EDISON

Civitas Social Housing

Q420 NAV update

No COVID-19 impact and increased DPS target

Real estate

The COVID-19 pandemic has thus far had no impact on Civitas Social Housing's rent collection or financial performance and the portfolio continues to grow and perform as expected. In the three months ended 31 March 2020 (Q420), IFRS NAV per share increased marginally and quarterly dividends continued. As a result of continuing acquisitions and CPI-linked rental growth, the run rate of dividend cover has reached 100% and the target DPS for the current year has been increased by 1.9% to 5.4p/share.

Year end	Net rental income (£m)	EPRA earnings* (£m)	EPRA EPS* (p)	EPRA NAV/ share* (p)	DPS (p)	P/NAV (x)	Yield (%)
03/18	18.6	9.1	1.44	105.5	4.25	0.99	4.1
03/19	35.7	22.6	3.63	107.1	5.00	0.97	4.8
03/20e	46.3	29.2	4.69	107.8	5.30	0.96	5.1
03/21e	52.2	34.2	5.50	109.7	5.40	0.95	5.2

Note: *EPRA earnings and NAV are fully diluted.

Rent collection as expected

Of the rents due to be paid during Q420, more than 99% have been received and Q121 rents continue to be collected as expected. Five properties were added in the quarter for an aggregate consideration of £17.8m taking total invested capital since IPO to £789m and including CPI-linked rent increases the annualised rent roll increased to £48.4m. Dividends are now 100% covered on a run rate basis and we expect full cover of the increased DPS on a reported basis in FY21 as past acquisitions make a full year contribution and as portfolio growth continues. IFRS NAV per share was 107.87p (Q320: 107.55p) and including DPS paid the quarterly total return was 1.5%.

Demand uncorrelated with the economy

Civitas invests in 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. In the near term, 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 lives in a cost-effective manner. SSH funding comes 100% from central government via local authorities, with cross-party support.

Valuation: Stable income and attractive yield

The shares have performed strongly over the past year reflecting the stable income profile, uncorrelated with the wider economy, and improved confidence over tenant quality. Despite this the shares continue to offer an attractive yield, with a growing dividend that we expect to be fully covered, and trade at a small discount to NAV.

20 May 2020

Price	**104p**
Market cap	**£647m**

Gross debt (£m) at 31 March 2020	272.5
Gross LTV at 31 March 2020 (gross debt as % gross assets on portfolio basis)	26.9%
Shares in issue	621.6m
Free float	99%
Code	CSH
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	6.8	4.4	21.4
Rel (local)	3.1	31.5	47.9
52-week high/low		103p	77p

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

FY20 results	Expected June 2020

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Edison profile page

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Further details on the update

COVID-19 resilience

Civitas properties provide homes for more than 4,200 vulnerable residents, typically working age adults with learning disabilities, autism, and mental health and other significant care needs. With an average age of 32 years they are far less likely to suffer from the types of underlying health conditions categorised as 'high risk' by the NHS in respect of COVID-19. Civitas's housing association and care provider partners remain fully operational, having made various adjustments to working practices, the implementation of which is significantly assisted by the configuration of many of the portfolio properties in the form of self-contained apartments and small housing clusters.

Positive total return in Q420 and +5.7% for the year

On an IFRS basis the unaudited end-Q420 NAV was £670.6m or 107.87p per share (end-Q320: £668.6m or 107.55p per share). Including the DPS of 1.325p paid during the period, the total accounting return was 1.53% (an annualised return of 6.3%). For the FY20 year, based on the unaudited NAV, the IFRS basis NAV total return was 5.7% with positive returns in each quarter. Q420 NAV per share on an EPRA basis will be available with the full year results but at H120 included a relatively small add-back for negative mark-to-market valuation effects in respect of derivative instruments used to hedge interest cost. Given the subsequent decline in market interest rates it is possible that the full-year negative mark to market will have increased and so too the EPRA add-back to IFRS NAV per share, but we do not expect this to be material.

The run-rate of dividend cover has reached 100%

The annualised rent roll has continued to increase, to £48.4m at end-Q420 and up from £47.2m at end-Q320, driven by acquisitions as well as rent indexation to consumer price inflation (CPI). The annual rate of CPI was 1.5% in March 2020 and has shown signs of moderating over the past year, from c 2.0%.

With growing income, the end-Q420 run rate of DPS cover, factoring in the period-end contracted rents as well as normalised expenses, had reached 100% compared with 97% at the end of Q320 and 96% at the half-year stage. On an achieved/reported basis, DPS cover in the first nine months of FY20 was 87% and we expect a slight increase for FY20 as a whole. With continuing rental growth and as recent acquisitions fully contribute, the company is on track to report full dividend cover in FY21, barring unforeseen costs and without factoring in additional acquisitions.

Continuing to invest with a robust pipeline

During Q420 the company acquired a further five properties, for an aggregate consideration of £17.8m (excluding acquisition costs), situated across five local authority areas, focused on the delivery of mid-to-higher acuity care, and let to existing housing association partners. For the year as a whole, Civitas acquired 22 properties for a total consideration of £31m. Total invested capital since IPO has now reached £789m, comprising 613 properties, fully let to 15 housing associations working with 117 care providers to provide homes on behalf of 164 local authorities to more than 4,200 individual tenants. The external property valuation is subject to what has become the industry standard 'material uncertainty' clause implemented by the valuers at a time of economic uncertainty and a significant reduction in market transactions to provide a benchmark. On this basis, the IFRS net initial yield of the portfolio was 5.26% at end-Q420, very slightly down on the 5.29% reported for end-Q320.

Looking ahead, Civitas expects to soon take delivery of the high acuity specialist facilities in Wales, an example of the company's proactive role in the design and delivery of new purpose-built facilities. (we had previously assumed late in FY20 in our modelling and have pushed this out to early FY21). Additionally, the company says that it is in active discussions over the potential acquisition of a range of high-quality existing and new build properties for acquisition at completion.

Strong, liquid balance sheet

With gross borrowings of £272.5m at end-Q420 Civitas has now fully deployed its existing debt facilities, increased by £60m in H120. The average cost of debt at end-Q420 was 2.46% with interest cover at 4.5x and a weighted average term to maturity of 3.4 years. Gross gearing (which the company measures as gross debt divided by gross assets including the investment properties on a portfolio valuation basis) was 26.9%, some way off the target 35%. The company has previously indicated an intention to increase debt facilities by an additional £80m to fund further accretive portfolio growth and we assume this in FY21 in our modelling. At end-Q420 properties with a value of £212m remained unencumbered and available as security for additional borrowing. The balance sheet remains liquid with cash balances of £49.3m (net of operating and financing amounts due) of which £24m is legally committed to transactions (primarily the Welsh facility) and the balance being held as a contingency buffer.

Financials and valuation

We have made only modest changes to our estimates. We had previously allowed for the completion of the acquisition of the Welsh facilities during FY20 and we have now deferred this into FY21. Our FY21 and FY22 estimates benefit positively from the recent decline in market interest rates. In our forecasts we continue to assume that Civitas will further gear its existing equity towards the target 35% LTV by increasing borrowing facilities by an additional £80m during the current year and investing the proceeds.

Exhibit 1: 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
03/20e	46.3	46.7	(0.9)	29.2	29.8	(2.2)	4.69	4.80	(2.2)	107.8	108.0	(0.1)	5.30	5.30	0.0
03/21e	52.2	52.2	(0.1)	34.2	33.6	1.8	5.50	5.41	1.8	109.7	109.9	(0.2)	5.40	5.40	0.0
03/22e	55.6	55.6	(0.0)	36.4	35.7	2.0	5.86	5.74	2.0	112.9	113.0	(0.1)	5.50	5.50	0.0

Source: Edison Investment Research

In Exhibit 2 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. Civitas shares have outperformed the peer group average, UK property sector and FTSE All-Share Index over one, three and 12 months which we believe reflects the stable and growing income stream and a recovery from earlier investor concerns regarding regulatory intervention in the housing association sector aimed at improving corporate governance and/or financial viability of several specialist supported housing providers. 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 discount to NAV.

Exhibit 2: Peer group valuation and performance

	Price (p)	Market cap. (£m)	P/NAV* (x)	Yield** (%)	Share price performance			
					1 month	3 months	12 months	From 12M high
Assura	76	2016	1.42	3.6	-2%	-7%	25%	-14%
Impact Healthcare	101	321	0.94	6.1	13%	-7%	-6%	-13%
Primary Health Properties	156	1894	1.44	3.6	-1%	-3%	17%	-7%
Residential Secure Income	85	146	0.80	5.9	-7%	-14%	-12%	-15%
Triple Point Social Housing	95	333	0.90	5.4	0%	-2%	1%	-11%
Target Healthcare	94	430	0.87	7.0	-11%	-24%	-18%	-25%
Average			**1.06**	**5.3**	**-2%**	**-10%**	**1%**	**-14%**
Civitas Social Housing	**104**	**647**	**0.96**	**5.1**	**5%**	**4%**	**23%**	**-2%**
UK property index	1,352			4.3	-6%	-30%	-21%	-31%
FTSE All-Share Index	3,311			4.6	3%	-20%	-17%	-22%

Source: Civitas Social Housing data, Refinitiv. Note: Prices at 20 May 2020. *Based on last reported EPRA NAV. **Based on trailing 12-month DPS declared.

Exhibit 3: Financial summary

Period ending 31 March (£'000s)	2018	2019	2020e	2021e	2022e
INCOME STATEMENT					
Revenue	18,606	35,738	46,311	52,180	55,559
Directors' remuneration	(205)	(163)	(168)	(168)	(168)
Investment advisory fees	(5,773)	(6,457)	(6,164)	(6,163)	(6,291)
General & administrative expenses	(2,915)	(3,022)	(3,310)	(2,900)	(2,958)
Total expenses	(8,893)	(9,642)	(9,642)	(9,231)	(9,417)
Total recurring expense ratio (TER)		1.36%	1.39%	1.36%	1.36%
Operating profit/(loss) before revaluation of properties	9,713	26,096	36,669	42,950	46,142
Change in fair value of investment properties	30,633	3,652	8,361	10,700	17,664
Operating profit/(loss)	40,346	29,748	45,030	53,649	63,806
Net finance expense	(628)	(3,484)	(7,485)	(8,749)	(9,709)
C share amortisation	(2,792)	(6,400)	0	0	0
PBT	36,926	19,864	37,545	44,900	54,097
Tax	0	0	0	0	0
Net profit	36,926	19,864	37,545	44,900	54,097
Adjusted for:					
Change in fair value of investment properties	(30,633)	(3,652)	(8,361)	(10,700)	(17,664)
C share amortisation	2,792	6,400	0	0	0
EPRA earnings	9,085	22,612	29,184	34,201	36,433
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	6.04	7.22	8.70
Diluted EPRA EPS (p)	1.44	3.63	4.69	5.50	5.86
DPS declared (p)	4.25	5.00	5.30	5.40	5.50
EPRA EPS/DPS	0.34	0.73	0.89	1.02	1.07
BALANCE SHEET					
Investment properties	516,222	820,094	865,100	979,484	997,148
Other receivables	0	6,824	8,079	8,193	8,307
Total non-current assets	516,222	826,918	873,179	987,677	1,005,455
Trade & other receivables	3,315	5,723	7,074	7,994	8,376
Cash & equivalents	249,608	54,347	68,994	47,334	50,809
Total current assets	252,923	60,070	76,068	55,329	59,186
Trade & other payables	(10,176)	(15,324)	(9,433)	(10,659)	(11,168)
C shares	(298,752)	0	0	0	0
Total current liabilities	(308,928)	(15,324)	(9,433)	(10,659)	(11,168)
Bank loan & borrowings	(90,822)	(205,156)	(269,245)	(350,445)	(351,645)
Total non-current liabilities	(90,822)	(205,156)	(269,245)	(350,445)	(351,645)
Net assets	369,395	666,508	670,570	681,902	701,828
Adjust for:					
C shares	298,752	0	0	0	0
Fair value of interest rate derivatives	0	0	180	180	180
Diluted EPRA NAV	668,147	666,508	670,750	682,082	702,008
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	107.8	109.7	112.9
Diluted EPRA NAV per share (p)	105.5	107.1	107.8	109.7	112.9
CASH FLOW					
Net cash flow from operating activity	8,057	23,335	35,838	43,142	46,155
Cash flow from investing activity	(483,898)	(302,577)	(42,795)	(103,684)	0
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)	(6,079)	(7,549)	(8,509)
Bank borrowings drawn/(repaid)	92,457	115,990	64,000	80,000	0
Share repurchase			(694)	0	0
Dividends paid to ordinary shareholders	(10,073)	(17,591)	(32,883)	(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)	(1,111)	0	0
Cash flow from financing activity	719,166	83,045	23,234	38,882	(42,680)
Change in cash	243,325	(196,197)	16,277	(21,659)	3,475
Opening cash	0	243,325	47,128	63,405	41,745
Closing cash (excluding restricted cash)	243,325	47,128	63,405	41,745	45,220
Restricted cash	6,283	7,219	5,589	5,589	5,589
Cash as per balance sheet	249,608	54,347	68,994	47,334	50,809
Debt as per balance sheet	(90,822)	(205,156)	(269,245)	(350,445)	(351,645)
Unamortised loan arrangement costs	(1,635)	(3,291)	(3,202)	(2,002)	(802)
Total debt	(92,457)	(208,447)	(272,447)	(352,447)	(352,447)
Net (debt)/cash excluding restricted cash	150,868	(161,319)	(209,042)	(310,702)	(307,227)
Net LTV (IFRS valuation basis)	n.m.	19.5%	23.9%	31.5%	30.6%

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

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