National Living Wage: coping with the cost

Many care homes are fighting for survival following the introduction of the National Living Wage, according to care home specialist Caresolve.

The company has carried out analysis showing the likely impact on an average operator's profits based on the phasing in of increases in the NLW during the period 2016-21.

The Chancellor's Autumn Statement in November confirmed that the NLW will increase to £7.50 per hour from April this year. Previous announcements have put in place a target of £9 per hour by April 2020.

The analysis has factored in a corresponding increase of average weekly fees of 2, 3 and 4%, each April in line with the increases in NLW. It assumed an occupancy level of 95% throughout and that similar NLW increases will continue beyond April 2020.

Caresolve's findings showed that an increase in weekly fees of 2% per annum will result in profits plummeting to 70% of current levels by 2021. Even an increase of 3% will be insufficient to maintain profits at the current level beyond 2019.

RICHARD SHORE: 'Many care homes are literally facing a fight for survival.'

"Our analysis reveals the potentially devastating impact the National Living Wage will have on care homes across the UK," said Caresolve's finance director Richard Shore. "The sector is already under immense pressures, but the NLW is probably the single biggest issue keeping both large and small care home operators awake at night. Many care homes are literally facing a fight for survival.

"Unless they take urgent steps, there is no question we will be hearing about hundreds, perhaps thousands of homes, closing due to the financial stresses caused by the NLW."

Caresolve has put together a 10-point guide to help operators address the impact of the NLW:

1. Understand and control your cost base.
2. Look at the dependency calculation for each resident based on specific nursing/care inputs, and prepare appropriate calculations for the cost of care for each.
3. Look at the profitability of your service provision.
4. Consider changing your service provision, e.g. is there an unmet demand in your area that could command higher fees/better occupancy rate?
5. Ensure key staff are aware of the true regulatory position of the business at any point in time.
6. Ensure that the business is underpinned by strong regulatory compliance.
7. Review all suppliers and supplier contracts.
8. Ensure recruitment and HR procedures are robust and the right people are in the right positions.
9. Ensure you retain good staff to avoid unnecessary cost and disruption.
10. Benchmark your business against your competitors.

Caresolve works with care home operators and their professional advisers to help them achieve excellence in three key areas – operational, financial and people.

The company is run by directors Ben Challinor, James Parkin and Richard Shore who together have more than 50 years' experience working in the care sector.

Caresolve is based in Tattenhall, Cheshire, and works with clients across the UK.

www.caresolve.org.uk

DEMYSTIFYING THE MARKET

FMOP and the 'Reasonably Efficient Operator'

With **SAM WRIGHT,** associate with the healthcare team at Knight Frank.

If EBITDA is the basis used for analysing the financial performance of a business, why do valuers use FMOP? And what exactly is it?

FMOP is Fair Maintainable Operating Profit. It is a forward looking assessment of the future level of sustainable profit the business should be able to generate in a normal year when traded at a mature level by a Reasonably Efficient Operator ('REO').

So that the profit metric used is transparent and can be compared to historical trade and other comparable properties, for care homes our FMOP is usually an assessment of normalised EBITDA or EBITDAR (the R being rent for if it's leasehold). We explained EBITDA in the February issue of *Caring Times*.

A key component of the FMOP is this concept of a Reasonably Efficient Operator. Defined as a 'competent operator, acting in an efficient manner', it means that the FMOP should reflect how a reasonably efficient operator would expect to operate the business, rather than how it is performing at that point in time. Consequently, while an assessment of FMOP should take into account historical trading (as it reflects how the business has actually performed) and the physical nature of the property, it should also reflect the levels of revenue and costs that are being achieved by its competitors. This can result in the assessment of FMOP being significantly different to the actual levels of EBITDA being produced.

At first glance, this approach can appear counter intuitive because it seemingly artificially inflates the cash flows of businesses that are operating poorly, while suppressing those of a business that are outperforming, but it doesn't really. This approach simply reflects that which a likely purchaser would take were they looking to buy the property. While they will of course have regard to historical performance, they will ultimately be trying to calculate the level of profit that they think they will be able to achieve.

As such, if a property has only historically traded at an occupancy of 50% but they think they can achieve 80% they are likely to calculate their offer on that basis. Conversely, if a business is achieving a very high profit margin (perhaps because of an element of personal goodwill) that is out of kilter with its competitors, it would be logical for a purchaser to discount their projected profit.

If these adjustments aren't made by a prospective purchaser, they run the risk of over paying for an income they will never be able to generate or receive, or risk being outbid by another operator who sees the potential in the home. Valuers are simply looking to mirror how a potential purchaser would assess the business were it to come to market and so to take this into account we use FMOP.