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BRIEFING PAPER

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Social care: care home market – structure, issues, and cross-subsidisation (England)

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Summary

This House of Commons Library briefing paper considers the current structure of the care home market in England, as well as issues facing the sector and how private clients ("self-funders") tend to pay more than local authority funded residents (known as "cross-subsidisation").

The care home market in England is now dominated by private providers, although the market is not concentrated. The "Big Four" providers account for only 15% of all care home beds, while the top 25 account for 31%; a feature of the care home market is the prevalence of small and medium sized providers.

Unlike the NHS, social care is not free at the point of use; a means-test is applied to determine eligibility for local authority funding support. Local authority-funded residents account for more than half of care home places (in both residential and nursing settings). However, local authorities have considerable negotiating power with care homes, and, combined with pressures on local authorities' finances, it has been shown that the local authority fees paid on average are near to or at cost. Some care homes therefore seek to charge self-funding clients more than their local authority counterparts, which is known as "cross-subsidisation".

In its November 2017 report, the Competition and Markets Authority (CMA) examined the issue of "cross-subsidisation", and while finding that self-funders typically paid some 40% more than local authority residents for the same care, the CMA did not seek to ban the practice but instead called for additional funding for local authority social care so that they could increase the fees they paid to care homes, among other measures. The Government response to the CMA's report is expected before the end of February 2018.

This note applies to England only.

1. Who owns care homes?

1.1 A sector dominated by private providers

The care home market, both for residential and nursing care, is dominated by private sector, for-profit, providers.

Figures from the consultants LaingBuisson in their 2017 report, *Care of Older People: UK Market Report*, highlight how the composition of the sector has shifted since the 1980s.

For over 65 year olds, in 1984 the number of residential care places in local authority-run accommodation for older and physically disabled people peaked at 144,564 (57% of all places), at a time when the private sector provided 66,700 places and the voluntary sector 42,704. However, in 1984, the number of private sector places was approaching double the number in 1980 (37,177), and the rapid expansion of the private sector continued in the following years.

By 2017, the number of private sector places had reached 196,600 (76% of all places). Local authority places were just 19,200 (8% of all places), which was under half the number of voluntary sector places (44,400).

In terms of nursing care homes, in 2017 the private sector had 179,000 places (86% of all places) compared to 15,200 in the voluntary sector and 10,500 NHS places. Of the 19,200 figure for the number of local authority residential care beds above, this included a small number of nursing beds.[1]

The figures above relate to the UK.

1.2 A lack of concentration among providers

The care home market is relatively diffuse: as of January 2017, the biggest 25 providers by market share had only 31% of all beds, and within this the "big four" – Bupa Care Homes, Four Seasons Health Care, Barchester Healthcare and HC-One Ltd – provided only 15% of all beds (and 17% of for-profit beds). The remaining (approximately) 70% of the market is composed of providers who each have no more than 0.4% of total beds, and is dominated by providers with a portfolio of three or less care homes.[2] LaingBuisson has described the level of market concentration as "fairly low compared with other more mature sectors of the economy, and indeed compared with other segments of healthcare provision".[3]

In August 2017, HC-One stated that it had agreed to acquire 122 Bupa care homes, subject to regulatory approval; this, it was reported, meant that HC-One was "poised to become the single largest care home operator in the UK",[4] having been formed in 2011 as a result of the collapse of care home provider Southern Cross.[5]

LaingBuisson contend that "there is no industrial logic to support any general move towards a handful of mega-providers", noting that "economies of scale are limited and there are significant diseconomies of scale". This, they argue, will mean that the care home sector is "likely to remain, as it is now, a relatively fragmented part of the British service economy".[6]

1.3 Substantial debts

LaingBuisson has noted that the largest four providers (Four Seasons Health Care, Barchester Healthcare, HC-One and Bupa) had improved their debt overhangs, for example through new external financing, and "mid-sized care home groups have resolved their debt overhang and others are in the process of doing so", adding that "there remain

1 LaingBuisson, *Care of Older People: UK Market Report*, 28th edition, May 2017, pp12–13, table 2.3
2 As above, pp118–120, tables 4.8–4.10
3 As above, p100
4 "HC-One clinches £300m Bupa deal in largest ever care home acquisition", *carehome.co.uk*, 23 August 2017
5 HC-One, *HC-One Takes Next Step Forward with Acquisition of 122 Bupa Care Homes*, press release, 23 August 2017
6 LaingBuisson, *Care of Older People: UK Market Report*, 28th edition, May 2017, p97

some unresolved debt overhangs, but it is less of an issue than it was in the UK care home sector".[7]

The financing model of care homes for older people is notable by their complete absence from the London stock market. LaingBuisson note that three of the five largest care home providers – Four Seasons Health Care, HC-One and Care UK – are owned by private equity firms. Indeed, private companies provided 46% of for-profit beds in the UK.[8]

The acquisition of a building capable of being used as a care home can require substantial borrowing, as well as further outlays to convert it to a care home that meets the statutory requirements set out by the regulator, the Care Quality Commission (CQC).[9]

Previously, care home operators had used what might be termed as "aggressive" sale and leaseback agreements in regard to their properties.[10] LaingBuisson observed that:

> Looking back to the turn of the century, risky financial gearing was also responsible for the last spate of financial failures which took place in the early years of the new century as providers which had expanded rapidly with 100% sale and leaseback funding found their narrow margins eliminated by adverse trading conditions brought about by local authority purchasers' unwillingness to increase fee rates by more [than] RPI [Retail Prices Index – a measure of inflation]. As a result, landlords forced several defaulting sale and leaseback operators into receivership.[11]

The most high-profile failure arising from sale and leaseback was Southern Cross in 2011, then the largest provider in the care home market. However, the model is still used although, as LaingBuisson note, "in more prudent form" – for example, Barchester Healthcare, one of the top four providers, sold and leased back its care homes in a September 2013 deal.[12]

The cost of servicing these debts can vary depending on factors including interest rates and the credit rating of the care home company.

2. Who pays for care home places

2.1 Composition of clients – self funding vs local authority funded

Although private sector for-profit companies now dominate the care home sector, a large number of their clients receive substantial funding support from local authorities.

A means-test is applied to care home residents to determine if they are eligible for support from their local authority.[13] For example, in 2016 for those aged 65 years or older, there were some 84,000 self-funders in residential care homes while there were around 127,000 whose place was funded by local authorities. In nursing homes, self-funders

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7 As above, pp102 and 122
8 As above, pp102, 113 and 114
9 See Care Quality Commission, *How CQC regulates: Residential adult social care services – Appendices to the provider handbook*, March 2015
10 These involved selling the care home building and entering into a lease agreement with the purchaser. This relieved the care home owner of the debt, but meant they had to meet the rent instead. If the property owner demanded a higher yield – as happened after the financial crisis around 2007–09, then this could cause financial difficulties for care home providers relying on this model.
11 LaingBuisson, *Care of Older People: UK Market Report*, 27th edition, p114
12 LaingBuisson, *Care of Older People: UK Market Report*, 28th edition, May 2017, pp102 and 104
13 For more information on the means-test, see the Library briefing paper *Social care: paying for care home places and domiciliary care (England)*.

numbered some 88,000, while those funded by local authorities or the NHS combined totalled 103,000.[14]

A number of private care home providers have a business model that operates on the basis of providing care for those funded by local authorities. For example, LaingBuisson notes that three of the "big four" care home providers – Four Seasons, Bupa and HC-One — are "primarily focussed on publicly paid clientele, principally as a consequence of portfolio location".[15]

The fourth and smallest member (in terms of number of beds) of the quartet, Barchester Healthcare, on the other hand, "operates a high quality portfolio, principally serving private payers"; LaingBuisson estimates that "50%-plus of its residents are private payers" and that its "geographic profile is concentrated in the more affluent areas of Britain".[16]

The distribution of profitable care homes is not even throughout the country: LaingBuisson note that the sector is "highly polarised" between "affluent areas (with typically high levels of private pay [self-funders] at premium rates" – making it likely many providers in these areas were "generating super-profits" – compared to non-affluent areas where care homes are more reliant on local authority paid rates, which tend to be lower meaning that returns were "insufficient … to maintain their estate in good condition".[17]

The *Financial Times* has also noted that "the care home market is highly polarised between lucrative self-pay homes, mostly in southeast England, and those with local government-funded residents, which are struggling".[18] The analysis demonstrates the contrasts between care home providers both by client mix and location.

In terms of local authority funding, LaingBuisson stated that "at March 2016, an estimated 47.5% of independent sector care home residents were having their fees paid, in part or in full, by local authorities". It added that "the level of resources that government makes available to local authorities to fund community care is, therefore, very important to the care home sector" and that was especially true "in less affluent areas where the local authority funding share is higher than average".

As the table overleaf from LaingBuisson demonstrates, the pool of self-funders varies acros the country:[19]

14 LaingBuisson, *Care of Older People: UK Market Report*, 28th edition, May 2017, p204, Table 7.1
15 As above, p124
16 As above, pp128 and 129
17 As above, p101
18 "Care home owners warn on spending cuts", *Financial Times*, 18 March 2015 (subscription required)
19 LaingBuisson, *Care of Older People: UK Market Report – 27th edition*, p210, table 7.3 and LaingBuisson, *Care of Older People: UK Market Report*, 28th edition, May 2017, table 7.3

	2014	2017
North East	18%	21.9%
North West	36%	39.0%
Yorkshire and the Humber	42%	40.3%
East Midlands	43%	49.5%
West Midlands	39%	41.4%
East of England	45%	45.5%
Greater London	30%	45.6%
South East	54%	61.9%
South West	49%	49.8%
Wales	24%	31.4%
Scotland	30%	35.6%
Northern Ireland	16%	10.5%
United Kingdom	41%	43.8%

2.2 Local authority purchasing power

LaingBuisson has observed that "the balance of market power in the public pay segment of the market has to date remained firmly with local authority commissioners, which are the largest single purchasers in most parts of the country".[20] Although some care home providers have a concentration of over 25% in some local authority areas, this "pales into insignificance", LaingBuisson contests, because of the concentration of purchasing power in the hands of local authorities. Local authorities "pay for about half of all care home residents nationally" and "in excess" of 75% of care home residents "in many less affluent council areas".[21]

Unlike individual self-funders, local authorities can enter into agreements with care home providers for a number of beds, which gives them more negotiating power. LaingBuisson observes that "independent sector providers … typically serve a catchment area of less than 10 miles in diameter and are often heavily reliant on referrals from a single council",[22] and they categorise local authorities as having "monopsony" purchasing power.[23]

2.3 Trends in local authority funding for state-funded residents

LaingBuisson note that "care home placements are local authorities' largest single cost head, and one that they would like to reduce".[24] Recent cuts in central government grants to local authorities have resulted in local authorities doing this, helped by their monopsony purchasing power (see section 2.2 above).

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20 LaingBuisson, *Care of Older People: UK Market Report*, 28th edition, May 2017, p88
21 As above, p117
22 As above, p211
23 A monopsony is a market where there is a single buyer, but many sellers.
24 LaingBuisson, *Care of Older People: UK Market Report*, 28th edition, May 2017, p203

LaingBuisson contends that, due to "intense budgetary pressures", local authorities had "reduced their fee rates by a national average of over 6% in real terms over the period 2010/11 to 2016/17".[25]

LaingBuisson calculates the "fair price band" for the cost of a care home place; following the recent cuts in local authority fee rates, the average fee rate paid by local authorities in England overall "is now below the floor" of its modelled fair price band, and has been since the end of the last decade.[26]

However, it wasn't always like this: during 2005/06 to 2007/08 there was what LaingBuisson described as a "golden period" for care home owners when, under the Labour Government, local authority "Personal Social Service" spending increased at an annual rate of "4%-plus in real terms". This ended when the 2007 Comprehensive Spending Review gave local authorities a 1% real-terms annual increase in their revenue support grant from 2008/09 to 2010/11.

However, in the Coalition Government's 2010 Comprehensive Spending Review, local government spending fell by 26% in real terms by 2014/15, although the fall was mitigated to 14% once council tax increases and other factors were taken into account. Using data from NHS Digital, LaingBuisson noted that:

> Gross current expenditure by English councils on social care reached a peak in 2009/10. It started to decline in real terms before the Coalition Government's austerity programme commenced and continued to decline in real terms by a compound annual growth rate (CAGR) of -1.5% a year between 2010/11 and 2015/16 (latest figures).

Looking ahead, a number of policy changes have been made to address the funding of care home places, including:

- the social care precept, allowing local authorities to increase council tax bills to pay for social care;
- £2 billion of additional (but not ring-fenced) social care funding in the March 2017 Budget;
- additional funding for the Better Care Fund and the Improved Better Care Fund, which is targeted at integration between the NHS and social care;
- a 40% increase in the NHS Funded Nursing Care rate which helped care homes providing nursing care for both local authority-funded and self-funded residents.[27]

However, various analyses suggest that there will still be a social care "funding gap" by 2019/20, with the Local Government Association stating in September 2017 that it would be in the magnitude of some £2.3 billion.[28]

For further information, see the Library briefing paper, *Adult Social Care Funding (England)*.

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25 LaingBuisson, *Care of Older People: UK Market Report*, 28th edition, May 2017, p211
26 As above, p211
27 As above, pp207–208
28 Local Government Association, *LGA Budget Submission – Autumn 2017*, September 2017, p7, table 1

3. Cross-subsidisation – self-funders paying more than local authority funded clients

3.1 Cross subsidisation of local authority funded clients by self-funded clients

Given local authorities have reduced fee rates for funded clients, LaingBuisson notes that "private payers [self-funders] are vitally important to care home operators as sources of premium fee rates, especially in locations where care home margins are under pressure because of inadequate state paid fees".[29] and, furthermore, "the stability of the UK care home sector for older people currently depends on the willingness of self-funders to pay premium prices" – known as "cross subsidisation".[30]

In terms of the evidence of cross-subsidisation, LaingBuisson noted the following based on a survey undertaken in 2015:

> Research … undertaken by LaingBuisson on behalf of a consortium of 12 counties forming part of the County Council Network of the Local Government Association, has demonstrated that in 96% of cases in a large scale sample across a number of geographies across England in 2015, private payers paid more than state funded residents in the *same* home for the *same* type of room and (presumably, though this was not specifically tested) the *same* level of care. The 12 counties study showed not only that private payers nearly always cross-subsidise state-funded residents, but also that the quantum of cross subsidy is usually substantial (a 43% private pay premium on average) and, by inference from accounting records, that care homes with mixed clientele usually depend on cross-subsidisation to generate a reasonable return on investment.[31]

The Competition and Markets Authority (CMA) found very similar evidence of cross-subsidisation as part of its investigation into the care home market. In its November 2017 report, the CMA noted that "many" care homes with a mix of self-funded and local authority-funded clients "charge much higher fees for self-funded than for LA [local authority] funded places. While there can be differences in the services individuals receive, such as size of rooms, we have been told by providers that the costs of LA and self-funded residents are very similar".

Using data on around 2,000 homes from 25 of the larger provider groups in the UK (covering nearly a third of the industry by revenue) for the 2016/17 financial year, the CMA said that its assessment:

> indicates that fees for self-funded places are on average 41% higher than those paid by LAs. This result is consistent with other published studies, which have found price differentials in the region of 25-50% … In absolute terms, the average differential is £236 per week which means that on average a self-funding resident is paying over £12,000 a year more than an LA to have a place in the same care home.

The CMA noted that for smaller care home operators, "the differential may be smaller", adding that "one piece of unpublished research into smaller providers found a smaller price differential".[32]

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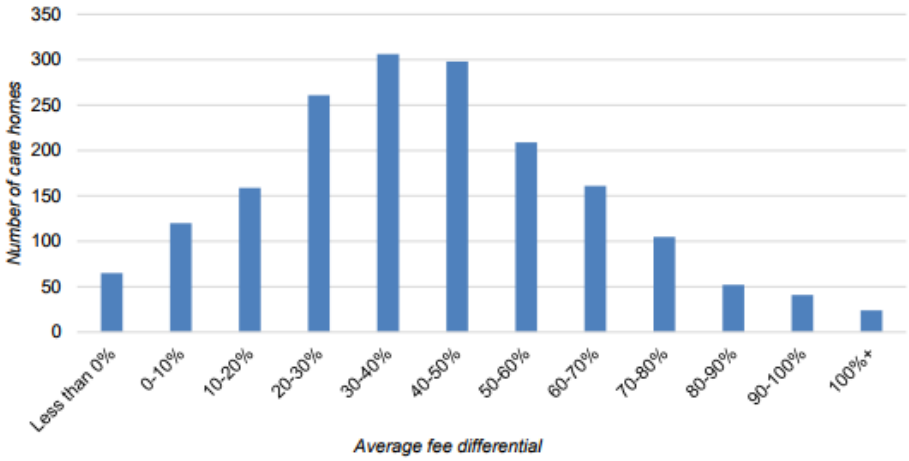
29 Laing and Buisson, *Care of Older People – UK Market Report 2013/14*, 26th edition, April 2014, p208
30 LaingBuisson, *Care of Older People: UK Market Report*, 28th edition, May 2017, p101
31 LaingBuisson, *Care of Older People: UK Market Report – 27th edition*, pp208–209
32 Competition and Markets Authority, *Care homes market study – Final report*, 30 November 2017, pp39–42, paras 2.37–2.44

While the average price differential was 41%, the CMA found that a number of care homes' price differential was substantially in excess of this; some care homes charged self-funders more than double the rate that the local authority paid, as the chart below shows:[33]

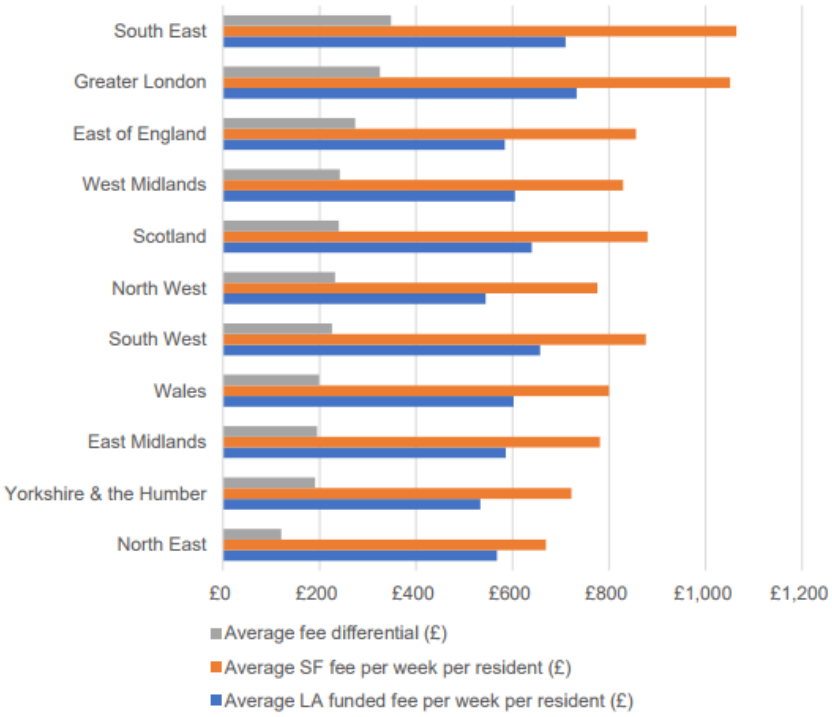
Figure C3: Price differentials by care home, UK 2016



Source: CMA analysis of data from 25 large UK care home providers (one provider has no care homes used in this figure).

The degree of cross-subsidisation varied by regions: the CMA said that it had "found considerable regional differences … in the rest of the UK [excluding Northern Ireland] we see significant differences in average prices paid". This is illustrated in the CMA's chart which is reproduced below.

Figure 2.6: Average self-funder and LA-funded fee rates and differential (£ per week) by region, Great Britain, 2016



[33] Competition and Markets Authority, *Care homes market study – Final report, appendices and glossary*, 30 November 2017, p C7, figure C3

This meant that while local authorities on average paid £621 per week for a care home place, for self-funders across the country the figure was £846 per week (some £44,000 per year) although this masked substantial regional variations, with "average weekly self-funder fees of £670 in the North East of England and £1060 in the South-East".

The CMA noted that "self-funded residents in mixed homes are meeting a much greater proportion of homes' fixed costs than LA-funded residents".[34]

3.2 An increasingly widespread issue

As the CMA's November 2017 report noted, "the incidence of differential pricing has increased markedly since 2005 when the [then] OFT [Office of Fair Trading] reported it found that only one in five homes charged differential prices".[35]

The OFT, the CMA's predecessor in respect of anti-competitive behaviour and issues with market sectors, had touched on the issue of cross-subsidisation briefing in its May 2005 report, *Care homes for older people in the UK – a market study*.

> We recognise that it can be seen as unfair when older people are charged different prices for the same standard of accommodation and level of care. Our research shows that around one in five homes charge self funders more than [Local] Authority funded residents for a similar room and similar care. This means that the majority of homes do not discriminate between residents according to their source of funding.[36]

The CMA's November 2017 report did not state a quantum of how many or what proportion of care homes charged differential rates for self-funders over local authorities funded clients, except to say:

> Most care homes serve a mix of self-funders and LA-funded residents. Many of these care homes charge much higher fees for self-funded than for LA-funded places.

and that, as noted above,

> the incidence of differential pricing has increased markedly since 2005.[37]

3.3 The CMA's decision not to ban or limit differential pricing

As LaingBuisson has noted (see above), "the stability of the UK care home sector for older people currently depends on the willingness of self-funders to pay premium prices" i.e. "cross subsidisation".[38]

The CMA considered whether to stop price-differentiation between self-funders and local authority funded places, but decided against such a step:

> We have considered whether recommendations should be made to require that fees charged to self-funders are set at the same level charged to LAs in any specific home. We have not made such a recommendation, for two major reasons. First, to do so would impose an immediate and very substantial public funding cost. Second, such a measure would be likely to cause the market to split in two as those care homes which could concentrate on self-funders (particularly those who are well placed and

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34 Competition and Markets Authority, *Care homes market study – Final report*, 30 November 2017, pp39–42, paras 2.37–2.44
35 Competition and Markets Authority, *Care homes market study – Final report*, 30 November 2017, p42, paras 2.43
36 Office of Fair Trading, *Care homes for older people in the UK – a market study*, May 2005, p14, para 1.56
37 Competition and Markets Authority, *Care homes market study – Final report*, 30 November 2017, p39, paras 2.37
38 LaingBuisson, *Care of Older People: UK Market Report*, 28th edition, May 2017, p101

with attractive facilities to meet areas of high local demand) might want to stop serving LA-funded residents altogether.

Instead, the CMA recommended:

- an "increase the fees paid by LAs to care homes to a more sustainable level over time" which it believed would have as "a consequence of our recommendations". The CMA acknowledged that "higher LA-fees will not necessarily result in downwards pressure on self-funder rates, but they would reduce the need for care homes to charge higher fees to self-funders". Furthermore, the CMA decided not to recommend in England "that local authorities be given statutory guidance on how they must calculate the cost of care or the rates which they must pay to providers, nor that there be mandatory national rates LAs must pay";[39]
- a proposed independent body whose roles "should include disclosure of local fee differentials in order to increase local political accountability on how care is being delivered";
- "our measures to improve decision making will increase competitive pressures in relation to self-funders. These measures will reduce existing fee differentials over time" (although the CMA did not estimate by how much or over what time period).[40]

3.4 The Government's response

The Government has stated that it "will publish a formal response to the CMA report within 90 days and will take forward these complex issues as part of the Green Paper on adult social care which will be published in summer 2018".[41]

39 Competition and Markets Authority, *Care homes market study – Final report*, 30 November 2017, p111, paras 8.34

40 Competition and Markets Authority, *Care homes market study – Final report*, 30 November 2017, pp208–209, paras 14.25–14.26

41 PQ HL3837 18 December 2017

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