

**From:** Liberum Real Estate Team  
**To:** [+ Ideas](#)  
**Subject:** Primary Health Properties & MedicX\* - The Irish opportunity  
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UK | REAL ESTATE | PHP LN | MXF LN | 22 October 2018

## Primary Health Properties & MedicX\*

### The Irish opportunity

PHP (BUY, TP 125p) | MedicX\* (BUY, TP 90p) | \*Corporate Client of Liberum

A tour of PHP's primary care centres in Ireland last week demonstrated their similar defensive income prospects to the UK market, but with higher returns and expansion potential. Underpinning market growth is a steadily rising and ageing population, with growing demand for large purpose-built facilities. A more attractive yield spread, potential maturation of investor demand and CPI linked rent reviews all provide potential for both PHP and MedicX to sustain strong returns, with negligible additional risk.

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#### Asset tour highlights similar defensive attributes, with stronger returns

PHP last week hosted a tour of three of its primary centres in Ireland, a market it entered in October 2016, following peer MedicX. We believe the tour demonstrated the similar defensive income prospects of the Irish primary care market to the UK, but with higher yields and expansion potential.

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#### Increasing dependence on primary care

Ireland has a growing and ageing population which is set to further increase pressure on its healthcare budget and quality of service. Similar to the UK, the use of modern purpose built primary care centres is seen as an increasingly important solution; enhancing the breadth of services available in the community and relieving stress on more costly hospital visits.

However, the Irish estate is in need of significant funding. The consolidation of smaller practices, often from converted housing, provides a more cost effective solution and has consequently received significant government support. PHP estimate ~120 primary care centres currently exist but only a small number reflect modern, purpose-built practices. The Department of Health has outlined its vision for 200 primary care centres throughout Ireland and has stated its willingness to use private sector investment in order to speed up the delivery.

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#### Similar defensive income prospects

Healthcare in Ireland operates under a two tier system. Access to healthcare is in principle available to any 'ordinary resident'. However, free healthcare is received based upon income. Residents can apply for a Medical Card or a GP Visit Card. The eligibility ranges based upon marital status and number of children.



Given the structure of the Irish healthcare market, government backed rents are lower at primary care centres with 60% - 75% (vs. ~90% in the UK) covered by The Health Service Executive (HSE) adding a slightly higher risk profile relative to the UK primary care market.

HSE leases are nevertheless agreed on an initial term of 25 - 30 years, albeit with two soft break clauses relating to building maintenance and a minimum number of GPs. However, interests are highly aligned so in practice the likelihood of such clauses being used is low. The remaining rent roll, while not government

backed, provides a defensive, long-term income stream with leases of similar length and structure to the HSE. Typical tenants include private GPs, private dental practices and pharmacies.

Rent reviews are aligned to Irish CPI (compounded every five years) for almost 99% of income. We believe this is an attractive alternative to the district valuer led rent reviews seen in the UK.

## Potential for superior returns

We see a number of reasons why investment in Irish primary care could enhance the returns profiles of both PHP and MedicX. With a ~6% yield and lower borrowing costs, income return is 2.5x higher in Ireland than the UK. Peer MedicX last reported a true equivalent yield of 6.6% on its Irish assets.



We also see the prospect for yield compression as investors take advantage of the attractive spread and the investment market matures.

As a proxy for an Irish risk premium we add 50bps to the UK primary care equivalent yield of 4.9% (reflecting the spread of the Irish 10-year to the German bund) and this suggests an Irish government backed income yield of 5.4%. This assumes UK assets are 100% government backed (realistically its ~90%).

Adjusting a 6%-6.6% equivalent yield on Irish assets for an average 70% HSE backed income suggests the defensive, 20+ year leases to non-government tenants commands a yield of 7.4% - 9.4%. To us this looks excessive and could, in due course, lead to yield compression as the market expands and matures.

**Figure 4: Implied yield on non-government income**

		UK	Ireland	Comment
A	True equivalent yield	4.9%	6% - 6.6%	
B	Government backed income	100%	70%	Cautious assumption for the UK (actually ~90%)
C	Government backed yield	4.9%	5.4%	Irish yield based on UK + Irish 10-year spread to Bunds
D	Non-government backed income	0%	30%	1 - B
E	<b>Implied yield on non-government income</b>	<b>n.a.</b>	<b>7.4% - 9.4%</b>	<b>(A-(B*C)) / D</b>

Source: Liberum, PHP, MedicX, Datastream

Finally, we believe index linked rent reviews in the Irish market also offer the prospect for more consistent rental growth. Rental growth in the UK has persistently disappointed despite a significant rise in CPI. The ability to increase rents in line with Irish CPI shields investors from the erosion of real income returns.



## An added growth lever

PHP entered the Irish market in October 2016 and has since acquired a total of 8 assets now valued at €106m and representing 6.6% of its portfolio.

MedicX was the first UK listed primary healthcare REIT to invest in Ireland and now has a total of 5 assets representing 6.4% of portfolio income.

We see the Irish market as a continued growth avenue for PHP and MedicX. A more attractive yield spread, potential maturation of investor demand and CPI linked rent reviews also provides potential for both PHP and MedicX to sustain strong returns, with negligible additional risk.

PHP trades on a CY18E P/NAV of 1.06x and MedicX trades on 0.97x.



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