

Fitch Affirms HCP's IDR at 'BBB+'; Outlook Stable

Written by Australian Business

NEW YORK--([BUSINESS WIRE](#))--Fitch Ratings has affirmed the ratings of HCP, Inc. (NYSE: HCP) as follows:

--Long-term IDR at 'BBB+';

--Unsecured bank credit facility at 'BBB+';

--Unsecured term loan at 'BBB+';

--Senior unsecured notes at 'BBB+'.

The Rating Outlook is Stable.

KEY RATING DRIVERS

The ratings reflect HCP's credit strengths, namely: the steady and predictable cash flows from a large portfolio of healthcare properties, maintenance of leverage and fixed-charge coverage metrics appropriate for the rating category, manageable lease expiration and debt maturity schedules, financial flexibility stemming from a large unencumbered pool, and a solid liquidity position.

Credit concerns include: operator concentration, which will increase further pro forma for the pending merger between Brookdale Senior Living and Emeritus Corporation, persistently low coverage metrics for HCP's largest tenant (HCR ManorCare), and the impact of government and regulatory actions on operators' profitability. HCP's commitment to existing conservative business and financing strategies mitigates the abrupt change in senior leadership (the termination in 4Q13 of Jay Flaherty who had been CEO since 2003).

DURABLE CASHFLOWS

HCP's same-store property performance has been strong over the past five years and is one of the largest factors behind the rating, with same property net operating income (NOI) increasing between 3.1% and 4.8% annually from 2009-2013. Same-property NOI increased 3.1% for 2013 as compared to 4.2%, 4% and 4.8% for 2012, 2011 and 2010, respectively. The strong fundamentals result from the lease structures (generally triple-net with contractual increases) as well as HCP's active management. Fitch estimates same-property NOI growth to remain within the historical 2%-4% range through 2015 despite the regulatory-based headwinds some operators are facing. Unlike many other rated healthcare REITs, HCP has an insignificant amount of RIDEA exposure, thereby increasing the durability of cash flows.

HCP's lease maturity schedule is well-staggered and long-dated as a result of the high percentage of long-term triple net leases. Less than 10% of annual base rent revenues expires in any one year. Limited lease expirations coupled with contractual rental bumps increase the predictability of future rental revenues, absent tenant bankruptcies and are credit strengths for HCP.

STRONG CREDIT METRICS

HCP's fixed-charge coverage was 3.5x for 2013 as compared to 3.1x and 2.7x in 2012 and 2011, respectively. Fitch projects fixed-charge coverage will improve further above 4.0x over the next 12-to-36 months driven by same-store NOI growth, earnings contributions from recent acquisitions and reduced fixed charges. Fitch defines fixed-charge coverage as recurring operating EBITDA less recurring capital expenditures less straight-line rent adjustments and direct financing lease accretion, divided by total interest incurred.

HCP's leverage was 5.2x and 5.0x for year and quarter ended Dec. 31, 2013, respectively which is within a range that is appropriate for a 'BBB+' IDR. Leverage was 5.4x and 5.3x as of Dec. 31, 2012 and 2011, respectively, pro forma for material acquisitions. Fitch projects HCP's leverage will decline towards 4.5x by 2016. That said, Fitch notes that HCP's propensity for large transactions may cause fluctuations in reported metrics.

Fitch defines leverage as net debt divided by recurring operating EBITDA.

STRONG LIQUIDITY & ACCESS TO CAPITAL

HCP has repaid the majority of its 2014 maturities pro forma for the \$350 million 4.2% senior unsecured bond issuance in 1Q'14 and has only 9.7% of total debt maturing through 2015. The company's debt maturity schedule is appropriately-staggered thereafter, with less than 17% of debt maturing in any one year. The largest year for debt maturities is 2016; however, HCP maintains options to extend the maturity of the term loan by one year. This reduces potential maturities in 2016 to 14% of total debt outstanding. As such, HCP maintains a strong liquidity position.

Sources of liquidity (unrestricted cash, availability under the company's unsecured revolving credit facility pro forma for the recent extension and amendment to \$2 billion and expected retained cash flows from operating activities after dividends and distributions) divided by uses of liquidity (pro rata debt maturities adjusted for recent repayments, development expenditures and estimated recurring capital expenditures) for the period Jan. 1, 2014 to Dec. 31, 2015 results in a liquidity coverage ratio of 2.4x. HCP has also demonstrated strong access to a wide variety of capital sources over the past two years, mitigating refinance risk.

HCP maintains solid financial flexibility stemming mainly from its large unencumbered property pool, which serves as a source of contingent liquidity. Using a stressed capitalization rate range of 8%-10%, HCP's unencumbered asset coverage of net unsecured debt was approximately 2.0x-2.4x, which is appropriate for the 'BBB+' IDR.

Further, HCP's distributions do not restrict financial flexibility. Fitch calculates that the company's common stock dividends represented only 83% and 90% of 2013 and 2012, respectively, funds from operations adjusted to account for capital expenditures, straight-line rents and non-cash income (company-reported funds available for distribution).

CONCENTRATED PORTFOLIO & PERSISTENTLY LOW COVERAGE AT HCR

Credit concerns include the potential impact of government fiscal imbalance and regulatory risk on operators' profitability and operator and geographic concentration. Rent from HCR ManorCare represents 29% of HCP's revenues. This tenant continues to have coverage ratios below 1.0x facility EBITDAR and 1.2x guarantor fixed-charge coverage for the trailing 12 months ended Dec. 31, 2013 which is a credit concern. Sustained and material improvements in HCR ManorCare's profitability may support positive ratings momentum if reflective of a generally improving and lower risk operating environment. Partially offsetting this concentration is the master lease structure and covenants to provide protection to HCP at the guarantor level.

Furthermore, HCP's tenant mix will become more concentrated upon the completion of the merger between Emeritus Corporation and Brookdale Senior Living (currently HCP's second and third largest tenants, respectively). The combined company will comprise 21% of revenues and result in the two largest tenants (HCR and Brookdale/Emeritus) comprising approximately 50% of revenues. The risks associated with a concentrated tenant mix are two-fold: 1) the effects of a potential default are greater and 2) tenants may have significant leverage when negotiating lease renewals given the pooling of assets into master leases. Fitch notes the merger has no immediate impact on HCP's credit ratings given its exposure to the underlying property cash flows is unchanged but notes the longer-term increase in risk.

Lastly, HCP's portfolio remains geographically concentrated, despite the company maintaining a diversified investment platform. As of Dec. 31, 2013, approximately 31% of HCP's consolidated net operating income from wholly owned assets was generated from properties located in California and Texas (though this is down from 47% as of Dec. 31, 2010).

STABLE OUTLOOK

The Stable Outlook is driven by Fitch's expectations that HCP will maintain its long-standing conservative business and financing strategies and metrics will remain appropriate for the rating over the next 12-to-24 months.

RATING SENSITIVITIES

The following factors may result in positive momentum on the rating and/or Outlook:

--A sustained and material improvement in coverage for skilled nursing/post-acute operators in whole and in part;

--Reduced tenant concentration;

--Fitch's expectation of fixed-charge coverage sustaining above 3.0x for several consecutive quarters (coverage was 3.5x for the TTM ended Dec. 31, 2013);

--Fitch's expectation of leverage sustaining below 4.5x (leverage was 5.2x at Dec. 31, 2013).

The following factors may have a negative impact on the ratings or Outlook:

--A sustained and material weakening in coverage for skilled nursing/post-acute operators in whole and in part;

--Fitch's expectation of leverage sustaining above 6.0x;

--Fitch's expectation of fixed-charge coverage sustaining below 2.5x;

--A liquidity shortfall.

Additional information is available at ' www.fitchratings.com '.

Applicable Criteria and Related Research:

--'Rating U.S. Equity REITs and REOCs: Sector Credit Factors' (Feb. 26, 2014);

--'Recovery Ratings and Notching Criteria for Equity REITs' (Nov. 19, 2013);

--'Corporate Rating Methodology: Including Short-Term Ratings and Subsidiary Linkage' (Aug. 5, 2013).

Applicable Criteria and Related Research:

Criteria for Rating U.S. Equity REITs and REOCs

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=700091

Recovery Ratings and Notching Criteria for Equity REITs

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=722363

Corporate Rating Methodology: Including Short-Term Ratings and Parent and Subsidiary Linkage

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=715139

Additional Disclosure

Solicitation Status

http://www.fitchratings.com/gws/en/disclosure/solicitation?pr_id=826339

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: <HTTP://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS> . IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEBSITE '

<WWW.FITCHRATINGS.COM>

' PUBLISHED RATINGS, CRITERIA AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE 'CODE OF CONDUCT' SECTION OF THIS SITE. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.