The Boatman Capital Research

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Dear Mr Moore,

--- OPEN LETTER ---

THE BOATMAN CAPITAL RESEARCH campaigns to ensure observance of ethical, social and governance issues by listed companies. We would like to bring a number of issues to your attention, in your role as senior independent director, that we believe makes the position of the chairwoman and of the audit chair of Home REIT Plc untenable.

We are also concerned that the board has been over-optimistic in its assumptions and that the value of the company's property portfolio may, as a result, be significantly inflated. Our own estimates suggest that a typical property could be 39-51% lower in value.

Entities related to The Boatman Capital currently hold stock in Home REIT Plc and we may consider making a larger investment. We may also consider engaging with other like-minded investors to achieve change if it is not otherwise forthcoming.

1. **Failure to highlight significant accounting issues to shareholders**
   Home REIT has recently offered the following information about its accounting procedures:
   - *"As part of each transaction, we ensure that the developer capitalises the Charity with a minimum of one year rent cover and sinking fund contribution."* [Company presentation Sept 2002, Slide 16]
   - *"Vendors typically provide the Company's Tenants with additional funding, usually representing twelve months of rent, to assist Tenants at any stage of the lease where*

the residential property may not have full occupancy." [Full Response to Short Selling Report, 30 November 2022, page 3]

- *"The Company structures its leases such that the first twelve weeks of rent are invoiced in a single invoice after three months."* [Full Response to Short Selling Report, 30 November 2022, page 11]

The first two statements above raise the issue of 'round-tripping', while the third (particularly in conjunction with the first two) raises the issue of weak counterparty finances.

Home REIT appears to fail to comprehend that whether the capitalisation of charities[1] is ***direct*** (i.e. Home REIT pays a tenant charity), or ***indirect*** (by developers as a requirement of purchase[2] by the company), the end result is the same. Seeking to minimise this issue by claiming the payments are indirect is disingenuous at best and reflects an attitude of hiding behind 'form' rather than reflecting the 'substance' of the matter to shareholders.

In our view both these items were of sufficient materiality that they should have been revealed under section '2.2 Accounting Policies: Significant account judgements and estimates' of your annual report for the period ended 31 August 2021 and your half year report to February 2022.

Failure to do so brings into question the effectiveness of the audit committee and in particular the audit chair. It is our opinion that attempting to hide behind 'form' rather than considering 'substance' raises considerable issues regarding the leadership of the company.

2. The status of any sinking funds

We note that Home REIT has recently disclosed that:

- *"As part of each transaction, we ensure that the developer … [provides a] sinking fund contribution"* [Company presentation Sept 2002, Slide 16]
- *"the Vendor:….Has an agreement with the Tenant to contribute to the property's sinking fund"* [Full Response to Short Selling Report, 30 November 2022, page 19]

We are unable to ascertain from the company's filings:

- The size of the 'sinking fund' contributions by developers
- The contractual requirement, if any, in tenant leases for a sinking fund
- Whether the sinking fund monies are legally segregated / held in escrow or comingled with a charity's general funds
- Whether the sinking fund is dedicated to the properties leased from Home REIT or all properties that the charity is connected to

We believe the same concerns as raised above regarding direct vs indirect support of tenants apply; that disclosure should have been made under '2.2 Accounting policies' and that the failure to do so raises questions of the board leadership.

[1] For the sake of convenience, we use the term charity to refer to charities, community interest companies and other regulated providers who are counterparties of Home REIT's long term leases. We assume that all such tenants are 'not-for-profit' but we have not used that term as we are unable to confirm.

[2] During the conference call held on 1st Dec 2022 it was stated that a condition of purchase of a property by Home REIT was that the developer capitalised the charity with one year of rent

3. **Possible failure to disclose other payments to tenants**

We note that in the annual report Home REIT provides a table[3] with both EPRA NIY and EPRA 'Topped-Up' NIY (but with no indication of how the calculations are made[4]) – the difference being 1.08% (5.32% and 6.4% respectively)[5]. We note that according to the EPRA methodology the difference between these two numbers should represent:

> *notional rent expiration of rent-free periods or other lease incentives*[6]

Given the adamant rebuttal by the company that developer capitalisation of tenants represent lease incentives by the company[7], we ask what does the difference between NIY and 'Topped-Up' NIY as described above represent? Are there other undisclosed incentives that investors are unaware of?

We feel it is reasonable for there to be full disclosure on all the following items forthwith:

- The value of developer capitalisation of tenants
- The contribution of developers to tenant sinking funds
- 'Rent-free periods or other lease incentives' explaining the gap between EPRA NIY and EPRA 'topped-up' NIY stated by the company in each of its accounts in a format that is proscribed by the EPRA

4. **Tenant and geographic concentration / lack of diversification**

a. Tenant concentration

As a result of the investigations by Viceroy Research, the company has accepted that a number of tenants have overlapping trustees, senior staff and offices.

The company has claimed that because there are some additional trustees this provides confidence in the independence of the tenants. Again, this is form over substance. It should not require us to state, yet we find we have to: *the increased underlying concentration and hence lack of diversification increases the risk to shareholders of 'bad actors'*.

The board and company owe shareholders a duty of *frank, open and honest* disclosures.

The lack of frankness on this topic raises questions about the leadership of the Board. The apparent lack of comprehension of the significance of undisclosed tenant concentration raises questions of both the board and the investment manager.

5. **Lack of sufficient due diligence**

We note that the company states (slide 16 Sep 2022 presentation, our emphasis):

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[3] Page 33 of Annual report 2021 and page 23 of half year report 2022

[4] EPRA Best Practises Recommendations Guidelines – November 2016 Page 5 states: 'Companies should provide detail on the calculation of the measure and reconciliation between the EPRA NIY and 'topped-up' NIY in the recommended format as shown in Section 3.4' See https://www.epra.com/application/files/7415/0306/4407/EPRA_BPR_Guidelines_2017.pdf (note that though the title states November 2016, the weblink states Guidelines 2017)

[5] The equivalent numbers for H1 2022 being 1.42% (difference between an NIY of 5.33% and a 'topped-up' NIY of 6.75%)

[6] See table at top of page 14 of EPRA BPR Guidelines (ibid). The footnotes go on to provide further guidance and disclosure requirements.

[7] For instance during the investor calls of 30 November 2022 and 1 December 2022

Conduct thorough financial and governance due diligence on the Charity to ensure it has ***sufficient balance sheet*** *and P&L strength to meet lease obligations*

And

Continued monitoring and due diligence of the tenant including ***balance sheet*** *and governance analysis*

Online observers[8] have pointed out that the auditor of Big Help Project is Leslie Eriera & Co Accountants, which appears to be the same auditor as for CG Community Council and for Dovecot and Princess Drive Community Association.

According to media reports, Leslie Eriera "was given a seven-year directorship ban" and that a company he was a director of had "unpaid tax liabilities but had paid £1,183,517 to unknown third parties"[9]. According to Eriera's LinkedIn page[10], his firm is a member of the ICPA[11], an accountancy body. But the ICPA membership page shows no evidence of this.

We would expect that a professional investment manager undertaking "continued monitoring and due diligence…. including balance sheet" would give due consideration to the auditor signing off those balance sheets, the commonality of auditors across tenants and the professional standing of the auditor.

At the very least this suggests that the professional investment managers' due diligence is weak; it also suggests inadequate supervision by the board.

6. Credibility of services provided by charities

We note that some of the residents in Home REIT's properties will need extensive support.

The company recently[12] provided staffing numbers of some charity tenants, which includes general admin staff as well as those working with residents:

Charity	Beds	Staff	Bed : staff ratio[13]
Supportive Homes CIC	1020	22	46:1
Gen Liv UK CIC	571	7	82:1
Dawson Housing	397	14	28:1

[8] See discussion on ADVFN – uk.advfn.com under Home REIT around posting 183-184
[9] https://www.mirror.co.uk/news/uk-news/take-vat-its-time-shame-23313824
[10] https://uk.linkedin.com/in/leslie-eriera-725b7919?original_referer=https%3A%2F%2Fwww.google.com%2F
[11] We note that elsewhere on the same LinkedIn page it is stated that he is NOT a member of the IPCA
[12] Within the company's Response to Short Selling Report
[13] Our calculation

This raises issues as to whether the charities provide the claimed support[14,15] in the quantity and quality that could be reasonably anticipated by the taxpayer[16].

We request the board provide detailed KPIs used to determine the suitability of care provided to residents by its tenants.

7. **Credibility of monitoring by investment manager**
We note that the company states (Sep 2022 presentation, slide 16):

> *"Annual site visits conducted to ensure the assets are being well maintained and **the underlying occupants are receiving the required care and support**"*

Having reviewed the short biographies of the investment management team on the company's website we are unable to ascertain who has appropriate healthcare or social care experience and expertise to enter tenant homes and assess that high-risk tenants have received the "required care and support".

We also note that the investment management team have other duties within Alvarium. We are therefore unclear how they find time to assess each of 11,000+ tenants and over 2,200 properties each year.

This raises questions over the credibility of these statements by the investment manager and the board.

8. **Excess profits**
The company challenged Viceroy's claims of "excess profits" by developers by providing its own numbers, which suggest that developers have made profit margins of 18%, 20%, 27%, 33%, 37% and 42% in its examples. We note that these are *unlevered* estimates.

The obvious corollary of this is that Home REIT shareholders have paid someone 18–42% above the potential cost had the company purchased the properties itself and managed any associated development or refurbishment.

The company also seems to be unaware of any transfer chains within developers or their closely connected parties – thus the company's estimates of developer margins may be significantly understating the true margins. Furthermore, it seems to be unfazed by suggestions that it is paying significantly above the asking price of neighbouring properties.

We note that in the prospectus the company stated that it would (page 45 of prospectus, our emphasis)

"target capital growth through:

[14] Slide 6 of the September 2022 company presentation states 'Wide range of support areas' and then lists 'Mental Health, Prison leavers, Drug & Alcohol', 'Domestic abuse' and 'Foster care leavers'.

[15] Chairwoman's statement in the Annual Report 2022 (page 5) states that the tenants 'provide care, support, training and rehabilitation at the properties to provide vulnerable homeless people with the skills and confidence to find long-term accommodation and enable them to reintegrate back into society'

[16] We note that a competitor, Civitas has claimed that most of its tenants (= residents) "receive an average of 40 hours per week active care" – see https://www.investorschronicle.co.uk/news/2022/08/22/the-controversial-reit-model-delivering-homes-for-the-vulnerable/ . We have been unable to identify how many hours of care and support residents of Home REIT can anticipate.

- *focussing on 'off market' transactions, benefitting from favourable purchase prices"*

The estimated profits of developers raise the question whether the company, and hence shareholders really are benefitting from 'favourable purchase prices'.

We suggest that this raises significant questions over the board's leadership and its custodianship of shareholder funds.

9. The nature of company leases

The company, the manager, the board and the broker(s) have allowed the narrative to be promulgated that the company benefits from "government-backed"[17], "long term index-linked"[18] leases.

The company leases properties to housing organisations (charities, community interest companies and others) on c. 25-year leases for provision of housing to residents who are eligible for funding (our emphasis, slide 2, interims presentation 2022[19]):

> *through the **provision of uncapped 'exempt' housing benefit** paid directly to the Registered Charity tenants from the relevant Local Authority, who are directly reimbursed by central government (Department of Work and Pensions).*

We do not believe this is the case. The company's lease counterparties are (often small) charities and CICs. Their relationships with local authorities are anything but substantive – they are not long-term contracts. When the contract relates to an individual resident, it is dependent on that individual remaining resident in the property and the provision of associated services. None of the charities have any credit rating by an internationally recognised ratings agency. Thus, the leases should NOT be treated as 'quasi'-government leases.

The inflation link for the duration of the lease is in the contract between Home REIT and the charity; it is NOT in the contract between the charity and the local authority. Hence suggesting that there is a government backed *index linked lease* is misleading.

Furthermore, a collar and cap mechanism means that the leases are not 'index-linked', so any use of that phrase without a qualifier is misleading (we also note that the company often uses the phrase 'index-linked' without specifying the index).

We note that we are not the only ones questioning the nature of these leases[20]:

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[17] The phrase 'government-backed' is used in the following media coverage of the company - https://www.proactiveinvestors.co.uk/companies/news/999812/home-reit-rebounds-after-firing-back-detailed-response-to-short-seller-s-attack-999812.html . The Investors' Chronicle mentions that companies such as Home REIT often describe their income as 'government backed' – see https://www.investorschronicle.co.uk/news/2022/08/22/the-controversial-reit-model-delivering-homes-for-the-vulnerable/

[18] Coverpage (page 1) of September 2022 Company Presentation states 'long term index-linked leases, providing superior inflation protected income and capital returns'

[19] See https://www.homereituk.com/wp-content/uploads/2022/05/interims-presentation-2022.pdf

[20] See https://www.investorschronicle.co.uk/news/2022/08/22/the-controversial-reit-model-delivering-homes-for-the-vulnerable/

"The RSH [Regulator of Social Housing] also questioned the 'government backed' nature of income – arguing that if the government changed the regulations around the way in which benefits can be used to pay rent for exempt accommodation, the model would be under threat."

10. The impact of leases on capitalisation rates

Valuation of the portfolio is ultimately the responsibility of the board[21]. The company states the valuation is based on a 5.87% average NIY[22].

Given that the leases are NOT government backed, are NOT wholly index-linked and are with weak[23] counterparties[24] of small size with (in many cases) limited financial history[25] whose own income is not contracted on a long-term basis we believe that a sub-6% yield is overly optimistic.

We believe that a realistic yield expectation for investors would be nearer 8 – 12%[26] for such counterparties. We note that press coverage has also suggested private landlords can obtain rents in this range[27].

We also note that the company expects its rents to rise faster than open market rents[28]. Given the constraint on government budgets, the growing concern at the uncapped nature of exempt housing benefit[29,30] and that the Government has frozen local housing budgets for three years[31] we believe that expectations of 1-4% annual rent increases may be overly optimistic[32].

In Appendix 1 we demonstrate how our estimates dramatically impact the valuation of a hypothetical property leading to cuts of 39-51% *before* any consideration of leverage.

We believe that it is the responsibility of a board to demonstrate a degree of conservatism and rationality in its estimates. We are unconvinced that the present leadership is capable of doing so.

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[21] Page 70 of the Annual Report 2021 states: 'The valuations are the ultimate responsibility of the Board'

[22] Page 15, and 17 (and number of other places) H1 Report 2022

[23] By 'weak' we mean with respect to financial characteristics that would be considered by a credit analyst or credit ratings agency

[24] We note that the counterparties have had to be capitalised by a third party (ie the developer has provided 12 months of rent) at the behest or to meet the requirements of Home REIT

[25] We note that many of these organisations have a limited operating track record in providing low-cost accommodation to homeless people. This contradicts the statement of the chairwoman on page 5 of the Annual Report 2021 (our emphasis: '*Our high quality properties are let at a low and sustainable rental level, on new, long term, full repairing and insuring ("FRI") leases to specialist registered homeless charities, housing associations, community interest companies and other regulated organisations, which have a* ***proven operating track record*** *in providing low-cost accommodation to homeless people*.')

[26] We believe that the developer support for charities (12 months rent plus sinking fund contribution) reflects a true market capitalisation rate in the range 8 – 12, if not more.

[27] See https://www.telegraph.co.uk/property/uk/want-12pc-yields-buy-to-let-property-make-council-pay/ and https://urbanistarchitecture.co.uk/hmo-investment-how-to-increase-your-rental-income/

[28] Table on slide 17 of September 2022 presentation, page 18 of Annual Report 2021 and page 17 of Half Year Report 2022

[29] See https://www.insidehousing.co.uk/insight/insight/supported-housing-report-leak-what-it-tells-us-about-the-exempt-accommodation-problem-74639 and https://committees.parliament.uk/committee/17/levelling-up-housing-and-communities-committee/news/173906/exempt-housing-and-support-services-are-a-complete-mess-says-committee/

[30] Panaroma Program 'The Housing Benefit Millionaire' - https://www.bbc.co.uk/iplayer/episode/m0018c0c/panorama-the-housing-benefit-millionaire

[31] See https://www.insidehousing.co.uk/news/news/local-housing-allowance-cash-levels-to-be-frozen-for-third-year-in-a-row-79155 and https://www.theyworkforyou.com/wrans/?id=2022-11-22.93713.h&s=disabled+people

[32] We note that the company provides an ESG report on page 26 of its Annual Report 2021. One might consider whether exploiting *uncapped exempt housing benefits* and raising rents above open market rents is compatible with wider social responsibility

We believe that by allowing a misleading representation of the strength of its leases the company may have overinflated its valuation.

11. **Leadership**

The company's rebuttal of the Viceroy report reveals substantive areas where it has been short in its disclosure. The performance of the share price after the issuance of the rebuttal report and during and after the investor calls held on 30 November 2022 and 1 December 2022 has not been positive.

We believe it is necessary for the leadership of Home REIT Plc. to be replaced, starting with the chair and the head of the audit committee.

12. No association

We have no commercial or other association or links with Viceroy Research or Oasis Capital (or its associated funds).

We look forward to your response.

THE BOATMAN CAPITAL

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Appendix 1 – valuation assumptions

We assume a weekly rent of £75[33]. In the following we use the reported 'current average net initial property purchase yield of 5.87%'[34,35] as a starting point (see column marked 'current valuation'). We include a 'growth rate' of 1% (to reflect the inflation link the company claims).

We use a simple Gordon Growth Model (d / (r-g)) to model the value of the property.

We then repeat the exercise with an 8% and a 10% yield which we believe better reflect the economic reality of properties leased to charities for homelessness. We also lower the inflation linked growth rate to 0% to reflect that local housing allowance (which reflects alternative use and pressure on government budgets) has not increased for three years.

It will be seen that the valuation of our hypothetical property falls by 39 – 51%.

	'Current valuation'	8% yield and no growth	10% yield and 0% growth
Weekly rent (£)	75	75	75
Annual rent (£)	3,900	3,900	3,900
Capitalisation rate	5.87%	8.00%	10.00%
Growth rate or inflation rate	1.0%	0.0%	0.0%
Value (£)	80,082	48,750	39,000
% change from current valuation		-39%	-51%

[33] The company reports that its weekly rent per bed in Liverpool is £75 (slide 13, Sep 2022 presentation)
[34] Not an EPRA measure
[35] Page 1 Half Year Report 2022

Appendix 2 – Growing Concern with the 'Lease model'

We note that a parliamentary committee[36] referred to specific concerns with the lease-based model of provision for exempt accommodation (our emphasis, reference numbers removed for clarity):

> *The lease-based model*
>
> *104. One model that was singled out for concern, which is particularly prevalent among non-commissioned provision, is the lease-based model. On this model, the entity that owns the property is for-profit, and leases the property to a not-for-profit entity which delivers the management and care services, often through agencies. The not-for-profit entity may be a private company or a registered provider. We heard that this is a perfectly legitimate model: the London Borough of Hackney explained that "it enables genuine supported not-for-profit providers to access the market where due to high capital values they could not afford to buy properties outright". However, it said, alongside several other contributors**, that problems arise when actors exploit this model for profit**. Because the landlord meets the criteria for uncapped housing benefit but the owner of the property sits outside those regulations, the uncapped rent can be pocketed as a "disguised profit income stream", and hidden through "complex legal structures". **Sometimes the not-for-profit entity has close links to the investors and has only been set up as a "front"**.*
>
> *105. Manchester City and West Devon Borough Councils gave examples of property market manipulation, whereby a company buys and sells properties on the same day at great profit because of the high yields they expect to gain from leasing the properties for exempt accommodation. Manchester gave this example: "a property was bought for £575,000 and sold on the same day for £1.8 million. This was then presented to us by the lessee … as a new specified accommodation scheme with a high core rent (lease rent)". **In West Devon's example, a portfolio of 12 properties were sold to a special purpose vehicle for £6 million and resold on the same day to an offshore investment company for £18 million**. Cllr Jory explained: "**That was done on the back of increasing the rents, through turning the tenants into exempt housing benefit tenants and increasing the rent on a 25-year lease in order to get that return over the period of the lease**".*
>
> *106. When we put our concerns about the lease-based model to the Ministers, the former Minister for Rough Sleeping and Housing agreed that the Government needs **"to clamp down on the cases …. Where people are making an inordinate amount of profit. That is my intention through the work we are doing**". However, he once again pointed to councils using the tools they already have "**to drive some of these people out of the market**".*

This debate and the cases cited do not specifically relate to Home REIT. But we would suggest that the above commentary provides support to our view that the capitalisation yield used by

[36] See https://publications.parliament.uk/pa/cm5803/cmselect/cmcomloc/21/report.html#heading-5

Home REIT is questionable, the weight put on the certainty of a 25-year lease is misplaced and that a potential Government clampdown is an increasingly present danger.

We also note that in the prospectus, Home REIT stated[37]:

> *The Investment Adviser is proud to be working in collaboration with Crisis to help support Crisis in ending homelessness.*

Yet the Investors' Chronicle[38] reports (our emphasis):

> *Matt Downie, Crisis chief executive, says the charity "has been concerned for some time about the worrying growth in unsafe, poorly managed exempt accommodation, and* ***the role of some investment vehicles such as Reits in driving this****".*

[37] Page 45 of Prospectus
[38] https://www.investorschronicle.co.uk/news/2022/08/22/the-controversial-reit-model-delivering-homes-for-the-vulnerable/