

HCP, INC.  
Form 10-Q  
May 06, 2014  
Table of Contents

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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(Mark One)

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

For the quarterly period ended March 31, 2014.

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 001-08895

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**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)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files). YES x NO o

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

Large Accelerated Filer x

Accelerated Filer o

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Non-accelerated Filer   
(Do not check if a smaller reporting company)

Smaller Reporting Company

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

**As of May 1, 2014, there were 458,197,511 shares of the registrant's \$1.00 par value common stock outstanding.**

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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  |
| <u>Item 2.</u> | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 25 |
| <u>Item 3.</u> | <u>Quantitative and Qualitative Disclosures About Market Risk</u>                            | 38 |
| <u>Item 4.</u> | <u>Controls and Procedures</u>   | 39 |

**PART II. OTHER INFORMATION**

|                   |  |    |
|-------------------|--|----|
| <u>Item 1A.</u>   | <u>Risk Factors</u>  | 40 |
| <u>Item 2.</u>    | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 40 |
| <u>Item 6.</u>    | <u>Exhibits</u>  | 40 |
| <u>Signatures</u> |  | 42 |

Table of Contents

## HCP, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

(Unaudited)

|  | March 31,<br>2014 | December 31,<br>2013 |
|--|-------------------|----------------------|
| <b>ASSETS</b>  |                   |                      |
| Real estate:   |                   |                      |
| Buildings and improvements   | \$ 10,570,071     | \$ 10,544,110        |
| Development costs and construction in progress   | 211,181           | 225,869              |
| Land   | 1,827,137         | 1,822,862            |
| Accumulated depreciation and amortization  | (2,015,034)       | (1,965,592)          |
| Net real estate  | 10,593,355        | 10,627,249           |
| Net investment in direct financing leases  | 7,190,400         | 7,153,399            |
| Loans receivable, net  | 371,172           | 366,001              |
| Investments in and advances to unconsolidated joint ventures   | 193,930           | 196,576              |
| Accounts receivable, net of allowance of \$1,897 and \$1,529, respectively   | 28,539            | 27,494               |
| Cash and cash equivalents  | 49,738            | 300,556              |
| Restricted cash  | 30,296            | 37,229               |
| Intangible assets, net   | 472,058           | 489,842              |
| Real estate assets held for sale, net  |                   | 9,819                |
| Other assets, net  | 929,190           | 867,705              |
| Total assets(1)  | \$ 19,858,678     | \$ 20,075,870        |
| <b>LIABILITIES AND EQUITY</b>  |                   |                      |
| Term loan  | \$ 228,269        | \$ 226,858           |
| Senior unsecured notes   | 6,912,812         | 6,963,375            |
| Mortgage debt  | 1,235,169         | 1,396,485            |
| Other debt   | 74,097            | 74,909               |
| Intangible liabilities, net  | 94,615            | 98,810               |
| Accounts payable and accrued liabilities   | 276,342           | 318,427              |
| Deferred revenue   | 67,801            | 65,872               |
| Total liabilities(2)   | 8,889,105         | 9,144,736            |
| Commitments and contingencies  |                   |                      |
| Common stock, \$1.00 par value: 750,000,000 shares authorized; 458,043,744 and 456,960,648 shares issued and outstanding, respectively | 458,044           | 456,961              |
| Additional paid-in capital   | 11,362,581        | 11,334,041           |
| Cumulative dividends in excess of earnings   | (1,044,302)       | (1,053,215)          |
| Accumulated other comprehensive loss   | (14,570)          | (14,487)             |
| Total stockholders' equity   | 10,761,753        | 10,723,300           |
| Joint venture partners   | 23,788            | 23,729               |
| Non-managing member unitholders  | 184,032           | 184,105              |
| Total noncontrolling interests   | 207,820           | 207,834              |
| Total equity   | 10,969,573        | 10,931,134           |
| Total liabilities and equity   | \$ 19,858,678     | \$ 20,075,870        |

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

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

See accompanying Notes to the Condensed Consolidated Financial Statements.

Table of Contents

## HCP, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)

(Unaudited)

|  | Three Months Ended March 31, |                   |
|--|------------------------------|-------------------|
|  | 2014                         | 2013              |
| <b>Revenues:</b>   |                              |                   |
| Rental and related revenues  | \$ 284,823                   | \$ 281,539        |
| Tenant recoveries  | 25,434                       | 24,202            |
| Resident fees and services   | 38,053                       | 35,746            |
| Income from direct financing leases  | 164,537                      | 156,870           |
| Interest income  | 16,696                       | 12,386            |
| Investment management fee income   | 449                          | 443               |
| Total revenues   | 529,992                      | 511,186           |
| <b>Costs and expenses:</b>   |                              |                   |
| Interest expense   | 106,638                      | 109,110           |
| Depreciation and amortization  | 107,388                      | 103,179           |
| Operating  | 75,707                       | 72,686            |
| General and administrative   | 21,394                       | 20,656            |
| Total costs and expenses   | 311,127                      | 305,631           |
| Other income, net  | 1,930                        | 12,112            |
| <b>Income before income taxes and equity income from unconsolidated joint ventures</b> | <b>220,795</b>               | <b>217,667</b>    |
| Income taxes   | (1,446)                      | (916)             |
| Equity income from unconsolidated joint ventures                                       | 14,528                       | 14,801            |
| <b>Income from continuing operations</b>   | <b>233,877</b>               | <b>231,552</b>    |
| <b>Discontinued operations:</b>  |                              |                   |
| Income before gain on sales of real estate, net of income taxes                        | 1,736                        | 2,232             |
| Gain on sales of real estate, net of income taxes                                      | 28,010                       |                   |
| Total discontinued operations  | 29,746                       | 2,232             |
| <b>Net income</b>  | <b>263,623</b>               | <b>233,784</b>    |
| Noncontrolling interests' share in earnings  | (4,512)                      | (3,199)           |
| <b>Net income attributable to HCP, Inc.</b>  | <b>259,111</b>               | <b>230,585</b>    |
| Participating securities' share in earnings  | (1,064)                      | (478)             |
| <b>Net income applicable to common shares</b>  | <b>\$ 258,047</b>            | <b>\$ 230,107</b> |
| <b>Basic earnings per common share:</b>  |                              |                   |
| Continuing operations  | \$ 0.50                      | \$ 0.50           |
| Discontinued operations  | 0.06                         | 0.01              |
| Net income applicable to common shares   | \$ 0.56                      | \$ 0.51           |
| <b>Diluted earnings per common share:</b>  |                              |                   |
| Continuing operations  | \$ 0.50                      | \$ 0.50           |
| Discontinued operations  | 0.06                         | 0.01              |
| Net income applicable to common shares   | \$ 0.56                      | \$ 0.51           |
| <b>Weighted average shares used to calculate earnings per common share:</b>            |                              |                   |

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|  |                 |              |
|--|-----------------|--------------|
| Basic                                      | 457,294         | 453,651      |
| Diluted                                    | 457,674         | 454,613      |
| <b>Dividends declared per common share</b> | <b>\$ 0.545</b> | <b>0.525</b> |

See accompanying Notes to the Condensed Consolidated Financial Statements.



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

|   | <b>Three Months Ended March 31,</b> |             |
|---|-------------------------------------|-------------|
|   | <b>2014</b>                         | <b>2013</b> |
| Net income  | \$ 263,623                          | \$ 233,784  |
| Other comprehensive income (loss):                                  |                                     |             |
| Change in net unrealized gains on securities:                       |                                     |             |
| Unrealized gains  | 3                                   | 1,355       |
| Reclassification adjustment realized in net income                  |                                     | (9,131)     |
| Change in net unrealized gains (losses) on cash flow hedges:        |                                     |             |
| Unrealized gains (losses)   | (695)                               | 5,320       |
| Reclassification adjustment realized in net income                  | 605                                 | 272         |
| Change in Supplemental Executive Retirement Plan obligation         | 54                                  | 55          |
| Foreign currency translation adjustment                             | (50)                                | 178         |
| Total other comprehensive loss                                      | (83)                                | (1,951)     |
| Total comprehensive income  | 263,540                             | 231,833     |
| Total comprehensive income attributable to noncontrolling interests | (4,512)                             | (3,199)     |
| Total comprehensive income attributable to HCP, Inc.                | \$ 259,028                          | \$ 228,634  |

See accompanying Notes to the Condensed Consolidated Financial Statements.

Table of Contents

## HCP, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF EQUITY

(In thousands, except per share data)

(Unaudited)

|   | Common Stock |            | Additional    | Cumulative     | Accumulated   | Total         | Total          | Total         |
|---|--------------|------------|---------------|----------------|---------------|---------------|----------------|---------------|
|   | Shares       | Amount     | Paid-In       | Dividends      | Other         | Stockholders  | Noncontrolling | Equity        |
|   |              |            | Capital       | In Excess      | Comprehensive | Equity        | Interests      |               |
|   |              |            |               | Of Earnings    | Income (Loss) |               |                |               |
| <b>January 1, 2014</b>                    | 456,961      | \$ 456,961 | \$ 11,334,041 | \$ (1,053,215) | \$ (14,487)   | \$ 10,723,300 | \$ 207,834     | \$ 10,931,134 |
| Net income                                |              |            |               | 259,111        |               | 259,111       | 4,512          | 263,623       |
| Other comprehensive loss                  |              |            |               |                | (83)          | (83)          |                | (83)          |
| Issuance of common stock, net             | 1,287        | 1,287      | 31,419        |                |               | 32,706        | (73)           | 32,633        |
| Repurchase of common stock                | (208)        | (208)      | (7,860)       |                |               | (8,068)       |                | (8,068)       |
| Exercise of stock options                 | 4            | 4          | 91            |                |               | 95            |                | 95            |
| Amortization of deferred compensation     |              |            | 4,890         |                |               | 4,890         |                | 4,890         |
| Common dividends (\$0.545 per share)      |              |            |               | (250,198)      |               | (250,198)     |                | (250,198)     |
| Distributions to noncontrolling interests |              |            |               |                |               |               | (3,975)        | (3,975)       |
| Issuance of noncontrolling interests      |              |            |               |                |               |               | 1,193          | 1,193         |
| Purchase of noncontrolling interests      |              |            |               |                |               |               | (1,671)        | (1,671)       |
| <b>March 31, 2014</b>                     | 458,044      | \$ 458,044 | \$ 11,362,581 | \$ (1,044,302) | \$ (14,570)   | \$ 10,761,753 | \$ 207,820     | \$ 10,969,573 |

|   | Common Stock |            | Additional    | Cumulative     | Accumulated   | Total         | Total          | Total         |
|---|--------------|------------|---------------|----------------|---------------|---------------|----------------|---------------|
|   | Shares       | Amount     | Paid-In       | Dividends      | Other         | Stockholders  | Noncontrolling | Equity        |
|   |              |            | Capital       | In Excess      | Comprehensive | Equity        | Interests      |               |
|   |              |            |               | Of Earnings    | Income (Loss) |               |                |               |
| <b>January 1, 2013</b>                    | 453,191      | \$ 453,191 | \$ 11,180,066 | \$ (1,067,367) | \$ (14,653)   | \$ 10,551,237 | \$ 202,540     | \$ 10,753,777 |
| Net income                                |              |            |               | 230,585        |               | 230,585       | 3,199          | 233,784       |
| Other comprehensive loss                  |              |            |               |                | (1,951)       | (1,951)       |                | (1,951)       |
| Issuance of common stock, net             | 555          | 555        | 13,901        |                |               | 14,456        | (2,179)        | 12,277        |
| Repurchase of common stock                | (14)         | (14)       | (675)         |                |               | (689)         |                | (689)         |
| Exercise of stock options                 | 685          | 685        | 19,980        |                |               | 20,665        |                | 20,665        |
| Amortization of deferred compensation     |              |            | 5,430         |                |               | 5,430         |                | 5,430         |
| Common dividends (\$0.525 per share)      |              |            |               | (238,467)      |               | (238,467)     |                | (238,467)     |
| Distributions to noncontrolling interests |              |            |               |                |               |               | (3,754)        | (3,754)       |
|   |              |            |               |                |               |               | 987            | 987           |

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Issuance of  
noncontrolling interests

|                       |         |    |         |    |            |    |             |    |          |    |            |    |         |    |            |
|-----------------------|---------|----|---------|----|------------|----|-------------|----|----------|----|------------|----|---------|----|------------|
| <b>March 31, 2013</b> | 454,417 | \$ | 454,417 | \$ | 11,218,702 | \$ | (1,075,249) | \$ | (16,604) | \$ | 10,581,266 | \$ | 200,793 | \$ | 10,782,059 |
|-----------------------|---------|----|---------|----|------------|----|-------------|----|----------|----|------------|----|---------|----|------------|

See accompanying Notes to the Condensed Consolidated Financial Statements.

Table of Contents

## HCP, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

|   | Three Months Ended March 31, |            |
|---|------------------------------|------------|
|   | 2014                         | 2013       |
| <b>Cash flows from operating activities:</b>  |                              |            |
| Net income  | \$ 263,623                   | \$ 233,784 |
| 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   | 107,388                      | 103,179    |
| Discontinued operations   |                              | 1,538      |
| Amortization of above and below market lease intangibles, net                       | (168)                        | (78)       |
| Amortization of deferred compensation   | 4,890                        | 5,430      |
| Amortization of deferred financing costs, net                                       | 4,965                        | 4,644      |
| Straight-line rents   | (13,968)                     | (18,793)   |
| Loan and direct financing lease interest accretion                                  | (21,503)                     | (24,266)   |
| Deferred rental revenues  | (145)                        | 1,257      |
| Equity income from unconsolidated joint ventures                                    | (14,528)                     | (14,801)   |
| Distributions of earnings from unconsolidated joint ventures                        | 2,430                        | 803        |
| Gain on sales of real estate  | (28,010)                     |            |
| Marketable securities and other (gains) losses, net                                 | 63                           | (11,082)   |
| Changes in:   |                              |            |
| Accounts receivable, net  | (1,045)                      | 1,967      |
| Other assets  | (8,942)                      | (8,699)    |
| Accounts payable and accrued liabilities  | (47,869)                     | (60,533)   |
| Net cash provided by operating activities   | 247,181                      | 214,350    |
| <b>Cash flows from investing activities:</b>  |                              |            |
| Acquisitions of real estate   | (5,473)                      | (25,654)   |
| Development of real estate  | (33,983)                     | (38,749)   |
| Leasing costs and tenant and capital improvements                                   | (12,405)                     | (8,959)    |
| Proceeds from sales of real estate, net   | 36,753                       |            |
| Distributions in excess of earnings from unconsolidated joint ventures              | 772                          | 568        |
| Proceeds from the sale of marketable securities                                     |                              | 28,030     |
| Principal repayments on loans receivable  | 3,133                        | 2,188      |
| Investments in loans receivable and other   | (42,281)                     | (14,957)   |
| Decrease in restricted cash   | 6,933                        | 173        |
| Net cash used in investing activities   | (46,551)                     | (57,360)   |
| <b>Cash flows from financing activities:</b>  |                              |            |
| Net borrowings under bank line of credit  |                              | 14,000     |
| Issuance of senior unsecured notes  | 350,000                      |            |
| Repayments of senior unsecured notes  | (400,000)                    | (150,000)  |
| Repayments of mortgage debt   | (162,739)                    | (12,135)   |
| Deferred financing costs  | (9,239)                      |            |
| Issuance of common stock and exercise of options                                    | 32,728                       | 32,942     |
| Repurchase of common stock  | (8,068)                      | (689)      |
| Dividends paid on common stock  | (250,198)                    | (238,467)  |
| Issuance of noncontrolling interests  | 41                           | 987        |
| Distributions to noncontrolling interests   | (3,975)                      | (3,754)    |

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|   |           |    |           |
|---|-----------|----|-----------|
| Net cash used in financing activities                   | (451,450) |    | (357,116) |
| Effect of foreign exchange on cash and cash equivalents | 2         |    |           |
| Net decrease in cash and cash equivalents               | (250,818) |    | (200,126) |
| Cash and cash equivalents, beginning of period          | 300,556   |    | 247,673   |
| Cash and cash equivalents, end of period                | \$ 49,738 | \$ | 47,547    |

See accompanying Notes to the Condensed Consolidated Financial Statements.

Table of Contents

**HCP, INC.**

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**(1) Business**

HCP, Inc., a Standard & Poor's (S&P) 500 company, together with its consolidated entities (collectively, HCP or the Company), invests primarily in real estate serving the healthcare industry in the United States (U.S.). The Company is a Maryland corporation and was organized to qualify as a self-administered real estate investment trust (REIT) in 1985. The Company is headquartered in 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) investments in senior housing operations utilizing the structure permitted by the Housing and Economic Recovery Act of 2008, which is commonly referred to as RIDEA.

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

*Basis of Presentation*

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

The condensed consolidated financial statements include the accounts of HCP, Inc., its wholly-owned subsidiaries 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 three months ended March 31, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. The accompanying unaudited interim financial information should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2013 included in the Company's Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission (the SEC).

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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 statements of income (see Note 4).

### *Allowance for Doubtful Accounts*

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

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

Table of Contents

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

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

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

*Recent Accounting Pronouncements*

In April 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2014-08, *Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity* (ASU 2014-08). This update changes the requirements for reporting and the definition of discontinued operations. Based on the current revisions, the disposal of a component of an entity, or a group of components of an entity, is required to be reported in discontinued operations if the disposal represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results when certain defined criteria are met. ASU 2014-08 is effective for fiscal years and interim periods ending after December 15, 2014 and shall be applied prospectively. Early adoption is permitted, but only for disposals (or classifications as held for sale) that have not been reported in financial statements previously issued or available for issuance. Upon the Company's early adoption of ASU 2014-08, on June 30, 2014, it does not expect that future sales of real estate assets will represent strategic shifts or have a major effect on the Company's operations or financial results; therefore, such dispositions would not be considered discontinued operations.

**(3) Real Estate Property Investments**

During the three months ended March 31, 2014, the Company acquired land for a senior housing community development project for \$7 million, subject to a 15 percent noncontrolling interest. During the three months ended March 31, 2013, the Company acquired the four remaining senior housing communities from a joint venture between Emeritus Corporation (Emeritus) and Blackstone Real Estate Partners VI for \$38 million and acquired 38 acres of land to be developed for use in the post-acute/skilled nursing segment for \$0.4 million.



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During the three months ended March 31, 2014 and 2013, the Company funded an aggregate of \$49 million and \$42 million, respectively, for construction, tenant and other capital improvement projects, primarily in its senior housing, life science and medical office segments.

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

During the three months ended March 31, 2014, the Company sold two post-acute/skilled nursing facilities for \$22 million and a hospital for \$17 million. There were no sales of real estate assets during the three months ended March 31, 2013.

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

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

|   | <b>Three Months Ended March 31,</b> |             |
|---|-------------------------------------|-------------|
|   | <b>2014</b>                         | <b>2013</b> |
| Rental and related revenues                                     | \$ 1,810                            | \$ 5,083    |
| Depreciation and amortization expenses                          |                                     | 1,538       |
| Operating expenses  | 54                                  | 919         |
| Other expenses, net   | 20                                  | 394         |
| Income before gain on sales of real estate, net of income taxes | \$ 1,736                            | \$ 2,232    |
| Gain on sales of real estate, net of income taxes               | \$ 28,010                           | \$          |
| Number of properties included in discontinued operations        | 3                                   | 13          |

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

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

|   | <b>March 31,</b> | <b>December 31,</b> |
|---|------------------|---------------------|
|   | <b>2014</b>      | <b>2013</b>         |
| Minimum lease payments receivable(1)          | \$ 24,666,528    | \$ 24,808,386       |
| Estimated residual values                     | 4,134,405        | 4,134,405           |
| Less unearned income                          | (21,610,533)     | (21,789,392)        |
| Net investment in direct financing leases     | \$ 7,190,400     | \$ 7,153,399        |
| Properties subject to direct financing leases | 364              | 364                 |

The minimum lease payments receivable are primarily attributable to HCR ManorCare, Inc. ( HCR ManorCare ) (\$23.4 billion and \$23.5 billion at March 31, 2014 and December 31, 2013, respectively). The triple-net master lease with HCR ManorCare provides for annual rent of \$524 million beginning April 1, 2014 (prior to April 1, 2014, annual rent was \$506 million). The rent increases by 3.5% per year over the next two years and by 3% for the remaining portion of the initial lease term. The properties are grouped into four pools, and HCR ManorCare has a

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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.

The following table summarizes the Company's internal ratings for net investment in DFLs at March 31, 2014 (in thousands):

| Investment Type            | Carrying Amount | Percentage of DFL Portfolio | Internal Ratings |                 |              |
|----------------------------|-----------------|-----------------------------|------------------|-----------------|--------------|
|                            |                 |                             | Performing DFLs  | Watch List DFLs | Workout DFLs |
| Senior housing             | \$ 1,484,656    | 21                          | \$ 1,111,264     | \$ 373,392      | \$           |
| Post-acute/skilled nursing | 5,581,853       | 77                          | 5,581,853        |                 |              |
| Hospital                   | 123,891         | 2                           | 123,891          |                 |              |
|                            | \$ 7,190,400    | 100                         | \$ 6,817,008     | \$ 373,392      | \$           |

Table of Contents

During the quarter ended September 30, 2013, the Company placed a 14-property senior housing DFL (the DFL Portfolio) on non-accrual status. Based on the Company's determination that the collection of all rental payments was no longer reasonably assured, rental revenue for the DFL Portfolio is recognized on a cash basis. Furthermore, the Company determined that the DFL Portfolio was not impaired at September 30, 2013, based on its belief that: (i) it was not probable that it will not collect all of the rental payments under the terms of the lease; and (ii) the fair value of the underlying collateral exceeded the DFL Portfolio's \$376 million carrying amount. The fair value of the DFL Portfolio was estimated based on a discounted cash flow model, the inputs to which are considered to be a Level 3 measurement within the fair value hierarchy. Inputs to this valuation model include real estate capitalization rates, industry growth rates and operating margins, some of which influence the Company's expectation of future cash flows from the DFL Portfolio and, accordingly, the fair value of its investment. During the three months ended March 31, 2014 and 2013, the Company recognized DFL income of \$4.9 million and \$7.0 million, respectively, and received cash payments of \$5.8 million and \$5.8 million, respectively, from the DFL Portfolio. The carrying value of the DFL Portfolio was \$373 million and \$374 million at March 31, 2014 and December 31, 2013, respectively. At March 31, 2014, the Company believes the fair value of the collateral supporting this loan is in excess of its carrying value.

**(6) Loans Receivable**

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

|                                       | March 31, 2014      |               |            | December 31, 2013   |               |            |
|---------------------------------------|---------------------|---------------|------------|---------------------|---------------|------------|
|                                       | Real Estate Secured | Other Secured | Total      | Real Estate Secured | Other Secured | Total      |
| Mezzanine                             | \$                  | \$ 234,455    | \$ 234,455 | \$                  | \$ 234,455    | \$ 234,455 |
| Other(1)                              | 152,759             |               | 152,759    | 147,669             |               | 147,669    |
| Unamortized discounts, fees and costs |                     | (2,632)       | (2,632)    |                     | (2,713)       | (2,713)    |
| Allowance for loan losses             |                     | (13,410)      | (13,410)   |                     | (13,410)      | (13,410)   |
|                                       | \$ 152,759          | \$ 218,413    | \$ 371,172 | \$ 147,669          | \$ 218,332    | \$ 366,001 |

(1) Includes \$123 million and \$117 million at March 31, 2014 and December 31, 2013, respectively, of construction loans outstanding related to senior housing development projects. At March 31, 2014, the Company had \$25 million remaining in its commitments to fund development projects.

The following table summarizes the Company's internal ratings for loans receivable at March 31, 2014 (in thousands):

| Investment Type     | Carrying Amount | Percentage of Loan Portfolio |               | Internal Ratings |               |
|---------------------|-----------------|------------------------------|---------------|------------------|---------------|
|                     |                 | Performing Loans             | Workout Loans | Watch List Loans | Workout Loans |
| Real estate secured | \$ 152,759      | 41                           | \$ 152,759    | \$               | \$            |
| Other secured       | 218,413         | 59                           | 200,342       |                  | 18,071        |
|                     | \$ 371,172      | 100                          | \$ 353,101    | \$               | \$ 18,071     |

*Other Secured Loans*

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

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

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### Table of Contents

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

|                            |    | <b>Amount</b> |
|----------------------------|----|---------------|
| Balance at January 1, 2014 | \$ | 13,410        |
| Additions                  |    |               |
| Balance at March 31, 2014  | \$ | 13,410        |

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

The Company owns interests in the following entities that are accounted for under the equity method at March 31, 2014 (dollars in thousands):

| Entity(1)                                      | Segment                     | Investment(2) | Ownership% |
|--|-----------------------------|---------------|------------|
| HCR ManorCare                                  | post-acute/skilled nursing  | \$ 82,311     | 9.5        |
| HCP Ventures III, LLC                          | medical office              | 7,065         | 30         |
| HCP Ventures IV, LLC                           | medical office and hospital | 29,074        | 20         |
| HCP Life Science(3)                            | life science                | 68,798        | 50-63      |
| Suburban Properties, LLC                       | medical office              | 6,180         | 67         |
| Advances to unconsolidated joint ventures, net |                             | 502           |            |
|  |                             | \$ 193,930    |            |
|  |                             |               |            |
| Edgewood Assisted Living Center, LLC           | senior housing              | \$ (431)      |            |
| Seminole Shores Living Center, LLC             | senior housing              | (656)         |            |
|  |                             | \$ (1,087)    |            |

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

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

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

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

|                                | March 31,<br>2014 | December 31,<br>2013 |
|--------------------------------|-------------------|----------------------|
| Real estate, net               | \$ 3,644,045      | \$ 3,662,450         |
| Goodwill and other assets, net | 5,414,544         | 5,384,553            |
| Total assets                   | \$ 9,058,589      | \$ 9,047,003         |

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|   |    |           |    |           |
|---|----|-----------|----|-----------|
| Capital lease obligations and mortgage debt | \$ | 6,736,980 | \$ | 6,768,815 |
| Accounts payable                            |    | 1,083,690 |    | 1,045,260 |
| Other partners' capital                     |    | 1,102,974 |    | 1,098,228 |
| HCP's capital(1)                            |    | 134,945   |    | 134,700   |
| Total liabilities and partners' capital     | \$ | 9,058,589 | \$ | 9,047,003 |

(1) The combined basis difference of the Company's investments in these joint ventures of \$57 million, as of March 31, 2014, is primarily attributable to goodwill, real estate, capital lease obligations, deferred tax assets and lease-related net intangibles.

|                               | <b>Three Months Ended March 31,</b> |              |
|-------------------------------|-------------------------------------|--------------|
|                               | <b>2014</b>                         | <b>2013</b>  |
| Total revenues                | \$ 1,079,891                        | \$ 1,093,374 |
| Net income                    | 7,996                               | 10,584       |
| HCP's share of earnings(1)    | 14,528                              | 14,801       |
| Fees earned by HCP            | 449                                 | 443          |
| Distributions received by HCP | 3,202                               | 1,371        |

(1) The Company's joint venture interest in HCR ManorCare is accounted for using the equity method and results in an ongoing elimination of DFL income proportional to HCP's ownership in HCR ManorCare. The elimination of the respective proportional lease expense at the HCR ManorCare level in substance results in \$15.6 million and \$15.9 million of DFL income that is recharacterized to the Company's share of earnings from HCR ManorCare (equity income from unconsolidated joint ventures) for the three months ended March 31, 2014 and 2013, respectively.

Table of Contents**(8) Intangibles**

At March 31, 2014 and December 31, 2013, intangible lease assets, comprised of lease-up intangibles, above market tenant lease intangibles and below market ground lease intangibles, were \$776 million and \$781 million, respectively. At March 31, 2014 and December 31, 2013, the accumulated amortization of intangible assets was \$304 million and \$292 million, respectively.

At both March 31, 2014 and December 31, 2013, intangible lease liabilities, comprised of below market lease intangibles and above market ground lease intangibles were \$207 million. At March 31, 2014 and December 31, 2013, the accumulated amortization of intangible liabilities was \$113 million and \$108 million, respectively.

**(9) Other Assets**

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

|   | March 31,<br>2014 | December 31,<br>2013 |
|---|-------------------|----------------------|
| Straight-line rent assets, net of allowance of \$34,214 and \$34,230 respectively | \$ 380,820        | \$ 368,919           |
| Marketable debt securities, net   | 245,649           | 244,089              |
| Leasing costs, net  | 104,386           | 104,601              |
| Deferred financing costs, net   | 48,230            | 42,106               |
| Goodwill  | 50,346            | 50,346               |
| Other(1)  | 99,759            | 57,644               |
| Total other assets  | \$ 929,190        | \$ 867,705           |

(1) 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 March 31, 2014 and December 31, 2013, the carrying value of interest accrued related to the Delphis loan was zero. See Note 6 for additional information about the Delphis loan and the related impairment. At March 31, 2014 and December 31, 2013, includes a loan receivable of \$12 million and \$10 million, respectively, from HCP Ventures IV, LLC, an unconsolidated joint venture (see Note 7 for additional information) with an interest rate of 12% which matures in May 2015. The loan is secured by the joint venture partner's 80% partnership interest in the joint venture.

During the three months ended March 31, 2013, the Company realized gains from the sale of marketable equity securities of \$11 million, which were included in other income, net.

*Four Seasons Health Care Senior Unsecured Notes*



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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 were 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 ( Four Seasons ), 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 was financed by a GBP denominated unsecured term loan that is discussed in Note 10. These senior unsecured notes are accounted for as marketable debt securities and classified as held-to-maturity.

### **(10) Debt**

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

On March 31, 2014, the Company amended its unsecured revolving line of credit facility (the Facility ) with a syndicate of banks, which was scheduled to mature in March 2016, increasing the borrowing capacity by \$500 million to \$2.0 billion. The amended Facility matures on March 31, 2018, with a one-year committed extension option. Borrowings under the Facility accrue interest at LIBOR plus a margin that depends upon the Company's debt ratings. The Company pays a facility fee on the entire revolving commitment that depends on its debt ratings. Based on the Company's debt ratings at March 31, 2014, the margin on the Facility was 0.925%, and the facility fee was 0.15%. The Facility also includes a feature that will allow the Company to increase the borrowing capacity by an aggregate amount of up to \$500 million, subject to securing additional commitments from existing lenders or new lending institutions. At March 31, 2014, the Company had no amounts drawn under the Facility.

Table of Contents

On July 30, 2012, the Company entered into a credit agreement with a syndicate of banks for a £137 million (\$228 million at March 31, 2014) 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.

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% and (iv) require a minimum Fixed Charge Coverage ratio of 1.5 times. The Facility also requires a Minimum Consolidated Tangible Net Worth of \$9.5 billion at March 31, 2014. The *Term Loan* also requires a formula-determined Minimum Consolidated Tangible Net Worth of \$9.2 billion at March 31, 2014. At March 31, 2014, the Company was in compliance with each of these restrictions and requirements of the Facility and *Term Loan*.

*Senior Unsecured Notes*

At March 31, 2014, the Company had senior unsecured notes outstanding with an aggregate principal balance of \$6.9 billion. At March 31, 2014, interest rates on the notes ranged from 1.20% to 6.99% with a weighted average effective interest rate of 5.06% and a weighted average maturity of six 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, maintenance of unencumbered assets, cross-acceleration provisions and other customary terms. The Company believes it was in compliance with these covenants at March 31, 2014.

On February 12, 2014, the Company issued \$350 million of 4.20% senior unsecured notes due 2024. The notes were priced at 99.537% of the principal amount with an effective yield-to-maturity of 4.257%; net proceeds from this offering were \$346 million.

On February 1, 2014, the Company repaid \$400 million of maturing senior unsecured notes, which accrued interest at a rate of 2.7%. The senior unsecured notes were repaid with a portion of the proceeds from the Company's November 2013 bond offering.

On December 16, 2013, the Company repaid \$400 million of maturing senior unsecured notes, which accrued interest at a rate of 5.65%. The senior unsecured notes were repaid with a portion of the proceeds from the Company's November 2013 bond offering.

On November 12, 2013, the Company issued \$800 million of 4.25% senior unsecured notes due 2023. The notes were priced at 99.540% of the principal amount with an effective yield to maturity of 4.307%; net proceeds from this offering were \$789 million.

On February 28, 2013, the Company repaid \$150 million of maturing senior unsecured notes, which accrued interest at a rate of 5.625%.

*Mortgage Debt*

At March 31, 2014, the Company had \$1.2 billion in aggregate principal amount of mortgage debt outstanding secured by 95 healthcare facilities (including redevelopment properties) with a carrying value of \$1.5 billion. At March 31, 2014, interest rates on the mortgage debt ranged from 0.69% to 8.69% with a weighted average effective interest rate of 6.19% and a weighted average maturity of three years.

Table of Contents

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 or 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.

*Debt Maturities*

The following table summarizes the Company's stated debt maturities and scheduled principal repayments at March 31, 2014 (in thousands):

| Year                          | Term Loan(1) | Senior Unsecured Notes | Mortgage Debt | Total(2)     |
|-------------------------------|--------------|------------------------|---------------|--------------|
| 2014 (Nine months)            | \$           | \$ 87,000              | \$ 17,597     | \$ 104,597   |
| 2015                          |              | 400,000                | 308,421       | 708,421      |
| 2016                          | 228,269      | 900,000                | 291,738       | 1,420,007    |
| 2017                          |              | 750,000                | 550,477       | 1,300,477    |
| 2018                          |              | 600,000                | 6,583         | 606,583      |
| Thereafter                    |              | 4,200,000              | 65,242        | 4,265,242    |
| (Discounts) and premiums, net |              | (24,188)               | (4,889)       | (29,077)     |
|                               | \$ 228,269   | \$ 6,912,812           | \$ 1,235,169  | \$ 8,376,250 |

(1) Represents £137 million translated into U.S. dollars.

(2) Excludes \$74 million of other debt that represents Life Care Bonds that have no scheduled maturities that are discussed below.

*Other Debt*

At March 31, 2014, the Company had \$74 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). The Life Care Bonds are generally refundable to the residents upon the termination of the contract or upon the successful resale of the unit.

**(11) Commitments and Contingencies***Legal Proceedings*

From time to time, the Company is a party to legal proceedings, lawsuits and other claims that arise in the ordinary course of the Company's business. 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, results of operations or cash flows. The Company's policy is to expense legal costs as they are incurred.

*Concentration of Credit Risk*

Concentrations of credit risks arise when one or more 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. The Company does not have significant foreign operations.

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

Table of Contents

The following table lists the Company's senior housing concentrations:

| Operators                                    | Percentage of<br>Senior Housing Gross Assets |                      | Percentage of<br>Senior Housing Revenues |                                      |
|--|--|----------------------|--|--------------------------------------|
|  | March 31,<br>2014                            | December 31,<br>2013 | Three Months Ended March 31,<br>2014     | Three Months Ended March 31,<br>2013 |
| HCR ManorCare                                | 11%  | 11%                  | 10%                                      | 10%                                  |
| Emeritus (1)                                 | 37   | 37                   | 34                                       | 35                                   |
| Sunrise Senior Living ( Sunrise )(2)         | 17   | 17                   | 11                                       | 13                                   |
| Brookdale Senior Living ( Brookdale )(1) (3) | 11   | 11                   | 12                                       | 12                                   |

The following table lists the Company's post-acute/skilled nursing concentrations:

| Operators     | Percentage of Post-Acute/<br>Skilled Nursing Gross Assets |                      | Percentage of Post-Acute/<br>Skilled Nursing Revenues |                                      |
|---------------|---|----------------------|---|--------------------------------------|
|               | March 31,<br>2014   | December 31,<br>2013 | Three Months Ended March 31,<br>2014                  | Three Months Ended March 31,<br>2013 |
| HCR ManorCare | 89%   | 88%                  | 86%   | 88%                                  |

The following table lists the total Company concentrations:

| Operators        | Percentage of<br>Total Company Assets |                      | Percentage of<br>Total Company Revenues |                                      |
|------------------|---------------------------------------|----------------------|---|--------------------------------------|
|                  | March 31,<br>2014                     | December 31,<br>2013 | Three Months Ended March 31,<br>2014    | Three Months Ended March 31,<br>2013 |
| HCR ManorCare    | 32%                                   | 32%                  | 28%                                     | 28%                                  |
| Emeritus(1)      | 15                                    | 14                   | 12                                      | 13                                   |
| Sunrise(2)       | 7                                     | 7                    | 4                                       | 5                                    |
| Brookdale(1) (3) | 4                                     | 4                    | 4                                       | 4                                    |

(1) On February 20, 2014, Brookdale and Emeritus signed definitive agreements to merge; the merger is anticipated to close in the third quarter of 2014. Contingent on the closing of this merger, on April 23, 2014, the Company agreed to amend all of its leases with Emeritus and enter into two RIDEA joint ventures with Brookdale (see Note 20 for additional information regarding these potential transactions).

(2) 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.

(3) Percentages do not include senior housing facilities that Brookdale operates on the Company's behalf under a RIDEA structure.

HCR ManorCare's summarized condensed consolidated financial information follows (in millions):

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|   | March 31,<br>2014 | December 31,<br>2013 |
|---|-------------------|----------------------|
| Real estate and other property, net             | \$ 2,984.1        | \$ 2,996.8           |
| Cash and cash equivalents                       | 169.7             | 141.8                |
| Goodwill, intangible and other assets, net      | 5,170.0           | 5,171.3              |
| Total assets                                    | \$ 8,323.8        | \$ 8,309.9           |
| Debt and financing obligations                  | \$ 6,227.6        | \$ 6,258.5           |
| Accounts payable, accrued liabilities and other | 1,049.7           | 1,013.4              |
| Total equity                                    | 1,046.5           | 1,038.0              |
| Total liabilities and equity                    | \$ 8,323.8        | \$ 8,309.9           |

Table of Contents

|  | <b>Three Months Ended March 31,</b> |                |
|--|-------------------------------------|----------------|
|  | <b>2014</b>                         | <b>2013</b>    |
| Revenues   | \$ 1,054.3                          | \$ 1,066.3     |
| Operating, general and administrative expense                | (904.6)                             | (907.7)        |
| Depreciation and amortization expense                        | (35.6)                              | (36.8)         |
| Interest expense   | (102.7)                             | (104.4)        |
| Other income, net  | 2.9                                 | 2.3            |
| <b>Income from continuing operations before income taxes</b> | <b>14.3</b>                         | <b>19.7</b>    |
| Income taxes   | (5.9)                               | (6.3)          |
| <b>Income from continuing operations</b>                     | <b>8.4</b>                          | <b>13.4</b>    |
| Loss from discontinued operations, net of taxes              |                                     | (1.7)          |
| <b>Net income</b>  | <b>\$ 8.4</b>                       | <b>\$ 11.7</b> |

To mitigate the 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 \$110 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 \$373 million as of March 31, 2014.

**(12) Equity***Common Stock*

The following table lists the common stock cash dividends declared by the Company in 2014:

| <b>Declaration Date</b> | <b>Record Date</b> | <b>Amount<br/>Per Share</b> | <b>Dividend<br/>Payable Date</b> |
|-------------------------|--------------------|-----------------------------|----------------------------------|
| January 30              | February 10        | \$ 0.545                    | February 25                      |
| May 1                   | May 12             | 0.545                       | May 27                           |

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



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|   | <b>Three Months Ended March 31,</b> |             |
|---|-------------------------------------|-------------|
|   | <b>2014</b>                         | <b>2013</b> |
| Dividend Reinvestment and Stock Purchase Plan | 875                                 | 382         |
| Conversion of DownREIT units(1)               | 2                                   | 51          |
| Exercise of stock options                     | 4                                   | 796         |
| Vesting of restricted stock units(2)          | 411                                 | 17          |

(1) Non-managing member LLC units.

(2) Issued under the Company's 2006 Performance Incentive Plan, as amended and restated.

*Accumulated Other Comprehensive Loss*

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

|  | <b>March 31,</b> |    | <b>December 31,</b> |
|--|------------------|----|---------------------|
|  | <b>2014</b>      |    | <b>2013</b>         |
| Unrealized gains on available for sale securities        | \$ 3             | \$ |                     |
| Unrealized losses on cash flow hedges, net               | (10,887)         |    | (10,797)            |
| Supplemental Executive Retirement Plan minimum liability | (2,856)          |    | (2,910)             |
| Cumulative foreign currency translation adjustment       | (830)            |    | (780)               |
| Total accumulated other comprehensive loss               | \$ (14,570)      | \$ | (14,487)            |

Table of Contents*Noncontrolling Interests*

At March 31, 2014, non-managing members held an aggregate of 4 million units in four limited liability companies ( DownREITs ), for which the Company is the managing member. At March 31, 2014, the carrying and fair values of these DownREIT units were \$184 million and \$232 million, respectively.

**(13) 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 primarily invests in single operator or tenant properties, through the acquisition and development of triple-net leased real estate, management of operations (RIDEA) and by debt issued by operators in these sectors. Under the medical office segment, the Company 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 herein and in the Company's 2013 Annual Report on Form 10-K filed with the SEC. There were no intersegment sales or transfers during the three months ended March 31, 2014 and 2013. The Company evaluates performance based upon property net operating income from continuing operations ( NOI ), adjusted (cash) NOI and interest income of the combined investments in each segment.

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

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

For the three months ended March 31, 2014:

| Segments           | Rental Revenues(1) | Resident Fees and Services | Interest Income | Investment Management Fee Income | Total Revenues | NOI(2)     | Adjusted NOI(2) (Cash NOI) |
|--------------------|--------------------|----------------------------|-----------------|----------------------------------|----------------|------------|----------------------------|
| Senior housing     | \$ 150,085         | \$ 38,053                  | \$ 3,284        | \$                               | \$ 191,422     | \$ 163,590 | \$ 150,375                 |
| Post-acute/skilled | 137,780            |                            | 13,412          |                                  | 151,192        | 137,248    | 118,099                    |
| Life science       | 76,122             |                            |                 | 1                                | 76,123         | 61,961     | 58,829                     |
| Medical office     | 89,262             |                            |                 | 448                              | 89,710         | 53,746     | 53,029                     |
| Hospital           | 21,545             |                            |                 |                                  | 21,545         | 20,595     | 20,661                     |
| Total              | \$ 474,794         | \$ 38,053                  | \$ 16,696       | \$ 449                           | \$ 529,992     | \$ 437,140 | \$ 400,993                 |

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For the three months ended March 31, 2013:

| Segments           | Rental<br>Revenues(1) | Resident Fees<br>and Services | Interest<br>Income | Investment<br>Management<br>Fee Income | Total<br>Revenues | NOI(2)            | Adjusted<br>NOI(2)<br>(Cash NOI) |
|--------------------|-----------------------|-------------------------------|--------------------|--|-------------------|-------------------|----------------------------------|
| Senior housing     | \$ 148,896            | \$ 35,746                     | \$ 2,401           | \$                                     | \$ 187,043        | \$ 161,120        | \$ 142,722                       |
| Post-acute/skilled | 133,836               |                               | 9,985              |  | 143,821           | 133,207           | 113,847                          |
| Life science       | 73,330                |                               |                    | 1                                      | 73,331            | 59,947            | 56,340                           |
| Medical office     | 86,831                |                               |                    | 442                                    | 87,273            | 52,567            | 51,240                           |
| Hospital           | 19,718                |                               |                    |  | 19,718            | 18,830            | 18,476                           |
| <b>Total</b>       | <b>\$ 462,611</b>     | <b>\$ 35,746</b>              | <b>\$ 12,386</b>   | <b>\$ 443</b>                          | <b>\$ 511,186</b> | <b>\$ 425,671</b> | <b>\$ 382,625</b>                |

(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 DFLs, 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, 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 or real estate companies, as those companies may use different methodologies for calculating NOI.

Table of Contents

The following is a reconciliation of reported net income to NOI and adjusted NOI (in thousands):

|   | <b>Three Months Ended March 31,</b> |                   |
|---|-------------------------------------|-------------------|
|   | <b>2014</b>                         | <b>2013</b>       |
| <b>Net income</b>   | \$ 263,623                          | \$ 233,784        |
| Interest income   | (16,696)                            | (12,386)          |
| Investment management fee income                              | (449)                               | (443)             |
| Interest expense  | 106,638                             | 109,110           |
| Depreciation and amortization                                 | 107,388                             | 103,179           |
| General and administrative                                    | 21,394                              | 20,656            |
| Other income, net   | (1,930)                             | (12,112)          |
| Income taxes  | 1,446                               | 916               |
| Equity income from unconsolidated joint ventures              | (14,528)                            | (14,801)          |
| Total discontinued operations                                 | (29,746)                            | (2,232)           |
| <b>NOI</b>  | <b>437,140</b>                      | <b>425,671</b>    |
| Straight-line rents   | (13,968)                            | (18,793)          |
| DFL accretion   | (21,422)                            | (24,170)          |
| Amortization of above and below market lease intangibles, net | (168)                               | (78)              |
| Lease termination fees  | (578)                               |                   |
| NOI adjustments related to discontinued operations            | (11)                                | (5)               |
| <b>Adjusted (Cash) NOI</b>                                    | <b>\$ 400,993</b>                   | <b>\$ 382,625</b> |

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

| <b>Segments</b>                           | <b>March 31,</b>     | <b>December 31,</b>  |
|---|----------------------|----------------------|
|   | <b>2014</b>          | <b>2013</b>          |
| Senior housing                            | \$ 7,812,723         | \$ 7,803,085         |
| Post-acute/skilled nursing                | 6,301,607            | 6,266,938            |
| Life science                              | 4,003,001            | 3,986,187            |
| Medical office                            | 2,674,280            | 2,686,069            |
| Hospital                                  | 639,357              | 639,357              |
| Gross segment assets                      | 21,430,968           | 21,381,636           |
| Accumulated depreciation and amortization | (2,318,562)          | (2,254,591)          |
| Net segment assets                        | 19,112,406           | 19,127,045           |
| Assets held-for-sale, net                 |                      | 9,819                |
| Other non-segment assets                  | 746,272              | 939,006              |
| <b>Total assets</b>                       | <b>\$ 19,858,678</b> | <b>\$ 20,075,870</b> |

At both March 31, 2014 and December 31, 2013, 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.

Table of Contents**(14) Earnings Per Common Share**

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

|   | <b>Three Months Ended March 31,</b> |             |
|---|-------------------------------------|-------------|
|   | <b>2014</b>                         | <b>2013</b> |
| <b>Numerator</b>  |                                     |             |
| Income from continuing operations                             | \$ 233,877                          | \$ 231,552  |
| Noncontrolling interests share in continuing operations       | (3,335)                             | (3,199)     |
| Income from continuing operations applicable to HCP, Inc.     | 230,542                             | 228,353     |
| Participating securities share in continuing operations       | (1,064)                             | (478)       |
| Income from continuing operations applicable to common shares | 229,478                             | 227,875     |
| Discontinued operations                                       | 29,746                              | 2,232       |
| Noncontrolling interests share in discontinued operations     | (1,177)                             |             |
| Net income applicable to common shares                        | \$ 258,047                          | \$ 230,107  |
| <b>Denominator</b>  |                                     |             |
| Basic weighted average common shares                          | 457,294                             | 453,651     |
| Dilutive potential common shares                              | 380                                 | 962         |
| Diluted weighted average common shares                        | 457,674                             | 454,613     |
| <b>Basic earnings per common share</b>                        |                                     |             |
| Income from continuing operations                             | \$ 0.50                             | \$ 0.50     |
| Discontinued operations                                       | 0.06                                | 0.01        |
| Net income applicable to common shares                        | \$ 0.56                             | \$ 0.51     |
| <b>Diluted earnings per common share</b>                      |                                     |             |
| Income from continuing operations                             | \$ 0.50                             | \$ 0.50     |
| Discontinued operations                                       | 0.06                                | 0.01        |
| Net income applicable to common shares                        | \$ 0.56                             | \$ 0.51     |

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 1.6 million and 0.5 million shares of common stock that had an exercise price (including deferred compensation expense) in excess of the average closing market price of the Company's common stock during the three months ended March 31, 2014 and 2013, 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 0.9 million and 0.4 million shares of common stock during the three months ended March 31, 2014 and 2013, respectively, were not included because they are anti-dilutive. Additionally, 6 million shares issuable upon conversion of 4 million DownREIT units during the three months ended March 31, 2014 were not included because they are anti-dilutive. During the three months ended March 31, 2013, 6 million shares issuable upon conversion of 4 million DownREIT units were not included because they are anti-dilutive.

**(15) Supplemental Cash Flow Information**

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

|  | <b>Three Months Ended March 31,</b> |             |
|--|-------------------------------------|-------------|
|  | <b>2014</b>                         | <b>2013</b> |
| <i>Supplemental cash flow information:</i>                     |                                     |             |
| Interest paid, net of capitalized interest                     | \$ 152,423                          | \$ 154,127  |
| Income taxes paid  | 629                                 | 75          |
| Capitalized interest   | 3,125                               | 4,111       |
| <i>Supplemental schedule of non-cash investing activities:</i> |                                     |             |
| Accrued construction costs                                     | 21,715                              | 15,029      |

Table of Contents*Supplemental schedule of non-cash financing activities:*

|  |       |        |
|--|-------|--------|
| Vesting of restricted stock units  | 411   | 17     |
| Cancellation of restricted stock   | (1)   | (6)    |
| Conversion of non-managing member units into common stock  | 73    | 2,179  |
| Noncontrolling interest issued in connection with real estate acquisition                                      | 1,152 |        |
| Noncontrolling interest issued in connection with real estate disposition                                      | 1,671 |        |
| Mortgages and other liabilities assumed with real estate acquisitions  | 1     | 12,728 |
| Unrealized gains (losses) on available-for-sale securities and derivatives designated as cash flow hedges, net | (692) | 6,675  |

**(16) Variable Interest Entities***Unconsolidated Variable Interest Entities*

At March 31, 2014, the Company leased 48 properties to a total of seven VIE tenants and has additional investments in a loan and marketable debt securities to VIE borrowers. The Company has determined that it is not the primary beneficiary of these VIEs.

The Company holds an interest-only, senior secured term loan made to a borrower (Delphis Operations, L.P.) that has been identified as a VIE (see Note 6 for additional information on the Delphis loan). 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, of which one partnership is a tenant of the Company).

The Company holds commercial mortgage-backed securities ( CMBS ) issued by Federal Home Loan Mortgage Corporation ( Freddie MAC ) through a special purpose entity 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 CMBS issued by the VIE are backed by mortgages on senior housing facilities.

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 March 31, 2014 (in thousands):

| VIE Type                     | Maximum Loss Exposure(1) | Asset/Liability Type                                      | Carrying Amount |
|------------------------------|--------------------------|---|-----------------|
| VIE tenants operating leases | \$ 239,495               | Lease intangibles, net and straight-line rent receivables | \$ 13,953       |
| VIE tenants DFLs             | 1,071,372                | Net investment in DFLs                                    | 601,476         |
| Loan senior secured          | 18,071                   | Loans receivable, net                                     | 18,071          |
| CMBS                         | 17,163                   | Marketable debt securities                                | 17,163          |

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(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 loans and marketable debt securities to the VIE borrowers represents its current aggregate carrying amount.

As of March 31, 2014, 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). See Notes 5 and 6 for additional descriptions of the nature, purpose and activities of the Company's unconsolidated VIEs and interests therein.

### *Consolidated Variable Interest Entities*

In September 2013, the Company made loans to two entities that entered into a tax credit structure ( Tax Credit Subsidiaries ). The Company consolidates the Tax Credit Subsidiaries because they are VIEs and the Company is the primary beneficiary of these VIEs. The assets and liabilities of the Tax Credit Subsidiaries substantially consist of notes receivable, prepaid expenses, notes payable and accounts payable and accrued liabilities generated from their operating activities. Assets generated by the operating activities of the Tax Credit Subsidiaries may only be used to settle their contractual obligations.



Table of Contents**(17) Fair Value Measurements**

The following table illustrates the Company's financial assets and liabilities measured at fair value on a recurring basis in the condensed consolidated balance sheets. Recognized gains and losses are recorded in other income, net on the Company's condensed consolidated statements of income. During the three months ended March 31, 2014, 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 March 31, 2014 follow (in thousands):

| <b>Financial Instrument</b>       | <b>Fair Value</b> |         | <b>Level 1</b> |    | <b>Level 2</b> |         | <b>Level 3</b> |     |
|-----------------------------------|-------------------|---------|----------------|----|----------------|---------|----------------|-----|
| Marketable equity securities      | \$                | 35      | \$             | 35 | \$             |         | \$             |     |
| Interest-rate swap assets(1)      |                   | 2,035   |                |    |                | 2,035   |                |     |
| Interest-rate swap liabilities(1) |                   | (8,292) |                |    |                | (8,292) |                |     |
| Currency swap liabilities(1)      |                   | (3,254) |                |    |                | (3,254) |                |     |
| Warrants(1)                       |                   | 167     |                |    |                |         |                | 167 |
|                                   | \$                | (9,309) | \$             | 35 | \$             | (9,511) | \$             | 167 |

(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.

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

The carrying values of cash and cash equivalents, restricted cash, accounts receivable, and accounts payable and accrued liabilities are reasonable estimates of fair value because of the short-term maturities of these instruments. The fair values of loans receivable, CMBS, bank line of credit, term loan, mortgage debt and other debt are based on rates currently prevailing for similar instruments with similar maturities. The fair values of interest-rate and currency swap contracts as well as common stock warrants are determined based on observable and unobservable market assumptions using standardized pricing models. The fair values of senior unsecured notes and marketable equity and debt securities, excluding CMBS, are determined utilizing market quotes.

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

|                                 | <b>March 31, 2014</b> |                   | <b>December 31, 2013</b> |                   |
|---------------------------------|-----------------------|-------------------|--------------------------|-------------------|
|                                 | <b>Carrying Value</b> | <b>Fair Value</b> | <b>Carrying Value</b>    | <b>Fair Value</b> |
| Loans receivable, net(2)        | \$ 371,172            | \$ 378,380        | \$ 366,001               | \$ 373,441        |
| Marketable debt securities(1)   | 245,649               | 283,335           | 244,089                  | 280,850           |
| Marketable equity securities(1) | 35                    | 35                |                          |                   |
| Warrants(3)                     | 167                   | 167               | 114                      | 114               |

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|                                   |           |           |           |           |
|-----------------------------------|-----------|-----------|-----------|-----------|
| Term loan(2)                      | 228,269   | 228,269   | 226,858   | 226,858   |
| Senior unsecured notes(1)         | 6,912,812 | 7,475,065 | 6,963,375 | 7,405,817 |
| Mortgage debt(2)                  | 1,235,169 | 1,259,067 | 1,396,485 | 1,421,214 |
| Other debt(2)                     | 74,097    | 74,097    | 74,909    | 74,909    |
| Interest-rate swap assets(2)      | 2,035     | 2,035     | 2,325     | 2,325     |
| Interest-rate swap liabilities(2) | (8,292)   | (8,292)   | 8,384     | 8,384     |
| Currency swap liabilities(2)      | (3,254)   | (3,254)   | 2,756     | 2,756     |

- 
- (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 standardized pricing models 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**(19) Derivative Financial Instruments**

The following table summarizes the Company's outstanding interest-rate and foreign currency swap contracts as of March 31, 2014 (dollars and GBP in thousands):

| Date Entered     | Maturity Date | Hedge Designation | Fixed Rate/Buy Amount | Floating/Exchange Rate Index | Notional/Sell Amount | Fair Value(1) |
|------------------|---------------|-------------------|-----------------------|------------------------------|----------------------|---------------|
| July 2005(2)     | July 2020     | Cash Flow         | 3.82%                 | BMA Swap Index               | \$ 45,600            | \$ (5,837)    |
| November 2008(3) | October 2016  | Cash Flow         | 5.95%                 | 1 Month LIBOR+1.50%          | \$ 26,300            | \$ (2,455)    |
| July 2012(3)     | June 2016     | Cash Flow         | 1.81%                 | 1 Month GBP LIBOR+1.20%      | £ 137,000            | \$ 2,035      |
| July 2012(4)     | June 2016     | Cash Flow         | \$ 56,800             | Buy USD/Sell GBP             | £ 36,200             | \$ (3,254)    |

(1) Derivative assets are recorded in other assets, net and derivative liabilities are recorded in accounts payable and accrued liabilities on the condensed consolidated balance sheets.

(2) Represents three interest-rate swap contracts, which hedge fluctuations in interest payments on variable-rate secured debt due to overall changes in hedged cash flows.

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

(4) 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. Represents a currency swap to sell £7.2 million at a rate of 1.5695 on various dates through June 2016.

The Company uses derivative instruments to mitigate the effects of interest rate and foreign currency fluctuations on specific forecasted transactions as well as recognized financial obligations or assets. Utilizing derivative instruments allows the Company to manage the risk of fluctuations in interest and foreign currency rates related to the potential impact these changes could have on future earnings and forecasted cash flows. 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. 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 position. At March 31, 2014, the Company does not anticipate non-performance by the counterparties to its outstanding derivative contracts.

At March 31, 2014, 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. During the three months ended March 31, 2014, there was no ineffective portion related to outstanding hedges.



Table of Contents

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<br>Points                                      | -50 Basis<br>Points | +100 Basis<br>Points | -100 Basis<br>Points |
| July 2005                         | July 2020     | \$ 1,248   | \$ (1,434)          | \$ 2,589             | \$ (2,775)           |
| November 2008                     | October 2016  | 333  | (318)               | 658                  | (644)                |
| July 2012 (interest-rate swap)    | June 2016     | 2,495  | (2,501)             | 4,993                | (4,999)              |
| July 2012 (foreign currency swap) | June 2016     | (546)  | 58                  | (848)                | 359                  |

**(20) Subsequent Events**

Contingent upon the closing of the announced Brookdale and Emeritus merger, on April 23, 2014, HCP and Brookdale agreed to create a new \$1.2 billion (before in-place refundable entry fee obligations) strategic joint venture to own and operate entry fee continuing care retirement communities ( CCRC JV ), representing 14 CCRC campuses, at closing. HCP and Brookdale will own 49% and 51%, respectively, of the CCRC JV based on each company's respective contributions at closing. Brookdale will continue to manage all properties post-closing under a long-term management agreement.

Further, all existing Emeritus purchase options encompassing 49 HCP properties will be cancelled at closing; in exchange, all triple-net leases between HCP and Emeritus covering 202 senior housing properties will be amended contemporaneously, resulting in two portfolios: (i) RIDEA Portfolio: 49 non-stabilized properties will be contributed into a RIDEA joint venture, with Brookdale managing the communities and acquiring a 20% ownership in the venture; and (ii) NNN leased Portfolio: Brookdale and HCP will amend the triple-net master leases for the remaining 153 properties, all guaranteed by Brookdale.

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 expectation 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 for the fiscal year ended December 31, 2013, 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) Volatility or uncertainty in the capital markets, including changes in the availability and cost of capital (impacted by changes in interest rates and the value of our common stock); which may adversely impact our ability to consummate transactions or reduce the earnings from potential transactions;
- (c) Our ability to manage our indebtedness level and changes in the terms of such indebtedness;
- (d) The effect on healthcare providers of recently enacted and pending Congressional legislation addressing entitlement programs and related services, including Medicare and Medicaid, which may result in future reductions in reimbursements;
- (e) 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;
- (f) 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;

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- (g) 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;
- (h) The potential impact of future litigation matters, including the possibility of larger than expected litigation costs, adverse results and related developments;
- (i) Competition for tenants and borrowers, including with respect to new leases and mortgages and the renewal or rollover of existing leases;
- (j) 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;
- (k) Availability of suitable properties to acquire at favorable prices and the competition for the acquisition and financing of those properties;
- (l) The financial, legal, regulatory and reputational difficulties of significant operators of our properties;

Table of Contents

(m) The risk that we may not be able to achieve the benefits of investments within expected time frames or at all, or within expected cost projections;

(n) The ability to obtain financing necessary to consummate acquisitions on favorable terms;

(o) 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; and

(p) Changes in the credit ratings on United States ( U.S. ) government debt securities or default or delay in payment by the U.S. of its obligations.

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
  
- 2014 Transaction Overview
  
- Dividends
  
- Critical Accounting Policies
  
- Results of Operations
  
- Liquidity and Capital Resources



- Funds from Operations ( FFO )
- 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 U.S. We acquire, develop, lease, manage and dispose of healthcare real estate, and provide financing to healthcare providers. At March 31, 2014, our portfolio of investments, including properties in our Investment Management Platform, consisted of interests in 1,154 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 or shorter investment horizons into assets representing longer term investments with attractive risk-adjusted 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 potential disposition of properties that no longer fit our strategy.

We primarily generate revenue by leasing healthcare properties under long term leases with fixed and/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. Operating expenses are generally related to medical office buildings ( MOBs ) and life science leased properties and senior housing properties managed by eligible independent contractors ( RIDEA properties ). Accordingly, for such MOBs, life science facilities and RIDEA properties, we incur certain property operating expenses, such as real estate taxes, repairs and maintenance, property management fees, utilities, employee costs for resident care 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.



Table of Contents

**2014 Transaction Overview**

*Expanding Relationship with Brookdale by Creating a \$1.2 Billion CCRC Joint Venture and Amending Existing Emeritus Leases*

On April 23, 2014, HCP and Brookdale Senior Living ( Brookdale ) agreed to create a new \$1.2 billion (before in-place refundable entry fee obligations) strategic joint venture to own and operate entry fee continuing care retirement communities ( CCRC JV ), representing 14 CCRC campuses, at closing. HCP and Brookdale will own 49% and 51%, respectively, of the CCRC JV based on each company's respective contributions at closing. Brookdale will continue to manage all properties post-closing under a long-term management agreement.

Further, all existing Emeritus purchase options encompassing 49 HCP properties will be cancelled at closing; in exchange, all triple-net leases between HCP and Emeritus covering 202 senior housing properties will be amended contemporaneously, resulting in two portfolios: (i) RIDEA Portfolio: 49 non-stabilized properties will be contributed into a RIDEA joint venture, with Brookdale managing the communities and acquiring a 20% ownership in the venture; and (ii) NNN leased Portfolio: Brookdale and HCP will amend the triple-net master leases for the remaining 153 properties. all guaranteed by Brookdale.

All transactions described above are contingent upon the closing of Brookdale's pending merger with Emeritus.

*Other Investment Transactions*

During the quarter ended March 31, 2014, the Company: (i) made a \$32 million investment in a medical office building ( MOB ); (ii) acquired an 85 percent interest in a \$51 million senior housing community development project; and (iii) funded \$53 million for construction and other capital projects, primarily in our life science, medical office and senior housing segments.

During the quarter ended March 31, 2014, we sold two post-acute/skilled nursing facilities for \$22 million and a hospital for \$17 million.

On May 1, 2014, we acquired two MOB's for \$26 million. The properties, located in the historic Coconut Grove neighborhood of Miami, are on the campus of HCA's Mercy Hospital.

*Financing Activities*

On February 12, 2014, we issued \$350 million of 4.20% senior unsecured notes due 2024. The notes priced at 99.537% of the principal amount with an effective yield-to-maturity of 4.257%; net proceeds from this offering were \$346 million.

On March 31, 2014, we amended our unsecured revolving credit facility and increased it by \$500 million to \$2.0 billion. The amended facility reduces our funded interest cost by 17.5 basis points and extends the maturity date to March 31, 2018. Based on our current credit ratings, the amended facility bears interest annually at LIBOR plus 92.5 basis points and has a facility fee of 15.0 basis points. Other terms of the amended facility were substantially unchanged, including a one-year extension option at our discretion, and the ability to increase the commitments by an aggregate amount of up to \$500 million, subject to customary conditions.

#### **Dividends**

On May 1, 2014, we announced that our Board declared a quarterly common stock cash dividend of \$0.545 per share. The common stock dividend will be paid on May 27, 2014 to stockholders of record as of the close of business on May 12, 2014 and represents an annualized dividend pay rate of \$2.18 per share.

Table of Contents

**Critical Accounting Policies**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles ( GAAP ) requires 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 revenue 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 for the year ended December 31, 2013 in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations ; our critical accounting policies have not changed during 2014.

**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, post-acute/skilled nursing, life science and hospital segments, we invest or co-invest primarily in single operator or tenant properties, through the acquisition and development of triple-net leased real estate, management of operations ( RIDEA ) 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 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 from continuing operations ( NOI ) and adjusted NOI to assess and compare property level performance, including our same property portfolio ( SPP ), to make decisions about resource allocations, and to assess and compare property level performance. 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 or real estate companies, as they may use different methodologies for calculating NOI. See Note 13 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 by eligible independent contractors (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

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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 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.

Table of Contents**Comparison of the Three Months Ended March 31, 2014 to the Three Months Ended March 31, 2013**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 1,066 properties representing properties acquired or placed in service and stabilized on or prior to January 1, 2013 and that remained in operations under a consistent reporting structure through March 31, 2014. Our consolidated total property portfolio represents 1,080 and 1,074 properties at March 31, 2014 and 2013, respectively, and excludes properties classified as discontinued operations.

Results are as of and for the three months ended March 31, 2014 and 2013 (dollars and square feet in thousands except per capacity data):

**Senior Housing**

|   | SPP        |            |          | Total Portfolio |            |          |
|---|------------|------------|----------|-----------------|------------|----------|
|   | 2014       | 2013       | Change   | 2014            | 2013       | Change   |
| Rental revenues(1)  | \$ 148,519 | \$ 148,502 | \$ 17    | \$ 150,085      | \$ 148,896 | \$ 1,189 |
| Resident fees and services                                    | 38,053     | 35,745     | 2,308    | 38,053          | 35,746     | 2,307    |
| Total revenues  | 186,572    | 184,247    | 2,325    | 188,138         | 184,642    | 3,496    |
| Operating expenses  | (24,075)   | (22,946)   | (1,129)  | (24,548)        | (23,522)   | (1,026)  |
| NOI   | 162,497    | 161,301    | 1,196    | 163,590         | 161,120    | 2,470    |
| Straight-line rents   | (10,230)   | (13,136)   | 2,906    | (10,524)        | (13,177)   | 2,653    |
| DFL accretion   | (2,544)    | (5,031)    | 2,487    | (2,544)         | (5,031)    | 2,487    |
| Amortization of above and below market lease intangibles, net | (147)      | (248)      | 101      | (147)           | (190)      | 43       |
| Adjusted NOI  | \$ 149,576 | \$ 142,886 | \$ 6,690 | \$ 150,375      | \$ 142,722 | \$ 7,653 |
| Adjusted NOI % change   |            |            | 4.7%     |                 |            |          |
| Property count(2)   | 438        | 438        |          | 444             | 443        |          |
| Average capacity (units)(3)                                   | 44,982     | 44,969     |          | 45,560          | 45,134     |          |
| Average annual rent per unit(4)                               | \$ 13,340  | \$ 12,754  |          | \$ 13,283       | \$ 12,743  |          |

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

(2) From our past presentation of SPP for the three months ended March 31, 2013, we removed two senior housing properties from SPP that were sold.

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

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(4) Average annual rent per unit for RIDEA properties is based on NOI.

*SPP NOI and Adjusted NOI.* SPP NOI increased primarily as a result of increased NOI from RIDEA properties as a result of increased occupancy and rent increases related to new leases and leases not recognized on a straight-line basis (cash basis), partially offset by a decline in DFL income as a result of a 14-property DFL portfolio (the DFL Portfolio ) that was placed on a cash basis during 2013. SPP adjusted NOI improved primarily as a result of annual rent increases, including increases from properties that were previously transitioned from Sunrise to other operators, and increased NOI from RIDEA properties as a result of increased occupancy.

*Total Portfolio NOI and Adjusted NOI.* In addition to the impact of our SPP, our total portfolio NOI and adjusted NOI primarily increased as a result of our senior housing acquisitions in 2013.



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

|   | SPP        |            |          | Total Portfolio |            |          |
|---|------------|------------|----------|-----------------|------------|----------|
|   | 2014       | 2013       | Change   | 2014            | 2013       | Change   |
| Rental revenues(1)  | \$ 137,659 | \$ 133,836 | \$ 3,823 | \$ 137,780      | \$ 133,836 | \$ 3,944 |
| Operating expenses  | (77)       | (128)      | 51       | (532)           | (629)      | 97       |
| NOI   | 137,582    | 133,708    | 3,874    | 137,248         | 133,207    | 4,041    |
| Straight-line rents   | (282)      | (232)      | (50)     | (282)           | (232)      | (50)     |
| DFL accretion   | (18,878)   | (19,139)   | 261      | (18,878)        | (19,139)   | 261      |
| Amortization of above and below market lease intangibles, net | 11         | 11         |          | 11              | 11         |          |
| Adjusted NOI  | \$ 118,433 | \$ 114,348 | \$ 4,085 | \$ 118,099      | \$ 113,847 | \$ 4,252 |
| Adjusted NOI % change   |            |            | 3.6%     |                 |            |          |
| Property count(2)   | 302        | 302        |          | 302             | 302        |          |
| Average capacity (beds)(3)                                    | 38,464     | 38,436     |          | 38,464          | 38,436     |          |
| Average annual rent per bed                                   | \$ 12,323  | \$ 11,912  |          | \$ 12,336       | \$ 11,912  |          |

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

(2) From our past presentation of SPP for the three months ended March 31, 2013, we removed ten post-acute/skilled nursing properties from SPP that were sold.

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

*NOI and Adjusted NOI.* SPP and total portfolio NOI and adjusted NOI increased primarily as a result of annual rent escalations.

**Life Science**

|   | SPP       |           |          | Total Portfolio |           |          |
|---|-----------|-----------|----------|-----------------|-----------|----------|
|   | 2014      | 2013      | Change   | 2014            | 2013      | Change   |
| Rental and related revenues                                   | \$ 61,857 | \$ 61,012 | \$ 845   | \$ 64,781       | \$ 62,438 | \$ 2,343 |
| Tenant recoveries   | 10,776    | 10,800    | (24)     | 11,341          | 10,892    | 449      |
| Total revenues  | 72,633    | 71,812    | 821      | 76,122          | 73,330    | 2,792    |
| Operating expenses  | (12,440)  | (12,224)  | (216)    | (14,161)        | (13,383)  | (778)    |
| NOI   | 60,193    | 59,588    | 605      | 61,961          | 59,947    | 2,014    |
| Straight-line rents   | (2,208)   | (3,648)   | 1,440    | (2,580)         | (3,692)   | 1,112    |
| Amortization of above and below market lease intangibles, net | (1)       | 97        | (98)     | 18              | 85        | (67)     |
| Lease termination fees  | (570)     |           | (570)    | (570)           |           | (570)    |
| Adjusted NOI  | \$ 57,414 | \$ 56,037 | \$ 1,377 | \$ 58,829       | \$ 56,340 | \$ 2,489 |

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|   |       |    |       |    |       |    |       |    |
|---|-------|----|-------|----|-------|----|-------|----|
| Adjusted NOI % change                                     | 2.5%  |    |       |    |       |    |       |    |
| Property count(2)   | 107   |    | 107   |    | 111   |    | 110   |    |
| Average occupancy   | 91.0% |    | 91.2% |    | 91.1% |    | 91.4% |    |
| Average occupied square feet                              | 6,228 |    | 6,264 |    | 6,411 |    | 6,423 |    |
| Average annual total revenues per occupied square foot(1) | \$    | 45 | \$    | 44 | \$    | 46 | \$    | 43 |
| Average annual base rent per occupied square foot         | \$    | 38 | \$    | 37 | \$    | 38 | \$    | 37 |

(1) Represents rental and related revenues and tenant recoveries.

(2) From our past presentation of SPP for the three months ended March 31, 2013, we removed two properties that were placed into redevelopment in 2014, which no longer meets our criteria for SPP as of the date it was placed into redevelopment.

Table of Contents

*SPP NOI and Adjusted NOI.* SPP NOI increased primarily as a result of an increase in termination fees. SPP adjusted NOI increased primarily as a result of annual rent escalations.

*Total portfolio NOI and Adjusted NOI.* In addition to the impact of our SPP, our total portfolio NOI and adjusted NOI increased primarily as a result of the impact of our life science development projects placed in service during 2014 and 2013.

During the three months ended March 31, 2014, 411,000 square feet of new and renewal leases commenced at an average annual base rent of \$28.91 per square foot compared to 471,000 square feet of expiring and terminated leases with an average annual base rent of \$21.60 per square foot.

**Medical Office**

|   | 2014      | SPP<br>2013 | Change   | 2014      | Total Portfolio<br>2013 | Change   |
|---|-----------|-------------|----------|-----------|-------------------------|----------|
| Rental and related revenues                                   | \$ 74,480 | \$ 72,603   | \$ 1,877 | \$ 75,765 | \$ 74,084               | \$ 1,681 |
| Tenant recoveries   | 13,333    | 12,621      | 712      | 13,497    | 12,747                  | 750      |
| Total revenues  | 87,813    | 85,224      | 2,589    | 89,262    | 86,831                  | 2,431    |
| Operating expenses  | (33,186)  | (32,213)    | (973)    | (35,516)  | (34,264)                | (1,252)  |
| NOI   | 54,627    | 53,011      | 1,616    | 53,746    | 52,567                  | 1,179    |
| Straight-line rents   | (938)     | (1,520)     | 582      | (1,002)   | (1,561)                 | 559      |
| Amortization of above and below market lease intangibles, net | 271       | 216         | 55       | 293       | 234                     | 59       |
| Lease termination fees  | (8)       |             | (8)      | (8)       |                         | (8)      |
| Adjusted NOI  | \$ 53,952 | \$ 51,707   | \$ 2,245 | \$ 53,029 | \$ 51,240               | \$ 1,789 |
| Adjusted NOI % change   |           |             | 4.3%     |           |                         |          |
| Property count(1)   | 204       | 204         |          | 207       | 204                     |          |
| Average occupancy   | 91.7%     | 91.4%       |          | 90.9%     | 91.2%                   |          |
| Average occupied square feet                                  | 12,659    | 12,593      |          | 12,861    | 12,768                  |          |
| Average annual total revenues per occupied square foot(2)     | \$ 27     | \$ 27       |          | \$ 27     | \$ 27                   |          |
| Average annual base rent per occupied square foot             | \$ 23     | \$ 23       |          | \$ 23     | \$ 23                   |          |

(1) From our past presentation of SPP for the three months ended March 31, 2013, we removed two MOB's from SPP that were sold and a MOB that was placed into redevelopment in 2013, which no longer meets our criteria for SPP as of the date it was placed into redevelopment.

(2) Represents rental and related revenues and tenant recoveries.

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*NOI and Adjusted NOI.* SPP and total portfolio NOI and adjusted NOI increased primarily as a result of increased occupancy and annual rent escalations.

During the three months ended March 31, 2014, 429,000 square feet of new and renewal leases commenced at an average annual base rent of \$22.37 per square foot compared to 483,000 square feet of expiring and terminated leases with an average annual base rent of \$23.72 per square foot.

Table of Contents**Hospital**

|   | SPP       |           |          | Total Portfolio |           |          |
|---|-----------|-----------|----------|-----------------|-----------|----------|
|   | 2014      | 2013      | Change   | 2014            | 2013      | Change   |
| Rental revenues(1)  | \$ 20,617 | \$ 19,142 | \$ 1,475 | \$ 20,948       | \$ 19,155 | \$ 1,793 |
| Tenant recoveries   | 597       | 563       | 34       | 597             | 563       | 34       |
| Total revenues  | 21,214    | 19,705    | 1,509    | 21,545          | 19,718    | 1,827    |
| Operating expenses  | (947)     | (887)     | (60)     | (950)           | (888)     | (62)     |
| NOI   | 20,267    | 18,818    | 1,449    | 20,595          | 18,830    | 1,765    |
| Straight-line rents   | 416       | (242)     | 658      | 408             | (242)     | 650      |
| Amortization of above and below market lease intangibles, net | (342)     | (112)     | (230)    | (342)           | (112)     | (230)    |
| Adjusted NOI  | \$ 20,341 | \$ 18,464 | \$ 1,877 | \$ 20,661       | \$ 18,476 | \$ 2,185 |
| Adjusted NOI % change   |           |           | 10.2%    |                 |           |          |
| Property count(2)   | 15        | 15        |          | 16              | 15        |          |
| Average capacity (beds)(3)                                    | 2,161     | 2,160     |          | 2,221           | 2,175     |          |
| Average annual rent per bed                                   | \$ 39,404 | \$ 35,830 |          | \$ 38,921       | \$ 35,607 |          |

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

(2) From our past presentation of SPP for the three months ended March 31, 2013, we removed two hospitals from SPP that were sold.

(3) Represents capacity as reported by the respective tenants or operators for the twelve-month 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.* SPP and total portfolio NOI and adjusted NOI primarily increased as a result of annual rent escalations.

Other Income and Expense Items*Interest income*

Interest income increased \$4 million to \$17 million for the three months ended March 31, 2014. The increase was primarily the result of interest earned from the second tranche funding of our mezzanine loan facility to Tandem Health Care (see Note 6 to the Condensed Consolidated Financial Statements for additional information) made in 2013.

*Interest expense*

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Interest expense decreased \$2 million to \$107 million for the three months ended March 31, 2014. The decrease was primarily the result of decreases in indebtedness.

Our exposure to expense fluctuations related to our variable rate indebtedness is substantially mitigated by our interest rate swap contracts. For a more detailed discussion of our interest rate risk, see [Quantitative and Qualitative Disclosures About Market Risk](#) in Item 3.

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

|                 | As of March 31,(1) |              |
|-----------------|--------------------|--------------|
|                 | 2014               | 2013         |
| <b>Balance:</b> |                    |              |
| Fixed rate      | \$ 8,371,372       | \$ 8,442,891 |
| Variable rate   | 33,955             | 54,365       |
| Total           | \$ 8,405,327       | \$ 8,497,256 |

Table of Contents

|   | As of March 31,(1) |       |
|---|--------------------|-------|
|   | 2014               | 2013  |
| <b>Percent of total debt:</b>                           |                    |       |
| Fixed rate  | 99.6%              | 99.0% |
| Variable rate   | 0.4                | 1.0   |
| Total   | 100%               | 100%  |
| <b>Weighted average interest rate at end of period:</b> |                    |       |
| Fixed rate  | 5.16%              | 5.24% |
| Variable rate   | 1.15%              | 1.46% |
| Total   | 5.14%              | 5.22% |

(1) Excludes \$74 million and \$79 million at March 31, 2014 and 2013, respectively, of other debt that represents non-interest bearing life care bonds and occupancy fee deposits at certain of our senior housing facilities, which have no scheduled maturities. At March 31, 2014 and 2013, \$72 million and \$86 million of variable-rate mortgages, respectively, and a £137 million (\$228 million and \$208 million, respectively) term loan are presented as fixed-rate debt as the interest payments under such debt have been swapped (pay fixed and receive float).

*Depreciation and amortization expense*

Depreciation and amortization expense increased \$4 million to \$107 million for the three months ended March 31, 2014. The increase was primarily the result of the impact of our medical office and life science development projects placed in service and our senior housing acquisitions in 2013.

*Other income, net*

Other income, net decreased \$10 million to \$2 million for the three months ended March 31, 2014. The decrease was primarily the result of gains from the sale of marketable equity securities during 2013 of \$11 million.

*Discontinued operations*

During the three months ended March 31, 2014, we sold two post-acute/skilled nursing facilities and a hospital, recognizing gains of \$28 million. There were no sales of properties during the three months ended March 31, 2013.

**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 2014, (iii) fund capital expenditures, including tenant improvements and leasing costs, (iv) fund acquisition

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and development activities, and (v) make dividend distributions. During the three months ended March 31, 2014, distributions to shareholders and noncontrolling interest holders exceeded cash flows from operations by approximately \$7 million, which was funded by cash on hand. We anticipate that cash flow from continuing operations over the next 12 months will be adequate to fund our business operations, debt service payments, recurring capital expenditures and cash dividends to shareholders. Capital requirements relating to maturing indebtedness, acquisitions and development activities may require funding from borrowings and/or equity and debt offerings.

Access to capital markets impacts our cost of capital and ability to refinance maturing indebtedness, as well as our ability to fund future acquisitions and development through the issuance of additional securities or secured debt. Credit ratings impact our ability to access capital and directly impact our cost of capital as well. For example, as noted below, our revolving line of credit facility accrues interest at a rate per annum equal to LIBOR plus a margin that depends upon our debt ratings. We also pay a facility fee on the entire revolving commitment that depends upon our debt ratings. As of May 1, 2014, we had a credit rating of Baa1 from Moody's, BBB+ from Standard & Poor's (S&P) and BBB+ from Fitch on our senior unsecured debt securities.

Net cash provided by operating activities was \$247 million and \$214 million for the three months ended March 31, 2014 and 2013, respectively. The increase in operating cash flows is primarily the result of the following: (i) the impact from our investments in 2013, (ii) assets placed in service during 2013 and (iii) rent escalations and resets in 2013 and 2014. Our cash flows from operations are dependent upon the occupancy levels of our buildings, rental rates on leases, our tenants' performance on their lease obligations, the level of operating expenses and other factors.



Table of Contents

The following are significant investing and financing activities for the three months ended March 31, 2014:

- made investments of \$54 million (development and acquisition of real estate and loans), net of proceeds from sales of real estate of \$37 million;
- paid dividends on common stock of \$250 million, which were generally funded by cash provided by our operating activities; and
- repaid \$563 million of mortgages and senior unsecured notes and raised \$350 million of unsecured notes to refinance the senior unsecured notes repayment.

*Debt*

*Bank Line of Credit and Term Loan*

On March 31, 2014, we amended our unsecured revolving line of credit facility (the Facility) with a syndicate of banks, which was scheduled to mature in March 2016, increasing the borrowing capacity by \$500 million to \$2.0 billion. The amended Facility matures on March 31, 2018, with a one-year committed extension option. Borrowings under the 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 April 30, 2014, the margin on the Facility was 0.925%, and the facility fee was 0.15%. The Facility also includes a feature that will allow us to increase the borrowing capacity by an aggregate amount of up to \$500 million, subject to securing additional commitments from existing lenders or new lending institutions. At March 31, 2014, we had no amounts drawn under the Facility.

On July 30, 2012, we entered into a credit agreement with a syndicate of banks for a £137 million (\$228 million at March 31, 2014) four-year unsecured term loan (the 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 contract that fixes the rate of the Term Loan at 1.81%, subject to adjustments based on our debt ratings. The Term Loan contains a one-year committed extension option.

The 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% and (iv) require a minimum Fixed Charge Coverage ratio of 1.5 times. The Facility also requires a Minimum Consolidated Tangible Net Worth of \$9.5 billion at March 31, 2014. The Term Loan also requires a formula-determined Minimum Consolidated Tangible Net Worth of \$9.2 billion at March 31, 2014. At March 31, 2014, we were in compliance with each of these restrictions and requirements of the Facility and Term Loan.

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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 March 31, 2014, we had senior unsecured notes outstanding with an aggregate principal balance of \$6.9 billion. Interest rates on the notes ranged from 1.20% to 6.99% with a weighted average effective interest rate of 5.06% and a weighted average maturity of six years at March 31, 2014. 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 March 31, 2014.

### *Mortgage Debt*

At March 31, 2014, we had \$1.2 billion in aggregate principal amount of mortgage debt outstanding is secured by 95 healthcare facilities (including redevelopment properties) with a carrying value of \$1.5 billion. Interest rates on the mortgage debt ranged from 0.69% to 8.69% with a weighted average effective interest rate of 6.19% and a weighted average maturity of three years at March 31, 2014.

Table of Contents

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.

*Debt Maturities*

The following table summarizes our stated debt maturities and scheduled principal repayments at March 31, 2014 (in thousands):

| <b>Year</b>                   | <b>Amount(1)</b> |
|-------------------------------|------------------|
| 2014 (Nine months)            | \$ 104,597       |
| 2015                          | 708,421          |
| 2016                          | 1,420,007        |
| 2017                          | 1,300,477        |
| 2018                          | 606,583          |
| Thereafter                    | 4,265,242        |
|                               | 8,405,327        |
| (Discounts) and premiums, net | (29,077)         |
|                               | \$ 8,376,250     |

(1) Excludes \$74 million of other debt that represents Life Care Bonds that have no scheduled maturities.

*Other Debt*

At March 31, 2014, we had \$74 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). The Life Care Bonds are generally refundable to the residents upon the termination of the contract or upon the successful resale of the unit.

*Derivative Instruments*

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

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The following table summarizes our outstanding interest-rate and foreign currency swap contracts as of March 31, 2014 (dollars and GBP in thousands):

| <b>Date Entered</b> | <b>Maturity Date</b> | <b>Hedge Designation</b> | <b>Fixed Rate/Buy Amount</b> | <b>Floating/Exchange Rate Index</b> | <b>Notional/Sell Amount</b> | <b>Fair Value</b> |
|---------------------|----------------------|--------------------------|------------------------------|-------------------------------------|-----------------------------|-------------------|
| July 2005(1)        | July 2020            | Cash Flow                | 3.82%                        | BMA Swap Index                      | \$ 45,600                   | \$ (5,837)        |
| November 2008       | October 2016         | Cash Flow                | 5.95%                        | 1 Month LIBOR+1.50%                 | \$ 26,300                   | \$ (2,455)        |
|                     |                      |                          |                              | 1 Month GBP                         |                             |                   |
| July 2012           | June 2016            | Cash Flow                | 1.81%                        | LIBOR+1.20%                         | £ 137,000                   | \$ 2,035          |
| July 2012           | June 2016            | Cash Flow                | \$ 56,800                    | Buy USD/Sell GBP                    | £ 36,200                    | \$ (3,254)        |

(1) Represents three interest-rate swap contracts, which hedge fluctuations in interest payments on variable-rate secured debt due to overall changes in hedged cash flows.

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

Table of Contents

*Equity*

At March 31, 2014, we had 458 million shares of common stock outstanding. At March 31, 2014, equity totaled \$11 billion, and our equity securities had a market value of \$18 billion.

At March 31, 2014, non-managing members held an aggregate of 4 million units in four limited liability companies ( DownREITs ) for 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*

We have a prospectus that we filed with the U.S. Securities and Exchange Commission (the 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 therein, we will not receive any proceeds if the securities are sold by a selling security holder.

**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 use 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.

Table of Contents

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

|   | <b>Three Months Ended March 31,</b> |             |
|---|-------------------------------------|-------------|
|   | <b>2014</b>                         | <b>2013</b> |
| Net income applicable to common shares  | \$ 258,047                          | \$ 230,107  |
| Depreciation and amortization of real estate, in-place lease and other intangibles: |                                     |             |
| Continuing operations   | 107,388                             | 103,179     |
| Discontinued operations   |                                     | 1,538       |
| DFL depreciation  | 3,846                               | 3,429       |
| Gain on sales of real estate  | (28,010)                            |             |
| Equity income from unconsolidated joint ventures                                    | (14,528)                            | (14,801)    |
| FFO from unconsolidated joint ventures  | 16,961                              | 17,541      |
| Noncontrolling interests and participating securities share in earnings             | 5,576                               | 3,677       |
| Noncontrolling interests and participating securities share in FFO                  | (6,141)                             | (5,141)     |
| FFO applicable to common shares   | 343,139                             | 339,529     |
| Distributions on dilutive convertible units   | 3,420                               | 3,328       |
| Diluted FFO applicable to common shares   | \$ 346,559                          | \$ 342,857  |
| <br>  |                                     |             |
| Diluted FFO per common share  | \$ 0.75                             | \$ 0.74     |
| <br>  |                                     |             |
| Weighted average shares used to calculate diluted FFO per common share              | 463,661                             | 460,650     |
| <br>  |                                     |             |
| Net income applicable to common shares  | \$ 0.56                             | \$ 0.51     |
| Depreciation and amortization of real estate, in-place lease and other intangibles  | 0.23                                | 0.23        |
| DFL depreciation  | 0.01                                | 0.01        |
| Gain on sales of real estate  | (0.06)                              |             |
| Joint venture and participating securities FFO adjustments                          | 0.01                                | (0.01)      |
| Diluted FFO applicable to common shares   | \$ 0.75                             | \$ 0.74     |

**Off-Balance Sheet Arrangements**

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

Table of Contents**Contractual Obligations**

The following table summarizes our material contractual payment obligations and commitments at March 31, 2014 (in thousands):

|                                   | <b>Total(1)</b>      | <b>Less than<br/>One Year</b> | <b>2015-2016</b>    | <b>2017-2018</b>    | <b>More than<br/>Five Years</b> |
|-----------------------------------|----------------------|-------------------------------|---------------------|---------------------|---------------------------------|
| Term loan(2)                      | \$ 228,269           | \$                            | \$ 228,269          | \$                  | \$                              |
| Senior unsecured notes            | 6,937,000            | 87,000                        | 1,300,000           | 1,350,000           | 4,200,000                       |
| Mortgage debt                     | 1,240,058            | 17,597                        | 600,159             | 557,060             | 65,242                          |
| Construction loan commitments(3)  | 55,481               | 11,581                        | 43,900              |                     |                                 |
| Development commitments(4)        | 57,307               | 27,068                        | 30,239              |                     |                                 |
| Ground and other operating leases | 227,680              | 4,714                         | 11,663              | 9,394               | 201,909                         |
| Interest(5)                       | 2,473,420            | 262,679                       | 745,613             | 482,374             | 982,754                         |
| <b>Total</b>                      | <b>\$ 11,219,215</b> | <b>\$ 410,639</b>             | <b>\$ 2,959,843</b> | <b>\$ 2,398,828</b> | <b>\$ 5,449,905</b>             |

(1) Excludes \$74 million of other debt that represents Life Care Bonds that have no scheduled maturities.

(2) Represents £137 million translated into U.S. dollars.

(3) Represents commitments to finance development projects and related working capital.

(4) Represents construction and other commitments for developments in progress.

(5) Interest on variable-rate debt is calculated using rates in effect at March 31, 2014.

**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. Most 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**

See Note 2 to the Condensed Consolidated Financial Statements for the impact of new accounting standards. 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 fair value. See Note 19 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 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 \$5 million. See Note 19 to the Condensed Consolidated Financial Statements for additional analysis details.

*Interest Rate Risk.* At March 31, 2014, we are exposed to market risks related to fluctuations in interest rates on the following: (i) properties with a gross value of \$83 million that are subject to leases where the payments fluctuate with changes in LIBOR that are partially offset by (ii) \$25 million of variable-rate senior unsecured notes and (iii) \$9 million of variable-rate mortgage debt payable (excludes \$72 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 \$228 million (£137 million) variable-rate Term Loan that has been hedged through interest-rate swap contracts.

Table of Contents

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 March 31, 2014, net interest income would improve by approximately \$500,000, or less than \$0.01 per common share on a diluted basis.

*Foreign Currency Risk.* At March 31, 2014, 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 senior unsecured notes in Note 9 to the Condensed Consolidated Financial Statements). Our foreign currency exchange exposure is mitigated by the forecasted interest and principal payments from our GBP denominated unsecured Term Loan (see Note 10 to the Condensed Consolidated Financial Statements for additional information), and a foreign currency swap contract for approximately 85% of the forecasted interest receipts from our Four Seasons senior unsecured notes through the non-call period ending June 15, 2016.

*Market Risk.* We have investments in marketable debt securities classified as held-to-maturity because we have the positive intent and ability to hold the securities to maturity. Held-to-maturity securities are recorded at amortized cost and adjusted for the amortization of premiums and discounts through maturity. 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 adjusted carrying value; 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 March 31, 2014, the fair value and carrying value of marketable debt securities were \$283 million and \$246 million, respectively.

**Item 4. Controls and Procedures**

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

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

As required by Rules 13a-15(b) and 15d-15(b) of the Securities Exchange Act of 1934, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer (Principal Executive Officer) and Chief Financial Officer (Principal Financial Officer), of the effectiveness of the design and operation of our disclosure controls and procedures as of March 31, 2014. 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.

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*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.

Table of Contents**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 for the year ended December 31, 2013.

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

(a)

None.

(b)

None.

(c)

The table below sets forth information with respect to purchases of our common stock made by us or on our behalf or by any affiliated purchaser, as such term is defined in Rule 10b-18(a)(3) of the Securities Exchange Act of 1934, as amended, during the three months ended March 31, 2014.

| Period Covered      | Total Number<br>Of Shares<br>Purchased(1) | Average Price<br>Paid Per Share | Total Number Of Shares<br>(Or Units) Purchased As<br>Part Of Publicly<br>Announced Plans Or<br>Programs | Maximum Number (Or<br>Approximate Dollar Value)<br>Of Shares (Or Units) That<br>May Yet Be Purchased<br>Under The Plans Or<br>Programs |
|---------------------|---|---------------------------------|---|--|
| January 1-31, 2014  | 180,918                                   | \$ 38.80                        |   |  |
| February 1-28, 2014 | 20,872                                    | 38.83                           |   |  |
| March 1-31, 2014    | 6,247                                     | 38.17                           |   |  |

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|       |         |       |
|-------|---------|-------|
| Total | 208,037 | 38.78 |
|-------|---------|-------|

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

### Item 6. Exhibits

- 3.1 Articles of Restatement of HCP (incorporated by reference to Exhibit 3.1 to HCP's Registration Statement on Form S-3 (Registration No. 333-182828)).
- 3.2 Fourth Amended and Restated Bylaws of HCP (incorporated herein by reference to Exhibit 3.1 to HCP's Current Report on Form 8-K (File No. 1-08895) (2006)).
- 3.2.1 Amendment No. 1 to Fourth Amended and Restated Bylaws of HCP (incorporated by reference herein to Exhibit 3.2.1 to HCP's Quarterly Report on Form 10-Q (File No. 1-08895) for the quarter ended March 31, 2007).
- 3.2.2 Amendment No. 2 to Fourth Amended and Restated Bylaws of HCP (incorporated herein by reference to Exhibit 3.2.2 to HCP's Quarterly Report on Form 10-Q (File No. 1-08895) for the quarter ended March 31, 2009).
- 3.2.3 Amendment No. 3 to Fourth Amended and Restated Bylaws of HCP (incorporated herein by reference to Exhibit 3.1 to HCP's Current Report on Form 8-K (File No. 1-08895) filed March 10, 2011).
- 3.2.4 Amendment No. 4 to Fourth Amended and Restated Bylaws of HCP (incorporated herein by reference to Exhibit 3.1 to HCP's Current Report on Form 8-K (File No. 1-08895) filed October 3, 2013).

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### Table of Contents

|         |   |
|---------|---|
| 4.1     | Third Supplemental Indenture dated February 21, 2014, between the Company and The Bank of New York Mellon Trust Company, N.A., as trustee (incorporated herein by reference to Exhibit 4.1 to HCP's Current Report on Form 8-K (File No. 1-08895) filed February 24, 2014).   |
| 4.2     | Form of 4.20% Senior Notes due 2024 (incorporated herein by reference to Exhibit 4.1 to HCP's Current Report on Form 8-K (File No. 1-08895) filed February 24, 2014).   |
| 10.1    | HCP, Inc. Change in Control Severance Plan (as Amended and Restated as of March 13, 2014) (incorporated by reference to Exhibit 10.1 to HCP's Current Report on Form 8-K (File No. 1-08895) filed March 19, 2014).  |
| 10.2    | Amendment No. 3 to Credit Agreement, dated March 31, 2014, by and among the Company, as borrower, the financial institutions referred to therein, and Bank of America, N.A., as administrative agent (incorporated by reference to Exhibit 10.1 to HCP's Current Report on Form 8-K (File No. 1-08895) filed March 31, 2014). |
| 31.1    | Certification by Lauralee E. Martin, 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 Lauralee E. Martin, HCP's Principal Executive Officer, Pursuant to Securities Exchange Act Rule 13a-14(b) and 18 U.S.C. Section 1350. **   |
| 32.2    | Certification by Timothy M. Schoen, HCP's Principal Financial Officer, Pursuant to Securities Exchange Act Rule 13a-14(b) and 18 U.S.C. Section 1350. **  |
| 101.INS | XBRL Instance Document.*  |
| 101.SCH | XBRL Taxonomy Extension Schema Document.*   |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document.*   |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document.*  |
| 101.LAB | XBRL Taxonomy Extension Labels Linkbase Document.*  |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document.*  |

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\* 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: May 6, 2014

HCP, Inc.

(Registrant)

/s/ LAURALEE E. MARTIN  
Lauralee E. Martin  
*President and Chief Executive Officer*  
*(Principal Executive Officer)*

/s/ TIMOTHY M. SCHOEN  
Timothy M. Schoen  
*Executive Vice President and*  
*Chief Financial Officer*  
*(Principal Financial Officer)*

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