IT'S THE LAW: Stock Rationalisation

What is it?

Put very simply, stock rationalisation involves the transfer of tenanted properties, their associated assets and the business of managing those properties, from one landlord to another.

It's all about the money, honey

Why do it? Registered Providers (RPs) are charged by the HCA's Regulatory Committee with optimising the return generated by their assets. The Chancellor's recent surprise announcement on RP rents is just the latest piece of news that has the sector looking at how to deliver for their tenants with greater efficiency. Stock rationalisation may be one option.

By undertaking an asset management review, an RP will be able to identify those properties it holds which are:

- underperforming financially and resulting in running costs that are disproportionate to the level of income generated;
- outside the type of stock that the RP wishes to concentrate its efforts upon (for example, the RP may wish to divest itself of its care homes which require specialist resources);
- located outside the geographical area the RP is concentrating on (for example, if the RP is based in Newcastle, they may not wish to be responsible for a single house in Kensington donated to them by a generous benefactor 60 years ago); and/or
- worth a lot of money and which, if liquidated, could be used in other areas of the RP's business (see the single house in Kensington example, above).

Disposing of the stock identified will raise funds which can be invested efficiently in new stock or reinvested in efficient current stock.

It's not all about the property

It's fundamental to remember that stock rationalisation schemes do not simply involve the transfer of a property. What is being transferred is the physical property, the obligations towards the residents

Neil Toner
Partner, Head of Real Estate
020 7065 1823
neil.toner@devonshires.co.uk

Aruna Sarwar
Partner
020 7065 1846
aruna.sarwar@devonshires.co.uk

Tryia Maicha
Partner
020 7065 1805
triya.maicha@devonshires.co.uk

pursuant to their tenancy agreements, the business of managing that property and the assets of that business and further, in many cases, the employees of that business. Putting to one side the law for a moment, it's important to bear in mind that we're talking about people's homes. Stock rationalisation is complex and multifaceted and preparation before going ahead and marketing the stock or deciding to submit a bid is essential.

Ready to rationalise?

If you've decided you want to go down the rationalisation route and you've identified a chunk of your stock, your first step is to "get to know" your stock so that any potential issues can be identified, investigated and, if possible, resolved even before the stock is marketed. At this stage you'll need really good lawyers- so give us a call.

Preparation, preparation, preparation

Preparation is key to the success of any stock rationalisation. As a minimum, this will include:

- **Local searches:** You should strongly consider ordering local searches for the property to identify any local authority agreements, financial charges or other notices registered against the property so that these can be obtained and, if necessary, dealt with before the Buyer raises them as an issue. For example, planning enforcement notices can be tricky. If you don't find out about them until you've already engaged with the Buyer, not only can it be embarrassing, it will almost certainly result in a delay measured in months, not to mention the inevitable price chip.
- **Obtaining third party consents:** If any of your stock is leasehold, you may require the landlord's consent before the transfer can take place. After going through the process of identifying and marketing your stock, the last thing an RP will want is for the deal to be placed in jeopardy by an uncooperative landlord. Any consents that are required should be sought at the earliest opportunity and the landlord's conditions for giving consent (if any) ascertained.
- **Arranging for the removal of charges:** If the stock is charged, the RP will need to arrange for the charge(s) to be discharged as soon as possible. As the discharge of any outstanding charge will be a condition of completion, it is in the best interest of the Seller to limit the number of charges it needs to deal with post-exchange. The RP should liaise with their lender as quickly as possible regarding the discharge of charges (and often portfolios of properties will all be charged under the same financial charge). If necessary, the RP should identify alternative security for the lender. It's important to check the lenders' covenants to ensure that the proposed transaction puts neither the Seller nor the Buyer in breach of their loan covenants.
- **Collating construction and planning documentation:** If you are transferring any newly or recently built properties, you will need to provide the Buyer with NHBC documentation, planning permission sign offs, building regulation consents, evidence of discharge of section 106 obligations and potentially collateral warranties from the contractor and sub-contractors.
- **Obtaining copies of tenancy agreements:** You will need to provide sample tenancy agreements and copies of rent increase notices served for at least the last three years. These may be hidden away in your archives and they will need to be retrieved so that we can then review them to ensure they are in order.
- **Records:** On completion, you will need to supply all records relating to the property to the Buyer. This will include all books, accounts, statistics, financial records and surveys relating exclusively to the business being sold. These can be hard to find and so you should begin your search as early as possible so that if anything cannot be located, your obligation to provide these can be specifically excluded from the sale.
- **Assets:** You will need to compile an inventory of those assets that will form part of the sale and those which will be specifically excluded. There will usually be a number of properties involved in a stock transfer so time and resources will need to be allocated to inspect all the properties and prepare these inventories.
- **Contracts:** The properties may have the benefit of service contracts, for example for cleaning, garden maintenance or security. It may be possible for these to be novated or assigned to

the Buyer or they may have to be terminated on completion. All such contracts will need to be reviewed so that a decision can be made as to what will happen to them on completion.

And another thing…

You will also need to bear in mind the following from the outset of the transaction:

- **HCA's consent:** The consent of the HCA will be required for the transfer of tenanted stock and they will need to be satisfied that the proposed transfer is in the best interest of the residents. This leads to…
- **Consultation with residents:** The Seller will need to liaise with its tenants as to how the proposed transfer will affect them and the management of their property. If, for example, the transfer is to an RP who is able to provide better local services, tenants may prefer this to having an RP landlord based hundreds of miles away. The outcome of this consultation will form part of the application by the Seller for HCA consent.
- **Consultation with the local authority:** The local authority may have a preferred list of RPs to whom the stock can be transferred and their consent might be required for any proposed transfer. If so, this will also help the RP to decide whether to market the sale as a competitive bid or enter into a private negotiation with a preferred, local-authority approved entity. The Buyer may also have to enter into a nominations agreement (which gives the local authority a right to nominate the tenants in some or all of the properties) with the local authority and you should try and obtain the form of agreement required as soon as possible.
- **Employees:** the Transfer of Undertakings (Protection of Employment) (TUPE) obligations may arise in respect of employees employed in connection with the properties being transferred. If so, the procedure in the TUPE Regulations must be followed and the employment contracts for any transferring employees will transfer to the Buyer.

Do or do not- there is no try

To conduct a successful stock rationalisation scheme, commitment is essential from the RP's project team. The project team should include representatives from housing management, IT, HR, finance and rent accounting and property services with a dedicated project leader. RPs should be aware that stock rationalisation can be all-consuming and it will be very difficult- if not impossible-to manage the demands of a scheme alongside regular day-to-day duties. If it is not possible to dedicate a project leader to the scheme, then this will need to be factored in to your proposed completion date so that realistic target dates are set. You should also not expect your involvement in the scheme to end on the day of completion of the transfer even if you are the Seller. Post-completion issues including the transfer of records and rent arrears reconciliation will continue until around 3 months after the completion date and in some cases post-completion matters can run beyond this.

The tiny print

Find out more

Neil Toner
Partner, Head of Real Estate
020 7065 1823
neil.toner@devonshires.co.uk