

RESEARCH &amp; FORECASTING UK

# CARE HOMES REVIEW



“Operators caring for residents funded by Local Authorities are unlikely to see fee growth keep pace with cost inflation in 2011 or 2012. There are, however, positive opportunities resulting from the austerity measures for private sector operators of high quality care homes.”

Kenneth MacKenzie, Target Advisers LLP

This is the thirteenth in a regular series of papers that provides in-depth analysis of the healthcare property and business sector, focusing on long-term residential and nursing care for the elderly. Our analysis is based on actual data used to support valuations conducted by the Colliers International Healthcare team and includes more than 3,500 records across a wide spectrum of different care providers, from corporates through to single home operators.

Nevertheless, our sample of elderly care homes, which varies in each six month period typically has a corporate bias. This paper aims to provide commentary on indicative trends in the healthcare market for the second half of 2010. Detailed data is available on request. Please contact us for further information or visit our website: [www.colliers.com/uk/healthcare](http://www.colliers.com/uk/healthcare)

In this edition, Kenneth Mackenzie of Target Advisers LLP supplies independent commentary on government spending cuts and the short to medium term impact of those cuts on the elderly healthcare sector.

## CARE HOMES

Two main types of CQC registered care home are covered in this paper:

- **Care Homes without Nursing Care (PC)**  
Residential care homes offer either short- or long-term care. They provide accommodation, meals and personal care, such as help with bathing and eating.
- **Care Homes with Nursing Care**  
These homes are similar to residential homes but they also employ registered nurses who provide care for more complex health needs.



Source: Amberley House, Stoke-on-Trent, courtesy of Target Advisers LLP

## Spending Cuts, Local Authority Closures and Private Sector Efficiency Savings

*The Local Authority spending cuts resulting from the Government's Comprehensive Spending Review are undoubtedly presenting challenges in the short to medium term for the elderly healthcare sector. Operators caring for residents funded by Local Authorities are unlikely to see fee growth keep pace with cost inflation in 2011 or 2012 (although the implications of the Pembrokeshire County Council case are yet to be seen). There are, however, positive opportunities resulting from the austerity measures for private sector operators of high quality care homes.*

*One such opportunity will be the withdrawal of in-house services currently operated by Local Authorities across the UK – approximately 920 homes (elderly and/or dementia) with circa 30,600 beds per Laing & Buisson (L&B). Beds in Local Authority homes are filled in priority to those in privately operated homes despite many of these homes being of relatively poor quality. We believe that many of these Local Authority homes are no longer fit for purpose (a view shared by L&B and, indeed, many Local Authorities themselves). Further, Local Authority operated homes tend to be much less efficient than their peers in the private sector – L&B estimate that the average weekly fee per resident is £400 more in a Local Authority home (in some cases, this equates to almost 100% additional cost over the alternatives). Two examples suggest L&B's estimate is reasonable – Durham, in announcing its intention to shut seven of its 12 facilities, indicated that its own homes were on average £292 per week more expensive; Stoke announced that it expected to save £1.7m pa by closing two homes with a combined 80 residents (a saving of £408 per week per resident).*

*The private sector has long complained about this situation but it now appears that the necessity to cut expenditure is outweighing the political difficulties in closing Local Authority facilities. We have been monitoring the situation and noted a trickle of closure announcements during 2010. However, there has been a very sharp increase in such announcements since the turn of the year with 153 homes across 29 Local Authorities being earmarked for closure with only one Local Authority announcing plans to build new homes (three homes) and one to invest heavily in the modernisation of two homes. The announcements this year represent a 16.6% of Local Authority homes and in all cases the intention is to transfer residents to alternative privately operated facilities.*

*Our firm belief is that those homes with the best facilities are well placed to benefit from these closures.*

**Kenneth MacKenzie**

Managing Partner, Target Advisers LLP



## Changes in Colliers International Care Home KPI Compilation Methodologies

*Over the last year, we have become increasingly aware that the number and sophistication of questions related to our Care Home KPI database have increased substantially. Increasingly, we are getting these detailed requests for both property related and business performance related data from equity analysts at banks as well as at private investment houses. The message we have taken away from this is that banks, as well as potential investors, are approaching care home sector investment opportunities with due diligence foremost in their minds. This must be a good sign for the general health and vitality of the healthcare investment sector.*

*Consequently, we have taken the opportunity to review the way we filter our valuation data (especially what is included and what is omitted) so as to ensure that the data is sufficiently robust to support this greater level of scrutiny, but also to remain generally indicative of mid-term trends. We have therefore revisited the full data series on a record by record basis and have tightened up the parameters on inclusion so as to reduce some of the volatility in the series. Most notably, we have cleared the database of records that we feel are not indicative of a standard corporate occupier, or where performance figures have been distorted by short-term redevelopment of premises, or other impacting events of a purely transitory nature. We do not include records with occupancy levels of less than 70%, nor do we include records with occupancy levels greater than 99%. The approach is somewhat similar to the way the LIBOR rate is calculated by the BBA. The top 20% of responses are removed, the bottom 20% is taken out and the remainder is averaged.*

*The results are robust and we are pleased to see that the volatility has been reduced, but that the basic trends in occupancy rates, fees averages, profit margins etc., are broadly similar to our previous series.*

*As always we remain open to suggestions on how we can continue to strengthen the reliability of our methodology and data. Furthermore, we are also putting the data to work directly as part of general consultancy work for clients who are reviewing the general performance of their care home portfolios, both nationally and regionally.*

**Walter Boettcher and Lisa Dean**

Research & Forecasting

OCCUPANCY RATES

	➔	➔
%	NURSING	PC
2010 H2	91.4	90.7
2010 H1	91.2	90.9
2009 H2	91.8	90.9

AVERAGE FEES

	↑	↑
£ PER WEEK	NURSING	PC
2010 H2	641	507
2010 H1	637	480
2009 H2	633	477

PAYROLL COST

	➔	➔
% TOTAL REVENUE	NURSING	PC
2010 H2	56.9	53.7
2010 H1	57.0	53.6
2009 H2	53.0	51.6

NON-PAYROLL COST

	➔	➔
% TOTAL REVENUE	NURSING	PC
2010 H1	15.6	15.5
2009 H1	15.8	15.6
2009 H1	14.5	14.7

PROFIT MARGIN (EBITDAR)

	➔	➔
% TOTAL REVENUE	NURSING	PC
2010 H1	29.9	31.9
2009 H2	29.6	31.9
2009 H1	32.8	33.2

# Key results

Our research focuses on the key drivers of the care homes 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:** Average occupancy rates for both nursing and care homes stood at or above 90% for the second half of 2010.

**Average Weekly Fee:** Our most recent analysis shows that, while average nominal weekly fees have increased steadily over the last two years, in real terms fee growth weakened significantly in the last year. In the last six months of 2010, nursing home nominal fees grew by 1%, although in real terms, fees fell by 3%. Care homes fees grew nominally by 6% over the same period although real growth only registered 2%.

We believe a turning point has been reached and that weekly fees will see a period of real decline due to local authority and government spending cuts.

**Payroll Costs:** Salary and national insurance costs as a proportion of total revenue remained at the same level as reported in H1 2010 around 57% (nursing) and around 54% (care homes).

**Non-Payroll Costs:** In the second half of 2010, non-payroll costs as a proportion of total revenue remained stable at around 16% for both nursing homes and care homes.

**EBITDAR:** Cost pressures alongside falling fee inflation saw profit margins shrink in the first half of 2010. For H2 2010 profit margins have remained broadly stable at around 30% or above for both nursing homes and care homes.



Source: Amberley House, Stoke-on-Trent, courtesy of Target Advisers LLP

# Colliers International Key Performance Indicators (KPIs)

## OCCUPANCY RATES

The average occupancy rate of both nursing homes and care homes across Great Britain remained at around 91% for the second half of 2010. This represents a series low (Figure 1).

The average level of occupancy across different sizes of care homes remains stable and in line with overall occupancy rates recorded for both nursing and care homes (91%). Occupancy rates were slightly higher (92%) for both nursing homes and care homes with 61+ beds. Care homes in Scotland and the West Midlands registered the highest average levels of occupancy at 94%, whereas care homes in Greater London registered the lowest average levels of occupancy at 88% in H2 2010.

## AVERAGE WEEKLY FEE

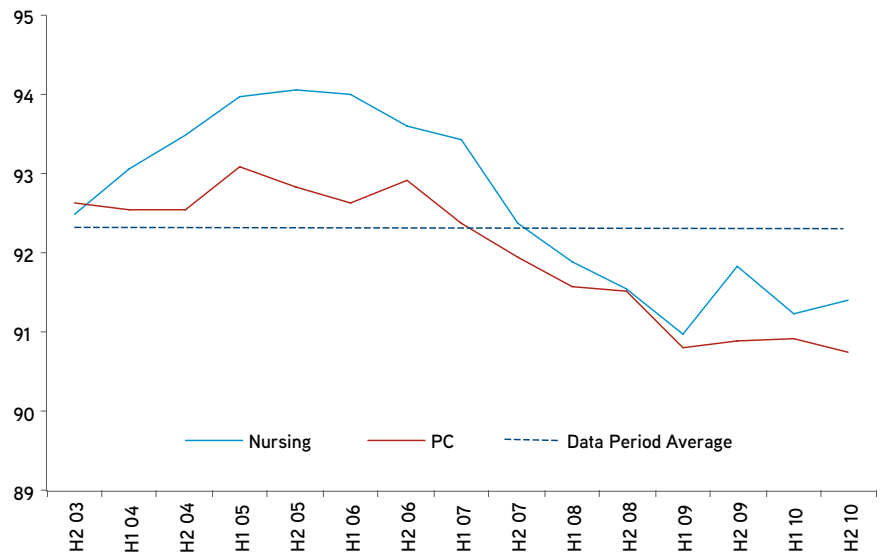
Figure 2 illustrates average weekly fees across nursing and care homes in Great Britain based on data from 2003-2010. Nominal weekly fees in nursing homes increased by 1% and by 6% for care homes.

The data suggests that average weekly fees have either kept pace or exceeded inflation over the last five years. These increases reflect, in large measure, local authority support for improvements in care quality as standards tightened and lower quality operators were squeezed out of the market.

Fee growth has begun to show signs of weakening over the latest reporting periods, especially over the last year of high inflation. Annual average weekly fee growth fell in real terms by 3% for nursing homes and increased by a marginal 2% for care homes. Worryingly, these real decreases have been accompanied by overall operating cost increases in line with inflation; even the most efficient operators are coming under increasing pressure.

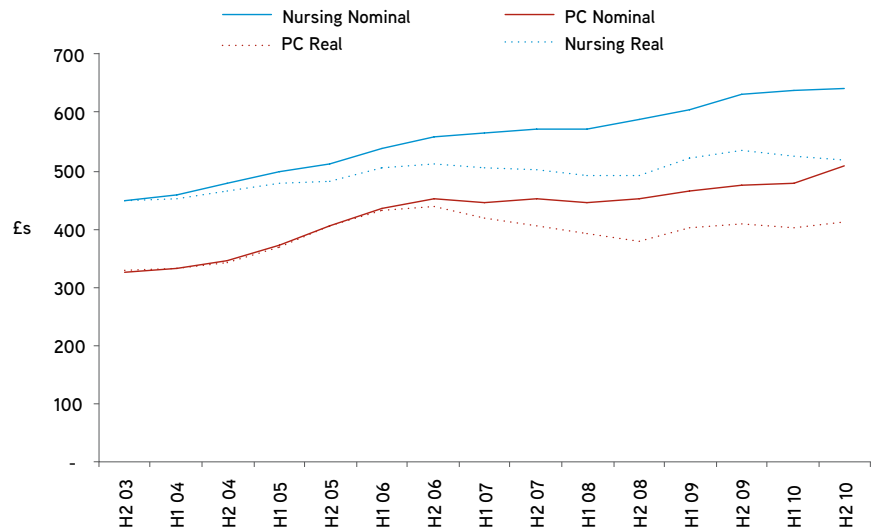
The end result of reduced fees will be to marginalise smaller inefficient operators, but also to put pressure on larger corporate operators to find further economies of scale. Where these additional economies are to be found is another question, especially given the increased efficiencies achieved in the recent past.

FIGURE 1: AVERAGE OCCUPANCY 2003 - 2010 (% -2 YEAR ROLLING AVERAGE)



Source: Colliers International

FIGURE 2: AVERAGE WEEKLY FEE BY TYPE OF HOME



Source: Colliers International

## OCCUPANCY RATES

	%	NURSING	PC
2010 H2	91.4	90.7	
2010 H1	91.2	90.9	
2009 H2	91.8	90.9	
2009 H1	91.0	90.8	
2008 H2	91.6	91.5	
2008 H1	91.9	91.6	

## AVERAGE FEES

£ PER WEEK	NURSING	PC
2010 H2	641	507
2010 H1	637	480
2009 H2	633	477
2009 H1	605	463
2008 H2	589	451
2008 H1	572	446

The occupancy rate is calculated by the total number of residents at the time of valuation divided by the number of registered beds.

Average fees are calculated by taking the average of weekly fees being paid by residents.

**PAYROLL COSTS**

% OF TOTAL REVENUE	NURSING	PC
2010 H2	56.9	53.7
2010 H1	57.0	53.6
2009 H2	53.0	51.6
2009 H1	51.4	50.4
2008 H2	50.6	49.5
2008 H1	51.8	48.2

Payroll costs are calculated by dividing wage and NIC costs by total revenue. Both figures are taken from the accounts at the time of valuation.

**PAYROLL COSTS**

Salary and national insurance costs as a proportion of total revenue remained stable over the second half of 2010 (Figure 3). Payroll costs within nursing homes have proved to be consistently higher than those in care homes, reaching around 57% of total revenue in H1 2010, compared to around 54% for care homes. This reflects the higher costs associated with staffing of professional nurses.

Wage costs were highest for nursing homes in Scotland (59%), whereas nursing homes in Wales registered the lowest payroll costs at 48%. Greater London care homes saw the highest level of payroll costs at 67%, in contrast to the lowest payroll costs of 46% in the West Midlands.

**NON-PAYROLL COSTS**

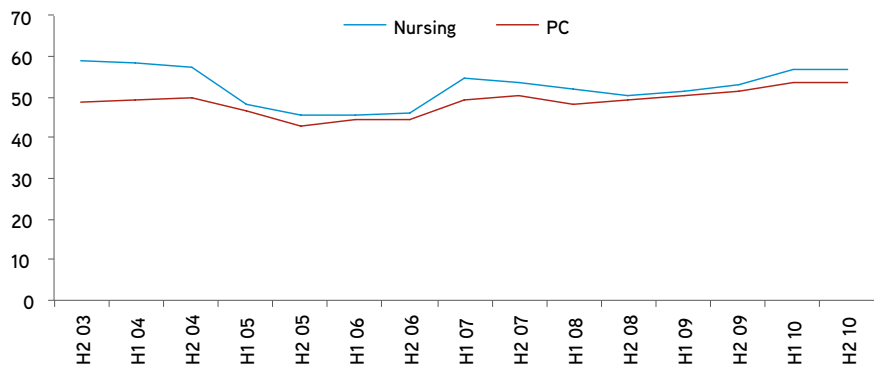
Non-payroll costs incurred by a care home include repairs and maintenance costs and utilities bills. Figure 4 illustrates the proportion of total revenue allocated to non-payroll costs from 2002 to 2010. Non-payroll costs have remained stable over the last two years, despite the much publicised growing burden of general input costs.

There was some variation in non-payroll costs across Great Britain, with care homes in the South East recording the highest costs at 19% and Scotland recording the lowest at 13%.

**EBITDAR (PROFIT MARGIN)**

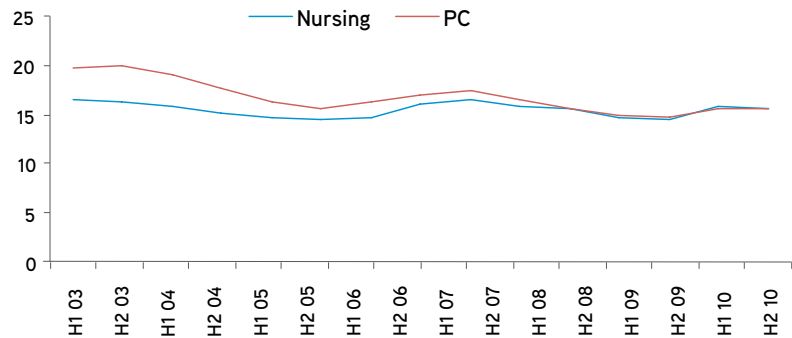
EBITDAR as a proportion of total revenue is used as an indicator of profitability. The pressure on operators from falling fee inflation and rising payroll costs can be seen in the shrinking of profit margins for both nursing and care homes during the first six months of 2010. The average profit margins for a nursing and care homes in Great Britain have levelled out at or above 30% in H2 2010 (Figure 5).

FIGURE 3: PAYROLL COSTS AS A % REVENUE, 2003 - 2010 (2 YEAR ROLLING AVERAGE)



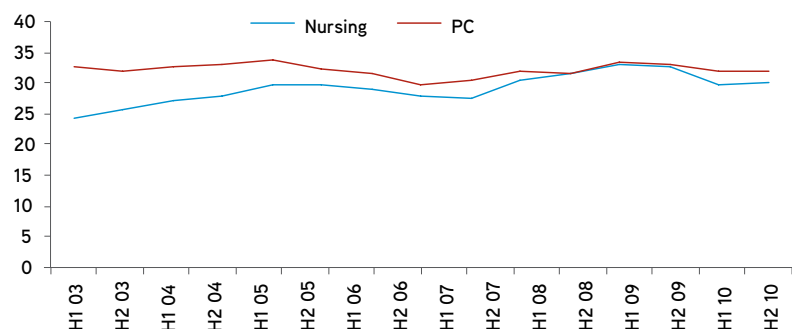
Source: Colliers International

FIGURE 4: NON-PAYROLL COSTS % OF REVENUE, 2003 - 2010 (2 YEAR ROLLING AVERAGE)



Source: Colliers International

FIGURE 5: EBITDAR % OF REVENUE, 2003 - 2010 (2 YEAR ROLLING AVERAGE)



Source: Colliers International

Average EBITDAR as a proportion of total revenue for elderly care homes varied substantially across Great Britain. Nursing care homes in Wales and the North West recorded the lowest profit margins of only 27% on average; care homes in Yorkshire & Humberside (40%) and nursing homes in Greater London (34%) and the South East (34%) experienced a considerably better year in terms of profit margins as a proportion of total revenue.

**NON-PAYROLL COSTS**

	➔	
	% OF TOTAL REVENUE	PC
2010 H2	15.5	15.6
2010 H1	15.6	15.8
2009 H2	14.7	14.5
2009 H1	15.0	14.8
2008 H2	15.5	15.7
2008 H1	16.5	15.9

**PROFIT MARGIN (EBITDAR)**

	➔	
	% OF TOTAL REVENUE	PC
2010 H2	29.9	31.9
2010 H1	29.6	31.9
2009 H2	32.8	33.2
2009 H1	32.9	33.4
2008 H2	31.6	31.4
2008 H1	30.8	32.1

*Non-payroll costs are calculated by dividing total costs excluding wages and NIC by total revenue. Both figures are taken from the accounts at the time of valuation.*

*Profit margin is calculated by dividing the profit EBITDAR (Earnings Before Interest Tax Depreciation, Amortisation And Rent) by total revenue. Both figures taken from the accounts at the time of valuation.*



## Conclusion

Key performance indicators for the second half of 2010 illustrate the impact of the varied pressures on operators. Government spending cuts, slowing housing market, lack of bank funding and a continued focus on alternative forms of elderly accommodation, rather than the traditional care home model, is putting pressure on profitability.

With below-inflation Local Authority baseline fees settlements, there is continuing pressure on operators to keep care standards high while keeping costs down. We are at a turning point where real average weekly fees will begin to fall due to government funding cuts. For those operators that have minimal exposure to the private pay market, diversification into alternative forms of care or a focus on specialised services, such as dementia care services, will become increasingly important.

Equally careful control of staffing costs, as well as renegotiating where possible of debt repayment levels and rental payments will also come to the fore.

## The healthcare investment market

*The Investment Property Database is scheduled to release the 2010 investment performance figures on 26 May 2011 for the primary and secondary (including care homes) healthcare segments. I hesitate to offer any prediction, except to say that income returns are likely to remain robust, especially as the majority of leases remain linked to the RPI index, which, in turn, reached 228.4 (up 4.8%) over the course of 2010. Whether this RPI link weathers 2011 intact is another question that is being followed very closely, as over-indebted operators have begun negotiations with landlords with the aim of reducing the cost of property rentals. The traditional RPI link has been tabled specifically for discussion. Income returns to 'secondary' healthcare reached 8.6% in 2009 outperforming IPD All Property which returned 7.4%. A similar outcome for healthcare is likely again in 2010 as investment yields in this sector remained broadly stable with limited capital growth. All property in contrast saw capital growth of 8.3%. The evidence suggests that total returns to Healthcare may lag somewhat behind All Property, although relatively few healthcare deals has perhaps not been sufficient to bring sufficient pricing transparency to the sector.*

*At the moment the focus appears to be on 'debt acquisition' as banks and other lenders choose whether to continue workout arrangements or seek more actively to sell debt so as to recycle cash for other projects. Judging by the number of queries received by Colliers, there is evidence to suggest that numerous fund operators are committing considerable time and effort in scouting out these opportunities.*

**Dr Walter Boettcher**

Director, Research & Forecasting, Colliers International

## Colliers International view

*Our latest data suggests that fee rates over the last five years have kept pace or exceeded inflation, reflecting local authority support for upgrading of the general care offer as standards were tightened and marginal, low quality operators squeezed out of the market.*

*More recently, fee growth rates have shown signs of weakness, especially over the last year with high inflation. The overall operating costs continue to increase in line with inflation, especially with respect to annual property leasing costs (which for most corporate operators are linked to RPI), while revenues are suffering real decreases. Hence, even the most efficient operators are feeling the squeeze and given continuing expectations of high inflation, the pressure is set to continue for the rest of 2011 and possibly into 2012.*

*Several operators report that local authorities began fee negotiations as early as summer last year rather than wait to the traditional review period in April each year. Hence many operators have already suffered actual fee reductions. Anecdotally many local authorities have shown some sympathy to operator claims of increasing cost bases; however, when 'push comes to shove' the final fee settlements may do little to allay these worries, although the impact of recent legal actions has not yet been seen. There are a few reports of fairly acrimonious discussions (FT, 30 Nov 10), but these remain the exception rather than the rule . . . so far.*

*The net effect of reducing fee growth in real terms will be to apply even more pressure to poorly targeted and inefficient operators. The larger corporate concerns will need to redouble their efforts to control costs and find further economies of scale by expanding market share.*

*The success of negotiations with landlords in reducing the rental cost base is another question. Already discussions have been linked to breaking the RPI links as well as changing payment to a monthly basis in order to conserve cash flows. Clearly it is in everybody's interest to find a resolution to the many problems, so as to ensure the continuity of care delivery to the tens of thousands of residents in the thousands of care homes throughout the UK.*

**Jeremy Tasker**

Head of Healthcare, Colliers International

# Research methodology

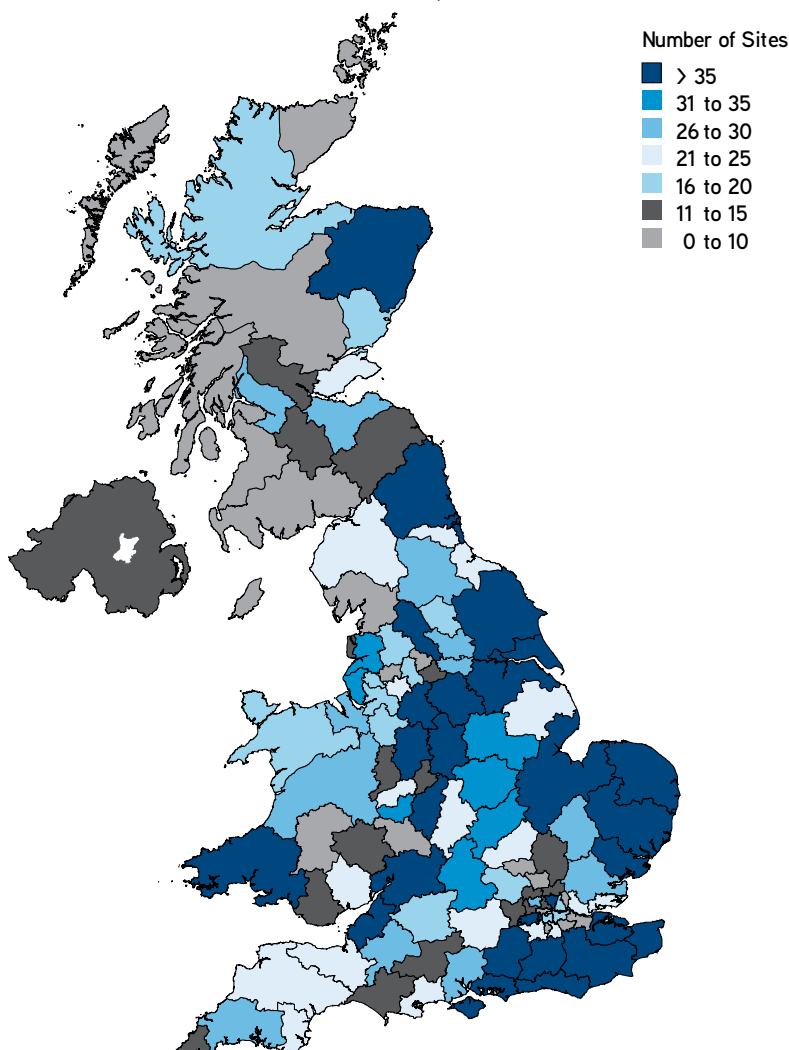
Colliers International specialises in all aspects of the healthcare property and business sector. The team is made up of experienced professionals and provides a wide range of valuation, investment, agency, consultancy and litigation related services to a variety of clients, from multi-national healthcare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

This research is based on data drawn from evidence submitted to support valuations (see map), and is based on authentic, audited information. The data is treated confidentially and there are safeguards in place to protect the records of individual clients. This paper differs from existing research in the marketplace in that it is based not just on surveys but on actual, real valuation data. The research results, therefore, should be indicative of general trends

in the market. The data for this paper includes over 3,500 records across a range of different care providers, including corporates, single home units and consists of nursing and residential homes. The data also 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 average, so for the most recent period ending at December 2010 (H2 2010) the data covers the period from H2 2009 to H2 2010. This two year period 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.

## AN ILLUSTRATIVE MAP OF THE LOCATION OF OPERATORS



## 480 offices in 61 countries on 6 continents

United States: 135  
 Canada: 39  
 Latin America: 17  
 Asia Pacific: 26  
 ANZ: 168  
 EMEA: 95

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We would like to extend our thanks to Target Advisers LLP and Kenneth MacKenzie for providing the photographs and commentary for this publication.

Views of the writer are not necessarily the views of Colliers International.

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