ICHA "State of the Market" survey 3

November 2016

Revolution Consulting

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This is the third survey of Children’s Homes providers.

The initial survey was in June 2015, and was followed by a second survey in February 2016. This latest version was carried out in October and November 2016.

Each survey provides a “point-in-time” picture of the state of the sector based on the reported experiences of providers.

Some small changes are made to improve the questions asked in each successive data collection, but there are many areas where the questions and the replies allow comparison across all of the surveys. This report therefore also looks at any trend information emerging.

A combination of factual (quantitative), and comment (qualitative) evidence was again requested via a short on-line survey.

ICHA commissioned the survey from Revolution Consulting.

Around 130 organisations accessed the survey and of these, over 100 gave comprehensive and detailed feedback to a majority of the questions. This represents an improvement on 84 comprehensive replies in the February 2016 survey and 79 full responses in June 2015.

The results can be considered to be most representative of the views of the ICHA membership. ICHA membership accounts for over eighty per cent of the independent sector and over half of the total provider sector. ICHA members operate in aggregate over 1,000 homes.

Revolution Consulting and ICHA extend their thanks and appreciation to those who thoughtfully completed the survey and for the openness displayed in the responses provided.

Commentary

This is the most comprehensive and representative survey of children's residential service providers to date.

The results illustrate a sector containing cohorts of providers with contrasting views about confidence, financial stability and the future of the sector and their role in it. On other areas, opinions on common issues coalesce.

Attention is drawn to the most significant issue, a continuation of the marked increase in referral activity being experienced by a majority of providers and the fact that occupancy rates are not responding to that increase.

The picture emerging is one of increasing difficulty for Local Authorities to find placements, especially for the most complex and challenging young people. Despite the clear benefits of higher occupancy, providers of many services are remaining very cautious, fearful of the prospect of taking a difficult to manage young person that may lead to a lesser grade by the regulator, Ofsted, and the knock-on effect that may have on future purchasing intent by Local Authorities choosing to place only in homes rated Good.

Providers with specialist services report being at the higher occupancy levels and under less financial pressure than their peers. In some segments, providers have started to be able to obtain modest fee rate increases for the first time in many years.

Providers unable to obtain fee rate increases face the same cost pressures as others from National Living Wage impact, pension auto-enrolment, and sleep-in adjustments to name just some of the inflationary pressures. In the face of an intense procurement effort by Local Authorities to contain or reduce fees, margins for some are challenged.

We therefore see a sector that perversely seems to be experiencing high demand levels but which is only partly able to respond. Some respondents express the question as to what happens when a LA fails to find an appropriate children's homes placement.

Unsurprisingly, with the above picture, viability of provision seems to be stabilising compared to earlier surveys. Equally, it should be noted 30% of the sector still reporting diminishing reserves. Though confidence is slightly improved, still 61% are unsure or less about the state of the sector. Investment and growth intent is low and at very cautious levels, and a minority are looking to exit the sector.

It is clear that the sector is looking to Government to respond to Sir Martin Narey's largely positive review of children's residential care, including its focus on how to improve the commissioning and procurement landscape.

Andrew Rome November 2016

Data analysis

How responsive was the audience for the survey?

The November survey is the most comprehensive to date with both the highest number of views and, for many questions over 100 respondents provided detailed data.

	Number of survey views	**Number of providers substantially completing all questions**
June 2015	121	79
February 2016	100	84
November 2016	130	Over 100

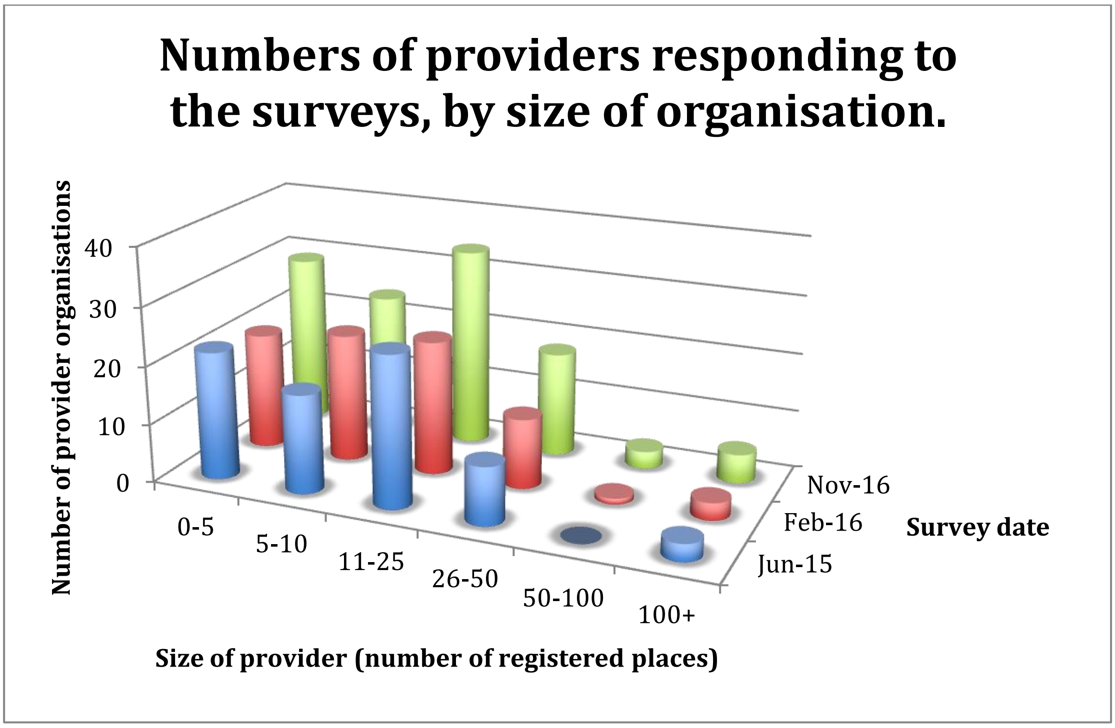
Not all respondents answered all questions. In the following analysis of data, the total number of responses for any given question will vary. Percentages are calculated based on the actual full response data only.

Who responded?

Only ICHA member organisations were invited to respond to the survey.

Disclosure of the name of the organisation providing a response is voluntary, but 92 respondents did identify the organisation they represent, a large increase from 58 and 57 in the previous two surveys.

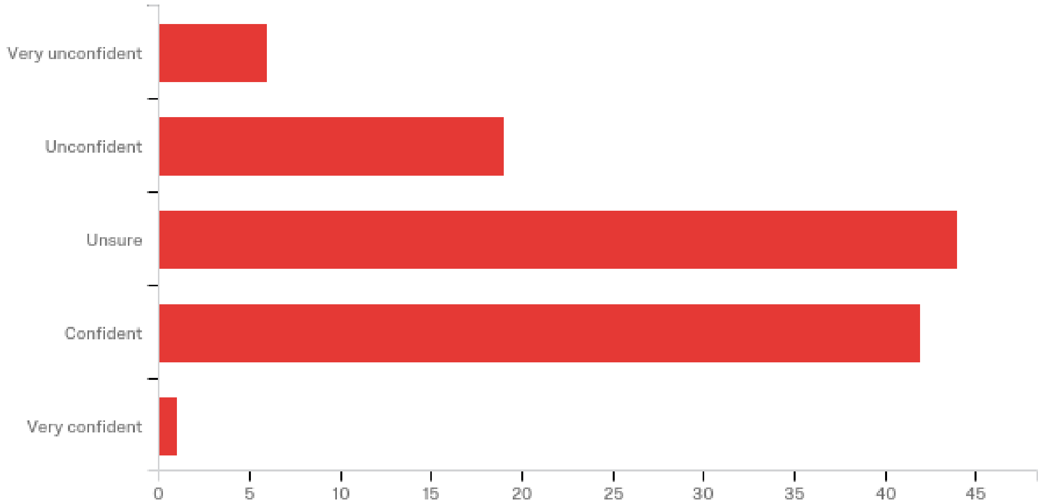
Responses again came from the full spectrum of size of provider, with strong representation of the smaller providers.



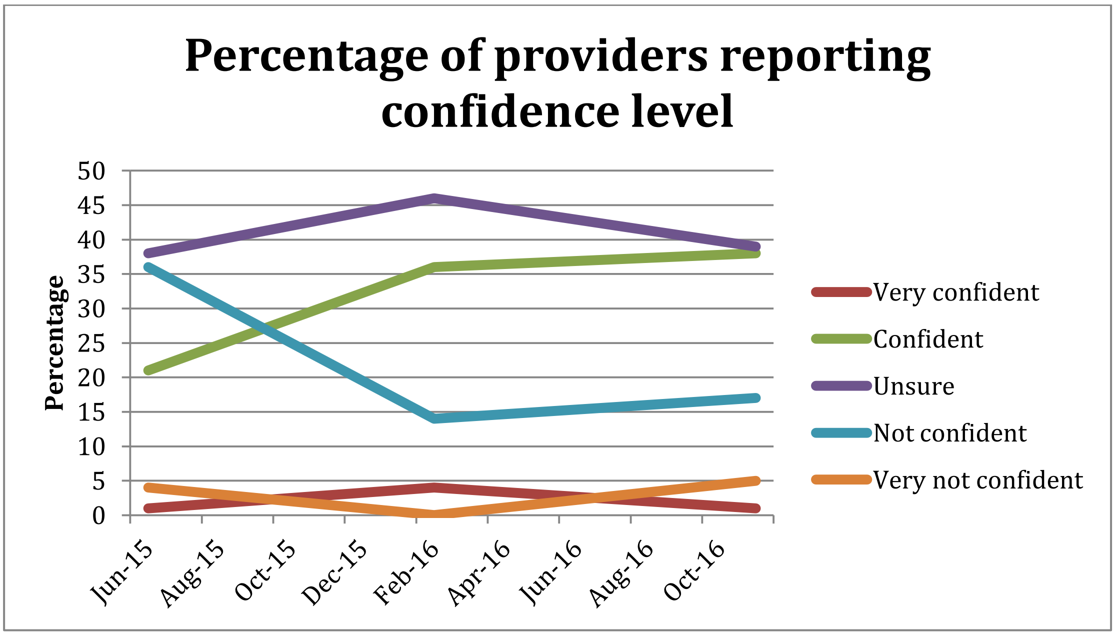
It is important to note that over half of respondents to this November 2016 survey have previous replied to one or both of the earlier surveys.

How confident are the providers about the state of the children's residential sector?

Numbers of providers reporting each confidence level (Nov 2016)



A clear majority of providers (61%) are at best unsure about the state of the sector; 38% of providers expressing confidence. The improvement in confidence levels compared to the first survey has largely been consolidated; there is a slight slippage from unsure to decreased confidence levels.



Respondents replied fulsomely (see below), when asked to describe the factors that influenced their rating of confidence in the sector. As the ratings themselves indicate there is a mix of influences offered:-

- The macro-economic picture of a long period of cuts to Local Authority budgets is well understood. Providers draw a straight line of inference from this to high levels of price pressure activity by commissioners and purchasers. There is recognition that, despite the overall cuts to Local Authority budgets, children's services has been one of the more protected areas and some providers quote this as a positive influence on their confidence level.

- On a more immediate basis, the high and increasing levels of direct referral activity being experienced is quoted as by far the most influential factor on the confidence levels expressed.

- However, the Local Authority commissioning processes come in for high levels of criticism. Tenders, frameworks, fixed prices, poor management and monitoring practice by Local Authorities of the same are all mentioned frequently in provider feedback. Poor placement and matching practice by Local Authorities is also indicated.

- In addition to high numbers of referrals, a significant number of providers also indicate a perspective that the levels of risk and complexity of young people being presented are also increased. For some (e.g. who operate specialist provision), this is seen as having a positive impact on occupancy, price and overall confidence. For many, it raises the issue of not feeling able to admit higher risk cases due to the risk of a lesser Ofsted grade. The fear of "Requires Improvement" from Good (or better) by Ofsted is seen as a factor that could make or break a smaller provider. What is perceived as the inconsistency of Ofsted judgments, allied to commissioning approaches that see Local Authorities attempting to place only in Good or better homes, still appears to be a significant factor influencing both behaviour and confidence on the sector.

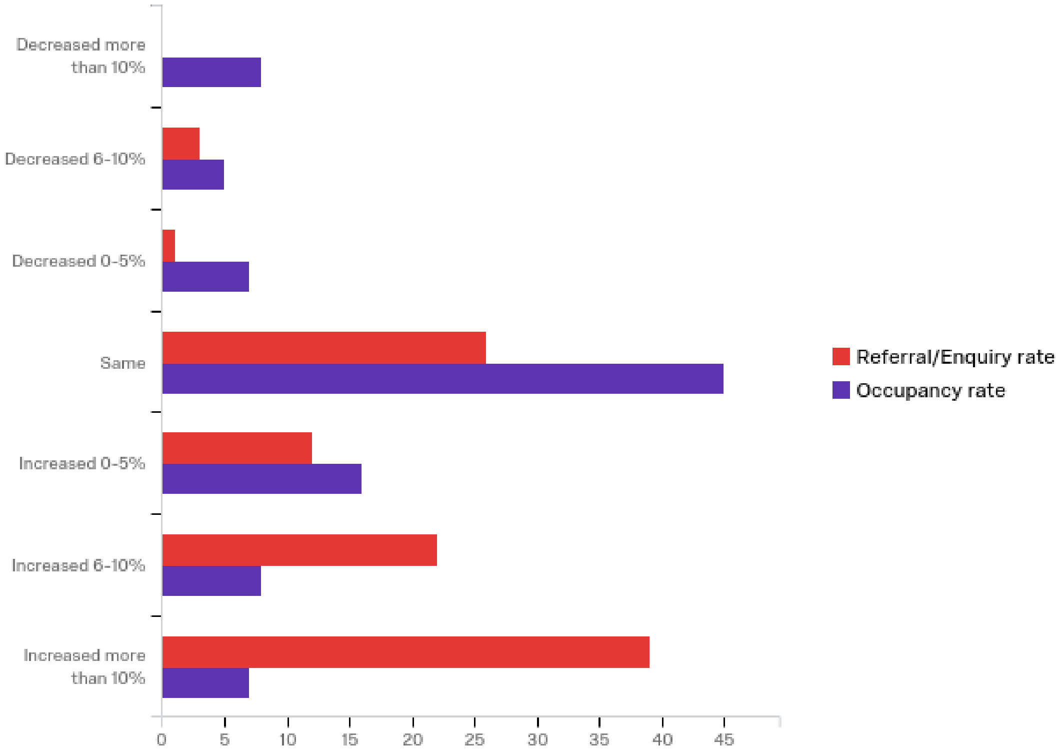
- The ability to successfully recruit both managers and staff generally appears to be an increasing issue in responses. Concerns are expressed that staff related cost increases due to Living Wage, driven pay rate increases and sleep-in costs cannot be recovered through current commissioned price arrangements.

- Hence viability of providers remains an issue reported by a number of providers. This conclusion is linked in responses to irrecoverable costs, aggressive price negotiations by purchasing Local Authorities, and an inability to admit high-risk referrals due to placing an Ofsted grade at risk.

- Those expressing greater confidence talk of a belief in residential placements always being needed, a confidence in their organisation's experience and quality of service, and of hope for a positive reaction to Sir Martin Narey's report and unity with fellow providers experienced through ICHA, along with the increasing levels of research and analysis of the sector aimed at informing policy makers.

Referrals and Occupancy – numerical data

Referral rate and occupancy trend Nov 2016 vs. previous 6 months – numbers of providers reporting each level.



Over 70% of providers report increased referral rates compared to the previous six months. This is the highest level reported in any of the three surveys. 38% of respondents report that the increase is over 10% and that too is the highest level seen in any of the three surveys.

The most striking feature of this information is that occupancy rates do not appear to respond to this increasing referral rate, with 71% of providers reporting occupancy the same as, or within 5% of the levels 6 months earlier, and equal numbers reporting higher levels of increased occupancy to those reporting lower levels. Hence, although individual providers experience ups and downs in occupancy levels, the overall effect is that the rapidly increasing levels of referrals is not translating into overall higher occupancy levels in the sector.

Comments offered by providers recognise this disparity. A number of factors are reported as the reason for this:-

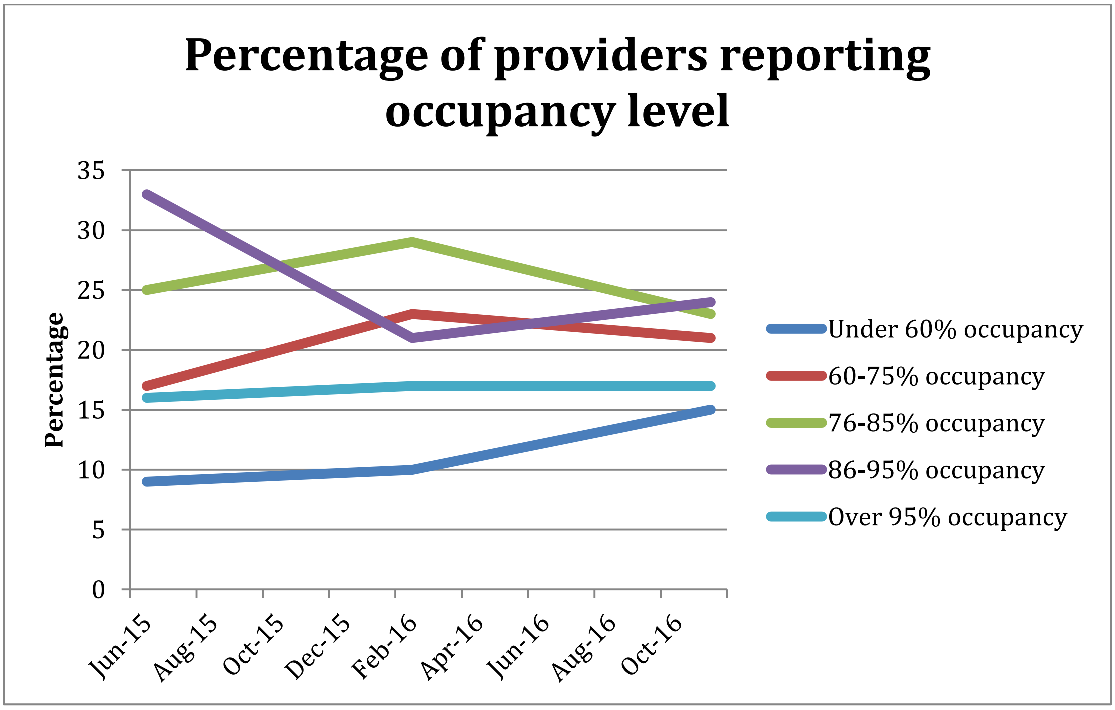
- Some providers report increased marketing activity and increased entry to frameworks. This results in much higher levels of referrals being received (e.g. electronically and on a daily basis). These referrals are not well matched to the provider's service, (e.g. not even geographically) or to vacancies and appear to involve emailing all providers. Emergency referrals are also reported by many to be increasing dramatically.

- Providers, some of whom are specialist, also report that with high or full occupancy levels, matching an individual child (with high needs) to an existing vacancy is extremely difficult so they are effectively unable to consider most referrals. Few go on to report expansion or investment plans that might change this.

- Many providers refer again to taking a risk averse approach, or from effectively being prevented by Ofsted from accepting referrals into vacancies.

- Although the number of referrals seems at a particular high level, comments from providers include observations that the same child or young person is often referred several times, indicating a protracted failure to find suitable placements, despite multiple serial attempts. This leads providers to begin to express concerns as to where the young people end up being placed.

Actual Occupancy levels trend



There would appear to be discreet cohorts of providers experiencing the sector differently:-

- The highest occupancy group, (some with particular specialisms) are maintaining that high occupancy rate, as indicated in some of the qualitative feedback. 17% of respondents again fit this category.

- An increase in proportion of providers reporting the next highest (86-95%) occupancy is accompanied by larger decreases in the proportion reporting 76-85% and 60-75% occupancy.

- Therefore there is clearly a growing cohort of providers slipping into occupancy levels below 60%. (Increased to 15% of all respondents in the Nov 2016 survey compared to just 10% of respondents in Feb 2016).

This would indicate a sector in which some are relatively stable (17%), a growing number (15%) are operating at occupancy rates likely to be unsustainable in the long-term, and the remaining group (68% of respondents) are seeing fluctuation fortunes, with a small overall increase in occupancy.

The picture of actual occupancy rates reported is consistent with a picture whereby occupancy rates are not responding quickly to the rapidly increasing referral activity.

<u>Have providers increased capacity?</u>

Percentage of respondents who have increased capacity?	Jun 2015	Feb 2016	Nov 2016
No	70	80	82
Yes	30	20	18
Total	100	100	100

A minority of providers added capacity in the last six months, continuing the downward ratio of investors seen in the previous surveys.

However, where new capacity investment was made (excluding acquisitions of existing homes by one provider from another), then some 154 beds were added. This compares to just 51 places newly registered as reported in the Feb 2016 survey.

Just two providers reported low levels of acquisition activity.

Again, the buoyant referral rates do not appear to be incentivising many providers to develop newly registered services.

The other factors discussed earlier, in relation to inhibitors on occupancy rate, may again be acting a disincentive to higher levels of investment by existing providers.

Have providers decreased capacity?

Percentage of respondents who have decreased capacity?	Jun 2015	Feb 2016	Nov 2016
No	86	92	95
Yes	14	8	5
Total	100	100	100

The providers reporting decreases in capacity have removed 19 (June 2015 - 18) beds from the sector.

The proportion of providers reducing capacity was fewer than the previous survey.

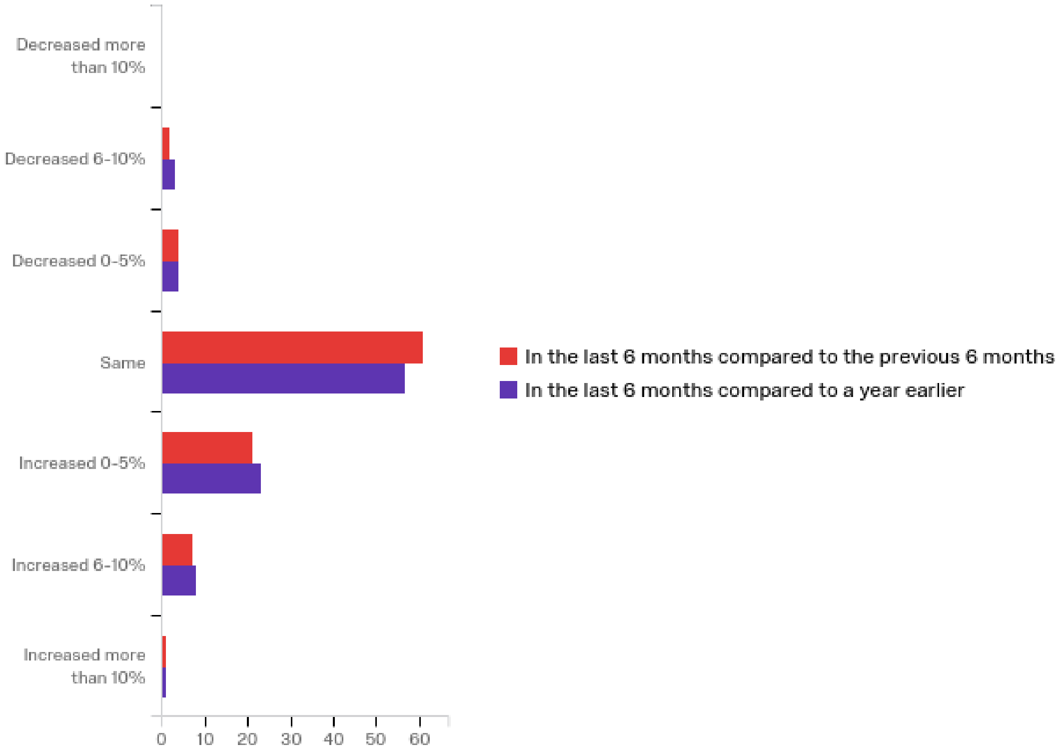
There again does not appear to be wholesale closure of capacity on a substantial basis.

The combined effect on capacity of investment/disinvestment, based on this survey, is a net growth of 135 beds. In the context of the reported demand levels, as exhibited through referral rates, this growth rate appears modest. In context it is between one quarter and one third of the number of referrals many providers receive per week.

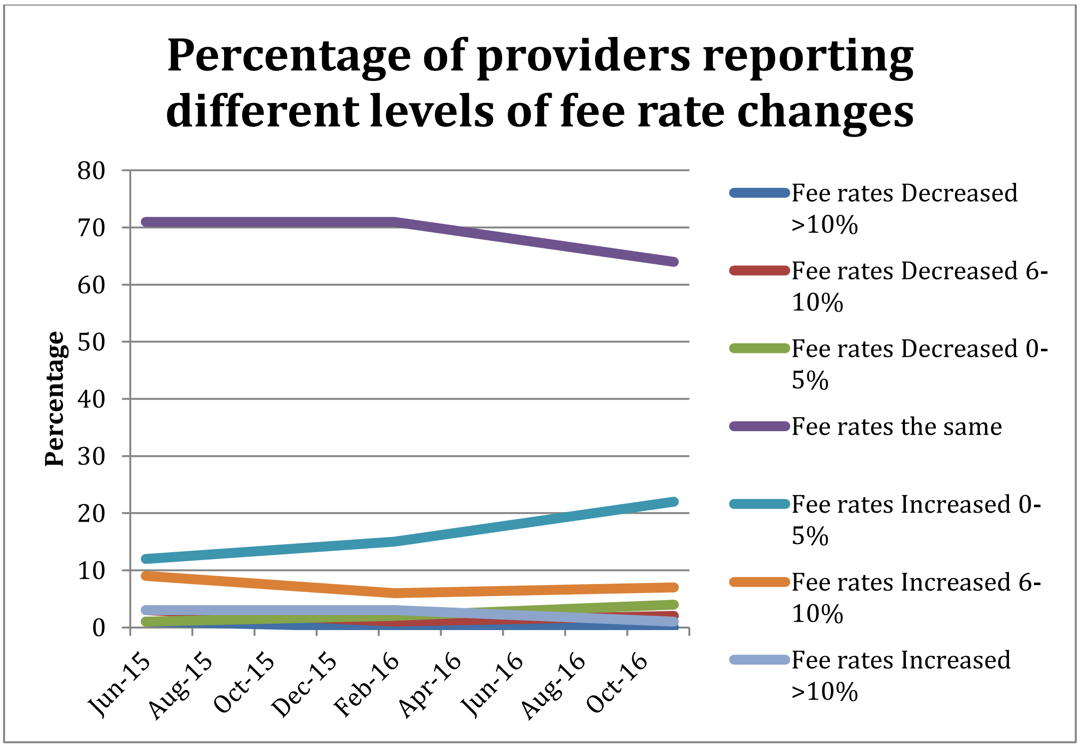
This perhaps reflects the overall risk/reward ratio perceived by investors in the sector. Although demand would seem to be high, service providers are likely to be factoring in the other challenges that inhibit occupancy growth in existing capacity. Concerns over the ability to maintain sustainable occupancy levels in existing homes have a knock-on effect that inhibits growth investment.

Prices/Fee rates

Numbers of providers reporting different levels of fee rate changes



Although the majority of providers (64%) again reported static fee rates, 22% reported increases between 0-5%, and 8% of respondents report higher increases.



These results indicate a strengthening of the signs that, after a long period where providers reported a price freeze or decline, the appearance of higher fees that first began to be indicated in the Feb 2016 survey has continued.

The comments offered by respondents in relation to the trends in pricing, reflect the different perspectives of parts of the sector.

- The most common theme is still one of Local Authorities wanting lower costs. This is sometimes linked to providers saying that Local Authorities want more service for less, or better outcomes for reduced fees.

- Against this a strong theme reported is that of provider cost increases. The impact of Living Wage is the most often quoted impact, followed by the sleep-in payments and pension auto-enrolment costs. Providers therefore highlight the contradictory pressures brought by Local Authorities wanting to hold or to reduce fee rates.

- That contradiction is felt most acutely where a provider is locked into a framework of several years in length or a block contract. Many providers report that, even where frameworks include periodic fee rate reviews, Local Authorities have held firm in largely not awarding increases.

- Several providers therefore report fees having been held for 3, 5, 7 and even 10-12 years, recognising the reduction in real terms that this represents. One reports a 3% reduction. This cohort of providers perceives the sector to be a “buyers market” still, where “regional monopolies” drive down real prices.

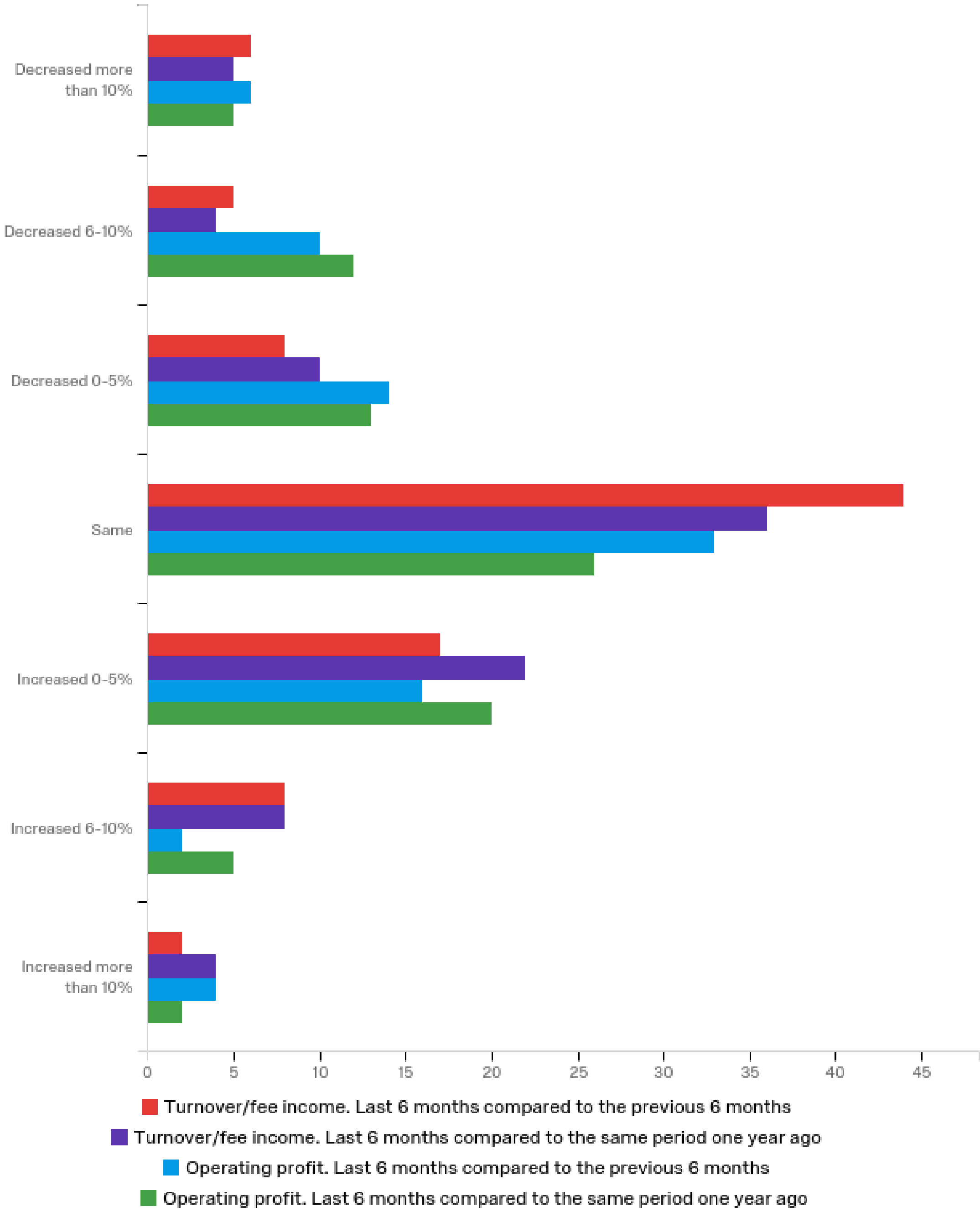
- However, a (smaller) number of providers report that their specific services are in high demand and that fee increase have been sought and gained in the most recent period, ranging from 1-4%. Others recognise that when longer-term tenders or blocks re-open that pricing will have to increase substantially in any bids.

- Other indicators of where pricing may be operating outside of these trends are providers charging additional fees for extra support (e.g. 1:1 or 2:1 staffing) case by case, and providers opting out of frameworks or offering off-framework placements at higher average fee rates.

- Comments not seen in earlier surveys were made in November 2016, in relation to late payments being experienced from Local Authorities, and reportedly of Local Authorities failing to honour higher prices agreed at the time of placement when the actual payments are made.

Turnover and Operating Profit

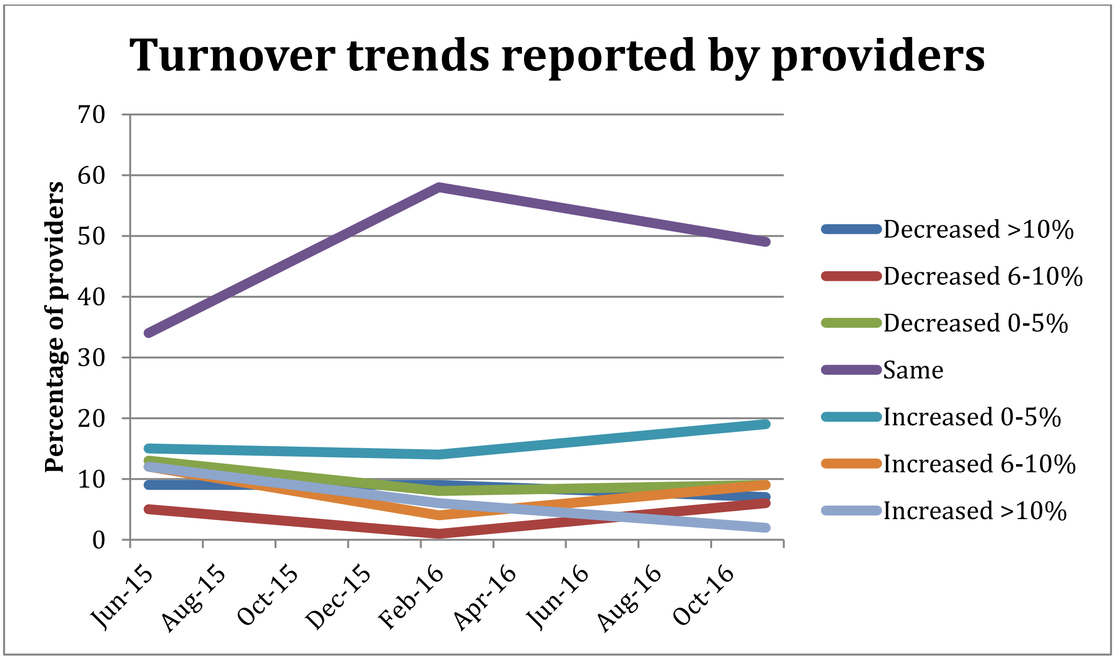
Turnover and Operating Profit trends - Number of Providers reporting different levels of increase/stability/decrease.

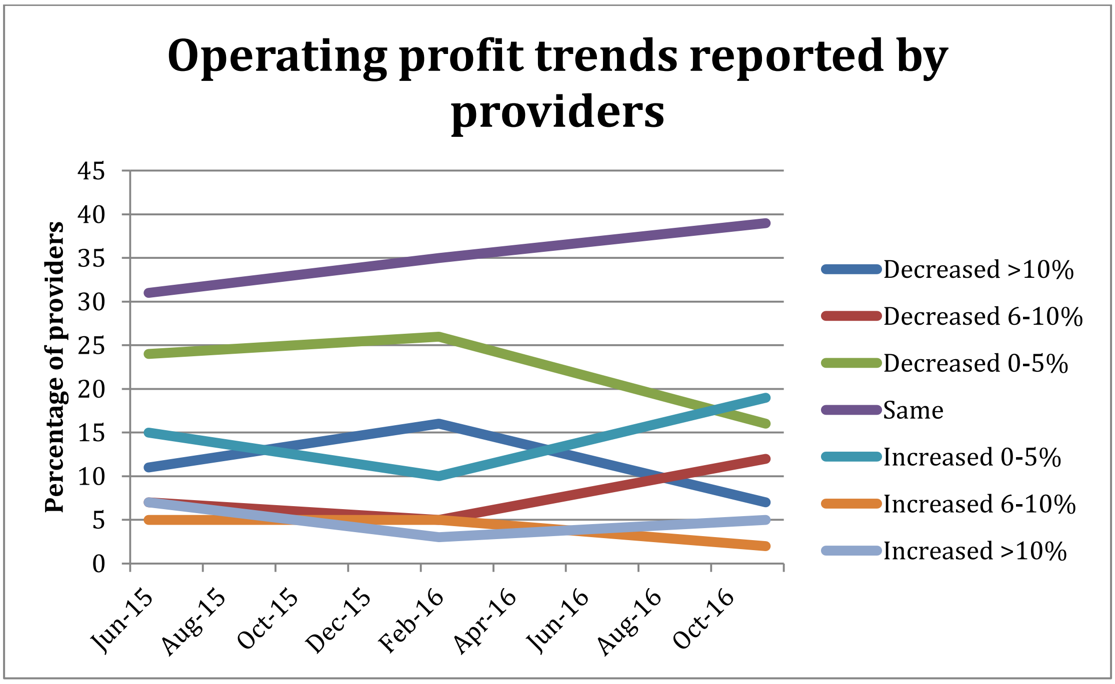


The overall picture represented here echoes much of what is observed above in relation to occupancy rates and fee rates. Where providers are maintaining stable or marginally improved occupancy rates, alongside stable or increased fee rates, then turnover and operating profits are maintained or improved.

19% of providers reported lower turnover, and 30% reported lower profitability.

Importantly, these are most likely those reporting stable or lower occupancy rates and an inability to recover cost increases through fee increases.





Previous surveys have commented on how, in any sector, competitive forces and local conditions create a mixture of winners and losers, when measured by financial outcomes. Hence, most markets will have a mixture of results reported by participants in that market, and the children's residential sector is no exception.

There are some signs here that more providers are reporting growth in turnover in this latest survey.

However, the number reporting the highest levels of growth (over 10%) is in continued decline. This is consistent with the low levels of risk taking and investment in capacity growth reported earlier.

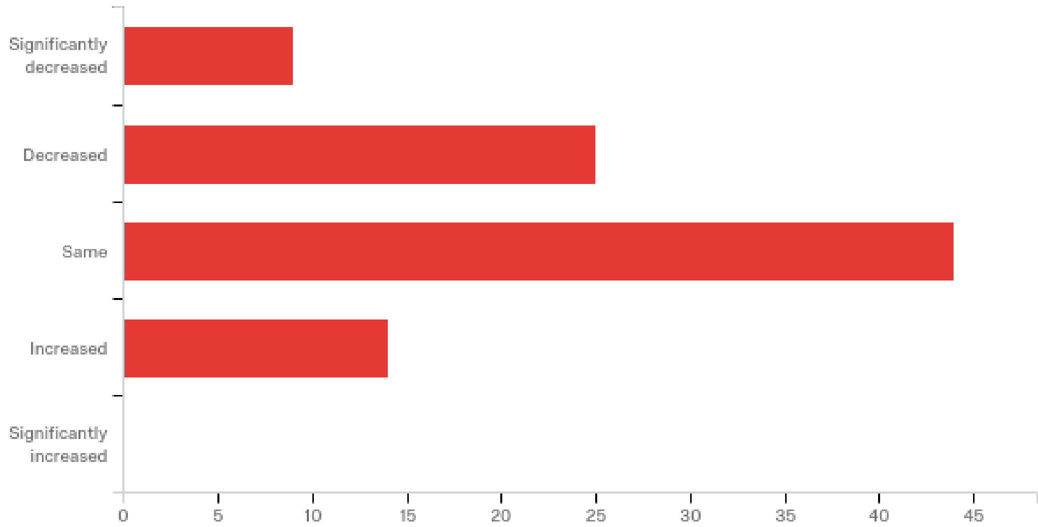
The picture presented by the operating profit trend is also mixed. The November 2016 survey includes higher proportions of providers reporting stable operating profits (39% vs. 31-35% in earlier surveys).

There are then mixed experiences of increased and decreased profitability reported. The proportion reporting 0-5% profit growth increased to 19% (vs. previous surveys at 10-15%), while the proportion reporting 0-5% profit decline reduced to 16% (vs. previous surveys at 24-26%).

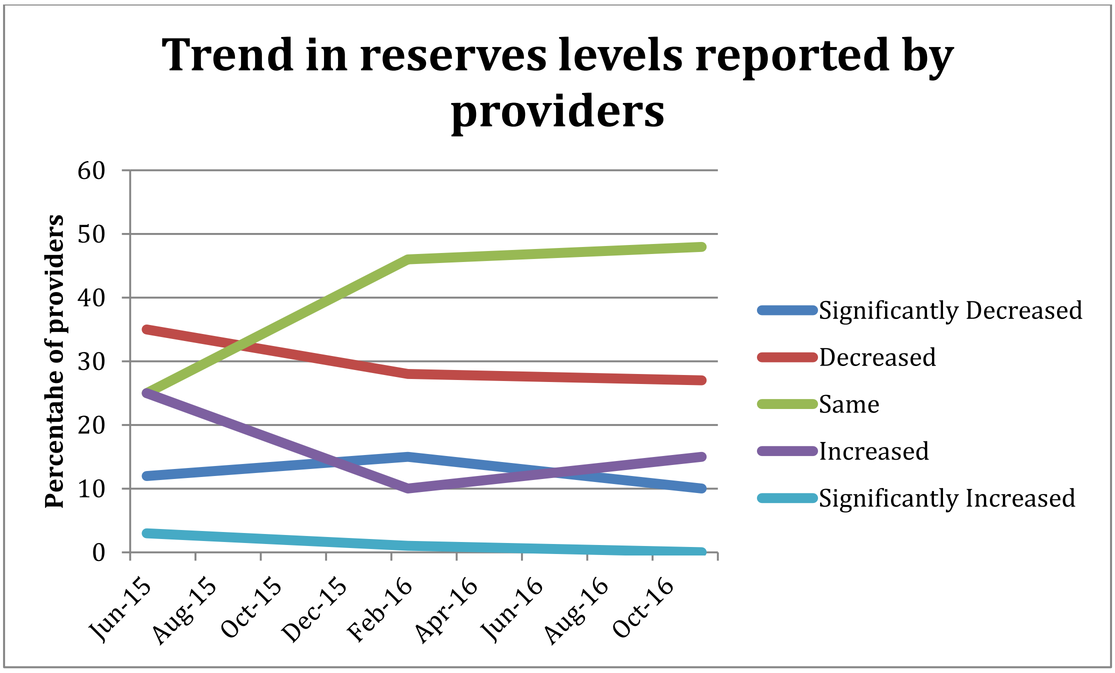
At the more extreme end of profit movements (6-10% and over 10% in either direction), the overall proportions across these groups is largely unchanged from previous surveys.

Viability and Reserves

Number of providers reporting levels of reserve movements in the last 12 months

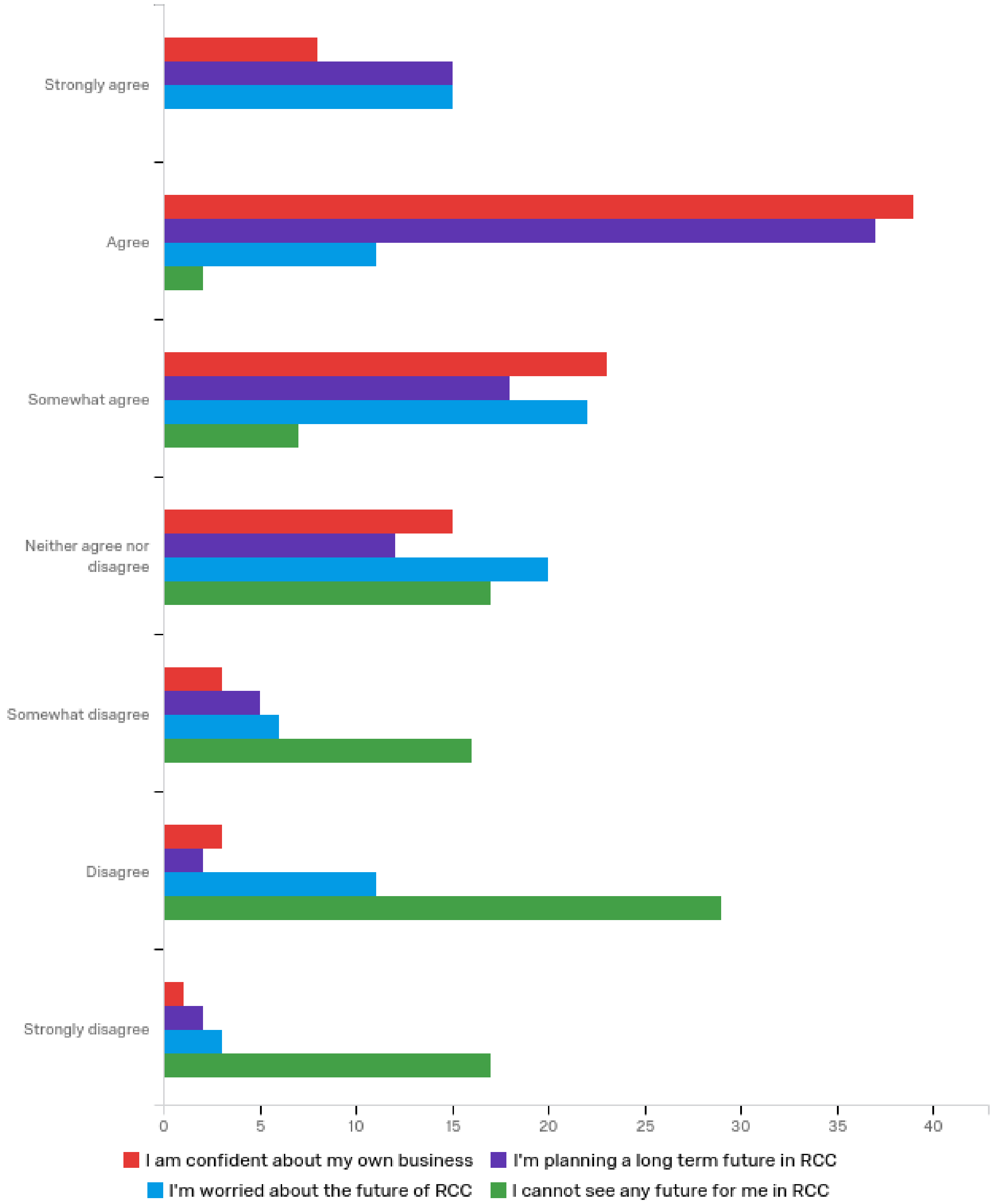


This indicator captures a view of the overall viability of providers by looking at changes in reserves levels. These will be impacted not only by the combined effects already discussed, and the operating results these produce, but also by funding structures and the servicing of debt and interest. Hence, an organisation reporting an operating profit may, after debt servicing costs, still experience a drain on reserves.



Whilst there is some greater stability indicated here, the proportion of providers reporting decreases in reserves (30%) still outweighs those reporting increases (14%).

Provider confidence and planning for the long-term future



The resilience of a majority of respondent providers strengthened in this November 2016 survey, (previously 65% in Feb 2016 and 59% in June 2015) with 70% of providers expressing some level of confidence in the abilities of their business. At the same time, there is a small increase (to 7% from 5% previously) in providers lacking confidence.

Comments and insights offered by respondents were more substantial than in previous surveys and give a snapshot of the sometimes-contradictory perspectives around the sector:

- Amongst a significant number of providers there is a robust, and sometimes long held belief that residential care will always be needed, almost to a level that is irrespective to policy direction that can favour fostering or other solutions.

- The level of referrals, especially of more complex and challenging young people who may be in need of specialist services, is also a prevalent theme.

- The introduction of Quality Standards is seen by some as having brought about improvement in quality in the sector which begins to add some much needed greater credibility.

- However, Ofsted are still the subject of significant criticism, with arbitrariness and inconsistency of inspection across the country being questioned.

- Whilst the financial pressures of rising costs in an environment where Local Authorities are seeking ever lower fees is reflected in feedback, there are also a number of providers who are keen to stress that they provide services for the children and young people first and the financial outcome is important but not the primary reason for their existence in the sector.

- The importance of unity and promotion of the provider sector through ICHA is recognised in the feedback.

- For some, be it through the attrition of the fee battles and dealing with Ofsted and staffing issues, or through impending retirement, the prospect of leaving the sector is attractive.

Intent to remain in the sector for the longer term remains strong. It is at similar levels to previous surveys, (e.g. 76-80% of providers see some sort of long-term future, and 10-11% do not).

When considering their overall feedback and attitudes to the sector, it is perhaps encouraging that the word map below (largest words highlighted are those most mentioned by providers) has “child” at the centre.