Extracts from the Public Accounts Committee - Fifty-Seventh Report : Oversight of user choice and provider competition in care markets on Southern Cross / care markets

The following extracts focus only on Southern Cross /care markets , particularly in relation to Local Authorities and Four Seasons.

For the full report go to**:** http://www.publications.parliament.uk/pa/cm201012/cmselect/cmpubacc/1530/153002.htm

Part one : Conclusions and recommendations on Southern Cross / care markets

Part two : Extracts from minutes

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Part one : Conclusions and recommendations on Southern Cross / care markets

1. There are no arrangements yet in place to oversee regional care markets, but the Department said that it was considering a range of options for overseeing the market in care. Recent trends in care markets indicate a trend towards fewer providers controlling an increasing share of the market. Care markets tend to operate at a local or regional level yet the Department looks at market dominance from a national perspective. For example, Southern Cross had a market share of around 9 % of the national care home market but held up to 30 % of the market in certain local authority areas in the North East of England. The Department has nothing in place to oversee the market at the local level to avoid certain providers becoming too dominant in a region. It must specify what market share at the local level is acceptable, what arrangements will be made to keep market shares of large-scale providers under review, and what additional powers it requires in case it needs to intervene to prevent a provider becoming dominant.

2. There is no clarity about what will happen in cases of failure of large-scale providers. The financial difficulties experienced by the then largest care home company, Southern Cross, in 2011, and the considerable level of debt held by another large-scale provider, Four Seasons Health Care, have demonstrated that the care home market is no longer the "land of milk and honey" it once was. There must be greater clarity over what will happen in cases of large-scale provider failure. The Department admitted to having insufficient powers, and must decide what pre-and-post failure regime powers it needs to put in place to protect care home residents, many of whom are frail and vulnerable, if or when large-scale providers fail.

3. The Department does not monitor the financial health of large-scale providers. The Department acknowledged that it was unaware of the financial difficulties at Southern Cross until the company approached it in March 2011. It is currently considering a range of options for overseeing the social care market and how it will gather better intelligence about providers and the market more widely. The Department has issued a discussion paper[2] to inform the Social Care White Paper. The Department must decide how it will monitor the financial health of large-scale providers so that it has early warning of difficulties and develop ways in which it might respond should problems arise, so that the interests of both social care users and the taxpayer are protected.

1 The oversight of care markets

1. Around £23 billion is spent annually by Government and private individuals on care services in the UK. Around £1.5 billion is spent by publicly-funded personal budget holders, mostly on domiciliary care. A further £6.3 billion is spent by those funding their own care. Both these groups have choice over the provision of their care. The term 'social care' covers a wide range of services from residential care homes and drop-in centres for disabled people, to help with daily routines in the home. The Department of Health is responsible for setting the overall policy framework for social care in England, and local authorities have statutory duties to provide or fund social care for those eligible for means-tested support. The Care Quality Commission is the independent regulator of all health and adult social care in England.[3]

2. Successive Governments since the 1990s have sought to diversify the provision of care services beyond direct local authority providers. Provider diversity is a necessary pre-condition for user choice.[4] The Government has a target that by April 2013 all eligible users of care services will be offered a personal budget in order to choose their care services. A vibrant market of providers that compete for and respond to the needs of users will therefore be of ever increasing importance in delivering value for money from care services.[5]

3. The Office of Fair Trading sets a benchmark of 40 % market share above which it considers there is a possibility of a particular company becoming overly dominant and harming effective competition.[6] There has been increasing consolidation in the care sector over recent years, in particular in the care home market, where a smaller number of providers now have a greater proportion of the market.[7] While Southern Cross had a market share of around 9% at a national level, it held up to 30 % of the market in parts of the North East.[8]

4. Despite the increasing risk of a single provider having a disproportionately large share of any individual local authority market, the Department does not have a clear idea of the upper limit above which there would no longer be a healthy, competitive market.[9]

5. As care markets operate at a local and regional level rather than as a national market, concentration matters a lot to individuals and their ability to choose between providers in their area.[10] The Department does not consider that it should monitor local markets and intervene if necessary, this being the responsibility of the local

authorities.[11] Furthermore, there are no mechanisms for monitoring or intervening in markets that cross local authority boundaries.[12] There are, however, examples of where authorities have worked together to commission domiciliary care.[13] The Department recognised that it had limited powers to intervene if there are problems in regional markets, and is exploring ways it can improve matters in the future, in particular whether Monitor may be given a regulatory role in this area.

6. Care homes are very reliant on their funding from local authorities.[14] The overall split of public to private funding across all care services is about 63 % to 37 %.[15] Since the financial crisis the care homes market is no longer what was once described as "a land flowing with milk and honey". Because of the constraints on local authorities, the fees paid and the numbers of individuals referred have been cut.[16] The drop in occupancy levels is part of a longer term trend, and they are now at their lowest level over the last decade.[17]

7. The failure of large care providers risks causing huge uncertainty and disruption to vulnerable individuals resident in those homes. This risk crystallised recently with the failure of Southern Cross. The Department has been working with the company, other providers, and local authorities to manage the impact. The Department issued a discussion paper in October 2011 that seeks stakeholders' views on different potential options for protecting care home residents from large-scale provider failure, including the roles and responsibilities of the different participants in the market.[18] However, the Department has not yet established a pre and or post failure regime.[19]

8. The problems created when a large provider fails were starkly illustrated with Southern Cross. This company failed because it relied on a business model that was based on low interest rates and high levels of debt, with presumed continuing certainty of revenue income. It was subsequently unable to adapt quickly enough when the financial crisis started.[20] The Department was concerned that Southern Cross was overvalued in 2007-08 and was also aware of concerns raised by various commentators about its business model. However, the Department was unaware of the true state of the financial difficulties facing Southern Cross until the company approached it in March 2011 to raise concerns about its viability and the continuity of care.[21]

9. There are signs that other providers may also be experiencing financial stress. For example, Four Seasons Health Care, a large-scale provider in the care homes market which has recently taken over 140 of the homes that were previously managed by Southern Cross, carries nearly £1 billion of debt that it is now having to re-finance for the second time.[22] However, the Department does not scrutinise levels of company debt or business models of large-scale care providers as a matter of course, and has limited powers to assess the financial health of these organisations.[23] The Department is, however, now considering a range of options for overseeing care markets.[24]

Part two : Extracts from minutes

Q22 Chair: You are changing the question that I asked. I am not talking about failure. I will come on to talk about failure. I am talking about a monopoly concentration in the market, which I think will happen because the way this market is going is that you are moving it towards larger providers. What you have just said—perhaps you want to go away and think about it again—is, "Actually, it's down to the local authorities. We'll work with them, but if they go to 41%, which is over the OFT figure, we will do nothing." Let me move on.

David Behan: I didn't say we would do nothing.

Chair: I don't think I have had a satisfactory answer.

Una O'Brien: I think it is important to explain the distinction between what we would do at the moment and the powers that are open to us at the moment, where the responsibilities of local government lie, and the relationship between the Department of Health, ADASS and the representative bodies of local government. As David has set it out, those are the tools and mechanisms that are open to us at the moment. We have recognised, through the experience of Southern Cross, that there are issues there for us that raise questions about market dominance. Ministers have gone on the record about this to say that we absolutely want to reflect on what we have learnt about this. We have gone out with what I think is a genuinely open set of questions about how we are going to get the balance right in regulating this market in the future. There are risks and trade-offs from over-reacting. Nevertheless, it is important that the Committee understands that this is a genuine intention to get this right. We want to understand what levers can have the best impact on the market.

Q23 Chair: I am really pleased, Una, that you are doing that. I am just somewhat surprised that that document is produced on the day that we take evidence, and therefore you can fluff on the re-evidence. That is the only thing that I feel slightly cross about.

Una O'Brien: If I might say, there is absolutely no intention on our part of that.

Q24 Chair: Well, I don't believe that. I will come to you, James, as I know you want to come in, but I just want to pursue these points.

We had the disaster with Southern Cross. We now have Four Seasons Health Care which, according to our report, is the second biggest player in the field. My understanding is that it has a debt at the moment. It has taken over 140 of the homes that were previously managed by Southern Cross, and has a debt of nearly £1 billion. Are you worried about it? It is currently running a debt. Not only has it got a current loss, but it is actually running a debt of nearly £1 billion. It already restructured its debt in 2009. At that point, it was £1.6 billion. What are you doing about that one? That looks really dodgy to me and could go bottom up on us too.

David Behan: I think there were press reports last week. It has begun to have discussions with its lenders in relation to refinancing its debt. At the present time, that arrangement is a very different one to Southern Cross. Yes, we are looking at that and having discussions with Four Seasons in relation to that, but there is a commercial conversation that it will have with its lenders in relation to refinancing its debt.

Q25 Chair: Well, there is a commercial conversation, but there is also a public interest in its homes. It took over 140 homes that were formerly managed by Southern Cross. In those homes, there are a lot of people living there who are living in an organisation, the financial health of which is hugely questionable. The lenders could foreclose on it any day. What are you doing to protect that, having learned the lessons from Southern Cross? What are you doing about Four Seasons, which seems to be the next in line?

David Behan: We have no alerts, Chair, that there is any threat to continuity of care in relation to Four Seasons.

Q26 Chair: Have you got any alerts that there may be problems with Four Seasons? I mean, there are problems with Four Seasons if it has restructured its debt once, maybe only two years ago, and is having to restructure again now. Does that not give you a sense of alert and concern?

David Behan: It is an issue that we need to attend to. It successfully restructured its debt. When it restructured its debt two years ago, a restructuring date was set for the future—

Chair: That was two years ago.

David Behan: Which will take place next year. This restructuring is not borne out of a crisis; it is absolutely to be anticipated. The last time it restructured the debt—

Q27 Chair: A £1 billion debt is to be anticipated for an organisation like this?

David Behan: It always knew, when it restructured previously, that it would have to come back and restructure the debt that it was carrying. So, in that sense—

Q28 Chair: £1 billion. Did it own these Southern Cross homes? I am very unclear about this. Does it own them, or is it another of these organisations, like Southern Cross, that are just dependent on the revenue that they get from the fees?

David Behan: It owns some of them. It was the landlord for some of the Southern Cross properties—in excess of 40.

Q29 Chair: It was the landlord?

David Behan: It was the landlord.

Q30 Chair: It owns some of the Southern Cross properties?

David Behan: It owned 40 of the Southern Cross properties. Other landlords have sought Four Seasons as their operator for their homes as they go forward to give the continuity of care to the individuals in those homes.

Q31 Chair: If it owns them, why the hell has it got such a huge debt?

David Behan: That goes back to its business model and how that business was taken over back from 2006 through to 2007-08. When the financial crisis began in 2008, it needed to restructure its debt. The structure is very different from that of Southern Cross. It had not got the same degree of opco-propco separation that Southern Cross had, but it did have a debt that needed to be refinanced. It refinanced that in 2008, I think it was.

Chair: 2009.

David Behan: It has to refinance it again next year, and that was to be anticipated.

Chair: No, this year.

David Behan: It begins it this year. I think it needs to be concluded by 2012.

Q32 Chair: Is it still Qatari owned?

David Behan: My understanding is that it is not owned in the same way it was when the original debt was set, when it was largely Qatari owned at that time.

Q33 Chair: Who owns it how?

David Behan: I will have to write to you with that detail.

Part three : Written evidence from the Permanent Secretary, Department of Health

PUBLIC ACCOUNTS COMMITTEE—OVERSIGHT OF USER CHOICE AND PROVIDER COMPETITION IN CARE MARKETS

At the Public Accounts Committee on Monday 10 October, I promised to write to the Committee in response to a number of questions raised. The Department of Health response is set out at Annex A.

18 October 2011

Annex A

DEPARTMENT OF HEALTH RESPONSE TO QUESTIONS RAISED AT THE PUBLIC ACCOUNTS COMMITTEE HEARING ON MONDAY 10 OCTOBER 2011

What proportion of the market does Four Seasons Healthcare currently own? (Question 10*)*

Four Seasons had 16,700 beds for older and physically disabled people and a market share of 4.6% of the for profit sector in July 2010. This does not include the care home freeholds owned by Four Seasons and leased to other operators, nor does it include the recent transfers from Southern Cross homes.[1]

In September 2011, Four Seasons announced that it would take over the operation of 140 Southern Cross Care Homes. The total transfers include Four Seasons taking back 45 homes it owns that had been leased to Southern Cross under an historic arrangement.

Currently, Four Seasons operate in 7% of the homes in the North East Region, accounting for 12% of the places available.[2]

Who owns Four Seasons Healthcare now? (Question 33*)*

Four Seasons is owned by its former lenders, of which the Royal Bank of Scotland (RBS) is the biggest shareholder with 38%.

Background on Four Seasons from *Care of the Elderly People: UK Market Survey 2010-11*, Laing and Buisson, 2010

Four Seasons, in July 2010, operated 320 care homes for older and physically disabled people with 16,700 beds, giving it a 4.6% share of the for-profit sector. In addition, Four Seasons is an operator of 23 care homes with 759 beds for people with learning disabilities, mental health problems, alcohol addiction and brain injury, plus seven mental health hospitals with 218 beds. It is also a substantial landlord of care homes leased to other operators.

The company operates under two brands, *Four Seasons Health Care* for the bulk of the portfolio including elderly care homes, and the *Huntercombe* brand, which operates specialised care facilities and the mental health hospitals.

Four Seasons reported revenues of £460.7 million for the year ending December 2009. EBITDAR stood at 24.5% of revenue, placing Four Seasons in the second rank of performance below Barchester (29.6%).

Statutory accounts for the year ending December 2009 reported average occupancy of 87.6% (2008: 86.4%) across the Four Seasons portfolio as a whole.

History

— Four Seasons was established in the early 1980s and achieved growth both through acquisition and construction of care facilities. In terms of earlier history, Four Seasons merged with the previously quoted CrestaCare plc in July 1999 with financial backing from Alchemy Investment Plan, within the stable of venture capital company Alchemy Partners.

— In September 2002, Four Seasons Health Care Ltd purchased Omega Worldwide Inc (owner of Idun Healthcare Ltd) and Principal Healthcare Finance Ltd, the Jersey based care home landlord. The deal value was reported at $500 million (£325 million).

— In July 2004, Four Seasons was acquired by Allianz Capital for a reported £775 million.

— In May 2005, Four Seasons acquired the BetterCare Group from management and 3i for £116 million.

— In September 2006, Four Seasons was sold to Delta Commercial Property LP, an investment vehicle for Three Delta LLP acting on behalf of the Qatar Investment Authority (QIA), for £1.4 billion, a multiple of about 14 times EBITDA.

[This a highly leveraged buyout and the point that Four Seasons incurred high levels of debt]

— The new owners found they were unable to refinance the asset following termination of the short term loans with which it had been acquired in 2006. Lenders lost substantial sums. A restructuring was agreed in September 2009 which saw a £1.55 billion debt pile reduced to £780 million via a debt-for-equity swap with RBS.

— In September 2010 a £600 million loan owed to special purpose vehicle Titan was due to mature in the wake of the 2009 restructuring. At this point, a deal was struck to extend the maturity of the loan to September 2012.