Research Update:

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

December 16, 2022

Overview

- We expect English social housing provider Aster Group Ltd. (Aster) to maintain solid financial metrics through the three-years forecast horizon, reflecting the delivery of new units and efficient cost controls.
- However, we forecast that Aster will increase its debt burden as it continues to implement an ambitious development program in the higher interest rate environment.
- Inflationary pressures and recent mergers with Cecil & Central Housing Trust (CCHT) and Enham Trust could weaken Aster's financial performance, given the elevated cost base and investment needs related to existing properties.
- We therefore affirmed our 'A+' ratings on Aster. The outlook remains negative.

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Rating Action

On Dec. 16, 2022, S&P Global Ratings affirmed its 'A+' long-term issuer credit rating on Aster Group Ltd. The outlook remains negative. At the same time, we assigned our 'A-1' short-term issuer rating to 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. We further assigned our 'A-1' short-term rating to Aster Treasury PLC's commercial paper program.

Outlook

The negative outlook reflects that Aster's credit metrics could deteriorate beyond our current expectations, as well as the risks associated with our ratings on the U.K.

Aster's credit metrics could weaken, for example, due to additional investments in existing assets and new development, rising inflationary pressure on its cost base, and challenges associated with the integration of recently acquired subsidiaries.

Downside scenario

We could downgrade Aster if, over the next 24 months, the challenges mentioned above result in a weaker debt burden, such that debt rises to above 20x of non-sales EBITDA while interest cover doesn't improve in line with our current projections.

We could also lower the ratings if the U.K. sovereign ratings are lowered, or if we consider that the likelihood of extraordinary support has diminished.

Upside scenario

We could revise the outlook to stable if management's actions to contain cost pressures were more effective than we currently forecast. This would result in a faster and more pronounced recovery to the group's financials. This scenario would also require our ratings on the U.K. to stabilize.

Rationale

The affirmation of the rating reflects our view that Aster has a balanced approach to risk, allowing it to maintain solid financial metrics. We believe that the group is well positioned to cope with inflationary pressures, rising interest rates, and increased investment in existing properties. Nevertheless, its elevated debt burden and relatively large development for sales activities, constrain the ratings on the group.

Aster operates mostly in southwest and southeast England, which we consider a relatively affluent region with strong demand for the group's services. It derives much of its revenue from low-risk and countercyclical social housing rental activities. Aster currently owns and manages close to 36,000 units, having expanded by 14% since 2019, which we consider quite fast compared with other groups of its size. This increase reflects both organic growth through continued development as well as its recent business combinations with three smaller entities.

Reflecting both the local housing shortage and effective management of its stock, the group's vacancy rates averaged around 1% of rent and service charges over the past three years, slightly lower than the sector's average of 1.5%. A low social and affordable rent-to-market rent ratio, which we estimate to be around 60%, further supports demand for Aster's units.

Although most of Aster's activities are focused on its social mission to provide homes at lower-than-market rents, Aster also develops properties for sale. We think this exposes the group to market volatility and to higher risks related to the real estate development sector. We forecast that Aster's sales income, including that generated through joint ventures, will remain sizable at close to one-third of total revenue. Historically the group has mostly developed units for shared ownership, but it is set to engage in open market sales.

Aster has a stable senior leadership team and good track record of sound financial management. We think that Aster's sound risk management practices, including extensive stress tests and clear and realistic mitigations, could help the group to weather upcoming challenges. These include inflationary pressures; an ambitious development plan including expansion in London; the integration of weaker organizations; and rising cost of debt, which could stretch the group's financial and management capacity.

Since 2020, Aster has completed three business combinations, which adds risk and potential complexity to its operations. Even though this is consistent with the group's strategy to expand its asset base and broaden its social impact, with less debt-funding required, the combinations are likely to drag on Aster's financial performance. All three entities are focused on lower margin activities, mainly supported housing and care, and are financially weaker than Aster.

We forecast that the group's adjusted EBITDA margins will remain below 30% in the coming three years, but to a level which we consider solid compared with the sector average. This reflects Aster's ambitious target for all its social housing units to obtain Energy Performance Certificate C by 2025, which will increase related spend through the forecast years. We understand Aster's increased spend also relates to catch up works due to disruption during the pandemic years and to address fire and building safety remediations at some of CCHT's properties. We expect margins to gradually improve through the base-case period, as new units are delivered, and one-off costs related to catching up on repairs and mergers fall away.

Near-term weakening of Aster's adjusted nonsales EBITDA will pressure the group's currently solid debt metrics. We forecast that the group's debt metrics will slightly weaken over the coming two years but recover thereafter. As the group progresses with 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. Aster's debt is mainly long term and bears fixed-interest rates, which to some extent limits the group's exposure to the risk of rising interest rates.

We assess the regulatory framework under which registered providers of social housing in England operate as strong (for more information see "Global Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers," published June 8, 2021).

We see a moderately high likelihood that Aster would receive timely extraordinary government-related support in case of financial distress. This leads us to apply a one-notch uplift to the stand-alone credit profile (SACP) to derive the issuer credit rating. As one of the key goals of the Regulator of Social Housing (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 consider Aster's liquidity position as a credit strength and anticipate that sources of funding will cover uses by a comfortable 1.8x over the next 12 months. We also assess Aster's access to external liquidity as satisfactory, underpinned by 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 £150 million;
- Current cash balances of close to £100 million;
- Undrawn committed lines of about £230 million that are contracted and mature after 12 months;
- Retained and secured bonds of £90 million; and
- Capital grants, receipts from fixed-asset sales, and other inflows of around £60 million.

Uses of liquidity over the same period include:

- Capex of about £280 million; and

- Interest and maturing debt repayments of £57 million.

Key Statistics

Table 1

Aster Group Ltd. --Key Statistics

	--Year ended March 31--				
Mil. £	**2021a**	**2022a**	**2023bc**	**2024bc**	**2025bc**
Number of units owned or managed	32,729	35,068	36,285	37,462	38,298
Adjusted operating revenue	224.0	240.3	288.2	346.6	345.7
Adjusted EBITDA	74.9	63.9	65.8	79.2	90.6
Non-sales adjusted EBITDA	70.3	57.8	58.2	67.4	81.8
Capital expense	146.1	190.8	230.8	304.8	300.4
Debt	1144.7	1099.0	1178.0	1305.1	1401.9
Interest expense	35.1	35.4	37.5	42.9	48.6
Adjusted EBITDA/Adjusted operating revenue (%)	33.4	26.6	22.8	22.8	26.2
Debt/Non-sales adjusted EBITDA (x)	16.3	19.0	20.3	19.4	17.1
Non-sales adjusted EBITDA/interest coverage(x)	2.0	1.6	1.6	1.6	1.7

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 Ltd.--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	4
Liquidity	2

S&P Global Ratings bases its ratings on non-profit 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: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- 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

- United Kingdom, Oct. 24, 2022
- United Kingdom Outlook Revised To Negative On Rising Fiscal Risks; 'AA/A-1+' Ratings Affirmed, Sept. 30, 2022
- Economic Outlook U.K. Q4 2022: Under The Pump, Oct. 3, 2022
- Non-U.S. Social Housing Sector Outlook 2023: The Most Negative Bias Since 2018 Implies Significant Pressure On Ratings, Dec. 1, 2022
- Inflation To Erode The Performance Of U.K. Public Finance Sectors, Nov. 29, 2022
- Cap On Rent Increases Is Consistent With Our Base Case For English Social Housing Providers, Nov. 17, 2022
- The U.K. Social Housing Sector Now Displays A More Pronounced Negative Bias In Its Creditworthiness, Oct. 11, 2022
- Launch Of Rent Cap Consultation Adds Uncertainty To Creditworthiness Across English Housing Sector, Sept. 1, 2022
- Rated U.K. Social Housing Providers' Creditworthiness Could Suffer If The Gap Between Rent And Cost Increases Persists, Aug. 1, 2022
- Non-U.S. Social Housing Providers Ratings Risk Indicators: July 2022, July 27, 2022
- Non-U.S. Social Housing Providers Ratings History: July 2022, July 27, 2022
- Non-U.S. Social Housing Providers Ratings Score Snapshot: July 2022, July 27, 2022
- U.K. Social Housing Sector Borrowing Needs To Rise To Fund Investment In New Homes, March 31, 2022
- Global Regulatory Framework Report Card: Public And Nonprofit Social Housing Providers, June 8, 2021

Ratings List

New Rating		
Aster Treasury PLC		
Commercial Paper	A-1	
Ratings Affirmed		
Aster Treasury PLC		
Senior Secured	A+	
Ratings Affirmed; New Rating		
	To	**From**
Aster Group Ltd.		
Issuer Credit Rating	A+/Negative/A-1	A+/Negative/--

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 Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; or Stockholm (46) 8-440-5914