QuotedData

Update | Real estate

15 April 2020

Civitas Social Housing

Proved its mettle

Some market commentators appear to have overstated the impact of regulatory concerns on Civitas Social Housing's (CSH's) performance. Regulatory notices served on some of its tenants knocked CSH's share price over 2018/2019. However, during the whole of this period, it collected its rents, paid its dividends and increased its net asset value (NAV).

Recognition of this fact, and the supply and demand fundamentals that support growth in the supported living sector, saw its share price recover and its discount to NAV narrow. That momentum, as has been the case in all global markets, has been somewhat curtailed by the coronavirus outbreak. However, owing to the strong characteristics of the supported living sector, CSH has been one of the best performing REITs and property companies since the covid-19 pandemic escalated.

The company is keen to expand but it has delayed taking on new debt facilities until the markets return to normality. Following the acquisition of a portfolio of properties in March 2020, CSH's dividend is fully covered by earnings on a run rate basis.

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 5.3% per annum on the issue price, with further growth expected. CSH intends to increase the dividend broadly in line with inflation.

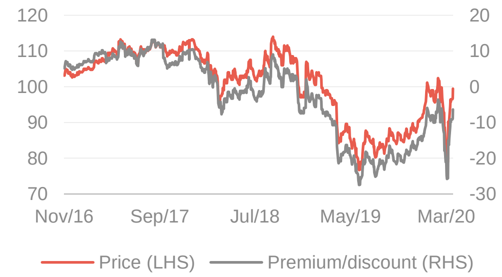
Year ended	Price total return (%)	NAV total return (%)	EPRA earnings per share (pence)	Dividend per share (pence)
31/03/18	(0.6)	10.7	1.44	4.25
31/03/19	4.2	9.4	3.63	5.0
31/03/20	6.6	4.3		5.3

Source: Morningstar, Marten & Co

Sector	Property – UK residential
Ticker	CSH LN
Base currency	GBP
Price	101.2p
NAV	106.23p
Premium/(discount)	(4.7%)
Yield	5.2%

Share price and discount

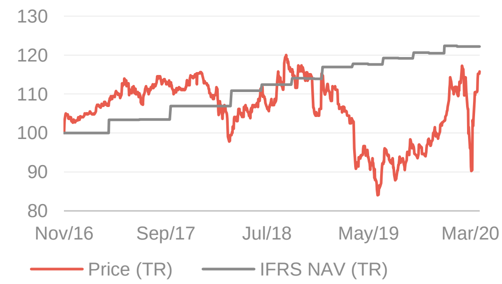
Time period 18/11/2016 to 14/04/2020



Source: Morningstar, Marten & Co

Performance since launch

Time period 18/11/2016 to 14/04/2020



Source: Morningstar, Marten & Co

Domicile	England and Wales
Inception date	18 November 2016
Investment adviser	Civitas Housing Advisors
Market cap	625.4m
Shares outstanding	621.6m
Daily volume (1yr avg)	1.39m shares

Click here for our most recent update note

Back on track following turbulent 2019

A wider acknowledgement of the strong foundations that support CSH's business appears to have been reflected in its share price, prior to the outbreak of covid-19.

Following a series of regulatory notices on some of the housing associations that rent CSH's supported living properties, the company's share price hit an all-time low of 76.7p in June 2019, from an inception price of 103.0p in November 2016 and a peak of 114.0p in September 2018.

Despite the well-publicised growing pains of the housing associations that lease CSH's properties, it continued to collect its rents, pay its dividends and increase its net asset value (NAV). Its share price bounced back in the second half of 2019 and has continued to track upwards into 2020.

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, and growing demand; the better health outcomes specialist supported housing brings to occupants; and the substantial cost saving to government – are not going away. In fact, demand is growing at an average of around 5% a year with more than 170,000 people already housed in supported living facilities like those provided by CSH.

We explained the structure of the specialist supported housing market in the UK in our September 2019 annual overview note. To recap, substantial savings are available to local authorities if they can rehome a person in need of supported living from a hospital into a property adapted to their needs. 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.

The sector desperately needs more supply of specialist homes for supported living. The chronic lack of housing led to the launch of a legal challenge in February 2020, against the Secretary of State for Health and Social Care, over the repeated failure to move people with learning disabilities and autism into appropriate accommodation.

The Equality and Human Rights Commission said that more than 2,000 people with learning difficulties and autism are detained in secure hospitals, amounting to a systemic failure to protect the right to a private and family life, and a right to live free from inhuman or degrading treatment or punishment.

New Tory government has made commitments to state funded health and social care

Central government has historically supported the specialist supported living sector. The new Conservative government has made commitments to support the delivery of state funded healthcare and social care, while recognising the cost savings and better personal outcomes for individuals that supported living accommodation offers.

As the biggest and most established specialist supported housing fund, CSH is playing a leading role in growing the sector. It currently owns 616 properties that house more than 4,200 people with long-term health issues.

Figure 1: Portfolio growth over time

	31 Dec 2017	30 June 2018	31 Dec 2018	30 June 2019	31 Dec 2019
Investment* (£m)	431	508	674	761	771
Properties	384	440	557	594	608
Tenancies	2,405	2,845	3,746	4,094	4,153
Local authorities	99	123	144	158	161
Housing associations	10	12	15	15	15
Care providers	59	71	98	113	115
WAULT (years)	24.3	25.4	24.7	24.1	23.8

Source: Civitas Social Housing, Marten & Co, * excluding purchase cost

In March 2020, CSH acquired eight freehold properties for a total of £19.6m, adding 74 tenancies to the portfolio. The properties are leased to housing associations that are existing tenants in its portfolio.

CSH has identified an acquisition pipeline worth more than £200m but needs additional capital to make real in-roads into it. With a current gross loan-to-value (LTV – total debt to property portfolio value) ratio of around 28%, CSH has ample capacity to borrow more to bring its LTV up to its target of 35%. With no debt held against some of its properties, which are valued at around £212m, CSH says it intends to implement its long-term debt strategy with the addition of further loan facilities. It says that it will do this in a prudent manner, taking full regard of prevailing circumstances surrounding covid-19.

With a 100% run-rate dividend cover already achieved (following the acquisitions in March 2020 and including a £12.1m commitment in Wales) further deployment of debt would increase CSH's rental income, pushing dividend cover further above 100%.

CSH close to securing additional funding that would bring its loan-to-value ratio up to its 35% target

An equity raise is an option for CSH further down the line, after markets return to normal following the covid-19 pandemic. CSH says that it will monitor its share price and if this recovers to where it was in early March 2020 and the discount narrows further, it may look to the market to raise equity.

The company wants to broaden its portfolio exposure in the supported living sector to include other areas of government-backed housing, such as facilities for homeless people and accommodation for people stepping down from the NHS. CSH has had a number of conversations with NHS trusts and other providers to develop a pipeline of NHS step-down facilities. These are long-term step-down homes and facilities for those with care needs who are currently housed in hospitals.

CSH would enter into long-term leases with the NHS, which may be structured in the form of specific joint venture arrangements, and also with registered charities. CSH will seek shareholder approval to expand its investment policy at an EGM (extraordinary general meeting).

Shareholder approval was received last year to open up CSH's investment criteria to include Scotland and Northern Ireland, and it has been actively looking at investment opportunities in these countries.

Coronavirus impact

CSH's share price has outperformed other REITs during the coronavirus pandemic

CSH's share price initially fell following the covid-19 pandemic but regained its losses and is up 14.2% in the month to 14 April 2020.The role of supported living and social care in assisting the NHS during the crisis has been well-publicised in the national media. CSH has said it has received direct and indirect enquiries from the NHS to see if it has any properties that could be made available to them and is working closely with them to provide these.

Although the coronavirus pandemic has delayed some business decisions, such as the new debt facilities, the mid to upper acuity nature of CSH's portfolio has meant it has been less impacted by the crisis and is in a strong position to grow further when life returns to normal.

Proactive to regulatory issues

CSH says that the concerns that the Regulator for Social Housing (RSH) had with specific housing associations have been or are currently being addressed. It comments that its leading position in the sector enables it to identify issues at associations early and act quickly and decisively in reassigning leases and minimising impact on its business.

Exposure to Westmoreland has reduced from 10.8% to 6.4%

This has been the case with Westmoreland Supported Housing, which has been the subject of several regulatory judgements relating to its governance and financial management (not specific to CSH). Nonetheless, CSH reassigned a significant proportion of Westmoreland's leases to several other housing associations already in its portfolio on the same terms, while Westmoreland works through its issues. Its exposure to Westmoreland, as measured by rental income, has been reduced to 6.4% from 10.8% at 30 September 2019.

It was a similar story with First Priority Housing Association in February 2018. The RSH published a regulatory notice on the company stating that it did not believe First Priority had sufficient working capital or the financial capacity to meet its debts and highlighted governance concerns. CSH took the decision to reassign the First Priority leases in its portfolio – of which there were 45 – to other providers on similar terms and without any material loss of revenue.

The Social Housing Family CIC

CSH is in frequent dialogue with the regulator and works closely with housing associations to support them and help recruit experienced and knowledgeable non-executive directors. Its aim is to strengthen corporate governance and to improve standards of disclosure and asset management.

CSH has set up a community interest company to help increase skills and experience among its tenants

CSH 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 enable the housing associations in CSH's portfolio to increase their skills and experience and to provide funding if required to promote enhanced performance. This should also give additional comfort to the regulator when it assesses the housing association's governance and financial viability.

The CIC is operationally and financially independent from CSH. It is supported by financial contributions from within the social housing sector alongside 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.

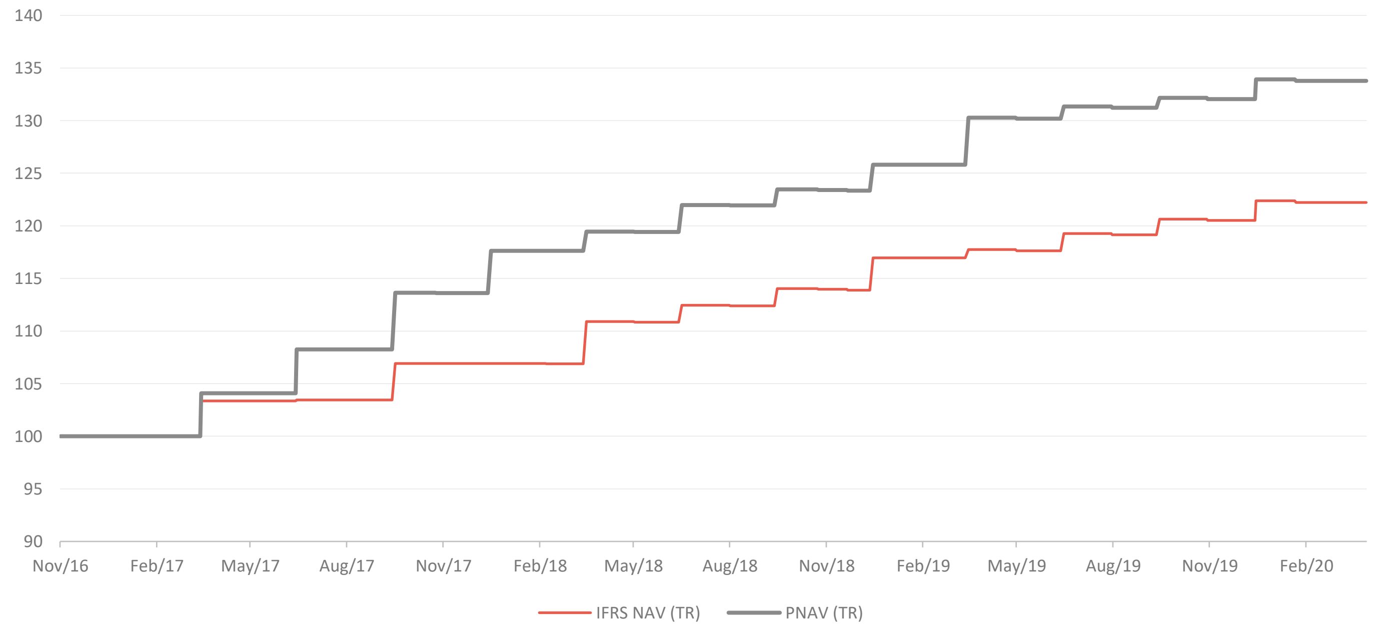
Auckland Home Solutions is the first housing association to join The Social Housing Family CIC, and recruitment of additional senior personnel for Auckland is already under way as a means of providing further resource and expertise.

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 reflects the fact that the properties are held in special purpose vehicles and attract a lower tax charge than selling properties individually.

At 31 December 2019, the IFRS NAV was £688.6m or 107.55p per share. On a portfolio basis, the NAV was £737.6m or 118.65p per share.

Figure 2: CSH NAV total return since launch



Source: Civitas Social Housing, Marten & Co

Share price

The second half of 2019 saw CSH's share price start to recover from an all-time low of 76.7p on 14 June 2019. The share price trended upwards in the second half of 2019 and into 2020 as the market became more comfortable with the fundamentals of the business. CSH's share price tailed off in March 2020 as part of a wider sell-off due to fears over the spread of covid-19, but regained all its losses.

Figure 3: CSH share price since launch

Source: Morningstar, Marten & Co

Peer group comparison

Up to date information on CSH and its peer group is available on the QuotedData website

CSH sits within a small group of listed peers comprised of Triple Point Social Housing REIT (SOHO) and Residential Secure Income REIT (RESI). CSH is by far the largest fund in this peer group. RESI's focus is more on retirement properties and shared ownership housing (without leases), and therefore SOHO may provide a better comparison. CSH is larger and has a longer track record and therefore its superior rating is merited.

Figure 4: Peer group comparison

	Market cap (£m)	Premium/ (Discount) (%)	Yield (%)	Launch date	NAV total return 1 year (%)*	Price total return 1 year (%)*
Civitas Social Housing	625.4	(4.7)	5.2	18/11/16	4.3	6.6
Residential Secure Income REIT	152.7	(17.9)	5.6	12/07/17	3.4	(1.1)
Triple Point Social Housing REIT	313.0	(10.5)	5.7	08/08/17	5.4	(4.9)

Source: Morningstar, Marten & Co. * Year to 31 March 2020

Premium/(discount)

CSH's ordinary 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 has narrowed since July 2019 and was as low as 3.6% in late February. The wider sell-off due to fears over the spread of covid-19 saw the discount initially widen before narrowing again, and at 14 April 2020 it stands at 4.7%.

Figure 5: CSH premium/(discount) to IFRS NAV since launch

Source: Civitas Social Housing, Morningstar, Marten & Co

Fund profile

The company's website is www.civitassocialhousing.com

CSH launched on 18 November 2016, raising £350m at IPO and expanded in November 2017, raising an additional £302m through a C share issue. 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 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 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 Housing Advisors

CSH is advised by Civitas Housing Advisors (CHA), a business established in 2016. Many of the 20-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 three previous notes on CSH. You can read them by clicking the link or by visiting the quoteddata.com website.

Figure 6: QuotedData 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

Source: Marten & Co

QuotedData

QuotedData is a trading name of Marten & Co, which is authorised and regulated by the Financial Conduct Authority
123a Kings Road, London SW3 4PL
0203 691 9430

www.quoteddata.com

Registered in England & Wales number 07981621,
2nd Floor Heathmans House
19 Heathmans Road, London SW6 4TJ

Edward Marten
(em@martenandco.com)

David McFadyen
(dm@martenandco.com)

Alistair Harkness
(ah@martenandco.com)

Investment company research:

Matthew Read
(mr@martenandco.com)

James Carthew
(jc@martenandco.com)

Shonil Chande
(sc@martenandco.com)

Richard Williams
(rw@martenandco.com)

IMPORTANT INFORMATION