



THE SCOTTISH
HOUSING
REGULATOR

GUIDANCE NOTE

To: All Registered Social Landlords (RSLs)

Subject: Amalgamations, Transfers of Engagements and RSL Group Structures

Issued by: The Scottish Housing Regulator

Ref no: SHR 05

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Summary

This guidance note introduces the criteria the Scottish Housing Regulator will use in consenting to changes to the constitution of a registered social landlord (RSL) to enable it to amalgamate with or transfer its engagements to another RSL. The guidance also covers the situation where an RSL wishes to change its constitution to become the subsidiary of another RSL and advises on the procedures to be followed by RSLs in developing proposals for any such constitutional changes.

This guidance is relevant for an RSL or a prospective RSL wishing to become the parent or subsidiary of another RSL or prospective RSL.

This guidance note does not deal with agreements or contracts between one RSL and another for the provision of services, for example management or development agreements or contracts. Nor does this guidance note cover non-RSL organisations within RSL headed groups. That subject is dealt with in SHGN 2000/08.

RSLs and prospective RSLs not considering amalgamating with, transferring to or

SHGN 2000/07

02/09

March 2000

becoming the subsidiary or parent of another RSL or prospective RSL may disregard this guidance note.

For any references to Communities Scotland (or Scottish Homes) please read the Scottish Housing Regulator.

If you have any questions about this guidance, you should direct them to:

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SHGN 2000/07

03/09

March 2000

INTRODUCTION

1. Registered social landlords (RSLs) are expected to be efficient and effective and to provide good value for tenants and for public funding. In this context many RSLs may consider amalgamating or transferring engagements or forming or joining a group structure along with other RSLs with a view to greater strength and increasing their potential to make a difference to the communities they work in.
2. Existing RSLs wishing to amalgamate or transfer engagements (merge) or become a subsidiary of another RSL will require the consent of Scottish Homes to the merger or to the necessary changes to their governing instruments to become a subsidiary. Prospective RSLs wishing to be the subsidiary of another RSL or prospective RSL will need Scottish Homes agreement to including the necessary clauses in their governing instruments. This guidance sets out the criteria Scottish Homes will apply in granting the necessary consents or giving agreement.
3. In setting the criteria, we have tried to ensure that RSLs are as free as possible to adopt the structures they consider will be most effective in pursuing their objectives. The criteria have therefore not been developed as rules on, for example, the preferred size of organisations or their governance arrangements, but are focused on the aims of the proposal and the involvement of those affected by the proposal in developing, assessing and approving it.
4. In determining the criteria, Scottish Homes has taken the following into account:
 - the interests of present and future tenants
 - the public investment in the housing stock
 - the reputation of RSLs generally and their ability to bring about private investment in social housing
5. We have also had regard to the Government's key objectives of:
 - Maximising community empowerment
 - Encouraging tenant involvement
 - Facilitating regeneration and social inclusion
 - Delivering continuous quality improvement
6. This guidance note is not *directly* concerned with RSLs or prospective RSLs who wish to

SHGN 2000/07

04/09

March 2000

become the *parent* of subsidiaries in a group structure. An RSL can form a group structure with itself as the parent, and include both RSL subsidiaries and non-registered subsidiaries in the group, without the need *to obtain consent* for its own actions in doing so from Scottish Homes.

7. However, an RSL which is considering becoming the parent of subsidiaries should be aware of the terms of this guidance note in relation to potential *RSL subsidiaries* and the terms of SHGN 2000/08 in relation to potential *non-RSL subsidiaries and related organisations*. A related organisation is an organisation sponsored or promoted by the RSL which is not legally constituted as a subsidiary of the RSL but with which the RSL intends to have a continuing relationship of any kind.
8. There are various legal definitions of *subsidiary* which apply in different circumstances. For the purposes of this guidance, Scottish Homes will regard an RSL as becoming a subsidiary if it wishes to make changes to its constitution such that another organisation has the right to control the majority of votes at its general meetings or to appoint and remove a majority of the members of its governing body.
9. The guidance does not cover agreements or contracts between RSLs for the provision of services, for example, management or development agreements or contracts.

CRITERIA FOR CONSENT TO MERGERS AND BECOMING A SUBSIDIARY

10. RSLs require the consent of Scottish Homes, either under statutory powers or as a provision in the registration contract, to amalgamate or transfer their engagements (to merge) or to make the constitutional changes necessary to become a subsidiary in a group structure. RSLs contemplating taking such action should, therefore, discuss them with Scottish Homes Registration and Supervision Department at an early stage in the development of the proposals. Scottish Homes Regional Office(s) concerned should also be consulted for their views on the proposals. The expectation is that a full options appraisal has been carried out and the aim of the discussions is to identify any possible impediments to the chosen course and to ensure that they can be dealt with before formal consent to any change is sought.
11. An RSL should submit proposals for a merger or for constitutional changes to Scottish Homes in the form of a business case. The business case should be rational and accountable and should demonstrate that the proposal meets the following criteria:

SHGN 2000/07

05/09

March 2000

- The proposed changes must not cause the RSLs involved to breach their registration criteria, charitable status if applicable, or any other contracts or covenants with other parties.
- If a merger, it must be with an RSL; if the merger includes a statutory RSL, the organisation which results must also be a statutory RSL.
- If the merger includes a charitable RSL, the resultant organisation should also be charitable.
- If becoming a subsidiary, the parent must be an RSL. If the applicant RSL is registered under statute, the parent must also be registered under statute.
- If a merger, the merged organisation should be stronger, or at least as strong as, the partners taken individually, in respect of:
 - ◆ financial strength;
 - ◆ cost efficiency;
 - ◆ quality of service to tenants.
- If becoming part of a group, each RSL partner in the group should be able to demonstrate that individually it will be stronger, or at least as strong as it was before, in regard to:
 - ◆ financial strength;
 - ◆ cost efficiency;
 - ◆ quality of service to tenants.

SHGN 2000/07

06/09

March 2000

12. It is accepted that these criteria may not be met by all proposals in the short term. However, it must be demonstrated that they can be met in the medium to long term. The time scale and plans for meeting them should be included in the business case. The specific issue of proposals stemming from performance failure is dealt with at paragraph 15 below.
13. The business case should set out the objectives the partnership proposal aims to meet, which should comprise some or all of the following list, which is not exhaustive
 - improvement of service delivery
 - protection of tenants' interests
 - increased opportunities for tenant involvement/participation
 - acceleration/enhancement of stock improvement programme
 - lower overheads
 - lower rent levels
 - cheaper borrowing
 - reduction of risk
 - stronger and better management control
 - greater ability to recruit, train and retain staff
 - greater ability to recruit and retain governing body members
 - increased capacity to undertake development work
 - increased ability to play a wider role in the community
14. It is accepted that some functions may be maintained rather than enhanced and that some mergers may be aimed at prevention of a decline in standards rather than immediate improvement. However, it is expected that continuous improvement will feature as part of the business case. It is important to note that the scale of the proposal will be taken into account in applying the criteria to any particular application for consent.
15. If the proposal is intended to address issues of performance failure by means of a transfer of engagements by a weak RSL or by a weak RSL becoming the subsidiary of another RSL, it should be made clear in the business case what the performance failures are, the options that have been considered and how the proposed changes are intended to remedy them. In this situation, we will regard the ability of the proposal to remedy the performance failure of the weaker RSL as more significant than its ability to deliver an

improved performance for the partner RSL. However, we will require it to be demonstrated

SHGN 2000/07

07/09

March 2000

that the performance of the partner RSL will not be damaged except possibly in a limited and recoverable way in the short term, which would need to be quantified.

16. Specifically, consent will not be granted in respect of a proposal aimed at resolving performance issues unless Scottish Homes is satisfied that it is likely to be successful.

ADDITIONAL CRITERIA FOR CONSENT TO BECOME A SUBSIDIARY

17. If consent is sought for changes to the governing instrument to constitute the RSL as the subsidiary of another RSL, Scottish Homes will also require evidence of compliance with the following:
 - Each organisation within the group should have a distinct legal identity and separate constitution.
 - The constitutional relationships between all the organisations (registered or not registered) in the group should be set out in detail.
 - The intended role of any charitable RSLs or organisations within the group and their relationships with the other members in the group should be set out in detail.
 - The extent of and arrangements for any intended cross collateral liability, equity investment or on lending within the group should be clearly identified in the business plans, budgets and accounts of the organisations concerned.
 - Any contractual relationships for the provision of services between members of the group should be set out in detail.
18. RSLs considering becoming part of a group structure which includes non-RSLs should also refer to SHGN 2000/08.

SHGN 2000/07

08/09

March 2000

PROCEDURES

19. Scottish Homes expects proposals for mergers and constitutional changes to be under the control of the governing body or bodies concerned and to have been subject to a wide consultation of affected parties. RSLs applying for consent to such changes therefore are expected to be able to demonstrate that appropriate procedures have been followed. The following list forms a guide. Not all the procedures will be appropriate in every case, but all which are should be followed:
- Comprehensive options appraisal carried out.
 - Business case made in accordance with paragraph 11 above.
 - Business plan in place showing how business case objectives will be met.
 - Other regulators consulted/informed and in principle approval obtained.
 - Agreed strategy, timetable and prioritised work plan covering key areas of the process in place.
 - Effective interim management arrangements agreed by governing bodies and staff teams involved.
 - Joint governing body/staff steering group established to oversee the process.
 - Independent advice on key elements of the proposal given to members of the governing bodies and to members/shareholders of the organisations concerned to enable them to vote on the basis of full information.
 - Explicit endorsement of the governing bodies involved has been obtained.
 - Staff kept fully informed and involved.
 - Views of tenants sought and taken into account.
 - Relevant local authorities informed/consulted.
 - Agreement of lenders obtained.
 - Full disclosure within and between the partners and due diligence work carried out.

SHGN 2000/07

09/09

March 2000

20. The order in which the procedures are set out above is not necessarily the order in which they should be implemented and, as noted above, not all the procedures may be applicable. A programme, which takes into account the particular circumstances surrounding the proposal, should be prepared for each proposal.
21. The importance is again emphasised of discussing any proposals for a merger, or for becoming a subsidiary, with Scottish Homes Registration and Supervision Department at the earliest possible date. Provided a proper options appraisal is carried out, a convincing business case is made and the terms of this guidance are complied with, Scottish Homes will not take a view on which organisations should be involved in any particular proposal.

SUPERVISION

22. Each RSL within a group structure will be dealt with separately for supervisory purposes. Individual financial, performance and statistical returns will be required and individual annual accounts. Group accounts may be required in some circumstances. As part of performance audits to individual RSLs in the group, the RSL's formal and actual relationships with other members of the group will be examined.
23. Generally, each RSL within a group is expected individually to comply with Performance Standards and each RSL will be awarded an individual grade. However, it is accepted that there may be RSLs in groups to which Performance Standards do not apply in full and performance audits will be tailored accordingly, for example:
 - The parent RSL may own all or most of the stock. In this situation, the application of Performance Standards will depend on the extent to which the parent either specifies the management contract or leaves a management only subsidiary to operate in its own way.
 - The parent RSL may own no stock and in this situation, the parent itself will only be assessed for compliance with Performance Standards to the extent to which the Standards actually apply.

SHGN 2000/07

010/09

March 2000

24. These are just two examples. The point is that supervision will always be based on compliance with Performance Standards but the relationships between parent and subsidiary RSLs will also be taken into account.
25. The financial arrangements between members of an RSL group will be subject to careful scrutiny and the following principles should be observed by every member in a group:
 - An RSL lending to or investing in another RSL must have the power to do so in its governing instruments. Charitable RSLs must take advice and particular care in this area.
 - Any lending or investment must be quantified and arrangements for repayment and interest to be applied must be agreed between the parties and clearly documented.
 - The time scale for any lending or investment should be agreed and documented.
 - Non-financial support should be similarly agreed beforehand in terms of amount, time scale and any payment to be made in due course.
 - The governing bodies of all RSLs involved should agree the detail of any such arrangements and ensure that the arrangements are kept fully under control.
26. Compliance with the above will be assessed on performance audits.