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INVESTOR

# Civitas Social Housing

**REITs | Annual overview | 17 November 2021**

## Short shrift to short seller

An unwarranted attack by an activist short seller on the fabric of Civitas Social Housing (CSH), coinciding with it falling out of the FTSE 250 index, has driven down CSH's share price in recent months. CSH has published a strong rebuttal (details of the claims and CSH's response are on page 6) saying these claims are baseless. The short seller may have made a quick profit, however CSH has had to put a planned capital raise to grow its portfolio on ice and it has impacted the wider sector to the detriment of thousands of people in need of specialist housing.

The fundamentals that support growth in the sector remain strong and aren't going away, namely increased demand from individuals and a lack of supply (as detailed on pages 4 and 11). The high dividend yield and the large discount to net asset value (NAV) that CSH's shares are now trading on and the increased dividend target for this year seem appealing.

### Income and capital growth from social housing

CSH aims to provide its shareholders with an attractive level of income, together with the potential for capital growth from investing in a portfolio of social homes. The company expects that these will benefit from inflation-adjusted long-term leases and that they will deliver a targeted dividend yield of 5% per annum on the issue price, with further growth expected. CSH intends to increase the dividend broadly in line with inflation.

| | |
|---|---|
| Sector | Property – UK residential |
| Ticker | CSH LN |
| Base currency | GBP |
| Price | 92.5p |
| NAV | 108.5p |
| Premium/(discount) | (15.3%) |
| Yield | 6.0% |

Predicted 30% growth in demand for specialised supported housing by 2030

Portfolio produces £127m of social value every year

Dividend target increased for 2022

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# Contents



| | |
|---|---|
| Domicile | England & Wales |
| Inception date | 18 November 2016 |
| Manager | Civitas Investment Management |
| Market cap | £570.6m |
| Shares outstanding (exc. treasury shares) | 616.6m |
| Daily vol. (1-yr. avg.) | 2,446k shares |
| Loan to value | 34.5% |

Click here for our most recent update note

Click here for an updated CSH factsheet

Click here for CSH's peer group analysis

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Click here to provide feedback to the company

Click if you are interested in meeting CSH's managers

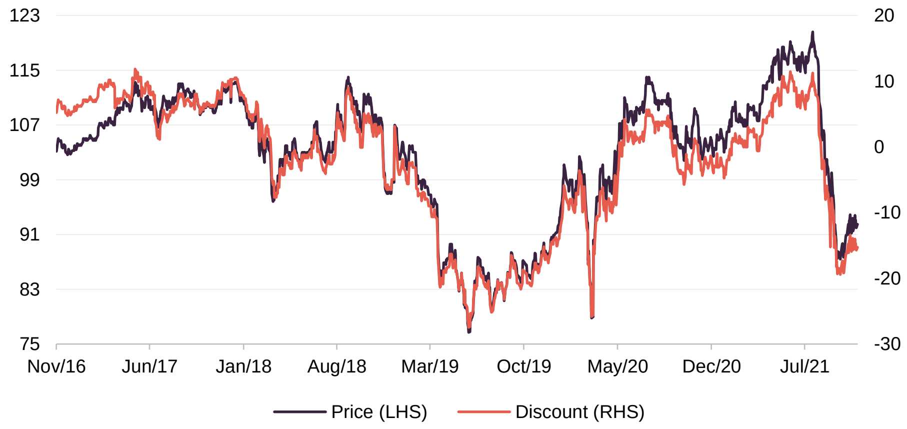
Click for links to share trading platforms

# At a glance

## Share price and discount

CSH's share price recovered well following an initial COVID-19 blip as the sector proved resilient, helped by secure government-backed income. However, the short seller attack coupled with the company dropping out of the FTSE 250 index saw its premium to NAV narrow from a peak of around 10% to a discount. At 15 November 2021 it was trading at a discount of 15.3%.

## Time period 18/11/2016 to 15/11/2021

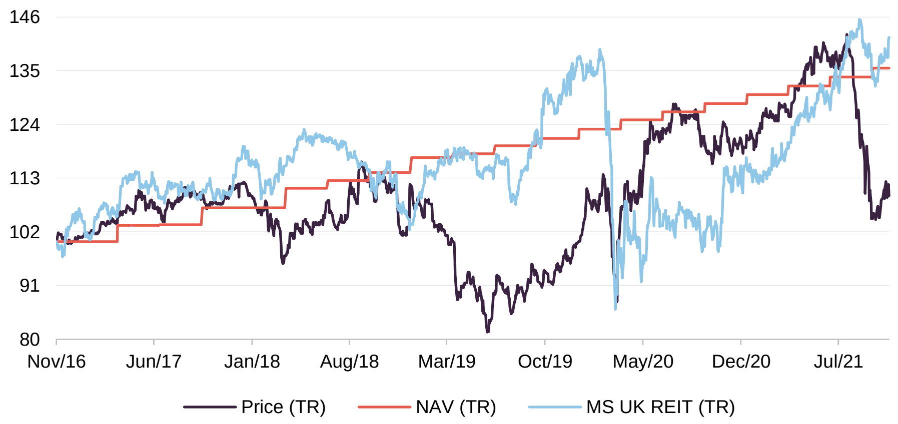



**Source:** Morningstar, Marten & Co

## Performance since launch

CSH's NAV has trended upwards since its launch almost five years ago and over the period the NAV total return is 35.1%.

## Time period 18/11/2016 to 31/10/2021




**Source:** Morningstar, Marten & Co

| Year ended | Share price total return (%) | NAV total return (%) | Morningstar UK REIT total return (%) | Peer group NAV total return (%) |
|---|---|---|---|---|
| 31/10/2017* | 8.1 | 6.9 | 9.9 | 7.0 |
| 31/10/2018 | 3.9 | 6.8 | 2.8 | 7.4 |
| 31/10/2019 | (18.3) | 6.1 | 14.6 | 7.4 |
| 31/10/2020 | 29.1 | 5.9 | (23.4) | 5.6 |
| 31/10/2021 | (5.2) | 5.7 | 39.3 | 5.4 |

**Source:** Morningstar, Marten & Co. Note*: From launch on 18 November 2016

## Fund profile

The company's website is civitassocialhousing.com

CSH has invested £825m to amass a portfolio of diversified supported social housing assets since it launched on 18 November 2016. It raised £350m at IPO and expanded in November 2017, raising an additional £302m through a C share issue (whereby C share investors own a separate class of shares which has its own portfolio). These two pools were merged together in December 2018.

Attractive yield, growing with inflation, plus capital growth from a portfolio of social homes

CSH aims to provide an attractive dividend yield, with stable income growing in line with inflation and the potential for capital growth. Its diversified portfolio is let to housing associations and local authorities (referred to as registered providers) on long-term lease agreements, typically 25 years. It buys only completed homes, which includes acquiring new developments on completion, but it does not get involved with forward funding deals (putting up money to finance the construction of new social homes), or the management of social homes directly.

CSH's portfolio has a low correlation to the general residential and commercial real estate sectors, as the supply and demand demographics driving the social home sector do not move in line with that of the wider real estate market. It is a real estate investment trust (REIT), giving it certain tax advantages. As a REIT, it must distribute at least 90% of its income profits for each accounting period.

### The adviser – Civitas Investment Management

CSH is advised by Civitas Investment Management (CIM), previously named Civitas Housing Advisors, a business established in 2016. Many of the 25-strong team have long experience of working in the sector and in specialist healthcare, and collectively, they have been involved in the acquisition, sale and management of more than 80,000 social homes in the UK.

## Market outlook

CSH remains the leading UK investor in specialist supported housing, which is an integral part of the healthcare sector in the UK and a key component in facilitating the delivery of care for individuals with significant long-term care needs. It enables such people to live fulfilling lives within the community and close to their families, rather than in a hospital or institutional setting.

Demand for supported housing is growing and expanding to cover other social needs

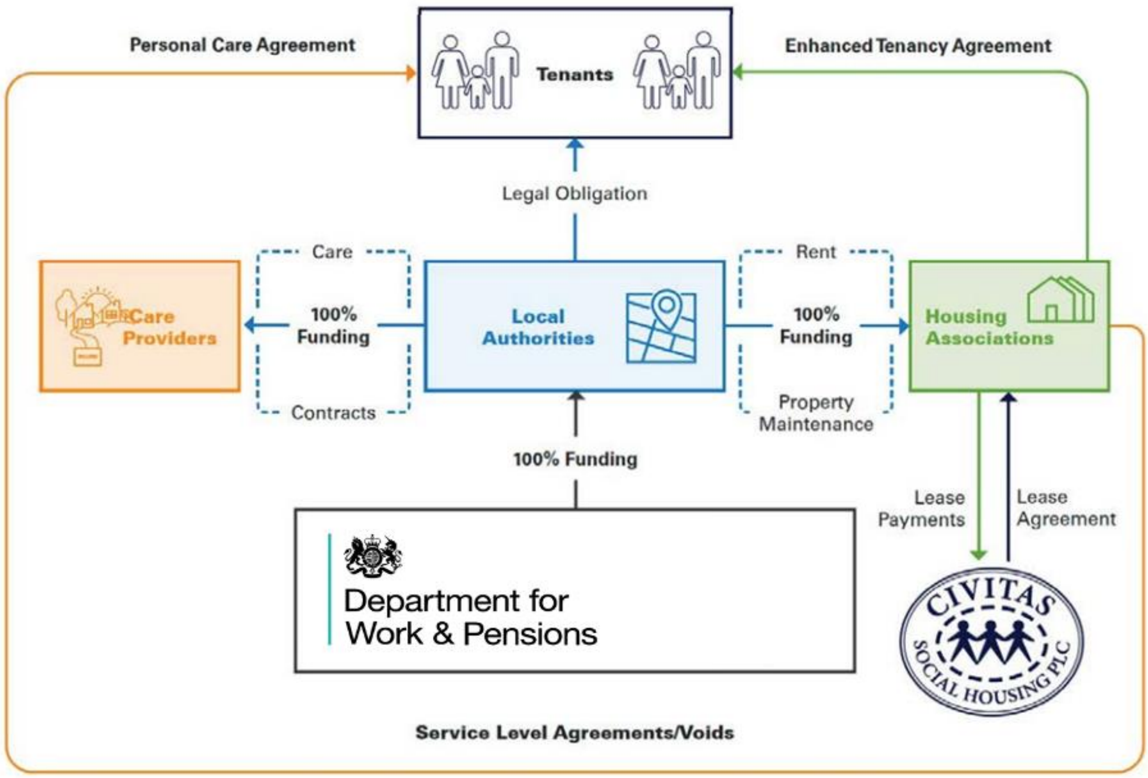
Individuals in supported housing properties require some form of care, and mainly include people with learning disabilities, autism, mental health issues and physical disabilities, although demand for supported housing is growing and expanding to cover a wide range of underlying needs faced by people who are battling homelessness, addiction or who are stepping down from the NHS into a more appropriate supportive care environment.

Local authorities are responsible for providing accommodation and funding care for individuals within their jurisdiction. Supported living provides local authorities with a cost-effective solution to housing people in need, with rents being cheaper than residential care placements and inpatient facilities. According to the monetisation calculations completed by the Social Profit Calculator in 2021, CSH's portfolio generated £75.9m of direct fiscal savings to local and national government per year. The setting also increases quality of life and life outcomes for the residents.

## How it works

Housing benefit typically provides 100% of the funding of rent and service charge for all supported housing, as shown in Figure 1.

### Figure 1: Lease structure




**Source:** Civitas Social Housing

Local authorities enter into care contracts with care providers, who are responsible for the personal care of each individual tenant, and pay them from funding provided by the Department for Work and Pensions.

The care provider in turn enters into a service level agreement with a registered provider, usually a housing association, which has ultimate responsibility for housing provision. Housing benefit is paid by the local authority to the registered provider to cover each individual tenant's rent and service charge.

CSH owns the property and rents it to registered providers, which pay CSH rent through housing benefit from central government

CSH owns the property and rents it under a long-term lease, or an occupancy agreement, to the registered provider. The registered provider uses the housing benefit that it receives to cover the rent due and the costs of managing and maintaining the property, as well as seeking to generate a modest surplus.

Of the £264bn spent by the UK government on welfare in 2017, around 10% (£25bn) covered housing benefit, according to the Office for National Statistics. Of the £25bn, supported social housing accounted for roughly 3.5% or £1.4bn. CSH's annualised rent roll represents roughly 6% of housing benefit spent on supported social housing, highlighting the significant growth opportunity for the company.

## Short seller attacks rebuffed

It has been a tumultuous couple of months for CSH that has seen around a quarter wiped off its market cap since early August. The group has come under fire from an activist short seller, ShadowFall, that has made several damaging claims with the goal of negatively impacting CSH's share price. Below, we have laid out the salient claims by the short seller and CSH's reply and given our view at the end. Bear with us, it does get technical in places but we feet it is important to tackle the issues raised by ShadowFall.

### Transparency

The short seller's claims centre around several property investments made by CSH with entities where two directors of the manager, CIM, own a combined 29.98% stake. These, it said, should have been disclosed to shareholders.

For context, a new care provider called Specialist Healthcare Operations Limited (SHO) was setup in 2018 with the help of CIM directors Tom Pridmore and Andrew Dawber. Whilst being an independent care provider (with Paul Hainsworth, a senior executive from Lifeways – one of the UK's leading specialist care providers – as chief executive and Paul Marriner – formerly chief executive of Lifeways – as chairman) SHO has participated in a small number of investment deals where CSH acquired the properties and SHO bought the operating businesses (called Opco/PropCo splits). These were in circumstances where the care provider wanted a clean exit from the entire business and where CSH says it would have struggled to find properties of equivalent quality on the open market.

As REIT rules exclude acquisition of anything but real estate, CSH says it sought to find third-party care providers to make joint bids but said this proved to be difficult. A new care provider was established that would be willing to work alongside CSH on a non-exclusive basis to acquire the care operating businesses and so enabling CSH to acquire the respective real estate assets. Mr Pridmore and Mr Dawber, utilising their sector contacts, brought together suitable investors and professionals to form SHO. CSH says that as originators of the business and to provide alignment with the incoming management team, Mr Pridmore and Mr Dawber each became 14.99% shareholders in SHO, which translates into a 10% economic interest each as a result of the preferential rights and shareholdings of the other SHO shareholders. CSH states that they are not directors and have no involvement in the running of the business. Neither have they received any remuneration or any other form of income from SHO.

CSH has undertaken four joint tenders with SHO for the purchase of existing built and occupied properties and associated care businesses. Three of the four were the acquisition of the entire care businesses including properties by CSH with an agreed back-to-back sale of the operating businesses to SHO. The fourth was structured so that the properties and the operating business were acquired separately by CSH and SHO on the same day.

To avoid any conflict-of-interest issues, a buy-side committee, which comprises CIM independent non-executive directors, was established to approve the deals before being submitted to CSH's board and alternative investment fund manager (AIFM) for their independent approvals.

Transactions deemed not to be related party transactions under listing rules

Prior to any transactions, CSH says that it also sought advice from its sponsor and professional advisers about the related party transaction rules under the Listing Rules and submissions were made to the FCA. The advice received was that these transactions were not related party transactions for the purposes of the Listing Rules as Mr Dawber's and Mr Pridmore's aggregate shareholding was below 30% and they would not receive any additional economic benefits.

CSH says that the deals were not disclosed to shareholders as it considered there was a competitive first mover advantage to the Opco/PropCo arrangements, which would enable CSH to participate in acquisition processes for high-quality properties from their owners. Whilst the OpCo/PropCo concept is common in the property industry, CIM says this was an innovation in the specialist care sector.

## OpCo sales price

The short seller also queried the price paid by SHO to CSH for the operating companies, implying these transactions had been done on the cheap to the detriment of CSH and its shareholders. It stated that the EBIT multiple paid for the operating companies was as low as 1.3x.

Operating businesses sold to SHO at EBITDA multiples between 2.3x and 3.4x

In response, CSH set out the purchase metrics for the four operating businesses acquired by SHO. It said due diligence reports and a formal 'fair and reasonableness' assessment had been received by CSH's board before the transactions. Figures 2 to 5 show CSH's purchase metrics of the four transactions, showing that the EBITDA multiple was between 2.3x and 3.4x.

### Figure 2: Transaction 1 'Project Charms'

| | £m |
|---|---|
| OpCo purchase price (with costs) | 5.5 |
| EBITDA | 1.8 |
| EBITDA multiple | 3.1x |

Source: Civitas Social Housing

### Figure 3: Transaction 2 'Project Bridge'

| | £m |
|---|---|
| OpCo purchase price (with costs) | 3.0 |
| EBITDA | 1.3 |
| EBITDA multiple | 2.3x |

Source: Civitas Social Housing

### Figure 4: Transcation 3 'Project Ruby'

| | £m |
|---|---|
| OpCo purchase price (with costs) | 11.0 |
| EBITDA | 3.2 |
| EBITDA multiple | 3.4x |

**Source:** Civitas Social Housing

### Figure 5: Transaction 4 'Project Sapphire'

| | £m |
|---|---|
| OpCo purchase price (with costs) | 3.3 |
| EBITDA | 1.2 |
| EBITDA multiple | 2.8x |

**Source:** Civitas Social Housing

In its financial year to March 2021, properties owned by CSH where a SHO entity acts as the care provider represented 14% (£6.9m) of the total annualised rent roll (£50.8m).

## Lease lengths

In its open letter to CSH's board and shareholders, ShadowFall questioned conflicting lease lengths reported by CSH and the registered providers in their respective accounts. The insinuation was that these were inflated by CSH in order to boost NAV and therefore CIM's management fee.

The discrepancies come in the financial reporting of the lease lengths on the balance sheet of the registered providers. CSH says that the leases it grants to tenants come in two phases – the initial lease term and an extension. Importantly, the extension is exercised at CSH's sole discretion. Leases may also be granted with a reversionary lease (of 10 to 20 years in length) that automatically commences the date after the initial lease (of 10 to 20 years) expires.

Registered providers may account for the initial (minimum) lease term only for the purposes of their financial reporting, as in theory, the option may not be exercised by CSH at that date. CSH adds that it is for the registered providers to determine the extent to which they recognise lease obligations on their balance sheets. For CSH, the lease has been valued by independent valuers on the normal basis of the full lease term on the premise that it would exercise its option to extend.

## 100% government backed income

The short seller additionally attempted to cast doubt over the validity of CSH's "100% government funded" model, stating that CSH had provided substantial lease incentives to tenants and also that two register providers received loans or rent support from developers – all of which, it said, showed the tenants were financially supported in meeting its rent obligations to CSH.

### Lease incentives

Lease incentives totalled £1.2m in CSH's financial year ending in 2021 (FY21)

Lease incentives are common within the real estate sector and are mainly used to encourage tenants to sign up to long leases at the start of a lease term. Typically, they comprise a rent reduction for an initial period of the lease or some funding support for development of the property.

The figure that ShadowFall uses to illustrate rising lease incentives across CSH's business is £11.2m in the 2021 financial year, up from £6.8m in FY20 and £3.2m in FY19. However, this includes a £10m payment made by CSH as a second instalment for a new-build property development to SHO. As is common practice in funding property developments (so as not to be exposed to any development risk), the project was paid for in two instalments, the first (£12.2m) when building works were complete and the second (£10m), when occupation had been achieved and care and rent packages were approved by the relevant local authorities. CSH says that the second payment is accounted for under the IFRS accounting standard as a lease incentive due to it being a further payment on an existing lease. For all intents and purposes, however, it is a second capital investment to acquire the development project.

Therefore, in the financial year 2021 lease incentives totalled £1.2m (which CSH says relates to on-boarding fees in respect of lease transfers). Figure 6 shows CSH's lease incentives since it launched.

**Figure 6: Lease incentives per year**

| Lease incentive reason | FY21 (£'000) | FY20 (£'000) | FY19 (£'000) | FY18 (£'000) |
|---|---|---|---|---|
| Lease transfers | 1,217 | 3,594 | - | - |
| Lease extensions | - | 2,036 | 2,358 | - |
| Repurposing | - | 1,213 | 820 | - |
| Total | 1,217 | 6,843 | 3,178 | - |

Source: Civitas Social Housing

CSH says that it anticipates that the level of lease incentives going forward is likely to be similar to FY21.

### Developer loans/rent support

Developer rent support typical during construction to cover lease payments

ShadowFall highlighted that two of CSH's tenants – Encircle and Westmoreland – had been supported by a developer through loans or rent support. Again, this is common practice in the real estate sector during the construction or development phase – in other property sectors usually through rent guarantees.

CSH states that developers have a legitimate role in meeting the costs of rental income before a property is fully occupied. During this time the registered provider will receive income to cover the cost of lease payments to CSH (and other landlords) and this will be paid either by the original developer or by the care provider (which could also be the developer). Once a resident is in place all occupation costs are met by the state.

CSH adds that some developers, as part of the range of services they offer, have provided assistance, funding and operational support to registered providers some of which has also been in the form of "in kind" services such as centralised repairs and maintenance and assistance with rent collection from local authorities. This was the case with Westmoreland where Fairhome Group provided support in this regard, CSH says.

## Tenant strength

Finally, the short seller questioned the long-term viability of CSH's rental income with several of its tenants in "financial difficulty". Since 2018, a number of CSH's tenants (nine of 17) have been deemed non-compliant by the Regulator of Social Housing for either governance or financial viability or both. Despite this, the impact on CSH has been minimal. It has continued to collect its rents in full throughout and the independent valuer of its portfolio has not seen fit to reduce the value of properties on the basis of the regulator's judgments on the tenants.

The most recent regulatory notice was on 12 November, which found Falcon Housing Association (CSH's largest tenant) non-compliant with governance and financial viability standards. It is true that the sector has suffered from growing pains as the sector matures, but CSH states it continues to work closely with all of the registered providers to assist in the strengthening of the businesses. Significant progress has been made, it states, with changes in personnel at both board and executive levels as well as operational enhancements.

In the case of Falcon, the regulator also identified issues around some deals Falcon had entered into with third parties, stating that some involved companies which were at the time linked to directors and shareholders of Falcon. This related to National Care Group, a care provider. CSH says that the presence of directors with outside interests, such as within the care sector or specialist developers, that are correctly disclosed is not unusual within the social housing sector. The origins of what are now large housing associations are often from the care industry, which was the case with Falcon. The two directors in question have since stepped down from the board of Falcon and have transferred ownership of their stake in Falcon to a trust.

## Property valuations

In its letter to shareholders responding to the short seller, CSH also included a section explaining the change in value between what developers/aggregators pay for properties and what CSH pays the developer. Put simply, the cost of works to adapt the property from a residential home into a specialist care accommodation with independent apartments is included in the price that CSH pays. The developer will initially be paid only the value that it has incurred in purchasing the property plus a margin to cover historic costs and an agreed transparent profit (usually around 15%). Costs relating to future works will not be paid until the works are completed. The price paid by CSH is supported by independent valuations. By way of example, Figure 7 shows a breakdown of a CSH transaction.

### Figure 7: CSH property purchase example

| | £ |
|---|---|
| CSH purchase price | 1,049,231 |
| | |
| Developer purchase price | 650,000 |
| Development works | 140,000 |
| Additional cost (stamp duty, legal fees, rent coverage to registered provider, etc) | 126,428 |
| Total developer costs | 916,428 |
| Developer profit (14.5%) | 132,803 |

Source: Civitas Social Housing

## QuotedData view

CSH has made a comprehensive rebuttal to ShadowFall's claims, most of which – as detailed above – are baseless. Even though there was no legal or regulatory requirement to do so, we feel that CSH made a mistake in not disclosing the information about the transactions at the outset, and we are pleased that it has committed to doing so from now on. In our estimation, the decision not to disclose information was not done out of deceit but was a genuine attempt to gain a competitive advantage relative to its peers. We continue to believe that from an operational viewpoint, the business is in a strong position.

ShadowFall has around a 1% short position in CSH and has benefited to the tune of more than £1m from the subsequent slump in CSH's share price. In the meantime, CSH has had to put a planned capital raise to grow its portfolio on ice and has shrunk in size in order to defend its discount. At the same time, an IPO of a competing fund that sought to raise £150m of equity to invest in the sector did not proceed. This has been to the detriment of thousands of people in need of the specialist social housing that CSH invests in, many of which have high-acuity care needs. These people are stuck in care homes and NHS beds, costing the UK taxpayer far more than they would if they were in specialist supported accommodation. The fundamentals that support growth in the sector remain strong and aren't going away.

## Market fundamentals strong

Predicted 30% growth in demand for specialised supported housing by 2030

The demand and supply characteristics in the specialist supported housing sector are compelling. There is a severe shortage of properties that are capable of hosting mid-to-higher-acuity care within local community settings, while demand for such properties is high due to the long-standing government policy to seek closure of remote hospitals in favour of community provision.

The trend for community provision has become established in the UK over the past 25 years and reflects much broader societal change in the manner that care is delivered for people of working age with lifelong care needs. What has developed more recently has been the emergence of specialist housing associations that deliver the augmented property services and who, in turn, enter into leases to secure available properties for their underlying tenants.

The Personal Social Services Research unit has predicted 30% growth in the demand for specialised supported housing in England by 2030 and 55% in respect of learning disability alone, as shown in Figure 8. Meanwhile the National Audit Office has forecast a 29% increase in adults aged 18 to 64 requiring care by 2038 compared to 2018.

**Figure 8: Growth in demand for specialised supported housing by need**

| | 2015 (000s) | 2020 (000s) | 2025 (000s) | 2030 (000s) | Change 2015-2030 |
|---|---|---|---|---|---|
| Learning disability | 38.5 | 47.9 | 53.9 | 59.8 | 55.3% |
| Mental health problems | 29.5 | 30.7 | 31.4 | 31.2 | 5.8% |
| Physical disability or sensory impairment | 9.0 | 9.4 | 9.6 | 9.6 | 6.2% |
| Total | 77.0 | 88.0 | 94.9 | 100.6 | 30.6% |

**Source:** Personal Social Services Research

On the supply side, Mencap states that a significant undersupply of specialised supported housing has resulted in a significant number of people with long-term care needs living with elderly parents and over 2,000 people with a learning disability being placed in inpatient units, miles away from their family. The supply of social housing in the UK fell from around 7m in 1980 to 5m in 2018.

## Social impact

Investment in supported living has an obvious positive social impact. Investments are designed with the intention of enhancing the lives of people who, as a result of the homes, are able to benefit from the availability of secure, long-term, high-quality housing, whether of a general nature or as a base for the provision of more specialist housing and care.

CSH's portfolio produces £127m of social value every year

Every year, social advisory firm The Good Economy publishes a report examining the social impact of CSH's investments. The 2021 report found CSH to be an "authentic impact investor" in accordance with the International Finance Corporation Principles for Impact Management. As part of the report, the Social Profit Calculator (SPC) – a social value consultancy that specialises in calculating the additional value of social, economic, and environmental impact – calculated the social value of CSH's portfolio in monetary terms and found the portfolio to have produced £127m of social value per year (this improves on the £114m calculated in 2019 – it didn't release a report in 2020 due to COVID). This total social value figure was split between £51.2m of social impact (this is the value of the improved personal outcomes for residents) and £75.9m of fiscal savings generated for public budgets through the reduced cost of care packages. The total figure equates to £3.51 of social value being created for every £1 of annualised investment.

# Investment process

CSH has invested £825m to build a portfolio of 648 properties, as at 30 September 2021. The company's investment portfolio offers dual exposure to both the social housing and healthcare sectors in the UK. It provides purpose-built and bespoke properties that support the delivery of mid-to-higher-acuity care for working-age adults with long-term care needs. It delivers this in local community settings supported by government-funded care providers and housing associations.

The bulk of the properties have been acquired from housing associations, care providers, developers and private owners, at yields of between 5.5% and 6.5%; mainly on an off-market basis. As the first and largest fund in the sector, CSH has established extensive relationships with developers, care providers and registered providers, which it uses to put in place acquisition agreements. All of the properties that it acquires already have a lease agreement with a registered provider in place, and so are income-producing from day one. It may, from time to time, require the seller to review and upgrade the contracts that it has with various parties before acquisition.

In May 2020, CSH received overwhelming approval from shareholders to expand its investment policy to allow transactions to be undertaken directly with other not-for-profit organisations, including the NHS as well as other entities in receipt of government funding.

CSH makes a detailed assessment of each property to ensure it is fit for purpose before acquisition. It only invests in completed buildings and does not engage in development or forward funding risk.

## Due diligence

CSH has a strict due diligence process for new investments

CSH has followed a detailed due diligence programme with its lease counterparties since launch, which encompasses:

- completion of diligence forms for key performance indicators, health and safety and finances;
- discussions with the chief executive and finance director of the registered provider;
- site visits to meet management and visit properties;
- standard investigation reports on key individuals for standards of conduct;
- regulatory checks;
- review of available management accounts and business plans;
- physical inspections of properties;
- independent, third-party benchmarking of rent;
- references from all significant care providers; and
- requests for ring-fencing, with segregated accounts or charges for protection of rent and deposits due to CSH.

## Promoting best practice

CSH works closely with housing associations to support them and help recruit experienced and knowledgeable non-executive directors onto boards in order to strengthen corporate governance and improve standards of disclosure and asset management.

It has taken its responsibility as the leading player in supported living further with the formation of a not-for-profit community interest company (CIC). The Social

Housing Family CIC's aim is to offer additional support, guidance and management skills to its member housing associations.

The CIC is operationally and financially independent from CSH, is supported by financial contributions from within the social housing sector and has a skills' commitment from CSH.

Members of the CIC transfer ownership of the housing association to the social housing family, thereby giving CSH enhanced certainty of future rental income as well as further protecting the interests of end users.

Auckland Home Solutions was the first housing association to join The Social Housing Family CIC, and recruitment of additional senior personnel for Auckland has provided further resource and expertise.

CSH ensures its tenants are structured for long-term stability through the formation of a community interest company and the adoption of a best-practice protocol

CSH has also developed a best-practice protocol to ensure that housing associations are structured for long-term stability.

The protocol contains 10 core principles relating to matters such as financial prudence, conflicts of interest, management and interaction with regulators. In addition, it contains detailed requirements for the on-boarding of new properties. These include:

- independent verification of rent to confirm this is appropriate within the local authority area and represents value for money;
- a minimum 'on-boarding fee' paid to the Registered Provider from the proceeds of the sale of the property to CSH, to cover the setup costs of getting the property ready for occupation by a tenant;
- the Registered Provider maintaining segregated accounts/charges for rent and service charges for properties leased from CSH;
- the establishment of a rental protection fund for each tenant, to cover three-to-six months' rent on every property;
- a sinking fund for each property to cover certain capital and maintenance costs and over-runs; and
- an indexation (inflation) reserve fund to be set up at the outset of a lease and topped up over its lifetime, with indexation being set with reference to CPI.

## Investment restrictions

CSH operates within the following investment restrictions:

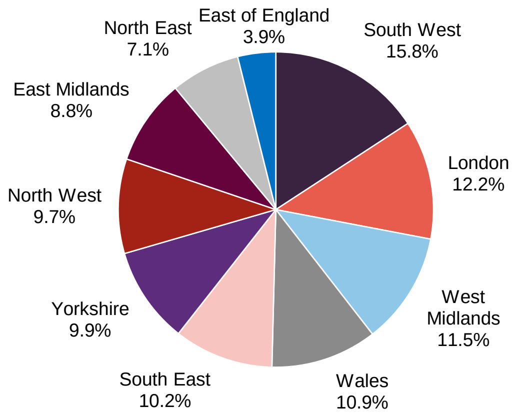
- It may only invest in social homes located in the UK.
- It may only invest in social homes where the counterparty to the lease is an approved provider.
- The minimum unexpired term for a lease or occupancy agreement at the time of acquisition will be 10 years (although leases with shorter lengths can be included in an acquisition of a portfolio that has a weighted average unexpired lease term (WAULT) of more than 15 years).
- The maximum exposure to any single approved provider is 25% of gross asset value (once the capital of the group is fully invested).

- The maximum exposure to a group of houses/apartment blocks in a single geographic location is 20% of gross asset value (once the capital of the group is fully invested).
- Only completed social homes will be acquired – forward finance of social homes under construction is not permitted.
- No investment in other investment companies or alternate finance funds.
- No short selling.

## Asset allocation

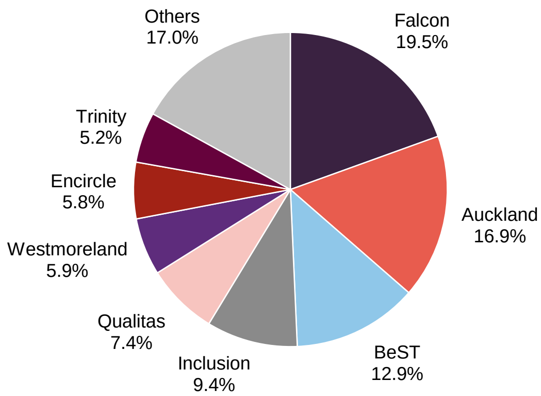
CSH's portfolio is valued at £940.4m and comprises 648 properties, let to 17 housing associations, with 4,391 individual tenants. The weighted average unexpired lease term (WAULT) on the portfolio is more than 22 years.

### Figure 9: Portfolio location (by value)




**Source:** Civitas Social Housing, Marten & Co

### Figure 10: Rental income by tenant




**Source:** Civitas Social Housing, Marten & Co

### Figure 11: Portfolio growth over time

| | 30 June 2018 | 31 Dec 2018 | 30 June 2019 | 31 Dec 2019 | 30 June 2020 | 31 Dec 2020 | 30 June 2021 |
|---|---|---|---|---|---|---|---|
| Investment (£m)* | 508 | 674 | 761 | 771 | 793 | 803 | 825 |
| Properties | 440 | 557 | 594 | 608 | 616 | 619 | 647 |
| Tenancies | 2,845 | 3,746 | 4,094 | 4,153 | 4,241 | 4,295 | 4,390 |
| Local authorities | 123 | 144 | 158 | 161 | 164 | 164 | 178 |
| Housing associations | 12 | 15 | 15 | 15 | 15 | 16 | 16 |
| Care providers | 71 | 98 | 113 | 115 | 118 | 118 | 119 |
| WAULT (years) | 25.4 | 24.7 | 24.1 | 23.8 | 23.2 | 22.7 | 22.1 |

**Source:** Civitas Social Housing. * excluding purchase cost

## Investment activity

CSH's investment activity has been limited in recent months as it looked to defend itself from the short-seller attack. It bought just one property in the quarter to 30

September 2021, for the delivery of learning disabilities and mental health care services. The manager says transaction volumes are likely to pick up again in due course and it has an expansive investment pipeline under consideration.

### Further enhancing ESG credentials

As mentioned earlier, there is an obvious positive social impact to investing in supported social housing. CSH is also pressing ahead with plans to increase the environmental credentials of its portfolio. In June 2021, the company entered into an agreement with energy provider E.ON to undertake environmental enhancements that will help to reduce the carbon footprint across its portfolio.

Initially focussed on 55 properties with lower EPC ratings, the initiative forms part of CSH's objective to reach carbon neutrality. The project will be part-funded by government grants, including the ECO3 funding scheme, part of the government's programme to make homes in the UK more energy efficient, and the Domestic Renewable Heat Incentive (RHI), the government's scheme to support renewable heating costs in homes.

The manager says that it intends to expand the environmental-enhancing schemes across its portfolio over a number of years. As well as having the obvious environmental benefits, improving the energy efficiency of homes should also provide a small incremental increase to the value of the portfolio, the manager believes.

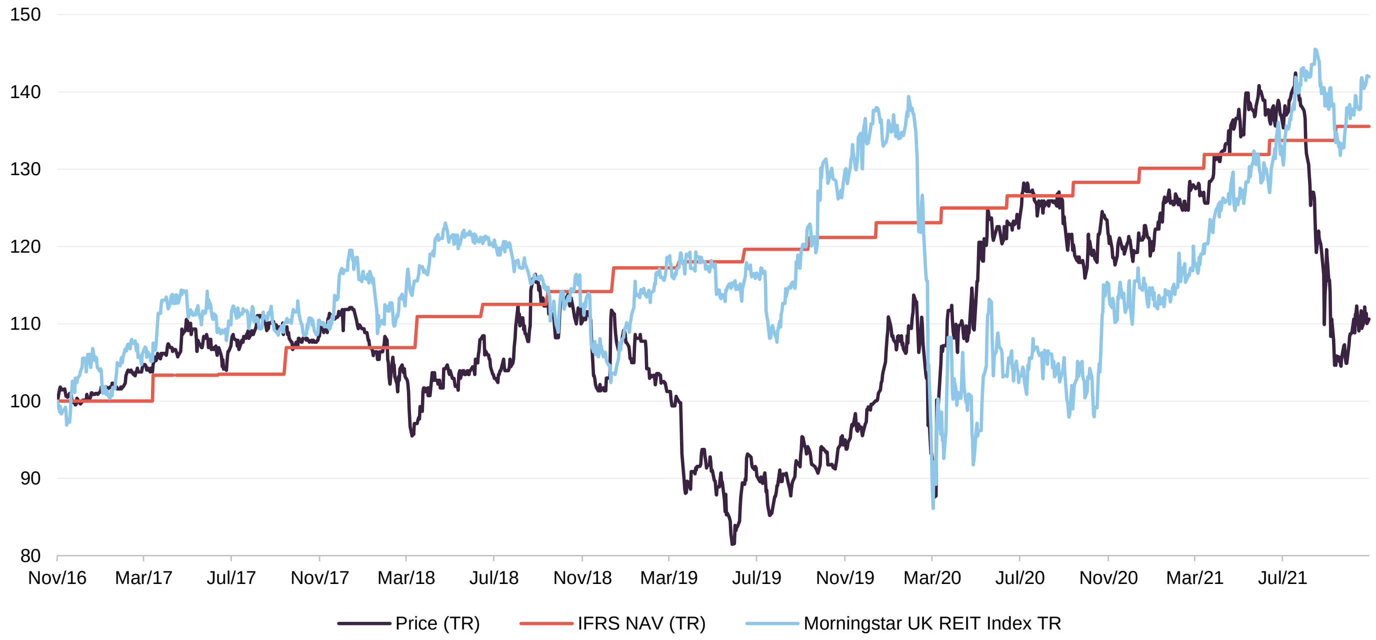
## Performance

CSH publishes two NAVs – an International Financial Reporting Standards (IFRS) NAV, which reflects the value of the portfolio if it was sold off on a piecemeal basis, and a portfolio NAV, which is based on the value if it were to be sold as a single portfolio. This is generally higher than the IFRS NAV, reflecting the fact that the properties are held in special purpose vehicles and attract a lower tax charge than selling properties individually.

At 30 September 2021, the IFRS NAV was £672.9m or 108.49p per share. On a portfolio basis, the NAV was £742.6m or 119.74p per share.

CSH's share price has fallen sharply since August 2021 as firstly a regulatory judgement on one of its tenants was published, then secondly it was targeted by the activist short-seller. This coincided with the company dropping out of the FTSE 250 index, which saw index trackers sell out of their position in the fund. The share price seems to have turned a corner in recent weeks. It had been on an upward trajectory since June 2019, apart from the COVID-19 induced blip in March 2020 when its share price crashed as part of a wider sell-off due to fears over the pandemic. The share price quickly regained all its losses as investors recognised the strength of its government-backed income. Unlike most other REITs, CSH has not seen a drop-off in its rent collection rates throughout the COVID-19 pandemic. Its NAV has trended upwards since its launch almost five years ago and over the period the NAV total return is 35.1%.

**Figure 12: CSH performance since launch**




**Source:** Morningstar, Marten & Co

## Peer group comparison

Up-to-date information on CSH is available on the QuotedData website

CSH sits within a small group of listed peers comprised of Triple Point Social Housing REIT (SOHO), Residential Secure Income REIT (RESI) and Home REIT (HOME).

RESI's focus is more on retirement properties and shared ownership housing (without leases), whilst HOME launched in October 2020 and is solely focused on providing homeless accommodation. Therefore, SOHO may provide a better direct comparison. CSH is larger and has a longer track record than SOHO, a greater yield and a comparable performance over one year in both price and NAV terms.

## Figure 13: Peer group comparison

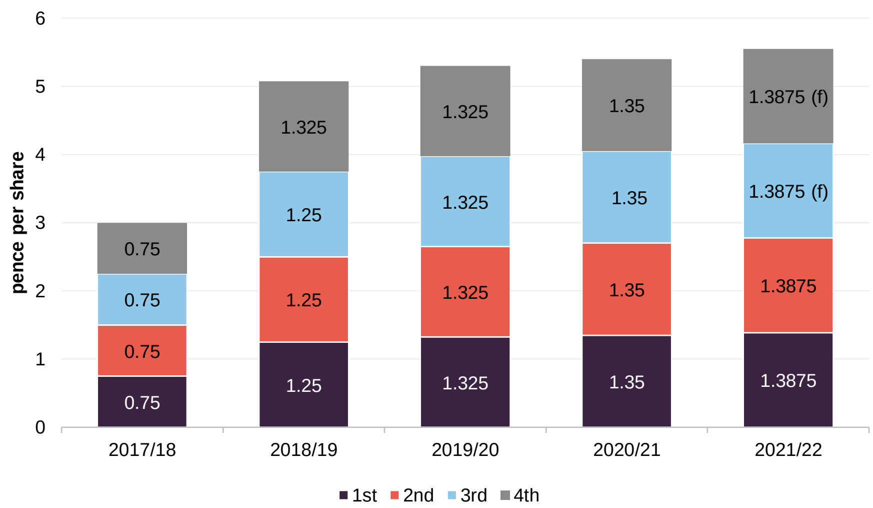
| | Market cap (£m) | Premium/ (discount) (%) | Yield (%) | Launch date | NAV total return 1 year (%)* | Price total return 1 year (%)* |
|---|---|---|---|---|---|---|
| Civitas Social Housing | 570.6 | (15.3) | 6.0 | 18/11/2016 | 5.7 | (5.2) |
| Triple Point Social Housing REIT | 385.5 | (8.1) | 5.4 | 08/08/2017 | 5.5 | (2.8) |
| Residential Secure Income REIT | 168.3 | (5.3) | 5.1 | 12/07/2017 | 3.8 | 17.7 |
| Home REIT | 651.5 | 8.0 | 4.7 | 12/10/2020 | 6.6 | 18.4 |

Source: Morningstar, Marten & Co. Note *: to 31 October 2021.

# Dividend

CSH is targeting a dividend for the financial year ending 31 March 2022 of 5.55p per share, continuing its upward progression since it launched five years ago (as shown in Figure 14). This is a 2.8% increase on the 5.4p it paid in the previous year. It declared a second quarterly dividend of 1.3875p on 8 November, which will be paid around 13 December.

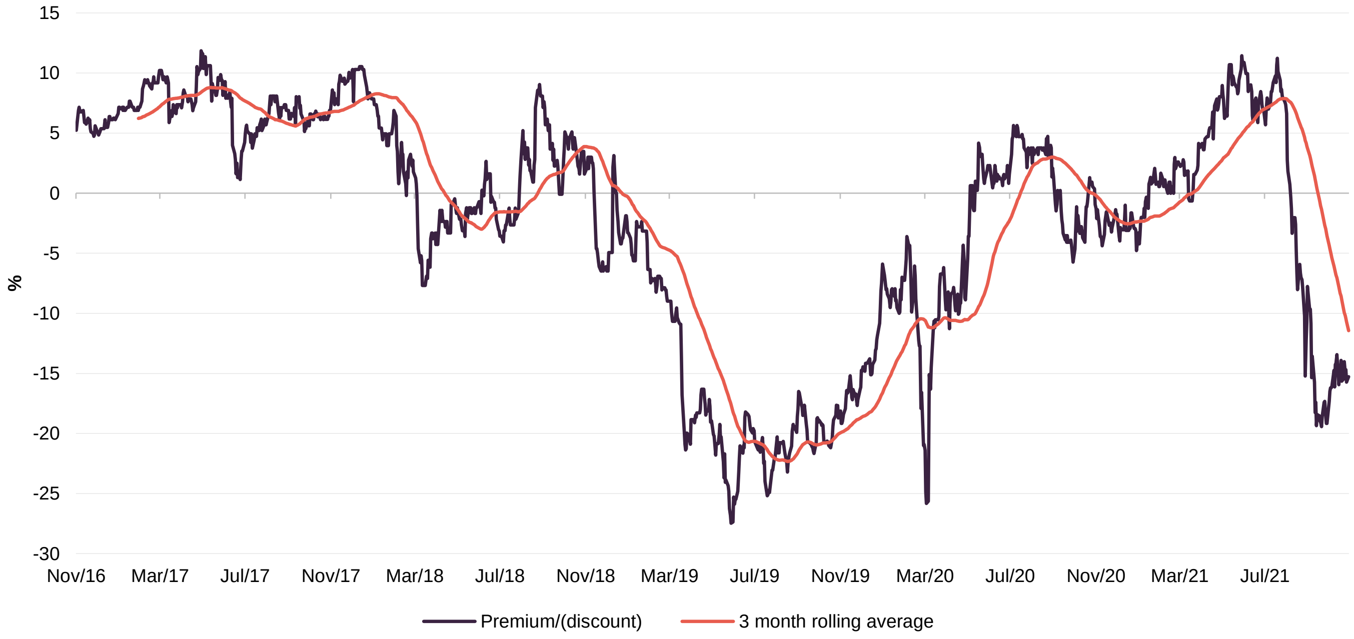
## Figure 14: CSH dividend history




Source: Civitas Social Housing, Marten & Co

## Premium/(discount)

### Figure 15: CSH's premium/(discount) to IFRS NAV since launch




**Source:** Morningstar, Marten & Co

CSH's shares initially traded at a premium to its IFRS NAV, but moved to trade at a discount due to the concerns that the regulator highlighted regarding some of the housing associations in its portfolio. As the company demonstrated the underlying fundamentals supporting growth in the supported living sector and its leading position in it, the discount narrowed from July 2019. The discount widened dramatically as COVID-19 was declared a global pandemic but quickly narrowed again as the company and the sector proved resilient, helped by secure government-backed income. Following the events mentioned earlier, the premium narrowed from a peak of around 10% to a discount. At 15 November 2021 it was trading at a discount of 15.3%.

CSH is authorised to repurchase up to 14.99% of the issued share capital (renewal of this authority is sought annually at the company's AGM). Any shares repurchased may be cancelled or held in treasury and later resold. Shares will not be resold from treasury at a discount to NAV unless as part of an offer that is being made to all shareholders on a pro-rata basis.

As at 15 November 2021 CSH had repurchased 5,850,000 shares to be held in treasury since 20 September 2021 at an average price of 90.5p per share and a cost of just under £5.3m. This represents 0.94% of the issued share capital. The share purchases were made with a view to reducing discount volatility following the short-seller attack and are accretive for shareholders.

## Fees and costs

Tiered management fee and no performance fee

CIM is entitled to an annual advisory fee based on a percentage of CSH's IFRS NAV. This is calculated as 1% on the first £250m, 0.9% on the next £250m, 0.8% on the next £500m and 0.7% on amounts above £1bn. The fee is calculated and paid quarterly in advance. There is no performance fee.

CIM's contract cannot be terminated before 30 May 2024 and thereafter 12 months' written notice is required.

## Capital structure and life

As at 15 November 2021, CSH had 616,611,380 ordinary shares in issue, with 5,850,000 shares held in treasury.

### Debt facilities

Borrowing may be used up to an absolute maximum of 40% of gross asset value (i.e. net gearing of 66.7%). Debt has to be secured at an asset level (a property or collection of properties held within a special purpose vehicle) without recourse to CSH. The board has stated that it intends that CSH should have an average leverage of 35% on a gross asset basis. CSH has total bank borrowings of £357.0m, equating to 34.5% of gross assets.

In February 2021, CSH announced it had secured a new seven-year-term, interest-only loan facility of £84.55m from M&G Investment Management, priced at 2.75% above a fixed rate set by reference to the LIBOR swap rate. It is secured by an existing portfolio of specialist supported living assets.

Other debt facilities comprise a £52.5m loan note from Scottish Widows with a maturity in November 2027 and an all-in fixed cost of 2.99%, two revolving credit facilities – a £60m facility with Lloyds maturing in July 2023 and a £100m facility with HSBC maturing in November 2022, and a £60m fixed-rate debt facility with NatWest maturing in August 2024. The NatWest loan can be extended for an additional two years and there is an option of a further £40m accordion.

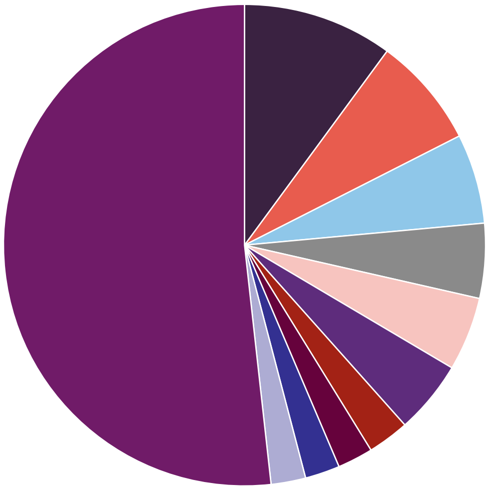
### Life

CSH's year end is 31 March. CSH will hold its first continuation vote at the AGM in 2022 and every five years thereafter.

### Major shareholders

The main change in CSH's largest shareholders has been the introduction of Scandinavian institutional investor Skandinaviska Enskilda Banken (SEB), which bought a 4.6% stake in CSH in early November and has since upped it to 5.0%.

## Figure 16: Substantial shareholdings (at 15 November 2021)




**Source:** Bloomberg, Marten & Co

## The investment team

CSH's investment advisor, CIM, has a proven track record in the social housing sector, combined with many years of experience in the investment industry and financial sector.

### Paul Bridge

Paul is CIM's chief executive (social housing) and joined the company at formation. He has over 20 years' experience of working at a senior level in the social housing sector. He was chief executive of Homes for Haringey, a registered provider, where he was responsible for 800 staff and 21,000 homes. He has also held a variety of non-executive roles including chairman of Thames Valley Charitable Housing Association and director at Hyde Group.

### Andrew Dawber

Andrew is a director and co-founder of CIM. He has been active in the social housing sector since 2012 and was part of the team that founded the private investment company Funding Affordable Homes. He also founded PFI Infrastructure, the first publicly traded social infrastructure fund.

### Tom Pridmore

Tom is group director and co-founder of CIM. He is a specialist in real estate and residential development finance and was part of the team that founded the private investment company, Funding Affordable Homes. He is a qualified lawyer with over 19 years' experience in real estate investment and development, and is responsible for sanctioning all property investment advice and portfolio monitoring.

### Dipesh Devchand

Dipesh is chief financial officer of CIM, having previously been managing director, head of fund finance & operations for the FTSE 100 listed alternative asset manager, ICG plc, since 2015. Prior to that he was European finance director for Apollo Global Management for eight years and with GlobeOp Financial Services for just over two years. Dipesh brings a wealth of experience covering financing, regulatory reporting, tax and operational matters pertinent to a variety of alternative asset classes. He is a fellow of the ICAEW, having trained as a Chartered Accountant with PwC's dedicated investment management team in London.

### Eleanor Corey

Eleanor is transactions director at CIM. She has extensive experience in all aspects of real estate management, investment, development and finance from stints at the in-house corporate real estate team at Lloyds Banking Group and a national housebuilder. She previously spent more than 12 years at international law firm CMS Cameron McKenna Nabarro Olswang, where she practised in their real estate team.

### Mary Finnigan

Mary is transactions director at CIM. She has worked in the real estate sector for over 20 years. Prior to Civitas, Mary was the head of transactions for WeWork where she led the real estate transaction team in the acquisition and asset management of over 150 buildings in 30 cities in EMEA, including numerous pre-lets in London, Paris and Berlin. During her five years at WeWork, Mary gained extensive experience in the regulatory and legal complexities of the key European markets. Mary is a qualified real estate lawyer and began her career at Jones Day Gouldens before moving to SJ Berwin where she advised major developers, landlords and tenants including The Crown Estate, Axa, British Land, SuperDry and Marks & Spencer. Mary is an active member of Women Talk Real Estate, Real Estate Women and Women on Boards.

## Board

The board is comprised of five non-executive directors, four of whom were appointed on the company's incorporation in November 2016. All members are non-executive and independent of the investment adviser.

All directors automatically stand for election at the first AGM following their appointment. Thereafter, they are required to stand for re-election at three-yearly intervals, unless they have served for nine or more years, after which they stand for re-election annually. Excluding newly-appointed directors and directors who have served more than nine years, one-third of the remaining directors must retire and stand for re-election by rotation at each AGM.

## Figure 17: The board

| Director | Position | Appointed | Length of service (years) | Annual fee (GBP) | Ordinary shares held |
|---|---|---|---|---|---|
| Michael Wrobel | Chairman | 18/11/16 | 5.0 | 52,000 | 100,598 |
| Caroline Gulliver | Chairman of the audit committee | 18/11/16 | 5.0 | 38,280 | 58,832 |
| Peter Baxter | Senior independent director | 18/11/16 | 5.0 | 33,280 | 47,065 |
| Alastair Moss | Director | 18/11/16 | 5.0 | 33,280 | 11,766 |
| Alison Hadden | Director | 21/11/19 | 2.0 | 33,280 | 0 |

Source: Civitas Social Housing

### Michael Wrobel

Michael Wrobel has over 30 years' experience in the investment industry. He is the non-executive chairman of Diverse Income Trust. He serves as a trustee director of the BAT UK Pension Fund and chair of its investment and funding committee. He is also the chairman of trustees of the Thornton's Pensions Scheme and Deutsche Bank UK Pension Schemes, a trustee of the Cooper Gay (Holdings) Ltd Retirement Benefits Scheme and acts as an investment adviser to a number of Rio Tinto pension schemes. Formerly, he was a non-executive director of JPMorgan European Smaller Companies Trust and NatWest Smaller Companies. He has served as a director of the Association of Investment Companies, the Investment Management Association and CoFunds. Michael has previously worked at Morgan Grenfell, Fidelity International, Gartmore Investment Management and F&C Management. He has an MA in Economics from Cambridge University.

### Caroline Gulliver

Caroline Gulliver is a chartered accountant with over 25 years' experience at Ernst & Young, latterly as an executive director. During that time, she specialised in the asset management sector and developed extensive experience of investment trusts. She was a member of various technical committees of the Association of Investment Companies and a member of the AIC SORP working party for the revision to the 2009 investment trust SORP (which set out how investment companies should lay out their accounts). Caroline is a non-executive director and audit committee chair for JP Morgan Global Emerging Markets Income Trust, International Biotechnology Trust and Aberdeen Standard European Logistics Income.

### Peter Baxter

Peter Baxter has 30 years' experience in the investment management industry. He is a managing director of Project Snowball, a social impact investment organisation, and a trustee of Trust for London, a charitable foundation. He is also a non-executive director of BlackRock Greater European Investment Trust. Previously he served as chief executive of Old Mutual Asset Managers (UK), and has worked for Schroders and Hill Samuel in a variety of investment roles. Peter holds an MBA from London Business School and is an associate of the Society of Investment Professionals.

### Alastair Moss

Alastair Moss is a property development lawyer with over 20 years' experience and is co-head of real estate at Memery Crystal. He has been a non-executive director of Notting Hill Housing Group (now Notting Hill Genesis) and a member of the audit and treasury committees. He is a former chairman of the investment committee of the City of London Corporation and chaired its property investment board. Alastair is currently chairman of the City's planning and transportation committee. He is a trustee of Marshall's Charity and a mentor to commercial directors in government departments, and has also been a board member of Soho Housing Association and was a member of the area board of CityWest Homes. He was a councillor at Westminster City Council for 12 years, including his tenure as chairman of the planning & city development committee.

### Alison Hadden

Alison Hadden has over 25 years' experience in the housing industry. She started her career at Dudley Metropolitan Borough Council and Birmingham City Council, and went on to hold chief executive positions at several major housing associations, including Paradigm Housing, a 13,000-home housing association based in Buckinghamshire. She has also been an executive director at Circle Housing, one of the largest housing associations in the UK. In these roles, she has worked with many of the stakeholders in the industry, including the Regulator of Social Housing. Alison was previously the chair of Housing Plus Group and is currently a non-executive director and member of the audit and risk committee of Yorkshire Housing and a non-executive director and member of the governance committee of Peaks and Plains Housing.

## Previous publications

QuotedData has published six previous notes on CSH. You can read them by clicking the links below or by visiting the QuotedData.com website.

**Figure 18: QuotedData's previously published notes on CSH**

| Title | Note type | Date |
|---|---|---|
| Socially beneficial investing | Initiation | 18 June 2018 |
| Regulatory action is positive | Update | 19 February 2019 |
| Targeting full dividend cover | Annual overview | 12 September 2019 |
| Proved its mettle | Update | 15 April 2020 |
| Solid foundations for future growth | Annual overview | 22 October 2020 |
| On firm footing | Update | 17 May 2021 |

Source: Marten & Co

## IMPORTANT INFORMATION

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