Brian Cronin readily admits the merger that created Your Housing, the 33,000-home landlord of which he is chief executive, was imperfect.

“We ended up in a bit of a muddle,” he explains. “We did save some money but we didn’t extract as much value as we could have done.”

In the sometimes cut-throat world of corporate mergers and acquisitions, euphemisms abound. The language is littered with talk of efficiencies, synergies, duplication and downsizing. In reality, these buzzwords boil down to one thing: cost cutting.

Whether by achieving economies of scale or reducing staff and other back-office expenses, taking cost out of a business either drives a corporate tie-up, or at least becomes a handy by-product of the deal.

This was the case for Mr Cronin and Your Housing as well. But what that organisation’s story tells us is that simply merging is not enough; it’s what you do afterwards that determines the effectiveness of your cost cutting.
Transformation

The decision-makers at the heart of the so-called ‘mega-mergers’ currently taking place have made plain their desire to make substantial savings. L&Q chief executive David Montague has said his organisation’s combination with Hyde Group and East Thames, which is expected to complete by the end of the year, intends to save £50m a year within five years. And while no figure has been put on it, Affinity Sutton CEO Keith Exford has talked of driving down operating costs once his organisation’s tie-up with Circle goes live, also later this year.

So if efficiency is the goal, what can the performance of landlords like Your Housing tell us about whether merging is the best way to achieve this?

When Harvest Housing Group and Arena Housing Association came together to form Your Housing Group in 2012, saving money was one of the goals - although the merger had other objectives too, such as building more homes, and wielding more influence both regionally and on the national stage. Despite saving £3.1m a year, on a turnover of £170m, management cost per unit has actually risen from around £1,200 at the time of the merger to about £1,300 today, admits Mr Cronin.

“We had a lot of things that we thought were sacred,” says Mr Cronin, who was previously CEO of Arena. “We tried to keep lots of things and reduce other things at the same time. That didn’t really work.”

Staff headcount reduction at the time was around 10%, which Mr Cronin describes as “typical of the mergers of the time”, such as Aster’s 2012 tie-up with Synergy. But now, Your Housing has now embarked on a second transformation programme, aiming to make a radical difference to the business.

Mr Cronin wants to take a further £20m out of the group’s operating costs, which were £130m in 2014/15. He wants to deliver a £50m surplus in the next two years, which will allow it to build 1,000 to 1,200 homes a year. In 2014/15, the landlord’s surplus was a third of that, at just £17.1m. In turn, this will help bring management costs per unit down to £890. To do this, further cuts are coming, with more redundancies in the offing than occurred post-merger.

For the landlords merging today - with far greater efficiency and development targets than Your Housing - getting it right first time is arguably more important than ever. Since the government shocked the sector with last year’s 1% rent cut, providers have been forced to make deeper reductions. Merging has become a tempting means to do so.

“There is a case to be made [for mergers] but the whole operating environment has changed since the [rent cut came in with the] July 2015 Budget. It’s not now about merging to be bigger, it’s about merging to get operating costs down to the lowest level possible,” says Ian Parker, lead finance associate at consultancy Housing Quality Network (HQN).

HQN analysed the Homes & Communities Agency’s overview of the financial accounts of English housing associations, and found that management costs per home have gone from an average of £908 in 2011/12 to £1,034 in 2014/15. That’s a 14% rise in three years at a time when the rhetoric has been about cost cutting.

Mr Parker believes that too much cost is still tied up in the structure and organisation of housing associations. Just merging to achieve economies of scale won’t be enough in today’s climate.
“There is no real relationship at all between size and cost,” he continues. “The costs of managing and maintaining stock do not automatically come down as size goes up. If you truly merge and downsize organisational structures [for example by making redundancies or cutting red tape], then you can make savings.”

One finance director at a major landlord which has experienced a merger agrees with Mr Parker: “It’s not enough to merge and remain flabby; you have to make some tough decisions. If you still have too much cost, either you didn’t make those decisions or you didn’t try hard enough.”

A senior director at another landlord formed through a series of recent mergers admits that it could have been more ruthless. “If we had known about the rent reduction, we might have been more proactive about operational costs,” the source tells Inside Housing. “We might have driven change a bit harder.”

Counterfactuals

Sovereign, with 38,000 homes, is another association poised to join forces with one of its peers. The proposed merger with Spectrum Housing Group will see its combined stock balloon to 56,000 homes.

But it’s not the first time Sovereign has overhauled its structure. The 2011 amalgamation of its previously federated group structure - a merger in everything but name - demonstrates how much more importance is attached to cost-cutting today.

In its 2015 annual report, Sovereign hails £21m of efficiency savings during the four years. However, over that same period, its overall costs are up more than 35%. The group’s cost per unit has climbed 20%, from £3,083 to £3,705. Sovereign director of strategy Clare Powell recognises that costs have risen since the group consolidated its structure, but pleads mitigating circumstances.

For one, the new structure has come at the same time as Sovereign has upped its development programme from around 700 homes a year to around 1,000 - but that comes at a price. While building new homes is good for an organisation’s balance sheet, the process of taking them into management brings one-off costs associated with nominations and lettings, says Ms Powell.

Extra investment to support tenants affected by welfare reform is another of what Ms Powell calls the “counterfactuals” that have contributed to higher costs than the ideal.

“We had just decided we would invest money in supporting tenants through the welfare reform process,” she explains, recalling the 2011 reorganisation. “Did we do it in a more efficient way [than we would have without the reorganisation]? Probably, but how much more efficient is hard to say.”

New focus

The publication of the National Housing Federation’s merger code last year is the clearest sign yet that the sector is more serious about mergers driving better value. It followed comments from the Homes and Communities Agency’s (HCA) regulation committee chair Julian Ashby, urging housing associations to think more commercially about mergers.

Today the regulator is somewhat sympathetic towards merging landlords. “People haven’t always been as focused on the bottom line, but there might be reasons for that,” suggests
Jonathan Walters, deputy director of strategy and performance at the HCA. “These are charities, housing vulnerable people, so there’s always a balance between commercial reality and the social mission. But you could ask whether the social mission has been used to stop them asking difficult questions of themselves.”

That looks set to change. The disappearance of grant funding, especially when combined with the 1% rent cut, has forced landlords with development ambitions to pursue commercial activity to increase revenue. This has sharpened their focus when it comes to mergers, argues Mr Walters.

“Without that commercial rationale there are not always the pressures to really look at how to take the costs out of a business and drive value.”

He also admits that the regulator has had its hands tied when it comes to its own role in merger activity. “We may well have seen mergers where it’s hard to see the business rationale, but as long as they satisfy governance and viability standards, it’s difficult to stop them. It’s been hard to drive some of the efficiencies we would have liked to see. It has to be led by the sector itself.”

Given the glut of merger activity, the indications are that the sector is responding, as the regulator would like, and not just among the biggest players currently eyeing their mega-deals. As Your Housing’s Mr Cronin says: “The model now is going to have to become more commercial for everyone.”

If past deals tell us anything, when it comes to mergers in today’s high-pressured environment, that may prove easier said than done.

**The mega-mergers**

- **Affinity Sutton and Circle Housing:** The pair, both members of the G15 group of leading London landlords, entered merger talks in July 2015. The combined organisation would have 127,000 homes under management and a turnover in excess of £650m.

- **L&Q, Hyde Group and East Thames:** The combination is set to go live before the end of the year, creating the UK’s biggest social landlord with 135,000 homes.

- **Genesis and Thames Valley Housing:** The boards of the two landlords approved an outline business case last November, setting the scene for a merger that would create a 47,000-home organisation.

- **Sovereign and Spectrum Housing Group:** The two landlords confirmed they were in talks in February 2016. The 56,000-home combined group would be the biggest provider in the south and South West, outside London.

[http://www.insidehousing.co.uk/analysis-and-data/analysis/merger-sense/7015273.article?](http://www.insidehousing.co.uk/analysis-and-data/analysis/merger-sense/7015273.article?)