2016 Market Insight Report

ADULT SOCIAL CARE 2016

Funding, Staffing & the Bottom Line

CHRISTIE & CO

Introduction

It is now just over 12 months since we published our ground-breaking piece of research on the shortage of nurses in the UK, "The UK Nursing Workforce – Crisis or Opportunity". With frequent reference being made to a shortage of nurses in both the NHS and adult social care, a dramatic increase in agency use and escalating staff costs, we sought to place into context the true extent of the issues and the solutions available.

Key headlines from our 2015 document included an estimated shortfall of 15,000 full-time equivalent nurses and the establishment of new industry staff cost benchmarks through our survey of 12 of the largest nursing home operators. On a positive note, we also drew attention to the innovative strategies being employed by leading care home operators to address the staffing shortfalls.

This new piece of research has been produced at a time when the sector is adjusting following the introduction of the new National Living Wage on 1 April 2016. With the vast majority of care homes reliant upon local authority funding, operators will only be able to offset the increase in cost if local authorities provide appropriate compensatory fee rate increases.

Within this document, we seek to place the issues of funding and staffing into context, assess what has changed in the last 12 months and provide answers to the pivotal questions around these crucial areas. Our research has leveraged the unique insight gained from our care sector specialists in each Christie & Co regional office. In addition, we have surveyed every local authority and nearly 200 operators, including specialist providers.

As with last year's research, we are also looking to provide insight into the potential changes for the industry ahead. With a number of policies currently being implemented and Brexit creating new uncertainties, we will examine the factors that will impact the industry over the coming years.

We hope that you find this piece of research to be informative and would like to express our thanks to all of the operators and other organisations who have contributed.

Michael Hodges – Head of Care Consultancy

"Will the 2016 local authority fee rate increases be sufficient for operating margins to be retained?"

Setting the Scene - Funding, Staffing & the Bottom Line

Funding

- 3-year average annual local authority fee increase of 1.8%
- 2% social care precept introduced in the November 2015 Comprehensive Spending Review
- 2016 local authority fee rate settlements

VS

Staffing

Key Findings from Christie & Co 2015 Report

- Estimated shortfall of 24,000 UK nurses with 15,000 permanent FTE vacancies
- Future supply challenges due to the reduction in commissioned student places, likely retirement trends & immigration policies
- Introduction of new Nursing Associate/Care Practitioner role

Developments since Christie & Co 2015 Report

- Announcement made over introduction of the National Living Wage from 1 April 2016
- Key policy changes in relation to immigration & student bursaries
- Continued spotlight on staffing pressures & agency spend in the NHS
- EU referendum

The Bottom Line

Healthy bottom line margins underpin operational viability & future investment

80% of bed provision is provided by the private sector

Ageing population & increasing care needs reinforce the importance of private sector providers

Operator Type (Beds)

7%	13%	80%
Public Sector	Voluntary Sector	Private Sector

Source: LB (2015)
N.B. Sources will appear as acronyms. Please see the glossary on page 27 for full source references.

Funding Backdrop

UK Care Home Residents by Main Funding Source

48% - Local authorities
12% - NHS/CCGs
40 % - Privately Funded

Sources: LB (2015), Christie & Co Analysis

Local Authority Fee Trends

- There has been a 37% real-term reduction in total government funding to local authorities over the last five years
- 40% of total savings between 2013 and 2015 were made through reducing adult social care services
- Prior to 2016, local authority fee rate increases have been nominal with a 3-year average annual increase of 1.8% (2013-2016)

Sources: NAO (2014), LB (2015), Christie & Co Analysis

Autumn 2015 Comprehensive Spending Review

Up to £394m in extra funding for 2016 if all local authorities charge the 2% precept

Source: CIPFA (2016)

Commentary

- Since austerity measures were introduced in 2010, local authorities have been grappling with funding constraints
- Average care home fee rate increases have been restricted to nominal levels over recent years
- The announcement of the introduction of the new National Living Wage in July 2015 caused immediate consternation. This was due to the significant number of staff remunerated at minimum wage levels and concern that many homes reliant upon local authority-funded residents would become unviable
- Following intensive lobbying, the Comprehensive Spending Review in November 2015 introduced a policy whereby local authorities could elect to charge a 2% precept on council tax bills to provide additional funding for adult social care
- This was welcome news for local authorities, a number of whom have been taken to Judicial Review over fee rate levels. In particular, following the introduction of The Care Act 2014, local authorities have been under a legal obligation to properly cover the cost of care
- Our own analysis undertaken at the end of 2015 indicated that fee rate increases would need to be at around 5% to offset the impact of the National Living Wage this year. Moving forward, with the National Living Wage set to rise to £9 by 2020, this level of increase will need to be maintained year on year

Staffing Backdrop

At the time of preparing our 2015 report, the primary focus was on the nurse workforce. The introduction of the National Living Wage, however, has a direct impact on care assistants and domestic staff who form the backbone of all care home businesses. Operators reliant upon local authority-funded residents are under particular pressure – the link between funding and staffing is now more important than ever in terms of maintaining the bottom line.

Workforce Issues

- Overall nurse shortage
- Commissioned student places
- Immigration policy
- Agency usage
- New nursing associates
- Competition for staff between the NHS & Adult Social Care

National Living Wage Issues

- 2016 wage cost increase
- Impact on differential between different staff grades
- Further increases to £9 by 2020
- Impact on specialist care providers as the wage differential with elderly care operators is closed

National Living Wage

In July 2015, the UK Government unexpectedly revealed plans to replace the National Minimum Wage with the National Living Wage for workers aged 25 and over. The NLW was initially set at £7.20 per hour from April 2016, with the Government planning an ambitious wage growth to over £9.00 by 2020. These rates are not arbitrary, corresponding to 55% and 60% of the median salary for workers above 25 in the UK, in 2016 and 2020 respectively. With over 40% of care home staff earning less than £7.20 per hour in 2015, the residential care sector is one of the sectors most impacted by the policy:

2015 £6.50

2016 £7.20

2020 £9.00

Care Home Staff	Average Hourly Wage 14/15	Average Annual Wage Growth 2015-2020	
		Wage Differentials for Senior Staff not Maintained	Full Wage Differentials for Senior Staff Maintained
Management	£17.43	2.0%	4.7%
Nurses	£13.39	2.0%	4.7%
Senior Carers	£7.76	3.6%	4.7%
Care Assistants	£6.92	5.4%	5.4%
Other Staff	£8.49	3.8%	3.9%
Total	**£8.34**	**4.1%**	**4.7%**

Source: Christie & Co Analysis

Expected 5-Year Average Annual Wage Growth – All Sectors

6.7%

Minimum Wage

2.0%

Other Wage Groups

Source: Christie & Co Analysis

Expected 5-Year Average Annual Wage Growth – Care Homes

4.1%

Wage Differentials Not Maintained

4.7%

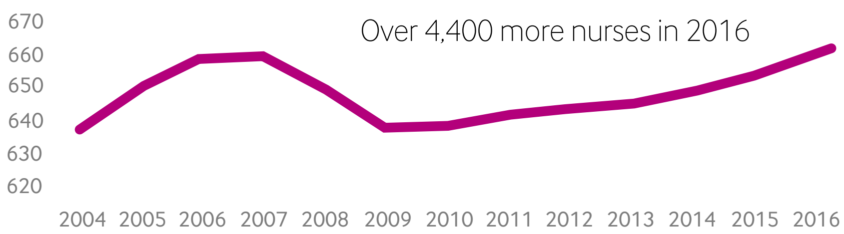
Wage Differentials Fully Maintained

Source: Christie & Co Analysis

Nursing Shortage

In our 2015 report "The UK Nursing Workforce – Crisis or Opportunity", we highlighted that weak workforce planning by policy makers has resulted in a shortfall of 15,000 FTE registered nurses in the UK in 2015. We predicted that the nursing shortage would stabilise and diminish over the course of five years once the number of UK-trained nursing graduates increases, the immigration of nurses stabilises or increases and a wave of de-registrations is prevented. Over the course of the past 12 months, a number of significant policy changes have occurred, with the changes to overseas immigration already having a material impact on the workforce:

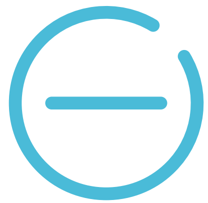
Registered Nurses (Headcount) in the UK (000's)



Sources: Christie & Co (2015), NMC (2016)

+29% new registrations of nurses trained in the European Economic Area (EEA)

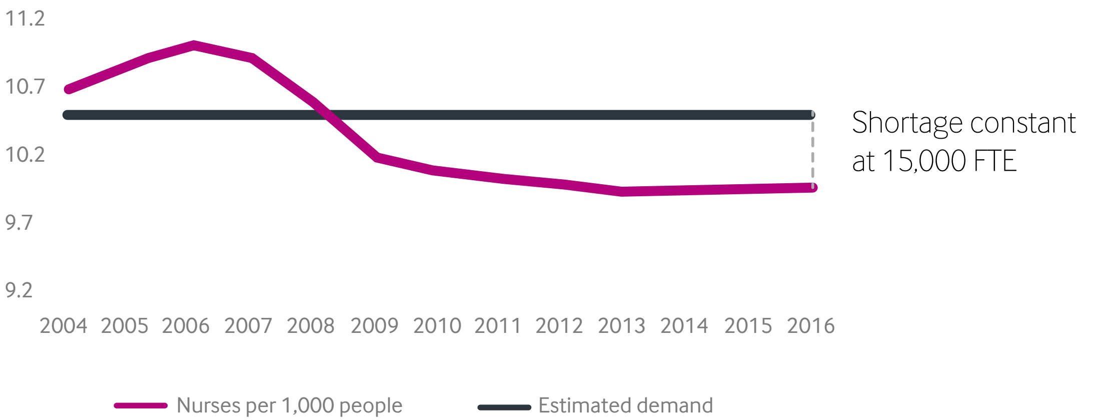
+150% new registrations of overseas-trained nurses



-5% new registrations of UK-trained nurses

+11% de-registrations

Nurses per 1,000 People in the UK Population



Nursing shortage remained stable

Sources: Christie & Co (2015), NMC (2016), ONS (2016)

UK Nurse Training

Austerity measures imposed by the Government between 2009 and 2012 resulted in a substantial reduction in the number of commissioned nursing student places in England. This is felt today, with close to 1,000 fewer nursing graduates entering employment in 2015 compared to 2014. While the funding for nursing student places has since recovered, other university students have experienced a tripling of tuition fees. Despite the increase in fees, student numbers today are higher than ever. The success of the restructuring of the university funding system has moved the Government to propose a similar reformation of the nursing student system:

Tuition fee hike for non-nursing students from £3,000 to £9,000

Announcement of plans to end bursaries for nursing students in England and introduce a Nursing Associate role in 2017

Government consultation confirms government decision to end bursaries for nursing students

Planned introduction of new funding scheme and Nursing Associate role

2009 2012 2015 2016 2017

-3,000 **+3,000**

Commissioned nursing student places in England

NHS Bursary e-petition with over 150,000 signatures discussed in Westminster

Health Education England consultation evaluates and confirms plans to introduce a Nursing Associate role

Sources: Christie & Co (2015), HEE (2016)

Student Bursaries

In the Autumn Spending Review 2015, the Government introduced plans to replace the current system of grants and bursaries for nursing students with the standard student support system for both living costs and tuition fees from 2017. The aim is to curb government spending while increasing the number of nursing student places:

NHS Bursary

VS

- Non-means tested grant
- Means tested bursary for living costs
- Maintenance loan for living costs
- Health Education England payment of tuition fees to universities

Standard Student Support System

- Living costs & full tuition fees covered by student loan scheme
- 30-year loan repayment cycle
- Minimum income threshold
- Additional teaching grant to UK universities

Potential Benefits

Potential savings to the Government

Up to £600m of annual savings to the taxpayer and £70m to universities

More student places

Removal of artificial cap on student places, currently determined by the amount of places funded by Health Education England

Use savings to create 10,000 new nursing student places by 2020

Better student retention

Loan scheme to provide 25% more disposable income to nursing students

Reduce drop-out rate and post-graduation brain drain

Potential Risks

Less demand from students

A number of surveys by nursing unions indicate that interest in nursing courses would decline substantially following the scrapping of bursaries

Mature students, who make up over 60% of the nurse student body, are most likely to be deterred by the prospect of a second loan or high levels of debt late in their careers

A loan system would not provide compensation for the required student work placements

Lack of required placements

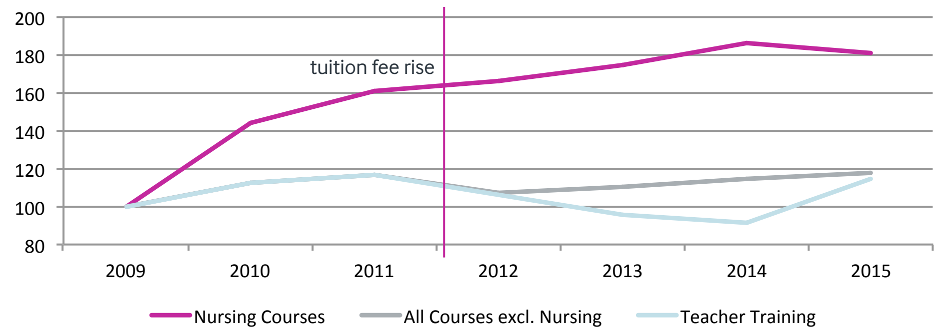
If nursing student places increase significantly in a short period of time, there may not be enough qualified staff to provide the work placements required for the degrees

Sources: Christie & Co (2015), UCAS (2016), DH (2016), LE (2016)

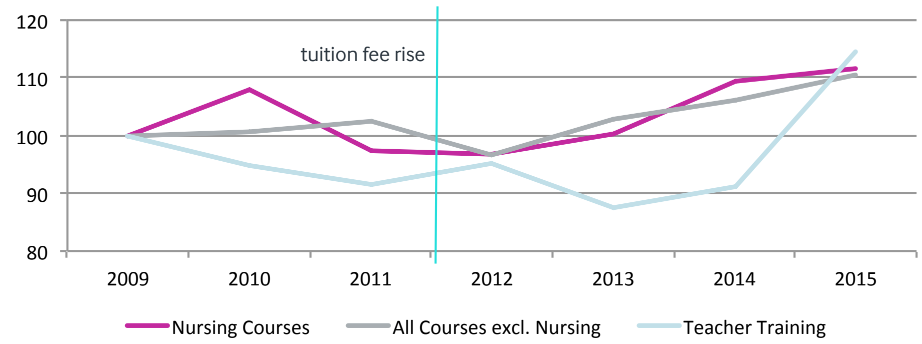
Student Bursaries – Case Study

The success of the nursing student funding reform will depend very much on the impact on applications for nursing degrees and the number of places available. The 2012 tuition fee rise provides a good example of the potential impact, in particular when looking at the changes for Teacher Training courses, which are of a similar vocational nature as nursing training:

UK University Course Applications (Index, 2009=100)



UK Undergraduate Course Acceptances (Index, 2009=100)



Source: UCAS (2016)

1. An initial fall in applications is very likely and may be prolonged

Applications for non-nursing courses decreased by 6% in the year that tuition fees increased.

Applications for Teacher Training fell by 22% in the three years after tuition fees went up.

The tuition fee hike has had a greater impact on mature students in comparison to other students. The share of mature students across non-nursing courses has fallen by two ppts post tuition fee rise and has remained at the lower level since.

2. An eventual uplift in applications is probable, although may require additional incentivisation and recruitment effort

Applications for non-nursing degrees recovered to pre-fee-hike-levels over a course of three years following the initial decline.

Applications for Teacher Training courses increased substantially in 2015 which is likely be an outcome of increased recruitment effort following years of decline and the escalating teacher shortage.

3. The number of student places may increase eventually if total funding to universities increases

Following the initial decline, the number of acceptances to non-nursing courses increased gradually.

The number of acceptances to Teacher Training declined less than the applications and increased substantially four years after fees increased.

The increase in acceptances can presumably be attributed to the increased funding available to universities through higher fees.

Nursing Associate

To complement the changes in funding to nursing degrees, the government announced plans to create a new Nursing Associate role which should improve access to the nursing profession. In response, Health Education England (HEE) undertook a consultation of 1,384 healthcare professionals and organisations to evaluate the Government's proposal:

Key Findings from the HEE Consultation on Nursing Associates

Potential benefits

Patients & Residents	Improved care quality, contact time and communication
Registered Nurses	More support, in particular with regard to the administration of medicine and assistive technologies
Care Assistants	Improved career pathway and supervision

Requirements

- Prioritisation of patient safety
- A clear definition of the role and its boundaries
- Apprenticeships with national curriculum and potential certification
- Comprehensive testing of the role to commence with **1,000** students beginning 2017

Source: HEE (2016)

Commentary

The Nursing Associate role will be fundamental in solving the staffing crisis in health and social care. We welcome the Government's and HEE's commitment to the Nursing Associate role. HEE's inclusive approach of working with health and social care organisations in developing the role is commendable and will be key to ensuring success of the model.

However, reforming the student funding structure is risky. Experience from the last tuition fee rise indicates that nursing student numbers may decline for a minimum period of one to three years. The historical level of oversubscription of the degree provides some hope that the decline in numbers may not be as strong as for other degree courses. The results of surveys on the same question paint a darker picture.

Nonetheless, the historical experience also shows that there is potential for a long-term improvement in the situation. If the issues around work placements are addressed and universities receive the required funding, the new policy may result in a better system with more nursing students. The new system may also provide new opportunities for employers to recruit and retain nurses. By offering work placements and loan repayment schemes to prospective graduates, employers can compete to hire nurses from universities with arrangements that also result in better staff retention.

Immigration

The level of immigration of nurses has changed dramatically over the past 20 years. Following a decade of decline in the 2000s, immigration has been increasing since 2009. This was driven by a general immigration influx due to the European economic crisis, as well as stagnating or falling numbers of UK-trained nurses. The number of nurses immigrating from Europe, however, was not enough to match growing demand in the UK. As a result, nursing has now been placed on the Shortage Occupation List. The prospect of Brexit now poses a whole new threat to employers seeking international staff to fill their vacant positions:

2009

Pan-European Economic Crisis

2010

EEA: 1,853
Overseas: 550

2014

Continued recession in Southern European countries

EEA: 7,051 +281%
Overseas: 639 +16%

2015

Home secretary places nurses temporarily on the Shortage Occupation List (SOL)

EEA: 9,069 +29%
Overseas: 1,627 +155%

Number of international nurses joining the register

2016

Brexit Vote

The Migration Advisory Committee (MAC) recommended to the Home Office that nurses remain on the SOL until 2019, with a cap of 5,000 nurses per annum and the limit gradually decreasing until 2019

2017

Immigration Skills Charge of £1,000 per non-EEA employee to be levied from April 2017

Sources: Christie & Co (2015), NMC (2016), MAC (2016)

Sources: Christie & Co (2015), NMC (2016)

Immigration

Number of international nurses joining the register in 2015/16

% change from 2014/15

Overseas

Philippines

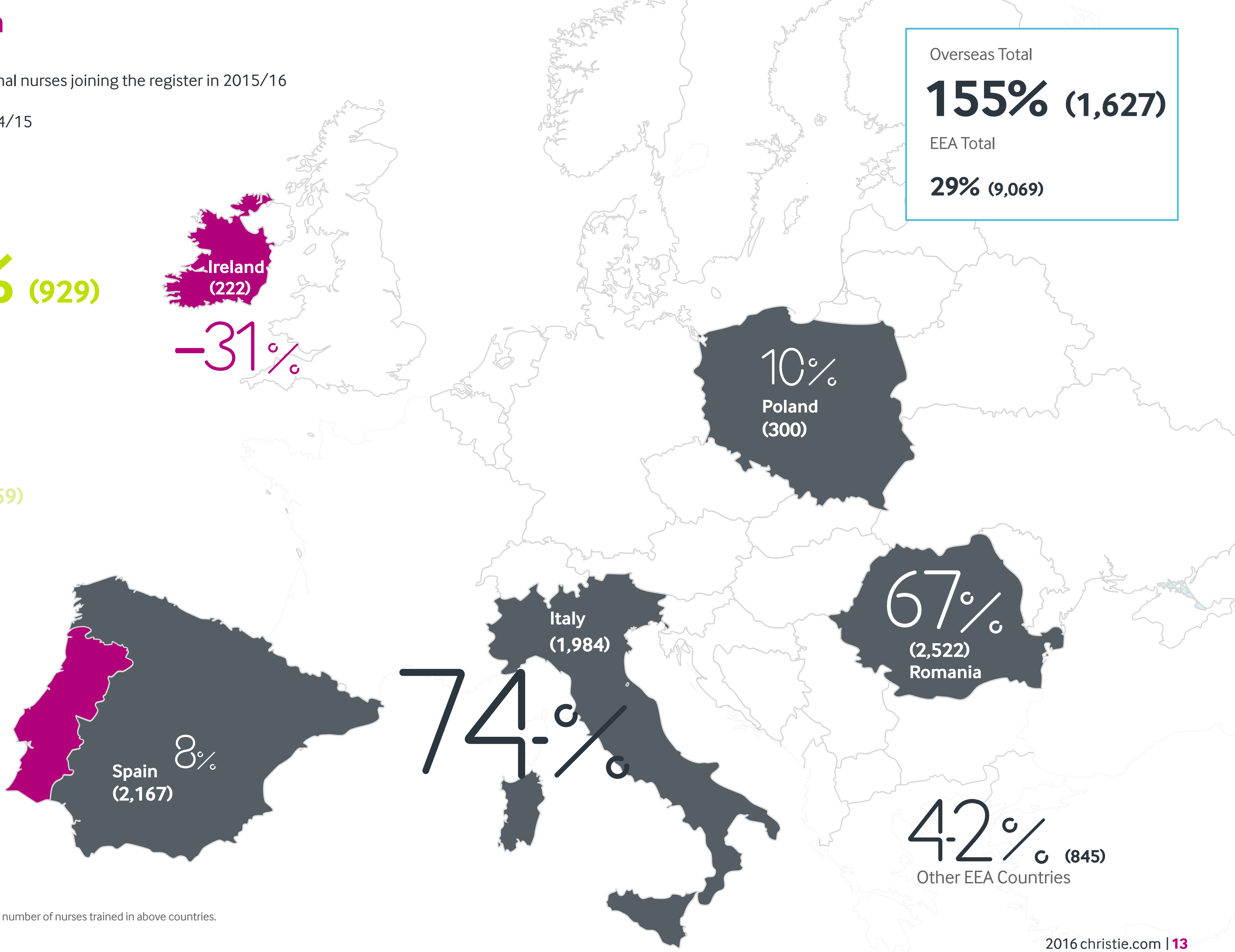
211% (929)

India

103% (539)

Other

115% (159)

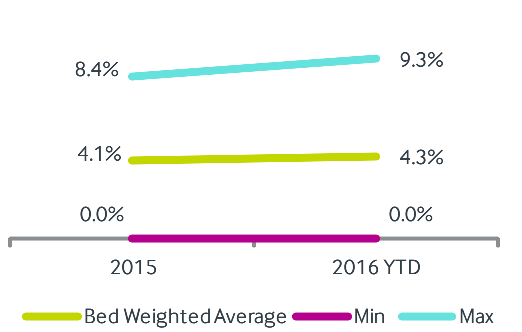


N.B. These numbers refer to the number of nurses trained in above countries.

Christie & Co Operator Survey – Elderly Care

This year Christie & Co has conducted a survey across the industry to identify the impact of the different policy changes and market dynamics on the industry. Whereas our survey last year focussed on care home groups specialised in nursing care, our 2016 survey endeavoured to capture the impact of the growing competition for all care staff in elderly care. By reaching out to a wider group of operators, we have gathered data for 101,000 beds representing 42% of the total supply provided by corporate and regional providers in the UK:

Elderly - Agency Hours / Care Hours

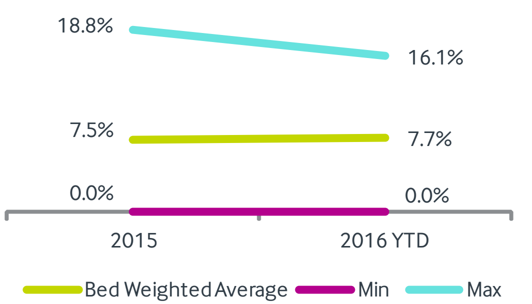


Average absolute change: **6%**

Largest increase: **91%**

Largest improvement: **-98%**

Elderly - Agency Costs / Staff Costs



Average absolute change: **3%**

Largest increase: **85%**

Largest improvement: **-98%**

Source: Christie & Co Operator Survey (2016)

Commentary

Compared to the dramatic increase in agency staff levels in previous years, agency staff use has only increased marginally in 2016. Our analysis overleaf shows that the shortage of nurses has stabilised over the course of the past year and this is reflected in our survey results:

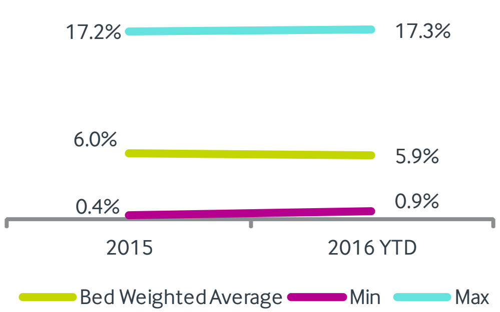
- Average agency hours and costs rose by 6% and 3% respectively, adding 0.2 ppts to the initial bases of 4.1% and 7.5%
- A quarter of the operators surveyed managed to reduce their agency cost share, whereas a third of the operators saw an increase in agency spending of over 20%
- There is an indication that care providers not providing nursing care have experienced a significant uplift in agency use in 2016
- The fact that agency costs have increased at a slightly lower rate than hours indicate that agency rates have increased at a lower rate than permanent staff wage rates - agency rates have been less impacted by the NLW

The strong competition for staff between operators became apparent from the survey. While the shortage of nurses remained stable since last year, operators had varying success in optimising their agency use. The competition now also goes beyond qualified staff, with non-qualified care staff taking up an increasingly large share of total agency hours and being an increasing problem for homes offering residential care only.

Christie & Co Operator Survey – Specialist Care

The shortage of qualified and unqualified care staff extends beyond the elderly care sector. Specialist care providers compete with the elderly care sector for unqualified care staff and with the NHS for specialist qualified nurses.
In order to shed some light on the staffing challenges in the specialist care sector, Christie & Co surveyed the leading specialist care providers on their use of agency staff. Our sample covers 5,300 beds which represents 13% of total supply provided by corporate and regional specialist care providers in the UK:

Specialist - Agency Hours / Care Hours

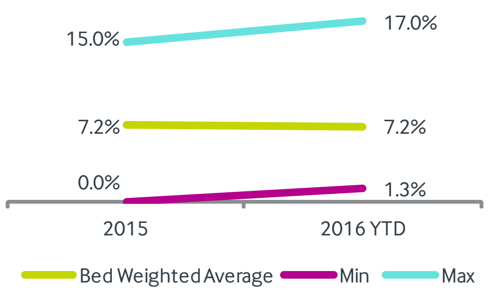


Average absolute change: **-2%**

Largest increase: **175%**

Largest improvement: **-44%**

Specialist - Agency Costs / Staff Costs



Average absolute change: **0%**

Largest increase: **150%**

Largest improvement: **-44%**

Source: Christie & Co Operator Survey (2016)

Commentary

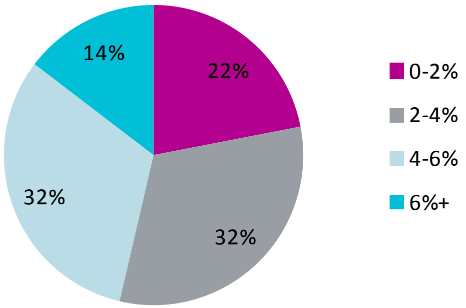
Given the size of the market and the complex nature of care provided at specialist care homes, it can be presumed that this industry inhibits a high degree of competition for specially-trained staff. The findings from our survey shed light on the challenges for the industry:

- In 2015, the share of agency hours relative to total care hours was close to 50% higher in specialist care compared to elderly care
- The use of agency staff was stable between 2015 and 2016, but varies significantly between operators
- Although the share of agency hours is substantially higher in specialist compared to elderly care, the share of agency costs is lower in specialist care. The reason for this is that agency staff in specialist care are mostly used for resident care, rather than to fill senior positions

Local Authority Fees in England 2016/17

When the NLW policy was announced, the question of how it will be funded took hold of the social care sector. Following years of funding cuts to social care and fee rate increases below cost inflation, the industry was worried that funding again would fall short of the level required to fund the Government's policies. George Osborne's answer to the question: the social care precept. A 2% increase in council tax across the country was calculated to be sufficient to cover the additional costs from the NLW. Industry participants, however, were sceptical. There were doubts about the willingness of councils to raise the precept, and for those who do, to distribute funds via fee increases. Christie & Co sets out to answer the key questions around this year's local authority fee rates by surveying all 152 local authorities (LA) in England for their fee rate increases 2016/17. At the time of completion of this report, 82 LAs responded to our freedom of information requests, representing around 66% of all LA funding for residential and nursing care:

Distribution of Local Authority Fee Increases



Source: CIPFA (2016)

95%

of local authorities in England adopted the social care precept

Local Authority Fee Increases and Fee Levels in England, 2016/17

	Median Increase	Avg Increase	Avg Fee 2016/17
Residential	4.03%	4.42%	£448.74
Residential Dementia	3.82%	4.70%	£490.86
Nursing	3.40%	4.47%	£606.66
Nursing Dementia	3.37%	4.31%	£625.47
Weighted Average*	**3.80%**	**4.50%**	**£497.87**

*Weighted by local authority spending on residential and nursing care 2014/15

Sources: Christie & Co FOI (2016), HSCIC (2015)

Have all local authorities in England adopted the social care precept?

- A total of 144 out of the 152 London boroughs, counties, metropolitan districts and unitaries in England will be deploying the adult social care precept over 2016-17, raising £382m
- This is £12m short of an estimated £394m which would have been raised in 2016 if all eligible local authorities used the precept
- Those LAs that have not raised the precept are: City of London, Ealing, Hammersmith and Fulham, Hillingdon, Hounslow, Kensington and Chelsea, Merton, and Stoke-on-Trent

Have local authorities converted the precept into appropriate fee increases?

Our survey shows that there is a large variance between LA fee increases:

- 46% of all respondent LAs have increased their fee rates by 4% or more, the minimum threshold necessary to broadly compensate for the NLW policy
- It is positive to note that 14% of LAs have implemented average fee increases in excess of 6%
- The majority of LAs however have increased their fee rates by less than 4% on average
- It is concerning that 18 (22%) of the respondant LAs have increased rates by under 2%, although 16 of those LAs have raised the precept

Overall, the median fee increase was 3.8%, compared to an average of 4.5%. It is particularly positive that those councils with larger population sizes and social care budgets have increased their fee rates by over 4%.

2016/17 Local Authority Fee Rate Increases By Region

Are there regional differences in fee increases?

England

It is very positive that within England, the North West, Yorkshire & The Humber and the East Midlands as regions with the lowest average fee rates in 2015/16, have experienced average fee rate increases of above 5%. The North West in particular has been suffering from very low fee levels historically, so the large average increase of close to 6.5% is very welcome.

Those areas with the highest fee rates in 2015/16, London and the South, are still experiencing healthy fee rate increases in the range of 3-5% from most councils. These regions are also most likely to experience the smallest impact from the NLW policy, as most staff are already paid above the new minimum hourly rate of £7.20.

The East of England stands out by having the lowest average fee increase this year.

Wales

In 2015/16, Wales had a higher average LA fee rate than England. The margin has narrowed though in 2016/17 with the average fee rate increase of 4.1% falling below the England average.

Scotland

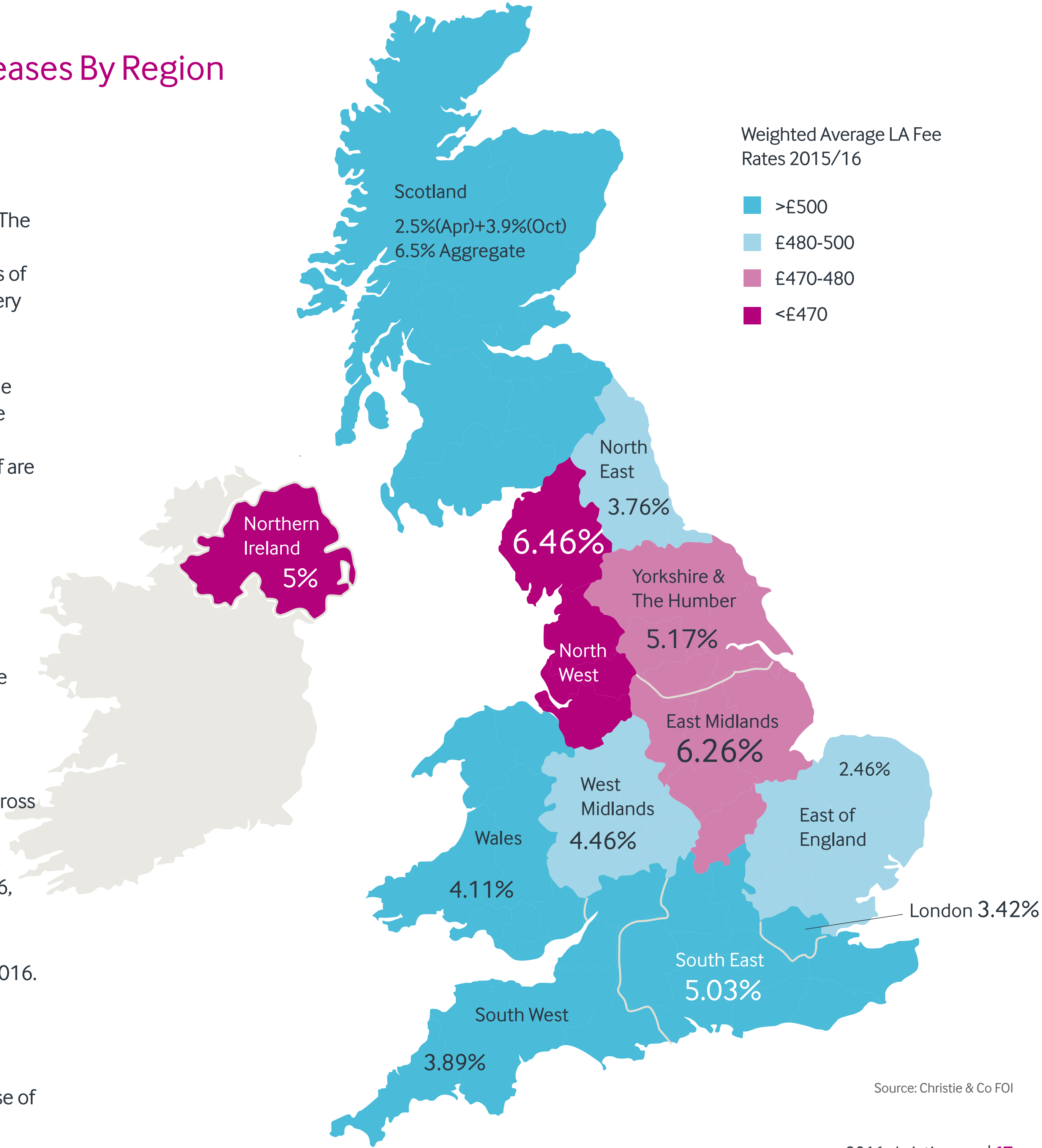
In 2015/16, Scotland had already some of the highest LA rates across the UK, only exceeded by London as a region.

The new funding settlement sets the care home fee uplift at 2.5% from 1 April 2016 and a further uplift of 3.9% from 1 October 2016, resulting in a cumulative uplift of 6.5%.

This settlement is dependent on all providers paying all care staff, regardless of age, a minimum of £8.25 per hour from 1 October 2016.

Northern Ireland

With some of the lowest rates in 2015/16, it is positive that the Department of Health in Northern Ireland agreed a flat fee increase of 5% across the country.



Source: Christie & Co FOI

Christie & Co Operator Survey - Average Fee Increases

Local authority elderly care fees only present part of the solution. Elderly care operators have over the past years increasingly relied on privately-funded residents and top-up funding to cross-subsidise the shortcomings in LA fee rates. Specialist care providers, however, are reliant upon LA funding with little or no scope to achieve private fees. As part of the survey this year, Christie & Co asked elderly and specialist care operators to provide their overall average fee rate increases thereby reflecting the aggregate of the outcomes achieved across public and private sources:

Average Fee Increase 2016 - Specialist vs Elderly Care

	Specialist Care	Elderly Care
Max	8.0%	8.5%
Average	1.9%	4.5%
Min	0.5%	1.9%

Elderly Care Fee Increase 2016 - LA vs Private

	Local Authority	Private
Max	8.6%	9.8%
Average	3.0%	6.2%
Min	1.3%	0.0%

Source: Christie & Co Operator Survey (2016)

Commentary

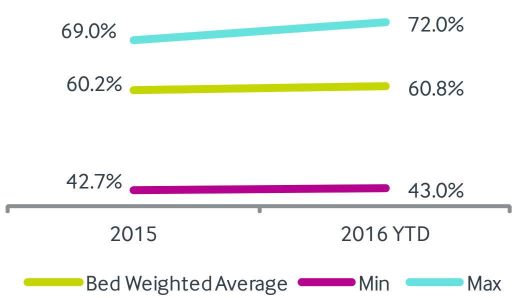
Our survey shows that specialist care operators fall short of the elderly care sector in terms of LA fee increases and that elderly care operators continue to rely on private residents to cross-subsidise LA funding:

- Specialist care operators almost exclusively rely on LAs to fund their residents. Specialist care fees are determined in direct discussions between providers and the authorities. They are highly individualistic, based on the exact nature of the care provided, as well as wider supply and demand dynamics. With average fee rate increases of 1.9%, the specialist care sector has fallen below elderly care in terms of the percentage increase achieved (as shown on the previous two pages)
- The elderly care sector, however, managed to increase average fee rates beyond the levels provided by LAs. With average private fee rate increases of over 6%, care home operators managed to subsidise their average LA fee rate increases of 3% so far this year to reach a total average of 4.5%
- With some exceptions, most operators increased their private fees in the range of 5-10%
- As not all local authority fee increases have been determined yet, the average local authority fee rate increase presented in our sample is not fully complete

Christie & Co Operator Survey - Bottom Line Impact

The final part of our survey looked at identifying how the staff cost pressures and the fee increases this year balance each other out. Our changes in staff cost margins are indicative of how the bottom line has changed so far this year:

Elderly - Staff Costs / Revenue

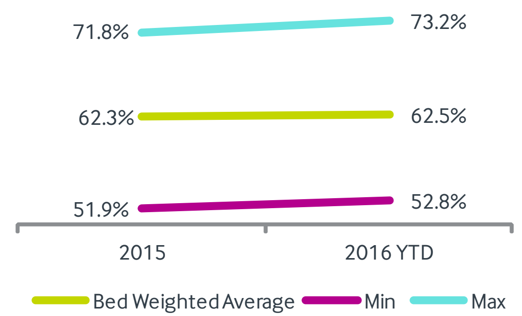


Average movement: **0.6 ppts**

Largest increase: **4.0 ppts**

Largest improvement: **-2.2 ppts**

Specialist - Staff Costs / Revenue



Average movement: **0.2 ppts**

Largest increase: **2.2 ppts**

Largest improvement: **-1.2 ppts**

Source: Christie & Co Operator Survey (2016)

Our findings

1. With still around 45% of local authority fee increases in England to be determined, the average fee increase in elderly care of 4.5% so far has not been sufficient to fully compensate for the increase in staff costs, driven by both the NLW and the continued staff shortage
2. Whilst a majority of elderly care operators experienced an increase in their staff cost margins, 27% of operators managed to keep or improve their margins so far this year
3. With further fee increases coming through, we would expect the staff cost margin increase seen to date to be gradually eroded over the course of the year
4. The impact on specialist care operators is more subtle. Staff cost margins increased by 0.2 ppts, with the spread between operators being significantly lower than in elderly care

EBITDA-Margin Impact YTD 2016*

Elderly: **-0.6 ppts**

Specialist: **-0.2 ppts**

* With around 45% of local authority fee increases in England still to be determined

Projections

As this year's cost increase from the NLW seems to be mostly compensated for through a combination of private and local authority fee increases, the question of how funding arrangements will progress over the next few years is looming. The NLW is set to increase to over £9.00 by 2020 which represents a further 25% increase in wages for those staff groups currently on minimum wage. In order to compensate for the expected increase in staff costs, fee levels need to continue to increase at a substantial rate:

Expected annual increase in wage costs 2015-2020
4.1-4.7%

Average local authority fee increase in England 2016/17
4.5%

Amount of funding raised through the social care precept in 2016/17
£382m through **95%** of LAs

Amount projected to be added to social care funding via the Better Care Fund in 2019/20
£1.5bn

Proposed Average Annual Fee Increase

Local Authorities	Avg. Residential Fee Increase (%)			Avg. Nursing Fee Increase (%)			Periods Projected
	2016/17	Future	%-change	2016/17	Future	%-change	
Norfolk	4.7	2.3	-51	3.0	1.2	-61	2017, 2018
Lincolshire	4.5	4.5	0	4.2	3.4	-19	2017
Surrey	11.6	9.4	-19	12.4	10.0	-19	2017, 2018, 2019

Source: Christie & Co Analysis, CIPFA (2016), Christie & Co FOI (2016)

Commentary

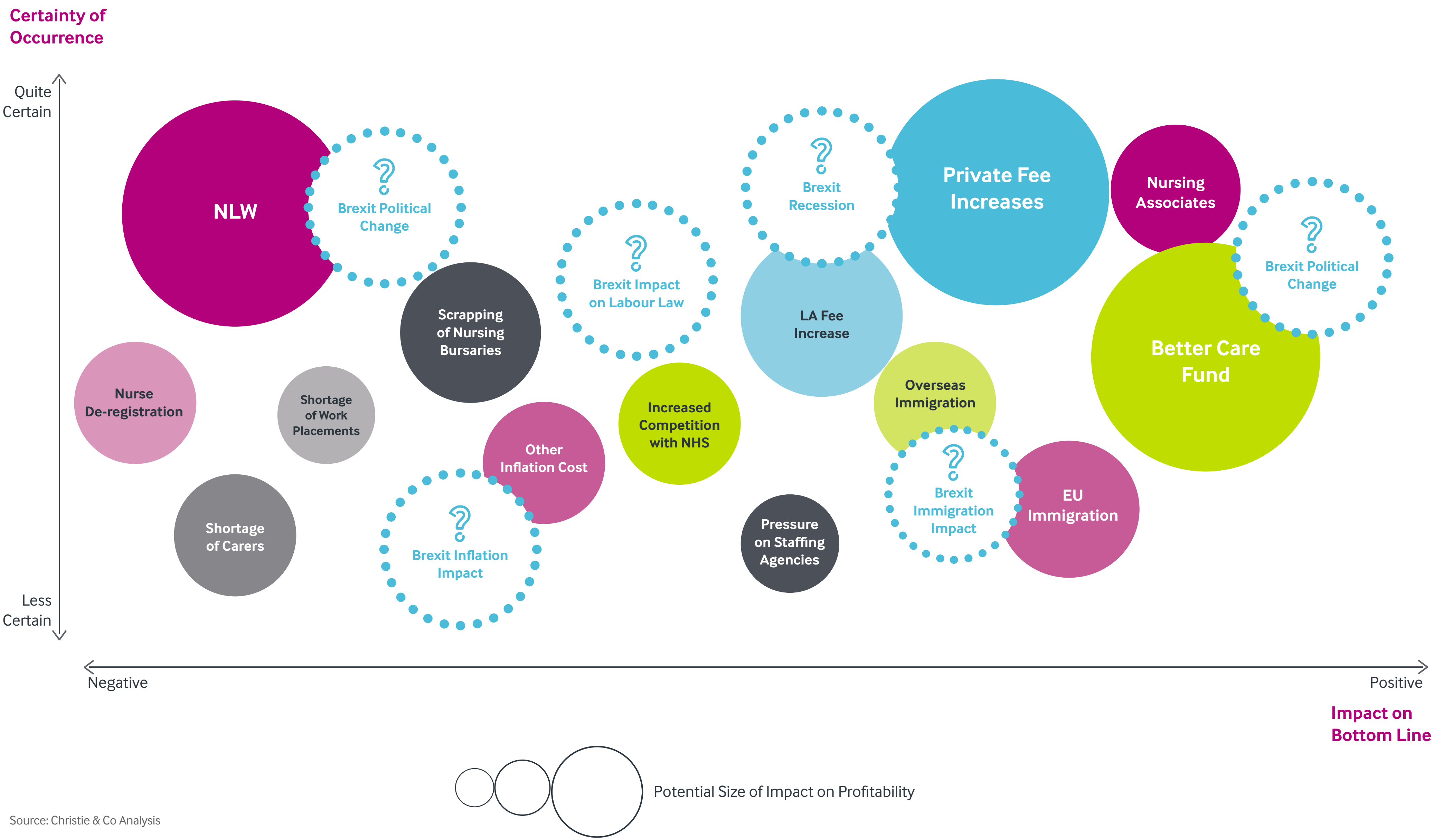
This year's increase in LA fee rates in England was broadly sufficient to cover the increased cost of the NLW policy in 2016. Raising the social care precept was the driver behind most LA fee increases this year.

With the Government's plan for gradual NLW hikes, fee increases need to be maintained at current levels to offset the expected increase in costs. To achieve these fee rate increases, LAs will need to raise the 2% precept year on year until 2020. Given the controversy around the current council tax hikes, it is hard to imagine that councils will subject residents to continuous tax rises over the next four years. Indeed, current proposals for fee rate increases over the next few years by some councils show that, while not completely reverting back to the marginal increases of the past years, fee rates are likely to increase at a significantly lower rate than in 2016.

One solution is proposed to come in the form of the Better Care Fund. The Government promised £1.5bn in additional funds in 2019/20 to support integration between health and social care. As of now, the sector's experience with this facility is limited: so far none of the existing £5.3bn in the Better Care Fund have been spent on independent care services. The sector would greatly benefit from clarification of the Government's spending plans and the planned involvement of independent providers.

Brexit may of course change a number of the factors outlined above. With the political and structural situation being as unclear as it is at the moment, it is too early to factor in any implications in a precise way.

The Bottom Line 2016-2020 - Potential Impact of Different Factors



Source: Christie & Co Analysis

Conclusion

Following years of austerity, increasing regulatory scrutiny and a dramatic shortfall in qualified nursing staff, in the summer of 2015, the Government threw the industry a new curve ball by announcing the NLW policy, effectively increasing the wage of the largest workforce in care by 11%. The industry embraced the general desire to increase remuneration rates for those staff remunerated at minimum wage levels in view of the vitally important role they play in delivering optimum resident outcomes. However, this was balanced against a very genuine concern over funding with it being clear that care operators could not absorb a cost increase of this proportion without additional funding.

Care home operators and sector representatives made it clear to the Government that the existing care home model could not continue without appropriate compensation. News headlines stated that, without substantial funding support from the Government, 5,000 care homes would close down. The shock this would have on care home residents and the NHS have resulted in action.

With reference to elderly care, our research is positive in showing that the overall tone of local authority fee settlements is sufficient to broadly preserve operating margins in 2016. The position for specialist care though is less clear. Whilst specialist care providers generally pay support workers at or above the NLW level, there has also been a historic differential with elderly care providers which has now been closed with adoption of the new NLW.

As our research shows, specialist care fee increases have been more modest and it remains to be seen whether specialist providers will need to increase remuneration rates moving forward in order to attract new staff who may otherwise opt to work in elderly care settings. If this was to occur, there is a strong argument to make that fee rates should increase to maintain the status quo and prevent margin erosion.

What about the future?

Prior to the EU referendum, the immediate outlook based on the findings of our research was relatively stable. With gradual NLW hikes for the next few years and positive first indications of future fee increases, the scene looked to be set for a degree of consistency following a tumultuous year.

The outcome of the EU referendum, however, brings new uncertainties across a number of different areas:

Staff Shortages

The number of nursing graduates over the next three years is largely unaffected by Brexit. The restructuring of the bursary system has already been decided and is unlikely to change despite the political uncertainty.

The formal creation of the Nursing Associate position is also likely to continue.

With nurses firmly placed on the Shortage Occupation List, immigration from overseas is likely to increase.

EU immigration, however, is likely to decrease substantially due to the uncertainty of residence status. A number of currently employed EU staff may also decide to leave amidst the uncertainty.

Staff Costs

The political and economic uncertainty at the moment makes the further increases of the NLW less predictable.

Brexit may however ultimately result in changes to employment law, which could be beneficial for employers.

Funding

Prior to Brexit, a number of local authorities have indicated that fee rate increases will be maintained over the next few years, albeit at a lower rate than in 2016.

Economic stagnation or recession, a potential short-to-medium-term outcome of the referendum, would impact councils' and private individuals' ability to pay for further fee increases over the next years.

In the long-term, the industry may benefit from additional government funding. However, the currently proposed scheme of improving the Better Care Fund in 2020 looks significantly less certain now.

Dealing with these new uncertainties will be key for the industry going forward. Funding and the supply of labour remain the two crucial areas with there being a need to create policies which will provide long term sustainability. As we move into the post Brexit era, social care needs to remain at the forefront of the government agenda. Providing this is achieved, the sector should be well placed to attract the investment which it needs to facilitate future development and innovation. We look forward to supporting the care sector with our expert knowledge and insight as we enter this interesting period of change.

Christie & Co Contacts

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Richard joined Christie & Co in 1989 from a major retirement housing developer. He has specialised in healthcare throughout his career and was appointed Christie & Co Head of Healthcare in 1999. Richard is acknowledged as one of the UK care sectors leading transactional specialists and has consistently featured in Health Investor's "Power 50" since its inception. Richard has an extensive network of relationships with the top healthcare operators and financiers, including US REITS, Hedge Funds and Special Opportunity buyers. Overall, Richard's team is responsible for more than 50% of all individually transacted deals in the UK market.

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Michael was appointed a Director of Christie & Co in 2005 and is a qualified Chartered Surveyor with 19 years experience within the care sector, providing valuation, consultancy and landlord and tenant advice to substantial portfolios and single asset properties. His market knowledge spans elderly and specialist care, as well as children's homes, day nurseries and schools in the UK and also Germany. Michael has also developed particular expertise in business turnaround, re-positioning studies and recovery having spent 22 months as a seconded resource to the restructuring team in RBS. Michael leads Christie & Co's Care Consultancy business with a client base which includes a number of leading private equity companies, hedge funds, operators and specialist investors.

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Andreas is the International Managing Director & Managing Director Consultancy at Christie & Co. He oversees Christie & Co's International operations and has extensive consultancy and M&A experience across the UK, Europe, the Middle East, Africa and the USA. Andreas joined from Deloitte, where he spent six years working in the UK and the USA across the company's Consultancy and Corporate Finance divisions. Prior to joining Deloitte, Andreas was based in Los Angeles as part of Arthur Andersen's Hotel Business Consultancy team. He has operational hotel experience in the USA, Switzerland and Hong Kong. He is a graduate of Cornell University's School of Hotel Administration and speaks fluent German and Swiss-German.

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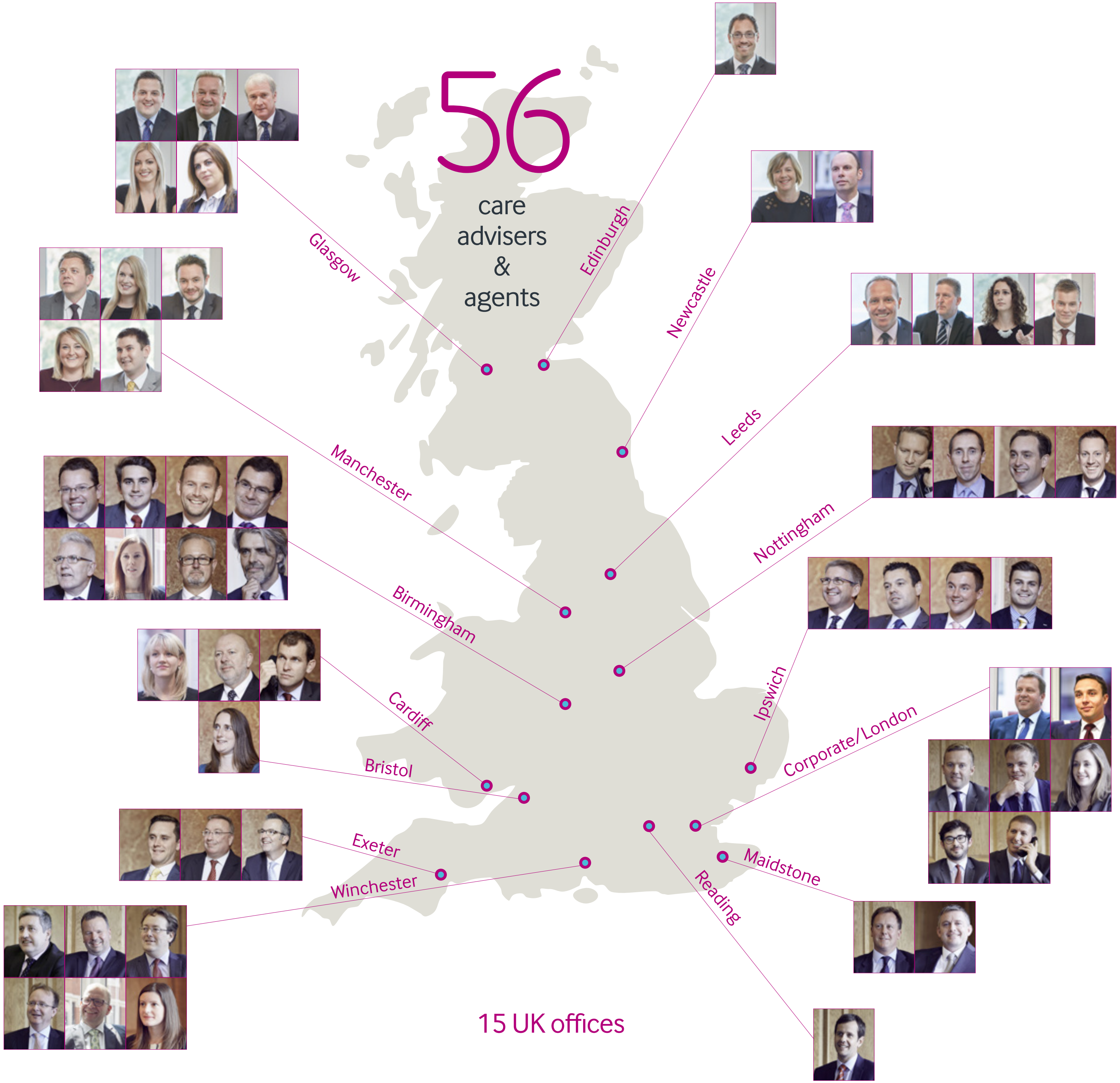
Max has worked on most of Christie & Co's recent major healthcare advisory and transactional mandates. He is a healthcare specialist with focus on strategic reviews, market research and data analysis. Prior to Christie & Co, Max worked for the Board of a major private equity backed operator of hospitals, clinics and care homes in Germany. His experience and market knowledge covers primary care, acute care, post-acute rehabilitation, elderly and specialist care. In previous roles, he worked in business strategy and development, as well as operational and financial optimisation. As a graduate of Boston University's Economic Policy programme, he is trained in statistical analysis and is responsible for Christie & Co's data analytics projects.

UK Healthcare Team

The UK's Strongest Network of Care Home Advisers & Brokerage Professionals

Our team includes 56 care-specialist advisers and agents across the UK - **the biggest sector specialist team of any firm**. All of our advisers and agents have multiple years' experience in the care industry and are experts in their local markets.

In 2015, our team completed over **200 individual deals** across the country with an aggregate value in excess of £300m (excluding corporate transactions). We also visited 3,554 care properties for transactional or advisory purposes. This equates to an average of **68.3 businesses every week** or nearly 18% of all registered provision. This level of market penetration provides us with an unparalleled level of market insight and makes us the trusted adviser for an extensive client list that includes the biggest strategic consolidators and the largest financiers in the sector.



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Maximise Pricing
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Control Disposal Process

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Feasibility Analysis
Development Appraisals
Lease Consultancy
Research Commissions

Investment & Development

Securing Forward Funding and Forward Sales
PropCo/OpCo/JV Structures
Lease, Franchise, Management Contracts
Investment Sales and Acquisition
Operator Search and Selection
Site Sales & Acquisitions
Market Screening

Insight Driven by Data Analytics

Christie & Co Provides Market Leading Business Intelligence

In 2015, we launched our unique data analytics system which dynamically combines health and care demand data, with market supply figures and performance rates across all operational variables that drive business value.

With over 1m benchmarking data points and a live-update system in line with all our advisory work, this database enables us to drill into the detail of local market dynamics and create bespoke analysis which is underpinned by a wealth of data, a significant proportion of which is proprietary.

Our data is sourced and filtered to provide maximum coverage while ensuring absolute robustness.

Over 1 million data points and growing...

References and Glossary

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