

HCP, INC.  
Form 10-Q  
November 02, 2010  
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**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 September 30, 2010.

OR

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

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

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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  NO

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

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

Large Accelerated Filer

Accelerated Filer

Non-accelerated Filer

Smaller Reporting Company

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(Do not check if a smaller reporting company)

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

**As of October 28, 2010, there were 310,532,601 shares of the registrant s \$1.00 par value common stock outstanding.**

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**HCP, INC.**

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## HCP, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

|  | September 30,<br>2010<br>(Unaudited) | December 31,<br>2009 |
|--|--------------------------------------|----------------------|
| <b>ASSETS</b>  |                                      |                      |
| Real estate:   |                                      |                      |
| Buildings and improvements   | \$ 8,117,148                         | \$ 7,774,052         |
| Development costs and construction in progress   | 143,072                              | 272,542              |
| Land   | 1,558,947                            | 1,542,393            |
| Accumulated depreciation and amortization  | (1,189,998)                          | (1,036,295)          |
| Net real estate  | 8,629,169                            | 8,552,692            |
| Net investment in direct financing leases  | 607,392                              | 600,077              |
| Loans receivable, net  | 1,852,521                            | 1,672,938            |
| Investments in and advances to unconsolidated joint ventures   | 197,697                              | 267,978              |
| Accounts receivable, net of allowance of \$4,663 and \$10,772, respectively  | 38,414                               | 43,726               |
| Cash and cash equivalents  | 52,635                               | 112,259              |
| Restricted cash  | 34,223                               | 33,000               |
| Intangible assets, net   | 325,859                              | 389,698              |
| Real estate held for sale, net   | 12,554                               | 32,653               |
| Other assets, net  | 494,835                              | 504,714              |
| Total assets(1)  | \$ 12,245,299                        | \$ 12,209,735        |
| <b>LIABILITIES AND EQUITY</b>  |                                      |                      |
| Bank line of credit  | \$ 318,000                           | \$                   |
| Term loan  |                                      | 200,000              |
| Senior unsecured notes   | 3,324,975                            | 3,521,325            |
| Mortgage and other secured debt  | 1,682,740                            | 1,834,935            |
| Other debt   | 93,990                               | 99,883               |
| Intangible liabilities, net  | 153,522                              | 200,260              |
| Accounts payable and accrued liabilities   | 338,806                              | 309,596              |
| Deferred revenue   | 79,482                               | 85,127               |
| Total liabilities(2)   | 5,991,515                            | 6,251,126            |
| Commitments and contingencies  |                                      |                      |
| Preferred stock, \$1.00 par value: 50,000,000 shares authorized; 11,820,000 shares issued and outstanding, liquidation preference of \$25.00 per share | 285,173                              | 285,173              |
| Common stock, \$1.00 par value: 750,000,000 shares authorized; 310,507,413 and 293,548,162 shares issued and outstanding, respectively                 | 310,507                              | 293,548              |
| Additional paid-in capital   | 6,237,663                            | 5,719,400            |
| Cumulative dividends in excess of earnings   | (761,036)                            | (515,450)            |
| Accumulated other comprehensive loss   | (7,426)                              | (2,134)              |
| Total stockholders' equity   | 6,064,881                            | 5,780,537            |
| Joint venture partners   | 14,095                               | 7,529                |
| Non-managing member unitholders  | 174,808                              | 170,543              |
| Total noncontrolling interests   | 188,903                              | 178,072              |
| Total equity   | 6,253,784                            | 5,958,609            |
| Total liabilities and equity   | \$ 12,245,299                        | \$ 12,209,735        |

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(1) The Company's condensed consolidated total assets at September 30, 2010, include assets of certain variable interest entities ( VIEs ) that can only be used to settle the liabilities of those VIEs as follows: accounts receivable, net, \$7.5 million; cash and cash equivalents, \$22.7 million; and other assets, net, \$0.5 million. See Note 17 for additional details.

(2) The Company's condensed consolidated total liabilities at September 30, 2010, include liabilities of certain VIEs for which the VIE creditors do not have recourse to HCP, Inc. as follows: accounts payable and accrued liabilities, \$27.3 million; and deferred revenue, \$0.7 million. See Note 17 for additional details.

See accompanying Notes to Condensed Consolidated Financial Statements.

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## HCP, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)

(Unaudited)

|   | Three Months Ended September 30, |             | Nine Months Ended September 30, |            |
|---|----------------------------------|-------------|---------------------------------|------------|
|   | 2010                             | 2009        | 2010                            | 2009       |
| <b>Revenues:</b>  |                                  |             |                                 |            |
| Rental and related revenues   | \$ 243,026                       | \$ 216,169  | \$ 697,802                      | \$ 656,384 |
| Tenant recoveries   | 23,356                           | 22,464      | 67,262                          | 67,124     |
| Income from direct financing leases   | 13,028                           | 13,173      | 37,238                          | 39,302     |
| Interest income   | 36,582                           | 33,936      | 108,004                         | 87,791     |
| Investment management fee income  | 1,157                            | 1,326       | 3,755                           | 4,133      |
| Total revenues  | 317,149                          | 287,068     | 914,061                         | 854,734    |
| <b>Costs and expenses:</b>  |                                  |             |                                 |            |
| Depreciation and amortization   | 78,334                           | 81,177      | 234,008                         | 240,308    |
| Interest expense  | 71,600                           | 74,039      | 220,303                         | 226,053    |
| Operating   | 60,461                           | 46,159      | 152,028                         | 139,767    |
| General and administrative  | 19,590                           | 22,856      | 65,039                          | 61,619     |
| Litigation provision  |                                  | 101,973     |                                 | 101,973    |
| Impairments (recoveries)  |                                  | 15,123      | (11,900)                        | 20,904     |
| Total costs and expenses  | 229,985                          | 341,327     | 659,478                         | 790,624    |
| Other income, net   | 6,657                            | 5,983       | 7,151                           | 5,107      |
| <b>Income (loss) before income taxes and equity income from and impairments of investments in unconsolidated joint ventures</b> |                                  |             |                                 |            |
|   | 93,821                           | (48,276)    | 261,734                         | 69,217     |
| Income taxes  | (867)                            | 325         | (1,809)                         | (1,395)    |
| Equity income from unconsolidated joint ventures  | 209                              | 1,328       | 4,078                           | 1,993      |
| Impairments of investments in unconsolidated joint ventures   | (71,693)                         |             | (71,693)                        |            |
| <b>Income (loss) from continuing operations</b>   | 21,470                           | (46,623)    | 192,310                         | 69,815     |
| <b>Discontinued operations:</b>   |                                  |             |                                 |            |
| Income before impairments and gain on sales of real estate, net of income taxes   | 716                              | 943         | 2,507                           | 6,620      |
| Impairments   |                                  |             |                                 | (125)      |
| Gain on sales of real estate, net of income taxes   | 3,987                            | 2,460       | 4,052                           | 34,357     |
| Total discontinued operations   | 4,703                            | 3,403       | 6,559                           | 40,852     |
| <b>Net income (loss)</b>  | 26,173                           | (43,220)    | 198,869                         | 110,667    |
| Noncontrolling interests share in earnings  | (3,518)                          | (3,466)     | (10,077)                        | (11,011)   |
| <b>Net income (loss) attributable to HCP, Inc.</b>  | 22,655                           | (46,686)    | 188,792                         | 99,656     |
| Preferred stock dividends   | (5,282)                          | (5,282)     | (15,848)                        | (15,848)   |
| Participating securities share in earnings  | (378)                            | (429)       | (1,648)                         | (1,136)    |
| <b>Net income (loss) applicable to common shares</b>  | \$ 16,995                        | \$ (52,397) | \$ 171,296                      | \$ 82,672  |

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|   |    |         |    |         |    |         |    |         |
|---|----|---------|----|---------|----|---------|----|---------|
| <b>Basic earnings (loss) per common share:</b>                              |    |         |    |         |    |         |    |         |
| Continuing operations   | \$ | 0.04    | \$ | (0.20)  | \$ | 0.55    | \$ | 0.16    |
| Discontinued operations   |    | 0.01    |    | 0.02    |    | 0.02    |    | 0.15    |
| Net income (loss) applicable to common shares                               | \$ | 0.05    | \$ | (0.18)  | \$ | 0.57    | \$ | 0.31    |
| <b>Diluted earnings (loss) per common share:</b>                            |    |         |    |         |    |         |    |         |
| Continuing operations   | \$ | 0.04    | \$ | (0.20)  | \$ | 0.55    | \$ | 0.16    |
| Discontinued operations   |    | 0.01    |    | 0.02    |    | 0.02    |    | 0.15    |
| Net income (loss) applicable to common shares                               | \$ | 0.05    | \$ | (0.18)  | \$ | 0.57    | \$ | 0.31    |
| <b>Weighted-average shares used to calculate earnings per common share:</b> |    |         |    |         |    |         |    |         |
| Basic   |    | 309,448 |    | 284,812 |    | 299,243 |    | 267,971 |
| Diluted   |    | 311,092 |    | 284,812 |    | 300,468 |    | 268,041 |
| <b>Dividends declared per common share</b>                                  | \$ | 0.465   | \$ | 0.46    | \$ | 1.395   | \$ | 1.38    |

See accompanying Notes to Condensed Consolidated Financial Statements.



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## HCP, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF EQUITY

(In thousands)

(Unaudited)

|  | Preferred Stock |            | Common Stock |            | Additional   | Cumulative   | Accumulated   | Total         | Total          | Total        |
|--|-----------------|------------|--------------|------------|--------------|--------------|---------------|---------------|----------------|--------------|
|  | Shares          | Amount     | Shares       | Amount     | Paid-In      | Dividends    | Other         | Stockholders' | Noncontrolling | Equity       |
|  |                 |            |              |            | Capital      | In Excess    | Comprehensive | Equity        | Interests      | Equity       |
|  |                 |            |              |            |              | Of Earnings  | Income (Loss) |               |                |              |
| <b>January 1, 2010</b>                                       | 11,820          | \$ 285,173 | 293,548      | \$ 293,548 | \$ 5,719,400 | \$ (515,450) | \$ (2,134)    | \$ 5,780,537  | \$ 178,072     | \$ 5,958,609 |
| Comprehensive income:  |                 |            |              |            |              |              |               |               |                |              |
| Net income   |                 |            |              |            |              | 188,792      |               | 188,792       | 10,077         | 198,869      |
| Change in net unrealized gains (losses) on securities:       |                 |            |              |            |              |              |               |               |                |              |
| Unrealized gains   |                 |            |              |            |              |              | 936           | 936           |                | 936          |
| Less reclassification adjustment realized in net income      |                 |            |              |            |              |              | (4,680)       | (4,680)       |                | (4,680)      |
| Change in net unrealized gains (losses) on cash flow hedges: |                 |            |              |            |              |              |               |               |                |              |
| Unrealized losses  |                 |            |              |            |              |              | (2,368)       | (2,368)       |                | (2,368)      |
| Less reclassification adjustment realized in net income      |                 |            |              |            |              |              | 630           | 630           |                | 630          |
| Change in Supplemental Executive Retirement Plan obligation  |                 |            |              |            |              |              | 97            | 97            |                | 97           |
| Foreign currency translation adjustment                      |                 |            |              |            |              |              | 93            | 93            |                | 93           |
| Total comprehensive income                                   |                 |            |              |            |              |              |               | 183,500       | 10,077         | 193,577      |
| Issuance of common stock, net                                |                 |            | 16,958       | 16,958     | 507,698      |              |               | 524,656       | (5,072)        | 519,584      |
| Repurchase of common stock                                   |                 |            | (149)        | (149)      | (4,152)      |              |               | (4,301)       |                | (4,301)      |
| Exercise of stock options                                    |                 |            | 150          | 150        | 3,411        |              |               | 3,561         |                | 3,561        |
| Amortization of deferred compensation                        |                 |            |              |            | 11,306       |              |               | 11,306        |                | 11,306       |
| Preferred dividends  |                 |            |              |            |              | (15,848)     |               | (15,848)      |                | (15,848)     |
| Common dividends (\$1.395 per share)                         |                 |            |              |            |              | (418,530)    |               | (418,530)     |                | (418,530)    |
| Distributions to noncontrolling interests                    |                 |            |              |            |              |              |               |               | (12,545)       | (12,545)     |
| Noncontrolling interest in acquired assets                   |                 |            |              |            |              |              |               |               | 9,267          | 9,267        |
| Sale of noncontrolling interests                             |                 |            |              |            |              |              |               |               | 8,395          | 8,395        |
| Other  |                 |            |              |            |              |              |               |               | 709            | 709          |

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September 30, 2010 11,820 \$ 285,173 310,507 \$ 310,507 \$ 6,237,663 \$ (761,036)\$ (7,426)\$ 6,064,881 \$ 188,903 \$ 6,253,784

See accompanying Notes to Condensed Consolidated Financial Statements.

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## HCP, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF EQUITY (Continued)

(In thousands)

(Unaudited)

|  | Preferred Stock |            | Common Stock |            | Additional<br>Paid-In<br>Capital | Cumulative Accumulated                |   | Total<br>Stockholder<br>Equity | Total<br>Noncontrolling<br>Interests | Total<br>Equity |
|--|-----------------|------------|--------------|------------|----------------------------------|---------------------------------------|---|--------------------------------|--------------------------------------|-----------------|
|  | Shares          | Amount     | Shares       | Amount     |                                  | Dividends<br>In Excess<br>Of Earnings | Other<br>Comprehensive<br>Income (Loss) |                                |                                      |                 |
| <b>January 1, 2009</b>                                       | 11,820          | \$ 285,173 | 253,601      | \$ 253,601 | \$ 4,873,727                     | \$ (130,068)                          | \$ (81,162)                             | \$ 5,201,271                   | \$ 206,569                           | \$ 5,407,840    |
| Comprehensive income:  |                 |            |              |            |                                  |                                       |   |                                |                                      |                 |
| Net income   |                 |            |              |            |                                  | 99,656                                |   | 99,656                         | 11,011                               | 110,667         |
| Change in net unrealized gains (losses) on securities:       |                 |            |              |            |                                  |                                       |   |                                |                                      |                 |
| Unrealized gains   |                 |            |              |            |                                  |                                       | 75,180                                  | 75,180                         |                                      | 75,180          |
| Less reclassification adjustment realized in net income      |                 |            |              |            |                                  |                                       | (2,797)                                 | (2,797)                        |                                      | (2,797)         |
| Change in net unrealized gains (losses) on cash flow hedges: |                 |            |              |            |                                  |                                       |   |                                |                                      |                 |
| Unrealized losses  |                 |            |              |            |                                  |                                       | (910)                                   | (910)                          |                                      | (910)           |
| Less reclassification adjustment realized in net income      |                 |            |              |            |                                  |                                       | 685                                     | 685                            |                                      | 685             |
| Change in Supplemental Executive Retirement Plan obligation  |                 |            |              |            |                                  |                                       | 66                                      | 66                             |                                      | 66              |
| Foreign currency translation adjustment                      |                 |            |              |            |                                  |                                       | (900)                                   | (900)                          |                                      | (900)           |
| Total comprehensive income                                   |                 |            |              |            |                                  |                                       |   | 170,980                        | 11,011                               | 181,991         |
| Issuance of common stock, net                                |                 |            | 39,639       | 39,639     | 830,617                          |                                       |   | 870,256                        | (21,873)                             | 848,383         |
| Repurchase of common stock                                   |                 |            | (95)         | (95)       | (2,153)                          |                                       |   | (2,248)                        |                                      | (2,248)         |
| Amortization of deferred compensation                        |                 |            |              |            | 11,068                           |                                       |   | 11,068                         |                                      | 11,068          |
| Preferred dividends  |                 |            |              |            |                                  | (15,849)                              |   | (15,849)                       |                                      | (15,849)        |
| Common dividends (\$1.38 per share)                          |                 |            |              |            |                                  | (360,949)                             |   | (360,949)                      |                                      | (360,949)       |
| Distributions to noncontrolling interests                    |                 |            |              |            |                                  |                                       |   |                                | (11,662)                             | (11,662)        |
| Purchase of noncontrolling interests                         |                 |            |              |            | (4,725)                          |                                       |   | (4,725)                        | (4,372)                              | (9,097)         |
| <b>September 30, 2009</b>                                    | 11,820          | \$ 285,173 | 293,145      | \$ 293,145 | \$ 5,708,534                     | \$ (407,210)                          | \$ (9,838)                              | \$ 5,869,804                   | \$ 179,673                           | \$ 6,049,477    |

See accompanying Notes to Condensed Consolidated Financial Statements.



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## HCP, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)  
(Unaudited)

|   | Nine Months Ended September 30, |            |
|---|---------------------------------|------------|
|   | 2010                            | 2009       |
| <b>Cash flows from operating activities:</b>  |                                 |            |
| Net income  | \$ 198,869                      | \$ 110,667 |
| 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   | 234,008                         | 240,308    |
| Discontinued operations   | 1,382                           | 2,276      |
| Amortization of above and below market lease intangibles, net                       | (5,337)                         | (12,657)   |
| Stock-based compensation  | 11,306                          | 11,068     |
| Amortization of debt premiums, discounts and issuance costs, net                    | 7,238                           | 6,187      |
| Straight-line rents   | (32,869)                        | (38,751)   |
| Interest accretion  | (46,997)                        | (23,813)   |
| Deferred rental revenue   | (2,245)                         | 10,507     |
| Equity income from unconsolidated joint ventures                                    | (4,078)                         | (1,993)    |
| Distributions of earnings from unconsolidated joint ventures                        | 5,441                           | 5,444      |
| Gain on sales of real estate  | (4,052)                         | (34,357)   |
| Marketable securities gains, net  | (5,642)                         | (6,420)    |
| Derivative losses, net  | 470                             | 922        |
| Impairments, net of recoveries  | 59,793                          | 21,029     |
| Changes in:   |                                 |            |
| Accounts receivable   | 1,987                           | 11,310     |
| Other assets  | 1,181                           | (2,991)    |
| Accrued liability for litigation provision  |                                 | 101,973    |
| Accounts payable and other accrued liabilities                                      | 10,273                          | (10,989)   |
| Net cash provided by operating activities   | 430,728                         | 389,720    |
| <b>Cash flows from investing activities:</b>  |                                 |            |
| Acquisitions and development of real estate   | (228,297)                       | (71,009)   |
| Leasing costs and tenant and capital improvements                                   | (65,183)                        | (27,321)   |
| Proceeds from sales of real estate, net   | 1,963                           | 58,046     |
| Contributions to unconsolidated joint ventures                                      | (6,445)                         | (48)       |
| Distributions in excess of earnings from unconsolidated joint ventures              | 2,469                           | 5,775      |
| Proceeds from the sale of securities  | 72,749                          | 119,665    |
| Principal repayments on loans receivable and direct financing leases                | 28,494                          | 8,654      |
| Investments in loans receivable   | (131,492)                       | (165,506)  |
| (Increase) decrease in restricted cash  | (1,223)                         | 3,090      |
| Net cash used in investing activities   | (326,965)                       | (68,654)   |
| <b>Cash flows from financing activities:</b>  |                                 |            |
| Net borrowings (repayments) under bank line of credit                               | 318,000                         | (150,000)  |
| Repayments of bridge and term loans   | (200,000)                       | (320,000)  |
| Repayments of mortgage debt   | (162,623)                       | (206,329)  |
| Issuance of mortgage debt   |                                 | 1,942      |
| Repurchase and repayment of senior unsecured notes                                  | (200,000)                       | (7,735)    |
| Debt issuance costs   |                                 | (718)      |
| Net proceeds from the issuance of common stock and exercise of options              | 518,844                         | 846,135    |
| Dividends paid on common and preferred stock  | (434,378)                       | (376,798)  |
| Sale (purchase) of noncontrolling interest  | 8,395                           | (9,097)    |

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|  |           |            |
|--|-----------|------------|
| Distributions to noncontrolling interests            | (11,625)  | (11,662)   |
| Net cash used in financing activities                | (163,387) | (234,262)  |
| Net increase (decrease) in cash and cash equivalents | (59,624)  | 86,804     |
| Cash and cash equivalents, beginning of period       | 112,259   | 57,562     |
| Cash and cash equivalents, end of period             | \$ 52,635 | \$ 144,366 |

See accompanying Notes to Condensed Consolidated Financial Statements.

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**HCP, INC.**

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**(1) Business**

HCP, Inc., an S&P 500 company, together with its consolidated entities (collectively, HCP or the Company), invests primarily in real estate serving the healthcare industry in the United States ( U.S. ). The Company is a self-administered, Maryland real estate investment trust ( REIT ) organized in 1985. The Company is headquartered in Long Beach, California, with offices in Nashville, Tennessee and San Francisco, California. The Company acquires, develops, leases, manages and disposes of healthcare real estate, and provides financing to healthcare providers. The Company's portfolio is comprised of investments in the following five healthcare segments: (i) senior housing, (ii) life science, (iii) medical office, (iv) skilled nursing and (v) hospital. The Company makes investments within its healthcare segments using the following five investment products: (i) properties under lease, (ii) debt investments, (iii) developments and redevelopments, (iv) investment management and (v) DownREITs.

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

*Basis of Presentation*

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

The condensed consolidated financial statements include the accounts of HCP, its wholly-owned subsidiaries and joint ventures or VIEs that it controls through voting rights or other means. All material intercompany transactions and balances have been eliminated upon consolidation. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) necessary to present fairly the Company's financial position, results of operations and cash flows have been included. Operating results for the three and nine months ended September 30, 2010 are not necessarily indicative of the results that may be expected for the year ending December 31, 2010. The accompanying unaudited interim financial information should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2009 included in the Company's Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission ( SEC ).

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

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Note 4). All prior period interest income and interest expense have been reclassified to be presented as components of revenues and costs and expenses, respectively, from other income, net on the condensed consolidated income statements as a result of a significant increase in the Company's lending operations.

### *Accounting Change*

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

### *Recent Accounting Pronouncements*

In January 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements*. The amendments in this update require, among other things, new disclosures and clarifications of existing disclosures related to transfers in and out of Level 1 and Level 2 fair value measurements, further disaggregation of fair value measurement disclosures for each class of assets and liabilities, and additional details of valuation techniques and inputs utilized. This update is consistent with the Company's current accounting application for fair value measurements and disclosures and did not have a material impact on its consolidated financial position or results of operations.



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In July 2010, the FASB issued Accounting Standards Update No. 2010-20, *Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses* (ASC 2010-20). The amendments in this update require additional disclosure about the credit quality of financing receivables, such as aging information and credit quality indicators. Both new and existing disclosures must be disaggregated by portfolio segment or class. The disaggregation of information is based on how allowances for credit losses are developed and how credit exposure is managed. ASC 2010-20 is effective for interim periods and fiscal years ending after December 15, 2010. The Company does not expect the adoption of ASC 2010-20 on December 31, 2010 to have an impact on its consolidated financial position or results of operations.

**(3) Real Estate Property Investments**

A summary of acquisitions for the nine months ended September 30, 2010 follows (in thousands):

| Acquisitions              | Cash Paid  | Consideration |                   | Assets Acquired |                 |          |
|---------------------------|------------|---------------|-------------------|-----------------|-----------------|----------|
|                           |            | Debt Assumed  | DownREIT Units(1) | Real Estate     | Net Intangibles |          |
| Senior housing facilities | \$ 124,935 | \$            | \$                | \$              | \$ 124,565      | \$ 370   |
| Medical office buildings  | 12,017     | 5,352         | 1,926             | 15,734          |                 | 3,561    |
| Life science facilities   | 21,843     |               | 7,341             | 23,998          |                 | 5,186    |
|                           | \$ 158,795 | \$ 5,352      | \$ 9,267          | \$ 164,297      |                 | \$ 9,117 |

(1) Non-managing member limited liability company units.

During the nine months ended September 30, 2010, the Company funded an aggregate of \$97 million for construction, tenant and other capital improvement projects, primarily in its life science segment. During the nine months ended September 30, 2010, four of the Company's life science facilities located in South San Francisco were placed into service representing 354,000 square feet.

During the nine months ended September 30, 2009, the Company purchased the remaining noncontrolling interests in three senior housing joint ventures for \$14 million and funded an aggregate of \$86 million for construction, tenant and other capital improvement projects, primarily in its life science segment.

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

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During the three months ended September 30, 2010 and 2009, the Company sold three skilled nursing facilities for \$10 million and two medical office buildings ( MOBs ) for \$6 million, respectively.

During the nine months ended September 30, 2010, the Company sold four properties for \$25.5 million, which were from the following segments: (i) \$15 million hospital; (ii) \$10 million skilled nursing; and (iii) \$0.5 million medical office. During the nine months ended September 30, 2009, the Company sold 11 properties for \$58 million, which were from the following segments: (i) \$47.2 million hospital; (ii) \$10.3 million medical office; and (iii) \$0.6 million senior housing.

### *Results from Discontinued Operations*

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

|   | Three Months Ended September 30, |          | Nine Months Ended September 30, |           |
|---|----------------------------------|----------|---------------------------------|-----------|
|   | 2010                             | 2009     | 2010                            | 2009      |
| Rental and related revenues   | \$ 870                           | \$ 2,347 | \$ 3,776                        | \$ 9,496  |
| Depreciation and amortization expenses  | 173                              | 1,180    | 1,382                           | 2,276     |
| Operating expenses  | 20                               | 239      | 25                              | 662       |
| Other income, net   | (39)                             | (15)     | (138)                           | (62)      |
| Income before impairments and gain on sales of real estate, net of income taxes | \$ 716                           | \$ 943   | \$ 2,507                        | \$ 6,620  |
| Impairments   | \$                               | \$       | \$                              | \$ 125    |
| Gain on sales of real estate, net of income taxes                               | \$ 3,987                         | \$ 2,460 | \$ 4,052                        | \$ 34,357 |
| Number of properties held for sale  | 9                                | 16       | 9                               | 16        |
| Number of properties sold   | 3                                | 2        | 4                               | 11        |
| Number of properties included in discontinued operations                        | 12                               | 18       | 13                              | 27        |

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

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

|   | September 30,<br>2010 | December 31,<br>2009 |
|---|-----------------------|----------------------|
| Minimum lease payments receivable             | \$ 1,258,119          | \$ 1,338,634         |
| Estimated residual values                     | 409,270               | 467,248              |
| Allowance for DFL losses                      |                       | (54,957)             |
| Less unearned income                          | (1,059,997)           | (1,150,848)          |
| Net investment in direct financing leases     | \$ 607,392            | \$ 600,077           |
| Properties subject to direct financing leases | 27                    | 30                   |

Lease payments previously due to the Company relating to three land-only DFLs, along with the land, were subordinate to and served as collateral for first mortgage construction loans entered into by Erickson Retirement Communities and its affiliate entities ( Erickson ) to fund development costs related to the properties. On October 19, 2009, Erickson filed for bankruptcy protection, which included a plan of reorganization.

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

In February 2010, the Company entered into a settlement agreement with Erickson which was subsequently approved by the bankruptcy court. In April 2010, the reorganization was completed, which resulted in the Company (i) retaining deposits held by the Company with balances of \$5 million and (ii) receiving an additional \$9.6 million. As a result, during the three months ended March 31, 2010, the Company recognized aggregate income of \$11.9 million in impairment recoveries, which represented the reversal of a portion of the allowances established pursuant to the previous impairment charges related to its investments in the three DFLs and participation interest in the senior construction loan. This amount is shown as impairments (recoveries) in the condensed consolidated statement of income.

**(6) Loans Receivable**

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

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|                                       | September 30, 2010  |               |              | December 31, 2009   |               |              |
|---------------------------------------|---------------------|---------------|--------------|---------------------|---------------|--------------|
|                                       | Real Estate Secured | Other Secured | Total        | Real Estate Secured | Other Secured | Total        |
| Mezzanine                             | \$                  | \$ 1,143,330  | \$ 1,143,330 | \$                  | \$ 1,083,197  | \$ 1,083,197 |
| Other                                 | 880,834             |               | 880,834      | 783,798             |               | 783,798      |
| Unamortized discounts, fees and costs | (100,528)           | (67,460)      | (167,988)    | (115,422)           | (66,196)      | (181,618)    |
| Allowance for loan losses             |                     | (3,655)       | (3,655)      | (8,148)             | (4,291)       | (12,439)     |
|                                       | \$ 780,306          | \$ 1,072,215  | \$ 1,852,521 | \$ 660,228          | \$ 1,012,710  | \$ 1,672,938 |

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The Company holds an interest-only, senior secured term loan made to an affiliate of the Cirrus Group, LLC ( Cirrus ). The loan had a maturity date of December 31, 2008, with a one-year extension period at the option of the borrower, subject to certain terms and conditions, under which amounts were borrowed to finance the acquisition, development, syndication and operation of new and existing surgical partnerships. The loan is collateralized by all of the assets of the borrower (comprised primarily of interests in partnerships operating surgical facilities, some of which are on the premises of properties owned by the Company or HCP Ventures IV, LLC, an unconsolidated joint venture of the Company) and is supported in part by limited guarantees made by certain principals of Cirrus. Recourse under certain of these guarantees is limited to the guarantors' respective interests in certain entities owning real estate that are pledged to secure such guarantees. At December 31, 2008, the borrower did not meet the conditions necessary to exercise its extension option and did not repay the loan upon maturity. On April 22, 2009, new terms for extending the maturity date of the loan were agreed to, including the payment of a \$1.1 million extension fee, and the maturity date was extended to December 31, 2010. In July 2009, the Company issued a notice of default for the borrower's failure to make interest payments. In December 2009, the Company determined that the loan was impaired and recognized a provision for loan loss of \$4.3 million. This provision for loan loss resulted from discussions that began in December 2009 to restructure the loan. The proposed terms of the restructure (effective February 1, 2010) bifurcates the loan into two tranches and modifies the related terms as follows: (i) tranche A is \$39 million and accrues interest at a rate of 14%, of which 9.5% is payable quarterly and 4.5% is deferred until maturity in January 2012; and (ii) tranche B is \$52 million and accrues interest at a rate of 8.5% (previously 14%); Cirrus may defer its interest payments on this tranche to the maturity of the loan in July 2012 to the extent that it does not generate excess cash flows from the related operations. During the three months ended June 30, 2010, Cirrus informed the Company that it continues to market for sale certain assets included in its collateral pool; Cirrus expects the sales to be completed during the remaining period of 2010 or early 2011. Assuming that Cirrus is successful in selling these assets, the Company estimates a partial repayment of its loan to Cirrus of up to \$80 million. At September 30, 2010 and December 31, 2009, the carrying value of this loan, including accrued interest of \$7.0 million and \$5.2 million, respectively, was \$90.8 million and \$83.5 million, respectively. During the three and nine months ended September 30, 2010, the Company recognized interest income from this loan of \$2.9 million and \$8.6 million, respectively, and received cash payments from the borrower of \$0.2 million and \$1.1 million, respectively.

On December 21, 2007, the Company made an investment in mezzanine loans having an aggregate par value of \$1.0 billion at a discount of \$100 million, which resulted in an acquisition cost of \$900 million, as part of the financing for The Carlyle Group's \$6.3 billion purchase of Manor Care, Inc. These interest-only loans mature in January 2013 and bear interest on their par values at a floating rate of one-month London Interbank Offered Rate ( LIBOR ) plus 4.0%. These loans are mandatorily pre-payable in January 2012 unless the borrower satisfies certain performance conditions. Among other things, these performance conditions require the borrower to: (i) maintain an interest-rate cap agreement(s) with a strike price of 5.25% at an equivalent maturity to that of the underlying loans; and (ii) maintain a trailing-twelve-month Debt Service Coverage Ratio, as defined in the respective agreement, of no less than 1.45 times. At closing, the loans were secured by an indirect pledge of equity ownership in 339 HCR ManorCare facilities located in 30 states and were subordinate to other debt of approximately \$3.6 billion. At September 30, 2010 and December 31, 2009, the carrying value of these loans was \$948 million and \$934 million, respectively.

On August 3, 2009, the Company purchased a \$720 million participation in the first mortgage debt of HCR ManorCare at a discount of \$130 million, which resulted in an acquisition cost of \$590 million. The \$720 million participation bears interest at LIBOR plus 1.25% and represents 45% of the \$1.6 billion most senior tranche of HCR ManorCare's mortgage debt incurred as part of the above mentioned financing for The Carlyle Group's acquisition of Manor Care, Inc. in December 2007. The mortgage debt matures in January 2013, if the borrower exercises a one-year extension option and meets certain performance conditions, which are similar to those described above. The mortgage debt was secured by a first lien on 331 facilities located in 30 states at closing. At September 30, 2010 and December 31, 2009, the carrying value of the participation in this loan was \$630 million and \$604 million, respectively.

In September 2010 the Company purchased participations in a senior loan and mezzanine note of Genesis Healthcare ( Genesis ) with face amounts of \$92.5 million and \$50.0 million, respectively, each at a discount for \$83.3 million and \$40.0 million, respectively. On October 8, 2010, the Company purchased an additional participation in Genesis' senior loan with a face amount of \$185 million, at a discount for \$167 million. These investments represent a portion of the \$1.67 billion of debt incurred in connection with the \$2.0 billion acquisition of Genesis in July 2007.

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The Genesis senior loan bears interest on the face amount at LIBOR (subject to a current floor of 1.5% increasing to 2.5% by maturity) plus a spread of 4.75% increasing to 5.75% by maturity. The senior loan is prepayable anytime without penalty, matures in September 2014 and is secured by all of Genesis' assets. The mezzanine note bears interest on the face amount at LIBOR plus a spread of 7.50% and matures in September 2014. In addition to the coupon interest payments, the mezzanine note requires payment of a termination fee, of which the Company's share is currently \$2 million, increasing to a maximum of \$5 million if the debt is repaid in full at maturity. The mezzanine note is subordinate to the senior loan and secured by the indirect pledge of equity ownership in Genesis' assets. At September 30, 2010, the coupon rates on the senior loan and mezzanine note were 6.25% and 7.76%, respectively.

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

The Company owns interests in the following entities which are accounted for under the equity method at September 30, 2010 (dollars in thousands):

| Entity(1)                                      | Properties                       | Investment(2) | Ownership% |
|--|----------------------------------|---------------|------------|
| HCP Ventures II (see Note 14)                  | 25 senior housing                | \$ 65,108     | 35         |
| HCP Ventures III, LLC                          | 13 medical office                | 10,274        | 30         |
| HCP Ventures IV, LLC                           | 54 medical office and 4 hospital | 38,423        | 20         |
| HCP Life Science(3)                            | 4 life science                   | 65,162        | 50-63      |
| Horizon Bay Hyde Park, LLC                     | 1 senior housing development     | 8,268         | 75         |
| Suburban Properties, LLC                       | 1 medical office                 | 8,984         | 67         |
| Advances to unconsolidated joint ventures, net |                                  | 1,478         |            |
|  |                                  | \$ 197,697    |            |
| Edgewood Assisted Living Center, LLC(4)        | 1 senior housing                 | \$ (331)      | 45         |
| Seminole Shores Living Center, LLC(4)          | 1 senior housing                 | (922)         | 50         |
|  |                                  | \$ 196,444    |            |

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

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

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

(4) As of September 30, 2010, the Company has guaranteed in the aggregate \$4 million of a total of \$8 million of mortgage debt for these joint ventures. No amounts have been recorded related to these guarantees at September 30, 2010. Negative investment amounts are included in accounts payable and accrued liabilities in the Company's condensed consolidated financial statements.

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

|                         | September 30,<br>2010 | December 31,<br>2009 |
|-------------------------|-----------------------|----------------------|
| Real estate, net        | \$ 1,637,197          | \$ 1,655,754         |
| Other assets, net       | 141,315               | 189,841              |
| Total assets            | \$ 1,778,512          | \$ 1,845,595         |
| Mortgage debt           | \$ 1,147,533          | \$ 1,159,589         |
| Accounts payable        | 41,846                | 38,255               |
| Other partners' capital | 419,296               | 462,243              |

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|   |    |           |    |           |
|---|----|-----------|----|-----------|
| HCP's capital(1)                        |    | 169,837   |    | 185,508   |
| Total liabilities and partners' capital | \$ | 1,778,512 | \$ | 1,845,595 |

(1) The combined basis difference of the Company's investments in these joint ventures of \$25 million, as of September 30, 2010, is primarily attributable to real estate and lease related net intangible assets.

|  | Three Months Ended September 30, |           | Nine Months Ended September 30, |            |
|--|----------------------------------|-----------|---------------------------------|------------|
|  | 2010                             | 2009      | 2010                            | 2009       |
| Total revenues   | \$ 40,733                        | \$ 46,366 | \$ 133,530                      | \$ 138,833 |
| Net income (loss)(1)                                     | (56,387)                         | 2         | (51,992)                        | (1,093)    |
| HCP's share in earnings(1)                               | 209                              | 1,328     | 4,078                           | 1,993      |
| HCP's impairment of its investment in HCP Ventures II(1) | (71,693)                         |           | (71,693)                        |            |
| Fees earned by HCP                                       | 1,157                            | 1,326     | 3,755                           | 4,133      |
| Distributions received by HCP                            | 2,539                            | 4,202     | 7,910                           | 11,219     |

(1) Net income (loss) for the periods ended September 30, 2010, includes an impairment of \$54.5 million related to straight-line rent assets of HCP Ventures II (the Ventures). Concurrently, during the quarter ended September 30, 2010 HCP recognized a \$71.7 million impairment of its investment in the Ventures that was primarily attributable to a reduction in the estimated fair value of the Ventures' real estate assets and includes the Company's share of the impact of the Ventures' impairment of its straight-line rent assets. Therefore, HCP's share in earnings for the periods ended September 30, 2010 do not include the impact of the Ventures' impairment of its straight-line rent assets.



Table of Contents**(8) Intangibles**

At September 30, 2010 and December 31, 2009, intangible lease assets, comprised of lease-up intangibles, above market tenant lease intangibles, below market ground lease intangibles and intangible assets related to non-compete agreements, were \$532.5 million and \$592.1 million, respectively. At September 30, 2010 and December 31, 2009, the accumulated amortization of intangible assets was \$206.6 million and \$202.4 million, respectively.

At September 30, 2010 and December 31, 2009, below market lease and above market ground lease intangible liabilities were \$233.1 million and \$284.2 million, respectively. At September 30, 2010 and December 31, 2009, the accumulated amortization of intangible liabilities was \$79.6 million and \$83.9 million, respectively.

On October 5, 2006, the Company acquired CNL Retirement Properties, Inc. ( CRP ) in a merger and through the purchase method of accounting, allocated \$35 million to above-market lease intangibles to 15 senior housing facilities that were operated by Sunrise Senior Living, Inc. In June 2009, in a subsequent review of the relative fair value calculations for these lease intangibles, the Company noted valuation errors, which resulted in an aggregate overstatement of above-market lease intangible assets and an understatement of building and improvements of \$28 million. In the periods from October 5, 2006 through March 31, 2009, these errors resulted in an understatement of rental and related revenues and depreciation expense of approximately \$6 million and \$2 million, respectively. The Company recorded the related corrections in the three months ended June 30, 2009, and determined that such misstatements to the Company's results of operations and financial position during the periods from October 5, 2006 through June 30, 2009, were immaterial.

**(9) Other Assets**

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

|  | September 30,<br>2010 | December 31,<br>2009 |
|--|-----------------------|----------------------|
| Marketable debt securities   | \$ 101,390            | \$ 172,799           |
| Marketable equity securities   | 4,231                 | 3,521                |
| Straight-line rent assets, net of allowance of \$34,159 and \$48,681, respectively | 192,245               | 158,674              |
| Leasing costs, net   | 82,240                | 41,933               |
| Deferred debt issuance costs, net  | 13,595                | 18,607               |
| Goodwill   | 50,346                | 50,346               |
| Other  | 50,788                | 58,834               |
| Total other assets   | \$ 494,835            | \$ 504,714           |

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

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|                            | Cost Basis(1) | Fair Value | Gains     | Gross Unrealized Losses |
|----------------------------|---------------|------------|-----------|-------------------------|
| <b>September 30, 2010:</b> |               |            |           |                         |
| Debt securities            | \$ 93,930     | \$ 101,390 | \$ 7,460  | \$                      |
| Equity securities          | 3,630         | 4,231      | 645       | (44)                    |
| Total investments          | \$ 97,560     | \$ 105,621 | \$ 8,105  | \$ (44)                 |
| <b>December 31, 2009:</b>  |               |            |           |                         |
| Debt securities            | \$ 160,830    | \$ 172,799 | \$ 11,969 | \$                      |
| Equity securities          | 3,685         | 3,521      | 236       | (400)                   |
| Total investments          | \$ 164,515    | \$ 176,320 | \$ 12,205 | \$ (400)                |

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

At September 30, 2010, \$81 million (par value) of the Company's marketable debt securities accrue interest at 9.625% and mature in November 2016 and \$13 million (par value) accrue interest at 9.25% and mature in May 2017.

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During the three months ended September 30, 2010 and 2009, the Company sold marketable debt securities for \$73 million and \$115 million, respectively, resulting in gains of approximately \$6 million in each period. During the nine months ended September 30, 2010 and 2009, the Company sold marketable debt securities for \$73 million and \$120 million, respectively, resulting in gains of approximately \$6 million and \$7 million, respectively. Realized gains on marketable debt securities are included in other income, net in the condensed consolidated statements of income.

In October 2010, the Company sold its remaining marketable debt securities for \$102 million and recognized gains of \$8 million.

**(10) Debt**

*Bank Line of Credit and Term Loan*

The Company's revolving line of credit facility with a syndicate of banks provides for an aggregate borrowing capacity of \$1.5 billion and matures on August 1, 2011. This revolving line of credit facility accrues interest at a rate per annum equal to LIBOR plus a margin that depends upon the Company's debt ratings. The Company pays a facility fee on the entire revolving commitment that depends upon its debt ratings. Based on the Company's debt ratings at September 30, 2010, the margin on the revolving line of credit facility was 0.55% and the facility fee was 0.15%. At September 30, 2010, the Company had \$318 million outstanding under this revolving line of credit facility with a weighted-average effective interest rate of 1.29%. At September 30, 2010, \$117 million of aggregate letters of credit were also outstanding against the revolving line of credit facility, including a \$103 million letter of credit as a result of the Ventas, Inc. ( Ventas ) litigation. For further information regarding the Ventas litigation, see Note 11.

The Company's revolving line of credit facility contains certain financial restrictions and other customary requirements, including cross-default provisions to other indebtedness. Among other things, these covenants, using terms defined in the agreement (i) limit the ratio of Consolidated Total Indebtedness to Consolidated Total Asset Value to 60%, (ii) limit the ratio of Unsecured Debt to Consolidated Unencumbered Asset Value to 65%, (iii) require a Fixed Charge Coverage ratio of 1.75 times, and (iv) require a formula-determined Minimum Consolidated Tangible Net Worth of \$5.3 billion at September 30, 2010. At September 30, 2010, the Company was in compliance with each of these restrictions and requirements of the revolving line of credit facility.

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

*Senior Unsecured Notes*

At September 30, 2010, the Company had senior unsecured notes outstanding with an aggregate principal balance of \$3.3 billion. Interest rates on the notes ranged from 1.19% to 7.07%. The weighted-average effective interest rate on the senior unsecured notes at September 30, 2010 was

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6.13%. Discounts and premiums are amortized to interest expense over the term of the related notes. The senior unsecured notes contain certain covenants including limitations on debt, cross-acceleration provisions and other customary terms. At September 30, 2010, the Company believes it was in compliance with these covenants.

In September 2010, the Company repaid \$200 million of maturing senior unsecured notes which accrued interest at a weighted-average interest rate of 4.88%.

### *Mortgage and Other Secured Debt*

At September 30, 2010, the Company had \$1.7 billion in aggregate principal amount of mortgage and other secured debt outstanding that is secured by 141 healthcare facilities, which had a carrying value of \$2.0 billion, as well as a participation in a first mortgage loan with a carrying value of \$630 million. Interest rates on the mortgage and other secured debt ranged from 1.27% to 8.30% with a weighted-average effective rate of 4.79% at September 30, 2010.

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

Table of Contents*Other Debt*

At September 30, 2010, the Company had \$94 million of non-interest bearing life care bonds at two of its continuing care retirement communities and non-interest bearing occupancy fee deposits at another of its senior housing facilities, all of which were payable to certain residents of the facilities (collectively, Life Care Bonds). At September 30, 2010, \$38.3 million of the Life Care Bonds were refundable to the residents upon the resident moving out or to their estate upon death, and \$55.7 million of the Life Care Bonds were refundable after the unit is successfully remarketed to a new resident.

*Debt Maturities*

The following table summarizes the Company's stated debt maturities and scheduled principal repayments at September 30, 2010 (in thousands):

| Year                             | Bank<br>Line of Credit | Senior<br>Unsecured<br>Notes | Mortgage<br>and Other<br>Secured<br>Debt | Total(1)     |
|----------------------------------|------------------------|------------------------------|--|--------------|
| 2010 (Three months)              | \$                     | \$ 6,421                     | \$ 13,713                                | \$ 20,134    |
| 2011                             | 318,000                | 292,265                      | 79,614                                   | 689,879      |
| 2012                             |                        | 250,000                      | 63,860                                   | 313,860      |
| 2013                             |                        | 550,000                      | 675,194                                  | 1,225,194    |
| 2014                             |                        | 87,000                       | 177,530                                  | 264,530      |
| Thereafter                       |                        | 2,150,000                    | 670,652                                  | 2,820,652    |
|                                  | 318,000                | 3,335,686                    | 1,680,563                                | 5,334,249    |
| (Discounts) and<br>premiums, net |                        | (10,711)                     | 2,177                                    | (8,534)      |
|                                  | \$ 318,000             | \$ 3,324,975                 | \$ 1,682,740                             | \$ 5,325,715 |

(1) Excludes \$94 million of other debt that represents non-interest bearing life care bonds and occupancy fee deposits at three of the Company's senior housing facilities, which have no scheduled maturities.

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

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

they are incurred.

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

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

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On September 22, 2009, the Company filed a motion for judgment as a matter of law or for a new trial. Also on September 22, 2009, Ventas filed a motion seeking approximately \$20 million in prejudgment interest and approximately \$4 million in additional damages to account for changes in currency exchange rates. The District Court denied both parties' post-trial motions on November 17, 2009. The Company filed a notice of appeal in the United States Court of Appeals for the Sixth Circuit on November 17, 2009; Ventas filed a notice of appeal on November 25, 2009. The Company is seeking to have the judgment against it reversed. In the cross-appeal, Ventas is seeking reversal of the district court's exclusion of Ventas' claim for punitive damages, additional damages due to currency and stock-price fluctuations, and pre-judgment interest. The appeal and cross-appeal have now been fully briefed; the Court of Appeals has not yet set a date for oral argument.

On June 29, 2009, several of the Company's subsidiaries, together with three of its tenants, filed complaints in the Delaware Court of Chancery against Sunrise Senior Living, Inc. and three of its subsidiaries (Sunrise). A complaint was also filed on behalf of several others of the Company's subsidiaries and one tenant on July 24, 2009 in the United States District Court for the Eastern District of Virginia.

On August 31, 2010, the Company entered into agreements with Sunrise that allowed the Company to terminate management contracts on 27 of the 75 senior housing communities owned by the Company and managed by Sunrise. In exchange, the Company agreed to pay Sunrise \$50 million, \$40 million of which was paid immediately with the remaining balance to be paid at the time the 27 communities were successfully transitioned to new operators. As part of this arrangement, the Company and Sunrise agreed to dismiss all litigation proceedings between them. Additionally, Sunrise agreed to limit certain fees and charges associated with the remaining in-place management contracts. On October 18, 2010, Emeritus Corporation entered into agreements with the Company to lease the 27 properties under two 15-year triple-net master leases that each includes two ten-year extension options. On November 1, 2010, the lease term commenced, operations were transitioned to Emeritus Corporation, and the Company paid to Sunrise the remaining \$10 million payment.

*Concentration of Credit Risk*

Concentrations of credit risks arise when a number of operators, tenants or obligors related to the Company's investments are engaged in similar business activities, 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 believes the current portfolio is reasonably diversified across healthcare related real estate and does not contain any other significant concentration of credit risks, except as disclosed herein. The Company does not have significant foreign operations.

At September 30, 2010 and December 31, 2009, the Company had investments in mezzanine and secured loans to HCR ManorCare with an aggregate par value of \$1.72 billion at each period end and carrying values of \$1.58 billion and \$1.54 billion, respectively. At September 30, 2010 and December 31, 2009, the carrying value of these investments represented approximately 81% and 85%, respectively, of the Company's skilled nursing segment assets and 13% and 13%, respectively, of its total assets. For the three months ended September 30, 2010 and 2009, the Company recognized \$28.6 million and \$19.6 million, respectively, in interest income from these investments, which represented approximately 75% and 59% respectively, of the Company's skilled nursing segment revenues and 9% and 7% respectively, of its total revenues. For the nine months ended September 30, 2010 and 2009, the Company recognized \$83.8 million and \$50.1 million, respectively, in interest income from these investments, which represented approximately 75% and 60% respectively, of the Company's skilled nursing segment revenues and 9% and 6% respectively, of its total revenues.

At September 30, 2010, Sunrise operated 75 of the Company's senior housing facilities. Sunrise is a publicly traded company and is subject to the informational filing requirements of the Securities Exchange Act of 1934, as amended, and is required to file periodic reports on Form 10-K and

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Form 10-Q with the SEC. Among other things, Sunrise has disclosed that as of June 30, 2010, it has no borrowing availability under its bank credit facility, has significant scheduled debt maturities in 2010 and significant long-term debt that is in default. At September 30, 2010 and December 31, 2009, the aggregate carrying value of the Company's gross assets leased to Sunrise represented approximately 41% and 40%, respectively, of the Company's senior housing segment assets and 14% and 14%, respectively, of its total assets. For the three months ended September 30, 2010 and 2009, the Company recognized \$43 million and \$30 million, respectively, in revenues from facilities operated by Sunrise, which represented approximately 42% and 36% respectively, of the Company's senior housing segment revenues and 14% and 10% respectively, of its total revenues. For the nine months ended September 30, 2010 and 2009, the Company recognized \$103.5 million and \$98.5 million, respectively, in revenues from facilities operated by Sunrise, which represented approximately 38% in each period of the Company's senior housing segment revenues and 11% in each period of its total revenues. The three and nine months ended September 30, 2010 include increases of \$13.7 million and \$12.7 million in revenues and operating expenses, respectively, as a result of reflecting the facility-level results from 27 facilities leased to four VIE tenants operated by Sunrise that were consolidated as a result of the rights the Company acquired from the settlement agreement mentioned above. See Note 17 for additional information regarding VIEs.



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To mitigate credit risk of certain senior housing leases, leases are combined into portfolios that contain cross-default terms, so that if a tenant of any of the properties in a portfolio defaults on its obligations under its lease, the Company may pursue its remedies under the lease with respect to any of the properties in the portfolio. Certain portfolios also contain terms whereby the net operating profits of the properties are combined for the purpose of securing the funding of rental payments due under each lease.

*DownREIT LLCs*

In connection with the formation of certain DownREIT limited liability companies ( LLCs ), members may contribute appreciated real estate to a DownREIT LLC in exchange for DownREIT units. These contributions are generally tax-deferred, so that the pre-contribution gain related to the property is not taxed to the member. However, if a contributed property is later sold by the DownREIT LLC, the unamortized pre-contribution gain that exists at the date of sale is specifically allocated and taxed to the contributing members. In many of the DownREITs, the Company has entered into indemnification agreements with those members who contributed appreciated property into the DownREIT LLC. Under these indemnification agreements, if any of the appreciated real estate contributed by the members is sold by the DownREIT LLC in a taxable transaction within a specified number of years, the Company will reimburse the affected members for the federal and state income taxes associated with the pre-contribution gain that is specially allocated to the affected member under the Internal Revenue Code of 1986, as amended ( make-whole payments ). These make-whole payments include a tax gross-up provision.

*Credit Enhancement Guarantee*

Certain of the Company's senior housing facilities serve as collateral for \$129 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 \$363 million as of September 30, 2010.

**(12) Equity**

*Preferred Stock*

At September 30, 2010, the Company had two series of preferred stock outstanding, Series E and Series F preferred stock. The Series E and Series F preferred stock have no stated maturity, are not subject to any sinking fund or mandatory redemption and are not convertible into any other securities of the Company. Holders of each series of preferred stock generally have no voting rights, except under limited conditions, and all holders are entitled to receive cumulative preferential dividends based upon each series' respective liquidation preference. To preserve the Company's status as a REIT, each series of preferred stock is subject to certain restrictions on ownership and transfer. Dividends are payable quarterly in arrears on the last day of March, June, September and December. The Series E and Series F preferred stock are currently redeemable at the Company's option.

The following table lists the Series E and Series F cumulative redeemable preferred stock cash dividends paid and declared by the Company during the nine months ended September 30, 2010:

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| <b>Declaration Date</b> | <b>Record Date</b> | <b>Dividend Payable Date</b> | <b>Series E Amount Per Share</b> | <b>Series F Amount Per Share</b> |
|-------------------------|--------------------|------------------------------|----------------------------------|----------------------------------|
| February 1              | March 15           | March 31                     | \$ 0.45313                       | \$ 0.44375                       |
| April 22                | June 15            | June 30                      | \$ 0.45313                       | \$ 0.44375                       |
| July 29                 | September 15       | September 30                 | \$ 0.45313                       | \$ 0.44375                       |

On October 28, 2010, the Company announced that its Board declared a quarterly cash dividend of \$0.45313 per share on its Series E cumulative redeemable preferred stock and \$0.44375 per share on its Series F cumulative redeemable preferred stock. These dividends will be paid on December 31, 2010 to stockholders of record as of the close of business on December 15, 2010.

*Common Stock*

On May 8, 2009, the Company completed a \$440 million public offering of 20.7 million shares of common stock at a price per share of \$21.25. The Company received net proceeds of \$422 million, which were used to repay all amounts of indebtedness outstanding under the bridge loan with the remainder used for general corporate purposes.

On August 10, 2009, the Company completed a \$441 million public offering of 17.8 million shares of its common stock at a price of \$24.75 per share. The Company received net proceeds of \$423 million, which were used to repay the total outstanding indebtedness under the Company's revolving line of credit facility, including borrowings for the acquired participation in first mortgage debt of HCR ManorCare, with the remainder used for general corporate purposes.

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In June 2010, the Company initiated a public offering, which resulted in the sale of 15.5 million shares of common stock at a price of \$33.00 per share for gross proceeds of \$512 million. This offering included: (i) the June 2010 public offering of 13.5 million shares for \$445.5 million; and (ii) the July 2010 sale of 2.025 million shares, for \$66.8 million, as a result of the underwriters exercising the over-allotment option from the June 2010 public offering. The Company received total net proceeds of \$492 million from these sales, which were used to repay the outstanding indebtedness under its revolving line of credit facility, fund acquisitions and capital expenditures, repay mortgage debt and for other general corporate purposes.

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

|  | Nine Months Ended September 30, |      |
|--|---------------------------------|------|
|  | 2010                            | 2009 |
|  | (shares in thousands)           |      |
| Dividend Reinvestment and Stock Purchase Plan ( DRIP ) | 869                             | 106  |
| Conversion of DownREIT units                           | 130                             | 525  |
| Exercise of stock options                              | 150                             | 26   |
| Restricted stock awards(1)                             | 221                             | 305  |
| Vesting of restricted stock units(1)                   | 265                             | 182  |

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

The following table lists the common stock cash dividends paid and declared by the Company during the nine months ended September 30, 2010:

| Declaration Date | Record Date | Dividend Payable Date | Amount Per Share |
|------------------|-------------|-----------------------|------------------|
| February 1       | February 11 | February 23           | \$ 0.465         |
| April 22         | May 3       | May 18                | \$ 0.465         |
| July 29          | August 9    | August 24             | \$ 0.465         |

On October 28, 2010, the Company announced that its Board declared a quarterly cash dividend of \$0.465 per share. The common stock cash dividend will be paid on November 23, 2010 to stockholders of record as of the close of business on November 8, 2010.

*Accumulated Other Comprehensive Income (Loss) ( AOCI )*

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

September 30,

December 31,

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|   | 2010 | (in thousands) | 2009       |
|---|------|----------------|------------|
| AOCI unrealized gains on available-for-sale securities, net | \$   | 8,061          | \$ 11,805  |
| AOCI unrealized losses on cash flow hedges, net             |      | (12,507)       | (10,769)   |
| Supplemental Executive Retirement Plan minimum liability    |      | (2,245)        | (2,342)    |
| Cumulative foreign currency translation adjustment          |      | (735)          | (828)      |
| Total accumulated other comprehensive loss                  | \$   | (7,426)        | \$ (2,134) |

*Noncontrolling Interests*

At September 30, 2010, there were 4.3 million non-managing member units outstanding in five DownREIT LLCs, all of which the Company is the managing member. At September 30, 2010, the carrying and fair values of these DownREIT units were \$175 million and \$216 million, respectively.

Table of Contents*Total Comprehensive Income (Loss)*

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

|                                   | Three Months Ended<br>September 30, |             | Nine Months Ended<br>September 30, |            |
|-----------------------------------|-------------------------------------|-------------|------------------------------------|------------|
|                                   | 2010                                | 2009        | 2010                               | 2009       |
| Net income (loss)                 | \$ 26,173                           | \$ (43,220) | \$ 198,869                         | \$ 110,667 |
| Other comprehensive income (loss) | (2,874)                             | 8,981       | (5,292)                            | 71,324     |
| Total comprehensive income (loss) | \$ 23,299                           | \$ (34,239) | \$ 193,577                         | \$ 181,991 |

Substantially all of other comprehensive income for the three and nine months ended September 30, 2009 related to the change in the estimated fair value of the Company's available-for-sale marketable debt securities. See additional information regarding available-for-sale marketable debt securities in Note 9.

**(13) Segment Disclosures**

The Company evaluates its business and makes resource allocations based on five business segments: (i) senior housing, (ii) life science, (iii) medical office, (iv) skilled nursing and (v) hospital. Under the senior housing, life science, skilled nursing and hospital segments, the Company invests primarily in single operator or tenant properties, through the acquisition and development of real estate or through investments in debt issued by operators in these sectors. Under the medical office segment, the Company invests through the acquisition of MOB's that are primarily leased under gross or modified gross leases, which are generally to multiple tenants and require a greater level of property management. The accounting policies of the segments are the same as those described in Note 2 to the Consolidated Financial Statements for the year ended December 31, 2009 in the Company's Annual Report on Form 10-K filed with the SEC. There were no intersegment sales or transfers during the nine months ended September 30, 2010 and 2009. The Company evaluates performance based upon property net operating income from continuing operations ( NOI ) and interest income of the combined investments in each segment.

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

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

For the three months ended September 30, 2010:

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| Segments        | Rental and Related Revenues | Tenant Recoveries | Income From DFLs | Interest Income | Investment Management Fee Income | Total Revenues | NOI(1)     |
|-----------------|-----------------------------|-------------------|------------------|-----------------|----------------------------------|----------------|------------|
| Senior housing  | \$ 88,151                   | \$                | \$ 13,028        | \$ 67           | \$ 577                           | \$ 101,823     | \$ 87,857  |
| Life science    | 59,201                      | 10,459            |                  |                 | 1                                | 69,661         | 56,953     |
| Medical office  | 66,022                      | 12,151            |                  |                 | 579                              | 78,752         | 44,837     |
| Skilled nursing | 9,274                       |                   |                  | 28,750          |                                  | 38,024         | 9,198      |
| Hospital        | 20,378                      | 746               |                  | 7,765           |                                  | 28,889         | 20,104     |
| Total           | \$ 243,026                  | \$ 23,356         | \$ 13,028        | \$ 36,582       | \$ 1,157                         | \$ 317,149     | \$ 218,949 |

For the three months ended September 30, 2009:

| Segments        | Rental and Related Revenues | Tenant Recoveries | Income From DFLs | Interest Income | Investment Management Fee Income | Total Revenues | NOI(1)     |
|-----------------|-----------------------------|-------------------|------------------|-----------------|----------------------------------|----------------|------------|
| Senior housing  | \$ 67,709                   | \$                | \$ 13,173        | \$ 304          | \$ 703                           | \$ 81,889      | \$ 81,134  |
| Life science    | 53,536                      | 9,696             |                  |                 |                                  | 63,232         | 51,302     |
| Medical office  | 65,419                      | 12,271            |                  |                 | 623                              | 78,313         | 44,117     |
| Skilled nursing | 9,494                       |                   |                  | 23,416          |                                  | 32,910         | 9,469      |
| Hospital        | 20,011                      | 497               |                  | 10,216          |                                  | 30,724         | 19,625     |
| Total           | \$ 216,169                  | \$ 22,464         | \$ 13,173        | \$ 33,936       | \$ 1,326                         | \$ 287,068     | \$ 205,647 |

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For the nine months ended September 30, 2010:

| Segments        | Rental and Related Revenues | Tenant Recoveries | Income From DFLs | Interest Income | Investment Management Fee Income | Total Revenues | NOI(1)     |
|-----------------|-----------------------------|-------------------|------------------|-----------------|----------------------------------|----------------|------------|
| Senior housing  | \$ 235,566                  | \$                | \$ 37,238        | \$ 352          | \$ 1,965                         | \$ 275,121     | \$ 257,794 |
| Life science    | 176,935                     | 29,706            |                  |                 | 3                                | 206,644        | 170,596    |
| Medical office  | 196,572                     | 35,709            |                  |                 | 1,787                            | 234,068        | 135,288    |
| Skilled nursing | 27,843                      |                   |                  | 84,636          |                                  | 112,479        | 27,668     |
| Hospital        | 60,886                      | 1,847             |                  | 23,016          |                                  | 85,749         | 58,928     |
| Total           | \$ 697,802                  | \$ 67,262         | \$ 37,238        | \$ 108,004      | \$ 3,755                         | \$ 914,061     | \$ 650,274 |

For the nine months ended September 30, 2009:

| Segments        | Rental and Related Revenues | Tenant Recoveries | Income From DFLs | Interest Income | Investment Management Fee Income | Total Revenues | NOI(1)     |
|-----------------|-----------------------------|-------------------|------------------|-----------------|----------------------------------|----------------|------------|
| Senior housing  | \$ 214,595                  | \$                | \$ 39,302        | \$ 880          | \$ 2,224                         | \$ 257,001     | \$ 249,960 |
| Life science    | 159,072                     | 30,311            |                  |                 | 2                                | 189,385        | 154,744    |
| Medical office  | 196,266                     | 35,319            |                  |                 | 1,907                            | 233,492        | 133,048    |
| Skilled nursing | 27,366                      |                   |                  | 54,751          |                                  | 82,117         | 27,254     |
| Hospital        | 59,085                      | 1,494             |                  | 32,160          |                                  | 92,739         | 58,037     |
| Total           | \$ 656,384                  | \$ 67,124         | \$ 39,302        | \$ 87,791       | \$ 4,133                         | \$ 854,734     | \$ 623,043 |

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

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

|   | Three Months Ended September 30, |            | Nine Months Ended September 30, |            |
|---|----------------------------------|------------|---------------------------------|------------|
|   | 2010                             | 2009       | 2010                            | 2009       |
| Net operating income from continuing operations | \$ 218,949                       | \$ 205,647 | \$ 650,274                      | \$ 623,043 |
| Interest income                                 | 36,582                           | 33,936     | 108,004                         | 87,791     |
| Investment management fee income                | 1,157                            | 1,326      | 3,755                           | 4,133      |
| Depreciation and amortization                   | (78,334)                         | (81,177)   | (234,008)                       | (240,308)  |
| Interest expense                                | (71,600)                         | (74,039)   | (220,303)                       | (226,053)  |

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|  |           |             |            |            |
|--|-----------|-------------|------------|------------|
| General and administrative                               | (19,590)  | (22,856)    | (65,039)   | (61,619)   |
| Litigation provision                                     |           | (101,973)   |            | (101,973)  |
| (Impairments) recoveries                                 |           | (15,123)    | 11,900     | (20,904)   |
| Other income, net  | 6,657     | 5,983       | 7,151      | 5,107      |
| Impairment of investment in unconsolidated joint venture | (71,693)  |             | (71,693)   |            |
| Income taxes   | (867)     | 325         | (1,809)    | (1,395)    |
| Equity income from unconsolidated joint ventures         | 209       | 1,328       | 4,078      | 1,993      |
| Total discontinued operations                            | 4,703     | 3,403       | 6,559      | 40,852     |
| <b>Net income (loss)</b>                                 | \$ 26,173 | \$ (43,220) | \$ 198,869 | \$ 110,667 |



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The Company's total assets by segment were:

| Segments                                  | September 30,<br>2010 | December 31,<br>2009 |
|---|-----------------------|----------------------|
| Senior housing                            | \$ 4,344,027          | \$ 4,322,298         |
| Life science                              | 3,674,934             | 3,593,550            |
| Medical office                            | 2,248,713             | 2,249,721            |
| Skilled nursing                           | 1,950,226             | 1,791,294            |
| Hospital                                  | 903,291               | 947,119              |
| Gross segment assets                      | 13,121,191            | 12,903,982           |
| Accumulated depreciation and amortization | (1,361,317)           | (1,209,253)          |
| Net segment assets                        | 11,759,874            | 11,694,729           |
| Real estate held for sale, net            | 12,554                | 32,653               |
| Other non-segment assets                  | 472,871               | 482,353              |
| Total assets                              | \$ 12,245,299         | \$ 12,209,735        |

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

At September 30, 2010, goodwill was allocated to segment assets as follows: (i) senior housing \$30.5 million, (ii) medical office \$11.4 million, (iii) skilled nursing \$3.3 million, and (iv) hospital \$5.1 million. Due to a decrease in the Company's market capitalization during the first quarter of 2009, it performed an interim goodwill impairment assessment. In connection with this review, the Company recognized an impairment charge of \$1.4 million, included in other income, net, for the goodwill allocated to its life science segment.

**(14) Impairments**

During the three months ended September 30, 2009, the Company recognized impairments of \$15.1 million related to two of its DFLs (see Note 5). During the nine months ended September 30, 2009, the Company recognized impairments of \$21.0 million as a result of (i) the above \$15.1 million related to two of its DFLs and (ii) \$5.9 million related to intangible assets on 12 of 15 senior housing communities which were determined to be impaired due to the termination of the Sunrise management agreements effective October 1, 2009.

On October 12, 2010, the Company concluded that its 35% interest in HCP Ventures II, which owns 25 senior housing properties leased by Horizon Bay Communities or certain of its affiliates (collectively Horizon Bay), was impaired. The impairment resulted from the recent and projected deterioration of the operating performance of the properties leased by Horizon Bay from HCP Ventures II. During the three months ended September 30, 2010 the Company recognized an impairment of \$71.7 million related to its investment in HCP Ventures II, which reduced the carrying value of its investment from \$136.8 million to \$65.1 million. The impairment was based on a discounted cash flow valuation model that is considered to be a Level III measurement within the fair value hierarchy. Inputs to the valuation model include real estate capitalization rates, discount rates, industry growth rates and operating margins, all of which influence the Company's expectation of future cash flows from HCP Ventures II and, accordingly, the estimated fair value of its investment.



Table of Contents**(15) Earnings Per Common Share**

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

|  | Three Months Ended September 30, |             | Nine Months Ended September 30, |           |
|--|----------------------------------|-------------|---------------------------------|-----------|
|  | 2010                             | 2009        | 2010                            | 2009      |
| <b>Numerator</b>   |                                  |             |                                 |           |
| Income (loss) from continuing operations                             | \$ 21,470                        | \$ (46,623) | \$ 192,310                      | \$ 69,815 |
| Noncontrolling interests share in continuing operations              | (3,518)                          | (3,466)     | (10,077)                        | (11,011)  |
| Income (loss) from continuing operations applicable to HCP, Inc.     | 17,952                           | (50,089)    | 182,233                         | 58,804    |
| Preferred stock dividends  | (5,282)                          | (5,282)     | (15,848)                        | (15,848)  |
| Participating securities share in continuing operations              | (378)                            | (429)       | (1,648)                         | (1,136)   |
| Income (loss) from continuing operations applicable to common shares | 12,292                           | (55,800)    | 164,737                         | 41,820    |
| Discontinued operations  | 4,703                            | 3,403       | 6,559                           | 40,852    |
| Net income (loss) applicable to common shares                        | \$ 16,995                        | \$ (52,397) | \$ 171,296                      | \$ 82,672 |
| <b>Denominator</b>   |                                  |             |                                 |           |
| Basic weighted-average common shares                                 | 309,448                          | 284,812     | 299,243                         | 267,971   |
| Dilutive stock options and restricted stock                          | 1,644                            |             | 1,225                           | 70        |
| Diluted weighted-average common shares                               | 311,092                          | 284,812     | 300,468                         | 268,041   |
| <b>Basic earnings (loss) per common share</b>                        |                                  |             |                                 |           |
| Income (loss) from continuing operations                             | \$ 0.04                          | \$ (0.20)   | \$ 0.55                         | \$ 0.16   |
| Discontinued operations  | 0.01                             | 0.02        | 0.02                            | 0.15      |
| Net income (loss) applicable to common stockholders                  | \$ 0.05                          | \$ (0.18)   | \$ 0.57                         | \$ 0.31   |
| <b>Diluted earnings (loss) per common share</b>                      |                                  |             |                                 |           |
| Income (loss) from continuing operations                             | \$ 0.04                          | \$ (0.20)   | \$ 0.55                         | \$ 0.16   |
| Discontinued operations  | 0.01                             | 0.02        | 0.02                            | 0.15      |
| Net income (loss) applicable to common shares                        | \$ 0.05                          | \$ (0.18)   | \$ 0.57                         | \$ 0.31   |

Restricted stock and certain of the Company's performance restricted stock units are considered participating securities which require the use of the two-class method when computing basic and diluted earnings per share. For both the three months ended September 30, 2010 and 2009, earnings representing nonforfeitable dividends of \$0.4 million each period were allocated to the participating securities. For the nine months ended September 30, 2010 and 2009, earnings representing nonforfeitable dividends of \$1.6 million and \$1.1 million, respectively, were allocated to the participating securities.

Options to purchase approximately 0.4 million and 7.1 million shares of common stock that had an exercise price in excess of the average market price of the common stock during the three months ended September 30, 2010 and 2009, 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 30,000 and 1.5 million shares of common stock during the three months ended September 30, 2010 and 2009, respectively, were not included because they are anti-dilutive. Additionally, 6.0 million shares issuable upon conversion of 4.3 million DownREIT units during the three months ended September 30, 2010 were not included since they are anti-dilutive. During the three months ended September 30, 2009, 5.9 million shares issuable upon conversion of 4.3 million DownREIT units were not included since they were anti-dilutive.

**(16) Supplemental Cash Flow Information**

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Nine Months ended September 30,  
2010 (in thousands) 2009

*Supplemental cash flow information:*

|  |    |         |    |         |
|--|----|---------|----|---------|
| Interest paid, net of capitalized interest | \$ | 232,504 | \$ | 236,905 |
| Taxes paid                                 |    | 1,717   |    | 2,101   |

*Supplemental schedule of non-cash investing activities:*

|   |  |        |  |         |
|---|--|--------|--|---------|
| Capitalized interest  |  | 15,514 |  | 18,994  |
| Increase (decrease) in accrued leasing and construction costs |  | 11,779 |  | (3,359) |
| Loans received upon real estate disposition                   |  | 21,519 |  | 251     |

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|  | Nine Months ended September 30, |         |
|--|---------------------------------|---------|
|  | 2010                            | 2009    |
|  | (in thousands)                  |         |
| <i>Supplemental schedule of non-cash financing activities:</i>   |                                 |         |
| Secured debt obtained in purchase of participation in secured loan receivable                                  |                                 | 425,042 |
| Restricted stock issued  | 221                             | 305     |
| Vesting of restricted stock units  | 265                             | 182     |
| Cancellation of restricted stock   | (52)                            | (34)    |
| Conversion of non-managing member units into common stock  | 5,072                           | 21,873  |
| Non-managing member units issued in connection with acquisitions   | 9,267                           |         |
| Mortgages assumed with acquisitions  | 5,352                           |         |
| Unrealized gains (losses) on available-for-sale securities and derivatives designated as cash flow hedges, net | (1,432)                         | 73,436  |

See discussions of the HCR ManorCare transaction in Note 6.

**(17) Variable Interest Entities**

At September 30, 2010, the Company leased 75 properties to a total of 11 tenants ( VIE tenants ) and had a loan to a borrower where each tenant and borrower has been identified as a VIE. In addition, the Company has additional investments in mezzanine loans consisting of an investment in December 2007 of approximately \$900 million and an investment in September 2010 of \$40 million where each mezzanine borrower has been identified as a VIE.

*Consolidated Variable Interest Entities*

At September 30, 2010, the Company had leasing relationships with a total of four VIE tenants, related to 27 properties, in which the VIEs operations were consolidated based on the Company's ability to control the activities that most significantly impact the VIEs economic performance. During the time that these properties are in transition to new operators, the Company will consolidate these four VIEs as a result of the rights it acquired through its August 2010 settlement agreement with Sunrise (see Note 11). Prior to August 2010, these four VIEs were not consolidated because the Company did not have the ability to control their activities (i.e., recurring operating activities) that most significantly impact their economic performance. The Company did not realize a gain or loss upon the initial consolidation of these four VIEs.

The assets and liabilities of these four VIEs substantially consist of cash and cash equivalents, accounts receivables, and accounts payable and accrued liabilities generated from their operating activities. The assets generated by the operating activities of these four VIEs may only be used to settle the VIEs contractual obligations, which include lease obligations to the Company. The Company is not entitled to these assets, does not guarantee these liabilities (or contractual obligations) and is not liable to the general creditors of these four VIEs.

*Unconsolidated Variable Interest Entities*

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At September 30, 2010, the Company leased 48 properties to a total of seven VIE tenants and had additional investments in loans to borrowers where each tenant and borrower were identified as a VIE. The Company has determined that it is not the primary beneficiary of these VIEs. The carrying value and classification of the related assets, liabilities and maximum exposure to loss as a result of the Company's involvement with these VIEs are presented below at September 30, 2010 (in thousands):

| VIE Type                     | Maximum Loss<br>Exposure(1) | Asset/Liability Type   | Carrying<br>Amount |
|------------------------------|-----------------------------|--|--------------------|
| VIE tenants operating leases | \$ 395,569                  | Lease intangibles, net and straight-line<br>rent receivables | \$ 14,371          |
| VIE tenants DFLs             | 1,189,437                   | Net investment in DFLs                                       | 581,372            |
| Loans senior secured         | 83,822                      | Loans receivable, net  | 83,822             |
| Loans mezzanine              | 988,394                     | Loans receivable, net  | 988,394            |

---

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

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As of September 30, 2010 the Company has not provided, and is not required to provide, financial support through a liquidity arrangement or otherwise, to its consolidated or unconsolidated VIEs, including circumstances in which it could be exposed to further losses (e.g., cash short falls). See Notes 5, 6 and 11 for additional description of the nature, purpose and activities of the Company's VIEs and interests therein.

**(18) Fair Value Measurements**

The following table illustrates the Company's fair value measurements of its financial assets and liabilities measured at fair value in the Company's condensed consolidated balance sheet. Recognized gains and losses are recorded in other income, net on the Company's condensed consolidated statements of income. During the nine months ended September 30, 2010, there were no transfers of financial assets or liabilities between levels.

The following is a summary of fair value measurements of financial assets and liabilities at September 30, 2010 (in thousands):

| Financial Instrument              | Fair Value | Level 1   | Level 2   | Level 3  |
|-----------------------------------|------------|-----------|-----------|----------|
| Marketable debt securities        | \$ 101,390 | \$ 87,701 | \$ 13,689 |          |
| Marketable equity securities      | 4,231      | 4,231     |           |          |
| Interest-rate swap assets(1)      | 5,762      |           | 5,762     |          |
| Interest-rate swap liabilities(1) | (7,066)    |           | (7,066)   |          |
| Warrants(1)                       | 1,608      |           |           | 1,608    |
|                                   | \$ 105,925 | \$ 91,932 | \$ 12,385 | \$ 1,608 |

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

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

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

|                            | September 30, 2010 |              | December 31, 2009 |              |
|----------------------------|--------------------|--------------|-------------------|--------------|
|                            | Carrying Value     | Fair Value   | Carrying Value    | Fair Value   |
|                            | (in thousands)     |              |                   |              |
| Loans receivable, net      | \$ 1,852,521       | \$ 1,898,660 | \$ 1,672,938      | \$ 1,728,599 |
| Marketable debt securities | 101,390            | 101,390      | 172,799           | 172,799      |

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|                                 |           |           |           |           |
|---------------------------------|-----------|-----------|-----------|-----------|
| Marketable equity securities    | 4,231     | 4,231     | 3,521     | 3,521     |
| Warrants                        | 1,608     | 1,608     | 1,732     | 1,732     |
| Bank line of credit             | 318,000   | 318,000   |           |           |
| Term loan                       |           |           | 200,000   | 200,000   |
| Senior unsecured notes          | 3,324,975 | 3,592,355 | 3,521,325 | 3,548,926 |
| Mortgage and other secured debt | 1,682,740 | 1,688,636 | 1,834,935 | 1,789,992 |
| Other debt                      | 93,990    | 93,990    | 99,883    | 99,883    |
| Interest-rate swap assets       | 5,762     | 5,762     | 3,523     | 3,523     |
| Interest-rate swap liabilities  | 7,066     | 7,066     | 3,438     | 3,438     |



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

The following table summarizes the Company's outstanding interest-rate swap contracts as of September 30, 2010 (dollars in thousands):

| <b>Date Entered</b> | <b>Maturity Date</b> | <b>Hedge Designation</b> | <b>Fixed Rate</b> | <b>Floating Rate Index</b> | <b>Notional Amount</b> | <b>Fair Value(1)</b> |
|---------------------|----------------------|--------------------------|-------------------|----------------------------|------------------------|----------------------|
| July 2005(2)        | July 2020            | Cash Flow                | 3.82%             | BMA Swap Index             | \$ 45,600              | \$ (6,382)           |
| June 2009(3)        | September 2011       | Fair Value               | 5.95%             | 1 Month LIBOR+4.21%        | 250,000                | 3,210                |
| July 2009(4)        | July 2013            | Cash Flow                | 6.13%             | 1 Month LIBOR+3.65%        | 14,300                 | (684)                |
| August 2009(5)      | February 2011        | Cash Flow                | 0.87%             | 1 Month LIBOR              | 250,000                | 546                  |
| August 2009(5)      | August 2011          | Cash Flow                | 1.24%             | 1 Month LIBOR              | 250,000                | 2,006                |

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

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

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

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

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

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

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

Credit risk is the risk that one of the parties to a derivative contract fails to perform or meet their financial obligation. The Company does not obtain collateral associated with its derivative instruments, but monitors the credit standing of its counterparties on a regular basis. Should a counterparty fail to perform, the Company would incur a financial loss to the extent that the associated derivative contract was in an asset position. At September 30, 2010, the Company does not anticipate non-performance by the counterparties to its outstanding derivative contracts.

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During October and November 2007, the Company entered into two forward-starting interest-rate swap contracts with an aggregate notional amount of \$900 million and settled the contracts during the nine months ended September 30, 2008. The settlement value, less the ineffective portion of the hedging relationships, was recorded to accumulated other comprehensive income to be reclassified into interest expense over the forecasted term of the underlying unsecured fixed-rate debt. The interest-rate swap contracts were designated in qualifying, cash flow hedging relationships, to hedge the Company's exposure to fluctuations in the benchmark interest rate component of interest payments on forecasted, unsecured, fixed-rate debt currently expected to be issued in 2011 and 2012. During 2010, the Company revised its estimated issuance date for the underlying unsecured, fixed-rate debt. As a result, the Company recognized a \$1.0 million charge in other income, net, during the nine months ended September 30, 2010, related to the interest payments that are no longer probable of occurring.

At September 30, 2010, the Company expects that the hedged forecasted transactions, for each of the outstanding qualifying cash flow hedging relationships, remain probable of occurring and no additional gains or losses recorded to accumulated other comprehensive income (loss) are expected to be reclassified to earnings as a result.

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To illustrate the effect of movements in the interest rate 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 of the derivative portfolio in order to determine the instruments' change in estimated fair value. The following table summarizes the results of the analysis performed (dollars in thousands):

| Date Entered | Maturity Date  | Effects of Change in Interest Rates |                  |                   |                   |
|--------------|----------------|-------------------------------------|------------------|-------------------|-------------------|
|              |                | +50 Basis Points                    | -50 Basis Points | +100 Basis Points | -100 Basis Points |
| July 2005    | July 2020      | \$ 1,845                            | \$ (2,201)       | \$ 3,869          | \$ (4,224)        |
| June 2009    | September 2011 | (1,213)                             | 1,213            | (2,426)           | 2,426             |
| July 2009    | July 2013      | 192                                 | (193)            | 385               | (386)             |
| August 2009  | February 2011  | (460)                               | 456              | (918)             | 914               |
| August 2009  | August 2011    | (1,078)                             | 1,092            | (2,163)           | 2,177             |

**(21) Subsequent Events**

On November 1, 2010, the Company sold nine senior housing facilities for \$27 million, recognizing gain on sales of real estate of approximately \$15 million. Additionally, on November 1, 2010, upon the early repayment of a mortgage loan receivable, the Company received \$46 million in proceeds, recognizing additional interest income of \$11 million for the prepayment premium included in the proceeds. This loan was secured by a hospital, had an original maturity of January 2016 and carried an interest rate of 8.5%.

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

**Cautionary Language Regarding Forward-Looking Statements**

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

- (a) Changes in national and local economic conditions, including a prolonged period of weak economic growth;
- (b) Continued volatility in the capital markets, including changes in interest rates and the availability and cost of capital;
- (c) The ability of the Company to manage its indebtedness level and changes in the terms of such indebtedness;
- (d) Changes in federal, state or local laws and regulations, including those affecting the healthcare industry that affect our costs of compliance or increase the costs, or otherwise affect the operations of our operators, tenants and borrowers;
- (e) The potential impact of existing and future litigation matters, including the possibility of larger than expected litigation costs and related developments;
- (f) Competition for tenants and borrowers, including with respect to new leases and mortgages and the renewal or rollover of existing leases;
- (g) The ability of the Company to negotiate the same or better terms with new tenants or operators if existing leases are not renewed or the Company exercises its right to replace an existing operator or tenant upon default;

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

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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
  
- 2010 Transaction Overview
  
- Dividends
  
- Critical Accounting Policies
  
- Results of Operations
  
- Liquidity and Capital Resources
  
- Non-GAAP Financial Measure Funds from Operations
  
- Off-Balance Sheet Arrangements
  
- Contractual Obligations
  
- Inflation

- Recent Accounting Pronouncements

## Executive Summary

We are a self-administered REIT that, together with our consolidated subsidiaries, invests primarily in real estate serving the healthcare industry in the United States ( U.S. ). We acquire, develop, lease, manage and dispose of healthcare real estate and provide financing to healthcare providers. At September 30, 2010, our portfolio of investments, including properties owned by our Investment Management Platform, consisted of interests in 670 facilities and \$2.0 billion of mezzanine and other secured loan investments. Our Investment Management Platform represents the following joint ventures: (i) HCP Ventures II, (ii) HCP Ventures III, LLC, (iii) HCP Ventures IV, LLC and (iv) the HCP Life Science ventures.

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

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

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

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

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**2010 Transaction Overview**

*Completed Transition of 27 Sunrise-managed Communities*

On August 31, 2010, we entered into agreements with Sunrise that allowed us to terminate management contracts on 27 of the 75 senior housing communities owned by us and managed by Sunrise. In exchange, we agreed to pay Sunrise \$50 million, \$40 million of which was paid immediately with the remaining balance to be paid at the time the 27 communities were successfully transitioned to new operators. As part of this arrangement, the Company and Sunrise agreed to dismiss all litigation proceedings between them. Additionally, Sunrise agreed to limit certain fees and charges associated with the remaining in-place management contracts. On October 18, 2010, Emeritus Corporation entered into agreements with us to lease the 27 properties under two 15-year triple-net master leases that each includes two ten-year extension options. On November 1, 2010, the lease term commenced, operations were transitioned to Emeritus Corporation, and we paid to Sunrise the remaining \$10 million payment.

*Investments*

During the nine months ended September 30, 2010, we made investments of \$413.2 million consisting of: (i) \$173.4 million of real estate; (ii) \$142.5 million of participations in Genesis HealthCare s ( Genesis ) senior loan and mezzanine note purchased at a discount for \$123.3 million; and (iii) \$97.3 million of construction and other capital projects (primarily in our life science segment). Additional details regarding these investments are as follows:

- In September 2010 we purchased participations in a Genesis senior loan and mezzanine note with face amounts of \$92.5 million and \$50 million, respectively, each at a discount for \$83.3 million and \$40 million, respectively. Subsequently, on October 8, 2010, we purchased an additional participation in Genesis senior loan with a face amount of \$185 million, at a discount for \$167 million. These investments represent a portion of the \$1.67 billion of debt incurred in connection with the \$2.0 billion acquisition of Genesis in July 2007.

The senior loan bears interest on the face amount at LIBOR (subject to a current floor of 1.5% increasing to 2.5% by maturity) plus a spread of 4.75% increasing to 5.75% by maturity. The senior loan is prepayable anytime without penalty, matures in September 2014 and is secured by all of Genesis assets. The mezzanine note bears interest on the face amount at LIBOR plus a spread of 7.50% and matures in September 2014. In addition to the coupon interest payments, the mezzanine note requires payment of a termination fee, of which our share is currently \$2 million, increasing to a maximum of \$5 million if the debt is repaid in full at maturity. The mezzanine note is subordinate to the senior loan and secured by the indirect pledge of equity ownership in Genesis assets. At September 30, 2010, the coupon rates on the senior loan and mezzanine note were 6.25% and 7.76%, respectively.

- On July 26, 2010, we acquired a life science facility and two medical office buildings for approximately \$48 million, including DownREIT units valued at \$9 million and assumed debt of \$5 million. The life science facility represents 85,000 rentable square feet and is occupied by a single tenant under a 15-year triple-net lease. The medical office buildings aggregate 103,000 rentable square feet and were 95% occupied at closing.



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- On June 1, 2010, we acquired four senior housing facilities for \$102 million. These facilities are leased to Emeritus Corporation under a master lease agreement that has an initial term of 10 years and two 10-year renewal options.

During the nine months ended September 30, 2010, we sold investments of \$98 million as follows: (i) \$72.5 million of debt investments (including \$65.4 million of HCA bonds) and recognized gains of \$5.6 million; and (ii) three skilled nursing facilities and a hospital for \$25.5 million and recognized gain on sales of real estate of \$4 million. Subsequently, in October 2010, we sold our remaining bond investments from HCA and one other issuer for \$102 million and recognized additional gains of \$8 million.

During the nine months ended September 30, 2010, four life science facilities located in South San Francisco were placed in service representing 354,000 square feet.

### *Financings*

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

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In June 2010, we initiated a public offering, which resulted in the sale of 15.5 million shares of common stock at a price of \$33.00 per share for gross proceeds of \$512 million. This offering included: (i) the June 2010 public offering of 13.5 million shares for \$445.5 million; and (ii) the July 2010 sale of 2.025 million shares, for \$66.8 million, as a result of the underwriters exercising the over-allotment option from the June 2010 public offering. We received total net proceeds of \$492 million from these sales, which were used to repay the outstanding indebtedness under our revolving line of credit, fund acquisitions and capital expenditures, repay mortgage debt and for other general corporate purposes.

*Other events*

On November 1, 2010, we received \$46 million in proceeds, including an \$11 million prepayment premium, upon the early repayment of a mortgage loan receivable that was secured by a hospital. This loan had an original maturity of January 2016 and carried an interest rate of 8.5%.

On October 12, 2010, we concluded that our 35% interest in HCP Ventures II, an unconsolidated joint venture that owns 25 senior housing properties leased by Horizon Bay Communities or certain of its affiliates ( Horizon Bay ), was impaired. During the quarter ended September 30, 2010, we recorded a non-cash impairment charge related to our investment in HCP Ventures II of \$72 million.

In February 2010, we entered into a settlement agreement with Erickson Retirement Communities ( Erickson ), which filed for bankruptcy in October 2009. On April 15, 2010, the bankruptcy court approved the settlement agreement and confirmed Erickson's final plan of reorganization. The settlement agreement and plan of reorganization provided that we (concurrently with the April 2010 closing of the sale of Erickson's assets and the transfer to the buyer of all of our interests in the three DFLs and participation in the senior construction loan): (i) retain deposits held by us with balances of \$5 million and (ii) receive an additional \$9.6 million. As a result, during the three months ended March 31, 2010, we recognized aggregate income of \$11.9 million, which represents impairment recoveries of portions of previous impairment charges related to investments in three direct financing leases ( DFLs ) and a participation interest in a senior construction loan related to Erickson.

**Dividends**

On October 28, 2010, we announced that our Board declared a quarterly common stock cash dividend of \$0.465 per share. The common stock dividend will be paid on November 23, 2010 to stockholders of record as of the close of business on November 8, 2010.

**Critical Accounting Policies**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles ( GAAP ) requires our management to use judgment in the application of accounting policies, including making estimates and assumptions. We base estimates on the best information available to us at the time, our experience and on various other assumptions believed to be reasonable under the circumstances. These estimates affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. If our judgment or interpretation of the facts and circumstances relating to various transactions or other matters had been different, it is possible that different accounting would have been applied, resulting in a different presentation of our condensed consolidated financial statements. From time to time, we re-evaluate our estimates and assumptions. In

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the event estimates or assumptions prove to be different from actual results, adjustments are made in subsequent periods to reflect more current estimates and assumptions about matters that are inherently uncertain. A summary of our critical accounting policies is included in our Annual Report on Form 10-K for the year ended December 31, 2009 in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations. There have been no significant changes to such policies for the nine months ended September 30, 2010, except for our policy regarding principles of consolidation, which we have updated to address the new requirements of Accounting Standards Update No. 2009-17, *Consolidations (Topic 810): Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities* (Update No. 2009-17). The revised critical accounting policy is as follows:

### *Principles of Consolidation*

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

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

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

**Results of Operations**

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

Our financial results for the three and nine months ended September 30, 2010 and 2009 are summarized as follows:

*Comparison of the Three Months Ended September 30, 2010 to the Three Months Ended September 30, 2009**Rental and related revenues*

| Segments        | Three Months Ended September 30, |            | Change    |     |
|-----------------|----------------------------------|------------|-----------|-----|
|                 | 2010                             | 2009       | \$        | %   |
|                 | (dollars in thousands)           |            |           |     |
| Senior housing  | \$ 88,151                        | \$ 67,709  | \$ 20,442 | 30% |
| Life science    | 59,201                           | 53,536     | 5,665     | 11  |
| Medical office  | 66,022                           | 65,419     | 603       | 1   |
| Skilled nursing | 9,274                            | 9,494      | (220)     | (2) |
| Hospital        | 20,378                           | 20,011     | 367       | 2   |
| Total           | \$ 243,026                       | \$ 216,169 | \$ 26,857 | 12% |

- *Senior housing.* The increase in senior housing rental and related revenues for the three months ended September 30, 2010 was primarily related to: (i) a \$13.7 million increase as a result of including facility-level revenues for 27 properties due to the consolidation of four variable interest entities on August 31, 2010 (see Notes 11 and 17 to the Condensed Consolidated Financial Statements for additional information regarding these VIEs), (ii) a \$4.2 million increase as a result of improvements related to the transition of management agreements on 15 communities previously operated by Sunrise on October 1, 2009, and (iii) a \$2.6 million increase due to the additive effect of our acquisitions in 2010.
- *Life science.* The increase in life science rental and related revenues was primarily the result of assets that were placed in service in 2010, which were previously under development.

*Interest income*

For the three months ended September 30, 2010, interest income increased \$2.6 million to \$36.6 million. This increase was primarily related to additional interest income of \$5.1 million earned from the \$720 million participation in the first mortgage debt of HCR ManorCare purchased in August 2009, which was partially offset by a \$2.6 million decrease of interest earned from marketable debt securities that were sold in 2009 and 2010. For a more detailed description of our participation in the first mortgage debt of HCR ManorCare, see Note 6 to the Condensed Consolidated Financial Statements. Our exposure to income fluctuations related to our variable rate loans is partially mitigated by our variable rate indebtedness. For a more detailed discussion of our interest rate risk, see *Quantitative and Qualitative Disclosures About Market Risk* in Item 3.

Table of Contents*Depreciation and amortization expense*

Depreciation and amortization expense decreased \$2.8 million to \$78.3 million for the three months ended September 30, 2010. Depreciation and amortization expense for the three months ended September 30, 2009 included \$4.7 million of accelerated amortization of intangible assets as a result of the modification of the lease term of a tenant in one of our life science facilities. No similar lease modifications were made during the three months ended September 30, 2010. The decrease in depreciation and amortization expense was partially offset by a \$1.9 million increase as a result of life science assets that were placed in service during 2010, which were previously under development.

*Interest expense*

Interest expense decreased \$2.4 million to \$71.6 million for the three months ended September 30, 2010. The decrease was primarily due to: (i) a \$2.1 million decrease from the net impact of the repayment of mortgage debt related to contractual maturities, offset in part by secured debt financing obtained in connection with our purchase of a \$720 million participation in the first mortgage debt of HCR ManorCare and (ii) a \$1.4 million decrease as a result of the early repayment of our term loan in March 2010. These decreases in interest expense were partially offset by a decrease of \$1.3 million of capitalized interest related to assets under development in our life science segment that were placed in service during 2010.

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

|   | As of September 30, |              |
|---|---------------------|--------------|
|   | 2010                | 2009         |
| <b>Balance:</b>   |                     |              |
| Fixed rate  | \$ 4,338,501        | \$ 4,722,757 |
| Variable rate   | 1,089,738           | 972,504      |
| Total   | \$ 5,428,239        | \$ 5,695,261 |
| <b>Percent of total debt:</b>                           |                     |              |
| Fixed rate  | 80%                 | 83%          |
| Variable rate   | 20                  | 17           |
| Total   | 100%                | 100%         |
| <b>Weighted-average interest rate at end of period:</b> |                     |              |
| Fixed rate  | 6.26%               | 6.32%        |
| Variable rate   | 2.07%               | 2.49%        |
| Total weighted-average rate                             | 5.42%               | 5.66%        |

*Operating expenses*

| Segments       | Three Months Ended September 30, |          | \$        | Change | %   |
|----------------|----------------------------------|----------|-----------|--------|-----|
|                | 2010                             | 2009     |           |        |     |
|                | (dollars in thousands)           |          |           |        |     |
| Senior housing | \$ 13,322                        | \$ (252) | \$ 13,574 | NM     | (1) |
| Life science   | 12,707                           | 11,930   | 777       |        | 7   |

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|                 |           |           |           |       |
|-----------------|-----------|-----------|-----------|-------|
| Medical office  | 33,336    | 33,573    | (237)     | (1)   |
| Skilled nursing | 76        | 25        | 51        | NM(1) |
| Hospital        | 1,020     | 883       | 137       | 16    |
| Total           | \$ 60,461 | \$ 46,159 | \$ 14,302 | 31%   |

(1) Percentage change not meaningful.

Operating expenses are generally related to MOB and life science properties where we incur the expenses and recover all or a portion of those expenses from the tenants. The presentation of expenses as operating or general and administrative is based on the underlying nature of the expense. Periodically, we review the classification of expenses between categories and make revisions based on changes in the underlying nature of the expenses. The increase in operating expenses during the three months ended September 30, 2010 was primarily the result of including facility-level operating expenses for 27 senior housing properties due to the consolidation of four VIEs on August 31, 2010 (see Notes 11 and 17 to the Condensed Consolidated Financial Statements for additional information regarding these VIEs).

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*General and administrative expenses*

General and administrative expenses decreased \$3.3 million to \$19.6 million for the three months ended September 30, 2010. The decrease in general and administrative expenses was primarily due to a decrease in legal fees associated with litigation matters, partially offset by increased costs related to acquisitions pursued in 2010. See the information set forth under the heading "Legal Proceedings" of Note 11 to the Condensed Consolidated Financial Statements.

*Litigation provision*

On September 4, 2009 a jury returned a verdict in favor of Ventas, Inc., in an action brought against us in the United States District Court for the Western District of Kentucky for tortious interference with prospective business advantage in connection with Ventas's 2007 acquisition of Sunrise REIT. The jury awarded Ventas approximately \$102 million in compensatory damages, which we recorded as a litigation provision expense during the quarter ended September 30, 2009 (See the information set forth under the heading "Legal Proceedings" of Note 11 to the Condensed Consolidated Financial Statements).

*Impairments (recoveries)*

During the three months ended September 30, 2009, we recognized impairments of \$15.1 million related to two of our senior housing DFLs as a result of an anticipated restructure of the underlying leases (see Note 5 to the Condensed Consolidated Financial Statements). No DFLs were determined to be impaired during the three months ended September 30, 2010.

*Other income, net*

For the three months ended September 30, 2010, other income, net increased \$0.7 million to \$6.7 million. The increase was primarily due to changes in the fair value of certain derivative instruments (warrants).

*Impairments of investments in unconsolidated joint ventures*

During the three months ended September 30, 2010, we recognized impairments of \$71.7 million related to our 35% interest in HCP Ventures II, an unconsolidated joint venture that owns 25 senior housing properties leased by Horizon Bay as a result of the recent and projected deterioration of the operating performance of the properties leased by Horizon Bay from HCP Ventures II.



*Income taxes*

For the three months ended September 30, 2010, income tax expense increased \$1.2 million to \$0.9 million. During the three months ended September 30, 2009, we recognized a tax benefit of \$1.6 million as a result of an increase in depreciation expense due to a correction of an immaterial error of one of our real estate investments held in a taxable REIT subsidiary ( TRS ). No similar corrections were recognized during the three months ended September 30, 2010.

*Equity income from unconsolidated joint ventures*

For the three months ended September 30, 2010, equity income from unconsolidated joint ventures decreased \$1.1 million to \$0.2 million. This decrease is primarily due to HCP Ventures II s (an unconsolidated joint venture) conclusion to cease recognizing non-cash rental income (i.e., straight-line rents) from Horizon Bay effective July 1, 2010, which resulted in lower earnings for, and our share of earnings from, HCP Ventures II during the three months ended September 30, 2010.

*Discontinued operations*

The increase of \$1.3 million in income from discontinued operations to \$4.7 million for the three months ended September 30, 2010 is primarily due to an increase in gain on real estate dispositions of \$1.5 million. During the three months ended September 30, 2010 and 2009, we sold three properties for \$10 million and two properties for \$5.8 million, respectively.

Table of Contents*Comparison of the Nine Months Ended September 30, 2010 to the Nine Months Ended September 30, 2009**Rental and related revenues*

| Segments        | Nine Months Ended September 30, |            | Change    | %   |
|-----------------|---------------------------------|------------|-----------|-----|
|                 | 2010                            | 2009       |           |     |
|                 | (dollars in thousands)          |            |           |     |
| Senior housing  | \$ 235,566                      | \$ 214,595 | \$ 20,971 | 10% |
| Life science    | 176,935                         | 159,072    | 17,863    | 11  |
| Medical office  | 196,572                         | 196,266    | 306       |     |
| Skilled nursing | 27,843                          | 27,366     | 477       | 2   |
| Hospital        | 60,886                          | 59,085     | 1,801     | 3   |
| Total           | \$ 697,802                      | \$ 656,384 | \$ 41,418 | 6%  |

- *Senior housing.* The increase in senior housing rental and related revenues for the nine months ended September 30, 2010 was primarily related to: (i) a \$13.7 million increase as a result of including facility-level revenues for 27 properties due to the consolidation of four VIEs on August 31, 2010 (see Notes 11 and 17 to the Condensed Consolidated Financial Statements for additional information regarding these VIEs), (ii) a \$5.8 million increase as a result of improvements related to the transition of management agreements on 15 communities previously operated by Sunrise on October 1, 2009, and (iii) a \$3.5 million increase due to the additive effect of our acquisitions in 2010. Senior housing rental and related revenues for the nine months ended September 30, 2009 included \$6.4 million as a result of a correction to the purchase price allocation of certain assets acquired in 2006, which were predominately offset by increases from rent escalations and resets during the comparable period in 2010.

- *Life science.* The increase in life science rental and related revenues was primarily the result of assets that were placed in service in 2010, which were previously under development.

*Income from direct financing leases*

Income from direct financing leases decreased \$2.1 million to \$37.2 million for the nine months ended September 30, 2010. The decrease was primarily due to three DFLs that were deemed to be substantially impaired during 2009 (see Note 5 to the Condensed Consolidated Financial Statements).

*Interest income*

For the nine months ended September 30, 2010, interest income increased \$20.2 million to \$108.0 million. This increase was primarily related to additional interest income of \$29.7 million earned from the \$720 million participation in the first mortgage debt of HCR ManorCare purchased in August 2009, which was partially offset by a \$9.3 million decrease of interest earned from marketable debt securities that were sold in 2009 and 2010. For a more detailed description of our participation in the first mortgage debt of HCR ManorCare, see Note 6 to the Condensed

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Consolidated Financial Statements. Our exposure to income fluctuations related to our variable rate loans is partially mitigated by our variable rate indebtedness. For a more detailed discussion of our interest rate risk, see *Quantitative and Qualitative Disclosures About Market Risk* in Item 3.

### *Depreciation and amortization expense*

Depreciation and amortization expense decreased \$6.3 million to \$234.0 million for the nine months ended September 30, 2010. The decrease in depreciation and amortization expense is primarily the result of lower depreciation of \$15.8 million from assets that became fully depreciated in 2009 and 2010, which was partially offset by additional amortization expense from leasing costs and tenant and capital improvements expenditures that were incurred in 2009 and 2010. The nine months ended September 30, 2010 also included the offsetting impact of the following: (i) a decrease of \$4.7 million of accelerated amortization of intangible assets as a result of the modification of the lease term of a tenant in one of our life science facilities in 2009, (ii) a decrease of \$2.0 million resulting from a 2009 adjustment to the purchase price allocation of certain assets acquired in 2006, (iii) a \$5.3 million increase due to our life science development assets placed in service during 2010, which were previously under development, and (iv) a \$1.9 million increase due to our 2010 real estate acquisitions.

Table of Contents*Interest expense*

Interest expense decreased \$5.8 million to \$220.3 million for the nine months ended September 30, 2010. The decrease was primarily due to: (i) a decrease of \$3.2 million from the net impact of the repayment of mortgage debt related to contractual maturities, offset in part by secured debt financing obtained in connection with our purchase of a \$720 million participation in the first mortgage debt of HCR ManorCare, (ii) a \$1.8 million decrease in interest expense resulting from the benefit of an interest-rate swap (pay float and receive fixed) that was placed on \$250 million of our unsecured senior notes in June 2009, (iii) a \$2.0 million decrease as a result of the early repayment of our term loan in March 2010, and (iv) a \$2.0 million decrease from the repayment of the outstanding balance under our bridge loan in May 2009. The decrease in interest expense was partially offset by a decrease of \$3.5 million of capitalized interest related to assets under development in our life science segment that were placed in service during 2010.

*Operating expenses*

| Segments        | Nine Months Ended September 30, |            | \$        | Change | %      |
|-----------------|---------------------------------|------------|-----------|--------|--------|
|                 | 2010                            | 2009       |           |        |        |
|                 | (dollars in thousands)          |            |           |        |        |
| Senior housing  | \$ 15,010                       | \$ 3,937   | \$ 11,073 |        | NM%(1) |
| Life science    | 36,045                          | 34,639     | 1,406     |        | 4      |
| Medical office  | 96,993                          | 98,537     | (1,544)   |        | (2)    |
| Skilled nursing | 175                             | 112        | 63        |        | 56     |
| Hospital        | 3,805                           | 2,542      | 1,263     |        | 50     |
| Total           | \$ 152,028                      | \$ 139,767 | \$ 12,261 |        | 9%     |

(1) Percentage change not meaningful.

Operating expenses are generally related to MOB and life science properties where we incur the expenses and recover all or a portion of those expenses from the tenants. The presentation of expenses as operating or general and administrative is based on the underlying nature of the expense. Periodically, we review the classification of expenses between categories and make revisions based on changes in the underlying nature of the expenses. The increase in operating expenses during the nine months ended September 30, 2010 was primarily the result of including facility-level operating expenses for 27 senior housing properties due to the consolidation of four VIEs on August 31, 2010 (see Notes 11 and 17 to the Condensed Consolidated Financial Statements for additional information regarding these VIEs).

*General and administrative expenses*

General and administrative expenses increased \$3.4 million to \$65.0 million for the nine months ended September 30, 2010. The increase in general and administrative expenses was primarily due to increased costs related to acquisitions pursued in 2010, partially offset by a decrease in legal fees associated with litigation matters and lower compensation related expenses and professional fees. See the information set forth under the heading "Legal Proceedings" of Note 11 to the Condensed Consolidated Financial Statements.

*Litigation provision*

On September 4, 2009 a jury returned a verdict in favor of Ventas, Inc., in an action brought against us in the United States District Court for the Western District of Kentucky for tortious interference with prospective business advantage in connection with Ventas's 2007 acquisition of Sunrise REIT. The jury awarded Ventas approximately \$102 million in compensatory damages, which we recorded as a litigation provision expense during the quarter ended September 30, 2009 (See the information set forth under the heading "Legal Proceedings" of Note 11 to the Condensed Consolidated Financial Statements).

*Impairments (recoveries)*

The nine months ended September 30, 2010 includes \$11.9 million related to the March 2010 reversal of portions of allowance established by previous impairment charges of investments related to Erickson. Erickson is the tenant at three of our senior housing continuing-care-retirement-communities DFLs and the borrower of a senior construction loan in which we have a participation interest (see Note 5 to the Condensed Consolidated Financial Statements). During the nine months ended September 30, 2009, we recognized impairments of \$21 million as a result of (i) \$15.1 million related to two of our senior housing DFLs as a result of an anticipated restructure of the underlying leases (see Note 5 to the Condensed Consolidated Financial Statements), and (ii) \$5.9 million of intangible assets on 12 of 15 senior housing communities that were determined to be impaired due to the termination of the Sunrise management agreements on 15 senior housing communities effective October 1, 2009.

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*Other income, net*

For the nine months ended September 30, 2010, other income, net increased \$2.0 million to \$7.2 million primarily due to a 2009 \$1.4 million impairment related to goodwill.

*Impairments of investments in unconsolidated joint ventures*

During the nine months ended September 30, 2010, we recognized impairments of \$71.7 million related to our 35% interest in HCP Ventures II, an unconsolidated joint venture that owns 25 senior housing properties leased by Horizon Bay as a result of the recent and projected deterioration of the operating performance of the properties leased by Horizon Bay from HCP Ventures II.

*Equity income from unconsolidated joint ventures*

For the nine months ended September 30, 2010, equity income from unconsolidated joint ventures increased \$2.1 million to \$4.1 million. This increase is primarily due to: (i) the recognition of additional rental revenues during 2010 from a life science tenant in one of our unconsolidated joint ventures that was previously deferred and (ii) a change in the expected useful life of certain intangible assets of one of our unconsolidated joint ventures that resulted in lower equity income due to higher amounts of amortization expense during 2009. These increases were partially offset by HCP Ventures II's conclusion to cease recognizing non-cash rental income (i.e., straight-line rents) from Horizon Bay effective July 1, 2010, which resulted in lower earnings for, and our share of earnings from, HCP Ventures II during the nine months ended September 30, 2010.

*Discontinued operations*

The decrease of \$34.3 million in income from discontinued operations to \$6.6 million for the nine months ended September 30, 2010 is primarily due to a decrease in gains on real estate dispositions of \$30.3 million and income from discontinued operations of \$4.1 million. During the nine months ended September 30, 2010 and 2009, we sold four properties for \$25 million and 11 properties for \$58 million, respectively. Discontinued operations for the nine months ended September 30, 2010 included 13 properties compared to 27 properties for the nine months ended September 30, 2009.

**Liquidity and Capital Resources**

Our principal liquidity needs are to: (i) fund normal operating expenses, (ii) meet debt service requirements, (iii) fund capital expenditures, including tenant improvements and leasing costs, (iv) fund acquisition and development activities, and (v) make dividend distributions. We believe these needs will be satisfied using cash flows generated by operations and from our various financing activities during the next twelve months. During the nine months ended September 30, 2010, distributions to shareholders and noncontrolling interest holders exceeded cash

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flows from operations by approximately \$15 million. During 2010, we raised aggregate net proceeds of \$566 million from issuances of common stock and sales of marketable debt securities and real estate, which proceeds, among other things, are the sources of cash used to fund the excess of distributions to shareholders and noncontrolling interest holders above cash flows from operations during the nine months ended September 30, 2010.

Access to capital markets impacts our cost of capital and ability to refinance maturing indebtedness, as well as to fund future acquisitions and development through the issuance of additional securities or secured debt. 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 October 28, 2010, we had a credit rating of Baa3 (positive) from Moody's, BBB (stable) from S&P and BBB (positive) from Fitch on our senior unsecured debt securities, and Ba1 (positive) from Moody's, BB+ (stable) from S&P and BB+ (positive) from Fitch on our preferred equity securities.

Net cash provided by operating activities was \$431 million and \$390 million for the nine months ended September 30, 2010 and 2009, respectively. The increase in operating cash flows is primarily the result of the following: (i) the additive impact of our investments in 2009 and 2010, (ii) assets placed in service in 2010 and (iii) rent escalations and resets in 2009 and 2010. Our cash flows from operations are dependent upon the occupancy level of multi-tenant buildings, rental rates on leases, our tenants' performance on their lease obligations, the level of operating expenses and other factors.

Net cash used in investing activities was \$327 million for the nine months ended September 30, 2010 and consisted primarily of fundings of: (i) \$228 million for acquisition and development of real estate, (ii) \$131 million for investments in loans receivables and DFLs, and (iii) \$65 million for leasing costs and tenant and capital improvements. These expenditures were partially offset by our proceeds of \$28 million from the repayment of loans receivable and DFLs and \$73 million from the sales of marketable debt securities.

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Net cash used in financing activities was \$163 million for the nine months ended September 30, 2010 and consisted primarily of: (i) payments of common and preferred dividends aggregating \$434 million, (ii) repayment of our term loan of \$200 million, (iii) repayment of \$200 million of senior unsecured notes and (iv) repayment of our mortgage debt of \$163 million. The amount of cash used in financing activities was partially offset by net proceeds of \$519 million from the issuances of common stock and \$318 million net borrowings from our revolving line of credit facility.

*Debt*

*Bank Line of Credit*

Our revolving line of credit facility with a syndicate of banks provides for an aggregate borrowing capacity of \$1.5 billion and matures on August 1, 2011. This revolving line of credit facility accrues interest at a rate per annum equal to LIBOR plus a margin that depends upon our debt ratings. We pay a facility fee on the entire revolving commitment that depends upon our debt ratings. Based on our debt ratings on September 30, 2010, the margin on the revolving line of credit facility was 0.55% and the facility fee was 0.15%. At September 30, 2010, we had \$318 million outstanding under this revolving line of credit facility with a weighted-average interest rate of 1.29%. At September 30, 2010, \$117 million of aggregate letters of credit were also outstanding against our revolving line of credit facility, including a \$103 million letter of credit as a result of the Ventas litigation. For further information regarding the Ventas litigation, see Note 11 to the Condensed Consolidated Financial Statements.

Our revolving line of credit facility contains certain financial restrictions and other customary requirements. Among other things, these covenants, using terms defined in the agreement, (i) limit the ratio of Consolidated Total Indebtedness to Consolidated Total Asset Value to 60%, (ii) limit the ratio of Unsecured Debt to Consolidated Unencumbered Asset Value to 65%, (iii) require a Fixed Charge Coverage ratio of 1.75 times and (iv) require a formula-determined Minimum Consolidated Tangible Net Worth of \$5.3 billion at September 30, 2010. At September 30, 2010, we were in compliance with each of these restrictions and requirements of our revolving line of credit facility.

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

*Senior Unsecured Notes*

At September 30, 2010, we had senior unsecured notes outstanding with an aggregate principal balance of \$3.3 billion. Interest rates on the notes ranged from 1.19% to 7.07% with a weighted-average effective interest rate of 6.13% at September 30, 2010. Discounts and premiums are amortized to interest expense over the term of the related notes. The senior unsecured notes contain certain covenants including limitations on debt, cross-acceleration provisions and other customary terms. At September 30, 2010, we believe we were in compliance with these covenants.



*Mortgage and Other Secured Debt*

At September 30, 2010, we had \$1.7 billion in aggregate principal amount of mortgage and other secured debt outstanding that is secured by 141 healthcare facilities, which had a carrying value of \$2.0 billion, as well as a participation in a first mortgage loan with a carrying value of \$630 million. Interest rates on the mortgage and other secured debt ranged from 1.27% to 8.30% with a weighted-average effective interest rate of 4.79% at September 30, 2010.

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

*Other Debt*

At September 30, 2010, we had \$94 million of non-interest bearing life care bonds at two of our continuing care retirement communities and non-interest bearing occupancy fee deposits at another of our senior housing facilities, all of which were payable to certain residents of the facilities (collectively, Life Care Bonds). At September 30, 2010, \$38.3 million of the Life Care Bonds were refundable to the residents upon the resident moving out or to their estate upon death, and \$55.7 million of the Life Care Bonds were refundable after the unit is successfully remarketed to a new resident.

Table of Contents*Debt Maturities*

The following table summarizes our stated debt maturities and scheduled principal repayments at September 30, 2010 (in thousands):

| <b>Year</b>                   | <b>Amount(1)</b> |
|-------------------------------|------------------|
| 2010 (Three Months)           | \$ 20,134        |
| 2011                          | 689,879          |
| 2012                          | 313,860          |
| 2013                          | 1,225,194        |
| 2014                          | 264,530          |
| Thereafter                    | 2,820,652        |
|                               | 5,334,249        |
| (Discounts) and premiums, net | (8,534)          |
|                               | \$ 5,325,715     |

(1) Excludes \$94 million of other debt that represents non-interest bearing life care bonds and occupancy fee deposits at three of our senior housing facilities, which have no scheduled maturities.

*Derivative Instruments*

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

The following table summarizes our outstanding interest rate swap contracts as of September 30, 2010 (dollars in thousands):

| <b>Date Entered</b> | <b>Maturity Date</b> | <b>Hedge Designation</b> | <b>Fixed Rate</b> | <b>Floating Rate Index</b> | <b>Notional Amount</b> | <b>Fair Value</b> |
|---------------------|----------------------|--------------------------|-------------------|----------------------------|------------------------|-------------------|
| July 2005(1)        | July 2020            | Cash Flow                | 3.82%             | BMA Swap Index             | \$ 45,600              | \$ (6,382)        |
| June 2009           | September 2011       | Fair Value               | 5.95%             | 1 Month LIBOR+4.21%        | 250,000                | 3,210             |
| July 2009           | July 2013            | Cash Flow                | 6.13%             | 1 Month LIBOR+3.65%        | 14,300                 | (684)             |
| August 2009         | February 2011        | Cash Flow                | 0.87%             | 1 Month LIBOR              | 250,000                | 546               |
| August 2009         | August 2011          | Cash Flow                | 1.24%             | 1 Month LIBOR              | 250,000                | 2,006             |

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

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

*Equity*

At September 30, 2010, we had 4.0 million shares of 7.25% Series E cumulative redeemable preferred stock, 7.8 million shares of 7.10% Series F cumulative redeemable preferred stock and 310.5 million shares of common stock outstanding. At September 30, 2010, equity totaled \$6.3 billion and our equity securities had a market value of \$11.7 billion.

At September 30, 2010, there were a total of 4.3 million DownREIT units outstanding in five limited liability companies in which we are the managing member. The DownREIT units are exchangeable for an amount of cash approximating the then-current market value of shares of our common stock or, at our option, shares of our common stock (subject to certain adjustments, such as stock splits and reclassifications).

*Shelf Registration*

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

Table of Contents**Non-GAAP Financial Measure Funds From Operations ( FFO )**

We believe FFO applicable to common shares, diluted FFO applicable to common shares, FFO, before the impact of impairments, recoveries and litigation provision, and basic and diluted FFO per common share are important supplemental measures of operating performance for a real estate investment trust. 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 real estate investment trust that uses historical cost accounting for depreciation could be less informative. The term FFO was designed by the real estate investment trust 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 real estate dispositions, plus real estate 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. Our computation of FFO may not be comparable to FFO reported by other real estate investment trusts that do not define the term in accordance with the current National Association of Real Estate Investment Trusts ( NAREIT ) definition or that have a different interpretation of the current NAREIT definition from us.

In addition, we present FFO, before the impact of impairments, recoveries and litigation provision. Management believes FFO, before the impact of impairments, recoveries and litigation provision, is useful to both the Company and its investors. This measure is a modification of the NAREIT definition of FFO and should not be used as an alternative to net income.

Details of certain items that affect comparability are discussed in the financials results summary of our financial results for the three and nine months ended September 30, 2010 and 2009. The following is a reconciliation from net income applicable to common shares, the most direct comparable financial measure calculated and presented with GAAP, to FFO (in thousands):

|  | Three Months Ended<br>September 30, |             | Nine Months Ended<br>September 30, |            |
|--|-------------------------------------|-------------|------------------------------------|------------|
|  | 2010                                | 2009        | 2010                               | 2009       |
| Net income (loss) applicable to common shares  | \$ 16,995                           | \$ (52,397) | \$ 171,296                         | \$ 82,672  |
| Depreciation and amortization of real estate,<br>in-place lease and other intangibles: |                                     |             |                                    |            |
| Continuing operations  | 78,334                              | 81,177      | 234,008                            | 240,308    |
| Discontinued operations  | 173                                 | 1,180       | 1,382                              | 2,276      |
| Gain on sales of real estate   | (3,987)                             | (2,460)     | (4,052)                            | (34,357)   |
| Equity income from unconsolidated joint ventures                                       | (209)                               | (1,328)     | (4,078)                            | (1,993)    |
| FFO from unconsolidated joint ventures   | 5,213                               | 6,433       | 19,709                             | 19,004     |
| Noncontrolling interests and participating securities<br>share in earnings             | 3,896                               | 3,895       | 11,725                             | 12,147     |
| Noncontrolling interests and participating securities<br>share in FFO                  | (4,334)                             | (4,331)     | (13,192)                           | (13,633)   |
| FFO applicable to common shares  | \$ 96,081                           | \$ 32,169   | \$ 416,798                         | \$ 306,424 |
|  | \$ 71,693                           | \$ 117,096  | \$ 59,793                          | \$ 123,002 |

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Impact of impairments, recoveries and litigation provision

|  |    |         |    |         |    |         |    |         |
|--|----|---------|----|---------|----|---------|----|---------|
| Diluted FFO, before giving effect to impairments, recoveries and litigation provision                  | \$ | 167,774 | \$ | 149,265 | \$ | 476,591 | \$ | 429,426 |
| Basic FFO per common share   | \$ | 0.31    | \$ | 0.11    | \$ | 1.39    | \$ | 1.14    |
| Diluted FFO per common share   | \$ | 0.31    | \$ | 0.11    | \$ | 1.39    | \$ | 1.14    |
| Per common share impact of impairments, recoveries and litigation provision on diluted FFO             | \$ | 0.23    | \$ | 0.41    | \$ | 0.19    | \$ | 0.46    |
| Diluted FFO per common share, before giving effect to impairments, recoveries and litigation provision | \$ | 0.54    | \$ | 0.52    | \$ | 1.58    | \$ | 1.60    |
| Weighted average shares used to calculate diluted FFO per common share                                 |    | 311,092 |    | 285,234 |    | 300,468 |    | 268,183 |

Table of Contents**Off-Balance Sheet Arrangements**

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

**Contractual Obligations**

The following table summarizes our material contractual payment obligations and commitments at September 30, 2010 (dollars in thousands):

|                                   | Total(1)     | Less than<br>One Year | 2011-2012    | 2013-2014    | More than<br>Five Years |
|-----------------------------------|--------------|-----------------------|--------------|--------------|-------------------------|
| Bank line of credit               | \$ 318,000   | \$                    | \$ 318,000   | \$           | \$                      |
| Senior unsecured notes            | 3,335,686    | 6,421                 | 542,265      | 637,000      | 2,150,000               |
| Mortgage and other secured debt   | 1,680,563    | 13,713                | 143,474      | 852,724      | 670,652                 |
| Development commitments(2)        | 9,606        | 5,735                 | 3,871        |              |                         |
| Ground and other operating leases | 199,443      | 1,254                 | 10,261       | 9,927        | 178,001                 |
| Interest(3)                       | 1,381,962    | 79,237                | 531,642      | 407,106      | 363,977                 |
| Total                             | \$ 6,925,260 | \$ 106,360            | \$ 1,549,513 | \$ 1,906,757 | \$ 3,362,630            |

(1) Excludes \$94 million of other debt that represents non-interest bearing life care bonds and occupancy fee deposits at three of our senior housing facilities, which have no scheduled maturities.

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

(3) Interest on variable-rate debt is calculated using rates in effect at September 30, 2010.

**Inflation**

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

## Recent Accounting Pronouncements

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

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

*Interest Rate Risk.* At September 30, 2010, we were exposed to market risks related to fluctuations in interest rates on approximately \$1.8 billion of variable-rate loan investments (see Note 6 to the Condensed Consolidated Financial Statements) and \$83 million of other investments where the payments fluctuate with changes in LIBOR. Our exposure to income fluctuations related to our variable-rate investments is partially offset by (i) \$318 million of variable-rate line of credit borrowings, (ii) \$497 million of variable-rate mortgage notes and other secured debt payable, excluding \$60 million of variable-rate mortgage notes which have been hedged through interest-rate swap contracts, (iii) \$25 million of variable-rate senior unsecured notes and (iv) \$750 million of additional variable interest rate exposure achieved through interest-rate swap contracts (pay float and receive fixed).

Interest rate fluctuations will generally not affect our future earnings or cash flows on our fixed rate debt, loans receivable and debt securities unless such instruments mature or are otherwise terminated. However, interest rate changes will affect the estimated 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 estimated fair value of those instruments. Assuming a one percentage point increase in the interest rate related to the variable-rate investments and variable-rate debt, and assuming no change in the outstanding balance as of September 30, 2010, net interest income would improve by approximately \$12.6 million, or \$0.04 per common share on a diluted basis. Assuming a 50 basis point decrease in interest rates under the above circumstances, taking into consideration that the index underlying many of our arrangements is currently below 50 basis points and is not expected to go below zero, net interest income would decline by \$6.3 million, or approximately \$0.02 per common share on a diluted basis.

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We use derivative instruments during the normal course of business to manage or hedge interest rate risk. We do not use derivative financial instruments for speculative purposes. Derivatives are recorded on the condensed consolidated balance sheet at their estimated fair value. See Note 20 to the Condensed Consolidated Financial Statements for further information.

To illustrate the effect of movements in the interest rate markets, we performed a market sensitivity analysis on our outstanding hedging instruments. We applied various basis point spreads to the underlying interest rate curves of the derivative portfolio in order to determine the instruments' change in estimated fair value. Assuming a one percentage point change in the underlying interest rate curve, the change in estimated fair value of each of the underlying derivative instruments would not exceed \$4.2 million. See Note 20 to the Condensed Consolidated Financial Statements for additional analysis details.

*Market Risk.* We are directly and indirectly affected by changes in the equity and bond markets. We have investments in marketable debt and equity securities classified as available-for-sale. Gains and losses on these securities are recognized in income when realized and losses are recognized when an other-than-temporary decline in value is identified. An initial indicator of other-than-temporary decline in value for marketable equity securities is based on the severity of the decline in estimated fair value below the carrying value for an extended period of time. We consider a variety of factors in evaluating an other-than-temporary decline in value, such as: the length of time and the extent to which the market value has been less than our cost basis; the issuer's financial condition, capital strength and near-term prospects; any recent events specific to that issuer and economic conditions of its industry; and our investment horizon in relationship to an anticipated near-term recovery in the stock or bond price, if any. At September 30, 2010, the fair value and cost, or the adjusted cost basis for those securities where a recognized loss was recorded, of marketable equity securities was \$4.2 million and \$3.6 million, respectively, and the fair value and cost basis of marketable debt securities was \$101.4 million and \$93.9 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 September 30, 2010. Based upon that evaluation, our Chief Executive Officer (Principal Executive Officer) and Chief Financial Officer (Principal Financial Officer) concluded that our disclosure controls and procedures were effective at the reasonable assurance level.



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

### **PART II. OTHER INFORMATION**

#### **Item 1. Legal Proceedings**

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

Table of Contents**Item 1A. Risk Factors**

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

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

None.

**(b)**

None.

**(c)**

The table below sets forth information with respect to purchases of our common stock made by us or on our behalf or by any affiliated purchaser, as such term is defined in Rule 10b-18(a)(3) of the Securities Exchange Act of 1934, as amended, during the nine months ended September 30, 2010.

| 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 |
|----------------------|---|---------------------------------|---|--|
| July 1-31, 2010      | 1,085                                     | \$ 32.66                        |   |  |
| August 1-31, 2010    | 1,745                                     | 36.01                           |   |  |
| September 1-30, 2010 | 331                                       | 36.52                           |   |  |
| Total                | 3,161                                     | 34.92                           |   |  |

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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 herein to Exhibit 3.1 to HCP's Quarterly Report on Form 10-Q (File No. 1-08895), filed October 30, 2007).
- 3.2 Fourth Amended and Restated Bylaws of HCP (incorporated herein by reference to Exhibit 3.1 to HCP's Current Report on Form 8-K (File No. 1-08895), filed September 25, 2006).
- 3.2.1 Amendment No. 1 to Fourth Amended and Restated Bylaws of HCP (incorporated by reference herein to Exhibit 3.2.1 to HCP's Quarterly Report on Form 10-Q (File No. 1-08895), filed October 30, 2007).
- 3.2.2 Amendment No. 2 to Fourth Amended and Restated Bylaws of HCP, filed November 3, 2009 (incorporated by reference herein to Exhibit 3.2.2 to HCP's Quarterly Report on Form 10-Q (File No. 1-08895), filed August 3, 2010).
- 4.1 Registration Rights Agreement, dated as of July 26, 2010, by and among HCP, Boyer Research Park Associates VIII, L.C., Boyer Research Park Associates IX, L.C., and Tegra Lakeview Associates, L.C.
- 10.1 Letter Agreement, dated July 7, 2010, by and between HCP and Kendall Young.
- 31.1 Certification by James F. Flaherty III, HCP's Principal Executive Officer, Pursuant to Securities Exchange Act Rule 13a-14(a).
- 31.2 Certification by Thomas M. Herzog, HCP's Principal Financial Officer, Pursuant to Securities Exchange Act Rule 13a-14(a).

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|         |   |
|---------|---|
| 32.1    | Certification by James F. Flaherty III, HCP's Principal Executive Officer, Pursuant to Securities Exchange Act Rule 13a-14(b) and 18 U.S.C. Section 1350. |
| 32.2    | Certification by Thomas M. Herzog, HCP's Principal Financial Officer, Pursuant to Securities Exchange Act Rule 13a-14(b) and 18 U.S.C. Section 1350.      |
| 101.INS | XBRL Instance Document.*  |
| 101.SCH | XBRL Taxonomy Extension Schema Document.*   |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document.*   |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document.*  |
| 101.LAB | XBRL Taxonomy Extension Labels Linkbase Document.*  |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document.*  |

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\* Furnished herewith.  
Management Contract or Compensatory Plan or Arrangement.

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**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: November 2, 2010

HCP, Inc.

(Registrant)

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

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

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