RESEARCH

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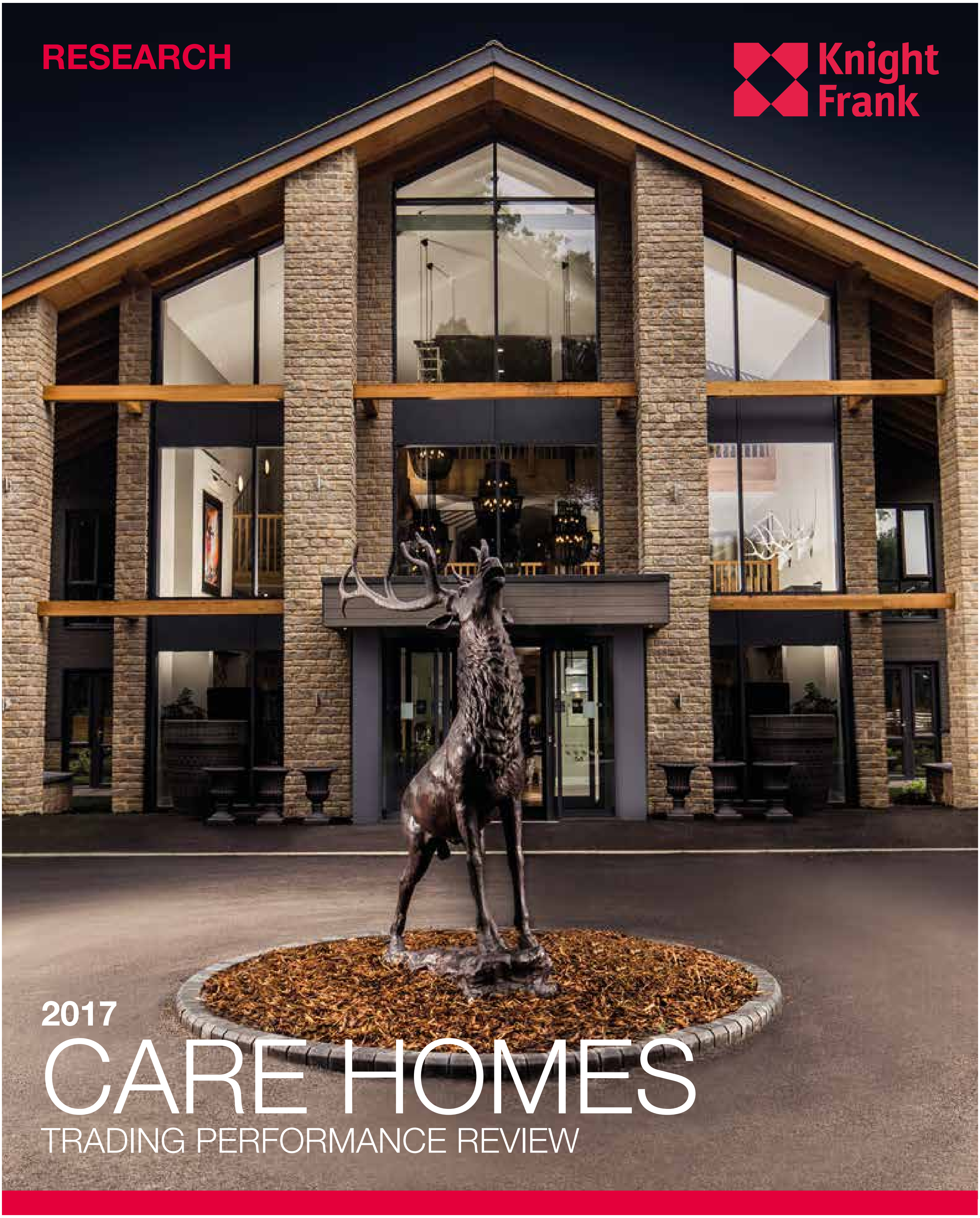


2017 CARE HOMES

TRADING PERFORMANCE REVIEW

HIGHLIGHTS

Occupancy rates at their highest level since 2006

Average weekly fees rise to a record high

Profitability falls to 25.2% of income

FOREWORD

Dr Lee Elliott
Head of Commercial Research

Knight Frank is pleased to introduce the sixth annual review of trading performance in the UK care home sector.

Supported by data kindly provided by leading care home operators, the Care Home Trading Performance Index (CHTPI) provides industry-leading benchmarks on occupancy rates, mix of funding type, average weekly fees (AWF), costs such as staff and agency outlays, and profitability.

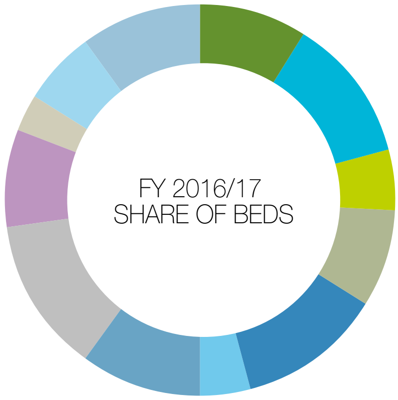
As figures 1 and 2 show, the distribution of homes within our analysis is geographically diverse and covers a range of home sizes from fewer than 40 beds to those with more than 100 beds. This permits some interesting regional analysis as well as an enhanced ability to look at the variation of performance by size, type of care or combinations of these factors.

Headline results show that for the 2016/17 financial year occupancy rates rose for the fifth consecutive year, while average fee levels outstripped RPI inflation for the fourth year running. With the National Living Wage (NLW) taking effect in the current reporting period, staff costs have increased significantly in absolute terms but fell as a percentage of income, as operators inflated their fee rates to mitigate the necessary increase in labour costs. Staffing remains a major concern within the sector, with a current shortfall of qualified nurses in the UK which could be further exacerbated by a changing immigration policy.

Although profitability edged up in last year's reporting period, there has been a gradual fall in EBITDARM as a percentage of income throughout the 10 year history of the dataset. The fall this year was triggered by increased food and property costs, coupled with public sector funders failing to increase fee rates in personal care to a level sufficient to offset higher wage costs.

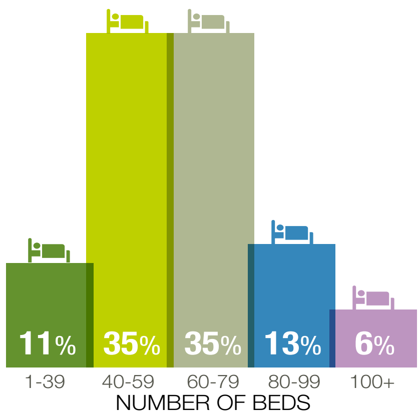
In the coming months, we aim to increase our analytical capabilities in regards to the healthcare sector and provide further insightful analysis specifically in relation to the staffing crisis and key hotspots for operators, so please keep a look out for these.

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



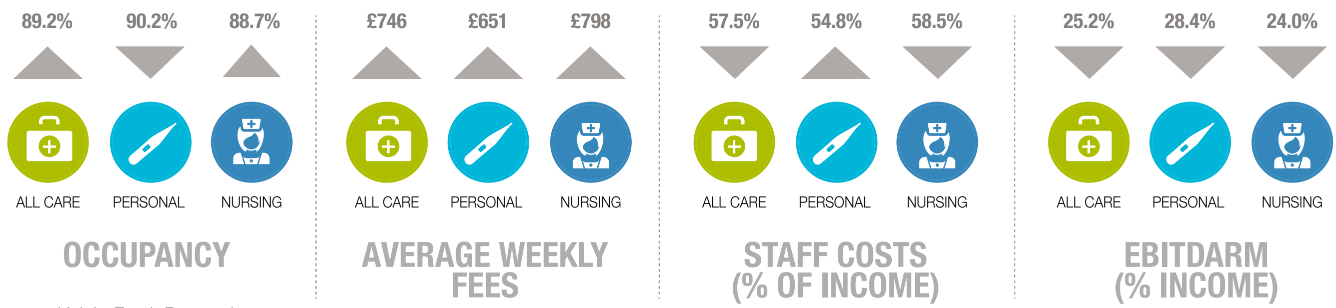
EAST MIDLANDS	9%
EAST OF ENGLAND	12%
LONDON	5%
NORTH EAST	8%
NORTH WEST	12%
NORTHERN IRELAND	4%
SCOTLAND	10%
SOUTH EAST	13%
SOUTH WEST	8%
WALES	3%
WEST MIDLANDS	6%
YORKSHIRE AND THE HUMBER	10%

FIGURE 2
Share of the sample by size
% of total care beds (FY 2016/17)



Source: Knight Frank Research

2016/17 RESULTS AT A GLANCE



Source: Knight Frank Research

OCCUPANCY AND FEES

Occupancy rates increased for the fifth consecutive year and are at their highest level since 2006.

With an ageing population and strong demand for elderly care facilities, this upwards trend is no surprise.

Figure 3 illustrates a 0.8% year-on-year uplift in occupancy. Although personal care occupancy fell marginally by 0.5% in comparison to last year's reporting period, it remained strong at 90.2%. Nursing care occupancy increased by 1% to 88.7%.

Occupancy rates in personal care homes are consistently higher than those in nursing homes across all regions with the exception of the North West, where nursing care occupancy is marginally higher (figure 4). This trend is driven by a number of factors, including longer average length of stay for personal care residents, the continued growth of personal care for dementia and the increasing demand for personal care from self-funders.

Regional disaggregation of occupancy rates shows a range between 83.2% and 93.5%, across the UK. There is a correlation between occupancy and the percentage of self-funder income per region, shown in figure 5. The regions with the highest percentage of self-funder income have the lowest occupancy rates, indicating longer fill periods for operators that are targeting the private pay market. The South West and South East are operating at occupancy rates of 83.2% and 86.3% respectively, with the self-funder ratio at 58.1% and 57.8% of income respectively. Similarly, at the other end of the spectrum, Scotland and Northern Ireland are operating at a rate of 93.5% and 92.8% respectively, with the self-funder ratio at 34.9% and a very low 7.8% respectively.

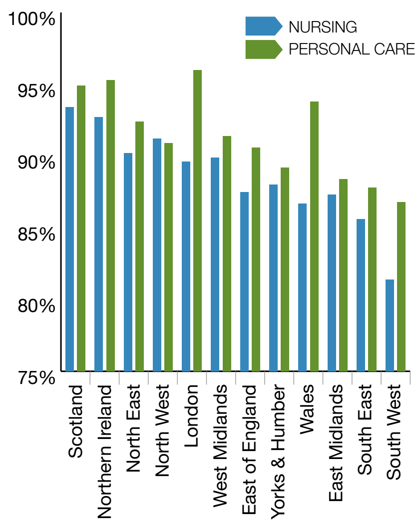
As in 2015/16, Scotland, Northern Ireland and the North West have the highest occupancy levels, above the UK average. The most notable movements were in the North East which saw a sizeable increase in occupancy from 86.2% to 91.3% and the South West which fell from 86.3% to 83.2%.

With an ageing population, an increase in demand for dementia care and a significant and continuing shortfall of care beds in the UK, occupancy rates will remain strong.

Average weekly fees (AWF)

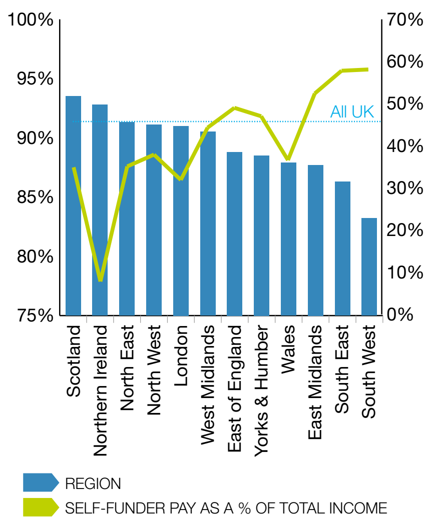
AWF increased by 7.4% to £746 in financial year 2016/17. The increase in fees is above RPI inflation of 3.1% for the corresponding period.

FIGURE 4
Occupancy rates by region & care type (FY 2016/17)



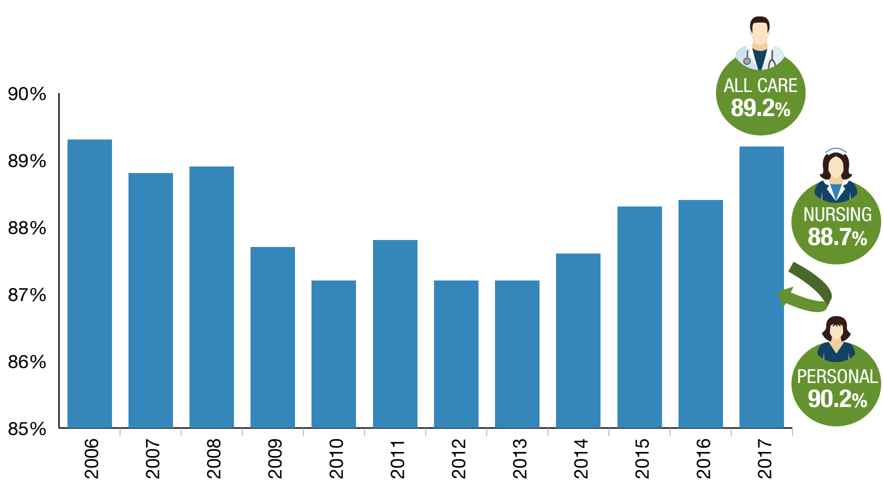
Source: Knight Frank Research

FIGURE 5
Occupancy rates by region
(FY 2016/17)



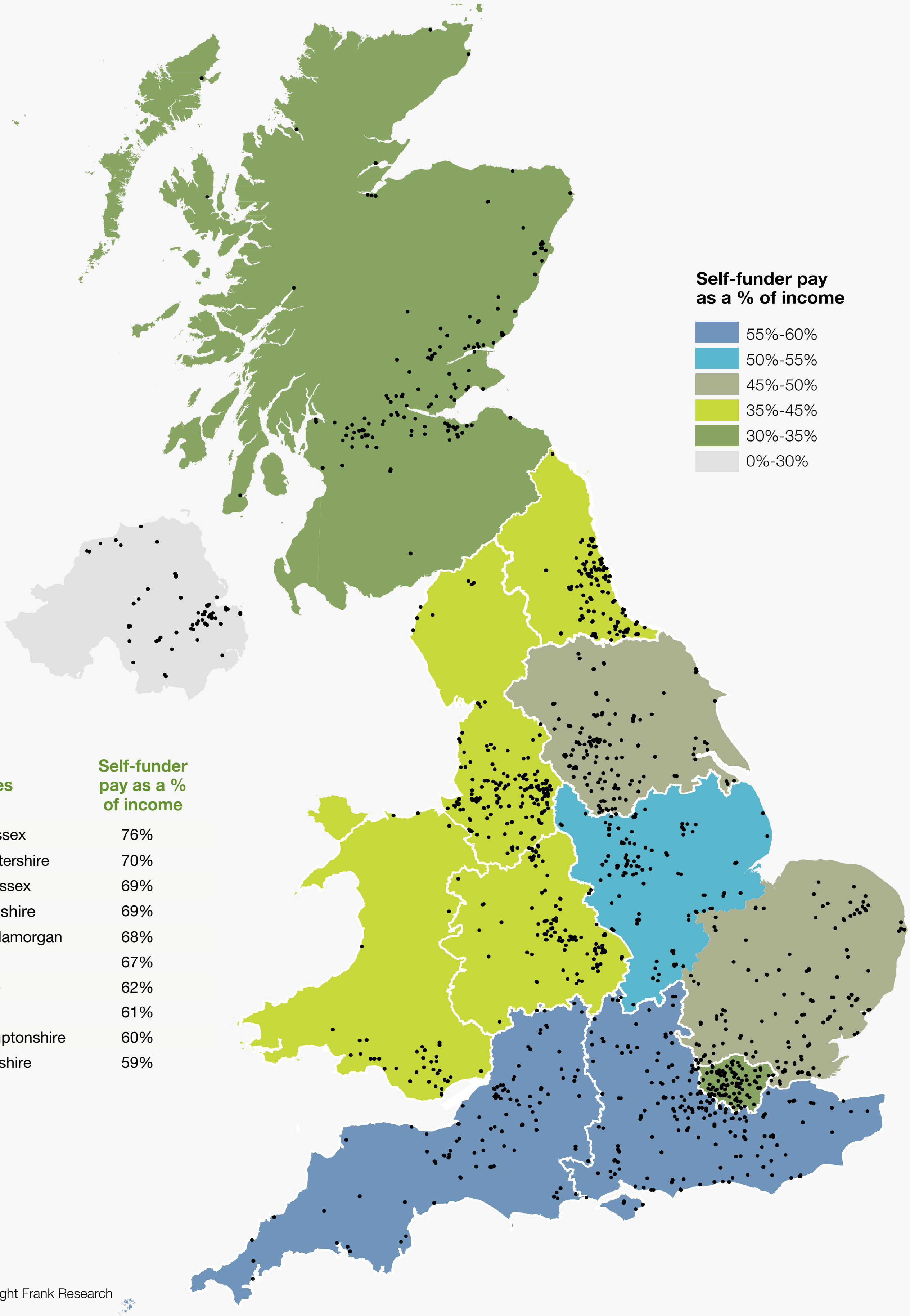
Source: Knight Frank Research

FIGURE 3
UK care home occupancy rate %



Source: Knight Frank Research

SELF-FUNDER PAY AS A % OF INCOME BY REGION



Top 10 Counties	Self-funder pay as a % of income
East Sussex	76%
Gloucestershire	70%
West Sussex	69%
Bedfordshire	69%
South Glamorgan	68%
Dorset	67%
Wiltshire	62%
Surrey	61%
Northamptonshire	60%
Hertfordshire	59%

Source: Knight Frank Research

This is the sixth consecutive year of growth and represents a record high, as illustrated in figure 6. In real terms, AWF rose to the equivalent of £566, which represents only a 4.4% increase since 2006.

This has been driven by increased local authority fee rates, the large increase in the NHS funded nursing care (FNC), both an attempt to offset the implications of the NLW, as well as continued self-funder fee inflation above RPI and the shift towards the private pay care market. Over 2016/17 care home operators mitigated the risk of increased staff costs by increasing fees, as illustrated in figure 7. To support this further, income per resident had an annual increase of 8% compared with an annual increase of 7% in staff costs per resident. This is a strong indicator of demand in the market, as operators have had the ability to inflate fees at this rate.

The gap between nursing and personal care fee rates has widened even further this year, driven in most part by the increased FNC. The 40% increase in FNC was implemented in July 2016, backdated to April 2016, increasing rates from £112 per week to £156 per week, which had a noticeable impact on average nursing fees. Since then, this rate has been marginally reduced to £155 per week from April 2017.

Figure 8 analyses AWF by both region and care type. The South East continues to dominate, achieving nursing care rates of £1,014, an increase of 13%. London and the South West follow with averages of £924 and £901 respectively. Personal care rates follow a similar trend for these regions.

The Southern regions are desirable for care home operators and developers due to the stronger affluence profile of the areas, coupled with demand for modern purpose-built facilities, fit for the 21st century. Furthermore, 58% of income is derived from private revenue in both the South East and the South West as shown in figure 9 (overpage) indicating greater demand amongst relatively wealthy individuals for the prime care homes. The viability of care home developments and operations are reliant upon self-funders in both locations. In the South East this is due to high land values and construction costs, while in the South West low local authority fee rates drive the dependency on self-funders.

The East Midlands also had a high percentage of self-funder income at 52% which is encouraging for those developers and operators who over the last few years have increased development in this region. London had a lower mix of self-funder pay at 32% which is skewed by income from the NHS making 22% of total income.

In 2016/17 local authority fees increased by an average of circa 3.4% which is significantly below the 7% increase in staff costs per resident. The shift towards private pay is therefore understandable.

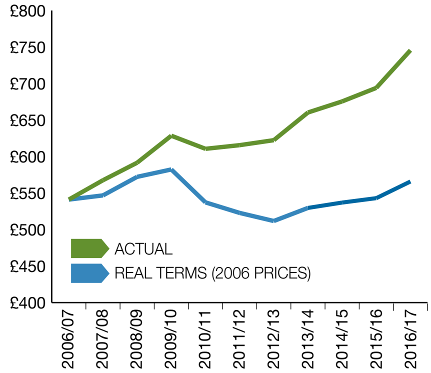
In the forthcoming year, we may continue to see a rise in self-funder income. However, Northern regions, Wales, Scotland and Northern Ireland remain heavily reliant upon government funding.

The 2017/18 financial year will see an average annual increase in Local Authority fees of 3.6% as per Laing Buisson's "Annual Survey of UK Local Authority, Usual Costs 2017/18". The sector will also welcome council tax rises to fund social care. We will be reviewing this topic next year to see whether this will be sufficient to cover continued staffing cost increases.

AVERAGE WEEKLY FEES

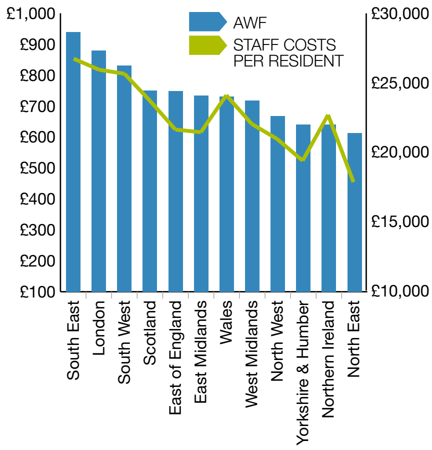
	AVERAGE WEEKLY FEE	ANNUAL CHANGE (LFL)
Personal Care	£651	8.4%
Care with Nursing	£798	9.9%

FIGURE 6
AWFs £ per week



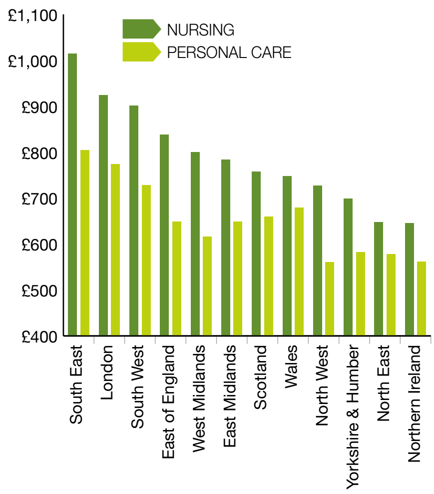
Source: Knight Frank Research

FIGURE 7
AWF (LHS) £ per week vs staffing cost per resident £ (RHS) (FY 2016/17)



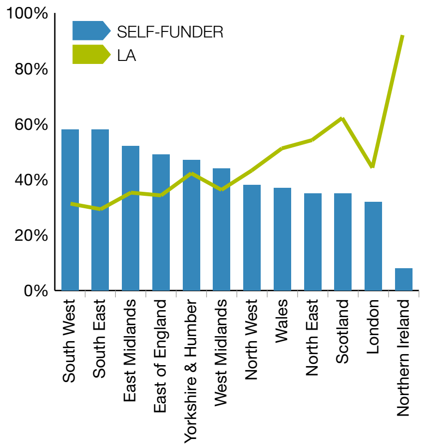
Source: Knight Frank Research

FIGURE 8
AWFs by region (FY 2016/17)
£ per week



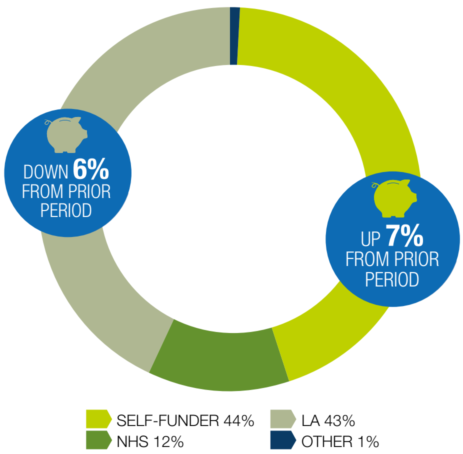
Source: Knight Frank Research

FIGURE 9
Self-funder as a % of income vs LA as a % of income (FY 2016/17)



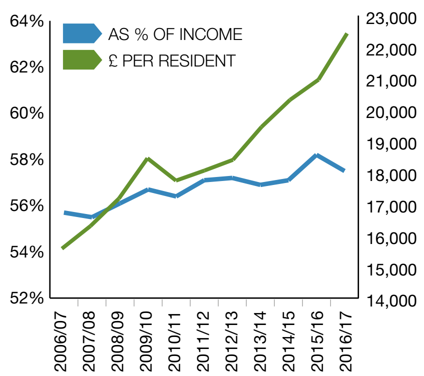
Source: Knight Frank Research

ALL UK FUNDING MIX (%)



Source: Knight Frank Research

FIGURE 10
Staff costs
As £ per resident (RHS) vs % of income (LHS)



Source: Knight Frank Research

COSTS

The impact of the NLW and the continuing shortfall of qualified nurses has challenged care home operators across the country.

Staff costs

Staff costs increased by 7% over 2016/17 to £22,512 per resident. This is the highest annual increase since 2009/10. As shown in figure 10, staff costs per resident have been rising since 2011/12.

As already noted, to mitigate the staff cost increases mainly driven by the introduction of NLW, operators inflated fee rates, subsequently reducing staff costs as a percentage of income from 58.2% to 57.5%.

The geographical divergence in staff costs is intuitive, as shown in the table below, with the largest per resident costs in the South East at £26,725, followed by London and the South West at similar costs. With staff costs representing 53.6% of income, the higher fees achieved in the South East comfortably compensated for higher labour costs.

In comparison to the 2015/16 financial year, Wales had a 19% increase in staff costs per resident with double digit increases in the North West (12%), the East, and East Midlands (both 11%). Once again, the region with the lowest operating costs was the North East at £17,826 per resident. Significantly the region also has a relatively low cost as a percentage at 55.9%.

Northern Ireland is showing high staff costs as a percentage of income at 68.2%, arguably making care provision in the region unviable. This is mainly due to agency costs contributing to 11.7% of total staff costs. Agency costs were also high in the South East at 9.4%, up from 8.3% in 2015/16. Across all regions, agency costs have reduced slightly, from 7.5% to 7.4% but require further reduction to ensure continuity of staff and better quality of care.

As shown in the table on the right, average nurse rates being paid in the Southern regions and London are well above national average, indicating an upwards pressure in the South to recruit and retain qualified nurses. Strong nursing rates are also being paid in the East and the Midlands. Following the introduction of the NLW at £7.20 per hour from April 2016 for workers aged 25 or above, the average carer rate is well above this benchmark across the country. In fact, the current average carer rate of £8.29 comfortably surpassed the NLW of £7.50 per hour imposed from April 2017 for workers aged 25 or above.

Staff costs (FY 2016/17)

Region	Per resident p.a.	As a % of revenue
South East	£26,725	53.6%
London	£25,928	56.7%
South West	£25,638	58.4%
Wales	£24,091	62.0%
Scotland	£23,687	59.9%
Northern Ireland	£22,674	68.2%
West Midlands	£22,018	58.4%
East of England	£21,612	55.2%
East Midlands	£21,423	55.5%
North West	£20,932	58.7%
Yorkshire and The Humber	£19,371	58.7%
North East	£17,826	55.9%
All UK	**£22,512**	**57.5%**

Source: Knight Frank Research

Woodland Manor, Chalfont St Peter (Porthaven)

This upwards pressure on carer rates is due to the combination of NLW and high staff turnover. Carers work in a challenging environment; looking after the frail, elderly and those with complex needs. For responsibility at this level, carers are paid a wage rate that many may argue is inadequate and which is certainly leading many staff to consider alternative careers. Staff retention is therefore a challenge and operators will need to provide an attractive wage rate to improve this.

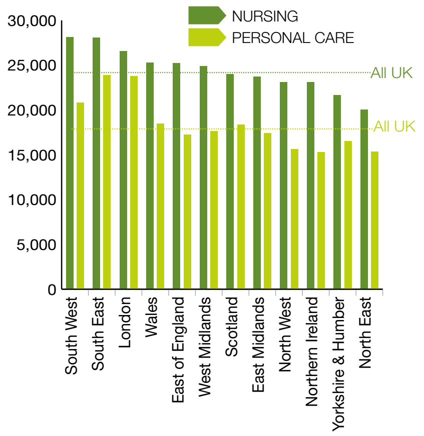
Government policy-making has also had an influence on the labour force. There was a fall in applications by students in England to nursing and midwifery courses at British universities, influenced no doubt by the Government's decision to charge fees to nursing students and replace NHS bursaries with student loans. Of course Brexit is likely to only exacerbate the crisis, with a risk of qualified nurses who are EU citizens returning to the continent. The government has committed to invest an extra £2bn into the social care system, which will hopefully help mitigate the staffing crisis issue to an extent.

In light of the nursing staff crisis, a shift towards personal care home developments is clear with personal care homes representing 64% of all new care homes opened in 2016/17. We will continue to monitor this trend very carefully in the coming months.

Property costs

Property costs comprising utilities, council tax, insurance, repairs and maintenance, are small in comparison to staffing costs,

FIGURE 11
Staff cost per resident (FY 2016/17)
£ per resident



Source: Knight Frank Research

Wage rates (FY 2016/17)

Regions	Average of nurse wage rate/hour (£)	Average of carer wage rate/hour (£)
South West	18.68	8.65
South East	18.01	8.74
London	17.59	8.66
East of England	17.11	8.10
East Midlands	16.90	8.19
West Midlands	16.75	8.09
Yorkshire and The Humber	15.93	8.01
North East	15.68	7.98
North West	15.67	7.96
Scotland	15.51	8.76
All UK	**16.62**	**8.29**

Source: Knight Frank Research

NEW OPENINGS
(FY 2016/17)

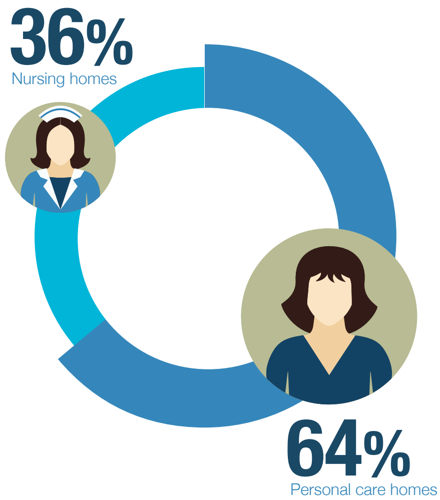
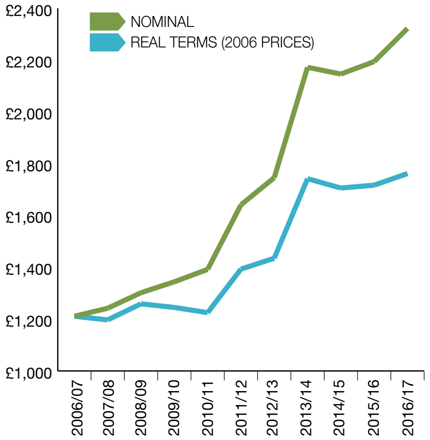


FIGURE 12

Property cost per bed

£ per bed



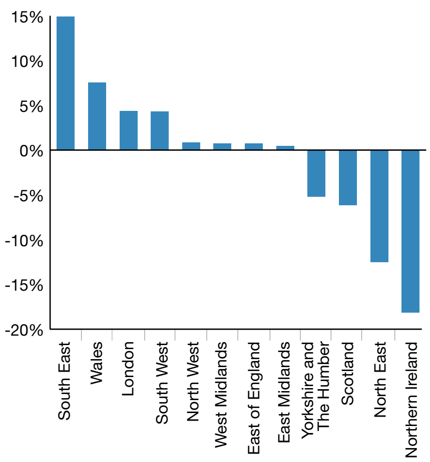
Source: Knight Frank Research

PROPERTY COST PER BED BY PROPERTY AGE (FY 2016/17)

FIGURE 13

Food cost index (FY 2016/17)

% difference from all UK



Source: Knight Frank Research

Chamberlain Court, Tunbridge Wells (Hallmark)

but they clearly must be managed efficiently to maximise profits. Property costs per bed increased by 5.8% in 2016/17 from last year's reporting period to £2,322 per bed. This equates to 6.6% of income.

With the exception of the fall witnessed in 2014/15, property costs per bed have been on the rise since dataset records began in 2006. The bulk of the increase in property costs is accounted for by uplifts in both repairs and maintenance costs, as well as rising utility bills.

On a regional basis, property costs range from 6.0% of income in London and the South East to 7.7% of income in the North West.

A large proportion of the care and nursing home stock in the country is either older converted properties or older purpose-built properties where upkeep is costly and regular maintenance is required. Older properties are also less energy efficient, leading to higher utility bills and therefore property owners should look to invest in technology to reduce their energy bills and thus improve the profitability of their homes. Typically, a property built prior to 2000 costs £2,938 per bed as opposed to a property built post 2000 costing £2,271 per bed.

In order to remain competitive, ensure sustainable operations and obtain an uplift in fees to remain profitable, operators will continue to feel pressure, specifically on older properties, to reinvest, refurbish, extend or redevelop their properties.

Food costs

The third largest cost for care home operators is the food bill, which consumes 3.6% of income. In comparison to last year's reporting period food cost per resident increased from £1,302 (£3.57 per day) to £1,425 (£3.90 per day), which is a significant 9.4% annual increase and represents the highest annual percentage increase per bed when compared with other operational costs.

The regional spread in food costs is again intuitive with the South East significantly above national average and the North East and Northern Ireland significantly below the national average (figure 13). Wales has had a noticeable shift towards an increased food cost, moving from below national average to well-above national average when compared with last year's reporting period, influenced by in part by changes in the underlying dataset.

Food cost as percentage of income has remained static at 3.6% from 2015/16 to 2016/17 financial years, which means that operators have been able to increase food costs in line with their fees.

The increase is driven by operators' continuing efforts to invest in good quality produce tailored to individual residents, offering choice and a wide variety of fresh fruit, dairy, vegetables, grains and protein, as nutrition for the elderly and specifically for dementia residents is an important area of focus.

The premium service will specifically be welcomed by residents that are willing and able to pay the premium and likewise operators will continue to invest within this focus area to improve the wellbeing of residents.

Other factors influencing increased food costs include currency movements following the EU referendum and crop damage in Southern Europe due to adverse weather.

PROFITABILITY

EBITDARM falls to stand at 25.2% of income.

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

The 2016/17 financial year witnessed a fall in profitability from 27.5% in 2015/16 to 25.2%, measured as a percentage of income.

As shown in figure 14, throughout the 10 year history of the dataset, there has been a gradual fall in EBITDARM as a percentage of income from 32.8% in 2006/07 to today's 25.2%. Only in the financial years 2011/12 and 2015/16, did we witness a marginal increase in this percentage.

EBITDARM per resident had an annual increase of 1% to £10,059 for nursing homes but personal care homes witnessed a 4% fall to £9,446. The 40% increase in FNC helped inflate nursing rates to compensate for the increase in staff costs however, personal care homes experienced an insufficient increase in fees and therefore their staff cost as a percentage of income increased from 52.3% to 54.8% in 2016/17. The majority of care staff at personal care homes is made up of carers, therefore the introduction of the NLW had a substantial impact on wage bills. However, many operators were not able to increase their fees to surpass the wage rate increase resulting in a fall in EBITDARM.

Nursing rates are typically higher than personal care rates due to the advanced level and medical nature of care provided; therefore, the scope to increase nursing care fees is higher unless personal care homes are predominantly self-funded. Interestingly, only 38% of the personal care home stock in our dataset had a self-funder percentage of income above 70%. Personal care homes that are predominantly self-funded i.e. over 70% self-funder income, achieved EBITDARM per resident at £11,594 and a margin of 31.5%, which is well-above national averages. In addition, a large proportion of the stock that is mainly publicly-funded is older stock, which limits the chances of achieving premium fees to counter the rising staff costs.

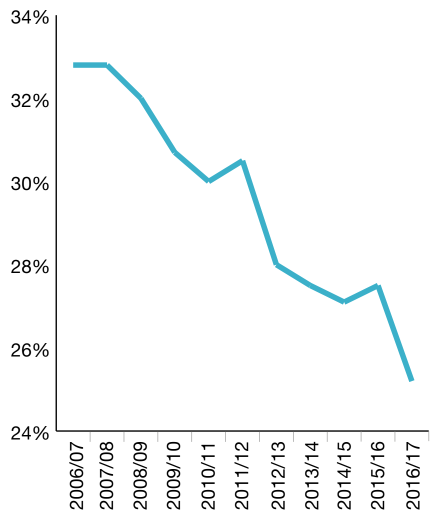
Other factors influencing a fall in EBITDARM are the annual increases in food and property costs by 9% and 6% respectively across all care types.

The East Midlands is the most profitable region

Geographically the East Midlands saw the highest level of profitability across the UK with an EBITDARM of 28%. This was driven primarily by the significant uplift in AWF (14%). The North East has also witnessed a much welcome pick up in profitability,

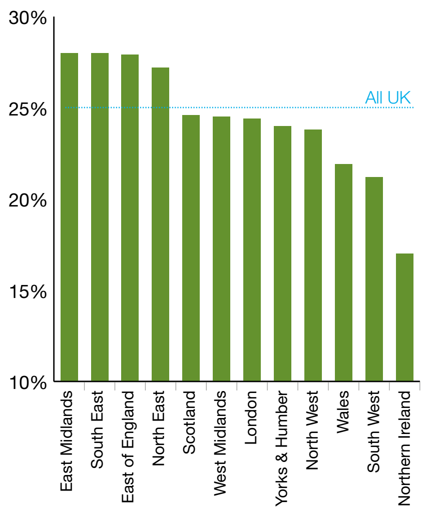

Bentley House, Hertford (Signature)

FIGURE 14
EBITDARM as a % of income



Source: Knight Frank Research

FIGURE 15
EBITDARM as a % of income
(FY 2016/17)

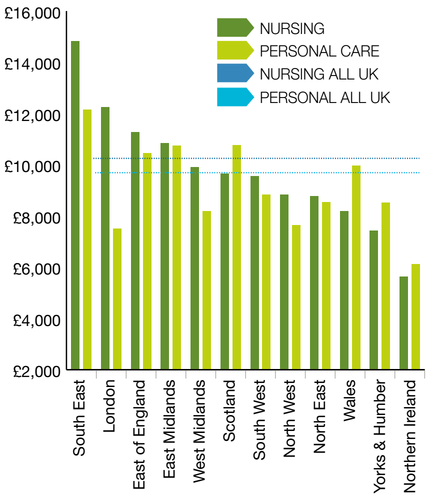


Source: Knight Frank Research

FIGURE 16

EBITDARM per bed (FY 2016/17)

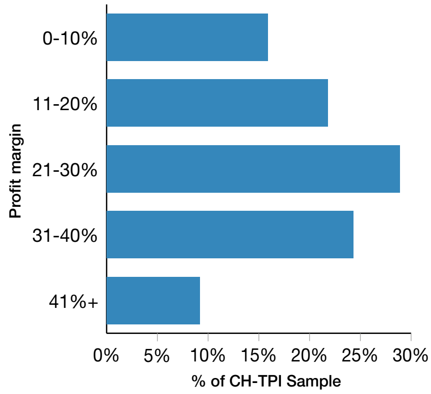
£ per bed



Source: Knight Frank Research

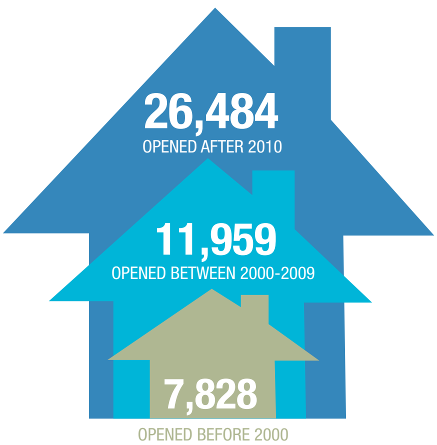
FIGURE 17

Distribution of profit margins across the CH-TPI (FY 2016/17)



Source: Knight Frank Research

LONDON REGION EBITDARM PER OCCUPIED BED (FY 2016/17)



as AWF increased by 10% from the last reporting period. The South East, albeit above national average at 28.0% margin, witnessed a fall from 32.3% recorded in the last reporting period.

London witnessed a fall from 32.6% to 24.4% mainly due to fall in profitability for personal care homes in the region (figure 16), and the change in sample data when compared with last year's reporting period. Profitability has again been hindered as appropriate fee uplifts have not been achieved for older stock predominately funded by the local authorities.

Profit margins in Northern Ireland are much harder to achieve with EBITDARM as a proportion of revenue at 17.0%. The South West is showing a fall in margin as well, principally impacted by lower occupancy levels at 83.2% and the rise in food and property costs. All other regions are within the range of 21-28% EBITDARM percentage of income.

Combining the regional picture with care home type, it is no surprise that the lowest profit margins are for nursing homes in Northern Ireland and some of the highest are for personal care homes in the East Midlands at 32%. Interestingly, the most profitable region for personal care is Scotland driven by a 4% uplift in AWF, and the age of the stock in the index, all of which is built post 2000.

Whilst averages are an interesting and intuitive way to analyse markets, distributions give an added dimension of insight. Considering 10 percentage point brackets for EBITDARM as a percentage of income, the largest proportion of homes (28.9%) make a profit between 20% and 30%. A quarter of homes make between 30% and 40% profit, as shown in figure 17. Interestingly 9.2% of homes make a profit margin above 40% which indicates demand for the premium end of the market driven by affluent locations, luxury products, good quality food and activities along with best in class care services.

We have also analysed the data set to investigate the correlation between care home age and profitability. There is a clear, positive correlation as shown in figure 18.

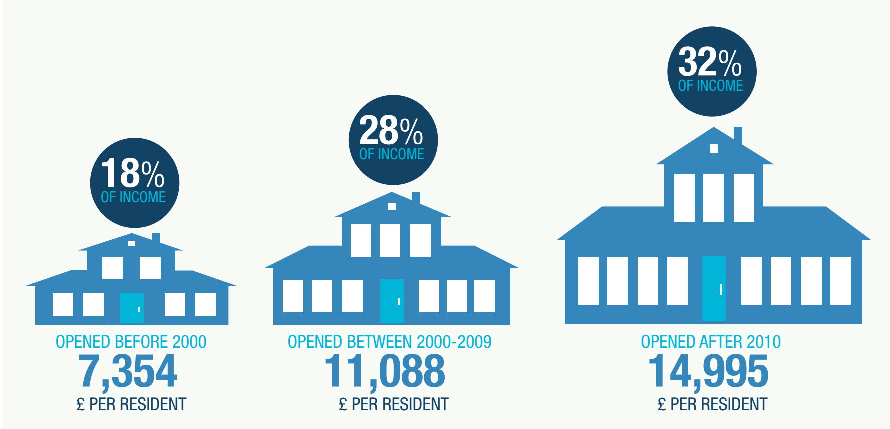
When comparing profitability of stock built prior to 2000 with stock build post 2010, there is a 104% uplift in EBITDARM per resident and EBITDARM percentage of income shifts from 18.0% to 32.3%.

At regional level, the largest difference identified between old and new stock in regards to EBITDARM per resident is in London, with homes built prior to 2000 achieving £7,828 in comparison to £26,484 for homes build post 2010.

One important point to note here, is that homes which opened during the financial year 2016/17 have been excluded from our analysis. These homes will not be trading at their optimal level and would therefore skew our analysis.

FIGURE 18

EBITDARM profitability by property age (FY 2016/17)



Source: Knight Frank Research

TRADING PERFORMANCE OUTLOOK

JULIAN EVANS FRICS
Head of Healthcare, Hotels & Leisure

The UK is facing a national crisis in care bed provision and there can be no doubt that the past twelve months has represented a stern test for the UK healthcare market. Operators have needed to react to staffing challenges ahead of Brexit; the introduction of, and subsequent increase in, the National Living Wage that further affects an already constrained labour market; and price inflation on raw materials, which has served to fetter new home development.

Despite this, the care home market has remained resilient and robust, particularly in direct comparison to other property types and the wider investment classes. Indeed, investor appetite for the sector is at its highest level for over 20 years.

The next 12 months is likely to bring more of the same.

As the Brexit negotiations make slow headway, significant uncertainty exists over the future free movement of labour and the legal rights of EU nationals already residing in the UK. A large proportion of the UK's skilled and qualified care staff are EU citizens and many have already started to leave the UK in anticipation of changes in immigration policy. The impact on the sector will be an increased reliance on agency staff and inevitable wage inflation.

The acute shortage of qualified nurses will also continue to bite. In response, care home operators will need to go beyond their basic pay rates. This study shows that the market rate for nursing staff already stands at an average of £16.62 per hour nationally. Rises above this level will clearly place a further dent in operator profitability. We will also see operators continuing to close nursing wards and shift towards personal care provision. This reshaping of the market will support trading performance but is hardly a solution to a growing market need. That said, the operators are increasingly upskilling their workforce to counter balance the nurse deficit, and the industry is becoming increasingly innovative.

Further staff cost pressure will emerge from the National Living Wage, which increased to £7.50 per hour from April 2017. This will continue to challenge those smaller sized and older care homes that are predominantly publicly-funded. As this report shows however, other operators and homes will seek to pass on the uplift in staffing costs to the service users through a commensurate increase in average weekly fees.

The entrenched crisis in UK care home bed provision shows no sign of abating. The issue will be further exacerbated as the baby boomer generation ages at a faster rate than new care homes can be developed. 2016 brought an annual net loss in UK care homes and beds of 11% and 5% respectively. We estimate that circa 6,000 care home beds are at risk of closure over the next 5 years. When coupled with an over 65 population that is forecast to rise from 11.6m in 2016 to 12.9m by 2021, investor and developer appetite will remain strong and will support further new entrants into the market.

This national crisis in provision will also place greater pressure on the government to provide sufficient funding for social care and encourage local authorities to support care home development in order to speed up the rate of delivery. As a result the north south divide at work within the market is beginning to dilute as investors look outside of the M4 corridor for a better return on capital.

On a more positive note, the next year will see significant evolution in the specification of care homes and the faster application of technology. Technology will create efficiencies in staffing ratios; enhance the quality of care provided and improve resident wellbeing. Examples include the acoustic monitor, where a single staff member monitors the sound waves generated per room and navigates carers to rooms as required, or the circadian rhythm lighting system, which improves the sleep patterns and daytime awareness of dementia residents.

On specification, as new care home developments target the private pay market a broader range of home amenities will be needed in order to compete for premium fees. Cinema rooms, cafeterias, hair salons, physiotherapy, spas and the like will become more recognised features of homes. This will clearly escalate fit-out costs in a development market already challenged by the rising costs of importing raw materials into the UK on the back of weak sterling. Accordingly, developers will need to revisit their build specifications to examine where costs can be controlled and where the uplift in build costs can filter through into average weekly fees.

Operational challenges are a constant within social care but investors, both domestic and international, are seeking defensive sectors to invest in and the care home sector remains an attractive target. The sectors institutional appeal is furthered by current bond market conditions and the paucity of long dated income in the broader property markets. The fundamentals of the care home sector remain robust.

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Front cover image: Kings Lodge Care Home, Aura Living

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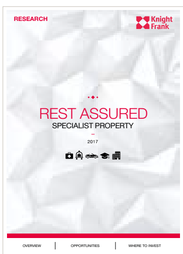

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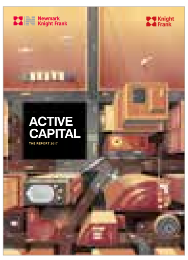

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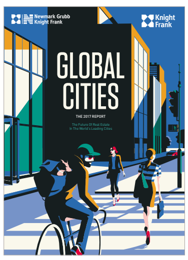

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