

Plugging the leaks in the UK care home industry

Strategies for resolving the financial crisis in the
residential and nursing home sector



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Key Facts

- £1.5bn** Out of a total annual income of £15bn, an estimated £1.5bn (10%) leaks out of the care home industry annually in the form of rent, dividend payments, net interest payments out, directors' fees, and profits before tax, money not going to front line care. This is equivalent to the £1.5bn of additional funding for social care promised by the government in the September 2019 Spending Review.
- £7** Out of every £100 put into small to medium-sized care home companies goes to profit before tax, rent payments, directors' remuneration, and net interest paid out.
- £15** Out of every £100 put into the 18 largest for-profit care home providers goes to profit before tax, rent payments, directors' remuneration, and net interest paid out.
- £261m** Of the annual income received by the largest 26 care home providers goes towards paying off their debts. Of this £117m (45%) are payments to related, and often offshore, companies.
- £102** The aggregate amount paid per bed per week in interest costs by the 5 largest private equity owned or backed care home providers. This is equivalent to 16% of the weighted average weekly fee (£622) paid for a residential care bed in the UK.
- 59%** The proportion of the £2.5bn of long-term debt owed by the largest 13 for-profit care home providers to related companies.
- 15 – 32%** The proportion of annual income spent by 7 of the 18 largest for-profit providers on rent payments, totaling £264m a year. In comparison, the 8 largest not-for-profit providers spent 2% of their income on rent payments, totaling £25m a year.
- 6** Of the largest 26 providers have owners based in a tax haven. This includes 4 out of the 5 largest private equity owned or backed providers and 2 of the 13 largest non-private equity for-profit care home providers.

Executive Summary:

Key Findings and Recommendations

The UK care home crisis – is it just about underfunding?

1. The UK care home industry is in crisis. The sector, which is almost entirely provided by independent companies, is frequently said to be on the brink of collapse. Since 2011 two major care home providers, Southern Cross and Four Seasons, who between them provided care to 45,000 residents, have either exited the industry or gone into administration.
2. Without doubt the financial model underpinning the UK care home industry is unsustainable. In addition the government's preparations for a No Deal Brexit forecast that an increase in inflation could, at worst, lead to the collapse of both small and large care home providers in the 6 months after a No Deal Brexit.¹
3. The cause of this crisis is unclear – the prevailing view is that there is insufficient money going into the system and that the government in England needs to increase the amount it pays the independent sector to look after state-funded residents.²
4. Yet news reports also detail large amounts of profit being extracted from the care home industry, either in the form of dividends or as loan repayments to investors.³ Detailed investigations of the Four Seasons care home group and similarly structured US nursing home chains also find large amounts of hidden profit extraction, casting doubt on the view that the industry's crisis is solely due to a lack of funding.^{4 5}
5. So where does all the money end up? In an ideal scenario, most of the money which goes into the sector would go directly to looking after the care home residents. This would mean enough staff with the right training to provide high quality care and good facilities, entertainment, food, and other services for the residents.
6. Despite the billions which go into the care home sector, care home workers are amongst the lowest paid workers in the country with high turnover rates (39.5%). Quality in care homes in England is also poor, with one in every five homes rated 'inadequate' or 'need improvement'.⁶

7. There is a growing consensus across the political parties that social care in England should receive a meaningful increase in state funding in order to provide free personal care in care homes to most of those who are in need.⁷ However, there are significant concerns that the injection of billions of pounds of additional funding into an industry which is beset by structural difficulties is unlikely to deliver either an improved level of care or value for money for the taxpayer.
8. In addition, given the increasingly tight restrictions on local authority-funded social care, 51% (£7.7bn) of the total annual income (£15.2bn) for independent care homes now comes from individuals and their families. The lack of financial transparency within the care home industry is therefore as much a consumer rights issue as it is a value for money issue for taxpayers.

Our approach to measuring the leakage out of the UK care home industry

9. This report is based upon a forensic study of the accounts of 830 adult care home companies, including the 26 largest providers. Collectively these companies represent 68% (£10.4bn) of the total estimated annual revenue (£15.2bn) for independent adult social care home providers.
10. Our analysis seeks to explain where the money going into the care home sector ends up and the nature of the structural problems which lie at the heart of the care home crisis.
11. It does this by quantifying the amount of money which 'leaks' out of the sector, and by examining the businesses practices and financial structures which enable this leakage for the 26 largest providers of care home services in the UK.

What do we mean by leakage?

12. When public services are provided by for-profit companies there is a public interest in ensuring that the level of profit made is reasonable. A balance needs to be struck between ensuring that as much of the money which goes into the care sector goes towards providing care, and the need to fairly reward the companies providing care so that they can continue to operate and grow.
13. Ideally, the profitability of a business can be measured by looking at its profit before tax figure. In accountancy terms, this measures the amount of income left over after all costs have been deducted apart from tax, and ordinarily this measure gives a good indication of the amount of income which leaks out.

14. However, previous reports into large care home providers in both the UK and the US have found difficulties in tracking the money which goes into the larger care home companies. This is because the complex nature of their corporate structures meant that “profits were hidden in the chain’s management fees, lease agreements, interest payments to owners, and purchases from related-party companies.”⁸
15. Similarly in the UK, a detailed analysis of the Four Seasons care home chain found “cash extraction tied to opportunistic loading of subsidiaries with debt; and tax avoidance through complex multi-level corporate structures which undermine any kind of accountability for public funding”.⁹
16. The highly varied and complex nature of some of the large care home companies now operating in the UK and the US means that using this standard measure understates the true profitability of these businesses and fails to capture the true level of leakage from the sector.
17. This is because the complexity and opacity of the company structures allows profit to be extracted in hidden ways, such as through property costs, management fees, and debt repayments.
18. To assess the true profitability of care home companies we therefore need to look not only at profit before tax but also at expenditure on rent, interest and repayments of debt, and directors’ remuneration, areas where hidden profit extraction occurs. Collectively they represent the total potential leakage out of the sector.
19. In this report we track the leakage rate for the 4 different types of provider by examining their business costs which are not directly related to the provision of care to residents. These 4 provider types are as follows:
 - Small and medium-sized care home companies
 - Large not-for-profit or employee-run providers
 - Large for-profit (Private Equity owned or backed) providers
 - Large for-profit (Non-Private Equity) providers
20. The small and medium-sized care home companies operate around 70% of the registered beds in the care home market, whilst the other 3 types comprise 26 large providers (‘the Big 26’) which operate the remaining 30%.

Key findings

The report finds the following:

Finding 1: There are significant levels of leakage across the care home sector and the type of care home business impacts the amount leaking out

21. There are big differences between the Big 26 providers (operating 30.8% of all registered beds) and all other (784) small to medium-sized care home companies identifiable in the sector, in the way in which income is allocated to various business costs. This is particularly true for those categories of business cost which include potential leakage.
22. For the Big 26, £13.35 of every £100 put in goes to profit before tax, rent payments, directors' remuneration, and net interest paid out.ⁱ In total this amounts to £653m a year out of a total income of £4.9bn.
23. For the 784 small to medium-sized care home companies, £7.07 of every £100 goes to profit before tax, rent payments, directors' remuneration, and net interest paid out. This amounts to £390m a year out of a total income of £5.5bn.
24. In total, across both the Big 26 providers and the small to medium-sized care home companies, we therefore estimate that £1.0 billion goes on profit before tax, rent payments, directors' remuneration, and net interest paid out, an average leakage rate of 10%.
25. Around £15.2 billion is spent each year on independent care homes for older people. Assuming that there is an average leakage rate of 10%, we estimate that a total of £1.5 billion leaks out of the UK care home sector in the form of profit before tax, rent payments, directors' remuneration and repayments on loans.
26. This is a significant potential loss of resources for the care home industry, equivalent to the additional £1.5 billion a year allocated to the social care sector in the Spending Review Statement in September 2019.

Finding 2: There are significant differences in the level of leakage among the largest ('Big 26') providers

27. For the 8 large not-for-profit providers the level of leakage is £8.60 out of every £100 received, and amounts to £93m a year
28. For the 5 large for-profit providers (Private Equity) the level of leakage is £9.06 out of every £100 received, and amounts to £159m a year.ⁱⁱ

i Net interest paid out is interest paid out (e.g. on loans) minus any interest paid in (e.g. on bank deposits).

ii This is lower than the aggregate leakage across the industry (£10.00) and significantly less than the leakage for the 13 other for-profit providers (£19.49). This is due to an aggregate loss before tax, which is mostly caused by a combined £159m loss by just two of the providers.

29. For the 13 large for-profit providers (Non-Private Equity) the level of leakage is £19.49 out of every £100 received, and amounts to £401m a year.

Finding 3: Some of the Big 26 care home providers use complex company structures to maximise leakage and hide profit extraction

30. Our review of the accounts and company structures of the Big 26 providers identified that many of the large for-profit companies have adopted structures which avoid tax, limit their liabilities if they are sued, and increase the amount of hidden profit which goes to their owners, investors, and related companies.
31. The Big 26 providers are part of large corporate groups totalling over 2,500 companies. Within this complex web, profit from the care home business can be funnelled out in the form of rental payments, debt repayments, and payments for services.
32. Table 1 shows how large care home companies use different structures which can disguise profit extraction and increase different forms of leakage.

Table 1 – The numbers of large care home companies of different types which use structures which can disguise profit extraction

Company Type	Offshore owner in tax haven	Split of operating and property companies	Sale and leaseback	Purchase services or supplies from a related company
5 large for-profit providers (Private Equity)	4/5	5/5	2/5	4/5
13 large for-profit providers (Non-Private Equity)	2/13	12/13	6/13	5/13
8 large not-for-profit providers	0/8	1/8	1/8	3/8

Finding 4: The Big 26 providers pay out significant amounts in rent payments each year, often to related companies which are based outside the UK's tax jurisdiction

33. Across the large for-profit providers it is common for rental payments to be made to separate companies which own the care home assets, which are either part of the same company group or an external company. As a result, one of the main areas of leakage for the Big 26 providers is the high cost of rent paid to landlords for using care home buildings.
34. Conversely the large not-for-profit providers tend to own most of their care home buildings. This explains why the 8 large not-for-profit providers pay out £2.34 out of every £100 of income on rent, compared to the 18 for-profit providers which spend £11.07 out of every £100 received.

35. The collapse of the care home provider, Southern Cross, was in part due to unaffordable rents. Whilst no company in the Big 26 has been as risky in its rental obligations, transparency over all these debts is a matter of public interest.
- 7 of the 18 large for-profit providers spend between 15% and 32% of their revenue on rent payments, totalling £264m a year.
 - The 9 providers with sale and leaseback arrangements paid the highest average rent: £14.32 out of every £100 of income received.
 - 5 of the 9 sale and leaseback arrangements amongst the Big 26 providers were with related companies (shares or has the same owners).
 - For those companies for which we were able to identify sufficient information we discovered that rental payments would often rise annually with inflation (RPI) plus a margin of usually around 2-4%. This puts pressure on fees to rise in tandem, to cover these costs.
36. When rental payments are paid between related companies it becomes hard to identify the true profitability of the underlying care home business and hence the true level of leakage, because rental charges may be levied by related companies at rates far higher than would be set by the market.
37. In addition, the offshore location of some of these related companies means that UK taxes can be avoided, which is another form of leakage from the system, although one that we have not been able to quantify.

Finding 5: Debt repayments are a significant area of leakage for some of the Big 26 providers

38. Our analysis reveals that a significant amount of debt has been loaded on to each of the care home beds by the Big 26 providers
- The 8 large not-for-profit providers have borrowed £21,069 for each care bed they own, and pay interest costs of £19 per bed per week.
 - The 13 large for-profit (Non-Private Equity) providers have borrowed £21,546 for each care bed they own, and pay interest costs of £14 per bed per week.
 - The 5 large for-profit (Private Equity) providers have borrowed £35,072 for each care bed they own, and pay interest costs of £102 per bed per week.ⁱⁱⁱ
39. The cost of the debt per bed owed by the 5 large for-profit (Private Equity) providers is especially high, amounting to around 16% (8 weeks of care) of the weighted average weekly fee of £622 paid for residential care in the UK, and 12% of the weighted average fee for nursing care of £856 per week.

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iii Despite having similar levels of long-term debt the 8 large not-for-profits and the 13 large for-profits (Non-Private Equity) have far lower interest charges than the 5 large for-profits (Private Equity) companies. This is in part due to the higher interest rates charged on the loans to private equity owned or backed companies. However, whilst the 13 large for-profits also have high interest rates on some of their intercompany debts these are often only repayable in one lump sum at the end of the loan. This means that they are not paying out as much in interest payments each year, but still face a high burden overall.

Finding 6: Much of the debt loaded onto the care homes by large for-profit providers is owed to related companies that are often based offshore and at high rates of interest i.e. a form of hidden profit extraction which also avoids tax

40. The Big 26 providers vary in how much of their long-term debt and interest payments are to related companies:
 - For the 8 large not-for-profit providers, loans from related companies comprise 1.4% (£7.5m) of their long-term debts and 0.0% (£0m) of their interest payments.
 - For the 5 large for-profit (Private Equity) providers, loans from related companies comprise 58.6% (£755.1m) of their long-term debts and 53.4% (£104.3m) of their interest payments.
 - For the 13 large for-profits (Non-Private Equity) their funding from related companies comprises 59.9% (£713.8m) of their long-term debts and 30.9% (£12.7m) of their interest payments.
41. The interest rates on these loans range between 7% and 16%, which is considerably higher than the cost of borrowing money from external investors or banks.
42. These debt arrangements may reasonably be seen as designed to generate extra hidden profit for the owners of the company – the debt repayments made to related companies leave these businesses before their pre-tax profit figure is calculated.
43. In addition, interest payments on loans are tax deductible and the related company paid is often offshore, so tax is saved at both ends – representing a double leakage for the taxpayer. This may explain why the Big 26 providers with an offshore owner paid out £9.09 of every £100 of income on net interest payments out, compared to £2.86 for all other large providers.
44. Overall, these arrangements make it hard to understand how much profit some of these companies are generating from providing care home services.

Finding 7: Splitting the care home business into separate operating and property companies raises other public interest concerns, including the ability of a care home operator to pay compensation for causing harm, and potential tax avoidance

45. Eighteen of the twenty-six largest providers had corporate structures where the operating company (which runs the care home) was split from the property company (which owns the home).

46. This leaves operating companies with few assets (since they no longer own care home buildings). These companies are responsible for providing safe care, and if they fail to do so they can be sued. But the only assets the company will have available to pay out any compensation are cash in the bank and any equipment it owns.
47. This means that the split can be seen as a way to protect valuable property assets from being at risk. Indeed, 5 out of the 18 companies with this split had negative assets (in 2017, or the latest available year) meaning that their liabilities (what they owed in total over time) were greater than the value of their assets. This is a public interest issue, since those providing care need to be able to be held financially responsible for any harm they may do.
48. Additionally, when these property companies are owned by related companies or based offshore there are concerns over hidden profit extraction and tax avoidance.

Finding 8: Leakage is also occurring through management fees and related company transactions

49. Twelve of the Big 26 companies had significant purchases from, or other transactions with, related companies. These ranged from consultancy services provided by another company owned by the same directors to the charging of high management and performance fees.
50. When transactions between related companies exist it is harder to determine how legitimate the prices set are, and the necessity of the services provided.
51. Many companies were charged management fees which went to related companies which had few or even no staff, making it seem to be a way to funnel profit out of the company (and often out of the UK).

Recommendations

52. In order to redress these significant deficiencies within the UK care home industry we make the following recommendations:

Recommendation 1:

A Care Home Transparency Act – care home providers should be mandated to disclose where their income goes

53. For anyone purchasing care home services, it is currently impossible to know how much of it goes on front line care and how much of it leaks out to investors. Irrespective of the mix of sources of a care home's income, whether from a local authority, the NHS, or from private individuals, there should be full transparency about how its income is spent.
54. Similar measures have been introduced in the US. In 2009 The Nursing Home Transparency and Improvement Act was passed as part of the Affordable Care Act. As in the UK, the complex management, ownership, and financial structures of large care home chains was found to impede the ability of federal and state governments to hold nursing home chains to account for their use of public money. This legislation requires nursing homes which are in receipt of public funding (Medicaid or Medicare) to report detailed information on ownership, staffing levels, other costs, complaints, and expenditure categories.
55. However unlike in the US, all the money which goes into the care home industry in the UK should be treated as public money and should be accounted for as such. Those individuals and family members who pay for care out of their own pockets are often required to do so because they are denied access to funding by the state, and as taxpayers they are entitled to know where their money goes.

Recommendation 2:

A new form of care regulation is required to prevent care home companies with unsatisfactory financial models from providing care in the UK

56. It is not in the interest of care home residents, their families, or the taxpayer for some types of company to own and run residential and nursing care homes. Companies which are registered outside the UK for tax purposes, or which have high levels of debt and/or make large payments to related property companies, or pay large management fees are not providing good value for money.
57. Moreover, as the government has recognised, companies which owe significant amounts of debt or who have high property costs are at risk of financial collapse. This creates an unnecessary risk of harm to care home residents and if it occurs it requires the state to pick up the pieces. There are currently no regulations in place to prevent a care home collapse, merely a mechanism for forewarning local authorities that this is likely to happen.

58. If, as seems likely, a future government commits to substantially increasing the amount of taxpayer money which goes into social care, there is a significant public interest in ensuring that the state only contracts with companies which can demonstrate that an acceptable proportion of their income goes to frontline care and have a sustainable financial model.
59. This will require a significant shift in how care is regulated in the UK, away from simply regulating the quality of care according to a series of output measures, to specifying that certain requirements are in place before a care home company is licensed. This is similar to current arrangements for defence contractors.
60. With regard to the finances of a licensed care home provider these requirements should include:
- tax registration in the UK of the ultimate controlling parties of the company providing the service;
 - full transparency in line with the requirements of the proposed Care Home Transparency Act;
 - minimum equity and net assets requirements to ensure that they can be held financially liable for any care malpractice in their homes;
 - an agreed proportion of income to be spent on staffing costs and non-staff operating costs; and
 - an agreed limit to the proportion of income to be spent on profit, debt repayment, and property costs.
61. Based upon our findings in this report we consider it likely that a significant proportion of the care home companies providing services in the UK would be able to meet these requirements as their expenditure on debt and rental payments is not significant, nor are their profit margins.
62. However, in the event that some care home providers are not able to meet these requirements the state should facilitate the restructuring of the companies so that they are able to achieve a licence to operate. Alternatively, they will need to be enabled to exit the market and the service re-provided by either the state or another company.
63. Whilst we anticipate that there will be significant concerns about the impact of such a regulatory regime on the viability of a number of the large care home companies, it should be borne in mind that the risks of insolvency, bankruptcy, and corporate collapse are current features of the existing care home market. Data provided by Company Watch shows that the percentage of the care home companies with a 1 in 4 chance of going into insolvency or in need of major restructuring in the next 3 years has increased from 24% in March 2014 to 30% in September 2019.¹⁰
64. As a result, a restructuring of some parts of the care home industry will be necessary at some point and it is preferable that this is undertaken in a managed way and in line with a clear set of public interest objectives.

***Recommendation 3:
Capital should be made available by the government for
the provision of new care homes***

65. The UK's current capital investment in new care homes is being provided by the larger for-profit care home providers and is being directed towards building large homes which are primarily focused on the more profitable part of the market, namely residents who fund their care out of pocket. In addition, the funding model of these new care homes is liable to lock in high rental and borrowing costs and there is evidence that larger care homes are associated with a worse quality of care.
66. In order to avoid locking these high costs into the care home infrastructure, and to ensure that there are different types of care home provision – including smaller care homes – the government should make available low-cost capital in the form of loans to small and medium sized care home operators too in order to encourage the development of a range of home sizes and care models.
67. Alternatively both local authorities and the NHS could build and own the new care home infrastructure. A decision could then be made about whether to operate these homes themselves or lease them out to other public, private, or not-for-profit providers. This would limit the opportunities for the type of extraction and leakage that we have identified in the form of rental payments and debt repayments. State ownership of the care home infrastructure would also offer protection for residents against the risks associated with the financial collapse of a care home company.

Introduction

- 68. Nearly all the care homes in the UK are now in private hands (94% of all beds). Whilst a substantial number of them are owned by small businesses a large number of them are owned by international private companies.
- 69. In total this means that 2,316 care homes in the UK (30.8% of the total number of registered beds) are owned by the 26 largest companies, whose investors see them as a source of income and profit.
- 70. Each year, independent care homes for older people receive £15.2bn in income. £7.4bn (49%) of this comes from local authorities (LAs) and the NHS whilst the majority, £7.7bn (51%), comes from individuals and their families, who are often forced to pay privately because of the tight restrictions governing access to state-funded care.¹¹
- 71. But where does all this money end up? In an ideal scenario, most of the money which goes into the sector would go directly to looking after the care home residents. This would mean enough staff with the right training to provide high quality care and good facilities, entertainment, food, and other services for the residents.
- 72. Yet, despite the billions which go into the care home sector, care home workers are amongst the lowest paid workers in the country with very high turnover rates. Quality in care homes in England is also poor, with one in every five homes rated 'inadequate' or 'need improvement'.¹²
- 73. Investors, naturally, view care homes as a business and have expectations on how much profit they can make. They will seek a share of the money which goes into the care home sector. Any income which goes to these investors will not go towards care workers or the residents of the care homes.
- 74. The care home industry is frequently said to be in crisis due to a lack of funds. But it is not clear how much of this extra funding is needed to provide good quality care, and how much will become unnecessary extra profit for the care homes' investors.
- 75. As a result we undertook a forensic study of the accounts of over 830 adult care home companies, including the 26 largest providers, to identify where each pound which goes into the care home industry actually goes. These companies have a combined income of £10.4bn, representing 68% of the total estimated market value for independent providers in 2017.

76. Our analysis of this sector finds 4 main types of company running care homes. They differ in how much of their income is spent on staff, rent, debt (e.g. loans) repayments, and profit. In other words, giving more money to some types of company will lead to more potential 'leakage' out as extra profit for the owners, and so less spent on residents, compared to others. The four main types of company are:
- Small and medium-sized care home companies
 - Large not-for-profit or employee-run providers
 - Large for-profit (Private Equity owned or backed) providers
 - Large for-profit (Non-Private Equity) providers
77. There is a noticeable variation in where the income is spent between (and sometimes within) these 4 types of company. Some of these types have financial structures which provide demonstrably worse value for money for society (i.e. more hidden profit extraction) and potentially a worse quality of care. Driving these differences are some behaviours and business structures which prioritise quick and frequent profit extraction, and can threaten financial sustainability.
78. Adult social care is a critical public service, with ultimate responsibility lying with local authorities and government, so there is a strong public interest in only allowing financially sustainable providers (with a reasonable level of profitability) to operate in this low risk and stable income industry.
79. Furthermore, the adult care home industry needs to build more homes to meet the extra demand in the coming decades, but only the larger operators are able and willing to do so. Our examination of their financial structures not only tells us how they spend the money that they currently receive, but also what future costs are being locked into the price of new beds. For example, expensive loans taken out to build new homes will ultimately have to be repaid by those (the government and the individuals) who wish to use the new beds.
80. The rest of this report will look at the leakage of funds and the differences in the financial structure of these 4 types of company in the care home industry, with both current spending and future care costs in mind.

SECTION A: The creation and development of the adult residential care and nursing home market for older people in the UK

Unlike NHS hospitals, the provision of nursing and residential care has never been seen as part of the state's infrastructure

81. The provision of residential and nursing care for older people in the UK has never been entirely provided by the state, in contrast to health care which is now mainly delivered in NHS hospitals and other NHS facilities. Instead, under the welfare settlement of the 1940s, social care – the delivery of personal care such as bathing, dressing, and feeding people who are in need – was not covered by the NHS and has remained the responsibility of local authorities and private individuals.
82. Even during periods in the 1970s when local authorities started to build their own care facilities, they have always arranged this type of care with voluntary, independent, and third sector providers, and as a result the state has never played a dominant role in this part of the national infrastructure either by owning the assets or by providing capital for new care homes to be built by public bodies. This history has meant that there has always been the potential for the provision of residential and nursing care services to be treated as a source of income and profit for investors.

Governments in the 1980s and 1990s created opportunities for large corporations backed by international investors to enter the UK care home market

83. It was only in the 1980s and 1990s that there was a significant increase in opportunities for international investors to build or purchase care homes in the UK. A combination of state subsidies for investors (via the social security budget) coupled with an expectation from central government that local authorities should not provide any services directly, meant that for-profit care home chains were created and the sector increasingly became corporatized.¹³

84. And whilst the NHS had previously provided long term care in NHS hospitals for older people – on the basis that they were meeting healthcare needs – the 1980s saw a large number of these old-style ‘geriatric’ wards being closed with the expectation that older people would instead be looked after in the community, or in purpose-built residential care facilities, and would also be subject to the means test associated with social care provision. With local authorities unable to provide these facilities themselves and with a growing population of older people, a new market opportunity was created for investors.¹⁴

Since the 1980s local authorities have been denied the resources to invest in residential and nursing care provision, creating further opportunities for the private sector to expand

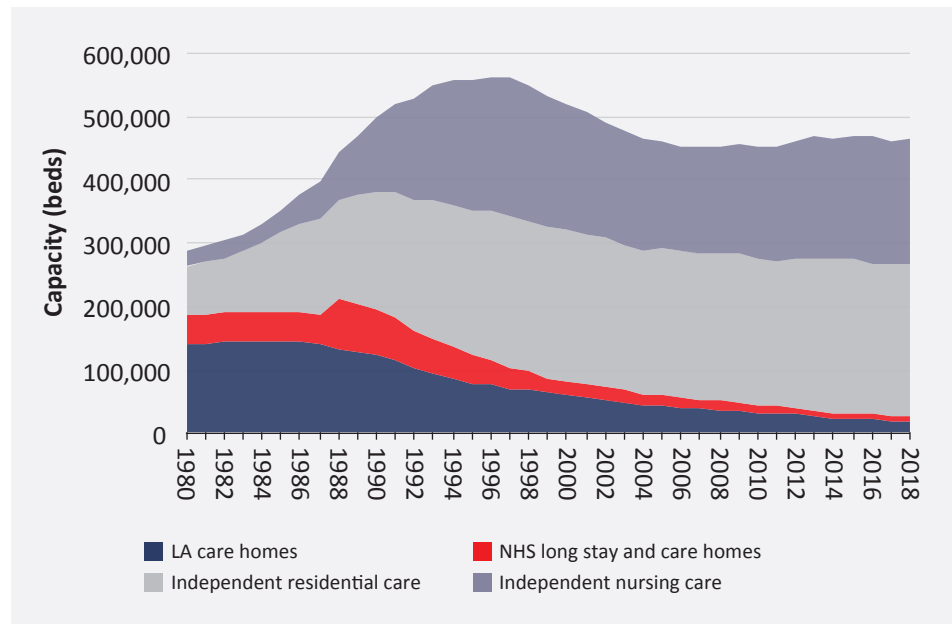
85. A key reason why local authorities were unable to build care homes was not unwillingness on their part but because central government denied them the ability to borrow to invest in them. This approach to limiting public investment in the care home sector survived the Conservative governments of the 1980s and 1990s and was continued by the Labour and Coalition governments up to the present day, resulting in further opportunities for the private sector to expand.
86. Thus in the early 2000s those local authorities which wished to keep hold of their care home stock, in order to avoid being entirely reliant on the market, were prevented from doing so. And when new regulatory requirements relating to the quality of facilities were introduced, local authorities either had to borrow to invest in their remaining care homes to bring them up to these new standards – which they couldn’t – or they had to sell or transfer them to the independent sector.¹⁵ In the mid-1990s it was estimated that 12 percent of all independent residential care homes were homes which had either been transferred from or sold by local authorities because of central government policy.¹⁶

The creation of a private market coincided with a drive to keep the cost of care for older people as low as possible

87. The introduction of a new regulatory regime – now overseen by the Care Quality Commission in England – also meant that many small providers had to close because they also did not have access to the finance needed to bring their homes up to the required standard. This in turn led to further growth in the share of the market owned by large investors.
88. As a result, since the 1980s the provision of residential and nursing home care has changed dramatically. From 1980 to 2018 the number of publicly provided (local authority) residential care beds fell from 141,719 to 17,100, a fall of 88%. In their place have grown independent sector operators (for and not-for-profits) who over the same period went from providing 76,811

residential care beds to 243,000, an increase of over 200%. Similarly for nursing care beds, independent providers have grown from providing 25,523 beds to 194,100 beds, an increase of over 660%.¹⁷

Figure 1: UK Capacity (beds) for older people (65+) in a residential setting by provider and care type.



Source: LaingBuisson 'Care Homes for Older People UK Market Report' 29th edition 2018.

The move from a cottage industry to corporate chains and the involvement of Private Equity funds and Real Estate Investment Trusts in the ownership of residential and nursing care homes

89. Although it has been the policy of successive governments to open up the care home sector to private companies there has never been a public debate about the type of private providers which should be involved in this aspect of care provision. Instead six main types of providers were identified during the initial market opening in the 1980s:
- 1 **traditional owner/managers** – either new entrants with training in a caring profession, predominantly nursing, or those involved in a career change.
 - 2 **colonizer chains** – over time some of the smaller care home providers were transformed into ‘colonizer chains’ by business people seeking new areas of investment.
 - 3 **hotel and leisure interests** – companies with subsidiaries in gambling and brewing.
 - 4 **construction and property groups**
 - 5 **private for-profit health care groups** – particularly UK and US corporations.

- 6 **private not-for-profit health care groups** – including BUPA, Nuffield Hospitals, and GM Healthcare.¹⁸
90. However, in a climate in which the government was committed to keeping the cost of residential and nursing care as low as possible, this range of providers whittled down to 3 main types:
- the large private for-profit groups
 - the large not-for-profit groups
 - the smaller traditional owner/manager
91. The large for-profit and not-for-profit groups were able to expand as they had access to the necessary finance, management, and marketing expertise, whilst smaller traditional owner/managers continued to provide services in a challenging market environment so long as they were content to generate smaller returns.¹⁹
92. As a result, the independent care home industry is now very fragmented, with a wide variety of firm sizes. The ten largest care home groups provide 21.4% of the UK's total bed capacity, 33% is provided by small operators (who run less than 3 care homes), with the remainder (45.6%) provided by other large or medium-sized groups.²⁰
93. For the large for-profit and not-for-profit chains, the care home sector is potentially lucrative because of the income which comes from providing a care service with growing demand, due to an ageing population, and because of the stability afforded by the fact that the state provides a significant share of the revenue. But it is also lucrative because of the value of the property – the homes themselves – which are central to the delivery of the service. From the perspective of investors, therefore, the care home industry both in the UK and in the US is seen as much as a property business as it is a care business.²¹
94. Thus the beds in care homes which are funded (whether by the state or by private individuals) generate steady and reliable income streams which can be used to pay a return to investors or lenders. And any company which owns the physical asset can generate income from renting it back to a company providing the care service, or can sell the property when its value rises.
95. The development of this way of thinking about care homes as a source of income and profit, as well as the lack of regulations regarding the types of companies that are allowed to provide care home services, saw the growing involvement of Private Equity funds and Real Estate Investment Trusts (REITs) in both the UK and the US care home markets from 2000 onwards.
96. The term Private Equity refers to a range of investments which are not traded on public stock markets so individual retail investors cannot buy shares in them. In general Private Equity funds tend to buy large commercial companies using a combination of capital raised from private investors (rather than on the stock market) and borrowed from lenders.²² In many cases a Private Equity fund will purchase a company using a loan which

is secured against the assets of the company being acquired. This means that a proportion of the income which is generated by the company will need to go towards repaying the original loan used to buy the company. The funds aim to invest in a company for up to 7 years and then sell it on for an increased price.

97. A study of the introduction of private equity into the care home market in the US described the approach taken by Private Equity funds as follows:

*“A typical transaction in what analysts term a “real estate play” is a deal where investors buy a company, use the real estate assets to help finance the deal (for example, leasing the properties to help pay off debt assumed in the acquisition), and hire a separate operating company to manage the assets. In addition to paying rent, the operator tenant usually pays all expenses of the properties, including operating expenses, property taxes, and capital improvements”*²³

98. In this scenario the care homes are often placed as assets in property investment companies such as Real Estate Investment Trusts (REITs), which both in the UK and in the US have a special tax status: they pay no corporation tax on the profits of their rental business.²⁴ Separating off the assets of the care home company into a separate REIT has led to concerns in the US that this may reduce the likelihood of the care home company being the subject of successful litigation, because the assets are separated from the care home operating companies and could therefore be beyond the reach of any claimant who has suffered injury or harm due to malpractice.²⁵

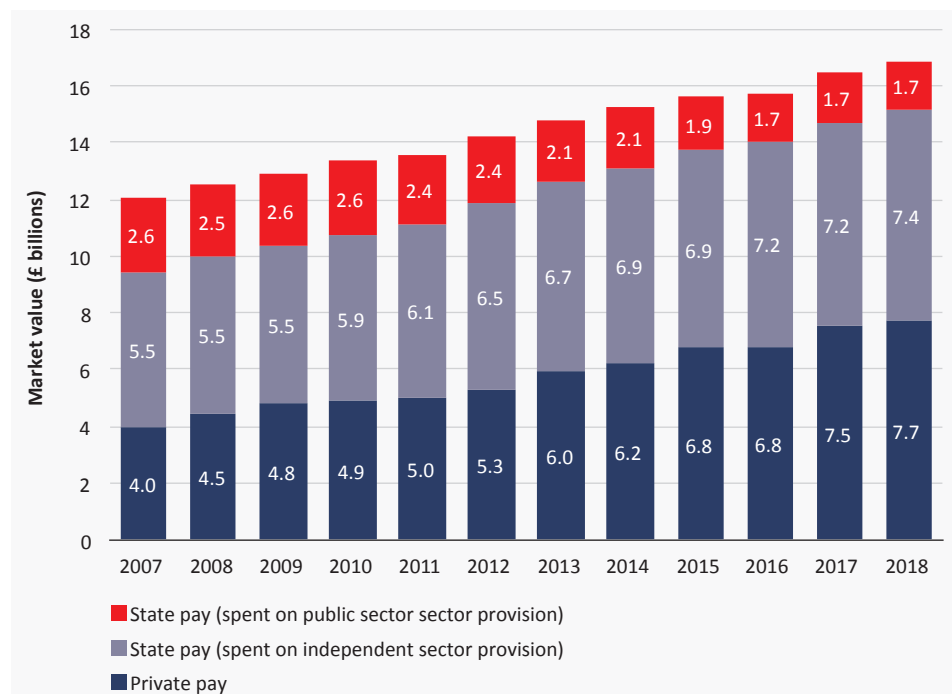
The funding of residential and nursing care has shifted away from the state and back to private individuals

99. In the UK there has been a significant shift away from local authority funding to funding by the NHS and by private individuals. In 2018 46% of residents in independent sector care homes were funded by local authorities, down from 54% in 2008. In contrast, the number of residents who pay for their own care (self-funders) increased from 42% in 2008 to 45% in 2018, whilst the number funded by the NHS increased from 4% in 2008 to 9% (2016).^{26 iv}
100. The fall in the number of care home residents funded by local authorities is due to a number of factors, including the financial constraints on local authorities, and the preference for older people to be cared for in their own homes, but most importantly the fact that it has become much more difficult for individuals to access local authority funding for residential care.

iv The increase in the number of care home places funded by the NHS is mainly down to the introduction of new guidelines regarding Continuing Healthcare and Personal Care with Nursing. For many years the NHS refused to accept responsibility for funding much of the nursing care in care homes as it was not formally classed as ‘healthcare’. Due to a number of high profile court cases and the introduction of new guidelines the number of people receiving NHS funding has grown on average by 6.4% a year. For more information on this see: National Audit Office (2017) – Investigation into NHS continuing healthcare funding. Available at: <https://www.nao.org.uk/report/nhs-continuing-healthcare-investigation/>

- 101. Local authority-funded social care in England is currently only available to people with assets (including housing wealth) and savings of less than £23,250. Even if individuals meet this ‘means test’ – which is becoming harder to meet, due to the increasing market value of houses – they may fail to be eligible for state funding because free local authority care is increasingly only available also to those with what are called ‘substantial’ care needs.
- 102. In terms of the total amount of revenue which goes into the independent care home industry, less than half – 49% (£7.4bn) – comes from local authorities or the NHS, whilst the majority, 51% or £7.7bn, comes from self-funders. The share paid by private individuals has grown rapidly (up from 45% in 2008) because of the growth in the number of older people needing care, the restrictions on accessing local authority-funded care, and the fact that care homes charge self-funders more than they do local authorities (an average of 36% more).²⁷
- 103. Local authorities, in particular, have often cut the price that they pay for care, due to the pressures on them to also provide a wide range of non-care services. The effect has been that the average (inflation-adjusted) spend per person in England fell from £345 (2010/11) to £310 per person (2015/16), whilst in Wales and Scotland the amount spent had fallen less dramatically but is still over £400 per head.²⁸

Figure 2: Market value for nursing, residential, and long stay care for older people (including those with dementia) by payer type.



Source: LaingBuisson (2018) – Care Homes for Older People – UK Market Report – 29th edition.

The future demand for care

104. The demand for social care is expected to grow as the proportion of the UK's population that is elderly rises along with life expectancy. Between 2018 and 2028 the proportion of those aged 85 and older (the most likely demographic to go into a care home) is projected to grow by 31% to 2.1m, compared to only 5% growth for the overall population.²⁹ At the same time, at age 65, a citizen is expected to live in poor health for, on average, 44% (male) or 47% (female) of the rest of their life, which suggests the need for social care during those years.³⁰
105. It is estimated that 1.2 million people (in 2016) didn't receive the help that they needed for essential daily tasks ('unmet needs').³¹ At the same time, around 8% of the UK's households were informal (unpaid) carers for someone, usually an elderly relative.³² There have been concerns that the ability of these informal carers to meet the growing levels of unmet needs will become increasingly unsustainable. Together with a rising proportion of elderly people these suggest that there will be a growing demand for social care services, including more care home beds.

Summary

It is important to note that the current state of the market for the provision of care home services in England is the result of a number of policy decisions taken by successive governments over the past three decades.

These include:

- treating the provision of care home services as separate from the NHS;
- using the market as a means to keep the cost of caring for older people down;
- transferring the cost of care home services from the state to private individuals;
- restricting the ability of local authorities to borrow to build state-run facilities;
- providing subsidies to the private sector to attract investment; and
- allowing any type of private company to run a care home business, including overseas investors and Private Equity funds.

SECTION B: Measuring leakage out of the care home sector – Key Findings

What we mean by leakage and why it is more than just profit before tax

106. Ideally, most of the income received by a care home company would be spent directly on caring for residents, through expenditure on care staff, facilities, food, laundry, entertainment, and other services for residents. Any money which does not go to these areas is less clearly legitimate, meriting critical analysis, and should therefore be treated as potential 'leakage'.
107. There is a strong public interest in minimising the level of leakage in order to ensure that as much of the money which goes into the care sector goes towards providing care and is therefore value for money. This is balanced by the need to fairly reward the companies providing care so that they can continue to operate and grow.
108. When public services are provided by for-profit companies there is a public interest in ensuring that the level of profit made is reasonable. In some instances – such as when the government contracts with the Defence Industry – there are regulations, designed to avoid leakage, governing the amount of profit which can be made by the defence contractor.³³
109. In accountancy terms, profit before tax measures the amount of income left over after all costs have been deducted apart from tax, and ordinarily this measure gives a good indication of the amount of income which leaks out.
110. However, the highly varied and complex nature of some of the large care home companies now operating in the UK and the US means that using this standard measure understates the true profitability of these businesses and fails to capture the true level of leakage from the sector. This is because the complexity and opacity of the company structures allows for profit to be extracted in hidden ways.
111. For example, in the US a 2015 study of a major nursing home chain found that “profits were hidden in the chain’s management fees, lease agreements, interest payments to owners, and purchases from related-party companies”.³⁴ Similarly in the UK, a detailed analysis of the Four Seasons care home chain found “cash extraction tied to opportunistic loading of subsidiaries with debt; and tax avoidance through complex multi-level corporate structures which undermine any kind of accountability for public funding”.³⁵ In the US the policy response to financial complexity and hidden profit extraction in the care home industry was the 2009 Nursing Home Transparency Act which mandated greater transparency regarding where taxpayer funds were spent.³⁶

Additional sources of leakage in addition to profit in the care home sector

112. It is therefore important to look for other less obvious sources of profit extraction. These can often be found in the following types of business cost in addition to profit before tax:
- **Property costs** – this includes rent for using the care home which may be paid to an external company or to a related company (one which shares or has the same owners).
 - **Debt repayments** – this includes payments to cover the interest and value of a loan used to buy, improve, or extend a care home, and in some cases to pay back a loan used to buy the company in the first place. These can be payments to banks, bondholders, or other investors, and can be at high interest rates.
 - **Directors' remuneration** – payments made to the directors of a company for managing the business and its finances.
 - **Management fees and central overhead costs** – these are costs charged to the company by a parent company for managing its finances and business functions such as payroll, HR, and legal services. These are discretionary sums and are often used by a parent company to extract money out of a subsidiary business.

Strategies used by companies to increase the amount of hidden profit extraction

113. Some common strategies are employed by care home companies to enable the extraction of profit through such business 'costs'. These strategies are built into the way in which some care home companies are structured and organised, and some companies employ them more than others.
114. In essence each of these strategies involves shifting profit out of the company which provides the care to other related companies in a corporate group. Shifting profit does not affect the overall profitability of the care business, but it allows the profit shown by the care home company to be reduced. This can lower the tax paid and obscure how profitable the care home business is. Having care home companies which look barely profitable is beneficial when you are publicly lobbying for more money from the government and from self-paying care home residents.

115. These strategies include:

- **Offshore ownership** – this allows tax to be avoided when money is paid to related companies that are based overseas. This is often achieved through repaying large loans which have been made to the care home business from a related offshore company. Expenditure on interest repayments is not usually subject to tax.
- **Splitting up the company** – care home businesses are often split into multiple companies with some companies in the group providing care in the homes, while other companies in the group own the properties or provide supplies and management services. The care home company is then charged rent or billed for supplies or management fees by the other companies. This reduces its pre-tax profit but not that of the overall business. The fees and prices charged can be at above-market rates, so that profits are moved out of the care home company, making it look less profitable than it actually is.
- **Sale and leaseback** – many of the large companies sell their care home premises to a buyer and then agree to rent them back over a number of years. In some cases the care homes are sold to and then rented back from a related company. These rental agreements are often opaque so it is hard to determine whether the rent paid by the care home company is reasonable or not. If the rent charges are set deliberately high then the profit of the care home company is reduced, although the profit of the overall business is not.

Summary

In an ideal situation most of the income which goes into the care home sector would go to caring for the care home residents. When care home services are provided by businesses rather than directly by the state there will always be some level of leakage. The aim for policy makers should be to minimise this leakage, to a reasonable level, in order to deliver value for money for the taxpayer.

Due to the complex financial structure of some of the care home companies which are currently providing care services, in the UK and the US, it is not possible to measure leakage just by looking at the amount of declared profit which these companies make. Some companies structure their businesses to extract hidden profits and to maximise the amount of money which leaks out. The policy response in the US has been to require greater transparency about where the money going into the care home sector ends up.

Methodology

The companies' accounts that we examined

- 116. We constructed two data sets for our analysis. For the largest 26 providers of adult social care we separately reviewed each of their accounts (group and where possible individual homes / care businesses), and recorded critical information about their financial and operational structures.^v This is referred to as the '**Big 26 data set**' or the 'large providers' and totals **£4.9bn** of income (2017) and **30.8%** of all registered care home beds.
- 117. To look at industry-wide trends we collected financial information from the accounts of all UK-registered companies which list their primary business as residential nursing care or residential care for the elderly and disabled.^{vi} Of these 11,928 companies we looked at those which had been trading from 2012-2017 (to ensure comparability), and which were not part of the corporate groups of the Big 26 providers.^{vii} This left us with **784 companies**. This is referred to as the '**Smaller trading companies data set**', and consists of small to medium-sized care home companies with a total of **£5.5bn** of income (2017).
- 118. The group of 'large' providers consists of 26 care home providers which account for 30.8% of the total number of registered care home beds in the sector. These are set out in Table 2.

Table 2: The large (Big 26) care home providers split by ownership type (2017, or latest year)

8 Large not-for-profit providers	5 Large for-profit providers (Private Equity)	13 Large for-profit providers (Non-Private Equity)
Total revenue: £1.1bn	Total revenue: £2.1bn	Total revenue £1.8bn
Number of residential and nursing beds: 24,964	Number of residential and nursing beds: 36,755	Number of residential and nursing beds: 55,330
Anchor Sanctuary Housing Association Methodist Homes Orders of St John Care Trust Abbeyfield Society Shaw Healthcare Quantum Care Somerset Care	HC-One Four Seasons Health Care Care UK Orchard Care Homes Akari Care	Barchester Healthcare Bupa Care Homes Runwood Homes Maria Mallaband and Countrywide Group Avery Healthcare Advinia Health Care Sunrise Senior Living Caring Homes Larchwood Care Minster Care Group Priory Group Excelcare Healthcare Homes

v See Appendix for a list of the main companies examined for each.

vi UK SIC primary and secondary codes: 871 and 873.

vii Specifically companies that were not dormant and had at least £1,000 of revenue across all years and for individual years of analysis their revenue was greater than £100,000.

How representative are our data sets

- 119. Together the two data sets represent an annual income of £10.4bn in 2017. This amounts to 68% of the total estimated market revenue (£15.2bn) for independent adult social care homes.³⁷
- 120. We couldn't identify all the companies and hence where all the market's revenue went due to two factors: firstly, there may be private or public companies providing adult social care which do not appear in Companies House, or which do not list adult social care as their primary or secondary industry codes. Secondly, for some of the largest twenty-six providers we could not precisely isolate the income that they derived from adult social care from their other business activities, which leads to some under and over estimates.

What our data sets can and cannot tell us

- 121. We can look at trends in the financial performance of companies which have been in the industry for a few years and identify different types of financial and business structures. We have more detailed information on the largest twenty-six companies and their strategies.
- 122. We cannot easily identify differences in region, the ratio of resident types (LA-funded or self-funded), types of care (e.g. nursing or residential), or new entrants using the Smaller trading companies data set. For the Big 26 data set we have more of this information.
- 123. We also do not have financial information for each individual care home run by these providers. These are hard to access in a systematic way because the results of multiple care homes are often presented together in a company's accounts. However, for this report we are interested in the financial and business structure of the companies running care homes and not the performance of individual care homes themselves.
- 124. Viewing this industry from the perspective of its companies and groups can reveal other forms of profit making (e.g. high management fees) that are not apparent at the care home level and reveal operational priorities.

There are significant levels of leakage across the care home sector and the type of care home business impacts the amount leaking out

- 125. To assess the true profitability of care home companies it is necessary to look not only at profit before tax but also at expenditure on rent, interest and repayments of debt, and directors’ remuneration, areas where hidden profit extraction may occur. Collectively they represent the total potential leakage out of the sector.
- 126. We initially looked at how the income received by all care home providers was spent in aggregate. We examined a total of 830 individual companies that accounted for 68% of the total estimated market revenue for independent adult social care homes in 2017 – i.e. £10.4bn, out of a total revenue of £15.2bn.
- 127. Table 3 provides a breakdown of how this £10.4 billion of income is spent. It also shows how the amount spent on each area of expenditure differs between the small to medium-sized companies and the largest (Big 26) providers in the industry.

Table 3: Costs of adult social care home operators as percentage of revenue (2017 or latest year available, excluding exceptional items)

Costs as a % of revenue (aggregate)	Small to Medium-sized care home companies	Large care home providers
	Every £100 of income is spent as follows	
Staff costs	£58.02	£56.10
Non-staff operating costs ^{viii}	£31.82	£25.07
Rent	£1.44	£9.14
Net Interest paid out ^{ix}	£1.27	£5.04
Directors remuneration	£0.62	£0.41
Depreciation and Amortization	£3.09	£5.47
Profit Before Tax	£3.74	-£1.24
Total potential leakage	£7.07	£13.35
Proportion of total estimated industry revenue	36%	32%
Number of companies	784	26 – but part of groups with >2,500 companies

Sources: Big 26 data set, Smaller trading companies data set – this analysis excludes exceptional items.

viii These include other costs of running a business such as care supplies and utilities.

ix Net interest paid out is interest paid out (e.g. on loans) minus any interest paid in (e.g. on bank deposits).

- 128.** Unsurprisingly expenditure on staff costs is similar across the industry. Social care is a labour-intensive business and all company types generally pay their basic care workers the national living wage. This is becoming increasingly unsustainable as staff with their skills levels are in shorter supply and have better-paid opportunities in other industries.
- 129.** There are big differences between the Big 26 providers (operating 30.8% of all registered beds) and all other (784) small to medium-sized care home providers identifiable in the sector, in how income is allocated to various business costs. This is particularly true for those categories of business cost which include leakage.
- 130.** For the Big 26, £13.35 of every £100 put in goes to profit before tax, rent payments, directors' remuneration, and net interest paid out. In total this amounts to £653m a year out of a total income of £4.9bn.^x
- 131.** For the 784 small to medium-sized care home companies, £7.07 of every £100 goes to profit before tax, rent payments, directors' remuneration, and net interest paid out. This amounts to £390m a year out of a total income of £5.5bn.
- 132.** In total, across both the Big 26 providers and the small to medium-sized care home companies, we estimate that £1.0 billion goes on profit before tax, rent payments, directors' remuneration, and net interest paid out; an aggregate leakage rate of 10%.
- 133.** A lot of the difference in the amount of leakage between the Big 26 providers and the small to medium-sized companies is due to their different company structures and their histories.
- 134.** For example, a large number of the small to medium-sized companies are family-run businesses or small charitable bodies providing services in from one to three properties which they own outright, so they pay little to no rent. Out of every £100 in income received they spend £1.44 on rent, compared to the Big 26 providers which spend £9.14 out of every £100 received.
- 135.** The Big 26 operate tens to hundreds of care homes each and they have often grown by renting new properties, so their rent costs are higher. However more of their rent payments are to related companies and so are, in part, a form of hidden profit extraction, which will be explained later.

x This total leakage figure is reduced by the overall negative profit before tax (i.e. loss) by the Big 26 providers, which is due to losses by 7 of the 26 companies. Over 83% (£159m) of these losses are due to just two companies which continue to operate in the industry. This suggests that they are either more profitable than they appear to be or that they see future profits outweighing any current losses. The largest loss is by Elli Investments Limited (Four Seasons Health Care), which has been identified as a company which "would be robustly profitable" without opaque and potentially discretionary charges levied on the company by its group management. (See Burns, D. et al. (2016) – Where does the money go? Financialised chains and the crisis in residential care, CRESC Public Interest Report). This again illustrates why it is not possible to rely on profit before tax figures to tell whether and by how much a company is profitable.

- 136.** Similarly, the amount of income spent on repaying debt is much lower in the small to medium-sized companies – £1.27 of every £100 in income received, compared to £5.04 for the Big 26 providers. This difference is probably due the fact that many of the small to medium-sized companies own their properties outright and are not borrowing in order to expand. The Big 26 providers include newer entrants and those that have expanded through borrowing. However, there is a large variation within the Big 26 providers.
- 137.** Interestingly, the profit before tax of the small to medium-sized companies is far higher than for the Big 26 providers – £3.74 out of every £100 received ends up as a profit before tax compared to a loss of £1.24 per £100 for the Big 26 providers. Because of their relatively simple corporate structures the amount of profit before tax generated by the small to medium-sized companies is likely to be a more accurate representation of their underlying profitability than is the case for the Big 26 providers.

Estimated total leakage out of the care home sector

- 138.** Around £15.2 billion is spent each year on independent care homes for older people. Assuming that there is a leakage rate of 10%, we estimate that a total of £1.5 billion leaks out of the UK care home sector in the form of profit before tax, rent payments, directors’ remuneration and repayments on loans.^{xi}
- 139.** This is a significant potential loss of resources for the care home industry, equivalent to the additional £1.5 billion a year allocated to the social care sector in the Spending Review Statement in September 2019.³⁸

xi A recent study by the Competition & Markets Authority (CMA) looked at the financial performance and sustainability of care home providers. As part of this work they produced an aggregated income statement for the largest twenty-six care home providers. Using the CMA’s figures for the largest 26 providers, £20.00 of every £100 put in goes to profit before tax, rent payments, management fees, and interest paid out. This amounts to £864m a year out of a total income of £4.3bn. This estimate of potential leakage is a lot higher than the one based upon our Big 26 data set. The reason why is because the CMA were able to identify management fees (including central costs) as a separate cost, whilst for us these are included with ‘Non-staff operating costs’. The CMA’s analysis suggested that this cost is “significant” and the bulk of this fee was likely payments to shareholders, usually private equity funds, for management services. In 2016 these fees totalled £221m, a growth of 9.0% from 2015 despite overall revenue growing by only 4.3%. Management fees are discretionary and can be used to extract hidden profit out of a business. This suggests that our total leakage figure for the Big 26 providers is likely an underestimate. If we assume, in line with the CMA, a management fees cost of 5.1%, then our overall estimate of leakage out of the Big 26 providers rises from £653m to £902m a year (i.e. 18.85% of revenue). See Competition & Markets Authority (2017) – Care homes market study: final report. Appendices and glossary.

There are significant differences in the level of leakage among the largest ('Big 26') providers

140. We broke down further the Big 26 providers by ownership type, giving us 4 different types of care home business.
- Small and medium-sized care home companies
 - Large not-for-profit or employee-run providers
 - Large for-profit (Private Equity owned or backed) providers
 - Large for-profit (Non-Private Equity) providers
141. The analysis set out in Tables 4 and 5 shows that there are also significant differences in the level of leakage among the large (Big 26) providers. Firstly, there are large differences between the not-for-profits and for-profits (Table 4), and then within the for-profits there are further differences (Table 5). In summary:
- For the **8 large not-for-profit providers** the level of leakage is £8.60 out of every £100 received, and amounts to £93m a year
 - For the **5 large for-profit providers (Private Equity)** the level of leakage is £9.06 out of every £100 received, and amounts to £159m a year.^{xii}
 - For the **13 large for-profit providers (Non-Private Equity)** the level of leakage is £19.49 out of every £100 received, and amounts to £401m a year.

Table 4: Costs of the large (Big 26) providers split by ownership type as a % of revenue (2017 or latest year available, excluding exceptional items)

Costs as a % of revenue (aggregate)	Large for-profit	Large not-for-profit
	Every £100 of revenue in is spent as follows:	
Staff costs	£56.51	£54.65
Non-staff operating costs	£24.32	£27.73
Rent	£11.07	£2.34
Net Interest	£5.88	£2.07
Directors remuneration	£0.42	£0.39
Depreciation and Amortization	£4.47	£9.01
Profit Before Tax	-£2.67	£3.80
Total potential leakage	£14.70	£8.60
Number of providers	18	8

Source: Big 26 data set

^{xii} This is lower than the aggregate leakage across the industry (£10.00) and significantly less than the leakage for the 13 other For-profit providers (£19.49). This is due to an aggregate loss before tax, which is mostly caused by a combined £159m loss by just two of the providers.

142. The not-for-profits mostly provide residential care beds whilst the for-profits offer more nursing beds. Nursing beds receive higher fees but also require nursing staff, who are increasingly scarce. The higher fees may be in part offset by the higher cost of staff but it shouldn't impact the financial structure i.e. where they allocate their costs (e.g. rent) and how they choose to fund themselves (e.g. who they borrow from).
143. As state funding growth has become limited all providers have been put under pressure to control or reduce their labour costs. Both not-for-profits and for-profits rely on a poorly paid workforce, paid at the statutory minimum wage rate. As social care is staff-intensive this means that 'costs' are reduced by sweating the staff e.g. working them harder without increasing pay, limiting annual leave, or not paying for handover meetings. These practices are common across all of the Big 26. Indeed, of the 5 Big 26 providers which spend less than 50% of their income on staff, two are not-for-profits.
144. The not-for-profits have far simpler corporate structures. They didn't have many subsidiary companies (ones that they own and control) or parent companies which had lent them money, so their profit before tax figures more accurately reflect their true profitability.
145. Both the large for-profits and not-for-profits are looking to expand the number of care homes and are following similar strategies.³⁹
146. **Diversification:** they are often expanding out of their core residential and nursing care businesses to provide specialist dementia care homes, integrated care, and intermediate care (care for those well enough to leave hospital but who can't return home yet).
147. **Restructuring:** a large number had closed down care homes and handed back contracts to LAs. A few cited difficulties with making a profit on domiciliary care services. A number of the for-profits were reducing their borrowings and trying to buy more of their new or existing properties as opposed to renting. This reflects an uncertainty for some over whether they can maintain such high rental costs given fee rates.
148. **Selective expansion:** Almost all the Big 26 providers aimed to increase the number of self-funders they have in their care homes. Many were also building new homes in areas and to specifications aimed at wealthy individuals. Aside from two not-for-profits, none were keen to build or refurbish homes for LA-funded residents.
149. Within the for-profits there was more variation in leakage by ownership type.

Table 5: Costs of the large (Big 26) providers split by ownership type as a % of revenue (2017 or latest year available, excluding exceptional items)

Costs as a % of revenue (aggregate)	Large for-profit (Private Equity)	Large for-profit (Non-Private Equity)	Large not-for-profit
	Every £100 of revenue in is spent as follows:		
Staff costs	£57.18	£55.95	£54.65
Non-staff operating costs	£28.76	£20.55	£27.73
Rent	£7.32	£14.26	£2.34
Net Interest paid out	£10.83	£1.66	£2.07
Directors remuneration	£0.15	£0.65	£0.39
Depreciation and Amortization	£5.00	£4.01	£9.01
Profit Before Tax	£-9.24	£2.92	£3.80
Total potential leakage	£9.06	£19.49	£8.60
Number of providers	5	13	8
Proportion of total annual revenue of Big 26	35.8%	42.1%	22.0%

Source: Big 26 data set

Summary

Tables 3–5 show that there are variations in how much the different types of care home company spend on their costs. These differences are particularly noticeable in costs where hidden profit extraction does occur, such as rent and interest paid out.

Within the large (Big 26) providers, the not-for-profits spend relatively consistent proportions of their revenue on each area of costs. The for-profits show more variation on these costs, even when split into further categories i.e. Private Equity or non-Private Equity ownership. These variations are explainable through a deeper analysis of the different corporate structures employed by providers.

SECTION C: Some of the Big 26 care home providers use complex company structures to maximise leakage and hide profit extraction

150. Some of the differences among the Big 26 providers can be explained by the nature of their company structure and how money flows to different investors and companies that have claims on the care home company’s revenues. Table 6 shows how large care home providers use different structures to disguise profit extraction and increase different forms of leakage.

Table 6 –The numbers of large (Big 26) care home providers of different types which use structures which can disguise profit extraction.

Company Type	Offshore owner in tax haven	Split of operating and property companies	Sale and leaseback	Purchase services or supplies from a related company
5 Large for-profit providers (Private Equity)	4/5	5/5	2/5	4/5
13 Large for-profit providers (Non Private Equity)	2/13	12/13	6/13	5/13
8 Large not-for-profit providers	0/8	1/8	1/8	3/8

Leakage in the form of rental payments and the impact of ‘Sale and Leaseback’

151. One of the reasons why leakage in the form of rental payments is so high for some of these providers is due to who owns the care home premises and in particular, the use of sale and leaseback arrangements, i.e. when a company sells an asset (in this case a care home building) to a buyer and then leases (rents) back the building (from the buyer) on a long-term contract.
152. It is estimated that amongst medium to large care home operators around 50% of all bed capacity is covered by sale and leaseback.⁴⁰ Our review of the Big 26 providers’ accounts identified 9 companies which had used sale and leaseback as a way of financing the expansion of their companies; 8 were large for-profit companies and one was a large not-for-profit company.

- 153.** In general the large not-for-profit providers have not relied on sale and leaseback because they mainly consist of older companies which initially started out providing housing and other services for older people. As charities, the level of financial risk that they are willing to take is lower. Therefore they own most of their care homes and buildings and so their rent payments are low, while consequently their (non-cash) depreciation payments are higher because they own their assets (buildings).
- 154.** These arrangements explain why the 8 large not-for-profit providers pay out £2.34 out of every £100 of income on rent compared to the 18 for-profit providers which spend £11.07 out of every £100 received.
- 155.** However, there are also significant differences within the large for-profit group of providers. The 5 for-profit (private equity) care home providers spend £7.32 out of every £100 received on rent; while for the other 13 other large for-profit providers £14.26 out of every £100 received is spent on rent.
- 156.** The 9 providers with sale and leaseback arrangements paid the highest average rent: £14.32 out of every £100 of income received.
- 157.** Sale and leaseback is popular amongst the Big 26 providers because it provides cash for expansion (buying new homes) whilst allowing them to still use the care homes they have sold. However, it also means that any rise in value of the property is forgone, and it is harder to dispose of businesses if they are locked into long-term rental contracts. For many for-profit providers, sale and leaseback may be one of the only ways that they can raise cash to expand, as banks are less willing to lend to businesses without a significant number of properties or other assets available as security.
- 158.** For the buyers of the care home assets the purchase allows them to receive a steady stream of income (along with any rise in property values) without the risks involved in providing the care services. Investment companies (such as Welltower Inc and Impact Healthcare REIT plc) have been keen to buy and rent back care homes, usually securing a 5-7% return on their investment for little risk.^{xiii}
- 159.** However, it is not always the case that the sale and leaseback arrangements are with separate property companies. We found that 5 of the 9 sale and leaseback arrangements amongst the Big 26 providers were with related companies or individuals.
- 160.** In the situations where sale and leaseback arrangements exist within a large corporate group, the care home company will have split their business into an operating company and a property company.

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 xiii Some REITs now also own stakes in operating companies too (i.e. companies which actually provide adult social care).

The Big 26 providers pay out significant amounts in rent payments each year, often to related companies which are based outside the UK's tax jurisdiction

161. When rental payments (via sale and leaseback or otherwise) are paid between related companies it becomes hard to identify the true profitability of the underlying care home business and hence the true level of leakage, because rental charges may be levied by related companies at rates far higher than would be set by the market.
162. In addition, the offshore location of some of these related companies means that UK taxes can be avoided, which is another form of leakage from the system, although one that we have not been able to quantify.

High rental payments reduce the money available to look after care home residents and lock in high fee rates

163. Even if the rental payments for the care homes are not to a related company there are legitimate concerns about the growth in rental payments and the impact that this has on care home fees. Seven of the 18 large for-profit providers currently spend between 15 and 32% of their revenue on rent payments, totalling £264m a year.
164. For those companies for which we were able to identify sufficient information we discovered that their rental or leaseback payments would often rise annually with inflation (RPI) plus a margin of usually around 2-4%.
165. This means that for any company with these arrangements their fee rates must increase yearly by an amount higher than the rate of inflation or cuts will need to be made to other areas of the business – such as staffing costs or investment in facilities or entertainment for residents.^{xiv} If the fee rates do not increase, or if cuts to other areas are not possible to meet the increased cost of growing rental payments, the company is put at risk of financial difficulties.
166. For the funders of the care of residents – whether the local authority or the NHS or individual residents and their families – these high rental costs, and their dependence on care home providers with these arrangements, puts pressure on them to continually increase the fees that they pay. As a result there is a significant public interest in transparency over the costs that are locked into these long-term rental agreements and in minimising increases in rental charges.

^{xiv} For example, one Big 26 provider that we reviewed had annual rental increases of up to 2.5%, but had managed to increase their annual fees by 5.2%. These yearly inflation plus rental increases lock in a minimum fee increase for the users of their care homes for the coming years.

167. The collapse of the care home provider Southern Cross was in part due to unaffordable rents on sale and leaseback care homes. Whilst no company in the Big 26 has been as risky in its rental obligations, transparency over all these debts is a matter of public interest. But it is a matter of concern that the group of Big 26 providers which have sale and leaseback transactions have an above average level of gearing of 578.4% – in other words their debts are almost six times greater than the assets they have available to pay them off.
168. For the purchasers of care home premises, a sale and leaseback transaction can quickly provide a return on their investment, leaving little downside risk for them if the business fails. This type of profit extraction via the selling off a company's assets is ill-suited for a low risk industry where returns are expected to be steady and yearly. It is especially against the public interest if it leads to higher debts which must be covered by care home fees.

Summary

Significant amounts of money leak out of the care home sector in the form of rental payments to companies which own care home buildings. Some care home providers have sold their assets to property investors and are often locked into paying high rents over a long period of time.

These high rental payments are not often seen as leakage out of the care home system, but because they are so significant for some providers they can eat into the money available to look after care home residents and lock in high fee rates which local authorities, the NHS, and private individuals have to pay.

This arrangement is especially problematic where a care home group has split its structure into an operating company and a property company, and rental payments are made by one company to lease the care home premises from another, both of which they own. These rental payments can include hidden profits, if the rental payments are artificially high.

Leakage in the form of debt repayments and the impact of inter-company loans

- 169.** The amount of income which leaks out in the form of debt repayments is also highly variable across the Big 26 providers, and is again a product of the way in which the companies are structured and how their loans are financed.
- 170.** For the 8 large not-for-profits, the amount spent on debt repayments amounts to £2.07 of every £100 of income received compared to the 18 large for-profit providers, which spend £5.88 on debt for every £100 of income received.
- 171.** However, it is the 5 large for-profit (Private Equity) providers whose debt repayment as a percentage of income is highest – across these five providers £10.83 of every £100 income received goes towards debt repayments. This is far higher than it is for the 13 large for-profit (Non-Private Equity) providers (£1.66), the 8 large not-for-profits (£2.07), and the 784 small to medium-sized companies (£1.27).
- 172.** As a group the 8 large not-for-profits are more conservative with their finances (partly due to the requirements imposed by their charitable status) and do not borrow much to expand, instead preferring to grow by reinvesting any surplus funds they have generated. Any borrowing they do is mostly from banks, using their care home properties as security. This means that their loan terms are very favourable, with interest rates as low as LIBOR + 1.5%.
- 173.** This stands in contrast to the large for-profit providers where over half their interest payments and almost 60% of their long-term debt is owed to related companies (i.e. companies with shared or the same owners).
- 174.** The 18 large for-profit providers also borrow from banks at low interest rates (LIBOR + 1.5%-4% being common), using their properties as security. This is less common because many don't have enough freehold properties (to offer as security) to borrow as much as they would like. However, they also receive significant funding from parent or other related companies. They tend to be part of larger groups of companies (comprising a total of over 2,500 companies across all Big 26 providers). This is because they are owned by investors, or are parts of businesses, which are operating in other industries too, and this means that they are also more likely to be funded out of loans from parent and related companies.
- 175.** The Big 26 providers vary in how much of their long-term debt and interest payments are to related companies:
- For the 8 large not-for-profit providers, loans from related companies comprise 1.4% (£7.5m) of their long-term debts and 0.0% (£0m) of their interest payments.
 - For the 5 large for-profit (Private Equity) providers, loans from related companies comprise 58.6% (£755.1m) of their long-term debts and 53.4% (£104.3m) of their interest payments.

- For the 13 large for-profits (Non-Private Equity) their funding from related companies comprises 59.9% (£713.8m) of their long-term debts and 30.9% (£12.7m) of their interest payments.
176. The interest rates on these loans typically ranges between 7% and 16%, which is considerably higher than the cost of borrowing money from external investors or banks.
 177. Ordinarily a company will seek to borrow as cheaply as possible in order to keep the cost of debt repayments as low as possible, and to maximise their profit. Because most of the debt in the large for-profits is owed to related companies at rates which are higher than would be available from external lenders, these debt arrangements may reasonably be seen as designed to generate extra hidden profit for the owners of the company, a sum which leaves these businesses before their profit before tax figure is calculated.
 178. In addition, interest payments on loans are tax deductible and often the related company to which they are made is offshore, so tax is saved at both ends – representing a double leakage for the taxpayer. This may explain why the Big 26 providers with an offshore owner paid out £9.09 of every £100 of income on net interest payments out, compared to £2.86 for all other large providers.
 179. The high levels of debt repayments by these companies also helps explain their low pre-tax profit figures. The fact that large for-profit (Private Equity) providers have very high interest payments going to related companies may explain why their owners are happy for them to keep on making apparent losses.
 180. Overall, these arrangements make it hard to understand how much profit some of these companies are generating from providing care home services.

The impact of the debt loaded on to care home beds and the effect on care home fees

181. Care home companies view the beds that they own as the basis for generating income – they sell the use of a bed at a weekly price to local authorities, the NHS, or private individuals. Because these income streams are relatively stable they can borrow against them, with lenders knowing that they will have an almost guaranteed income to cover interest and repayments.
182. One way of comparing the impact of debt on the operation of a care home company is therefore to look at how much debt has been loaded onto each of the care beds owned by the company, and the weekly cost of repaying the debt and interest. Our analysis reveals the following aggregate figures:
 - The 8 large not-for-profit providers have borrowed £21,069 for each care bed they own, and pay interest costs of £19 per bed per week.
 - The 13 large for-profit (Non-Private Equity) providers have borrowed £21,546 for each care bed they own, and pay interest costs of £14 per bed per week.

- The 5 large for-profit (Private Equity) providers have borrowed £35,072 for each care bed they own, and pay interest costs of £102 per bed per week.^{xv}
- 183.** The cost of the debt per bed owed by the 5 large for-profit (Private Equity) providers is especially high, amounting to around 16% of the weighted average weekly fee of £622 paid for residential care in the UK, and 12% of the equivalent fee for nursing care at £856 per week.⁴¹
- 184.** However it should also be noted that the rental payments due over the lifetime of some their lease arrangements are not necessarily included in the long-term liabilities in the care home companies' accounts.^{xvi} Consequently these debt per bed figures are likely to be an understatement of the amount of debt borrowed on these care beds, the cost of which funders ultimately have to shoulder.
- 185.** Regardless of who ultimately receives the money, an aggregate interest cost of £102 per bed per week is an extremely high leakage out of the fees paid by local authorities, the NHS, or private individuals and is a substantial resource which could be going directly towards the care of residents.

Summary

The large for-profit providers owe a substantial amount of their debt to related companies. On top of this the interest rates on these loans are very high, compared with the rates paid by the not-for-profits, and with external borrowing rates. This suggests that a substantial amount of the leakage in this area is hidden profit extraction.

The particularly high aggregate interest costs per bed per week for for-profit (Private Equity) providers is especially concerning as it places a large pressure on funders to shoulder these costs or accept cuts to other areas of care costs.

xv Despite having similar levels of long-term debt the 8 large not-for-profits and the 13 large for-profits (Non-Private Equity) have far lower interest charges than the 5 large for-profits (Private Equity) companies. This is in part due to the higher interest rates charged on the loans to Private Equity owned or backed companies. However, whilst the 13 large for-profits also have high interest rates on some of their intercompany debts these are often only repayable in one lump sum at the end of the loan. This means that they are not paying out as much in interest payments each year, but still face a high burden overall.

xvi This will change in accounts from periods after 1st January 2019 following the implementation of IFRS 16.

Splitting the care home business into separate operating and property companies raises other public interest concerns, including the ability of a care home operator to pay compensation for causing harm, and potential tax avoidance

186. There are other concerns with splitting up the care homes business into separate operating companies (those that provide the care) and property companies (those that own the home). Firstly, it leaves operating companies with few assets (since they no longer own care home buildings). These companies are responsible for providing safe care, and if they fail to do so they can be sued. But the only assets the company will have available to pay out any compensation is cash in the bank and any equipment it owns.
187. This means that the split can be seen as a way to protect valuable property assets from being at risk. Indeed, 5 out of the 18 companies with this split had negative assets (in 2017, or the latest available year) meaning that their liabilities (what they owed in total over time) were greater than the value of their assets. This is a public interest issue, since those providing care need to be able to be held financially responsible for any harm they may do.
188. Secondly, in many cases the property company was owned by a related company. This hinders transparency because it obscures how profitable the care home business is when the rent is going to the same overall owner.
189. Thirdly, there are property companies in the Big 26 which are offshore. Yet again, this means that the tax paid in the UK falls (rental payments are a cost that reduces the tax due), without necessarily a corresponding rise in UK tax paid by the property company.

Summary

There is a public interest in ensuring that those providing public services can be held accountable for malpractice. Placing the assets in separate companies raises concerns over the ability of care home operating companies to pay out sufficient compensation, and creates opportunities for tax avoidance.

Leakage through management fees and purchasing supplies from a related company

190. Twelve of the Big 26 had significant purchases or other transactions with related companies. These ranged from consultancy services provided by another company owned by the same directors to the charging of high management and performance fees.
191. When transactions between related companies exist it is harder to determine how legitimate the prices set are, and the necessity of the services provided.
192. Many companies were charged management fees which went to related companies which had few or even no staff, making it seem to be a way to funnel profit out of the company (and often out of the UK). The Competition and Market Authority's (CMA) aggregated income statement for the largest twenty-six care home providers found the charging of management fees and central costs consumed 5.1% (£221m) of the annual revenue of the Big 26 providers, most of it going to private equity investors.⁴²
193. It is important to note that these fees are discretionary – the amounts paid are the choice of the parent company. They reduce the profits before tax in the care home business's accounts, but still amount to leakage from the sector. Yet again, such inter-company purchases and management fee payments make the profitability of care home businesses less transparent.

Summary

A lot of the variation and differences in the cost allocations of the Big 26 for-profit providers can be explained with the behaviours and business structures listed above.

This section makes clear that these are behaviours that hinder public scrutiny of how profitable or sustainable a care home business is. They also allow for more profit extraction and undermine our ability to measure the profit actually made by looking at care homes and their operators in isolation.

Just as importantly, some behaviours and financial structures increase financial fragility and lock in high future costs.

Conclusion and Recommendations

- 194.** This report demonstrates that the care home sector is in crisis, partly because of the financial structures present in sections of the industry and not just because there are insufficient amounts of money going into it.
- 195.** The current financial structure of many of the largest providers hinders public accountability and hides the true extent of profits being made at the expense of front line care.
- 196.** Care homes are capital and labour-intensive businesses. When rental costs and debt repayments are high (because investors expect a certain level of returns) this puts pressure on care home businesses to squeeze labour costs by overworking and underpaying staff. This partly explains why the turnover rate for care workers is 39.5% a year as workers can get similar pay (at national minimum wage) and better working conditions in other industries such as retail.⁴³
- 197.** Reducing the excessive and often hidden leakage of some of the big companies in the care home industry could free up funds to pay staff higher wages and offer them improved career progression. Re-directing the money which leaks out of the UK economy to off-shore investors and towards frontline care could also be used to help revitalise the declining economies of those English regions with ageing populations and provide attractive jobs for younger people.⁴⁴
- 198.** But policy makers also need to consider how the financial structure of the care home industry and the investment decisions taken will impact on the care homes that are being built to meet future demand.
- 199.** Whilst research shows that smaller care homes tend to have the highest satisfaction scores and that the larger the care home the worse the quality of care, it is also the case that many of the family businesses which run smaller care homes are leaving the sector as their owners retire.^{45 46}
- 200.** In addition, the larger for-profit care home companies are not interested in either purchasing or building smaller homes but instead prefer to build or invest in very large homes with 60-120 beds. These facilities - which have the potential to generate large amounts of income - are also increasingly being built to attract the growing private pay market rather than to meet the planned needs of specific communities.

201. Both the high levels of debt which are loaded onto these new facilities and the high cost lease arrangements which underpin them means that this is an expensive way to finance new facilities for older people. The use of private finance to build public infrastructure such as schools and hospitals can lock taxpayers into repaying the high cost loans which have been used to finance them.⁴⁷
202. Because the state has rarely invested directly in care homes in the UK - instead leaving it to private investors or charities - policy makers do not consider them to be part of the essential national infrastructure like schools or hospitals. Yet, the rising number of older people in the UK population means that there is a growing imperative to provide new care facilities which are affordable, high quality, and meet the needs of care home residents rather than being built in order to provide a set return to investors.
203. As a result, resolving the care home crisis will require policy makers to both address the amount of money currently leaking out of the care home sector and to develop a capital investment strategy which ensures that the future provision of care home facilities is in the public interest.^{xvii} On this basis we make the following recommendations:

xvii A strong case for changing how we view the benefits of public and private infrastructure investments can be found in: Foundational Economy Collective 'Foundational Economy: The infrastructure of everyday life' Manchester University Press 2018.

Recommendation 1

A Care Home Transparency Act – care home providers should be mandated to disclose where their income goes

204. For anyone purchasing care home services, it is currently impossible to know how much of it goes on front line care and how much of it leaks out to investors. Irrespective of the mix of sources of a care home's income, whether from a local authority, the NHS, or from private individuals, there should be full transparency about how its income is spent.
205. Similar measures have been introduced in the US. In 2009 The Nursing Home Transparency and Improvement Act was passed as part of the Affordable Care Act. As in the UK, the complex management, ownership, and financial structures of large care home chains was found to impede the ability of federal and state governments to hold nursing home chains to account for their use of public money. This legislation requires nursing homes which are in receipt of public funding (Medicaid or Medicare) to report detailed information on ownership, staffing levels, other costs, complaints, and expenditure categories.
206. However, it is important to learn from the US experience when framing a UK Act. Whilst the US regulations have improved transparency, they only require individual nursing homes to provide details of their finances, but not the corporate groups which now operate many care homes.⁴⁸ This means there is less transparency about the money which goes to the property and management companies which make up these groups.⁴⁹
207. In addition, the US Act only provides data in relation to care home services funded by Medicare and Medicaid. Again this is a limitation which should be addressed in a UK Care Home Transparency Act. All the money which goes into the care home industry in the UK should be treated as public money and should be accounted for as such. Those individuals and family members who pay for care out of their own pockets are often required to do so because they are denied access to funding by the state, and as taxpayers they are entitled to know where their money goes.

Recommendation 2

A new form of care regulation is required to prevent care home companies with unsatisfactory financial models from providing care in the UK

208. It is not in the interest of care home residents, their families, or the taxpayer for some types of company to own and run residential and nursing care homes. Companies which are registered outside the UK for tax purposes, or which have high levels of debt and/or make large payments to related property companies, or pay large management fees are not providing good value for money.
209. Moreover, as the government has recognised, companies which owe significant amounts of debt or who have high property costs are at risk of financial collapse. This creates an unnecessary risk of harm to care home residents and if it occurs it requires the state to pick up the pieces. There are currently no regulations in place to prevent a care home collapse, merely a mechanism for forewarning local authorities that this is likely to happen.⁵⁰
210. If, as seems likely, a future government commits to substantially increasing the amount of taxpayer money which goes into social care, there is a significant public interest in ensuring that the state only contracts with companies which can demonstrate that an acceptable proportion of their income goes to frontline care and have a sustainable financial model.
211. This will require a significant shift in how care is regulated in the UK, away from simply regulating the quality of care according to a series of output measures, to specifying that certain requirements are in place before a care home company is licensed.
212. It is not unusual for the state to make requirements of private companies regarding their finances before contracting with them. The Defence Reform Act 2014 for example permits the Single Source Regulations Office to determine both profit rates and allowable costs for non-competitive defence contracts.⁵¹

- 213.** With regard to the finances of a licensed care home provider these requirements should include:
- tax registration in the UK of the ultimate controlling parties of the company providing the service;
 - full transparency in line with the requirements of the proposed Care Home Transparency Act;
 - minimum equity and net assets requirements to ensure that they can be held financially liable for any care malpractice in their homes;
 - an agreed proportion of income to be spent on staffing costs and non-staff operating costs; and
 - an agreed limit to the proportion of income to be spent on profit, debt repayment, and property costs.
- 214.** Based upon our findings in this report we consider it likely that a significant proportion of the care home companies providing services in the UK would be able to meet these requirements as their expenditure on debt and rental payments is not significant, nor are their profit margins.
- 215.** However, in the event that some care home providers are not able to meet these requirements the state should facilitate the restructuring of the companies so that they are able to achieve a licence to operate. Alternatively, they will need to be enabled to exit the market and the service re-provided by either the state or another company.
- 216.** Whilst we anticipate that there will be significant concerns about the impact of such a regulatory regime on the viability of a number of the large care home companies, it should be borne in mind that the risks of insolvency, bankruptcy, and corporate collapse are current features of the existing care home market. Data provided by Company Watch shows that the percentage of the care home companies with a 1 in 4 chance of going into insolvency or in need of major restructuring in the next 3 years has increased from 24% in March 2014 to 30% in September 2019.^{xviii}
- 217.** As a result, a restructuring of some parts of the care home industry will be necessary at some point and it is preferable that this is undertaken in a managed way and in line with a clear set of public interest objectives.

xviii For more information see: <https://www.companywatch.net/platform/scores-definition>

Recommendation 3

Capital should be made available by the government for the provision of new care homes

218. Given the ageing population there is a need for new care homes, in a range of sizes and formats and at an affordable cost. The UK's current capital investment in new care homes is being provided by the larger for-profit care home providers and is being directed towards building large homes which are primarily focused on the more profitable part of the market, namely residents who fund their care out of pocket. In addition, the funding model of these new care homes is liable to lock in high rental and borrowing costs and there is evidence that larger care homes are associated with a worse quality of care.⁵²
219. In order to avoid locking these high costs into the care home infrastructure, and to ensure that there are different types of care home provision – including smaller care homes – the government should make available low-cost capital in the form of loans to small and medium sized care home operators too in order to encourage the development of a range of home sizes and care models.
220. Alternatively both local authorities and the NHS could build and own the new care home infrastructure. A decision could then be made about whether to operate these homes themselves or lease them out to other public, private, or not-for-profit providers. This would limit the opportunities for the type of extraction and leakage that we have identified in the form of rental payments and debt repayments. State ownership of the care home infrastructure would also offer protection for residents against the risks associated with the financial collapse of a care home company.

Appendix

The Big 26 providers consisted of the following:

- HC-One Ltd
- Four Seasons Health Care (Elli Investments Ltd)
- Barchester Healthcare Ltd
- Care UK (Care UK Health & Social Care Holdings Ltd)
- Bupa Care Homes (results of 9 companies)
- Anchor (The Anchor Trust)
- Sanctuary Housing Association (Sanctuary Care Limited)
- Methodist Homes (MHA)
- Runwood Homes Ltd
- Maria Mallaband and Countrywide Group (MMCG Holdings Ltd)
- Avery Healthcare Holdings Ltd
- Orders of St John Care Trust
- Advinia Health Care Limited
- Sunrise Senior Living (Sunrise UK Operations Limited)
- Caring Homes (Myriad Healthcare Holdings Ltd)
- Larchwood Care (Larchwood Holdco Limited)
- Orchard Care Homes (Cortina Race LLP)
- Minster Care Group Limited
- Priory Group (results of 13 companies)
- Excelcare (Excelcare Holdings Ltd)
- Abbeyfield Society Limited
- Akari Care (AK (SPV) Ltd)
- Shaw Healthcare (Group) Ltd
- Healthcare Homes (Healthcare Homes Holdings Ltd)
- Quantum Care Ltd
- Somerset Care Ltd

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