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## Research Update:

# UK-Based Housing Association Aster Group Outlook Revised To Negative; 'A+' Ratings Affirmed

### Primary Credit Analyst:

Dennis Nilsson, Stockholm (46) 8-440-5354; dennis.nilsson@spglobal.com

### Secondary Contact:

Eileen X Zhang, CFA, London (44) 20-7176-7105; eileen.zhang@spglobal.com

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## Research Update:

# UK-Based Housing Association Aster Group Outlook Revised To Negative; 'A+' Ratings Affirmed

## Overview

- We project that U.K.-based Aster Group will increase its development of shared-ownership and outright sales, partly carried out via joint ventures over the coming three years.
- We view these activities as higher risk than traditional social housing activities, with increased exposure potentially resulting in less predictable revenues and lower margins.
- We are therefore revising our outlook on Aster to negative from stable and affirming our 'A+' rating.
- The negative outlook reflects both that on the U.K. and our view that risks associated with increased sales related activities could increase over the next 24 months.

## Rating Action

On Dec. 17, 2018, S&P Global Ratings revised to negative from stable its outlook on U.K.-based social housing provider Aster Group Ltd. 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 the Aster Treasury PLC, the fully owned finance subsidiary of Aster Group Ltd.

## 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 "Methodology For Rating Public And Nonprofit Social Housing Providers," published on Dec. 17, 2014, on RatingsDirect when assessing the industry risk for housing associations that generate more than one third of their revenues from market sales. We do this by blending S&P Global Ratings' industry risk assessment for social housing providers (2), and that for

homebuilders and real estate developers (4) in line with the "Key Credit Factors For The Homebuilder And Real Estate Developer Industry" criteria published on Feb. 3, 2014. For more information see "Credit FAQ: How S&P Global Ratings Assesses Industry Risk For English Social Housing Providers," published on Aug. 6, 2018.

We believe that the industry risk for U.K. social housing entities with a high and increasing reliance on sales activities, particularly outright sales and first-tranche shared ownership sales, has structurally increased. The expected increase in revenues over the coming years from Aster's market-related activities reflects a sector-wide shift resulting from a reduction in grants and strong demand for housing in areas where housing associations operate. As a result, we have revised down our assessment of Aster's enterprise profile, consequently also revising down its stand-alone credit profile (SACP) to 'a' from 'a+'.

Surpluses from outright sales and shared-ownership first-tranche sales are used to cross-subsidize social housing development. However, unlike traditional rental activities, these sales activities expose housing associations to the cyclicity of the residential property development sector and potentially more volatile revenues. We believe that Aster's ambitious development program for the next three years will see its sale-related activities, such as shared ownership and open market sales (including its share of joint ventures, via which most of the outright sales are made), exceed one-third of revenues. While this will allow Aster to develop more homes, it increases the risk profile of its business, with typical underlying demand drivers--consumer confidence, disposable income, employment levels and growth, as well as interest rates and the availability of mortgage loans for properties for sale-- heightening revenue volatility. This is demonstrated by the recent fluctuations in U.K. housing prices compared with the stable nature of rental income.

We continue to assess Aster's economic fundamentals as strong, with its operations in the southwest of England benefitting from high demand for its services. Population growth is limited, at 0.7% annually on average. Aster maintains low rents for its social and affordable housing properties compared with market rents, serving its social purpose and enjoying high demand for its properties. However, we estimate that gross arrears will be over 6% of rental revenues in the coming years, with the rollout of Universal Credit weighing negatively on profitability.

Overall we consider that Aster's management is experienced in the sector and risk averse with regards to the 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, or the related exposure to market volatility.

We expect Aster will maintain healthy EBITDA margins of over 35% on average for the coming three years, excluding exposure to open market sales in JVs. Increased shared-ownership first-tranche sales drag on margins, but we expect

they will remain contained at this level. Including Aster's share in JVs in our calculations, we estimate EBITDA margins will average 31.6% until end of March 2021, due to the lower-margin nature of open market sales carried out by JVs. We forecast that the strong performance, in EBITDA terms, in social-housing lettings will cover interest payments by 1.8x over the coming three years, supported by the removal of a government-imposed rent cut in 2020 that allows a rent increase of the consumer price index plus 1% annually from April 2020.

We project debt will decrease over the coming years, despite Aster's ambitious development plan, with debt to EBITDA expected to decrease to 9x by end of 2021 compared with 9.9x by end of 2018. We forecast that Aster will develop 2725 units by the end of 2021, with capital needs largely covered by cash flows, including proceeds from the sale of new and existing properties, with limited need for additional borrowing.

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 to Aster in the event of financial distress. Therefore, the final rating on Aster is one notch above its 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 its 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 2x 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 £74 million;
- Cash and liquid investments of about £130 million;
- Undrawn committed lines about £173 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 £110 million; and
- £95 million of debt and principal payments.

## Outlook

The negative outlook on Aster reflects our view that exposure to sales-related activities could increase beyond our current base-case expectation. This could, for example, lead to increasing financial risks in the coming 24 months, either because of weakening EBITDA margins or pressure on Aster's strong liquidity position.

The negative outlook also reflects the outlook on the U.K. We could lower the rating if we were to lower our sovereign credit rating on the U.K. or if we revised downward our view of the likelihood of extraordinary support to Aster from the U.K. government in the event of financial distress.

We could revise the outlook to stable if we the proportion of market related activities levelled out, containing financial risks, and if the outlook on the sovereign rating on the U.K. was stable.

**Table 1**

Aster Group Key Statistics					
	--Year ended March 31--				
(Mil. £)	2017a	2018a	2019bc	2020bc	2021bc
Number of unites owned or managed	29,219	29,912	30,826	31,552	32,206
Vacancy rates (% of rent net of identifiable service charge)	0.7	1.0	N.A.	N.A.	N.A.
Arrears (% of rent net of identifiable service charge)*	5.3	7.3	N.A.	N.A.	N.A.
Revenue§	190.4	204.5	210.6	212.2	225.9
Share of revenue from nontraditional activities (%)	21.4	26.2	37.5	38.1	43.5
EBITDA†	78.6	67.8	76.2	73.5	82.3
EBITDA/revenue (%)	41.3	33.2	36.2	34.6	36.4
Interest expense	30.4	30.7	34.4	35.5	35.3
Debt/EBITDA (x)	10.5	12.8	12.2	12.7	11.0
EBITDA/interest coverage** (x)	2.6	2.2	2.2	2.1	2.3
Capital expense‡	107.8	158.1	136.1	96.1	81.1
Debt	821.5	866.8	931.2	933.3	902.5
Housing properties (according to balance sheet valuation)	1,386.2	1,490.5	1,576.8	1,630.3	1,668.2
Loan to value of properties (%)	59.3	58.2	59.1	57.2	54.1
Cash and liquid assets	108.9	101.1	131.7	131.6	122.4

\*Rent and service charge arrears. §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	
Industry Risk	3

**Table 2**

<b>Aster Group Ltd. Ratings Score Snapshot (cont.)</b>	
Economic fundamentals and market dependencies	3
Strategy and management	3
Asset quality and operational performance	2
Enterprise profile	3
Financial performance	4
Debt profile	3
Liquidity	2
Financial policies	2
Financial profile	3

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: 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: Group Rating Methodology, Nov. 19, 2013
- 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

- Countdown to Brexit: No Deal Moving Into Sight, Oct. 30, 2018
- Ratings On The United Kingdom Affirmed At 'AA/A-1+'; Outlook Remains Negative, Oct. 26, 2018
- U.K. Social Housing Providers To Borrow £12 Billion Of New Debt By 2020, Total Debt to Reach £89 Billion, March 7, 2018
- New Rent Policy Brings Relief, But No Big Boost To The Credit Standing Of U.K. Housing Associations, Jan. 31, 2018
- Global Social Housing Risk Indicators: January 2018, Jan. 30, 2018
- U.K. Social Housing Scenario Analysis: What Could Happen To Ratings In A Market Downturn? Sept. 25, 2017

## Ratings List

Outlook Action/Ratings Affirmed

	To	From
Aster Group Ltd. Issuer Credit Rating	A+/Negative/--	A+/Stable/--

Ratings Affirmed

Aster Treasury PLC Senior Secured [1]	A+
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Dependent Participant(s): Aster Group Ltd.

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](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://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; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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