






Calculating operating costs for care homes

New research by William Laing of health and community care analysts Laing & Buisson has devised a means of calculating the reasonable operating costs of efficient care homes for older and older mentally infirm people. The research is intended to offer a guide to all parties involved in negotiating baseline fee rates in a transparent and robust way. The research finds:

-  **The three principal care home cost categories are: staffing; other non-staffing current costs; and capital costs, the latter including the investor's and operator's return. Capital is the most challenging category of cost to estimate, because of varying capital structures of care homes.**
-  **The study is founded on the assumption that 'spot' purchase fees should be based on a target rate of return on capital of 16% per annum for care home providers. This level of return reflects the market's perception of care home operation as a moderately risky business activity.**
-  **On the basis of UK average wages and land prices in 2001, and a 16% return on capital, the study estimates the full cost of operating an efficient, good quality care home meeting all national minimum standards at £459 per week for nursing care of older people and £353 per week for residential care.**
-  **These costs are some £75-£85 per week higher than the average fees paid by local authorities. The public sector would have to find an additional £1billion per annum to fund fees at this level.**
-  **The study concludes that the extra cost to the public sector could reasonably be phased through a 'Care Home Modernisation Grant', payable to each council in line with local homes' compliance with national minimum standards. Such a mechanism would avoid over-paying non-compliant homes and give them an incentive to invest in meeting all standards.**

Background

Fees paid to care homes by councils throughout Britain typically offer inadequate returns to operators of care homes catering for older people dependent on state funding. This has led to a decline in care home capacity - which is threatening the stability of some local care markets, leading to reduced choice and contributing to delayed discharges from hospital.

This study aimed to enable care commissioners to identify the reasonable costs that a typical, *efficient* care home operator may expect to incur. This included devising a complementary 'toolkit' spreadsheet which can be used as a template for entering locally variable costs.

The study specifically rejects an average cost approach on the grounds that average costs include the costs of *inefficient* operators. A relatively non-contentious illustration of this principle is scale economies in nursing home operation. It seems reasonable to base benchmark costs on an efficient scale of operation - say 50-60 beds - rather than a scale of less than 10 beds, which is wholly uneconomic in terms of staffing costs.

Terms and conditions of employment represent a more contentious illustration. Voluntary bodies and private operators subject to TUPE arrangements (protecting employment rights of staff when activities are transferred to a new provider) typically offer markedly more generous terms. In some cases, benchmarks incorporated in the study specifically reflect more 'efficient' private sector costs. These benchmarks may be modified in the 'toolkit' spreadsheet and the effect of such modifications analysed.

Establishing care home costs

The three principal care home cost categories are: staffing; other non-staffing current costs; and capital costs.

Staffing

Staffing costs typically absorb 45-60% of care home fees. They include care staff, catering, cleaning and laundry staff, and management, administration and reception staff. Costs for each component can be calculated by multiplying the volume of resources required (using benchmark data on the number of staff hours per resident) by weighted average hourly pay rates (taking account of enhancements for unsocial hours) plus on-costs such as employers' National Insurance, holiday pay, sick pay and employers' pension contributions.

While this approach sits easily alongside the simple 'tariff' system that most local authorities currently adopt in paying care homes, it can be adapted to cope with any future move to individual, dependency-based fees, since the key *nurse & care assistant hours per resident per week* statistics can be generated on an individual resident basis using

assessment systems such as MDS (Minimum Data Set).

In the case of nursing care for older people, UK benchmarks of 8.1 qualified nurse hours and 18.9 care assistant hours per resident per week have been entered in the toolkit spreadsheet. They can be amended as necessary to meet local commissioning requirements or national regulatory changes. These benchmarks are based on data collected by Laing & Buisson during 2001 from several major for-profit nursing home operators, representing a significant proportion of the UK nursing home sector. For residential care of older people, the corresponding benchmark is 16 day and night care assistant hours per resident per week (no nursing staff). These figures reflect the staffing requirements applied by a multiplicity of inspection and registration units for larger scale care homes before the national minimum standards were set. From April 2002, the National Care Standards Commission (NCSC) has been responsible for setting minimum staffing requirements nationally for England, with corresponding arrangements for other parts of the UK. At the time of writing, the Department of Health had not yet issued guidelines on minimum care staff input requirements for care homes that will be applied by the NCSC.

The tool-kit spreadsheet uses a norm of 6 hours of catering, cleaning and laundry staff time per resident per week; this does not vary between homes which offer nursing care and those that do not.

To determine local pay rates care commissioners would need to survey actual rates and enhancements paid by local care home providers, distinguishing between public and voluntary sector providers, whose pay rates are typically higher than average, and private sector providers, whose pay rates are typically lower than average. The study proposes that more 'efficient' private sector pay rates should be used as benchmarks.

A cost allowance for (typically salaried) management, administration and reception staff is based on norms for a home of approximately 50 beds.

Staff on-costs include:

- Holiday pay under the Working Time Regulations. Full-time staff are entitled to 20 days holiday plus (in England) 8 bank holidays at full pay, equivalent to an on-cost of 12%. Part-time staff have the same entitlement pro rata.
- Employers' National Insurance (NI) contributions of 11.8% of gross pay above the (NI) threshold. Because many care home employees work part-time, the average NI paid by employers is lower. Based on group operator norms, NI on-costs of 9.0% for nurses and 7.5% for care assistants and catering, cleaning and domestic staff have been entered in the toolkit spreadsheet.

- A sick pay on-cost of 2% is assumed, based on private sector group operator norms. Nearly all private sector care home operators pay no more than Statutory Sick Pay (SSP) to hourly paid nursing, care assistant and domestic staff. Voluntary sector operators and private sector operators subject to TUPE frequently have more generous sick pay arrangements.
- Based on almost universal private sector practice, a zero employer's pension contribution on-cost has been entered in the tool-kit spreadsheet for hourly paid care and domestic staff. An allowance is, however, made for employers' pension contributions for management and administrative staff, which increases their aggregate on-cost to 30% in the toolkit spreadsheet.

Non-staffing current costs

This category includes costs such as utilities, provisions, registration fees, grounds maintenance and maintenance capital expenditure (the latter in place of depreciation). Typically, they absorb 12-16% of care home fees. They can be calculated fairly readily on a 'per resident' basis, with relatively little regional variation. In the study, benchmark data from major care home operators have been used.

Capital costs

Capital costs, including the investor's and operator's return, account for the balance of care home fees. The

study emphasises the importance of using a simple formula which can be applied regardless of the capital structure of any home. To do otherwise would lead to a hopelessly complex requirement for commissioners to understand and allow for the intricacies of different capital funding structures.

In the context of 'spot' purchase, which is likely to remain the dominant mode of public sector purchasing of care home places for the foreseeable future, the study proposes that a reasonable return on capital is 16% per annum. There is a solid basis for this figure, but it should not be regarded as set in stone. With a different market structure, rates of return as low as 10% might be sufficient to give investors an incentive to develop and maintain capacity. However, the study concludes that a rate of return at this level is unlikely to stabilise the care home market as it is currently structured.

Summary of care home costs

Table 1 summarises the estimated reasonable costs incurred by efficient providers of nursing and residential care for older people in 2001. (The figures use national average wage rates and land prices.)

Affordability of reasonable fees

The toolkit spreadsheet typically produces fees that are substantially higher than the baseline fee rates currently being paid by local authorities for care home placements.

The potential cost of a UK-wide realignment of

Table 1: Illustrative summary of the reasonable costs of care homes

<i>Cost head</i>	<i>£ per resident per week older people, UK 2001</i>	
	<i>Nursing older people</i>	<i>Residential older people</i>
Staff, including on-costs, at UK average pay rates		
Qualified nurse staff cost per resident	£89	-
Care assistant staff cost per resident (including activities)	£108	£92
Catering, cleaning and laundry staff cost per resident	£37	£37
Management / administration / reception staff cost per resident	£26	£26
Total staff	£261	£155
Other non-staffing costs		
Non-staff current expenses, food, utilities, etc	£50	£50
Maintenance capital expenditure	£11	£11
Total non-staffing costs	£61	£61
Cost of capital (16% p.a. return)		
Buildings & equipment meeting all regulatory and commissioners' physical standards at £36,111 per resident (90% occupancy)	£111	£111
Land allowance at £8,333 per resident (90% occupancy)	£26	£26
Total capital costs	£137	£137
Grand total	£459	£353

Figures may not add because of rounding

Table 2: Cost of increasing local authority fees to 'fair price' levels, UK 2001

	<i>Nursing older people</i>	<i>Residential older people</i>	<i>Total</i>
a) Reasonable costs at UK average wages and land prices and assuming 16% return on capital (from Table 1, above)	£459 pw	£353 pw	
b) Average fees paid by local authorities, UK 2001 estimate ¹	£385 pw	£268 pw	
c) Difference (a-b)	£74 pw	£85 pw	
d) Number of local authority supported residents ²	100,000	149,000	249,000
Total cost of funding the difference (c x d x 52)	£385m pa	£659m pa	£1,044m pa

1 Estimated from Laing & Buisson survey data on the assumption that local authority fees are on average £50 per week below average private- and NHS-funded fees across the UK.

2 Care of Elderly People Market Survey 2001, Table 7.5. Laing & Buisson. Income supported residents have been added to the local authority total because of the planned transfer of funding to local authorities in April 2002.

baseline fee levels can be approximated (see Table 2) by comparing the 'reasonable costs' (from Table 1) with estimated average fees currently being paid by local authorities. An additional £1 billion per annum might have to be found to fund a stable care home sector which is fully compliant with all national minimum physical standards.

Most local authorities would not currently be able to afford a realignment of baseline fee levels of this order.

Possible ways forward

Additional costs could, however, be phased. The study proposes a mechanism whereby the necessary funding might be made available to local authorities through a 'Care Home Modernisation Grant', payable by central government to each social services department according to the degree of compliance with national minimum standards achieved by the homes with which it contracts.

What is proposed is that care commissioners might develop a simple, transparent and local measure of the degree to which each contracting home falls short of full compliance with physical standards. Such a measure might be based on inspection reports. For substantially non-compliant homes, it might assign a capital value at about 50% of that for a fully compliant home. On the basis of the parameters within the spreadsheet toolkit, this might lead to a saving of about £50-£60 per resident per week.

If care commissioners were to base their fee rates on such a model, it would have the effect of:

- paying non-compliant homes substantially less than fully compliant homes, thus mitigating the cost of a 'fair price' policy to local authorities; and

- giving non-compliant homes an incentive to invest in becoming fully compliant in order to benefit from higher fees.

As well as providing a rationale for phasing the public sector cost of paying fair prices to care homes, the concept offers an approach, subject to the construction of a detailed framework, to a fair and workable division of the cost consequences between central and local government.

About the project

The study is based on benchmark data on care home operation derived from a number of sources including: care home groups, registration and inspection units and recent survey material from over 5000 care homes. The approach, including the toolkit spreadsheet, was piloted in an English county council authority during 2001.

How to get further information

The full report, *Calculating a fair price for care: A toolkit for residential and nursing care costs* by William Laing, is published for the Foundation by The Policy Press (ISBN 1 86134 426 0, price £10.95).