Third Sector Partnerships for Service Delivery

English Housing Mergers and Groups

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Case Study Summary

One: Context

The English housing association sector has an extensive and well documented history of merger. Between 1976 and 1998 around 1% of associations a year disappeared through merger. There were 3 spikes in mergers associated with disturbances in the external environment (public funding in 1974, private funding in 1988/9 and taxation changes in 1996/7). Between 2002 and 2010 43% of all associations and 90% of larger associations with above 10,000 homes were involved in mergers or groups. There was a further spike associated with the Investment Partnering (IP) procurement policy which concentrated new funding on just over 70 IP leads of the 400 or so developing associations. The average housing stock of associations doubled from 955 in 2002 to 1816 in 2010. The market share of the largest 20 associations increased from 26 in 2002 to 30% in 2010. The largest associations now have over 50,000 homes. This case study updates this analysis and explores factors affecting mergers and groups after the credit crisis of 2008. Not only did this further 'external disturbance' reduce the number of new mergers and groups but it also inhibited the process of 'group streamlining' into simpler more integrated structures that had been occurring before 2008.

[Graph and Tables available for slides – see full report]

Two: Types of partnership and collaboration

While the main focus of this case study was on mergers and groups the opportunity was taken to review the other main types of partnership that are currently prevalent in the housing sector and how these options interact with mergers. This provided a more dynamic picture than would have emerged from focusing only on one partnership form. One important new trend was for a formerly 'insular' sector to engage in cross-sector partnerships arising from the vertical supply chain approaches emerging in the commissioning of wider public services of relevance to housing. Another growing trend was for financially driven collaboration to secure procurement savings, to form contractor consortia to bid for public contracts, and more recently to share back office and other services. The shared services option was hitting a VAT barrier not encountered by group structures (cost savings needed to exceed 20% to break-even). The sector was lobbying HMRC to remove this barrier to combining efficiency with independence.

In some cases other forms of collaboration were seen as an alternative to merger preserving a greater degree of independence. However, in other cases there was a sense that 'one thing leads to another' with members of some procurement consortia moving on to fuller collaboration within group structures to maximise savings. One interviewee explained: '*We wished to go beyond the group procurement that had been possible within the IP consortium. The consortium was a stepping stone to the group structure'.*

The housing sector has a long history of contract based joint work with private house builders but this has rarely been more than transactional with limited trust or shared values. Place based partnerships with the public sector and other third sector organisations have been important for some housing organisations but involvement in Total Place and community budgeting type partnerships has been quite limited especially for large housing associations with widely distributed housing stock. There were some signs that this form of partnership might grow in the future as a response to diminished public spending and the need for shared services. Some associations were seeking opportunities to provide services for public sector bodies drawing on their core competences in property development and management and facilities management. One interviewee said '*This is more about widening the range of partners than widening the range of products we provide'.*

[Table of collaboration forms other than mergers and groups available – see full report]

Three: Drivers of and barriers to partnership and collaboration

The case studies confirmed the importance of the 2004 Investment Partnering procurement policy as the strongest external driver for consortia and subsequent mergers. However, they also revealed the relatively low level of prescription of this policy compared, for example, with the more recent procurement groups in Northern Ireland. It had been possible for IP consortia members to exit and move to another consortium, and relatively small associations had been able to preserve their development role and independence by forming new partnerships such as joint building companies nested within IP consortia. It is therefore not inevitable that associations will move from consortia to group to merger.

The importance of the credit crisis as a barrier to new mergers and to the consolidation of groups into simpler structures was confirmed. New merger activity and group consolidation had been hampered by dramatic changes in bank lending policies which increased borrowing margins significantly (typically from 2 to 3% over LIBOR between 2008 and 2009). Lenders were increasingly keen to use any opportunities to re-price historic loans to the higher current rates. Constitutional changes were being regarded by lenders as material events affecting loan covenants, triggering re-pricing of entire loan portfolios and thereby acting as a considerable deterrent to mergers and restructuring. In one case '*at a stroke the credit crisis put streamlining on hold since lenders would have used the opportunity to re-price the overall loan portfolio, potentially adding £100million interest costs over the life of the business plan'.* There were signs of some changes to this impasse by 2011. While there was little increase in the rate of new mergers, negotiations between groups wishing to collapse their structures and lenders were being resolved in various ways. Some groups had moved to virtual consolidation in which staff were re-organised into single functional divisions while governance structures and asset ownership remained based on parent:subsidiary structures. Some HAs were said to have *'made use of aggressive lawyers to challenge interpretation of loan documents, with a degree of success'* and in some cases *'there is now a sense that they are prepared to do a deal – may be to charge arrangement fees and a hefty upfront payment but to relent on increasing margins over the life of the loan'.* The willingness of associations to pay these lower but still substantial penalties does indicate the scale of the savings that they anticipate will arise from full integration.

Another barrier that some associations experienced to full integration was resistance from subsidiary board members and in some cases local authorities seeking to retain the level of local accountability formerly promised by local subsidiary structures within groups. This proved to be a highly contested theme between the case study interviews, perhaps reflecting different local circumstances, as the following two comments illustrate. In one case '*confirming our approach of retaining locally accountable subsidiaries –they are strongly embedded in local partnerships (LSPs, Childrens Trusts, Safer Communities)- you could not do that with a single centralised structure'.* In the other '*I would argue we are more local today where we choose to concentrate our effort (because we have rationalised out of some areas) than we ever were in the past* '. Perhaps the conflict between efficiency and localism will ultimately be addressed by defining the local as the neighbourhood and by large integrated structures adapting delivery structures to provide a degree of neighbourhood accountability as the following interview comment suggests *'Localism has also had some influence in getting HAs to consider stock rationalisation and moving from 'phony accountability structures' at sub-regional (subsidiary) level to neighbourhood accountability within more centralised overall structures.'*

In summary the main drivers for structural and constitutional changes were associated with the efficiency agenda. However, while the housing programme had been a major casualty of deficit reduction, falling by two thirds, housing association revenue budgets were less affected in the short term than many public services due to national rent policies that maintained their main source of income. Nevertheless, associations were 'spooked' by the wider climate of public spending cuts and anticipating impacts of welfare benefit reforms leading to arguments for full mergers to maximise cost advantages- '*at a time when Government are withdrawing funding we have to find other ways of continuing with the work'.* At the same time there were both financial and political barriers to full integration. Powerful financial disincentives from lenders were preventing or at least slowing the process of mergers and streamlining. Political barriers associated with the removal of subsidiary boards within associations and reducing ties with local authorities were also having an impact, but seemed to be being accommodated by interpretations of 'localism' focused on the neighbourhood level that few association governance structures could directly mirror.

Structures

The case of housing mergers has provided four main types of structures reflecting both organisational values and preferences and in some cases a staged process of restructuring. These structures are presented as 'ideal types' with a fuller description of characteristics in Figure 2 in the full report (summarised here):

- **Preserving independence through collaboration** (procurement consortia and shared services seen as ways to gain some scale economies while maintaining organizational independence, but can be difficult to maintain)
- **Federal structures- the best of both worlds?** (a popular compromise in the housing sector in 1990s but compromised by the regulatory requirement for the parent to be in control and has proved to be fairly unstable).
- **Groups as a staging post** Groups have often been used as a way to achieve mergers: **'***The plan from the outset was to maximise benefits of the merger through integration of functions and streamlining of the structure'.*
- **Integrated unitary organisations** These operate at the far end of a continuum of partnership and alliance options and enable centralised control and target setting and may claim to deliver both business efficiency and community benefit.

Four: Impacts of partnership and collaboration

Users and Outcomes:

Users were rarely involved in setting the outcomes of housing mergers although housing associations are required to produce a business case including intended benefits to users. Users were expected to benefit from greater efficiency and consistency of service delivery across large integrated structures. The main sources of evidence used to assess these claims were service delivery key performance indicators and customer satisfaction surveys. While housing associations have been encouraged by their regulator to develop 'local service offers'; larger merged organisations have tended to stress the similarities in what tenants want across different types of areas and the advantages of a consistent service over local tailoring and that '*top down targets work in delivering consistency'*. There was some evidence that in the current financial and policy climate business cases are tending to play down benefits to tenants '*because the policy landscape is changing –an uncertain future led to avoiding overpromising but aimed to preserve as much as possible of existing service benefits'.* Some landlords were claiming enhanced tenant involvement opportunities and capacities in their merged structures (e.g. customer panels, resident scrutiny, resident involvement in selecting contractors, residents on appointment panels for housing management staff appointments). A key test may be whether users will be more involved in setting the outcomes for future mergers.

Changes within the organisation:

The evidence on efficiency savings arising from mergers and group structures is now much stronger than it was in 2001 when the Audit Commission were unable to find conclusive evidence of cost savings from group structures apart from those associated with corporation tax and procurement. While it is rare for evaluations to be conducted that truly isolate the impacts of merger from other factors such as ongoing efficiency measures that do not require merger, a statement of efficiency savings is now a key element of the business case for merger and for its review (although this is not a regulatory requirement and there is rarely independent external validation of merger savings). Housing organisations are wary of charges of over-promising and under-delivering and tend to report in the opposite manner. A common formula is to recognise the initial costs associated with merger such as consultancy fees, displacement of key staff, redundancies etc and to programme savings for years 3-5. Earlier delivery of savings can then be heralded as exceeding expectations while early integration problems and service dips can be explained as necessary birth pains.

Savings claimed are quite considerable for example two medium sized organisations had each aimed to take £5million out of costs by year 5. In one case following an initial saving of £0.25 million '*There was a further savings target of £4 million p.a. after 5 years by restructuring and job cuts. We are now in YEAR 4 and these savings have been achieved. A new target is to save £6million a year by 2014'.* Sources of savings can be identified ranging from easy wins to those requiring considerable planning and integration to achieve. For example:

- easy= external procurement (e.g. group insurance cover, car fleet, feed-in tariffs)
- pretty easy – executive team consolidation (unless retain entirely federal structure) – but need to watch for grade creep and extra specialists. In one case the cost of executive management was claimed to have fallen by 2/3 in real terms over 10 years by consolidating the executive teams of 13 predecessor organisations into a single unitary structure
- harder = borrowing costs – likely to go up unless avoid restructure – therefore portfolio asset management gains are currently harder to achieve
- harder operational staff restructuring – can be painful and '*don't always lose and keep the right people'.*
- hardest - board restructuring – scene of real blood on the carpet!

There is a strong belief in parts of the sector that fully integrated structures can generate greater savings by consolidating assets and borrowing capacity, by reducing senior management and governance costs and simplifying systems and performance management. But of course full integration is hard to achieve requiring financial, governance and accountability barriers outlined earlier to be overcome and the biggest challenge identified in the private sector mergers literature, of cultural integration.

Merged organisations tend to judge their success through standard performance measures benchmarked against the sector, external symbols of validation such as competitive awards, accreditation, successful funding applications and most of all credit ratings. On all of these areas some organisations would claim that merger has taken them much further than groups of less formal forms of collaboration could have done. In contrast smaller organisations tend to judge success by relationships with communities and local reputation. This may lead to increasing polarisation of the sector in values as well as scale of operations as stock becomes increasingly concentrated under a small number of dominant providers.

Learning from collaboration

The following learning points were mainly concerned with management of the merger process:

- We learned from previous mergers that member buy-in important and able to challenge executive thinking.
- Another important success enabler was bringing together senior and middle managers for joint management development training – good for breaking the ice, sharing ideas on practice and getting early sense of common purpose.
- Avoided use of consultants wherever possible, learned from previous experience.
- Managed to avoid loan repricing by **keeping the loan agreements and security with the existing HA subsidiaries.**
- Take the difficult decisions as early as possible – decisions to do with structure, governance, process and people
- Be more sophisticated about who stayed and who went – sometimes wrong people go
- Its painful 2-3 restructurings since the merger but that happens in large organisations anyway – strengthened the business – staff will agree – we came through the recession stronger.

Five: Future

Since the election, for whatever reason, interest in mergers has 'ratcheted up a notch' across the sector. Interviewees expect to see more mega-mergers over the next few years, The first 100,000 stock housing group may not be too far away. Like the previous cohort these new large scale mergers may take a staged approach via group structures to fuller integration over time. Turning to other forms of partnership. These are expected to continue alongside mergers, it was anticipated that these would continue to be mainly with other housing associations. However, developments in supply chain procurement and community budgeting were expected to lead to some increases in cross-sector partnerships.

Relationships with private housebuilders would continue and with much lower public grant available there would probably be more joint ventures and risk sharing.

Local authorities might be expected to outsource more activities in the face of budget cuts and there is clearly scope for greater local collaboration between providers to maintain local services but there was limited evidence of housing organisations being involved. One area where this might develop in the context of the welfare benefit reforms, including the end of direct payments to landlords is in the area of financial inclusion. Landlords will have a vested interest in developing partnerships with advice agencies, credit unions and other partners to promote financial capability, debt management and savings among their tenants to ensure that rental income is maintained.

Personalisation was also expected to lead to more lateral thinking to provide the services that people want and are willing to pay for.

One change in policy that would promote more shared services would be a relaxation of 20% VAT levied on internal services between group members. Another important policy influence would of course be any softening of lenders policies on re-pricing loans and while there seemed to be some hints of this in our interviews any renewed financial and banking crisis would make this an unlikely scenario.