GR: 026/07

ISLE OF MAN OFFICE OF FAIR TRADING

Report on Investigation into Nursing Home Charges

30th March 2007

Price £2.00

To: Hon N. Q. Cringle, President of Tynwald, and the Honourable Council and Keys in Tynwald assembled

Background

In March 2006 the Council of Ministers agreed that the Isle of Man Office of Fair Trading (OFT) should undertake an investigation under Section 19 of the Fair Trading Act 1996 into the appropriateness of the level of charges being imposed by Isle of Man nursing homes.

The relevant part of Section 19 of the Fair Trading Act 1996 states that:-

> *(3) On completion of an investigation under this section the Board shall make a report on the investigation to the Council of Ministers-*
>
> *(a) stating its findings of fact which are material to the information which it provides; and*
> *(b) containing such additional observations (if any) as it considers should be brought to the attention of the Council of Ministers as a result of the investigation.*

Progress to date

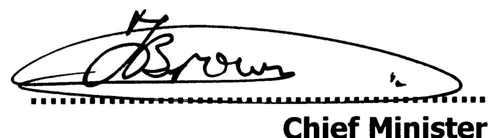
In May 2006 the OFT engaged consultancy assistance from Laing and Buisson, a UK based company which specialises in the analysis of non-clinical aspects of health and social care markets.

Laing and Buisson completed their research in September and the OFT prepared a report for the Council of Ministers, which included responses received from the nursing homes, where appropriate, and that report was laid before Tynwald on 16th October 2006 under the title "Report on Investigation into Nursing Home Charges on the Isle of Man by the Office of Fair Trading".

The report concluded that nursing home charges on the Isle of Man were higher than that as identified by Laing and Buisson as being fair. The report also concluded that nursing home fees were higher than residential home fees by a greater amount than would be expected.

Following consideration of the report by the Council of Ministers and representation by the key stakeholders with regard to the findings of the report, in October 2006 the then Chief Minister advised Tynwald that in accordance with the Fair Trading Act 1996, Council of Ministers had agreed, following submission of the Section 19 Report, to conduct a full accountancy analysis to further corroborate the initial findings of the inquiry.

The Report is appended herewith.



Chief Minister

Contents

Summary ... 2

1. Introduction ... 3

2. Objectives ... 5

3. Methodology ... 6

4. Findings ... 7

4.1 The level of profits generated before and after tax. ... 7
4.2 The cost of capital employed in the business. ... 7
4.3 The staffing costs required to operate the homes to the standard required by DHSS for registration and the actual staffing establishment in operation. ... 8
4.4 The cost of retaining and training staff to the required levels. ... 9
4.5 The financial value of the nursing home property and any associated land used for the operation of the homes ... 12
4.6 Maintenance costs associated with operating the property as a nursing home. ... 13
4.7 The likely replacement value of such properties. ... 13
4.8 The non-fixed costs, such as food, energy, consumables etc. used in the operation of the business. ... 14
4.9 The economic efficiency with which the homes are operated. ... 14
4.10 The issue of whether any Isle of Man nursing homes provide superior quality service or accommodation to that found in the United Kingdom or Ireland. ... 15
4.11 Why prices charged by nursing homes in the Isle of Man might be higher than those found in the United Kingdom, Ireland or the Channel Islands. ... 18
4.12 What would be a reasonable rate of return on investment? ... 19
4.13 Whether it is fair for all residents of a nursing home to pay a standard weekly rate, regardless of their level of dependency. ... 20
4.14 What would be a fair price to pay for nursing home care based on high, medium or low dependency rates? ... 21
4.15 The relationship between occupancy rates and prices charged. ... 22
4.16 Comparison of the profit levels earned by homes in the Isle of Man with levels earned by nursing homes operating in the United Kingdom, Ireland or the Channel Islands. ... 23

5. Policy Issues ... 24

6. Conclusions ... 26

7. Recommendations ... 32

APPENDIX 1 SOURCES OF REFERENCE FOR ACCOUNTANCY BASED ANALYSIS CONDUCTED BY MOORE STEPHENS ... 33
APPENDIX 2 Inspection Unit's minimum staffing levels in nursing homes ... 34
APPENDIX 3 UK LOCAL AUTHORITY BASELINE FEE RATES 06/07 (£ per resident, per week) ... 35
APPENDIX 4 Laing and Buisson, Fair Price for Care model - Target return on capital ... 41

Summary

The Office of Fair Trading was requested by the Council of Ministers at their meeting on 30th March 2006 to instigate an investigation under Section 19 of the 1996 Fair Trading Act as amended into the appropriateness of the level of charges being imposed by Isle of Man nursing homes. This report was laid before Tynwald on 16th October 2006 under the title "Report on Investigation into Nursing Home Charges on the Isle of Man by the Office of Fair Trading". The report concluded that nursing home charges were higher than the price range identified by consultants Laing and Buisson, using their "Fair Price for Care" model as being fair, that nursing home fees were higher than residential home fees by a greater amount than would be expected and that there was a possible lack of efficiency in local nursing home operations. The Chief Minster, the Hon D J Gelling, made a statement to Tynwald advising that the Council of Ministers had asked the Office of Fair Trading to conduct a further investigation based on a full accountancy analysis, rather than application of a model, to determine whether or not the nursing homes in the Isle of Man were levying a fair charge for nursing care.

The accountancy analysis has been undertaken by an independent accountancy firm who were tasked with analysing the accounts and financial information of the Island's nursing home operators to report on the terms of reference, agreed by the Council of Ministers. The conclusions of this analysis examine the four main components of nursing home fees; staffing, repairs and maintenance, other non-staffing current costs and capital costs.

The Recommendations arising from this report can be summarised as follows:-

- Fees that may be regarded as fair for one nursing home may not be the same as those regarded as fair for another nursing home. Homes differ in several ways, including quality standards and cost structure.

- The fair price for nursing care provided by any given operator is calculated on the basis of operating costs incurred with capital costs being obtained from the financial value in use of the homes calculated in accordance with the UK Generally Accepted Accounting Practice.

- If a single figure for use across all operators is required, the OFT recommends that the fair price for nursing home care is calculated on the basis of the Laing and Buisson Fair Price Model.

- The DHSS should expedite the progress of the Care Standards Bill and the implications of funding the nursing care component of the fee.

- That the DHSS urgently reviews its policy of funding nursing home care through the payment of benefits. Options identified in this report and the 2006 Report include the direct purchasing of beds from operators.

1. Introduction

At their meeting on 30th March 2006 the Council of Ministers requested that the Isle of Man Office of Fair Trading ('OFT') instigate an investigation under Section 19 of the 1996 Fair Trading Act as amended into the appropriateness of the level of charges being imposed by Isle of Man nursing homes. Section 19 of the Fair Trading Act states that "The Board may carry out an investigation into any price, with a view to providing the Council of Ministers with information relating to that price, if it is satisfied that the price in question is one of major public concern."

At their meeting on 6th April 2006 Council issued the following Terms of Reference to the OFT:-

- Establish how the nursing homes have determined the level of their charges to be charged from 10th April 2006;
- Determine if the level of IOM nursing homes fees are fair and reasonable;
- Consider whether the differential between nursing and residential care charges in the Isle of Man are appropriate or otherwise;
- Compare the level of IOM nursing home charges with those being charged or to be charged in nursing homes operating in the United Kingdom; and
- Identify the costs of providing nursing care and health care products (where appropriate) which are being passed on to residents as part of the nursing homes fee in the Isle of Man.

In addition Council also requested the Office to investigate, under Section 9 of the Fair Trading Act, the question of "...whether the IOM Nursing Homes Association has been or is pursuing a course of conduct which does amount to anti-competitive practice."

The OFT instigated a competitive tendering process to select a company to provide expert support and advice during the investigation. The successful tenderers were Laing and Buisson, a UK consultancy company which specialises in the analysis of non-clinical aspects of health and social care markets. Laing & Buisson carried out a detailed survey of the operating costs of the nursing and residential homes during June 2006.

The information obtained from that survey was then fed into what is known as the "Fair Price Model" which was developed by Laing and Buisson for the Joseph Rowntree Foundation in the UK. The model is used for setting a fair price for a UK local authority with social services responsibility to pay for care but has been significantly modified to reflect the different circumstances in the Isle of Man.

Laing and Buisson drafted a report on the survey and the "modelling" exercise (entitled "Appropriate fees in Care Homes for Older People in the Isle of Man", referred to hereafter as the Laing and Buisson Report) and this was first circulated to the nursing homes involved in July 2006 to clarify the technical detail, resolve any commercial confidences and to seek their general comments. Detailed responses were received from the nursing homes and a lengthy meeting was also held with one of the providers to discuss some of the financial items appearing in the model that were used to establish the fair price for both nursing and residential homes. Laing and Buisson together with the Office of Fair Trading considered these responses and re-drafted the report where appropriate.

The OFT circulated drafts of the report prepared by Laing and Buisson to operators of nursing and residential homes for comment before preparing its own report. This report was laid before Tynwald on 16th October 2006 under the title "Report on Investigation into Nursing Home Charges on the Isle of Man by the Office of Fair Trading" and with the reference GR 035/06 (hereafter referred to as the 2006 OFT Report). The report concluded

that nursing home charges were higher than the price range identified by Laing and Buisson as being fair, that nursing home fees were higher than residential home fees by a greater amount than would be expected and that there was a possible lack of efficiency in local nursing home operations. The Chief Minster, the Hon D J Gelling, made a statement to Tynwald advising that the Council of Ministers had resolved to support the Minister of the Department of Health and Social Security in resisting the increase in price requested by the nursing homes but also to ask the Office of Fair Trading to conduct a further investigation based on a full accountancy analysis, rather than application of a model, to determine whether or not the nursing homes in the Isle of Man were levying a fair charge for nursing care. In view of concerns raised about the uncertainty to both residents and operators of nursing homes that resulted from the decision to resist any rise in benefit rates despite the increasing of fees in some homes, the Office of Fair Trading agreed to conduct this work as quickly as possible.

This final report addresses issues raised in both the investigation based on the Fair Price Model ('the first stage of investigation') and on the accountancy analysis ('the second stage of investigation'). It is important to note that this final report only addresses issues relevant to nursing home care. Whilst the investigation has raised matters related to the provision of care more broadly and to the payment of benefits, the operation of residential homes has not been considered further in the second stage of investigation and is thus not directly considered in this report.

2. Objectives

The Office of Fair Trading undertook to report to Council on the basis of the following terms of reference for the accountancy based investigation, which are without prejudice to the overall requirement of Section 19 of the Fair Trading Act 1996. The following matters were to be considered as part of the investigation into nursing home charges:

i. The level of profits generated before and after tax.
ii. The cost of capital employed in the business.
iii. The staffing costs required to operate the homes to the standard required by DHSS for registration and the actual staffing establishment in operation.
iv. The cost of retaining and training staff to the required levels.
v. The financial value of the nursing home property and any associated land used for the operation of the homes.
vi. Maintenance costs associated with operating the property as a nursing home.
vii. The likely replacement value of such properties.
viii. The non-fixed costs, such as food, energy, consumables etc. used in the operation of the business.
ix. The economic efficiency with which the homes are operated.
x. The issue of whether any Isle of Man nursing homes provide superior quality service or accommodation to that found in the United Kingdom or Ireland.
xi. Why prices charged by nursing homes in the Isle of Man might be higher than those found in the United Kingdom, Ireland or the Channel Islands.
xii. What would be a reasonable rate of return on investment?
xiii. Whether it is fair for all residents of a nursing home to pay a standard weekly rate, regardless of their level of dependency.
xiv. What would be a fair price to pay for nursing home care based on high, medium or low dependency rates?
xv. The relationship between occupancy rates and prices charged.
xvi. Comparison of the profit levels earned by homes in the Isle of Man with levels earned by nursing homes operating in the United Kingdom, Ireland or the Channel Islands.

These terms of reference are designed to cover those financial elements needed to complete the requested accountancy based investigation and those more qualitative items that were viewed by the nursing home operators as having been insufficiently addressed in the 2006 OFT Report.

3. Methodology

The OFT selected an independent accountancy firm to support the investigation following a selection process undertaken with the support of Treasury. Moore Stephens Consulting Ltd ('Moore Stephens') were tasked with analysing the accounts and financial information of the Island's nursing home operators and using the data to answer those terms of reference that could be addressed on an accountancy basis. The documents used as sources of reference for this work are listed at **Appendix 1**.

Moore Stephens examined and analysed the information received from the OFT using, as far as possible, information that appeared to have been independently audited and to be complete. Where this was not possible, unaudited information was used, for example, management accounts. If necessary, recourse was made to partial period information that required annualising.

The information used related to seven private nursing homes owned by five legal entities and comprised management accounts, audited and unaudited financial statements to varying year/period ends and ancillary information. Where group accounts were provided, it was not always possible to analyse financial information for the individual homes, therefore the information was shown on a group basis instead. Other publicly available information has also been used in the analysis.

The OFT decided that the most appropriate means of determining the likely replacement value of the nursing home properties was to ask the Assistant Government Valuer to visit all homes and to state an opinion. The OFT is grateful to Treasury for the support offered.

The remaining items (listed as terms of reference iv, x, xii and xiv) were addressed by the OFT. The issue of quality was addressed by asking home operators to provide evidence to establish whether or not the quality, service or accommodation offered was superior to that found in the United Kingdom or Ireland. One business made a submission based on expert opinion and the OFT considered this and the views of other operators when addressing this point.

The Fair Trading Act 1996 as amended includes provisions for process of investigations at Schedule 3. Whilst this is relevant to the general carrying out of any investigation, Section 3(1) specifically requires the OFT, in its role as a commission, to have regard to the need to exclude from a report any matter which relates specifically to the affairs of a particular body of persons where publication of that matter would or might, in the opinion of the commission, seriously and prejudicially affect the interests of that body. The OFT considered on advice that the publication of detailed analysis of unpublished financial statements would be an unnecessary breach of commercial confidentiality and that anonymising the data would be inappropriate with such a small number of operators. The OFT has therefore decided to base its conclusions on the full data available to it but to report the information on the basis of illustrating the range of data obtained. Therefore in the information presented in the following section the highest, mean (average) and lowest observed values will be reported. **This approach means that interpretation of the reported data should be treated with caution and it follows that the values reported in each category do not relate consistently to a single home.**

The OFT believes that the impact of commercial confidentiality on this report has not affected the validity of the conclusions which were made on data that has been obtained but is not reported. The OFT accepts that this issue would be more significant when reporting under Section 19A and wishes to make it clear that its decision on commercial confidentiality in this matter is the result of the application of the legal test contained in the 1996 Act to the nursing home market and not one of binding policy.

4. Findings

The findings of the OFT are presented in accordance with the terms of reference set for the second stage of the investigation and in that order.

4.1 The level of profits generated before and after tax.

The levels of profits generated were calculated by Moore Stephens for the two most recent years for which data was available. **Year 1 refers to the most recent year in all subsequent tables**. The results reported as earnings before tax per resident, are as follows:

Table 1: The level of profit generated before tax

Value	Earnings before tax per resident Year 1 £'000	Earnings before tax per resident Year 2 £'000
High	7.40	8.30
Mean	5.28	6.10
Low	2.20	3.90

The most recent high value equates to earnings of £142 profit per resident per week whilst the operation with the lowest value earns £42 profit per resident per week.

4.2 The cost of capital employed in the business.

The cost of the capital employed was calculated by Moore Stephens and the results are contained in **Table 2** below.

Any business requires capital to operate and that capital has a cost. Moore Stephens identified two types of capital, namely debt and equity. Moore Stephens considered that the cost of debt capital was relatively easy to establish as it has an interest cost which may often be identified from the financial statements. Where the financial statements did not disclose the cost of debt, or if it could not be calculated, they approximated the cost by identifying similar debt and ascertaining its cost from information available in the market place. They assumed a commercial loan rate of 9.95%.

Turning to owners' equity capital, it was assumed that owners would invest their own capital as long as they could achieve a rate at least the same as that achievable by investing without risking their capital. This risk free rate on equity and reserves was assumed to be 4.95% (estimated from most recent yields in UK Gilts market for 2017 bonds yielding 4.84 and 5.07). Moore Stephens applied current rates to historical financial information on the basis that rates have been reasonably stable over the time period covered by the financial information. They consistently applied the same rates to all companies.

Once the cost of debt and the cost of equity were established, the weighted average was calculated to produce the cost of capital, expressed as a % rate per annum. This figure therefore reflects the capital structure of the business, such that a higher cost of capital means the company has more debt than equity, with the cost of capital ranging from 4.95% (all equity) to 9.95% (mostly debt, negligible equity). Additionally, an investor might look at this figure to assess whether or not the business is properly funded as the wrong funding

strategy could mean higher than optimum finance costs. It can also be compared to, for example, Return on Equity (ROE) which should be at least the same or higher. This is a relatively stable figure, unless there is restructuring of debt and equity or changes in market interest rates.

In the case of the nursing homes studied, the cost of capital for one operator was 4.95% for both years. This arises because they have no debt on which they pay a charge. There are loans from shareholders that are interest free and which have been treated the same as equity. Another operator has high levels of debt as well as loans to shareholders. This has generated a much higher cost of capital than would have been the case if shareholder loans were used to settle the interest bearing debt, which would have reduced the cost of capital from 6.12% to 4.95%.

Table 2: The cost of capital employed in the business

Value	Cost of Capital Year 1 %	Cost of Capital Year 2 %
High	7.77	8.52
Mean	6.04	6.20
Low	4.95	4.95

4.3 The staffing costs required to operate the homes to the standard required by DHSS for registration and the actual staffing establishment in operation.

While this involves a clinical assessment in respect of staffing levels, Moore Stephens were able to establish a comparison between costs based on the DHSS Inspection Unit requirements and actual costs. For the purpose of this analysis they assumed that the staffing levels required to operate the homes to the standard required by the DHSS are the same as those reported by The Laing and Buisson Report, "Table 2: Inspection Unit's minimum staffing levels in nursing homes, per resident per week". This table is reproduced at **Appendix 2.** This translates an average of a sample of the Inspection Unit's matrix into staff hours necessary per resident per week based on the number of residents in a nursing home.

These rates of hours per resident per week were multiplied by the number of beds and by the average rate per hour paid by the nursing homes to nurses and care assistants, arriving at an expected staffing cost for nurses and care assistants. Moore Stephens then compared this to actual (or derived, where actual values were unavailable) costs of nurses and care assistants. The homes' full bed capacity was used in determining the required standards on the assumption that the homes are staffed to capacity.

The clinical assessment of adequacy of staffing was outside the scope of this report. However, this measure was considered on the basis that it could provide information on a mix of staff. One home did show a major variation at 19%, though given that average wage rates are significantly variable, no real comparison could be made regarding the mix of nurses (more expensive) and care assistants.

Table 3: The observed difference in staffing costs - actual staffing establishment compared to the staffing standard required by DHSS for registration

Value	Difference %
High	19
Mean	6.83
Low	-4

4.4 The cost of retaining and training staff to the required levels.

Aside from the costs of converting overseas nursing qualifications to a level accepted by the nursing authorities in the United Kingdom and the Isle of Man, there is an expectation on the homes in the Island to train staff to National Vocational Qualification (NVQ) standards.

The training cost involved with a member of staff achieving NVQ Level 2 is estimated at £470.60 (this comprises five days training at £75 per day, £66.60 registration fee and £29 certificate fee), Level 3 £410.90 (£300 training fee, £81.90 registration fee and £29 certificate fee). This course takes 8 ½ days and does require an additional amount of on-site work by the student). NVQ Level 4 is the Registered Managers Award and this qualification is required for all home managers by the DHSS Registration and Inspections unit. This qualification costs £630, it requires 10 days training at a cost of £500, a £101 registration fee and a £29 certificate fee. Several of the nursing homes have pointed out to the OFT the additional cost involved when the homes have to employ assessors and verifiers. This is estimated to be in the region of £400 plus any relevant expenses. The OFT has also been advised that there could be a further hidden cost in terms of the extra hours required to pay these assessors for undertaking the assessments required as part of the NVQ training programme.

The DHSS supports the provision of NVQ training to private sector nursing homes on the Island by allowing their training courses to be open to attendees from the private sector where there is space available. There may be a nominal fee.

Putting NVQ qualifications aside, there are other mandatory training courses that employees in nursing homes are expected to attend. These include:

- First Aid (Basic one day first aid course - £92)
- Basic Food Hygiene (this course is run by Environmental Health at cost for participants of £35 and a duration of six hours training over one evening a week for three weeks)
- ROSPA Moving and Handling training. The cost is in the region of £530 per attendee and the course takes 5 days, this information was provided by one nursing home operator whose members of staff had recently attended this course. Once an attendee has successfully completed this course, it is then acceptable for them to cascade their training within their organisation
- Infection Control (facilitated by Nobles Hospital)

In addition qualified nursing staff are expected to keep their professional qualification up to date through completing the required amount of Continuous Professional Development.

Due to the staffing requirement placed upon the homes by the DHSS Registration and Inspection unit, the homes are obliged to maintain specified staffing levels at all times. Consequently when staff members are removed from providing rotated care hours to attend any training, it is necessary to ensure that other suitably qualified staff to cover their shifts. This is an additional cost above those involved with the training directly.

Most homes use overseas nurses as their main method of recruiting nursing staff. This is mainly due to the problems in recruiting suitably qualified staff locally. In their examination of the Island's nursing home market, Laing and Buisson looked at the costs involved with recruiting nursing staff from overseas. The findings from their report to the Office of Fair Trading on the mechanism of the 'Fair Price' model are detailed below:-

" The process of training a nurse to obtain UK registration was called adaptation, but is now called the Overseas Nurses Programme and has a more formal structure. We have estimated the cost of recruiting and adapting a nurse using the following assumptions; airfare £500, agency fee £1,000, training fees £600, pay while training at care assistant rates (20 days protected learning) £950, a working life of a recruited overseas nurse of 2.5 years before moving on and an allocation of three nurses for 51 residents. This gives an estimated recruitment and adaptation cost for nurses of £1.38 per resident per week."

The OFT revisited the above information, following queries made by some nursing home operators and confirmed with the DHSS that the training fee for the Overseas Nurses Programme was £600. The DHSS also advised that the 20 days protected learning are a minimum and that more are often given in practise. The requirements of the programme are such that a nurse undergoing the overseas training programme cannot work as a registered nurse until the training is complete and the award processed. These staff can therefore only be counted against staffing requirements as care assistants.

Another home raises the issue of the cost involved by the requirement placed upon homes with nurses on the Overseas Nursing Programme to ensure adequately trained 'mentors' are provided to supervise and guide the students.

Nursing home operators expressed grave concerns about the loss of staff to the DHSS due to the attractive pay rates and conditions offered by the Department. Table 4 and the associated chart below show the extent of the differentials in hourly rates of pay.

The differences in the hourly rates of pay are significant and most homes advised that one of their main drivers for asking for an increased fee rate is to be able to narrow the gap between the hourly rate of pay between their staff and what they could earn by working for the DHSS. The difference is most pronounced for care staff with NVQ2 or higher and senior care staff as the Government operated homes pay these employees hourly wages that are 61% and 78% higher respectively. Some nursing home operators have commented that the value of other benefits, such as sick pay and pension provision, mean that certain staff could expect to be paid twice as much in DHSS employment.

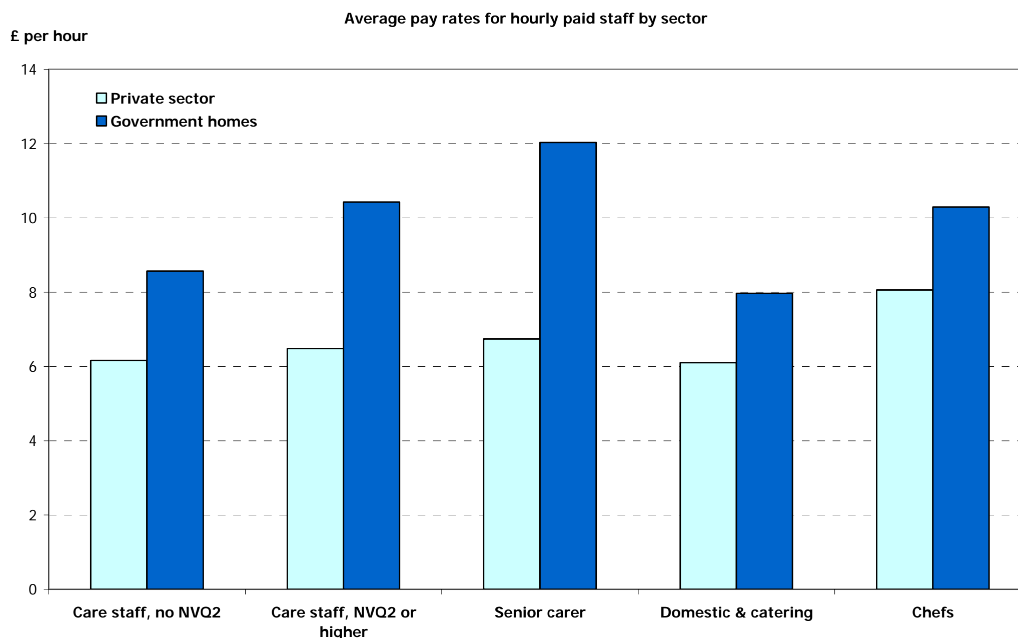
Many nursing homes explained the difficulty they experienced when staff who they had invested in substantially to ensure that their qualifications meet the specified standard leave to work for the DHSS. They then have to return to the process of recruiting and training replacement staff.

Table 4: Average pay rates for hourly paid staff by sector

	Private sector	Government homes	Difference
Care staff, no NVQ2	6.16	8.57	39%
Care staff, NVQ2 or higher	6.48	10.43	61%
Senior carer	6.74	12.03	78%
Domestic & catering	6.10	7.97	31%
Chefs	8.06	10.29	28%

Includes pay in nursing homes
Refers to one daytime weekday hour, which accounts for the most hours provided

Source: Laing & Buisson survey, June 2006



In addition to the difference in the hourly rates of pay, it is important to also note the difference in terms and conditions of employment that working for a Government residential home offers. These issues are fully examined in the 2006 OFT Report. There is also an indication of the subsidised cost element involved in operating the Government run care homes. *"The Office re-ran the fair price model, substituting only the pay rates and total hours provided for the usual parameters, and found upper and lower fair price values of £729 and £647, an indication of the cost of operating care homes that charge fees of £321.30"* . It should be noted that these figures are for residential homes and that figures for nursing homes would be significantly higher.

Whilst the Office does not intend to re-examine the issues already highlighted by the first report, it would advise that the DHSS should acknowledge the impact upon the private sector of the wage rates paid to its own staff. It should also acknowledge that any further increase in wages which is out of step with wage market tendencies will only further exacerbate this problem for the private sector care homes on the Island. The first report advised quite clearly that staffing costs are the single biggest component of a care home's costs.

It is accepted by some operators that wages paid on the Island compare favourably with those in the UK but recruitment difficulties are met currently by the use of overseas nurses whose qualification is revalidated by formal training on the Island. There are a limited number of nurses wishing to pursue a career in the care of the elderly and home operators report that in addition to their losing staff to DHSS care homes, some nursing staff seek to move to working for the Health Services Division of the DHSS as soon as they are contractually able to do so. The increasing surplus of nurses in the UK is not expected to help the current situation. One operator advised the OFT that it had placed advertisements in areas where the NHS was known to be making redundancies with the aim of recruiting a senior member of staff at significant level of remuneration and yet had still had great difficulty interesting candidates in the post. The UK situation may actually worsen the situation as operators will now have to show that no-one in the EU will be available for work before making a successful application for an overseas labour permit, which is operated to UK controls for immigration purposes.

4.5 The financial value of the nursing home property and any associated land used for the operation of the homes.

The approach used by Laing and Buisson to determine the value of a nursing home was to use the cost of developing new care home capacity as opposed to market values. Laing and Buisson felt that this was appropriate due to the lack of a local market. They regarded the standard method of valuing a nursing home as being based on the profits that it is projected to make in the future. They felt that this approach is not appropriate for use in a fair price model, as a circular calculation would result, with the fair price depending on the profits made and the profits made depending on the fair price. However, the value of the asset is of major significance to judgements made about the profitability of the business. In addition, this part of the assessment looked at the price to pay to acquire the business rather than simply land and buildings which may have a different value depending on their reasons for purchase. Thus it was felt appropriate that Moore Stephens be asked to calculate a value based on future profits.

Moore Stephens defined the financial value of an asset as being the present value of the net cash benefits receivable, over a period of time, from owning and exploiting rights attributable to that asset. They calculated the financial value in use in accordance with United Kingdom Generally Accepted Accounting Practice, defined as the present value of the future cash flows obtainable as a result of the asset's continued use over a period, assumed to be 10 years. In the case of nursing homes, Moore Stephens considered income and expenditure to be a fair approximation of cash flows because collections would be expected to be by direct debit and major costs items, such as payroll, are generally regular. They assumed that Earnings After Tax (EAT) was a reasonable approximation of net cash flows and excluded non-cash items such as depreciation and added back any deemed distributions of profit.

When calculating a discount rate to account for the time value of money, Moore Stephens used the cost of capital calculated previously (between 4.95% 'risk free' and 9.95% 'debt finance'), i.e. the cost of funding to the business, as the rate to be used to "discount" to present values the net benefits to be received from the continued use of the asset. They assumed that the net benefits will arise over the next 10 years and that there will be some form of growth in the net benefits over that time. Using EAT growth rates designed to achieve the expected growth rates of 9% and 22%, after 5 years and 10 years respectively, noted in the 2006 Report on Investigation into Nursing Home Charges by the Isle of Man Office Of Fair Trading. They considered that if demand grows at 22% over the next 10 years without an increase in capacity then current providers will attempt to increase prices in order to maximise profit. A balance may be reached when the current high cost of land becomes economical for use as nursing homes but not enough data is available to determine when, or if, this may happen. Consequently, some form of inflation factor should be applied to EAT as adjusted for growth in demand. They assumed an average rate of 5% per annum over the next 10 years, without any comfort of precision, but noting that Income Support increases have ranged from 5% - 6% per annum since 2001. Accordingly, they increased EAT each year by a growth factor and by an inflation factor and then discounted each year back to the present value.

It was not possible for Moore Stephens to isolate land from buildings in all cases for the purposes of this calculation and therefore value in use was based on land and buildings in its entirety.

The results of the calculations are given in **Table 5.** It was not possible from the data used to provide a value for each property and the figures in the table relate to group assets, which in the case of two operators relate to two homes. The value in use will be affected by several factors such as age of the building and expected occupancy. Low expected occupancy rates and fees will reduce value and hence the resale value of the business and the expected returns of the asset. Thus, in order to maximise on price, particularly as defined by the Fair Price Model, a high value is needed to generate a high weekly money

return on capital and may justify a higher weekly charge to residents.

Table 5: The financial value in use of the nursing home property and any associated land used for the operation of the homes.

Value	Value of property in use £'000
High	9,720
Mean	4,432
Low	1,854

4.6 Maintenance costs associated with operating the property as a nursing home.

The Laing and Buisson Fair Price Model suggested a fair cost per resident per week of £29.87. This is made up of maintenance capital expenditure (£18.74), revenue repairs and costs (£8.35) and contract maintenance of equipment (£2.78). The expenditure on a handyman's wages is assigned to staffing costs. Moore Stephens were unable to identify consistently these components for each home and used the total Repairs and Maintenance figures, as disclosed. They ignored the distinction between fixed and variable cost elements owing to lack of sufficient information and doubts as to the additional value the information would provide. The figures are as shown below:

Table 6: Maintenance costs per resident per week associated with operating the property as a nursing home.

Value	Year 1 £	Year 2 £
High	29.66	59.13
Mean	20.24	22.69
Low	15.19	10.64

The exceptionally high Year 2 figure was investigated further by Moore Stephens. They concluded that this may be due to allocation discrepancies within the accounts

These values obtained suggest that the suggested figure used in the Fair Price model cost was not unreasonable and that it could therefore be used in price calculations.

4.7 The likely replacement value of such properties.

The Assistant Government Valuer visited all of the nursing homes individually to provide guidance regarding the estimated replacement cost of the properties, excluding the land value and the value of the operator's removable fixtures and fittings. Information used in the compilation of these valuations has been based on sample visual inspections of the properties and office records.

Basic construction rates for a modern replacement building have been identified using data from 132nd Edition Spon's Architect's & Builder's Price Book with adjustment for the regional location factor, professional fees and site clearance to reflect the quality and suitability of the existing buildings.

Based on the above, the Assistant Government Valuer's opinion of the estimated replacement cost of the seven properties is as follows:-

Table 7: Estimated Replacement Cost of Nursing Homes

Value	£
High	4,000,000
Mean	3,212,143
Low	1,750,000

It is important to stress that the valuations calculated are not considered to be the market value of the properties and that the Assistant Government Valuer advised caution against any analysis of these figures in terms of comparison of price per bed space, as he found that the size and quality of the facilities offered at the homes differ considerably.

4.8 The non-fixed costs, such as food, energy, consumables etc. used in the operation of the business.

Moore Stephens defined non-fixed costs as non-staff current expenses, per the Laing and Buisson Fair Price Model. Laing and Buisson suggest a rate of £70.59 per resident per week, comprising 3 major components, viz. food (£19.77), incontinence products (£8.05), utilities (£16.00) and several smaller items including insurance, medical supplies, training etc (totalling £26.77). The results from the accountancy analysis were as follows:

Table 8: The non-fixed costs, such as food, energy and consumables etc, used in the operation of the business, per resident per week

Value	Year 1 £	Year 2 £
High	97.51	88.53
Mean	83.08	75.32
Low	73.60	63.50

It appears that homes on the whole are spending more on non-fixed costs than was allowed for in the Fair Price Model, with the lowest priced operator spending £3.01 more than the allowance of £70.59.

Some further consideration of the funding of incontinence products is merited. The DHSS do not provide these products to home operators although they are provided for individuals not in nursing care. Each operator purchases supplies direct, and some benefit may accrue to operators at minimal cost to the DHSS if operators were allowed to purchase through the DHSS and so take advantage of its purchasing procedures.

4.9 The economic efficiency with which the homes are operated.

This element of the investigation was designed to reflect the view that whilst the costs of running a particular nursing home may be high, a higher fee level might appear necessary to provide an acceptable return to the operator but may not be justified if the home is not being operated efficiently. In effect, the objective is to ensure that the residents of the home are not paying for the inefficiencies of the operator. This is particularly relevant where there is a market without significant price competition, when an inefficient operator may feel able to increase charges rather than maximise the efficiency of operation. An organisation that is operating with economic efficiency is one that is making optimum use of its resources. Moore Stephens focussed only on accounting measures and selected four accounting ratios with which to assess efficiency, as follows:

GP	Gross Profit = (sales – cost of sales)/sales
EBIT	Earnings Before Interest and Taxes = Operating profit before interest, tax and deemed distributions.
NP	Net Profit = profit after tax, before deemed distributions/sales.
ROCE	Return on Capital Employed = EBIT/(shareholders equity + interest free shareholder loans)

"Sales", "cost of sales", "interest and taxes" all have their generally accepted meanings. Included in "equity" were share capital, all reserves and interest free shareholder loans. The latter was included on the basis that as long as there is no charge applied to this type of loan and as long as it is from a shareholder (or related party), then the presumption can be made that there is an expected return required of at least the risk free rate (see 4.2 above). Certain payments to owners (or related parties) were added back to certain profit figures on the basis that they appeared to be distributions of profit rather than, say, consulting fees or salaries.

Profitability is reflected by the first three measures and provides answers to questions such as "is the business covering its costs over a given period of time?", "what is the impact of interest charges on the profitability of the business?" and "is the business able to make distributions to shareholders?"

The issue of return is addressed by the fourth measure, return on capital employed. Given that a certain amount of equity has been invested, is there sufficient profit to pay for debt finance costs, taxes and still have sufficient remaining to provide at least the risk free rate to the owners of the equity? Earnings before interest and taxes are used in this measure as opposed to net profit to facilitate comparison. Different organisations may use different mixes of debt and equity to finance a business and also make use of different debt instruments at different times. They may also have different tax situations. Consequently, in order to assess the efficiency of the care home operations (rather than their ability to raise finance or avoid taxes), Moore Stephens excluded the effects of debt interest and taxes.

These are not always reliable measures, particularly in respect of group accounts where intra-group charges can distort comparisons and where funding structures can generate oddities at company level. An example in illustration of this point is that Moore Stephens noted the extremely high Year 2 ROCE derived from the 2005 audited financial statements of one operator. This appears to result from an EBIT 50% higher as compared to 2004 and 2006, and a larger interest free net loan due from shareholders that adjusted the equity figure downwards.

Table 9: The economic efficiency with which the homes are operated.

Value	ROCE Year 1 %	ROCE Year 2 %	GP Year 1 %	GP Year 2 %	EBIT Year 1 %	EBIT Year 2 %	NP Year 1 %	NP Year 2 %
High	174	1,198	49	48	32	31	30	29
Mean	59.6	277	33.4	36.4	21	24.6	19	21.2
Low	15	24	18	27	7	13	7	12

4.10 The issue of whether any Isle of Man nursing homes provide superior quality service or accommodation to that found in the United Kingdom or Ireland.

As observed in the previous report, the nursing home market in the Isle of Man has historically seen residents' fees charged at a rate equivalent to the maximum level of benefits available to a resident from Social Security provision. This resulted in the market having a single price regardless of how a home was operated, the physical environment for

the patient or the level of care being administered.

Presently there is no formal assessment of the quality, service or accommodation provided in the Island's nursing homes other than the fact that they can all be judged to be administering an acceptable quality of care as the homes are authorised to remain in operation by the DHSS Registration and Inspection unit.

Following the initial investigation, many nursing homes raised the issue regarding the 'quality' of care that they provide. The OFT invited the homes (in December 2006) to make submissions with regard to whether they believed that they offered a superior quality service or accommodation to that found in the United Kingdom or Ireland. One home supplied a report from an industry professional who advised that, in his opinion the home was of very good quality. A number of homes also provided copies of their announced inspection report as evidence of the observations of the assessing professional.

Many homes raised objections to the application of a 'fair price model' on the grounds that they had made significant investment in the business (in terms of both the physical environment, staff training and various other factors) to ensure that they offer the best level of care possible.

Presently on the Isle of Man the reports of the DHSS Registration and Inspection unit are not made publicly available by the registering authority, unlike the equivalent UK reports. Many homes choose to put copies of their latest inspection report on display in their public areas. This means that there is presently no complete set of information available for members of the public looking to ascertain the quality of individual homes other than the assurance that all homes meet the standards as required by the Registration and Inspection unit of the DHSS

The issue of quality of care, service and accommodation is clearly an important one to home operators. A number of operators agreed that the issue of care quality was especially difficult to judge and accepted that the views of individual residents could vary even in respect of individual carers.

Following discussion with operators, it became clear that no home could evidence a claim to offer standards superior to those in adjacent jurisdictions, although one home operator provided the opinion of an industry professional that the home was at the higher end of the market. However, it is accepted by the OFT that there is evidence that the UK market allows the existence of homes that provide commodity level care. In essence, this is the level of care, service and accommodation that just meets the minimum standards required and therefore is sometimes associated with fully funded occupancy. The OFT believes that it is this sort of provision that was being referred to by operators who believed themselves to offer an improved service.

A number of operators provided copies of inspection reports that confirm that they fully meet the local standards for care, service and accommodation. They believed the monitoring regime to be rigorous and respected the competence and thoroughness of the DHSS officers engaged in this work. The Inspections and Registrations Unit can force operators to improve standards or ultimately to cease to trade. The OFT accepts that all operators on the Island meet a standard of care, service and accommodation that meets the local standards. Furthermore, it accepts the advice of the Unit Manager that standards are improving over time and that homes will not need to improve significantly to meet the proposed new standards contained in the Care Standards Bill.

In respect of fee levels and standards of quality, the OFT concludes that the local homes can only be assessed as fully meeting local standards and that no reduction or increase on a standard rate can fairly be applied to homes until a formal and fair quality assessment process is in place. Furthermore, the DHSS policy of funding for nursing care through the benefit system, if continued, would mean that persons resident in different homes would

need to be paid different benefit levels and that the price charged would be increased by agreement between the operator and the Department.

The registering authority in England, the Commission for Social Care and Inspection (CSCI) intends to pilot a 'star system' of rating for its homes so as to allow potential residents to make informed choices regarding the quality of care given in care homes. This is described in CSCI's December 2006 report 'Inspecting for Better Lives: A Quality Future'. The aim of the proposed system is to give people a really easy-to-understand way of comparing services. CSCI also hope that the new quality rating system will encourage care providers to improve their services where appropriate. The scheme will assess the homes' performance separately in each of the following seven main areas, before finally giving an overall quality rating:

i. Quality of life
ii. Exercising choice and control
iii. Making a positive contribution
iv. Personal dignity and respect
v. Freedom from discrimination and harassment
vi. Improved health and emotional well being
vii. Exercising choice and control

CSCI also intend to make judgement on the 'Leadership and Management' of the homes. In each of these areas information will be given as to whether the service given is either; excellent, good, adequate or poor.

CSCI is proposes that the overall quality rating is series of stars awarded; from one to four, with four stars representing an excellent quality service. The star rating will be awarded on the basis of the home's performance in the areas detailed above.

There is the need for the DHSS to make a policy decision with regard to the quality issue. The Department may choose to provide funding for quality in homes that could be regarded as 'superior' i.e. in excess of those required by the DHSS Registration and Inspection or may decide to set benefit levels at a rate that would allow a resident to purchase their care at the lowest price on the market. There is a risk that this latter approach could ultimately cause a distinction in the market; with fully-funded residents only being able to afford care in the lower priced homes.

One possible solution is for the benefit levels to include a quality premium for those homes meeting a prescribed level. Examination of the average local authority fee information, taken by a survey conducted in July 2006 and published by Laing & Buisson and provided at **Appendix 3,** shows a large number of local authorities offering premiums of various sorts. The survey found 21 of the 171 authorities in England and Wales said they offered a premium for single rooms and/or en-suite facilities, ranging from £3 per week to £30 (Brighton & Hove). The 30 Scottish authorities generally apply a £20 single room premium (or £20 deduction for sharing) following a national level negotiation with the Confederation of Scottish Local Authorities (COSLA). 22 of the 204 UK authorities said they offered a quality premium relating to non-environmental aspects of care, such as accreditation with quality assurance schemes. These ranged widely from £5 per week to up to £55 per week in the case of Wirral, following a 'fair price for care' review. One authority, Haringey, offers a specific supplement of £40 per week for culturally sensitive services aligned to the needs of people from ethnic minorities. Excluding Scotland, 43 of the 171 authorities in England and Wales offer some sort of quality premium, whether environmental or non-environmental. This represents a quarter of all authorities, which was found to be about the same as the previous year. However these authorities purchase beds directly from the provider.

Some local authorities use an external quality assurance rating system such as the Interface Independent Quality Assurance Programme or the RDB Star Rating System (which is used by local authorities in Blackpool and Lancashire). The results of these rating systems are used

to determine the level of fee the authority will pay.

The OFT believes that the DHSS should discuss with the nursing homes (on an individual basis) a mutually acceptable basis upon which the quality of the homes can be assessed. The DHSS should also decide whether they will financially remunerate the homes who reach a certain quality level. This is complicated by the current policy of paying benefit as opposed to funding care home fees directly.

4.11 Why prices charged by nursing homes in the Isle of Man might be higher than those found in the United Kingdom, Ireland or the Channel Islands.

There is clearly an interest in comparing local charges with those in adjacent jurisdictions and the figures that were obtained for UK regions as a result of the research into this element in the first stage of investigation were supplemented by figures for the other jurisdictions and are contained in Table 11 below.

When the information was provided in the 2006 Report, important caveats accompanied the information taken from Laing & Buisson's Care of Elderly People Market Survey 2006. The report advised caution as follows: *"Care home fees in the UK reflect the practice of social services buying some places in a care home at well below the fair price that the Laing & Buisson model would suggest and care homes also selling rooms to self-funding residents above the social services level. It is not unusual for self-funding residents to subsidise those who are supported and a care home with a high proportion of self-funding residents will not have to struggle as would one that relies mostly on fully supported residents."*

The information for the UK regions is calculated on the basis of average fees charged to a mixture of self-funding and supported residents for a single room in UK private care homes for older people.

Table 11: Nursing homes charges in UK regions, Channel Islands and Ireland

Rank	Region	Average Rate per Week £
1	Channel Islands	794
2	Northern Home Counties	746
3	Greater London	725
4	Southern Home Counties	694
5	**Isle of Man**	**642**
6	South West	622
7	East Anglia	572
8	West Midlands	568
9	East Midlands	553
10	North West	537
11	Scotland	510
12	Yorkshire & Humberside	509
13	Northern Ireland	500
14	Wales	499
15	Ireland	468
16	North	463

Further enquiries by Moore Stephens revealed that the Channel Islands nursing and residential home market is characterised by private sector nursing and residential homes that are subsidised by parish or charitable organisations. Moore Stephens excluded residential, state operated homes and those supported by parish and charitable organisations. They then selected six organisations and were able to obtain historical rates that were uplifted to likely current rates using a bed rate inflation rate of 5% per annum and from which they calculated the weighted average above. This was also corroborated using the published databases. Figures for Irish homes were taken from reports published early in 2007 by the Irish Nursing Homes Organisation relating to private homes. One local operator with business interests in Ireland believes the figure to be an underestimate. That operator also obtained a professional opinion to the effect that a number of the rates quoted above would be below a Fair Price calculated on the Laing and Buisson model. Another operator noted that operators in the Channel Islands faced similar cost problems as on the Isle of Man in matters such as staffing, supply costs and land values and noted that limited supply of beds resulted increased prices.

The OFT Report and the Laing and Buisson Report cite several reasons why prices charged by nursing homes on the Isle of Man might be higher than those found in the United Kingdom. Some relate to factors that drive local costs and others relate to local market conditions.

The primary cost element in the operation of a nursing home is the staff costs, allocated as 60% by the Laing and Buisson Fair Price Model. The 2006 OFT Report states that the average full time employee earnings on the Isle of Man rank fourth highest behind London, South East and the East. This is comparable to the rankings in the above table given that Moore Stephens report that Jersey's average weekly earnings in June 2005 were £520.

Another significant cost element in the operation of a nursing home is transport costs. The Laing & Buisson Report states costs to transport goods to the Island make assets and consumables costs more than in the United Kingdom, citing 9.7% in the case of food and 15-25% in respect of building costs for repairs and maintenance.

The Laing & Buisson Report acknowledges utility charges on the Island are higher than the United Kingdom and the Fair Price Model for nursing homes on the Isle of Man allows for a 25% increase in utility costs over those in the United Kingdom.

A figure of £500,000 per acre has been used in the Fair Price Model for nursing homes in the Isle of Man. The Laing & Buisson Report notes that had they been undertaking a similar exercise for a United Kingdom council with social services responsibilities, they would have used a figure of £375,000 per acre.

The 2006 OFT Report commented on local market conditions, explaining the process of using Income Support levels to set care home prices for both state-supported and private residents. The use of a single fee level would not be expected in UK homes, which are able to charge privately funded residents more to offset rates negotiated by councils with social care responsibilities (CSSRs) for their supported residents. The report also highlights the shortage of capacity and the now discontinued practice of collective fee negotiation and both these factors could be interpreted as allowing higher fees to be charged in the Island.

4.12 What would be a reasonable rate of return on investment?

In their fair price model Laing & Buisson determined a reasonable blended (i.e. on equity and debt) return on investment as 12.5%. This figure has changed over the years to reflect the level of risk in the market and was reduced by Laing and Buisson to reflect lower levels of risk for investors.

Any required rate of return would be based on the risk free rate and an uplift to compensate

for risk inherent in the investment. Moore Stephens advised that in their opinion the risk free rate would be equivalent to a 4.95% yield from a 10-year government bond (see section 4.2 above).

The uplift for risk can vary, with smaller homes carrying a much higher risk factor than larger homes or groups (three or more homes) that are able to diversify as to, inter alia, geography, scale and/or services. The Healthcare Fund, Quercus, forecasted in its June 2006 report a 13.6% p.a. fund return for 2006-2008. Allowing for the risk free rate of 4.95% (assumed valid for the period) the fund requires an 8.65% uplift to compensate for the risk from a diversified, geared and managed fund comprising healthcare homes and related properties.

With one exception, the Isle of Man is categorised by independent investors (owning one or two homes) who, by definition can carry much greater personal risk possibly extending to personal guarantees. It would be reasonable that the required blended return would be at least equivalent to that of an investor in a managed, diversified fund. It could be argued that there is an even higher blended return required to compensate for personal risk, over and above business risk, particularly in owner-managed homes.

The 12.5% rate of return is used in this report, with the acknowledgement that higher returns could be justified.

4.13 Whether it is fair for all residents of a nursing home to pay a standard weekly rate, regardless of their level of dependency.

At present the homes do not make any distinction in the fee levels they charge to residents on the basis of their dependency levels. There is likely to be a wide spectrum in the level of nursing care needed between a patient at the low dependency end of the spectrum and a patient who is extremely dependent on nursing staff.

Many local authorities in the UK choose to distinguish the fee they pay to care homes on the basis of the dependency level of the client. The table shown at **Appendix 3** indicates that at least seven local authorities offer a fee premium to those patients who they assess to be at a higher level of dependency.

In 2001, the UK Department of Health published a practice guide and workbook that describes the process used to determine the contribution for registered nursing care. Entitled 'NHS Funded Nursing Care – Practice Guide and Workbook', it provides a tool that can be used to assess the amount of nursing care that an older person needs and that the NHS will fund. A joint assessment of need should be undertaken by relevant social care professionals before the registered nursing care contribution (RNCC) tool is applied to new residents. This initial assessment is undertaken under the auspices of the single assessment process, designed to ensure that indications for nursing care need are established and recorded in the care plan.

The criteria for being awarded the various RNCC rates are as follows:

- The High Band consists of people with high needs for registered nursing care, who will have complex needs that require frequent mechanical, technical and/or therapeutic interventions. They will need frequent intervention and re-assessment by a registered nurse throughout a 24 hour period, and their physical/mental health state will be unstable and/or unpredictable.

- People whose needs for registered nursing care are judged to be in the Medium Band may have multiple care needs. They will require the intervention of a registered nurse on at least a daily basis, and may need access to a nurse at any time. However, their condition (including physical, behavioural and psychosocial needs) is stable and

predictable and likely to remain so if treatment and care regimes continue.

- The Low Band of need for nursing care will apply to people who are self-funding whose care needs can be met with minimal registered nurse input. Assessment will indicate that their needs could normally be met in another setting (such as at home or in a care home that does not provide nursing care, with support from the district nurse), but they have chosen to place themselves in a nursing home.

The allocation of a person into the bands is determined by two factors:

- the type of care the person needs – i.e. whether a registered nurse needs to deliver some or all of the care
- the requirement for monitoring and overview – i.e. the extent to which the person's condition is stable and predictable.

People who need substantial registered nursing input and whose condition is unstable and requires constant monitoring with rapid response are therefore placed in the high band of nursing care, while those who are more stable are placed in lower bands. The lowest banding indicates people who do not need to be in a care home which provides nursing care – that is, community nurses could provide their nursing needs in the same way that they provide for people living in their own homes or residential homes.

During the OFT investigations many of the nursing homes operators observed to the Office that the level of dependency of their patients has increased over recent years. As the dependency levels of their patients has increased, many of the homes have observed that they have had to increase their staffing levels above the minimum level prescribed in their staffing notice issued by the DHSS to deal with the dependency levels of their patients.

It should be noted that the DHSS do make some provision for additional dependency in the levels set for attendance allowance. This distinguishes between patient care needs and is almost without exception paid at a higher rate for persons needing nursing home care. It does not however distinguish between the dependency levels of nursing home residents, to the extent that those resident in an Elderly Mental Infirm unit attract no additional funding, though the level of patient safeguards or staff numbers may be higher.

The issue at hand is one of fairness. Currently, homes are required to provide a minimum staffing level but with an over-riding proviso that there are on duty at any one time sufficient staff to meet the needs of the residents. Registered managers assess the dependency of existing residents and of potential residents and address this registration condition by selecting potential new residents whose needs can be met within the available staffing. It is clearly not in the interest of a nursing home operator to accept a resident with high dependency when they could offer the place to one with lower dependency as to do so could increase not just staff workload but staff costs. This is, as a result, unlikely to further the care of a potential resident with high dependencies.

4.14 What would be a fair price to pay for nursing home care based on high, medium or low dependency rates?

Income Support, which funds around half of nursing home placements, usually pays the same rate irrespective of dependency levels. Should different rates be introduced for clients with different care needs the average numbers of hours provided would have to be adjusted accordingly, with a reduction in hours for less dependent clients and an increase for more dependent ones.

The first report published by the OFT advised that the NHS in England has funded the nursing care of nursing home residents through its registered nursing care contribution since April 2003. This contribution is paid at three levels; high rate £133 per week, medium rate £83 and a low band from £40 per week. In April 2006, the then DHSS Minister, Hon S

Rodan MHK, advised his Department's legislative intentions with respect to the wider issues of nursing care and the long-term care of the elderly in the Island. He advised that the Department was planning to introduce into the next legislative session a Care Standards Bill and drafting instructions are in the process of being carried out and should be complete by the summer, ready for introduction into the branches at the end of 2006.

The Bill has not yet been brought forward but is intended to change the way nursing and residential homes are registered. At the present time a home is registered to be either a nursing home or a residential home or, in some cases, both. The Minister advised that in the future, it is proposed that the registration process will be around the needs of the individual as being either low, medium or high levels of dependency and each category of dependency will attract a certain level of remuneration. More dependent residents would receive a higher level of fee for that person.

Operators are in general supportive of these proposals and would welcome the opportunity to comment.

At the same sitting of Tynwald, the Honourable Court passed a motion resolving to support the Department of Health and Social Security in its policy intention to provide assistance to those in nursing homes with the costs of nursing care, in accordance with the principle of the Coughlan judgement in the United Kingdom.

The OFT does not have sufficient expertise to assess the differing levels of nursing care needed by patients with differing levels of dependency and is thus unable to identify what a fair price or a suitable premium would be for each level of dependency.

4.15 The relationship between occupancy rates and prices charged.

The practice of nursing homes charging fees at rates equivalent to maximum total benefit rates has meant that historically there has been no relationship between a home's occupancy rate and the fees charged by that nursing home.

The 2006 Report published found that the private nursing sector in June 2006 was operating at 96% occupancy. The report stated that this occupancy rate can be considered above the level considered within the industry that will ensure a sustainable long-term supply market while allowing flexibility to meet sudden demand and to allow residents a choice of home. This is further explained in the Laing and Buisson report which noted: "If occupancy rates are too high, people are unable to be admitted to the home of their choice promptly and the shortage of places may lead to higher prices based on market pressures. If occupancy rates are too low, either care homes go out of business or residents have to subsidise the empty beds through their fees... For the last two years we have used an occupancy rate of 92.5 percent as a sustainable long-term occupancy rate in our fair price analyses, and this has been accepted by UK purchasers and providers. This implies that on average at any given time one bed in twelve is vacant. This suggests that one "task" of the fair price analysis is to encourage the development of new capacity (not necessarily care home beds) to maintain nursing home occupancy rates at a sustainable level at current patterns of care, assuming demand remains the same."

Whilst the OFT supports the use of a 92.5% occupancy rate in the model, it accepts that a reduction in occupancy from 96% to 92.5% will reduce earnings and be reflected in the financial statements.

4.16 Comparison of the profit levels earned by homes in the Isle of Man with levels earned by nursing homes operating in the United Kingdom, Ireland or the Channel Islands.

The information on smaller nursing homes in the United Kingdom, Ireland or the Channel Islands required for comparison was not readily available, given the time restrictions, owing to different filing requirements and use of abbreviated accounts, in respect of companies, and a simple lack of availability in respect of other forms of entity.

Consequently Moore Stephens selected information based on United Kingdom market coverage, familiarity and local presence. Quercus Healthcare Fund identified the organisations described in **Table 12** as the top five in the United Kingdom.

Table 12: Basic details of UK operators selected for comparison

Name	No of Homes	No of Beds
Southern Cross Group *	573	28,000
BUPA	299	21,280
Four Seasons Health Care	446	21,154
Barchester Health Care	164	10,172
Craegmoor	318	5,878

* Primarily Local Authority clients

Table 13 compares the earnings before taxes per bed of the Island's highest, lowest and mean values with three of the providers detailed above. Moore Stephens selected BUPA on the basis of size and familiarity, Four Seasons because a company belonging to this group owns two homes on the Isle of Man and Craegmoor as it is the smallest of the five. Whilst it has been accepted that the rates of return for smaller businesses may well be higher than those of large groups to account for the increased risk and personal liability that characterise smaller businesses (see section 4.12 above), some local home operators appear to be earning greater amounts per bed than the major UK operators. Whilst the OFT had asked Moore Stephens to provide more directly comparable benchmarks, UK legislative and professional requirements mean that audited financial statements of this sort are not publicly available. One local operator noted that the results of the UK firms may not be directly comparable either by size or scope of operation and that small local businesses should be able to operate more efficiently that large operators due to reduced administration costs.

Table 13: Comparison of earnings before taxes per bed

Operator	Year 1 £'000	Year 2 £'000
IOM High	7.0	6.9
IOM Mean	4.8	5.5
IOM Low	2.1	3.4
BUPA Ltd	3.6	3.3
Craegmoor Homes Ltd	0.2	0.1
Four Seasons Health Care Group	-0.5	-0.4

5. Policy Issues

The Department of Health and Social Security presently funds the provision of nursing home care through the payment of benefits. Historically, the maximum benefit level has been used as the basis for the setting of fees by all nursing homes. Until 2006 a fully funded resident could meet the cost of care from the benefits paid, though this could involve the surrender of the personal care allowance to the home operator and leave the resident with no disposable income.

The 2006 OFT Report noted that there was no reason why the benefit level should be used as the fee level being by charged all homes and suggested, especially with reference to self-funded clients, that fees be set based on local conditions and costs. There is now some variation in fee levels, with some homes charging fees in excess of the maximum benefit payment of £647.69 per week. The current maximum is £695 per week, although operators report that not all fully funded residents have been able to meet the increased amount. Several operators assured the OFT that they would not take steps to recover any debts owed from the residents and there is no evidence of any operator evicting a resident or withdrawing any element of care. It is accepted that the receipt of a fee statement showing accumulating arrears is distressing for some residents.

The work undertaken by Moore Stephens shows clearly that each home has a different cost structure, both in terms of capital assets and operating expenditure. It therefore follows that the fee levels too should vary if all operators are to make an acceptable return on their investment. Whilst it is clear that all homes meet minimum quality standards, some operators believe that they offer a higher standard than the norm and have provided professional opinion to support this. This difference in standards would also be expected to result in differing fee levels.

It is important that the DHSS addresses the issue of what level of care should be provided for fully funded state-supported residents. If the policy is to be that care must meet the standards set by the Department's own Registration and Inspection Unit, then funding places in homes that achieve higher standards would suggest that maximum value for money may not be achieved. A policy of offering the potential resident maximum choice could be expected to cost more. Conversely, a policy driven by cost concerns might set or create a state provision that removes choice of location. The UK market shows a wider range of fees levels charged and of support offered by CSSRs, allowing state provision to be made on the basis of an acceptable level of care. Self funded residents can benefit from higher quality provision if they chose to pay for the same, though it should be noted that many CSSRs do pay over their normal maxima where an individual assessment determines that this is justified. If the DHSS chose to set benefit levels to reflect the lowest of the local home fee levels in the interests of efficiency of expenditure they could in effect promote a stratified market. Some providers may opt to offer that level of care for fully funded residents that can be provided for the amount. If no local home wished to set fees at the benefit rate, those without any means to top up any benefits received may be unable to access nursing home care.

The DHSS does purchase a small number of residential and nursing home beds directly for the provision of respite care with allocation determined by its officers. It is open to the DHSS to reconsider its policy on the funding of nursing home care by exploring the benefit of negotiating prices for beds with operators according to the number of fully supported individuals needing care. This could reduce the overall cost as the operators would be exposed to reduced risk of empty beds and almost no risk of non-payment and they could revise their prices accordingly. A number of operators reported having made proposals of this sort to the DHSS. If cost concerns were paramount, the Department could buy the number of beds that it requires for fully funded residents on the basis of the lowest priced beds available at the required level of care.

This approach would also facilitate the payment of any premium determined to be appropriate to reward higher standards of quality. The DHSS response to Recommendation 8.3.1 of the 2006 Report confirms that it has a policy aim of assessing the care needs of older people, and it is expected that this will be done in such as way as to identify and band the level of dependency in a way that can be linked to fee levels.

There have been suggestions that the DHSS should provide nursing home care directly. In the 2006 report, this suggestion was limited to the use of beds in DHSS residential homes for nursing purposes. The Department responded by advising that it preferred to use its resources to create innovative services that prevent entry into long term nursing care. The 2006 Report did compare the cost of DHSS residential homes with the private sector homes studied. The costs were such that the Fair Price Model would have allowed charges to be more than double those of the average private residential home. This therefore shows the level of subsidy paid by the DHSS to allow their homes to charge their present rate of fees. Private nursing home operators are acutely aware that the DHSS pays staff almost twice as much as they do, if the basic wage figures given in Table 4 are viewed as minimum levels not allowing for premium payments and the value of such issues as sick pay and pension provision. Whilst it is simplistic to suggest that a nursing home run by the DHSS would cost double the average private sector fee level, it is highly unlikely that the Department would be able to match its costs to the fees charged by private operators.

The wages paid by the DHSS have had a major impact on the cost of care on the Island. The DHSS should be aware that the payment of significant rises to its own staff will put pressure on private operators and ultimately increase the cost of care.

If there remains a pressure for direct state provision other than by the purchase of beds, the OFT believes that the DHSS should have regard to the Fair Price Model and note that the cost of providing a return on capital employed by a business is one of the major determinants of the price of care. The Isle of Man Government may be in a position to use its property and financial resources to provide nursing care beds at a competitive rate. By placing a contract for the operation and maintenance of such a home by a private operator, the DHSS should be able to secure the provision of beds at rates based on the costs incurred by the Island's private sector providers, with beds being allocated by the DHSS as per the current approach to DHSS residential care. As an additional benefit, this approach could provide the additional beds that will be required for the Island's aging population and may introduce beneficial competition into the market by reducing overall occupancy rates to the 92.5% figure advocated in the 2006 Report.

6. Conclusions

When Laing & Buisson conducted their survey of the Isle of Man care home market, they concluded that there are four main components of care home costs:

1. staffing
2. repairs and maintenance
3. other non-staffing current costs and
4. capital costs.

These issues have been considered further in the light of Moore Stephens analysis and the OFT has reached the following conclusions.

Staffing

In respect of staffing costs, Laing and Buisson advised that whilst it may be a goal of voluntary and Government care home operators to improve the lot of care staff, as it probably is for private sector operators, this may come second in many purchasers' priorities behind paying an affordable weekly fee.

Nursing home operators advised the OFT that they consider their pay rates to be inadequate, particularly in comparison with overall DHSS remuneration, and that they wished to pay more. This is addressed at section 4.4 above. The need to give staff substantial pay rises was one reason given for the nursing homes' proposed fee increases: some operators would like to award rises of 10% for the year 2006-7 and have given interim rises or non-consolidated bonuses pending the agreement of a new benefit rate. Laing and Buisson advised that:

- the nursing homes did not report insuperable difficulties in recruiting staff and no agency market has developed to provide otherwise unobtainable staff at higher rates
- no nursing homes reported employing second rate staff due to their pay rates
- the nursing homes do make a profit and could have increased pay at the expense of profits had it been essential.

The OFT does acknowledge, however, that terms and conditions in the private sector are significantly worse than those offered by the DHSS and that homes are increasingly concerned about their ability to recruit if immigration rules prevent them from using nurses from non-EU countries. It also accepts the comment of one local operator that if increased staff costs are met entirely from profits operators may decide to seek improved returns on their investment by closing the home and investing elsewhere.

The work of Moore Stephens showed that mean staffing costs were higher than those required to meet the registration condition, though it is accepted by the OFT that this is to some extent the result of an over-riding registration requirement and the associated lack of dependency scoring. The accountancy analysis showed that 5 of the 7 homes are paying staff costs higher than those provided for by the Fair Price Model, at an average of £339.03 per resident per week ('prpw') as opposed to the allowed figure of £329.01, an increase of £10.02 prpw.

Operators have indicated a wish to award pay rises of between 5% and 10% on the levels paid currently and again refer to the rises awarded by the DHSS in recent years as the reason. The OFT is unable to advise on the merit of supporting nursing home operators in their desire to increase wages, though it would note the difficulty of ensuring that any increase in fees so allowed is actually passed on in increased staff wages and salaries. It would also note that any serious difficulties in recruiting staff will force homes to reduce capacity to meet registration requirements. This however should be set against the Laing

and Buisson observation that a profitable business can choose to pay staff more at the expense of the overall level of profit and against the Moore Stephens conclusions in respect of profitability.

Repairs and Maintenance

In their report, Laing and Buisson state that the main component of repairs and maintenance in the UK model is £700 per resident per year for maintenance capital expenditure, based on estimates by corporate groups of expenditure over the lifetime of a care home, increased to allow for building cost inflation. To avoid double-counting, no allowance is used for the non-cash items of depreciation. They also state that the accountancy profession's standard is to depreciate buildings at two percent over 50 years. Equipment is depreciated over variable but much shorter time periods. The report states "There are sound accounting reasons for depreciating buildings, but in reality the value of buildings may rise over time and the effect of annual depreciation allowances are often reversed through periodic revaluations of property assets to create revaluation reserves. From the perspective of local authority purchasers, making allowances for both depreciation and maintenance capital expenditure would be double counting."

In respect of maintenance, Moore Stephens was unable to identify the capital repairs maintenance and revenue, due to the lack of information in the accounts provided. One operator has suggested that the figure for its home is in the order of £34 prpw, though this appears to include a figure for staff wages of £4.41 prpw and does not lead the OFT to conclude that the Fair Price figure of £29.87 is inappropriate.

Non-staffing current costs

The non-fixed costs, such as utilities, food and incontinence products, were considered by Moore Stephens and are reported at section 4.8 above. In the most recent year studied, homes incurred costs above the figure allowed by Laing and Buisson in the Fair Price model of £12.49 prpw on average.

Capital Costs

The most conceptually difficult and contentious part of both investigations has been the establishment of a basis for the assessment of the capital value of a business upon which to allow an acceptable rate of return on investment. In the fair price model used by Laing and Buisson, they state that the market value of a business may not be the most appropriate basis of assessing capital, for two main reasons:

- there is no liquid market for nursing homes on the Island. It is some years since a nursing home was sold, and so the price paid then would not reflect current values
- the standard method of valuing a nursing home is based on the profits that it is projected to make in the future. These profits depend on the prices that the home is able to charge its residents, and this report may affect those profits. Thus a circular calculation would result, with the fair price depending on the profits made and the profits made depending on the fair price.

Moore Stephens calculated the financial value in use of the nursing home property and any associated land used for the operation of the homes. This is reported in section 4.5 above. They also calculated a historic cost of capital based on the amounts shown on the balance sheet. The OFT believes that it is not realistic to reward operators based on the amount they invested in the business irrespective of how long ago that was.

Laing and Buisson therefore used in their model the cost of developing new care home capacity. Industry sources indicated that at 2006 prices a fully equipped, new build care home with 45 square metres gross space per bed (including common parts) in England can

be delivered as a design and build turnkey project at between £55-60,000 per bed, depending on how far above minimum standards it is built. This cost has risen over the last year due to the increased cost of energy. This is the experience of the few active, specialist care home builders, which tend to operate nationwide at prices that do not vary by geography. Laing and Buisson then added 20 percent to allow for the higher cost of building on the Island. A sum of £69,000 per bed was used in the model as the capital cost of buildings and equipment for care homes that meet UK national standards on physical environment in full. This is equivalent to £74,595 per resident at 92.5 % occupancy.

Laing and Buisson advised that they recognised that this is below the prices that builders on the Island are asking to build a new 40-50 bedded care home, which have been reported to be between £79,000 per bed for the basic building to £100,000 for a turnkey home. These construction costs appear to be associated with access to development land, however, and may not reflect the prices that a competitive tender among contractors would achieve if that were possible. Furthermore, it is less likely that a general builder, whether based on the Island or in the UK, would construct a care home for the same cost as a specialist.

The figure of £79,000 is in line with an estimate of construction costs provided to one local operator by a quantity surveyor, with the higher figure also being supported by that operator. For comparison, the DHSS has informed the OFT that the construction cost per bedroom for the Southlands Residential Care Home was £56,200 per bed three years ago (excluding land and equipment, and the cost of the Ambulance Station and an EMI Daycare Centre). The projected cost of the cancelled EMI unit was significantly higher.

The OFT accepts that operators have consistently queried the construction cost of £69,000 per bed used previously and that a figure of £79,000 per bed can be argued. This is equivalent to £82,000 per bed if the fitting out figure of £3,000 per bed suggested by one local operator is used. Following comments received from a nursing home operator, the OFT confirmed with Customs and Excise Division of Treasury that the development of a new nursing home would not attract a VAT liability. The effect of the values described above would be to suggest that in the case of developing new care home capacity, the average cost faced by an Isle of Man operator in developing a new nursing home would mean an increase over the original Laing and Buisson capital cost allowed in respect of buildings and equipment of £33.79 prpw.

When the model has been used to calculate fair price for councils with social services responsibilities in the UK the same building and equipment cost is allowed for any care home, whether new build or not, which meets the same standards. The rationale for this is that the fees must be at a level not only to attract new capacity but also to incentivise operators of existing stock to remain in operation and to upgrade facilities if necessary to meet national minimum standards as well as any additional standards that the market requires.

Laing and Buisson advised that in their opinion it is desirable to have one simple formula for return on capital, which can be applied regardless of the capital structure of the home. To do otherwise would require an understanding of the intricacies of different capital funding structures. For these reasons the fair price for care model used previously was not based the value of the approaches that Laing and Buisson understand have been made by UK companies for the purchase of nursing homes on the Island, nor was it on the historic purchase prices of the businesses. The Laing and Buisson methodology concerning a rate of return on capital has been reproduced in full at **Appendix 4.**

The fair price model referred to the physical quality of UK care homes and the differing level of fees that could be justified for homes meeting the full UK National Minimum Standards.

These are standards for new homes and are not applied on the Isle of Man. All homes on the Island meet registration conditions, and these conditions have evolved over the years to ensure that homes are improved in line with the expectation of the DHSS Registration and Inspections Unit. One home provided evidence on the overall quality offered, and 3 homes claimed that they fully met the standards used in the UK to attract the additional £82 prpw allowed by the model. They did not submit detailed evidence of compliance. The OFT does not believe that it is appropriate to withhold the allowance from all homes, nor is it able to state with confidence that the differences in standards are of such a minor nature that the full allowance is merited. There is no doubt that local standards are being fully met as without this compliance homes would not be permitted to operate. The principle of rewarding those who invest in higher standards is supported, and it would be appropriate to allow the full payment for any home able to demonstrate to the satisfaction of the Registration and Inspections Unit compliance with either the full UK standards or the standards contained in the draft Care Standards Bill.

A Fair Price for Care

The Moore Stephens analysis of the accounts showed that the Island's homes are profitable and that some local home operators appear to be earning greater amounts per bed than the major UK operators, as shown in section 4.16 above. Laing and Buisson's conclusions, as reported in the 2006 OFT report, were that fee levels charged in the Isle of Man were in excess of fees that were, in their opinion, fair. It is against this background that the OFT has considered the fair price for care.

Moore Stephens provided values for fair prices based on analysis of the accounts of the home operators using a historical cost basis for assessing return on capital. The OFT does not feel this to be entirely appropriate, and accordingly assessed the fair price for individual homes based on financial value in use of the nursing home property and any associated land used for the operation of the homes. Using financial value in use excludes the lack of relevance often encountered using the historical cost method and the local construction issues in respect of replacement value. Being based on the relevant use of the asset, it is the most conceptually correct approach in the absence of any relevant market information suggesting otherwise. There is an element of a circular nature in this approach as more profitable businesses will have a higher financial value in use, but that is more a function of the method selected to determine the price, rather than the financial value in use approach. As a method based on financial principles, the financial value in use will reward success achieved through increased profitability, cash flow and effective cost of capital. This assessment gave the results shown in Table 14, which shows the component cost categories for the homes reporting the lowest and highest fair prices calculated by this method. This differs from the other tables given in this report in that the figures are consistent for individual homes and not the lowest and highest observed value in each category.

Table 14 Costs for homes with lowest and highest fair price with capital costs calculated on the basis of financial value in use.

Cost Category	Values for home with lowest fair price	Values for home with highest fair price
Staff	289.89	334.00
Repairs and maintenance	29.66	15.19
Non-staff current expenses	73.60	84.40
Capital costs	129.70	244.88
Fair price for homes meeting all standards for 'new' homes in UK National Minimum Standards for Care Homes for Older People	522.85	678.47
Maximum capital cost adjustment factor for homes not meeting UK physical standards for 'new' homes	(82.00)	(82.00)
Fair price for homes which do not meet the standards for 'new' homes in UK National Minimum Standards for Care Homes for Older People	440.85	596.47

The OFT believes the approach of calculating a fair price using the financial value in use investment appraisal method to be most appropriate means of judging whether prices are fair and reasonable. Operators of 3 homes have advised that they meet the UK 2002 physical standards, and thus the fair price for care in the Island's nursing homes would lie between £522.85 prpw and £678.47 prpw for homes that do meet the latest physical standards and between £440.85 prpw and £596.47 prpw for homes that do not.

This approach does not lend itself to the payment of a single benefit rate for use in all homes. Whilst it might be possible to use the mean figure as a single fair price this would be flawed in that some homes would be over-compensated and some not sufficiently rewarded for the investment they have made. The lower figures could be used if the DHSS were prepared to purchase sufficient beds for fully funded residents only from the cheapest providers.

The Laing and Buisson fair price work quoted in the 2006 OFT report proposed a nursing home fee level of £628.28 for a home meeting the UK 2002 standards and £546.28 for one that does not. Whilst Laing and Buisson did not advise as to how they might reward partial compliance with the 2002 physical standards or full compliance with the Isle of Man's lower existing standards, they did advise that in the UK they adjust the model for partial compliance when supporting councils with social services responsibilities. However the level of reward is determined, the work suggested that an efficient operator could earn at least a 12.5% return on the investment made at a fee level of £628.

The Laing and Buisson Fair Price Model is designed to assist those purchasing residential and nursing home beds by establishing a fee level at which an efficient operator should be able to make an adequate return on the investment made. The DHSS may wish to adopt the model as a means to assist in determining what price that Department should pay to purchase beds in homes meeting a given physical standard. It may however choose to accept that it is necessary to pay in excess of the fair price level to reflect the costs of the average rather than efficient operator if it believes that it cannot secure adequate beds for its needs within the prevailing market conditions. The revised values are given in Table 15.

Table 15 Actual average observed nursing home costs, compared those used in Laing and Buisson model, £ per resident per week

Category	Laing and Buisson Fair Price model	Average observed costs (all IOM operators)	Difference between observed costs and model
Staff	329.00	339.03	10.02
Repairs and Maintenance	29.87	29.87*	-
Non-staff current expenses	70.59	83.08	12.49
Capital Costs	198.80	232.59	33.79
Fair price for homes meeting all standards for 'new' homes in UK National Minimum Standards for Care Homes for Older People	628.28	684.57	56.29
Maximum capital cost adjustment factor for homes not meeting UK physical standards for 'new' homes	(82.00)	(82.00)	(82.00)
Fair price for homes which do not meet the standards for 'new' homes in UK National Minimum Standards for Care Homes for Older People	546.28	602.57	

*See section 4.6

The DHSS may also wish to refine this approach by substituting a full assessment of quality for the allowance based on physical standards and by varying the rates paid by the assessed dependency of the resident.

It might be noted that if the Isle of Man Government were able to provide and equip suitable premises, possibly constructed privately on a design and build basis, interpretation of the analysis provided by Moore Stephens suggests that a private contractor could be asked to operate the home on the basis of a contract for services at a cost of £442.22 at 2006 values, this figure being the sum of the mean values achieved by Isle of Man operators in the most recent year for which data was supplied for staffing (£339.03), repairs and maintenance (£18.52) and non-staff current expenses (£84.67). Some allowance would have to be made for an element of profit for the operator and for the lost opportunity cost of the reserves. With Treasury's capital investment cost currently being 6.11%, the DHSS would have to reward the use of capital by loan charges payable at this rate. Furthermore, if this approach were adopted with the result that there was genuine competition for residents between existing homes, the Moore Stephens analysis of historical costs suggests that some operators could make reductions in their charges and still make an acceptable return on the capital given in the financial statements.

The OFT notes that the figures in respect of the Fair Price model in this report are based on financial information supplied by care home operators in June 2006 values and that those used in the accountancy analysis are the most recently available figures provided by the nursing home operators. The OFT accepts that an allowance should be made for inflation.

7. Recommendations

7.1 The OFT notes that fees that may be regarded as fair for one nursing home may not be the same as those regarded as fair for another nursing home. Homes differ in several ways, including quality standards and cost structure. This investigation has been carried out under S19 of the Fair Trading Act 1996 as amended and it is therefore inappropriate to consider in this report the issue of whether or not individual nursing home prices in the Isle of Man are excessive.

7.2 The OFT has reviewed the work of Laing and Buisson and the work of Moore Stephens and recommends that the fairest way to assess the fees charged by nursing homes on the Isle of Man is by examining the operating costs incurred by each operator and by assessing the return on investment on the basis of a financial value in use calculation to UK Generally Accepted Accounting Practice. The OFT has therefore concluded that the fair price for nursing care on the Isle of Man is between a minimum of £440.85 prpw and a maximum of £678.47 prpw.

7.4. If a single figure for use across all operators is required, the OFT recommends that the fair price for nursing home care is calculated on the basis of the Laing and Buisson Fair Price Model as this represents what an efficient operator should be able to achieve. This approach may at best result in limited choice for the fully funded resident if local providers choose to not offer care at this basic level. The fair price figure obtained by this method is £546.28 prpw at 2006 levels. If an increased level of quality is required the model allows for a maximum fee of £628.28 prpw. The OFT believes that this should be allocated in proportion to compliance with the 2002 UK standards or the standards to be required under the Care Standards Bill. The OFT recommends that the payment of any quality premia due under a Fair Price Model should be based on assessment by the DHSS Registration and Inspection Unit or a published tool approved by the Unit. The higher level should be made available to all to provide an incentive to operators to maintain and upgrade homes.

7.5 The OFT recommends that if the DHSS wishes to set a benefit rate for fully funded residents in excess of the fair price established by the Laing and Buisson Fair Price Model such that the fully funded resident is offered a greater choice of provider, then the fair price figure could be increased by up to £56.29 to reflect the observed average costs incurred by the existing operators. The same allowance can be made for the differing levels of quality offered, giving a lower figure of £602.57 prpw and an upper figure of £684.57 prpw.

7.6 The OFT recommends that the DHSS should expedite the progress of the Care Standards Bill and the implications of funding the nursing care component of the fee. Prior to the introduction of the Care Standards Bill, the DHSS should consider further the issue of dependency so that proper account may be taken of the impact of dependency levels on operators.

7.7 The OFT recommends that the DHSS urgently reviews its policy of funding nursing home care through the payment of benefits. Options identified in this report and the 2006 Report include the direct purchasing of beds from operators and the provision of a Department owned nursing home, with this latter option being recommended solely on the basis that the home is not operated by the Department itself but rather by a specialist operational contractor. Whatever policy direction is selected, the DHSS should determine and publish a method for calculating the amount that it is willing to pay for private sector nursing care that addresses the needs of the individual, the needs of the operators and the resources of the Department.

APPENDIX 1 SOURCES OF REFERENCE FOR ACCOUNTANCY BASED ANALYSIS CONDUCTED BY MOORE STEPHENS

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- Kings Reach Profit and Loss 25 December 2005
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- Kings Reach Staff List
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- http://archives.tcm.ie/irishexaminer/2007/02/07/story24848.asp Downloaded 27/02/2007
- The Quercus Healthcare Fund. Report to Advisors and Institutional Investors. 30 June 2006.
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- BUPA Limited Notes to the Audited Financial Statements for the year ended 31 December 2005
- The Four Seasons Healthcare Group Limited Directors' Report and Audited Financial Statements for the year ended 31 December 2005
- Craegmoor Homes Limited Directors' Report and Audited Financial Statements for the year ended 31 December 2005

APPENDIX 2 Inspection Unit's minimum staffing levels in nursing homes

The Inspection Unit has issued homes with a matrix of minimum nurse and care worker numbers to be on duty during three periods across the 24-hour period for various sizes of nursing home. Table 2, which has translated the average of a sample of these into hours per resident per week (prpw), illustrates how economies of scale exist in care home size. Most nursing home operators considered the staffing levels required by the Inspection Unit to be about right, with a few thinking them to be too low or too high.

Table A1 Inspection Unit's minimum staffing levels in nursing homes, hours per resident per week

Number of residents	prpw nurse	prpw care assistant	prpw both
5	33.6	33.6	67.2
10	16.8	28.0	44.8
15	11.2	22.4	33.6
20	8.4	22.4	30.8
25	9.0	17.9	26.9
30	7.5	17.7	25.2
35	6.4	19.2	25.6
40	7.7	18.2	25.9
45	7.5	17.4	24.9
50	7.8	16.8	24.6
55	7.1	17.3	24.4
60	7.5	17.7	25.2

Excludes hand-over periods

Source: derived by Laing & Buisson as an average of a sample of Inspection Unit staffing notices June 2006.

APPENDIX 3 UK LOCAL AUTHORITY BASELINE FEE RATES 06/07 (£ per resident, per week)

Region	Local Authority	Elderly Min	Elderly Max	EMI Min	EMI Max	Notes
NORTH	Cumbria	425	518	462	555	Min and Max nursing rates include low and high RNCC respectively
	Darlington	374	488	379	493	Min and Max nursing rates include low and high RNCC respectively. Max rates include £21 for homes deemed to be quality compliant
	Durham	452	545	452	545	Min and Max nursing rates include low and high RNCC respectively
	Gateshead	324	492	324	508	Min and Max rates are for shared and single rooms respectively. Most people are placed in single rooms.
	Middlesbrough	383	476	383	476	Min and Max nursing rates include low and high RNCC respectively. A 'fair price for care' review is being commissioned by the council in 2006/07
	Newcastle upon Tyne	395	488	405	498	
	North Tyneside	401	494	405	497	All fees shown are subject to agreement. Min and Max nursing rates include low and high RNCC respectively
	Northumberland	372.94	513.42	393.29	533.78	Max rates for older clients care includes £47 single room supplement. Min and Max nursing rates include low and high RNCC respectively. Phased increase plan: 6% in 2006/07 and 3.9% in 2007/08 + annual inflation + NMW addition from Oct. 2006.
	Redcar & Cleveland	370	483			
	South Tyneside	389	488	399	498	All homes in the borough are graded 1 and 2, with grade 1 homes attracting the maximum fee (net of RNCC). This applies to all categories.
	Stockton on Tees	367	493	383	509	Min and Max nursing rates include low and high RNCC respectively
	Sunderland	399	492	419	512	Min and Max nursing rates include low and high RNCC respectively. EMI nursing rates include £5 for EMI nursing care users.
YORKSHIRE & HUMBERSIDE	Barnsley	356.25	449.25	356.25	449.25	After adding on free nursing bands, elderly nursing fees will increase to a minimum of £367.50 and a maximum of £460.50 in October 2006.
	Bradford	381.18	527.45			Max rates include quality premium (£10.29 level 1 and £32.97 level 2 + £10.01 level 3). Min and Max nursing rates include low and high RNCC respectively
	Calderdale	415	432	432	448	Max rates include single room supplement of £16 to £17.
	East Riding of Yorkshire	326.80	461.80	373.30	508.30	Max rates include quality premia (Part One, Quality Services £21; Part Two, Staff Qualifications £21). Min and Max nursing rates include low and high RNCC respectively.
	Kingston upon Hull	318.50	460.50	355.50	501.50	Rates include "Quality Development Scheme" premium.
	Kirklees	377.28	493.74	377.28	493.74	Min and Max nursing rates include low and high RNCC respectively. Max rates include single room and en suite supplements of £11.73 each. Further increases from October 2006.
	Leeds	357.15	560.67	420	572.5	Min and Max nursing rates include low and high RNCC respectively.
	North Lincolnshire	352	460	401	509	Max rates include Quality Development Scheme Gold Aware of £15 per week. Min and Max nursing rates include low and high RNCC respectively. New fee structure and quality scheme in October 2006 will significantly change fee rate and slightly increase average fees.
	North Yorkshire	399	492			
	Rotherham	384	477			
	Sheffield	381	478	419	518	Min and Max nursing rates include low and high RNCC respectively. Maximum rates include a Higher Environmental Standard fee, which relates to the size of the room.
	Wakefield	399	492	399	492	
	York	456.76		466.76		Fees reflect minimum rate for new residents.

Region	Local Authority	Elderly Min	Elderly Max	EMI Min	EMI Max	Notes
NORTH WEST	Blackburn with Darwen	452.50	475	452.50	496	Max rates include a Quality Assurance Scheme (QAS) premium. Enhanced QAS from Oct 2006 when max fees will rise to £488. Min and Max nursing rates include low and high RNCC respectively.
	Bolton	349.88	483.04	390.15	523.31	Min and Max nursing rates include low and high RNCC respectively. Max rates include premium for single rooms (£29.86), en suite (£5) and IIP (£5.30). The EMI premium of £40.27 for care in an EMI registered unit include in min and max EMI.
	Bury	379	474	379	474	Min and Max nursing rates include low and high RNCC respectively. Max rates include £2 premium for IIP accreditation.
	Cheshire	430.35	523.35	457	550	
	Halton	380.04	473.04	380.04	473.04	
	Knowsley	457.17				Low, medium or high RNCC included in quoted min nursing figures.
	Lancashire	455.50	471	455.50	471	
	Liverpool		397.5	399	466.5	
	Manchester	423.65	537.4	423.65	537.4	Min and Max nursing rates include low and high RNCC respectively. Max rates are for single rooms and include £5.30 premium for en suite facilities.
	Rochdale	390	486.01	390	486.01	Min and Max nursing rates include low and high RNCC respectively. Max rates include £3.01 for IIP accreditation
	Sefton	426	463.5	451	488.5	Min and Max rates quoted reflect range for basic to 5 star rating for homes.
	Stockport	424	517	445	538	Min and Max nursing rates include low and high RNCC respectively. Max residential rate for elderly client include a higher dependency fee.
	Tameside	440.75	473.75	465.35	498.35	Max rates include a max quality premium of £33. Premium paid applicable to single rooms of at least 10 sq metres.
	Trafford	409.81	509.81	456.84	554.84	Min and Max nursing rates include low and high RNCC respectively. Max rates includes additional IIP premium and en-suite premium.
	Warrington	401	494	430	523	Min & Max nursing fees include low & high RNCC respectively
	Wigan	340.32	480.64	340.32	480.64	Min and Max nursing rates include low and high RNCC respectively. Max fees include additional quality payments.
	Wirral	429.62	579.22			3 stars quality premium banding available. Max rates includes 3 stars band of £56.60. Min and Max nursing rates include low and high RNCC respectively.
WEST MIDLANDS	Birmingham	383	506			
	Coventry	430	484	456	499	Quality premia are available ranging from £5 to £20. Max rates include maximum £20 premium.
	Dudley	434	447	434	447	
	Herefordshire	455.2	489.4	463.8	495.8	Max rate is for arrangements established after 7 April 2003 (those before are paid +£15 less), and includes a single room premium of £19.20.
	Sandwell	439	446	439		Max rates include premium of £7 for homes meeting quality criteria in Sandwell.
	Shropshire	408.13	455.48	418.46	470.86	3 levels of quality premia available for based on CSCI reports (£15, £20, £25). Max rates include addition for single rooms.
	Solihull	340	482	345	511	Additions of £5 and £7 available for en-suite rooms and single rooms respectively.
	Staffordshire	367	460	374	467	Min and Max nursing rates include low and high RNCC respectively.
	Stoke	406		412		All fees are for single rooms
	Telford & Wrekin	324.48	655.2	337.47	619.43	
	Walsall	412.28	463.5		450.49	

Region	Local Authority	Elderly Min	Elderly Max	EMI Min	EMI Max	Notes
	Warwickshire	448	456			
	Wolverhampton	418	428	418	428	Min and Max rates reflect prices for shared and single rooms respectively.
	Worcestershire	447	458	474	485	Max rates include additions for single room occupancy.
EAST MIDLANDS	Derby	384	477			Min and Max nursing rates include low and high RNCC respectively.
	Derbyshire	378.65	480.15	389.5	491	
	Leicester City	377	470	377	470	Min and Max nursing rates include low and high RNCC respectively.
	Leicestershire	374.65	464	374.65	464	
	Lincolnshire	419	512	419	512	Min and Max nursing rates include low and high RNCC respectively.
	Northamptonshire	384.78	477.78	406.94	499.94	
	Nottingham City	349	442			Min and Max nursing rates include low and high RNCC respectively.
	Nottinghamshire	383	476			Min and Max nursing rates include low and high RNCC respectively.
	Rutland	425	518	425	518	Min and Max nursing rates include low and high RNCC respectively.
EAST ANGLIA	Norfolk	433.3	446.3	490.3	503.3	Min and Max rates are for shared and single rooms respectively.
	Peterborough	476.46		476.46		
	Suffolk	399	492	425	518	Min and Max rates are for shared and single rooms respectively.
NORTHERN HOME COUNTIES	Bracknell Forest	497	590	561	654	
	Buckinghamshire		472.15		561.68	
	Essex	448.28	518.7			
	Hertfordshire	475	528	550	565	All rates are for single rooms.
	Luton	507		507		
	Milton Keynes	529		529		
	Oxfordshire	481	589			
	Reading	500	600		564	
	Slough		540		604	
	Southend on Sea	434.5	636			Min fee is spot purchase rate. Max fee is block purchase rate.
	Thurrock	553.42				
	Windsor & Maidenhead		433			
	Wokingham	510	649	510	649	Min and Max nursing rates include low and high RNCC respectively.
INNER LONDON	Camden		600		620	
	Hackney	476	545	416	475	
	Islington	530		600		
	Lambeth	521		532		
	Lewisham	500	615	550	610	Placements are in single rooms only.
	Southwark	490	653	474	690	Min and Max nursing rates include low and high RNCC respectively.
	Tower Hamlets	420.27	664.4	481.07	728.43	All placements are in single rooms (discount will be sought for shared rooms).

Region	Local Authority	Elderly Min	Elderly Max	EMI Min	EMI Max	Notes
	Westminster	445	600	525	600	Min rates are for placements outside of London. Max rates reflect fees in London. Min and Max nursing rates include low and high RNCC respectively.
OUTER LONDON	Barking & Dagenham	545		510		
	Barnet		589.4		610.83	Min and Max nursing rates include low and high RNCC respectively.
	Brent		717		848	
	Bromley	523.54	542.19			Min and Max rates are for shared and single rooms respectively.
	Croydon	524.58		544.32		
	Ealing	499.98	601.8	586.5	637.5	
	Enfield	451.56				
	Haringey	505	620	540	700	
	Harrow	500	600	500	600	Min and Max rates reflect placements within and outside South East England respectively.
	Havering	520		520		Rates are for single rooms.
	Hillingdon	600		620		Figures shown are provisional
	Hounslow	550		575		Figures shown are average fees
	Kingston upon Thames		512.23		554.1	
	Newham	321	664	400	639	
	Redbridge	544		544		
	Sutton		529		552	
SOUTHERN HOME COUNTIES	Brighton & Hove	454	536	492	574	Min and Max rates are for medium and high dependency respectively
	East Sussex	417.15		418.18		
	Hampshire	470.5	563.5			Min and Max nursing rates include low and high RNCC respectively.
	Isle of Wight	586.04				
	Kent	426.98	568.72			Min and Max nursing rates include low and high RNCC respectively. Min and Max rate reflect two band price system based on geographical location.
	Medway	486				
	Portsmouth	439.77	532.77	480.76	573.76	Min and Max nursing rates include low and high RNCC respectively
	Southampton	570.5	563.5			Council pays max social care rate of £430.50 for nursing placements. Min and Max nursing rates include low and high RNCC respectively.
	West Sussex	456	549	456	549	Min and Max nursing rates include low and high RNCC respectively
SOUTH WEST	Bath & North East Somerset	476		510		Additions available based on individual assessed needs.
	Bournemouth	471	564	501	594	Min and Max nursing rates include low and high RNCC respectively.
	Bristol	456		488		
	Devon	477	492			Min and Max nursing rates include low and high RNCC respectively. Min and Max rates also reflect standard and high dependency levels respectively.
	Dorset	441	550	441	550	
	Gloucestershire	423.35	467.9	423.35		Geographic bandings of £15.40 and £30.45 are available
	North Somerset	494.58		527.66		

Region	Local Authority	Elderly Min	Elderly Max	EMI Min	EMI Max	Notes
	Plymouth	395	488	395	488	
	Poole	474	567			Min and Max nursing rates include low and high RNCC respectively.
	Somerset	464	487			Max rate includes addition for very dependent elderly people in quality rated homes.
	South Gloucestershire	490		528		Fees can be increased if the service user has exceptional needs. Higher fees will also be paid if in line with LAC 2001 (20), there is no suitable bed available at the local authority price.
	Torbay	385	516	395	527	Min and Max range 9 tier banding system for nursing care.
	Wiltshire	376.99	527.21	434.21	527.21	Max rates include addition for higher dependency levels.
WALES	Anglesey	443	479		519	Max rates include quality premium for homes meeting quality criteria.
	Blaenau Gwent	430.45		476.2		
	Bridgend	459		485		
	Caerphilly	447		492		
	Cardiff	471				
	Carmarthenshire		438.85	459.85		Rates to increase by a further 2% from September 2006.
	Ceredigion		457		474	
	Conwy	464		501		
	Denbighshire	471.5		493.5		
	Flintshire	444	465	472	494	Rates paid net of RNCC. Enhance rates for homes on approved provider list reflected in max rates.
	Gwynedd		455.26		480.95	
	Merthyr	465		496		
	Monmouthshire	466		486		
	Newport	464		509		
	Neath Port Talbot	452		470		
	Powys	490		491		
	Rhondda Cynon Taff	465		494		
	Swansea	458		463		
	Torfaen	426.6		471.5		
	Vale of Glamorgan	402	444	460		Max rate includes addition for higher level of dependency
	Wrexham	461.64		494.64		
SCOTLAND	Aberdeenshire	471				
	Angus	472		472		
	Argyll & Bute	471.45				
	Clackmannanshire	471.28				
	Dumfries & Galloway	471.45				
	Dundee	414	472			Min and max rates reflect difference between shared and single rooms respectively. Max rate include addition for meeting quality criteria
	East Ayrshire	451.45	471.45			Min and max rates are for shared and single rooms respectively
	East Dunbartonshire	451.45	471.45			
	East Lothian	451	471			Max rate includes £20 addition for single room occupancy
	East Renfrewshire	451.45	471.45			

Region	Local Authority	Elderly Min	Elderly Max	EMI Min	EMI Max	Notes
	Falkirk	421.65	470.95			Min and max rates are for shared and single rooms respectively
	Fife	471				
	Glasgow	471.45	471.45			
	Highland	408	436.91	430	458.91	Min rate reflects shared room occupancy rate. Max rate include £20 addition for single occupancy and £8.91 for higher levels of dependency.
	Inverclyde	451.45	471.45	452.45	471.45	Max rates include £20 addition for single room occupancy
	Moray	427		469		
	North Ayrshire	451	471			Min and max rates are for shared and single rooms respectively
	North Lanarkshire	456.45	471.45			Min and max rates are for shared and single rooms respectively
	Orkney		471			
	Perth & Kinross	471.45				
	Renfrewshire	471	472	472		Max rates are for high dependency clients.
	Scottish Borders	471		471		
	South Ayrshire	451	471	451	471	Max rate includes £20 addition for single room occupancy
	South Lanarkshire	451.45	471.45	451.45	471.45	Max rate includes £20 addition for single room occupancy
	West Lothian		471.45	471.45	490	
N I	Eastern	470				
	Northern	470	522			
	Western	470		470		The WHSSB does not buy nursing home care directly. Local Trusts buy the care directly from Providers. The rates shown are gross of Social Security benefits available to the residents.

Source: Annual survey of fee rates for nursing and residential care. Laing and Buisson, July 2006

APPENDIX 4 Laing and Buisson, Fair Price for Care model - Target return on capital

Appendix 2.1 Target return on capital

The economic theory behind the model requires that the rate of return on capital be viewed from a purchaser's perspective. In the UK these fair price analyses are usually undertaken **for councils with social services responsibilities (CSSRs). This analysis has been undertaken** for the Office of Fair Trading for the benefit of all residents, and so we have used the term "purchaser" in this section to refer to the DHSS or to a private purchaser who wishes to pay a fair fee.

Our conclusion is that the purchaser should ideally set 'spot purchase' fees at levels sufficient to offer providers a return on capital of 12.5 percent. Long term block contract commissioning offers a bulk purchaser scope for a lower rate of return. The background to the proposed 'spot' return of 12.5 percent is as follows, looking in turn at the main types of capital structure found in the for-profit sector, as well as the voluntary, not-for-profit sector.

Appendix 2.1.1 Independent owners funded by a mixture of equity and debt

Despite the expansion of corporate operators, Laing & Buisson data show that some 60 percent of for-profit care home places in the UK remained in the hands of independent (non-group) operators in 2005. The definition of a 'group' is any individual, partnership or company that operates three or more care homes. Care home groups, so defined, own the remaining 40 percent. Independent operators, therefore, are the dominant source of care home supply in the UK and are likely to remain so for the foreseeable future.

For most of the last 20 years *good quality* care homes have been bought by independent operators at a 'profit purchase' multiple of about 6 – 6.5 times sustainable Earnings Before Interest, Tax, Depreciation, Amortisation and Rent (EBITDAR) at the level of the individual home (*i.e.* excluding any corporate overheads). In the last three years (between 2002 and 2005) the EBITDAR multiple has risen to a range centred on approximately 7.75 for *good quality* homes (*i.e.* those which amongst other things meet all current 'aspirational' physical environment standards) catering for a state funded clientele. Homes with a predominantly privately funded clientele may attract a yet higher multiple because the quality of their future earning streams is perceived at better. The reasons for the general rise in care home EBITDAR multiples may include the continuation of a low interest rate environment and a perception amongst investors of better prospects for the care home sector. The rate used until very recently has been 13 percent. Recent market transactions show that the multiple has risen, and is currently eight times EBITDAR.

A 'profit purchase' multiple of eight times implies that purchasers are willing to invest in *good quality* care homes in the expectation of a return of 12.5 percent (*i.e.* the reciprocal of eight). It comes as close as possible to an objective, market related norm for expected rate of return.

The return of 12.5 percent is a 'blended' rate. The owner (equity investor) seeks a much higher return on capital, about 25-30 percent, and achieves this by leveraging with bank finance.

The gross return on capital of 25-30 percent sought by the equity investor compensates him/her for:

- opportunity cost of not investing in alternative, non-risk securities such as gilts;
- risk
- time and energy spent overseeing the business

There are few areas of the country where it is possible to earn a blended 12.5 percent return on new developments for frail elderly residents or those with dementia costing over £50,000 per bed including land costs from fees on offer from local authorities. This is believed to be the major reason why few new care homes are currently being built for older clients who are state-funded, despite acute shortages of supply in some areas.

Appendix 2.1.2 Groups funded by a mixture of equity and debt

Care home groups operate in the same market as independent operators and the rates of return they seek are comparable. Despite the well-publicised financial stress suffered by the care home sector, there remains an appetite for investment in the acquisition of existing care home businesses, if not in developing new care homes. The explanation for this is that care home values have declined along with declining profits and investors can still buy assets which offer a 12.5 percent EBITDAR yield at the individual home level. In other words, financial stresses have not reduced the yield for investors making new acquisitions, though they have certainly kept the perceived risk profile of the sector high, thus reinforcing the need for a relatively high EBITDAR yield of around 12.5 percent for a property based business.

Care home groups may derive their equity funding from private investors, including the group's principals, or from venture capital companies (VCs). Like independent operators, groups seek to leverage their equity with debt finance. The structure of debt and equity may be more complex, but the essential features are the same. Like independent operators, active corporate purchasers in the market at present are typically seeking to buy good quality homes which meet, or are capable of meeting, all minimum standards, at a multiple of about eight times sustainable earnings. To the extent that purchase multiples stretch upwards, it reflects an expectation that sustainable profits are likely to grow in the next few years.

Like independent operators, care home groups are rarely able to justify development of new care homes for a 'spot purchased' state-funded clientele in the current climate, though they may be able to justify the addition of new capacity to existing care homes, where land costs are zero.

Unlike independent operators, larger corporate groups must bear an additional cost in the form of head office and regional office overheads. These represent costs over and above management and administration at the level of the individual home. Typically, such overheads absorb around 4 - 5 percent of gross fee income for an efficiently run group, which is equivalent to around three percent of the capital value of a typical good quality portfolio. These additional group overheads can be ignored by the purchaser for the purposes of setting a fair price for care. Such overheads should be viewed as portfolio management costs. Equity providers are either prepared to operate on a lower blended return on capital than independent owners (3 percentage points lower, i.e. 10%) or they expect to recoup at least part of the diminution in return from better financial engineering, higher leverage, lower interest rates from providers of debt or improvements in operational profitability. In these ways, VCs can still realistically seek to achieve a return on their equity capital of 25-30 percent per annum.

Appendix 2.1.3 Sale and leaseback

Sale and leaseback funding became a major driver of acquisition and development activity at the end of the 1990s, but it evaporated in the early months of 2000 with the withdrawal from new business of NHP plc and other sale and leaseback providers.

The fundamental reason for the (temporary) demise of sale and leaseback was reduced profit margins of care home operation which in turn reduced 'rent cover' (the ratio of a home's operating profit to its rent commitment) to dangerously low levels. Though there is little or no new sale and leaseback business being transacted at present, over £1 billion of care home assets throughout the UK remain subject to sale and leaseback arrangements. Many of the operators remain distressed and there have been several bankruptcies. The homes themselves, however, continue to operate since they are predominantly good quality physical assets with few alternative uses.

Sale and leaseback is a mechanism for separating the property element from the operating element of care home provision. It is widely used in other sectors of the service economy, including hotels and pubs. The rationale of sale and leaseback was and is that care homes represent an important class of asset which should attract property investors at relatively low rates of return, though not as low as commercial property or office space. Sale and leaseback allows operators to borrow 100 percent of the capital cost of care homes and thus develop their businesses from a low (arguably too low) equity base. The strategy of NHP was to generate a continuing flow of new capital from 'securitisation' of its rental streams on the Eurobond market. Essentially, NHP would spend its available cash on care homes, rent them to operators and then sell the rental stream to bond holders, giving NHP the cash to start the process again. The attraction of bond holders as an ultimate source of funding was and is that they will accept low interest rates in return for having the first claim on secure rental streams. NHP itself makes its return from any surplus remaining after paying bond holders and its own operating costs. In the event, because of the squeeze on care home margins, NHP failed to achieve its target profitability.

Though bond holders will accept low rates of return, securitisation is a complex piece of financial engineering requiring payment of very substantial fees. For this and other reasons, NHP set its rent at 10.8 percent of lending. In other words, care home operators which opted for sale and leaseback had to achieve a 10.8 percent return (on historical capital costs) plus (say) a further three percent to cover group overheads to make a total of 13.8 percent before breaking even. It is easy to see, therefore, how some highly geared operators got into difficulties.

For the purposes of this exercise, if purchasers across the UK were to offer a return of 12.5 percent on new build care homes, there would potentially be an adequate margin available for a re-appearance of new, lower cost sale and leaseback business. However, a revision of fee levels on the Isle of Man alone would not trigger a resurgence of this market. That would require a general upward revision of fees throughout the UK.

Appendix 2.1.4 Publicly quoted companies

From a peak of 20 a decade ago, the number of UK publicly quote care home groups has fallen to just four. Only one of these, Care UK, is a substantial operator and it differs from most care home groups in that it describes itself as an 'outsourcing company' and seeks long term (as opposed to 'spot') contract business from local authorities and the NHS.

The principal motivation for seeking stock exchange quotations a decade ago was the personal enrichment of principals. The stock exchange initially placed a high valuation on what was viewed as an exciting new sector, but disenchantment soon set in with poor profit performance and share prices fell below net asset values. There is no prospect for the foreseeable future of a resurgence of stock exchange quoted care home groups. In any case, the stock market is generally not comfortable with gearing ratios of more than 50 percent, which puts stock market listed care home companies at a disadvantage to private companies able to operate at much higher gearing ratios. The return on capital requirements of the stock market, therefore, are not relevant to the purchaser's fair price calculation.

Appendix 2.1.5 Small owner-manager

Small, owner-managed homes, up to say 10 beds, are the only exception in principle to the benchmark of a 12.5 percent return, or a profit purchase multiple of 8 on top quality assets. This is because, at a very small scale of operation, business oversight is in practice inseparable from the home management and administration function. Valuers do not, therefore, typically impute a cost of management when calculating value. Rather, they allow a lower profit purchase multiple, say five for a small home meeting all standards, which implies a higher target blended rate of return of 20 percent. This difference, however, should in principle wash out in the allowances for management and return on capital.

Appendix 2.1.6 Not-for-profit provider

There is no reason in principle why voluntary sector or not-for-profit providers should seek a lower rate of return on investment than for-profit providers. They may indeed be obliged under their charitable objects to seek the best return on their capital available for investment.