

HCP, INC.  
Form 10-Q  
April 27, 2010  
Table of Contents

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

---

**FORM 10-Q**

---

(Mark One)

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

For the quarterly period ended March 31, 2010.

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 1-08895

---

**HCP, INC.**

(Exact name of registrant as specified in its charter)

Edgar Filing: HCP, INC. - Form 10-Q

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

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

**3760 Kilroy Airport Way, Suite 300**  
**Long Beach, CA 90806**  
(Address of principal executive offices)

**(562) 733-5100**  
(Registrant's telephone number, including area code)

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

---

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES  NO

Indicate by check mark 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  NO

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   
(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  NO

As of April 22, 2010, there were 293,960,511 shares of the registrant's \$1.00 par value common stock outstanding.



Table of Contents

**HCP, INC.**

**INDEX**

**PART I. FINANCIAL INFORMATION**

|                |  |    |
|----------------|--|----|
| Item 1.        | Financial Statements:  |    |
|                | <u>Condensed Consolidated Balance Sheets</u>   | 3  |
|                | <u>Condensed Consolidated Statements of Income</u>   | 4  |
|                | <u>Condensed Consolidated Statement of Equity</u>  | 5  |
|                | <u>Condensed Consolidated Statements of Cash Flows</u>                                       | 6  |
|                | <u>Notes to the Condensed Consolidated Financial Statements</u>                              | 7  |
| <u>Item 2.</u> | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 23 |
| <u>Item 3.</u> | <u>Quantitative and Qualitative Disclosures About Market Risk</u>                            | 32 |
| <u>Item 4.</u> | <u>Controls and Procedures</u>   | 33 |

**PART II. OTHER INFORMATION**

|                   |  |    |
|-------------------|--|----|
| <u>Item 1.</u>    | <u>Legal Proceedings</u>   | 34 |
| <u>Item 1A.</u>   | <u>Risk Factors</u>  | 34 |
| <u>Item 2.</u>    | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 34 |
| <u>Item 6.</u>    | <u>Exhibits</u>  | 34 |
| <u>Signatures</u> |  | 36 |

Table of Contents

## HCP, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

|  | March 31,<br>2010<br>(Unaudited) | December 31,<br>2009 |
|--|----------------------------------|----------------------|
| <b>ASSETS</b>  |                                  |                      |
| Real estate:   |                                  |                      |
| Buildings and improvements   | \$ 7,991,118                     | \$ 7,802,979         |
| Development costs and construction in progress   | 96,991                           | 272,542              |
| Land   | 1,546,068                        | 1,544,004            |
| Accumulated depreciation and amortization  | (1,091,615)                      | (1,047,641)          |
| Net real estate  | 8,542,562                        | 8,571,884            |
| Net investment in direct financing leases  | 612,991                          | 600,077              |
| Loans receivable, net  | 1,687,415                        | 1,672,938            |
| Investments in and advances to unconsolidated joint ventures   | 266,365                          | 267,978              |
| Accounts receivable, net of allowance of \$8,661 and \$10,772, respectively  | 39,461                           | 43,726               |
| Cash and cash equivalents  | 44,604                           | 112,259              |
| Restricted cash  | 37,953                           | 33,000               |
| Intangible assets, net   | 373,001                          | 389,698              |
| Real estate held for sale, net   | 12,638                           | 13,461               |
| Other assets, net  | 522,580                          | 504,714              |
| Total assets   | \$ 12,139,570                    | \$ 12,209,735        |
| <b>LIABILITIES AND EQUITY</b>  |                                  |                      |
| Bank line of credit  | \$ 210,000                       | \$                   |
| Term loan  |                                  | 200,000              |
| Senior unsecured notes   | 3,523,339                        | 3,521,325            |
| Mortgage and other secured debt  | 1,828,637                        | 1,834,935            |
| Other debt   | 97,023                           | 99,883               |
| Intangible liabilities, net  | 193,153                          | 200,260              |
| Accounts payable and accrued liabilities   | 293,932                          | 309,596              |
| Deferred revenue   | 85,315                           | 85,127               |
| Total liabilities  | 6,231,399                        | 6,251,126            |
| Commitments and contingencies  |                                  |                      |
| Preferred stock, \$1.00 par value: 50,000,000 shares authorized; 11,820,000 shares issued and outstanding, liquidation preference of \$25.00 per share | 285,173                          | 285,173              |
| Common stock, \$1.00 par value: 750,000,000 shares authorized; 293,966,405 and 293,548,162 shares issued and outstanding, respectively                 | 293,966                          | 293,548              |
| Additional paid-in capital   | 5,722,827                        | 5,719,400            |
| Cumulative dividends in excess of earnings   | (577,006)                        | (515,450)            |
| Accumulated other comprehensive loss   | (406)                            | (2,134)              |
| Total stockholders' equity   | 5,724,554                        | 5,780,537            |
| Joint venture partners   | 14,969                           | 7,529                |
| Non-managing member unitholders  | 168,648                          | 170,543              |
| Total noncontrolling interests   | 183,617                          | 178,072              |
| Total equity   | 5,908,171                        | 5,958,609            |
| Total liabilities and equity   | \$ 12,139,570                    | \$ 12,209,735        |

Edgar Filing: HCP, INC. - Form 10-Q

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

## HCP, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)  
(Unaudited)

|   | Three Months Ended March 31, |                  |
|---|------------------------------|------------------|
|   | 2010                         | 2009             |
| <b>Revenues:</b>  |                              |                  |
| Rental and related revenues   | \$ 225,339                   | \$ 212,226       |
| Tenant recoveries   | 21,786                       | 23,650           |
| Income from direct financing leases   | 12,215                       | 12,925           |
| Interest income   | 35,266                       | 26,771           |
| Investment management fee income  | 1,308                        | 1,438            |
| <b>Total revenues</b>   | <b>295,914</b>               | <b>277,010</b>   |
| <b>Costs and expenses:</b>  |                              |                  |
| Depreciation and amortization   | 78,147                       | 80,223           |
| Operating   | 46,117                       | 47,953           |
| General and administrative  | 24,924                       | 18,531           |
| Impairment recoveries   | (11,900)                     |                  |
| <b>Total costs and expenses</b>   | <b>137,288</b>               | <b>146,707</b>   |
| <b>Other income (expense):</b>  |                              |                  |
| Other income, net   | 356                          | (2,438)          |
| Interest expense  | (75,956)                     | (76,674)         |
| <b>Total other income (expense)</b>   | <b>(75,600)</b>              | <b>(79,112)</b>  |
| <b>Income before income taxes and equity income (loss) from unconsolidated joint ventures</b> | <b>83,026</b>                | <b>51,191</b>    |
| Income taxes  | (387)                        | (888)            |
| Equity income (loss) from unconsolidated joint ventures                                       | 1,383                        | (462)            |
| <b>Income from continuing operations</b>  | <b>84,022</b>                | <b>49,841</b>    |
| <b>Discontinued operations:</b>   |                              |                  |
| Income before gain on sales of real estate, net of income taxes                               | 79                           | 1,511            |
| Gain on sales of real estate, net of income taxes   |                              | 1,357            |
| <b>Total discontinued operations</b>  | <b>79</b>                    | <b>2,868</b>     |
| <b>Net income</b>   | <b>84,101</b>                | <b>52,709</b>    |
| Noncontrolling interests share in earnings  | (3,065)                      | (3,826)          |
| <b>Net income attributable to HCP, Inc.</b>   | <b>81,036</b>                | <b>48,883</b>    |
| Preferred stock dividends   | (5,283)                      | (5,283)          |
| Participating securities share in earnings  | (917)                        | (315)            |
| <b>Net income applicable to common shares</b>   | <b>\$ 74,836</b>             | <b>\$ 43,285</b> |
| <b>Basic earnings per common share:</b>   |                              |                  |
| Continuing operations   | \$ 0.26                      | \$ 0.16          |
| Discontinued operations   |                              | 0.01             |
| <b>Net income applicable to common shares</b>   | <b>\$ 0.26</b>               | <b>\$ 0.17</b>   |
| <b>Diluted earnings per common share:</b>   |                              |                  |
| Continuing operations   | \$ 0.25                      | \$ 0.16          |



Edgar Filing: HCP, INC. - Form 10-Q

|   |    |         |    |         |
|---|----|---------|----|---------|
| Discontinued operations   |    |         |    | 0.01    |
| Net income applicable to common shares                                      | \$ | 0.25    | \$ | 0.17    |
| <b>Weighted average shares used to calculate earnings per common share:</b> |    |         |    |         |
| Basic   |    | 293,223 |    | 253,335 |
| Diluted   |    | 294,087 |    | 253,423 |
| <b>Dividends declared per common share</b>                                  | \$ | 0.465   | \$ | 0.460   |

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents**HCP, INC.****CONDENSED CONSOLIDATED STATEMENT OF EQUITY****(In thousands)****(Unaudited)**

|  | Preferred Stock |            | Common Stock |            | Additional   | Cumulative   | Accumulated   | Total        | Total          | Total        |
|--|-----------------|------------|--------------|------------|--------------|--------------|---------------|--------------|----------------|--------------|
|  | Shares          | Amount     | Shares       | Amount     | Paid-In      | Dividends    | Other         | Stockholders | Noncontrolling | Equity       |
|  |                 |            |              |            | Capital      | In Excess    | Comprehensive | Equity       | Interests      | Equity       |
|  |                 |            |              |            |              | Of Earnings  | Income (Loss) |              |                |              |
| <b>January 1, 2010</b>                                       | 11,820          | \$ 285,173 | 293,548      | \$ 293,548 | \$ 5,719,400 | \$ (515,450) | \$ (2,134)    | \$ 5,780,537 | \$ 178,072     | \$ 5,958,609 |
| Comprehensive income:  |                 |            |              |            |              |              |               |              |                |              |
| Net income   |                 |            |              |            |              | 81,036       |               | 81,036       | 3,065          | 84,101       |
| Change in net unrealized gains (losses) on securities:       |                 |            |              |            |              |              |               |              |                |              |
| Unrealized gains (losses)                                    |                 |            |              |            |              |              | 43            | 43           |                | 43           |
| Less reclassification adjustment realized in net income      |                 |            |              |            |              |              | (22)          | (22)         |                | (22)         |
| Change in net unrealized gains (losses) on cash flow hedges: |                 |            |              |            |              |              |               |              |                |              |
| Unrealized gains (losses)                                    |                 |            |              |            |              |              | 1,217         | 1,217        |                | 1,217        |
| Less reclassification adjustment realized in net income      |                 |            |              |            |              |              | 436           | 436          |                | 436          |
| Change in Supplemental Executive Retirement Plan obligation  |                 |            |              |            |              |              | 32            | 32           |                | 32           |
| Foreign currency translation adjustment                      |                 |            |              |            |              |              | 22            | 22           |                | 22           |
| Total comprehensive income                                   |                 |            |              |            |              |              |               | 82,764       | 3,065          | 85,829       |
| Issuance of common stock, net                                |                 |            | 554          | 554        | 3,722        |              |               | 4,276        | (1,885)        | 2,391        |
| Repurchase of common stock                                   |                 |            | (139)        | (139)      | (3,864)      |              |               | (4,003)      |                | (4,003)      |
| Exercise of stock options                                    |                 |            | 3            | 3          | 63           |              |               | 66           |                | 66           |
| Amortization of deferred compensation                        |                 |            |              |            | 3,506        |              |               | 3,506        |                | 3,506        |
| Preferred dividends  |                 |            |              |            |              | (5,283)      |               | (5,283)      |                | (5,283)      |
| Common dividends (\$0.465 per share)                         |                 |            |              |            |              | (137,309)    |               | (137,309)    |                | (137,309)    |
| Distributions to noncontrolling                              |                 |            |              |            |              |              |               |              | (4,739)        | (4,739)      |

Edgar Filing: HCP, INC. - Form 10-Q

|                                  |        |            |         |            |              |              |       |              |            |              |       |
|----------------------------------|--------|------------|---------|------------|--------------|--------------|-------|--------------|------------|--------------|-------|
| interests                        |        |            |         |            |              |              |       |              |            |              |       |
| Sale of noncontrolling interests |        |            |         |            |              |              |       |              | 8,395      |              | 8,395 |
| Other                            |        |            |         |            |              |              |       |              | 709        |              | 709   |
| <b>March 31, 2010</b>            | 11,820 | \$ 285,173 | 293,966 | \$ 293,966 | \$ 5,722,827 | \$ (577,006) | (406) | \$ 5,724,554 | \$ 183,617 | \$ 5,908,171 |       |

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

## HCP, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)  
(Unaudited)

|   | Three Months Ended March 31, |           |
|---|------------------------------|-----------|
|   | 2010                         | 2009      |
| <b>Cash flows from operating activities:</b>  |                              |           |
| Net income  | \$ 84,101                    | \$ 52,709 |
| 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   | 78,147                       | 80,223    |
| Discontinued operations   | 824                          | 375       |
| Amortization of above and below market lease intangibles, net                       | (1,904)                      | (2,660)   |
| Stock-based compensation  | 3,506                        | 3,546     |
| Amortization of debt premiums, discounts and issuance costs, net                    | 3,468                        | 2,201     |
| Straight-line rents   | (13,276)                     | (11,422)  |
| Interest accretion  | (15,077)                     | (6,121)   |
| Deferred rental revenue   | 574                          | 6,914     |
| Equity (income) loss from unconsolidated joint ventures                             | (1,383)                      | 462       |
| Distributions of earnings from unconsolidated joint ventures                        | 1,420                        | 1,468     |
| Gain on sales of real estate  |                              | (1,357)   |
| Marketable securities (gains) losses, net   | (35)                         | 309       |
| Derivative losses, net  | 533                          | 439       |
| Impairment recoveries   | (11,900)                     |           |
| Changes in:   |                              |           |
| Accounts receivable   | 4,265                        | 5,165     |
| Other assets  | (7,463)                      | (483)     |
| Accounts payable and accrued liabilities  | (16,341)                     | (14,756)  |
| Net cash provided by operating activities   | 109,459                      | 117,012   |
| <b>Cash flows from investing activities:</b>  |                              |           |
| Acquisitions and development of real estate   | (31,041)                     | (20,269)  |
| Lease commissions and tenant and capital improvements                               | (4,620)                      | (9,642)   |
| Proceeds from sales of real estate, net   |                              | 5,764     |
| Contributions to unconsolidated joint ventures                                      | (151)                        |           |
| Distributions in excess of earnings from unconsolidated joint ventures              | 804                          | 1,714     |
| Proceeds from the sale of securities  | 242                          |           |
| Principal repayments on loans receivable and direct financing leases                | 1,009                        | 2,485     |
| Investments in loans receivable   |                              | (16)      |
| (Increase) decrease in restricted cash  | (4,953)                      | 2,105     |
| Net cash used in investing activities   | (38,710)                     | (17,859)  |
| <b>Cash flows from financing activities:</b>  |                              |           |
| Net borrowings under bank line of credit facility                                   | 210,000                      | 85,000    |
| Repayment of term loan  | (200,000)                    |           |
| Repayments of mortgage debt   | (8,842)                      | (38,463)  |
| Net proceeds from the issuance (repurchase) of common stock and exercise of options | (1,546)                      | (1,478)   |
| Dividends paid on common and preferred stock  | (142,592)                    | (122,174) |
| Sale of noncontrolling interest   | 8,395                        |           |
| Purchase of noncontrolling interests  |                              | (9,097)   |
| Distributions to noncontrolling interests   | (3,819)                      | (4,127)   |
| Net cash used in financing activities   | (138,404)                    | (90,339)  |
| Net increase (decrease) in cash and cash equivalents                                | (67,655)                     | 8,814     |

Edgar Filing: HCP, INC. - Form 10-Q

|  |    |         |    |        |
|--|----|---------|----|--------|
| Cash and cash equivalents, beginning of period |    | 112,259 |    | 57,562 |
| Cash and cash equivalents, end of period       | \$ | 44,604  | \$ | 66,376 |

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

**HCP, INC.**

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**(1) Business**

HCP, Inc., an S&P 500 company, which, 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 self-administered, Maryland real estate investment trust ( REIT ) organized in 1985. The Company is headquartered in Long Beach, 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) life science, (iii) medical office, (iv) hospital and (v) skilled nursing. The Company makes investments within its healthcare segments using the following five investment products: (i) properties under lease, (ii) debt investments, (iii) developments and redevelopments, (iv) investment management and (v) DownREITs.

**(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 revenue and expenses during the reporting period. Actual results could differ from those estimates.

The condensed consolidated financial statements include the accounts of HCP, its wholly-owned subsidiaries and joint ventures that it controls through voting rights or other means. All material intercompany transactions and balances have been eliminated upon consolidation. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) necessary to present fairly the Company's financial position, the results of operations and the cash flows have been included. Operating results for the three months ended March 31, 2010 are not necessarily indicative of the results that may be expected for the year ending December 31, 2010. 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, 2009 included in the Company's Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission ( SEC ).

Certain amounts in the Company's condensed consolidated financial statements for prior periods have been reclassified to conform to the current period presentation. Assets sold or held for sale and associated liabilities have been reclassified on the condensed consolidated balance sheets and operating results reclassified from continuing to discontinued operations (see Note 4). All prior period interest earned on loans receivable

## Edgar Filing: HCP, INC. - Form 10-Q

and other interest bearing investments have been reclassified to interest income as a component of revenues from other income, net as a result of a significant increase in the Company's investments in loans receivable.

### *Accounting Change*

Effective January 1, 2010, the Company implemented the requirements of Accounting Standards Update No. 2009-17, *Consolidations (Topic 810): Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities* (Update No. 2009-17). Update No. 2009-17 requires enterprises to perform a qualitative approach to determining whether or not a variable interest entity (VIE) will need to be consolidated on a continuous basis. This evaluation is based on an enterprise's ability to direct and influence the activities of a variable interest entity that most significantly impact that entity's economic performance. As a result from its implementation analysis, the Company concluded that it had additional variable interests in various VIEs. The Company has determined that it is not the primary beneficiary of these additional VIEs (see Note 16).

### *Recent Accounting Pronouncements*

In January 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements*. The amendments in this update require, among other things, new disclosures and clarifications of existing disclosures related to

Table of Contents

transfers in and out of Level 1 and Level 2 fair value measurements, further disaggregation of fair value measurement disclosures for each class of assets and liabilities, and additional details of valuation techniques and inputs utilized. This update is consistent with the Company's current accounting application for fair value measurements and disclosures and did not have a material impact on the consolidated financial position or results of operations.

In January 2010, the FASB issued Accounting Standards Update No. 2010-01, *Equity (Topic 505): Accounting for Distributions to Shareholders with Components of Stock and Cash*. This update requires that dividends declared and payable in a combination of stock and cash be included in earnings per share prospectively and not considered a stock dividend for purposes of computing earnings per share. To date, the Company has not declared dividends in this manner so this update has had no impact on the Company's computation of earnings per share.

**(3) Real Estate Property Investments**

During the three months ended March 31, 2010, the Company purchased a senior housing facility for \$9 million and funded an aggregate of \$27 million for construction, tenant and other capital improvement projects, primarily in the life science segment.

During the three months ended March 31, 2010, three of the Company's life science facilities located in South San Francisco were placed into service representing 329,000 square feet.

During the three months ended March 31, 2009, the Company purchased the remaining noncontrolling interests in three senior housing joint ventures for \$14 million and funded an aggregate of \$25 million for construction, tenant and other capital improvement projects, primarily in our life science segment.

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

*Dispositions of Real Estate*

During the three months ended March 31, 2009, the Company sold properties with an aggregate value of \$6 million primarily from our medical office segment.

*Results from Discontinued Operations*



## Edgar Filing: HCP, INC. - Form 10-Q

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</b> |                  |
|---|---------------------------|------------------|
|   | <b>2010</b>               | <b>March 31,</b> |
|   |                           | <b>2009</b>      |
| Rental and related revenues                                     | \$ 885                    | \$ 2,159         |
| Depreciation and amortization expenses                          | 824                       | 375              |
| Operating expenses  |                           | 173              |
| Other (income) expenses   | (18)                      | 100              |
| Income before gain on sales of real estate, net of income taxes | \$ 79                     | \$ 1,511         |
| Gain on sales of real estate                                    | \$                        | \$ 1,357         |
| Number of properties held for sale                              | 1                         | 8                |
| Number of properties sold                                       |                           | 7                |
| Number of properties included in discontinued operations        | 1                         | 15               |

Table of Contents**(5) Net Investment in Direct Financing Leases**

The components of net investment in direct financing leases ( DFLs ) consist of the following (dollars in thousands):

|   | <b>March 31,<br/>2010</b> | <b>December 31,<br/>2009</b> |
|---|---------------------------|------------------------------|
| Minimum lease payments receivable             | \$ 1,317,557              | \$ 1,338,634                 |
| Estimated residual values                     | 467,248                   | 467,248                      |
| Allowance for DFL losses                      | (43,857)                  | (54,957)                     |
| Less unearned income                          | (1,127,957)               | (1,150,848)                  |
| Net investment in direct financing leases     | \$ 612,991                | \$ 600,077                   |
| Properties subject to direct financing leases | 30                        | 30                           |

Lease payments due to the Company relating to three land-only DFLs, along with the land, are subordinate to and serve as collateral for first mortgage construction loans entered into by Erickson Retirement Communities and its affiliate entities ( Erickson ) to fund development costs related to the properties. During the three months ended December 31, 2008, the Company determined that two of these DFLs were impaired and began recognizing income on a cost-recovery basis. As a result of Erickson's October 19, 2009 bankruptcy filing, the Company recorded a provision for DFL losses (impairment charges) of \$15.1 million for the three months ending September 30, 2009 related to the two DFLs above, which was based on the Company's estimate of the present value of future cash flows that would result from what was then viewed as the probable outcome of Erickson's reorganization plan. At that time, the Company determined that an impairment charge would not be required for the third DFL since that asset was performing, nor would an impairment charge be required for a \$10 million participation in a senior construction loan, for which Erickson is the borrower, since the estimated fair value of the underlying collateral supporting the loan was sufficient for the Company to recover its investment.

On December 23, 2009, an auction was concluded with respect to Erickson's assets, and on December 30, 2009, Erickson filed an amended plan of reorganization providing additional detail about the results of the auction and the allocation of auction proceeds. The amended plan proposed that the Company would not be entitled to any of the proceeds with respect to the three DFLs and would receive only a nominal recovery with respect to the Company's participation in the senior construction loan. Additionally, on January 4, 2010, Erickson served the Company with adversary complaints claiming, among other things, that the Company's interest as a landlord under the DFLs should be treated as if it were instead the interest of a lender with a security interest in the properties. Even though Erickson's amended plan of reorganization had not been confirmed in the bankruptcy proceedings, the Company concluded that, as a result of the auction, the subsequent allocation of the auction proceeds and management's evaluation of Erickson's pursuit of remedies consistent with the extinguishment of the Company's DFL interests, it was appropriate to reduce the carrying value of these assets to a nominal amount associated with the expected partial recovery of the participation interest in the senior construction loan.

In February 2010, the Company entered into a settlement agreement with Erickson. On April 15, 2010, the bankruptcy court approved the settlement agreement and confirmed Erickson's final plan of reorganization. The settlement agreement and plan of reorganization provide that the Company will, concurrently with the closing of the sale of Erickson's assets and the transfer to the buyer of all of the Company's interests in the three DFLs and participation in the senior construction loan, be entitled to: (i) retain deposits held by the Company with balances of \$5 million as of March 31, 2010; and (ii) receive an additional \$9.6 million. The closing is expected to occur on April 30, 2010, and remains subject to customary closing conditions. As a result, during the three months ended March 31, 2010, the Company recognized aggregate income of \$11.9 million in impairment recoveries, which represents the reversal of a portion of the allowances established pursuant to the previous impairment charges related to its investments in the three DFLs and participation interest in the senior construction loan. This amount is shown as impairment recoveries in the condensed consolidated statement of income.



Table of Contents**(6) Loans Receivable**

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

|                                       | March 31, 2010      |              |              | December 31, 2009   |               |              |
|---------------------------------------|---------------------|--------------|--------------|---------------------|---------------|--------------|
|                                       | Real Estate Secured | Other        | Total        | Real Estate Secured | Other Secured | Total        |
| Mezzanine                             | \$ 782,822          | \$ 999,118   | \$ 999,118   | \$ 783,798          | \$ 999,118    | \$ 999,118   |
| Other                                 |                     | 85,468       | 868,290      |                     | 84,079        | 867,877      |
| Unamortized discounts, fees and costs | (106,952)           | (61,402)     | (168,354)    | (115,422)           | (66,196)      | (181,618)    |
| Allowance for loan losses             | (7,348)             | (4,291)      | (11,639)     | (8,148)             | (4,291)       | (12,439)     |
|                                       | \$ 668,522          | \$ 1,018,893 | \$ 1,687,415 | \$ 660,228          | \$ 1,012,710  | \$ 1,672,938 |

On October 5, 2006, the Company acquired an interest-only, senior secured term loan made to an affiliate of the Cirrus Group, LLC ( Cirrus ). The loan had a maturity date of December 31, 2008, with a one-year extension period at the option of the borrower, subject to certain conditions, under which amounts were borrowed to finance the acquisition, development, syndication and operation of new and existing surgical partnerships. The loan accrues interest at a rate of 14.0%, of which 9.5% is payable monthly and 4.5% is deferred until maturity. The loan is collateralized by all of the assets of the borrower (comprised primarily of interests in partnerships operating surgical facilities, some of which are on the premises of properties owned by HCP Ventures IV or the Company) and is supported in part by limited guarantees made by certain principals of Cirrus. Recourse under certain of these guarantees is limited to the guarantors' respective interests in certain entities owning real estate that are pledged to secure such guarantees. At December 31, 2008, the borrower did not meet the conditions necessary to exercise its extension option and did not repay the loan upon maturity. On April 22, 2009, new terms for extending the maturity date of the loan were agreed to, including the payment of a \$1.1 million extension fee, and the maturity date was extended to December 31, 2010. In July 2009, the Company issued a notice of default for the borrower's failure to make interest payments. In December 2009, the Company determined the loan was impaired and recognized a provision for loan loss of \$4.3 million. This provision for loan loss resulted from discussions that began in December of 2009 to restructure the loan. The proposed terms of the loan restructure include an extension of the maturity date and a reduction of the contractual interest rate for a portion of the outstanding principal balance. Beginning January 2010, the borrower has made the required payments under the proposed terms of the restructure. At March 31, 2010 and December 31, 2009, the carrying value of this loan, including accrued interest of \$5.7 million and \$5.2 million, respectively, was \$85.8 million and \$83.5 million, respectively. During the three months ended March 31, 2010, the Company recognized interest income from this loan of \$2.9 million and received cash payments from the borrower of \$0.7 million.

On December 21, 2007, the Company made an investment in mezzanine loans having an aggregate par value of \$1.0 billion at a discount of \$100 million, which resulted in an acquisition cost of \$900 million, as part of the financing for The Carlyle Group's \$6.3 billion purchase of Manor Care, Inc. These interest-only loans mature in January 2013 and bear interest on their par values at a floating rate of one-month London Interbank Offered Rate ( LIBOR ) plus 4.0%. These loans are mandatorily pre-payable in January 2012 unless the borrower satisfies certain performance conditions. Among other things, these performance conditions require the borrower to: (i) maintain an interest-rate cap agreement(s) with a strike price of 5.25% at an equivalent maturity to that of the underlying loans; and (ii) maintain a trailing-twelve-month Debt Service Coverage Ratio, as defined in the respective agreement, of no less than 1.45 times. At closing, the loans were secured by an indirect pledge of equity ownership in 339 HCR ManorCare facilities located in 30 states and were subordinate to other debt of approximately \$3.6 billion. At March 31, 2010 and December 31, 2009, the carrying value of these loans was \$939 million and \$934 million, respectively.

On August 3, 2009, the Company purchased a \$720 million participation in the first mortgage debt of HCR ManorCare at a discount of \$130 million, which resulted in an acquisition cost of \$590 million. The \$720 million participation bears interest at LIBOR plus 1.25% and

## Edgar Filing: HCP, INC. - Form 10-Q

represents 45% of the \$1.6 billion most senior tranche of HCR ManorCare's mortgage debt incurred as part of the above mentioned financing for The Carlyle Group's acquisition of Manor Care, Inc. in December 2007. The mortgage debt matures in January 2013, if the borrower exercises a one-year extension option and meets certain performance conditions, which are similar to those described above. The mortgage debt was secured by a first lien on 331 facilities located in 30 states at closing. At March 31, 2010 and December 31, 2009, the carrying value of the participation in this loan was \$612 million and \$604 million, respectively.

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

The Company owns interests in the following entities which are accounted for under the equity method at March 31, 2010 (dollars in thousands):

| Entity(1)                                      | Properties                           | Investment(2) | Ownership% |
|--|--------------------------------------|---------------|------------|
| HCP Ventures II                                | 25 senior housing facilities         | \$ 138,834    | 35         |
| HCP Ventures III, LLC                          | 13 medical office buildings ( MOBs ) | 10,791        | 30         |
| HCP Ventures IV, LLC                           | 54 MOBs and 4 hospitals              | 39,264        | 20         |
| HCP Life Science(3)                            | 4 life science facilities            | 64,371        | 50-63      |
| Horizon Bay Hyde Park, LLC                     | 1 senior housing development         | 8,078         | 75         |
| Suburban Properties, LLC                       | 1 MOB                                | 3,255         | 67         |
| Advances to unconsolidated joint ventures, net |                                      | 1,772         |            |
|  |                                      | \$ 266,365    |            |
| Edgewood Assisted Living Center, LLC(4)(5)     | 1 senior housing facility            | \$ (326)      | 45         |
| Seminole Shores Living Center, LLC(4)(5)       | 1 senior housing facility            | (911)         | 50         |
|  |                                      | \$ 265,128    |            |

(1) These joint ventures are not consolidated since the Company does not control, through voting rights or other means, the joint ventures. See Note 2 to the Consolidated Financial Statements for the year ended December 31, 2009 in the Company's Annual Report on Form 10-K filed with the SEC regarding the Company's policy on consolidation.

(2) Represents the carrying value of the Company's investment in the unconsolidated joint venture. See Note 2 to the Consolidated Financial Statements for the year ended December 31, 2009 in the Company's Annual Report on Form 10-K filed with the SEC regarding the Company's policy for accounting for joint venture interests.

(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: (i) Torrey Pines Science Center, LP (50%); (ii) Britannia Biotech Gateway, LP (55%); and (iii) LASDK, LP (63%).

(4) As of March 31, 2010, the Company has guaranteed in the aggregate \$4 million of a total of \$8 million of notes payable for these joint ventures. No amounts have been recorded related to these guarantees at March 31, 2010.

(5) Negative investment amounts are included in accounts payable and accrued liabilities in the Company's condensed consolidated financial statements.

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

|                   | March 31,<br>2010 | December 31,<br>2009 |
|-------------------|-------------------|----------------------|
| Real estate, net  | \$ 1,644,815      | \$ 1,655,754         |
| Other assets, net | 193,327           | 189,841              |
| Total assets      | \$ 1,838,142      | \$ 1,845,595         |

Edgar Filing: HCP, INC. - Form 10-Q

|   |    |           |    |           |
|---|----|-----------|----|-----------|
| Mortgage debt                           | \$ | 1,155,925 | \$ | 1,159,589 |
| Accounts payable                        |    | 37,846    |    | 38,255    |
| Other partners' capital                 |    | 459,508   |    | 462,243   |
| HCP's capital(1)                        |    | 184,863   |    | 185,508   |
| Total liabilities and partners' capital | \$ | 1,838,142 | \$ | 1,845,595 |

(1) Aggregate basis difference of the Company's investments in these joint ventures of \$78 million, as of March 31, 2010, is primarily attributable to real estate and related intangible assets.

|                             | <b>Three Months Ended March 31,</b> |             |
|-----------------------------|-------------------------------------|-------------|
|                             | <b>2010</b>                         | <b>2009</b> |
| Total revenues              | \$ 45,846                           | \$ 46,601   |
| Net income (loss)           | 888                                 | (1,146)     |
| HCP's equity income (loss)  | 1,383                               | (462)       |
| Fees earned by HCP          | 1,308                               | 1,438       |
| Distributions received, net | 2,224                               | 3,182       |

Table of Contents**(8) Intangibles**

At March 31, 2010 and December 31, 2009, intangible lease assets, comprised of lease-up intangibles, above market tenant lease intangibles, below market ground lease intangibles and intangible assets related to non-compete agreements, were \$576.8 million and \$592.1 million, respectively. At March 31, 2010 and December 31, 2009, the accumulated amortization of intangible assets was \$203.8 million and \$202.4 million, respectively.

At March 31, 2010 and December 31, 2009, below market lease and above market ground lease intangible liabilities were \$278.3 million and \$284.2 million, respectively. At March 31, 2010 and December 31, 2009, the accumulated amortization of intangible liabilities was \$85.1 million and \$83.9 million, respectively.

**(9) Other Assets**

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

|  | <b>March 31,<br/>2010</b> | <b>December 31,<br/>2009</b> |
|--|---------------------------|------------------------------|
| Marketable debt securities   | \$ 171,764                | \$ 172,799                   |
| Marketable equity securities   | 4,537                     | 3,521                        |
| Straight-line rent assets, net of allowance of \$51,112 and \$48,681, respectively | 172,178                   | 158,674                      |
| Deferred debt issuance costs, net  | 16,059                    | 18,607                       |
| Goodwill   | 50,346                    | 50,346                       |
| Other  | 107,696                   | 100,767                      |
| Total other assets   | \$ 522,580                | \$ 504,714                   |

The cost or amortized cost, estimated fair value and gross unrealized gains and losses on marketable securities follows (in thousands):

|                           | <b>Cost Basis (1)</b> | <b>Fair Value</b> | <b>Gross Unrealized</b> |               |
|---------------------------|-----------------------|-------------------|-------------------------|---------------|
|                           |                       |                   | <b>Gains</b>            | <b>Losses</b> |
| <b>March 31, 2010:</b>    |                       |                   |                         |               |
| Debt securities           | \$ 160,830            | \$ 171,764        | \$ 10,934               | \$            |
| Equity securities         | 3,645                 | 4,537             | 892                     |               |
| Total investments         | \$ 164,475            | \$ 176,301        | \$ 11,826               | \$            |
| <b>December 31, 2009:</b> |                       |                   |                         |               |
| Debt securities           | \$ 160,830            | \$ 172,799        | \$ 11,969               | \$            |
| Equity securities         | 3,685                 | 3,521             | 236                     | (400)         |
| Total investments         | \$ 164,515            | \$ 176,320        | \$ 12,205               | \$ (400)      |



---

(1) Represents the original cost basis of the marketable securities adjusted for discount accretion and other-than-temporary impairments recorded through earnings, if any.

At March 31, 2010, \$141 million (par value) of the Company's marketable debt securities accrue interest at 9.625% and mature in November 2016 and \$20 million (par value) accrue interest at 9.25% and mature in May 2017. The issuers of these notes may elect to pay interest in cash or by issuing additional notes for all or a portion of the interest payments.

## **(10) Debt**

### *Bank Line of Credit and Term Loan*

The Company's revolving line of credit facility with a syndicate of banks provides for an aggregate borrowing capacity of \$1.5 billion and matures on August 1, 2011. This revolving line of credit facility accrues interest at a rate per annum equal to LIBOR plus a margin that depends upon the Company's debt ratings. The Company pays a facility fee on the entire revolving commitment that depends upon its debt ratings. Based on the Company's debt ratings at March 31, 2010, the margin on the revolving line of credit facility was 0.55% and the facility fee was 0.15%. At March 31, 2010, the Company had \$210 million outstanding under this revolving line of credit facility with a weighted-average effective interest rate of 1.24%. At March 31, 2010, a \$103 million letter of credit is outstanding against its revolving line of credit facility as a result of the Ventas, Inc. ( Ventas ) litigation. For further information regarding the Ventas litigation, see Note 11.

Table of Contents

The Company's revolving line of credit facility contains certain financial restrictions and other customary requirements, including cross-default provisions to other indebtedness. Among other things, these covenants, using terms defined in the agreement (i) limit the ratio of Consolidated Total Indebtedness to Consolidated Total Asset Value to 60%, (ii) limit the ratio of Unsecured Debt to Consolidated Unencumbered Asset Value to 65%, (iii) require a Fixed Charge Coverage ratio of 1.75 times, and (iv) require a formula-determined Minimum Consolidated Tangible Net Worth of \$4.9 billion at March 31, 2010. At March 31, 2010, the Company was in compliance with each of these restrictions and requirements of the revolving line of credit facility.

On March 10, 2010, the Company repaid the total outstanding indebtedness of \$200 million under its term loan. The term loan, with an original maturity of August 1, 2011, was repaid primarily with funds available under the Company's revolving line of credit facility. As a result of the early repayment of the term loan, the Company recognized a charge of \$1.3 million related to unamortized issuance costs. At the time the term loan was paid off, it accrued interest at a rate per annum equal to LIBOR plus 2.00%.

*Senior Unsecured Notes*

At March 31, 2010, the Company had \$3.5 billion in aggregate principal amount of senior unsecured notes outstanding. Interest rates on the notes ranged from 1.16% to 7.07%. The weighted-average effective interest rate on the senior unsecured notes at March 31, 2010 was 6.12%. Discounts and premiums are amortized to interest expense over the term of the related notes. The senior unsecured notes contain certain covenants including limitations on debt, cross-acceleration provisions and other customary terms. At March 31, 2010, the Company believes it was in compliance with these covenants.

*Mortgage and Other Secured Debt*

At March 31, 2010, the Company had \$1.8 billion in mortgage debt secured by 165 healthcare facilities with a carrying value of \$2.3 billion and a participation in a first mortgage loan with a carrying value of \$612 million. Interest rates on the mortgage notes ranged from 0.30% to 8.63% with a weighted average effective rate of 4.97% at March 31, 2010.

Mortgage debt generally requires monthly principal and interest payments, is collateralized by certain properties and is generally non-recourse. Mortgage debt typically restricts transfer of the encumbered properties, prohibits additional liens, restricts prepayment, requires payment of real estate taxes, requires maintenance of the properties in good condition, requires maintenance of insurance on the properties and includes requirements to obtain lender consent to enter into and terminate material leases. Some of the mortgage debt is also cross-collateralized by multiple properties and may require tenants or operators to maintain compliance with the applicable leases or operating agreements of such properties.

*Other Debt*

## Edgar Filing: HCP, INC. - Form 10-Q

At March 31, 2010, the Company had \$97 million of non-interest bearing life care bonds at two of its continuing care retirement communities and non-interest bearing occupancy fee deposits at another of its senior housing facilities, all of which were payable to certain residents of the facilities (collectively, Life Care Bonds). At March 31, 2010, \$41.6 million of the Life Care Bonds were refundable to the residents upon the resident moving out or to their estate upon death, and \$55.4 million of the Life Care Bonds were refundable after the unit is successfully remarketed to a new resident.

### *Debt Maturities*

The following table summarizes the Company's stated debt maturities and scheduled principal repayments, excluding debt premiums and discounts, at March 31, 2010 (in thousands):

| Year               | Bank Line of<br>Credit | Senior<br>Unsecured<br>Notes | Mortgage<br>and Other<br>Secured<br>Debt | Total (1)    |
|--------------------|------------------------|------------------------------|--|--------------|
| 2010 (Nine months) | \$                     | \$ 206,421                   | \$ 97,046                                | \$ 303,467   |
| 2011               | 210,000                | 292,265                      | 146,917                                  | 649,182      |
| 2012               |                        | 250,000                      | 63,776                                   | 313,776      |
| 2013               |                        | 550,000                      | 675,104                                  | 1,225,104    |
| 2014               |                        | 87,000                       | 177,435                                  | 264,435      |
| Thereafter         |                        | 2,150,000                    | 665,680                                  | 2,815,680    |
|                    | \$ 210,000             | \$ 3,535,686                 | \$ 1,825,958                             | \$ 5,571,644 |

---

(1) Excludes \$97 million of other debt that represents non-interest bearing Life Care Bonds and occupancy fee deposits at three of the Company's senior housing facilities, which have no scheduled maturities.

Table of Contents

**(11) Commitments and Contingencies**

*Legal Proceedings*

From time to time, the Company is a party to legal proceedings, lawsuits and other claims that arise in the ordinary course of the Company's business. Regardless of their merits, these matters may force the Company to expend significant financial resources. Except as described herein, the Company is not aware of any other legal proceedings or claims that it believes may have, individually or taken together, a material adverse effect on the Company's business, prospects, financial condition or results of operations. The Company's policy is to accrue legal expenses as they are incurred.

On May 3, 2007, Ventas filed a complaint against the Company in the United States District Court for the Western District of Kentucky asserting claims of tortious interference with contract and tortious interference with prospective business advantage. The complaint alleged, among other things, that the Company interfered with Ventas' purchase agreement with Sunrise Senior Living Real Estate Investment Trust (Sunrise REIT); that the Company interfered with Ventas' prospective business advantage in connection with the Sunrise REIT transaction; and that the Company's actions caused Ventas to suffer damages. As part of the same litigation, the Company filed counterclaims against Ventas as successor to Sunrise REIT. On March 25, 2009, the District Court issued an order dismissing the Company's counterclaims. On April 8, 2009, the Company filed a motion for leave to file amended counterclaims. On May 26, 2009, the District Court denied the Company's motion.

Ventas sought approximately \$300 million in compensatory damages plus punitive damages. On July 16, 2009, the District Court dismissed Ventas's claim that HCP interfered with Ventas's purchase agreement with Sunrise REIT, dismissed claims for compensatory damages based on alleged financing and other costs, and allowed Ventas's claim of interference with prospective advantage to proceed to trial. Ventas's claim was tried before a jury between August 18, 2009 and September 4, 2009. During the trial, the District Court dismissed Ventas's claim for punitive damages. On September 4, 2009, the jury returned a verdict in favor of Ventas in the amount of approximately \$102 million in compensatory damages. The District Court entered a judgment against the Company in that amount on September 8, 2009, which the Company recognized as a provision for litigation expense during the three months ended September 30, 2009.

On September 22, 2009, the Company filed a motion for judgment as a matter of law or for a new trial. Also on September 22, 2009, Ventas filed a motion seeking approximately \$20 million in prejudgment interest and approximately \$4 million in additional damages to account for changes in currency exchange rates. The District Court denied both parties' post-trial motions on November 17, 2009. The Company filed a notice of appeal in the United States Court of Appeals for the Sixth Circuit on November 17, 2009; Ventas filed a notice of appeal on November 25, 2009. The court of appeals has set a briefing schedule for the appeal; the court of appeals has not yet set a date for oral argument.

On June 29, 2009, several of the Company's subsidiaries, together with three of its tenants, filed complaints in the Delaware Court of Chancery against Sunrise Senior Living, Inc. and three of its subsidiaries (Sunrise). A complaint was also filed on behalf of several other of the Company's subsidiaries and one tenant on July 24, 2009 in the United States District Court for the Eastern District of Virginia. The complaints are based on Sunrise's defaults under management and related agreements governing Sunrise's operation of 64 Company subsidiary-owned facilities, 62 of which are leased to the tenants and two of which are leased directly to Sunrise. The complaints generally allege that Sunrise systematically breached various contractual and fiduciary duties by, among other things, (i) failing to maintain licenses necessary to the facilities' operation; (ii) demonstrating a conscious disregard for the facilities' budgets and other controls over expenditures related to the facilities; (iii) failing to provide various marketing and financial reports necessary for the Company's subsidiaries' and the tenants' monitoring of Sunrise's performance; (iv) retaining funds for Sunrise's own benefit, and/or the benefit of its affiliates, that were properly due to the tenants; (v) charging the facilities for inappropriate overhead and similar corporate-level pass-through expenses that should have been borne by Sunrise and/or its affiliates; and

## Edgar Filing: HCP, INC. - Form 10-Q

(vi) obstructing the Company's subsidiaries' and the tenants' contractually-prescribed audits of Sunrise's operation of the facilities. The Company's subsidiaries also allege that Sunrise's policies constitute a breach of fiduciary duties to the Company's subsidiaries and the tenants. The Company's subsidiaries and tenants are generally seeking judicial confirmation of Sunrise's material defaults of the management agreements and the Company's subsidiaries' and tenants' rights to terminate the agreements for the 64 communities, and associated injunctive relief requiring Sunrise to vacate the facilities after cooperating in the transition of the facilities to another operator. In addition, the Company subsidiaries and tenants are seeking monetary damages related to the defaults. With regard to two of the Company's subsidiary-owned facilities in the State of New York, the relevant Company's subsidiary and tenant also seek judicial confirmation of the impossibility of the parties' performance under the applicable management agreements due to the passage and implementation of new state legislation and related regulations.

Table of Contents

In response to each of the complaints, Sunrise has asserted counterclaims against the Company, and certain of its subsidiaries and tenants alleging that (i) such subsidiaries and tenants have breached contractual duties and the implied covenant of good faith and fair dealing under the management and related agreements; (ii) the Company and its relevant subsidiaries have intentionally interfered with tenants' performance of the management agreements; and (iii) the Company, its relevant subsidiaries and tenants have conspired to harm Sunrise's business and reputation.

A trial has been scheduled to commence on June 1, 2010 for the complaint filed in the Eastern District of Virginia. A trial date has not yet been set for the complaints filed in the Delaware Court of Chancery. The Company expects that enforcing its and the Companies' subsidiaries' rights, and potentially defending against Sunrise's counterclaims, will require it to expend significant funds. There can be no assurance that the Company's subsidiaries or its tenants will prevail in their claims against Sunrise or in defending against Sunrise's counterclaims.

*Concentration of Credit Risk*

Concentrations of credit risks arise when a number of operators, tenants or obligors related to the Company's investments are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations, including those to the Company, to be similarly affected by changes in economic conditions. The Company regularly monitors various segments of its portfolio to assess potential concentrations of risks. Management believes the current portfolio is reasonably diversified across healthcare related real estate and does not contain any other significant concentration of credit risks, except as disclosed herein. The Company does not have significant foreign operations.

At March 31, 2010, the Company had investments in mezzanine and secured loans to HCR ManorCare with an aggregate par value of \$1.72 billion and a carrying value of \$1.55 billion. At December 31, 2009, the Company had investments in mezzanine and secured loans to HCR ManorCare with an aggregate par value of \$1.72 billion and a carrying value of \$1.54 billion. At March 31, 2010 and December 31, 2009, the carrying value of these investments represented approximately 86% and 85%, respectively, of the Company's skilled nursing segment assets and 13% and 13%, respectively, of total assets. For the three months ended March 31, 2010 and 2009, the Company recognized \$27 million and \$15 million, respectively, in interest income from these investments, which represents approximately 73% and 62%, respectively, of the Company's skilled nursing segment revenues and 0% and 6%, respectively, of total revenues.

At March 31, 2010, Sunrise operated 75 of the Company's senior housing facilities. Sunrise is a publicly traded company and is subject to the informational filing requirements of the Securities Exchange Act of 1934, as amended, and is required to file periodic reports on Form 10-K and Form 10-Q with the SEC. Among other things, Sunrise has disclosed that as of December 31, 2009, it has no borrowing availability under its bank credit facility, has significant scheduled debt maturities in 2010 and significant long-term debt that is in default. At March 31, 2010 and December 31, 2009, the aggregate carrying value of the Company's gross assets leased to Sunrise represented approximately 40% and 40%, respectively, of the Company's senior housing segment assets and 5% and 14%, respectively, of total assets. For the three months ended March 31, 2010 and 2009, the Company recognized \$30 million and \$28 million, respectively, in revenues from facilities operated by Sunrise, which represents approximately 35% and 34%, respectively of the Company's senior housing segment revenues and 0% and 10%, respectively, of total revenues.

To mitigate credit risk of certain senior housing leases, leases are combined into portfolios that contain cross-default terms, so that if a tenant of any of the properties in a portfolio defaults on its obligations under its lease, the Company may pursue its remedies under the lease with respect

## Edgar Filing: HCP, INC. - Form 10-Q

to any of the properties in the portfolio. Certain portfolios also contain terms whereby the net operating profits of the properties are combined for the purpose of securing the funding of rental payments due under each lease.

### *DownREIT LLCs*

In connection with the formation of certain DownREIT limited liability companies ( LLCs ), members may contribute appreciated real estate to the DownREIT LLC in exchange for DownREIT units. These contributions are generally tax-deferred, so that the pre-contribution gain related to the property is not taxed to the member. However, if the contributed property is later sold by the DownREIT LLC, the unamortized pre-contribution gain that exists at the date of sale is specially allocated and taxed to the contributing members. In many of the DownREITs, the Company has entered into indemnification agreements with those members who contributed appreciated property into the DownREIT LLC. Under these indemnification agreements, if any of the appreciated real estate contributed by the members is sold by the DownREIT LLC in a taxable transaction within a specified number of years, the Company will reimburse the affected members for the federal and state income taxes associated with the pre-contribution gain that is specially allocated to the affected member under the Internal

Table of Contents

Revenue Code of 1986, as amended ( make-whole payments ). These make-whole payments include a tax gross-up provision. At March 31, 2010, there were 4.2 million non-managing member units outstanding in six DownREIT LLCs, for all of which the Company is the managing member. At March 31, 2010, the carrying value and market value of the 4.2 million DownREIT units were \$168.6 million and \$192.7 million, respectively.

*Credit Enhancement Guarantee*

Certain of the Company's senior housing facilities serve as collateral for \$131 million of debt (maturing May 1, 2025) that is owed by a previous owner of the facilities. This indebtedness is guaranteed by the previous owner who has an investment grade credit rating. These senior housing facilities, which are classified as DFLs, had a carrying value of \$358 million as of March 31, 2010.

**(12) Equity**

*Preferred Stock*

At March 31, 2010, the Company had two series of preferred stock outstanding, Series E and Series F preferred stock. The Series E and Series F preferred stock have no stated maturity, are not subject to any sinking fund or mandatory redemption and are not convertible into any other securities of the Company. Holders of each series of preferred stock generally have no voting rights, except under limited conditions, and all holders are entitled to receive cumulative preferential dividends based upon each series' respective liquidation preference. To preserve the Company's status as a REIT, each series of preferred stock is subject to certain restrictions on ownership and transfer. Dividends are payable quarterly in arrears on the last day of March, June, September and December. The Series E and Series F preferred stock are currently redeemable at the Company's option.

On February 1, 2010, the Company announced that its Board declared a quarterly cash dividend of \$0.45313 per share on its Series E cumulative redeemable preferred stock and \$0.44375 per share on its Series F cumulative redeemable preferred stock. These dividends were paid on March 31, 2010 to stockholders of record as of the close of business on March 15, 2010.

On April 22, 2010, the Company announced that its Board declared a quarterly cash dividend of \$0.45313 per share on its Series E cumulative redeemable preferred stock and \$0.44375 per share on its Series F cumulative redeemable preferred stock. These dividends will be paid on June 30, 2010 to stockholders of record as of the close of business on June 15, 2010.

*Common Stock*



## Edgar Filing: HCP, INC. - Form 10-Q

The following is a summary of the Company's common stock issuances:

|  | Three Months Ended March 31, |      |
|--|------------------------------|------|
|  | 2010                         | 2009 |
|  | (in thousands)               |      |
| Dividend Reinvestment and Stock Purchase Plan ( DRIP ) | 82                           | 34   |
| Conversion of DownREIT units                           | 46                           | 9    |
| Exercise of stock options                              | 3                            |      |
| Restricted stock awards ( RSAs )(1)                    | 177                          | 249  |
| Restricted stock units ( RSUs )(1)                     | 255                          | 182  |

---

(1) Issued under the Company's 2006 Performance Incentive Plan.

On February 1, 2010, the Company announced that its Board declared a quarterly cash dividend of \$0.465 per share. The common stock cash dividend was paid on February 23, 2010 to stockholders of record as of the close of business on February 11, 2010.

On April 22, 2010, the Company announced that its Board declared a quarterly cash dividend of \$0.465 per share. The common stock cash dividend will be paid on May 18, 2010 to stockholders of record as of the close of business on May 3, 2010.

Table of Contents*Accumulated Other Comprehensive Income (Loss) ( AOCI )*

The following is a summary of the Company's accumulated other comprehensive income (loss):

|   | <b>March 31,<br/>2010</b> | <b>December 31,<br/>2009</b> |
|---|---------------------------|------------------------------|
|   | <b>(in thousands)</b>     |                              |
| AOCI unrealized gains on available-for-sale securities, net | \$ 11,826                 | \$ 11,805                    |
| AOCI unrealized losses on cash flow hedges, net             | (9,116)                   | (10,769)                     |
| Supplemental Executive Retirement Plan minimum liability    | (2,310)                   | (2,342)                      |
| Cumulative foreign currency translation adjustment          | (806)                     | (828)                        |
| Total accumulated other comprehensive loss                  | \$ (406)                  | \$ (2,134)                   |

*Total Comprehensive Income*

The following table provides a reconciliation of comprehensive income (in thousands):

|                            | <b>Three Months Ended March 31,<br/>2010</b> |        | <b>2009</b> |        |
|----------------------------|--|--------|-------------|--------|
| Net income                 | \$   | 84,101 | \$          | 52,709 |
| Other comprehensive income |  | 1,728  |             | 3,693  |
| Total comprehensive income | \$   | 85,829 | \$          | 56,402 |

**(13) Segment Disclosures**

The Company evaluates its business and makes resource allocations based on its five business segments: (i) senior housing, (ii) life science, (iii) medical office, (iv) hospital and (v) skilled nursing. Under the senior housing, life science, hospital and skilled nursing segments, the Company invests primarily in single operator or tenant properties, through the acquisition and development of real estate or through investment in debt issued by operators in these sectors. Under the medical office segment, the Company invests through the acquisition of MOBs that are primarily leased under gross or modified gross leases, which are generally to multiple tenants and require a greater level of property management. The accounting policies of the segments are the same as those described in Note 2 to the Consolidated Financial Statements for the year ended December 31, 2009 in the Company's Annual Report on Form 10-K filed with the SEC. There were no intersegment sales or transfers during the three months ended March 31, 2010 and 2009. The Company evaluates performance based upon property net operating income from continuing operations ( NOI ) and interest income of the combined investments in each segment.

Non-segment assets consist primarily of real estate held for sale and corporate assets including cash, restricted cash, accounts receivable, net and deferred financing costs. Interest expense, depreciation and amortization and non-property specific revenues and expenses are not allocated to individual segments in determining the Company's performance measure. See Note 11 for other information regarding concentrations of credit risk.

Edgar Filing: HCP, INC. - Form 10-Q

Summary information for the reportable segments follows (in thousands):

For the three months ended March 31, 2010:

| Segments        | Rental and<br>Related<br>Revenues | Tenant<br>Recoveries | Income<br>From<br>DFLs | Interest<br>Income | Investment<br>Management<br>Fees | Total<br>Revenues | NOI(1)     |
|-----------------|-----------------------------------|----------------------|------------------------|--------------------|----------------------------------|-------------------|------------|
| Senior housing  | \$ 73,004                         | \$                   | \$ 12,215              | \$ 126             | \$ 700                           | \$ 86,045         | \$ 84,289  |
| Life science    | 58,624                            | 9,650                |                        |                    | 1                                | 68,275            | 56,692     |
| Medical office  | 65,256                            | 11,618               |                        |                    | 607                              | 77,481            | 45,527     |
| Hospital        | 18,845                            | 518                  |                        | 7,533              |                                  | 26,896            | 17,154     |
| Skilled nursing | 9,610                             |                      |                        | 27,607             |                                  | 37,217            | 9,561      |
| Total           | \$ 225,339                        | \$ 21,786            | \$ 12,215              | \$ 35,266          | \$ 1,308                         | \$ 295,914        | \$ 213,223 |

Edgar Filing: HCP, INC. - Form 10-Q

Table of Contents

For the three months ended March 31, 2009:

| Segments        | Rental and Related Revenues | Tenant Recoveries | Income From DFLs | Interest Income | Investment Management Fees | Total Revenues | NOI(1)     |
|-----------------|-----------------------------|-------------------|------------------|-----------------|----------------------------|----------------|------------|
| Senior housing  | \$ 68,741                   | \$                | \$ 12,925        | \$ 326          | \$ 783                     | \$ 82,775      | \$ 78,805  |
| Life science    | 52,044                      | 11,094            |                  |                 | 1                          | 63,139         | 51,696     |
| Medical office  | 65,071                      | 12,023            |                  |                 | 654                        | 77,748         | 44,305     |
| Hospital        | 17,468                      | 533               |                  | 10,783          |                            | 28,784         | 17,202     |
| Skilled nursing | 8,902                       |                   |                  | 15,662          |                            | 24,564         | 8,840      |
| Total           | \$ 212,226                  | \$ 23,650         | \$ 12,925        | \$ 26,771       | \$ 1,438                   | \$ 277,010     | \$ 200,848 |

(1) NOI is a non-GAAP supplemental financial measure used to evaluate the operating performance of real estate. The Company defines NOI as rental revenues, including tenant recoveries and income from direct financing leases, less property level operating expenses. NOI excludes interest income, investment management fee income, depreciation and amortization, general and administrative expenses, impairments, impairment recoveries, other income, net, interest expense, income taxes, equity income from unconsolidated joint ventures and discontinued operations. The Company believes NOI provides investors relevant and useful information because it measures the operating performance of the Company's real estate at the property level on an unleveraged basis. The Company uses NOI to make decisions about resource allocations and assess property level performance. The Company believes that net income is the most directly comparable GAAP measure to NOI. NOI should not be viewed as an alternative measure of operating performance to net income as defined by GAAP since it does not reflect the aforementioned excluded items. Further, the Company's definition of NOI may not be comparable to the definition used by other REITs, as those companies may use different methodologies for calculating NOI.

The following is a reconciliation from NOI to reported net income, the most direct comparable financial measure calculated and presented in accordance with GAAP (in thousands):

|   | Three Months Ended March 31, |            |
|---|------------------------------|------------|
|   | 2010                         | 2009       |
| <b>Net operating income from continuing operations</b>  | \$ 213,223                   | \$ 200,848 |
| Interest income   | 35,266                       | 26,771     |
| Investment management fee income                        | 1,308                        | 1,438      |
| Depreciation and amortization                           | (78,147)                     | (80,223)   |
| General and administrative                              | (24,924)                     | (18,531)   |
| Impairment recoveries                                   | 11,900                       |            |
| Other income, net                                       | 356                          | (2,438)    |
| Interest expense  | (75,956)                     | (76,674)   |
| Income taxes  | (387)                        | (888)      |
| Equity income (loss) from unconsolidated joint ventures | 1,383                        | (462)      |
| Total discontinued operations                           | 79                           | 2,868      |
| <b>Net income</b>                                       | \$ 84,101                    | \$ 52,709  |

The Company's total assets by segment were:

March 31, December 31,

Edgar Filing: HCP, INC. - Form 10-Q

| Segments                                  | 2010          | 2009          |
|---|---------------|---------------|
| Senior housing                            | \$ 4,367,156  | \$ 4,342,607  |
| Life science                              | 3,603,203     | 3,593,550     |
| Medical office                            | 2,227,979     | 2,249,721     |
| Hospital                                  | 947,098       | 947,120       |
| Skilled nursing                           | 1,814,243     | 1,801,521     |
| Gross segment assets                      | 12,959,679    | 12,934,519    |
| Accumulated depreciation and amortization | (1,264,618)   | (1,220,599)   |
| Net segment assets                        | 11,695,061    | 11,713,920    |
| Real estate held for sale, net            | 12,638        | 13,461        |
| Non-segment assets                        | 431,871       | 482,354       |
| Total assets                              | \$ 12,139,570 | \$ 12,209,735 |

Table of Contents

On October 5, 2006, simultaneous with the closing of the Company's merger with CNL Retirement Properties, Inc. ( CRP ), the Company also merged with CNL Retirement Corp. ( CRC ). CRP was a REIT that invested primarily in senior housing and MOB's. Under the purchase method of accounting, the assets and liabilities of CRC were recorded at their estimated relative fair values, with \$51.7 million paid in excess of the estimated fair value of CRC's assets and liabilities recorded as goodwill. The CRC goodwill amount was allocated in proportion to the assets of the Company's reporting units (property sectors) subsequent to the CRP acquisition.

At March 31, 2010, goodwill was allocated to segment assets as follows: (i) senior housing \$30.5 million, (ii) medical office \$11.4 million, (iii) hospital \$5.1 million, and (iv) skilled nursing \$3.3 million. Due to a decrease in our market capitalization during the first quarter of 2009, we performed an interim assessment of goodwill. In connection with this review, the Company recognized an impairment charge of \$1.4 million, included in other income, net, for the goodwill allocated to the life science segment.

**(14) Earnings Per Common Share**

The following table illustrates the computation of basic and diluted earnings per share (dollars in thousands, except per share amounts):

|   | <b>Three Months Ended March 31,</b> |             |
|---|-------------------------------------|-------------|
|   | <b>2010</b>                         | <b>2009</b> |
| <b>Numerator</b>  |                                     |             |
| Income from continuing operations                             | \$ 84,022                           | \$ 49,841   |
| Noncontrolling interests' share in continuing operations      | (3,065)                             | (3,826)     |
| Income from continuing operations applicable to HCP, Inc.     | 80,957                              | 46,015      |
| Preferred stock dividends                                     | (5,283)                             | (5,283)     |
| Participating securities' share in continuing operations      | (917)                               | (315)       |
| Income from continuing operations applicable to common shares | 74,757                              | 40,417      |
| Discontinued operations                                       | 79                                  | 2,868       |
| Net income applicable to common shares                        | \$ 74,836                           | \$ 43,285   |
| <b>Denominator</b>  |                                     |             |
| Basic weighted average common shares                          | 293,223                             | 253,335     |
| Dilutive stock options and restricted stock                   | 864                                 | 88          |
| Diluted weighted average common shares                        | 294,087                             | 253,423     |
| <b>Basic earnings per common share</b>                        |                                     |             |
| Income from continuing operations                             | \$ 0.26                             | \$ 0.16     |
| Discontinued operations                                       |                                     | 0.01        |
| Net income applicable to common stockholders                  | \$ 0.26                             | \$ 0.17     |
| <b>Diluted earnings per common share</b>                      |                                     |             |
| Income from continuing operations                             | \$ 0.25                             | \$ 0.16     |
| Discontinued operations                                       |                                     | 0.01        |
| Net income applicable to common shares                        | \$ 0.25                             | \$ 0.17     |

Restricted stock and certain of the Company's performance restricted stock units are considered participating securities which require the use of the two-class method when computing basic and diluted earnings per share. For the three months ended March 31, 2010 and 2009, earnings representing nonforfeitable dividends of \$0.9 million and \$0.3 million, respectively, were allocated to the participating securities.

Options to purchase approximately 2.6 million and 6.2 million shares of common stock that had an exercise price in excess of the average market price of the common stock during the three months ended March 31, 2010 and 2009, respectively, were not included because they are anti-dilutive. Restricted stock and performance restricted stock units representing 86,000 and 0.6 million shares of common stock during the three months ended March 31, 2010 and 2009, respectively, were not included because they are anti-dilutive. Additionally, 5.8 million shares issuable upon conversion of 4.2 million DownREIT units during the three months ended March 31, 2010 were not included since they are anti-dilutive. During the three months ended March 31, 2009, 6.4 million shares issuable upon conversion of 4.8 million DownREIT units were not included since they were anti-dilutive.

Table of Contents**(15) Supplemental Cash Flow Information**

|   | <b>Three Months Ended March 31,</b> |             |
|---|-------------------------------------|-------------|
|   | <b>2010</b>                         | <b>2009</b> |
|   | <b>(in thousands)</b>               |             |
| <i>Supplemental cash flow information:</i>  |                                     |             |
| Interest paid, net of capitalized interest  | \$ 89,965                           | \$ 94,252   |
| Taxes paid  | 526                                 | 360         |
| <i>Supplemental schedule of non-cash investing activities:</i>  |                                     |             |
| Capitalized interest  | 5,050                               | 6,020       |
| Increase (decrease) in accrued construction costs   | 1,412                               | (1,820)     |
| Loan received upon real estate disposition  |                                     | 251         |
| <i>Supplemental schedule of non-cash financing activities:</i>  |                                     |             |
| Restricted stock issued   | 177                                 | 249         |
| Vesting of restricted stock units   | 255                                 | 182         |
| Cancellation of restricted stock  | (6)                                 | (12)        |
| Conversion of non-managing member units into common stock   | 1,885                               | 246         |
| Unrealized gains on available-for-sale securities and derivatives designated as cash flow hedges, net | 1,260                               | 3,748       |

**(16) Variable Interest Entities**

At March 31, 2010, the Company leased 75 properties to a total of 11 tenants ( VIE tenants ) and had a loan to a borrower where each tenant and borrower has been identified as a VIE. On December 21, 2007, the Company made an investment of approximately \$900 million in mezzanine loans where each mezzanine borrower has been identified as a VIE. The Company has determined that it is not the primary beneficiary of these VIEs.

The carrying value and classification of the related assets, liabilities and maximum exposure to loss as a result of the Company's involvement with VIEs are presented below (in thousands):

| VIE Type                     | Maximum Loss Exposure(1) | Asset/Liability Type                                      | Carrying Amount |
|------------------------------|--------------------------|---|-----------------|
| VIE tenants operating leases | \$ 647,470               | Lease intangibles, net and straight-line rent receivables | \$ 10,624       |
| VIE tenants DFLs             | 1,268,253                | Net investment in DFLs                                    | 574,241         |
| Senior secured loans         | 85,776                   | Loans receivable, net                                     | 85,776          |
| Mezzanine loans              | 938,862                  | Loans receivable, net                                     | 938,862         |

(1) The Company's maximum loss exposure related to the VIE tenants represents the future minimum lease payments over the remaining term of the respective leases, which may be mitigated by re-leasing the properties to new tenants. The Company's maximum loss exposure related to loans to VIEs represents their current aggregate carrying value.



## Edgar Filing: HCP, INC. - Form 10-Q

See Notes 5, 6 and 11 for additional description of the nature, purpose and activities of the Company's VIEs and interests therein.

### **(17) Fair Value Measurements**

The following table illustrates the Company's fair value measurements of its financial assets and liabilities measured at fair value in the Company's condensed consolidated financial statements. Recognized gains and losses are recorded in other income, net on the Company's condensed consolidated statements of income. During the three months ended March, 31, 2010, there were no transfers of financial assets or liabilities between levels.

## Edgar Filing: HCP, INC. - Form 10-Q

### Table of Contents

The following is a summary of fair value measurements of financial assets and liabilities at March 31, 2010 (in thousands):

| Financial Instrument              | Fair Value | Level 1    | Level 2   | Level 3  |
|-----------------------------------|------------|------------|-----------|----------|
| Marketable debt securities        | \$ 171,764 | \$ 150,864 | \$ 20,900 |          |
| Marketable equity securities      | 4,537      | 4,537      |           |          |
| Interest-rate swap assets(1)      | 6,026      |            | 6,026     |          |
| Interest-rate swap liabilities(1) | (3,722)    |            | (3,722)   |          |
| Warrants(1)                       | 1,539      |            |           | 1,539    |
|                                   | \$ 180,144 | \$ 155,401 | \$ 23,204 | \$ 1,539 |

(1) Interest-rate swaps and common stock warrants are valued using observable and unobservable market assumptions, as well as standardized derivative pricing models.

### **(18) Disclosures About Fair Value of Financial Instruments**

The carrying values of cash and cash equivalents, restricted cash, receivables, payables, and accrued liabilities are reasonable estimates of fair value because of the short-term maturities of these instruments. Fair values for loans receivable, bank line of credit, term loan, mortgage and other secured debt, and other debt are estimates based on rates currently prevailing for similar instruments of similar maturities. The estimated fair values of the interest-rate swaps and warrants were determined based on observable market assumptions and standardized derivative pricing models. The fair values of the senior unsecured notes and marketable equity and debt securities were determined based on market quotes.

|                                 | March 31, 2010 |              | December 31, 2009 |              |
|---------------------------------|----------------|--------------|-------------------|--------------|
|                                 | Carrying Value | Fair Value   | Carrying Value    | Fair Value   |
|                                 | (in thousands) |              |                   |              |
| Loans receivable, net           | \$ 1,687,415   | \$ 1,739,083 | \$ 1,672,938      | \$ 1,728,599 |
| Marketable debt securities      | 171,764        | 171,764      | 172,799           | 172,799      |
| Marketable equity securities    | 4,537          | 4,537        | 3,521             | 3,521        |
| Warrants                        | 1,539          | 1,539        | 1,732             | 1,732        |
| Bank line of credit             | 210,000        | 210,000      |                   |              |
| Term loan                       |                |              | 200,000           | 200,000      |
| Senior unsecured notes          | 3,523,339      | 3,650,667    | 3,521,325         | 3,548,926    |
| Mortgage and other secured debt | 1,828,637      | 1,802,277    | 1,834,935         | 1,789,992    |
| Other debt                      | 97,023         | 97,023       | 99,883            | 99,883       |
| Interest-rate swap assets       | 6,026          | 6,026        | 3,523             | 3,523        |
| Interest-rate swap liabilities  | 3,722          | 3,722        | 3,438             | 3,438        |

### **(19) Derivative Instruments**

The following table summarizes the Company's outstanding interest-rate swap contracts as of March 31, 2010 (dollars in thousands):

Edgar Filing: HCP, INC. - Form 10-Q

| Date Entered   | Maturity Date  | Hedge Designation | Fixed Rate | Floating Rate Index | Notional Amount | Fair Value(1) |
|----------------|----------------|-------------------|------------|---------------------|-----------------|---------------|
| July 2005(2)   | July 2020      | Cash Flow         | 3.82%      | BMA Swap Index      | \$ 45,600       | \$ (3,423)    |
| June 2009(3)   | September 2011 | Fair Value        | 5.95%      | 1 Month LIBOR+4.21% | 250,000         | 3,233         |
| July 2009(4)   | July 2013      | Cash Flow         | 6.13%      | 1 Month LIBOR+3.65% | 14,400          | (299)         |
| August 2009(5) | February 2011  | Cash Flow         | 0.87%      | 1 Month LIBOR       | 250,000         | 955           |
| August 2009(5) | August 2011    | Cash Flow         | 1.24%      | 1 Month LIBOR       | 250,000         | 1,838         |

---

(1) Interest-rate swap assets are recorded in other assets, net and interest-rate swap liabilities are recorded in accounts payable and accrued liabilities on the condensed consolidated balance sheets.

(2) Represents three interest-rate swap contracts with an aggregate notional amount of \$45.6 million, which hedge fluctuations in interest payments on variable-rate secured debt due to overall changes in hedged cash flows.

(3) Hedges the changes in fair value of the Company's outstanding senior unsecured fixed-rate notes (approximately 86% of the notes maturing in September 2011) due to fluctuations in the underlying benchmark interest rate.

(4) Hedges fluctuations in interest payments on variable-rate secured debt due to fluctuations in the underlying benchmark interest rate.

(5) Hedges fluctuations in interest receipts on a participation interest in a floating-rate secured mortgage note due to fluctuations in the underlying benchmark interest rate.

Table of Contents

The Company uses derivative instruments to mitigate the effects of interest rate fluctuations on specific forecasted transactions as well as recognized obligations or assets. The Company does not use derivative instruments for speculative or trading purposes.

The primary risks associated with derivative instruments are market and credit risk. Market risk is defined as the potential for loss in value of a derivative instrument due to adverse changes in market prices (interest rates). Utilizing derivative instruments allows the Company to effectively manage the risk of fluctuations in interest rates with respect to the potential effects these changes could have on future earnings, forecasted cash flows and the fair value of recognized obligations.

Credit risk is the risk that one of the parties to a derivative contract fails to perform or meet their financial obligation. The Company does not obtain collateral associated with its derivative instruments, but monitors the credit standing of its counterparties on a regular basis. Should a counterparty fail to perform, the Company would incur a financial loss to the extent that the associated derivative contract was in an asset position. At March 31, 2010, the Company does not anticipate non-performance by the counterparties to its outstanding derivative contracts.

During October and November 2007, the Company entered into two forward-starting interest-rate swap contracts with an aggregate notional amount of \$900 million and settled the contracts during the three months ended June 30, 2008. The settlement value, less the ineffective portion of the hedging relationships, was recorded to accumulated other comprehensive income to be reclassified into interest expense over the forecasted term of the underlying unsecured fixed-rate debt. The interest-rate swap contracts were designated in qualifying, cash flow hedging relationships, to hedge the Company's exposure to fluctuations in the benchmark interest rate component of interest payments on forecasted, unsecured, fixed-rate debt currently expected to be issued in 2010 and 2011. At March 31, 2010, the Company revised its estimated issuance date for the underlying unsecured, fixed-rate debt. As a result, the Company recognized a \$0.3 million charge in other income, net related to the interest payments that are no longer probable of occurring.

At March 31, 2010, the Company expects that the hedged forecasted transactions, for each of the outstanding qualifying cash flow hedging relationships, remain probable of occurring and no additional gains or losses recorded to accumulated other comprehensive income (loss) are expected to be reclassified to earnings as a result.

To illustrate the effect of movements in the interest rate markets, the Company performed a market sensitivity analysis on its hedging instruments. The Company applied various basis point spreads, to the underlying interest rate curves of the derivative portfolio in order to determine the instruments' change in estimated fair value. Assuming a one percentage point change in the underlying interest rate curve, the estimated change in fair value of each of the underlying derivative instruments would not exceed \$4.2 million.

Table of Contents

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

**Cautionary Language Regarding Forward-Looking Statements**

Statements in this Quarterly Report on Form 10-Q that are not historical factual statements are forward-looking statements. We intend to have our forward-looking statements covered by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 and include this statement for purposes of complying with those provisions. Forward-looking statements include, among other things, statements regarding our and our officers' intent, belief or expectations as identified by the use of words such as may, will, project, expect, believe, intend, anticipate, forecast, plan, estimate, could, would, should and other comparable and derivative terms or the negatives thereof. In addition, we, through our officers, from time to time, make forward-looking oral and written public statements concerning our expected future operations, strategies, securities offerings, growth and investment opportunities, dispositions, capital structure changes, budgets and other developments. Readers are cautioned that, while forward-looking statements reflect our good faith belief and reasonable assumptions based upon current information, we can give no assurance that our expectations or forecasts will be attained. Therefore, readers should be mindful that forward-looking statements are not guarantees of future performance and that they are subject to known and unknown risks and uncertainties that are difficult to predict. As more fully set forth under Part I, Item 1A. Risk Factors in the Company's Annual report on Form 10-K for the fiscal year ended December 31, 2009, factors that may cause our actual results to differ materially from the expectations contained in the forward-looking statements include:

- (a) Changes in national and local economic conditions, including a prolonged recession;
- (b) Continued volatility in the capital markets, including changes in interest rates and the availability and cost of capital;
- (c) The ability of the Company to manage its indebtedness level and changes in the terms of such indebtedness;
- (d) Changes in federal, state or local laws and regulations, including those affecting the healthcare industry that affect our costs of compliance or increase the costs, or otherwise affect the operations of our operators, tenants and borrowers;
- (e) The potential impact of existing and future litigation matters, including the possibility of larger than expected litigation costs and related developments;
- (f) Competition for tenants and borrowers, including with respect to new leases and mortgages and the renewal or rollover of existing leases;

## Edgar Filing: HCP, INC. - Form 10-Q

- (g) The ability of the Company to negotiate the same or better terms with new tenants or operators if existing leases are not renewed or the Company exercises its right to replace an existing operator or tenant upon default;
- (h) Availability of suitable properties to acquire at favorable prices and the competition for the acquisition and financing of those properties;
- (i) The ability of our operators, tenants and borrowers to conduct their respective businesses in a manner sufficient to maintain or increase their revenues and to generate sufficient income to make rent and loan payments to us;
- (j) The financial weakness of some operators and tenants, including potential bankruptcies and downturns in their businesses, which results in uncertainties regarding our ability to continue to realize the full benefit of such operators' and/or tenants' leases;
- (k) The risk that we will not be able to sell or lease properties that are currently vacant, at all or at competitive rates;
- (l) The financial, legal and regulatory difficulties of significant operators of our properties, including Sunrise Senior Living, Inc. ( Sunrise );
- (m) The risk that we may not be able to achieve the benefits of investments within expected time-frames or at all, or within expected cost projections;
- (n) The ability to obtain financing necessary to consummate acquisitions on favorable terms; and
- (o) Changes in the reimbursement available to our tenants and borrowers by governmental or private payors, including changes in Medicare and Medicaid payment levels and the availability and cost of third party insurance coverage.

Except as required by law, we undertake no, and hereby disclaim any, obligation to update any forward-looking statements, whether as a result of new information, changed circumstances or otherwise.

Table of Contents

The information set forth in this Item 2 is intended to provide readers with an understanding of our financial condition, changes in financial condition and results of operations. We will discuss and provide our analysis in the following order:

- Executive Summary
  
- 2010 Transaction Overview
  
- Dividends
  
- Critical Accounting Policies
  
- Results of Operations
  
- Liquidity and Capital Resources
  
- Off-Balance Sheet Arrangements
  
- Contractual Obligations
  
- Inflation
  
- Recent Accounting Pronouncements

**Executive Summary**

## Edgar Filing: HCP, INC. - Form 10-Q

We are a self-administered REIT that, together with our consolidated subsidiaries, invests primarily in real estate serving the healthcare industry in the United States ( U.S. ). We acquire, develop, lease, manage and dispose of healthcare real estate and provide financing to healthcare providers. At March 31, 2010, our portfolio of investments, excluding assets held for sale, but including properties owned by our Investment Management Platform, consisted of interests in 677 facilities and \$1.9 billion of mezzanine and other secured loan investments. Our Investment Management Platform represents the following joint ventures: (i) HCP Ventures II, (ii) HCP Ventures III, LLC, (iii) HCP Ventures IV, LLC and (iv) the HCP Life Science ventures.

Our business strategy is based on three principles: (i) opportunistic investing, (ii) portfolio diversification, and (iii) conservative financing. We actively seek to redeploy capital from investments with lower return potential into assets with higher return potential. We make investments where the expected risk-adjusted return exceeds our cost of capital and strive to leverage our operator, tenant and other business relationships.

Our strategy sometimes involves structuring transactions that are tax-advantaged. Generally, we prefer larger, more complex private transactions that leverage our management team's experience and our infrastructure. We follow a disciplined approach to enhancing the value of our existing portfolio, including ongoing evaluation of potential disposition of properties and other investments that no longer fit our strategy. We always seek to mitigate risks in our underwriting process.

We primarily generate revenue by leasing healthcare properties under long-term leases. Most of our rents and other earned income from leases are received under triple-net leases or leases that provide for substantial recovery of operating expenses; however, some of our medical office and life science leases are structured as gross or modified gross leases. Accordingly, for such medical office buildings ( MOBs ) and life science facilities we incur certain property operating expenses, such as real estate taxes, repairs and maintenance, property management fees, utilities and insurance. Our growth for these assets depends, in part, on our ability to (i) increase rental income and other earned income from leases by increasing rental rates and occupancy levels; (ii) maximize tenant recoveries given the underlying lease structures; and (iii) control operating and other expenses. Our operations are impacted by property specific, market specific, general economic and other conditions.

Access to capital markets impacts our cost of capital and ability to refinance maturing indebtedness, as well as to fund future acquisitions and development through the issuance of additional securities or secured debt. Access to external capital on favorable terms is critical to the success of our strategy.



Table of Contents

**2010 Transaction Overview**

*Investments*

During the three months ended March 31, 2010, we made investments of \$36 million, which included the acquisition of a senior housing facility for \$9 million and funding of \$27 million for construction and other capital projects primarily in our life science segment.

During the three months ended March 31, 2010, three life science facilities located in South San Francisco were placed in service representing 329,000 square feet.

*Financings*

On March 10, 2010, we repaid the total outstanding indebtedness of \$200 million under our term loan. The term loan, with an original maturity of August 1, 2011, was repaid primarily with funds available under our revolving line of credit facility. As a result of the early repayment of the term loan, we recognized a charge of \$1.3 million related to unamortized issuance costs.

*Erickson Settlement*

In February 2010, we entered into a settlement agreement with Erickson Retirement Communities ( Erickson ), which filed for bankruptcy in October 2009. On April 15, 2010, the bankruptcy court approved the settlement agreement and confirmed Erickson 's final plan of reorganization. The settlement agreement and plan of reorganization provide that we will, concurrently with the closing of the sale of Erickson 's assets, be entitled to: (i) retain deposits held by us with balances of \$5 million as of March 31, 2010; and (ii) receive an additional \$9.6 million. The closing is expected to occur on April 30, 2010, and remains subject to customary closing conditions. As a result, during the quarter ended March 31, 2010, we recognized aggregate income of \$11.9 million, which represents impairment recoveries of portions of previous impairment charges related to investments in three direct financing leases ( DFLs ) and a participation interest in a senior construction loan related to Erickson.

**Dividends**

On April 22, 2010, we announced that our Board declared a quarterly common stock cash dividend of \$0.465 per share. The common stock dividend will be paid on May 18, 2010 to stockholders of record as of the close of business on May 3, 2010.

**Critical Accounting Policies**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles ( GAAP ) requires our management to use judgment in the application of accounting policies, including making estimates and assumptions. We base estimates on the best information available to us at the time, our experience and on various other assumptions believed to be reasonable under the circumstances. These estimates affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. If our judgment or interpretation of the facts and circumstances relating to various transactions or other matters had been different, it is possible that different accounting would have been applied, resulting in a different presentation of our financial statements. From time to time, we re-evaluate our estimates and assumptions. In the event estimates or assumptions prove to be different from actual results, adjustments are made in subsequent periods to reflect more current estimates and assumptions about matters that are inherently uncertain. A summary of our critical accounting policies is included in our Annual Report on Form 10-K for the year ended December 31, 2009 in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations. There have been no significant changes to such policies for the three months ended March 31, 2010, except for our policy regarding principles of consolidation, which we have updated to address the new requirements of Accounting Standards Update No. 2009-17, *Consolidations (Topic 810): Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities* ( Update No. 2009-17 ). Our revised critical accounting policy regarding principles of consolidation is as follows:

*Principles of Consolidation*

The condensed consolidated financial statements include the accounts of HCP, our wholly owned subsidiaries and joint ventures that we control, through voting rights or other means. We consolidate investments in variable interest entities ( VIEs ) when we are the primary beneficiary of the VIE at: (i) the creation of the variable interest entity, (ii) as a result of our continuous evaluation of our VIE relationships or (iii) upon the occurrence of a qualifying reconsideration event.

Table of Contents

We make judgments with respect to our level of influence or control of an entity and whether we are (or are not) the primary beneficiary of a VIE. Consideration of various factors includes, but is not limited to, our ability to direct the activities that most significantly impact the entity's economic performance, our form of ownership interest, our representation on the entity's governing body, the size and seniority of our investment, our ability and the rights of other investors to participate in policy making decisions and to replace the manager of and/or liquidate the entity, if applicable. Our ability to correctly assess our influence or control over an entity at inception of our involvement or on a continuous basis and determine the primary beneficiary of a VIE affects the presentation of these entities in our condensed consolidated financial statements. If we were to perform a primary beneficiary analysis at a date other than at creation of the variable interest entity, our assumptions may be different, which could result in the identification of a different primary beneficiary.

If we determine that we are the primary beneficiary of a VIE, our condensed consolidated financial statements would include the results of the VIE (either tenant or borrower) rather than the results of our lease or loan to the VIE. We would depend on the VIE to provide us timely financial information, and we would rely on the internal controls of the VIE to provide accurate financial information. If the VIE has deficiencies in its internal controls over financial reporting, or does not provide us with timely financial information, this may adversely impact our financial reporting and our internal controls over financial reporting.

**Results of Operations**

We evaluate our business and allocate resources among our five business segments: (i) senior housing, (ii) life science, (iii) medical office, (iv) hospital, and (v) skilled nursing. Under the senior housing, life science, hospital and skilled nursing segments, we invest primarily in single operator or tenant properties, through the acquisition and development of real estate, and debt issued by operators in these sectors. Under the medical office segment, we invest through the acquisition of MOB's that are leased under gross or modified gross leases, generally to multiple tenants, and which generally require a greater level of property management.

Our financial results for the three months ended March 31, 2010 and 2009 are summarized as follows:

*Comparison of the Three Months Ended March 31, 2010 to the Three Months Ended March 31, 2009**Rental and related revenues*

| Segments        | Three Months Ended March 31, |            | \$        | Change | % |
|-----------------|------------------------------|------------|-----------|--------|---|
|                 | 2010                         | 2009       |           |        |   |
|                 | (dollars in thousands)       |            |           |        |   |
| Senior housing  | \$ 73,004                    | \$ 68,741  | \$ 4,263  | 6%     |   |
| Life science    | 58,624                       | 52,044     | 6,580     | 13     |   |
| Medical office  | 65,256                       | 65,071     | 185       |        |   |
| Hospital        | 18,845                       | 17,468     | 1,377     | 8      |   |
| Skilled nursing | 9,610                        | 8,902      | 708       | 8      |   |
| Total           | \$ 225,339                   | \$ 212,226 | \$ 13,113 | 6%     |   |

## Edgar Filing: HCP, INC. - Form 10-Q

- *Senior housing.* Senior housing rental and related revenues for the three months ended March 31, 2010 included \$2.8 million of additional rents related to our properties operated by Sunrise. The remaining increase in senior housing rental and related revenues primarily relates to rent escalations and resets, which were partially offset by the decline in rents from facility-level operating revenues for three senior housing properties that were previously under management agreements and re-leased on a triple-net basis during 2009.
  
- *Life science.* The increase in life science rental and related revenues was primarily the result of two development assets that were fully leased and placed in service on January 1, 2010.

Table of Contents*Tenant recoveries*

| Segments       | Three Months Ended March 31, |           | Change     |       |
|----------------|------------------------------|-----------|------------|-------|
|                | 2010                         | 2009      | \$         | %     |
|                | (dollars in thousands)       |           |            |       |
| Life science   | \$ 9,650                     | \$ 11,094 | \$ (1,444) | (13)% |
| Medical office | 11,618                       | 12,023    | (405)      | (3)   |
| Hospital       | 518                          | 533       | (15)       | (3)   |
| Total          | \$ 21,786                    | \$ 23,650 | \$ (1,864) | (8)%  |

- *Life science.* During the three months ended March 31, 2009, we recognized \$1.6 million as a result of a change in estimate of our life science common area maintenance receivables related to the year ended December 31, 2008. No similar change in estimate was recognized in the three months ended March 31, 2010.

*Income from direct financing leases*

Income from direct financing leases decreased \$0.7 million to \$12.2 million for the three months ended March 31, 2010. The decrease was primarily due to three DFLs that were deemed to be substantially impaired during 2009 (see Note 5 to the Condensed Consolidated Financial Statements).

*Interest Income*

For the three months ended March 31, 2010, interest income increased \$8.5 million to \$35.3 million. This increase was primarily related to additional interest income of \$12 million earned from the \$720 million participation in the first mortgage debt of HCR ManorCare purchased in August 2009, which was partially offset by a \$3 million decrease of interest earned from marketable debt securities that were sold during 2009. For a more detailed description of our participation in the first mortgage debt of HCR ManorCare (see Note 6 to the Condensed Consolidated Financial Statements). Our exposure to income fluctuations related to our variable rate loans is partially mitigated by our variable rate indebtedness. For a more detailed discussion of our interest rate risk, see *Quantitative and Qualitative Disclosures About Market Risk* in Item 3.

*Depreciation and amortization expense*

Depreciation and amortization expense decreased \$2.1 million to \$78.1 million for the three months ended March 31, 2010. The decrease in depreciation and amortization expense is primarily related to assets which became fully depreciated during 2009 and 2010, which resulted in a \$3.8 million decrease in depreciation and amortization expense. This decrease was partially offset by a \$1.7 million increase in depreciation expense due to three life science development assets placed in service on January 1, 2010.

*Operating expenses*

| Segments        | Three Months Ended March 31, |           | Change     |       |
|-----------------|------------------------------|-----------|------------|-------|
|                 | 2010                         | 2009      | \$         | %     |
|                 | (dollars in thousands)       |           |            |       |
| Senior housing  | \$ 930                       | \$ 2,861  | \$ (1,931) | (67)  |
| Life science    | 11,582                       | 11,442    | 140        | 1     |
| Medical office  | 31,347                       | 32,789    | (1,442)    | (4)   |
| Hospital        | 2,209                        | 799       | 1,410      | NM(1) |
| Skilled nursing | 49                           | 62        | (13)       | 21    |
| Total           | \$ 46,117                    | \$ 47,953 | \$ (1,836) | (4)%  |

(1) Percentage change not meaningful.

Operating expenses are predominantly related to MOB and life science properties where we incur the expenses and recover all or a portion of those expenses from the tenants. The presentation of expenses as operating or general and administrative is based on the underlying nature of the expense. Periodically, we review the classification of expenses between categories and make revisions based on changes in the underlying nature of the expenses.

- *Senior housing.* The decrease in senior housing operating expenses primarily relates to a decrease in facility-level operating expenses for three senior housing properties that were previously under management agreements and re-leased on a triple-net basis during 2009.

Table of Contents

- *Hospital.* Hospital operating expenses increased primarily as a result of incurring facility costs and property taxes for one of our hospitals located in Texas that is currently experiencing operational difficulties.

*General and administrative expenses*

General and administrative expenses increased \$6.4 million to \$24.9 million for the three months ended March 31, 2010. The increase in general and administrative expenses was primarily due to an increase in legal fees associated with litigation matters, which increased by \$6.5 million to \$9.4 million for the three months ended March 31, 2010. See the information set forth under the heading *Legal Proceedings* of Note 11 to the Condensed Consolidated Financial Statements.

*Impairment recoveries*

During the three months ended March 31, 2010, we recognized aggregate income of \$11.9 million, which represents impairment recoveries of portions of previous impairment charges of investments related to Erickson. Erickson is the tenant at three of our senior housing CCRC DFLs and the borrower of a senior construction loan in which we have a participation interest (see Note 5 to the Condensed Consolidated Financial Statements).

*Other income, net*

For the three months ended March 31, 2010, other income, net increased \$2.8 million to \$0.4 million. The increase in other income net is primarily due to: (i) a \$0.6 million net increase in gains on marketable securities, (ii) a 2009 \$1.4 million impairment related to goodwill, and (iii) a 2009 \$0.8 million impairment related to investments in unconsolidated joint ventures.

*Interest expense*

Interest expense decreased \$0.7 million to \$76.0 million for the three months ended March 31, 2010. The decrease was primarily due to: (i) \$1.3 million from the repayment of the outstanding balance under our bridge loan in May 2009 and (ii) a \$1.0 million decrease in interest expense resulting from the benefit of an interest-rate swap (pay float and receive fixed) that was placed on \$250 million of our unsecured senior notes in June 2009. These decreases in interest expense were partially offset by a \$1.3 million charge related to unamortized issuance costs which were written-off as a result of the early repayment of our term loan in March 2010.

The table below sets forth information with respect to our debt, excluding premiums and discounts (dollars in thousands):

Edgar Filing: HCP, INC. - Form 10-Q

|   | As of March 31, |              |
|---|-----------------|--------------|
|   | 2010            | 2009         |
| <b>Balance:</b>   |                 |              |
| Fixed rate  | \$ 4,686,330    | \$ 5,021,407 |
| Variable rate   | 982,337         | 977,471      |
| Total   | \$ 5,668,667    | \$ 5,998,878 |
| <b>Percent of total debt:</b>                           |                 |              |
| Fixed rate  | 83%             | 84%          |
| Variable rate   | 17              | 16           |
| Total   | 100%            | 100%         |
| <b>Weighted average interest rate at end of period:</b> |                 |              |
| Fixed rate  | 6.27%           | 6.34%        |
| Variable rate   | 2.15%           | 1.83%        |
| Total weighted average rate                             | 5.56%           | 5.60%        |



Table of Contents

*Discontinued operations*

The decrease of \$2.8 million in income from discontinued operations to \$79,000 for the three months ended March 31, 2010 is primarily due to a decrease in income from discontinued operations of \$1.4 million and gains on real estate dispositions of \$1.4 million. Discontinued operations for the three months ended March 31, 2010 included one property compared to 15 properties for the three months ended March 31, 2009. During the three months ended March 31, 2009, we sold seven properties for \$6.0 million. We did not sell any properties during the three months ended March 31, 2010.

**Liquidity and Capital Resources**

Our principal liquidity needs are to: (i) fund normal operating expenses, (ii) meet debt service requirements, including \$206 million of senior unsecured notes and \$97 million of mortgage debt principal payments and maturities in 2010, (iii) fund capital expenditures, including tenant improvements and leasing costs, (iv) fund acquisition and development activities, and (v) make dividend distributions. We believe these needs will be satisfied using cash flows generated by operations and from our various financing activities during the next twelve months. During the three months ended March 31, 2010, distributions to shareholders and noncontrolling interest holders exceeded cash flows from operations by approximately \$37 million. During 2009, we raised proceeds of \$1.1 billion from issuances of common stock and sales of marketable debt securities and real estate, which proceeds, among other things, were the sources of cash used to fund the excess of distributions to shareholders and noncontrolling interest holders above cash flows from operations during the three months ended March 31, 2010.

Access to capital markets impacts our cost of capital and ability to refinance maturing indebtedness, as well as to fund future acquisitions and development through the issuance of additional securities or secured debt. As of April 22, 2010, we had a credit rating of Baa3 (positive) from Moody's, BBB (stable) from S&P and BBB (positive) from Fitch on our senior unsecured debt securities, and Ba1 (positive) from Moody's, BB+ (stable) from S&P and BB+ (positive) from Fitch on our preferred equity securities.

Net cash provided by operating activities was \$109 million and \$117 million for the three months ended March 31, 2010 and 2009, respectively. The decrease in operating cash flows is primarily the result of changes in working capital. Our cash flows from operations are dependent upon the occupancy level of multi-tenant buildings, rental rates on leases, our tenants' performance on their lease obligations, the level of operating expenses and other factors.

Net cash used in investing activities was \$39 million for the three months ended March 31, 2010 and consisted of fundings of \$31 million for acquisition and development of real estate and \$5 million for lease commissions and tenant and capital improvements.

Net cash used in financing activities was \$138 million for the three months ended March 31, 2010 and consisted of the net effects of: (i) net borrowings under our bank revolving line of credit of \$210 million, (ii) repayment of our term loan of \$200 million and (iii) payments of common and preferred dividends aggregating \$143 million.

*Debt*

*Bank Line of Credit*

Our revolving line of credit facility with a syndicate of banks provides for an aggregate borrowing capacity of \$1.5 billion and matures on August 1, 2011. This revolving line of credit facility accrues interest at a rate per annum equal to LIBOR plus a margin that depends upon our debt ratings. We pay a facility fee on the entire revolving commitment that depends upon our debt ratings. Based on our debt ratings on March 31, 2010, the margin on the revolving line of credit facility was 0.55% and the facility fee was 0.15%. At March 31, 2010, we had \$210 million outstanding under this revolving line of credit facility with a weighted-average effective interest rate of 1.24%. At March 31, 2010, a \$103 million letter of credit is outstanding against our revolving line of credit facility as a result of the Ventas litigation. For further information regarding the Ventas litigation, see Note 11 to the Condensed Consolidated Financial Statements.

Our revolving line of credit facility contains certain financial restrictions and other customary requirements. Among other things, these covenants, using terms defined in the agreement, (i) limit the ratio of Consolidated Total Indebtedness to Consolidated Total Asset Value to 60%, (ii) limit the ratio of Unsecured Debt to Consolidated Unencumbered Asset Value to 65%, (iii) require a Fixed Charge Coverage ratio of 1.75 times and (iv) require a formula-determined Minimum Consolidated Tangible Net Worth of \$4.9 billion at March 31, 2010. At March 31, 2010, we were in compliance with each of these restrictions and requirements of our revolving line of credit facility.

Table of Contents

Our revolving line of credit facility also contains cross-default provisions to other indebtedness of ours, including in some instances, certain mortgages on our properties. Certain mortgages contain default provisions relating to defaults under the leases or operating agreements on the applicable properties by our operators or tenants, including default provisions relating to the bankruptcy filings of such operator or tenant. Although we believe that we would be able to secure amendments under the applicable agreements if a default as described above occurs, such default may result in significantly less favorable borrowing terms than currently available, material delays in the availability of funding or other material adverse consequences.

*Senior Unsecured Notes*

At March 31, 2010, we had \$3.5 billion in aggregate principal amount of senior unsecured notes outstanding. Interest rates on the notes ranged from 1.16% to 7.07% with a weighted average effective interest rate of 6.12% at March 31, 2010. Discounts and premiums are amortized to interest expense over the term of the related notes. The senior unsecured notes contain certain covenants including limitations on debt, cross-acceleration provisions and other customary terms. At March 31, 2010, we believe we were in compliance with these covenants.

*Mortgage and Other Secured Debt*

At March 31, 2010, we had \$1.8 billion in mortgage debt secured by 165 healthcare facilities with a carrying value of \$2.3 billion and a participation in a first mortgage loan with a carrying value of \$612 million. Interest rates on the mortgage notes ranged from 0.30% to 8.63% with a weighted average effective interest rate of 4.97% at March 31, 2010.

Mortgage debt generally requires monthly principal and interest payments, is collateralized by certain properties and is generally non-recourse. Mortgage debt typically restricts transfer of the encumbered properties, prohibits additional liens, restricts prepayment, requires payment of real estate taxes, requires maintenance of the properties in good condition, requires maintenance of insurance on the properties and includes requirements to obtain lender consent to enter into and terminate material leases. Some of the mortgage debt is also cross-collateralized by multiple properties and may require tenants or operators to maintain compliance with the applicable leases or operating agreements of such properties.

*Other Debt*

At March 31, 2010, we had \$97 million of non-interest bearing life care bonds at two of our continuing care retirement communities and non-interest bearing occupancy fee deposits at another of our senior housing facilities, all of which were payable to certain residents of the facilities (collectively, Life Care Bonds). At March 31, 2010, \$41.6 million of the Life Care Bonds were refundable to the residents upon the resident moving out or to their estate upon death, and \$55.4 million of the Life Care Bonds were refundable after the unit is successfully remarketed to a new resident.

*Debt Maturities*

## Edgar Filing: HCP, INC. - Form 10-Q

The following table summarizes our stated debt maturities and scheduled principal repayments, excluding debt premiums and discounts, at March 31, 2010 (in thousands):

| <b>Year</b>        | <b>Amount(1)</b> |
|--------------------|------------------|
| 2010 (Nine months) | \$ 303,467       |
| 2011               | 649,182          |
| 2012               | 313,776          |
| 2013               | 1,225,104        |
| 2014               | 264,435          |
| Thereafter         | 2,815,680        |
|                    | \$ 5,571,644     |

---

(1) Excludes \$97 million of other debt that represents non-interest bearing Life Care Bonds and occupancy fee deposits at three of our senior housing facilities, which have no scheduled maturities.

Table of Contents*Derivative Instruments*

We use derivative instruments to mitigate the effects of interest rate fluctuations on specific forecasted transactions as well as recognized obligations or assets. We do not use derivative instruments for speculative or trading purposes.

The following table summarizes our outstanding interest rate swap contracts as of March 31, 2010 (dollars in thousands):

| <b>Date Entered</b> | <b>Maturity Date</b> | <b>Hedge Designation</b> | <b>Fixed Rate</b> | <b>Floating Rate Index</b> | <b>Notional Amount</b> | <b>Fair Value</b> |
|---------------------|----------------------|--------------------------|-------------------|----------------------------|------------------------|-------------------|
| July 2005(1)        | July 2020            | Cash Flow                | 3.82%             | BMA Swap Index             | \$ 45,600              | \$ (3,423)        |
| June 2009           | September 2011       | Fair Value               | 5.95%             | 1 Month LIBOR+4.21%        | 250,000                | 3,233             |
| July 2009           | July 2013            | Cash Flow                | 6.13%             | 1 Month LIBOR+3.65%        | 14,400                 | (299)             |
| August 2009         | February 2011        | Cash Flow                | 0.87%             | 1 Month LIBOR              | 250,000                | 955               |
| August 2009         | August 2011          | Cash Flow                | 1.24%             | 1 Month LIBOR              | 250,000                | 1,838             |

(1) Represents three interest-rate swap contracts with an aggregate notional amount of \$45.6 million.

For a more detailed description of our derivative financial instruments, see Note 19 of the Condensed Consolidated Financial Statements and Item 3. *Quantitative and Qualitative Disclosures About Market Risk*.

*Equity*

At March 31, 2010, we had 4.0 million shares of 7.25% Series E cumulative redeemable preferred stock, 7.8 million shares of 7.10% Series F cumulative redeemable preferred stock and 294 million shares of common stock outstanding. At March 31, 2010, equity totaled \$5.9 billion and our equity securities had a market value of \$10.2 billion.

At March 31, 2010, there were a total of 4.2 million DownREIT units outstanding in six limited liability companies in which we are the managing member. The DownREIT units are exchangeable for an amount of cash approximating the then-current market value of shares of our common stock or, at our option, shares of our common stock (subject to certain adjustments, such as stock splits and reclassifications).

*Shelf Registration*

## Edgar Filing: HCP, INC. - Form 10-Q

We have a prospectus on file with the SEC as part of a registration statement on Form S-3, using a shelf registration process which expires in September 2012. Under this shelf process, we may sell from time to time any combination of the registered securities in one or more offerings. The securities described in the prospectus include common stock, preferred stock and debt securities. Each time we sell securities under the shelf registration, we will provide a prospectus supplement that will contain specific information about the terms of the securities being offered and of the offering. We may offer and sell the securities pursuant to this prospectus from time to time in one or more of the following ways: through underwriters or dealers, through agents, directly to purchasers or through a combination of any of these methods of sales. Proceeds from the sale of these securities may be used for general corporate purposes, which may include repayment of indebtedness, working capital and potential acquisitions.

### **Off-Balance Sheet Arrangements**

We own interests in certain unconsolidated joint ventures, including HCP Ventures II, HCP Ventures III, LLC and HCP Ventures IV LLC, as described under Note 7 to the Condensed Consolidated Financial Statements. Except in limited circumstances, our risk of loss is limited to our investment in the joint venture and any outstanding loans receivable. In addition, we have certain properties which serve as collateral for debt that is owed by a previous owner of certain of our facilities, as described under Note 11 to the Condensed Consolidated Financial Statements. Our risk of loss for these certain properties is limited to the outstanding debt balance plus penalties, if any. We have no other material off-balance sheet arrangements that we expect would materially affect our liquidity and capital resources except those described below under *Contractual Obligations*.

Table of Contents**Contractual Obligations**

The following table summarizes our material contractual payment obligations and commitments at March 31, 2010 (in thousands):

|                                   | Total(1)            | Less than<br>One Year | 2011-2012           | 2013-2014           | More than<br>Five Years |
|-----------------------------------|---------------------|-----------------------|---------------------|---------------------|-------------------------|
| Bank line of credit               | \$ 210,000          | \$                    | \$ 210,000          | \$                  | \$                      |
| Senior unsecured notes            | 3,535,686           | 206,421               | 542,265             | 637,000             | 2,150,000               |
| Mortgage and other secured debt   | 1,825,958           | 97,046                | 210,693             | 852,539             | 665,680                 |
| Development commitments(2)        | 11,922              | 11,922                |                     |                     |                         |
| Ground and other operating leases | 199,227             | 3,687                 | 10,261              | 9,911               | 175,368                 |
| Interest(3)                       | 1,494,108           | 225,752               | 529,254             | 406,569             | 332,533                 |
| <b>Total</b>                      | <b>\$ 7,276,901</b> | <b>\$ 544,828</b>     | <b>\$ 1,502,473</b> | <b>\$ 1,906,019</b> | <b>\$ 3,323,581</b>     |

- 
- (1) Excludes \$97 million of other debt that represents non-interest bearing Life Care Bonds and occupancy fee deposits at three of our senior housing facilities, which have no scheduled maturities.
- (2) Represents construction and other commitments for developments in progress.
- (3) Interest on variable-rate debt is calculated using rates in effect at March 31, 2010.

**Inflation**

Our leases often provide for either fixed increases in base rents or indexed escalators, based on the Consumer Price Index or other measures, and/or additional rent based on increases in the tenants' operating revenues. Substantially all of our MOB leases require the tenant to pay a share of property operating costs such as real estate taxes, insurance and utilities. Substantially all of our senior housing, life science, skilled nursing and hospital leases require the operator or tenant to pay all of the property operating costs or reimburse us for all such costs. We believe that inflationary increases in expenses will be offset, in part, by the operator or tenant expense reimbursements and contractual rent increases described above.

**Recent Accounting Pronouncements**

See Note 2 to the Condensed Consolidated Financial Statements for the impact of recent accounting pronouncements. There were no accounting pronouncements that were issued, but not yet adopted by us, that we believe will materially impact our condensed consolidated financial statements.

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

## Edgar Filing: HCP, INC. - Form 10-Q

*Interest Rate Risk.* At March 31, 2010, we were exposed to market risks related to fluctuations in interest rates on approximately \$1.7 billion of variable-rate HCR ManorCare loan investments (see Note 6 to the Condensed Consolidated Financial Statements) and \$83 million of other investments where the payments fluctuate with changes in LIBOR. Our exposure to income fluctuations related to our variable-rate investments is partially offset by (i) \$210 million of variable-rate line of credit borrowings, (ii) \$497 million of variable-rate mortgage notes and other secured debt payable, excluding \$60 million of variable-rate mortgage notes which have been hedged through interest-rate swap contracts, (iii) \$25 million of variable-rate senior unsecured notes, and (iv) \$750 million of additional variable interest rate exposure achieved through interest-rate swap contracts (pay float and receive fixed).

Interest rate fluctuations will generally not affect our future earnings or cash flows on our fixed rate debt, loans receivable and debt securities unless such instruments mature or are otherwise terminated. However, interest rate changes will affect the fair value of our fixed rate instruments. Conversely, changes in interest rates on variable rate debt and investments would change our future earnings and cash flows, but not significantly affect the fair value of those instruments. Assuming a one percentage point increase in the interest rate related to the variable-rate investments and variable-rate debt, and assuming no change in the outstanding balance as of March 31, 2010, net interest income would improve by approximately \$3.2 million, or \$0.01 per common share on a diluted basis. Assuming a 50 basis point decrease in interest rates under the above circumstances, taking into consideration that the index underlying many of our arrangements is currently below 50 basis points and is not expected to go below zero, net interest income would decline by \$1.6 million, or less than \$0.01 per common share on a diluted basis.



Table of Contents

We use derivative instruments during the normal course of business to manage or hedge interest rate risk. We do not use derivative financial instruments for speculative purposes. Derivatives are recorded on the condensed consolidated balance sheet at their estimated fair value. See Note 19 to the Condensed Consolidated Financial Statements for further information.

To illustrate the effect of movements in the interest rate markets, we performed a market sensitivity analysis on our hedging instruments. We applied various basis point spreads to the underlying interest rate curves of the derivative portfolio in order to determine the instruments' change in estimated fair value. Assuming a one percentage point change in the underlying interest rate curve, the estimated change in fair value of each of the underlying derivative instruments would not exceed \$4.2 million.

*Market Risk.* We are directly and indirectly affected by changes in the equity and bond markets. We have investments in marketable debt and equity securities classified as available-for-sale. Gains and losses on these securities are recognized in income when realized and losses are recognized when an other-than-temporary decline in value is identified. The initial indicator of an other-than-temporary decline in value for marketable equity securities is a sustained decline in market price below the carrying value for an extended period of time. We consider a variety of factors in evaluating an other-than-temporary decline in value, such as: the length of time and the extent to which the market value has been less than our cost; the issuer's financial condition, capital strength and near-term prospects; any recent events specific to that issuer and economic conditions of its industry; and our investment horizon in relationship to an anticipated near-term recovery in the stock or bond price, if any. At March 31, 2010, the fair value and cost, or the adjusted cost basis for those securities where a recognized loss was recorded, of marketable equity securities was \$4.5 million and \$3.6 million, respectively, and the fair value and cost basis of marketable debt securities was \$171.8 million and \$160.8 million, respectively.

**Item 4. Controls and Procedures**

*Disclosure Controls and Procedures.* We 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 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 (Principal Executive Officer) and Chief Financial Officer (Principal Financial Officer), 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.

Also, we have investments in certain unconsolidated entities. Our disclosure controls and procedures with respect to such entities are substantially more limited than those we maintain with respect to our consolidated subsidiaries.

As required by Rules 13a-15(b) and 15d-15(b) of the Securities Exchange Act of 1934, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer (Principal Executive Officer) and Chief Financial Officer (Principal Financial Officer), of the effectiveness of the design and operation of our disclosure controls and procedures as of March 31, 2010. Based upon that evaluation, our Chief Executive Officer (Principal Executive Officer) and Chief Financial Officer (Principal Financial Officer) concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

## Edgar Filing: HCP, INC. - Form 10-Q

*Changes in Internal Control Over Financial Reporting.* There were no changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) during the fiscal quarter to which this report relates that have materially affected, or are reasonable likely to materially affect, our internal control over financial reporting.

Table of Contents

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

See the Ventas and Sunrise litigation matters under the heading "Legal Proceedings" of Note 11 to the Condensed Consolidated Financial Statements in this report for information regarding legal proceedings, which information is incorporated by reference in this Item 3.

**Item 1A. Risk Factors**

There are no material changes to the risk factors previously disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2009.

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

(a)

None.

(b)

None.

(c)

The table below sets forth information with respect to purchases of our common stock made by us or on our behalf or by any affiliated purchaser, as such term is defined in Rule 10b-18(a)(3) of the Securities Exchange Act of 1934, as amended, during the three months ended March 31, 2010.

Edgar Filing: HCP, INC. - Form 10-Q

| Period Covered      | Total Number<br>Of Shares<br>Purchased(1) | Average Price<br>Paid Per Share | Total Number Of Shares<br>(Or Units) Purchased As<br>Part Of Publicly<br>Announced Plans Or<br>Programs | Maximum Number (Or<br>Approximate Dollar Value)<br>Of Shares (Or Units) That<br>May Yet Be Purchased<br>Under The Plans Or<br>Programs |
|---------------------|---|---------------------------------|---|--|
| January 1-31, 2010  | 128,232                                   | \$ 28.67                        |   |  |
| February 1-28, 2010 | 10,683                                    | 29.16                           |   |  |
| March 1-31, 2010    | 437                                       | 32.71                           |   |  |
| Total               | 139,352                                   | 28.72                           |   |  |

(1) Represents restricted shares withheld under our 2006 Performance Incentive Plan (the 2006 Incentive Plan ), to offset tax withholding obligations that occur upon vesting of restricted shares. Our 2006 Incentive Plan provides that the value of the shares withheld shall be the closing price of our common stock on the date the relevant transaction occurs.

**Item 6. Exhibits**

- 3.1 Articles of Restatement of HCP (incorporated by reference herein to Exhibit 3.1 to HCP's Quarterly Report on Form 10-Q (File No. 1-08895), filed October 30, 2007).
- 3.2 Fourth Amended and Restated Bylaws of HCP (incorporated herein by reference to Exhibit 3.1 to HCP's Current Report on Form 8-K (File No. 1-08895), filed September 25, 2006).
- 3.2.1 Amendment No. 1 to Fourth Amended and Restated Bylaws of HCP (incorporated by reference herein to Exhibit 3.2.1 to HCP's Quarterly Report on Form 10-Q (File No. 1-08895), filed October 30, 2007).
- 3.2.2 Amendment No. 2 to Fourth Amended and Restated Bylaws of HCP (incorporated by reference herein to Exhibit 3.2.2 to HCP's Quarterly Report on Form 10-Q (File No. 1-08895), filed November 3, 2009).

Table of Contents

|         |   |
|---------|---|
| 4.1     | Acknowledgment and Consent, dated as of February 5, 2010, by and among ML Private Finance, LLC, A. Daniel Weyland, an individual, HCPI/Tennessee, LLC, and HCP. |
| 31.1    | Certification by James F. Flaherty III, HCP's Principal Executive Officer, Pursuant to Securities Exchange Act Rule 13a-14(a).                                  |
| 31.2    | Certification by Thomas M. Herzog, HCP's Principal Financial Officer, Pursuant to Securities Exchange Act Rule 13a-14(a).                                       |
| 32.1    | Certification by James F. Flaherty III, HCP's Principal Executive Officer, Pursuant to Securities Exchange Act Rule 13a-14(b) and 18 U.S.C. Section 1350.       |
| 32.2    | Certification by Thomas M. Herzog, HCP's Principal Financial Officer, Pursuant to Securities Exchange Act Rule 13a-14(b) and 18 U.S.C. Section 1350.            |
| 101.INS | XBRL Instance Document.*  |
| 101.SCH | XBRL Taxonomy Extension Schema Document.*   |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document.*   |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document.*  |
| 101.LAB | XBRL Taxonomy Extension Labels Linkbase Document.*  |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document.*  |

---

\* Furnished herewith.

Table of Contents

**SIGNATURES**

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.

Date: April 27, 2010

HCP, Inc.

(Registrant)

/s/ JAMES F. FLAHERTY III  
James F. Flaherty III  
*Chairman and Chief Executive Officer*  
*(Principal Executive Officer)*

/s/ THOMAS M. HERZOG  
Thomas M. Herzog  
*Executive Vice President-*  
*Chief Financial Officer*  
*(Principal Financial Officer)*

/s/ SCOTT A. ANDERSON  
Scott A. Anderson  
*Senior Vice President-*  
*Chief Accounting Officer*  
*(Principal Accounting Officer)*