Research Update:

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

December 18, 2020

Overview

- Continued investments in existing properties and lower margins on sales will somewhat weaken Aster Group Ltd.'s (Aster's) profitability, although S&P Global Ratings-adjusted EBITDA margins are expected to remain about 30% on average.
- Gradually improving EBITDA and a proactive asset disposal program will help finance Aster's large development plan and relieve pressures on its debt burden.
- We are therefore affirming our 'A+' long-term issuer credit rating on Aster.
- The stable outlook reflects our expectation that Aster's management will retain solid performance despite rising maintenance costs and investment in new and existing properties. Also, we expect the management to restrain its exposure to development for sale, which is set to increase post-pandemic. We anticipate this will support adjusted EBITDA margins of around 30%.

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Rating Action

On Dec. 18, 2020, S&P Global Ratings affirmed its 'A+' long-term issuer credit rating on U.K.-based social housing provider Aster Group Ltd. (Aster). The outlook is stable.

We also affirmed our 'A+' issue rating on the £450 million senior secured bond issued by Aster Treasury PLC, the fully owned finance subsidiary of Aster.

Rationale

One or more of the credit ratings referenced within this article was assigned by deviating from S&P Global Ratings' published criteria. We think that significant exposure to sales activities limits visibility and predictability of future earnings in a way not typically seen with a traditional housing association providing mainly social rent properties. In our view, exposure to sales activities reduces the ability to withstand external risks. We therefore deviate from our "Criteria - Governments - General: Methodology For Rating Public And Nonprofit Social Housing Providers," published Dec. 17, 2014, on RatingsDirect, when assessing the industry risk for housing associations that generate more than one-third of their revenue from market sales. We do this by blending S&P Global Ratings' industry risk assessment for social housing providers, and that for homebuilders and real estate developers, in line with the "Criteria - Corporates - Industrials: Key Credit Factors For The Homebuilder And Real Estate Developer Industry," criteria published Feb. 3, 2014. For more information see "Credit FAQ: How S&P Global Ratings Assesses Industry Risk For English Social Housing Providers," published Aug. 6, 2018.

Aster's development strategy includes a large portion of sales-related activities, in particular on its shared ownership. Although this is consistent with its social mission of providing more homes for the population in its region, this activity entails higher risks. In our view, the industry risk for U.K. social housing entities with a higher reliance on sales activities, particularly outright sales and first-tranche shared ownership sales, is higher than that of entities with a relatively higher share of revenue coming from the general needs business segment. Overall, we consider Aster's management to be experienced with regards to its social housing activities. The gradual transition toward more sales activities, including joint ventures, exposes the group to market volatility, indicating higher risk tolerance.

Similar to our expectations for other English housing associations, we believe there is a moderately high likelihood that Aster would receive extraordinary support in case of financial distress. This provides a one-notch uplift from the stand-alone credit profile. Aster's primary purpose is to provide affordable homes, supporting important policy objectives of the U.K. government. We consider that the Regulator of Social Housing (RSH), a government agency, regulates Aster to promote a viable, efficient, and well-governed social housing sector, and maintain lender confidence and low funding costs across the sector. It is therefore our view that the RSH would step in to prevent a default in the sector, based on its record of being willing and able to provide extraordinary support on a timely basis.

We consider that Aster's social and affordable rent is about 65% of average market rent in the region. However, we think that demand for Aster's properties will remain strong, evidenced by low vacancy rates of just under 1% and supported by higher than national population growth. Gross arrears have been relatively high, at more than 6% of rent and service charge receivables, and we expect this will continue because of the pandemic's likely impact on Universal Credit applications.

Aster's average property age is around 40 years, and its gradually decreasing average age reflects recent development, with over 20% of the stock having been developed in the past 10 years. We think that increased repair costs and the shift toward more sales activities weigh on S&P Global Ratings-adjusted EBITDA margins, which we expect to average 31% through financial year (FY) ending March 31, 2023. Aster 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 timeframe. We think this could allow for some flexibility in managing spend on existing properties, and view this proactive approach positively.

We forecast that Aster's nominal debt will increase, as the group progresses with delivering a large development program of over 3,000 units through FY2023, of which around two-thirds would be designated for general needs rent. We expect the debt burden will peak in FY2021, at which point debt to EBITDA will reach about 18x, before decreasing thanks to improved EBITDA. In our view, capital needs will be partly covered by internally generated cash flow, including sales income and proceeds from Aster's active voids disposal program. Despite the increase in debt, we expect adjusted EBITDA-to-interest cover, including and excluding sales, will remain solid. We view positively Aster's financial policies--including a prudent liquidity framework--which account for securing funding considerably ahead of development spend.

Liquidity

We consider Aster's liquidity position as positive and anticipate that sources of funding will cover uses by about 1.8x over the next 12 months. We see Aster's access to external liquidity as satisfactory, supported by the outstanding bond issued by Aster Treasury PLC and a pool of existing lenders.

Sources of liquidity over the next 12 months include:

- Internally generated cash flow of about £115 million;
- Current cash and liquid investments of about £90 million;
- Undrawn committed lines of about £340 million that are contracted and mature after 12 months;
- Grants and other receipts of just under £20 million; and
- Fixed asset sales receipts of about £20 million.

Uses of liquidity over the same period include:

- Capital expenditure of about £220 million; and
- £110 million of debt and principal payments.

Outlook

The stable outlook reflects our expectation that Aster's management will retain solid performance despite rising maintenance costs and investment in new and existing properties. Also, we expect the management to restrain its exposure to development for sale, which is set to increase post-pandemic. We anticipate that this will support adjusted EBITDA margins of around 30%.

Downside scenario

We could take a negative rating action on Aster if exposure to sales-related activities increased beyond our current base-case expectation, or if investments in existing assets are much higher than we expect. We think this could lead to pressure on the group's adjusted EBITDA, such that margins fall below 30% on a sustained basis and Aster's debt metrics weaken.

The ratings could also come under pressure if there were renewed pressure on our U.K. sovereign credit ratings, or if we saw a decreased likelihood of timely extraordinary support from the U.K. government.

Upside scenario

We could consider an upgrade if Aster substantially scaled back its development program, such that risk exposure to market sales and the need for debt funding decreased. This would likely have a positive impact on the group's profitability and debt burden.

Key Statistics

Table 1

Aster Group Ltd. Key Statistics

	--Year ended March 31--				
(Mil. £)	2019a	2020a	2021bc	2022bc	2023bc
Number of units owned or managed	30,791	32,039	32,548	33,875	34,845
Revenue§	211.7	214.3	192.4	246.0	270.9
Share of revenue from sales activities (%)	21.0	21.8	13.8	25.5	28.4
EBITDA§†	71.4	65.0	64.6	74.8	81.5
EBITDA/revenue §†(%)	33.7	30.3	33.6	30.4	30.1
Capital expense†	165.4	186.1	185.4	235.5	231.3
Debt	946.6	1,042.3	1,174.2	1,202.9	1,292.9
Debt/EBITDA §†(x)	13.3	16.0	18.2	16.1	15.9
Interest expense*	32.8	35.1	38.8	41.6	43.7
EBITDA/interest coverage§†* (x)	2.2	1.8	1.7	1.8	1.9
Cash and liquid assets	132.0	148.1	173.1	96.3	93.1

*Including capitalized interest. §Adjusted for grant amortization. †Adjusted for capitalized repairs. a--Actual. e--Estimate. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. N.A.--Not available.

Ratings Score Snapshot

Table 2

Aster Group Ltd.

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S&P Global Ratings bases its ratings on non-profit social housing providers on the eight main rating factors listed in the table above. S&P Global Ratings' "Methodology For Rating Public And Nonprofit Social Housing Providers," published on Dec. 17, 2014, summarizes how the eight factors are combined to derive each social housing provider's stand-alone credit profile and issuer credit rating. For social housing providers generating more than a third of its consolidated revenues from open market sales, we also refer to the "Key Credit Factors For The Homebuilder And Real Estate Developer Industry."

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Governments | General: Methodology For Rating Public And Nonprofit Social Housing Providers, Dec. 17, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Homebuilder And Real Estate Developer Industry, Feb. 3, 2014
- 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

- Global Social Housing Ratings Risk Indicators: December 2020, Dec. 10, 2020
- Global Social Housing Ratings Score Snapshot: December 2020, Dec. 10, 2020
- Outlook 2021: Strong Liquidity Should Help Social Housing Providers Remain Resilient, Dec. 8, 2020
- United Kingdom 'AA/A-1+' Ratings Affirmed; Outlook Stable, Oct. 23, 2020
- ESG Industry Report Card: Public And Nonprofit Social Housing Providers Outside The U.S., Aug. 4, 2020
- U.K. Social Housing Providers Should Remain Largely Resilient To Short-Term Economic Difficulties From COVID-19, April 23, 2020
- COVID-19: Emerging Market Local Governments And Non-Profit Public-Sector Entities Face Rising Financial Strains, April 6, 2020

Ratings List

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

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; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.