

HEALTH CARE PROPERTY INVESTORS INC

Form 10-Q

October 30, 2006

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

**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, 2006.

**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 1-8895

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**HEALTH CARE PROPERTY INVESTORS, INC.**

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(Exact name of registrant as specified in its charter)

**Maryland**  
(State or other jurisdiction of  
incorporation of organization)

**33-0091377**  
(I.R.S. Employer  
Identification No.)

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

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

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

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

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 23, 2006, there were 164,808,806 shares of \$ 1.00 par value common stock outstanding.

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**HEALTH CARE PROPERTY INVESTORS, INC.**

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## HEALTH CARE PROPERTY INVESTORS, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

|   | September 30,<br>2006<br>(Unaudited) | December 31,<br>2005 |
|---|--------------------------------------|----------------------|
| <b>ASSETS</b>   |                                      |                      |
| Real estate:  |                                      |                      |
| Buildings and improvements  | \$ 3,754,173                         | \$ 3,365,869         |
| Developments in process   | 19,822                               | 22,286               |
| Land  | 361,391                              | 328,609              |
| Less accumulated depreciation and amortization  | 657,552                              | 573,767              |
| Net real estate   | 3,477,834                            | 3,142,997            |
| Loans receivable, net:  |                                      |                      |
| Joint venture partners  | 7,053                                | 7,006                |
| Others  | 138,258                              | 179,825              |
| Investments in and advances to unconsolidated joint ventures  | 49,757                               | 48,598               |
| Accounts receivable, net of allowance of \$1,188 and \$1,205, respectively  | 12,676                               | 13,313               |
| Cash and cash equivalents   | 645,363                              | 21,342               |
| Restricted cash   | 125,165                              | 2,270                |
| Intangibles, net  | 58,501                               | 38,804               |
| Real estate held for sale, net  | 27,964                               | 98,855               |
| Other assets, net   | 68,930                               | 44,255               |
| Total assets  | \$ 4,611,501                         | \$ 3,597,265         |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |                                      |                      |
| Bank line of credit   | \$                                   | \$ 258,600           |
| Senior unsecured notes  | 2,471,274                            | 1,462,250            |
| Mortgage debt   | 452,154                              | 236,096              |
| Accounts payable and accrued liabilities  | 89,371                               | 68,718               |
| Deferred revenue  | 31,372                               | 22,551               |
| Total liabilities   | 3,044,171                            | 2,048,215            |
| Minority interests:   |                                      |                      |
| Joint venture partners  | 24,848                               | 20,905               |
| Non-managing member unitholders   | 127,763                              | 128,379              |
| Total minority interests  | 152,611                              | 149,284              |
| Stockholders equity:  |                                      |                      |
| Preferred stock, \$1.00 par value: 50,000,000 shares authorized; 11,820,000 shares issued and outstanding, liquidation preference of \$25 per share | 285,173                              | 285,173              |
| Common stock, \$1.00 par value: 750,000,000 shares authorized; 137,560,108 and 136,193,764 shares issued and outstanding, respectively              | 137,560                              | 136,194              |
| Additional paid-in capital  | 1,478,990                            | 1,446,349            |
| Cumulative net income   | 1,697,419                            | 1,521,146            |
| Cumulative dividends  | (2,179,535)                          | (1,988,248)          |
| Accumulated other comprehensive loss  | (4,888)                              | (848)                |

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|  |    |           |    |           |
|--|----|-----------|----|-----------|
| Total stockholders' equity                 |    | 1,414,719 |    | 1,399,766 |
| Total liabilities and stockholders' equity | \$ | 4,611,501 | \$ | 3,597,265 |

See accompanying Notes to Condensed Consolidated Financial Statements.



## HEALTH CARE PROPERTY INVESTORS, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)

(Unaudited)

|   | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|---|-------------------------------------|------------|------------------------------------|------------|
|   | 2006                                | 2005       | 2006                               | 2005       |
| <b>Revenues and other income:</b>   |                                     |            |                                    |            |
| Rental revenues and other income  | \$ 130,952                          | \$ 111,948 | \$ 376,499                         | \$ 316,796 |
| Equity income (loss) from unconsolidated joint ventures                     | 1,044                               | (531)      | 7,580                              | (232)      |
| Interest and other income   | 7,601                               | 7,807      | 29,709                             | 18,998     |
|   | 139,597                             | 119,224    | 413,788                            | 335,562    |
| <b>Costs and expenses:</b>  |                                     |            |                                    |            |
| Interest  | 36,968                              | 28,262     | 102,701                            | 76,872     |
| Depreciation and amortization   | 32,237                              | 26,690     | 93,683                             | 75,697     |
| Operating   | 20,105                              | 13,373     | 56,786                             | 42,062     |
| General and administrative  | 8,280                               | 7,301      | 25,218                             | 23,413     |
| Impairments   |                                     |            | 3,087                              |            |
|   | 97,590                              | 75,626     | 281,475                            | 218,044    |
| <b>Income before minority interests</b>                                     | 42,007                              | 43,598     | 132,313                            | 117,518    |
| Minority interests  | (3,511)                             | (3,415)    | (11,458)                           | (9,593)    |
| <b>Income from continuing operations</b>                                    | 38,496                              | 40,183     | 120,855                            | 107,925    |
| <b>Discontinued operations:</b>   |                                     |            |                                    |            |
| Operating income  | 2,594                               | 4,585      | 10,441                             | 14,444     |
| Gain on sales of real estate, net of impairments                            | 35,728                              | 273        | 44,977                             | 9,177      |
|   | 38,322                              | 4,858      | 55,418                             | 23,621     |
| <b>Net income</b>   | 76,818                              | 45,041     | 176,273                            | 131,546    |
| Preferred stock dividends   | (5,282)                             | (5,282)    | (15,848)                           | (15,848)   |
| <b>Net income applicable to common shares</b>                               | \$ 71,536                           | \$ 39,759  | \$ 160,425                         | \$ 115,698 |
| <b>Basic earnings per common share:</b>                                     |                                     |            |                                    |            |
| Continuing operations   | \$ 0.24                             | \$ 0.26    | \$ 0.77                            | \$ 0.69    |
| Discontinued operations   | 0.28                                | 0.03       | 0.41                               | 0.17       |
| Net income applicable to common shares                                      | \$ 0.52                             | \$ 0.29    | \$ 1.18                            | \$ 0.86    |
| <b>Diluted earnings per common share:</b>                                   |                                     |            |                                    |            |
| Continuing operations   | \$ 0.24                             | \$ 0.26    | \$ 0.77                            | \$ 0.69    |
| Discontinued operations   | 0.28                                | 0.03       | 0.40                               | 0.17       |
| Net income applicable to common shares                                      | \$ 0.52                             | \$ 0.29    | \$ 1.17                            | \$ 0.86    |
| <b>Weighted average shares used to calculate earnings per common share:</b> |                                     |            |                                    |            |

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|         |         |         |         |         |
|---------|---------|---------|---------|---------|
| Basic   | 136,682 | 135,225 | 136,402 | 134,385 |
| Diluted | 143,538 | 136,135 | 139,195 | 135,291 |

See accompanying Notes to Condensed Consolidated Financial Statements.

## HEALTH CARE PROPERTY INVESTORS, INC.

## CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY

(In thousands)

(Unaudited)

|   | Preferred Stock |            | Common Stock |            | Additional<br>Paid-In<br>Capital | Cumulative   |                | Accumulated<br>Other<br>Comprehensive<br>Loss | Total        |
|---|-----------------|------------|--------------|------------|----------------------------------|--------------|----------------|---|--------------|
|   | Shares          | Amount     | Shares       | Amount     |                                  | Net Income   | Dividends      |   |              |
| December 31,<br>2005                        | 11,820          | \$ 285,173 | 136,194      | \$ 136,194 | \$ 1,446,349                     | \$ 1,521,146 | \$ (1,988,248) | \$ (848)                                      | \$ 1,399,766 |
| Exercise of stock<br>options                |                 |            | 360          | 360        | 5,926                            |              |                |   | 6,286        |
| Other issuances<br>of common<br>stock, net  |                 |            | 1,006        | 1,006      | 20,655                           |              |                |   | 21,661       |
| Net income                                  |                 |            |              |            |                                  | 176,273      |                |   | 176,273      |
| Preferred stock<br>dividends                |                 |            |              |            |                                  |              | (15,848)       |   | (15,848)     |
| Common stock<br>dividends                   |                 |            |              |            |                                  |              | (175,439)      |   | (175,439)    |
| Amortization of<br>deferred<br>compensation |                 |            |              |            | 6,060                            |              |                |   | 6,060        |
| Other<br>comprehensive<br>loss, net         |                 |            |              |            |                                  |              |                | (4,040)                                       | (4,040)      |
| September 30,<br>2006                       | 11,820          | \$ 285,173 | 137,560      | \$ 137,560 | \$ 1,478,990                     | \$ 1,697,419 | \$ (2,179,535) | \$ (4,888)                                    | \$ 1,414,719 |

See accompanying Notes to Condensed Consolidated Financial Statements.

## HEALTH CARE PROPERTY INVESTORS, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

|   | Nine Months Ended<br>September 30, |            |
|---|------------------------------------|------------|
|   | 2006                               | 2005       |
| <b>Cash flows from operating activities:</b>                                      |                                    |            |
| Net income  | \$ 176,273                         | \$ 131,546 |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                    |            |
| Depreciation and amortization of real estate and in-place lease intangibles:      |                                    |            |
| Continuing operations   | 93,683                             | 75,697     |
| Discontinued operations   | 2,142                              | 3,410      |
| Amortization of above and below market lease intangibles, net                     | (1,383)                            | (1,708)    |
| Stock-based compensation  | 6,060                              | 4,779      |
| Debt issuance costs amortization  | 2,746                              | 2,344      |
| Recovery of loan losses   |                                    | (56)       |
| Straight-line rents   | (7,436)                            | (4,651)    |
| Equity (income) loss from unconsolidated joint ventures                           | (7,580)                            | 232        |
| Distributions of earnings from unconsolidated joint ventures                      | 7,580                              |            |
| Minority interests  | 11,458                             | 9,593      |
| Gain on sales of securities, net  | (1,552)                            | (2,758)    |
| Impairments   | 4,711                              |            |
| Gain on sales of real estate, net   | (46,601)                           | (9,177)    |
| Changes in:   |                                    |            |
| Accounts receivable   | 637                                | 1,327      |
| Other assets  | (6,898)                            | (1,405)    |
| Accounts payable, accrued liabilities and deferred revenue                        | 20,653                             | 11,868     |
| Net cash provided by operating activities   | 254,493                            | 221,041    |
| <b>Cash flows from investing activities:</b>                                      |                                    |            |
| Acquisition and development of real estate  | (336,709)                          | (376,713)  |
| Lease commissions and tenant and capital improvements                             | (12,003)                           | (4,474)    |
| Net proceeds from sales of real estate  | 100,217                            | 46,328     |
| Distributions from unconsolidated joint ventures                                  | 161                                | 6,712      |
| Proceeds from the sale of securities  | 5,630                              | 2,858      |
| Purchase of securities  | (12,895)                           |            |
| Principal repayments on loans receivable  | 45,525                             | 12,589     |
| Investment in loans receivable  | (4,005)                            | (9,787)    |
| (Increase) decrease in restricted cash  | (122,895)                          | 2,288      |
| Net cash used in investing activities   | (336,974)                          | (320,199)  |
| <b>Cash flows from financing activities:</b>                                      |                                    |            |
| Repayments of bank lines of credit  | (258,600)                          | (130,100)  |
| Repayment of mortgage debt  | (20,399)                           | (15,295)   |
| Issuance of mortgage debt   | 161,874                            |            |
| Repayment of senior unsecured notes   | (135,000)                          | (22,500)   |
| Issuance of senior unsecured notes  | 1,142,877                          | 445,471    |
| Settlement of cash flow hedges  | (4,354)                            |            |

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|  |            |           |
|--|------------|-----------|
| Net proceeds from the issuance of common stock and exercise of options | 21,686     | 39,788    |
| Dividends paid on common and preferred stock                           | (191,287)  | (185,866) |
| Net distributions to minority interests                                | (10,295)   | (11,128)  |
| Net cash provided by financing activities                              | 706,502    | 120,370   |
| Net increase in cash and cash equivalents                              | 624,021    | 21,212    |
| Cash and cash equivalents, beginning of period                         | 21,342     | 16,962    |
| Cash and cash equivalents, end of period                               | \$ 645,363 | \$ 38,174 |

See accompanying Notes to Condensed Consolidated Financial Statements.

**HEALTH CARE PROPERTY INVESTORS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(1) Business**

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

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

*Basis of Presentation*

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ( GAAP ) for interim financial information and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, the unaudited condensed consolidated financial statements do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the nine months ended September 30, 2006, are not necessarily indicative of the results that may be expected for the year ending December 31, 2006. For further information, refer to the consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2005, filed with the Securities and Exchange Commission ( SEC ).

*Use of Estimates*

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

*Principles of Consolidation*

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

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

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

Investments in entities which the Company does not consolidate but for which the Company has the ability to exercise significant influence over operating and financial policies are reported under the equity method of accounting. Generally, under the equity method of accounting, the Company's share of the investee's earnings or losses is included in the Company's operating results.

### *Revenue Recognition*

Rental income from tenants is recognized in accordance with GAAP, including SEC Staff Accounting Bulletin No. 104, *Revenue Recognition* ( SAB 104 ). For leases with minimum scheduled rent increases, the Company recognizes income on a straight-line basis over the lease term when collectibility is reasonably assured. Recognizing rental income on a straight-line basis for leases results in recognized revenue exceeding amounts contractually due from tenants. Such cumulative excess amounts are included in other assets and were approximately \$27 million and \$18 million, net of allowances, at September 30, 2006 and December 31, 2005, respectively. In the event the Company determines that collectibility of straight-line rents is not reasonably assured, the Company limits future recognition to amounts contractually owed, and, where appropriate, the Company establishes an allowance for estimated losses. Certain leases provide for additional rents based upon a percentage of the facility's revenue in excess of specified base periods or other thresholds. Such revenue is deferred until the related thresholds are achieved.

The Company monitors the liquidity and creditworthiness of its tenants and borrowers on an ongoing basis. The evaluation considers industry and economic conditions, property performance, security deposits and guarantees, and other matters. The Company establishes provisions and maintains an allowance for estimated losses resulting from the possible inability of its tenants and borrowers to make payments sufficient to recover recognized assets. For straight-line rent amounts, the Company's assessment is based on income recoverable over the term of the lease. At September 30, 2006 and December 31, 2005, the Company had an allowance of \$26 million and \$22 million, respectively, included in other assets, as a result of the Company's determination that collectibility is not reasonably assured for certain straight-line rent amounts.

### *Loans Receivable*

Loans receivable are classified as held-to-maturity because the Company has the positive intent and ability to hold the securities to maturity. Held-to-maturity securities are stated at amortized cost. The Company recognizes interest income on loans, including the amortization of discounts and premiums, using the effective interest method.

### *Real Estate*

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

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

The Company records acquired above- and below-market leases at their fair value using a discount rate which reflects the risks associated with the leases acquired, equal to the difference between (i) the contractual amounts to be paid pursuant to each in-place lease and (ii) management's estimate of fair market lease rates for each corresponding in-place lease, measured over a period equal to the remaining term of the lease for above-market leases and the initial term plus the term for any below-market fixed rate renewal options for below-market leases. Other intangible



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assets acquired include amounts for in-place lease values that are based on the Company's evaluation of the specific characteristics of each tenant's lease. Factors to be considered include estimates of carrying costs during hypothetical expected lease-up periods, market conditions, and costs to execute similar leases. In estimating carrying costs, the Company includes real estate taxes, insurance and other operating expenses, and estimates of lost rentals at market rates during the expected lease-up periods, depending on local market conditions. In estimating costs to execute similar leases, the Company considers leasing commissions, legal and other related costs.

Real estate assets and related intangibles are periodically reviewed for potential impairment by comparing the carrying amount to the expected undiscounted future cash flows to be generated from the assets. If the sum of the expected future net undiscounted cash flows is less than the carrying amount of the property, the Company will recognize an impairment loss by adjusting the asset's carrying amount to its estimated fair value. Fair value for properties to be held and

used is based on the present value of the future cash flows expected to be generated from the asset. Properties held for sale are recorded at the lower of their carrying amount or fair value less costs to dispose.

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

The Company computes depreciation on properties using the straight-line method over the assets' estimated useful lives. Depreciation is discontinued when a property is identified as held for sale. Buildings and improvements are depreciated over useful lives ranging up to 45 years. Above- and below-market rent intangibles are amortized primarily to revenue over the remaining noncancellable lease terms and bargain renewal periods. Other in-place lease intangibles are amortized to expense over the remaining lease terms and bargain renewal periods. At September 30, 2006 and December 31, 2005, lease intangible assets, net were \$58.5 million and \$38.8 million, respectively. At September 30, 2006 and December 31, 2005, lease intangible liabilities, net were \$13.0 million and \$5.3 million, respectively, and are included in deferred revenue.

#### *Income Taxes*

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

Certain activities the Company undertakes must be conducted by entities which elect to be treated as taxable REIT subsidiaries (TRSs). TRSs are subject to both federal and state income taxes. The Company's income tax expense for the nine months ended September 30, 2006 and 2005 was insignificant.

#### *Discontinued Operations*

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

The Company periodically sells assets based on market conditions and the exercise of purchase options by tenants. The operating results of properties meeting the criteria established in SFAS No. 144 are reported as discontinued operations in the Company's consolidated statements of income. Discontinued operations for the three and nine months ended September 30, 2006, include 20 and 28 properties with revenues of \$3.2 million and \$12.6 million, respectively. The Company had 38 and 46 properties classified as discontinued operations for the three and nine

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months ended September 30, 2005, with revenues of \$5.7 and \$18.3 million, respectively. During the nine months ended September 30, 2006 and 2005, 12 properties were sold in each period, with net gains on real estate dispositions of \$46.6 million and \$9.2 million, respectively. At September 30, 2006 and December 31, 2005, the number of assets held for sale was 16 and 28 with carrying amounts of \$28.0 million and \$98.9 million, respectively, and are included in real estate held for sale, net on the Company's consolidated balance sheets.

### *Stock-Based Compensation*

On January 1, 2002, the Company adopted the fair value method of accounting for stock-based compensation in accordance with SFAS No. 123, *Accounting for Stock-Based Compensation* ( SFAS No. 123 ), as amended by SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure* ( SFAS No. 148 ). The fair value provisions of SFAS No. 123 were adopted prospectively with the fair value of all new stock option grants recognized as compensation expense beginning January 1, 2002. Since only new grants are accounted for under the fair value method, stock-based

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compensation expense is less than that which would have been recognized if the fair value method had been applied to all awards. Compensation expense for awards with graded vesting is generally recognized ratably over the period from the date of grant to the date when the award is no longer contingent on the employee providing additional services.

SFAS No. 123R, *Share-Based Payments* ( SFAS No. 123R ), which is a revision of SFAS No. 123, was issued in December 2004. Generally, the approach in SFAS No. 123R is similar to that in SFAS No. 123. However, SFAS No. 123R requires all share-based payments to employees, including grants of employee stock options, be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative. On January 1, 2006, the Company adopted SFAS No. 123R using the modified prospective application transition method which provides for only current and future period stock-based awards to be measured and recognized at fair value. The adoption of SFAS No. 123R did not have a significant impact on the Company's financial position or results of operations since the fair value provisions of SFAS No. 123 were adopted prospectively on January 1, 2002.

The following table reflects net income and earnings per share, adjusted as if the fair value based method had been applied to all outstanding stock awards (in thousands, except per share amounts):

|  | <b>Three Months<br/>Ended<br/>September 30,<br/>2005</b> | <b>Nine Months<br/>Ended<br/>September 30,<br/>2005</b> |
|--|--|---|
| Net income, as reported  | \$ 45,041  | \$ 131,546  |
| Add: Stock-based compensation expense included in reported net income                          | 1,581  | 4,779   |
| Deduct: Stock-based employee compensation expense determined under the fair value based method | (1,660)  | (5,018)   |
| Pro forma net income   | \$ 44,962  | \$ 131,307  |
| <b>Earnings per share:</b>   |  |   |
| Basic as reported  | \$ 0.29  | \$ 0.86   |
| Basic pro forma  | \$ 0.29  | \$ 0.86   |
| Diluted as reported  | \$ 0.29  | \$ 0.86   |
| Diluted pro forma  | \$ 0.29  | \$ 0.85   |

### *Cash and Cash Equivalents*

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

### *Restricted Cash*

Restricted cash generally consists of amounts held by mortgage lenders to provide for future real estate tax expenditures and tenant improvements and security deposits. On September 30, 2006, restricted cash included amounts deposited into escrow in connection with the redemption of \$120 million of the Company's senior unsecured notes due January 2007. The notes were redeemed on October 4, 2006.

*Derivatives*

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

other comprehensive income (loss) whereas the ineffective portion is recognized in earnings.

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

#### *Marketable Securities*

The Company classifies its existing marketable equity securities as available-for-sale in accordance with the provisions of SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities* ( SFAS No. 115 ). These securities are carried at market value, with unrealized gains and losses reported in stockholders' equity as a component of accumulated other comprehensive income (loss). Gains or losses on securities sold are based on the specific identification method. During the nine months ended September 30, 2006 and 2005, the Company received proceeds from the sale of securities for \$5.6 million and \$2.9 million and recognized gains of approximately \$1.6 million and \$2.8 million, respectively.

All debt securities are classified as held-to-maturity because the Company has the positive intent and ability to hold the securities to maturity. Held-to-maturity securities are stated at amortized cost, adjusted for amortization of premiums and accretion of discounts to maturity.

#### *Segment Reporting*

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

#### *New Accounting Pronouncements*

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections* ( SFAS No. 154 ), which replaces Accounting Principles Board Opinion No. 20, *Accounting Changes* and SFAS No. 3, *Reporting Accounting Changes in Interim Financial Statements*. SFAS No. 154 changes the requirements for the accounting for and reporting of a change in accounting principles. It requires retrospective application to prior periods' financial statements of changes in accounting principles, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. This statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The adoption of SFAS No. 154 did not have a significant impact on the Company's financial position or results of operations.

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In April 2006 the FASB issued FASB Staff Position FIN 46R-6, *Determining the Variability to Be Considered in Applying FASB Interpretation No. 46R* ( FSP FIN 46R-6 ). FSP FIN 46R-6 addresses how variability should be considered when applying FIN 46R. Variability affects the determination of whether an entity is a VIE, which interests are variable interests, and which party, if any, is the primary beneficiary of the VIE that is required to be consolidated. FSP FIN 46R-6 clarifies that the design of the entity also should be considered when identifying which interests are variable interests. FSP FIN 46R-6 must be applied prospectively to all entities in which the Company first becomes involved, beginning September 1, 2006. Early application is permitted. The Company does not expect that the adoption of FSP FIN 46R-6 will have a material effect on the Company's financial position or results of operations.

In July 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ( FIN 48 ). This interpretation, among other things, creates a two step approach for evaluating uncertain tax positions. Recognition (step one) occurs when an enterprise concludes that a tax position, based solely on its technical merits, is more-likely-than-not to be sustained upon examination. Measurement (step two) determines the amount of benefit that more-likely-than-not will be realized upon settlement. Derecognition of a tax position that was previously recognized would occur when a company

subsequently determines that a tax position no longer meets the more-likely-than-not threshold of being sustained. FIN 48 specifically prohibits the use of a valuation allowance as a substitute for derecognition of tax positions, and it has expanded disclosure requirements. FIN 48 is effective for fiscal years beginning after December 15, 2006, in which the impact of adoption should be accounted for as a cumulative effect adjustment to the beginning balance of retained earnings. The Company is evaluating FIN 48 and has not yet determined the impact the adoption will have on the Company's financial position or results of operations.

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

#### *Reclassifications*

Certain reclassifications have been made for comparative financial statement presentation.

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

On May 1, 2006, HCP entered into a definitive merger agreement with CNL Retirement Properties, Inc. (CRP). In connection with the proposed merger with CRP, HCP also entered into a definitive merger agreement with respect to CNL Retirement Corp. (CRC), the external advisor to CRP. On October 5, 2006, HCP closed its merger with CRP for aggregate consideration of approximately \$5.3 billion. In the merger, HCP paid an aggregate of \$2.9 billion of cash, issued 22.9 million shares of common stock, and assumed or refinanced approximately \$1.7 billion of CRP's outstanding debt. Simultaneously, with the closing of the merger with CRP, HCP also closed its merger with CRC for aggregate consideration of approximately \$120 million. In the CRC merger, HCP issued 4.4 million shares.

In connection with the CRP merger, HCP also obtained from a syndicate of banks a bridge loan, a term loan, and a revolving credit facility providing for aggregate borrowings of \$3.4 billion.

See Note 8 for additional information on the new bridge, term and revolving credit facilities.

### **(4) Operator Concentration**



Tenet Healthcare Corporation ( Tenet ) (NYSE: THC) and Brookdale Senior Living Inc. ( Brookdale ) (NYSE: BKD), or American Retirement Corporation (NYSE: ARC) prior to Brookdale's acquisition of ARC on July 25, 2006, accounted for 10% and 8%, respectively, of the Company's revenue during the nine months ended September 30, 2006, and accounted for 12% and 9% respectively, of the Company's revenue during the nine months ended September 30, 2005. The carrying amount of the Company's real estate assets leased to Tenet and Brookdale at September 30, 2006, was \$335.2 million and \$365.2 million, respectively.

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These companies are publicly traded and are subject to the informational filing requirements of the Securities and Exchange Act of 1934, as amended. Accordingly, each is required to file periodic reports on Form 10-K and Form 10-Q with the SEC.

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

### (5) Acquisitions and Dispositions

A summary of acquisitions through September 30, 2006, follows (in thousands):

| Acquisitions (1)            | Consideration |             |                 | DownREIT<br>Units (2) | Assets Acquired |                    |
|-----------------------------|---------------|-------------|-----------------|-----------------------|-----------------|--------------------|
|                             | Cash Paid     | Real Estate | Debt<br>Assumed |                       | Real Estate     | Net<br>Intangibles |
| Medical office buildings    | \$ 141,405    | \$          | \$ 11,928       | \$ 5,523              | \$ 147,478      | \$ 11,378          |
| Senior housing facilities   | 128,753       | 16,600      | 61,393          |                       | 202,070         | 4,676              |
| Hospitals                   | 17,410        |             |                 |                       | 17,037          | 373                |
| Other healthcare facilities | 31,072        |             |                 |                       | 28,308          | 2,764              |
|                             | \$ 318,640    | \$ 16,600   | \$ 73,321       | \$ 5,523              | \$ 394,893      | \$ 19,191          |

A summary of fiscal year 2005 acquisitions follows (in thousands):

| Acquisitions (1)          | Consideration |             |                 | DownREIT<br>Units (2) | Assets Acquired |                    |
|---------------------------|---------------|-------------|-----------------|-----------------------|-----------------|--------------------|
|                           | Cash Paid     | Real Estate | Debt<br>Assumed |                       | Real Estate     | Net<br>Intangibles |
| Medical office buildings  | \$ 96,863     | \$          | \$ 61,424       | \$ 10,967             | \$ 154,182      | \$ 15,072          |
| Senior housing facilities | 313,744       |             | 52,060          | 19,431                | 379,745         | 5,490              |
|                           | \$ 410,607    | \$          | \$ 113,484      | \$ 30,398             | \$ 533,927      | \$ 20,562          |

(1) Includes transaction costs, if any.

(2) Non-managing member LLC units.

During the nine months ended September 30, 2006, the Company acquired properties aggregating \$414.1 million, including the following significant acquisitions:

On July 28, 2006, the Company acquired two assisted living facilities, in exchange for three assisted living facilities valued at approximately \$20 million, and \$37 million in cash. The two acquired properties have an initial effective lease term of ten years, with two ten-year renewal options, and an initial contractual annual lease rate of 7.0% with escalators based on the properties' revenue growth. The acquired properties are included in a new master lease that contains six properties leased to the operator.

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On June 1, 2006, the Company acquired two senior housing properties for \$27 million, through a sale-leaseback transaction. These facilities have an initial lease term of fifteen years, with two ten-year renewal options. The initial annual lease rate is approximately 9.0% with annual escalators based on the Consumer Price Index ( CPI ) that have a floor of 2.75%.

On May 31, 2006, the Company acquired nine assisted living and independent living facilities for \$99 million, including assumed debt valued at \$61 million, through a sale-leaseback transaction. These facilities have an initial lease term of ten years, with two ten-year renewal options. The initial annual lease rate is approximately 8.0% with annual CPI-based escalators.

During the three months ended March 31, 2006, the Company acquired 13 medical office buildings for \$138 million, including DownREIT units valued at \$6 million, in related transactions. The 13 buildings, with 730,000 rentable square feet, have an initial yield of 7.3%.

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On February 24, 2006, the Company acquired two medical office buildings for approximately \$21 million including assumed debt valued at \$12 million. The two buildings, with 157,000 rentable square feet, have an initial yield of 8.0%.

On February 8, 2006, the Company acquired four laboratory, office and biotechnology manufacturing buildings located in San Diego, California for \$30 million. The initial yield on these buildings is 6.1%, with the stabilized yield expected to be 8.3%. The buildings include approximately 158,000 rentable square feet.

During the nine months ended September 30, 2006, the Company sold 12 properties for \$116.8 million and recognized gains of approximately \$46.6 million, which includes one building, sold on July 25, 2006, for \$73 million with a gain of approximately \$32 million.

See Note 17 for a discussion of acquisitions and dispositions subsequent to September 30, 2006.

### **(6) Investments in and Advances to Unconsolidated Joint Ventures**

#### *HCP Medical Office Portfolio, LLC*

On October 24, 2006, the Company entered into a definitive agreement to acquire the interest held by affiliate of General Electric Company ( GE ) in HCP Medical Office Portfolio, LLC ( HCP MOP ), for \$141 million. The closing of the transaction is subject to certain customary conditions. Upon the closing of this acquisition, expected to occur on or before November 30, 2006, HCP will be the sole owner of the venture and its fifty-nine medical office buildings ( MOB ) with approximately 4 million rentable square feet.

HCP MOP is a joint venture formed in June 2003 between the Company and GE. HCP MOP is engaged in the acquisition, development and operation of MOB properties. The Company has a 33% ownership interest therein and is the managing member. Activities of the joint venture requiring equity capital are generally funded on a transactional basis by the members in proportion to their ownership interests. Cash distributions are made to the members in proportion to their ownership interests until GE's cumulative return, as defined, exceeds specified thresholds. Thereafter, the Company will be entitled to an additional promoted interest. In addition, the joint venture agreement includes buy/sell provisions and imposes certain restrictions on the transfer of the Company's joint venture interests by the Company and GE to third parties.

The Company uses the equity method of accounting for its investment in HCP MOP because it exercises significant influence through voting rights and its position as managing member. However, the Company does not consolidate HCP MOP since it does not control, through voting rights or other means, the joint venture as GE has substantive participating decision-making rights and has the majority of the economic interest. The accounting policies of HCP MOP are the same as those described in the summary of significant accounting policies (see Note 2).

Summarized unaudited condensed financial information of HCP MOP is as follows (In thousands):

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| Balance Sheets                                 | September 30,<br>2006 | December 31,<br>2005 |
|--|-----------------------|----------------------|
| Real estate, at cost                           | \$ 398,920            | \$ 390,840           |
| Less accumulated depreciation and amortization | 30,006                | 21,342               |
| Net real estate                                | 368,914               | 369,498              |
| Real estate held for sale, net                 | 171                   | 78,811               |
| Other assets, net                              | 30,147                | 36,790               |
| Total assets                                   | \$ 399,232            | \$ 485,099           |
| Mortgage debt and notes payable                | \$ 262,840            | \$ 270,466           |
| Mortgage debt on assets held for sale          |                       | 58,232               |
| Other liabilities                              | 20,189                | 21,439               |
| GE's capital                                   | 77,856                | 90,424               |
| HCP's capital                                  | 38,347                | 44,538               |
| Total liabilities and members' capital         | \$ 399,232            | \$ 485,099           |

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| Statements of Operations (in thousands) | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30 |           |
|---|-------------------------------------|-----------|-----------------------------------|-----------|
|   | 2006                                | 2005      | 2006                              | 2005      |
| Revenues and other income               | \$ 19,514                           | \$ 17,524 | \$ 57,539                         | \$ 52,791 |
| Discontinued operations                 | 1,779                               | (859)     | 19,805                            | (726)     |
| Net income (loss)                       | 2,680                               | (1,540)   | 22,176                            | (1,655)   |
| HCP's equity income (loss)              | 1,072                               | (511)     | 7,495                             | (549)     |
| Fees earned by HCP                      | 663                                 | 775       | 2,630                             | 2,326     |
| Distributions received by HCP           | 8,313                               | 1,560     | 13,529                            | 4,942     |

The Company has not guaranteed any indebtedness or other obligations of HCP MOP. Generally, the Company may only be required to provide additional funding to HCP MOP under limited circumstances as specified in the related agreements. At September 30, 2006, investments in and advances to unconsolidated joint ventures include outstanding advances to HCP MOP of \$4.3 million.

In August and September 2005, ten medical office buildings owned by HCP MOP, principally in Louisiana and the surrounding area, sustained varying degrees of damage due to hurricanes Katrina and Rita. Four of the buildings have incurred substantial damage and are a total loss. For the years ended December 31, 2005 and 2004, the four buildings generated revenues for HCP MOP of \$0.9 million and \$1.4 million, respectively. As of December 31, 2005, the \$3.8 million carrying value of these four buildings was written off and an equal amount was recorded as a receivable for the expected insurance proceeds. At December 31, 2005, the remaining six buildings had resumed operations with repairs completed as of June 30, 2006. Revenues of HCP MOP for the six facilities were \$2.9 million and \$4.2 million for the nine months ended September 30, 2006 and 2005, respectively.

Repairs and other related expenditures for damages caused by hurricanes Katrina and Rita during the nine months ended September 30, 2006, were approximately \$2.1 million, and were added to the expected insurance receivable. The Company has property, business interruption and other related insurance coverage to mitigate the financial impact of these types of events; such coverage is subject to various limits and deductible provisions based on the terms of the policies. Any excess insurance recovery above the carrying value of the assets is expected to be recognized by HCP MOP as a gain at the time the claims are settled with the insurance carrier. For the nine months ended September 30, 2006, HCP MOP received \$6.3 million in proceeds from its insurance carriers, including \$1.2 million in excess of insurance receivable.

During the nine months ended September 30, 2006, HCP MOP sold 34 MOB's with 1.4 million of rentable square feet for \$100.7 million, net of transaction costs, and recognized aggregate gains of approximately \$19.7 million. In connection with these transactions, approximately \$64.9 million of HCP MOP's mortgage debt was either repaid or assumed by the purchasers.

*Other Unconsolidated Joint Ventures*

The Company owns interests in the following entities, which are accounted for on the equity method of accounting at September 30, 2006 (in thousands):

| Entity                               | Investment (1) | Ownership (2)(3) |
|--------------------------------------|----------------|------------------|
| Arborwood Living Center, LLC         | \$ 803         | 45%              |
| Edgewood Assisted Living Center, LLC | (432)          | 45%              |
| Greenleaf Living Center, LLC         | 424            | 45%              |

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|                                    |       |     |
|------------------------------------|-------|-----|
| Seminole Shores Living Center, LLC | (888) | 50% |
| Suburban Properties, LLC           | 5,690 | 66% |

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- (1) Represents the Company's investment in the identified unconsolidated joint venture. Negative investment amounts are included in accounts payable and accrued liabilities in the Company's consolidated balance sheet. See Note 2 regarding the Company's policy for accounting for joint venture interests.
- (2) The Company's ownership interest and economic interest are substantially the same.
- (3) The Company is not the general partner or managing member of any of the joint ventures.



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Summarized unaudited condensed combined financial information for the other unconsolidated joint ventures follows (in thousands):

| <b>Balance Sheets</b>                          | <b>September 30,<br/>2006</b> |               | <b>December 31,<br/>2005</b> |               |
|--|-------------------------------|---------------|------------------------------|---------------|
| Real estate, net                               | \$                            | 21,179        | \$                           | 14,708        |
| Other assets, net                              |                               | 2,099         |                              | 1,407         |
| <b>Total assets</b>                            | <b>\$</b>                     | <b>23,278</b> | <b>\$</b>                    | <b>16,115</b> |
| Notes payable                                  | \$                            | 25,367        | \$                           | 15,449        |
| Accounts payable                               |                               | 868           |                              | 55            |
| Other partners' capital                        |                               | (875)         |                              | 351           |
| HCP's capital                                  |                               | (2,082)       |                              | 260           |
| <b>Total liabilities and partners' capital</b> | <b>\$</b>                     | <b>23,278</b> | <b>\$</b>                    | <b>16,115</b> |

| <b>Statements of Operations</b> | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|---------------------------------|---|-------------|--|-------------|
|                                 | <b>2006</b>                                 | <b>2005</b> | <b>2006</b>                                | <b>2005</b> |
| Revenues and other income       | \$ 1,138                                    | \$ 814      | \$ 3,221                                   | \$ 4,365    |
| Net income (loss)               | \$ 70                                       | \$ 32       | \$ 287                                     | \$ 333      |
| HCP's equity income (loss)      | \$ (28)                                     | \$ (20)     | \$ 85                                      | \$ 317      |
| Distributions received          | \$ 248                                      | \$          | \$ 439                                     | \$ 359      |

As of September 30, 2006, the Company has guaranteed approximately \$7.2 million of a total of \$15.4 million of notes payable for four of these joint ventures.

**(7) Loans Receivable**

Loans receivable consist of the following (in thousands):

|                        | <b>September 30, 2006</b> |                  |                   | <b>December 31, 2005</b> |                  |                   |
|------------------------|---------------------------|------------------|-------------------|--------------------------|------------------|-------------------|
|                        | <b>Secured</b>            | <b>Unsecured</b> | <b>Total</b>      | <b>Secured</b>           | <b>Unsecured</b> | <b>Total</b>      |
| Joint venture partners | \$                        | \$ 7,053         | \$ 7,053          | \$                       | \$ 7,006         | \$ 7,006          |
| Others                 | 138,026                   | 1,296            | 139,322           | 175,426                  | 6,663            | 182,089           |
| Loan loss allowance    |                           | (1,064)          | (1,064)           |                          | (2,264)          | (2,264)           |
|                        | <b>\$ 138,026</b>         | <b>\$ 7,285</b>  | <b>\$ 145,311</b> | <b>\$ 175,426</b>        | <b>\$ 11,405</b> | <b>\$ 186,831</b> |

On February 9, 2006, the Company refinanced two existing loans secured by a hospital in Texas. The loans were combined into a new single loan that carries an interest rate of 8.5% per annum and matures in 2016. The original loans matured in January 2006 and had a weighted average interest rate of 10.35%.

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On March 14, 2006, the Company received \$38 million in proceeds, including \$7.3 million in excess of the carrying value, upon the early repayment of a secured loan receivable due May 1, 2010. The amount received in excess of the carrying value of the secured loan receivable was recorded as interest income and is included in interest and other income in the Company's condensed consolidated statements of income for the nine months ended September 30, 2006. This loan was secured by nine skilled nursing facilities and carried an interest rate of 11.4% per annum.

**(8) Debt**

*Bank lines of credit.* As of September 30, 2006, all amounts outstanding under the Company's \$500 million, three-year line of credit facility were repaid. In connection with the completion of the CRP merger, on October 5, 2006, the Company terminated its \$500 million line of credit facility and closed on new bridge, term and revolving credit facilities providing for aggregate borrowings of up to \$3.4 billion with a syndicate of banks. In connection with the termination of the Company's previous line of credit facility, \$1.2 million of unamortized deferred financing costs as of September 30, 2006, were written-off in October 2006.

The Company's \$1.0 billion new revolving line of credit matures on October 2, 2009, and accrues interest at a rate per annum equal to LIBOR plus a margin ranging from 0.475% to 1.10%, depending upon the Company's non-credit enhanced senior unsecured long-term debt ratings (debt ratings). The Company pays a facility fee on the entire revolving commitment ranging from 0.125% to 0.25%, depending upon its debt ratings. The revolving credit facility contains a negotiated rate option, whereby the lenders participating in the credit facility bid on the interest to be charged and which may result in a reduced interest rate, is available for up to 50% of borrowings. In addition, the revolving credit facility contains an accordion feature allowing borrowings to be increased by \$100 million under certain conditions. Based on the Company's debt ratings on October 27, 2006 the margin on the revolving loan facility is 0.70% and the facility fee is 0.15%.

The Company's bridge loan facility for \$705.7 million matures on October 3, 2007, and accrues interest at a rate per annum equal to LIBOR plus a margin ranging from 0.60% to 1.10%, depending upon the Company's debt ratings. Based on the Company's debt ratings on October 27, 2006, the margin on the bridge loan facility is 0.85%.

The Company's term loan facility for \$1.7 billion matures on October 3, 2008, and accrues interest at a rate per annum equal to LIBOR plus a margin ranging from 0.60% to 1.10%, depending upon the Company's debt ratings. Based on the Company's debt ratings on October 27, 2006, the margin on the term loan facility is 0.85%.

The Company's bridge, term and revolving credit agreements contain certain financial restrictions and other customary requirements. Among other things, these covenants, using terms defined in the agreement, initially limit (i) Consolidated Total Indebtedness to Consolidated Total Asset Value to 70%, (ii) Secured Debt to Consolidated Total Asset Value to 30% and (iii) beginning January 1, 2007, Unsecured Debt to Consolidated Unencumbered Asset Value to 100%. The agreement also requires that the Company maintain (i) a Fixed Charge Coverage ratio, as defined, of 1.50 times and (ii) a formula-determined Minimum Tangible Net Worth. These financial covenants become more restrictive over a period of approximately two years and (i) limit Consolidated Total Indebtedness to Consolidated Total Asset Value to 60%, (ii) limit Unsecured Debt to Consolidated Unencumbered Asset Value to 65%, and (iii) require a Fixed Charge Coverage ratio, as defined, of 1.75 times.

In addition, the bridge and term loan facilities impose certain mandatory prepayments with the proceeds from asset sales, capital market transactions, and contributions to joint ventures. As of September 30, 2006, the Company was in compliance with each of these restrictions and requirements of its existing revolving credit facility.

*Senior unsecured notes.* At September 30, 2006, the Company had \$2.5 billion in aggregate principal of senior unsecured notes outstanding. Interest rates on the notes ranged from 4.88% to 7.62% with a weighted average effective rate of 6.06% at September 30, 2006. Discounts and premiums are amortized to interest expense over the term of the related

debt.

On September 19, 2006, the Company issued \$1 billion of senior unsecured notes, which consisted of \$300 million of floating rate notes due 2008, \$300 million of 5.95% notes due 2011, and \$400 million of 6.30% notes due 2016. The notes were priced at 100.00% of the principal amount for the floating rate notes due 2008, 99.971% of the principal amount for an effective yield of 5.957% for the 5.95% notes due 2011, and 99.877% of the principal amount for an effective yield of 6.317% for the 6.30% notes due 2016. The Company received net proceeds of \$994 million, which together with cash on hand and borrowings under the new credit facilities were used to repay the Company's previous line of credit facility and finance the CRP merger.

On February 27, 2006, the Company issued \$150 million of 5.625% senior unsecured notes due 2013. The notes were priced at 99.071% of the principal amount for an effective yield of 5.788%. The Company received net proceeds of \$149 million, which were used to repay outstanding indebtedness and for other general corporate purposes.

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In February 2006, the Company repaid \$135 million of maturing senior unsecured notes which accrued interest at a weighted average rate of 6.7%. These notes were repaid with funds available under the Company's bank lines of credit.

On October 4, 2006, the Company repaid \$120 million of senior unsecured notes which accrue interest at a rate of 7.5%. These notes were repaid with funds available under a deposit held in escrow, which was classified as restricted cash at September 30, 2006.

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

*Mortgage debt.* At September 30, 2006, the Company had \$452.2 million in mortgage debt secured by 70 healthcare facilities with a carrying amount of \$748.1 million. Interest rates on the mortgage notes ranged from 3.75% to 9.32% with a weighted average effective rate of 6.44% at September 30, 2006.

During the nine months ended September 30, 2006, the Company obtained \$165 million of ten-year mortgage financing with a weighted average effective rate of 6.36% in four separate transactions. The Company received net proceeds of \$161.9 million, which were used to repay outstanding indebtedness and for other general corporate purposes.

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

### **(9) Stockholders' Equity**

#### *Common Stock*

During the nine months ended September 30, 2006 and 2005, the Company issued 596,000 and 674,000 shares, respectively, of common stock under its Dividend Reinvestment and Stock Purchase Plan. The Company issued 360,000 and 1,424,000 shares upon exercise of stock options during the nine months ended September 30, 2006 and 2005, respectively.

During the nine months ended September 30, 2006 and 2005, the Company issued 102,000 and 119,000 shares of restricted stock, respectively, under the Company's 2000 Stock Incentive Plan (the "Incentive Plan"). The Company also issued 121,000 and 2,800 shares upon the vesting of performance restricted stock units during the nine months ended September 30, 2006 and 2005, respectively.

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On July 27, 2006, the Company announced that its Board of Directors declared a quarterly cash dividend of \$0.425 per share of common stock. The common stock cash dividend was paid on August 18, 2006 to stockholders of record as of the close of business on August 7, 2006.

On October 5, 2006, the Company issued an aggregate of 27.3 million shares of common stock in connection with the CRP and CRC mergers.

On October 26, 2006, the Company announced that its Board of Directors declared a quarterly cash dividend of \$0.425 per share of common stock. The common stock cash dividend will be paid on November 21, 2006 to stockholders of record as of the close of business on November 3, 2006.

### *Preferred Stock*

On July 27, 2006, the Company announced that its Board of Directors declared a quarterly cash dividend of \$0.45313 per share on its Series E cumulative redeemable preferred stock and \$0.44375 per share on its Series F cumulative redeemable preferred stock. These dividends were paid on September 30, 2006 to stockholders of record as of the close of business on September 15, 2006.

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On October 26, 2006, the Company announced that its Board of Directors declared a quarterly cash dividend of \$0.45313 per share on its Series E cumulative redeemable preferred stock and \$0.44375 per share on its Series F cumulative redeemable preferred stock. These dividends will be paid on December 29, 2006 to stockholders of record as of the close of business on December 15, 2006.

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

|   | September 30,<br>2006 | December 31,<br>2005 |
|---|-----------------------|----------------------|
|   | (in thousands)        |                      |
| AOCI-unrealized gains on securities available for sale            | \$ 1,573              | \$ 1,080             |
| AOCI-unrealized gains (losses) on cash flow hedges                | (4,221)               | 388                  |
| Supplemental Executive Retirement Plan ( SERP ) minimum liability | (2,240)               | (2,316)              |
|   | \$ (4,888)            | \$ (848)             |

Other comprehensive income and loss amounts are additions to and reductions of net income, respectively, in calculating comprehensive income. Comprehensive income for the nine months ended September 30, 2006 and 2005 was \$172.2 million and \$131.9 million, respectively.

### **(10) Impairments**

During the nine months ended September 30, 2006, three properties were deemed impaired resulting in impairment charges of \$4.7 million. Impairment charges principally arose as a result of the disposition of two properties and a decrease in expected cash flows from a third property. During the three months ended September 30, 2006 and 2005 and the nine months ended September 30, 2005, no properties were determined to be impaired.

### **(11) Segment Disclosures**

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

Non-segment revenue consists mainly of interest on unsecured loans and fee income. Non-segment assets consist of corporate assets including cash, restricted cash, accounts receivable, and deferred financing costs. Interest expense, depreciation and amortization, and other non-property specific revenues and expenses are not allocated to individual segments in measuring each segment's performance.





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

For the three months ended September 30, 2006:

| Segments                              | Rental Revenues | Equity Income (Loss) from Unconsolidated Joint Ventures | Interest and Other Income | Total Revenues | NOI(1)     |
|---------------------------------------|-----------------|---|---------------------------|----------------|------------|
| Triple-net leased facilities:         |                 |   |                           |                |            |
| Senior housing facilities             | \$ 38,746       | \$ (28)   | \$ 454                    | \$ 39,172      | \$ 35,535  |
| Hospitals                             | 23,431          |   | 2,214                     | 25,645         | 23,431     |
| Skilled nursing facilities            | 20,101          |   | 591                       | 20,692         | 20,043     |
| Other healthcare facilities           | 6,959           |   |                           | 6,959          | 5,681      |
| Total triple-net leased facilities    | 89,237          | (28)  | 3,259                     | 92,468         | 84,690     |
| Medical office buildings              | 41,715          | 1,072   |                           | 42,787         | 26,157     |
| Non-segment revenues and other income |                 |   | 4,342                     | 4,342          |            |
| Total                                 | \$ 130,952      | \$ 1,044  | \$ 7,601                  | \$ 139,597     | \$ 110,847 |

For the three months ended September 30, 2005:

| Segments                              | Rental Revenues | Equity Income (Loss) from Unconsolidated Joint Ventures | Interest and Other Income | Total Revenues | NOI(1)    |
|---------------------------------------|-----------------|---|---------------------------|----------------|-----------|
| Triple-net leased facilities:         |                 |   |                           |                |           |
| Senior housing facilities             | \$ 30,886       | \$ (20)   | \$ (156)                  | \$ 30,710      | \$ 28,509 |
| Hospitals                             | 23,642          |   | 1,508                     | 25,150         | 23,642    |
| Skilled nursing facilities            | 19,411          |   | 1,466                     | 20,877         | 19,408    |
| Other healthcare facilities           | 6,232           |   |                           | 6,232          | 5,100     |
| Total triple-net leased facilities    | 80,171          | (20)  | 2,818                     | 82,969         | 76,659    |
| Medical office buildings              | 31,777          | (511)   |                           | 31,266         | 21,916    |
| Non-segment revenues and other income |                 |   | 4,989                     | 4,989          |           |
| Total                                 | \$ 111,948      | \$ (531)  | \$ 7,807                  | \$ 119,224     | \$ 98,575 |

For the nine months ended September 30, 2006:

| Segments                           | Rental Revenues | Equity Income from Unconsolidated Joint Ventures | Interest and Other Income | Total Revenues | NOI(1)    |
|------------------------------------|-----------------|--|---------------------------|----------------|-----------|
| Triple-net leased facilities:      |                 |  |                           |                |           |
| Senior housing facilities          | \$ 107,363      | \$ 85  | \$ 1,937                  | \$ 109,385     | \$ 98,628 |
| Hospitals                          | 67,828          |  | 6,751                     | 74,579         | 67,828    |
| Skilled nursing facilities         | 60,008          |  | 9,659                     | 69,667         | 59,839    |
| Other healthcare facilities        | 20,376          |  |                           | 20,376         | 16,595    |
| Total triple-net leased facilities | 255,575         | 85   | 18,347                    | 274,007        | 242,890   |

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|                                       |            |    |       |    |         |    |                    |
|---------------------------------------|------------|----|-------|----|---------|----|--------------------|
| Medical office buildings              | 120,924    |    | 7,495 |    | 128,419 |    | 76,823             |
| Non-segment revenues and other income |            |    |       |    | 11,362  |    | 11,362             |
| Total                                 | \$ 376,499 | \$ | 7,580 | \$ | 29,709  | \$ | 413,788 \$ 319,713 |

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For the nine months ended September 30, 2005:

| Segments                              | Rental Revenues   | Equity Income (Loss) from Unconsolidated Joint Ventures | Interest and Other Income | Total Revenues    | NOI(1)            |
|---------------------------------------|-------------------|---|---------------------------|-------------------|-------------------|
| Triple-net leased facilities:         |                   |   |                           |                   |                   |
| Senior housing facilities             | \$ 79,458         | \$ 317  | \$ 1,316                  | \$ 81,091         | \$ 73,126         |
| Hospitals                             | 67,574            |   | 4,544                     | 72,118            | 67,574            |
| Skilled nursing facilities            | 58,113            |   | 4,461                     | 62,574            | 58,303            |
| Other healthcare facilities           | 18,905            |   |                           | 18,905            | 15,278            |
| Total triple-net leased facilities    | 224,050           | 317   | 10,321                    | 234,688           | 214,281           |
| Medical office buildings              | 92,746            | (549)   |                           | 92,197            | 60,453            |
| Non-segment revenues and other income |                   |   | 8,677                     | 8,677             |                   |
| <b>Total</b>                          | <b>\$ 316,796</b> | <b>\$ (232)</b>   | <b>\$ 18,998</b>          | <b>\$ 335,562</b> | <b>\$ 274,734</b> |

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

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

|   | Three Months Ended September 30, |                  | Nine Months Ended September 30, |                   |
|---|----------------------------------|------------------|---------------------------------|-------------------|
|   | 2006                             | 2005             | 2006                            | 2005              |
| <b>Net operating income from continuing operations</b>  | \$ 110,847                       | \$ 98,575        | \$ 319,713                      | \$ 274,734        |
| Equity (income) loss from unconsolidated joint ventures | 1,044                            | (531)            | 7,580                           | (232)             |
| Interest and other income                               | 7,601                            | 7,807            | 29,709                          | 18,998            |
| Interest expense  | (36,968)                         | (28,262)         | (102,701)                       | (76,872)          |
| Depreciation and amortization                           | (32,237)                         | (26,690)         | (93,683)                        | (75,697)          |
| General and administrative                              | (8,280)                          | (7,301)          | (25,218)                        | (23,413)          |
| Impairments   |                                  |                  | (3,087)                         |                   |
| Minority interests                                      | (3,511)                          | (3,415)          | (11,458)                        | (9,593)           |
| Discontinued operations                                 | 38,322                           | 4,858            | 55,418                          | 23,621            |
| <b>Net income</b>                                       | <b>\$ 76,818</b>                 | <b>\$ 45,041</b> | <b>\$ 176,273</b>               | <b>\$ 131,546</b> |

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

| Segments                                       | September 30,<br>2006 | December 31,<br>2005 |
|--|-----------------------|----------------------|
| Triple-net leased facilities:                  |                       |                      |
| Senior housing facilities                      | \$ 1,495,025          | \$ 1,318,245         |
| Hospitals                                      | 827,377               | 809,930              |
| Skilled nursing facilities                     | 618,922               | 701,687              |
| Other healthcare facilities                    | 233,618               | 243,166              |
| Total triple-net leased assets                 | \$ 3,174,942          | \$ 3,073,028         |
| Medical office building facilities             | 1,219,315             | 1,034,651            |
| Gross segment assets                           | 4,394,257             | 4,107,679            |
| Less accumulated depreciation and amortization | 703,106               | 619,673              |
| Net segment assets                             | 3,691,151             | 3,488,006            |
| Non-segment assets                             | 920,350               | 109,259              |
| Total assets                                   | \$ 4,611,501          | \$ 3,597,265         |

**(12) Supplemental Cash Flow***Supplemental Cash Flow Information*

|  | Nine Months Ended September 30, |           |
|--|---------------------------------|-----------|
|  | 2006                            | 2005      |
|  | (in thousands)                  |           |
| Interest paid, net of capitalized interest and other                     | \$ 98,364                       | \$ 68,383 |
| Taxes paid   | 13                              | 106       |
| Capitalized interest   | 588                             | 482       |
| Mortgages assumed with real estate acquisitions                          | 73,321                          | 88,520    |
| Loans received upon the sale of unconsolidated joint venture investments |                                 | 6,228     |
| Real estate exchanged in real estate acquisitions                        | 16,600                          |           |
| Non-managing member units issued in connection with acquisitions         | 5,523                           | 19,431    |
| Restricted stock issued  | 102                             | 119       |
| Performance restricted stock units vesting                               | 117                             | 3         |
| Restricted stock cancellations   | (60)                            | (20)      |
| Conversion of non-managing member units into common stock                | 274                             | 385       |

**(13) Earnings Per Share of Common Stock**

The Company computes earnings per share in accordance with SFAS No. 128, *Earnings Per Share*. Basic earnings per common share is computed by dividing net income applicable to common shares by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per common share is calculated including the effect of dilutive securities. Approximately 0.9 million options to purchase shares of common stock during the three and nine months ended September 30, 2005 were not included because they are not dilutive. Additionally, 5.7 million shares issuable upon conversion of 3.2 million non-managing member units during the three months ended September 30, 2005, were not included because they are not dilutive. No options to purchase shares of common stock or shares issuable upon conversion of non-managing member units were anti-dilutive during the three and nine months ended September 30, 2006.

|  | Income           | Three Months Ended September 30,         |                | Income           | 2005<br>Shares | Per Share      |
|--|------------------|--|----------------|------------------|----------------|----------------|
|  |                  | 2006<br>Shares                           | Per Share      |                  |                |                |
|  |                  | (in thousands, except per share amounts) |                |                  |                |                |
| <b>Basic earnings per common share:</b>        |                  |  |                |                  |                |                |
| Net income applicable to common shares         | \$ 71,536        | 136,682                                  | \$ 0.52        | \$ 39,759        | 135,225        | \$ 0.29        |
| Dilutive convertible non-managing member units | 2,533            | 5,960                                    |                |                  |                |                |
| Dilutive options and unvested restricted stock |                  | 896                                      |                |                  | 910            |                |
| <b>Diluted earnings per common share</b>       | <b>\$ 74,069</b> | <b>143,538</b>                           | <b>\$ 0.52</b> | <b>\$ 39,759</b> | <b>136,135</b> | <b>\$ 0.29</b> |

|   | Income     | Nine Months Ended September 30,          |           | Income     | 2005<br>Shares | Per Share |
|---|------------|--|-----------|------------|----------------|-----------|
|   |            | 2006<br>Shares                           | Per Share |            |                |           |
|   |            | (in thousands, except per share amounts) |           |            |                |           |
| <b>Basic earnings per common share:</b> |            |  |           |            |                |           |
| Net income applicable to common shares  | \$ 160,425 | 136,402                                  | \$ 1.18   | \$ 115,698 | 134,385        | \$ 0.86   |

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|  |            |         |         |            |         |         |  |
|--|------------|---------|---------|------------|---------|---------|--|
| Dilutive convertible non-managing member units | 2,533      | 1,986   |         |            |         |         |  |
| Dilutive options and unvested restricted stock |            | 807     | (0.01)  |            |         | 906     |  |
| <b>Diluted earnings per common share</b>       | \$ 162,958 | 139,195 | \$ 1.17 | \$ 115,698 | 135,291 | \$ 0.86 |  |

**(14) Derivative Financial Instruments**

In July 2005, the Company entered into three interest-rate swap contracts that are designated as hedging the variability in expected cash flows for variable rate debt assumed in connection with the acquisition of a portfolio of real estate assets in July 2005. The cash flow hedges have a notional principal amount of \$45.6 million and expire in July 2020. The fair value of these contracts at September 30, 2006, was \$0.1 million and is included in other assets. For the nine months ended September 30, 2006, the Company recognized increased interest expense of \$151,000 attributable to the contracts. The Company determined that these swap agreements were highly effective in offsetting future variability of interest cash flows related to the assumed mortgages. The effective portion of gains and losses on these contracts is recognized in accumulated other comprehensive loss, net whereas the ineffective portion is recognized in earnings. During the nine months ended September 30, 2006, there was no ineffective portion related to these hedges.

In August 2006, the Company entered into two treasury lock contracts that were designated as hedging the variability in forecasted interest payments, attributable to changes in the U.S. Treasury rate, on long-term fixed rate debt forecasted to be issued between September 1, and October 31, 2006. The cash flow hedges had a notional principal amount of \$560.5 million and were settled on September 16, 2006, which was the date that the forecasted debt was issued. The cash settlement value of these contracts at September 16, 2006, was \$4.4 million and is included in accumulated other comprehensive loss. The Company determined that these treasury lock agreements were highly effective in offsetting future variability of forecasted interest payments. Amounts reported in accumulated other comprehensive loss related to these hedges will be recognized as additional interest expense on the Company's hedged fixed-rate debt. During the next 12 months, the Company estimates that \$0.5 million will be recognized.

**(15) Commitments and Contingencies**

The Company, from time to time, is party to legal proceedings, lawsuits and other claims in the ordinary course of the Company's business. These claims, even if not meritorious, could force the Company to spend significant financial resources. The Company is not aware of any legal proceedings or claims that it believes will have, individually or taken together, a material adverse effect on its business, prospects, financial condition or results of operations.

*State of California Senate Bill 1953.* One of the Company's properties located in Tarzana, California is affected by State of California Senate Bill 1953 ( SB 1953 ), which requires certain seismic safety building standards for acute care hospital facilities. This hospital is operated by Tenet under a lease expiring in February 2009. The Company and Tenet are currently reviewing the SB 1953 compliance of this hospital, multiple plans of action to cause such compliance, the estimated time for completing the same, and the cost of performing necessary remediation of the property. We cannot currently estimate the remediation costs that will need to be incurred prior to 2013 in order to make the facility SB 1953-compliant through 2030 and the final allocation of any remediation costs between the Company and Tenet. Rent on the hospital for the nine months ended September 30, 2006 was \$7.7 million and for the years ended December 31, 2005 and 2004 was \$10.8 million and \$10.6 million, respectively, and the carrying amount was \$74.5 million at September 30, 2006.

*Master Trust Liabilities.* Certain residents of two of the Company's senior housing facilities have entered into a master trust agreement with the operator of the facilities whereby amounts paid upfront by such residents were deposited into a trust account. These funds were then made available to the senior housing operator in the form of a non-interest

bearing loan to provide permanent financing for the related communities. The operator of the senior housing facilities is the borrower under these arrangements; however, two of the Company's properties are collateral under the master trust agreements. As of September 30, 2006, the remaining obligation under the master trust agreements for these two properties is \$9.9 million. The Company's properties are released as collateral as the master trust liabilities are extinguished.

*Promoted Interests and Other Contractual Obligations.* Upon the achievement of certain return thresholds and the occurrence of certain events, the Company may be obligated to make payments to certain joint venture partners pursuant to the terms and provisions of their contractual agreements with the partnership. From time to time in the normal course of the Company's business, the Company enters into various contracts with third parties that may obligate it to make payments or perform other obligations upon the occurrence of certain events.

*Earnout Obligations.* Pursuant to the terms of certain acquisition-related agreements, the Company may be obligated to make additional payments ( Earnouts ) upon the achievement of certain criteria. If it is probable at the time of acquisition of the related properties that the Earnout criteria will be achieved, the Earnout payments are accrued. Otherwise,



the additional purchase consideration is recognized when the performance criteria are achieved. During the nine months ended September 30, 2006, the Company made Earnout payments in the aggregate of \$3.7 million.

*General Uninsured Losses.* The Company obtains various types of insurance to mitigate the impact of property, business interruption, liability, flood, earthquake and terrorism related losses. The Company attempts to obtain appropriate policy terms, conditions, limits and deductibles, considering the relative risk of loss, the cost of such coverage and current industry practice. There are, however, certain types of extraordinary losses, such as those due to acts of war or other events, that may be either uninsurable or not economically insurable. Although the Company has obtained coverage to mitigate the impact of various casualty losses, with policy specifications and insured limits that it believes are commercially reasonable, there can be no assurance that the Company will be able to collect under such policies or that the policies will provide adequate coverage. Should an uninsured loss occur at a property, the Company's assets may become impaired and the Company may not be able to operate its business at the property for an extended period of time.

#### (16) Stock Incentive Plans

On May 11, 2006, the Company's stockholders approved the 2006 Performance Incentive Plan (the "2006 Incentive Plan"). The 2006 Incentive Plan replaces the Company's 2000 Stock Incentive Plan and provides for the granting of stock based compensation, including stock options, restricted stock, and performance restricted stock units, to officers, employees and directors in connection with their employment with or services provided to the Company. The maximum number of shares available for future awards over the term of the 2006 Incentive Plan is 8.3 million shares at September 30, 2006, of which 4.1 million may be issued as restricted stock and performance restricted stock units.

#### *Stock Options*

Stock options are generally granted with an exercise price equal to the fair market value of the underlying stock on the date of grant. Stock options generally vest ratably over a five-year period. Vesting of certain options may accelerate upon retirement, a change in control of the Company, as defined, and other events. A summary of the option activity is presented in the following table (in thousands, except per share amounts):

|                                      | Shares Under<br>Options | Weighted<br>Average<br>Exercise Price | Shares Under<br>Options<br>Exercisable at<br>Period End |
|--------------------------------------|-------------------------|---------------------------------------|---|
| Outstanding as of January 1, 2006    | 3,862                   | \$ 22.47                              | 1,157   |
| Granted                              | 1,215                   | 27.11                                 |   |
| Exercised                            | (360)                   | 17.47                                 |   |
| Forfeited                            | (307)                   | 25.94                                 |   |
| Outstanding as of September 30, 2006 | 4,410                   | 23.91                                 | 1,619   |

The following table summarizes additional information concerning outstanding and exercisable stock options at September 30, 2006 (shares in thousands):

| Range of<br>Exercise Price | Shares Under<br>Options | Weighted<br>Average<br>Exercise Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Life in Years | Currently Exercisable   |                                       |
|----------------------------|-------------------------|---------------------------------------|--|-------------------------|---------------------------------------|
|                            |                         |                                       |  | Shares Under<br>Options | Weighted<br>Average<br>Exercise Price |
| \$11.94 - \$16.88          | 309                     | \$ 14.45                              | 3.3  | 309                     | \$ 14.45                              |
| 17.93 - 18.73              | 576                     | 18.11                                 | 5.6  | 440                     | 18.12                                 |
| 19.14 - 21.40              | 382                     | 19.20                                 | 5.5  | 260                     | 19.21                                 |
| 23.50 - 27.52              | 3,143                   | 26.48                                 | 8.4  | 610                     | 26.36                                 |
|                            | 4,410                   | 23.91                                 | 7.4  | 1,619                   | 20.70                                 |

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The following table summarizes additional information concerning unvested stock options at September 30, 2006 (shares in thousands):

|                                | Shares Under<br>Options | Weighted<br>Average<br>Exercise Price |
|--------------------------------|-------------------------|---------------------------------------|
| Unvested at January 1, 2006    | 2,705                   | \$ 23.76                              |
| Granted                        | 1,215                   | 27.11                                 |
| Vested                         | (822)                   | 21.08                                 |
| Forfeited                      | (307)                   | 25.94                                 |
| Unvested at September 30, 2006 | 2,791                   | 25.77                                 |

Proceeds received from options exercised under the Stock Incentive Plans for the nine months ended September 30, 2006 and 2005, were \$6.3 million and \$22.6 million, respectively. The total intrinsic value of options exercised during the nine months ended September 30, 2006 and 2005 was \$3.8 million and \$14.7 million, respectively. The total intrinsic value of options outstanding and exercisable as of September 30, 2006 was \$16.8 million.

The fair value of the stock options granted during the nine months ended September 30, 2006 and 2005 was estimated on the date of grant using a Black-Scholes option valuation model that uses the assumptions noted in the table below. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant. The expected life (estimated period of time outstanding) of the stock options granted was estimated using the historical exercise behavior of employees. Expected volatility was based on historical volatility for a period equal to the stock option's expected life, ending on the day of grant, and calculated on a weekly basis.

|                          | 2006   | 2005   |
|--------------------------|--------|--------|
| Risk-free rate           | 4.51%  | 3.93%  |
| Expected life (in years) | 6.50   | 6.50   |
| Expected volatility      | 20.00% | 20.00% |
| Expected dividend yield  | 7.50%  | 7.50%  |

The weighted average fair value per share at the date of grant for options awarded during the nine months ended September 30, 2006 and 2005, was \$2.18 and \$1.92, respectively.

### *Restricted Stock and Performance Restricted Stock Units*



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Under the 2006 Incentive Plan, restricted stock and performance restricted stock units generally vest over a three to five year period. The vesting of certain restricted shares and units may accelerate upon retirement, a change in control of the Company, as defined, and other events. When vested, each performance restricted stock unit is convertible into one share of common stock. The restricted stock and performance restricted stock units are valued on the grant date based on the market price of a common share on that date. Generally, the Company recognizes the fair value of the awards over the applicable vesting period as compensation expense.

The following table summarizes additional information concerning unvested restricted stock and restricted stock units at September 30, 2006 (units and shares in thousands):

| Unvested Shares                | Restricted<br>Stock<br>Units | Weighted<br>Average<br>Grant Date<br>Fair Value | Restricted<br>Shares | Weighted<br>Average<br>Grant Date<br>Fair Value |
|--------------------------------|------------------------------|---|----------------------|---|
| Unvested at January 1, 2006    | 469                          | \$ 19.83  | 454                  | \$ 23.43  |
| Granted                        | 401                          | 27.78   | 102                  | 26.85   |
| Vested                         | (117)                        | 19.48   | (79)                 | 22.88   |
| Forfeited                      | (28)                         | 26.46   | (59)                 | 24.41   |
| Unvested at September 30, 2006 | 725                          | 26.99   | 418                  | 24.24   |

The total fair values of restricted stock and restricted stock units vested, based on the market price on the vesting date, during the nine months ended September 30, 2006 and 2005 were \$5.0 million and \$4.8 million, respectively.

As of September 30, 2006, there was \$27.5 million of total unrecognized compensation cost, related to unvested share-based compensation arrangements granted under the Company's incentive plans, which is expected to be recognized over a weighted-average period of 3.6 years.

On August 14, 2006, the Company granted to the Company's Chairman and Chief Executive Officer, 219,000 restricted stock units. The restricted stock units vest over a period of 10 years beginning 2012. Additionally, as the Company pays dividends on its outstanding common stock, the original award will be credited with additional restricted stock units as dividend equivalents (as opposed to receiving a cash payment). The dividend equivalent restricted stock units will be subject to the same vesting and other conditions as applied to the grant generally.

**(17) Subsequent Events**

On October 2, 2006, the Company acquired five assisted living and independent living facilities for \$31 million, through a sale-leaseback transaction. These facilities have an initial lease term of fifteen years, with two ten-year renewal options. The initial annual lease rate is approximately 8.5% with annual of 3%. These assets are included in a master lease that has 31 properties leased to the operator.

On October 10, 2006, the Company entered into a definitive agreement to sell 78 skilled nursing facilities, that is expected to close during the fourth quarter of 2006. The closing of the transaction is subject to certain customary conditions.

On October 27, 2006, the Company entered into a joint venture agreement with an institutional partner. Pursuant to the agreement, this partner will acquire a majority equity interest in a portfolio consisting of 13 medical office buildings located in five states. HCP will act as the managing member and receive a one-time acquisition fee and ongoing asset management fees.

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

**Cautionary Language Regarding Forward-looking Statements**

Statements in this Quarterly Report that are not historical factual statements are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The statements include, among other things, statements regarding the intent, belief or expectations of Health Care Property Investors, Inc. and its officers and can be identified by the use of terminology such as may, will, expect, believe, intend, plan, estimate, should and other comparable terms or the negative thereof. In addition, we, through our senior management, from time to time make forward-looking oral and written public statements concerning our expected future operations and other developments. Readers are cautioned that, while forward-looking statements reflect our good faith belief and best judgment based upon current information, they are not guarantees of future performance and are subject to known and unknown risks and uncertainties. Actual results may differ materially from the expectations contained in the forward-looking statements as a result of various factors. In addition to the factors set forth under Part I, Item 1A - Risk Factors in the Company's Annual Report and Part II, Item 1A - Risk Factors in this Quarterly Report, readers should consider the following:

- a) Legislative, regulatory, or other changes in the healthcare industry at the local, state or federal level which increase the costs of, or otherwise affect the operations of, our tenants and borrowers;
- b) Changes in the reimbursement available to our tenants and borrowers by governmental or private payors, including changes in Medicare and Medicaid payment levels and the availability and cost of third party insurance coverage;
- c) Competition for tenants and borrowers, including with respect to new leases and mortgages and the renewal or rollover of existing leases;
- d) Availability of suitable healthcare facilities to acquire at favorable prices and the competition for such acquisition and financing of healthcare facilities;
- e) The ability of our tenants and borrowers to operate our properties in a manner sufficient to maintain or increase revenues and to generate sufficient income to make rent and loan payments;
- f) The financial weakness of some operators, including potential bankruptcies, which results in uncertainties regarding our ability to continue to realize the full benefit of such operators' leases;
- g) Changes in national or regional economic conditions, including changes in interest rates and the availability and cost of capital;

- h) The risk that we will not be able to sell or lease facilities that are currently vacant;
- i) The potential costs of SB 1953 compliance with respect to our hospital in Tarzana, California;
- j) The financial, legal and regulatory difficulties of significant operators of our properties, including Tenet and HealthSouth; and
- k) The potential impact of existing and future litigation matters.

Readers should consider that many of these risks and uncertainties are also applicable to CNL Retirement Properties, Inc. ( CRP ) and its business and any forward-looking statements made by or with respect to CRP or its business. We acquired CRP on October 5, 2006. Additional risks and uncertainties to which our forward-looking statements are subject include our ability to integrate the CRP business and to achieve expected synergies, operating efficiencies and other benefits within expected time-frames or at all, or within expected cost projections, to execute our delevering strategy and to preserve the goodwill of the acquired businesses.



## Executive Summary

We are a real estate investment trust ( REIT ) that invests in healthcare-related properties primarily located throughout the United States. We develop, acquire, and manage healthcare real estate and provide mortgage financing to healthcare providers. We invest directly, often structuring sale-leaseback transactions, and through joint ventures. At September 30, 2006, our real estate portfolio, excluding assets held for sale but including assets held through joint ventures and mortgage loans, consisted of interests in 521 facilities located in 42 states.

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

Our strategy contemplates acquiring and developing properties on favorable terms. We attempt to structure transactions that are tax-advantaged and mitigate risks in our underwriting process. Generally, we prefer larger, more complex private transactions that leverage our management team's experience and our infrastructure. During the nine months ended September 30, 2006, we made gross investments of \$451 million. These investments had an average first year yield on cost of just over 7.7%. Our investments for the nine months ended September 30, 2006 were allocated among the following healthcare sectors: (i) 47% senior housing facilities; (ii) 42% medical office buildings ( MOBs ); (iii) 4% Hospitals; and (iv) 7% other healthcare facilities.

We follow a disciplined approach to enhancing the value of our existing portfolio, including the ongoing evaluation of properties that no longer fit our strategy for potential disposition. We sold 12 properties during the nine months ended September 30, 2006 for \$116.8 million and had 16 properties with a carrying amount of \$28.0 million classified as held for sale at September 30, 2006. On October 10, 2006, we also entered into a definitive agreement to sell 78 skilled nursing facilities, that is expected to close during the fourth quarter of 2006. The closing of the transaction is subject to certain customary conditions.

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

Access to external capital on favorable terms is critical to the success of our strategy. We attempt to match the long-term duration of our leases with long-term fixed rate financing. At September 30, 2006, 11% of our consolidated debt is at variable interest rates. We intend to maintain an investment grade rating on our fixed income securities and manage various capital ratios and amounts within appropriate parameters. As of October 27, 2006, our senior debt is rated BBB by Standard & Poor's Ratings Group, BBB by Fitch Ratings and Baa3 by Moody's Investors Service.

Capital market access impacts our cost of capital and our ability to refinance existing indebtedness as it matures, as well as to fund future acquisitions and development through the issuance of additional securities. Our ability to access capital on favorable terms is dependent on various factors, including general market conditions, interest rates, credit ratings on our securities, perception of our potential future earnings and cash distributions, and the market price of our capital stock.

**2006 Overview**

*Mergers with CNL Retirement Properties, Inc. and CNL Retirement Corp.*

On October 5, 2006, we closed our merger with CNL Retirement Properties, Inc. ( CRP ) for aggregate consideration of approximately \$5.3 billion. In the merger, we paid an aggregate of \$2.9 billion of cash, issued 22.9 million shares of common stock, and we either assumed or refinanced approximately \$1.7 billion of CRP s outstanding debt. Simultaneously, with the closing of the merger with CRP, we also merged with CNL Retirement Corp. ( CRC ).

*Capital Market Transactions*

In connection with the CRP merger, we obtained from a syndicate of banks a bridge loan, a term loan, and a revolving credit facility providing for aggregate borrowings of \$3.4 billion. The facilities contain covenants similar to those contained in our previous line of credit agreement, including leverage ratios, a secured debt ratio, an unsecured debt ratio, a fixed charge coverage ratio and a minimum net worth test. In addition, the bridge and term loan facilities impose certain mandatory prepayments with the proceeds from asset sales, capital market transactions, and contributions to joint ventures.

On September 19, 2006, we issued \$1 billion of senior unsecured notes, which consisted of \$300 million of floating rate notes due 2008, \$300 million of 5.95% notes due 2011, and \$400 million of 6.30% notes due 2016. We received net proceeds of \$994 million, which together with cash on hand and borrowings under the new credit facilities were used to repay our previous line of credit facility and finance the CRP merger.

On February 27, 2006, we issued \$150 million of 5.625% senior unsecured notes due 2013. The notes were priced at 99.071% of the principal amount for an effective yield of 5.788%. We received net proceeds of \$149 million, which were used to repay outstanding indebtedness and for other general corporate purposes.

During the nine months ended September 30, 2006, we obtained \$165 million of ten-year mortgage financing with a weighted average effective rate of 6.36% in four separate transactions. We received net proceeds of \$161.9 million, which were used to repay outstanding indebtedness and for other general corporate purposes.

*Real Estate Transactions*

During the nine months ended September 30, 2006, we have acquired interests in properties aggregating \$451 million, including the following:

On July 28, 2006, we acquired two assisted living facilities, in exchange for three assisted living facilities valued at approximately \$20 million, and \$37 million in cash. The two acquired properties have an initial lease term of ten years, with two ten-year renewal options, and an initial contractual annual lease rate of 7.0% with escalators based on the properties' revenue growth. The acquired properties are included in a new master lease that contains six properties leased to the operator.

On June 1, 2006, we acquired two senior housing properties for \$27 million, through a sale-leaseback transaction. These facilities have an initial lease term of fifteen years, with two ten-year renewal options. The initial annual lease rate is approximately 9.0% with annual escalators based on the Consumer Price Index (CPI) that have a floor of 2.75%.

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On May 31, 2006, we acquired nine assisted living and independent living facilities for \$99 million, including assumed debt valued at \$61 million, through a sale-leaseback transaction. These facilities have an initial lease term of ten years, with two ten-year renewal options. The initial annual lease rate is approximately 8.0% with annual CPI-based escalators.

During the three months ended March 31, 2006, we acquired 13 medical office buildings for \$138 million, including DownREIT units valued at \$6 million, in related transactions. The 13 buildings, with 730,000 rentable square feet, have an initial yield of 7.3%.

On February 24, 2006, we acquired two medical office buildings for approximately \$21 million including assumed debt valued at \$12 million. The two buildings, with 157,000 rentable square feet, have an initial yield of 8.0%.

On February 8, 2006, we acquired four laboratory, office and biotechnology manufacturing buildings located in San Diego, California for \$30 million. The initial yield on these buildings is 6.1%, with the stabilized yield expected to be 8.3%. The buildings include approximately 158,000 rentable square feet.

During the nine months ended September 30, 2006, we sold 12 properties for \$116.8 million and recognized gains of approximately \$46.6 million, which includes one building sold on July 25, 2006, for \$73 million with a gain of approximately \$32 million.

On October 10, 2006, we entered into a definitive agreement to sell 78 skilled nursing facilities, that is expected to close during the fourth quarter of 2006. The closing of the transaction is subject to certain customary conditions.

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On October 2, 2006, we acquired five assisted living and independent living facilities for \$31 million, through a sale-leaseback transaction. These facilities have an initial lease term of fifteen years, with two ten-year renewal options. The initial annual lease rate is approximately 8.5% with annual escalators of 3%. These assets are included in a master lease that has 31 properties leased to the operator.

On October 24, 2006, we entered into a definitive agreement to acquire the interest of an affiliate of General Electric Company in HCP Medical Office Portfolio, LLC ( HCP MOP ), for \$141 million. The closing of the transaction is subject to certain customary conditions. Upon the closing of this acquisition, expected to occur on or before November 30, 2006, we will be the sole owner of the venture and its fifty-nine MOB's with approximately 4 million rentable square feet.

On October 27, 2006, we entered into a joint venture agreement with an institutional partner. Pursuant to the agreement, this partner will acquire a majority equity interest in a portfolio consisting of 13 medical office buildings located in five states. We will act as the managing member and receive a one-time acquisition fee and ongoing asset management fees.

### *Other Events*

On October 26, 2006, we announced that our Board of Directors declared a quarterly cash dividend of \$0.425 per share of common stock. The common stock cash dividend will be paid on November 21, 2006 to stockholders of record as of the close of business on November 3, 2006.

### **Critical Accounting Policies**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles ( GAAP ) requires management to use judgment in the application of accounting policies, including making estimates and assumptions. We base estimates on our experience and on various other assumptions believed to be reasonable under the circumstances. These judgments affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting periods. If our judgment or interpretation of the facts and circumstances relating to various transactions or other matters had been different, it is possible that different accounting would have been applied, resulting in a different presentation of our financial statements. From time to time, we re-evaluate our estimates and assumptions. In the event estimates or assumptions prove to be different from actual results, adjustments are made in subsequent periods to reflect more current estimates and assumptions about matters that are inherently uncertain. The critical accounting policies used in the preparation of our financial statements are described in our 2005 Annual Report on Form 10-K.

### **Results of Operations**

*Three Months Ended September 30, 2006 Compared to Three Months Ended September 30, 2005*

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*Rental and other revenue.* MOB rental revenue increased 31% to \$41.7 million for the three months ended September 30, 2006. The increase in MOB rental revenue of \$9.9 million primarily relates to the additive effect of our acquisitions in 2006 and 2005, which contributed \$8.1 million to rental revenues.

Triple-net lease rental revenues increased 11% to \$89.2 million for the three months ended September 30, 2006. The increase in triple-net lease rental revenue of \$9.1 million primarily relates to rent escalations and resets, and the additive effect of our acquisitions in 2006 and 2005, as detailed below:

| Property Type               | Triple-net lease rental<br>revenue resulting from<br>acquisitions for the three<br>months ended September 30, |                        |          | Change |
|-----------------------------|---|------------------------|----------|--------|
|                             | 2006  | 2005<br>(in thousands) |          |        |
| Senior housing facilities   | \$ 10,947   | \$ 4,895               | \$ 6,052 |        |
| Hospitals                   | 89  |                        | 89       |        |
| Other healthcare facilities | 857   | 59                     | 798      |        |
| Total                       | \$ 11,893   | \$ 4,954               | \$ 6,939 |        |

Additionally, included in triple-net lease rental revenues are facility-level operating revenues for five senior housing properties that were previously leased on a triple-net basis. Periodically tenants default on their leases, which cause us to take temporary possession of the operations of the facility. We contract with third party managers to manage these properties until a replacement tenant can be identified or the property can be sold. The operating revenues and expenses for these properties are included in triple-net lease rental revenues and operating expenses, respectively. The increase in reported revenues for these facilities of \$0.3 million to \$2.5 million for the three months ended September 30, 2006 was primarily related to an increase in the overall occupancy of such facilities.

*Equity income.* Equity income increased by \$1.6 million primarily due to our investment in HCP MOP, for which we recorded equity income of \$1.1 million and equity losses of \$0.5 for the three months ended September 30, 2006 and 2005, respectively. See Note 6 to the Condensed Consolidated Financial Statements for additional information on HCP MOP.

*Interest and other income.* Interest and other income was \$7.6 million for the three months ended September 30, 2006. During the three months ended September 30, 2006 and 2005, we recognized management and other fees from HCP MOP of \$0.7 million and \$0.8 million, respectively.

*Interest expense.* Interest expense increased 31% to \$37.0 million for the three months ended September 30, 2006. The increase was due to increased borrowing levels resulting from the issuance of an aggregate of \$1.6 billion of senior notes in February and September of 2006, and April and September of 2005, and the assumption and issuance of mortgages payable aggregating to \$238 million during the nine months ended September 30, 2006. This higher interest expense was offset by the repayment of \$135 million of senior notes in February 2006 and the repayment of our line of credit in September 2006.

The table below sets forth information with respect to our debt as of September 30, 2006 and 2005:

|   | As of September 30,    |              |
|---|------------------------|--------------|
|   | 2006                   | 2005         |
|   | (dollars in thousands) |              |
| <b>Balance:</b>   |                        |              |
| Fixed rate  | \$ 2,592,845           | \$ 1,650,518 |
| Variable rate   | 336,400                | 206,665      |
| Total   | \$ 2,929,245           | \$ 1,857,183 |
| <b>Percent of total debt:</b>                           |                        |              |
| Fixed rate  | 89%                    | 89%          |
| Variable rate   | 11%                    | 11%          |
| Total   | 100%                   | 100%         |
| <b>Weighted average interest rate at end of period:</b> |                        |              |
| Fixed rate  | 6.11%                  | 6.41%        |
| Variable rate   | 5.77%                  | 3.59%        |
| Total weighted average rate                             | 6.07%                  | 6.10%        |

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*Depreciation and amortization.* Real estate depreciation and amortization increased 21% to \$32.2 million for the three months ended September 30, 2006. The increase in depreciation and amortization of \$5.5 million primarily relates to the additive effect of our acquisitions in 2006 and 2005, as detailed below:

| Property Type               | Depreciation and<br>amortization resulting from<br>acquisitions for the three<br>months ended September 30, |                        | Change   |
|-----------------------------|---|------------------------|----------|
|                             | 2006  | 2005<br>(in thousands) |          |
| Senior housing facilities   | \$ 3,930  | \$ 1,442               | \$ 2,488 |
| Hospitals                   | 39  |                        | 39       |
| Medical office buildings    | 2,974   |                        | 2,974    |
| Other healthcare facilities | 454   |                        | 454      |
| Total                       | \$ 7,397  | \$ 1,442               | \$ 5,955 |

During the three months September 30, 2005, we revised our purchase price allocation and attributed more of the purchase price of the properties acquired from MedCap Properties LLC and MOBs to below market lease intangibles, other



intangibles and real estate assets. Lease intangibles generally amortize over a shorter period of time relative to tangible real estate assets which resulted in higher depreciation expense during the three months ended September 30, 2005, when compared to the comparable period in the current year.

*Operating expenses.* Operating costs increased 50% to \$20.1 million for the three months ended September 30, 2006. Operating costs are predominantly related to MOB properties that are leased under gross or modified gross lease agreements where we share certain costs with tenants. Accordingly, the number of properties in our MOB portfolio directly impacts operating costs. Additionally, we contract with third party property managers for most of our MOB properties. The increase in operating expenses of \$6.7 million primarily relates to the effect of our acquisitions in 2006 and 2005, as detailed below:

| Property Type               | Operating expenses<br>resulting from acquisitions<br>for the three months ended<br>September 30, |                        | Change   |
|-----------------------------|--|------------------------|----------|
|                             | 2006   | 2005<br>(in thousands) |          |
| Medical office buildings    | \$ 3,176   | \$                     | \$ 3,176 |
| Other healthcare facilities | 185  |                        | 185      |
| Total                       | \$ 3,361   | \$                     | \$ 3,361 |

Additionally, included in operating expenses are facility-level operating expenses for five senior housing properties that were previously leased on a triple-net basis. Periodically tenants default on their leases, which cause us to take temporary possession of the operations of the facility. We contract with third party managers to manage these properties until a replacement tenant can be identified or the property can be sold. The operating revenues and expenses for these properties are included in triple-net lease rental revenues and operating expenses, respectively. The increase in reported operating expenses for these facilities of \$0.7 million to \$3.1 million for the three months ended September 30, 2006, was primarily related to an increase in the overall occupancy of such facilities.

The presentation of expenses as general and administrative or operating expenses is based on the underlying nature of the expense. Periodically, we review the classification of expenses between categories and make revisions based on changes in the underlying nature of the expense.

*General and administrative expenses.* General and administrative expenses increased 13% to \$8.3 million for the three months ended September 30, 2006. The increase is primarily due to a \$0.7 million increase in expenses related to our directors' retirement plans, and \$0.4 million of integration related expenses.

*Discontinued operations.* Income from discontinued operations for the three months ended September 30, 2006, was \$38.3 million compared to \$4.9 million for the comparable period in the prior year. The change is due to an increase in gains on real estate dispositions of \$35.5 million. Discontinued operations for the three months ended September 30, 2006, includes 20 properties compared to 38 properties classified as discontinued operations for the three months ended September 30, 2005.

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*Nine Months Ended September 30, 2006 Compared to Nine Months Ended September 30, 2005*

*Rental and other revenue.* MOB rental revenue increased 30% to \$120.9 million for the nine months ended September 30, 2006. The increase in MOB rental revenue of \$28.2 million primarily relates to the additive effect of our acquisitions in 2006 and 2005, which contributed \$26.5 million to rental revenues over the comparable prior year period.

Triple-net lease rental revenues increased 14% to \$255.6 million for the nine months ended September 30, 2006. The increase in triple-net lease rental revenue of \$31.5 million primarily relates to rent escalations and resets, and the additive effect of our acquisitions in 2006 and 2005, as detailed below:

| <b>Property Type</b> | <b>Triple-net lease rental<br/>revenue resulting from<br/>acquisitions for the nine<br/>months ended September 30,<br/>2006                      2005<br/>(in thousands)</b> | <b>Change</b> |
|----------------------|--|---------------|
|----------------------|--|---------------|

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|                             |    |        |    |       |    |        |
|-----------------------------|----|--------|----|-------|----|--------|
| Senior housing facilities   | \$ | 30,588 | \$ | 7,244 | \$ | 23,344 |
| Hospitals                   |    | 89     |    |       |    | 89     |
| Other healthcare facilities |    | 2,028  |    | 59    |    | 1,969  |
| Total                       | \$ | 32,705 | \$ | 7,303 | \$ | 25,402 |

Additionally, included in triple-net lease rental revenues are facility-level operating revenues for five senior housing properties that were previously leased on a triple-net basis. Periodically tenants default on their leases, which cause us to take temporary possession of the operations of the facility. We contract with third party managers to manage these properties until a replacement tenant can be identified or the property can be sold. The operating revenues and expenses for these properties are included in triple-net lease rental revenues and operating expenses, respectively. The increase in reported revenues for these facilities of \$1.5 million to \$7.0 million for the nine months ended September 30, 2006, was primarily due to us taking possession of two of these properties in 2005 and an increase in overall occupancy of such properties.

*Equity income.* Equity income increased by \$7.8 million primarily due to our investment in HCP MOP, for which we recorded equity income of \$7.5 million and equity losses of \$0.5 million for the nine months ended September 30, 2006 and 2005, respectively. During the nine months ended September 30, 2006, HCP MOP sold 34 MOB's for approximately \$100.7 million, net of transaction costs, and recognized aggregate gains of \$19.7 million. See Note 6 to the Condensed Consolidated Financial Statements for additional information on HCP MOP.

*Interest and other income.* Interest and other income increased by \$10.7 million to \$29.7 million for the nine months ended September 30, 2006. The increase in interest and other income is primarily due to a \$7.3 million prepayment premium received on March 14, 2006, upon the early repayment of a secured loan receivable of \$30.0 million with an original maturity of May 1, 2010 and an interest rate of 11.4%. During the nine months ended September 30, 2006 and 2005, we also recognized management and other fees from HCP MOP of \$2.6 million and \$2.3 million, respectively.

*Interest expense.* Interest expense increased 34% to \$102.7 million for the nine months ended September 30, 2006. The increase was due to increased borrowing levels resulting from the issuance of an aggregate of \$1.6 billion of senior notes in February and September of 2006, and April and September of 2005, and the assumption and issuance of mortgages payable aggregating to \$238 million during the nine months ended September 30, 2006. This higher interest expense was offset by the repayment of \$135 million of senior notes in February 2006 and the repayment of our line of credit in September 2006.

The table below sets forth information with respect to our debt as of September 30, 2006 and 2005:

|   | As of September 30,    |              |
|---|------------------------|--------------|
|   | 2006                   | 2005         |
|   | (dollars in thousands) |              |
| <b>Balance:</b>   |                        |              |
| Fixed rate  | \$ 2,592,845           | \$ 1,650,518 |
| Variable rate   | 336,400                | 206,665      |
| Total   | \$ 2,929,245           | \$ 1,857,183 |
| <b>Percent of total debt:</b>                           |                        |              |
| Fixed rate  | 89%                    | 89%          |
| Variable rate   | 11%                    | 11%          |
| Total   | 100%                   | 100%         |
| <b>Weighted average interest rate at end of period:</b> |                        |              |

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|                             |       |       |
|-----------------------------|-------|-------|
| Fixed rate                  | 6.11% | 6.41% |
| Variable rate               | 5.77% | 3.59% |
| Total weighted average rate | 6.07% | 6.10% |

*Depreciation and amortization.* Real estate depreciation and amortization increased 24% to \$93.7 million for the nine months ended September 30, 2006. The increase in depreciation and amortization of \$18.0 million primarily relates to the additive effect of our acquisitions in 2006 and 2005, as detailed below:

| Property Type               | Depreciation and<br>amortization resulting from<br>acquisitions for the nine<br>months ended September 30, |          |                | Change |
|-----------------------------|--|----------|----------------|--------|
|                             | 2006   | 2005     | (in thousands) |        |
| Senior housing facilities   | \$ 10,714  | \$ 2,191 | \$ 8,523       |        |
| Medical office buildings    | 11,383   | 1,511    | 9,872          |        |
| Hospitals                   | 39   |          | 39             |        |
| Other healthcare facilities | 1,156  |          | 1,156          |        |
| Total                       | \$ 23,292  | \$ 3,702 | \$ 19,590      |        |

During the nine months September 30, 2005, we revised our purchase price allocation and attributed more of the purchase price of the properties acquired from MedCap Properties LLC and other MOBs to below market lease intangibles, other intangibles and real estate assets. Lease intangibles generally amortize over a shorter period of time relative to tangible real estate assets which resulted in higher depreciation expense during the nine months ended September 30, 2005, when compared to the comparable period in the current year.

*Operating expenses.* Operating costs increased 35% to \$56.8 million for the nine months ended September 30, 2006. Operating costs are predominantly related to MOB properties that are leased under gross or modified gross lease agreements where we share certain costs with tenants. Accordingly, the number of properties in our MOB portfolio directly impacts operating costs. Additionally, we contract with third party property managers for most of our MOB properties. The increase in operating expenses of \$14.7 million primarily relates to the effect of our acquisitions in 2006 and 2005, as detailed below:

| Property Type               | Operating expenses<br>resulting from acquisitions<br>for the nine months ended<br>September 30, |          |                | Change |
|-----------------------------|---|----------|----------------|--------|
|                             | 2006  | 2005     | (in thousands) |        |
| Medical office buildings    | \$ 11,474   | \$ 1,403 | \$ 10,071      |        |
| Other healthcare facilities | 418   |          | 418            |        |
| Total                       | \$ 11,892   | \$ 1,403 | \$ 10,489      |        |

Additionally, included in operating expenses are facility-level operating expenses for five senior housing properties that were previously leased on a triple-net basis. Periodically tenants default on their leases, which cause us to take temporary possession of the operations of the facility. We contract with third party managers to manage these properties until a replacement tenant can be identified or the property can be sold. The operating revenues and expenses for these properties are included in triple-net lease rental revenues and operating expenses, respectively. The increase in reported operating expenses for these facilities of \$2.3 million to \$8.4 million for the nine months ended September 30, 2006, was primarily due to us taking possession of two of these properties in 2005 and an increase in overall occupancy of such properties.

The presentation of expenses as general and administrative or operating expenses is based on the underlying nature of the expense. Periodically, we review the classification of expenses between categories and make revisions based on changes in the underlying nature of the expense.

*General and administrative expenses.* General and administrative expenses increased 8% to \$25.2 million for the nine months ended September 30, 2006. The increase is primarily due to higher compensation-related expenses resulting

from an increase in full-time employees and \$0.5 million of integration related expenses.

*Discontinued operations.* Income from discontinued operations for the nine months ended September 30, 2006, was \$55.4 million compared to \$23.6 million for the comparable period in the prior year. The change is due to an increase in gains on real estate dispositions of \$37.4 million, net of a decline in operating income from discontinued operations of \$4.0 million. Discontinued operations for the nine months ended September 30, 2006, includes 28 properties compared to 46 properties classified as discontinued operations for the nine months ended September 30, 2005.

## Liquidity and Capital Resources

Our principal liquidity needs are to (i) fund normal operating expenses, (ii) meet debt service requirements, (iii) fund capital expenditures including tenant improvements and leasing costs, (iv) fund acquisition and development activities, and (v) make minimum distributions required to maintain our REIT qualification under the Internal Revenue Code. We believe these other needs will be satisfied using cash flows generated by operations and provided by financing activities.

We intend to repay a portion of the CRP merger related borrowings, along with \$20 million in senior notes maturing in 2007 and other maturing debt, with proceeds from future preferred equity or other securities offerings, sales of real estate, and proceeds from real estate joint ventures. We expect that these activities will reduce our future credit ratios.

We anticipate making future investments dependent on the availability of cost-effective sources of capital. We intend to use our revolving facility, and the public debt and equity markets as our principal sources of financing. As of October 27, 2006, our senior debt is rated BBB by Standard & Poor's Ratings Group, BBB by Fitch Ratings and Baa3 by Moody's Investors Service.

Net cash provided by operating activities was \$254.5 million and \$221.0 million for the nine months ended September 30, 2006 and 2005, respectively. Cash flow from operations reflects increased revenues partially offset by higher costs and expenses, and changes in receivables, payables, accruals, and deferred revenue. Our cash flows from operations are dependent upon the occupancy level of multi-tenant buildings, rental rates on leases, our tenants' performance on their lease obligations, the level of operating expenses, and other factors.

Net cash used in investing activities was \$337.0 million during the nine months ended September 30, 2006, and principally reflects the net effect of: (i) \$336.7 million used to fund acquisitions and construction of real estate, (ii) \$12.9 million used to purchase securities, (iii) \$100.2 million received from the sale of several facilities, and (iv) \$45.5 million in principal repayments received on loans. During the nine months ended September 30, 2006 and 2005, we used \$12.0 million and \$4.5 million to fund lease commissions and tenant and capital improvements, respectively.

Net cash provided by financing activities was \$706.5 million for the nine months ended September 30, 2006 and includes proceeds of \$1.1 billion from senior note issuances, \$21.7 million from common stock issuances, and \$161.9 million from mortgage debt issuances. These proceeds were partially offset by or used for: (i) the repayment of \$135.0 million of senior notes, (ii) the repayment of our line of credit of \$258.6 million, and (iii) payment of common and preferred dividends aggregating \$191.3 million. In order to qualify as a REIT for federal income tax purposes, we must distribute at least 90% of our taxable income to our shareholders. Accordingly, we intend to continue to make regular quarterly distributions to holders of our common and preferred stock.

At September 30, 2006, we held approximately \$19.0 million in deposits and \$41.6 million in irrevocable letters of credit from commercial banks securing tenants' lease obligations and borrowers' loan obligations. We may draw upon the letters of credit or depository accounts if there are defaults under the related leases or loans. Amounts available under letters of credit could change based upon facility operating conditions and other factors, and such changes may be material.

### *Debt*



*Bank lines of credit.* As of September 30, 2006, all amounts outstanding under our \$500 million, three-year line of credit facility were repaid. In connection with the completion of the CRP merger, on October 5, 2006, we terminated our \$500 million line of credit facility and closed on new bridge, term and revolving credit facilities providing for aggregate borrowings of up to \$3.4 billion with a syndicate of banks.

Our \$1.0 billion new revolving line of credit matures on October 2, 2009, and accrues interest at a rate per annum equal to LIBOR plus a margin ranging from 0.475% to 1.10%, depending upon our non-credit enhanced senior unsecured long-term debt ratings ( debt ratings ). We pay a facility fee on the entire revolving commitment ranging from 0.125% to 0.25%, depending upon our debt ratings. The revolving credit facility contains a negotiated rate option, whereby the lenders participating in the credit facility bid on the interest to be charged and which may result in a reduced interest rate, is available for up to 50% of borrowings. In addition, the revolving credit facility contains an accordion feature allowing borrowings to be increased by \$100 million under certain conditions. Based on our debt ratings on October 27, 2006, the margin on the revolving loan facility is 0.70% and the facility fee is 0.15%.

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Our bridge loan facility for \$705.7 million matures on October 3, 2007, and accrues interest at a rate per annum equal to LIBOR plus a margin ranging from 0.60% to 1.10%, depending upon the our debt ratings. Based on our debt ratings on October 27, 2006, the margin on the bridge loan facility is 0.85%.

Our term loan facility for \$1.7 billion matures on October 3, 2008, and accrues interest at a rate per annum equal to LIBOR plus a margin ranging from 0.60% to 1.10%, depending upon our debt ratings. Based on our debt ratings on October 27, 2006, the margin on the term loan facility is 0.85%.

Our bridge, term and revolving credit agreements contain certain financial restrictions and other customary requirements. Among other things, these covenants, using terms defined in the agreement, initially limit (i) Consolidated Total Indebtedness to Consolidated Total Asset Value to 70%, (ii) Secured Debt to Consolidated Total Asset Value to 30% and (iii) beginning January 1, 2007, Unsecured Debt to Consolidated Unencumbered Asset Value to 100%. The agreement also requires that we maintain (i) a Fixed Charge Coverage ratio, as defined, of 1.50 times and (ii) a formula-determined Minimum Tangible Net Worth. These financial covenants become more restrictive over a period of approximately two years and (i) limit Consolidated Total Indebtedness to Consolidated Total Asset Value to 60%, (ii) limit Unsecured Debt to Consolidated Unencumbered Asset Value to 65%, and (iii) require a Fixed Charge Coverage ratio, as defined, of 1.75 times.

*Senior unsecured notes.* At September 30, 2006, we had \$2.5 billion in aggregate principal of senior unsecured notes outstanding. Interest rates on the notes ranged from 4.88% to 7.62% with a weighted average rate of 6.06% at September 30, 2006. Discounts and premiums are amortized to interest expense over the term of the related debt.

On September 19, 2006, we issued \$1 billion of senior unsecured notes, which consisted of \$300 million of floating rate notes due 2008, \$300 million of 5.95% notes due 2011, and \$400 million of 6.30% notes due 2016. The notes were priced at 100.00% of the principal amount for the floating rate notes due 2008, 99.971% of the principal amount for an effective yield of 5.957% for the 5.95% notes due 2011, and 99.877% of the principal amount for an effective yield of 6.317% for the 6.30% notes due 2016. We received net proceeds of \$994 million, which together with cash on hand and borrowings under the new facilities were used to repay our previous line of credit facility and finance the CRP merger.

On February 27, 2006, we issued \$150 million of 5.625% senior unsecured notes due 2013. The notes were priced at 99.071% of the principal amount for an effective yield of 5.788%. We received net proceeds of \$149 million, which were used to repay outstanding indebtedness and for other general corporate purposes.

In February 2006, we repaid \$135 million of maturing senior unsecured notes which accrued interest at a weighted average rate of 6.7%. These notes were repaid with funds available under our bank lines of credit.

On October 4, 2006, we repaid \$120 million of senior unsecured notes which accrue interest at a rate of 7.5%. These notes were repaid with funds available under a deposit held in escrow, which was classified as restricted cash at September 30, 2006.

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

*Mortgage debt.* At September 30, 2006, we had \$452.2 million in mortgage debt secured by 70 healthcare facilities with a carrying amount of \$748.1 million. Interest rates on the mortgage notes ranged from 3.75% to 9.32% with a weighted average rate of 6.44% at September 30, 2006.

During the nine months ended September 30, 2006, we obtained \$165 million of ten-year mortgage financing with a weighted average effective rate of 6.36% in four separate transactions. We received net proceeds of \$161.9 million, which were used to repay outstanding indebtedness and for other general corporate purposes.

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

*Debt Maturities*

The following table summarizes our stated debt maturities and scheduled principal repayments at September 30, 2006 (in thousands):

| <b>Year</b>         | <b>Amount</b> |
|---------------------|---------------|
| 2006 (three months) | \$ 121,518    |
| 2007                | 31,773        |
| 2008                | 327,143       |
| 2009                | 39,293        |
| 2010                | 272,680       |
| Thereafter          | 2,136,838     |
|                     | \$ 2,929,245  |

*Equity*

At September 30, 2006, we had 4.0 million shares of 7.25% Series E cumulative redeemable preferred stock, 7.8 million shares of 7.10% Series F cumulative redeemable preferred stock, and 137.6 million shares of common stock outstanding.

During the nine months ended September 30, 2006, we issued approximately 596,000 shares of our common stock under our Dividend Reinvestment and Stock Purchase Plan at an average price per share of \$27.13 for an aggregate amount of \$16.2 million. We also received \$6.3 million in proceeds from stock option exercises. At September 30, 2006, stockholders' equity totaled \$1.4 billion and our equity securities had a market value of \$4.8 billion.

As of September 30, 2006, there were a total of 3.4 million DownREIT units outstanding in six limited liability companies in which we are the managing member (i) HCPI/Tennessee, LLC; (ii) HCPI/Utah, LLC; (iii) HCPI/Utah II, LLC; (iv) HCPI/Indiana, LLC; (v) HCP DR California, LLC; and (vi) HCP DR Alabama, LLC. The DownREIT units are redeemable for an amount of cash approximating the then-current market value of shares of our common stock or, at our option, shares of our common stock (subject to certain adjustments, such as stock splits and reclassifications).

On October 5, 2006, we issued an aggregate of 27.3 million shares of common stock in connection with the acquisitions of CRP and CRC.

**Off-Balance Sheet Arrangements**

We own interests in certain unconsolidated joint ventures, including HCP MOP, as described under Note 6 to the Condensed Consolidated Financial Statements. Except in limited circumstances, our risk of loss is limited to our investment's carrying amount and any outstanding loans receivable. We have no other off-balance sheet arrangements that we expect to materially affect our liquidity and capital resources except those described under Contractual Obligations.

**Contractual Obligations (1)**

The following schedule summarizes our material contractual payment obligations and commitments at September 30, 2006 (in thousands):

|  | <b>Less than<br/>One Year</b> | <b>2007-2008</b>  | <b>2009-2010</b>  | <b>More than<br/>Five Years</b> | <b>Total</b>        |
|--|-------------------------------|-------------------|-------------------|---------------------------------|---------------------|
| Senior unsecured notes and mortgage debt | \$ 121,518                    | \$ 358,916        | \$ 311,973        | \$ 2,136,838                    | \$ 2,929,245        |
| Ground and other operating leases        | 630                           | 3,872             | 4,014             | 156,594                         | 165,110             |
| Acquisition and construction commitments | 4,800                         |                   |                   |                                 | 4,800               |
| Interest expense                         | 43,151                        | 332,553           | 290,242           | 533,329                         | 1,199,275           |
| <b>Total</b>                             | <b>\$ 170,099</b>             | <b>\$ 695,341</b> | <b>\$ 606,229</b> | <b>\$ 2,826,761</b>             | <b>\$ 4,298,430</b> |



(1) Does not include the obligations assumed and the debt issued in our merger with CRP, which closed October 5, 2006. These totaled approximately \$4.4 billion.

## **Inflation**

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

## **New Accounting Pronouncements**

See Note 2 to the Condensed Consolidated Financial Statements for the impact of new accounting standards.

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

At September 30, 2006, we are exposed to market risks related to fluctuations in interest rates on \$57.0 million of variable rate mortgage notes payable and \$325 million of variable rate senior unsecured notes. Of the \$57.0 million of variable rate mortgage notes payable outstanding, \$45.6 million has been hedged through interest rate swap contracts. We do not have, and do not plan to enter into, derivative financial instruments for trading or speculative purposes. Of our consolidated debt of \$2.9 billion at September 30, 2006, excluding the \$45.6 million of variable rate debt where the rates have been hedged to a fixed rate, approximately 11% is at variable interest rates.

Fluctuation in interest rates will not affect our future earnings and cash flows on our fixed rate debt until that debt must be replaced or refinanced. However, interest rate changes will affect the fair value of our fixed rate instruments and our hedge contracts. Conversely, changes in interest rates on variable rate debt would change our future earnings and cash flows, but not affect the fair value of those instruments. Assuming a one percentage point increase in the interest rate related to the variable-rate debt and related swap contracts, and assuming no change in the outstanding balance as of September 30, 2006, interest expense for 2006 would increase by approximately \$3.4 million, or \$0.02 per common share on a diluted basis.

## **Item 4. Controls and Procedures**

*Disclosure Controls and Procedures.* We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow for timely decisions regarding required disclosures. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.



Also, we have investments in certain unconsolidated entities. Our disclosure controls and procedures with respect to such entities are substantially more limited than those we maintain with respect to our consolidated subsidiaries.

As required by Rule 13a-15(b) and 15d-15(b) of the Securities Exchange Act of 1934, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer, Chief Financial Officer and Chief Accounting Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2006. Based on the foregoing, our Chief Executive Officer, Chief Financial Officer and Chief Accounting Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

*Changes in Internal Control Over Financial Reporting.* There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Securities and Exchange Act of 1934) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II. OTHER INFORMATION

### Item 1A. Risk Factors

The following risks related to the Company's acquisition of CRP supplement the risks discussed in Part 1, Item 1A of our 2005 Annual Report on Form 10-K:

#### **Risks Relating to the Merger with CNL Retirement Properties**

**If HCP is unable to successfully integrate the operations of CRP, its business and earnings may be negatively affected.**

The merger with CRP involves the integration of companies that have previously operated independently. Successful integration of the operations of CRP depends primarily on HCP's ability to consolidate operations, systems procedures, properties and personnel and to eliminate redundancies and costs. The merger also poses other risks commonly associated with similar transactions, including unanticipated liabilities, unexpected costs and the diversion of management's attention to the integration of the operations of HCP and CRP. We cannot assure you that HCP will be able to integrate CRP's operations without encountering difficulties, including, but not limited to, the loss of key employees, the disruption of its respective ongoing businesses or possible inconsistencies in standards, controls, procedures and policies. Estimated cost savings are projected to come from various areas that HCP's management has identified through the due diligence and integration planning process. If HCP has difficulties with any of these integrations, it might not achieve the economic benefits it expects to result from the CRP merger, and this may hurt its business and earnings. In addition, HCP may experience greater than expected costs or difficulties relating to the integration of the business of CRP and/or may not realize expected cost savings from the CRP merger within the expected time frame, if at all.

**Difficulties associated with establishing joint ventures and contributing properties to those joint ventures or selling properties, including CRP's properties, could limit the combined company's flexibility and adversely affect the anticipated benefits of the merger and the market price of HCP common stock.**

HCP has established joint ventures with respect to certain of its properties or sold certain of its properties to third parties in recent years and intends to continue to establish joint ventures and sell properties as opportunities arise. HCP believes that many of CRP's current and future developments will be good candidates to contribute to joint ventures or sell to third parties. The combined company's ability to establish joint ventures or sell properties, including those owned or developed by CRP, on advantageous terms is dependent upon several factors, some of which are beyond the control of HCP's management. These factors include the ability of HCP to identify financial partners willing to contribute to joint ventures on acceptable terms, if at all, and the ability of HCP to obtain debt financing for such joint ventures on attractive terms, if at all, as well as competition from other owners of properties and rights of third parties with respect to such properties. Continued interest from and capital provided by other joint venture investors is necessary in order for HCP to continue its strategy of contributing properties to such joint ventures. The inability of HCP to establish joint ventures and contribute properties to such joint ventures or to sell properties, including those owned by CRP, or to do so on advantageous terms could materially adversely affect HCP.

**HCP and CRP incurred substantial costs in connection with the merger, which could result in HCP not realizing some of the anticipated benefits of the merger.**

HCP and CRP incurred one-time, pre-tax costs of approximately \$33.1 million in connection with the CRP merger. These costs include investment banking expenses, legal and accounting fees, printing expenses and other related charges incurred by HCP and CRP. Completion of the merger also required the payment of fees under certain of CRP's existing debt. In addition, HCP anticipates prepaying and/or refinancing other of CRP's existing debt. HCP also expects to incur one-time, pre-tax cash and non-cash costs related to the integration of HCP and CRP, which cannot be estimated at this time. There can be no assurance that the costs incurred by HCP and CRP in connection with the CRP merger will not be higher than expected or that HCP will not incur additional unanticipated costs and expenses in connection with the merger.

**The combined company's indebtedness following the completion of the merger is higher than HCP's indebtedness at September 30, 2006. This increased level of indebtedness could adversely affect HCP in many ways, including by reducing funds available for other business purposes, reducing HCP's flexibility and subjecting HCP to variations in interest rates.**

The indebtedness of HCP as of September 30, 2006 was approximately \$2.9 billion. HCP's pro forma indebtedness as of September 30, 2006, giving effect to the merger and taking into account HCP's debt financings in connection with the CRP merger, would be approximately \$7 billion. HCP's debt financings include up to \$3.4 billion of aggregate borrowings under a 364 day bridge facility and a two-year term loan facility. In addition, it is expected that HCP will continue to incur debt in the future. As a result of the increase in debt, demands on HCP's cash resources will increase after the merger. The increased levels of debt could reduce funds available to HCP to pay dividends, or make capital expenditures and acquisitions or create competitive disadvantages for HCP compared to other companies with lower debt levels. In addition to requiring repayment or refinancing within a period of time ranging from 364 days to three years, the debt facilities that HCP expects to enter into to finance the merger will be required to be repaid from the cash proceeds of non-ordinary course asset sales, the incurrence of certain debt, the issuance of additional equity and specified other events. As a result of such covenants and HCP's expected level of debt generally, HCP's flexibility could be significantly limited, including its ability to finance or refinance its properties, contribute properties to joint ventures or sell properties as needed.

At September 30, 2006, approximately \$336 million of HCP's debt was subject to variable interest rates. Approximately \$3 billion of the new debt incurred or assumed in connection with the CRP merger is also subject to variable interest rates and therefore, following the CRP merger, a higher percentage of HCP's debt overall will be subject to variable interest rates. If interest rates increase, the combined company's interest costs will also increase, which could harm our cash flow and our ability to service debt. An increase in market interest rates may also lead investors to demand a higher annual distribution rate, which could adversely affect the market price of HCP common stock.

**As a result of the CRP merger and the CRC merger, HCP may have inherited tax liabilities and attributes from CRP and CRC.**

Prior to the CRP merger, CRP was organized as REIT for federal income tax purposes. If CRP failed to qualify as a REIT for any of its taxable years, it would be required to pay federal income tax (including any applicable alternative minimum tax) on its taxable income at regular corporate rates. Unless statutory relief provisions apply, CRP would have been disqualified from treatment as a REIT for the four taxable years following the year during which it lost qualification. Because the CRP merger was treated for income tax purposes as if CRP sold all of its assets in a taxable transaction to HCP, if CRP did not qualify as a REIT for the taxable year of the merger, it would be subject to tax in respect of the built-in gain in all of its assets. Built-in gain generally means the excess of the fair market value of an asset over its adjusted tax basis. As successor-in-interest to CRP, HCP would be required to pay these taxes. After the merger, the nature of the assets that HCP acquired from CRP and the income HCP derives from those assets may have an effect on HCP's tax status as a REIT.

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In connection with the CRP merger, CRP's REIT counsel render an opinion to HCP, dated as of the closing date of the merger, to the effect that CRP qualified as a REIT under the code for the taxable years ending December 31, 1999 through December 31, 2005, CRP was organized in conformity with the requirements for qualification as a REIT, and CRP's method of operation had enabled CRP to satisfy the requirements for qualification as a REIT under the Code for the taxable years ending on or prior to the closing date of the merger. This opinion was based on various assumptions and representations as to factual matters, including representations made by CRP in a factual certificate provided by one of its officers, as well as other oral and written statements of officers and other representatives of CRP and others as to the existence and consequence of certain factual and other matters.

As a result of the CRC merger, HCP succeeded to the assets and the liabilities of CRC, including any liabilities for unpaid taxes and any tax liabilities created in connection with the CRC merger. At the closing of the CRC merger, HCP received an opinion of its counsel, and CRC and its stockholders received an opinion of their counsel, substantially to the effect that, on the basis of the facts, representations and assumptions set forth or referred to in such opinions, for federal income tax purposes the CRC merger qualified as a reorganization within the meaning of Section 368(a) of the Code. To the extent that the CRC merger so qualified, no gain or loss was recognized by CRC or HCP in the CRC merger. If the CRC merger did not qualify as a reorganization within the meaning of Section 368(a) of the Code, the CRC merger would have been treated as a sale of CRC's assets to HCP in a taxable transaction, and CRC would have recognized taxable gain. In such a case, as CRC's successor-in-interest, HCP would be required to pay the tax on any such gain.

Assuming that the CRC merger qualified as a reorganization under the Code, HCP succeeded to the tax attributes and earnings and profits of CRC. To qualify as a REIT, HCP must distribute such earnings and profits by the close of the taxable year in which the CRC merger occurred. Any adjustments of CRC's income for taxable years ending on or before the CRC merger,

including as a result of an examination of CRC's tax returns by the Internal Revenue Service, could affect the calculation of CRC's earnings and profits. If the Internal Revenue Service were to determine that HCP acquired earnings and profits from CRC that HCP failed to distribute prior to the end of the taxable year in which the CRC merger occurred, HCP could avoid disqualification as a REIT by using deficiency dividend procedures. Under these procedures, HCP generally would be required to distribute any such earnings and profits to its stockholders within 90 days of the determination and pay a statutory interest charge at a specified rate to the Internal Revenue Service.

The opinions of counsel delivered in connection with the CRP merger and the CRC merger represent the best legal judgment of counsel and are not binding on the Internal Revenue Service or the courts. None of HCP, CRP or CRC has requested nor will request a ruling from the Internal Revenue Service as to the status of CRP as a REIT or the tax consequences of the CRC merger, and there can be no assurance that the Internal Revenue Service will agree with the conclusions in the above-described opinions.

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

The table below sets forth the information with respect to purchases of our common stock made by us or on our behalf during the quarter ended September 30, 2006.

| <b>Period Covered</b> | <b>Total Number<br/>Of Shares<br/>Purchased(1)</b> | <b>Average Price<br/>Paid Per Share</b> | <b>Total Number Of Shares<br/>(Or Units) Purchased As<br/>Part Of Publicly<br/>Announced Plans Or<br/>Programs</b> | <b>Maximum Number (Or<br/>Approximate Dollar Value)<br/>Of Shares (Or Units) That<br/>May Yet Be Purchased<br/>Under The Plans Or<br/>Programs</b> |
|-----------------------|--|---|--|--|
| July 1-31, 2006       | 358  | \$ 27.35                                |  |  |
| August 1-31, 2006     |  |   |  |  |
| September 1-30, 2006  |  |   |  |  |
| <b>Total</b>          | <b>358</b>   | <b>\$ 27.35</b>                         |  |  |



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(1) Represents restricted shares withheld under our Amended and Restated 2000 Stock Incentive Plan, as amended, to offset tax withholding obligations that occur upon vesting of restricted shares. Our Amended and Restated 2000 Stock Incentive Plan, as amended, provides that the value of the shares withheld shall be the closing price of our common stock on the date the relevant transaction occurs.

### Item 5. Other Information

On October 26, 2006, our Board of Directors approved changes to the compensation arrangements for the members of our Board of Directors who are not also employed by HCP. The Board of Directors agreed to (i) increase each Director's annual retainer from \$24,000 to \$35,000, (ii) increase the additional annual retainer for our Lead Director from \$15,000 to \$25,000, (iii) pay an additional annual retainer to our Compensation Committee Chairperson of \$15,000 and (iv) pay an additional annual retainer to our Finance Committee Chairperson of \$10,000. These changes are effective as of October 1, 2006, and were the only changes made to our existing Director compensation arrangements.

### Item 6. Exhibits

- 2.1 Agreement and Plan of Merger, dated May 1, 2006, by and among Health Care Property Investors, Inc., CNL Retirement Properties, Inc. and Ocean Acquisition 1, Inc. (incorporated by reference to exhibit 2.1 to HCP's report on Form 8-K, dated May 1, 2006).
- 3.1 Articles of Restatement of HCP (incorporated by reference to exhibit 3.1 to HCP's report on Form 10-Q for the period of September 30, 2004).
- 3.2 Third Amended and Restated Bylaws of HCP. (incorporated by reference to exhibit 3.2 to HCP's report on Form 10-Q for the period of September 30, 2004).
- 4.1 Indenture, dated as of September 1, 1993, between HCP and The Bank of New York, as Trustee (incorporated by reference to exhibit 4.1 to HCP's registration statement on Form S-3 dated September 9, 1993).
- 4.2 Form of Fixed Rate Note (incorporated by reference to exhibit 4.2 to HCP's registration statement on Form S-3 dated March 20, 1989).
- 4.3 Form of Floating Rate Note (incorporated by reference to exhibit 4.3 to HCP's registration statement on Form S-3 dated March 20, 1989).
- 4.4 Registration Rights Agreement dated November 20, 1998 between HCP and James D. Bremner (incorporated by reference to exhibit 4.8 to HCP's annual report on Form 10-K for the year ended December 31, 1999). This exhibit is identical in all material respects to two other documents except the parties thereto. The parties to these other documents, other than HCP, were James P. Revel and Michael F. Wiley.
- 4.5 Registration Rights Agreement dated January 20, 1999 between HCP and Boyer Castle Dale Medical Clinic, L.L.C. (incorporated by reference to exhibit 4.9 to HCP's annual report on Form 10-K for the year ended December 31, 1999). This exhibit is identical in all material respects to 13 other documents except the parties thereto. The parties to these other documents, other than HCP, were Boyer Centerville Clinic Company, L.C., Boyer Elko, L.C., Boyer Desert Springs, L.C., Boyer Grantsville Medical, L.C., Boyer-Ogden Medical Associates, LTD., Boyer Ogden Medical Associates No. 2, LTD., Boyer Salt Lake Industrial Clinic Associates, LTD., Boyer-St. Mark's Medical Associates, LTD., Boyer McKay-Dee Associates, LTD., Boyer St. Mark's Medical Associates #2, LTD., Boyer Iomega, L.C., Boyer Springville, L.C., and Boyer Primary Care Clinic Associates, LTD. #2.



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- 4.6 Indenture, dated as of January 15, 1997, between American Health Properties, Inc. and The Bank of New York, as trustee (incorporated herein by reference to exhibit 4.1 to American Health Properties, Inc.'s current report on Form 8-K (file no. 001-09381), dated January 21, 1997).
- 4.7 First Supplemental Indenture, dated as of November 4, 1999, between HCP and The Bank of New York, as trustee (incorporated by reference to HCP's quarterly report on Form 10-Q for the period ended September 30, 1999).
- 4.8 Registration Rights Agreement dated August 17, 2001 between HCP, Boyer Old Mill II, L.C., Boyer-Research Park Associates, LTD., Boyer Research Park Associates VII, L.C., Chimney Ridge, L.C., Boyer-Foothill Associates, LTD., Boyer Research Park Associates VI, L.C., Boyer Stansbury II, L.C., Boyer Rancho Vistoso, L.C., Boyer-Alta View Associates, LTD., Boyer Kaysville Associates, L.C., Boyer Tatum Highlands Dental Clinic, L.C., Amarillo Bell Associates, Boyer Evanston, L.C., Boyer Denver Medical, L.C., Boyer Northwest Medical Center Two, L.C., and Boyer Caldwell Medical, L.C. (incorporated by reference to exhibit 4.12 to HCP's annual report on Form 10-K for the year ended December 31, 2001).
- 4.9 Acknowledgment and Consent dated as of March 1, 2005 by and among Merrill Lynch Bank USA, Gardner Property Holdings, L.C., HCPI/Utah, LLC, the unit holders of HCPI/Utah, LLC and HCP (incorporated by reference to exhibit 4.12 to HCP's annual report on Form 10-K for the year ended December 31, 2004).\*
- 4.10 Acknowledgment and Consent dated as of March 1, 2005 by and among Merrill Lynch Bank USA, The Boyer Company, L.C., HCPI/Utah, LLC, the unit holders of HCPI/Utah, LLC and HCP (incorporated by reference to exhibit 4.13 to HCP's annual report on Form 10-K for the year ended December 31, 2004).\*
- 4.11 Officers' Certificate pursuant to Section 301 of the Indenture dated as of September 1, 1993 between the Company and The Bank of New York, as Trustee, establishing a series of securities entitled 6.5% Senior Notes due February 15, 2006 (incorporated by reference to exhibit 4.1 to HCP's report on Form 8-K, dated February 21, 1996).
- 4.12 Officers' Certificate pursuant to Section 301 of the Indenture dated as of September 1, 1993 between the Company and The Bank of New York, as Trustee, establishing a series of securities entitled 6 7/8% MandatOry Par Put Remarketed Securities due June 8, 2015 (incorporated by reference to exhibit 4.1 to HCP's report on Form 8-K, dated June 3, 1998).
- 4.13 Officers' Certificate pursuant to Section 301 of the Indenture dated as of September 1, 1993 between the Company and The Bank of New York, as Trustee, establishing a series of securities entitled 6.45% Senior Notes due June 25, 2012 (incorporated by reference to exhibit 4.1 to HCP's report on Form 8-K, dated June 19, 2002).
- 4.14 Officers' Certificate pursuant to Section 301 of the Indenture dated as of September 1, 1993 between HCP and the Bank of New York, as Trustee, establishing a series of securities entitled 6.00% Senior Notes due March 1, 2015 (incorporated by reference to exhibit 3.1 to HCP's report on Form 8-K (file no. 001-08895), dated February 25, 2003).
- 4.15 Officers' Certificate pursuant to Section 301 of the Indenture dated as of September 1, 1993 between the Company and The Bank of New York, as Trustee, establishing a series of securities entitled 5 5/8% Senior Notes due May 1, 2017 (incorporated by reference to exhibit 4.2 to HCP's report on Form 8-K, dated April 22, 2005).
- 4.16 Registration Rights Agreement dated October 1, 2003 between HCP, Charles Crews, Charles A. Elcan, Thomas W. Hulme, Thomas M. Klaritch, R. Wayne Price, Glenn T. Preston, Janet Reynolds, Angela M. Playle, James A. Croy, John Klaritch as Trustee of the 2002 Trust F/B/O Erica Ann Klaritch, John Klaritch as Trustee of the 2002 Trust F/B/O Adam Joseph Klaritch, John Klaritch as Trustee of the 2002 Trust F/B/O Thomas Michael Klaritch, Jr. and John Klaritch as Trustee of the 2002 Trust F/B/O Nicholas James Klaritch (incorporated by reference to exhibit 4.16 to HCP's quarterly report on Form 10-Q for the period ended September 30, 2003).
- 4.17 Amended and Restated Dividend Reinvestment and Stock Purchase Plan, dated October 23, 2003 (incorporated by reference to HCP's registration statement on Form S-3 dated December 5, 2003, registration number 333-110939).

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- 4.18 Specimen of Stock Certificate representing the Series E Cumulative Redeemable Preferred Stock, par value \$1.00 per share (incorporated herein by reference to exhibit 4.1 of HCP s 8-A12B filed on September 12, 2003).
- 4.19 Specimen of Stock Certificate representing the Series F Cumulative Redeemable Preferred Stock, par value \$1.00 per share (incorporated herein by reference to exhibit 4.1 of HCP s 8-A12B filed on December 2, 2003).
- 4.20 Form of Floating Rate Note (incorporated by reference to exhibit 4.3 to HCP s Current Report on Form 8-K dated November 19, 2003).
- 4.21 Form of Fixed Rate Note (incorporated by reference to exhibit 4.4 to HCP s Current Report on Form 8-K dated November 19, 2003).
- 4.22 Acknowledgment and Consent dated as of March 1, 2005 by and among Merrill Lynch Bank USA, Gardner Property Holdings, L.C., HCPI/Utah II, LLC, the unit holders of HCPI/Utah II, LLC and HCP (incorporated by reference to exhibit 4.21 to HCP s annual report on Form 10-K for the year ended December 31, 2004).\*
- 4.23 Acknowledgment and Consent dated as of March 1, 2005 by and among Merrill Lynch Bank USA, The Boyer Company, L.C., HCPI/Utah II, LLC, the unit holders of HCPI/Utah II, LLC and HCP (incorporated by reference to exhibit 4.22 to HCP s annual report on Form 10-K for the year ended December 31, 2004).\*
- 4.24 Registration Rights Agreement dated July 22, 2005 between HCP, William P. Gallaher, Trustee for the William P. & Cynthia J. Gallaher Trust; Dwayne J. Clark; Patrick R. Gallaher, Trustee for the Patrick R. & Cynthia M. Gallaher Trust; Jeffrey D. Civian, Trustee for the Jeffrey D. Civian Trust dated August 8, 1986; Jeffrey Meyer; Steven L. Gallaher; Richard Coombs; Larry L. Wasem; Joseph H. Ward, Jr., Trustee for the Joseph H. Ward, Jr. and Pamela K. Ward Trust; Borue H. O Brien; William R. Mabry; Charles N. Elsbree, Trustee for the Charles N. Elsbree Jr. Living Trust dated February 14, 2002; Gary A. Robinson; Thomas H. Persons, Trustee for the Persons Family Revocable Trust under trust dated February 15, 2005; Glen Hammel; Marilyn E. Montero; Joseph G. Lin, Trustee for the Lin Revocable Living Trust; Ned B. Stein; John Gladstein, Trustee for the John & Andrea Gladstein Family Trust dated February 11, 2003; John Gladstein, Trustee for the John & Andrea Gladstein Family Trust dated February 11, 2003; Francis Connelly, Trustee for the The Francis J & Shannon A Connelly Trust; Al Coppin, Trustee for the Al Coppin Trust; Stephen B. McCullagh, Trustee for the Stephen B. & Pamela McCullagh Trust dated October 22, 2001; and Larry L. Wasem SEP IRA (incorporated by reference to exhibit 4.24 to HCP s quarterly report on Form 10-Q for the period ended June 30, 2005).
- 4.25 Form of Floating Rate Notes Due 2008 (incorporated by reference to exhibit 4.1 to HCP s Current Report on Form 8-K dated September 12, 2006).
- 4.26 Form of 5.95% Notes Due 2011 (incorporated by reference to exhibit 4.2 to HCP s Current Report on Form 8-K dated September 12, 2006).
- 4.27 Form of 6.30% Notes Due 2016 (incorporated by reference to exhibit 4.3 to HCP s Current Report on Form 8-K dated September 12, 2006).
- 10.1 Amendment No. 1, dated as of May 30, 1985, to Partnership Agreement of Health Care Property Partners, a California general partnership, the general partners of which consist of HCP and certain affiliates of Tenet (incorporated by reference to exhibit 10.1 to HCP s annual report on Form 10-K for the year ended December 31, 1985).
- 10.2 HCP Second Amended and Restated Directors Stock Incentive Plan (incorporated by reference to exhibit 10.43 to HCP s quarterly report on Form 10-Q for the period ended March 31, 1997).\*
- 10.2.1 First Amendment to Second Amended and Restated Directors Stock Incentive Plan, effective as of November 3, 1999 (incorporated by reference to exhibit 10.1 to HCP s quarterly report on Form 10-Q for the period ended September 30, 1999).\*

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- 10.2.2 Second Amendment to Second Amended and Restated Directors Stock Incentive Plan, effective as of January 4, 2000 (incorporated by reference to exhibit 10.15 to HCP's annual report on Form 10-K for the year ended December 31, 1999).\*
- 10.3 HCP Second Amended and Restated Stock Incentive Plan (incorporated by reference to exhibit 10.44 to HCP's quarterly report on Form 10-Q for the period ended March 31, 1997).\*
- 10.3.1 First Amendment to Second Amended and Restated Stock Incentive Plan effective as of November 3, 1999 (incorporated by reference to exhibit 10.3 to HCP's quarterly report on Form 10-Q for the period ended September 30, 1999).\*
- 10.4 HCP 2000 Stock Incentive Plan, effective as of May 7, 2003 (incorporated by reference to HCP's Proxy Statement regarding HCP's annual meeting of shareholders held May 7, 2003).\*
- 10.4.1 Amendment to the Company's Amended and Restated 2000 Stock Incentive Plan (effective as of May 7, 2003) (incorporated herein by reference to exhibit 10.1 to HCP's current report on Form 8-K, dated January 28, 2005).\*
- 10.5 HCP Second Amended and Restated Directors Deferred Compensation Plan (incorporated by reference to exhibit 10.45 to HCP's quarterly report on Form 10-Q for the period ended September 30, 1997).\*
- 10.5.1 First Amendment to Second Amended and Restated Directors Deferred Compensation Plan, effective as of April 11, 1997 (incorporated by reference to exhibit 10.5.1 to HCP's quarterly report on Form 10-Q for the period ended March 31, 2005).\*
- 10.5.2 Second Amendment to Second Amended and Restated Directors Deferred Compensation Plan, effective as of July 17, 1997 (incorporated by reference to exhibit 10.5.2 to HCP's quarterly report on Form 10-Q for the period ended March 31, 2005).\*
- 10.5.3 Third Amendment to Second Amended and Restated Directors Deferred Compensation Plan, effective as of November 3, 1999 (incorporated by reference to exhibit 10.2 to HCP's quarterly report on Form 10-Q for the period ended September 30, 1999).\*
- 10.5.4 Fourth Amendment to Second Amended and Restated Director Deferred Compensation Plan, effective as of January 4, 2000 (incorporated by reference to exhibit 10.19 to HCP's annual report on Form 10-K for the year ended December 31, 1999).\*
- 10.6 Various letter agreements, each dated as of October 16, 2000, among HCP and certain key employees of the Company (incorporated by reference to exhibit 10.12 to HCP's annual report on Form 10-K for the year ended December 31, 2000).\*
- 10.7 HCP Amended and Restated Executive Retirement Plan (incorporated by reference to exhibit 10.13 to HCP's annual report on Form 10-K for the year ended December 31, 2001).\*
- 10.8 Amended and Restated Limited Liability Company Agreement dated November 20, 1998 of HCPI/Indiana, LLC (incorporated by reference to exhibit 10.15 to HCP's annual report on Form 10-K for the year ended December 31, 1998).
- 10.9 Amended and Restated Limited Liability Company Agreement dated January 20, 1999 of HCPI/Utah, LLC (incorporated by reference to exhibit 10.16 to HCP's annual report on Form 10-K for the year ended December 31, 1998).
- 10.10 Cross-Collateralization, Cross-Contribution and Cross-Default Agreement, dated as of July 20, 2000, by HCP Medical Office Buildings II, LLC, and Texas HCP Medical Office Buildings, L.P., for the benefit of First Union National Bank (incorporated by reference to exhibit 10.20 to HCP's annual report on Form 10-K for the year ended December 31, 2000).

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- 10.11 Cross-Collateralization, Cross-Contribution and Cross-Default Agreement, dated as of August 31, 2000, by HCP Medical Office Buildings I, LLC, and Meadowdome, LLC, for the benefit of First Union National Bank (incorporated by reference to exhibit 10.21 to HCP's annual report on Form 10-K for the year ended December 31, 2000).
- 10.12 Amended and Restated Limited Liability Company Agreement dated August 17, 2001 of HCPI/Utah II, LLC (incorporated by reference to exhibit 10.21 to HCP's annual report on Form 10-K for the year ended December 31, 2001).
- 10.12.1 First Amendment to Amended and Restated Limited Liability Company Agreement dated October 30, 2001 of HCPI/Utah II, LLC (incorporated by reference to exhibit 10.22 to HCP's annual report on Form 10-K for the year ended December 31, 2001).
- 10.13 Employment Agreement dated October 26, 2005 between HCP and James F. Flaherty III (incorporated by reference to exhibit 10.13 to HCP's quarterly report on Form 10-Q for the period ended September 30, 2005).\*
- 10.14 Amended and Restated Limited Liability Company Agreement dated as of October 2, 2003 of HCPI/Tennessee, LLC (incorporated by reference to exhibit 10.28 to HCP's quarterly report on Form 10-Q for the period ended September 30, 2003).
- 10.14.1 Amendment No.1 to Amended and Restated Limited Liability Company Agreement dated September 29, 2004 of HCPI/Tennessee, LLC (incorporated by reference to exhibit 10.37 to HCP's quarterly report on Form 10-Q for the period ended September 30, 2004).
- 10.14.2 Amendment No.2 to Amended and Restated Limited Liability Company Agreement dated October 29, 2004 of HCPI/Tennessee, LLC (incorporated by reference to exhibit 10.43 to HCP's annual report on Form 10-K for the year ended December 31, 2004).
- 10.14.3 Amendment No.3 to Amended and Restated Limited Liability Company Agreement and New Member Joinder Agreement dated October 19, 2005 of HCPI/Tennessee, LLC (incorporated by reference to exhibit 10.14.3 to HCP's quarterly report on Form 10-Q for the period ended September 30, 2005).
- 10.15 Employment Agreement dated October 1, 2003 between HCP and Charles A. Elcan (incorporated by reference to exhibit 10.29 to HCP's quarterly report on Form 10-Q for the period ended September 30, 2003).\*
- 10.15.1 Amendment No.1 to the Employment Agreement dated October 1, 2003 between HCP and Charles A. Elcan (incorporated herein by reference to exhibit 10.5 to HCP's current report on Form 8-K, dated January 28, 2005).\*
- 10.16 Form of Restricted Stock Agreement for employees and consultants effective as of May 7, 2003, as approved by the Compensation Committee of the Board of Directors of the Company, relating to the Company's Amended and Restated 2000 Stock Incentive Plan (incorporated by reference to exhibit 10.30 to HCP's annual report on Form 10-K for the year ended December 31, 2003).\*
- 10.17 Form of Restricted Stock Agreement for directors effective as of May 7, 2003, as approved by the Compensation Committee of the Board of Directors of the Company, relating to the Company's Amended and Restated 2000 Stock Incentive Plan (incorporated by reference to exhibit 10.31 to HCP's annual report on Form 10-K for the year ended December 31, 2003).\*
- 10.18 Form of Performance Award Letter for employees effective as of May 7, 2003, as approved by the Compensation Committee of the Board of Directors of the Company, relating to the Company's Amended and Restated 2000 Stock Incentive Plan (incorporated by reference to exhibit 10.32 to HCP's annual report on Form 10-K for the year ended December 31, 2003).\*
- 10.19 Form of Stock Option Agreement for eligible participants effective as of May 7, 2003, as approved by the Compensation Committee of the Board of Directors of the Company, relating to the Company's Amended and Restated 2000 Stock Incentive Plan (incorporated by reference to exhibit 10.33 to HCP's annual report on Form 10-K for the year ended December 31, 2003).\*

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- 10.20 Amended and Restated Executive Retirement Plan effective as of May 7, 2003 (incorporated by reference to exhibit 10.34 to HCP's annual report on Form 10-K for the year ended December 31, 2003).\*
- 10.21 Revolving Credit Agreement, dated as of October 26, 2004, among HCP, each of the banks identified on the signature pages hereof, Bank of America, N.A., as administrative agent, JPMorgan Chase Bank, as syndicating agent, Barclays Bank PLC, Wachovia Bank, National Association, and Wells Fargo Bank, N.A., as documentation agents, with Calyon New York Branch, Citicorp, USA, and Key National Association as managing agents, and Banc of America Securities LLC and J.P. Morgan Securities, Inc., as joint lead arrangers and joint book managers (incorporated herein by reference to exhibit 10.1 to HCP's current report on Form 8-K (file no. 001-08895), dated November 1, 2004).
- 10.22 Form of CEO Performance Restricted Stock Unit Agreement with five year installment vesting effective as of March 15, 2004, as approved by the Compensation Committee of the Board of Directors of the Company, relating to the Company's Amended and Restated 2000 Stock Incentive Plan (incorporated herein by reference to exhibit 10.34 to HCP's annual report on Form 10-K, dated March 15, 2005).\*
- 10.23 Form of CEO Performance Restricted Stock Unit Agreement with three year cliff vesting effective as of March 15, 2004, as approved by the Compensation Committee of the Board of Directors of the Company, relating to the Company's Amended and Restated 2000 Stock Incentive Plan (incorporated herein by reference to exhibit 10.35 to HCP's annual report on Form 10-K, dated March 15, 2005).\*
- 10.24 Form of employee Performance Restricted Stock Unit Agreement with five year installment vesting effective as of March 15, 2004, as approved by the Compensation Committee of the Board of Directors of the Company, relating to the Company's Amended and Restated 2000 Stock Incentive Plan (incorporated herein by reference to exhibit 10.36 to HCP's annual report on Form 10-K, dated March 15, 2005).\*
- 10.25 Form of employee Performance Restricted Stock Unit Agreement with three year cliff vesting effective as of March 15, 2004, as approved by the Compensation Committee of the Board of Directors of the Company, relating to the Company's Amended and Restated 2000 Stock Incentive Plan (incorporated herein by reference to exhibit 10.37 to HCP's annual report on Form 10-K, dated March 15, 2005).\*
- 10.26 Form of CEO Performance Restricted Stock Unit Agreement with five year installment vesting effective as of March 15, 2004, as approved by the Compensation Committee of the Board of Directors of the Company, relating to the Company's Amended and Restated 2000 Stock Incentive Plan (incorporated herein by reference to exhibit 10.4 to HCP's current report on Form 8-K, dated January 28, 2005).\*
- 10.27 Form of CEO Performance Restricted Stock Unit Agreement with three year cliff vesting, as approved by the Compensation Committee of the Board of Directors of the Company, relating to the Company's Amended and Restated 2000 Stock Incentive Plan (incorporated herein by reference to exhibit 10.2 to HCP's current report on Form 8-K, dated January 28, 2005).\*
- 10.28 Form of employee Performance Restricted Stock Unit Agreement with five year installment vesting, as approved by the Compensation Committee of the Board of Directors of the Company, relating to the Company's Amended and Restated 2000 Stock Incentive Plan (incorporated herein by reference to exhibit 10.3 to HCP's current report on Form 8-K, dated January 28, 2005).\*
- 10.29 CEO Performance Restricted Stock Unit Agreement, as approved by the Compensation Committee of the Board of Directors of the Company, relating to the Company's Amended and Restated 2000 Stock Incentive Plan (incorporated by reference to exhibit 10.29 to HCP's quarterly report on Form 10-Q for the period ended September 30, 2005).\*
- 10.30 Form of directors and officers Indemnification Agreement as approved by the Board of Directors of the Company (incorporated by reference to exhibit 10.30 to HCP's quarterly report on Form 10-Q for the period ended September 30, 2005).\*

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- 10.31 Various letter agreements, each dated as of October 16, 2000, among HCP and certain key employees of the Company (incorporated herein by reference to exhibit 10.12 to HCP's annual report on Form 10-K, dated March 9, 2001).\*
- 10.32 Term Loan Agreement dated as of February 14, 2006 among HCP., as Borrower, UBS AG, Stamford Branch, as Administrative Agent, UBS Securities LLC and Barclays Bank plc, as joint lead arrangers, and the lenders party thereto (incorporated herein by reference to exhibit 10.1 to HCP's current report on Form 8-K, dated February 21, 2006).
- 10.33 Form of employee Performance Restricted Stock Unit Agreement with five year installment vesting, as approved by the Compensation Committee of the Board of Directors of the Company, relating to the Company's Amended and Restated 2000 Stock Incentive Plan (incorporated by reference to exhibit 10.33 to HCP's quarterly report on Form 10-Q for the period ended March 31, 2006).\*
- 10.34 Form of CEO Performance Restricted Stock Unit Agreement with five year installment vesting, as approved by the Compensation Committee of the Board of Directors of the Company, relating to the Company's Amended and Restated 2000 Stock Incentive Plan (incorporated by reference to exhibit 10.34 to HCP's quarterly report on Form 10-Q for the period ended March 31, 2006).\*
- 10.35 Form of CEO Performance Restricted Stock Unit Agreement with three year cliff vesting, as approved by the Compensation Committee of the Board of Directors of the Company, relating to the Company's Amended and Restated 2000 Stock Incentive Plan (incorporated by reference to exhibit 10.35 to HCP's quarterly report on Form 10-Q for the period ended March 31, 2006).\*
- 10.36 Form of employee Restricted Stock Award Agreement with five year installment vesting, as approved by the Compensation Committee of the Board of Directors of the Company, relating to the Company's 2006 Performance Incentive Plan (incorporated by reference to exhibit 10.36 to HCP's quarterly report on Form 10-Q for the period ended June 30, 2006).\*
- 10.37 Form of employee Nonqualified Stock Option Agreement with five year installment vesting, as approved by the Compensation Committee of the Board of Directors of the Company, relating to the Company's 2006 Performance Incentive Plan (incorporated by reference to exhibit 10.37 to HCP's quarterly report on Form 10-Q for the period ended June 30, 2006).\*
- 10.38 Form of director Restricted Stock Award Agreement with five year installment vesting, as approved by the Board of Directors of the Company, relating to the Company's 2006 Performance Incentive Plan (incorporated by reference to exhibit 10.38 to HCP's quarterly report on Form 10-Q for the period ended June 30, 2006).\*
- 10.39 Form of Non-Employee Directors Stock-For-Fees Program, as approved by the Board of Directors of the Company, relating to the Company's 2006 Performance Incentive Plan.\* (incorporated herein by reference to exhibit 10.1 to HCP's current report on Form 8-K, dated July 27, 2006).
- 10.40 Stock Unit Award Agreement, dated August 14, 2006, by and between the Company and James F. Flaherty III (incorporated by reference to exhibit 10.1 to HCP's Current Report on Form 8-K dated August 14, 2006).\*
- 31.1 Certification by James F. Flaherty III, the Company's Principal Executive Officer, Pursuant to Securities Exchange Act Rule 13a-14(a).
- 31.2 Certification by Mark A. Wallace, the Company's Principal Financial Officer, Pursuant to Securities Exchange Act Rule 13a-14(a).
- 32.1 Certification by James F. Flaherty III, the Company's Principal Executive Officer, Pursuant to Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350.
- 32.2 Certification by Mark A. Wallace, the Company's Principal Financial Officer, Pursuant to Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350.
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\* Management Contract or Compensatory Plan or Arrangement.

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For the purposes of complying with the amendments to the rules governing Form S-8 (effective July 13, 1990) under the Securities Act of 1933, the undersigned registrant hereby undertakes as follows, which undertaking shall be incorporated by reference into registrant's Registration Statement on Form S-8 Nos. 33-28483 and 333-90353 filed May 11, 1989 and November 5, 1999, respectively, Form S-8 Nos. 333-54786 and 333-54784 each filed February 1, 2001, and Form S-8 No. 333-108838 filed September 16, 2003.

Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers and controlling persons of the registrant pursuant to the foregoing provisions, or otherwise, the registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act of 1933 and is therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy expressed in the Securities Act of 1933 and will be governed by the final adjudication of such issue.



**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: October 30, 2006

HEALTH CARE PROPERTY INVESTORS, INC.

(Registrant)

/s/ Mark A. Wallace  
**Mark A. Wallace**  
**Senior Vice President and**  
**Chief Financial Officer**  
**(Principal Financial Officer)**

/s/ George P. Doyle  
**George P. Doyle**  
**Vice President and Chief Accounting Officer**  
**(Principal Accounting Officer)**