RESEARCH

2019

CARE HOMES

TRADING PERFORMANCE REVIEW

HIGHLIGHTS

Average weekly fees up for the eighth year in a row

Staff costs continue to grow with operators increasingly dependent on agency workers

Profit margins remain squeezed but the private pay market is performing well

Joe Brame
Healthcare Analyst

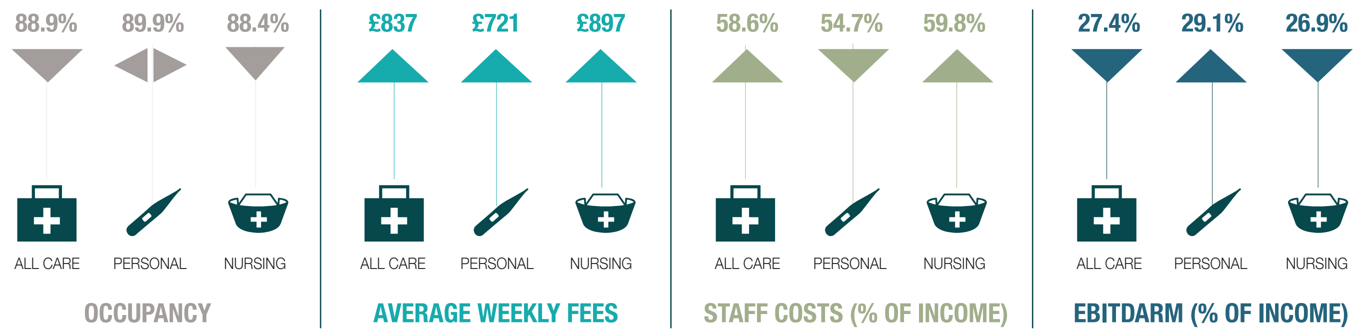
INTRODUCTION

As we deliver our 8th annual review of care home trading performance, we'd like to say a huge thank you to all the operators that have contributed their data for the 2018/19 financial year.

This years' index is the most comprehensive to date, aggregating data from 82% of the UK corporate market. Without the willingness of so many care operators, the research would not be possible.

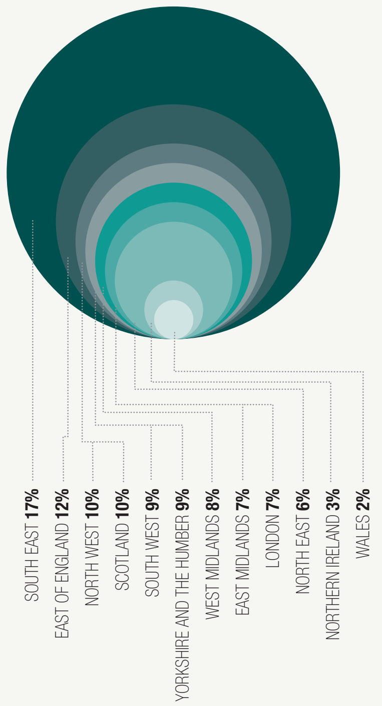
The care home trading performance index (CHTPI) provides industry leading benchmarks on occupancy rates, average weekly fees (AWF), major costs and profitability. As well as comparing performance across regions and care types, this years' review also compares trading performance by funding type (local authority vs private pay). We hope you find it useful.

FIGURE 4
2018/19 RESULTS AT A GLANCE



THE SAMPLE

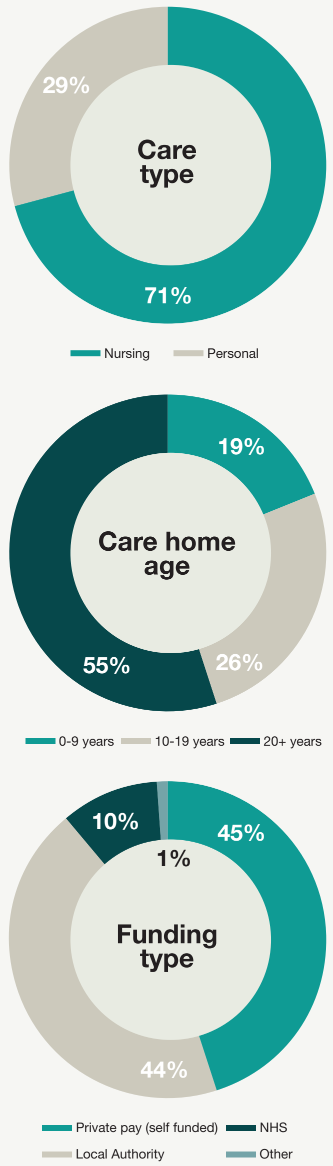
FIGURE 1
Regional share of the sample by % of beds



While individual homes will derive income from a mixture of sources, the CHTPI shows that across the UK 44% of income is derived from local authorities, 10% from the NHS, and 45% from the private pay market. At a regional level the split of funding varies further, as shown by Figure 2 which illustrates the extent of the private pay market in each region. Funding models can have a strong influence on care home trading performance and we explore this later in the report.

FIGURE 2
Share of private pay market, self-funder % of total income

FIGURE 3
Sample characteristics



A DECADE OF DATA

FIGURE 5
UK average occupancy rate

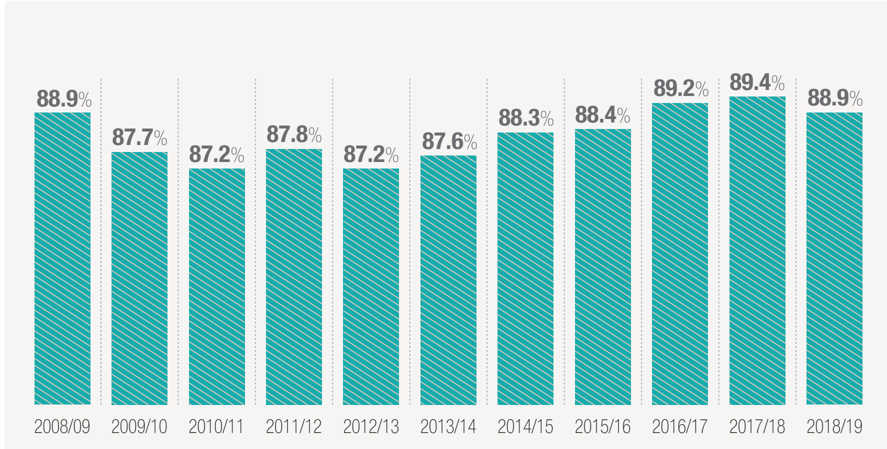


FIGURE 6
UK average weekly fees

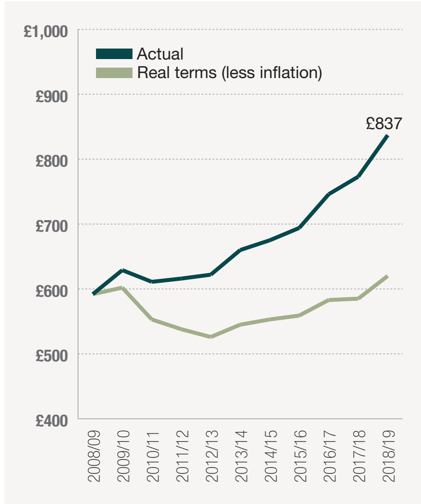
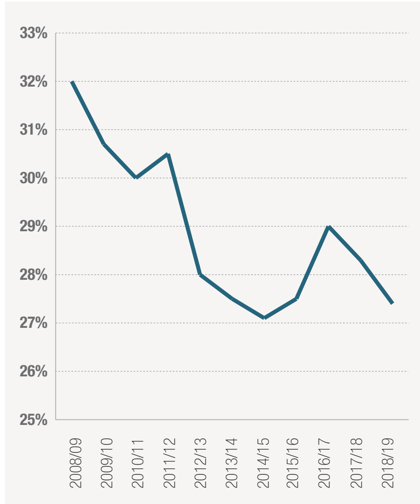


FIGURE 7
UK profitability, EBITDARM % of income



Source for all charts: Knight Frank Research

OCCUPANCY AND FEES

Occupancy

As shown in figure 5, the UK occupancy rate has been on an upward trend in recent years edging close to ninety percent. This trend appeared to be bucked In 2018/19 with occupancy falling -0.5% to 88.9%. This moderate fall is largely down to variances in our survey respondents rather than any meaningful change in the balance of supply and demand.

Occupancy rates in the personal care sector saw very little decline in 2018/19, as shown by Figure 8. In contrast, the nursing sector fell by -0.7% to 88.4%. The high cost of nursing care could be discouraging home admissions, but we must remember that full-time nursing care is usually a necessity rather than a choice. As such, we expect a rapidly ageing population to drive continued bed demand and keep occupancy rates elevated in 2019/20 and beyond.

As shown in Figure 9, regions of the UK that derive most of their income from public sources, generally have higher occupancy rates because of a more limited supply of care homes in these regions. As we know from our development analysis, new supply is heavily focused on regions that have larger private pay markets like the South East and South West.

As a reflection of the new high-end stock being delivered, these regions have marginally lower occupancy rates.

Fees

Average weekly fees have increased sharply over the last five years and were up a further 8% in 2018/19 to reach £837. Adjusted for the UK rate of inflation, fees are only just edging above 2009 levels in real terms and look less dramatic on this measure (See figure 6). Nevertheless, there are a number of factors that help to explain current rises:

- Rising staff and property costs have forced operators to adjust fee rates to protect earnings.
- Elderly people continue to enter residential care with more severe medical needs, resulting in a shift towards more expensive nursing care as well as dementia care.
- The typically more expensive private pay market is growing in size. This is due to a mixture of greater demand for luxury product and a shrinking pool of people eligible for public funding. The upper capital threshold has been frozen at £23,250 (in England and N.Ireland) since 2010/11 and anyone assessed as having assets worth more than this must pay the full cost of care.
- Higher care standards are forcing care home providers to improve and reinvest in their facilities. Increasing fees is one way to offset capital expenditure.

As shown in Figure 11, the South East and London remain the most expensive regions for both personal and nursing care. Higher fees match the higher staff costs and salaries paid in these regions. Privately funded homes in London command the highest fees in the UK, but are few in number relative to the South East where many new homes targeting the private pay market are being developed.

When we look at which regions saw the greatest rate of fee inflation over the last financial year (Figure 12), we can see how all markets except London exceeded the UK rate of inflation (indicated by RPI). Markets such as Wales, Yorkshire and The Humber, and the North West which typically have lower fee levels saw the highest rates of year-on-year growth. Although starting from a lower base, this demonstrates how widespread fee inflation is.

FIGURE 8
Occupancy rates by care type

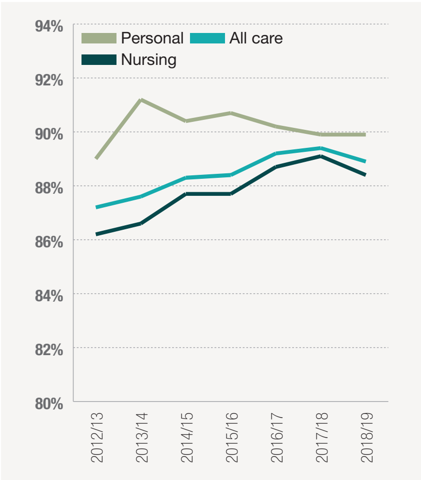
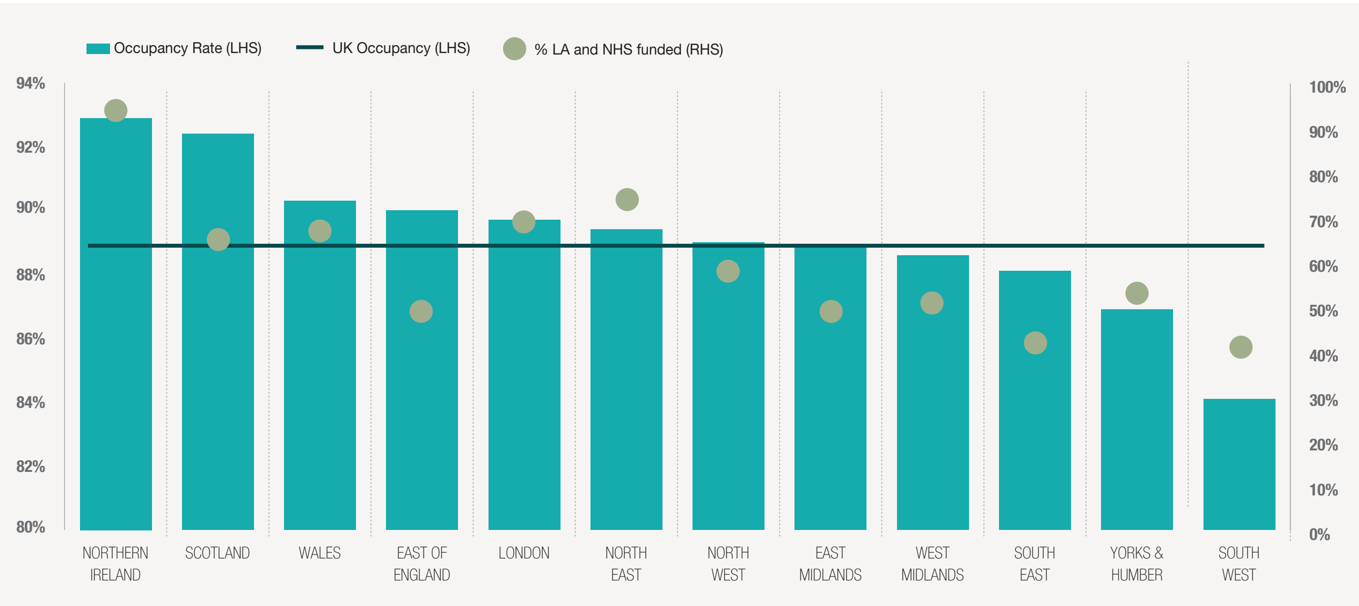


FIGURE 9
Occupancy rates and % of public funding



Bourne View, Colten Care

FIGURE 10
AWF fee by care type

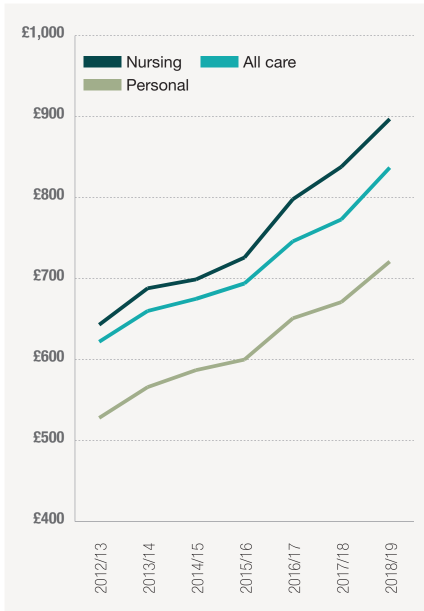


FIGURE 11
AWF by region and care type

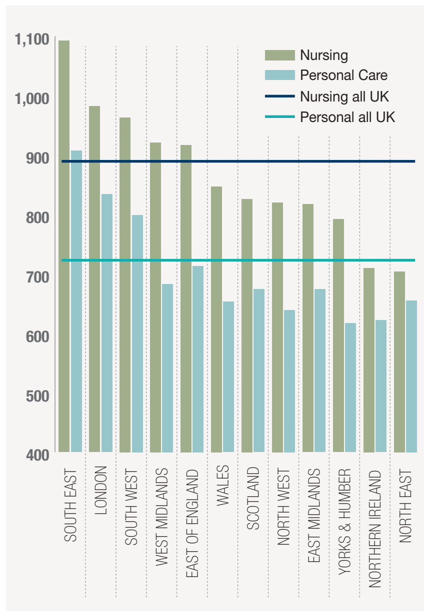
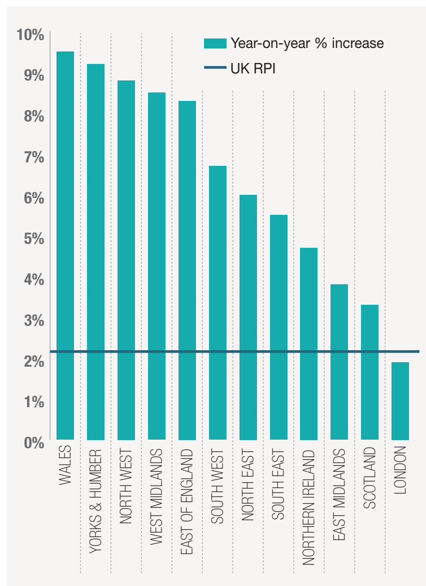


FIGURE 12
AWF all homes, year-on-year change (2018 vs 2019)



Source for all charts: Knight Frank Research

COSTS

Staffing costs

Staffing remains the number one challenge for care home operators both in terms of costs and recruitment. As shown in Figure 13, average UK staff costs have increased by 50% over the last decade, measuring £25,938 in 2018/19 on a per resident per annum basis. The growth has mirrored increases in the National Living Wage (NLW) which has gone up for the fourth consecutive year since replacing the minimum wage in 2016. Growing staff costs are a challenge, but recruitment remains an issue of equal footing for many operators and higher salaries are one way to attract the qualified nurses and carers needed.

UK wide, staff costs represented as much as 58.6% of income in 2018/19, up 1% from last year. The extra costs are directly impacting the bottom line, with UK average profit margins down by a further 0.9% (see Figure 7).

The 2018/19 index confirms that operators are increasingly reliant on agency staff to deliver care, often at a further cost. As figure 14 shows, agency staff costs typically represent 6% total staff costs in personal care homes and as much as 9.7% in nursing homes. The reliance on agency staff in the nursing care sector is related to the growing shortage of nurses in the UK, a factor compounded by the removal of the university bursary for student nurses in 2017 and the potential for a reduced pool of EU migrant workers following Brexit.

FIGURE 13
UK staff costs vs National Living Wage (NLW)

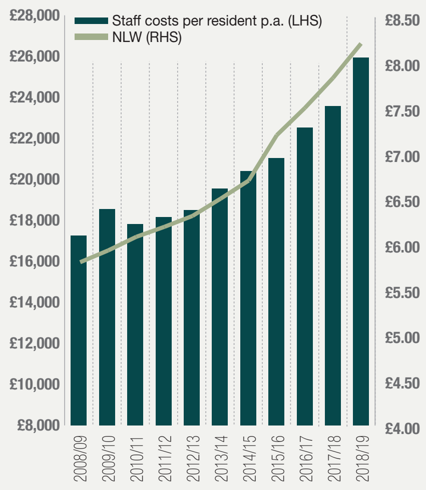
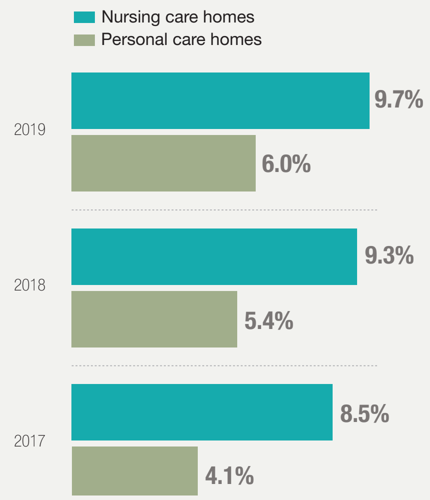


FIGURE 14
Agency staff costs as % of total staff costs



> **The National Living Wage (NLW) increased to £8.21 in April 2019."**

TABLE 1

INCOME AND MAJOR COSTS

Region	INCOME Per resident p.a.	STAFF COSTS Per resident p.a.	STAFF COSTS % of Income	STAFF COSTS Agency % of staff costs	FOOD COSTS Per resident p.a.	PROPERTY COSTS Per bed p.a.
South East	£54,744	£29,576	54.0%	10.3%	£1,746	£2,583
London	£49,642	£30,607	61.7%	8.6%	£1,612	£2,253
South West	£47,384	£28,872	60.9%	9.8%	£1,625	£2,522
Wales	£43,890	£25,707	58.6%	7.9%	£1,692	£2,168
East of England	£43,657	£24,841	56.9%	9.3%	£1,547	£2,301
West Midlands	£42,870	£25,466	59.4%	9.3%	£1,644	£2,308
Scotland	£42,725	£26,402	61.8%	7.0%	£1,484	£2,304
East Midlands	£40,081	£22,082	55.1%	5.7%	£1,475	£2,252
North West	£40,053	£24,293	60.7%	10.2%	£1,562	£2,250
Yorkshire & The Humber	£38,328	£22,840	59.6%	7.8%	£1,556	£2,157
Northern Ireland	£36,750	£26,409	71.9%	14.0%	£1,308	£1,913
North East	£35,769	£20,277	56.7%	3.8%	£1,428	£2,073
ALL UK	**£44,294**	**£25,938**	**58.6%**	**8.8%**	**£1,578**	**£2,316**
ALL UK Personal Care	**£37,477**	**£20,509**	**54.7%**	**6.0%**	**£1,547**	**£2,320**
All UK Nursing Care	**£47,129**	**£28,197**	**59.8%**	**9.7%**	**£1,591**	**£2,315**

Source for all charts: Knight Frank Research

Property & food costs

Property costs saw a significant rise of 15% over the last year, averaging £2,316 per bed per annum in 2018/19. As figure 15 shows, the rise occurred across all regions of the UK. Broken down, property costs consist of utilities, council tax, insurance, repairs and maintenance – all of which are costs relating to the day-to-day running of a care home. A number of these costs saw significant increases in 2018/19:

- Utility costs increased at an annual rate of 7.3% per annum (ONS RPI), the highest rate since 2012.
- Council taxes, although a small outlay, were up on average 5.1% in 2018/19 (ONS).
- 55% of homes in the index are now 20 years or older, adding to the level of maintenance and repair required in many homes.

Food costs increased 8% in 2018/19 to reach £1,578 per resident per annum or £4.32 per day. Food price inflation is at its highest rate in five years and a weakening pound sterling has also made imported goods more expensive. Operators are also making significant efforts to improve the quality of produce they provide, adding to the level of spending. This is particularly the case in the private pay market where food costs averaged £1,852, per resident per annum in 2018/19.

Capital expenditure

Last year we reported how a lack of capex was a concern for the UK market given the age of stock. Data this year suggests that many corporate operators are now investing more heavily in upgrading their facilities. Average capex increased 15% to reach £1,644 per bed in 2018/19, compared to £1,430 per bed in 2017/18.

Figure 16 shows how capex spending per bed generally increases with property age. However, there is a clear difference in reinvestment between private pay homes and LA funded homes. Capex for private pay homes increases significantly with property age, averaging as much as £3,247 per bed for homes older than 20 years. In contrast, capex for LA-funded homes is much lower at £1,265 per bed for homes older than 20 years. This section of the market clearly has a more restricted pool of money for reinvestment.

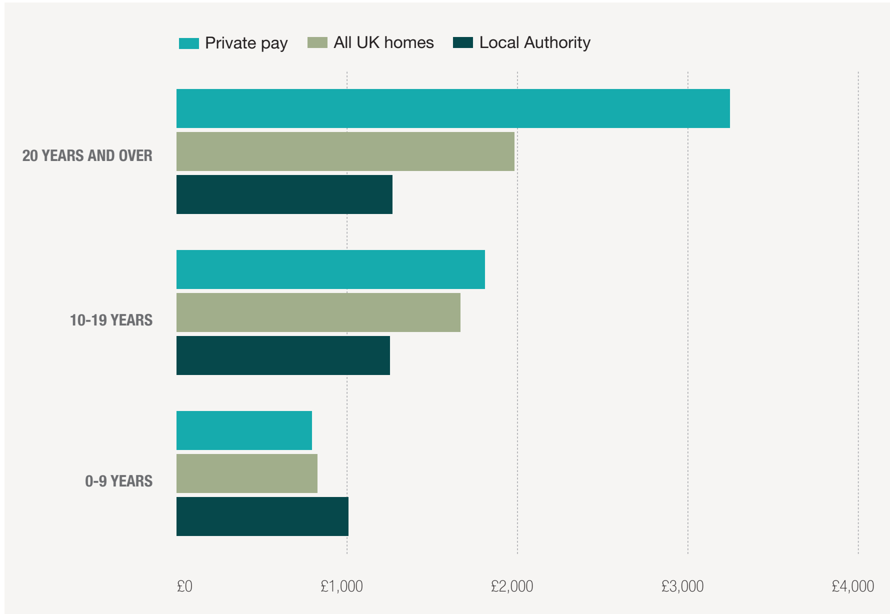
TABLE 2

CAPEX/BED

REGION	CAPEX/BED
London	£2,025
Wales	£1,913
South East	£1,837
West Midlands	£1,718
East of England	£1,698
North West	£1,653
East Midlands	£1,607
South West	£1,567
Scotland	£1,406
North East	£1,405
Northern Ireland	£1,463
Yorkshire & The Humber	£1,389
UK Average	**£1,644**

FIGURE 15
Property costs per bed (2018 vs 2019)

FIGURE 16
Capex/bed by funding type and age



PRIVATE PAY VS LOCAL AUTHORITY

In this section we have compared trading data between funding models and our analysis shows some key differences across the personal and nursing care sectors.

Definitions:

- Private pay refers to all homes where more than 75% of income is derived from self-funded residents. 17% of homes in the index fit into this category.
- Local authority (LA) refers to all homes where more than 75% of income is derived from local authority councils. 19% of homes in the index fit into this category.

FIGURE 18
Occupancy rates

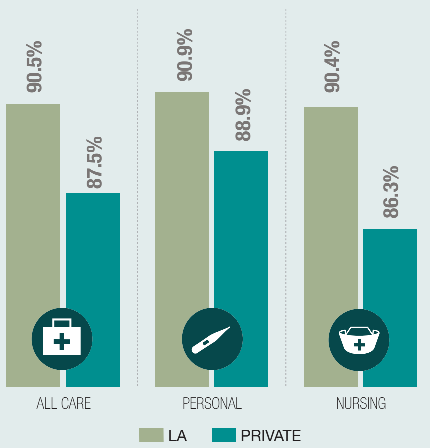


FIGURE 19
Average weekly fees

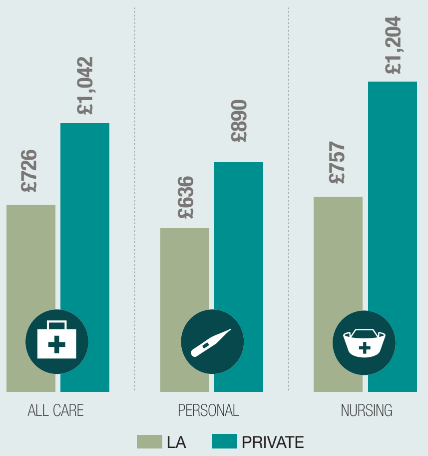


FIGURE 20
Staff costs, % of income

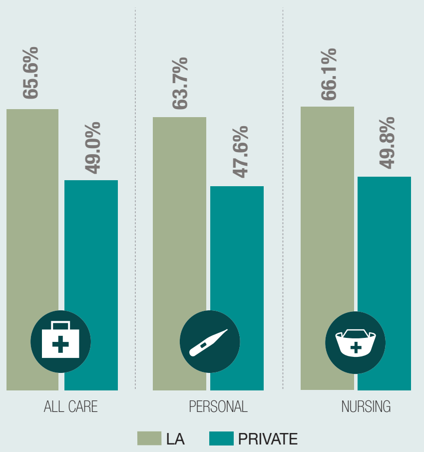


FIGURE 21
EBITDARM, % of income

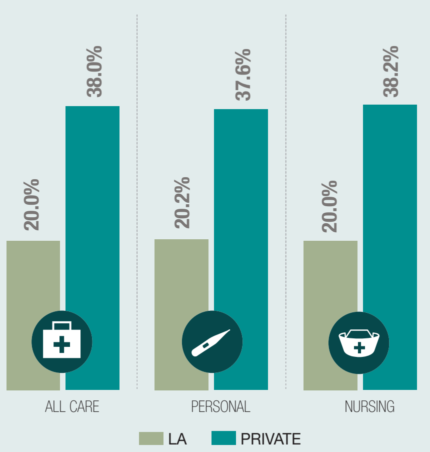
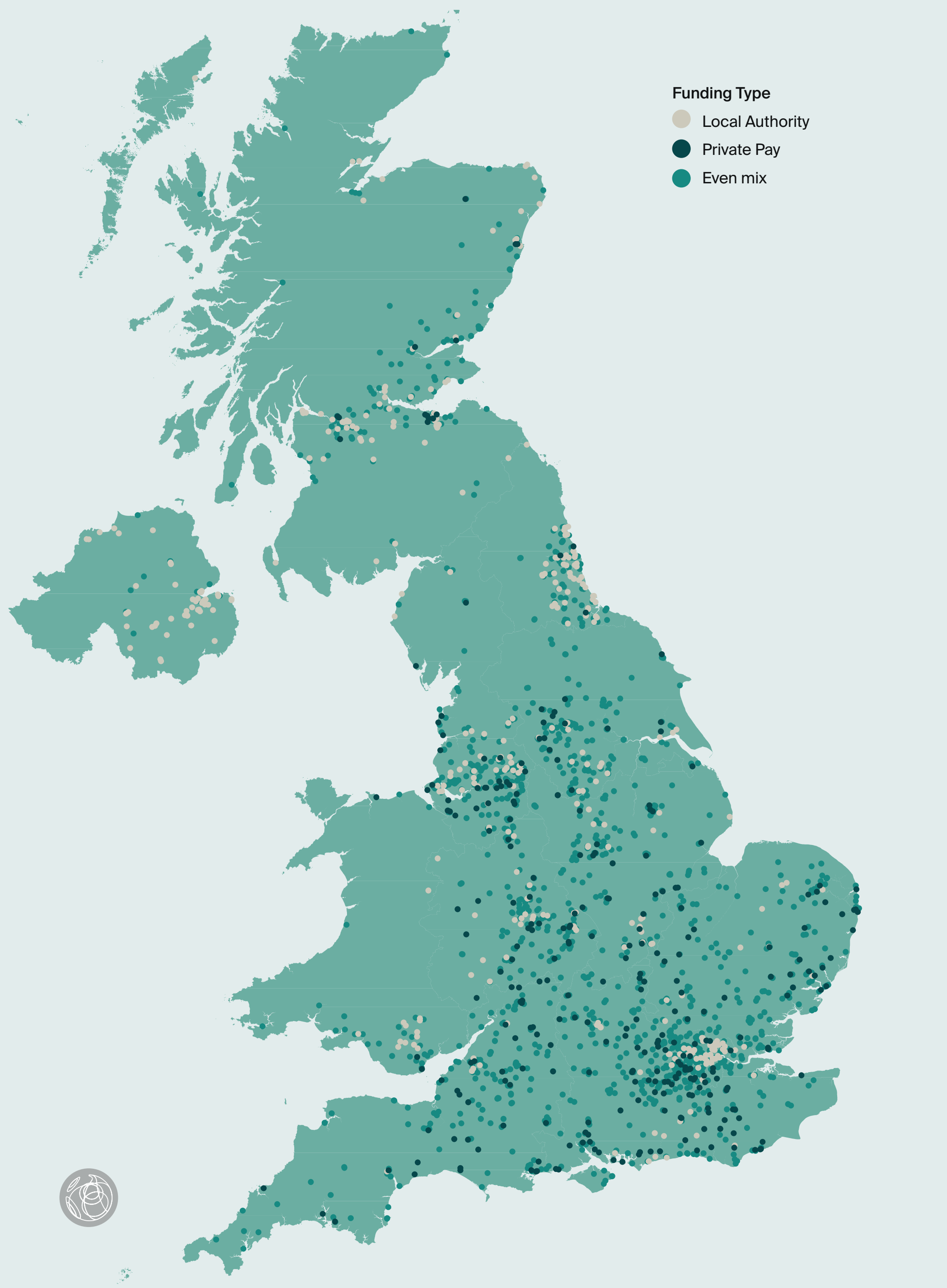


FIGURE 17
Locations for private pay vs local authority homes



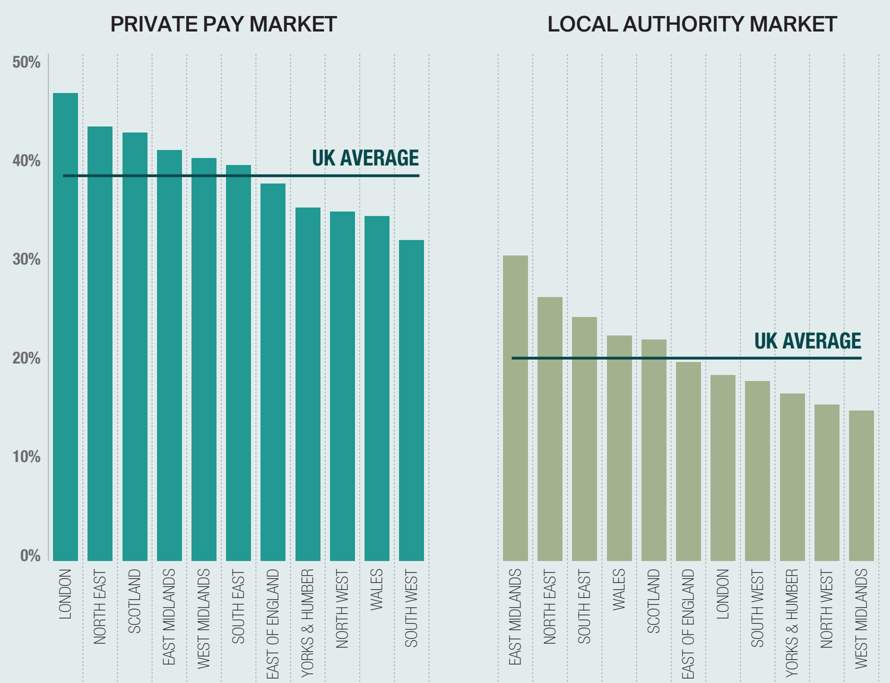
Despite higher occupancy rates, LA homes typically achieve lower levels of profitability compared to the private pay market. Across all care homes the private pay market averaged EBITDARM margins of 38% compared to an average of 20% for LA homes. Although fees are between 40-50% higher in the private pay market, these homes are still able to achieve occupancy rates in excess of 86% across the nursing and personal care sectors.

In Figure 22, we can see how private pay homes in all regions of the UK averaged profit margins in excess of 30%. London, the North East and Scotland have relatively small private pay markets, but the few homes targeting the self-funder market in these regions are achieving profitability in excess of 40%.

LA funded homes are typically encountering tougher trading conditions, with many regions experiencing EBITDARM margins of less than 20%. Once any rental obligations, capital expenditure, and management costs are taken into account many of these homes are operating at break even or at a loss.

> “Private pay homes in all regions of the UK averaged EBITDARM margins in excess of 30%.”

FIGURE 22
Profitability, EBITDARM % of income



Source for all charts: Knight Frank Research

PROFITABILITY

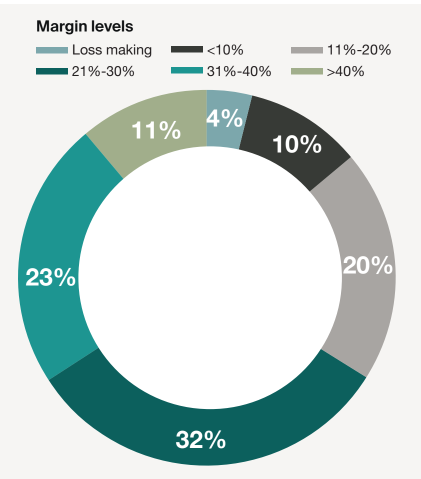
Profitability:

The historical trend for profitability doesn't make pretty viewing. Average EBITDARM has fallen from 32% in 2008/09 to 27.4% in 2018/19. Broadly speaking, year-on-year fee increases have not been enough to counteract escalating staff costs and protect profit margins. Operators also endured significantly increased property costs in 2018/19, and many of these are unavoidable if care home managers are to ensure the smooth running of homes.

Despite tough conditions overall, Figure 23 shows how the vast majority of homes in our 2018/19 index achieved EBITDARM margins in excess of 20% and a third of homes achieved EBITDARM in excess of 30%. The picture looks much more positive on this measure. Further to this, we have already pointed out the differing performance of homes according to funding model, with the private pay market averaging EBITDARM margins of around 38%.

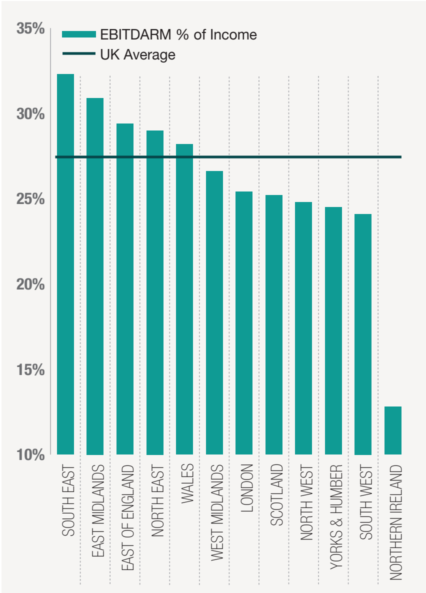
Funding is certainly not the only factor in determining trading performance and profitability. Figure 24 shows how the North East, which derives three-quarters of income from LA and NHS funds, has an average EBITDARM margin of 29.0% – the 4th highest of the UK regions. At the other end, the South West region has one of the largest private pay markets, but EBITDARM margins average much lower at 24.1%. Clearly a multitude of factors and conditions can influence the profitability of a care home.

FIGURE 23
Distribution of EBITDARM margins across the CHTPI



EBITDARM – The industry standard definition of earnings before interest, tax depreciation, amortisation, rent and management allows for consistent comparison across all homes (owned or rented)

FIGURE 24
EBITDARM % of income



Care Standards:

This year, we are also able to provide an indication of care standards for the English homes in the index, as indicated by the Care Quality Commission (CQC).

By comparing the ratings of homes in the CHTPI against the CQC's whole market ratings, we can assess how the standard of care being delivered in the corporate (group) market compares to the total market, including all non-group providers. Figure 25 suggests that care standards in the corporate market are generally similar in most regions. The exceptions are London, the South West and North West, where the corporate market looks to be underperforming with notably less homes rated as 'Good' or 'Outstanding'.

Figure 26 shows how homes with healthy profit margins upwards of 30% tend to have the best standards of care with 80-90% of these homes rated as 'Good' or 'Outstanding'. There is clearly a correlation between high care standards and stronger financial performance of care homes. Homes operating at a loss or less than 10% profit margins, are more commonly rated as 'Requires Improvement' or 'Inadequate', but nevertheless, over 55-60% of these homes are still achieving 'Good' or 'Outstanding' ratings. Many operators and homes in the index are clearly prioritising care standards over profit and should be commended.

FIGURE 25
Care homes rated 'Good' or 'Outstanding'

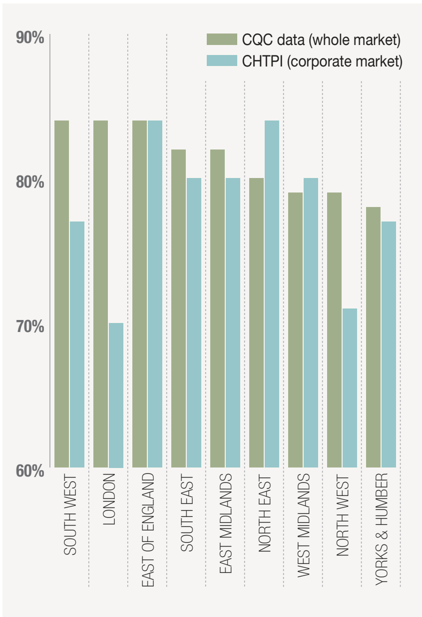
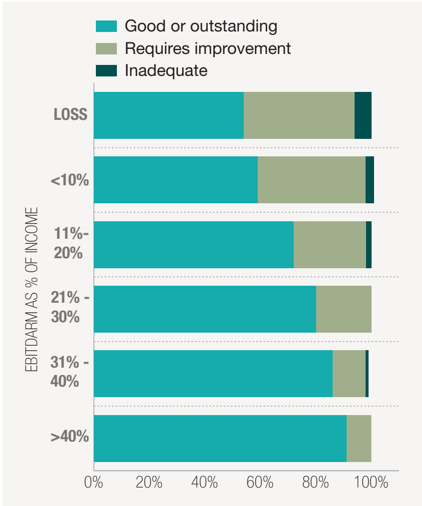


FIGURE 26
CQC ratings in England by profit level



Source for all charts: Knight Frank Research

Julian Evans FRICS
Head of Healthcare

OUTLOOK

Despite the moderate fall in occupancy recorded in 2018/19, it is hard to foresee any significant change in market conditions just yet. Demand for elderly care beds remains robust and new supply, while growing, is not enough to reverse the high occupancy rates seen in preceding years. One thing is for sure, the record number of care homes in our index this year can only give a more accurate picture of the market.

This years' index provides greater evidence of the polarisation within the sector. Many homes, particularly those focused on the private pay market continue to report excellent profit margins of the level needed to enable operators to grow their businesses. Other homes are experiencing a more challenging operating environment, especially those dependent on local authority money. Despite the funding challenges, data shows that operators have done superbly well to maintain high standards of care and we should recognise this achievement.

Challenges

Staffing remains the biggest challenge to operators, both in terms of cost and recruitment. The shortage of nurses is a huge concern given that demand for specialised nursing care (including dementia care) has never been greater. A more comprehensive solution is needed to address this and increase the number of registered nurses across the care sector.

Many providers continue to be effected by the social care funding crisis, especially those drawing income from budget constrained local authorities. The green paper hoped to address the funding problem has now been delayed several times but Brexit negotiations and leadership changes have taken precedent. Care operators, among many other UK businesses, will be hoping for some political stability going forward to at least give a chance of resolving the issues.

Regulatory requirements across the UK are becoming more stringent and rightly so if the UK is to lead international standards of care. Despite the newspaper headlines, group run care homes rarely fail their residents.

Opportunities

The private pay market continues to grow with success stories common among operators and individual homes. The rise of the luxury care market reflects growing consumer demand from affluent self-funded residents and the ability of independent care operators and developers to service that demand and deliver an exceptional standard of care.

New care home development represents an excellent opportunity for all stakeholders. Elderly population projections across the UK suggest there will be unprecedented demand for residential care in decades to come, creating a huge opportunity for those ready to invest.

Innovation and technology is increasingly moving its way into the sector as we search for ways to improve operating efficiency and deliver better care. In June 2019, a host of care organisations and bodies partnered with NHS Digital to create Digital Social Care, a dedicated online resource to advise the sector on technology and data matters. Many operators have already started to invest in various technologies but there is certainly an opportunity for more to follow.

Elderly care meets senior living

The senior living (or retirement communities) property market is one of the fastest growing residential markets in the UK. The sector could prove to be vital in improving health and well-being for the over 65's and allow for a smoother transition from family home to full-time residential care. We expect to see greater synergies between the senior living and care home sector as operators look to provide residents with both low-acuity assisted living and high-acuity care on the same site. "Care Villages" are already hitting the market providing a fantastic model for care.

Lessons from Europe

The elderly care home sector is developing just as fast across the continent, particularly in more developed markets like France, Germany, The Netherlands and Spain. All nations are united by the expectation of rapid elderly population growth over the next few decades and this is opening up huge opportunities in the private sector. There are certainly lessons to be exchanged with neighbouring countries as care models adapt to cope with future demand.

> "Our index shows that only 1% of English homes were rated as 'Inadequate' by the CQC."

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