RECENT MERGER TRENDS

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THE STORY BEHIND THE RECENT MERGER TREND WITHIN THE SOCIAL HOUSING MARKET

After the financial uncertainty caused by the COVID-19 pandemic, the topic of mergers is once again sharply in the spotlight. The likes of GreenSquare Group Limited and Accord Housing Group Limited merged on 1 April 2021 and Catalyst Housing Limited and Peabody Trust merged on 1 April 2022.

This article explores and discusses these recent merger trends, as well as asking why, in some circumstances, merger discussions collapse as seen in the case of Sanctuary and Southern Housing in April 2021.

As of 31 March 2021, the Regulator of Social Housing reported that the UK had 1,624 social housing providers. According to the regulator's deputy chief executive, Jonathan Walters, it is likely to "see quite a lot of mergers coming down the track".

Mr Walters noted that the operational and strategic challenges facing housing providers in the current climate, such as balancing new build delivery against investment in existing stock, is likely to drive housing associations to explore mergers as an option. Joanna Makinson, senior independent director of Abri, went further still in a recent webinar, suggesting boards should be actively considering mergers owing to pressures in the sector.

However, these pressures go beyond that balancing act. Following the introduction of the 2020 Building Safety Bill, and the government-set target to ensure all social housing units are carbon neutral by 2050, the daily challenges facing housing providers have been extended further. This comes on top of the decision by the government to cut universal credit by £20 a week, which was met with severe criticism amongst the housing sector. Therefore, housing providers are under significant financial pressure to meet numerous challenges. Moody's recently warned that housing associations could face costs of up to £20bn on just building safety and decarbonisation.

In order to resolve this burden, housing providers are looking to take advantage of economies of scale, increase efficiencies and encourage administrative savings in the business. At which point the prospect of merging becomes significantly more attractive. As Ruth Cooke - chief executive of the newly merged GreenSquareAccord - identified, a larger housing provider can look to widen the overall offering to its tenants by increasing its breadth of services. A similar rationale was used by Lord Kerslake – chairman of Peabody Trust, who merged with Catalyst Housing – that a merger provides a platform and opportunity to "make the most difference to people who may be struggling".

The growing importance of net-zero target and ambitions and the costs associated to meet these targets, has meant housing associations have already accounted for these costs in their long term business plans, with Matthew Walker, chair of PlaceShapers and chief executive of Leeds Federated, alerting MPs at the Levelling Up, Housing and Communities committee that "the majority of housing associations" would go bust without extra support. Therefore, an amalgamation between housing associations can be a platform to achieve these net-zero target with support coming from each housing association combining their strengths, whilst sharing resources and expertise to achieve the targets by 2050.

Thus, the merging of housing providers can be viewed as a strategy to combat recent and future challenges of which housing associations face and enable provision of better services to tenants. According to a report issued by New Street Consulting Group, a total of 14 housing association mergers completed in 2020, at the peak of the COVID-19 pandemic. As Sarah Stevenson, a director at New Street Consulting Group commented, financial and administrative pressures resulted in housing associations looking to develop economies of scale to put themselves in a position to optimise the potential gains of a large social housing provider. Ms Stevenson also proposed that a larger housing provider is able to "increase their borrowing power" due to having a greater portfolio and improved efficiencies which come out of a merger. This in turn would enable the association to build more homes. However, it should be recognised that this will be of limited advantage since borrowing power will be constrained by asset levels as well as gearing levels. Furthermore, as evidenced by the GreenSquareAccord merger, governance ratings could be downgraded, which would contradict the argument of greater borrowing power.

This is not the only potential flaw in the argument for more mergers. As David Bogle - chief executive of Hightown Housing Association – noted, larger housing associations usually means complex governance arrangements – with senior management further distanced from the communities they serve. This is in direct conflict to justifications provided by pro-merger advocates. Indeed, Mr Bogle further argued that actual evidence of economies of scale is scarce. This supports Arun Poobalasingam's recent article that "bigger isn't necessarily better" as there is no guarantee a merger will prepare the housing provider for all the challenges it faces in relation to building new homes and investing in existing stock to meet current regulations.

The realisation that a merger may not resolve the challenges housing providers face was the reasoning Sanctuary and Southern Housing Group provided in their joint statement confirming their proposed merger was no longer being pursued. They agreed "that the combination would not deliver all of the intended benefits within the planned timescale".

Despite the risks of merger talks collapsing and a lack of certainty that mergers can better enable housing providers to tackle their longer-term challenges, such discussions are becoming more frequent. Moreover, merger activity is viewed as on the rise by the market, a view with which the Regulator of Social Housing agrees. Lee Gibson, a senior director of Newbridge Advisors, commented that merger activity has been triggered by housing associations being financially stretched and providers have come to a conclusion that they would benefit from support. Finally, the Regulator of Social Housing acknowledged through analysis of the sector risk profile that providers were experiencing a trade-off between addressing existing stock and new homes.

Therefore, the combination of pressures from external parties and ambitious development plans has led to housing institutions becoming financially stretched to the point they are hitting their capacity. This means they are increasingly looking for the backing of more financially stable sector peers with the likes of Network Homes and Progress Housing Group openly discussing the possibility of future mergers in press releases as a way to accommodate their ambitious long term goals.

The merging of housing providers is far from an exact science, and the market clearly contains both enthusiastic supporters and sceptics. However, it is apparent increased merger discussions are due to take place. We are likely to see more merger activity, as housing providers try to juggle numerous requirements, whether meeting the demands of government, providing the best service to tenants, or trying to adapt to the ever-changing climate of the housing market. As Helen Collins - head of housing consultancy for Savills - predicts, housing providers are expected to face "some major costs in the coming years with continued work on building safety, the ramping up of decarbonisation and increasing costs for new homes to meet the Future Homes Standard".

Within the sector, mergers are seen as one strategy with a track record of success, as shown clearly by the continued willingness of providers to discuss the possibility of a merger.

However, an important underlying factor to the recent success of mergers has been the ability to identify a merger partner with similar ideologies and drivers to ensure the long term objectives can be achieved.

One initial step is to decide what structure any potential merger should take. There are a number of different approaches, and those we see most are explored in the table below. Agreeing to the preferred structure early on in any discussion will provide a platform for a more fruitful combination of housing providers.

TYPE OF MERGER	SUMMARY	PRACTICAL NOTES
Transfer of engagements	The transfer of a registered society's business to another registered society	A registered society (the **Transferor**) may pass special resolutions to transfer its engagements to another registered society (the **Transferee**) which undertakes to fulfil those engagements under section 110 of the Co-operative and Community Benefit Societies Act 2014 (the **Act**). The Act provides that a transfer of engagements does not prejudice any right of a creditor of either of the societies. Upon transfer of all assets and liabilities from the Transferor to the Transferee, members of the Transferor will be made members of the Transferee. The proprietorship register will need to be updated, to ensure that real properties are registered under the correct entity name. The Transferor will still exist until it is removed from the Financial Conduct Authority (**FCA**) register, which can only happen once a certificate confirming all its property has been transferred has been lodged with the FCA under section 126 of the Act. One of the key benefits of this statutory process is that if the special resolutions required by the Act approve the transfer of engagements, all assets, rights and liabilities of the Transferor automatically vest in the Transferee by operation of law and without the need for further formality. Therefore, this statutory process presents a very streamlined method of achieving a merger.

		Depending on each housing association's specific covenants, a transfer of engagements can sometimes trigger fewer consent requirements, meaning that the cost of a merger is potentially reduced. Even where the transfer of engagements route is chosen, the receiving entity can be re-structured and branded if required.
Amalgamation	Merger of registered societies to form a single legal entity	Any two or more registered societies may pass special resolutions to become amalgamated together as one society under section 109 of the Act. The Act provides that the amalgamation does not prejudice any right of a creditor of any of the societies. Members of each amalgamating association will become members of the new society and hold shares in it in place of the shares they held in the separate associations before amalgamation. The proprietorship register will need to be updated, to ensure that real properties are registered under the correct entity name. Similarly to a transfer of engagements, if the requirements of the Act are complied with the property of each society will be vested in the new society without the need for any form of conveyance so an amalgamation also presents a very streamlined method of achieving a merger. Amalgamations are often chosen as the preferred route of merger, due to its impact on pensions, as an amalgamation can have a lesser impact on pension risk exposure than a transfer of engagements. A number of pension authorities and scheme trustees have accepted that an amalgamation does not have the effect of crystallising pension fund deficits in respect of the amalgamating entities or triggering the termination of pension admission agreements. This is in contrast to a transfer of engagements which can give rise to a pension debt payable by the transferring employer. Costs associated with pension deficits can be significant, to the extent that they could be prohibitive to merger. Because an amalgamation can help to mitigate the impact on pensions, amalgamation rather than transfer of engagements is often chosen to effect a merger.
Acquisition of/becoming a subsidiary	Acquisition of a housing association as part of the wider group	This option is often chosen where the housing associations' preference is for the individual identity of each entity to remain in place post-merger, at least initially. Acquisition as a subsidiary can also help to keep the activities of one merging party ring-fenced in a separate entity. Unlike on a transfer of engagements or amalgamation, this route of merger has no automatic asset or property transfers and the staff of each entity will also remain employed by their current employer. Therefore, if there is to be any restructure of staff and assets as part of the merger, this would have to be delivered manually. From a purely constitutional perspective, the new subsidiary entity will alter its rules/articles in order to reflect its new subsidiary status. This may require consents from funders as part of the covenants under the legacy financing agreements. Depending on each housing association's specific covenants, this approach can have a lesser impact on loan covenants and pensions, thereby reducing the cost of the merger. This option is often chosen where a smaller or single entity is joining an existing or larger group. The inclusion of an additional entity into an existing

		group structure can have a minimal impact on things such as staff and pensions and so can present a straightforward way of bringing merger partners together.

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