

Calculating the costs of efficient care homes

Findings
Informing change

September 2008

This study refines the formula published by the JRF in 2002 (revised 2004) for calculating reasonable fees, based on the operating costs of efficient care homes for older people in England. Using 2008 benchmarks, the study guides users through its associated spreadsheet and advises on modifications to reflect local market conditions.

Key points

- Four principal care home cost categories are: staffing; repairs and maintenance; other current costs; and capital costs (including investors' and operators' returns).
- For the 2008/09 financial year, fair market fees for operating a modern, efficient care home outside London were £665 per week for nursing care (all categories of older people), £538 for the personal care of frail older people, and £566 for those with dementia. Costs were higher in more affluent parts of England and in London.
- The study suggests:
 - Basing 'spot' purchase fees on a benchmark rate of 12 per cent yearly return on capital, reflecting investors' perception of care homes as a moderately risky business activity.
 - A 'good' or 'excellent' rating for a home as a prerequisite for these 'fair market fee' levels.
 - Using a 'capital cost adjustment factor', proportional to the degree to which a home/room falls short of national minimum physical environment standards. This would lead to a maximum weekly difference of £74–£76 between 'ceiling' and 'floor' rates.
- The author concludes that local authorities may have to find an additional £540 million annually to fund fair fees for a fully modernised care home sector to meet the latest physical environment standards. If 'modernisation' is extended to include a professionalised workforce, paid accordingly, the additional cost would be substantially greater.

The research

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Background

Despite upward realignment between 2002 and 2006, fees paid by most English councils still offer inadequate returns to care homes for older people. This has reduced choice for council-supported residents and led to a virtual cessation of development of new care home capacity catering primarily for them. However, such is the projected demographic pressure of demand that substantial expansion of capacity will be required. Independent sector providers will not develop such capacity unless fees offer a reasonable return.

Building on reports published in 2002 and 2004, this study refines and develops guidance to enable care commissioners to identify the reasonable costs that typical, *efficient* care home operators may incur, and the reasonable fees they may expect to receive. The study rejects an average cost approach, as this would include the costs of *inefficient* operators.

Establishing care home costs

The toolkit spreadsheet generates costs (fair market fees) as summarised in Table 1.

Table 1: Costs summary calculated from the toolkit spreadsheet, 2008/09

	Nursing care		Personal care	
	Frail elderly/ dementia £ per week ³	Frail elderly £ per week	Dementia £ per week	
a) Provincial location				
Ceiling ¹	665	538	566	
Floor ²	589	463	491	
b) London				
Ceiling ¹	776	648	680	
Floor ²	700	574	606	

1 The upper end of the range (ceiling) represents a fair market fee for homes with a Commission for Social Care Inspection (CSCI) star rating of 'good' or 'excellent' and which meet physical environment standards for 'new' homes registered since April 2002, as defined in *National Minimum Standards: Care Homes for Older People* (3rd ed), Feb 2003.

2 The lower end (floor) represents a fair fee for homes/rooms with a CSCI rating of 'good' or 'excellent', but which the proposed physical environment grading tool places on the borderline of acceptability.

3 Including NHS Registered Nursing Care Contribution.

Staffing

Staffing costs typically absorb 45–60 per cent of care home fees, and include care, catering, cleaning, laundry, management, administration and reception staff. Costs for hourly paid staff can be calculated by multiplying the volume of resources required (using benchmark data on the number of staff hours per resident) by weighted average hourly pay rates (including unsocial hours enhancements), plus on-costs (see below). To determine local pay rates, care commissioners need to survey actual rates and enhancements paid. A cost allowance for (salaried) management, administration and reception staff is based on national norms for a home of approximately 50 beds.

On-costs include the following:

- Holiday pay – from April 2009, staff will be entitled to a minimum of 28 days' paid holiday, including bank holidays, equivalent to an on-cost of 12 per cent.
- Employers' National Insurance benchmarks of 9 per cent for nurses and 8 per cent for carers and catering, cleaning and domestic staff. This is lower than the standard 12.8 per cent because of high numbers of part-time care home staff.
- An assumed sick pay on-cost of 2 per cent, based on private sector norms. Nearly all private sector care home operators pay no more than statutory sick pay to hourly paid nursing, care assistant and domestic staff.
- Based on private sector practice, a zero employer's pension contribution has been adopted as the benchmark for hourly paid care and domestic staff.
- An allowance is, however, made for employers' pension contributions for management and administrative staff, increasing their aggregate on-cost to 30 per cent in the toolkit spreadsheet.

Non-staffing current costs

These include utilities, food, registration fees, grounds maintenance, and maintenance capital expenditure (in place of depreciation). Typically, these costs absorb 12–15 per cent of care home fees. They can be calculated fairly readily on a 'per resident' basis, with relatively little regional variation. The study used benchmark data from major care home operators.

Capital costs

Capital costs, including investors' and operators' returns, account for the balance of fees. The study proposed a target return on capital of 12 per cent annually for 'spot' purchase, which remains the dominant procurement mode of care home services among councils.

Summary of costs

Table 2 summarises the estimated reasonable costs incurred by efficient care home providers.

Table 2: Fair market fees for care homes, 2008/09 (£)

	Nursing care, older people/people with dementia		Personal care, frail older people		Personal care, older people with dementia	
	Provincial	London	Provincial	London	Provincial	London
STAFF, INCLUDING ON-COSTS						
Qualified nurse	107	109	0	0	0	0
Care	157	177	144	166	171	198
Domestic	46	49	46	49	46	49
Management/admin	40	43	40	43	40	43
Agency staff allowance (nurses)	3	3	0	0	0	0
Agency staff allowance (carers)	2	3	2	2	3	3
Training backfill	4	4	2	3	3	3
Total staff	358	387	234	263	262	295
REPAIRS AND MAINTENANCE						
Maintenance capital expenditure	19	19	19	19	19	19
Repairs and maintenance (revenue)	11	11	11	11	11	11
Contract maintenance of equipment	3	3	3	3	3	3
Total repairs and maintenance	33	33	33	33	33	33
NON-STAFF CURRENT COSTS						
Food	23	23	23	23	23	23
Utilities	22	22	22	22	22	22
Handyman/gardening (on contract)	7	7	7	7	7	7
Insurance	5	5	5	5	5	5
Medical supplies (inc. equipment rental)	3	3	3	3	3	3
Registration fees (inc. CRB checks)	3	3	3	3	3	3
Recruitment	2	2	2	2	2	2
Direct training expenses	2	2	2	2	2	2
Incontinence products	0	0	0	0	0	0
Other	6	6	6	6	6	6
Total non-staff current expenses	79	79	79	79	79	79
CAPITAL COSTS (@ 12% return on capital)						
Land	43	125	43	125	43	125
Buildings and equipment meeting national minimum physical standards for 'new' homes first registered since April 2002	153	153	149	149	149	149
Total capital costs	195	277	192	273	192	273
Fair price for homes meeting standards for 'new' homes in <i>National Minimum Standards: Care Homes for Older People</i> (3rd ed), Feb 2003	665	776	538	648	566	680
Maximum capital cost adjustment factor for homes not meeting physical standards for 'new' homes	76	76	74	74	74	74
Fair price for homes not exceeding interim physical standards for 'existing' homes in <i>National Minimum Standards</i>	589	700	463	574	491	606

NOTE: Figures may not add up due to rounding-up.

Capital cost adjustment factor

To avoid super-profits for physically sub-standard homes, the study proposes that councils should apply a *capital cost adjustment factor*, with the 'floor' being 50 per cent of the 'ceiling' capital costs of a home which fully complies with physical standards. This would be based on a transparent physical environment grading tool, which should be developed by stakeholders.

Such tools are already used, for example within several councils in the north-east. CSCI ratings should also be used as an overall quality trigger for payment of fair market fees as calculated through the toolkit spreadsheet.

The proposed approach to setting 'ceiling' and 'floor' fair market fees 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' rate (see Table 1).
- Those homes with a 'good' or 'excellent' rating, but which do not fully meet the physical environment standards, should receive the 'ceiling' rate, less the *capital cost adjustment factor* as determined by the physical environment grading tool.
- The 20 per cent of homes (in 2008) with 'poor' or 'adequate' ratings will be 'orphaned' under this mechanism. They should be paid at the local authority's discretion whatever amount best incentivises them to improve their rating or, if they cannot improve, to exit the sector.

Modifications to the toolkit spreadsheet

The principal modifications in the 2008 toolkit spreadsheet are:

- The benchmark for return on capital has been reduced to 12 per cent, having been set at 16 per cent in 2002 and revised to 14 per cent in 2004. These downward revisions reflect the care home sector's emergence as part of the mainstream commercial property market and the consequent reduction in yields sought by investors.
- Start-up losses have been included as a capital cost for the first time.
- Staff input benchmarks have been increased (compared with 2004) to reflect residents' increased dependency. Non-qualified care staffing has risen from 19.5 to 20.5 hours per resident per week for nursing care, from 16 to 18.5 hours for personal care of frail older people, and from 20 to 22 hours for those with dementia.
- Working Time Regulations are raising statutory minimum paid holiday entitlement to 28 days from April 2009. Thus, the holiday on-cost has increased from 8.3 per cent (2004) to 12.0 per cent (forthcoming statutory minimum).

On balance, the modifications have increased the calculated fair market price for care at a faster rate than general inflation.

Conclusion

The study concludes that most public sector commissioning bodies do not at present pay fees at levels which are adequate to support and sustain a care home sector that meets all of the most recent National Minimum Standards.

The potential additional cost to the public sector of an England-wide commitment to pay a fair market price for a fully modernised care home sector, in terms of physical environment, can be approximated by comparing the England ceiling rates (i.e. the fair market fees calculated for 'new' homes) with the average gross fees currently 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.

About the project

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

- a mailed survey of care homes requesting information on staff pay and employment terms and conditions;
- interviews with senior managers of the seven largest care home providers in England, plus an extensive email questionnaire; and
- a telephone survey of major business transfer agents in the care home sector.

The toolkit spreadsheet is available for free download at: www.jrf.org.uk/bookshop/details.asp?pubid=974

For further information

The full report, **Calculating a fair market price for care: a toolkit for residential and nursing homes** by William Laing, is published by the Joseph Rowntree Foundation.

Further information is available from William Laing, Laing & Buisson, 29 Angel Gate, City Road, London EC1V 2PT, tel: 020 7833 9123; email: william@laingbuisson.co.uk.

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