

Real Estate


Source: Eikon Thomson Reuters

Market data

EPIC/TKR	CSH
Class	Ord.
Price (p)	106
12m High (p)	113
12m Low (p)	96
Shares (m)	350.0
Mkt Cap (£m)	371.0
EV (£m)	463.0
Market	LSE premium

C share holds net cash
Description

Civitas is a REIT investing in English and Welsh social housing. Over 75% (100% to date and near 100% likely ongoing) is invested in supported living assets. Management targets a 5% dividend yield on full deployment

Company information

CEO (Advisors)	Paul Bridge
Director (Advisors)	Andrew Dawber
CFO (Advisors)	Graham Peck
	+ 44 203 058 4840
	www.civitasocialhousing.com

Key Ordinary shareholders

Directors	0.03%
Investec Wealth	15.8%
East Riding Yorkshire	5.7%
Close Asset Mgt.	3.3%
Killik & Co	3.0%

Diary

Oct'18	Fact sheet quarter to September 2018
Nov'18	Latest date C shares convert to Ordinary
Nov'18	Interim results

Analysts

Mike Foster	020 7194 7633
	mf@hardmanandco.com

CIVITAS SOCIAL HOUSING

Housing security

We initiate coverage on Civitas Social Housing. Floated in November 2016, with a 5% dividend target, this was the first LSE-listed REIT dedicated to investing in regulated social housing, principally care-based supported living (100% here, to date). Civitas has provided an update to end-June: IFRS NAV (Ordinary) was 105.8p, with a £31.1m rent roll. 2016 IPO proceeds are fully invested. To date, Civitas has invested £550m in specially configured supported social housing for adults. Current equity resources enable at least £1bn investment. Civitas has identified a pipeline (off-market transactions), part of which, £100m, is described as available in the near term.

- **Strategy:** Civitas addresses the acute housing provision shortfall in quality, community-based healthcare. Housing gives both tenants and investors security (long, secure CPI-linked income for the latter). Tenant rents and other costs are met by central government, and received by the property's relevant housing association, which has entered into long leases with Civitas.
- **Deployment of capital well on target:** £350m gross was raised in the November 2016 IPO – fully invested with some financial gearing. The £302m November 2017 C class share issue is £150m invested (£108.5m end-June). We model C shares to be fully invested by November this year, when conversion to Ordinary is due.
- **Valuation:** Acquisition net initial yields (NIY) of 5.9% have been achieved, a level commensurate with the assets being in an emerging real estate class, leaving potential for future positive revaluation. The shares trade at a small discount to NAV and on a 4.8% current-year dividend yield. 4.25p DPS has been paid to date.
- **Risks:** Civitas's income derives entirely from 20+year commercial leases. We are encouraged that, when one lessee, First Priority Housing Association (FP), encountered difficulties, all leases were reallocated on the same terms in a short number of weeks. This shows Civitas's due diligence on the sustainability of the rent income supporting the leases. Civitas's selection is rigorous, turning down £300m of properties assessed during its due diligence investment process.
- **Investment summary:** IPO dividend projections (5.0p DPS this year) are well on-track, and should grow ca.4% p.a. A strong, experienced team is proving its worth. Re-assignment of certain leases on unchanged terms strongly validates Civitas's due diligence on long-term income sustainability, 100% CPI. linked.

Financial summary and valuation (Ord. shares – C shares convert Nov'18)

Year-end Mar (£m)	2018[1]	2019E	2020E	2021E	2022E	2023E
Income	18.6	34.5	49.3	53.2	54.8	56.2
Operating profit	9.7	25.3	39.6	43.3	44.8	46.3
Finance	-3.4	-2.5	-6.7	-9.6	-10.1	-10.6
Revaluation	30.6	10.0	17.0	17.0	17.0	17.5
Profit declared	36.9	32.8	49.9	50.7	51.7	53.2
EPRA profit	6.3	22.8	32.9	33.7	34.7	35.6
EPRA EPS (p)	1.8	5.0	5.2	5.3	5.5	5.6
DPS (p)	3.00	5.00	5.20	5.35	5.50	5.65
IFRS NAV (p)	105.5	109.5	112.2	114.9	117.6	120.4
Property assets	516.2	830.7	1012.7	1036.7	1060.7	1085.2
Dividend yield	n.a.	4.8%	4.9%	5.0%	5.2%	5.3%
Ord. price to NAV	0.98%	0.95%	0.94%	0.92%	0.90%	0.87%

[1] Whole period since float – not representative

Source: Hardman & Co Research

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Executive summary

Secure and non-correlated assets

Civitas invests in fully-let assets with long leases, whose capital values are not correlated to commercial or residential assets, or other asset classes. It enters into long commercial leases (CPI-linked) with housing associations; the latter take responsibility and manage all aspects of the property from rental income to maintenance. Civitas undertakes no developments, buying occupied property.

First mover – floated November 2016; £550m invested to date

Market addressed and deployment of Civitas funds

In November 2016, Civitas became the UK's first quoted social housing REIT, floated on the LSE (premium listing) through an oversubscribed £350m fund raise. The UK faces a chronic shortage of specialist, care-based supported housing. Civitas has invested £550m to date (£507.6m to end-June). Residents are adults requiring care, in specially configured homes, for a range of needs, including autism and other chronic medical conditions. Civitas purchases occupied assets, creating new long leases, following a rigorously defined investment process. This includes all underlying rents charged being at or below the local median rate, as assessed independently. These tenant rent-streams underpin lease sustainability.

Civitas supports local authorities' legal obligations

Local authorities have a legal responsibility, through the Care Act 2014 and the Homelessness Reduction Act 2017, to provide vulnerable adults with long-term, safe accommodation. Civitas's social impact is high, as it supports this market. In 2016, the Department for Health published the National Transforming Care Programme, to enable more people requiring care to live within communities – all part of the same trend. The local authority will arrange or provide care and support services, to enable people to live as independently as possible in a community setting. This requires major, customised adaptations to the relevant property. Many who require care currently live at home with ageing parents. Alternatively, there may be care home or warden-/guardian-assisted accommodation. To date, much of the accommodation has been large-building residential and in-patient care, which is expensive and sub-optimal. Civitas provides a better alternative: local authorities pay the housing association and care provider on the tenants' behalf, funded by the Department for Communities and Local Government, and also by the Department of Work and Pensions – an established arrangement re-confirmed by the Prime Minister in 2018.

Civitas fulfils a need for supported housing and benefits from long lease income

Typically, central government funding to the housing associations for each tenant under this categorisation represents 100% of the cost. This includes housing (rent and property maintenance) and the cost for care. The latter is paid to the third-party care provider and usually represents the largest element of the overall funding. If better accommodation can reduce this cost, this is all to the good.

NAV uplifts

Civitas's financial characteristics and valuation

Civitas enters into long leases with housing associations, benefiting from a weighted average term of over 25 years to expiry. Leases include CPI (or up to CPI +1%) clauses. Civitas neither undertakes nor forward-funds development. Civitas's latest (end-June) IFRS NAV is 105.8p per Ordinary share, having seen valuation uplifts.

Asset class benefits from low correlation

- ▶ The UK social housing sector has a nil financial-return correlation against the general residential estate sector and a very weak correlation with commercial real estate.
- ▶ Deployment of funds has been a clear success. £550m has been invested to date (£508m end-June, £471m end-March). The Ordinary share equity has been fully invested, with a level of borrowing. Deployment of funds is via C class shares.

Civitas’s valuation versus comparables appears attractive, as we show below.

- ▶ The four nearest comparables (two primary medical property REITs, PHP and MedicX; Residential Secure Income REIT; Triple Point Social Housing, the supported social housing REIT) trade, respectively, on 113%, 100%, 95% and 107% multiples of historical EPRA NAV. Civitas (Ordinary shares) trades on 98%.
- ▶ With respect to prospective dividend yields, these comparables trade, respectively, on 4.7%, 4.5%, 5.3% and 4.7%. MedicX has stated that its historically uncovered dividend will be cut. The figure for Civitas (Ordinary shares) is 4.8%.

Civitas’s policy is to direct at least 75% of funds raised to supported social housing, i.e. community-based accommodation for vulnerable tenants with care needs. The balance may be invested in general-purpose social housing. To date, effectively 100% has been invested in supported housing, and we anticipate this to remain the case.

Flow of funds and their responsibilities

Below, we summarise the flow of funds, services and responsibilities in the Civitas care-supported specialist housing model.

Fund flows: see also page 14

Investment and service flows		
Beneficiary	From	Inputs
Civitas	RP	Lease agreement (typically 25 years)
RP	Tenant	Tenancy agreement (indeterminate length)
Tenant	DWP	Housing benefit
Local Authority	Care provider	Care package agreement
Local Authority	Ring-fenced HMG funds	Local Government Finance Settlement

Source: Hardman & Co summary of part of Civitas prospectus; an RP is a registered provider, which encompasses housing associations, local authorities and other bodies.

We consider this supports investors’ dividend stream through well-defined and tightly-regulated funding

Within the relationships above, the Care Quality Commission regulates the care providers. The Homes and Communities Agency is an executive non-departmental public body sponsored by the Ministry of Housing, Communities and Local Government. The housing-related regulator, initially initiated through the HCA, is the Regulator for Social Housing.

The Civitas investment process

The security is the asset and the visibility of its underlying tenant income

The investment process has been designed to ensure the long-term sustainability of the income to support lease payments to Civitas. We expand on this process and due diligence later in the report. Civitas has itself adopted a formalised Best Practice Protocol, and is engaging with partners and counterparts (developers, vendors, etc), for all parties to embrace this protocol. See page 11.

Investment process works – hence...

There is a diverse spread of locations, reducing risk and enhancing the offering. Civitas has rejected around £300m of property during the due diligence process, for a variety of reasons, including high rental levels. We understand that the ratio of accepted versus considered is relatively stable. On 21 February Civitas announced that FP, a significant leaseholder, had received a regulatory notice having fallen into financial difficulties. On 9 May 2018, Civitas announced that all relevant leases had been assigned to a new housing association on the same terms. We believe this illustrates how important it is for Civitas and investors to assess the underlying property asset and the counterparty housing associations, and that the rents paid by the residents are not ‘above market’. The reassignment was, in our view, a successful hurdle for the

Civitas due diligence. Both property *and* counterparty due diligence are mission-critical. Hardman & Co believes that this individual, resolved situation highlights this. Full resolution took under three months, and the financial cost (we estimate) is *de minimis*.

Performance and projections

The NIY on cost has been in a 5.5% to 6.5% range to date. Hardman & Co estimates the average at 5.9%. We model a cumulative 5.7% NIY (which we consider conservative in the light of progress to date) to a fully invested, geared position.

4.25p dividends per Ordinary share, to date...
well on track for 5.0p target

Civitas has paid four 0.75p Ordinary dividends, and a further 1.25p on 8 June, resulting in 4.25p total. Civitas is on track to pay at least a 5.0p total dividend in FY2019 (March year-end). Its stated IPO intention was paying 5.0p in the year of full fund deployment. On 10 May 2018, Civitas reiterated: "The Directors are targeting to pay dividends of 5.0 pence per Ordinary Share in respect of the calendar year to 31 December 2018". Civitas Ordinary shares go ex-dividend for a further 1.25p on 16 August 2018.

The subsequent £302m (gross) funds raised are being deployed through a C share, converting to Ordinary shares (at respective portfolio NAVs) in November this year, at the latest. A 1.13p dividend has been paid on the C shares to date, with 0.75p due in September. For the Ordinary shareholders, FY2019 will be the first 5.0p dividend year, with 5.0p modelled for EPRA EPS (profits per share before revaluations).

We estimate fully covered 2019 dividends. Earnings growth thereafter supports both DPS cover expansion and progressive dividends. C share equity should be deployed this November. We estimate £1.0bn deployment well before the March 2020 year-end, reaching an LTV (loan to value) 30% target.

Conclusion

- ▶ An uncorrelated long-term secure UK income stream, in a regulated sector.
- ▶ Civitas's reach enables it to assess a large range of potential investments. It has invested now in 123 local authorities. It is investing at good NIYs, with robust underlying income streams. Its long-term leases are 100% CPI-indexed. Rent used to pay the Civitas leases is 100% government-funded.
- ▶ The shares' rating appears far from stretched, trading just below NAV and on a current-year, progressive dividend yield of 4.8%.
- ▶ Our model sees DPS growth in the range of 3% to 4% for some years.

Wide range of potential investments in its speciality. Good income 100% CPI-linked, nil voids.

3%-4% DPS growth potential

Civitas fills a real social requirement, supporting local authorities' legal obligations for specialist long-term accommodation. In 2016, to drive a substantial reduction in the reliance on residential and in-patient care, the Department for Health published the National Transforming Care Programme. The explicit aim was to enable more people requiring care to live within communities, with the right support, while being close to their friends and family. Civitas supports this through its investment.

Market position and background

Breadth and focus of opportunities

Civitas active across over 120 local authorities

Civitas's spread is national, in 123 local authorities, up from 68 a year ago and 99 at end-calendar 2017. Civitas provides housing associations access to capital, it saves public purse money, helping reduce time input from carers; and it improves tenant life outcomes. It has a wide geographical base from which to select the best opportunities from the best developer partners. It deploys its deep expertise and focus, dedicated to social housing with care needs. It acquires completed assets, either extensively re-configured or built new, taking no development risk, even in the form of forward-funding – which is not undertaken. Its developer partners agree tightly-defined criteria, the achievements of which trigger Civitas's purchase.

It has no exposure to development risk

The Civitas geographical locations tend to be broadly spread (including London), rather than in the areas of highest economic deprivation. The need is to be accessible to family or where the resident has connections. To date, there is a modest bias towards deprived areas, but this is not a particular driver. As to the risk that this geographical spread could raise ongoing management costs, we note that the care is provided entirely by third-party organisations. Further, the housing associations are responsible for running and maintaining all properties, and collecting rents. Property is leased to 12 housing associations, up from seven a year ago and 10 as of end-2017.

A large market, currently an emerging asset class

Within learning disability, it is estimated that, in 2015, there were ca.155,000 adults with severe or critical learning disabilities housed and/or cared for in accommodation funded by local authorities or central government – mostly in larger institutions outside the local community. This number is estimated to grow to ca.180,000 by 2025 (Source: Civitas, for all data). Just 25% of this potential 180,000, equates to £6.75bn, assuming the amount invested per tenant by Civitas remains at £150,000.

Within a tightly defined focus

Social housing stock in England and Wales totals ca.4.9m (45% rented from councils, 55% from housing associations). There are no specific data for supported living, but we understand that this stock totals some 0.6m houses – divided into typically half-a-dozen flats offering privacy, with common areas. Who lives in supported living homes? According to latest data (Source: 2017 Civitas Social Care Impact Report), 59% of Civitas's residents have mental health requirements, 24% rehabilitation with learning difficulties, and 14% have physical disabilities with learning difficulties. The proportion for the elderly is *de minimis*. Most tenants are in their 30s.

Third parties act as carers and as rent collectors. Housing associations pay the long lease income to Civitas.

Civitas provides properties, principally, for residents with learning disabilities, mental health issues, autism dependency, NHS step-down and homelessness as a result of the residents' particular, health-related needs. Arm's length care providers undertake the care with no recourse to Civitas, but Civitas undertakes detailed due diligence to ensure that the providers' capabilities and resources are appropriate. The choice of potential providers is wide. Registered providers (housing associations) collect the rent and pay a long lease to Civitas. This housing is 'social infrastructure' – an alternative to living at home with ageing family-related carers or a more institutional setting.

Social impact; the National Transforming Care Programme

Residents in specialised supported housing require care – most in excess of four hours a day, we understand. Civitas's properties enhance the lives of people who are able to benefit from the availability of appropriate, high-quality housing as a base for the provision of more specialist housing and care. In addition to its direct investments,

Civitas intends to play a broader role in the housing and homelessness environment. Civitas also intends, as part of its broader financial and operational reporting, to provide commentary on the positive social changes and impacts resulting from the investments that have been made, and to spread best practice.

Civitas's most recent published independent report on the positive social impact can be read at <http://civitassocialhousing.com/the-good-economy-civitas-social-housing-plc-impact-report-june-2018/>. Among its content is a case study on each of a housing association, a property and a resident.

The social case and the drive to increase this type of stock

In 2016, to drive a substantial reduction in the reliance on residential and in-patient care, the Department for Health published the National Transforming Care Programme. The explicit aim was to enable more people requiring care to live within communities, with the right support, while being close to their friends and family. 2018 saw further re-affirmation of this.

The cost of this support – using visiting care workers – will be a substantial multiple of the rent paid. The positive impact on the public purse will stem from the lower cost of the provision of care and a better occupier outcome, resulting from the right mix of private and communal space, allied to a design customised to balance an element of independence with the support required. The assets are purpose-built or converted without a public subsidy.

The current shortfall in housing provision is felt acutely within the specialist areas of care, and thus good-quality properties providing healthcare in the community are in significant and growing demand, and are likely to remain so for many years to come. The requirement is substantial – for residents in parents' homes, in larger institutions, in care homes and elsewhere – and it is rising. This is a function of advancing medical science and successive government policies, including the recent National Transforming Care Programme.

There is strong evidence that both purpose-built and suitably extensively reconfigured housing help occupiers' quality of life and thus reduce the input (hence cost) of carers. In many instances, the alternative accommodation is an NHS institution or care home. Despite the efforts of staff, placement in an NHS institution or care home may not, however, provide the optimal outcome for the individual.

Civitas thus works with Registered Providers to expand their operating portfolio. Expanding the operating portfolio fulfils the social remit but may also cover costs better for the Registered Providers. Civitas's expertise, as the largest owner of such properties, could facilitate running efficiencies in the medium term – maybe including PV (photovoltaic cells), as well as benchmarking for both the operators and the developers.

The supported social housing investment properties

In the past four years or so, private investment funds have been directed towards this sector of supported residential assets. It is specifically in the past 20 months that publicly quoted REITs have invested in the sector – the first to float being Civitas.

As Civitas stated (Source: Civitas Manager's Update, March 2018), "Specialist supported housing today is typically provided and managed by housing associations that have been established over the past decade and are now growing in size Several of these housing associations have broken through the 1,000-property level in recent years and so have entered the top 100. Clearly, more will do so in coming years as they continue to grow and develop into mature, professional organisations."

*Government strategy re-affirmed in 2016;
government-funded resident rents ring-fenced*

Major shortfall in supply....

*... for Civitas's type of purpose-built asset,
which enhances quality of life*

Capital for housing associations

Saving public money and improving outcomes

*In the past 20 months, a number of quoted
REITs have invested in the sector – the first
being Civitas*

Civitas's property types

Civitas undertakes no forward-funding or development risk of any kind



■ Specially adapted ■ Purpose built ■ Repurposed

Source: Civitas presentations

Long-term property management is the responsibility of the lessee – typically a housing association – not Civitas.

A mix of re-configured and purpose-built – the latter likely to predominate in future years

Civitas's property types

48% of Civitas's properties are specially adapted, traditional homes within the local community. 24% are purpose-built (source: Civitas Manager's Update, March 2018). 29% have been 'repurposed' (under-utilised offices or general care buildings).

Civitas's participation

Civitas purchases from housing associations, care providers (where local authorities and stakeholders welcome the separation of provider and investor), individuals and other small investors. To date, Civitas has invested ca.£150,000 per person housed.

Civitas's Investment Advisor's position, its partnerships and experience have resulted in investment opportunities, and enabled materially all properties to be acquired off-market to date – hence capital appreciation from day one.

Capital deployment

Ordinary shares raised £350m: £399m deployed

C shares deployed £109m as of end-June. Fully on track to fully deploy before November 2018 target deadline.

The investment made, costs and debt taken on for 1) Ordinary shares and 2) C shares are laid out below, as of end-May 2018. Deployment continues and is accelerating. At end-May, the C shares had deployed £72.5m. The figure is now £150m.

Deployment of £652m cumulative equity raise as of end-June 2018

£m as of relevant date	Ordinary shares	C shares (Nov. 2017)
Equity raise (gross)	350.0	302.0
Purchase cost of investment properties owned end-June 2018 [1]	399.0	109.0
Number of properties owned, June 2018	351	89
Debt drawn [2]	92.5	0.0
Interest rate, blended estimated cost of debt [3]	2.7%	Cash held
Date of full ungeared deployment [4]	Achieved	November 2018
Date of full geared deployment [5]	Calendar 2019	2H'19 calendar year
Estimated net rent income [6] on full ungeared deployment	20.0	17.0

Source: Hardman & Co Research
Note [1] Excluding purchase costs
Note [2] Hardman & Co estimate

Note [3] £52.5m 10-year Scottish Widows' facility at 2.99%, plus three-year revolving credit facility
Note [4] This is a Hardman & Co estimate for the C shares; Ordinary shares' equity is already fully deployed
Note [5] Hardman & Co estimates that a 30% LTV target will be achieved BEFORE the date stated in the table above.

Note [6] Rent is a Hardman & Co estimate and assumes NIY (which is calculated POST all costs of acquisition) on 5.7%, which Hardman & Co considers a conservative (low) estimate. Hardman & Co estimates a 5.9% NIY to date. This is net of minimal property costs and before investment management fees.

Investments since 1 June 2018

Recent investments

Date	Properties	Tenancies	Purchase price
1 June 2018	4	53	£8.2m
11 June 2018	5	43	£9.0m
14 June 2018	7	44	£5.4m
6 August 2018	2	15	£3.9m
22 August 2018	-	-	£37.6m

Source: Civitas announcements

Good progress on deployment has minimised future returns' risks

Sensitivities

A variance of 10bps (e.g. NIY of 5.7% as opposed to 5.8%) affects EPRA EPS by 2.5%. Given that the majority of funds have been deployed, variance on the balance does not lead us to be other than confident of the ability to increase covered dividends in initial years at a rate of 4%-5% p.a. from the 5.0p for 2019E, fully covered.

A £100m near-term pipeline with more, beyond

The pipeline

The 3 August update stated a £100m near-term pipeline. Above this, Civitas has a significant breadth of opportunities (geographically and by Registered Provider) on its medium-term pipeline. Since that date, on 22 August, Civitas announced it has completed the acquisition of a £37.6m portfolio of regulated social housing - as this document goes to press.

Investment process

Due diligence on a number of levels

Civitas undertakes extensive due diligence on all potential asset purchases. This includes, among other parameters:

Acquiring completed assets

- ▶ the physical asset;
- ▶ the affordability, and hence sustainability of its underlying rent, which residents pay to the housing association (assessment is by third party);
- ▶ micro-location; and
- ▶ the requirements of the occupiers.

Not purchasing assets whose underlying rent is over median level for the location

Civitas successfully aims to acquire assets whose rent is not above the median level for the locality. Crucially, it also includes assessment of the requirements of the public-sector bodies (overwhelmingly the Local Authority) who pay the housing benefit, and ensures that all criteria are met – in addition to the rent being deemed affordable.

No development risk

No development

The development risk is entirely that of the developers, but, again, due diligence is essential. Crucially, also, it includes all aspects of the re-development of the property into special-status, appropriate for the specialist needs of the occupiers. Civitas purchases some property that is purpose-built and some that has been extensively re-configured. Not even forward-funding is entertained.

No forward-funding

Due diligence: housing associations

- ▶ Completion of due diligence form – KPIs, regulatory, health and safety, and finances.
- ▶ Discussion with CEO & Finance Director – introduction to principles, and aims and objectives.
- ▶ Full day site visit to meet with the Board and senior team, and visits to properties.
- ▶ Standard investigation report into key individuals – good standards of conduct.
- ▶ Regulatory check – to ensure there are no reported concerns.
- ▶ Review of available management accounts and business plan, and additional information requested as necessary.
- ▶ References from all significant care provider partners.

“The above is pre take-on. Housing association due diligence is itemised in terms of the management team, monitoring KPIs and the business plan, business systems, and portfolio management. Post take-on, many more items are assessed and monitored, including regular reviews of finance and visits at site levels. We have referred to some of the additional requirements/‘hurdles’ as “additional measures”.

We would highlight, among several items stated, the “Request for ring fencing with segregated accounts or charges for protection of rent and deposits due to Civitas.

Circa 30% of the stock assessed for purchase is not proceeded with

First arrangements have been put in place with others in discussion". (Civitas analyst presentation, 30 May 2018).

Civitas reiterates the substantial amount of rejection of properties offered, on the basis of due diligence. Last stated, this was ca.30% of the stock assessed. Civitas provided a selection of 'worked examples' on specific portfolios within its analyst presentation 30 May 2018, posted on the Civitas website.

On 30 May, Civitas provided <http://civitassocialhousing.com/wp-content/uploads/2018/05/Analyst-Presentation-FINAL-Video.pdf>, an in-depth assessment of its due diligence process. We provide a *limited summary* of some of the key points below.

Civitas Social Housing Best Practice Protocol

On 30 May, Civitas stated "we are in discussion to implement these with as many of our existing and future partners as possible:"

- ▶ Introduction of the Best Practice Protocol (see below) to present and future partners, to maximise robustness of all counterparties involved.
- ▶ Request for ring-fencing with segregated accounts or charges for protection of rent and deposits due to Civitas. First charges have already been put in place.
- ▶ Deeper and more regular interaction with care providers and housing associations, particularly to examine void payments and other operational and financial data.

Civitas's Best Practice Protocol has been shared with all housing association partners, as well as potential property vendors

The Civitas Social Housing Best Practice Protocol (the Protocol) has been shared with all housing association partners, as well as potential property vendors and other key entities within the social housing sector. The objective is to ensure that, when a housing association enters into a property transaction, it is structured for long-term stability. This protects the tenant, the housing association and the investors. The Protocol contains 10 core principles relating to matters such as financial prudence, resolving any possible conflicts of interest, and management and control of interaction with regulators. In addition, it contains detailed requirements for the on-boarding of new properties. These include the following.

- ▶ Independent verification of rent to confirm that this is appropriate within the local authority area and represents value for money.
- ▶ Minimum "on-boarding fee" paid to housing association from the property vendor in respect of each tenant to cover set-up costs (if the housing association is the vendor, it must set this aside from the consideration received).
- ▶ Segregated accounts/charges for rent and service charge for CSH properties.
- ▶ Rental Protection Fund for each tenant to cover three to six months' rent.
- ▶ Sinking Fund for each property to cover certain capital and maintenance costs and over-runs.
- ▶ Indexation Reserve Fund to be set up at outset and topped up over life of the lease with indexation being set at CPI. Civitas has stated, "Our ambition is to implement all aspects of the Protocol on each new transaction and to retrofit certain aspects within the portfolio, to the extent that they are not already in

place (many aspects have been standard since IPO), and to the extent that we are able to do so by agreement.”

More positive than negative but, understandably, investors need time to be fully reassured that this is indeed a net positive

Lease reassignment

There was understandable investor attention on Civitas’s February 2018 announcement that its former second-largest lessee, FP, a Registered Provider, was in financial difficulties. However, this was quickly resolved for Civitas, with leases transferred on the same terms to another housing association. We consider some investors are overlooking that this highlights positively the investment process’s due diligence on the sustainability of the lease terms and their underlying dynamics, as evidenced by a new provider coming forward promptly. Of course, it is unfortunate that FP defaulted in the first place, but the event has highlighted the success of the process, albeit some weeks’ lease payments from FP are at risk.

On 9 May 2018, Civitas published an announcement of all FP leases being assigned to Falcon, another housing association. The Civitas income risk is therefore on a finite period of lease income from a lessee, which, in February 2018, comprised 11% of Civitas’s total lease income. Our modelling leads us to quantify this as a small number of hundreds of thousands of pounds sterling, and certainly gives us no concern about the estimated 5.0p dividend payable for FY19 or any growth thereafter. Lease payments (under the new lessee) were immediately re-started, at the same quantum.

Having verified the current position, we are confident that the leases contracted by FP to Civitas are not above market levels. Extensive due diligence is undertaken, including the housing commissioner at the Local Authority who pays the occupants’ rents. While this is paid to the housing association (or other lessee), and not to Civitas, it clearly is the cashflow that enables the lessee to pay Civitas’s long-term lease contract.

All leases were assigned to a better covenant

Independent verification of rent to confirm this is sustainable within local authority area and represents value for money

The first point stated by Civitas in its presentation of ‘Best Practice Protocol’ (updated at end-May) is as follows: “Independent verification of rent to confirm achievable within local authority area and represents value for money”. On assets selected, rent (i.e. tenant rents to the housing association) has been set at or below median levels for the particular locality. Importantly, among many other points, the property is, in all cases, specified directly by local authority commissioners.

It is important that all of Civitas’s properties are rented at or below local market comparables. Civitas is in no way contractually liable for the flow of rent to the residents. However, if that rent is seen as high in some way, there is a future risk to its sustainability, or a risk, at least, that it would not rise with CPI. This might lead, some years on, to strain. Lease payments to Civitas are the responsibility of the housing association lessee from its total resources. Naturally, it is best for all parties for each property’s cashflow to provide financial strength to the housing association.

The sector’s tight regulation is a positive

Civitas’s due diligence is multi-layered. At its heart it requires that all properties must be top-quality, and also affordable, compared with local alternatives.

A strongly regulated sector, which favours Civitas’s model

There is a useful ‘backstop’ to the management of assets in this sector, with a Regulator actively overseeing this market, providing regulatory input and help. The Regulator may become actively involved in solving any emerging problems rapidly, deploying its significant statutory powers to manage the running of the homes.

Risk mitigation

Readers should refer to the Civitas Prospectus which was published pre- flotation.

The Civitas model and due diligence for risk mitigation

FP's February default was unfortunate, but we believe there is tangible reassurance for the present and future

Income streams are inherently long-term

The residents are expected (from medically assessed long-term needs) typically to remain in the property for many years.

Covenants are important, but not the main financial underpinning

Income has been demonstrated to be resilient – end values provide a modest element to NPV

As of February 2018, out of its 414 total, Civitas leased 45 properties to FP. As stated earlier, all were reassigned on the same terms (option to extend to 40 years) by early May. As at 31 January 2018, all rents were received in full from FP by Civitas. The rapid reassignment shows that the properties themselves were attractive investments: the due diligence Civitas undertook on the actual properties and their underlying income stream from tenant rents proved its worth.

Sustainability of underlying rents is the key

Civitas acquires assets on long-term, upward-only leases. As the average lease is now 25 years to break/maturity, the end value is *de minimis*. Lease income comprises the very significant component of net present value (NPV) of the assets.

Counterparts are smaller specialist RPs

Government-funded, albeit not government-underwritten income

Income derives overwhelmingly from housing associations (RPs). These are all regulated by government agencies but, while there is an indirect implicit desire to provide support for any RPs facing difficulties, this is not government-underwritten income. Furthermore, this is an emerging asset class, and a specialised one. Much of the stock is owned or operated by specialist and smaller RPs. Civitas's largest number of leases is with Westmoreland Supported Housing Association, an RP that focuses on supported housing for people with learning and physical disabilities and on the autistic spectrum. It is experienced at what it does, but it is not a large organisation.

Civitas has rejected around £300m of property during the due diligence process, we understand. This is for a variety of reasons, including high rental levels. We also understand that the ratio of accepted versus considered is relatively stable.

The housing commissioner at the Local Authority pays the occupants' rents – this money derives from central government

Assets' rent income underpins Civitas's lease income

The housing commissioner at the Local Authority pays the occupants' rents. While this is paid to the housing association (or other lessee), and not to Civitas, it clearly is the cashflow that enables the lessee to pay Civitas's long-term lease contract. From the housing association's point of view, this enables it to be responsible for providing a greater number of rooms to vulnerable adults, and, of course, the optimal arrangement would be for the housing association to receive sufficient rent to cover its costs and its lease payment to Civitas, and to generate an equitable surplus for itself. In the meantime, the housing association takes, among other risks, the occupancy risk.

Care providers

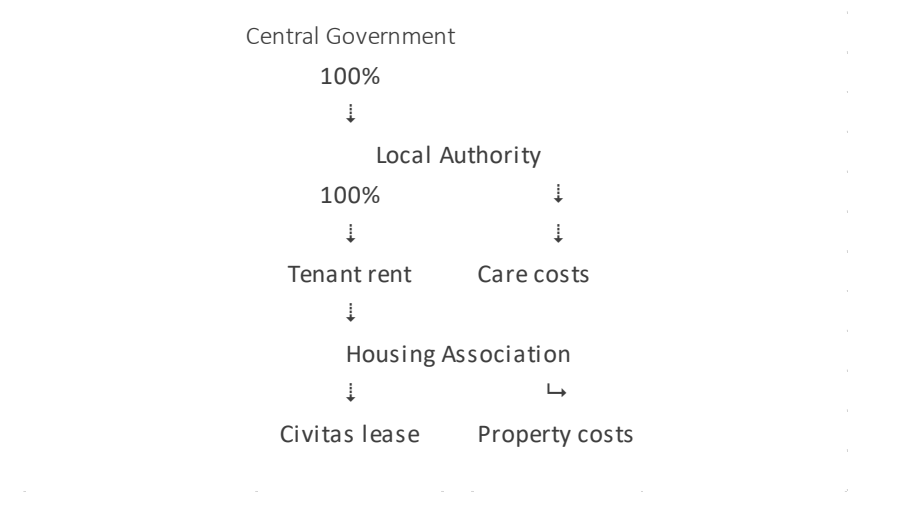
Long-term provision of care is the responsibility of a care provider – typically a large or medium-sized provider, of which there are several-hundred in the UK – not Civitas. Civitas has, since 2016, sought to establish strategic relationships with a number of nationally based care operators within the disciplines of learning disability, autism and mental health. Going forward, Civitas intends to build upon these relationships, in support of the business plans of the larger national care operators, to expand and to further consolidate the care market.

Civitas has contracts with 12 housing associations and 71 care providers – all in England and Wales. Not linked to this, and not affecting Civitas, a leading UK care provider has been mentioned in the press as being in financial difficulties. Civitas has no contracts or contacts with this care provider. Its contracts with care providers compute to an average of 6.5 houses each.

Central Government 100% funding

HMG re-iterated, earlier in 2018, its funding to the local authorities for this supported housing (housing benefit) via grant allocations. It is important, we consider, that HMG has specifically stated this; however, there is no guarantee for the length of time of such a ring-fenced full grant. Tenants will continue to receive housing benefit, having specialised long-term needs. The housing associations are legally committed to paying Civitas’s leases.

Funding flows



Source: Hardman & Co, Civitas prospectus

See also page 4.

Development

No involvement of Civitas, no risk

This is undertaken by third parties. Civitas has no development risk exposure on any factor whatsoever. This is including timing, specification, suitability for local authority commissioners and many other factors. Civitas does not forward-fund. It commits to buying at a price at an exact, certified specification and time.

The developer almost invariably takes the risk of paying the underlying rental income on all rooms until let. In no case is Civitas exposed to the rental income until the house is fully let post-development. Ongoing, the housing association for the property is at risk for rent income, maintenance and legislative/regulatory issues.

The developer now almost invariably takes the risk of keeping a substantial financial buffer in escrow (we believe, in most cases, this is a year’s rent), to be available to the housing association’s operation of the property (see page 10).

Ring-fence developer relationship

No development or 'forward-funding'

- ▶ Civitas does not undertake or, in any way, underwrite any development.
- ▶ Civitas does not forward-fund development.
- ▶ Civitas does undertake, by contract, to purchase at a given price and time, and at an exact specification.

No occupancy risk

- ▶ Civitas never takes any occupancy risk, either at handover or until the end of the lease. It may purchase immediately after the reconfiguration/refurbishment. All property would usually be assigned to specific tenants, configured for them.

Development risk stays with the developer. Civitas does not share in the risk or the reward for the developer. While significant 'intellectual property' is required by the developer, this is a competitive market, with many developers and a rising number of institutional investors.

From Civitas's point of view, it is important to understand that it facilitates renovation or purpose building, through its contingent commitment to purchase when finished. It will commit to purchase, but only contingent on a specific set of criteria being achieved prior to handover.

Occupancy risk starts off with the developer, and then moves to the operator – usually a care provider. The housing association is the lessee – typically of 25 years' duration – of Civitas. Civitas has no contractual risk with regard to occupancy at any stage of the lease. It states that its tenants are typically in their 30s, and, in many cases, a tenant is likely to remain in residence for many years, or indeed decades. The criteria for Civitas's purchase do not include all rooms being tenanted, although, invariably, the large majority are. In all but a small minority of cases, the developer takes the risk of letting the rooms, we understand, until the achievement of both handover of the physically complete property and the full letting of each room. Note that, as per the 30 May 2018 Civitas analyst presentation, the local authority provides care payments, including void cover to the care provider, and pays rental income (for the residents) to the housing association.

3 August Manager's Update and NAV

Latest figures saw a 0.3% uplift in Ordinary share NAV (1.1% annualised).

Civitas Social Housing, a REIT, released the following data on 3 August 2018.

IFRS NAV, Ordinary shares: 105.8p

The unaudited IFRS NAV, disclosed below, reflects an independent RICS "Red Book" valuation, prepared on an individual asset basis by Jones Lang LaSalle Ltd. Ordinary share NAV stood at 105.8p at end-June, having been 98p immediately post the IPO costs as of November 2016.

Civitas achieved a total IFRS accounting return, including 4.25p dividends and an IFRS NAV uplift, on the Ordinary shares of 10.0% from IPO to end-June 2018.

IFRS NAV			
	30 Sep'17 or 14 Nov'17*	31 Mar'18	30 Jun'18
Ordinary NAV (£'000)	361,300	369,495	370,388
Ordinary NAV/share (p)	103.2	105.5	105.8
C Share NAV (£'000)	295,960	298,934	297,218
C Share NAV/share (p)	98.0	98.9	98.4
Ord. Portfolio NAV/share			115.0

November 2017 C share issuance

Source: Civitas accounts and statements

** Comparable figures for the C share reflect the net proceeds at issue on 14 November 2017*

Subsequent to the C share issuance, deployment has been via C shares. All Ordinary share equity is deployed. Civitas also releases the unaudited Portfolio NAV, disclosed below, which reflects an independent RICS "Red Book" valuation, prepared on a portfolio basis by Jones Lang LaSalle Ltd.

The NAV uplifts for Ordinary and for C shares differ as a function of the timing of deployment. Clearly, as a function of its smaller current size (the C class portfolio NAV is assessed as a standalone, not merged with the Ordinary), the portfolio effect is much more muted.

The spread of assets and due diligence

The geographical spread of asset locations is wide. As of the latest update, no one region comprised over 22% of the geared gross assets (source: 2018 Civitas Impact Report). Concentration of risk by housing association varies as the capital is deployed, but the largest was latest stated by Civitas as comprising 19%, with the next largest 13%.

We see the wide geographical split as a positive, while the negative asset management implications often associated with such 'pepper-potting' are not applicable, as long-term asset management is the responsibility of the lessee – typically a housing association – not Civitas.

Note that the Investment Process is outlined further on page 10. Fuller exposition is on Civitas's website. This covers many layers of due diligence and also the progressive engagement with all stakeholders to apply a Best Practice Protocol.

Lease counterparts are important, but it is the underlying assets – selected by Civitas – that drive everything

We consider it worth repeating and emphasising that the foundation to all operational and financial aspects of the Civitas REIT is the suitability of each asset for the underlying tenants and local authorities' needs. Further, provision of care is the responsibility of a third-party care provider, not Civitas.

123 local authority locations

Civitas's assets are broadly spread across England, with some in Wales. Most recent data (to June) indicate Civitas's investments are located across 123 local authorities. Importantly, we highlight that Civitas undertakes significant due diligence, and the two main areas of risk comprise the handover of properties being reconfigured or newly developed, and also the level of rental income. To be clear, this is the rental income paid by central government, via the residents, to the lessees of Civitas, almost exclusively being housing associations. Specifications at handover are strictly contracted in relation to the third-party developers. We reiterate that Civitas undertakes no development or forward-funding.

Progression						
End-month	Mar'17	Jun'17	Sep'17	Dec'17	Mar'18	Jun'18
Investment (£m)	106	206	284	431	472	508
Properties	82	167	282	384	414	440
Tenancies	487	1,130	1,820	2,405	2,621	2,845
Local authorities	32	68	82	99	109	123
Housing associations	5	7	10	10	11	12

Source: Civitas accounts and statements

Social impact

We anticipate a further, updated, Social Impact report in early autumn

Civitas' social impact is important. Regular updates are provided – from an independent provider – posted on the Civitas website. We anticipate a further, updated, report in early autumn. The overarching social driver reduces overall spending, as well as raising outcomes. There is strong evidence that both purpose-built and suitably extensively reconfigured housing help occupiers' quality of life and thus reduce the input (hence cost) of carers.

The current shortfall in housing provision is felt acutely within the specialist areas of care, and thus good-quality properties providing healthcare in the community are in significant and growing demand, and are likely to remain so for many years to come. The requirement is substantial – for residents in parents' homes, in larger institutions, in care homes and elsewhere – and it is rising, as a function of advancing medical science and successive government policies, including the recent National Transforming Care Programme.

Senior management

Civitas Social Housing PLC

The Board of Directors comprises:

Michael Wrobel – Independent non-executive Chairman

Alastair Moss – Independent NED

Peter Baxter – Independent NED

Caroline Gulliver – Independent NED, chair of audit committee

Civitas Housing Advisors Limited: this is the investment advisor to Civitas Social Housing. The team's proven track record in the social housing sector combines with many years of experience in the investment industry and financial sector.

Civitas Housing Advisors' senior team includes the following and other members

Paul Bridge – Chief Executive Officer

Paul has worked in all aspects of Social Housing for over 20 years, and is a senior industry figure. From 2008 to 2014, Paul was Chief Executive of Homes for Haringey, an RP, and was responsible for 800 staff and 21,000 homes. For eight years prior to this, Paul was a director of Hyde Group (a major RP).

Andrew Dawber – Director

Andrew has been in the social housing sector for more than five years, including being part of the team that established the housing investment company, Funding Affordable Homes. He was the advisor to and founder of The PFI Infrastructure Co, which, in 2004, became the first publicly traded company in London dedicated to investment in social infrastructure. Andrew has worked in a senior capacity involved in the financial sector for over 25 years.

Graham Peck – Finance Director

Graham, a chartered accountant with 10 years' experience in real estate finance, was formerly CFO for pan-European private equity real estate investor Palm Capital.

There are also a number of other directors.

An experienced team in senior positions across the industry

Benchmarks

The REITs: comparables

Civitas provides secure CPI-linked dividend income

We consider the four nearest comparables to be REITs whose income derives from the government and who undertake no development. This includes the two primary medical property REITs, PHP and MedicX, in addition to Residential Secure Income REIT and Triple Point Social Housing, the supported social housing REIT. These four trade respectively on a 113%, 100%, 95% and 107% multiple of historical EPRA NAV. The figure for Civitas (Ordinary shares) is 98%.

Broader comparables are UK REITs whose remit is UK secure-income focused (see page 22).

A small asset class market – competitors/comparators will emerge, but de minimis, currently

Civitas has first-mover advantage in the quoted arena. There is successful private equity, and there are pension funds and other investors in supported social housing in the UK, but their combined investment quantum, we understand, is less than that of Civitas alone. There are a number of other quoted residential-focused REITs, all of which are in the process of deploying capital, and a number of which are partly or solely investing in the same market as Civitas – namely social housing, with 75% or more in supported housing.

The operating track record of the quoted REITs is short, and the non-quoted investment vehicles' data are not necessarily comparable, and they cover a modest quantum of assets.

The assets: an emerging asset class, now starting to mature

We believe this emerging asset class will mature well...

In coming years, this emerging asset class will mature in three ways:

- ▶ The quantum invested will rise, much of this increase being into new additions to the sector's assets.
- ▶ The respective importance to REIT investors of 1) the actual assets and their rental stream, versus 2) the leases and the covenants to Civitas of the lessees. Hardman & Co considers 1) to be the dominant factor, as evidenced by the successful outcome – reassignment of leases on same terms to better covenants – from the Civitas announcement dated 21 February 2018, "First Priority Housing association update".
- ▶ As with UK purpose-built student accommodation, international institutional investors are likely to be investigating the long-term income streams of UK social housing. Furthermore, these income streams are not correlated to UK all-property, private-sector residential or equity income. Leases are long-term, and there are CPI uplifts with a *de minimis* impact on NPV from the asset valuation at the end of the lease.

... with investor focus on the underlying assets

We see UK primary medical properties (NIYs typically under 5.0% here) as ultimately also a comparable class, once the investors and counterpart understanding of supported social housing have matured. We would not benchmark this NIY, but many characteristics are similar.

Civitas NIY: 5.9%

The current NIY is in the range of 5.5% to 6.5%, property by property.

Valuation

See page 22 for valuation comparables.

Share valuation metrics

Ordinary share price	106p
Number of Ordinary shares	350m
Market capitalisation, Ordinary shares	£371m
C share price	99p
Number of C shares	302m
Total market capitalisation based on 99p for C shares	£670m

Source: Civitas, Eikon Thomson Reuters

Ordinary share valuation metrics

Ordinary share price	106p
Premium /(discount) to historical NAV	+0.5%
Dividend yield current year	4.7%

Source: Civitas, Eikon Thomson Reuters

At the time of IPO, Civitas stated a 5.0p dividend, to be paid in the year of full deployment of the original £350m (gross) raise. It has confirmed that this remains the intention and, for calendar 2018, Civitas has therefore forecast a 5.0p dividend.

C shares convert after a year – in November 2018

C class shares, issued November 2017

The C shares trade separately, with a separate NAV and portfolio NAV (the latter reflects the inherent premium deserved through assessing the assets as a portfolio). Note the recent 1.13p dividend payment to C class shareholders, with a further C class dividend declared. All our NAV assessments are the IFRS NAV, i.e. assets valued on an individual basis. We would note that, in comparing Ordinary share and C share portfolio valuations, the latter currently feature a modest portfolio uplift versus IFRS, as, currently, the C share class's smaller portfolio size limits the quantum of this uplift. As the C class is invested, the rising quantum of the portfolio should be expected to widen the uplift premium of assessing it as a portfolio.

The C shares convert to Ordinary shares this November (12 months after their issuance), at which stage we anticipate the whole C share equity being invested. The ratio at which C converts to Ordinary is the respective ratio of portfolio NAV. Hardman & Co estimates, for its model, that this ratio is 93%. The IFRS (i.e. property by property) ratio currently is 93.0%, albeit the portfolio ration is (30 June 2018) 87.6%. We anticipate this disparity to close for the reasons outlined in the previous paragraph.

Post November 2018, therefore, we model that the Ordinary shares in issue will rise from 350m to 631m.

Conclusions: investment case

Secure, rising income, 100% CPI- linked

- ▶ There is a significant role to be played by REITs offering secure, progressive income on acceptable dividend yields (i.e. ca.5% or more).
- ▶ Civitas's assets benefit from 25-year leases on upward-only payments, CPI-linked.
- ▶ All Civitas's assets are in English and Welsh social housing, with a policy for over 75% to be in supported housing, and for tenants with particular chronic needs. To date, 100% has been in this category.

*100% Government-funded income streams
(not Government- guaranteed)*

- ▶ The lessees are housing associations that are not HM Government-guaranteed, but that do benefit from a strong regulatory framework. Some are very small, however, and this is particularly the case in such a specialist sector as supported housing. All underlying income is Government-funded.
- ▶ The assets purchased and the level of rents received by the residents (public money) are subject to Civitas's Investment Process due diligence. To date, ca.30% of assets in advanced discussions for purchase have been ruled out in the due diligence process.

*Investment Process has been 'tested' and
found robust*

- ▶ Civitas's investment criteria are founded on purchasing completed assets. 47.8%, to date, are houses or commercial buildings comprehensively re-configured by developers. 28.9% are re-purposed buildings, and 23.3% are purpose-built new. Developers take the risk of securing the initial residents (typically six per house).
- ▶ Events in February 2018 have tested Civitas's due diligence processes, and we believe they have demonstrated their robustness. The most likely reason for Civitas's withdrawing from considering any particular purchase is stated by Civitas as rents being too high or not being fit for purpose: <http://civitassocialhousing.com/wp-content/uploads/2018/05/Analyst-Presentation-FINAL-Video.pdf>. Other examples include the extent of works and any risk of over-run or disruption, or structural issues. Civitas's firm aim is to acquire properties – all with long, upward-only leases in place – where the underlying rents the residents pay are no higher than the median level for the area (local authority/specific area within a town or location). Among other points, Civitas looks at the property and its rent, not just the long income stream from the lease. This is for two reasons. First, it helps underwrite the sustainability of the long lease payments, which are paid dependent on the whole resources of the housing association lessee, but are naturally looking to the individual asset as the focus of attention. Secondly – as has been demonstrated by rapid and successful resolution of the significant issue with the potential default by Civitas's former second-largest lessee, FP – the lease is underpinned by sustainable income. The rapid assignment of all leases to a different RP must, we conclude, be underpinned by the underlying sustainability of the rental stream received by the residents of the individual properties (i.e. not being 'over-rented').

*£550m total, including £150m C share
deployment*

- ▶ Deployment of funds has been a clear success. £550m has been invested to date (£508m by end-June). The Ordinary shares benefit from full investment and a small level of borrowing. Further funds are being deployed via a C share class, created through a £302m second fund raise last November, with £150m to date.

This is a valuation opportunity and one where the close interrogation of the investment process gives us reassurance that it is robust and successful

- ▶ This is a valuation opportunity. The problems faced by FP, Civitas's second-largest lessee, do give pause for thought. This, in itself, understandably curbed the share price rating. The FP issue would have been best avoided, but it tested due diligence. This did result in a positive outcome, however – as well as reminding all concerned that the lessees, and thus the leases, are at a normal commercial risk. Importantly, the Regulator of Social Housing regulates Civitas's lessees. There is no explicit underwriting of the sector by HMG, but we note that, to date, the Regulator assists the orderly support of housing associations that find themselves in difficulty.

Why now?

Valuation opportunity

Valuation discount

Bar Civitas, only one other stock from the list below trades at a discount to EPRA NAV. Civitas offers an attractive combination of property (market-median or less as regards comparable-occupier rents) and counterparty covenants (most housing associations are Moody's A3 or higher-rated and are closely regulated).

Civitas at 9% historical EPRA NAV discount to the average of the three closest comparables

As stated earlier, the four nearest comparables trade respectively on a 113%, 100%, 95% and 107% multiple of historical EPRA NAV. The figure for Civitas (Ordinary shares) is 98%.

Civitas's prospective dividend yield is 4.9%, vs. 4.7%, 4.5%, 5.3% and 4.7% for nearest comparables

We consider the closest comparables to be PHP and MedicX, long-established investors into primary medical assets (where 95%+ income is from the NHS or Irish Republic equivalent), and also Residential Secure Income REIT, which, however, has not initially deployed capital quite at the rate anticipated. Further, we include Triple Point Social Housing REIT (although Triple Point Social Housing is not as advanced in its deployment programme).

In terms of prospective dividend yields, the four nearest comparables trade, respectively, on 4.7%, 4.5%, 5.3% and 4.7%. MedicX has stated that its historically uncovered dividend will be cut. The figure for Civitas (Ordinary shares) is 4.8%.

UK secure income-focused REITs

REIT	Ticker	Main asset class	Latest price (p)	EPRA NAV (p)	DPS (p)	Note
Civitas Social Housing	CSH	Social housing	106	106	5.0	[1]
Impact Healthcare	IHR	Residential care	102	101	6.0	[1]
LXi	LXI	Managed property	109	108	5.5	[1]
MedicX	MXF	Primary medical	81	73	3.5	[2]
PHP	PHP	Primary medical	114	101	5.2	
The PRS REIT	PRSR	Open mkt. housing	105	99	6.0	[1]
Residential Secure Inc.	RESI	Social housing types	94	99	5.0	[1]
Secure Income	SIR	Hospitals and leisure	375	355	15.5	[1]
Target Healthcare	THRL	Residential care	113	106	6.3	
Triple Point Social	SOH O	Social housing	107	101	5.0	[1]
Tritax Big Box	BBOX	Distribution centres	152	129	6.4	

Source: Hardman & Co Research

Note [1] stated target – company is paying dividends, historically.

Note [2] a new, reduced policy. 6.05p dividend likely for current year, Hardman & Co estimates 3.5p next year.

All NAV figures are historical, and dividend per share figures are prospective current year.

The share price setback's resolution demonstrates good underlying asset cashflow

The current Civitas share price setback has been triggered, clearly, by the FP cashflow uncertainty and the questions this raised about the lessees' positions. Many of the Civitas lease counterparts are small, including the largest, Westmoreland Supported Housing Association. Our research, via Civitas, indicates that most of, and possibly all of, the late FP payment should be recovered, and that the properties affected are not over-rented.

Emerging asset class, with 'proving-up' to be done, but assets valued at a good starting point of 5.8% NIY

This is an emerging asset class, and represents a long-term income stream on a commercial lease, where the covenant is the due diligence undertaken on the rental income from the residents, the houses meeting the social needs required by the local authority and the stability of the housing association. By their nature, the residents (typically initially in their 30s) will be very long-term tenants.

The NIYs on the portfolio properties average, ongoing, we believe, ca.5.8%, and this compares favourably with other real estate, based on public-sector funding, and other assets, based on long-term income.

Civitas has largely de-risked on its asset deployment investment plans.

Longer term

Reason to anticipate that the asset class should prove to trend towards mainstream status

- ▶ As with UK purpose-built student accommodation, international institutional investors are likely to be investigating the long-term income streams of UK public housing.
- ▶ Furthermore, those income streams are not correlated to UK all-property, private-sector residential or equity income.
- ▶ Leases are long-term, and there is a CPI uplift with a *de minimis* impact on NPV from the asset valuation at the end of the lease.
- ▶ Acquisition yields support the IPO target 5.0% dividend yield (at IPO price), which we anticipate to grow ca.3% p.a.

Civitas's assets yielded – we calculate – an NIY of ca.5.9% at acquisition (pre costs), since which time there has been a *de minimis* rent increase. The run-rate lease income stood at £31.1m as of end-June 2018 (£28.4m as of end-March), on a pre-cost invested amount of £508.

All leases are CPI (some CPI+)-based.

Timing constraints are hindering extra supply growth

Were broader institutional investment to materialise in this sector – at the earliest, this would be several years away – the constraints on developing such assets might lead to a demand/supply imbalance in the future.

Planning permission is not easily won

This potential positive demand/supply imbalance stems, we believe, from planning constraints and the small lot size of each development. Planning permission for residential assets tends to be hard-won and, furthermore, the requirements of these assets are quite specific – so the configurations provide further hurdles. For example, very few, if any, of the assets would ever be located over commercial property, although they are, in some cases, converted ex-commercial buildings. Developers need to be well aware of the specific configuration and specification of the structure of the building, as well as the fit-out of the building. Development is house-by-house individually (with

some being converted from small commercial buildings). The average number of tenants is just over six per asset.

The 'top level' drivers into income-focused REITs

The growing role for secure income-focused REITs

Turning to the investor and real estate funds' profile, secure income-focused REITs have a strong and growing role to fulfil. This brings investor interest, now, to such REITs.

Within the real estate investment community, the desire for income prevails over the aspiration to make asset-price gains from yield shifts. Indeed, as capital markets look to a shift from quantitative easing to potential tightening, investors seek to minimise equity risk while optimising income.

Over £20bn of real estate (Source: Evershed Sutherland conference, 26 April 2018) is held by investors in the form of open-ended funds. Given real estate's illiquid nature, this can cause problems, either as regards delayed redemptions or reduced pricing (including widening buy/sell 'spreads'). This has been a significant issue on a number of occasions in the real estate sector – the latest at the time of the UK EU Referendum vote (see Hardman & Co research of 30 November 2017 – "*Homes for Investors*"). The REIT structure ensures investor liquidity, while permitting the REIT's assets to be invested and managed for holding a long-term position.

How Civitas adds value to investors

Civitas's deployment of funds is £512m, at a 5.9% average NIY. This provides strong visibility on its ability to pay a progressive 5.0p per share dividend (once fully invested). As outlined above, this sector requires the type of long-term investment Civitas is bringing. While supported social housing is unlikely to be a mainstream real-estate sector for some time, we see it treading a path similar to purpose-built student accommodation, moving from emerging to alternative to mainstream. On this basis, the valuation is, at the least, well underpinned.

Deployment on schedule

Capital raised (gross) November 2016	£350m
Capital raised (gross) November 2017	£302m
Total asset purchases to date	£512m

Source: Civitas

Civitas has re-confirmed its indication of full C share equity deployment by November 2018.

Drivers to the Hardman & Co model

Acceleration in deployment

Hardman & Co forecasts

- ▶ The property purchases are currently effected via the C shares, and we estimate a rising run rate being increased to ca. £40m per month from August 2018 to end-March 2019 (year-end).
- ▶ We estimate full investment (ungeared) of C shares by November 2018, with the Ordinary and C shares merged in November 2018 – all as outlined by Civitas.
- ▶ Investment in FY2020 is estimated to proceed, to achieve a 30% LTV significantly before the end of that fiscal period, at which stage the company would be fully invested to its target indicated at the time of flotation.
- ▶ We estimate that assets are fully invested on the basis of a 5.7% average NIY post costs. We calculate that, to date, at least 5.9% NIY has been achieved.
- ▶ £92.5m debt has been drawn – all at rates below 3%. Debt rises to net £140m by end-March 2019E and to £302m by end-March 2020E.
- ▶ We assume no further equity issuance; thus property investment continues post March 2020 at a minimal rate. £7m p.a. would maintain LTV at 30%. This assumes a revaluation of property each year of ca.1.5% (based on our CPI estimates). As a REIT, the dividend payout must be 90% of EPRA EPS or more.

This REIT has every capacity to provide long-term dividend income, with sustainable modest income growth

Financial investment case

- ▶ To date (end August 2018), £550m assets have been invested. This represents 84% of gross funds raised. This goes a long way to de-risking the income stream that is required to achieve the target dividend payout.
- ▶ Assets to date have been purchased, on average, at ca.5.9% NIY. This leaves ample scope to distribute a 5% and rising dividend yield (on IPO price of 100p). Given the point above, the ongoing NIY could be lowered (mathematically even to just below 5.5%) and still support the progressive dividend.
- ▶ £31.1m contracted lease income as at end-June 2018 compares with our FY 2019 income estimate of £34.5m (and vs. our estimated £51m FY 2020).
- ▶ Contractually, void risk is minimal. Contracts are for 20+ year-long leases with housing associations and, while one – FP – has failed, experience here indicates that the strength of the underlying income enables re-assignment of the leases. This could not be guaranteed to be achievable in all potential future scenarios, but the prospects are robust.
- ▶ While Civitas's income is from the lessees, namely housing associations, and not the 'underlying' residents, we consider the risk of voids regarding the rooms themselves to be minimal, as there is strong demand and the tenants tend to remain in this type of accommodation for long-term periods. Residents' rents are paid by central government and, while there is no

guarantee that this arrangement might not change, there is no indication of change (this was re-confirmed earlier this year). In addition, there is a need for this configuration for the residents, and it is more cost-effective and sustainable than other assets might provide.

Debt

Debt drawn to date is nil for the C shares and £92.5m for the Ordinary shares. This comprises:

- ▶ A £52.5m 10-year fixed-term facility with Scottish Widows, at 2.99%.
- ▶ A £60m revolving facility with Lloyds for three years from November 2017, at a margin over LIBOR. £20m of this was agreed in May.
- ▶ Note that, at IPO, a maximum LTV of 40% gross asset value was outlined. Hardman & Co models 30% LTV as a 'fully invested' position, which is within the maximum, outlined at IPO.

Financial analysis

Revenue account and key ratios

Revenues, year-end Mar (£m)	Float to end-Sep'17	Float to end-Mar'18 [1]	FY2019E	FY2020E	FY2021E	FY2022E	FY2023E
Rental income	7.0	18.6	34.5	49.2	53.1	54.8	56.2
Investment advisory fees	-3.0	-5.8	-6.2	-6.7	-6.8	-7.0	-7.1
Other expenses	-1.6	-3.1	-3.0	-3.0	-3.0	-3.0	-2.8
Operating profit pre-revaluation	2.4	9.7	25.3	39.5	43.3	44.8	46.3
Revaluation	21.0	30.6	10.0	17.0	17.0	17.0	17.5
Operating profit reported	23.4	40.4	35.3	56.5	60.3	61.8	63.8
Finance income, net [2]	0.2	-3.4	-2.5	-6.7	-9.6	-10.1	-10.6
Profit [3]	23.6	36.9	32.8	49.9	50.7	51.7	53.2
EPRA profit [3]	2.6	6.3	22.8	32.9	33.7	34.7	35.6
EPS reported (p) [3]	6.7	10.6	7.2	7.9	8.0	8.2	8.4
EPS EPRA (p) [3, 4]	0.74	1.80	5.00	5.20	5.35	5.50	5.65
DPS declared in period (p)	1.50	3.00	5.00	5.20	5.35	5.50	5.65
NAV/share (p)	103.2	105.5	109.5	112.2	114.9	117.6	120.4
Shares in issue average (m)	350.0	350.0	453.0	631.0	631.0	631.0	631.0
Shares in issue period-end (m)	350.0	350.0	631.0	631.0	631.0	631.0	631.0

Key ratios, annual growth (%)

Revenue growth	n.a.	n.a.	n.a.	52.0	1.7	2.0	2.8
Total costs growth	n.a.	n.a.	n.a.	44.1	2.6	3.0	2.7
EPRA profit growth	n.a.	n.a.	n.a.	9.1	1.7	2.0	2.8
EPRA EPS growth	n.a.	n.a.	n.a.	3.7	2.6	3.0	2.7
DPS growth	n.a.	n.a.	n.a.	4.0	2.9	2.8	2.7
NAV/ share growth	n.a.	n.a.	3.8	2.5	2.4	2.3	2.4
DPS payout ratio	n.a.	n.a.	100.0	100.0	100.0	100.0	100.0
CPI assumption	n.a.	n.a.	2.0	2.0	1.5	1.5	1.5
LTV based on net debt	n.a.	n.a.	16.8	30.1	30.1	30.0	30.0
EPRA income, cost ratio	n.a.	n.a.	n.a.	19.7	18.5	18.2	17.6

Source: Hardman & Co Research

Notes:

[1] Includes aggregated Ord and C shares

[2] The -£3.4m for period to end Mar 2018 includes £2.8m amortisation of the costs of issue for the C shares

[3] The figures for 2018 are stated post the negative effect of £2.8 costs (see [2])

[4] The figure for 2018, adding back (ignoring) the £2.8m cost, equates to 2.6p

Our estimate for current fiscal year rental income is £34.5m, and this should be contrasted with the current run-rate of £31.1m and the ongoing capital deployment.

We have made allowance in the 2019 "other expenses" for ongoing transactional-related legal costs, deriving from the current ongoing capital deployment. This factor reduces as the rate of investment slows, and as targets are achieved.

Note re C share conversion to Ordinary:

The number of shares in issue currently is 350.0m Ordinary plus 302.0m C shares – the former issued in November 2016 on IPO flotation and the latter issued at the follow-on C share fund raise of 14 November 2017. C shares convert into Ordinary no later than 12 months post issue – i.e. later this calendar year.

The analysis above is for the Ordinary shares. Historical data for the quarter to December 2017 and estimates to March 2018 do not include an analysis of the progress of investment within the C shares.

We assume conversion of C shares to Ordinary shares at a ratio of 96%, based on the respective portfolio NAV of the two classes in November this fiscal year (2019). Thus the 302m C shares become 290m new shares. This figure may vary slightly as per NAV

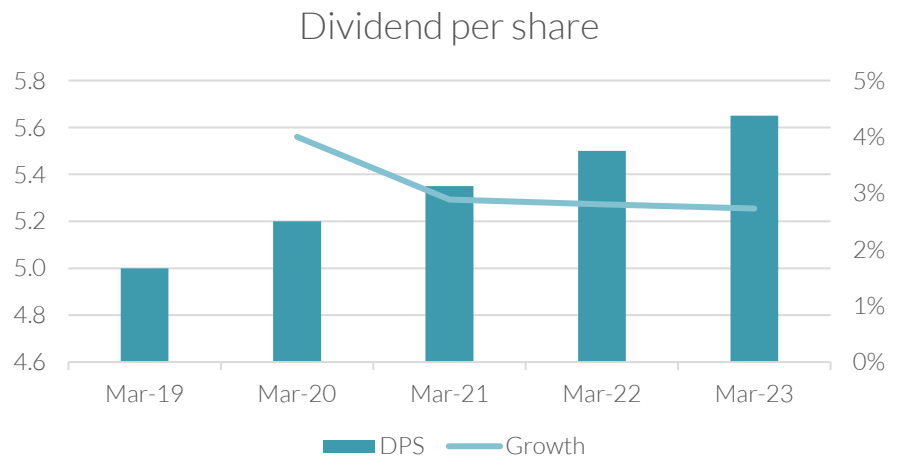
ratios. The number of new Ordinary shares created by the conversion due in November 2018 will therefore vary, dependent on respective valuations and costs of the 'Ordinary portfolio' and the 'C share portfolio'. This variance – as they are similar assets – should be of a very modest quantum.

Note re model input:

Note also that our model assumes an NIY post cost of 5.7% on all acquisitions. This assumes that an element of value rises in the market; our estimate is that purchases to date have yielded ca.5.8% or more. Currently, evidence is that this potential value rise (this fall in NIY) has been small, for professional buyers.

Note that our model assumes no further fund raises. Future equity raises would tend to enhance the medium- (under two years post putative equity raise) and long-term DPS-paying capacity.

Dividends per share (p) and growth (%)



Source: Historical data, Civitas; forward estimates, Hardman & Co Research

Ordinary shares: balance sheet

@ 31 Mar (£m)	Sep'17	Mar'18	FY2019E	FY2020E	FY2021E	FY2022E	FY2023E	
Investment property	321.0	516.2 [1]	830.7	1012.7	1036.7	1060.7	1085.2	
C shares		-298.7	n.a.	n.a.	n.a.	n.a.	n.a.	
Net cash + trade receivables/payables	40.3	151.9 [2]	-139.7	-304.7	-311.7	-318.7	-325.7	
Net assets	361.3	369.4	691.0	708.0	725.0	742.0	759.5	
NAV/share	103.2	105.5	109.5	112.8	114.9	117.6	120.4	
LTV [1]	cash	n.a.	16.9%	30.0%	30.0%	30.0%	30.0%	
Cumulative investment via C share	0.0	72.0	<i>C share merged</i>					

Source: Hardman & Co Research

Note:

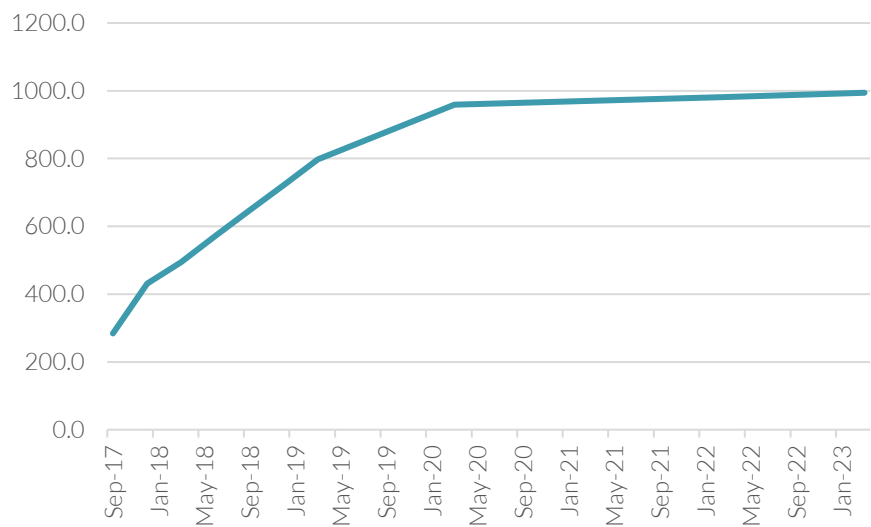
[1] Ordinary plus C share assets

[2] £249.6m gross cash; £90.8m gross debt; balance trade debtor / creditor
C shares merge into Ordinary shares in November this year.

Assets

We summarise estimates in the chart below. We emphasise that this assumes no further equity raise and a 30% ongoing LTV. This set of data includes revaluations. Ongoing, we assume 2.5% revaluation p.a.

Investment property held on balance sheet, £m



Source: Historical data, Civitas; forward estimates, Hardman & Co Research

Notes

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research@hardmanandco.com

35 New Broad Street
London
EC2M 1NH

+44(0)20 7194 7622

www.hardmanandco.com