Appendix A Executive Summary

This report has been completed by Glyn Morgan, an independent accountant employed by the Council, to ascertain the actual cost of care at residential and nursing care homes, reviewing and analysing information provided by care home owners.

The initial review was not accepted by care home owners and so a second more comprehensive review has taken place which will show the cost of care for 2013/14 and highlight what the cost would be for 2014/15 if inflation was included.

This report covers only the cost of total care supplied in care homes across Herefordshire. It does not take into account the quality of care, the level of service provided or take account of any efficiencies that may be made. It deals solely with the cost of care. Any affordability issues must be considered by the Council and does not form part of this report.

Average Residential & Nursing Cost of Care 2013/14

Actual Cost of Care 2013/14	Nursing	Residential	Residential with dementia
	£ (prpw)	***£ (prpw)***	***£ (prpw)***
Baseline	642.75	444.27	475.52
Return on Capital @7 %	82.50	82.50	82.50
Profit @ 5%	36.26	26.34	27.90
Total	761.51	553.11	585.93

The costs have been calculated based on occupancy levels, provided by owners, of care homes which on average are 89% occupancy in nursing homes and 90% occupancy in residential and dementia care homes.

Return on capital and profit has been subject to negotiation with providers and the rates included have been based on those negotiations. Return on capital can be calculated in many different ways and this paper includes three such methods. An alternative option where an average of the three options is included below:

Actual Cost of Care 2013/14	Nursing	Residential	Residential with dementia
	£ (prpw)	***£ (prpw)***	***£ (prpw)***
Baseline	642.75	444.27	475.52
Return on Capital @7 %	60.84	60.84	60.84
Profit @ 5%	35.18	25.26	26.82
Total	738.77	530.37	563.19

All figures represent 2013/14 costs. Inflation has not been included for 2014/15 but does represent a true cost to the Owner and the Council. Current CPI is 2.2% and RPI is 2.6%.

Introduction

Herefordshire Council commissioned an open book review of nursing and residential care for older people in July 2012. An open book review is based on the principles of fairness and transparency, enabling a balanced approach to commissioning services of an acceptable quality that represent value for money, within a climate of increasing demand for services and significant financial constraints and cost pressures for both commissioners and providers. The Council appointed 2 independent leads – an accountant and a social care specialist – to complete the review. No authority could be found who used the L&B model for anything other than as a comparison tool. Other authorities do not use the L&B model and have devised their own cost model to measure costs.

At the request of owners, an extension was granted so additional evidence could be supplied. The request has been allowed because owners questioned the figures used in the original paper, the cost of capital and the process used to determine cost of care rates for nursing and residential care homes.

Owners were given the opportunity to complete a further questionnaire if they chose to and submit actual accounts so they could be considered to ensure all costs were correctly considered. No questionnaire would be considered without a full set of audited accounts to support. Those care homes that had already submitted as part of the initial process were not requested to re-submit but were given the same opportunity to re-submit if they chose. If a care home owner had already submitted their questionnaire and did not re-submit then their original questionnaire was considered to be valid. Original models were inflated to take into account 2013/14 costs.

As part of the additional work requested, actual costs shown in financial accounts were used to determine the real cost of care. All care home owners submitting revised cost models were asked to provide audited accounts. The actual cost was compared to the results coming from the questionnaire and cost model and shared with the owner as per the timetable shown below. This allowed the care home owner the opportunity to challenge figures before they were finalised as part of the review.

Actual accounts, provided in the initial survey carried out, have been used where no further accounts have been provided as a starting point for negotiation with owners. It is accepted that accounts relating to different time periods may reflect different costs. Whilst this is true it is also accepted that costs can go down as well as up.

All revised cost models have been used in the final assessment. Owners completed the cost model, these were all challenged based on the review of their financial and/or management accounts provided.

Background

The paper completed and concluded upon in May 2013, gave the Council options to consider. None of the options were taken in full as the Council used their discretion in

utilising the OBR option but reducing the cost of capital percentage to 2.5% from a proposed rate of 7%.

Four options were explored in the initial paper, including benchmarking, reverting to 2010 rates and leaving rates as they were. None of these were acceptable for various reasons so will not be explored further here. The original paper is available through the Council website.

The revised timeline agreed to by the Council after discussion with some owners is shown below:

Date	Action	Responsible
27 September 2013	Questionnaire sent to all providers	Glyn Morgan / Alison Clay
1 November 2013	Deadline for receipt of questionnaires and accounts	Providers
2 November – 8 November	Individual cost models sent to all providers	Glyn Morgan
2 November – 11 November	Providers to contact Herefordshire Council to discuss findings	Providers
Between 12 November and 15 November	Meeting with providers to share overall findings	Glyn Morgan
2 December	Report completed	Glyn Morgan

The meeting with providers to share findings has slipped, however, discussions with their recognised point of contact have continued. A meeting with all providers was held on 5 December and this paper has been finalised subsequent to that meeting.

As part of the further work, more emphasis has been placed on actual costs. Profit and loss accounts produced have been used to ensure some accuracy, however the report has been compiled based on financial information relating to 2013/14 which will not have audited accounts at this stage.

Findings

The Council received 23 revised or new returns, this was supplemented by 3 further returns that had been received in the initial work carried out. Within the total of 26 returns, 24 were supplemented by financial accounts.

Two of the new returns did not have a set of financial accounts attached to them and despite repeated requests no financial accounts were received. Consideration was given to excluding the information but in the spirit of goodwill both were allowed to stand.

The review was carried out considering the following 3 key components:

a. The L&B model – used as a basis and to provide guidance
b. The cost model and cost model questionnaire – this offers information about what an owner believes the cost to be, and
c. Financial Accounts or, where part of a group, Management Accounts.

Financial accounts are key because they provide actual costs incurred in a financial year. There was an expectation that costs included within the cost model would be similar to financial accounts produced when taking into account inflation. There was no expectation they would be exactly the same but a variance of roughly three (3) % on the total cost per financial year would be reasonable. Where costs were greater owners were requested to provide further evidence to support. Owners were informed that if agreement could not be reached then this would be included in this report.

All Twenty Six (26) care home owners were contacted, twenty two (22) responded and agreement was achieved. Four (4) did not respond which included the three (3) owners who did not re-submit information. Care was taken with the original returns to ensure inflation has been included within the cost models completed from the original assessment. At the meeting on 5 December, providers who attended the meeting felt that the original 3 assessments should be removed.

Occupancy and Capacity

Owners were requested to provide occupancy data. Of the twenty six (26) that provided data, twenty five (25) were accepted and one (1) was challenged. After discussion the occupancy levels at all 26 care homes have been agreed.

Occupancy can go up as well as down and this has led to challenges in determining the actual cost of care. Care homes occupancy levels have been accepted as part of this exercise and the costs shown are based on occupancy levels offered. The average nursing and residential care home occupancy reported during this exercise is:

Residential – 93%
Residential with dementia – 88%
Nursing – 89%

Many of the costs in a care home are fixed costs. If owners operated at full or greater occupancy the rate per resident would be lower.

Outliers

A full list of all baseline costs (before profit and return on capital) included in this exercise anonymised is shown in appendix.

Consideration has been given to removing outliers from the calculations as there are wide discrepancies between the most expensive and least expensive cost of care.

One care home owner assisted 23 other care home owners to complete their cost of care model. There are three independent cost models also. The provider who supported the 23 would like all of the cost models he helped complete to be included in the final assessment and his view is that the others (the independents) may be incorrect. Individual cost models were forwarded to each of the owners who took part in this exercise so they could review and challenge the cost model analysis. Of the 26 models that were forwarded, 22 challenges were made by owners, the other four, including the 3 independents did not challenge.

There are wide discrepancies between the most expensive and the least expensive care homes shown below:

	High	Low	Average
Nursing	834.42	541.92	642.75
Residential	655.13	322.90	444.27
Residential with dementia	537.22	331.25	475.52

I have considered the representation made and decided the owners of those three care homes were given the same opportunity to challenge and discuss the findings. No challenge was forthcoming and so a decision has been taken to include cost models received in the calculation.

Baseline Costs

Baseline costs are comprised of three elements, staff costs, non-staff costs and corporate overhead. Not all care homes will have a corporate overhead but these costs have been considered for all care homes.

Staff Costs

The cost model provided an estimate for staff costs which was then reviewed against actual accounts to ensure accuracy within the figures. Consideration was also given to the latest payroll data for October 2013 which included the national minimum wage increase.

The average staff costs and higher and lower ranges for staff costs across care homes are shown below:

Staff Costs	Nursing		Residential		Res with dementia	
	£ (prpw)	£ (prpw)	£ (prpw)	£ (prpw)	£ (prpw)	£ (prpw)
Average Cost	451.18		274.87		304.39	
Range	373.59	550.34	203.70	385.03	231.78	346.15

The range in staff costs for nursing and residential costs is considerable.

Nursing Costs

Of the eleven nursing homes analysed, occupancy ranged between twenty nine and sixty six. Three care homes had occupancy levels between 29 and 31. Although capacity and occupancy levels were similar between these three care homes (average 87%) staff costs ranged between £393 - £519 suggesting one care home may be more efficient with staffing levels than another.

Residential with Dementia

Many of the dementia care homes are reporting under occupancy with only one reporting an occupancy level of 100%. The average amongst the others is around the 87% rate. The lowest staff costs were found at the care home with the highest capacity and occupancy level which would be expected due to economies of scale. One care home did show that even at an occupancy level of 86% with 20 occupant's staff cost can be contained at under £300 per resident per week.

Residential

Four care homes are considered for residential care, of those the staff costs range between £219.11 and £319.29. the care home with low staff costs are at 100% occupancy whereas the care home with the highest staff costs are working at an occupancy level of 92%.

Making the assumption that the care home operating at 92% were operating at 100% would reduce the staff cost per resident per week to £293.40, this is still higher than the staff costs for a care home with 100% occupancy.

Non Staff Costs

Non-staff costs reflect the costs in the latest set of accounts with inflationary uplifts to reflect the financial year 2013/14. Non staff costs include costs for food, utilities, repairs and maintenance and other non-staff costs.

Non Staff Costs	Nursing		Residential		Res with dementia	
	£ (prpw)	£ (prpw)	£ (prpw)	£ (prpw)	£ (prpw)	£ (prpw)
Average Cost	174.04		145.30		135.70	
Range	104.06	264.62	96.49	252.71	78.22	179.17

The range of costs highlights significant differences in both nursing and residential costs.

Nursing

The range for nursing non staff costs was significant, between £104 and £264, it has not been possible given time restraints to review each of the differences in turn, however the most significant differences per resident per week were:

Repairs and maintenance – between £16 - £47 per resident per week
Food - £22 - £37

Utilities - £14 - £38
Non Staff Costs - £10 - £111

Residential with dementia

The range of non-staff costs is £78 - £179. As with nursing staff costs, the detail underneath the figures has not been reviewed, main differences per resident per week were:

Food - £21 - £42
Repairs and maintenance - £12 - £85
Non staff costs - £9 - £45

Residential

There are two significant outliers in this section, one high and one low, the explanation that follows relates to the other four care homes that would not be classed as outliers. The four main cost components within non staff costs are repairs and maintenance, other non-staff costs, food and utilities. There were no significant differences between repairs and maintenance, food costs or utilities, however the main difference was found in non-staff costs where there was an overall range of £14 - £58, which is the difference between the lowest and highest within the range.

Corporate Overheads

Corporate overheads were a little more challenging with some owners including salaries paid to them for work carried out in their business.

There is no doubt this is a cost to the business. The issue related to how this was shown in financial accounts provided. In many cases these costs were included after net operating profit. If these payments are taken after net operating profit this effectively reduces the profit of the business as these costs relate to the running of the Care Home:

Corporate Overhead	Nursing		Residential		Res with dementia	
	£ (prpw)	£ (prpw)	£ (prpw)	£ (prpw)	£ (prpw)	£ (prpw)
Average Cost	25.86		27.76		36.89	
Range	8.67	59.36	12.75	48.52	15.30	57.44

The range within corporate overheads is significant with wide variations across nursing and residential care.

Summary all costs

There is a significant range in costs in nursing and residential care homes. Within the terms of reference the Council reflect that they are looking for care that is good enough to meet national minimum standards.

'The Council expects to pay for services that are "good enough" to meet people's needs and outcomes. This is in line with local and national policy to provide "just enough support" to meet the needs of those who are eligible for public funding'

Overview

Nursing Care

A review of all the data supplied highlights that in general larger care homes have lower costs than those in smaller care homes. This in itself appears reasonable, greater economies of scale can be achieved with lower costs in larger care homes, however this was not always the case with one nursing care home reporting both high capacity and high occupancy being more expensive to run than care homes with lower capacity and occupancy.

Residential with dementia

In overall terms the care home with the lowest cost is the one with the highest capacity and occupancy, however one of the smaller care homes with a capacity (23) to occupancy (20) ratio of 86% is operating at much lower levels of cost. The cost difference between the two is only £10 per resident per week. At the higher end of the scale the care home operating at a cost of £530.69 has a 92% ratio with a capacity of 33 and an occupancy level of 30 clients.

Residential

It is not surprising that the lowest cost care home is one with full occupancy, however all residential care homes assessed are operating at over 90% occupancy.

Inflation

2013/14

Staff and non-staff costs included in the cost model have been completed using the latest data which includes 2013/14 information. No inflationary uplift is considered for 2013/14.

2014/15

No costs have been included to reflect any charge for inflation in 2014/15. It is for the Council to consider inflation. Current inflation rates for October 2013 are RPI of 2.6% and CPI of 2.2%.

Dementia

Questionnaire returns did not offer sufficient information to enable a calculation for dementia care. A review of all residential care homes that took part in the exercise showed that all of the care homes take clients with dementia. In the original report it was accepted that dementia clients should receive a premium and that view has not changed.

Because cost models completed were inconclusive a different approach was taken, the owner acting on behalf of the 23 had offered a view on those care homes he believed to be predominantly residential care. A further review was carried out on information held within the Council and it became apparent that his list was reasonable and so this was used to support calculation for dementia and non-dementia care homes so two rates could be considered.

Capital Costs

The capital costs included in the paper submitted in May 2013 offered capital costs at 7%, in line with Laing and Buisson methodology. Opinions and views have been offered by both Council officers and owners. I have reviewed the original paper, analysed the accounts provided by owners, calculated the return on capital included within their accounts and see no reason to change my original assessment of 7% for return on capital.

The original paper offered a return of 7% based on the best interest rates that could be obtained from a fixed investment and the best rate had money been invested in the stock market for the last year. The reported rate of 7% was the same as the rate included in the Laing & Buisson model.

A commitment was made to completely review the return on capital findings from the original paper, three options were considered, no method for calculating return on capital is perfect. All options have been considered using the return on capital rate of 7%:

Option A

The favoured option of providers is the L&B option, this option allows for a return on capital based on a new build and existing buildings requiring upgrades. The L&B model allows a 7% return but reduces that return dependent upon quality factors. The L&B model describes those reductions as:

> 'it is proposed that the fair market price grading tool 'floor' should be 50% of the 'ceiling'. This leads to a maximum capital cost adjustment factor roughly in line with that proposed in the 2004 and 2008 reports. Ultimately, this percentage is arbitrary, but it is believed to roughly reflect the difference in investment between a new-build care home on the one hand and, on the other, one whose physical environment is on the borderline of acceptability to local authority care purchasers.'

If the maximum L&B figure was allowed then the calculation would suggest a return in the region of £98 to £107. The L&B model suggests a reduction of 50% from the ceiling rate should buildings not meet requisite quality, although they also say this figure is arbitrary. If the 50% was considered reasonable, this could reduce the rate to a floor rate of between £49 and £53.50.

There are weaknesses with using this method as the L&B model is based on a new build property. At a meeting with the providers they insisted that L&B should be used in the

calculation of return on capital and also believed that no other methodology for calculating return on capital would be acceptable.

Taking the concerns of the owners into account would suggest a maximum return on capital of £107 would be applied. Given the care homes in Herefordshire are not new build, an estimated reduction of 20% should be considered, hence leaving a return on capital of £85.

Whilst the method of calculation is not perfect and the estimation is just that, an estimate the L&B model is a model the providers trust and the results from it should not be discounted.

Option B

For the avoidance of doubt, return on capital for option B is calculated:

Earnings before interest & tax / (Total assets less current liabilities)

There are other methods of calculating return on capital and this is acknowledged, however the method shown above is not un-common practice for calculating return on capital.

Owners provided their financial accounts, in most cases, and this has provided the opportunity to obtain the total assets less current liabilities figures from accounts provided. This is not a perfect solution because the value of fixed assets can fall dependent upon the method of depreciation calculation used. Also it was clear from some owners accounts that fixed asset values were so low there accounts could not be used. Fifteen of the submitted financial accounts could be used to offer a total assets less current liabilities figure.

Providers were concerned

a. This was 'cherry picking'
b. Many of their accounts did not include an up to date fixed asset valuation

If the accounts had not been cherry picked then homes which had figures included in fixed assets which were clearly incorrect would have reduced the value by which the return on capital calculation would have been calculated.

It is recognised that some accounts did not have up to date fixed asset valuations and this is a weakness in using this method of calculation.

Accounts provided offered the opportunity to use the actual balance sheets of Herefordshire owners to assess the total assets less current liabilities included in accounts and use this as a basis to calculate what the 7% rate of return should be calculated on. The total assets less current liabilities value is £1.7m. Using this valuation for return on capital offers a return on capital of £57.96.

Option C

A review of care homes for sale in Herefordshire was undertaken and one care home with both nursing and residential facilities was being marketed at a fee of £750k for a 24 bed care home. ***Source www.carehome.co.uk***

It is accepted that no two care homes are identical, however it is not unreasonable to base the cost of capital calculation on the basis of a care home for sale in the Herefordshire area. If this option were taken, the return on capital per resident per week would be in the region of £42.07.

Option D

None of the methods mentioned above are perfect, but all offer a return on capital that should be considered, a possible fourth option is to average the findings of the three options. This would offer a return rate of £60.86.

Conclusion

None of the above options are perfect and arguments can be had either way as to the method to be used. Using the methods of calculation above offers a range in cost of capital between £42.07 and £107.00. Actual accounts were supplied and the remainder of the report has been constructed based on actual costs, therefore Option B should not be dismissed. Option C appears reasonable and a similar method of calculating return on capital has been adopted in Staffordshire, however further work would be required. The providers were clear in the meeting on 5 December that no option, other than option A would be accepted by them. Option D offers an alternative.

Profit

Profit in the original paper was included at 5%. Some owners questioned this rate of return, one of the main reasons the profit rate was questioned was because owners felt that a comparison with BUPA Care Homes was not realistic. There were a number of reasons why this was seen as unfair on the Herefordshire provider market.

A review of Shaw profit before tax was undertaken, the profit reported was 4.6% which is lower than the rate of profit offered by BUPA. Shaw is much smaller than BUPA but also have care homes in Herefordshire.

Quotes taken from both Shaw and BUPA reports show the difficulties being faced by both providers and councils.

> ***Shaw quote***
>
> *'The current economic environment and the pressure on public sector bodies to cut costs have an impact on the group's ability to achieve annual inflationary increases in*

non-contracted residential and nursing fees. In many cases it was necessary to maintain the same fee levels as in the previous year'

'However, the proportion of the group's income that does not derive from long-term contracts is subject to economic and political factors such as the current pressure on public sector bodies to cut costs. This has an impact on the group's ability to achieve annual inflationary increases.'

BUPA quote

'Challenging trading conditions continued, adversely impacting customer numbers and profit'

'While this is a step in the right direction, the cap will only cover the 'care' element of costs and people will have to continue to pay for the 'hotel' elements such as food.'

For clarity, profit is being calculated on all costs, this includes staff costs, non-staff costs, corporate overhead and return on capital. This is the same way that BUPA and Shaw have shown their calculations so the BUPA and Shaw model can be used for comparison purposes. The L&B model does not allow for profit on return on capital.

Herefordshire care home owners are of the view that the L&B model which allows a percentage profit of 10% should be used, however were accepting of the 5% rate if the L&B model was used for return on capital. The profit percentage is based on profit on staff costs, non-staff costs and corporate overheads only.

After careful consideration and taking into account the current challenging climate, I see no reason to increase the rates included in the original report of 5%.

Conclusion

The figures presented in this report are based on a Herefordshire cost model which takes account of changes in costs during the financial year 2013/14 and therefore reflects increases in utilities and staff minimum wage. It also highlights that as occupancy reduces, costs rise. Accounts offered by owners have been used as a basis and owners have been requested to explain differences and provide evidence to support their costs. Their latest accounts have been used to ensure the figures reflect the current financial year.

This paper does not take into account affordability, efficiencies, quality requirements, nor does it take into account what is expected to be paid for as part of a care package that the council is expected to pay for, although the terms of reference are clear in that they expect care home owners to provide a service that is 'good enough'. These are matters for the Council to consider.

Return on capital and profit have both been reassessed and the findings in the original paper appear reasonable, 7% for return on capital and 5% for profit and I see no reason to change either percentage.

I would like to pass on my thanks to Council officers and owners for their assistance in completing this report.

Appendix – Baseline costs for all care homes including outliers

Nursing care homes

Nurse Care 1	834.42
Nurse Care 2	751.63
Nurse Care 3	692.00
Nurse Care 4	685.91
Nurse Care 5	634.18
Nurse Care 6	622.33
Nurse Care 7	599.64
Nurse Care 8	584.76
Nurse Care 9	572.76
Nurse Care 10	550.67
Nurse Care 11	541.92

Residential with dementia

Dementia Care 1	£537.22
Dementia Care 2	£530.69
Dementia Care 3	£511.76
Dementia Care 4	£493.17
Dementia Care 5	£479.33
Dementia Care 6	£476.45
Dementia Care 7	£464.28
Dementia Care 8	£455.56
Dementia Care 9	£331.25

Residential Care

Residential Care 1	£655.13
Residential Care 2	£445.61
Residential Care 3	£440.15
Residential Care 4	£405.82
Residential Care 5	£396.00
Residential Care 6	£322.90