

HCP, INC.
Form 10-Q
November 01, 2016
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(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, 2016.

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

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.)

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)

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.

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Large Accelerated Filer

Accelerated Filer

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 28, 2016, there were 467,971,166 shares of the registrant's \$1.00 par value common stock outstanding.

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CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

(Unaudited)

	September 30, 2016	December 31, 2015
ASSETS		
Real estate:		
Buildings and improvements	\$ 12,534,471	\$ 12,198,704
Development costs and construction in progress	395,349	388,576
Land	1,971,601	1,948,757
Accumulated depreciation and amortization	(2,799,969)	(2,541,334)
Net real estate	12,101,452	11,994,703
Net investment in direct financing leases	5,860,401	5,905,009
Loans receivable, net	682,994	768,743
Investments in and advances to unconsolidated joint ventures	592,097	605,244
Accounts receivable, net of allowance of \$4,704 and \$3,261, respectively	41,371	48,929
Cash and cash equivalents	132,891	346,500
Restricted cash	71,727	60,616
Intangible assets, net	538,631	603,706
Real estate and related assets held for sale, net	372,968	314,126
Other assets, net	794,013	802,273
Total assets(1)	\$ 21,188,545	\$ 21,449,849
LIABILITIES AND EQUITY		
Bank line of credit	\$ 1,372,032	\$ 397,432
Term loans	462,181	524,807
Senior unsecured notes	8,229,731	9,120,107
Mortgage debt	762,715	932,212
Other debt	93,876	94,445
Intangible liabilities, net	46,135	56,147
Intangible and other liabilities related to assets held for sale, net	23,002	19,126
Accounts payable and accrued liabilities	487,033	436,239
Deferred revenue	136,406	123,017
Total liabilities(1)	11,613,111	11,703,532
Commitments and contingencies		
Common stock, \$1.00 par value: 750,000,000 shares authorized; 467,820,181 and 465,488,492 shares issued and outstanding, respectively	467,820	465,488
Additional paid-in capital	11,720,552	11,647,039
Cumulative dividends in excess of earnings	(2,975,096)	(2,738,414)
Accumulated other comprehensive loss	(30,164)	(30,470)
Total stockholders' equity	9,183,112	9,343,643
Joint venture partners	212,807	217,066

Non-managing member unitholders	179,515	185,608
Total noncontrolling interests	392,322	402,674
Total equity	9,575,434	9,746,317
Total liabilities and equity	\$ 21,188,545	\$ 21,449,849

(1) HCP, Inc.'s consolidated total assets and total liabilities at September 30, 2016 and December 31, 2015 include certain assets of variable interest entities ("VIEs") that can only be used to settle the liabilities of the related VIE. The VIE creditors do not have recourse to HCP, Inc. Total assets at September 30, 2016 include VIE assets as follows: buildings and improvements \$3.4 billion; development costs \$23 million; land \$324 million; accumulated depreciation and amortization \$629 million; investments in unconsolidated joint ventures \$14 million; accounts receivable \$19 million; cash \$59 million; restricted cash \$27 million; intangible assets, net \$177 million; and other assets, net \$68 million. Total assets at December 31, 2015 include VIE assets as follows: buildings and improvements \$3.4 billion; development costs \$54 million; land \$327 million; accumulated depreciation and amortization \$537 million; investments in unconsolidated joint ventures \$14 million; accounts receivable \$19 million; cash \$61 million; restricted cash \$21 million; intangible assets, net \$204 million; and other assets, net \$63 million. Total liabilities at September 30, 2016 include VIE liabilities as follows: mortgage debt \$568 million; intangible liabilities, net \$9 million; accounts payable and accrued liabilities \$127 million and deferred revenue \$26 million. Total liabilities at December 31, 2015 include VIE liabilities as follows: mortgage debt \$589 million; intangible liabilities, net \$10 million; accounts payable and accrued liabilities \$107 million and deferred revenue \$19 million. See Note 16 to the Consolidated Financial Statements for additional information.

See accompanying Notes to the Consolidated Financial Statements.

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HCP, Inc.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Revenues:				
Rental and related revenues	\$ 297,178	\$ 293,566	\$ 893,448	\$ 845,382
Tenant recoveries	35,195	33,084	100,862	94,356
Resident fees and services	170,752	155,290	500,717	367,141
Income from direct financing leases	130,663	155,717	390,731	478,976
Interest income	20,482	19,842	71,298	89,049
Total revenues	654,270	657,499	1,957,056	1,874,904
Costs and expenses:				
Interest expense	117,860	122,157	361,255	357,569
Depreciation and amortization	142,874	134,704	425,582	369,629
Operating	188,747	173,515	545,827	441,888
General and administrative	34,787	20,534	83,079	74,152
Acquisition and pursuit costs	17,568	1,553	34,570	23,350
Impairments	—	69,622	—	592,921
Total costs and expenses	501,836	522,085	1,450,313	1,859,509
Other income (expense):				
(Loss) gain on sales of real estate	(9)	52	119,605	6,377
Other income (expense), net	1,454	(572)	5,128	13,125
Total other income (expense), net	1,445	(520)	124,733	19,502
Income before income taxes and equity (loss)				
income from and impairment of unconsolidated				
joint ventures	153,879	134,894	631,476	34,897
Income tax benefit (expense)	2,213	1,980	(48,822)	6,620
Equity (loss) income from unconsolidated joint				
ventures	(2,053)	8,314	(4,028)	33,916
Impairment of investments in unconsolidated				
joint ventures	—	(27,234)	—	(27,234)
Net income	154,039	117,954	578,626	48,199
Noncontrolling interests' share in earnings	(2,789)	(2,592)	(9,540)	(8,566)
Net income attributable to HCP, Inc.	151,250	115,362	569,086	39,633
Participating securities' share in earnings	(326)	(316)	(977)	(1,020)
Net income applicable to common shares	\$ 150,924	\$ 115,046	\$ 568,109	\$ 38,613
Earnings per common share:				
Basic	\$ 0.32	\$ 0.25	\$ 1.22	\$ 0.08

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Diluted	\$ 0.32	\$ 0.25	\$ 1.22	\$ 0.08
Weighted average shares used to calculate earnings per common share:				
Basic	467,628	463,337	466,931	462,039
Diluted	467,835	463,586	467,132	462,302
Dividends declared per common share	\$ 0.575	\$ 0.565	\$ 1.725	\$ 1.695

See accompanying Notes to the Consolidated Financial Statements.

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HCP, Inc.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net income	\$ 154,039	\$ 117,954	\$ 578,626	\$ 48,199
Other comprehensive income (loss):				
Change in net unrealized gains (losses) on securities	4	(361)	(1)	(358)
Change in net unrealized gains (losses) on cash flow hedges:				
Unrealized gains (losses)	1,184	(87)	1,532	(289)
Reclassification adjustment realized in net income	154	(367)	494	(19)
Change in Supplemental Executive Retirement Plan obligation	70	70	211	208
Foreign currency translation adjustment	(838)	410	(1,930)	(8,097)
Total other comprehensive income (loss)	574	(335)	306	(8,555)
Total comprehensive income	154,613	117,619	578,932	39,644
Total comprehensive income attributable to noncontrolling interests	(2,789)	(2,592)	(9,540)	(8,566)
Total comprehensive income attributable to HCP, Inc.	\$ 151,824	\$ 115,027	\$ 569,392	\$ 31,078

See accompanying Notes to the Consolidated Financial Statements.

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HCP, Inc.

CONSOLIDATED STATEMENTS OF EQUITY

(In thousands, except per share data)

(Unaudited)

	Common Shares	Stock Amount	Additional Paid-In Capital	Cumulative Dividends In Excess Of Earnings	Accumulated Other Comprehensive Loss	Total Stockholders' Equity	Total Noncontrolling Interests	Total Equity
January 1, 2016	465,488	\$ 465,488	\$ 11,647,039	\$ (2,738,414)	\$ (30,470)	\$ 9,343,643	\$ 402,674	\$ 9,746,317
Net income	—	—	—	569,086	—	569,086	9,540	578,626
Other comprehensive income	—	—	—	—	306	306	—	306
Issuance of common stock, net	2,290	2,290	53,421	—	—	55,711	—	55,711
Conversion of DownREIT units to common stock	145	145	5,948	—	—	6,093	(6,093)	—
Repurchase of common stock	(236)	(236)	(8,431)	—	—	(8,667)	—	(8,667)
Exercise of stock options	133	133	3,340	—	—	3,473	—	3,473
Amortization of deferred compensation	—	—	19,307	—	—	19,307	—	19,307
Common dividends (\$1.725 per share)	—	—	—	(806,243)	—	(806,243)	—	(806,243)
Distributions to noncontrolling interests	—	—	(36)	—	—	(36)	(18,651)	(18,687)
Issuance of noncontrolling interests	—	—	—	—	—	—	4,785	4,785
Deconsolidation of noncontrolling interests	—	—	(36)	475	—	439	67	506
	467,820	\$ 467,820	\$ 11,720,552	\$ (2,975,096)	\$ (30,164)	\$ 9,183,112	\$ 392,322	\$ 9,575,434

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September 30,
2016

	Common Stock		Additional	Cumulative	Accumulated	Total	Total	Total
	Shares	Amount	Paid-In	Dividends	Other	Stockholders'	Noncontrolling	Equity
			Capital	In Excess	Comprehens	Equity	Interests	
				Of Earnings	Loss			
January 1, 2015	459,746	\$ 459,746	\$ 11,431,987	\$ (1,132,541)	\$ (23,895)	\$ 10,735,297	\$ 261,802	\$ 10,997,099
Net income	—	—	—	39,633	—	39,633	8,566	48,199
Other comprehensive loss	—	—	—	—	(8,555)	(8,555)	—	(8,555)
Issuance of common stock, net	4,054	4,054	140,591	—	—	144,645	(2,659)	141,986
Repurchase of common stock	(178)	(178)	(7,828)	—	—	(8,006)	—	(8,006)
Exercise of stock options	820	820	26,691	—	—	27,511	—	27,511
Amortization of deferred compensation	—	—	21,068	—	—	21,068	—	21,068
Common dividends (\$1.695 per share)	—	—	—	(783,578)	—	(783,578)	—	(783,578)
Distributions to noncontrolling interests	—	—	(263)	—	—	(263)	(13,444)	(13,707)
Issuance of noncontrolling interests	—	—	—	—	—	—	38,440	38,440
September 30, 2015	464,442	\$ 464,442	\$ 11,612,246	\$ (1,876,486)	\$ (32,450)	\$ 10,167,752	\$ 292,705	\$ 10,460,457

See accompanying Notes to the Consolidated Financial Statements.

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HCP, Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine Months Ended September 30,	
	2016	2015
Cash flows from operating activities:		
Net income	\$ 578,626	\$ 48,199
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	425,582	369,629
Amortization of market lease intangibles, net	(1,393)	(980)
Amortization of deferred compensation	19,307	21,068
Amortization of deferred financing costs	15,598	14,950
Straight-line rents	(14,412)	(24,817)
Loan and direct financing lease non-cash interest	385	(71,243)
Deferred rental revenues	(1,027)	(1,496)
Equity loss (income) from unconsolidated joint ventures	4,028	(33,916)
Distributions of earnings from unconsolidated joint ventures	5,919	4,587
Lease termination income, net	—	(1,103)
Gain on sales of real estate	(119,605)	(6,377)
Deferred income tax expense	47,195	—
Foreign exchange and other gains, net	(127)	(7,103)
Impairments	—	620,155
Changes in:		
Accounts receivable, net	7,558	(10,634)
Other assets, net	(9,674)	(1,186)
Accounts payable and accrued liabilities	40,672	(52,073)
Net cash provided by operating activities	998,632	867,660
Cash flows from investing activities:		
Acquisitions of real estate	(257,242)	(1,200,661)
Development of real estate	(304,818)	(190,082)
Leasing costs and tenant and capital improvements	(64,501)	(52,371)
Proceeds from sales of real estate, net	211,810	19,555
Contributions to unconsolidated joint ventures	(10,169)	(43,242)
Distributions in excess of earnings from unconsolidated joint ventures	14,458	16,086
Proceeds from the sales of marketable securities	—	782
Principal repayments on loans receivable, direct financing leases and other	221,179	51,491
Investments in loans receivable and other	(129,335)	(283,252)
Decrease (increase) in restricted cash	4,459	(3,891)
Net cash used in investing activities	(314,159)	(1,685,585)
Cash flows from financing activities:		

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Net borrowings under bank line of credit	1,157,897	282,099
Repayments under bank line of credit	(135,000)	(102,063)
Borrowings under term loan	—	333,014
Issuance of senior unsecured notes	—	1,338,555
Repayments of senior unsecured notes	(900,000)	(400,000)
Repayments of mortgage and other debt	(249,540)	(50,187)
Deferred financing costs	(1,057)	(14,556)
Issuance of common stock and exercise of options	59,184	169,497
Repurchase of common stock	(8,667)	(8,006)
Dividends paid on common stock	(806,243)	(783,578)
Issuance of noncontrolling interests	4,785	4,812
Distributions to noncontrolling interests	(18,687)	(13,707)
Net cash (used in) provided by financing activities	(897,328)	755,880
Effect of foreign exchange on cash and cash equivalents	(754)	(1,267)
Net decrease in cash and cash equivalents	(213,609)	(63,312)
Cash and cash equivalents, beginning of period	346,500	183,810
Cash and cash equivalents, end of period	\$ 132,891	\$ 120,498

See accompanying Notes to the Consolidated Financial Statements.

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HCP, Inc.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 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 organized in 1985 and qualifies as a self-administered real estate investment trust ("REIT"). The Company is headquartered in Irvine, California, with offices in Nashville, Los Angeles, San Francisco and London. The Company acquires, develops, leases, manages and disposes of healthcare real estate, and provides financing to healthcare providers. The Company's diverse portfolio is comprised of investments in the following reportable healthcare segments: (i) senior housing triple-net ("SH NNN"), (ii) senior housing operating portfolio ("SHOP"), (iii) life science, (iv) medical office and (v) QCP (defined below).

On October 31, 2016, the Company completed its previously announced spin-off (the "Spin-Off") of its subsidiary, Quality Care Properties, Inc. ("QCP") (NYSE:QCP). QCP's assets include 338 properties, primarily comprised of the HCR ManorCare, Inc. ("HCRMC") direct financing lease ("DFL") investments and an equity investment in HCRMC. Following the completion of the Spin-Off on October 31, 2016, QCP is an independent, publicly-traded, self-managed and self-administrated REIT.

On October 17, 2016, subsidiaries of QCP issued \$750 million in aggregate principal amount of senior secured notes due 2023 (the "QCP Notes"), the gross proceeds of which were deposited in escrow until they were released in connection with the consummation of the Spin-Off on October 31, 2016. The QCP Notes bear interest at a rate of 8.125% per annum, payable semiannually. From October 17, 2016 until the completion of the Spin-Off, QCP (a then wholly owned subsidiary of HCP) incurred \$2 million in interest expense. In addition, immediately prior to the effectiveness of the Spin-Off, subsidiaries of QCP received \$1.0 billion of proceeds from their borrowings under a senior secured term loan, bearing interest at a rate at QCP's option of either: (i) LIBOR plus 5.25%, subject to a 1% floor or (ii) a base rate specified in the first lien credit and guaranty agreement plus 4.25%, bringing the total gross proceeds raised by QCP and its subsidiaries under those financings to \$1.75 billion. In connection with the consummation of the Spin-Off, QCP and its subsidiaries transferred \$1.69 billion in cash and approximately 94 million shares of QCP common stock to HCP and certain of its other subsidiaries, and HCP and its applicable subsidiaries transferred the assets comprising the QCP portfolio to QCP and its subsidiaries. HCP then distributed substantially all of the outstanding shares of QCP common stock to its stockholders, based on the distribution ratio of one share of QCP common stock for every five shares of HCP common stock held by HCP stockholders as of the October 24, 2016 record date for the distribution. The Company will record the distribution of the assets and liabilities of QCP from its consolidated balance sheet on a historical cost basis as a dividend from stockholders' equity, and no gain or loss will be recorded. The Company will use the \$1.69 billion proceeds of the cash distribution it received from QCP upon consummation of the Spin-Off to pay down certain of the Company's existing debt obligations.

Because QCP is presented as part of the Company's continuing operations as of September 30, 2016, the consolidated financial information presented herein includes QCP for all periods presented. Beginning in the fourth quarter of 2016, the historical financial results of QCP will be reflected in the Company's consolidated financial statements as discontinued operations for all periods presented.

The Company entered into a Separation and Distribution Agreement (the "Separation and Distribution Agreement") with QCP in connection with the Spin-Off. The Separation and Distribution Agreement divides and allocates the assets and liabilities of the Company prior to the Spin-Off between QCP and HCP, governs the rights and obligations of the parties regarding the Spin-Off, and contains other key provisions relating to the separation of QCP's business from HCP.

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In connection with the Spin-Off, the Company has entered into a Transition Services Agreement ("TSA") with QCP. Per the terms of the TSA, the Company has agreed to provide certain administrative and support services to QCP on a transitional basis for established fees. The TSA provides that QCP generally has the right to terminate a transition service upon thirty days notice to the Company. The TSA contains provisions under which the Company will, subject to certain limitations, be obligated to indemnify QCP for losses incurred by QCP resulting from the Company's breach of the TSA.

Following completion of the Spin-Off, which occurred on October 31, 2016, HCP is the sole lender to QCP of a \$100 million unsecured revolving credit facility maturing in 2018 (the "Unsecured Revolving Credit Facility"). Commitments under the Unsecured Revolving Credit Facility will automatically and permanently decrease each calendar month by an amount equal to 50% of QCP's and its restricted subsidiaries' retained cash flow for the prior calendar month. All borrowings under the Unsecured Revolving Credit Facility will be subject to the satisfaction of certain conditions, including (i) QCP's senior secured revolving credit facility being unavailable, (ii) the failure of HCRMC to pay rent and (iii) other customary conditions, including the absence of a default and the accuracy of representations and warranties. QCP may only draw on the Unsecured Revolving Credit Facility prior to the one-year anniversary of the completion of the Spin-Off. Borrowings under the Unsecured Revolving Credit Facility bear interest at a rate equal to LIBOR, subject to a 1.00% floor, plus an applicable margin of 6.25%. In addition to paying interest on outstanding principal under the Unsecured Revolving Credit Facility, QCP will be required to pay a facility fee equal to 0.50% per annum of the unused capacity under the Unsecured Revolving Credit Facility to HCP, payable quarterly.

NOTE 2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited 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 consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from management's estimates.

The consolidated financial statements include the accounts of HCP, Inc., its wholly-owned subsidiaries, joint ventures ("JVs") and 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 three and nine months ended September 30, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016. 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, 2015 included in the Company's Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission ("SEC").

Segment Reporting

The Company reports its consolidated financial statements in accordance with Accounting Standards Codification 280, Segment Reporting (“ASC 280”). The Company’s reportable segments, based on how it evaluates its business and allocates resources in accordance with ASC 280, are as follows: (i) SH NNN, (ii) SHOP, (iii) life science, (iv) medical office and (v) QCP.

Prior to the third quarter of 2016, the Company operated through five reportable segments: (i) senior housing, (ii) post-acute/skilled nursing, (iii) life science, (iv) medical office and (v) hospital. During the third quarter of 2016, primarily as a result of the planned spin-off of QCP, the Company revised its operating analysis structure. The Company believes the change to its reportable segments is appropriate and consistent with how its chief operating decision makers review the Company’s operating results and determine resource allocations. Accordingly, all prior period segment information has been reclassified to conform to the current period presentation.

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Recent Accounting Pronouncements

In October 2016, the Financial Accounting Standards Board (the “FASB”) issued Accounting Standards Update (“ASU”) No. 2016-16, Intra-Entity Transfers of Assets Other Than Inventory (“ASU 2016-16”). The amendments in ASU 2016-16 require an entity to recognize the income tax consequences of intra-entity transfers of assets other than inventory at the time that the transfer occurs. Current guidance does not require recognition of tax consequences until the asset is eventually sold to a third party. ASU 2016-16 is effective for fiscal years, and interim periods within, beginning after December 15, 2017. Early adoption is permitted as of the first interim period presented in a year. The Company is evaluating the impact of the adoption of ASU 2016-16 on January 1, 2018 to its consolidated financial position or results of operations.

In August 2016, the FASB issued ASU No. 2016-15, Classification of Certain Cash Receipts and Cash Payments (“ASU 2016-15”). The amendments in ASU 2016-15 are intended to clarify current guidance on the classification of certain cash receipts and cash payments in the statement of cash flows. ASU 2016-15 is effective for fiscal years, and interim periods within, beginning after December 15, 2017. Early adoption is permitted. The Company is evaluating the impact of the adoption of ASU 2016-15 on January 1, 2018 to its consolidated statements of cash flows.

In June 2016, the FASB issued ASU No. 2016-13, Measurement of Credit Losses on Financial Instruments (“ASU 2016-13”). ASU 2016-13 is intended to improve financial reporting by requiring timelier recognition of credit losses on loans and other financial instruments held by financial institutions and other organizations. ASU 2016-13 is effective for fiscal years, and interim periods within, beginning after December 15, 2019. Early adoption is permitted for fiscal years, and interim periods within, beginning after December 15, 2018. The Company is evaluating the impact of the adoption of ASU 2016-13 on January 1, 2020 to its consolidated financial position or results of operations.

In May 2016, the FASB issued ASU No. 2016-12, Narrow-Scope Improvements and Practical Expedients (“ASU 2016-12”). The amendments in ASU 2016-12 do not change the core principles of the guidance in the new revenue standard described in ASU No. 2014-09 below. The amendments in ASU 2016-12 provide practical expedients and improvements on the previously narrow scope of the standard. ASU 2016-12 is effective for fiscal years, and interim periods within, beginning after December 15, 2017. Early adoption is permitted at the original effective date of the new revenue standard (January 1, 2017). The Company is evaluating the impact of the adoption of ASU 2016-12 on January 1, 2018 to its consolidated financial position or results of operations.

In March 2016, the FASB issued ASU No. 2016-09, Improvements to Employee Share-Based Payment Accounting (“ASU 2016-09”). ASU 2016-09 is intended to simplify accounting for share-based payment transactions. The areas for simplification in this update involve several aspects of accounting for share-based payment transactions, including income tax consequences, classification of awards as either equity or liabilities and classification on the statements of cash flows. ASU 2016-09 is effective for fiscal years, and interim periods within, beginning after December 15, 2016. Early adoption is permitted. The Company is evaluating the impact of the adoption of ASU 2016-09 on January 1, 2017 to its consolidated financial position, results of operations or cash flows.

In March 2016, the FASB issued ASU No. 2016-08, Principal versus Agent Considerations (Reporting Revenue Gross versus Net) (“ASU 2016-08”). ASU 2016-08 is intended to improve the operability and understandability of the implementation guidance on principal versus agent considerations. ASU 2016-08 is effective for fiscal years, and interim periods within, beginning after December 15, 2017. Early adoption is permitted at the original effective date of the new revenue standard described in ASU No. 2014-09 below (January 1, 2017). The Company is evaluating the impact of the adoption of ASU 2016-08 on January 1, 2018 to its consolidated financial position or results of operations.

In February 2016, the FASB issued ASU No. 2016-02, Leases (“ASU 2016-02”). ASU 2016-02 amends the current accounting for leases to (i) require lessees to put most leases on their balance sheets, but continue recognizing expenses on their income statements in a manner similar to requirements under current accounting guidance, (ii) eliminate current real estate specific lease provisions and (iii) modify the classification criteria and accounting for sales-type leases for lessors. ASU 2016-02 is effective for fiscal years, and interim periods within, beginning after December 15, 2018. Early adoption is permitted. The Company is evaluating the impact of the adoption of ASU 2016-02 on January 1, 2019 to its consolidated financial position or results of operations.

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In January 2016, the FASB issued ASU No. 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities (“ASU 2016-01”). ASU 2016-01 requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. This update also simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment at each reporting period. ASU 2016-01 is effective for fiscal years, and interim periods within, beginning after December 15, 2017. Early adoption is permitted only for updates to certain disclosure requirements. The Company is evaluating the impact of the adoption of ASU 2016-01 on January 1, 2018 to its consolidated financial position or results of operations.

In September 2015, the FASB issued ASU No. 2015-16, Simplifying the Accounting for Measurement-Period Adjustments (“ASU 2015-16”). ASU 2015-16 simplifies the accounting for adjustments made to provisional amounts recognized in a business combination by requiring the acquirer to (i) recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amount is determined, (ii) record, in the same period, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date and (iii) present separately or disclose the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. ASU 2015-16 is effective for fiscal years, and interim periods within, beginning after December 15, 2015. Early adoption is permitted. The Company adopted ASU 2015-16 on January 1, 2016; the adoption of which did not have a material impact on its consolidated financial position or results of operations.

In February 2015, the FASB issued ASU No. 2015-02, Amendments to the Consolidation Analysis (“ASU 2015-02”). ASU 2015-02 requires amendments to both the VIE and voting consolidation accounting models. The amendments (i) rescind the indefinite deferral of certain aspects of accounting standards relating to consolidations and provide a permanent scope exception for registered money market funds and similar unregistered money market funds, (ii) modify (a) the identification of variable interests (fees paid to a decision maker or service provider), (b) the VIE characteristics for a limited partnership or similar entity and (c) the primary beneficiary determination under the VIE model and (iii) eliminate the presumption within the current voting model that a general partner controls a limited partnership or similar entity. ASU 2015-02 is effective for fiscal years, and interim periods within, beginning after December 15, 2015. Early adoption is permitted. A reporting entity may apply the amendments in ASU 2015-02 using either a modified retrospective or retrospective approach by recording a cumulative-effect adjustment to equity as of the beginning of the fiscal year of adoption. The Company adopted ASU 2015-02 on January 1, 2016; the adoption of which did not have a material impact to its consolidated financial position or results of operations (see Note 16).

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (“ASU 2014-09”). This update changes the requirements 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. In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date (“ASU 2015-14”). ASU 2015-14 defers the effective date of ASU 2014-09 by one year to fiscal years, and interim periods within, beginning after December 15, 2017. Early adoption is permitted for annual periods, and interim periods within, beginning after

December 15, 2016. A reporting entity may apply the amendments in ASU 2014-09 using either a modified retrospective or retrospective approach by recording a cumulative-effect adjustment to equity as of the beginning of the fiscal year of adoption. The Company is evaluating the impact of the adoption of ASU 2014-09 on January 1, 2018 to its consolidated financial position or results of operations.

Reclassifications

Certain amounts in the Company's consolidated financial statements have been reclassified for prior periods to conform to the current period presentation. Real estate and related assets held for sale, net and intangible liabilities related to assets held for sale, net have been reclassified on the consolidated balance sheets (see Note 4). See Segment Reporting above for additional reclassifications.

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NOTE 3. Real Estate Property Investments

2016 Acquisitions

The following table summarizes the Company's real estate acquisitions for the nine months ended September 30, 2016 (in thousands):

Segment	Consideration		Assets Acquired(1)	
	Cash Paid	Mortgage and Other Liabilities Assumed	Real Estate	Net Intangibles
SH NNN	\$ 76,362	\$ 1,200	\$ 71,875	\$ 5,687
SHOP	113,971	76,931	177,551	13,351
Life Science	49,000	—	47,400	1,600
Other	17,909	—	16,596	1,313
	\$ 257,242	\$ 78,131	\$ 313,422	\$ 21,951

(1) The purchase price allocations are preliminary and may be subject to change. Revenues and earnings since the acquisition dates, as well as the supplementary pro forma information, assuming these acquisitions occurred as of the beginning of the prior periods, were not material.

2015 Acquisitions

Acquisition of Private Pay Senior Housing Portfolio ("RIDEA III"). On June 30, 2015, the Company and Brookdale Senior Living, Inc. ("Brookdale") acquired a portfolio of 35 private pay senior housing communities from Chartwell Retirement Residences, including two leasehold interests, representing 5,025 units (reported within the Company's SHOP segment). The portfolio was acquired under a RIDEA structure which is permitted by the Housing and Economic Recovery Act of 2008 (commonly referred to as "RIDEA"), with Brookdale owning a 10% noncontrolling interest. Brookdale has operated these communities since 2011 and continues to manage the communities under a long-term management agreement, which is cancellable under certain conditions (subject to a fee if terminated within seven years from the acquisition date). The Company paid \$770 million in cash consideration, net of cash assumed, and assumed \$32 million of net liabilities and \$29 million of noncontrolling interests to acquire: (i) real estate with a fair value of \$776 million, (ii) lease-up intangible assets with a fair value of \$48 million and (iii) working capital of \$7 million. As a result of the acquisition, the Company recognized a net termination fee of \$8 million in rental and related revenues, which represents the termination value of the two leasehold interests. The lease-up intangible assets recognized were attributable to the value of the acquired underlying operating resident leases of the senior housing communities that were stabilized or nearly stabilized (i.e., resident occupancy above 80%).

Pro Forma Results of Operations. The following unaudited pro forma consolidated results of operations assume that the RIDEA III acquisition was completed as of January 1, 2014 (in thousands, except per share data):

	Nine Months Ended September 30, 2015
Revenues	\$ 1,963,402
Net income	56,009
Net income applicable to HCP, Inc.	46,662
Basic earnings per common share	0.10
Diluted earnings per common share	0.10

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2015 Other Acquisitions. The following table summarizes the Company's real estate acquisitions for the nine months ended September 30, 2015 (in thousands):

Segment	Consideration			Assets Acquired(1)	
	Cash Paid/ Debt Settled	Liabilities Assumed	Noncontrolling Interest	Real Estate	Intangibles
SH NNN	\$ 208	\$ —	\$ —	\$ 208	\$ —
SHOP	103,296	1,373	3,885	102,579	5,975
Medical office	377,351 (2)	12,849	—	349,649	40,551
Other	296,226 (3)	6,854	—	257,960	45,120
	\$ 777,081	\$ 21,076	\$ 3,885	\$ 710,396	\$ 91,646

- (1) Revenues and earnings since the acquisition dates, as well as the supplementary pro forma information, assuming these acquisitions occurred as of the beginning of the prior periods, were not material.
- (2) Includes \$225 million for a medical office building ("MOB") portfolio acquisition completed in June 2015 and placed in HCP Ventures V, of which, in October 2015, the Company issued a 49% noncontrolling interest for \$110 million (see Note 12).
- (3) Includes £174 million (\$254 million) of the Company's HC-One Facility (see Note 6) converted to fee ownership in a portfolio of 36 care homes located throughout the United Kingdom ("U.K.").

Construction, Tenant and Other Capital Improvements

The following table summarizes the Company's funding for construction, tenant and other capital improvements (in thousands):

Segment	Nine Months Ended September 30,	
	2016	2015
SH NNN	\$ 35,687	\$ 27,289
SHOP	55,795	49,351
Life science	152,739	80,871
Medical office	88,523	93,012
Other	6,840	3,406
	\$ 339,584	\$ 253,929

NOTE 4. Dispositions of Real Estate

Held for Sale

At September 30, 2016, eight life science facilities and two SHOP facilities were classified as held for sale, with an aggregate carrying value of \$373 million. At December 31, 2015, four life science facilities were classified as held for sale, with an aggregate carrying value of \$314 million.

2016 Dispositions

During the nine months ended September 30, 2016, the Company sold five post-acute/skilled nursing facilities and two SH NNN facilities for \$130 million, a life science facility for \$74 million, three medical office buildings for \$20 million and a SHOP facility for \$6 million and recognized total gain on sales of \$120 million.

2015 Dispositions

During the nine months ended September 30, 2015, the Company sold the following: (i) nine SH NNN facilities for \$60 million, resulting from Brookdale's exercise of its purchase option received as part of a transaction with Brookdale in 2014, (ii) a parcel of land in its life science segment for \$11 million and (iii) a MOB for \$400,000.

Pending Dispositions

In October 2016, the Company entered into definitive agreements to sell 64 assets, currently under triple-net leases with Brookdale, for \$1.125 billion to affiliates of Blackstone Real Estate Partners VIII L.P. The closing of this transaction is expected to occur in the first quarter of 2017 and remains subject to regulatory and third party approvals and other

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customary closing conditions. Additionally, in October 2016, the Company entered into definitive agreements for a multi-element transaction with Brookdale to: (i) sell or transition 25 assets currently triple-net leased to Brookdale, for which Brookdale will receive a \$10.5 million annualized rent reduction upon sale or transition, (ii) re-allocate annual rent of \$9.6 million from those 25 assets to the remaining Brookdale triple-net lease portfolio and (iii) transition eight triple-net leased assets into RIDEA structures. The closing of these transactions is expected to occur during the fourth quarter of 2016 and throughout 2017 and remain subject to regulatory and third party approvals and other customary closing conditions.

In July 2016, the Company entered into a definitive agreement to sell four life science facilities in Salt Lake City, Utah for \$76 million (classified as held for sale as of September 30, 2016). The transaction is expected to close in the first quarter of 2017.

In June 2016 and September 2016, the Company entered into a definitive agreement to sell two SHOP facilities out of RIDEA III for \$22 million (sold in October 2016) and \$13 million, respectively (both classified as held for sale as of September 30, 2016). The remaining SHOP facility is expected to close in the fourth quarter of 2016.

In May 2016, the Company entered into a master contribution agreement with Brookdale to contribute its ownership interest in RIDEA II to an unconsolidated JV owned by HCP and an investor group led by Columbia Pacific Advisors, LLC (“CPA”) (the “HCP/CPA JV”). The members have also agreed to recapitalize RIDEA II with an estimated \$630 million of debt, of which an estimated \$365 million will be provided by a third-party and an estimated \$265 million will be provided by HCP. In return, the Company will receive an estimated \$470 million in cash proceeds from the HCP/CPA JV and an estimated \$265 million in note receivables and retain an approximately 40% beneficial interest in RIDEA II (the note receivable and 40% beneficial interest are herein referred to as the “RIDEA II Investments”). The Company’s RIDEA II Investments will be recognized and accounted for as equity method investments. This transaction, upon completion, would result in the Company deconsolidating the net assets of RIDEA II because it will not direct the activities that most significantly impact the venture. The closing of these transactions is expected to occur in the fourth quarter of 2016 and remains subject to regulatory and third party approvals and other customary closing conditions.

In January 2016, the Company entered into a definitive agreement for purchase options that were exercised on eight life science facilities in South San Francisco, California, to be sold in two tranches for \$311 million (classified as held for sale as of September 30, 2016) and \$269 million, respectively. These transactions are expected to close in the fourth quarter of 2016 for the first tranche and in 2018 for the second tranche.

Subsequent Events

In October 2016, the Company sold seven SH NNN facilities for \$88 million. As part of the sale transaction the Company provided a \$10 million mezzanine loan with a five year term which accrues interest at 9%. Concurrently, the Company modified the in-place NNN master lease to transition the operations of the remaining three properties to

a new regional operator.

NOTE 5. Net Investment in Direct Financing Leases

Net investment in DFLs consisted of the following (dollars in thousands):

	September 30, 2016	December 31, 2015
Minimum lease payments receivable	\$ 25,799,416	\$ 26,283,392
Estimated residual values	3,934,795	3,900,679
Less unearned income	(23,056,770)	(23,462,022)
Net investment in direct financing leases before allowance	6,677,441	6,722,049
Allowance for DFL losses	(817,040)	(817,040)
Net investment in direct financing leases	\$ 5,860,401	\$ 5,905,009
Properties subject to direct financing leases	340	348

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HCR ManorCare, Inc.

The Company acquired 334 post-acute, skilled nursing and assisted living facilities in its 2011 transaction with HCRMC and entered into a triple-net Master Lease and Security Agreement (the “Master Lease”) with a subsidiary (“Lessee”) of HCRMC. The Master Lease, as amended by the “HCRMC Lease Amendment” described below, is referred to herein as the “Amended Master Lease.”

As part of the Company’s fourth quarter 2015 review process, including its internal rating evaluation, it assessed the collectibility of all contractual rent payments under the Amended Master Lease, as discussed below. The Company’s evaluation included, but was not limited to, consideration of: (i) the continued decline in HCRMC’s operating performance and fixed charge coverage ratio during the second half of 2015, with the most significant deterioration occurring during the fourth quarter, (ii) the reduced growth outlook for the post-acute/skilled nursing business and (iii) HCRMC’s 2015 audited financial statements. The Company determined that the timing and amounts owed under the Amended Master Lease were no longer reasonably assured and assigned an internal rating of “Watch List” as of December 31, 2015. Further, the Company placed the HCRMC DFL investments on nonaccrual status and began utilizing a cash basis method of accounting in accordance with its policies.

As a result of assigning an internal rating of “Watch List” to its HCRMC DFL investments during the quarterly review process, the Company further evaluated the carrying amount of its HCRMC DFL investments. As a result of the significant decline in HCRMC’s fixed charge coverage ratio in the fourth quarter of 2015, combined with a lower growth outlook for the post-acute/skilled nursing business, the Company determined that it was probable that its HCRMC DFL investments were impaired and the amount of the loss could be reasonably estimated. In the fourth quarter of 2015, the Company recorded an allowance for DFL losses (impairment charge) of \$817 million, reducing the carrying amount of its HCRMC DFL investments from \$6.0 billion to \$5.2 billion at December 31, 2015.

In December 2015, the Company reduced the carrying amount of its equity investment in HCRMC to zero and, beginning in January 2016, income is recognized only if cash distributions are received from HCRMC. As a result, the Company no longer recharacterizes (eliminates) its proportional ownership share of income from DFLs to equity income from unconsolidated JVs (see Note 7).

During the three months ended March 31, 2015, the Company and HCRMC agreed to market for sale the real estate and operations associated with 50 non-strategic facilities under the Master Lease. HCRMC will receive an annual rent reduction under the Master Lease based on 7.75% of the net sales proceeds received by HCP. During the year ended December 31, 2015, the Company completed sales of 22 non-strategic HCRMC facilities for \$219 million. During the nine months ended September 30, 2016, the Company sold an additional 11 facilities for \$62 million, bringing the total facilities sold through October 31, 2016 to 33. Of the 17 remaining non-strategic facilities, seven are expected to close by the end of 2016 and 10 are expected to be sold in the first quarter of 2017, for an aggregate amount of \$62 million.

On March 29, 2015, certain subsidiaries of the Company entered into an amendment to the Master Lease (the “HCRMC Lease Amendment”) effective April 1, 2015. The HCRMC Lease Amendment reduced initial annual rent by a net \$68 million from \$541 million to \$473 million. Commencing on April 1, 2016, the minimum rent escalation was reset to 3.0% for each lease year through the expiration of the initial term of each applicable pool of facilities. Prior to the HCRMC Lease Amendment, rent payments would have increased 3.5% on April 1, 2015 and 2016 and 3.0% annually thereafter. The initial term was extended five years to an average of 16 years, and the extension options’ aggregate terms remained the same.

As consideration for the rent reduction, the Company received a deferred rent obligation (“DRO”) from the Lessee equal to an aggregate amount of \$525 million, which was allocated into two tranches: (i) a Tranche A DRO of \$275 million and (ii) a Tranche B DRO of \$250 million. The Lessee made rental payments equal to 6.9% of the outstanding amount (representing \$19 million) for the initial lease year until the entire Tranche A DRO was paid in full in March 2016 in connection with the nine facility purchases discussed below. Commencing on April 1, 2016, until the Tranche B DRO is paid in full, the outstanding principal balance of the Tranche B DRO will be increased annually by (i) 3.0% initially, (ii) 4.0% commencing on April 1, 2019, (iii) 5.0% commencing on April 1, 2020, and (iv) 6.0% commencing on April 1, 2021 and annually for the remainder of its term. The DRO is due and payable on the earlier of (i) certain capital or liquidity events of HCRMC, including an initial public offering or sale, or (ii) March 31, 2029, which is not subject to any

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extensions. The HCRMC Lease Amendment also imposes certain restrictions on the Lessee and HCRMC until the DRO is paid in full, including with respect to the payment of dividends and the transfer of interest in HCRMC.

Additionally, HCRMC agreed to sell, and HCP agreed to purchase, nine post-acute facilities for an aggregate purchase price of \$275 million. Through December 31, 2015, HCRMC and HCP completed seven of the nine facility purchases for \$183 million. Through March 31, 2016, HCRMC and HCP completed the remaining two facility purchases for \$92 million, bringing the nine facility purchases to an aggregate \$275 million, the proceeds of which were used to settle the Tranche A DRO discussed above. Following the purchase of a facility, the Lessee leases such facility from the Company pursuant to the Amended Master Lease. The nine facilities initially contribute an aggregate of \$19 million of annual rent (subject to escalation) under the Amended Master Lease.

In March 2015, the Company recorded a net impairment charge of \$478 million related to its HCRMC DFL investments. The impairment charge reduced the carrying value of the HCRMC DFL investments from \$6.6 billion to \$6.1 billion, based on the present value of the future lease payments effective April 1, 2015 under the Amended Master Lease discounted at the original DFL investments' effective lease rate.

During the three months ended September 30, 2016 and 2015, the Company recognized DFL income of \$116 million and \$141 million, respectively, and received cash payments of \$116 million and \$118 million, respectively, from the HCRMC DFL investments. During the nine months ended September 30, 2016, the Company recognized DFL income of \$346 million and \$433 million, respectively, and received cash payments of \$346 million and \$367 million, respectively, from the HCRMC DFL investments. During the three and nine months ended September 30, 2015, the Company recognized a total of \$23 million and \$66 million, respectively, of net accretion related to its HCRMC DFL investments. No accretion related to its HCRMC DFL investments has been recognized in 2016 due to the Company utilizing a cash basis method of accounting beginning January 1, 2016. The carrying value of the HCRMC DFL investments was \$5.1 billion and \$5.2 billion at September 30, 2016 and December 31, 2015, respectively.

The Company acquired the HCRMC DFL investments in 2011 through an acquisition of a C-Corporation, which was subject to federal and state built-in gain tax of up to \$2 billion, if all the assets were sold within 10 years. At the time of acquisition, the Company intended to hold the assets for at least 10 years, at which time the assets would no longer be subject to the built-in gain tax.

In December 2015, the U.S. Federal Government passed legislation which permanently reduced the holding period, for federal tax purposes, to five years. The Company satisfied the five year holding period requirement in April 2016. In June 2016, the U.S. Department of the Treasury issued proposed regulations that would change the holding period back to 10 years, but effective only for conversion transactions after August 8, 2016. As currently proposed, these regulations will not impact the properties in the HCRMC DFL as the HCRMC conversion transaction occurred on April 7, 2011. However, certain states still require a 10-year holding period and, as such, the assets are still subject to state built-in gain tax.

During the nine months ended September 30, 2016, the Company determined that it may sell assets during the next five years and, therefore, recorded a deferred tax liability of \$47 million representing its estimated exposure to state built-in gain tax.

On April 20, 2015, the U.S. Department of Justice (“DOJ”) unsealed a previously filed complaint in the U.S. District Court for the Eastern District of Virginia against HCRMC and certain of its affiliates in three consolidated cases following a civil investigation arising out of three lawsuits filed by former employees of HCRMC under the qui tam provisions of the federal False Claims Act. The DOJ’s complaint in intervention is captioned United States of America, ex rel. Ribik, Carson, and Slough v. HCR ManorCare, Inc., ManorCare Inc., HCR ManorCare Services, LLC and Heartland Employment Services, LLC (Civil Action Numbers: 1:09cv13; 1:11cv1054; 1:14cv1228 (CMH/TCB)). The complaint alleges that HCRMC submitted claims to Medicare for therapy services that were not covered by the skilled nursing facility benefit, were not medically reasonable and necessary, and were not skilled in nature, and therefore not entitled to Medicare reimbursement. The DOJ is seeking treble damages (in an unspecified amount); civil penalties (in an unspecified amount); compensation for alleged unjust enrichment; recovery of certain payments the government made to HCRMC; and costs, pre-judgment interest, and expenses. In June 2016, the court approved the parties’ joint discovery plan, which provides for discovery to be completed by February 2017. The court has not yet issued a scheduling order setting forth dates for summary judgment

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motions, other pre-trial motions or a trial date. While this litigation is at an early stage and HCRMC has indicated that it believes the claims are unjust and it will vigorously defend against them, the ultimate outcome is uncertain and could, among other things, cause HCRMC to: (i) incur substantial additional time and costs to respond to and defend HCRMC's actions in the litigation with the DOJ and any other third-party payors, (ii) refund or adjust amounts previously paid for services under governmental programs and to change business operations going forward in a manner that negatively impacts future revenue, (iii) pay substantial fines and penalties and incur other administrative sanctions, including having to conduct future business operations pursuant to a corporate integrity agreement, which may be with the Office of Inspector General of the Department of Health and Human Services, (iv) lose the right to participate in the Medicare or Medicaid programs, and (v) suffer damage to HCRMC's reputation. In addition, any settlement in the DOJ litigation, with or without an admission of wrongdoing, may include a substantial monetary component that could have a material adverse effect on HCRMC's liquidity and financial condition.

See Notes 1, 7, 11 and 17 for additional discussion of HCRMC.

DFL Internal Ratings

The following table summarizes the Company's internal ratings for DFLs at September 30, 2016 (dollars in thousands):

Segment	Carrying Amount	Percentage of DFL Portfolio	Internal Ratings		
			Performing DFLs	Watch List DFLs	Workout DFLs
SH NNN	\$ 629,330	11	\$ 267,326	\$ 362,004	\$ —
QCP	5,107,180	87	—	5,107,180	—
Other	123,891	2	123,891	—	—
	\$ 5,860,401	100	\$ 391,217	\$ 5,469,184	\$ —

Beginning September 30, 2013, the Company placed a 14-property senior housing triple-net DFL (the "DFL Portfolio") on nonaccrual status and assigned an internal rating of "Watch List." The Company determined that the collection of all rental payments was and continues to be no longer reasonably assured; therefore, rental revenue from the DFL Portfolio is recognized when cash is received utilizing a cash basis method of accounting in accordance with its policies. During the three months ended September 30, 2016 and 2015, the Company recognized DFL income of \$4 million and \$3 million, respectively, and received cash payments of \$5 million from the DFL Portfolio. During the nine months ended September 30, 2016 and 2015, the Company recognized DFL income of \$11 million and \$12 million, respectively, and received cash payments of \$15 million and \$16 million, respectively, from the DFL Portfolio. The carrying value of the DFL Portfolio was \$362 million and \$366 million at September 30, 2016 and December 31, 2015, respectively.

NOTE 6. Loans Receivable

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

	September 30, 2016			December 31, 2015		
	Real Estate		Other Secured	Real Estate		Other Secured
	Secured	Secured		Secured	Secured	
Mezzanine(1) (2)	\$ —	\$ 622,671	\$ 622,671	\$ —	\$ 660,138	\$ 660,138
Other(3)	64,057	—	64,057	114,322	—	114,322
Unamortized discounts, fees and costs(1)	539	(4,273)	(3,734)	961	(6,678)	(5,717)
	\$ 64,596	\$ 618,398	\$ 682,994	\$ 115,283	\$ 653,460	\$ 768,743

- (1) At September 30, 2016, included £281 million (\$365 million) outstanding and £3 million (\$3 million) of associated unamortized discounts, fees and costs. At December 31, 2015, included £273 million (\$403 million) outstanding and £4 million (\$5 million) of associated unamortized discounts, fees and costs.
- (2) At September 30, 2016, the Company had £37 million (\$49 million) remaining under its commitments to fund development projects and capital expenditures under its U.K. development projects.
- (3) At September 30, 2016, the Company had \$0.5 million remaining of commitments to fund development projects and capital expenditures under its senior housing development loan program.

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Loans Receivable Internal Ratings

The following table summarizes the Company's internal ratings for loans receivable at September 30, 2016 (dollars in thousands):

Investment Type	Carrying Amount	Percentage of Loan Portfolio	Internal Ratings		
			Performing Loans	Watch List Loans	Workout Loans
Real estate secured	\$ 64,596	9	\$ 64,596	\$ —	\$ —
Other secured	618,398	91	362,041	256,357	—
	\$ 682,994	100	\$ 426,637	\$ 256,357	\$ —

Real Estate Secured Loans

Four Seasons Health Care. In December 2015, the Company purchased £28 million (\$42 million) of Four Seasons Health Care's ("Four Seasons") £40 million senior secured term loan. The loan is secured by, among other things, the real estate assets of Four Seasons, and represents the most senior debt tranche. The loan bears interest at a rate of LIBOR plus 6.0% per annum and matures in December 2017.

Other Secured Loans

HC-One Facility. In November 2014, the Company was the lead investor in the financing for Formation Capital and Safanad's acquisition of NHP, a company that, at closing, owned 273 nursing and residential care homes representing over 12,500 beds in the U.K. principally operated by HC-One. The Company provided a loan facility (the "HC-One Facility"), secured by substantially all of NHP's assets, totaling £395 million, with £363 million (\$574 million) drawn at closing and has a five-year term. In February 2015, the Company increased the HC-One Facility by £108 million (\$164 million) to £502 million (\$795 million), in conjunction with HC-One's acquisition of Meridian Healthcare. In April 2015, the Company converted £174 million of the HC-One Facility into a sale-leaseback transaction for 36 nursing and residential care homes located throughout the U.K. In September 2015, the Company amended and increased its commitment under the HC-One Facility by £11 million primarily for the funding of capital expenditures and a development project. As part of the amendments, the Company shortened the non-call period by 17 months and provided consent for (i) the paydown of £34 million from disposition proceeds without a prepayment premium and (ii) the spin-off of 36 properties into a separate JV. In return, the Company retained security over the spin-off properties for a period of two years. During the year ended December 31, 2015, the Company received paydowns of £34 million (\$52 million). At September 30, 2016, the HC-One Facility had an outstanding balance of \$362 million.

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. In May 2015, the Company increased and extended the mezzanine loan facility with Tandem to: (i) fund \$50 million (the "Third Tranche") and \$5 million (the "Fourth Tranche"), which proceeds were used to repay a portion of Tandem's existing senior and mortgage debt, respectively, (ii) extend its maturity to October 2018 and (iii) extend the prepayment penalty period to January 2017. The loans bear interest at fixed rates of 12%, 14%, 6% and

6% per annum for the First, Second, Third and Fourth Tranches, respectively.

Based on the recent decline in Tandem's operating performance, as of September 30, 2016, the Company assigned an internal rating of "Watch List" to its Tandem Health Care Loan. Although Tandem continues to remain current on its contractual obligations, the collection and timing of all future amounts owed is no longer reasonably assured. During the three months ended September 30, 2016 and 2015, the Company recognized interest income and received cash payments of \$8 million from Tandem. During the nine months ended September 30, 2016 and 2015, the Company recognized interest income of \$23 million and \$22 million, respectively, and received cash payments of \$23 million and \$21 million, respectively, from Tandem. At September 30, 2016, the facility had an outstanding balance of \$256 million at an 11.5% blended interest rate and was subordinate to \$377 million of senior mortgage debt.

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NOTE 7. Investments in and Advances to Unconsolidated Joint Ventures

The Company owns interests in the following entities that are accounted for under the equity method at September 30, 2016 (dollars in thousands):

Entity(1)	Segment	Carrying Amount	Ownership%
CCRC JV(2)	SHOP	\$ 450,188	49
HCRMC	QCP	—	9
MBK JV(3)	SHOP	39,876	50
HCP Ventures III, LLC	Medical office	9,492	30
HCP Ventures IV, LLC	Medical office	7,220	20
HCP Life Science(4)	Life science	68,251	50 – 63
Vintage Park Development JV	SHOP	8,088	85
MBK Development JV(3)	SHOP	2,464	50
Suburban Properties, LLC	Medical office	4,667	67
K&Y(5)	Other	1,324	80
Advances to unconsolidated JVs, net and other		527	
		\$ 592,097	

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- (1) These entities are not consolidated because the Company does not control, through voting rights or other means, the JVs.
- (2) Includes two unconsolidated JVs in a RIDEA structure (CCRC PropCo and CCRC OpCo).
- (3) Includes two unconsolidated JVs in a RIDEA structure.
- (4) Includes the following unconsolidated 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%).
- (5) Includes three unconsolidated JVs.

The following tables summarize combined financial information for the Company's equity method investments (in thousands):

	September 30, 2016	December 31, 2015
Real estate, net	\$ 4,434,643	\$ 4,470,249
Goodwill and other assets, net	4,945,250	4,935,343
Assets held for sale	67,817	94,866
Total assets	\$ 9,447,710	\$ 9,500,458
Capital lease obligations and mortgage debt	\$ 6,419,016	\$ 6,575,531
Accounts payable	1,314,659	1,111,350

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Liabilities and mortgage debt held for sale	1,593	6,318
Other partners' capital	1,078,758	1,163,501
HCP's capital(1)	633,684	643,758
Total liabilities and partners' capital	\$ 9,447,710	\$ 9,500,458

- (1) The combined basis difference of the Company's investments in these JVs of \$42 million, as of September 30, 2016, is attributable to goodwill, real estate, capital lease obligations, deferred tax assets and lease-related net intangibles.

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	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Total revenues	\$ 1,057,213	\$ 1,106,667	\$ 3,210,868	\$ 3,375,747
Income (loss) from discontinued operations	904	(1,794)	3,476	(15,696)
Net loss	(43,248)	(65,819)	(81,214)	(77,529)
HCP's share of earnings(1)	(2,053)	8,314		