RESEARCH

2013

CARE HOMES

Trading Performance Review

Knight Frank

HIGHLIGHTS

- Average fee rates increased by 1.1% during 2012, improving on the 0.7% rise recorded in 2011. However, last year's rise equates to a third successive year of falling fees in real terms, with RPI inflation reaching 3.1% in 2012.
- Care home pre-tax profit margins decreased to 28.0% of total income in 2012, falling from 30.5% in 2011. Residential care homes were more profitable, at 31.3% of total income, compared with 27.4% for nursing homes.
- Profit margins were affected by a slight fall in occupancy, with the overall occupancy rate slipping from 87.8% to 87.2% during 2012. Occupancy levels in the South West and North East were significantly below those of other UK regions.
- Our updated analysis continues to indicate that there is an optimal size of care home. Homes with a capacity of 60-79 beds demonstrate superior levels of profitability compared with both the smaller and larger size categories.

FOREWORD

Following the success of the inaugural Care Homes Trading Performance Review in 2012, on behalf of Knight Frank's Healthcare team I am delighted to welcome you to the 2013 update. For a number of years, Knight Frank has had the largest share of the market for care home valuations. Consequently, the results from this research provide the most definitive evaluation of trading performance for the UK elderly care home sector.

While the dust has now settled following the demise of Southern Cross, the headline results for 2012 reveal that UK care home trading performance as a whole remains challenged by ongoing budgetary pressures in social care funding. The 1.1% uplift in fee levels revealed by the research was hardly sufficient to offset rising staff costs and a slight fall in occupancy rates. This resulted in a notable tightening of profit margins in 2012.

Positively, however, the sector as a whole has coped admirably with these pressures and the erosion of profit margins is manageable for the time being. Indeed, the marked rise in investment interest for the best quality elderly care facilities noted over the past 12 months reflects confidence in the long-term prospects for the sector, underpinned by the UK's rapidly ageing population.

I would like to thank the many leading care providers who contributed to this year's updated report, without which this research would not be possible. In return, we hope that the findings provide a basis for the benchmarking of care home trading performance, informing care providers, investors and public bodies of latest trends in the sector with regard to occupancy, fee rates, costs and profitability.

Oliver du Sautoy, Associate, Research

Cedar Court Care Home, Surrey (Acer Healthcare)

2012 RESULTS AT A GLANCE

	All care	Nursing	Personal care
Occupancy	87.2% ↓	86.2% ↓	89.0% ↓
Average Weekly Fees	£622 ↑	£643 ↑	£528 ⇨⇦
Staff Costs (% of income)	57.2% ↑	57.9% ↑	52.8% ↑
EBITDARM (% income)	28.0% ↓	27.4% ↓	31.3% ↓

Source: Knight Frank

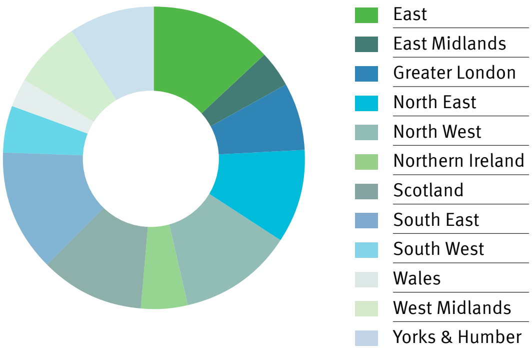
INTRODUCTION

Following positive feedback on Knight Frank's inaugural report in 2012, the 2013 update welcomes a number of additional care providers to the Knight Frank Care Homes Trading Performance Index (CH-TPI). As a result, the size of the index is even larger than last year, making it the most comprehensive and representative of its kind in the industry. Many of the UK's top 30 care providers are included in the analysis, giving the sample a distinct bias towards corporately-operated, rather than independently-run facilities.

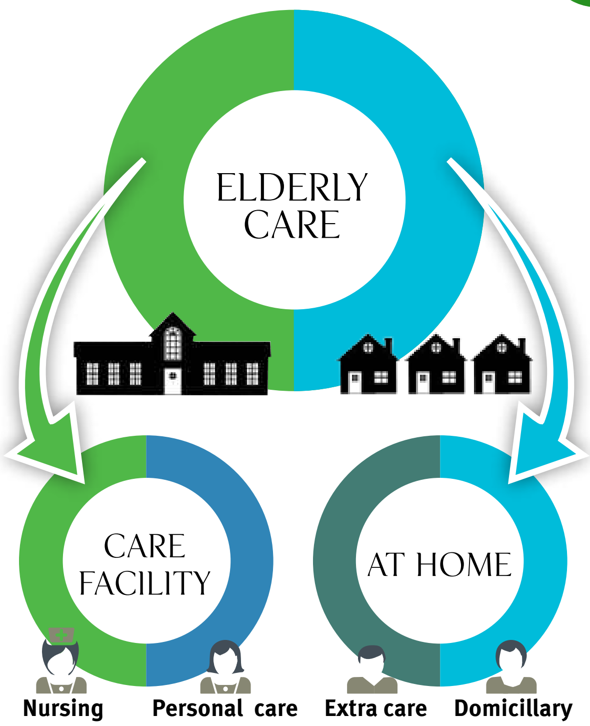
The total number of care beds in our index has increased by 36% from last year. This has greatly enhanced the reliability of our regional-level analysis across all parts of the UK, as well as providing much greater scope to disaggregate the analysis of key performance indicators (KPIs), according to the type of care registration (i.e. nursing and personal care facilities).


Elm Bank, Northamptonshire (Avery)

Figure 1
Regional share of the sample
% of total care beds



Elderly care provision



Nursing care – Care home with professionally qualified nursing staff.

Personal care – Residential care home with non-professionally qualified care staff.

Extra care – Retirement housing, where residents live independently with care services attached as required.

Domiciliary care – Care provided at the resident's own home.

This report assesses care facilities with a bias towards nursing homes in our sample.

OCCUPANCY AND INCOME

Occupancy

Our analysis of the CH-TPI reveals that the overall occupancy rate fell from 87.8% to 87.2% during 2012, effectively reversing the uplift seen during 2011 (Figure 2). Moreover, the general pattern over the last five years is one of falling occupancy rates, a consequence of the increasing preference among local authorities to provide care services at home and until as late into life as possible, given the budgetary pressures they currently face.

As an aside, the analysis for 2012 reveals that residential care homes benefit from higher occupancy rates than nursing registered care homes, with occupancy rates of 89.0% and 86.2% respectively. The likely reason for this difference relates to the higher levels of dependency associated with nursing registered care homes, with a resident's stay at a residential home being typically longer.

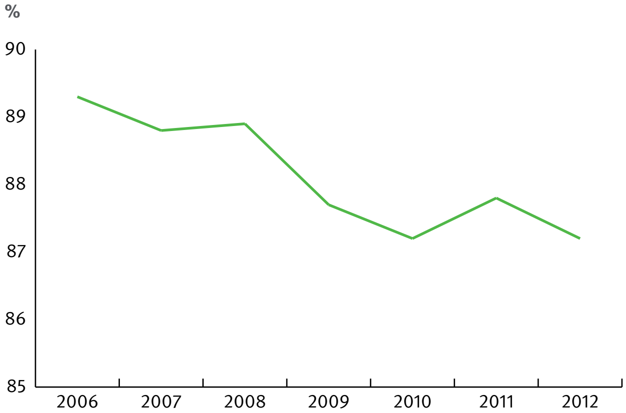
Levels of occupancy vary markedly between UK regions, although the pattern in 2012 was broadly unchanged from 2011 (Figure 3). Northern Ireland continues to enjoy the highest occupancy rates of any UK region, standing at 91% overall. However, the expansion of the CH-TPI has seen Wales move up several places from its 2011 position, making it the only other UK region to achieve an occupancy rate of over 90% in 2012.

The majority of UK regions actually revealed occupancy levels which were ahead of the overall UK level for 2012. This is particularly true of the South East and Greater London (both at 89.0%), where competition with residential uses is strongest and the supply of care beds is consequently under significant pressure.

In contrast, the North East and South West regions revealed particularly weak occupancy levels, at 82.2% and 79.6% respectively, and acted as a drag on the overall occupancy rate. While this is difficult to explain for the South West, low occupancy in the North East stems from an over-supply of beds in the region, a consequence of a glut of care home development during the last decade.


Chestnut View, Lincolnshire (Prime Life)

Figure 2
Occupancy rates



Source: Knight Frank

RESIDENTIAL CARE HOMES BENEFIT FROM HIGHER OCCUPANCY RATES THAN NURSING HOMES

Figure 3
Occupancy rates by region (2012)

Source: Knight Frank

Income

For the UK as a whole, the CH-TPI reveals average weekly fee levels of £622 in 2012. While this represents a modest 1.1% rise on 2011, it is nevertheless an improvement on the 0.7% rise recorded during 2010 (Figure 4). There is however a tangible difference in the way 2012's overall fee rise was apportioned between the two types of care home. Nursing homes saw fee growth of 2.2% in 2012 (to £643 per week), while residential care homes recorded no growth in fee levels (at £528 per week) during the year (Table 1).

With RPI inflation reaching 3.1% during 2012, last year's rise in fee levels equates to a third successive year of falling fee rates in real terms (Figure 4). The trend underlines the budgetary pressures local authorities currently face with regard to the funding of social care, which in turn is eroding profitability.

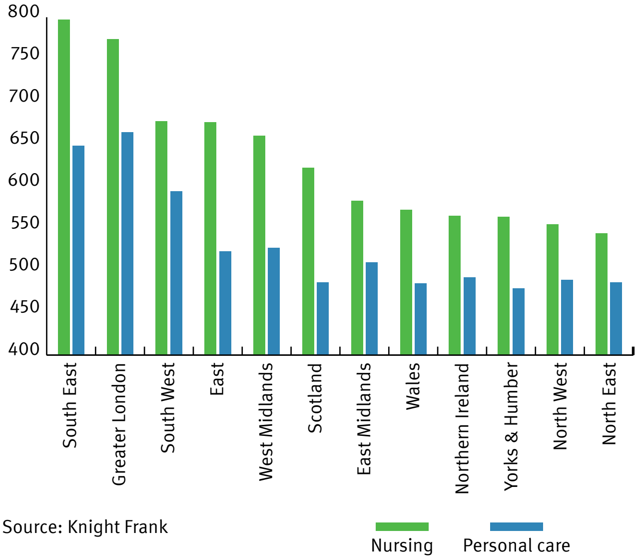
Regional level analysis confirms the relatively higher fee levels associated with the UK's southern regions (Figure 5). For nursing registered homes, the South East has the highest average weekly fee levels in the UK, at £797, followed by Greater London, at £773. As the UK's most affluent regions, this reflects the greater prevalence of private paying residents, which in turn supports the fee levels required to cover the higher staff costs and land values associated with these regions.

In contrast, average weekly fee levels for nursing care are lower in the northern regions of England and Wales, at well under £600 per week. The private pay market is correspondingly less prevalent in these parts of the UK, with local authority fees typically accounting for the majority of a care home's revenues. It is unsurprising to see that the North East continues to possess the lowest average fee levels of any UK region, at £486 per week, given that ongoing fee pressures have been compounded by an over-supply of care beds.

With regard to residential care, Greater London had the highest average fee levels in 2012 (£663 per week), followed by the South East (£648 per week). While the overall pattern is ostensibly the same, residential care reveals less variation in fee levels between regions than for nursing care, with the majority of regions outside the South East showing average fee rates in a relatively narrow band of £485 to £525 per week.

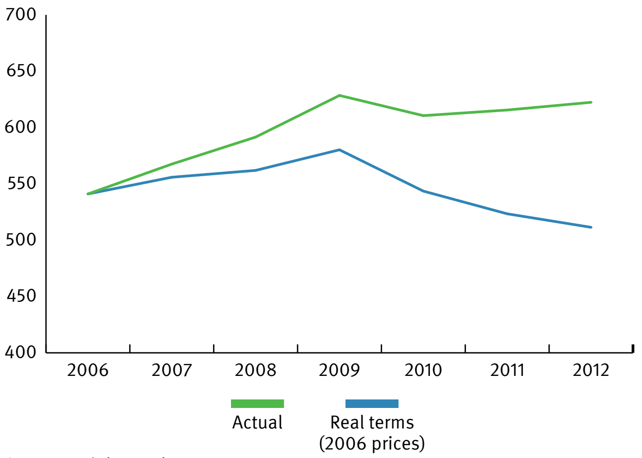
Interestingly, London and the South East account for eight of the UK's ten most expensive counties for average weekly fees. Oxfordshire shows the highest average fee rates of any county, at £898 per week, followed by Surrey, at £842 per week.

Figure 5
Average weekly fees by region (2012)
£ per week



Source: Knight Frank

Figure 4
Average weekly fees
£ per week



Source: Knight Frank

Table 1
Average weekly fees by registration type

	Average weekly fee (2012)	Change 2012 (%)	Change 2006–2012 (% p.a.)
Nursing Care	£643	2.2	2.3
Personal Care	£528	0.0	2.5
All Care homes	£622	1.1	2.4
RPI/CPI		*3.1 / 2.7*	*3.3 / 3.1*

Source: Knight Frank, ONS

COSTS

Staff costs

In 2012, the overall cost of care home staff as a percentage of income stood at 57.2%, rising very slightly from 57.1% in 2011. However, on a per resident basis, annual staff costs increased by a seemingly more significant 1.9% over the year to stand at £18,489 (Figure 6). The apparently contradictory results can be explained by the fact that the overall fall in the occupancy rate in 2012 was partially offset by a rise in fee income.

Care home staff costs are, predictably, much higher in the UK's southern regions. The South East continues to have the highest staff costs, averaging £21,808 per resident in 2012, followed closely by Greater London, where staff costs amounted to £21,114 per resident. However, while staff costs are relatively higher in these more affluent regions, they are lowest when expressed as a proportion of total revenue (Table 2).

Evidence therefore suggests that despite lower staff costs outside the Southern regions, margins are more exposed to upward pressure in staff costs, either through labour supply shortages or increases to the National Minimum Wage. For example, on a per resident basis, average staff costs in Wales and Northern Ireland are broadly in line with overall UK average, yet account for over 60% of fee income.

There is of course a substantial difference in staff costs between nursing and personal care, reflecting the higher pay that qualified nurses typically receive compared with care staff at residential care homes. In 2012, average staff costs at nursing homes stood at £19,351 per resident, compared with £14,365 per resident at residential care homes, a difference of 34%.

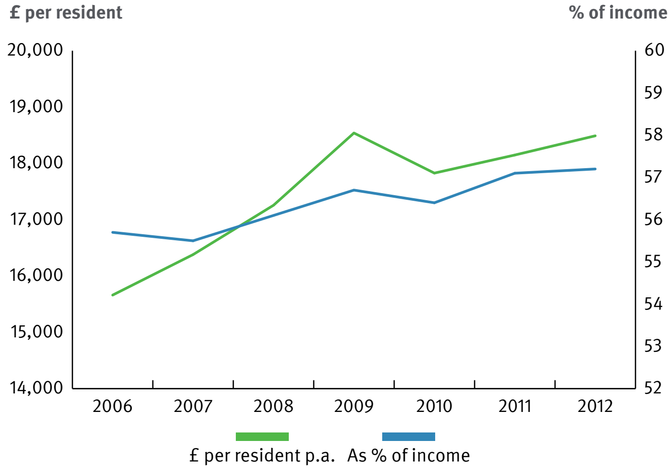
However, this differential varies markedly between UK regions (Figure 7). The widest differentials are apparent in Scotland and the North West, with average staff costs at nursing homes over 40% higher than for residential homes. In contrast, the differential is lowest in Greater London, with staff costs at nursing homes standing only 19% above those for residential homes.

Table 2
Staff costs per resident (2012)

Region	Staff cost per resident	Costs as a proportion of income
South East	£21,808	54.0%
Greater London	£21,114	53.4%
South West	£20,576	59.0%
West Midlands	£19,462	58.6%
Scotland	£18,893	59.0%
East	£18,223	56.1%
Northern Ireland	£18,083	62.0%
Wales	£17,630	62.4%
East Midlands	£17,035	57.6%
Yorks & Humber	£16,741	58.9%
North East	£16,112	58.5%
North West	£16,015	56.9%
All UK	**£18,489**	**57.2%**

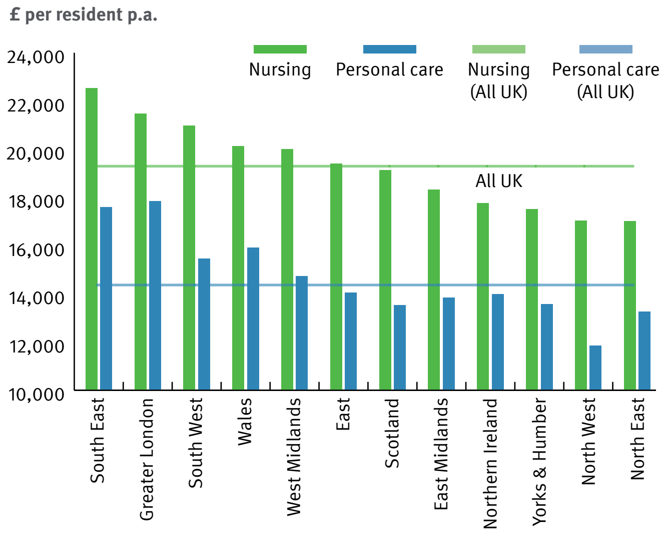
Source: Knight Frank

Figure 6
Staff costs



Source: Knight Frank

Figure 7
Staff costs per resident (2012)



Source: Knight Frank

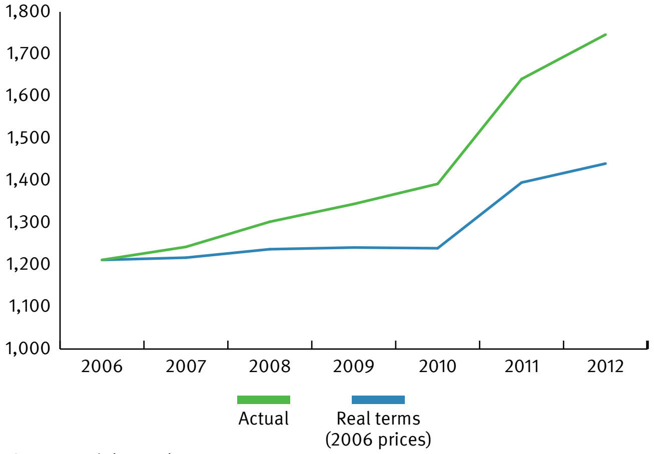
Care home operators regularly employ agency staff to make-up for temporary shortages. While this is a flexible means of ensuring that care needs are adequately met, these costs come at a significant premium compared with permanently contracted or bank staff. Our analysis of the CH-TPI reveals that agency staff costs represent 4.1% of total staff costs across the UK. There is a degree of regional variation. Agency staff costs make up the highest share of overall staff costs in the South West region, at 6.6%, and the lowest share in Greater London, at just 1.6%.

Property costs

The leap in property costs recorded in 2011 was followed by another inflation-busting increase in 2012. On a per bed basis, overall property costs increased by 6.4% during 2012 to stand at £1,746 per bed. Expressed as a percentage of total income, property costs increased from 6.0% in 2011 to 6.2% in 2012, having been closer to circa 5% in previous years (Figure 8).

Although property costs in the CH-TPI have increased ahead of UK RPI inflation, they do more closely reflect increases to water and energy costs which have been widely documented in the media. Care homes have clearly not been immune to this, with gas prices (+10.6%), water rates (+5.5%) and electricity (+5.7%) all rising above UK inflation during 2012.

Figure 8
Property costs per bed (2012)
£ per bed



Source: Knight Frank

Property costs

These are the costs which relate to the day-to-day running and servicing of the property. They include utilities, council tax and repairs & maintenance but exclude any rental obligations in the case of leased care homes.

AGENCY STAFF COSTS REPRESENT 4.1% OF TOTAL STAFF COSTS ACROSS THE UK

Highclere House, Dorset (Gracewell Healthcare)

Main bedroom Tall Trees, Chipping Norton, Oxon (Caring Homes Group)

Anjulita Court, Bedfordshire (Methodist Homes)

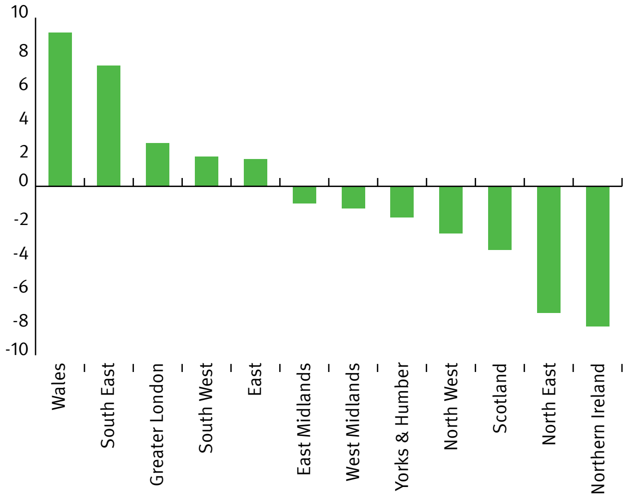
Food costs

While food costs may account for a far lower proportion of a care home's outgoings than staff costs, the quality of food provision can be an important determining factor in a resident's choice of care home.

Our analysis of the CH-TPI suggests that care providers are placing greater emphasis on the quality of catering. Food costs increased by 7.6% during 2012, running markedly ahead of UK food inflation, which reached 4.2% for the year (Figure 9). However, over a longer time period, increases in care home food costs have actually lagged UK food inflation, rising at an annual rate of 4.9% and 5.2% per annum respectively since 2006.

Food costs do vary between the regions, but the extent of variation is less pronounced compared with other outgoings, namely staff costs. In 2012, food costs per resident were highest in the South East, at 9.1% above the overall UK average, and lowest in Northern Ireland, at 8.3% below the average. Food costs in the majority of UK regions showed less than 4% variance from the overall UK average.

Figure 9
Food cost index
% difference from all UK



Source: Knight Frank

CARE PROVIDERS ARE PLACING GREATER EMPHASIS ON THE QUALITY OF CATERING

PROFITABILITY

Gross profit margins were negatively impacted in 2012, reflecting the fall in occupancy rates and sub-inflation fee rises, combined with rising costs on staffing, food and property. For both types of care facility combined, overall EBITDARM profit margins as a percentage of income slipped from 30.5% in 2011 to 28.0% in 2012, its lowest level on the CH-TPI to date (Figure 10). While every region except London saw a decline in profit margins in 2012, the North East and Northern Ireland saw the steepest falls.

Additional analysis reveals different levels of profitability between the two types of care registration. Expressed in absolute terms, EBITDARM per bed was marginally higher for nursing homes (£7,935 per bed) than for residential care homes (£7,696 per bed) in 2012. However, it is important to note that residential care homes actually revealed a higher level of profitability, at 31.3%, compared with 27.4% for nursing homes.

The implication is, therefore, that while nursing homes deliver higher profits in absolute terms, profitability in this segment tends to be lower due to the higher staff costs associated with the more complex level of care required relative to fee incomes.

Mirroring the results for 2011, Greater London, the South East and East outperformed the overall UK level of care home profitability in 2012 (Figure 11). This result stems from the higher occupancy rates care homes typically see in these regions, together with the relatively higher average fees and greater prevalence of private pay residents.

Northern Ireland and Wales are the two regions where profit as a percentage of income most clearly lag the UK average, a result which reflects the high staff costs in the regions relative to fee income.

EBITDARM

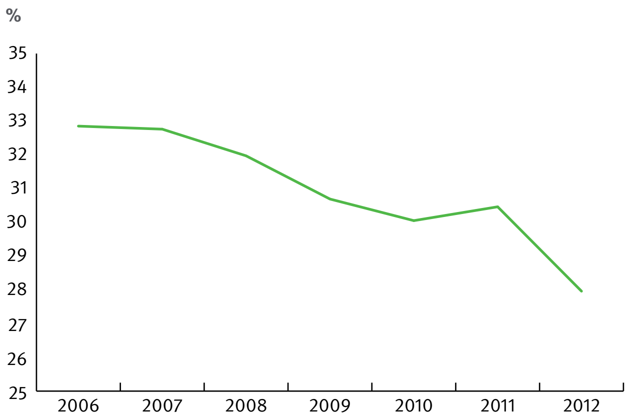
Earnings before Interest Tax, Amortisation, Rent and Management.

This is a particular measure of profitability which allows for direct like-for-like comparison between individual care homes, before costs of rent and management charges are accounted for.

GREATER LONDON, THE SOUTH EAST AND EAST OUTPERFORMED THE OVERALL UK LEVEL OF PROFITABILITY IN 2012

Figure 10

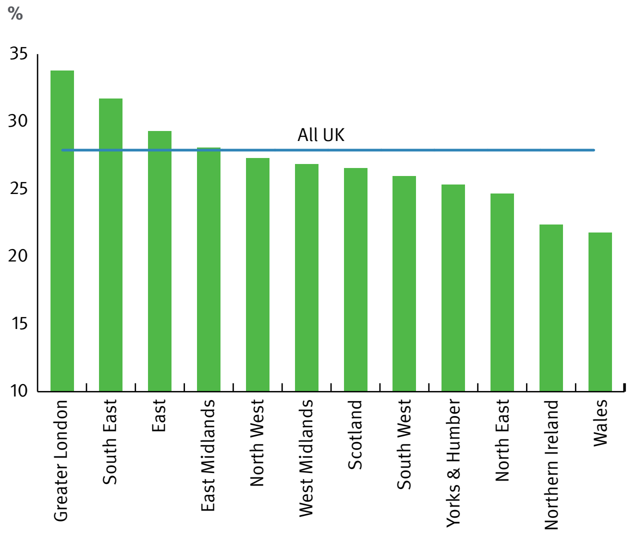
EBITDARM as a % of income



Source: Knight Frank

Figure 11

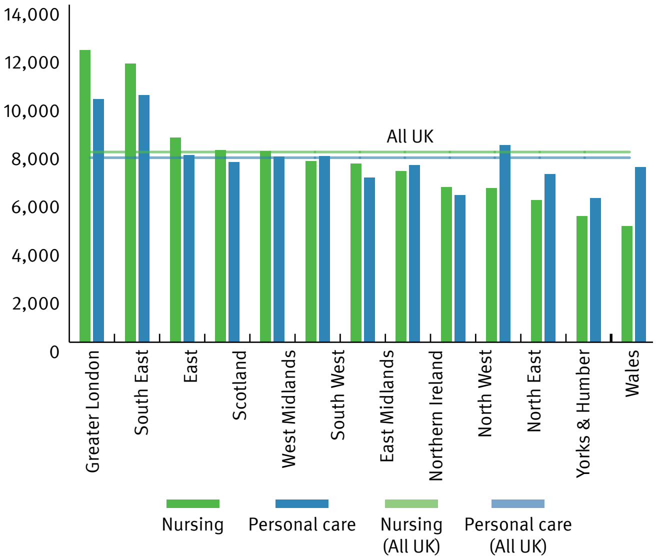
EBITDARM as % of income (2012)



Source: Knight Frank

It is interesting to note the extent to which profits vary between the UK regions according to the type of care being provided (Figure 12). On a per bed basis, nursing homes in Greater London and the South East are more profitable than residential homes, arguably reflecting the closer parity in staff costs between the two types of care homes relative to income. Conversely, regions which are more exposed to higher nursing staff costs, such as the North West and Wales, reveal higher absolute profit levels for residential care facilities.

Figure 12
EBITDARM per bed (2012)
£ per bed



Source: Knight Frank

Care home size and profitability

For any developer or prospective operator of a new build care home, there are a number of revealing insights into the trading performance based on the size of the facility. Our analysis of the 2012 data again confirms that care homes with a capacity of 60-79 beds are the most profitable, followed closely by the largest care homes with a capacity of over 100 beds (Table 3).

The higher profitability of the medium sized home category is evident both in absolute terms (with EBITDARM per bed of £8,290 at 5.1% above the sample average) and in relative terms (with EBITDARM as a percentage of income at 29.2%, compared with 28.0% for the sample as a whole).

The two KPIs which are largely responsible for this intriguing set of results are average weekly fee levels and average staff costs. Homes with a bed capacity of 60-79 beds command the highest average weekly fees (2.7% above the average for the entire sample), while staff costs as a percentage of income are correspondingly the lowest of any size category.

The implication of this analysis is that 'medium sized' care homes are the most efficient. While the largest homes (100+ beds) sit only marginally below in terms of profitability, the economies of scale they are able to achieve in terms of costs appear to be compromised by their relatively low average fees levels compared with other home size categories.

Warren Lodge, Kent (Bupa)

Table 3
Key Performance Indicators by size of care home (2012)

Bed Size category	Average weekly fee	Staff cost as % of income	Staff cost per resident	EBITDARM as a % of income	EBITDARM per bed
under 40	£620	58.6%	£18,888	25.7%	£7,352
40 - 59	£624	57.0%	£18,500	27.5%	£7,793
60 - 79	£639	56.3%	£18,692	29.3%	£8,290
80 - 99	£611	58.9%	£18,714	28.0%	£7,879
100+	£600	56.6%	£17,659	28.9%	£7,917
ALL UK	**£622**	**57.2%**	**£18,489**	**28.0%**	**£7,890**

Source: Knight Frank

TRADING PERFORMANCE OUTLOOK

While our analysis revealed a reduction in profit margins during 2012, our experience in the market is that operators are by and large managing to cope with the significant challenges posed by austerity to social care funding. More than ever, care providers are having to scrutinise their costs and seek to make savings wherever possible, while not compromising standards of care.

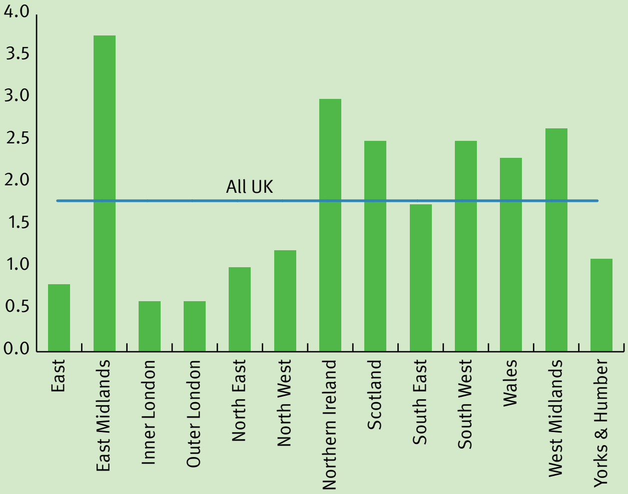
However, the leap in property costs recorded in 2012 is of no surprise, with utility costs continuing to rise above inflation and a growing need to maintain care homes to high standards. Indeed, a major issue across the UK care homes sector is the requirement for 'catch up capex'; those operators that have been undergoing financial restructuring simply have not had the cash flow to maintain their facilities to the standard they would like.

Our research underlines the challenges operators have had in maintaining fee levels, which have not kept pace with inflation in recent years. However, anecdotal evidence for this year suggests that providers have been able to negotiate more successfully with local authorities. This sentiment is partly echoed by Laing & Buisson's latest survey of local authority baseline fee rates, which points to an average overall rise of 1.8% for the 2013/14 financial year (Figure 13).

Figure 13

Regional baseline fee increases (2013/14)

% change



Source: Laing & Buisson

While welcome, the predicted rise will do nothing to make up for the real terms decline in fee rates seen over recent years. With little prospect of above-inflation rises in the short term, the emphasis will remain on keeping costs down and, where possible, enhancing revenues from the self-pay market. In this regard, it is important to differentiate where the challenges are most acute. There remains a stark north-south divide on local authority fee levels and, with robust private fee levels being achieved in the south, performance is set to become ever more geographically polarised.

The slight fall in occupancy rates in 2012 was arguably unsurprising in light of the increasing preference among local authorities to provide cheaper, domiciliary-based care. Anecdotally, however, the fall is more likely to be explained by the unusual dip in occupancy linked to increased infection levels from the weather and the admission of increasingly frail clients. The North East's drag on the overall occupancy rate is inextricably linked to the oversupply of beds in the region.

By the end of this calendar year, a significant tranche of UK healthcare businesses will have completed their financial restructuring, which we expect to be in the order of £5bn. This is tremendous news. As the UK healthcare landscape stabilises, overseas investor demand for healthcare assets continues to increase. Demand is significantly outstripping supply for healthcare fixed income in North America, prompting the US REITs in particular to seek out product in the UK.

With financial stability returning among the corporate care home operators, the long-term outlook for growth in the sector is positive, based on projections of a significant ageing of the UK's population profile. However, the research demonstrates the scale to which the elderly care sector remains polarised. This is reflected in the weight of investment demand for stock in relatively affluent markets where self-paying residents predominate. If the sector as a whole is to benefit from the long-term investment it needs, more clarity must be provided into how the government intends to fund its commitments to reform the costs of elderly care.

Julian Evans, Head of Knight Frank Healthcare

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