HCP, INC.
Form 10-Q
July 31, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2012.

OR

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

For the transition period from to

Commission file number 001-08895

HCP, INC.

(Exact name of registrant as specified in its charter)

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

3760 Kilroy Airport Way, Suite 300
Long Beach, CA 90806
(Address of principal executive offices)

(562) 733-5100
(Registrant s telephone number, including area code)

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

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

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

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

Large Accelerated Filer x	Accelerated Filer o
Non-accelerated Filer o (Do not check if a smaller reporting company)	Smaller Reporting Company o

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

As of July 26, 2012, there were 429,523,635 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)

	June 30, 2012	December 31, 2011
ASSETS		
Real estate:		
Buildings and improvements	$ 8,994,048	$ 8,933,278
Development costs and construction in progress	204,018	190,590
Land	1,734,469	1,729,677
Accumulated depreciation and amortization	(1,614,148)	(1,472,272)
Net real estate	9,318,387	9,381,273
Net investment in direct financing leases	6,804,929	6,727,777
Loans receivable, net	125,521	110,253
Investments in and advances to unconsolidated joint ventures	219,877	224,052
Accounts receivable, net of allowance of $1,696 and $1,341, respectively	25,974	26,681
Cash and cash equivalents	169,636	33,506
Restricted cash	42,782	41,553
Intangible assets, net	347,670	373,763
Real estate held for sale, net		4,159
Other assets, net	734,992	485,458
Total assets	$ 17,789,768	$ 17,408,475
LIABILITIES AND EQUITY		
Bank line of credit	$ 215,015	$ 454,000
Senior unsecured notes	5,615,979	5,416,063
Mortgage debt	1,726,944	1,764,571
Other debt	84,060	87,985
Intangible liabilities, net	114,939	124,142
Accounts payable and accrued liabilities	273,344	275,478
Deferred revenue	68,548	65,614
Total liabilities	8,098,829	8,187,853
Commitments and contingencies		
Preferred stock, $1.00 par value: aggregate liquidation preference of $295.5 million as of December 31, 2011		285,173
Common stock, $1.00 par value: 750,000,000 shares authorized; 429,401,611 and 408,629,444 shares issued and outstanding, respectively	429,402	408,629
Additional paid-in capital	10,159,580	9,383,536
Cumulative dividends in excess of earnings	(1,062,049)	(1,024,274)
Accumulated other comprehensive loss	(19,703)	(19,582)
Total stockholders equity	9,507,230	9,033,482
Joint venture partners	15,855	16,971
Non-managing member unitholders	167,854	170,169
Total noncontrolling interests	183,709	187,140

Total equity		9,690,939		9,220,622
Total liabilities and equity	$	17,789,768	$	17,408,475

See accompanying Notes to Condensed Consolidated Financial Statements.

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HCP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)

(Unaudited)

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Revenues:				
Rental and related revenues	$ 248,627	$ 260,157	$ 492,962	$ 513,238
Tenant recoveries	23,581	22,441	46,231	45,885
Resident fees and services	35,569	835	71,748	3,340
Income from direct financing leases	154,976	143,662	309,511	157,057
Interest income	1,216	60,526	2,035	98,622
Investment management fee income	470	504	963	1,111
Total revenues	464,439	488,125	923,450	819,253
Costs and expenses:				
Interest expense	103,225	105,129	207,793	213,705
Depreciation and amortization	87,924	89,814	176,165	180,996
Operating	70,087	46,615	137,436	93,460
General and administrative	14,812	34,872	34,914	56,824
Total costs and expenses	276,048	276,430	556,308	544,985
Other income, net	1,028	7,518	1,464	17,827
Income before income taxes and equity income from unconsolidated joint ventures	189,419	219,213	368,606	292,095
Income taxes	(176)	(248)	533	(285)
Equity income from unconsolidated joint ventures	15,732	14,950	29,407	15,748
Income from continuing operations	204,975	233,915	398,546	307,558
Discontinued operations:				
Income before gain on sales of real estate, net of income taxes		337	137	678
Gain on sales of real estate, net of income taxes			2,856	
Total discontinued operations		337	2,993	678
Net income	204,975	234,252	401,539	308,236
Noncontrolling interests share in earnings	(2,951)	(5,493)	(6,135)	(9,384)
Net income attributable to HCP, Inc.	202,024	228,759	395,404	298,852
Preferred stock dividends		(5,283)	(17,006)	(10,566)
Participating securities share in earnings	(557)	(483)	(1,674)	(1,347)
Net income applicable to common shares	$ 201,467	$ 222,993	$ 376,724	$ 286,939
Basic earnings per common share:				
Continuing operations	$ 0.48	$ 0.55	$ 0.90	$ 0.74
Discontinued operations			0.01	
Net income applicable to common shares	$ 0.48	$ 0.55	$ 0.91	$ 0.74
Diluted earnings per common share:				
Continuing operations	$ 0.48	$ 0.55	$ 0.90	$ 0.73

Discontinued operations								
Net income applicable to common shares	$	0.48	$	0.55	$	0.90	$	0.73
Weighted average shares used to calculate earnings per common share:								
Basic		420,468		406,193		415,243		389,249
Diluted		421,671		411,710		416,666		391,100
Dividends declared per common share	$	0.50	$	0.48	$	1.00	$	0.96

See accompanying Notes to Condensed Consolidated Financial Statements.

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HCP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

(Unaudited)

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Net income	$ 204,975	$ 234,252	$ 401,539	$ 308,236
Other comprehensive income (loss):				
Unrealized gains (losses) on securities	(961)	1,331	343	1,331
Change in net unrealized gains (losses) on cash flow hedges:				
Unrealized losses	(1,056)	(1,368)	(780)	(1,041)
Reclassification adjustment realized in net income	90	95	179	(1,218)
Change in Supplemental Executive Retirement Plan obligation	45	32	90	66
Foreign currency translation adjustment	(155)	85	47	266
Total other comprehensive income (loss)	(2,037)	175	(121)	(596)
Total comprehensive income	202,938	234,427	401,418	307,640
Total comprehensive income attributable to noncontrolling interests	(2,951)	(5,493)	(6,135)	(9,384)
Total comprehensive income attributable to HCP, Inc.	$ 199,987	$ 228,934	$ 395,283	$ 298,256

See accompanying Notes to Condensed Consolidated Financial Statements.

HCP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF EQUITY

(In thousands)

(Unaudited)

	Preferred Stock Shares	Preferred Stock Amount	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Cumulative Dividends In Excess Of Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders Equity	Total Noncontrolling Interests	Total Equity
January 1, 2012	11,820	$ 285,173	408,629	$ 408,629	$ 9,383,536	$ (1,024,274)	$ (19,582)	$ 9,033,482	$ 187,140	$ 9,220,622
Net income						395,404		395,404	6,135	401,539
Other comprehensive income							(121)	(121)		(121)
Preferred stock redemption	(11,820)	(285,173)				(10,327)		(295,500)		(295,500)
Issuance of common stock, net			18,912	18,912	737,145			756,057	(2,273)	753,784
Repurchase of common stock			(189)	(189)	(7,678)			(7,867)		(7,867)
Exercise of stock options			2,050	2,050	35,170			37,220		37,220
Amortization of deferred compensation					11,407			11,407		11,407
Preferred dividends						(6,679)		(6,679)		(6,679)
Common dividends ($1.00 per share)						(416,173)		(416,173)		(416,173)
Distributions to noncontrolling interests									(7,778)	(7,778)
Issuance of noncontrolling interests									873	873
Purchase of noncontrolling interests									(388)	(388)
June 30, 2012		$	429,402	$ 429,402	$ 10,159,580	$ (1,062,049)	$ (19,703)	$ 9,507,230	$ 183,709	$ 9,690,939

	Preferred Stock Shares	Preferred Stock Amount	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Cumulative Dividends In Excess Of Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders Equity	Total Noncontrolling Interests	Total Equity
January 1, 2011	11,820	$ 285,173	370,925	$ 370,925	$ 8,089,982	$ (775,476)	$ (13,237)	$ 7,957,367	$ 188,680	$ 8,146,047
Net income						298,852		298,852	9,384	308,236
Other comprehensive loss							(596)	(596)		(596)
Issuance of common stock, net			35,691	35,691	1,236,276			1,271,967	(2,599)	1,269,368
			(131)	(131)	(4,678)			(4,809)		(4,809)

Repurchase of common stock										
Exercise of stock options			635	635	16,381			17,016		17,016
Amortization of deferred compensation					10,205			10,205		10,205
Preferred dividends						(10,566)		(10,566)		(10,566)
Common dividends ($0.96 per share)						(374,349)		(374,349)		(374,349)
Distributions to noncontrolling interests									(7,166)	(7,166)
Noncontrolling interest in acquired assets									1,500	1,500
Purchase of noncontrolling interests					(19,559)			(19,559)	(14,059)	(33,618)
June 30, 2011	11,820	$ 285,173	407,120	$ 407,120	$ 9,328,607	$ (861,539)	$ (13,833)	$ 9,145,528	$ 175,740	$ 9,321,268

See accompanying Notes to Condensed Consolidated Financial Statements.

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HCP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)
(Unaudited)

	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Cash flows from operating activities:		
Net income	$ 401,539	$ 308,236
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	176,165	180,996
Discontinued operations	35	476
Amortization of above and below market lease intangibles, net	(1,322)	(2,093)
Amortization of deferred compensation	11,407	10,205
Amortization of deferred financing costs, net	8,459	18,402
Straight-line rents	(21,787)	(32,912)
Loan and direct financing lease interest accretion	(48,159)	(41,858)
Deferred rental revenues	1,169	(1,077)
Equity income from unconsolidated joint ventures	(29,407)	(15,748)
Distributions of earnings from unconsolidated joint ventures	1,878	1,569
Gain on sales of real estate	(2,856)	
Gain upon settlement of loans receivable		(22,812)
Gain upon consolidation of joint venture		(7,769)
Derivative gains, net	(52)	(3,308)
Changes in:		
Accounts receivable, net	708	8,822
Other assets	(8,188)	(4,010)
Accounts payable and accrued liabilities	(6,038)	35,696
Net cash provided by operating activities	483,551	432,815
Cash flows from investing activities:		
Cash used in the HCR ManorCare Acquisition, net of cash acquired		(3,801,624)
Cash used in the HCP Ventures II purchase, net of cash acquired		(135,550)
Other acquisitions and development of real estate	(62,860)	(148,032)
Leasing costs and tenant and capital improvements	(27,112)	(20,940)
Proceeds from sales of real estate, net	7,238	
Purchase of an interest in unconsolidated joint ventures		(95,000)
Distributions in excess of earnings from unconsolidated joint ventures	1,529	1,558
Principal repayments on loans receivable	4,508	303,720
Investments in loans receivable	(20,757)	(360,932)
Increase in restricted cash	(1,229)	(7,851)
Purchase of marketable securities	(214,859)	
Net cash used in investing activities	(313,542)	(4,264,651)
Cash flows from financing activities:		
Net repayments under bank line of credit	(238,985)	
Repayments of mortgage and other debt	(42,538)	(141,684)
Issuance of senior unsecured notes	450,000	2,400,000
Repayment of senior unsecured notes	(250,000)	
Deferred financing costs	(10,236)	(42,852)
Preferred stock redemption	(295,500)	
Net proceeds from the issuance of common stock and exercise of options	783,137	1,281,575
Dividends paid on common and preferred stock	(422,852)	(384,915)

Issuance (purchase) of noncontrolling interests		873		(33,618)
Distributions to noncontrolling interests		(7,778)		(7,166)
Net cash provided by (used in) financing activities		(33,879)		3,071,340
Net increase (decrease) in cash and cash equivalents		136,130		(760,496)
Cash and cash equivalents, beginning of period		33,506		1,036,701
Cash and cash equivalents, end of period	$	169,636	$	276,205

See accompanying Notes to Condensed Consolidated Financial Statements.

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HCP, INC.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(1) Business

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

(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, its wholly-owned subsidiaries and joint ventures or variable interest entities (VIEs) that it controls through voting rights or other means. Intercompany transactions and balances have been eliminated upon consolidation. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) necessary to present fairly the Company s financial position, results of operations and cash flows have been included. Operating results for the six months ended June 30, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. 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, 2011 included in the Company s Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission (SEC).

Certain amounts in the Company s condensed consolidated financial statements have been reclassified for prior periods to conform to the current period presentation. Assets sold or held for sale and associated liabilities have been reclassified on the condensed consolidated balance sheets and the related operating results reclassified from continuing to discontinued operations on the condensed consolidated income statements (see Note 5). Facility-level revenues from 21 senior housing communities that are in a RIDEA structure are presented in resident fees and services on the condensed consolidated income statements; all facility-level resident fee and service revenue previously reported in rental and related revenues has been reclassified to resident fees and services (see Note 12 for additional information regarding the 21 RIDEA facilities).

Foreign Currency Translation and Transactions

Assets and liabilities denominated in foreign currencies that are translated into U.S. dollars use exchange rates in effect at the end of the period, and revenues and expenses denominated in foreign currencies that are translated into U.S. dollars use average rates of exchange in effect during the related period. Gains or losses resulting from translation are included in accumulated other comprehensive income, a component of stockholders equity on the condensed consolidated balance sheets. Gains or losses resulting from foreign currency transactions are translated into U.S. dollars at the rates of exchange prevailing at the dates of the transactions. The effects of transaction gains or losses are included in other income, net in the condensed consolidated statements of income.

Recent Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* (ASU 2011-04). The amendments in this update result in additional fair value measurement and disclosure requirements within U.S. GAAP and International Financial Reporting Standards. Consequently, the amendments change the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. The adoption of ASU 2011-04 on January 1, 2012 did not have an impact on the Company s consolidated financial position or results of operations.

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(3) HCR ManorCare Acquisition

On April 7, 2011, the Company completed its acquisition of substantially all of the real estate assets of HCR ManorCare, Inc. (HCR ManorCare), for a purchase price of $6 billion (HCR ManorCare Acquisition). The purchase price consisted of the following: (i) $4 billion in cash consideration; and (ii) $2 billion representing the fair value of the Company s former HCR ManorCare debt investments that were settled as part of this acquisition. Through this transaction, the Company acquired 334 HCR ManorCare post-acute, skilled nursing and assisted living facilities. The facilities are located in 30 states, with the highest concentrations in Ohio, Pennsylvania, Florida, Illinois and Michigan. A wholly-owned subsidiary of HCR ManorCare operates the assets pursuant to a long-term triple-net master lease agreement supported by a guaranty from HCR ManorCare. Additionally, the Company exercised its option to purchase an ownership interest in HCR ManorCare for $95 million that represented a 9.9% equity interest at closing.

The total purchase price of the HCR ManorCare Acquisition follows (in thousands):

Payment of aggregate cash consideration, net of cash acquired	$	3,801,624
HCP s loan investments in HCR ManorCare s debt settled at fair value(1)		1,990,406
Assumed HCR ManorCare accrued liabilities at fair value(2)		224,932
Total purchase consideration	$	6,016,962
Legal, accounting and other fees and costs(3)	$	26,839

(1) At closing, the Company recognized a gain of approximately $23 million, included in interest income, which represented the fair value of the Company s existing mezzanine and mortgage loan investments in HCR ManorCare in excess of its carrying value on the acquisition date.

(2) In August 2011, the Company paid these amounts to certain taxing authorities or the seller.

(3) Represents estimated fees and costs of $15.5 million (general and administrative) and the write-off of unamortized bridge loan fees of $11.3 million (interest expense) upon its termination that were expensed in 2010 and 2011, respectively. These charges are directly attributable to the transaction and represent non-recurring costs.

The following table summarizes the fair value of the HCR ManorCare assets acquired and liabilities assumed at the April 7, 2011 acquisition date (in thousands):

Assets acquired		
Net investments in direct financing leases	$	6,002,074
Cash and cash equivalents		6,996
Intangible assets, net		14,888
Total assets acquired		6,023,958
Total liabilities assumed		224,932
Net assets acquired	$	5,799,026

In connection with the HCR ManorCare Acquisition, the Company entered into a credit agreement for a 365-day bridge loan facility (from funding to maturity) in an aggregate amount of up to $3.3 billion, which was terminated in accordance with its terms in March 2011.

The assets and liabilities of the Company s investments related to HCR ManorCare and the related results of operations are included in the condensed consolidated financial statements from the April 7, 2011 acquisition date. The Company recognized revenues and earnings from its investments related to HCR ManorCare of $143 million and $158 million, respectively, for the three months ended June 30, 2012, and $285 million and $313 million, respectively, for the six months ended June 30, 2012. The Company recognized revenues and earnings from its investments related to HCR ManorCare of $130 million and $145 million, respectively, for both the three and six months ended June 30, 2011.

See Note 8 for additional information regarding the Company s investment related to HCR ManorCare.

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Pro Forma Results of Operations

The following unaudited pro forma consolidated results of operations assume that the HCR ManorCare Acquisition, including the Company s equity interest in HCR ManorCare, was completed as of January 1, 2011 (in thousands, except per share amounts):

	Three Months Ended June 30, 2011	Six Months Ended June 30, 2011
Revenues	$ 472,186	$ 911,959
Net income	219,335	409,372
Net income applicable to HCP, Inc.	213,842	399,988
Basic earnings per common share	$ 0.51	$ 0.96
Diluted earnings per common share	0.51	0.96

(4) Other Real Estate Property Investments

A summary of real estate acquisitions for the six months ended June 30, 2012 follows (in thousands):

	Consideration		Assets Acquired	
Segment	Cash Paid	Noncontrolling Interest	Real Estate	Net Intangibles
Life science	$ 7,970	$ 80	$ 7,580	$ 470
Hospital	3,000		3,000	
	$ 10,970	$ 80	$ 10,580	$ 470

During the six months ended June 30, 2012, the Company funded an aggregate of $79 million for construction, tenant and other capital improvement projects, primarily in its life science and medical office segments.

A summary of real estate acquisitions for the six months ended June 30, 2011 follows (in thousands):

	Consideration			Assets Acquired	
Segment	Cash Paid	Debt Assumed	Noncontrolling Interest	Real Estate	Net Intangibles
Life science	$ 84,047	$ 48,252	$	$ 126,610	$ 5,689
Medical office	29,743		1,500	26,191	5,052
	$ 113,790	$ 48,252	$ 1,500	$ 152,801	$ 10,741

See discussion of the January 2011 purchase and consolidation of HCP Ventures II in Note 8.

During the six months ended June 30, 2011, the Company funded an aggregate of $54 million for construction, tenant and other capital improvement projects, primarily in its life science and medical office segments. During the six months ended June 30, 2011, two of the Company s life science facilities located in South San Francisco were placed in service representing 88,000 square feet.

(5) Dispositions of Real Estate and Discontinued Operations

During the first quarter of 2012, the Company sold a medical office building for $7 million.

The following table summarizes operating income from discontinued operations (dollars in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	**2011**	**2012**	**2011**
Rental and related revenues	$	$ 581	$ 246	$ 1,158
Depreciation and amortization expenses		238	35	476
Operating expenses		6	2	7
Other (income) expense, net			72	(3)
Income, net of income taxes	$	$ 337	$ 137	$ 678
Gain on sales of real estate, net of income taxes	$	$	$ 2,856	$
Number of properties included in discontinued operations		4	1	4

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(6) Net Investment in Direct Financing Leases

On April 7, 2011, the Company completed the acquisition of 334 HCR ManorCare properties subject to a single master lease that the Company classified as a direct financing lease (DFL). See discussion of the HCR ManorCare Acquisition in Note 3.

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

	June 30, 2012	December 31, 2011
Minimum lease payments receivable(1)	$ 25,483,105	$ 25,744,161
Estimated residual values	4,010,514	4,010,514
Less unearned income	(22,688,690)	(23,026,898)
Net investment in direct financing leases	$ 6,804,929	$ 6,727,777
Properties subject to direct financing leases	361	361

(1) The minimum lease payments receivable are primarily attributable to HCR ManorCare ($24.3 billion and $24.5 billion at June 30, 2012 and December 31, 2011, respectively). The triple-net master lease with HCR ManorCare provides for annual rent of $489 million beginning April 1, 2012. The rent increases by 3.5% per year over the next four years and by 3% for the remaining portion of the initial lease term. The properties are grouped into four pools, and HCR ManorCare has a 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.

Certain of the non-HCR ManorCare leases contain provisions that allow the tenants to elect to purchase the properties during or at the end of the lease terms for the aggregate initial investment amount plus adjustments, if any, as defined in the lease agreements. Certain leases also permit the Company to require the tenants to purchase the properties at the end of the lease terms.

(7) Loans Receivable

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

	June 30, 2012			December 31, 2011		
	Real Estate Secured	Other Secured	Total	Real Estate Secured	Other Secured	Total
Mezzanine	$	$ 83,282	$ 83,282	$	$ 90,148	$ 90,148
Other	57,258		57,258	35,643		35,643
Unamortized discounts, fees and costs	(521)	(1,088)	(1,609)	(1,040)	(1,088)	(2,128)
Allowance for loan losses		(13,410)	(13,410)		(13,410)	(13,410)

	$	56,737	$	68,784	$	125,521	$	34,603	$	75,650	$	110,253

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 all of the assets of the Borrower, which collateral is comprised primarily of interests in partnerships operating surgical facilities, some of which are on the premises of properties owned by the Company or HCP Ventures IV, LLC, an unconsolidated joint venture of the Company. In December 2009, the Company determined that the loan was impaired and recognized a provision for loan loss (impairment) of $4.3 million. In January 2011, the Company placed the loan on cost-recovery status, whereby accrual of interest income was suspended and any payments received from the Borrower are applied to reduce the recorded investment in the loan. In September 2011, the Company determined that the fair value of the collateral assets was no longer in excess of the carrying value of the loan and therefore recognized an additional provision for losses of $15.4 million.

As part of a March 2012 agreement (the 2012 Agreement) between Delphis, certain past and current principals of Delphis and the Cirrus Group, LLC (the Guarantors), and the Company, the Company agreed, among other things, to allow the distribution of $1.5 million to certain of the Guarantors from funds generated from sales of assets that were pledged as additional collateral for this loan. In consideration of this distribution, among other things, the Company received cash of $4.9 million (including funds that had been escrowed from past sales of the Guarantors collateral) and the assignment of certain rights to general and limited partnership interests (including the release of claims by such entities). Further, the Company, as part of the 2012 Agreement, agreed to provide financial incentives to the Borrower regarding the liquidation of the primary collateral assets for this loan.

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The Company valued the cash payments and other consideration received through the 2012 Agreement (after reducing the consideration by $0.5 million for related legal expenses) at $6.9 million, which the Company applied to the carrying value of the loan, reducing the balance to $68.8 million as of June 30, 2012 from its balance of $75.7 million as of December 31, 2011. During the six months ended June 30, 2011, the Company received cash payments from the Borrower of $1.2 million. At June 30, 2012, the Company believes that the fair value of the collateral supporting this loan is in excess of the loan s carrying value.

HCR ManorCare Loans

In December 2007, the Company made a $900 million investment (at a discount of $100 million) in HCR ManorCare mezzanine loans, which paid interest at a floating rate of one-month London Interbank Offered Rate (LIBOR) plus 4.0%. Also, in August 2009 and January 2011, the Company purchased $720 million (at a discount of $130 million) and $360 million, respectively, in participations in HCR ManorCare first mortgage debt, which paid interest at LIBOR plus 1.25%.

On April 7, 2011, upon closing of the HCR ManorCare Acquisition, the Company s loans to HCR ManorCare were settled, which resulted in additional interest income of $23 million, which represents the excess of the loans fair values above their carrying values at the acquisition date. See Note 3 for additional discussion related to the HCR ManorCare Acquisition.

Genesis HealthCare Loans

In September and October 2010, the Company purchased participations in a senior loan and mezzanine note of Genesis HealthCare (Genesis) with par values of $278 million (at a discount of $28 million) and $50 million (at a discount of $10 million), respectively. The Genesis senior loan paid interest at LIBOR (subject to a floor of 1.5%, increasing to 2.5% by maturity) plus a spread of 4.75%, increasing to 5.75% by maturity. The senior loan was secured by all of Genesis assets. The mezzanine note paid interest at LIBOR plus a spread of 7.50%. In addition to the coupon interest payments, the mezzanine note required the payment of a termination fee, of which the Company s share prior to the early repayment of this loan was $2.3 million.

On April 1, 2011, the Company received $330.4 million from the early repayment of its loans to Genesis, and recognized additional interest income of $34.8 million, which represents the related unamortized discounts and termination fee.

(8) Investments in and Advances to Unconsolidated Joint Ventures

HCP Ventures II

On January 14, 2011, the Company acquired its partner s 65% interest in HCP Ventures II, a joint venture that owned 25 senior housing facilities, becoming the sole owner of the portfolio.

The purchase consideration of HCP Ventures II follows (in thousands):

Cash paid for HCP Ventures II s partnership interest	$	135,550
Fair value of HCP s 35% interest in HCP Ventures II (carrying value of $65,223 at closing)(1)		72,992
Total consideration	$	208,542
Estimated fees and costs		
Legal, accounting and other fees and costs(2)	$	150
Debt assumption fees(3)		500
Total	$	650

(1) In January 2011, the Company recognized a gain of approximately $8 million, included in other income, net, which represents the fair value of the Company s 35% interest in HCP Ventures II in excess of its carrying value on the acquisition date.

(2) Represents estimated fees and costs that were expensed and included in general and administrative expenses. These charges are directly attributable to the transaction and represent non-recurring costs.

(3) Represents debt assumption fees that were capitalized as deferred financing costs.

In accordance with the accounting guidance applicable to acquisitions of the partner s ownership interests that result in consolidation of previously unconsolidated entities, the Company recorded all of the assets and liabilities of HCP Ventures II at their fair values as of the January 14, 2011 acquisition date. The Company utilized relevant market data and valuation techniques to determine the acquisition date fair value for HCP Ventures II. Relevant market data and valuation techniques included, but were not limited to, market data comparables for capitalization and discount rates, credit spreads, property specific building cost information and cash flow assumptions. The market data comparables utilized in the Company s valuation model were based on information that it believes to be within a reasonable range of the then current market transactions.

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The following table summarizes the fair values of the HCP Ventures II assets acquired and liabilities assumed at the January 14, 2011 acquisition date (in thousands):

Assets acquired		
Buildings and improvements	$	683,633
Land		79,580
Cash		2,585
Restricted cash		1,861
Intangible assets		78,293
Total assets acquired	$	845,952
Liabilities assumed		
Mortgage debt	$	635,182