The last ten years in the sector has provided a challenging and frequently changing environment for good operators, who have had to embrace a necessary, but at times tough, progression to a better care sector. Regulation forces operators to invest and aim for higher standards, resulting in overall improved quality.”

Elderly long-term care

This is the twelfth 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 3,700 records across a wide spectrum of different care providers, from corporates through to single home operators. In this edition, Craegmoor supply independent commentary on providing a comprehensive approach to dementia care services, whilst David Rees from Davis Langdon LLP discusses maximising tax returns for care businesses with optimised tax reliefs.

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 2010. More detailed data is available on many aspects of this paper. Please contact us for further information or visit our website: www.colliers.com/uk/healthcare.

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 washing and eating.

- **Care Homes with Nursing Care (Nursing)**
  These homes are similar to residential homes but they also employ registered nurses who provide care for more complex health needs.

Source: Craegmoor
Delivering a comprehensive approach to dementia care services

Providers of support for older people are increasingly seeking to tailor that support to reflect the needs of people living with dementia. Craegmoor is passionate about person-centred support and enabling people with dementia to lead the life they want to lead.

For older people living with dementia, feelings of comfort and safety are so important – a home environment that makes daily activities easier to do, and staff who recognise that everyone’s individual needs are different. Under the guidance of Debra Fox, Quality Development Advisor for Dementia, Craegmoor’s Dementia Care strategy covers everything from redesigning living environments to delivering sector-leading training programmes for all levels of staff.

Craegmoor’s Project Living Spaces creates the perfect environment for people with dementia, and is founded on best practice principles. The project comprehensively addresses the way Craegmoor’s care homes are decorated and furnished with specifically designed colour schemes, patterns and furniture to create both a relaxed and homely atmosphere, and also to help people living with dementia find their way around their home.

Craegmoor’s dementia training programme delivers several tiers of training, from an introductory course for all staff, right through to a management level course. Developed in conjunction with the University of Worcester (Association of Dementia Studies), the programme aims to ensure that those providing care for people living with dementia really understand the condition and how the work they do impacts upon their quality of life.

Debra Fox, Craegmoor’s Quality Development Advisor for Dementia describes the aspirations behind the strategy:

“Craegmoor’s Dementia Strategy is designed to provide the best in dementia care for the people we support. Project Living Spaces is delivering new living environments from the ground up in existing services, which meet the specific support needs of people living with dementia. This project provides sound evidence-based examples of best practice which we can roll-out across our services.

“As well as training our staff in best practice, we also encourage them and the people they support to continually give us feedback, so we can work together to provide the best quality of life possible.”

Debra Fox
Quality Development Advisor for Dementia, Craegmoor

Maximising returns for care businesses with optimised tax reliefs

The recession has been an opportunity for some care businesses with strong balance sheets and low gearing, to utilise a combination of lower interest rates, falling land costs and construction tender prices, to advantageously procure new high specification homes that readily attract customers. For others however, in older buildings that are increasingly costly to maintain, the outlook may be more uncertain with rising operational costs, Care Quality Commission assessments, and the possible impact of falling local authority placements. Meanwhile, in an austerity era undertaking improvements can represent a serious financial undertaking.

As energy costs seem set to rise over time and carbon reduction becomes more tightly regulated, there are compelling arguments to achieve running cost savings. The increased emphasis on energy is also likely over time to increase the awareness of Energy Performance Certificate (EPC) ratings.

This may have a bearing on asset values in the next decade and needs to be borne in mind when considering future disposals or exit strategies. The UK has a highly developed and valuable tax relief system that can, when properly applied, significantly improve the returns from commercial property investment. The problem is that during the pre-recession years, business fundamentals were so strong that few people actually considered Capital Allowances prior to undertaking construction schemes. Making claims became a post-project issue as part of financial reporting and might often be overlooked altogether. More importantly it has resulted in a low awareness of the subject within the construction industry.

However, a growing interest is now emerging in factoring in the value of potential savings at the drawing board stage. The benefits can be considerable – typically up to 35% of the construction cost of a new care home may be tax relieved, and for refurbishments this might rise to as much as 75% of budget cost. Early consideration of savings can also mean the opportunity to improve the design specification.

The Enhanced Capital Allowances scheme provides a dual benefit with 100% first year relief for qualifying energy saving equipment – with subsequent running cost savings and improved EPC ratings.

Commercial lenders are starting to become aware of the benefits as financial projections have improved viability by including potential savings to show a better financial safety for the borrowers and persuasive support to funding proposals. Funding for energy-saving improvements can also be augmented for Small to Medium Enterprises with 0% interest loans from the Carbon Trust.

Tax relief may not seem as interesting as looking at the architect’s plans – but its impact might be just as important in project planning to help underpin ultimate business success.

David Rees
Partner, Banking Tax & Finance, Davis Langdon LLP
Key results

Our research focuses on the key components of the healthcare 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: Occupancy rates averaged sub-90% for both nursing and care homes in the first six months of 2010. At 88%, nursing homes averaged their lowest rates of occupation since our records began, whilst care homes saw only a marginal improvement from late 2009 figures.

Average weekly fee: From their plateau in 2009, nursing home fees fell slightly to £670 per week, however, care home fees recovered to reach £512.

Payroll costs: Salary and National Insurance costs as a proportion of total revenue continued to rise in both nursing and care homes in the first half of 2010, to 56% and 54% respectively.

Non-payroll costs: Non-payroll costs as a proportion of total revenue remained stable at 14% for nursing homes in the first half of 2010, whilst care homes experienced a small rise in costs to 16% of total revenue.

EBITDAR: Cost pressures alongside falling fee inflation resulted in a shrinking of profit margins in the first half of 2010, with both nursing homes and care homes experiencing a decrease in EBITDAR as a proportion of total revenue. Profit margins for nursing homes returned to levels not seen since 2007.

Source: Craegmoor
OCCUPANCY RATES

The average occupancy rate of nursing homes across Great Britain fell to 88% in the first half of 2010, the lowest figure since our records began in 2002. Occupancy rates within care homes recovered slightly from their trough at the end of 2009, however remain, on average, sub-90% across Great Britain (Figure 1).

The average level of occupancy across different sizes of care homes remains fairly stable (Figure 2), with greater variability seen across different sizes of nursing homes. Nursing homes with between 11 and 20 beds had an average occupancy level of 72%, yet large nursing homes performed relatively well in the first half of the year, averaging 90%.

Homes within Wales recorded the highest occupancy rates in the first six months of 2010, at an average of 92%, whilst elderly care homes in the East of England had the lowest average rates of occupancy, at 84%.

AVERAGE WEEKLY FEE

Figure 3 illustrates average weekly fees across nursing and care homes in Great Britain from 2002 until H1 2010. Weekly fees in nursing homes fell 5% from figures seen in the last half of 2009 to £670 per week. Weekly fees within care homes, however, increased by almost 3% to £512 per week, a two-year high.

Unsurprisingly, nursing and care homes in Greater London recorded some of the highest average weekly fees across the country, at £930 per week for a bed in a nursing home in the capital and £557 for a bed in a care home. Whilst nursing homes in the North East charged residents the lowest weekly fee, at £539, care homes in the East Midlands recorded the lowest fees for personal care only.

OCCUPANCY RATES

<table>
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<th>%</th>
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<td>2008 H1</td>
<td></td>
<td>91</td>
<td>92</td>
<td></td>
</tr>
<tr>
<td>2007 H1 &amp; H2</td>
<td></td>
<td>90</td>
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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

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<tr>
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<tr>
<td>2007 H1 &amp; H2</td>
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<td>475</td>
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</table>

Average fees are calculated by taking the average of weekly fees being paid by residents at the time of valuation.
PAYROLL COSTS

<table>
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<th>% OF TOTAL REVENUE</th>
<th>NURSING</th>
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<tr>
<td>2007 H1 &amp; H2</td>
<td>52</td>
<td>50</td>
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</tbody>
</table>

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.

Figure 4 illustrates the relationship between average weekly fee for nursing and care homes and GDP per capita.

PAYROLL COSTS

Salary and National Insurance costs as a proportion of total revenue rose in the first six months of 2010 for both nursing and care homes as shown in Figure 5. Payroll costs within nursing homes have proved to be consistently higher than those in care homes, reaching 56% of total revenue in 2010 H1, compared to 54% for care homes.

Wage costs were highest for homes in the South East (32%) and the South West (32%), closely followed by Greater London (30%). However, elderly care homes in Scotland and the North West recorded the lowest payroll costs, at 26% and 27% respectively.

Source: Colliers International, Experian

FIGURE 4: AVERAGE WEEKLY FEE V GDP PER CAPITA

FIGURE 5: PAYROLL COSTS AS A PROPORTION OF REVENUE, 2002 - 2010

Source: Colliers International

FIGURE 6: NON-PAYROLL COSTS AS A PROPORTION OF REVENUE, 2002 - 2010

Source: Colliers International
NON-PAYROLL COSTS

Non-payroll costs incurred by a care home include repairs and maintenance costs and utilities bills. Figure 6 illustrates the proportion of total revenue allocated to non-payroll costs from 2002 until the first six months of 2010. Whilst costs for nursing homes remained stable for a further six months at 14%, non-payroll costs in the average care home rose marginally from 2009 figures to 16% of total revenue.

There was some variation in non-payroll costs across Great Britain, with homes in Scotland recording the lowest costs at 13%, whilst at almost 17%, homes in the North East had the highest non-payroll costs a proportion of total revenue in 2010.

EBITDAR (PROFIT MARGIN)

EBITDAR as a proportion of total revenue is used as an indicator of profitability. The pressure on operators from stalling fee inflation and rising payroll costs can be seen in the shrinking of profit margins for both nursing and care homes. The average profit margin for a nursing home in Great Britain shrunk by almost 6% compared to late 2009 figures, whilst care homes fared only slightly better with a 3.5% decrease in the same period (Figure 7).

Average EBITDAR as a proportion of total revenue for elderly care homes varied substantially across Great Britain (Figure 8). Whilst homes in Scotland recorded a profit margin of only 26% on average, homes in Greater London experienced a considerably better year with the average EBITDAR as a proportion of total revenue set at 34%.

Figure 9 depicts the variation in size of profit margin across both nursing and care homes by number of beds. Nursing homes across Great Britain with a greater number of beds reported larger profit margins (an average of 30%) than those with fewer beds. Homes with between 11 and 20 beds, for example, recorded EBITDAR as a proportion of total revenue at an average of 26%. Care homes with over 61 beds, the size usually associated with large corporate operators, were the most profitable in the first half of 2010, with an average profit margin on 33%. Mid-sized care homes with between 40 and 60 beds were reported to be the least profitable, with an average profit margin of around 27%.

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.
Conclusion

Key performance indicators for the first half of 2010 illustrate the impact of the varied pressures on operators. A stagnating housing market, the persistent political focus on alternative forms of elderly accommodation rather than the traditional care home model and a lack of debt available to improve buildings to sustain occupancy rates is now beginning to squeeze the bottom line.

With below-inflation local authority baseline fee increases and the increase in payroll costs engendered by the October National Minimum Wage, further pressure on profit margins is expected in late 2010 and 2011. 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 necessary.

The healthcare investment market

Since last spring’s report, the impetus to increased private sector investment and participation in all aspects of public health has received a decisive impulse. Andrew Lansley’s White Paper ‘Equity and Excellence: Liberating the NHS, and its embrace of ‘social enterprise’ published on July 12th has evoked strong responses, especially the proposed rapid pace of implementation. Despite balanced criticisms (King’s Fund), the government has reiterated its resolve to push through the restructurings at pace.

The UK healthcare investment market is also showing signs of life. Continued operator indebtedness and LTV issues in the care home segment have stymied development and prevent high quality property assets from reaching the market. Nevertheless, in April Southern Cross completed a £14m ‘sale and leaseback’ agreement for two care homes in the South East at a yield of 8%. The yield undoubtedly reflects concerns about Southern Cross operational performance, especially given their exposure to what many understand as a weakening local authority fee referral base. In August though, Southern Cross received a takeover bid by Tower Brook (a UK based private equity firm) which might reasonably be understood as an expression of confidence in both the operator and the sector. Four Seasons also successfully restructured £600m of debt in September. In the mid-market, activity has remained steady with local operators expanding.

Interest in primary care centres continues with PHP acquiring in excess of £100m over the last year. February’s purchase of the northern portfolio was followed in June with acquisition of a southern based primary care portfolio for £38.4m at a yield of 6.1%. The owner/operator Health Investments was acquired in a separate transaction for £11.7m. Prime is also contemplating joining PHP, Assura and AH Medical as a listed property company with GP surgeries with a £400m flotation. UK institutions remain interested in the sector. Standard Life acquired a health centre with offices in Bury for £25m. The BMI Woodlands hospital was sold to Legal and General for £16.7m at a yield of 6.25%. Aegon, L&G, Medicx and Quercus are all remain engaged.

Dr Walter Boettcher
Director, Research and Forecasting, Colliers International

Colliers International view

1 October 2010 saw the implementation of the new regulation system under the Health and Social Care Act 2008, replacing the Care Standards Act 2000. Over the past five months, an exasperated care sector has been preparing itself for yet another new regime – despite the star rating system only being in place for just over a year.

While there were concerns over consistency and inflexibility, the star rating system was viewed by many operators and the wider public as an easy to use and convenient grading system. Many of the larger operators also implemented their own internal review programmes to help drive up the ratio of two star and above homes within their own portfolios. The net result was to generally improve standards. There are now concerns that the implementation of another new system will be costly and time consuming, and that in the worst case scenario, it could have an adverse impact.

The Care Quality Commission is working with stakeholders to discuss and develop a new way to compare quality across adult social care services in order to produce a fair and transparent service. Compliance will be continually monitored once the initial application for registration has been completed, as part of a new ‘dynamic, responsive and robust system of regulation’. In line with broader coalition health policy, there will be more focus on ‘outcomes’.

The last ten years in the sector has provided a challenging and frequently changing environment for good operators who have had to embrace a necessary, but at times tough, progression to a better care sector. Regulation forces operators to invest and aim for higher standards resulting in overall improved quality, which can only be a good thing for the sector. However, consolidation has been and remains inevitable as smaller operators and those with zero to one star ratings (under the old system) struggle to compete and in some cases, face closure.

The ensuing adjustment will generally be positive for the sector and the lower occupancy levels currently seen in the market mean there is capacity in the better care homes to compensate, driving up occupancy levels, margins and ultimately values.

Rachel McCarthy
Director, Healthcare Agency, Colliers International
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 covers over 3,700 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 data period average, so for the most recent period ending at June 2010 (2010 H1) the data covers the period from 2009 H2 to 2010 H1. This two 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

Number of Sites
- > 30
- 25 to 30
- 20 to 24
- 15 to 19
- 10 to 14
- < 10

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We would like to extend our thanks to Craegmoor and David Rees of Davis Langdon LLP 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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