

10 April 2019

Civitas Social Housing PLC

('Civitas' or the 'Company')

Update on the Civitas Portfolio and Commentary on the Social Housing Sector

Following the close of the financial year to 31 March 2019, we set out below an Advisor's commentary on the Civitas portfolio, the sector and the regulatory environment for care-based housing in England and Wales.

We also take this opportunity to set out the steps and procedures that we have undertaken over the year and indeed since launch to help make the eco-system that supports the specialist supported housing ("SSH") sector (the "Sector") as robust and sustainable as possible to mitigate risk to Civitas, enhance governance within housing associations and protect the interests of the underlying tenants and to provide value money for local authorities.

Executive Summary

- **The Civitas Portfolio.** This is a highly diversified portfolio located across England and Wales and as at 31st March comprised the following (including committed funds):

| | | | |
|------------------------|--------------|-----------------------------|-----|
| Total Invested* | £767 million | Care Providers | 113 |
| Properties | 587 | Registered Providers | 15 |
| Tenancies | 4,119 | Local Authorities | 157 |

**excluding purchase costs*

- **Demand for SSH remains very strong.** The National Housing Federation has estimated there will be an annual shortage of over 29,000 places by 2019/20 and over 46,000 by 2024/25¹. Mencap, in a 2018² report state that SSH "should be seen and treated by government as an important accommodation investment model, contributing to solving the housing crisis for vulnerable people." SSH by definition must be delivered without any public subsidy or government grant. Rent payments are usually met from Housing Benefit and are subject to various forms of means testing for each tenant.
- **Civitas Rents fall within the average range for the SSH sector.** Within the Civitas portfolio there is an individual rent agreement in respect of each of the tenants. Our objective is to acquire properties where rents have been determined at an average or median level for equivalent SSH properties in each region. We test each transaction against an independent review from external consultants, by reference to our own database and in dialogue with local authorities, care providers and RPs. This average measure is intended to reflect all SSH properties and not just those that are subject to lease arrangements with private sector REITs.

¹ National Housing Federation; Supported Housing – Understanding need and supply

² Mencap and Housing LIN; Funding Supported Housing for All

The Mencap report referred to above states that the Average Weekly Rent for shared SSH is £185.60 and the Average Weekly Rent for self-contained SSH is £194.43 (as at the report's publication in April 2018). This is the most recent and most representative survey conducted. The average weekly rent for a standard SSH property, which represents the majority of the Civitas portfolio, is £178. This is consistent with the market average for standard SSH properties and is slightly lower than the Mencap findings. If the minority of specific very high acuity or more specialist properties in the portfolio were included, the weekly average would be £211. Civitas has rejected rents that it considered to be out of line with its analysis and will continue to do so.

- **Leases are evolving to balance risk.** Discussions are well advanced for the introduction of a force majeure clause into new Civitas leases that will bring all parties together in the unlikely event of a change in law or government policy that permanently reduces the income received by registered providers (registered housing associations and local authorities) ("RPs"). The clause that we have evolved in conjunction with the sector is based on similar provisions found in many other long-income/infrastructure sectors and we are advised it will not alter the value of leases as it does not change any underlying risk or expectation of cashflows. However, it will address the specific concerns expressed around RPs and their exposure under leases to any future changes in law or government policy that affects their income and their ability to service leases. We expect that it will become widely if not universally adopted in the sector.
- **Contractual obligations between RPs and Care Providers.** Civitas has developed in-depth, trusted relationships with many of the leading care providers which provide care for tenants in our SSH properties. The Investment Advisor has built extensive expertise in the care sector through the recruitment of senior operational care executives.

In the SSH sector, care providers enter into service level agreements and lease obligations with RPs (typically for the provision of long term void cover in most circumstances for the RP) and care agreements with the tenants themselves.

We can confirm that the average length of contractual obligations from care providers to RPs across the Civitas portfolio is c.10 years. This provides significant alignment when measured against the leases signed by RPs and our objective is to continue where possible to extend the average length of these agreements when measured across the portfolio.

In doing so this provides a high degree of comfort for the RPs in relation to cover in the event of voids within the properties and the length of the agreements has been a particular focus for Civitas in determining to enter into certain transactions and to reject others. In many cases void reserve deposits are also put in place on acquisition of properties to further underpin RPs' resources.

- **Ensuring Safe and Well-Maintained Properties.** It is noted that only well-maintained properties that are fit for purpose and meet stringent health and safety requirements are suitable to act as a long-term home within the SSH sector. Civitas has codified an eight-step approach (including the force majeure clause noted above) against which to test each property to ensure that it can meet these objectives, the details of which are set out in the full Advisor's Update ([click here](#)). This process has evolved and has led to the rejection of over £400m of properties which Civitas considered would not meet these objectives or which did not pass our due diligence with respect to location, specific configuration, insufficient care provision or issues relating to the vendors.

- **Capital Works and Asset Management.** Civitas requires, as part of its take-on procedures for all properties (including new properties) to meet the level of the Decent Homes Standard for social housing or better. It requires vendors to meet the costs of improvements to achieve this and for these works to be independently monitored to completion. At the present time approximately £19.5 million of works are being undertaken without any cost to the relevant RPs or Civitas. The asset management team is overseen by Jeremy Kape who has over 30 years' experience in social housing and has led asset management for one of the largest RPs. Civitas also budgets each year to undertake certain additional capital works (above the lease obligations for the RPs) on a small number of properties where we determine that a modest capital investment is appropriate to maximize the potential of the property for the long-term. This includes amending the use for a different category of care need if that is required.
- **Active Engagement to Strengthen RPs.** The Civitas team comprises a number of senior figures from the social housing sector including Paul Bridge, formerly Chief Executive of Homes for Haringey and a board member of Metropolitan Thames Valley, one of the largest housing associations. Utilising the skills developed over many years in large RPs the team is actively engaged in working with all our RP partners. The purpose is to develop communication and shared knowledge between all 15 of our HA partners and where needed to offer active engagement on the ground to provide guidance and support the growth and professionalism of the organisations. This includes support relating to governance and risk management as well as sharing ideas for the development of boards and executives. In undertaking this work the team is able to draw upon their experiences in running organisations holding many tens of thousands of properties. We have for example devoted considerable time to working over the past year with Trinity Housing Association (5.75% of current rent roll and 4.75% of target rent roll based on 35% gross leverage) supporting the strengthening of the board and the executive to enhance future financial and operational performance. We are confident of our portfolio with Trinity which enjoys a high level of occupancy of approximately 95%.
- **Focus on the Tenant.** Since each of the underlying tenants has a recognised high level of acute needs to qualify for life long care in the community, Civitas has the ability to reassign the lease if the RP is not performing its obligations, thereby ensuring continuity of care and accommodation for individuals and longevity of income for Civitas. This was achieved in the case of First Priority and would be available to be undertaken in the future if needed.
- **A New Community Interest Company.** A challenge for many smaller RPs is the ability to access senior sector professionals and draw upon their knowledge above and beyond the regular engagement that already occurs with Civitas. We are leading the development of a new, independent community interest company that is designed to work with our RP partners and offer advice, support and guidance as they seek to enhance their performance and gradings. We will report on this initiative further in due course as it evolves and particularly as our RP partners draw upon the opportunity offered to assist them as they move forward.

For the full Advisor's Update, please [click this link](#).

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For further information, please contact:

Civitas Housing Advisors Limited

Paul Bridge
Andrew Dawber

Tel: +44 (0)20 3058 4844
Tel: +44 (0)20 3058 4846

Cenkos Securities PLC

Sapna Shah
Tom Scrivens

Tel: +44 (0)20 7397 1922
Tel: +44 (0)20 7397 1915

Buchanan

Helen Tarbet / Henry Harrison-Topham
Henry Wilson / Hannah Ratcliff

Tel: +44 (0) 20 7466 5000
civitas@buchanan.uk.com

Notes to Editors:

Civitas Social Housing PLC is the first Real Estate Investment Trust offering pure play exposure to social housing in England and Wales. The Company is advised by Civitas Housing Advisors Limited, who are authorised and regulated by the Financial Conduct Authority under Firms Reference Number 815699. The Company is listed on the premium listing segment of the Official List of the Financial Conduct Authority and was admitted to trading on the main market for listed securities of the London Stock Exchange in November 2016. The company is a constituent of the FTSE 250 index.