. Stock Awards**

The Company has adopted the Second Amended and Restated Medical Properties Trust, Inc. 2004 Equity Incentive Plan (the Equity Incentive Plan) which authorizes the issuance of options to purchase shares of common stock, restricted stock awards, restricted stock units, deferred stock units, stock appreciation rights, performance units and other stock-based awards, including profits interest in the operating partnership. The Equity Incentive Plan is administered by the Compensation Committee of the Board of Directors. At September 30, 2007, the Company had 4,961,672 shares of common stock available for awards under the Equity Incentive Plan, which includes the addition of 2,750,000 shares approved by the Company s shareholders in May, 2007.

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In the nine month period ended September 30, 2007, the Compensation Committee of the Board of Directors awarded 844,000 shares of restricted stock to management and other employees of the Company. The awards vest over periods of five to seven years based on service criteria, except for 455,000 shares which vest over seven years based on the Company s annual total return to shareholders. The Committee also awarded 215,000 partnership units ( LTIP units ) in the Company s operating partnership. The LTIP units represent profits interests in the operating partnership. Of the LTIP units awarded, 115,000 vest over a seven year period based on service criteria and 100,000 LTIP units vest based on the Company s total return to shareholders each year over a seven year period. When vested, the LTIP units may be converted into shares of Company stock or cash equal to the then current price of the Company s common stock. If the Company s stock price reaches certain price targets over the period of March 2007 through December 2010, up to an additional 360,000 LTIP units and 360,000 shares of restricted stock will be awarded, which would then vest over a three year service period of January 1, 2011 through December 31, 2013. If the Company s share price does not meet these price targets, but does achieve a total return to shareholders in excess of the 50$^{th}$ percentile of a defined index, then 120,000 shares of restricted stock and 120,000 LTIP units will instead be awarded by the Company, vesting over the same three year service period. In May, 2007, the Compensation Committee awarded 28,750 shares of restricted stock to Company directors. These restricted shares vest over three years. The Company recorded non-cash expense for share based compensation of approximately $1,088,000 and $2,675,000 in the three and nine month periods ended September 30, 2007, respectively, compared to approximately $791,000 and $2,363,000 in the same periods in 2006, respectively.

**7. Discontinued Operations**

In 2006, the Company terminated leases for a hospital and medical office building ( MOB ) complex and re-possessed the real estate. In January, 2007, the Company sold the hospital and MOB complex for a sales price of approximately $71.7 million and recorded a gain of approximately $4.1 million, which is reported in results from discontinued operations. During the period from the lease termination to the date of sale, the hospital was leased to and operated by a third party operator under contract to the hospital. The Company has substantially funded through loans the working capital requirements of the operator pending the operator s collection of patient receivables from Medicare and other third party payors. The accompanying financial statements include provisions to reduce such loans to their estimated net realizable value.

The following table presents the results of discontinued operations for the three and nine months ended September 30, 2007 and 2006:

| | **For the Three Months Ended September 30,** | | **For the Nine Months Ended September 30,** | |
|---|---|---|---|---|
| | **2007** | **2006** | **2007** | **2006** |
| Revenues | $ | $ 2,205,522 | $ 132,411 | $ 6,394,674 |
| Net (loss) profit | (415,134) | 856,049 | 1,758,004 | 2,731,150 |
| (Loss) earnings per share basic and diluted | $ (0.01) | $ 0.02 | $ 0.04 | $ 0.07 |

**8. Earnings Per Share**

The following is a reconciliation of the weighted average shares used in net income per common share to the weighted average shares used in net income per common share assuming dilution for the three and six months ended September 30, 2007 and 2006, respectively:

| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| Weighted average number of shares issued and outstanding | 49,027,576 | 39,481,070 | 46,956,969 | 39,417,433 |
| Vested deferred stock units | 44,230 | 48,617 | 43,539 | 35,980 |
| Weighted average shares basic | 49,071,806 | 39,529,687 | 47,000,508 | 39,453,413 |

| | | | | |
|---|---|---|---|---|
| Common stock options and unvested restricted stock | 299,749 | 327,668 | 211,103 | 306,494 |
| Weighted average shares diluted | 49,371,555 | 39,857,355 | 47,211,611 | 39,759,907 |

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

The following discussion and analysis of the consolidated financial condition and consolidated results of operations should be read together with the consolidated financial statements of Medical Properties Trust, Inc. and notes thereto contained in this Form 10-Q and the financial statements and notes thereto contained in our Annual Report on Form 10-K for the year ended December 31, 2006.

**Forward-Looking Statements.**

This report on Form 10-Q contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results or future performance, achievements or transactions or events to be materially different from those expressed or implied by such forward-looking statements, including, but not limited to, the risks described in our Annual Report on Form 10-K for the year ended December 31, 2006, filed with the Securities and Exchange Commission (SEC) under the Securities Exchange Act of 1934, as amended. Such factors include, among others, the following:

National and local economic, business, real estate and other market conditions;

The competitive environment in which the Company operates;

The execution of the Company s business plan;

Financing risks;

Acquisition and development risks;

Potential environmental and other liabilities;

Other factors affecting real estate industry generally or the healthcare real estate industry in particular;

Our ability to attain and maintain our status as a REIT for federal and state income tax purposes;

Our ability to attract and retain qualified personnel; and,

Federal and state healthcare regulatory requirements.

**Overview**

We were incorporated under Maryland law on August 27, 2003 primarily for the purpose of investing in and owning net-leased healthcare facilities across the United States. We have operated as a real estate investment trust ( REIT ) since April 6, 2004, and accordingly, elected REIT status upon the filing in September 2005 of our calendar year 2004 federal income tax return. We acquire and develop healthcare facilities and lease the facilities to healthcare operating companies under long-term net leases. We also make mortgage loans to healthcare operators secured by their real estate assets. We also selectively make loans to certain of our operators through our taxable REIT subsidiary, the proceeds of which are used for acquisitions and working capital.

At September 30, 2007, we owned 24 operating healthcare facilities and held five mortgage loans secured by interests in real property. The facilities we owned and the facilities on which we had made mortgage loans were in ten states, had a carrying cost of approximately $792.4 million and comprised approximately 86.8% of our total assets. Our acquisition and other loans of approximately $76.0 million represented approximately 8.3% of our total assets. We do not expect such loan assets at any time to exceed 20% of our total assets.

At November 1, 2007, we had 22 employees. Over the next 12 months, we expect to add four to six additional employees as we acquire new properties and manage our existing properties and loans.

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## Key Factors that May Affect Our Operations

Our revenues are derived from rents we earn pursuant to the lease agreements with our tenants and from interest income from loans to our tenants and other facility owners. Our tenants operate in the healthcare industry, generally providing medical, surgical and rehabilitative care to patients. The capacity of our tenants to pay our rents and interest is dependent upon their ability to conduct their operations at profitable levels. We believe that the business environment of the industry segments in which our tenants operate is generally positive for efficient operators. However, our tenants operations are subject to economic, regulatory and market conditions that may affect their profitability. Accordingly, we monitor certain key factors, changes to which we believe may provide early indications of conditions that may affect the level of risk in our lease and loan portfolio.

Key factors that we consider in underwriting prospective tenants and in monitoring the performance of existing tenants include the following:

- the historical and prospective operating margins (measured by a tenant s earnings before interest, taxes, depreciation, amortization and facility rent) of each tenant and at each facility;
- the ratio of our tenants operating earnings both to facility rent and to facility rent plus other fixed costs, including debt costs;
- trends in the source of our tenants revenue, including the relative mix of Medicare, Medicaid/MediCal, managed care, commercial insurance, and private pay patients; and
- the effect of evolving healthcare regulations on our tenants profitability.

Certain business factors, in addition to those described above that directly affect our tenants, will likely materially influence our future results of operations. These factors include:

- trends in the cost and availability of capital, including market interest rates, that our prospective tenants may use for their real estate assets instead of financing their real estate assets through lease structures;
- unforeseen changes in healthcare regulations that may limit the opportunities for physicians to participate in the ownership of healthcare providers and healthcare real estate;
- reductions in reimbursements from Medicare, state healthcare programs, and commercial insurance providers that may reduce our tenants profitability and our lease rates, and;
- competition from other financing sources.

## CRITICAL ACCOUNTING POLICIES

In order to prepare financial statements in conformity with accounting principles generally accepted in the United States, we must make estimates about certain types of transactions and account balances. We believe that our estimates of the amount and timing of lease revenues, credit losses, fair values and periodic depreciation of our real estate assets, stock compensation expense, and the effects of any derivative and hedging activities will have significant effects on our financial statements. Each of these items involves estimates that require us to make subjective judgments. We rely on our experience, collect historical data and current market data, and develop relevant assumptions to arrive at what we believe to be reasonable estimates. Under different conditions or assumptions, materially different amounts could be reported related to the accounting policies described below. In addition, application of these accounting policies involves the exercise of judgment on the use of assumptions as to future uncertainties and, as a result, actual results could materially differ from these estimates. Our accounting estimates include the following:

***Revenue Recognition***. Our revenues, which are comprised largely of rental income, include rents that each tenant pays in accordance with the terms of its respective lease reported on a straight-line basis over the initial term of the lease. Since some of our leases provide for rental increases at specified intervals, straight-line basis accounting requires us to record as an asset, and include in revenues, straight-line rent that we will only receive if the tenant makes all rent payments required through the expiration of the term of the lease.

Accordingly, our management determines, in its judgment, to what extent the straight-line rent receivable applicable to each specific tenant is collectible. We review each tenant s straight-line rent receivable on a quarterly basis and take into consideration the tenant s payment history, the financial condition of the tenant, business conditions in the industry in which the tenant operates, and economic conditions in the area in which the facility is located. In the event that the collectibility of straight-line rent with respect to any given tenant is in doubt, we are required to record an increase in our allowance for uncollectible accounts or record a direct write-off of the specific rent receivable, which would have an adverse effect on our net income for the year in which the reserve is increased or the direct write-off is recorded and would decrease our total assets and stockholders equity. At that time, we stop accruing additional straight-line rent income.

Our development projects normally allow for us to earn what we term construction period rent . Construction period rent accrues to us during the construction period based on the funds which we invest in the facility. During the construction period, the unfinished facility does not generate any earnings for the lessee/operator which can be used to pay us for our funds used to build the facility. In such cases, the lessee/operator pays the accumulated construction period rent over the term of the lease beginning when the lessee/operator takes physical possession of the facility. We record the accrued construction period rent as deferred revenue during the construction period, and recognize earned revenue as the construction period rent is paid to us by the lessee/operator. We make loans to our tenants and from time to time may make construction or mortgage loans to facility owners or other parties. We recognize interest income on loans as earned based upon the principal amount outstanding. These loans are generally secured by interests in real estate, receivables, the equity interests of a tenant, or corporate and individual guarantees and are usually cross-defaulted with their leases and/or other loans. As with straight-line rent receivables, our management must also periodically evaluate loans to determine what amounts may not be collectible. Accordingly, a provision for losses on loans receivable is recorded when it becomes probable that the loan will not be collected in full. The provision is an amount which reduces the loan to its estimated net receivable value based on a determination of the eventual amounts to be collected either from the debtor or from the collateral, if any. At that time, we discontinue recording interest income on the loan to the tenant.

***Investments in Real Estate***. We record investments in real estate at cost, and we capitalize improvements and replacements when they extend the useful life or improve the efficiency of the asset. While our tenants are generally responsible for all operating costs at a facility, to the extent that we incur costs of repairs and maintenance, we expense those costs as incurred. We compute depreciation using the straight-line method over the estimated useful life of 40 years for buildings and improvements, three to seven years for equipment and fixtures, and the shorter of the useful life or the remaining lease term for tenant improvements and leasehold interests.

We are required to make subjective assessments as to the useful lives of our facilities for purposes of determining the amount of depreciation expense to record on an annual basis with respect to our investments in real estate improvements. These assessments have a direct impact on our net income because, if we were to shorten the expected useful lives of our investments in real estate improvements, we would depreciate these investments over fewer years, resulting in more depreciation expense and lower net income on an annual basis.

We have adopted Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, which establishes a single accounting model for the impairment or disposal of long-lived assets, including discontinued operations. SFAS No. 144 requires that the operations related to facilities that have been sold, or that we intend to sell, be presented as discontinued operations in the statement of operations for all periods presented, and facilities we intend to sell be designated as held for sale on our balance sheet.

When circumstances such as adverse market conditions indicate a possible impairment of the value of a facility, we review the recoverability of the facility s carrying value. The review of recoverability is based on our estimate of the future undiscounted cash flows, excluding interest charges, from the facility s use and eventual disposition. Our forecast of these cash flows considers factors such as expected future operating income, market and other applicable trends, and residual value, as well as the effects of leasing demand, competition and other factors. If impairment exists due to the inability to recover the carrying value of a facility, an impairment loss is recorded to the extent that the carrying value exceeds the estimated fair value of the facility. We are required to make subjective assessments as to whether there are impairments in the values of our investments in real estate.

***Purchase Price Allocation***. We record above-market and below-market in-place lease values, if any, for the facilities we own which are based on the present value (using an interest rate which reflects the risks associated with the leases acquired) of the difference between (i) the contractual amounts to be paid pursuant to the in-place leases and (ii) management s estimate of fair market lease rates for the corresponding in-place leases, measured over a period equal to the remaining non-cancelable term of the lease. We amortize any resulting capitalized above-market lease values as a reduction of rental income over the remaining non-cancelable terms of the respective leases. We amortize any resulting capitalized below-market lease values as an increase to rental income over the initial term and any fixed-rate renewal periods in the respective leases. Because our strategy to a large degree involves the origination of long term lease arrangements at market rates at the same time we acquire the property, we do not expect the above-market and below-market in-place lease values to be significant for many of our anticipated transactions.

We measure the aggregate value of other intangible assets to be acquired based on the difference between (i) the property valued with existing leases adjusted to market rental rates and (ii) the property valued as if vacant. Management s estimates of value are made using methods similar to those used by independent appraisers (*e.g.*, discounted cash flow analysis). Factors considered by management in its analysis include an estimate of carrying costs during hypothetical expected lease-up periods considering current market conditions, and costs to execute similar leases. We also consider information obtained about each targeted facility as a result of our pre-acquisition due diligence, marketing, and leasing activities in estimating the fair value of the tangible and intangible assets acquired. In estimating carrying costs, management also includes real estate taxes, insurance and other operating expenses and estimates of lost rentals at market rates during the expected lease-up periods, which we expect to range primarily from three to eighteen months, depending on specific local market conditions. Management also estimates costs to execute similar leases including leasing commissions, legal costs, and other related expenses to the extent that such costs are not already incurred in connection with a new lease origination as part of the transaction.

The total amount of other intangible assets to be acquired, if any, is further allocated to in-place lease values and customer relationship intangible values based on management s evaluation of the specific characteristics of each prospective tenant s lease and our overall relationship with that tenant. Characteristics to be considered by management in allocating these values include the nature and extent of our existing business relationships with the tenant, growth prospects for developing new business with the tenant, the tenant s credit quality, and expectations of lease renewals, including those existing under the terms of the lease agreement, among other factors.

We amortize the value of in-place leases to expense over the initial term of the respective leases, which range primarily from 10 to 15 years. The value of customer relationship intangibles is amortized to expense over the initial term and any renewal periods in the respective leases, but in no event will the amortization period for intangible assets exceed the remaining depreciable life of the building. Should a tenant terminate its lease, the unamortized portion of the in-place lease value and customer relationship intangibles would be charged to expense.

***Loans and Losses from Rent Receivables and Loans***. We record provisions for losses on rent receivables and loans when it becomes probable that the receivable or loan will not be collected in full. The provision is an amount which reduces the rent or loan to its estimated net realizable value based on a determination of the eventual amounts to be collected either from the debtor or from the collateral, if any. The determination of when to record a provision for loss on loans and rent requires us to estimate amounts to be recovered from collateral, the ability of the tenant and/or borrower to repay, the ability of the tenant and/or borrower to improve its operations.

***Accounting for Derivative Financial Investments and Hedging Activities***. We account for our derivative and hedging activities, if any, using SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended by SFAS No. 137 and SFAS No. 149, which requires all derivative instruments to be carried at fair value on the balance sheet.

Derivative instruments designated in a hedge relationship to mitigate exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. We expect to formally document all relationships between hedging instruments and hedged items, as well as our risk-management objective and strategy for undertaking each hedge transaction. We plan to review periodically the effectiveness of each hedging transaction, which involves estimating future cash flows. Cash flow hedges, if any, will be accounted for by recording the fair value of the derivative instrument on the balance sheet as either an asset or liability, with a corresponding amount recorded in other comprehensive income within stockholders equity. Amounts will be reclassified from other comprehensive income to the income statement in the period or periods the hedged forecasted transaction affects earnings. Derivative instruments designated in a hedge relationship to mitigate exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, which we expect to affect the Company primarily in the form of interest rate risk or variability of interest rates, are considered fair value hedges under SFAS No. 133. We are not currently a party to any derivatives contracts designated as cash flow hedges.

In 2006, we entered into derivative contracts as part of our offering of Exchangeable Senior Notes (the exchangeable notes ). The contracts are generally termed capped call or call spread contracts. These contracts are financial instruments which are separate from the exchangeable notes themselves, but affect the overall potential number of shares which will be issued by us to satisfy the conversion feature in the exchangeable notes. The exchangeable notes can be exchanged into shares of our common stock when our stock price exceeds $16.53 per share, which is the equivalent of 60.4583 shares per $1,000 note. The number of shares actually issued upon conversion will be equivalent to the amount by which our stock price exceeds $16.53 times the 60.4583 conversion rate. The capped call transaction allows us to effectively increase that exchange price from $16.53 to $18.94. Therefore, our shareholders will not experience dilution of their shares from any settlement or conversion of the exchangeable notes until the price of our stock exceeds $18.94 per share rather than $16.53 per share. When evaluating this transaction, we have followed the guidance in Emerging Issues Task Force (EITF) No. 00-19 *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock.* EITF No. 00-19 requires that contracts such as this capped call which meet certain conditions must be accounted for as permanent adjustments to equity rather than periodically adjusted to their fair value as assets or liabilities. We have evaluated the terms of these contracts and recorded this capped call as a permanent adjustment to stockholders equity in 2006.

The exchangeable notes themselves also contain the conversion feature described above. SFAS No. 133 also states that certain embedded derivative contracts must follow the guidance of EITF No. 00-19 and be evaluated as though they also were a freestanding derivative contract. Embedded derivative contracts such as the conversion feature in the notes should not be treated as a financial instrument separate from the note if it meets certain conditions in EITF No. 00-19. We have evaluated the conversion feature in the exchangeable notes and have determined that it should not be reported separately from the debt.

***Variable Interest Entities***. In January 2003, the FASB issued Interpretation No. 46 (FIN 46), *Consolidation of Variable Interest Entities*. In December 2003, the FASB issued a revision to FIN 46, which is termed FIN 46(R). FIN 46(R) clarifies the application of Accounting Research Bulletin No. 51, *Consolidated Financial Statements*, and provides guidance on the identification of entities for which control is achieved through means other than voting rights, guidance on how to determine which business enterprise should consolidate such an entity, and guidance on when it should do so. This model for consolidation applies to an entity in which either (1) the equity investors (if any) do not have a controlling financial interest or (2) the equity investment at risk is insufficient to finance that entity s activities without receiving additional subordinated financial support from other parties. An entity meeting either of these two criteria is a variable interest entity, or VIE. A VIE must be consolidated by any entity which is the primary beneficiary of the VIE. If an entity is not the primary beneficiary of the VIE, the VIE is not consolidated. We periodically evaluate the terms of our relationships with our tenants and borrowers to determine whether we are the primary beneficiary and would therefore be required to consolidate any tenants or borrowers that are VIEs. Our evaluations of our transactions indicate that we have loans receivable from two entities which we classify as VIEs. However, because we are not the primary beneficiary of these VIEs, we do not consolidate these entities in our financial statements.

***Stock-Based Compensation***. Prior to 2006, we used the intrinsic value method to account for the issuance of stock options under our equity incentive plan in accordance with APB Opinion No. 25, *Accounting for Stock Issued to Employees*. SFAS No. 123(R) became effective for our annual and interim periods beginning January 1, 2006, but had no material effect on the results of our operations. During the three and nine month periods ended September 30, 2007, we recorded $1,088,000 and $2,675,000 of expense for share based compensation. In 2006 and 2007, we also granted performance based restricted share awards. Since these awards will vest based on the Company s performance and stock price, we must evaluate and estimate the probability of achieving those performance and price targets.

**LIQUIDITY AND CAPITAL RESOURCES**

From the time of our initial capitalization in April 2004 through completion of our 2007 follow-on offering, we have sold approximately 48.0 million shares of common stock and realized net proceeds of approximately $494.5 million. We have also issued $125.0 million in fixed rate term notes and $138.0 million in fixed rate exchangeable notes. At November 1, 2007, we have in place $192.0 million of secured revolving credit facilities with an available borrowing base of approximately $116.8 million. In August, 2007, we borrowed from two banks (the Lead Banks) an additional

$100.0 million under a bridge loan facility and used the proceeds to acquire the real estate of two hospitals. The bridge loan is secured by substantially all of our assets not secured pursuant to our revolving credit facilities and matures on November 30, 2007.

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*Short-term Liquidity Requirements:* Our immediate capital requirements are to repay the $100.0 million bridge loan and continue to execute our acquisition plans. We and the Lead Banks have signed a term sheet for a secured revolving credit and term loan agreement to replace our existing $150.0 million revolving credit facility. Based on the status of the syndication including the amount and conditions of commitments received from prospective syndication participants, we believe the new facility will provide sufficient proceeds to repay the bridge loan and allow us to continue to make acquisitions. However, since we began the process of negotiating the syndicated facility, conditions in the debt and capital markets have deteriorated dramatically. Accordingly, there is no assurance that we will successfully complete the syndication. In the event that market conditions preclude a successful syndication, we expect the Lead Banks will extend the maturity of the bridge loan for a period sufficient to allow us to add collateral to our existing revolver borrowing base and repay the bridge loan with borrowings from the existing revolver. That facility has an initial maturity of October, 2009 and the maximum amount of borrowings may be increased by $75.0 million upon the payment of additional fees.

*Long-term Liquidity Requirements:* We believe that, regardless of the outcome of the new syndicated facility, cash flow from operating activities subsequent to 2007 will be sufficient to provide adequate working capital and make required distributions to our stockholders in compliance with our requirements as a REIT. As previously noted, our strategy for growing our earnings per share is dependent on continued acquisitions of healthcare real estate assets. If conditions in the credit markets do not improve or continue to deteriorate, we believe that our access to debt capital will be impaired. Moreover, disruptions in the credit markets may lead to equity market conditions that would preclude us from using equity capital for acquisitions. Although we are unable to predict the availability and cost of capital for acquisitions in either the short or long terms, we may be unable to maintain our historical rate of asset growth in the foreseeable future.

In the first quarter of 2007, we sold 9.2 million shares of common stock and realized net proceeds of $136.1 million. Concurrently, the underwriters borrowed from third parties and sold 3 million shares of our common stock in connection with forward sale agreements between us and affiliates of the underwriters. We did not receive any proceeds from the sale of shares of our common stock by the forward purchasers. We expect to settle the forward sale agreements and receive proceeds, subject to certain adjustments, from the sale of those shares upon one or more future physical settlements of the forward sale agreements on a date or dates specified by us by February 28, 2008. We would receive approximately $42.0 million in proceeds if we settled the contract prior to the next adjustment date.

**Results of Operations**

***Three Months Ended September 30, 2007 Compared to Three Months Ended September 30, 2006***

Net income for the three months ended September 30, 2007, was $11,646,646 compared to net income of $8,673,547 for the three months ended September 30, 2006, a 34.3% increase.

A comparison of revenues for the three month periods ended September 30, 2007 and 2006, is as follows, as adjusted in 2006 for discontinued operations:

| | 2007 | % of Total | 2006 | % of Total | Year over Year Change |
|---|---|---|---|---|---|
| Base rents | $ 14,184,929 | 55.3% | $ 7,113,736 | 55.1% | 99.4% |
| Straight-line rents | 4,517,344 | 17.6% | 1,690,252 | 13.1% | 167.3% |
| Percentage rents | 157,756 | 0.6% | 597,395 | 4.6% | (73.6%) |
| Fee income | 34,106 | 0.1% | 39,470 | 0.3% | (13.6%) |
| Interest from loans | 6,784,473 | 26.4% | 3,474,822 | 26.9% | 95.2% |
| Total revenue | $ 25,678,608 | 100.0% | $ 12,915,675 | 100.0% | 98.8% |

Revenue of $25,678,608 in the three months ended September 30, 2007, was comprised of rents (73.5%) and interest from loans and fee income (26.5%). In the third quarter of 2007, we owned 24 rent producing properties compared to 14 in the third quarter of 2006, which accounted for the increase in base rents. During the third quarter of 2007, we received percentage rents of approximately $128,000 from Vibra, a $469,000 decrease from the third quarter of 2006, which is related to revisions and extensions of certain leases and loans with Vibra. Interest income from loans in the quarter ended September 30, 2007 compared to the same period in 2006 increased due to origination of four additional mortgage loans totaling $185,000,000 in the third quarter of 2006 and the first quarter of 2007 offset by the repayment of a $40.0 million mortgage loan in the second quarter of 2007. Vibra accounted for 37.2% and 53.8% of our gross revenues during the three months ended September 30, 2007 and 2006, respectively, and affiliates of Prime accounted for 26.5% and 18.2% of total revenue, respectively.

In August, 2007, we completed the amendment of six leases with Vibra. The amendments were retroactive to January 1, 2007, the date on which the general terms of the amendments were effective. In general, the amendments reduced Vibra s current percentage rent obligations, extended the terms of the leases and increased the amount of annual base rental payments. As a result of the lease amendments, we recorded additional base and straight-line rent revenue of approximately $1.4 million in the three months ended September 30, 2007.

We expect our revenue to continue to increase in future quarters as a result of expected acquisitions and potential new development projects. The pace of our acquisitions may be affected by the capital market conditions discussed in Liquidity and Capital Resources. We also expect that the relative portion of our revenue that is paid by Vibra will continue to decline as a result of continued tenant diversification. In the near term, we expect the relative portion of our revenue that is paid by Prime will increase, but will then decrease over the longer term as we focus our acquisition efforts on other operators.

Depreciation and amortization during the third quarter of 2007, was $3,288,419, compared to $1,640,256 during the third quarter of 2006, a 100.5% increase. All of this increase is related to an increase in the number of rent producing properties from the third quarter of 2006 to the third quarter 2007. We expect our depreciation and amortization expense to continue to increase commensurate with our acquisition and development activity.

General and administrative expenses in the third quarter of 2007 increased compared to the same period in 2006, increasing approximately $963,000, or 38.5%, from $2,500,740 to $3,463,786. General and administrative expenses include compensation expense related to our Equity Incentive Plan of $1,088,000 and $791,000, in the three months ended September 30, 2007 and 2006, respectively.

Interest expense for the quarter ended September 30, 2007 totaled $6,999,768. We recorded no capitalized interest in the quarter ended September 30, 2007, compared to $1,155,623 in the same quarter in the prior year. Interest expense increased due to larger debt balances in 2007 compared to 2006. Capitalized interest decreased due to our final development under construction being placed into service in April, 2007, compared to three developments under construction totaling $99.2 million at September 30, 2006.

***Nine Months Ended September 30, 2007 Compared to Nine Months Ended September 30, 2006***

Net income for the nine months ended September 30, 2007, was $33,362,179 compared to net income of $24,566,229 for the nine months ended September 30, 2006, a 35.8% increase.

A comparison of revenues for the nine month periods ended September 30, 2007 and 2006, is as follows, as adjusted in 2006 for discontinued operations:

| | 2007 | % of Total | 2006 | % of Total | Year over Year Change |
|---|---|---|---|---|---|
| Base rents | $ 37,219,679 | 54.4% | $ 20,642,677 | 59.7% | 80.3% |
| Straight-line rents | 8,506,996 | 12.5% | 3,686,862 | 10.7% | 130.7% |
| Percentage rents | 426,502 | 0.6% | 1,893,991 | 5.4% | (77.5%) |
| Fee income | 2,715,968 | 4.0% | 344,710 | 1.0% | 687.9% |
| Interest from loans | 19,459,102 | 28.5% | 8,014,921 | 23.2% | 142.8% |

| | | | | | |
|---|---|---|---|---|---|
| Total revenue | $ 68,328,247 | 100.0% | $ 34,583,161 | 100.0% | 97.6% |

Revenue of $68,328,247 in the nine months ended September 30, 2007, was comprised of rents (67.5%) and interest from loans and fee income (32.5%). In the first three quarters of 2007, we owned 26 rent producing properties compared to 14 in the first three quarters of 2006, which accounted for the increase in base rents. The sale of the Victorville and Chino facilities and the related funding of mortgage loans in the first quarter of 2007 required the reversal of previously recorded non-cash straight-line rent receivable of approximately $1.25 million.

During the first three quarters of 2007, we received percentage rents of approximately $396,000 from Vibra, a $1.5 million decrease from the first three quarters of 2006, which is related to revisions and extensions of certain leases and loans with Vibra. Fee income in the nine months ended September 30, 2007 compared to the same period in 2006 increased due to a fee of approximately $2.3 million received from the prepayment of one of our mortgage loans in May, 2007. Interest income from loans in the three quarters ended September 30, 2007 compared to the same period in 2006 increased due to origination of four additional mortgage loans totaling $185,000,000 in the third quarter of 2006 and the first quarter of 2007. Vibra accounted for 36.8% and 60.2% of our gross revenues during the nine months ended September 30, 2007 and 2006, respectively, and affiliates of Prime accounted for 24.8% and 18.4% of total revenue, respectively.

In August, 2007, we amended six leases with Vibra. The amendments were retroactive to January 1, 2007, the date on which the general terms of the amendments were effective. In general, the amendments reduced Vibra s current percentage rent obligations, extended the terms of the leases and increased the amount of annual base rental payments. As a result of the lease amendments, we recorded additional base and straight-line rent revenue of approximately $1.4 million in the nine months ended September 30, 2007.

We expect our revenue to continue to increase in future quarters as a result of expected acquisitions and potential new development projects. The pace of our acquisitions may be affected by the capital market conditions discussed in Liquidity and Capital Resources. We also expect that the relative portion of our revenue that is paid by Vibra will continue to decline as a result of continued tenant diversification.

Depreciation and amortization during the first three quarters of 2007, was $8,619,358, compared to $4,509,609 during the first three quarters of 2006, a 91.1% increase. All of this increase is related to an increase in the number of rent producing properties from the first three quarters of 2006 to the first three quarters of 2007. We expect our depreciation and amortization expense to continue to increase commensurate with our acquisition and development activity.

General and administrative expenses in the first three quarters of 2007 and 2006 totaled $11,122,938, and $7,855,357, respectively, an increase of 41.6%. Of the increase, approximately $1.6 million was the result of a non-recurring adjustment in compensation policies during the first quarter of 2007. General and administrative expenses included compensation expense related to our Equity Incentive Plan of $2,675,000 and $2,363,000 for the nine months ended September 30, 2007 and 2006, respectively.

Interest expense for the nine months ended September 30, 2007, totaled $17,394,641. Capitalized interest for the nine months ended September 30, 2007 and 2006, totaled $1,335,413 and $4,728,153, respectively. Interest expense increased due to larger debt balances in 2007 compared to 2006. Capitalized interest decreased due to our final development under construction being placed into service in April, 2007, compared to three developments under construction totaling $99.2 million at September 30, 2006.

**Discontinued Operations**

In 2006, the Company terminated leases for a hospital and medical office building ( MOB ) complex and re-possessed the real estate. In January, 2007, the Company sold the hospital and MOB complex for a sales price of approximately $71.7 million and recorded a gain of approximately $4.1 million, which is reported in results from discontinued operations. During the period from the lease termination to the date of sale, the hospital was leased to and operated by a third party operator under contract to the hospital. The Company has substantially funded through loans the working capital requirements of the operator pending the operator s collection of patient receivables from Medicare and other third party payors. The accompanying financial statements include provisions to reduce such loans to their net realizable value.

**Reconciliation of Non-GAAP Financial Measures**

Investors and analysts following the real estate industry utilize funds from operations, or FFO, as a supplemental performance measure. While we believe net income available to common stockholders, as defined by generally accepted accounting principles (GAAP), is the most appropriate measure, our management considers FFO an appropriate supplemental measure given its wide use by and relevance to investors and analysts. FFO, reflecting the assumption that real estate asset values rise or fall with market conditions, principally adjusts for the effects of

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GAAP depreciation and amortization of real estate assets, which assume that the value of real estate diminishes predictably over time.

As defined by the National Association of Real Estate Investment Trusts, or NAREIT, FFO represents net income (loss) (computed in accordance with GAAP), excluding gains (losses) on sales of real estate, plus real estate related depreciation and amortization and after adjustments for unconsolidated partnerships and joint ventures. We compute FFO in accordance with the NAREIT definition. FFO should not be viewed as a substitute measure of the Company s operating performance since it does not reflect either depreciation and amortization costs or the level of capital expenditures and leasing costs necessary to maintain the operating performance of our properties, which are significant economic costs that could materially impact our results of operations.

The following table presents a reconciliation of FFO to net income for the three months and nine months ended September 30, 2007 and 2006:

| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| Net income | $ 11,646,646 | $ 8,673,547 | $ 33,362,179 | $ 24,566,229 |
| Depreciation and amortization | 3,288,419 | 1,640,256 | 8,619,358 | 4,509,609 |
| Gain on sale of real estate | | | (4,061,626) | |
| Funds from operations FFO | 14,935,065 | 10,313,803 | 37,919,911 | 29,075,838 |
| Discontinued operations of real estate sold | 415,134 | (856,049) | 2,303,622 | (2,731,150) |
| Funds from operations from continuing operations | $ 15,350,199 | $ 9,457,754 | $ 40,223,533 | $ 26,344,688 |

<u>Per diluted share amounts:</u>

| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| Net income | $ 0.24 | $ 0.22 | $ 0.71 | $ 0.62 |
| Depreciation and amortization | 0.06 | 0.04 | 0.18 | 0.11 |
| Gain on sale of real estate | | | (0.09) | |
| Funds from operations FFO | 0.30 | 0.26 | 0.80 | 0.73 |
| Discontinued operations of real estate sold | 0.01 | (0.02) | 0.05 | (0.07) |
| Funds from operations from continuing operations | $ 0.31 | $ 0.24 | $ 0.85 | $ 0.66 |

**Distribution Policy**

We have elected to be taxed as a REIT commencing with our taxable year that began on April 6, 2004 and ended on December 31, 2004. To qualify as a REIT, we must meet a number of organizational and operational requirements, including a requirement that we distribute at least 90% of our REIT taxable income, excluding net capital gain, to our stockholders.

The table below is a summary of our distributions paid or declared during the two year period ended September 30, 2007:

| Declaration Date | Record Date | Date of Distribution | Distribution per Share |
|---|---|---|---|
| August 16, 2007 | September 14, 2007 | October 19, 2007 | $ 0.27 |
| May 17, 2007 | June 14, 2007 | July 12, 2007 | $ 0.27 |
| February 15, 2007 | March 29, 2007 | April 12, 2007 | $ 0.27 |
| November 16, 2006 | December 14, 2006 | January 11, 2007 | $ 0.27 |
| August 18, 2006 | September 14, 2006 | October 12, 2006 | $ 0.26 |
| May 18, 2006 | June 15, 2006 | July 13, 2006 | $ 0.25 |
| February 16, 2006 | March 15, 2006 | April 12, 2006 | $ 0.21 |
| November 18, 2005 | December 15, 2005 | January 19, 2006 | $ 0.18 |
| August 18, 2005 | September 15, 2005 | September 29, 2005 | $ 0.17 |

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We intend to pay to our stockholders, within the time periods prescribed by the Code, all or substantially all of our annual taxable income, including taxable gains from the sale of real estate and recognized gains on the sale of securities. It is our policy to make sufficient cash distributions to stockholders in order for us to maintain our status as a REIT under the Code and to avoid corporate income and excise tax on undistributed income.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

Market risk includes risks that arise from changes in interest rates, foreign currency exchange rates, commodity prices, equity prices and other market changes that affect market sensitive instruments. In pursuing our business plan, we expect that the primary market risk to which we will be exposed is interest rate risk.

In addition to changes in interest rates, the value of our facilities will be subject to fluctuations based on changes in local and regional economic conditions and changes in the ability of our tenants to generate profits, all of which may affect our ability to refinance our debt if necessary. The changes in the value of our facilities would be reflected also by changes in cap rates, which is measured by the current base rent divided by the current market value of a facility.

If market rates of interest on our variable rate debt increase by 1%, the increase in annual interest expense on our variable rate debt would decrease future earnings and cash flows by approximately $1.2 million per year. If market rates of interest on our variable rate debt decrease by 1%, the decrease in interest expense on our variable rate debt would increase future earnings and cash flows by approximately $1.2 million per year. This assumes that the amount outstanding under our variable rate debt remains approximately $120.9 million, the balance at September 30, 2007. In addition, we have approximately $259.0 million in fixed rate, long-term debt. We intend to maintain a majority of our debt in fixed rate facilities for the foreseeable future. As interest rates fluctuate, we will consider implementing strategies to fix a portion of our variable rate debt.

We currently have no assets denominated in a foreign currency, nor do we have any assets located outside of the United States. We also have no exposure to derivative financial instruments.

Our exchangeable notes are exchangeable into 60.3346 shares of our stock for each $1,000 note. This equates to a conversion price of $16.57 per share. This conversion price adjusts based on a formula which considers increases to our dividend subsequent to the issuance of the notes in November, 2006. Our dividends declared since the notes we issued have adjusted our conversion price to $16.53 per share. Future changes to the conversion price will depend on our level of dividends which cannot be predicted at this time. Any adjustments for dividend increases until the notes are settled in 2011 will affect the price of the notes and the number of shares for which they will eventually be settled.

At the time we issued the exchangeable notes, we also entered into a capped call or call spread transaction. The effect of this transaction was to increase the conversion price from $16.57 to $18.94. As a result, our shareholders will not experience any dilution until our share price exceeds $18.94. If our share price exceeds that price, the result would be that we would issue additional shares of common stock. At a price of $20 per share, we would be required to issue an additional 434,000 shares. At $25 per share, we would be required to issue an additional two million shares.

## Item 4. Controls and Procedures

We have adopted and maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by Rule 13a-15(b), under the Securities Exchange Act of 1934, as amended, we have carried out an evaluation, under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the quarter covered by this report. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information required to be disclosed by the Company in the reports that the Company files with the SEC. There has been no change in our internal control over financial reporting during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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## PART II OTHER INFORMATION

**Item 1. Legal Proceedings**

Not applicable.

**Item 1.A. Risk Factors**

There have been no material changes to the Risk Factors as presented in our Annual Report on Form 10-K for the year ended December 31, 2006 as filed with the Commission on March 16, 2007.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

(a) Not applicable.
(b) Not applicable.
(c) Not applicable.

**Item 3. Defaults Upon Senior Securities**

Not applicable.

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

Not applicable.

**Item 5. Other Information.**

(a) Information required to be disclosed on Form 8-K, Item 1.01. Entry into a Material Definitive Agreement.

On November 7, 2007, the Company, MPT Operating Partnership, L.P., the Company s operating partnership (the Borrower ), KeyBank National Association and JPMorgan Chase Bank, N.A., as Lenders party thereto, KeyBank National Association, as Syndication Agent, and JPMorgan Chase Bank, N.A., as Administrative Agent, signed a First Amendment to Term Loan Credit Agreement (the Amendment ) which extended the maturity date of a $100.0 million Term Loan Credit Agreement, dated August 9, 2007, among the Company, the Borrower, the Syndication Agent, the Administrative Agent and the several lenders from time to time parties thereto, from November 9, 2007 to November 30, 2007. All of the other terms, conditions and provisions of the Term Loan Credit Agreement remain unchanged. The foregoing description of the Amendment is qualified in its entirety by the full terms and conditions of the Amendment which is filed as Exhibit 10.1 to this Periodic Report on Form 10-Q and incorporated herein by reference.

Some of the lending banks under the Amendment and their affiliates have in the past provided and may from time to time in the future provide commercial banking, financial advisory, investment banking and other services to the Company and the Borrower.

**Item 6. Exhibits**

The following exhibits are filed as a part of this report:

| Exhibit Number | Description |
|---|---|
| 10.1 | First Amendment to Term Loan Credit Agreement among Medical Properties Trust, Inc., MPT Operating Partnership, L.P., as Borrower, KeyBank National Association and JPMorgan Chase Bank, N.A., as Lenders party thereto, KeyBank National Association, as Syndication Agent, and JPMorgan Chase Bank, N.A. as Administrative Agent |
| 31.1 | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 |
| 31.2 | Certification of Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 |
| 32 | Certification of Chief Executive Officer and Chief Financial Officer pursuant to Rule 13a-14(b) under the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350 |
| 99.1 | |

Consolidated Financial Statements of Vibra Healthcare, LLC as of June 30, 2007. Since Vibra Healthcare, LLC leases more than 20% of our properties under triple net leases, the financial status of Vibra may be considered relevant to investors. The most recently available financial statements for Vibra are attached as Exhibit 99.1 to this Quarterly Report on Form 10-Q. We have not participated in the preparation of Vibra s financial statements nor do we have the right to dictate the form of any financial statements provided to us by Vibra.

99.2 Consolidated Financial Statements of Prime Healthcare Services, Inc., as of June 30, 2007. Since affiliates of Prime Healthcare Services, Inc. lease more than 20% of our properties under triple net leases, the financial status of Prime may be considered relevant to investors. The most recently available financial statements for Prime are attached as Exhibit 99.2 to this Quarterly Report on Form 10-Q. We have not participated in the preparation of Prime s financial statements nor do we have the right to dictate the form of any financial statements provided to us by Prime.

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## SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**MEDICAL PROPERTIES TRUST, INC.**

By: /s/ R. Steven Hamner
R. Steven Hamner
Executive Vice President and Chief Financial Officer
(On behalf of the Registrant and as the Registrant s
Principal Financial and Accounting Officer)

Date: November 9, 2007

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INDEX TO EXHIBITS

| Exhibit Number | Description |
|---|---|
| 10.1 | First Amendment to Term Loan Credit Agreement among Medical Properties Trust, Inc., MPT Operating Partnership, L.P., as Borrower, the Several Lenders from Time to Time Parties Thereto, KeyBank National Association, as Syndication Agent, and JPMorgan Chase Bank, N.A. as Administrative Agent, with J.P. Morgan Securities Inc. and KeyBank National Association, as Joint Lead Arrangers and Bookrunners |
| 31.1 | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 |
| 31.2 | Certification of Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 |
| 32 | Certification of Chief Executive Officer and Chief Financial Officer pursuant to Rule 13a-14(b) under the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350 |
| 99.1 | Consolidated Financial Statements of Vibra Healthcare, LLC as of June 30, 2007 |
| 99.2 | Consolidated Financial Statements of Prime Healthcare Services, Inc. as of June 30, 2007 |