



# Is big really best – or can small and friendly deliver?

A briefing on the size, efficiency and effectiveness of housing associations

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I wrote to the chairs of housing associations earlier this month setting out our expectations of the proposals they present to us for mergers and group arrangements.

This briefing, produced by the CIH with IGP funding, was already being written, and it helpfully reinforces the points which we are making. The briefing is not a statement of the Corporation's policy. It is a useful and timely contribution to a wider debate which we believe is needed about the purpose and outcomes of the merger and restructuring of associations into larger or more complex organisations.

As I made clear in my letter, we do not have a preferred size or style of organisation; but we do have very clear expectations about the outcomes of merger activity and in particular about the effect on organisational efficiency, capacity, and services to current and future tenants.

Boards must ensure that sound reasons for mergers or enlargement of group structures exist. It is not sufficient just to plan for larger organisations for the sake of it. It must lead to better services for tenants and greater organisational effectiveness.

*June 2005*

Debates about whether smaller or larger associations are best able to deliver housing services are not new in the housing world. But they have been given added importance by:

- the Housing Corporation's move to focus investment in fewer developing associations;
- the real efficiency pressures from the rent regime – based on RPI increases at a time when wage and building costs are running well ahead of RPI.

These factors combined with the introduction of competition for grant from bodies other than associations means that there are now real drivers for restructuring the sector. This calls into question whether the way the sector is organised actually helps or hinders efficiency and effectiveness.

There is an underlying assumption behind much of the current debate that if there are fewer, larger associations they will be more effective.

This briefing examines the available evidence about the links between efficiency and effectiveness and organisational size and structure, and asks what this means for the future of the housing sector as a whole.

## The Housing Corporation's own evidence

Our starting point is to examine the available evidence on efficiency and effectiveness held by the Housing Corporation.

### Operating costs

If we start by looking at the Performance Indicator (PI) showing the per unit general needs operating costs of associations, we find that among traditional associations, those managing less than 750 homes have the highest costs. This contrasts with stock transfers, where those managing over 10,000 homes have the highest costs. Beyond this there is no clear relationship between size of stock and per-unit operating costs in either 2003 or 2004.

#### Number of general needs dwellings managed and weekly operating cost per unit (2004)

Dwellings managed	Traditional HAs	Stock transfer HAs
750 and under	£50.18	£56.01
751 - 1,500	£44.20	£46.79
1,501 - 5,000	£44.81	£50.54
5,001 - 7,000	£44.20	£52.52
7,001 - 10,000	£45.02	£49.70
10,001+	£43.62	£61.83

Other potentially-relevant evidence is the Corporation's Operating Cost Index. The analysis which underpins the OCI found no strong evidence of economies or diseconomies of scale. However, if we consider the results of the OCI, and compare the mean average performance (including major repairs) by size, associations with less than 5,000 units have a higher average ranking than larger ones, but those between 5,001-7,000 have a noticeably lower ranking than the largest associations. If major repairs are excluded there are no clear differences in the comparative results based on size.

## Effectiveness

An analysis of the PI figures over the last two years shows that there is no clear, consistent correlation between performance and size. However, some interesting observations can still be made.

- Performance of the very large associations (more than 10,000 units) on relet times and emergency repairs; and of the large associations (more than 7,000 units) on rent loss and tenant satisfaction, are noticeably lower than their smaller counterparts.
- The very smallest associations clearly perform best on relet times but they do not perform well on emergency and urgent repairs or rent loss through vacancy, compared to their larger counterparts.

Generalisations from the PI figures are that:

- repairs performance is best in associations with between 5,000-10,000 units;
- tenant satisfaction is highest in associations between 750-5,000 units;
- relet times are minimised at less than 750 units; and,
- rent loss through voids is minimised at 1501-5,000 units.

## Do large developers deliver services well?

To test for any correlations between efficiency in development and housing management we examined the available PI information for lead partners within the pilot Investment Partnering programme.

The average size of lead partner associations is 7,522 general needs properties, which contrasts with the national average size of 3,111. However, it is worth noting that not all lead partners are large (some because they are developing properties for the Corporation's shared ownership programme).

We took five key indicators and considered how the lead partner HAs compared with the national average. This showed that they perform better than the national average, except on tenant satisfaction:

### Performance of lead partner HAs on five key PIs (1)

	Group average	National average	
Relet times	35.7 days	40 days	better than national average
Urgent repairs	93%	91.7%	better than national average
Rent loss through voids	1.48%	2.1%	better than national average
Tenant satisfaction	75.5%	78%	worse than national average
Operating costs	£44.57	£48.09	better than national average

However, it might be reasonable to expect that those HAs which are managing the majority of new Corporation-funded social housing should perform particularly well. Consideration of where lead HAs fit in the national upper and lower quartile shows that many are not the best performers:

### Performance of lead partner HAs on five key PIs (2)

	Upper Quartile		Lower Quartile	
	Rating	% lead HAs in UQ	Rating	% lead HAs in LQ
Relet times	22 days	22%	48 days	22%
Urgent repairs	97%	26%	90.2%	23.1%
Rent loss through voids	0.9%	23.5%	2.4%	8.7%
Tenant satisfaction	86%	19%	73%	39.7%
Operating cost	£39.82	29.4%	£51.83	16.2%

It cannot be expected that every lead partner HA will be in the top quartile of associations on most figures. But seven are below average on four of the five PIs chosen. This plus the tenant satisfaction results and the number of them in the bottom quartiles for the other PIs, shows clearly that not all IP developers are necessarily the best managers.

Size may be relevant here, as four of the seven consistently poor performers have stock greater than 10,000, and only three of the 16 who are above average on all five performance indicators are in this size group.

This suggests that the Corporation needs to look hard at how and who is to manage the homes produced by its investment. It might be that measures need to be brought in to:

- ensure that the worst performing Investment Partners outsource their housing management;
- ensure that larger developing HAs provide a percentage of new rented homes for ownership or management by effective, non-IP associations.

The latter would also help access the balance sheet capacity of such associations and give them the basis for growing their businesses centred on customer service.

### **What do the Corporation's statistics tell us?**

**The available Corporation statistics are inconclusive in terms of operating costs and effectiveness and do not provide evidence that moving to a smaller number of larger associations would improve efficiency or effectiveness in delivering housing services.**

### **Big or small: efficient at what?**

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The debate about the optimum scale for delivery of housing services is invariably muddled by a failure to specify *which* services are to be considered. Blanket statements such as 'big is best' and 'small is friendly' may not be helpful, but there may be different optimum scales for different services where these statements can prove to be true.

The recently-published discussion paper on *Social Housing Efficiency*<sup>1</sup> (referred to here as the ETN – Efficiency Technical Note) distinguishes four areas for examination:

- new housing supply
- procurement of capital works
- wider procurement
- housing management and maintenance.

To examine these issues we considered them in turn, to look at what size might be appropriate for each.

#### **New housing supply**

Public policy set out in the Housing Corporation's *Reinventing Investment* programme is explicitly to focus investment on the best developing associations in order to achieve economies of scale.

The new CIH report *Investment Partnering – an Evaluation of the Pilot Programme*<sup>2</sup> concludes that there has been an efficiency gain representing an average of 28 additional homes for every £10m of grant.

<sup>1</sup> ODPM, 2005.

<sup>2</sup> CIH and Tribal HCH, June 2005.

The evaluation also shows that associations and developers are confident that longer and bigger programmes will improve efficiency through better supply chain management and enhanced take-up of MMC.

This suggests that there are benefits to having larger programmes delivered by fewer developers.

Also, while in some cases consortia of associations have been the partners, the bulk of the partners in the pilot programme are existing, single associations or groups. The lead partners range from the smallest owning around 400 homes to the largest owning 35,000. The Corporation's statistics are published according to lead association, which masks the true scale of the partnerships.

### **Procurement of capital works**

There have also been significant moves by associations to gain efficiencies from their repairs and improvement capital works by improving information systems, organising the supply chain and gaining good prices through volume purchasing.

To deliver these, some associations may be too small to invest in the necessary infrastructure without working with other partners. It has therefore been argued that it makes no sense for every association to have its own systems and procedures – particularly if they are looking to improve the effectiveness and efficiency of a service which is often delivered to an overlapping customer base by a scarce contracting resource.

The recent CIH report on responsive repairs services *Right First Time*<sup>3</sup> emphasised that the search for efficiencies needs to take advantage of scale in terms of infrastructure, procedures, procurement and management expertise, while delivering a service that tenants want and can influence. It shows how this is leading to a variety of approaches. Some organisations are outsourcing their whole repairs function to private bodies, others are partnering part of the service with private bodies or other associations, while others have developed really effective DLOs which are now selling services to other associations.

*Right First Time* also suggests that social landlords should spend around £1000 pa per home on stock investment. A healthy programme that might attract a fully-equipped partner is typically £5m pa, which would be generated from a stock size of over 5,000 homes.

### **Wider procurement**

The government has put a lot of emphasis on associations gaining efficiency savings from better procurement. The ODPM's ETN launches a new fund to promote procurement consortia. Although the idea of formal target sizes for consortia has been abandoned, for ODPM's targets to be met consortia of significant size and spending power will be needed.

One focus of all the best practice advice on efficiency is the 'back office'. As the requirements of the job have become increasingly sophisticated and regulatory expectations extended, so the demand for professional services has developed. Association managers all form their own judgements about the resources they can devote to the back office and there are step changes when associations or groups reach a certain size or intensity of activity.

There is a clear need for minimum overheads to be able to carry larger capital projects or expensive staff teams. Conversations with professionals working in this area suggest that minimum effective sizes for these may be:

- full range of financial services, including treasury and risk management – at least 5,000 homes; and,
- full range of IT, communications and company secretariat service – at least 10,000 homes.

<sup>3</sup> *Right First Time – How housing associations are improving their responsive repairs*. CIH, 2005.

But it is important to make the caveat that in searching for size in wider procurement there is the danger of losing local flexibilities. For instance what if tenants locally don't want what the consortium can get most cheaply? – this can create costs and cause frustration for staff and customers.

### Housing management and maintenance – local delivery

Public policy has in the past capped the *maximum* size of landlord through the transfer process, mainly because there was a clear perception that large monopoly landlords were not the best way to manage social housing. For many years the limit was 5,000 homes irrespective of the cost of split transfers. It was then increased to 12,000 homes. The 2005 guidance, while removing this limit, emphasises that authorities with large stocks should still transfer 'to two or more distinct associations with clearly separate identities' and places 'great importance on delivery and locally-based management'. The consequence of this policy is that in most cases transfers are organised to break down the stock into geographically-close units that will be sustained at around 5,000 homes after improvement.

Evidence from the home ownership sector provides an instructive lesson. In the 1980s the major financial institutions piled into estate agency, hoping to sell financial services through their chains. In the subsequent property crash those who failed to give their branches extensive delegated authority to respond to local market conditions went under – for example both Prudential and Lloyds Bank lost substantial sums in unwinding ineffective operations.

So, even if larger scale is good for market reach and efficient back office services, it needs to be coupled with small-scale, market-sensitive, local customer-facing operations.

The PI data on tenant satisfaction and rent loss suggest that smaller and medium associations may have advantages in terms of effective service delivery. Given that the smallest landlords have the highest operating costs, a working assumption would be that 1,000 homes are necessary to deliver the full range of services.

These scales are also probably relevant for wider neighbourhood and regeneration activities where local expertise is vital. This probably means that the optimum scale goes along with housing management and maintenance – 1,000-5,000 homes.

### An optimum scale for activities?

The evidence above is limited. However it is worth making a tentative hypothesis as to what the economically-optimum scale of activity for each of the following outputs might be:

Output	Optimal size range
Housing management and maintenance	1,000–5,000
Stock investment or major repairs as per the OCI	>5,000
Commodity procurement	500–2,000
Development as per Investment Partnering	>7,000
Full range of financial skills	>5,000
Full range of back office services	>10,000

This suggests that associations have to think about economies of scale in different ways for different functions. Given that the evidence above shows that satisfaction does not get better with size, how then to combine and organise to achieve optimum approaches?

## Groups and mergers

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For many the preferred way to achieve economies of scale is to grow the business by increasing its size. This is often driven by the search for resources for development (assets, borrowing potential, skilled staff, knowledge of sites, etc.).

Aside from development, the potential benefits claimed for mergers or for entering into groups can include:

- lower administration costs through pooling central support services;
- improved borrowing terms achieved through inter-company borrowing; or
- risk sheltering.

Given the large numbers of group structures formed and mergers pursued in recent years we would expect evidence that amalgamations of associations produce greater efficiency and effectiveness. This section examines whether this is the case.

### Groups

Groups usually involve a parent HA and a number of subsidiaries. Boards and staff of associations have tended to favour grouping over outright merger. The reasons often stated are:

- the valued brand and/or local service will often be retained;
- positions among boards and staff teams can be retained, and any down-sizing is managed incrementally;
- for smaller HAs, groups can mean increased scope for management and growth opportunities and for buy-in to corporate services that they could not have supported alone;
- they allow different business units within a group to develop clear specialisms.

A significant proportion of separate HAs within groups result from the requirements of councils at stock transfer to have a locally-accountable body plus the need to ring fence such transfers at the point of entry into the group.

The only significant evaluation of the performance of groups published so far is *Group Dynamics – group structures and registered social landlords*.<sup>4</sup> At that time 75% of association homes were part of a formal group.

*Group Dynamics* identifies the variety of motives for setting up groups (including tax and borrowing savings, ring fencing diverse activities and providing local subsidiaries that can 'act locally'). It notes that while many of these aims had been achieved (especially tax savings) there was much less evidence that groups were more efficient or that economies of scale were delivered quickly:

*'Performance information shows no clear link between membership of a group and improvements in RSL management costs or performance.'*

*'Existing evidence does not show that groups deliver a different quality of services to tenants and other stakeholders when compared to associations that are not group members.'*

Group Dynamics.

The analysis underpinning the Corporation's OCI also looked but could find no evidence that being in a group improved the comparative cost of individual associations.

In the interviews which CIH and Tribal HCH undertook for the report *Investment Partnering – an Evaluation of the Pilot Programme*<sup>5</sup> a number of associations involved in the formation of group structures pointed both to the initial costs of setting up structures and to the ongoing costs and complexity of maintaining elaborate management and governance arrangements.

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<sup>4</sup> Written by the Audit Commission and published by the Housing Corporation, 2001.

<sup>5</sup> CIH, 2005.

There is also the danger that for many HAs already in groups, choices in how they can go about improving costs can be pre-empted. David Mullins in his report on constitutional and structural partnerships,<sup>6</sup> draws attention to the:

*'significant concerns [which] exist about the inevitable inequalities in relationship between parent and subsidiaries, who can become 'captive markets' for central services provided by the parent.'*

This throws up interesting questions about what happens to those HAs already subsidiaries within groups, as efficiency pressures bite. Theoretically they can leave groups, but this has rarely happened.

Some groups can also be seen as a way to gain economies of scale without having to make decisions on staffing and board composition issues. Someone involved in lending to HAs commented during the course of this work that groups are often a way of avoiding the hard choices that a real merger would enforce.

There does therefore seem to be little practical evidence to support the idea that groups have delivered improving efficiency and effectiveness. Indeed if efficiency gains are to be made then the costs involved in elaborate group structures may be a key area.

## **Mergers**

If groups are not able to show real gains in efficiency and effectiveness then perhaps the route to economies of scale is via straight mergers (full integration of the activities of two or more landlords into a single new structure) – which need fewer board members and less complex structures.

Traditionally, mergers have been driven by weaknesses in particular associations. Quite often these arise because of Corporation action against an HA that is seen to be failing. Yet even in such situations the onus is still on the board of the 'failing' HA to determine who they merge with. One step forward would be if the government were to allow the Corporation more leeway in dealing with HAs by, for instance, forcing weak HAs to hand over the management of the stock to a successful association or by the Corporation being more involved in determining takeovers of weak HAs.

A key driver for some recent mergers has been striving to achieve operating efficiencies through streamlining processes that, as we saw above, can be costly to administer:

- One group has estimated that maintaining a separate legal entity can cost as much as £140,000 per year – on top of which is the opportunity cost of senior staff time spent covering board meetings and the staff time in meeting the regulatory requirements of each group member.
- The Drum Housing Group in moving to unpick its group to form a single association claimed that it anticipated reductions in expenditure of over £1 million over a ten-year period.
- The Circle 33/Anglia merger will result in a structure with a parent and four other registered associations, as opposed to the 12 registered bodies involved in the two separate groups.

All this would seem to argue for a move towards mergers to help improve efficiency and effectiveness.

However the evidence from private sector merger research shows that there are complex issues to be faced:

- A report by KPMG showed that less than half of mergers produce added shareholder value.<sup>7</sup>

<sup>6</sup> *Who Benefits?* University of Birmingham, 2000.

<sup>7</sup> Reference needed here.

- The need to focus on the cultural and organizational fit (i.e. how they rationalise staffing and organizational systems) to get benefits from mergers rather than just the strategic fit (i.e. growth and consolidation in relation to their markets).<sup>8</sup>
- The trend whereby a period of merger growth is followed by a rationalisation of businesses to refocus on core functions.
- Generally, firms should expect a dip in performance before and after the merger is completed, so payback should be expected over a longer period and certainly no sooner than two years.<sup>9</sup>

There is also an element of 'fashion' to such mergers. Merger mania swept corporate boardrooms in the mid to late 1990s as executives across all sectors decided that growth through acquisition was the best way of building up the scale to compete in global markets. KPMG have reported both that global merger and acquisition activity subsequently slumped to a 10-year low, with business leaders gripped by a new mood of caution and that a significant proportion of mergers which did take place were being dismantled.

Associations need to budget for the transaction costs of mergers and groups and need to look at the set up costs and pay back period in assessing these benefits. For many associations, no sooner is one merger or group enlargement completed that they are looking for the next partner. This makes any real analysis of the benefits of merger difficult and the evidence of real benefits is very much based on HAs' own claims.

Mergers can also absorb energy which might be better devoted to other activities unless there is clear evidence that the merger is going to result in significant economies of scale or better services to tenants.

There is also the danger of losing local focus on service delivery. It is worth noting the way the new head of UK banking at Barclays is arguing for power to be devolved back to local branches which are to be encouraged to know and respond to local circumstances.

Without clear market mechanisms there is a danger that growth and size *in themselves* become the basis on which those running HAs judge themselves and are judged. Indeed, there is a widely-held belief that merger activity is often motivated by the ambitions of senior members of staff.

Seeking the most efficient way of running the business in the interest of the aims of the HA and the most effective delivery of services should be the key driver. Growth is only desirable if it supports this. As Peter Dixon's recent letter to HAs states: *'It is not sufficient just to plan for larger organisations for the sake of it'*.

### **Wider issues for growth**

In looking at groups and mergers we have recognised that there are wider issues that are encouraging associations down these routes. Before leaving this subject we examine three key areas:

#### **Risk management**

The analysis so far looks at associations operating without encountering risks. But dealing with risks has been put forward as a driver for moving to a larger structure because an adverse event could be fatal for a small association but less problematic for a larger one.

Development is one of the riskiest activities that associations undertake. For a development with a total scheme cost in excess of £2 million, a 10% cost over-run could require additional borrowing

<sup>8</sup> Based on findings in CURS, 2000, see above.

<sup>9</sup> *ibid.*

of £200,000, interest payments on which might run to £20,000 pa. This will represent an insignificant 0.1% of turnover to a 5,000 home association, but a more significant 1% of turnover for a 500 home association that might affect its performance and stretch its borrowing capacity.

The least well-researched area is risk arising from the age and condition of stock, with the risks of a substantial up-lift in unit costs during the next five years or the emergence of additional costs during periodic stock condition surveys.

Associations can also look to offset other risks such as the revenue risks from a significant exposure to supported housing and care activities.

### Tax advantages

*Group Dynamics* pinpointed the tax advantages achievable through groups. Small associations that outsource services can save VAT if they purchase them from a group member. Non-charitable associations can lawfully avoid corporation tax by gift-aiding surpluses to charitable members of the group.

This suggests that one of the key drivers for larger structures may be to maximise tax advantages.

### Financial strength

The report *Do You Have the Capacity?*<sup>10</sup> used the housing association life cover ratio (HALCR) to assess whether an association has the long-term capacity to grow. On the question of scale it concluded:

*‘There are also significant size differentials; small associations have considerable potential in percentage terms, but of course from a low base; the largest associations have adequate capacity to engage in further expansion beyond present plans, but this is not generally the case for ones between 2,500 and 10,000 homes’.*

*Group Dynamics* also pointed to possible savings on borrowings from larger structures. Group parents can borrow at the rates available to the largest associations and pass the benefits on to their subsidiaries.

Analysis of the effective interest rates (EIRs) of associations by size from the 2004 Global Accounts does not support this:

#### EIRs of associations by size

	<1,000	1,000 – 2,499	2,500 – 4,999	5,000 – 9,999	10,000+	total traditional	LSVT	overall total
Effective Interest Rate	6.3%	6.0%	6.3%	6.0%	6.5%	6.3%	5.9%	6.1%

The largest associations have a higher EIR than smaller ones. This could be because larger traditional associations have fixed-rate loans from the 80s and early 90s at high interest rates which are prohibitively expensive to refinance.

A comparison could best be made from a correlation between size and the cost of the latest borrowings.

The evaluation of the IP pilot<sup>11</sup> raised a related concern – that funders may become nervous about the increasing scale and complexity of group structures and mergers, particularly where the over-complicated flow of funds through partnerships may increase the costs of securing funding.

<sup>10</sup> NHF, 2003.

<sup>11</sup> CIH, 2005.

## Conclusions from evidence on groups and mergers

There are potentially some benefits to mergers in terms of risk and taxation issues. Mergers also offer the potential to tackle some of the costs of group structures.

We have found no compelling evidence that size has real benefits in terms of the efficiency of organisation, better delivery of services or costs of borrowing. Indeed it appears from the evidence above that a focus on outcomes and effective management is more important than structures.

So in looking to grow, HAs have to be clear what value they are seeking to add.

## Partnerships for scale

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One issue that arises from the analysis above is whether rather than focus on *economies of scale* we should instead be focussing on *economies of scope*.

A recent report on economies in the water industry<sup>12</sup> argued that there were diseconomies of scale which meant that increasing the size of companies would not result in lower costs of production, and further consolidation of the industry would not generate any real economic benefits.

Instead they argued that the real potential lay in *economies of scope*, which they defined as *where the joint production of services means that the costs of production are less than the sum of the production costs by separate firms*. They concluded that there was scope to achieve these through water companies to share inputs, network management and billing.

While the water industry is very different to housing, with many fewer players, and where consolidation may have already produced the optimum economies of scale attainable, the concept of *economies of scope* is a useful one to look at how associations might seek to move forward.

This section therefore looks at what partnerships are already in place or are emerging to achieve improvements without going for full-scale merger or grouping.

### Strategic alliances

Associations that do not want to commit themselves to a group have begun to develop comprehensive strategic alliances, governed by mutual agreements rather than constitutional changes. This may allow associations to avoid the costs of groups/mergers.

### Single purpose consortia

Housing associations have a tradition of working together on specific services or projects. By doing so they can lever up their bargaining power to achieve economies of scale or tackle challenges they could not face alone.

Consortia for management tend to be created for specialist services. For example, associations in Hampshire have established a consortium to provide specialist services to tackle anti-social behaviour. These sorts of arrangements could be used to provide a broader range of services and so increase scope.

### Development consortia

The most common recent application of consortia has been in delivering development. The incidence of large-scale opportunities beyond the reach of individual associations and the need to manage competition has commonly led to the creation of project-based consortia. More recently, the need to secure programmes large enough to qualify has brought like-minded associations

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<sup>12</sup> Stone and Webster, 2005.

together in a range of partnerships. Such partnerships are described in the CIH's *Towards Investment Partnering*.<sup>13</sup>

### Procurement consortia

Obtaining economies of scale in procurement has always proved elusive. A number of collective organisations have ceased trading (HAPM – the Housing Association Property Mutual and the Amphion Consortium established to deliver modern methods of construction in development, are two examples). However, the government efficiency imperative suggests that this is an idea whose time has come, especially in procuring stock investment.

The social housing sector has already established Procurement for Housing at national level and there are a range of partnerships aimed at improved procurement being established by associations. As the CIH report *Right First Time* identified, collective purchasing power promises to improve both price and specification, while realising efficiency gains in the purchasing process. The advantages can then be extended into joint works contracts.

There will also be scope for more local consortia, for example for IT services.

### Service partnerships

Whatever the benefits of collective purchasing, it is difficult to imagine associations matching the collective purchasing power of the biggest players in the market. What seems to be happening, however, is a recognition that expertise exists, in a variety of guises, that can be harnessed in the search for lower costs and better service.

Collective procurement in its various guises may therefore accelerate the trend towards service partnerships. On repairs this can involve using the specialist expertise of builders' merchants to handle purchasing and supply arrangements, allowing associations to focus on providing the repair service itself.

### Vertical integration

Another possibility which may arise out of the development of Investment Partnering and SHG being given to private bodies is vertical integration. We are already seeing some joint vehicles between associations and between builders and associations being pioneered.

With the introduction of grant to developers, there is a likelihood of the further development of special purpose vehicles, already operating in many regeneration and PFI schemes. These could comprise a mix of associations and developers and are organized to meet the scale requirements of commissioning bodies.

## So what future for the sector?

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We have no doubt that the thrust of current government and Housing Corporation policy is leading to the most significant restructuring of the sector since its growth in the 1970s and 1980s.

The prevailing wisdom is that the sector will evolve into one characterised by two main types of association:

- large developing associations
- smaller specialists

– with local transfer associations possibly constituting a third.

Signs already exist in the proposals for several so-called 'mega-associations' which would result in property portfolios of around 30,000 homes each (for example, the Amicus/Horizon, Keynote/Prime Focus and Circle 33/Anglia proposals).

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<sup>13</sup> CIH, 2004.

This potentially leaves the medium-sized and many smaller associations with a choice between:

- forming a merger/group with a larger association;
- developing specialisms that appeal to partnerships with larger associations or developers; or
- keeping their current size and choosing not to grow.

The dangers with this scenario are that:

- We may lose the local expertise of medium and smaller associations.
- A significant proportion of the sector's development capacity is in the small and medium-sized associations. If they choose the third option above this would be 'locked in' to those associations.
- There may be unintended consequences – without clear evidence that bigger organisations produce better performance there is always the danger of outcomes which are not beneficial to the sector and its stakeholders.

In the absence of clear evidence that larger associations deliver better outcomes, there is a need to question whether the possibility of a sector dominated by a small number of large developing associations working within a strong central government agenda is in reality going to deliver the best homes and services in localities.

**Without the disciplines of a market or a real means of localised accountability there is a danger that the needs of producers rather than customers will predominate.**

### Deconstructing housing associations?

So what is the alternative to a sector dominated by a few larger associations?

An alternative scenario might well be one that moves away from seeing the norm as 'ring-fenced' independent bodies seeking to do development, asset management, customer services and specialisms within that ring fence. If we look at the utilities sectors, these services are considered to be separate functions requiring different skills and foci and organised in different bodies.

The growth of partnership working across associations that we described earlier suggests that the rationalisation might be less about the growth of big associations or groups, and more about a sea change in what we think of as a housing association. An alternative scenario might see a sector emerging which has a diversity of types of organisations and partnerships.

The move to give SHG to private bodies may hasten such an approach as it does in effect split the management of the properties from their development. This may create opportunities for good manager associations to grow despite not being Investment Partners.

### The Corporation's role

The Corporation's role is crucial in shaping the way the sector develops as its actions clearly influence the decisions which associations make.

It has in recent years appeared to be more supportive of groupings and mergers than earlier. Yet on the basis of the evidence presented here we believe that the Corporation should be prepared to test merger/group proposals very thoroughly to ensure that they are aimed at maximising efficiency and using the savings to support their aims and their services to tenants. As Keith Exford<sup>14</sup> is quoted as saying *'If there are no staffing reductions (from mergers) – why do it?'*

We therefore believe that the correct way forward is set by the recent letter from the Chairman of the Corporation to associations, clarifying the Corporation's position and requiring a case for merger to be based on:

- evidence that the new structure will improve services to tenants and others;
- evidence that there will be significant and measurable efficiency savings;
- arrangements to monitor outcomes against those intended savings; and,
- simple, clear and straightforward governance structures.

<sup>14</sup> Chief Executive, Affinity Group.

What will need to be clear is the minimum expectations that the Corporation will be demanding from associations and how these are to be monitored.

The Corporation also needs to be clear whether in moving to fewer developers it is also creating large-scale landlords and to consider whether that is in the best interests of effective delivery of tenant services. This may require measures, as we suggest on page 5 above, to ensure that good local managers can thrive as well.

### **Associations: moving forward?**

The evidence we have examined leads us to be wary of prescriptions which say that a particular form of restructuring will deliver efficiencies and/or effective services. There is little evidence that big really is better, particularly in terms of delivery of tenant services.

Neither is their evidence to support the view that smaller HAs produce better results. Small HAs cannot themselves just sit there and say that small is beautiful – they also have to ask if their tenants would benefit from economies of scale or scope.

There is a danger of over-emphasis on structures rather than on outcome and outputs. While individual associations are understandably concerned to ensure they join the right kind of partnership, much of the restructuring activity, in particular the moves to groups and mergers, often seems to occur without clear evidence of how the new arrangements will either improve services for tenants or deliver more cost-efficient homes and services.

Our research suggests that there needs to be a cultural change within associations. Many still seem to see development, and particularly Corporation-funded development, as the driver of business growth. With fewer developers under the Corporation's IP regime and private contractors having access to part of the ADP, many associations can no longer take this route.

But we do not see why smaller and medium-sized associations should not develop their businesses on the basis of providing top quality services. They will need to be competitive on costs, but they have the advantage that not being developers has a beneficial effect on their finances. After all, Pinnacle has shown that a private body can do that for housing management, so why not an association for that or other local services where they have real expertise?

To date the possibility of scaling down staff to improve competitiveness has rarely been contemplated as there is no real incentive for associations to retrench or outsource, in the way that the drive for profits does so in the private sector.

For individual associations, as efficiency will become a tougher driver, the analysis highlights the need to be very hard-headed in considering their options:

- identifying and focussing on what their strengths are;
- considering whether they can retain a range of functions or develop their specialisms (whether in customer services, repairs, neighbourhood management, regeneration, care, etc);
- considering a variety of structural options ranging from the consolidation of group structures, through partnerships with other associations, to solutions based on contracting-out the service to specialist providers;
- if seeking to enter into a new group arrangement or merger, being clear about the efficiency and service delivery gains from such a move; and,
- carrying forward their decisions in a clear plan of action.

**We have found no evidence that size, better quality services and lower costs are linked. For associations to be effective, it is more important that they are clear about their values and the outcomes they want, with effective management in place to achieve them. Size and structure should be a by-product.**

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