
# PRIMARY HEALTH PROPERTIES PLC

**A dedicated healthcare REIT**

Annual Report for the year ended 31 December 2014

Primary Health Properties

**Primary Health Properties PLC ("PHP") is a UK Real Estate Investment Trust ("REIT") and a leading investor in modern healthcare premises.**

**The objective of the Group is to generate increased rental income and capital growth through investment in property assets in the UK leased principally to GPs, NHS organisations and other associated healthcare users.**


Front cover: St. Johns House Medical Centre, Worcester.  Inside front cover: Rumney Primary Care Centre, South Wales.

# STRATEGIC REVIEW



# CORPORATE GOVERNANCE



# GROUP FINANCIAL STATEMENTS



# COMPANY FINANCIAL STATEMENTS



# FURTHER INFORMATION

# PRIMARY HEALTH PROPERTIES PLC: A SNAPSHOT

DATA INCLUDES ASSETS UNDER CONSTRUCTION AS AT 31 DECEMBER 2014

| | |
|---|---|
| 2014 | 265 |
| 2013 | 259 |
| 2012 | 182 |

**PORTFOLIO COMPRISES OF**
**265 ASSETS**

| | |
|---|---|
| 2014 | £1.04bn |
| 2013 | £0.96bn |
| 2012 | £0.65bn |

**TOTAL CAPITAL VALUE***
**£1.04 BILLION**

| | |
|---|---|
| 2014 | £60.9m |
| 2013 | £57.6m |
| 2012 | £38.9m |

**CONTRACTED RENT ROLL**
**£60.9 MILLION**

| | |
|---|---|
| 2014 | 15.3 years |
| 2013 | 15.7 years |
| 2012 | 16.0 years |

**WEIGHTED AVERAGE UNEXPIRED LEASE TERM**
**15.3 YEARS**

| | |
|---|---|
| 2014 | 2.72m |
| 2013 | 2.63m |
| 2012 | 1.89m |

**PATIENTS REGISTERED AT PHP PROPERTIES**
**2.72 MILLION**

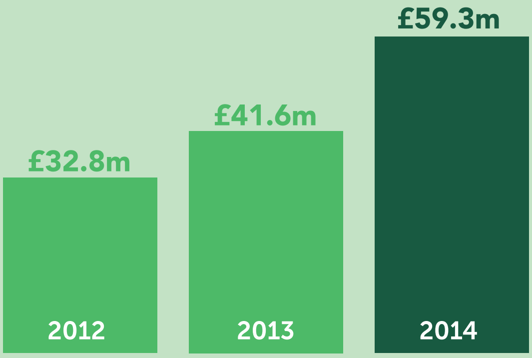
* Refer to page 14 for reconciliation of total capital value.

# 2014 FINANCIAL HIGHLIGHTS

DATA FOR THE PERIOD ENDED 31 DECEMBER 2014

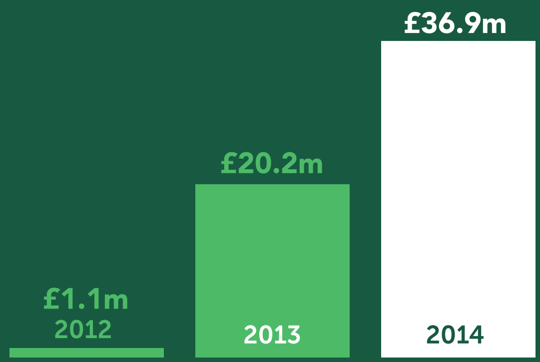
## NET RENTAL INCOME

**£59.3m ↑42.5%**



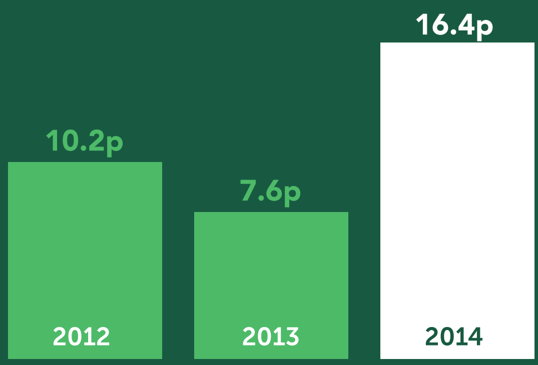

## IFRS PROFIT FOR THE YEAR

**£36.9m ↑82.7%**



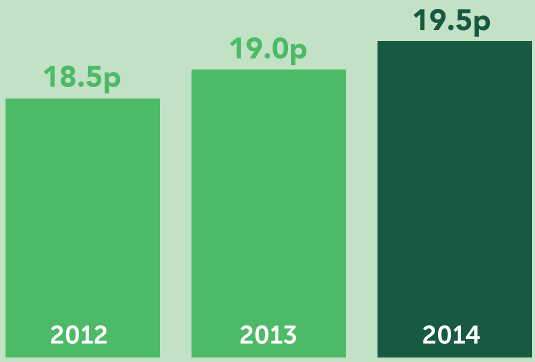

## EPRA EARNINGS PER SHARE*

**16.4p ↑116%**



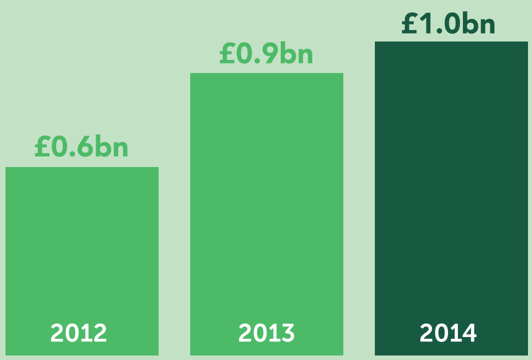

## DIVIDEND PER SHARE

**19.5p ↑2.6%**



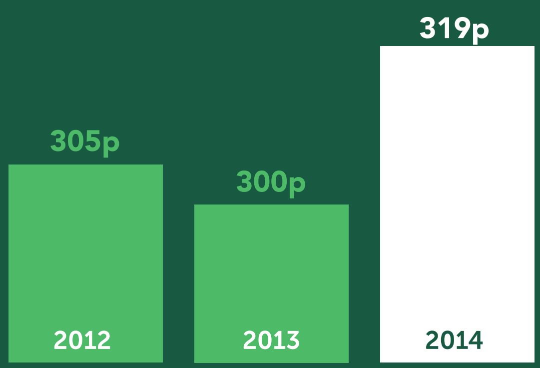

## INVESTMENT PORTFOLIO

**£1.0bn ↑9.0%**




## EPRA NAV PER SHARE*

**319p ↑6.3%**




* Refer to Note 9 for calculation of EPRA Earnings Per Share and Note 26 for calculation of EPRA NAV Per Share.

# CHAIRMAN'S STATEMENT

I am pleased to present the Group's Annual Report for 2014, another busy and successful year. We have grown the Group's property portfolio, passing the £1 billion milestone in the year and have delivered on our key objective for the period of significantly increasing dividend cover from 57%[1] in 2013 to 84% in 2014.

Our proven strategy of investing in modern, purpose built primary care premises is evident in the results and activity of the year. Underpinned by long term, secure income streams, the Group's portfolio has delivered growth in both income and capital value which has been translated into increased earnings and shareholder value. Total NAV return for the year, being the increase in EPRA net asset value per share and dividends paid, was 12.8% (2013: 4.6%)

## PERFORMANCE HIGHLIGHTS

All aspects of our business have contributed to the strong financial performance in the year. The acquisitions of the PPP portfolio in December 2013 and further assets totalling £43.0 million in 2014 were the major contributors to a 42.5% increase in net rental income in the year to £59.3 million (2013: £41.6 million).

The consolidation of advisory services to the Group, effective from May 2014, has reduced administrative costs as a proportion of assets with the Group's total expense ratio falling to 69 basis points (2013: 88 basis points). Fresh debt issuance, most notably the issue of the Group's 4.25% 2019 Convertible Bond in May 2014, and the restructuring or refinancing of other existing facilities during the year, has resulted in lower marginal borrowing costs, a wider spread of debt providers to the Group and an increase in the average maturity of facilities.

The combined effect of these actions is a 168% increase in EPRA earnings to £18.2 million (2013: £6.8 million) and a 116% increase in EPRA earnings per share of 16.4 pence (2013: 7.6 pence). IFRS profit before tax increased 82.7% to £36.9 million (2013: £20.2 million). The Board has continued to grow the dividend paid to shareholders with a total of 19.5 pence per share paid in 2014, an increase of 2.6% (2013: 19.0 pence per share). This is the eighteenth year of successive dividend growth. Notwithstanding the increase in both dividend paid and the number of shares in issue, the Group made significant progress in rebuilding dividend cover, improving to 84% for the year from 57%[1] in 2013.

At 31 December 2014, our property portfolio, including commitments as complete, was valued at £1.04 billion. Allowing for costs associated with acquisitions in the year, the net surplus on revaluation was £29.2 million. Overall, EPRA net asset value per share increased by 6.3% to 319 pence (2013: 300 pence).

## DIVIDENDS

The Board has approved the payment of an interim dividend of 10.0 pence per share, payable on 1 April 2015 to shareholders on the register on 27 February 2015. The Board is committed to maintaining its progressive dividend policy whilst growing dividend cover.

## THE NHS BACKDROP

As we enter 2015, the upcoming General Election dominates the political and fiscal landscape but the unwavering cross party support for the NHS is already evident. Each of the major political parties made specific statements in the autumn of 2014 on their commitment to the future of the NHS, its funding and its importance to British society. These included continued ring-fencing of the NHS budget with annual increases in expenditure in real terms targeting increases in GP numbers and improved access to GP services.

This was boosted in the Chancellor's Autumn Statement with the provision of an additional £2 billion of funding for front-line NHS services in 2015/2016 and a further pool of more than £1 billion, to be provided over a four year period to directly enhance GP premises.

In October 2014, NHS England published its Five Year Forward View of the Health Service in England. This reinforced "list-based primary care" as the foundation of the NHS and outlined planned changes to better integrate health and social care,

(1) Includes add back of non-recurring contractual administrative services contract fee.

working closer with others such as Local Government to promote health and wellbeing. It is also planned that a greater number of services located within the local communities to provide economic efficiencies and meet the objectives of giving patients "far greater control of their own care".

The modern premises provided by the Group will help the NHS achieve these objectives, providing flexible accommodation that can be used for GP services, to house specialist equipment and services and facilitate greater integration and collaboration between providers of health and social care.

## OUTLOOK

The structural changes to the NHS in 2013 have slowed the rate of approval of new medical centre developments and the inception of new projects for future schemes. As we move beyond the Election, the need to upgrade many existing GP premises and the integration of both primary and secondary care and of health and social services will increase the demand for new facilities and we anticipate the rate of approvals to improve. We have an identified pipeline of investment properties that will secure further portfolio and earnings growth.

PHP's track record as one of the leading investors in healthcare real estate will position us at the forefront of providing new, modern premises and support the NHS in its development.

We will continue to work with our existing GP tenants to invest in our portfolio to enhance our facilities and adapt and extend them to meet their changing needs. Using our depth of knowledge of the sector we will deliver more asset management projects that will generate increased and lengthened income streams and growth in capital values.

Through these activities, together with efficient administrative management and appropriate financing of the Group, we expect to further our objectives of increasing earnings and dividend cover.

## APPOINTMENT

I am delighted to announce the appointment of Phil Holland as a Director of the Company. Mr Holland has been a key contributor to the Group's growth since joining Nexus in 2010. Mr Holland is a Chartered Accountant and experienced listed property company director who will serve as Finance Director and Deputy Managing Director of PHP. I wish him every success in his new role.

I would like to thank my fellow Board members and all of those who work with us to ensure the continued success of the Group. I look forward to 2015 and the expected growth and progression of the Group with confidence.

**Alun Jones, Chairman**
18 February 2015

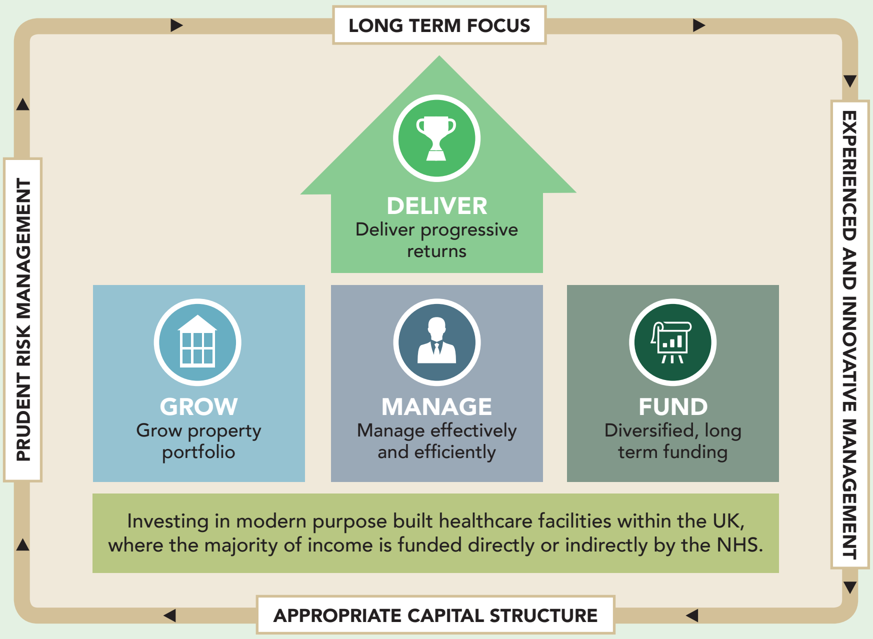
## STRATEGIC OBJECTIVES

**DELIVER** PROGRESSIVE RETURNS

**GROW** PROPERTY PORTFOLIO

**MANAGE** EFFECTIVELY AND EFFICIENTLY

DIVERSIFIED, LONG TERM **FUNDING**




Find out more on pages 8 and 9.

# STRATEGIC REVIEW

## STRATEGIC OBJECTIVES

## HOW HAVE WE PERFORMED?

### DELIVER

#### DELIVER PROGRESSIVE RETURNS

Generate progressive shareholder returns through a combination of earnings and valuation growth.
See pages 12 and 13.

Operating activity in the year has increased overall profitability, which translates into improved earnings per share. A total of 19.5 pence per share was paid in dividend to shareholders, an increase of 2.6%. Dividend cover rose to 84% (2013: 57%).

The quality of the Group's portfolio, a successful acquisition strategy and the execution of value adding management projects has underpinned significant valuation growth.

### GROW

#### GROW PROPERTY PORTFOLIO

Fund the development of and acquire modern, purpose built health care premises that provide secure long term income streams with the potential for rental growth and capital enhancement. See pages 14 to 17.

In the year PHP acquired three completed assets and committed to fund the development of four further assets with an aggregate cost of £42.9 million.

We also took delivery of five assets on completion of their construction with a total cost of £21.7 million.

### MANAGE

#### MANAGE EFFECTIVELY AND EFFICIENTLY

Work to improve the rental potential, longevity of underlying income streams and secure capital growth from assets within the portfolio, whilst controlling operating costs.
See pages 18 and 19.

In the year we have completed eight asset management projects that have (i) created new lettable areas and income streams from extending existing properties, (ii) increased the rent received from the existing asset, or (iii) extended the unexpired lease terms with tenants at the centres, or a combination of these.

The provision of advisory and administrative services were consolidated to Nexus in May 2014, amending the charging structure and reducing fee rates.

### FUND

#### DIVERSIFIED, LONG TERM FUNDING

Fund activities through a prudent mix of shareholder equity and debt, from a diverse range of sources with varied maturities.
See pages 20 and 21.

The £178 million of debt that was assumed with the PPP acquisition in December 2013 was all refinanced in the year.

The Group has introduced new lenders in the year and widened the range of debt products it utilises with the issue of a £82.5 million Convertible Bond.

Existing facilities have been extended and renegotiated to reduce overall borrowing costs.

The overall objective of the Group is to create progressive returns to shareholders through a combination of earnings growth and capital appreciation. To achieve this, PHP invests in health care properties across the United Kingdom let on long term leases, backed by a secure underlying covenant where the majority of rental income is funded directly or indirectly by the UK government.

| PERFORMANCE MEASURES | LOOKING FORWARD | KEY RISKS MANAGED BY THE GROUP |
|---|---|---|
| EPRA EPS increased 116% to 16.4p<br>Property portfolio valuation surplus of £29.2 million, like for like growth of 3.2%<br>EPRA NAV per share increased by 6.3% to 319 pence per share<br>Total NAV return of 12.8%<br>Dividend cover 84% (2013: 57%) | By delivering on each of the operational strategic objectives, the Board will deliver growing returns to shareholders.<br>An interim dividend of 10.0 pence per share has been declared, payable on 1 April 2015. | The key overall risk associated with the Group's businesss strategy is its investment in a niche sector that is greatly influenced by Government policy.<br>The valuation and return from the Group's portfolio may be affected by adverse economic conditions. |
| Total capital value (including commitments) increased by 8.2% to £1.04 billion<br>Acquisitions in period totalling £42.9 million, WAULT of 24 years | The sector fundamentals are strong with continued demand for modern, purpose built premises.<br>We have a good pipeline of further commitments and opportunities that will be delivered in 2015. | The development of new properties is tightly controlled by the NHS and recent structural changes within the NHS have slowed the level of approvals. Continued availability of funding is key to the Group's ability to secure further assets. |
| Eight completed projects, committing £4.4 million of capital<br>Generated additional WAULT of 15.7 years and additional rental income of £0.3 million<br>Portfolio WAULT of 15.3 years (2013: 15.7 years)<br>TER managed down to 69 basis points (2013: 88 basis points) | Two further projects on-site committing £2.1 million of capital to add 20.5 years to the lease term and £0.2 million of rental income. A number of projects are under discussion with tenants and the NHS.<br>TER will continue to fall due to the reducing scale advisory fee basis as the property portfolio continues to grow. | The bespoke nature of the Group's assets can lead to limited alternative use requiring them to be kept fit for purpose.<br>The Group has no employees and depends upon services provided by third parties for its efficient operation and management. |
| Facilities available to the Group total £785.9 million, with facility headroom of £116.7 million<br>Average maturity of facilities 6.2 years (2013: 5.8 years)<br>LTV of 64.1% (31 Dec 2013: 61.6%) | The longevity and security of the Group's income is attractive to both equity and debt investors.<br>The Group has strong relationships with a number of providers keen to provide more capital to PHP. | Movement in underlying interest rates could adversely affect the Group's profits and cash flows.<br>Without the continuity and longevity of debt facilities, PHP may be unable to meet current and future commitments. |

# BUSINESS MODEL

The Group works in partnership with its stakeholders to create and maintain a portfolio of fit for purpose facilities that provide a long term home for local healthcare provision and that are easily adapted to meet the changing needs of a community. Initial lease terms are typically of 21 years or more, at effectively upward only rentals and the large majority of income is received either directly from the NHS or from NHS funded GP tenants providing a secure, transparent income stream.

By successfully achieving each of the strategic objectives outlined below PHP is able to meet its overriding aim of **delivering progressive shareholder returns** through a combination of income and long term value growth.

(i) The Group looks to **grow its property portfolio** by funding and acquiring high quality newly delivered facilities and investing in already completed, let properties. PHP concentrates on assets with strong underlying fundamentals that it can acquire for a fair price and secure an acceptable gap between the income yield an asset generates and the cost of managing and funding that investment.

(ii) Each potential investment is evaluated for its income and asset value growth potential. PHP seeks to **manage its portfolio effectively and efficiently**, looking to identify opportunities to add income and value by providing additional space, facilitating the provision of additional services or extending the term of underlying leases. This is undertaken within an **efficient management structure** where operating costs are tightly controlled and structured to gain economies of scale as the Group continues to grow.

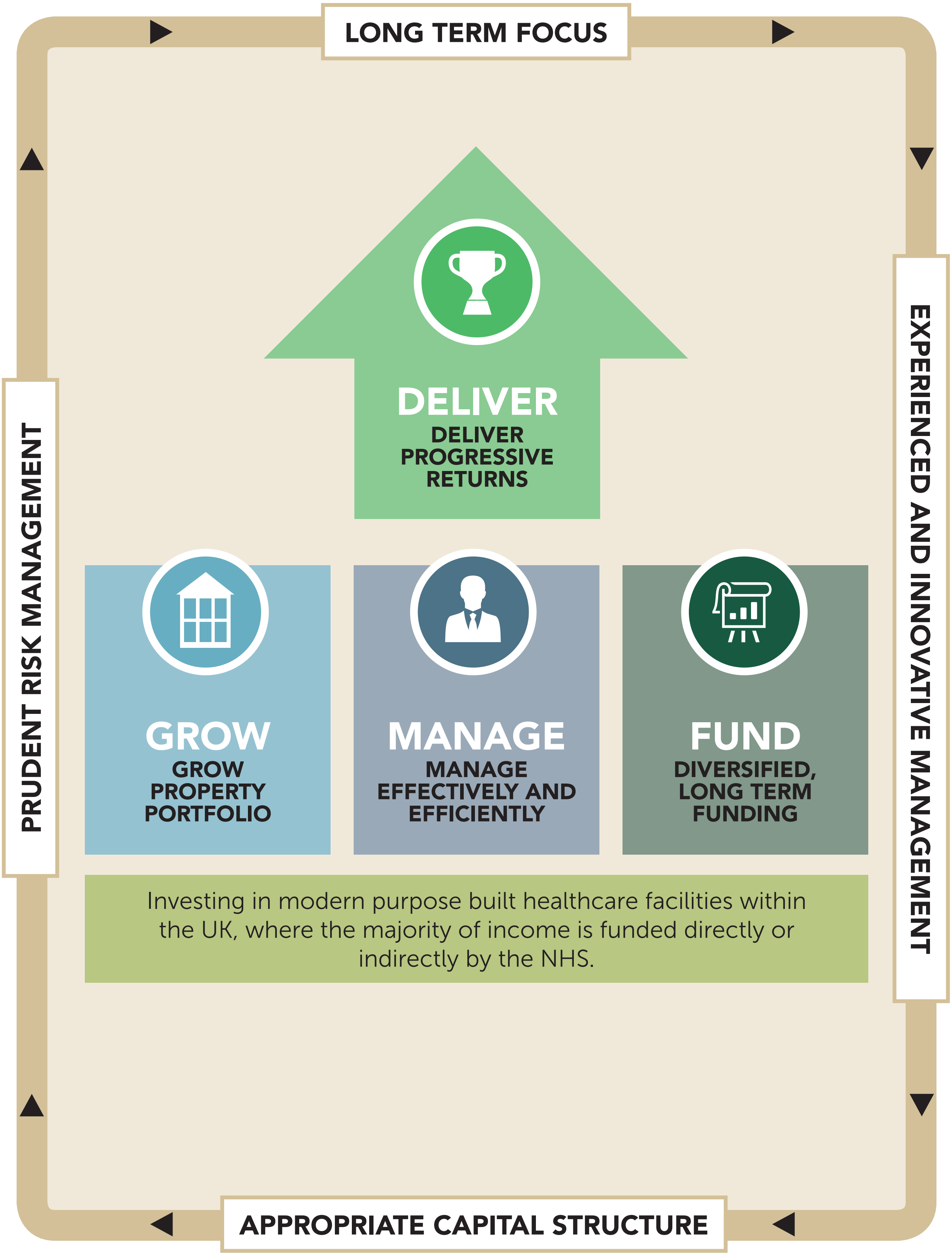
(iii) The Group finances its portfolio with a **diversified** mix of equity and debt, in order to optimise risk adjusted returns to shareholders. Debt facilities are arranged on both a secured and unsecured basis, provided by traditional bank lenders and debt capital markets and with a spread of maturities that ensures flexibility and availability over the longer term to match the longevity of income streams.

(iv) PHP recognises that effective management of risks faced by its business is key to its ability to achieve its strategic objectives. PHP takes a **long term view** of its business, in keeping with the strategic horizons of its tenants and length of its income streams. The portfolio is managed by an **experienced and innovative management team** and funded within an **appropriate capital structure**. Through a well-defined system of **robust risk management**, the Board monitors internal and external risks and actively manages the potential impact and possible opportunities they create.

## LEAP VALLEY MEDICAL CENTRE
BRISTOL

PHP forward funded the development of the new medical centre in Downend, Bristol. The medical centre completed in November 2014 and is fully let on a 21 year term to the GPs. The building is completed to a high standard replacing the former medical centre that was no longer fit for purpose; accommodation is arranged over two floors and includes a medical centre with ancillary pharmacy.

- Size: 794 sqm
- Built: November 2014
- Cost: £3.1m
- Tenants: GP practice, pharmacy
- Patient list size: 10,043


LONG TERM FOCUS
DELIVER
DELIVER PROGRESSIVE RETURNS
GROW
GROW PROPERTY PORTFOLIO
MANAGE
MANAGE EFFECTIVELY AND EFFICIENTLY
FUND
DIVERSIFIED, LONG TERM FUNDING
Investing in modern purpose built healthcare facilities within the UK, where the majority of income is funded directly or indirectly by the NHS.
EXPERIENCED AND INNOVATIVE MANAGEMENT
APPROPRIATE CAPITAL STRUCTURE
PRUDENT RISK MANAGEMENT

# MARKET BACKDROP

## OUR MARKET

PHP is a long term investor in modern purpose-built healthcare properties located within the UK. Tenants comprise of general practitioners, NHS organisations and other associated healthcare users, including on-site pharmacies.

## THE OPPORTUNITY

Primary care is the foundation of the NHS in the UK and the GP continues to be the first point of access to healthcare services for UK residents other than acute emergency care. More than 1.3 million patients visit their GP practice each day[1], representing 90% of all NHS patient contacts. The recent five year plan published by the NHS reiterated that "the foundation of NHS care will remain list-based primary care" and the provision of more GPs is a stated objective of each of the three main political parties.

The latest available data[2] shows that across the UK there are more than 43,000 GPs, operating within 9,700 partnerships. Alongside mostly GP occupied premises, there are a growing number of directly NHS tenanted primary care facilities that house outpatient departments, provide urgent care centres and other such services that are being relocated into the community which they serve.

The NHS England Five Year Plan commits to invest more in primary care and provide more services within the local community. Here, these services can be delivered more cost effectively and provide greater choice to the patient.

This change in delivery requires modern, purpose built flexible premises from which these services can be provided, whereas a large part of the primary care estate is comprised of ageing, converted residential properties with 40% of GPs seeing their properties as being inadequate for the provision of general practice services[3]. In December 2014, the Government announced £1.1 billion in funding over the next four years specifically to improve GP premises, but in order to fund the large scale investment that is required to properly modernise the primary care estate, investment capital from private sector investors such as PHP will be in demand.

## HUME STREET MEDICAL CENTRE
KIDDERMINSTER


The 2,387 sqm medical centre was acquired within a portfolio acquisition completed in August 2014. The property was built in 2012 and is let to GPs and a pharmacy with an unexpired lease term of 28 years. It is located near to Kidderminster town centre and is adjacent to Kidderminster Hospital.

- Size: 2,384 sqm
- Built: October 2012
- Cost: £11.0m
- Tenants: Two GP practices, pharmacy
- Patient list size: 25,493

## THE FUNDAMENTALS

**Patient driven demand**

The UK's population is growing and ageing. In 2013, the UK's population was 64.1 million, with 7.6 million people aged 70 or over[4]. The total population is projected to grow by 10% in the next 15 years, but the number over the age of 70 will grow by more than 45%. This will bring with it ever increasing and changing demands both in terms of providing the range of services needed by the population, but also in order to generate delivery efficiencies, for the continued viability of the NHS.

The policy of integrating of local authority social care and health and wellbeing services with primary care will only increase the need for further flexible, but community based premises.

**Strong property characteristics**

The primary care premises market is tightly controlled by the NHS, meaning there is **no speculative development** of new facilities. Structural changes in the NHS in 2013 have led to a significant reduction in the number of approvals since that time. Now that new management systems and processes have been put in place and with the announcement of additional funding, we anticipate an increase in new approvals in the near future.

Buildings are often located within residential areas which can lead to restricted alternative use potential. Against this, initial lease terms are longer than in general commercial markets, more than 20 years on average, have no break terms and benefit from a shorter rent review cycle, typically three yearly and in general on an upwards only basis.

A key feature of the sector is that GPs receive reimbursement for costs associated with their premises from the NHS, a practice that is set out in legislation. Where properties are leased from landlords such as PHP, a GPs rent and costs of maintaining and insuring the property are funded by the NHS. Together with leases direct to the NHS, the sector benefits from a very strong underlying rental covenant.

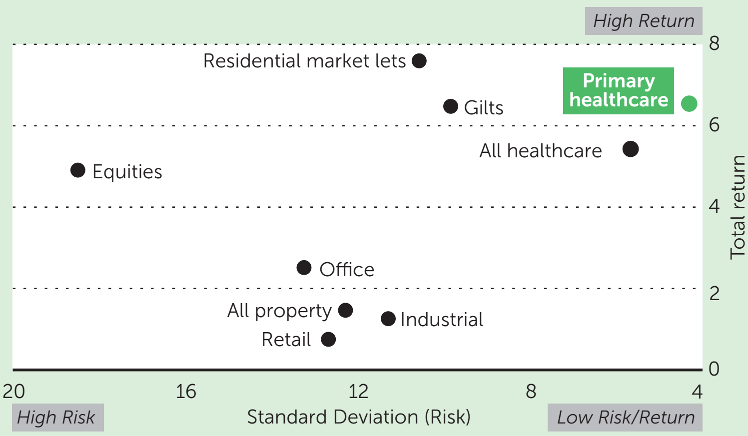
These factors combine to create a long term, low risk income environment where over the medium term, through a mix of indexed linked and open market review characteristics, rental growth has broadly tracked inflation.

## RETURNS

IPD established its Healthcare Property Index in 2007 which is published in March each year. The chart to the right shows how the primary healthcare real estate sector has produced superior returns over the life of the index. This reflects the low risk nature of its tenants and lower volatility in capital values underpinned by the long term nature of the income streams, generating a very compelling investment case.

**Risk reward spectrum**

Seven year total return versus standard deviation 2007-2013




Source: IPD

(1) Royal College of General Practitioners January 2015.
(2) Office for National Statistics.
(3) British Medical Association GP Committee Premises Survey.
(4) Office for National Statistics.

# BUSINESS REVIEW

## DELIVERING PROGRESSIVE RETURNS

In 2014, PHP continued to deliver on its overarching strategic aim of delivering progressive returns to shareholders. It has met its operating objectives of:

(i) acquiring modern healthcare premises
(ii) investing in its existing property assets to generate additional income and enhance value
(iii) managing operating costs to make the Group more efficient
(iv) securing capital resource to provide a strong longer term base from which to invest, whilst ensuring that the average cost of debt is effectively managed.

We have achieved our objective of increasing earnings and as a result dividend cover. This was whilst paying a modestly increased dividend, but on a much larger number of shares in issue compared to that of 2013.

**Earnings**

The Group's earnings were significantly increased by the impact of the transactions completed in late 2013 and through 2014. The PPP portfolio produced a total of £14.8 million of rental income in the year, helping to increase rents received by 42.5% to £59.3 million (2013: £41.6 million). Reductions in advisory and management fee rates and the average cost of the Group's debt finance further improved earnings performance. Group profit before tax rose by 82.7% to £36.9 million (2013: £20.2 million).

Total dividends paid in the year increased by 2.6% to 19.5 pence per share (2013: 19.0 pence), but the increase in Group earnings saw dividend cover rise to 84%. This is a significant increase over that of 2013, of 57%, and a significant step forward towards reaching 100% cover.

**Summarised results**

| | 2014 £m | 2013 £m |
|---|---|---|
| Net rental income | 59.3 | 41.6 |
| Administrative expenses | (6.8) | (6.1) |
| **Operating profit before revaluation gain and financing** | 52.5 | 35.5 |
| Net financing costs | (34.3) | (26.0) |
| Non-recurring operating costs[1] | - | (2.7) |
| **EPRA earnings** | 18.2 | 6.8 |
| Net result on property portfolio | 29.2 | 2.3 |
| Profit on sale of finance lease | - | 0.6 |
| Early loan repayment fee | (1.2) | (0.9) |
| Fair value (loss)/gain on interest rate derivatives | (2.4) | 11.4 |
| Fair value loss on convertible bond | (4.5) | - |
| Non-recurring: convertible bond issue costs | (2.4) | - |
| **IFRS profit before tax** | 36.9 | 20.2 |
| **EPRA earnings per share** | 16.4p | 7.6p |

(1) JOHCM contractural termination fee

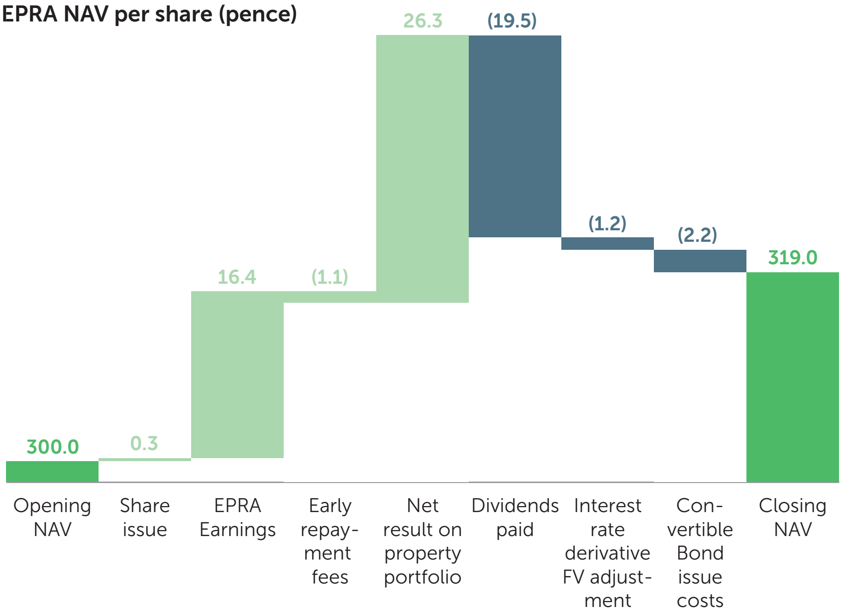
**Shareholder Value**

The characteristics of the Group's property portfolio with its longevity and security of income have made healthcare real estate more attractive to real estate investors, particularly those looking for consistent yield. The revaluation of the Group's property portfolio at 31 December 2014 produced a net surplus of £29.2 million.

As is required by accounting standards, the total issue costs of the convertible bond issued in the year, £2.45 million, have been fully expensed and the Group incurred other early repayment charges related to the refinance of the PPP debt of £1.2 million.

The net effect of the above has been an overall increase in EPRA Net Asset Value per share of 19.0 pence. Including the dividend paid in 2014, Total NAV Return for the period was 38.5 pence per share or 12.8% (2013: 4.6%).

**EPRA NAV per share (pence)**




**EPRA EARNINGS PER SHARE**

**16.4p**

**116%** INCREASE

**DIVIDEND PER SHARE**

**19.5p**

**2.6%** INCREASE

**EPRA NAV PER SHARE**

**319p**

**6.3%** INCREASE

**TOTAL NAV RETURN**

**38.5p**

**12.8%** INCREASE

BUSINESS REVIEW (CONTINUED)

## GROW PROPERTY PORTFOLIO

As at 31 December 2014, the Group held a total of 265 property assets, with 260 completed and five on-site, under construction. The entire portfolio was independently valued by Lambert Smith Hampton ("LSH"), at market value in accordance with RICS rules. This totalled £1.04 billion including commitments, generating a surplus of £29.2 million, after the effect of the total costs of assets purchased and asset management projects undertaken in the period. This surplus, equivalent to 26.3 pence per share, is an increase of 8.8% on opening EPRA NAV per share of 300 pence per share at the start of 2014.

**Portfolio valuation and performance**

| | 2014 £m | 2013 £m |
|---|---|---|
| Investment properties | 1,002.4 | 929.9 |
| Properties in the course of development | 23.9 | 11.7 |
| Total properties at 31 December 2014 | 1,026.3 | 941.6 |
| Cost to complete development commitments | 11.2 | 17.1 |
| Total completed and committed | 1,037.5 | 958.7 |

Yields in the property sector in general have tightened considerably through 2014. Prime real estate markets have seen heightened investor appetite as confidence has returned with the improved performance of the UK economy and the emergence of rental growth in some sectors. Institutional investors have also looked more closely at alternative real estate classes and we have seen increased competition for assets that have longer lease terms with fixed or index linked rent review terms, particularly those that are larger lot sizes.

With the underlying characteristics of our sector and our largest income source, the NHS (directly or indirectly), being unchanged, a movement in yields in the primary care real estate sector has occurred but has been less pronounced than for commercial propery generally. This underpins the attractiveness of the sector with PHPs portfolio reflecting an average net initial yield of 5.52% (2013: 5.65%) and a true equivalent yield of 5.75% (2013: 5.92%).

The table below shows the total property return for periods ended 31 December 2014. TPR represents the sum of net rental income and valuation movement for the respective periods.

| | One year | Three years | Five years |
|---|---|---|---|
| Primary Health Properties | 8.9% | 7.1% | 8.3% |
| IPD All Property Index | 18.6% | 7.3% | 8.0% |

As in prior years, IPD will also prepare a Healthcare Property Index enabling a more bespoke benchmarking of PHP's performance to its direct peers. This will again be published in February/early March 2015 and we will report our relative performance with our interim statement.

Following an exceptional period of activity in 2013, the Group added seven properties to its portfolio in the year, comprising three standing let investments and four development assets. These added £2.4 million of additional rent and an average of 24 years of unexpired lease term.

| Asset | Acquisition basis | Acquisition cost | Size | WAULT at acquisition/on completion |
|---|---|---|---|---|
| Pharmacy unit, Albany Surgery, Newton Abbot | Completed investment | £1.6 million | 753 sqm | 18 years |
| Hume Street Medical Centre, Kidderminster | Completed investment | £11.0 million | 2,387 sqm | 28 years |
| South Petherton Medical Centre, Somerset | Completed investment | £2.6 million | 916 sqm | 18 years |
| The Fountains Health Centre, Chester | Development asset | £18.5 million | 5,754 sqm | 25 years |
| Caia Park, Wrexham | Development asset | £2.2 million | 850 sqm | 20 years |
| Hope Primary Care Resource Centre, Wrexham | Development asset | £3.4 million | 1,793 sqm | 20 years |
| Crown Medical Centre, Clipstone | Development asset | £3.7 million | 1,016 sqm | 25 years |

We took delivery of five previously contracted and let assets in the year, following completion of their construction by our development partners. We work closely with a number of specialist healthcare developers where our combined reputation, knowledge and experience of the sector plays a key role in securing new projects. We provide support to other developers who may be undertaking a primary care development for the first time or as part of a larger regeneration or development scheme.

In all instances, we work with our development partners, the GPs and the NHS who will be our longer term customers to ensure that we are delivering a property that meets their needs and provides flexibility for reconfiguration or expansion at any time in their occupation.

As at 31 December 2014, the Group's contracted rent roll had increased by 5.7% to £60.9 million (31 December 2013: £57.6 million). More than 90% of rental income is funded directly or indirectly by the NHS and the portfolio has an average unexpired lease term of 15.3 years (2013: 15.7 years).

**TOTAL CAPITAL VALUE**

**£1.04bn**

8.2%
INCREASE

**REVALUATION SURPLUS**

**£29.2m**

26.3
PENCE PER SHARE

**CONTRACTED RENT ROLL**

**£60.9m**

5.7%
INCREASE

**WAULT**

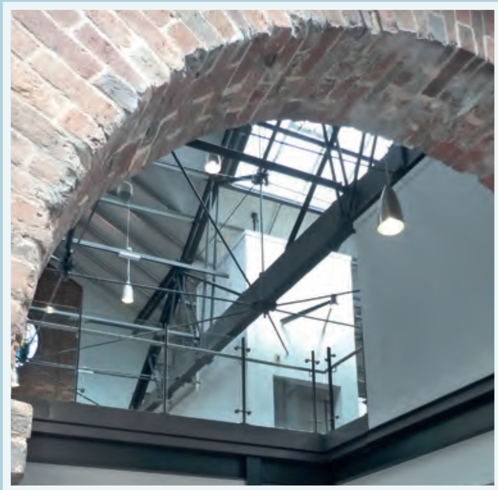
**15.3 YEARS**

2013: 15.7 YEARS

## LION MEDICAL CENTRE
### STOURBRIDGE

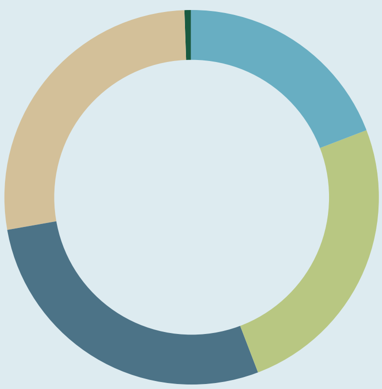
A substantial newly developed two storey medical centre incorporating the conversion of a listed foundry building that houses half of the lettable space. The property was completed in March 2014 and houses a 10 GP practice and pharmacy unit.

» Size: 2,600 sqm
» Built: 2014
» Cost: £8.5 million
» Patient list size: 29,500
» Tenants: GP practice and pharmacy



## ANALYSIS OF PORTFOLIO BY CAPITAL VALUE OF BUILDING

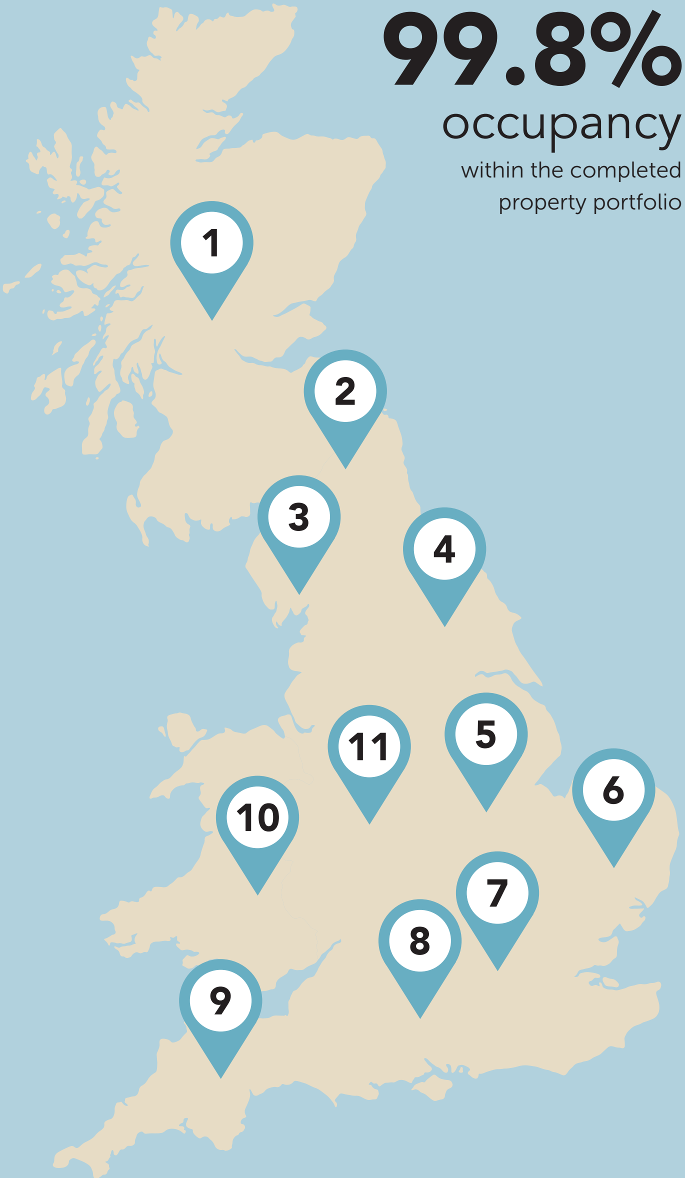
Average lot size within the portfolio grew to £3.9 million (2013: £3.7 million)



| Capital value | Number[1] | Value £m[2] | Proportion 2014 | Proportion 2013 |
|---|---|---|---|---|
| £0-£1 million | 3 | 2.7 | 0.3% | 0.3% |
| £1-£3 million | 133 | 284.2 | 27.4% | 30.1% |
| £3-£5 million | 77 | 290.4 | 28.0% | 27.4% |
| £5-£10 million | 39 | 260.9 | 25.1% | 26.6% |
| £10 million + | 13 | 198.8 | 19.2% | 15.6% |
| **Total** | **265** | **1,037.0** | **100.0%** | **100.0%** |
| **Average lot size 2014** | | **3.9** | | |

(1) Including development commitments. (2) Including values of land plots

# PROPERTY PORTFOLIO




**99.8%**
occupancy
within the completed property portfolio

## 1 SCOTLAND

| | |
|---|---|
| 29 properties | £131.9m capital value |
| 53 tenancies | £7.9m rent roll |

## 2 NORTH

| | |
|---|---|
| 22 properties | £66.9m capital value |
| 42 tenancies | £3.9m rent roll |

## 3 NORTH WEST

| | |
|---|---|
| 28 properties | £124.0m capital value |
| 56 tenancies | £7.6m rent roll |

## 4 YORKSHIRE & HUMBERSIDE

| | |
|---|---|
| 20 properties | £82.1m capital value |
| 42 tenancies | £4.9m rent roll |

## 5 EAST MIDLANDS

| | |
|---|---|
| 19 properties | £78.7m capital value |
| 39 tenancies | £3.9m rent roll |

## 6 EAST ANGLIA

| | |
|---|---|
| 7 properties | £16.9m capital value |
| 11 tenancies | £1.0m rent roll |

## 7 LONDON

| | |
|---|---|
| 10 properties | £44.8m capital value |
| 15 tenancies | £2.3m rent roll |

## 8 SOUTH EAST

| | |
|---|---|
| 61 properties | £187.2m capital value |
| 124 tenancies | £11.7m rent roll |

## 9 SOUTH WEST

| | |
|---|---|
| 14 properties | £42.6m capital value |
| 23 tenancies | £2.3m rent roll |

## 10 WALES

| | |
|---|---|
| 21 properties | £93.8m capital value |
| 74 tenancies | £5.6m rent roll |

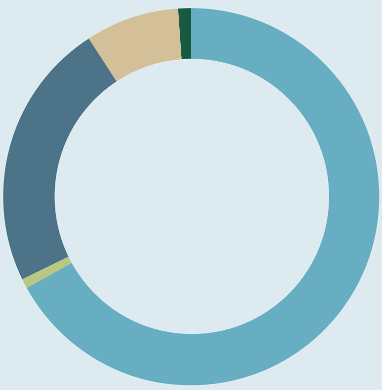
## 11 WEST MIDLANDS

| | |
|---|---|
| 29 properties | £134.2m capital value |
| 72 tenancies | £7.8m rent roll |

## COVENANT ANALYSIS BY ANNUAL RENT

91% of the Group's rent roll is paid directly or indirectly by the Government.

- GPs **67%**
- HM Govt **1%**
- NHS **23%**
- Pharmacy **8%**
- Other **1%**



BUSINESS REVIEW (CONTINUED)

## MANAGING EFFECTIVELY AND EFFICIENTLY

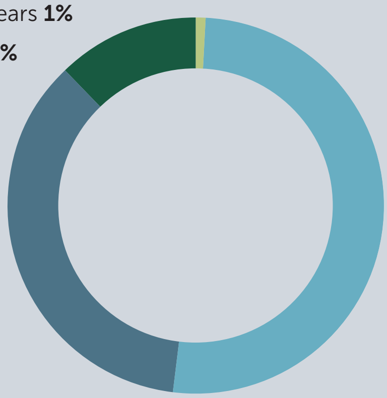
Once an asset is completed and rent producing, we implement our property and asset management strategies. These relate to both a high standard of ongoing maintenance and the longer term configuration and suitability of the premises in order that they continue to meet the needs of our tenants.

The Adviser, Nexus, is responsible for ensuring that PHP meets its obligations as Landlord at each of its assets. In addition, Nexus provides a service to tenants that offers advice and assistance where the tenant itself maintains a building. This includes regular meetings with our tenants in addition to a telephone helpdesk facility and online tools with repairs and maintenance advice.

Each occupational lease will include a periodic review of rental levels. 10% are performed annually, 76% on a three yearly basis and 13% being reviewed every five years. Most leases in the PHP portfolio have either explicit or effectively upwards only review terms (i.e. where the review is triggered by the landlord only). Just over a fifth, 23% of leases have fixed periodic rental uplifts or increases that are formally indexed linked, mostly in line with RPI. The most common review is undertaken to "open market".

### ANALYSIS OF ANNUALISED RENT BY UNEXPIRED LEASE TERM

48% of occupational leases have an unexpired term of 15 years or longer. The weighted unexpired average lease term (including commitments) is 15.3 years (2013: 15.7 years).




## TODDINGTON MEDICAL CENTRE
BEDFORDSHIRE


£0.38m extension of a GP Practice and the creation of a new pharmacy unit. The GPs were interested in new consulting rooms for current and additional services which the NHS could not afford. By bringing pharmacy to site we were able to develop new accommodation for the GPs. All leases were re-geared to 24 years. This shows additional rental income of around £24,000 p.a.

We have continued to secure satisfactory rental growth on review, with the weighted average uplift on 135 reviews completed in 2014 being 1.8% per annum. This is slightly reduced from that achieved in 2013 of 2.2% and reflects both the recent economic conditions and new centre approvals by the NHS which normally provide more immediate support for current rental levels. We expect to see rental growth at similar levels for the immediate future, but to increase as the rate of new development approvals increase.

We work closely with each of our tenants to ensure that over the longer term their property continues to be fit for purpose and offers the flexibility to be adapted and/or extended to meet the aspirations and changing demands put upon primary care providers.

This ensures that we retain our tenants and enables us to increase contracted rental income and lengthen occupational lease durations which add to both earnings and capital value. Projects take a number of forms that include:

- capital expenditure, ranging from small extensions to major construction projects; and
- managing existing leases through re-gearing or refurbishment and planned or specific maintenance programmes.

In 2014, PHP completed eight projects, investing a total of £4.4 million. These generated total additional rental income of £0.3 million, adding an average 15.7 additional years to the unexpired lease term and producing an aggregated 42% valuation gain on capital spent.

Two further projects are currently in progress, which will cost a total of £2.1 million. These will generate £0.2 million of additional rent for an average additional term of 20 years, a valuation surplus of 35% over the capital invested.

The Board continues to employ Nexus to source new investment opportunities and manage the Group's property portfolio. Nexus receives a fee based on a proportion of the gross value of the Group's property assets with the incremental rate reducing as the portfolio grows. Further reductions were made to fee rates with effect from May 2014 in anticipation of the portfolio exceeding £1 billion in value.

On 1 May 2014, Nexus assumed responsibility for the administration of the Group and provision of Company Secretarial services. Fees that had been paid to the previous administrator were contractually calculated as a proportion of gross property asset value, but Nexus receives a greatly reduced fixed annual fee that may be varied upwards or downwards in line with RPI.

The net impact of these changes was to lower the fees paid by the Group to its Advisers (Nexus and JOHCM[1]) to an average of 55 basis points of gross assets, a 22.5% reduction on 2013 when this average was 71 basis points. Including other overhead costs, the Group's total expense ratio reduced to 69 basis points (2013: 88 basis points).

**RENTAL GROWTH ON REVIEW**

**1.8% p.a.**

**£0.6m p.a.**

ADDITIONAL RENT

**CAPITAL PROJECTS**

**£4.4m**

INVESTED

**£0.3m**

ADDITIONAL RENT

AVERAGE OF
15.7 YEARS
ADDITIONAL WAULT

**TOTAL EXPENSE RATIO**

**69 BASIS POINTS**

**FOR THE YEAR**

**19 BASIS POINTS**

REDUCTION

(1) JOHCM provided administrative and company secretarial services for periods to 30 April 2014.

## DIVERSIFIED, LONG TERM FUNDING

The Board seeks to fund the Group with an appropriate combination of shareholder equity and external debt to enhance the returns that are generated. A key objective is to ensure that facilities continue to be available to the Group to enable continued growth, for a range of maturities at an appropriate blended cost and from a range of sources.

As part of the acquisition of the PPP portfolio in December 2013 the Group assumed £178 million of existing Aviva debt secured on those assets. It was the Board's intention to refinance the debt and an allowance of £13.7 million toward the cost of this was made in the acquisition pricing. This debt was fully refinanced during 2014 by the completion of a number of transactions as set out below.

In February, the purchase provision was utilised to re-set the interest rate on the PPP Aviva allowance loans to 5.04% from the average upon purchase of 5.9%. This interest rate was applied from 1 January 2014. A capital repayment of £15 million was also made at this time, funded from the Group's available headroom on existing facilities.

In April, a new £50 million, five year revolving debt facility was completed with HSBC Bank plc at an initial margin of 200 basis points over LIBOR. The first drawing from the HSBC facility upon its completion was used to repay £25 million of the outstanding PPP Aviva debt. A further £25 million of the PPP Aviva debt was repaid in April following the transfer of applicable collateral from Aviva to existing Group facilities.

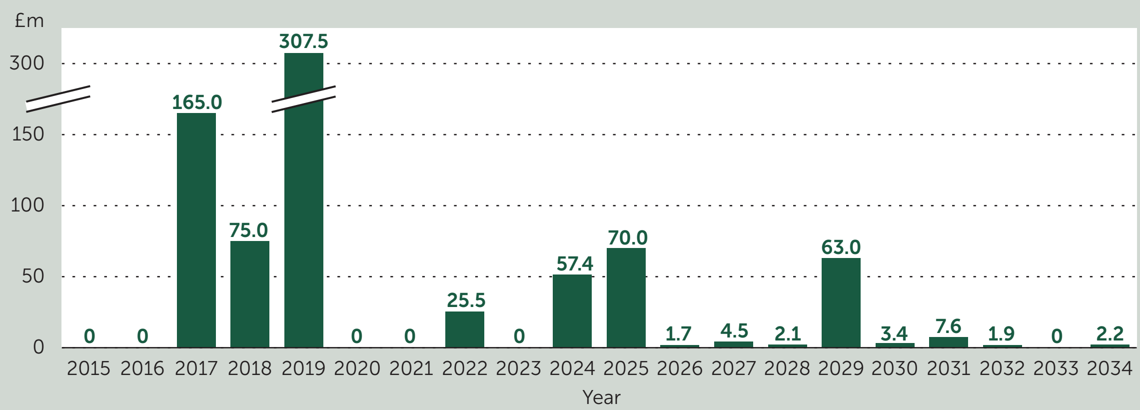
The Group successfully issued an £82.5 million unsecured convertible bond on 20 May 2014, which it listed on the Channel Islands Stock Exchange. The unsecured bond is for a five year term with coupon of 4.25% per annum payable semi-annually. The initial conversion price applicable to the bond is 390 pence per share, a premium of 16% to the volume weighted share price on the day of pricing. The unsecured nature of this funding will increase the flexibility of the Group in structuring more traditional secured debt and allowed overall costs to be reduced as highlighted below.

The remaining £113 million of PPP debt was refinanced with Aviva in August with the creation of two facilities. These comprised a £50 million, 10 year interest only bullet repayment facility and a £63 million 15 year loan, interest only for five years with an element of amortisation from year six onwards and a further bullet repayment. Both loans carry a fixed interest rate of 4.91% for their duration, further reducing the interest cost to the Group.

Two further amendments to the Group's debt portfolio were completed in August 2014:

- the loan with Barclays Bank PLC was increased by £30 million to an overall £100 million facility, consisting of a £40 million term loan and a £60 million revolving facility. This was agreed for a new five year term and the interest margin reduced from 220 basis points to an initial 170 basis points, and
- the Group's £165 million Club facility with Royal Bank of Scotland and Santander was re-advanced for a new

### DEBT MATURITY PROFILE



three year term, an additional 18 months on the original term. PHP used an element of the proceeds from the convertible bond, to lower the LTV within this facility and secure a reduction in the lending margin for this debt by 65 basis points to 185 basis points.

The principal value of debt drawn as at 31 December 2014 totalled £670.1 million. After Group cash balances of £12.0 million, Group net debt stood at £658.1 million. Allowing for funding the cost to complete development commitments at the year end of £11.2 million, headroom on existing facilities of £116.7 million was available to the Group (2013: £67.2 million).

Group loan to value ("LTV") was 64.1% (31 December 2013: 61.6%) with interest cover for the year being 1.73 times (2013: 1.60 times). Certain debt facilities include a covenant requiring Group interest cover not to be less than 1.3 times, which has been met throughout 2014.

The average maturity of the Group's debt facilities as at 31 December 2013, excluding the PPP loans was 5.8 years. The transactions set out above have increased the weighted average facility maturity to 6.2 years at the balance sheet date.

Unsecured debt facilities now represents 24% of the Group's debt portfolio. Total debt comprises a mix of fixed and variable rate facilities and in order to mitigate the risk of increases in market interest rates, the Group holds a portfolio of interest rate derivative contracts (see Note 18 for details).

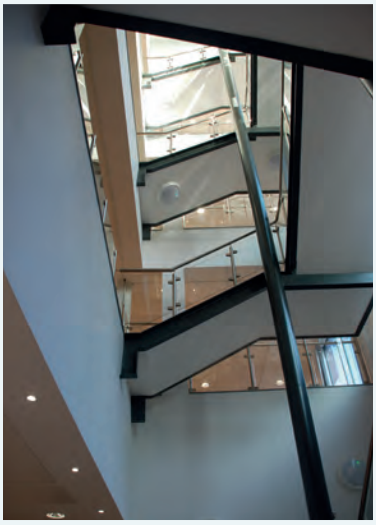
An analysis of the Group's exposure to interest rate risk is as follows:

| | Facilities £m | Facilities % | Drawn £m | Drawn % |
|---|---|---|---|---|
| Fixed rate debt | 395.9 | 50.4 | 395.9 | 59.1 |
| Debt hedged by interest rate swaps/caps | 221.0 | 28.1 | 221.0 | 33.0 |
| Floating rate debt | 169.0 | 21.5 | 53.2 | 7.9 |
| Total | 785.9 | 100.0 | 670.1 | 100.0 |

**NET DEBT**
**£658.1m**
2013: £579.7m

**AVERAGE FACILITY MATURITY**
**6.2 YEARS**
2013: 5.8 YEARS

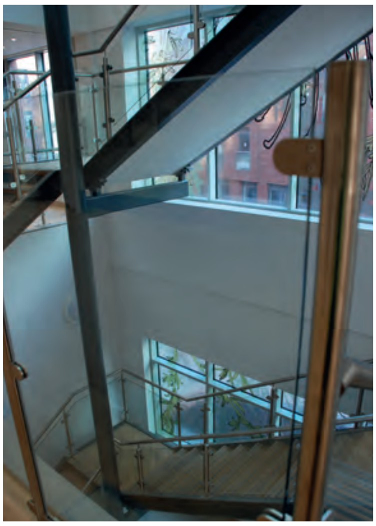
**LOAN TO VALUE**
**64.1%**
2013: 61.6%



## THE FOUNTAINS HEALTH CENTRE
CHESTER

The Fountains Health Centre is a fully integrated health centre located in the historical city of Chester. It is part of a mixed use scheme with residential apartments, offices, retail and public car park due to complete in Quarter 1 2015. PHP has forward funded the healthcare element of the scheme which will be let for a term of 25 years.

» Size: 5,754 sqm
» Built: Target completion Q1 2015
» Cost: £18.5m
» Tenants: Four GP practices, physiotherapy suite, podiatry suite and a pharmacy.



# APPROACH TO RISK MANAGEMENT

The Board regularly reviews and monitors the risks facing the Group. Effective risk management is a key element of the Board's operational processes, impacting on decision making so as to ensure that risks that are accepted are appropriate to the returns they may generate and within the overall risk appetite of the Board. The Group aims to operate in a relatively low risk environment, appropriate for its strategic objective of generating progressive returns for shareholders.

The Board has overall responsibility for effective risk management across the Group. The Audit Committee is delegated responsibility for reviewing the Group's systems of risk management on behalf of the Board. The Adviser is delegated responsibility for assessing and monitoring operational and financial risks and has in place robust systems and procedures to ensure this is embedded in its approach to managing the Group's portfolio and business.

The Adviser has established a wide ranging system of internal controls and operational procedures that are designed to manage risk as effectively as possible, but it is recognised that risk cannot be totally eliminated.

The Adviser has established a Risk Committee that is formed of members of its senior management team. The chairman of the Adviser's Risk Committee is independent of both the Adviser and the Group and experienced in the operation and oversight of risk management processes. The Adviser's Risk Committee reports on its processes of risk management and the rating of risks it identifies to the Audit Committee, who agrees those risks that will be managed by the Adviser and those where the Board will assume direct responsibility for management and monitoring.

Key risks are recorded in a Risk Register and owned by the Board which is responsible for overseeing the monitoring and mitigation of that risk.

The Board recognises that it has limited ability to control a number of the external risks that the Group faces, such as Government policy, but keeps the possible impact of such risks under review and considers them as part of its decision making process.

# RISK MANAGEMENT

| Strategic Objective | Risk | Change to risk rating in 2014 |
|---|---|---|
| **DELIVER** DELIVER PROGRESSIVE RETURNS | PHP invests in a niche asset sector where a change of Government policy with regard to primary care may adversely affect the Group's portfolio and performance. | Unchanged |
| | Negatively changing economic conditions could lead to a decline in the attractiveness of the Group's assets compared to other investment classes. | Reduced |
| **GROW** GROW PROPERTY PORTFOLIO | The development of new properties is tightly controlled by the NHS. Recent structural changes have slowed the level of approvals and may be further impacted by the upcoming General Election, so restricting the ability of the Group to secure new investments. | Increased |
| | The Group uses a mix of shareholder equity and external debt to fund its operations. A restriction on the availability of funds would limit the Group's ability to invest. | Reduced |
| **MANAGE** MANAGE EFFECTIVELY AND EFFICIENTLY | The bespoke nature of the Group's assets can lead to limited alternative use. Their continued use as fit for purpose medical centres is key to delivering on the Group's strategic objectives. | Unchanged |
| | The Group has no employees. The continuance of the Adviser contract is a key for the efficient operation and management of the Group. | Unchanged |
| **FUND** DIVERSIFIED, LONG TERM FUNDING | Without appropriate confirmed debt facilities, PHP may be unable to meet current and future commitments or repay or refinance debt facilities as they become due. | Unchanged |
| | Adverse movement in underlying interest rates could adversely affect the Group's earnings and cash flows. | Reduced |

| Factors affecting risk in the year | Mitigation | Further information |
|---|---|---|
| NHS budgets have been ring fenced by the Government. The major political parties have confirmed their commitment to the NHS, increasing primary care provision and moving services into the local community. | The Board includes members experienced and active in primary care provision. Management regularly engages with the NHS and government directly to promote the continued investment in primary care and modern premises. | See page 10 |
| The UK economy has performed well in 2014, boosting confidence and leading to valuation growth in property sectors. The attractiveness of the long term, growing income streams of our sector leads to stability of values. | The Board and Adviser focus on keeping lease terms as long as possible, identifying opportunities to generate additional income and valuation stability. | See page 11 |
| The sector has seen a limited number of new development approvals through 2014. This has limited the number of investment opportunities for the Group. | The Group has a number of formal pipeline agreements and long standing development relationships that provide an increased opportunity to secure those developments that come to market. The reputation and track record of the Group in the sector means it is able to source investment in existing standing investments from investors and owner occupiers. | See page 14 |
| There has continued to be a healthy appetite from both equity investors and debt providers to fund the sector through 2014. There has been a number of new providers to the sector in the year. | The Board monitors its capital structure and maintains regular with contact funders. A programme of meetings with existing and potential equity investors is supported by regular discussions with debt providers. | See page 20 |
| As the Group's portfolio grows in the number of assets that it owns and initial lease terms erode, the importance of active management to extend the use of a building is increased. | The Adviser meets with all of the Group's occupiers on at least an annual basis to discuss the building and the tenant's aspirations and needs for their future occupation. The Group is experienced in identifying and implementing asset management projects that enhance income and values at properties and extend occupational lease terms. | See page 18 |
| The provision of administrative and company secretarial services was consolidated with the Adviser in the year, significantly reducing the costs of these services. The consolidation removed execution risk arising from the previous split responsibilities of joint advisers. | The Advisory Agreement with and performance of Nexus is regularly reviewed. Nexus remuneration is linked to the performance of the Group to incentivise long term levels of performance.<br>Nexus can be required to serve all or any part of its notice period should the Group decide to terminate providing protection for an efficient handover. | See page 31 |
| The Group has been successful in extending the availability and widening the sources from which it obtains debt funds in the year. New entrants to the debt capital markets have increased available resource.<br>The Group has increased to proportion of its facilities advanced on an unsecured basis. | Management constantly monitors the composition of the Group's debt portfolio to ensure compliance with covenants and continued availability of funds.<br>The Adviser regularly reports to the Board on current debt positions and provides projections of future covenant compliance to ensure early warning of any possible issues. | See page 20 |
| Competition in debt markets has increased during the year lowering the cost of new facilities.<br>The Group has continued to apply its defined policy as regards mitigating interest rate risk. | The Group retains a proportion of its debt on a long term, fixed rate basis. It also mitigates its exposure to interest rate movements on floating rate facilities through the use of a series of interest rate swaps and other derivative instruments. | See page 20 |

# KEY ASSETS

## ST CATHERINE'S HEALTH CENTRE
BIRKENHEAD

Acquired within the PPP portfolio in December 2013, this facility occupies the site of the former St Catherine's Hospital which has been delivering healthcare on the Wirral for over 150 years.

- Size: 4,614 sqm
- Built: 2012
- Tenants: Two GP practices, NHS Trust, Pharmacy
- WAULT: 28 years
- Patient list size: 15,352



## VICTORIA CENTRAL HEALTH CENTRE
WALLASEY

- Size: 4,904 sqm
- Built: 2008
- Tenants: Three GP Practices, NHSPS, Pharmacy
- WAULT: 19 years
- Patient list size: 14,600

## NAIRN HEALTH CENTRE NAIRN

- Size: 4,977 sqm
- Built: 2009
- Tenants: Two GP Practices, Local Council
- WAULT: 21 years
- Patient list size: 14,475

## LYNG CENTRE
WEST BROMWICH

- Size: 5,630 sqm
- Built: 2005
- Tenants: Four GP Practices, NHSPS, Pharmacy
- WAULT: 15 years
- Patient list size: 20,722

## LINKS HEALTH CENTRE
MONTROSE

- Size: 4,001 sqm
- Built: 2003
- Tenants: Three GP Practices, NHS Trust
- WAULT: 10 years
- Patient list size: 17,152

## ROTHERHAM COMMUNITY HEALTH CENTRE
ROTHERHAM

- Size: 4,636 sqm
- Built: 2008
- Tenants: NHSPS
- WAULT: 14 years
- Patient list size: 1,475*

## FORT WILLIAM HEALTH CENTRE
FORT WILLIAM

- Size: 4,468 sqm
- Built: 2007
- Tenants: Three GP Practices, Scottish Ministers, Pharmacy
- WAULT: 12 years
- Patient list size: 14,020

## PORT TALBOT RESOURCE CENTRE
PORT TALBOT

- Size: 3,934 sqm
- Built: 2009
- Tenants: Four GP Practices, Local Health Board, Council, Pharmacy
- WAULT: 15 years
- Patient list size: 28,289

## CONNAH'S QUAY RESOURCE CENTRE
CONNAH'S QUAY

- Size: 3,595 sqm
- Built: 2010
- Tenants: Three GP Practices, Local Health Board, Council, Pharmacy
- WAULT: 16 years
- Patient list size: 14,383


## PROSPECT HOUSE KETTERING

- Size: 3,667 sqm
- Built: 2008
- Tenants: GP Practice, Pharmacy
- WAULT: 17 years
- Patient list size: 14,765

* walk in centre

# ENVIRONMENTAL AND SOCIAL ISSUES

## ENVIRONMENTAL CONSIDERATIONS

Properties in the sector are specified to meet the NHS's exacting standards with regard to environmental considerations. Environmental matters are an integral element of PHP's assessment of the suitability of new medical centres that the Group looks to fund and acquire.

PHP undertakes an assessment of environmental risk as an important element of its due diligence process, obtaining an environmental desktop study and energy performance certificates ("EPC"). PHP has engaged an Environmental Consultant, Collier & Madge, to help in this process.

PHP engages with its development partners to promote the highest possible standards of environmental performance when designing and constructing new premises. As a minimum, new properties are required to achieve a BREEAM "Excellent" rating, but where possible the aim is to exceed this. Ongoing environmental responsibilities are included in the leases entered into by the occupational tenants as a norm for newly built premises. 100% of the newly completed assets delivered in 2014 held an EPC with a rating of B or better.

Where PHP acquires already completed assets, however, its ability to influence energy efficiency is limited. In these instances and for existing assets within its portfolio, PHP will assess the opportunities to improve the environmental efficiency of a property and work with its tenants to improve the environmental performance of an asset with enhancements such as the installation of solar panels.

PHP is committed to the principles of continuous improvement in managing environmental issues, including the proper management and monitoring of waste, the reduction of pollution and emissions, and compliance with environmental legislation and codes of practice. PHP works with its development partners, tenants and other stakeholders to develop ways in which to monitor and improve the management of such issues.

## SOCIAL IMPACT

PHP's aim is to modernise and improve the ability to provide efficient and effective healthcare in the UK through the provision of modern, purpose built properties, let to GPS, the NHS and other healthcare operators. The facilities are predominantly located within residential communities and enable the UK population to access better health services in their local area. This is central to the organisation's strategic objectives and business planning processes.

PHP is committed to ensuring that the properties it develops and owns both meet NHS requirements and also provide flexibility for future change, update and expansion. When working with its partners to develop a new healthcare property, PHP's appraisal of a project will include a review of matters such as:

- **Location:** looking at the sustainable nature of a site and how it will serve the local population,
- **Importance to the local healthcare provision:** ensuring that the centre is affordable and that the centre meets the needs of the local healthcare demand,
- **Flood risk:** to ensure the risk is avoided or appropriate prevention measures are developed,
- **Design standards and environmental responsibility:** a review of a project to ensure that it conforms from a design and environmental standpoint with applicable requirements.

Ongoing active management of the property portfolio seeks to maintain the centres as fit for purpose, minimise obsolescence and provide for repairs and maintenance to be undertaken efficiently, so as to minimise both cost and pollution.

PHP is a founder member of the Social Stock Exchange ("SSE") which was formed on 6 June 2013. The SSE provides a platform for the promotion of businesses who have a focus on their social and environmental impact. There is a stringent admission policy where member companies set out their objectives, policies, monitoring procedures and reporting measures which are updated annually in the form of an Impact Report.

Social impact consideration and management sits at the heart of the management of the Group and is directly reviewed by the Board. Systems have been established to ensure that PHP is properly monitoring its social impact and identifying and managing opportunities and risks associated with the provision of its properties. Where possible, data is collected that evidences PHP's impact against set measures, such as continuing to obtain energy certificates for properties within PHP's portfolio. Ongoing activity also includes regular engagement with key stakeholders, for example, to assess their experience of working in or visiting a PHP centre so as to identify opportunities to enhance the facilities or address issues that may arise.

# OUTLOOK

**HARRY HYMAN**
Managing Director

We have delivered greatly improved performance in 2014, through earnings and valuation growth, significantly rebuilding dividend cover. As we move into 2015, we have continued to grow the Group's property portfolio through prudent acquisitions and development funding and to secure further enhancement and extension projects driving additional income and asset value from existing owned properties.

Property markets have thrived in the last 12 months with a weight of capital seeking quality assets and in particular longer dated income streams. We will seek to add further assets but will do so where the underlying fundamentals meet our exacting criteria and where properties offer the potential for both income and capital growth. Our acquisition pipeline includes a mix of investment and development opportunities which will generate rental surpluses that will increase Group earnings.

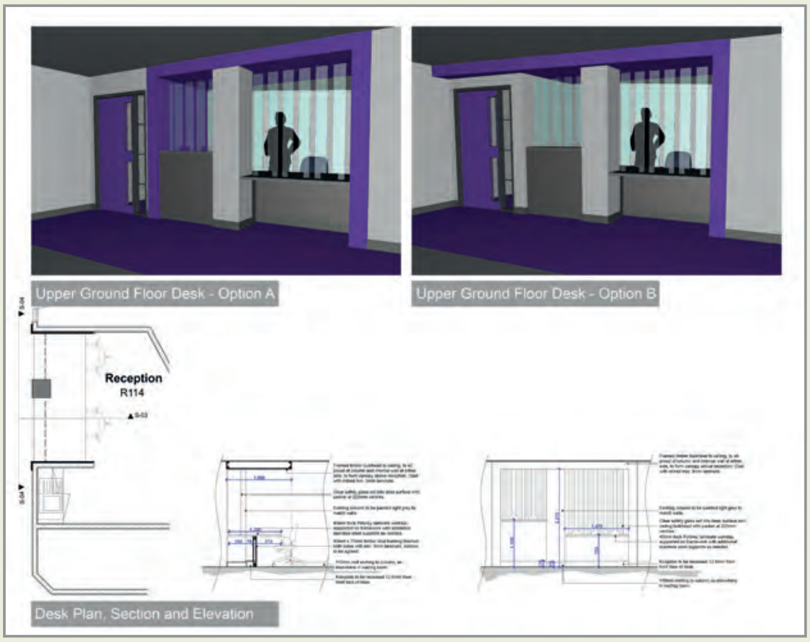
A full year's impact of restructuring the basis of, and fee rates for, the provision of property management and administration services to the Group will be seen in 2015, helping to further improve earnings from effective cost management.

PHP is well placed to continue to be a major contributor to the ongoing development and modernisation of the primary care estate. The General Election will shift the focus of government in the periods immediately before and following 7 May 2015 and will further slow the pace of change within the NHS. We take comfort, however, from the statements from all of the political parties that underline that the GP will remain the gatekeeper to the NHS and that increased GP numbers and integration of care will see the demand for the modern premises that PHP provides will continue to grow.

**Harry Hyman**
**Managing Director**
18 February 2015

# WILLESDEN MEDICAL CENTRE
## LONDON

£1.67 million refurbishment of 1980s urban medical centre for 10 GPs, reconfiguring and re-gearing all leases to 21 years, improving NHS service delivery and patient access, and preventing obsolescence. The building also contains a pharmacy and some vacant accommodation which the NHS is keen to utilise to further expand services.





AFTER

BEFORE

# ADVISER

## NEXUS TRADECO LIMITED ("NEXUS")

Nexus identifies suitable properties, negotiates the terms of purchase of those properties and provides property management services on behalf of the Group. It also provides the services of the Managing Director and the Finance Director.

The Nexus Group is engaged in the provision of independent advice and financial services to organisations operating in the public and private sectors, with particular emphasis on health, education and property.

## SENIOR MANAGEMENT

Nexus provides the Company with the services of Harry Hyman, Managing Director and Phil Holland, Finance Director. Both are experienced advisers to and managers of listed property groups and have many years experience of PHP's sector of focus. Please see page 33 for further details.

## PROPERTY ADVISORY SERVICES

Nexus has provided property advisory and management services since its appointment in March 1996. The Nexus property team has grown with PHP's business and currently comprises of 13 members of staff. It is headed by Tim Walker-Arnott, a qualified surveyor who joined Nexus in January 2006 having previously worked with NHP Plc. The team includes a further eight qualified surveyors, two trainee surveyors and two administrative assistants.

The property team has a wealth of experience of the healthcare real estate sector, having between them worked in investment, development and asset and property management functions at either Nexus or other specialist sector operators prior to joining Nexus.

Fees payable to Nexus for Property Advisory Services are calculated based on the Group's gross asset value as follows:

| Gross Assets | Total Fee |
|---|---|
| First £250 million | 0.5000% |
| Between £250 million and £500 million | 0.4750% |
| Between £500 million and £750 million | 0.4000% |
| Between £750 million and £1 billion | 0.3750% |
| Between £1 billion and £1.25 billion | 0.3250% |
| Above £1.25 billion | 0.3000% |

## ADMINISTRATIVE SERVICES

Nexus was appointed to provide administrative accounting services to the Group with effect from 1 May 2014.

In addition to Harry Hyman and Phil Holland, who are both Chartered Accountants, Nexus' administrative team includes three further qualified accountants, a trainee accountant and two finance assistants. Prior to joining Nexus, members of the team have worked within large professional services companies advising major property companies or held positions within listed and privately owned real estate businesses.

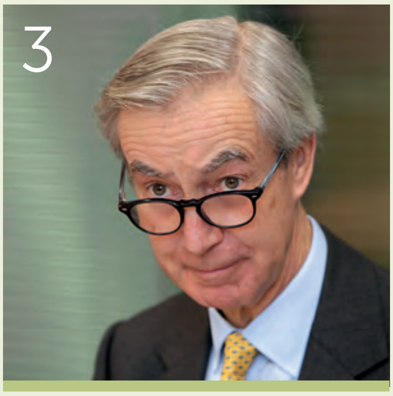
## COMPANY SECRETARIAL SERVICES

On 1 May 2014, Nexus was also appointed to provide the services of Company Secretary to the Group. These services are provided on a day to day basis by a dedicated member of the Nexus team who is an experienced company secretary and who is supported by the administrative team, many of whom have held positions as company secretary to listed companies or subsidiary companies in listed groups.

Further details of the terms and conditions of Nexus' appointment and the fees that they receive can be found in the Directors' Report on page 46.

# BOARD OF DIRECTORS










## 1 ALUN JONES [1 2 3 4]

**Non-Executive Chairman**

Appointed to the Board on 1 May 2007 and appointed as Chairman on 10 April 2014. A Chartered Accountant, Mr Jones retired from PricewaterhouseCoopers LLP in 2006, having been a previous member of PwC's UK and Global Supervisory Boards. He was a member of the Financial Reporting Review Panel from 2006 to 2011.

## 2 MARK CREEDY [1 2 3 4]

**Non-Executive Director**

Appointed 1 November 2008. Chairman of the Advisers Engagement Committee. Mr Creedy is currently Director of Fund Management at UNITE Group plc overseeing the fund management of the UNITE UK Student Accommodation Fund and UNITE's other joint ventures. He was Managing Director of the property fund management subsidiary of Legal & General Investment Management from 2002 to 2007 and was previously Managing Director of Chartwell Land plc, a wholly owned subsidiary of Kingfisher plc. He was also a non-executive director of B&Q.

## 3 JAMES HAMBRO

**Non-Executive Director**

Appointed February 1996. Mr Hambro is Chairman of James Hambro & Partners LLP and Chairman of J O Hambro Capital Management Holdings Limited, the parent company of J O Hambro Capital Management Limited, previously a Joint Adviser and the Company Secretary of Primary Health Properties PLC. Mr Hambro was appointed as a Joint Adviser representative prior to 1 May 2014. He is also Non-Executive Chairman of Hansteen Holdings PLC.

## 4 WILLIAM HEMMINGS

**Non-Executive Director**

Appointed 18 June 2012. Mr Hemmings is Head of Closed End Funds at Aberdeen Asset Managers Limited, a Director of a number of subsidiary companies of Aberdeen Asset Management PLC. Mr Hemmings is also a director of the Association of Investment Companies.

## 5 PHIL HOLLAND [5]

**Finance Director and Deputy Managing Director**

Appointed 17 February 2015. Mr Holland is a Chartered Accountant who joined Nexus in November 2010. He was previously CFO of Natixis Capital Partners Limited, a private equity real estate fund manager, managing a family of funds invested in commercial real estate across Western Europe. Mr Holland has previously held board positions within both public and private property investment, development and fund management companies operating across the UK and mainland Europe. Mr Holland is also a non-executive director of Network Housing Group.

## 6 HARRY HYMAN [5]

**Managing Director**

Appointed February 1996. A Chartered Accountant and Managing Director of Nexus Tradeco Limited, the Adviser and the parent company of Nexus Management Services Limited, the Company Secretary of the Group. Nexus has three operating divisions, property fund management, publishing and corporate finance. The group specialises in health, education and property. He is the non-executive chairman of Summitt Germany Limited, a company registered in Guernsey and listed on AIM, Chairman of ORBIG, the Orderbook of Retail Bond Issuers Group, and a director of Quoted Companies Alliance. PHP has been a member of the Quoted Companies Alliance since 2002.

## 7 STEVEN OWEN [1 2 3 4]

**Non-Executive Director and Senior Independent Director**

Appointed 1 January 2014. Chairman of the Audit Committee. A Chartered Accountant, Steven is currently CEO and Partner of Wye Valley Partners LLP and a non-executive Director of the Milford Haven Port Authority since 1 December 2014. He was Deputy CEO and Finance Director at Brixton plc until 2009.

## 8 DR IAN RUTTER OBE [1 2 3 4]

**Non-Executive Director**

Appointed 22 September 2005. Chairman of the Remuneration and Nomination Committees. He has worked as a GP since 1980 in Shipley, Yorkshire. He is currently the Senior European Faculty Head of IHI, the Institute of Healthcare Improvement, based in Boston, USA. He is a former CEO of North Bradford and Airedale PCTs. He has worked at the Department of Health as Clinical Lead in the Policy and Strategy Unit and as Deputy National Director of Primary Care. During the year under review, Dr Rutter's period of service as a director passed nine years. Notwithstanding this, the Board consider that Dr Rutter is objective and professional and brings specialist expertise of clinical and NHS matters to the Board and remains independent in his capacity as a Director of the Company and is described as such in the following pages of this report.

(1) Member of the Audit Committee. (2) Independent. (3) Member of the Nomination and Remuneration Committees.
(4) Member of the Advisers Engagement Committee. (5) Adviser representative

# CORPORATE GOVERNANCE REPORT

The Group's policy is to achieve best practice in its standards of business integrity in all of its activities. This includes a commitment to follow the highest standards of corporate governance throughout the Group where possible.

This report describes how the Group has complied with the applicable provisions of the UK Corporate Governance Code ("the Code") published by the Financial Reporting Council ("FRC") in September 2012. The Board considers that it has complied with the provisions of the Code throughout the year with the exception that there is no internal audit function and certain Directors have served on the Board for more than three terms of three years. However, all Directors have been subject to rigorous review, performance evaluation and annual election. A further edition of the Code was issued in September 2014 which applies to reporting periods beginning on or after 1 October 2014.

## BOARD COMPOSITION

The Board comprises the Chairman, Managing Director, Finance Director and five non-executive Directors, four of whom are considered by the Board to be independent. Details of the Chairman, the Directors and their individual roles are shown on pages 32 and 33. Their biographical details demonstrate a range of corporate, financial, property, investment and NHS experience relevant to the Group's business and demonstrate sufficient calibre to bring independent judgement on issues of strategy and performance of the Group.

The roles of the Chairman and the Managing Director are distinct and have been agreed by the Board. The Chairman chairs the Board and general meetings of the Company, sets the agenda of such meetings and promotes the highest standards of integrity, probity and corporate governance throughout the Group, particularly at Board level. He ensures that the Board receives accurate, timely and clear information, communicates effectively with Shareholders and facilitates the effective contribution of non-executive Directors and constructive relations between executive and non-executive Directors. He also ensures that any new Directors participate in a full, formal and tailored induction programme and that the performance of the Board, its committees and individual Directors is evaluated at least once a year. There is a clear structure for, and the effective running of, Board committees.

The Managing Director is accountable for the management of the Group with the Adviser as set out in the Advisory Agreement. Steven Owen is the Senior Independent Director. He is available to Shareholders if they have any concerns that cannot be resolved through the normal channels. His role is to support the Chairman and act as his sounding board when required and, if necessary, to act as an intermediary for the other Directors.

As part of its annual self-assessment, the Board critically evaluates the independence of individual Directors and has concluded that all of the Directors continue to act independently in both character and judgement, taking account of the interest of all Shareholders. Alun Jones, Mark Creedy and Steven Owen meet the independence criteria set out in the Code, whilst James Hambro has been on the Board longer than nine years and so does not meet these criteria. During the year under review, Dr Rutter's period of service as a director passed the period of nine years. Notwithstanding this, the Board consider that Dr Rutter is objective and professional and brings specialist expertise of clinical and NHS matters to the board and remains independent in his capacity as a director of the Company. The Board considers that William Hemmings meets the criteria of independence in spirit. However, having acted as an alternate director since March 2000, he is not considered independent under the Code.

## BOARD DIVERSITY

The Board believes that it must include the right blend of individuals whose skills and experience have been derived from a variety of backgrounds. Directors must demonstrate independence of mind, integrity and willingness to challenge constructively. Appointments are made first and foremost on the basis of merit using objective criteria and taking into account the recognised benefits of all types of diversity. The Board will continue to ensure that diversity is taken into account when considering any new appointments.

## BOARD CHANGES

On 10 April 2014, the date of the Company's Annual General Meeting, Graeme Elliot retired from the Board and Alun Jones was appointed Chairman from that date.

On 1 January 2014, Steven Owen was appointed as an independent non-executive director. Steven was elected by shareholders at the 2014 AGM and became chairman of the audit committee and was appointed Senior Independent Director on 10 April 2014.

Phil Holland was appointed by the Board on 17 February 2015 and will also stand for election at the AGM on 22 April 2015.

Terms of reference for each committee are available on the Group's website at: www.phpgroup.co.uk/governance

## OPERATION OF THE BOARD

The Board is responsible for leading and steering the Group within a framework of prudent and effective controls which enable risk to be assessed and managed. It also sets the Group's strategic aims, ensuring that the necessary resources are available for the Group to meet its objectives, reviews the performance of the Adviser through its Advisers Engagement Committee and sets the Group's values and standards, ensuring that its obligations to its Shareholders and other stakeholders are satisfied.

The Board has a schedule of matters formally reserved to it for its decision such as strategic, major financial and key operational issues. Matters not requiring debate or necessary for the implementation of urgent decisions, on matters previously discussed at Board Meetings, are delegated to a Standing Committee.

The Board has delegated certain activities to the Adviser as described on page 31 in the Advisory Agreement section of the Directors' Report on page 46.

The Advisory Agreement also provides for the appointment of Nexus as Company Secretary, meaning that it is responsible for ensuring that Board procedures are followed, that applicable rules and regulations are complied with and for advising the Board (through the Chairman) on governance matters. The appointment and removal of the Company Secretary is a matter for the Board as a whole.

The training needs of each Director are regularly reviewed by the Chairman. Directors are able to receive training or additional information on any specific subject pertinent to their role as a Director that they request or require. During the year, the Board has reviewed and discussed the prospective Financial Reporting Council Revisions to the UK Corporate Governance Code and associated Guidance on Audit Committees published by the FRC in September 2014. All Directors have access to independent professional advice at the Company's expense, if deemed necessary and subject to clearance by the Chairman.

The Group maintains appropriate insurance cover in respect of legal action against the Company's Directors.

In addition to the Board meetings held during the year, the Board is regularly in touch for consultation by electronic means and met for an off-site strategy meeting and for the AGM. Directors were sometimes unable to attend meetings due to unavoidable business interests, but full Board packs are distributed to all Board members for all meetings and separate discussions were held with, or comments were sought by, the Chairman on all matters of relevance.

There are opportunities throughout the year for the Chairman and Independent Directors to discuss matters without the other Directors being present.

## BOARD COMMITTEES

The following Committees have been established by the Board and have been granted specific delegated authority to consider certain aspects of the Group's affairs:

- Audit Committee
- Remuneration Committee
- Nomination Committee
- Advisers Engagement Committee

The Chairmen of the Committees report back to the Board as and when appropriate. Reports from each committee chairman are included on pages 36 to 40.

## MEETINGS AND ATTENDANCE

| | Board Meetings (Total in year 9) | Audit Committee (Total in year 2) |
|---|---|---|
| Graeme Elliot[1] | 2 | 1 |
| Alun Jones | 9 | 2 |
| Mark Creedy | 9 | 2 |
| James Hambro | 9 | n/a |
| William Hemmings | 8 | n/a |
| Harry Hyman | 9 | n/a |
| Dr Ian Rutter | 9 | 2 |
| Steven Owen | 9 | 2 |

(1) Mr Elliot was eligible to attend two Board Meetings and one Audit Meeting before his retirement from the Board

# AUDIT COMMITTEE REPORT

**STEVEN OWEN**
Non-Executive Director and Senior Independent Director

I am pleased to present my first report following my appointment as Chairman of the Audit Committee on 10 April 2014. I am supported by Alun Jones and two independent non-executive Directors, Dr Ian Rutter and Mark Creedy. All members served throughout the year.

Alun Jones and I are both Chartered Accountants and, as can be seen from our biographies on page 33, we both possess the recent and relevant commercial knowledge and experience to satisfy the provisions of the Code. There are no employees of the Adviser on the Committee. The Committee may invite the Managing Director, representatives of the Adviser and non-independent Directors to attend the meetings as appropriate.

**Responsibilities**
The main roles and responsibilities of the Audit Committee include:
- monitoring the integrity of the Group's financial statements and reviewing significant financial reporting issues and judgments contained therein;
- reviewing the Group's systems of financial control and risk management;
- making recommendations to the Board on the appointment and dismissal of the external Auditor and approving their remuneration and terms of engagement;
- monitoring and reviewing the external Auditor's independence, objectivity and effectiveness, taking into account professional and regulatory requirements; and
- annually considering the need for an internal audit function.

There are arrangements in place whereby employees of the Adviser may, in confidence, raise concerns about possible improprieties in matters of financial reporting amongst other things. The Committee ensures that the Adviser has in place arrangements for the proportionate and independent investigation of such matters.

**Report on the Committee's activities during the year**
During the year, the Committee discharged its responsibilities under its terms of reference, by:
- reviewing the Group's draft annual financial statements and 2014 half year results statement prior to discussion and approval by the Board, and reviewing the external Auditor's reports thereon;
- reviewing and approving the Group's property portfolio valuation at each Balance Sheet date;
- reviewing the continuing appropriateness of the Group's accounting policies;
- reviewing the Auditor's plan for the audit of the Group's 2014 financial statements, receiving and reviewing confirmations of auditor independence and approving the terms of engagement and proposed fees for the 2014;
- considering the qualifications, expertise, resources and independence of the Auditors through reviews of their reports and performance;
- recommending the re-appointment of the Auditor for 2015;
- the Committee chairman meeting with the Auditor and with employees of the Adviser in February, early August and October to review the audit plans and progress, accounting processes and to discuss emerging points and the financial reports; and
- the Committee receiving presentations from the Adviser on the subject of risk, its identification, management and control, accounting and control and property portfolio management.

The Audit Committee has reviewed the contents of this year's Annual Report and Financial Statements and advised the Board that, in its view, the report is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's performance, business model and strategy.

**Auditor independence**
The Company has a policy governing the provision of non-audit work by the Auditor. Under that policy, the Auditor is prohibited from performing services where the Auditor may be required to audit their own work, participate in activities that would normally be undertaken by management, are remunerated through a 'success fee' structure where the success of a project is dependent upon the accounting treatment, or act in an advocacy role for the Company. Other than the above, there is not an automatic ban in place on the Auditor undertaking non-audit work. Each possible appointment is, however, reviewed on a case by case basis. Activities that may be perceived to be in conflict with the role of the external Auditor must be submitted to the Committee for approval prior to

engagement, regardless of the fee involved. The Committee pays particular attention to matters it considers to be important due to their impact on the Group's results and where a high level of complexity, judgement or evaluation is involved. Details of the amounts paid to the external Auditor during the year for audit and other services are set out in note 4 to the financial statements.

**Effectiveness of external Auditor**

The effectiveness of the audit process is dependent on appropriate audit risk identification at the start of the audit cycle. The Committee received from Deloitte LLP a detailed audit plan, identifying their assessment of these key risks. For 2014, the primary risks identified were in relation to the valuation of the property portfolio, revenue recognition, financing and valuation of financial instruments and going concern.

The Board and the Adviser take responsibility for exercising judgement when necessary in preparing the Annual Report and Financial Statements. They prepare and review papers provided to the Auditor, setting out their judgements and approaches taken to specific items. The work undertaken by the Auditor in this area to test management's assumptions and estimates is challenged by the Audit Committee who assess the effectiveness of the audit process through the reporting received from Deloitte LLP at both half-year and year end. In addition, the Audit Committee seeks feedback from the Adviser on the effectiveness of the audit process. The Committee is satisfied with the effectiveness of the Auditor.

Deloitte LLP have been Auditors of PHP since being appointed in June 2013 which is also the date of the last audit tender.

**Significant accounting matters**

The Committee considers all financial information published in the Annual and Half Year Financial Statements and considers accounting policies adopted by the Group, presentation and disclosure of financial information and, in particular, the following key judgements made in preparing the Financial Statements.

**Valuation of the property portfolio**

The Group has property assets of £1.03 billion as detailed on the Group Balance Sheet. As explained in Note 11 to the Financial Statements, properties are independently valued by Lambert Smith Hampton in accordance with IAS 40: Investment Property. The Audit Committee reviewed and discussed with management the judgements and assumptions made in respect of the property valuation, reviewed the Valuer's report and the Auditor's comments thereon, and concluded that the valuation remains appropriate.

**Revenue recognition**

Following objective assessments, the Group adopts a policy of recognising 90% of the expected uplift from rent reviews from the date a rent review falls due until the date it is settled, when any additional balance due is recognised. The Committee reviewed the judgments made in respect of this policy, reviewed past experience of settlements and challenged management as to its continued appropriateness. The Committee received confirmation from management that the policy remained appropriate. The Committee also received detailed reporting from Deloitte LLP, the external auditors, on this matter and is satisfied that the policy remains appropriate.

**Financing: repayment and restructuring of loan facilities**

The Group undertook a number of financing transactions during the year.

The Aviva debt assumed with the acquisition of the PPP portfolio in December 2013 was refinanced in a number of tranches through 2014. An initial sum of £15 million was repaid in January 2014. A further £50 million was refinanced in April 2014 through a combination of a new £50 million facility with HSBC Bank PLC and the utilisation of an element of headroom on existing debt facilities. In August 2014, the remaining loans were restructured into two consolidated tranches with Aviva.

In August 2014, the Group (i) extended the term of its £165 million Club debt facility with Royal Bank of Scotland plc and Santander Banking Group plc, for a new three year term, and (ii) enlarged the quantum of its loan facility with Barclays Bank plc, extending the duration to a new five year term. In both transactions, the margins over LIBOR charged by the lending banks were reduced.

The Committee considered the potential impact of the early settlement of these transactions and the resulting accounting impact. This was achieved by holding discussions with management and Deloitte LLP and reviewing reports received from both parties.

The key accounting issues arising from these transactions concerned the treatment of breakage costs related to such repayments and the treatment of unamortised arrangement fees in accordance with classifying the nature of the loan transaction in accordance with IFRS.

The Group recognised costs of £1.2 million in respect of the early repayment of elements of the Aviva debt assumed with the PPP portfolio acquisition. This included both contractual early repayment fees and an element of unamortised arrangement fees resulting from the repayment and restructuring being classified as the inception of a new debt facility in accordance with IAS 39.

# AUDIT COMMITTEE REPORT (CONTINUED)

The extension of the Club and Barclays facilities were classified as modifications and no adjustment was made to the balance of unamortised arrangement fees carried forward by the Group.

The Committee was satisfied that the accounting guidelines had been followed appropriately.

**Financing: Convertible Bond issue**
In May 2014, the Group issued an £82.5 million, five year Convertible Bond. This transaction served to diversify the Group's funding sources and procure a greater proportion of unsecured loan capital, leading to increased transactional flexibility and reduced overall risk.

The Board has opted to account for the Convertible Bond at fair value through profit and loss in accordance with IAS 32. Further detail is provided in Notes 17 and 19 to the Financial Statements.

The Committee is satisfied that the Group has adopted appropriate accounting policies and treatment and that appropriate accounting guidelines have been followed.

**Financing and valuation of financial instruments**
The Group hedges its exposure to interest rate risks swaps using financial instruments. The Group accounts for these instruments in accordance with IAS 39 and makes the additional required disclosures under IFRS 7 'Financial Instruments: Disclosures'.

The valuation of the financial instruments is undertaken by J C Rathbone ("JCRA"), an independent specialist in this area. The Committee has considered the Group's compliance with the requirements of IFRS 13, concerning the measurement of credit risk in the valuation of financial instruments. The Group received detailed written reporting from JCRA and accordingly the Committee is satisfied that the accounting guidelines have been applied appropriately.

## INTERNAL CONTROL

The Audit Committee reviews the Group's system of internal control for effectiveness, which has been in operation throughout the year and to the date of this Report. It believes that the key risks facing the business have been identified and it has implemented an ongoing system to identify, evaluate, monitor and manage these risks that is based upon, and relevant to, the Group's business as a UK REIT.

Following the Financial Reporting Council's publication of "Internal Control: Revised Guidance for the Directors on the Combined Code", and the FRC's Guidance on Audit Committees published in September 2012, the Committee believes key features of the system of internal control include a comprehensive system of budgeting, financial reporting and business planning, formal documentation procedures and the close involvement of the Managing Director and the Adviser in all aspects of the day-to-day operations. The scope and quality of the Adviser's systems of internal controls are regularly monitored and reviewed. Any incidences of significant control failings or weaknesses that have been identified and the extent to which they have impacted on the Group are reported to the Board who ensures that the Adviser takes the necessary actions to remedy those failings or weaknesses immediately. Nevertheless, the Committee believes that, although robust, the Group's system of internal control is designed to manage, rather than eliminate, the risk of failure to achieve the Group's business objectives. Therefore the system can provide only reasonable and not absolute assurance against material misstatement or loss.

In reviewing the periodic financial reports of the Group, the Committee is reliant on the policies and procedures followed by the Adviser to ensure that the records accurately reflect transactions so as to facilitate the production of consolidated financial statements in accordance with International Financial Reporting Standards ("IFRS") and other applicable reporting standards. In addition, the integrity of the financial reporting and consolidation processes and the completeness and accuracy of financial information are subject to review by the Audit Committee and the Board.

At the time of reviewing the half yearly and annual financial reports, the Audit Committee also receives a comfort letter from the Adviser to assist the Board in making the disclosures.

No significant deficiencies in internal control have been identified.

## INTERNAL AUDIT

The Audit Committee considers annually the requirement for an internal audit department and the Board, on the recommendation of the Audit Committee, having regard to the matters considered above, have concluded that one is not currently required.

**Steven Owen**
**Chairman of the Audit Committee**
18 February 2015

**MARK CREEDY**
Chairman of the Advisers Engagement Committee

## ADVISERS ENGAGEMENT COMMITTEE

The Advisers Engagement Committee comprises Mark Creedy (Chairman), Dr Ian Rutter, Alun Jones and Steven Owen, who joined the Committee in January 2014. The Committee meets at least annually to review the terms of the Advisory Agreement and the performance of the Adviser. The other non-executive Directors may attend the meetings if invited to do so by the Chairman.

During the year, the Advisers Engagement Committee met or consulted several times and reviewed the terms of the Advisory Agreement. This involved concluding negotiations with the Advisers to agree revised fee rates for the provision of Property Advisory Services which was completed on 28 January 2014, and applied from 30 April 2014.

In addition, the Advisers Engagement Committee oversaw the transfer of responsibility for the provision of Administrative Services including the company secretary role from J O Hambro Capital Management to Nexus, effective from 30 April 2014.

## BOARD PERFORMANCE AND EVALUATION

The Chairman is responsible for ensuring the annual evaluation of the Board's performance and that of its Committees and individual Directors. This was done by the circulation of a questionnaire based on the process and questions outlined in the Code concerning Board and Committee performance and meetings. In addition to discussing the completion questionnaire, the Chairman discussed with the Board broad themes and outcomes for 2014 and highlighted strengths and any areas of weakness. The outcome of the evaluation process was that the Board and its Committees were judged to be operating effectively. The other Directors, led by the Senior Independent Director, evaluated the performance of the Chairman.

## COMMUNICATION WITH SHAREHOLDERS

The Company communicates regularly with institutional shareholders, analysts and the financial press throughout the year. Annual and interim reports are presented to formal meetings of analysts and interim management statements are widely distributed to these and other parties who may have an interest in the Group's performance. These documents, statements and analyst presentations are also made available on the Company's website.

The Managing Director reports at each Board meeting on investor relations and to provide feedback from meetings with major shareholders and analysts and the Board receives copies of all research published on the Group. The Board meets periodically on a formal and informal basis with the Company's brokers and professional advisers in order to better understand the views of major shareholders about the Company.

Investors are encouraged to attend the Annual General Meeting at which they have an opportunity to ask questions of the Board. The Annual General Meeting is normally attended by all Directors and the chairmen of each of the Board committees are available to answer questions.

The Company ensures that any price-sensitive information is released to all shareholders at the same time in accordance with regulatory requirements. All major presentations are available to all shareholders through the Company's website. Shareholders may choose to receive the annual and interim reports either in paper form or electronically. These reports, along with a wide range of shareholder information, are also available on the Company's website. Additional information for shareholders can be found on pages 92 and 93.

**Mark Creedy**
**Chairman of the Advisers Engagement Committee**
18 February 2015

**DR IAN RUTTER**
Chairman of the Remuneration and Nomination Committees

## REMUNERATION COMMITTEE

The Remuneration Committee normally meets once per year and comprises four non-executive Independent Directors being Dr Ian Rutter (Chairman), Alun Jones, Mark Creedy and Steven Owen, following his appointment to the Committee on 1 January 2014.

Its role is to seek and retain the appropriate calibre of people on the Board and recommend fee levels to the Board consistent with prevailing market conditions, peer group companies and Directors' roles and responsibilities. The Company has no employees and therefore pay and employment considerations are not taken into account in determining Directors' fees, nor does it determine executive pay. The Committee met once during the year to review Directors' remuneration with all members in attendance.

Please see pages 41 to 44 for the Directors' Remuneration Report.

## NOMINATION COMMITTEE

**Composition and responsibilities**
The Nominations Committee is chaired by Dr Ian Rutter and its other members are Alun Jones, Mark Creedy and Steven Owen, all of whom are Independent and non-executive. Steven Owen joined the Committee in January 2014. The Committee is charged with the responsibility of nominating any new Directors to the Board and considering succession planning. It reviews from time to time the composition of the Board, having regard to its balance and structure.

**Board diversity**
The Terms of Reference of the Nomination Committee state that potential candidates should be considered on merit and against objective criteria and with due regard for the benefits of diversity on the Board, including gender.

The Directors consider the background and experience brought to the Board by each individual to contribute to its diversity. In any recruitment, the Board prefers to select the best qualified candidate to provide the Board with the expertise required to implement its long-term strategy, rather than to fulfil any fixed quota. Subject to that overriding principle, the Directors believe that the Board's perspective and approach can be greatly enhanced through gender, age and cultural diversity. In recommending new appointments to the Board, the Nomination Committee considers the existing balance of skills, knowledge and experience and the time candidates have available to commit to the role.

**Report on the Committee's activities during the year**
During the year, the Committee discharged its responsibilities, under its Terms of Reference, by:

- considering the composition of the Board and (without Dr Rutter participating) confirmed its opinion that Dr Rutter remained independent; and
- reviewing the succession plan for the Board.

Non-executive Directors are appointed for an initial three year term and are subject to annual re-election by shareholders and to three months' notice from the Company or the Director. Each Director, on appointment, is provided with a letter setting out the terms of appointment, the fees to be paid and the time commitment expected.

Subsequent to year end, the Committee considered and recommended to the Board the appointment of Phil Holland as Finance Director and Deputy Managing Director. This was confirmed by the Board on 18 February 2015.

**Dr Ian Rutter**
**Chairman of the Remuneration and Nomination Committees**
18 February 2015

# DIRECTORS' REMUNERATION REPORT

**STATEMENT FROM CHAIRMAN OF THE REMUNERATION COMMITTEE**

We have presented the remuneration report for the year to 31 December 2014 in accordance with the regulations governing the disclosure and approval of Directors' remuneration. The report has been divided into two parts:

- Directors' Remuneration Policy, which was approved by shareholders at the Company's AGM on 10 April 2014 and will be submitted to shareholders for approval every three years thereafter;
- Annual Report on Remuneration, which provides information on how the policy has been applied during the year and which will be subject to an advisory resolution at the forthcoming AGM.

In preparing the report the Committee has taken into account guidance on directors' remuneration reporting from the GC100 and Investors Group.

The role of the Remuneration Committee is to seek and retain the appropriate calibre of people on the Board and recommend fee levels to the Board consistent with prevailing market conditions, peer group companies and Directors' roles and responsibilities.

The Committee met once during the year. The Committee concluded that annual benchmarking of the remuneration of non-executive directors should be conducted by means of comparison with a small number of comparable companies with effect from 2015.

## DIRECTORS' REMUNERATION POLICY

The Company's policy is to pay each Director a fixed fee per annum commensurate with the level of commitment required and prevailing rates informed by external consultants and comparable organisations. Additional responsibility, such as that of the Chairman, is rewarded by a fixed additional sum and expenses incurred in connection with the Company's business are reimbursed.

This Remuneration Policy was approved by shareholders at the Company's AGM on 10 April 2014. Accordingly, the Remuneration Policy provisions set out below will apply until they are next put to shareholders for renewal of that approval, which must be at intervals of not more than three years, or the Remuneration Policy is varied, in which case, shareholder approval for the new Remuneration Policy will be sought.

The Company has no employees and therefore pay and employment considerations are not taken into account in determining Directors' fees, nor does it determine executive pay. No component of any Director's remuneration is subject to performance factors. The Committee determines appropriate levels of remuneration for all Directors' fees, subject to the overall limit as set out in the Articles of Association of £500,000.

The table below shows the rates of annual fees paid to non-executive Directors for the year ending 31 December 2014. Fees for 2015 are currently under review.

| Component | Director | Sum |
|---|---|---|
| Annual fee | All Directors | £30,000 |
| Additional fee | Chairman of the Board | £10,000 |
| Additional fee | Chairman of the Audit Committee | £6,000 |
| Expenses | All Directors | n/a |

**Recruitment and remuneration policies**

- The Committee seeks to attract and retain high calibre Directors by offering a market competitive fee level. The level of the fee is reviewed periodically by the Remuneration Committee, with reference to market levels at other companies having similar profiles to that of the Company, and consultation with third party advisors. A recommendation is then made to the Board.
- The Company has no employees. Accordingly, there are no differences in policy on the remuneration of Directors and the remuneration of employees.
- No Director is entitled to receive any remuneration which is performance related. As a result there are no performance conditions in relation to any elements of the Directors' remuneration in existence to set out in this policy.
- The remuneration package for any new Chairman

# DIRECTORS' REMUNERATION REPORT (CONTINUED)

or non-executive Director will be the same as the prevailing rates determined on the bases set out above. The fee and entitlement to reclaim reasonable expenses is set out in the Directors' Letter of Appointment.

- The Company will not pay any introductory fee or incentive to any person to encourage them to become a Director, but may pay fees to search and selection consultants in connection with the appointment of any non-executive Director.
- Having appointed Phil Holland as Finance Director and Deputy Managing Director on 17 February 2015, the Company only intends to appoint non-executive Directors for the foreseeable future.
- The maximum aggregate fee currently payable to all Directors is £500,000.

There have been no changes to the Company's remuneration policy for Directors since the publication of the last Annual Report of the Group.

**Service contracts**

No Director has a service contract. The contract for the services of Harry Hyman is with Nexus, pursuant to the Advisory Agreement. There are letters of appointment in place for the other Directors including the Chairman. These provide, subject to the appointment and any re-appointment being in accordance with the terms of the Articles of Association and to retirement by rotation, that Directors are appointed for an initial turn of three years and that such appointment can be terminated upon either party giving not less than three months' prior written notice, with no compensation for loss of office. These letters of appointment are available for inspection at the Registered Office and at the AGM.

All Directors are subject to re-appointment by Shareholders at the first Annual General Meeting held after their appointment and annual re-election thereafter in accordance with Code Provision B.7.1.

*Loss of Office:* Directors do not have any entitlement to payment upon loss of office over and above the pro-rated fees due to them and any outstanding expenses.

*Scenarios:* as the Directors' fees are fixed at annual rates, there are no other scenarios where remuneration will vary. It is accordingly not considered appropriate to provide different remuneration scenarios for each Director.

*Statement of consideration of conditions elsewhere in the Company:* as the Company has no employees, the process of consulting with employees on the setting of the Remuneration Policy is not relevant.

**Other items**

None of the Directors has any entitlement to pensions or pension related benefits, medical or life insurance schemes, share options, long-term incentive plans, or performance related payments. No Director is entitled to any other monetary payment or any assets of the Company except in their capacity as shareholders of the Company.

Director's and Officer's liability insurance cover is maintained by the Company, at its expense, on behalf of the Directors.

## ANNUAL REPORT ON REMUNERATION

This part of the report has been prepared in accordance with Part 3 of Schedule 8 of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2013, and relevant sections of the Listing Rules. The annual report on remuneration will be put to an advisory shareholder vote at the 2015 AGM. The information on pages 41 to 44 has been audited where required under the regulations and indicated as audited information where applicable.

The Remuneration Committee determines appropriate levels of remuneration for all Directors' fees as set out in the Articles of Association. The Committee makes recommendations to the Board as a whole and no Director is involved in any decision regarding his own remuneration. Directors' fees were last reviewed on 1 January 2014. The set fee for each Director is currently £30,000 per annum and £40,000 per annum for the Chairman. The Audit Committee Chairman receives an additional £6,000 per annum.

The Directors who served during the year received the following fees:

**Single total figure of remuneration (audited information)**

| | Year ended 31 Dec 2014 | Year ended 31 Dec 2013 |
|---|---|---|
| Graeme Elliot[1] | £20,000 | £36,000 |
| Alun Jones[2] | £39,000 | £33,000 |
| Harry Hyman (Managing Director) | £30,000 | £27,500 |
| James Hambro | £30,000 | £27,500 |
| William Hemmings | £30,000 | £27,500 |
| Dr Ian Rutter | £30,000 | £27,500 |
| Mark Creedy | £30,000 | £27,500 |
| Steven Owen[3] | £34,348 | - |
| **Total** | **£243,348** | **£206,500** |

(1) Payment in role as Chairman until retirement on 10 April 2014
(2) Payment as Chairman of Audit Committee from 1 January 2014 to 10 April 2014 and as Chairman from 11 April 2014
(3) Payment as a Director from appointment in 1 January 2014. Additional fee paid from 11 April 2014 following appointment as Chairman of Audit Committee

Harry Hyman is a Director of Nexus, the Adviser to the Group. The fees in respect of the services of Mr Hyman are paid to Nexus. The Advisory Agreement provides for the first £100,000 of the adviser fee to be payable to Nexus each year in respect of the services of the Managing Director.

James Hambro is a Director of J O Hambro Capital Management Holdings Limited, the holding company for JOHCM. Until the termination of its service agreement on 30 April 2014, JOHCM were a joint adviser to the Group. For the period from 1 January 2014 to 30 April 2014, Mr Hambro's entitlements to Directors' fees (which are the same as other Directors) were paid to JOHCM.

The fee in respect of Mr Hemmings' services as a Director is paid to Aberdeen Asset Management PLC.

The fee in respect of Mr Owen's service as a Director is paid to Oakland Ventures Limited.

The Company has not complied with Code provision D.1.2 and has not disclosed the amount of fees received by the Managing Director in respect of his other non-executive Director appointments. Since he is committed to working a certain number of days a month for this Company, this amount is not deemed relevant and the Remuneration Committee is satisfied that the Company received the appropriate time commitment from the Managing Director.

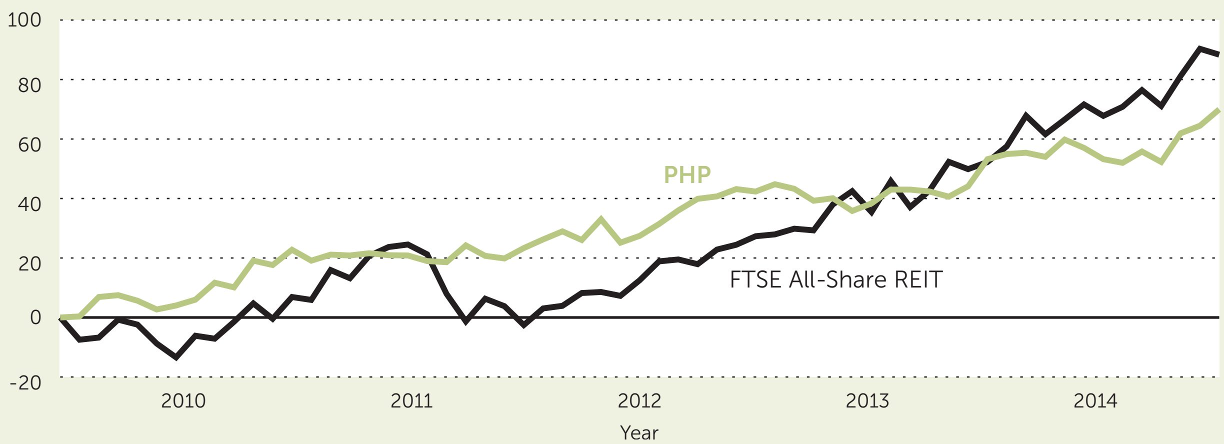
Further details of the Advisory Agreement are given in the Directors' Report on page 46 and details of the amounts paid to the Adviser in Note 4 to the financial statements.

Non-executive Directors are not eligible for bonuses, pension benefits, share options, long-term incentive schemes or other benefits. Directors may be reimbursed for travel and accommodation expenses in connection with Board Meetings and in line with the Group's expense policy.

## COMPANY'S PERFORMANCE

The following graph compares, over a five year period, the total Shareholder return (as required by Company Law) of the Company's Ordinary shares relative to a return on a hypothetical holding over the same period in the FTSE All-Share Real Estate Investment Trust Index. This Index has been chosen by the Board as the most appropriate in the circumstances. Total Shareholder return is the measure of returns provided by a company to Shareholders reflecting share price movements and assuming reinvestment of dividends.

For the year ended 31 December 2014, the highest and lowest mid-market price of the Company's Ordinary Shares was 370p (high) and 328p (low) respectively.



# DIRECTORS' REMUNERATION REPORT (CONTINUED)

## RELATIVE IMPORTANCE OF SPEND ON PAY

The following table shows the total remuneration paid to Directors and total management fees paid compared to the dividends paid to shareholders:

| | 2014 | 2013 | Difference |
|---|---|---|---|
| Directors' fees[1] | £243,348 | £206,500 | £36,848 |
| Management fee | £5,345,000 | £4,887,000 | £458,000 |
| Dividends | £21,651,318 | £16,518,350 | £5,132,968 |

(1) As the Company has no employees the total spend on remuneration comprises just the Directors' fees.

Note: the items listed in the table above are as required by the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 s.20 with the exception of the management fee which has been included because the Directors believe it will help shareholders' understanding of the relative importance of the spend on pay. The figures for this measure are as shown in Note 4 to the financial statements.

The interests of the Directors in the share capital of the Company (all of which are beneficial unless otherwise stated) and any interests of a person connected with a Director (within the meaning of the Disclosure and Transparency Rules) are shown below:

| Audited | 31 Dec 2014 | 31 Dec 2013 |
|---|---|---|
| Mark Creedy | 12,000 | 12,000 |
| Mark Creedy (non-beneficial) | 635 | 635 |
| James Hambro | 48,857 | 48,857 |
| James Hambro (non-beneficial) | - | 503,327 |
| William Hemmings | 5,937 | 5,266 |
| Harry Hyman | 638,525 | 72,640 |
| Harry Hyman (non-beneficial) | 3,463,450 | 4,023,357 |
| Alun Jones | 22,500 | 22,500 |
| Steven Owen | 8,718 | - |
| Dr Ian Rutter | 9,619 | 9,144 |

Save as disclosed below, no changes occurred between 31 December 2014 and the date of this Report.

Mr Hyman and Mr Hemmings are participants in the Company's monthly investment account that is administered by Equiniti on the Company's behalf. As a consequence of this participation, at the date of this Report Mr Hemmings' beneficial interest had increased to 5,988 shares and Mr Hyman's to 638,627 shares.

At the date of this report, Mr Holland held 6,734 shares in the Company.

## STATEMENT OF SHAREHOLDER VOTING

At the 2014 AGM, shareholder voting on the remuneration report was as follows:

| Remuneration Report | No of shares | % of votes cast |
|---|---|---|
| Votes cast in favour | 33,786,979 | 99.70 |
| Votes cast against | 101,738 | 0.30 |
| Total votes cast | 33,888,717 | 100.00 |
| Abstentions | 429,399 | 1.25 |

| Remuneration Policy | No of shares | % of votes cast |
|---|---|---|
| Votes cast in favour | 33,775,226 | 99.69 |
| Votes cast against | 103,389 | 0.31 |
| Total votes cast | 33,878,615 | 100.00 |
| Abstentions | 439,501 | 1.28 |

## APPROVAL

The Directors' remuneration report, including both the Directors' Remuneration Policy and the Annual Report on Remuneration has been approved by the Board of Directors.

Signed on behalf of the Board of Directors.

**Dr Ian Rutter**
**Chairman of the Remuneration Committee**
18 February 2015

# DIRECTORS' REPORT

The Directors present their Annual Report to Shareholders for the year ended 31 December 2014. Further information on the Group's business, which is required by Section 417 of the Companies Act 2006, can be found in the following sections of the annual report, which are incorporated by reference into this report:

- Chairman's Statement on pages 4 to 5, and
- Strategic Review on pages 6 to 29.

## PRINCIPAL ACTIVITY

The principal activity of the Group (of which Primary Health Properties PLC is the parent company) continues to be the generation of rental income and capital growth through investment in primary health care property throughout the United Kingdom.

The Group became a Real Estate Investment Trust ('UK REIT') on 1 January 2007. It is the opinion of the Directors that the Group has conducted its affairs so as to be able to continue as a UK REIT.

## FINANCIAL

The results for the year are shown in the Group Statement of Comprehensive Income on page 54.

Interim ordinary dividends totalling 19.5p per Ordinary share were paid during the year (year ended 31 December 2013: 19.0p).

The Board proposes to pay an interim ordinary dividend of 10.0p per Ordinary share on 1 April 2015. Further information on dividends can be found in the Shareholder Information section on page 92.

## DIRECTORS

Biographical information for the current Directors can be found on pages 32 and 33.

The Company's Articles of Association require that Directors should submit themselves for election at the first Annual General Meeting following their appointment and thereafter for re-election at least every three years. The Company has, however, adopted the requirements of the UK Corporate Governance Code in relation to the annual re-election of Directors. Phil Holland, who was appointed by the Board with effect from 18 February 2015, will offer himself for election at the AGM. All directors, who served throughout the year, will retire and, being eligible, offer themselves for re-election.

Information on the performance evaluation of the Board is shown in the Corporate Governance report on page 34. Details of Directors' interests in the share capital and equity of the Company and Directors' Remuneration are contained in the Directors' Remuneration Report on pages 41 to 44.

## POWERS OF THE DIRECTORS

The Directors have been authorised to allot and issue Ordinary shares and to make market purchases of the Company's Ordinary shares. These powers are pursuant to the passing of resolutions at the Company's Annual General Meeting.

Details of the resolutions regarding the allotment, issue and purchase of the Company's shares are set out in the explanatory notes to the Notice of Annual General Meeting which can be found in the separate document posted to shareholders with this Annual Report.

## SUBSTANTIAL INTERESTS

As at 18 February 2015, the Company had been notified or was otherwise aware of the following shareholders who were directly or indirectly interested in 3% or more of the voting rights in the Company's issued share capital:

| | Voting rights | % |
|---|---|---|
| Investec Wealth & Investment | 6,518,513 | 5.86 |
| Unicorn Asset Management | 6,151,026 | 5.53 |
| Blackrock | 5,588,517 | 5.02 |
| Brooks Macdonald Asset Management | 5,170,474 | 4.65 |
| CCLA Investment Management | 4,781,300 | 4.30 |
| Charles Stanley | 4,737,655 | 4.26 |
| Troy Asset Management | 4,720,000 | 4.24 |
| R Laing | 4,012,184 | 3.61 |
| Nexus Group Holdings Limited | 4,000,000 | 3.59 |
| Neptune Investment Management | 3,423,671 | 3.08 |

The Ordinary Shares held by Nexus Group Holdings Limited ("Nexus Group") are subject to a debenture and fixed charge over all of Nexus Group assets. As at the date of this report, Nexus Group has confirmed that it is not in default of any of its banking commitments and that it has no current intention to sell any of its holding. Nexus Group is connected to Harry Hyman.

# DIRECTORS' REPORT (CONTINUED)

## SHARE CAPITAL

The Company has one class of share in issue, being Ordinary Shares of 50 pence each. At the date of this report, the Company had 111,276,662 Ordinary Shares of 50 pence each in issue, each carrying the right to one vote. Details of changes in share capital are set out in Note 20 of the financial statements.

## CORPORATE GOVERNANCE

A report on corporate governance and compliance with the provisions of the UK Corporate Governance Code, which forms part of this Directors' Report, is contained on pages 34 to 35.

## REPORT ON GREENHOUSE GAS EMISSIONS

The Group has no employees or premises and is externally advised and administered by the Adviser. The Group is financially but not operationally responsible for emissions related to its property portfolio. Any emissions are therefore negligible. Further information on the Group's social and environmental impact can be found on page 28.

## REQUIREMENTS OF THE LISTING RULES

None of the requirements of the Listing Rule 9.8.4R are applicable to the Group and therefore a separate identifiable section or table has not been included.

## ARTICLES OF ASSOCIATION

The Company's Articles of Association (adopted by special resolution on 6 October 2009) may only be amended by special resolution at a General Meeting of the shareholders.

## SIGNIFICANT AGREEMENTS

The Company is required to disclose details of any agreements that it considers to be essential to the business. The Board do not consider the banking facility agreements with the Group's lenders to fall into this category as if any one of these arrangements ended, the Group would seek alternative funding and the loss or disruption caused should only be temporary.

The Advisory Agreement with the Adviser (further details of which can be found in the Related Party Transactions section below) is considered essential to the business as the Group has no employees. The agreement is reviewed at least annually by the Advisers Engagement Committee.

During the financial year and as at the date of this report, none of the Directors other than those referred to below was materially interested in any significant agreements relating to the Group's business or in any proposed transactions.

## RELATED PARTY TRANSACTIONS

Mr Hyman is a director of Nexus Tradeco Limited ("Nexus") and Nexus Group. Nexus is the Adviser to the Group and as a result, Mr Hyman is deemed to have an interest in the Advisory Agreement referred to above and is thus a related party.

Mr Hambro is chairman of J O Hambro Capital Management Holdings Limited, the parent company of J O Hambro Capital Management Limited ("JOHCM"). Until the termination of the Joint Advisory Agreement on 30 April 2014, JOHCM was Joint Adviser to the Group (see below). Mr Hambro is therefore deemed to have had an interest in the Joint Advisory Agreement (see below) and thus was a related party during that period.

## ADVISORY AGREEMENT

On 30 April 2014, the Company terminated the provision of Administrative Services by JOHCM and its appointment as Company Secretary, pursuant to notice served on 25 September 2013.

Nexus has been retained by the Company under an agreement dated 14 March 1996 (the "Advisory Agreement") to provide property advisory and management services to the Group. The Advisory Agreement gave Nexus the right to appoint and remove one person as a Director of the Company and to receive the applicable Director's fee. Nexus provides the services of the Managing Director. On 30 April 2014, the Advisory Agreement was amended and Nexus was appointed to provide the Administrative Services previously provided by JOHCM and to provide the services of Company Secretary.

The Advisory Agreement contains no provisions to amend, alter or terminate the Advisory Agreement upon a change of control of the Group following a takeover bid.

**Advisory Fees**

The fees received by Nexus comprise of three components designed to compensate them for their ongoing activity at rates appropriate to the different services provided, together with a performance related element in order to align their objectives with those of shareholders.

**(a) Property Advisory Services**

Nexus receives a fee based on a proportion of the gross asset value of the Group. With effect from 1 May 2014 the Advisory Agreement has been amended and a revised rate structure has been applied in calculating property advisory and management fees paid to Nexus. The fee rates are as set out on page 31.

Additional payments may be made to Nexus for non-standard real estate related services but are capped at 10% of the total annual Property Advisory Services fee payable to Nexus in a financial year.

The Advisory Agreement as regards Property Advisory Services is terminable by not less than two years' written notice.

**(b) Administrative Services**

The Company pays Nexus a fixed annual fee of £748,621 in relation to Administrative Services for a period of two years from 1 May 2014 (the "Effective Date") and an annual fee of £935,776 after that date (the "Administrative Services Fee"). The Administrative Services Fee may be increased or decreased by up to 5 percent subject to movements in RPI.

The appointment of Nexus to provide the Administrative Services shall continue for a period of two years from the Effective Date and thereafter the notice period to terminate such services shall be 12 months given by Nexus or the Company.

**(c) Performance Incentive Fee ("PIF")**

Nexus is entitled to a PIF equal to 11.25% of any performance in excess of an 8% per annum increase in the Group's "Total Return" (as derived from the audited accounts for the immediately preceding financial period prior to the date of payment) provided that if the Total Return is less than 8% in any one year, the deficit must be made up in subsequent years before any subsequent PIF is paid. No performance fee was payable in 2014 or 2013 and there is a deficit of some £41.9 million (2013: £51.3 million) to be made up in the net asset value before any further PIF becomes payable under the terms of the Agreement.

Using the relevant audited accounts, the Total Return for the purpose of PIF is determined by calculating the change in the net asset value per ordinary share, on a fully diluted basis, after any adjustment for any increase or reduction in the issued share capital and adding back gross dividends paid per ordinary share.

## EMPLOYEES

The Group has no employees, nor any employee share scheme and there are no agreements between the Company and its Directors providing for compensation for loss of office or employment (whether through resignation, proposed redundancy or otherwise) that may occur because of a takeover bid.

## DONATIONS

The Group does not make any political or charitable donations.

## SHARE SERVICE

The Shareholder Information section on pages 92 to 93 provides details of the share services available.

## FINANCIAL INSTRUMENTS

The Group's financial risk management objectives and policies are discussed in Notes 18 and 19.

## POST BALANCE SHEET EVENTS

Details of events occurring since the year end are given in Note 30 on page 83.

## FUTURE DEVELOPMENTS

Details of future developments are included in the Strategic Review and the Chairman's Statement.

## GOING CONCERN

The Group's business activities together with the factors likely to affect its future development, performance and position are set out in the Strategic Review on pages 6 to 29. The financial result of the Group, its position, its cash flows, liquidity position and borrowing facilities are described on pages 20 to 21 and Notes 16 and 17 on pages 72-74. In addition, Notes 18 and 19 to the financial statements include the Group's financial risk objectives,

# DIRECTORS' REPORT (CONTINUED)

capital position, details of financial instruments and hedging activities and its exposure to credit risk and liquidity risk.

The Group's property portfolio is 91% let to tenants with strong covenants and the property acquisition pipeline is currently adequate. During 2014, the Group refinanced the debt assumed with the PPP portfolio. This was achieved through (i) the procurement of a new £50 million, five year revolving debt facility with HSBC Bank PLC, (ii) the restructuring of £113 million of the facilities assumed with the acquisition with Aviva into a £50 million, ten year interest only tranche and a £63 million, 15 year tranche, interest free for the first 5 years with limited amortisation thereafter and (iii) the utilisation of an element of the headroom within the Group's existing debt facilities.

On 20 May 2014, the Group issued an unsecured £82.5 million, five year, convertible bond.

In addition, in August 2014, the Group (i) extended the term of its £165 million Club facility with Royal Bank of Scotland plc and Santander Banking Group plc for a new three year term, and (ii) enlarged its facility with Barclays Bank plc to £100 million, for a new five year term.

As at 31 December 2014, the Group had £116.7 million of headroom within existing facilities, with a further £12.0 million of cash. The Group's current loan to value ratio is 64.1%, with all banking covenants being met during the year and subsequent to the year end.

The Directors believe that the Group is well placed to manage its business risks successfully. Having reviewed the Group's current position and cash flow projections, actual and prospective loan facilities and covenant cover, the Directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. For this reason the Directors continue to adopt the going concern basis of accounting in preparing the financial statements.

## DIRECTORS' STATEMENT AS TO DISCLOSURE OF INFORMATION TO AUDITORS

The Directors who were members of the Board at the time of approving the Directors' report are listed on page 33. Having made enquiries of fellow Directors and of the Company's Auditors, each of the Directors confirms that:

- to the best of each Director's knowledge and belief, there is no information (that is, information needed by the Group's Auditors in connection with preparing the report) of which the Company's Auditors are unaware; and
- each Director has taken all the steps a director might reasonably be expected to have taken to be aware of relevant audit information and to establish that the Company's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of S418 of the Companies Act 2006.

## ANNUAL GENERAL MEETING

The Annual General Meeting will be held on 22 April 2015 at 10.30 a.m. The Notice convening the Annual General Meeting and explanatory notes for the resolutions sought are set out in the separate document enclosed.

The Directors consider that all of the resolutions proposed are in the best interests of the Company and it is their recommendation that shareholders support these proposals as they intend to do so in respect of their own shareholdings.

## AUDITOR

A resolution to reappoint Deloitte LLP as the Group's auditor and to authorise the Board to determine their remuneration will be put to Shareholders at the forthcoming Annual General Meeting.

By order of the Board

**Nexus Management Services Limited**
**Company Secretary**
18 February 2015

Primary Health Properties PLC
Registered office: 5th Floor, Greener House,
66-68 Haymarket, London SW1Y 4RF

Registered in England No: 3033634

# DIRECTORS' RESPONSIBILITY STATEMENTS

## STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE GROUP AND COMPANY FINANCIAL STATEMENTS

The Directors are responsible for preparing the Annual Report, the Directors' Remuneration Report and the Group and Company financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law, the Directors have prepared the Group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and the Parent Company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law, the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and the Company and of the profit or loss of the Group for that period.

In preparing the Group financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- make judgements and estimates that are reasonable and prudent;
- state whether IFRSs as adopted by the European Union and applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the Group and Parent Company financial statements respectively; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to disclose with reasonable accuracy at any time the financial position of the Company and the Group and to enable them to ensure that the financial statements and the Directors' Remuneration Report comply with the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulations. They are also responsible for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

## RESPONSIBILITY STATEMENTS UNDER THE DISCLOSURE AND TRANSPARENCY RULES

Each of the current Directors confirms that, to the best of his knowledge:

- the Group financial statements, prepared in accordance with IFRSs as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit of the Company and the undertakings included in the consolidation taken as a whole; and
- the Strategic Review on pages 6 to 29 includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that it faces.

In addition, having taken all the matters considered by the Board and brought to the attention of the Board during the year into account, the Directors are satisfied that the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's performance, business model and strategy.

For and on behalf of the Board

**Alun Jones**
**Chairman**
18 February 2015

# INDEPENDENT AUDITOR'S REPORT

## TO THE MEMBERS OF PRIMARY HEALTH PROPERTIES PLC

**Opinion on financial statements of Primary Health Properties plc**

In our opinion:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2014 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation.

The financial statements comprise the Group Statement of Comprehensive Income, the Group and Parent Company Balance Sheet, the Group Cash Flow Statement, the Group Statement of Changes in Equity, the Parent Company Reconciliation of Movement in Shareholders' Funds and the related Notes 1 to 30 for the Group and 1 to 16 for the Parent Company. The financial reporting framework that has been applied in the preparation of the group financial statements is applicable law and IFRSs as adopted by the European Union. The financial reporting framework that has been applied in the preparation of the parent company financial statements is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

## GOING CONCERN

As required by the Listing Rules we have reviewed the directors' statement contained within the Directors Report on pages 47 and 48 that the group is a going concern. We confirm that:

- we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate; and
- we have not identified any material uncertainties that may cast significant doubt on the group's ability to continue as a going concern.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the group's ability to continue as a going concern.

## OUR ASSESSMENT OF RISKS OF MATERIAL MISSTATEMENT

The assessed risks of material misstatement described below are those that had the greatest effect on our audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team:

| Risk | How the scope of our audit responded to the risk |
|---|---|
| **Valuation of property portfolio**<br>The Group owns and manages a portfolio of modern primary healthcare properties that are carried at fair value in the financial statements. The portfolio is valued at £1,026.2 million as at 31 December 2014.<br><br>The valuation is subject to estimation uncertainty because it is underpinned by a number of judgements and assumptions. The Group uses a professionally qualified external valuer to provide the fair value of the Group's portfolio at six-monthly intervals. The portfolio was valued by the investment method of valuation with development properties valued by the same methodology with a deduction made by management for all costs necessary to complete the development.<br><br>Please see accounting policy at page 58 and Note 11 to the financial statements. | We assessed management's process for reviewing and challenging the work of the external valuer. We also assessed the competence, independence and integrity of the external valuer.<br><br>We obtained the external valuation reports and met with the external valuer appointed by management to discuss the results of their work on a sample of properties. We assessed the valuation process, performance of the portfolio and significant judgements and assumptions applied in the valuations, including estimated rental values and yields. We challenged the key assumptions, in particular the yield, by benchmarking against comparable portfolios.<br><br>We tested the integrity of the data provided by management to the external valuer by vouching a sample of the information to the underlying lease agreements.<br><br>We assessed the forecast costs to complete on development properties by reviewing the commitment per the development agreement and auditing a sample of costs incurred in the year to supporting documentation. |

| Risk | How the scope of our audit responded to the risk |
|---|---|
| **Accounting for financing transactions**<br>PHP has undertaken significant financing transactions in the year, including the modification of existing debt facilities and the issue of an £82.5 million convertible bond.<br><br>The accounting standards in relation to the initial recognition and subsequent measurement of such transactions are typically complex and require judgement from management.<br><br>Please see accounting policy at page 60 and Notes 16 and 17 to the financial statements. | We have audited the initial recognition and subsequent measurement of each significant transaction within the financial statements against the relevant accounting standards.<br><br>We have audited the legal documents which govern the financial transactions and confirmed the flow of funds into the Group.<br><br>We audited a sample of the costs in relation to each significant transaction and assessed the presentation within the financial statements. |
| **Valuation of derivative financial instruments**<br>The Group uses a portfolio of interest rate swaps to hedge the risk associated with the variable rate debt facilities. These are recognised in the financial statements at fair value and give rise to a significant audit risk due to the complexity and judgement required in the valuation and recognition in the financial statements. The portfolio was valued at a liability of £41.0 million at 31 December 2014.<br><br>The Group uses a professionally qualified external valuer to provide the fair value of the Group's interest rate swap portfolio at six-monthly intervals. The portfolio was valued by assessing future interest rates in order to provide a present value of the cash flows payable on the swap contract.<br><br>Please see accounting policy at pages 60 and 61 and Note 18 to the financial statements. | With the assistance of a member of the audit team who specialises in financial instrument valuations, we have audited a sample of the interest rate swaps by assessing and recalculating the valuation using our own models with reference to the terms of the underlying derivative contracts.<br><br>We have independently recalculated hedge effectiveness calculations and reviewed the hedge designation documentation for a sample of the hedged instruments to assess that the appropriate hedge accounting has been reflected in the financial statements. |
| **Revenue recognition in respect of outstanding rent reviews and tenant incentives**<br>Within the property portfolio there are a number of leases which require adjusted accounting entries. These include rent free periods, fixed rental increases or where the Group recognises 90% of the expected uplift from rent reviews from the date when a rent review falls due to the date it is settled.<br><br>Please see accounting policy at page 59 and Note 3 to the financial statements. | In respect of tenant incentives and fixed rental uplifts, we have agreed the terms of the leases within the calculation to a sample of underlying lease agreements and recalculated the associated accounting entries.<br><br>We have tested a sample of rental income recognised under the 90% policy by assessing the accuracy of the predicted future rent against the settled rent reviews in the period and reviewing the estimated rental values for a sample of leases in the calculation against the value assumed by the external valuer in the valuation process.<br><br>We have tested a sample of further lease agreements to ensure there are not further tenant incentives or fixed rental uplifts to be recognised. |

Last year our report included an additional risk relating to the accounting for property transactions. This is not included in our report this year due to the lower complexity of current year acquisitions and disposals.

The description of risks above should be read in conjunction with the significant issues considered by the Audit Committee discussed on pages 37 and 38.

Our audit procedures relating to these matters were designed in the context of our audit of the financial statements as a whole, and not to express an opinion on individual accounts or disclosures. Our opinion on the financial statements is not modified with respect to any of the risks described above, and we do not express an opinion on these individual matters.

# INDEPENDENT AUDITOR'S REPORT (CONTINUED)

## OUR APPLICATION OF MATERIALITY

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

We determined materiality for the Group to be £6.2 million (2013: £6.0 million), which is based on 2% (2013: 2%) of net assets. In addition to net assets, we consider EPRA Earnings to be a critical financial performance measure for the Group and we applied a lower threshold of £0.6 million (2013: £0.4 million) based on 5% (2013: 5%) of that measure for testing of all impacted balances.

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £125,000 (2013: £100,000), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

## AN OVERVIEW OF THE SCOPE OF OUR AUDIT

Our group audit was scoped by obtaining an understanding of the Group and its environment, including group-wide controls, and assessing the risks of material misstatement at the group level. The Group is audited by one audit team, led by the Senior Statutory Auditor. The audit is performed centrally, as the books and records for each entity within the Group are maintained at the offices of the adviser.

We also tested the consolidation process and carried out analytical procedures to confirm our conclusion that there were no significant risks of material misstatement of the aggregated financial information.

We audit all of the Group's subsidiaries which are subject to audit at statutory materiality level, which in most cases is substantially lower than Group materiality.

## OPINION ON OTHER MATTERS PRESCRIBED BY THE COMPANIES ACT 2006

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

## MATTERS ON WHICH WE ARE REQUIRED TO REPORT BY EXCEPTION

**Adequacy of explanations received and accounting records**

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

**Directors' remuneration**

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of directors' remuneration have not been made or the part of the Directors' Remuneration Report to be audited is not in agreement with the accounting records and returns. We have nothing to report arising from these matters.

**Corporate Governance Statement**

Under the Listing Rules we are also required to review the part of the Corporate Governance Statement relating to the company's compliance with ten provisions of the UK Corporate Governance Code. We have nothing to report arising from our review.

**Our duty to read other information in the Annual Report**

Under International Standards on Auditing (UK and Ireland), we are required to report to you if, in our opinion, information in the annual report is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the group acquired in the course of performing our audit; or
- otherwise misleading.

In particular, we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the directors' statement that they consider the annual report is fair, balanced and understandable and whether the annual report appropriately discloses those matters that we communicated to the audit committee which we consider should have been disclosed. We confirm that we have not identified any such inconsistencies or misleading statements.

## RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITOR

As explained more fully in the Directors' Responsibilities Statement, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors. We also comply with International Standard on Quality Control 1 (UK and Ireland). Our audit methodology and tools aim to ensure that our quality control procedures are effective, understood and applied. Our quality controls and systems include our dedicated professional standards review team and independent partner reviews.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

## SCOPE OF THE AUDIT OF THE FINANCIAL STATEMENTS

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the group's and the parent company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

**Claire Faulkner**
**Senior Statutory Auditor**
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London, United Kingdom

18 February 2015

# GROUP STATEMENT OF COMPREHENSIVE INCOME

## FOR THE YEAR ENDED 31 DECEMBER 2014

| | | Notes | 2014 £000 | 2013 £000 |
|---|---|---|---|---|
| Rental income | | | 59,985 | 41,895 |
| Finance lease income | | | - | 87 |
| Direct property expenses | | | (723) | (398) |
| **Net rental income** | | 3 | 59,262 | 41,584 |
| Administrative expenses | | 4 | (6,782) | (6,080) |
| Non-recurring expenses: Convertible bond expenses | | | (2,426) | - |
| Non-recurring expenses: Termination Fee | | 4d | - | (2,485) |
| Non-recurring expenses: Costs associated with PPP acquisition | | | - | (217) |
| Profit on termination of finance lease | | 5 | - | 638 |
| Net result on property portfolio | | 11 | 29,204 | 2,313 |
| **Operating profit** | | | 79,258 | 35,753 |
| Finance income | | 6 | 977 | 434 |
| Finance costs | | 7a | (35,252) | (26,450) |
| Early loan repayment fees | | 7b | (1,187) | (950) |
| Fair value (loss)/gain on derivative interest rate swaps and amortisation of cash flow hedging reserve | | 7c | (2,454) | 11,432 |
| Fair value loss on convertible bond | | 7d | (4,462) | - |
| **Profit before taxation** | | | 36,880 | 20,219 |
| Taxation charge | | 8 | - | 1 |
| **Profit for the year**[1] | | | 36,880 | 20,220 |
| **Other comprehensive (loss)/income:** | | | | |
| **Items that may be reclassified subsequently to profit and loss:** | | | | |
| Fair value (loss)/gain on interest rate swaps treated as cash flow hedges | | 24 | (9,980) | 12,840 |
| **Other comprehensive (loss)/income for the year net of tax**[1] | | | (9,980) | 12,840 |
| **Total comprehensive income for the year net of tax**[1] | | | 26,900 | 33,060 |
| **Earnings per share** | Basic | 9 | 33.2p | 22.7p |
| | Diluted | | 31.5p | |
| **EPRA earnings per share** | Basic | 9 | 16.4p | 7.6p |
| | Diluted | | 16.4p | |

The above relates wholly to continuing operations.

(1) Wholly attributable to equity shareholders of Primary Health Properties PLC.

# GROUP BALANCE SHEET

## AT 31 DECEMBER 2014

| | Notes | 2014 £000 | 2013 £000 |
|---|---|---|---|
| **Non-current assets** | | | |
| Investment properties | 11 | 1,026,207 | 941,548 |
| Derivative interest rate swaps | 18 | 25 | 472 |
| | | 1,026,232 | 942,020 |
| **Current assets** | | | |
| Trade and other receivables | 13 | 5,668 | 4,764 |
| Cash and cash equivalents | 14 | 12,072 | 9,288 |
| | | 17,740 | 14,052 |
| **Total assets** | | 1,043,972 | 956,072 |
| **Current liabilities** | | | |
| Derivative interest rate swaps | 18 | (5,802) | (7,566) |
| Corporation tax payable | | - | (23) |
| Deferred rental income | | (12,308) | (11,934) |
| Trade and other payables | 15 | (14,244) | (16,269) |
| Borrowings: Term loans and overdraft | 16 | (711) | (3,843) |
| | | (33,065) | (39,635) |
| **Non-current liabilities** | | | |
| Borrowings: Term loans and overdraft | 16 | (437,022) | (460,185) |
| Borrowings: Bonds | 17 | (229,543) | (132,408) |
| Derivative interest rate swaps | 18 | (35,212) | (21,459) |
| | | (701,777) | (614,052) |
| **Total liabilities** | | (734,842) | (653,687) |
| **Net assets** | | 309,130 | 302,385 |
| **Equity** | | | |
| Share capital | 20 | 55,638 | 55,237 |
| Share premium account | 21 | 56,416 | 55,611 |
| Capital reserve | 22 | 1,618 | 1,618 |
| Special reserve | 23 | 115,438 | 135,483 |
| Cash flow hedging reserve | 24 | (23,847) | (14,337) |
| Retained earnings | 25 | 103,867 | 68,773 |
| **Total equity**[1] | | 309,130 | 302,385 |
| **Net asset value per share – basic** | 26 | 278p | 274p |
| **EPRA net asset value per share** | 26 | 319p | 300p |

(1) Wholly attributable to equity shareholders of Primary Health Properties PLC.

These financial statements were approved by the Board of Directors on 18 February 2015 and signed on its behalf by:

**Alun Jones**
Chairman

# GROUP CASH FLOW STATEMENT

## FOR THE YEAR ENDED 31 DECEMBER 2014

| | Notes | 2014 £000 | 2013 £000 |
|---|---|---|---|
| **Operating activities** | | | |
| Profit on ordinary activities before tax | | 36,880 | 20,219 |
| Finance income | 6 | (977) | (434) |
| Finance costs | 7a | 35,252 | 26,450 |
| Provision for early loan repayment fee | 7b | 1,187 | 950 |
| Amortisation of cash flow hedge reserve | 7c | - | 571 |
| Fair value loss/(gain) on derivatives | 7c | 2,454 | (12,003) |
| Fair value loss on convertible bond | 7d | 4,462 | - |
| Operating profit before financing costs | | 79,258 | 35,753 |
| Adjustments to reconcile Group operating profit to net cash flows from operating activities: | | | |
| Revaluation gain on property portfolio | 11 | (29,204) | (2,313) |
| Profit on termination of finance lease | 5 | - | (638) |
| Fixed rent uplift | | (1,025) | (905) |
| Convertible bond issue costs | | 2,426 | - |
| (Increase)/decrease in trade and other receivables | | (447) | 4,402 |
| Increase/(decrease) in trade and other payables | | (1,985) | 383 |
| **Cash generated from operations** | | 49,023 | 36,682 |
| Taxation paid | 8 | (23) | (89) |
| **Net cash flow from operating activities** | | 49,000 | 36,593 |
| **Investing activities** | | | |
| Payments to acquire investment properties | | (54,921) | (44,560) |
| Proceeds from disposal of investment properties | | 525 | - |
| Proceeds from disposal of finance lease | 5 | - | 3,768 |
| Subsidiaries acquired | | - | (13,939) |
| Interest received on developments | | 478 | 188 |
| Bank interest received | | 40 | 48 |
| **Net cash flow used in investing activities** | | (53,878) | (54,495) |
| **Financing activities** | | | |
| Proceeds from issue of shares | | - | 68,500 |
| Cost of share issue | | (15) | (2,728) |
| Cost of share issue - PPP | | - | (540) |
| Term bank loan drawdowns | | 164,922 | 120,718 |
| Term bank loan repayments | | (176,343) | (195,740) |
| Proceeds of bond issues | | 92,500 | 60,000 |
| Bond issue costs | | (2,560) | (1,320) |
| Swap interest paid | | (7,667) | (7,661) |
| Non utilisation fees | | (990) | (1,023) |
| Loan arrangement fees | | (3,092) | (1,274) |
| Interest paid | | (24,078) | (18,328) |
| Breakage fee on Aviva debt | | (14,327) | (2,380) |
| Equity dividends paid net of scrip dividend | 10 | (20,688) | (16,130) |
| **Net cash flow from financing activities** | | 7,662 | 2,094 |
| **Increase/(decrease) in cash and cash equivalents for the year** | | 2,784 | (15,808) |
| **Cash and cash equivalents at start of year** | | 9,288 | 25,096 |
| **Cash and cash equivalents at end of year** | 14 | 12,072 | 9,288 |

# GROUP STATEMENT OF CHANGES IN EQUITY

## FOR THE YEAR ENDED 31 DECEMBER 2014

| | Share capital £000 | Share premium £000 | Capital reserve £000 | Special reserve £000 | Cash flow hedging reserve £000 | Retained earnings £000 | Total £000 |
|---|---|---|---|---|---|---|---|
| **1 January 2014** | **55,237** | **55,611** | **1,618** | **135,483** | **(14,337)** | **68,773** | **302,385** |
| Profit for the year | - | - | - | - | - | 36,880 | 36,880 |
| **Other comprehensive income** | | | | | | | |
| Fair value movement on interest rate swaps | - | - | - | - | (9,980) | - | (9,980) |
| **Total comprehensive income** | - | - | - | - | (9,980) | 36,880 | 26,900 |
| Interest rate derivative fair value adjustment | - | - | - | - | - | (1,316) | (1,316) |
| Reclassification of swap from ineffective to effective[2] | - | - | - | - | 470 | (470) | - |
| Share issue as part of consideration for PPP | 259 | - | - | 1,605 | - | - | 1,864 |
| Share issue expenses | - | (15) | - | - | - | - | (15) |
| **Dividends paid:** | | | | | | | |
| Second interim dividend for the year ended 31 December 2013 (9.75p) | - | - | - | (10,542) | - | - | (10,542) |
| Scrip dividends in lieu of second interim cash dividend (net of expenses) | 41 | 238 | - | (279) | - | - | - |
| First interim dividend for the year ended 31 December 2014 (9.75p) | - | - | - | (10,146) | - | - | (10,146) |
| Scrip dividend in lieu of first interim cash dividend (net of expenses) | 101 | 582 | - | (683) | - | - | - |
| **31 December 2014** | **55,638** | **56,416** | **1,618** | **115,438** | **(23,847)** | **103,867** | **309,130** |
| **1 January 2013** | **38,017** | **58,606** | **1,618** | **59,473** | **(27,177)** | **48,553** | **179,090** |
| Profit for the year | - | - | - | - | - | 20,220 | 20,220 |
| **Other comprehensive income** | | | | | | | |
| Fair value movement on interest rate swaps | - | - | - | - | 12,269 | - | 12,269 |
| Amortisation of cash flow hedging reserve | | | | | 571 | | 571 |
| **Total comprehensive income** | - | - | - | - | 12,840 | 20,220 | 33,060 |
| Proceeds from equity issue | 10,873 | - | - | 57,627 | - | - | 68,500 |
| Expenses of equity issue | - | - | - | (2,728) | - | - | (2,728) |
| Share issue as part of consideration for PPP | 6,289 | - | - | 35,344 | - | - | 41,633 |
| Share issue expenses (PPP) | - | - | - | (1,040) | - | - | (1,040) |
| Reserves transfer[1] | - | (3,325) | - | 3,325 | - | - | - |
| **Dividends paid:** | | | | | | | |
| Second interim dividend for the year ended 31 December 2012 (9.50p) | - | - | - | (7,006) | - | - | (7,006) |
| Scrip dividends in lieu of second interim cash dividend (net of expenses) | 32 | 185 | - | (217) | - | - | - |
| First interim dividend for the year ended 31 December 2013 (9.50p) | - | - | - | (9,124) | - | - | (9,124) |
| Scrip dividend in lieu of first interim cash dividend (net of expenses) | 26 | 145 | - | (171) | - | - | - |
| **31 December 2013** | **55,237** | **55,611** | **1,618** | **135,483** | **(14,337)** | **68,773** | **302,385** |

(1) £3.3 million has been transferred from Share Premium to the Special Reserve with regards to the Apollo transaction under the merger relief provision of the Companies Act 2006. Refer to Note 22 for further details.
(2) This relates to fair value changes in prior periods incorrectly recognised within the cash flow hedge reserve movements.

# NOTES TO THE FINANCIAL STATEMENTS

## 1. CORPORATE INFORMATION

The Group's financial statements for the year ended 31 December 2014 were approved by the Board of Directors on 18 February 2015 and the Balance Sheets were signed on the Board's behalf by the Chairman, Alun Jones. Primary Health Properties PLC is a public limited company incorporated and domiciled in England & Wales. The Company's Ordinary shares are admitted to the Official List of the UK Listing Authority, a division of the Financial Conduct Authority, and traded on the London Stock Exchange.

## 2. ACCOUNTING POLICIES

### 2.1 Basis of preparation

The Group's financial statements have been prepared on the historical cost basis, except for investment properties and derivative financial instruments that have been measured at fair value.

The Group's financial statements are prepared on the going concern basis and presented in Sterling rounded to the nearest thousand.

**Statement of compliance**

The Group prepares consolidated financial statements under International Financial Reporting Standards ("IFRS") as adopted by the European Union and applied in accordance with the Companies Act 2006 and Article 4 of the IAS Regulations.

### 2.2 Summary of significant accounting policies

**Basis of consolidation**

The Group's financial statements consolidate the financial statements of Primary Health Properties PLC and its wholly owned subsidiary undertakings. Subsidiaries are consolidated from the date of their acquisition, being the date on which the Group obtained control, and continue to be consolidated until the date that such control ceases. Control comprises the power to govern the financial and operating policies of the investee so as to obtain benefit from its activities and is achieved through direct or indirect ownership of voting rights; currently exercisable or convertible potential voting rights; or by way of contractual agreement. The financial statements of the subsidiary undertakings are prepared for the accounting reference period ending 31 December each year using consistent accounting policies. All intercompany balances and transactions, including unrealised profits arising from them, are eliminated on consolidation.

The individual financial statements of Primary Health Properties PLC and each of its subsidiary undertakings will continue to be prepared under UK GAAP for the current year. The use of IFRS at Group level does not affect the distributable reserves available to the Group.

**Segmental reporting**

The Directors are of the opinion that the Group is engaged in a single segment of business, being investment in property in the United Kingdom leased principally to GPs, NHS organisations and other associated health care users.

**Investment properties and investment properties under construction**

The Group's investment properties are held for long-term investment. Investment properties and those under construction are initially measured at cost, including transaction costs. Subsequent to initial recognition, investment properties and investment properties under construction are stated at fair value based on market data and a professional valuation made as of each reporting date. The fair value of investment property does not reflect future capital expenditure that will improve or enhance the property and does not reflect future benefits from this future expenditure.

Gains or losses arising from changes in the fair value of investment properties and investment properties under construction are included in the Group Statement of Comprehensive Income in the year in which they arise.

Investment properties are recognised for accounting purposes upon completion of contract, unless a specific completion date is noted in the contract, in which case the property will be recognised on the date specified. Investment properties cease to be recognised when they have been disposed of. Any gains and losses arising are recognised in the Group Statement of Comprehensive Income in the year of disposal.

**Development loans**

The Group has entered into development loan agreements with third party developers in respect of certain properties under development. These loans are repayable at the option of the developer at any time. The Group has entered into contracts to purchase the properties under development when they are completed in accordance with the terms of the contracts. The loans are repayable by the developers in the event that the building work is not completed in accordance with the purchase contracts. Interest is charged under the terms detailed in the respective development agreements and taken to the Group Statement of Comprehensive Income in the year in which it accrues.

**Property acquisitions and business combinations**

Where a property is acquired through the acquisition of corporate interests, the Board considers the substance of the assets and activities of the acquired entity in determining whether the acquisition represents the acquisition of a business. The basis of the judgement is set out in Note 2.3(b).

Where such acquisitions are not judged to be an acquisition of a business, they are not treated as business combinations. Rather, the cost to acquire the corporate entity is allocated between the identifiable assets and liabilities of the entity based on their relative fair values on the acquisition date. Accordingly, no goodwill or additional deferred taxation arises. Otherwise, corporate acquisitions are accounted for as business combinations.

**Impairment of assets**
The Group assesses, at each reporting date, whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Group makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's, or cash-generating units, fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Impairment losses are recognised in the Group Statement of Comprehensive Income.

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated.

A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in the Group Statement of Comprehensive Income.

**Net rental income**
Rental income arising from operating leases on investment properties is accounted for on a straight line basis over the lease term. An adjustment to rental income is recognised from the rent review date of each lease in relation to unsettled rent reviews. Such adjustments are accrued at 90% of the additional rental income that is expected to result from the review. For leases which contain fixed or minimum deemed uplifts, the rental income is recognised on a straight line basis over the lease term. Incentives for lessees to enter into lease agreements are spread evenly over the lease terms, even if the payments are not made on such a basis. Rental income is measured at the fair value of the consideration receivable, excluding discounts, rebates, VAT and other sales taxes or duty.

**Interest income**
Revenue is recognised as interest accrues, using the effective interest method (that is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument to the net carrying amount of the financial asset).

**Trade and other receivables**
Trade receivables are recognised and carried at the lower of their original invoiced value and recoverable amount. Where the time value of money is material, receivables are carried at amortised cost. Provision is made when there is objective evidence that the Group will not be able to recover balances in full. Balances are written off when the probability of recovery is assessed as being remote.

**Cash and cash equivalents**
Cash and cash equivalents are defined as cash and short term deposits, including any bank overdrafts, with an original maturity of three months or less.

**Trade and other payables**
Trade payables are recognised and carried at their invoiced value inclusive of any VAT that may be applicable.

**Bank loans and borrowings**
All loans and borrowings are initially measured at fair value less directly attributable transaction costs. After initial recognition, all interest-bearing loans and borrowings are subsequently measured at amortised cost, using the effective interest method.

**Borrowing costs**
Borrowing costs that are separately identifiable and directly attributable to the acquisition or construction of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale are capitalised as part of the cost of the respective assets. All other borrowing costs are expensed in the period in which they occur. Borrowing costs consist of interest and other costs the Group incurs in connection with the borrowing of funds.

**Convertible bond**
The convertible bond is designated as "at fair value through profit or loss" and so is presented on the Group Balance Sheet at fair value with all gains and losses, including the write-off of issuance costs, recognised in the Group Statement of Comprehensive Income. The interest charge in respect of the coupon rate on the bond has been recognised within the underlying component of net financing costs on an accruals basis. Refer to Note 17 for further details.

**Conversion to UK-REIT**
The Group's conversion to UK-REIT status was effective from 1 January 2007. Conversion to a UK-REIT results in, subject to continuing relevant UK-REIT criteria being met, the Group's property profits, both income and gains, being exempt from UK taxation from 1 January 2007. Acquired companies are effectively converted to UK-REIT status from the date on which they become a member of the Group. There were no charges payable upon the acquisition of companies by the Group following the abolition of the REIT conversion charge.

**Taxation**
Taxation on the profit or loss for the period not exempt under UK-REIT regulations comprises current and deferred tax. Taxation is recognised in the Group Statement of Comprehensive Income except to the extent that it relates to items recognised as direct movements in equity, in which case it is also recognised as a direct movement in equity.

# NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Current tax is the expected tax payable on any non-REIT taxable income for the period, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

**Financial instruments**
*Financial assets at fair value through profit or loss*
Financial assets at fair value through profit or loss include financial assets designated upon initial recognition as fair value through profit and loss. This category includes derivative financial instruments entered into by the Group that do not meet the hedge accounting criteria as defined by IAS39. Financial assets at fair value through profit and loss are carried in the Group Balance Sheet at fair value with gains or losses recognised in the Group Statement of Comprehensive Income.

*Financial liabilities at fair value through profit or loss*
Financial liabilities at fair value through profit or loss include financial liabilities held for trading and financial liabilities designated upon initial recognition at fair value through profit or loss. Financial liabilities are classified as held for trading if they are acquired for the purpose of selling in the near term. This category includes derivative financial instruments entered into by the Group that are not designated as hedging instruments in hedging relationships as defined by IAS 39. Gains or losses on liabilities held for trading are recognised in the Group Statement of Comprehensive Income.

*Loans and receivables*
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted on an active market. Such assets are carried at amortised cost using the effective interest method. Gains and losses are recognised in the Group Statement of Comprehensive Income when the loans and receivables are de-recognised or impaired, as well as through the amortisation process.

**De-recognition of financial assets and liabilities**
*Financial assets*
A financial asset (or where applicable a part of a financial asset or part of a Group of similar financial assets) is de-recognised where:
- the rights to receive cash flows from the asset have expired;
- the Group retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass-through' arrangement; or
- the Group has transferred its right to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Where the Group has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

*Financial liabilities*
A financial liability is de-recognised when the obligation under the liability is discharged or cancelled or expires.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a de-recognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in income.

When the exchange or modification of an existing financial liability is not accounted for as an extinguishment, any costs or fees incurred adjust the liability's carrying amount and are amortised over the modified liability's remaining term.

**Fair value measurements**
The Group measures certain financial instruments such as derivatives, and non-financial assets such as investment property, at fair value at the end of each reporting period. Also, fair values of financial instruments measured at amortised cost are disclosed in the financial statements.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:
- In the principal market for the asset or liability; or
- In the absence of a principal market, in the most advantageous market for the asset or liability

The Group must be able to access the principal or the most advantageous market at the measurement date.

The fair value of an asset or liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Group uses valuation techniques at three levels that are appropriate in the circumstances and for which sufficient data is available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs significant to the fair value measurement as a whole:

Level 1 Quoted (unadjusted) market prices in active markets for identical assets or liabilities.
Level 2 Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable.

Level 3 Valuation techniques for which the lowest input that is significant to the fair value measurement is unobservable.

For assets and liabilities that are recognised in the financial statements on a recurring basis, the Group determines whether transfers have occurred between levels in the hierarchy by reassessing categorisation at the end of each reporting period.

**Derivative financial instruments (derivatives) and hedge accounting**
The Group uses interest rate swaps to help manage its interest rate risk.

At the inception of the transaction the Group documents the relationship between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedging transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions meet the strict criteria of IAS 39 for being described as "effective" in offsetting changes in cash flows of hedged items.

All derivatives are initially recognised at fair value at the date the derivative is entered into and are subsequently re-measured at fair value. The fair values of the Group's interest rate swaps are calculated by J.C. Rathbone Associates Limited, an independent specialist which provides treasury management services to the Group.

The method of recognising the resulting gain or loss depends on whether the derivative is designated as an effective hedging instrument.

- where a derivative is designated as a hedge of the variability of a highly probable forecast transaction, such as an interest payment, the element of the gain or loss on the derivative that is an "effective" hedge is recognised directly in equity. When the forecast transaction subsequently results in the recognition of a financial asset or a financial liability, the associated gains or losses that were recognised directly in equity are reclassified into the Group Statement of Comprehensive Income in the same period or periods during which the asset acquired or liability assumed affects the Group Statement of Comprehensive Income i.e. when interest income or expense is recognised;
- the gain or loss on derivatives that do not meet the strict criteria for being "effective" and so do not qualify for hedge accounting and the non-qualifying element of derivatives that do qualify for hedge accounting, are recognised in the Group Statement of Comprehensive Income immediately. The treatment does not alter the fact that the derivatives are economic hedges of the underlying transaction.

For swaps that have been cancelled which previously qualified for hedge accounting, the remaining value within the cash flow hedging reserve at the date of cancellation is recycled to the Group Statement of Comprehensive Income on a straight line basis from the date of cancellation to the original swap expiry date.

**Dividends payable to Shareholders**
Dividends proposed by the Board of Directors and unpaid at the year end are not recognised in the financial statements as they are appropriations of income. Furthermore, any final dividends would not be recognised until they have been approved by Shareholders at an Annual General Meeting.

**Leases – Group as a lessor**
The vast majority of the Group's properties are leased out under operating leases and are included within investment properties. Rental income, including the effect of lease incentives, is recognised on a straight line basis over the lease term.

Where the Group transfers substantially all the risks and benefits of ownership of the asset, the arrangement is classified as a finance lease and a receivable is recognised for the initial direct costs of the lease and the present value of the minimum lease payments. Finance income is recognised in the Group Statement of Comprehensive Income so as to achieve a constant rate of return on the remaining net investment in the lease. Interest income on finance leases is restricted to the amount of interest actually received.

**2.3 Significant accounting estimates and judgements**
The preparation of the Group financial statements requires management to make a number of estimates and judgements that affect the reported amounts of assets and liabilities and may differ from future actual results. The estimates and judgements that are considered most critical and that have a significant inherent risk of causing a material adjustment to the carrying amounts of assets and liabilities are:

**a) Estimates**
*Fair value of investment properties*
Investment property includes (i) completed investment property, and (ii) investment property under construction. Completed investment property comprises real estate held by the Group or leased by the Group under a finance lease in order to earn rentals or for capital appreciation, or both.

The fair market value of a property is deemed by the independent property valuers appointed by the Group, to be the estimated amount for which a property should exchange, on the date of valuation, in an arm's length transaction. Properties have been valued on an individual basis, assuming that they will be sold individually over time. Allowances are made to reflect the purchaser's costs of professional fees and stamp duty.

In accordance with RICS Appraisal and Valuation Standards, factors taken into account are current market conditions; annual rentals; state of repair, ground stability, contamination issues and fire and health and safety legislations.

In determining the fair value of investment properties

# NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

under construction the valuer is required to consider the significant risks which are relevant to the development process including, but not limited to, construction and letting risks. Where assets under construction are pre-let and construction risk remains with the respective developer or contractor, these facts are taken into account in estimating fair values.

*Fair value of derivatives*
In accordance with IAS 39, the Group values its derivative financial instruments at fair value. Fair value is estimated by J.C. Rathbone Associates Limited on behalf of the Group, using a number of assumptions based upon market rates and discounted future cash flows. The derivative financial instruments have been valued by reference to the mid-price of the yield curve prevailing on 31 December 2014. Fair value represents the net present value of the difference between the cash flows produced by the contracted rate and the valuation rate.

*Rent reviews*
The Group's occupational leases include periodic rent review provisions. All reviews are effectively upwards only and either reviewed to Open Market Rent, linked to RPI or subject to a fixed uplift at the review date. The Group accrues for the potential uplift in rent from the date of the review. Estimated rents are established by the Adviser using their own data from previous reviews supported by estimates from third party advisers. The Group then accrues 90% of the estimated rental increase. Any additional rent receivable is booked on receipt when the rent review is agreed.

**b) Judgements**

*Leases*
The Group has entered into commercial property leases on its investment property portfolio. The Group has determined that it retains all the significant risks and rewards of ownership of the vast majority of the properties, which are leased out on operating leases. The Group has entered into a small number of finance lease arrangements where it has determined that it has transferred substantially all the risks and rewards incidental to ownership to the occupier.

*Hedge effectiveness*
The Group has a number of interest rate swaps that mature after the Group's bank facilities, to which they relate, are due to expire. In accordance with IAS39, in order to apply hedge accounting in relation to these interest rate swaps, the Group has determined that it is highly probable that these bank facilities will be re-negotiated on or before expiry and that variable interest rate debt finance will be in place until the expiry date of the swaps.

*Property acquisitions during the year*
The Directors have reviewed the acquisitions during the year on an individual basis in accordance with the requirements of IFRS 3(R). They consider that they all meet the criteria of asset acquisitions rather than business combinations and have accounted for them as such. This judgement was made due to the absence of business processes inherent in the entities acquired.

**2.4 Standards adopted during the year**

The accounting policies adopted are consistent with those of the previous financial year, except for the following new and amended IFRSs effective for this Group as of 1 January 2014. The nature and the impact of each of the new standards and amendments are described below.

- IFRS 10, 'Consolidated financial statements' - Under IFRS 10, subsidiaries are all entities (including structured entities) over which the Group has control. The Group controls an entity when the Group has power over an entity, is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect these returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date that control ceases. The Group has applied IFRS 10 retrospectively in accordance with the transition provisions of IFRS 10 and there has been no material impact to the financial statements as a result.

Other new standards and amendments to certain standards apply for the first time in 2014. However, they do not impact the annual consolidated financial statements of the Group. They are as follows:

- IFRS 11 'Joint arrangements'
- IFRS 12 'Disclosure of interests in other entities'
- IAS 27 'Separate Financial Statements'
- IAS 28 'Investments in Associates and Joint Ventures'
- Amendments to IAS 32 'Financial Instruments: Presentation'
- IAS 36 'Recoverable Amount Disclosures for Non-Financial Assets'
- Amendments to IAS 39 'Financial instruments: Recognition and measurement'

**2.5 Standards issued but not yet effective**

A number of new standards and amendments to standards and interpretations are effective for annual periods beginning after 1 January 2014 but are not yet applicable to the Group, and have not been applied in preparing these consolidated financial statements. None of these are expected to have a significant effect on the consolidated financial statements of the Group, except the following set out below:

IFRS 9, 'Financial instruments', addresses the classification, measurement and recognition of financial assets and financial liabilities. The complete version of IFRS 9 was issued in July 2014. It replaces the guidance in IAS 39 that relates to the classification and measurement of financial instruments. IFRS 9 retains but simplifies the mixed measurement model and establishes three primary measurement categories for financial assets: amortised cost, fair value through other comprehensive income and fair value through profit and loss. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. Investments in equity instruments are required to be measured at fair value through profit or loss with the irrevocable option at inception to present changes in fair value in other comprehensive income not recycling. There is now a new expected credit losses model that replaces the incurred loss impairment model used in IAS 39. For financial liabilities there were no changes to classification and measurement except for the recognition of changes in own credit risk in other comprehensive income, for liabilities designated at fair value through profit or loss. IFRS 9 relaxes the requirements for hedge effectiveness by replacing the bright line hedge effectiveness tests. It requires an economic relationship between the hedged item and hedging instrument and for the 'hedged ratio' to be the same as the one management actually use for risk management purposes. Contemporaneous documentation is still required but is different to that currently prepared under IAS 39. The standard is effective for accounting periods beginning on or after 1 January 2018. Early adoption is permitted, subject to EU endorsement. The Group is assessing the full impact of IFRS 9.

IFRS 15, 'Revenue from contracts with customers' deals with revenue recognition and establishes principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers.

Revenue is recognised when a customer obtains control of a good or service and thus has the ability to direct the use and obtain the benefits from the good or service. The standard replaces IAS 18 'Revenue' and IAS 11 'Construction contracts' and related interpretations. The standard is effective for annual periods beginning on or after 1 January 2017 and earlier application is permitted, subject to EU adoption. The Group is assessing the impact of IFRS 15.

## 3. RENTAL AND RELATED INCOME

Revenue comprises rental income and finance lease income receivable on property investments in the UK, which is exclusive of VAT. Revenue is derived from one reportable operating segment. Details of the lease income are given below.

**Group as a lessor**

a) The future minimum lease payments under non-cancellable operating leases receivable by the Group are as follows:

| | Less than one year £000 | 1 to 5 years £000 | More than 5 years £000 | Total £000 |
|---|---|---|---|---|
| 2014 | 58,811 | 234,577 | 591,842 | 885,230 |
| 2013 | 56,188 | 224,122 | 587,088 | 867,398 |

The future minimum lease payments include amounts due in future years from investment properties under development at the year end.

b) The rental income earned on operating leases is recognised on a straight line basis over the lease term.

The Group leases medical centres to GPs, NHS organisations and other healthcare users, typically on long term occupational leases which provide for regular reviews of rent on an effectively upwards only basis.

## 4. GROUP OPERATING PROFIT IS STATED AFTER CHARGING

| | 2014 £000 | 2013 £000 |
|---|---|---|
| **Administrative expenses include:** | | |
| Advisory fees (note 4a) | 5,345 | 4,887 |
| Directors' fees (note 4c) | 243 | 219 |
| **Audit fees** | | |
| Fees payable to the Company's auditor and their associates for the audit of the Company's annual accounts | 105 | 100 |
| Fees payable to the Company's auditor and their associates for other services to the audit of the Company's subsidiaries | 101 | 92 |
| Total audit fees | 206 | 192 |
| **Non-audit fees** | | |
| Audit-related assurance services | 41 | 40 |
| Other assurance services | 50 | 8 |
| Total non-audit fees | 91 | 48 |

The Group's policy on non-audit fees is discussed in the Audit Committee Report.

# NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

**a) Advisory fees**

The advisory fee calculated and payable for the period to 31 December was as follows:

| | 2014 £000 | 2013 £000 |
|---|---|---|
| Nexus | 4,697 | 3,154 |
| J O Hambro Capital Management ("JOHCM") | 648 | 1,733 |
| | 5,345 | 4,887 |

Further details on the Advisory Agreement can be found in the Corporate Governance section of the Strategic Report.

As at 31 December 2014, nil advisory fees payable to JOHCM were outstanding (2013: £0.2 million) and £0.4 million was payable to Nexus (2013: £0.4 million). Refer to the Corporate Governance section of the Strategic Review for further information on the termination of the JOHCM services on 30 April 2014.

Further fees paid to Nexus in accordance with the Advisory Agreement of £0.1 million (2013: £0.07 million) in respect of capital projects were capitalised in the year.

**b) Performance Incentive Fee ("PIF")**

Information about the Performance Incentive Fee ("PIF") is provided in the Corporate Governance section of the Strategic Review.

**c) Remuneration of Directors**

Information about the remuneration of individual Directors is provided in the Directors' Remuneration Report in the Annual Report.

**d) Termination Fee: non-recurring**

| | 2014 £000 | 2013 £000 |
|---|---|---|
| JOHCM | - | 2,485 |

On 26 September 2013 the Board of PHP announced that it served notice to terminate the contract under which JOHCM provided services to the Group (the "Joint Advisory Agreement"). A contractual termination fee of £2.5 million became payable to JOHCM upon completion of their notice period on 30 April 2014. This sum was provided for in the Group Statement of Comprehensive Income for the year ended 31 December 2013 and settled on 13 May 2014.

## 5. PROFIT ON TERMINATION OF FINANCE LEASE

| | 2014 £000 | 2013 £000 |
|---|---|---|
| Profit on termination of finance lease | - | 638 |

On 27 March 2013, the Group recognised a profit on disposal of a property held under a finance lease. Disposal proceeds of £3.8 million were received and the carrying value of the asset at the date of disposal was £3.1 million. A small amount of disposal costs were incurred.

## 6. FINANCE INCOME

| | 2014 £000 | 2013 £000 |
|---|---|---|
| **Interest income on financial assets** | | |
| Bank interest | 37 | 41 |
| Development loan interest | 937 | 388 |
| Other interest | 3 | 5 |
| | 977 | 434 |

## 7. FINANCE COSTS

| | 2014 £000 | 2013 £000 |
|---|---|---|
| **Interest expense and similar charges on financial liabilities** | | |
| **a) Interest** | | |
| Bank loan interest | 16,959 | 12,021 |
| Swap interest | 7,609 | 7,699 |
| Bond interest | 8,058 | 4,314 |
| Bank facility non-utilisation fees | 926 | 976 |
| Bank charges and loan commitment fees | 1,700 | 1,440 |
| | 35,252 | 26,450 |
| **b) Early loan repayment fees** | | |
| Fee on breakage of Apollo debt | - | 824 |
| Fee on breakage of PHCC debt | - | 126 |
| Fee on breakage of PPP debt | 1,187 | - |
| | 1,187 | 950 |

Following the Apollo transaction in December 2012, the debt assumed as part of the transaction was fully repaid in March 2013. A charge of £0.8 million was made to the Group Statement of Comprehensive Income in 2013 in 2013 with regard to this repayment.

Following the PHCC transaction in July 2013, the debt assumed as part of the transaction was fully repaid in October 2013. An additional charge to the Group Statement of Comprehensive Income in 2013 was made of £0.1 million.

As part of the acquisition of the companies that held the PPP portfolio in December 2013, the Group assumed £178 million of loan obligations funded by Aviva. The transaction pricing included a provision of £13.7 million that estimated the cost of re-setting those loans to current market rates. An additional charge of £1.2 million was made to the Group Statement of Comprehensive Income with regard to costs associated with the early repayment and restructuring of these loans during the year.

| | 2014 £000 | 2013 £000 |
|---|---|---|
| **c) Derivatives** | | |
| Net fair value (loss)/gain on interest rate swaps | (2,454) | 12,003 |
| Amortisation of cash flow hedging reserve | - | (571) |
| | (2,454) | 11,432 |

The fair value gain on derivatives recognised in the Group Statement of Comprehensive Income has arisen from the interest rate swaps for which hedge accounting does not apply. A fair value loss on derivatives which meet the hedge effectiveness criteria under IAS 39 of £9.9 million (2013 gain: £12.0 million) is accounted for directly in equity, together with amortisation of the hedging reserve of nil (2013: £0.5 million).

Details of the fair value loss on hedges which meet the effectiveness criteria for hedge accounting under IAS 39 are set out in Note 24.

| | 2014 £000 | 2013 £000 |
|---|---|---|
| **d) Convertible bond** | | |
| Fair value (loss) on convertible bond | (4,462) | - |

The fair value movement in the convertible bond is recognised in the Group Statement of Comprehensive Income within Profit before taxation and is excluded from the calculation of EPRA earnings and EPRA NAV. Refer to Note 17 for further details about the convertible bond.

# NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

| | 2014 £000 | 2013 £000 |
|---|---|---|
| **Net finance costs** | | |
| Finance income (note 6) | (977) | (434) |
| Finance costs (as per above) | 35,252 | 26,450 |
| | 34,275 | 26,016 |

## 8. TAXATION

**a) Tax credit in the Group Statement of Comprehensive Income**
The tax credit is made up as follows:

| | 2014 £000 | 2013 £000 |
|---|---|---|
| **Current tax** | | |
| UK corporation tax (note 8b) | - | (1) |

The 2013 tax credit relates to the release of tax provisions from prior years and variances in the amount of corporation tax paid in acquired companies against the agreed provision at acquisition.

A reduction in the UK corporation tax rate from 23% to 21% was effective from 1 April 2014. Accordingly, these rates have been applied in the measurement of the Group's tax liability at 31 December 2014.

**b) Factors affecting the tax credit for the year**
The tax assessed for the year is lower than (2013: lower than) the standard rate of corporation tax in the UK. The differences are explained below:

| | 2014 £000 | 2013 £000 |
|---|---|---|
| Profit before taxation | 36,880 | 20,219 |
| Theoretical tax at UK corporation tax rate of 21.5% (2013: 23.3%) | 7,929 | 4,711 |
| REIT exempt income | (5,935) | (3,280) |
| Transfer pricing adjustments | 2,886 | 1,870 |
| Non-taxable items | (4,270) | (3,302) |
| Finance lease adjustment | - | 1 |
| Losses carried forward | (610) | - |
| Movement in tax provision relating to prior years | - | (1) |
| Current tax credit (note 8a) | - | (1) |

## 9. EARNINGS PER SHARE

The calculation of basic and diluted earnings per share is based on the following:

| | | Net profit attributable to Ordinary Shareholders £000 | Ordinary shares[1] (number) | Per share (pence) |
|---|---|---|---|---|
| **2014** | | | | |
| **Basic and diluted earnings** | | | | |
| Basic earnings | | 36,880 | 111,044,085 | 33.2p |
| Dilutive effect of convertible bond | | 2,170 | 13,097,998 | |
| Diluted earnings | | 39,050 | 124,142,083 | 31.5p |
| **EPRA basic and diluted earnings** | | | | |
| Basic earnings | | 36,880 | | |
| Adjustments to remove: | Net result on property (Note 11) | (29,204) | | |
| | Fair value loss on derivatives | 2,454 | | |
| | Fair value movement on convertible bond | 4,462 | | |
| | Issue costs of convertible bond | 2,426 | | |
| | Early loan repayment fee charges[2] | 1,187 | | |
| EPRA basic and diluted earnings per share | | 18,205 | 111,044,085 | 16.4p |
| **2013** | | | | |
| **Basic and diluted earnings** | | | | |
| Basic and diluted earnings | | 20,220 | 89,121,611 | 22.7p |
| **EPRA basic and diluted earnings** | | | | |
| Basic and diluted earnings | | 20,220 | | |
| Adjustments to remove: | Net result on property (Note 11) | (2,313) | | |
| | Fair value loss on derivatives | (11,432) | | |
| | Profit on termination of finance lease[2] | (637) | | |
| | Early loan repayment fee charges | 950 | | |
| EPRA basic and diluted earnings per share | | 6,788 | 89,121,611 | 7.6p |

(1) Weighted average number of Ordinary Shares in issue during the year.
(2) Revised EPRA best practice guidance was issued in January 2014 which advised that early repayment fees associated with the close out of debt instruments should be excluded from EPRA earnings. This has been reflected in the calculation of EPRA earnings for both 2013 and 2014. As a result of these changes the Group no longer calculates an adjusted earnings figure.

On 20 May 2014, the Group issued £82.5 million of unsecured convertible bonds, refer to Note 17 for further details. In accordance with IAS 33 Earnings per Share the Company is required to assess and disclose the dilutive impact of the contingently issuable shares within the convertible bond. The impact is not recognised where it is anti-dilutive. The convertible bonds are dilutive for basic earnings per share but not EPRA earnings per share.

The dilutive impact to basic EPS of convertible bonds is represented by the accrued bond coupon which has been included in the results of the year ended 31 December 2014. The number of dilutive shares is calculated as if the contingently issuable shares within the convertible bond had been in issue for the period from issuance of the bonds to 31 December 2014.

# NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

## 10. DIVIDENDS

Amounts recognised as distributions to equity holders in the year:

| | 2014 £000 | 2013 £000 |
|---|---|---|
| Second interim dividend for the year ended 31 December 2013 (9.75p) paid 22 April 2014 (2013: 9.50p) | 10,542 | 7,006 |
| Scrip dividend in lieu of second interim cash dividend | 279 | 217 |
| First interim dividend for the year ended 31 December 2014 (9.75p) paid 7 November 2014 (2013: 9.50p) | 10,146 | 9,124 |
| Scrip dividend in lieu of first interim cash dividend | 683 | 171 |
| Total dividends distributed in the year | 21,650 | 16,518 |
| Per share | 19.5p | 19.0p |

The Board proposes to pay a second interim of 10.0p per Ordinary Share for the year to 31 December 2014, payable on 1 April 2015. This dividend will not be a Property Income Distribution ("PID").

## 11. INVESTMENT PROPERTIES, INVESTMENT PROPERTIES UNDER CONSTRUCTION

Properties have been independently valued at fair value by Lambert Smith Hampton ("LSH"), Chartered Surveyors and Valuers, as at the balance sheet date in accordance with IAS 40: Investment Property. LSH confirm that they have valued the properties in accordance with the Practice Statements in the RICS Appraisal and Valuation Standards ("Red Book"). There were no changes to the valuation techniques during the year. The Valuers are appropriately qualified and have sufficient market knowledge and relevant experience of the location and category of investment property and have had full regard to market evidence when determining the values.

The properties are 99.8% let (2013: 99.7%). The valuations reflected a 5.52% initial yield (2013: 5.65%) and a 5.75% (2013: 5.92%) true equivalent yield. Where properties have outstanding rent reviews, an estimate is made of the likely rent on review in line with market expectations and the knowledge of the Valuer.

In accordance with IAS 40, investment properties under construction have also been valued at fair value by LSH. In determining the fair value, the Valuer is required to consider the significant risks which are relevant to the development process including, but not limited to, construction and letting risks. In the case of the Group's portfolio under construction, where the sites are pre-let and construction risk remains with the builder/developer, the valuers have used the special assumptions that, as at the valuation date, the developments have been completed satisfactorily, the agreements of leases have been completed and the rents and other tenants lease obligations have commenced. A fair value increase of £2.8 million (2013: increase of £0.5 million) in respect of investment property under construction has been recognised in the Group Statement of Comprehensive Income, as part of the total net valuation gain on property portfolio in the year of £29.2 million (2013: gain of £2.3 million).

In line with Accounting Policies, the Group has treated the acquisitions during the year as asset purchases rather than business combinations as they were judged to be acquisitions of properties rather than businesses.

| | Investment properties freehold £000 | Investment properties long leasehold £000 | Investment properties under construction £000 | Total £000 |
|---|---|---|---|---|
| As at 1st January 2014 | 759,871 | 169,998 | 11,679 | 941,548 |
| Property additions | 22,835 | 2,050 | 30,070 | 54,955 |
| Property disposals | (525) | - | - | (525) |
| Impact of lease incentive adjustment | 857 | 168 | - | 1,025 |
| Transfer from properties in the course of development | 20,698 | - | (20,698) | - |
| | 803,736 | 172,216 | 21,051 | 997,003 |
| Revaluations for the year | 21,944 | 4,454 | 2,806 | 29,204 |
| As at 31 December 2014 | 825,680 | 176,670 | 23,857 | 1,026,207 |

| | Investment properties freehold £000 | Investment properties long leasehold £000 | Investment properties under construction £000 | Total £000 |
|---|---|---|---|---|
| As at 1 January 2013 | 510,295 | 96,421 | 15,731 | 622,447 |
| Property Additions | 11,351 | 18,326 | 18,447 | 48,124 |
| Acquisition of PHCC[1] | 23,711 | 5,171 | - | 28,882 |
| Acquisition of PPP[1] | 199,188 | 38,168 | - | 237,356 |
| Impact of lease incentive adjustment | 1,262 | 228 | - | 1,490 |
| Transfer from properties in the course of development | 14,702 | 8,275 | (22,977) | - |
| | 760,509 | 166,589 | 11,201 | 938,299 |
| Revaluations for the year (see below) | (638) | 3,409 | 478 | 3,249 |
| As at 31 December 2013 | 759,871 | 169,998 | 11,679 | 941,548 |
| **Reconciliation of net result on property portfolio - 2013** | | | | |
| Additional consideration on property transactions | (17) | (919) | - | (936) |
| Revaluations for the year | (638) | 3,409 | 478 | 3,249 |
| Revaluations for the year ending 31 December 2013 | (655) | 2,490 | 478 | 2,313 |

(1) Figures include a fair value adjustment made on acquisition as well as acquisition related costs.

Additional consideration on property transactions relate to payments made following the letting of various areas of expansion space on certain properties acquired as part of the Apollo portfolio. Each letting has created additional rental income for the Group leading to an additional capital payment being made to the vendors. There was no additional consideration on property transactions related to the Apollo portfolio in 2014.

Bank borrowings, bonds and interest rate swaps are secured on investment properties with a value of £997.3 million (2013: £929.1 million).

**Fair value hierarchy**

All of the Group's properties are level 3, as defined by IFRS 13, in the fair value hierarchy as at 31 December 2014 and 2013. There were no transfers between levels during the year or for the year ended 31 December 2013. Level 3 inputs used in valuing the properties, are those which are unobservable, as opposed to level 1 (inputs from quoted prices) and level 2 (observable inputs either directly, i.e. as prices, or indirectly, i.e. derived from prices).

**Valuation techniques used to derive Level 3 fair values**

The valuations have been prepared on the basis of Fair Market Value (FMV) which is defined in the RICS Valuation Standards, as:

*"The estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion."*

**Valuation techniques: market comparable method**

Under the market comparable method (or market comparable approach), a property's fair value is estimated based on comparable transactions and using certain unobservable inputs. These inputs are detailed below.

**Unobservable input: estimated rental value (ERV) range**

| ERV | ERV |
|---|---|
| **2014**<br>£55,436-£1,158,011 per annum | **2013**<br>£30,000-£1,157,725 per annum |

The rent at which space could be let in the market conditions prevailing at the date of valuation.

**Unobservable input: true equivalent yield range**

| True equivalent yield | True equivalent yield |
|---|---|
| **2014**<br>4.83%-6.76% | **2013**<br>4.88%-6.85% |

The equivalent yield is defined as the internal rate of return of the cash flow from the property, assuming a rise to ERV at the next review date, but with no further rental growth.

# NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

**Unobservable input: physical condition of the property**
The properties are physically inspected by the valuer on a three year rotating basis.

**Unobservable input: rental growth**
The estimated average increase in rent based on both market estimations and contractual situations.

**Special assumptions**
With regards to properties in the course of development and in various stages of construction the following assumptions have been applied:

- That all works to construct the proposed developments have been completed fully and to an acceptable standard in accordance with plans and specifications;
- The leases to the various occupiers have been completed in accordance with the agreed lease terms provided to the valuer; and
- The rent and other tenant and landlord obligations under the leases commence at the valuation date.

**Sensitivity of measurement of significant unobservable inputs**

- A decrease in the estimated annual rent will decrease the fair value.
- A decrease in the equivalent yield will increase the fair value.
- An increase in the remaining lease term will increase fair value.

## 12. GROUP ENTITIES

Those subsidiaries listed below are considered to be the only principal subsidiaries of the Company:

| Subsidiary | Subsidiary |
|---|---|
| Primary Health Investment Properties Limited[1] | PHP Bond Finance PLC[1] |
| Primary Health Investment Properties (No. 2) Limited[1] | PHP Healthcare Investments Limited[2] |
| Primary Health Investment Properties (No. 3) Limited[1] | PHIP (Stourbridge) Limited[2] |
| Primary Health Investment Properties (No. 4) Limited[1] | PHP Clinics Limited[2] |
| PHIP[5] Limited[2] | PHP St. Johns Limited[2] |
| Patientfirst Partnerships Limited[2] | PHP (Project Finance) Limited[2] |
| Patientfirst (Hinckley) Limited[2] | PHP Empire Holdings Limited[1] |
| Patientfirst (Burnley) Limited[2] | PHP AssetCo (2011) Limited[2] |
| Health Investments Limited[1] | PHP Glen Spean Limited[2] |
| Motorstep Limited[2] | PHP Medical Properties Limited[2] |
| PHP Investments No.1 Limited[2] | Gracemount Medical Centre Limited[2 3 4] |
| PHP Investments No.2 Limited[2] | PHP Primary Properties (Haymarket) Limited[1 5] |
| PHP Investments (2011) Limited[1] | PHP Primary Properties Limited[2 5] |
| PHIP (Gorse Stacks) Limited[1] | PHP Medical Investments Limited[1] |
| Anchor Meadow Limited[1] | PHP Finance (Jersey) Limited[1 6] |

With the exception of PHP Bond Finance PLC, Primary Health Investment Properties (No. 4) Limited and PHP Finance (Jersey) Limited the principal activity of all of the above is property investment. PHP Bond Finance PLC and Primary Health Investment Properties (No. 4) Limited both act as intermediary financing companies within the Group. 100% of all voting rights and shares are held directly or indirectly by the Company.

(1) Subsidiary directly held by the Company.
(2) Subsidiary indirectly held by the Company.
(3) Subsidiary acquired during the year.
(4) Subsidiary company registered in Scotland.
(5) Subsidiary acquired during 2013 (name changed from Prime Public Partnerships Limited post acquisition).
(6) Subsidiary company registered in Jersey.

## 13. TRADE AND OTHER RECEIVABLES

| | 2014 £000 | 2013 £000 |
|---|---|---|
| Trade receivables | 1,916 | 2,318 |
| Prepayments and accrued income | 2,527 | 1,370 |
| Other debtors | 459 | 768 |
| Development loan interest | 766 | 308 |
| | 5,668 | 4,764 |

As at 31 December, the analysis of trade receivables, some of which were past due but not impaired, is set out below:

| | 2014 £000 | 2013 £000 |
|---|---|---|
| Neither past due nor impaired: | | |
| <30 days | 1,260 | 1,998 |
| Past due but not impaired: | | |
| 30-60 days | 99 | 15 |
| 60-90 days | 2 | - |
| 90-120 days | 257 | 62 |
| >120 days | 298 | 243 |
| | 1,916 | 2,318 |

The Group's principal customers are invoiced and pay quarterly in advance, usually on the English quarter days. No bad debt provision was required (2013: £nil) and no receivables were considered impaired or overdue. There is no significant concentration of credit risk with respect to trade receivables, as the Group has a large number of tenants.

## 14. CASH AND CASH EQUIVALENTS

| | 2014 £000 | 2013 £000 |
|---|---|---|
| Cash held at bank | 8,472 | 8,788 |
| Restricted cash | 3,600 | 500 |
| | 12,072 | 9,288 |

Restricted cash at 31 December 2014 is an amount held as security in relation to debt service and repayment of bank borrowings.

Restricted cash as at 31 December 2013 represents a deposit held by the Trustee of the Secured Bond issued by the Group. The deposit was held as temporary collateral until the completion of property assets that are charged as security to the Trustee. The cash deposit was released on 30 June 2014.

Bank interest is earned at floating rates depending upon the bank deposit rate. Short term deposits may be made for varying periods of between one day and six months, dependent on available cash and forthcoming cash requirements of the Group. These deposits earn interest at various short term deposit rates.

# NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

## 15. TRADE AND OTHER PAYABLES

| | 2014 £000 | 2013 £000 |
|---|---|---|
| Trade payables | 954 | 906 |
| Bank and bond loan interest accrual | 4,287 | 3,313 |
| Other payables | 6,752 | 7,671 |
| VAT | 1,237 | 2,302 |
| Accruals | 1,014 | 2,077 |
| | 14,244 | 16,269 |

An additional 282,768 shares were issued on 31 January 2014 upon agreement of the final completion accounts in respect of the acquisition of PPP in 2013, and a further 235,475 shares were also issued on that date upon a Deed of Variation being entered into regarding the St Catherine's property. Provision was made for these sums at the market price for a PHP share as at 31 December 2013 of 353 pence per share giving a total provision of £1.8 million included in other payables.

## 16. BORROWINGS: TERM LOANS AND OVERDRAFTS

The table indicates amounts drawn and undrawn from each individual facility as at 31 December:

| | Facility | | Amounts drawn | | Undrawn | |
|---|---|---|---|---|---|---|
| | 2014 £000 | 2013 £000 | 2014 £000 | 2013 £000 | 2014 £000 | 2013 £000 |
| **Current** | | | | | | |
| Overdraft facility[1] | 5,000 | 5,000 | - | - | 5,000 | 5,000 |
| Fixed rate term loan[3] | 711 | 1,857 | 711 | 1,857 | - | - |
| Fixed rate term loan[8] | - | 1,986 | - | 1,986 | - | - |
| | 5,711 | 8,843 | 711 | 3,843 | 5,000 | 5,000 |
| **Non Current** | | | | | | |
| Term loan to August 2018[2] | 165,000 | 140,000 | 123,500 | 100,500 | 41,500 | 39,500 |
| Fixed Rate term loan[3] | 24,702 | 25,511 | 24,702 | 25,511 | - | - |
| Fixed Rate term loan to December 2022[4] | 25,000 | 25,000 | 25,000 | 25,000 | - | - |
| Term loan to April 2019[5] | 50,000 | - | 21,513 | - | 28,487 | - |
| Term loan to November 2018[6] | 75,000 | 75,000 | 75,000 | 75,000 | - | - |
| Term loan to August 2019[7] | 100,000 | 70,000 | 59,160 | 49,470 | 40,840 | 20,530 |
| Fixed rate term loan 24 - 29 year[8] | 113,000 | 188,271 | 113,000 | 188,271 | - | - |
| | 552,702 | 523,782 | 441,875 | 463,752 | 110,827 | 60,030 |
| | 558,413 | 532,625 | 442,586 | 467,595 | 115,827 | 65,030 |

Providers:
(1) The Royal Bank of Scotland plc
(2) The Royal Bank of Scotland plc ("RBS") and Abbey National Treasury Services plc (branded Santander from January 2010) ("The Club Facility")
(3) Aviva facility (acquired as part of HIL acquisition) repayable in tranches to 31 January 2032
(4) Aviva GPFC facility
(5) HSBC Bank facility
(6) Aviva facility
(7) Barclays facility
(8) Aviva facility (acquired with PPP). The nominal value of this debt was £177.9 million but the table above includes an adjustment of £13.6 million to reflect the fair value of the debt on acquisition of PPP.

At 31 December 2014, total facilities of £785.9 million (2013: £677.6 million) were available to the Group. This included a £75 million Unsecured Retail Bond, a £70 million Secured Bond, a £82.5 million Convertible Bond and a £5 million overdraft facility. Of these facilities, as at 31 December 2014, £670.1 million was drawn (2013: £602.6 million).

As part of the acquisition in December 2013 of the companies that held the PPP portfolio, the Group assumed £178 million of loan obligations funded by Aviva. The transaction pricing included a provision of £13.7 million that estimated the cost of re-setting those loans to current market rates. This amount was paid to Aviva in full in February 2014, reducing the average interest rate on these loans to 5.04% from an inherited average of 5.9%, but with the reduction being effective from 1 January 2014. The Group took the opportunity to make a capital repayment of £15 million at this time also.

On 15 April 2014, a further £50 million of the Aviva loan was repaid following the completion of a new £50 million revolving debt facility with HSBC Bank PLC. This facility was secured at an initial margin of 200 basis points over LIBOR for a five year term and includes an element that can be utilised to match the stage payments that the Group makes on its development of new properties.

On 19 August 2014, the Group entered into a revised and extended loan facility agreement with Barclays Bank PLC. This extended the total facility from £70 million to £100 million for a new four year term and reduced the initial margin chargeable on the debt to 190 basis points over LIBOR.

On 20 August 2014, the Group concluded the final stage of the refinance of the Aviva PPP debt. Two new facilities have been created to split the balance of £113 million of assumed debt. A £50 million, 10 year facility has been completed on an interest only basis and a £63 million 15 year facility has been established with an initial 5 year interest only period and partial amortisation thereafter. This resulted in a further reduction of the interest rate applicable to both facilities to 4.91%. The refinancing is recognised as an extinguishment of an existing financial liability and the inception of a new facility. As a result the unamortised costs associated with the original assumed loan facilities have been written off together with other early repayment fees in the Group Statement of Comprehensive Income.

On 21 August 2014, the Group extended its current Club Facility with RBS and Santander for a new three year term with the option to extend for one additional year and reduced the initial margin chargeable on the debt to 185 basis points over LIBOR.

Costs associated with the arrangement and extension of the facilities, including legal advice and loan arrangement fees are amortised over the remaining life of the related facility.

Any amounts unamortised as at the period end are offset against amounts drawn on the facilities as shown in the table below:

| | 2014<br>£000 | 2013<br>£000 |
|---|---|---|
| Term loans drawn: due within one year | 711 | 3,843 |
| Term loans drawn: due in greater than one year | 441,875 | 463,752 |
| Total terms loans drawn | 442,586 | 467,595 |
| Less: Unamortised borrowing costs | (4,853) | (3,567) |
| Total term loans per the Group Balance Sheet | 437,733 | 464,028 |

The Group has been in compliance with all of the financial covenants of the above facilities as applicable through the year. Further details are shown in note 19e.

The Group has entered into interest rate swaps to manage its exposure to interest rate fluctuations. These are set out in note 18.

## 17. BORROWINGS: BONDS

| | 2014<br>£000 | 2013<br>£000 |
|---|---|---|
| **Secured** | | |
| Secured Bond December 2025 | 70,000 | 60,000 |
| **Unsecured** | | |
| Retail Bond July 2019 | 75,000 | 75,000 |
| Convertible Bond May 2019 | 86,962 | - |
| Unamortised issue costs | (2,419) | (2,592) |
| | 229,543 | 132,408 |

# NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

**Secured Bond**
On 18 December 2013, PHP successfully listed the floating rate guaranteed secured bonds issued on 4 November 2013 (the "Secured Bonds") on the London Stock Exchange. The Secured Bonds have a nominal value of £70 million and mature on or about 30 December 2025. £60 million was paid up on the issue of the Secured Bonds with the remaining £10 million being received on 30 June 2014 following the completion of the construction of four further secured assets. The Secured Bonds incur interest on the paid up amount at an annualised rate of 220 basis points above six month LIBOR, payable semi-annually in arrears.

**Retail Bond**
On 23 July 2012, PHP announced that it had become the first UK REIT to issue a Retail Bond following the issue of a £75 million, unsecured, seven year bond, to retail investors with an annual interest rate of 5.375% paid semi-annually in arrears. The Retail Bond issue costs are being amortised on a straight line basis over seven years.

**Convertible Bond**
On 20 May 2014, PHP Finance (Jersey) Limited ("the Issuer"), a wholly owned subsidiary of the Group issued a £82.5 million 4.25% convertible bonds due 2019 (the "Bonds") at par. The Company has guaranteed the due and punctual performance by the Issuer of all of its obligations (including payments) in respect of the Bonds.

Subject to certain conditions, the Bonds are convertible into preference shares of the Issuer which will be automatically and mandatorily exchangeable into fully paid ordinary shares of the Company (the "Shares"). The initial conversion price has been set at 390 pence per Share (the "Exchange Price"). Under the terms of the Bonds, the Company will have the right to settle any conversion rights entirely in Shares, in cash or with a combination of Shares and cash.

The bondholders have the right to convert the Bonds up until 20 May 2017 only where the Parity Value (as defined in the Bond's terms) is greater than the Exchange Price.

On or after 20 May 2017, the Bonds may be redeemed at par at the Company's option subject to the Parity Value equalling or exceeding £130,000. If not previously converted, redeemed or purchased and cancelled, the Bonds will be redeemed at par on the maturity date.

| | 2014<br>£000 |
|---|---|
| Nominal value on issuance on 20 May 2014 | 82,500 |
| Fair value movement in convertible bond | 4,462 |
| Balance at 31 December 2014 | 86,962 |

The fair value of the convertible bond at 31 December 2014 was established by obtaining quoted market prices. The fair value movement is recognised in the Group Statement of Comprehensive Income within Profit before Taxation and is excluded from the calculation of EPRA earnings and EPRA NAV.

## 18. DERIVATIVES AND OTHER FINANCIAL INSTRUMENTS

It is Group policy to maintain the proportion of floating rate interest exposure at between 20%-40% of total interest rate cost. The Group uses interest rate swaps to mitigate its remaining exposure to interest-rate risk. The fair value of these contracts is recorded in the balance sheet and is determined by discounting future cash flows at the prevailing market rates at the balance sheet date.

| | 2014 £000 | 2013 £000 |
|---|---|---|
| Fair value of interest rate swaps treated as cash flow hedges under IAS39 ("effective swaps") | | |
| Non-current assets | - | 472 |
| Current liabilities | (2,825) | (3,772) |
| Non-current liabilities | (20,956) | (10,499) |
| | (23,781) | (13,799) |
| Fair value of interest rate swaps not qualifying as cash flow hedges under IA539 ("ineffective swaps") | | |
| Non-current assets | 25 | - |
| Current liabilities | (2,977) | (3,794) |
| Non-Current liabilities | (14,256) | (10,960) |
| | (17,208) | (14,754) |
| Total fair value of interest rate swaps | (40,989) | (28,553) |
| **Shown in the Balance Sheet as** | | |
| Total non-current assets | 25 | 472 |
| Total current liabilities | (5,802) | (7,566) |
| Total non-current liabilities | (35,212) | (21,459) |

Changes in the fair value of the contracts that do not meet the strict IAS 39 criteria to be designated as effective hedging instruments are taken to the Group Statement of Comprehensive Income. For contracts that meet the IAS 39 criteria and are designated as 'effective' cash flow hedges, the change in fair value of the contract is recognised in the Group Statement of Changes in Equity through the cash flow hedging reserve. The result recognised in the Group Statement of Comprehensive Income on 'ineffective' cash flow hedges in 2014 was a £2.5 million loss (2013: £11.4 million profit).

# NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Floating to fixed interest rate swaps with a contract value of £206.0 million (2013: £206.0 million) were in effect at 31 December 2014. Details of all floating to fixed rate interest rate swaps contracts held are as follows:

| Contract value | Start date | Maturity | Fixed interest per annum % |
|---|---|---|---|
| **2014** | | | |
| £70.0 million | July 2013 | July 2015 | 4.805 |
| £28.0 million | March 2013 | March 2017 | 0.900 |
| £50.0 million[1] | August 2007 | August 2021 | 4.835 |
| £38.0 million[1] | August 2007 | August 2021 | 4.740 |
| £10.0 million | August 2005 | August 2015 | 4.530 |
| £10.0 million | June 2006 | June 2026 | 4.810 |
| £206.0 million | | | |
| **2013** | | | |
| £70.0 million | July 2013 | July 2015 | 4.805 |
| £28.0 million | March 2013 | March 2017 | 0.900 |
| £50.0 million[1] | August 2007 | August 2021 | 4.835 |
| £38.0 million[1] | August 2007 | August 2021 | 4.740 |
| £10.0 million | August 2005 | August 2015 | 4.530 |
| £10.0 million | June 2006 | June 2026 | 4.810 |
| £206.0 million | | | |
| **Contracts not yet in effect** | | | |
| £80.0 million | July 2015 | July 2016 | 4.805 |
| £10.0 million | June 2016 | June 2026 | 4.510 |
| £10.0 million | July 2016 | July 2026 | 4.400 |
| £10.0 million | July 2016 | July 2026 | 4.475 |
| £10.0 million | July 2016 | July 2026 | 4.455 |
| £20.0 million | July 2016 | July 2026 | 4.479 |
| £20.0 million | July 2017 | July 2027 | 4.760 |
| £160.0 million | | | |

(1) On 27 February 2012 PHP signed an agreement to cancel the callability option held by the counter party on the £50.0 million and the £38.0 million swaps in place. The callability option has been cancelled for four years until 11 February 2016 at which time it will be reinstated.

Details of the single interest rate cap held by the Group is as follows:

| Contract value | Start date | Maturity date | Premium paid | Floating rate cap per % annum |
|---|---|---|---|---|
| £15.0 million | April 2014 | April 2017 | 176,000 | 2.000 |

## 19. FINANCIAL RISK MANAGEMENT

In pursuing its investment objectives, the Group is exposed to a variety of risks that could impact net assets or distributable profits.

The Group's principal financial liabilities, other than interest rates swaps, are loans and borrowings hedged by these swaps. The main purpose of the Group's loans and borrowings is to finance the acquisition and development of the Group's property portfolio. The Group has trade and other receivables, trade and other payables and cash and short-term deposits that arise directly from its operations.

A review of the Group's objectives, policies and processes for managing and monitoring risk is set out in the Strategic Review. This note provides further detail on financial risk management and includes quantitative information on specific financial risks.

**Financial risk factors**

**a) Interest rate risk**

Interest rate risk is the risk that future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Group's exposure to the risk of changes in market interest rates relates primarily to the Group's long-term debt obligations with floating rates as the Group, generally, does not hold significant cash balances, with short term borrowings being used when required. To manage its interest rate risk, the Group enters into interest rate swaps, in which the Group agrees to exchange, at specified intervals, the difference between fixed and variable rate interest amounts calculated by reference to an agreed-upon principal amount. Note 18 provides details of interest swap contracts in effect at the year end.

The sensitivity analysis below shows the impact on profit before tax and equity of reasonably possible movements in interest rates with all other variables held constant. It should be noted that the impact of movement in the interest rate variable is not necessarily linear.

The fair value is arrived at with reference to the difference between the contracted rate of a swap and the market rate for the remaining duration at the time the valuation is performed. As market rates increase and this difference reduces, the associated fair value also decreases.

| | | Effect on fair value of financial instruments £000 | Effect on profit before taxation £000 | Effect on equity £000 |
|---|---|---|---|---|
| **2014** | | | | |
| London InterBank Offered Rate | Increase of 50 basis points | 9,089 | 4,549 | 13,638 |
| London InterBank Offered Rate | Decrease of 50 basis points | (9,089) | (4,549) | (13,638) |
| **2013** | | | | |
| London InterBank Offered Rate | Increase of 50 basis points | 8,615 | 2,916 | 11,531 |
| London InterBank Offered Rate | Decrease of 50 basis points | (8,615) | (2,916) | (11,531) |

**b) Credit risk**

Credit risk is the risk that a counterparty will not meet its obligations under financial instruments or customer contract, leading to a financial loss. The Group is exposed to credit risk from its principal financial assets being cash and cash equivalents, trade and other receivables.

*Trade receivables*

Trade receivables, primarily tenant rentals, are presented in the balance sheet net of allowances for doubtful receivables and are monitored on a case-by-case basis. Impairment allowance is recorded where there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivable concerned. Credit risk is primarily managed by requiring tenants to pay rentals in advance. The Group has policies in place to ensure that rental contracts are entered into only with lessees with an appropriate credit history, but the Group does not monitor the credit quality of receivables on an ongoing basis. An analysis of trade receivables past due is shown in Note 13.

*Bank and financial institutions*

One of the principal credit risks of the Group arises from financial derivative instruments and deposits with banks and financial institutions. The Board of Directors believes that the credit risk on short-term deposits and interest rate swaps is limited because the counterparties are banks, who are committed lenders to the Group, with high credit ratings assigned by international credit-rating agencies.

# NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

**c) Liquidity risk**

The liquidity risk is that the Group will encounter difficulty in meeting obligations associated with its financial liabilities as the majority of the Group's assets are property investments and are therefore not readily realisable. The Group's objective is to maintain a mixture of available cash and committed bank facilities that are designed to ensure that the Group has sufficient available funds for its operations and to fund its committed capital expenditure. This is achieved by continuous monitoring of forecast and actual cash flows by the Adviser.

The table below summarises the maturity profile of the Group's financial liabilities based on contractual undiscounted payments including interest.

| | On demand £000 | Less than 3 months £000 | 3 to 12 months £000 | 1 to 5 years £000 | > 5 years £000 | Total £000 |
|---|---|---|---|---|---|---|
| **2014** | | | | | | |
| Interest-bearing loans and borrowings | - | 6,186 | 20,038 | 528,325 | 295,132 | 849,681 |
| Interest rate swaps (net) | - | 1,910 | 5,597 | 31,030 | 27,772 | 66,309 |
| Trade and other payables | 2,166 | 7,333 | 2,909 | 1,312 | 92 | 13,812 |
| | 2,166 | 15,429 | 28,544 | 560,667 | 322,996 | 929,802 |
| **2013** | | | | | | |
| Interest-bearing loans and borrowings | - | 8,219 | 20,617 | 339,849 | 456,039 | 824,724 |
| Interest rate swaps (net) | - | 1,914 | 5,741 | 28,782 | 37,672 | 74,109 |
| Trade and other payables | 119 | 7,890 | 4,595 | 1,130 | 48 | 13,782 |
| | 119 | 18,023 | 30,953 | 369,761 | 493,759 | 912,615 |

The Group's borrowings have financial covenants which, if breached, could result in the borrowings becoming repayable immediately. Details of the covenants are given below under (e) capital risk management and are disclosed to the facility providers on a quarterly basis. There have been no breaches during the year (2013: nil).

**d) Market risk**

Market risk is the risk that fair values of financial instruments will fluctuate because of changes in market prices. The Board of Directors has identified two elements of market risk that principally affect the Group - interest rate risk and other price risk.

**Interest rate risk**

Interest rate risk is outlined above. The Advisor assesses the exposure to other price risks when making each investment decision and monitors the overall level of market risk on the investment portfolio on an ongoing basis through a discounted cash flow analysis. Details of this analysis can be found in the Strategic Report in the Annual Report.

**Price risk**

The Group is exposed to price risk in respect property price risk including property rentals risk. Refer to Note 2.3. The Group has no significant exposure to price risk in respect of financial instruments other than the convertible bond and interest rate derivatives (see Notes 17 and 18) as it does not hold any equity securities or commodities.

**Fair values**

Set out below is a comparison by class of the carrying amount and fair values of the Group's financial instruments that are carried in the financial statements.

| | Book value 2014 £000 | Fair value 2014 £000 | Book value 2013 £000 | Fair value 2013 £000 |
|---|---|---|---|---|
| **Financial assets** | | | | |
| Trade and other receivables | 2,682 | 2,682 | 2,626 | 2,626 |
| Effective interest rate swaps | - | - | 472 | 472 |
| Ineffective interest rate swaps | 25 | 25 | - | - |
| Cash and short-term deposits | 12,072 | 12,072 | 9,288 | 9,288 |
| **Financial liabilities** | | | | |
| Interest-bearing loans and borrowings | (662,814) | (771,727) | (596,436) | (769,794) |
| Effective interest rate swaps | (23,782) | (23,782) | (14,271) | (14,271) |
| Ineffective interest rate swaps (net) | (17,233) | (17,233) | (13,812) | (13,812) |
| Trade and other payables | (14,244) | (14,244) | (13,782) | (13,782) |

The fair value of the financial assets and liabilities is included as an estimate of the amount at which the instruments could be exchanged in a current transaction between willing parties, other than a forced sale. The following methods and assumptions were used to estimate fair values:

- The fair values of the Group's cash and cash equivalents and trade payables and receivables are not materially different from those at which they are carried in the financial statements due to the short-term nature of these instruments.
- The fair value of floating rate borrowings is estimated by discounting future cash flows using rates currently available for instruments with similar terms and remaining maturities. The fair value approximates their carrying values gross of unamortised transaction costs.
- The fair values of the derivative interest rate swap contracts are estimated by discounting expected future cash flows using market interest rates and yield curves over the remaining term of the instrument.

**Fair value hierarchy**

The table below analyses financial instruments carried at fair value, by valuation method. The different levels are defined as follows:

Level 1: Quoted (unadjusted) prices in active markets for identical assets or liabilities

Level 2: Other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly

Level 3: Techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data

Fair value measurements at 31 December are as follows:

| | 2014 | | | | 2013 | | | |
|---|---|---|---|---|---|---|---|---|
| Recurring fair value measurements | Level 1 (1) £000 | Level 2 (2) £000 | Level 3 (3) £000 | Total £000 | Level 1 (1) £000 | Level 2 (2) £000 | Level 3 (3) £000 | Total £000 |
| **Financial assets** | | | | | | | | |
| Derivative interest rate swaps | - | 25 | - | 25 | - | 472 | - | 472 |
| **Financial liabilities** | | | | | | | | |
| Derivative interest rate swaps | - | (41,014) | - | (41,014) | - | (29,025) | - | (29,025) |
| Convertible bond | (86,962) | - | - | (86,962) | - | - | - | - |

(1) Valuation is based on unadjusted quoted prices in active markets for identical financial assets and liabilities.
(2) Valuation is based on inputs (other than quoted prices included in Level 1) that are observable for the financial asset or liability, either directly (i.e. as unquoted prices) or indirectly (i.e. derived from prices).
(3) Valuation is based on inputs that are not based on observable market data.

# NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The interest rate swaps whose fair values include the use of level 2 inputs are valued by discounting expected future cash flows using market interest rates and yield curves over the remaining term of the instrument. The following inputs are used in arriving at the valuation:

- Interest rates
- Yield curves
- Swaption volatility
- Observable credit spreads
- Credit default swap curve
- Observable market data

**e) Capital risk management**

The primary objectives of the Group's capital management is to ensure that it remains a going concern, operates within its quantitative banking covenants and meets the criteria so as to continue to qualify for UK-REIT status.

The capital structure of the Group consists of shareholders' equity and net borrowings. The type and maturity of the Group's borrowings are analysed further in notes 16 and 17 and the Group's equity is analysed into its various components in the Statement of Changes in Equity. The Board, with the assistance of the Adviser, monitors and reviews the Group's capital so as to promote the long-term success of the business, facilitate expansion and to maintain sustainable returns for Shareholders.

Under its banking facilities, the Group is subject to the following capital and covenant requirements:

- Rental income must exceed borrowing costs by the ratio 1.3: 1 (2013: 1.3: 1).
- UK-REIT compliance tests. These include loan to property and gearing tests. The Group must satisfy these tests in order to continue trading as a UK-REIT. This is also an internal requirement imposed by the Articles of Association.

Facility level covenants also operate with regard to specific pools of property assets provided to lenders to secure individual loan facilities. These range as follows:

Interest cover: 1:0 to 1.5:1 (2013: 1:1 to 1.5:1)
Loan to value: 50% to 75% (2013: 60% to 100%)

During the period the Group has complied with all of the requirements set out above.

| | 2014 £000 | 2013 £000 |
|---|---|---|
| Fair value of completed investment properties | 1,002,350 | 929,869 |
| Fair value of development properties | 23,857 | 11,679 |
| | 1,026,207 | 941,548 |
| Carrying value of interest-bearing loans and borrowings | 662,814 | 596,436 |
| Unamortised borrowing costs | 7,272 | 6,159 |
| Less PPP fair value adjustment (see note 16) | - | (13,589) |
| Less cash held | (12,072) | (9,288) |
| Nominal amount of interest-bearing loans and borrowings | 658,014 | 579,718 |
| Group loan to value ratio | 64.1% | 61.6% |

## 20. CALLED UP SHARE CAPITAL

| | 2014 Number | 2014 £000 | 2013 Number | 2013 £000 |
|---|---|---|---|---|
| Issued and fully paid at 50p each | 111,276,662 | 55,638 | 110,474,230 | 55,237 |
| Balance at beginning of year | 110,474,230 | 55,237 | 76,034,208 | 38,017 |
| Scrip issues in lieu of second interim cash dividend | 81,554 | 41 | 64,036 | 32 |
| Scrip issues in lieu of first interim cash dividend | 202,635 | 101 | 52,183 | 26 |
| Proceeds from capital raisings | - | - | 21,746,032 | 10,873 |
| Shares issued as consideration for PPP | 518,243 | 259 | 12,577,771 | 6,289 |
| Balance at end of year | 111,276,662 | 55,638 | 110,474,230 | 55,237 |

On 3 December 2013, the Group issued 12,577,771 new Ordinary Shares of 50 pence each at an agreed price of 320 pence per share as part of the consideration for the acquisition of Prime Public Partnerships Holdings Limited and its subsidiary Prime Public Partnerships Limited ("PPP"). The market price of a PHP share on the issue date was 331 pence. A further 518,243 Ordinary Shares of 50 pence each were issued on 31 January 2014 on agreement of the completion accounts of PPP. The market price of a PHP share on 31 January 2014 was 360 pence.

On 13 June 2013, the Group completed a share placing at a price of 315 pence per share. 21,746,032 shares were issued generating net cash proceeds of £65.8 million.

## 21. SHARE PREMIUM

| | 2014 £000 | 2013 £000 |
|---|---|---|
| Balance at beginning of year | 55,611 | 58,606 |
| Reserves transfer | - | (3,325) |
| Share issue expense | (15) | - |
| Scrip issues in lieu of interim cash dividends | 820 | 330 |
| Balance at end of year | 56,416 | 55,611 |

During 2013, an amount of £3.3 million was transferred from Share Premium to the Special Reserve with regards to the acquisition of Apollo Medical Properties Limited in December 2012. This is in accordance with the merger relief provision of the Companies Act 2006.

## 22. CAPITAL RESERVE

The capital reserve is held to finance any proposed repurchases of Ordinary Shares, following approval of the High Court in 1998.

| | 2014 £000 | 2013 £000 |
|---|---|---|
| Balance at beginning and end of year | 1,618 | 1,618 |

## 23. SPECIAL RESERVE

The special reserve arose on the Firm Placing and Placing and Open Offer on 7 October 2009, the Firm Placing on 12 April 2011 and 23 May 2012 and the Firm Placing, Placing, Open Offer and Offer for Subscription on 12 June 2013. It represents the share premium on the issue of the shares net of expenses.

| | 2014 £000 | 2013 £000 |
|---|---|---|
| Balance at beginning of year | 135,483 | 59,473 |
| Placing: 13 June 2013 (2012: 23 May 2012) | - | 57,627 |
| Associated costs | - | (2,728) |
| Second interim dividend for the year ended 31 December 2013 (2013: 31 December 2012) | (10,542) | (7,006) |
| Scrip issue in lieu of second interim cash dividend | (279) | (217) |
| First interim dividend for the year ended 31 December 2014 (2013: 31 December 2013) | (10,146) | (9,124) |
| Scrip issue in lieu of first interim cash dividend | (683) | (171) |
| Shares issued in consideration for PPP (note 20) | 1,605 | 35,344 |
| Share issue expenses | - | (1,040) |
| Reserves transfer from share premium | - | 3,325 |
| Balance at end of year | 115,438 | 135,483 |

As the special reserve is a distributable reserve, the dividends declared in the year have been distributed from this reserve.

# NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The issue of shares on 13 June 2013, referred to in note 20, was effected by way of a cash box mechanism. A cash box raising is a mechanism for structuring a capital raising whereby the cash proceeds from investors are invested in a subsidiary company of the parent instead of the parent itself. Use of a cash box mechanism has enabled the share premium arising from the issue of shares to be deemed to be a distributable reserve and has therefore been shown as a special reserve in these financial statements. Any issue costs are also deducted from the special reserve.

In 2013, £35.3 million was included within the Special Reserve which comprises the premium on the share placing for the acquisition of PPP through the operation of the merger relief provisions of the Companies Act 2006. A further £1.6 million of shares were issued in January 2014 upon agreement of the completion accounts of PPP and the premium amount has been included within the Special Reserve.

Also in 2013, £3.3 million was transferred from Share Premium to the Special Reserve with regards to the Apollo transaction under the same merger relief provisions (see Note 21).

## 24. CASH FLOW HEDGING RESERVE

Information on the Group's hedging policy and interest rate swaps is provided in Note 18.

The transfer to Group Statement of Comprehensive Income and the fair value movement on cash flow hedges which meet the effectiveness criteria under IAS 39, taken to equity can be analysed as follows:

| | 2014<br>£000 | 2013<br>£000 |
|---|---|---|
| Balance at beginning of year | (14,337) | (27,177) |
| Fair value movement on cash flow hedges | (9,980) | 12,269 |
| Amortisation of cash flow hedge reserve | - | 571 |
| Reclassification of ineffective hedge to effective | 470 | - |
| Net movement on cash flow hedges ("effective swaps") and amortisation of cash flow hedging reserve | (9,510) | 12,840 |
| Balance at end of year | (23,847) | (14,337) |

## 25. RETAINED EARNINGS

| | 2014<br>£000 | 2013<br>£000 |
|---|---|---|
| Balance at beginning of year | 68,773 | 48,553 |
| Reclassification of ineffective hedge to effective | (470) | - |
| Interest rate derivative fair value adjustment | (1,316) | - |
| Retained profit for the year | 36,880 | 20,220 |
| Balance at end of year | 103,867 | 68,773 |

## 26. NET ASSET VALUE PER SHARE

Net asset values have been calculated as follows:

| | 2014<br>£000 | 2013<br>£000 |
|---|---|---|
| Net assets per Group Balance Sheet | 309,130 | 302,385 |
| Derivative interest rate swaps (net liability) | 40,989 | 28,553 |
| Convertible bond fair value movement | 4,462 | - |
| EPRA net asset value | 354,581 | 330,938 |

| | No. of shares | No. of shares |
|---|---|---|
| **Ordinary Shares:** | | |
| Issued share capital | 111,276,662 | 110,474,230 |
| **Net asset value per share:** | | |
| Basic net asset value per Share | 278p | 274p |
| EPRA NAV per Share | 319p | 300p |

EPRA NAV is calculated as Balance Sheet net assets including the valuation result on trading properties but excluding fair value adjustments for debt and related derivatives.

As detailed in Note 9, the Company is required to assess the dilutive impact of the unsecured convertible bond on its net asset value per share, but only report any impact if it is dilutive. With an initial conversion price of 390 pence, the unsecured convertible bond issued by the Group on 20 May 2014 is anti-dilutive to all measures of net asset value per share.

## 27. CAPITAL COMMITMENTS

As at 31 December 2014, the Group has entered into separate development agreements with third parties for the purchase of primary health developments; these agreements are conditional on the completion of certain building development work at a consideration of £11.2 million plus VAT (2013: £17.1 million plus VAT).

## 28. RELATED PARTY TRANSACTIONS

The terms and conditions of the Advisory Agreement are described in the Directors' Report and the Directors' Remuneration Report in the Annual Report. Details of the amounts paid in relation to related party transactions are provided in Note 4.

## 29. CONTINGENT LIABILITIES

The terms and conditions agreed on acquiring Apollo Medical Partners Limited ("Apollo") may oblige the Group to pay a number of potential additional elements of consideration conditional upon events that may be achieved by the vendor in an agreed period after the acquisition.

A number of the properties acquired with Apollo include small areas of vacant space to which no value was ascribed on acquisition. PHP has agreed a three year period within which the vendor is engaged to let this space and should they be successful, additional consideration may become payable, with the sums due being valued based on the underlying terms of each letting achieved, type of the tenant and the area of space let. The Group estimates the maximum potential payment for these events at £0.2 million as at 31 December 2014 (2013: £0.6 million), but there is no certainty that such lettings will be achieved within the agreed time frame. The new lettings will add value to the investment portfolio.

## 30. SUBSEQUENT EVENTS

On 18 December 2014, the Group entered into a conditional contract to fund the development of and acquire a new, modern, purpose built medical centre to be constructed in Colwyn Bay, North Wales. The conditions attached to the contract were fully satisfied on 2 January 2015 and the contract completed. The total consideration will be £4.53 million and construction is expected to complete in January 2016.

# COMPANY BALANCE SHEET

## AS AT 31 DECEMBER 2014

| | Notes | 2014 £000 | 2013 £000 |
|---|---|---|---|
| **Fixed assets** | | | |
| Investment in and amounts due from subsidiaries | 5 | 423,276 | 346,026 |
| | | 423,276 | 346,026 |
| **Current assets** | | | |
| Debtors | 6 | 3,796 | 3,561 |
| Cash at bank | 7 | - | 12 |
| | | 3,796 | 3,573 |
| Total assets | | 427,072 | 349,599 |
| **Current liabilities** | | | |
| Other creditors and accruals | 8 | (1,939) | (4,341) |
| **Net current assets/(liabilities)** | | 1,857 | (768) |
| **Total assets less current liabilities** | | 425,133 | 345,258 |
| **Creditors: amounts falling due after more than one year** | | | |
| Amounts due to subsidiaries | | (39,480) | (23,875) |
| Borrowings | 9 | (155,056) | (73,941) |
| **Net assets** | | 230,597 | 247,442 |
| **Capital and reserves** | | | |
| Share capital | 11 | 55,638 | 55,237 |
| Share premium | 12 | 56,416 | 55,611 |
| Capital reserve | | 1,618 | 1,618 |
| Special reserve | 13 | 115,438 | 135,483 |
| Retained earnings | | 1,487 | (507) |
| **Equity shareholders' funds** | | 230,597 | 247,442 |
| **Net asset value per share - basic** | 14 | 207p | 224p |

These financial statements were approved by the Board of Directors on 18 February 2015 and signed on its behalf by:

**Alun Jones**
**Chairman**

# COMPANY RECONCILIATION OF MOVEMENT IN SHAREHOLDERS' FUNDS

## FOR THE YEAR ENDED 31 DECEMBER 2014

| | Share capital £000 | Share premium £000 | Capital reserve £000 | Special reserve £000 | Retained earnings £000 | Total £000 |
|---|---|---|---|---|---|---|
| **1 January 2014** | **55,237** | **55,611** | **1,618** | **135,483** | **(507)** | **247,442** |
| Profit for the year | - | - | - | - | 1,994 | 1,994 |
| Share issue as part of consideration for PPP | 259 | - | - | 1,605 | - | 1,864 |
| Less: Share issue expenses | - | (15) | - | - | - | (15) |
| **Dividends paid:** | | | | | | |
| Second interim dividend for the year ended 31 December 2013 (9.75p) | - | - | - | (10,542) | - | (10,542) |
| Scrip dividends in lieu of second interim cash dividend (net of expenses) | 41 | 238 | - | (279) | - | - |
| First interim dividend for the year ended 31 December 2014 (9.75p) | - | - | - | (10,146) | - | (10,146) |
| Scrip dividend in lieu of first interim cash dividend (net of expenses) | 101 | 582 | - | (683) | - | - |
| **31 December 2014** | **55,638** | **56,416** | **1,618** | **115,438** | **1,487** | **230,597** |
| **1 January 2013** | **38,017** | **58,606** | **1,618** | **59,473** | **949** | **158,663** |
| Loss for the year | - | - | - | - | (1,456) | (1,456) |
| Proceeds from capital raisings | 10,873 | - | - | 57,627 | - | 68,500 |
| Expenses of capital raisings | - | - | - | (2,728) | - | (2,728) |
| Share issue as part of consideration for PPP | 6,289 | - | - | 35,344 | - | 41,633 |
| Less: Share issue expenses | - | - | - | (1,040) | - | (1,040) |
| Reserves transfer[1] | - | (3,325) | - | 3,325 | - | - |
| **Dividends paid:** | | | | | | |
| Second interim dividend for the year ended 31 December 2012 (9.50p) | - | - | - | (7,006) | - | (7,006) |
| Scrip dividends in lieu of second interim cash dividend (net dividend) | 32 | 185 | - | (217) | - | - |
| First interim dividend for the year ended 31 December 2013 (9.50p) | - | - | - | (9,124) | - | (9,124) |
| Scrip dividend in lieu of first interim cash dividend (net of expenses) | 26 | 145 | - | (171) | - | - |
| **31 December 2013** | **55,237** | **55,611** | **1,618** | **135,483** | **(507)** | **247,442** |

(1) £3.3 million has been transferred from Share Premium to the Special Reserve in regards to the Apollo transaction under the merger relief provision of the Companies Act 2006.

# NOTES TO THE COMPANY FINANCIAL STATEMENTS

## 1. ACCOUNTING POLICIES

**Basis of preparation/statement of compliance**
These financial statements have been presented as required by the Companies Act 2006 and have been prepared under the historical cost convention and in accordance with applicable Accounting Standards and policies in the United Kingdom ("UK GAAP").

The Company has taken advantage of the Companies Act 2006 exemption from presenting a Company Profit and Loss Account together with related profit and loss notes. The Company has also taken advantage of the exemption from preparing a cash flow statement, under the terms of FRS 1 (Revised 1996) 'Cash Flow Statements'.

The profit attributable to the Parent Company for the financial year amounted to £2.0 million (2013: loss of £1.5 million).

**Convention**
The financial statements are presented in Sterling rounded to the nearest thousand.

**Income**
Revenue is recognised in the financial statements as follows:

*Interest income:* Revenue is recognised as interest accrues using the effective interest method: that is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument to the net carrying amount of the financial asset.

*Dividends:* Dividend income is recognised in the period in which it received Board approval and hence, when the Company's right to receive payment is established.

**Investment in subsidiaries**
The carrying value of investments in subsidiaries is reviewed for impairment if events or changes in circumstances indicate that the carrying value may not be recoverable.

## 2. SEGMENTAL REPORTING

The Company operates under one business segment and one geographical segment being the holding Company of subsidiaries that invest in primary health care property within the United Kingdom.

## 3. TAXATION

| | 2014 £000 | 2013 £000 |
|---|---|---|
| UK Corporation tax | - | - |

## 4. DIVIDENDS

Amounts recognised as distributions to equity holders in the year:

| | 2014 £000 | 2013 £000 |
|---|---|---|
| Second interim dividend for the year ended 31 December 2013 (9.75p) paid 22 April 2014 (2013: 9.50p) | 10,542 | 7,006 |
| Scrip dividend in lieu of second interim cash dividend | 279 | 217 |
| First interim dividend for the year ended 31 December 2014 (9.75p) paid 7 November 2014 (2013: 9.50p) | 10,146 | 9,124 |
| Scrip dividend in lieu of first interim cash dividend | 683 | 171 |
| Total dividends | 21,650 | 16,518 |
| Per share | 19.5p | 19.0p |

## 5. INVESTMENTS

Investment in subsidiaries:

| | Shares £000 | Loans £000 | Total £000 |
|---|---|---|---|
| At 1 January 2014 | 133,893 | 212,133 | 346,026 |
| Impairment of investment in subsidiaries | (13,164) | - | (13,164) |
| Acquistion of PPP Limited | 95 | - | 95 |
| Increase in loans to subsidiaries during the year | - | 90,319 | 90,319 |
| At 31 December 2014 | 120,824 | 302,452 | 423,276 |
| | | | |
| At 1 January 2013 | 80,231 | 150,380 | 230,611 |
| Acquistion of PPP Limited | 43,403 | - | 43,403 |
| Acquisition of PHCC Limited | 10,246 | - | 10,246 |
| Incorporation of PHP Bond Finance plc as a subsidiary | 13 | - | 13 |
| Increase in loans to subsidiaries during the year | - | 61,753 | 61,753 |
| At 31 December 2013 | 133,893 | 212,133 | 346,026 |

Those subsidiaries listed below are considered to be the only principal subsidiaries of the Company:

| Subsidiary |
|---|
| Primary Health Investment Properties Limited (PHIP)[1] |
| Primary Health Investment Properties (No. 2) Limited[1] |
| Primary Health Investment Properties (No. 3) Limited[1] |
| Primary Health Investment Properties (No. 4) Limited[1] |
| PHIP[5] Limited[2] |
| Patientfirst Partnerships Limited[2] |
| Patientfirst (Hinckley) Limited[2] |
| Patientfirst (Burnley) Limited[2] |
| Health Investments Limited[1] |
| Motorstep Limited[2] |
| PHP Investments No.1 Limited[2] |
| PHP Investments No.2 Limited[2] |
| PHP Investments (2011) Limited[1] |
| PHIP (Gorse Stacks) Limited[1] |
| Anchor Meadow Limited[1] |

| Subsidiary |
|---|
| PHP Bond Finance PLC[1] |
| PHP Healthcare Investments Limited[2] |
| PHIP (Stourbridge) Limited[2] |
| PHP Clinics Limited[2] |
| PHP St. Johns Limited[2] |
| PHP (Project Finance) Limited[2] |
| PHP Empire Holdings Limited[1] |
| PHP AssetCo (2011) Limited[2] |
| PHP Glen Spean Limited[2] |
| PHP Medical Properties Limited[2] |
| Gracemount Medical Centre Limited[2 3 4] |
| PHP Primary Properties (Haymarket) Limited[1 5] |
| PHP Primary Properties Limited[2 5] |
| PHP Medical Investments Limited[1] |
| PHP Finance (Jersey) Limited[1 6] |

With the exception of PHP Bond Finance PLC, Primary Health Investment Properties (No. 4) Limited and PHP Finance (Jersey) Limited the principal activity of all of the above is property investment. PHP Bond Finance PLC and Primary Health Investment Properties (No. 4) Limited both act as intermediary financing companies within the Group. 100% of all voting rights and shares are held directly or indirectly by the Company.

(1) Subsidiary directly held by the Company.
(2) Subsidiary indirectly held by the Company.
(3) Subsidiary acquired during the year.
(4) Subsidiary company registered in Scotland.
(5) Subsidiary acquired during 2013 (name changed from Prime Public Partnerships Limited post acquisition).
(6) Subsidiary company registered in Jersey.

## 6. DEBTORS

| | 2014 £000 | 2013 £000 |
|---|---|---|
| VAT | 191 | - |
| Other debtors and prepayments | 65 | 21 |
| 6% Preference dividend due from subsidiary | 3,540 | 3,540 |
| | 3,796 | 3,561 |

# NOTES TO THE COMPANY FINANCIAL STATEMENTS (CONTINUED)

## 7. CASH AT BANK

| | 2014 £000 | 2013 £000 |
|---|---|---|
| Cash held at bank | - | 12 |

## 8. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

| | 2014 £000 | 2013 £000 |
|---|---|---|
| Other creditors and accruals | 1,939 | 4,341 |

## 9. BORROWINGS

| | 2014 £000 | 2013 £000 |
|---|---|---|
| Retail Bond July 2019 | 75,000 | 75,000 |
| Unamortised issue costs | (869) | (1,059) |
| Intra-group loan with PHP (Finance) Jersey Limited | 77,968 | - |
| Option to convert | 2,957 | - |
| | 155,056 | 73,941 |

On 23 July 2012, PHP announced that it had become the first UK REIT to issue a Retail Bond following the issue of a £75 million, unsecured, seven year bond, to retail investors with an interest rate of 5.375% paid semi-annually in arrears. The bond issue costs are being amortised on a straight line basis over seven years.

## 10. INTRA-GROUP LOAN WITH PHP (FINANCE) JERSEY LIMITED

On 20 May PHP Finance (Jersey) Limited (the Issuer) – a wholly-owned subsidiary of the Company – issued £82.5m of convertible bonds due 2019 (the Bonds) at par. The proceeds have been loaned to the Company and the Company has unconditionally and irrevocably guaranteed the due and punctual performance by the Issuer of all of its obligations (including payments) in respect of the Bonds.

Subject to their terms, the Bonds are convertible into preference shares of the Issuer which are automatically transferred to the Company in exchange for Ordinary Shares in the Company or, at the Company's election, any combination of Ordinary Shares and cash.

The intra-group loan between the Issuer and the Company arising from the transfer of the loan proceeds was initially recognised at fair value, net of capitalised issue costs and is accounted for using the amortised cost method.

In addition to the intra-group loan, the Company has effectively entered into a derivative contract due to its guarantee of the obligations of the Issuer in respect of the Bonds and the commitment to provide shares or a combination of shares and cash on conversion of the Bonds. This derivative contract is included within the balance sheet as a liability carried at fair value through profit and loss.

See Note 17 in the Group financial statements for further details about the convertible bond.

## 11. CALLED UP SHARE CAPITAL

| | 2014 Number | 2014 £000 | 2013 Number | 2013 £000 |
|---|---|---|---|---|
| Issued and fully paid at 50p each | 111,276,662 | 55,638 | 110,474,230 | 55,237 |
| Balance at beginning of year | 110,474,230 | 55,237 | 76,034,208 | 38,017 |
| Scrip issue in lieu of second interim cash dividends | 81,554 | 41 | 64,036 | 32 |
| Scrip issue in lieu of first interim cash dividend | 202,635 | 101 | 52,183 | 26 |
| Proceeds from capital raisings | - | - | 21,746,032 | 10,873 |
| Shares issued in consideration of PPP | 518,243 | 259 | 12,577,771 | 6,289 |
| Balance at end of year | 111,276,662 | 55,638 | 110,474,230 | 55,237 |

On 3 December 2013, the Group issued 12,577,771 new Ordinary Shares of 50 pence each at an agreed price of 320 pence per share as part of the consideration for the acquisition of Prime Public Partnerships Holdings Limited and its subsidiary Prime Public Partnerships Limited ("PPP"). The market price of a PHP share on the issue date was 331 pence. A further 518,243 Ordinary Shares of 50 pence each were issued on 31 January 2014 on agreement of the completion accounts of PPP. The market price of a PHP share on 31 January 2014 was 360 pence.

On 13 June 2013, the Group completed a share placing at a price of 315 pence per share. 21,746,032 shares were issued generating net cash proceeds of £65.8 million.

## 12. SHARE PREMIUM

| | 2014 £000 | 2013 £000 |
|---|---|---|
| Balance at beginning of year | 55,611 | 58,606 |
| Reserves transfer | - | (3,325) |
| Issue expenses | (15) | - |
| Scrip issue in lieu of interim cash dividends | 820 | 330 |
| Balance at end of year | 56,416 | 55,611 |

During 2013, an amount of £3.3 million was transferred from Share Premium to the Special Reserve with regards to the acquisition of Apollo Medical Properties Limited in December 2012. This is in accordance with the merger relief provision of the Companies Act 2006 (see Note 25).

# NOTES TO THE COMPANY FINANCIAL STATEMENTS (CONTINUED)

## 13. SPECIAL RESERVE

The special reserve arose on the Firm Placing and Placing and Open Offer on 7 October 2009, the Firm Placings on 12 April 2011 and 23 May 2012 and the Firm Placing, Placing, Open Offer and Offer for Subscription on 12 June 2013. It represents the share premium on the issue of the shares net of expenses.

| | 2014 £000 | 2013 £000 |
|---|---|---|
| Balance at start of year | 135,483 | 59,473 |
| Placing: 13 June 2013 | - | 57,627 |
| Associated costs | - | (2,728) |
| Second interim dividend for the year ended 31 December 2013 (2013: 31 December 2012) | (10,542) | (7,006) |
| Scrip issue in lieu of second interim cash dividend | (279) | (217) |
| First interim dividend for the year ended 31 December 2014 (2013: 31 December 2013) | (10,146) | (9,124) |
| Scrip issue in lieu of first interim cash dividend | (683) | (171) |
| Shares issued in consideration for PPP (note 20) | 1,605 | 35,344 |
| Share issue expenses | - | (1,040) |
| Reserves transfer from share premium | - | 3,325 |
| Balance at end of year | 115,438 | 135,483 |

As the special reserve is a distributable reserve, the dividends declared in the year have been distributed from this reserve.

The issue of shares on 13 June 2013, referred to in note 20, was effected by way of a cash box mechanism. A cash box raising is a mechanism for structuring a capital raising whereby the cash proceeds from investors are invested in a subsidiary company of the parent instead of the parent itself. Use of a cash box mechanism has enabled the share premium arising from the issue of shares to be deemed to be a distributable reserve and has therefore been shown as a special reserve in these financial statements. Any issue costs are also deducted from the special reserve.

In 2013, £35.3 million was included within the Special Reserve which comprises the premium on the share placing for the acquisition of PPP through the operation of the merger relief provisions of the Companies Act 2006. A further £1.6 million of shares were issued in January 2014 upon agreement of the completion accounts of PPP and the premium has been included within the Special Reserve.

Also in 2013, £3.3 million was transferred from Share Premium to the Special Reserve with regards to the Apollo transaction under the same merger relief provisions (see Note 11).

## 14. NET ASSET VALUE PER ORDINARY SHARE

| | 2014 pence | 2013 pence |
|---|---|---|
| Basic and diluted | 207 | 224 |

The basic net asset value per Ordinary Share is based on net assets attributable to Ordinary Shareholders of £230.6 million (2013: £247.4 million) and on 111,276,662 (2013: 110,474,230 shares), being the number of shares in issue at the year end.

## 15. CONTINGENT LIABILITIES

The Company has guaranteed the performance of its subsidiaries in respect of development agreements totalling £11.2 million plus VAT (2013: £17.1 million plus VAT).

## 16. RELATED PARTY TRANSACTIONS

Details of related party transactions are provided in the Directors' Report on page 45, Directors' Remuneration Report on page 41 and Notes 28 to the Group Financial Statements on page 80. There are no employees other than the Directors, listed on page 32.

The Company has taken advantage of the exemption available in FRS 8 "Related Party Disclosures" not to disclose transactions with other members of the Group as the Company's own financial statements are presented together with its consolidated financial statements.

# FIVE YEAR SUMMARY OF GROUP FINANCIAL PERFORMANCE

| | IFRS | | | | |
|---|---|---|---|---|---|
| | 2010 | 2011 | 2012 | 2013 | 2014 |
| **Net assets (£m)** | 164.7 | 168.1 | 179.1 | 302.4 | 309.1 |
| **Net asset value per share (p)** | | | | | |
| • basic and diluted | 262 | 246 | 236 | 274 | 278 |
| **EPRA net asset value per share (p)** | | | | | |
| • basic and diluted | 312 | 319 | 305 | 300 | 319 |
| **Closing portfolio including development loans and finance leases (£m)** [1] | 472.4 | 528.7 | 625.5 | 941.5 | 1,026.2 |
| **Annualised rent roll (£m)** [1] | 28.0 | 31.4 | 36.8 | 56.2 | 60.9 |
| **Profit before taxation (£m)** | 25.7 | 12.7 | 1.1 | 20.2 | 36.9 |
| **Earnings per share (p)** | | | | | |
| • basic | 41.3 | 19.0 | 1.6 | 22.7 | 33.2 |
| • adjusted | 14.7 | 14.5 | 10.2 | 10.6 | 16.4 |
| **Total dividend per share (p)** | 17.5 | 18.0 | 18.5 | 19.0 | 19.5 |
| **Market price per share at 31 December (p)** | 335.0 | 318.5 | 340.0 | 353.0 | 370.0 |
| **Total return (%)** | | | | | |
| • PHP Ordinary Share | 22.8 | 0.5 | 15.4 | 7.6 | 10.9 |
| • FTSE All Share | 14.5 | 3.5 | 12.3 | 20.8 | 1.2 |
| • FTSE All Share Real Estate Investment Trust | 6.9 | 8.8 | 30.6 | 19.6 | 23.7 |

(1) Completed assets only

# SHAREHOLDER INFORMATION

## FINANCIAL CALENDAR

| 2015 | | |
|---|---|---|
| February | 19th | Announcement of 2014 Annual Results |
| | 26th | Ex dividend date |
| | 27th | Record date |
| | 27th | 2014 Annual Report Posted |
| April | 1st | Second interim dividend payment |
| | 22nd | Annual General Meeting |
| June | 30th | Half year end |
| August | | Announcement of Half Year Results |
| October | | Expected first interim dividend payment |
| December | 31st | Financial year end |

## INVESTMENT ACCOUNT

As described in the Directors' Report, the Company has made arrangements for an Investment Account to be made available to allow investors to purchase the Company's Ordinary Shares. The Investment Account Service is provided by Equiniti Financial Services Limited and is designed to allow lump sum and regular savings to facilitate the purchase of the Company's shares. The URL link accessing the detail and forms for the this Service can be accessed from the Company website or alternatively at: www.shareview.co.uk/dealing

For details of the service please contact:
Equiniti,
PO Box 4605, Aspect House,
Spencer Road, Lancing,
West Sussex, BN99 6DA

Shareholder helpline: 0845 300 0430

Equiniti Financial Services Limited is authorised and regulated by the Financial Conduct Authority.

As with all stock market investments, the price of shares can go down as well as up and on sale investors may not get back the full amount they invested.

## SHARE PRICE

The Company's mid market share price is quoted daily in the Financial Times appearing under "Real Estate" and is quoted on the Company's website.

## PAYMENT OF DIVIDENDS

If you would like your dividend/interest paid directly into your bank or building society account you should write to Equiniti Registrars including details of your nominated account. Although this will enable your dividend/interest to be paid directly into your account, your tax voucher will be sent to your registered address.

## DIVIDEND POLICY

The Company's policy is to make all of its dividend payments (currently two per annum) as interim dividends. This enables the second dividend payment to be made approximately two months earlier than would be the case if that dividend were categorised as a Final Dividend and therefore subject to a shareholder resolution at the Annual General Meeting. This arrangement is made for the interests of the shareholders, enabling shareholders to benefit from the earlier receipt of the second dividend.

In accordance with principles of good corporate governance, a resolution to approve the Company's dividend policy will be proposed to shareholders at the Annual General Meeting and annually thereafter.

## SCRIP DIVIDEND SCHEME

The optional Scrip Dividend Scheme enables Shareholders to receive new Ordinary Shares in PHP instead of cash dividends without incurring dealing costs, stamp duty or stamp duty reserve tax by electing to take a scrip dividend instead of a cash dividend. A circular describing the scrip dividend offer will be posted to Shareholders other than those who have already elected to participate in the Group Dividend Scheme at the appropriate time.

## TAXATION STATUS

The REIT Regulations in force require that a REIT is obliged to pay distributions equal to 90% of its exempt rental income (as calculated for tax purposes). Distributions from the Company may comprise PIDs, ordinary cash dividends or a combination of the two. No PIDs have been paid by the Group since 1 January 2007.

A PID will be taxed as property letting income for Shareholders who pay tax, but this is separate from any other property letting business they may carry on. PIDs are paid out under deduction of tax at the basic rate (currently

20% withholding tax). The Regulations provide that tax is not deducted if the PID is paid to certain classes of Shareholders, in particular UK Companies, charities, local authorities and UK Pension schemes.

In order to pay a PID without withholding tax, the Company has to be satisfied that the shareholder concerned is entitled to that treatment. For that purpose the Company requires Shareholders to submit a valid form. Shareholders who wish to apply for a Tax Exemption Form should contact the registrars on 0871 384 2030* or apply in writing to: Equiniti, Aspect House, Spencer Road, Lancing, West Sussex BN99 6DA.

Her Majesty's Revenue and Customs ("HMRC") has produced guidance on Real Estate Investment Trusts paying PIDs to non residents and this can be found at the following web address:
http://www.hmrc.gov.uk/cnr/dt-guide-note-9.htm

The above is a general guide only and Shareholders who have any doubt about their tax position should consult their own appropriate independent professional adviser.

## GENERAL INFORMATION ABOUT THE COMPANY

General information about the Company can be found on the PHP web site at www.phpgroup.co.uk. Alternatively you may contact Harry Hyman, Phil Holland or Tim Walker-Arnott on 020 7451 7050.

Registered No. 3033634

## SHARE DEALING

Investors wishing to purchase more Ordinary Shares or dispose of all or part of their holding may do so through a stockbroker. Many banks also offer this service.

The Company's registrars are Equiniti. In the event of any queries regarding your holding of shares, please contact the registrars on 0871 384 2030*.

Changes of name or address must be notified to the registrars in writing.

* Calls to this number are charged at 8p per minute plus network extras. Lines are open 8.30am to 5.30pm Monday to Friday.

## EQUINITI SHAREVIEW DEALING SERVICES

A quick and easy share dealing service is available to either sell or buy more PHP shares. An online and telephone dealing facility is available providing Shareholders with an easy to access and simple to use service. The table below provides you with details of the associated charges.

There is no need to pre-register and there are no complicated forms to fill in. The online and telephone dealing service allows you to trade 'real time' at a known price which will be given to you at the time you give your instruction. To deal online or by telephone all you need is your shareholder reference number, full postcode and your date of birth. Your shareholder reference number can be found on your latest dividend statement. Please have the appropriate documents to hand when you log on or call, as this information will be needed before you can buy or sell shares.

For further information on this service, or to buy and sell shares, please contact:
Equiniti customer services 0845 300 0430 (8.00am – 6.00pm Monday to Friday), www.shareview.co.uk/dealing

**Equiniti Shareview dealing services associated charges**

| | |
|---|---|
| Dealing by telephone: | Trade of £0-£50,000: the charge is 1.50% of the traded amount, with a minimum charge of £45 |
| | Trade of £50,000+: the charge is 1.50% of the traded amount for the first £50,000, with a charge of 0.2% on the remainder of the amount |
| Dealing on the internet: | For all trades: the charge is 1.50% of the traded amount, with a minimum charge of £40 |

# CORPORATE PROFILE AND ADVISERS

## DIRECTORS
Alun Jones (Chairman)
Mark Creedy
James Hambro
William Hemmings
Harry Hyman (Managing Director)
Steven Owen (appointed 1 January 2014, Chairman of Audit Committee, Senior Independent Director)
Dr Ian Rutter OBE
Philip Holland (appointed 17 February 2015)

## COMPANY SECRETARY AND REGISTERED OFFICE
Nexus Management Services Limited
5th Floor, Greener House
66-68 Haymarket, London SW1Y 4RF
Tel: 020 7451 7050

## ADVISER
Nexus Tradeco Limited
5th Floor, Greener House
66-68 Haymarket, London SW1Y 4RF
Tel 020 7451 7050

## REGISTRARS
Equiniti
Aspect House, Spencer Road, Lancing
West Sussex BN99 6DA
General enquiries: 0871 384 2030*
Telephone dealing: 0845 300 0430
Online dealing: www.shareview.co.uk/dealing

## STOCKBROKERS
Numis Securities Limited
The London Stock Exchange Building
10 Paternoster Square, London EC4M 7LT

Peel Hunt Limited
Moor House, 120 London Wall, London, EC2Y 5ET

## SOLICITORS
Nabarro LLP
125 London Wall, London EC2Y 5AL

Shepherd and Wedderburn LLP
191 West George Sreet, Glasgow G2 2LB

Wragge Lawrence Graham and Co LLP
4 More London Riverside, London SE1 2AU

## AUDITOR
Deloitte LLP
2 New Street Square, London EC4A 3BZ

## BANKERS
AIB
St Helens, 1 Undershaft, London EC3A 8AB

Aviva Commercial Finance Limited
Surrey Street, Norwich NR1 3NJ

Barclays Bank PLC,
1 Churchill Place, London E14 5HP

HSBC
8 Canada Square, London E14 5HQ

The Royal Bank of Scotland Plc
280 Bishopsgate, London EC2M 3UR

Santander Corporate Banking
2 Triton Square, Regent's Place, London NW1 3AN

## ENVIRONMENTAL CONSULTANT
Collier & Madge
One Great Cumberland Place, London W1H 7AL

## PROPERTY VALUER
Lambert Smith Hampton Group Limited
Interchange Place, Edmund Street, Birmingham B3 2TA

# GLOSSARY OF TERMS

| | |
|---|---|
| Adviser | is Nexus Tradeco Limited. |
| Building Research Establishment Environmental Assessment Method ("BREEAM") | assesses the sustainability of buildings against a range of criteria. |
| Clinical Commissioning Groups ("CCGs") | are the groups of GPs and other healthcare professionals that are responsible for designing local health services in England with effect 1 April 2013. |
| Company and or Parent | is Primary Health Properties PLC. |
| Direct Property Costs | comprise ground rents payable under head leases, void costs, other direct irrecoverable property expenses, rent review fees and valuation fees. |
| District Valuer ("DV") | is the District Valuer Service being the commercial arm of the Valuation Office Agency ("VOA"). It provides professional property advice across the public sector and in respect of Primary Healthcare represents NHS bodies on matters of valuation, rent reviews and initial rents on new developments. |
| Dividend Cover | is the number of times the dividend payable (on an annual basis) is covered by EPRA earnings (2013 after add back of non-recurring contractual administrative services termination fee). |
| Earnings per Ordinary Share from Continuing Operations ("EPS") | is the profit attributable to equity holders of the parent divided by the weighted average number of shares in issue during the period. |
| European Public Real Estate Association ("EPRA") | is a real estate industry body, who have issued Best Practices Recommendations in order to provide consistency and transparency in real estate reporting across Europe. |
| EPRA net assets ("EPRA NAV") | are the balance sheet net assets excluding own shares held and mark-to-market derivative financial instruments. |
| Equivalent Yield (true and nominal) | is a weighted average of the Net Initial Yield and Reversionary Yield and represents the return a property will produce based upon the timing of the income received. The true equivalent yield assumes rents are received quarterly in advance. The nominal equivalent assumes rents are received annually in arrears. |
| Estimated Rental Value ("ERV") | is the external valuers' opinion as to the open market rent which, on the date of valuation, could reasonably be expected to be obtained on a new letting or rent review of a property. |
| Exchange Price | is 116% of the share price at the date of issue. |
| Gross Rental Income | is the gross accounting rent receivable. |
| Group | is Primary Health Properties PLC and its subsidiaries. |
| IFRS | is International Financial Reporting Standards as adopted by the European Union. |
| Interest Cover | is the number of times net interest payable is covered by net rental income. |
| Interest Rate Swap | is a contract to exchange fixed payments for floating payments linked to an interest rate, and is generally used to manage exposure to fluctuations in interest rates. |
| IPD | is the Investment Property Databank Limited which provides performance analysis for most types of real estate and produces an independent benchmark of property returns. |
| IPD Healthcare | is the Investment Property Databank's UK Annual Healthcare Property Index. |
| IPD Total Return | is calculated as the change in capital value, less any capital expenditure incurred, plus net income, expressed as a percentage of capital employed over the period, as calculated by IPD. |
| London Interbank Offered Rate ("LIBOR") | is the interest rate charged by one bank to another for lending money. |
| Local Improvement Finance Trusts ("LIFT") | are public-private consortia that develop primary care and community based facilities and services. |
| Loan to Value ("LTV") | is the ratio of net debt to the total value of property and LIFT assets. |
| Mark to Market ("MtM") | is the difference between the book value of an asset or liability and its market value. |

# GLOSSARY OF TERMS (CONTINUED)

| | |
|---|---|
| Net Initial Yield | is the annualised rents generated by an asset, after the deduction of an estimate of annual recurring irrecoverable property outgoings, expressed as a percentage of the asset valuation (after notional purchaser's costs). |
| Net Rental Income | is the rental income receivable in the period after payment of direct property costs. Net rental income is quoted on an accounting basis. |
| NHSPS | is NHS Property Services Limited is the company, wholly owned and funded by the Department of Health, which, as of 1 April 2013, has taken on all property obligations formerly borne by the Primary Care Trusts ("PCTs"). |
| Parity Value | is calculated based on the dividing the convertible bond value by the Exchange Price. |
| Property Income Distribution ("PID") | is the required distribution of income as dividends under the REIT regime. It is calculated as 90% of exempted net income. |
| Real Estate Investment Trust ("REIT") | is a listed property company which qualifies for and has elected into a tax regime, which exempts qualifying UK profits, arising from property rental income and gains on investment property disposals, from corporation tax, but which has a number of specific requirements. |
| Rent Reviews | take place at intervals agreed in the lease and their purpose is usually to adjust the rent to the current market level at the review date. |
| Rent Roll | is the passing rent being the total of all the contracted rents reserved under the leases. |
| Reversionary Yield | is the anticipated yield, which the initial yield will rise to once the rent reaches the ERV and when the property is fully let. It is calculated by dividing the ERV by the valuation. |
| Retail Price Index ("RPI") | is the official measure of the general level of inflation as reflected in the retail price of a basket of goods and services such as energy, food, petrol, housing, household goods, travelling fare, etc. RPI is commonly computed on a monthly and annual basis. |
| RICS | is the Royal Institution of Chartered Surveyors. |
| RPI Linked Leases | are those leases which have rent reviews which are linked to changes in the RPI. |
| Special Reserve | is a distributable reserve. |
| Total Expense Ratio ("TER") | is calculated as total administrative costs for the year divided by the average total asset value during the year. |
| Total Property Return | is the overall return generated by properties on a debt free basis. It is calculated as the net rental income generated by the portfolio plus the change in market values, divided by opening property assets plus additions. |
| Total NAV Return | is the combination of dividends paid to shareholders and the net movement in the share price during the year. It is calculated as the movement in the share price for the period plus the dividends paid, divided by the opening share price. |
| Underlying Profit | is the pre-tax earnings measure adjusted for non-cash fair value adjustments and non-recurring items such as revaluation gains, revaluation of derivatives, share-based payment charge and gains on sale of property. |
| Weighted Average Facility Maturity | is calculated by multiplying each tranche of Group debt by the remaining period to its maturity and dividing the result by total Group debt in issue at the year end. |
| Weighted Average Unexpired Lease Term ("WAULT") | is the average lease term remaining to first break, or expiry, across the portfolio weighted by contracted rental income. |
| Yield on cost | is the estimated annual rent of a completed development divided by the total cost of development including site value and finance costs expressed as a percentage return. |
| Yield shift | is a movement (usually expressed in basis points) in the yield of a property asset, or like-for-like portfolio over a given period. Yield compression is a commonly-used term for a reduction in yields. |

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