

HCP, INC.  
Form 10-Q  
November 04, 2014  
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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, 2014.

OR

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

For the transition period from            to

Commission file number 001-08895

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HCP, INC.

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(Exact name of registrant as specified in its charter)

|   |   |
|---|---|
| Maryland  | 33-0091377                              |
| (State or other jurisdiction of<br>incorporation or organization) | (I.R.S. Employer<br>Identification No.) |

1920 Main Street, Suite 1200

Irvine, CA 92614

(Address of principal executive offices)

(949) 407-0700

(Registrant's telephone number, including area code)

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

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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

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Non-accelerated Filer

Smaller Reporting Company

(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 NO

As of October 30, 2014, there were 459,263,486 shares of the registrant's \$1.00 par value common stock outstanding.

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HCP, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

(Unaudited)

|  | September 30,<br>2014 | December 31,<br>2013 |
|--|-----------------------|----------------------|
| <b>ASSETS</b>  |                       |                      |
| Real estate:   |                       |                      |
| Buildings and improvements   | \$ 10,852,544         | \$ 10,544,110        |
| Development costs and construction in progress   | 261,514               | 225,869              |
| Land   | 1,885,081             | 1,822,862            |
| Accumulated depreciation and amortization  | (2,159,115)           | (1,965,592)          |
| Net real estate  | 10,840,024            | 10,627,249           |
| Net investment in direct financing leases  | 7,245,122             | 7,153,399            |
| Loans receivable, net  | 418,801               | 366,001              |
| Investments in and advances to unconsolidated joint ventures   | 647,923               | 196,576              |
| Accounts receivable, net of allowance of \$4,073 and \$1,529, respectively   | 34,687                | 27,494               |
| Cash and cash equivalents  | 83,531                | 300,556              |
| Restricted cash  | 54,448                | 37,229               |
| Intangible assets, net   | 479,226               | 489,842              |
| Real estate assets held for sale, net  | —                     | 9,819                |
| Other assets, net  | 941,128               | 867,705              |
| Total assets(1)  | \$ 20,744,890         | \$ 20,075,870        |
| <b>LIABILITIES AND EQUITY</b>  |                       |                      |
| Bank line of credit  | \$ 70,000             | \$ —                 |
| Term loan  | 222,118               | 226,858              |
| Senior unsecured notes   | 7,625,041             | 6,963,375            |
| Mortgage debt  | 1,199,633             | 1,396,485            |
| Other debt   | 97,845                | 74,909               |
| Intangible liabilities, net  | 88,490                | 98,810               |
| Accounts payable and accrued liabilities   | 329,209               | 318,427              |
| Deferred revenue   | 76,380                | 65,872               |
| Total liabilities(2)   | 9,708,716             | 9,144,736            |
| Commitments and contingencies  |                       |                      |
| Common stock, \$1.00 par value: 750,000,000 shares authorized; 459,145,515 and 456,960,648 shares issued and outstanding, respectively | 459,146               | 456,961              |
| Additional paid-in capital   | 11,409,843            | 11,334,041           |

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|  |               |               |
|--|---------------|---------------|
| Cumulative dividends in excess of earnings | (1,078,400)   | (1,053,215)   |
| Accumulated other comprehensive loss       | (17,464)      | (14,487)      |
| Total stockholders' equity                 | 10,773,125    | 10,723,300    |
| Joint venture partners                     | 73,977        | 23,729        |
| Non-managing member unitholders            | 189,072       | 184,105       |
| Total noncontrolling interests             | 263,049       | 207,834       |
| Total equity                               | 11,036,174    | 10,931,134    |
| Total liabilities and equity               | \$ 20,744,890 | \$ 20,075,870 |

(1) The Company's consolidated total assets at September 30, 2014 and December 31, 2013 include assets of certain variable interest entities ("VIEs") that can only be used to settle the liabilities of those VIEs. Total assets at September 30, 2014 includes VIE assets as follows: buildings and improvements \$668 million; land \$113 million; accumulated depreciation and amortization \$105 million; accounts receivable \$2 million; cash \$52 million; and other assets \$19 million. Total assets at December 31, 2013 includes other assets of \$1 million from VIEs. See Note 17 to the Condensed Consolidated Financial Statements for additional information.

(2) The Company's consolidated total liabilities at September 30, 2014 and December 31, 2013 include certain liabilities of VIEs for which the VIE creditors do not have recourse to HCP, Inc. Total liabilities at September 30, 2014 includes accounts payable and accrued liabilities of \$36 million and deferred revenue of \$11 million from VIEs. Total liabilities at December 31, 2013 includes accounts payable and accrued liabilities of \$9 million from VIEs. See Note 17 to the Condensed Consolidated Financial Statements for additional information.

See accompanying Notes to the 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<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|--|-------------------------------------|------------|------------------------------------|------------|
|  | 2014                                | 2013       | 2014                               | 2013       |
| Revenues:  |                                     |            |                                    |            |
| Rental and related revenues  | \$ 321,451                          | \$ 284,072 | \$ 894,465                         | \$ 843,380 |
| Tenant recoveries  | 29,323                              | 25,920     | 81,867                             | 75,266     |
| Resident fees and services   | 62,213                              | 36,370     | 138,205                            | 108,509    |
| Income from direct financing leases  | 165,687                             | 157,253    | 495,724                            | 472,409    |
| Interest income  | 17,517                              | 42,078     | 51,150                             | 68,611     |
| Investment management fee income   | 447                                 | 464        | 1,340                              | 1,406      |
| Total revenues   | 596,638                             | 546,157    | 1,662,751                          | 1,569,581  |
| Costs and expenses:  |                                     |            |                                    |            |
| Interest expense   | 111,275                             | 108,088    | 324,755                            | 325,650    |
| Depreciation and amortization  | 122,975                             | 104,783    | 343,496                            | 317,172    |
| Operating  | 99,599                              | 75,417     | 254,173                            | 221,990    |
| General and administrative   | 24,954                              | 45,326     | 75,410                             | 90,043     |
| Total costs and expenses   | 358,803                             | 333,614    | 997,834                            | 954,855    |
| Other income, net  | 3,111                               | 1,632      | 5,750                              | 17,032     |
| Income before income taxes and equity income from<br>unconsolidated joint ventures | 240,946                             | 214,175    | 670,667                            | 631,758    |
| Income taxes   | (55)                                | (1,034)    | (2,840)                            | (3,553)    |
| Equity income from unconsolidated joint ventures                                   | 10,168                              | 13,892     | 39,388                             | 44,278     |
| Income from continuing operations  | 251,059                             | 227,033    | 707,215                            | 672,483    |
| Discontinued operations:   |                                     |            |                                    |            |
| Income before gain on sales of real estate, net of<br>income taxes                 | —                                   | 1,527      | 1,736                              | 5,699      |
| Gain on sales of real estate, net of income taxes                                  | —                                   | 8,298      | 28,010                             | 9,185      |
| Total discontinued operations  | —                                   | 9,825      | 29,746                             | 14,884     |
| Net income   | 251,059                             | 236,858    | 736,961                            | 687,367    |
| Noncontrolling interests' share in earnings  | (3,405)                             | (3,102)    | (11,311)                           | (9,625)    |
| Net income attributable to HCP, Inc.   | 247,654                             | 233,756    | 725,650                            | 677,742    |

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|  |            |            |            |            |
|--|------------|------------|------------|------------|
| Participating securities' share in earnings                          | (446)      | (474)      | (1,999)    | (1,330)    |
| Net income applicable to common shares                               | \$ 247,208 | \$ 233,282 | \$ 723,651 | \$ 676,412 |
| Basic earnings per common share:                                     |            |            |            |            |
| Continuing operations  | \$ 0.54    | \$ 0.49    | \$ 1.52    | \$ 1.46    |
| Discontinued operations  | —          | 0.02       | 0.06       | 0.03       |
| Net income applicable to common shares                               | \$ 0.54    | \$ 0.51    | \$ 1.58    | \$ 1.49    |
| Diluted earnings per common share:                                   |            |            |            |            |
| Continuing operations  | \$ 0.54    | \$ 0.49    | \$ 1.52    | \$ 1.46    |
| Discontinued operations  | —          | 0.02       | 0.06       | 0.03       |
| Net income applicable to common shares                               | \$ 0.54    | \$ 0.51    | \$ 1.58    | \$ 1.49    |
| Weighted average shares used to calculate earnings per common share: |            |            |            |            |
| Basic  | 458,799    | 455,345    | 458,119    | 454,553    |
| Diluted  | 459,141    | 456,078    | 458,473    | 455,388    |
| Dividends declared per common share                                  | \$ 0.545   | \$ 0.525   | \$ 1.635   | 1.575      |

See accompanying Notes to the Condensed Consolidated Financial Statements.



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HCP, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

(Unaudited)

|   | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|---|-------------------------------------|------------|------------------------------------|------------|
|   | 2014                                | 2013       | 2014                               | 2013       |
| Net income  | \$ 251,059                          | \$ 236,858 | \$ 736,961                         | \$ 687,367 |
| Other comprehensive income (loss):                                  |                                     |            |                                    |            |
| Change in net unrealized gains (losses) on securities:              |                                     |            |                                    |            |
| Unrealized gains (losses)   | (1)                                 | —          | (5)                                | 1,355      |
| Reclassification adjustment realized in net income                  | —                                   | —          | —                                  | (9,131)    |
| Change in net unrealized gains (losses) on cash flow hedges:        |                                     |            |                                    |            |
| Unrealized gains (losses)   | 2,521                               | (3,710)    | 1,829                              | 5,635      |
| Reclassification adjustment realized in net income                  | (1,409)                             | 191        | (766)                              | 751        |
| Change in Supplemental Executive Retirement Plan obligation         | 55                                  | 56         | 163                                | 167        |
| Foreign currency translation adjustment                             | (6,961)                             | (56)       | (4,198)                            | (3)        |
| Total other comprehensive loss                                      | (5,795)                             | (3,519)    | (2,977)                            | (1,226)    |
| Total comprehensive income  | 245,264                             | 233,339    | 733,984                            | 686,141    |
| Total comprehensive income attributable to noncontrolling interests | (3,405)                             | (3,102)    | (11,311)                           | (9,625)    |
| Total comprehensive income attributable to HCP, Inc.                | \$ 241,859                          | \$ 230,237 | \$ 722,673                         | \$ 676,516 |

See accompanying Notes to the Condensed Consolidated Financial Statements.



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HCP, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF EQUITY

(In thousands, except per share data)

(Unaudited)

|   | Common Stock |            | Additional    | Cumulative     | Accumulated   | Total         | Total          | Total         |
|---|--------------|------------|---------------|----------------|---------------|---------------|----------------|---------------|
|   | Shares       | Amount     | Paid-In       | Dividends      | Other         | Stockholders' | Noncontrolling | Total         |
|   |              |            | Capital       | In Excess      | Comprehensive | Equity        | Interests      | Equity        |
|   |              |            |               | Of Earnings    | Income (Loss) |               |                |               |
| January 1, 2014                                 | 456,961      | \$ 456,961 | \$ 11,334,041 | \$ (1,053,215) | \$ (14,487)   | \$ 10,723,300 | \$ 207,834     | \$ 10,931,111 |
| Net income                                      | —            | —          | —             | 725,650        | —             | 725,650       | 11,311         | 736,961       |
| Comprehensive                                   | —            | —          | —             | —              | (2,977)       | (2,977)       | —              | (2,977)       |
| Issuance of common stock,                       | 2,351        | 2,351      | 67,474        | —              | —             | 69,825        | (73)           | 69,752        |
| Repurchase of common stock                      | (297)        | (297)      | (11,302)      | —              | —             | (11,599)      | —              | (11,599)      |
| Exercise of options                             | 131          | 131        | 3,176         | —              | —             | 3,307         | —              | 3,307         |
| Conversion of preferred                         | —            | —          | 16,467        | —              | —             | 16,467        | —              | 16,467        |
| Share repurchases of non-employees              | —            | —          | —             | (750,835)      | —             | (750,835)     | —              | (750,835)     |
| Contributions to noncontrolling interests       | —            | —          | —             | —              | —             | —             | (11,706)       | (11,706)      |
| Change in ownership of noncontrolling interests | —            | —          | —             | —              | —             | —             | 57,354         | 57,354        |
| Change in ownership of noncontrolling interests | —            | —          | (13)          | —              | —             | (13)          | (1,671)        | (1,684)       |
| December 30,                                    | 459,146      | \$ 459,146 | \$ 11,409,843 | \$ (1,078,400) | \$ (17,464)   | \$ 10,773,125 | \$ 263,049     | \$ 11,036,174 |

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|                                | Common Stock |            | Additional    | Cumulative     | Accumulated   | Total         | Total          | Total       |
|--------------------------------|--------------|------------|---------------|----------------|---------------|---------------|----------------|-------------|
|                                | Shares       | Amount     | Paid-In       | Dividends      | Other         | Stockholders' | Noncontrolling | Total       |
|                                |              |            | Capital       | In Excess      | Comprehensiv  | Equity        | Interests      | Equity      |
|                                |              |            |               | Of Earnings    | Income (Loss) |               |                |             |
| January 1, 2013                | 453,191      | \$ 453,191 | \$ 11,180,066 | \$ (1,067,367) | \$ (14,653)   | \$ 10,551,237 | \$ 202,540     | \$ 10,753,7 |
| Income                         | —            | —          | —             | 677,742        | —             | 677,742       | 9,625          | 687,367     |
| Comprehensive                  | —            | —          | —             | —              | (1,226)       | (1,226)       | —              | (1,226)     |
| Issuance of common stock,      | 1,859        | 1,859      | 78,647        | —              | —             | 80,506        | (2,997)        | 77,509      |
| Repurchase of common stock     | (51)         | (51)       | (2,451)       | —              | —             | (2,502)       | —              | (2,502)     |
| Exercise of options            | 875          | 875        | 16,622        | —              | —             | 17,497        | —              | 17,497      |
| Stock repurchase authorization | —            | —          | 33,833        | —              | —             | 33,833        | —              | 33,833      |
| Deferred compensation          | —            | —          | —             | (716,869)      | —             | (716,869)     | —              | (716,869)   |
| Share repurchases              | —            | —          | —             | —              | —             | —             | (11,536)       | (11,536)    |
| Share repurchases              | —            | —          | —             | —              | —             | —             | 12,387         | 12,387      |
| December 30,                   | 455,874      | \$ 455,874 | \$ 11,306,717 | \$ (1,106,494) | \$ (15,879)   | \$ 10,640,218 | \$ 210,019     | \$ 10,850,2 |

See accompanying Notes to the Condensed Consolidated Financial Statements.



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HCP, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

|   | Nine Months Ended<br>September 30, |            |
|---|------------------------------------|------------|
|   | 2014                               | 2013       |
| Cash flows from operating activities:   |                                    |            |
| Net income  | \$ 736,961                         | \$ 687,367 |
| 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   | 343,496                            | 317,172    |
| Discontinued operations   | —                                  | 4,604      |
| Amortization of above and below market lease intangibles, net                       | (619)                              | (6,414)    |
| Amortization of deferred compensation   | 16,467                             | 33,833     |
| Amortization of deferred financing costs, net                                       | 14,122                             | 13,922     |
| Straight-line rents   | (35,082)                           | (28,559)   |
| Loan and direct financing lease interest accretion                                  | (58,271)                           | (65,296)   |
| Deferred rental revenues  | (420)                              | 73         |
| Equity income from unconsolidated joint ventures                                    | (39,388)                           | (44,278)   |
| Distributions of earnings from unconsolidated joint ventures                        | 3,895                              | 2,724      |
| Lease termination income, net   | (38,001)                           | —          |
| Gain on sales of real estate  | (28,010)                           | (9,185)    |
| Marketable securities and other gains, net  | (2,143)                            | (10,964)   |
| Changes in:   |                                    |            |
| Accounts receivable, net  | (7,193)                            | 6,389      |
| Other assets  | (14,345)                           | (43,939)   |
| Accounts payable and accrued liabilities  | (8,447)                            | (13,769)   |
| Net cash provided by operating activities   | 883,022                            | 843,680    |
| Cash flows from investing activities:   |                                    |            |
| Cash used to acquire the CCRC unconsolidated joint venture interest, net            | (370,186)                          | —          |
| Acquisitions of real estate   | (467,147)                          | (63,878)   |
| Development of real estate  | (118,732)                          | (96,914)   |
| Leasing costs and tenant and capital improvements                                   | (44,953)                           | (33,964)   |
| Proceeds from sales of real estate, net   | 36,938                             | 3,777      |
| Contributions to unconsolidated joint ventures                                      | (2,935)                            | —          |
| Distributions in excess of earnings from unconsolidated joint ventures              | 1,986                              | 1,194      |
| Purchases of marketable debt securities   | —                                  | (16,706)   |
| Proceeds from the sales of marketable securities                                    | —                                  | 28,403     |
| Principal repayments on loans receivable and direct financing leases, net           | 49,503                             | 231,004    |
| Investments in loans receivable and other   | (24,480)                           | (316,494)  |
| Increase in restricted cash   | (17,219)                           | (10,376)   |

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|   |           |           |
|---|-----------|-----------|
| Net cash used in investing activities                     | (957,225) | (273,954) |
| Cash flows from financing activities:                     |           |           |
| Net borrowings under bank line of credit                  | 70,000    | 283,082   |
| Issuance of senior unsecured notes                        | 1,150,000 | —         |
| Repayments of senior unsecured notes                      | (487,000) | (150,000) |
| Issuance of mortgage and other debt                       | 39,671    | 6,798     |
| Repayments of mortgage debt                               | (202,134) | (285,005) |
| Deferred financing costs                                  | (16,550)  | —         |
| Issuance of common stock and exercise of options          | 73,059    | 92,504    |
| Repurchase of common stock                                | (11,599)  | —         |
| Dividends paid on common stock                            | (750,835) | (716,869) |
| Issuance of noncontrolling interests                      | 4,282     | 12,387    |
| Distributions to and purchase of noncontrolling interests | (11,719)  | (11,536)  |
| Net cash used in financing activities                     | (142,825) | (768,639) |
| Effect of foreign exchange on cash and cash equivalents   | 3         | 654       |
| Net decrease in cash and cash equivalents                 | (217,025) | (198,259) |
| Cash and cash equivalents, beginning of period            | 300,556   | 247,673   |
| Cash and cash equivalents, end of period                  | \$ 83,531 | \$ 49,414 |

See accompanying Notes to the Condensed Consolidated Financial Statements.

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HCP, INC.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(1)Business

HCP, Inc., a Standard & Poor's ("S&P") 500 company, together with its consolidated entities (collectively, "HCP" or the "Company"), invests primarily in real estate serving the healthcare industry in the United States ("U.S."). The Company is a Maryland corporation and was organized to qualify as a self-administered real estate investment trust ("REIT") in 1985. The Company is headquartered in Irvine, California, with offices in Nashville, Tennessee and San Francisco, California. The Company acquires, develops, leases, manages and disposes of healthcare real estate, and provides financing to healthcare providers. The Company's portfolio is comprised of investments in the following five healthcare segments: (i) senior housing, (ii) post-acute/skilled nursing, (iii) life science, (iv) medical office and (v) hospital. The Company makes investments within the healthcare segments using the following five investment products: (i) properties under lease, (ii) debt investments, (iii) developments and redevelopments, (iv) investment management and (v) investments in senior housing operations utilizing the structure permitted by the Housing and Economic Recovery Act of 2008, which is commonly referred to as "RIDEA."

(2)Summary of Significant Accounting Policies

Basis of Presentation

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

The condensed consolidated financial statements include the accounts of HCP, Inc., its wholly-owned subsidiaries, joint ventures and variable interest entities ("VIEs") that it controls through voting rights or other means. Intercompany transactions and balances have been eliminated upon consolidation. In the opinion of management, all adjustments (consisting of normal recurring adjustments) necessary to present fairly the Company's financial position, results of



operations and cash flows have been included. Operating results for the nine months ended September 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. The accompanying unaudited interim financial information should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2013 included in the Company's Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission (the "SEC").

Certain amounts in the Company's condensed consolidated financial statements have been reclassified for prior periods to conform to the current period presentation. For periods through March 31, 2014, operating results for real estate assets sold have been reclassified from continuing to discontinued operations on the condensed consolidated statements of income (see Note 5).

#### Allowance for Doubtful Accounts

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

The Company evaluates the liquidity and creditworthiness of its tenants, operators and borrowers on a monthly and quarterly basis. The Company's evaluation considers industry and economic conditions, individual and portfolio property performance, credit enhancements, liquidity and other factors. The Company's tenants, borrowers and operators furnish property, portfolio and guarantor/operator-level financial statements, among other information, on a monthly or

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quarterly basis; the Company utilizes this financial information to calculate the lease or debt service coverages that it uses as a primary credit quality indicator. Lease and debt service coverage information is evaluated together with other property, portfolio and operator performance information, including revenue, expense, net operating income, occupancy, rental rate, reimbursement trends, capital expenditures and earnings before interest, tax, and depreciation and amortization (“EBITDA”), along with liquidity. The Company evaluates, on a monthly basis or immediately upon a change in circumstances, its tenants’, operators’ and borrowers’ ability to service their obligations with the Company.

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

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

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

## Recent Accounting Pronouncements

In April 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update No. 2014-08, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity (“ASU 2014-08”). This update changes the requirements for reporting and the definition of discontinued operations. Based on the current revisions, the disposal of a component of an entity, or a group of components of an entity, is required to be reported in

discontinued operations if the disposal represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results when certain defined criteria are met. ASU 2014-08 is effective for fiscal years and interim periods beginning after December 15, 2014 and shall be applied prospectively. Early adoption is permitted, but only for disposals (or classifications as held for sale) that have not been reported in financial statements previously issued or available for issuance. On April 1, 2014, the Company early adopted ASU 2014-08; the adoption of ASU 2014-08 did not have a material impact on the Company's consolidated financial position or results of operations.

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers ("ASU 2014-09"). This update changes the guidance for recognizing revenue. ASU 2014-09 provides guidance for revenue recognition to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 is effective for fiscal years and interim periods beginning after December 15, 2016. Early adoption is not permitted. The Company is evaluating the impact of the adoption of ASU 2014-09 on January 1, 2017 to the Company's consolidated financial position and results of operations.

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(3) Brookdale Lease Amendments and Terminations and the Formation of Two RIDEA Joint Ventures (“Brookdale Transaction”)

On July 31, 2014, Brookdale Senior Living (“Brookdale”) completed its acquisition of Emeritus Corporation (“Emeritus”). Brookdale, as the acquiring entity, became the Company’s largest senior housing lessee and operator. On August 29, 2014, the Company and Brookdale completed a multiple-element transaction that has three major components:

- amended existing lease agreements on 153 HCP-owned senior housing communities previously leased and operated by Emeritus that included the termination of embedded purchase options in leases relating to 30 properties and future rent reductions;
  - terminated existing lease agreements on 49 HCP-owned senior housing properties previously leased and operated by Emeritus (including the termination of embedded purchase options in these leases relating to 19 properties). At closing, the Company contributed 48 of these properties to a newly formed consolidated RIDEA partnership structure (“RIDEA Subsidiaries”); the 49th property is expected to be contributed in December 2014. Brookdale owns a 20% noncontrolling equity interest in the RIDEA Subsidiaries and manages the facilities on behalf of the partnership; and
  - entered into new unconsolidated joint ventures that own 14 campuses of continuing care retirement communities (“CCRC”) in a RIDEA structure (collectively, the “CCRC JV”) with the Company owning a 49% equity interest and Brookdale owning a 51% equity interest. Brookdale manages these communities on behalf of the CCRC JV.
- Leases Amended on 153 Properties (“NNN Lease Restructuring”)

The Company and Brookdale entered into amended and restated triple-net master leases for 153 properties formerly leased to Emeritus. As part of the lease amendments, Brookdale forfeited purchase option rights related to 30 of these properties. The master leases have weighted average terms of 15 years, with two extension options that average 10 years each. Total base rent for 2014 will remain unchanged from the existing 2014 rent. However, these leases provide for reduced escalators beginning 2015 compared to those which were in-place; beginning in 2016, the leases contain reduced rent payments of \$6.5 million in 2016 and \$7.5 million each subsequent year thereafter. All obligations under the amended and restated leases are guaranteed by Brookdale. In addition, the new leases include a purchase option in favor of Brookdale for up to 10 communities at an aggregate purchase price not to exceed \$60 million.

Effectively, the Company paid consideration of \$129 million to terminate the existing purchase options and received consideration of: (i) \$76 million for lower rent payments and escalators discussed above, which take effect beginning 2015 and 2016 and (ii) \$53 million to settle the amount that the Company owed to Brookdale for the RIDEA Subsidiaries transaction discussed below. See the Fair Value Measurement Techniques and Quantitative Information section below for additional information.

The Company will amortize the \$53 million of net consideration paid to Brookdale for the NNN Lease Restructuring as a reduction in rental income on a straight-line basis over the term of the new leases. Additionally, the lease-related

intangibles, initial direct costs and straight-line rent receivables associated with the previous leases will be amortized prospectively over the new (or amended) lease terms.

#### Lease Terminations of 49 Properties that were contributed to a RIDEA Structure (“RIDEA Subsidiaries”)

The Company and Brookdale terminated leases for a 49 property portfolio, which resulted in Brookdale forfeiting its purchase option rights to 19 of these properties; the net value of the terminated leases and forfeited purchase options was \$108 million (\$131 million for the value of the terminated leases, less \$23 million for the value of the forfeited purchase options). At closing, the Company contributed the properties into partnerships, with Brookdale owning a 20% noncontrolling equity interest in each of the RIDEA Subsidiaries (“SH PropCo” and “SH OpCo”). Brookdale’s 20% interest in the RIDEA Subsidiaries was valued at \$47 million. Brookdale also manages the properties on behalf of the RIDEA Subsidiaries under long-term management contracts. See the Fair Value Measurement Techniques and Quantitative Information section below for additional information.

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As consideration for the net value of \$108 million for of the terminated leases and the \$47 million sale to Brookdale of the 20% noncontrolling interest in the RIDEA Subsidiaries, the Company received the following: (i) a \$34 million short-term receivable recorded in other assets; (ii) a \$68 million note from Brookdale (the “Brookdale Receivable”) recorded in loans receivable (see Note 7 for additional information); and (iii) an effective offset for the \$53 million associated with the additional consideration owed by the Company to Brookdale for the NNN Lease Restructuring transaction discussed above. The fair values of the short-term receivable and Brookdale Receivable were estimated based on similar instruments available in the marketplace and are considered to be Level 2 measurements within the fair value hierarchy.

As a result of terminating these leases, the Company recognized a net gain of \$38 million consisting of: (i) \$108 million gain based on the fair value of the net consideration received; less (ii) \$70 million to write-off the direct leasing costs and straight-line rent receivables related to the former in-place leases.

The Company has identified the SH PropCo and SH OpCo entities as VIEs (see Note 17 for additional information).

### Continuing Care Retirement Communities Joint Venture

HCP and Brookdale formed new unconsolidated joint ventures that own 14 CCRC campuses in a RIDEA structure (“CCRC PropCo” and “CCRC OpCo”). HCP and Brookdale own 49% and 51%, respectively, of CCRC PropCo and CCRC OpCo, based on each company’s respective contributions. CCRC PropCo owns eight campuses that are leased to CCRC OpCo; CCRC OpCo owns six campuses and the operations of the campuses leased from CCRC PropCo. Brookdale manages the campuses of the CCRC JV under long-term management contracts.

At closing, Brookdale contributed eight of its owned campuses; the Company contributed two campuses previously leased to Brookdale valued at \$162 million (carrying value of \$92 million) and \$370 million of cash (includes amounts used to fund the purchase of properties and working capital), which was primarily used to acquire four additional campuses from third parties. At closing, the CCRC JV campuses were encumbered by \$569 million of mortgage and entrance fee obligations.

The Company has identified the CCRC OpCo entity as a VIE (see Note 17 for additional information).

### Fair Value Measurement Techniques and Quantitative Information

The fair values of the forfeited rental payments and purchase option rights related to the NNN Lease Restructuring and the RIDEA Subsidiaries were based on the income approach and are considered Level 3 measurements within the fair value hierarchy. The Company utilized discounted cash flow models with observable and unobservable valuation inputs. These fair value measurements, or valuation techniques, were based on current market participant expectations and information available as of the close of the transaction on August 29, 2014.

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A summary of the quantitative information about fair value measurements for the NNN Lease Restructuring and RIDEA Subsidiaries transactions follows (dollars in thousands):

|  | Fair Value   | Valuation Technique  | Valuation Inputs        | Input Average or Range |
|--|--------------|----------------------|-------------------------|------------------------|
| NNN Lease Restructuring Rental payment concessions by HCP (benefiting Brookdale) | \$ 76,000    | Discounted Cash Flow | NNN Rent Coverage Ratio | 1.20x                  |
|  |              |                      | NNN Rent Growth Rate    | 3.0 %                  |
|  |              |                      | Discount Rate           | 8.00%-8.50 %           |
|  |              |                      | Capitalization Rates    | 7.50%-9.25 %           |
| Forfeited purchase options by Brookdale (benefiting HCP)                         | \$ (129,000) | Discounted Cash Flow | Discount Rate           | 10.50%-11.00 %         |
|  |              |                      | Exercise Probability    | 100.00 %               |
|  |              |                      |                         |                        |
| RIDEA Subsidiaries Forfeited rental payments by HCP (benefiting Brookdale)       | \$ 131,000   | Discounted Cash Flow | NNN Rent Coverage Ratio | 1.20x                  |
|  |              |                      | NNN Rent Growth Rate    | 3.0 %                  |
|  |              |                      | EBITDAR Growth Rate     | 5.5 %                  |
|  |              |                      | Discount Rate           | 8.00%-11.00 %          |
| Forfeited purchase options by Brookdale (benefiting HCP)                         | \$ (23,000)  | Discounted Cash Flow | Capitalization Rates    | 7.50%-9.25 %           |
|  |              |                      | Discount Rate           | 10.50%-11.00 %         |
|  |              |                      | Exercise Probability    | 100.00 %               |

In determining which valuation technique the Company would utilize to calculate fair value for the multiple elements of this transaction, the Company considered the market approach and obtained published investor survey and sales transaction data, where available. The information obtained was consistent with the valuation inputs and assumptions used by the Company in the discounted cash flow models that were applied to this transaction. Investor survey and sales transaction data reviewed for similar transactions in similar marketplaces, included, but were not limited to, sales price per unit, rent coverage ratios, rental rate growth as well as capitalization and discount rates.



Rental Payment Concessions and Forfeitures. The fair value of the rental payment concessions related to the NNN Lease Restructuring Transaction was determined to be the present value of the difference between (i) the remaining contractual rental payments of the in-place leases, limited to first purchase option date, where available; thereafter market rents to complete the initial lease term of the amended Brookdale leases and (ii) the contractual rental payments under the amended Brookdale leases.

The fair value of the forfeited rental payments related to the RIDEA Subsidiaries transaction was calculated as the present value of the difference between (i) the remaining contractual rental payments of the terminated in-place leases, limited to first purchase option date, where available and (ii) the forecasted cash flows of the facility-level operating results of the RIDEA Subsidiaries.

Forfeited Purchase Option Rights. The fair value of the forfeited purchase option rights was determined to be the present value of the difference between (i) the fair value of the underlying property as of the initial exercise date and (ii) the exercise price for purchase option rights as defined in the lease agreement. To determine the fair value of the underlying property as of the initial exercise date, the Company utilized a cash flow model that incorporated growth rates to forecast the underlying property's operating results and applied capitalization rates to establish the expected fair value. The Company utilized an appropriate risk-adjusted discount rate to estimate the present value as of the transaction close date.

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## (4)Real Estate Property Investments

A summary of real estate acquisitions for the nine months ended September 30, 2014 follows (in thousands):

| Segment        | Property<br>Count | Consideration  |  |                            | Assets Acquired |                    |
|----------------|-------------------|----------------|--|----------------------------|-----------------|--------------------|
|                |                   | Cash Paid      | Debt and Other<br>Liabilities<br>Assumed | Noncontrolling<br>Interest | Real Estate     | Net<br>Intangibles |
| Senior housing | 22                | \$ 215,381 (1) | \$ 1,021                                 | \$ 6,321 (2)               | \$ 205,778      | \$ 16,945          |
| Life science   | 1                 | 43,500         | 250                                      | —                          | 41,281          | 2,469              |
| Medical office | 5                 | 208,266        | 463                                      | —                          | 186,799         | 21,930             |
|                | 28                | \$ 467,147     | \$ 1,734                                 | \$ 6,321                   | \$ 433,858      | \$ 41,344          |

(1) Includes the acquisition of a \$127 million (£75.8 million) portfolio of 20 care homes in the UK.

(2) Includes \$5 million of non-managing member limited liability company units.

A summary of real estate acquisitions for the nine months ended September 30, 2013 follows (in thousands):

| Segment                       | Property<br>Count | Consideration |  |  | Assets Acquired |                    |
|-------------------------------|-------------------|---------------|--|--|-----------------|--------------------|
|                               |                   | Cash Paid     | Fair Value<br>of<br>Real Estate<br>Exchanged | Debt and Other<br>Liabilities<br>Assumed | Real Estate     | Net<br>Intangibles |
| Senior housing                | 6                 | \$ 59,341     | \$ —   | \$ 12,728                                | \$ 68,795       | \$ 3,274           |
| Post-acute/skilled<br>nursing | N/A               | 408 (1)       | —  | —  | 408             | —                  |
| Hospital                      | 1                 | —             | 15,204 (2)                                   | —  | 11,822          | 3,382              |
|                               | 7                 | \$ 59,749     | \$ 15,204                                    | \$ 12,728                                | \$ 81,025       | \$ 6,656           |

(1) Represents 38 acres of land acquired.

(2) See Note 5 for additional information on real estate exchanged.

During the nine months ended September 30, 2014 and 2013, the Company funded an aggregate of \$163 million and \$123 million, respectively, for construction, tenant and other capital improvement projects, primarily in its senior housing, life science and medical office segments.

(5) Dispositions of Real Estate and Discontinued Operations

On August 29, 2014, in conjunction with the Brookdale Transaction, the Company contributed three senior housing facilities with a carrying value of \$92 million into the CCRC JV (an unconsolidated joint venture with Brookdale discussed in Note 3). The Company recorded its investment in the CCRC JV for the contribution of these properties at their carrying value (carryover basis) and therefore did not recognize either a gain or loss upon the contribution.

During the nine months ended September 30, 2014, the Company sold two post-acute/skilled nursing facilities for \$22 million, a hospital for \$17 million and a medical office building ("MOB") for \$145,000.

During the nine months ended September 30, 2013, the Company sold a senior housing facility for \$4 million. In addition, in September 2013, the Company sold a 62-bed hospital located in Greenfield, Wisconsin in exchange for a 60-bed hospital located in Webster, Texas and recognized a gain of \$8 million based on the fair value of the hospital acquired.

There were no assets classified as held for sale at September 30, 2014. At December 31, 2013, one hospital and two post-acute/skilled nursing facilities were classified as held for sale, with a carrying value of \$10 million.

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We adopted ASU 2014-08 effective April 1, 2014 (the “adoption date”). The Company separately presented as discontinued operations the results of operations for all consolidated assets disposed of and all properties held for sale, if any, prior to the adoption date. The amounts included in discontinued operations, for the nine months September 30, 2014, represent the activity for properties sold prior to the adoption date. No properties sold subsequent to the adoption date met the new criteria for reporting discontinued operations (see Note 2 for additional information).

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<br>Ended September 30,<br>2013 | Nine Months<br>Ended September 30,<br>2014      2013 |           |
|---|---|--|-----------|
| Rental and related revenues                                     | \$ 4,261                                    | \$ 1,810   | \$ 14,169 |
| Depreciation and amortization expenses                          | 1,509                                       | —  | 4,604     |
| Operating expenses  | 1,155                                       | 54   | 3,001     |
| Other expenses, net   | 70  | 20   | 865       |
| Income before gain on sales of real estate, net of income taxes | \$ 1,527                                    | \$ 1,736   | \$ 5,699  |
| Gain on sales of real estate, net of income taxes               | \$ 8,298                                    | \$ 28,010  | \$ 9,185  |
| Number of properties included in discontinued operations        | 14  | 3  | 16        |

## (6)Net Investment in Direct Financing Leases

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

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|   | September 30,<br>2014 | December 31,<br>2013 |
|---|-----------------------|----------------------|
| Minimum lease payments receivable             | \$ 24,329,517         | \$ 24,808,386        |
| Estimated residual values                     | 4,126,426             | 4,134,405            |
| Less unearned income                          | (21,210,821)          | (21,789,392)         |
| Net investment in direct financing leases     | \$ 7,245,122          | \$ 7,153,399         |
| Properties subject to direct financing leases | 363                   | 364                  |

The minimum lease payments receivable are primarily attributable to HCR ManorCare, Inc. (“HCR ManorCare”) (\$23.1 billion and \$23.5 billion at September 30, 2014 and December 31, 2013, respectively). The triple-net master lease with HCR ManorCare provides for annual rent of \$524 million beginning April 1, 2014 (prior to April 1, 2014, annual rent was \$506 million). The rent increases by 3.5% per year over the next two years and by a minimum of 3% for the remaining portion of the initial lease term. The properties are grouped into four pools, and HCR ManorCare has a one-time extension option for each pool with rent increased for the first year of the extension option to the greater of fair market rent or a 3% increase over the rent for the prior year. Including the extension options, which the Company determined to be bargain renewal options, the four leased pools had total initial available terms ranging from 23 to 35 years.

During the nine months ended September 30, 2014, the Company received a \$13 million payoff from the HCR ManorCare proceeds of the sale of a post-acute/skilled nursing facility that collateralized this DFL.

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The following table summarizes the Company's internal ratings for net investment in DFLs at September 30, 2014 (in thousands):

| Investment Type            | Carrying     | Percentage of DFL | Internal Ratings |                 |              |
|----------------------------|--------------|-------------------|------------------|-----------------|--------------|
|                            | Amount       | Portfolio         | Performing DFLs  | Watch List DFLs | Workout DFLs |
| Senior housing             | \$ 1,492,862 | 20                | \$ 1,121,658     | \$ 371,204      | \$ —         |
| Post-acute/skilled nursing | 5,628,369    | 78                | 5,628,369        | —               | —            |
| Hospital                   | 123,891      | 2                 | 123,891          | —               | —            |
|                            | \$ 7,245,122 | 100               | \$ 6,873,918     | \$ 371,204      | \$ —         |

During the quarter ended September 30, 2013, the Company placed a 14-property senior housing DFL (the "DFL Portfolio") on non-accrual status. Based on the Company's determination that the timing of the collection of all rental payments was no longer reasonably assured, rental revenue for the DFL Portfolio is recognized on a cash basis. Furthermore, the Company determined that the DFL Portfolio was not impaired at September 30, 2013, based on its belief that: (i) it was not probable that it will not collect all of the rental payments under the terms of the lease; and (ii) the fair value of the underlying collateral exceeded the DFL Portfolio's \$376 million carrying amount. The fair value of the DFL Portfolio was estimated based on a discounted cash flow model, which inputs are considered to be a Level 3 measurement within the fair value hierarchy. Inputs to this valuation model include real estate capitalization rates, industry growth rates and operating margins, some of which influence the Company's expectation of future cash flows from the DFL Portfolio and, accordingly, the fair value of its investment. During the three months ended September 30, 2014 and 2013, the Company recognized DFL income of \$5 million in each period, and received cash payments of \$6 million in each period from the DFL Portfolio. During the nine months ended September 30, 2014 and 2013, the Company recognized DFL income of \$15 million and \$19 million, respectively, and received cash payments of \$18 million in each period from the DFL Portfolio. The carrying value of the DFL Portfolio was \$371 million and \$374 million at September 30, 2014 and December 31, 2013, respectively. At September 30, 2014, the Company continues to believe that the fair value of the underlying collateral is in excess of the carrying value of this DFL.

## (7)Loans Receivable

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

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|                                       | September 30, 2014  |               |            | December 31, 2013   |               |            |
|---------------------------------------|---------------------|---------------|------------|---------------------|---------------|------------|
|                                       | Real Estate Secured | Other Secured | Total      | Real Estate Secured | Other Secured | Total      |
| Mezzanine                             | \$ —                | \$ 301,494    | \$ 301,494 | \$ —                | \$ 234,455    | \$ 234,455 |
| Other(1)                              | 133,406             | —             | 133,406    | 147,669             | —             | 147,669    |
| Unamortized discounts, fees and costs | —                   | (2,689)       | (2,689)    | —                   | (2,713)       | (2,713)    |
| Allowance for loan losses             | —                   | (13,410)      | (13,410)   | —                   | (13,410)      | (13,410)   |
|                                       | \$ 133,406          | \$ 285,395    | \$ 418,801 | \$ 147,669          | \$ 218,332    | \$ 366,001 |

(1) Includes \$133 million and \$117 million at September 30, 2014 and December 31, 2013, respectively, of construction loans outstanding related to senior housing development projects. At September 30, 2014, the Company had \$13 million remaining under its commitments to fund development projects.

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The following table summarizes the Company's internal ratings for loans receivable at September 30, 2014 (in thousands):

| Investment Type     | Carrying   | Percentage of Loan | Internal Ratings    |                        |                  |
|---------------------|------------|--------------------|---------------------|------------------------|------------------|
|                     | Amount     | Portfolio          | Performing<br>Loans | Watch<br>List<br>Loans | Workout<br>Loans |
| Real estate secured | \$ 133,406 | 32                 | \$ 133,406          | \$ —                   | \$ —             |
| Other secured       | 285,395    | 68                 | 267,925             | —                      | 17,470           |
|                     | \$ 418,801 | 100                | \$ 401,331          | \$ —                   | \$ 17,470        |

## Other Secured Loans

**Brookdale Receivable.** In conjunction with the Brookdale Transaction, on August 29, 2014, the Company provided \$68 million in financing to Brookdale in the form of an interest-only loan. The Brookdale Receivable has a five-year term, is guaranteed by Brookdale and is secured by Brookdale's 20% equity interest in the RIDEA Subsidiaries. The loan bears interest at a rate of 7% for the first two years and increases to 7.65% by the end of the five-year term. On November 3, 2014, the Company received \$68 million from the early repayment of this loan. See additional information regarding the Brookdale Transaction in Note 3.

**Barchester Loan.** On May 2, 2013, the Company acquired £121 million (\$188 million) of subordinated debt at a discount for £109 million (\$170 million). The loan was secured by an interest in 160 facilities leased and operated by Barchester Healthcare ("Barchester"). On August 23, 2013, the Company acquired an additional investment in this loan of £9 million (\$14 million) at a discount for £5 million (\$8 million). This loan accrued interest on its face value at a floating rate of LIBOR plus a weighted-average margin of 3.14%. This loan investment was financed by a GBP denominated draw on the Company's revolving line of credit facility that is discussed in Note 11. On September 6, 2013, the Company received £129 million (\$202 million) from the par payoff of its Barchester debt investments. As a result, the Company recognized interest income of \$24 million primarily representing the debt investment's unamortized discounts. A portion of the proceeds from the Barchester repayment were used to repay the total outstanding amount of the Company's GBP denominated draw on its revolving line of credit facility.

**Tandem Health Care Loan.** On July 31, 2012, the Company closed a mezzanine loan facility to lend up to \$205 million to Tandem Health Care ("Tandem"), as part of the recapitalization of a post-acute/skilled nursing portfolio. The Company funded \$100 million (the "First Tranche") at closing and funded an additional \$102 million (the "Second Tranche") in June 2013. At September 30, 2014, the loans were subordinate to \$440 million of senior mortgage debt. The loans bear interest at fixed rates of 12% and 14% per annum for the First and Second Tranches, respectively. This loan facility has a total term of up to 63 months from the First Tranche closing, is prepayable at the borrower's option



and is secured by real estate partnership interests. The loans are subject to prepayment premiums if repaid on or before the third anniversary from the First Tranche closing date.

Delphis Operations, L.P. Loan. The Company holds a secured term loan made to Delphis Operations, L.P. (“Delphis” or the “Borrower”) that is collateralized by assets of the Borrower. The Borrower’s collateral is comprised primarily of a partnership interest in an operating surgical facility that leases a property owned by the Company. This loan is on cost recovery status and classified as “workout”. The carrying value of the loan, net of an allowance for loan losses of \$13 million, was \$17.5 million and \$18.1 million at September 30, 2014 and December 31, 2013, respectively. During the nine months ended September 30, 2014 and 2013, the Company received cash payments from the Borrower of \$0.6 million and \$1.5 million, respectively. At September 30, 2014, the Company believes the fair value of the collateral supporting this loan is in excess of its carrying value.

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

|                               | Amount    |
|-------------------------------|-----------|
| Balance at January 1, 2014    | \$ 13,410 |
| Additions                     | —         |
| Balance at September 30, 2014 | \$ 13,410 |

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

On August 29, 2014, as part of the Brookdale Transaction discussed in Note 3, HCP and Brookdale formed new unconsolidated joint ventures that own 14 CCRC campuses in a RIDEA structure. At closing, Brookdale contributed eight of its owned campuses; the Company contributed two campuses previously leased to Brookdale valued at \$162 million (carrying value of \$92 million) and \$370 million of cash. At closing, the CCRC JV campuses were encumbered by \$569 million of mortgage and entrance fee obligations. See additional information regarding the Brookdale Transaction in Note 3.

The Company owns interests in the following entities that are accounted for under the equity method at September 30, 2014 (dollars in thousands):

| Entity(1)             | Segment                    | Investment(2) | Ownership% |
|-----------------------|----------------------------|---------------|------------|
| CCRC JV(3)            | senior housing             | \$ 459,916    | 49         |
| HCR ManorCare         | post-acute/skilled nursing | 76,876        | 9.4        |
| HCP Ventures III, LLC | medical office             | 6,868         | 30         |

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|  |                             |            |    |      |
|--|-----------------------------|------------|----|------|
| HCP Ventures IV, LLC                           | medical office and hospital | 27,560     | 20 |      |
| HCP Life Science(4)                            | life science                | 70,771     | 50 | – 63 |
| Suburban Properties, LLC                       | medical office              | 5,716      | 67 |      |
| Advances to unconsolidated joint ventures, net |                             | 216        |    |      |
|  |                             | \$ 647,923 |    |      |
| Edgewood Assisted Living Center, LLC           | senior housing              | \$ (440)   |    |      |
| Seminole Shores Living Center, LLC             | senior housing              | (645)      |    |      |
|  |                             | \$ (1,085) |    |      |

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

(2) Represents the carrying value of the Company's investment in the unconsolidated joint ventures. Negative balances are recorded in accounts payable and accrued liabilities on the Company's Condensed Consolidated Balance Sheets.

(3) Includes two unconsolidated joint ventures between the Company and Brookdale: (i) CCRC PropCo (\$210 million) and (ii) CCRC OpCo (\$250 million). See additional information regarding the Brookdale Transaction in Note 3.

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

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

|   | September 30,<br>2014(1) | December 31,<br>2013 |
|---|--------------------------|----------------------|
| Real estate, net                        | \$ 5,159,092             | \$ 3,662,450         |
| Goodwill and other assets, net          | 5,482,542                | 5,384,553            |
| Total assets                            | \$ 10,641,634            | \$ 9,047,003         |
| Capital lease obligations and debt      | \$ 7,221,580             | \$ 6,768,815         |
| Accounts payable                        | 1,103,072                | 1,045,260            |
| Other partners' capital                 | 1,648,992                | 1,098,228            |
| HCP's capital(2)                        | 667,990                  | 134,700              |
| Total liabilities and partners' capital | \$ 10,641,634            | \$ 9,047,003         |

(1) Includes the financial information of the CCRC JV, which the Company formed on August 29, 2014.

(2) The combined basis difference of the Company's investments in these joint ventures of \$21 million, as of September 30, 2014, is primarily attributable to goodwill, real estate, capital lease obligations, deferred tax assets and lease-related net intangibles.

|  | Three Months Ended<br>September 30, |              | Nine Months Ended<br>September 30, |              |
|--|-------------------------------------|--------------|------------------------------------|--------------|
|  | 2014(1)                             | 2013         | 2014(1)                            | 2013         |
| Total revenues                             | \$ 1,087,010                        | \$ 1,046,789 | \$ 3,224,839                       | \$ 3,182,052 |
| Income (loss) from discontinued operations | 3,600                               | (2,600)      | (2,000)                            | (8,300)      |
| Net income (loss)                          | (702)                               | 2,538        | (4,826)                            | 23,032       |
| HCP's share of earnings(2)                 | 10,168                              | 13,892       | 39,388                             | 44,278       |
| Fees earned by HCP                         | 447                                 | 464          | 1,340                              | 1,406        |
| Distributions received by HCP              | 2,113                               | 1,390        | 5,881                              | 3,918        |

(1) Includes the financial information of the CCRC JV, which the Company formed on August 29, 2014.

(2) The Company's joint venture interest in HCR ManorCare is accounted for using the equity method and results in an ongoing elimination of DFL income proportional to HCP's ownership in HCR ManorCare. The elimination of the respective proportional lease expense at the HCR ManorCare level in substance results in \$16 million and \$15 million of DFL income that is recharacterized to the Company's share of earnings from HCR ManorCare (equity income from unconsolidated joint ventures) for the three months ended September 30, 2014 and 2013, respectively. For both the nine months ended September 30, 2014 and 2013, \$47 million of DFL income was recharacterized to the Company's

share of earnings from HCR ManorCare.

(9)Intangibles

At September 30, 2014 and December 31, 2013, intangible lease assets, comprised of lease-up intangibles, above market tenant lease intangibles and below market ground lease intangibles, were \$808 million and \$781 million, respectively. At September 30, 2014 and December 31, 2013, the accumulated amortization of intangible assets was \$329 million and \$291 million, respectively.

At September 30, 2014 and December 31, 2013, intangible lease liabilities, comprised of below market lease intangibles and above market ground lease intangibles were \$209 million and \$207 million, respectively. At September 30, 2014 and December 31, 2013, the accumulated amortization of intangible liabilities was \$121 million and \$108 million, respectively.

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## (10)Other Assets

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

|  | September 30,<br>2014 | December 31,<br>2013 |
|--|-----------------------|----------------------|
| Straight-line rent assets, net of allowance of \$34,648 and \$34,230, respectively | \$ 347,109            | \$ 368,919           |
| Marketable debt securities, net  | 239,801               | 244,089              |
| Leasing costs and inducements, net   | 144,465               | 104,601              |
| Deferred financing costs, net  | 50,567                | 42,106               |
| Goodwill   | 50,346                | 50,346               |
| Other(1)   | 108,840               | (2) 57,644           |
| Total other assets   | \$ 941,128            | \$ 867,705           |

(1) Includes a \$5.4 million allowance for losses related to accrued interest receivable on the Delphis loan, which accrued interest is included in other assets. At both September 30, 2014 and December 31, 2013, the carrying value of interest accrued related to the Delphis loan was zero. Also includes a loan receivable for \$15 million and \$10 million at September 30, 2014 and December 31, 2013, respectively, from HCP Ventures IV, LLC, an unconsolidated joint venture (see Note 8 for additional information). The loan bears interest at a fixed rate of 12% per annum and matures in May 2015.

(2) Includes a \$30.1 million non-interest bearing short-term receivable from Brookdale payable in eight quarterly installments (see Note 3 for additional information).

## Four Seasons Health Care Senior Unsecured Notes

On June 28, 2012, the Company purchased senior unsecured notes with an aggregate par value of £138.5 million at a discount for £136.8 million (par value of \$237 million). The notes were issued by Elli Investments Limited, a subsidiary of Terra Firma, a European private equity firm, as part of its financing for the acquisition of Four Seasons Health Care ("Four Seasons"), an elderly and specialist care provider in the UK. The notes mature in June 2020 and are non-callable through June 2016. The notes bear interest on their par value at a fixed rate of 12.25% per annum, with an original issue discount resulting in a yield to maturity of 12.5%. This investment was financed by a GBP denominated unsecured term loan that is discussed in Note 11. These senior unsecured notes are accounted for as marketable debt securities and classified as held-to-maturity.

(11) Debt

Bank Line of Credit and Term Loan

On March 31, 2014, the Company amended its unsecured revolving line of credit facility (the “Facility”) with a syndicate of banks, which was scheduled to mature in March 2016, increasing the borrowing capacity by \$500 million to \$2.0 billion. The amended Facility matures on March 31, 2018, with a one-year committed extension option. Borrowings under the Facility accrue interest at LIBOR plus a margin that depends upon the Company’s debt ratings. The Company pays a facility fee on the entire revolving commitment that depends on its debt ratings. Based on the Company’s debt ratings at September 30, 2014, the margin on the Facility was 0.925%, and the facility fee was 0.15%. The Facility also includes a feature that will allow the Company to increase the borrowing capacity by an aggregate amount of up to \$500 million, subject to securing additional commitments from existing lenders or new lending institutions. At September 30, 2014, the Company had \$70 million outstanding under the Facility with a weighted average effective interest rate of 1.34%.

On July 30, 2012, the Company entered into a credit agreement with a syndicate of banks for a £137 million (\$222 million at September 30, 2014) four-year unsecured term loan (the “Term Loan”). Based on the Company’s debt ratings at September 30, 2014, the Term Loan accrues interest at a rate of GBP LIBOR plus 1.20%. Concurrent with the closing of the Term Loan, the Company entered into a four-year interest rate swap contract that fixes the interest rate of the Term Loan at 1.81%, subject to adjustments based on the Company’s debt ratings. The Term Loan contains a one-year committed extension option.

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The Facility and Term Loan contain certain financial restrictions and other customary requirements, including cross-default provisions to other indebtedness. Among other things, these covenants, using terms defined in the agreements, (i) limit the ratio of Consolidated Total Indebtedness to Consolidated Total Asset Value to 60%, (ii) limit the ratio of Secured Debt to Consolidated Total Asset Value to 30%, (iii) limit the ratio of Unsecured Debt to Consolidated Unencumbered Asset Value to 60% and (iv) require a minimum Fixed Charge Coverage ratio of 1.5 times. The Facility and Term Loan also require a Minimum Consolidated Tangible Net Worth of \$9.5 billion at September 30, 2014. At September 30, 2014, the Company was in compliance with each of these restrictions and requirements of the Facility and Term Loan.

Senior Unsecured Notes

At September 30, 2014, the Company had senior unsecured notes outstanding with an aggregate principal balance of \$7.7 billion. At September 30, 2014, interest rates on the notes ranged from 2.79% to 6.99% with a weighted average effective interest rate of 4.95% and a weighted average maturity of six years. The senior unsecured notes contain certain covenants including limitations on debt, maintenance of unencumbered assets, cross-acceleration provisions and other customary terms. The Company believes it was in compliance with these covenants at September 30, 2014.

On August 14, 2014, the Company issued \$800 million of 3.875% senior unsecured notes due 2024. The notes were priced at 99.63% of the principal amount with an effective yield-to-maturity of 3.92%; net proceeds from this offering were \$792 million.

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

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

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

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



offerings were \$789 million.

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

#### Mortgage Debt

At September 30, 2014, the Company had \$1.2 billion in aggregate principal amount of mortgage debt outstanding secured by 88 healthcare facilities (including redevelopment properties) with a carrying value of \$1.4 billion. At September 30, 2014, interest rates on the mortgage debt ranged from 0.44% to 8.69% with a weighted average effective interest rate of 6.21% and a weighted average maturity of three years.

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

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## Debt Maturities

The following table summarizes the Company's stated debt maturities and scheduled principal repayments at September 30, 2014 (in thousands):

| Year                | Bank<br>Line of<br>Credit | Term Loan(1) | Senior             |                  | Total(2)     |
|---------------------|---------------------------|--------------|--------------------|------------------|--------------|
|                     |                           |              | Unsecured<br>Notes | Mortgage<br>Debt |              |
| 2014 (Three months) | \$ —                      | \$ —         | \$ —               | \$ 249,052       | \$ 249,052   |
| 2015                | —                         | —            | 400,000            | 40,164           | 440,164      |
| 2016                | —                         | 222,118      | 900,000            | 291,736          | 1,413,854    |
| 2017                | —                         | —            | 750,000            | 550,477          | 1,300,477    |
| 2018                | 70,000                    | —            | 600,000            | 6,583            | 676,583      |
| Thereafter          | —                         | —            | 5,000,000          | 65,242           | 5,065,242    |
|                     | 70,000                    | 222,118      | 7,650,000          | 1,203,254        | 9,145,372    |
| Discounts, net      | —                         | —            | (24,959)           | (3,621)          | (28,580)     |
|                     | \$ 70,000                 | \$ 222,118   | \$ 7,625,041       | \$ 1,199,633     | \$ 9,116,792 |

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

(2) Excludes \$98 million of other debt that represents Life Care Bonds and Demand Notes that have no scheduled maturities.

## Other Debt

At September 30, 2014, the Company had \$72 million of non-interest bearing life care bonds at two of its continuing care retirement communities and non-interest bearing occupancy fee deposits at two of its senior housing facilities, all of which were payable to certain residents of the facilities (collectively, "Life Care Bonds"). The Life Care Bonds are generally refundable to the residents upon the termination of the contract or upon the successful resale of the unit.

In conjunction with the Brookdale Transaction, on August 29, 2014, the Company borrowed \$26 million from the CCRC JV in the form of on-demand notes ("Demand Notes"). The Demand Notes bear interest at a rate of 4.5%. See additional information regarding the Brookdale Transaction in Note 3.

(12) Commitments and Contingencies

Legal Proceedings

From time to time, the Company is a party to legal proceedings, lawsuits and other claims that arise in the ordinary course of the Company's business. The Company is not aware of any legal proceedings or claims that it believes may have, individually or taken together, a material adverse effect on the Company's business, prospects, financial condition, results of operations or cash flows. The Company's policy is to expense legal costs as they are incurred.

Concentration of Credit Risk

Concentrations of credit risks arise when one or more operators, tenants or obligors related to the Company's investments are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations, including those to the Company, to be similarly affected by changes in economic conditions. The Company regularly monitors various segments of its portfolio to assess potential concentrations of risks. The Company does not have significant foreign operations.

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

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

|               | Percentage of Senior Housing Gross Assets |                   | Percentage of Senior Housing Revenues Three Months Ended |      | Percentage of Senior Housing Revenues Nine Months Ended |      |
|---------------|---|-------------------|--|------|---|------|
|               | September 30, 2014                        | December 31, 2013 | September 30, 2014                                       | 2013 | September 30, 2014                                      | 2013 |
| Operators     |   |                   |  |      |   |      |
| HCR ManorCare | 10  | % 11              | % 7  | % 10 | % 9   | % 10 |
| Brookdale(1)  | 34  | 48                | 32   | 47   | 40  | 47   |

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

|               | Percentage of Post-Acute/Skilled Nursing Gross Assets |                   | Percentage of Post-Acute/Skilled Nursing Revenues Three Months Ended |      | Percentage of Post-Acute/Skilled Nursing Revenues Nine Months Ended |      |
|---------------|---|-------------------|--|------|---|------|
|               | September 30, 2014                                    | December 31, 2013 | September 30, 2014   | 2013 | September 30, 2014  | 2013 |
| Operators     |   |                   |  |      |   |      |
| HCR ManorCare | 89  | % 89              | % 86   | % 74 | % 86  | % 82 |

The following table lists the total Company concentrations:

|               | Percentage of Total Company Assets |                   | Percentage of Total Company Revenues Three Months Ended |      | Percentage of Total Company Revenues Nine Months Ended |      |
|---------------|------------------------------------|-------------------|---|------|--|------|
|               | September 30, 2014                 | December 31, 2013 | September 30, 2014                                      | 2013 | September 30, 2014                                     | 2013 |
| Operators     |                                    |                   |   |      |  |      |
| HCR ManorCare | 31                                 | % 32              | % 25  | % 27 | % 27   | % 28 |
| Brookdale(1)  | 14                                 | 19                | 13  | 16   | 15   | 17   |

(1) On July 31, 2014, Brookdale completed its acquisition of Emeritus. These percentages of segment revenues, total revenues, segment assets and total assets for all periods presented are prepared on a pro forma basis to reflect the combined concentration for Brookdale and Emeritus, as if the merger had occurred as of the beginning of the periods

presented. On August 29, 2014, the Company and Brookdale amended or terminated all former leases with Emeritus and entered into two RIDEA joint ventures (see Note 3 for additional information regarding the Brookdale Transaction). Percentages do not include senior housing facilities that Brookdale manages (is not a tenant) on behalf of the Company, under a RIDEA structure.

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

|   | September 30,<br>2014 | December 31,<br>2013 |
|---|-----------------------|----------------------|
| Real estate and other property, net             | \$ 2,956.4            | \$ 2,993.2           |
| Cash and cash equivalents                       | 137.2                 | 141.8                |
| Goodwill, intangible and other assets, net      | 5,084.1               | 5,174.9              |
| Total assets                                    | \$ 8,177.7            | \$ 8,309.9           |
| Debt and financing obligations                  | \$ 6,145.1            | \$ 6,258.5           |
| Accounts payable, accrued liabilities and other | 993.7                 | 1,013.4              |
| Total equity                                    | 1,038.9               | 1,038.0              |
| Total liabilities and equity                    | \$ 8,177.7            | \$ 8,309.9           |

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|   | Three Months Ended |            | Nine Months Ended |            |
|---|--------------------|------------|-------------------|------------|
|   | September 30,      |            | September 30,     |            |
|   | 2014               | 2013       | 2014              | 2013       |
| Revenues  | \$ 1,030.9         | \$ 1,021.2 | \$ 3,117.6        | \$ 3,105.0 |
| Operating, general and administrative expense               | (888.3)            | (875.5)    | (2,698.6)         | (2,639.5)  |
| Depreciation and amortization expense                       | (36.0)             | (35.7)     | (106.9)           | (108.1)    |
| Interest expense  | (101.8)            | (103.6)    | (306.5)           | (311.7)    |
| Other income (expense), net                                 | (0.5)              | 2.4        | 4.0               | 4.1        |
| Income from continuing operations before income tax expense | 4.3                | 8.8        | 9.6               | 49.8       |
| Income tax expense  | (2.2)              | (3.6)      | (4.4)             | (17.1)     |
| Income from continuing operations                           | 2.1                | 5.2        | 5.2               | 32.7       |
| Income (loss) from discontinued operations, net of taxes    | 3.6                | (2.6)      | (2.0)             | (8.3)      |
| Net income  | \$ 5.7             | \$ 2.6     | \$ 3.2            | \$ 24.4    |

As of September 30, 2014, Brookdale provided comprehensive property management and accounting services with respect to 68 of the Company's senior housing facilities, for which the Company pays annual management fees pursuant to long-term management agreements. Most of the management agreements have terms ranging from 10 to 15 years, with 5-year renewals. The base management fees are 4.5% to 5.0% of gross revenues (as defined) generated by the RIDEA facilities. In addition, there are incentive management fees payable to Brookdale if operating results of the RIDEA properties exceed pre-established EBITDAR (as defined) thresholds.

Brookdale is subject to the registration and reporting requirements of the SEC and is required to file with the SEC annual reports containing audited financial information and quarterly reports containing unaudited financial information. The information related to Brookdale contained or referred to in this Quarterly Report on Form 10-Q has been derived from SEC filings made by Brookdale, as the case may be, or other publicly available information, or was provided to the Company by Brookdale, and the Company has not verified this information through an independent investigation or otherwise. The Company has no reason to believe that this information is inaccurate in any material respect, but the Company cannot assure the reader of its accuracy. The Company is providing this data for informational purposes only, and encourages the reader to obtain Brookdale's publicly available filings, which can be found at the SEC's website at [www.sec.gov](http://www.sec.gov).

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

Credit Enhancement Guarantee

Certain of the Company's senior housing facilities serve as collateral for \$107 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 \$371 million as of September 30, 2014.

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## (13) Equity

## Common Stock

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

| Declaration Date | Record Date | Amount<br>Per Share | Dividend<br>Payable Date |
|------------------|-------------|---------------------|--------------------------|
| January 30       | February 10 | \$ 0.545            | February 25              |
| May 1            | May 12      | 0.545               | May 27                   |
| July 31          | August 11   | 0.545               | August 26                |
| October 30       | November 10 | 0.545               | November 25              |

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

|   | Nine Months<br>Ended<br>September 30, |       |
|---|---------------------------------------|-------|
|   | 2014                                  | 2013  |
| Dividend Reinvestment and Stock Purchase Plan | 1,775                                 | 1,681 |
| Conversion of DownREIT units(1)               | 2                                     | 85    |
| Exercise of stock options                     | 131                                   | 875   |
| Vesting of restricted stock units             | 575                                   | 110   |

(1) Non-managing member LLC units.

## Accumulated Other Comprehensive Loss

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



|  | September 30,<br>2014 | December 31,<br>2013 |
|--|-----------------------|----------------------|
| Unrealized losses on available for sale securities       | \$ (5)                | \$ —                 |
| Unrealized losses on cash flow hedges, net               | (9,734)               | (10,797)             |
| Supplemental Executive Retirement Plan minimum liability | (2,747)               | (2,910)              |
| Cumulative foreign currency translation adjustment       | (4,978)               | (780)                |
| Total accumulated other comprehensive loss               | \$ (17,464)           | \$ (14,487)          |

#### Noncontrolling Interests

At September 30, 2014, non-managing members held an aggregate of 4 million units in five limited liability companies (“DownREITs”), for which the Company is the managing member. At September 30, 2014, the carrying and fair values of these DownREIT units were \$189 million and \$242 million, respectively.

#### Severance-related charges

The Company’s Board of Directors, after its deliberations during the third quarter 2013, terminated its former Chairman, Chief Executive Officer and President on October 2, 2013. As a result of the termination, general and administrative expenses for the three and nine months ended September 30, 2013 include severance-related charges of \$26.4 million related to: (i) the acceleration of \$16.7 million of deferred compensation for restricted stock units and options that vested upon termination; and (ii) severance payments and other costs of approximately \$9.7 million.

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## (14) Segment Disclosures

The Company evaluates its business and makes resource allocations based on its five business segments: (i) senior housing, (ii) post-acute/skilled nursing, (iii) life science, (iv) medical office and (v) hospital. Under the senior housing, post-acute/skilled nursing, life science and hospital segments, the Company primarily invests, through the acquisition and development of real estate, in single operator or tenant properties and debt issued by operators in these sectors. Under the medical office segment, the Company invests through the acquisition and development of MOB's, which generally require a greater level of property management. The accounting policies of the segments are the same as those described in Note 2 to the Consolidated Financial Statements herein and in the Company's 2013 Annual Report on Form 10-K filed with the SEC. There were no intersegment sales or transfers during the nine months ended September 30, 2014 and 2013. The Company evaluates performance based upon property net operating income from continuing operations ("NOI"), adjusted NOI (cash NOI) and interest income of the combined investments in each segment.

Non-segment assets consist primarily of corporate assets including cash and cash equivalents, restricted cash, accounts receivable, net, marketable equity securities, deferred financing costs and, if any, real estate held-for-sale. Interest expense, depreciation and amortization and non-property specific revenues and expenses are not allocated to individual segments in determining the Company's performance measure. See Note 12 for other information regarding concentrations of credit risk.

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

For the three months ended September 30, 2014:

| Segments           | Rental Revenues(1) | Resident Fees and Services | Interest Income | Investment Management Fee Income | Total Revenues | NOI(2)     | Adjusted (Cash) NOI(2) |
|--------------------|--------------------|----------------------------|-----------------|----------------------------------|----------------|------------|------------------------|
| Senior housing     | \$ 183,834         | \$ 62,213                  | \$ 3,919        | \$ —                             | \$ 249,966     | \$ 203,030 | \$ 155,512             |
| Post-acute/skilled | 139,205            | —                          | 13,598          | —                                | 152,803        | 138,671    | 121,978                |
| Life science       | 79,450             | —                          | —               | 1                                | 79,451         | 62,813     | 60,722                 |
| Medical office     | 92,412             | —                          | —               | 446                              | 92,858         | 53,953     | 54,481                 |
| Hospital           | 21,560             | —                          | —               | —                                | 21,560         | 20,608     | 20,738                 |
| Total              | \$ 516,461         | \$ 62,213                  | \$ 17,517       | \$ 447                           | \$ 596,638     | \$ 479,075 | \$ 413,431             |

For the three months ended September 30, 2013:

| Segments           | Rental<br>Revenues(1) | Resident Fees<br>and Services | Interest<br>Income | Investment<br>Management<br>Fee Income | Total<br>Revenues | NOI(2)     | Adjusted<br>(Cash) NOI(2) |
|--------------------|-----------------------|-------------------------------|--------------------|--|-------------------|------------|---------------------------|
| Senior housing     | \$ 149,443            | \$ 36,370                     | \$ 3,121           | \$ —                                   | \$ 188,934        | \$ 162,078 | \$ 148,684                |
| Post-acute/skilled | 136,017               | —                             | 38,642             | —                                      | 174,659           | 135,388    | 117,921                   |
| Life science       | 72,531                | —                             | —                  | 1                                      | 72,532            | 58,440     | 56,352                    |
| Medical office     | 88,425                | —                             | —                  | 463                                    | 88,888            | 52,438     | 52,397                    |
| Hospital           | 20,829                | —                             | 315                | —                                      | 21,144            | 19,854     | 19,883                    |
| Total              | \$ 467,245            | \$ 36,370                     | \$ 42,078          | \$ 464                                 | \$ 546,157        | \$ 428,198 | \$ 395,237                |

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For the nine months ended September 30, 2014:

| Segments           | Rental Revenues(1) | Resident Fees and Services | Interest Income | Investment Management Fee Income | Total Revenues | NOI(2)       | Adjusted (Cash) NOI(2) |
|--------------------|--------------------|----------------------------|-----------------|----------------------------------|----------------|--------------|------------------------|
| Senior housing     | \$ 485,823         | \$ 138,205                 | \$ 10,633       | \$ —                             | \$ 634,661     | \$ 531,640   | \$ 459,363             |
| Post-acute/skilled | 415,533            | —                          | 40,517          | —                                | 456,050        | 413,934      | 362,182                |
| Life science       | 233,113            | —                          | —               | 3                                | 233,116        | 186,866      | 178,890                |
| Medical office     | 273,215            | —                          | —               | 1,337                            | 274,552        | 162,075      | 161,280                |
| Hospital           | 64,372             | —                          | —               | —                                | 64,372         | 61,573       | 61,874                 |
| Total              | \$ 1,472,056       | \$ 138,205                 | \$ 51,150       | \$ 1,340                         | \$ 1,662,751   | \$ 1,356,088 | \$ 1,223,589           |

For the nine months ended September 30, 2013:

| Segments           | Rental Revenues(1) | Resident Fees and Services | Interest Income | Investment Management Fee Income | Total Revenues | NOI(2)       | Adjusted (Cash) NOI(2) |
|--------------------|--------------------|----------------------------|-----------------|----------------------------------|----------------|--------------|------------------------|
| Senior housing     | \$ 448,600         | \$ 108,509                 | \$ 8,328        | \$ —                             | \$ 565,437     | \$ 486,516   | \$ 439,410             |
| Post-acute/skilled | 405,108            | —                          | 59,656          | —                                | 464,764        | 403,218      | 349,590                |
| Life science       | 221,088            | —                          | —               | 3                                | 221,091        | 179,775      | 170,957                |
| Medical office     | 265,252            | —                          | —               | 1,403                            | 266,655        | 159,888      | 157,406                |
| Hospital           | 51,007             | —                          | 627             | —                                | 51,634         | 48,177       | 59,664                 |
| Total              | \$ 1,391,055       | \$ 108,509                 | \$ 68,611       | \$ 1,406                         | \$ 1,569,581   | \$ 1,277,574 | \$ 1,177,027           |

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

(2) NOI is a non-GAAP supplemental financial measure used to evaluate the operating performance of real estate. The Company defines NOI as rental and related revenues, including tenant recoveries, resident fees and services, and income from DFLs, less property level operating expenses. NOI excludes interest income, investment management fee income, interest expense, depreciation and amortization, general and administrative expenses, litigation settlement, impairments, impairment recoveries, other income, net, income taxes, equity income from and impairments of investments in unconsolidated joint ventures, and discontinued operations. The Company believes NOI provides relevant and useful information because it reflects only income and operating expense items that are incurred at the property level and presents them on an unleveraged basis. Adjusted NOI is calculated as NOI after eliminating the effects of straight-line rents, DFL accretion, amortization of above and below market lease intangibles, and lease termination fees. Adjusted NOI is also referred to as "Cash NOI." The Company uses NOI and adjusted NOI to make decisions about resource allocations and to assess and compare property level performance. The Company believes that net income is the most directly comparable GAAP measure to NOI. NOI should not be viewed as an alternative

measure of operating performance to net income as defined by GAAP because it does not reflect the aforementioned excluded items. Further, the Company's definition of NOI may not be comparable to the definition used by other REITs or real estate companies, as those companies may use different methodologies for calculating NOI.

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

|   | Three Months Ended |            | Nine Months Ended |              |
|---|--------------------|------------|-------------------|--------------|
|   | September 30,      |            | September 30,     |              |
|   | 2014               | 2013       | 2014              | 2013         |
| Net income  | \$ 251,059         | \$ 236,858 | \$ 736,961        | \$ 687,367   |
| Interest income   | (17,517)           | (42,078)   | (51,150)          | (68,611)     |
| Investment management fee income                              | (447)              | (464)      | (1,340)           | (1,406)      |
| Interest expense  | 111,275            | 108,088    | 324,755           | 325,650      |
| Depreciation and amortization                                 | 122,975            | 104,783    | 343,496           | 317,172      |
| General and administrative                                    | 24,954             | 45,326     | 75,410            | 90,043       |
| Other income, net   | (3,111)            | (1,632)    | (5,750)           | (17,032)     |
| Income taxes  | 55                 | 1,034      | 2,840             | 3,553        |
| Equity income from unconsolidated joint ventures              | (10,168)           | (13,892)   | (39,388)          | (44,278)     |
| Total discontinued operations                                 | —                  | (9,825)    | (29,746)          | (14,884)     |
| NOI   | 479,075            | 428,198    | 1,356,088         | 1,277,574    |
| Straight-line rents   | (8,627)            | (12,604)   | (35,082)          | (28,559)     |
| DFL accretion   | (18,760)           | (19,822)   | (57,995)          | (65,386)     |
| Amortization of above and below market lease intangibles, net | (276)              | (346)      | (619)             | (6,414)      |
| Lease termination fees  | (37,981)           | (205)      | (38,792)          | (220)        |
| NOI adjustments related to discontinued operations            | —                  | 16         | (11)              | 32           |
| Adjusted (Cash) NOI   | \$ 413,431         | \$ 395,237 | \$ 1,223,589      | \$ 1,177,027 |

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

| Segments                                  | September 30,<br>2014 | December 31,<br>2013 |
|---|-----------------------|----------------------|
| Senior housing                            | \$ 8,427,636          | \$ 7,803,085         |
| Post-acute/skilled nursing                | 6,336,758             | 6,266,938            |
| Life science                              | 4,113,227             | 3,986,187            |
| Medical office                            | 2,892,081             | 2,686,069            |
| Hospital                                  | 639,922               | 639,357              |
| Gross segment assets                      | 22,409,624            | 21,381,636           |
| Accumulated depreciation and amortization | (2,488,484)           | (2,257,188)          |
| Net segment assets                        | 19,921,140            | 19,124,448           |
| Assets held-for-sale, net                 | —                     | 9,819                |
| Other non-segment assets                  | 823,750               | 941,603              |

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|              |               |               |
|--------------|---------------|---------------|
| Total assets | \$ 20,744,890 | \$ 20,075,870 |
|--------------|---------------|---------------|

At both September 30, 2014 and December 31, 2013, goodwill of \$50 million was allocated to segment assets as follows: (i) senior housing—\$31 million, (ii) post-acute/skilled nursing—\$3 million, (iii) medical office—\$11 million, and (iv) hospital—\$5 million.

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## (15) Earnings Per Common Share

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

|   | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|---|-------------------------------------|------------|------------------------------------|------------|
|   | 2014                                | 2013       | 2014                               | 2013       |
| <b>Numerator</b>  |                                     |            |                                    |            |
| Income from continuing operations                             | \$ 251,059                          | \$ 227,033 | \$ 707,215                         | \$ 672,483 |
| Noncontrolling interests' share in continuing operations      | (3,405)                             | (3,055)    | (10,134)                           | (9,442)    |
| Income from continuing operations applicable to HCP, Inc.     | 247,654                             | 223,978    | 697,081                            | 663,041    |
| Participating securities' share in continuing operations      | (446)                               | (474)      | (1,999)                            | (1,330)    |
| Income from continuing operations applicable to common shares | 247,208                             | 223,504    | 695,082                            | 661,711    |
| Discontinued operations                                       | —                                   | 9,825      | 29,746                             | 14,884     |
| Noncontrolling interests' share in discontinued operations    | —                                   | (47)       | (1,177)                            | (183)      |
| Net income applicable to common shares                        | \$ 247,208                          | \$ 233,282 | \$ 723,651                         | \$ 676,412 |
| <b>Denominator</b>  |                                     |            |                                    |            |
| Basic weighted average common shares                          | 458,799                             | 455,345    | 458,119                            | 454,553    |
| Dilutive potential common shares                              | 342                                 | 733        | 354                                | 835        |
| Diluted weighted average common shares                        | 459,141                             | 456,078    | 458,473                            | 455,388    |
| <b>Basic earnings per common share</b>                        |                                     |            |                                    |            |
| Income from continuing operations                             | \$ 0.54                             | \$ 0.49    | \$ 1.52                            | \$ 1.46    |
| Discontinued operations                                       | —                                   | 0.02       | 0.06                               | 0.03       |
| Net income applicable to common shares                        | \$ 0.54                             | \$ 0.51    | \$ 1.58                            | \$ 1.49    |
| <b>Diluted earnings per common share</b>                      |                                     |            |                                    |            |
| Income from continuing operations                             | \$ 0.54                             | \$ 0.49    | \$ 1.52                            | \$ 1.46    |
| Discontinued operations                                       | —                                   | 0.02       | 0.06                               | 0.03       |
| Net income applicable to common shares                        | \$ 0.54                             | \$ 0.51    | \$ 1.58                            | \$ 1.49    |

Restricted stock and certain of the Company's performance restricted stock units are considered participating securities, because dividend payments are not forfeited even if the underlying award does not vest, which requires the use of the two-class method when computing basic and diluted earnings per share. Options to purchase approximately 1.1 million and 0.9 million shares of common stock that had an exercise price (including deferred compensation expense) in excess of the average closing market price of the Company's common stock during the three months ended September 30, 2014 and 2013, respectively, were not included in the Company's earnings per share calculations because they are anti-dilutive. Restricted stock and performance restricted stock units representing 0.1 million and



7,500 shares of common stock during the three months ended September 30, 2014 and 2013, respectively, were not included because they are anti-dilutive. Additionally, 6 million shares issuable upon conversion of 4 million DownREIT units during the three months ended September 30, 2014 and 2013 were not included because they are anti-dilutive.

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## (16) Supplemental Cash Flow Information

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

|   | Nine Months Ended<br>September 30, |            |
|---|------------------------------------|------------|
|   | 2014                               | 2013       |
| Supplemental cash flow information:   |                                    |            |
| Interest paid, net of capitalized interest  | \$ 359,483                         | \$ 363,229 |
| Income taxes paid (refunded)  | 4,282                              | (2)        |
| Capitalized interest  | 8,185                              | 10,852     |
| Supplemental schedule of non-cash investing activities:   |                                    |            |
| Accrued construction costs  | 28,933                             | 18,495     |
| Loan originated in connection with Brookdale Transaction  | 67,640                             | —          |
| Real estate contributed to CCRC JV  | 91,603                             | —          |
| Fair value of real estate acquired in exchange for sale of real estate                                | 32,000                             | 15,204     |
| Supplemental schedule of non-cash financing activities:   |                                    |            |
| Vesting of restricted stock units   | 575                                | 110        |
| Cancellation of restricted stock  | 1                                  | 17         |
| Conversion of non-managing member units into common stock   | 73                                 | 2,997      |
| Noncontrolling interest issued in connection with Brookdale Transaction                               | 46,751                             | —          |
| Noncontrolling interest issued in connection with real estate acquisition                             | 6,321                              | —          |
| Noncontrolling interest assumed in connection with real estate disposition                            | 1,671                              | —          |
| Mortgages and other liabilities assumed with real estate acquisitions                                 | 1,734                              | 12,728     |
| Unrealized gains on available-for-sale securities and derivatives designated as cash flow hedges, net | 1,824                              | 6,990      |

See also discussions of the Brookdale Transaction in Note 3.

## (17) Variable Interest Entities

## Unconsolidated Variable Interest Entities

At September 30, 2014, the Company had investments in: (i) an unconsolidated VIE joint venture; (ii) 48 properties leased to VIE tenants; (iii) a loan to a VIE borrower; and (iv) marketable debt securities of a VIE borrower. The Company has determined that it is not the primary beneficiary of these VIEs.

The Company holds an equity interest in an unconsolidated joint venture (CCRC OpCo) that has been identified as a VIE (see Note 3 for additional information on the CCRC JV). The equity members of CCRC OpCo share certain operating rights with Brookdale as manager of the CCRCs; however, the Company does not consolidate this VIE because it does not have the ability to control the activities that most significantly impact this VIE's economic performance. The assets of CCRC OpCo primarily consist of the CCRCs that it owns and leases, resident fees receivable, notes receivable and cash and cash equivalents; its obligations primarily consist of operating lease obligations and accounts payable and expense accruals associated with the cost of its CCRCs operations. Assets generated by the CCRC operations (primarily rents from CCRC residents) of CCRC OpCo may only be used to settle its contractual obligations (primarily the rental costs and operating expenses incurred to manage such facilities).

The Company leased 48 properties to a total of seven tenants that have been identified as VIEs ("VIE tenants"). These VIE tenants are thinly capitalized entities that rely on the cash flows generated from the senior housing facilities to pay operating expenses, including the rent obligations under their leases. The Company has no formal involvement in these VIE tenants beyond its investment. The Company does not consolidate the VIE tenants because it does not have the ability to control the activities that most significantly impact the VIE's economic performance.

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The Company holds an interest-only, senior secured term loan made to a borrower (Delphis Operations, L.P.) that has been identified as a VIE (see Note 7 for additional information on the Delphis loan). The Company does not consolidate the VIE because it does not have the ability to control the activities that most significantly impact the VIE's economic performance. The loan is collateralized by all of the assets of the borrower (comprised primarily of interests in partnerships that operate surgical facilities, of which one partnership is a tenant of the Company).

The Company holds commercial mortgage-backed securities ("CMBS") issued by Federal Home Loan Mortgage Corporation ("Freddie MAC") through a special purpose entity that has been identified as a VIE. The Company does not consolidate the VIE because it does not have the ability to control the activities that most significantly impact the VIE's economic performance. The CMBS issued by the VIE are backed by mortgages on senior housing facilities.

The carrying value and classification of the related assets, liabilities and maximum exposure to loss as a result of the Company's involvement with these VIEs are presented below at September 30, 2014 (in thousands):

| VIE Type                     | Maximum Loss Exposure(1) | Asset/Liability Type                                      | Carrying Amount |
|------------------------------|--------------------------|---|-----------------|
| CCRC OpCo                    | \$ 249,856               | Investments in unconsolidated joint ventures              | \$ 249,856      |
| VIE tenants—operating leases | 215,504                  | Lease intangibles, net and straight-line rent receivables | 13,258          |
| VIE tenants—DFLs             | 1,050,995                | Net investment in DFLs                                    | 600,493         |
| Loan—senior secured          | 17,470                   | Loans receivable, net                                     | 17,470          |
| CMBS                         | 17,433                   | Marketable debt securities                                | 17,433          |

(1) The Company's maximum loss exposure related to its equity investment in unconsolidated joint ventures, and loans and marketable debt securities to the VIE borrowers represents its current aggregate carrying amount. 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.

As of September 30, 2014, the Company has not provided, and is not required to provide, financial support through a liquidity arrangement or otherwise, to its unconsolidated VIEs, including circumstances in which it could be exposed to further losses (e.g., cash shortfalls). See Notes 3, 6, 7 and 8 for additional descriptions of the nature, purpose and activities of the Company's unconsolidated VIEs and interests therein.

## Consolidated Variable Interest Entities

The Company holds a 90% ownership interest in a joint venture entity formed in September 2011 that operates senior housing properties in a RIDEA structure (“RIDEA OpCo”). The Company historically has consolidated RIDEA OpCo as a result of the rights it acquired through the joint venture agreement with Brookdale utilizing the voting interest model. In the third quarter of 2014, upon the occurrence of a reconsideration event, it was determined that RIDEA OpCo is a VIE and that the Company is the primary beneficiary because it has the ability to control the activities that most significantly impact the VIEs’ economic performance. The assets of RIDEA OpCo primarily consist of leasehold interests in senior housing facilities (operating leases), resident fees receivable, and cash and cash equivalents; its obligations primarily consist of lease payments to a non-VIE consolidated subsidiary of the Company and operating expenses of its senior housing facilities (accounts payable and accrued expenses). Assets generated by the senior housing operations (primarily rents from senior housing residents) of RIDEA OpCo may only be used to settle its contractual obligations (primarily the rental costs and operating expenses incurred to manage such facilities).

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The Company holds an 80% equity interest in joint venture entities that own and operate senior housing properties in a RIDEA structure (RIDEA Subsidiaries). The Company consolidates RIDEA Subsidiaries (SH PropCo and SH OpCo) as the primary beneficiary because it has the ability to control the activities that most significantly impact the VIEs' economic performance. The assets of SH PropCo primarily consist of leased properties (net real estate), rents receivable and cash and cash equivalents; its obligations primarily consist of a note payable to a non-VIE consolidated subsidiary of the Company. The assets of SH OpCo primarily consist of leasehold interests in senior housing facilities (operating leases), resident fees receivable and cash and cash equivalents; its obligations primarily consist of lease payments to SH PropCo and operating expenses of its senior housing facilities (accounts payable and accrued expenses). Assets generated by the senior housing operations (primarily rents from senior housing residents) of RIDEA Subsidiaries may only be used to settle its contractual obligations (primarily the rental costs and operating expenses incurred to manage such facilities). See Note 3 for additional information of the RIDEA Subsidiaries and the Company's interests therein.

The Company made loans to two entities that entered into a tax credit structure ("Tax Credit Subsidiaries") and an investment in a development joint venture ("Development JV"). The Company consolidates the Tax Credit Subsidiaries and Development JV because they are VIEs and the Company is the primary beneficiary of these VIEs because it has the ability to control the activities that most significantly impact the VIEs' economic performance. The assets and liabilities of the Tax Credit Subsidiaries and Development JV substantially consist of development in progress, notes receivable, prepaid expenses, notes payable and accounts payable and accrued liabilities generated from their operating activities. Assets generated by the operating activities of the Tax Credit Subsidiaries and Development JV may only be used to settle their contractual obligations.

## (18) Fair Value Measurements

The following table illustrates the Company's financial assets and liabilities measured at fair value on a recurring basis in the condensed consolidated balance sheets. Recognized gains and losses are recorded in other income, net on the Company's condensed consolidated statements of income. During the nine months ended September 30, 2014, there were no transfers of financial assets or liabilities within the fair value hierarchy.

The financial assets and liabilities carried at fair value on a recurring basis at September 30, 2014 follow (in thousands):

| Financial Instrument(1)      | Fair Value | Level 1 | Level 2 | Level 3 |
|------------------------------|------------|---------|---------|---------|
| Marketable equity securities | \$ 26      | \$ 26   | \$ —    | \$ —    |

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|                                |            |       |            |       |
|--------------------------------|------------|-------|------------|-------|
| Interest-rate swap assets      | 1,447      | —     | 1,447      | —     |
| Interest-rate swap liabilities | (7,580)    | —     | (7,580)    | —     |
| Currency swap assets           | 484        | —     | 484        | —     |
| Currency swap liabilities      | (1,337)    | —     | (1,337)    | —     |
| Warrants                       | 69         | —     | —          | 69    |
|                                | \$ (6,891) | \$ 26 | \$ (6,986) | \$ 69 |

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

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

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

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

|                                   | September 30, 2014 |            | December 31, 2013 |            |
|-----------------------------------|--------------------|------------|-------------------|------------|
|                                   | Carrying Value     | Fair Value | Carrying Value    | Fair Value |
| Loans receivable, net(2)          | \$ 418,801         | \$ 426,598 | \$ 366,001        | \$ 373,441 |
| Marketable debt securities(1)     | 239,801            | 272,420    | 244,089           | 280,850    |
| Marketable equity securities(1)   | 26                 | 26         | —                 | —          |
| Warrants(3)                       | 69                 | 69         | 114               | 114        |
| Term loan(2)                      | 222,118            | 222,118    | 226,858           | 226,858    |
| Senior unsecured notes(1)         | 7,625,041          | 8,144,262  | 6,963,375         | 7,405,817  |
| Mortgage debt(2)                  | 1,199,633          | 1,234,725  | 1,396,485         | 1,421,214  |
| Other debt(2)                     | 97,845             | 97,845     | 74,909            | 74,909     |
| Interest-rate swap assets(2)      | 1,447              | 1,447      | 2,325             | 2,325      |
| Interest-rate swap liabilities(2) | 7,580              | 7,580      | 8,384             | 8,384      |
| Currency swap assets(2)           | 484                | 484        | —                 | —          |
| Currency swap liabilities(2)      | 1,337              | 1,337      | 2,756             | 2,756      |

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

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

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





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## (20) Derivative Financial Instruments

The following table summarizes the Company's outstanding interest-rate and foreign currency swap contracts as of September 30, 2014 (dollars and GBP in thousands):

| Date Entered     | Maturity Date | Hedge Designation | Fixed Rate/Buy Amount | Floating/Exchange Rate Index     | Notional/Sell Amount | Fair Value(1) |
|------------------|---------------|-------------------|-----------------------|----------------------------------|----------------------|---------------|
| July 2005(2)     | July 2020     | Cash Flow         | 3.82                  | % Index                          | \$ 45,600            | \$ (5,635)    |
| November 2008(3) | October 2016  | Cash Flow         | 5.95                  | % LIBOR+1.50%<br>1 Month         | \$ 26,000            | \$ (1,945)    |
| July 2012(3)     | June 2016     | Cash Flow         | 1.81                  | % LIBOR+1.20%<br>Buy<br>USD/Sell | \$ 137,000           | \$ 1,447      |
| July 2012(4)     | June 2016     | Cash Flow         | \$ 45,500             | GBP<br>Buy<br>USD/Sell           | £ 29,000             | \$ (1,337)    |
| July 2014(5)     | December 2015 | Cash Flow         | \$ 9,300              | GBP                              | £ 5,500              | \$ 484        |

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

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

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

(4) Currency swap contract (buy USD/sell GBP) hedges the foreign currency exchange risk related to a portion of the Company's forecasted interest receipts on GBP denominated senior unsecured notes. Represents a currency swap to sell £7.2 million at a rate of 1.5695 on various dates through June 2016.

(5) Currency swap contract (buy USD/sell GBP) hedges the foreign currency exchange risk related to the Company's forecasted GBP denominated interest receipts on intercompany loans. Represents a currency swap to sell £0.4 million at a rate of 1.7060 on various dates through December 2015.

The Company uses derivative instruments to mitigate the effects of interest rate and foreign currency fluctuations on specific forecasted transactions as well as recognized financial obligations or assets. Utilizing derivative instruments allows the Company to manage the risk of fluctuations in interest and foreign currency rates related to the potential impact these changes could have on future earnings and forecasted cash flows. The Company does not use derivative instruments for speculative or trading purposes.

The primary risks associated with derivative instruments are market and credit risk. Market risk is defined as the potential for loss in value of a derivative instrument due to adverse changes in market prices. Credit risk is the risk that one of the parties to a derivative contract fails to perform or meet their financial obligation. The Company does not obtain collateral associated with its derivative contracts, but monitors the credit standing of its counterparties on a regular basis. Should a counterparty fail to perform, the Company would incur a financial loss to the extent that the associated derivative contract was in an asset position. At September 30, 2014, the Company does not anticipate non-performance by the counterparties to its outstanding derivative contracts.

On July 16, 2014, the Company entered into a foreign currency swap contract to hedge the foreign currency exchange risk related to GBP interest receipts on two intercompany loans (see additional discussion of the UK facilities in Note 4). The cash flow hedge has a fixed USD/GBP exchange rate of 1.7060 (buy \$0.6 million and sell £0.4 million monthly) and matures in December 2015. The fair value of the contract at September 30, 2014 was \$0.5 million and is included in other assets, net. During the three and nine months ended September 30, 2014, there was no ineffective portion related to this hedge.

In December 2010, the Company assumed a cash flow hedge as part of a real estate acquisition. During the three months ended September 30, 2014, the Company determined a portion of the hedge was ineffective and reclassified \$2.1 million of unrealized gains related to this interest-rate swap contract into other income, net.

At September 30, 2014, the Company expects that the hedged forecasted transactions for each of the outstanding qualifying cash flow hedging relationships remain probable of occurring, and as a result, no additional gains or losses recorded to accumulated other comprehensive loss are expected to be reclassified to earnings for any other outstanding

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hedges, other than discussed above. During the nine months ended September 30, 2014, there were no additional ineffective portions related to other outstanding hedges, other than discussed above.

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

| Date Entered  | Maturity Date | Effects of Change in Interest and Foreign Currency Rates |                     |                      |                      |
|---------------|---------------|--|---------------------|----------------------|----------------------|
|               |               | +50 Basis<br>Points                                      | -50 Basis<br>Points | +100 Basis<br>Points | -100 Basis<br>Points |
| July 2005     | July 2020     | \$ 1,128   | \$ (1,337)          | \$ 2,361             | \$ (2,570)           |
| November 2008 | October 2016  | 267  | (253)               | 527                  | (512)                |
| July 2012     | June 2016     | 1,900  | (1,865)             | 3,783                | (3,748)              |
| July 2012     | June 2016     | (399)  | 71                  | (633)                | 306                  |
| July 2014     | December 2015 | (65)   | 23                  | (110)                | 67                   |

## (21) Subsequent Events

On November 3, 2014, the Company committed to be the lead lender for Formation Capital and Safanad's pending acquisition of NHP, a company that owns care homes in the UK. The Company will provide a loan facility (the "Facility"), secured by substantially all of NHP's assets, totaling £394.5 million (approximately \$630 million), with £362.5 million funded at closing. The closing of the acquisition and funding of the Facility are expected to occur later in November 2014, subject to customary closing conditions.

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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 expectation as identified by the use of words such as "may," "will," "project," "expect," "believe," "intend," "anticipate," "see," "forecast," "plan," "estimate," "could," "would," "should" and other comparable and derivative terms or the negatives thereof. In addition, we, through our officers, from time to time, make forward-looking oral and written public statements concerning our expected future operations, strategies, securities offerings, growth and investment opportunities, dispositions, capital structure changes, budgets and other developments. Readers are cautioned that, while forward-looking statements reflect our good faith belief and reasonable assumptions based upon current information, we can give no assurance that our expectations or forecasts will be attained. Therefore, readers should be mindful that forward-looking statements are not guarantees of future performance and that they are subject to known and unknown risks and uncertainties that are difficult to predict. As more fully set forth under "Part I, Item 1A. Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2013, factors that may cause our actual results to differ materially from the expectations contained in the forward-looking statements include:

- (a) Changes in global, national and local economic conditions, including a prolonged period of weak economic growth;
- (b) Volatility or uncertainty in the capital markets, including changes in the availability and cost of capital (impacted by changes in interest rates and the value of our common stock); which may adversely impact our ability to consummate transactions or reduce the earnings from potential transactions;
- (c) Our ability to manage our indebtedness level and changes in the terms of such indebtedness;
- (d) The effect on healthcare providers of recently enacted and pending Congressional legislation addressing entitlement programs and related services, including Medicare and Medicaid, which may result in future reductions in reimbursements;
- (e) The ability of our operators, tenants and borrowers to conduct their respective businesses in a manner sufficient to maintain or increase their revenues and to generate sufficient income to make rent and loan payments to us and our ability to recover investments made, if applicable, in their operations;
- (f)

The financial weakness of some operators and tenants, including potential bankruptcies and downturns in their businesses, which results in uncertainties regarding our ability to continue to realize the full benefit of such operators' and/or tenants' leases;

- (g) Changes in federal, state or local laws and regulations, including those affecting the healthcare industry that affect our costs of compliance or increase the costs, or otherwise affect the operations of our operators, tenants and borrowers;
- (h) The potential impact of future litigation matters, including the possibility of larger than expected litigation costs, adverse results and related developments;
- (i) Competition for tenants and borrowers, including with respect to new leases and mortgages and the renewal or rollover of existing leases;
- (j) Our ability to negotiate the same or better terms with new tenants or operators if existing leases are not renewed or we exercise our right to replace an existing operator or tenant upon default;

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- (k) Availability of suitable properties to acquire at favorable prices and the competition for the acquisition and financing of those properties;
- (l) The financial, legal, regulatory and reputational difficulties of significant operators of our properties;
- (m) The risk that we may not be able to achieve the benefits of investments within expected time frames or at all, or within expected cost projections;
- (n) The ability to obtain financing necessary to consummate acquisitions on favorable terms;
- (o) The risks associated with our investments in joint ventures and unconsolidated entities, including our lack of sole decision making authority and our reliance on our joint venture partners' financial condition and continued cooperation; and
- (p) Changes in the credit ratings on United States ("U.S.") government debt securities or default or delay in payment by the U.S. of its obligations.

Except as required by law, we undertake no, and hereby disclaim any, obligation to update any forward-looking statements, whether as a result of new information, changed circumstances or otherwise.

The information set forth in this Item 2 is intended to provide readers with an understanding of our financial condition, changes in financial condition and results of operations. We will discuss and provide our analysis in the following order:

- Executive Summary
- 2014 Transaction Overview
- Dividends
- Critical Accounting Policies
- Results of Operations
- Liquidity and Capital Resources
- Funds from Operations ("FFO")
- Off-Balance Sheet Arrangements
- Contractual Obligations
- Inflation
- Recent Accounting Pronouncements

Executive Summary

We are a Maryland corporation and were organized to qualify as a self-administered real estate investment trust (“REIT”) that, together with our unconsolidated joint ventures, invests primarily in real estate serving the healthcare industry in the U.S. We acquire, develop, lease, manage and dispose of healthcare real estate, and provide financing to healthcare providers. At September 30, 2014, our portfolio of investments, including properties in our Investment Management Platform, consisted of interests in 1,177 facilities. Our Investment Management Platform represents the following joint ventures: (i) HCP Ventures III, LLC, (ii) HCP Ventures IV, LLC and (iii) the HCP Life Science ventures.



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

Our strategy contemplates acquiring and developing properties on terms that are favorable to us. Generally, we prefer larger, more complex private transactions that leverage our management team's experience and our infrastructure. We follow a disciplined approach to enhancing the value of our existing portfolio, including ongoing evaluation of potential disposition of properties that no longer fit our strategy.

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

## 2014 Transaction Overview

### Brookdale Lease Amendments and Terminations and the Formation of Two RIDEA Joint Ventures ("Brookdale Transaction")

On August 29, 2014, HCP and Brookdale Senior Living ("Brookdale"), through a Master Contribution and Transactions Agreement, closed a multiple-element transaction that has three major components:

- formed new unconsolidated joint ventures that collectively own 14 campuses of continuing care retirement communities (the "CCRC JV"). At closing, Brookdale contributed eight of its owned campuses; we contributed two campuses previously leased to Brookdale and cash used to acquire four additional campuses from third parties. HCP and Brookdale own 49% and 51%, respectively, of the CCRC JV. Brookdale continues to manage these communities;

amended existing lease agreements on 153 HCP-owned senior housing communities, including the termination of embedded tenant purchase options relating to 30 properties and future rent reductions; and

- terminated existing lease agreements on 49 HCP-owned senior housing properties, including the termination of embedded tenant purchase options relating to 19 properties. At closing, we created a newly formed consolidated RIDEA partnership with Brookdale who is a 20% equity partner. Brookdale continues to manage the communities.

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\$630 Million (£395 Million) Debt Investment in UK Care Home Portfolio

On November 3, 2014, we committed to be the lead investor in the financing for Formation Capital and Safanad's pending acquisition of NHP, a company that owns 273 nursing and residential care homes representing over 12,500 beds in the UK. We will provide a loan facility (the "Facility"), secured by substantially all of NHP's assets, totaling £394.5 million (approximately \$630 million), with £362.5 million funded at closing. The closing of the acquisition and funding of the Facility are expected to occur later in November 2014, subject to customary closing conditions.

Other Investment Transactions

During the nine months ended September 30, 2014, we completed and committed \$583 million of other investments and commitments in 27 assets across our senior housing, life science and medical office segments.

During the nine months ended September 30, 2014, we funded \$175 million for construction and other capital projects, primarily in our life science, medical office and senior housing segments.

Financing Activities

On February 1, 2014, the Company repaid \$400 million of maturing senior unsecured notes, which accrued interest at a rate of 2.7%.

On February 12, 2014, we issued \$350 million of 4.2% senior unsecured notes due 2024. The notes priced at 99.537% of the principal amount with an effective yield-to-maturity of 4.257%.

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

On August 14, 2014, we issued \$800 million of 3.875% senior unsecured notes due 2024. The notes were priced at 99.63% of the principal amount with an effective yield-to-maturity of 3.92%.

## Dividends

On October 30, 2014, we announced that our Board declared a quarterly common stock cash dividend of \$0.545 per share. The common stock dividend will be paid on November 25, 2014 to stockholders of record as of the close of business on November 10, 2014 and represents an annualized dividend pay rate of \$2.18 per share.

## Critical Accounting Policies

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (“GAAP”) requires management to use judgment in the application of accounting policies, including making estimates and assumptions. We base estimates on the best information available to us at the time, our experience and on various other assumptions believed to be reasonable under the circumstances. These estimates affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting periods. If our judgment or interpretation of the facts and circumstances relating to various transactions or other matters had been different, it is possible that different accounting would have been applied, resulting in a different presentation of our condensed consolidated financial statements. From time to time, we re-evaluate our estimates and assumptions. In the event estimates or assumptions prove to be different from actual results, adjustments are made in subsequent periods to reflect more current estimates and assumptions about matters that are inherently uncertain. A summary of our critical accounting policies is included in our Annual Report on Form 10-K for the year ended December 31, 2013 in “Item 7. Management’s Discussion and Analysis of Financial

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Condition and Results of Operations”; our critical accounting policies have not changed during 2014, except for the “Allowance for Doubtful Accounts” update included in Note 2 to the Condensed Consolidated Financial Statements.

Results of Operations

We evaluate our business and allocate resources among our five business segments: (i) senior housing, (ii) post-acute/skilled nursing, (iii) life science, (iv) medical office and (v) hospital. Under the senior housing, post-acute/skilled nursing, life science and hospital segments, we primarily invest, through the acquisition and development, in single operator or tenant properties and debt issued by operators in these sectors. Under the medical office segment, we invest, through the acquisition and development, in single or multi-tenant MOB, which generally require a greater level of property management.

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

Operating expenses are generally related to MOB and life science leased properties and senior housing properties managed by eligible independent contractors (RIDEA properties). We generally recover all or a portion of MOB and life science expenses from the tenants (tenant recoveries). The presentation of expenses as operating or general and administrative is based on the underlying nature of the expense. Periodically, we review the classification of expenses between categories and make revisions based on changes in the underlying nature of the expenses.

Our evaluation of results of operations by each business segment includes an analysis of our SPP and our total property portfolio. SPP information allows us to evaluate the performance of our leased property portfolio under a consistent population by eliminating changes in the composition of our portfolio of properties. We identify our SPP as stabilized properties that remained in operations and were consistently reported as leased properties or RIDEA properties for the duration of the year-over-year comparison periods presented. Accordingly, it takes a stabilized property a minimum of 12 months in operations under a consistent reporting structure to be included in our SPP. Newly acquired operating assets are generally considered stabilized at the earlier of lease-up (typically when the tenant(s) controls the physical use of at least 80% of the space) or 12 months from the acquisition date. Newly completed developments, including redevelopments, are considered stabilized at the earlier of lease-up or 24 months from the date the property is placed in service. SPP NOI excludes certain non-property specific operating expenses

that are allocated to each operating segment on a consolidated basis.

As part of the Brookdale Transaction, we contributed properties that were previously triple-net leased into a RIDEA structure, with Brookdale managing the communities and acquiring a 20% equity interest in the RIDEA Subsidiaries. For the properties in the RIDEA structure, we report the resident level revenues and corresponding operating expenses in our condensed consolidated financial statements rather than the triple-net rents. On August 29, 2014 (the "Closing Date"), we recorded an approximate \$38 million net termination fee in rental and related revenues, which represents the termination value for the 49 leases, net of the cost to write-off the related straight-line rent assets and lease intangibles. For periods subsequent to the Closing Date, we expect increases in resident fees and services revenue and operating expenses and a decrease in rental and related revenues.

Further, we formed the unconsolidated CCRC JV, which will be managed by Brookdale. For periods subsequent to the Closing Date, we record our share of income from unconsolidated joint ventures; and as a result of deconsolidating three properties, we expect a decrease in rental and related revenues and depreciation expense.

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See additional information regarding the Brookdale Transaction in Note 3 to the Condensed Consolidated Financial Statements.

Comparison of the Three Months Ended September 30, 2014 to the Three Months Ended September 30, 2013

## Segment NOI and Adjusted NOI

The tables below provide selected operating information for our SPP and total property portfolio for each of our five business segments. Our consolidated SPP consists of 1,021 properties representing properties acquired or placed in service and stabilized on or prior to July 1, 2013 and that remained in operations under a consistent reporting structure through September 30, 2014. Our consolidated total property portfolio represents 1,103 and 1,070 properties at September 30, 2014 and 2013, respectively, and excludes properties that were sold.

Results are as of and for the three months ended September 30, 2014 and 2013 (dollars and square feet in thousands except per capacity data):

## Senior Housing

|   | SPP                                   |            |          | Total Portfolio                       |            |           |
|---|---------------------------------------|------------|----------|---------------------------------------|------------|-----------|
|   | Three Months Ended September 30, 2014 | 2013       | Change   | Three Months Ended September 30, 2014 | 2013       | Change    |
| Rental revenues(1)  | \$ 127,282                            | \$ 126,317 | \$ 965   | \$ 183,834                            | \$ 149,443 | \$ 34,391 |
| Resident fees and services                                    | 38,419                                | 36,370     | 2,049    | 62,213                                | 36,370     | 25,843    |
| Total revenues  | 165,701                               | 162,687    | 3,014    | 246,047                               | 185,813    | 60,234    |
| Operating expenses  | (24,206)                              | (23,369)   | (837)    | (43,017)                              | (23,735)   | (19,282)  |
| NOI   | 141,495                               | 139,318    | 2,177    | 203,030                               | 162,078    | 40,952    |
| Straight-line rents   | (6,087)                               | (8,688)    | 2,601    | (7,140)                               | (10,806)   | 3,666     |
| DFL accretion   | (2,230)                               | (2,440)    | 210      | (2,230)                               | (2,440)    | 210       |
| Amortization of above and below market lease intangibles, net | (147)                                 | (147)      | —        | (147)                                 | (148)      | 1         |
| Lease termination fees  | —                                     | —          | —        | (38,001)                              | —          | (38,001)  |
| Adjusted NOI  | \$ 133,031                            | \$ 128,043 | \$ 4,988 | \$ 155,512                            | \$ 148,684 | \$ 6,828  |
| Adjusted NOI % change   |                                       |            | 3.9      | %                                     |            |           |

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|                                 |           |           |           |           |
|---------------------------------|-----------|-----------|-----------|-----------|
| Property count(2)               | 393       | 393       | 463       | 441       |
| Average capacity (units)(3)     | 39,113    | 39,150    | 44,202    | 45,495    |
| Average annual rent per unit(4) | \$ 13,645 | \$ 13,125 | \$ 15,889 | \$ 15,157 |

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- (1) Represents rental and related revenues and income from direct financing leases (“DFLs”).
- (2) From our past presentation of SPP for the three months ended September 30, 2013, we removed one senior housing property from SPP that was sold and 30 senior housing properties that were contributed to partnerships under a RIDEA structure as part of the Brookdale Transaction and no longer meet our criteria for SPP as of the date of contribution.
- (3) Represents average capacity as reported by the respective tenants or operators for the twelve-month period and a quarter in arrears from the periods presented.
- (4) Average annual rent per unit for RIDEA properties is based on NOI.

SPP NOI and Adjusted NOI. SPP adjusted NOI improved as a result of annual rent increases.

Total Portfolio NOI. In addition to the impact of our SPP, our total portfolio NOI increased as a result of recognizing net fees of \$38 million for terminating the leases on the 49 senior housing properties in the Brookdale Transaction (see Note 3 to the Condensed Consolidated Financial Statements for additional information).



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## Post-Acute/Skilled Nursing

|   | SPP                              |            |          | Total Portfolio                  |            |          |
|---|----------------------------------|------------|----------|----------------------------------|------------|----------|
|   | Three Months Ended September 30, |            |          | Three Months Ended September 30, |            |          |
|   | 2014                             | 2013       | Change   | 2014                             | 2013       | Change   |
| Rental revenues   | \$ 138,885                       | \$ 135,663 | \$ 3,222 | \$ 139,205                       | \$ 136,017 | \$ 3,188 |
| Operating expenses  | (77)                             | (116)      | 39       | (534)                            | (629)      | 95       |
| NOI   | 138,808                          | 135,547    | 3,261    | 138,671                          | 135,388    | 3,283    |
| Straight-line rents   | (162)                            | (96)       | (66)     | (174)                            | (96)       | (78)     |
| DFL accretion   | (16,516)                         | (17,338)   | 822      | (16,530)                         | (17,382)   | 852      |
| Amortization of above and below market lease intangibles, net | 11                               | 11         | —        | 11                               | 11         | —        |
| Adjusted NOI  | \$ 122,141                       | \$ 118,124 | \$ 4,017 | \$ 121,978                       | \$ 117,921 | \$ 4,057 |
| Adjusted NOI % change   |                                  |            | 3.4 %    |                                  |            |          |
| Property count(1)   | 301                              | 301        |          | 301                              | 301        |          |
| Average capacity (beds)(2)                                    | 38,338                           | 38,219     |          | 38,400                           | 38,404     |          |
| Average annual rent per bed                                   | \$ 12,751                        | \$ 12,374  |          | \$ 12,761                        | \$ 12,346  |          |

- (1) From our past presentation of SPP for the three months ended September 30, 2013, we removed 11 post-acute/skilled nursing properties from SPP that were sold.
- (2) Represents average capacity as reported by the respective tenants or operators for the twelve-month period and a quarter in arrears from the periods presented.

NOI and Adjusted NOI. SPP and total portfolio NOI and adjusted NOI increased primarily as a result of annual rent escalations from our HCR ManorCare, Inc. (“HCRMC”) DFL investments.

During the quarter ended September 30, 2014, we evaluated HCRMC’s financial performance, including their ability to service their obligations with us, as part of our on-going assessment of our HCRMC equity method and DFL investments. HCRMC’s fixed charge coverage, excluding certain general and professional liability (“GL/PL”) charges, which we use as our primary credit quality indicator, declined from 1.19 to 1.10 on a year-over-year trailing twelve-month basis and from 1.09 to 1.04 on a year-over-year trailing three-month basis for the periods ended September 30, 2013 and 2014, respectively; the twelve-month periods exclude \$64 million and \$30 million of GL/PL charges in 2013 and 2014, respectively, the quarter-over-quarter periods did not incur additional GL/PL charges. We continue to believe that all present contractual obligations, and collection and timing of all amounts owed by HCRMC under its master lease (“Master Lease”) are reasonably assured. HCRMC’s business over the near future continues to be impacted by the dynamic changes occurring in the healthcare industry, including Medicare, Medicare Advantage and Medicaid reimbursement trends, as well as changes in managed care and new evolving healthcare delivery models. As one of the premier operators in its industry, HCRMC believes that it is favorably positioned to grow as part of the ongoing changes in the healthcare environment. Based on discussions with the management of HCRMC and our evaluation of other industry data, we note the following factors that influence our evaluation of HCRMC: (i) overall

net Medicare rate increases of 2.0% are effective as of October 1, 2014; (ii) additional cost cutting measures are anticipated in the fourth quarter of 2014, resulting in lower operating expenses; (iii) new facility developments and expansions will be operational in 2015; (iv) assisted living and hospice operations demonstrate continued growth and a 1.4% Medicare hospice reimbursement increase is effective October 1, 2014; and (v) year-over-year forecasted improvements in hospital admissions.

While we remain confident in HCRMC's ongoing adjustments to their business model, there is no assurance that HCRMC will be able to reverse the decline in their financial performance. Failure of HCRMC to reverse the decline in its financial performance could cause us to conclude that we should recognize an impairment charge to reduce the carrying value of our equity method investment. A further deterioration in HCRMC's financial performance could then

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lead us to conclude that the collection and timing of contractual obligations, or a portion thereof, under the HCRMC Master Lease may not be reasonably assured. If we further determine that it is probable that we will not be able to collect all amounts due under the terms of the HCRMC Master Lease, we may incur an impairment on the applicable portion of the HCRMC DFL investment.

## Life Science

|   | SPP                              |           |          | Total Portfolio                  |           |          |
|---|----------------------------------|-----------|----------|----------------------------------|-----------|----------|
|   | Three Months Ended September 30, |           |          | Three Months Ended September 30, |           |          |
|   | 2014                             | 2013      | Change   | 2014                             | 2013      | Change   |
| Rental and related revenues                                   | \$ 62,961                        | \$ 62,128 | \$ 833   | \$ 66,273                        | \$ 61,891 | \$ 4,382 |
| Tenant recoveries   | 12,007                           | 10,555    | 1,452    | 13,177                           | 10,640    | 2,537    |
| Total revenues  | 74,968                           | 72,683    | 2,285    | 79,450                           | 72,531    | 6,919    |
| Operating expenses  | (13,948)                         | (12,572)  | (1,376)  | (16,637)                         | (14,091)  | (2,546)  |
| NOI   | 61,020                           | 60,111    | 909      | 62,813                           | 58,440    | 4,373    |
| Straight-line rents   | (1,932)                          | (3,100)   | 1,168    | (2,119)                          | (1,864)   | (255)    |
| Amortization of above and below market lease intangibles, net | (4)                              | (39)      | 35       | 28                               | (43)      | 71       |
| Lease termination fees  | —                                | (181)     | 181      | —                                | (181)     | 181      |
| Adjusted NOI  | \$ 59,084                        | \$ 56,791 | \$ 2,293 | \$ 60,722                        | \$ 56,352 | \$ 4,370 |
| Adjusted NOI % change   |                                  |           | 4.0 %    |                                  |           |          |
| Property count(1)   | 108                              | 108       |          | 112                              | 111       |          |
| Average occupancy   | 93.6 %                           | 91.7 %    |          | 93.7 %                           | 91.8 %    |          |
| Average occupied square feet                                  | 6,497                            | 6,361     |          | 6,739                            | 6,496     |          |
| Average annual total revenues per occupied square foot(2)     | \$ 45                            | \$ 44     |          | \$ 46                            | \$ 43     |          |
| Average annual base rent per occupied square foot             | \$ 38                            | \$ 37     |          | \$ 38                            | \$ 37     |          |

(1) From our past presentation of SPP for the three months ended September 30, 2013, we removed two life science facilities from SPP that were placed into land held for development in 2014, which no longer meet our criteria for SPP as of the date placed into development.

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

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

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

During the three months ended September 30, 2014, 565,000 square feet of new and renewal leases commenced at an average annual base rent of \$31.59 per square foot compared to 391,000 square feet of expiring leases with an average annual base rent of \$38.74 per square foot.

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## Medical Office

|   | SPP                              |           |          | Total Portfolio                  |           |          |
|---|----------------------------------|-----------|----------|----------------------------------|-----------|----------|
|   | Three Months Ended September 30, |           |          | Three Months Ended September 30, |           |          |
|   | 2014                             | 2013      | Change   | 2014                             | 2013      | Change   |
| Rental and related revenues                                   | \$ 72,890                        | \$ 73,103 | \$ (213) | \$ 76,876                        | \$ 73,789 | \$ 3,087 |
| Tenant recoveries   | 14,715                           | 14,578    | 137      | 15,536                           | 14,636    | 900      |
| Total revenues  | 87,605                           | 87,681    | (76)     | 92,412                           | 88,425    | 3,987    |
| Operating expenses  | (34,767)                         | (34,028)  | (739)    | (38,459)                         | (35,987)  | (2,472)  |
| NOI   | 52,838                           | 53,653    | (815)    | 53,953                           | 52,438    | 1,515    |
| Straight-line rents   | 435                              | (566)     | 1,001    | 334                              | (299)     | 633      |
| Amortization of above and below market lease intangibles, net | 235                              | 259       | (24)     | 174                              | 282       | (108)    |
| Lease termination fees  | —                                | (24)      | 24       | 20                               | (24)      | 44       |
| Adjusted NOI  | \$ 53,508                        | \$ 53,322 | \$ 186   | \$ 54,481                        | \$ 52,397 | \$ 2,084 |
| Adjusted NOI % change   |                                  |           | 0.3 %    |                                  |           |          |
| Property count(1)   | 204                              | 204       |          | 211                              | 205       |          |
| Average occupancy   | 91.3 %                           | 90.9 %    |          | 90.7 %                           | 90.6 %    |          |
| Average occupied square feet                                  | 12,656                           | 12,578    |          | 13,347                           | 12,736    |          |
| Average annual total revenues per occupied square foot(2)     | \$ 28                            | \$ 28     |          | \$ 28                            | \$ 28     |          |
| Average annual base rent per occupied square foot             | \$ 23                            | \$ 23     |          | \$ 23                            | \$ 23     |          |

(1) From our past presentation of SPP for the three months ended September 30, 2013, we removed three MOB's from SPP that were sold and a MOB that was placed into redevelopment in 2013, which no longer meets our criteria for SPP as of the date it was placed into redevelopment.

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

SPP NOI. SPP NOI decreased primarily as a result of the write-off of straight-line rents as we determined that collectibility was not probable.

Total Portfolio NOI and Adjusted NOI. In addition to the impact of our SPP, our total portfolio NOI and adjusted NOI increased primarily as a result of the impact of our medical office acquisitions in 2014.

During the three months ended September 30, 2014, 587,000 square feet of new and renewal leases commenced at an average annual base rent of \$23.70 per square foot compared to 584,000 square feet of expiring and terminated leases with an average annual base rent of \$25.88 per square foot. During the three months ended September 30, 2014, we

acquired 538,000 square feet with an average annual base rent of \$24.75 per square foot.

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## Hospital

|  | SPP                                 |           |        | Total Portfolio                     |           |        |
|--|-------------------------------------|-----------|--------|-------------------------------------|-----------|--------|
|  | Three Months Ended<br>September 30, |           |        | Three Months Ended<br>September 30, |           |        |
|  | 2014                                | 2013      | Change | 2014                                | 2013      | Change |
| Rental revenues  | \$ 20,619                           | \$ 20,151 | \$ 468 | \$ 20,950                           | \$ 20,185 | \$ 765 |
| Tenant recoveries  | 610                                 | 644       | (34)   | 610                                 | 644       | (34)   |
| Total revenues   | 21,229                              | 20,795    | 434    | 21,560                              | 20,829    | 731    |
| Operating expenses   | (950)                               | (975)     | 25     | (952)                               | (975)     | 23     |
| NOI  | 20,279                              | 19,820    | 459    | 20,608                              | 19,854    | 754    |
| Straight-line rents  | 476                                 | 372       | 104    | 472                                 | 371       | 101    |
| Amortization of above and below<br>market lease intangibles, net | (342)                               | (342)     | —      | (342)                               | (342)     | —      |
| Adjusted NOI   | \$ 20,413                           | \$ 19,850 | \$ 563 | \$ 20,738                           | \$ 19,883 | \$ 855 |
| Adjusted NOI % change  |                                     |           | 2.8 %  |                                     |           |        |
| Property count(1)  | 15                                  | 15        |        | 16                                  | 12        |        |
| Average capacity (beds)(2)                                       | 2,161                               | 2,146     |        | 2,221                               | 2,146     |        |
| Average annual rent per bed                                      | \$ 39,543                           | \$ 38,822 |        | \$ 39,063                           | \$ 38,884 |        |

- (1) From our past presentation of SPP for the three months ended September 30, 2013, we removed two hospitals from SPP that were sold.
- (2) Represents capacity as reported by the respective tenants or operators for the twelve-month period and a quarter in arrears from the periods presented. Certain operators in our hospital portfolio are not required under their respective leases to provide operational data.

## Other Income and Expense Items

## Interest income

Interest income decreased \$25 million to \$18 million for the three months ended September 30, 2014. The decrease was primarily the result of income realized from the repayment of our Barchester loan in September 2013 that was acquired earlier in 2013 (see Note 7 to the Condensed Consolidated Financial Statements for additional information).

## Interest expense

Interest expense increased \$3 million to \$111 million for the three months ended September 30, 2014. The increase was primarily the result of our senior unsecured notes offerings during 2013 and 2014, partially offset by maturities of certain senior unsecured notes and mortgage debt during 2013 and 2014.

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



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

|  | As of September 30,(1) |   |              |   |
|--|------------------------|---|--------------|---|
|  | 2014                   |   | 2013         |   |
| Balance:   |                        |   |              |   |
| Fixed rate                                       | \$ 9,066,872           |   | \$ 8,185,353 |   |
| Variable rate                                    | 78,500                 |   | 324,902      |   |
| Total  | \$ 9,145,372           |   | \$ 8,510,255 |   |
| Percent of total debt:                           |                        |   |              |   |
| Fixed rate                                       | 99.1                   | % | 96.0         | % |
| Variable rate                                    | 0.9                    |   | 4.0          |   |
| Total  | 100                    | % | 100          | % |
| Weighted average interest rate at end of period: |                        |   |              |   |
| Fixed rate                                       | 5.05                   | % | 5.21         | % |
| Variable rate                                    | 1.26                   | % | 1.57         | % |
| Total  | 5.01                   | % | 5.07         | % |

- (1) At September 30, 2014, excludes \$98 million of other debt that represents non-interest bearing life care bonds and occupancy fee deposits at certain of our senior housing facilities and demand notes that have no scheduled maturities. At September 30, 2013, excludes \$78 million of other debt that represents non-interest bearing life care bonds and occupancy fee deposits at certain of our senior housing facilities. At both September 30, 2014 and 2013, \$72 million of variable-rate mortgages and a £137 million (\$222 million) term loan are presented as fixed-rate debt as the interest payments were swapped from variable to fixed.

#### Depreciation and amortization expense

Depreciation and amortization expense increased \$18 million to \$123 million for the three months ended September 30, 2014. The increase was primarily the result of a change in estimate of the depreciable life and residual value of certain properties and the impact of our senior housing acquisitions and our medical office and life science development projects placed in service during 2013 and 2014.

#### General and administrative expenses

General and administrative expenses decreased \$20 million to \$25 million for the three months ended September 30, 2014. The three months ended September 30, 2013 included \$26.4 million of severance-related charges (see Note 13

to the Condensed Consolidated Financial Statements for additional information). The decrease was partially offset by increases in professional fees for transactional costs.

#### Equity income from unconsolidated joint ventures

Equity income from unconsolidated joint ventures decreased \$4 million to \$10 million for the three months ended September 30, 2014. The decrease was primarily the result of our share of losses recognized from the newly formed CCRC JV and an increase in our share of losses from our HCR ManorCare investment.

#### Discontinued operations

During the three months ended September 30, 2013, we sold a hospital and recognized a gain of \$8 million. There were no sales of real estate during the three months ended September 30, 2014.

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Comparison of the Nine Months Ended September 30, 2014 to the Nine Months Ended September 30, 2013

## Segment NOI and Adjusted NOI

The tables below provide selected operating information for our SPP and total property portfolio for each of our five business segments. Our consolidated SPP consists of 1,014 properties representing properties acquired or placed in service and stabilized on or prior to January 1, 2013 and that remained in operations under a consistent reporting structure through September 30, 2014. Our consolidated total property portfolio represents 1,103 and 1,070 properties at September 30, 2014 and 2013, respectively, and excludes properties that were sold.

Results are as of and for the nine months ended September 30, 2014 and 2013 (dollars and square feet in thousands except per capacity data):

## Senior Housing

|   | SPP                             |            |           | Total Portfolio                 |            |           |
|---|---------------------------------|------------|-----------|---------------------------------|------------|-----------|
|   | Nine Months Ended September 30, |            |           | Nine Months Ended September 30, |            |           |
|   | 2014                            | 2013       | Change    | 2014                            | 2013       | Change    |
| Rental revenues   | \$ 378,195                      | \$ 377,505 | \$ 690    | \$ 485,823                      | \$ 448,600 | \$ 37,223 |
| Resident fees and services                                    | 114,398                         | 108,474    | 5,924     | 138,205                         | 108,509    | 29,696    |
| Total revenues  | 492,593                         | 485,979    | 6,614     | 624,028                         | 557,109    | 66,919    |
| Operating expenses  | (72,538)                        | (69,127)   | (3,411)   | (92,388)                        | (70,593)   | (21,795)  |
| NOI   | 420,055                         | 416,852    | 3,203     | 531,640                         | 486,516    | 45,124    |
| Straight-line rents   | (22,789)                        | (27,446)   | 4,657     | (26,953)                        | (34,371)   | 7,418     |
| DFL accretion   | (6,882)                         | (12,202)   | 5,320     | (6,882)                         | (12,202)   | 5,320     |
| Amortization of above and below market lease intangibles, net | (442)                           | (610)      | 168       | (441)                           | (533)      | 92        |
| Lease termination fees  | —                               | —          | —         | (38,001)                        | —          | (38,001)  |
| Adjusted NOI  | \$ 389,942                      | \$ 376,594 | \$ 13,348 | \$ 459,363                      | \$ 439,410 | \$ 19,953 |
| Adjusted NOI % change   |                                 |            | 3.5       | %                               |            |           |
| Property count(1)   | 388                             | 388        |           | 463                             | 441        |           |
| Average capacity (units)(2)                                   | 38,682                          | 38,655     |           | 45,123                          | 45,495     |           |
| Average annual rent per unit(3)                               | \$ 13,482                       | \$ 13,034  |           | \$ 13,654                       | \$ 12,959  |           |

- (1) From our past presentation of SPP for the nine months ended September 30, 2013, we removed one senior housing property from SPP that was sold and 30 senior housing properties that were contributed to partnerships under a RIDEA structure as part of the Brookdale Transaction and no longer meet our criteria for SPP as of the date of contribution.
- (2) Represents average capacity as reported by the respective tenants or operators for the twelve-month period and a quarter in arrears from the periods presented.
- (3) Average annual rent per unit for RIDEA properties is based on NOI.

SPP Adjusted NOI. SPP adjusted NOI improved as a result of annual rent increases.

Total Portfolio NOI and Adjusted NOI. In addition to the impact of our SPP, our total portfolio NOI increased as a result of recognizing net fees of \$38 million for terminating the leases on the 49 senior housing properties in the Brookdale Transaction. Our total portfolio NOI and adjusted NOI increased as a result of our senior housing acquisitions in 2014 and 2013.

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## Post-Acute/Skilled Nursing

|   | SPP                             |            |           | Total Portfolio                 |            |           |
|---|---------------------------------|------------|-----------|---------------------------------|------------|-----------|
|   | Nine Months Ended September 30, |            |           | Nine Months Ended September 30, |            |           |
|   | 2014                            | 2013       | Change    | 2014                            | 2013       | Change    |
| Rental revenues   | \$ 414,208                      | \$ 404,053 | \$ 10,155 | \$ 415,533                      | \$ 405,108 | \$ 10,425 |
| Operating expenses  | (225)                           | (352)      | 127       | (1,599)                         | (1,890)    | 291       |
| NOI   | 413,983                         | 403,701    | 10,282    | 413,934                         | 403,218    | 10,716    |
| Straight-line rents   | (662)                           | (478)      | (184)     | (673)                           | (478)      | (195)     |
| DFL accretion   | (51,012)                        | (53,050)   | 2,038     | (51,113)                        | (53,184)   | 2,071     |
| Amortization of above and below market lease intangibles, net | 34                              | 34         | —         | 34                              | 34         | —         |
| Adjusted NOI  | \$ 362,343                      | \$ 350,207 | \$ 12,136 | \$ 362,182                      | \$ 349,590 | \$ 12,592 |
| Adjusted NOI % change   |                                 |            | 3.5 %     |                                 |            |           |
| Property count(1)   | 301                             | 301        |           | 301                             | 301        |           |
| Average capacity (beds)(2)                                    | 38,338                          | 38,219     |           | 38,481                          | 38,404     |           |
| Average annual rent per bed                                   | \$ 12,608                       | \$ 12,229  |           | \$ 12,603                       | \$ 12,202  |           |

(1) From our past presentation of SPP for the nine months ended September 30, 2013, we removed 11 post-acute/skilled nursing properties from SPP that were sold.

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

NOI and Adjusted NOI. SPP and total portfolio NOI and adjusted NOI increased primarily as a result of annual rent escalations from our HCRMC DFL investments.

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## Life Science

|   | SPP                             |            |          | Total Portfolio                 |            |          |
|---|---------------------------------|------------|----------|---------------------------------|------------|----------|
|   | Nine Months Ended September 30, |            |          | Nine Months Ended September 30, |            |          |
|   | 2014                            | 2013       | Change   | 2014                            | 2013       | Change   |
| Rental and related revenues                                   | \$ 185,998                      | \$ 183,110 | \$ 2,888 | \$ 196,384                      | \$ 188,309 | \$ 8,075 |
| Tenant recoveries   | 34,204                          | 32,090     | 2,114    | 36,729                          | 32,779     | 3,950    |
| Total revenues  | 220,202                         | 215,200    | 5,002    | 233,113                         | 221,088    | 12,025   |
| Operating expenses  | (39,814)                        | (37,165)   | (2,649)  | (46,247)                        | (41,313)   | (4,934)  |
| NOI   | 180,388                         | 178,035    | 2,353    | 186,866                         | 179,775    | 7,091    |
| Straight-line rents   | (6,434)                         | (9,689)    | 3,255    | (7,480)                         | (8,759)    | 1,279    |
| Amortization of above and below market lease intangibles, net | (8)                             | 160        | (168)    | 74                              | 135        | (61)     |
| Lease termination fees  | (570)                           | (194)      | (376)    | (570)                           | (194)      | (376)    |
| Adjusted NOI  | \$ 173,376                      | \$ 168,312 | \$ 5,064 | \$ 178,890                      | \$ 170,957 | \$ 7,933 |
| Adjusted NOI % change   |                                 |            | 3.0 %    |                                 |            |          |
| Property count(1)   | 107                             | 107        |          | 112                             | 111        |          |
| Average occupancy   | 92.3 %                          | 91.4 %     |          | 92.4 %                          | 91.6 %     |          |
| Average occupied square feet                                  | 6,330                           | 6,275      |          | 6,572                           | 6,465      |          |
| Average annual total revenues per occupied square foot(1)     | \$ 45                           | \$ 44      |          | \$ 46                           | \$ 44      |          |
| Average annual base rent per occupied square foot             | \$ 38                           | \$ 37      |          | \$ 38                           | \$ 37      |          |

(1) From our past presentation of SPP for the nine months ended September 30, 2013, we removed two life science facilities from SPP that were placed into land held for development in 2014, which no longer meet our criteria for SPP as of the date placed into development.

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

SPP Adjusted NOI. SPP adjusted NOI increased as a result of annual rent escalations and increased occupancy.

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

During the nine months ended September 30, 2014, 1.1 million square feet of new and renewal leases commenced at an average annual base rent of \$30.72 per square foot compared to 927,000 square feet of expiring and terminated

leases with an average annual base rent of \$28.92 per square foot. During the nine months ended September 30, 2014, we acquired 83,000 square feet with an average annual base rent of \$33.87 per square foot.

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## Medical Office

|   | SPP                             |            |          | Total Portfolio                 |            |          |
|---|---------------------------------|------------|----------|---------------------------------|------------|----------|
|   | Nine Months Ended September 30, |            |          | Nine Months Ended September 30, |            |          |
|   | 2014                            | 2013       | Change   | 2014                            | 2013       | Change   |
| Rental and related revenues                                   | \$ 221,830                      | \$ 219,295 | \$ 2,535 | \$ 229,880                      | \$ 224,600 | \$ 5,280 |
| Tenant recoveries   | 41,824                          | 40,308     | 1,516    | 43,335                          | 40,652     | 2,683    |
| Total revenues  | 263,654                         | 259,603    | 4,051    | 273,215                         | 265,252    | 7,963    |
| Operating expenses  | (101,866)                       | (99,166)   | (2,700)  | (111,140)                       | (105,364)  | (5,776)  |
| NOI   | 161,788                         | 160,437    | 1,351    | 162,075                         | 159,888    | 2,187    |
| Straight-line rents   | (967)                           | (3,219)    | 2,252    | (1,315)                         | (3,206)    | 1,891    |
| Amortization of above and below market lease intangibles, net | 759                             | 684        | 75       | 741                             | 750        | (9)      |
| Lease termination fees  | (192)                           | (27)       | (165)    | (221)                           | (26)       | (195)    |
| Adjusted NOI  | \$ 161,388                      | \$ 157,875 | \$ 3,513 | \$ 161,280                      | \$ 157,406 | \$ 3,874 |
| Adjusted NOI % change   |                                 |            | 2.2 %    |                                 |            |          |
| Property count(1)   | 203                             | 203        |          | 211                             | 205        |          |
| Average occupancy   | 91.6 %                          | 91.2 %     |          | 90.8 %                          | 90.6 %     |          |
| Average occupied square feet                                  | 12,636                          | 12,569     |          | 13,046                          | 12,748     |          |
| Average annual total revenues per occupied square foot(2)     | \$ 28                           | \$ 27      |          | \$ 28                           | \$ 27      |          |
| Average annual base rent per occupied square foot             | \$ 23                           | \$ 23      |          | \$ 23                           | \$ 23      |          |

(1) From our past presentation of SPP for the nine months ended September 30, 2013, we removed three MOB's from SPP that were sold and a MOB that was placed into redevelopment in 2013, which no longer meets our criteria for SPP as of the date it was placed into redevelopment.

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

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

Total Portfolio NOI and Adjusted NOI. In addition to the impact of our SPP, our total portfolio NOI and adjusted NOI increased primarily as a result of our medical office acquisitions in 2014 and 2013.



During the nine months ended September 30, 2014, 1.6 million square feet of new and renewal leases commenced at an average annual base rent of \$22.35 per square foot compared to 1.7 million square feet of expiring and terminated leases with an average annual base rent of \$24.34 per square foot. During the nine months ended September 30, 2014, we acquired 660,000 square feet with an average annual base rent of \$26.95 per square foot.

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## Hospital

|   | SPP                             |           |           | Total Portfolio                 |           |           |
|---|---------------------------------|-----------|-----------|---------------------------------|-----------|-----------|
|   | Nine Months Ended September 30, |           |           | Nine Months Ended September 30, |           |           |
|   | 2014                            | 2013      | Change    | 2014                            | 2013      | Change    |
| Rental revenues   | \$ 61,579                       | \$ 49,112 | \$ 12,467 | \$ 62,569                       | \$ 49,172 | \$ 13,397 |
| Tenant recoveries   | 1,802                           | 1,835     | (33)      | 1,803                           | 1,835     | (32)      |
| Total revenues  | 63,381                          | 50,947    | 12,434    | 64,372                          | 51,007    | 13,365    |
| Operating expenses  | (2,792)                         | (2,828)   | 36        | (2,799)                         | (2,830)   | 31        |
| NOI   | 60,589                          | 48,119    | 12,470    | 61,573                          | 48,177    | 13,396    |
| Straight-line rents   | 1,348                           | 17,971    | (16,623)  | 1,328                           | 17,969    | (16,641)  |
| Amortization of above and below market lease intangibles, net | (1,027)                         | (6,482)   | 5,455     | (1,027)                         | (6,482)   | 5,455     |
| Adjusted NOI  | \$ 60,910                       | \$ 59,608 | \$ 1,302  | \$ 61,874                       | \$ 59,664 | \$ 2,210  |
| Adjusted NOI % change   |                                 |           | 2.2       | %                               |           |           |
| Property count(1)   | 15                              | 15        |           | 16                              | 12        |           |
| Average capacity (beds)(2)                                    | 2,161                           | 2,146     |           | 2,221                           | 2,146     |           |
| Average annual rent per bed                                   | \$ 39,304                       | \$ 38,798 |           | \$ 38,825                       | \$ 38,834 |           |

(1) From our past presentation of SPP for the nine months ended September 30, 2013, we removed two hospitals from SPP that were sold.

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

NOI and Adjusted NOI. SPP and total portfolio NOI increased primarily due to a net \$12 million correction reducing previously recognized straight-line rents and increasing amortization of below market lease intangibles related to our Medical City Dallas hospital during 2013. SPP and total portfolio adjusted NOI increased primarily as a result of annual rent escalations.

## Other Income and Expense Items

## Interest income

Interest income decreased \$17 million to \$51 million for the nine months ended September 30, 2014. The decrease was primarily the result of interest income from the repayment of our Barchester loan in September 2013 that was

acquired earlier in 2013, partially offset by the interest earned from the second tranche funding in September 2013 of our mezzanine loan facility to Tandem Health Care (see Note 7 to the Condensed Consolidated Financial Statements for additional information) made in 2013.

#### Interest expense

Interest expense decreased \$1 million to \$325 million for the nine months ended September 30, 2014. The decrease was primarily the result of maturities of certain senior unsecured notes and mortgage debt during 2013 and 2014, offset by our senior unsecured notes offerings during 2013 and 2014.

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

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Depreciation and amortization expense

Depreciation and amortization expense increased \$26 million to \$343 million for the nine months ended September 30, 2014. The increase was primarily the result of a change in estimate of the depreciable life and residual value of certain properties and the impact of our medical office and life science development projects placed in service and senior housing acquisitions in 2013.

General and administrative expenses

General and administrative expenses decreased \$15 million to \$75 million for the nine months ended September 30, 2014. The nine months ended September 30, 2013 included \$26.4 million of severance-related charges (see Note 13 to the Condensed Consolidated Financial Statements for additional information). The decrease was partially offset by increases in professional fees for transactional costs.

Other income, net

Other income, net decreased \$11 million to \$6 million for the nine months ended September 30, 2014. The decrease was primarily the result of 2013 gains of \$11 million from the sale of marketable securities.

Equity income from unconsolidated joint ventures

Equity income from unconsolidated joint ventures decreased \$5 million to \$39 million for the nine months ended September 30, 2014. The decrease was primarily the result of our share of losses recognized from the newly formed CCRC JV and an increase in our share of losses for our HCR ManorCare investment.

Discontinued operations

During the nine months ended September 30, 2014, we sold two post-acute/skilled nursing facilities, a hospital and a MOB, recognizing gains of \$28 million. During the nine months ended September 30, 2013, we sold two properties realizing a gain of \$9 million.

## Liquidity and Capital Resources

Our principal liquidity needs are to: (i) fund recurring operating expenses, (ii) meet debt service requirements including principal payments and maturities in the last three months of 2014, (iii) fund capital expenditures, including tenant improvements and leasing costs, (iv) fund acquisition and development activities, and (v) make dividend distributions. We anticipate that cash flow from continuing operations over the next 12 months will be adequate to fund our business operations, debt service payments, recurring capital expenditures and cash dividends to shareholders. Capital requirements relating to maturing indebtedness, acquisitions and development activities may require funds from borrowings and/or sales of equity and debt securities.

Access to capital markets impacts our cost of capital and ability to refinance maturing indebtedness, as well as our ability to fund future acquisitions and development through the issuance of additional securities or secured debt. Credit ratings impact our ability to access capital and directly impact our cost of capital as well. For example, as noted below, our revolving line of credit facility accrues interest at a rate per annum equal to LIBOR plus a margin that depends upon our debt ratings. We also pay a facility fee on the entire revolving commitment that depends upon our debt ratings. As of October 30, 2014, we had a credit rating of Baa1 from Moody's, BBB+ from Standard & Poor's ("S&P") and BBB+ from Fitch on our senior unsecured debt securities.

Net cash provided by operating activities was \$883 million and \$844 million for the nine months ended September 30, 2014 and 2013, respectively. The increase in operating cash flows is primarily the result of the following: (i) the impact from our investments in 2013 and 2014, (ii) assets placed in service during 2013 and 2014 and (iii) rent escalations and resets in 2013 and 2014. Our cash flows from operations are dependent upon the occupancy levels of our

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buildings, rental rates on leases, our tenants' performance on their lease obligations, the level of operating expenses and other factors.

The following are significant investing and financing activities for the nine months ended September 30, 2014:

- made investments of \$939 million (development and acquisition of real estate and loans), net of proceeds from sales of real estate and loan and DFL repayments of \$86 million;
- paid dividends on common stock of \$751 million, which were generally funded by cash provided by our operating activities; and
- repaid \$689 million of mortgages and senior unsecured notes and raised proceeds of \$1.3 billion primarily from sales of senior unsecured notes and borrowings under our unsecured revolving line of credit facility.

Debt

Bank Line of Credit and Term Loan

On March 31, 2014, we amended our unsecured revolving line of credit facility (the "Facility") with a syndicate of banks, which was scheduled to mature in March 2016, increasing the borrowing capacity by \$500 million to \$2.0 billion. The amended Facility matures on March 31, 2018, with a one-year committed extension option. Borrowings under the Facility accrue interest at LIBOR plus a margin that depends upon our debt ratings. We pay a facility fee on the entire revolving commitment that depends on our debt ratings. Based on our debt ratings at October 30, 2014, the margin on the Facility was 0.925%, and the facility fee was 0.15%. The Facility also includes a feature that will allow us to increase the borrowing capacity by an aggregate amount of up to \$500 million, subject to securing additional commitments from existing lenders or new lending institutions. At September 30, 2014, we had \$70 million outstanding under the Facility with a weighted average effective interest rate of 1.34%.

On July 30, 2012, we entered into a credit agreement with a syndicate of banks for a £137 million (\$222 million at September 30, 2014) four-year unsecured term loan (the "Term Loan"). Based on our debt ratings at September 30, 2014, the Term Loan accrues interest at a rate of GBP LIBOR plus 1.20%. Concurrent with the closing of the Term Loan, we entered into a four-year interest rate swap contract that fixes the rate of the Term Loan at 1.81%, subject to adjustments based on our debt ratings. The Term Loan contains a one-year committed extension option.

The Facility and Term Loan contain certain financial restrictions and other customary requirements. Among other things, these covenants, using terms defined in the agreements, (i) limit the ratio of Consolidated Total Indebtedness to Consolidated Total Asset Value to 60%, (ii) limit the ratio of Secured Debt to Consolidated Total Asset Value to 30%, (iii) limit the ratio of Unsecured Debt to Consolidated Unencumbered Asset Value to 60% and (iv) require a minimum Fixed Charge Coverage ratio of 1.5 times. The Facility and Term Loan also require a Minimum Consolidated Tangible Net Worth of \$9.5 billion at September 30, 2014. At September 30, 2014, we were in compliance with each of these restrictions and requirements of the Facility and Term Loan.

#### Senior Unsecured Notes

At September 30, 2014, we had senior unsecured notes outstanding with an aggregate principal balance of \$7.7 billion. Interest rates on the notes ranged from 2.79% to 6.99% with a weighted average effective interest rate of 4.95% and a weighted average maturity of six years at September 30, 2014. The senior unsecured notes contain certain covenants including limitations on debt, maintenance of unencumbered assets, cross-acceleration provisions and other customary terms. We believe we were in compliance with these covenants at September 30, 2014.

#### Mortgage Debt

At September 30, 2014, we had \$1.2 billion in aggregate principal amount of mortgage debt outstanding is secured by 88 healthcare facilities (including redevelopment properties) with a carrying value of \$1.4 billion. Interest rates on the mortgage debt ranged from 0.44% to 8.69% with a weighted average effective interest rate of 6.21% and a weighted average maturity of three years at September 30, 2014.

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

## Debt Maturities

The following table summarizes our stated debt maturities and scheduled principal repayments at September 30, 2014 (in thousands):

| Year                          | Amount(1)    |
|-------------------------------|--------------|
| 2014 (Three months)           | \$ 249,052   |
| 2015                          | 440,164      |
| 2016                          | 1,413,854    |
| 2017                          | 1,300,477    |
| 2018                          | 676,583      |
| Thereafter                    | 5,065,242    |
|                               | 9,145,372    |
| (Discounts) and premiums, net | (28,580)     |
|                               | \$ 9,116,792 |

(1) Excludes \$98 million of other debt that represents Life Care Bonds and Demand Notes that have no scheduled maturities that are discussed below.

## Other Debt

At September 30, 2014, we had \$72 million of non-interest bearing life care bonds at two of our continuing care retirement communities and non-interest bearing occupancy fee deposits at two of our senior housing facilities, all of which were payable to certain residents of the facilities (collectively, "Life Care Bonds"). The Life Care Bonds are generally refundable to the residents upon the termination of the contract or upon the successful resale of the unit.



In conjunction with the Brookdale Transaction, on August 29, 2014, we borrowed \$26 million from the CCRC JV in the form of on-demand notes (“Demand Notes”). The Demand Notes mature on June 30, 2015 and bears interest at a rate of 4.5%.

#### Derivative Instruments

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

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The following table summarizes our outstanding interest-rate and foreign currency swap contracts as of September 30, 2014 (dollars and GBP in thousands):

| Date Entered  | Maturity Date | Hedge Designation | Fixed Rate/Buy Amount |   | Floating/Exchange Rate Index | Notional/Sell Amount | Fair Value |
|---------------|---------------|-------------------|-----------------------|---|------------------------------|----------------------|------------|
| July 2005(1)  | July 2020     | Cash Flow         | 3.82                  | % | BMA Swap Index               | \$ 45,600            | \$ (5,635) |
| November 2008 | October 2016  | Cash Flow         | 5.95                  | % | LIBOR+1.50%<br>1 Month       | \$ 26,000            | \$ (1,945) |
| July 2012     | June 2016     | Cash Flow         | 1.81                  | % | LIBOR+1.20%                  | £ 137,000            | \$ 1,447   |
| July 2012     | June 2016     | Cash Flow         | \$ 45,500             |   | Buy USD/Sell GBP             | £ 29,000             | \$ (1,337) |
| July 2014     | December 2015 | Cash Flow         | \$ 9,300              |   | Buy USD/Sell GBP             | £ 5,500              | \$ 484     |

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

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

## Equity

At September 30, 2014, we had 459 million shares of common stock outstanding. At September 30, 2014, equity totaled \$11.0 billion, and our equity securities had a market value of \$18.5 billion.

At September 30, 2014, non-managing members held an aggregate of 4 million units in five limited liability companies (“DownREITs”) for which we are the managing member. The DownREIT units are exchangeable for an amount of cash approximating the then-current market value of shares of our common stock or, at our option, shares of our common stock (subject to certain adjustments, such as stock splits and reclassifications).

## Shelf Registration

We have a prospectus that we filed with the U.S. Securities and Exchange Commission (the “SEC”) as part of a registration statement on Form S-3ASR, using a shelf registration process which expires in July 2015. Under the “shelf” process, we may sell any combination of the securities described in the prospectus in one or more offerings. The securities described in the prospectus include common stock, preferred stock, depositary shares, debt securities and warrants.

#### Funds From Operations (“FFO”)

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

FFO is defined as net income applicable to common shares (computed in accordance with GAAP), excluding gains or losses from acquisition and dispositions of depreciable real estate or related interests, impairments of, or related to, depreciable real estate, plus real estate and DFL depreciation and amortization, with adjustments for joint ventures. Adjustments for joint ventures are calculated to reflect FFO on the same basis. FFO does not represent cash generated from operating activities in accordance with GAAP, is not necessarily indicative of cash available to fund cash needs and should not be considered an alternative to net income. We compute FFO in accordance with the current National Association of Real Estate Investment Trusts’ (“NAREIT”) definition; however, other REITs may report FFO differently or have a different interpretation of the current NAREIT definition from ours. FFO as adjusted represents FFO before the

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impact of impairments (recoveries) of non-depreciable assets, transaction-related items (defined below), severance-related items and preferred stock redemption charges. Management believes that FFO as adjusted is useful to investors, because it allows investors to compare our results to prior reporting periods without the effect of items that by their nature would not be comparable. This measure is a modification of the NAREIT definition of FFO and should not be used as an alternative to net income or NAREIT FFO.

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

|  | Three Months Ended |            | Nine Months Ended |              |
|--|--------------------|------------|-------------------|--------------|
|  | September 30,      |            | September 30,     |              |
|  | 2014               | 2013       | 2014              | 2013         |
| Net income applicable to common shares   | \$ 247,208         | \$ 233,282 | \$ 723,651        | \$ 676,412   |
| Depreciation and amortization of real estate,<br>in-place lease and other intangibles: |                    |            |                   |              |
| Continuing operations  | 122,975            | 104,783    | 343,496           | 317,172      |
| Discontinued operations  | —                  | 1,509      | —                 | 4,604        |
| Other depreciation and amortization  | 4,769              | 3,631      | 12,571            | 10,589       |
| Gain on sales of real estate   | —                  | (8,298)    | (28,010)          | (9,185)      |
| Equity income from unconsolidated joint ventures                                       | (10,168)           | (13,892)   | (39,388)          | (44,278)     |
| FFO from unconsolidated joint ventures   | 14,571             | 16,642     | 48,683            | 52,539       |
| Noncontrolling interests’ and participating<br>securities’ share in earnings           | 3,851              | 3,576      | 13,310            | 10,955       |
| Noncontrolling interests’ and participating<br>securities’ share in FFO                | (5,902)            | (5,162)    | (17,425)          | (15,569)     |
| FFO applicable to common shares  | 377,304            | 336,071    | 1,056,888         | 1,003,239    |
| Distributions on dilutive convertible units  | 3,486              | 3,302      | 10,327            | 9,966        |
| Diluted FFO applicable to common shares  | \$ 380,790         | \$ 339,373 | \$ 1,067,215      | \$ 1,013,205 |
| <br>   |                    |            |                   |              |
| Diluted FFO per common share   | \$ 0.82            | \$ 0.73    | \$ 2.30           | \$ 2.20      |
| <br>   |                    |            |                   |              |
| Weighted average shares used to calculate diluted<br>FFO per common share              | 465,247            | 462,082    | 464,512           | 461,403      |

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|   | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |              |
|---|-------------------------------------|------------|------------------------------------|--------------|
|   | 2014                                | 2013       | 2014                               | 2013         |
| Net income applicable to common shares  | \$ 0.54                             | \$ 0.51    | \$ 1.58                            | \$ 1.49      |
| Depreciation and amortization of real estate,<br>in-place lease and other intangibles | 0.26                                | 0.23       | 0.75                               | 0.70         |
| Other depreciation and amortization   | 0.01                                | 0.01       | 0.02                               | 0.02         |
| Gain on sales of real estate  | —                                   | (0.02)     | (0.06)                             | (0.02)       |
| Joint venture and participating securities FFO<br>adjustments                         | 0.01                                | —          | 0.01                               | 0.01         |
| Diluted FFO applicable to common shares   | \$ 0.82                             | \$ 0.73    | \$ 2.30                            | \$ 2.20      |
| Impact of adjustments to FFO:   |                                     |            |                                    |              |
| Transaction-related items(1)  | \$ (31,778)                         | \$ —       | \$ (24,939)                        | \$ —         |
| Severance-related charges(2)  | —                                   | 26,374     | —                                  | 26,374       |
|   | \$ (31,778)                         | \$ 26,374  | \$ (24,939)                        | \$ 26,374    |
| FFO as adjusted applicable to common shares   | \$ 345,526                          | \$ 362,445 | \$ 1,031,949                       | \$ 1,029,613 |
| Distributions on dilutive convertible units and other                                 | 3,554                               | 3,247      | 10,383                             | 9,907        |
| Diluted FFO as adjusted applicable to common<br>shares                                | \$ 349,080                          | \$ 365,692 | \$ 1,042,332                       | \$ 1,039,520 |
| Diluted FFO as adjusted per common share  | \$ 0.75                             | \$ 0.79    | \$ 2.24                            | \$ 2.25      |
| Weighted average shares used to calculate diluted<br>FFO as adjusted per common share | 465,247                             | 462,082    | 464,512                            | 461,403      |

(1) Transaction-related items include significant direct costs (e.g., pursuit, due diligence and closing) and gains/charges incurred as a result of mergers and acquisitions and lease amendment or restructure activities. The nine months ended September 30, 2014, include the impact of \$25 million resulting primarily from the Brookdale Transaction, consisting of:

(i) \$108 million of net gains related to the terminated leases of the HCP owned 49-property portfolio; partially offset by a

(ii) \$70 million charge to write-off the existing straight-line rents and intangible other assets, net related to the terminated leases of the 49-property portfolio; and

(iii) \$13 million in charges for direct costs.

(2) Severance-related charges were attributable to the termination of the Company's former Chairman, Chief Executive Officer and President on October 2, 2013.

## Off-Balance Sheet Arrangements

We own interests in certain unconsolidated joint ventures as described under Note 8 to the Condensed Consolidated Financial Statements. Except in limited circumstances, our risk of loss is limited to our investment in the joint venture and any outstanding loans receivable. In addition, we have certain properties which serve as collateral for debt that is owed by a previous owner of certain of our facilities, as described under Note 12 to the Condensed Consolidated Financial Statements. Our risk of loss for these certain properties is limited to the outstanding debt balance plus penalties, if any. We have no other material off-balance sheet arrangements that we expect would materially affect our liquidity and capital resources except those described below under “Contractual Obligations.”

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## Contractual Obligations

The following table summarizes our material contractual payment obligations and commitments at September 30, 2014 (in thousands):

|                                      | Total(1)             | Less than<br>One Year | 2015-2016           | 2017-2018           | More than<br>Five Years |
|--------------------------------------|----------------------|-----------------------|---------------------|---------------------|-------------------------|
| Line of credit                       | \$ 70,000            | \$ —                  | \$ —                | \$ 70,000           | \$ —                    |
| Term loan(2)                         | 222,118              | —                     | 222,118             | —                   | —                       |
| Senior unsecured notes               | 7,650,000            | —                     | 1,300,000           | 1,350,000           | 5,000,000               |
| Mortgage debt                        | 1,203,254            | 249,052               | 331,900             | 557,060             | 65,242                  |
| Construction loan<br>commitments(3)  | 13,157               | 676                   | 12,481              | —                   | —                       |
| Development commitments(4)           | 73,213               | 22,312                | 50,901              | —                   | —                       |
| Ground and other operating<br>leases | 245,675              | 1,588                 | 12,249              | 9,777               | 222,061                 |
| Interest(5)                          | 2,567,211            | 51,732                | 801,435             | 545,290             | 1,168,754               |
| <b>Total</b>                         | <b>\$ 12,044,628</b> | <b>\$ 325,360</b>     | <b>\$ 2,731,084</b> | <b>\$ 2,532,127</b> | <b>\$ 6,456,057</b>     |

(1) Excludes \$98 million of other debt that represents Life Care Bonds and Demand Notes that have no scheduled maturities.

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

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

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

(5) Interest on variable-rate debt is calculated using rates in effect at September 30, 2014.

## Inflation

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

## Recent Accounting Pronouncements

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



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Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

To illustrate the effect of movements in the interest rate and foreign currency markets, we performed a market sensitivity analysis on our hedging instruments. We applied various basis point spreads to the underlying interest rate curves and foreign currency exchange rates of the derivative portfolio in order to determine the change in fair value. Assuming a one percentage point change in the underlying interest rate curve and foreign currency exchange rates, the estimated change in fair value of each of the underlying derivative instruments would not exceed \$4 million. See Note 20 to the Condensed Consolidated Financial Statements for additional analysis details.

**Interest Rate Risk.** At September 30, 2014, we are exposed to market risks related to fluctuations in interest rates primarily on variable rate investments, which has been predominately hedged through interest rate swap contracts.

Interest rate fluctuations will generally not affect our future earnings or cash flows on our fixed rate debt and assets unless such instruments mature or are otherwise terminated. However, interest rate changes will affect the fair value of our fixed rate instruments. Conversely, changes in interest rates on variable rate debt and investments would change our future earnings and cash flows, but not significantly affect the fair value of those instruments. Assuming a one percentage point increase in the interest rate related to the variable-rate investments and variable-rate debt, and assuming no other changes in the outstanding balance as of September 30, 2014, net interest income would improve by approximately \$40,000, or less than \$0.01 per common share on a diluted basis.

**Foreign Currency Risk.** At September 30, 2014, our exposure to foreign currencies primarily relates to UK investments in leased real estate, senior unsecured notes and the related GBP denominated cash flows from such investments. Our foreign currency exposure is partially mitigated through the use of GBP denominated borrowings and foreign currency swap contracts.

**Market Risk.** We have investments in marketable debt securities classified as held-to-maturity because we have the positive intent and ability to hold the securities to maturity. Held-to-maturity securities are recorded at amortized cost and adjusted for the amortization of premiums and discounts through maturity. We consider a variety of factors in evaluating an other-than-temporary decline in value, such as: the length of time and the extent to which the market value has been less than our current adjusted carrying value; the issuer's financial condition, capital strength and near-term prospects; any recent events specific to that issuer and economic conditions of its industry; and our investment horizon in relationship to an anticipated near-term recovery in the market value, if any. At September 30,

2014, the fair value and carrying value of marketable debt securities were \$272 million and \$240 million, respectively.

#### Item 4. Controls and Procedures

**Evaluation of 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 (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934), 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.

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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, 2014. Based upon that evaluation, our Chief Executive Officer (Principal Executive Officer) and Chief Financial Officer (Principal Financial Officer) concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control Over Financial Reporting. There were no changes in our internal control over financial reporting during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1A. Risk Factors

There are no material changes to the risk factors previously disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2013.

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

(a)

None.

(b)

None.

(c)

The table below sets forth information with respect to purchases of our common stock made by us or on our behalf or by any “affiliated purchaser,” as such term is defined in Rule 10b-18(a)(3) of the Securities Exchange Act of 1934, as amended, during the three months ended September 30, 2014.

| Total Number<br>Of Shares | Average Price | Total Number Of Shares<br>Total Number Of Shares<br>(Or Units) Purchased As<br>Part Of Publicly<br>Announced Plans Or | Maximum Number (Or<br>Approximate Dollar Value)<br>Of Shares (Or Units) That<br>May Yet Be Purchased<br>Under The Plans Or |
|---------------------------|---------------|---|--|
|---------------------------|---------------|---|--|

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| Period Covered       | Purchased(1) | Paid Per Share | Programs | Programs |
|----------------------|--------------|----------------|----------|----------|
| July 1-31, 2014      | 4,803        | \$ 41.46       | —        | —        |
| August 1-31, 2014    | 109          | 41.53          | —        | —        |
| September 1-30, 2014 | 7,719        | 40.13          | —        | —        |
| Total                | 12,631       | 40.65          | —        | —        |

(1) Represents restricted shares withheld under our 2014 Performance Incentive Plan (the “2014 Incentive Plan”) to offset tax withholding obligations that occur upon vesting of restricted shares and restricted stock units. Our 2014 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

Pursuant to the rules and regulations of the SEC, we have filed certain agreements as exhibits to this Quarterly Report on Form 10-Q. These agreements may contain representations and warranties by each of the parties to the applicable agreement. These representations and warranties were made solely for the benefit of the other parties to the applicable agreement and

- were not intended to be treated as categorical statements of fact, but rather as a way of allocating the risk to one of the parties if those statements prove to be inaccurate;
- may have been qualified in such agreement by disclosures that were made to the other party in connection with the negotiation of the applicable agreement;

- may apply contract standards of “materiality” that are different from “materiality” under the applicable securities laws; and
- were made only as of the date of the applicable agreement or such other date or dates as may be specified in the agreement.

Accordingly, these representations and warranties may not describe the actual state of affairs as of the date they were made or at any other time. The Company acknowledges that, notwithstanding the inclusion of the foregoing cautionary statements, it is responsible for considering whether additional specific disclosures of material information regarding material contractual provisions are required to make the statements in this Form 10-Q not misleading.

- 2.1 Master Contribution and Transactions Agreement, dated April 23, 2014, by and between HCP, Inc. and Brookdale Senior Living Inc.† (incorporated herein by reference to Exhibit 2.1 to HCP’s Quarterly Report on Form 10-Q (File No. 1-08895) filed August 5, 2014).
- 3.1 Articles of Restatement of HCP (incorporated herein by reference to Exhibit 3.1 to HCP’s Registration Statement on Form S-3 (Registration No. 333-182824), filed July 24, 2012).
- 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 herein by reference to Exhibit 3.2.1 to HCP’s Quarterly Report on Form 10-Q (File No. 1-08895) for the quarter ended September 30, 2007).
- 3.2.2 Amendment No. 2 to Fourth Amended and Restated Bylaws of HCP (incorporated herein by reference to Exhibit 3.2.2 to HCP’s Quarterly Report on Form 10-Q (File No. 1-08895) for the quarter ended September 30, 2009).
- 3.2.3 Amendment No. 3 to Fourth Amended and Restated Bylaws of HCP (incorporated herein by reference to Exhibit 3.1 to HCP’s Current Report on Form 8-K (File No. 1-08895), filed March 10, 2011).
- 3.2.4 Amendment No. 4 to Fourth Amended and Restated Bylaws of HCP (incorporated herein by reference to Exhibit 3.1 to HCP’s Current Report on Form 8-K (File No. 1-08895), filed October 3, 2013).
- 4.1 Fourth Supplemental Indenture, dated August 14, 2014, between HCP and The Bank of New York Mellon Trust Company, N.A., as trustee (incorporated herein by reference to Exhibit 4.1 to HCP’s Current Report on Form 8-K (File No. 1-08895) filed August 14, 2014).
- 4.2 Form of 3.875% Senior Notes due 2024 (incorporated herein by reference to Exhibit 4.2 to HCP’s Current Report on Form 8-K (File No. 1-08895) filed August 14, 2014).
- 10.1 Eighth Amendment to Master Lease and Security Agreement, dated as of July 31, 2014, by and among the parties signatory thereto and HCR III Healthcare, LLC.\*

- 10.2 Ninth Amendment to Master Lease and Security Agreement, dated as of September 30, 2014, by and among the parties signatory thereto and HCR III Healthcare, LLC.\*
- 10.3 Omnibus Amendment to Leases, dated as of July 31, 2014, which amends the Master Lease and Security Agreement, dated as of October 31, 2012, by and between HCPI Trust, HCP Senior Housing Properties Trust, HCP SH ELP1 Properties, LLC, HCP SH ELP2 Properties, LLC, HCP SH ELP3 Properties, LLC, HCP SH Lassen House, LLC, HCP SH Mountain Laurel, LLC, HCP SH Mountain View, LLC, HCP SH Oakridge, LLC, HCP SH River Valley Landing, LLC and HCP SH Sellwood Landing, LLC, as lessor, and Emeritus Corporation, as lessee, as amended.\*

- 10.4 Amended and Restated Master Lease and Security Agreement, dated as of August 29, 2014, by and between HCP AUR1 California A Pack, LLC, HCP EMOH, LLC, HCP Hazel Creek, LLC, HCP MA2 California, LP, HCP MA2 Massachusetts, LP, HCP MA2 Ohio, LP, HCP MA2 Oklahoma, LP, HCP MA3 California, LP, HCP MA3 South Carolina, LP, HCP MA3 Washington LP, HCP Partners, LP, HCP Senior Housing Properties Trust, HCP SH Eldorado Heights LLC, HCP SH ELP1 Properties, LLC, HCP SH ELP2 Properties, LLC, HCP SH ELP3 Properties, LLC, HCP SH Lassen House, LLC, HCP SH Mountain Laurel, LLC, HCP SH Mountain View, LLC, HCP SH River Valley Landing, LLC, HCP SH Sellwood Landing, LLC, HCP ST1 Colorado, LP, HCP, Inc. and HCPI Trust, as their interests may appear, as lessor, and Emeritus Corporation, Summerville at Hazel Creek, LLC and Summerville at Prince William, Inc., as lessee.\*††
- 31.1 Certification by Lauralee E. Martin, HCP's Principal Executive Officer, Pursuant to Securities Exchange Act Rule 13a-14(a).\*
- 31.2 Certification by Timothy M. Schoen, HCP's Principal Financial Officer, Pursuant to Securities Exchange Act Rule 13a-14(a).\*
- 32.1 Certification by Lauralee E. Martin, HCP's Principal Executive Officer, Pursuant to Securities Exchange Act Rule 13a-14(b) and 18 U.S.C. Section 1350.\*\*
- 32.2 Certification by Timothy M. Schoen, HCP's Principal Financial Officer, Pursuant to Securities Exchange Act Rule 13a-14(b) and 18 U.S.C. Section 1350.\*\*
- 101.INS XBRL Instance Document.\*
- 101.SCH XBRL Taxonomy Extension Schema Document.\*
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document.\*
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document.\*
- 101.LAB XBRL Taxonomy Extension Labels Linkbase Document.\*
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document.\*

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\* Filed herewith.

\*\* Furnished herewith.

† Certain schedules or similar attachments have been omitted pursuant to Item 601(b)(2) of Regulation S-K. The Company agrees to furnish supplementally copies of any of the omitted schedules or attachments upon request by the SEC.

†† Portions of this exhibit have been omitted pursuant to a request for confidential treatment with the SEC.





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 4, 2014 HCP, Inc.

(Registrant)

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

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

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