

HEALTH CARE REIT INC /DE/

Form 10-Q

October 20, 2006

**Table of Contents**

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 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 1-8923  
HEALTH CARE REIT, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

**34-1096634**

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

**One SeaGate, Suite 1500, Toledo, Ohio**

**43604**

(Address of principal executive office)

(Zip Code)

**(419) 247-2800**

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to the filing requirements for at least 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 13, 2006, the registrant had 63,067,226 shares of common stock outstanding.

**Table of Contents**

**TABLE OF CONTENTS**

	<b>Page</b>
<b><u>PART I.</u></b>	
<b><u>FINANCIAL INFORMATION</u></b>	
<u>Item 1.</u>	
<u>Financial Statements (Unaudited)</u>	
<u>Consolidated Balance Sheets September 30, 2006 and December 31, 2005</u>	3
<u>Consolidated Statements of Income Three and nine months ended September 30, 2006 and 2005</u>	4
<u>Consolidated Statements of Stockholders Equity Nine months ended September 30, 2006 and 2005</u>	5
<u>Consolidated Statements of Cash Flows Nine months ended September 30, 2006 and 2005</u>	6
<u>Notes to Unaudited Consolidated Financial Statements</u>	7
<u>Item 2.</u>	
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	13
<u>Item 3.</u>	
<u>Quantitative and Qualitative Disclosures About Market Risk</u>	32
<u>Item 4.</u>	
<u>Controls and Procedures</u>	32
<b><u>PART II.</u></b>	
<b><u>OTHER INFORMATION</u></b>	
<u>Item 1A.</u>	
<u>Risk Factors</u>	33
<u>Item 6.</u>	
<u>Exhibits</u>	33
Signatures	33
<u>EX-12</u>	
<u>EX-31.1</u>	
<u>EX-31.2</u>	
<u>EX-32.1</u>	
<u>EX-32.2</u>	

**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****CONSOLIDATED BALANCE SHEETS****HEALTH CARE REIT, INC. AND SUBSIDIARIES**

	<b>September 30 2006 (Unaudited)</b>	<b>December 31 2005 (Note)</b>
	<b>(In thousands)</b>	
<b>Assets</b>		
Real estate investments:		
Real property owned		
Land	\$ 276,480	\$ 261,236
Buildings & improvements	2,815,206	2,659,746
Real property held for sale, net of accumulated depreciation	27,678	11,912
Construction in progress	98,675	3,906
	<b>3,218,039</b>	<b>2,936,800</b>
Less accumulated depreciation	<b>(332,925)</b>	<b>(274,875)</b>
Total real property owned	<b>2,885,114</b>	<b>2,661,925</b>
Loans receivable	<b>216,870</b>	194,054
Less allowance for losses on loans receivable	<b>(7,156)</b>	<b>(6,461)</b>
	<b>209,714</b>	<b>187,593</b>
Net real estate investments	<b>3,094,828</b>	<b>2,849,518</b>
Other assets:		
Equity investments	<b>5,070</b>	2,970
Deferred loan expenses	<b>12,309</b>	12,228
Cash and cash equivalents	<b>15,490</b>	36,237
Receivables and other assets	<b>73,132</b>	71,211
	<b>106,001</b>	<b>122,646</b>
Total assets	<b>\$ 3,200,829</b>	<b>\$ 2,972,164</b>
<b>Liabilities and stockholders equity</b>		
Liabilities:		
Borrowings under unsecured lines of credit arrangements	\$ 276,000	\$ 195,000
Senior unsecured notes	<b>1,196,897</b>	1,198,278
Secured debt	<b>130,405</b>	107,540
Accrued expenses and other liabilities	<b>50,558</b>	40,590
Total liabilities	<b>1,653,860</b>	<b>1,541,408</b>
Stockholders equity:		
Preferred stock, \$1.00 par value:	<b>276,875</b>	276,875

Authorized	25,000,000 shares		
Issued and outstanding	11,074,989 shares at September 30, 2006 and 11,074,989 shares at December 31, 2005 at liquidation preference		
Common stock, \$1.00 par value:		<b>63,005</b>	58,050
Authorized	125,000,000 shares		
Issued	64,143,473 shares at September 30, 2006 and 58,182,592 shares at December 31, 2005		
Outstanding	63,067,226 shares at September 30, 2006 and 58,124,657 shares at December 31, 2005		
Capital in excess of par value			
	<b>1,469,491</b>	1,306,471	
Treasury stock			
	<b>(2,714)</b>	(2,054)	
Cumulative net income			
	<b>909,894</b>	830,103	
Cumulative dividends			
	<b>(1,171,302)</b>	(1,039,032)	
Accumulated other comprehensive income			
	<b>0</b>	0	
Other equity			
	<b>1,720</b>	343	
Total stockholders' equity			
	<b>1,546,969</b>	1,430,756	
Total liabilities and stockholders' equity			
	<b>\$3,200,829</b>	\$2,972,164	

NOTE: The consolidated balance sheet at December 31, 2005 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements.

See notes to unaudited consolidated financial statements

Table of Contents**CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)  
HEALTH CARE REIT, INC. AND SUBSIDIARIES**

	<b>Three Months Ended September 30</b>		<b>Nine Months Ended September 30</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
	<b>(In thousands, except per share data)</b>			
<b>Revenues:</b>				
Rental income	<b>\$ 75,290</b>	\$ 64,516	<b>\$ 220,002</b>	\$ 180,960
Interest income	<b>4,436</b>	4,997	<b>13,178</b>	15,249
Transaction fees and other income	<b>1,019</b>	773	<b>3,049</b>	2,742
	<b>80,745</b>	70,286	<b>236,229</b>	198,951
<b>Expenses:</b>				
Interest expense	<b>24,007</b>	20,477	<b>70,587</b>	57,707
Provision for depreciation	<b>24,094</b>	19,915	<b>70,256</b>	56,879
General and administrative	<b>5,223</b>	4,640	<b>16,517</b>	12,993
Loan expense	<b>782</b>	673	<b>2,199</b>	2,209
Loss on extinguishment of debt	<b>0</b>	0	<b>0</b>	18,448
Provision for loan losses	<b>250</b>	300	<b>750</b>	900
	<b>54,356</b>	46,005	<b>160,309</b>	149,136
Income from continuing operations	<b>26,389</b>	24,281	<b>75,920</b>	49,815
<b>Discontinued operations:</b>				
Net gain (loss) on sales of properties	<b>108</b>	0	<b>2,590</b>	(134)
Income from discontinued operations, net	<b>316</b>	1,016	<b>1,281</b>	2,685
	<b>424</b>	1,016	<b>3,871</b>	2,551
Net income	<b>26,813</b>	25,297	<b>79,791</b>	52,366
Preferred stock dividends	<b>5,333</b>	5,389	<b>15,998</b>	16,261
Net income available to common stockholders	<b>\$ 21,480</b>	\$ 19,908	<b>\$ 63,793</b>	\$ 36,105
<b>Average number of common shares outstanding:</b>				
Basic	<b>62,524</b>	54,038	<b>60,766</b>	53,498
Diluted	<b>62,866</b>	54,359	<b>61,102</b>	53,867
<b>Earnings per share:</b>				
<b>Basic:</b>				
Income from continuing operations available to common stockholders	<b>\$ 0.34</b>	\$ 0.35	<b>\$ 0.99</b>	\$ 0.63

Edgar Filing: HEALTH CARE REIT INC /DE/ - Form 10-Q

Discontinued operations, net	<b>0.01</b>	0.02	<b>0.06</b>	0.05
Net income available to common stockholders*	<b>\$ 0.34</b>	\$ 0.37	<b>\$ 1.05</b>	\$ 0.67
Diluted:				
Income from continuing operations available to common stockholders	<b>\$ 0.33</b>	\$ 0.35	<b>\$ 0.98</b>	\$ 0.62
Discontinued operations, net	<b>0.01</b>	0.02	<b>0.06</b>	0.05
Net income available to common stockholders*	<b>\$ 0.34</b>	\$ 0.37	<b>\$ 1.04</b>	\$ 0.67
Dividends declared and paid per common share	<b>\$ 0.64</b>	\$ 0.62	<b>\$ 1.90</b>	\$ 1.84

\* Amounts may not sum due to rounding.

See notes to unaudited consolidated financial statements

**Table of Contents****CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY (UNAUDITED)  
HEALTH CARE REIT, INC. AND SUBSIDIARIES**

Nine Months Ended September 30, 2006

	Preferred Stock	Common Stock	Capital in Excess of Par Value	Treasury Stock	Cumulative Net Income (In thousands)	Cumulative Dividends Income	Accumulated Other Comprehensive Income	Other Equity	Total
Balances at beginning of period	\$ 276,875	\$ 58,050	\$ 1,306,471	\$ (2,054)	\$ 830,103	\$ (1,039,032)	\$ 0	\$ 343	\$ 1,430,756
Comprehensive income:									
Net income					79,791				79,791
Other comprehensive income:									
Unrealized gain (loss) on equity investments									0
Total comprehensive income									79,791
Proceeds from issuance of common shares from dividend reinvestment and stock incentive plans, net of forfeitures		1,732	57,015	(660)				(18)	58,069
Proceeds from issuance of common shares SFAS 123(R) reclassification		3,223	106,526						109,749
Compensation expense related to stock options			(521)					521	0
Cash dividends paid:									
Common stock-\$1.90 per share						(116,272)		874	874
									(116,272)



Preferred stock, Series D-\$1.4766 per share						(5,906)		(5,906)	
Preferred stock, Series E-\$1.125 per share						(84)		(84)	
Preferred stock, Series F-\$1.4297 per share						(10,008)		(10,008)	
Balances at end of period	\$ 276,875	\$ 63,005	\$ 1,469,491	\$ (2,714)	\$ 909,894	\$ (1,171,302)	\$ 0	\$ 1,720	\$ 1,546,969

**Nine Months Ended September 30, 2005**

	Preferred Stock	Common Stock	Capital In Excess of Par Value	Treasury Stock	Cumulative Net Income	Cumulative Dividends	Accumulated Other Comprehensive Income		Total
							Equity	Other	
Balances at beginning of period	\$ 283,751	\$ 52,860	\$ 1,139,723	\$ (1,286)	\$ 745,817	\$ (884,890)	\$ 1	\$ (697)	\$ 1,335,279
Comprehensive income:									
Net income					52,366				52,366
Other comprehensive income:									
Unrealized gain (loss) on equity investments									0
Total comprehensive income									52,366
Proceeds from issuance of common shares from dividend reinvestment and stock incentive plans, net of forfeitures		1,467	44,962	(480)					45,949
Conversion of preferred stock	(6,762)	207	6,555						0
Restricted stock amortization							552	397	552
							397		397

Compensation expense related to stock options									
Cash dividends paid:									
Common stock-\$1.84 per share						(98,586)			(98,586)
Preferred stock, Series D-\$1.4766 per share						(5,906)			(5,906)
Preferred stock, Series E-\$1.125 per share						(347)			(347)
Preferred stock, Series F-\$1.4297 per share						(10,008)			(10,008)
Balances at end of period	\$ 276,989	\$ 54,534	\$ 1,191,240	\$ (1,766)	\$ 798,183	\$ (999,737)	\$ 1	\$ 252	\$ 1,319,696

See notes to unaudited consolidated financial statements

**Table of Contents****CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)  
HEALTH CARE REIT, INC. AND SUBSIDIARIES**

	<b>Nine Months Ended September 30</b>	
	<b>2006</b>	<b>2005</b>
	<b>(In thousands)</b>	
<b>Operating activities</b>		
Net income	\$ 79,791	\$ 52,366
Adjustments to reconcile net income to net cash provided from operating activities:		
Provision for depreciation	71,918	63,473
Amortization	2,199	3,318
Provision for loan losses	750	900
Stock-based compensation expense	3,543	949
Rental income less than (in excess of) cash received	9,756	(4,149)
(Gain) loss on sales of properties	(2,590)	134
Increase (decrease) in accrued expenses and other liabilities	9,853	(1,243)
Decrease (increase) in receivables and other assets	(16,236)	(775)
Net cash provided from (used in) operating activities	<b>158,984</b>	114,973
<b>Investing activities</b>		
Investment in real property	(290,596)	(226,085)
Investment in loans receivable	(74,126)	(39,125)
Investment in investment securities	(2,100)	0
Principal collected on loans receivable	42,468	56,373
Proceeds from sales of properties	35,288	9,900
Other	(738)	259
Net cash provided from (used in) investing activities	<b>(289,804)</b>	(198,678)
<b>Financing activities</b>		
Net increase (decrease) under unsecured lines of credit arrangements	81,000	153,000
Proceeds from issuance of senior notes	0	250,000
Principal payments on senior notes	0	(230,170)
Principal payments on secured debt	(2,184)	(8,210)
Net proceeds from the issuance of common stock	165,808	46,429
Decrease (increase) in deferred loan expense	(2,281)	(5,141)
Cash distributions to stockholders	(132,270)	(114,847)
Net cash provided from (used in) financing activities	<b>110,073</b>	91,061
Increase (decrease) in cash and cash equivalents	(20,747)	7,356
Cash and cash equivalents at beginning of period	36,237	19,763
Cash and cash equivalents at end of period	<b>\$ 15,490</b>	<b>\$ 27,119</b>
Supplemental cash flow information-interest paid	<b>\$ 64,549</b>	<b>\$ 63,283</b>

See notes to unaudited consolidated financial statements

6

---

**Table of Contents****HEALTH CARE REIT, INC.****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****NOTE A Basis of Presentation**

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

**NOTE B Real Estate Investments**

During the nine months ended September 30, 2006, we invested \$290,596,000 of cash in real property (including \$103,236,000 of advances for construction in progress) and provided cash loan financings of \$74,126,000. In addition, real property acquisitions included the assumption of secured debt totaling \$25,049,000. We also converted \$12,093,000 of completed construction projects and \$11,204,000 of mortgage loans into operating lease properties during the nine months ended September 30, 2006. As of September 30, 2006, we had \$265,112,000 of unfunded construction commitments relating to existing construction in progress projects. Also during the nine months ended September 30, 2006, we sold real property generating \$35,288,000 of net cash proceeds and collected \$42,468,000 of cash as repayment of principal on loans receivable.

**NOTE C Equity Investments**

Equity investments, which consist of investments in private and public companies over which we do not have the ability to exercise influence, are accounted for under the cost method. Under the cost method of accounting, investments in private companies are carried at cost and are adjusted only for other-than-temporary declines in fair value, distributions of earnings and additional investments. For investments in public companies that have readily determinable fair market values, we classify our equity investments as available-for-sale and, accordingly, record these investments at their fair market values with unrealized gains and losses included in accumulated other comprehensive income, a separate component of stockholders' equity. These investments represent a minimal ownership interest in these companies.

**NOTE D Distributions Paid to Common Stockholders**

On February 21, 2006, we paid a dividend of \$0.62 per share to stockholders of record on January 31, 2006. This dividend related to the period from October 1, 2005 through December 31, 2005.

On May 19, 2006, we paid a dividend of \$0.64 per share to stockholders of record on April 28, 2006. This dividend related to the period from January 1, 2006 through March 31, 2006.

On August 21, 2006, we paid a dividend of \$0.64 per share to stockholders of record on July 31, 2006. This dividend related to the period from April 1, 2006 through June 30, 2006.

**NOTE E Derivative Instruments**

We are exposed to various market risks, including the potential loss arising from adverse changes in interest rates. We may elect to use financial derivative instruments to hedge interest rate exposure. These decisions are principally based on our policy to match our variable rate investments with comparable borrowings, but are also based on the general trend in interest rates at the applicable dates and our perception of the future volatility of interest rates.

In June 2000, the Financial Accounting Standards Board ( FASB ) issued Statement No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities, which amends Statement No. 133, Accounting for Derivative Instruments and Hedging Activities. Statement No. 133, as amended, requires companies to record derivatives at fair market value on the balance sheet as assets or liabilities.

**Table of Contents****HEALTH CARE REIT, INC.****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

On May 6, 2004, we entered into two interest rate swap agreements (the Swaps ) for a total notional amount of \$100,000,000 to hedge changes in fair value attributable to changes in the LIBOR swap rate of \$100,000,000 of fixed rate debt with a maturity date of November 15, 2013. The Swaps are treated as fair-value hedges for accounting purposes and we utilize the short-cut method in accordance with Statement No. 133, as amended. The Swaps are with highly rated counterparties in which we receive a fixed rate of 6.0% and pay a variable rate based on six-month LIBOR plus a spread. At September 30, 2006, the Swaps were reported at their fair value as a \$946,000 other asset (\$2,211,000 other asset at December 31, 2005). For the three and nine months ended September 30, 2006, we incurred \$29,000 and \$100,000, respectively, of losses related to the Swaps that was recorded as an addition to interest expense. For the three and nine months ended September 30, 2005, we generated \$200,000 and \$977,000, respectively, of savings related to the Swaps that was recorded as a reduction in interest expense.

The valuation of derivative instruments requires us to make estimates and judgments that affect the fair value of the instruments. Fair values for our derivatives are estimated by a third party consultant, which utilizes pricing models that consider forward yield curves and discount rates. Such amounts and the recognition of such amounts are subject to significant estimates that may change in the future.

**NOTE F Discontinued Operations**

Eight assisted living facilities were held for sale as of September 30, 2006. We did not recognize an impairment loss on these assets as the fair value less estimated costs to sell exceeded our carrying values. During the nine months ended September 30, 2006, we sold four assisted living facilities, three skilled nursing facilities and two parcels of land with carrying values of \$35,366,000 for a net gain of \$2,590,000. In accordance with Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, we have reclassified the income and expenses attributable to all properties sold and attributable to the properties held for sale at September 30, 2006 to discontinued operations. Expenses include an allocation of interest expense based on property carrying values and our weighted average cost of debt. The following illustrates the reclassification impact of Statement No. 144 as a result of classifying properties as discontinued operations for the periods presented (in thousands):

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30</b>		<b>September 30</b>	
	<b>2006</b>	2005	<b>2006</b>	2005
Revenues:				
Rental income	<b>\$ 1,015</b>	\$ 4,314	<b>\$ 3,954</b>	\$ 12,827
Expenses:				
Interest expense	<b>267</b>	1,147	<b>1,012</b>	3,548
Provision for depreciation	<b>432</b>	2,151	<b>1,661</b>	6,594
Income from discontinued operations, net	<b>\$ 316</b>	\$ 1,016	<b>\$ 1,281</b>	\$ 2,685

**NOTE G Contingent Liabilities**

We have an outstanding letter of credit issued for the benefit of certain insurance companies that provide workers compensation insurance to one of our tenants. Our obligation under the letter of credit matures in 2009. At September 30, 2006, our obligation under the letter of credit was \$2,450,000.

As of September 30, 2006, we had \$265,112,000 of unfunded construction commitments.

**NOTE H Accumulated Other Comprehensive Income**

Accumulated other comprehensive income includes unrealized gains or losses on our equity investments. This item is included as a component of stockholders' equity. We did not recognize any comprehensive income other than the

recorded net income for the three or nine months ended September 30, 2006 or 2005.

**Table of Contents****HEALTH CARE REIT, INC.****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE I Earnings Per Share**

The following table sets forth the computation of basic and diluted earnings per share (in thousands, except per share data):

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30</b>		<b>September 30</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Numerator for basic and diluted earnings per share net income available to common stockholders	<b>\$ 21,480</b>	\$ 19,908	<b>\$ 63,793</b>	\$ 36,105
Denominator for basic earnings per share weighted average shares	<b>62,524</b>	54,038	<b>60,766</b>	53,498
Effect of dilutive securities:				
Employee stock options	<b>81</b>	137	<b>75</b>	185
Non-vested restricted shares	<b>261</b>	184	<b>261</b>	184
Dilutive potential common shares	<b>342</b>	321	<b>336</b>	369
Denominator for diluted earnings per share adjusted weighted average shares	<b>62,866</b>	54,359	<b>61,102</b>	53,867
Basic earnings per share	<b>\$ 0.34</b>	\$ 0.37	<b>\$ 1.05</b>	\$ 0.67
Diluted earnings per share	<b>\$ 0.34</b>	\$ 0.37	<b>\$ 1.04</b>	\$ 0.67

The diluted earnings per share calculation excludes the dilutive effect of 0 and 112,000 stock options for the three and nine months ended September 30, 2006, respectively, because the exercise prices were greater than the average market price. The diluted earnings per share calculation excludes the dilutive effect of 0 and 112,000 stock options for the three and nine months ended September 30, 2005, respectively, because the exercise prices were greater than the average market price. The Series E Cumulative Convertible and Redeemable Preferred Stock was not included in these calculations as the effect of the conversion into common stock was anti-dilutive for the periods presented.

**NOTE J Other Equity**

Other equity consists of the following (in thousands):

	<b>September</b>	<b>December</b>
	<b>30</b>	<b>31</b>
	<b>2006</b>	<b>2005</b>
Accumulated compensation expense related to stock options	<b>\$ 1,720</b>	\$ 864
Unamortized restricted stock	<b>0</b>	(521)
	<b>\$ 1,720</b>	\$ 343

Unamortized restricted stock at December 31, 2005 represents the unamortized value of restricted stock granted to officers, key employees and directors prior to January 1, 2003. Pursuant to the provisions of Statement No. 123(R) adopted on January 1, 2006, the unamortized restricted stock balance of \$521,000 was reclassified to capital in excess



of par value. Expense, which is recognized as the restricted shares vest based on the market value at the date of the award, totaled \$648,000 and \$3,316,000 for the three and nine months ended September 30, 2006, respectively, and \$184,000 and \$552,000 for the three and nine months ended September 30, 2005, respectively. See Note K for further discussion.

Accumulated option compensation expense represents the amount of amortized compensation costs related to stock options awarded to employees and directors subsequent to January 1, 2003. Expense, which is recognized as the options vest based on the market value at the date of the award, totaled \$191,000 and \$874,000 for the three and nine months ended September 30, 2006, respectively, and \$132,000 and \$397,000 for the same periods in 2005.

**Table of Contents****HEALTH CARE REIT, INC.****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE K Stock Incentive Plans**

Our 2005 Long-Term Incentive Plan authorizes up to 2,200,000 shares of common stock to be issued at the discretion of the Compensation Committee of the Board of Directors. The 2005 Plan replaced the 1995 Stock Incentive Plan and the Stock Plan for Non-Employee Directors. The options granted to officers and key employees under the 1995 Plan continue to vest through 2010 and expire ten years from the date of grant. Our non-employee directors, officers and key employees are eligible to participate in the 2005 Plan. The 2005 Plan allows for the issuance of, among other things, stock options, restricted stock, deferred stock units and dividend equivalent rights. Vesting periods for options and restricted shares range from three years for directors to five years for officers and key employees. Options expire ten years from the date of grant.

**Impact of the Adoption of Statement No. 123(R)**

We adopted the fair value-based method of accounting for share-based payments effective January 1, 2003 using the prospective method described in Statement of Financial Accounting Standards No. 148, Accounting for Stock-Based Compensation Transition and Disclosure. Currently, we use the Black-Scholes-Merton option pricing model to estimate the value of stock option grants and expect to continue to use this acceptable option valuation model. Because we adopted Statement No. 123 using the prospective transition method (which applied only to awards granted, modified or settled after the adoption date of Statement No. 123), compensation cost for some previously granted awards that were not recognized under Statement No. 123 will now be recognized effective with the adoption of Statement No. 123(R) on January 1, 2006. In addition, we previously amortized compensation cost for share-based payments to the date that the awards became fully vested or to the expected retirement date, if sooner. Effective with the adoption of Statement No. 123(R), we began recognizing compensation cost to the date the awards become fully vested or to the retirement eligible date, if sooner. Compensation cost totaled \$1,690,000 for the nine months ended September 30, 2006. We expect that the adoption of Statement No. 123(R) will increase compensation cost by approximately \$1,287,000 for the full year 2006 as a result of amortizing share-based awards to the retirement eligible date.

**Valuation Assumptions**

The fair value of each option grant is estimated on the date of grant using the Black-Scholes-Merton option pricing model with the following weighted-average assumptions:

	<b>Nine Months Ended September 30, 2006</b>	Nine Months Ended September 30, 2005
Dividend yield (1)	<b>0.00% 6.79%</b>	0.00%
Expected volatility	<b>20.3%</b>	22.8%
Risk-free interest rate	<b>4.35%</b>	4.25%
Expected life (in years)	<b>5</b>	7
Weighted-average fair value (1)	<b>\$5.26</b>	\$ 12.48

- (1) Certain of the options granted to employees in 2006 include dividend equivalent rights. The fair value of these options are calculated based on the above assumptions and then adjusted for the

present value of estimated dividend payments over the expected life of the options. All options granted to officers and key employees in 2005 include dividend equivalent rights. These options are assumed to have a dividend yield of 0% for purposes of the Black-Scholes-Merton option pricing model and result in higher fair values than options without dividend equivalent rights.

The dividend yield represented the dividend yield of our common stock on the dates of grant. Our computation of expected volatility was based on historical volatility. The risk-free interest rates used were the 10-year U.S. Treasury Notes yield on the dates of grant. The expected life was based on historical experience of similar awards, giving consideration to the contractual terms, vesting schedules and expectations regarding future employee behavior.

**Table of Contents****HEALTH CARE REIT, INC.****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Option Award Activity**

The following table summarizes information about stock option activity for the nine months ended September 30, 2006:

	<b>Number of Shares (000 s)</b>	<b>Weighted Average Exercise Price</b>	<b>Weighted Average Remaining Contract Life (years)</b>	<b>Aggregate Intrinsic Value (\$000 s)</b>
<b>Stock Options</b>				
Options at beginning of year	685	\$ 26.87	6.3	
Options granted	155	36.50		
Options exercised	(214)	21.90		
Options terminated	0			
Options at end of period	626	\$ 30.94	7.7	\$ 2,527
Options exercisable at end of period	164	\$ 26.07	5.7	\$ 1,462
Weighted average fair value of options granted during the period		\$ 5.26		

The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying options and the quoted price of our common stock for the options that were in-the-money at September 30, 2006. During the three and nine months ended September 30, 2006, the aggregate intrinsic value of options exercised under our stock incentive plans was \$914,000 and \$3,025,000, respectively, determined as of the date of option exercise. During the three and nine months ended September 30, 2005, the aggregate intrinsic value of options exercised under our stock incentive plans was \$915,000 and \$4,395,000, respectively, determined as of the date of option exercise. Cash received from option exercises under our stock incentive plans for the three and nine months ended September 30, 2006 was \$1,411,000 and \$4,601,000, respectively. Cash received from option exercises under our stock incentive plans for the three and nine months ended September 30, 2005 was \$1,981,000 and \$7,827,000, respectively.

As of September 30, 2006, there was approximately \$2,474,000 of total unrecognized compensation cost related to unvested stock options granted under our stock incentive plans. That cost is expected to be recognized over a weighted average period of three years. As of September 30, 2006, there was approximately \$5,553,000 of total unrecognized compensation cost related to unvested restricted stock granted under our stock incentive plans. That cost is expected to be recognized over a weighted average period of three years.

The following table summarizes information about non-vested stock incentive awards as of September 30, 2006 and changes for the nine months ended September 30, 2006:

	<b>Stock Options</b>		<b>Restricted Stock</b>	
	<b>Number of Shares (000 s)</b>	<b>Weighted Average Grant Date Fair Value</b>	<b>Number of Shares (000 s)</b>	<b>Weighted Average Grant Date Fair Value</b>
Non-vested at December 31, 2005	428	\$ 5.36	222	\$ 31.56
Vested	(105)	5.23	(59)	30.81
Granted	155	5.26	98	36.51
Terminated	0		0	

Edgar Filing: HEALTH CARE REIT INC /DE/ - Form 10-Q

Non-vested at September 30, 2006	478	\$	5.35	261	\$	33.58
----------------------------------	-----	----	------	-----	----	-------

11

---

**Table of Contents****HEALTH CARE REIT, INC.****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Pro forma Information for Periods Prior to the Adoption of Statement No. 123(R)***

The following table illustrates the effect on net income available to common stockholders for the periods presented if we had applied the fair value recognition provisions of Statement No. 123, as amended, to stock-based compensation for options granted since 1995 but prior to adoption at January 1, 2003 (in thousands, except per share data):

	<b>Three Months Ended September 30, 2005</b>	<b>Nine Months Ended September 30, 2005</b>
Numerator:		
Net income available to common stockholders as reported	\$ 19,908	\$ 36,105
Deduct: Additional stock-based employee compensation expense determined under fair value based method for all awards	45	136
Net income available to common stockholders pro forma	\$ 19,863	\$ 35,969
Denominator:		
Basic weighted average shares as reported and pro forma	54,038	53,498
Effect of dilutive securities:		
Employee stock options pro forma	129	379
Non-vested restricted shares	184	184
Dilutive potential common shares	313	563
Diluted weighted average shares pro forma	54,351	54,061
Net income available to common stockholders per share as reported		
Basic	\$ 0.37	\$ 0.67
Diluted	\$ 0.37	\$ 0.67
Net income available to common stockholders per share pro forma		
Basic	\$ 0.37	\$ 0.67
Diluted	\$ 0.37	\$ 0.67

**NOTE L New Accounting Pronouncements**

On September 29, 2006, the Financial Accounting Standards Board issued Statement No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans An amendment of FASB Statements No. 87, 88, 106 and 132(R). The statement requires employers to recognize the overfunded and underfunded portion of a defined benefit plan as an asset or liability, respectively, and any unrecognized gains and losses or prior service costs as a component of accumulated other comprehensive income. It also requires a plan's funded status to be measured at the employer's fiscal year-end. The new statement, which is effective as of December 31, 2006, is not expected to have a material impact on our financial position.

**NOTE M Significant Changes and Events**

***New Unsecured Credit Facility***

We closed on a \$700,000,000 unsecured revolving credit facility to replace our \$500,000,000 facility which was scheduled to mature in June 2008. Among other things, the new facility provides us with additional financial flexibility and borrowing capacity, extends our agreement to July 2009 and adds two new lenders to the bank group in addition to commitment increases by eight of the ten existing lenders.

***Windrose Merger Agreement***

On September 13, 2006, we announced a definitive merger agreement with Windrose Medical Properties Trust ( Windrose ). The transaction will be consummated through the issuance of Health Care REIT, Inc. common and preferred stock and the assumption of Windrose liabilities. It is expected that the merger will be accounted for as a purchase of Windrose by Health Care REIT, Inc. under U.S. GAAP. Under the purchase method of accounting, the assets and liabilities of Windrose will be, as of the completion of the merger, recorded at their respective fair values and added to our assets and liabilities. It is anticipated that the merger will close on or around year-end 2006.

**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations****Recent Developments**

On September 13, 2006, we announced the execution of a merger agreement with Windrose Medical Properties Trust ( Windrose ). The merger will further diversify and expand our real estate portfolio throughout the health care delivery spectrum. The combined entity will have more than 550 properties in 37 states and gross real estate assets of approximately \$4 billion. We anticipate that the merger will close on or around year-end 2006. The combined entity will offer:

- expertise and critical mass across all sectors of senior housing and health care real estate;
- property management and development capabilities;
- increased portfolio growth through expanded investment and development opportunities;
- enhanced asset type diversification, reduced tenant concentration, and a favorable investment maturity profile;
- and
- improved key portfolio metrics, including a higher non-governmental component of tenant revenues.

The following discussion and analysis is based primarily on the consolidated financial statements of Health Care REIT, Inc. for the periods presented and should be read together with the notes thereto contained in this Quarterly Report on Form 10-Q. Other important factors are identified in our Annual Report on Form 10-K for the year ended December 31, 2005, including factors identified under the headings Business, Risk Factors and Management's Discussion and Analysis of Financial Condition and Results of Operations.

**Executive Overview****Business**

Health Care REIT, Inc. is a self-administered, equity real estate investment trust that invests in health care and senior housing properties. Founded in 1970, we were the first REIT to invest exclusively in health care facilities. The following table summarizes our portfolio as of September 30, 2006:

Type of Facility	Investments (in thousands)	Percentage	Revenues (in thousands)	Percentage	Number of Facilities	Number of Beds/Units	Investment per Bed/Unit (in \$)	Number of Operators	Number of States
		of Investments		of Revenues					
Independent living/CCRCs	\$ 488,863	16%	\$ 29,756	12%	39	5,224	\$ 112,737	16	18
Assisted living facilities	996,318	32%	85,271	36%	204	12,615	88,480	23	33
Skilled nursing facilities	1,413,508	46%	111,262	46%	220	30,063	47,662	22	28
Specialty care facilities	205,745	6%	13,894	6%	14	1,265	183,067	7	8
Totals	\$ 3,104,434	100%	\$ 240,183	100%	477	49,167			

(1) Investments include gross real estate investments and credit enhancements which amounted to \$3,101,984,000



and \$2,450,000, respectively.

(2) Revenues include gross revenues and revenues from discontinued operations for the nine months ended September 30, 2006.

(3) Investment per Bed/Unit was computed by using the total investment amount of \$3,369,546,000 which includes gross real estate investments, credit enhancements and unfunded construction commitments for which initial funding has commenced which amounted to \$3,101,984,000, \$2,450,000 and \$265,112,000, respectively.

(4) We have investments in properties located in 37 states and managed by 58 different operators.

Our primary objectives are to protect stockholders' capital and enhance stockholder value. We seek to pay consistent cash dividends to stockholders and create opportunities to increase dividend payments to stockholders as a result of annual increases in rental and interest income and portfolio growth. To meet these objectives, we invest in properties managed by experienced operators and diversify our investment portfolio by operator and geographic

location.

Substantially all of our revenues and sources of cash flows from operations are derived from operating lease rental income and interest earned on outstanding loans receivable. These items represent our primary source of liquidity to fund distributions and are dependent upon our operators' continued ability to make contractual rent and interest payments to us. To the extent that our operators experience operating difficulties and are unable to generate sufficient cash to make payments to us, there could be a material adverse impact on our consolidated results of operations, liquidity and/or financial condition. To mitigate this risk, we monitor our investments through a variety of methods determined by the type of facility and operator. Our asset management process includes review of monthly financial statements for each facility, periodic review of operator credit, periodic facility inspections and review of covenant compliance relating to licensure, real estate taxes, letters of credit and other collateral. In monitoring our portfolio, our personnel use a proprietary database to collect and analyze facility-specific data. Additionally, we conduct extensive research to ascertain industry trends and risks. Through these asset management and research efforts, we are typically able to intervene at an early stage and address payment risk, and in so doing, support both the collectibility of revenue and the value of our investment.

In addition to our asset management and research efforts, we also structure our investments to help mitigate payment risk. We typically limit our investments to no more than 90% of the appraised value of a property. Operating leases and loans are normally credit enhanced by guaranties and/or letters of credit. In addition, operating leases are typically structured as master leases and loans are generally cross-defaulted and cross-collateralized with other loans, operating leases or agreements between us and the operator and its affiliates. As of September 30, 2006, 87% of our real property was subject to master leases.

For the nine months ended September 30, 2006, rental income and interest income represented 93% and 5%, respectively, of total gross revenues (including revenues from discontinued operations). Our standard lease structure contains annual rental escalators that are contingent upon changes in the Consumer Price Index and/or changes in the gross operating revenues of the tenant's properties. These

## **Table of Contents**

escalators are not fixed, so no straight-line rent is recorded; however, rental income is recorded based on the contractual cash rental payments due for the period. Our yield on loans receivable depends upon a number of factors, including the stated interest rate, the average principal amount outstanding during the term of the loan and any interest rate adjustments.

Depending upon the availability and cost of external capital, we anticipate making investments in additional facilities. New investments are generally funded from temporary borrowings under our unsecured lines of credit arrangements, internally generated cash and the proceeds from sales of real property. Our investments generate internal cash from rent and interest receipts and principal payments on loans receivable. Permanent financing for future investments, which replaces funds drawn under the unsecured lines of credit arrangements, is expected to be provided through a combination of public and private offerings of debt and equity securities and the incurrence of secured debt. We believe our liquidity and various sources of available capital are sufficient to fund operations, meet debt service obligations (both principal and interest), make dividend distributions and finance future investments.

Depending upon market conditions, we believe that new investments will be available in the future with spreads over our cost of capital that will generate appropriate returns to our stockholders. During the nine months ended September 30, 2006, we completed \$395,814,000 of gross new investments and had \$65,412,000 of investment payoffs, resulting in net investments of \$330,402,000. We expect to complete gross new investments of \$525,000,000 to \$575,000,000 during 2006, including acquisitions of approximately \$350,000,000 to \$400,000,000 and funded new development of approximately \$175,000,000. We anticipate the sale of real property and the repayment of loans receivable totaling approximately \$150,000,000 resulting in net new investments of \$375,000,000 to \$425,000,000 during 2006. It is possible that additional loan repayments or sales of real property may occur in the future. To the extent that loan repayments and real property sales exceed new investments, our revenues and cash flows from operations could be adversely affected. We expect to reinvest the proceeds from any loan repayments and real property sales in new investments. To the extent that new investment requirements exceed our available cash on hand, we expect to borrow under our unsecured lines of credit arrangements. At September 30, 2006, we had \$15,490,000 of cash and cash equivalents and \$464,000,000 of available borrowing capacity under our unsecured lines of credit arrangements.

### ***Key Transactions in 2006***

We have completed the following key transactions to date in 2006:

our Board of Directors increased our quarterly dividend to \$0.64 per share, which represents a two cent increase from the quarterly dividend of \$0.62 paid for 2005. The dividend declared for the quarter ended September 30, 2006 represents the 142<sup>nd</sup> consecutive dividend payment;

we completed \$395,814,000 of gross investments and had \$65,412,000 of investment payoffs during the nine months ended September 30, 2006;

we completed a public offering of 3,222,800 shares of common stock with net proceeds to the company of approximately \$109,749,000 in April 2006;

we extended our \$40,000,000 unsecured line of credit which matured in May 2006 to May 2007 and reduced pricing by 40 basis points; and

we closed on a \$700,000,000 unsecured revolving credit facility to replace our \$500,000,000 facility, which was scheduled to mature in June 2008. Among other things, the new facility provides us with additional financial flexibility and borrowing capacity, extends our agreement to July 2009 and adds two new lenders to the bank group in addition to commitment increases by eight of the ten existing lenders.

### ***Key Performance Indicators, Trends and Uncertainties***

We utilize several key performance indicators to evaluate the various aspects of our business. These indicators are discussed below and relate to operating performance, concentration risk and credit strength. Management uses these key performance indicators to facilitate internal and external comparisons to our historical operating results, in

making operating decisions and for budget planning purposes.

*Operating Performance.* We believe that net income available to common stockholders ( NICS ) is the most appropriate earnings measure. Other useful supplemental measures of our operating performance include funds from operations ( FFO ) and funds available for distribution ( FAD ); however, these supplemental measures are not defined by U.S. generally accepted accounting principles ( U.S. GAAP ). Please refer to the section entitled Non-GAAP Financial Measures for further discussion of FFO and FAD and for reconciliations of FFO and FAD to NICS. These earnings measures and their relative per share amounts are widely used by

**Table of Contents**

investors and analysts in the valuation, comparison and investment recommendations of companies. The following table reflects the recent historical trends of our operating performance measures for the periods presented (in thousands, except per share data):

	Three Months Ended						
	March 31 2005	June 30 2005	September 30 2005	December 31 2005	March 31 2006	June 30 2006	September 30 2006
Net income (loss) available to common stockholders	\$ 17,803	\$ (1,606)	\$ 19,908	\$ 26,587	\$ 19,645	\$ 22,668	\$ 21,480
Funds from operations	38,309	19,427	41,975	44,581	41,354	45,870	45,898
Funds available for distribution	35,454	18,251	41,857	49,457	49,264	46,364	47,250
Per share data (fully diluted):							
Net income (loss) available to common stockholders	\$ 0.33	\$ (0.03)	\$ 0.37	\$ 0.47	\$ 0.34	\$ 0.37	\$ 0.34
Funds from operations	0.72	0.36	0.77	0.79	0.71	0.74	0.73
Funds available for distribution	0.66	0.34	0.77	0.88	0.84	0.75	0.75

*Concentration Risk.* We evaluate our concentration risk in terms of asset mix, investment mix, operator mix and geographic mix. Concentration risk is a valuable measure in understanding what portion of our investments could be at risk if certain sectors were to experience downturns. Asset mix measures the portion of our investments that are real property. In order to qualify as an equity REIT, at least 75% of our real estate investments must be real property whereby each property, which includes the land, buildings, improvements and related rights, is owned by us and leased to an operator pursuant to a long-term operating lease. Investment mix measures the portion of our investments that relate to our various facility types. Operator mix measures the portion of our investments that relate to our top five operators. Geographic mix measures the portion of our investments that relate to our top five states. The following table reflects our recent historical trends of concentration risk for the periods presented:

	March 31 2005	June 30 2005	September 30 2005	December 31 2005	March 31 2006	June 30 2006	September 30 2006
Asset mix:							
Real property	90%	91%	91%	93%	94%	94%	93%
Loans receivable	10%	9%	9%	7%	6%	6%	7%
Investment mix:							
Independent living/CCRCs (1)				15%	15%	15%	16%
Assisted living facilities	55%	51%	50%	34%	33%	33%	32%

Edgar Filing: HEALTH CARE REIT INC /DE/ - Form 10-Q

Skilled nursing facilities	39%	42%	42%	44%	45%	45%	46%
Specialty care facilities	6%	7%	8%	7%	7%	7%	6%
Operator mix:							
Emeritus Corporation	15%	14%	14%	13%	12%	12%	11%
Brookdale Senior Living Inc. (2)					10%	10%	9%
Home Quality Management, Inc.	7%	7%	6%				8%
Life Care Centers of America, Inc.				7%	7%	8%	7%
Merrill Gardens L.L.C.				7%	7%	7%	6%
Tara Cares, LLC						6%	
Delta Health Group, Inc.	7%	7%	7%		6%		
Southern Assisted Living, Inc. (2)	8%	8%	8%	7%			
Commonwealth Communities Holdings LLC	8%	7%	7%	7%			
Remaining operators	55%	57%	58%	59%	58%	57%	59%
Geographic mix:							
Florida	15%	15%	15%	14%	14%	14%	15%
Massachusetts	15%	14%	13%	13%	12%	11%	11%
Ohio	6%	6%	6%		9%	9%	8%
Texas		9%	8%	8%	8%	8%	8%
North Carolina	8%	7%	7%	8%	7%	7%	6%
California				7%			
Tennessee	6%						
Remaining states	50%	49%	51%	50%	50%	51%	52%

**Table of Contents**

(1) As a result of our significant independent living/continuing care retirement community acquisitions in the fourth quarter of 2005, we began to separately disclose this facility classification in our portfolio reporting. We adopted the National Investment Center definitions and reclassified certain of our existing facilities to this classification.

(2) In September 2005, Alterra Healthcare Corporation, one of our tenants, became an indirect wholly-owned subsidiary of Brookdale Senior Living Inc. as a result of Brookdale's merger with FEBC-ALT Investors LLC. In April 2006, Brookdale completed the acquisition of Southern

Assisted Living,  
Inc.

*Credit Strength.* We measure our credit strength both in terms of leverage ratios and coverage ratios. Our leverage ratios include debt to book capitalization and debt to market capitalization. The leverage ratios indicate how much of our balance sheet capitalization is related to long-term debt. The coverage ratios indicate our ability to service interest and fixed charges (interest, secured debt principal amortization and preferred dividends). We expect to maintain capitalization ratios and coverage ratios sufficient to maintain investment grade ratings with Moody's Investors Service, Standard & Poor's Ratings Services and Fitch Ratings. The coverage ratios are based on earnings before interest, taxes, depreciation and amortization ( EBITDA ) which is discussed in further detail, and reconciled to net income, below in Non-GAAP Financial Measures. Leverage ratios and coverage ratios are widely used by investors, analysts and rating agencies in the valuation, comparison, investment recommendations and rating of companies. The following table reflects the recent historical trends for our credit strength measures for the periods presented:

	Three Months Ended						
	March 31 2005	June 30 2005	September 30 2005	December 31 2005	March 31 2006	June 30 2006	September 30 2006
Debt to book capitalization ratio	48%	51%	51%	51%	52%	49%	51%
Debt to market capitalization ratio	38%	37%	37%	40%	38%	37%	36%
Interest coverage ratio	3.21x	2.31x	3.22x	3.52x	2.99x	3.16x	2.98x
Fixed charge coverage ratio	2.46x	1.78x	2.51x	2.75x	2.41x	2.52x	2.41x

We evaluate our key performance indicators in conjunction with current expectations to determine if historical trends are indicative of future results. Our expected results may not be achieved and actual results may differ materially from our expectations. Factors that may cause actual results to differ from expected results are described in more detail in Forward-Looking Statements and Risk Factors and other sections of this Quarterly Report on Form 10-Q. Management regularly monitors economic and other factors to develop strategic and tactical plans designed to improve performance and maximize our competitive position. Our ability to achieve our financial objectives is dependent upon our ability to effectively execute these plans and to appropriately respond to emerging economic and company-specific trends. Please refer to our Annual Report on Form 10-K for the year ended December 31, 2005, under the headings Business, Risk Factors and Management's Discussion and Analysis of Financial Condition and Results of Operations for further discussion of these risk factors.

#### **Portfolio Update**

Payment coverages in our portfolio continue to remain strong. Our overall payment coverage is at 1.95 times and represents an increase of four basis points from the prior year. The table below reflects our recent historical trends of portfolio coverages. Coverage data reflects the 12 months ended for the periods presented. CBMF represents the ratio of facilities' earnings before interest, taxes, depreciation, amortization, rent and management fees to contractual rent or interest due us. CAMF represents the ratio of earnings before interest, taxes, depreciation, amortization, and rent (but after imputed management fees) to contractual rent or interest due us.

	June 30, 2005		June 30, 2006	
	CBMF	CAMF	CBMF	CAMF
Independent living/CCRCs (1)			1.47x	1.25x
Assisted living facilities	1.51x	1.28x	1.51x	1.30x
Skilled nursing facilities	2.20x	1.65x	2.16x	1.55x
Specialty care facilities	3.53x	2.91x	3.18x	2.65x



Weighted averages	1.91x	1.54x	1.95x	1.53x
-------------------	-------	-------	-------	-------

(1) As a result of our significant independent living/continuing care retirement community acquisitions in the fourth quarter of 2005, we began to separately disclose this facility classification in our portfolio reporting. We adopted the National Investment Center definitions and reclassified certain of our existing facilities to this classification.

***Corporate Governance***

Maintaining investor confidence and trust has become increasingly important in today's business environment. Health Care REIT, Inc.'s Board of Directors and management are strongly committed to policies and procedures that reflect the highest level of ethical business practices. Our corporate governance guidelines provide the framework for our business operations and emphasize our commitment to increase stockholder value while meeting all applicable legal requirements. In March 2004, the Board of Directors

**Table of Contents**

adopted its Corporate Governance Guidelines. These guidelines meet the listing standards adopted by the New York Stock Exchange and are available on our Web site at [www.hcreit.com](http://www.hcreit.com) and from us upon written request sent to the Senior Vice President Administration and Corporate Secretary, Health Care REIT, Inc., One SeaGate, Suite 1500, P.O. Box 1475, Toledo, Ohio 43603-1475.

**Table of Contents****Liquidity and Capital Resources****Sources and Uses of Cash**

Our primary sources of cash include rent and interest receipts, borrowings under unsecured lines of credit arrangements, public and private offerings of debt and equity securities, proceeds from the sales of real property and principal payments on loans receivable. Our primary uses of cash include dividend distributions, debt service payments (including principal and interest), real property investments (including construction advances), loan advances and general and administrative expenses. These sources and uses of cash are reflected in our Consolidated Statements of Cash Flows and are discussed in further detail below.

The following is a summary of our sources and uses of cash flows (dollars in thousands):

	Nine Months Ended		Change	
	Sept. 30, 2006	Sept. 30, 2005	\$	%
Cash and cash equivalents at beginning of period	\$ 36,237	\$ 19,763	\$ 16,474	83%
Cash provided from (used in) operating activities	158,984	114,973	44,011	38%
Cash provided from (used in) investing activities	(289,804)	(198,678)	(91,126)	46%
Cash provided from (used in) financing activities	110,073	91,061	19,012	21%
Cash and cash equivalents at end of period	\$ 15,490	\$ 27,119	\$ (11,629)	-43%

*Operating Activities.* The change in net cash provided from operating activities is primarily attributable to an increase in net income. Net income increased primarily due to the impact of the loss on extinguishment of debt recognized during the second quarter of 2005 on the prior year's net income.

Net straight-line rental income changed primarily due to a decrease in gross straight-line rental income and increases in cash payments outside normal monthly rental payments. The following is a summary of our straight-line rent (dollars in thousands):

	Nine Months Ended		Change	
	Sept. 30, 2006	Sept. 30, 2005	\$	%
Gross straight-line rental income	\$ 6,520	\$ 10,193	\$ (3,673)	-36%
Cash receipts due to real property sales	(1,623)	(2,971)	1,348	-45%
Prepaid rent receipts	(14,653)	(3,073)	(11,580)	377%
Cash receipts less than (in excess of) rental income	\$ (9,756)	\$ 4,149	\$ (13,905)	n/a

Gross straight-line rental income represents the non-cash difference between contractual cash rent due and the average rent recognized pursuant to Statement of Financial Accounting Standards No. 13, Accounting for Leases. This amount is positive in the first half of a lease term (but declining every year due to annual increases in cash rent due) and is negative in the second half of a lease term. Our standard lease structure contains annual rental escalators that are contingent upon changes in the Consumer Price Index and/or changes in the gross operating revenues of the tenant's properties. These escalators are not fixed, so no straight-line rent is recorded. Instead, rental income is recorded based on the contractual cash rental payment due for the period. The increase in non-recurring cash receipts is primarily attributable to cash received in connection with the acquisition of Commonwealth Communities Holdings LLC by Kindred Healthcare, Inc. in February 2006 as discussed in our Annual Report on Form 10-K for the year ended December 31, 2005.

**Table of Contents**

*Investing Activities.* The changes in net cash used in investing activities are primarily attributable to net changes in real property and loans receivable. The following is a summary of our investment and disposition activities (dollars in thousands):

	Nine Months Ended			
	Sept. 30, 2006		Sept. 30, 2005	
	Facilities	Amount	Facilities	Amount
Real property acquisitions:				
Independent living/CCRCs	2	\$ 25,337		
Assisted living facilities	4	30,650	4	\$ 47,660
Skilled nursing facilities	16	141,482	27	126,181
Specialty care facilities			5	51,000
Land parcels		3,274		
Total acquisitions	22	200,743	36	224,841
Less: Assumed debt		(25,049)		(22,309)
Cash disbursed for acquisitions		175,694		202,532
Construction in progress cash advances		103,237		4,782
Capital improvements to existing properties		11,665		18,771
Total cash invested in real property		290,596		226,085
Real property dispositions:				
Assisted living facilities	4	26,974	2	9,060
Skilled nursing facilities	3	7,827		
Land parcels		487		840
Proceeds from real property sales	7	35,288	2	9,900
Net cash investments in real property	15	\$ 255,308	34	\$ 216,185
Advances on loans receivable:				
Investments in new loans		\$ 64,319		\$ 11,500
Draws on existing loans		9,807		27,625
Total investments in loans		74,126		39,125
Receipts on loans receivable:				
Loan payoffs		30,046		38,146
Principal payments on loans		12,422		18,227
Total principal receipts on loans		42,468		56,373
Net cash advances (receipts) on loans receivable		\$ 31,658		\$ (17,248)

*Financing Activities.* The changes in net cash provided from or used in financing activities are primarily attributable to changes related to our unsecured lines of credit arrangements, principal payments on senior notes, common stock issuances and cash distributions to stockholders.

For the nine months ended September 30, 2006, we had a net increase of \$81,000,000 on our unsecured lines of credit arrangements as compared to a net increase of \$153,000,000 for the same period in 2005.

In April 2005, we closed on a public offering of \$250,000,000 of 5.875% senior unsecured notes due May 2015 at an effective yield of 5.913%. In May 2005, we redeemed all of our outstanding \$50,000,000 8.17% senior unsecured notes due March 2006, we completed a tender offer for \$57,670,000 of our outstanding \$100,000,000 7.625% senior unsecured notes due March 2008 and we redeemed \$122,500,000 of our outstanding \$175,000,000 7.5% senior unsecured notes due August 2007. We recognized one-time charges on the extinguishment of debt totaling approximately \$18,448,000 in the second quarter of 2005 as a result of this activity.

The increase in net proceeds from the issuance of common stock is primarily attributable to our April 2006 offering and common stock issuances related to our dividend reinvestment and stock purchase plan ( DRIP ). In April 2006, we completed a public offering of 3,222,800 shares of common stock, which generated net proceeds of approximately \$109,749,000. During the nine months ended September 30, 2006, we issued 1,440,000 shares of common stock pursuant to our DRIP, which generated net proceeds of approximately \$50,811,000. During the nine months ended September 30, 2005, we issued 1,081,000 shares of common stock pursuant to our DRIP, which generated net proceeds of approximately \$37,570,000. The remaining difference in common stock issuances is primarily due to issuances pursuant to stock incentive plans.

**Table of Contents**

In order to qualify as a REIT for federal income tax purposes, we must distribute at least 90% of our taxable income (including 100% of capital gains) to our stockholders. The increases in dividends are primarily attributable to increases in outstanding shares of common stock and increases in our annual common stock dividend per share.

The following is a summary of our dividend payments (in thousands, except per share amounts):

	Nine Months Ended			
	Sept. 30, 2006		Sept. 30, 2005	
	Per Share	Amount	Per Share	Amount
Common Stock	\$ 1.900	\$ 116,272	\$ 1.840	\$ 98,586
Series D Preferred Stock	1.477	5,906	1.477	5,906
Series E Preferred Stock	1.125	84	1.125	347
Series F Preferred Stock	1.430	10,008	1.430	10,008
Totals		\$ 132,270		\$ 114,847

**Off-Balance Sheet Arrangements**

We have an outstanding letter of credit issued for the benefit of certain insurance companies that provide workers compensation insurance to one of our tenants. Our obligation under the letter of credit matures in 2009. At September 30, 2006, our obligation under the letter of credit was \$2,450,000.

We are exposed to various market risks, including the potential loss arising from adverse changes in interest rates. We may or may not elect to use financial derivative instruments to hedge interest rate exposure. These decisions are principally based on the general trend in interest rates at the applicable dates, our perception of the future volatility of interest rates and our relative levels of variable rate debt and variable rate investments. As of September 30, 2006, we participated in two interest rate swap agreements related to our long-term debt. Our interest rate swaps are discussed below in Contractual Obligations.

**Contractual Obligations**

The following table summarizes our payment requirements under contractual obligations as of September 30, 2006 (in thousands):

Contractual Obligations	Total	Payments Due by Period			
		2006	2007-2008	2009-2010	Thereafter
Unsecured lines of credit arrangements					
(1)	\$ 740,000	\$ 0	\$ 40,000	\$ 700,000	\$ 0
Senior unsecured notes (2)	1,194,830		94,830		1,100,000
Secured debt	130,405	787	25,363	42,540	61,715
Contractual interest obligations	729,535	35,432	219,787	175,198	299,118
Capital lease obligations	0				
Operating lease obligations	17,782	366	2,909	2,765	11,742
Purchase obligations	303,873	4,525	234,820	64,528	
Other long-term liabilities	0				
Total contractual obligations	\$ 3,116,425	\$ 41,110	\$ 617,709	\$ 985,031	\$ 1,472,575

(1) Unsecured lines of credit arrangements reflected at 100% capacity.

- (2) Senior unsecured notes represent principal amounts due and do not reflect unamortized premiums/discounts or the fair value of interest-rate swap agreements as reflected on the balance sheet.

At September 30, 2006, we had an unsecured credit arrangement with a consortium of twelve banks providing for a revolving line of credit ( revolving credit ) in the amount of \$700,000,000, which is scheduled to expire on July 26, 2009. Borrowings under the agreement are subject to interest payable in periods no longer than three months at either the agent bank s prime rate of interest or the applicable margin over LIBOR interest rate, at our option (7.00% at September 30, 2006). The applicable margin is based on our ratings with Moody s Investors Service and Standard & Poor s Ratings Services and was 0.9% at September 30, 2006. In addition, we pay a facility fee annually to each bank based on the bank s commitment under the revolving credit facility. The facility fee depends on our ratings with Moody s Investors Service and Standard & Poor s Ratings Services and was 0.15% at September 30, 2006. We also pay an annual agent s fee of \$50,000. Principal is due upon expiration of the agreement. We have another unsecured line of credit arrangement with a bank for a total of \$40,000,000, which expires May 31, 2007. Borrowings under this line of credit are subject to interest at either the bank s prime rate of interest (8.25% at September 30, 2006) or 0.9% over LIBOR interest

**Table of Contents**

rate, at our option. Principal is due upon expiration of the agreement. At September 30, 2006, we had \$276,000,000 outstanding under the unsecured lines of credit arrangements and estimated total contractual interest obligations of \$46,983,000. Contractual interest obligations are estimated based on the assumption that the balance of \$276,000,000 at September 30, 2006 is constant until maturity at interest rates in effect at September 30, 2006.

We have \$1,194,830,000 of senior unsecured notes principal outstanding with fixed annual interest rates ranging from 5.875% to 8.0%, payable semi-annually. Total contractual interest obligations on senior unsecured notes totaled \$588,566,000 at September 30, 2006. Additionally, we have mortgage loans totaling \$130,405,000, collateralized by owned properties, with fixed annual interest rates ranging from 5.3% to 8.5%, payable monthly. The carrying values of the properties securing the mortgage loans totaled \$204,359,000 at September 30, 2006. Total contractual interest obligations on mortgage loans totaled \$48,461,000 at September 30, 2006.

On May 6, 2004, we entered into two interest rate swap agreements (the Swaps ) for a total notional amount of \$100,000,000 to hedge changes in fair value attributable to changes in the LIBOR swap rate of \$100,000,000 of fixed rate debt with a maturity date of November 15, 2013. The Swaps are treated as fair-value hedges for accounting purposes and we utilize the short-cut method in accordance with Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended. The Swaps are with highly rated counterparties in which we receive a fixed rate of 6.0% and pay a variable rate based on six-month LIBOR plus a spread. At September 30, 2006, total contractual interest obligations were estimated to be \$45,525,000.

At September 30, 2006, we had operating lease obligations of \$17,782,000 relating to our office space, one assisted living facility and seven skilled nursing facilities.

Purchase obligations are comprised of unfunded construction commitments and contingent purchase obligations. At September 30, 2006, we had outstanding construction financings of \$98,675,000 for leased properties and were committed to providing additional financing of approximately \$265,112,000 to complete construction. At September 30, 2006, we had contingent purchase obligations totaling \$38,761,000. These contingent purchase obligations primarily relate to deferred acquisition fundings and capital improvements. Deferred acquisition fundings are contingent upon a tenant satisfying certain conditions in the lease. Upon funding, amounts due from the tenant are increased to reflect the additional investment in the property.

**Capital Structure**

As of September 30, 2006, we had stockholders' equity of \$1,546,969,000 and a total outstanding debt balance of \$1,603,302,000, which represents a debt to total book capitalization ratio of 51%. Our ratio of debt to market capitalization was 36% at September 30, 2006. For the nine months ended September 30, 2006, our interest coverage ratio was 3.04 to 1.00. For the nine months ended September 30, 2006, our fixed charge coverage ratio was 2.44 to 1.00. Also, at September 30, 2006, we had \$15,490,000 of cash and cash equivalents and \$464,000,000 of available borrowing capacity under our unsecured lines of credit arrangements.

Our debt agreements contain various covenants, restrictions and events of default. Among other things, these provisions require us to maintain certain financial ratios and minimum net worth and impose certain limits on our ability to incur indebtedness, create liens and make investments or acquisitions. As of September 30, 2006, we were in compliance with all of the covenants under our debt agreements. None of our debt agreements contain provisions for acceleration which could be triggered by our debt ratings. However, under our unsecured lines of credit arrangements, the ratings on our senior unsecured notes are used to determine the fees and interest payable.

As of October 13, 2006, our senior unsecured notes were rated Baa3 (positive), BBB- (positive) and BBB- (stable) by Moody's Investors Service, Standard & Poor's Ratings Services and Fitch Ratings, respectively. We plan to manage the Company to maintain investment grade status with a capital structure consistent with our current profile. Any downgrades in terms of ratings or outlook by any or all of the noted rating agencies could have a material adverse impact on our cost and availability of capital, which could in turn have a material adverse impact on our consolidated results of operations, liquidity and/or financial condition.

On May 12, 2006, we filed an open-ended automatic or universal shelf registration statement with the Securities and Exchange Commission covering an indeterminate amount of future offerings of debt securities, common stock, preferred stock, depositary shares, warrants and units. As of October 13, 2006, we had an effective registration statement on file in connection with our enhanced DRIP program under which we may issue up to 6,314,213 shares of



common stock. As of October 13, 2006, 1,634,404 shares of common stock remained available for issuance under this registration statement. Depending upon market conditions, we anticipate issuing securities under our registration statements to invest in additional properties and to repay borrowings under our unsecured lines of credit arrangements.

**Table of Contents****Results of Operations**

Net income available to common stockholders for the three months ended September 30, 2006 totaled \$21,480,000, or \$0.34 per diluted share, as compared with \$19,908,000, or \$0.37 per diluted share, for the same period in 2005. Net income available to common stockholders for the nine months ended September 30, 2006 totaled \$63,793,000, or \$1.04 per diluted share, as compared with \$36,105,000, or \$0.67 per diluted share, for the same period in 2005. Net income available to common stockholders increased from the prior year primarily due to an increase in rental income offset by increases in interest expense and provision for depreciation and the recognition of a loss on extinguishment of debt totaling \$18,448,000, or \$0.34 per diluted share, during the second quarter of 2005. These items are discussed in further detail below.

FFO for the three months ended September 30, 2006 totaled \$45,898,000, or \$0.73 per diluted share, as compared with \$41,974,000, or \$0.77 per diluted share, for the same period in 2005. FAD for the three months ended September 30, 2006 totaled \$47,250,000, or \$0.75 per diluted share, as compared to \$41,857,000, or \$0.77 per diluted share, for the same period in 2005. FFO for the nine months ended September 30, 2006 totaled \$133,120,000, or \$2.18 per diluted share, as compared with \$99,712,000, or \$1.85 per diluted share, for the same period in 2005. FAD for the nine months ended September 30, 2006 totaled \$142,876,000, or \$2.34 per diluted share, as compared to \$95,563,000, or \$1.77 per diluted share, for the same period in 2005. The increase in FFO is due primarily to an increase in rental income offset by an increase in interest expense and general and administrative expenses and the recognition of the loss on extinguishment of debt during the second quarter of 2005. The increase in FAD is primarily due to the items noted above for FFO and the change in net straight-line rental income. Please refer to the discussion of Non-GAAP Financial Measures below for further information regarding FFO and FAD and for reconciliations of FFO and FAD to NICS.

EBITDA for the three months ended September 30, 2006 totaled \$76,464,000, as compared with \$69,582,000 for the same period in 2005. Our interest coverage ratio was 2.98 times for the three months ended September 30, 2006 as compared with 3.22 times for the same period in 2005. Our fixed charge coverage ratio was 2.41 times for the three months ended September 30, 2006 as compared with 2.51 times for the same period in 2005. EBITDA for the nine months ended September 30, 2006 totaled \$225,588,000, as compared with \$180,632,000 for the same period in 2005. Our interest coverage ratio was 3.04 times for the nine months ended September 30, 2006 as compared with 2.92 times for the same period in 2005. Our fixed charge coverage ratio was 2.44 times for the nine months ended September 30, 2006 as compared with 2.25 times for the same period in 2005. The increases in EBITDA are primarily due to the increase in rental income offset by an increase in general and administrative expenses and the recognition of a loss on extinguishment of debt totaling \$18,448,000 during the second quarter of 2005. The increases in our coverage ratios are primarily due to the impact of the prior year recognition of a loss on extinguishment of debt. These items are discussed in further detail below. Please refer to the discussion of Non-GAAP Financial Measures below for further information regarding EBITDA and a reconciliation of EBITDA to net income.

Revenues were comprised of the following (dollars in thousands):

	Three Months Ended		Change		Nine Months Ended		Change	
	Sept. 30, 2006	Sept. 30, 2005	\$	%	Sept. 30, 2006	Sept. 30, 2005	\$	%
Rental income	\$ 75,290	\$ 64,516	\$ 10,774	17%	\$ 220,002	\$ 180,960	\$ 39,042	22%
Interest income	4,436	4,997	(561)	-11%	13,178	15,249	(2,071)	-14%
Transaction fees and other income	1,019	773	246	32%	3,049	2,742	307	11%
Totals	\$ 80,745	\$ 70,286	\$ 10,459	15%	\$ 236,229	\$ 198,951	\$ 37,278	19%

The increase in gross revenues is primarily attributable to increased rental income resulting from the acquisitions of new properties from which we receive rent. See the discussion of investing activities in Liquidity and Capital

Resources above for further information. In addition, our standard lease structure contains annual rental escalators that are contingent upon changes in the Consumer Price Index and/or changes in the gross operating revenues of the tenant's properties. These escalators are not fixed, so no straight-line rent is recorded; however, rental income is recorded based on the contractual cash rental payments due for the period. If gross operating revenues at our facilities and/or the Consumer Price Index do not increase, a portion of our revenues may not continue to increase. Sales of real property would offset revenue increases and, to the extent that they exceed new acquisitions, could result in decreased revenues. Our leases could renew above or below current rent rates, resulting in an increase or decrease in rental income. As of September 30, 2006, we had no leases scheduled to expire before March 2009, excluding the assets held for sale referenced in Note F to our unaudited consolidated financial statements.

Interest income decreased from 2005 primarily due to a decrease in the balance of outstanding loans. Transaction fees and other income increased for the year primarily due to the receipt of \$1,041,000 from a warrant position we held in a private company that was sold during the second quarter of 2006. The prior year included a \$750,000 assignment consent fee received in the first quarter of 2005 relating to a payoff which did not occur.

**Table of Contents**

Expenses were comprised of the following (dollars in thousands):

	Three Months Ended		Change		Nine Months Ended		Change	
	Sept. 30, 2006	Sept. 30, 2005	\$	%	Sept. 30, 2006	Sept. 30, 2005	\$	%
Interest expense	\$ 24,007	\$ 20,477	\$ 3,530	17%	\$ 70,587	\$ 57,707	\$ 12,880	22%
Provision for depreciation	24,094	19,915	4,179	21%	70,256	56,879	13,377	24%
General and administrative	5,223	4,640	583	13%	16,517	12,993	3,524	27%
Loan expense	782	673	109	16%	2,199	2,209	(10)	0%
Loss on extinguishment of debt	0	0	0	n/a	0	18,448	(18,448)	-100%
Provision for loan losses	250	300	(50)	-17%	750	900	(150)	-17%
Totals	\$ 54,356	\$ 46,005	\$ 8,351	18%	\$ 160,309	\$ 149,136	\$ 11,173	7%

The change in total expenses is primarily attributable to increases in interest expense, the provision for depreciation and general and administrative expense offset by the loss on extinguishment of debt in 2005. The increase in interest expense is primarily due to higher average borrowings offset by lower average borrowing costs.

The following is a summary of our interest expense (dollars in thousands):

	Three Months Ended		Change		Nine Months Ended		Change	
	Sept. 30, 2006	Sept. 30, 2005	\$	%	Sept. 30, 2006	Sept. 30, 2005	\$	%
Senior unsecured notes	\$ 19,574	\$ 14,885	\$ 4,689	32%	\$ 58,723	\$ 46,544	\$ 12,179	26%
Secured debt	2,357	3,204	(847)	-26%	6,704	9,491	(2,787)	-29%
Unsecured lines of credit	3,698	3,747	(49)	-1%	8,566	6,823	1,743	26%
Capitalized interest	(1,384)	(12)	(1,372)	11,433%	(2,494)	(626)	(1,868)	298%
SWAP losses (savings)	29	(200)	229	n/a	100	(977)	1,077	n/a
Discontinued operations	(267)	(1,147)	880	-77%	(1,012)	(3,548)	2,536	-71%
Totals	\$ 24,007	\$ 20,477	\$ 3,530	17%	\$ 70,587	\$ 57,707	\$ 12,880	22%

The increase in interest expense on senior unsecured notes is due to the net effect and timing of issuances and extinguishments. The following is a summary of our senior unsecured note activity (dollars in thousands):

	Three Months Ended		Three Months Ended		Nine Months Ended		Nine Months Ended	
	September 30, 2006	September 30, 2005	September 30, 2005	September 30, 2005	September 30, 2006	September 30, 2006	September 30, 2005	September 30, 2005
	Face	Weighted Avg.	Face	Weighted Avg.	Face	Weighted Avg.	Face	Weighted Avg.

Edgar Filing: HEALTH CARE REIT INC /DE/ - Form 10-Q

	Amount	Interest Rate	Amount	Interest Rate	Amount	Interest Rate	Amount	Interest Rate
Beginning balance	\$ 1,194,830	6.566%	\$ 894,830	6.689%	\$ 1,194,830	6.566%	\$ 875,000	7.181%
Debt issued							250,000	5.875%
Debt extinguished							(230,170)	7.677%
Ending balance	\$ 1,194,830	6.566%	\$ 894,830	6.689%	\$ 1,194,830	6.566%	\$ 894,830	6.689%
Monthly averages	\$ 1,194,830	6.566%	\$ 894,830	6.689%	\$ 1,194,830	6.566%	\$ 921,461	6.911%

23

**Table of Contents**

The change in interest expense on secured debt is due to the net effect and timing of assumptions, extinguishments and principal amortizations. The following is a summary of our secured debt activity (dollars in thousands):

	Three Months Ended September 30, 2006		Three Months Ended September 30, 2005		Nine Months Ended September 30, 2006		Nine Months Ended September 30, 2005	
	Amount	Weighted Avg. Interest Rate	Amount	Weighted Avg. Interest Rate	Amount	Weighted Avg. Interest Rate	Amount	Weighted Avg. Interest Rate
Beginning balance	\$ 131,178	7.135%	\$ 168,790	6.807%	\$ 107,540	7.328%	\$ 160,225	7.508%
Debt assumed			6,705	5.800%	25,049	6.315%	22,309	6.561%
Debt extinguished			(472)	11.891%			(6,168)	6.790%
Principal payments	(773)	7.213%	(687)	7.556%	(2,184)	7.264%	(2,030)	7.623%
Ending balance	\$ 130,405	7.135%	\$ 174,336	6.785%	\$ 130,405	7.135%	\$ 174,336	6.785%

Monthly averages	\$ 130,794	7.135%	\$ 169,894	7.465%	\$ 124,024	7.185%	\$ 168,288	7.478%
------------------	------------	--------	------------	--------	------------	--------	------------	--------

The change in interest expense on unsecured lines of credit arrangements is due primarily to the net effect and timing of average draws, paydowns and variable interest rate changes. The following is a summary of our unsecured lines of credit arrangements (dollars in thousands):

	Three Months Ended September 30		Nine Months Ended September 30	
	2006	2005	2006	2005
Balance outstanding at quarter end	\$276,000	\$304,000	\$276,000	\$304,000
Maximum amount outstanding at any month end	\$276,000	\$309,000	\$276,000	\$318,000
Average amount outstanding (total of daily principal balances divided by days in period)	\$209,662	\$303,988	\$168,518	\$184,395
Weighted average interest rate (actual interest expense divided by average borrowings outstanding)	7.05%	4.93%	6.78%	4.93%

We capitalize certain interest costs associated with funds used to finance the construction of properties owned directly by us. The amount capitalized is based upon the borrowings outstanding during the construction period using the rate of interest that approximates our cost of financing. Our interest expense is reduced by the amount capitalized. Capitalized interest for the three and nine months ended September 30, 2006 totaled \$1,384,000 and \$2,494,000, respectively, as compared with \$12,000 and \$626,000 for the same periods in 2005.

On May 6, 2004, we entered into two interest rate swap agreements (the Swaps ) for a total notional amount of \$100,000,000 to hedge changes in fair value attributable to changes in the LIBOR swap rate of \$100,000,000 of fixed rate debt with a maturity date of November 15, 2013. The Swaps are treated as fair-value hedges for accounting purposes and we utilize the short-cut method in accordance with Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended. The Swaps are with highly rated counterparties in which we receive a fixed rate of 6.0% and pay a variable rate based on six-month LIBOR plus a

spread. For the three and nine months ended September 30, 2006, we incurred \$29,000 and \$100,000, respectively, of losses related to our Swaps that was recorded as an addition to interest expense. For the three and nine months ended September 30, 2005, we generated \$200,000 and \$977,000, respectively, of savings related to our Swaps that was recorded as a reduction of interest expense.

The provision for depreciation increased primarily as a result of additional investments in properties owned directly by us. See the discussion of investing activities in Liquidity and Capital Resources above for additional details. To the extent that we acquire or dispose of additional properties in the future, our provision for depreciation will change accordingly.

General and administrative expenses as a percentage of revenues (including revenues from discontinued operations) for the three and nine months ended September 30, 2006, were 6.39% and 6.88%, respectively, as compared with 6.22% and 6.14% for the same period in 2005. Approximately \$1,690,000 of the year-to-date increase from 2005 to 2006 relates directly to the adoption of Statement of Financial Accounting Standards No. 123(R), Accounting for Stock-Based Compensation, on January 1, 2006. Effective with the adoption of Statement No. 123(R), we began recognizing stock-based compensation cost to the date the awards become fully vested or to the retirement eligible date, if sooner. We expect that the adoption of Statement No. 123(R) will increase compensation cost by approximately \$1,287,000 for 2006 as a result of amortizing share-based awards to the retirement eligible date. See Note K to our unaudited consolidated financial statements for additional information. The remaining increase from 2005 is primarily related to costs associated with our initiatives to attract and retain appropriate personnel to achieve our business objectives.

**Table of Contents**

Loan expense represents the amortization of deferred loan costs incurred in connection with the issuance and amendments of debt. The change in loan expense is primarily due to the net effect of issuances and redemptions of senior unsecured notes subsequent to September 30, 2005. In April 2005, we issued \$250,000,000 of 5.875% senior unsecured notes due May 2015. In May 2005, we redeemed all of our outstanding \$50,000,000 8.17% senior unsecured notes due March 2006, we completed a public tender offer for \$57,670,000 of our outstanding \$100,000,000 7.625% senior unsecured notes due March 2008, and we redeemed \$122,500,000 of our outstanding \$175,000,000 7.5% senior unsecured notes due August 2007. In November 2005, we issued \$300,000,000 of 6.2% senior unsecured notes due June 2016.

The provision for loan losses is consistent with the prior year. The provision for loan losses is related to our critical accounting estimate for the allowance for loan losses and is discussed below in Critical Accounting Policies.

Other items were comprised of the following (dollars in thousands):

	Three Months Ended		Change		Nine Months Ended		Change	
	Sept. 30, 2006	Sept. 30, 2005	\$	%	Sept. 30, 2006	Sept. 30, 2005	\$	%
Gain (loss) on sales of properties	\$ 108	\$ 0	\$ 108	n/a	\$ 2,590	\$ (134)	\$ 2,724	n/a
Discontinued operations, net	316	1,016	(700)	-69%	1,281	2,685	(1,404)	-52%
Preferred dividends	(5,333)	(5,389)	56	-1%	(15,998)	(16,261)	263	-2%
Totals	\$ (4,909)	\$ (4,373)	\$ (536)	12%	\$ (12,127)	\$ (13,710)	\$ 1,583	-12%

Eight assisted living facilities were held for sale as of September 30, 2006. We did not recognize an impairment loss on these assets as the fair value less estimated costs to sell exceeded our carrying values. During the nine months ended September 30, 2006, we sold four assisted living facilities, three skilled nursing facilities and two parcels of land with carrying values of \$35,366,000 for a net gain of \$2,590,000. These properties generated \$1,281,000 of income after deducting depreciation and interest expense from rental revenue for the nine months ended September 30, 2006. All properties sold subsequent to January 1, 2005 and held for sale at September 30, 2006 generated \$2,685,000 of income after deducting depreciation and interest expense from rental revenue for the nine months ended September 30, 2005. Please refer to Note F of our unaudited consolidated financial statements for further discussion.

The decrease in preferred stock dividends is due to a decrease in average outstanding preferred shares as a result of conversions of Series E Cumulative Convertible and Redeemable Preferred Stock into common stock.

**Non-GAAP Financial Measures**

We believe that net income, as defined by U.S. GAAP, is the most appropriate earnings measurement. However, we consider FFO and FAD to be useful supplemental measures of our operating performance. Historical cost accounting for real estate assets in accordance with U.S. GAAP implicitly assumes that the value of real estate assets diminishes predictably over time as evidenced by the provision for depreciation. However, since real estate values have historically risen or fallen with market conditions, many industry investors and analysts have considered presentations of operating results for real estate companies that use historical cost accounting to be insufficient. In response, the National Association of Real Estate Investment Trusts ( NAREIT ) created FFO as a supplemental measure of operating performance for REITs that excludes historical cost depreciation from net income. FFO, as defined by NAREIT, means net income, computed in accordance with U.S. GAAP, excluding gains (or losses) from sales of real estate, plus depreciation and amortization, and after adjustments for unconsolidated partnerships and joint ventures. FAD represents FFO excluding the non-cash straight-line rental adjustments.



In April 2002, the Financial Accounting Standards Board issued Statement No. 145 that requires gains and losses on extinguishment of debt to be classified as income or loss from continuing operations rather than as extraordinary items as previously required under Statement No. 4. We adopted the standard effective January 1, 2003 and have properly reflected the losses on extinguishment of debt of \$18,448,000, or \$0.34 per diluted share, for the three months ended June 30, 2005. These charges have not been added back for the calculations of FFO, FAD or EBITDA.

EBITDA stands for earnings before interest, taxes, depreciation and amortization. We believe that EBITDA, along with net income and cash flow provided from operating activities, is an important supplemental measure because it provides additional information to assess and evaluate the performance of our operations. Additionally, restrictive covenants in our long-term debt arrangements contain financial ratios based on EBITDA. We primarily utilize EBITDA to measure our interest coverage ratio, which represents EBITDA divided by total interest, and our fixed charge coverage ratio, which represents EBITDA divided by fixed charges. Fixed charges include total interest, secured debt principal amortization and preferred dividends.

**Table of Contents**

FFO, FAD and EBITDA are financial measures that are widely used by investors, equity and debt analysts and rating agencies in the valuation, comparison, rating and investment recommendations of companies. Management uses these financial measures to facilitate internal and external comparisons to our historical operating results and in making operating decisions. Additionally, FFO and FAD are utilized by the Board of Directors to evaluate management. FFO, FAD and EBITDA do not represent net income or cash flow provided from operating activities as determined in accordance with U.S. GAAP and should not be considered as alternative measures of profitability or liquidity. Finally, FFO, FAD and EBITDA, as defined by us, may not be comparable to similarly entitled items reported by other real estate investment trusts or other companies.

The table below reflects the reconciliation of FFO to net income available to common stockholders, the most directly comparable U.S. GAAP measure, for the periods presented. The provision for depreciation includes provision for depreciation from discontinued operations. Amounts are in thousands except for per share data.

	Three Months Ended						
	March 31 2005	June 30 2005	September 30 2005	December 31 2005	March 31 2006	June 30 2006	September 30 2006
FFO Reconciliation:							
Net income (loss) available to common stockholders	\$ 17,803	\$ (1,606)	\$ 19,908	\$ 26,587	\$ 19,645	\$ 22,668	\$ 21,480
Provision for depreciation	20,396	21,009	22,066	21,355	23,262	24,131	24,526
Loss (gain) on sales of properties	110	24	0	(3,361)	(1,553)	(929)	(108)
Funds from operations	\$ 38,309	\$ 19,427	\$ 41,974	\$ 44,581	\$ 41,354	\$ 45,870	\$ 45,898
Average common shares outstanding:							
Basic	52,963	53,429	54,038	55,992	58,178	61,548	62,524
Diluted for net income (loss) purposes	53,454	53,429	54,359	56,368	58,535	61,868	62,866
Diluted for FFO purposes	53,454	53,765	54,359	56,368	58,535	61,868	62,866
Per share data:							
Net income (loss) available to common stockholders							
Basic	\$ 0.34	\$ (0.03)	\$ 0.37	\$ 0.47	\$ 0.34	\$ 0.37	\$ 0.34
Diluted	0.33	(0.03)	0.37	0.47	0.34	0.37	0.34
Funds from operations							

Edgar Filing: HEALTH CARE REIT INC /DE/ - Form 10-Q

Basic	\$ 0.72	\$ 0.36	\$ 0.78	\$ 0.80	\$ 0.71	\$ 0.75	\$ 0.73
Diluted	0.72	0.36	0.77	0.79	0.71	0.74	0.73

---

26

**Table of Contents**

The table below reflects the reconciliation of FAD to net income available to common stockholders, the most directly comparable U.S. GAAP measure, for the periods presented. The provision for depreciation includes provision for depreciation from discontinued operations. Amounts are in thousands except for per share data.

	Three Months Ended						
	March 31 2005	June 30 2005	September 30 2005	December 31 2005	March 31 2006	June 30 2006	September 30 2006
FAD Reconciliation:							
Net income							
(loss) available to common stockholders	\$ 17,803	\$ (1,606)	\$ 19,908	\$ 26,587	\$ 19,645	\$ 22,668	\$ 21,480
Provision for depreciation	20,396	21,009	22,066	21,355	23,262	24,131	24,526
Loss (gain) on sales of properties	110	24	0	(3,361)	(1,553)	(929)	(108)
Gross straight-line rental income	(3,708)	(3,536)	(2,950)	(2,949)	(2,400)	(2,216)	(1,904)
Prepaid/straight-line rent receipts	853	2,360	2,832	7,825	10,310	2,710	3,256
Funds available for distribution	\$ 35,454	\$ 18,251	\$ 41,856	\$ 49,457	\$ 49,264	\$ 46,364	\$ 47,250
Average common shares outstanding:							
Basic	52,963	53,429	54,038	55,992	58,178	61,548	62,524
Diluted for net income							
(loss) purposes	53,454	53,429	54,359	56,368	58,535	61,868	62,866
Diluted for FAD purposes	53,454	53,765	54,359	56,368	58,535	61,868	62,866
Per share data:							
Net income							
(loss) available to common stockholders							
Basic	\$ 0.34	\$ (0.03)	\$ 0.37	\$ 0.47	\$ 0.34	\$ 0.37	\$ 0.34
Diluted	0.33	(0.03)	0.37	0.47	0.34	0.37	0.34
Funds available for distribution							
Basic	\$ 0.67	\$ 0.34	\$ 0.77	\$ 0.88	\$ 0.85	\$ 0.75	\$ 0.76
Diluted	0.66	0.34	0.77	0.88	0.84	0.75	0.75

**Table of Contents**

The table below reflects the reconciliation of EBITDA to net income, the most directly comparable U.S. GAAP measure, for the periods presented. The provision for depreciation and interest expense includes provision for depreciation and interest expense from discontinued operations. Tax expense represents income-based taxes. Amortization represents the amortization of deferred loan expenses. Adjusted EBITDA represents EBITDA as adjusted below for items pursuant to covenant provisions of our unsecured lines of credit arrangements. Dollars are in thousands.

	Three Months Ended						
	March 31 2005	June 30 2005	September 30 2005	December 31 2005	March 31 2006	June 30 2006	September 30 2006
<b>EBITDA Reconciliation:</b>							
Net income	\$23,239	\$ 3,830	\$25,297	\$31,921	\$24,978	\$28,001	\$26,813
Interest expense	19,645	19,986	21,624	21,369	24,238	23,087	24,274
Tax expense	3	216	1	62	0	12	70
Provision for depreciation	20,396	21,009	22,066	21,355	23,262	24,131	24,526
Amortization	726	1,998	594	618	711	707	781
<b>EBITDA</b>	<b>64,009</b>	<b>47,039</b>	<b>69,582</b>	<b>75,325</b>	<b>73,189</b>	<b>75,938</b>	<b>76,464</b>
Stock-based compensation expense	316	316	317	90	2,513	838	192
Provision for loan losses	300	300	300	300	250	250	250
Loss on extinguishment of debt, net	0	18,448	0	2,214	0	0	0
<b>Adjusted EBITDA</b>	<b>\$64,625</b>	<b>\$66,103</b>	<b>\$70,199</b>	<b>\$77,929</b>	<b>\$75,952</b>	<b>\$77,026</b>	<b>\$76,906</b>
<b>Interest Coverage Ratio:</b>							
Interest expense	\$19,645	\$19,986	\$21,624	\$21,369	\$24,238	\$23,087	\$24,274
Capitalized interest	265	348	12	39	202	909	1,384
<b>Total interest</b>	<b>19,910</b>	<b>20,334</b>	<b>21,636</b>	<b>21,408</b>	<b>24,440</b>	<b>23,996</b>	<b>25,658</b>
<b>EBITDA</b>	<b>\$64,009</b>	<b>\$47,039</b>	<b>\$69,582</b>	<b>\$75,325</b>	<b>\$73,189</b>	<b>\$75,938</b>	<b>\$76,464</b>
<b>Interest coverage ratio</b>	<b>3.21x</b>	<b>2.31x</b>	<b>3.22x</b>	<b>3.52x</b>	<b>2.99x</b>	<b>3.16x</b>	<b>2.98x</b>
<b>Adjusted EBITDA</b>	<b>\$64,625</b>	<b>\$66,103</b>	<b>\$70,199</b>	<b>\$77,929</b>	<b>\$75,952</b>	<b>\$77,026</b>	<b>\$76,906</b>
<b>Interest coverage ratio adjusted</b>	<b>3.25x</b>	<b>3.25x</b>	<b>3.24x</b>	<b>3.64x</b>	<b>3.11x</b>	<b>3.21x</b>	<b>3.00x</b>
<b>Fixed Charge Coverage Ratio:</b>							
Total interest	\$19,910	\$20,334	\$21,636	\$21,408	\$24,440	\$23,996	\$25,658
Secured debt principal amortization	627	716	699	643	643	768	773
Preferred dividends	5,436	5,436	5,389	5,334	5,333	5,333	5,333
<b>Total fixed charges</b>	<b>25,973</b>	<b>26,486</b>	<b>27,724</b>	<b>27,385</b>	<b>30,416</b>	<b>30,097</b>	<b>31,764</b>
<b>EBITDA</b>	<b>\$64,009</b>	<b>\$47,039</b>	<b>\$69,582</b>	<b>\$75,325</b>	<b>\$73,189</b>	<b>\$75,938</b>	<b>\$76,464</b>

Edgar Filing: HEALTH CARE REIT INC /DE/ - Form 10-Q

Fixed charge coverage ratio	2.46x	1.78x	2.51x	2.75x	2.41x	2.52x	2.41x
EBITDA adjusted	\$64,625	\$66,103	\$70,199	\$77,929	\$75,952	\$77,026	\$76,906

Fixed charge coverage ratio adjusted	2.49x	2.50x	2.53x	2.85x	2.50x	2.56x	2.42x
--------------------------------------	-------	-------	-------	-------	-------	-------	-------

28

**Table of Contents****Critical Accounting Policies**

Our consolidated financial statements are prepared in accordance with U.S. GAAP, which requires us to make estimates and assumptions. Management considers an accounting estimate or assumption critical if:

the nature of the estimates or assumptions is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change; and

the impact of the estimates and assumptions on financial condition or operating performance is material.

Management has discussed the development and selection of its critical accounting policies with the Audit Committee of the Board of Directors and the Audit Committee has reviewed the disclosure presented below relating to them. Management believes the current assumptions and other considerations used to estimate amounts reflected in our consolidated financial statements are appropriate and are not reasonably likely to change in the future. However, since these estimates require assumptions to be made that were uncertain at the time the estimate was made, they bear the risk of change. If actual experience differs from the assumptions and other considerations used in estimating amounts reflected in our consolidated financial statements, the resulting changes could have a material adverse effect on our consolidated results of operations, liquidity and/or financial condition. Please refer to our Annual Report on Form 10-K for the year ended December 31, 2005 for further information regarding significant accounting policies that impact us. There have been no material changes to these policies in 2006.

We adopted Statement of Financial Accounting Standards No. 123(R) on January 1, 2006. See Note K to our unaudited consolidated financial statements for additional information.

The following table presents information about our critical accounting policies, as well as the material assumptions used to develop each estimate:

<b>Nature of Critical Accounting Estimate</b>	<b>Assumptions/Approach Used</b>
---	--------------------------------------

**Allowance for Loan Losses**

We maintain an allowance for loan losses in accordance with Statement of Financial Accounting Standards No. 114, Accounting by Creditors for Impairment of a Loan, as amended, and SEC Staff Accounting Bulletin No. 102, Selected Loan Loss Allowance Methodology and Documentation Issues. The allowance for loan losses is maintained at a level believed adequate to absorb potential losses in our loans receivable. The determination of the allowance is based on a quarterly evaluation of all outstanding loans. If this evaluation indicates that there is a greater risk of loan charge-offs, additional allowances or placement on non-accrual status may be required. A loan is impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due as scheduled according to the contractual terms of the original loan agreement. Consistent with this definition, all loans on non-accrual are deemed impaired. To the extent circumstances improve and the risk of collectibility is diminished, we will return these loans to full accrual status.

The determination of the allowance is based on a quarterly evaluation of all outstanding loans, including general economic conditions and estimated collectibility of loan payments and principal. We evaluate the collectibility of our loans receivable based on a combination of factors, including, but not limited to, delinquency status, historical loan charge-offs, financial strength of the borrower and guarantors and value of the underlying property.

For the nine months ended September 30, 2006, we recorded \$750,000 as provision for loan losses, resulting in an allowance for loan losses of \$7,156,000 relating to loans with outstanding balances of \$67,181,000 at September 30, 2006. Also at September 30, 2006, we had loans with outstanding balances of \$10,979,000 on non-accrual status.





**Table of Contents**

**Nature of Critical Accounting Estimate**

**Assumptions/Approach Used**

**Depreciation and Useful Lives**

Substantially all of the properties owned by us are leased under operating leases and are recorded at cost. The cost of our real property is allocated to land, buildings, improvements and intangibles in accordance with Statement of Financial Accounting Standards No. 141, Business Combinations. The allocation of the acquisition costs of properties is based on appraisals commissioned from independent real estate appraisal firms.

We compute depreciation on our properties using the straight-line method based on their estimated useful lives which range from 15 to 40 years for buildings and five to 15 years for improvements.

For the nine months ended September 30, 2006, we recorded \$58,476,000 and \$13,441,000 as provision for depreciation relating to buildings and improvements, respectively. The average useful life of our buildings and improvements was 32.8 years and 10.3 years, respectively, for the nine months ended September 30, 2006.

**Impairment of Long-Lived Assets**

We review our long-lived assets for potential impairment in accordance with Statement of Financial Accounting Standards No. 144, Accounting for the Impairment and Disposal of Long-Lived Assets. An impairment charge must be recognized when the carrying value of a long-lived asset is not recoverable. The carrying value is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. If it is determined that a permanent impairment of a long-lived asset has occurred, the carrying value of the asset is reduced to its fair value and an impairment charge is recognized for the difference between the carrying value and the fair value.

The net book value of long-lived assets is reviewed quarterly on a property by property basis to determine if there are indicators of impairment. These indicators may include anticipated operating losses at the property level, the tenant's inability to make rent payments, a decision to dispose of an asset before the end of its estimated useful life and changes in the market that may permanently reduce the value of the property. If indicators of impairment exist, then the undiscounted future cash flows from the most likely use of the property are compared to the current net book value. This analysis requires us to determine if indicators of impairment exist and to estimate the most likely stream of cash flows to be generated from the property during the period the property is expected to be held.

We did not record any impairment charges for the nine months ended September 30, 2006.

**Fair Value of Derivative Instruments**

The valuation of derivative instruments is accounted for in accordance with Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities ( SFAS133 ), as amended by Statement of Financial Accounting Standards No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities. SFAS133, as amended,

The valuation of derivative instruments requires us to make estimates and judgments that affect the fair value of the instruments. Fair values for our derivatives are estimated by a third party consultant, which utilizes pricing models that consider forward yield curves and discount rates. Such amounts and the recognition of such amounts are subject to significant estimates which may

requires companies to record derivatives at fair market value on the balance sheet as assets or liabilities.

change in the future. At September 30, 2006, we participated in two interest rate swap agreements related to our long-term debt. At September 30, 2006, the swaps were reported at their fair value as a \$946,000 other asset. For the nine months ended September 30, 2006, we incurred \$100,000 of losses related to our swaps that was recorded as an addition to interest expense.

30

---

**Table of Contents****Nature of Critical Accounting Estimate****Assumptions/Approach Used****Revenue Recognition**

Revenue is recorded in accordance with Statement of Financial Accounting Standards No. 13, Accounting for Leases, and SEC Staff Accounting Bulletin No. 101, Revenue Recognition in Financial Statements, as amended ( SAB101 ). SAB101 requires that revenue be recognized after four basic criteria are met. These four criteria include persuasive evidence of an arrangement, the rendering of service, fixed and determinable income and reasonably assured collectibility. If the collectibility of revenue is determined incorrectly, the amount and timing of our reported revenue could be significantly affected. Interest income on loans is recognized as earned based upon the principal amount outstanding subject to an evaluation of collectibility risk. Our standard lease structure contains annual rental escalators that are contingent upon changes in the Consumer Price Index and/or changes in the gross operating revenues of the property. These escalators are not fixed, so no straight-line rent is recorded; however, rental income is recorded based on the contractual cash rental payments due for the period.

We evaluate the collectibility of our revenues and related receivables on an on-going basis. We evaluate collectibility based on assumptions and other considerations including, but not limited to, the certainty of payment, payment history, the financial strength of the investment s underlying operations as measured by cash flows and payment coverages, the value of the underlying collateral and guaranties and current economic conditions.

If our evaluation indicates that collectibility is not reasonably assured, we may place an investment on non-accrual or reserve against all or a portion of current income as an offset to revenue.

For the nine months ended September 30, 2006, we recognized \$13,178,000 of interest income and \$223,956,000 of rental income, including discontinued operations. Cash receipts on leases with deferred revenue provisions were \$16,276,000 as compared to gross straight-line rental income recognized of \$6,520,000 for the nine months ended September 30, 2006. At September 30, 2006, our straight-line receivable balance was \$54,594,000. Also at September 30, 2006, we had loans with outstanding balances of \$10,979,000 on non-accrual status.

**Forward-Looking Statements and Risk Factors**

This Quarterly Report on Form 10-Q may contain forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. These forward-looking statements concern and are based upon, among other things, the possible expansion of our portfolio; the sale of properties; the performance of our operators and properties; our ability to enter into agreements with new viable tenants for properties that we take back from financially troubled tenants, if any; our ability to make distributions; our policies and plans regarding investments, financings and other matters; our tax status as a real estate investment trust; our ability to appropriately balance the use of debt and equity; our ability to access capital markets or other sources of funds; our ability to meet our earnings guidance; and with respect to the prospective merger of the Company and Windrose Medical Properties Trust ( Windrose ), the possible increase in the size and composition of the portfolios of each entity and the combined entity; potential benefits associated with the proposed transaction; the sale of properties; the performance of the operators and properties of each of the Company and Windrose; the ability of each of the Company and Windrose to complete the transaction; the ability to make new investments and to maintain returns from existing investments; the ability to enter into agreements with new and existing tenants; the policies and plans of each of the Company and Windrose regarding investments, financings and other matters; the tax status of each of the Company and Windrose as a real estate investment trust; the ability of each of the Company and Windrose to appropriately balance the use of debt and equity; the ability of each of the Company and Windrose to access capital markets or other sources of funds; and the ability of each of the

Company and Windrose and of the combined entity to meet earnings guidance. When we use words such as may, will, intend, should, believe, expect, anticipate, project, estimate or similar expressions, we are making forward statements. Forward-looking statements are not guarantees of future performance and involve risks and uncertainties. Our expected results may not be achieved, and actual results may differ materially from expectations. This may be a result of various factors, including, but not limited to: the status of the economy; the status of capital markets, including prevailing interest rates; serious issues facing the health care industry, including compliance with, and changes to, regulations and payment policies and operators' difficulty in obtaining and maintaining adequate liability and other insurance; changes in financing terms; competition within the health care and senior housing industries; negative developments in the operating results or financial condition of operators, including, but not limited to, their ability to pay rent and repay loans; our ability to transition or sell facilities with profitable results; the failure of closings to occur as and when anticipated; acts of God affecting our properties; our ability to reinvest sale proceeds at similar rates to assets sold; operator bankruptcies; government regulations affecting Medicare and Medicaid reimbursement rates; liability claims and insurance costs for our operators; unanticipated difficulties and/or expenditures relating to future acquisitions; environmental laws affecting our properties; delays in reinvestment of sales proceeds; changes in rules or practices governing our financial reporting; other factors, including REIT qualification, anti-takeover provisions and key management personnel; and with respect to the prospective merger of the Company and Windrose, unexpected delays or conditions to receipt of shareholder and third party approvals; delays in the implementation and execution of merger integration plans; unexpected costs or delays in the successful integration of IT systems and elimination of duplicative overhead and IT costs; and unanticipated developments relating to previously disclosed lawsuits or similar matters. Other important factors are identified in our Annual Report on Form 10-K for the year ended December 31, 2005, including factors identified under the headings Business, Risk Factors and Management's Discussion and Analysis of Financial Condition and Results of Operations. Finally, we assume no obligation to update or revise any forward-looking statements or to update the reasons why actual results could differ from those projected in any forward-looking statements.

**Table of Contents****Item 3. Quantitative and Qualitative Disclosures about Market Risk**

We are exposed to various market risks, including the potential loss arising from adverse changes in interest rates. We seek to mitigate the effects of fluctuations in interest rates by matching the terms of new investments with new long-term fixed rate borrowings to the extent possible. We may or may not elect to use financial derivative instruments to hedge interest rate exposure. These decisions are principally based on our policy to match our variable rate investments with comparable borrowings, but are also based on the general trend in interest rates at the applicable dates and our perception of the future volatility of interest rates. This section is presented to provide a discussion of the risks associated with potential fluctuations in interest rates.

We historically borrow on our unsecured lines of credit arrangements to acquire, construct or make loans relating to health care and senior housing properties. Then, as market conditions dictate, we will issue equity or long-term fixed rate debt to repay the borrowings under the unsecured lines of credit arrangements.

A change in interest rates will not affect the interest expense associated with our fixed rate debt. Interest rate changes, however, will affect the fair value of our fixed rate debt. A 1% increase in interest rates would result in a decrease in fair value of our senior unsecured notes by approximately \$33,301,000 at September 30, 2006 (\$36,931,000 at September 30, 2005). Changes in the interest rate environment upon maturity of this fixed rate debt could have an effect on our future cash flows and earnings, depending on whether the debt is replaced with other fixed rate debt, variable rate debt, or equity or repaid by the sale of assets.

On May 6, 2004, we entered into two interest rate swap agreements (the Swaps ) for a total notional amount of \$100,000,000 to hedge changes in fair value attributable to changes in the LIBOR swap rate of \$100,000,000 of fixed rate debt with a maturity date of November 15, 2013. The Swaps are treated as fair-value hedges for accounting purposes and we utilize the short-cut method in accordance with Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended. The Swaps are with highly rated counterparties in which we receive a fixed rate of 6.0% and pay a variable rate based on six-month LIBOR plus a spread. At September 30, 2006, the Swaps were reported at their fair value as a \$946,000 other liability (\$3,237,000 other asset at September 30, 2005). A 1% increase in interest rates would result in a decrease in fair value of our Swaps by approximately \$6,145,000 at September 30, 2006 (\$6,945,000 at September 30, 2005). Assuming no changes in the notional amount of \$100,000,000 of our Swaps, a 1% increase in interest rates would result in increased annual interest expense of \$1,000,000.

Our variable rate debt, including our unsecured lines of credit arrangements, is reflected at fair value. At September 30, 2006, we had \$276,000,000 outstanding related to our variable rate debt and assuming no changes in outstanding balances, a 1% increase in interest rates would result in increased annual interest expense of \$2,760,000. At September 30, 2005, we had \$304,000,000 outstanding related to our variable rate debt and assuming no changes in outstanding balances, a 1% increase in interest rates would have resulted in increased annual interest expense of \$3,040,000.

We are subject to risks associated with debt financing, including the risk that existing indebtedness may not be refinanced or that the terms of refinancing may not be as favorable as the terms of current indebtedness. The majority of our borrowings were completed under indentures or contractual agreements that limit the amount of indebtedness we may incur. Accordingly, in the event that we are unable to raise additional equity or borrow money because of these limitations, our ability to acquire additional properties may be limited.

**Item 4. Controls and Procedures**

Our management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the Exchange Act )) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective in providing reasonable assurance that information required to be disclosed by us in the reports we file with or submit to the Securities and Exchange Commission ( SEC ) under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms. No change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) occurred during the period covered by this Quarterly Report on

Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents**

**PART II. OTHER INFORMATION**

**Item 1A. Risk Factors**

Except as provided in Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations Forward-Looking Statements and Risk Factors, there have been no material changes from the risk factors identified under the heading Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2005.

**Item 6. Exhibits**

- 2.1 Agreement and Plan of Merger, dated as of September 12, 2006, by and among Health Care REIT, Inc., Heat Merger Sub, LLC, Heat OP Merger Sub, L.P., Windrose Medical Properties Trust and Windrose Medical Properties, L.P. (filed with the Commission as Exhibit 2.1 to the Company's Form 8-K filed September 15, 2006, and incorporated herein by reference thereto).
- 2.2 Amendment No. 1 to Agreement and Plan of Merger, dated as of October 12, 2006, by and among Health Care REIT, Inc., Heat Merger Sub, LLC, Heat OP Merger Sub, L.P., Windrose Medical Properties Trust and Windrose Medical Properties, L.P. (filed with the Commission as Exhibit 2.1 to the Company's Form 8-K filed October 13, 2006, and incorporated herein by reference thereto).
- 10.1 Third Amended and Restated Loan Agreement, dated as of July 26, 2006, by and among Health Care REIT, Inc. and certain of its subsidiaries, the banks signatory thereto, KeyBank National Association, as administrative agent, Deutsche Bank Securities Inc., as syndication agent, and UBS Securities LLC, Bank of America, N.A. and JPMorgan Chase Bank, N.A., as documentation agents (filed with the Commission as Exhibit 10.2 to the Company's Form 10-Q filed July 28, 2006, and incorporated herein by reference thereto).
- 10.2 Amendment No. 1 to Third Amended and Restated Loan Agreement by and among the Company and certain of its subsidiaries, the banks signatory thereto, KeyBank National Association, as administrative agent, Deutsche Bank Securities Inc., as syndication agent, and UBS Securities LLC, Bank of America, N.A. and JPMorgan Chase Bank, N.A., as documentation agents, dated as of September 20, 2006 (filed with the Commission as Exhibit 10.1 to the Company's Form 8-K filed September 26, 2006, and incorporated herein by reference thereto).
- 12 Statement Regarding Computation of Ratio of Earnings to Fixed Charges and Ratio of Earnings to Combined Fixed Charges and Preferred Stock Dividends.
- 31.1 Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer.
- 31.2 Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer.
- 32.1 Certification pursuant to 18 U.S.C. Section 1350 by Chief Executive Officer.
- 32.2 Certification pursuant to 18 U.S.C. Section 1350 by Chief Financial Officer.

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.

**HEALTH CARE REIT, INC.**

Date: October 20, 2006

By: /s/ George L. Chapman

George L. Chapman,  
Chairman and Chief Executive Officer  
(Principal Executive Officer)

Date: October 20, 2006

By: /s/ Scott A. Estes

Scott A. Estes,  
Senior Vice President and Chief Financial  
Officer  
(Principal Financial Officer)

Date: October 20, 2006

By: /s/ Paul D. Nungester, Jr.

Paul D. Nungester, Jr.,  
Vice President and Controller  
(Principal Accounting Officer)

33