RESEARCH

2014

CARE HOMES

TRADING PERFORMANCE REVIEW

HIGHLIGHTS

Average weekly fees rise by 2.1% in 2013/14, but lag RPI inflation for a fourth consecutive year.

Occupancy rates increase marginally, although rising costs are putting margins under pressure.

Trading performance remains strongest in Greater London and the South East region.

FOREWORD

On behalf of Knight Frank's Healthcare team I am delighted to welcome you to our third annual update of the Care Homes Trading Performance Review.

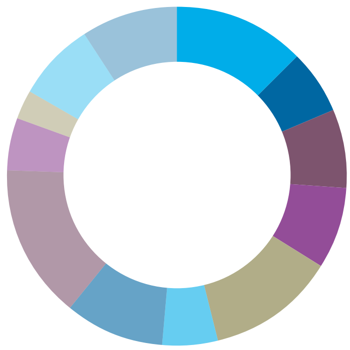
This year's update welcomes a number of additional leading care providers to the Care Homes Trading Performance Index (CH-TPI), making the research the most definitive evaluation of trading performance for the UK elderly care home sector. The index now comprises the majority of the UK's care providers, with a distinct bias towards corporately operated over independently run facilities.

The expansion of the CH-TPI has further enhanced the reliability of our geographical analysis down to the county level, as well as providing much greater scope to assess key performance indicators (KPIs) according to care home age and size. That said, the significant change to the index's composition brings added complexity, with trends over time requiring comparisons on a like-for-like (LFL) basis in order to be meaningful.

We would like to thank the growing number of leading care providers for contributing to the index. We hope that the findings provide a basis for the benchmarking of care home trading performance; informing care providers, public bodies and investors of latest trends in the sector with regard to occupancy, fee rates, costs and profitability.

OLIVER DU SAUTOY
Head of Regional Research

FIGURE 1
Regional share of the sample
% of total care beds



	CURRENT SHARE OF BEDS	12-MONTH CHANGE IN BED NO.S
EAST	13%	33% ▲
EAST MIDLANDS	6%	61% ▲
GREATER LONDON	7%	35% ▲
NORTH EAST	8%	6% ▲
NORTH WEST	12%	22% ▲
NORTHERN IRELAND	5%	28% ▲
SCOTLAND	10%	17% ▲
SOUTH EAST	14%	49% ▲
SOUTH WEST	5%	21% ▲
WALES	3%	65% ▲
WEST MIDLANDS	8%	50% ▲
YORKS & HUMBER	9%	30% ▲

Source: Knight Frank

2013/14 RESULTS AT A GLANCE

	All care	LFL annual change	Personal care	LFL annual change	Care with nursing	LFL annual change
Occupancy	87.6%	↑	91.2%	↑	86.6%	→
Average Weekly Fees	£660	↑	£566	↑	£688	↑
Staff Costs (% of income)	56.9%	↑	55.1%	↓	57.3%	↑
EBITDARM (% income)	27.5%	↓	29.2%	↓	27.1%	↓

Source: Knight Frank

OCCUPANCY AND INCOME

Occupancy rates see marginal increase, although the rise in fees lags inflation.

Occupancy

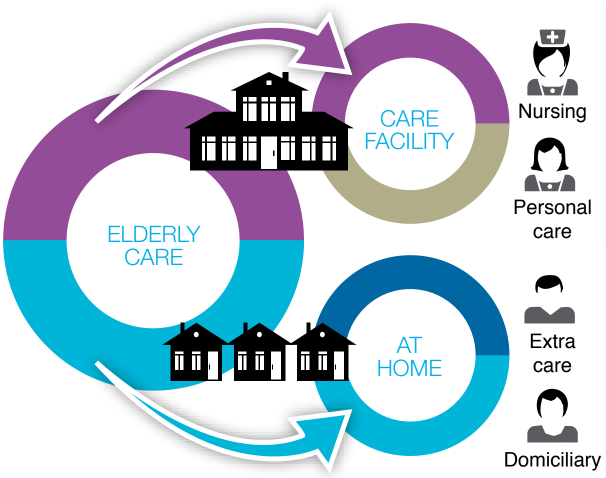
The overall care home occupancy rate increased marginally during FY 2013/14, rising from 87.2% to 87.6%. While the rise was not quite sufficient to reverse the fall seen during 2012, occupancy has been broadly stable since 2010, having fallen relatively sharply during the preceding years corresponding to the height of the recession (Figure 2).

Personal care homes continue to demonstrate stronger occupancy than nursing homes, with occupancy rates of 91.2% and 86.5% respectively in FY 2013/14. The difference is linked to a number of factors, principally; the strengthening of demand for dementia care at homes without nursing, the growing demand for privately funded care in personal care facilities, and the higher levels of dependency associated with nursing registered homes.

Occupancy rates vary markedly between the UK regions, although the overall pattern remains broadly similar to previous years (Figure 3). Wales shows the highest occupancy this year, standing at 92% overall and considerably above the overall UK rate. London, East and South East all show occupancy rates above the all UK level, which is unsurprising given the pressure on bed supply from alternative uses is typically greater here than elsewhere.

As last year, the North East and South West regions continue to show the weakest occupancy levels, at 85% and 82% respectively, which acted as a drag on the overall Index occupancy rate. While there is no clear explanation for the South West, low occupancy in the North East stems from a systemic over-supply of beds in the region, a consequence of a glut of care home development during the last decade.

ELDERLY CARE PROVISION



Nursing care – Care home with professionally qualified nursing staff.

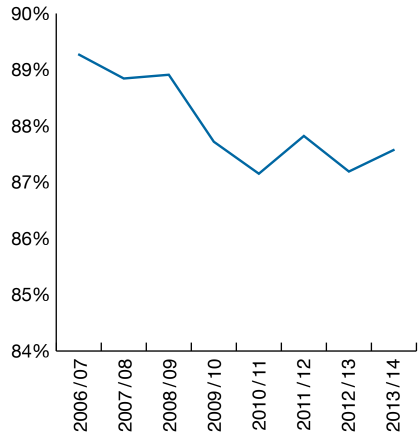
Personal care – Residential care home with non-professionally qualified care staff.

Extra care – Retirement housing, where residents live independently with care services attached as required.

Domiciliary care – Care provided at the resident's own home.

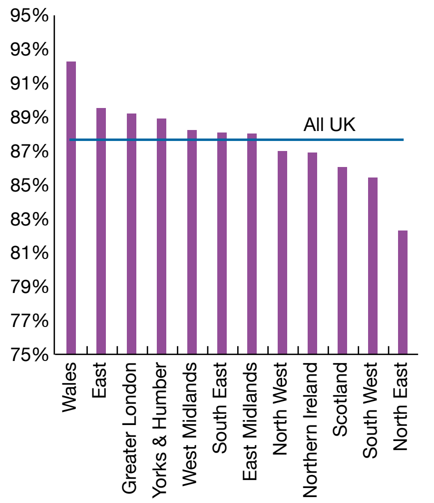
This report assesses **care facilities** with a bias towards nursing homes in our sample. Note that many facilities provide both nursing care and personal care on-site, and these fall under Nursing in our analysis.

FIGURE 2
Occupancy rates
%



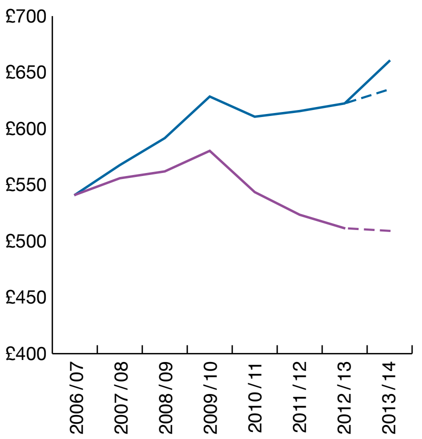
Source: Knight Frank

FIGURE 3
Occupancy rates by region (FY 2013/14)
%



Source: Knight Frank

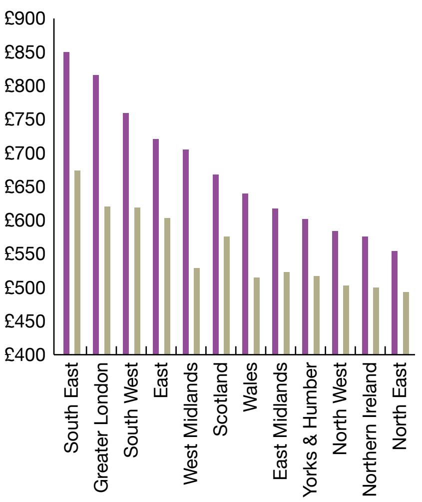
FIGURE 4
Average weekly fees
£ per week



ACTUAL
REAL TERMS (2006 PRICES)
LIKE FOR LIKE CHANGE

Source: Knight Frank

FIGURE 5
Average weekly fees by region
(FY 2013/14)
£ per week



CARE WITH NURSING
PERSONAL CARE

Source: Knight Frank

Income

For the UK as a whole, the CH-TPI reveals average weekly fee levels of £660 in FY 2013/14. While this is markedly higher than last year's equivalent figure (£622 per week), this largely reflects the changing composition of the index. A truer, LFL comparison reveals that overall fee rates increased by 2.1% during FY 2012/13. This is clear improvement on the 1.1% uplift seen during 2012, but nevertheless equates to a fourth consecutive year of below inflation fee growth (Figure 4).

There was a notable difference between the extent of fee increases between the two types of care; Personal care saw above inflation LFL growth of 2.9% in average fees while nursing homes saw fee growth of 1.8%. This divergence reflects the bias towards self-funded care that is evident in personal care homes, where fee rises have reflected individuals' ability to pay, rather than being dictated by local authority budgetary constraints.

From the regional perspective, the UK's southern regions continue to command the highest average fee levels (Figure 5). For nursing homes, the South East has the highest average fee levels, at £850 per week, followed by Greater London, at £816 per week. This reflects the greater prevalence of private paying residents, which supports the fee levels required to cover the higher staff costs and land values associated with these regions.

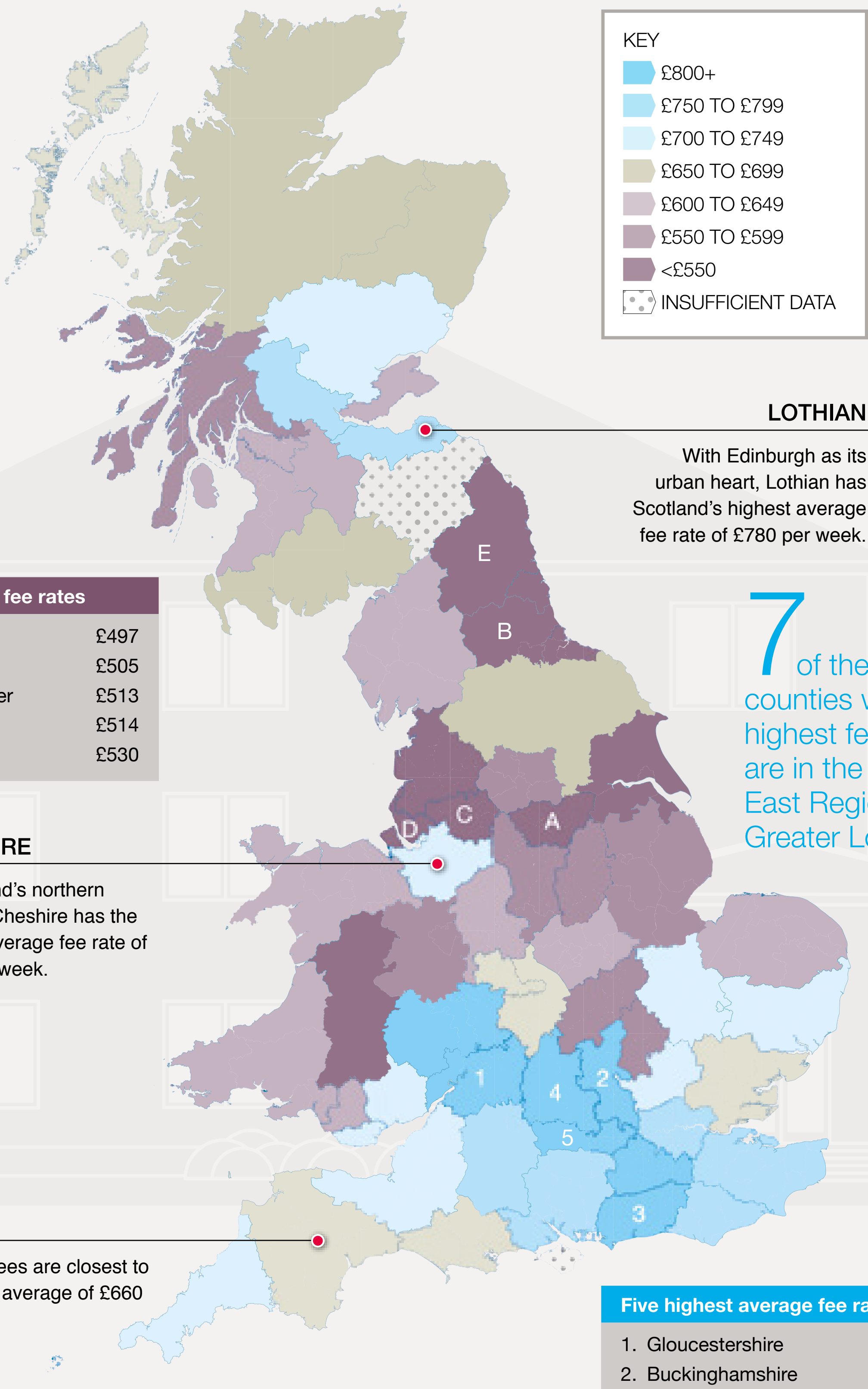
Average fee levels for nursing care are correspondingly lower in the northern regions of England, at £554 per week. With the private pay market being less prevalent here, local authority fees typically account for the majority of a care home's revenues. The North East continues to have the lowest average fees of any region, at £486 per week, with ongoing fee pressures exacerbated by over-supply.

Turning to personal care, the regional ordering of fee rates is broadly in line with that of nursing homes. While England's southern regions again show the highest fees, the regional differential is far less significant than it is for nursing care. Nursing care's 'premium' over personal care fees is also more pronounced in the South compared with elsewhere – in Greater London average nursing fees are 32% higher than personal care fees, compared with a difference of c.15% for the majority of UK regions.

AVERAGE WEEKLY FEES

	AVERAGE WEEKLY FEE	ANNUAL CHANGE (LFL)
Personal Care	£566	2.9%
Care with Nursing	£688	1.8%
All Care Homes	£660	2.1%
RPI Inflation (FY 2013/14)		2.5%

AVERAGE WEEKLY FEES AT THE COUNTY LEVEL



LOTHIAN

With Edinburgh as its urban heart, Lothian has Scotland's highest average fee rate of £780 per week.

7 of the ten counties with the highest fee rates are in the South East Region and Greater London.

Five lowest average fee rates	
A. South Yorkshire	£497
B. County Durham	£505
C. Greater Manchester	£513
D. Merseyside	£514
E. Northumberland	£530

CHESHIRE

Of England's northern regions, Cheshire has the highest average fee rate of £725 per week.

DEVON

Devon's fees are closest to the mean average of £660 per week.

Five highest average fee rates	
1. Gloucestershire	£890
2. Buckinghamshire	£884
3. West Sussex	£855
4. Oxfordshire	£846
5. Berkshire	£843

The South East has the highest staff costs for nursing care

COSTS

Care home costs continue to increase, impacting on operators' profitability.

Staff costs

Average staff costs amounted to £19,531 per resident for the FY 2013/14, a LFL increase of 2.9% from last year. Meanwhile, as a percentage of income, staff costs stood at 56.9%, although a LFL comparison reveals that costs increased from 57.2% to 57.6% of total income during FY 2013/14 (Figure 6).

Care home staff costs remain, predictably, much higher in the UK's southern regions. By a clear margin, the South East has the highest staff costs for nursing care, averaging c. £24,000 per resident in FY 2013/14. However, Greater London has the highest staff costs in the personal care sector, at an average of just over £20,000 per resident (Figure 7).

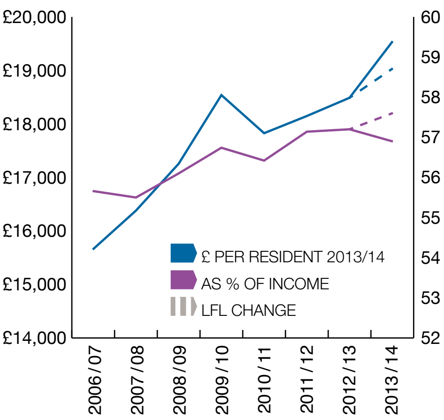
There is of course a marked difference in staff costs between nursing and personal care, reflecting the higher pay qualified nurses receive compared with care staff at personal care homes. However, this differential varies markedly between UK regions, and is the lowest in Greater London, with staff costs per resident at nursing homes standing only 12% above those for personal care homes.

While staff costs in the relatively affluent regions of Greater London and the South East are highest on a per resident basis, they equate to the lowest when considered as a proportion of total revenue (Table 2). Staff costs as a percentage of income are correspondingly higher elsewhere in the UK and it is these regions which are more exposed to upward pressures in staff costs, for example through labour shortages or increases to the minimum wage.

To this regard, Northern Ireland provides the most fitting example. While Northern Ireland's staff costs are some way below the UK average, they translate to the highest costs of any region as a proportion of revenue, standing at 60.9%, and considerably higher than the South East, at 53.4%.

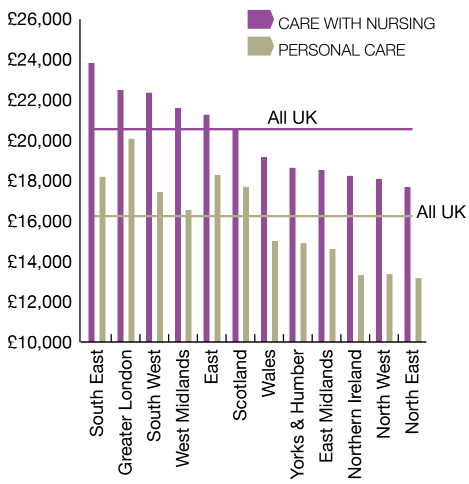
Agency staff costs as a proportion of total staff costs also increased from 4.1% last year to 4.8% for the FY 2013/14, a trend which likely reflects the growing difficulties with staff resourcing and retention. There is a significant degree of regional variation, however, with agency staff costs making up the highest share of overall staff costs in the South East region, at 6.3%, and the lowest share in Wales, at only 1.7%. The evidence suggests that care homes in areas of the UK with lower unemployment are likely to have a greater reliance on agency staff.

FIGURE 6
Staff costs
As £ per resident (LHS) vs % of income (RHS)



Source: Knight Frank

FIGURE 7
Staff cost per resident
£ per resident



Source: Knight Frank

TABLE 1 **Staff Costs FY 2013/14**

Region	Per resident p.a.	As a proportion of revenue
South East	£22,548	53.4%
Greater London	£22,159	54.0%
South West	£21,854	56.4%
Scotland	£20,554	59.3%
West Midlands	£20,099	59.1%
East	£20,097	57.1%
Wales	£18,379	55.4%
Northern Ireland	£18,034	61.0%
Yorks & Humber	£17,828	58.7%
North West	£17,077	58.0%
East Midlands	£17,041	56.0%
North East	£16,158	58.3%
All UK	**£19,531**	**56.9%**

Source: Knight Frank

Property costs

Care home property costs have increased sharply over the past few years, moving significantly ahead of inflation (Figure 8). On a per bed basis, overall property costs increased by a substantial 24% during FY 2013/4 (or LFL 18%) to stand at £2,179 per bed. Property costs now equate to 7.2% of total income, having stood relatively stable at c. 5% during the years prior to 2010 (Figure 8).

While energy and water prices have moved ahead of inflation in recent years, the sharp rise in property costs during FY 2013/14 is more closely associated with insurance costs and, particularly, increased repair and maintenance costs.

With further regard to the property aspects, it is also encouraging that operators, post financial restructuring, are now deploying increased capital expenditure on their portfolios which is enhancing the quality of accommodation to prospective residents.

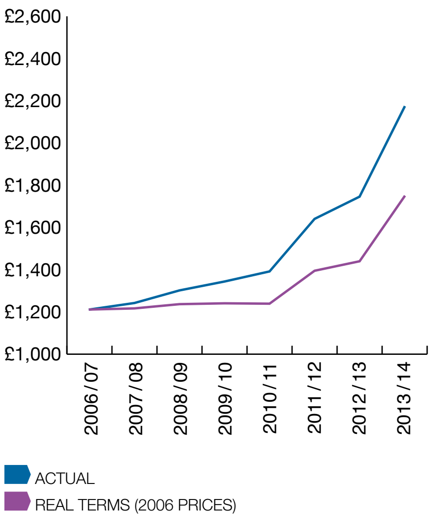
Food costs

Average food costs per resident in FY 2013/14 were 8.6% above the previous year, although the LFL rise was only 3.5%, which is much more closely in line with food UK food inflation. Evidently, different operators are able to source food at different costs to one another – the operator with the highest food costs was expending 53% more per resident than the operator with the lowest food costs.

Understandably, food costs differ between the regions, but the extent of variation is far less pronounced compared with other outgoings, such as staff costs. As with last year, food costs per resident were highest in the South East during 2013, at 11.0% above the overall UK average, and lowest in Northern Ireland, at 11.0% below the average. However, food costs in the majority of UK regions showed less than 5% variance from the overall UK average (Figure 9).

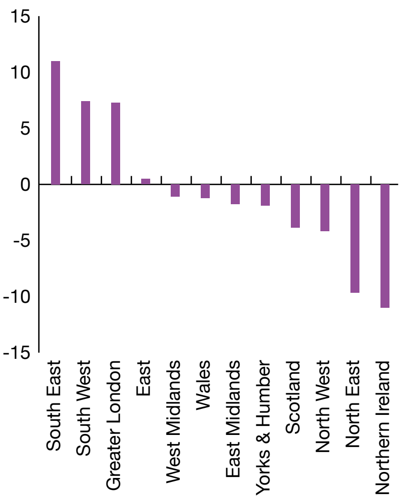
Phoenix Parkway, Scunthorpe (PrimeLife)

FIGURE 8
Property cost per bed
£ per bed



Source: Knight Frank

FIGURE 9
Food cost index (FY 2013/14)
% difference from all UK



Source: Knight Frank

Bucklesham Grange, Ipswich (Hallmark Care Homes)

Property costs

These are the costs which relate to the day-to-day running and servicing of the property. They include utilities, council tax, insurance and repairs & maintenance, but exclude any rental obligations in the case of leased care homes.

PROFITABILITY

Profit margins remain under pressure from rising costs and underline the geographical polarisation in the care sector.

Greater London and the South East comfortably outperform the UK's other regions on profitability

Gross profit margins have reduced in each of the last two years, and follow a general trend of declining profitability which extends back to 2006. Overall EBITDARM as a percentage of income slipped from 28.0% to 27.5% during FY 2103/14, although the LFL fall was more pronounced, reducing to 26.1% (Figure 10). With the occupancy rate being broadly stable and a sub-inflation rise in fee rates, the latest reduction in profitability largely reflects increases in costs, particularly staff costs.

Profitability continues to differ between the two types of care registration. In absolute terms, EBITDARM for nursing care (£8,376 per bed) stood 7% higher than for personal care homes (£7,825 per bed) in FY 2013/14. Importantly, however, personal care homes show higher profitability when expressed as a percentage of income, at 29.2%, compared with 27.0% for nursing homes. This is because while fees for nursing care are higher than for personal care, the additional income is more than offset by higher staff costs.

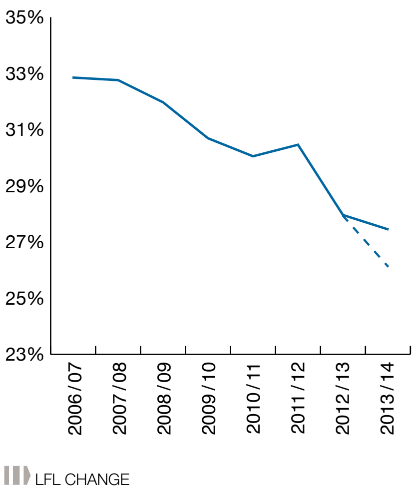
From the regional perspective, Greater London and the South East comfortably outperform the UK's other regions on profitability, with EBITDARM as a percentage of income at 31.8% and 31.2% respectively for FY 2013/14 (Figure 11). The result stems for the relatively higher occupancy rates associated with these regions together with the greater prevalence of private pay residents, which supports higher fee levels.

Wales is perhaps the most surprising result on profitability, rising to third in this year's analysis with EBITDARM as a percentage of income at 29.9%,

The Oakes, Huddersfield (Meridian Healthcare)

FIGURE 10

EBITDARM as a % of income



Source: Knight Frank

FIGURE 11

EBITDARM as % of income (FY 2013/14)

Source: Knight Frank

having been the lowest last year. This is a clear consequence of the change to composition of the index, with Wales' high occupancy rate being the main determinant of its strong performance.

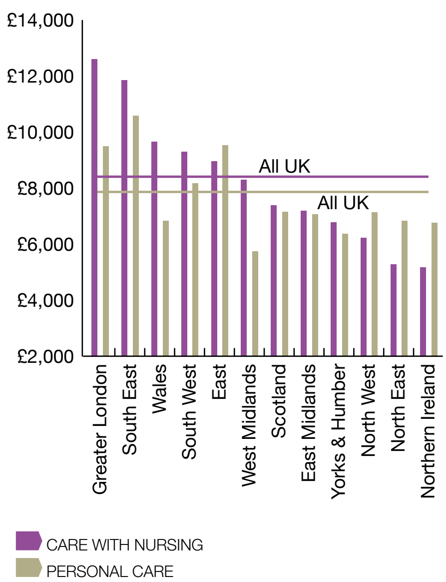
Profitability also varies significantly between the UK regions according to the type of care registration (Figure 12). On a per bed basis, nursing homes in Greater London and the South East are more profitable than personal care homes, contributing to the overall UK trend. However, the opposite is true in less affluent regions such as the North East and Northern Ireland, largely because these areas are more exposed to nursing staff costs amid tight budgetary controls on local authority care funding.

EBITDARM

Earnings before Interest, Tax, Depreciation, Amortisation, Rent and Management.

This is a particular measure of profitability which allows for direct like-for-like comparison between individual care homes, before costs of rent and management charges are accounted for.

FIGURE 12
EBITDARM per bed (FY 2013/14)
£ per bed



Source: Knight Frank

Maycroft Manor, Brighton (Hallmark Care Homes)

Overall profitability is demonstrably higher in the 60-79 and 80-99 bed size categories

Factors influencing performance

For any prospective developer or operator of a new build care home, the index provides revealing insights into other factors influencing trading performance, such as the size of the facility.

Overall profitability is demonstrably higher for homes in the 60-79 and 80-99 bed size categories vis-à-vis the smaller and largest, 100 bed plus categories. Average EBITDARM per bed stands at £9,455 in the 80-99 bed category, which is 14% above the all index average and 34% higher than the weakest performing under 40 bed category.

While these results stem from a number of factors acting in combination, the main driving factor relates to fee levels, which stand at £711 per week in the 80-99 category, or 8% higher than the all index average (see below infographic). Occupancy rates arguably have the most limited impact on profitably relative to fee levels and staff costs, with sub 40-bed homes possessing the highest average occupancy rates but the lowest EBITDARM per bed of any size category.

For the largest 100+ bed category, economies of scale do contribute positively to profit margins, notably with regard to staff, food and property costs. However, these efficiency advantages are more than offset by comparatively weak occupancy and fee levels.

Beyond home size, the age of the facility also appears to have a bearing on trading performance, with more modern facilities typically outperforming older ones. It is revealing that EBITDARM for homes built after 2000 stands at £9,041 per bed, 10% higher than homes built in the 1990s and 17% higher than homes built prior to 1990. This is largely explained by fee levels rather than cost efficiencies or occupancy levels, with post-2000 built homes carrying a 7% fee premium over homes built prior to 2000.

Key Performance Indicators by size of care home (FY 2013/14) **Source**: Knight Frank

	Average weekly fee	Occupancy	Staff cost per bed	EBITDARM per bed
< 40 beds	£634	89.7%	£17,356	£6,986
40-59 beds	£649	88.5%	£17,255	£7,926
60-79 beds	£682	87.3%	£17,085	£9,037
80-99 beds	£711	86.1%	£17,691	£9,455
100+ beds	£632	85.3%	£16,210	£7,837
All care homes	£660	87.6%	£17,106	£7,890

TRADING PERFORMANCE OUTLOOK

JULIAN EVANS
Head of Healthcare

The results from our 2014 update were closely in line with expectations, with increasing costs and sub-inflation fee rises prompting another edging down of profit margins in the elderly care sector. While the near-term outlook remains one of margins coming under further pressure, operators are in the main continuing to trade with robust EBITDA.

The economy is now expanding at an encouraging rate, but austerity in the public sector will continue to impact on local authority budgets, restricting fee rises for some years to come. However, many sub-standard care facilities are now closing, and the best operators should start to benefit from increasing occupancy levels.

Arguably the most pressing challenge that operators face is rising staff costs. There is a growing shortage of qualified UK nurses, and operators are increasingly having to turn to agency staff or recruit foreign labour to plug the gap. Indeed, an emerging trend is that many providers are now repositioning their existing care facilities toward personal rather than nursing care, as is the case for new build care homes.

The 2.1% like-for-like increase in fees was ahead of Laing & Buisson's 1.7% baseline survey rise last year, with the difference likely to be explained by the 'cross-subsidisation' of the private pay market, which continues to expand gradually. Evidence of this is also provided by the relative outperformance of the personal care sector, which saw an above-inflation fee rise of 2.9%.

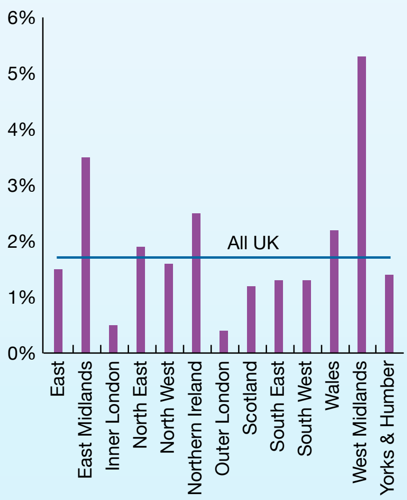
Geographical polarisation remains an enduring theme in the market, and a major long term challenge is replacing poor quality stock to meet care demand in less affluent areas outside the South East. Encouragingly, however, investors and operators alike are now recognising that a robust return on capital can be achieved elsewhere in the UK, where land is cheaper while still offering sound demographic fundamentals.

Fundamentally, there is a structural undersupply of care beds, one of the reasons for the huge amount of inward investment into the UK from overseas capital. The demographic change is compelling for long term growth in the sector, but this is at odds with the uncertainty surrounding the long term funding of care.

There remain areas of uncertainty surrounding UK Healthcare, including the outcome of the 2015 general election which could well include topics such as the 'living wage' and constitutional reforms post the Scotland referendum. Dilnot's reforms are expected to be implemented in 2016 and it is projected that an extra 35,000 care home residents will qualify for funding assistance under the new proposals. While welcome, there remains uncertainty as to how this will be funded, and whether the newly enfranchised residents will do part funded top-ups or be entirely funded by their local authority.

Encouragingly, the last 18 months have seen the refinancing of some of the major care providers, and the entry of new investors to UK Healthcare sector from all corners of the globe. Notwithstanding the political uncertainty, this demonstrates just how UK Healthcare is widely seen as a defensive, growing and sustainable asset class.

FIGURE 13
Regional baseline fee increases
(2014/15)
% change



Source: Laing & Buisson

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Front cover image: The Shelbourne Care Home in Sway, Hampshire (Gracewell Healthcare)

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