

HCP, INC.
Form 10-Q
October 30, 2012
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 September 30, 2012.

OR

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

For the transition period from to

Commission file number 001-08895

HCP, INC.

(Exact name of registrant as specified in its charter)

Maryland
(State or other jurisdiction of
incorporation or organization)

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

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
(Do not check if a smaller reporting company)

Smaller Reporting Company

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

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 October 25, 2012, there were 452,066,005 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 Statements of Comprehensive Income</u>	5
	<u>Condensed Consolidated Statements of Equity</u>	6
	<u>Condensed Consolidated Statements of Cash Flows</u>	7
	<u>Notes to the Condensed Consolidated Financial Statements</u>	8
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	27
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	47
Item 4.	<u>Controls and Procedures</u>	48

PART II. OTHER INFORMATION

Item 1A.	<u>Risk Factors</u>	48
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	48
Item 5.	<u>Other Information</u>	49
Item 6.	<u>Exhibits</u>	50
	<u>Signatures</u>	51

Table of Contents

HCP, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

(Unaudited)

	September 30, 2012	December 31, 2011
ASSETS		
Real estate:		
Buildings and improvements	\$ 9,069,420	\$ 8,822,653
Development costs and construction in progress	229,543	190,590
Land	1,724,563	1,723,601
Accumulated depreciation and amortization	(1,662,116)	(1,452,688)
Net real estate	9,361,410	9,284,156
Net investment in direct financing leases	6,843,249	6,727,777
Loans receivable, net	240,929	110,253
Investments in and advances to unconsolidated joint ventures	217,092	224,052
Accounts receivable, net of allowance of \$1,498 and \$1,341, respectively	31,763	26,681
Cash and cash equivalents	96,476	33,506
Restricted cash	43,428	41,553
Intangible assets, net	382,321	372,390
Assets held for sale, net	91,226	102,649
Other assets, net	771,442	485,458
Total assets	\$ 18,079,336	\$ 17,408,475
LIABILITIES AND EQUITY		
Bank line of credit	\$	\$ 454,000
Term loan	221,214	
Senior unsecured notes	5,913,690	5,416,063
Mortgage debt	1,684,514	1,715,039
Liabilities related to assets held for sale, net	5,649	55,897
Other debt	84,580	87,985
Intangible liabilities, net	105,191	117,777
Accounts payable and accrued liabilities	270,843	275,478
Deferred revenue	65,802	65,614
Total liabilities	8,351,483	8,187,853
Commitments and contingencies		
Preferred stock, \$1.00 par value: aggregate liquidation preference of \$295.5 million as of December 31, 2011		285,173
Common stock, \$1.00 par value: 750,000,000 shares authorized; 429,980,165 and 408,629,444 shares issued and outstanding, respectively	429,980	408,629
Additional paid-in capital	10,185,982	9,383,536
Cumulative dividends in excess of earnings	(1,081,317)	(1,024,274)
Accumulated other comprehensive loss	(16,646)	(19,582)
Total stockholders' equity	9,517,999	9,033,482
Joint venture partners	14,884	16,971

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

Non-managing member unitholders	194,970	170,169
Total noncontrolling interests	209,854	187,140
Total equity	9,727,853	9,220,622
Total liabilities and equity	\$ 18,079,336	\$ 17,408,475

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 September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Revenues:				
Rental and related revenues	\$ 249,409	\$ 250,809	\$ 736,645	\$ 758,322
Tenant recoveries	23,425	23,879	69,656	69,764
Resident fees and services	36,076	11,974	107,824	15,314
Income from direct financing leases	155,834	153,496	465,345	310,553
Interest income	10,278	577	12,313	99,199
Investment management fee income	460	494	1,423	1,605
Total revenues	475,482	441,229	1,393,206	1,254,757
Costs and expenses:				
Interest expense	103,513	103,459	309,875	315,695
Depreciation and amortization	88,686	86,672	259,039	265,742
Operating	72,667	57,662	210,083	151,103
General and administrative	19,443	19,647	54,356	76,471
Impairments	7,878	15,400	7,878	15,400
Total costs and expenses	292,187	282,840	841,231	824,411
Other income (expense), net	770	(772)	2,233	17,056
Income before income taxes and equity income from unconsolidated joint ventures	184,065	157,617	554,208	447,402
Income taxes	598	(5)	1,131	(289)
Equity income from unconsolidated joint ventures	13,396	17,050	42,803	32,798
Income from continuing operations	198,059	174,662	598,142	479,911
Discontinued operations:				
Income (loss) before gain on sales of real estate, net of income taxes	984	809	(416)	3,796
Gain on sales of real estate, net of income taxes			2,856	
Total discontinued operations	984	809	2,440	3,796
Net income	199,043	175,471	600,582	483,707
Noncontrolling interests share in earnings	(2,935)	(3,276)	(9,070)	(12,660)
Net income attributable to HCP, Inc.	196,108	172,195	591,512	471,047
Preferred stock dividends		(5,282)	(17,006)	(15,848)
Participating securities share in earnings	(479)	(546)	(2,154)	(1,893)
Net income applicable to common shares	\$ 195,629	\$ 166,367	\$ 572,352	\$ 453,306
Basic earnings per common share:				
Continuing operations	\$ 0.45	\$ 0.41	\$ 1.36	\$ 1.14
Discontinued operations	0.01			0.01
Net income applicable to common shares	\$ 0.46	\$ 0.41	\$ 1.36	\$ 1.15

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

Diluted earnings per common share:								
Continuing operations	\$	0.45	\$	0.41	\$	1.36	\$	1.13
Discontinued operations								0.01
Net income applicable to common shares	\$	0.45	\$	0.41	\$	1.36	\$	1.14
Weighted average shares used to calculate earnings per common share:								
Basic		429,557		407,081		420,049		395,258
Diluted		430,778		408,646		421,404		397,013
Dividends declared per common share	\$	0.50	\$	0.48	\$	1.50	\$	1.44

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net income	\$ 199,043	\$ 175,471	\$ 600,582	\$ 483,707
Other comprehensive income (loss):				
Unrealized gains (losses) on securities	5,374	(11,483)	5,716	(10,152)
Change in net unrealized gains (losses) on cash flow hedges:				
Unrealized losses	(2,734)	(3,051)	(3,513)	(4,092)
Reclassification adjustment realized in net income	129	96	308	(1,122)
Change in Supplemental Executive Retirement Plan obligation	46	34	136	100
Foreign currency translation adjustment	243	(246)	289	20
Total other comprehensive income (loss)	3,058	(14,650)	2,936	(15,246)
Total comprehensive income	202,101	160,821	603,518	468,461
Total comprehensive income attributable to noncontrolling interests	(2,935)	(3,276)	(9,070)	(12,660)
Total comprehensive income attributable to HCP, Inc.	\$ 199,166	\$ 157,545	\$ 594,448	\$ 455,801

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

HCP, INC.

CONDENSED CONSOLIDATED STATEMENTS 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)			
January 1, 2012	11,820	\$ 285,173	408,629	\$ 408,629	\$ 9,383,536	\$ (1,024,274)	\$ (19,582)	\$ 9,033,482	\$ 187,140	\$ 9,220,622
Net income						591,512		591,512	9,070	600,582
Other comprehensive income							2,936	2,936		2,936
Preferred stock redemption	(11,820)	(285,173)				(10,327)		(295,500)		(295,500)
Issuance of common stock, net			19,096	19,096	744,412			763,508	(2,438)	761,070
Repurchase of common stock			(196)	(196)	(7,971)			(8,167)		(8,167)
Exercise of stock options			2,451	2,451	49,058			51,509		51,509
Amortization of deferred compensation					16,947			16,947		16,947
Preferred dividends						(6,679)		(6,679)		(6,679)
Common dividends (\$1.50 per share)						(631,549)		(631,549)		(631,549)
Distributions to noncontrolling interests									(11,759)	(11,759)
Noncontrolling interests in acquisitions									27,432	27,432
Issuance of noncontrolling interests									826	826
Purchase of noncontrolling interests									(417)	(417)
September 30, 2012		\$ 429,980	\$ 429,980	\$ 10,185,982	\$ (1,081,317)	\$ (16,646)	\$ 9,517,999	\$ 209,854	\$ 9,727,853	

	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)			
January 1, 2011	11,820	\$ 285,173	370,925	\$ 370,925	\$ 8,089,982	\$ (775,476)	\$ (13,237)	\$ 7,957,367	\$ 188,680	\$ 8,146,047
Net income						471,047		471,047	12,660	483,707
							(15,246)	(15,246)		(15,246)

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

Other comprehensive loss										
Issuance of common stock, net	36,256	36,256	1,254,609			1,290,865	(2,533)	1,288,332		
Repurchase of common stock	(135)	(135)	(4,805)			(4,940)		(4,940)		
Exercise of stock options	733	733	18,758			19,491		19,491		
Amortization of deferred compensation			15,286			15,286		15,286		
Preferred dividends					(15,848)	(15,848)		(15,848)		
Common dividends (\$1.44 per share)					(570,200)	(570,200)		(570,200)		
Distributions to noncontrolling interests							(11,001)	(11,001)		
Noncontrolling interests in acquisitions							1,500	1,500		
Issuance of noncontrolling interests							14,028	14,028		
Purchase of noncontrolling interests					(20,045)	(20,045)	(14,059)	(34,104)		
September 30, 2011	11,820	\$ 285,173	407,779	\$ 407,779	\$ 9,353,785	\$ (890,477)	\$ (28,483)	\$ 9,127,777	\$ 189,275	\$ 9,317,052

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

HCP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2012	2011
Cash flows from operating activities:		
Net income	\$ 600,582	\$ 483,707
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	259,039	265,742
Discontinued operations	7,300	4,286
Amortization of above and below market lease intangibles, net	(1,855)	(3,271)
Amortization of deferred compensation	16,947	15,286
Amortization of deferred financing costs, net	12,415	22,118
Straight-line rents	(33,608)	(46,936)
Loan and direct financing lease interest accretion	(71,923)	(65,973)
Deferred rental revenues	1,101	(1,284)
Equity income from unconsolidated joint ventures	(42,803)	(32,798)
Distributions of earnings from unconsolidated joint ventures	2,775	2,462
Gain on sales of real estate	(2,856)	
Gain upon consolidation of joint venture		(7,769)
Gain upon settlement of loans receivable		(22,812)
Derivative (gains) losses, net	43	(1,226)
Impairments	7,878	15,400
Changes in:		
Accounts receivable, net	(5,082)	3,206
Other assets	(7,303)	28,631
Accounts payable and accrued liabilities	(21,697)	(71,848)
Net cash provided by operating activities	720,953	586,921
Cash flows from investing activities:		
Cash used in the HCR ManorCare Acquisition, net of cash acquired		(4,026,556)
Cash used in the HCP Ventures II purchase, net of cash acquired		(135,550)
Other acquisitions of real estate	(172,380)	(113,462)
Development of real estate	(87,119)	(57,167)
Leasing costs and tenant and capital improvements	(42,817)	(31,772)
Proceeds from sales of real estate, net	7,238	
Purchase of an interest in unconsolidated joint ventures		(95,000)
Distributions in excess of earnings from unconsolidated joint ventures	2,051	1,936
Purchase of marketable securities	(214,859)	(22,449)
Principal repayments on loans receivable	4,660	303,867
Investments in loans receivable	(145,597)	(363,337)
Increase in restricted cash	(1,875)	(11,532)
Net cash used in investing activities	(650,698)	(4,551,022)
Cash flows from financing activities:		
Net borrowings (repayments) under bank line of credit	(454,000)	375,000
Borrowings under term loan	214,789	
Repayments of mortgage debt	(109,569)	(152,517)
Issuance of senior unsecured notes	750,000	2,400,000
Repayment of senior unsecured notes	(250,000)	(292,265)
Deferred financing costs	(18,256)	(43,716)

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

Preferred stock redemption	(295,500)	
Net proceeds from the issuance of common stock and exercise of options	804,412	1,302,883
Dividends paid on common and preferred stock	(638,228)	(586,048)
Issuance of noncontrolling interests	826	14,028
Purchase of noncontrolling interests		(34,104)
Distributions to noncontrolling interests	(11,759)	(11,001)
Net cash provided by (used in) financing activities	(7,285)	2,972,260
Net increase (decrease) in cash and cash equivalents	62,970	(991,841)
Cash and cash equivalents, beginning of period	33,506	1,036,701
Cash and cash equivalents, end of period	\$ 96,476	\$ 44,860

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, together with its consolidated entities (collectively, HCP or the Company), invests primarily in real estate serving the healthcare industry in the United States (U.S.). The Company is a Maryland corporation and was organized to qualify as a self-administered real estate investment trust (REIT) in 1985. The Company is headquartered in 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) post-acute/skilled nursing, (iii) life science, (iv) medical office and (v) hospital. The Company makes investments within the healthcare segments using the following five investment products: (i) properties under lease, (ii) debt investments, (iii) developments and redevelopments, (iv) investment management and (v) RIDEA, which represents investments in senior housing operations utilizing the structure permitted by the Housing and Economic Recovery Act of 2008.

(2) Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information. Management is required to make estimates and assumptions in the preparation of financial statements in conformity with GAAP. These estimates and assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from management's estimates.

The condensed consolidated financial statements include the accounts of HCP, its wholly-owned subsidiaries and joint ventures or variable interest entities (VIEs) that it controls through voting rights or other means. Intercompany transactions and balances have been eliminated upon consolidation. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) necessary to present fairly the Company's financial position, results of operations and cash flows have been included. Operating results for the nine months ended September 30, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. 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, 2011 included in the Company's Annual Report on Form 10-K, as amended, filed with the U.S. Securities and Exchange Commission (SEC).

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

Certain amounts in the Company's condensed consolidated financial statements have been reclassified for prior periods 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 the related operating results reclassified from continuing to discontinued operations on the condensed consolidated income statements (see Note 5). Facility-level revenues from 21 senior housing communities that are in a RIDEA structure are presented in resident fees and services on the condensed consolidated income statements; all facility-level resident fee and service revenue previously reported in rental and related revenues has been reclassified to resident fees and services (see Note 12 for additional information regarding the 21 RIDEA facilities).

Foreign Currency Translation and Transactions

Assets and liabilities denominated in foreign currencies that are translated into U.S. dollars use exchange rates in effect at the end of the period, and revenues and expenses denominated in foreign currencies that are translated into U.S. dollars use average rates of exchange in effect during the related period. Gains or losses resulting from translation are included in accumulated other comprehensive income, a component of stockholders' equity on the condensed consolidated balance sheets. Gains or losses resulting from foreign currency transactions are translated into U.S. dollars at the rates of exchange prevailing at the dates of the transactions. The effects of transaction gains or losses are included in other income (expense), net in the condensed consolidated statements of income.

Table of Contents*Recent Accounting Pronouncements*

In July 2012, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2012-01, *Continuing Care Retirement Communities Refundable Advance Fees* (ASU 2012-01). This update clarifies the situations in which recognition of deferred revenue for refundable advance fees is appropriate. ASU 2012-01 is effective for fiscal years beginning after December 15, 2012. The Company does not expect the adoption of ASU 2012-01 on January 1, 2013 to have a material impact on its consolidated financial position or results of operations.

In July 2012, the FASB issued Accounting Standards Update No. 2012-02, *Testing Indefinite-Lived Intangible Assets for Impairment* (ASU 2012-02). The amendments in this update provide an entity with the option to make a qualitative assessment about the likelihood that an indefinite-lived intangible asset is impaired to determine whether it should perform a quantitative impairment test. ASU 2012-02 is effective for fiscal years and interim periods beginning after September 15, 2012. The Company does not expect the adoption of ASU 2012-02 on January 1, 2013 to have an impact on its consolidated financial position or results of operations.

In May 2011, the FASB issued Accounting Standards Update No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* (ASU 2011-04). The amendments in this update result in additional fair value measurement and disclosure requirements within U.S. GAAP and International Financial Reporting Standards. The amendments update the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. The adoption of ASU 2011-04 on January 1, 2012 did not have an impact on the Company's consolidated financial position or results of operations.

(3) HCR ManorCare Acquisition

On April 7, 2011, the Company completed its acquisition of substantially all of the real estate assets of HCR ManorCare, Inc. (HCR ManorCare), for a purchase price of \$6 billion (HCR ManorCare Acquisition). The purchase price consisted of the following: (i) \$4 billion in cash consideration; and (ii) \$2 billion representing the fair value of the Company's former HCR ManorCare debt investments that were settled as part of this acquisition. Through this transaction, the Company acquired 334 HCR ManorCare post-acute, skilled nursing and assisted living facilities. The facilities are located in 30 states, with the highest concentrations in Ohio, Pennsylvania, Florida, Illinois and Michigan. A wholly-owned subsidiary of HCR ManorCare operates the assets pursuant to a long-term triple-net master lease agreement supported by a guaranty from HCR ManorCare. Additionally, the Company exercised its option to purchase an ownership interest in HCR ManorCare for \$95 million that represented a 9.9% equity interest at closing.

The total purchase price of the HCR ManorCare Acquisition follows (in thousands):

Payment of aggregate cash consideration, net of cash acquired	\$	3,801,624
HCP's loan investments in HCR ManorCare's debt settled at fair value(1)		1,990,406
Assumed HCR ManorCare accrued liabilities at fair value(2)		224,932
Total purchase consideration	\$	6,016,962
Legal, accounting and other fees and costs(3)	\$	26,839

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

-
- (1) At closing, the Company recognized a gain of approximately \$23 million, included in interest income, which represented the fair value of the Company's existing mezzanine and mortgage loan investments in HCR ManorCare in excess of its carrying value on the acquisition date.
- (2) In August 2011, the Company paid these amounts to certain taxing authorities or the seller.
- (3) Represents estimated fees and costs of \$15.5 million (general and administrative) and the write-off of unamortized bridge loan fees of \$11.3 million (interest expense) upon its termination that were expensed in 2010 and 2011, respectively. These charges are directly attributable to the transaction and represent non-recurring costs.

The following table summarizes the fair value of the HCR ManorCare assets acquired and liabilities assumed at the April 7, 2011 acquisition date (in thousands):

Assets acquired	
Net investments in direct financing leases	\$ 6,002,074
Cash and cash equivalents	6,996
Intangible assets, net	14,888
Total assets acquired	6,023,958
Total liabilities assumed	
	224,932
Net assets acquired	\$ 5,799,026

Table of Contents

In connection with the HCR ManorCare Acquisition, the Company entered into a credit agreement for a 365-day bridge loan facility (from funding to maturity) in an aggregate amount of up to \$3.3 billion, which was terminated in accordance with its terms in March 2011.

The assets and liabilities of the Company's investments related to HCR ManorCare and the related results of operations are included in the condensed consolidated financial statements from the April 7, 2011 acquisition date. From the acquisition date to September 30, 2011, the Company recognized revenues and earnings from its investments related to HCR ManorCare of \$270.4 million and \$301.5 million, respectively.

See Note 8 for additional information regarding the Company's investment related to HCR ManorCare.

Pro Forma Results of Operations

The following unaudited pro forma consolidated results of operations assume that the HCR ManorCare Acquisition, including the Company's equity interest in HCR ManorCare, was completed as of January 1, 2011 (in thousands, except per share amounts):

	Nine Months Ended September 30, 2011	
Revenues	\$	1,351,574
Net income		590,333
Net income applicable to HCP, Inc.		577,673
Basic earnings per common share	\$	1.38
Diluted earnings per common share		1.38

(4) Other Real Estate Property Investments

A summary of real estate acquisitions for the nine months ended September 30, 2012 follows (in thousands):

Segment	Cash Paid	Consideration		Assets Acquired	
		Debt and Other Liabilities Assumed	Noncontrolling Interest	Real Estate	Net Intangibles
Medical office	\$ 157,556	\$ 35,120	\$ 27,346(1)	\$ 170,443	\$ 49,579
Life science	7,964		86	7,580	470
Senior housing	3,860			3,541	319
Hospital	3,000			3,000	
	\$ 172,380	\$ 35,120	\$ 27,432	\$ 184,564	\$ 50,368

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

(1) Represents non-managing member limited liability company units.

During the nine months ended September 30, 2012, the Company funded an aggregate of \$126 million for construction, tenant and other capital improvement projects, primarily in its life science and medical office segments.

A summary of real estate acquisitions for the nine months ended September 30, 2011 follows (in thousands):

Segment	Cash Paid	Consideration		Noncontrolling Interest	Assets Acquired	
		Debt Assumed			Real Estate	Net Intangibles
Life science	\$ 84,087	\$ 57,869		\$ 1,500	\$ 133,040	\$ 8,916
Medical office	29,743			1,500	26,191	5,052
	\$ 113,830	\$ 57,869		\$ 1,500	\$ 159,231	\$ 13,968

See discussion of the January 2011 purchase and consolidation of HCP Ventures II in Note 8.

During the nine months ended September 30, 2011, the Company funded an aggregate of \$87 million for construction, tenant and other capital improvement projects, primarily in its life science and medical office segments. During the nine months ended September 30, 2011, two of the Company's life science facilities located in South San Francisco were placed in service representing 88,000 square feet.

Table of Contents**(5) Dispositions of Real Estate and Discontinued Operations**

During the nine months ended September 30, 2012, the Company sold a medical office building for \$7 million.

At September 30, 2012, properties classified as held for sale included two senior housing facilities with an aggregate carrying value of \$91.2 million. At September 30, 2011, properties classified as held for sale included five senior housing facilities and a medical office building, with a combined aggregate carrying value of \$102.6 million.

The following table summarizes operating income from discontinued operations (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Rental and related revenues	\$ 2,844	\$ 3,443	\$ 8,816	\$ 10,326
Depreciation and amortization expenses	1,453	1,884	7,300	4,286
Operating expenses	4	10	26	36
Other expense, net	403	740	1,906	2,208
Income (loss)	\$ 984	\$ 809	\$ (416)	\$ 3,796
Gain on sales of real estate, net of income taxes	\$	\$	\$ 2,856	\$
Number of properties included in discontinued operations	2	6	3	6

(6) Net Investment in Direct Financing Leases

On April 7, 2011, the Company completed the acquisition of 334 HCR ManorCare properties subject to a single master lease that the Company classified as a direct financing lease (DFL). See discussion of the HCR ManorCare Acquisition in Note 3.

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

	September 30, 2012	December 31, 2011
Minimum lease payments receivable(1)	\$ 25,350,888	\$ 25,744,161
Estimated residual values	4,010,514	4,010,514
Less unearned income	(22,518,153)	(23,026,898)
Net investment in direct financing leases	\$ 6,843,249	\$ 6,727,777

Properties subject to direct financing leases	361	361
---	-----	-----

(1) The minimum lease payments receivable are primarily attributable to HCR ManorCare (\$24.2 billion and \$24.5 billion at September 30, 2012 and December 31, 2011, respectively). The triple-net master lease with HCR ManorCare provides for annual rent of \$489 million beginning April 1, 2012. The rent increases by 3.5% per year over the next four years and by 3% for the remaining portion of the initial lease term. The properties are grouped into four pools, and HCR ManorCare has a one-time extension option for each pool with rent increased for the first year of the extension option to the greater of fair market rent or a 3% increase over the rent for the prior year. Including the extension options, which the Company determined to be bargain renewal options, the four leased pools had total initial available terms ranging from 23 to 35 years.

Certain of the non-HCR ManorCare leases contain provisions that allow the tenants to elect to purchase the properties during or at the end of the lease terms for the aggregate initial investment amount plus adjustments, if any, as defined in the lease agreements. Certain leases also permit the Company to require the tenants to purchase the properties at the end of the lease terms.

(7) Loans Receivable

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

	September 30, 2012			December 31, 2011		
	Real Estate Secured	Other Secured	Total	Real Estate Secured	Other Secured	Total
Mezzanine	\$	\$ 183,253	\$ 183,253	\$	\$ 90,148	\$ 90,148
Other	74,413		74,413	35,643		35,643
Unamortized discounts, fees and costs	(255)	(3,072)	(3,327)	(1,040)	(1,088)	(2,128)
Allowance for loan losses		(13,410)	(13,410)		(13,410)	(13,410)
	\$ 74,158	\$ 166,771	\$ 240,929	\$ 34,603	\$ 75,650	\$ 110,253

Table of Contents

Tandem Health Care Loan

On July 31, 2012, the Company closed a mezzanine loan facility to lend up to \$205 million to Tandem Health Care (Tandem), an affiliate of Formation Capital, as part of the recapitalization of a post-acute/skilled nursing portfolio. The Company funded \$100 million (the First Tranche) at closing and expects to fund an additional \$105 million (the Second Tranche) between March 2013 and August 2013. The Second Tranche will be used to repay debt senior to the Company's loan. The loan is subordinate to \$400 million in senior mortgage debt and \$137 million in senior mezzanine debt. The loan bears interest at a fixed rate of 12% and 14% per annum for the First and Second Tranche, respectively. The facility will have a total term of up to 63 months from the initial closing.

Delphis Operations, L.P. Loan

The Company holds a secured term loan made to Delphis Operations, L.P. (Delphis or the Borrower) that is collateralized by all of the assets of the Borrower, which collateral is comprised primarily of interests in partnerships operating surgical facilities, some of which are on the premises of properties owned by the Company or HCP Ventures IV, LLC, an unconsolidated joint venture of the Company. In December 2009, the Company determined that the loan was impaired and recognized a provision for loan loss (impairment) of \$4.3 million. In January 2011, the Company placed the loan on cost-recovery status, whereby accrual of interest income was suspended and any payments received from the Borrower are applied to reduce the recorded investment in the loan. In September 2011, the Company determined that the fair value of the collateral assets was no longer in excess of the carrying value of the loan and therefore recognized an additional provision for losses of \$15.4 million.

As part of a March 2012 agreement (the 2012 Agreement) between Delphis, certain past and current principals of Delphis and the Cirrus Group, LLC (the Guarantors), and the Company, the Company agreed, among other things, to allow the distribution of \$1.5 million to certain of the Guarantors from funds generated from sales of assets that were pledged as additional collateral for this loan. In consideration of this distribution, among other things, the Company received cash of \$4.9 million (including funds that had been escrowed from past sales of the Guarantors collateral) and the assignment of certain rights to general and limited partnership interests (including the release of claims by such entities). Further, the Company, as part of the 2012 Agreement, agreed to provide financial incentives to the Borrower regarding the liquidation of the primary collateral assets for this loan.

The Company valued the cash payments and other consideration received through the 2012 Agreement (after reducing the consideration by \$0.5 million for related legal expenses) at \$6.9 million, which the Company applied to the carrying value of the loan, reducing the balance to \$68.8 million as of September 30, 2012 from its balance of \$75.7 million as of December 31, 2011. During the nine months ended September 30, 2011, the Company received cash payments from the Borrower of \$2.1 million. At September 30, 2012, the Company believes that the fair value of the collateral supporting this loan is in excess of the loan's carrying value.

Subsequent to September 30, 2012, Delphis closed on the sale of one of the primary collateral assets for the loan, and the Company received \$9.7 million in sales proceeds, net of an incentive payment provided for in the 2012 Agreement, which net proceeds were applied to reduce the principal balance of the loan to \$59.1 million as of October 2012.

HCR ManorCare Loans

In December 2007, the Company made a \$900 million investment (at a discount of \$100 million) in HCR ManorCare mezzanine loans, which paid interest at a floating rate of one-month London Interbank Offered Rate (LIBOR) plus 4.0%. Also, in August 2009 and January 2011, the Company purchased \$720 million (at a discount of \$130 million) and \$360 million, respectively, in participations in HCR ManorCare first mortgage debt, which paid interest at LIBOR plus 1.25%.

On April 7, 2011, upon closing of the HCR ManorCare Acquisition, the Company's loans to HCR ManorCare were settled, which resulted in additional interest income of \$23 million, which represents the excess of the loans' fair values above their carrying values at the acquisition date. See Note 3 for additional discussion related to the HCR ManorCare Acquisition.

Genesis HealthCare Loans

In September and October 2010, the Company purchased participations in a senior loan and mezzanine note of Genesis HealthCare (Genesis) with par values of \$278 million (at a discount of \$28 million) and \$50 million (at a discount of \$10 million), respectively. The Genesis senior loan paid interest at LIBOR (subject to a floor of 1.5%, increasing to 2.5% by maturity) plus a spread of 4.75%, increasing to 5.75% by maturity. The senior loan was secured by all of Genesis' assets. The mezzanine note paid interest at LIBOR plus a spread of 7.50%. In addition to the coupon interest payments, the mezzanine note required the payment of a termination fee, of which the Company's share prior to the early repayment of this loan was \$2.3 million.

Table of Contents

On April 1, 2011, the Company received \$330.4 million from the early repayment of its loans to Genesis, and recognized additional interest income of \$34.8 million, which represents the related unamortized discounts and termination fee.

(8) Investments in and Advances to Unconsolidated Joint Ventures*HCP Ventures II*

On January 14, 2011, the Company acquired its partner's 65% interest in HCP Ventures II, a joint venture that owned 25 senior housing facilities, becoming the sole owner of the portfolio.

The purchase consideration of HCP Ventures II follows (in thousands):

Cash paid for HCP Ventures II's partnership interest	\$	135,550
Fair value of HCP's 35% interest in HCP Ventures II (carrying value of \$65,223 at closing)(1)		72,992
Total consideration	\$	208,542
Estimated fees and costs		
Legal, accounting and other fees and costs(2)	\$	150
Debt assumption fees(3)		500
Total	\$	650

(1) In January 2011, the Company recognized a gain of approximately \$8 million, included in other income (expense), net, which represents the fair value of the Company's 35% interest in HCP Ventures II in excess of its carrying value on the acquisition date.

(2) Represents estimated fees and costs that were expensed and included in general and administrative expenses. These charges are directly attributable to the transaction and represent non-recurring costs.

(3) Represents debt assumption fees that were capitalized as deferred financing costs.

In accordance with the accounting guidance applicable to acquisitions of the partner's ownership interests that result in consolidation of previously unconsolidated entities, the Company recorded all of the assets and liabilities of HCP Ventures II at fair value as of the acquisition date. The Company utilized relevant market data and valuation techniques to determine the acquisition date fair value for HCP Ventures II. Relevant market data and valuation techniques included, but were not limited to, market data comparables for capitalization and discount rates, credit spreads, property specific building cost information and cash flow assumptions. The market data comparables utilized in the Company's valuation model were based on information that it believes to be within a reasonable range of the then current market transactions.

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

The following table summarizes the fair values of the HCP Ventures II assets acquired and liabilities assumed at the January 14, 2011 acquisition date (in thousands):

Assets acquired	
Buildings and improvements	\$ 683,633
Land	79,580
Cash	2,585
Restricted cash	1,861
Intangible assets	78,293
Total assets acquired	\$ 845,952
Liabilities assumed	
Mortgage debt	\$ 635,182
Other liabilities	2,228
Total liabilities assumed	637,410
Net assets acquired	\$ 208,542

The related assets, liabilities and results of operations of HCP Ventures II are included in the condensed consolidated financial statements from the January 14, 2011 acquisition date.

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

Table of Contents

Summary of Unconsolidated Joint Venture Information

The Company owns interests in the following entities that are accounted for under the equity method at September 30, 2012 (dollars in thousands):

Entity(1)	Properties/Segment	Investment(2)	Ownership %
HCR ManorCare	post-acute/skilled nursing operations	\$ 94,358	9.4(3)
HCP Ventures III, LLC	13 medical office	7,774	30
HCP Ventures IV, LLC	54 medical office and 4 hospital	33,071	20
HCP Life Science(4)	4 life science	67,263	50-63
Horizon Bay Hyde Park, LLC	1 senior housing	6,927	72
Suburban Properties, LLC	1 medical office	7,508	67
Advances to unconsolidated joint ventures, net		191	
		\$ 217,092	
Edgewood Assisted Living Center, LLC	1 senior housing	\$ (449)	45
Seminole Shores Living Center, LLC	1 senior housing	(737)	50
		\$ (1,186)	

(1) These entities are not consolidated because 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, 2011 in the Company's Annual Report on Form 10-K, as amended, 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, 2011 in the Company's Annual Report on Form 10-K, as amended, filed with the SEC regarding the Company's policy for accounting for joint venture interests.

(3) Presented after adjusting the Company's 9.9% ownership rate for the dilution of certain of HCR ManorCare's employee equity awards. See HCR ManorCare Acquisition discussion in Note 3.

(4) 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%).

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

	September 30, 2012	December 31, 2011
Real estate, net	\$ 3,751,592	\$ 3,806,187
Goodwill	2,736,400	2,736,400
Other assets, net	3,019,757	3,061,290
Total assets	\$ 9,507,749	\$ 9,603,877
Capital lease obligations and other debt	\$ 6,014,200	\$ 5,976,500
Mortgage debt	887,956	895,243
Accounts payable	954,622	1,083,581

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

Other partners' capital	1,467,292	1,465,536
HCP's capital(1)	183,679	183,017
Total liabilities and partners' capital	\$ 9,507,749	\$ 9,603,877

(1) The combined basis difference of the Company's investments in these joint ventures of \$32 million, as of September 30, 2012, is primarily attributable to goodwill, real estate, capital lease obligations, deferred tax assets and lease related net intangibles.

	Three Months Ended September 30,		Nine Months Ended September 30,(1)	
	2012	2011	2012	2011(2)
Total revenues	\$ 1,057,567	\$ 1,123,742	\$ 3,196,086	\$ 2,174,711
Net income (loss)	(8,851)	31,076	8,416	9,198
HCP's share in earnings(3)	13,396	17,050	42,803	32,798
Fees earned by HCP	460	494	1,423	1,605
Distributions received by HCP	1,419	1,271	4,826	4,398

(1) Beginning April 7, 2011, includes the financial information of HCR ManorCare, in which the Company acquired an interest for \$95 million that represented a 9.9% equity interest at closing.

(2) Includes the financial information of HCP Ventures II, which was consolidated on January 14, 2011.

(3) The Company's joint venture interest in HCR ManorCare is accounted for using the equity method and results in an ongoing reduction of DFL income, proportional to HCP's ownership in HCR ManorCare. The Company recorded a reduction of \$14.9 million and \$44.4 million for the three and nine months ended September 30, 2012, respectively, and a reduction of \$14.4 million and \$27.7 million for the three and nine months ended September 30, 2011. Further, the Company's share of earnings from HCR ManorCare (equity income) increases for the corresponding reduction of related lease expense recognized at the HCR ManorCare level.

Table of Contents**(9) Intangibles**

At September 30, 2012 and December 31, 2011, intangible lease assets, comprised of lease-up intangibles, above market tenant lease intangibles and below market ground lease intangibles, were \$607.6 million and \$571.5 million, respectively. At September 30, 2012 and December 31, 2011, the accumulated amortization of intangible assets was \$225.3 million and \$199.1 million, respectively.

At September 30, 2012 and December 31, 2011, intangible lease liabilities, comprised of below market lease intangibles and above market ground lease intangible liabilities were \$194.0 million and \$208.2 million, respectively. At September 30, 2012 and December 31, 2011, the accumulated amortization of intangible liabilities was \$88.8 million and \$90.4 million, respectively.

(10) Other Assets

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

	September 30, 2012	December 31, 2011
Straight-line rent assets, net of allowance of \$32,940 and \$34,457, respectively	\$ 299,754	\$ 266,620
Marketable debt securities(1)	221,018	
Leasing costs, net	93,619	92,288
Deferred financing costs, net	40,782	35,649
Goodwill	50,346	50,346
Marketable equity securities	22,769	17,053
Other(2)	43,154	23,502
Total other assets	\$ 771,442	\$ 485,458

(1) Represents £136.8 million of Four Seasons senior unsecured notes translated into U.S. dollars as of September 30, 2012 (see below for additional information).

(2) Includes a \$5.4 million allowance for losses related to accrued interest receivable on the Delphis loan, which accrued interest is included in other assets. At both September 30, 2012 and December 31, 2011, the carrying value of interest accrued related to the Delphis loan was zero. See Note 7 for additional information about the Delphis loan and the related impairment.

The marketable equity securities are classified as available-for-sale and had a fair value and adjusted cost basis of \$22.8 million and \$17.1 million, respectively, at September 30, 2012. At December 31, 2011, the fair value and adjusted cost basis of the marketable equity securities were both \$17.1 million.

Four Seasons Health Care Senior Unsecured Notes

On June 28, 2012, the Company purchased senior unsecured notes with an aggregate par value of £138.5 million at a discount for £136.8 million (\$214.9 million). The notes are issued by Elli Investments Limited, a subsidiary of Terra Firma, a European private equity firm, as part of its financing for the acquisition of Four Seasons Health Care, an elderly and specialist care provider in the United Kingdom. The notes mature in June 2020 and are non-callable through June 2016. The notes bear interest on their par value at a fixed rate of 12.25% per annum, with an original issue discount resulting in a yield to maturity of 12.5%. This investment is financed by a GBP denominated unsecured term loan that is discussed in Note 11. These senior unsecured notes are accounted for as marketable debt securities and classified as held-to-maturity.

(11) Debt

Bank Line of Credit and Term Loan

On March 27, 2012, the Company executed an amendment to its existing \$1.5 billion unsecured revolving line of credit facility (the Facility). This amendment reduces the cost to the Company of the Facility (lower borrowing rate and facility fee) and extends the Facility's maturity by one additional year to March 2016. The Facility contains a one-year extension option. Borrowings under this Facility accrue interest at LIBOR plus a margin that depends on 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 September 30, 2012, the margin on the Facility was 1.075%, and the facility fee was 0.175%. The Company has the right to increase the commitments under the Facility by an aggregate amount of up to \$500 million, subject to customary conditions. At September 30, 2012, the Company had had no balance outstanding under this Facility.

Table of Contents

On July 30, 2012, the Company entered into a credit agreement with a syndicate of banks for a £137 million (\$221 million at September 30, 2012) four-year unsecured term loan (the *Term Loan*) that accrues interest at a rate of GBP LIBOR plus 1.20%, based on the Company's current debt ratings. Concurrent with the closing of the *Term Loan*, the Company entered into a four-year interest rate swap contract that fixes the interest rate of the *Term Loan* at 1.81%, subject to adjustments based on the Company's debt ratings. The *Term Loan* contains a one-year committed extension option and covenants similar to those in the *Facility*.

The *Facility* and *Term Loan* contain certain financial restrictions and other customary requirements, including cross-default provisions to other indebtedness. Among other things, these covenants, using terms defined in the agreements (i) limit the ratio of Consolidated Total Indebtedness to Consolidated Total Asset Value to 60%, (ii) limit the ratio of Secured Debt to Consolidated Total Asset Value to 30%, (iii) limit the ratio of Unsecured Debt to Consolidated Unencumbered Asset Value to 60%, (iv) require a minimum Fixed Charge Coverage ratio of 1.5 times and (v) require a formula-determined Minimum Consolidated Tangible Net Worth of \$8.3 billion at September 30, 2012. At September 30, 2012, the Company was in compliance with each of these restrictions and requirements of the *Facility* and *Term Loan*.

Senior Unsecured Notes

At September 30, 2012, the Company had senior unsecured notes outstanding with an aggregate principal balance of \$5.9 billion. At September 30, 2012, interest rates on the notes ranged from 1.29% to 7.07% with a weighted average effective interest rate of 5.40% and a weighted average maturity of 6.11 years. Discounts and premiums are amortized to interest expense over the term of the related senior unsecured notes. The senior unsecured notes contain certain covenants including limitations on debt, cross-acceleration provisions and other customary terms. The Company believes it was in compliance with these covenants at September 30, 2012.

On July 23, 2012, the Company issued \$300 million of 3.15% senior unsecured notes due in 2022. The notes were priced at 98.888% of the principal amount with an effective yield to maturity of 3.28%; net proceeds from the offering were \$294 million.

On June 25, 2012, the Company repaid \$250 million of maturing senior unsecured notes, which accrued interest at a rate of 6.45%. The senior unsecured notes were repaid with proceeds from the Company's June 2012 common stock offering.

On January 23, 2012, the Company issued \$450 million of 3.75% senior unsecured notes due in 2019. The notes were priced at 99.523% of the principal amount with an effective yield to maturity of 3.83%; net proceeds from the offering were \$444 million.

On September 15, 2011, the Company repaid \$292 million of maturing senior unsecured notes, which accrued interest at a rate of 4.82%. The senior unsecured notes were repaid with funds available under the *Facility*.

On January 24, 2011, the Company issued \$2.4 billion of senior unsecured notes as follows: (i) \$400 million of 2.70% notes due 2014; (ii) \$500 million of 3.75% notes due 2016; (iii) \$1.2 billion of 5.375% notes due 2021; and (iv) \$300 million of 6.75% notes due 2041. The notes had an initial weighted average maturity of 10.3 years and a weighted average yield of 4.83%; net proceeds from the offering were \$2.37 billion.

Mortgage Debt

At September 30, 2012, the Company had \$1.7 billion in aggregate principal amount of mortgage debt outstanding that is secured by 137 healthcare facilities (including redevelopment properties) with a carrying value of \$2.1 billion. At September 30, 2012, interest rates on the mortgage debt ranged from 1.54% to 8.69% with a weighted average effective interest rate of 6.14% and a weighted average maturity of 3.80 years.

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

Table of Contents*Other Debt*

At September 30, 2012, the Company had \$85 million of non-interest bearing life care bonds at two of its continuing care retirement communities and non-interest bearing occupancy fee deposits at two of its senior housing facilities, all of which were payable to certain residents of the facilities (collectively, Life Care Bonds). At September 30, 2012, \$28 million of the Life Care Bonds were refundable to the residents upon the resident moving out or to their estate upon death, and \$57 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 at September 30, 2012 (in thousands):

Year	Term Loan(1)	Senior Unsecured Notes	Mortgage Debt	Total(2)
2012 (Three months)	\$	\$	\$ 8,715	\$ 8,715
2013		550,000	320,207	870,207
2014		487,000	184,495	671,495
2015		400,000	304,761	704,761
2016	221,214	900,000	293,175	1,414,389
Thereafter		3,600,000	584,762	4,184,762
	221,214	5,937,000	1,696,115	7,854,329
(Discounts) and premiums, net		(23,310)	(11,601)	(34,911)
	\$ 221,214	\$ 5,913,690	\$ 1,684,514	\$ 7,819,418

(1) Represents £137 million translated into U.S. dollars as of September 30, 2012.

(2) Excludes \$85 million of other debt that represents the Life Care Bonds that have no scheduled maturities.

(12) 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. The Company is not aware of any 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.

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.

The following table provides information regarding the Company's concentration with respect to certain operators; the information provided is presented for the gross assets and revenues that are associated with certain operators as percentages of the respective segment's and total Company's gross assets and revenues:

Segment Concentrations:

Operators	Percentage of Senior Housing Gross Assets		Percentage of Senior Housing Revenues		Percentage of Senior Housing Revenues	
	September 30, 2012	December 31, 2011	Three Months Ended September 30, 2012	September 30, 2011	Nine Months Ended September 30, 2012	September 30, 2011
HCR ManorCare(1)	14%	14%	12%	13%	12%	9%
Brookdale Senior Living(2)	14	14	14	16	14	17
Emeritus Corporation	18	19	20	23	21	25
Sunrise Senior Living(3)	22	22	16	18	16	21

Operators	Percentage of Post-Acute/Skilled Nursing Gross Assets		Percentage of Post-Acute/Skilled Nursing Revenues		Percentage of Post-Acute/Skilled Nursing Revenues	
	September 30, 2012	December 31, 2011	Three Months Ended September 30, 2012	September 30, 2011	Nine Months Ended September 30, 2012	September 30, 2011
HCR ManorCare(1)	89%	94%	87%	93%	91%	80%

Table of Contents

Total Company Concentrations:

Operators	Percentage of Total Company Gross Assets		Percentage of Total Company Revenues Three Months Ended September		Percentage of Total Company Revenues Nine Months Ended September 30,	
	September 30, 2012	December 31, 2011	2012	30, 2011	2012	2011
HCR ManorCare(1)	34%	35%	30%		32%	
Brookdale Senior Living(2)	4	5	5		5	5
Emeritus Corporation	6	6	7		7	7
Sunrise Senior Living(3)	7	7	5		6	6

(1) On April 7, 2011, the Company completed the acquisition of HCR ManorCare's real estate assets, which included the settlement of the Company's HCR ManorCare debt investments, see Notes 3 and 7 for additional information.

(2) As of September 30, 2012 and December 31, 2011, Brookdale Senior Living (Brookdale) percentages exclude \$685.4 and \$682.7 million, respectively, of senior housing assets related to 21 senior housing facilities that Brookdale operates (beginning September 1, 2011) on the Company's behalf under a RIDEA structure. Assuming that these assets were attributable to Brookdale, the percentage of segment and total assets for Brookdale would be 25% and 8%, respectively, as of September 30, 2012. Assuming that these assets were attributable to Brookdale, the percentage of segment and total assets for Brookdale would be 26% and 9%, respectively, as of December 31, 2011. For the three and nine months ended September 30, 2012, Brookdale percentages exclude \$36.1 million and \$106.8 million, respectively, of senior housing revenues related to these facilities. Assuming that these revenues were attributable to Brookdale, the percentage of segment and total revenues for Brookdale would be 38% and 12% respectively, for both the three months and nine months ended September 30, 2012.

(3) Certain of the Company's properties are leased to tenants who have entered into management contracts with Sunrise to operate the respective property on their behalf. The Company's concentration of gross assets includes properties directly leased to Sunrise and properties that are managed by Sunrise on behalf of third party tenants.

On September 1, 2011, the Company completed a strategic venture with Brookdale that includes the operation of 37 HCP-owned senior living communities previously leased to or operated by Horizon Bay Retirement Living (Horizon Bay). As part of this transaction, Brookdale acquired Horizon Bay and: (i) assumed an existing triple-net lease for nine HCP communities; (ii) entered into a new triple-net lease related to four HCP communities; (iii) assumed Horizon Bay's management of three HCP communities, one of which was developed by HCP; and (iv) entered into management contracts and a joint venture agreement for a 10% interest in the real estate and operations for 21 of the Company's communities that are in a RIDEA structure. Concurrent with these transactions, the Company purchased \$22.4 million of Brookdale's common stock in June 2011 (see Note 10 for additional information regarding these marketable equity securities).

Under the provisions of RIDEA, a REIT may lease qualified healthcare properties on an arm's length basis to a taxable REIT subsidiary if the property is operated on behalf of such subsidiary by a person who qualifies as an eligible independent contractor. The three months ended September 30, 2012 include \$36.1 million and \$24.1 million in revenues and operating expenses, respectively, and the nine months ended September 30, 2012 include \$106.8 million and \$67.5 million in revenues and operating expenses, respectively, as a result of reflecting the facility-level results for the 21 RIDEA facilities operated by Brookdale beginning September 1, 2011.

To mitigate credit risk of leasing properties to certain senior housing and post-acute/skilled nursing operators, leases with operators are often 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 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.

Credit Enhancement Guarantee

Certain of the Company's senior housing facilities serve as collateral for \$119 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 \$374 million as of September 30, 2012.

Table of Contents**(13) Equity***Preferred Stock*

On April 23, 2012, the Company redeemed all of its outstanding preferred stock consisting of 4,000,000 shares of its 7.25% Series E preferred stock and the 7,820,000 shares of its 7.10% Series F preferred stock. The shares of Series E and Series F preferred stock were redeemed at a price of \$25.00 per share, or \$295.5 million in aggregate, plus all accrued and unpaid dividends to the redemption date. As a result of the redemption, which was announced on March 22, 2012, the Company incurred a charge of \$10.4 million related to the original issuance costs of the preferred stock (this charge is presented as an additional preferred stock dividend in the Company's consolidated income statements).

On January 26, 2012, 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 30, 2012 to stockholders of record as of the close of business on March 15, 2012.

Common Stock

The following table lists the common stock cash dividends declared by the Company in 2012:

Declaration Date	Record Date	Amount Per Share	Dividend Payable Date
January 26	February 6	\$ 0.50	February 22
April 26	May 7	0.50	May 22
July 26	August 6	0.50	August 21
October 25	November 5	0.50	November 20

In June 2012, the Company completed a \$376 million offering of 8.97 million shares of common stock at a price of \$41.88 per share, which proceeds were primarily used to repay \$250 million of maturing senior unsecured notes, which accrued interest at a rate of 6.45%.

In March 2012, the Company completed a \$359 million offering of 9.0 million shares of common stock at a price of \$39.93 per share, which proceeds were primarily used to redeem all outstanding shares of the Company's preferred stock.

In March 2011, the Company completed a \$1.273 billion public offering of 34.5 million shares of common stock at a price of \$36.90 per share. The Company received total net proceeds of \$1.235 billion, which proceeds were used to fund the HCR ManorCare Acquisition. See Note 3 for additional information on the HCR ManorCare Acquisition.

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

The following is a summary of the Company's other common stock issuances (shares in thousands):

	Nine Months Ended September 30,	
	2012	2011
Dividend Reinvestment and Stock Purchase Plan	675	1,533
Conversion of DownREIT units(1)	72	30
Exercise of stock options	2,451	733
Vesting of restricted stock units(2)	385	228

(1) Non-managing member LLC units.

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

Accumulated Other Comprehensive Loss

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

	September 30, 2012	December 31, 2011
Unrealized gains on available for sale securities	\$ 5,716	\$ (15,712)
Unrealized losses on cash flow hedges, net	(18,917)	(2,794)
Supplemental Executive Retirement Plan minimum liability	(2,658)	(1,076)
Cumulative foreign currency translation adjustment	(787)	(19,582)
Total accumulated other comprehensive loss	\$ (16,646)	\$ (19,582)

Table of Contents*Noncontrolling Interests*

At September 30, 2012, there were 4.4 million DownREIT units outstanding in five LLCs, for which the Company is the managing member. At September 30, 2012, the carrying and fair values of these DownREIT units were \$195 million and \$285 million, respectively.

(14) Segment Disclosures

The Company evaluates its business and makes resource allocations based on its five business segments: (i) senior housing, (ii) post-acute/skilled nursing, (iii) life science, (iv) medical office and (v) hospital. Under the senior housing, post-acute/skilled nursing, life science and hospital segments, the Company invests or co-invests primarily in single operator or tenant properties, through the acquisition and development of real estate, management of operations and by debt issued by operators in these sectors. Under the medical office segment, the Company invests or co-invests through the acquisition and development of medical office buildings (MOBs) that are leased under gross, modified gross or triple-net leases, generally to multiple tenants, and which generally 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, 2011 in the Company's Annual Report on Form 10-K, as amended, filed with the SEC. There were no intersegment sales or transfers during the nine months ended September 30, 2012 and 2011. The Company evaluates performance based upon property net operating income from continuing operations (NOI), adjusted 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, marketable equity securities 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 12 for other information regarding concentrations of credit risk.

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

For the three months ended September 30, 2012:

Segments	Rental Revenues(1)	Resident Fees and Services	Interest Income	Investment Management Fee Income	Total Revenues	NOI(2)	Adjusted NOI(2)
Senior housing	\$ 114,856	\$ 36,076	\$ 876	\$	\$ 151,808	\$ 126,060	\$ 113,592
Post-acute/skilled	135,508		9,135		144,643	135,354	116,898
Life science	71,194			1	71,195	59,403	56,341
Medical office	85,800			459	86,259	50,852	49,669
Hospital	21,310		267		21,577	20,408	19,950
Total	\$ 428,668	\$ 36,076	\$ 10,278	\$ 460	\$ 475,482	\$ 392,077	\$ 356,450

For the three months ended September 30, 2011:

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

Segments	Rental Revenues(1)	Resident Fees and Services	Interest Income	Investment Management Fee Income	Total Revenues	NOI(2)	Adjusted NOI(2)
Senior housing	\$ 122,849	\$ 11,974	\$ 42	\$	\$ 134,865	\$ 125,209	\$ 112,755
Post-acute/skilled	132,392		287		132,679	132,148	112,881
Life science	71,093			1	71,094	57,860	52,785
Medical office	80,996			493	81,489	47,650	46,514
Hospital	20,854		248		21,102	19,629	19,065
Total	\$ 428,184	\$ 11,974	\$ 577	\$ 494	\$ 441,229	\$ 382,496	\$ 344,000

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

Table of Contents

For the nine months ended September 30, 2012:

Segments	Rental Revenues(1)	Resident Fees and Services	Interest Income	Investment Management Fee Income	Total Revenues	NOI(2)	Adjusted NOI(2)
Senior housing	\$ 341,936	\$ 107,824	\$ 1,686	\$	\$ 451,446	\$ 379,834	\$ 342,368
Post-acute/skilled	404,180		9,842		414,022	403,654	346,900
Life science	215,569			3	215,572	177,339	171,179
Medical office	246,661			1,420	248,081	148,030	144,272
Hospital	63,300		785		64,085	60,530	58,996
Total	\$ 1,271,646	\$ 107,824	\$ 12,313	\$ 1,423	\$ 1,393,206	\$ 1,169,387	\$ 1,063,715

For the nine months ended September 30, 2011:

Segments	Rental Revenues(1)	Resident Fees and Services	Interest Income	Investment Management Fee Income	Total Revenues	NOI(2)	Adjusted NOI(2)
Senior housing	\$ 355,496	\$ 15,314	\$ 49	\$ 70	\$ 370,929	\$ 359,460	\$ 319,393
Post-acute/skilled	265,377		98,167		363,544	265,059	228,034
Life science	215,045			3	215,048	176,384	159,544
Medical office	240,603			1,532	242,135	143,243	138,469
Hospital	62,118		983		63,101	58,704	56,863
Total	\$ 1,138,639	\$ 15,314	\$ 99,199	\$ 1,605	\$ 1,254,757	\$ 1,002,850	\$ 902,303

(1) Represents rental and related revenues, tenant recoveries, and income from DFLs.

(2) NOI is a non-GAAP supplemental financial measure used to evaluate the operating performance of real estate. The Company defines NOI as rental and related revenues, including tenant recoveries, resident fees and services, and income from direct financing leases, less property level operating expenses. NOI excludes interest income, investment management fee income, interest expense, depreciation and amortization, general and administrative expenses, litigation settlement, impairments, impairment recoveries, other income (expense), net, income taxes, equity income from and impairments of investments in unconsolidated joint ventures, and discontinued operations. The Company believes NOI provides relevant and useful information because it reflects only income and operating expense items that are incurred at the property level and presents them on an unleveraged basis. Adjusted NOI is calculated as NOI after eliminating the effects of straight-line rents, DFL accretion, amortization of above and below market lease intangibles, and lease termination fees. Adjusted NOI is sometimes referred to as cash NOI. The Company uses NOI and adjusted NOI to make decisions about resource allocations and to assess and compare 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 because 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 reported net income to NOI and adjusted NOI (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net income	\$ 199,043	\$ 175,471	\$ 600,582	\$ 483,707
Interest income	(10,278)	(577)	(12,313)	(99,199)
Investment management fee income	(460)	(494)	(1,423)	(1,605)

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

Interest expense	103,513	103,459	309,875	315,695
Depreciation and amortization	88,686	86,672	259,039	265,742
General and administrative	19,443	19,647	54,356	76,471
Impairments	7,878	15,400	7,878	15,400
Other (income) expense, net	(770)	772	(2,233)	(17,056)
Income taxes	(598)	5	(1,131)	289
Equity income from unconsolidated joint ventures	(13,396)	(17,050)	(42,803)	(32,798)
Total discontinued operations, net of income taxes	(984)	(809)	(2,440)	(3,796)
NOI	392,077	382,496	1,169,387	1,002,850
Straight-line rents	(11,821)	(14,024)	(33,608)	(46,936)
DFL accretion	(23,433)	(23,571)	(71,072)	(48,508)
Amortization of above and below market lease intangibles, net	(533)	(1,178)	(1,855)	(3,271)
Lease termination fees	(175)	(239)	(574)	(3,417)
NOI adjustments related to discontinued operations	335	516	1,437	1,585
Adjusted NOI	\$ 356,450	\$ 344,000	\$ 1,063,715	\$ 902,303

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

Table of Contents

The Company's total assets by segment were (in thousands):

Segments	September 30, 2012	December 31, 2011
Senior housing	\$ 5,867,914	\$ 5,792,196
Post-acute/skilled nursing	6,057,501	5,644,472
Life science	3,928,661	3,886,851
Medical office	2,586,231	2,336,302
Hospital	760,222	757,618
Gross segment assets	19,200,529	18,417,439
Accumulated depreciation and amortization	(1,885,172)	(1,649,845)
Net segment assets	17,315,357	16,767,594
Real estate held for sale, net	91,226	102,649
Other non-segment assets	672,753	538,232
Total assets	\$ 18,079,336	\$ 17,408,475

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 facilities 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 September 30, 2012, goodwill of \$50 million was allocated to segment assets as follows: (i) senior housing \$31 million, (ii) post-acute/skilled nursing \$3 million, (iii) medical office \$11 million, and (iv) hospital \$5 million.

(15) Earnings Per Common Share

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

Numerator	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Income from continuing operations	\$ 198,059	\$ 174,662	\$ 598,142	\$ 479,911
Noncontrolling interests' share in continuing operations	(2,935)	(3,276)	(9,070)	(12,660)
Income from continuing operations applicable to HCP, Inc.	195,124	171,386	589,072	467,251
Preferred stock dividends		(5,282)	(17,006)	(15,848)
Participating securities' share in continuing operations	(479)	(546)	(2,154)	(1,893)
Income from continuing operations applicable to common shares	194,645	165,558	569,912	449,510
Discontinued operations	984	809	2,440	3,796
Net income applicable to common shares	\$ 195,629	\$ 166,367	\$ 572,352	\$ 453,306

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

Denominator						
Basic weighted average common shares	429,557		407,081		420,049	395,258
Dilutive potential common shares	1,221		1,565		1,355	1,755
Diluted weighted average common shares	430,778		408,646		421,404	397,013
Basic earnings per common share						
Income from continuing operations	\$ 0.45	\$ 0.41	\$ 1.36	\$ 1.14		
Discontinued operations	0.01			0.01		
Net income applicable to common shares	\$ 0.46	\$ 0.41	\$ 1.36	\$ 1.15		
Diluted earnings per common share						
Income from continuing operations	\$ 0.45	\$ 0.41	\$ 1.36	\$ 1.13		
Discontinued operations				0.01		
Net income applicable to common shares	\$ 0.45	\$ 0.41	\$ 1.36	\$ 1.14		

Table of Contents

Restricted stock and certain of the Company's performance restricted stock units are considered participating securities, because dividend payments are not forfeited even if the underlying award does not vest, which require the use of the two-class method when computing basic and diluted earnings per share.

Options to purchase approximately 0.5 million and 1.1 million shares of common stock that had an exercise price (including deferred compensation expense) in excess of the average market price of the Company's common stock during the three months ended September 30, 2012 and 2011, respectively, were not included in the Company's earnings per share calculations because they are anti-dilutive. Restricted stock and performance restricted stock units representing 15,000 shares of common stock during the three months ended September 30, 2011 were not included because they are anti-dilutive. Additionally, 6.4 million shares issuable upon conversion of 4.4 million DownREIT units during the three months ended September 30, 2012 were not included because they are anti-dilutive. During the three months ended September 30, 2011, 5.9 million shares issuable upon conversion of 4.2 million DownREIT units were not included because they are anti-dilutive.

(16) Supplemental Cash Flow Information

The following table provides supplemental cash flow information (in thousands):

	Nine Months Ended September 30,	
	2012	2011
<i>Supplemental cash flow information:</i>		
Interest paid, net of capitalized interest	\$ 339,190	\$ 290,738
Income taxes paid	1,645	583
Capitalized interest	18,517	19,395
<i>Supplemental schedule of non-cash investing activities:</i>		
Accrued construction costs	18,024	11,353
Settlement of loans receivable as consideration for the HCR ManorCare Acquisition		1,990,406
<i>Supplemental schedule of non-cash financing activities:</i>		
Vesting of restricted stock units	385	228
Cancellation of restricted stock	6	(35)
Conversion of non-managing member units into common stock	2,398	2,533
Mortgages included in the consolidation of HCP Ventures II		635,182
Noncontrolling interests issued in connection with acquisitions	27,432	1,500
Mortgages and other liabilities assumed with other real estate acquisitions	35,120	57,869
Unrealized gains (losses) on available-for-sale securities and derivatives designated as cash flow hedges, net	2,203	(14,244)

See additional information regarding supplemental non-cash financing activities related to the HCR ManorCare transaction in Notes 3 and 7, the HCP Ventures II purchase in Note 8 and preferred stock redemption in Note 13.

(17) Variable Interest Entities

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

At September 30, 2012, the Company leased 48 properties to a total of seven VIE tenants and had an additional investment in a loan to a VIE borrower. 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 these VIEs are presented below at September 30, 2012 (in thousands):

VIE Type	Maximum Loss Exposure(1)	Asset/Liability Type	Carrying Amount
VIE tenants operating leases	\$ 308,905	Lease intangibles, net and straight-line rent receivables	\$ 15,122
VIE tenants DFLs	1,132,359	Net investment in DFLs	597,792
Loan senior secured	68,755	Loans receivable, net	68,755

(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 its loan to the VIE represents its current aggregate carrying amount.

Table of Contents

As of September 30, 2012, the Company has not provided, and is not required to provide, financial support through a liquidity arrangement or otherwise, to its unconsolidated VIEs, including circumstances in which it could be exposed to further losses (e.g., cash shortfalls).

The Company holds an interest-only, senior secured term loan made to a borrower that has been identified as a VIE. The Company does not consolidate the VIE because it does not have the ability to control the activities that most significantly impact the VIE's economic performance. The loan is collateralized by all of the assets of the borrower (comprised primarily of interests in partnerships that operate surgical facilities, some of which are on the premises of properties owned by the Company or HCP Ventures IV, LLC) and is supported in part by limited guarantees made by certain former and current principals of the borrower. Recourse under certain of these guarantees is limited to the guarantors' respective ownership interests in certain entities owning real estate that are pledged to secure such guarantees.

See Notes 6, 7 and 12 for additional description of the nature, purpose and activities of the Company's VIEs and interests therein.

(18) Fair Value Measurements

The following table presents the Company's fair value measurements of its financial assets and liabilities measured at fair value in the condensed consolidated balance sheets. Recognized gains and losses are recorded in other income (expense), net in the condensed consolidated income statements. During the nine months ended September 30, 2012, there were no transfers of financial assets or liabilities within the fair value hierarchy.

The financial assets and liabilities carried at fair value on a recurring basis at September 30, 2012 follow (in thousands):

Financial Instrument	Fair Value	Level 1	Level 2	Level 3
Marketable equity securities	\$ 22,769	\$ 22,769		
Interest-rate swap liabilities(1)	(13,319)		(13,319)	
Currency swap liabilities (1)	(2,317)		(2,317)	
Warrants(1)	1,290			1,290
	\$ 8,423	\$ 22,769	\$ (15,636)	\$ 1,290

(1) Interest rate and currency swaps as well as common stock warrant fair values are determined based on observable and unobservable market assumptions utilizing standardized derivative pricing models.

(19) Disclosures About Fair Value of Financial Instruments

The carrying values of cash and cash equivalents, restricted cash, accounts receivable, accounts payable and accrued liabilities are reasonable estimates of fair value because of the short-term maturities of these instruments. Fair value of loans receivable, bank line of credit, term loan,

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

mortgage debt and other debt are based on rates currently prevailing for similar instruments with similar maturities. The fair value of the marketable debt securities, interest-rate and currency swap contracts as well as common stock warrants were determined based on observable and unobservable market assumptions using standardized pricing models. The fair values of the senior unsecured notes and marketable equity securities were determined utilizing market quotes.

The table below summarizes the carrying amounts and fair values of the Company's financial instruments (in thousands):

	September 30, 2012		December 31, 2011	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Loans receivable, net(2)	\$ 240,929	\$ 252,032	\$ 110,253	\$ 111,073
Marketable debt securities(3)	221,018	221,018		
Marketable equity securities(1)	22,769	22,769	17,053	17,053
Warrants(3)	1,290	1,290	1,334	1,334
Bank line of credit(2)			454,000	454,000
Term loan(2)	221,214	221,214		
Senior unsecured notes(1)	5,913,690	6,623,609	5,416,063	5,819,304
Mortgage debt(2)	1,684,514	1,786,940	1,764,571	1,870,070
Other debt(2)	84,580	84,580	87,985	87,985
Interest-rate swap liabilities(2)	13,319	13,319	12,123	12,123
Currency swap liabilities(2)	2,317	2,317		

(1) Level 1: Fair value calculated based on quoted prices in active markets.

(2) Level 2: Fair value based on quoted prices for similar or identical instruments in active or inactive markets, respectively, or calculated utilizing model-derived valuations in which significant inputs or value drivers are observable in active markets.

(3) Level 3: Fair value determined based on significant unobservable market inputs using standardized derivative pricing models.

Table of Contents**(20) Derivative Financial Instruments**

The following table summarizes the Company's outstanding interest-rate and foreign currency swap contracts as of September 30, 2012 (dollars in thousands):

July 2005(2)	July 2020	Cash Flow		3.82%	BMA Swap Index	\$	45,600	\$	(8,868)
July 2009(4)	July 2013	Cash Flow		6.13%	1 Month LIBOR+3.65%		13,700		(234)
July 2012(5)	June 2016	Cash Flow	\$	11,400	Buy USD/Sell GBP	£	7,200		(2,317)

(1) Interest-rate and foreign currency swap assets are recorded in other assets, net and interest-rate and foreign currency 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) Acquired in conjunction with mortgage debt assumed related to real estate acquired on December 28, 2010. Hedges fluctuations in interest payments on variable-rate secured debt due to fluctuations in the underlying benchmark interest rate.

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

(5) Currency swap contract (buy USD/sell GBP) hedges the foreign currency exchange risk related to a portion of the Company's forecasted interest receipts on GBP denominated senior unsecured notes.

The Company uses derivative instruments to mitigate the effects of interest rate fluctuations on specific forecasted transactions as well as recognized financial 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. Utilizing derivative instruments allows the Company to effectively manage the risk of fluctuations in interest and foreign currency rates related 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 contracts, 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

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

position. At September 30, 2012, the Company does not anticipate non-performance by the counterparties to its outstanding derivative contracts.

On July 27, 2012, the Company entered into a foreign currency swap contract to hedge the foreign currency exchange risk related to a portion of the forecasted interest receipts from its GBP denominated senior unsecured notes (see additional discussion of the Four Seasons Health Care Senior Unsecured Notes in Note 10). The cash flow hedge has a fixed USD/GBP exchange rate of 1.5695 (buy \$11.4 million and sell £7.2 million) for a portion of its forecasted semi-annual cash receipts denominated in GBP. The foreign currency swap contract matures in June 2016 (the end of the non-call period of the senior unsecured notes). The fair value of the contract at September 30, 2012 was a liability of \$2.3 million and is included in accounts payable and accrued liabilities. During the nine months ended September 30, 2012, there was no ineffective portion related to this hedge.

On July 27, 2012, the Company entered into an interest-rate swap contract that is designated as hedging the interest payments on its GBP denominated Term Loan due to fluctuations in the underlying benchmark interest rate (see additional discussions of the Term Loan in Note 11). The cash flow hedge has a notional amount of £137 million and expires in June 2016 (the maturity of the Term Loan). The fair value of the contract at September 30, 2012 was a liability of \$75,000 and is included in accounts payable and accrued liabilities. During the nine months ended September 30, 2012, there was no ineffective portion related to this hedge.

In August 2009, the Company entered into an interest-rate swap contract (pay float and receive fixed), that was designated as hedging fluctuations in interest receipts related to its participation in the variable-rate first mortgage debt of HCR ManorCare. At March 31, 2011 the Company determined, based on the anticipated closing of the HCR ManorCare Acquisition during April 2011, that the underlying hedged transactions (underlying mortgage debt interest receipts) were not probable of occurring. As a result, the Company reclassified \$1 million of unrealized gains related to this interest-rate swap contract into other income (expense), net. Concurrent with closing the HCR ManorCare Acquisition (for additional details see Note 3), the Company settled the interest-rate swap contract for proceeds of \$1 million.

Table of Contents

At September 30, 2012, the Company expects that the hedged forecasted transactions for each of the outstanding qualifying cash flow hedging relationships remain probable of occurring and as a result no gains or losses recorded to accumulated other comprehensive loss are expected to be reclassified to earnings.

To illustrate the effect of movements in the interest rate and foreign currency markets, the Company performed a market sensitivity analysis on its outstanding hedging instruments. The Company applied various basis point spreads to the underlying interest rate curves and foreign currency exchange rates of the derivative portfolio in order to determine the instruments' change in fair value. The following table summarizes the results of the analysis performed (dollars in thousands):

Date Entered	Maturity Date	Effects of Change in Interest and Foreign Currency Rates			
		+50 Basis Points	-50 Basis Points	+100 Basis Points	-100 Basis Points
July 2005	July 2020	\$ 1,605	\$ (1,760)	\$ 3,287	\$ (3,443)
November 2008	October 2016	528	(526)	1,055	(1,052)
July 2009	July 2013	49	(55)	102	(107)
July 2012	June 2016	4,238	(3,872)	8,293	(7,926)
July 2012	June 2016	(699)	232	(1,164)	697

(21) Impairments

During the three months ended September 30, 2012, the Company executed an expansion of its tenant relationship with General Atomics in Poway, CA, to a total of 396,000 square feet, consisting of the following: (i) a lease extension of 281,000 square feet through June 2024, (ii) a new 10 year lease for a 115,000 square feet building to be developed and (iii) the purchase of a 19 acre land parcel from the Company for \$19 million. As a result of the pending land sale the Company recognized an impairment charge of \$7.9 million, which reduced the carrying value of the Company's investment from \$27 million to the expected sales price of \$19 million. The fair value of the Company's land parcel was based on the sales price from its anticipated disposition in conjunction with this transaction. The contractual sales price of the land parcel is considered to be a Level 2 measurement within the fair value hierarchy.

During the three months ended September 30, 2011, the Company recognized additional provisions for losses (impairment) of \$15.4 million related to its Cirrus loan investment that reduced the carrying value of its loan and related receivables from \$91.1 million to \$75.7 million, which was the fair value of the collateral supporting this loan. See Note 7 for additional information on this loan and related impairment. The fair value of the collateral supporting the Company's loan investment was based on a discounted cash flow valuation model and inputs considered to be a Level 3 measurement within the fair value hierarchy. Inputs to this valuation model include discount rates, earnings multiples, market comparables, industry growth rates and operating margins, some of which influence the fair value of the collateral supporting this loan.

(22) Subsequent Events

On October 16, 2012, the Company entered into a definitive agreement to acquire 133 senior housing communities for \$1.73 billion, from a joint venture between Emeritus Corporation (Emeritus) and Blackstone Real Estate Partners VI, an affiliate of Blackstone (the Blackstone JV). Located in 29 states, the portfolio encompasses 10,350 units representing a diversified care mix of 61% assisted living, 25% independent living, 13% memory care and 1% skilled nursing. Based on current operating performance, the 133 communities consist of 99 that are stabilized and 34

that are currently in lease up.

Emeritus will continue to operate the communities pursuant to long-term triple-net leases. To the extent any of the communities are leased to a subsidiary of Emeritus, the leases will be guaranteed by Emeritus. The leases provide total contractual rent in the first year of \$105.5 million. The contractual rent will increase annually by the greater of the percentage increase in the Consumer Price Index (CPI) or 3.7% on average over the initial five years, and thereafter by the greater of CPI or 3.0% for the remaining portion of the initial lease term. At the beginning of the sixth lease year, rent on the 34 lease-up properties will be increased to the greater of the percentage increase in CPI or fair market, subject to a floor of 103% and a cap of 130% of the prior year's rent.

The properties will be grouped into three comparable pools with initial terms of 14 to 16 years. Emeritus has two extension options, which, if exercised, bring total available lease terms to 30 to 35 years.

Concurrent with the acquisition, Emeritus will purchase nine communities from the Blackstone JV, for which the Company has agreed to provide secured debt financing of \$52 million with a four-year term. The loan is secured by the underlying real estate and is prepayable at Emeritus' option. The interest rate on the loan will initially be 6.1% and will gradually increase during its four year term to 7.05%.

On October 19, 2012, the Company completed a public offering of 22 million shares of common stock and received net proceeds of \$979 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 our Annual Report on Form 10-K, as amended, for the fiscal year ended December 31, 2011, factors that may cause our actual results to differ materially from the expectations contained in the forward-looking statements include:

- (a) Changes in global, national and local economic conditions, including a prolonged period of weak economic growth;
- (b) Continued volatility in the capital markets, including changes in interest rates and the availability and cost of capital;
- (c) Our ability to manage our 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 future litigation matters, including the possibility of larger than expected litigation costs, adverse results 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) Our ability to negotiate the same or better terms with new tenants or operators if existing leases are not renewed or we exercise our 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 financial, legal, regulatory and reputational difficulties of significant operators of our properties;
- (j) 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;
- (k) The ability to obtain financing necessary to consummate acquisitions on favorable terms;
- (l) Changes in the reimbursement available to our operators, tenants and borrowers by governmental or private payors (including the July 2011 Centers for Medicare & Medicaid Services final rule reducing Medicare skilled nursing facility Prospective Payment System payments in FY 2012 by 11.1% compared to FY 2011) and other potential changes in Medicare and Medicaid payment levels, which, among other effects, could negatively impact the value of our approximate 10% equity interest in the operations of HCR ManorCare, Inc.;
- (m) The risks associated with our investments in joint ventures and unconsolidated entities, including our lack of sole decision making authority and our reliance on our joint venture partners' financial condition and continued cooperation;
- (n) 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 and our ability to recover investments made, if applicable, in their operations; and
- (o) 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.

Table of Contents

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.

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

- 2012 Transaction Overview

- Dividends

- Critical Accounting Policies

- Results of Operations

- Liquidity and Capital Resources

- Funds from Operations

- Off-Balance Sheet Arrangements

- Contractual Obligations

- Inflation

- Recent Accounting Pronouncements

Executive Summary

We are a Maryland corporation and were organized to qualify as a self-administered real estate investment trust (REIT) that, together with our unconsolidated joint ventures, 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 September 30, 2012, our portfolio of investments, including properties in our Investment Management Platform, consisted of interests in 1,029 facilities. Our Investment Management Platform represents the following joint ventures: (i) HCP Ventures III, LLC, (ii) HCP Ventures IV, LLC and (iii) 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 redeploy capital from investments with lower return potential into investments with higher return potential. We make investments where the expected risk-adjusted return exceeds our cost of capital and strive to capitalize on our operator, tenant and other business relationships to grow our business.

Our strategy contemplates acquiring and developing properties on terms that are favorable to us. 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 the potential disposition of properties that no longer fit our strategy.

We primarily generate revenue by leasing healthcare properties under long-term leases with fixed or inflation indexed escalators. 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 underlying lease structures; and (iii) control operating and other expenses. Our operations are impacted by property specific, market specific, general economic and other conditions. At September 30, 2012, the contractual maturities in our portfolio of leased assets were 10% through 2014 (measured in dollars of expiring rents).

Table of Contents

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.

2012 Transaction Overview

Announced \$1.73 Billion Senior Housing Portfolio Acquisition and \$52 Million Secured Financing

On October 16, 2012, we entered into a definitive agreement to acquire 133 senior housing communities for \$1.73 billion, from a joint venture between Emeritus Corporation (Emeritus) and Blackstone Real Estate Partners VI, an affiliate of Blackstone (the Blackstone JV). Located in 29 states, the portfolio encompasses 10,350 units representing a diversified care mix of 61% assisted living, 25% independent living, 13% memory care and 1% skilled nursing. Based on current operating performance, the 133 communities consist of 99 that are stabilized and 34 currently in lease up.

Emeritus will continue to operate the communities pursuant to long-term triple-net leases. To the extent any of the communities are leased to a subsidiary of Emeritus, the leases will be guaranteed by Emeritus. The leases provide total contractual rent in the first year of \$105.5 million. The contractual rent will increase annually by the greater of the percentage increase in the Consumer Price Index (CPI) or 3.7% on average over the initial five years, and thereafter by the greater of CPI or 3.0% for the remaining portion of the initial lease term. At the beginning of the sixth lease year, rent on the 34 lease-up properties will be increased to the greater of the percentage increase in CPI or fair market, subject to a floor of 103% and a cap of 130% of the prior year's rent, allowing HCP to capture potential upside from these non-stabilized assets.

The properties will be grouped into three comparable pools with initial terms of 14 to 16 years. Emeritus has two extension options, which, if exercised, bring total available lease terms to 30 to 35 years.

Concurrent with the acquisition, Emeritus will purchase nine communities from the Blackstone JV, for which we have agreed to provide secured debt financing of \$52 million with a four-year term. The loan is secured by the underlying real estate and is prepayable at Emeritus' option. The interest rate on the loan will mirror the 6.1% lease yield, including the annual increases through maturity.

We expect to close the real estate acquisition in phases beginning early November 2012.

Additional Investment Transactions

On August 7, 2012, we completed the acquisition of eight on-campus medical office buildings (MOBs) for \$81 million from Scottsdale Healthcare. Located in Scottsdale, Arizona, the portfolio represents 398,000 square feet with a current occupancy of 89%.

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

Between July and October 2012, we acquired 12 MOBs from The Boyer Company valued at \$186 million, including non-managing member LLC units (DownREIT units) and debt valued at \$41 million and \$59 million, respectively; the MOBs are primarily located on the campuses of HCA, Iasis Healthcare and Community Health Systems and comprise 758,000 square feet with a current occupancy of 88%. The transaction closed in three stages: (i) six MOBs on July 31, 2012 for \$78 million representing 327,000 square feet; (ii) four MOBs on August 15, 2012 for \$49 million representing 199,000 square feet and; (iii) two MOBs on October 19, 2012 for \$59 million representing 232,000 square feet.

On July 31, 2012, we closed a mezzanine loan facility to lend up to \$205 million to Tandem Health Care (Tandem), an affiliate of Formation Capital, as part of the recapitalization of a post-acute/skilled nursing portfolio. We funded \$100 million (the First Tranche) at closing and expect to fund an additional \$105 million (the Second Tranche) between March 2013 and August 2013. The Second Tranche will be used to repay debt senior to our loan. The loan is subordinate to \$400 million in senior mortgage debt and \$137 million in senior mezzanine debt. The loan bears interest at a fixed rate of 12% and 14% per annum for the First and Second Tranche, respectively. Including fees received at closing, the loan has a blended yield to maturity of approximately 13%. The facility will have a total term of up to 63 months from the initial closing.

Table of Contents

On June 28, 2012, we made an investment in senior unsecured notes with an aggregate par value of £138.5 million at a discount for £136.8 million, as part of the financing for Terra Firma's £825 million acquisition of Four Seasons Health Care (Four Seasons), the largest elderly and specialist care provider in the United Kingdom with 445 care homes and 61 specialist care centers. The notes mature in June 2020 and are non-callable until June 2016. The notes bear interest on their par value at a fixed rate of 12.25% per annum, with an original discount resulting in a yield to maturity of 12.5%. Terra Firma, a leading European private equity firm, provided £345 million in equity financing, resulting in a loan-to-capitalization of 62% for the Four Seasons notes. The £136.8 million for this investment is match funded by an equivalent GBP denominated unsecured term loan discussed below.

During the third quarter, we expanded our tenant relationship with General Atomics in Poway, CA to a total of 396,000 square feet, consisting of the following: (i) a lease extension of 281,000 square feet through June 2024, and (ii) a new 10-year lease (expected to commence mid-2014) for a 115,000 square feet build-to-suit development. As part of this transaction, General Atomics agreed to purchase a 19-acre land parcel from HCP for \$19 million, resulting in a \$7.9 million impairment charge.

During the nine months ended September 30, 2012, we made other investments of \$192 million as follows: (i) acquisition of a MOB for \$14 million; (ii) acquisition of a life science facility for \$8 million; (iii) acquisition of a senior housing facility for \$4 million; (iv) acquisition of a parcel of land adjacent to one of our hospitals for \$3 million; and (v) funding of development and other capital projects of \$163 million, primarily in our life science, senior housing and medical office segments.

Financing Activities

On October 19, 2012, we completed a public offering of 22 million shares of common stock and received net proceeds of \$979 million.

On July 30, 2012, we entered into a credit agreement with a syndicate of banks for a £137 million four-year unsecured term loan (the Term Loan) that accrues interest at a rate of GBP London Interbank Offered Rate (LIBOR) plus 1.20%, based on our current debt ratings. Concurrent with the closing of the Term Loan, we entered into a four-year interest rate swap agreement that fixes the rate of the Term Loan at 1.81%, subject to adjustments based on our credit ratings. The Term Loan contains a one-year committed extension option and similar covenants to those in our unsecured revolving line of credit facility.

On July 23, 2012, we issued \$300 million of 3.15% senior unsecured notes due in 2022. The notes were priced at 98.888% of the principal amount with an effective yield to maturity of 3.28%. Net proceeds from this offering were \$294 million.

In June 2012, we completed a \$376 million offering of 8.97 million shares of common stock at \$41.88 per share with the proceeds used primarily to repay \$250 million of 6.45% senior unsecured notes at maturity on June 25, 2012.

On March 27, 2012, we completed an amendment to our existing \$1.5 billion unsecured revolving line of credit facility. We improved the pricing and extended the maturity of the facility one additional year to March 2016. Based on our current credit ratings, the amended facility bears interest annually at one-month LIBOR plus 1.075% and has a facility fee of 0.175%, which in the aggregate represent a 55 basis point

reduction to our funded interest cost.

On March 22, 2012, we announced the redemption of the 4.0 million shares of 7.25% Series E and 7.82 million shares of 7.10% Series F preferred stock at a price of \$25.00 per share, or \$295.5 million in aggregate, plus all accrued and unpaid dividends to April 23, 2012 (the redemption date). As a result of the redemption, we incurred a charge of \$10.4 million related to the original issuance costs of the preferred stock (this charge is presented as an additional preferred stock dividend in our consolidated income statements).

On March 22, 2012, we priced a \$359 million offering of 9.0 million shares of common stock at \$39.93 per share with the proceeds used primarily to redeem all outstanding shares of our preferred stock.

On January 23, 2012, we issued \$450 million of 3.75% senior unsecured notes due in 2019; net proceeds from the offering were \$444 million.

Dividends

On October 25, 2012, we announced that our Board declared a quarterly common stock cash dividend of \$0.50 per share. The common stock dividend will be paid on November 20, 2012 to stockholders of record as of the close of business on November 5, 2012. Quarterly common stock cash dividends paid or declared have aggregated to \$2.00 per share in 2012.

Table of Contents

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 condensed consolidated 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, as amended, for the year ended December 31, 2011 in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations ; our critical accounting policies have not changed during 2012.

Results of Operations

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

We use net operating income (NOI) and adjusted NOI to assess and compare property level performance, including our same property portfolio (SPP), and to make decisions about resource allocations. We believe these measures provide investors relevant and useful information because they reflect only income and operating expense items that are incurred at the property level and present them on an unleveraged basis. We believe 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 NOI excludes certain components from net income. Further, NOI may not be comparable to that of other REITs, as they may use different methodologies for calculating NOI. See Note 14 to the Condensed Consolidated Financial Statements for additional segment information and the relevant reconciliations from net income to NOI and adjusted NOI.

Operating expenses are generally related to MOB and life science leased properties and senior housing properties managed on our behalf (RIDEA properties). We generally recover all or a portion of MOB and life science expenses from the tenants (tenant recoveries). 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.

Our evaluation of results of operations by each business segment includes an analysis of our SPP and our total property portfolio. SPP information allows us to evaluate the performance of our leased property portfolio under a consistent population by eliminating changes in the composition of our portfolio of properties. We identify our SPP as stabilized properties that remained in operations and were consistently reported as leased properties or RIDEA properties for the duration of the year-over-year comparison periods presented. Accordingly, it takes a stabilized property a minimum of 12 months in operations under a consistent reporting structure to be included in our SPP. Newly acquired operating assets are generally considered stabilized at the earlier of lease-up (typically when the tenant(s) controls the physical use of at least

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

80% of the space) or 12 months from the acquisition date. Newly completed developments, including redevelopments, are considered stabilized at the earlier of lease-up or 24 months from the date the property is placed in service. SPP NOI excludes certain non-property specific operating expenses that are allocated to each operating segment on a consolidated basis.

Comparison of the Three Months Ended September 30, 2012 to the Three Months Ended September 30, 2011

Segment NOI and Adjusted NOI

The tables below provide selected operating information for our SPP and total property portfolio for each of our five business segments. Our consolidated SPP consists of 905 properties representing properties acquired or placed in service and stabilized on or prior to July 1, 2011 and that remained in operations under a consistent reporting structure through September 30, 2012. Our consolidated total property portfolio represents 955 and 933 properties at September 30, 2012 and 2011, respectively, and excludes properties classified as discontinued operations.

Table of Contents**Senior Housing**

Results are as of and for the three months ended September 30, 2012 and 2011 (dollars in thousands except per unit data):

	SPP		Change		Total Portfolio		Change	
	2012	2011		2012	2011			
Rental revenues(1)	\$ 114,759	\$ 113,940	\$ 819	\$ 114,856	\$ 122,849	\$ (7,993)		
Resident fees and services	1	76	(75)	36,076	11,974	24,102		
Total revenues	\$ 114,760	\$ 114,016	\$ 744	\$ 150,932	\$ 134,823	\$ 16,109		
Operating expenses	(151)	(179)	28	(24,872)	(9,614)	(15,258)		
NOI	\$ 114,609	\$ 113,837	\$ 772	\$ 126,060	\$ 125,209	\$ 851		
Straight-line rents	(6,976)	(8,948)	1,972	(6,989)	(8,948)	1,959		
DFL accretion	(5,121)	(4,498)	(623)	(5,121)	(4,498)	(623)		
Amortization of above and below market lease intangibles, net	(358)	(358)		(358)	(358)			
Lease termination fees					1,350	(1,350)		
Adjusted NOI	\$ 102,154	\$ 100,033	\$ 2,121	\$ 113,592	\$ 112,755	\$ 837		
Adjusted NOI % change			2.1%					
Property count(2)	291	291		312	312			
Average capacity (units)(3)	30,386	30,196		35,393	35,232			
Average annual revenue per unit(4)	\$ 13,463	\$ 13,270		\$ 12,922	\$ 12,891			

(1) Represents rental and related revenues and income from DFLs.

(2) From our past presentation of SPP for the three months ended September 30, 2011, we removed five senior housing properties from SPP that were sold or classified as held for sale; the property-level results of these properties are classified in discontinued operations.

(3) Represents average capacity as reported by the respective tenants or operators for the three months period and a quarter in arrears from the periods presented.

(4) Average annual revenue per unit for operating properties under a RIDEA structure is based on NOI.

SPP NOI and Adjusted NOI. SPP NOI increased primarily as a result of rent escalations related to new leases or leases not subject to straight-line rents. SPP adjusted NOI improved primarily as a result of annual rent escalations and an increase in rental revenues from properties that were previously transitioned from Sunrise to other operators. The increases in SPP NOI and Adjusted NOI were partially offset by additional rents earned in 2011 that did not reoccur in 2012.

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

Total Portfolio NOI and Adjusted NOI. The increases in adjusted NOI SPP discussed above were partially offset by a decline of \$1.4 million from 21 senior housing communities. This decline was primarily the result of the transition of operations on September 1, 2011 for these 21 communities from Horizon Bay (leased on triple-net basis) to Brookdale Senior Living (Brookdale) under a RIDEA Structure and a decline in occupancy. The adjusted NOI earned from these 21 properties for the three months ended September 30, 2012 represent resident level fee and service income and facility operating expenses; the NOI earned for the comparable period in 2011 represents a combination of two months of triple-net lease income and one month of resident level fee and service income.

Table of Contents**Post-Acute/Skilled Nursing**

Results are as of and for the three months ended September 30, 2012 and 2011 (dollars in thousands, except per bed data):

	2012		SPP 2011		Change		2012		Total Portfolio 2011		Change	
Rental revenues(1)	\$	135,508	\$	132,392	\$	3,116	\$	135,508	\$	132,392	\$	3,116
Operating expenses		(154)		(239)		85		(154)		(244)		90
NOI	\$	135,354	\$	132,153	\$	3,201	\$	135,354	\$	132,148	\$	3,206
Straight-line rents		(155)		(206)		51		(155)		(206)		51
DFL accretion		(18,312)		(19,073)		761		(18,312)		(19,073)		761
Amortization of above and below market lease intangibles, net		11		11				11		12		(1)
Adjusted NOI	\$	116,898	\$	112,885	\$	4,013	\$	116,898	\$	112,881	\$	4,017
Adjusted NOI % change						3.6%						
Property count		313		313				313		313		
Average capacity (beds)(2)		40,040		39,984				40,040		39,984		
Average annual revenue per bed	\$	11,692	\$	11,316			\$	11,692	\$	11,316		

(1) Represents rental and related revenues and income from DFLs.

(2) Represents average capacity as reported by the respective tenants or operators for the three months period and a quarter in arrears from the periods presented.

NOI and Adjusted NOI. SPP and total portfolio NOI and adjusted NOI for the three months ended September 30, 2012 primarily increased as a result of annual rent escalations from 268 post-acute/skilled nursing leased properties classified as DFLs from HCR ManorCare, Inc. (see Notes 3 and 6 to the Condensed Consolidated Financial Statements for additional information regarding the HCR ManorCare Acquisition and Net Investments in DFLs, respectively).

Life Science

Results are as of and for the three months ended September 30, 2012 and 2011 (dollars and square feet in thousands, except per sq. ft. data):

	2012		SPP 2011		Change		2012		Total Portfolio 2011		Change	
	\$	60,940	\$	60,282	\$	658	\$	61,797	\$	60,586	\$	1,211

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

Rental and related revenues														
Tenant recoveries		9,344		10,431		(1,087)		9,397		10,507		(1,110)		
Total revenues	\$	70,284	\$	70,713	\$	(429)	\$	71,194	\$	71,093	\$	101		
Operating expenses		(10,422)		(12,358)		1,936		(11,791)		(13,233)		1,442		
NOI	\$	59,862	\$	58,355	\$	1,507	\$	59,403	\$	57,860	\$	1,543		
Straight-line rents		(2,790)		(3,101)		311		(3,010)		(3,132)		122		
Amortization of above and below market lease intangibles, net														
Lease termination fees		135		(341)		476		123		(354)		477		
Adjusted NOI	\$	57,032	\$	53,324	\$	3,708	\$	56,341	\$	52,785	\$	3,556		
Adjusted NOI % change														
								7.0%						
Property count								101	101		109		104	
Occupancy								91.4%	91.1%		90.0%		90.0%	
Average occupied sq. ft.								6,099	6,082		6,268		6,114	
Average annual revenue per occupied sq. ft.								\$ 44	\$ 43		\$ 43		\$ 43	

Table of Contents

NOI and Adjusted NOI. NOI increased primarily as a result of new leases, lease expansions and extensions and a decline in non-reimbursable operating expenses, partially offset by a decline in lease termination fees. Adjusted NOI primarily increased as a result of transactions impacting NOI (discussed above) and annual rent escalations on existing leases.

During the three months ended September 30, 2012, 405,000 square feet of new and renewal leases commenced at an average annual base rent of \$19.57 per square foot compared to 379,000 square feet of expiring and terminated leases with an average annual base rent of \$22.16 per square foot.

Medical Office

Results are as of and for the three months ended September 30, 2012 and 2011 (dollars and square feet in thousands, except per sq. ft. data):

	2012	SPP 2011	Change	2012	Total Portfolio 2011	Change
Rental and related revenues	\$ 68,496	\$ 67,179	\$ 1,317	\$ 72,344	\$ 68,180	\$ 4,164
Tenant recoveries	12,931	12,713	218	13,456	12,816	640
Total revenues	\$ 81,427	\$ 79,892	\$ 1,535	\$ 85,800	\$ 80,996	\$ 4,804
Operating expenses	(31,752)	(31,409)	(343)	(34,948)	(33,346)	(1,602)
NOI	\$ 49,675	\$ 48,483	\$ 1,192	\$ 50,852	\$ 47,650	\$ 3,202
Straight-line rents	(980)	(1,095)	115	(1,331)	(1,115)	(216)
Amortization of above and below market lease intangibles, net	101	91	10	148	(21)	169
Adjusted NOI	\$ 48,796	\$ 47,479	\$ 1,317	\$ 49,669	\$ 46,514	\$ 3,155
Adjusted NOI % change			2.8%			
Property count(1)	184	184		204	187	
Occupancy	91.8%	90.9%		91.5%	91.0%	
Average occupied sq. ft.	11,787	11,671		12,494	11,861	
Average annual revenue per occupied sq. ft.	\$ 27	\$ 27		\$ 27	\$ 27	

(1) From our past presentation of SPP for the three months ended September 30, 2011, we removed (i) a MOB that was sold or classified as held for sale; the property-level results of this property are classified in discontinued operations; and (ii) three MOBs that were placed into redevelopment in 2012, which no longer meet our criteria for SPP as of the date they were placed into redevelopment.

SPP Portfolio NOI and Adjusted NOI. SPP NOI and adjusted NOI increased year-over-year primarily as a result of rent escalations and an increase in medical office occupancy.

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

Total Portfolio NOI and Adjusted NOI. In addition to the impact from SPP, NOI and adjusted NOI increased year-over-year as a result of the additive effect of our MOB acquisitions during 2011 and 2012.

During the three months ended September 30, 2012, 1.6 million square feet of new and renewal leases (includes 968,000 square feet related to properties that were acquired during the period with an average annual base rent of \$22.01 per square foot) commenced at an average annual base rent of \$22.26 per square foot compared to 594,000 square feet of expiring and terminated leases with an average annual base rent of \$23.69 per square foot.

Table of Contents**Hospital**

Results are as of and for the three months ended September 30, 2012 and 2011 (dollars in thousands, except per bed data):

	2012	SPP 2011	Change	2012	Total Portfolio 2011	Change
Rental and related revenues	\$ 19,974	\$ 19,534	\$ 440	\$ 20,738	\$ 20,298	\$ 440
Tenant recoveries	573	557	16	572	556	16
Total revenues	\$ 20,547	\$ 20,091	\$ 456	\$ 21,310	\$ 20,854	\$ 456
Operating expenses	(900)	(1,226)	326	(902)	(1,225)	323
NOI	\$ 19,647	\$ 18,865	\$ 782	\$ 20,408	\$ 19,629	\$ 779
Straight-line rents	(99)	(192)	93	(241)	(346)	105
Amortization of above and below market lease intangibles, net	(193)	(193)		(217)	(218)	1
Adjusted NOI	\$ 19,355	\$ 18,480	\$ 875	\$ 19,950	\$ 19,065	\$ 885
Adjusted NOI % change			4.7%			
Property count	16	16		17	17	
Capacity (beds)(1)	2,379	2,379		2,410	2,379	
Average annual revenue per bed	\$ 34,056	\$ 33,133		\$ 34,609	\$ 34,115	

(1) Represents capacity as reported by the respective tenants or operators for the three months period and a quarter in arrears from the periods presented. Certain operators in our hospital portfolio are not required under their respective leases to provide operational data.

NOI and Adjusted NOI. NOI and adjusted NOI increased for the three months ended September 30, 2012 primarily as a result of new leases on two of our hospitals.

Other Income and Expense Items*Interest income*

Interest income increased \$9.7 million to \$10.3 million for the three months ended September 30, 2012. The increase was primarily the result interest income from our mezzanine loan facility and senior unsecured notes investments in 2012 (see Notes 7 and 10, respectively, to the Condensed Consolidated Financial Statements for additional information).

Interest expense

Interest expense increased \$54,000 to \$103.5 million for the three months ended September 30, 2012. The increase was primarily from our senior unsecured notes offerings, net of related maturities of certain senior unsecured notes during 2011 and 2012.

Depreciation and amortization expense

Depreciation and amortization expense increased \$2.0 million to \$88.7 million for the three months ended September 30, 2012. The increase was primarily the result of the additive effects of our MOB acquisitions during 2011 and 2012.

General and administrative expenses

General and administrative expenses decreased \$0.2 million to \$19.4 million for the three months ended September 30, 2012. The decrease was primarily due to a decrease in legal fees associated with litigation matters, which decrease was partially offset by increases in acquisition pursuit costs and compensation related expenses.

Table of Contents*Impairments*

During the three months ended September 30, 2012, we recognized an impairment of \$7.9 million as a result of the decline in fair value of a life science land parcel based on the contract sales price from the anticipated disposition (see Note 21 to the Condensed Consolidated Financial Statements for additional information). During the three months ended September 30, 2011, we recognized an impairment of \$15.4 million related to a senior secured term loan as a result of concluding that the carrying value of the loan was in excess of the fair value of the related collateral supporting the loan (see Note 7 to the Condensed Consolidated Financial Statements for additional information).

Equity income from unconsolidated joint ventures

Equity income from unconsolidated joint ventures decreased \$3.7 million to \$13.4 million for the three months ended September 30, 2012. The decrease was primarily the result of a decrease in our share of earnings from our approximate 10% interest in HCR ManorCare, Inc. (see Notes 3 and 8 to the Condensed Consolidated Financial Statements for additional information).

*Comparison of the Nine Months Ended September 30, 2012 to the Nine Months Ended September 30, 2011*Segment NOI and Adjusted NOI

The tables below provide selected operating information for our SPP and total property portfolio for each of our five business segments. Our consolidated SPP consists of 566 properties representing properties acquired or placed in service and stabilized on or prior to January 1, 2011 and that remained in operations under a consistent reporting structure through September 30, 2012. Our consolidated total property portfolio represents 955 and 933 properties at September 30, 2012 and 2011, respectively, and excludes properties classified as discontinued operations.

Senior Housing

Results are as of and for the nine months ended September 30, 2012 and 2011 (dollars in thousands except per unit data):

	SPP			Total Portfolio		
	2012	2011	Change	2012	2011	Change
Rental revenues(1)	\$ 282,430	\$ 283,089	\$ (659)	\$ 341,936	\$ 355,496	\$ (13,560)
Resident fees and services	1,050	3,416	(2,366)	107,824	15,314	92,510
Total revenues	\$ 283,480	\$ 286,505	\$ (3,025)	\$ 449,760	\$ 370,810	\$ 78,950
Operating expenses	(367)	(724)	357	(69,926)	(11,350)	(58,576)

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

NOI	\$	283,113	\$	285,781	\$	(2,668)	\$	379,834	\$	359,460	\$	20,374
Straight-line rents		(20,941)		(27,974)		7,033		(21,686)		(28,058)		6,372
DFL accretion		(5,774)		(6,506)		732		(14,706)		(12,251)		(2,455)
Amortization of above and below market lease intangibles, net		(1,177)		(1,177)				(1,074)		(1,108)		34
Lease termination fees										1,350		(1,350)
Adjusted NOI	\$	255,221	\$	250,124	\$	5,097	\$	342,368	\$	319,393	\$	22,975
Adjusted NOI % change						2.0%						
Property count(2)		221		221				312		312		
Average capacity (units)(3)		25,069		24,877				35,393		33,229		
Average annual revenue per unit(4)	\$	13,594	\$	13,445			\$	12,985	\$	12,916		

(1) Represents rental and related revenues and income from DFLs.

(2) From our past presentation of SPP for the nine months ended September 30, 2011, we removed five senior housing properties from SPP that were sold or classified as held for sale; the property-level results of these properties are classified in discontinued operations.

(3) Represents average capacity as reported by the respective tenants or operators for the three months period and a quarter in arrears from the periods presented.

(4) Average annual revenue per unit for operating properties under a RIDEA structure is based on NOI.

Table of Contents

SPP NOI and Adjusted NOI. SPP NOI declined primarily as a result of a decrease in additional rents earned in 2011 that did not reoccur in 2012 and a decline in resident fees and services revenue, which relates to certain working capital adjustments from properties that were previously transitioned from Sunrise to other operators, partially offset by rent escalations related to new leases or leases not subject to straight-line rents.

SPP adjusted NOI improved primarily as a result of annual rent escalations and an increase in rental revenues from properties that were previously transitioned from Sunrise to another operator, partially offset by a decrease in additional rents and a decline related to the working capital adjustments discussed above.

Total Portfolio NOI and Adjusted NOI. Including the impact of our SPP, our total portfolio NOI and adjusted NOI for the nine months ended September 30, 2012 primarily increased as a result of 66 senior housing leased properties classified as DFLs that were acquired on April 7, 2011 from HCR ManorCare, Inc. (see Notes 3 and 6 to the Condensed Consolidated Financial Statements for additional information regarding the HCR ManorCare Acquisition and Net Investments in DFLs, respectively).

Additionally, HCP Ventures II was consolidated on January 14, 2011 (see Note 8 to the Condensed Consolidated Financial Statements for additional information), resulting in us recognizing rental and related revenues for the 25 leased properties commencing on that date. On September 1, 2011, for 21 of these 25 properties, we entered into management contracts in a structure permitted by RIDEA (see Note 12 to the Condensed Consolidated Financial Statements for additional information), resulting in the termination of the properties' leases. For these 21 properties that are now in a RIDEA structure, the resident-level revenues and related operating expenses are reported in our condensed consolidated financial statements beginning on that date.

Post-Acute/Skilled Nursing

Results are as of and for the nine months ended September 30, 2012 and 2011 (dollars in thousands, except per bed data):

	SPP			Total Portfolio		
	2012	2011	Change	2012	2011	Change
Rental revenues(1)	\$ 28,835	\$ 28,495	\$ 340	\$ 404,180	\$ 265,377	\$ 138,803
Operating expenses	(103)	(69)	(34)	(526)	(318)	(208)
NOI	\$ 28,732	\$ 28,426	\$ 306	\$ 403,654	\$ 265,059	\$ 138,595
Straight-line rents	(422)	(792)	370	(422)	(791)	369
DFL accretion				(56,366)	(36,257)	(20,109)
Amortization of above and below market lease intangibles, net				34	23	11
Adjusted NOI	\$ 28,310	\$ 27,634	\$ 676	\$ 346,900	\$ 228,034	\$ 118,866
Adjusted NOI % change			2.4%			
Property count	45	45		313	313	
Average capacity (beds)(2)	5,226	5,219		40,040	27,494	

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

Average annual revenue per bed	\$	7,249	\$	7,078	\$	11,568	\$	11,073
-----------------------------------	----	-------	----	-------	----	--------	----	--------

(1) Represents rental and related revenues and income from DFLs.

(2) Represents average capacity as reported by the respective tenants or operators for the three months period and a quarter in arrears from the periods presented.

Total Portfolio NOI and Adjusted NOI. Total portfolio NOI and adjusted NOI for the nine months ended September 30, 2012 primarily increased as a result of 268 post-acute/skilled nursing leased properties classified as DFLs that were acquired on April 7, 2011 from HCR ManorCare, Inc. (see Notes 3 and 6 to the Condensed Consolidated Financial Statements for additional information regarding the HCR ManorCare Acquisition and Net Investments in DFLs, respectively).

Table of Contents**Life Science**

Results are as of and for the nine months ended September 30, 2012 and 2011 (dollars and square feet in thousands, except per sq. ft. data):

	2012	SPP 2011	Change	2012	Total Portfolio 2011	Change
Rental and related revenues	\$ 182,467	\$ 182,602	\$ (135)	\$ 184,600	\$ 183,834	\$ 766
Tenant recoveries	30,639	30,979	(340)	30,969	31,211	(242)
Total revenues	\$ 213,106	\$ 213,581	\$ (475)	\$ 215,569	\$ 215,045	\$ 524
Operating expenses	(34,460)	(35,980)	1,520	(38,230)	(38,661)	431
NOI	\$ 178,646	\$ 177,601	\$ 1,045	\$ 177,339	\$ 176,384	\$ 955
Straight-line rents	(5,530)	(11,024)	5,494	(6,300)	(11,308)	5,008
Amortization of above and below market lease intangibles, net	352	(722)	1,074	315	(765)	1,080
Lease termination fees	(175)	(4,767)	4,592	(175)	(4,767)	4,592
Adjusted NOI	\$ 173,293	\$ 161,088	\$ 12,205	\$ 171,179	\$ 159,544	\$ 11,635
Adjusted NOI % change			7.6%			
Property count	101	101		109	104	
Occupancy	91.4%	91.1%		90.0%	90.0%	
Average occupied sq. ft.	6,090	6,048		6,212	6,090	
Average annual revenue per occupied sq. ft.	\$ 45	\$ 43		\$ 45	\$ 43	

NOI and Adjusted NOI. NOI increased primarily as a result of lease expansions and extensions and decline in non-reimbursable operating expenses, partially offset by a decline in lease termination fees. Adjusted NOI increased primarily as a result of a \$4 million rent payment in connection with a February 2012 amendment to a lease, annual rent escalations, lease expansions and extensions, and a decline in non-reimbursable operating expenses.

During the nine months ended September 30, 2012, 884,000 square feet of new and renewal leases (includes 77,000 square feet acquired during the period with an average annual base rent of \$9.79 per square foot) commenced at an average annual base rent of \$21.55 per square foot compared to 697,000 square feet of expiring and terminated leases with an average annual base rent of \$25.31 per square foot.

Table of Contents**Medical Office**

Results are as of and for the nine months ended September 30, 2012 and 2011 (dollars and square feet in thousands, except per sq. ft. data):

	2012	SPP 2011	Change	2012	Total Portfolio 2011	Change
Rental and related revenues	\$ 202,937	\$ 199,242	\$ 3,695	\$ 209,714	\$ 203,807	\$ 5,907
Tenant recoveries	35,175	35,658	(483)	36,947	36,796	151
Total revenues	\$ 238,112	\$ 234,900	\$ 3,212	\$ 246,661	\$ 240,603	\$ 6,058
Operating expenses	(90,927)	(90,801)	(126)	(98,631)	(97,360)	(1,271)
NOI	\$ 147,185	\$ 144,099	\$ 3,086	\$ 148,030	\$ 143,243	\$ 4,787
Straight-line rents	(3,236)	(4,581)	1,345	(3,747)	(4,723)	976
Amortization of above and below market lease intangibles, net	258	274	(16)	240	(51)	291
Lease termination fees	(251)		(251)	(251)		(251)
Adjusted NOI	\$ 143,956	\$ 139,792	\$ 4,164	\$ 144,272	\$ 138,469	\$ 5,803
Adjusted NOI % change			3.0%			
Property count(1)	183	183		204	187	
Occupancy	91.8%	90.8%		91.5%	91.0%	
Average occupied sq. ft.	11,621	11,548		12,048	11,852	
Average annual revenue per occupied sq. ft.	\$ 27	\$ 27		\$ 27	\$ 26	

(1) From our past presentation of SPP for the nine months ended September 30, 2011, we removed (i) a MOB that was sold or classified as held for sale; the property-level results of this property are classified in discontinued operations; and (ii) three MOBs that were placed into redevelopment in 2012, which no longer meet our criteria for SPP as of the date they were placed into redevelopment.

NOI and Adjusted NOI. NOI and adjusted NOI increased year-over-year primarily as a result of rent escalations and an increase in medical office occupancy.

During the nine months ended September 30, 2012, 2.6 million square feet of new and renewal leases (includes 968,000 square feet related to properties acquired during the period with an average annual base rent of \$22.01 per square foot) commenced at an average annual base rent of \$22.03 per square foot compared to 1.7 million square feet of expiring and terminated leases with an average annual base rent of \$22.23 per square foot (includes 180,000 square feet related to properties that were sold or placed into redevelopment with an average annual base rent of \$15.98 per square foot).

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

Hospital

Results are as of and for the nine months ended September 30, 2012 and 2011 (dollars in thousands, except per bed data):

	2012	SPP 2011	Change	2012	Total Portfolio 2011	Change
Rental and related revenues	\$ 59,267	\$ 57,969	\$ 1,298	\$ 61,560	\$ 60,361	\$ 1,199
Tenant recoveries	1,741	1,757	(16)	1,740	1,757	(17)
Total revenues	\$ 61,008	\$ 59,726	\$ 1,282	\$ 63,300	\$ 62,118	\$ 1,182
Operating expenses	(2,764)	(3,412)	648	(2,770)	(3,414)	644
NOI	\$ 58,244	\$ 56,314	\$ 1,930	\$ 60,530	\$ 58,704	\$ 1,826
Straight-line rents	(444)	(720)	276	(881)	(1,188)	307
Amortization of above and below market lease intangibles, net	(578)	(578)		(653)	(653)	
Adjusted NOI	\$ 57,222	\$ 55,016	\$ 2,206	\$ 58,996	\$ 56,863	\$ 2,133
Adjusted NOI % change			4.0%			
Property count	16	16		17	17	
Capacity (beds)(1)	2,379	2,379		2,410	2,379	
Average annual revenue per bed	\$ 33,620	\$ 32,747		\$ 34,171	\$ 33,783	

(1) Represents capacity as reported by the respective tenants or operators for the three months period and a quarter in arrears from the periods presented. Certain operators in our hospital portfolio are not required under their respective leases to provide operational data.

NOI and Adjusted NOI. NOI and adjusted NOI increased for the nine months ended September 30, 2012 primarily as a result of new leases on two of our hospitals.

Table of ContentsOther Income and Expense Items*Interest income*

Interest income decreased \$86.9 million to \$12.3 million for the nine months ended September 30, 2012. The decrease was primarily the result of the following: (i) a decrease of \$54.3 million as a result of the early settlement of our HCR ManorCare debt investments in 2011 and (ii) a decrease of \$43.0 million as a result of the early repayment of our loans to Genesis in 2011. The decreases in interest income were partially offset by increases of \$9 million from our mezzanine loan facility and our senior unsecured notes investments in 2012 (see Notes 7 and 10, respectively, to the Condensed Consolidated Financial Statements for additional information).

Interest expense

Interest expense decreased \$5.8 million to \$309.9 million for the nine months ended September 30, 2012. The decrease was primarily due to the \$11.3 million write-off of unamortized loan fees related to a terminated bridge loan commitment during the nine months ended September 30, 2011, a decrease of \$3.4 million resulting from the payoff of certain mortgage debt during 2011 and more favorable borrowing rates on recently issued debt, partially offset by an increase of \$7.2 million resulting from our senior unsecured notes offerings, net of related maturities of certain senior unsecured notes during 2011 and 2012.

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

	As of September 30, ⁽¹⁾	
	2012	2011
Balance:		
Fixed rate	\$ 7,813,925	\$ 7,182,192
Variable rate	40,404	424,002
Total	\$ 7,854,329	\$ 7,606,194
Percent of total debt:		
Fixed rate	99%	94%
Variable rate	1	6
Total	100%	100%
Weighted average interest rate at end of period:		
Fixed rate	5.49%	5.81%
Variable rate	1.53%	2.65%
Total weighted average rate	5.47%	5.64%

(1) Excludes \$85 million and \$89 million of other debt at September 30, 2012 and 2011, respectively, that represent non-interest bearing life care bonds and occupancy fee deposits at certain of our senior housing facilities, which have no scheduled maturities.

Table of Contents

Depreciation and amortization expense

Depreciation and amortization expense decreased \$6.7 million to \$259.0 million for the nine months ended September 30, 2012. The decrease was primarily the result of assets becoming fully depreciated during 2011 and 2012, partially offset by the additive effects of our acquisitions during 2011 and 2012.

General and administrative expenses

General and administrative expenses decreased \$22.1 million to \$54.4 million for the nine months ended September 30, 2012. The decrease was primarily due to an insurance recovery of \$7.2 million during 2012 for previously incurred legal expenses and \$15.6 million of acquisition costs incurred during 2011 related to our HCR ManorCare Acquisition.

Impairments

During the nine months ended September 30, 2012, we recognized an impairment of \$7.9 million as a result of the decline in fair value of a life science land parcel based on the contract sales price from the anticipated disposition (see Note 21 to the Condensed Consolidated Financial Statements for additional information). During the nine months ended September 30, 2011, we recognized an impairment of \$15.4 million related to a senior secured term loan as a result of concluding that the carrying value of the loan was in excess of the fair value of the related collateral supporting the loan (see Note 7 to the Condensed Consolidated Financial Statements for additional information).

Other income (expense), net

Other income (expense), net, decreased \$14.8 million to \$2.2 million for the nine months ended September 30, 2012. The decrease was primarily the result of a gain of \$7.8 million resulting from our acquisition of our partner's 65% interest in and consolidation of HCP Ventures II in January 2011 (see Note 8 to the Condensed Consolidated Financial Statements for additional information) and \$5.7 million received in connection with a litigation settlement in June 2011 that represents proceeds owed to us from a prior sale of assets. No similar gain upon consolidation was recognized or settlements were received during the nine months ended September 30, 2012.

Equity income from unconsolidated joint ventures

Equity income from unconsolidated joint ventures increased \$10 million to \$42.8 million for the nine months ended September 30, 2012. The increase was primarily the result of an increase in our share of earnings from our approximate 10% interest in HCR ManorCare, Inc. which interest was acquired in April 2011 (see Notes 3 and 8 to the Condensed Consolidated Financial Statements for additional information).

Discontinued operations

During the nine months ended September 30, 2012, we sold one property for \$7 million, realizing a gain of \$2.9 million. There were no sales of properties during the nine months ended September 30, 2011.

Preferred stock dividends

On March 22, 2012, we announced the redemption of all outstanding shares of preferred stock. On April 23, 2012, the shares of our preferred stock were redeemed, plus all accrued and unpaid dividends to the redemption date. During the nine months ended September 30, 2012, we incurred a redemption charge of \$10.4 million related to the original issuance costs of the preferred stock (this charge is presented as an additional preferred stock dividend in our consolidated income statements).

Table of Contents

Liquidity and Capital Resources

Our principal liquidity needs are to: (i) fund recurring operating expenses, (ii) meet debt service requirements including principal payments and maturities in the last nine months of 2012, (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.

We anticipate making future investments dependent on the availability of cost-effective sources of capital. We intend to use our revolving line of credit facility and the public capital markets as our principal sources of financing. As of October 25, 2012, we had credit ratings of Baa2 (stable) from Moody's, BBB (positive) from S&P and BBB+ (stable) from Fitch on our senior unsecured debt securities.

Net cash provided by operating activities was \$721 million and \$587 million for the nine months ended September 30, 2012 and 2011, respectively. The increase in operating cash flows is primarily the result of the following: (i) the additive impact of our investments in 2011 and 2012, (ii) assets placed in service during 2011 and 2012 and (iii) rent escalations and resets in 2011 and 2012, which increases were partially offset by increased debt interest payments. 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 \$651 million and \$4.6 billion for the nine months ended September 30, 2012 and 2011, respectively. The cash used in investing activities for the nine months ended September 30, 2012 primarily reflects the net effect of: (i) \$215 million used for the purchase of marketable securities, (ii) \$172 million for the acquisitions of real estate, (iii) \$146 million used for investments in loans receivable, (iv) \$87 million used for development of real estate and (v) \$43 million used for leasing costs and tenant and capital improvements, which were partially offset by (i) \$7 million of proceeds from the sale of real estate and (ii) \$5 million received from the repayments from our investments in loans receivable.

Net cash used in financing activities was \$7.3 million for the nine months ended September 30, 2012, and net cash provided by financing activities was \$3.0 billion for the nine months ended September 30, 2011. The cash used in financing activities for the nine months ended September 30, 2012 consisted primarily of: (i) payments of common and preferred dividends aggregating \$638 million, (ii) net repayments under our revolving line of credit facility of \$454 million, (iii) redemption of our preferred stock for \$296 million, (iv) repayment of senior unsecured notes of \$250 million, (v) repayment of mortgage debt of \$110 million and (vi) debt issuance and origination costs (deferred financing costs) of \$18 million. The amount of cash used in financing activities was partially offset by: (i) net proceeds of \$804 million from the issuances of common stock and exercise of stock options, (ii) the issuance of \$750 million of senior unsecured notes and (iii) borrowings under the Term Loan of \$215 million.

Debt

Bank Line of Credit and Term Loan

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

On March 27, 2012, we executed an amendment to our existing \$1.5 billion unsecured revolving line of credit facility (the Facility). This amendment reduces the cost to us of the Facility (lower borrowing rate and facility fee) and extends the Facility's maturity by one additional year to March 2016. The Facility contains a one-year extension option. Borrowings under this Facility accrue interest at LIBOR plus a margin that depends upon our debt ratings. We pay a facility fee on the entire revolving commitment that depends on our debt ratings. Based on our debt ratings at October 25, 2012, the margin on the Facility was 1.075%, and the facility fee was 0.175%. We have the right to increase the commitments under the Facility by an aggregate amount of up to \$500 million, subject to customary conditions. At September 30, 2012, we had no balance outstanding under this Facility.

On July 30, 2012, we entered into a credit agreement with a syndicate of banks for a £137 million (\$221 million at September 30, 2012) four-year unsecured Term Loan that accrues interest at a rate of GBP LIBOR plus 1.20%, based on our current debt ratings. Concurrent with the closing of the Term Loan, we entered into a four-year interest rate swap agreement that fixes the rate of the Term Loan at 1.81%, subject to adjustments based on our credit ratings. The Term Loan contains a one-year committed extension option and covenants similar to those in the Facility.

Our Facility and Term Loan contain certain financial restrictions and other customary requirements. Among other things, these covenants, using terms defined in the agreements (i) limit the ratio of Consolidated Total Indebtedness to Consolidated Total Asset Value to 60%, (ii) limit the ratio of Secured Debt to Consolidated Total Asset Value to 30%, (iii) limit the ratio of Unsecured Debt to Consolidated Unencumbered Asset Value to 60%, (iv) require a minimum Fixed Charge Coverage ratio of 1.5 times and (v) require a formula-determined Minimum Consolidated Tangible Net Worth of \$8.3 billion at September 30, 2012. At September 30, 2012, we were in compliance with each of these restrictions and requirements of the Facility and Term Loan.

Table of Contents

Our 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 a 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 September 30, 2012, we had senior unsecured notes outstanding with an aggregate principal balance of \$5.9 billion. Interest rates on the notes ranged from 1.29% to 7.07% with a weighted average effective interest rate of 5.40% and a weighted average maturity of 6.11 years at September 30, 2012. The senior unsecured notes contain certain covenants including limitations on debt, maintenance of unencumbered assets, cross-acceleration provisions and other customary terms. We believe we were in compliance with these covenants at September 30, 2012.

Mortgage Debt

At September 30, 2012, we had \$1.7 billion in aggregate principal amount of mortgage debt outstanding that is secured by 137 healthcare facilities (including redevelopment properties) with a carrying value of \$2.1 billion. Interest rates on the mortgage debt ranged from 1.54% to 8.69% with a weighted average effective interest rate of 6.14% and a weighted average maturity of 3.80 years at September 30, 2012.

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 assets in good condition, requires maintenance of insurance on the assets and includes conditions 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 real estate assets.

Other Debt

At September 30, 2012, we had \$85 million of non-interest bearing life care bonds at two of our continuing care retirement communities and non-interest bearing occupancy fee deposits at two of our senior housing facilities, all of which were payable to certain residents of the facilities (collectively, Life Care Bonds). At September 30, 2012, \$28 million of the Life Care Bonds were refundable to the residents upon the resident moving out or to their estate upon death, and \$57 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 at September 30, 2012 (in thousands):

Year	Amount(1)
2012 (Three months)	\$ 8,715
2013	870,207
2014	671,495
2015	704,761
2016	1,414,389
Thereafter	4,184,762
	7,854,329
(Discounts) and premiums, net	(34,911)
	\$ 7,819,418

(1) Excludes \$85 million of other debt that represents Life Care Bonds that have no scheduled maturities.

Table of Contents*Derivative Instruments*

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

The following table summarizes our outstanding interest rate and foreign exchange swap contracts as of September 30, 2012 (dollars in thousands):

Date Entered	Maturity Date	Hedge Designation	Fixed Rate/Buy Amount	Floating/Exchange Rate Index	Notional/Sell Amount	Fair Value
July 2005(1)	July 2020	Cash Flow	3.82%	BMA Swap Index	\$ 45,600	\$ (8,868)
November 2008	October 2016	Cash Flow	5.95%	1 Month LIBOR+1.50%	27,200	(4,142)
July 2009	July 2013	Cash Flow	6.13%	1 Month LIBOR+3.65%	13,700	(234)
				1 Month GBP		
July 2012	June 2016	Cash Flow	1.81%	LIBOR+1.20%	£ 137,000	(75)
July 2012	June 2016	Cash Flow	\$ 11,400	Buy USD/Sell GBP	£ 7,200	(2,317)

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

For a more detailed description of our derivative instruments, see Note 20 to the Condensed Consolidated Financial Statements and Item 3. *Quantitative and Qualitative Disclosures About Market Risk.*

Equity

At September 30, 2012, we had 430 million shares of common stock outstanding. At September 30, 2012, equity totaled \$9.7 billion, and our equity securities had a market value of \$19 billion.

At September 30, 2012, there were a total of 4.4 million DownREIT units outstanding in five 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 that we filed with the U.S. Securities and Exchange Commission (SEC) as part of a registration statement on Form S-3ASR, using a shelf registration process which expires in July 2015. Under the shelf process, we may sell any combination of the securities in one or more offerings. The securities described in the prospectus include common stock, preferred stock, depositary shares, debt securities and warrants.

The prospectus only provides a general description of the securities we may offer. The prospectus may not be used to sell securities unless accompanied by a prospectus supplement or a free writing prospectus. 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. The prospectus supplement may also add, update or change information contained in the prospectus.

We may offer and sell the securities pursuant to the prospectus through underwriters, dealers or agents or directly to purchasers, on a continuous or delayed basis. The securities may also be resold by selling security holders. The prospectus supplement for each offering will describe in detail the plan of distribution for that offering and will set forth the names of any underwriters, dealers or agents involved in the offering and any applicable fees, commissions or discount arrangements. We intend to use the net proceeds from the sales of the securities as set forth in the applicable prospectus supplement, and unless otherwise set forth in a therein, we will not receive any proceeds if the securities are sold by a selling security holder.

Table of Contents**Funds From Operations (FFO)**

We believe FFO applicable to common shares, diluted FFO applicable to common shares, and basic and diluted FFO per common share are important supplemental non-GAAP measures of operating performance for a REIT. Because the historical cost accounting convention used for real estate assets utilizes straight-line depreciation (except on land), such accounting presentation implies that the value of real estate assets diminishes predictably over time. Since real estate values instead have historically risen and fallen with market conditions, presentations of operating results for a REIT that uses historical cost accounting for depreciation could be less informative. The term FFO was designed by the REIT industry to address this issue.

FFO is defined as net income applicable to common shares (computed in accordance with GAAP), excluding gains or losses from acquisition and dispositions of depreciable real estate or related interests, impairments of, or related to, depreciable real estate, plus real estate and DFL depreciation and amortization, with adjustments for joint ventures. Adjustments for joint ventures are calculated to reflect FFO on the same basis. FFO does not represent cash generated from operating activities in accordance with GAAP, is not necessarily indicative of cash available to fund cash needs and should not be considered an alternative to net income. We compute FFO in accordance with the current National Association of Real Estate Investment Trusts (NAREIT) definition; however, other REITs may report FFO differently or have a different interpretation of the current NAREIT definition from us. In addition, we present FFO before the impact of litigation settlement charges, preferred stock redemption charges, impairments (recoveries) of non-depreciable assets and merger-related items (defined below) (FFO as adjusted). Management believes FFO as adjusted is a useful alternative measurement. This measure is a modification of the NAREIT definition of FFO and should not be used as an alternative to net income (determined in accordance with GAAP).

Details of certain items that affect comparability are discussed under *Results of Operations* above. The following is a reconciliation from net income applicable to common shares, the most direct comparable financial measure calculated and presented in accordance with GAAP, to FFO and FFO as adjusted (in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net income applicable to common shares	\$ 195,629	\$ 166,367	\$ 572,352	\$ 453,306
Depreciation and amortization of real estate, in-place lease and other intangibles:				
Continuing operations	88,686	86,672	259,039	265,742
Discontinued operations	1,453	1,884	7,300	4,286
DFL depreciation	3,234	2,874	9,426	5,879
Gain on sales of real estate			(2,856)	
Gain upon consolidation of joint venture				(7,769)
Equity income from unconsolidated joint ventures	(13,396)	(17,050)	(42,803)	(32,798)
FFO from unconsolidated joint ventures	16,043	19,574	50,495	40,408
Noncontrolling interests and participating securities share in earnings	3,414	3,822	11,224	14,553
Noncontrolling interests and participating securities share in FFO	(4,821)	(4,572)	(15,512)	(16,385)
FFO applicable to common shares	290,242	259,571	848,665	727,222
Distributions on dilutive convertible units	3,148	3,048	9,397	9,066
	\$ 293,390	\$ 262,619	\$ 858,062	\$ 736,288

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

Diluted FFO applicable to common shares

Diluted FFO per common share	\$	0.67	\$	0.63	\$	2.01	\$	1.83
Weighted average shares used to calculate diluted FFO per common share		437,043		414,590		427,388		402,967
Impact of adjustments to FFO:								
Preferred stock redemption charge(1)	\$		\$		\$	10,432	\$	
Merger-related items(2)								26,596
Impairments(3)		7,878		15,400		7,878		15,400
	\$	7,878	\$	15,400	\$	18,310	\$	41,996
FFO as adjusted applicable to common shares	\$	298,120	\$	274,971	\$	866,975	\$	769,218
Distributions on dilutive convertible units and other		3,127		3,011		9,345		8,927
Diluted FFO as adjusted	\$	301,247	\$	277,982	\$	876,320	\$	778,145
Diluted FFO as adjusted per common share	\$	0.69	\$	0.67	\$	2.05	\$	2.02
Weighted average shares used to calculate diluted FFO as adjusted per common share(4)		437,043		414,590		427,388		385,693

Table of Contents

- (1) In connection with the redemption of our preferred stock, during the nine months ended September 30, 2012, we incurred a redemption charge of \$10.4 million related to the original issuance costs.
- (2) Merger-related items for the nine months ended September 30, 2011 are attributable to the HCR ManorCare Acquisition (incurred from January 1st through April 6th 2011), which include the following: (i) \$26.8 million of direct transaction costs, (ii) \$23.9 million of interest expense associated with the \$2.4 billion senior unsecured notes issued on January 24, 2011, proceeds from which were obtained to prefund the HCR ManorCare Acquisition, partially offset by (iii) \$24.1 million of income related to gains upon the reinvestment of the Company's debt investment in HCR ManorCare and other miscellaneous items.
- (3) The third quarter 2012 impairment charge of \$7.9 million relates to the pending sale of a land parcel in our life science segment. The third quarter 2011 impairment charge of \$15.4 million relates to our senior secured loan to Cirrus Health.
- (4) Our weighted average shares used to calculate diluted FFO as adjusted eliminate the impact of our December 2010 46 million shares common stock offering and 30 million shares from our March 2011 common stock offering (excludes 4.5 million shares sold to the underwriters upon exercise of their option to purchase additional shares), which issuances increased our weighted average shares by 17 million for the nine months ended September 30, 2011. Proceeds from these offerings were used to fund a portion of the cash consideration for the HCR ManorCare Acquisition.

Off-Balance Sheet Arrangements

We own interests in certain unconsolidated joint ventures as described under Note 8 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 12 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*.

Contractual Obligations

The following table summarizes our material contractual payment obligations and commitments at September 30, 2012 (in thousands):

	Total(1)	Less than One Year	2013-2014	2015-2016	More than Five Years
Term loan(2)	\$ 221,214	\$	\$	\$ 221,214	\$
Senior unsecured notes	5,937,000		1,037,000	1,300,000	3,600,000
Mortgage debt	1,696,115	8,715	504,702	597,936	584,762
Construction loan commitments(3)	71,598	23,178	48,420		
Development commitments(4)	19,422	10,010	9,412		
Ground and other operating leases	203,288	1,415	10,699	8,515	182,659
Interest(5)	2,449,362	54,538	760,326	598,570	1,035,928
Total	\$ 10,597,999	\$ 97,856	\$ 2,370,559	\$ 2,726,235	\$ 5,403,349

(1) Excludes \$85 million of other debt that represents Life Care Bonds that have no scheduled maturities.

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

- (2) Represents £137 million translated into U.S. dollars as of September 30, 2012.
- (3) Represents commitments to finance development projects and related working capital financings.
- (4) Represents construction and other commitments for developments in progress.
- (5) Interest on variable-rate debt is calculated using rates in effect at September 30, 2012.

Table of Contents

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, post-acute/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

There are no accounting pronouncements that have been 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

We use derivative financial instruments in the normal course of business to mitigate interest rate and foreign currency risk. We do not use derivative financial instruments for speculative or trading purposes. Derivatives are recorded on the condensed consolidated balance sheets at their fair value. See Note 20 to the Condensed Consolidated Financial Statements for additional information.

To illustrate the effect of movements in the interest rate and foreign currency markets, we performed a market sensitivity analysis on our hedging instruments. We applied various basis point spreads to the underlying interest rate curves and foreign currency exchange rates of the derivative portfolio in order to determine the instruments' change in fair value. Assuming a one percentage point change in the underlying interest rate curve and foreign currency exchange rates, the estimated change in fair value of each of the underlying derivative instruments would not exceed \$8.3 million. See Note 20 to the Condensed Consolidated Financial Statements for additional analysis details.

Interest Rate Risk. At September 30, 2012, we were exposed to market risks related to fluctuations in interest rates on properties with a gross value of \$83 million that are subject to leases where the payments fluctuate with changes in LIBOR (excludes \$221 million of variable-rate senior unsecured notes that have been hedged through interest-rate swap contracts). Our exposure to income fluctuations related to our variable-rate investments is partially offset by: (i) \$25 million of variable-rate senior unsecured notes and (ii) \$15 million of variable-rate mortgage debt payable (excludes \$87 million of variable-rate mortgage notes that have been hedged through interest-rate swap contracts). Additionally, our exposure to market risks related to fluctuations in interest rates excludes our GBP denominated \$221 million (£137 million) variable-rate Term Loan that has been hedged through interest-rate swap contracts.

Interest rate fluctuations will generally not affect our future earnings or cash flows on our fixed rate debt and assets 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 other changes in the outstanding balance as of September 30, 2012, our annual interest expense would increase by approximately \$0.4 million, or less than \$0.01 per common share on a diluted basis.

Foreign Currency Risk. At September 30, 2012, our exposure to foreign currency exchange rates relates to forecasted interest receipts from our GBP denominated senior unsecured notes (see additional discussion of the Four Seasons Health Care Senior Unsecured Notes in Note 10 of the Condensed Consolidated Financial Statements). To mitigate our foreign currency exchange exposure, we entered into a foreign currency swap contract for approximately 85% of the forecasted interest receipts from our senior unsecured notes, which represents our remaining foreign currency exposure after we consider the forecasted interest payments for our GBP denominated unsecured Term Loan interest and principal payments (see Note 11 to the Condensed Consolidated Financial Statements for additional information).

Market Risk. We have investments in marketable 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. An initial indicator of an other-than-temporary decline in value for marketable equity securities is based on the severity of the decline in market value below the cost basis 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 current cost basis; 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 market value, if any. At September 30, 2012, the fair value and current cost basis of marketable equity securities were \$22.8 million and \$17.1 million, respectively.

Table of Contents

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 September 30, 2012. 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.

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 reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

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, as amended, for the year ended December 31, 2011.

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

(a)

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

On July 6, 2012, we issued 4,800 shares of our common stock upon the redemption of 2,400 non-managing member units of our subsidiary, HCPI/Tennessee, LLC (HCPI/TN), to a non-managing member of HCPI/TN. The shares of our common stock were issued in a private placement to an accredited investor pursuant to Section 4(a)(2) of the Securities Act of 1933, as amended. We did not receive any cash proceeds from the issuance of shares of our common stock to the non-managing member upon redemption of the units, although we did acquire non-managing member units of HCPI/TN in exchange for the shares of common stock we issued to the non-managing member.

(b)

None.

Table of Contents

(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 September 30, 2012.

Period Covered	Total Number Of Shares Purchased(1)	Average Price Paid Per Share	Total Number Of Shares (Or Units) Purchased As Part Of Publicly Announced Plans Or Programs	Maximum Number (Or Approximate Dollar Value) Of Shares (Or Units) That May Yet Be Purchased Under The Plans Or Programs
July 1-31, 2012	4,037	\$ 44.41		
August 1-31, 2012	934	46.94		
September 1-30, 2012	1,652	46.86		
Total	6,623	45.38		

(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 5. Other Information.

(a) On October 25, 2012, the Company entered into a new Employment Agreement (the Employment Agreement) with James W. Mercer, the Company's Executive Vice President, General Counsel and Corporate Secretary.

The Employment Agreement provides that Mr. Mercer will continue to receive a base salary of \$500,000 annually, which may subsequently be increased by the Company but not reduced, and an annual incentive bonus based on Company and individual performance criteria as determined by the Compensation Committee. Mr. Mercer is also entitled to participate in the Company's benefit plans made available generally to the Company's senior executives. The Employment Agreement provides for a three-year term, which will be automatically extended for additional one-year periods unless either party gives prior written notice that the term will not be extended.

If Mr. Mercer's employment with the Company is terminated by the Company without cause or by Mr. Mercer for good reason (as such terms are defined in the Employment Agreement), Mr. Mercer will be entitled to a severance benefit, to be paid in a lump sum, equal to the sum of (i) his base salary at the annualized rate in effect on his termination date, and (ii) the greater of his annual incentive bonus for the last fiscal year of the Company for which the Compensation Committee of the Company's Board of Directors has determined bonuses for the Company's executives generally prior to the termination date (the last bonus year) or the average of his annual incentive bonuses for the last three fiscal years of the Company ending with the last bonus year. In addition, any portion of Mr. Mercer's then-outstanding equity awards granted by the Company that are scheduled to vest within two years following the termination date will immediately vest (or, in the case of awards subject to performance-based vesting requirements, the award will be held open until the end of the relevant performance period and, as to any portion of the award eligible to vest based on the level of performance achieved, the executive will be credited with two additional years of service after the

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

termination date for purposes of applying any time-based vesting requirements applicable to the award). Mr. Mercer's right to receive the severance benefits described above is contingent on the executive providing a general release of claims in favor of the Company and complying with certain non-solicitation and other restrictive covenants set forth in the Employment Agreement. In addition, in the event of termination of the executive's employment as described above, the executive would generally be entitled to reimbursement for his COBRA premiums for continued health coverage for up to 12 months following his termination date.

In the event the executive becomes entitled to severance benefits under the Company's Change in Control Severance Plan (the "CIC Plan"), he would be entitled to receive the benefits provided under the CIC Plan and not the benefits provided under his Employment Agreement.

The foregoing description of certain provisions of the Employment Agreement does not purport to be complete and is qualified in its entirety by reference to the full text of the Employment Agreement filed as Exhibit 10.1 to this Quarterly Report on Form 10-Q for the quarter ended September 30, 2012 and incorporated herein by reference.

Table of Contents

Item 6. Exhibits

- 3.1 Articles of Restatement of HCP (incorporated by reference to Exhibit 3.1 to HCP's Registration Statement on Form S-3 (Registration No. 333-1
- 10.1 Employment Agreement, dated October 25, 2012, by and between HCP, Inc. and James W. Mercer. *
- 10.2 Change in Control Severance Plan. *
- 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 Timothy M. Schoen, 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. Sec
- 32.2 Certification by Timothy M. Schoen, HCP's Principal Financial Officer, Pursuant to Securities Exchange Act Rule 13a-14(b) and 18 U.S.C. Sec
- 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.*

* Filed herewith.

** Furnished herewith.

Management Contract or Compensatory Plan or Arrangement.

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: October 30, 2012

HCP, Inc.

(Registrant)

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

/s/ TIMOTHY M. SCHOEN
Timothy M. Schoen
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)