

Annex B: Cost of Care Exercise Covering Statement – Peterborough City Council 65+ Care Homes

Update January 2023: This report was produced in October 2022, based upon data gathered during the summer of 2022 and snapshots of the Council's average placement rates in October 2022. It does not include market sustainability monies given to care home providers during 22/23 (£185k) or market sustainability & improvement funding announced in the provisional local government financial settlement for 23/24.

In November 2022, the Chancellor announced the delay of adult social care reforms until 2025, including the charging reforms referenced within this paper.

In 2021, the Department for Health and Social Care (DHSC) published [Build Back Better-our plan for health and social care](#) and [People at the heart of care - adult social care reform white paper](#) which outlined significant legislative changes to Adult Social Care which will come into effect from October 2023. As part of these changes, councils across England with social care responsibilities are required to conduct an exercise with the local provider market to establish the costs of providing care based on guidance and a standardised methodology issued by DHSC.

In June 2022, the Council commissioned LaingBuisson to undertake the Cost of Care (CoC) exercise covering CQC registered care homes for people aged 65+ across Peterborough, as described and specified in the DHSC guidance. Data was collected between June and September 2022 using the care home submissions relating to individual, registered care home services within Peterborough City Council's (PCC) boundaries where care homes responded via the DHSC recommended CareCubed portal hosted by iESE. LaingBuisson undertook provider engagement, data collection, validation and analysis for the Council and provided the Council with a CoC report and their analysis Excel spreadsheet. The Council's Finance Team then undertook their own analysis and quality checking of the data.

The median cost of care returned through the exercise for each bed type is shown in the table below, together with the average cost of current Peterborough City Council (PCC) placements for over 65s. The average rate values for Nursing and Nursing Dementia beds have been adjusted for Funded Nursing Care (FNC)³ to make them comparable to the Cost of Care (CoC) output.

	Nursing Dementia/Enhanced Nursing (inclusive of FNC)	Nursing (inclusive of FNC)	Residential Dementia/Enhanced Residential	Residential
Current Market Rate	£971.24	£992.61	£702.64	£738.49
FCoC Rate	£1,455.88	£1,424.30	£1,114.37	£1,129.09

Table 1: Comparison of the cost of care at current market rates and the median costs of care homes 65+ located in Peterborough at 2022/23 prices. Average current market rates as of October 22.

The data collected shows a higher cost for all care types from the CoC exercise than the average rates the Council is currently able to procure through its current commissioning approach. This is a key concern with the data produced from this exercise as the Council strives to balance its duties to obtain best value for money for the public purse with the market position on costs that are being incurred in the provision of care.

Provider Engagement

Approach

LaingBuisson worked with the Council throughout July and August to engage with providers through a variety of communication channels. The Council sent out multiple communications about the exercise to its providers via formal letters, email, newsletters and promoted the exercise through relevant provider forums and contract management meetings and negotiations. LaingBuisson contacted providers by telephone, explaining the exercise and encouraging them to participate.

The Council and LaingBuisson held 2-weekly project meetings to discuss progress with provider engagement and submission of toolkits. Council officers identified key strategic providers (those who provide a large number of Council-commissioned care home placements) who had not responded. LaingBuisson engaged in more targeted and intensive communication for those providers, with Council officers from contracts and commissioning teams contacting the providers where they still did not want to engage with the process.

Whilst clear deadlines were set and communicated to the market, a flexible approach was taken to receiving submissions which aimed to maximise the response rate. The Council and LaingBuisson agreed to extend the deadline for providers to submit returns three times from the original date of the 24th June 2022 being extended to the final submission date of the 1st September 2022. This increased the initial length of time for submissions from 2 weeks to just under 12 weeks. Providers have also been able to alter their submissions after that date, with any updated submissions incorporated into data analysis.

LaingBuisson re-contacted all providers submitting toolkits by telephone after receiving their returns. The re-contact was necessary to clarify ambiguities in the toolkit submissions and provided the opportunity to ask further questions to gather supplementary information that could be used to inform the Council's future commissioning strategy.

Level of Engagement

There were 25 registered care home providers in scope located within the boundaries of PCC and 6 submissions were received despite intensive engagement from LaingBuisson and Council representatives who engaged personally with each care home provider in scope. From these 6 providers 2 were fully validated, 2 were partially validated and 2 were out of scope. This means that the response rate was low and not a fair reflection of the Peterborough market. In order to supplement the data deemed in-scope within Peterborough, 4 care homes which operate outside of PCC, but which the council had

placed significant numbers of residents into, were included in the analyses and have been accounted for in the following analysis.

The overall validated response rate was 34% of all care homes in scope (31% for nursing homes and 38% for residential homes – including the 4 additional homes discussed above). Representation and response rates remain highly variable even with these additional homes included.

The response rate was significantly lower than anticipated, despite attempts to engage with providers through a variety of communication channels, including intensive, direct telephone contact with providers to encourage participation and completion of the toolkit. Challenges for providers included:

1. Unease over the level of detail and confidentiality of data requested;
2. Lack of resource, including access to their own data on the finite details required;
3. Lack of time to complete the tool;
4. Lack of interest, including the perceived lack of meaningful results from comparable exercises in the past.

Based on the PCC submissions the total providers spend with the local authority equated to 25% of the market share. This suggests a significant proportion of the market has not been represented within our cost of care analysis. It is reasonable to assume the validity of the fair cost of care rate is poor.

	Nursing Dementia/ Enhanced Nursing (inclusive of FNC)	Nursing (inclusive of FNC)	Residential Dementia/Enhanced Residential	Residential
Current Market Rate	£971.24	£992.61	£702.64	£738.49
FCoC Rate	£1,455.88	£1,424.30	£1,114.37	£1,129.09
Percentage of overall commitment of PCC current spend represented	26.02%	35%	23.85%	25.54%

Table 2: Percentage of overall commitment of PCC current spend represented by the FCoC data submissions. Average current market rates as at October 22.

Relationship between the cost of care and fee rates

The Department for Health and Social Care (DHSC) has recognised in its guidance that the median actual operating costs from which local authorities arrive at a cost of care in their area will not reflect the costs of each individual provider in their local area. The guidance states that “the outcome of this cost of care exercise is not therefore intended to be a replacement for the fee setting element of local authority commissioning processes or individual contract negotiation.”¹

¹ <https://www.gov.uk/government/publications/market-sustainability-and-fair-cost-of-care-fund-2022-to-2023-guidance/market-sustainability-and-fair-cost-of-care-fund-2022-to-2023-guidance> (accessed 30/09/22)

The DHSC expectation is that actual fees will be informed by the cost of care exercise, but fee rates will continue to be based on sound judgement, evidence, and through a negotiation process, as is the case currently. The guidance goes on to say “paying a fair cost of care does not mean that all providers are paid the same rate, but rather the fair cost of care is the median value which fee rates will be “moving towards”.... As many local authorities move towards paying the fair cost of care, it is expected that actual fee rates may differ due to such factors as rurality, personalisation of care, quality of provision and wider market circumstances.”

PCC commission all 65+ Care Home placements by spot purchasing through the pseudo-dynamic purchasing system (DPS). This approach means providers can negotiate current market rates for a bed. Price is based on current market pressures, capacity within the market and individual need. This approach offers flexibility and promotes choice for the individual and ensures that the bed price is reflective of market conditions at the time. However, this also means there is a wide variation in the rates paid for a bed and rates are less predictable.

As demonstrated by the data in Table 1, the Council currently pays substantially less than the CoC output across all its bed types. However, these rates do reflect what the Cambridgeshire and surrounding market is willing to sell placements to the Council at and demonstrates that the market is not currently demanding the median rates that are returned by the CoC exercise. However, the difference would also suggest there is a level of cross subsidy within the current market from self-funded rates.

The overall opinion on the sustainability of the Care Home market in Peterborough is that:

- Whilst PCC commissions care homes at a competitive market rate, some placements may be under-funded when considering the impact of inflation and rising costs over time on historical placements. However, current levels of capacity are sufficient to meet need at present.
- Recruitment and retention of care staff is a real problem for providers. Sustainable care rates are important to assist the market in maintaining competitive rates of pay
- Peterborough has 13 of the 25 homes (736 beds) with providers that have only 1 care home within the Peterborough market. This suggests a high proportion of the local market capacity may not have the capacity to engage in and challenge fee uplift strategies in the same way as the larger providers. A number of these homes are not purpose-built homes and in need of modernisation. Sustainable rates are important to enable investment in modernisation and ensure Peterborough continues to have sufficient capacity in the future as demand increases.
- PCC has evolved strong working partnerships with our 65+ care home providers to ensure the delivery of high standards of care despite historical and ongoing immense financial pressures. However, market intelligence and feedback suggest providers are facing significant challenges and small providers within the market lack resources to invest in their buildings for the ongoing comfort of their residents.
- As yet unknown impact of social care charging reforms on the provider market

Conclusions

The exercise has helped to improve the Council’s understanding of the costs of care delivery locally and will inform the development of Peterborough’s market sustainability plan.

However, particular concerns with the CoC exercise include:

- The low number of submissions overall means the median rate produced are not representative of the local market

- The CoC rate produced is unusually high when benchmarked against other bordering local authorities and does not align to local market conditions and intelligence
- the low level of engagement of smaller providers in the cost of care exercise. Larger providers have a higher response rate as many small providers struggle to find the resource to engage;
- differences in the participation of care providers across Peterborough, and the labour markets and capital values within which those homes are operating.
- Impact of inflation running at such unusually high levels at the current time; and
- varying occupancy levels and the impact these might have on average costs.

Although the Council intends to move towards uplifting lower fee rates should funding allow, it does consider the output of the CoC exercise to represent the fee rates it should currently be paying the market. **The Council will continue to use commissioning processes and individual contract negotiation to determine the fee rates it pays as it strives to balance its duty to get best value for public money with the costs of care delivery.**

The cost of care is a longer-term view which is critical to informing DHSC the impact Adult Social Care Reforms will have on local authorities –an impact which will require additional and ongoing funding if a sustainable approach is to be implemented. Whilst the Council will utilise funding allocations in the spirit of which they are given, it will be unable to fund any gap identified without this due to the financial challenges it faces.

Further work will be needed in collaboration with the market as part of future fee setting.

Fair Cost of Care

Care Homes for Older People (65+)

**Results and Analysis from FCoC Toolkits submitted by Providers located in
Peterborough**

DRAFT FINAL REPORT 6th October 2022

Prepared for Peterborough City Council by LaingBuisson

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1 EXECUTIVE SUMMARY

LaingBuisson was commissioned by Peterborough City Council in June 2022 to undertake a Fair Cost of Care (FCoC) exercise covering registered care homes for older people (65+), as described, and specified in government guidance².

This report is based on validated submissions relating to individual, registered care home services within the council's boundaries which responded via the DHSC recommended CareCubed portal hosted by iESE.

In the validation process, toolkit submissions were checked by LaingBuisson for sense and consistency, and anomalies were amended as necessary with the agreement of providers.

This report is presented together with a companion spreadsheet which lists all validated responses, one row per registered service, each with a range of data points arranged in columns covering:

- All of the detailed operating cost categories and supporting items of information required by DHSC, extracted from respondents' validated toolkit submissions;
- Return on capital and return on operations, calculated from benchmarks determined by the council on the basis of the best available evidence (see Appendix 1). The benchmarks are: 6% per annum return on capital and 10% mark-up on operating costs for return on operations. In line with DHSC guidance, these benchmarks have superseded the return on capital and return on operations figures stated by providers in their toolkit submissions;
- Key characteristics of each care home which may assist in analysis related to market sustainability, such as scale, sector, group ownership, etc. This data is sourced from CQC and LaingBuisson's data warehouse; and
- Other ratios derived from the toolkit submissions, which may assist in understanding drivers of costs.

² Market Sustainability and Fair Cost of Care Fund 2022 to 2023: guidance, updated 25 August 2022

<https://www.gov.uk/government/publications/market-sustainability-and-fair-cost-of-care-fund-2022-to-2023-guidance>

1.1 Headline results

A summary of median total costs derived from the FCoC exercise is presented in Table 1. A more granular analysis of the cost of care results, including all of the cost lines prescribed by DHSC for councils to qualify for grant funding, is set out in Table 4³.

Table 1 Median total costs¹ calculated from wholly or partly validated FCoC toolkit submissions by providers located in Peterborough City Council (including return on capital and operating profit) at 2022/23 prices

	Standard	Enhanced Care	A) Fully validated submissions	B) Partially validated submissions (with one or more validated cost lines)	C) Services in scope	Response rate (A + B) / C * 100
	£ per week	£ per week	Number	Number	Number	%
Nursing homes (65+)	1,424	1,456	3	2	16	31
Residential homes (65+)	1,129	1,114	2	3	13	38
The calculated values incorporate the following council-determined benchmarks, which supersede median values from toolkit responses:						
-	Return on capital	6% pa applied to median freehold valuation per resident ²				
-	Return on operations	10% mark-up on median operating costs derived from validated toolkit responses				

¹ Derived from Table 4

² Care home valuation per resident may be capped to excludes costs of high specification assets aimed at the private pay market, see Section 2.11.1.

1.2 Response rates

³ It should be noted that the segmentation into four care home modalities, Standard / Enhanced, Residential / Nursing, does not necessarily capture the full range of possible sub-segmentation that exists within the care home sector.

The LaingBuisson team fully validated 5 toolkit submissions and partially validated 5 toolkit submissions, the latter being those for which one or more (but not all) of the cost lines had been validated. Adding these together, the 10 fully or partially validated toolkits represents a response rate of 34% of care homes in scope (31% for nursing homes and 38% for residential homes). For some individual cost lines the effective response rate was higher and for others it was lower, see Table 4 for the number of respondents (in brackets) for each individual cost line.

The overall validated response rate was lower than that typically achieved in similar cost of care exercises carried out in various locations by LaingBuisson in recent years, see Section 2.7 for contributory factors.

1.3 Methodology - validation, correction of anomalies, outlier exclusions and calculation of medians

The methodology for calculating median costs from the submitted toolkits is described in Sections 2.4 to 2.6.

1.4 Sensitivity analysis

The median total costs summarised in Table 1 and broken down by cost line in Table 4 are sensitive to the following factors, see Section 2.11:

- The efficacy of the validation process in eliminating implausible and incorrect toolkit submissions for individual cost lines;
- The validity of the rules adopted for elimination of outliers before calculating the medians for each cost line;
- The return on capital and return on operations benchmarks;
- Calculation of capital cost per occupied bed, to which the return on capital benchmark is applied;
- Adjustment for occupancy, if any;
- The approach to calculating confidence intervals for the median total costs; and
- Special local factors, if any,

1.5 Confidence intervals

While there is no reason to believe that the toolkit responses were biased in any systematic way⁴, the number of respondents in any given council area was limited and there was a high degree of variance in many of the cost lines submitted by respondents. This may give rise to concerns about the statistical validity of the calculated medians. This concern is best addressed by calculating margins of error (confidence intervals) around the calculated medians, as illustrated by Figure 2 of Section 2.12.

1.6 Special local factors

There are no special features of the Peterborough market which justify variation of the analytical approach adopted for other councils that LaingBuisson has supported in the national FCoC exercise.

1.7 Conclusions

The key item of data that the national FCoC exercise has sought to reveal is the gap (if any) between the calculated median cost of care and the fee rates currently being paid by councils, in order to inform policy decisions on the quantum of the gap to fill (if any) and the pace at which it can be filled with the resources available.

The results summarised in Figure 2 indicate that there is currently a substantial fee gap in Peterborough for all four care modalities. The fee gaps, as measured by the differences between the FCoC medians and the average fees currently paid to independent sector providers by Peterborough City Council, range from £425 to £466 per week.

The FCoC medians, however, are subject to margins of error, and the fee gaps are smaller when measured by the differences between the lower 95% confidence bounds of the FCoC medians and the average fees currently paid by Peterborough, with fee gaps ranging from £67 to £228 per week.

Therefore, Peterborough City Council can be confident that real fee gaps do exist, and that the minimum quantum of these fee gaps are £170 for residential, £162 for residential with enhancement, £228 for nursing, and £67 for nursing with enhancement, these being the gaps between the rates the council is currently paying and the lower bounds of the 95% confidence limits of the calculated FCoC medians.

⁴ We cannot, however, rule out the possibility that providers may have overstated their costs, and it was not practicable within the timescale available to carry out a range of checks applied by LaingBuisson in other cost of care exercises, including requesting evidence of staff costs from payroll records.

These numbers can be viewed as the minimum fee gaps for Peterborough City Council to seek to bridge, with the pace of bridging subject to available resources, see Section 2.14.

2 FAIR COST OF CARE RESULTS FOR SUBMISSION TO DHSC

2.1 The IESE toolkit

Under the instructions of Peterborough City Council, LaingBuisson registered with the IESE CareCubed portal to use their toolkit, with comprehensive support, as recommended by the Local Government Association and DHSC. The CareCubed platform takes the form of a multi-page survey seeking general information about the care home to which a submission refers, general expenditure, return on operations and return on capital, occupancy rates, staffing hours, and direct staffing costs.

2.2 Services in scope

There were 25 registered care homes in scope (predominantly for older people, aged 65+) located within the boundaries of Peterborough Council, after removing homes primarily for younger adults. DHSC guidance states that only older people's care homes in contact with local authorities are in scope, but since nearly all older people's care homes have at least one council-funded resident, predominantly privately funded homes were interpreted as being in scope as well. Additionally, as a means of increasing the validity of results, it was agreed with the council that care homes within Cambridgeshire that did not primarily care for residents who had been placed by Peterborough City Council would be included where Peterborough City Council place a significant number of older residents. These inclusions increased the number of in-scope homes by 4 to 29.

2.3 Engagement with providers

LaingBuisson worked with the council over July and August 2022 to engage with providers through a variety of communication channels, the most important being intensive, direct telephone contact to encourage participation and completion of the toolkit. In addition, support was given to providers who were in the process of completing their submissions. Over the course of the project, a total of 138 calls (169 including calls to external providers that Peterborough City Council places residents in) were made to care home providers to encourage participation, the validating of completed toolkits (including querying anomalies via CareCubed) took place in parallel.

2.4 Quality of toolkit submissions

LaingBuisson's experience, gained from similar care cost exercises carried out in recent years, is that the quality of submissions is variable. Large corporate groups typically have the resources to submit consistent and reliable numbers, but SMEs and micro-businesses can find it challenging to deal with the volume

and complexity of data requested in toolkits and may leave some questions unanswered or incorrectly answered. Consequently, it is necessary to apply a robust validation process, including querying anomalous submissions with respondents and assisting them to provide the appropriate data.

2.5 Validation

In the validation process, toolkit submissions were checked by LaingBuisson for sense and consistency, and anomalies were amended as necessary with the agreement of providers. Checking of toolkits was conducted individually through a comparison of submissions from similar care homes, and through comparisons between submissions and LaingBuisson's historic Care Cost Benchmarks dataset⁵. Toolkit submissions for individual cost lines were queried when they were found to be significantly outside of expected ranges, with particular attention paid to the plausibility of figures which contribute most notably towards total costs, such as staffing.

A facility to query submissions was made available through the Local Authority user interface of the CareCubed platform. This involved the submission of comments on individual figures given by providers. Providers were then notified that their response had been put into a query and were able to see the flagged queries with comments, upon logging into the platform. Changes to submissions were only enabled on the provider side, meaning that any queried anomalies which a provider did not understand or did not attempt to resolve, could not be fully validated through the platform.

Consequently, even after applying such validation processes as were practicably possible, there remained toolkits with one or more cost lines which were inappropriately null or zero, or which appeared to be outside of reasonable ranges. In most cases, the anomalies related to minor cost items, and it was evident that an approach was needed which would optimise the use of fully validated data without discarding toolkits which still contained unvalidated data for some minor cost lines.

2.6 Incomplete toolkit submissions

2.6.1 Interpolation vs outlier exclusion

There are two basic approaches to optimising value from survey results where, even after a robust validation process, some cost lines in any given toolkit submission may be zero or empty (null), and some may be outside a reasonable range:

⁵ LaingBuisson has collected cost data from UK wide care home surveys and Local Fair Price exercises commissioned by councils, the NHS and independent care associations over more than a decade. They provided a useful source of benchmarking data against which 2022 FCoC toolkit submissions could be compared, in particular with regard to staff hours per resident per week, which is the single most important driver of care home costs.

- **Interpolation** is one approach, in which null, zero or extreme outlier data for any individual cost line in any given toolkit submission is substituted by the median (or mean) value among those toolkits that submitted valid, in range data for that cost line. By this means, otherwise valid toolkits can avoid being discarded due to the absence of minor cost items. In this approach it is reasonable to interpolate values for minor cost lines, though not for major cost lines, such as staffing costs, which are major drivers of total costs; Interpolation maximises the number of valid toolkit responses, from which the median numbers for each individual cost line, as well as the median total cost for all validated toolkits can be calculated. A downside of the interpolation approach, however, is that the nature of medians (the DHSC's preferred measure of central tendency) means that the individual cost line medians do not add to the subtotal medians and the subtotal medians do not add to the total cost median.
- **Outlier exclusion** is another approach, in which median values are calculated separately for each cost line, using all submitted toolkits where that particular cost line was validated, and excluding all 'outliers' whether they be null or zero values or outside a defined range. The full output required by DHSC can then be built-up from individual cost line medians. A bonus from this method is that each of the four median total costs required by DHSC (for residential, residential enhanced, nursing and nursing enhanced care) are equal to the sum of the median subtotals and the median subtotals are equal to the sums of the relevant individual cost lines.

We have opted to use the **outlier exclusion** approach, and we have defined outliers to encompass:

- a) Null (empty) or zero values for any cost line where a null / zero value is inappropriate; and
- b) Non-zero values which are outside specified boundaries.

With respect to b), having researched various methodologies, we adopted Double Median Absolute Deviation (Double MAD) as the preferred approach to setting outlier boundaries for each individual cost line.

$$MAD = \text{median}(|X_i - \bar{X}|)$$

Median Absolute Deviation (MAD) is calculated by finding the absolute difference between each validated data point and the validated sample median, and then calculating the median of these absolute differences. For normally distributed data, MAD is multiplied by a constant $b = 1.4826$, however, the distribution is unknown and not symmetric in our data sample.

Furthermore, statistically testing for skewness in the sample confirms that the data suffers from a highly asymmetric distribution across all categories. Using a singular Median Absolute Deviation value, disregarding the asymmetry in the distribution, would produce unreliable results. For this reason, we opted for an enhanced method called “Double MAD”.

The premises of this method are similar to the classic version, with the only difference being the calculation of two Median Absolute Deviations: (1) the median absolute deviation from the median of all points less than or equal to the median and (2) the median absolute deviation from the median of all points greater than or equal to the median. This allows us to set pertinent outlier thresholds taking into account skewness in the data sample. Finally, for each cost line, we have defined as an outlier any data point which is more than 2 X MAD above or below the median. All such outliers have been excluded from the calculation of median costs in Table 4.

2.7 Response rates

The overall validated and partially validated response rate was 34% of all care homes in scope (31% for nursing homes and 38% for residential homes). Table 2 segments response rates according to key care home characteristics which might have a bearing on costs. Representation and response rates are highly variable as a result of a low response rate and small market. As a result, response rates are frequently either 0% or 100%.

In addition to the care homes deemed as in-scope within Peterborough, 4 care homes which operate outside of Peterborough City Council, but which the council had placed numerous residents into, were included in analyses and have been accounted for in Table 2. These were 2 residential and 2 Nursing homes, all but one of which were full validated by LB prior to their inclusion.

Table 2 – Segmented response rates (validated plus partially validated) by key characteristics

	Nursing Homes			Residential Homes		
	Respondents	Homes in scope with the relevant characteristic	Response rate (%)	Respondents	Homes in scope with the relevant characteristic	Response rate (%)
Total	5	16	31	5	13	38
Strategic providers	2	9	22	2	4	50
Provider sector						
For-profit	5	15	33	4	12	33
Not-for-profit	0	1	0	1	1	100

Build status						
Purpose built	5	12	42	2	2	100
Not purpose built	0	4	0	3	11	27
Operator scale						
Large corporate group ¹	4	5	80	2	2	100
Medium group ²	1	10	10	1	3	33
Small group or independent ³	0	1	0	2	8	25
Service scale						
Large service scale(50+ beds)	5	10	50	2	2	100
Medium service scale(20-49 beds)	0	5	0	3	8	38
Small service scale (<20beds)	0	1	0	0	3	0
CQC ratings						
Good or Outstanding	4	14	29	3	9	33
Not Good or Outstanding	1	1	100	2	3	67

¹ 40 or more care homes for older people across the UK

² 3 - 39 care homes for older people across the UK

³ Fewer than 3 care homes for older people across the UK

Note: The discrepancy in residential and nursing homes listed by CQC rating as compared to total in-scope homes is a result of two homes which have been registered with the CQC, but have not yet received ratings.

The median results presented in Tables 1 and 4 are derived from a response rate of completed and validated toolkits which, for some councils, was lower than usually achieved in cost of care exercises carried out by LaingBuisson over the last decade. One reason was the challenging timescale for the national FCoC programme. Feedback received from providers during the engagement process identified some of their reasons for hesitancy to respond:

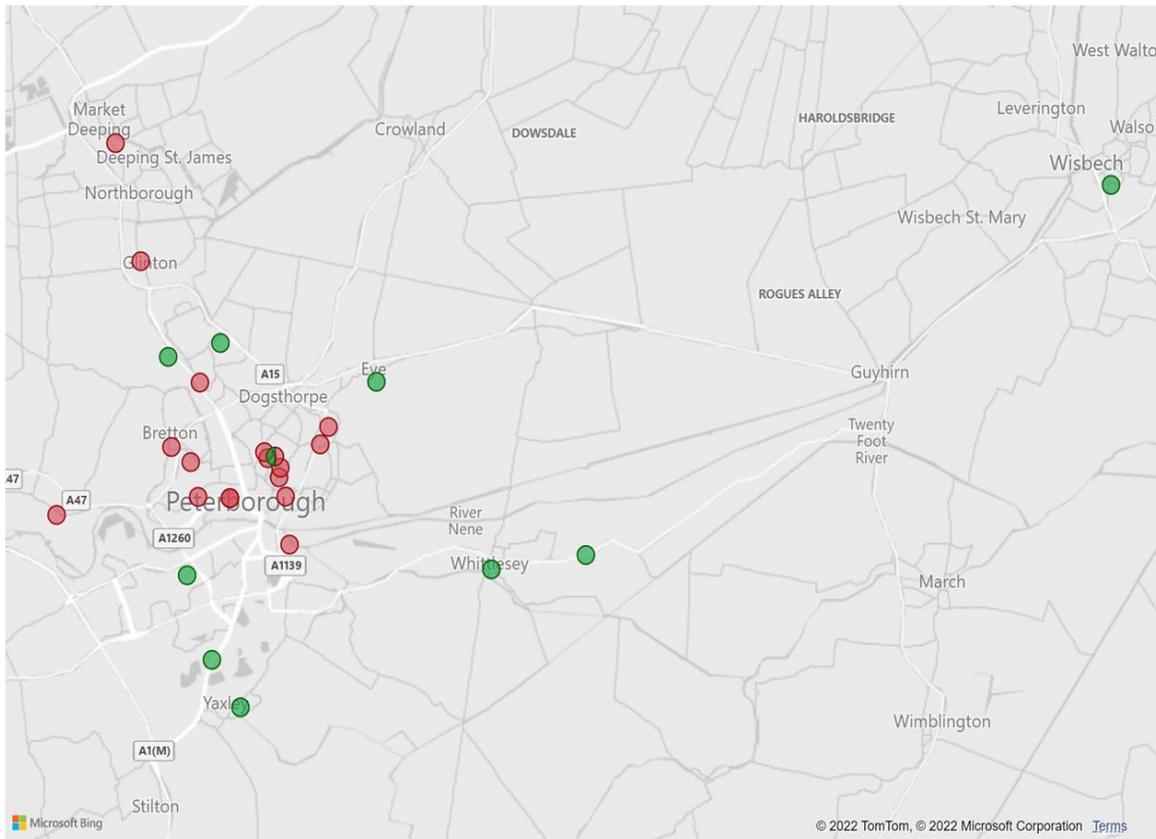
- Demanding toolkit and insufficient time to complete it (may have been exacerbated by current staffing challenges);
- Concern about confidentiality, since local authorities are able to inspect individual respondents' data (previous LaingBuisson exercises have guaranteed confidentiality);

- Lack of confidence that the exercise would lead to financial benefits for providers, in the light of the perceived absence of benefits from earlier cost of care exercises.

2.7.1 Geographical spread of care homes

The geographical spread of respondent and non-respondent care homes in Peterborough is illustrated in Figure 1.

Figure 1 Map of care homes in Peterborough



2.8 Base price year and uplifts

All of the FCoC results cited in this report are expressed at April 2022 prices. They have been calculated by multiplying the ‘uplift’ factors entered in the toolkit submissions by the 2021/22 (base year) toolkit costs per resident, for each cost line, to arrive at costs per resident at April 2022 prices. In any normal year, costs at April (the beginning of the financial year) would be expected to prevail over the full financial year (April 2022 to March 2023) because staffing is the main driver of cost, and pay rates are usually set at the beginning of the financial year for the whole year in light of the National Living Wage settlement which is implemented in April. The surge of inflation in 2022/23, however, means that care home costs per resident may well change significantly over the course of the new financial year, over and above this report’s results at April 2022. It is expected that council decisions in relation to fee setting should have regard to this.

For submissions with a 2021/22 base price year and no uplifts entered in the toolkit submission, uplifts have been interpolated based on the National Living Wage for low-paid staff (care and domestic), the monthly earnings index for other staff, and CPI (Consumer Price Index) and CPIH (Consumer Price Index with Housing) percentage change figures for non-staffing costs for the 12 months up to April 2022⁶. These figures have been chosen on a point-by-point basis, where appropriate figures have been identified to account for relative price effects⁷, with overall CPI inflation figures used where no appropriate, goods/services-specific CPI figure has been identified. Uplift figures with CPI codes for each cost heading can be found in Table 3.

Table 3 – Uplifts from 2021/22 to 2022/23

	CPI Code	CPI Item	12 Month % change to April 2022
Low paid staff (carers and domestic staff)	-	National Living Wage % increase, April - April ⁸	6.6
Other staff (nurses and back office)	-	Average earnings index, April – April	4.1
Fixtures & fittings	D7GW	05.3 Household appliances, fitting, and repairs	9.9

⁶ Table 22, <https://www.ons.gov.uk/economy/inflationandpriceindices/datasets/consumerpriceinflation>

⁷ Our approach to uplifting is broadly in line with guidance on inflationary adjustment set out in The Green Book 2022, Section 5.13, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1063330/Green_Book_2022.pdf

⁸ [https://www.gov.uk/government/news/national-living-wage-increase-boosts-pay-of-low-paid-workers#:~:text=The%20improvement%20in%20the%20economic,2.2%20per%20cent\)%20in%202021.](https://www.gov.uk/government/news/national-living-wage-increase-boosts-pay-of-low-paid-workers#:~:text=The%20improvement%20in%20the%20economic,2.2%20per%20cent)%20in%202021.)

Repairs and maintenance	D7GR	04.3 Regular maintenance and repair of the dwelling	7.6
Furniture, furnishings, and equipment	D7GU	05.1 Furniture, furnishings, and carpets	15.0
<i>Other care home premises costs</i>	D7G7	CPI (overall index)	9.0
Food supplies	D7G8	01 Food and non-alcoholic beverages	6.7
Domestic and cleaning supplies	D7GZ	05.6 Goods and services for routine maintenance	6.8
Medical supplies (excluding PPE)	D7NO	06.1 Medical products, appliances, and equipment	1.3
PPE	D7NO	06.1 Medical products, appliances, and equipment	1.3
Office Supplies	D7IH	05.6.1 Non-durable household goods	10.3
Insurance (all risks)	D7HF	12.5 Insurance	11.7
Registration fees	D7G7	CPI (overall index)	9.0
Telephone & internet	D7GF	08 Communication	2.8
Council tax / rates	CRQT	Council tax and rates (CPIH) ⁹	7.9
Electricity, Gas & Water	D7GB	04 Housing, water, electricity, gas and other fuels	19.2
Trade and clinical waste	D7G7	CPI (overall index)	9.0
Transport & Activities	D7GG	09 Recreation and Culture	5.9
<i>Other care home supplies and services costs</i>	D7G7	CPI (overall index)	9.0
Central / Regional Management	D7NN	All services	4.7
Support Services (finance / HR / legal / marketing etc.)	D7NN	All services	4.7
Recruitment, Training & Vetting (incl. DBS checks)	D7NN	All services	4.7
<i>Other head office costs (please specify)</i>	D7OB	12.7 Other services (NEC)	-3.1

Source: Office for National Statistics for different CPI series

⁹ Tables 8 and 22, <https://www.ons.gov.uk/economy/inflationandpriceindices/datasets/consumerpriceinflation>

2.9 Return on capital and return on operations

DHSC guidance indicates that councils should determine, on the basis of available evidence, the appropriate return on capital and return on operations rates that should be added to operating costs (calculated at medians from validated toolkit responses) in order to arrive at the median total cost for each of the four modalities of care in the FCoC returns, and that these rates should be evidence based. The rates recommended by LaingBuisson are:

- a) Return on capital 6% per annum
- b) Return on operations 10% mark-up on operating costs

The evidence base for these rates is described in Appendix 1,

In order to determine the £ value of return on capital, it is necessary to apply the rate of return to a capital value per resident. This can be derived from the toolkit submissions as the median of freehold valuation per bed (see Supporting Information at the foot of Table 4), divided by occupancy per registered bed (see also Supporting Information at the foot of Table 4), to express the £ value on a 'per resident' basis. The calculation for Peterborough City Council based on validated toolkit submissions at the date of this report is: 6% TIMES £108,097 DIVIDED BY 78.3% TIMES 7/365 = £158.94 per resident per week, see Table 4

Return on operations based on validated toolkit submissions at the date of this report is calculated at 10% of the Operating cost subtotals in Table 4.

2.10 Analysis and results

Summary results for care homes located in Peterborough are presented in Table 4, in the form prescribed by the DHSC guidance. All operating costs have been derived from validated toolkit submissions, after applying the outlier exclusion rules described in Section 2.6. Return on capital and return on operations are based on the benchmarks set out in Section 2.9, being 6% per annum for return on capital and a 10% mark-up on operating costs for the return on operations.

Because of the way in which CareCubed calculates costs, the differential (if any) between 'enhanced' (usually interpreted as dementia) and non-enhanced total costs is entirely due to the staffing costs. All other cost lines are identical for enhanced and non-enhanced care.

We have used LaingBuisson’s *Care Cost Benchmarks* model as a broad check on the plausibility of the FCoC results in Table 4. We would expect (from *Care Cost Benchmarks*) nursing care costs to be about £250 per week higher than residential care costs – made up from registered nursing staff input at around the 2022/23 NHS FNC rate of £209, plus some additional non-nurse carer staff input. We would also expect (from *Care Cost Benchmarks* data set going back over a decade) a differential between ‘enhanced’ (i.e. dementia) and non-enhanced residential care, the former being more costly. But we would *not* expect any differential between enhanced and non-enhanced nursing care.

Any divergence from the expected pattern in the Table 4 median results may be a result of normal variance within small numbers of validated toolkits, see Section 2.12.

These results in Table 4 should be seen in the context of policy guidance from the Department of Health and Social Care. The latest DHSC guidance, dated 25 August 2022, recognises that ‘median figures for the broad service types within scope (standard residential care, residential care for enhanced needs, standard nursing care and nursing care for enhanced needs)’ ... ‘may oversimplify what is a complex picture of care and support needs.’

Table 4 Median costs of care homes (65+) located in Peterborough, £ per week at 2022/23 prices

Cost of Care exercise results - all cells should be £ per resident per week	Non-Nursing	Non-Nursing with enhancement	Nursing	Nursing with enhancement
Staffing	577.13	563.74	845.50	874.21
Nursing Staff	-	-	296.60 (2)	310.47 (3)
Care Staff	366.22 (6)	352.83 (5)	337.99 (2)	352.83 (3)
Therapy Staff	-	-	-	-
Activity Coordinators	18.9 (7)	18.9 (7)	18.9 (7)	18.9 (7)
Service Management	47.18 (7)	47.18 (7)	47.18 (7)	47.18 (7)
Reception & Admin	16.95 (7)	16.95 (7)	16.95 (7)	16.95 (7)
Chefs / Cooks	45.97 (8)	45.97 (8)	45.97 (8)	45.97 (8)
Domestic Staff	47.84 (8)	47.84 (8)	47.84 (8)	47.84 (8)
Maintenance & Gardening	11.68 (3)	11.68 (3)	11.68 (3)	11.68 (3)
Other Care Home Staff	22.39 (3)	22.39 (3)	22.39 (3)	22.39 (3)

Care Home Premises	60.31	60.31	60.31	60.31
Fixtures & Fittings	27.07 (5)	27.07 (5)	27.07 (5)	27.07 (5)
Repairs and Maintenance	25.22 (7)	25.22 (7)	25.22 (7)	25.22 (7)
Furniture, Furnishings and Equipment	6.51 (8)	6.51 (8)	6.51 (8)	6.51 (8)
Other Care Home Premise Costs	1.51 (4)	1.51 (4)	1.51 (4)	1.51 (4)
Care Home Supplies and Services	132.53	132.53	132.53	132.53
Food	46.01 (7)	46.01 (7)	46.01 (7)	46.01 (7)
Domestic & Cleaning	6.19 (8)	6.19 (8)	6.19 (8)	6.19 (8)
Medical Supplies	6.08 (6)	6.08 (6)	6.08 (6)	6.08 (6)
PPE	1.61 (2)	1.61 (2)	1.61 (2)	1.61 (2)
Office Supplies	5.44 (6)	5.44 (6)	5.44 (6)	5.44 (6)
Insurance	8.32 (5)	8.32 (5)	8.32 (5)	8.32 (5)
Registration Fees	4.54 (9)	4.54 (9)	4.54 (9)	4.54 (9)
Telephone & Internet	2.8 (6)	2.8 (6)	2.8 (6)	2.8 (6)
Council Tax / rates	1.33 (8)	1.33 (8)	1.33 (8)	1.33 (8)
Electricity, Gas & Water	36.51 (7)	36.51 (7)	36.51 (7)	36.51 (7)
Trade and Clinical Waste	7.3 (7)	7.3 (7)	7.3 (7)	7.3 (7)
Transport & Activities	3.54 (4)	3.54 (4)	3.54 (4)	3.54 (4)
Other Care Home	2.86 (6)	2.86 (6)	2.86 (6)	2.86 (6)
Head Office	111.99	111.99	111.99	111.99
Central / Regional Management	60.04 (4)	60.04 (4)	60.04 (4)	60.04 (4)
Support Services	21.7 (8)	21.7 (8)	21.7 (8)	21.7 (8)
Recruitment, training & vetting	13.16 (6)	13.16 (6)	13.16 (6)	13.16 (6)
Other head office costs	17.09 (3)	17.09 (3)	17.09 (3)	17.09 (3)
Sub-total Operating Costs	881.96	868.57	1,150.33	1,179.04
Return on Operations	88.20	86.86	115.03	117.90
Return on Capital	158.94	158.94	158.94	158.94

Total	1,129.09	1,114.37	1,424.30	1,455.88
Supporting information				
Number of Location level survey responses received	5	4	5	3
Number of locations eligible to fill in the survey (excluding those found to be ineligible)	13	13	16	16
Number of residents covered by the responses	117	117	119	156
Number of carer hours per resident per week	25	32	24	26
Number of nursing hours per resident per week	-	-	11	10
Average carer basic pay per hour	£11.11	£11.11	£10.79	£10.95
Average nurse basic pay per hour	-	-	£19.41	£18.97
Average occupancy as a percentage of active beds				78.3%
Freehold valuation per bed				£108,097

All data derived from toolkit responses except for return on capital and return on operations, which have been superseded by the council based on a 6% annual return on capital for premises and a 10% mark-up on operating and head office costs for return on operations

2.11 Sensitivity analysis

The median total costs set out in Table 4 are sensitive to the following factors:

- The efficacy of the validation process in eliminating implausible and incorrect toolkit submissions for individual cost lines. We believe that the validation process, as described in Section 2.5, was effective;
- The validity of the rules adopted for elimination of outliers before calculating the medians for each cost line. Outlier exclusion was limited and we believe the rules adopted, as described in Section 2.6, were appropriate;
- The return on capital and return on operations benchmarks. The values which have been adopted are set out in Section 2.9 and the evidence is presented in Appendix 1;
- Calculation of capital cost per occupied bed, to which the return on capital benchmark is applied, see Section 2.11.1

- Adjustment for occupancy, if any, see Section 2.11.2
- The approach to calculating confidence intervals for the median total costs, see Section 2.12
- Special local factors, if any, see Section 2.13.

2.11.1 Sensitivity to capital cost per occupied bed

Actual values of capital costs per occupied bed are calculated from the toolkits as freehold valuation divided by number of residents. In some cases, particularly in affluent areas where developers have targeted the private pay market in recent years, land and build costs for high specification homes may be considerably greater than the council is reasonably willing to pay for a standard physical environment for council placements. For the purpose of determining a fair cost of care, therefore, councils may reasonably wish to supersede the freehold valuations per occupied bed reported in toolkits with a suitable benchmark value.

LaingBuisson has addressed this issue in its *Care Cost Benchmarks* model by gathering evidence on the cost of developing a new-build care home constructed to a standard specification in an area of moderate land costs. The projected (national) land and build cost at April 2022 is calculated at £110,000 per registered bed (equivalent to £122,000 per occupied bed at 90% occupancy). This is viewed as the **ceiling** asset value that councils may wish to fund in order to incentivise the development of new capacity. The **floor** asset value, according to the *Care Cost Benchmarks* model, is approximately £30,000 per bed, representing converted care home stock on the borderline of registrable quality. Assuming an even spread of stock between the floor and ceiling, in line with the national balance between converted and new build stock, the average capital value is about £70,000 per registered bed (£78,000 per occupied bed) nationally. This is a benchmark that may be suitable for a council which seeks to support existing capacity sustainably, but not incentivise new care home capacity.

Our recommendation is that, for the purposes of calculating a fair cost of care for council supported residents, the median freehold valuation per bed derived from toolkit submissions should be capped at a maximum of £110,000, being the estimated build+land cost of developing a new care home to a standard mid-market specification. The median freehold valuation from the toolkit submissions was slightly lower, at £108,097 per bed, meaning that the cap did not apply for Peterborough.

2.11.2 Sensitivity to occupancy rates

Care home occupancy rates in many council areas are still recovering from excess deaths during the Covid pandemic, and possibly from a dampening of demand as a result of negative experiences during Covid. There is a case, in principle, for adjusting the median costs in Table 4 (which are based on 2021/22 occupancy levels) to take account of possibly higher average occupancy rates by April 2022, or to adjust costs to an ‘efficient’ benchmark, which might be in the region of 90%.

While the council may take occupancy rates into consideration when looking at market sustainability and setting fee rates for 2022/23 and beyond, we do not recommend making any occupancy-based adjustments to the median costs set out in Table 4 for the purposes of FCoC, for the following reasons:

- Based on validated submissions to date, occupancy rates in most council areas are not substantially different from national, sector-wide pre-Covid averages;
- Occupancy adjustments would need to make assumptions about fixed and variable costs of care homes, which may be contentious; and
- Any adjustment introduces an additional layer of potential contention, and begs the question: why not consider other adjustments?

The potential impact of adjusting calculated median costs, to reflect a benchmark occupancy rate of 90%, is set out in Table 5, though it requires an assumption on fixed and variable costs. For illustration, we have arbitrarily assumed that 75% of average care home operating costs would remain fixed as occupancy changed within the observed rate and the selected benchmark, and that 25% would be variable, varying pro rata with occupancy. The resulting counterfactual differences in median total costs are illustrated in Table 5. If any occupancy adjustment is proposed in subsequent market sustainability work, we would recommend the council consult with providers regarding the appropriate method of adjustment.

Table 5 Illustrative impact of superseding the median toolkit occupancy rate with a ‘counterfactual’ benchmark occupancy rate of 90% , assuming that 30% of operating costs are fully variable and 70% are fixed within the range bounded by the benchmark occupancy and the toolkit median occupancy

	Non-Nursing	Non-Nursing with enhancement	Nursing	Nursing with enhancement
Calculated value of the occupancy adjustment (£ pw)	-£46	-£46	-£59	-£60

2.12 Confidence intervals

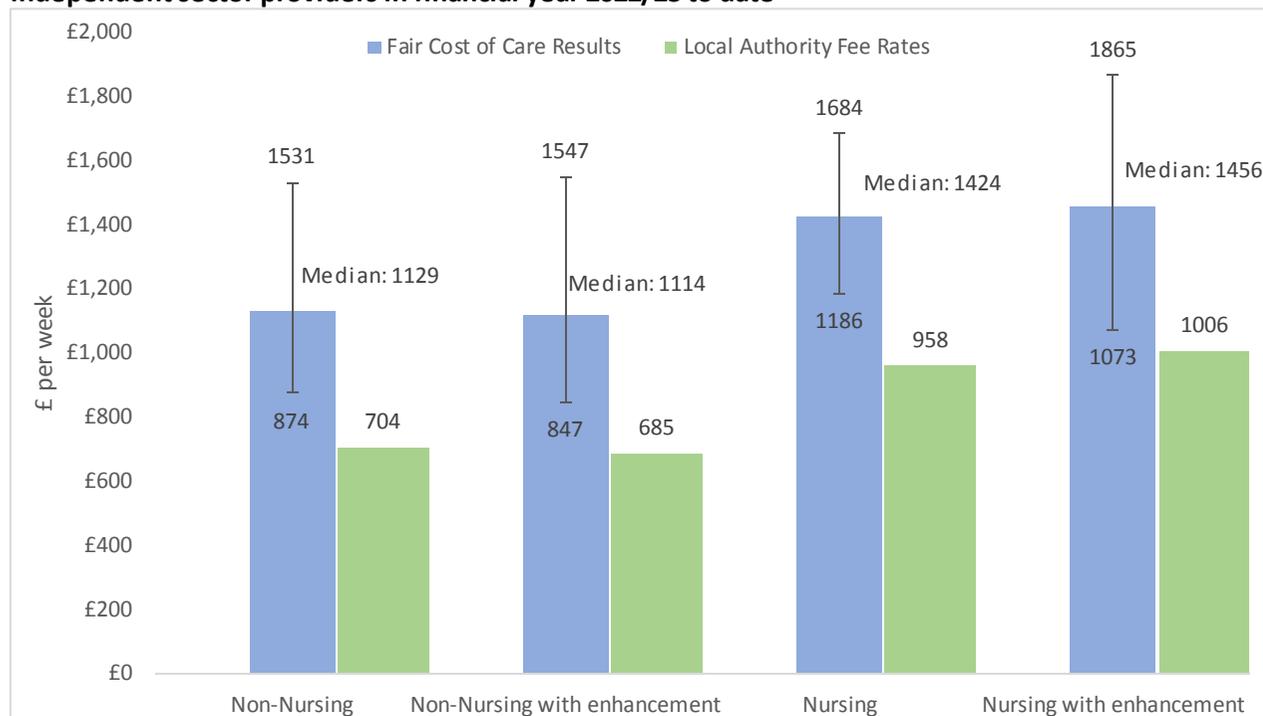
While there is no reason to believe that the toolkit responses were biased in any systematic way¹⁰, the number of respondents in any given council area was limited and there was a high degree of variance in many of the cost lines submitted by respondents. In particular, staff input per resident per week, which is the largest single driver of costs, was highly variable across homes within each of the four modalities of care considered¹¹.

DHSC guidance does not ask for any assessment of the statistical reliability of the FCoC results. However, because of the relatively low number of validated responses, and the high degree of variance among the sample of toolkits in most of the cost lines, councils will wish to have some indication of margins of error, and particularly whether confidence limits for the FCoC medians overlap with average fees currently being paid by councils in the 2022/23 financial year. Calculations are set out in Figure 2.

¹⁰ We cannot, however, rule out the possibility that providers may have overstated their costs, and it was not practicable within the timescale available to carry out a range of checks applied by LaingBuisson in other cost of care exercises, including requesting evidence of staff costs from payroll records.

¹¹ Variability in staff input is consistent with all previous cost of care exercises carried out by LaingBuisson. It may be attributed to a number of factors including the dependency levels of residents, the capacity of staff to cater of different levels of need and the scale and physical layout of homes. The absence of homogeneity means that cost of care exercises cannot aspire to identifying a single 'true' cost of care for all efficient providers, not even when segmented into the four modalities of residential / nursing / enhanced / not enhanced. In the absence of any more developed needs matrix than exists at present, cost of care exercises can only aspire to identifying a reasonable sector wide average, or median, around which the costs of individual homes inevitably vary.

Figure 2 Fair Cost of Care median costs for April 2022 with 95% confidence intervals, and comparison with fee rates paid by Peterborough City Council to independent sector providers in financial year 2022/23 to date



Note: The Local authority nursing care rates include £209.19 per week funding contribution from NHS FNC

2.13 Special local factors

Every local care economy is different, but there are no special features of the Peterborough market which justify variation of the analytical approach adopted for other councils that LaingBuisson has supported in the national FCoC exercise.

2.14 Conclusions

The key item of data that the national FCoC exercise has sought to reveal is the gap (if any) between the calculated median cost of care and the fee rates currently being paid by councils, in order to inform policy decisions on the quantum of the gap to fill (if any) and the pace at which it can be filled with the resources available.

The results summarised in Figure 2 indicate that there is currently a substantial fee gap in Peterborough for all four care modalities. The fee gaps, as measured by the differences between the FCoC medians and the average fees currently paid to independent sector providers by Peterborough City Council, range from £425 to £466 per week.

The FCoC medians, however, are subject to margins of error, and the fee gaps are smaller when measured by the differences between the lower 95% confidence bounds of the FCoC medians and the average fees currently paid by Peterborough, with fee gaps ranging from £67 to £228 per week.

Therefore, Peterborough City Council can be confident that real fee gaps do exist, and that the minimum quantum of these fee gaps are £170 for residential, £162 for residential with enhancement, £228 for nursing, and £67 for nursing with enhancement, these being the gaps between the rates the council is currently paying and the lower bounds of the 95% confidence limits of the calculated FCoC medians.

These numbers can be viewed as the minimum fee gaps for Peterborough City Council to seek to bridge, with the pace of bridging subject to available resources.

In considering the confidence intervals and results of our analysis in Peterborough, one must also consider that there is a direct relationship between the small sample size even after bringing additional Cambridgeshire-based care homes, and the size of our confidence intervals, and by extension, the confidence it is possible to have in the results presented in table 4. The confidence intervals vary between almost £500 and almost £800 in width. This gap represents the range we can be 95% confident the fair cost of care is within. Though we can say that the minimum gap Peterborough should aim to bridge would be the £162 between the current rate paid and the minimum confidence interval for enhanced residential care, it is necessary to consider that this is essentially the lower boundary in the £700 range of plausible fair cost values for enhanced residential care based on a small, and not perfectly representative sample.

2.14.1 Segmentation into standard and enhanced care

In many ways, the segmentation into standard and enhanced care in the DHSC reporting template is unhelpful. There is no clear definition of 'enhanced' in the CareCubed cost collection tool (though it was widely interpreted as dementia). Second, the segmentation is not necessarily aligned with the tiered fee rates that local authorities have adopted to recognise the variability of needs that they are purchasing care for. Third, the segmentation means that FCoC

medians must be calculated on smaller numbers of respondents than otherwise, meaning that the margins of error are wider and anomalies such as enhanced care medians turning out higher than standard care are more likely to occur.

The conclusions from the FCoC exercise may have been more readily actionable if segmentation had been simplified to nursing and residential care only. This would have led to greater certainty (lower margins of error) in the calculated medians, and greater certainty on the 'fee gap' (if any), leaving local authorities with a simpler target of setting locally appropriate tiers of fee rates such as to move the overall average fees they pay towards the single target median (one for nursing and one for residential), subject to the availability of resources.

The latest DHSC guidance, dated 25 August 2022, effectively recognises that market segmentation is best left to local discretion: '*median figures for the broad service types within scope (standard residential care, residential care for enhanced needs, standard nursing care and nursing care for enhanced needs)*' ... '*may oversimplify what is a complex picture of care and support needs.*' ... '*As many local authorities move towards paying the fair cost of care, it is expected that actual fee rates paid may differ due to such factors as rurality, personalisation of care, quality of provision and wider market circumstances.*'

APPENDIX 1 EVIDENCE BASE FOR RETURN ON CAPITAL AND OPERATING PROFIT PARAMETERS

A1.1 Introduction

Total costs of care services are made up of Operating Costs, derived from responses to validated toolkits, plus the following two items, which DHSC advises may be determined by councils based on available evidence:

- a) Return on Capital invested in accommodation assets PLUS return on operations, for care homes (65+); and

b) Return on Operations only for domiciliary care (18+)

After staffing, return on capital is the second largest cost line for care homes and return on operations is the third largest.

DHSC guidance on return on capital, published on June 29 2022, is reproduced in Box 1. Guidance on return on operations is reproduced in Box 2. DHSC guidance is fully consistent with the framework adopted in LaingBuisson’s Care Cost Benchmarks model, allowing the latter to be adduced in evidence in the commentary which follows.

Box 1 Return on Capital (care homes only)

Care home cost of care exercises will require local authorities to specify the amounts that they have allowed for both returns on capital and return on operations (expressed as pounds per resident per week, or pounds per contact hour). This is different from a 'whole business return on capital, which includes the return on operations within the return on capital.

Return on capital is a judgement rather than hard science, and as described below, the local authority should retain the flexibility to vary the return on capital paid to any individual provider, but the following overarching principles are relevant.

- Investment by nature involves risk. The cost of capital is the return that investors require to invest in a business. Within the care home market, return on capital payments within the care fee encourages new investors to invest in care home land and buildings and keep existing capital invested in social care rather than investing in another business with similar risk. They may cover payments such as rent and mortgages. They are an important consideration for the full economic cost of running a care home and apply to all care home providers as made clear by CMA (2017).
- Return on capital is an important consideration for the impact of section 18(3), as it is one of the main fixed costs in a care home and to some extent determines who is paying for those fixed costs.
- Nevertheless, return on capital is not a hard entitlement nor is it fully objective. There is judgement involved in setting the amounts included in the cost of care exercise, and further judgement when setting the amounts for any particular provider. The amounts included in the cost of care exercise are not intended to be fixed across all providers in the local authority; the amount paid to any one provider is a judgement according to considerations such as area and building type. It is important to balance spending on return on capital with other potential uses of public money in meeting care needs.

- It is important to remember that return on capital may in some cases be reinvested in the business. This can make their business more desirable to the market in future, and help the market develop more generally, for example by improving quality, improving efficiency, serving more people, or moving into new types of care.
- While they involve judgement, the amounts included in the cost of care exercise will need to be defensible, with the evidence that has informed them set out. The CMA (2017) suggest the cost of capital is calculated as the product of both:
 - (a) the value of the assets invested in the care home
 - (b) the required percentage annual return on capital
- There are several approaches to estimate a) and b) above, although in general, the value of assets used in the cost of capital calculation should reflect the market value of those assets. This is where local authorities may find it helpful to adopt multiple approaches to triangulate and validate their returns. For example, freehold valuations of land and buildings that reflect what those assets could be sold for as an alternative to continuing to use them within the care business.

Cost-of-care exercises should be clear about how their reported return on capital values have been calculated. Approaches including (but not limited to) those below can inform a local authority's overall judgment on the level of return on capital reported as part of its cost of care exercise. The methods below reflect that property prices and rents, and therefore justifiable levels of return on capital, vary substantially between local authorities. As discussed above, local authorities may wish to flex the return on capital value for different care homes in their area.

Potential approach 1

Providers should be asked to state the current freehold value of their care home, and the median freehold value per bed can then be calculated for the local authority conducting the exercise. There is a second-hand market for care homes which can provide a sense check. A percentage rental yield can then be applied to the freehold value per bed. For example, the commercial estate agents Knight Frank cite a 5.5% yield for core care home stock (note that it is a lower 4% for prime stock and 3.5% for super prime stock). For example, consider a local authority with a median freehold valuation of £60,000 per bed. The cost of care exercise could report a return on capital of $5.5\% * £60,000 / 52 \text{ weeks} = £63$ per resident per week.

Potential approach 2

Local Housing Allowance (LHA) is paid to Housing Benefit recipients to support the cost of the rent. The rates are set at the 30th percentile of local rents. The one-bedroom rate of LHA (minus fixtures/fittings/repairs/maintenance) can arguably be used as a proxy for the property rental element within a local authority. This is because whilst a one-bedroom flat has features that a care home does not, such as a kitchen in every flat, a care home has many communal areas that the flat would not have. The LHA rates are paid at Broad Rental Market Area (BRMA) level, and several of these areas may

overlap within the local authority's boundaries. For example, consider a local authority with an average one-bedroom LHA rate of £130 per week, and fixtures/fittings/maintenance of £30 per week, the cost of care exercise could report a return on capital of £100 per resident per week.

Source: Market Sustainability and Fair Cost of Care Fund 2022 to 2023: guidance published 25 August 2022. <https://www.gov.uk/government/publications/market-sustainability-and-fair-cost-of-care-fund-2022-to-2023-guidance>

Box 2 Return on Operations (care homes and domiciliary care)

The return on operations amounts to a reward and incentive for operating the care and support services in a care home, and as a reward and incentive for the whole business of domiciliary care. It is important to note that in domiciliary care, return on operations is the only source of profit (there is no return on capital nor any capital gains from the property). It is therefore particularly important to understand the costs of domiciliary care providers and how they are changing, to ensure that profits remain at a sufficient level.

Return on operations can be calculated as a percentage markup on operations and head office costs.

As noted for the return on capital above, providers can choose to reinvest part of their return on operations into the business. This can make their business more desirable to the market in future, and help the market develop more generally, for example by improving quality, improving efficiency, serving more people, or moving into new types of care.

Source: Market Sustainability and Fair Cost of Care Fund 2022 to 2023: guidance published 25 August 2022. <https://www.gov.uk/government/publications/market-sustainability-and-fair-cost-of-care-fund-2022-to-2023-guidance>

A1.2 Care homes

LaingBuisson's *Care Cost Benchmarks* model contains a methodology which we believe comes as close as possible to setting an objective, market-related norms for return on capital and return on operations for care homes. *Care Cost Benchmarks* have been established for two decades and have been widely used by both commissioners and care home providers seeking to find common ground on fair costs.

The starting point of the methodology is to determine a reasonable, evidence-based 'whole business' return for a sustainable care home capable of being rated Good by CQC. The whole business return can then be divided into two component parts, return on capital and return on operations, using available evidence.

A1.2.1 Whole business return for care homes

Market behaviour is the best indicator of what the benchmark for a reasonable 'whole business' return on investment should be. LaingBuisson has approached this question by seeking advice from major business transfer agents and property funds active in the care home space. The current consensus is that good-quality, modern care homes sell at a multiple of about 9x sustainable EBITDARM¹². A 'profit purchase' multiple of 9x implies in turn that investors are typically seeking a 'whole business' return of 11% per annum (that is, the reciprocal of 9). **Therefore 11% comes as close as possible to an objective, market-related norm for expected whole business returns at the individual home level¹³.**

One of the merits of the approach described is that it is independent of capital structure. It side-steps the near impossible task of calculating capital costs for an infinite combination of financing options - mortgages, other loans, leases and the imputed cost of the proprietor's own capital, or, just as bad, choosing a single capital structure as a 'standard' for the purposes of calculating capital costs.

The whole business benchmark rate of return (of 11%) is made up of two components, which are aligned with DHSC guidance:

- c) The rate of return on capital tied up in the care home accommodation asset, for which LaingBuisson recommends 6% per annum, see Section A1.2.2;
- d) Return on Operations for delivering the care home service, which Laing Buisson recommends should make up the balance of the 11% whole business EBITDARM return at the individual home level, see Section A1.2.3.

¹² EBITDARM stands for Earnings Before Interest, Tax, Depreciation, Amortisation of goodwill, Rent on leased premises and central Management overheads

¹³ In LaingBuisson's Care Cost Benchmarks model, the whole business benchmark return can be expressed in two equivalent ways: a) 11% at the home level when measured as EBITDARM (before charging corporate overheads) and b) 9.5% at the group level when measured as EBITDAR (after charging corporate Management overheads). This is a presentational change only. The two benchmarks are different ways of expressing the same thing. The 9.5% group level return implies typical acquisition multiples for an average freehold care home portfolio of a little over 10 times group EBITDAR, which is borne out by transaction evidence.

The rationale for the split is described in the next two sections.

A1.2.2 Return on capital invested in care home accommodation

DHSC guidance¹⁴ cites the Competition and Markets Authority's advice in its 2017 report on the care home market¹⁵, that the cost of capital for care homes should be calculated as the product of a) the **value of the assets invested in the care home** and (b) the **required percentage annual return on capital**. This is the same approach as used in LaingBuisson's *Care Cost Benchmarks* model.

In addition to capital tied up in the care home accommodation asset, providers will have working capital requirements, but these are relatively small and have been ignored in these calculations.

A1.2.2.1 Value of assets

The IESE toolkit for care homes contains a field for providers to record the 'Red Book' valuation for the care home in question and the year of that valuation. The 'Red Book' refers to guidance from the Royal Institute of Chartered Surveyors (RICS) on how to make a whole business valuation of a freehold care home business. It is done by applying an appropriate multiple to its sustainable annual operating profits. It should be noted that the term 'sustainable' means that any premium due to exceptionally strong management is discounted and the home is valued according to the sustainable operating profits that the valuer considers competent replacement management could achieve.

The 'Red Book' valuations in the care home toolkit returns have been adjusted for inflation (since the year of valuation) and expressed as a 2022/23 £ value per resident in the home by the home master spreadsheet which accompanies this report. Among the 4 Peterborough toolkits (and Cambridgeshire toolkits which were chosen for inclusion) which reported valuations, the median figure was £2,073.09¹⁶ per resident per week. This can be accepted as a reasonable estimate of the median value of all assets invested in care home stock for older people in Peterborough.

[Annex E: further detail on return on capital and return on operations - GOV.UK \(www.gov.uk\)](#)

¹⁵ <https://www.gov.uk/government/publications/care-homes-market-study-summary-of-final-report>

A1.2.2.2 Percentage annual return on capital

The provision of care homes in the UK now takes place almost entirely outside the public sector. It is mainly undertaken by for-profit providers and will remain so for the foreseeable future. Care home development and operation is viewed by the business community as a moderately risky activity and investors in care home property, whether they are care home operators themselves or third-party property investors, expect a reasonable rate of return on capital. From a public policy perspective, the return should be sufficient to:

- e) Attract investment in new care home capacity to meet potentially increasing underlying demand driven by the ageing population;
- f) Incentivise existing operators to continue in business and upgrade their physical assets where appropriate;
- g) Encourage providers of new and existing homes to make services accessible to publicly as well as privately paying residents.

An objective measure of the annual cost of providing the accommodation (property) is required, independent of the care and other services provided within the property. This is readily available from the price that a care home operator typically has to pay for a long-term (c. 25 years) lease on a turnkey care home asset. Much of the care home capacity that has come on stream in recent years has been financed by this means¹⁷. The consensus view is that a yield of 6%-7% plus would be expected by a property investor leasing premises to an operator with a moderate covenant, though a yield of as low as 5% may be adequate for assets leased to the handful of operators with a strong balance sheet and excellent covenant¹⁸. These rates can be equated to the cost to a care home business of providing accommodation. The range is higher than a typical mortgage rate because it reflects the cost of (riskier) 100% finance.

Based on this evidence, **LaingBuisson's Care Cost Benchmarks model proposes a Return on Capital benchmark rate of 6% per annum for care home property**, being at the lower end of the yield range of 6%-7% plus for care home operators with a moderate covenant, which is representative of the bulk of the UK care home market for older people. This conclusion is consistent with the DHSC 'Potential approach 1', as set out in Box 1.

¹⁷ There are now two London Stock Exchange quoted property investment companies, Target Healthcare REIT and Impact Healthcare REIT, specialising in financing new care home developments under arrangements in which the property investor owns the freehold and, 'as landlord', leases the asset to a care home operator 'tenant' at an escalating rent for a typical period of 25 years. There are also several European and other overseas-based property investors which are active in the UK market,

¹⁸ The DHSC guidance (Box One) notes Knight Frank's citation of a 5.5% yield for core care home stock (or 4% for prime stock and 3.5% for super prime stock). These rates, however, are only available for care home operators with a good covenant in the form of a strong balance sheet. Most care home operators are viewed as having a moderate covenant only, and would expect to pay a higher yield for 100% finance.

We have rejected the DHSC's 'Potential approach 2' as set out in Box 1. We do not believe that LHA rates can be considered a good proxy for sustainable care home returns since the risk profile of residential property investment is different from the risk profile of care home investment.

A1.2.3 Return on operations for care homes

In the approach described above, the benchmark for return on operations can be derived by deducting the benchmark return on capital for the care home property asset (6%) from the benchmark whole business return on investment (11%, see section A1.2.1). The difference is 5%. However, this needs to be expressed not as a return on capital but as a mark-up on operating costs and head (in line with DHSC guidance, see Box 1).

After adjusting for the different denominators, **the return on operations benchmark can be re-expressed as a 10% mark-up on care home operating costs and head office costs.**

There remains a subsidiary question over whether the mark-up should be the same for not-for-profit care homes as for for-profit care homes, given the typically lower profitability (surplus) aspirations of not-for-profits.