Partners at L.E.K. Consulting **Jonathan Sparey** and **Eilert Hinrichs** provide insight into the prospects of the care home sector

# Care homes
## a new wave of investment

Spending cuts and pressure on budgets mean local authorities (LAs) are having difficulty funding services for an ageing population, and as such they are struggling to fulfil their obligations to ensure the availability of good quality, suitable public-pay care.

One of the root causes of the problem lies within the care homes sector, where the supply of homes is failing to meet consumers' needs.

Public sector funding for care home places is unsustainably low (averaging £620 a week) and covers no more than day-to-day operating costs for many operators.

The lack of a viable rate of return on capital invested deters many care home operators, especially those that have a strong bias towards LA funding, from reinvesting in existing and new capacity.

Despite the negative headlines, there are a number of indicators suggesting that a new wave of investment may be forthcoming to address the UK's long-term care needs.

While in the past it has been underserved, L.E.K.'s analysis suggests that the UK's care homes market presents an increasingly viable investment opportunity.

## Scale of the problem

Care homes in the UK, particularly those funded by the public purse, have long suffered from structural underinvestment, and it is clear that the market is in dire need of both extra capacity and reform.

According to statistics, investment in additional public and private care home capacity was greater than capacity withdrawn in only two out of the five years between 2011 and 2016, and a number of market observers are suggesting an even bleaker picture.

Successive years have seen a net loss of capacity at a time when the number of older people in the population is increasing, along with the subsequent additional demand for nursing and residential care.

Many existing care homes are old and are not purpose-built, resulting in often-inadequate facilities for residents and carers.

At least another 200,000 private and public beds, equivalent to c. 45% of capacity, are needed over the next ten years if the shortage is to be addressed.

THE PRIVATE-PAY SEGMENT OF THE MARKET WILL CONTINUE TO OFFER ATTRACTIVE INVESTMENT OPPORTUNITIES

In the publicly funded sector, insufficient weekly fee levels are the result of limited annual increases over an extended period, making investment unattractive and the building of new care homes economically unviable.

This is of particular concern given that c. 95% of publicly funded capacity is now provided by the private sector. By contrast, private-pay fee rates have continued to increase by 5-6% per annum.

Amid budget uncertainty, many LAs have been favouring spot contracts over block contracts with private care providers, further removing urgently needed long-term visibility and certainty of funding.

Finally, investigations conducted by the Competition and Markets Authority and the Care Quality Commission have concluded that the public-pay care homes market is not sustainable in its current state, further highlighting the necessity for change.

## Positive indicators

Despite the history of underinvestment and poor performance, there are a number of positive indicators in the care homes market.

The increasing wealth of the ageing population, for instance, is particularly notable, combined with the fact that a proportion of LAs are paying economically viable rates, at least for value-for-money based providers, such as Care UK, Barchester and HC One.

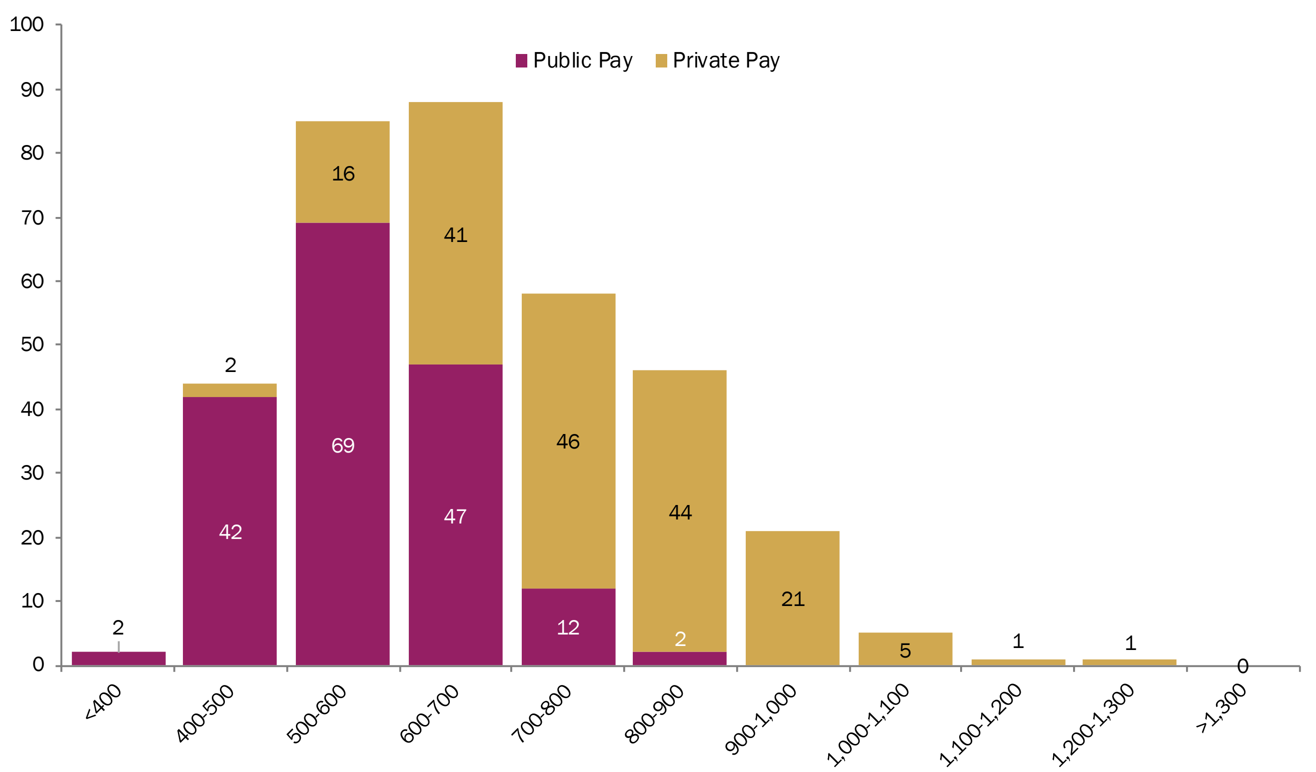
Increasingly elderly people are able and willing to consider paying for nursing or residential care, with more than 45% of those aged over 60 planning to fund care from their own financial resources.

Indeed, changing consumer perceptions about care homes have created new opportunities in the private-pay sector for increasingly sophisticated and consumer-orientated private operators who are able to demonstrate a good understanding of the customer journey and propositions that appeal to both private and public payers.

Fees average £820 a week in high-quality private-pay care homes, which remain 30% above public-pay services, and annual price increases have enabled private providers to mitigate underlying rises in costs and wages.

As a result, the private-pay market has seen more investment in recent years, particularly from real estate investment trusts and other infrastructure investors

CARE HOME POPULATION (000s) BY AVERAGE WEEKLY FEE (£) AND FUNDING SOURCE
2018




**SOURCE** CAREDATA.CO.UK; CACI; NHS DIGITAL, L.E.K. ANALYSIS

attracted by long-term sustainable rental yields.

Analysis of care home demand in the UK has identified approximately 1,800 'hotspot' postcode districts, which lack fit-for-purpose capacity and have sufficient wealth among the local population to fund private care.

Evidently, there are sizable investment opportunities for the private-pay sector (and parts of the public sector) to cater for this structural demand.

## Opportunities for the astute

Investing in the care homes sector over the past five years has not been straightforward, but leading providers have demonstrated that it can be economically attractive.

The expectation is that government reforms will stimulate renewed interest in accelerated capital investment, with the medium-term effect of making investment in public care home capacity more attractive.

The private-pay segment of the market will continue to offer attractive investment opportunities.

Established private care providers are already reporting growing interest from LAs in innovative ways of creating and supporting sustainable provision of care homes in the public-pay market – for example, Care UK's contract with the LA in Suffolk.

With the public sector's willingness to pay enhanced rates for value-for-money care and the wealth of the mass affluent stimulating an attractive private-pay market, the expectation is that we will soon see an accelerated flow of funding into the sector.

While the future remains uncertain, with determination and policy support, the next five years should create much greater opportunity than the past decade did.