QuotedData
BY MARTEN & CO
INTERNATIONAL

Civitas Social Housing

REITs | Update | 27 May 2022

'Fundamentals remain strong'

Civitas Social Housing's (CSH's) discount has yet to recover from an activist short seller attack last year, with its share price almost as low as it has ever been in over five years since it launched. Although CSH's manager made a strong rebuttal to the allegations made by the short seller, regulatory concerns around the financial strength of some of its tenants has persisted throughout its existence. To aid regulatory compliance, CSH plans to add a new clause to leases that would enable greater risk-sharing with the housing associations and allow them to temporarily stop paying rent in certain circumstances.

The manager says that the fundamentals that support growth in the sector remain strong and aren't going away. Since the short seller attack, CSH's shares have traded on a wide discount, while it has increased its dividend target for this year.

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.

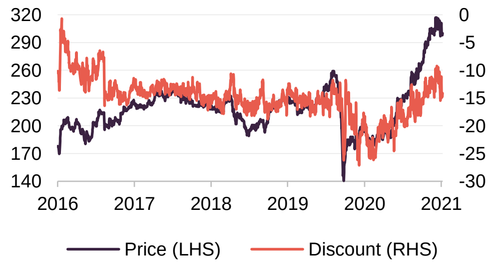
Year ended	Share price total return (%)	NAV total return (%)	Morning-star UK REIT total return (%)	Peer group NAV total return (%)
30/04/2018	2.7	10.8	21.3	10.2
30/04/2019	(10.9)	6.4	(2.8)	8.5
30/04/2020	18.8	5.9	(11.7)	6.0
30/04/2021	22.6	6.0	21.0	5.6
30/04/2022	(20.5)	7.2	12.8	8.0

Source: Morningstar, Marten & Co

Sector	Property – UK residential
Ticker	CSH LN
Base currency	GBP
Price	84.0p
NAV	108.9p
Premium/(discount)	(22.9%)
Yield	6.6%

Share price and discount

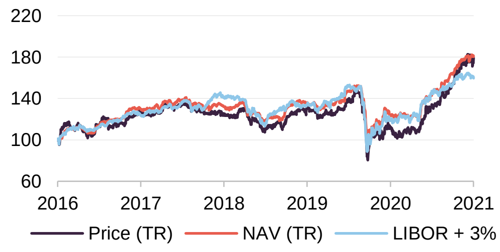
Time period 18/11/2016 to 25/05/2022



Source: Morningstar, Marten & Co

Performance over five years

Time period 30/04/2017 to 30/04/2022



Source: Morningstar, Marten & Co

Contents

Domicile	England & Wales
Inception date	18 November 2016
Manager	Civitas Investment Management
Market cap	£513.0m
Shares outstanding (exc. treasury shares)	610.7m
Daily vol. (1-yr. avg.)	2,816k shares
Net gearing	34.5%

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Hear about the manager

Backdrop

CSH's share price has struggled since a short seller attack last year wiped almost a quarter off the value of the company (you can read a detailed analysis of the short seller's allegations and CSH's rebuttal in our last note on CSH here). The share price has yet to return to anywhere near the levels of early in 2021, despite the manager saying it had proven almost all the points made by the short seller to be unfounded.

The main point raised that was irrefutable centred around disclosure of interests in a small number of 'Opco-Propco' investment deals. These deals involved CSH bidding in tandem with a care provider to buy care business – whereby CSH would acquire the properties and the care provider would buy the operating businesses. The company did not declare to shareholders that two directors of its manager, CIM, also owned a stake in the care provider, which was specifically established 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.

CSH argued that by declaring the particulars of the deals it would lose significant competitive advantage over peers in sourcing these investments. Neither director made any economic gain from the setup, it added.

In defending itself from the short seller, CSH put a planned capital raise to grow its portfolio on ice and has shrunk in size in an attempt to moderate its discount. The manager states that until the share price recovers, the group cannot grow meaning that potentially thousands of people in need of the specialist social housing that CSH invests in – many of which have high-acuity care needs – are stuck in care homes and NHS beds and 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, it adds.

Rehoming a person in need of supported living is said to save local authorities money and provide better quality of life and medical outcomes

Substantial savings are available to local authorities if they can rehome a person in need of supported living (for example, people with learning disabilities, autism, mental health issues or physical disabilities) from a hospital into a property adapted to their needs, the manager says. Research has also shown that these tenants then have an improved quality of life and better medical outcomes. Local authorities turn to care providers to manage the day-to-day welfare of the tenant and to housing associations to provide the accommodation. The housing associations lease property on a long-term basis from the likes of CSH.

Lack of supply and huge demand underpins the strength of the supported living sector

The fundamentals that underpin the supported living sector – namely, the chronic shortage in supply of appropriate accommodation for the delivery of mid- to higher-acuity care, and growing demand – the better health outcomes that specialist supported housing brings to occupants – and the substantial cost saving to government – are only intensifying, the manager says.

The Personal Social Services Research unit has predicted 30% growth in the demand for SSH 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 1: Growth in demand for SSH 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 SSH 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.

New lease clause in bid to achieve regulatory compliance

In an effort to address repeated concerns raised by the regulator in regards to the leased-based social housing model – namely the financial weakness of the housing association tenants and the mismatch of long-term lease liabilities and short-term income streams – CSH intends to add a new clause to leases that would enable greater risk-sharing with the housing associations. The clause would allow a housing association to temporarily stop paying rent in certain circumstances, such as if it had not received housing benefit from a local authority. This would apply after an initial period of time, and then only if paying the rent in full would cause the housing association to fail to meet the regulator's standards. CSH would receive rent arrears as and when the housing benefit is subsequently received by the housing association. Under the terms of the clause, the housing association would provide CSH with full data and step-in rights.

CSH's manager says that it anticipates that the clause will only be relevant to a small number of properties at any one time, and will not have any material impact on the company's rent roll.

The manager hopes that the move will enable the housing associations to be in a better position to achieve regulatory compliance with the RSH's Governance and

Financial Viability Standard and lift the long-standing cloud of regulatory uncertainty over its share price. Judgments passed by the regulator on CSH's tenants are usually followed by a drop in CSH's share price.

CSH intends to initially incorporate the clause into a limited number of existing leases on unencumbered properties. If the clause is well-received by stakeholders in the sector, it will be rolled out across the portfolio. The manager says it has formal written confirmation from valuers that the inclusion of the clause within new and existing leases will not impact on the value of the leases or assets. The manager believes that the enhanced regulatory alignment would, in fact, result in asset value appreciation over the medium term.

Inflation

CSH's leases are linked to CPI, with its housing association tenants seeking sign-off from the relevant housing benefit officers within each local authority in which they operate for this amount. With inflation soaring to 9%, as measured by CPI, and forecast to increase further this year, this may give some cause for concern about the affordability of specialist supported housing. Across CSH's portfolio, 27% of rents benefit from indexation at CPI+1%, with the balance of 73% at CPI. Additionally, 31% of rents are subject to a cap of 4%.

Inflation uplifts come into effect on the anniversary that each lease was signed

The manager says that it has engaged with its housing association tenants, who have confirmed that they have in recent months continued to achieve positive settlements with local authorities that reflect the current higher levels of inflation. The manager says that it will continue to monitor the situation but so far sees no sign of issues. Inflation uplifts come into effect on the anniversary that each lease was signed (with the CPI rate usually backdated two months to ensure availability of data) so the higher rates of inflation over the past few months may not filter through for some time.

The manager says that rental levels across its portfolio are regularly tested for affordability and agreed with housing associations. It adds that rent levels vary significantly, as they do in the general housing sector, depending on their location, as well as their use (properties that deliver high-acuity care will be more expensive than mid-acuity due to the extra cost of adapting the property), but usually make up a small part (10% – 15%) of the overall cost of the delivery of high-acuity care provision.

CSH has previously indicated that the average weekly rent for a mid-acuity property in its portfolio is £194 (which is in line with rents quoted by Mencap) and £311 a week for very high-acuity residential care accommodation. In both cases, this represents a significantly lower cost than other forms of accommodation such as institutional or hospital care, the manager says. CSH's small portfolio of properties for homeless individuals or refugees (see page 7 for more detail) have an average weekly rent of £124, due to the lower level of adaptation needed to deliver the care required.

Figure 2: CSH's average weekly rent by region

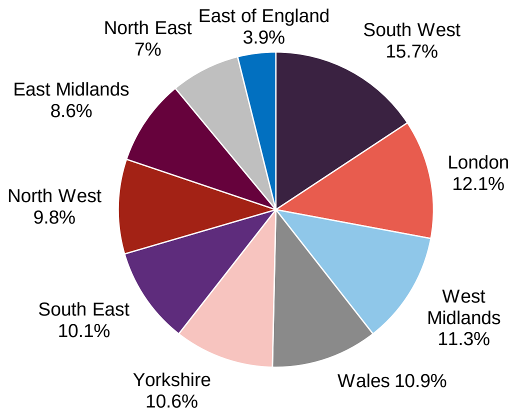
Region	Average weekly rent
Midlands	£203
East of England	£244
London	£394
North East	£135
North West	£152
South East	£266
South West	£215
Wales	£217
Yorkshire & the Humber	£116

Source: Civitas Social Housing, Marten & Co

Asset allocation

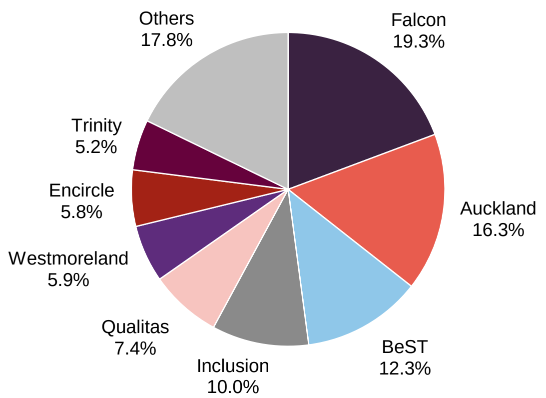
CSH's portfolio was valued at £946.3m (at 30 September 2021) and comprises 696 properties, let to 18 housing associations, with 4,592 individual tenants. The weighted average unexpired lease term (WAULT) on the portfolio is more than 22 years.

Figure 3: Portfolio location (by value)



Source: Civitas Social Housing, Marten & Co

Figure 4: Rental income by tenant



Source: Civitas Social Housing, Marten & Co

Figure 5: Portfolio growth over time

	31 Mar 2019	30 Sept 2019	31 Mar 2020	30 Sept 2020	31 Mar 2021	30 Sept 2021	31 Mar 2022
Investment (£m)*	758	764	789	803	803	825	835
Properties	591	599	613	618	619	648	696
Tenancies	4,072	4,114	4,216	4,292	4,295	4,391	4,592
Local authorities	157	160	164	164	164	178	178
Housing associations	15	15	15	15	16	17	18
Care providers	113	114	117	118	118	119	130
WAULT (years)	24.4	24.1	23.7	22.9	22.6	22.7	

Source: Civitas Social Housing. * excluding purchase cost

Investment activity

So far this year CSH has completed the acquisition of 47 four-bed properties in Yorkshire and Humberside for a total of £8.1m. It has signed an indexed-linked lease with Qualitas Housing and benefits from an underlease with a leading national housing provider holding a long-term Government contract to deliver asylum accommodation. The properties are immediately income producing.

In 2020, CSH expanded its investment horizon to include other types of social housing including accommodation for homeless people. Properties providing homeless/asylum seeker accommodation now represent 3.7% of the company's portfolio by value following the recent deal.

Strong ESG credentials

Investment in supported living 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

According to social advisory firm The Good Economy's Social Profit Calculator (SPC) – a social value consultancy that specialises in calculating the additional value of social, economic, and environmental impact – the social value of CSH's portfolio in monetary terms was £127m of social value per year in 2021. 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.

CSH is also pressing ahead with plans to increase the environmental credentials of its portfolio. It has an agreement with energy provider E.ON to undertake environmental enhancements that will help to reduce the carbon footprint across its portfolio and reach carbon neutrality.

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 increase to the value of the portfolio, the manager believes.

Dividend target increased

Dividend target for FY 2022 increased to 5.55p per share

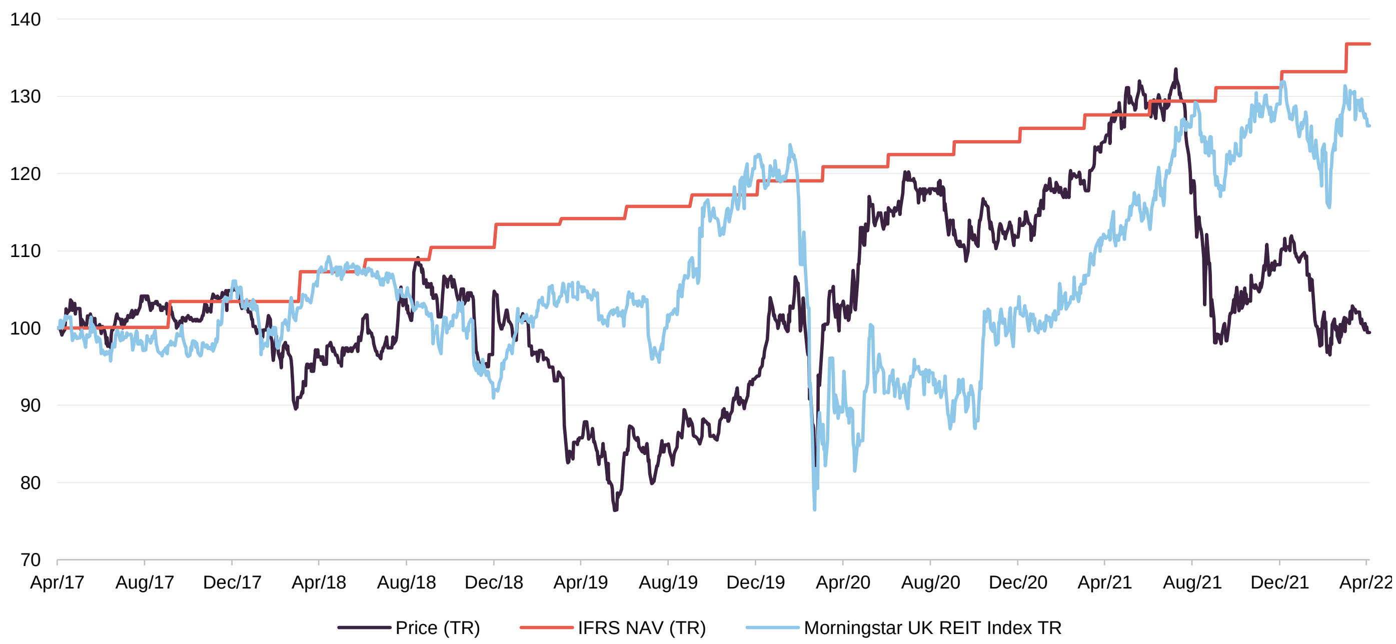
CSH's board is targeting a dividend of at least 5.7p per share for the financial year ending 31 March 2023, 2.7% above the 5.55p per share it has paid for the year to 31 March 2022.

As mentioned earlier, the effect of a jump in inflation is not immediately reflected in the leases. The average increase in CPI since March 2019 (when the company completed payment of the first full annual dividend) to the end of March 2022 was 2.6% a year and compares to an average increase in the company's dividend of 3.3% a year over the same period.

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 31 March 2022, the IFRS NAV was £675.5m or 110.3p per share. On a portfolio basis, the NAV was £752.3m or 122.84p per share.

Figure 6: CSH performance over five years



Source: Morningstar, Marten & Co

CSH's share price fell sharply in August 2021 after 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 has yet to recover its losses. 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. Its NAV has trended upwards since its launch and over five years the NAV total return is 36.8%.

Peer group comparison

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).

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

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.

Figure 7: Peer group comparison

	Market cap (£m)	Premium/ (discount) (%)	Yield (%)
Civitas Social Housing	513	(22.9)	6.6
Triple Point Social Housing REIT	362	(17.3)	5.8
Residential Secure Income REIT	186	(9.4)	5.1
Home REIT	659	1.5	4.7

Source: Morningstar, Marten & Co

CSH is larger and has a longer track record than SOHO, a greater yield and a comparable performance over all periods to three years in both price and NAV terms.

Figure 8: Peer group analysis – performance over 6 months, one, three, and five-years

	6-month NAV TR (%)	1-year NAV TR (%)	3-year NAV TR (%)	5-year NAV TR (%)	6-month price TR (%)	1-year price TR (%)	3-year price TR (%)	5-year price TR (%)
Civitas Social Housing	4.3	7.2	19.8	36.8	(5.6)	(20.5)	15.9	(0.6)
Triple Point Social Housing REIT	4.1	6.7	20.9	-	(7.6)	(12.3)	8.8	-
Residential Secure Income REIT	2.9	6.9	15.6	-	12.3	17.0	35.6	-
Home REIT	6.8	11.0	-	-	7.9	11.4	-	-

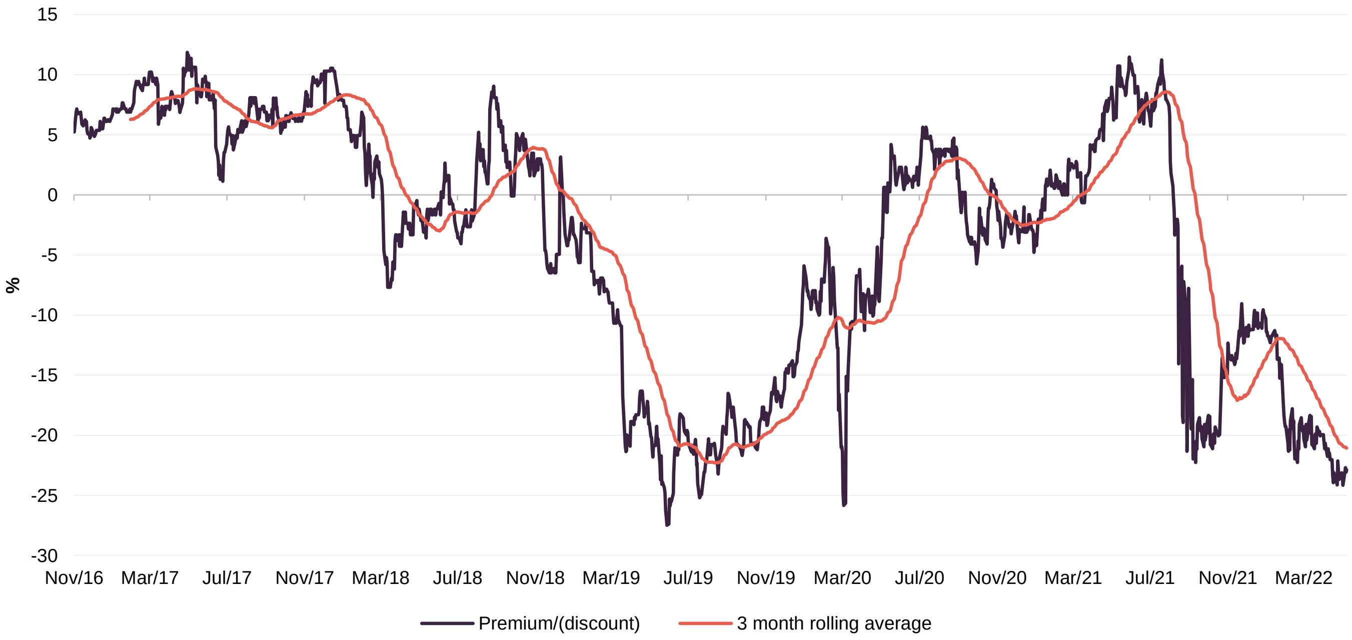
Source: Morningstar, Marten & Co. Note: performance calculated to 30 April 2022

Premium/(discount)

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. Following the short seller attack, the premium narrowed from a peak of around 10% in August 2021 to a discount and has yet to recover. At 25 May 2022 it was trading at a discount of 22.9%.

To defend its discount following the short seller attack, CSH has been repurchasing shares (it is authorised to repurchase up to 14.99% of the issued share capital). As at 25 May 2022 CSH had repurchased 11.725m shares to be held in treasury since 20 September 2021 at an average price of 91.2p per share and a cost of just under £10.7m. This represents 1.88% of the issued share capital.

Figure 9: CSH's premium/(discount) to IFRS NAV since launch



Source: Morningstar, Marten & Co

Fund profile

The company's website is civitassocialhousing.com

CSH has invested £835m 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.

CSH aims to provide an attractive 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 40-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.

Previous publications

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

Figure 10: 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
Short shrift to short seller	Annual overview	17 November 2021

Source: Marten & Co

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