EDISON

Civitas Social Housing

Q221 update

Performing well and looking to further growth

Real estate

The Q221 trading update for the three months ended 30 September 2020 shows Civitas Social Housing continuing to perform in line with expectations, with no COVID-19 impact on rent collections or property valuations. Quarterly DPS has continued uninterrupted, while continuing moderate growth in the portfolio and rent roll delivers 100% cover by EPRA earnings on a run-rate basis.

Year end	Net rental income (£m)	EPRA earnings* (£m)	EPRA EPS* (p)	EPRA NAV/ share* (p)	DPS (p)	P/NAV (x)	Yield (%)
03/19	35.7	22.6	3.63	107.1	5.08	1.02	4.7
03/20	46.2	28.8	4.63	107.9	5.30	1.01	4.9
03/21e	49.0	31.8	5.11	108.3	5.40	1.01	5.0
03/22e	55.2	36.2	5.82	110.3	5.50	0.99	5.0

Note: *EPRA earnings and NAV are fully diluted

Performing as expected

The specialised supported housing sector provides an essential public service, 100% funded by central government (paid directly to the housing associations that lease the properties). As a result, rental income has continued to be received as normal with no COVID-19 impact. By 5 November 2020, 98% of rents due to Civitas for Q221 had been received, with the balance expected shortly. A Q221 quarterly DPS of 1.35p has been declared for payment in early December, leaving the company on track to meet its annual targeted 5.4p (+1.9%). Previously committed investments with an aggregate value of c £14m (before costs) have completed and including inflation-indexed rent uplifts the annualised rent roll has increased to £50.0m (end-FY19: £48.4m). Property valuations have increased and quarterly IFRS NAV per share increased slightly to 108.01p (Q121: 107.92p) after acquisition costs. Including DPS paid, IFRS NAV total return in Q221 was 1.42% (H121: 2.72%). COVID-19 has slightly delayed negotiations to raise £80–120m of additional debt, moving gross gearing closer to the 35% target. As a result, we have deferred forecast investment, reducing FY21 estimates but with no material impact on FY22.

Attention turns to growth opportunities

During the COVID-19 pandemic, the healthcare and housing sectors in which Civitas operates have proved to be operationally resilient and demand has remained strong. Including its recently widened investment remit permitting long-term leases with a broader range of counterparties such as the NHS, the company has a growing pipeline of potential investment opportunities amounting to c £200m, with several large, early stage opportunities on top. With existing free cash resources committed at end-FY20 and deployed in H121, converting this pipeline is dependent on finalising additional debt facilities. Additional equity would provide scope for additional investment while offering scale and diversification benefits.

Valuation: Stable income and attractive yield

The shares offer an attractive c 5% prospective yield and trade at a around EPRA NAV. Dividends are backed by stable income, uncorrelated with the wider economy, with good inflation-linked growth prospects.

13 November 2020

Price	**109p**
Market cap	**£679m**

Gross debt (£m) at 30 September 2020	272.5
Gross LTV at 31 March 2020 (gross debt as % gross assets on portfolio basis)	26.8%
Shares in issue	622.5m
Free float	99%
Code	CSH
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	5.2	(1.1)	24.7
Rel (local)	(1.0)	(5.4)	40.5
52-week high/low		114p	79p

Business description

Civitas Social Housing is the leading listed UK social housing REIT. Its investment objective is to provide an attractive level of income, with the potential for capital growth, from investing in a diversified portfolio of fully developed social homes, particularly specialist supported housing for vulnerable adults.

Next events

H121 results	Early December 2020
Q3 DPS paid	4 December 2020

Analyst

Martyn King +44 (0)20 3077 5745

financials@edisongroup.com

Edison profile page

Civitas Social Housing is a research client of Edison Investment Research Limited

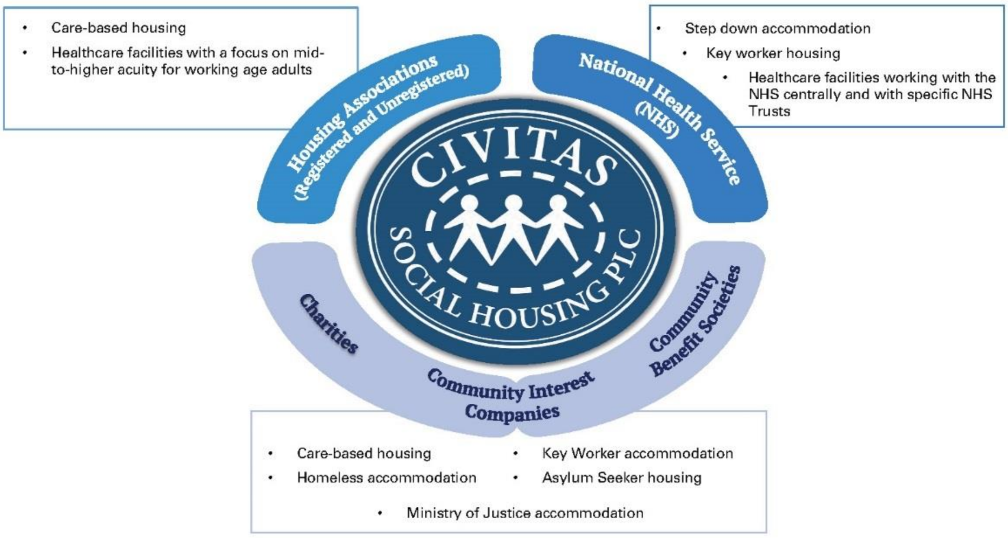
Performing well and looking to further growth

Since IPO, Civitas has built a c £900m portfolio of primarily specialist supported social housing (SSH) properties, providing much needed homes for vulnerable young adults. The properties are fully let on long, inflation-adjusted leases and we expect the sector's historically low correlation to the general economy, or the broader residential and commercial property sectors, to continue.

During the COVID-19 pandemic, the sector proved to be operationally resilient and the fundamental demand for specially adapted, high-quality accommodation has remained strong and even increased as local authorities look to relieve pressure on other care services. The impact of COVID-19 is mitigated by a relatively low average age of residents, less likely to suffer from the types of underlying health conditions categorised as 'high risk' by the NHS, and the configuration of much of the modern housing stock, around self-contained apartments and small housing clusters, which supports infection control and management. In the longer term, the chronic shortage of SSH homes is forecast to increase and compared with the alternatives of residential care or hospitals, it is widely recognised to improve life outcomes in a cost-effective manner.

In addition to the continuing strong demand from local authorities for specialised supported housing, the broadening of Civitas's investment remit approved by shareholders in May has further increased the range and scale of the potential investment opportunities available. The revised investment policy allows the company to enter into long-term lease opportunities with a broader range of counterparties, expanding from the current focus on local authorities and housing associations to include the NHS, major charities and community interest companies. Over the coming one to two years, Civitas aims to position itself as a strategic partner with these to provide a wide range of community-based social assets to meet an expanding range of needs.

Exhibit 1: New opportunities and additional counterparties



Source: Civitas Social Housing FY20 annual results presentation

With the FY20 annual results at the end of June 2020, Civitas disclosed a pipeline of investment opportunities of c £200m including specialised supported housing investments as well as investments from across its expanded counterparty base. Not included in the c £200m were several large transactions that it had begun to discuss. With the Q221 trading update, Civitas confirmed that active discussions are continuing over the potential acquisition of a range of high-quality existing and new build properties to be acquired at completion without the need for forward financing of the development.

Existing investment commitments completed during H121

During the first two quarters of the current financial year to 31 March 2021 (FY21), Civitas has completed the acquisition of five properties for an aggregate investment of c £14m (before acquisition costs). The properties had all been contracted for at year end and most significantly include the high acuity, newbuild, state-of-the-art supported housing and healthcare facilities in Wales (£12.1m) as well as smaller properties in Telford and Sunderland. The company has set aside an additional £10m in respect of the Welsh facilities, payment of which is contingent upon certain financial conditions being met. Including the completed acquisitions and annual rent indexation, by the end of Q221 the run-rate of contracted rent roll had reached £50.0m, compared with £48.4m at the end of FY20.

Exhibit 2: Key portfolio statistics

	FY17	FY18	FY19	FY20	Q121	Q221
	31-Mar-17	31-Mar-18	31-Mar-09	31-Mar-20	30-Jun-20	30-Sep-20
Investment (£m)	106	472	758	789	793	**803**
Properties	82	414	591	613	616	**618**
Tenancies	487	2,621	4,072	4,216	4,241	**4,292**
Local Authorities	32	109	157	164	164	**164**
Housing Associations	5	11	15	15	15	**15**
Care Providers	25	64	113	117	118	**118**
WAULT (years)	24.3	24.1	24.1	23.7	23.2	**22.9**

Source: Civitas Social Housing

Funding the investment pipeline

As previously disclosed, the company continues to target £80–120m of additional debt, the upper range of which is consistent with its target gross gearing of c 35% (and a maximum 40%). Gross gearing is defined as gross debt divided by gross assets including the investment properties on a portfolio valuation basis, and it was 26.9% at end-FY20. Current borrowing facilities of £272.5m are fully drawn and free cash resources fully committed. The end-FY20 cash balance of £58.4m roughly breaks down into the c £30m liquidity reserve that Civitas prudently targets and the committed investments (including the contingent payment) that have since completed or are expected to do so before year-end.

The general economic uncertainty created by COVID-19 has slowed discussions with potential lenders regarding the additional debt facilities, with many lenders focused on managing existing exposures to borrowers that were negatively affected, but Civitas says that lending activity is beginning to move forward and that it expects to provide an update in due course.

Clearly, the scale of the investment pipeline, including the large transactions in early stage discussion, would exceed even £120m of additional borrowing, but to be consistent with meeting the gearing targets, acquisitions above this level would require additional equity funding. Given the stable, inflation-indexed nature of the existing portfolio, the benefits of scale and increased diversification (by counterparty, care need, and regulatory regime) that further growth offers, we would expect a good level of investor interest in any equity raising.

Financials and valuation

As a result of the slight delay in financing we have pushed back some our investment assumptions, deferring rental income, although given the scale of the investment pipeline we have increased our aggregate investment assumption from c £98m (all during FY21) to £115m spread over FY21 and the first half of FY22. Given the company's comments about the large scale of certain investment opportunities, we would expect additional debt capital to be deployed fairly quickly and we assume

£55m (before costs) of investment in H221 (all in Q4 and none in Q321) followed by £60m (before costs) in H221, all at an assumed net initial yield of 5.5% with costs assumed at 6.8%.

To fund the acquisitions we have assumed £100m (within the range of £80–120m the company is targeting) of borrowing from 31 December 2020 (end-Q320) at an assumed cost of c 3%, above the current weighted average cost of debt (2.47% at end-FY20 and we estimate c 2.15% recently based on the three-month Libor rate of c 0.05%) but similar to the current cost of Civitas's fixed rate debt (c 41% of the total).

Our FY21 forecasts are reduced a little by the delayed borrowing and deployment, but there is very little change to FY22 even though the H122 acquisitions will not contribute for a full year in FY22.

Our FY21 forecasts indicate DPS substantially (c 95%) covered by EPRA earnings. On a run rate basis, the dividend has been fully covered since the beginning of FY21, but this includes the properties on which contracts had been exchanged or where investment had been legally committed; these only contribute partially to FY21. Our FY22 forecast assumed continuing DPS growth (+1.9%) and increasing cover (to 1.06x).

On the company's basis of measuring gross gearing, we expect c 32% at end-FY22, closer to its medium-term target of c 35%, and our estimate of net loan to value (debt adjusted for cash as percentage of the IFRS balance sheet portfolio value) is c 33%.

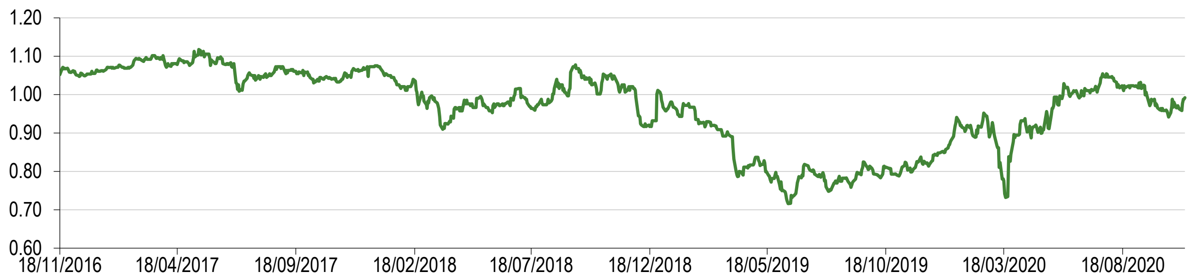
Exhibit 3: Forecast revisions

	Net rental income (£m)			EPRA earnings (£m)			EPRA EPS* (p)			EPRA NAV/share* (p)			DPS (p)		
	New	Old	% chg	New	Old	% chg	New	Old	% chg	New	Old	% chg	New	Old	% chg
03/21e	49.0	52.2	(6.2)	31.8	34.2	(7.1)	5.11	5.50	(7.1)	108.3	109.7	(1.2)	5.40	5.40	0.0
03/22e	55.2	55.6	(0.6)	36.2	36.4	(0.8)	5.82	5.86	(0.8)	110.3	112.9	(2.3)	5.50	5.50	0.0

Source: Edison Investment Research. Note: *Fully diluted

Civitas shares offer an attractive 5.0% dividend yield with good visibility of inflation-indexed dividend growth and trade at around NAV. Since IPO in November 2016 the average discount to NAV has been around 3% (Exhibit 4) with a peak premium of c 10%, but the average is reduced by two distinct periods of temporary weakness. The first of these occurred from late-2018 to mid-2019 reflecting initial investor caution in response to increased regulatory intervention in the sector. As the issues became better understood, the share price began to move higher, only for the improvement to be punctuated by COVID-19 fears at the beginning of the lockdown. An appreciation of the critical role that the sector performs, the factors that mitigate the operational risks of COVID-19 and the robustness of rent payments have resulted in the shares recovering.

Exhibit 4: Price to NAV history since IPO



Source: Refinitiv

In Exhibit 5 we show a share price performance and valuation comparison with a group of companies that we would consider to be the closest peers to Civitas, investing in housing and healthcare properties. Civitas shares have outperformed the peer group average, UK property sector and FTSE All-Share Index over the past year, which we believe reflects the stable and growing income stream and a recovery from earlier investor concerns regarding regulatory intervention in the specialised housing association sector. This continuing regulatory scrutiny is aimed at improving corporate governance and/or financial viability of several lease-based specialist supported housing providers and should reinforce the sector's ability to meet the growing needs of local authorities for additional accommodation. Despite this strong share price performance, the shares continue to offer an attractive yield, with a growing dividend that we expect to be fully covered, while continuing to trade at a small discount to NAV. Performance during the pandemic has demonstrated the resilience of the sector and the business model.

Exhibit 5: Peer group comparison

	Price (p)	Market cap (£m)	P/NAV* (x)	Yield** (%)	Share price performance			
					One month	Three months	12 months	From 12M high
Assura	75	1996	1.39	3.7	-3%	-7%	5%	-15%
Impact Healthcare	104	332	0.95	6.0	4%	0%	-4%	-6%
Primary Health Properties	150	1967	1.37	3.9	1%	-1%	6%	-11%
Residential Secure Income	90	154	0.01	5.6	-1%	1%	0%	-11%
Triple Point Social Housing	111	445	1.05	4.7	4%	6%	27%	-3%
Target Healthcare	114	520	1.05	5.9	8%	2%	-1%	-9%
Average			**0.97**	**5.0**	**2%**	**0%**	**6%**	**-9%**
Civitas Social Housing	**109**	**678**	**1.01**	**4.9**	**5%**	**-1%**	**24%**	**-6%**
UK property index	1,583				9%	5%	-12%	-20%
FTSE All-Share Index	3,547				6%	3%	-12%	-17%

Source: Civitas Social Housing data, Refinitiv. Note: Prices at 12 November 2020. *Based on last reported EPRA NAV. **Based on trailing 12-month DPS declared.

Exhibit 6: Financial summary

Period ending 31 March (£'000s)	2018	2019	2020	2021e	2022e
INCOME STATEMENT					
Net rental income	18,606	35,738	46,165	48,967	55,205
Directors' remuneration	(205)	(163)	(176)	(184)	(184)
Investment advisory fees	(5,773)	(6,457)	(6,131)	(6,141)	(6,202)
General & administrative expenses	(2,915)	(3,022)	(3,501)	(3,100)	(3,162)
Total expenses	(8,893)	(9,642)	(9,808)	(9,425)	(9,548)
Total recurring expense ratio (TER)		1.36%	2.84%	1.40%	1.40%
Operating profit/(loss) before revaluation of properties	9,713	26,096	36,357	39,541	45,657
Change in fair value of investment properties	30,633	3,652	9,389	4,014	10,606
Operating profit/(loss)	40,346	29,748	45,746	43,555	56,262
Net finance expense	(628)	(3,484)	(7,710)	(7,776)	(9,501)
C share amortisation	(2,792)	(6,400)	0	0	0
PBT	36,926	19,864	38,036	35,779	46,761
Tax	0	0	0	0	0
Net profit	36,926	19,864	38,036	35,779	46,761
Adjusted for:					
Change in fair value of investment properties	(30,633)	(3,652)	(9,389)	(4,014)	(10,606)
C share amortisation	2,792	6,400	0	0	0
EPRA earnings	9,085	22,612	28,647	31,765	36,155
Average number of shares (m)	350.0	425.4	622.1	621.6	621.6
Average diluted shares (m)	633.1	622.5	622.1	621.6	621.6
Basic IFRS EPS (p)	10.55	4.67	6.06	5.76	7.52
Diluted EPRA EPS (p)	1.44	3.63	4.63	5.11	5.82
DPS declared (p)	4.25	5.08	5.30	5.40	5.50
DPS paid (p)	3.00	5.00	5.30	5.40	5.50
EPRA EPS/DPS	0.34	0.72	0.87	0.95	1.06
BALANCE SHEET					
Investment properties	516,222	820,094	867,988	945,587	1,020,273
Other receivables	0	6,824	10,755	10,815	10,875
Total non-current assets	516,222	826,918	878,743	956,402	1,031,148
Trade & other receivables	3,315	5,723	10,838	7,420	8,497
Cash & equivalents	249,608	54,347	58,374	34,693	29,096
Total current assets	252,923	60,070	69,212	42,114	37,594
Trade & other payables	(10,176)	(15,324)	(7,743)	(9,894)	(11,330)
Bank loan & borrowings	0	0	(59,730)	0	0
C shares	(298,752)	0	0	0	0
Total current liabilities	(308,928)	(15,324)	(67,473)	(9,894)	(11,330)
Bank loan & borrowings	(90,822)	(205,156)	(209,440)	(315,370)	(371,570)
Total non-current liabilities	(90,822)	(205,156)	(209,440)	(315,370)	(371,570)
Net assets	369,395	666,508	671,042	673,252	685,842
Adjust for:					
C shares	298,752	0	0	0	0
Fair value of interest rate derivatives	0	0	478	478	478
Diluted EPRA NAV	668,147	666,508	671,520	673,730	686,320
Period-end basic number of shares (m)	350.0	622.5	621.6	621.6	621.6
Period end diluted number of shares (m)	633.1	622.5	621.6	621.6	621.6
Basic IFRS NAV per share (p)	105.5	107.1	107.87	108.22	110.25
Diluted EPRA NAV per share (p)	105.5	107.1	107.95	108.30	110.33
CASH FLOW					
Net cash flow from operating activity	8,057	23,335	32,905	45,050	45,956
Cash flow from investing activity	(483,898)	(302,577)	(61,901)	(66,640)	(57,580)
Net proceeds from equity issuance	343,000	(56)	0	0	0
Net proceeds from C share issuance	295,960	0	0	0	0
Loan interest paid	(417)	(2,958)	(5,804)	(6,576)	(8,301)
Bank borrowings drawn/(repaid)	92,457	115,990	64,053	45,000	55,000
Share repurchase			(699)	0	0
Dividends paid to ordinary shareholders	(10,073)	(17,591)	(32,889)	(33,569)	(34,171)
Dividends paid to C shareholders	0	(9,966)	0	0	0
Other cash flow from financing activity	(1,761)	(2,374)	(1,364)	0	0
Cash flow from financing activity	719,166	83,045	23,297	4,855	12,528
Change in cash	243,325	(196,197)	(5,699)	(16,736)	903
Opening cash	0	243,325	47,128	41,429	24,693
Closing cash (excluding restricted cash)	243,325	47,128	41,429	24,693	25,596
Restricted cash	6,283	7,219	16,945	10,000	3,500
Cash as per balance sheet	249,608	54,347	58,374	34,693	29,096
Debt as per balance sheet	(90,822)	(205,156)	(269,170)	(315,370)	(371,570)
Unamortised loan arrangement costs	(1,635)	(3,291)	(3,330)	(2,130)	(930)
Total debt	(92,457)	(208,447)	(272,500)	(317,500)	(372,500)
Net (debt)/cash excluding restricted cash	150,868	(161,319)	(231,071)	(292,807)	(346,904)
Net LTV (IFRS valuation basis)	n.m.	19.5%	26.3%	30.6%	33.6%

Source: Civitas Social Housing historical data, Edison Investment Research forecasts

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