

Changing Beds: French Nursing Homes and Opportunities for the Private Sector

The market for nursing homes in France has undergone significant change in recent years as a result of government healthcare reforms. Following the 2003 heatwave when 15,000 elderly died, the state initially responded with ambitious plans to end historic undercapacity of nursing homes and reduce the burden of elderly care on hospitals.

However, the 2008 financial crisis and ensuing government budget constraints have heaped pressure on these objectives and led to a policy shift. Since 2010, a series of belt-tightening measures, coupled with a re-organization of administration and financing, have restricted the growth of nursing home capacity and forced a change in priorities, shifting the emphasis towards home care for the less dependent and more medicalized facilities in nursing homes to treat the more dependent elderly. As a result, few new beds have been authorized, with most additions since 2011 planned before 2010. For now, supply and demand in the French nursing home market is in equilibrium, but in the longer term it is highly likely that shortages will once again be the norm.

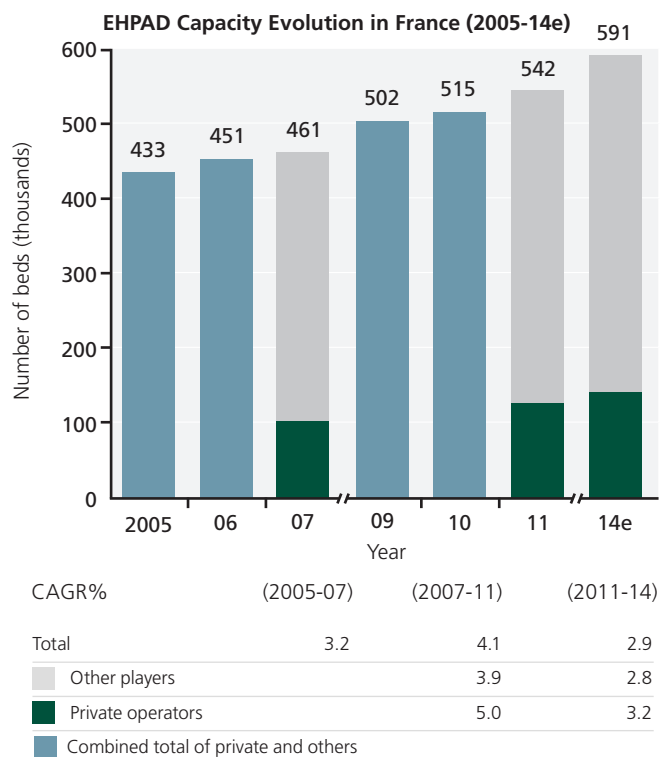
We believe this shortage will benefit private operators. This, combined with market consolidation opportunities in a still relatively fragmented market, will continue to attract private equity players as shown by some recent significant investments by PAI Partners and Eurazeo.

In this *Executive Insights*, we examine the significant opportunities that exist for privately-operated nursing homes, which present

the cheapest and most expedient solution for the government as it seeks to provide high quality care at a time of budgetary constraint.

An Evolving Policy Framework

Figure 1



Source: Statistix, L.E.K. Consulting analysis

Changing Beds: French Nursing Homes and the Opportunities for the Private Sector was written by **Arnaud Sergent** and **Serge Hovsepian**, partners, and **Nohmie Ben Rekassa**, a manager, in L.E.K. Consulting's Paris office. For more information, please contact healthcare@lek.com.

The August 2003 heatwave in France accelerated government plans to improve care for the aged. Medicalized nursing homes, which are known in French as EHPAD (Établissements d’hébergement pour personnes âgées dépendantes), received additional state funds to increase bed capacity and add staff under a national plan to deal with Alzheimer’s disease. Between 2005 and 2006, almost 20,000 beds were added in nursing homes, an increase of nearly 5% (see Figure 1). The investment drive continued until 2010, leading to a substantial growth in capacity.

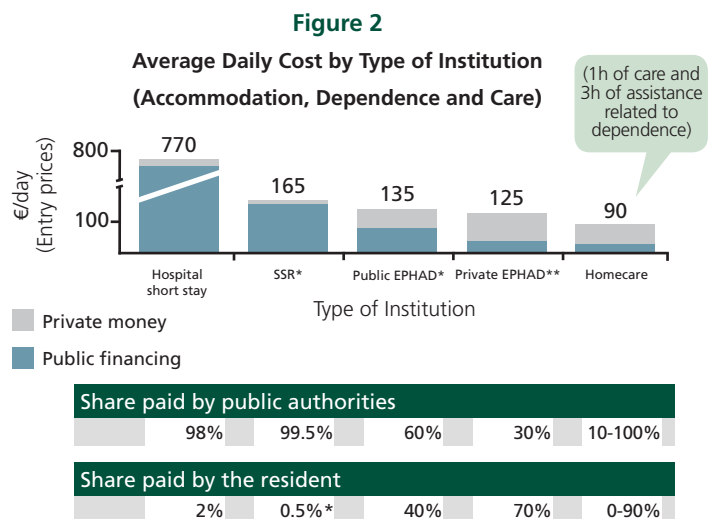
The 2010 Reform

The policy reform that was implemented in 2010 was largely dictated by the political imperative of controlling healthcare costs and reining in the widening deficit in the Social Security budget. Known by its acronym HPST (Hôpital, Patients, Santé, Territoires), this was an administrative overhaul that covered a wide range of clinics, hospitals, mental health institutions and other medical facilities. The reform created territorial administrations responsible for healthcare, the Agences Régionales de Santé, or ARS. For nursing homes, it resulted in tighter controls on authorization of EHPAD capacity increases. Previously, private operators could submit bed capacity creation projects together with a study of local market needs that they had ordered themselves. The actual needs would then be reviewed before approval. Under the revised system, the ARS take the lead and are responsible for the overall process of estimating the needs of the elderly. If they decide that additional capacity is necessary, they will issue a call for tenders.

The result of this change is striking. ARS have acted as a brake on nursing home expansion in practice, with relatively few new authorizations granted since 2010. Where there was an average of c. 20,000 additional beds created per year between 2007 and 2011, and 16,000 between 2011 and 2014, the number of new beds is expected to drop to approximately 5,000 annually from 2015 onwards.

New Objectives: Adapting Care to Needs

With the 2010 reform came a change in the objectives. One of the key government aims for nursing homes has been to improve the medical facilities and the provision of care. This is aimed at reducing the onus of elderly care on hospitals, where costs can be six times higher on average, and the daily care provided is often less suitable. At the same time, the French state has pushed to develop home care for elderly who are less dependent (estimated as people requiring less than four hours of care and assistance per day). For public finance, this remains by far the cheapest option for this population (See Figure 2).



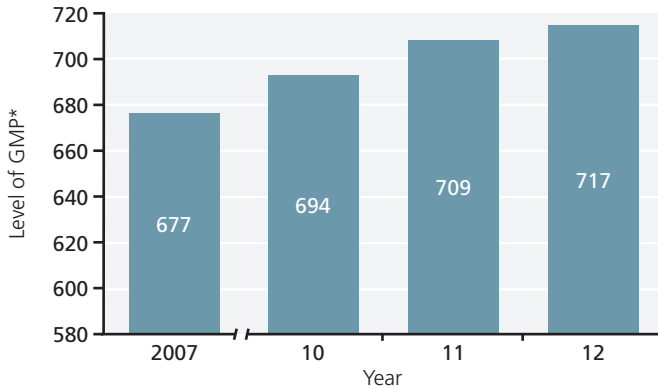
Note: *Assuming a stay longer than 31 days at the institution, over 65 year old average pathologies only; **Excludes medical expenses not included in the nursing home tariff.

Source: APHP, ATIH, Audit Board of the Sécurité Sociale, L.E.K. Consulting analysis

These efforts have borne fruit. The average level of dependency in EHPADs (characterized under an official scale known as the GIR Moyen Pondéré, or GMP) has grown, as nursing homes switch to focus on more dependent and severely dependent elderly people (see Figure 3). The provision of home care has also increased, thereby slightly reducing the proportion of less dependent elderly in nursing homes. At the same time, the pressure on hospitals has declined: for the population over 80 years of age, time spent in hospital fell from about 7.5% in 2007 to just 6% in 2011.

Figure 3

Evolution of the Dependence Level in EHPAD (2007-12)



CAGR% (2007-12) 1.2

Note: *GMP (GIR moyen pondéré, KPI used to assess the level of dependency of the residents) is calculated as follows: GIR1 is 1000 points, GIR2 840 points, GIR3 is 660 points, GIR4 is 420 points, GIR5 is 250 points and GIR6 is 70 points; those point per residents are averaged to calculate the GMP

Source: DRESS, L.E.K. Consulting analysis

The medicalization trend, coupled with an increase in life expectancy and the development of home care, has led to an aging of the nursing home population. Whereas in 1994, the average age of residents was 81 years and 10 months, by 2007 (latest data available), this had grown to 84 years and two months. For the private EHPADs, the average age is higher still, at 86 years and two months.

Despite these shifts in policy, some of the key indicators for operators of nursing homes have not been greatly impacted, and in fact remain quite stable. Resident rotation rate in private EHPAD is around 40%, and has only moderately declined. This is largely explained by the presence of two quite distinct populations within the homes: residents who end their life there and tend to stay longer, thanks to the increased medical care and facilities available, and those who stay only for short periods and either move back home, to their relatives, or to other care facilities. Fewer than 60% of the residents of private EHPADs actually die in nursing homes, and this figure is on the decline, while a growing number, about 30% currently, leaves to move back home or to a relative's place. The shorter stays have been boosted by the increased availability of temporary beds in nursing homes, currently about 3% of the total.

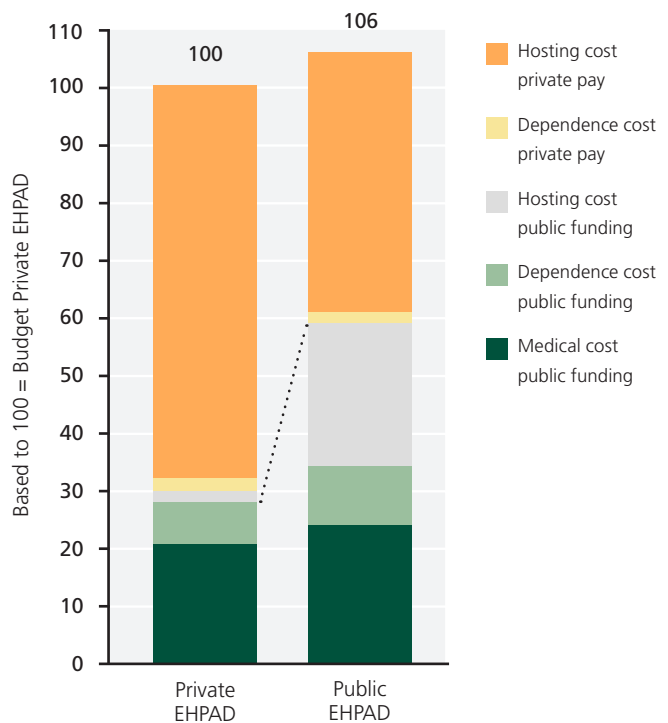
Opportunities for Private Operators

The demographic trends in France continue to point to increasing demand for nursing homes, with home care continuing to remain a viable option only for a portion of the elderly who aren't overly dependent. At the same time, the government has limited ability to fund the creation of new beds in public nursing homes. Depending on the evolution of demand, this could create substantial opportunities for private nursing home operators, who already account for 24% of the market.

Nursing home costs are divided between the ARS, local governments (Conseil Général des départements) and residents and their families. The average price per night paid by the resident at a private sector EHPAD is, on average, more expensive than in a public nursing home because residents themselves fund a larger part of the cost (see Figure 4). However, in terms of public spending, it is substantially cheaper to subsidize a private EHPAD than it is to finance a public one.

Figure 4

Estimated Private and Publicly Financed Cost of EHPAD



Source: L.E.K. Consulting analysis

Moreover, many public institutions will need to undertake high-cost renovation and overhaul in coming years. This will account for an important share of the public financing available. As a result, if demand for new capacity grows, private operators will likely face only modest competition from the public sector. The only exception is where local authorities, such as in Essonne, show a very strong willingness to promote public EHPADs and are prepared (and able) to pay for it.

Consolidation of the sector is in full swing: the private market is still fragmented, and many private operators are quite weak. A 2013 study by the Ministry of Health concluded that there are 600-800 private EHPAD operators in financial difficulty, because their homes are too small and outdated or don't comply with regulation. Big players will take advantage of the situation. The recent merger between Korian and Medica, alongside PAI's investment in DomusVi, the third largest operator, and Eurazeo's

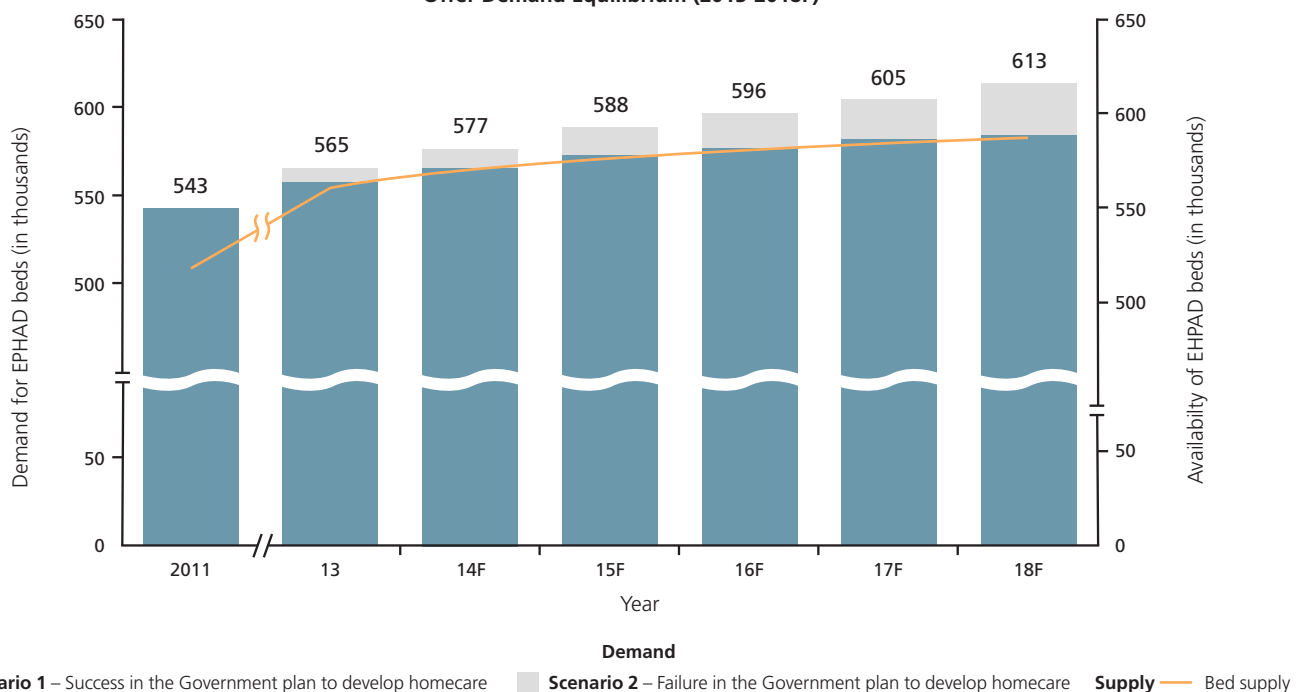
acquisition of Colisée Patrimoine, the fourth largest operator, confirms that the consolidation is already underway and that the financial community is taking a close interest in the sector.

Two Scenarios

For now, supply and demand for nursing home beds is more or less balanced, although there is a waiting list for public EHPAD beds in some areas. Between now and 2018, the government is emphasizing the development of home care as an alternative to nursing home care for less dependent elderly people, those who are in category 4 of the French GIR scale of dependency. Increasingly there's a demand for sophisticated care in nursing homes for dependent elderly who require close medical attention.

We identify two principle scenarios (see Figure 5). The first is that the government's efforts to boost home care are effective,

Figure 5
Offer-Demand Equilibrium (2013-2018F)



Source: L.E.K. Consulting analysis

so that only about 15% of this category 4 elderly will seek an EHPAD solution. In this case, the current equilibrium in supply and demand for EHPAD beds will be maintained through 2018.

The second scenario is that government policy fails, and about 20% of category 4 dependent elderly seek nursing home beds. This would be in line with historic levels. The result would be a significant shortage of up to 30,000 new nursing home beds, of which private operators will most likely get a significant share.

In either scenario, we believe there will be a growing imbalance between supply and demand after 2018. Budget constraints and pressure to squeeze Social Security spending is likely to continue, and local governments will also need to keep their belts tightened. Yet demand for nursing home beds will continue to rise, including for the beds providing costly specialized medical care. Private operators are best placed to take advantage of this market demand, and the largest and best-capitalized groups will benefit the most.

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