HEALTH CARE PROPERTY INVESTORS INC
Form 10-Q
August 06, 2007

# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION
**Washington, D.C. 20549**

# FORM 10-Q

**(Mark One)**

| | |
|---|---|
| **x** | **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.** |
| | **For the quarterly period ended June 30, 2007.** |
| | **OR** |
| **o** | **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934** |
| | **For the transition period from to** |

**Commission file number 1-8895**

# HEALTH CARE PROPERTY INVESTORS, INC.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Maryland** | **33-0091377** |
| (State or other jurisdiction of incorporation of organization) | (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)

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of Accelerated Filer and Large Accelerated Filer in Rule 12b-2 of the Exchange Act. (check one):
Large Accelerated Filer x Accelerated Filer o Non-accelerated Filer o

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

**As of July 25, 2007, there were 206,380,189 shares of $ 1.00 par value common stock outstanding.**

**HEALTH CARE PROPERTY INVESTORS, INC.**

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**HEALTH CARE PROPERTY INVESTORS, INC.**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

**(In thousands, except share and per share data)**

| | June 30, 2007 (Unaudited) | December 31, 2006 |
|---|---|---|
| **ASSETS** | | |
| Real estate: | | |
| Buildings and improvements | $ 6,205,698 | $ 5,779,689 |
| Developments in process | 29,056 | 42,366 |
| Land | 770,010 | 655,624 |
| Less accumulated depreciation and amortization | 618,321 | 526,348 |
| Net real estate | 6,386,443 | 5,951,331 |
| | | |
| Net investment in direct financing leases | 682,176 | 678,013 |
| Loans receivable, net | 203,147 | 196,480 |
| Investments in and advances to unconsolidated joint ventures | 214,904 | 25,389 |
| Accounts receivable, net of allowance of $22,730 and $24,205, respectively | 33,652 | 31,026 |
| Cash and cash equivalents | 351,217 | 60,687 |
| Intangible assets, net | 328,753 | 380,568 |
| Real estate held for sale, net | 204,683 | 490,075 |
| Real estate held for contribution, net | | 1,684,341 |
| Other assets, net | 474,351 | 514,839 |
| Total assets | $ 8,879,326 | $ 10,012,749 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| Bank line of credit and term loan | $ | $ 1,129,093 |
| Senior unsecured notes | 3,223,422 | 2,748,522 |
| Mortgage debt | 1,260,885 | 1,292,485 |
| Mortgage debt on assets held for sale | | 34,813 |
| Mortgage debt on assets held for contribution | | 889,356 |
| Other debt | 108,497 | 107,746 |
| Intangible liabilities, net | 145,047 | 134,050 |
| Accounts payable and accrued liabilities | 166,648 | 200,088 |
| Deferred revenue | 29,638 | 20,795 |
| Total liabilities | 4,934,137 | 6,556,948 |
| Minority interests: | | |
| Joint venture partners | 34,305 | 34,211 |
| Non-managing member unitholders | 306,497 | 127,554 |
| Total minority interests | 340,802 | 161,765 |
| Stockholders equity: | | |
| Preferred stock, $1.00 par value: 50,000,000 shares authorized; 11,820,000 shares issued and outstanding, liquidation preference of $25 per share | 285,173 | 285,173 |
| Common stock, $1.00 par value: 750,000,000 shares authorized; 206,378,679 and 198,599,054 shares issued and outstanding, respectively | 206,379 | 198,599 |
| Additional paid-in capital | 3,392,612 | 3,108,908 |
| Cumulative net income | 2,155,265 | 1,938,693 |
| Cumulative dividends | (2,449,360) | (2,255,062) |
| Accumulated other comprehensive income | 14,318 | 17,725 |
| Total stockholders equity | 3,604,387 | 3,294,036 |
| Total liabilities and stockholders equity | $ 8,879,326 | $ 10,012,749 |

See accompanying Notes to Condensed Consolidated Financial Statements.

**HEALTH CARE PROPERTY INVESTORS, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

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

| | Three Months Ended June 30, 2007 | 2006 | Six Months Ended June 30, 2007 | 2006 |
|---|---|---|---|---|
| **Revenues and other income:** | | | | |
| Rental and related revenues | $ 204,580 | $ 109,894 | $ 407,946 | $ 209,147 |
| Income from direct financing leases | 15,215 | | 30,205 | |
| Investment management fee income | 4,220 | 943 | 10,459 | 1,997 |
| Interest and other income | 18,732 | 5,395 | 34,947 | 19,084 |
| | 242,747 | 116,232 | 483,557 | 230,228 |
| **Costs and expenses:** | | | | |
| Interest | 72,359 | 33,485 | 151,337 | 65,418 |
| Depreciation and amortization | 60,434 | 26,975 | 121,328 | 52,469 |
| Operating | 38,949 | 19,143 | 81,350 | 36,589 |
| General and administrative | 18,292 | 8,396 | 38,884 | 16,868 |
| | 190,034 | 87,999 | 392,899 | 171,344 |
| | | | | |
| **Operating income** | 52,713 | 28,233 | 90,658 | 58,884 |
| Equity income from unconsolidated joint ventures | 1,302 | 2,714 | 2,516 | 6,536 |
| Gains on sale of real estate interests, net | 10,141 | | 10,141 | |
| Minority interests share of earnings | (6,739) | (4,170) | (11,974) | (7,947) |
| **Income from continuing operations** | 57,417 | 26,777 | 91,341 | 57,473 |
| | | | | |
| **Discontinued operations:** | | | | |
| Operating income | 11,796 | 17,219 | 19,115 | 35,820 |
| Gains on sales of real estate, net of impairments | 2,071 | (2,429) | 106,116 | 6,162 |
| | 13,867 | 14,790 | 125,231 | 41,982 |
| | | | | |
| **Net income** | 71,284 | 41,567 | 216,572 | 99,455 |
| Preferred stock dividends | (5,283) | (5,283) | (10,566) | (10,566) |
| **Net income applicable to common shares** | $ 66,001 | $ 36,284 | $ 206,006 | $ 88,889 |
| | | | | |
| **Basic earnings per common share:** | | | | |
| Continuing operations | $ 0.25 | $ 0.16 | $ 0.39 | $ 0.34 |
| Discontinued operations | 0.07 | 0.11 | 0.62 | 0.31 |
| Net income applicable to common shares | $ 0.32 | $ 0.27 | $ 1.01 | $ 0.65 |
| **Diluted earnings per common share:** | | | | |
| Continuing operations | $ 0.25 | $ 0.16 | $ 0.39 | $ 0.34 |
| Discontinued operations | 0.07 | 0.10 | 0.61 | 0.31 |
| Net income applicable to common shares | $ 0.32 | $ 0.26 | $ 1.00 | $ 0.65 |
| **Weighted average shares used to calculate earnings per common share:** | | | | |
| Basic | 205,755 | 136,484 | 204,882 | 136,262 |
| Diluted | 207,024 | 137,192 | 206,470 | 137,024 |
| | | | | |
| **Dividends declared per common share** | $ 0.445 | $ 0.425 | $ 0.890 | $ 0.850 |

See accompanying Notes to Condensed Consolidated Financial Statements.

**HEALTH CARE PROPERTY INVESTORS, INC.**

**CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY**

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

| | Six Months Ended June 30, 2007 |
|---|---|
| **Preferred Stock, $1.00 Par Value** | |
| Shares, beginning and ending | 11,820 |
| Amounts, beginning and ending | $ 285,173 |
| | |
| **Common Stock, Shares** | |
| Shares at beginning of period | 198,599 |
| Issuance of common stock, net | 7,743 |
| Exercise of stock options | 37 |
| Shares at end of period | 206,379 |
| | |
| **Common Stock, $1.00 Par Value** | |
| Balance at beginning of period | $ 198,599 |
| Issuance of common stock, net | 7,743 |
| Exercise of stock options | 37 |
| Balance at end of period | $ 206,379 |
| | |
| **Additional Paid-In Capital** | |
| Balance at beginning of period | $ 3,108,908 |
| Issuance of common stock, net | 277,236 |
| Exercise of stock options | 626 |
| Amortization of deferred compensation | 5,842 |
| Balance at end of period | $ 3,392,612 |
| | |
| **Cumulative Net Income** | |
| Balance at beginning of period | $ 1,938,693 |
| Net income | 216,572 |
| Balance at end of period | $ 2,155,265 |
| | |
| **Cumulative Dividends** | |
| Balance at beginning of period | $ (2,255,062 ) |
| Common dividends ($0.89 per share) | (183,732 ) |
| Preferred dividends | (10,566 ) |
| Balance at end of period | $ (2,449,360 ) |
| | |
| **Accumulated Other Comprehensive Income** | |
| Balance at beginning of period | $ 17,725 |
| Net unrealized gains (losses) on securities: | |
| Unrealized losses | (650 ) |
| Reclassification adjustment for gains recognized in net income | (4,144 ) |
| Unrealized gains on cash flow hedges | 1,336 |
| Changes in Supplemental Executive Retirement Plan ( SERP ) obligation | 51 |
| Balance at end of period | $ 14,318 |
| | |
| **Total Comprehensive Income** | |
| Net income | $ 216,572 |
| Other comprehensive income | (3,407 ) |
| Total comprehensive income | $ 213,165 |

See accompanying Notes to Condensed Consolidated Financial Statements.

**HEALTH CARE PROPERTY INVESTORS, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(In thousands)**
**(Unaudited)**

| | Six Months Ended June 30, 2007 | 2006 |
|---|---|---|
| **Cash flows from operating activities:** | | |
| Net income | $ 216,572 | $ 99,455 |
| 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 | 121,328 | 52,469 |
| Discontinued operations | 6,248 | 10,568 |
| Amortization of above and below market lease intangibles, net | (1,572) | (921) |
| Stock-based compensation | 5,842 | 4,248 |
| Debt issuance costs amortization | 5,643 | 1,804 |
| Recovery of loan losses | (210) | |
| Interest accretion on direct financing leases and straight-line rents | (24,542) | (4,721) |
| Equity income from unconsolidated joint ventures | (2,516) | (6,536) |
| Distributions of earnings from unconsolidated joint ventures | 2,067 | 5,623 |
| Minority interests share of earnings | 11,974 | 7,947 |
| Impairments | | 4,711 |
| Gains on sales of real estate and real estate interests, net | (116,257) | (10,873) |
| Gains on sales of securities, net | (4,874) | |
| Changes in: | | |
| Accounts receivable | (3,912) | 891 |
| Other assets | (5,204) | (282) |
| Accounts payable, accrued liabilities and deferred revenue | 4,135 | 9,484 |
| Net cash provided by operating activities | 214,722 | 173,867 |
| | | |
| **Cash flows from investing activities:** | | |
| Acquisition and development of real estate | (274,458) | (264,133) |
| Lease commissions and tenant and capital improvements | (14,408) | (8,093) |
| Net proceeds from sales of real estate | 356,556 | 27,609 |
| Contributions to unconsolidated joint ventures | (1,172) | (563) |
| Distributions from unconsolidated joint ventures, net | 475,685 | |
| Purchase of securities | (26,647) | (12,895) |
| Proceeds from the sale of securities | 53,317 | |
| Principal repayments on loans receivable | 6,630 | 44,298 |
| Investment in loans receivable and debt securities | (7,939) | (3,154) |
| Decrease (increase) in restricted cash | 12,088 | (105) |
| Net cash provided by (used in) investing activities | 579,652 | (217,036) |
| | | |
| **Cash flows from financing activities:** | | |
| Net borrowings (repayments) under bank lines of credit | (624,500) | 6,500 |
| Repayments of term loan | (504,593) | |
| Repayments of mortgage debt | (66,813) | (19,373) |
| Issuance of mortgage debt, net of issuance costs | 141,817 | 161,874 |
| Repayments of senior unsecured notes | (20,000) | (135,000) |
| Issuance of senior unsecured notes, net of issuance costs | 493,365 | 148,606 |
| Net proceeds from the issuance of common stock and exercise of options | 282,080 | 14,237 |
| Dividends paid on common and preferred stock | (194,298) | (127,423) |
| Distributions to minority interests | (10,902) | (6,118) |
| Net cash provided by (used in) financing activities | (503,844) | 43,303 |
| | | |
| Net increase in cash and cash equivalents | 290,530 | 134 |

| | | |
|---|---|---|
| Cash and cash equivalents, beginning of period | 60,687 | 21,342 |
| Cash and cash equivalents, end of period | $ 351,217 | $ 21,476 |

See accompanying Notes to Condensed Consolidated Financial Statements.

**HEALTH CARE PROPERTY INVESTORS, INC.**

**NOTES TO THE CONDENSED CONSOLIDATED STATEMENTS**

**(1) Business**

*Health Care Property Investors, Inc. is a real estate investment trust ( REIT ) that, together with its consolidated entities (collectively, HCP or the Company ), invests directly, or through joint ventures and mortgage loans, in healthcare related properties located throughout the United States.*

**(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 and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, the unaudited condensed consolidated financial statements do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and six months ended June 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. For further information, refer to the consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2006, filed with the Securities and Exchange Commission ( SEC ).

*Use of Estimates*

Management is required to make estimates and assumptions in the preparation of financial statements in conformity with GAAP. These estimates and assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

*Principles of Consolidation*

The consolidated financial statements include the accounts of HCP, its wholly-owned subsidiaries and its controlled, through voting rights or other means, joint ventures. All material intercompany transactions and balances have been eliminated in consolidation.

The Company applies Financial Accounting Standards Board ( FASB ) Interpretation No. 46R, *Consolidation of Variable Interest Entities*, as revised ( FIN 46R ), for arrangements with variable interest entities. FIN 46R provides guidance on the identification of entities for which control is achieved through means other than voting rights ( variable interest entities or VIEs ) and the determination of which business enterprise is the primary beneficiary of the VIE. A variable interest entity is broadly defined as an entity where either (i) the equity investors as a group, if any, do not have a controlling financial interest or (ii) the equity investment at risk is insufficient to finance that entity s activities without additional subordinated financial support. The Company consolidates investments in VIEs when it is determined that the Company is the primary beneficiary of the VIE at either the creation of the variable interest entity or upon the occurrence of a reconsideration event.

The Company adopted Emerging Issues Task Force ( EITF ) Issue 04-5, *Investor s Accounting for an Investment in a Limited Partnership When the Investor is the Sole General Partner and the Limited Partners Have Certain Rights* ( EITF 04-5 ), effective June 2005. The issue concludes as to what rights held by the limited partner(s) preclude consolidation in circumstances in which the sole general partner would otherwise consolidate the limited partnership in accordance with GAAP. The assessment of limited partners rights and their impact on the presumption of control of the limited partnership by the sole general partner should be made when an investor becomes the sole general partner and should be reassessed if (i) there is a change to the terms or in the exercisability of the rights of the limited partners, (ii) the sole general partner increases or decreases its ownership of limited partnership interests, or (iii) there is an increase or decrease in the number of outstanding limited partnership interests.

This EITF also applies to managing members in limited liability companies. The adoption of EITF 04-5 did not have an impact on the Company s consolidated financial position or results of operations.  Investments in entities which the Company does not consolidate but for which the Company has the ability to exercise significant influence over operating and financial policies are reported under the equity method. Under the equity method of accounting, the Company s share of the investee s earnings or loss is included in the Company s operating results.

*Revenue Recognition*

Rental income from tenants is recognized in accordance with GAAP, including SEC Staff Accounting Bulletin No. 104, *Revenue Recognition* ( SAB 104 ). For leases with minimum scheduled rent increases, the Company recognizes income on a straight-line basis over the lease term when collectibility is reasonably assured. Recognizing rental income on a straight-line basis for leases results in recognized revenue exceeding amounts contractually due from tenants. Such cumulative excess amounts are included in other assets and were $50.2 million and $35.6 million, net of allowances, at June 30, 2007 and December 31, 2006, respectively. In the event the Company determines that collectibility of straight-line rents is not reasonably assured, the Company limits future recognition to amounts contractually owed, and, where appropriate, the Company establishes an allowance for estimated losses. Certain leases provide for additional rents based upon a percentage of the facility s revenue in excess of specified base amounts or other thresholds. Such revenue is recognized when the related thresholds are achieved.

The Company monitors the liquidity and creditworthiness of its tenants and borrowers on an ongoing basis. The evaluation considers industry and economic conditions, property performance, security deposits and guarantees, and other matters. The Company establishes provisions and maintains an allowance for estimated losses resulting from the possible inability of its tenants and borrowers to make payments sufficient to recover recognized assets. For straight-line rent amounts, the Company s assessment is based on income recoverable over the term of the lease. At June 30, 2007 and December 31, 2006, respectively, the Company had an allowance of $37.3 million and $29.7 million, included in other assets, as a result of the Company s determination that collectibility is not reasonably assured for certain straight-line rent amounts. The results for three and six months ended June 30, 2007, includes income of $6.0 million resulting from the Company s change in estimate relating to the collectibility of straight-line rents due from Emeritus Corporation.

*Loans Receivable*

Loans receivable are classified as held-for-investment based on management s intent and ability to hold the loans for the foreseeable future or to maturity. Loans held for investment are carried at amortized cost reduced by a valuation allowance for estimated credit losses. The Company recognizes interest income on loans, including the amortization of discounts and premiums, using the effective interest method.

*Real Estate*

Real estate, consisting of land, buildings, and improvements, is recorded at cost. The Company allocates acquisition costs to the acquired tangible and identified intangible assets and liabilities, primarily lease intangibles, based on their estimated fair values in accordance with Statement of Financial Accounting Standards (SFAS) No. 141, *Business Combinations* (SFAS No. 141).

The Company assesses fair value based on estimated cash flow projections that utilize appropriate discount and/or capitalization rates, third-party appraisals and available market information. Estimates of future cash flows are based on a number of factors including historical operating results, known and anticipated trends, and market and economic conditions. The fair value of the tangible assets of an acquired property considers the value of the property as if it were vacant.

The Company records acquired above and below market leases at their fair value using a discount rate which reflects the risks associated with the leases acquired, equal to the present value of the difference between (i) the contractual amounts to be paid pursuant to each in-place lease and (ii) management s estimate of fair market lease rates for each corresponding in-place lease, measured over a period equal to the remaining term of the lease for above-market leases and the initial term plus the term for any below-market fixed rate renewal options for below-market leases. Other intangible assets acquired include amounts for in-place lease values that are based on the Company s evaluation of the specific characteristics of each tenant s lease. Factors to be considered include estimates of carrying costs during hypothetical expected lease-up periods, market conditions, and costs to execute similar leases. In estimating carrying costs, the Company includes estimates of lost rentals at market rates during the hypothetical expected lease-up periods, depending on local market conditions. In estimating costs to execute similar leases, the Company considers leasing commissions, legal and other related costs.

Developments in process are carried at cost which includes pre-construction costs essential to development of the property, construction costs, capitalized interest, and other costs directly related to the property. Capitalization of interest ceases when the property is ready for service which generally is near the date that a certificate of occupancy is obtained. Expenditures for tenant improvements and leasing commissions are capitalized and amortized over the terms of the respective leases. Repairs and maintenance are expensed as incurred.

The Company computes depreciation on properties using the straight-line method over the assets estimated useful lives. Depreciation is discontinued when a property is identified as held for sale. Building and improvements are depreciated over useful lives ranging up to 45 years. Above and below market rent intangibles are amortized primarily to revenue over the remaining noncancellable lease terms and bargain renewal periods, if any. Other in-place lease intangibles are amortized to expense over the remaining lease term and bargain renewal periods, if any. At June 30, 2007 and December 31, 2006, lease intangible assets, net were $328.8 million and $380.6 million, respectively. At June 30, 2007 and December 31, 2006, lease intangible liabilities, net were $145.0 million and $134.1 million, respectively.

*Impairment of Long-Lived Assets and Goodwill*

The Company assesses the carrying value of its long-lived assets whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long Lived Assets* and, with respect to goodwill, at least annually applying a fair-value-based test in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets* ( SFAS No. 142 ). If the sum of the expected future net undiscounted cash flows is less than the carrying amount of the long-lived asset, an impairment loss will be recognized by adjusting the asset s carrying amount to its estimated fair value. The determination of the fair value of long-lived assets, including goodwill, involves significant judgment. This judgment is based on the Company s analysis and estimates of the future operating results and resulting cash flows of each long-lived asset whose carrying amount may not be recoverable. The Company s ability to accurately predict future operating results, and resulting cash flows, impact the determination of fair value.

*Net Investment in Direct Financing Leases*

The Company uses the direct finance method of accounting to record income from direct financing leases ( DFLs ). For leases accounted for as DFLs, future minimum lease payments are recorded as a receivable. The difference between the future rents and the estimated residual values less the cost of the properties is recorded as unearned income. Unearned income is deferred and amortized to income over the lease terms to provide a constant yield. Investments in direct financing leases are presented net of unamortized unearned income. DFLs have initial terms that range from 5 to 35 years. Certain leases contain provisions that allow the tenants to elect to purchase the properties during or at the end of the lease terms for the aggregate initial investment amount plus adjustments, if any, as defined in the lease agreements. Certain leases also permit the Company to require the tenants to purchase the properties at the end of the lease terms.

*Assets Held for Sale and Discontinued Operations*

Certain long lived assets are classified as discontinued operations in accordance with SFAS No. 144. Long-lived assets to be disposed of are reported at the lower of their carrying amount or their fair value less cost to sell. Further, depreciation of these assets ceases at the time the assets are classified as discontinued operations. Discontinued operations are defined in SFAS No. 144 as a component of an entity that has either been disposed of or is deemed to be held for sale if both the operations and cash flows of the component have been or will be eliminated from ongoing operations as a result of the disposal transaction and the entity will not have any significant continuing involvement in the operations of the component after the disposal transaction.

*Assets Held for Contribution*

Properties classified as held for contribution to joint ventures, in which the Company maintains an ownership interest, qualify as held for sale under SFAS No. 144, but are not included in discontinued operations due to the Company s continuing interest in the ventures.

*Stock-Based Compensation*

On January 1, 2002, the Company adopted the fair value method of accounting for stock-based compensation in accordance with SFAS No. 123, *Accounting for Stock-Based Compensation* ( SFAS No. 123 ), as amended by SFAS No. 148*, Accounting for Stock-Based Compensation Transition and Disclosure* ( SFAS No. 148 ). The fair value provisions of SFAS No. 123 were adopted prospectively with the fair value of all new stock option grants recognized as compensation expense beginning January 1, 2002. Since only new grants are accounted for under the fair value method, stock-based compensation expense is less than that which would have been recognized if the fair value method had been applied to all awards. Compensation expense for awards with graded vesting is generally recognized ratably over the period from the date of grant to the date when the award is no longer contingent on the employee providing additional services.

SFAS No. 123R, *Share-Based Payments* ( SFAS No. 123R ), which is a revision of SFAS No. 123*,* was issued in December 2004. Generally, the approach in SFAS No. 123R is similar to that in SFAS No. 123. However, SFAS No. 123R requires all share-based payments to employees, including grants of employee stock options, be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative. On January 1, 2006, the Company adopted SFAS No. 123R using the modified prospective application transition method which provides for only current and future period stock-based awards to be measured and recognized at fair value. The adoption of SFAS No. 123R did not have a significant impact on the Company s financial position or results of operations since the fair value provisions of SFAS No. 123 were previously adopted.

*Cash and Cash Equivalents*

Cash and cash equivalents includes short-term investments with original maturities of three months or less when purchased.

*Restricted Cash*

Restricted cash primarily consists of amounts held by mortgage lenders to provide for future real estate tax expenditures and tenant improvements, tenant capital improvement reserves and security deposits. At June 30, 2007 and December 31, 2006, restricted cash amounts were $22.2 million and $38.5 million, respectively, and are included in other assets.

*Derivatives*

The Company adopted SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended by SFAS No. 137, SFAS No. 138 and SFAS No. 148 ( SFAS No. 133 ). SFAS No. 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and hedging activities. It requires the recognition of all derivative instruments as assets or liabilities in the Company s condensed consolidated balance sheets at fair value. Changes in the fair value of derivative instruments that are not designated as hedges or that do not meet the hedge accounting criteria of SFAS No. 133 are recognized in earnings. For derivatives designated as hedging instruments in qualifying cash flow hedges, the change in fair value of the effective portion of the derivatives is recognized in accumulated other comprehensive income (loss) whereas the change in fair value of the ineffective portion is recognized in earnings.

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk-management objectives and strategy for undertaking various hedge transactions. This process includes linking all derivatives that are designated as cash flow hedges to specific assets and liabilities in the balance sheet. The Company also assesses and documents, both at the hedging instrument s inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows associated with the hedged items. When it is determined that a derivative ceases to be highly effective as a hedge, the Company discontinues hedge accounting prospectively.

*Income Taxes*

The Company has elected and believes it operates so as to qualify as a REIT under Sections 856 to 860 of the Internal Revenue Code of 1986, as amended (the Code ). Under the Code, the Company generally is not subject to federal income tax on its taxable income distributed to stockholders if certain distribution, income, asset, and shareholder tests are met. A REIT must distribute at least 90% of its annual taxable income to stockholders.

Certain activities the Company undertakes must be conducted by entities which elect to be treated as taxable REIT subsidiaries ( TRSs ). TRSs are subject to both federal and state income taxes. For the six months ended June 30 2007, income taxes related to the Company s TRSs were $1.0 million. Income taxes related to the Company s TRS s were insignificant for the six months ended June 30, 2006.

Effective January 1, 2007, the Company adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ( FIN 48 ). This interpretation, among other things, creates a two step approach for evaluating uncertain tax positions. Recognition (step one) occurs when an enterprise concludes that a tax position, based solely on its technical merits, is more-likely-than-not to be sustained upon examination. Measurement (step two) determines the highest amount of benefit that more-likely-than-not will be realized upon settlement. Derecognition of a tax position that was previously recognized would occur when a company subsequently determines that a tax position no longer meets the more-likely-than-not threshold of being sustained. FIN 48 specifically prohibits the use of a valuation allowance as a substitute for derecognition of tax positions, and it has expanded disclosure requirements. FIN 48 is effective for fiscal years beginning after December 15, 2006, in which the impact of adoption should be accounted for as a cumulative effect adjustment to the beginning balance of retained earnings. The adoption of FIN 48 on January 1, 2007 did not have a significant impact on the Company s financial position or results of operations.

The Company, its partnerships and its taxable REIT subsidiaries file U.S. federal income tax returns and state income and franchise tax returns in over 40 state jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal or state income tax examinations by taxing authorities for years prior to 2003. The Company s policy is to recognize interest relating to unrecognized tax benefits in interest expense and related penalties as additional tax expense. The Company has no unrecognized tax benefits, and there is no associated interest or penalty accrual at June 30, 2007.

*Marketable Securities*

The Company classifies its existing marketable equity and debt securities as available-for-sale in accordance with the provisions of SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Investment*, ( SFAS No. 115 ). These securities are carried at fair market value, with unrealized gains and losses reported in stockholders equity as a component of accumulated other comprehensive income. Gains or losses on securities sold are based on the specific identification method. At June 30, 2007, the carrying value of equity securities was $16.4 million, which includes $0.2 million in unrealized gains and is included in other assets. During the six months ended June 30, 2007, the Company realized gains totaling $1.0 million related to the sale of various equity securities. At June 30, 2007, the carrying value of debt securities was $294.3 million, which includes $19.3 million in unrealized gains and is included in other assets. During the six months ended June 30, 2007, the Company realized gains totaling $3.9 million related to the sale of $45.0 million of debt securities. There were no sales of debt or equity securities during the six months ended June 30, 2006.

*Capital Raising Issuance Costs*

Costs incurred in connection with the issuance of both common and preferred shares are recorded as a reduction in additional paid-in capital. Costs incurred in connection with the issuance of debt are deferred and included in other assets and amortized to interest expense over the remaining term of the related debt.

*Segment Reporting*

The Company reports its consolidated financial statements in accordance with SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information* ( SFAS No. 131 ). The Company s segments are based on the Company s method of internal reporting which classifies its operations by leasing activities. The Company s segments include medical office buildings ( MOBs ) and triple-net leased properties.

*Life Care Bonds Payable*

Two of the Company s continuing care retirement communities ( CCRCs ) issue non-interest bearing life care bonds payable to certain residents of the CCRCs. Generally, the bonds are refundable to the resident or to the resident s estate upon termination or cancellation of the CCRC agreement. One of the Company s other senior housing facilities requires that certain residents of the facility post non-interest bearing occupancy fee deposits that are refundable to the resident or the resident s estate the earlier of the re-letting of the unit or after two years of vacancy. Proceeds from the issuance of new bonds are used to retire existing bonds. As the maturity of these obligations is not determinable, no interest is imputed. These amounts are included in other debt in the Company s consolidated balance sheets.

*New Accounting Pronouncements*

In September 2006, the SEC issued Staff Accounting Bulletin (SAB) Topic 1N, *Financial Statements Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* ( SAB 108 ). The SEC staff is providing guidance on how prior year misstatements should be taken into consideration when quantifying misstatements in current year financial statements for purposes of determining whether the current year s financial statements are materially misstated. The SEC staff indicates that registrants must quantify the impact of correcting all misstatements, including both the carryover and reversing effects of prior year misstatements, on the current year financial statements. If correcting a misstatement in the current year would materially misstate the current year s income statement, the SEC staff indicates that the prior year financial statements should be adjusted. These adjustments to prior year financial statements are necessary even though such adjustments were appropriately viewed as immaterial in the prior year. If the Company determines that an adjustment to prior year financial statements is required upon adoption of SAB 108 and does not elect to restate its previous financial statements, then it must recognize the cumulative effect of applying SAB 108 in fiscal 2007 beginning balances of the affected assets and liabilities with a corresponding adjustment to the fiscal 2007 opening balance in retained earnings. The adoption of SAB 108 did not have a material effect on the Company s financial position or results of operations.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ( SFAS No. 157 ). SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurement. SFAS No. 157 requires prospective application for fiscal years ending after November 15, 2007. The Company is evaluating SFAS No. 157 and has not yet determined the impact the adoption will have on the Company s financial position or results of operations.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ( SFAS No. 159 ). SFAS No. 159 permits all entities to choose to measure eligible items at fair value at specified election dates. SFAS 159 is effective as of the beginning of an entity s first fiscal year that begins after November 15, 2007. The Company is evaluating SFAS No. 159 and has not yet determined the impact the adoption will have on the Company s financial position or results of operations.

*Reclassifications*

Certain reclassifications have been made for comparative financial statement presentation.

**(3) Acquisition of Slough Estates USA Inc.**

On August 1, 2007, the Company closed its acquisition of Slough Estates USA Inc. ( SEUSA ) for aggregate consideration of approximately $2.9 billion, subject to certain adjustments. SEUSA s portfolio is concentrated in the San Francisco Bay Area and San Diego County and comprises 83 existing properties representing approximately 5.2 million square feet of life science/pharma space. In addition to the existing portfolio, SEUSA has an established development infrastructure and a pipeline currently comprised of 3.8 million square feet in the San Francisco Bay Area and San Diego County.

In connection with the Company s acquisition of SEUSA, the Company obtained from a syndicate of banks a bridge loan for $2.75 billion.

See Note 11 for additional information on the bridge loan.

**(4) Mergers with CNL Retirement Properties, Inc. and CNL Retirement Corp.**

On October 5, 2006, HCP acquired CNL Retirement Properties, Inc. ( CRP ). CRP was a REIT that invested primarily in senior housing and medical office buildings located across the United States. This transaction further diversified HCP s portfolio by property type, geographic location and operator, and diversified HCP s sources of revenues across the healthcare industry.

In connection with the CRP Merger, the Company incurred merger integration costs, such as employee transition costs and severance costs for certain former CRP employees.

Under the merger agreement with CRP, each share of CRP common stock was exchanged for $11.1293 in cash and 0.0865 of a share of HCP s common stock, equivalent to approximately $2.9 billion in cash, and 22.8 million shares. Fractional shares were paid in cash. The Company financed the cash consideration paid to CRP stockholders and the expenses related to the transaction through a $1 billion offering of senior unsecured notes and a draw down under new term and bridge loan facilities and a new three-year revolving credit facility. As of January 22, 2007, the term and bridge facilities had been repaid with proceeds from the issuance of senior notes, secured debt and common stock, disposition of certain real estate properties and from real estate joint ventures. Simultaneous with the closing of the merger with CRP, HCP also merged with CNL Retirement Corp. ( CRC ) for aggregate consideration of approximately $120 million, which included the issuance of 4.4 million shares of HCP common stock.

The allocation of the purchase price of $5.6 billion was based upon estimates and assumptions. The current allocations are substantially complete; however, there are certain items that may be subject to revision if additional information becomes available. The Company does not expect future revisions to have a significant impact on its financial position or results of operations.

The following unaudited pro forma consolidated results of operations assume that the acquisitions of CRP and CRC were completed as of January 1 for the three and six months ended June 30, 2006 (in thousands, except per share amounts):

| | Three Months Ended June 30, 2006 | | Six Months Ended June 30, 2006 | |
|---|---|---|---|---|
| Revenues | $ | 223,985 | $ | 442,074 |
| Net income | $ | 19,271 | $ | 57,609 |
| Basic earnings per common share | $ | 0.09 | $ | 0.29 |
| Diluted earnings per common share | $ | 0.09 | $ | 0.29 |

Pro forma data may not be indicative of the results that would have been obtained had the acquisitions actually occurred at the beginning of each of the periods presented, nor does it intend to be a projection of future results.

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**(5) Acquisitions**

A summary of acquisitions for the six months ended June 30, 2007, is as follows (in thousands):

| | Consideration | | | Assets Acquired | |
|---|---|---|---|---|---|
| **Acquisitions (1)** | **Cash Paid** | **Real Estate** | **DownREIT Units (2)** | **Real Estate** | **Net Intangibles** |
| Medical office buildings | $ 124,811 | $ | $ 93,887 | $ 209,048 | $ 9,650 |
| Senior housing facilities | 8,071 | | | 7,927 | 144 |
| Hospitals | 120,562 | 35,205 | 84,719 | 235,084 | 5,402 |
| Other healthcare facilities | 1,815 | | 2,092 | 3,907 | |
| | $ 255,259 | $ 35,205 | $ 180,698 | $ 455,966 | $ 15,196 |

A summary of acquisitions during 2006, excluding the CRP and CRC acquisitions (Note 4) and consolidation of HCP Medical Office Portfolio, LLC ( HCP MOP ) (Note 8), is as follows (in thousands):

| | Consideration | | | | Assets Acquired | |
|---|---|---|---|---|---|---|
| **Acquisitions (1)** | **Cash Paid** | **Real Estate** | **Debt Assumed** | **DownREIT Units (2)** | **Real Estate** | **Net Intangibles** |
| Medical office buildings | $ 141,449 | $ | $ 11,928 | $ 5,523 | $ 147,522 | $ 11,378 |
| Senior housing facilities | 222,275 | 16,600 | 68,819 | | 299,970 | 7,724 |
| Hospitals | 41,490 | | | | 40,661 | 829 |
| Other healthcare facilities | 36,070 | | | | 33,306 | 2,764 |
| | $ 441,284 | $ 16,600 | $ 80,747 | $ 5,523 | $ 521,459 | $ 22,695 |

(1) Includes transaction costs, if any.

(2) Non-managing member LLC units.

During the six months ended June 30, 2007, the Company acquired properties aggregating $471 million, including the following significant acquisitions:

On January 31, 2007, the Company acquired three long-term acute care hospitals and received proceeds of $36 million in exchange for 11 skilled nursing facilities ( SNFs ) valued at approximately $77 million. The Company recognized a $47 million gains on the sale of these 11 SNFs. The three acquired properties have an initial lease term of ten years with two ten-year renewal options, and an initial contractual yield of 12% with escalators based on the lessee s revenue growth. The acquired properties are included in a new master lease that contains 14 properties leased to the same operator.

On February 9, 2007, the Company acquired a medical campus that includes two hospital towers, six MOBs, and three parking garages for approximately $350 million, including non-managing member LLC units ( DownREIT units ) valued at $179 million. The initial yield on this campus is 7.2%. As of June 30, 2007, the purchase price allocation is preliminary and is pending the receipt of information necessary to complete the valuation of certain tangible assets.

On February 28, 2007, the Company acquired three MOBs for $25 million from the Cirrus Group, LLC ( Cirrus ). The three medical office buildings include approximately 131,000 rentable square feet and have an initial yield of 8.2%.

**(6) Dispositions of Real Estate Interests and Discontinued Operations**

*Dispositions of Real Estate.* During the six months ended June 30, 2007, the Company sold 47 properties for $392 million and recognized gains of approximately $106 million. During the six months ended June 30, 2006, the Company sold eight properties for proceeds of $28 million and recognized gains of approximately $11 million.

*Dispositions of Real Estate Interests.* On January 5, 2007, the Company formed a senior housing joint venture ( HCP Ventures II ), which included 25 properties valued at $1.1 billion. The 25 properties included in this joint venture were acquired in the Company s acquisition of CRP and were classified as held for contribution within three months from the close of the CRP acquisition.  These assets were not depreciated or amortized and the value allocated to these assets was based on the disposition proceeds received.  No gain or loss was recognized for the sale of the Company s 65% interest in this joint venture.

On April 30, 2007, the Company formed an MOB joint venture ( HCP Ventures IV ), which included 55 properties valued at approximately $585 million. Upon the disposition of an 80% in this venture, the Company recognized a gain of $10 million. There were no sales of interests in joint ventures during the six months ended June 30, 2006.

*Properties Held for Sale.* At June 30, 2007 and December 31, 2006, the number of assets held for sale was 47 and 36 with carrying amounts of $205 million and $490 million, respectively.

*Properties Held for Contribution.* At December 31, 2006, the Company classified as held for contribution 25 senior housing assets and 52 MOB with an aggregate carrying value of $1.7 billion. There were no assets classified as held for contribution at June 30, 2007.

The following table summarizes income from discontinued operations and the related realized gains on sales of real estate from discontinued operations for the three and six months ended June 30, 2007 and 2006 (in thousands):

| | **Three months ended June 30,** | | **Six months ended June 30,** | |
|---|---|---|---|---|
| | **2007** | **2006** | **2007** | **2006** |
| Total revenues | $ 15,972 | $ 22,570 | $ 30,000 | $ 46,775 |
| Depreciation and amortization | (2,769) | (5,206) | (6,248) | (10,568) |
| Other costs and expenses | (1,407) | (145) | (4,637) | (387) |
| Operating income from discontinued operations | $ 11,796 | $ 17,219 | $ 19,115 | $ 35,820 |
| | | | | |
| Gains on sales of real estate, net | $ 2,071 | $ 2,282 | $ 106,116 | $ 10,873 |
| Impairments | | (4,711) | | (4,711) |
| Gains on sales of real estate interest, net of impairments | $ 2,071 | $ (2,429) | $ 106,116 | $ 6,162 |
| | | | | |
| Number of properties held for sale | 47 | 144 | 47 | 144 |
| Number of properties sold | 20 | 2 | 47 | 8 |
| Number of properties contributing to operating results from discontinued operations | 67 | 146 | 94 | 152 |

See discussions of the HCP Ventures II and HCP Ventures IV transactions in Note 8.

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

The components of net investment in DFLs consisted of the following at June 30, 2007 (dollars in thousands):

| | |
|---|---|
| Minimum lease payments receivable | $ 1,486,315 |
| Estimated residual values | 515,470 |
| Less unearned income | (1,319,609) |
| Net investment in direct financing leases | $ 682,176 |
| | |
| Properties subject to direct financing leases | 32 |

The DFLs were acquired in the Company s merger with CRP. CRP determined that these leases were DFLs, and the Company is generally required to carry forward CRP s accounting conclusions after the acquisition date relative to their assessment of these leases. Lease payments due to the Company relating to five land-only direct financing leases with a carrying value of $106.2 million are subordinate to first mortgage construction loans with third parties entered into by the tenants to fund development costs related to the properties. In addition, the Company s land interest serves as collateral to the first mortgage construction lender.

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

The Company owns interests in the following entities which are accounted for under the equity method at June 30, 2007 (dollars in thousands):

| Entity (1) | Investment(2) | Ownership |
|---|---|---|
| HCP Ventures II | $ 145,839 | 35 % |
| HCP Ventures III, LLC | 13,901 | 26 % |
| HCP Ventures IV, LLC | 47,581 | 20 % |
| Arborwood Living Center, LLC(4) | 888 | 45 % |
| Greenleaf Living Centers, LLC(4) | 424 | 45 % |
| Suburban Properties, LLC | 5,369 | 67 % |
| Advances to unconsolidated joint ventures | 902 | |
| | $ 214,904 | |
| | | |
| Edgewood Assisted Living Center, LLC(3)(4) | $ (422 ) | 45 % |
| Seminole Shores Living Center, LLC(3)(4) | (844 ) | 50 % |
| | $ (1,266 ) | |

(1) These joint ventures are not consolidated since 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. See Note 2 regarding the Company s policy for accounting for joint venture interests.

(3) Negative investment amounts are included in accounts payable and accrued liabilities.

(4) As of June 30, 2007, the Company has guaranteed in the aggregate $7.1 million of a total of $15.3 million of notes payable for these four joint ventures.

On October 27, 2006, the Company formed an MOB joint venture, HCP Ventures III, with an institutional capital partner. The joint venture includes 13 properties valued at $140 million and encumbered by $92 million of mortgage debt. Upon sale of a 70% interest in the venture, the Company received approximately $36 million in proceeds, including a one-time acquisition fee of $0.7 million. An effective 26% interest in the venture was retained, and the Company acts as the managing member, and will receive ongoing asset management fees.

On January 5, 2007, the Company formed a senior housing joint venture, HCP Ventures II, with an institutional capital partner. The joint venture includes 25 properties valued at $1.1 billion and encumbered by a $686 million secured debt facility. Upon the sale of a 65% interest in the venture, the Company received approximately $280 million in proceeds, including a one-time acquisition fee of $5.4 million. The acquisition fee of $5.4 million is included in investment management fee income for the six months ended June 30, 2007. The Company acts as the managing member, and will receive ongoing asset management fees.

On April 30, 2007, the Company formed an MOB joint venture, HCP Ventures IV, with an institutional capital partner. The joint venture included 55 properties valued at approximately $585 million and encumbered by $344 million of secured debt. Upon the sale of an 80% interest in the venture, the Company received proceeds of $196 million and recognized a gain of $10 million. These proceeds include a one-time acquisition fee of $3 million, which is included in investment management fee income for the three and six months ended June 30, 2007. The Company acts as the managing member and will receive ongoing asset management fees.

On May 31, 2007, this joint venture acquired two MOBs valued at $23 million and concurrently placed $15 million of secured debt. This acquisition was funded pro-rata by the Company and its joint venture partner.

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Summarized unaudited condensed combined financial information for the Company s unconsolidated joint ventures follows:

| | June 30, 2007 (in thousands) | December 31, 2006 |
|---|---|---|
| Real estate, net | $ 1,707,585 | $ 150,206 |
| Other assets, net | 177,225 | 25,358 |
| Total assets | $ 1,884,810 | $ 175,564 |
| | | |
| Notes payable | $ 1,155,209 | $ 116,805 |
| Accounts payable | 38,036 | 13,690 |
| Other partners capital | 502,806 | 32,549 |
| HCP s capital (1) | 188,759 | 12,520 |
| Total liabilities and partners capital | $ 1,884,810 | $ 175,564 |

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2007 (In thousands) | 2006 (2) | 2007 (In thousands) | 2006 (2) |
| Total revenues | $ 42,607 | $ 19,220 | $ 85,032 | $ 39,409 |
| Discontinued operations | | 8,361 | | 18,159 |
| Net income | $ 2,330 | $ 8,399 | $ 8,466 | $ 19,619 |
| HCP s equity income | $ 1,302 | $ 2,714 | $ 2,516 | $ 6,536 |
| Fees earned by HCP | $ 4,220 | $ 943 | $ 10,459 | $ 1,997 |
| Distributions received, net | $ 200,532 | $ 1,135 | $ 477,752 | $ 5,623 |

(1) Aggregate basis difference of the Company s investments in these joint ventures of $24 million is primarily attributable to real estate and related intangible assets.

(2) The amounts for the three and six months ended June 30, 2006, include the results of HCP MOP.

*HCP Medical Office Portfolio, LLC*

HCP MOP was a joint venture formed in June 2003 between the Company and an affiliate of General Electric Company ( GE ). HCP MOP was engaged in the acquisition, development and operation of MOB properties. Prior to November 30, 2006, the Company was the managing member and had a 33% ownership interest therein. On November 30, 2006, the Company acquired the interest held by GE for $141 million, which resulted in the consolidation of HCP MOP beginning on that date. The Company is now the sole owner of the venture and its 59 MOBs, which have approximately four million rentable square feet. Under the purchase method of accounting, the cost of the HCP MOP acquisition was allocated based on the relative fair values as of the date that the Company acquired each of its interests in HCP MOP. During the six months ended June 30, 2007, the Company revised its initial purchase price allocation of its acquired interest in HCP MOP, which resulted in the Company allocating an additional $43.0 million to land and reducing intangible assets by the same amount from its preliminary allocation at December 31, 2006. The changes from the Company s initial purchase price allocation did not have a significant impact in the Company s results of operations during the six months ended June 30, 2007.

Prior to November 30, 2006, the Company accounted for its investment in HCP MOP using the equity method of accounting because it exercised significant influence through voting rights and its position as managing member. However, the Company did not consolidate HCP MOP until November 30, 2006, since it did not control, through voting rights or other means, the joint venture as GE had substantive participating decision making rights and had the majority of the economic interest. The accounting policies of HCP MOP prior to November 30, 2006, are the same as those described in the summary of significant accounting policies (see Note 2).

## (9) Loans Receivable

Loans receivable, net consist of the following (in thousands):

| | June 30, 2007 Real Estate Secured | Other | Total | December 31, 2006 Real Estate Secured | Other | Total |
|---|---|---|---|---|---|---|
| Joint venture partners | $ | $ 7,053 | $ 7,053 | $ | $ 7,054 | $ 7,054 |
| Others | 122,829 | 73,682 | 196,511 | 121,482 | 69,624 | 191,106 |
| Loan loss allowance | | (417) | (417) | | (1,680) | (1,680) |
| | $ 122,829 | $ 80,318 | $ 203,147 | $ 121,482 | $ 74,998 | $ 196,480 |

Through the Company s merger with CRP, it assumed an agreement to provide an affiliate of the Cirrus Group, LLC with an interest only, five-year, senior secured term loan under which up to $85.0 million may be borrowed to finance the acquisition, development, syndication and operation of new and existing surgical partnerships. Certain of these surgical partnerships are tenants in the MOBs CRP acquired from Cirrus. During the first 48 months of the term, which began in August 2005, interest will accrue at a rate of 14.0%, of which 9.5% will be payable monthly and the balance of 4.5% will be deferred; thereafter, interest at the greater of 14.0% or LIBOR plus 9.0% will be payable monthly. The loan is subject to equity contribution requirements and borrower financial covenants that will dictate the draw down availability. The loan is collateralized by all of the assets of the borrower (comprised primarily of interests in partnerships operating surgical facilities in premises leased from a Cirrus affiliate, HCP Ventures IV or the Company) and is guaranteed up to $50.0 million through a combination of (i) a personal guarantee of up to $13.0 million by a principal of Cirrus and (ii) a guarantee of the balance by other principals of Cirrus under arrangements for recourse limited only to their interests in certain entities owning real estate. At June 30, 2007, the carrying value of this loan is $73.2 million, including accrued interest of $5.2 million.

### (10) Other Assets

The Company s other assets consisted of the following:

| | June 30, 2007 (in thousands) | December 31, 2006 |
|---|---|---|
| Available for sale debt securities | $ 294,286 | $ 322,500 |
| Available for sale equity securities | 16,425 | 15,159 |
| Restricted cash | 22,249 | 38,504 |
| Goodwill | 51,746 | 51,746 |
| Straight-line rent assets, net | 50,214 | 35,582 |
| Other | 39,431 | 51,348 |
| Total other assets | $ 474,351 | $ 514,839 |

At December 31, 2006, the Company had $300 million senior secured notes from a healthcare provider. These notes accrue interest at 9.625%, mature on November 15, 2016, and are secured by second-priority liens on the assets of the issuer and its subsidiary guarantors. During the three months ended June 30, 2007, the Company sold notes with a par value of $45 million for proceeds of $49 million, which resulted in a gain of approximately $4 million. At June 30, 2007, the notes are classified as available for sale with the fair value of the remaining senior secured notes of $274.3 million.

In April 2007, the Company purchased $20 million of senior secured notes from a different healthcare provider. These notes accrue interest at 9.25% and mature on April 15, 2017. At June 30, 2007, the notes are classified as available for sale with a fair value of $20.0 million.

**(11) Debt**

*Bank lines of credit, bridge and term loans*. As of June 30, 2007, all amounts outstanding under the Company s $1.0 billion, three-year line of credit facility were repaid. In connection with the completion of the SEUSA acquisition, on August 1, 2007, the Company terminated its $1.0 billion line of credit facility and closed on a $2.75 billion bridge loan and a $1.5 billion revolving credit facility with a syndicate of banks. In connection with the termination of the Company s previous revolving credit facility, $6.2 million of unamortized deferred financing costs were written-off in August 2007.

The Company s $1.5 billion revolving line of credit matures on August 1, 2011, and accrues interest at a rate per annum equal to LIBOR plus a margin ranging from 0.325% to 1.00%, depending upon the Company s non-credit enhanced senior unsecured long-term debt ratings ( debt ratings ). The Company pays a facility fee on the entire revolving commitment ranging from 0.10% to 0.25%, depending upon its debt ratings. The revolving credit facility contains a negotiated rate option, whereby the lenders participating in the credit facility bid on the interest to be charged and which may result in a reduced interest rate, is available for up to 50% of borrowings. Based on the Company s debt ratings on August 1, 2007 the margin on the revolving loan facility is 0.55% and the facility fee is 0.15%.

The Company s bridge loan for $2.75 billion matures on July 31, 2008 and accrues interest at a rate per annum equal to LIBOR plus a margin ranging from 0.425% to 1.25%, depending upon the Company s debt ratings. Based on the Company s debt ratings on August 1, 2007, the margin on the bridge loan facility is 0.70%. The bridge loan facility includes two 6-month extensions.

The revolving credit agreement contains certain financial restrictions and other customary requirements. Among other things, these covenants, using terms defined in the agreement, initially limit (i) Consolidated Total Indebtedness to Consolidated Total Asset Value to 75%, (ii) Secured Debt to Consolidated Total Asset Value to 30%, and (iii) Unsecured Debt to Consolidated Unencumbered Asset Value to 90%. The agreement also requires that the Company maintains (i) a Fixed Charge Coverage ratio, as defined, of 1.50 times and (ii) a formula-determined Minimum Consolidated Tangible Net Worth. These financial covenants become more restrictive over a period of approximately two years and ultimately (i) limit Consolidated Total Indebtedness to Consolidated Total Asset Value to 60%, (ii) limit Unsecured Debt to Consolidated Unencumbered Asset Value to 65%, and (iii) require a Fixed Charge Coverage ratio, as defined, of 1.75 times. As of June 30, 2007, the Company was in compliance with each of the restrictions and requirements of its former revolving credit facility.

On January 22, 2007, the Company repaid all amounts outstanding under a former $1.7 billion term loan with proceeds from capital market and joint venture transactions.

*Senior unsecured notes.* At June 30, 2007, the Company had $3.2 billion in aggregate principal of senior unsecured notes outstanding. Interest rates on the notes ranged from 4.88% to 7.07% with a weighted average effective rate of 6.10% at June 30, 2007. Discounts and premiums are amortized to interest expense over the term of the related debt.

On January 22, 2007, the Company issued $500 million of 6.00% senior unsecured notes due in 2017. The notes were priced at 99.323% of the principal amount for an effective yield of 6.09%. The Company received net proceeds of $493 million, which were used to repay its former term loan facility and reduce borrowings under its revolving credit facility.

The senior unsecured notes contain certain covenants including limitations on debt and other customary terms.

*Mortgage debt.* At June 30, 2007, the Company had $1.3 billion in mortgage debt secured by 194 healthcare facilities with a carrying amount of $2.8 billion. Interest rates on the mortgage notes ranged from 3.80% to 8.42% with a weighted average effective rate of 6.10% at June 30, 2007.

On April 27, 2007, in anticipation of the formation of HCP Ventures IV, $122 million of 10-year term mortgage notes were placed with an interest rate of 5.53%. The proceeds from the placement of these notes were used to repay borrowings under the Company s revolving credit facility and for other general corporate purposes.

The instruments encumbering the properties restrict title transfer of the respective properties subject to the terms of the mortgage, prohibit additional liens, restrict prepayment, require payment of real estate taxes, maintenance of the properties in good condition, maintenance of insurance on the properties and include a requirement to obtain lender consent to enter into material tenant leases.

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*Other debt.* At June 30, 2007, the Company had $108.5 million of non-interest bearing Life Care Bonds at two of its CCRCs and non-interest bearing occupancy fee deposits at another of its senior housing facilities, all of which were payable to certain residents of the facilities (collectively Life Care Bonds ). At June 30, 2007, $36.6 million of the Life Care Bonds were refundable to the residents upon the resident moving out or to a resident s estate upon the resident s death, and $71.9 million of the Life Care Bonds were refundable after the unit has been successfully remarketed to a new resident.

**(12) Stockholders Equity**

*Common Stock*

During the six months ended June 30, 2007 and 2006, the Company issued 656,000 and 395,000 shares, respectively, of common stock under its Dividend Reinvestment and Stock Purchase Plan. The Company issued 37,000 and 287,000 shares upon exercise of stock options during the six months ended June 30, 2007 and 2006, respectively.

During the six months ended June 30, 2007 and 2006, the Company issued 138,000 and 100,000 shares of restricted stock, respectively, under the Company s 2000 Stock Incentive Plan (the Incentive Plan ). The Company also issued 109,000 and 117,000 shares upon the vesting of performance restricted stock units during the six months ended June 30, 2007 and 2006, respectively.

On January 19, 2007, the Company issued 6.8 million shares of its common stock and received net proceeds of approximately $261 million, which were used to repay borrowings under the Company s term loan and revolving credit facilities.

On April 25, 2007, the Company announced that its Board of Directors declared a quarterly cash dividend of $0.445 per share of common stock. The common stock cash dividend was paid on May 18, 2007 to stockholders of record as of the close of business on May 7, 2007.

On July 26, 2007, the Company announced that its Board of Directors declared a quarterly cash dividend of $0.445 per share of common stock. The common stock cash dividend will be paid on August 21, 2007 to stockholders of record as of the close of business on August 6, 2007.

*Preferred Stock*

On April 25, 2007, the Company announced that its Board of Directors declared a quarterly cash dividend of $0.45313 per share on its Series E cumulative redeemable preferred stock and $0.44375 per share on its Series F cumulative redeemable preferred stock. These dividends were paid on June 29, 2007 to stockholders of record as of the close of business on June 15, 2007.

On July 26, 2007, the Company announced that its Board of Directors declared a quarterly cash dividend of $0.45313 per share on its Series E cumulative redeemable preferred stock and $0.44375 per share on its Series F cumulative redeemable preferred stock. These dividends will be paid on September 28, 2007 to stockholders of record as of the close of business on September 14, 2007.

*Accumulated Other Comprehensive Income ( AOCI )*

| | **June 30, 2007 (in thousands)** | **December 31, 2006** |
|---|---|---|
| AOCI unrealized gains on available for sale securities | $ 19,481 | $ 24,536 |
| AOCI unrealized losses on cash flow hedges, net | (2,999) | (4,596) |
| Supplemental Executive Retirement Plan ( SERP ) minimum liability | (2,164) | (2,215) |
| | $ 14,318 | $ 17,725 |

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**(13) Operator Concentration**

Sunrise Senior Living (NYSE:SRZ) ( Sunrise ) accounted for 14.8% of the Company s revenue for the six months ended June 30, 2007. The carrying amount of the Company s real estate assets and direct financing leases operated by Sunrise was $2.2 billion at June 30, 2007. Prior to the Company s merger with CRP on October 5, 2006, Sunrise was not an operator of any of the Company s properties.

Sunrise is publicly traded and is subject to the informational filing requirements of the Securities and Exchange Act of 1934, as amended. Accordingly, it is required to file periodic reports on Form 10-K and Form 10-Q with the Securities and Exchange Commission.

Certain operators of the Company s properties are experiencing financial, legal and regulatory difficulties. The loss of a significant operator or a combination of smaller operators could have a material impact on the Company s financial position or results of operations.

**(14) Impairments**

During the three and six months ended June 30, 2007, no properties were deemed to be impaired. During the three months ended June 30, 2006, three properties were deemed impaired resulting in impairment charges of $4.7 million. Impairment charges principally arose as a result of an assessment of the planned near-term disposition of two properties and a decrease in expected cash flows from a third property.

**(15) Segment Disclosures**

The Company s business consists of financing and leasing healthcare-related real estate. The Company evaluates its business and makes resource allocations on its two business segments triple-net leased and medical office building segments. Under the triple-net leased segment, the Company invests in healthcare-related real estate through acquisition and secured financing of primarily single tenant properties. Properties acquired are primarily leased under triple-net leases. Under the medical office building segment, the Company invests in medical office buildings that are primarily leased under gross or modified gross leases, generally to multiple tenants, and generally require a greater level of property management. The accounting policies of the segments are the same as those described in the summary of significant accounting policies (see Note 2). There are no intersegment sales or transfers. The Company evaluates performance based upon property net operating income from continuing operations ( NOI ) of the combined properties in each segment.

Non-segment revenue consists mainly of interest on unsecured loans, gains on sales of securities and other income. Non-segment assets consist of corporate assets including cash, restricted cash, accounts receivable, net, debt and equity securities and deferred financing costs. Interest expense, depreciation and amortization, and other non-property specific revenues and expenses are not allocated to individual segments in determining the Company s performance measure.

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

For the three months ended June 30, 2007:

| Segments | Rental and Related Revenues | Income From DFLs | Investment Management Fees | Interest and Other | Total Revenues | NOI(1) |
|---|---|---|---|---|---|---|
| Triple-net leased: | | | | | | |
| Hospital | $ 35,166 | $ | $ | $ 1,625 | $ 36,791 | $ 35,166 |
| Skilled nursing | 10,968 | | | 558 | 11,526 | 10,944 |
| Senior housing | 69,886 | 15,215 | 799 | 564 | 86,464 | 66,920 |
| Other healthcare facilities | 6,639 | | | | 6,639 | 5,157 |
| Total triple-net leased | $ 122,659 | $ 15,215 | $ 799 | $ 2,747 | $ 141,420 | $ 118,187 |
| Medical office building | 81,921 | | 3,421 | | 85,342 | 47,444 |
| Non-segment revenues | | | | 15,985 | 15,985 | |
| Total | $ 204,580 | $ 15,215 | $ 4,220 | $ 18,732 | $ 242,747 | $ 165,631 |

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For the three months ended June 30, 2006:

| Segments | Rental and Related Revenues | Investment Management Fees | Interest and Other | Total Revenues | NOI(1) |
|---|---|---|---|---|---|
| Triple-net leased: | | | | | |
| Hospital | $ 24,887 | $ | $ 1,596 | $ 26,483 | $ 24,887 |
| Skilled nursing | 10,187 | | 567 | 10,754 | 10,182 |
| Senior housing | 27,180 | | 528 | 27,708 | 24,498 |
| Other healthcare | 6,442 | | | 6,442 | 5,089 |
| Total triple-net leased | $ 68,696 | $ | $ 2,691 | $ 71,387 | $ 64,656 |
| Medical office building | 41,198 | 943 | | 42,141 | 26,095 |
| Non-segment revenues | | | 2,704 | 2,704 | |
| Total | $ 109,894 | $ 943 | $ 5,395 | $ 116,232 | $ 90,751 |

For the six months ended June 30, 2007:

| Segments | Rental and Related Revenues | Income From DFLs | Investment Management Fees | Interest and Other | Total Revenues | NOI(1) |
|---|---|---|---|---|---|---|
| Triple-net leased: | | | | | | |
| Hospital | $ 62,579 | $ | $ | $ 3,251 | $ 65,830 | $ 62,449 |
| Skilled nursing | 21,547 | | | 1,118 | 22,665 | 21,497 |
| Senior housing | 138,225 | 30,205 | 6,964 | 1,145 | 176,539 | 130,645 |
| Other healthcare facilities | 14,304 | | | | 14,304 | 11,178 |
| Total triple-net leased | $ 236,655 | $ 30,205 | $ 6,964 | $ 5,514 | $ 279,338 | $ 225,769 |
| Medical office building | 171,291 | | 3,495 | | 174,786 | 100,827 |
| Non-segment revenues | | | | 29,433 | 29,433 | |
| Total | $ 407,946 | $ 30,205 | $ 10,459 | $ 34,947 | $ 483,557 | $ 326,596 |

For the six months ended June 30, 2006:

| Segments | Rental and Related Revenues | Investment Management Fees | Interest and Other | Total Revenues | NOI(1) |
|---|---|---|---|---|---|
| Triple-net leased: | | | | | |
| Hospital | $ 44,397 | $ | $ 3,295 | $ 47,692 | $ 44,397 |
| Skilled nursing | 20,225 | | 1,136 | 21,361 | 20,209 |
| Senior housing | 52,924 | | 1,022 | 53,946 | 47,230 |
| Other healthcare | 12,391 | | | 12,391 | 9,774 |
| Total triple-net leased | $ 129,937 | $ | $ 5,453 | $ 135,390 | $ 121,610 |
| Medical office building | 79,210 | 1,997 | | 81,207 | 50,948 |
| Non-segment revenues | | | 13,631 | 13,631 | |
| Total | $ 209,147 | $ 1,997 | $ 19,084 | $ 230,228 | $ 172,558 |

(1) NOI is a non-GAAP supplemental financial measure used to evaluate the operating performance of real estate properties. The Company defines NOI as rental revenues, including tenant reimbursements, less property-level operating expenses, which exclude depreciation and amortization, general and administrative expenses, impairments, interest expense and discontinued operations. The Company believes NOI provides investors relevant and useful information because it measures the operating performance of the Company s real estate at the property level on an unleveraged basis. The Company uses NOI to make decisions about resource allocations and assess property-level performance. The Company believes that net income is the most directly comparable GAAP measure to NOI. NOI should not be viewed as an alternative measure of operating performance to net income as defined by GAAP since it does not reflect the aforementioned excluded items. Further, NOI may not be comparable to that of other real estate investment trusts, as they may use different methodologies for calculating NOI.

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The following is a reconciliation from NOI to reported net income, a financial measure under GAAP (in thousands):

| | Three Months Ended June 30, 2007 | Three Months Ended June 30, 2006 | Six ,Months Ended June 30, 2007 | Six ,Months Ended June 30, 2006 |
|---|---|---|---|---|
| **Net operating income from continuing operations** | $ 165,631 | $ 90,751 | $ 326,596 | $ 172,558 |
| Income from DFLs | 15,215 | | 30,205 | |
| Investment management fee income | 4,220 | 943 | 10,459 | 1,997 |
| Interest and other income | 18,732 | 5,395 | 34,947 | 19,084 |
| Interest expense | (72,359) | (33,485) | (151,337) | (65,418) |
| Depreciation and amortization | (60,434) | (26,975) | (121,328) | (52,469) |
| General and administrative | (18,292) | (8,396) | (38,884) | (16,868) |
| Equity income from unconsolidated joint ventures | 1,302 | 2,714 | 2,516 | 6,536 |
| Gains on sale of real estate interest, net | 10,141 | | 10,141 | |
| Minority interests share of earnings | (6,739) | (4,170) | (11,974) | (7,947) |
| Total discontinued operations | 13,867 | 14,790 | 125,231 | 41,982 |
| **Net income** | $ 71,284 | $ 41,567 | $ 216,572 | $ 99,455 |

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

| Segments | June 30, 2007 | December 31, 2006 |
|---|---|---|
| Triple-net leased facilities: | | |
| Senior housing facilities | $ 4,359,987 | $ 5,919,517 |
| Hospitals | 1,120,776 | 951,548 |
| Skilled nursing facilities | 324,918 | 336,494 |
| Other healthcare facilities | 224,705 | 264,298 |
| Total triple-net leased assets | $ 6,030,386 | $ 7,471,857 |
| Medical office building facilities | 2,185,784 | 2,438,607 |