S&P Global
Ratings

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Research Update:

U.K.-Based Housing Association Aster Group Ltd. Outlook Revised To Negative; 'A+' Ratings Affirmed

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Overview

- We forecast that higher investments in existing properties and low sales margins will weaken Aster Group Ltd.'s financial performance.
- We also think that Aster's planned merger with Cecil & Central Housing Trust (CCHT) will contribute to the weakening of its S&P Global Ratings-adjusted EBITDA margins.
- Weaker adjusted EBITDA, combined with the debt associated with Aster's development program, is set to increase the group's debt burden.
- We therefore revised our outlook on Aster to negative from stable. At the same time, we affirmed our 'A+' long-term issuer credit rating.

Rating Action

On Dec. 8, 2021, S&P Global Ratings revised its outlook on U.K.-based social housing provider Aster Group Ltd. to negative from stable. At the same time, we affirmed our 'A+' long-term issuer credit rating on Aster.

We also affirmed our 'A+' issue rating on the senior secured debt and the £1 billion senior secured medium-term note program issued by Aster Treasury PLC, which we consider to be a core subsidiary of the group.

Outlook

The negative outlook indicates that management's spending policy could materially weaken Aster's currently solid financial metrics. Higher investments in both existing and new assets, combined with other cost pressures such as those from its planned merger with CCHT, could cause a sustained weakening of the group's interest coverage and increase its debt burden.

Downside scenario

We could lower the rating on Aster over the next two years if the group's debt exceeds 20x of adjusted nonsales EBITDA, or if its adjusted nonsales EBITDA interest coverage falls below 1.75x, on a sustained basis.

Upside scenario

Alternatively, we could revise the outlook back to stable if management were successful in containing the increasing costs, such that Aster's adjusted EBITDA improves, which in turn should have a positive impact on the group's debt metrics.

Rationale

The outlook revision indicates an increased risk that the group's adjusted EBITDA could weaken and its debt could increase, which could weigh on its financials more than we currently anticipate. We understand the group still aims to have all properties reach Energy Performance Certificate (EPC) C standards by 2025. Aster is investing heavily in its existing asset base to achieve this, as well as to ensure that the properties meet fire and safety regulations. These costs will weigh on its adjusted EBITDA margins.

Aster operates in the economically solid southwest and southeast England, which underpins its rating. It derives much of its revenue from low-risk and countercyclical social housing rental activities. Aster currently owns and manages close to 33,000 units, and its vacancy rates averaged around 1% over the past three years, slightly lower than the sector's average. Its social and affordable market rent ratio, which we calculate at around 60%, supports continued strong demand for its units.

Earlier this year, Aster announced its intention to merge with London-based CCHT, a registered social housing provider whose main activities is the provision of affordable housing and residential care homes for people aged 55+. The merger was approved by the respective boards at the end of October, and we understand it will complete early next year. We estimate that CCHT's adjusted EBITDA is significantly weaker than Aster's and that additional investments are needed on its properties. The planned merger will also mark the group's first step into the London market. That said, it will have less than 2,000 units in London, which is a relatively small number. We do not expect the merger to materially depress the group's demand and vacancy rates.

Although most of Aster's activities are focused on its social mission of providing more homes, we consider that developing units for sales exposes the group to market volatility and to higher risk. We forecast that Aster's sales income, including joint ventures, will surpass one-third of total revenue. The group has historically developed shared ownership units, but we understand that going forward it will also develop units for open market sale.

We assess the regulatory framework under which registered providers of social housing in England operate as strong, underpinned by their public policy mandate to provide affordable homes. We also consider that the sector benefits from solid ongoing oversight by the Regulator for Social Housing (RSH). These strengths are offset, in our view, by the relatively low levels of grant funding that providers in England receive for the development of affordable homes. Although providers in England can develop homes for outright sale and use the proceeds as an alternative funding source, we think that this exposes them to greater risks and more potential volatility than providers in other regions. Providers in England are also subjected to negative intervention from the U.K. government in the form of constraints on rent setting or additional spending responsibilities, without adequate additional funding. This weighs on our view of the regulatory framework assessment.

We consider that Aster's management has adequate expertise and skills to manage the group's activities, with a focus on ensuring the quality of its asset base. The group is proactive in managing the transition toward carbon neutrality and expects all its properties to meet EPC C standards by 2025, five years ahead of the set government target. Although this weighs on the group's profitability, we understand there is some flexibility in managing the spending on existing properties. We think that future challenges include the integration of CCHT into the group, given its relatively weak financial and operational performance.

We expect Aster's adjusted EBITDA margins to weaken to a fairly solid 26% in the coming three years, down from more than 30% in the past two years. This is largely the result of increased spending on existing properties, low margins from the increasing share of revenue coming from sales activities, and the planned integration of CCHT. We understand that Aster plans to increase spending on CCHT properties, as well as the existing Aster properties, to maintain the group's high asset quality standards and to meet enhanced fire and safety standards.

We forecast that the group's debt metrics will gradually improve, such that nonsales EBITDA interest cover will reach 1.8x in the financial year ending March 31, 2024 and that debt to nonsales EBITDA will remain below 20x. However, the weakening of Aster's nonsales EBITDA could weigh on the group's debt metrics. As the group progresses toward delivering on its development plan, we expect capital expenditure (capex) to ramp up over the next two-to-three years, funded through a mix of new debt intake, grant funding from Homes England, and proceeds from the disposal of untenanted properties.

We see a moderately high likelihood that Aster would receive timely extraordinary government-related support in case of financial distress. This provides a one-notch uplift from the stand-alone credit profile (SACP). As one of the key goals of the RSH is to maintain lender confidence and low funding costs across the sector, we believe it is likely that the RSH would step in to try and prevent a default in the sector. We base our view on the RSH's record of mediating mergers or arranging liquidity support from other registered providers in cases of financial distress; we think it would perform the same role for Aster.

Liquidity

We assess Aster's liquidity position as positive and anticipate that sources of funding will cover uses by about 2.3x over the next 12 months. We also assess Aster's access to external liquidity as satisfactory, supported by its outstanding bonds (issued by Aster Treasury PLC) and a diversified pool of existing lenders.

Sources of liquidity over the next 12 months include:

- Cash flow from operations, adding back noncash cost of sales, of close to £115 million;
- Current cash balances of around £145 million;
- Undrawn committed lines of about £305 million that are contracted and mature after 12 months;
- Retained and already secured bonds of about £115 million;
- Grants and other receipts of around £27 million; and
- Fixed-asset sales receipts of about £25 million.

Uses of liquidity over the same period include:

- Capex of about £230 million; and
- Interest and maturing debt repayments of £85 million.

Key Statistics

Table 1

Aster Group--Key Statistics

	--Year ended March 31--				
Mil. £	**2020a**	**2021a**	**2022bc**	**2023bc**	**2024bc**
Number of units owned or managed	32,039	32,729	35,273	36,501	37,506
Adjusted operating revenue	214.3	224.0	230.4	284.6	334.5
Adjusted EBITDA	65.0	74.9	63.8	71.1	83.3
Non-sales-adjusted EBITDA	57.5	70.3	58.7	63.8	71.5
Capital expense	186.1	146.8	202.9	244.8	257.8
Debt	1,042.3	1,144.7	1,131.4	1,233.6	1,295.4
Interest expense	35.1	35.1	36.5	37.9	39.7
Adjusted EBITDA/Adjusted operating revenue (%)	30.3	33.4	27.7	25.0	24.9
Debt/Non-sales-adjusted EBITDA (x)	18.1	16.3	19.3	19.3	18.1
Non-sales-adjusted EBITDA/interest coverage(x)	1.6	2.0	1.6	1.7	1.8

a--Actual. e--Estimate. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario.

Ratings Score Snapshot

Table 2

Aster Group--Ratings Score Snapshot

	Assessment
Enterprise risk profile	3
Industry risk	3
Regulatory framework	3
Market dependencies	3
Management and Governance	3
Financial risk profile	3
Financial performance	4
Debt profile	3
Liquidity	2

S&P Global Ratings bases its ratings on nonprofit social housing providers on the seven main rating factors listed in the table above. S&P Global Ratings' "Methodology For Rating Public And Nonprofit Social Housing Providers," published on June 1, 2021, summarizes how the seven factors are combined to derive each social housing provider's stand-alone credit profile and issuer credit rating.

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | General: Methodology For Rating Public And Nonprofit Social Housing Providers, June 1, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Related Research

- Social Housing Outlook 2022: Green Agenda Takes Root In Investment Plans, Nov. 23, 2021
- How U.K. Public Finance Sectors Fare Under Latest Spending Review, Nov. 11, 2021
- United Kingdom 'AA/A-1+' Ratings Affirmed; Outlook Stable, Oct. 22, 2021
- Global Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers Published, June 8, 2021
- Building Up Debt: U.K. Social Housing Sector Braces Itself For Borrowing, March 16, 2021
- ESG Industry Report Card: Public And Nonprofit Social Housing Providers Outside The U.S., Aug. 4, 2020

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Aster Group Ltd.		
Issuer Credit Rating	A+/Negative/--	A+/Stable/--
Ratings Affirmed		
Aster Treasury PLC		
Senior Secured	A+	

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support

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