

HCP, INC.  
Form 10-Q  
August 01, 2017  
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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 June 30, 2017.

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 33-0091377  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

1920 Main Street, Suite 1200

Irvine, CA 92614

(Address of principal executive offices)

(949) 407-0700

(Registrant's telephone number, including area code)

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

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, smaller reporting company or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer

Accelerated Filer

Non-accelerated Filer

Smaller Reporting Company

(Do not check if a smaller reporting company)

Emerging Growth Company

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

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Exchange Act.

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

At July 28, 2017, there were 468,963,146 shares of the registrant's \$1.00 par value common stock outstanding.

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HCP, INC.

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HCP, Inc.

## CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

(Unaudited)

	June 30, 2017	December 31, 2016
<b>ASSETS</b>		
Real Estate:		
Buildings and improvements	\$11,114,139	\$11,692,654
Development costs and construction in progress	444,528	400,619
Land	1,765,305	1,881,487
Accumulated depreciation and amortization	(2,672,489 )	(2,648,930 )
Net real estate	10,651,483	11,325,830
Net investment in direct financing leases	711,777	752,589
Loans receivable, net	393,575	807,954
Investments in and advances to unconsolidated joint ventures	829,231	571,491
Accounts receivable, net of allowance of \$4,104 and \$4,459, respectively	36,969	45,116
Cash and cash equivalents	391,965	94,730
Restricted cash	61,481	42,260
Intangible assets, net	414,404	479,805
Assets held for sale, net	—	927,866
Other assets, net	611,690	711,624
Total assets	\$14,102,575	\$15,759,265
<b>LIABILITIES AND EQUITY</b>		
Bank line of credit	\$136,311	\$899,718
Term loans	218,832	440,062
Senior unsecured notes	6,889,045	7,133,538
Mortgage debt	146,337	623,792
Other debt	94,801	92,385
Intangible liabilities, net	51,463	58,145
Liabilities of assets held for sale, net	—	3,776
Accounts payable and accrued liabilities	389,690	417,360
Deferred revenue	147,155	149,181
Total liabilities	8,073,634	9,817,957
Commitments and contingencies		
Common stock, \$1.00 par value: 750,000,000 shares authorized; 468,879,344 and 468,081,489 shares issued and outstanding, respectively	468,879	468,081
Additional paid-in capital	8,216,781	8,198,890
Cumulative dividends in excess of earnings	(2,956,324 )	(3,089,734 )
Accumulated other comprehensive loss	(27,289 )	(29,642 )
Total stockholders' equity	5,702,047	5,547,595
Joint venture partners	149,456	214,377
Non-managing member unitholders	177,438	179,336
Total noncontrolling interests	326,894	393,713
Total equity	6,028,941	5,941,308
Total liabilities and equity	\$14,102,575	\$15,759,265

See accompanying Notes to the Unaudited Consolidated Financial Statements.



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HCP, Inc.

## CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Revenues:				
Rental and related revenues	\$263,820	\$292,168	\$550,038	\$582,548
Tenant recoveries	35,259	33,531	68,934	64,906
Resident fees and services	125,416	164,202	265,648	329,965
Income from direct financing leases	13,564	15,647	27,276	30,557
Interest income	20,869	32,787	39,200	50,816
Total revenues	458,928	538,335	951,096	1,058,792
Costs and expenses:				
Interest expense	77,788	121,333	164,506	243,395
Depreciation and amortization	130,751	139,919	267,305	279,774
Operating	153,163	179,080	312,244	355,037
General and administrative	21,286	22,779	43,764	48,230
Acquisition and pursuit costs	867	823	1,924	3,298
Impairment	56,682	—	56,682	—
Total costs and expenses	440,537	463,934	846,425	929,734
Other income:				
Gain on sales of real estate, net	412	119,614	317,670	119,614
Other income, net	71	2,340	51,279	3,632
Total other income, net	483	121,954	368,949	123,246
Income before income taxes and equity income (loss) from unconsolidated joint ventures	18,874	196,355	473,620	252,304
Income tax benefit (expense)	2,987	2,179	9,149	(1,525 )
Equity income (loss) from unconsolidated joint ventures	240	(1,067 )	3,509	(1,975 )
Income from continuing operations	22,101	197,467	486,278	248,804
Discontinued operations:				
Income before income taxes	—	107,551	—	225,293
Income taxes	—	(176 )	—	(49,510 )
Total discontinued operations	—	107,375	—	175,783
Net income	22,101	304,842	486,278	424,587
Noncontrolling interests' share in earnings	(2,718 )	(3,125 )	(5,750 )	(6,751 )
Net income attributable to HCP, Inc.	19,383	301,717	480,528	417,836
Participating securities' share in earnings	(100 )	(342 )	(674 )	(651 )
Net income applicable to common shares	\$19,283	\$301,375	\$479,854	\$417,185
Basic earnings per common share:				
Continuing operations	\$0.04	\$0.42	\$1.02	\$0.52
Discontinued operations	—	0.23	—	0.37
Net income applicable to common shares	\$0.04	\$0.65	\$1.02	\$0.89
Diluted earnings per common share:				
Continuing operations	\$0.04	\$0.42	\$1.02	\$0.52
Discontinued operations	—	0.22	—	0.37
Net income applicable to common shares	\$0.04	\$0.64	\$1.02	\$0.89
Weighted average shares used to calculate earnings per common share:				

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Basic	468,646	467,084	468,474	466,579
Diluted	468,839	471,425	473,366	466,777
Dividends declared per common share	\$0.37	\$0.575	\$0.74	\$1.15

See accompanying Notes to the Unaudited Consolidated Financial Statements.

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HCP, Inc.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Net income	\$22,101	\$304,842	\$486,278	\$424,587
Other comprehensive income (loss):				
Change in net unrealized (losses) gains on securities	(3 )	10	6	(5 )
Change in net unrealized gains (losses) on cash flow hedges:				
Unrealized (losses) gains	(6,131 )	1,038	(6,433 )	348
Reclassification adjustment realized in net income	(193 )	171	20	340
Change in Supplemental Executive Retirement Plan obligation	74	71	148	141
Foreign currency translation adjustment	7,622	(355 )	8,612	(1,092 )
Total other comprehensive income (loss)	1,369	935	2,353	(268 )
Total comprehensive income	23,470	305,777	488,631	424,319
Total comprehensive income attributable to noncontrolling interests	(2,718 )	(3,125 )	(5,750 )	(6,751 )
Total comprehensive income attributable to HCP, Inc.	\$20,752	\$302,652	\$482,881	\$417,568

See accompanying Notes to the Unaudited Consolidated Financial Statements.



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HCP, Inc.

## CONSOLIDATED STATEMENTS OF EQUITY

(In thousands, except per share data)

(Unaudited)

	Common Stock		Additional Paid-In Capital	Cumulative Dividends In Excess Of Earnings	Accumulated Other Comprehensive Loss	Total Stockholders' Equity	Total Noncontrolling Interests	Total Equity
	Shares	Amount						
January 1, 2017	468,081	\$468,081	\$8,198,890	\$(3,089,734)	\$(29,642 )	\$5,547,595	\$393,713	\$5,941,308
Net income	—	—	—	480,528	—	480,528	5,750	486,278
Other comprehensive income	—	—	—	—	2,353	2,353	—	2,353
Issuance of common stock, net	850	850	12,443	—	—	13,293	—	13,293
Conversion of DownREIT units to common stock	68	68	2,003	—	—	2,071	(2,071 )	—
Repurchase of common stock	(141 )	(141 )	(4,220 )	—	—	(4,361 )	—	(4,361 )
Exercise of stock options	21	21	573	—	—	594	—	594
Amortization of deferred compensation	—	—	7,092	—	—	7,092	—	7,092
Common dividends (\$0.74 per share)	—	—	—	(347,118 )	—	(347,118 )	—	(347,118 )
Distributions to noncontrolling interests	—	—	—	—	—	—	(13,087 )	(13,087 )
Issuances of noncontrolling interests	—	—	—	—	—	—	650	650
Deconsolidation of noncontrolling interests	—	—	—	—	—	—	(58,061 )	(58,061 )
June 30, 2017	468,879	\$468,879	\$8,216,781	\$(2,956,324)	\$(27,289 )	\$5,702,047	\$326,894	\$6,028,941
	Common Stock		Additional Paid-In Capital	Cumulative Dividends In Excess Of Earnings	Accumulated Other Comprehensive Loss	Total Stockholders' Equity	Total Noncontrolling Interests	Total Equity
	Shares	Amount						
January 1, 2016	465,488	\$465,488	\$11,647,039	\$(2,738,414)	\$(30,470 )	\$9,343,643	\$402,674	\$9,746,317
Net income	—	—	—	417,836	—	417,836	6,751	424,587
Other comprehensive	—	—	—	—	(268 )	(268 )	—	(268 )

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income								
Issuance of common stock, net	1,715	1,715	41,357	—	—	43,072	—	43,072
Conversion of DownREIT units to common stock	120	120	4,902	—	—	5,022	(5,022)	—
Repurchase of common stock	(109)	(109)	(3,765)	—	—	(3,874)	—	(3,874)
Exercise of stock options	111	111	2,741	—	—	2,852	—	2,852
Amortization of deferred compensation	—	—	9,505	—	—	9,505	—	9,505
Common dividends (\$1.15 per share)	—	—	—	(537,061)	—	(537,061)	—	(537,061)
Distributions to noncontrolling interests	—	—	(36)	—	—	(36)	(12,437)	(12,473)
Issuances of noncontrolling interests	—	—	—	—	—	—	3,225	3,225
Deconsolidation of noncontrolling interests	—	—	(36)	475	—	439	67	506
June 30, 2016	467,325	\$467,325	\$11,701,707	\$(2,857,164)	\$(30,738)	\$9,281,130	\$395,258	\$9,676,388
See accompanying Notes to the Unaudited Consolidated Financial Statements.								

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HCP, Inc.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Six Months Ended	
	June 30,	
	2017	2016
Cash flows from operating activities:		
Net income	\$486,278	\$424,587
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	267,305	279,774
Discontinued operations	—	2,934
Amortization of deferred compensation	7,092	9,505
Amortization of deferred financing costs	7,702	10,561
Straight-line rents	(8,176 )	(11,117 )
Equity (income) loss from unconsolidated joint ventures	(3,509 )	1,975
Distributions of earnings from unconsolidated joint ventures	18,528	3,202
Gain on sales of real estate, net	(317,670 )	(119,614 )
Allowance for loan losses	56,682	—
Deferred income tax (benefit) expense	(12,472 )	49,156
Foreign exchange and other gains, net	(845 )	(91 )
Gain on sale of marketable securities	(50,895 )	—
Other non-cash items	(1,478 )	(1,502 )
Changes in:		
Accounts receivable, net	(2,002 )	(2,871 )
Other assets, net	(6,775 )	(2,892 )
Accounts payable and accrued liabilities	(8,176 )	23,305
Net cash provided by operating activities	431,589	666,912
Cash flows from investing activities:		
Acquisitions of real estate	(26,446 )	(94,271 )
Development of real estate	(157,898 )	(204,624 )
Leasing costs and tenant and capital improvements	(48,575 )	(41,161 )
Proceeds from sales of real estate, net	1,195,860	96,652
Contributions to unconsolidated joint ventures	(21,302 )	(10,156 )
Distributions in excess of earnings from unconsolidated joint ventures	1,609	6,421
Net proceeds from the RIDEA II transaction (Note 4)	480,614	—
Proceeds from the sales of Four Seasons investments	135,538	—
Principal repayments on direct financing leases, loans receivable and other	414,221	205,576
Investments in loans receivable and other	(18,433 )	(122,113 )
Decrease in restricted cash	2,398	10,058
Net cash provided by (used in) investing activities	1,957,586	(153,618 )
Cash flows from financing activities:		
Net (repayments) borrowings under bank line of credit	(441,581 )	642,898
Repayments under bank line of credit	(339,826 )	(135,000 )
Repayment of term loans	(234,459 )	—
Repayments of senior unsecured notes	(250,000 )	(500,000 )
Issuance of mortgage and other debt	5,395	—
Repayments of mortgage and other debt	(481,667 )	(246,387 )

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Issuance of common stock and exercise of options	13,887	45,924
Repurchase of common stock	(4,361 )	(3,874 )
Dividends paid on common stock	(347,118 )	(537,061 )
Issuance of noncontrolling interests	650	3,225
Distributions to noncontrolling interests	(13,087 )	(12,473 )
Net cash used in financing activities	(2,092,167 )	(742,748 )
Effect of foreign exchange on cash and cash equivalents	227	(596 )
Net increase (decrease) in cash and cash equivalents	297,235	(230,050 )
Cash and cash equivalents, beginning of period	94,730	346,500
Cash and cash equivalents, end of period	\$391,965	\$116,450
See accompanying Notes to the Unaudited Consolidated Financial Statements.		

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HCP, Inc.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1. Business

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HCP, Inc., a Standard & Poor's ("S&P") 500 company, is a Maryland corporation that is organized to qualify as a real estate investment trust ("REIT") which, together with its consolidated entities (collectively, "HCP" or the "Company"), invests primarily in real estate serving the healthcare industry in the United States ("U.S."). The Company acquires, develops, leases, manages and disposes of healthcare real estate and provides financing to healthcare providers. The Company's diverse portfolio is comprised of investments in the following reportable healthcare segments: (i) senior housing triple-net; (ii) senior housing operating portfolio ("SHOP"); (iii) life science and (iv) medical office.

NOTE 2. Summary of Significant Accounting Policies

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**Basis of Presentation**

The accompanying unaudited 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 consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from management's estimates.

The consolidated financial statements include the accounts of HCP, Inc., its wholly-owned subsidiaries, joint ventures ("JVs") and variable interest entities ("VIEs") that it controls through voting rights or other means. Intercompany transactions and balances have been eliminated upon consolidation. In the opinion of management, all adjustments (consisting of normal recurring adjustments) necessary to present fairly the Company's financial position, results of operations and cash flows have been included. Operating results for the three and six months ended June 30, 2017 are not necessarily indicative of the results that may be expected for the year ending December 31, 2017. 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, 2016 included in the Company's Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission ("SEC").

**Real Estate**

On January 1, 2017 the Company adopted Accounting Standards Update ("ASU") No. 2017-01, Clarifying the Definition of a Business ("ASU 2017-01") which narrows the Financial Accounting Standards Board's ("FASB") definition of a business and provides a framework that gives entities a basis for making reasonable judgments about whether a transaction involves an asset, or a group of assets, or a business. ASU 2017-01 states that when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or group of similar identifiable assets, the set is not a business. If this initial test is not met, a set cannot be considered a business unless it includes an acquired input and a substantive process that together significantly contribute to the ability to create outputs. In addition, ASU 2017-01 clarifies the requirements for a set of activities to be considered a business and narrows the definition of an output. This ASU is to be applied prospectively and the Company expects that a majority of its future real estate acquisitions and dispositions will be deemed asset transactions rather than business combinations. As a result, for asset acquisitions the Company will record identifiable assets acquired, liabilities assumed and any associated noncontrolling interests at cost on a relative fair value basis. In addition, for such asset acquisitions, no goodwill will be recognized, third party transaction costs will be capitalized and any associated contingent consideration will be recorded when the contingency is resolved.

**Segment Reporting**

The Company's reportable segments, based on how it evaluates its business and allocates resources, are as follows: (i) senior housing triple-net, (ii) SHOP, (iii) life science and (iv) medical office.

Prior to the third quarter of 2016, the Company had five reportable segments: (i) senior housing, (ii) post-acute/skilled

nursing, (iii) life science, (iv) medical office and (v) hospital. During the third quarter of 2016, primarily as a result of the planned spin-off of Quality Care Properties, Inc. (“QCP”) (NYSE:QCP), the Company revised its operating analysis structure and changed its reportable segments. The Company believes the change to its reportable segments is appropriate and consistent with how its chief operating decision makers review the Company’s operating results and determine resource allocations. Accordingly, all prior period segment information has been reclassified to conform to the current period presentation.

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## Reclassifications

Certain amounts in the Company’s consolidated financial statements have been reclassified for prior periods to conform to the current period presentation. Certain prior period amounts have been reclassified on consolidated statements of operations for discontinued operations (see Note 4). See Segment Reporting above for additional reclassifications.

## Recent Accounting Pronouncements

In February 2017, the FASB issued ASU No. 2017-05, Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets (“ASU 2017-05”). The amendments in ASU 2017-05 clarify the scope of the FASB’s recently established guidance on nonfinancial asset derecognition which applies to the derecognition of all nonfinancial assets and in-substance nonfinancial assets. In addition, ASU 2017-05 clarifies the accounting for partial sales of nonfinancial assets and in-substance nonfinancial assets to align with the new revenue recognition standard (see below). ASU 2017-05 is effective for annual periods beginning after December 15, 2017, including interim periods within, and must be adopted in conjunction with the Revenue ASUs (as defined below). ASU 2017-05 can be adopted using a full retrospective approach or a modified retrospective approach, resulting in a cumulative-effect adjustment to equity as of the beginning of the fiscal year in which the guidance is effective. The Company has not yet elected a transition method and is evaluating the complete impact of the adoption of the Revenue ASUs (see below) on January 1, 2018 to its consolidated financial position, results of operations and disclosures. The Company expects to complete its evaluation of the impacts of the Revenue ASUs during the second half of 2017. In June 2016, the FASB issued ASU No. 2016-13, Measurement of Credit Losses on Financial Instruments (“ASU 2016-13”). ASU 2016-13 is intended to improve financial reporting by requiring timelier recognition of credit losses on loans and other financial instruments held by financial institutions and other organizations. The amendments in ASU 2016-13 eliminate the “probable” initial threshold for recognition of credit losses in current accounting guidance and, instead, reflect an entity’s current estimate of all expected credit losses over the life of the financial instrument. Previously, when credit losses were measured under current accounting guidance, an entity generally only considered past events and current conditions in measuring the incurred loss. The amendments in ASU 2016-13 broaden the information that an entity must consider in developing its expected credit loss estimate for assets measured either collectively or individually. The use of forecasted information incorporates more timely information in the estimate of expected credit loss. ASU 2016-13 is effective for fiscal years, and interim periods within, beginning after December 15, 2019. Early adoption is permitted for fiscal years, and interim periods within, beginning after December 15, 2018. A reporting entity is required to apply the amendments in ASU 2016-13 using a modified retrospective approach by recording a cumulative-effect adjustment to equity as of the beginning of the fiscal year of adoption. A prospective transition approach is required for debt securities for which an other-than-temporary impairment had been recognized before the effective date. Upon adoption of ASU 2016-13, the Company is required to reassess its financing receivables, including direct finance leases and loans receivable, and expects that application of ASU 2016-13 may result in the Company recognizing credit losses at an earlier date than would otherwise be recognized under current accounting guidance. The Company is evaluating the impact of the adoption of ASU 2016-13 on January 1, 2020 to its consolidated financial position and results of operations.

Between May 2014 and May 2016, the FASB issued three ASUs changing the requirements for recognizing and reporting revenue (together, herein referred to as the “Revenue ASUs”): (i) ASU No. 2014-09, Revenue from Contracts with Customers (“ASU 2014-09”), (ii) ASU No. 2016-08, Principal versus Agent Considerations (Reporting Revenue Gross versus Net) (“ASU 2016-08”) and (iii) ASU No. 2016-12, Narrow-Scope Improvements and Practical Expedients (“ASU 2016-12”). ASU 2014-09 provides guidance for revenue recognition to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2016-08 is intended to improve the operability and understandability of the implementation guidance on principal versus agent considerations. ASU 2016-12 provides practical expedients and improvements on the previously narrow scope of ASU 2014-09. In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date (“ASU 2015-14”). ASU 2015-14 defers the effective date of ASU 2014-09 by one year to fiscal years, and interim periods within, beginning after December 15, 2017. All subsequent ASUs related to ASU 2014-09, including ASU 2016-08 and ASU 2016-12,

assumed the deferred effective date enforced by ASU 2015-14. Early adoption of the Revenue ASUs is permitted for annual periods, and interim periods within, beginning after December 15, 2016. A reporting entity may apply the amendments in the Revenue ASUs using either a modified retrospective approach, by recording a cumulative-effect adjustment to equity as of the beginning of the fiscal year of adoption or full retrospective approach.

As the primary source of revenue for the Company is generated through leasing arrangements, which are excluded from the Revenue ASUs (as it relates to the timing and recognition of revenue), the Company expects that it may be impacted in its recognition of non-lease revenue, such as certain resident fees in its RIDEA structures (a portion of which are not generated through leasing arrangements), non-lease components of revenue from lease agreements and its recognition of real estate sale transactions. Under ASU 2014-09, revenue recognition for real estate sales is largely based on the transfer of control versus continuing involvement under current guidance. As a result, the Company generally expects that the new guidance will result in more transactions qualifying as sales of real estate and revenue being recognized at an earlier date than under current accounting guidance. Additionally, upon adoption of the Revenue ASUs in 2018, the Company anticipates that it will be required to separately disclose the components of



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its total revenue between lease revenue accounted for under existing lease guidance and service revenue accounted for under the new Revenue ASUs, including non-lease components such as certain services embedded in base leasing fees. The Company has not yet elected a transition method and is evaluating the complete impact of the adoption of the Revenue ASUs on January 1, 2018 to its consolidated financial position, results of operations and disclosures. The Company expects to complete its evaluation of the impacts of the Revenue ASUs during the second half of 2017. In February 2016, the FASB issued ASU No. 2016-02, Leases (“ASU 2016-02”). ASU 2016-02 amends the current accounting for leases to: (i) require lessees to put most leases on their balance sheets, but continue recognizing expenses on their income statements in a manner similar to requirements under current accounting guidance, (ii) eliminate current real estate specific lease provisions and (iii) modify the classification criteria and accounting for sales-type leases for lessors. ASU 2016-02 is effective for fiscal years, and interim periods within, beginning after December 15, 2018. Early adoption is permitted. The transition method required by ASU 2016-02 varies based on the specific amendment being adopted. As a result of adopting ASU 2016-02, the Company will recognize all of its significant operating leases for which it is the lessee, including corporate office leases and ground leases, on its consolidated balance sheets and will capitalize fewer legal costs related to the drafting and execution of its lease agreements. From a lessor perspective, the Company expects that it will be required to further bifurcate lease agreements to separately recognize and disclose non-lease components that are executory in nature. Lease components will continue to be recognized on a straight-line basis over the lease term and certain non-lease components will be accounted for under the new revenue recognition guidance in ASU 2014-09. The disaggregated disclosure of lease and executory non-lease components (e.g., maintenance) will be required upon the adoption of ASU 2016-02. The Company anticipates that it will elect a practical expedient offered in ASU 2016-02 that allows an entity to not reassess the following upon adoption (must be elected as a group): (i) whether an expired or existing contract contains a lease arrangement, (ii) lease classification related to expired or existing lease arrangements, or (iii) whether costs incurred on expired or existing leases qualify as initial direct costs. The Company does not expect the bifurcation of non-lease components from a lease agreement to significantly impact the existing revenue recognition pattern. The Company is still evaluating the complete impact of the adoption of ASU 2016-02 on January 1, 2019 to its consolidated financial position, results of operations and disclosures.

The following ASUs have been issued, but not yet adopted, and the Company does not expect a material impact to its consolidated financial position, results of operations, cash flows, or disclosures upon adoption:

ASU No. 2017-04, Simplifying the Test for Goodwill Impairment (“ASU 2017-04”). ASU 2017-04 is effective for fiscal years, including interim periods within, beginning after December 15, 2019 (upon the first goodwill impairment test performed during that fiscal year). Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. A reporting entity must apply the amendments in ASU 2017-04 using a prospective approach.

ASU No. 2016-18, Restricted Cash (“ASU 2016-18”). ASU 2016-18 is effective for fiscal years, and interim periods within, beginning after December 15, 2017. Early adoption is permitted. A reporting entity must apply the amendments in ASU 2016-18 using a full retrospective approach.

ASU No. 2016-16, Intra-Entity Transfers of Assets Other Than Inventory (“ASU 2016-16”). ASU 2016-16 is effective for fiscal years, and interim periods within, beginning after December 15, 2017. Early adoption is permitted as of the first interim period presented in any year following issuance. A reporting entity must apply the amendments in ASU 2016-16 using a modified retrospective approach by recording a cumulative-effect adjustment to equity as of the beginning of the fiscal year of adoption.

ASU No. 2016-15, Classification of Certain Cash Receipts and Cash Payments (“ASU 2016-15”). ASU 2016-15 is effective for fiscal years, and interim periods within, beginning after December 15, 2017. Early adoption is permitted. A reporting entity must apply the amendments in ASU 2016-15 using a full retrospective approach.

ASU No. 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities (“ASU 2016-01”). ASU 2016-01 is effective for fiscal years, and interim periods within, beginning after December 15, 2017. Early adoption is permitted only for updates to certain disclosure requirements. A reporting entity is required to apply the amendments in ASU 2016-01 using a modified retrospective approach by recording a cumulative-effect adjustment to equity as of the beginning of the fiscal year of adoption.



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## NOTE 3. Real Estate Property Investments

The following table summarizes the Company's real estate acquisitions for the six months ended June 30, 2017 (in thousands):

Segment	Consideration		Assets Acquired	
	Cash Paid/ Debt Settled	Liabilities Assumed	Real Estate	Net Intangibles
Life science	\$26,019	\$ 155	\$24,398	\$ 1,776
Medical office	427	5	432	—
	\$26,446	\$ 160	\$24,830	\$ 1,776

The following table summarizes the Company's real estate acquisitions for the six months ended June 30, 2016 (in thousands):

Segment	Consideration		Assets Acquired	
	Cash Paid/ Debt Settled	Liabilities Assumed	Real Estate	Net Intangibles
Senior housing triple-net	\$76,362	\$ 1,200	\$71,875	\$ 5,687
Other non-reportable segments	17,909	—	16,596	1,313
	\$94,271	\$ 1,200	\$88,471	\$ 7,000

## NOTE 4. Discontinued Operations and Dispositions of Real Estate

## Discontinued Operations - Quality Care Properties, Inc.

On October 31, 2016, the Company completed the spin-off (the "Spin-Off") of its subsidiary, QCP. The Spin-Off included 338 properties, primarily comprised of the HCR ManorCare, Inc. ("HCRMC") direct financing lease ("DFL") investments and an equity investment in HCRMC. QCP is an independent, publicly-traded, self-managed and self-administrated REIT.

In connection with the Spin-Off, the Company entered into a Transition Services Agreement ("TSA") with QCP. Per the terms of the TSA, the Company has agreed to provide certain administrative and support services to QCP on a transitional basis for established fees. The TSA will terminate on the expiration of the term of the last service provided under the agreement, which will be on or prior to October 30, 2017. The TSA provides that QCP generally has the right to terminate a transition service upon thirty days notice to the Company. The TSA contains provisions under which the Company will, subject to certain limitations, be obligated to indemnify QCP for losses incurred by QCP resulting from the Company's breach of the TSA.

Summarized financial information for discontinued operations for the three and six months ended June 30, 2016 is as follows (in thousands):

	Three Months Ended June 30, 2016	Six Months Ended June 30, 2016
Revenues:		
Rental and related revenues	\$6,908	\$13,722
Tenant recoveries	399	761
Income from direct financing leases	116,453	229,511

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Total revenues	123,760	243,994
Costs and expenses:		
Depreciation and amortization	(1,467 )	(2,934 )
Operating	(1,045 )	(2,043 )
General and administrative	(14 )	(62 )
Acquisition and pursuit costs	(13,704 )	(13,704 )
Other income, net	21	42
Income before income taxes	107,551	225,293
Income tax expense	(176 )	(49,510 )
Total discontinued operations	\$107,375	\$175,783

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## HCR ManorCare, Inc.

Discontinued operations is primarily comprised of QCP's HCRMC DFL investments. During the six months ended June 30, 2016, the Company received cash payments of \$116 million from the HCRMC DFL investments.

No accretion related to its HCRMC DFL investments was recognized in 2016 due to the Company utilizing a cash basis method of accounting beginning January 1, 2016.

The Company's acquisition of the HCRMC DFL investments in 2011 was subject to federal and state built-in gain tax of up to \$2 billion if all the assets were sold within 10 years of the acquisition date. At the time of acquisition, the Company intended to hold the assets for at least 10 years, at which time the assets would no longer be subject to the built-in gain tax. In December 2015, the U.S. Federal Government passed legislation which permanently reduced the holding period, for federal tax purposes, to 5 years, which the Company satisfied in April 2016. This legislation was not extended to certain states, which maintain a 10 year requirement. During the three months ended March 31, 2016, the Company determined that it may sell assets during the next five years and, therefore, recorded a deferred tax liability of \$49 million representing its estimated exposure to state built-in gain tax.

## Dispositions of Real Estate

## Held for Sale

At June 30, 2017, there were no assets classified as held for sale.

At December 31, 2016, 64 senior housing triple-net facilities, four life science facilities and a SHOP facility were classified as held for sale, with an aggregate carrying value of \$928 million, primarily comprised of real estate assets of \$809 million. All facilities held for sale at December 31, 2016 were sold during the first quarter of 2017.

## 2017 Dispositions

In January 2017, the Company sold four life science facilities in Salt Lake City, Utah for \$76 million, resulting in a net gain on sale of \$45 million.

Also in January 2017, the Company completed the contribution of its ownership interest in RIDEA II to an unconsolidated JV owned by HCP and an investor group led by Columbia Pacific Advisors, LLC ("HCP/CPA PropCo" and "HCP/CPA OpCo," together, the "HCP/CPA JV"). In addition, RIDEA II was recapitalized with \$602 million of debt, of which \$360 million was provided by a third-party and \$242 million was provided by HCP. In return for both transaction elements, the Company received combined proceeds of \$480 million from the HCP/CPA JV and \$242 million in note receivables and retained an approximately 40% beneficial interest in RIDEA II (the note receivable and 40% beneficial interest are herein referred to as the "RIDEA II Investments"). This transaction resulted in the Company deconsolidating the net assets of RIDEA II and recognizing a net gain on sale of \$99 million. The RIDEA II Investments are now recognized and accounted for as equity method investments.

In March 2017, the Company sold 64 senior housing triple-net assets, previously under triple-net leases with Brookdale Senior Living Inc. ("Brookdale"), for \$1.125 billion to affiliates of Blackstone Real Estate Partners VIII, L.P., resulting in a net gain on sale of \$170 million.

In April 2017, the Company sold a land parcel in San Diego, California for \$27 million and one life science building in San Diego, California for \$5 million.

## 2016 Dispositions

During the six months ended June 30, 2016, the Company sold five post-acute/skilled nursing facilities and two senior housing triple-net facilities for \$130 million, a life science facility for \$74 million, two medical office buildings for \$19 million and a SHOP facility for \$6 million and recognized total gain on sales of \$120 million.

## NOTE 5. Net Investment in Direct Financing Leases

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Net investment in DFLs consisted of the following (dollars in thousands):

	June 30, 2017	December 31, 2016
Minimum lease payments receivable	\$1,081,187	\$1,108,237
Estimated residual value	500,368	539,656
Less unearned income	(869,778 )	(895,304 )
Net investment in direct financing leases	\$711,777	\$752,589

Properties subject to direct financing leases 29                      30

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Certain DFLs 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. In February 2017, the Company sold a hospital within a DFL in Palm Beach Gardens, Florida for \$43 million to the current tenant.

## Direct Financing Lease Internal Ratings

The following table summarizes the Company's internal ratings for DFLs at June 30, 2017 (dollars in thousands):

Segment	Carrying Amount	Percentage of DFL Portfolio	Internal Ratings			
			Performing DFLs	Watch List DFLs	Workout DFLs	
Senior housing triple-net	\$627,173	88%	\$268,815	\$359,586,000	\$358,358	\$ —
Other non-reportable segments	84,604	12	84,604	—	—	—
	\$711,777	100%	\$353,419		\$358,358	\$ —

Beginning September 30, 2013, the Company placed a 14 property senior housing triple-net DFL (the "DFL Watchlist Portfolio") on nonaccrual status and "Watch List" status. The Company determined that the collection of all rental payments was and continues to be no longer reasonably assured; therefore, rental revenue for the DFL Watchlist Portfolio has been recognized on a cash basis. During both the three months ended June 30, 2017 and 2016, the Company recognized DFL income of \$4 million and received cash payments of \$5 million from the DFL Watchlist Portfolio. During the six months ended June 30, 2017 and 2016, the Company recognized DFL income of \$7 million and \$8 million, respectively, and received cash payments of \$9 million and \$10 million, respectively, from the DFL Watchlist Portfolio. The carrying value of the DFL Watchlist Portfolio was \$358 million and \$361 million at June 30, 2017 and December 31, 2016, respectively.

## NOTE 6. Loans Receivable

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

	June 30, 2017		December 31, 2016	
	Real Estate Secured	Total	Real Estate Secured	Total
Mezzanine <sup>(1)</sup>	\$—	\$274,799	\$—	\$615,188
Other <sup>(2)</sup>	176,186	176,186	195,946	195,946
Unamortized discounts, fees and costs <sup>(1)</sup>				