A perfect storm

Candesic's **Dr Leonid Shapiro** examines the confounding factors challenging the elderly care industry and how operators should navigate the troubled waters

We've all heard about the plights of the care sector, driven by increasing demand, flat or even real term reduction in funding, and increased regulatory pressures. But recently, a number of discrete events in the industry have created a step-change in the challenges operators face, with financial implications that may see many exit the sector. Candesic estimates that if these are left unchecked, they could reduce operator margins by 12%, driving many care homes /companies out of business.

There are a number of recent events exerting or threatening to exert sudden pressure on the sector *(figure 1)*. The living wage is perhaps the most talked about and stands to add significant labour costs to all operators. Paying home care carers for travel time and sleep-ins is another blow to operator wage costs. The Care Quality Commission's (CQC) new inspection methodology, together with its ever rising bar for what is acceptable, is further driving increased costs as operators spend to meet them. And recent pension auto-enrolment legislation, requiring all operators to contribute to carer pensions, is further driving up costs. Candesic recently interviewed over a dozen local authorities (LAs) about these issues.

National living wage

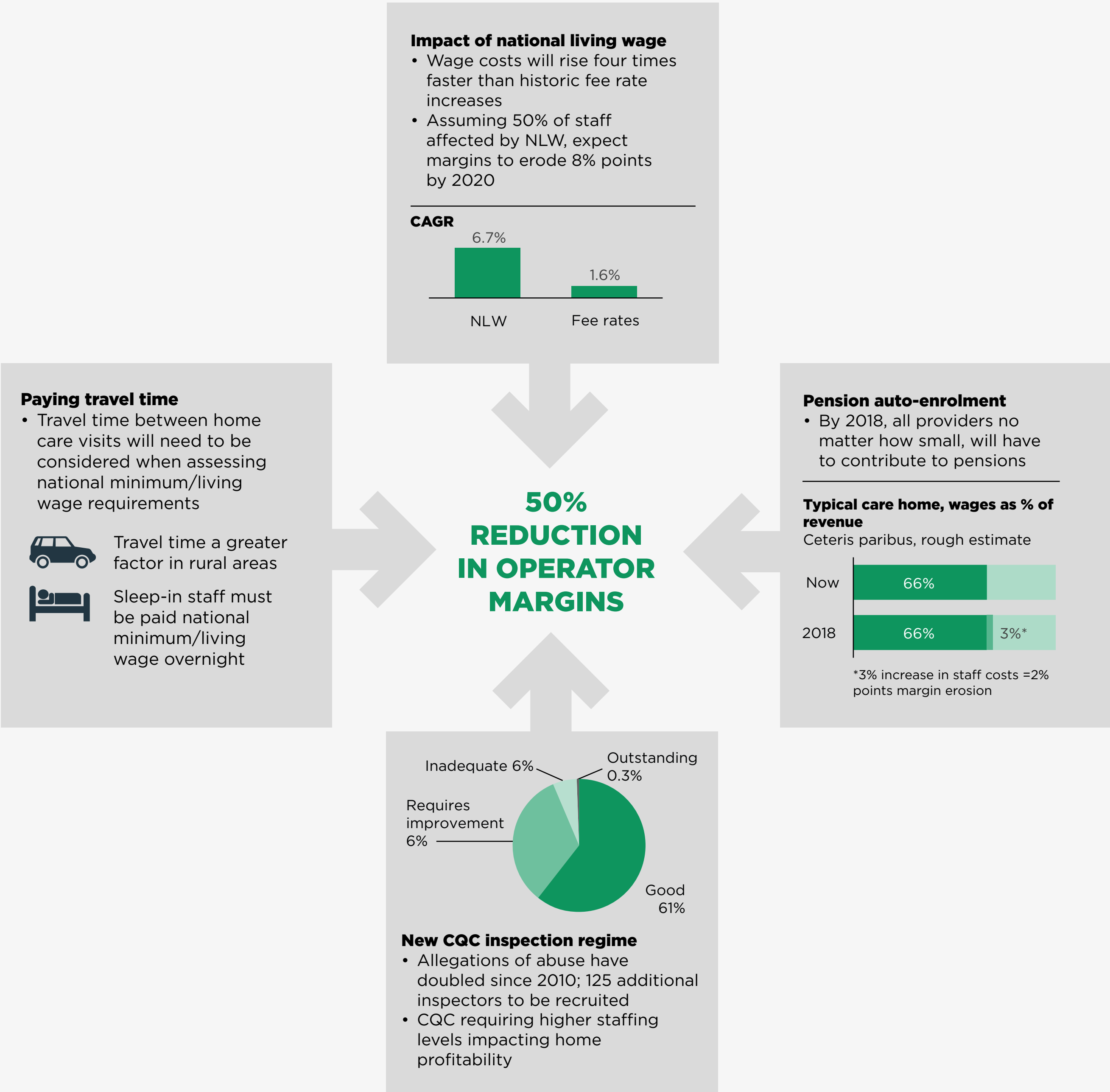
The chancellor's recent budget announcement included provision for a national living wage (NLW), which in effect increases the national minimum wage (NMW) from £6.50/hr now to £9/hr in 2020 for all those aged 25 and over. That's an increase of 6.7% per year, well above the rate of inflation which is hovering at around 1%-2%. Furthermore, at the same time, weekly fee rates paid by LAs have grown by only 1.6% across England in the last year. Candesic figures estimate that circa 80% of care home workers are 25 and over and with staff costs accounting for almost two thirds of revenues, the NLW could erode around 10% points of operator margin over the next five years. With larger operators' margins being around 20% before rent, this would halve contribution and cause masses of operators to miss rent and debt payments.

Most operators, however, expect LAs to increase fees to compensate for the NLW. Most LAs we interviewed said they were planning on raising fees to take into account NLW and about 15% said they had already internally calculated the impact on their elderly care budget. However, none of them knew exactly where the extra money was going to come from, many giving a generic answer of some combination of cutting other budgets and increasing council tax. Some said they expected NHS money to become available to them through integrated care and others expected providers to increase staff productivity as they would have more highly paid workers.

One key feature of this is that LAs are likely to ask for quality improvements as part of increasing fees to meet NLW. One council told us that they would force reduction in zero-hour contracts in order for operators to get access to higher fee rates. Another council told us

FIGURE 1: A NUMBER OF RECENT EVENTS WILL CHALLENGE THE CARE SECTOR GOING FORWARD

PRESSURES ON SOCIAL CARE



that they expect the NLW to improve the quality of staff and reduce churn rates so as to improve continuity of care and care quality overall.

Another key feature is the interesting dynamic that will occur with hiring young carers. Operators may age-discriminate and preferentially give entry-level jobs to under 25s to save paying the NLW. Even those close to 25 will become less desirable as employers will be cognisant of the 10% pay hike they will have on their 25th birthday. The carer pool might shift towards younger people with less life experiences.

But whatever happens, the results are going to be patchy. It's inevitable when you have central government legislating a top-down cost increase (through NLW) while leaving local government to decide on fees. Up north, where supply generally exceeds demand, we expect LAs to keep fee pressure high. In the South East, LAs can't afford for providers to exit the market so are likely to raise fees to meet additional NLW costs. However, all is not lost for those in oversupplied micromarkets as eventually providers will exit those markets and ▶

those left standing can expect higher occupancy rates. We estimate that an increase of 4-5% in occupancy will fully compensate the cost implications of the NLW, and that is easier to do in the north than in the south, which is already operating at occupancies in the 90s.

Also, home care operators are more likely to be able to pass on NLW pay hikes to commissioners, since home care economics are more transparent. Indeed, one council told us they estimated their home care budget would rise by 19% by 2020, however, they went on to say that they are unlikely to be able to meet these additional costs in the first year of the NLW.

Paying travel time to home care staff

Another pressure on the industry is the increasing call for operators to pay for travel time between home care visits. At the moment, most providers pay an hourly rate to home care carers only for the time they are in the client's home. Any travel time between clients is not specifically paid for in most cases. Many operators say they bundle assumed travel time into the 'client time' hourly rate, and this generally works, however, in more rural areas, where travel time is higher as a proportion of care hours, this can be a problem. HMRC has already named and shamed several care sector operators for not paying the NMW and this issue is only going to get worse with the NLW.

Candesic estimates that there are around 150,000 home care workers who regularly travel between clients and that while most of them are currently being paid above the NMW even if one includes travel time, many of them will not once the NLW comes into effect and that operators will have to start specifically paying for travel time. This will mean home care costs in less populated areas will go up faster than in urban areas. We think that there will be a shift in the market to pay staff a single rate for caring for clients as well as travelling, or at worst a differential rate but one which does specifically pay for travel time. Either way, costs for operators and commissioners will rise.

Furthermore, a similar thing has happened with sleep-in staff, who historically have been paid a nominal fee (as little as £20) to sleep overnight in a client's home, effectively being 'on call' should the client need them. Now carers must be paid the NMW (and soon the NLW) for sleeping in. We have seen one example of a care home turn from profitable to unprofitable due to this single change.

Increased CQC requirements

Operating a care home is not as easy as it used to be. Not only has the CQC implemented a more stringent rating methodology with a huge proportion of homes they inspect 'requiring improvement', but they have also back-tracked on things they previously said were allowable. For example, one operator recently saw their staffing cost skyrocket when the CQC changed their mind about the appropriateness of staffing a 25 bed nursing floor as one unit. The CQC ordered that due to its length (it was spread across a long hallway with a lift in the middle), it had to be run as two units. This forced doubling of some staff, in particular nurses, to cover the same 25 beds and turned the once profitable home into a loss maker.

Rates of allegations of abuse in care settings has also skyrocketed, reaching 60,000 per year, double the rate recorded in 2010. Furthermore, over two thirds of these were in care homes. That's an average of over two allegations of abuse per care home per year. These safeguarding issues take time and money to sort out, even if they are unfounded. Andrea Sutcliffe, CQC's chief inspector of adult social care, said she was hiring 125 additional inspectors to deal with these issues.

Analysis we have done in the past has also showed how the CQC is targeting larger providers with more frequent inspections, presumably to avoid another Southern Cross incident, or perhaps, as some providers believe, because the larger groups are more worried about bad press and therefore more responsive and take quicker action than mom-and-pop operators.

Pensions auto-enrolment

Over the next few years, new pensions legislation requires all businesses, no matter how small or how lowly paid their employees are, to organise and make a contribution to the pension of every employee. In addition to the administration costs, this new legislation will eventually see providers pay an additional 3% of their wage bill toward mandatory pension contribution. While this is a only a one-time hike, it will have the effect of wiping off 2% points of operator margin from care homes and even more for home care operators.

Doom and gloom?

There are some positives. The NLW might reduce churn. Typically, higher paid jobs churn less so a higher wage should reduce churn. One may argue that this will not happen as all 'low pay' jobs will move up and we will have the same problem, but this may not happen. One thing NLW will do is to compress salaries at the lower levels. As such, employers, social care and non-social care alike, will tend to not pay a differential to employees in a larger segment at the bottom of the range. So there will be fewer situations where one employer offers to pay 20 pence more per hour and 'pinches' an employee from another job. As such there will be less changing of jobs and in theory reduced churn at the lower levels. Operators would be wise to pay more now to entice quality staff to join their ranks as it may be harder to use money to win over staff after the NLW becomes entrenched. This will serve to improve staff quality now when the labour market is more fluid/ responsive before churn reduces later.

Another positive is that good operators will eventually prevail. In any time of market stress there are exits and those who are left standing (due to deeper pockets, better inherent infrastructure, and/or more efficient operating models) will do better in the end. We already mentioned how increased occupancy as a result of this in some parts of the country can completely counteract the impact of the NLW.

Paying for travel time will make wages more transparent and may increase the availability of home carers. Currently, the industry is supply constrained by the number of carers willing to be traveling home carers. Being more transparent and paying fairly for travel time could see a new breed of carers join the ranks and reduce supply side pressure on the industry. Operators would be wise to more closely align pay with the expectations of their carers and adopt the use of technologies that might reduce travel time and do other things to make traveling care more efficient.

The other good news is that the implementation of the Dilnot elements of the Care Act have been delayed until

2020 as the Government has realised they cannot afford this and paying for the NLW at the same time. The delayed reforms not only included the care cap, but more importantly for providers the obligation of LAs to organise the residential care of private payers. Under the legislation, private payers could use the LA to commission care home places and would likely get them at the LA rate rather than the usually higher 'private' rate. This would in effect stop the cross subsidisation of LA paid residents by privately paid residents and would eventually lead to higher LA fees all around – another thing the government couldn't afford.

Overall, we believe elderly care can be a good investment in the right micromarket. And care needs to be provided to our aging population, whether paid by the state or privately. So long term investments in the right places and the right assets will undoubtedly do well in the long run. Operators should take advantage of the changes being brought about by the NLW by securing quality staff and investing in training, two things churn usually makes unprofitable. They should also choose their battles, and choose which homes in a portfolio to close and which to keep open at all costs, for after the shakeout, those left standing will do well. ■

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