



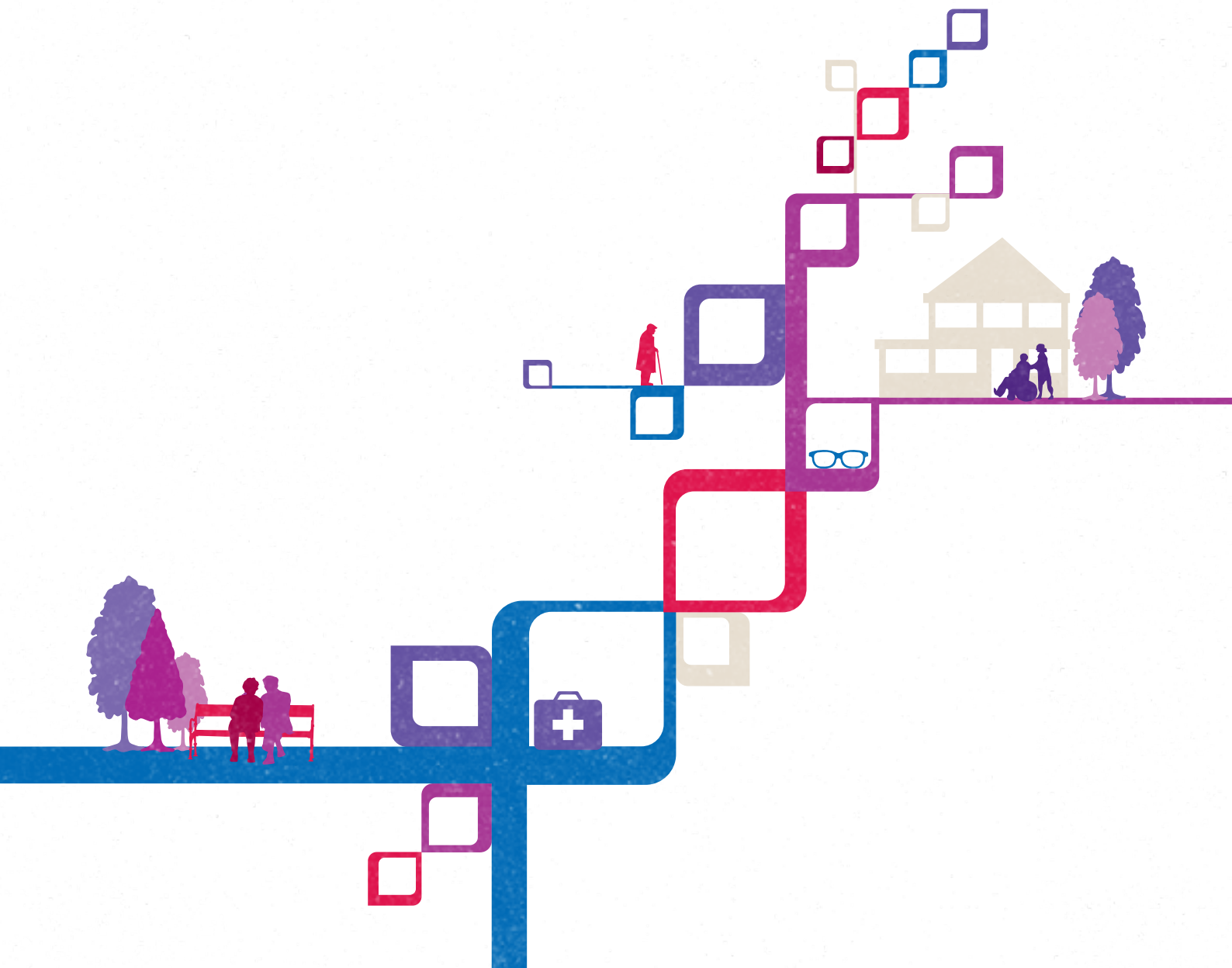
Grant Thornton

An instinct for growth™

2014

Residential elderly care

UK sector review



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About the report

This review of the residential elderly care sector seeks to provide lenders, financiers and corporates with an overview of:

- latest sector performance
- key trends
- an assessment of the market environment including the impact of Local Authority (LA) budget cuts and other government policies

The review combines market data with Grant Thornton's hands-on experience and sector commentary.

Foreword

This is our third annual elderly care report and what is very apparent is the change in sector structure and tougher Government intervention/regulations.

Over these last three years we have witnessed the collapse of Southern Cross, Government austerity impacting on Local Authority fees and far tougher Care Quality Commission (CQC) strategies in the wake of some well publicised care (private and public) scandals, attracting widespread negative media attention.

Despite this, the private residential elderly care sector continues to meet/overcome challenges and attract new investment, particularly into new build 'state of the art' care homes. The low numbers of high specification and proliferation of older 'no longer fit for purpose' care homes highlights a growing polarity which seems to characterise the elderly sector today.

I am, however, optimistic that a positive UK economy is now a reality which, when harnessed with increased bank lending on new builds, will create increased choice for tomorrow's residents, hopefully at an affordable fee.



Daniel Smith
Partner, Head of Private
Sector Healthcare

Grant Thornton is a recognised leader in the private care sector providing advice to elderly care and specialist care operators and their stakeholders. Our expertise covers:

Operational turnaround and governance

- trading
- reporting
- clinical compliance
- corporate governance

Management

- structures
- responsibilities/ accountabilities
- incentives

Property

- rent negotiations
- fit for purpose

Financial structures

- bank debt
- private equity
- opco/propco
- corporate bonds
- alternative lenders

Executive summary

Whilst we subscribe to positive demographics underpinning the long-term prospects of the Residential Elderly Care (REC) sector, our immediate concerns focus on the rising cost of REC and the effects of Government austerity on Local Authorities (LA) fees, referrals and operators' margins.

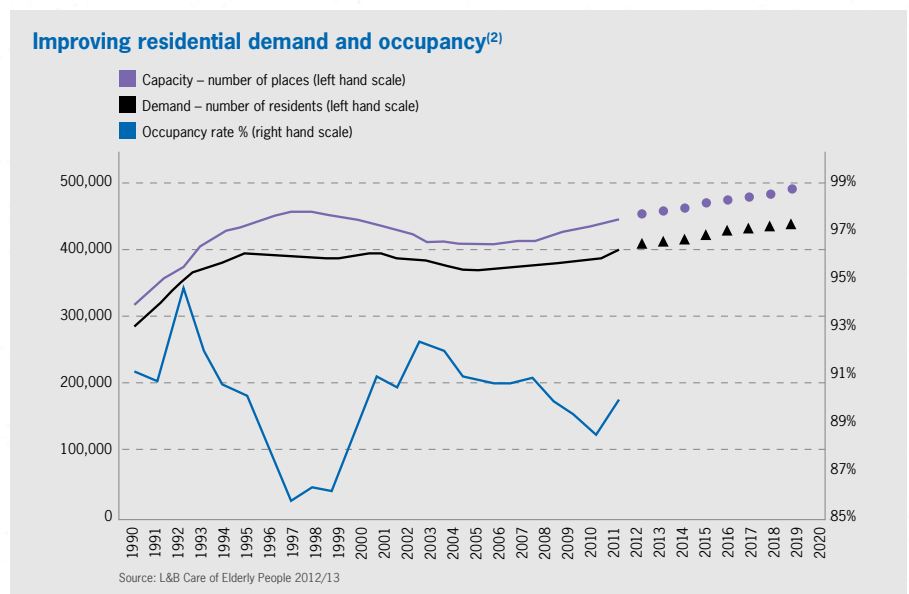
Demand and occupancy

Prior to 2008, the sector experienced a decade of decline arising largely from budget constrained LAs applying needs assessment for the first time. Since 2008, private and voluntary status providers (ie the independent sector) who service 92%⁽¹⁾ of all REC, have experienced a moderate reversal in trading, reporting an upswing in demand and occupancy.

The net increase in residential demand, and more recently improved occupancy, are products of a number of competing forces which we summarise opposite.

Within the private care sub sector there is current overcapacity of c11%⁽³⁾ of beds, reducing to c8%⁽³⁾ eliminating double bedrooms. This overcapacity should see reduction following the forecast closure of LA beds and continued exit of older 'not fit for purpose' care homes.

Unless the supply of new builds increases (currently c7,500 beds p.a.) it is possible that some regions may see bed shortages - a phenomena not seen for many years which would have a dramatic impact by forcing up LA fees.



Fees

- REC independent sector fees have increased over the last five years by c.3.25% p.a.⁽⁴⁾
- We foresee fee growth continuing despite on-going harsh economic conditions with LAs seeking to avoid Judicial Review (JR) challenges by acceding to reasonable annual base fee rate increases

Costs

- Wages are the major cost driver for the sector typically representing 49%⁽⁵⁾ (residential care) to 57%⁽⁵⁾ (nursing care) of revenues
- Wage costs are very closely linked to a rising National Minimum Wage (NMW)
- High usage of agency staff costing approximately double that of payroll staff, can significantly erode profitability
- All operators are likely to be affected by a possible cap on the UK's immigrant workforce community



Positives/negatives on demand & occupancy

The general robustness of the REC independent sector arises primarily from:

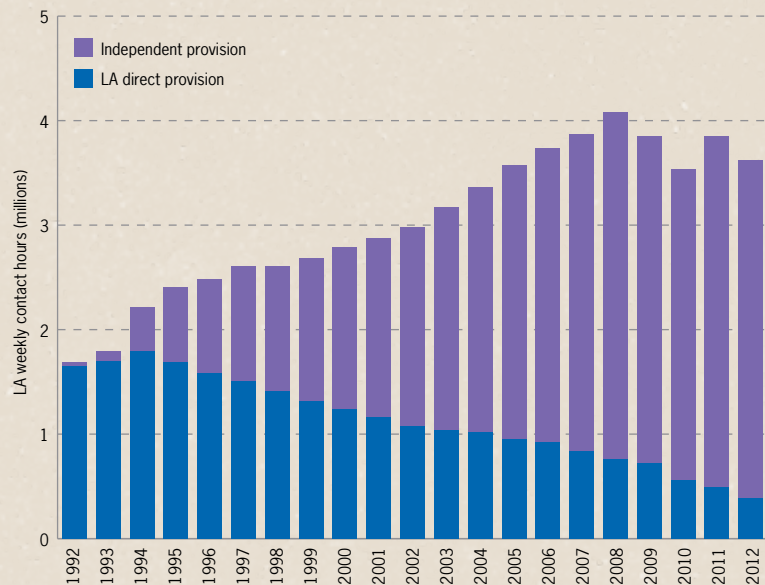
- ✓ an increasingly elderly demographic
- ✓ the long term transfer of residents from LA homes to independent care homes
- ✓ the credit crisis restricting new builds thereby assisting current occupancy levels

The REC independent sector is under threat from the Government's increasing usage and promotion of non-residential/domiciliary care (ie care in own home) to:

- ✗ counter institutionalisation of the elderly community
- ✗ benefit from the lower costs of domiciliary care provision

(Noting some recent reversal and slowdown in domiciliary care growth due to tighter eligibility criteria)

Long term increasing usage of domiciliary care (contact hours)⁽²⁾



Source: L&B Domiciliary Care 2013

UK regions

- Regional factors have a considerable impact on occupancy and fees
- These reflect localised affluence and the ability to self-pay, together with a region's historic available stock of care homes
- Certain areas outside of London and the South East, such as the North East, are amongst the most challenging environments for a care home provider to service
- These areas are also most likely to be sensitive to NMW annual rises

Corporate profitability and consolidation

Larger corporate EBITDAR ranges typically from c20% to 32%⁽⁶⁾, with profitability recently reduced in the sector reflecting lower fee growth and higher costs, together with the increasing cost of regulation and compliance.

Corporate consolidation however, continues with larger corporates increasingly dominating the nursing sector with ownership of the larger purpose built homes, while private businesses operate smaller converted nursing and residential homes.

Debt lending and valuation multiples

Debt lending is now returning to more normalised Debt/EBITDA lending

parameters of x4-6 post the credit crunch of 2008 (when leverage reached x14)⁽⁷⁾.

Some private transactions that Grant Thornton has advised on recently reflect Enterprise Value (EV)/EBITDA multiples of:

- x3.5-6 for smaller private transactions with non-purpose built care home property stock
- x5 for non-purpose built national portfolios
- x7-8 for better quality modern purpose built care homes in areas of high demand (typical of a sizeable regional/national portfolio)

For propco investors, typical net asset yield for future proof stock is currently around 7% p.a. and +/- 1% subject to the covenant risk attaching to the care operator.

Government policy

Government cuts have prevailed to date but future funding may substantially increase following the Dilnot Report (Commission on the Funding of Care and Support) capping private contribution to government provided care at £72,000 (excluding accommodation costs), likely from 2016.

Increasing regulatory intervention is also high on the Government's agenda to avoid a repetition of the Southern Cross

failure. The Department of Health's (DoH) consultative paper 'Oversight in Adult Social Care', proposes the (CQC) acting in a financial monitoring capacity over the largest sector providers within the next 12 to 18 months.

Overview

In the short to medium term, highly leveraged operators and particularly those with compliance issues and operating from older properties and outside of London and the South East are most likely to be challenged, potentially leading to business failures.

Critically, in the longer term, positive demographics should assist the REC sector to retain and attract investors and their funders.

"Government austerity, increasing costs and static fees will continue to erode private sector earnings. Recovery, for quality operators, will come over the longer term as the proportion of self pay residents increasingly accept the need to pay higher fees for proportionately better quality accommodation and facilities."

Daniel Smith
Head of Private Sector Healthcare
Grant Thornton UK LLP

Sector trading

“Some regions may see bed shortages – a phenomena not seen for many years which would have a dramatic impact by forcing up Local Authority fees”

Bryan Higgins
Healthcare Advisory
Grant Thornton UK LLP



Market definitions

The Elderly care sector includes the following care categories:

- elderly
- physical disability
- dementia

This compares with the specialist care sector which includes the following care categories:

- learning disability (including autism)
- mental health
- acquired brain injury
- drug and alcohol rehabilitation
- children’s services

How the private (only) REC and specialist care sectors compare and contrast is shown in the table below:

Private sector market share⁽⁸⁾

	Unit no	Reg'd beds no	Av beds per home	Value £bn
Elderly:	10,033	381,000	38	11.2
Specialist:				
Mental Health Hospitals	251	8,100	33	0.9
Learning Disability/Mental Illness	5,164	49,900	10	2.5
Children's' homes		16,700		1.2
Specialist Total		74,700		4.6

Source: L&B Care of Elderly People 2012/13, and L&B specialist care market reports 2013

REC sector - composition

Within the total REC sector, the private sector:

- provides 381,000 beds (78% of total provision)
- generates £11.2 billion revenues

Elderly care beds and market value⁽¹⁾

	Private	Voluntary	NHS/LA	Non-residential	Total
Elderly					
Registered beds	381,000	68,000	39,000	–	488,000
%	78%	14%	8%	–	100%
Market value £bn	£11.2	£2.2	£1.9	£8.8	£24.1
%	46%	9%	8%	37%	100%

Source: L&B Care of Elderly People 2012/13

Registered beds - movement

Total current REC bed capacity of 488,000 has increased over the last five years by 16,000 beds (+3%) driven by:

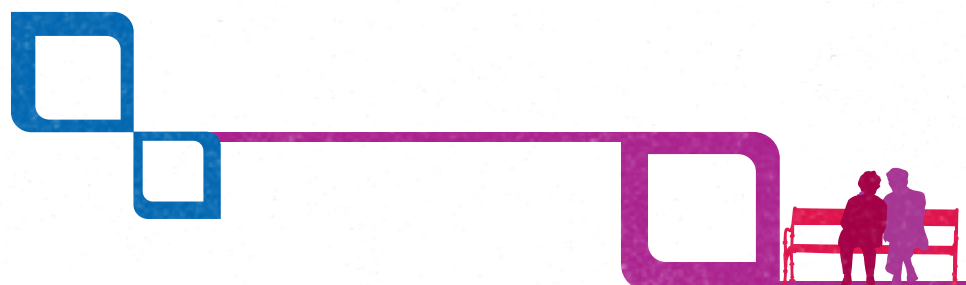
- Private sector growth of 34,000 beds (+10%) to 381,000 beds
- LA and NHS reduction of 19,000 beds (-33%) to 39,000 beds

We forecast this trend will continue with LA/NHS beds reducing to just 18,000 by 2020 with private sector beds increasing to c.400,000 beds.

Registered beds⁽⁹⁾

Sub-sector	2007	2012	Change
Private sector	347,000	381,000	10%
Voluntary sector	67,000	68,000	1%
Total independent	414,000	449,000	
LA/NHS long stay beds	58,000	39,000	(33%)
Total	472,000	488,000	3%

Source: L&B Care of Elderly People 2012/13



Currently there is an overcapacity of 41,000 (11%)⁽³⁾ private sector beds, but in reality this number is more likely to be c.30,000 beds (8%)⁽³⁾ if the available double bedrooms are counted on the basis of single occupancy - as reflected by current LA purchasing strategy. This should see a reduction following the forecast closure of LA beds and continued exit of older 'not fit for purpose' care homes. We estimate the independent sector will continue the current loss of older stock of beds at a rate of around 4,000⁽²⁵⁾ beds a year.

Unless the supply of new builds increases, it is possible that some regions may see bed shortages, a phenomena not seen for many years, which would have a dramatic impact on forcing up LA fees.

New care homes

New independent care home registrations remain at around 7,500 beds p.a. (in the last 3.5 years and excluding de-registrations)⁽⁹⁾. This rate actually exceeds the pre-credit crunch build average of 5,000 beds per year which is thought to be explained, at least in part, by the post 2008 reduction in land prices. Examples of operators opening new care homes are LNT (Orchard Care), Barchester and Avery Healthcare.

Occupancy

Occupancy in the private sector is 89% and 90% for nursing and residential care, respectively. Voluntary sector occupancy is 94%, being normally at a slightly higher rate compared with private provision. Of particular note is the low occupancy in both LA and NHS long stay provision, a further reason why state care provision is reducing.

As is well publicised, LAs are having to absorb significant budget cuts and consequently LA referrals for the independent sector are under significant pressure.

Additionally, both the Government and LAs are increasingly choosing non-residential/domiciliary based care, both as a preferable care environment for the individual and also a cheaper form of care provision. This stance remains the most significant threat to the REC sector.

Occupancy by sub-sector in 2012⁽¹⁰⁾

Sub-sector	Registered beds	Occupied beds	Occupancy %
Private sector – Nursing	186,000	165,000	89%
Private sector – Residential	195,000	175,000	90%
Voluntary sector – nursing and residential	68,000	64,000	94%
Sub-total	449,000	404,000	90%
Local Authority (LA)	25,000	16,000	64%
NHS long stay beds	14,000	12,000	86%
Total	488,000	432,000	89%

Source: L&B Care of Elderly People 2012/13

Whilst there appears to be spare capacity to absorb forecast increases in demand, only 17%⁽¹¹⁾ of current available beds were registered after 2000 leaving a very significant number of older provision that is increasingly becoming not fit for purpose, which under normalised economic conditions would exit and be replaced by new builds.

A lack of recent funding combined with negative sector press sentiment has deterred investors and perpetuated older stock to the detriment of the market. This situation does however appear to be changing with a larger number of new builds coming onto the market since the credit crisis.



“Government and LAs are increasingly choosing non-residential/domiciliary based care. This stance remains the most significant threat to the REC sector.”

Bryan Higgins
Healthcare Advisory
Grant Thornton UK LLP

Care home development

Of increasing importance is the rising quality of homes in build since the 1990s, as illustrated.

What does a well specified home look like?

1 Pre 1990 Original model



- Mainly conversions
- Mix of single and twin rooms
- Few en-suites

2 1990s 1st generation homes



- Purpose built
- Mostly en-suite WC and wash hand basin
- 10m² room sizes
- Mainly single



3

Post 2000s 2nd generation homes

- All single with en-suite showers and WC
- 12-16m²
- Improving in quality throughout the decade

4



Post 2010 New generation homes

- Often 18-20 sq m + rooms with full en-suite wet rooms
- All single accommodation
- Wide variety of lounges, dining rooms and other communal areas
- Specialist therapy suites, sensory rooms and clinic areas
- Cinema rooms, cafés and shops



Today's
Homes

Source: Christie + Co.



Demand and supply

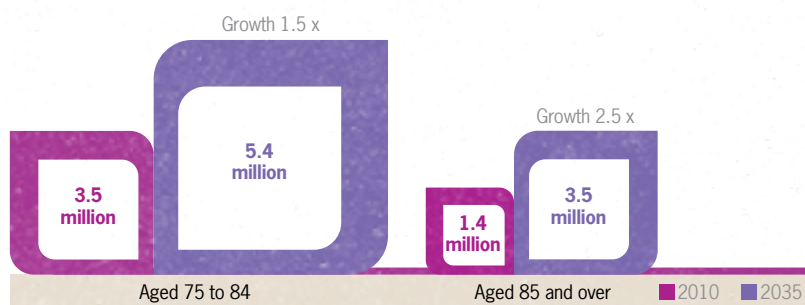
Whilst LAs are seeking to divert placements to cheaper non-residential/domiciliary based alternatives, the increasingly ageing population of the UK appears to be underpinning the overall rise in REC capacity and occupancy.

This is shown in population forecasts of the Office for National Statistics (ONS) which projects that by 2035 there will be 3.5 million UK residents aged 85+ compared to only 1.4 million currently. Over the coming 20 years, the Government accordingly estimate that 1.7 million more adults will require some type of care and support⁽²⁴⁾.

Due in part to demographics, the REC sector has shown a recent upswing in demand (since 2008) after a decade of decline arising from budget constrained LAs.

Total REC demand has risen slightly over the last year (to 2012) to 432,000 residents (2011: 422,000) with occupancy of 89% (2011: 87%)⁽¹⁰⁾.

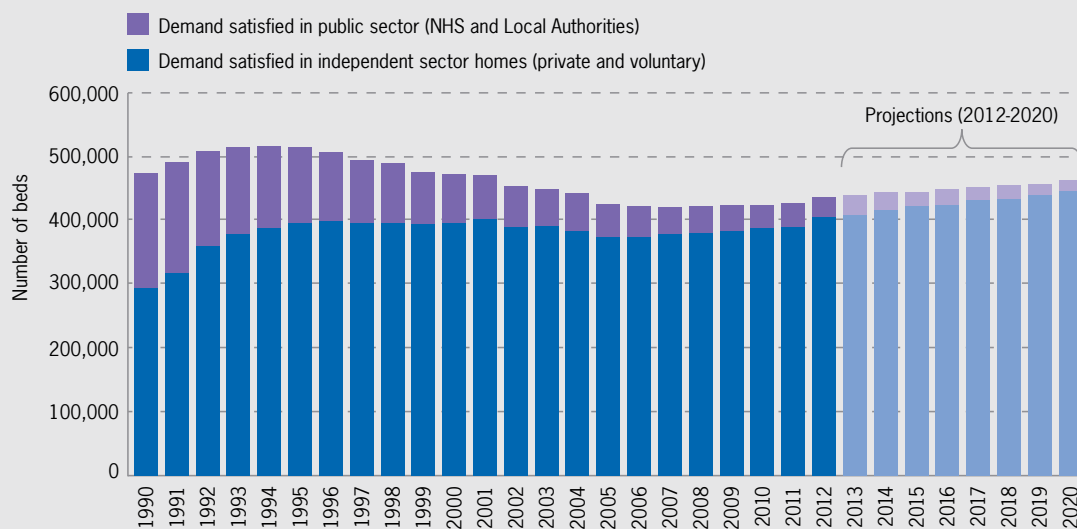
Ageing UK population forecast – 25 years⁽¹²⁾



Source: L&B Care of Elderly People 2012/13

Laing & Buisson (L&B) forecasts that by 2020 demand for REC will increase by over 5% (23,000 occupied beds)⁽¹³⁾, reflecting demographic trends. The chart below illustrates this position further and also the long term transfer of residents from LA to (mainly) private care providers.

Increasing reliance on independent sector beds for long term care



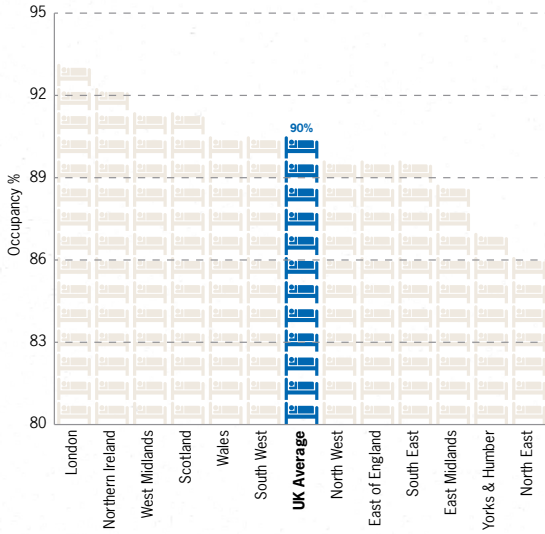
Source: L&B Care of Elderly People 2012/13

Occupancy by region

While UK independent sector occupancy averages 90%, occupancy varies considerably by region with:

- London reporting the highest average occupancy at 93%; and
- The North East of England the lowest average occupancy at 86%

Occupancy by region⁽¹⁵⁾ (average of nursing and residential care)



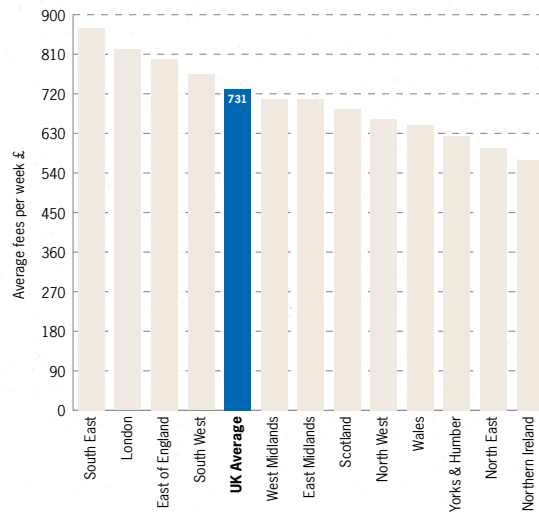
Source: L&B Care of Elderly People 2012/13

Fees

Similar to occupancy, fees vary considerably by region for the independent sector with:

- The South East and London reporting the highest average nursing/residential fees of £869 and £598, respectively;
- Northern Ireland, Yorkshire and Humberside the lowest average nursing/residential fees of £570 and £463, respectively; and
- Overall UK fees being an average for nursing/residential occupation at £731 and £531, respectively

Average fees per week – nursing care by region⁽¹⁶⁾

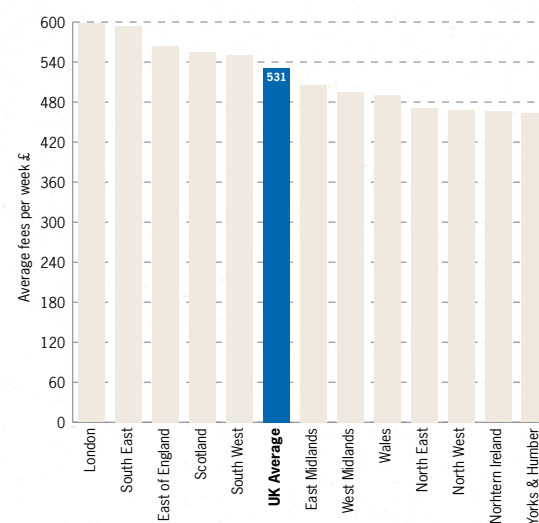


Source: L&B Care of Elderly People 2012/13

“Our specialist team of healthcare relationship managers has a strong knowledge and sound understanding of the challenges facing the social care sector. Our lending criteria takes into account regional occupancy and fee rates, and we do not anticipate significant change to either of these business drivers over the next 12-24 months.”

Mark Ellis
Head of Property and Social Care Banking Services, Lloyds Banking Group

Average fees per week – residential care by region⁽¹⁶⁾



Source: L&B Care of Elderly People 2012/13

Over the last five years the compound average growth (CAG) rate of fees (including LA funded and self-pay) rose by between 3-4% as shown in the table below:

Movement in average fees⁽¹⁶⁾

	2007	2012	%CAG
Nursing	£629	£731	3%
Residential	£447	£531	4%

Source: L&B Care of Elderly People 2012/13

Despite such increases, many operators argue that the fee increases are misleading when compared to the rise in acuity of new nursing clients.

The rising incidence of Judicial Reviews following the landmark Pembroke case in 2010, where operators challenge stagnant or negative LA fee rises, are however making an impact on how LAs set their annual base fee rates. The result is that many LAs are seeking to set fee increases at a reasonable level to avoid a costly legal challenge.

We note the private pay segment remains notably robust considering economic conditions prevailing and has been increasingly cross-subsidising LA fees, or more correctly, paying the true cost of care.

Funding composition

The funding profile of REC continues to change:

- the proportion of LA funded residents falling marginally to 50%, continuing the gradual decline seen over the last 10 years
- the proportion of self-pay residents rising marginally to 43%
- the proportion of NHS funded residents remaining static at around 7%

Funding sources⁽¹⁷⁾

Funding source	Number of residents	% of residents
Private and voluntary sectors		
Local Authority (pure)	144,000	36%
Local Authority with top-up	56,000	14%
Local Authority – sub-total	200,000	50%
Self-pay (pure)	175,000	43%
NHS	29,000	7%
Total	404,000	100%

Source: L&B Care of Elderly People 2012/13



“The private pay segment remains notably robust considering economic conditions prevailing and has been increasingly cross-subsidising Local Authority fees, or more correctly, paying the true cost of care.”

Bryan Higgins
Healthcare Advisory
Grant Thornton UK LLP

Rising costs

The annual cost of nursing and residential care is illustrated below.

Wages are the major sector cost of care homes, accounting for typically around 57%⁽⁵⁾ of revenue in nursing homes and 49%⁽⁵⁾ in residential homes. Non-staff costs including food costs run at an average of 18%-23%⁽¹⁸⁾ of fee income.

Care home operators across the North, Yorkshire & Humberside and the Midlands, in particular, will be affected by wage cost increases. Operators in these locations are more sensitive to increased NMW and related staff costs, having the lowest average resident fee rates and a comparatively high percentage of LA funded residents.

The NMW has increased by 2.5%, 1.8% and 1.9% in the three years to October 2013.

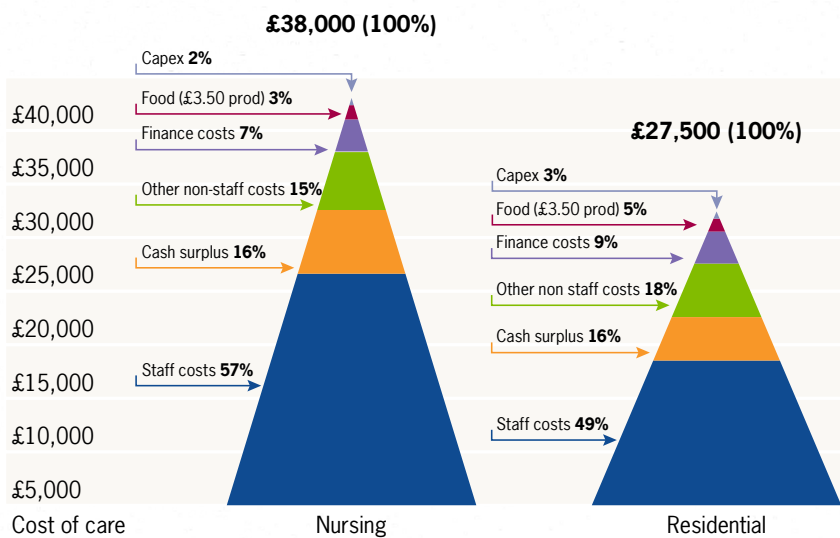
Traditionally, the sector has been reliant on plentiful foreign labour for both trained and carer positions. This is under threat as the Government seeks to cap immigration from non EU countries, which if implemented, could drive up operators' wage costs even further.

Impact on corporate profitability

EBITDAR ranges typically between 20% and 32% for larger corporate businesses, extracted by Grant Thornton analysis of the largest four providers shown overleaf. Four Seasons' 20% reflects predominantly state funded residents and Barchester's 32% a higher proportion of private pay. Outside of this range is the new corporate, HC-One (12%), which includes the NHP properties spun out of Southern Cross.

Cost of care per annum

Assuming an average home and at 90% occupancy



Source: L&B Care of Elderly People 2012/13 and Grant Thornton analysis

Major elderly care providers financial performance comparison⁽¹⁹⁾

Funding source	Four Seasons Health Care	Bupa Care Homes plc	Barchester Healthcare Ltd	HC-One Ltd	Average KPIs
Year-end Months	December 2012 12 mths £m	December 2012 12 mths £m	December 2012 12 mths £m	September 2011 14 mths £m	
Revenue	712	482	463	277	100%
Staff costs	(429)	(282)	(230)	(185)	(58%)
Non-staff costs	(138)	(93)	(87)	(59)	(19%)
EBITDAR	145	107	146	33	23%
EBITDAR/Revenue %	20%	22%	32%	12%	
Property rent payable	(48)	(44)	(100)	(37)	(11%)
EBITDA	97	63	46	(3)	12%

Source: Companies House/Company presentations/Grant Thornton analysis

Note: EBITDAR is the best profitability measure for a like-for-like comparison being unaffected by whether property is owned or rented.

“Despite the recession, the private sector remains attractive for PE to selectively invest, noting the growing polarity in the sector with quality and specialist private care providers producing best returns.”

Bryan Higgins
Healthcare Advisory
Grant Thornton UK LLP

“There is an opportunity for independent care providers to play a more beneficial part in the health and social care mix alongside the public sector; for example taking some of the strain from NHS to ease bed blocking by the estimated one third of patients, mostly elderly, who have no clinical need to be in a hospital ward. By caring for them in residential settings the independent care sector could potentially save the NHS billions of pounds. For this to happen requires political will to reform and, once again, an integrated approach to health and social care.”

Ian Smith
Chairman and Interim CEO
Four Seasons Health Care Limited

Corporate activity

Despite the credit crisis, major corporate providers continue their gradual consolidation and now account for 58% of all private provision (50% in 2008)⁽²⁰⁾.

With recent emphasis on consolidation, as opposed to growth, the corporate operators are far more focused on nursing care (70% share) rather than residential care (41% share)⁽²¹⁾.

The remaining private capacity is provided by small businesses with a high proportion of non-purpose built homes operating mainly residential homes, as opposed to nursing homes. This type of care provision is more frequently operationally and financially inefficient and is not 'future proof', therefore it has a limited appeal to corporate purchasers or mainstream lenders.

Private Equity investment/sale and leaseback

Many large corporate providers owe their existence to private equity (PE) and the vibrant sale-and-leaseback market in 1998 to 2006.

The demise of Southern Cross in 2011 challenged the integrity of the Propco/Opco model when the Group's EBITDAR to rent cover reduced to 1:1 against a de-minimis industry norm considered to be nearer a range 1.6 to 1.8:1⁽²²⁾.

Recently there has been some resurgence for this funding model with the market entry of US Real Estate Investment Trusts (REITs), aimed primarily at recent modern purpose built units in the South East tapping into the private pay market. REITs possess liquidity and are particularly attracted by the UK demographic profile, stable trading and long RPI linked leases.

For propco investors typical net asset yield for future proof stock is currently around 7% p.a. and +/- 1%, subject to the covenant risk attaching to the operator.

Generally, PE continues to selectively invest in quality REC and specialist care where the margins and multiples are stronger. A number of PE firms also specialise in distressed funds seeking turnaround opportunities involving quality assets.

"Healthcare remains an attractive sector for both lenders and investors alike. Notwithstanding ongoing austerity measures, the sector still benefits from the strong demand drivers of an ageing population and in recent months it has successfully attracted new sources of investment, particularly from overseas."

Stuart Dean
Head of Healthcare and Pharmaceuticals,
Royal Bank of Scotland plc

Debt lending

Debt lending is now returning to more normalised Debt/EBITDA lending parameters of x4-6 after the credit crunch of 2008 prior to which leverage reached x14⁽⁷⁾.

Major transactions and valuation multiples

After the collapse of Lehman Brothers in September 2008 there have been two major deals in the REC sector:

- Care UK/Bridgepoint deal in April 2010 with a x7 EBITDA and enterprise value (EV) of £423 million
- Four Seasons/Terra Firma deal in May 2012 with a x8.1 EBITDA and EV of £825 million

Some private transactions that Grant Thornton has advised on recently reflect EV/EBITDA multiples of:

- x3.5-6 for smaller private transactions with non-purpose built stock
- x5 for non-purpose built national portfolios
- x7-8 for better quality modern purpose built care homes in areas of high demand

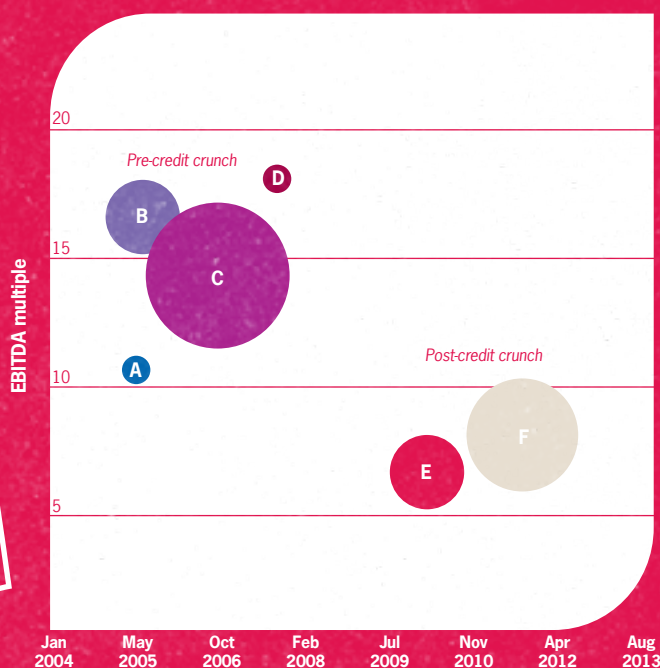
These EBITDA multiples are still a long way off the double digit multiples seen prior to the credit crisis.



“Trading performance is a key driver of value. Occupancy, fee rates and staff costs are the three most critical variables,”

Richard Lunn
Head of Care
Christie + Co

Major UK care sector transactions 2005-2013 (excluding specialist care) ⁽²³⁾



- A** BetterCare/Four Seasons Healthcare - EV £116m
- B** ANS Plc/BUPA - EV £328m
- C** Four Seasons Healthcare/Three Delta - EV £1,400m
- D** Avery Healthcare/Southern Cross Healthcare - EV £97m
- E** Care UK/Bridgepoint Capital - EV £423m
- F** Four Seasons Healthcare/Terra Firma - EV £825m

Source: Grant Thornton UK LLP analysis

Government policy

In addition to the impact of Government cuts and LAs raising eligibility criteria, operators will be impacted by the recent and proposed care legislation which includes:

- Clinical Commissioning Groups (CCG) replacing Primary Care Trusts (PCT)
- increases to GP's powers to commission care services
- strengthening of the CQC's remit and development of the CQC's role into a financial regulator for the social care sector

The recent DoH's consultation paper 'Oversight in Adult Social Care' published in May 2013, shows the Government's determination to avoid another 'too big to fail' elderly care operator insolvency by proposing the introduction of CQC to police the top 50 or so private care providers.

The concern for lenders involved with this target group of the largest national care providers is a potential loss of control should CQC intervene and obtain a 28-day moratorium on creditor enforcement and who will fund and pay for any trading losses during this period. Lenders should consider covenants requiring their larger care clients to provide them with all information and correspondence exchanged with CQC as part of the market oversight process.

What is being proposed now looks to be a relatively light touch compared to earlier proposals. The paper recognises the structure/resilience of the private care sector, while at the same time seeking a legislative safety net to demonstrate a level of Government control. This 'interventionist' model will require very close evaluation as it is developed. These proposed changes will be implemented over the next 12 to 18 months and undoubtedly will make life for REC operators more challenging.

CQC's increased activity and powers are already being seen with the number of care inspections increasing from 13,470 (2011) to 35,371 (2012) and the number of warning notices increasing from 638 to 910 over the same period.

Finally, the Government's efforts to increase the use of domiciliary care (ie home care), seen as a cheaper alternative to residential care, will have a longer term impact on elderly care operators. Going forward, we expect an increased share of the care budget to be given to fund domiciliary care, supported living, re-ablement and other related services.

"Social care provides vital support for vulnerable people and should be one of the Government's central priorities because good social care enables people to be as independent as possible, reduces pressure on the NHS, and is a vital part of the national and local economy. Despite this, the Government seems incapable of providing leadership, and allows local authorities to underfund the care system and fails to acknowledge the economic importance of care to the UK economy. It is in everybody's interest to have a vibrant and sustainable social care sector and we cannot leave its development to the mercy of monopsony commissioning. We need proper funding to ensure a sustainable future."

Professor Martin Green
Chief Executive
English Community Care Association

The future

So what does the future hold?

Government figures estimate that in 20 years there will be 1.7 million more elderly people requiring care and proportionately fewer people of working age to fund them⁽²⁴⁾.

With this increasing and impending burden, the Government has set up the Commission on the Funding of Care and Support (the Dilnot Report) which recommended a range of options to tackle funding of elderly residential care. However, this will inevitably increase Government funding. The central current proposal, being a cap on the contribution individuals have to make for care, was welcomed by operators. The Government has confirmed it will introduce a £72,000 cap for care fees (excluding accommodation costs), although this is not likely to happen until 2016.

In the meantime, whilst positive demographics should assist the industry, the sector will face significant challenges over the coming years, notably:

- existing private sector overcapacity of beds
- limited LA funding increases and squeezed private payers. LAs will however be mindful to set realistic rates to avoid Judicial Reviews
- payroll costs rising to reflect the rise in the NMW
- the significant stock of older, poorer quality properties requiring significant capital investment or replacement
- pension costs of between 1-3% to be borne by operators by 2015

Most affected will be the higher leveraged operators in areas of current over capacity and lower fees, compounded by low occupancy and operating from older properties. The regions most at risk are the North East, Yorkshire and Humberside – although no region will be immune.

These challenges will have a significant impact in the coming years, undoubtedly resulting in increased business failures.

Restricted access to finance will also continue the slow burn of older care home closures.

Those businesses failing with quality assets will most probably be sold to new corporate owners but those with average/low quality and non-purpose built assets, particularly with sub 80% occupancy, are likely to suffer increasing difficulties, potentially leading to closure.

Despite the recession, the private sector remains attractive for PE to selectively invest, noting the growing polarity in the sector with quality and specialist private care providers producing best returns.



“2013 has seen an increase in confidence as operators focus on the provision of quality care which bodes well for the future.”

Paul Birley
Head of Public Sector and
Healthcare
Barclays Bank plc

Appendix 1. Key performance indicators

	Nursing	Residential	All
Financial			
Fee income (singles) ⁽¹⁶⁾	£731	£531	
Average occupancy ⁽¹⁵⁾	89%	90%	
LA funded clients ⁽¹⁷⁾			50%
NHS funded nursing clients ⁽¹⁷⁾			7%
Privately funded clients ⁽¹⁷⁾			43%
Average staff costs ⁽⁵⁾	57%	49%	
Average non-staff costs ⁽³⁾	18%	23%	
EBITDAR ⁽³⁾	25%	28%	
Food costs prpd ⁽³⁾	£3.50	£3.50	
Operational			
Single rooms ⁽²⁶⁾	92%	92%	
En-suites ⁽²⁶⁾	76%	68%	
Average care home size (beds) ⁽⁸⁾	50	28	
Number of beds (private and voluntary) ⁽¹⁰⁾	204,500	244,500	449,000













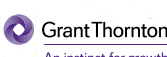
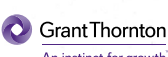
Source: L&B Care of Elderly People 2012/13 and Grant Thornton UK LLP analysis.


















Appendix 2. Recent assignments and transactions

Grant Thornton has a leading position in the private healthcare sector and a track record of delivering value and minimising risks for operators, their funders and other stakeholders. Our experience includes high profile corporate finance and restructuring transactions across elderly, specialist and domiciliary care, as well as high street care services.

Selected healthcare assignments

<p>Southern Cross</p>  <p>Advisory</p> <p>Restructure and disposal options to the UK's largest healthcare company</p> <p>2011</p> <p>Grant Thornton advised on strategic options</p>	<p>Castlebeck Care</p>  <p>Restructuring and disposal</p> <p>Learning disabilities and mental health – 50 sites (MHC, Young Foundations and Castlebeck under administration trading)</p> <p>2010-2013</p> <p>Grant Thornton provided advice to creditors</p>	<p>Mild Professional Homes</p>  <p>Restructuring and disposal</p> <p>Learning disability hospitals, step down units and adolescent care - 14 sites – administration trading and disposal</p> <p>2012</p> <p>Grant Thornton provided advice to creditors</p>	<p>Project Boot</p>  <p>Advisory</p> <p>Operator of 60 care homes providing care for the elderly</p> <p>2011</p> <p>Grant Thornton provided advice to creditors</p>	<p>Project Angel</p>  <p>Advisory</p> <p>Operator of 30 Care homes providing care for the elderly</p> <p>2013</p> <p>Grant Thornton provided advice to creditors</p>
<p>Project Glorious</p>  <p>Advisory</p> <p>Local Authority defending a Judicial Review- selective critique of financial model/assumptions</p> <p>2012</p> <p>Grant Thornton provided advice to its client</p>	<p>Project Swan</p>  <p>Advisory</p> <p>Operator of eight homes providing care for the elderly</p> <p>2011</p> <p>Grant Thornton advised on strategic options</p>	<p>Rotel</p>  <p>Restructuring</p> <p>Learning Disabilities- Residential and Domiciliary Care – administration trading and disposal</p> <p>2011</p> <p>Grant Thornton provided advice to creditors</p>	<p>Project Spring</p>  <p>Advisory</p> <p>Solvent review of a major extra-care operator on multiple sites</p> <p>2010</p> <p>Grant Thornton advised on strategic options</p>	<p>Project Peak</p>  <p>Advisory</p> <p>Learning Disabilities, Children's services partial transfer to Supported Living/Domiciliary Care on the 3 sites</p> <p>2011-12</p> <p>Grant Thornton provided advice to creditors</p>
<p>Gentle Care Services</p>  <p>Restructuring</p> <p>Elderly/Physical Disability nursing home – administration trading and disposal</p> <p>2012</p> <p>Grant Thornton provided advice to creditors</p>	<p>Project Honda</p>  <p>Advisory</p> <p>Care Home Association challenging a Local Authority on annual care fees</p> <p>2012</p> <p>Grant Thornton provided advice to its client</p>	<p>Atlas Project Team</p>  <p>Restructuring</p> <p>Operator of eight homes providing learning disability care - partial administration trading and disposal</p> <p>2012</p> <p>Grant Thornton provided advice to creditors</p>	<p>Alutarius</p>  <p>Restructuring</p> <p>Operator of eight elderly care homes – administration trading and disposal</p> <p>2010-11</p> <p>Grant Thornton provided advice to creditors</p>	<p>Park Group</p>  <p>Restructuring</p> <p>Operator of four elderly care homes – administration trading and disposal</p> <p>2008-2010</p> <p>Grant Thornton provided advice to creditors</p>

Corporate Finance transactions

<p>CB Care Limited</p>  <p>Disposal of trade and assets of Castlebeck Care (Teesside) Limited to Danshell Group</p> <p>Specialist care provider</p> <p>£undisclosed September 2013</p> <p>Grant Thornton provided corporate finance advisory and tax services</p>	<p>CB Care Limited</p>  <p>Disposal of Young Foundations Limited to private investor</p> <p>Specialist care provider</p> <p>£undisclosed February 2012</p> <p>Grant Thornton provided corporate finance advisory and tax services</p>	<p>CB Care Limited</p>  <p>Disposal of Mental Health Care (UK) Limited to private investor</p> <p>Specialist care provider</p> <p>£undisclosed November 2012</p> <p>Grant Thornton provided corporate finance advisory and tax services</p>	<p>Rutland Partners</p>  <p>Sale of Advantage Healthcare Holdings Limited to Interserve plc</p> <p>Healthcare services</p> <p>£26.5 million December 2012</p> <p>Grant Thornton provided financial, tax and IT vendor due diligence services</p>	<p>City and County Healthcare Holdings Limited</p>  <p>Acquisition of Comfort Call Limited</p> <p>Homecare</p> <p>£26.5 million November 2012</p> <p>Grant Thornton provided due diligence services</p>
<p>Direct Health Group Limited</p>  <p>Disposal to Accord Housing Association</p> <p>Domiciliary care provider</p> <p>£undisclosed June 2012</p> <p>Grant Thornton provided vendor due diligence services</p>	<p>Accord Housing Association</p>  <p>Acquisition of Direct Health Group Limited</p> <p>Social housing</p> <p>£undisclosed June 2012</p> <p>Grant Thornton provided financial and tax due diligence services</p>	<p>Abbey Care Investments Limited/Life Style Care Plc</p>  <p>Refinancing</p> <p>Care homes</p> <p>£45 million June 2012</p> <p>Grant Thornton provided due diligence services</p>	<p>Nightingale House</p>  <p>Merger with Hammerson Home</p> <p>Operator of care homes</p> <p>£undisclosed April 2012</p> <p>Grant Thornton provided due diligence services</p>	<p>Phoenix Learning & Care</p>  <p>Disposal to Ashridge Capital</p> <p>LD & BESD care and education</p> <p>£undisclosed March 2012</p> <p>Grant Thornton provided corporate finance, advisory services</p>
<p>Acorn Care and Education Ltd</p>  <p>Acquisition of Pathway Care fostering</p> <p>Fostering services</p> <p>£undisclosed August 2011</p> <p>Grant Thornton provided corporate finance advisory services</p>	<p>Ludlow Street Healthcare</p>  <p>Merger of Beechwood Court and Orbis Education & Care</p> <p>Specialist education and care</p> <p>April 2011</p> <p>Grant Thornton provided corporate finance advisory services</p>	<p>Partners in Specialist Care Ltd</p>  <p>Disposal to Voyage Holdings Ltd</p> <p>Specialist domiciliary care</p> <p>£undisclosed December 2010</p> <p>Grant Thornton provided corporate finance advisory services</p>	<p>CareTech Holdings plc</p>  <p>Acquisition of Branas Isaf (Holdings) Limited</p> <p>Residential care for young persons</p> <p>August 2010</p> <p>Grant Thornton provided financial due diligence services</p>	<p>August Equity</p>  <p>Acquisition of Active Assistance Limited and First Call Care Services Limited</p> <p>Complex homecare provider</p> <p>£23 million March 2010</p> <p>Grant Thornton provided corporate finance advisory services</p>

Appendix 3. Bibliography

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- (3) Grant Thornton UK LLP sector comment/estimate from L&B report data
- (4) L&B report p21
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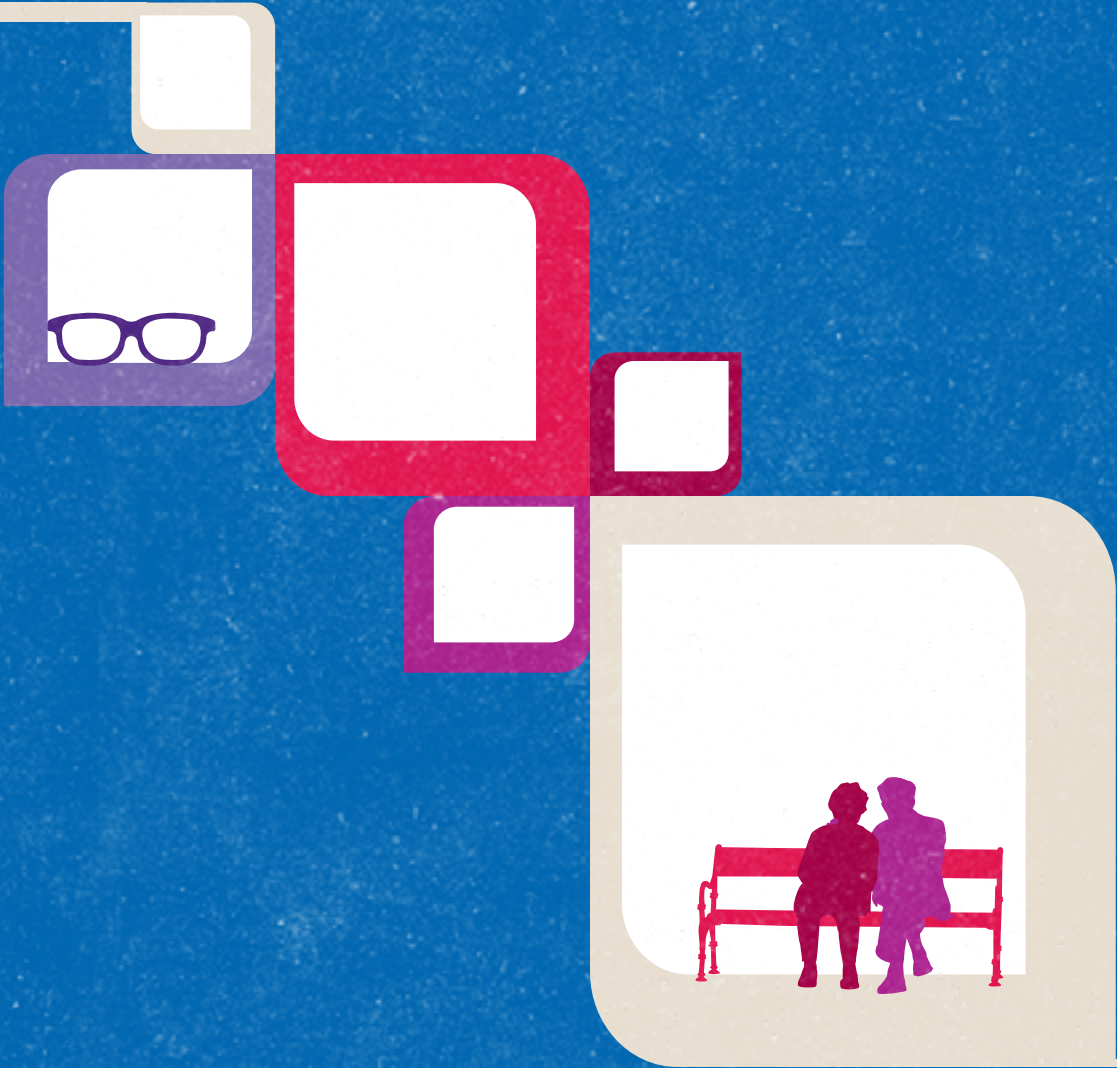
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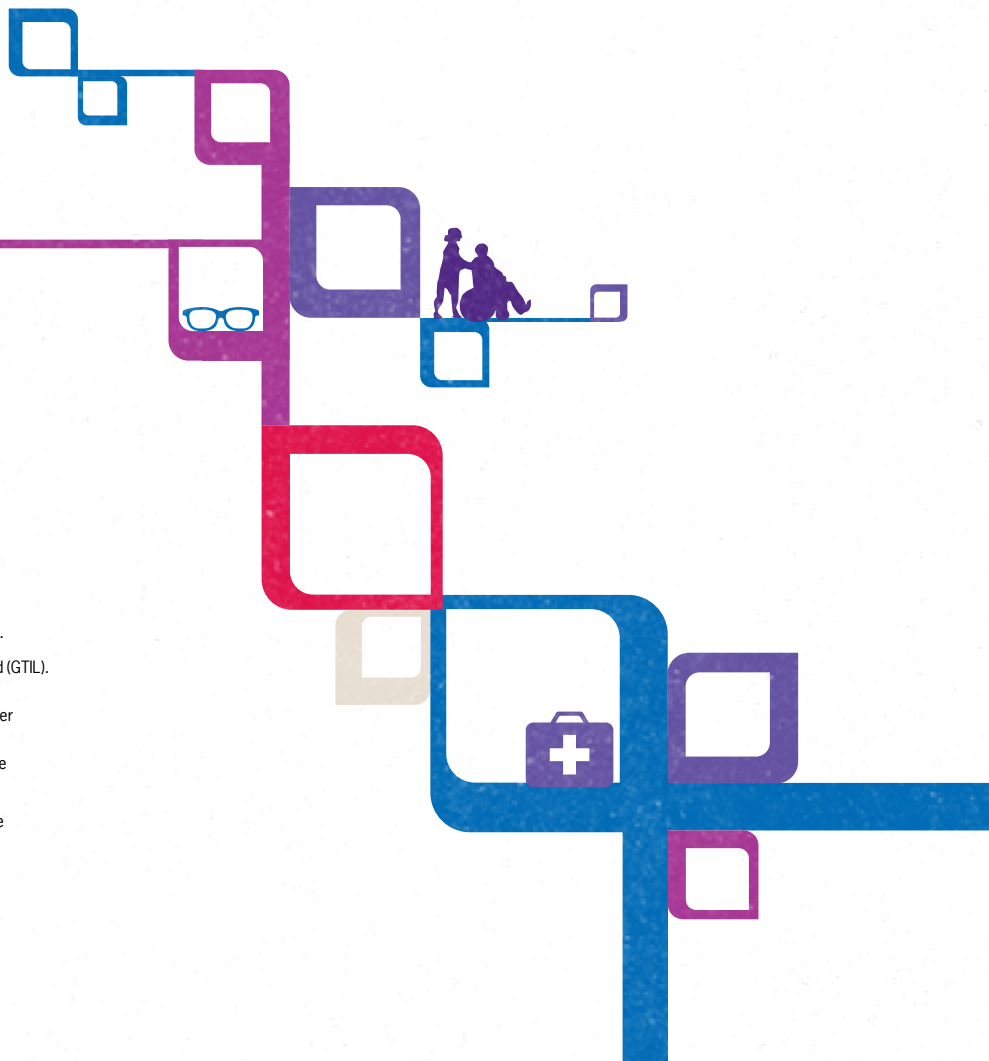
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