



CARE HOMES TRADING PERFORMANCE REVIEW



HIGHLIGHTS



INTRODUCTION

We are pleased to introduce the seventh annual review of trading performance in the UK care home sector.

Knight Frank are kindly provided with data by leading care home operators. We are proud to announce a 46% increase in the number of operators in our care homes trading performance index (CHTPI) for the financial year 2017/18.

The CHTPI review provides industry-leading benchmarks on occupancy rates, mix of funding type, average weekly fees (AWF), costs such as staff and agency outlays, and profitability.

The headlines show that both occupancy and AWF increased, as did staff costs as a percentage of income but profit margins fell against last year's performance.



Occupancy rates have hit a record high since records began in 2006, increasing for the sixth consecutive year to 89.4%, finally surpassing the 2006 figure of 89.3%.

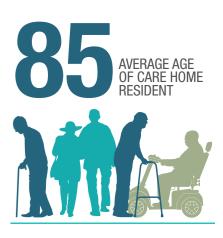
As illustrated in Figure 4, a marginal uplift of 0.2% in occupancy percentage has been seen. With a strong demand for elderly care facilities, this upward trend is no surprise.

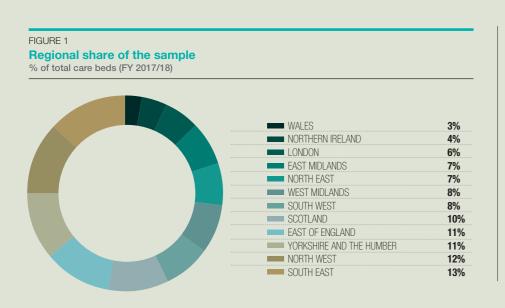
In 2018, the gap between personal and nursing care occupancy closed further, following a similar trend to last year's review. Occupancy in nursing homes increased from 88.7% to 89.1% while occupancy rates fell for personal care homes from 90.2% to 89.9%. The following reasons are contributing to this trend:

NORTH / SOUTH DIVIDE

- Residents are moving into care homes when their needs and acuity levels are higher and admission is necessary
- Nursing care providers are shifting their offering to personal care due to the nursing staff shortages
- Only 39% of the existing provision is registered as a nursing home compared with 61% of personal care homes.

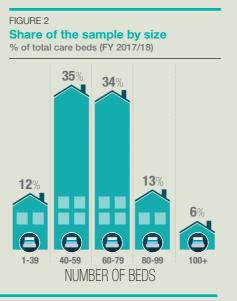
Similar to last year's review, the South West region is operating at the lowest





Mandip Bhogal

Associate, Healthcare

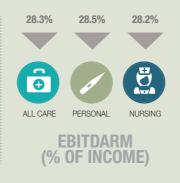


2017/18 RESULTS AT A GLANCE

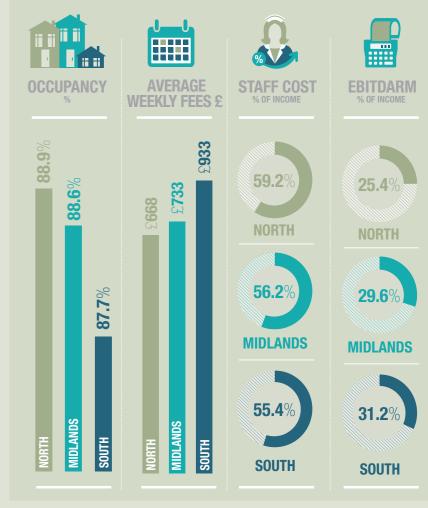












Source for all charts: Knight Frank Research

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occupancy rate of 83.1% triggered by a low occupancy rate (81.6%) in its nursing homes as shown in Figure 5. This region also has the second largest self-funder (SF) percentage of income (56%), indicating longer fill periods for operators targeting the private pay market. The most noticeable movement was in Wales, where occupancy rose from 87.9% to 90.8%.

Figure 7 illustrates that the highest occupancy rate (90.2%) is in properties built from 2000-2009. Occupancy is significantly lower for properties built after 2010 mainly due to slower fill rates for new developments strategically positioned to predominantly target the SF market.

Please note, Knight Frank Research use effective beds as opposed to registered beds to determine an accurate measure of occupancy. Effective beds are also known as operational beds, which are available during the financial year.

Fees

AWF increased for the seventh consecutive year rising by 3.7% to £773 in the financial year 2017/18. This is above the RPI inflation of 3.3% for the corresponding period, and represents the highest rate since records began in 2006 (Figure 8). In real terms, the AWF increase represents a less impressive movement of only 5% since 2006 (Figure 8).

The increase in fees has been driven by:

 Increased Local Authority (LA) fee rates (rising on average at 3.6% as per LaingBuisson's Care Markets Annual Survey report, July 2017) Continued SF fee inflation, above RPI and the continued shift towards the private pay care market.

Income per resident increased 4.5% to £40,922. However, this is less than the 4.7% increase in staff costs per resident.

The gap between nursing and personal care fee rates has widened even further. This has been driven by the appetite for nursing homes to inflate fee rates for the acute nature of care provided and due to increasing nursing staffing costs. In addition, the NHS-funded nursing care (FNC) rate increased 2% to £158 per week from April 2018. This is to assist with the nursing wage pressure, due to the shortfall of qualified nurses within the UK. In real terms, this reflects a fall.

Figure 10 illustrates the South East region's continuing dominance,

supported by its strong affluence profile which is reflected in the SF percentage of income increasing in this region by 2% to 60% of income. The East Midlands also had a high percentage of SF income at 54% (increasing 2% from the prior period) which is encouraging for developers who continue to head north of the Watford Gap to maximise returns. Figure 9 and Figure 10 also identify a North South divide.

In comparison to the prior period, the North East is relegated to bottom place, switching with Northern Ireland, driven by the region's SF percentage of income falling from 35% to 25%.

Figure 10 examines the relationship between SF and LA income by region. The outcome is predictable with the exception of London where a large proportion of the stock was built in the last century and is funded by the LA and NHS PCT.



The Hamptons, New Care

FIGURE 4 UK care home occupancy rate % 89.3% 88.8% 88.9% 87.2% 87.2% 87.2% 87.2% 87.2% 87.6% 88.3% 88.4% 89.2% 89.9% PERSONAL CARE \$9.4% 89.9% PERSONAL CARE \$9.9% PERSONAL CARE \$9.1% NURSING CARE



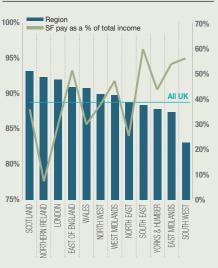
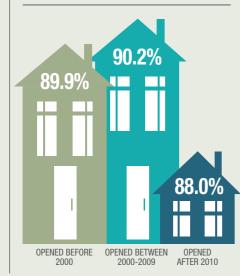
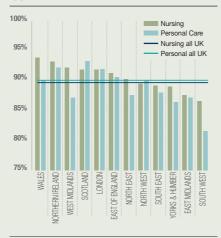


FIGURE 7

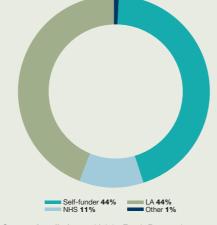
Occupancy rates by property age
(FY 2017/18) %



Occupancy rates by region & care type (FY 2017/18) %

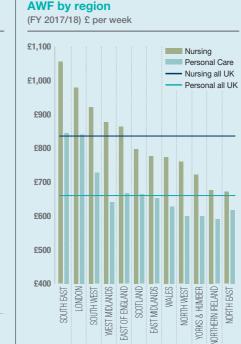


ALL UK FUNDING MIX (%)



Source for all charts: Knight Frank Research







Source for all charts: Knight Frank Research

FIGURE 10 SF as a % of income vs. LA as a % of income (FY 2017/18) %



FIGURE 11 **AWF by property age**£ per week (FY 2017/18)



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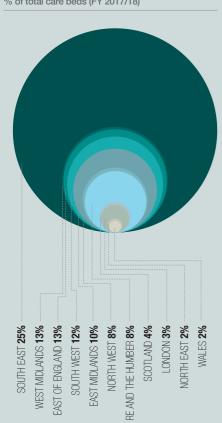


PRIVATE PAY MARKET

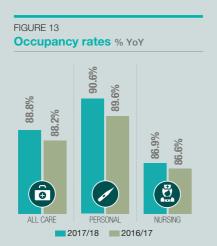
This section focuses on the key performance indicators where more than 70% of income is derived from self-funded care (17% of the overall index). Year-on-year, the analysis points to a stellar performance!

FIGURE 12

Regional share of the sample
% of total care beds (FY 2017/18)



Source for all charts: Knight Frank Research





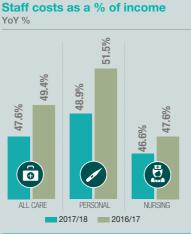
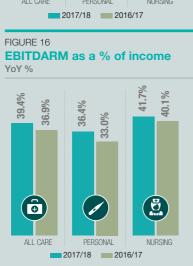


FIGURE 15



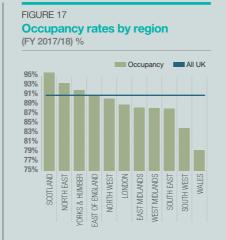
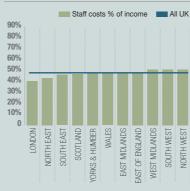




FIGURE 18









COSTS

Although care home operators are coming to terms with the impact of the National Living Wage (NLW), retaining good quality staff, particularly qualified nurses, remains challenging.

Staffing costs

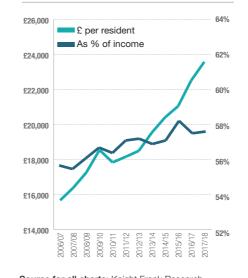
Staff costs in 2017/18 increased 4.7% to $\mathfrak{L}23,575$ per resident. This has reduced from a 7% increase witnessed in last year's review, when care assistant pay rates were inflated to meet the NLW standards. The national average wage rate per hour for a care assistant stands at $\mathfrak{L}8.00$ which is 50 pence per hour higher than the NLW in 2017/18. The current rate is also above the 2018/19 NLW of $\mathfrak{L}7.83$ per hour. However, the NLW is projected to rise to at least $\mathfrak{L}9.00$ per hour by 2020, therefore the rising staff costs per resident, since 2011/12, as illustrated in Figure 21, will continue this upwards trend.

Even though staff costs per resident increased materially, staff costs as a percentage of income only marginally increased by 0.1% to 57.6% due to:

- AWF inflation
- Increasing SF ratios
- An average 3.6% LA fee rate increase.

However, when predominantly focusing on the LA pay market (90% of income and above) staff costs as a percentage

FIGURE 21 Staff costs As a % of income (RHS) vs. £ per resident (LHS)



Source for all charts: Knight Frank Research

of income stand at 69.9%, up from 65.5% in last year's review which indicates that the LA fee rate increases are insufficient.

Recruiting and retaining good quality staff remains the biggest challenge for operators as agency costs increase from 7.4% to 8.2% when compared with last year's analysis. The UK unemployment rate fell to 4% in the three months to June 2018, its lowest rate since 1975.

INCREASING AGENCY STAFF COSTS

ACROSS THE UK, AGENCY STAFF COSTS INCREASE FROM 7.4% TO 8.2% WITH NORTHERN IRELAND AT 14.3%

Staff costs per resident (LHS) £ per resident vs. staff agency cost % (RHS) by region (FY 2017/18)

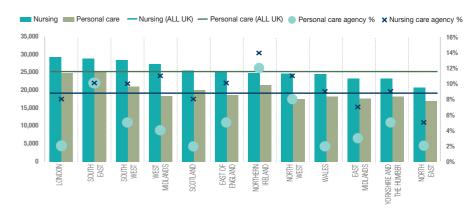


TABLE 1 Staff costs (FY 2017/18)

LOCATION		3	
	Per resident P.A.	As a % of revenue	Agency staff cost as % of total staff costs
London	£28,266	58.3%	6.9%
South East	£27,822	52.9%	9.9%
South West	£26,150	57.9%	8.4%
Scotland	£25,230	60.9%	7.2%
Northern Ireland	£24,642	71.0%	14.3%
Wales	£23,415	58.7%	8.1%
West Midlands	£22,689	57.4%	8.2%
North West	£22,198	60.0%	9.9%
East of England	£22,149	54.7%	8.2%
East Midlands	£20,977	54.7%	5.3%
Yorkshire and The Humber	£20,551	60.0%	7.3%
North East	£18,984	56.7%	3.7%
All UK	£23,575	57.6%	8.2%

6



More choice and opportunities are available for staff, allowing them to switch jobs for preferential pay rates and to work in less challenging environments. This is quite evident in the South East region where staff agency costs are above national average, at 10%.

The shortfall of skilled nursing staff in the UK continues to hamper the sector and mount further pressure on existing staff. This is affecting trading performance as agency costs in nursing homes reflect 9.3% (8.5% in 2016/17) when compared with 5.4% (4.1% in 2016/17) for personal care homes. As per Knight Frank's Healthcare Development Opportunities Review 2018, the sector witnessed 226 home closures in 2017/18 in the UK (6,740 beds), 90% of which were rated Inadequate or Requires Improvement by the Care Quality Commission before deregistration. A large proportion closed due to the impact of the NLW and challenges of recruiting nursing staff.

In light of the nursing staff crisis, a shift towards personal care home developments has continued as 54% of new openings in 2017/18 were for personal care homes only.

In regards to staff costs per resident, London takes top spot from the South East region as shown in Table 1 when compared with 2016/17, driven by the upwards pressure to recruit and retain staff within the M25. The lowest staff cost as a percentage of income was established in the South East at 52.9% driven by the higher fees, comfortably compensating for higher labour costs.

Staff costs as a percentage of income has reached 71% for Northern Ireland, driven by low fee rates paid by the Trusts and a low percentage of SF (7%) coupled with the challenges of recruiting staff from only six counties within the region and required nursing ratios.

Property costs

Property costs comprising utilities, council tax, insurance, repairs and maintenance, are small in comparison to staffing costs, but must be managed efficiently to maximise profits.

Property costs were similar to the previous year's review at £2,006 per bed, which equates to 5% of income. Figure 23

illustrates a surge in property costs to 2013/14 before they started to stabilise. This is mainly due to a substantial change in dataset sample to reflect a higher proportion of newer properties. Properties built in the last century cost £2.167 per bed in comparison with £1,910 per bed for properties built after 2010.

We expect to see property costs rise due to increasing energy costs, despite the Government's strategy to price cap by the end of 2018. Repairs and maintenance will continue to dent the Profit and Loss account, specifically for properties built in the last century.

On a regional level, property costs as a percentage of income were lowest in the London region (4.5%), compensated by its strong AWF and highest in the North East driven by low AWF.

Capital expenditure (Capex)

Capex/bed by region

TABLE 2

REGIONS

East of England

West Midlands

East Midlands

Scotland

London

North West

North East

South West

South Fast

Northern Ireland

UK AVERAGE

Yorkshire and The Humber

Source for all charts: Knight Frank Research

Wales

New to the Index is an assessment of capex across the sector. 85% of UK care home stock is over 40 years old and the

CAPEX/BED

£1.804

£1.614

የ1 581

£1,574

£1,454

£1,425

£1,421

£1,372

£1,364 £1.258

£1,228

£1,126

£1,430

lack of capex remains a concern. We have carried out a review to show capex spend per bed by property type and age. On a national level capex per bed stands at £1,430 for the financial year 2017/18.

Food costs

Food costs increased 3% from last year's study to £1,462 per resident (£4.00 per day) which consumes 3.6% of income. Food costs as a percentage of income remain static when compared with 2016/17. This means that operators have been able to increase fees in line with their food costs, which is encouraging.

The increase is driven by operators' continuous efforts to invest in good quality produce tailored to individual residents, offering a wide variety of fresh fruit, dairy, vegetables, grains and protein, as nutrition for the elderly. This is specifically important for dementia residents, in order to improve their wellbeing. Interestingly, food costs per resident in homes that are predominantly SF (70% and above) are at £1,676 (£4.59 per day).

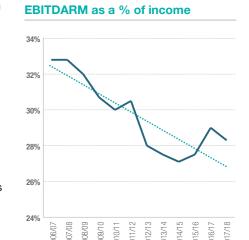
PROFITABILITY

EBITDARM as a percentage of income fell to 28.3%.

The industry standard definition of earnings before interest, tax, depreciation and amortisation, rent and management (EBITDARM) allows for consistent comparison across all care homes. The 2017/18 financial year witnessed a fall in profitability from 29.0% in 2016/17 to 28.3%, measured as a percentage

The trend line in Figure 25 shows a gradual downwards slope in EBITDARM as a percentage of income since dataset records began in 2006, and profit margins achieved before the recession in 2007/08 have not been regained.

One of the main reasons for this fall is contributed by the decline in profit margins for personal care homes from 29.9% to 28.5%. The year-on-year increase in staff costs per resident (7%) exceeded the increase in income per resident (5%). Within our dataset, over 50% of the personal care home stock was built in the last century and circa 30% was built in the early 2000's. This limits their ability to inflate fee rates to

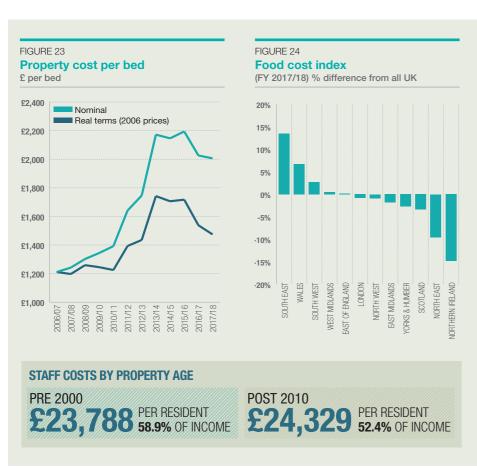


Source: Knight Frank Research

a sufficient level when compared with future-proof assets built over the last 10 years.

Interestingly, in the homes that are mainly LA funded (90% of income and above) profit margins stand at 15.9%, down from 20.7%.

CAPEX PER BED CAPEX PER BED BY PROPERTY **BY PROPERTY** TYPE AGE PRF-2000 CONVERTED PROPERTY £1,933 PFR BFD £1,247 2000-2009 PURPOSE BUILT PROPERTY £935 £1,346 POST-2010 PER BED







Avonmere, Avery





FIGURE 26
EBITDARM as a % of income
(FY 2017/18)

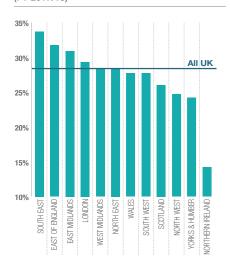


FIGURE 27

EBITDARM per resident
(FY 2017/18) £ per bed

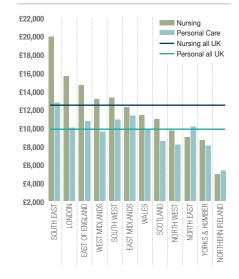
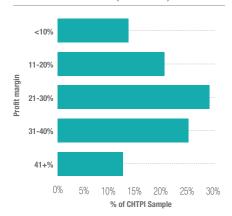


FIGURE 28

Distribution of profit margins across the CHTPI (FY 2017/18)



Source for all charts: Knight Frank Research

There was only a marginal fall in profitability for nursing homes from 28.6% in 2016/17 to 28.2%, which is supported by the increase in occupancy in nursing homes, as discussed earlier in the report.

The South East remains in top position as the most profitable region. Its robust trading performance is driven by the affluence of the region.

The region's AWF increased by 5% while staff cost per resident increased 4%. Staff costs as a percentage of income are also controlled well and the region presents the highest percentage of SF income.

Combining the regional picture with the care home type, the East Midlands have the most profitable personal care homes with a margin of 33.0%. Staff agency costs are at 3.0% which is well below national average. It also has the lowest staff costs

as a percentage of income at 51.9%. The most profitable nursing homes are in the South East region. It is also no surprise that Northern Ireland remains rock bottom, driven by its low AWF and high staff costs.

Whilst averages are an interesting and intuitive way to analyse markets, distributions give an added dimension of insight (Figure 28). Considering 10 percentage point brackets for EBITDARM as a percentage of income, the largest proportion of homes (28.9%) make a profit between 20% and 30%. A quarter of homes make between 30% and 40% profit. Interestingly 12.4% of homes make a profit margin above 40% (increasing from 9.2%) which indicates demand for the premium end of the market driven by affluent locations, luxury products, good quality food and activities.

INCREASING CARE NEEDS

Increasing care needs of residents creating upwards pressure on existing nursing provision as operators continue to shift towards personal care only

RECRUITMENT ISSUES

Recruitment and retention of skilled staff, exacerbated by BREXIT

INCREASED PENSION CONTRIBUTIONS

Staff pension contributions increased from April 2018 to a minimum employer contribution of 2%, increasing to 3% from April 2019

INSUFFICIENT LA FEE RATE Failure of LA fee rate increases to track

rising costs leading to further closures, particularly for smaller and older stock

INCREASING REGULATORY REQUIREMENTS

Increasing regulatory requirements from the CQC and health and safety legislation

SLOWER FILL RATES

Slower fill rates for new developments, strategically placed to target the SF market

FUTURE-PROOF CARE HOME STOCK

State-of-the-art stock entering the market, providing a lifestyle choice for residents with amenities such as a cinema room, cafeteria, gym and spa and hair salon

CARE-TECH

With regulatory requirements becoming more stringent, technology will play a substantial part to improve processes and efficiencies, such as electronic care plans, medication systems and more long term, Artificial Intelligence

IMPROVED STAFF EFFICIENCIES

Technology such as acoustic monitoring to improve staff efficiencies

BONUSES

The sector is already seeing welcome bonuses and rewards being paid to nursing staff to enhance the recruitment and retention process



JULIAN EVANS FRICS
Head of Healthcare

Where we are today?

The lack of social care funding and the shortfall of skilled labour continued to present a stern test for the UK care home market over the past twelve months. Nonetheless, it has remained resilient and robust in comparison to some of the other property types and wider investment classes.

Although 2018 Q1 traded with low occupancy due to higher death rates in the bitter cold winter months, occupancy in the financial year remained strong. We are however seeing slower fill rates, specifically in the South East, where commissioning periods on average are now taking up to four years before reaching maturity.

There is an increasing reliance on agency staff, and not just for nursing. Recruiting at management level is also proving to be a challenge. Operators are continuing to think creatively, recruiting Medical Technicians and upskilling them to nursing levels.

Operators are repositioning from nursing to personal care homes due to nursing staff shortages and higher clinical standards. There has been a decline of 16,580 nursing degree applications since March 2016, the last year in which students received an NHS bursary. If this trend continues, this will no doubt exacerbate the national crisis in nursing bed provision.

Furthermore, the social care funding crisis shows no signs of abating

and, indeed, the statistics speak for themselves. Almost 7,000 beds deregistered in 2017/18 as homes became unviable. Our study shows how staff costs as a percentage of income is significantly higher for homes that are mainly local authority funded (70%). Profit margins have fallen to 16% for these homes.

There is also inconsistency from the CQC inspections where operators are increasingly challenging report findings. This is coupled with the Competition and Markets Authority continuing to challenge the sector.

Although activity from the traditional lenders into the sector has been subdued over the last year or so, they have been replaced by a broader church of domestic and international capital.

What does the future hold?

The next 12 months are likely to bring more of the same. Uncertainty remains over the long term plans from the Government for social care and the green paper on care and support for older people has been delayed until autumn 2018.

As Brexit negotiations make slow headway, significant uncertainty exists over the future free movement of labour and the legal rights of EU nationals already residing in the UK. An analysis of the Office for National Statistics suggest that ending freedom of movement could result in 115,000 fewer adult social care workers by 2026. This crisis will need a bit more than enhanced pay packages to recruit and retain staff in the coming years.

Our study reveals a capex differentiation between older and converted stock against new purposebuilt facilities. Older homes are having to increase spend on refurbishment and maintenance as new purposebuilt homes open and threaten their trading performance. We will continue to see this trend as the quality of care home schemes in the development pipeline reach new heights.

There are a lot of exciting new builds coming into the market with improved design, providing a lifestyle experience. Amenities comprise restaurants, cinemas, gym and spa facilities and children's play areas.

The Dutch model

There is also an emerging interest for the "Dutch model" driven by their innovative design, improving wellbeing of the residents.

It is truly overwhelming to see a strong investor appetite for future proof assets coming into the market.

The role of technology

Technology will also play a substantial part in improving care to meet regulatory requirements. Operators have already started to invest in Artificial Intelligence, electronic care plans, medication monitoring devices and acoustic monitors, which alleviate pressure from staff. Examples include a smart wristband which comprises sensors to track and alert caregivers to falls, alterations in eating habits and behaviour.

Working alongside hospitals

We will also see care homes working more closely with hospitals in regards to step down provisions, particularly in winter months when hospitals are under pressure to release blocked beds. In early 2018 we saw a Foundation Trust sign a five year sublease on a care home adjacent to the hospital campus.

An attractive target

Despite operational challenges, particularly within social care, it is our view that the healthcare sector is one that is least affected by Brexit volatility, as demand is typically driven by domestic factors. Both domestic and international investors are seeking defensive sectors to invest in. Care homes remain an attractive target.

10 11

Front cover image: Mayflower Court, Anchor

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