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Empire building? Analysing the drivers towards mega-mergers in the English housing association sector

Dr Nicky Morrison & Dr Nikodem Szumilo

Department of Land Economy

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Structure of Presentation

Research focus

- Analyzing external drivers and managerial motivations behind mega-mergers in English not-for-profit housing Association sector
- Draw on business theory of mergers
- Re-examine theory in context of the sector
- Research methods
- Emerging findings
- Preliminary conclusions and policy implications

Critical juncture for Housing Associations

- Fundamental changes:
  - to the economic climate
  - government regulations
  - investment funding
- New strategies to ensure their long-term survival
- A wave of mega-mergers
- Becoming the largest volume housing builders in the country!

Operating environment for mergers

- Key external drivers that make mergers attractive option common to all firms e.g.
  - Regulatory changes and political developments (Thelen 2009)
  - Changes in the financial market (Rhodes-Kropf and Viswanathan 2004)
- ‘Positioning acquisitions' in response to a regime shift so that individual businesses ensure long-term legitimacy and survival (Gorton et al 2009)
- Over time mergers tend to come in waves (Toxvaerd 2008)
  - ➢ Institutional entrepreneurs take lead (Garud et al 2007)

Race for firm size

Organisational motivations

- ***Maximise shareholder value***

Increase business performance and profit-making (Morek et al 1990)

- ***Efficiency benefits through positive synergy gains***

Financial efficiency through reduced cost of capital (Lewellen 1971)

Operating efficiency through economies of scale(Scherer 1988)

Increase market share (Masksimovic & Philips 2001)

Access to new technologies & markets (Manne 1965)

- ***Managerial benefits***

Managers may seek their personal objectives (Morck et al 1990)

Market conditions

Industry conditions

Company conditions

Decision maker conditions

Market structure:

- Industry regulation
- Social responsibility
- Custom and embedded practices

Market environment:

- Interest rates
- Business cycle
- Economic growth
- Capital availability
- Competition

Strategic:

- Objectives
- Business model
- Core markets

Operational:

- Financing
- Efficiency
- Management

Self interest:

- Compensation maximization
- Empire building

The English HA sector

Core activity	Providing affordable and social housing.
Business model	Based on social housing lettings but increasingly supported by commercial activities.
Profit	Surplus reinvested into core activities
Financing	Government grants, retained profits and private loans.
Loan security	Government guaranteed rents and social housing assets.
Credit ratings	A (varies)
Regulation	Regulated by Homes and Community agency
Voting rights	Public can apply to have voting rights but do not receive dividends.
Corporate governance	Board members are recruited by shareholders and managers.
Tax optimisation	Taxable subsidiaries use gift aid to minimize tax at group level

Contemporary shake up of English HA sector

Media hostility

- ‘True villains of housing crisis’ (Channel 4 News 23/7/15)
- ‘Public sector lethargy and private sector greed’ (*The Spectator*, 25/7/15)
- ‘Sleeping giants’ (*The Economist*, 21/11/15)
- ‘High salary, low performance - £350,000 salary for Britain’s worst housing chiefs’ (*The Times*, 18/3/16)

Government hostility

- *‘There has not been much pressure on the sector to be particularly efficient in recent years’* (Osborne, HoC, 8/9/15)
- *‘Part of the public sector that haven’t been through efficiencies, haven’t improved their performance and it is about time they did’* (Cameron, HoC, 15/9/15)
- Steep cuts in government grants for new build
- Government stipulates 1% rent cuts per annum next 4 years

➢ *Self financing/ Efficiency agenda*

Organisational motivations

- Debt has become an increasingly popular method of funding expansion in the HA sector (Wainwright and Manville 2017).
- To attract investment from institutional funders, individual HAs require high ratings from credit rating agencies (Manzi & Morrison 2017).
- Economies of scale, including shared and integrated back-office functions and consequent projected costs savings (Bortel et al 2010, HNQ 2016).
- Yet, the government regulatory body, Homes and Communities Agency has found NO statistical correlation between size of HA and efficiency in terms of unit costs (HCA 2016, p.18)

Research Methods

- Case study analysis of the six London-based HAs undergone mergers (2016/17):
    - Affinity Sutton and Circle HA (Clarion Group) *(>125,000 units)*
    - London & Quadrant (L&Q) and East Thames *(>90,000 units)*
    - Family Mosaic and Peabody *(>55,000 units)*
- All merger deals examined in the context of the analytical framework and supported with evidence from interviews with key senior executive decision makers & financial accounts of all analysed entities

Key data on paired HAs

Size	Affinity Sutton	Circle	East Thames	London & Quadrant	Family Mosaic	Peabody Trust	England total
Total fixed assets	£2,939,629	£3,958,700	£1,108,059	£7,747,254	£2,364,306	£3,032,867	£143,223,847
Turnover	£386,423	£439,200	£128,723	£719,788	£265,640	£351,979	£19,979,660
Closing social housing units managed	58,679	62,647	13,577	63,604	24,878	24,598	2744785
CEO compensation	£320,933	£239,109	£155,000	£355,105	£220,000	£223,060	
Operations							
Surplus for the period	£144,779	£85,800	£28,036	£273,535	£73,486	£122,118	£3,341,367
Headline Social Housing Costs per Unit	3.46	4.19	3.94	3.32	6.86	5.79	3.97
Operating Ratio	51%	64%	59%	35%	61%	42%	0%
Financing							
Gearing ratio	40%	53%	53%	27%	30%	36%	45%
Credit rating pre/post merger (Moody's)	Aa3/A2	A2/A2	A3/A2	A1/A2	A1	A3	
Diversification							
Surplus from non-SH activity	8%	23%	11%	21%	24%	30%	15%
Non SH - Market rent - Surplus	£660	£8,000	£0	£9,014	£0	£2,989	£96,937
Social properties added	1,015	450	- 214	419	504	743	51,333

(Source: Authors compiled from HCA 2017, individual financial accounts, Inside Housing CEO salary survey 2016)

External drivers to merger..

Political imperative to be more self-financing & efficient

"Challenged by government to sweat our assets − claims not doing enough"

"We are seen as part of the problem YET we want to be part of the solution"

"Better together"

- *Re-positioning/ staying relevant*

Managerial motivations

Size

- Circle is 35% bigger than Affinity Sutton = *merger of equals*
- Peabody is 28% bigger than FM = *merger of equals*
- L&Q is 7 times as large as East Thames = *take over merger*

Financial efficiency

- Take risk of credit rating being downgraded
- Yet opportunity to access additional debt at better rates
- Borrow more in order to increase development output

Managerial motivations cont.

Operational efficiencies

- Forced to make cost savings due to Government's 1% rent cuts p.a.
- Large differences between HAs in operating ratios − cost per unit
- Ability to introduce IT 24/7 service delivery
- Back office savings YET local accountability sacrificed?

Exploit new business opportunities

- Increase exposure e.g. to market rental housing (Morrison 2016a)
- Ability to share risk & offers greater options
- 'Flex' tenure to reduce over-exposure to market sales

Managerial motivations cont.

Extend market share

- Ability to extend geographically e.g.
  - L&Q extends its reach into East London through acquiring East Thames
  - Family Mosaic benefit from Peabody owning Thamesmead (London's largest development site)
- Increase asset base more quickly than through organic growth

Managerial motives

- No shareholder accountability
- Reputational damage once CEO salaries announced
- Acting in best interests of organisation & society − long tern stewardship
- Over-estimating merger benefits − common across all sectors…

Preliminary Conclusions & policy implications

- Mergers in the HA are not new
- YET new breed of super-sized HAs - 'institutional entrepreneurs' (Garud et al 2007)
- Ensure legitimacy & meet government expectations
  - More self financing, Increased efficiency & maximize development capacity
  - YET to be proven & takes time to embed organisational & cultural change..
- With size comes status and take control of futures
  - Potential to demand greater freedoms and challenge government
- Institutional isomorphism – as others fear being left behind
  - ➢ At expense of local accountability & social purpose?