THIRD EDITION

Calculating a fair market price for care

A toolkit for residential and nursing homes

William Laing

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The demands resulting from an ageing population means that more care homes will be needed in the future. However, most public sector funding agencies do not currently offer fees that are sufficient to encourage care home operators to invest in new capacity for state-funded clients. *Calculating a fair market price for care* **offers a transparent and evidence-based mechanism for working out what such fees should be, based on the costs borne by care homes in the financial year 2008/09.**

Updates for the third edition include:

- A new and simplified approach to working out 'floor' and 'ceiling' fair fees.
- New staff input and other cost benchmarks derived from a survey of major corporate operators of care homes in 2008.
- A downward revision in the target rate of return on capital from 13% to 12%.

JOSEPH ROWNTREE FOUNDATION

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Foreword

As part of our work on social policy and practice, the Joseph Rowntree Foundation (JRF) seeks to understand and improve the experiences of older people and disabled people. 'Empowerment' is one of our three core themes (alongside 'poverty' and 'place') and brings with it commitment to enabling rather than disabling, and recognition of the challenges that may be faced by those people requiring 'care'.

And these are exciting times for the 'care agenda'.

- A new Green Paper about adult social care is on its way, intending to ensure that state spending in the sector is effective, and that choice is promoted. The hopes are great; that this may offer the prospect of addressing a huge and complex unresolved issue with which the JRF has long been concerned – a sustainable model for meeting the costs of long-term care.

- The policy push for personalisation and the shift towards individualised budgets also have huge resonance with long-held JRF ambitions. Most recently, our Independent Living programme has been seeking to identify and understand the key barriers to achieving person-centred support for older people and disabled people, and to find approaches to address these barriers that, crucially, have both credibility with users *and* viability in policy and practice.

- Extra-care provision continues to be high on policy agendas too, and rightly so. JRF knowledge, derived from both its research activity and its practical experience as a service provider, has confirmed the value of 'housing with care' models in offering the combination of peace of mind and independence that many people seek as they grow older.

But within this plethora of positive activity, it can be easy to overlook and underestimate the challenges ahead of us.

Care homes represent a model that attracts little policy attention, but they also constitute a model in which hundreds of thousands of (mainly older) people continue to live. They are a model staffed by a (primarily female) workforce, which is frequently underpaid, underskilled and undervalued. Some would argue that this position reflects a wider reality of marginalisation facing older people with care needs too. If reforms in the care sphere are to be meaningful – whether concerned with personalisation, choice and control, or effective use of resources – care homes must have a place on the agenda, certainly for the foreseeable future.

And even without a process of whole-scale modernisation (of service as well as of physical standards), the day-to-day challenges faced by the sector need to be tackled. Inevitably, this means addressing issues of funding, and ensuring that the dialogue that takes place between those commissioning services and those providing them is well informed.

William Laing's report and toolkit, the third edition supported by the JRF, intends to do just that. It provides a consistent and data-founded means of calculating 'reasonable operating costs' of 'efficient care homes' based on the reality of the situation as it faces us today. The guide will not replace negotiation between commissioners and providers, and nor is it intended to do so. The toolkit encompasses a spreadsheet that allows its users to vary the data entered according to local circumstances and conditions, and is simply intended to *inform* negotiation from a *transparent* basis.

The JRF will continue to engage with the full range of issues and policy activity currently under way concerning the care world. But against this wider backdrop, we hope that this specific output provides a tool that is of practical value to those grappling with one particular set of issues on the ground.

Julia Unwin
Director
Joseph Rowntree Foundation

1 Summary and conclusions

How to use the report and the toolkit spreadsheet

The text of the report has been structured not only to elucidate the issues under discussion but also to offer guidance notes for users wishing to enter local data into the associated toolkit spreadsheet in order to estimate fair market fees for any given locality. Users of the printed report should inspect all highlighted (emboldened) paragraphs. Users of the electronic report may use the hyperlinks to move directly to the relevant cells in the toolkit spreadsheet.

In order to make use of this facility, the Word and Excel files should be placed in the same folder on a PC running a Windows operating system. All of the parameters set in the toolkit spreadsheet may be varied, if desired, to test the effect on calculated fee levels. It is recommended that users save the original before making such modifications. Note that the hyperlinks will no longer work if either of the file names is changed.

Objective

The principal objective of this report is to provide local authority and NHS commissioners of care services, care home operators and others with an interest in the care sector with a transparent and robust means of calculating the reasonable operating costs of efficient care homes for frail older people and older people with dementia in any given locality, and thus determining fee levels necessary to sustain delivery of adequate care services by independent sector providers, now and in the future.

Scope

This report is limited to care home services for frail older people and older people with dementia in England. A similar approach would be equally valid in other parts of the UK, although some costs would differ because of regulatory and practice variances.

Modifications in successive 'fair market price' reports

This 2008 report updates and revises two earlier reports published by The Policy Press for the JRF, the first in 2002 entitled *Calculating a fair price for care: A toolkit for residential and nursing home costs* (Laing, 2002; 'the 2002 report') and the second in 2004 with the same title (Laing, 2004; 'the 2004 report').

The principal modifications adopted since the original 2002 report are summarised in Box 1 in Chapter 2.

Since the 2004 report, other costing models have been developed. These include a model developed by the consultancy firm PricewaterhouseCoopers for local authorities in the North East of England. It is not, however, in the public domain. A 'Care Funding Calculator' has also been developed in a local authority collaboration led by Regional Efficiency and Improvement Partnerships (formerly Centres of Regional Excellence for social services commissioning) in the South East and South West of England. At the time of writing in 2008, version 19 of the Care Funding Calculator had been distributed. However, the model relates to care homes for learning disabled adults and some of the key data cells remain hidden.

In the absence of publicly available information, no elements of these other models have been incorporated in the 2008 report or its toolkit spreadsheet.

The evidence base

While the structure of the toolkit spreadsheet has remained virtually unchanged since the 2004 report, it has been repopulated with data collected

in 2008 by Laing & Buisson from three principal sources:

- a mailed survey of care homes for frail older people carried out in spring 2008 requesting information such as the pay and terms and conditions of care home staff;
- face-to-face or telephone interviews with senior managers from the seven largest care home groups in England, supplemented by an emailed questionnaire;
- a telephone survey of major business transfer agents active in the care home sector.

Is investment in new care home stock needed?

The recommendations on fee levels contained within this report are based on the premise that a substantial amount of investment in new care home stock will be required to replace old stock and to meet future demand generated by an ageing population.

Such is the projected demographic pressure of demand that, even with a substantial further transfer of demand away from traditional care homes and towards home care and extra care alternatives in the future, it seems unlikely that further investment in traditional care homes can be avoided.

Care home costs and fair fees

There are four main components of care home costs:

- staffing;
- repairs and maintenance;
- other non-staffing current costs; and
- capital costs.

These costs are calculated in the associated toolkit spreadsheet. Because capital costs are assessed to incorporate a reasonable return for investors, including profit, 'fair market fees' are identical to the sum of the four cost items above.

Table 1 summarises results from the toolkit spreadsheet calculations when applied to two illustrative types of locality:

- (a) an average provincial location where care assistant and domestic staff pay rates are close to the National Minimum Wage (NMW) and where land prices are relatively low;

Table 1: Summary of fair fees calculated from the toolkit spreadsheet, 2008/09 (£ per week)

	Nursing care	**Personal care**	
	Frail older people and older people with dementia[1]	**Frail older people**	**Older people with dementia**
(a) Provincial location			
Ceiling[2]	665	538	566
Floor[3]	589	463	491
(b) London			
Ceiling[2]	776	648	680
Floor[3]	700	574	606

Notes:

[1] Including Registered Nursing Care Contribution (RNCC) from the National Health Service (NHS).

[2] The upper end of the range (ceiling) represents a fair market fee for homes that have been given a Commission for Social Care Inspection (CSCI) star rating of either 'good' or 'excellent' and which meet physical environment standards for 'new' homes first registered since April 2002, as defined in Care homes for older people (DH, 2003)

[3] The lower end of the range (floor) represents a fair fee for homes/rooms that have been given a CSCI star rating of either 'good' or 'excellent' but which the proposed physical environment grading tool finds to be on the borderline of acceptability.

- (b) a typical location in London where pay rates are higher than provincial locations and land prices may be about three times as high.

The numbers in Table 1 should be viewed as illustrative only. In reality there are some localities outside London where pay and land prices are comparable to London and, conversely, some localities within the boundaries of London where pay and land prices are not markedly different from the provinces. In order to reach valid conclusions, it is essential that any local 'fair market price' calculations be based on local pay rates and land prices. It may also be necessary to calculate more than one set of fair fee rates within a given social services authority. Large counties like Cambridgeshire and Kent, for example, have wide inter-district disparities in pay rates and land values.

The illustrative fair fees in Table 1 are based on costs for *efficient* homes. One important element of efficiency is scale. In practice, an efficiently configured home is one that is large enough to exploit staffing economies of scale. No allowance has been made for higher costs of smaller-scale homes. The rationale is that Laing & Buisson is aware of no clear evidence that small-scale homes deliver an inherently higher quality for frail older people or older people with dementia. On this premise, there is no case for councils to pay higher prices for small-scale homes – unless specifically justified by some other overriding factor.

Pay rates represent a much more controversial aspect of efficiency. In line with previous editions, this 2008 report specifically opts to use hourly wage rates paid by private sector operators, which represent the most 'efficient' practice in terms of lowest cost. Laing & Buisson's spring 2008 survey found that weighted average pay for unqualified care assistants outside London was £6.07 per hour, with a premium of about 20p per hour for those with NVQ2 qualifications and a further 70p for 'senior carers'. Domestic staff were paid an average of £5.94 per hour. In addition to these low pay rates, hourly staff employed by private care home operators typically receive statutory sick pay only and no employers' pension contributions. Voluntary sector providers offer somewhat more generous terms and conditions (and local authority in-house pay rates are more generous still) but these are ignored in the calculation of payroll costs for an 'efficient' care home. It is important to recognise, therefore, that the 'fair market price' benchmarks calculated in this report would be substantially higher if there were a commitment by all stakeholders – providers, local government and central government – to paying staff at the higher level that many commentators argue would be necessary to create a professionalised social care sector in Britain. Every extra £1 per hour paid to non-qualified carers and domestic and catering staff would add an additional £32 per week on average to fair market fees (see 'What would a fully modernised care home sector cost?', p 8).

The toolkit spreadsheet calculates fair fees separately for personal care of frail older people and for older people with dementia, reflecting the higher staff inputs for dementia. On the other hand, there continues to be no consistent evidence of any significant difference in the cost of nursing care between frail older residents and those with dementia. Major care home operators who provided information to Laing & Buisson reported that qualified nursing care staff input was similar for both client groups while some, although not all, reported that care assistant staffing input was between one and one-and-a-half hours per resident per week (prpw) higher for people with dementia than for frail older people. The cost differential of less than £10 per week at most was considered insufficient to justify the separation of dementia nursing care from frail older people nursing care in the toolkit spreadsheet.

Capital cost adjustment factor

Councils and their NHS partners should not pay physically substandard homes at the same rate as physically good quality homes. If they were to do so, they would find themselves paying fees to substandard care homes at a level that would generate super-profits for them. This is the reason for proposing the application of a *capital cost adjustment factor*, giving rise to a range (ceiling and floor) for fair market fees.

The maximum capital cost adjustment factor is entered as £74 to £76 prpw in the toolkit spreadsheet, being 50% of the benchmark build/equip cost of the £149 to £153 prpw for those care

homes meeting the physical environment National Minimum Standards (NMS) for homes built since 2002.

It is proposed that stakeholders, including local authorities and providers of care services, should seek to develop a physical environment grading tool, which is as objective and transparent as possible, to determine the capital cost adjustment factor (between 0% and 50%) to be applied to each individual home or room.

It is further proposed that only homes rated by CSCI as 'good' or 'excellent' should qualify for the ceiling rate or the ceiling rate less the capital cost adjustment factor. Homes classed as 'adequate' or 'poor', which in mid-2008 accounted for 20% of care homes with a star rating, should be paid whatever amount the local authority at its discretion judges best incentivises them to improve their star rating.

In summary, the approach to setting 'ceiling' and 'floor' fair market fees proposed in this 2008 edition of the 'fair market price' reports is that:

- Those care homes with a 'good' or 'excellent' star rating, which also meet the 2002 physical environment NMS for new homes, should receive the 'ceiling' fair market rate as shown in the toolkit spreadsheet (see Table 1, p 6).

- Those care homes with a 'good' or 'excellent star rating, but which do not meet the 2002 physical environment NMS for new homes in full, should receive the 'ceiling' rate less the capital cost adjustment factor as determined by the physical environment grading tool.

- Remaining homes that are rated 'poor' or 'adequate' will be 'orphaned' under this mechanism, and should be paid whatever amount best incentivises them to improve their star rating.

Gap between fair fees and fees currently paid by councils

The 2002 report found that there were substantial gaps in most English localities between 'fair market' rates and the weekly fees paid by social services. The gaps had diminished by the time of the 2004 report and have diminished further since, although since 2007 there has been evidence of renewed downward pressure on fees in real terms as many cash-strapped local authorities have sought to contain fee increases at below inflation. An analysis of the 2008/09 round of baseline fee increases is published in the July issue of *Community Care Market News* (2008), published by Laing & Buisson.

In essence, the conclusion to be drawn is that the fees that are typically on offer from local authorities are fairly close to being adequate for unmodernised care home stock. But they remain inadequate to fund a modernised care home sector meeting the physical standards set by the government for new homes registered after April 2002.

What would a fully modernised care home sector cost?

The potential additional cost to the public sector of an England-wide commitment to pay a fair price for a fully modernised care home sector, in terms of physical environment, can be approximated by comparing the ceiling rates for England (that is, the fair market fees calculated for 'new' homes) with the average gross fees paid by English local authorities. The additional cost to the public sector is estimated at approximately £540 million per annum at 2008/09 prices and volumes of demand.

If the concept of 'fully modernised' is extended to include a professionalised workforce, paid accordingly, then the additional cost would be substantially greater. It can be calculated from the toolkit spreadsheet that:

- every extra £1 per hour paid to non-qualified carers and domestic and catering staff would add £280 million per annum to local authority costs; and

- implementation of the proposal within the 2007 Pensions Bill for a minimum 3% employers' pension contribution (subject to opt-out) could add £52 million per annum to local authority costs.

Future changes in care home costs

It is proposed that each broad cost heading in the toolkit spreadsheet should have a specific inflation factor. These are described in Chapter 5.

There are, however, health warnings. The toolkit spreadsheet should not be overreliant on inflation factors and benchmarks should be re-examined afresh at intervals to ensure that the toolkit spreadsheet does not diverge from reality.

2 Introduction

Objective

The principal aim of this report is to provide local authority and NHS commissioners of care services, care home operators and others with an interest in the care sector with a transparent and robust means of calculating the reasonable operating costs of efficient care homes for frail older people and older people with dementia in any given locality, and thus determining fee levels necessary to sustain delivery of adequate care services by independent sector providers, now and in the future. It is hoped that the report will act as a guide to commissioners revising baseline fee rates or negotiating them with local providers.

Alongside this report, a 'toolkit' spreadsheet has been prepared, which will allow commissioners and others to enter locally variable components of care home costs, such as pay rates and land prices, so that total costs can be calculated that fairly reflect local market conditions.

Scope

This report is limited to care home services for frail older people and older people with dementia in England. A very similar approach would be equally valid in Wales, Scotland and Northern Ireland, although some costs would differ because of variances in their regulatory systems.

Until April 2002, care homes in England were divided under the 1984 Registered Homes Act into 'nursing homes' offering nursing care and 'residential homes' offering residential care. This statutory distinction disappeared under the 2000 Care Standards Act and all such establishments are now referred to as 'care homes'. Nevertheless, there remains a regulatory distinction between:

- 'care homes with nursing', which may offer either 'nursing care' or 'personal care' and must employ an appropriate level of qualified nursing staff; and
- 'care homes only', which may offer 'personal care' only and do not need to employ qualified nursing staff.

In line with these changes, this report uses the term 'personal care' to refer to what used to be called 'residential care'. Because of the qualified nursing staff input, nursing care is more costly than personal care – other things being equal.

Modifications in successive 'fair market price' reports

This 2008 report updates and revises two earlier reports published by The Policy Press for the JRF, the first in 2002 entitled *Calculating a fair price for care: A toolkit for residential and nursing home costs* (Laing, 2002; 'the 2002 report') and the second in 2004 with the same title (Laing, 2004; 'the 2004 report'). This 2008 revision was considered necessary because of material changes that have taken place since, including:

- a reduction in the rate of return on capital typically being sought by investors in care homes;
- increased dependency levels of care home residents, leading to higher staffing requirements;
- inflation in non-staffing current cost items, such as utilities and provisions.

The opportunity has also been taken, in this revision, to modify the illustrative methodology for calculating 'ceiling' and 'floor' fair fees for each client type in the light of the star ratings introduced in 2008 by the sector regulator, the CSCI. The principal modifications adopted since the original 2002 report are summarised in Box 1.

Box 1: Modifications in the fair market price model, 2002-08

Return on capital benchmark

The return on capital benchmark is the rate required to incentivise providers to invest in new care home capacity, and to maintain and/or upgrade existing capacity to the latest physical standards. Originally set at 16% in the 2002 report, it was reduced to 14% in the 2004 report and has been further reduced to 12% in this 2008 report. The successive reductions reflect the decline in expected yields as care home investment has entered the mainstream of commercial property investment.

'Ceiling' and 'floor' fair fees

The concept was introduced in 2004 in order to differentiate between fair fees for those providers that have invested in the physical environment to the latest standards and those that have not. The 2008 report proposes that CSCI ratings of either 'good' or 'excellent' should be used as the overall quality trigger for payment of 'ceiling' fair fee rates – provided the care home (or room) meets the latest physical environment standards. The 2008 report further proposes that stakeholders should work together to introduce a transparent physical environment grading tool to determine what capital cost adjustment factor should be applied to 'ceiling' rates in order to arrive at a fair fee for any given home (or room).

Capital costs

For the 2008 report, the method of estimating the build and equip costs of a new care home have been refined. They are now calculated from benchmarks for: floor space (m^2) per bed; and build/equip costs per m^2 including professional fees. Also, for the first time in 2008, allowances are made for start-up losses (operating losses during occupancy build up for a new home) and for additional equipment required for nursing care as against personal care.

Staffing input

Benchmark staffing input remained unchanged in the 2002 and 2004 reports. The 2008 report incorporates the following changes:

- *nursing care of frail older people and people with dementia:* non-qualified care staff increased from 19.5 hours per resident per week (prpw) to 20.5; qualified nurse staff unchanged at 7.5 hours prpw;
- *personal care of frail older people:* care staff increased from 16 to 18.5 hours prpw;
- *personal care of older people with dementia:* care staff increased from 20 to 22 hours prpw.

Head and regional office overheads

In all three reports, no allowance is made within the fair market price model for head and regional office overheads, on the grounds that they would not normally be incurred by a standalone care home operator and should be regarded as portfolio management costs, which investors in corporate care home groups are prepared to absorb in order to gain access to the market. For the 2008 edition, however, it has been recognised that a proportion of costs incurred at head or regional office level represents centralised functions, which would otherwise have to be incurred at the home level, and these have been reincorporated into the fair market price model.

Level 1 and level 2 nurses
The 2002 and 2004 reports separated the cost of qualified nurse staffing into level 1 (Registered General Nurse) and level 2 (State Enrolled Nurse) components, level 2 pay rates being slightly lower. For the 2008 report the distinction has been abandoned, since all nursing staff are now effectively level 1.

NVQ2 qualifications
The proportion of care hours filled by staff with NVQ level 2 or above (excluding qualified nursing staff) has been entered into the toolkit spreadsheet at 50%, compared with 30% in the 2004 report.

Senior carers
The proportion of non-nurse care hours filled by staff designated as senior carers has been entered at 10% for nursing care and 25% for personal care in the 2008 report and toolkit spreadsheet. This has replaced the combined average of 15% in the 2004 report.

Paid holidays
Working Time Regulations have raised the statutory minimum paid holiday entitlement from 20 days to 24 days in October 2007, and to 28 days from April 2009. As a consequence, holiday on-cost has increased from 8.3% in the 2004 report to 12.0% (that is, the forthcoming statutory minimum) in the 2008 report.

Food and utilities
For the 2008 report, the benchmark costs of food and utilities obtained from major care home groups have been adjusted upwards to be gross of estimated discounts that groups are able to obtain from bulk purchasing. This is necessary because the 'fair market price' toolkit spreadsheet does not recognise group overhead costs. To be even-handed, therefore, the bulk discounts obtained by virtue of their being a group overhead structure in place should not be recognised either. Therefore, the food and utility costs entered in the toolkit spreadsheet have been adjusted to represent estimated costs for an efficient, larger-scale standalone care home without the benefit of group negotiated discounts. These cost items have also been subject to high recent inflation.

The evidence base

While the structure of the toolkit spreadsheet has remained virtually unchanged since the 2004 report, it has been repopulated with data collected in 2008 by Laing & Buisson from three principal sources:

(1) A mailed survey of care homes for frail older people carried out by Laing & Buisson in spring 2008 requesting, among other things, pay and terms and conditions of employment for home managers and hourly pay for domestic and catering staff. At the time of analysis, responses had been received from 1,008 out of 10,100 care homes in England.

- average home manager pay rates for larger-scale homes (50 beds or more) have been used to populate manager salary cells in the toolkit spreadsheet; and

- averages from the responses have been used to populate toolkit spreadsheet cells relating to pay rates for each type of hourly paid staff for

each type of shift. The hourly staff pay survey form is reproduced in Appendix 1.

(2) The seven largest care home groups in England were approached with a request for data:

- Southern Cross Healthcare Group plc
- BUPA Care Homes
- Four Seasons Health Care Ltd
- Barchester Healthcare Ltd
- Anchor Trust
- Orders of St John Care Trust
- MHA Care Group.

Senior managers from each organisation were interviewed either face to face or by telephone. Extensive additional information was collected by means of an emailed questionnaire (Appendix 2) and has been used to populate other benchmark cells within the toolkit spreadsheet.

The benchmarks reported by the groups were clustered fairly closely together. Where there were outliers, however, these were ignored. Rather than use a simple average of reported benchmarks, the lowest modal cost figures were adopted for input into the toolkit spreadsheet. Therefore, the 'fair market fees', which are outputted from the toolkit spreadsheet represent those for the most efficient operators among corporate operators, which in turn are generally more cost efficient than care homes that do not form part of large groups.

(3) A telephone survey of major business transfer agents active in the care home sector was carried out, to gauge recent experience from professional valuers on care home sale prices as a multiple of operating profits. This evidence was used to determine the rate of return on capital benchmark within the toolkit spreadsheet.

Market background – fees, stability and investment

The first edition of this report was published in 2002 at a time when there was real concern about the stability of the care home market. Care home fees had been tracking the Retail Price Index for several years while care home costs were rising more in line with wages, and this had led to contraction of margins and several financial failures among corporate providers. Capacity losses through care home closures were running at 10-15,000 beds a year while new care home registrations had dropped to a low point of about 3,000 places a year.[1] The root cause of market instability was the unwillingness (or inability) of local authorities (which were and remain the dominant source of funding for people dependent on financial support from the state) to pay fee levels adequate to cover providers' costs and offer a reasonable return on investment, as demonstrated in the 2002 report. As well as threatening the stability of local care markets, the decline in capacity led to reduced local choice for state-funded care users, since self-payers and people with top-up funding crowded them out of remaining local homes, requiring councils to seek placements for them out of the local area. This was not just a matter of concern for organisations providing care services. It was a matter of public concern because, for better or for worse, the delivery of residential and nursing care in Britain had been largely privatised during the 1980s and early 1990s. Reversing that process was not, and still is not, a realistic option and Britain will remain reliant on private sector provision for the foreseeable future.

Since 2002, the financial position of care home operators has improved considerably. Over the period from 2003 to 2006 most local authorities responded to local market pressures and raised fees at rates well over general inflation. This upward fee realignment took place at a variable pace among the 150 councils in England, but by the

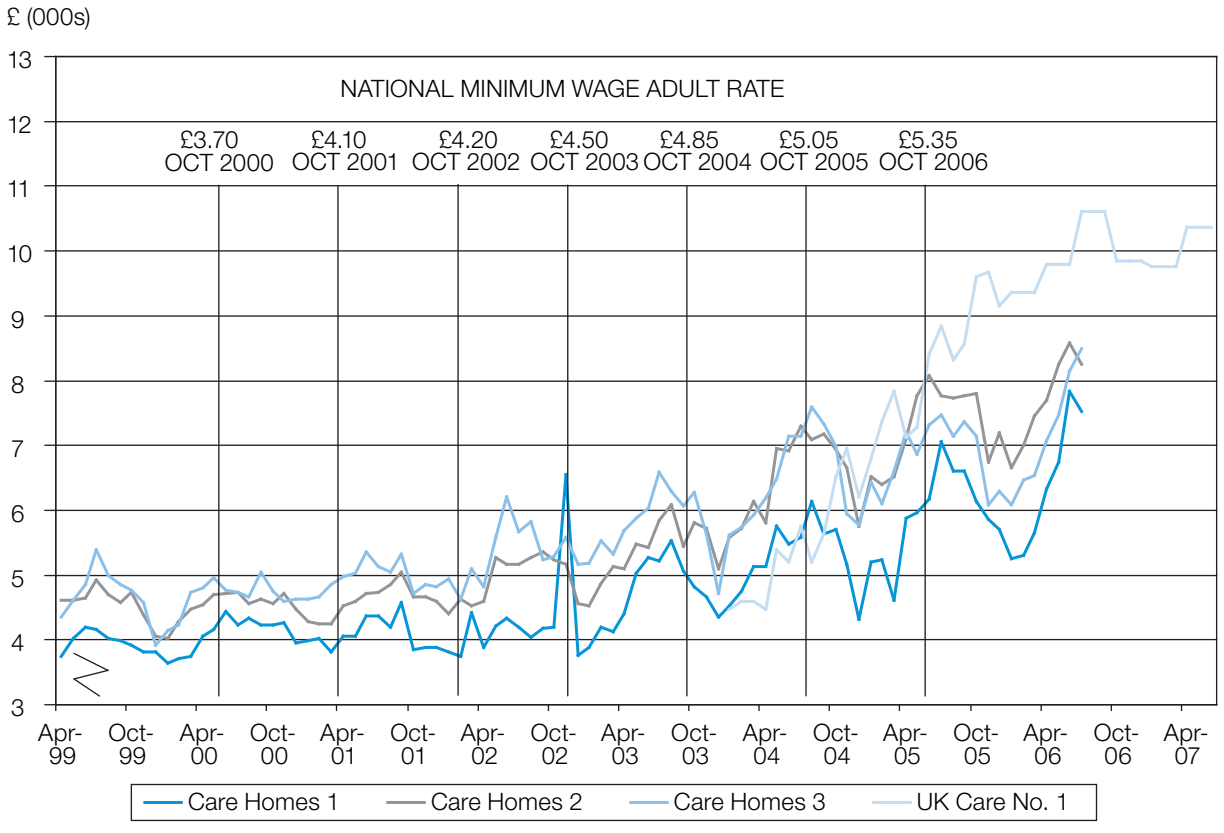
end of the period care home margins had broadly returned to levels adequate to reward investors in existing care home capacity, if not sufficient to incentivise operators to develop new care home capacity for state-funded clientele. The broad increase in care home profitability in the period 2003-06 is illustrated in Figure 1, which is based on data from a number of 'securitised' portfolios of care home properties that had been sold on the Eurobond market and which were required by the terms of their securitisations to report on the profitability of the underlying care home business.

Since 2006, above inflation increases in baseline fee rates among English councils have largely come to an end. While full results from Laing & Buisson's annual survey of baseline fee rates for 2008/09 were not available at the time of going to print, early indications are that the care home sector has entered into a new phase in which cash constrained local authorities are broadly seeking to contain fee increases at below cost inflation once again.

The position in 2008 is that fees paid by most social services departments throughout England remain below the 'fair market price' rates calculated in this report, and are inadequate to incentivise independent sector providers to develop new care home capacity for frail older and older mentally infirm people dependent on state funding.

The key issue, in this situation, is whether or not new care home capacity is actually required. The fact that demand has been declining since the mid-1990s might be adduced as evidence that it is not (Banks et al, 2006). Laing & Buisson's view, however, is that the era of declining demand has come to an end and that substantial new capacity will inevitably be needed in the future. According to national projections published by Laing & Buisson (2007), population ageing has now reasserted itself as a driver of growth in demand for care homes, following a decade in which local authorities effectively cut care home demand by tightening eligibility criteria and diverting demand to community-based services. Latest available

Figure 1: Profit (EBITDAR[1]) per bed per annum for securitised portfolios in the UK care home sector



Note:[1] EBITDAR (Earnings Before Interest, Tax Depreciation, Amortisation of goodwill and Rent).

Source: Laing & Buisson (2007), derived from Fitch Ratings data

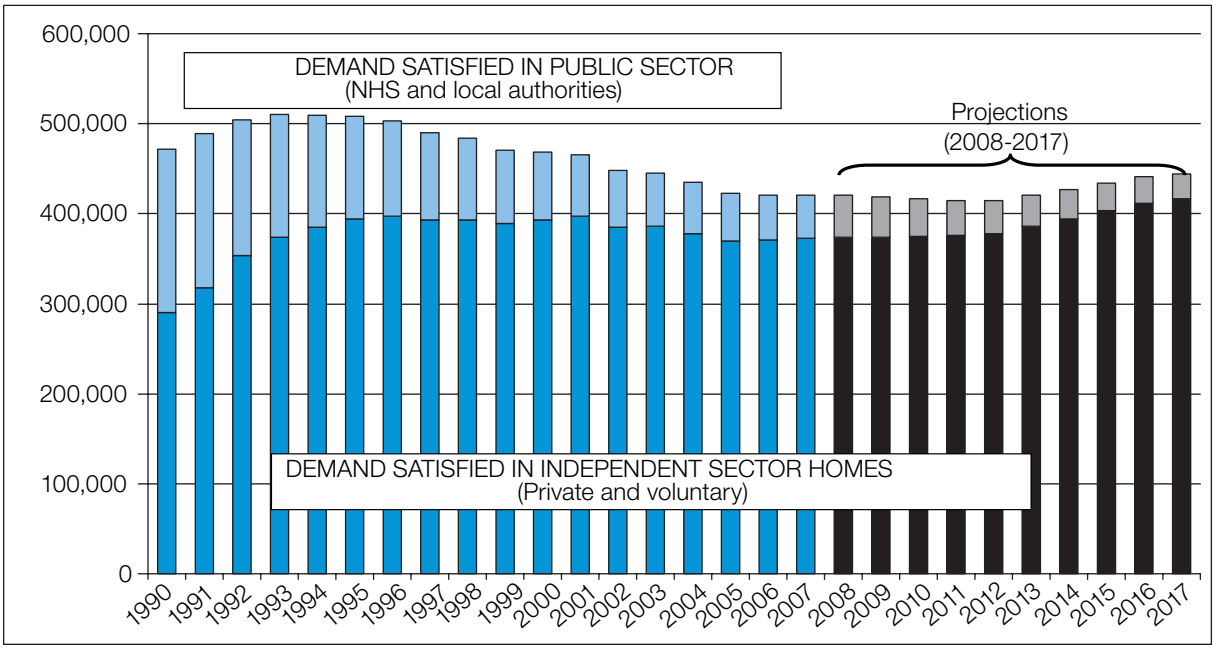
statistics strongly suggest that a point of inflection has been reached and that demand for care home places for frail older people is returning to an upward trend (Figure 2), one which will accelerate from the 2020s as population ageing intensifies.

While care home capacity in the independent sector has started to grow once more, a matter of particular concern is the virtual cessation of investment in new care home stock catering for state-funded clients. All senior managers of major care home operators interviewed for this study stated that their new capacity pipeline was focused almost exclusively on areas of high privately paid demand.

The recommendations on fee levels contained within this report are based on the premise, as described above, that a substantial amount of investment in new care home stock will be required to meet future demand. It should be noted, however, that there is a contrary view – which is that the traditional care home sector will continue to contract, as it has over most of the last decade and a half, and that the demand for new facilities in the future will be focused on home care and new models such as 'extra care'. The 'extra care' model of delivering home care services typically to tenants/owners of clustered independent living units is certainly attractive. The issue, however, is whether it can realistically substitute for such a large proportion of traditional care home services as to render further development of care homes unnecessary.

Laing & Buisson's view is that this is unlikely, bearing in mind (a) the level of dependency of care home residents now; (b) questions over some home care users' quality of life and the relative cost of delivering dispersed care services to the most highly dependent people; and (c) the scale of increase in care services overall required to meet the demands of an ageing population. On this latter point, calculations based on the most recent UK population projections from the Government Actuary show that, if age-specific rates of usage per unit population were to remain as they are now, there would be 1,200,000 frail older people living in care homes or long-stay hospitals in the UK by the time the older population peaks in 2071, compared with 420,000 in 2007 (Figure 2). Even with a substantial transfer of demand away from traditional care homes and towards home care and extra care alternatives, therefore, it seems unlikely that further investment in traditional care homes can be avoided.

Figure 2: UK demand for places in care homes for older and physically disabled people, 1990-2007, and projections 2008-17



Source: Laing & Buisson (2007)

Why calculate fees from a cost model using local data?

It is implicit in the aims described above, that:

- calculating fee rates from a cost model – rather than tendering or some other negotiating process – is the most practical way of determining fair levels of remuneration for care homes catering for state-funded clients; and

- costs and fee rates should be calculated *locally* rather than nationally.

Limitations of tendering

Tendering processes are well established in local government procurement. So why not use a tendering process to establish care home fee levels that are acceptable to both care commissioners and each successful tenderer, rather than seeking to establish a set of baseline fee rates applicable to all local care home providers?

When the community care reforms were implemented in 1993, many local authorities did indeed undertake tendering exercises with local care home providers. More recently, some NHS agencies including regional procurement hubs have also conducted tendering exercises, prompted by the new national eligibility criteria for NHS continuing care and the increase in the number of frail older people being supported in nursing homes by the NHS. In practice, however, the dominant mode of commissioning care home places remains 'spot' purchase by local authorities under standard terms and conditions at specified 'baseline' fee levels, which may vary within different areas within a large council's boundaries, and which are typically revised by the council at the start of each financial year.

'Spot' purchase remains dominant despite moves among some local authorities towards block contracting, particularly of nursing care places. The dominance of spot purchasing at baseline fee rates is a consequence of certain features of the care market:

- Most important is the choice directive, enshrined in the 1992 National Assistance Act (Choice of Accommodation) Directions. This requires local authorities to allow individuals entering care homes under a local authority contract to go into a care home of their choice, and have their fees topped up by a third party, without unreasonable hindrance by the local authority – provided, among other things, that the individual's choice does not cost the local authority more than it would usually pay for someone with the individual's assessed need. The wording of the choice directive implies that each local authority must have a set of 'baseline' fees, representing what it will usually pay.

- Moreover, client choice limits the opportunities for local authorities to negotiate block contracts that can purport to guarantee a flow of placements to successful tendering parties. In several reports, the Audit Commission has recommended more widespread use of block contracts for care home services. In some cases this could be achieved without infringing the directive on choice by local authorities' block contracting with the most popular homes, where they can be confident there will always be an excess of individual demand over places available. But it would be difficult to envisage such block contracts for all, or even the majority, of homes in which a local authority may wish to make placements.

- Another factor militating against the use of tendering is the large number of providers that must be successful. Local authorities now pay for 59% of care home residents nationally while the NHS pays for 10%. In order to give themselves access to sufficient capacity, therefore, local authorities typically need to have purchasing arrangements in place with the bulk of care homes operating within their localities. In larger social services authorities, this amounts to several hundred homes. Properly managed tendering processes would have high transaction costs. Moreover, it would be difficult to sustain a genuinely competitive process when there are many legitimate ways in which local care homes could act in concert.

For these reasons, it is likely that 'spot' purchase using baseline fee rates will remain the dominant mode of care home commissioning in the future. Even where the tender route is chosen, care commissioners would still find it useful to have robust information on care home cost structures.

There is a further problem with tendering, which relates to the current structure of the market for care services. First, the market is 'imperfect', in the sense that most local authority purchasers occupy a dominant position *vis-â-vis* providers. Second, the physical environment of most care homes is 'substandard' in the sense that they fall short of the physical environment standards for 'new' homes first registered since April 2002, as defined in *Care homes for older people* (DH, 2003). Many also fall short of the less demanding physical environment standards set by NMS for existing homes when the Care Standards Act was implemented in April 2002 – which the government shortly afterwards downgraded to 'aspirational' only, in response to fears of a catastrophic shake-out of non-compliant homes. With any degree of excess capacity at all in such a market, a tendering process is bound to generate fee levels that reflect the cost structure of physically 'substandard' homes, and which are inadequate to support continuing investment in facilities meeting modern standards.

Local rather than national baseline costs/fees

The case for local rather than national baseline costs and fees is easy to state. Pay rates and land prices are two principal determinants of care home costs and they vary significantly from authority to authority. There can be wide variations between neighbouring authorities in London and other metropolitan areas. There are also many individual social services authorities where cost variances within boundaries are sufficient to justify banding of fee rates by district.

Prior to April 1993, nearly all state-funded placements were funded by Income Support, with a single set of national fee limits other than a weighting for Greater London. With national limits set in line with the lower end of the fee distribution, this gave rise to major inequities (Laing, 2000). Care home residents and their families in more expensive areas of England typically had to top up their Income Support funding and were often severely financially disadvantaged compared with those in less expensive areas of England. A significant achievement of the 1993 community reforms was to eradicate these inequities. Local authorities that took over funding responsibilities assumed at that time an obligation to pay the full costs of care and consequently set baseline fee rates that better reflected local care market conditions.

It would be a retrograde step to revert to a system in which central government set national fee rates, which would be bound to be too high in some areas and too low in others. The framework for care commissioning that was set up in 1993 is a fundamentally sound one, in which individual, budget-capped local authorities seek to obtain best value in the light of local market conditions. The way forward is to address whatever problems have emerged within this local commissioning framework.

3 Method for calculating reasonable costs

Cost of care home services

The method builds up total costs from its component parts. The four principal care home cost categories are:

- staffing;
- repairs and maintenance;
- other non-staffing current costs; and
- capital costs.

These costs are calculated in the associated toolkit spreadsheet. Because capital costs have been assessed to incorporate a reasonable return for investors – including profit – 'fair market fees' are identical to the sum of the four cost items above.

Conceptual framework

We have interpreted the cost of supplying nursing and personal care services as being the 'reasonable cost' that a typical, *efficient* care home operator would expect to incur. It is important to note that the 'reasonable cost' so defined differs in principle from average costs incurred across all operators, since averages include the costs of *inefficient* operators as well.

We have specifically rejected the option of estimating 'reasonable cost' on the basis of simple averages of costs incurred by all operators, on the grounds that councils would not wish to pay for inefficient modes of operation on a cost-plus basis – unless they were specifically to decide to do so for service quality reasons, or some other overriding reason.

A relatively non-contentious illustration of this principle of *efficient operator costs i*s scale economies in the operation of nursing homes for frail older people . Staff requirements per bed vary significantly and it seems reasonable to base benchmark costs on an efficient scale of operation – say 50 plus beds – rather than (say) a scale of operation of less than 10 beds, which is wholly uneconomic in terms of staffing costs.

Terms and conditions of employment represent a much more contentious illustration. Local authority in-house providers, voluntary organisations and private operators subject to Transfer of Undertakings (Protection of Employment) Regulations (TUPE) arrangements typically offer staff higher remuneration (better basic pay rates, bigger enhancements for unsocial hours and more generous additional benefits such as pension contributions) than do other private sector care home operators. It may further be argued that even the higher pay currently offered by councils and voluntary organisations is inadequate to bring about the creation of a more qualified and professionalised social care workforce, as widely advocated. The choice of which pay rates to enter has a major impact on the 'fair market price' that is calculated by the toolkit spreadsheet, and indeed raises the question of 'fair to whom?' – investors in care homes or staff? For the purposes of this report we have opted to enter pay benchmarks in the spreadsheet toolkit that specifically reflect 'more efficient' private sector costs. These benchmarks may, however, be modified in the spreadsheet and the effect of such modifications analysed. It will become apparent that the cost of ensuring a 'fair price' to care home investors at the same time as 'fair pay' (however defined) for staff could be very high.

4 Estimates of reasonable costs by category

Many of the costs of care home operation are dependent on occupancy levels. Nationally, occupancy rates reached a low of around 85% in 1997, at a time when there was considerable overcapacity in the market. With the decline in capacity since then, occupancy rates have now recovered to about 90%. This average masks wide variations, with almost a half of care homes running at 95% plus at any one time and about a tenth running at below 75%. A sustainable long-term average occupancy rate in the care home sector is believed to be around 90%.

An ***occupancy rate*** of 90% for 'efficient' homes is assumed in the toolkit spreadsheet. This may be varied if required.

Staffing costs

Staffing is the largest cost item for care homes, typically absorbing 50-60% or more of fees at present. Staffing costs are the product of:

- pay rates and on-costs per hour; and
- staff hours.

Staff turnover costs

No specific allowance is made in the toolkit spreadsheet for the cost of staff turnover. Many operators argue, however, that staff turnover is unusually elevated in the care home sector because of low pay and minimal employee benefits resulting from the financial constraints to which care homes are subject. Staff turnover costs may be incurred under a number of different heads. The largest contribution is likely to result from induction training, where the presence of paid trainees does not count towards the staffing levels required by regulators. Should users wish to make an additional allowance for the cost of staff turnover, it is best done by modifying the training backfill percentage allowance in the toolkit spreadsheet (see 'Training backfill', p 28).

Unskilled staff turnover results from competition for unqualified staff from all sectors of the economy, including retail (for example, supermarkets). The NHS and local authorities are the most important competitors for skilled and qualified staff. Competition from these public sector bodies has increased as care homes have progressed towards the national minimum standard that 50% of care staff (excluding nurses) should have NVQ2 qualifications or above, since on gaining their qualification such staff may become potential recruits for the NHS.

Table 2 illustrates how pay rates in the care home sector have fallen significantly below the NHS by comparing 2008 care home pay rates for provincial locations, drawn from Laing & Buisson survey results, with pay bands from November 2007 in Agenda for Change, the new pay and grading system for the NHS. The pay advantage of the NHS is in fact substantially greater than the headline figures suggest, since NHS holiday and sick pay entitlements and pension arrangements are substantially more generous. Pay and conditions offered by local authority residential and home care providers are also more generous than those afforded by the private care home sector.

The gap in pay and conditions between care homes and other sectors for similarly skilled jobs is likely to remain a potent factor leading to staff turnover in the future, until such time as it becomes affordable for care homes to equalise pay.

Pay rates

Pay and on-costs per hour are best derived from actual local pay rates, as revealed by surveys of local care providers. The advantages of such an approach are:

Table 2: Comparative hourly pay rates for certain job types, care homes and NHS Agenda for Change pay bands, provincial location

	Private sector care homes 2008	**NHS Agenda for Change Pay Bands[1] from 1 November 2007**	
	£ per hour (illustrative)[2]	**£ per hour equivalent[3]**	**£ per annum**
Domestic, catering or laundry assistant	£5.82	£7.25-£7.89	BAND 1: £12,182-£13,253
Healthcare assistant (assumed to be NVQ2 or equivalent)	£6.07	£7.49-£9.24	BAND 2: £12,577-£15,523
Nurse (qualified)	£11.12	£11.71-£15.13	BAND 5: £19,683-£25,424

Notes:

[1] Before additions for unsocial hours, high cost areas and recruitment and retention premia.

[2] Toolkit spreadsheet rate for Monday to Friday daytime, based on Laing & Buisson surveys of homes outside London.

[3] Based on an average of 224 working days per year @ 7.5 hours per day.

Source: Laing & Buisson surveys for private sector care homes; NHS Agenda for Change

- it takes account of local labour market variations;
- it provides a clear focus for debate on what reasonable pay rates are.

The pay rates and on-costs entered into the toolkit spreadsheet have been derived from responses to an annual survey of care homes carried out by Laing & Buisson in the spring of each year, the latest being spring 2008. They are representative of the ***'Provincial location'*** illustrated in Table 1 (p 6). Pay rates for the ***'London'*** illustration in Table 1 are also derived from the Laing & Buisson survey.

Care home staff fall into the following categories, for each of which hourly pay or salary rates and on-costs have been collected:

- care staff, comprising qualified nursing staff, senior carers and care assistants, including activities coordinators;
- supernumerary management, administration and reception staff;
- domestic staff (cleaning, laundry and catering staff – excluding chefs/cooks);
- chefs/cooks.

Maintenance and gardening are assumed to be provided under contract and are included in the 'other non-staffing current costs' category.

Staff hours

The most practical approach to estimating staff hours is by determining benchmarks for *staff hours prpw* in typical, *efficient* homes catering for each of the client groups. The advantages of such an approach are:

- simplicity, compared with the alternative of using staff/resident ratio benchmarks, which vary according to the time of day;
- each of the major care homes that was asked for staffing data for this report was able to provide the data in terms of hprpw;
- staff hours prpw benchmarks can be selected deliberately to exclude inefficient modes of operation;
- a limited number of benchmarks helps to focus debate on key parameters, which can then be flexed in the toolkit spreadsheet to illustrate the impact of modifying them;

- the National Care Standards Commission (NCSC), which was responsible for care home regulation between April 2002 and April 2004, stated its intention (never fulfilled) to set care staffing requirements in terms of hours prpw. It is likely that any recommendations on staffing that emerge from the care home regulator in the future will be couched in terms of hours prpw.

Most councils' standard contracts with care homes do not themselves specify staffing requirements. Rather, social services commissioners usually adopt whatever are the regulatory body's (that is, CSCI's) staffing requirements for the time being as appropriate for its contracts with care home operators.

No national staffing guidelines have yet been promulgated, except for those proposed for personal care only in *Care staffing in homes for older people* (Residential Forum, 2002), and these (as yet) apply only to new homes and homes that have varied their registration since April 2002. The Residential Forum document proposed a range of 16 (low dependency) to 20 (high dependency) care assistant hours prpw for frail older people , plus a formula for a (small) number of staff hours for leisure, social and cultural activities. The document also proposed a formula for calculating staff 'overheads'. Initially, these benchmarks were to apply only to new homes, and to homes seeking a variation in registration. As regards staffing requirements for 'existing' (pre-April 2002) homes, which comprise the vast majority, the Department of Health has indicated that for the time being the staffing requirements of the now defunct (since 2002) health and local authority inspection units will continue to apply and care homes have been instructed not to reduce their staffing levels from those agreed prior to April 2002. The review of the NMS and associated care home regulations that has been ongoing since 2004 may in due course make further recommendations on staffing levels. Completion of this review is not expected until the merger of CSCI with the Healthcare Commission has been achieved in 2009.

It is important to emphasise that care staffing is the single most important determinant of care home costs. Should CSCI, therefore, adopt benchmarks that are significantly different from those described below, it would be necessary to recalculate 'reasonable costs' and adjust 'fair market fees' accordingly.

Nursing homes

Care staff

For the 2004 edition of this report, care staffing benchmarks were derived from:

- inspection of written minimum requirements of several former health authority inspection units and discussion with local NCSC regulators of how the requirements are interpreted in practice;

- care staff hours reported by care homes responding to Laing & Buisson surveys;

- national, corporate operator benchmarks, derived from detailed information provided by several major care home groups in late 2003 and early 2004.

The staff benchmarks provided by corporate operators were given the greatest weight. They are likely to be more reliable than other sources and their portfolios consist almost exclusively of larger-scale (staffing-efficient) homes. Moreover, the figures provided by different groups were broadly consistent.

For this new edition of the report, updated information for 2008 was obtained from seven of the largest care home providers in the UK with a combined 20% share of the care home market for frail older people and older people with dementia. Again, there was a high degree of consistency in the data they provided.

A key conclusion from corporate responses is that while qualified nurse input appears not to have changed, non-qualified care staffing input has increased to a small but significant degree between 2004 and 2008, from an average of 19.5 to 20.5 hours prpw. This is consistent with anecdotal evidence from the sector that residents' dependency levels have increased.

A further key conclusion is that there is still no consistent evidence of any significant inherent difference in the number of care hours prpw

for nursing care of frail older people as against people with dementia – other than variations in dependency levels, which might be just as great among nursing homes catering for frail older clients only as between frail older and dementia clients. All of the corporate care home operators who provided information to Laing & Buisson agreed that qualified nursing care staff input was similar for both client groups while some, although not all, reported that care assistant staffing input was between one and one-and-a-half hours prpw higher for dementia than for frail elderly care. The cost differential of less than £10 per week, for some operators only, was considered insufficient to justify the separation of dementia nursing care from frail elderly nursing care in the toolkit spreadsheet.

In the toolkit spreadsheet, benchmarks of 7.5 and 20.5 hours prpw have been entered for ***nursing*** and ***other care staff*** respectively for nursing care of both frail older people and older people with dementia, making a total of 28.5 care hours prpw. These norms should be kept under continuing review and amended in the toolkit spreadsheet as necessary in the light of any further guidance on staffing inputs that may emerge from the care home regulator.

It should be noted that staff input outside the corporate care home sector is highly variable and smaller-scale homes may bear much higher staffing costs. In the absence of any clear relationship between small scale and quality, however, there is no case for councils to fund such higher costs.

Catering, cleaning and laundry staff

A figure of six hours prpw for catering, cleaning and laundry staff was proposed as a minimum standard by the Centre for Policy on Ageing in the first draft of the National Care Standards in 2000, although this was subsequently rejected by the government as being too prescriptive. Generally, regulatory authorities do not set any minimum number of hours. Rather, they couch requirements in non-quantitative terms such as 'sufficient' or 'adequate'.

The same benchmark of six hours prpw was used in the 2002 edition of this report and the benchmark was confirmed as accurate by several corporate operators during 2003 and 2004, although some considered that it errs, if anything, on the generous side. Corporate operators confirmed that the benchmark of six hours prpw does not vary by registration type (nursing or personal care) or by client type (frail older people or older people with dementia).

Corporate operators confirmed in 2008 that the six hours prpw benchmark remains valid, although there was significant variation in the share allocated to chefs/cooks on the one hand, and catering, cleaning and laundry staff on the other. The former group enjoys significantly higher pay rates than the latter.

In the toolkit spreadsheet, benchmarks of 1.5 hours prpw and 4.5 hours prpw have been entered for ***chefs/cooks*** and other ***domestic staff*** respectively. These norms should be kept under continuing review and amended in the toolkit spreadsheet as necessary.

Supernumerary management, administration and reception staff

See 'Management, administrative and reception staff', p 26.

Care homes offering personal care only

Care staff

Care staffing benchmarks for personal care have been derived from sources similar to those for nursing care (see 'Care staff', p 21). In the 2002 report, a benchmark of 16 care staff hours prpw was used for frail older clients. No specific care staff benchmark was proposed for personal care of people with dementia, although it was noted that some inspection and registration units had specified higher minimum inputs than for frail older clients; many local authorities pay higher fee rates for dementia; and care staffing levels reported by respondents to Laing & Buisson surveys are typically higher for homes offering personal care to people with dementia than for those catering for frail older people. This contrasts with nursing care, where there is no consistent evidence that staffing is higher for people with dementia than for frail older people.

The review of benchmarks in 2003 and 2004 found no evidence of material change since 2002, and the reasonableness of the 16 hours prpw minimum was broadly confirmed by the minimum staffing levels published by the Residential Forum (2002) (Table 3). The Residential Forum levels are now part of the NMS for homes newly registered since April 2002, although not for pre-existing homes, which generally operate to less demanding standards.

While not obligatory for existing homes, the Residential Forum benchmarks have to date provided a useful indicator of the additional care staff input (four hours prpw) that may be reasonable to allow for higher dependency clients such as people with dementia.

For this new edition of the 'fair market price' report, updated information relating to 2008 was obtained from five of the largest care home providers in the UK with a combined 20% share of the care home market for frail older people and older people with dementia. A key conclusion from these corporate responses is that care staffing input has increased significantly between 2004 and 2008 and that the 16 hours prpw minimum benchmark is no longer valid. This is consistent with anecdotal evidence from the sector that residents' dependency levels have increased.

Based on corporate providers' staffing levels, a benchmark of 18.5 ***care hours*** prpw has been entered into the toolkit spreadsheet for personal care of frail older clients and a benchmark of 22 ***care hours*** prpw has been entered for personal care of clients with dementia. These norms should be kept under continuing review and amended in the toolkit spreadsheet as necessary in the light of any further guidance on staffing inputs that may emerge from the care home regulator.

It should be noted that smaller-scale homes may bear much higher staffing costs. In the absence of any clear relationship between small scale and quality, however, there is no case for councils to fund such higher costs.

Catering, cleaning and laundry staff

Benchmarks of 1.5 hours prpw and 4.5 hours prpw have been entered for chefs/cooks and other domestic staff respectively, for homes offering personal care only, whether for frail older people or older people with dementia – that is, the same as for nursing care (see 'Nursing homes', p 21).

Supernumerary management, administration and reception staff

See 'Management, administrative and reception staff', p 26.

Staff pay rates and on-costs

Surveys carried out by Laing & Buisson consistently show that voluntary sector operators pay higher hourly wage rates than private sector providers to both care and domestic staff. The differential is compounded by higher voluntary sector on-costs in the form of holiday and sick pay and pension

Table 3: Residential Forum minimum staffing levels for new (first registered after April 2002) homes offering personal care in England

	Hours prpw		
A: Basic care hours			
Low dependency	16		
Medium dependency	18		
High dependency	20		
Plus:			
Social, recreation and cultural hours	15 hours/home +1% of A		
Difficulties in providing care	5% of A		
Non-care duties	10% of A		
	Dependency		
	Low	Medium	High
Total for typical 30-bed home (no difficulties in providing care)	18.3	20.5	22.7

Source: Residential Forum (2002)

contributions (see 'On-costs for hourly paid staff', p 25).

Voluntary sector homes may have more scope to pay higher wages than private sector homes because they have other sources of capital and current funding not accessible to private homes. Whatever the reason, councils will have to take a view on whether they wish in principle to fund pay rates at the level of a typical voluntary sector provider.

For the purposes of this report, and in line with the principle that council fee rates should aim to cover the costs of *efficient* operators only, it is recommended that voluntary sector pay rates be disregarded, and that only private sector pay rates be used to calculate the reasonable costs of care. All of the pay rates set out below are based on data provided by private sector homes only.

Nurse pay rates

Weighted average nurse pay rates have been calculated from responses to Laing & Buisson surveys, the latest being in spring 2008 (see model survey form in Appendix 1, p 46). These surveys collect differential pay rates for weekday, night time, weekend and bank holiday working. Premiums are typically not paid for evening/weekend working by nurses, although care homes do frequently pay a substantial premium for bank holiday working, in some cases double time.

Laing & Buisson's 2008 survey found a weighted average hourly pay rate for nurses in provincial locations of £11.45 per hour.

Average nurse pay rates in previous editions of this report were calculated as a weighted average of level 1 (registered) and level 2 (enrolled) nurses. Corporate care home operators, however, report that the distinction is now outdated and effectively all nurses employed by care homes are level 1.

For the provincial locality illustration (see Table 1 , p 6) ***weighted average nurse pay*** rates are calculated within the toolkit spreadsheet at £11.45 per hour.

For any given locality, these illustrative pay *rates* should be superseded by comparable ***local*** pay rates. There are two ways of doing this – a long way and a short way. Ideally (the long way) a local pay survey should be carried out using the model survey form provided in Appendix 1. From the results, the full range of ***shift-specific pay rates*** can then be entered into the toolkit spreadsheet. The toolkit spreadsheet will then automatically calculate the weighted average nurse pay rate through a formula. Alternatively (the short way) a single, composite hourly rate for nurse pay may be estimated on the basis of the best available local information and entered directly into the ***composite nurse pay rate cell*** in the toolkit spreadsheet, overwriting the formula.

Care assistant pay rates

Weighted average care staff pay rates have similarly been calculated from Laing & Buisson pay surveys, the latest being in spring 2008 (see model survey form in Appendix 1, p 46). As with nurses, pay premiums for care assistants are typically not paid for evening/weekend working (except in London), although care homes do frequently pay a substantial premium for bank holiday working, in some cases double time.

Laing & Buisson's spring 2008 survey found a weighted average hourly pay rate of £6.07 for care assistants with no qualifications, compared with the adult National Minimum Wage (NMW) at that time of £5.52. The survey found an average premium of about 20 pence per hour for NVQ2 qualified care assistants and a further premium of about 70 pence per hour for staff classified as senior carers. Based on survey data and industry sources, it is estimated that about 50% of carer hours (excluding qualified nurse hours) were filled by those with NVQ2 qualifications or higher.

Laing & Buisson surveys have found no significant difference in care assistant pay rates between homes offering nursing or personal care or between homes catering for frail older people or people with dementia.

Based on Laing & Buisson survey responses in 2008, the proportion of care hours filled by staff with ***NVQ level 2*** or above (excluding qualified nursing staff) has been entered into the toolkit spreadsheet at 50%. This parameter should be superseded by local data, where available. The percentage may increase over time. All care homes in England were expected to meet a NMS

of 50% by 2005, although the standard was reported not to have been met at that time.

On the basis of information collected from major care home operators in 2008, the proportion of non-nurse care hours filled by staff designated as ***senior carers*** has been entered into the toolkit spreadsheet at 10% for nursing care and 25% for personal care. This has replaced the combined average of 15% in the 2004 report. All senior carers are assumed to have NVQ level 2 or above.

For the provincial locality illustration (see Table 1, p 6), weighted average pay rates for 2008 are calculated within the toolkit spreadsheet at £6.07 per hour for ***care assistants with no qualifications***, £6.24 per hour for ***care assistants with NVQ level 2*** and above and £6.95 for ***senior carers***, giving a composite private sector weighted average of £6.23 per hour for all (non-nurse) care staff in the case of nursing care and £6.33 for all care staff in the case of personal care.

For any given locality, these illustrative pay rates should be superseded by comparable *local* pay rates. There are two ways of doing this – a long way and a short way. Ideally (the long way) a local pay survey should be carried out using the model survey form provided in Appendix 1. From the results, the full range of ***shift-specific pay rates*** can then be entered into the toolkit spreadsheet for each of the three classes of (non-nurse) care staff: care assistants without NVQ2; care assistants with NVQ2; and senior carers. The toolkit spreadsheet will then automatically calculate the composite care staff pay rates through a formula. Alternatively (the short way) a single, composite hourly rate for (non-nurse) care staff pay may be estimated on the basis of the best available local information and entered directly into the ***composite (non-nurse) care staff pay rate cells*** in the toolkit spreadsheet, overwriting the formula.

Domestic and catering staff

Weighted average domestic and catering staff pay rates have similarly been calculated from Laing & Buisson pay surveys, the latest being in spring 2008.

For the provincial locality illustration (see Table 1, p 6), the weighted average hourly pay rate is calculated within the toolkit spreadsheet at £5.94 per hour for ***cleaning, laundry and catering staff (excluding chefs/cooks)*** and £6.93 per hour for ***chefs/cooks***.

For any given locality, these illustrative pay rates should be superseded by comparable *local* pay rates. There are two ways of doing this – a long way and a short way. Ideally (the long way) a local pay survey should be carried out using the model survey form provided in Appendix 1. From the results, the full range of ***shift-specific pay rates*** can then be entered into the toolkit spreadsheet for ***chefs/cooks*** and ***other domestic staff***. Alternatively (the short way) a single, composite hourly rate for (non-nurse) care staff pay may be estimated on the basis of the best available local information and entered directly into the ***composite chef/cook pay rate cell*** and the ***composite other domestic staff pay rate cell*** in the toolkit spreadsheet, overwriting the formulae.

On-costs for hourly paid staff

There are four types of employee on-cost borne by care home operators:

Working Time Regulations

Under the Working Time Regulations (WTR), full-time and part-time staff have been entitled to 24 days holiday, including bank holidays, since October 2007 (previously 20 days). From April 2009 the minimum entitlement will be raised to 28 days including bank holidays. The norm within the private care home sector has for many years been to offer staff minimum holiday entitlements only. However, some large care home operators report that they intend to accelerate the 28-day entitlement and offer it within financial year 2008/09 instead of waiting until April 2009.

A WTR paid holiday on-cost of 12.0% (that is, the forthcoming statutory minimum) has been entered into the toolkit spreadsheet for both

nurses and ***care, catering and domestic staff***. This represents a significant upward revision on the 8.3% (statutory minimum) entered in the 2004 report.

Employers' National Insurance (NI)

Employers pay NI contributions of 12.8% of pay above the NI threshold. Because some care home employees work part time, they do not reach the threshold. As a result, average NI paid by employers is on average below 12.8% of the payroll.

Based on data provided by major corporate operators in 2008, NI on-costs of 9.0% for ***nurses*** and 8.0% for ***care, catering and domestic staff*** have been entered into the toolkit spreadsheet, the same as in 2004.

Sick Pay

According to information received in 2008 from both major corporate operators and Laing & Buisson's broader-based spring survey, the norm among private care homes is to pay no more than Statutory Sick Pay (SSP) to hourly paid staff. SSP rules are complex, but major corporate groups estimate that SSP adds 2% to their hourly paid wage bill.

Based on almost universal private sector practice, an SSP on-cost of 2% has been entered into the toolkit spreadsheet for both ***nurses*** and ***care, catering and domestic staff***.

Employers' pension contributions

According to information received in 2008 from both major corporate operators and Laing & Buisson's broader-based spring survey, the norm among private care homes is to do no more than offer stakeholder pension arrangements as required by law, with no employers' contributions, to hourly paid nursing, care assistant and domestic staff. Such pension contributions that private care home providers offer are restricted to management and administrative staff (see 'Management, administrative and reception staff' below). Major corporate operators report that they would prefer to be able to offer pension contributions in line with employers in other sectors, but cannot do so because of financial constraints. Most voluntary sector care home operators, on the other hand, do make employers' pension contributions.

Based on almost universal private sector practice, a zero employer's pension contribution on-cost has been entered into the toolkit spreadsheet for both ***nurses*** and ***care, catering and domestic staff***.

This cost item will, however, need to be kept under review. The 2007 Pensions Bill was progressing through Parliament as this report went to press. If its provisions become law, employees will automatically be enrolled in a pension scheme (unless they expressly opt out) and employers will be legally obliged to contribute at least 3% of each employee's earnings (within a band). The additional cost at 2008/09 pay rates would be £7.74 per resident per week for nursing care, £4.74 for personal care of frail older people and £5.42 for personal care of older people with dementia.

Management, administrative and reception staff

This is an element of cost where there are economies of both small scale and large scale. For very small homes, no management costs may appear in the home's accounts. A management cost may be imputed, however, and this may be reflected in a higher return on capital norm for smaller owner-managed homes (see 'Small owner manager', p 32). The accounts of medium- and larger-scale homes run by owner/managers may also have no specific management costs allocated. Again, a management cost may be imputed, and the normal practice of valuers is to deduct a reasonable estimate of management costs from profits when calculating the value of such a home as a multiple of profits.

In fact, the great majority of homes responding to Laing & Buisson 'fair market price' surveys in different localities in England state that they employ a manager, whose costs must be spread across all residents. In line with the principle that councils should only pay for *efficient* modes of delivery, it is clear that the management cost allowance should be based on larger-scale homes, although

the choice of exactly what scale is ultimately arbitrary. Laing & Buisson's most recent survey of care home costs in spring 2008 found that the average manager's salary for a larger-scale (50 place plus) care home outside London was £37,000 per annum. The figure was broadly confirmed by separate information provided by the major corporate groups in 2008.

Based on £37,000 per annum spread over 50 residents, a ***manager's salary*** cost of £16 prpw before on-costs has been entered into the toolkit spreadsheet.

Other management costs include administrative, accounts and reception functions at the individual home level, as well as deputising for the home manager. The way in which homes are staffed to cover these functions varies widely. Some homes employ a deputy manager, some of whose time may be spent providing 'rostered' care. Others do not. Some homes employ a receptionist, while others do not.

Corporate care home operators are the most reliable source of information on these other management costs in an efficiently run home. Typically, corporate operators centralise some of the functions such as accounts, sales ledger, purchase ledger, payroll, legal and commercial, human resources, estates management, IT and marketing. If such essential functions are allocated back to the care home level, and added to the costs still incurred at home level, a figure of approximately £15 prpw is reached. It should be noted that this excludes group head and regional office overheads, which would not normally be incurred by a standalone care home operator, and which can be regarded as group portfolio management costs for which no allowance should be made in the fair market price model (see 'Group overheads' p 28). One of the major corporate operators estimated in 2008 that all 'back office' functions combined, whether carried out at home, regional or head office level, amounted to £25 prpw.

Based on major corporate group norms, a further £15 prpw before on-costs for ***other management, administrative and reception staff pay*** has been entered into the toolkit spreadsheet.

An on-cost allowance of 30% for all ***management, administrative and reception staff*** has been entered into the toolkit spreadsheet, to allow for enhanced benefits, particularly pension contributions, over and above those available to hourly paid staff, plus bonuses. The allowance, similar to that used in 2004, was confirmed as reasonable by major corporate providers in 2008.

Agency staff

Agency usage is very variable. According to Laing & Buisson surveys, the majority of care homes do not use any agency staff at all in any one week, but a small minority may fill a large proportion of their shifts, 20% or even more, with agency staff and this can have a major impact on overall costs. Some corporate operators' agency usage in the past is believed to have been in the order of 5% of staff hours or more, but both care home and staff agency sources indicate that usage has declined in recent years as care home groups have sought to contain those significant cost items that are amenable to management control. Agency usage is largely restricted to nurses and other care staff. Use of domestic agency staff appears to be minimal.

The question is, what level of agency usage, if any, should be allowed for in a typical *efficient* home? The 2002 report argued the case for allowing nothing at all, for two reasons:

- First, the norm is zero agency usage, in the sense that most homes do not use agency staff, or if they do, only occasionally; and the minority of homes that rely heavily on agency staff may do so for reasons that do not in principle justify reimbursement by councils. For example, heavy agency use may arise from poor management or from inappropriate location.

- Second, agency usage is one response to an inability to fill shifts from employed or bank staff. Another response is not to fill the shift and possibly seek an exception to the home's staffing notice from the regulatory body. When the 2002 report was written, information

available to Laing & Buisson showed that care home groups often paid fewer staff hours than they budgeted for and the savings were broadly similar to the excess costs from agency usage. This was a major factor in the decision not to make any allowance for agency staff costs.

A significant change arising from implementation of the Care Standards Act in April 2002, however, called for a review of the original approach in the 2004 report. Since April 2002 it has become potentially a criminal offence for care home managers to breach NMS, for which managers may be in danger of losing their registration and their ability to continue to work in the industry. Under these new conditions, unforeseen staff absences are less likely to remain unfilled and more likely to result in agency usage. This remains the case today, and on the balance of evidence this 2008 edition of the 'fair market price' report uses the same, revised agency allowance as that used in the 2004 edition.

An agency usage allowance of 2.5% of ***nurse shifts*** and 1.5% of ***care assistant shifts*** has been entered into the toolkit spreadsheet.

The benchmark of 1.5-2.5% is intended to represent a reasonable level of agency usage across an efficient portfolio of homes, in order to provide the flexibility to ensure that resident care is not compromised even when unplanned absences occur at short notice. Some corporate care home groups have reported actual agency usage in 2008 at a higher level.

An 'agency premium' of 100% has been entered into the toolkit spreadsheet for both ***nurses*** and ***care assistants***, in line with national sector norms.

Training backfill

In line with English NMS, the backfill costs of a minimum of 3 days of paid training per employee need to be added to staffing costs. Other direct training and recruitment costs are incorporated in 'Other non-staff current costs' (p 29). Major corporate care home operators reported in 2008 that they would prefer to undertake more than the minimum supernumerary training, especially for nursing care, but were prevented from doing so by financial constraints.

A ***training backfill*** on-cost of 1.3% (3 days as a percentage of 233 working days in the year) has been added to staffing costs in the toolkit spreadsheet, amounting to £4 prpw.

Training costs may rise as a result of staff turnover. If local staff turnover is elevated for reasons that are beyond the control of care home operators, there may be a case for the training backfill on-cost percentage to be increased in the toolkit spreadsheet (see 'Staff turnover costs', p 19).

Group overheads

This category of expense, consisting of head office and regional office costs, is borne only by care home groups. It typically absorbs around 4-5% of fees for an efficiently run group. Conceptually these costs should be divided into two parts. The first element is those costs that relate to the administration of a group, and which would not be incurred by a standalone care home. These should be ignored for the purposes of estimating what fee rates councils should pay since such overheads are best regarded as portfolio management costs, which corporate investors are prepared to absorb within their gross rate of return (see 'Capital costs', p 29). Expressed in another way, there is no reason why corporate operators should receive a special allowance for employing staff and other resources to manage their portfolios, while independent operators do not. The second element of head and regional office costs, however, relates to essential functions, such as accounts, purchase and sales ledger, payroll and response to enquiries, which may have been transferred from home level to head or regional office level, which do need to be recognised for the purposes of estimating what fee rates councils should pay. Although conceptually different, the two elements of cost are difficult to disentangle. However, based on responses from major corporate operators in 2008, an estimate has been made of the costs that should be apportioned back to the home level, to arrive at an 'other management, administrative

and reception staff costs' figure of £15 prpw (see section 'Management, administrative and reception staff' p 26).

No allowance is made for group overheads in the toolkit spreadsheet.

Repairs and maintenance

This section revises the 2004 report format in the light of information received during the 2008 updating exercise.

Data collected from major corporate providers of care homes for frail older people and older people with dementia during 2008 indicate a UK average spend of about £900 per annum per bed on maintenance capital expenditure (large items that are spread over several years in accounts) and about £500 per annum per bed on repairs and maintenance (items that are expensed in full on the profit and loss account in a single year). There was significant variation between operators, and those with predominantly recently developed new build portfolio may experience somewhat lower expenditure. The benchmarks above were, however, confirmed as a reasonable average for an efficiently run, good-quality portfolio.

Since the cost head is relatively small, it is not essential to supersede this with local data in the toolkit spreadsheet. Should users wish to do so, however, regional variances in building costs can be obtained from the Royal Institution of Chartered Surveyors (RICS).

£19 prpw has been entered into the toolkit spreadsheet for ***maintenance capital expenditure***. To avoid double-counting, no allowance has been entered for the non-cash item of depreciation (see 'Depreciation', p 34).

£11 prpw has been entered into the toolkit spreadsheet for ***repairs and maintenance***.

Other non-staff current costs

Non-staff current costs are based on norms reflecting the experience of several major corporate providers of care homes for frail older people and older people with dementia, gathered during 2008. The two largest items are food and utilities. There is a range of smaller items, but not all corporate groups classify cost heads in the same way. Corporate norms provide the best available indication of the costs borne by larger-scale, efficient homes. Since these costs are relatively invariable throughout the country, there is no need to supersede them with local data.

One significant adjustment has been made to other non-staff current costs, however. The costs of food and utilities have been adjusted upwards to be gross of estimated discounts that major operators have been able to obtain from bulk purchasing. This is necessary because the 'fair market price' toolkit spreadsheet does not recognise group overhead costs. To be even-handed, therefore, the bulk discounts obtained by virtue of there being a group overhead structure in place should not be recognised either. Therefore, the food and utility costs entered into the toolkit spreadsheet have been adjusted to represent estimated costs for an efficient, larger-scale standalone care home without the benefit of group negotiated discounts.

In the toolkit spreadsheet, £79 prpw has been entered for ***non-staff current costs***, a significant rise over the £55 entered in the 2004 edition.

Within the overall figure, £23 is allowed for food and £22 for utilities, including power. In a volatile market, the utilities benchmark that has been used factors in expected price increases during 2008/09. Both food and power remain subject to strong inflationary pressures and these cost items will need to be kept under review in the toolkit spreadsheet.

As in previous editions, no cost allowance has been made for continence products, on the grounds that this is an NHS responsibility. It is recognised that this is a contentious point, and that while Primary Care Trusts are in principle responsible for funding continence products, not all of them in practice do so. However, the sums of money involved are relatively small.

Capital costs

An adequate return on capital for care home operators is the key to achieving a stable

independent sector of sufficient size and appropriate quality to meet the commissioning needs of councils and their NHS partners. On the assumption that new and/or replacement care home capacity *is* required (see Market background – fees,stability and investment, p 13), councils throughout the country need to set fee rates such as to (a) incentivise existing operators to continue to offer services and to upgrade their physical assets where they are below NMS for newly registered homes; (b) attract investment in new care home capacity to meet increasing underlying demand driven by the ageing population; and (c) compete with private payers and residents funded by other public sector agencies for available care home places.

It is desirable to have one simple formula for return on capital, which can be applied regardless of the capital structure of the home. To do otherwise would lead to a hopelessly complex requirement to understand the intricacies of different capital funding structures.

Target return on capital

The conclusion is that councils should ideally set 'spot purchase' fees at levels sufficient to offer providers a return on capital of 12%. This compares with the figure of 14% recommended within the 2004 report and 16% in the 2002 report. Long-term block contract commissioning offers scope for a lower target rate of return.

The background to the proposed 'spot' return of 12% is as follows, looking in turn at the main types of capital structure found in the for-profit sector, as well as the voluntary, not-for-profit sector.

Independent owners funded by a mixture of equity and debt

Despite the expansion of corporate operators, Laing & Buisson data show that some 52% of privately owned care home places nationally remained in the hands of independent (non-group) operators in 2007 (Laing & Buisson, 2007). The definition of a 'group' is any individual, partnership or company which operates three or more care homes. Care home groups, so defined, own the remaining 48%. Independent operators, therefore, remain the single largest source of care home supply.

During the 1990s and up until the time (2002) when the first edition of this report was published, good-quality individual care homes were bought and sold at a 'profit purchase' multiple of about 6-6.5 times sustainable Earnings Before Interest, Tax, Depreciation, Amortisation of goodwill and Rent (EBITDAR) at the level of the individual home (that is, excluding any corporate overheads). The next five years witnessed a continuing increase in EBITDAR multiples, which reached a peak towards the end of 2007 when the 'credit crunch' began to impact on the care home transactions market. In May 2008 Laing & Buisson sought advice from several major business transfer agents on EBITDAR multiples being achieved in the current market. The consensus was a multiple of 8.5 times sustainable EBITDAR for good-quality homes, which at least meet all the room size and single/sharing ratio standards incorporated in the NMS for existing older people's care homes introduced in April 2002, and subsequently relegated to 'aspirational' only.

The reason for the general rise in care home EBITDAR multiples over the last five to six years include:

- the continuation of a low interest rate environment;
- a perception among investors of better prospects for the care home sector, as occupancies have increased and as margins have improved since the troubled times at the turn of the century;
- a recognition among commercial property investors that care homes have become 'mainstream', which has led to an equalisation of expected yields for care home freehold investments on the one hand and commercial property generally on the other.

A 'profit purchase' multiple of 8.5 implies that purchasers are willing to invest in good-quality care homes in the expectation of a return of 12% (that is, the reciprocal of 8.5). It comes as close as possible to an objective, market-related norm for expected rate of return.

The return of 12% is a 'blended' rate. The owner (equity investor) seeks a much higher return on capital, about 25% or more, and usually achieves this by leveraging with bank finance. The gross return on capital of 25% plus sought by the equity investor compensates them for:

- the opportunity cost of not investing in alternative, non-risk securities such as gilts;
- risk;
- time and energy spent overseeing the business.

There are at present few if any areas of the country where it is possible to earn a blended 12% return on new developments for frail older residents or residents with dementia costing around £70,000 per bed including land costs (see p 34) from spot purchase fees on offer from local authorities. This is believed to be the major reason why few new care homes are currently being built for older clients who are state funded, despite shortages of supply in some areas.

Groups funded by a mixture of equity and debt

Care home groups operate in the same market as independent operators and the rates of return they seek are comparable.

Care home groups may derive their equity funding from private investors, including the group's principals, or from private equity and venture capital companies. Like independent operators, groups seek to leverage their equity with debt finance. The structure of debt and equity may be more complex, but the essential features are the same. Like independent operators, active corporate purchasers in the market at present are typically seeking to buy good-quality homes, at a multiple of about 8.5 times sustainable earnings at the home level. To the extent that purchase multiples stretch upwards, it may reflect a view that the operational efficiency of the target home(s) can be improved, or synergies such as savings on group overheads, or development opportunities and an expectation that sustainable profits are likely to grow over succeeding years.

Like independent operators, care home groups are rarely able to justify development of new care homes for a 'spot-purchased' state-funded clientele in the current climate, although they may be able to justify the addition of new capacity to existing care homes, where land costs are zero, and they may be able to develop entirely new care homes on the basis of block contracts.

Unlike independent operators, larger corporate groups must bear an additional cost in the form of head office and regional office overheads. These represent costs that would not be incurred by standalone homes or small groups with no corporate infrastructure. Typically, head and regional office costs absorb around 4-5% of gross fee income for an efficiently run group. Part of this represents essential functions such as accounts and response to enquiries that have been transferred from home to head office level. The remainder represents group overheads that would not be incurred at all by a standalone home and can be ignored by councils for the purposes of setting a fair market price for care. Such overheads should be viewed as portfolio management costs, which large-scale equity providers must absorb in order to get access to the care home market. Either they are prepared to operate on a lower blended return on capital than that available to independent owners (12%) or they expect to recoup at least part of the diminution in return from better financial engineering, higher leverage, lower interest rates from providers of debt or improvements in operational profitability. In these ways, venture capital companies can still realistically seek to achieve a return on their equity capital of 25% plus per annum.

Sale and leaseback

Sale and leaseback funding became a major driver of acquisition and development activity at the end of the 1990s, but it evaporated in the early months of 2000 with the withdrawal from new business of NHP plc and other sale and leaseback providers against a background of reduced margins and financial failures in the sector. Since then, sale and leaseback has re-emerged in the form of the 'Opco/Propco' model adopted by some corporate operators. In this model, a care home portfolio's freeholds are sold to a property company ('Propco',

which may or may not be at arm's length) to which the operating company ('Opco') pays rent. This has in the recent past been viewed as a model for maximising value for care home groups, although it has become less attractive since the 'credit crunch' since large amounts of bank debt have become more difficult and more expensive to obtain. Southern Cross Healthcare Group plc, the stock exchange company that is the UK's largest care home provider, is a pure 'Opco' business that aims to own none of the care homes that it operates. Its business model is to acquire smaller care home groups and as soon as practicable sell the freeholds to property investors. Because of the strength of its covenant it has been able by this means to recoup its entire acquisition costs from freehold sales, thus acquiring future cash flow for a zero consideration. Sale and leaseback is widely used in other sectors of the service economy, including hotels and pubs, and in one form or another is likely to remain a feature of the care home sector.

Publicly quoted companies

From a peak of 20 a decade ago, the number of UK publicly quoted operators of care homes for older people has fallen to just two with a full listing on the London Stock Exchange. One of these, however, Southern Cross Healthcare Group plc, is, as already mentioned, the UK's largest care home group. The other is Care UK, which differs from most care home groups in that it describes itself as a public sector outsourcing company and seeks long-term contract business from local authorities and the NHS across the acute and long-term sectors of healthcare. The two listed care home companies operate 8.5% of the UK's care homes for frail older people and older people with dementia.

The main motivation for seeking stock exchange quotations a decade ago was the personal enrichment of principals. The stock exchange initially placed a high valuation on what was viewed as an exciting new sector, but disenchantment soon set in with poor profit performance and share prices fell below net asset values. Currently, most commentators see little prospect for the foreseeable future of a resurgence of stock exchange-quoted care home groups, unless run as pure 'Opco' businesses like Southern Cross. This is because the stock market is generally not comfortable with gearing ratios of more than 50%, which would put stock market-listed care home companies with freeholds on their balance sheets at a disadvantage to private companies able to operate at much higher gearing ratios.

A listed 'Opco' company like Southern Cross needs to generate sufficient profit to pay its rent, its overheads and some level of dividends to shareholders. With a market share of only 8.5%, however, the financial viability of this model is less central to councils' fee setting than the financial viability of privately owned groups or standalone homes. We have not, therefore, attempted specifically to analyse whether and to what extent the two types of capital structure differ from each other in terms of return on capital requirements.

Small owner manager

Small, owner-managed homes, up to say 10 beds, are the only exception in principle to the benchmark of a 12% return, or a profit purchase multiple of 8 on good-quality assets. This is because, at a very small scale of operation, business oversight is in practice inseparable from the home management and administration function. Valuers do not, therefore, typically impute a cost of management when calculating value. Rather, they allow a lower profit purchase multiple, say 6, for a small home meeting all standards, which implies a higher target blended rate of return of 17%. This difference, however, should in principle wash out in the allowances for management and return on capital.

Not-for-profit provider

There is no reason in principle why voluntary sector or not-for-profit providers should seek a lower rate of return on investment than for-profit providers. They may indeed be obliged under their charitable objects to seek the best return on their capital available for investment.

Based on the foregoing, a target rate of ***return on capital*** of 12% has been entered into the toolkit spreadsheet.

During the interviews carried out in 2008, representatives of one of the major corporate care

home groups argued that the target rate of return should be higher for nursing homes than for care homes offering personal care only, on the grounds of higher risk, citing:

(1) shorter length of stay and more volatile occupancy in nursing homes than in care homes offering personal care only;

(2) lower profit margins as a percentage of revenue, which mean that break-even occupancy is higher;

(3) more rigid staffing requirements, which mean less flexibility to save on staff costs when occupancy falls.

However, since the business transfer agency valuers consulted during 2008 did not report any variance in EBITDAR multiples between nursing and personal care homes, no distinction has been made between the target rate of return for the two in the toolkit spreadsheet.

Capital value of care homes

If commissioners are to attract investment in new care home capacity they will need to offer a reasonable rate of return (that is, 12% for spot purchase) on the costs of new development, made up from building/equipment costs and land costs.

Building and equipment costs

Once again, major corporate groups are the best source of information on benchmark costs for the development of new care home capacity. Benchmarks that emerged from interviews with senior managers of major groups in 2008 are as follows:

- A basic specification for a new-build care home catering primarily for state-funded clients, with a minimum single room space of 12m^2 plus en-suite facilities, would typically work out at 45m^2 per place including common parts.

- The benchmark for a 'premium' care home targeting private payers is 55 m^2 per place.

- Current (2008) turnkey build and equip costs, including professional fees, are about £1,200 per m^2 (towards the lower end of the range indicated by major groups).

- Build and equip costs are fairly constant throughout England.

- Additional equipment for nursing care (for administering medication by injection, pressure-relieving equipment, profile beds, respiration equipment) costs £500 per place.

A sum of £54,000 per bed has been entered into the toolkit spreadsheet as the ***capital cost of buildings and equipment*** for care homes meeting physical environment standards for 'new' homes first registered since April 2002, as defined in *Care homes for older people* (DH, 2003). This is equivalent to £60,000 per resident at 90% occupancy.

In the light of new information provided by major group operators in 2008, two additional costs have been added in the 2008 edition of this report.

A sum of £5,000 per bed in start-up losses for nursing homes has been entered into the toolkit spreadsheet, equivalent to £5,556 per resident, and a sum of £4,000 per bed for care homes only, equivalent to £4,444 per resident, on the assumption that break-even is reached within eight months of opening.

A sum of £500 per bed has been entered into the toolkit spreadsheet as the additional ***capital cost of nursing care equipment***, for nursing homes only.

The same building and equipment cost should in principle be allowed for *any* care home, whether new build or not, which meets the same standards. The rationale for this is that councils and their NHS partners must not only attract new capacity but also incentivise operators of existing stock to remain in operation and to upgrade facilities if necessary to meet the highest physical standards for which commissioners are willing to pay.

Land costs

Land price data from all areas of the country is collected by the HM Revenue & Customs and collated in *Property Market Report*, published twice yearly by the Estates Gazette. The latest issue for January 2008 reported the average price of small sites for residential development at £2.95 million per hectare in England and Wales, excluding London, based on sales data from late 2007. In view of the decline in property and land values since then, the illustrative land value outside London has been revised downwards in the toolkit spreadsheet to £2.75 million per hectare.

A minimum of three quarters of an acre is required for a 50-bed care home. On this basis, the land cost per care home bed and per resident can be calculated at three quarters of the cost per acre of suitable development land, divided by 50 and adjusted for occupancy.

For the provincial locality illustration (see Table 1 p 6), ***land costs*** of £2,750,000 per hectare, or £1,112,900 per acre, have been entered into the toolkit spreadsheet. This is equivalent to £16,694 per bed or £18,548 per resident at 90% occupancy, assuming a 12% return on capital. This is the single most highly variable parameter in the cost model. For any given locality, the illustrative land cost should be superseded by comparable *local* land costs. Costs in London and other high-priced areas throughout the country may be three times as high and sometimes much higher still.

Depreciation

The accountancy profession's standard is to depreciate buildings at 2% over 50 years. Equipment is depreciated over variable but much shorter time periods. Land is not depreciated.

There are sound accounting reasons for depreciating buildings, but in reality the value of buildings may rise over time and the effect of annual depreciation allowances are often reversed through periodic revaluations of property assets to create revaluation reserves.

From the perspective of local authority purchasers, making allowances for both deprecation and maintenance capital expenditure would be double counting.

In the toolkit spreadsheet, an allowance for ***maintenance capital expenditure*** has been entered (see'Repairs and maintenance' p 29). No allowance has been made for depreciation.

Capital cost adjustment factor and physical environment grading tool

Councils and their NHS partners should not pay physically substandard homes at the same rate as for physically good-quality homes. If they were to do so, they would find themselves paying fees to substandard care homes at a level that would generate super-profits for them. This is the reason for proposing a range (ceiling and floor) for fair market fees.

A proposed framework for calculating *capital cost adjustment factors* is described below. It is based on the following propositions:

- Councils should be prepared to pay the full cost of providing care of an acceptable standard in any home that meets the physical environment standards for 'new' homes first registered since April 2002, as defined in *Care homes for older people* (DH, 2003) – for example single rooms with a minimum of 12m^2 of usable space excluding en-suite facilities.

- Councils should not pay for standards higher than NMS.

- Councils should not pay fees that are likely to generate super-profits for care homes. (This proposition applies equally to homes that may be highly rated on 'soft' quality criteria but which have not invested in their physical environment up to post-April 2002 standards.)

- All homes should be expected to score highly on 'soft' quality criteria, most of which do not impose an additional cost burden on the home, and this should be viewed as a precondition for unlocking their capital cost entitlement as calculated through the capital cost adjustment factor.

- For homes that meet 'soft' quality standards, any fee rate differentials (for residents with

similar levels of need) should be based on the degree of compliance with physical environment standards, since physical environment is the principal source of additional cost burdens on the home for which local authorities should be prepared to pay.

- Any grading tool for measuring compliance with physical environment standards should be as objective and transparent as possible.

A major development that has taken place since 2004, which potentially renders the application of a capital cost adjustment factor simpler and more transparent, is the recent publication by CSCI of star ratings. This 2008 edition of the 'fair market price' report proposes that the quality hurdle for unlocking payment of benchmark capital costs should simply be the achievement of a 'good' or 'excellent' star rating from CSCI. For a discussion of the merits of this approach, see Box 2 (p 36).

In June 2008, a search of the CSCI website indicated that 80% of those care homes for frail older people and people with dementia that had a rating were rated 'good' or 'excellent'. Based on experience with other public sector performance indicators, it is likely that the 20% tail of homes with a 'poor' or 'adequate' star rating will diminish over time.

What is the upper end of the range of physical standards for which councils should be willing to pay? Ultimately, that is a matter for each democratically elected council. However, there must be a strong presumption that councils, which receive most of their funding from central government, should be prepared to pay a fee that fairly reflects the build/equip costs of any home in their locality that meets the physical environment standards for 'new' homes first registered since April 2002, as defined by the government in *Care homes for older people* (DH, 2003) (the NMS). In practice, this means the build/equip of a new-build home, estimated in 2008 at £60,000 per occupied place in the toolkit spreadsheet, plus £500 for additional nursing home equipment.

Build/equip costs for a home at the lower end of the acceptable physical quality range are more difficult to derive. Conceptually, they should reflect the current value of the historic bricks and mortar costs of providing capacity (usually by conversion) in homes that do not exceed the interim physical environment standards for 'existing' homes as defined in the NMS.[1] Measuring these costs or values objectively is more problematic. In the 2004 report a 'floor' build/equip cost was estimated, but it was recognised that the basis of the estimation was arbitrary. For the current report we propose a new approach, which is that all stakeholders, including local authorities and providers of care services, seek to develop a physical environment grading tool which is as objective and transparent as possible.

Such a grading tool would seek to grade care homes, or individual rooms within care homes, according to their compliance with the physical environment standards for 'new' homes first registered since April 2002, as defined in the NMS. Elements of this may be room size, en-suite facilities and communal areas, and the condition of the physical environment would need to be incorporated in the grading as well. Such a grading tool is in use within a number of local authorities in the North East of England, following a 'fair price' exercise carried out by Pricewaterhouse Coopers. While we make no comment on the details of the tool (which are not in the public domain) it shares common features to the grading tool proposed in this report.

For the purposes of illustration, it is proposed that the fair market price grading tool 'floor' should be 50% of the 'ceiling'. This leads to a maximum capital cost adjustment factor roughly in line with that proposed in the 2004 report. Ultimately, this percentage is arbitrary, but it is believed to roughly reflect the difference in investment between a new-build care home on the one hand and, on the other, one whose physical environment is on the borderline of acceptability to local authority care purchasers.

Box 2: What quality measures should trigger payment of fair market fees?

This report proposes that the quality hurdle for unlocking payment of benchmark capital costs should simply be the achievement of a 'good' or 'excellent' star rating from CSCI. While some providers, and commissioners as well, may have reservations about the fairness, consistency and scope of CSCI star ratings, there is a compelling logic in seeking to use them because:

- the regulatory process offers a very substantial existing resource, which it would be wasteful to duplicate;
- CSCI offers a mechanism, albeit not yet fully tested, for appealing against a star rating;
- the star rating process is relatively transparent – at least more so than some of the in-house processes set up by local authorities to determine individual care homes' eligibility for quality premiums to be added to baseline fees.

There are alternatives to the use of CSCI ratings as a quality trigger for payment of fair market fees. These include:

- the RDB star rating, a independent accreditation company that specialises in the assessment of care homes;
- individual local authority social services departments, many of which have devised their own in-house quality measures to support premium fee payments to qualifying homes. Some of these quality measures are briefly described in Laing & Buisson's annual survey of baseline fee rates paid by local authorities throughout the UK, published in the July 2008 issue of *Community Care Market News*.

The arguments against using quality rating schemes other than CSCI, however, are:

- There is a substantial additional cost to running quality rating schemes parallel to CSCI regulation.
- With a multiplicity of quality rating schemes, no single one may receive sufficient resources and focus from stakeholders to ensure that it is fair, consistent, transparent and responsive.

What this implies is that CSCI and other stakeholders should recognise that the star rating scheme has a potentially key de facto role in achieving a fair system for determining care home fee rates, and should work towards making it fully fit for that purpose. This is not a role that was necessarily envisaged when the decision to publish star ratings was taken, but there have already been early adopters, with some local authority quality rating schemes now using CSCI star ratings to act as a trigger for payment of quality premiums to care homes.

A specific objection to the proposal in the report may be the consignment of homes with an 'adequate' star rating to an orphan status, with no entitlement to fees calculated according to the ceiling rate less the capital cost adjustment factor. These homes are, however, in a minority – less than 20% at present – and they would have every incentive to improve their star ratings. Ideally, if stakeholders were committed to making the methodology work, it would be possible to request – or pay for – a new inspection once issues that led to an 'adequate'-only rating had been addressed.

A more fundamental objection may be that CSCI star ratings do not truly capture quality in terms of resident outcomes. However, star ratings have the merit of being operational and there is no reason in principle why they should not be capable of refinement as the evidence base improves.

The ***maximum capital cost adjustment factor*** is entered as £74-£76 prpw in the toolkit spreadsheet, being 50% of the benchmark build/equip cost of the £149-£153 prpw for those care homes meeting the NMS physical environment standards for homes built since 2002.

It is proposed that stakeholders, including local authorities and providers of care services, seek to develop a physical environment grading tool, which is as objective and transparent as possible, to determine the capital cost adjustment factor (between 0% and 50%) for individual homes/rooms.

There would be a significant cost associated with the application of a physical environment grading tool, and ensuring that the process continues to have the confidence of stakeholders. Such 'transaction' costs, although significant, should not be disproportionate in view of the very substantial sums of money being spent by councils on care services and the importance of ensuring that the market operates effectively. The proposed tool would be important in mitigating the cost consequences of any fair market price policy adopted by councils, it would hopefully be viewed as fair by providers and it would incentivise providers to invest in providing good quality.

The approach described above can best be viewed as a means of building on, and harmonising, the wide variety of quality premiums, or deductions for failing to meet quality criteria, that have been introduced by local authority social service departments in recent years. These include single room and en-suite premiums, premiums for achieving certain levels of NVQ qualifications among care staff, premiums based on alternative quality rating systems such as the independent accreditation scheme and those based on CSCI star ratings. The merit of a capital cost adjustment factor based on a physical environment grading tool, as proposed here, is that it would align higher/lower fees with higher/lower costs, which are in practice driven principally by the amount invested in the physical environment. At the same time, the 'ceiling' rates would only be available to those homes that achieve a 'good' or 'excellent' CSCI star rating, thus incentivising the achievement of quality in general.

In summary, the approach to setting 'ceiling' and 'floor' fair market fees proposed in this 2008 edition of the 'fair market price' report is that:

- Those care homes with a 'good' or 'excellent' star rating, which also meet the 2002 physical environment standards for new homes, should receive the 'ceiling' fair market rate as shown in the toolkit spreadsheet (see Table 1, p 6).

- Those care homes with a 'good' or 'excellent' star rating, but which do not meet the 2002 physical environment standards for new homes in full, should receive the 'ceiling' rate less the capital cost adjustment factor as determined by the physical environment grading tool.

- The (currently) 20% of homes with star ratings of 'poor' or 'adequate' will be 'orphaned' under this mechanism, and should be paid at the discretion of the local authority whatever amount best incentivises them to improve their star rating, or if they cannot improve, to exit the sector.

Summary of care home costs and fair fees

Tables 4 to 6 (pp 39-41) illustrate the reasonable costs incurred by efficient providers of nursing and personal care for frail older people and people with dementia in financial year 2008/09, and the corresponding range of fair market fee levels for purchasers. Two sets of illustrative figures are given for each client group, reflecting two types of location at opposite ends of the range of wage costs and land prices: (a) provincial location and (b) London.

These are illustrative figures only. In order for commissioners to estimate reasonable costs and fair fees in their own areas, it is essential that they substitute *local* wage rates and land prices in the toolkit spreadsheet and if necessary adjust the *nurse* and *care assistant hours prpw* benchmarks to reflect their own service specifications and/or the requirements of local regulators.

In each of the illustrative cases in Tables 4 to 6, a range of fair fees is identified. At the higher end of the range is the fair fee appropriate to a care home that has invested in providing a physical environment that meets national minimum standards for 'new' homes first registered after April 2002 – and which is also graded as 'good' or 'excellent' by CSCI (see 'Capital cost adjustment factor and physical environment grading tool', p 34). At the lower end of the range is the fair fee appropriate to a care home that does not exceed the interim physical environment standards for 'existing' homes incorporated in the revised NMS published in February 2003. The difference between the top and the bottom of the range, equal to £77-£79 per week according to the assumptions built into the toolkit spreadsheet, represents the maximum capital cost adjustment factor for homes that fail to meet the more demanding standards for 'new' homes (see 'Capital cost adjustment factor and physical environment grading tool', p 34).

Gap between and fair fees and fees paid by social services

The 2002 report found that there were substantial gaps in most English localities between 'fair market' rates and the weekly fees paid by social services. The gaps had diminished by the time of the 2004 report and have diminished further since, although from 2007 there has been evidence of renewed downward pressure on fees in real terms as many cash-strapped local authorities have sought to contain fee increases at below inflation. An analysis of the 2008/09 round of baseline fee increases is published in *Community Care Market News* (2008), published by Laing & Buisson.

In essence, the conclusion to be drawn is that the fees that are typically on offer from local authorities are fairly close to being adequate for unmodernised care home stock. But they remain inadequate to fund a modernised care home sector meeting the physical standards set by the government for new homes registered after April 2002.

What would a fully modernised care home sector cost?

The potential additional cost to the public sector of an England-wide commitment to pay a fair price for a fully modernised care home sector (in terms of physical environment) can be approximated by comparing the ceiling rates for England (that is, the fair fees calculated for 'new' homes) with the average gross fees paid by English local authorities. The additional cost to the public sector is calculated at about £540 million per annum at 2008/09 prices (Table 7, p 42). This figure is an approximation based on imperfect information, as described in the notes to the Table. In particular, the NHS Information Centre data on fees paid by local authorities cannot be relied on since there are significant inconsistencies between these data and other apparently comparable datasets published by the NHS Information Centre. Subject to this caveat, Table 7 at least gives an indication of the order of magnitude of the potential additional cost to the public sector of an England-wide commitment to pay a fair price for a fully modernised care home sector (in terms of physical environment).

The beneficiaries of this additional expenditure would be:

- good-quality care homes, whose profitability when catering for state-funded residents would be raised to reasonable levels;
- state-funded residents, who would have access to fully modernised facilities in all areas of the country;
- charities and the relatives and friends of state-funded care home residents, who would no longer make third-party top-ups to inadequate local authority fees;
- privately funded residents who would no longer need to cross-subsidise local authority-funded residents.

If the concept of 'fully modernised' is extended to include a professionalised workforce, paid accordingly, then the additional cost would be substantially greater. To illustrate the additional

Table 4: Fair market fees for nursing care (frail older people/older people with dementia), £ prpw, 2008/09 (based on spring 2008 pay rates)

Cost heads	(a) Provincial location	b) London
(A) STAFF, INCLUDING EMPLOYERS' ON-COSTS		
Qualified nurse staff cost per resident	£107	£109
Care assistant staff cost per resident (including activities)	£157	£177
Catering, cleaning and laundry staff cost per resident	£46	£49
Management/administration/reception staff cost per resident	£40	£43
Agency staff allowance – nurses	£3	£3
Agency staff allowance – care assistants	£2	£3
Training backfill	£4	£4
Total staff	£358	£387
(B) REPAIRS AND MAINTENANCE		
Maintenance capital expenditure	£19	£19
Repairs and maintenance (revenue costs)	£11	£11
Contract maintenance of equipment	£3	£3
Total repairs and maintenance	£33	£33
(C) OTHER NON-STAFF CURRENT COSTS AT HOME LEVEL		
Food	£23	£23
Utilities (gas, oil, electricity, water, telephone)	£22	£22
Handyperson and gardening (on contract)	£7	£7
Insurance	£5	£5
Medical supplies (including medical equipment rental)	£3	£3
Registration fees (including Criminal Records Bureau [CRB] checks)	£3	£3
Recruitment	£2	£2
Direct training expenses net of grants and subsidies	£2	£2
Continence products	£0	£0
Other non-staff current expenses	£6	£6
Total non-staff current expenses	£79	£79
(D) CAPITAL COSTS (12% return on capital)		
Land	£43	£125
Buildings and equipment meeting physical NMS for new homes, extensions and 1st registrations since April 2002, including start-up losses	£153	£153
Total capital costs	£195	£277
'Ceiling' fair market price for homes meeting all standards for 'new' homes in *Care homes for older people* (DH, 2003)	£665	£776
Maximum capital cost adjustment factor for homes not meeting physical standards for 'new' homes	£76	£76
'Floor' fair market price for homes that do not exceed the interim physical standards for 'existing' homes in *Care homes for older people* (DH, 2003)	£589	£700

Note: Numbers may not add due to rounding.

Source: Toolkit spreadsheet

Table 5: Fair market fees for personal care (frail older people), £ prpw, 2008/09 (based on spring 2008 pay rates)

Cost heads	**(a) Provincial location**	**(b) London**
(A) STAFF, INCLUDING EMPLOYERS' ON-COSTS		
Qualified nurse staff cost per resident	£0	£0
Care assistant staff cost per resident (including activities)	£144	£166
Catering, cleaning and laundry staff cost per resident	£46	£49
Management/administration/reception staff cost per resident	£40	£43
Agency staff allowance – nurses	£0	£0
Agency staff allowance – care assistants	£2	£2
Training backfill	£2	£3
Total staff	£234	£263
(B) REPAIRS AND MAINTENANCE		
Maintenance capital expenditure	£19	£19
Repairs and maintenance (revenue costs)	£11	£11
Contract maintenance of equipment	£3	£3
Total repairs and maintenance	£33	£33
(C) OTHER NON-STAFF CURRENT COSTS AT HOME LEVEL		
Food	£23	£23
Utilities (gas, oil, electricity, water, telephone)	£22	£22
Handyperson and gardening (on contract)	£7	£7
Insurance	£5	£5
Medical supplies (including medical equipment rental)	£3	£3
Registration fees (including CRB checks)	£3	£3
Recruitment	£2	£2
Direct training expenses net of grants and subsidies	£2	£2
Continence products	£0	£0
Other non-staff current expenses	£6	£6
Total non-staff current expenses	£79	£79
(D) CAPITAL COSTS (12% return on capital)		
Land	£43	£125
Buildings and equipment meeting physical NMS for new homes, extensions and 1st registrations since April 2002, including start-up losses	£149	£149
Total capital costs	£192	£273
'Ceiling' fair market price for homes meeting all standards for 'new' homes in *Care homes for older people (DH, 2003)*	£538	£648
Maximum capital cost adjustment factor for homes not meeting physical standards for 'new' homes	£74	£74
'Floor' fair market price for homes that do not exceed the interim physical standards for 'existing' homes in *Care homes for older people (DH, 2003)*	£463	£574

Note: Numbers may not add due to rounding.

Source: Toolkit spreadsheet

Table 6: Fair market fees for personal care (older people with dementia), £ prpw, 2008/09 (based on spring 2008 pay rates)

Cost heads	**(a) Provincial location**	**(b) London**
(A) STAFF, INCLUDING EMPLOYERS' ON-COSTS		
Qualified nurse staff cost per resident	£0	£0
Care assistant staff cost per resident (including activities)	£171	£198
Catering, cleaning and laundry staff cost per resident	£46	£49
Management/administration/reception staff cost per resident	£40	£43
Agency staff allowance – nurses	£0	£0
Agency staff allowance – care assistants	£3	£3
Training backfill	£3	£3
Total staff	£262	£295
(B) REPAIRS AND MAINTENANCE		
Maintenance capital expenditure	£19	£19
Repairs and maintenance (revenue costs)	£11	£11
Contract maintenance of equipment	£3	£3
Total repairs and maintenance	£33	£33
(C) OTHER NON-STAFF CURRENT COSTS AT HOME LEVEL		
Food	23	23
Utilities (gas, oil, electricity, water, telephone)	22	22
Handyperson and gardening (on contract)	£7	£7
Insurance	£5	£5
Medical supplies (including medical equipment rental)	£3	£3
Registration fees (including CRB checks)	£3	£3
Recruitment	£2	£2
Direct training expenses net of grants and subsidies	£2	£2
Continence products	£0	£0
Other non-staff current expenses	£6	£6
Total non-staff current expenses	£79	£79
D) CAPITAL COSTS (12% return on capital)		
Land	£43	£125
Buildings and equipment meeting physical NMS for new homes, extensions and 1st registrations since April 2002, including start-up losses	£149	£149
Total capital costs	£192	£273
'Ceiling' fair market price for homes meeting all standards for 'new' homes in *Care homes for older people (DH, 2003)*	£566	£680
Maximum capital cost adjustment factor for homes not meeting physical standards for 'new' homes	£74	£74
'Floor' fair market price for homes that do not exceed the interim physical standards for 'existing' homes in *Care homes for older people (DH, 2003)*	£491	£606

Note: Numbers may not add due to rounding.

Source: Toolkit spreadsheet

Table 7: Estimated cost to the public sector in 2008/09 of increasing local authority fees for older care home residents in England to levels sufficient to reimburse the reasonable costs of care homes meeting physical environment standards for 'new' homes first registered since April 2002[1]

	Nursing care	Personal care	Total
(a) Reasonable costs at England weighted average prices including London (from Tables 4-6)	£680 pw	£550 pw	
(b) Average fees paid by local authorities, England 2008/09 projection[2]	£607 pw	£495 pw	
(c) Difference: (a)-(b)	£73 pw	£55 pw	
(d) Number of English local authority-supported older residents in independent sector care homes, 2007[3]	61,750	109,030	170,780
Total cost of funding the difference: (c) x (d) x 52	£234 million per annum	£309 million per annum	£543 million per annum

Notes/sources:

[1] As defined in Care homes for older people (DH, 2003)

[2] Average fees paid to providers other than local authorities' own in-house provision, as reported by the NHS Information Centre in Finance statistics of council social services departments: 1994-95 to 2006-07: Unit costs summary 2006-07. Fees for 2006/07 have been inflated by 3% per annum to give projections for 2008/09.

[3] Department of Health Community care statistics 2007 supported residents (adults), England

potential cost, it can be calculated from the toolkit spreadsheet that:

- every extra £1 per hour paid to non-qualified carers and domestic and catering staff would add £280 million per annum to local authority costs, based on an additional £32 per week on average for each of the 170,780 care home residents supported by councils in England in 2007 (Table 7);

- implementation of the proposal within the 2007 Pensions Bill for a minimum 3% employers' pension contribution (subject to opt-out) could add £52 million per annum to local authority costs, based on an additional cost of £7.74 prpw for nursing care, £4.74 for personal care of frail older people and £5.42 for personal care of older people with dementia.

The benefits of such additional expenditure would accrue to currently low-paid staff and care home residents (if higher pay translates into higher quality).

5 Future changes in care home costs

Proposed method and health warnings

This chapter proposes a method for adjusting fees in line with cost inflation. The proposal is that each broad cost heading in the toolkit spreadsheet should have a specific inflation factor, using information and indices set out below. There are, however, health warnings.

All inflation indexes are historic. Therefore, if a council is seeking to set fee rates for the coming financial year in advance, it will need to project forward the relevant indices on the best available information and subsequently adjust them to re-establish a correct baseline on which the subsequent year's inflation factors are to be applied.

There is the potential for index-based cost projections to diverge from reality. It will, therefore, be desirable at regular intervals (say every three years, or earlier if there is a significant material change such as new regulatory staffing guidance) to recalibrate the benchmark figures that have been entered into the toolkit spreadsheet. This will correct for two sources of divergence:

- where the prices of care home inputs diverge from the best available inflation index (for example, where the NMW has a specific impact on pay rates for low-paid staff);
- where the volume of inputs changes (for example, a material change in NMS applied by CSCI, or some material alteration in councils' service specifications).

Staffing costs

Many long-term contracts for nursing and personal care throughout England now build in two or more inflation factors to reflect changes in broad groups of costs. Most frequently, a wage index is applied to the bulk (50-70%) of the baseline fee and the *Retail Price Index (RPI)* for the remainder. Although this does not capture all of the variation in rates of change in cost, it addresses the primary concern of care home operators – that use of RPI alone is bound to reduce their margins over a period of time, because labour is such a large component of cost and because labour efficiency savings are generally denied by regulatory controls on labour inputs. The particular wage index typically used in many such long-term contracts is the Office for National Statistics (ONS) average earnings index for health and social work, on the grounds that this may be expected to reflect movements in public and private pay rates most closely aligned with care home staff costs. The index is published as series S56 in *Labour Market Trends* by the ONS.

In the absence of any other data series more closely aligned with care home staff costs, we recommend that councils use the ***Average Earnings Index for Health and Social Work*** as a measure of staff cost inflation, as indicated in the toolkit spreadsheet.

However, this should be superseded where there are other, more relevant measures of staff cost inflation, for example for staff members who are paid close to the NMW. This is particularly important in those periods, which have occurred in the recent past, where NMW increases greatly exceed general wage inflation.

For the provincial locality illustration (see Table 1, p 6), where low pay tracks the NMW, it may be necessary to enter an ***NMW inflation factor*** in the toolkit spreadsheet specifically for non-nurse care staff and domestic staff.

Councils should also be aware of another factor that may push pay rates for hourly paid care home staff ahead of average wage inflation adjusted

for NMW. This is the fact that pay rates in the care sector have been held back by the financial stress experienced by operators. It is likely that any reduction in financial stress (for example from councils paying higher fees) would trigger pressure for pay rises.

There may also be specific statutory or regulatory changes that will need to be built into the toolkit spreadsheet as they take effect. The proposal for a compulsory 3% employers' pension contribution is the most significant pending example.

Repairs and maintenance

The RICS publishes two sets of indexes, each with a regional breakdown:

- *All-in Tender Price Index* (which measures changes in tender prices per unit of building work – £per m^2);
- *General Building Cost Index* (which measures changes in material costs and wage rates in the building industry).

The two series should in theory converge in the long term. Both are available in the *Quarterly Review of Building Prices* published by the RICS on annual subscription.

It is recommended that the ***RCIS General Building Cost Index*** should be used as an inflation factor for repairs and maintenance in the toolkit spreadsheet since it is less subject to year-on-year fluctuations caused by the level of demand in the economy for building services.

Other non-staff current costs

It is recommended that the ***RPI*** should be used in the toolkit spreadsheet as the inflation factor for other non-staff current costs.

It is recognised that some specific items may be subject to higher inflation rates, such as food and power in 2008. The toolkit spreadsheet should be recalibrated if there is volatility in the price of significant cost items.

Capital costs

The RCIS General Building Cost Index (see 'Repairs and maintenance' above) is entered into the toolkit spreadsheet as the inflation factor for the buildings and equipment element of capital costs.

No inflation factor is entered for the land element of capital costs. It is recommended that a revaluation of land be part of less frequent general recalibrations of the toolkit spreadsheet (see 'Proposed method and health warnings', p 43). Meanwhile, changes in land prices should be monitored.

Notes

2 Introduction

1 The historical evolution of the care home market is described in various editions of *Care of Elderly People Market Survey*, published annually by Laing & Buisson.

4 Estimates of reasonable costs by category

1 These are referred to as 'interim' because they result from a government decision to amend the more demanding physical standards initially introduced in April 2002, for fear of a catastrophic loss of capacity. They continue to be subject to further review.

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Appendix 1
Model survey form for pay rates

Grade	Shift	Average hourly pay rate[1] £ per hour	
		Daytime	Night (Waking)
CARE ASSISTANT (No NVQ qualification)	Monday - Friday		
	Saturday		
	Sunday		
	Bank holiday		
CARE ASSISTANT (NVQ or above)	Monday - Friday		
	Saturday		
	Sunday		
	Bank holiday		
SENIOR CARER	Monday - Friday		
	Saturday		
	Sunday		
	Bank holiday		
QUALIFIED NURSE (Care homes with nursing only)	Monday - Friday		
	Saturday		
	Sunday		
	Bank holiday		
CHEFS/COOKS	Monday - Friday		
	Saturday		
	Sunday		
	Bank holiday		
DOMESTIC & CATERING STAFF (excluding chefs/cooks)	Monday - Friday		
	Saturday		
	Sunday		
	Bank holiday		

[1] *Hourly pay rate means gross hourly pay for the employee. Do not include National Insurance. Do not include any holiday pay allowance.*

Appendix 2
Care home group questionnaire

Fair Market Price for Care: update for financial year 2008/09

Request for information from major care home operators

Laing & Buisson has been commissioned by the Joseph Rowntree Foundation to revise and update its 'Fair Price for Care' toolkit spreadsheet for nursing and residential care of frail older people , including older people with dementia, in England.

In order to estimate costs borne by a typical, efficient, larger-scale (around 50-bed) care home, Laing & Buisson is requesting information on actual costs from a number of major for-profit and not-for-profit operators. All information provided will be treated as confidential and aggregated and/or averaged prior to being used to inform benchmarks in the toolkit spreadsheet.

To make the process as simple as possible, Laing & Buisson has attached to this request for information a template copy of the Fair Price spreadsheet.

The list of questions below refers to cell numbers in this spreadsheet.

It may help to scan all the questions before starting to answer them.

Please enter your responses and/or comments in the box against each question and return the document as soon as practicable to William Laing, ideally in electronic format.

william@laingbuisson.co.uk
Laing & Buisson
29 Angel Gate
City Road
London EC1V 2PT

Should you need clarification, please call William Laing on 020 7923 5399 (direct) or 020 7833 9123 (main line).

STAFF INPUT

(Note: for all staff input figures, we are seeking a reasonable benchmark which averages out low and high users of staff time in a typical, *efficient* care home for the type of client concerned.)

1.

Typically, in an efficient home, how many *qualified nursing staff hours per resident per week* are provided for *nursing* care of frail older people? [see worksheet: A) Nursing care, older people, Cell B51, where the current benchmark is 7.5]	Response / Comments

2.

Is the number of *qualified nursing staff hours per resident per week* the same for *nursing* care of older people with *dementia*? If not, what is the number? [see worksheet: B) Nursing care, dementia, Cell B51, where the current benchmark is the same, at 7.5]	Response / Comments

3.

Typically, in an efficient home, how many *carer (non-nurse) hours per resident per week, including activities coordination***,** are provided for *nursing* care of frail older people ? [see worksheet: A) Nursing care, older people, Cell B52, where the current benchmark is 19.5]	Response / Comments

4.

Is the number of *carer (non-nurse) hours per resident per week, including activities coordination,* the same for *nursing* care of older people with *dementia*? If not, what is the number? [see worksheet: B) Nursing care, dementia, Cell B52, where the current benchmark is the same, at 19.5]	Response / Comments

5.

Typically, in an efficient home, how many *carer (non-nurse) hours per resident per week, including activities coordination*, are provided for *residential* care of frail older people ? [see worksheet: C) Personal care, older people, Cell B52, where the current benchmark is 16]	Response / Comments

6.

Typically, in an efficient home, how many *carer (non-nurse) hours per resident per week, including activities coordination***,** are provided for *residential* care of older people with *dementia*? [see worksheet: D) Personal care, dementia, Cell B52, where the current benchmark is 20]	Response / Comments

7.

Typically, in an efficient home, how many *domestic (cleaning, laundry and catering, excluding chefs/cooks*) hours per resident per week are provided? [see worksheet: Parameters and assumptions, Cell B15, where the current benchmark is 4.1, which is applied to all client types – nursing and residential, frail older people and older people with dementia	Response / Comments

8.

Typically, in an efficient home, how many *chef/cook* hours per resident per week are provided? [see worksheet: Parameters and assumptions, Cell B16, where the current benchmark is 1.9, which is applied to all client types – nursing and residential, frail older people and older people with dementia	Response / Comments

SKILL MIX

9.

The model currently assumes that 90% of qualified nurse staff input is from Level 1 nurses (RGN) and the remaining 10% from Level 2 (old SEN) [see worksheet: Parameters and assumptions, Cell B19]. The Level 1/Level 2 distinction may, however, now be outdated. • Can we assume that 100% of qualified nurse staff are now Level 1 (RGN)? • If not, what should the percentage be?	Response / Comments

10.

The model currently assumes that 30% of care hours (excluding qualified nursing staff) are filled by staff with NVQ2 or above [see worksheet: Parameters and assumptions, Cell B20]. • What is the percentage now?	Response / Comments

11.

The model currently assumes that 15% of care hours (excluding qualified nursing staff) are filled by 'senior carers' [see worksheet: Parameters and assumptions, Cell B20]. • What is the percentage now?	Response / Comments

ON-COSTS

12.

The model currently assumes that all hourly paid staff currently receive 24 days paid holiday per year, including bank holidays, or pro rata for part-time staff, being the minimum set under Working Time Directive from October 2007 (to rise to 28 days from April 2009 [see worksheet: Parameters and assumptions, Cells B92 and B99]. • Do hourly paid staff receive this minimum only? • If not, what is the average holiday entitlement per year of your hourly paid staff?	Response / Comments

13.

The model currently assumes an employers' NI on-cost for hourly paid staff of 9% of gross pay for qualified nurses [see worksheet: Parameters and assumptions, Cell B93] and 8% for other hourly paid staff [see worksheet: Parameters and assumptions, Cell B100] – i.e. lower than the standard 12.8% because of the effect of part-timers below the NI threshold. • Are the figures of 9% and 8% about right? • If not, what are more accurate figures?	Response / Comments

14.

The model currently assumes that all hourly paid staff are entitled to statutory sick pay only and that the on-cost to employers is 2% of gross pay [see worksheet: Parameters and assumptions, Cells B94 and B101]. • Is this figure of 2% about right? • If not, what is a more accurate figure?	Response / Comments

15.

The model currently assumes *zero* employers' contribution to hourly paid staff pensions [see worksheet: Parameters and assumptions, Cell B102]. • Does this remain valid? • If not, what reasonable allowance should be made for pension on-costs for hourly paid staff?	Response / Comments

16.

The model currently makes a 'training backfill' allowance of 1.3% of gross pay of hourly paid staff (to reflect the NMS minimum 3 paid training days per staff member per annum) [see worksheet: Parameters and assumptions, Cell B138]. • Does this remain valid? • If not, what reasonable allowance should be made for training backfill?	Response / Comments

AGENCY STAFF USAGE

17.

The benchmark allowances within the model are: • 2.5% of qualified nurse shifts filled by agency staff [see worksheet: Parameters and assumptions, Cells B106] • 1.5% of other care staff shifts filled by agency staff [see worksheet: Parameters and assumptions, Cells B107]. These benchmarks are intended to reflect a reasonable level of agency usage across an efficient portfolio of homes, necessary to provide the flexibility to ensure that resident care is not compromised even when unplanned absences occur at short notice. • Are these figure reasonable? • If not, what should the allowances be?	Response / Comments

PAY RATES

18.

The hourly staff pay rate cells within the model are populated with data from Laing & Buisson's survey of care home costs in February 2006, to which about 1,000 responses were received [see worksheet: Parameters and assumptions, Cells B22–B88]. We are not seeking any further data from you on hourly pay rates. The cells will be repopulated on the basis of Laing & Buisson's February 2008 cost survey. However: • Can you confirm that the categories of staff and the allowances for different pay rates during the day/night/weekend and bank holidays are reasonably aligned with industry practice? • If not, how might these rows within the spreadsheet be remodelled?	Response / Comments

SUPERNUMERARY MANAGEMENT, ADMINISTRATIVE AND RECEPTION STAFF

19.

Based on Laing & Buisson's surveys of care home costs, the model allows a gross salary (before bonuses and employers' on-costs) of £35,000 per year for the manager of a care home outside London with 50 or more beds [see worksheet: Parameters and assumptions, Cell B113]. • Is this figure reasonable? • If not, what should the figure be?	Response / Comments

20.

The model currently allows £14 per resident per week for *"other management, administration and reception salaries, before on-costs"* outside London [see worksheet: Parameters & assumptions, Cell B114]. This is calculated from a baseline established in 2002 from corporate providers' management accounts. • Is this figure reasonable? • If not, what should the figure be? How much do you estimate that this figure would be if all essential back office functions such as accounts and enquiry handling were done at the individual home level, and none were undertaken at head/regional office level? *(for the reason behind this question, see HEAD OFFICE OVERHEADS, below)*	Response / Comments

21.

The model currently allows on-costs of 30% per resident per week for management, administration and reception staff, to include employers' NI @ 12.8%, holiday and sickness backfill by supernumerary senior nurse/carer, employers' pension contributions, any other benefits such as medical insurance, plus any bonus [see worksheet: Parameters & assumptions, Cell B115]. • Is this figure reasonable? • If not, what should the figure be? • How do you typically backfill for the manager during holidays and sickness absence? • Do you use agency staff to backfill, and if so how frequently?	Response / Comments

REPAIRS AND MAINTENANCE

22.

The model currently has three cost heads for maintenance [see worksheet: Parameters & assumptions, Cells B119 - B121]: • maintenance capital expenditure (items that are significant enough to treat as capital expenditure, but which do not create any new capacity); • repairs and maintenance (items that are expensed); • contract maintenance of equipment. These categories were found to be aligned with operational and accounting practice in 2002 and 2004. • Does that remain the case now? • If not, how could maintenance costs be categorised differently?	Response / Comments

23.

The model currently allows £900 per annum per bed for 'maintenance capital expenditure; [see worksheet: Parameters & assumptions, Cell B119]. • Is this figure reasonable? • If not, what should the figure be?	Response / Comments

24.

The model currently allows £400 per annum per bed for 'repairs and maintenance (revenue costs)' [see worksheet: Parameters & assumptions, Cell B120]. • Is this figure reasonable? • If not, what should the figure be?	Response / Comments

25.

The model currently allows £130 per annum per bed for 'contract maintenance of equipment' [see worksheet: Parameters & assumptions, Cell B121]. • Is this figure reasonable? • If not, what should the figure be?	Response / Comments

NON-STAFF CURRENT COSTS AT HOME LEVEL

26.

The model currently has 10 cost heads for non-staff current costs [see worksheet: Parameters & assumptions, Cells B126–B135]. These categories were found to be aligned with operational and accounting practice in 2002 and 2004. • Does that remain the case now? • If not, how could heads for non-staff current costs be categorised differently?	Response / Comments

27.

Based on 2004 data, the model currently makes the following allowances per resident per week for non-staff current costs [see worksheet: Parameters & assumptions, Cells B126–B135]. • Are the figures reasonable? • If not, what should they be?		Response / Comments
Food	£20	
Utilities	£14	
Handyperson and gardening (on contract)	£7	
Insurance	£5	
Medical supplies (including medical equipment rental)	£3	
Registration fees (including CRB checks)	£2	
Recruitment	£2	
Direct training expenses (fees, facilities, travel and materials) net of grants and subsidies	£2	
Incontinence supplies (provided by the NHS?)	£0	
Other non-staff current expenses (postage, printing, stationery, telephone, motor expenses, professional fees, etc)	£8	
Total non-staff current expenses	**£63**	
How much do you estimate that this total for non-staff current expenses would be if there were no central purchasing function and if all purchasing were done at the individual home level? *(For the reason behind this question, see HEAD OFFICE OVERHEADS, below)*		

CAPITAL COSTS (BUILDINGS & LAND)

28.

The model allows three quarters of an acre for a 50-bed care home built today for local authority-funded clients [see worksheet: Parameters & assumptions, Cell B144]. • Is this figure reasonable? • If not, what should the figure be?	Response / Comments

29.

The model allows 45m^2 per bed for a care home built today for local authority funded clients [see worksheet: Parameters & assumptions, Cell B146]. • Is this figure reasonable? • If not, what should the figure be?	Response / Comments

30.

The model allows turnkey new build costs of £1,150 per m^2 including *equipment* and *professional fees*) [see worksheet: Parameters & assumptions, Cell B149]. • Is this figure reasonable? • If not, what should the figure be? • Should any allowance be made for extra equipment in nursing homes, and if so, how much?	Response / Comments

31.

The model allows £5,000 per bed start-up losses [see worksheet: Parameters & assumptions, Cell B156]. • Is this figure reasonable? • If not, what should the figure be?	Response / Comments

HEAD OFFICE OVERHEADS

Head and regional office overheads are currently excluded entirely from the cost model. The rationale was expressed in the 2004 report published by the JRF as follows:

> *Unlike independent operators, larger corporate groups must bear an additional cost in the form of head office and regional office overheads. These represent costs over and above management and administration at the level of the individual home. Typically, such overheads absorb around 4%–5% of gross fee income for an efficiently run group, which is equivalent to around 3% of the capital value of a typical good quality portfolio. These additional group overheads can be ignored by councils for the purposes of setting a fair price for care. Such overheads should be viewed as portfolio management costs. Equity providers are either prepared to operate on a lower blended return on capital than independent owners (3 percentage points lower, i.e. 11%) or they expect to recoup at least part of the diminution in return from better financial engineering, higher leverage, lower interest rates from providers of debt or improvements in operational profitability. In these ways, VCs can still realistically seek to achieve a return on their equity capital of 25%–30% per annum.*

We now consider that some adjustments need to be made to this position.
For example:

- Some head and regional office overheads may relate to essential back office functions such as accounting and enquiry handling, which would, if not centralised, need to be carried out at individual home level. Question 20, above, is designed to assist in making any necessary adjustment.
- There is also a case for adding back any bulk purchasing discounts – for example on utilities and provisions – that are obtained through centralised purchasing. Question 27, above, is designed to assist in making any necessary adjustment.

COMPREHENSIVENESS OF THE 'FAIR PRICE' MODEL

32.

Do you think the Laing & Buisson/JRF spreadsheet model comprehensively covers all costs at the home level? If not, what other costs ought to be included?	Response / Comments

FURTHER BACKGROUND QUESTIONS

33.

• What proportion of your local authority funded residents receive a third-party top-up? • Do you expect this to be higher or lower or about the same in a year's time? • What do you estimate is the average third-party top-up amount in £s per week? a) in the North and Midlands of England; b) in the South and East of England.	Response / Comments

34.

• What proportion of your NURSING CARE residents are wholly funded by the NHS as 'continuing healthcare' patients (i.e. excluding those for whom RNCC is payable)? • Do you expect this to be higher or lower or about the same in a year's time?	Response / Comments

– END –

Completed by:

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List of abbreviations

CRB	Criminal Records Bureau
CSCI	Commission for Social Care Inspection
EBITDAR	Earnings Before Interest, Tax, Depreciation, Amortisation of goodwill and Rent
NCSC	National Care Standards Commission
NHS	National Health Service
NI	National Insurance
NMS	National Minimum Standards
NMW	National Minimum Wage
ONS	Office for National Statistics
prpw	per resident per week
RICS	Royal Institution of Chartered Surveyors
RNCC	Registered Nursing Care Contribution
RPI	Retail Price Index
SSP	Statutory Sick Pay
WTR	Working Time Regulations

About the author

William Laing is Chief Executive of Laing & Buisson, the health and care sector analysts. His position as an adviser to local authorities, care operators and financial institutions gives him unique access to relevant information and an understanding of the requirements of all parties.

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