

HEALTH CARE REIT, INC. ANNUAL REPORT 2002



2002



Introduction

The foundation of Health Care REIT, Inc. is the dedication of our Board of Directors, management and employees to stringent portfolio underwriting and monitoring and a conservative financial profile.

These core values are intended to generate positive long-term returns to our stockholders.

Corporate Profile

Health Care REIT, Inc., a Delaware corporation, is a self-administered, equity real estate investment trust that invests in health care facilities, primarily skilled nursing and assisted living facilities. We also invest in specialty care facilities. As of December 31, 2002, long-term care facilities, which include skilled nursing and assisted living facilities, comprised approximately 92% of our investment portfolio. Founded in 1970, we were the first real estate investment trust to invest exclusively in health care facilities.

As of December 31, 2002, we had \$1,537,257,000 of real estate investments, inclusive of credit enhancements, in 244 facilities located in 33 states and managed by 44 different operators. At that date, the portfolio included 160 assisted living facilities, 76 skilled nursing facilities and eight specialty care facilities.



REIT Glossary of Terms

Real Estate Investment Trusts (REITs)

Real Estate Investment Trusts (REITs) are an efficient way for many investors to invest in commercial and residential real estate businesses. As an investment, REITs combine the best features of real estate and stocks. They give an investor a practical and effective means to include professionally-managed real estate in a diversified investment portfolio. The REIT industry began its fifth decade in 2000. Because of the industry's overall maturity and performance over the last four decades, REITs can be viewed as "all-weather" investments.

Real estate investors are offered three important qualities through modern REITs that were never accessible or available to them before: liquidity, security and performance.

Equity REIT

A REIT which owns, or has an "equity interest" in rental real estate (rather than making loans secured by real estate collateral).

Real Estate Investment Trust Act of 1960

The federal law that authorized REITs. Its purpose was to allow small investors to pool their investments in real estate in order to get the same benefits as might be obtained by direct ownership, while also diversifying their risks and obtaining professional management.

Total Market Cap

The total market value of a REIT's (or other company's) outstanding common stock and indebtedness.

Total Return

A stock's dividend income plus capital appreciation, before taxes and commissions.

Source: NAREIT

Financial Highlights

	Year ended December 31				
	2002	2001	2000	1999	1998
(In thousands, except per share data)					
Operating Data					
Revenues (1)	\$ 163,794	\$ 130,699	\$ 133,664	\$ 126,519	\$ 96,375
Total expenses (2)	96,135	70,150	65,608	50,881	34,066
Net income	67,659	60,549	68,056	75,638	62,309
Preferred stock dividends	12,468	13,505	13,490	12,814	4,160
Net income available to common stockholders	\$ 55,191	\$ 47,044	\$ 54,566	\$ 62,824	\$ 58,149
Other Data					
Average diluted common shares outstanding	37,301	31,027	28,643	28,384	25,954
Funds from operations (3)	\$ 99,274	\$ 77,744	\$ 77,531	\$ 78,441	\$ 66,766
Per Share Data					
Net income available to common stockholders - diluted	\$ 1.48	\$ 1.52	\$ 1.91	\$ 2.21	\$ 2.24
Funds from operations - diluted	2.66	2.51	2.71	2.76	2.57
Cash distributions per common share	2.34	2.34	2.335	2.27	2.19
Balance Sheet Data					
Net real estate investments	\$ 1,524,457	\$ 1,213,564	\$ 1,121,419	\$ 1,241,722	\$ 1,047,511
Total assets	1,594,110	1,269,843	1,156,904	1,271,171	1,073,424
Total debt	676,331	491,216	439,752	538,842	418,979
Total liabilities	696,878	511,973	458,297	564,175	439,665
Total stockholders' equity	897,232	757,870	698,607	706,996	633,759

(1) Revenues include gross revenues, gain or loss on sales of property and income from discontinued operations.

(2) Total expenses include operating expenses and extraordinary losses on extinguishment of debt.

(3) Funds from operations is defined as net income available to common stockholders (computed in accordance with accounting principles generally accepted in the United States) excluding prepayment fees and gains or losses from sales of property or debt extinguishments, and adding back depreciation of real estate (including depreciation on discontinued operations). 2000 FFO excludes loss on investment of \$2,000,000. The following table represents a reconciliation of net income and FFO (in thousands).

	Year ended December 31				
	2002	2001	2000	1999	1998
Net income available to common stockholders	\$ 55,191	\$ 47,044	\$ 54,566	\$ 62,824	\$ 58,149
Depreciation expense	40,350	30,227	22,706	17,885	10,254
Extraordinary losses on extinguishments of debt	403	213			
Loss on investment			2,000		
Impairment of assets	2,298				
Loss (Gain) on sales of property	1,032	1,250	(1,684)	(703)	(1,049)
Prepayment fees		(990)	(57)	(1,565)	(588)
Funds from operations	\$ 99,274	\$ 77,744	\$ 77,531	\$ 78,441	\$ 66,766



George L. Chapman

*Chairman and
Chief Executive Officer*

In last year's Letter to Stockholders, I described the benefits of investing in long-term care facilities and then went on to describe the keys to successful investing. Although the sector had been in a down cycle for two or three years, I identified an improving investment environment and highlighted our success in positioning your company to capture investment opportunities. In this letter I describe our progress in this improving, yet still challenging, investment arena.

A good deal of attention will be dedicated to our facilities and their viability for providing quality care in the evolving health care delivery system. Towards the end of the letter, I'll make a few comments relating to our management "philosophy," including some reflections on corporate governance.

2002 Highlights

Let me take a moment to highlight our achievements in 2002, including:

1. Record new investments of \$457 million were booked driving our total assets to almost \$1.6 billion.
2. This significant investment activity and resulting improving funds from operations drove our dividend payout ratio to 88% for the year and 85% for the fourth quarter. We are well on our way to a payout ratio at the low 80% level.
3. Our line of credit was renewed and expanded to \$175 million for a three-year term with a fourth year at our option. The covenants package was streamlined and interest rate spreads were reduced by approximately 30 basis points.
4. We received a positive outlook from Moody's, a necessary step on

our way to investment grade ratings across the board.

5. Finally, but importantly, we were the leader in the health care REIT sector with a 2002 total return of 21%. For the last three years, we provided a 35% total stockholder return, a performance that ranked in the top 10 of all publicly-traded REITs.

While we all too briefly enjoyed these 2002 accomplishments, we are now facing remaining challenges in 2003 and building on our successes to date.

Portfolio Management

The 51 facilities purchased in 2002 are quality real estate projects with strong operators. A number of these facilities are pictured in the pages of this report. These new investments, together with the addition of nine new operators to the portfolio, significantly enhanced portfolio quality. During the year, we also disposed of \$110 million of assets. Many of these dispositions related to projects that we wished to eliminate from our portfolio. This ongoing process of culling through our portfolio, adding new properties and operators and eliminating others, is a critical part of our job as a portfolio manager.

As we begin 2003, the nursing sector outlook remains difficult due to a combination of factors. Neither Congress nor the Administration has provided the level of Medicare reimbursement appropriate for this critical component of the health care delivery system. The picture is further clouded by pressures on Medicaid reimbursement due to state budgetary difficulties. Moreover, although there has been some progress on the tort reform side, the liability/insurance outlook remains unfavorable and costly.

Letter to Stockholders

Conditions in the assisted living sector generally look more favorable for 2003. The virtual cessation of development during the last several years has led to a much more advantageous demand and supply relationship with increasing occupancies. The enhanced pricing power for operators has allowed rental rates to increase during the last two years, although such increases have been somewhat offset by rising insurance premiums and operating expenses.

We continue to allocate a portion of our portfolio to a category of facilities we characterize as specialty care facilities. We had early success with investments in stand-alone heart hospitals. We recently invested in a neurosurgical hospital and began construction of an orthopedic hospital. These investments tend to have common elements: the active involvement and support of physicians, a less institutional setting and a cost-effective platform. The goal of producing better outcomes through specialization, state of the art technology and customer-friendly environment appears at this preliminary stage to be proving out. While these investments are attractive, they have a different risk profile and return characteristics than long-term care facilities. We will continue to evaluate specialty care investments but, for now, plan to limit them to 10-15% of our portfolio.

In making investments, we have continued to refine our investment process. Clearly, careful underwriting and monitoring are required to achieve appropriate risk-adjusted returns. As a specialized, focused investor, we believe we are able to structure investments that contain appropriate safeguards. Moreover, in these uncertain times, competition from other financiers for investments has substantially dimin-

ished. If our experience holds true, this improving, but challenging, period is likely to produce solid, new portfolio investments. In the long run, based upon our experience and compelling demographics, we believe that investing in need-driven facilities with a proven, cost-effective delivery platform will provide consistent returns to our stockholders.

Let me attempt to put some conceptual framework around the evolving health care sector. The evolution of the health care sector reflects a movement towards delivering quality care in the most cost-effective, least institutional setting. The acute care hospital has certainly felt these pressures. Although the ultimate role of the acute care hospital in the health care delivery system is unclear, specialty care facilities have enjoyed increasing success as “customer focused,” cost-effective alternatives. In addition, as a result of cost and other pressures, more patients are being discharged sooner to nursing facilities that have, as a result, become higher acuity platforms.

The nature of the nursing facility platform has changed due to the influx of higher acuity patients from hospitals as well as the exodus of the custodial care residents to assisted living facilities. It is estimated that up to one-third of the former nursing facility population moved to the more appropriate assisted living setting. Despite the higher acuity levels, many new nursing facilities have improved both the physical environment as well as their attention to the patient as a customer.

Our Portfolio

The demand/supply relationship in the long-term care sector has improved significantly. The supply of nursing facility beds has

decreased nationally as outmoded facilities are taken out of service. The virtual cessation of development in the assisted living sector also bodes well for the supply side.

We believe our portfolio benefits from high quality assets positioned generally in strong markets. Our portfolio is institutional quality with approximately 85% of the portfolio located in a statistical metropolitan service area. Our facilities are located in markets with above average elderly concentrations and growth rates. Moreover, most of our markets have significant legal and practical constraints to future development. In the assisted living area, the constraints are often local zoning and other local land use restrictions. In our nursing facility portfolio, 95% of the facilities are in states with either a certificate of need or moratorium, both of which significantly restrain new competition.

The favorable demand/supply characteristic is enhanced by the strong real estate component within our portfolio. The following table presents some pertinent data as of December 31, 2002:

	Number of Facilities	Average Age
Skilled Nursing	76	17.2
Assisted Living	160	5.9
Specialty Care	8	9.0
Total	244	9.5

The average age of the skilled nursing facilities is in some ways misleading, as there are a number of factors, both legal and practical, that restrain the development of new facilities. Accordingly, many of

our operators have made substantial investments in quality renovation projects to modernize their facilities. We believe that, on the whole, the average economic age of our portfolio is substantially below that of comparable properties in the United States.

We're obviously pleased to have investments in modern, state-of-the-art real estate in strong markets which, in turn, should provide protection to investors in these turbulent times.

Corporate Governance

Over the last several years we have kept you up-to-date on our progress in reaching our goal of becoming a leader in the health care REIT sector. These goals included becoming a self-managed, investment grade equity REIT with state of the art, proprietary systems. We have attained most of those goals largely as a result of the hardworking team that has been assembled.

During this period, directors have been nominated, and then elected, to add value to the policy and decision-making process. Capital markets' knowledge and an understanding of the unique obligation of a public company to its investors have been key points of focus in this selection process.

Eight of our nine directors and all of the directors on the Audit, Compensation and Nominating Committees are independent. For several years, we have had a practice of ending our Board meetings with a private meeting of the eight independent directors. Today, mandated by Sarbanes-Oxley, the SEC and emerging practices, there are new, formal procedures required or recommended for all public

Letter to Stockholders

companies. Some will be constructive; others will, undoubtedly, be unwieldy. All have been mandated because certain management groups and advisers lost their essential focus.

In last year's Letter to Stockholders, we reprised our 30-year history noting a set of core principles that drove consistent success. Inherent in these principles is the primacy of our obligation to our stockholders, which has been our standard since 1970.

I noted earlier our total return rankings for health care REITs, and all REITs during 2002 and the last three years, respectively. More important to this team of Directors, management and employees is our 16.6% total return over our 32-year history. This solid, consistent performance permitted the payment of our 127th consecutive dividend on February 20, 2003. With a long-term perspective on our chosen investment sector and an understanding of our obligation to our stockholders, we are committed to producing continued value in the future.



George L. Chapman
Chairman and Chief Executive Officer
March 10, 2003

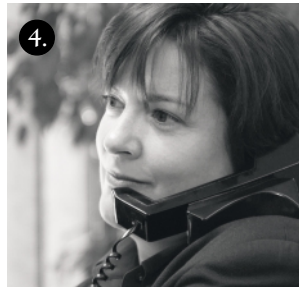
1. Raymond W. Braun
*President and
Chief Financial Officer*

2. Michael A. Crabtree
Treasurer

3. Charles J. Herman, Jr.
Vice President, Operations

4. Erin C. Ibele
*Vice President and
Corporate Secretary*

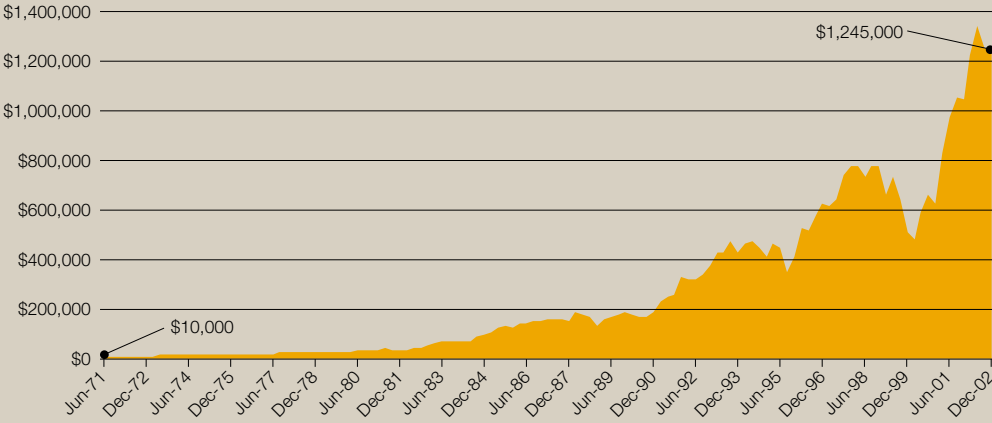
5. J. Michael Stephen
Vice President, Marketing



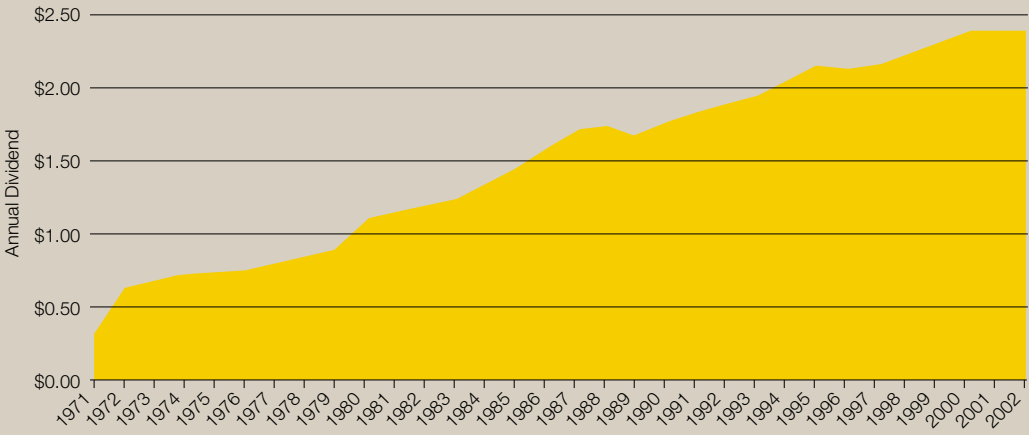
2002 Highlights

- Record new investments of \$457 million
- Added nine new operators
- Reduced FFO payout ratio to 85% for the fourth quarter of 2002
- Expanded line of credit to \$175 million
- Raised \$288 million in new capital
- Received positive outlook from Moody's
- Led health care REIT sector with 2002 total return of 21%
- Ranked in the top 10 of all REITs for 3-year total returns
- 16.6% total return over 32-year history
- Paid 126th consecutive dividend in November 2002

Health Care REIT, Inc. Growth of \$10,000 Investment



Health Care REIT, Inc. Dividend History



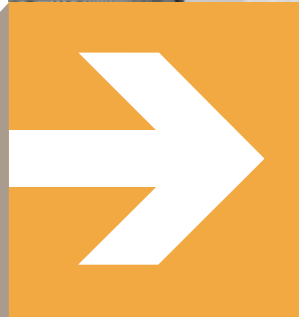
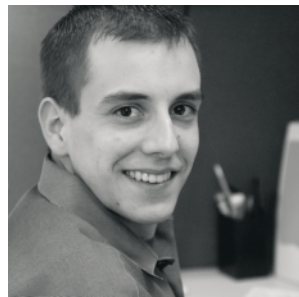
Taking Care of Business

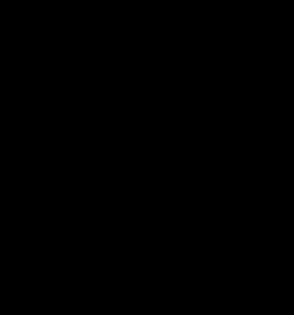
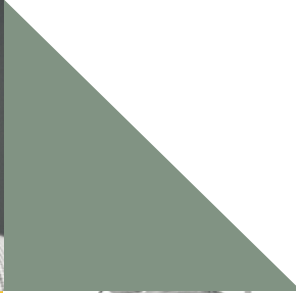
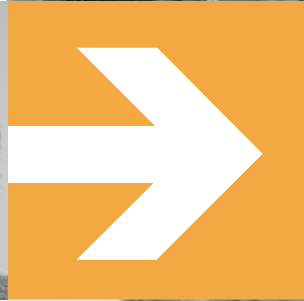
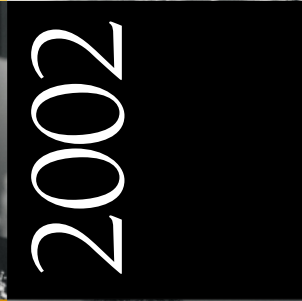
A strong combination of directors, management and staff gives us an advantage in this fast-paced business.

The Company has an independent Board of Directors, consisting of nine individuals with experience in health care, real estate, finance and public companies.

Our management is a focused, conservative team dedicated to the success of the Company. This team provides over 100 years of combined health care experience.

We are very proud of each and every one of our 31 employees. From administration to management, our employees put forth superior effort every day to make sure that we meet, and often exceed, our goals.





Refining the Mix

Through careful underwriting, selective investing and stringent monitoring, we continually adjust our portfolio to enhance property values and improve revenue streams.

Several steps were taken in 2002 to refine the portfolio mix:

- Acquired 51 new facilities
- Added nine new operators
- Disposed of \$110 million in assets, including some non-core assets
- Increased the percentage of stable facilities to 92% of our portfolio
- Raised master leases to 88% of our owned property

For 2003, we plan to continue to stabilize the assisted living portfolio. We will continue to react to emerging opportunities and make investments based on the best risk/reward relationship.

1. Silverado Senior Living-San Juan Capistrano

Assisted Living Facility
San Juan Capistrano, California
Operator Silverado Senior Living, Inc.
Acquired 2000

2. Merrill Gardens at Naples

Assisted Living Facility
Naples, Florida
Operator Merrill Gardens LLC
Acquired 1997

3. Laurel Lake Center for Rehabilitation and The Village of Laurel Lake

Assisted Living Facility
Lee, Massachusetts
Operator Commonwealth Communities Management LLC
Acquired 2002

4. Greenridge Place

Assisted Living Facility
Rocky Hill, Connecticut
Operator Newton Senior Living, LLC
Acquired 2002

5. Crossroads Place

Assisted Living Facility
Waterford, Connecticut
Operator Newton Senior Living, LLC
Acquired 2002

6. Larson Place

Assisted Living Facility
Hamden, Connecticut
Operator Newton Senior Living, LLC
Acquired 2002

7. Parke Plaza Retirement Residence

Assisted Living Facility
North Miami Beach, Florida
Operator Home Quality Management, Inc.
Acquired 1998

8. Lake Pointe Landing

Assisted Living Facility
Hendersonville, North Carolina
Operator Life Care Centers of America, Inc.
Acquired 1998

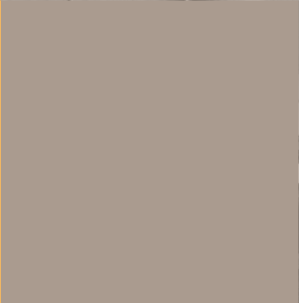
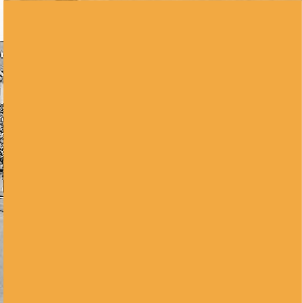
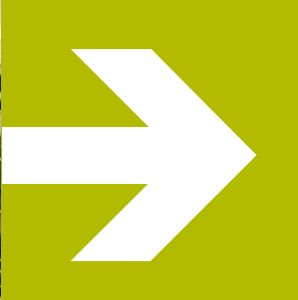
9. Clare Bridge of Adams II

Assisted Living Facility
Seven Fields, Pennsylvania
Operator Recovery Care Management, LLC
Acquired 1999

10. New Albany Surgical Hospital

Rendering-Specialty Care Facility
New Albany, Ohio
Operator Surgical Alliance, LLC
Completion 2004



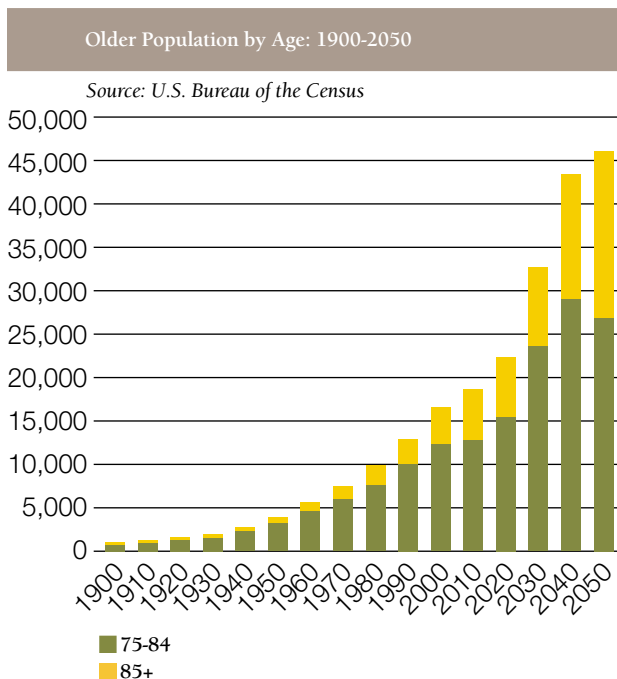


Looking to the Future

Health Care REIT, Inc. has built a foundation based on favorable demographic trends that allow for growth well into the future.

Our Nation's population continues to age. According to the U.S. Census Bureau, America's population age 75 and older grew by 120% between the years 1970 and 2000, from 7.5 million to 16.6 million people.

While the age 75 and older growth rate will continue to outpace the general population for the period 2000-2010, the aging of the Baby-Boom generation will increase these growth rates even more dramatically in the period 2010-2050.



1. Alterra Clare Bridge Cottage of Vero Beach
Assisted Living Facility
Vero Beach, Florida
Operator Alterra Healthcare Corporation
Acquired 2001

2. Highgate Manor
Skilled Nursing Facility
Dedham, Massachusetts
Operator Commonwealth Communities Management LLC
Acquired 2002

3. Outlook Manor at Westerville
Assisted Living Facility
Westerville, Ohio
Operator Recovery Care Management, LLC
Acquired 1998

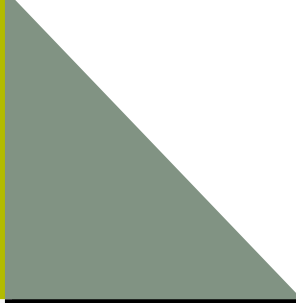
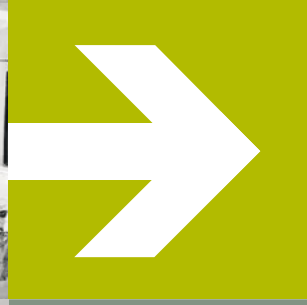
4. Clare Bridge of Bradenton
Assisted Living Facility
Bradenton, Florida
Operator Alterra Healthcare Corporation
Acquired 1996

5. Clare Bridge of Adams II
Assisted Living Facility
Seven Fields, Pennsylvania
Operator Recovery Care Management, LLC
Acquired 1999

6. Avery Manor & Avery Crossings
Skilled Nursing Facility
Lee, Massachusetts
Operator Commonwealth Communities Management LLC
Acquired 2002

7. The Rehabilitation & Healthcare Center at Baytown
Skilled Nursing Facility
Baytown, Texas
Operator Paramount Health Care Company, Inc.
Acquired 2002

8. Larson Place
Assisted Living Facility
Hamden, Connecticut
Operator Newton Senior Living, LLC
Acquired 2002



Facility Definitions

Assisted Living Facilities

An assisted living facility is a special combination of housing, personalized supportive services and health care designed to meet the needs — both scheduled and unscheduled — of those who need help with activities of daily living. More intensive medical needs of the resident within assisted living facilities may be provided by home health providers. Assisted living facilities represent less costly and less institutional-like alternatives for the care of the elderly or the frail.

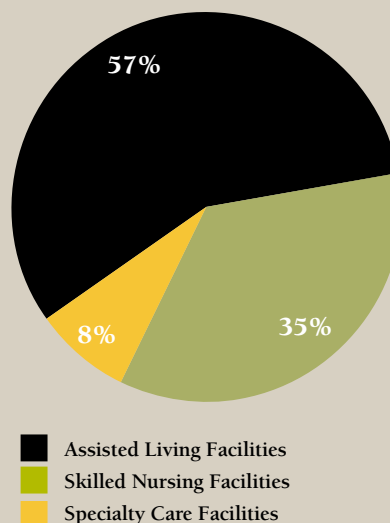
Skilled Nursing Facilities

Skilled nursing facilities provide inpatient skilled nursing and personal care services as well as rehabilitative, restorative and transitional medical services. In some instances, skilled nursing facilities supplement hospital care by providing specialized care for medically complex patients whose conditions require intense medical and therapeutic services, but who are medically stable enough to have these services provided in facilities that are less expensive than acute care hospitals.

Specialty Care Facilities

Our specialty care facilities include acute care hospitals, long-term acute care hospitals and other specialty care hospitals. Acute care hospitals provide a wide range of inpatient and outpatient services including, but not limited to, surgery, rehabilitation, therapy and clinical laboratories. Long-term acute care hospitals provide inpatient services for patients with complex medical conditions that require more intensive care, monitoring or emergency support than that available in most skilled nursing facilities. Other specialty care hospitals provide specialized inpatient and outpatient services for specific illnesses or diseases including, among others, orthopedic, neurosurgical and behavioral care services.

Asset Mix

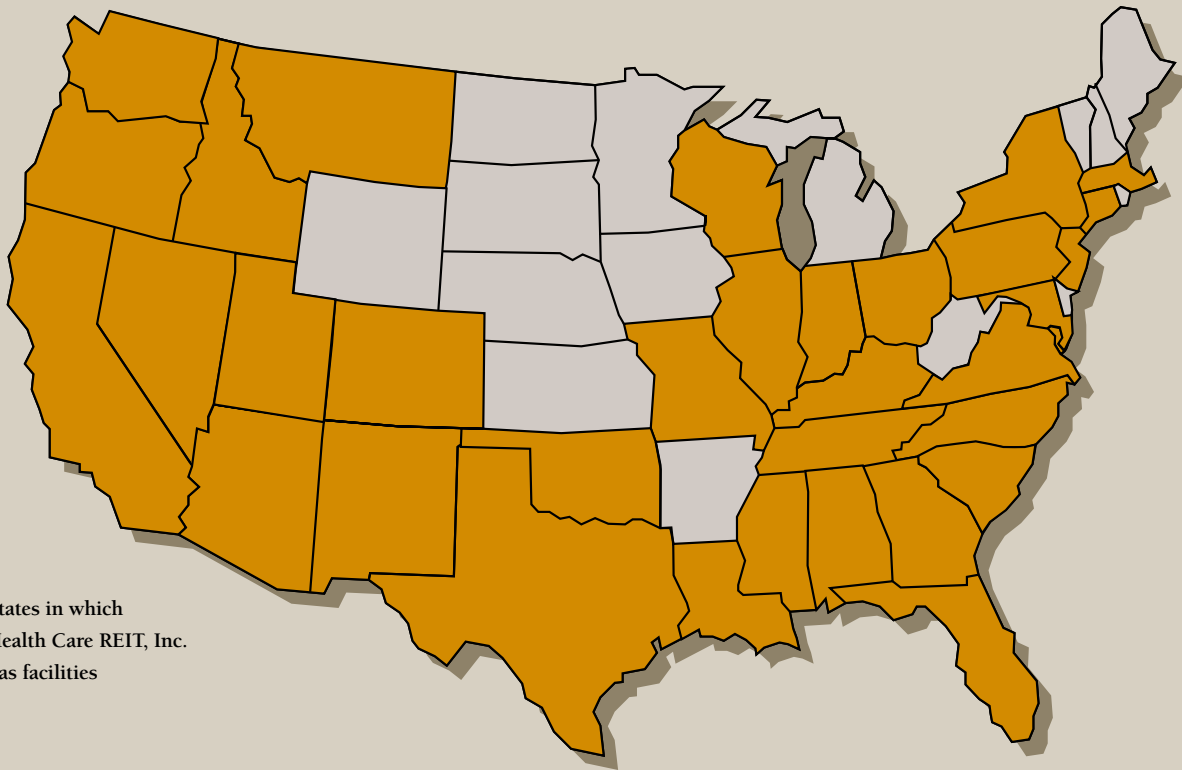


Portfolio Information

Type of Facility	Number of Facilities	Number of Operators (1)	Number of States (1)
Assisted Living Facilities	160	27	31
Skilled Nursing Facilities	76	17	16
Specialty Care Facilities	8	6	5
Total	244		

(1) We have investments in properties located in 33 states and managed by 44 different operators.

Facility Map



States in which
Health Care REIT, Inc.
has facilities

1. Sterling House of Canton
Assisted Living Facility
Canton, Ohio
Operator Alterra Healthcare Corporation
Acquired 1998

2. Larson Place
Assisted Living Facility
Hamden, Connecticut
Operator Newton Senior Living, LLC
Acquired 2002



Financial Review



Management's Discussion and Analysis

Liquidity and Capital Resources

At December 31, 2002, our net real estate investments totaled approximately \$1,524,457,000 and included 160 assisted living facilities, 76 skilled nursing facilities and eight specialty care facilities. Depending upon the availability and cost of external capital, we anticipate making additional investments in health care related facilities. New investments are funded from temporary borrowings under our line of credit arrangements, internally generated cash and the proceeds derived from asset sales. Permanent financing for future investments, which replaces funds drawn under the line 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 and dividend requirements and finance future investments.

The following table summarizes our capital activity during the year ended December 31, 2002 (in thousands):

Date	Type	Gross Proceeds	Net Proceeds
February 2002	Common Stock	\$ 25,000	\$ 23,657
May 2002	Common Stock	91,770	91,578
September 2002	Senior Notes	150,000	147,750
November 2002	Common Stock	25,017	24,952
Totals		\$ 291,787	\$ 287,937

During the year ended December 31, 2002, the holder of our Series C Cumulative Convertible Preferred Stock converted 900,000 shares into 878,000 shares of common stock.

During 2002, we invested \$389,873,000 in real property, provided permanent mortgage and loan financings of \$85,006,000, made construction advances of \$19,833,000 and funded \$3,510,000 of subdebt investments. As of December 31, 2002, we had approximately \$42,885,000 in unfunded construction commitments. Also during 2002, we sold real property generating \$52,279,000 of net proceeds and collected \$80,590,000 and \$12,380,000 as repayment of principal on loans receivable and subdebt investments, respectively.

As of December 31, 2002, we had stockholders' equity of \$897,232,000 and a total outstanding debt balance of \$676,331,000, which represents a debt to total capitalization ratio of 0.43 to 1.0.

In August 2002, we announced the amendment and extension of our primary unsecured revolving line of credit. The line of credit was expanded to \$175,000,000, expires in August 2005 (with the ability to extend for one year at our discretion if we are in compliance with all covenants) and currently bears interest at the lender's prime rate or LIBOR plus 1.3% at our option. In addition, at December 31, 2002, we had an unsecured revolving line of credit in the amount of \$25,000,000, bearing interest at the lender's prime rate and which expires in June 2003. Also, at December 31, 2002, we had a secured line of credit in the amount of \$60,000,000 bearing interest at the lender's prime rate or LIBOR plus 2.0%, at our option, with a floor of 7.0% and which expires in April 2004. Additionally, at December 31, 2002, we had a secured note in the amount of \$4,000,000 bearing interest at LIBOR plus 2.0% and which matures in November 2004. At December 31, 2002, we had \$109,500,000 in borrowings outstanding under the unsecured line of credit arrangements and \$4,000,000 outstanding on the secured note.

As of February 20, 2003, we had an effective shelf registration on file with the Securities and Exchange Commission under which we may issue up to \$385,600,000 of securities including debt securities, common and preferred stock and warrants. Depending upon market conditions, we anticipate issuing securities under our shelf registration to invest in additional health care facilities and to repay borrowings under our line of credit arrangements.

Management's Discussion and Analysis

The following table summarizes our principal payments under contractual obligations as of December 31, 2002:

	Payments Due by Period (\$000s)				
	Total	2003	2004-2005	2006-2007	After 2007
Unsecured senior notes payable	\$ 515,000	\$ 0	\$ 40,000	\$ 225,000	\$ 250,000
Unsecured lines of credit (1)	200,000	25,000	175,000		
Secured line of credit (1)	60,000		60,000		
Mortgage notes payable	47,831	400	1,335	828	45,268
Secured note payable	4,000		4,000		
Operating lease obligations	720	216	432	72	
Total contractual obligations	\$ 827,551	\$ 25,616	\$ 280,767	\$ 225,900	\$ 295,268

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

The following table summarizes our commercial commitments as of December 31, 2002:

	Amount of Commitment Expiration per Period (\$000s)				
	Total	2003	2004-2005	2006-2007	After 2007
Unfunded construction commitments	\$ 42,885	\$ 42,885	\$ 0	\$ 0	\$ 0
Credit enhancements	7,845	4,650			3,195
Total commercial commitments	\$ 50,730	\$ 47,535	\$ 0	\$ 0	\$ 3,195

As of December 31, 2002, we had approximately \$42,885,000 of unfunded construction commitments.

We have guaranteed the payment of industrial revenue bonds for one assisted living facility in the event that the present owner defaults upon its obligations. In consideration for this guaranty, we receive and recognize fees annually related to this agreement. This guaranty expires upon the repayment of the industrial revenue bonds which currently mature in 2009. At December 31, 2002, we were contingently liable for \$3,195,000 under this guaranty.

In addition, we have an outstanding letter of credit issued to a bank, which bank provided additional financing for a project on which we have a first mortgage. We have also partially guaranteed the payment of loans made by the bank on this project. The letter of credit currently matures in 2003 and the guaranties expire upon the repayment of the loans which currently mature in 2003. At December 31, 2002, obligations under these agreements for which we were contingently liable aggregated approximately \$4,650,000.

Results of Operations December 31, 2002 vs. December 31, 2001

Revenues were comprised of the following:

	Year ended		Change	
	Dec. 31, 2002	Dec. 31, 2001	\$	%
(in thousands)				
Rental income	\$ 133,791	\$ 93,237	\$ 40,554	43%
Interest income	26,525	31,294	(4,769)	-15%
Commitment fees and other income	2,802	3,848	(1,046)	-27%
Prepayment fees		990	(990)	n/a
Totals	\$ 163,118	\$ 129,369	\$ 33,749	26%

Management's Discussion and Analysis

We generated increased rental income as a result of the acquisition of properties for which we receive rent. This was partially offset by a reduction in interest income due to the repayment of mortgage loans. Commitment fees and other income decreased primarily as a result of the completion of construction projects.

During 2001, we received payoffs on mortgages that had significant prepayment fee requirements, generating \$990,000 in that year. During 2002, we did not receive any prepayment fees with respect to mortgage loan payoffs.

Expenses were comprised of the following:

	Year ended		Change	
	Dec. 31, 2002	Dec. 31, 2001	\$	%
(in thousands)				
Interest expense	\$ 41,085	\$ 30,359	\$ 10,726	35%
Provision for depreciation	39,311	28,725	10,586	37%
General and administrative expenses	9,665	8,078	1,587	20%
Loan expense	2,373	1,775	598	34%
Impairment of assets	2,298		2,298	n/a
Provision for losses	1,000	1,000	0	0%
Totals	\$ 95,732	\$ 69,937	\$ 25,795	37%

The increase in interest expense from 2001 to 2002 was primarily due to higher average borrowings during the year and a reduction in the amount of capitalized interest offsetting interest expense.

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 year ended December 31, 2002, totaled \$170,000, as compared with \$841,000 for the same period in 2001.

The provision for depreciation increased primarily as a result of additional investments in properties owned directly by us.

General and administrative expenses as a percentage of revenues (including revenues from discontinued operations) for the year ended December 31, 2002, were 5.83% as compared with 6.03% for the same period in 2001.

The increase in loan expense was primarily due to the additional amortization of costs related to the unsecured line of credit renewal and the unsecured senior notes issued in 2001 and 2002.

During the year ended December 31, 2002, it was determined that the projected undiscounted cash flows from a parcel of land, one assisted living facility and one specialty care facility did not exceed their related net book values and impairment charges of \$2,298,000 were recorded to reduce the properties to their estimated fair market values. The estimated fair market values of the properties were determined by offers to purchase received from third parties or estimated net sales proceeds.

Other items:	Year ended		Change	
	Dec. 31, 2002	Dec. 31, 2001	\$	%
(in thousands)				
Gain (loss) on sales of properties	\$ (1,032)	\$ (1,250)	\$ 218	-17%
Discontinued operations, net	1,708	2,580	(872)	-34%
Loss on extinguishment of debt	(403)	(213)	(190)	89%
Preferred dividends	(12,468)	(13,505)	1,037	-8%
Totals	\$ (12,195)	\$ (12,388)	\$ 193	-2%

Management's Discussion and Analysis

During the years ended December 31, 2002 and 2001, we sold properties with carrying values of \$53,311,000 and \$23,829,000 for net losses of \$1,032,000 and \$1,250,000, respectively. In August 2001, the Financial Accounting Standards Board issued Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, which is effective for fiscal years beginning after December 15, 2001. We adopted the standard effective January 1, 2002. In accordance with Statement No. 144, we have reclassified the income and expenses attributable to the properties sold during 2002 to discontinued operations. These properties generated \$1,708,000 and \$2,580,000 of income after deducting depreciation and interest expense from rental revenue for the years ended December 31, 2002 and 2001, respectively.

In April 2002, we purchased \$35,000,000 of our outstanding unsecured senior notes that were due in 2003 and recorded a charge of \$403,000 in connection with this early extinguishment. In September 2001, we purchased \$7,750,000 of our outstanding unsecured senior notes that were due in 2002 and recorded a charge of \$213,000 in connection with this early extinguishment.

As a result of the various factors mentioned above, net income available to common stockholders was \$55,191,000, or \$1.48 per diluted share, for 2002 as compared with \$47,044,000, or \$1.52 per diluted share, for 2001.

Results of Operations December 31, 2001 vs. December 31, 2000

Revenues were comprised of the following:

	Year ended		Change	
	Dec. 31, 2001	Dec. 31, 2000	\$	%
(in thousands)				
Rental income	\$ 93,237	\$ 82,522	\$ 10,715	13%
Interest income	31,294	41,064	(9,770)	-24%
Commitment fees and other income	3,848	5,837	(1,989)	-34%
Prepayment fees	990	57	933	1637%
Totals	\$ 129,369	\$ 129,480	\$ (111)	0%

We generated increased rental income as a result of the completion of real property construction projects for which we began receiving rent and the purchase of properties previously financed by us. This offset a reduction in interest income due to the repayment of mortgage loans and the purchase of properties previously financed by us.

The reduction in commitment fees and other income is due primarily to the significant reduction in construction activity.

During 2001, we received payoffs on mortgages that had significant prepayment fee requirements, generating the large increase over the prior year.

Expenses were comprised of the following:

	Year ended		Change	
	Dec. 31, 2001	Dec. 31, 2000	\$	%
(in thousands)				
Interest expense	\$ 30,359	\$ 32,855	\$ (2,496)	-8%
Provision for depreciation	28,725	21,183	7,542	36%
Loss on investment		2,000	(2,000)	n/a
General and administrative expenses	8,078	7,405	673	9%
Loan expense	1,775	1,165	610	52%
Provision for losses	1,000	1,000	0	0%
Totals	\$ 69,937	\$ 65,608	\$ 4,329	7%

Management's Discussion and Analysis

The decrease in interest expense from 2000 to 2001 was primarily due to lower average borrowings during the year offset by a reduction in the amount of capitalized interest offsetting interest expense.

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 year ended December 31, 2001, totaled \$841,000, as compared with \$3,079,000 for the same period in 2000.

The provision for depreciation increased primarily as a result of additional investments in properties owned directly by us.

In 2000, we restructured our investments with Summerville Health Care. As part of the restructuring agreement, Summerville agreed to permit us to re-lease 10 of its 11 facilities to new operators and repaid substantially all of our subdebt investment. As part of Summerville's recapitalization, our \$2,000,000 non-yielding preferred stock investment was substantially diluted. Accordingly, we wrote off our investment in 2000, resulting in a \$2,000,000 charge.

General and administrative expenses as a percentage of revenues (including revenues from discontinued operations) for the year ended December 31, 2001, were 6.03% as compared with 5.41% for the same period in 2000.

The increase in loan expense was primarily due to the additional amortization of costs related to the unsecured senior notes issued in 2001.

Other items:	Year ended		Change	
	Dec. 31, 2001	Dec. 31, 2000	\$	%
(in thousands)				
Gain (loss) on sales of properties	\$ (1,250)	\$ 1,684	\$ (2,934)	-174%
Discontinued operations, net	2,580	2,500	80	3%
Loss on extinguishment of debt	(213)		(213)	n/a
Preferred dividends	(13,505)	(13,490)	(15)	0%
Totals	\$ (12,388)	\$ (9,306)	\$ (3,082)	33%

During the years ended December 31, 2001 and 2000, we sold properties with carrying values of \$23,829,000 and \$107,182,000, respectively, for a net loss of \$1,250,000 in 2001 and a net gain of \$1,684,000 in 2000. In August 2001, the Financial Accounting Standards Board issued Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, which is effective for fiscal years beginning after December 15, 2001. We adopted the standard effective January 1, 2002. In accordance with Statement No. 144, we have reclassified the income and expenses attributable to the properties sold during 2002 to discontinued operations. These properties generated \$2,580,000 and \$2,500,000 of income after deducting depreciation and interest expense from rental revenue for the years ended December 31, 2001 and 2000, respectively.

In September 2001, we purchased \$7,750,000 of our outstanding unsecured senior notes that were due in 2002 and recorded a charge of \$213,000 in connection with this early extinguishment.

As a result of the various factors mentioned above, net income available to common stockholders was \$47,044,000, or \$1.52 per diluted share, for 2001 as compared with \$54,566,000, or \$1.91 per diluted share, for 2000.

Critical Accounting Policies

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States, which require us to make estimates and assumptions (see Note 1 to our audited consolidated financial statements). We believe that of our significant accounting policies, the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

Management's Discussion and Analysis

Revenue Recognition

Revenue is recorded in accordance with SEC Staff Accounting Bulletin No. 101, Revenue Recognition in Financial Statements ("SAB 101"), as amended. SAB 101 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. Operating lease income includes base rent payments plus fixed annual rent increases, which are recognized on a straight-line basis over the minimum lease period. This lease income is greater than the amount of cash received during the first half of the lease term.

Impairment of Long-Lived Assets

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. If the undiscounted cash flows are less than the net book value, an impairment loss would be recognized to the extent that the net book value exceeds the current fair market 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. If the projections or assumptions change in the future, we may be required to record an impairment charge and reduce the net book value of the property owned.

Allowance for Loan Losses

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 these loans, including general economic conditions and estimated collectibility of loan payments. We regularly evaluate the collectibility of our loans receivable based on a combination of factors. These factors include delinquency status (as determined by frequency of payments), historical loan charge-offs, financial strength of the borrower and guarantors and value of the underlying property. If these factors indicate that there is greater risk of loan charge-offs, additional allowances or placement on non-accrual status may be required.

Depreciation and Useful Lives

We compute depreciation on our properties using the straight-line method based on their estimated useful lives which range from fifteen to forty years for buildings and five to twelve years for improvements. A significant portion of the acquisition cost of each property is allocated to the building (usually approximately 90%). The allocation of the acquisition cost to building and the determination of the useful life of a property are based on appraisals commissioned from independent real estate appraisal firms. If we do not allocate appropriately to the building or if we incorrectly estimate the useful life of our properties, the computation of depreciation will not appropriately reflect the allocation of our capital expenditures over future periods.

Impact of Inflation

During the past three years, inflation has not significantly affected our earnings because of the moderate inflation rate. Additionally, our earnings are primarily long-term investments with fixed interest rates. These investments are mainly financed with a combination of equity, senior notes and borrowings under our revolving lines of credit. During inflationary periods that generally are accompanied by rising interest rates, our ability to grow may be adversely affected because the yield on new investments may increase at a slower rate than new borrowing costs. Presuming the current inflation rate remains moderate and long-term interest rates do not increase significantly, we believe that inflation will not impact the availability of equity and debt financing.

Management's Discussion and Analysis

Forward-Looking Statements and Risk Factors

We have made and incorporated by reference statements in this document that constitute "forward-looking statements" as that term is defined in the federal securities laws. These forward-looking statements concern:

- The possible expansion of our portfolio;
- The performance of our operators and properties;
- Our ability to obtain new viable tenants for properties which 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; and
- Our ability to access capital markets or other sources of funds.

When we use words such as "believe," "expect," "anticipate," "estimate" or similar expressions, we are making forward-looking statements. Forward-looking statements are not guaranties of future performance and involve risks and uncertainties. Our expected results may not be achieved and actual results may differ materially from our 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;
- Changes in financing terms; and
- The risks described below:

Risk factors related to our operators' revenues and expenses

Our skilled nursing and specialty care facility operators' revenues are primarily driven by occupancy and Medicaid, Medicare and private pay rates. Our assisted living facility operators' revenues are primarily driven by occupancy and private pay rates. Expenses for these three types of facilities are primarily driven by the costs of labor, food, utilities, taxes, insurance and rent or debt service. Revenues from government reimbursement have, and are likely to continue, to come under pressure due to Medicare cuts and state budget shortfalls. Liability insurance and staffing costs continue to increase for our operators. To the extent that any decrease in revenues and/or any increase in operating expenses result in a facility not generating enough cash to make payments to us, the credit of our operator and the value of other collateral would have to be relied upon.

Risk factors related to operator bankruptcies

We are exposed to the risk that our operators may not be able to meet the rent, principal and interest or other payments due us, which may result in an operator bankruptcy or insolvency, or that an operator might become subject to bankruptcy or insolvency proceedings for other reasons. Although our operating lease agreements provide us the right to evict an operator, demand immediate payment of rent and exercise other remedies, and our mortgage loans provide us the right to terminate any funding obligation, demand immediate repayment of principal and unpaid interest, foreclose on the collateral and exercise other remedies, the bankruptcy laws afford certain rights to a party that has filed for bankruptcy or reorganization. An operator in bankruptcy may be able to limit or delay our ability to collect unpaid rent in the case of a lease or to receive unpaid principal and interest in the case of a mortgage loan, and to exercise other rights and remedies.

Management's Discussion and Analysis

The receipt of liquidation proceeds or the replacement of an operator that has defaulted on its lease or loan could be delayed by the approval process of any federal, state or local agency necessary for the transfer of the facility or the replacement of the operator licensed to manage the facility. In addition, we may be required to fund certain expenses (e.g., real estate taxes and maintenance) to preserve the value of a facility, avoid the imposition of liens on a facility and/or to transition a facility to a new operator. In some instances, we have terminated our lease with an operator and relet the facility to another operator. In some of those situations, we provided working capital loans to and limited indemnification of the new operator. If we cannot transition a leased facility to a new operator, we may take possession of that facility, which may expose us to certain successor liabilities. Should these events occur, our revenue and operating cash flow may be adversely affected.

On November 20, 2002, Doctors Community Health Care Corporation and five subsidiaries filed for Chapter 11 bankruptcy protection. Doctors has stated that the bankruptcy filing was due to the bankruptcy of National Century Financial Enterprises and affiliates, who halted payments to health care providers, including Doctors. We have provided mortgage financing to Doctors in the form of a loan secured by Pacifica Hospital of the Valley in Sun Valley, CA, a property that is owned by one of the debtor subsidiaries. The outstanding principal balance of the loan is approximately \$18.8 million at December 31, 2002. Based upon an appraisal and historical performance of Pacifica Hospital, we expect to receive payment in full of the outstanding principal and accrued interest, which we believe we are entitled to as an oversecured creditor. We do not currently intend to recognize any interest on the loan if payment is not received.

Alterra Healthcare Corporation filed for Chapter 11 bankruptcy protection on January 23, 2003. We have a master lease with Alterra for 45 assisted living facilities with a depreciated book value of \$106 million at December 31, 2002. We expect Alterra to remain current on rent payments and to assume the master lease at current rental levels.

Risk factors related to government regulations

Our operators' businesses are affected by government and private payor reimbursement rates. To the extent that any skilled nursing or specialty care facility receives a significant portion of its revenues from governmental payors, primarily Medicaid and Medicare, these revenues may be subject to statutory and regulatory changes, retroactive rate adjustments, recovery of program overpayments or set-offs, administrative rulings, policy interpretations, payment or other delays by fiscal intermediaries, government funding restrictions (at a program level or with respect to specific facilities) and interruption or delays in payments due to any ongoing governmental investigations and audits at the facility. In recent years, governmental payors have frozen or reduced payments to health care providers due to budgetary pressures. This trend in health care reimbursement will likely continue to be of paramount importance to federal and state authorities. We cannot make any assessment as to the ultimate timing or effect any future legislative reforms may have on the financial condition of the skilled nursing industry, the specialty care industry or on the health care industry in general. There can be no assurance that adequate reimbursement levels will continue to be available for services provided by any facility operator, whether the facility receives reimbursement from Medicare, Medicaid or private payors. Significant limits on the scope of services reimbursed and on reimbursement rates and fees could have a material adverse effect on an operator's liquidity, financial condition and results of operations, which could adversely affect the ability of an operator to meet its obligations to us.

Risk factors related to liability claims and insurance costs

Long-term care facility operators (assisted living and skilled nursing facilities) have experienced substantial increases in both the number and size of patient care liability claims in recent years, particularly in the states of Texas and Florida. As a result, general and professional liability costs have increased and may continue to increase. Nationwide, long-term care liability insurance rates are increasing because of large jury awards in states like Texas and Florida. Over the past two years, both Texas and Florida have adopted skilled nursing facility liability laws that modify or limit statutes in the nature of tort reform. Despite some of these reforms, the long-term care industry overall continues to experience very high general and professional liability costs. Insurance markets have responded to this claim crisis by severely restricting their capacity to write long-term care general and professional liability policies. No assurances can be given that the climate for long-term care general and professional liability insurance will improve in Texas, Florida or any other states where our facility operators conduct business. Insurance companies may continue to reduce or stop writing general and professional liability policies for skilled nursing and assisted living facilities. Thus, general and professional liability insurance coverage may be restricted or very costly, which may adversely affect the facility operators' future operations, cash flows and financial condition, and may have a material adverse effect on the facility operators' ability to meet their obligations to us.

Management's Discussion and Analysis

Risk factors related to our structure

We are also subject to a number of risks on the corporate level. First, we might fail to qualify or remain qualified as a real estate investment trust ("REIT"). We intend to operate as a REIT under the Internal Revenue Code and believe we have and will continue to operate as a REIT. Since REIT qualification requires us to meet a number of complex requirements, it is possible that we may fail to fulfill them, and if we do, our earnings will be reduced by the amount of federal taxes owed. A reduction in our earnings would affect the amount we could distribute to our stockholders. Also, if we were not a REIT, we would not be required to make distributions to stockholders since a non-REIT is not required to pay dividends to stockholders amounting to at least 90% of its annual taxable income.

Second, the anti-takeover provisions in our Second Restated Certificate of Incorporation and Amended and Restated By-laws contain provisions that could make it more difficult for or even prevent a third party from acquiring us without the approval of our incumbent Board of Directors. We have adopted a "poison pill" rights plan that has anti-takeover effects. The rights plan, if triggered, will cause substantial dilution to a person or group that attempts to acquire us on terms not approved by the Board of Directors. Provisions and agreements that inhibit or discourage takeover attempts could reduce the market value of our common stock.

Third, we are dependent on key personnel. Although we have entered into employment agreements with our executive officers, losing any one of them could, at least temporarily, have an adverse impact on our operations. We believe that losing more than one of our executive officers would have a material adverse impact on our business.

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. The following section is presented to provide a discussion of the risks associated with potential fluctuations in interest rates.

We historically borrow on our revolving lines of credit to make acquisitions of, loans to or to construct health care facilities. Then, as market conditions dictate, we will issue equity or long-term fixed rate debt to repay the borrowings under the revolving lines of credit.

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 \$15 million at December 31, 2002 (\$16 million at December 31, 2001). 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, with variable rate debt, with equity or by the sale of assets.

Our variable rate debt, including our unsecured and secured revolving credit arrangements, is reflected at fair value. At December 31, 2002, a 1% increase in interest rates related to this variable rate debt (assuming no changes in outstanding balances) would result in increased annual interest expense of \$1,135,000 (\$500,000 at December 31, 2001).

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.

We may or may not elect to use financial derivative instruments to hedge variable 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.

Consolidated Balance Sheets

(In thousands)	December 31	
	2002	2001
Assets		
Real estate investments:		
Real property owned		
Land	\$ 112,044	\$ 89,601
Buildings & improvements	1,288,520	947,794
Construction in progress	19,833	
	1,420,397	1,037,395
Less accumulated depreciation	(113,579)	(80,544)
Total real property owned	1,306,818	956,851
Loans receivable		
Real property loans	208,016	240,126
Subdebt investments	14,578	23,448
	222,594	263,574
Less allowance for losses on loans receivable	(4,955)	(6,861)
	217,639	256,713
Net real estate investments	1,524,457	1,213,564
Other assets:		
Equity investments	7,494	6,498
Deferred loan expenses	9,291	7,190
Cash and cash equivalents	9,550	9,826
Receivables and other assets	43,318	32,765
	69,653	56,279
Total assets	\$ 1,594,110	\$ 1,269,843
Liabilities and stockholders' equity		
Liabilities:		
Borrowings under line of credit obligations	\$ 109,500	\$ 0
Senior unsecured notes	515,000	412,250
Secured debt	51,831	78,966
Accrued expenses and other liabilities	20,547	20,757
Total liabilities	696,878	511,973
Stockholders' equity:		
Preferred stock, \$1.00 par value:	127,500	150,000
Authorized - 10,000,000 shares		
Issued and outstanding - 5,100,000 shares in 2002 and 6,000,000 shares in 2001 at liquidation preference		
Common stock, \$1.00 par value:	40,086	32,740
Authorized - 75,000,000 shares		
Issued and outstanding - 40,085,827 shares in 2002 and 32,739,826 shares in 2001		
Capital in excess of par value	790,838	608,942
Cumulative net income	580,496	512,837
Cumulative dividends	(638,085)	(540,946)
Accumulated other comprehensive income	(170)	(923)
Unamortized restricted stock	(3,433)	(4,780)
Total stockholders' equity	897,232	757,870
Total liabilities and stockholders' equity	\$ 1,594,110	\$ 1,269,843

See accompanying notes

Consolidated Statements of Income

(In thousands, except per share data)	Year ended December 31		
	2002	2001	2000
Revenues:			
Rental income	\$ 133,791	\$ 93,237	\$ 82,522
Interest income	26,525	31,294	41,064
Commitment fees and other income	2,802	3,848	5,837
Prepayment fees		990	57
	163,118	129,369	129,480
Expenses:			
Interest expense	41,085	30,359	32,855
Provision for depreciation	39,311	28,725	21,183
Loss on investment			2,000
General and administrative	9,665	8,078	7,405
Loan expense	2,373	1,775	1,165
Impairment of assets	2,298		
Provision for loan losses	1,000	1,000	1,000
	95,732	69,937	65,608
Income from continuing operations before extraordinary item	67,386	59,432	63,872
Discontinued operations:			
Net gain (loss) on sales of properties	(1,032)	(1,250)	1,684
Income from discontinued operations, net	1,708	2,580	2,500
	676	1,330	4,184
Income before extraordinary item	68,062	60,762	68,056
Extraordinary loss on extinguishment of debt	(403)	(213)	
Net income	67,659	60,549	68,056
Preferred stock dividends	12,468	13,505	13,490
Net income available to common stockholders	\$ 55,191	\$ 47,044	\$ 54,566
Average number of common shares outstanding:			
Basic	36,702	30,534	28,418
Diluted	37,301	31,027	28,643
Earnings per share:			
Basic:			
Income from continuing operations and after preferred stock dividends	\$ 1.49	\$ 1.51	\$ 1.77
Discontinued operations, net	0.02	0.04	0.15
Extraordinary item	(0.01)	(0.01)	
Net income available to common stockholders	\$ 1.50	\$ 1.54	\$ 1.92
Diluted:			
Income from continuing operations and after preferred stock dividends	\$ 1.47	\$ 1.49	\$ 1.76
Discontinued operations, net	0.02	0.04	0.15
Extraordinary item	(0.01)	(0.01)	
Net income available to common stockholders	\$ 1.48	\$ 1.52	\$ 1.91

See accompanying notes

Consolidated Statements of Stockholders' Equity

(In thousands, except per share data)	Preferred Stock	Common Stock	Capital in Excess of Par Value	Cumulative Net Income	Cumulative Dividends	Accumulated Other Comprehensive Income	Unamortized Restricted Stock	Total
Balances at January 1, 2000	\$ 150,000	\$ 28,532	\$ 524,204	\$ 384,232	\$ (375,349)	\$ 593	\$ (5,216)	\$ 706,996
Comprehensive income:								
Net income				68,056				68,056
Other comprehensive income:								
Unrealized loss on equity investments						(733)		(733)
Foreign currency translation adjustment						(604)		(604)
Total comprehensive income								66,719
Proceeds from issuance of common stock from dividend reinvestment and stock incentive plans, net of forfeitures		274	3,934				(79)	4,129
Restricted stock amortization							1,090	1,090
Cash dividends:								
Common stock-\$2.335 per share					(66,837)			(66,837)
Preferred stock, Series B-\$2.22 per share					(6,656)			(6,656)
Preferred stock, Series C-\$2.27 per share					(6,834)			(6,834)
Balances at December 31, 2000	150,000	28,806	528,138	452,288	(455,676)	(744)	(4,205)	698,607
Comprehensive income:								
Net income				60,549				60,549
Other comprehensive income:								
Unrealized loss on equity investments						(52)		(52)
Foreign currency translation adjustment						(127)		(127)
Total comprehensive income								60,370
Proceeds from issuance of common stock from dividend reinvestment and stock incentive plans, net of forfeitures		484	10,070				(1,739)	8,815
Restricted stock amortization							1,164	1,164
Net proceeds from sale of common stock		3,450	70,734					74,184
Cash dividends:								
Common stock-\$2.34 per share					(71,765)			(71,765)
Preferred stock, Series B-\$2.22 per share					(6,656)			(6,656)
Preferred stock, Series C-\$2.28 per share					(6,849)			(6,849)
Balances at December 31, 2001	150,000	32,740	608,942	512,837	(540,946)	(923)	(4,780)	757,870
Comprehensive income:								
Net income				67,659				67,659
Other comprehensive income:								
Unrealized loss on equity investments						(66)		(66)
Foreign currency translation adjustment						819		819
Total comprehensive income								68,412
Proceeds from issuance of common stock from dividend reinvestment and stock incentive plans, net of forfeitures		1,182	25,373				(208)	26,347
Restricted stock amortization							1,555	1,555
Net proceeds from sale of common stock		5,286	134,901					140,187
Conversion of preferred stock	(22,500)	878	21,622					0
Cash dividends:								
Common stock-\$2.34 per share					(84,671)			(84,671)
Preferred stock, Series B-\$2.22 per share					(6,656)			(6,656)
Preferred stock, Series C-\$2.28 per share					(5,812)			(5,812)
Balances at December 31, 2002	\$ 127,500	\$ 40,086	\$ 790,838	\$ 580,496	\$(638,085)	\$ (170)	\$ (3,433)	\$ 897,232

See accompanying notes

Consolidated Statements of Cash Flows

(In thousands)	Year ended December 31		
	2002	2001	2000
Operating activities			
Net income	\$ 67,659	\$ 60,549	\$ 68,056
Adjustments to reconcile net income to net cash provided from operating activities:			
Provision for depreciation	40,350	30,464	22,961
Amortization	3,928	2,977	2,255
Provision for loan losses	1,000	1,000	1,000
Loss on investment			2,000
Impairment of assets	2,298		
Commitment fees earned greater than cash received	(1,530)	(1,039)	(1,960)
Rental income in excess of cash received	(9,256)	(6,614)	(6,732)
Equity in earnings of affiliated companies	(15)	(332)	(318)
(Gain) loss on sales of properties	1,032	1,250	(1,684)
Increase (decrease) in accrued expenses and other liabilities	1,320	3,249	(4,827)
Decrease (increase) in receivables and other assets	(1,419)	(2,822)	264
Net cash provided from operating activities	105,367	88,682	81,015
Investing activities			
Investment in real property	(409,706)	(147,081)	(46,449)
Investment in loans receivable	(88,516)	(48,284)	(34,631)
Other investments, net of payments	(228)	(913)	(1,828)
Principal collected on loans	92,970	94,337	70,567
Proceeds from sale of properties	52,279	22,579	108,866
Other	(229)	(262)	(742)
Net cash provided from (used in) investing activities	(353,430)	(79,624)	95,783
Financing activities			
Net increase (decrease) under line of credit arrangements	109,500	(119,900)	(57,600)
Proceeds from issuance of senior notes and secured debt	150,000	175,000	
Principal payments on senior notes and secured debt	(76,633)	(48,840)	(41,491)
Net proceeds from the issuance of common stock	166,534	82,999	4,129
Increase in deferred loan expense	(4,475)	(6,065)	(794)
Cash distributions to stockholders	(97,139)	(85,270)	(80,327)
Net cash provided from (used in) financing activities	247,787	(2,076)	(176,083)
Increase (decrease) in cash and cash equivalents	(276)	6,982	715
Cash and cash equivalents at beginning of year	9,826	2,844	2,129
Cash and cash equivalents at end of year	\$ 9,550	\$ 9,826	\$ 2,844
Supplemental cash flow information – interest paid	\$ 39,466	\$ 29,014	\$ 39,638

See accompanying notes

Notes to Consolidated Financial Statements

1 Accounting Policies and Related Matters

Industry We are a self-administered, equity real estate investment trust that invests primarily in long-term care facilities, which include skilled nursing and assisted living facilities. We also invest in specialty care facilities.

Principles of Consolidation The consolidated financial statements include the accounts of the Company and our wholly owned subsidiaries after the elimination of all significant intercompany accounts and transactions.

Use of Estimates The preparation of the financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Loans Receivable Loans receivable consist of long-term mortgage loans, working capital loans and subdebt investments. Interest income on loans is recognized as earned based upon the principal amount outstanding. The mortgage loans are primarily collateralized by a first mortgage on or an assignment of a partnership interest in the related facilities, which consist of skilled nursing, assisted living and specialty care facilities. The working capital loans are generally secured by second mortgages or interests in receivables. Subdebt investments represent debt instruments to operators of facilities that have been financed by us. These obligations are generally secured by the operator's leasehold rights and corporate guaranties.

Real Property Owned Substantially all of the properties owned by us are leased under operating leases and are recorded at cost. These properties are depreciated on a straight-line basis over their estimated useful lives which range from fifteen to forty years for buildings and five to twelve years for improvements. The net book value of long-lived assets is reviewed quarterly on a property by property basis to determine if facts and circumstances suggest that the assets may be impaired or that the depreciable life may need to be changed. We consider external factors relating to each asset. If these external factors and the projected undiscounted cash flows of the asset over the remaining depreciation period indicate that the asset will not be recoverable, the carrying value will be adjusted to the estimated fair market value. The leases generally extend for a minimum 10-year period and provide for payment of all taxes, insurance and maintenance by the tenants. In general, operating lease income includes base rent payments plus fixed annual rent increases, which are recognized on a straight-line basis over the minimum lease period. This income is greater than the amount of cash received during the first half of the lease term.

Capitalization of Construction Period Interest We capitalize 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 which approximates our cost of financing.

We capitalized interest costs of \$170,000, \$841,000 and \$3,079,000 during 2002, 2001 and 2000, respectively, related to construction of real property owned by us. Our interest expense reflected in the consolidated statements of income has been reduced by the amounts capitalized.

Allowance for Loan Losses 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 these loans, including general economic conditions and estimated collectibility of loan payments. We regularly evaluate the collectibility of our loans receivable based on a combination of factors. These factors include delinquency status (as determined by frequency of payments), historical loan charge-offs, financial strength of the borrower and guarantors and value of the underlying property. If these factors indicate that there is greater risk of loan charge-offs, additional allowances or placement on non-accrual status may be required. At December 31, 2002, we had loans with outstanding balances of \$15,311,000 on non-accrual status.

Deferred Loan Expenses Deferred loan expenses are costs incurred by us in connection with the issuance of short-term and long-term debt. We amortize these costs over the term of the debt using the straight-line method, which approximates the interest yield method.

Cash and Cash Equivalents Cash and cash equivalents consist of all highly liquid investments with an original maturity of three months or less.

Equity Investments We have an investment in Atlantic Healthcare Finance L.P., a property group that specializes in the financing, through sale and leaseback transactions, of nursing and care homes located in the United Kingdom. This investment is accounted for under the equity method of accounting because we have the ability to exercise significant influence, but not control, over the investee due to our 31% ownership interest.

Notes to Consolidated Financial Statements

1 Accounting Policies and Related Matters, continued

Other equity investments, which consist of investments in private and public companies for 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.

Foreign Currency Translation For our investment in Atlantic Healthcare Finance L.P., the functional currency is the local currency. The income and expenses of the entity are translated into U.S. dollars using the average exchange rates for the reporting period to derive our equity earnings. Translation adjustments are recorded in accumulated other comprehensive income, a separate component of stockholders' equity.

Commitment Fees Commitment fees are earned by us for our agreement to provide direct and standby financing to, and credit enhancement for, owners and operators of health care facilities. We amortize commitment fees over the initial fixed term of the lease, the mortgage or the construction period related to these investments.

Federal Income Tax No provision has been made for federal income taxes since we have elected to be treated as a real estate investment trust under the applicable provisions of the Internal Revenue Code, and we believe that we have met the requirements for qualification as a real estate investment trust for each taxable year. See Note 10.

Stock-Based Compensation We have elected to follow APB Opinion No. 25, Accounting for Stock Issued to Employees, in accounting for our stock options as permitted under FASB Statement No. 123 ("FASB 123"), Accounting for Stock-Based Compensation, and, accordingly, recognize no compensation expense for the stock option grants when the market price on the underlying stock on the date of the grant equals the exercise price of the stock option. See Note 8 for more information about our stock-based compensation plans.

The following table illustrates the effect on net income available to common stockholders if we had applied the fair value recognition provisions of FASB 123 to stock-based compensation for options granted since 1995 (in thousands, except per share data):

Year ended December 31	2002	2001	2000
Numerator:			
Net income available to common stockholders - as reported	\$ 55,191	\$ 47,044	\$ 54,566
Deduct: Total stock based employee compensation expense determined under fair value based method for all awards, net of related tax effects	539	465	267
Net income available to common stockholders - pro forma	\$ 54,652	\$ 46,579	\$ 54,299
Denominator:			
Basic weighted average shares – as reported and pro forma	36,702	30,534	28,418
Effect of dilutive securities:			
Employee stock options – pro forma	394	178	
Non-vested restricted shares	162	255	225
Dilutive potential common shares	556	433	225
Diluted weighted average shares – pro forma	37,258	30,967	28,643
Net income available to common stockholders per share - as reported			
Basic	\$ 1.50	\$ 1.54	\$ 1.92
Diluted	1.48	1.52	1.91
Net income available to common stockholders per share - pro forma			
Basic	1.49	1.53	1.91
Diluted	1.47	1.50	1.90

Notes to Consolidated Financial Statements

1 Accounting Policies and Related Matters, continued

The pro forma effect on net income available to common stockholders for 2002 is not representative of the pro forma effect on net income available to common stockholders in future years because of the number of options awarded.

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

	2002	2001	2000
Dividend yield	8.0%	9.3%	12.0%
Expected volatility	24.3%	24.3%	24.4%
Risk-free interest rate	3.44%	3.44%	5.14%
Expected life (in years)	7	7	7
Weighted-average fair value	\$2.10	\$1.43	\$0.63

Net Income Per Share Basic earnings per share is computed by dividing net income available to common stockholders by the weighted-average number of shares for the period adjusted for non-vested shares of restricted stock. The computation of diluted earnings per share is similar to basic earnings per share, except that the number of shares is increased to include the number of additional common shares that would have been outstanding if the potentially dilutive common shares had been issued.

Accumulated Other Comprehensive Income Accumulated other comprehensive income includes unrealized gains or losses on our equity investments (\$12,000 and \$78,000 at December 31, 2002 and 2001, respectively) and foreign currency translation adjustments ((\$182,000) and (\$1,001,000) at December 31, 2002 and 2001, respectively). These items are included as components of stockholders' equity.

New Accounting Standards In April 2002, the Financial Accounting Standards Board ("FASB") issued Statement No. 145, Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections, that we are required to adopt for fiscal years beginning after May 15, 2002 with transition provisions for certain matters. This Statement rescinds FASB Statement No. 4, Reporting Gains and Losses from Extinguishment of Debt, and an amendment of that Statement, FASB Statement No. 64, Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements. This Statement also rescinds FASB Statement No. 44, Accounting for Intangible Assets of Motor Carriers. This Statement amends FASB Statement No. 13, Accounting for Leases, to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. This Statement also amends other existing authoritative pronouncements to make various technical corrections, clarify meanings or describe their applicability under changed conditions. We do not expect the adoption of this Statement to have a material impact on the consolidated financial statements, except that the extraordinary losses on extinguishments of debt recorded in 2001 and 2002 will be reclassified to income from continuing operations in the consolidated statements of income and any future gains or losses on debt extinguishments will be similarly treated.

In November 2002, the FASB issued Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others. This Interpretation will significantly change current practice in the accounting for and disclosure of guarantees. Guarantees meeting the characteristics described in the Interpretation are required to be initially recorded at fair value, which is different from the general current practice of recording a liability only when a loss is probable and reasonably estimable. The Interpretation's initial recognition and initial measurement provisions are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. The Interpretation also requires a guarantor to make significant new disclosures for virtually all guarantees even if the likelihood of the guarantor having to make payments under the guaranty is remote. The Interpretation's disclosure requirements are effective for the current year's financial statements. We have included appropriate disclosures of guarantees of debt in Note 11.

In December 2002, the FASB issued Statement No. 148, Accounting for Stock-Based Compensation – Transition and Disclosure, that we are required to adopt for fiscal years beginning after December 15, 2002, with transition provisions for certain matters. This Statement amends FASB Statement No. 123, Accounting for Stock-Based Compensation, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In

Notes to Consolidated Financial Statements

1 Accounting Policies and Related Matters, continued

in addition, this Statement amends the disclosure requirements of Statement 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. We have revised our disclosures in accordance with these rules and intend to record the expense related to stock-based compensation under the fair value based method of accounting on a prospective basis effective January 1, 2003. The projected impact on 2003 diluted earnings per share is not expected to have a material effect.

2 Loans Receivable

The following is a summary of loans receivable (in thousands):

	December 31	
	2002	2001
Mortgage loans	\$ 178,942	\$ 211,722
Working capital loans	28,255	27,583
Mortgage loans to related parties	819	821
Subdebt investments	14,578	23,448
TOTALS	\$ 222,594	\$ 263,574

Loans to related parties (an entity whose ownership includes one Company director) included above are at rates comparable to other third-party borrowers equal to or greater than our net interest cost on borrowings to support such loans. The amount of interest income and commitment fees from related parties amounted to \$59,000, \$108,000 and \$152,000 for 2002, 2001 and 2000, respectively.

The following is a summary of mortgage loans at December 31, 2002:

Final Payment Due	Number of Loans	Payment Terms	Principal Amount at Inception	Carrying Amount
(In thousands)				
2003	4	Monthly payments from \$36,520 to \$200,971, including interest from 10.50% to 18.00%	\$ 38,230	\$ 35,527
2005	8	Monthly payments from \$8,082 to \$84,491, including interest from 11.00% to 12.67%	28,227	28,227
2006	6	Monthly payments from \$3,958 to \$250,000, including interest from 8.11% to 12.93%	30,125	27,159
2007	2	Monthly payments from \$45,421 to \$78,829, including interest from 10.78% to 11.00%	17,198	12,540
2008	1	Monthly payments of \$89,963, including interest of 15.11%	7,400	7,145
2009	2	Monthly payments from \$4,605 to \$78,234, including interest from 6.75% to 12.17%	3,130	2,385
2012	1	Monthly payments of \$112,183, including interest of 10.60%	12,700	12,700
2014	1	Monthly payments of \$2,750, including interest of 12.00%	280	280
2015	2	Monthly payments from \$20,399 to \$56,133, including interest from 10.00% to 11.85%	7,618	7,566
2017	1	Monthly payments of \$6,464, including interest of 8.11%	7,600	1,321
2019	10	Monthly payments from \$23,563 to \$52,603, including interest of 10.00%	44,911	44,911
TOTALS			\$197,419	\$179,761

Notes to Consolidated Financial Statements

3 Real Property Owned

The following table summarizes certain information about our real property owned as of December 31, 2002 (dollars in thousands):

	Number of Facilities	Land	Building & Improvements	Total Investment	Accumulated Depreciation
Assisted Living Facilities:					
Arizona	4	\$ 1,510	\$ 17,063	\$ 18,573	\$ 1,211
California	7	8,420	47,224	55,644	1,705
Colorado	1	940	3,721	4,661	79
Connecticut	4	4,950	33,762	38,712	2,149
Florida	16	5,142	66,663	71,805	9,764
Georgia	3	3,786	26,741	30,527	3,594
Idaho	1	550	14,740	15,290	
Illinois	1	670	6,780	7,450	150
Indiana	13	2,891	60,549	63,440	6,376
Louisiana	1	1,100	10,161	11,261	1,400
Maryland	5	3,730	53,560	57,290	4,457
Massachusetts	2	960	26,715	27,675	416
Mississippi	1	560	5,790	6,350	130
Montana	2	910	7,282	8,192	601
Nevada	3	2,086	26,235	28,321	3,324
New Jersey	4	5,337	31,074	36,411	3,690
New York	3	2,320	23,980	26,300	1,770
North Carolina	12	7,993	63,795	71,788	7,354
Ohio	7	2,525	31,898	34,423	3,153
Oklahoma	16	1,928	24,346	26,274	4,334
Oregon	3	1,677	14,139	15,816	1,006
Pennsylvania	4	1,951	17,259	19,210	1,755
South Carolina	5	2,072	19,087	21,159	1,716
Tennessee	5	1,835	15,527	17,362	1,264
Texas	17	5,013	60,147	65,160	8,380
Utah	1	1,059	6,141	7,200	310
Virginia	1	950	7,553	8,503	197
Washington	1	1,400	5,476	6,876	551
Wisconsin	1	420	4,007	4,427	105
Construction in progress	3			9,828	
	147	74,685	731,415	815,928	70,941
Skilled Nursing Facilities:					
Arizona	1	180	3,988	4,168	609
California	1	1,460	3,942	5,402	803
Colorado	1	370	6,051	6,421	904
Florida	9	4,382	59,036	63,418	7,334
Idaho	3	2,010	20,662	22,672	2,858
Illinois	4	1,110	22,346	23,456	1,332
Kentucky	3	910	16,680	17,590	1,430
Massachusetts	15	4,788	128,616	133,404	8,188
Missouri	3	1,247	23,133	24,380	166
Ohio	5	4,286	62,592	66,878	3,217
Oklahoma	1	470	5,673	6,143	790
Oregon	1	300	5,316	5,616	767
Pennsylvania	3	669	17,584	18,253	3,397
Tennessee	10	3,780	61,963	65,743	2,281
Texas	5	2,663	37,963	40,626	3,609
Virginia	1	680	4,423	5,103	35
	66	29,305	479,968	509,273	37,720
Specialty Care Facilities:					
Florida	1	979		979	
Illinois	1	3,650	7,505	11,155	
Massachusetts	4	3,425	69,632	73,057	4,918
Construction in progress	1			10,005	
	7	8,054	77,137	95,196	4,918
Total Real Property Owned	220	\$112,044	\$1,288,520	\$1,420,397	\$113,579

Notes to Consolidated Financial Statements

3 Real Property Owned, continued

At December 31, 2002, future minimum lease payments receivable under operating leases are as follows (in thousands):

2003	\$	141,252
2004		143,301
2005		146,762
2006		150,501
2007		154,132
Thereafter		1,299,821
TOTAL	\$	2,035,769

We converted \$33,972,000, \$13,683,000 and \$60,648,000 of mortgage loans into operating lease properties in 2002, 2001 and 2000, respectively. In 2002, we acquired properties which included the assumption of mortgages totaling \$2,248,000. These noncash activities are appropriately not reflected in the accompanying statements of cash flows.

During the year ended December 31, 2002, it was determined that the projected undiscounted cash flows from one assisted living facility, one specialty care facility and one parcel of land did not exceed their respective net book values and impairment charges of \$2,298,000 were recorded to reduce the properties to their estimated fair market values. The estimated fair market values of the properties were determined by offers to purchase received from third parties or estimated net sales proceeds.

4 Concentration of Risk

As of December 31, 2002, long-term care facilities, which include skilled nursing and assisted living facilities, comprised 92% (93% at December 31, 2001) of our real estate investments and were located in 33 states. Investments in assisted living facilities comprised 57% (63% at December 31, 2001) of our real estate investments. The following table summarizes certain information about our operator concentration as of December 31, 2002 (dollars in thousands):

Concentration by investment:	Number of Facilities	Total Investment (1)	Percent of Investment (2)
Commonwealth Communities L.L.C.	14	\$ 195,552	13%
Merrill Gardens L.L.C.	18	137,094	9%
Life Care Centers of America, Inc.	17	119,054	8%
Home Quality Management, Inc.	19	116,664	8%
Alterra Healthcare Corp.	45	106,319	7%
Remaining Operators	131	862,574	55%
TOTAL	244	\$ 1,537,257	100%

Concentration by revenue:	Number of Facilities	Total Revenues (3)	Percent of Revenue (4)
Merrill Gardens L.L.C.	18	\$ 16,271	10%
Commonwealth Communities L.L.C.	14	15,987	10%
Alterra Healthcare Corp.	45	14,207	9%
Home Quality Management, Inc.	19	13,948	8%
Life Care Centers of America, Inc.	17	10,548	6%
Remaining Operators	131	95,920	57%
TOTAL	244	\$ 166,881	100%

(1) Investments include real estate investments and credit enhancements which amounted to \$1,529,412,000 and \$7,845,000, respectively.

(2) Investments with top five operators comprised 42% of total investments at December 31, 2001.

(3) Revenues include gross revenues and revenues from discontinued operations for the year ended December 31, 2002.

(4) Revenues from top five operators were 40% and 38% for the years ended December 31, 2001 and 2000, respectively.

Notes to Consolidated Financial Statements

5 Allowance for Loan Losses

The following is a summary of the allowance for loan losses (in thousands):

Year ended December 31	2002	2001	2000
Balance at beginning of year	\$ 6,861	\$ 5,861	\$ 5,587
Provision for loan losses	1,000	1,000	1,000
Charge-offs	(2,906)		(726)
Balance at end of year	\$ 4,955	\$ 6,861	\$ 5,861

In addition, we recorded a \$2,000,000 loss during 2000 related to an investment in the preferred stock of a private corporation that became substantially diluted as a result of a recapitalization of that corporation.

6 Borrowings Under Line of Credit Arrangements and Related Items

We have an unsecured credit arrangement with a consortium of nine banks providing for a revolving line of credit in the amount of \$175,000,000, which expires on August 31, 2005. The agreement specifies that borrowings under the revolving line of credit are subject to interest payable in periods no longer than three months on either the agent bank's prime rate of interest or 1.3% over LIBOR interest rate (at our option). In addition, we pay a commitment fee ranging from an annual rate of 0.20% to 0.375% and an annual agent's fee of \$50,000. Principal is due upon expiration of the agreement. We have another unsecured line of credit with a bank for a total of \$25,000,000, which expires on June 30, 2003. Borrowings under this line of credit are subject to interest at the bank's prime rate of interest (4.25% at December 31, 2002) and are due on demand.

The following information relates to aggregate borrowings under the unsecured line of credit arrangements (in thousands, except percentages):

Year ended December 31	2002	2001	2000
Balance outstanding at December 31	\$ 109,500	\$ 0	\$ 119,900
Maximum amount outstanding at any month end	130,000	140,800	185,000
Average amount outstanding (total of daily principal balances divided by days in year)	69,180	66,217	140,981
Weighted average interest rate (actual interest expense divided by average borrowings outstanding)	4.58%	7.67%	7.77%

7 Senior Notes and Other Long-Term Obligations

We have \$515,000,000 of unsecured senior notes with annual interest rates ranging from 7.50% to 8.17%.

During the year ended December 31, 2002, we repurchased \$35,000,000 of unsecured senior notes that were due in 2003. We incurred expenses of \$403,000 related to this repurchase, which was recorded as an extraordinary item. During the year ended December 31, 2001, we repurchased \$7,750,000 of our outstanding unsecured senior notes that were due in 2002. We incurred expenses of \$213,000 related to this repurchase, which was recorded as an extraordinary item.

We have five mortgage notes payable, collateralized by health care facilities, with annual interest ranging from 7.69% to 12.00%.

We have one secured note collateralized by one health care facility with an annual interest rate 2% over LIBOR (3.38% at December 31, 2002).

We have a \$60,000,000 secured line of credit, collateralized by 16 health care facilities, with interest at the prime rate of interest or 2% over LIBOR (at our option), with a floor of 7% (7% at December 31, 2002).

The carrying values of the health care properties securing the mortgages and secured debt totaled \$136,023,000 at December 31, 2002.

Notes to Consolidated Financial Statements

7 Senior Notes and Other Long-Term Obligations, continued

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.

At December 31, 2002, the annual principal payments on these long-term obligations are as follows (in thousands):

	Senior Notes	Secured Line of Credit	Secured Note	Mortgages	Totals
2003	\$ 0	\$ 0	\$ 0	\$ 400	\$ 400
2004	40,000		4,000	475	44,475
2005				860	860
2006	50,000			398	50,398
2007	175,000			430	175,430
2008	100,000			464	100,464
2009				501	501
Thereafter	150,000			44,303	194,303
TOTALS	\$515,000	\$ 0	\$ 4,000	\$ 47,831	\$566,831

8 Stock Incentive Plans and Retirement Arrangements

Our 1995 Stock Incentive Plan authorizes up to 3,768,000 shares of common stock to be issued at the discretion of the Board of Directors. The 1995 Plan replaced the 1985 Incentive Stock Option Plan. The options granted under the 1985 Plan continue to vest through 2005 and expire ten years from the date of the grant. Our officers and key salaried employees are eligible to participate in the 1995 Plan. The 1995 Plan allows for the issuance of stock options, restricted stock grants and Dividend Equivalency Rights. There were no Dividend Equivalency Rights outstanding under the 1995 Plan for any of the years presented. In addition, we have a Stock Plan for Non-Employee Directors, which authorizes up to 384,000 shares to be issued.

The following summarizes the stock option activity in these three plans (shares in thousands):

Year ended December 31	2002		2001		2000	
	Number of Shares	Average Exercise Price	Number of Shares	Average Exercise Price	Number of Shares	Average Exercise Price
Stock Options						
Options at beginning of year	2,337	\$ 21.23	1,953	\$ 20.34	1,813	\$ 21.62
Options granted	40	27.17	515	23.89	507	16.79
Options exercised	(821)	20.54	(111)	18.63		
Options terminated			(20)	17.73	(367)	21.76
Options at end of year	1,556	\$ 21.74	2,337	\$ 21.23	1,953	\$ 20.34
Options exercisable at end of year	838	\$ 21.98	1,161	\$ 21.27	949	\$ 21.32
Weighted average fair value of options granted during the year		\$ 2.10		\$ 1.43		\$ 0.63

Vesting periods for options and restricted shares range from six months to ten years. Options expire ten years from the date of grant. We issued 8,000, 75,750 and 77,250 restricted shares during 2002, 2001 and 2000, respectively, including 8,000, 8,000 and 8,000 shares for directors in 2002, 2001 and 2000, respectively. Expense, which is recognized as the restricted shares vest based on the market value at the date of the award, totaled \$1,555,000, \$1,164,000 and \$1,090,000 in 2002, 2001 and 2000, respectively.

Notes to Consolidated Financial Statements

8 Stock Incentive Plans and Retirement Arrangements, continued

The following table summarizes information about stock options outstanding at December 31, 2002 (shares in thousands):

Range of Per Share Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contract Life	Number Exercisable	Weighted Average Exercise Price
\$16-\$20	624	\$17.75	6.8	322	\$17.93
\$20-\$25	743	23.46	7.1	327	23.46
\$25-\$30	189	26.31	6.0	189	26.31
	1,556	\$21.74	6.8	838	\$21.98

We have a 401(k) Profit Sharing Plan and a Money Purchase Pension Plan (which has been merged into the 401(k) Profit Sharing Plan effective September 30, 2002) covering all eligible employees. Under these plans, eligible employees may make contributions, and we may make matching contributions and a profit sharing contribution. Our contributions to these plans totaled \$184,000, \$175,000 and \$171,000 in 2002, 2001 and 2000, respectively.

We have a non-qualified senior executive retirement plan designed to provide pension benefits for certain officers. Pension benefits are based on compensation and length of service and the plan is unfunded. The accrued liability for the plan was \$206,000 at December 31, 2002 (\$41,000 at December 31, 2001).

9 Preferred Stock

In January 1999, we sold 3,000,000 shares of Series C Cumulative Convertible Preferred Stock. These shares have a liquidation value of \$25.00 per share and will pay dividends equivalent to the greater of (i) the annual dividend rate of \$2.25 per share (a quarterly dividend rate of \$0.5625 per share); or (ii) the quarterly dividend then payable per common share on an as converted basis. The preferred shares are convertible into common stock at a conversion price of \$25.625 per share. We have the right to redeem the preferred shares after five years.

During the year ended December 31, 2002, the holder of our Series C Cumulative Convertible Preferred Stock converted 900,000 shares into 878,000 shares of common stock, leaving 2,100,000 shares outstanding at December 31, 2002.

We have 3,000,000 shares of 8.875% Series B Cumulative Redeemable Preferred Stock outstanding with a liquidation preference of \$25.00 per share. Dividends are payable quarterly in arrears. On and after May 1, 2003, these preferred shares may be redeemed for cash at our option, in whole or in part, at \$25.00 per share, plus accrued and unpaid dividends on these shares to the redemption date.

10 Income Taxes and Distributions

To qualify as a real estate investment trust for federal income tax purposes, 90% of taxable income must be distributed to stockholders. Real estate investment trusts that do not distribute a certain amount of current year taxable income in the current year are also subject to a 4% federal excise tax. The principal reasons for the difference between undistributed net income for federal income tax purposes and financial statement purposes are the recognition of straight-line rent for reporting purposes, different useful lives and depreciation methods for real property and the provision for losses for reporting purposes versus bad debt expense for tax purposes. Cash distributions paid to common stockholders, for federal income tax purposes, are as follows:

Notes to Consolidated Financial Statements

10 Income Taxes and Distributions, continued

Year ended December 31	2002	2001	2000
Per Share:			
Ordinary income	\$ 1.655	\$ 1.673	\$ 2.330
Return of capital	0.671	0.648	0.000
Capital gains	0.014	0.019	0.005
TOTALS	\$ 2.340	\$ 2.340	\$ 2.335

11 Commitments and Contingencies

We have guaranteed the payment of industrial revenue bonds for one assisted living facility, in the event that the present owner defaults upon its obligations. In consideration for this guaranty, we receive and recognize fees annually related to this agreement. This guaranty expires upon the repayment of the industrial revenue bonds which currently mature in 2009. At December 31, 2002, we were contingently liable for \$3,195,000 under this guaranty.

In addition, we have an outstanding letter of credit issued to a bank, which bank provided additional financing for a project on which we have a first mortgage. We have also partially guaranteed the payment of loans made by the bank on this project. The letter of credit currently matures in 2003 and the guaranties expire upon the repayment of the loans, which currently mature in 2003. At December 31, 2002, obligations under these agreements for which we were contingently liable aggregated approximately \$4,650,000.

As of December 31, 2002, we had approximately \$42,885,000 of unfunded construction commitments.

On November 20, 2002, Doctors Community Health Care Corporation and five subsidiaries filed for Chapter 11 bankruptcy protection. Doctors has stated that the bankruptcy filing was due to the bankruptcy of National Century Financial Enterprises and affiliates, who halted payments to health care providers, including Doctors. We have provided mortgage financing to Doctors in the form of a loan secured by Pacifica Hospital of the Valley in Sun Valley, CA, a property that is owned by one of the debtor subsidiaries. The outstanding principal balance of the loan is approximately \$18.8 million at December 31, 2002. Based upon an appraisal and historical performance of Pacifica Hospital, we expect to receive payment in full of the outstanding principal and accrued interest, which we believe we are entitled to as an oversecured creditor. We do not currently intend to recognize any interest on the loan if payment is not received.

Alterra Healthcare Corporation filed for Chapter 11 bankruptcy protection on January 23, 2003. We have a master lease with Alterra for 45 assisted living facilities with a depreciated book value of \$106 million at December 31, 2002. We expect Alterra to remain current on rent payments and to assume the master lease at current rental levels.

12 Stockholder Rights Plan

Under the terms of a Stockholder Rights Plan approved by our Board of Directors in July 1994, a preferred share right is attached to and automatically trades with each outstanding share of common stock.

The rights, which are redeemable, will become exercisable only in the event that any person or group becomes a holder of 15% or more of our common stock, or commences a tender or exchange offer, which, if consummated, would result in that person or group owning at least 15% of our common stock. Once the rights become exercisable, they entitle all other stockholders to purchase one one-thousandth of a share of a new series of junior participating preferred stock for an exercise price of \$48.00. The rights will expire on August 5, 2004, unless exchanged earlier or redeemed earlier by us for \$0.01 per right at any time before public disclosure that a 15% position has been acquired.

Notes to Consolidated Financial Statements

13 Earnings Per Share

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

Year ended December 31	2002	2001	2000
Numerator for basic and diluted earnings per share - net income available to common stockholders	\$ 55,191	\$ 47,044	\$ 54,566
Denominator for basic earnings per share - weighted average shares	36,702	30,534	28,418
Effect of dilutive securities:			
Employee stock options	437	238	
Non-vested restricted shares	162	255	225
Dilutive potential common shares	599	493	225
Denominator for diluted earnings per share - adjusted weighted average shares	37,301	31,027	28,643
Basic earnings per share	\$ 1.50	\$ 1.54	\$ 1.92
Diluted earnings per share	\$ 1.48	\$ 1.52	\$ 1.91

The diluted earnings per share calculation excludes the dilutive effect of 10,000, 1,301,000 and 1,954,000 options for 2002, 2001 and 2000, respectively, because the exercise price was greater than the average market price. The Series C Cumulative Convertible Preferred Stock was not included in this calculation as the effect of the conversion was anti-dilutive.

14 Disclosure about Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value.

Mortgage Loans The fair value of all mortgage loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

Working Capital Loans and Subdebt Investments The carrying amount is a reasonable estimate of fair value based on the interest rates received, which approximates current market rates.

Cash and Cash Equivalents The carrying amount approximates fair value.

Equity Investments Equity investments are recorded at their fair market value.

Borrowings Under Line of Credit Arrangements and Secured Debt The carrying amount of the lines of credit and secured debt approximates fair value because the borrowings are interest rate adjustable.

Senior Unsecured Notes The fair value of the senior unsecured notes payable was estimated by discounting the future cash flows using the current borrowing rate available to us for similar debt.

Mortgage Notes Payable Mortgage notes payable is a reasonable estimate of fair value based on the interest rates paid, which approximates current market rates.

Notes to Consolidated Financial Statements

14 Disclosure about Fair Value of Financial Instruments, continued

The carrying amounts and estimated fair values of our financial instruments are as follows (in thousands):

	December 31, 2002		December 31, 2001	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial Assets:				
Mortgage loans	\$ 179,761	\$ 192,037	\$ 212,543	\$ 229,422
Working capital loans	28,255	28,255	27,583	27,583
Subdebt investments	14,578	14,578	23,448	23,448
Cash and cash equivalents	9,550	9,550	9,826	9,826
Equity investments	12	12	78	78
Financial Liabilities:				
Borrowings under line of credit arrangements	109,500	109,500		
Senior unsecured notes	515,000	616,478	412,250	418,179
Secured debt	4,000	4,000	33,000	33,000
Mortgage notes payable	47,831	47,831	45,966	45,966

15 Discontinued Operations

In August 2001, the Financial Accounting Standards Board issued Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, which is effective for fiscal years beginning after December 15, 2001. We adopted the standard effective January 1, 2002.

During the year ended December 31, 2002, we sold eight assisted living facilities, one specialty care facility and one parcel of land with carrying values of \$53,311,000 for a net loss of \$1,032,000. In accordance with Statement No. 144, we have reclassified the income and expenses attributable to these properties 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 the properties as discontinued operations (in thousands):

Year ended December 31	2002	2001	2000
Revenues:			
Operating lease rents	\$ 3,763	\$ 5,751	\$ 5,790
Expenses:			
Interest expense	1,016	1,669	1,767
Provision for depreciation	1,039	1,502	1,523
Income from discontinued operations, net	\$ 1,708	\$ 2,580	\$ 2,500

Notes to Consolidated Financial Statements

16 Quarterly Results of Operations (Unaudited)

The following is a summary of our unaudited quarterly results of operations for the years ended December 31, 2002 and 2001 (in thousands, except per share data):

Year ended December 31, 2002	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter (1)
Revenues	\$ 36,074	\$ 39,365	\$ 42,255	\$ 45,424
Income before extraordinary item	15,889	17,235	19,763	15,175
Income before extraordinary item per share:				
Basic	0.48	0.49	0.51	0.39
Diluted	0.47	0.48	0.50	0.38
Net income available to common stockholders	12,511	13,490	16,885	12,303
Net income available to common stockholders per share:				
Basic	0.38	0.38	0.44	0.31
Diluted	0.37	0.37	0.43	0.31
Year ended December 31, 2001	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter (2)
Revenues	\$ 31,140	\$ 31,327	\$ 33,396	\$ 33,506
Income before extraordinary item	15,204	15,124	17,180	13,254
Income before extraordinary item per share:				
Basic	0.53	0.52	0.53	0.41
Diluted	0.53	0.51	0.52	0.40
Net income available to common stockholders	11,827	11,747	13,591	9,879
Net income available to common stockholders per share:				
Basic	0.41	0.41	0.42	0.30
Diluted	0.41	0.40	0.41	0.30

(1) The decrease in net income and amounts per share is primarily attributable to impairment of assets, losses on sales of properties and a common stock issuance recorded in fourth quarter 2002.

(2) The decrease in net income and amounts per share is primarily attributable to losses on sales of properties recorded in fourth quarter 2001.

Report of Independent Auditors

Stockholders and Directors
Health Care REIT, Inc.

We have audited the accompanying consolidated balance sheets of Health Care REIT, Inc. as of December 31, 2002 and 2001, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Health Care REIT, Inc. at December 31, 2002 and 2001, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States.

As discussed in Note 15 to the consolidated financial statements, in 2002 the Company adopted the provisions of Financial Accounting Standards Board Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets.

Ernst & Young LLP

Toledo, Ohio
January 17, 2003

Market and Dividend Information

The following table sets forth, for the periods indicated, the high and low prices of our common stock on the New York Stock Exchange, as reported on the Composite Tape and dividends paid per share. There were 4,579 stockholders of record as of February 20, 2003.

	Sales Price		Dividends Paid
	High	Low	
2002			
First Quarter	\$ 28.30	\$ 24.08	\$ 0.585
Second Quarter	31.82	27.41	0.585
Third Quarter	29.94	24.26	0.585
Fourth Quarter	28.65	24.27	0.585

	Sales Price		Dividends Paid
	High	Low	
2001			
First Quarter	\$ 21.16	\$ 16.06	\$ 0.585
Second Quarter	24.80	20.87	0.585
Third Quarter	26.25	22.50	0.585
Fourth Quarter	26.40	24.25	0.585

Income Tax Information

	2002 Dividend Report Dates				
	Feb. 20	May 20	Aug. 20	Nov. 20	Total
Ordinary Income	\$ 0.417	\$ 0.417	\$ 0.417	\$ 0.404	\$ 1.655
Short-Term Capital Gain	0.000	0.000	0.000	0.000	0.000
Mid-Term Capital Gain	0.000	0.000	0.000	0.000	0.000
Long-Term Capital Gain/(Loss)	0.000	0.000	0.000	0.000	0.000
Unrecaptured Sec. 1250 Gain	0.000	0.000	0.000	0.014	0.014
Return of Capital	0.168	0.168	0.168	0.167	0.671
Total	\$ 0.585	\$ 0.585	\$ 0.585	\$ 0.585	\$ 2.340
Foreign Tax Credit	0.000	0.000	0.000	0.000	0.000
Tax Exempt Interest	0.000	0.000	0.000	0.000	0.000

Board of Directors

William C. Ballard, Jr., *age 62*

4, 5, 6

Of Counsel

Greenebaum Doll &

McDonald PLLC

Louisville, Kentucky

Pier C. Borra, *age 63*

3, 4, 6

Chairman and

Chief Executive Officer

CORA Health Services, Inc.

Lima, Ohio

George L. Chapman, *age 55*

2, 4, 6

Chairman and

Chief Executive Officer

Health Care REIT, Inc.

Toledo, Ohio

Committees:

1. Audit Committee

2. Executive Committee

3. Compensation Committee

Jeffrey H. Donahue, *age 56*

3, 4, 6

President and

Chief Executive Officer

The Enterprise Social

Investment Corporation

Columbia, Maryland

Peter J. Grua, *age 49*

4, 5, 6

Principal and President

HLM Management Company, Inc.

Boston, Massachusetts

Sharon M. Oster, *age 54*

1, 4, 6

Professor of Economics,

Entrepreneurship and Management

Yale University School of Management

New Haven, Connecticut

4. Investment Committee

5. Nominating Committee

6. Planning Committee

Bruce G. Thompson, *age 73*

2, 4, 6

President

First Toledo Corporation

Toledo, Ohio

R. Scott Trumbull, *age 54*

1, 4, 6

Chairman and

Chief Executive Officer

Franklin Electric Co., Inc.

Bluffton, Indiana

Richard A. Unverferth, *age 79*

1, 2, 3, 4, 5, 6

Chairman

Unverferth Manufacturing

Company, Inc.

H.C.F., Inc.

Kalida, Ohio

Stockholder Information

Officers

George L. Chapman

Chairman and

Chief Executive Officer

Raymond W. Braun

President and

Chief Financial Officer

Charles J. Herman, Jr.

Vice President, Operations

Michael A. Crabtree

Treasurer

Erin C. Ibele

Vice President and

Corporate Secretary

J. Michael Stephen

Vice President, Marketing

General Offices

Health Care REIT, Inc.

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Toledo, Ohio

Independent Auditors

Ernst & Young LLP

Toledo, Ohio

Transfer Agent

Mellon Investor Services LLC

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Overpeck Centre

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Dividend Reinvestment Administrator

Mellon Bank, N.A.

85 Challenger Road

Overpeck Centre

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Form 10-K

The Company's Form 10-K Annual Report, filed with the Securities and Exchange Commission, is available at no charge upon written request to the Corporate Secretary. This report is also available on the Company's website at www.hcreit.com.

Exchange Listing

New York Stock Exchange

Trading Symbol: HCN

Member

National Association of Real Estate Investment Trusts, Inc.



