S&P Global Ratings

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Research Update:

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

December 18, 2019

Overview

- On Dec. 17, 2019, S&P Global Ratings revised the outlook on the unsolicited 'AA' long-term ratings on the U.K. to stable from negative.
- Given's Aster Group Ltd.'s (Aster's) potential option to increase rents from April 2020 and the contained share of sales activities development, we anticipate EBITDA margins will remain above 30% and strengthen from April 2020.
- We are therefore revising our outlook to stable and affirming our 'A+' long-term issuer credit rating on Aster.
- The stable outlook reflects our view that exposure to sales-related activities will be contained.

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Rating Action

On Dec. 18, 2019, S&P Global Ratings revised its outlook on U.K.-based social housing provider Aster Group Ltd. (Aster) to stable from negative. At the same time, we affirmed our 'A+' long-term issuer credit rating.

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.

The outlook revision reflects the outlook revision on the U.K. sovereign credit rating "United Kingdom Outlook Revised To Stable; 'AA/A-1+' Ratings Affirmed", published Dec. 17, 2019. Aster's development strategy includes an increased 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. We note that Aster's development plan includes an expansion eastward from its main region in the southwest of England. Overall, we consider Aster's management to be experienced in the sector and risk averse with regard to its social housing portfolio. The gradual transition toward more sales activities, however, weighs negatively on our assessment because management has less experience dealing with these activities and the related exposure to market volatility. In our view, the shift toward sales activities indicates a higher risk tolerance.

We note that spending on maintenance indicates that properties are generally well maintained, exemplified by the average technical property age of 41 years. The decreasing average age of properties also reflects recent development--20% of the stock has been developed in the past 10 years. The financial performance of the stock has gradually decreased with the shift toward more sales activities, however, we expect EBITDA margins to bottom out in fiscal 2020 at 31.8%. They should then increase, supported by the removal of a government-imposed rent cut in 2020, for an average EBITDA margin of 33.1% until year-end fiscal 2022. Including Aster's exposure in joint ventures, the margin falls to slightly below 30% with an expected average EBITDA margin of 28.9% in the same period.

We expect the debt trajectory to follow the same trend as margins. We believe the debt burden will peak in fiscal 2020, at which point debt to EBITDA will reach 14.9x. We forecast that Aster will develop 2,908 units from April 2019 to year-end fiscal 2022, with capital needs partly covered by cash flows, including proceeds from the sale of new and existing properties, and additional borrowing needs of about £70 million a year. Although debt continues to increase as a result of development beyond 2020, we expect EBITDA to increase faster, resulting in slowly decreasing debt to EBITDA. We note that Aster takes a conservative approach to interest-rate risk, with only 12% of its debt portfolio exposed to interest rate changes.

In our view, Aster's creditworthiness benefits from a moderately high likelihood that the U.K. government--working through the Regulator of Social Housing (RHS)--would provide timely and sufficient extraordinary support in the event of financial distress. Therefore, the final rating on Aster is one notch above its stand-alone credit profile (SACP). In our view, Aster has an important role in providing housing, and a strong link with the RSH. We base this view on Aster's important role for the U.K. government and its public policy mandate and strong link with the U.K. government, demonstrated by the government's track record of providing strong credit support to the sector in certain circumstances.

Liquidity

We assess Aster's liquidity as very strong and anticipate that sources of funding will cover uses by more than 2.3x over the next 12 months, in line with our previous expectations.

Sources of liquidity over the next 12 months include:

- Cash flow from operations of £77 million;
- Cash and liquid investments of about £104 million;
- Undrawn committed lines about £264 million that are contracted and mature after 12 months; and
- Proceeds from asset sales.

Uses of liquidity over the same period include:

- Capital expenditure of about £167 million; and
- £37 million of debt and principal payments.

Outlook

The stable outlook reflects our expectation that Aster will contain its share of total revenue coming from sales-related activities to about one-third. We therefore anticipate Aster will maintain EBITDA margins above 30%, before rising from April 2020 when a rent freeze comes to an end.

Downside scenario

We could take a negative rating action on Aster if exposure to sales-related activities increased beyond our current base-case expectation. This could lead to pressure on either EBITDA margins or Aster's liquidity.

The ratings could also come under pressure over the next two years if there is renewed pressure on our U.K. sovereign credit ratings. In addition, we could lower the rating on Aster if we believed that the likelihood of timely extraordinary support from the U.K. government were to decrease.

Upside scenario

We could raise the rating if management took active steps to decrease financial risk by decreasing the proportion of market-related activities structurally below one-third of total revenue.

Key Statistics

Table 1

Aster Group Ltd. Selected Indicators

	--Year ended March 31--				
(Mil. £)	**2018a**	**2019a**	**2020e**	**2021bc**	**2022bc**
Number of units owned or managed	29,912	30,791	31,699	33,019	33,699
Revenue§	204.5	211.7	207.8	240.0	225.5
Share of revenue from sales activities (%)	18.2	21.0	17.8	24.7	15.2

Table 1

Aster Group Ltd. Selected Indicators (cont.)

	--Year ended March 31--				
(Mil. £)	2018a	2019a	2020e	2021bc	2022bc
EBITDA§†	67.5	71.4	66.2	77.2	79.8
EBITDA/revenue §†(%)	33.0	33.7	31.8	32.2	35.4
Capital expense†	158.1	160.0	167.4	144.5	159.4
Debt	864.7	945.2	987.3	1,028.4	1,097.6
Debt/EBITDA §†(x)	12.8	13.2	14.9	13.3	13.7
Interest expense*	30.6	32.9	31.9	33.3	35.1
EBITDA/interest coverage§†* (x)	2.2	2.2	2.1	2.3	2.3
Cash and liquid assets	101.1	132.0	97.2	80.3	81.3

§Adjusted for grant amortization. †Adjusted for capitalized repairs. *Including capitalized interest. 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. Ratings Score Snapshot

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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: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- United Kingdom Outlook Revised To Stable; 'AA/A-1+' Ratings Affirmed, Dec. 17, 2019
- The State Of Social Housing: Is The English Model Catching On?, July 25, 2019

Ratings List

Ratings Affirmed; Outlook Action

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