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Overall, we are seeing occupancy levels beginning to plateau across all three sectors although there is some optimism demonstrated by the increase in personal care occupancy. Looking ahead, the most likely scenario is the homes that are largely relying on local authority funding, operating out of poorer quality assets will find it harder to maintain occupancy levels and EBITDAR margins.

The sector itself remains buffeted by legislative uncertainty as the Social Care Bill continues its ponderous passage through Parliament with an ill-defined ‘capped cost’ mode and no clear adjudication process for local fee referral rates. There is yet little financial certainty for care home operators dependent on public referrals.

Dr Walter Boettcher | Director | Research and Forecasting | Colliers International

Care Homes Review

This is the eighteenth in a regular series of research papers which provide an in-depth analysis of the healthcare property and business sector, focusing on long-term personal care and nursing care for both the elderly and specialist markets. Colliers International has reported performance KPIs in the healthcare sector since 2002. Our analysis is based on actual performance data confidentially sourced for valuations, due diligence consultancy work and transactions undertaken by the Colliers International Healthcare team. The database includes 4,500 records from the full spectrum of care providers, from national corporates to regional private companies and operators of single homes.

The sample of care homes varies in each six month period but typically has a corporate bias. This paper provides commentary on indicative trends in the healthcare market for the first half of 2013. More detailed data is available on many aspects of this paper. For further information please contact us (contact details on back page) or visit our website: www.colliers.com/uk/healthcare
Key Results

LONG-TERM ELDERLY CARE AND SPECIALIST CARE

Our research focuses on the key drivers of the care home industry, covering occupancy rates, average weekly fees, payroll costs, non-payroll costs and profit margins (EBITDAR). These five measures have been adopted as the Colliers International Key Performance Indicators.

Occupancy Rates:
While fluctuations are only marginal, occupancy rates have fallen below 90% in all three sectors; nursing, personal care and specialist care. Personal care and specialist care occupancy rates have been below 90% since H2 2012; however this is the first time that occupancy levels in the nursing sector have been sub 90%.

Average Weekly Fees:
In H1 2013, average weekly fees have reduced significantly in both personal care (-1.5%) and specialist care (-2.6%). Nursing care average weekly fees have declined marginally in the first six months of the year.

Payroll Costs:
Wage costs across the sectors were largely stable. Nursing sector payroll costs remained the same over the first half, while payroll costs in both the personal care and specialist care sectors have declined marginally.

Non-Payroll Costs:
Non-payroll costs rose marginally in specialist care in H1 2013 but reduced slightly in personal care down to 16.9%. Non-wage costs remained static in nursing homes.

EBITDAR:
Our research shows that profit margins (before making an allowance for central head office costs) in the nursing sector have remained unchanged over the last six months at 28.6% of total revenue. However, EBITDAR margins for personal care homes have increased marginally, while profit margins in specialist homes have slipped for the second consecutive period, after remaining relatively stable since 2010.
Occupancy Rates:
The occupancy rate is calculated by the total number of residents at the time of valuation/transaction, divided by the number of available beds.

Although occupancy levels in the nursing sector are down slightly on H2 2012 levels, they appear to have largely levelled off and now stand at 89.9%. However, this is the first time that they have been recorded at less than 90% since the start of our data set in 2002 (see Figure 1). In contrast, we are seeing a positive uptick in occupancy levels in the personal care sector of 0.4 percentage points - the last time an increase was reported in this sector by such an amount was in H2 2008.

Chris Saberton, Director in the Healthcare team, remarked that the slight increase in personal care occupancy rates was, “perhaps indicating a tendency by Local Authorities to place more dependent service users at the lowest possible fees”.

Average Weekly Fees:
We have been tracking the relationship between nominal fees and real fees (weekly fees with inflation taken into account) and have found that although overall nominal fees are increasing in both the nursing and personal care sectors, real fees are much lower and exerting significant pressure on operators.

Nominal fees and real fees have fallen marginally since the second half of last year (see Figure 2) and in the personal care sector fees have withstood inflation pressures better than nursing sector fees.

Personal care nominal fees have seen a 61% increase since H2 2003, while in real terms fees have increased by 20%. However, since H1 2009, real fees in the personal care sector have fallen by 3%.

Nursing care nominal fees have increased 48% since 2003, but have only increased by 10% in real terms over the same period.

Since H2 2012, our data has shown a downward trend in average weekly fees and
this is continuing. In the year to June 2013, reductions were reported in personal care average weekly fees; down 1.5% to £522. Nursing home average weekly fees also saw modest reductions and now stand at £661. Chris Saberton, adds that, “There is obviously pressure on fees for both personal care and nursing care. This could be due to a higher proportion of publically funded fees when compared to self-funders”.

Payroll Costs:
Payroll costs including wages and NIC costs are taken from accounts at the time of valuation/transaction. Payroll costs remained largely unchanged (see Figure 3). Payroll costs in nursing homes remain at 56.6%, with a minor reduction in payroll costs in the personal care sector.

Non-Payroll Costs:
Non-payroll costs are calculated by dividing total costs excluding payroll costs by total revenue. Figure 4 illustrates the proportion of total revenue apportioned to non-payroll costs from 2003 to date.

Non-payroll costs for the nursing sector remain unchanged at 14.5%, with marginal decreases reported in the personal care sector.

As variable costs continue to rise, our analysis of food, heating and lighting costs per person per week reveals how well these increases are being managed by operators in the long-term elderly care sectors. Average food costs are in line with inflation over the six months to June 2013 in both sectors and were around £25 per person per week for the same period.

Heating costs per person per week in the long-term elderly care sectors have increased below inflation, with reductions in overall energy costs in both sectors in the first half of the year. Personal care heating and lighting costs have declined by 13% since 2010 and currently stand at £12.85 pppw. Nursing home operators are seeing the first decrease in heating and lighting costs since 2012 with costs falling by 6% to reach £14.27 pppw. This shows a decrease of over 18% since 2010. (See Figures 5, 6, 7, 8)
EBITDAR (Profit Margin)

Profit margin is calculated at the EBITDAR level (Earnings Before Interest Tax Depreciation, Amortisation And Rent), having taken the data at the time of valuation/transaction.

Profit margins across the long-term elderly sectors have shown little change since the end of 2012 despite operators being under pressure due to lower occupancy levels and continued cost constraints. Profitability in the personal care sector is slightly up on H2 2012 figures at 31.5%, while nursing care profitability is unchanged at 28.6% (see Figure 9).

Source: Colliers International, Haver Analytics

FIGURE 7: NURSING HOME AVERAGE FOOD COSTS PER PERSON PER WEEK

Source: Colliers International, Haver Analytics

FIGURE 8: NURSING HOME HEATING & LIGHTING COSTS PER PERSON PER WEEK

Source: Colliers International, Haver Analytics

FIGURE 9: EBITDAR AS A % OF TOTAL REVENUE 2003-2013 (2YR ROLLING AVERAGE)

Source: Colliers International
Key Performance Indicators (KPIs)

SPECIALIST CARE SECTOR

This section of the paper provides analysis of the specialist care property and business markets, focusing on homes catering for adults with long-term physical and learning disabilities.

Our analysis shows that the declines reported in H2 2012 have slowed over the first half of 2013 with only a marginal decrease in EBITDAR in H1 2013, due primarily to falling fee levels.

Occupancy Rates:

Occupancy rates remain unchanged at 89.9% since H2 2012 (see Figure 10). Since H2 2010 occupancy rates have fallen by 1.9 percentage points and have fallen by more than seven percentage points since H2 2007.

Average Weekly Fees:

Average weekly fees in the specialist sector have reduced significantly in H1 2013 by 2.6%, falling to £1,424 (see Figure 10). When taking inflation into account, fees have fallen by 4.2% since H2 2012 and are down 1.1% since H2 2003. This is the only sector to have experienced negative real fee growth since the base year.

Adrian Ilott, Director, made the following observations: “The specialist care sector continues to see pressure on fees. Since 2010, fees in the sector have fallen by 12.5% in real terms, against decreases of 6.2% in the nursing sector and 1.7% in personal care fees. It would seem that a ‘top down’ approach is being applied by funding bodies when looking to make savings in care budgets”.

Payroll and Non-Payroll Costs:

Payroll costs declined marginally to 52.2% in the first half of the year after increasing during 2012 (see Figure 11). Non-payroll costs increased marginally to 13.1% over the same period. Payroll and non-payroll cost pressures will continue to affect specialist care operators, as a result of reduced weekly fees and occupancy levels.
Jose de Pablo, Director, mentioned that, “Specialist operators are seeing payroll costs continue to creep upwards, even if their payroll costs per person have been controlled”.

**EBITDAR (Profit Margin):**

Profitability in the specialist sector continues to be under pressure from falling occupancy levels, fee reductions and inflationary cost pressures. Since H2 2010, profit margins have reduced by almost one percentage point to 34.2% (see Figure 11).

### Conclusion

Although our KPI statistics do not show signs of significant change over the first six months of 2013, this at least demonstrates some stability in what remain challenging trading conditions. Overall, we are seeing occupancy levels beginning to plateau across all three sectors although there is some optimism demonstrated by the increase in personal care occupancy. While only 0.4 percentage points, this is the largest increase since H2 2008. Average weekly fees remain under pressure across the sectors with no increases shown in the data set for H1 2013. This is putting pressure on operators to continue to control payroll and non-payroll cost increases as much as possible. Due to cost rationalisation, profit margins remain largely unchanged over the first half of 2013 with only marginal downward pressure seen on specialist care. Looking ahead, it will be interesting to see whether these KPIs represent future sustainable operational performance levels or whether we will see further pressures filter through. The most likely scenario is the homes that are operating out of poor quality assets and largely reliant on local authority funding, will find it harder to maintain occupancy levels and EBITDAR margins; well run homes operating out of better quality purpose built properties, with a high proportion of private fee paying residents will continue to outperform the rest of the market through strong occupancy, year-on-year average fee growth and in many cases EBITDAR margins well in excess of 30%.

Thanks to Target Advisers and Signature Senior Living for providing photographs of their award winning homes.
The Care Home Investment Market

The recent results of a Colliers International investment survey shows that investors are increasingly looking beyond sovereign and political risks in assessing opportunities. Property fundamentals are the main driver in decision making. This is apparent also in the UK long-term care sector. The sector itself remains buffeted substantially by legislative uncertainty as the Social Care Bill continues its ponderous passage through Parliament with an ill-defined ‘capped cost’ mode and no clear adjudication process for local fee referral rates. There is yet little scope for the development of pre-funded long-term care insurance products and little financial certainty for care home operators dependent on public referrals. Greater clarity may only come after the next election.

Nevertheless, investors continue to show interest in care facilities with strong operators. Care homes have changed hands at yields of around 7% to 7.5% as evidenced by Target Healthcare’s recent purchases including two purpose built care homes operated by Orchard Care Homes (for approximately £11.5m representing an initial yield in excess of 7.0%) and Hambleton Grange Care Home operated by Ideal Carehomes (for approximately £4m representing an initial yield in excess of 7.0%). Earlier this year, Schroder UK Property Fund forward funded the development of five new care homes with Care UK for £28m at a 7% IY and the operator Caring Homes, who focus on the private market with a South East bias concluded a sale and leaseback in May with the American Healthcare REIT who paid £305m at a 6.5% IY. In contrast, primary health centres have been trading at sub 6% yields, suggesting that greater risk diversity comes at a price. So despite an appetite to look beyond certain risks, fundamentals remain firmly in the equation.

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Research Methodology

Colliers International specialises in all aspects of the healthcare property and business sector. The team is made up of experienced professionals and provides a wide range of valuation, agency, investment, consultancy and litigation related services to a variety of clients, from multi-national healthcare and finance corporations to individual operators.

This research is based on data drawn from both formal accounts and unaudited management accounts submitted to support valuations and agency activity (see map). The data is treated confidentially and there are safeguards in place to protect the records of individual clients. This research paper accordingly differs from most other published data which typically relies on informal surveys and informed comments. All data used in this research report has in addition been diligently checked by the Colliers International Healthcare team in the course of our valuation and agency activity.

The research results, therefore, are indicative of real trends in the market. The data for this paper covers over 4,500 records across a range of different care providers, including corporates and single home operators and consists of nursing and personal care homes in the long term elderly and specialist sectors. The data covers the whole of Great Britain and is therefore representative of the country as a whole.

Unless otherwise stated, the data covers a moving two year data period average, so for the most recent period ending at June 2013 (H1 2013) the data covers the period from H2 2011 to H1 2013. This two year rolling average has been adopted to eliminate any problems caused by outliers and helps to smooth any irregularities which may distort the true picture of what is happening in the market place.

 Disclaimer: This report gives information based primarily on published data which may be helpful in anticipating trends in the property sector. However, no warranty is given as to the accuracy of, and no liability for negligence is accepted in relation to the forecasts, figures or conclusions contained in it and they must not be relied on for investment purposes. This report does not constitute and must not be treated as investment advice or an offer to buy or sell property. November 2013 13238

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