RESPONSE OF FPCFPC AND THE NIC WORKING GROUP TO THE COUNCIL'S PROPOSALS FOR CHANGES TO ITS USUAL PRICES FOR 2016/17 FOR OLDER PERSONS RESIDENTIAL CARE

Dear Steve

Please note below our response to the consultation on the council's usual price for 2016/17.

1. **We consider the consultation to be invalid as there is no clarity on the price that most providers will receive under the proposals.**

   We note the ongoing communication between providers and the council, seeking to clarify the council's position on the interaction between proposed increases in the usual price and third party top-up payments received by providers. The failure of the council to clarify its position with respect to 16/17 means that a substantial number of providers (who accept third party top-ups) are unable to understand what the impact of these proposals will be.

   Despite various late clarifications being issued, providers are still unclear about the impact of increases in the council's usual price on what they will receive. The latest verbal clarification received by one provider at 5pm on the closing date of the consultation is:

   the council will pass on increases in its usual price in full to all providers irrespective of top-ups received; and

   the top-up amount will remain unchanged from previous contractual top-up rates plus inflation, notwithstanding that a proportion of top-ups were credited back to payers in 15/16.

   Providers are still not clear on what happens in cases were the council funds care on its own account in excess of its usual price.

Notwithstanding our objection to this consultation, given the council's refusal to our previous request to withdraw from this flawed and invalid exercise, we offer the following comments on the assumption that all providers will benefit from the proposed uplift as verbally confirmed by the council above.

2. **Issues pertaining to the council's cost model and uplift mechanism.**

   The council relies on its cost model in assessing the inflationary pressures on providers and so in determining its uplift proposals. Unfortunately, the council's model is faulty in a number of respects including, but not limited to, the areas set out below. The result of this is that the council underestimates the costs and the inflationary pressures which providers face:

2.1 Direct and Indirect Staff Costs

The council ignores and/or departs from direct empirical evidence in relation to staffing hours without explanation. Such a departure is irrational.

2.1.1 The council fails to use empirical evidence in relation to staffing levels

Norfolk Independent Care previously gathered and supplied the council with raw data and analysis on staffing levels at older persons care homes across Norfolk. The data is robust and representative, covering providers with c.2,000 beds. Though the council has adjusted its estimate of care staffing levels during the consultation process for deriving its 15/16 cost-model, the council's cost model still fails to fully allow for the staffing levels presented in evidence. The council provides no rationale or explanation as to why it departs from evidence gathered from providers. We summarise the data below:

Category	NIC Evidence Submitted (Hours per service user)	NCC Cost Model (Hrs per service user)
Residential – Standard	25.88	20.91
Residential – Enhanced	29.39	25.76
Nursing - Standard	23.8	21.4
Nursing - Enhanced	23.6	23.4

The data has been discussed in more detail in previous submissions and meetings with the council, and we refer the council to previous submissions in this regard. In particular, we urge caution with respect to interpreting NIC data for 'Nursing – Enhanced' care hours due to the small sample size and other data considerations (this group reported higher nursing and activities hours).

To the extent that the council relies on data from NorseCare homes in support of departing from the above evidence, we point out that there is good reason why NorseCare is not representative of the independent market, and why the council errs in this regard:

- It continues to effectively be NCC's policy that service users are placed in NorseCare homes in preference over independent providers' homes in order to utilize its 'block contract'. This means that referrals to independent homes are frequently for more complex needs than can be met at NorseCare homes and so independent homes require additional staffing input. Indeed, we are aware of many cases where a service user is transferred from NorseCare homes to independent homes due to complex needs not being met, and are not aware of any such transfers in the opposite direction;

- By virtue of its more generous funding arrangements from the council, NorseCare is able to offer more generous terms to employees and regularly attracts more experienced care staff away from the independent sector. This may enable NorseCare to achieve efficiencies in staffing that the independent sector is unable to match due to inadequate council funding.

If the council is to avoid misdirecting itself with regards to setting fees for 16/17, it should base the staffing assumptions in its cost model on reliable empirical evidence from providers.

2.1.2 The council under-estimates the impact of NLW and NMW on provider costs

2.1.2.1 The council does not account for the impact of NorseCare submissions on NMDS data

The council uses NMDS data for care homes in Norfolk to estimate staff pay rates in its model. As pointed out above, NorseCare pays significantly higher rates of pay than most independent providers and is able to do so by virtue of the generous subsidies it receives. As NorseCare submits NMDS data and represents a significant portion of the market, the care staff pay rates on which the council's model relies are skewed by NorseCare submissions and overstate the pay costs for independent providers.

To illustrate – median NMDS care staff pay rates for Nursing Homes (where Norse does not submit data) were approximately 10% lower than that for older persons Care Homes in 2015/16 (which includes Norse submissions). To take account of the 'skewing' of NMDS data by NorseCare submissions, in our analysis, we take the 40th centile figures (instead of the median figure) as representative of the independent sector. This results in pay rates consistent with the data gathered by NCC from 35 homes in its own data gathering exercise.

The impact of the council's over-estimate of pay rates in its model is that the higher pay rates partially compensate for the lower number of care hours alluded to in 2.2.1 above (see comparison table attached) in 15/16. However, for the use of inflated pay rates in the cost model means that for 16/17 ***the council substantially underestimates the impact of NLW on independent providers.*** We quantify our assessment of the impact below.

We call on the council to review its cost model in light of the evidence above in order that the model more faithfully reflect the costs and cost pressures providers face. The council should not rely on a defective model in settings its fee rates.

2.1.2.2 The council ignores the importance of maintaining pay differentials.

The council makes a number of faulty assumptions in calculating its the impact of pay rate uplifts for 16/17 - approaching the issue by looking at the minimum theoretical uplift, rather than a fair estimation of the actual uplift. Recent NMDS data, which includes pay rates for April and May 16 following the introduction of NLW, shows that the assumptions underpinning the council's approach are clearly false. It should be no surprise to the council that pay rates have risen sharply (more than theoretical minimums) as the sector continues to combat staff shortages and a high turnover rate of almost 40%.

The council also fails to take into account the impact of higher gross wage rates on its on-cost assumptions. Higher pay rates result in higher average Employer NIC costs, as additional pay attracts the marginal NIC rate of 13%.

- **Under 25's pay rates:** The council assumes that care workers aged under-25 will receive a 1% uplift in pay. **This is demonstrably false**, for even though these workers will not be impacted by NLW legislation, their pay will still be subject to NMW uplifts of c4%. In addition, pressures on recruitment and staff turnover mean that many employers will offer the NLW voluntarily to those under 25 in order to retain experienced members of staff, and there will be an on-cost effect through higher NIC contributions. Taking these factors into account, a 5% uplift would more reasonably reflect the increase in pay, rather than 1%. (See table attached)

- **Over 25's earning below NLW prior to April 16** - The council assumes that these staff will only have their pay increased to the NLW without any maintenance of existing differentials above NMW. While it is difficult to estimate what the increases for these workers may be, it is unreasonable to assume that employers will abolish all differentials and simply raise the tail to a level of £7.20. The latest NMDS data shows an average of 49p (c6%) in hourly rates for median care workers, and this rises to 56p once (c6.8%) once the additional marginal cost of employer's NI contributions are taken into account.

- **Over 25's earning in excess of NLW prior to April 16.** The council assumes that these workers will also only benefit from a 1% uplift. The latest NMDS data (April/May 16) shows that this assumption is without basis – for example for Senior Care workers in independent care homes the median wage has risen from £7.41 per hour in 15/16 to £7.73 per hour in April/May 16, an increase of 4.25% or £0.33 per hour. While there has been some compression of differentials, the 1% figure is clearly wrong.

Taking all of these factors into account, using the council's own blending rates and NMDS data from April and May 16, we calculate that the average pay rate of care staff **has** increased by circa 6.2% over 15/16 rather than 2.97% as the council contends. This higher figure should be applied to the councils' model for direct and indirect staff costs in assessing the uplift for 16/17. Given the context of a 9% rise in NLW and c4% rise in NMW, the figure is reasonable and supported by NMDS data. Detailed breakdown of the above calculations are set out in tables attached to this response.

2.2 Other costs

We accept that in the absence of any specific cost pressures, application of the forecast CPI is a reasonable mechanism for determining uplifts for accommodation cost.

2.2.1 Returns on Capital

With respect to the returns on capital, we find that the council's approach to determining this amount is flawed and irrational. Simply put, no provider would seek to engage in this market, and invest their equity at risk where returns are so low (c4.9% in the council's model).

The care home market operates with significant risk to the equity investor – including occupancy risks, staffing risks, regulatory risks, competition and other general business risks. More significantly, care home investors face the risk of substantial capital losses should a care home fail, as the value of a vacant care home is usually substantially below its value when trading. Furthermore, care home assets eventually become unfit-for-purpose (as the council is aware in decommissioning older homes) reducing the long-term value of the investment. Contrast this proposition, with a 'buy-to-let' residential investment where most of these risks are negligible. For a property investor, the asset is more liquid, and the long term capital gains are greater as there is no risk of obsolescence. Given that average rental yields are 5% for buy-to-let investors, it stands to reason that a sustainable market in care cannot ensue with similar returns, as risk-adjusted returns are greater elsewhere.

We note that having consulted with providers over a 7% return model in December 2015, the council decided to change its approach thereby significantly reducing the costs in its model. The resultant return on capital of £49 per room per week is wholly insufficient to sustain and promote the market and will deter investment in new homes in Norfolk. The figure is patently unreasonable. It is c50% below the cost of renting purpose built student accommodation in the county (which has lower capital requirements) and is less than 50% of the return calculated in the L&B model and 25% below the council's approach in its December consultation.

As there is no evidence to support the council's contention that this is an acceptable rate of return, and evidence supports that continued investment in the sector is only feasible with higher returns - the council should revisit its

methodology in this regard without the pre-determination to come to a low figure.

We note that the council does not propose any uplift in the value of capital return in 16/17. This is irrational as the cost of the underlying capital items would have been subject to inflationary pressures during the year.

3.1 The council's approach to setting its fee

The council errs when it considers return on capital to be an optional cost, which does not need to be covered by its usual price. The cost of capital is an actual cost, the nature of which courts accept. By stating that the council considers an acceptable range of usual prices to start with a zero contribution to capital costs (and profit), the council is in clear error.

Taking the argument further, the council's methodology for deriving the capital cost is through estimating loan repayments that a care home owner may have to make. Following this logic it is absurd and irrational to hold a position that it is acceptable for the council to make a zero or partial contribution to loan repayment costs in setting its usual price. The care home owner, reliant on Norfolk funded residents would not be in a position to meet loan repayments and the bank would foreclose. The council is doing exactly what the Care Act guidance expressly prohibits – it is setting fee rates below level that are sustainable in the long-term.

Given the under-estimation of capital costs and returns, failure to even meet these costs is not sustainable for providers in the long run.

In setting fee rates below the cost of care, the council assumes that the market is sustainable via subsidy from other income sources. Courts have rejected the proposition that reliance on such subsidy is permissible and the council has an obligation for setting fee rates (each year) which are 'sustainable in the long-run'.

The council implicitly accepts that the fee rate proposed for 15/16 and 16/17 are not 'sustainable in the long-run' as it has also proposed real-terms increases in future years to bridge the gap. It is irrational for the council to accept that higher real fee rates are required to meet capital costs in 18/19 but are not required now. The council is clearly setting current year fee rates too low to be sustainable.

3.2 Potential for Subsidy from Other Sources

To the extent that 'cross subsidy' from other income sources may be permissible (we would contend that they are not), arrangements in Norfolk make them inherently unsustainable. The only means of cross-subsidy are from third-party top-ups or self-funding residents.

Third-party top-ups and enhanced rates funded by the council are widely used as price adjustments reflecting both the higher dependency of some service users and the fact that the council's usual cost does not meet the cost of care. Where these are agreed for 'higher dependency' (equating to higher staffing costs), providers face even greater inflationary pressures due to the impact of NLW. This is not reflected in the council's proposals.

The framework contract between the council and providers prohibits providers from instituting or changing third-party top-ups for existing service users. This severely limits the ability of providers to meet their actual costs from this source of income, let alone achieve a cross-subsidy. Third party top-up amounts for individual service users have been frozen since at least before 2012 for providers and have fallen in real-terms over this period. The council now accepts that third party top-ups should rise in line with inflationary measures and in correspondence with providers it proposes to do so. However, increases in dependency driven by the council's commissioning agenda and increases in regulation and service expectations means that providers costs are set to rise by in excess of inflation. There is no mechanism by which providers are able to adjust their prices to reflect these cost pressures and make investment in improvements. The council has directly refused a request for a variation in the contract to allow for limited changes above inflation in the value of top-ups.

Furthermore, the council effectively imposed a fee cut of c£650 per service user in 2015/16 for providers that rely on third party top-ups to meet their costs. This was perverse in the context where the council accepts that its 'usual price' for 15/16 was far below the price needed by providers to meet their actual costs. This cut should be reversed in 16/17, with a one-off payment to those providers impacted, allowing them to cover the shortfall of investment in their homes.

Most providers rely on higher fee rates levied on self-funders to bridge the gap in their incomes. This differential has reached a point beyond which it is unsustainable, as the impact of NLW has pushed fee rates to record levels. Providers who need cross-subsidy for NCC funded residents are unable to demonstrate that they now offer good value for money for self-funded residents. We are seeing the emergence of a 'two-tier' care market where homes focused on only self-funded residents are able to invest in better care for a lower price as they have no need to cross-subsidise.

The council has no evidence to support its assumption that cross-subsidy is sustainable in this market and should not rely on it in setting its usual price.

4. Other matters

The council has failed to properly take into account its obligations under the Care Act. The council continues to set its usual prices at levels that destabilize the market, fail to support the development of a stable workforce or high quality of care. We draw the council's attention to the following as evidence of the lack of stability in the care market:

- There continues to be closures of nursing homes and loss of vital capacity for nursing care across Norfolk. The council's usual price for nursing bands combined with FNC does not come close to meeting the costs of this care. The council makes a great deal of the shortage of nurses driving instability in this market. While it is difficult to recruit nurses, the truth is that homes that have closed or de-registered were **fully** staffed by nurses, as they were required to under regulations. There may be reliance on 'agency' nurses working at nursing homes in Norfolk, but this does not mean that there aren't enough nurses. It is simply that current arrangements do not provide sufficient funding for operators to employ nurses at the pay rates they require for permanent employment, and homes close as operators have no incentive to continue to offer nursing care.

- The quality of care as rated by CQC in Norfolk is frequently poor, below national benchmarks and declining. This is clear evidence that the market is unstable, and that funding at levels below the cost of care is not sustainable. We note that the council only refers to the 'overall' rating when looking at CQC quality measures. While even this high level approach paints a disturbing picture, it understates the extent of the problem as providers with one are of non-compliance are still rated as 'good' overall. Providers and the council should have aspirations beyond simply 'compliance' with CQC minimum standards and these aspirations can only become possible with appropriate funding.

- The council takes no account of the very high levels of staff turnover in the independent care sector. While the NMDS data is skewed by NorseCare submissions, based on this data we estimate that workforce turnover certainly exceeds 40% and may be closer to 50% amongst care workers in independent homes. This is clear evidence of instability, and by failing to set fee levels that meet the cost of care, the council fails in its obligations under the Care Act.

We urge the council, as we previously have done, to abandon these proposals and work with provider representatives to develop proposals that bring certainty and stability to the sector.

On Behalf of FPCFPC and the NIC Working Group
24.06.2016