

HCP, INC.  
Form 10-Q  
August 05, 2014  
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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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(Mark One)

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

For the quarterly period ended June 30, 2014.

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 001-08895

## HCP, INC.

(Exact name of registrant as specified in its charter)

**Maryland**  
(State or other jurisdiction of  
incorporation or organization)

**33-0091377**  
(I.R.S. Employer  
Identification No.)

**1920 Main Street, Suite 1200**

**Irvine, CA 92614**

(Address of principal executive offices)

**(949) 407-0700**

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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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 x NO o

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 (§232.405 of this chapter) during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files). YES x NO o

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

Large Accelerated Filer

Accelerated Filer

Non-accelerated Filer

Smaller Reporting Company

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(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) YES o NO x

**As of July 31, 2014, there were 458,820,961 shares of the registrant s \$1.00 par value common stock outstanding.**

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## HCP, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

(Unaudited)

	June 30, 2014	December 31, 2013
<b>ASSETS</b>		
Real estate:		
Buildings and improvements	\$ 10,783,296	\$ 10,544,110
Development costs and construction in progress	251,400	225,869
Land	1,880,408	1,822,862
Accumulated depreciation and amortization	(2,100,223)	(1,965,592)
Net real estate	10,814,881	10,627,249
Net investment in direct financing leases	7,223,878	7,153,399
Loans receivable, net	375,717	366,001
Investments in and advances to unconsolidated joint ventures	190,730	196,576
Accounts receivable, net of allowance of \$3,052 and \$1,529, respectively	32,719	27,494
Cash and cash equivalents	54,070	300,556
Restricted cash	34,329	37,229
Intangible assets, net	477,837	489,842
Real estate assets held for sale, net		9,819
Other assets, net	940,008	867,705
Total assets(1)	\$ 20,144,169	\$ 20,075,870
<b>LIABILITIES AND EQUITY</b>		
Bank line of credit	\$ 310,000	\$ 226,858
Term loan	234,352	6,963,375
Senior unsecured notes	6,826,884	1,396,485
Mortgage debt	1,229,773	74,909
Other debt	73,020	98,810
Intangible liabilities, net	90,426	318,427
Accounts payable and accrued liabilities	339,364	65,872
Deferred revenue	67,756	9,144,736
Total liabilities(2)	9,171,575	9,144,736
Commitments and contingencies		
Common stock, \$1.00 par value: 750,000,000 shares authorized; 458,742,070 and 456,960,648 shares issued and outstanding, respectively	458,742	456,961
Additional paid-in capital	11,388,641	11,334,041
Cumulative dividends in excess of earnings	(1,075,583)	(1,053,215)
Accumulated other comprehensive loss	(11,669)	(14,487)
Total stockholders' equity	10,760,131	10,723,300
Joint venture partners	23,391	23,729
Non-managing member unitholders	189,072	184,105
Total noncontrolling interests	212,463	207,834
Total equity	10,972,594	10,931,134
Total liabilities and equity	\$ 20,144,169	\$ 20,075,870

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(1) The Company's consolidated total assets at June 30, 2014 and December 31, 2013 each include \$1 million of other assets of certain variable interest entities ( VIEs ) that can only be used to settle the liabilities of those VIEs. See Note 16 to the Condensed Consolidated Financial Statements for additional information.

(2) The Company's consolidated total liabilities at June 30, 2014 and December 31, 2013 each include \$9 million of accounts payable and accrued liabilities of certain VIEs for which the VIE creditors do not have recourse to HCP, Inc. See Note 16 to the Condensed Consolidated Financial Statements for additional information.

See accompanying Notes to the Condensed Consolidated Financial Statements.

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## HCP, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
<b>Revenues:</b>				
Rental and related revenues	\$ 288,191	\$ 277,769	\$ 573,014	\$ 559,308
Tenant recoveries	27,110	25,144	52,544	49,346
Resident fees and services	37,939	36,394	75,992	72,139
Income from direct financing leases	165,500	158,286	330,037	315,156
Interest income	16,937	14,147	33,633	26,533
Investment management fee income	444	499	893	942
Total revenues	536,121	512,239	1,066,113	1,023,424
<b>Costs and expenses:</b>				
Interest expense	106,842	108,452	213,480	217,562
Depreciation and amortization	113,133	109,210	220,521	212,389
Operating	78,867	73,887	154,574	146,573
General and administrative	29,062	24,062	50,456	44,717
Total costs and expenses	327,904	315,611	639,031	621,241
Other income, net	709	3,288	2,639	15,400
<b>Income before income taxes and equity income from unconsolidated joint ventures</b>				
Income taxes	(1,339)	(1,604)	(2,785)	(2,519)
Equity income from unconsolidated joint ventures	14,692	15,585	29,220	30,386
<b>Income from continuing operations</b>	<b>222,279</b>	<b>213,897</b>	<b>456,156</b>	<b>445,450</b>
<b>Discontinued operations:</b>				
Income before gain on sales of real estate, net of income taxes		1,941	1,736	4,172
Gain on sales of real estate, net of income taxes		887	28,010	887
Total discontinued operations		2,828	29,746	5,059
<b>Net income</b>	<b>222,279</b>	<b>216,725</b>	<b>485,902</b>	<b>450,509</b>
Noncontrolling interests share in earnings	(3,394)	(3,324)	(7,906)	(6,523)
<b>Net income attributable to HCP, Inc.</b>	<b>218,885</b>	<b>213,401</b>	<b>477,996</b>	<b>443,986</b>
Participating securities share in earnings	(489)	(378)	(1,552)	(856)
<b>Net income applicable to common shares</b>	<b>\$ 218,396</b>	<b>\$ 213,023</b>	<b>\$ 476,444</b>	<b>\$ 443,130</b>
<b>Basic earnings per common share:</b>				
Continuing operations	\$ 0.48	\$ 0.46	\$ 0.98	\$ 0.96
Discontinued operations		0.01	0.06	0.02
Net income applicable to common shares	\$ 0.48	\$ 0.47	\$ 1.04	\$ 0.98
<b>Diluted earnings per common share:</b>				
Continuing operations	\$ 0.48	\$ 0.46	\$ 0.98	\$ 0.96
Discontinued operations		0.01	0.06	0.01

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Net income applicable to common shares	\$	0.48	\$	0.47	\$	1.04	\$	0.97
<b>Weighted average shares used to calculate earnings per common share:</b>								
Basic		458,247		454,618		457,773		454,137
Diluted		458,588		455,431		458,134		455,024
<b>Dividends declared per common share</b>	\$	0.545	\$	0.525	\$	1.09		1.05

See accompanying Notes to the Condensed Consolidated Financial Statements.



Table of Contents**HCP, INC.****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****(In thousands)****(Unaudited)**

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
Net income	\$ 222,279	\$ 216,725	\$ 485,902	\$ 450,509
Other comprehensive income (loss):				
Change in net unrealized gains (losses) on securities:				
Unrealized gains (losses)	(7)		(4)	1,355
Reclassification adjustment realized in net income				(9,131)
Change in net unrealized gains (losses) on cash flow hedges:				
Unrealized gains (losses)	3	4,025	(692)	9,345
Reclassification adjustment realized in net income	38	288	643	560
Change in Supplemental Executive Retirement Plan obligation	54	55	108	111
Foreign currency translation adjustment	2,813	(125)	2,763	53
Total other comprehensive income	2,901	4,243	2,818	2,293
Total comprehensive income	225,180	220,968	488,720	452,802
Total comprehensive income attributable to noncontrolling interests	(3,394)	(3,324)	(7,906)	(6,523)
Total comprehensive income attributable to HCP, Inc.	\$ 221,786	\$ 217,644	\$ 480,814	\$ 446,279

See accompanying Notes to the Condensed Consolidated Financial Statements.

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## HCP, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF EQUITY

(In thousands, except per share data)

(Unaudited)

	Common Stock		Additional	Cumulative	Accumulated	Total	Total	Total
	Shares	Amount	Paid-In	Dividends	Other	Stockholders	Noncontrolling	Equity
			Capital	In Excess	Comprehensive	Equity	Interests	Equity
				Of Earnings	Income (Loss)			
<b>January 1, 2014</b>	456,961	\$ 456,961	\$ 11,334,041	\$ (1,053,215)	\$ (14,487)	\$ 10,723,300	\$ 207,834	\$ 10,931,134
Net income				477,996		477,996	7,906	485,902
Other comprehensive income					2,818	2,818		2,818
Issuance of common stock, net	1,954	1,954	51,728			53,682	(73)	53,609
Repurchase of common stock	(284)	(284)	(10,802)			(11,086)		(11,086)
Exercise of stock options	111	111	2,681			2,792		2,792
Amortization of deferred compensation			11,006			11,006		11,006
Common dividends (\$1.09 per share)				(500,364)		(500,364)		(500,364)
Distributions to noncontrolling interests							(7,967)	(7,967)
Issuance of noncontrolling interests							6,434	6,434
Purchase of noncontrolling interests			(13)			(13)	(1,671)	(1,684)
<b>June 30, 2014</b>	458,742	\$ 458,742	\$ 11,388,641	\$ (1,075,583)	\$ (11,669)	\$ 10,760,131	\$ 212,463	\$ 10,972,594

	Common Stock		Additional	Cumulative	Accumulated	Total	Total	Total
	Shares	Amount	Paid-In	Dividends	Other	Stockholders	Noncontrolling	Equity
			Capital	In Excess	Comprehensive	Equity	Interests	Equity
				Of Earnings	Income (Loss)			
<b>January 1, 2013</b>	453,191	\$ 453,191	\$ 11,180,066	\$ (1,067,367)	\$ (14,653)	\$ 10,551,237	\$ 202,540	\$ 10,753,777
Net income				443,986		443,986	6,523	450,509
Other comprehensive income					2,293	2,293		2,293
Issuance of common stock, net	1,097	1,097	49,221			50,318	(2,997)	47,321
Repurchase of common stock	(46)	(46)	(2,224)			(2,270)		(2,270)
	852	852	15,957			16,809		16,809

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Exercise of stock options															
Amortization of deferred compensation			11,638			11,638			11,638						
Common dividends (\$1.05 per share)			(477,453)			(477,453)			(477,453)						
Distributions to noncontrolling interests							(7,506)		(7,506)						
Issuance of noncontrolling interests							3,141		3,141						
<b>June 30, 2013</b>	455,094	\$	455,094	\$	11,254,658	\$	(1,100,834)	\$	(12,360)	\$	10,596,558	\$	201,701	\$	10,798,259

See accompanying Notes to the Condensed Consolidated Financial Statements.

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## HCP, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Six Months Ended June 30,	
	2014	2013
<b>Cash flows from operating activities:</b>		
Net income	485,902	\$ 450,509
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of real estate, in-place lease and other intangibles:		
Continuing operations	220,521	212,389
Discontinued operations		3,095
Amortization of above and below market lease intangibles, net	(343)	(6,068)
Amortization of deferred compensation	11,006	11,638
Amortization of deferred financing costs, net	9,474	9,440
Straight-line rents	(26,455)	(15,955)
Loan and direct financing lease interest accretion	(39,401)	(45,539)
Deferred rental revenues	(515)	(965)
Equity income from unconsolidated joint ventures	(29,220)	(30,386)
Distributions of earnings from unconsolidated joint ventures	2,655	1,624
Gain on sales of real estate	(28,010)	(887)
Marketable securities and other (gains) losses, net	58	(10,197)
Changes in:		
Accounts receivable, net	(5,225)	462
Other assets	(6,136)	(12,852)
Accounts payable and accrued liabilities	13,394	5,294
Net cash provided by operating activities	607,705	571,602
<b>Cash flows from investing activities:</b>		
Acquisitions of real estate	(285,429)	(60,353)
Development of real estate	(72,334)	(67,983)
Leasing costs and tenant and capital improvements	(27,458)	(19,938)
Proceeds from sales of real estate, net	36,897	3,777
Distributions in excess of earnings from unconsolidated joint ventures	1,113	904
Purchases of marketable debt securities		(16,706)
Proceeds from the sales of marketable securities		28,030
Principal repayments on loans receivable	5,547	19,112
Investments in loans receivable and other	(46,434)	(300,673)
(Increase) decrease in restricted cash	2,900	(7,105)
Net cash used in investing activities	(385,198)	(420,935)
<b>Cash flows from financing activities:</b>		
Net borrowings under bank line of credit	310,000	265,049
Issuance of senior unsecured notes	350,000	
Repayments of senior unsecured notes	(487,000)	(150,000)
Repayments of mortgage debt	(169,843)	(40,380)
Deferred financing costs	(9,239)	
Issuance of common stock and exercise of options	56,401	61,860
Repurchase of common stock	(11,086)	
Dividends paid on common stock	(500,364)	(477,453)
Issuance of noncontrolling interests	113	3,141

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Distributions to and purchase of noncontrolling interests	(7,980)	(7,506)
Net cash used in financing activities	(468,998)	(345,289)
Effect of foreign exchange on cash and cash equivalents	5	63
Net decrease in cash and cash equivalents	(246,486)	(194,559)
Cash and cash equivalents, beginning of period	300,556	247,673
Cash and cash equivalents, end of period	\$ 54,070	\$ 53,114

See accompanying Notes to the Condensed Consolidated Financial Statements.

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**HCP, INC.**

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**(1) Business**

HCP, Inc., a Standard & Poor's (S&P) 500 company, together with its consolidated entities (collectively, HCP or the Company), invests primarily in real estate serving the healthcare industry in the United States (U.S.). The Company is a Maryland corporation and was organized to qualify as a self-administered real estate investment trust (REIT) in 1985. The Company is headquartered in Irvine, California, with offices in Nashville, Tennessee and San Francisco, California. The Company acquires, develops, leases, manages and disposes of healthcare real estate, and provides financing to healthcare providers. The Company's portfolio is comprised of investments in the following five healthcare segments: (i) senior housing, (ii) post-acute/skilled nursing, (iii) life science, (iv) medical office and (v) hospital. The Company makes investments within the healthcare segments using the following five investment products: (i) properties under lease, (ii) debt investments, (iii) developments and redevelopments, (iv) investment management and (v) investments in senior housing operations utilizing the structure permitted by the Housing and Economic Recovery Act of 2008, which is commonly referred to as RIDEA.

**(2) Summary of Significant Accounting Policies**

*Basis of Presentation*

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information. Management is required to make estimates and assumptions in the preparation of financial statements in conformity with GAAP. These estimates and assumptions affect the reported amounts of assets and liabilities and the 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 management's estimates.

The condensed consolidated financial statements include the accounts of HCP, Inc., its wholly-owned subsidiaries, joint ventures and variable interest entities (VIEs) that it controls through voting rights or other means. Intercompany transactions and balances have been eliminated upon consolidation. In the opinion of management, all adjustments (consisting of normal recurring adjustments) necessary to present fairly the Company's financial position, results of operations and cash flows have been included. Operating results for the six months ended June 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. The accompanying unaudited interim financial information should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2013 included in the Company's Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission (the SEC).

Certain amounts in the Company's condensed consolidated financial statements have been reclassified for prior periods to conform to the current period presentation. For periods through March 31, 2014, operating results for real estate assets sold have been reclassified from continuing to

discontinued operations on the condensed consolidated statements of income (see Note 4).

*Allowance for Doubtful Accounts*

The Company maintains an allowance for doubtful accounts, including an allowance for straight-line rent receivables, for estimated losses resulting from tenant defaults or the inability of tenants to make contractual rent and tenant recovery payments. For straight-line rent amounts, the Company's assessment is based on amounts estimated to be recoverable over the term of the lease.

The Company evaluates the liquidity and creditworthiness of its tenants, operators and borrowers on a monthly and quarterly basis. The Company's evaluation considers industry and economic conditions, individual and portfolio property performance, credit enhancements, liquidity and other factors. The Company's tenants, borrowers and operators furnish property, portfolio and guarantor/operator-level financial statements, among other information, on a monthly or quarterly basis; the Company utilizes this financial information to calculate the lease or debt service coverages that it uses as a primary credit quality indicator. Lease and debt service coverage information is evaluated together with other property, portfolio and operator performance information, including revenue, expense, net operating income, occupancy, rental rate, reimbursement trends, capital expenditures and EBITDA, along with liquidity. The Company evaluates, on a monthly basis or immediately upon a change in circumstances, its tenants', operators' and borrowers' ability to service their obligations with the Company.

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In connection with the Company's quarterly loans receivable and direct financing leases (DFLs) (collectively, Finance Receivables) review process, Finance Receivables are assigned an internal rating of Performing, Watch List or Workout. Finance Receivables that are deemed Performing meet all present contractual obligations, and collection and timing of all amounts owed is reasonably assured. Watch List Finance Receivables meet all present contractual obligations; however, the timing and/or collection of all amounts owed may not be reasonably assured. Workout Finance Receivables are defined as Finance Receivables where the Company has determined, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the agreement.

Finance Receivables are placed on nonaccrual status when management determines that the collectibility of contractual amounts is not reasonably assured. If the ultimate collectibility of the recorded nonaccrual Finance Receivable balance is in doubt, the cost recovery method is used, and cash collected is applied to first reduce the carrying value of the Finance Receivable. Otherwise, the cash basis method is used, whereby income may be recognized to the extent cash is received. Generally, the Company returns a Finance Receivable to accrual status when all delinquent payments become current under the terms of the loan or lease agreements and collectibility of remaining loan or lease payments is no longer in doubt.

Allowances are established for Finance Receivables based upon an estimate of probable losses on an individual basis, if they are determined to be impaired. Finance Receivables are impaired when it is deemed probable that the Company will be unable to collect all amounts due in accordance with the contractual terms of the loan or lease. An allowance is based upon the Company's assessment of the borrower's or lessee's overall financial condition, economic resources, payment record, the prospects for support from any financially responsible guarantors and, if appropriate, the net realizable value of any collateral. These estimates consider all available evidence, including the expected future cash flows discounted at the Finance Receivable's effective interest rate, fair value of collateral, general economic conditions and trends, historical and industry loss experience, and other relevant factors, as appropriate.

*Recent Accounting Pronouncements*

In April 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2014-08, *Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity* (ASU 2014-08). This update changes the requirements for reporting and the definition of discontinued operations. Based on the current revisions, the disposal of a component of an entity, or a group of components of an entity, is required to be reported in discontinued operations if the disposal represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results when certain defined criteria are met. ASU 2014-08 is effective for fiscal years and interim periods ending after December 15, 2014 and shall be applied prospectively. Early adoption is permitted, but only for disposals (or classifications as held for sale) that have not been reported in financial statements previously issued or available for issuance. On April 1, 2014, the Company early adopted ASU 2014-08; the adoption of ASU 2014-08 did not have a material impact on the Company's consolidated financial position or results of operations.

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers* (ASU 2014-09). This update changes the guidance for recognizing revenue. ASU 2014-09 provides guidance for revenue recognition to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 is effective for fiscal years and interim periods ending after December 15, 2016, including interim periods. Early adoption is not permitted. The Company is evaluating the impact of the adoption of ASU 2014-09 on January 1, 2017 to the Company's consolidated financial position or results of operations.

**(3) Real Estate Property Investments**



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On June 6, 2014, the Company acquired a portfolio of 20 care homes for \$127 million (£75.8 million) subject to long-term triple-net leases. These facilities are located throughout the United Kingdom ( UK ) and are leased to Maria Mallaband Care Group. The triple-net leases have initial terms of 15 years, plus two 10-year extension options and provide for initial annual rent of \$9.7 million (£5.8 million). The cross-defaulted contractual rents will increase annually based on the Retail Price Index (UK measure of inflation), subject to a floor of 2% and a ceiling of 4.5%.

A summary of real estate acquisitions for the six months ended June 30, 2014 follows (in thousands):

Segment	Cash Paid	Consideration		Assets Acquired		
		Debt and Other Liabilities Assumed	Noncontrolling Interest	Real Estate	Net Intangibles	
Senior housing	\$ 215,381(1)	\$ 1	\$ 6,321(2)	\$ 204,758	\$ 16,945	
Life science	43,500	250		41,281	2,469	
Medical office	26,548	272		22,820	4,000	
	\$ 285,429	\$ 523	\$ 6,321	\$ 268,859	\$ 23,414	

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(1) Includes £75.8 million translated into U.S. dollars.

(2) Includes \$5 million of non-managing member limited liability company units.

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During the six months ended June 30, 2013, the Company acquired four senior housing communities from a joint venture between Emeritus Corporation ( Emeritus ) and Blackstone Real Estate Partners VI for \$38 million, acquired a senior housing facility for \$18 million, exercised its purchase option for a senior housing facility it previously leased for \$16 million and acquired 38 acres of land in the post-acute/skilled nursing segment for \$408,000.

During the six months ended June 30, 2014 and 2013, the Company funded an aggregate of \$101 million and \$76 million, respectively, for construction, tenant and other capital improvement projects, primarily in its senior housing, life science and medical office segments.

**(4) Dispositions of Real Estate and Discontinued Operations**

During the six months ended June 30, 2014, the Company sold two post-acute/skilled nursing facilities for \$22 million, a hospital for \$17 million and a medical office building ( MOB ) for \$145,000. During the six months ended June 30, 2013, the Company sold a senior housing facility for \$4 million.

There were no assets classified as held for sale at June 30, 2014. At December 31, 2013, one hospital and two post-acute/skilled nursing facilities were classified as held for sale, with a carrying value of \$10 million.

The following table summarizes operating income from discontinued operations and gain on sales of real estate included in discontinued operations (dollars in thousands):

	<b>Three Months Ended June 30, 2013</b>		<b>Six Months Ended June 30, 2014</b>		<b>Six Months Ended June 30, 2013</b>	
Rental and related revenues	\$	4,824	\$	1,810	\$	9,908
Depreciation and amortization expenses		1,557				3,095
Operating expenses		927		54		1,846
Other expenses, net		399		20		795
Income before gain on sales of real estate, net of income taxes	\$	1,941	\$	1,736	\$	4,172
Gain on sales of real estate, net of income taxes	\$	887	\$	28,010	\$	887
Number of properties included in discontinued operations		16		2		16

**(5) Net Investment in Direct Financing Leases**

The components of net investment in DFLs consisted of the following (dollars in thousands):

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	June 30, 2014	December 31, 2013
Minimum lease payments receivable	\$ 24,517,865	\$ 24,808,386
Estimated residual values	4,134,405	4,134,405
Less unearned income	(21,428,392)	(21,789,392)
Net investment in direct financing leases	\$ 7,223,878	\$ 7,153,399
Properties subject to direct financing leases	364	364

The minimum lease payments receivable are primarily attributable to HCR ManorCare, Inc. ( HCR ManorCare ) (\$23.3 billion and \$23.5 billion at June 30, 2014 and December 31, 2013, respectively). The triple-net master lease with HCR ManorCare provides for annual rent of \$524 million beginning April 1, 2014 (prior to April 1, 2014, annual rent was \$506 million). The rent increases by 3.5% per year over the next two years and by 3% for the remaining portion of the initial lease term. The properties are grouped into four pools, and HCR ManorCare has a one-time extension option for each pool with rent increased for the first year of the extension option to the greater of fair market rent or a 3% increase over the rent for the prior year. Including the extension options, which the Company determined to be bargain renewal options, the four leased pools had total initial available terms ranging from 23 to 35 years.

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The following table summarizes the Company's internal ratings for net investment in DFLs at June 30, 2014 (in thousands):

Investment Type	Carrying Amount	Percentage of DFL Portfolio		Internal Ratings		
		Performing DFLs	Watch List DFLs	Workout DFLs		
Senior housing	\$ 1,488,704	20	\$ 1,116,401	\$ 372,303	\$	
Post-acute/skilled nursing	5,611,283	78	5,611,283			
Hospital	123,891	2	123,891			
	\$ 7,223,878	100	\$ 6,851,575	\$ 372,303	\$	

During the quarter ended September 30, 2013, the Company placed a 14-property senior housing DFL (the "DFL Portfolio") on non-accrual status. Based on the Company's determination that the timing of the collection of all rental payments was no longer reasonably assured, rental revenue for the DFL Portfolio is recognized on a cash basis. Furthermore, the Company determined that the DFL Portfolio was not impaired at September 30, 2013, based on its belief that: (i) it was not probable that it will not collect all of the rental payments under the terms of the lease; and (ii) the fair value of the underlying collateral exceeded the DFL Portfolio's \$376 million carrying amount. The fair value of the DFL Portfolio was estimated based on a discounted cash flow model, which inputs are considered to be a Level 3 measurement within the fair value hierarchy. Inputs to this valuation model include real estate capitalization rates, industry growth rates and operating margins, some of which influence the Company's expectation of future cash flows from the DFL Portfolio and, accordingly, the fair value of its investment. During the three months ended June 30, 2014 and 2013, the Company recognized DFL income of \$5 million and \$7 million, respectively, and received cash payments of \$6 million in each period, respectively, from the DFL Portfolio. During the six months ended June 30, 2014 and 2013, the Company recognized DFL income of \$10 million and \$14 million, respectively, and received cash payments of \$12 million in each period from the DFL Portfolio. The carrying value of the DFL Portfolio was \$372 million and \$374 million at June 30, 2014 and December 31, 2013, respectively. At June 30, 2014, the Company believes the fair value of the collateral supporting this loan is in excess of its carrying value.

**(6) Loans Receivable**

The following table summarizes the Company's loans receivable (in thousands):

	June 30, 2014			December 31, 2013		
	Real Estate Secured	Other Secured	Total	Real Estate Secured	Other Secured	Total
Mezzanine	\$	\$ 233,854	\$ 233,854	\$	\$ 234,455	\$ 234,455
Other(1)	157,819		157,819	147,669		147,669
Unamortized discounts, fees and costs		(2,546)	(2,546)		(2,713)	(2,713)
Allowance for loan losses		(13,410)	(13,410)		(13,410)	(13,410)
	\$ 157,819	\$ 217,898	\$ 375,717	\$ 147,669	\$ 218,332	\$ 366,001

(1) Includes \$128 million and \$117 million at June 30, 2014 and December 31, 2013, respectively, of construction loans outstanding related to senior housing development projects. At June 30, 2014, the Company had \$19.5 million remaining under its commitments to fund development projects.

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The following table summarizes the Company's internal ratings for loans receivable at June 30, 2014 (in thousands):

Investment Type	Carrying Amount	Percentage of Loan Portfolio		Performing Loans	Internal Ratings	
					Watch List Loans	Workout Loans
Real estate secured	\$ 157,819	42	\$	157,819	\$	
Other secured	217,898	58		200,428		17,470
	\$ 375,717	100	\$	358,247	\$	17,470

### *Other Secured Loans*

*Barchester Loan.* On May 2, 2013, the Company acquired £121 million (\$188 million) of subordinated debt at a discount for £109 million (\$170 million). The loan was secured by an interest in 160 facilities leased and operated by Barchester Healthcare ( Barchester ). On August 23, 2013, the Company acquired an additional investment in this loan of £9 million (\$14 million) at a discount for £5 million (\$8 million). This loan accrued interest on its face value at a floating rate of LIBOR plus a weighted-average margin of 3.14%. This loan investment was financed by a GBP denominated draw on the Company's revolving line of credit facility that is discussed in Note 10. On September 6, 2013, the Company received £129 million (\$202 million) from the par payoff of its Barchester debt investments. As a result, the Company recognized interest income of \$24 million primarily representing the debt investment's unamortized discounts. A portion of the proceeds from the Barchester repayment were used to repay the total outstanding amount of the Company's GBP denominated draw on its revolving line of credit facility.

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**Tandem Health Care Loan.** On July 31, 2012, the Company closed a mezzanine loan facility to lend up to \$205 million to Tandem Health Care ( Tandem ), as part of the recapitalization of a post-acute/skilled nursing portfolio. The Company funded \$100 million (the First Tranche ) at closing and funded an additional \$102 million (the Second Tranche ) in June 2013. At June 30, 2014, the loans were subordinate to \$442 million of senior mortgage debt. The loans bear interest at fixed rates of 12% and 14% per annum for the First and Second Tranches, respectively. This loan facility has a total term of up to 63 months from the First Tranche closing, is prepayable at the borrower's option and is secured by real estate partnership interests. The loans are subject to prepayment premiums if repaid on or before the third anniversary from the First Tranche closing date.

**Delphis Operations, L.P. Loan.** The Company holds a secured term loan made to Delphis Operations, L.P. ( Delphis or the Borrower ) that is collateralized by assets of the Borrower. The Borrower's collateral is comprised primarily of a partnership interest in an operating surgical facility that leases a property owned by the Company. This loan is on cost recovery status. The carrying value of the loan, net of an allowance for loan losses of \$13 million, was \$17.5 million and \$18.1 million at June 30, 2014 and December 31, 2013, respectively. During the three and six months ended June 30, 2014, the Company received cash payments from the Borrower of \$0.6 million. At June 30, 2014, the Company believes the fair value of the collateral supporting this loan is in excess of its carrying value.

A reconciliation of the Company's allowance related to the Company's senior secured loan to Delphis follows (in thousands):

	<b>Amount</b>
Balance at January 1, 2014	\$ 13,410
Additions	
Balance at June 30, 2014	\$ 13,410

**(7) Investments in and Advances to Unconsolidated Joint Ventures**

The Company owns interests in the following entities that are accounted for under the equity method at June 30, 2014 (dollars in thousands):

<b>Entity(1)</b>	<b>Segment</b>	<b>Investment(2)</b>	<b>Ownership%</b>
HCR ManorCare	post-acute/skilled nursing	\$ 80,777	9.4
HCP Ventures III, LLC	medical office	6,944	30
HCP Ventures IV, LLC	medical office and hospital	28,369	20
HCP Life Science(3)	life science	68,329	50-63
Suburban Properties, LLC	medical office	5,952	67
Advances to unconsolidated joint ventures, net		359	
		\$ 190,730	
Edgewood Assisted Living Center, LLC	senior housing	\$ (384)	
Seminole Shores Living Center, LLC	senior housing	(580)	
		\$ (964)	

(1) These entities are not consolidated because the Company does not control, through voting rights or other means, the joint ventures.

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(2) Represents the carrying value of the Company's investment in the unconsolidated joint ventures. Negative balances are recorded in accounts payable and accrued liabilities on the Company's Condensed Consolidated Balance Sheets. Includes a 72% interest in a senior housing partnership that has a zero investment balance.

(3) Includes three unconsolidated joint ventures between the Company and an institutional capital partner for which the Company is the managing member. HCP Life Science includes the following partnerships (and the Company's ownership percentage): (i) Torrey Pines Science Center, LP (50%); (ii) Britannia Biotech Gateway, LP (55%); and (iii) LASDK, LP (63%).

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Summarized combined financial information for the Company's unconsolidated joint ventures follows (in thousands):

	<b>June 30, 2014</b>	<b>December 31, 2013</b>
Real estate, net	\$ 3,627,622	\$ 3,662,450
Goodwill and other assets, net	5,326,719	5,384,553
<b>Total assets</b>	<b>\$ 8,954,341</b>	<b>\$ 9,047,003</b>
Capital lease obligations and mortgage debt	\$ 6,700,301	\$ 6,768,815
Accounts payable	1,033,229	1,045,260
Other partners' capital	1,089,086	1,098,228
HCP's capital(1)	131,725	134,700
<b>Total liabilities and partners' capital</b>	<b>\$ 8,954,341</b>	<b>\$ 9,047,003</b>

(1) The combined basis difference of the Company's investments in these joint ventures of \$58 million, as of June 30, 2014, is primarily attributable to goodwill, real estate, capital lease obligations, deferred tax assets and lease-related net intangibles.

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
Total revenues	\$ 1,064,655	\$ 1,051,012	\$ 2,137,843	\$ 2,135,263
Loss from discontinued operations	(4,200)	(3,000)	(5,600)	(5,700)
Net (loss) income	(11,834)	10,122	(3,973)	20,494
HCP's share of earnings(1)	14,692	15,585	29,220	30,386
Fees earned by HCP	444	499	893	942
Distributions received by HCP	566	1,157	3,768	2,528

(1) The Company's joint venture interest in HCR ManorCare is accounted for using the equity method and results in an ongoing elimination of DFL income proportional to HCP's ownership in HCR ManorCare. The elimination of the respective proportional lease expense at the HCR ManorCare level in substance results in \$16 million and \$15 million of DFL income that is recharacterized to the Company's share of earnings from HCR ManorCare (equity income from unconsolidated joint ventures) for the three months ended June 30, 2014 and 2013, respectively. For both the six months ended June 30, 2014 and 2013, \$31 million of DFL income was recharacterized to the Company's share of earnings from HCR ManorCare.

### **(8) Intangibles**

At June 30, 2014 and December 31, 2013, intangible lease assets, comprised of lease-up intangibles, above market tenant lease intangibles and below market ground lease intangibles, were \$796 million and \$781 million, respectively. At June 30, 2014 and December 31, 2013, the accumulated amortization of intangible assets was \$318 million and \$291 million, respectively.

At both June 30, 2014 and December 31, 2013, intangible lease liabilities, comprised of below market lease intangibles and above market ground lease intangibles were \$207 million. At June 30, 2014 and December 31, 2013, the accumulated amortization of intangible liabilities was



\$117 million and \$108 million, respectively.

**(9) Other Assets**

The Company's other assets consisted of the following (in thousands):

	<b>June 30, 2014</b>	<b>December 31, 2013</b>
Straight-line rent assets, net of allowance of \$34,274 and \$34,230 respectively	\$ 392,766	\$ 368,919
Marketable debt securities, net	251,888	244,089
Leasing costs, net	104,984	104,601
Deferred financing costs, net	45,782	42,106
Goodwill	50,346	50,346
Other(1)	94,242	