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Annex F: Market awareness and the impact of external factors

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With more than five thousand operators nationwide, there is a significant number of smaller operators many of whom are family businesses operating just one care home. This fragmented industry structure is a key reason for a large proportion of the care home stock now being at risk of becoming outdated and unfit for purpose.

This is a key risk as often most of the family wealth and source of income tends to be derived from these assets and operations and therefore there is a real need to foresee the potential challenges and meet them head-on as waiting too long yields the worst possible outcome.

The current dynamics in the industry create a favourable landscape for expansion, benefiting both larger operators and a specific subset of smaller ones. This trend can be traced back to the entry of Real Estate Investment Trusts nearly a decade ago, introducing substantial liquidity and a fresh design approach.

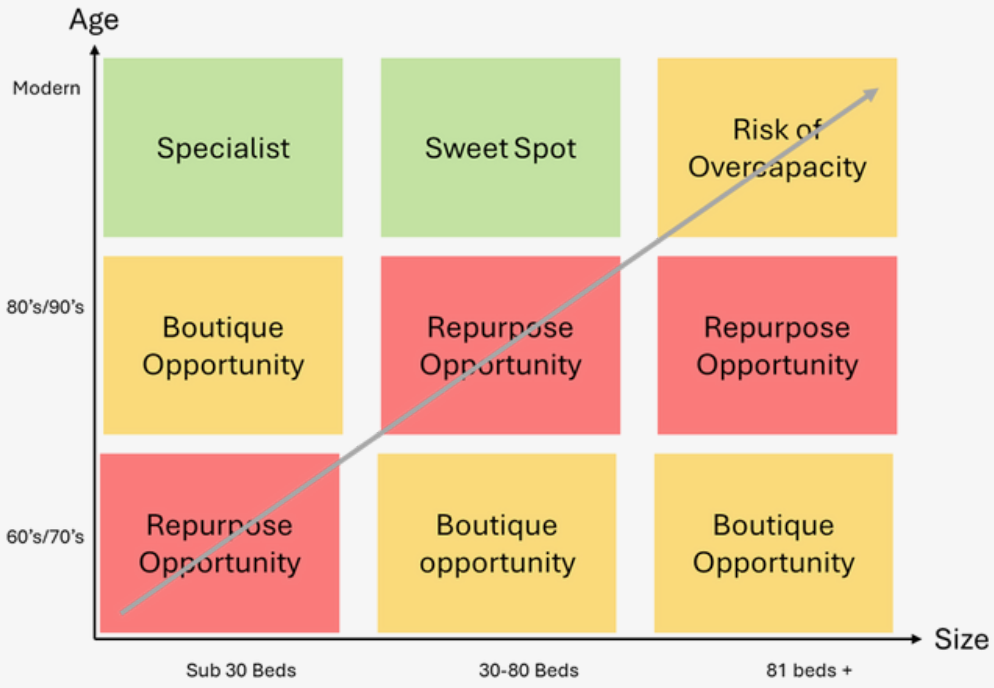
Over the years, the expectations for care home aesthetics have evolved, encompassing features like wet rooms, private dining areas, and cinema rooms.

Despite a temporary hiatus in the past 12-18 months due to a more challenging funding market, the influx of international funds into the UK market, coupled with a likely shift in UK pension funds towards fixed income amid the lacklustre performance of the FTSE stock index, suggests that the coming years may pose significant challenges for smaller operators with older facilities at an increased risk of displacement.

Operators in this category may find themselves squeezed from various angles, including heightened competition, persistent difficulties with local authority fee rates, rising costs, staffing shortages, and the prospect of a higher interest rate (compared to previous years) environment during refinancing.

The array of challenges is extensive, and it is unsurprising that, despite the emergence of new-generation homes in recent years, the net increase in bed capacity over the last sixteen years has been modest, with only thirteen thousand additional beds, as older homes continue to face displacement.

Research has identified different categories of homes based on age and size as shown by the model:



There is a strong caveat here in that this is a very high-level and overarching theme whereas the location, quality of operations and other localised factors will heavily depend on the outcome. However, generally, the homes most at risk are those counterintuitively which were the original purpose builds (first generation and second generation).

Many of these homes went up quickly, often timber frame, and now have limited space and reconfiguration opportunities which can leave them looking dated and often, after years of underinvestment, render them uncompetitive.

Surprisingly, older homes, many of which may be converted, have better future viability even if they're not fully ensuite. Often, they are more interesting buildings, perhaps even listed, and can be run or reconfigured to be homely, boutique-style homes. The least at risk are the newer, modern wave homes albeit very large ones should be mindful of local oversupply.

If your home(s) are at risk as above, subject to the localised caveats, it is important to remember that strong operations underpin the success of the home, not the real estate. There have been several instances where operators fail to run modern, state-of-the-art homes, whilst some older 'uncompetitive' homes march on due to the exceptional care.

Where a care home is facing performance risks, or the owners have been contemplating an exit in the future, it is imperative to take prompt action and seek advice immediately, as delaying could result in it becoming "too late."

For the middle band of stock (80s/90's) in the model above, the key opportunity, subject to the operational performance, is repurposing. Mental health and hospital operators are acquiring these types of assets, whilst asylum, student accommodation and other non-care uses are also viable opportunities. It pays to know which provision is currently in the boom of its respect industry cycle. These types of assets usually have large plots too, so knowing residential values and understanding potential land values is another key route. Ultimately, taking action earlier provides the luxury of options and usually results in a much smoother and more profitable exit. If action is taken too late, providers are left resulting in diminished operations, insistent banks, and fire sale-type scenarios.

Where there are challenges, there are also opportunities. However, in such a fragmented market, and with a plethora of real estate sale/conversion opportunities, it can be difficult to identify these opportunities. However, the importance of incorporating exit planning from the earliest possible opportunity is critical. Taking action earlier provides the luxury of options and usually results in a much smoother and more profitable exit. If action is taken too late, providers are left resulting in diminished operations, insistent banks, and fire sale-type scenarios. But how can you ensure strategic exit planning?

The journey of care home ownership is multifaceted, encompassing challenges, triumphs, and the need for meticulous planning. Among the crucial aspects often overlooked is the formulation of a comprehensive exit strategy.

Early discussions about exit planning become imperative when assessing the financial health of the care home. This involves scrutinising budgetary constraints, and cash flow projections, and identifying potential areas that could impact long-term sustainability. Furthermore, a proactive approach to compliance ensures that regulatory standards are not only met but consistently exceeded, laying the groundwork for a smoother and more lucrative exit.

Personal considerations, such as changes in the owner's life circumstances or priorities, necessitate open discussions about the future of the care home. Additionally, regularly assessing market conditions is also paramount. This continuous dialogue ensures that owners are well-informed and can adapt business strategies based on evolving circumstances.

The assessment of viability and readiness for exit is a continuous process. Conducting periodic financial health checks becomes a routine practice to identify potential challenges and implement plans to address them proactively.

The adaptability of care homeowners to market changes is crucial, recognising that being attuned to the environment enhances the success of exit strategies. Regularly reassessing the care home's overall readiness for an eventual exit ensures that the business is continually optimised for a lucrative transition.

As conditions evolve, refining exit strategies is crucial. Owners must pay close attention to market dynamics to plan sale opportunities when conditions are favourable. Leveraging networks will allow owners to stay informed about potential buyers or investors. Succession planning, whether involving family discussions or a potential management transition, should be tailored to current conditions, ensuring that decisions align with the ever-changing dynamics of the home and the owner.

Professional guidance is not a one-time necessity but a continuous support system throughout the care home ownership journey. Proactively engaging legal advisors becomes essential, seeking ongoing advice to address potential legal issues that may arise. Regular consultations with financial experts ensure that the exit strategy aligns with evolving financial goals. Collaborating with healthcare consultants throughout the care home ownership journey provides a continuous understanding of industry nuances while maintaining connections with peers and offers ongoing insights into successful exits and industry trends.