Cairneagle Insight

Healthcare – December 2010

Local authority spending on adult social care and the impact of budget cuts

Cairneagle has surveyed 80 local authorities regarding their provision of adult social care in order to reveal the current state of the market. We have also analysed future local authority spending plans in light of the Comprehensive Spending Review (CSR) in order to project market trends out to 2015.

The 28% cut in Government-funded local authority budgets by 2015 combined with the increasing use of call monitoring and direct payments will increase pressure on social care providers. We continue to expect a significant amount of consolidation and the on-going emergence of buy-and-build ventures. Entrepreneurial companies, with effective consumer offerings to take advantage of the growth in private pay and personalisation, should be able to generate strong earnings growth despite the challenging market conditions.

We have also carried out a survey of Primary Care Trusts to map the trends in the continuing care market and to assess the future impact of GP consortia commissioning. The high level findings are described in a separate publication.

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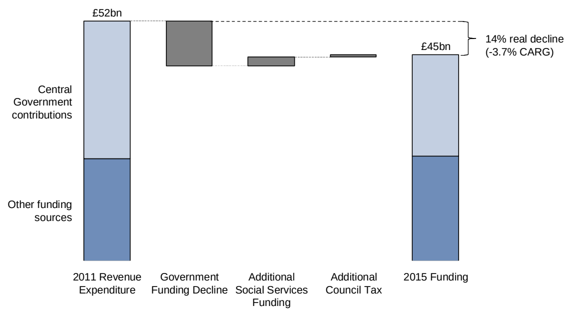
- Despite the CSR cuts not coming into effect until next year, LA expenditure on adult social care is expected to decline by 3% this year following 4% growth last year
- As budget cuts take effect, we expect total spending on social care to be flat until 2015. In real terms this is equivalent to a decline of almost 2% a year
- Care for adults with learning disabilities continues to grow, due in part to PCTs completing the migration of learning disability social services to LAs
- The shift from establishments to homecare and supported living was particularly apparent last year, although this trend appears to be partially stalling
- Call monitoring continues to show increased uptake with 47% of LAs expecting to adopt this in FY10 (from 27% in FY09)
- The personalisation agenda is showing huge momentum

Section 1: Impact of Comprehensive Spending Review

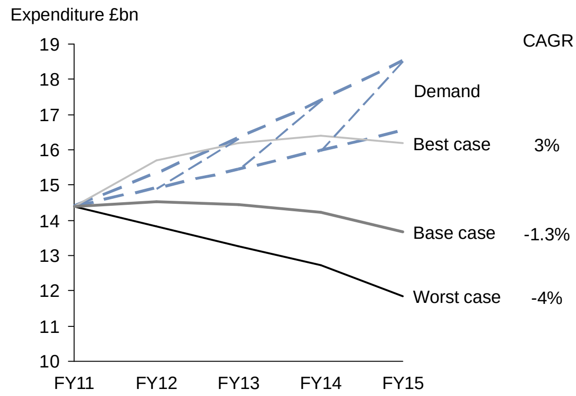
The Government's recent Comprehensive Spending Review will see local authority revenue expenditure fall by around 14% in real terms over the next 4 years

A. Change in LA budgets 2011-2015



- Overall LA funding will decline by £7bn, in today's money, by 2015
- This is equivalent to a 3.7% annual decline, or 1.8% after factoring in a 2% inflation rate
- In the Spending Review the Government revealed plans to provide an additional £2bn of funding for social care by 2015, half of which will come from the NHS
- However there has been a move away from ring-fenced funding, with the total number of specific grants reduced from over 90 to less than 10 which increases the uncertainty over total spending
- Internal efficiency savings may allow LAs to increase the funding of some council services
- Of the £52bn of LA spending, social care accounts for £15bn. The remainder incorporates housing, highways and transport and cultural and environmental planning
- Our discussions with local authorities suggest that these services are more likely to see deeper cuts to their budget than social care

B. LA adult social care real expenditure scenarios



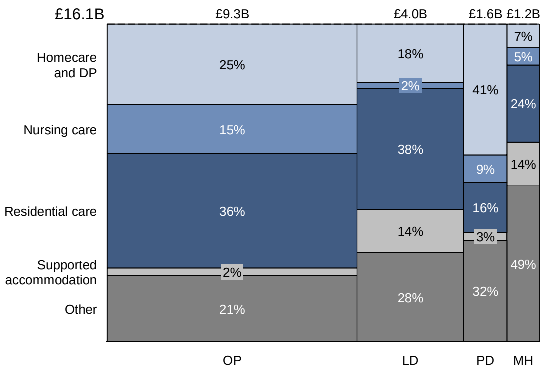
- The graph above shows three scenarios for LA spending on adult social care. *Note: the growth rates are all before inflation*
  - High Case: social care funding remains at FY11 levels with the additional £2bn as detailed in the Spending Review
  - Low Case: social care funding declines in line with LA budget cuts despite the additional ear-marked funding
  - Base Case: social care funding declines in line with LA budget cuts, with the additional ear-marked funding as detailed in the Spending Review
- The Local Government Group has forecast that in order to maintain the current level of social care, funding requirements could increase by as much as £6bn by 2015 driven by demographics and increased patient care costs
- In practice, the number of older people receiving LA funding will likely decline over the next few years despite the increasing number of older people. Those individuals receiving the lowest levels of care will be most at risk from service cuts

Note: FYXX is the 12 months to March 20XX

Section 2: Context – Historical Overview

The local authority adult social care is a £16bn market

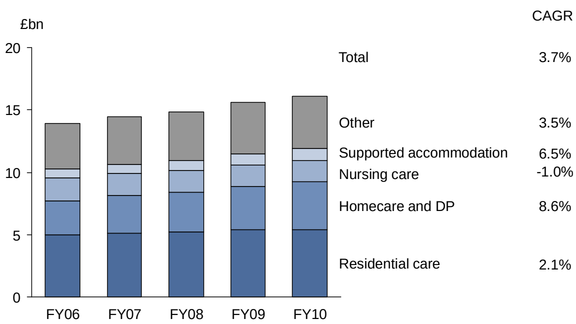
1. Gross current expenditure on adult social care FY10



Source: The NHS Information Centre
Note: older people (OP), learning disabilities (LD), physical disabilities (PD) and mental health (MH)
The £16.1bn includes non-LA funding sources

The adult social care market has been growing at just under 4% over the last 4 years

2. Historical gross expenditure on adult social care

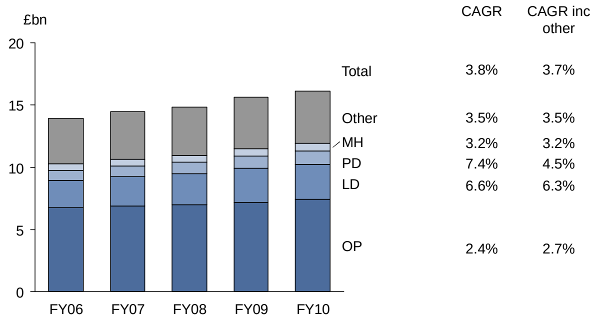


Source: The NHS Information Centre

- Homecare, direct payments and supported accommodation have all been growing strongly at the expense of residential and nursing care
- "Other" services, which include equipment, meals and day centres, have been growing broadly in line with the market

The more acute segments have been growing faster than older people care

3. Adult social care by segment

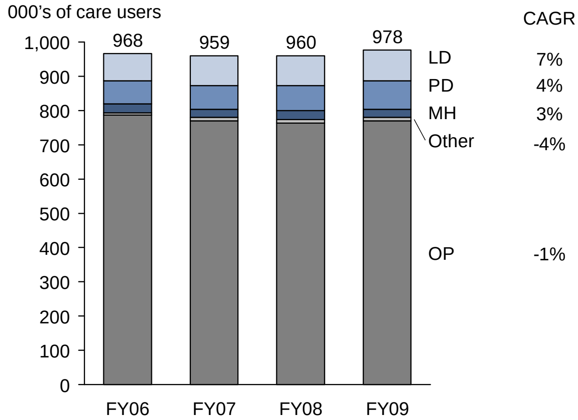


Source: The NHS Information Centre

- LA expenditure on care for individuals with learning and physical disabilities care has been growing strongly over the last five years
- Following the 'Valuing People Now' LD strategy paper, LAs have been gradually taking responsibility for all LD adult social care, with PCTs retaining responsibility for the healthcare component
- £1.3bn of NHS controlled care funding for LD has been gradually transferred to LA control over the last few years. While most of this funding will have been already captured in the LA data at the gross level (the LA spending figures include the net amount plus funding from other sources including the NHS), it may have marginally distorted the growth rates upwards
- A key implication of this reallocation of NHS spending has been that service providers have had to form new relationships with commissioners

LD patient volumes have experienced the strongest growth

4. 2006 – 2009 care users by segment



Source: The NHS Information Centre

Note: FYXX is the 12 months to March 20XX

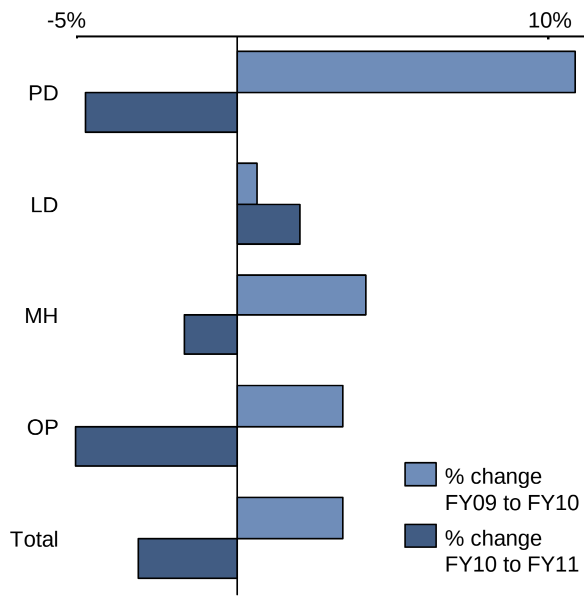
Section 3: Cairneagle survey of Local Authorities

Cairneagle has surveyed 80 local authorities to gauge the current state of the adult social care market

- This survey was conducted before the Government Comprehensive Spending Review came out
- As well as looking at the high level spending patterns, we have analysed the impact of direct payments, personal budgets, call monitoring and block contracts, while drilling down into pricing trends and the level of outsourcing to the private sector
- Expected budget figures are gross expenditure (including other income sources). The FY10 data is published by NHSIC

Total LA spending on social care is expected to fall by 3% in FY11

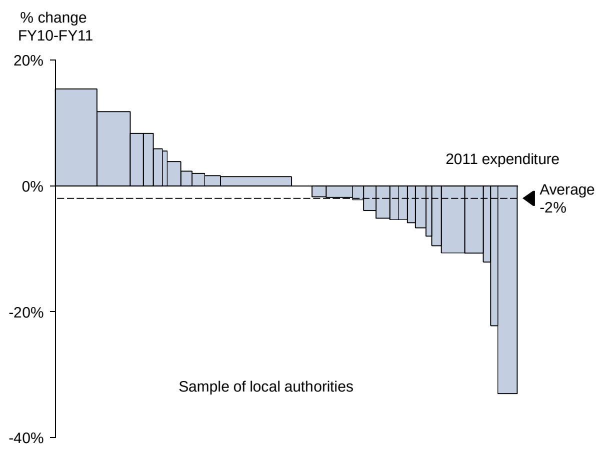
1. Expenditure growth by segment



- Total expenditure on adult social care is expected to drop by £360m in FY11
- Just over 60% of local authorities cut their spending in FY10 while 71% are expected to cut their spending in FY11
- LAs are budgeting for a 5% reduction in spend on older people in FY11, which accounts for approximately 60% of total LA spend
- LD is the only segment not expecting to experience a material expenditure decline in FY11. This is partly driven by the migration of care recipients from PCTs to LAs
- PD is witnessing the biggest negative swing in growth
- Our data also breaks out the market growth for independents (i.e. the portion that LAs outsource to third parties) which is growing faster than the overall market
- Within each segment, there are significant differences between the growth rates for homecare, residential care, nursing, supported accommodation and direct payments

At a local level, there can be significant changes in social care budgets from year to year

2. Change in outsourced social care budgets by LA

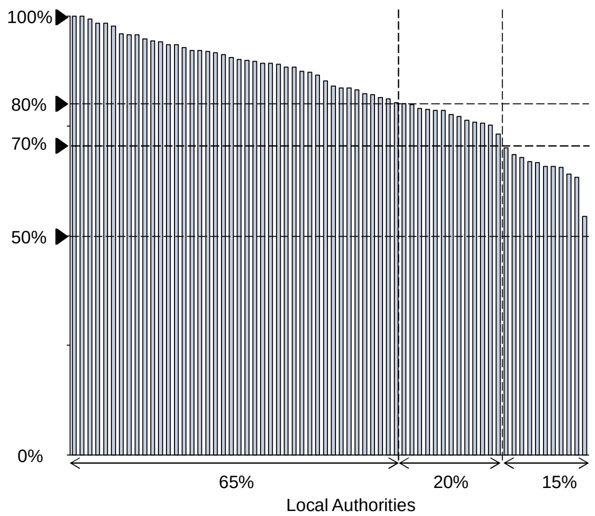


- Reliance on a small number of local authorities is risky
- The annual variation is even more extreme at a segment level, such as mental health, where there may be few cases per local authority
- Any sales targeting initiatives should factor in the degree of outsourcing still available in each region

Note: FYXX is the 12 months to March 20XX

The degree of outsourcing varies by local authority

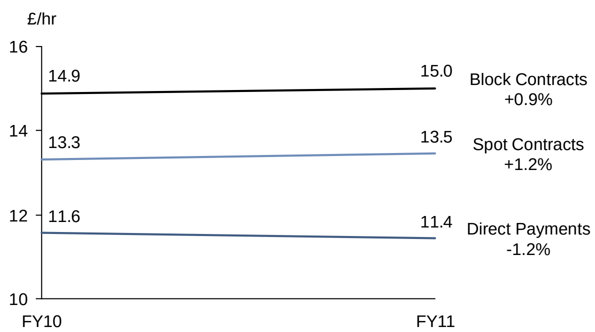
3. Proportion of homecare and direct payments outsourced by local authorities to independents



- Our previous survey highlighted an increasing trend towards outsourcing of homecare and direct payments
- The average level of outsourcing is expected to increase from 75% to 77% this year, and our regression model suggests that this trend will continue for another 4 years
- The variation in outsourcing between LAs highlights the need for care providers to carefully target the regions in which they want to work

The price of homecare services is expected to decline in real terms

4. Average price of homecare services



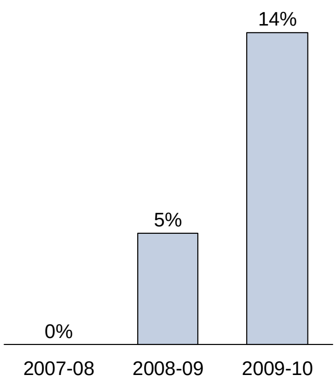
- Direct payment prices are expected to remain 16% lower than spot contracts and 24% lower than block contracts
- Many LAs are freezing prices; overall, prices are increasing below the rates of inflation
- The increasing share of direct payments is expected to continue to supress average price growth

The increasing use of direct payments is expected to continue into 2011

- The use of direct payments has been growing rapidly, driven by ring-fenced government funding and targets to increase the percentage of eligible users on direct payments from 8% in March 2009 to 10% by March 2010 and 30% by March 2011
- According to our survey, LAs are broadly on track to meet the targets, despite much scepticism in the industry
- Given the low average pricing for DP, this will continue to suppress margins
- This trend provides opportunities for more nimble operators with efficient sales targeting and marketing operations, and companies who get awarded large block contracts will likely see a large proportion of their expect hours lost

The use of individual budgets grew three-fold

5. The number of people with individual budgets relative to the number receiving homecare, direct payments and supported accommodation



- The number of people with individual budgets has increased significantly over the last 3 years
- Uptake is lowest among older people and highest for those with physical disabilities

The healthcare market remains fragmented

- Allied Healthcare, Carewatch and Care UK were the three companies most commonly identified by LAs as one of their top 5 providers
- The market remains highly fragmented, with LAs reporting an average of 32 homecare providers
- 41% of LAs reported an increase in the number of homecare providers compared to FY09 while 33% reported no change

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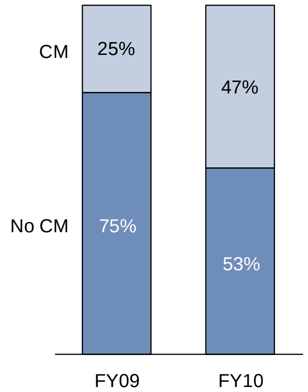
The number of LAs using call monitoring increased from 25% to 47%

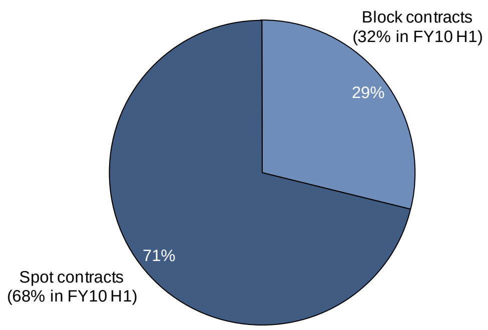
6. Proportion of LAs that implement call monitoring



- Only 21% of LAs identified call monitoring as mandatory with nearly 60% stating they had no plans to make call monitoring mandatory in the future
- Of those LAs currently implementing call monitoring, 73% of hours are provided under call monitoring
- Given that call monitoring makes the homecare service more transparent, the increased use of call monitoring has the potential to suppress revenues as well as the appetite for carers to work
- Companies must ensure that procedures, IT systems, and carer training are all aligned to minimise potential negative impacts

The proportion of hours on block contracts continues to fall

7. FY10 homecare hours split between spot and block contracts



- Block contracts continue to account for only a third of hours
- The proportion of spot contracts has increased slightly from our previous survey

About Cairneagle

Cairneagle Associates is a boutique strategy consulting, venturing and advisory firm with a commitment to helping its clients to maximise the long term value of their businesses.

We combine leading edge strategic, financial and operational disciplines in an integrated approach to identify and prioritise issues, develop strategies and align client organisations to deliver sustainable improvements in business performance. We typically work with chairmen and chief executives, and often take an active role in the delivery of key initiatives when appropriate.

Our boutique operating model means we can be extremely flexible in responding to client requirements and can supply experienced consultants, industry experts, seasoned interim managers or high firepower teams as required to help our clients. Our distinctive approach to consulting owes much to our involvement with ventures. In ventures, there is reward only for success. In consulting, making our clients successful is often explicitly part of how we are rewarded.

We have strong links with banks and private equity and are able to help companies to secure financial backing. We conduct due diligence assignments for corporates as well as for private equity firms including transactions ranging from £20 million to over £1 billion in value.

Please contact Matt Cooksley on 0207 036 9400 or matt.cooksley@cairneagle.com if you would like to discuss the content of this report or if you have any business issues where you believe Cairneagle may be able to offer assistance.

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