

# Impact Healthcare REIT

Company update

Performing well in a challenging environment

Impact Healthcare REIT's performance year to date provides evidence of the continuing robustness of its strategy and the resilience of its tenants. For tenants, fee growth and increased occupancy are mitigating the impact of inflation such that rents continue to be paid in full while rent cover remains strong. For Impact, indexed rent uplifts are driving organic growth. Rising interest rates will negatively affect earnings and delay capital deployment, but we expect further fully covered DPS growth.

Year end	Net rental income (£m)	EPRA earnings* (£m)	EPRA EPS*(p)	EPRA NTA/share (p)	DPS (p)	P/NAV (x)**	Yield (%)**
12/20	30.8	23.1	7.3	109.6	6.29	0.90	6.4
12/21	36.4	27.4	8.1	112.4	6.41	0.88	6.5
12/22e	41.6	31.5	8.2	115.7	6.54	0.86	6.6
12/23e	49.2	32.9	8.1	115.5	6.76	0.86	6.8

Note: \*EPRA earnings exclude fair value movements on properties and interest rate derivatives. \*\*P/NAV and yield are based on the current share price.

## Indexed rents and acquisitions driving growth

Indexed rent growth, 100% collected, acquisitions, and economies of scale have driven strong earnings growth year to date and Impact is well on track to meet its full year DPS target of 6.54p (+2%), fully covered by adjusted 'cash' earnings. For H122, DPS was covered 112% by adjusted earnings and 129% on an EPRA basis. With the portfolio valuation yield stable, rent growth continues to drive capital growth. EPRA NTA per share has increased 3.6% year to date to 116.5p, with a total return of 7.9%. Gearing is low and 77% of Q322 borrowing was fixed/hedged, but Impact is still exposed to further increases in the cost of capital. In volatile money markets we have based our forecasts on an increased SONIA benchmark rate to 6% (versus c 2.2% currently), assuming no further acquisitions despite available capital and opportunities. We expect continuing growth in fully covered DPS despite a reduction in forecast adjusted EPS (FY23e by 17%). Our broadly flat EPRA NTA forecast now allows for c 0.35% yield widening by end-FY23.

## Predictable cash flow and progressive dividends

Impact operates in a structurally supported market, driven by the demographics of a growing elderly population rather than the economy. There is a shortage of homes with the quality to sustainably meet demand, non-discretionary over the medium term. Impact's homes are let on long, triple net leases at affordable initial rents, indexed to inflation. As well as full rent collection, Impact expects strong rent cover to have increased in Q322 (1.73x in Q222). With predictable cash flow, DPS has increased each year since IPO in 2017, driving consistently positive accounting returns. Having raised c £62m of new equity in the year to date, Impact has a strong balance sheet with conservative gearing, and c £78m of available liquidity.

## Valuation: Robust, indexed, long-term income

FY22e DPS represents an attractive yield of 6.6% and despite headwinds we continue to forecast fully covered dividend growth from inflation-indexed rent uplifts and a full contribution from recent investments. The c 15% discount to NAV already anticipates some weakening of property values as government bond yields increase.

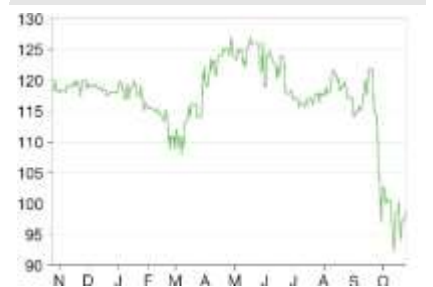
Real estate

25 October 2022

**Price** 99p  
**Market cap** £399m

Gross debt (£m) at 30 September 2022	130.6
Gross LTV at 30 September 2022	21.4%
Shares in issue	404.8m
Free float	90%
Code	IHR
Primary exchange	LSE
Secondary exchange	N/A

### Share price performance



%	1m	3m	12m
Abs	(11.5)	(16.2)	(16.6)
Rel (local)	(10.9)	(11.6)	(10.3)
52-week high/low		127p	92p

### Business description

Impact Healthcare REIT, traded on the Main Market of the London Stock Exchange, invests in a diversified portfolio of UK healthcare assets, primarily residential and nursing care homes, let on long leases to high-quality operators. It aims to provide shareholders with attractive and sustainable returns, primarily in the form of dividends, underpinned by structural growth in demand for care.

### Next events

Payment of Q322 DPS 25 November 2022

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**Impact Healthcare REIT is a research client of Edison Investment Research Limited**

## Performing well in a challenging environment

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In this note we provide an update on the factors that mitigate inflation risks for both Impact and its tenants, and our expectations for Impact to build further on its existing strong financial and operational performance. For an in-depth discussion of Impact Healthcare REIT's strategy, please see our [May Outlook](#). In that report we highlighted the strong fundamentals of the care home investment market, uncorrelated with the wider economy, and the predictability and sustainability of cash flows, supporting fully covered progressive dividend growth.

### Indexed rents and acquisitions, supported by robust tenant performance, have driven strong y-t-d growth

The H122 results were reported on 16 August 2022, followed by the Q322 update on 21 October, discussed in detail later in this report. Despite the building headwinds of increased inflation and interest rates and economic and political uncertainty in the UK, tenant operators have seen their occupancy ratios continue to recover towards pre-pandemic levels, with strong growth in the underlying fees they charge for the care they provide; and they have been managing underlying cost pressures effectively.

In brief, H122 income grew strongly, driven by portfolio investment and inflation-indexed rent growth. Compared with H121, cash rental income increased c 16% year-on-year and including interest on property investment via loans, total income grew 28%. Compared with H221, the half-yearly growth rates were 7% and 15% respectively. With portfolio growth delivering economies of scale, adjusted 'cash' earnings increased by 28% versus H121, to £13.8m, and by 12% versus H221. H122 adjusted EPS of 3.66p (H121: 3.26p) covered DPS of 3.27p (+2% vs H121) by 112%. On an EPRA basis, DPS cover was 129%. Property revaluation gains, driven by rent uplifts and asset management initiatives, drove EPRA NTA per share growth of 3.3% in the period to 116.1p.

On an annualised basis, H122 contracted rents had increased from to £42.0m from £38.0m at end-FY21, and increased further, to £43.2m at end-Q322. In contrast to more mainstream UK commercial property sectors, the underlying valuation yield remained stable (EPRA topped-up net initial yield of 6.7%) with indexed rent growth translating into a 0.8% like-for-like valuation uplift. EPRA NTA per share increased 0.3% in the quarter to 116.5p (IFRS NAV of 116.6p includes a positive interest rate derivative balance) and including DPS paid the EPRA NTA total return was 1.7%.

The end-Q322 portfolio was valued at £581m, including £38m of investments via loans. Including assets where acquisition contracts have been exchanged and assets under construction, this comprised 134 care homes and two healthcare facilities, let to 14 tenants. All rents are inflation-indexed (with caps and collars) with a weighted average unexpired lease term (WAULT) of 19.7 years. Just after the quarter end, as part of its active asset management programme, Impact sold a non-core for £2.7m, 4% ahead of the end-Q222 book value.

### Inflation and rising interest rates are the new challenge

The COVID-19 pandemic presented many operational financial challenges to home operators and although it may not be over, the effects have become considerably more manageable. The key concerns for the sector are now the rapid acceleration in inflation and staff shortages. In this environment, Impact's tenants have remained resilient, with increasing occupancy and strong fee growth mitigating inflationary cost pressures, supporting rent cover and the payment of rents in full.

Impact has built a strong track record of identifying attractively priced assets, mostly off-market, with an average gross yield on acquisitions of 7.4% since its initial public offering (IPO). At current

interest rates, acquisitions remain accretive, but with money markets recently volatile and indicating a peak in the SONIA benchmark interest rate at between 5–6% (before declining) we expect a highly selective near-term approach to acquisitions (our forecasts include none).<sup>1</sup> As a long-term investor, as interest rates begin to decline and, perhaps, with vendors also adjusting downwards their pricing expectations, we would expect acquisitions to resume from the significant pipeline of opportunities that have been identified. Meanwhile, rising market rates will have a negative effect on existing drawn variable rate debt, although we would expect Impact to seek opportunities to extend its interest rate protection or even refinance floating rate debt with fixed-rate, longer-term debt (but this is not assumed in our forecasts).

## No change to DPS forecasts with strong cover maintained, despite increased funding costs

Exhibit 1 shows a summary of our revised forecasts. Despite the increase in interest rates and our reduced expectation for acquisitions, our DPS targets are unchanged and remain in line with Impact's rent-growth linked dividend policy. Our forecasts for net revenue, comprising net rental income plus interest on investment via loans, are reduced for both years, primarily due to lower acquisition activity, partly offset by increased monetised capex, and modelling adjustments. The inflationary impact on administrative costs is limited by the significant weight of investment manager fees, linked to the level of net asset value. Higher borrowing costs are partly offset by lower average borrowings (the flip side of lower acquisition spend) but in FY23 the effect is particularly marked as the higher interest costs have a full impact and a £25m interest rate swap matures (see below).

**Exhibit 1: Summary of forecasts**

£m unless stated otherwise	New forecast		Old forecast		Change			
	FY22e	FY23e	FY22e	FY23e	FY22e	FY23e	FY22e	FY23e
Net revenue*	44.2	49.2	46.1	50.6	(1.8)	(1.3)	-4%	-3%
Administrative costs	(6.6)	(7.0)	(6.4)	(6.7)	(0.2)	(0.2)	4%	3%
Net finance costs	(6.1)	(9.4)	(6.1)	(6.8)	(0.0)	(2.6)	1%	38%
Tax	0.0	0.0	(0.5)	0.0	0.5	0.0		
<b>EPRA earnings</b>	<b>31.5</b>	<b>32.9</b>	<b>33.1</b>	<b>37.0</b>	<b>(1.7)</b>	<b>(4.1)</b>	<b>-5%</b>	<b>-11%</b>
IFRS adjustments	(5.6)	(6.5)	(5.7)	(6.5)	0.0	0.1	-1%	-1%
Amortisation of loan arrangement fees	1.2	1.2	1.1	1.1	0.1	0.1	11%	11%
<b>Adjusted earnings</b>	<b>27.0</b>	<b>27.6</b>	<b>28.5</b>	<b>31.5</b>	<b>(1.5)</b>	<b>(3.9)</b>	<b>-5%</b>	<b>-12%</b>
EPRA EPS (p)	8.2	8.1	8.8	9.6	(0.6)	(1.5)	-7%	-15%
Adjusted EPS (p)	7.0	6.8	7.5	8.2	(0.5)	(1.4)	-7%	-17%
DPS declared (p)	6.5	6.8	6.5	6.8	0.0	0.0	0%	0%
EPRA DPS cover	125%	120%	134%	142%				
Adjusted DPS cover	107%	101%	115%	121%				
EPRA NTA per share (p) – 'NAV per share'	115.7	115.5	117.9	124.1	(2.2)	(8.6)	-2%	-7%
NAV total return	8.7%	5.6%	10.6%	11.0%				

Source: Edison Investment Research. Note: \*Includes acquisition-related loan interest.

## Tenants are resilient despite the challenges

In building and diversifying its tenant base Impact has sought to identify quality operators with which to partner and grow over the long term, targeting those that are most likely to provide good care, while running a sustainable and profitable business. A key element of this sustainability has been to set rents at an affordable level, typically representing 11–15% of home-level revenues. Allowing for development completions, we estimate average capital value per portfolio bed at c £80k and the average annual contracted rent per bed at c £5,800.

<sup>1</sup> Based on the current debt structure, acquisitions would be primarily funded by variable rate debt facilities.

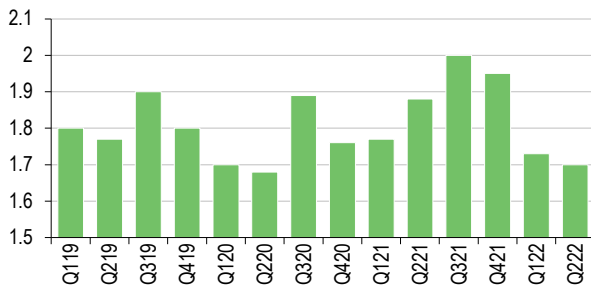
Occupancy has continued its steady recovery from its low in March 2021 (c 79%) and by end-Q322 had reached 87.3%<sup>2</sup> (end-H122: 85.4%). A continuation of the average rate of improvement since March 2021 would see occupancy approach pre-pandemic levels (c 90%) by the end of 2022, but this is not a given.

Average rent cover<sup>3</sup> was 1.85x over the 12 months to end-H122 and 1.73x at the end of the period, compared with c 1.90x before the pandemic (Exhibit 2). With the Q322 update, the investment manager had received operator trading data for 88% of the portfolio for July and August and based on these early indications anticipates that Q322 rent cover will have increased versus Q222. This would be in line with the seasonal pattern of rent cover evident from Exhibit 2, typically driven by operators agreeing and implementing most salary increases in December or January, while fee increases are mostly agreed during Q2, taking effect in Q3. In addition to seasonal factors, the reduction in rent cover from Q321 to Q222 reflects the following:

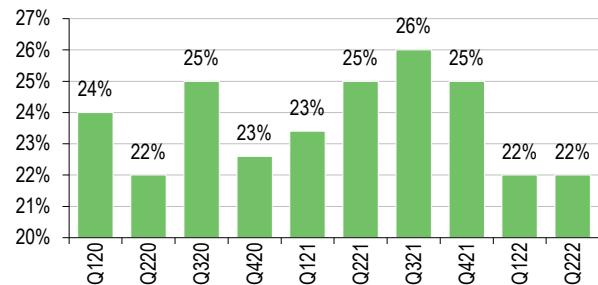
- A high starting point, with Q322 rent cover at above pre-pandemic levels.
- During Q3 and Q4 of 2021 the operators were benefiting from improving occupancy, fee growth and continuing government financial support for pandemic infection control, in place until the end of Q122. Those government grants were scaled down from Q122 and during Q322 have effectively fully tailed off.
- The acceleration of inflation through Q122 and Q222.

Occupancy and fee increases should continue to support operator profitability and rent cover in the second half of the year, but the impact of inflationary cost pressure remains uncertain.

**Exhibit 2: Trend in average tenant rent cover\***



**Exhibit 3: Trend in average tenant EBITDARM<sup>4</sup> margin**



Source: Impact Healthcare REIT. Note: \*12-month rolling average.

Source: Impact Healthcare REIT

Additional factors that mitigate the inflationary risks to operators include:

- The demand for care home places is effectively non-discretionary, at least for anything other than short periods. The pandemic provided an extreme example of this, with admissions highly restricted for a period but occupancy now rebuilding.
- UK care operators have a track record of being able to pass inflationary pressures through to fee increases. Between 1998 and 2021, weekly fees grew by an average of 3.8% per year for

<sup>2</sup> Excludes three turnaround homes that are yet to reach maturity.

<sup>3</sup> Rent cover is a key metric Impact uses in monitoring and assessing the ability of individual homes and operators to sustainably support the rents it expects from its portfolio. The ratio tracks operational cash earnings at the home level (before rent) with the agreed rent on a quarterly basis.

<sup>4</sup> EBITDARM is calculated as home-level earnings before interest, tax, depreciation and amortisation, rents and management overheads. The measure reflects the ability of homes to cover their rental costs with cash earnings.

nursing care and 3.6% for residential care, a premium of c 1% per year over average annual growth in the Retail Price Index (RPI) of 2.8%.<sup>5</sup>

- Average weekly fees charged by Impact's tenants continue to increase in line with inflation and were up 10.7% in August 2022 compared with the average for Q321.
- Most tenants are ungeared.
- Utility and food costs, two areas of significant inflationary pressure, remain at manageable levels. Food costs were 3.7% of revenues in the eight-month period to 31 August, up from 3.6% of revenues in the year to December 2021. Utility costs were 2.5% of revenues, up from 2.0% of revenues in the year to December 2021. Based on the Q222 tenant profitability data, in the unlikely event that these costs were to double, with no ability for tenants to pass through any of the increase to resident fees, average EBITDARM margins would be negatively affected by a similar amount, but average rents would remain fully covered.<sup>6</sup>
- Staffing is understandably the key cost across the sector and this has remained stable as a proportion of revenues (c 64% for Impact's tenants), including a reduction in the use of more expensive temporary staff following a peak in Q122. Impact notes a widespread recognition that improvements to staff levels and conditions are generally to be welcomed and care home staff are not typically 'overpaid', which has historically made it easier to pass through staffing costs to fee increases.
- While all rents paid to Impact are linked to inflation<sup>7</sup> (c 99% to RPI and c 1% to the Consumer Price Index (CPI)), uplifts are typically capped at c 4% with a floor of c 2%.<sup>8</sup> This means that while RPI inflation is above 4% Impact's rental growth will lag in real terms, but it contributes towards rents remaining affordable for tenant operators and enhances the security of Impact's income.

## Interest rate protection on Impact's borrowings

At end-Q322, borrowing costs on 77% of the £130.6m gross drawn debt were fixed or capped, comprising £75m of long-term, fixed-rate debt and a £25m nominal interest rate cap at 1% (ie, capping the SONIA benchmark rate at 1%). The cap matures in June 2023 at the same time as a £30m floating rate facility with Metro Bank (of which £15.3m was drawn at end-Q322). Impact has sufficient liquidity to repay this and is engaged in positive discussion over the arrangement of incremental facilities. While interest rate exposure on drawn debt is less than £30m, this would increase with further borrowings, based on the current debt structure. Total debt facilities (drawn and undrawn) of £206m are 48% fixed or capped. Meanwhile, gearing is prudent, with an end-Q322 gross loan to value ratio (LTV) of 21.4%, below the company's c 25% medium-term target and well below the 35% maximum specified by the company's gearing policy. Including exercise of the extension options<sup>9</sup> the end-Q322 average debt maturity was 5.8 years.

Capturing the effect of the September 2022 increase in the Bank of England base rate to 2.25%, the average running cost of drawn debt at end-Q322 was 3.9%. The cost of undrawn debt is at a margin of over SONIA, which closely tracks the base rate, which in September 2022 increased

<sup>5</sup> Impact Healthcare REIT.

<sup>6</sup> We note that the tenant EBITDARM margins, estimated by Impact, for Q1 and Q2 2022 (c 22%) also reflect the negative timing and seasonality factors discussed above.

<sup>7</sup> As measured by the RPI and CPI.

<sup>8</sup> Q322 data show that in total, 84% of leases are RPI linked with an annual floor at 2% and cap at 4%; 15% are RPI-linked with an annual floor at 1% and cap at 5%; and 1% increase in line with CPI.

<sup>9</sup> Additionally, Impact has an accordion option to extend the size of its revolving credit facility with NatWest by £24m to £50m with lender approval, and two one-year options to extend the maturity.

further to 2.25%. The market expectation, reflected in the forward curve, is for base rate/SONIA to increase much further, but has recently been volatile, anticipating a peak of between 5% and 6% by mid-2023 followed by a steady decline to a long-term 3%-4%. Our forecasts are based on 6.0% through FY23, which may prove to be conservative. On an annualised basis, a 0.5% shift in the benchmark rate is equivalent to a c 1.5% movement in adjusted earnings. We expect Impact to seek opportunities to extend its interest rate protection or even refinance floating-rate debt with fixed-rate, longer-term debt but this is not assumed in our forecasts.

Exhibit 4 provides a summary of Impact's debt portfolio at end-Q322, including strong borrowing covenants. On a blended basis, the Q322 interest cover ratio (ICR) was more than 900% against the covenant requirement of 239%. On the same basis, the blended LTV of the banking facilities (excluding the private placement) was 19% versus a maximum limit of 48%. End-Q322 unsecured assets and cash amounted to £52.9m.

**Exhibit 4: Summary of debt portfolio and covenants**

	Metro	Clydesdale	HSBC	NatWest	Total bank debt	Private placement
Facility type	RCF	RCF	RCF	RCF		
Facility size	£30.0m	£25.0m	£50.0m	£26.0m	£131.0m	£75.0m
Amount drawn	£15.3m	£5.0m	£10.0m	£25.3m	£55.6m	£75.0m
Expiry	Jun-23	Mar-24	Apr-25	Jun-24		2035
Margin	265bps	225bps	200bps	190bps		Fixed 2.97%
Security pool	Propco 1&2	Propco 3	Propco 4	Propco 7		Propco 8
Propci ICR covenant	200%	325%	250%	250%	239%	250%
Blended ICR					903%	
Propco LTV covenant	35%	55%	55%	50%	48%	55%
Blended LTV					19%	

Source: Impact Healthcare REIT

## We forecast a continuation of dividend growth, fully covered by earnings

Impact aims to provide shareholders with attractive and sustainable returns, primarily in the form of quarterly dividends, with the potential for capital growth. Supported by strong cash flow, covered DPS has increased each year since Impact's IPO, with a clear and progressive dividend policy that targets growth in line with the inflation-linked rental uplifts received in the preceding financial year. Dividends paid have driven the consistently positive quarterly total returns since the company listed in 2017, with aggregate NAV total return (adjusted for dividends paid, but not reinvested) to end-Q322 of 52.5%, a compound annual return of 7.9%. We believe this is attractive in the low interest rate environment that has persisted since IPO and the headwind of the pandemic, even if slightly below the company's medium-term return target of 9% per year.

Across the commercial property sector, income returns have historically shown less volatility than capital values, which have displayed material swings. Healthcare property returns have been less volatile than mainstream sectors. Despite the recent sharp increase in market interest rates and the cost of capital, we forecast continuing dividend growth, fully covered by adjusted earnings, in turn supported by index-linked rental growth. With government bond yields significantly higher than at the start of the year<sup>10</sup> there is a widespread expectation that the widening of property valuation yields (decrease in values) that is already apparent across much of the UK commercial property sector will spread. When reporting the H122 results the investment manager said that it had observed some signs that valuation yields had begun to increase, from very low levels (less than 3%) at the very high end (super-super prime) of the market, but that it did not expect any material

<sup>10</sup> The yield on the 10-year UK government gilt has increased from around 1% at the start of the year to around 4% recently, having reached a high of c 4.5% in late September.

change in its chosen market segment where yields are already much higher. For Impact's Q322 external property valuation, there was no change in the underlying valuation yield although our forecasts for FY22/FY23 allow for a c 0.35% widening, in aggregate, over the period. In this context, we expect NAV per share to be relatively flat through H222 and FY23, with an NAV total return in FY22 of 8.7% (H122: 6.2%) followed by 5.6% in FY23, all driven by dividends paid.

The end-Q322 EPRA 'topped-up' net initial yield of the Impact portfolio was 6.7%. In addition to the yield widening reflected in our forecasts, we estimate that a 10-basis point increase/decrease in yield would decrease/increase FY23e NAV per share by c 2.4p.

**Exhibit 5: EPRA NTA ('NAV') total return record\***

	2017**	2018	2019	2020	2021	Q322	FY17-Q322
Opening NAV per share (p)	97.9	100.6	103.2	106.8	109.6	112.4	97.9
Closing NAV per share (p)	100.6	103.2	106.8	109.6	112.4	116.6	116.6
Dividends paid (p)	3.0	6.0	6.1	6.3	6.4	4.9	32.6
<b>Annualised NAV total return</b>	<b>7.2%</b>	<b>8.5%</b>	<b>9.5%</b>	<b>8.5%</b>	<b>8.4%</b>	<b>8.1%</b>	<b>52.5%</b>
Of which dividends	3.1%	6.0%	5.9%	5.9%	5.8%	4.3%	33.3%
Of which capital growth	2.8%	2.5%	3.5%	2.6%	2.6%	3.7%	19.1%
<b>Average total return per annum</b>							<b>7.9%</b>

Source: Impact Healthcare REIT data, Edison Investment Research. Note: \*EPRA NTA adjusted for dividends paid but not assuming reinvestment. \*\* From March 2017, adjusted for IPO issuance costs.

## We expect acquisitions to pause near term, but Impact continues to seek opportunities for growth with tenants

Impact's business model is focused on forming long-term relationships with selected tenants, investing in suitable properties that those tenants can efficiently and profitably operate, while providing a good quality of care. With its equity raise in June 2022,<sup>11</sup> the company provided details of a strong pipeline of potential acquisition opportunities<sup>12</sup> and we understand that this continues to be the case. Impact also has available liquidity for acquisitions, which we estimate at c £78m, comprising cash and available undrawn debt less outstanding commitments.<sup>13</sup>

However, given the significant recent increase in the cost of capital, we anticipate that Impact will take a highly selective approach to acquisitions, even where these offer attractive operational and strategic opportunities. In most cases we believe care home operators that may be seeking to exit the sector are yet to adjust their pricing expectations to the increased cost of capital that must be borne by investors, and we assume no additional acquisitions in our forecast period to end-FY24.

Where attractive terms can be agreed, perhaps because of vendor willingness to accept lower prices, a decline in interest rates or the potential for innovative financing solutions, acquisitions may still be possible.

## Recent financial and operational performance in detail

Exhibit 5 provides a summary of the H122 financial performance arranged to show a breakdown of adjusted 'cash' earnings and a reconciliation to EPRA and statutory IFRS earnings.

<sup>11</sup> This was announced in June 2022 and closed in early July, raising £22.3m (gross) at 117p per share, a 1.8% premium to the NAV at the time.

<sup>12</sup> Amounting to c £169m at the time.

<sup>13</sup> Adjusting for the proceeds of the equity issue, Impact stated end-H122 available liquidity at a pro forma £90m and has since exchanged contracts to acquire two additional homes for £14.0m (before costs) and the sale of one non-core home for £2.65m.

**Exhibit 6: Summary of H122 financial performance**

£m unless stated otherwise	H122	H121	H122/H121
Cash rental income	16.9	14.6	16%
Interest on loan investments *	1.8	0.0	
<b>Total adjusted income</b>	<b>18.8</b>	<b>14.6</b>	<b>28%</b>
Administrative and other expenses	(3.2)	(2.8)	16%
Net finance expense	(1.8)	(1.2)	54%
<b>Adjusted earnings</b>	<b>13.8</b>	<b>10.7</b>	<b>28%</b>
EPRA adjustments			
IFRS rent smoothing & lease incentive adjustments	2.7	3.2	
Amortisation of debt arrangement fees and lease incentives	(0.6)	(0.4)	
<b>EPRA earnings</b>	<b>15.9</b>	<b>13.5</b>	<b>18%</b>
Change in fair value of investment properties	10.6	1.0	
Change in fair value of call option	0.5	0.0	
Change in fair value of interest rate derivative	0.2	0.0	
<b>IFRS earnings</b>	<b>27.3</b>	<b>14.5</b>	<b>88%</b>
<b>Other data:</b>			
IFRS EPS (p)	7.26	4.41	65%
<b>EPRA EPS (p)</b>	<b>4.22</b>	<b>4.10</b>	<b>3%</b>
<b>Adjusted EPS (p)</b>	<b>3.66</b>	<b>3.26</b>	<b>12%</b>
DPS declared (p)	3.27	3.21	2%
<b>DPS cover (EPRA earnings)</b>	<b>129%</b>	<b>128%</b>	
<b>DPS cover (adjusted earnings)</b>	<b>112%</b>	<b>102%</b>	
Investment properties at valuation*	568.9	432.4	
Gross debt	137.6	62.4	
Gross LTV	23.1%	13.7%	
EPRA net assets ('NAV')	448.1	388.0	
EPRA NTA per share (p) – 'NAV per share'	116.09	110.7	5%
EPRA NTA total return ('NAV total return')	6.2%	3.9%	

Source: Impact Healthcare REIT data, Edison Investment Research. Note: \*Reflects properties invested in via loans to the operators with options for Impact to acquire.

Looking first at adjusted earnings, the key highlights of the H122 financial performance were:

- Cash rental income increased c 16% versus H121, primarily the result of completed acquisitions and inflation-indexed rent growth.
- Interest on the £37.5m investment via a loan to existing tenant Holmes Care Group<sup>14</sup> for the purchase of a 12-home property portfolio amounted to c £1.8m.
- Total income increased c 28% and administrative expenses by a much lower c 16%. Expense growth primarily reflected increased asset management fees (up c 19%), driven by higher average net assets, with other expenses up c 7%. Including loan interest received, the adjusted EPRA cost ratio reduced to 14.8% compared with 15.8% in FY21.
- Higher finance costs, before loan arrangement fee amortisation and interest rate derivative gains, were driven by higher average debt, reflecting borrowings drawn to fund portfolio investment.
- Adjusted earnings increased c 28% to £13.8m and adjusted EPS by c 12% to 3.66p.
- EPRA earnings including non-cash IFRS rent smoothing adjustments as well as loan arrangement fee amortisation increased c 18% to £15.9m and EPRA EPS by c 3% to 4.22p.
- DPS of 3.27p (+2% vs H121) was covered 129% by EPRA earnings and 112% by adjusted earnings.
- Including fair value movements, IFRS earnings increased 88% to £27.3m.

<sup>14</sup> The loan enabled Holmes Care to take immediate operational control of the homes pending the completion of a potentially lengthy regulatory approval process, and for Impact to earn immediate income on the investment. Once this process completes, we expect Impact to exercise its purchase option to acquire the homes at a 7.2% gross yield. Meanwhile, the loan earns interest at a similar level (net of tax). Impact has the option to purchase the assets once all necessary regulatory approvals required by the operators have completed. Assuming option exercise, the loan interest converts to equivalent rental income.



- The property revaluation movements of £10.6m included market value property uplifts of £13.4m before accounting adjustments to offset the non-cash rental income reported in IFRS earnings. Market value uplifts were driven by inflation indexed rent increases and a £1.9m gain (c 30% on the £6.1m cost) triggered by practical completion of Impact's first forward-funded development in Hartlepool. The EPRA 'topped-up' net initial yield of 6.69% was little changed from 6.71% at end-FY21.
- A £0.5m fair value gain was generated on the option to acquire the properties underlying the loan investment to Holmes Care.
- IFRS net asset value per share increased to 116.18p and, adjusted for the fair value of interest rate derivatives, EPRA net tangible assets (NTA) to 116.09p, a 3.3% increase from end-FY21.

Exhibit 7 shows a summary of the Q323 financial performance, provided by Impact. With IFRS smoothing adjustments netted off against revaluation costs. The 'remaining contribution to reserves' excluded non-recurring issuance costs related to the July 2022 equity issuance and was above the quarterly DPS paid. Adjusted 'cash' earnings adds back amortisation of loan arrangement fees and other non-cash adjustments, and allowing for this, as well as the increased number of shares, we estimate that DPS was well covered, consistent with our FY22 forecasts. Meanwhile, adjusting IFRS NAV per share of 116.62p for the positive mark to market impact of interest rate derivatives, EPRA NTA per share was 116.46p.

#### Exhibit 7: Reconciliation of Q3 NAV movement

	Pence per share
IFRS NAV per share at end-H122	116.18
Revaluation gains on investment properties	0.57
Non-recurring costs	(0.18)
Quarterly dividend paid	(1.64)
Net remaining contribution to reserves	1.69
Unaudited IFRS NAV per share at end-Q322	116.62

Source: Impact Healthcare REIT

## Year-to-date acquisitions and further diversification

During H122, Impact completed the acquisition of seven homes and exchanged contracts to acquire a further three, for a total consideration of £55.2m. In each case these transactions were in line with Impact's strategy to grow partnership with selected tenants. The end-H122 portfolio was diversified across 13 tenants, operating 134 homes (including properties under exchange), providing more than 7,000 beds. On 22 August, Impact announced it had exchanged contracts to acquire two additional homes for £14.0m (before costs), at an accretive gross yield of 6.4% and operated by a new (14th) tenant to the group, Belmont Healthcare. One of the homes is purpose built and offers asset management opportunities, including realising the potential of its large site. The other has been recently refurbished. Both are rated EPC B.<sup>15</sup>

## Asset management creating value for Impact and tenants

While we forecast a pause in acquisition activity, we expect asset management projects to continue. Asset management is led by tenants and directed at those projects that can create value for both parties: tenants benefit from the potential to enhance or extend facilities, broaden their appeal to residents and increase earnings, while Impact benefits from higher rents, improved rental cover and, in many cases, capital value uplifts. Impact considers asset management to be one of the most attractive strategies available to it for the deployment of capital and for enhancing returns beyond a pure 'buy and hold' strategy, typically generating a low-risk yield on capital of at least 8%

<sup>15</sup> Energy Performance Certificate

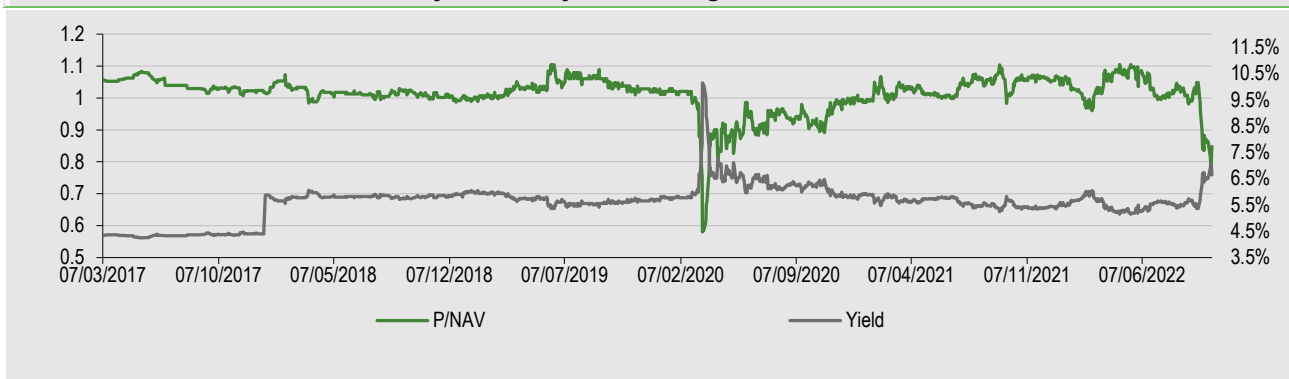
pa and supporting capital values. With the H122 results, the company reported that four projects had been completed since the beginning of 2022, with a further 15 projects started or in planning.

In addition to asset management of existing assets, Impact also forward-funds the development of pre-let, modern purpose-built facilities, bringing new capacity to market in attractive locations with good structural demand-supply balances. During H122 it achieved practical completion at a 94-bed development in Hartlepool at a cost of £6.1m and an expected annual yield of 7.8%. A £1.9m (30%) valuation uplift was recorded. Detailed planning continues for the construction of an 80-bed home in Norwich that will provide a range of residential, nursing and dementia care, at a total cost of £10.5m. Impact expects to start construction before the end of the year.

## Valuation: Attractive yield with progressive, fully covered DPS

Impact's FY22 target DPS of 6.54p (+2.0%), fully covered, represents an attractive yield of 6.6%. Meanwhile the shares trade at a 15% discount to the end-Q322 EPRA NTA (NAV) per share of 116.46p and appear to already anticipate a weakening of property valuations. The valuation is now similar to that reached at the peak of pandemic uncertainty in 2020, which proved to be an attractive entry point, with the robustness of tenants subsequently confirmed.

**Exhibit 8: Price to NAV and dividend yield history since listing**



Source: Refinitiv prices as at 15 October 2022. Note: Company published NAV and DPS data.

Exhibit 7 shows a summary of the performance and valuation of a group of real estate investment trusts (REITs) that we consider to be Impact's closest peers within the broad and diverse commercial property sector. The group is invested in the primary healthcare, supported housing and care home sectors, all targeting stable, long-term income growth derived from long-lease exposures.

**Exhibit 9: Peer group comparison**

	WAULT*** (years)	Price (p)	Market cap (£m)	P/NTA* (x)	Yield** (%)	Share price performance			
						1 month	3 months	1 year	3 years
Assura	12	51	1494	0.83	5.9	-12%	-26%	-30%	-32%
Civitas Social Housing	22	58	352	0.52	9.6	-17%	-29%	-37%	-32%
Home REIT	24	82	647	0.74	6.7	-14%	-31%	-27%	N/A
Primary Health Properties	11	107	1425	0.91	6.0	-12%	-26%	-30%	-23%
Target Healthcare	27	80	496	0.71	8.5	-18%	-30%	-32%	-30%
Triple Point Social Housing	26	66	264	0.59	8.0	-15%	-31%	-34%	-26%
<b>Average</b>	<b>20</b>			<b>0.72</b>	<b>7.5</b>	<b>-14%</b>	<b>-29%</b>	<b>-32%</b>	<b>-28%</b>
<b>Impact Healthcare</b>	<b>20</b>	<b>99</b>	<b>399</b>	<b>0.85</b>	<b>6.6</b>	<b>-11%</b>	<b>-16%</b>	<b>-16%</b>	<b>-10%</b>
UK property index		1,246				-5%	-27%	-33%	-32%
FTSE All-Share Index		3,821				-1%	-5%	-7%	-5%

Source: Historical company data, Refinitiv. Note: \*Based on last published EPRA NTA/NAV per share. \*\*Based on trailing 12-month DPS declared. \*\*\*Weighted average unexpired lease term. Refinitiv price data at 25 October 2022.

Impact's shares have outperformed the peer group and the broad UK property market over the past one and three years. Its trailing yield is now below the peer group and its P/NAV is above the average, albeit of a wide range, and has converged on the rating of the primary healthcare investors, Assura and PHP, long recognised for the security and predictability of income. In our view, Impact's valuation will have benefited from a robust performance during the pandemic, providing investor confidence in the sustainability of its growing stream of contracted rental income, a combination of the long weighted average unexpired lease terms and upwards-only, triple net leases, and rents mostly linked to RPI.

**Exhibit 10: Financial summary**

Year to 31 December (£m)	2018	2019	2020	2021	2022e	2023e
<b>INCOME STATEMENT</b>						
Cash rental income	13.9	19.1	25.9	30.5	36.0	42.8
Rental income arising from recognising rental premiums, fixed rent uplifts & lease incentives	3.4	4.9	4.9	5.9	5.6	6.5
Net rental income	17.3	24.0	30.8	36.4	41.6	49.2
Administrative & other expenses	(4.3)	(4.6)	(5.3)	(5.8)	(6.6)	(7.0)
Realised gain on disposal	0.0	0.0	0.2	0.3	0.0	0.0
Operating profit before change in fair value of investment properties	13.0	19.4	25.7	30.9	34.9	42.3
Unrealised change in fair value of investment properties	4.1	9.1	5.6	4.2	7.1	(6.5)
Operating profit	17.2	28.5	31.3	35.2	42.0	35.8
Loan related interest	0.0	0.0	0.0	0.1	2.6	0.0
Other net finance cost	(0.7)	(2.1)	(2.5)	(3.3)	(5.9)	(9.4)
Profit before taxation	16.5	26.3	28.8	32.0	38.8	26.4
Tax	0.0	0.0	0.0	0.0	0.0	0.0
Profit for the year (IFRS)	16.5	26.3	28.8	32.0	38.8	26.4
Adjust for:						
Change in fair value of investment properties	(4.1)	(9.1)	(5.6)	(4.2)	(7.1)	6.5
Gain on disposal	0.0	0.0	(0.2)	(0.3)	0.0	0.0
Change in fair value of interest rate derivatives	0.1	0.4	0.1	(0.1)	(0.2)	0.0
EPRA earnings	12.4	17.6	23.1	27.4	31.5	32.9
Rental income arising from recognising rental premiums & fixed rent uplifts	(3.4)	(4.9)	(4.9)	(6.0)	(5.6)	(6.5)
Amortisation of loan arrangement fees	0.2	0.4	0.7	1.0	1.2	1.2
Amortisation of lease incentive				0.1	0.0	0.0
Non-recurring costs	0.7	0.2	0.0	0.0	0.0	0.0
Gain on disposal	0.0	0.0	0.2	0.3	0.0	0.0
Adjusted earnings	9.9	13.4	19.1	22.7	27.0	27.6
Average number of shares in issue (m)	192.2	254.0	319.0	339.8	385.5	404.8
Basic & diluted IFRS EPS (p)	8.57	10.37	9.02	9.41	10.06	6.53
EPRA EPS (p)	6.47	6.95	7.25	8.05	8.16	8.12
Adjusted EPS (p)	5.17	5.26	5.98	6.68	7.01	6.82
Dividend per share (declared) (p)	6.00	6.17	6.29	6.41	6.54	6.76
EPRA earnings dividend cover	108%	113%	115%	126%	125%	120%
Adjusted earnings dividend cover	86%	85%	95%	104%	107%	101%
NAV total return	8.5%	9.5%	8.5%	8.4%	8.7%	5.6%
<b>BALANCE SHEET</b>						
Investment properties	220.5	310.5	405.7	437.6	581.3	586.9
Other non-current assets	5.7	10.1	15.9	62.0	30.3	36.7
Non-current assets	226.2	320.7	421.6	499.7	611.6	623.6
Cash and equivalents	1.5	47.8	8.0	13.3	13.1	2.4
Other current assets	0.6	0.6	0.1	1.6	1.8	1.8
Current assets	2.1	48.3	8.1	14.8	14.9	4.3
Borrowings	(24.7)	(23.5)	(74.2)	(110.9)	(148.8)	(150.0)
Other non-current liabilities	(1.9)	(1.8)	(2.8)	(2.6)	(2.6)	(2.6)
Non-current liabilities	(26.6)	(25.2)	(77.0)	(113.5)	(151.4)	(152.6)
Borrowings	0.0	0.0	0.0	0.0	0.0	0.0
Other current liabilities	(3.3)	(3.1)	(3.1)	(6.7)	(6.6)	(7.5)
Current Liabilities	(3.3)	(3.1)	(3.1)	(6.7)	(6.6)	(7.5)
Net assets	198.3	340.7	349.5	394.2	468.5	467.8
Adjust for derivative financial liability/(asset)	(0.5)	(0.1)	(0.0)	(0.1)	(0.3)	(0.3)
EPRA NTA	197.9	340.6	349.5	394.2	468.2	467.5
Period end shares (m)	192.2	319.0	319.0	350.6	404.8	404.8
IFRS NAV per ordinary share	103.2	106.8	109.6	112.4	115.8	115.6
EPRA NTA per share	102.9	106.8	109.6	112.4	115.7	115.5
<b>CASH FLOW</b>						
Net cash flow from operating activities	10.0	14.9	21.0	23.6	24.8	36.7
Purchase of investment properties (including acquisition costs)	(55.1)	(73.4)	(88.5)	(28.1)	(125.0)	(8.0)
Capital improvements	(3.9)	(8.2)	(1.7)	(1.1)	(6.7)	(4.0)
Other cash flow from investing activities	0.0	0.1	0.9	(35.9)	39.6	0.0
Net cash flow from investing activities	(58.9)	(81.5)	(89.3)	(65.1)	(92.1)	(12.0)
Issue of ordinary share capital (net of expenses)	(0.1)	132.2	0.0	34.6	60.9	0.0
(Repayment)/drawdown of loans	26.0	(0.9)	51.2	38.2	37.1	0.0
Dividends paid	(11.6)	(16.1)	(20.0)	(21.9)	(25.4)	(27.1)
Other cash flow from financing activities	(2.3)	(2.2)	(2.8)	(4.1)	(5.4)	(8.2)
Net cash flow from financing activities	12.0	112.9	28.5	46.8	67.1	(35.4)
Net change in cash and equivalents	(36.9)	46.3	(39.8)	5.3	(0.2)	(10.6)
Opening cash and equivalents	38.4	1.5	47.8	8.0	13.3	13.1
Closing cash and equivalents	1.5	47.8	8.0	13.3	13.1	2.4
Balance sheet debt	(24.7)	(23.5)	(74.2)	(110.9)	(148.8)	(150.0)
Unamortised loan arrangement costs	(1.3)	(1.7)	(2.2)	(3.6)	(2.8)	(1.6)
Net cash/(debt)	(24.5)	22.7	(68.4)	(101.3)	(138.5)	(149.2)
Gross LTV (net debt as % gross assets)	11.4%	6.8%	17.8%	22.3%	24.2%	24.1%

Source: Impact Healthcare REIT historical data, Edison Investment Research forecasts

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