

Form Follows Function – Summary and toolkit

A framework for housing association boards to use when developing their strategy on partnerships, mergers and acquisitions

Draft – for consultation

Produced by Housing Quality Network

With thanks to Tpas and Anthony Collins Solicitors for their valuable input and advice.

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Why have we produced this toolkit?

RPs are facing a lot of tough challenges with the rent cut, the benefit cap and an uncertain market for home sales. Yet need is not going away. How do you square the circle? Well many RPs are looking at working more closely with others. This could be by way of merger, cost sharing deals or less formal alliances. It's not at all easy to pick the option that is best for you. Our toolkit:

- sets out some key principles for assessing the right way forwards,
- poses some questions that will help you to pick the option that makes sense for you, and
- suggests ways in which tenants can be involved in the process.

It comes off the back of our research that covers:

- an in-depth survey of tenant's views,
- an academic review of mergers in housing and other industries at home and abroad,
- case studies of decisions to merge (and not merge) and form cost sharing vehicles in the UK.

What do we want you to do?

We want your comments so we can get it right. These are big decisions for RPs so it does matter. And we are well aware that a first draft will have flaws that you can help us to correct.

We are keen to get your views on any aspect of it and in particular:

- Do you agree with our six principles?
- Do you agree with our questions for boards?
- Have we picked out the questions that tenants will want to get answers to?
- Is our approach right? Will it spark a balanced and probing debate in the boardroom?

Please address your feedback to HQN by emailing hqn@hqnetwork.co.uk by Friday 18 November.

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Introduction

Rent cuts, welfare reform, Brexit, regulatory action and new homes shortages are driving renewed interest in mergers and other alliances in the housing sector.

Registered providers need to consider how they can support tenants, help tackle shortages, and continue to make efficiency savings. This guide, designed to be read alongside our full report, [\(link\)](#) aims to help organisations take the right decisions in consideration of all the factors, and to carry through those decisions to benefit stakeholders.

Merger may be the right route for some, others will continue to 'stand alone': no single answer will be right for all because each organisation faces its own blend of challenges.

We will also be issuing alongside this:

- a summary of the legal steps and timetables for implementing mergers and alliances by Anthony Collins, and
- a tenant's version of this toolkit so they can make informed contributions to the decision making process

Form and function – getting things the right way round

Our experts – residents and practitioners – have told us that values, culture and service are the starting points. So our approach is to start by looking at what an RP wants to do (its functions) before we get into how it does it (the form). Surely that is the right way round. Staying on your own could be the right answer or merger might be better. It all depends on what you are trying to achieve.

We learnt from residents that in their view critical success factors in deciding your organisation's future include agreement on objectives and clarity of communication, equity between any partners involved, and the addition of value to existing arrangements. From our experts we learnt that culture fit, clarity of vision, focus on outcomes and sheer hard work are key ingredients. A bit of humility goes a long way too.

This practical guide is designed to take RPs through all the necessary steps in deciding their own future, and responding to offers from other RPs. It begins with a summary of our six principles for approaching the issue of merger and partnership, and includes our checklist of 'exam questions' for tackling the practicalities of making and receiving offers.

How to use this toolkit

Why should you use it?

We undertook extensive research looking at:

- How decisions to work together in alliances and partnerships and merge or de-merge get taken in other sectors,

- How these sorts of reviews are working out in housing, and
- What residents think of these deals.

The advice in this toolkit flows from our findings.

Who is it for?

We want boards and executives to use our toolkit to help shape their reviews. There's a lot of change going on and many RPs are looking at new ways of doing things. So it's timely.

The toolkit is for RPs that are in control of their own destiny. Life is challenging but they are not on the rocks. There is a bit of time to take stock and do a review.

We will be bringing out a tenants' version soon. For now we list out the questions tenants are likely to put to you.

You will need to decide who gets involved and at what stage. Of course it is for the board to agree the general approach to making or responding to offers of working with others. Can the executives do an initial sift to see if an offer looks like it may be of interest before it goes any further? And at what stage do you bring in the tenants. We have seen cases where they have been involved from the start. This can work so long as the tenants agree to see things on a confidential basis.

How does it work?

The toolkit is based on a set of questions to help you:

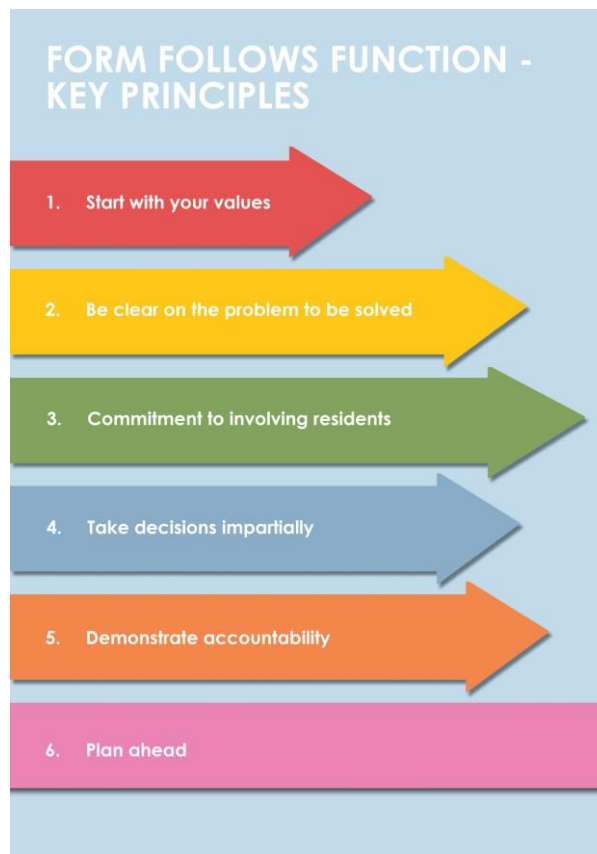
- Firm up on the challenges and opportunities ahead
- Think about what it is you want to do in response
- Determine whether you can do this on your own or in some sort of alliance, and
- Decide what sort of alliance you might need and with whom.

Health warning

This toolkit is for RPs that want to be objective and do the right thing. We do not point you in a specific direction. That's for you to decide. Of course we cannot cover everything and there are limits to what a toolkit can do. You will need to get your own legal and financial advice.

The six principles

Based on all of our research, we have established six principles for organisational review. They are intended to ensure that debate and decisions are taken on the right basis, in the right order.



1. Start with your values

Whatever you do in business you must stick to your values. RPs can use other terms to describe these such as mission, purpose or objectives. It doesn't matter what you call them as long as they set the broad direction of what you want to do.

The key questions are:

- ▮ Are our values up to date?
- ▮ Do they still make sense?
- ▮ Do they capture what you are trying to do?

Now let's consider the context you work in. What do your stakeholders – residents, local communities and staff – think?

- ▮ Are you helping councils to meet need?
- ▮ Are you doing enough for the groups you want to house?
- ▮ Are services up to scratch?
- ▮ Do you build enough homes? And of the right sort?

Once you've dealt with the fundamentals of your values and the competing demands on your organisation, questions on the practicalities become obvious: what actions flow from these values and demands?

- ▮ Can you afford to deliver on them?
- ▮ Should you develop more realistic targets?
- ▮ Could you do more if you linked up with others?
- ▮ Can you make a big enough impact on your own?

Those last two questions are provoking debate in boardrooms across the country.

Your choices will have a significant impact on the form of your RP and the services it offers.

2. Be clear on the problem to be solved – and where the opportunities lie

In Principle 1 you considered the bigger picture. Now it's time to draw up a list of the key practical issues to be resolved. This principle is all about setting the 'exam questions' for your option review (see our checklist starting on Page 9). You'll need to bring a sharp focus to looking at what you want to do, and work quickly.

So what sorts of issues should you try to resolve? Where do the opportunities for your organisation lie? Obvious areas to consider include:

- ▮ Delivering services in the face of cuts
- ▮ Building more homes
- ▮ Boosting borrowing capacity and spreading risk
- ▮ Procuring goods and services on better terms
- ▮ Bringing in innovative IT
- ▮ Eliminating price competition for land between RPs
- ▮ Getting into new business areas.

It all boils down to these big questions:

- ▮ Can you fix things on your own?
- ▮ Do you need to work in a partnership? Or
- ▮ Does it look as if you should be exploring the case for merger?

3. Commit to involving residents

Now is the time to listen to tenants. Some residents do worry about getting lost in a big RP. So they can start out by being sceptical about a merger. On the other hand, some can see the good things like cost savings and more building that a merger might bring. Wisely, there are many “don’t knows”.

We think an RP should:

- ▮ Set out clearly the pros and cons of merger, partnership and other options
- ▮ Identify the concerns of tenants
- ▮ Explain how these will be addressed
- ▮ Give measurable commitments on service delivery and building post-merger.

There are a few judgement calls to make, particularly around the timing of consultation. And can you put a time limit on the process? Is there a risk of a neverendum?

4. Take decisions impartially

Whatever you choose to do, you will have to demonstrate that you did it for the right reasons. This is where our Form Follows Function approach comes into its own. Decisions must be based on:

- ▮ How far an option meets your objectives
- ▮ Facts about current solvency, capacity and performance
- ▮ Reasonable future projections about savings, levels of building and service improvements – tested for stresses
- ▮ Thorough cost/benefit analysis including all costs of transition.

Ensure that you consider all options thoroughly. The National Housing Federation has identified five types of potential structural change. You will need to evaluate each impartially against your values, objectives and current activities.

- Transfer of engagements
- Amalgamation
- Group structures
- Strategic alliance
- Cost-sharing groups.

Of course you can find many examples of mergers that have worked out well. Even with all the uncertainty surrounding Brexit we have still seen £85bn worth of deals in the UK economy so far this year. But you need to tread warily:

- Identify risks and benefits accurately: our literature review ([link](#)) found evidence that a large proportion of mergers and acquisitions across a number of industries fail to deliver expected efficiency gains. Cultural mismatch emerged as a key issue, often not anticipated or actively planned for. Partnerships preserve control systems but may carry transaction costs and be vulnerable to partners pulling out. It's important to consider the question of added value across a range of stakeholders
- Avoid over optimistic modelling: *"We have a good future on our own"* RP chair spurning merger – *"They've no chance, they need to be taken over"* Director of the jilted RP
- Use realistic assumptions – not just those that make the plan work
- Test the resilience of the future modelling
- Make the most of due diligence: *"Due diligence is the best bit of merger discussions. We attack their business plan. And they attack ours. What a test it is. They spot things we didn't see and vice versa"* RP director who has negotiated a number of mergers
- Anticipate reputational damage – be alive to accusations of unjustified pay offs and wage hikes in mergers or complacency if you stay as you are
- Take the right advice and act on it: Everyone uses advisors on these studies – it's seen as one way of ensuring the work is impartial. But you must put checks in place. You don't want anyone to say they are dancing to the tune of the CEO or leaning towards the most expensive-to-implement option.

5. Demonstrate accountability – with measured and realistic outcomes

"This is the bit we need to get better at in truth" CEO of large merged RP

You will need to evaluate whether the option you chose lived up to the promises you made. So whether you merge, go into partnership or stand alone:

- Set tangible measures of success
- Report on these transparently.

And if you have fallen short, explain why and what you will do to put things right.

6. Plan ahead

Whether you merge, form a strategic partnership, share functions or stand-alone, money is the big deal. You need to get the cash in and make savings. If you let teething problems stand in the way you won't make good on your promises. Other things can trip you up too. Watch out when you bring IT systems together – we've seen cut and shut jobs that led to lots of lost repair orders. The HCA takes a dim view.

Mergers

It's the job of leaders to get deals across the line. That doesn't always happen. When a merger proposal fails a lot of money spent on fees goes down the drain. In effect your residents pay the fine. So you've got to pull out all the stops to make sure you take the right decision and push it through.

Of course you must keep the lenders in the loop. And after the merger the HCA will want to visit. Are you ready for this?

"The basic problem in closing the accounts was that all the experienced finance staff from one of the merged RPs had left. We really struggled to piece it all together" Interim Manager

You need to commit to working as one team from an early stage if you are merging.

"Don't give me that rubbish about culture. It's nonsense. We spent lots of time with them at strategy days and seemed to get on. They just didn't want to do it" CEO after a failed merger

The Form Follows Function checklist

Our checklist for selecting RP partners for mergers, cost sharing vehicles, joint-ventures and other deals

“Be clear on the problem to be solved” – is one of our key principles.

If a deal sorts this out then it is worth pursuing. And if it brings with it opportunities to do more, then so much the better. But if it doesn't then it's better to say no.

This checklist will help you draw up your *exam questions* to focus your offer to any prospective partner, or evaluate any offers you receive. You will want to set your own local criteria for considering which organisations to approach or which approaches to take forward to your board or a task group for consideration. Our checklist will help you refine your final list.

The checklist is for RPs that have a choice about how they run things in the future. It does not apply to those that need rescuing.

There are a few words of caution: no checklist can cover every eventuality. Your access to information will vary, and events can change quickly.

Part A: For RPs that have decided they want to select another RP for a potential merger or similar deal

You have considered your values and strategy, and concluded that the best way to achieve your objectives is by joining forces with another RP. You will want to choose another RP that shares your values and answers your *exam questions*.

A recent example is the partnership between Trafford Housing Trust and L&Q. As Matthew Gardiner, CEO of Trafford Housing Trust, explains: *“We know that good quality affordable housing to rent and to own provides a sense of safety and financial security for the many people currently living in unsatisfactory conditions.”*

“In L&Q we have found a progressive and like-minded partner that shares our ambitions to build more homes and to help more people out of poverty.”

“It is clear that the combination of Trafford Housing Trust’s knowledge of the local housing market with L&Q’s formidable capacity as a house builder, and our shared vision to create neighbourhoods people want to live in, will result in a unique and exciting offering at scale to the North West housing market.”

We suggest a straightforward three stage process.

First you've got to do some sifting to spot the likely candidates. Then you need to talk to them to see if there is any common ground. And you also need to assess whether any deal will stack up for your tenants. Now this does seem obvious doesn't it? But some RPs have aroused concerns by taking more of a scattergun approach. The golden rule is that you mustn't waste people's time.

The initial sift: Whom should we talk to?

Here you will be working with the accounts, HCA reports , e.g., on cost per home and regulatory judgements, and other publicly available material. Sometimes you might have more intelligence to hand.

Your questions	How the other RP measures up
<p>Are our values similar? For example, do they sign up to Placeshaper style values?</p> <p>On the face of it – is there any sort of case for a deal? Can they help us to extend our scale or our scope? Or both?</p> <ul style="list-style-type: none"> ■ Do we fit together geographically? ■ Could we benefit by sharing services such as a DLO or development team? ■ Can they help us get into a new market? ■ Is there anything else that appeals and fits our objectives? <p>Are their finances on a firm footing?</p> <p>Does it look as though we could build more homes if we worked together?</p>	

The more detailed evaluation: Can the other RP answer your exam questions? And can you help to answer their questions too? It needs to be a win-win. If you want to grow or extend by working with other RPs you must make a compelling offer.

“I am sure there will be businesses looking for opportunities to become more financially and operationally efficient, and Sanctuary will be looking to work with other organisations to deliver better value” David Bennett, CEO of Sanctuary Group

Here are the sorts of questions you should be discussing with other RPs that interest you:

Possible criteria for assessing a merger partner	Responses with quantified answers and clear justifications – merger/partnership	Current and projected figures on stand-alone basis as the benchmark
If we come together:		

Will our finances be more resilient? (What is their surplus? How do costs compare? What is their income stream net of voids and arrears?)		
Will we build more of the right sort of homes in the right places?		
Will we boost our borrowing capacity? (Do they have access to funds? What headroom do they have on covenants?)		
Will the balance sheet get stronger?		
Will it improve our buying power?		
Will it strengthen our management capacity?		
Will our services get better?		
Are there any legal or other impediments to doing a deal? Can we overcome these?		

Does the deal stack up for tenants? Questions they are likely to ask will be:

- ▮ What is the reason for this merger or partnership?
- ▮ Will any new organisation be financially strong? How do you know?
- ▮ How will this affect rent levels and service charges? What commitments can you give?
- ▮ Will our security of tenure stay the same? Do we keep all of our rights?
- ▮ How good is the other RP? What is the % of tenant satisfaction?
- ▮ How much say do tenants have in decision-making?
- ▮ Will service levels change in any way? How do we know that our money will not be spent somewhere else?
- ▮ Will you build more homes? Where will these be? What sort of rents will you pass on?
- ▮ Will you pay for us to bring in an independent adviser?

- ▮ How will you take account of our views in coming to a decision about whether or not to merge or form a partnership?

If it does look as if the other RP can indeed help you to solve the problems you want to, and offers the right opportunities for both of you, then it's time to take things further. Our full report sets out a process for doing this with a timetable.

In summary: Making an offer

- ▮ Work up a compelling offer for other RPs that solves your exam questions
- ▮ Identify likely RPs that could help with these and make contact
- ▮ If they respond positively complete their questionnaire (their list of exam questions)
- ▮ Consider the issues for tenants
- ▮ If both sides agree there is a case to look at, hold preliminary discussions and exchange relevant information
- ▮ If it seems as if there is a potential deal to be done, start the process set out by Anthony Collins (see separate document).

Part B: For RPs that have received an enquiry from another RP seeking a merger or partnership

In this scenario, you will have assessed your values, strategy and business plan. You might have decided to ‘go it alone’ but keep an open mind, or ‘wait and see’. Alternatively, you may be actively seeking a partner, and an approach has been made in the meantime – or the other RP may be responding to your approach.

The process we suggest has three elements:

- An initial sift to see if there is any basis at all for talks about talks. If there is, you can move on to
- A more detailed examination of what you could get out of any deal
- Consideration of whether any deal would stack up for tenants.

The initial sift: Is it worth starting to talk to them? These questions should be determined by the Board to allow an initial sift of any approaches. We have suggested some questions below as a starting point.

Your questions	How does the other RP measure up?
Are our values similar? For example, do they sign up to Placeshaper style values?	
On the face of it – is there any sort of case for a deal? Can they help us to extend our scale or our scope? Or both?	
<ul style="list-style-type: none"> ■ Do we fit together geographically? ■ Could we benefit by sharing services such as a DLO or development team? ■ Can they help us get into a new market? ■ Is there anything else that appeals and fits our objectives? 	
Are their finances on a firm footing?	
Does it look as though we could build more homes if we worked together?	

You would expect that an initial offer from a competent RP would cover these points. But if the other RP does not get through the first hurdle you will not take things further.

“We all got the same letter from them when we lost our last CEO. There was no real information in it. It just looked opportunistic to us” RP board after receiving merger offers from the same RP based in another part of the country

The detailed examination If there is a case for talking, what issues should you raise? It’s all about the other RP helping you to answer your *exam questions*. These will vary. Remember our Principle 2: ‘Be clear on the problem to be solved’.

Here are the sorts of issues you need to be talking about. In the first instance you might want to send them a questionnaire covering these points.

Possible criteria for assessing a merger partner If we come together:	Responses with quantified answers and clear justifications – merger/partnership	Current and projected figures on stand-alone basis as the benchmark
Will our finances be more resilient? (What is their surplus? How do costs compare? What is their income stream net of voids and arrears?)		
Will we build more of the right sort of homes in the right places?		
Will we boost our borrowing capacity? (Do they have access to funds? What headroom do they have on covenants?)		
Will the balance sheet get stronger?		
Will it improve our buying power?		
Will it strengthen our management capacity?		
Will our services get better?		
Are there any legal or other impediments to doing a deal? Can we overcome these?		

Does the deal stack up for tenants? Questions they are likely to ask will be:

- ▮ What is the reason for this merger or partnership?
- ▮ Will any new organisation be financially strong? How do you know?
- ▮ How will this affect rent levels and service charges? What commitments can you give?
- ▮ Will our security of tenure stay the same? Do we keep all of our rights?
- ▮ How good is the other RP? What is the percentage of tenant satisfaction?
- ▮ How much say do tenants have in decision-making?
- ▮ Will service levels change in any way? How do we know that our money will not be spent somewhere else?
- ▮ Will you build more homes? Where will these be? What sort of rents will you pass on?
- ▮ Will you pay for us to bring in an independent adviser?
- ▮ How will you take account of our views in coming to a decision about whether or not to merge or form a partnership?

If it does look as if the other RP can indeed help you to solve the problems you want to, and offers the right opportunities for both of you, then it's time to take things further. Our full report sets out a process for doing this with a timetable.

In summary: Responding to offers

- ▮ Initial check to see if the offer addresses your exam questions
- ▮ If no – decline
- ▮ If yes – issue your questionnaire
- ▮ If their response does not meet your needs – decline
- ▮ If their response does look of interest – hold preliminary discussions and exchange relevant information
- ▮ Consider the issues for tenants
- ▮ If it seems like there is a potential deal to be done start the process set out in our main report.

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