



Department
for Education

Financial stability, cost charge and value for money in the children's residential care market

Research report

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**Institute of Public Care, Oxford Brookes
University**

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The project task

This project “*Financial stability, cost charge and value for money in the children’s residential care market*” was commissioned by the Department for Education (DfE) in November 2014. It was awarded to the Institute of Public Care at Oxford Brookes (IPC) working in partnership with Revolution Consulting and due for completion by mid-February 2015.

The primary aim of the research was to “...*improve our understanding of the children’s residential care market, both on the detailed financial stability of the main operators in the market and also a more detailed operational cost model, and to provide options for how to improve the functioning of the market. We need to understand how stable the market is, how to monitor, manage and influence it and understand the true costs (and their drivers) of residential care provision to provide national benchmarks for Local Authorities*”. There were then a series of additional aims as described in Appendix 1 of this report.

We were not asked to cover the secure children’s homes market as defined by section 25 of the Children Act 1989¹.

From the original planning meeting with representatives of the DfE, IPC outlined a timetable of activities for achieving the aims of the project. The activities included:

- Interviews (Providers, Investors, Commissioners, Regional Consortia, Other key stakeholders)
- Focus groups with provider organisations
- A survey of homes (now replaced by a series of telephone interviews)
- Development of a benchmarking model
- Development of the final report, project management & other activities

In addition, we have reviewed a range of sources relevant to markets in public care and to the children’s residential care market in particular. These include; previous research reports relevant to the market, publicly available financial information and credit reports relating to the larger providers, data sources such as the 903 and the 251 return and the Children’s Homes Data Pack².

¹ Secure accommodation accommodates children and young people who are remanded or have been sentenced for committing a criminal offence. It also accommodates children and young people who are placed there they have a history of absconding, or if absconding may come to significant harm or if kept in other accommodation may injure themselves or somebody else.

² Children’s Homes Data Pack December 2014, DfE

This project was completed over a tight timescale from November 2014 to February 2015 (with the Christmas break in the middle). As a consequence of the short time period it was not always possible to obtain all the data we would have liked³. It was also not always possible to see and meet with everybody we would have wished. However, we did receive considerable help from both providers and from Local Authority Commissioners and for that we are very grateful.

An interim report was presented to the Department on 9th January 2015. This report comprises three papers: This main document including conclusions and recommendations, a separate set of Appendices and a third paper on benchmarking.

³ Issues concerning methodology are explained in Appendix 2

Different types of markets?

Markets in general

In considering what kind of market operates in respect of children's residential care it is helpful to benchmark how this market compares to other markets or to an 'ideal' model. There are a range of sources that describe a 'perfect market'^{4, 5, 6, 7}. In reviewing these definitions there tends to be four common factors that shape what might be considered as a 'perfect market' or 'perfect competition'.

1. There is homogeneity, and good knowledge, about the product.
2. There are no or very few barriers to entry or exit.
3. There is open knowledge about price.
4. There are a large number of buyers and sellers.

There are then a wide range of additional factors that different commentators include, such as:

- Plentiful labour supply
- No transaction costs, etc.

In crude terms all markets operate in a dynamic tension between demand for goods or services and the supply of those goods and services at a given price. For example if demand outstrips the supply of a good then prices will normally rise until equilibrium is found where demand roughly equals supply at a particular price. Price in effect acts as a regulator on demand. Increased demand and rising prices will normally tempt more suppliers to enter a market. That may continue until supply outstrips demand. In that situation the price falls and suppliers exit the market until it again finds equilibrium between the level of demand and the volume of supply. Therefore, organisations entering or exiting a market should not be regarded as a sign of market failure. More telling maybe the rate at which such changes occur, i.e. what does a rapid expansion or contraction of the market tell us?

However, few markets operate in such a purist way. Access to raw materials, labour supply, ease of market entry and risk, are all factors that affect the supply side of the

⁴ <http://www.lse.co.uk/financeglossary/>

⁵ <http://www.investopedia.com/terms/p/perfectcompetition.asp>

⁶ http://www.economicsonline.co.uk/Business_economics/Perfect_competition.html

⁷ <http://www.open.edu/openlearn/money-management/money/accounting-and-finance/the-financial-markets-context/content-section-3>

equation, and hence influence price irrespective of demand. Additionally, most markets are controlled by legislation in some way, through the need to protect the public, consumers or employees. For example:

- Regulation – most industries are regulated, some by more than one regulator. For example, sale of food may be regulated from a health and safety or hygiene perspective through to highly complex regulation in for example industries such as nuclear energy or air traffic. Generally, it would be argued the greater the public risk then the greater the degree of regulation.
- Planning controls – People wishing to change the use of, or build, property must have consent to do and be prepared to have their designs changed.
- Labour laws – Legislation related to employment including terms and conditions, holidays, dismissal and a minimum wage level.
- Advertising laws – People selling goods must conform to a set of standards about what, and how, they can advertise.
- Licensing and limitations on who may be a provider – Many markets are licensed by government which limit who can participate in such activities, e.g. rail provision, mobile phone networks, etc.

Most of the above examples are fairly obvious but show that few markets are simply governed by supply and demand alone without any other influence. They also illustrate that public care markets may not be quite as different as they are sometimes portrayed, given, as stated above, that most markets are influenced by; regulation, the availability of suitably qualified labour and by a need to protect the public and consumers.

Such factors not only influence price but also the stability or volatility of the market. For example, terrorism can affect volatility in the holiday industry, not just from which destinations people might travel to but from increased security regulations. Airports need to put in greater checks, the costs of which are passed on in increased landing charges. Holiday companies then need to charge more for flights or seek out cheaper airports at which they can land. Some people may be deterred from flying altogether because of their experience at airports⁸.

Increased regulation may force some suppliers to leave a market, in other instances de-regulation may bring suppliers into a market where they have not previously operated. Therefore:

- Supply and demand are still the primary determinants of price in markets.
- Few markets operate in an unregulated environment.

⁸ See <http://www.telegraph.co.uk/travel/travelnews/10460093/Airport-security-campaign-The-high-price-of-safety.html>

- There is a dynamic relationship between regulation, quality, price and supply.
- Although care markets may have tighter regulations and controls they are still strongly influenced by the interaction between supply and demand.

Public care markets

Since the 1980s and under successive governments, public care provision has moved from being delivered by the state and by local government into the voluntary and, in particular, the private sector. Prior to that time Local Authorities and the NHS were predominantly purchasers, providers and often the only quality controllers of their provision.

Yet, there have been some significant differences between health and social care in their use and development of the market. In the case of social care, change was initially driven by easy access to the state paying for adult residential care, forcing up the costs of the social security budget in the 1980s in a fairly uncontrolled way (an increase from £10m in 1979 to £2.5bn by 1992)⁹. Although this amount was then capped by the government (with responsibility being given to Local Authorities), the requirement was that Local Authorities must spend the majority of the new, ex-benefits, funding in the private and voluntary sector. This encouraged far more private providers to enter the market and for Local Authorities to outsource their previously in-house provision.

A similar effect was seen with the initially high expenditure (and relatively open ended budget) on the Supporting People programme from 2003 onwards¹⁰. New providers entered the market, or existing providers extended their activities, when funding was growing, only for those same suppliers to leave, or scale back their role, when greater controls were put on spending and the funding ceased to be ring fenced¹¹.

By 2012/13 the vast majority of adult social care in England was being delivered by the private and voluntary sector (with around 92% of care home places and about 89% of home care hours purchased by councils being provided by the independent sector¹²).

However in recent years this shift has not been without its problems. On 11th June 2011 the shares of England's biggest residential care provider for old people, Southern Cross Healthcare PLC, were suspended from trading on the London Stock Exchange. Shortly afterwards Southern Cross, which operated 752 homes and looked after 31,000 older people, collapsed. Although the market, working with central and local government

⁹ See Paying for social care: Beyond Dilnot, Richard Humphries, Kings Fund,

¹⁰ <http://www.publications.parliament.uk/pa/cm200809/cmselect/cmcomloc/649/649i.pdf>

¹¹ The Supporting People Programme; research paper, House of Commons Library 12/40, 2012

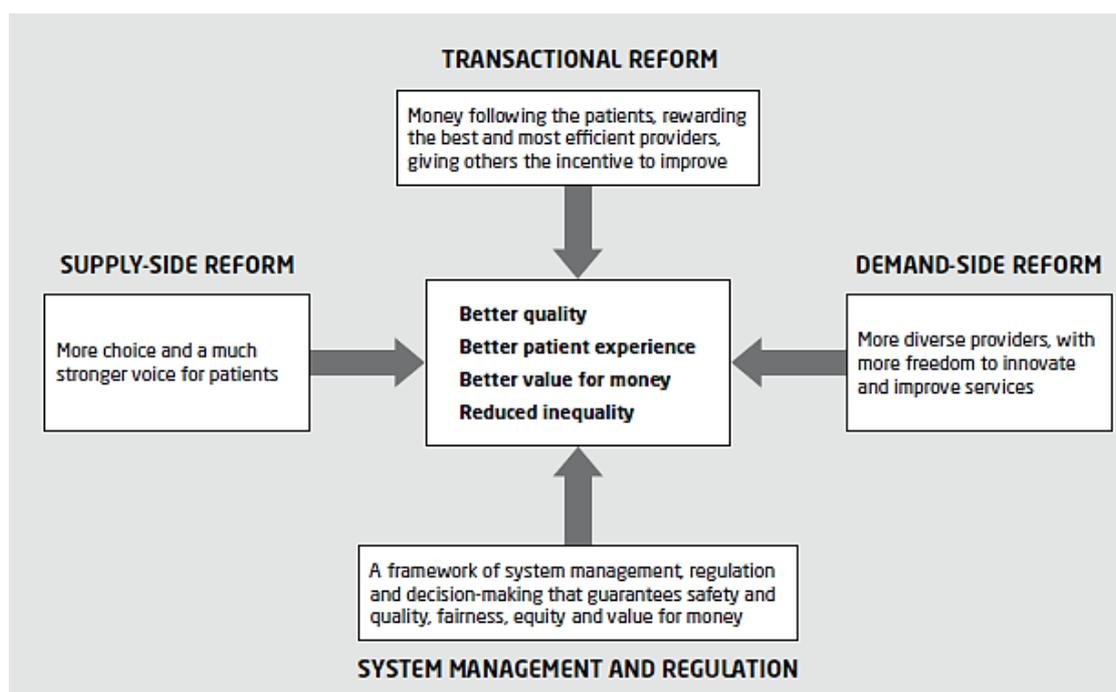
¹² Laing Buisson, Care of Elderly People Market Survey 2012/13 (percentage relates to 2011/12)

ensured no older people were left without care¹³, this sudden, and to some, unexpected collapse, led to market reforms being included in the 2014 Care Act¹⁴.

Two initiatives in particular were introduced as a consequence of the failure of Southern Cross. The first was to make the regulator, The Care Quality Commission (CQC) responsible for oversight of large care companies, in effect setting up an early warning system designed to detect care organisations in trouble¹⁵. The second was to encourage Local Authorities to have greater knowledge about supply and demand within their local markets, including the capture and publishing of information, commonly called market position statements. Should a care company be failing then it would be the Local Authority's responsibility to ensure that continuity of care was secured. Local Authorities will also be required to ensure a sufficiency of supply locally, to make sure the market is sustainable and that care, from a range of suppliers, is of high quality.

Similarly, the health service reforms under first the Conservative and then Labour governments in the 1980's and 90's were also driven by policy imperatives, in this instance primarily to rapidly reduce hospital waiting times, although as can be seen in Fig 1. marketisation was seen as offering a range of benefits.

Figure 1. The framework for NHS market reforms 2002



¹³ See for example <http://www.theguardian.com/business/2011/jul/11/southern-cross-landlords-take-over-all-homes>

¹⁴ For a detailed description of the changes included in the Act see; Care and Support Statutory Guidance, October 2014, pps 41.-66

¹⁵ Although not the same set of powers, Ofsted point to Annex K of their Social Care Registration Handbook as being able to refer concerns about financial viability of a provider to Ofsted's finance team. There is no published data of how many organisations are referred for this reason and what the outcome is.

However, despite legislation, government encouragement and substantially increased funding (UK public health care spending increased by almost 70% between 2000 and 2011) making the NHS an attractive market proposition for providers, has not developed as substantially as in social care. For example Primary Care Trust spending on secondary care services provided by non-NHS providers between 2006/7 to 2011/2012 only grew from 9% to 12% (of which less than 1% was with the voluntary sector)¹⁷.

Therefore, the marketisation of public care has been a consistent theme over time. It has also often been accompanied by attempts to make the market attractive to providers through some sort of fiscal stimulus. However:

- In health care, developing new provision, such as hospitals or other treatment centres, can be a considerable barrier to market entry and for some private provider costs are not always easy to control. Reputational risks are also greater in the healthcare sector and there has been opposition to the reforms from trade unions.
- Private involvement tends to focus on areas where products or activities lend themselves more to;
 - commoditisation, e.g., older peoples residential care,
 - routinisation e.g., hip replacement surgery in the health service
 - or where greatest market stability is present, e.g., high cost placements for people with profound and multiple disabilities.
- Outcomes and performance are difficult to measure and few public care contracts have been based on performance measures.
- Implementation of the policy has not been uniform

¹⁶ Understanding New Labour's market reforms of the English NHS, Anna Dixon, Nicholas Mays, Lorelei Jones, Kings Fund, 2011

¹⁷ Public payment and private provision: The changing landscape of health care in the 2000s, Sandeepa Arora and Anita Charlesworth, Nuffield Trust, 2013

The Children's Residential Care Market

Although not as marked as in Adult Social Care there have been considerable shifts in the Children's Accommodation market over the last thirty years. In Children's Residential Care around three quarters of all homes are within the private and voluntary sector, (although the role of the voluntary sector has considerably diminished over the last twenty years¹⁸) similarly in foster care. Ofsted reports there are 454 active fostering services of which 281 are in the private and voluntary sector (of which 74% are privately owned)¹⁹. Adoption still remains a state and voluntary sector activity given that it is a service that is forbidden from being for profit.

In the section on markets in general, four tests of a perfect market were outlined. So how do these four concepts get reflected in the children's residential care market?

- **Homogeneity and good knowledge about the product.** It is hard to describe children's residential care as a single market. In effect there are probably at least three distinct markets; one for children with profound and multiple disabilities, one for children with specific behavioural conditions and one where children have a series of problems stemming from their family and / or environment. However, even within these distinctions there are still a variety of sub markets, e.g., girls only homes or homes for children with a specific disability. The care market is also still relatively small both in terms of the number of providers and the number of people at any one time who are users of that market. Consequently, it might be expected that communication within the market would be good although little evidence of that was found from the interviews conducted for this project.
- **Barriers to entry and exit.** Although there are few barriers to exit most would probably argue this is not an easy sector to enter. The degree of regulation is considerable and running a home requires a property and high levels of staffing. Although not a physical barrier to entry there is also a high degree of reputational risk (as Castlebeck discovered with Winterbourne View in the case of adult care) that can have a substantial impact on the viability of an organisation regardless of its profitability.
- **Open knowledge about price.** In general in care markets there is a lack of transparency about price say as compared to a supermarket, where prices for the

¹⁸ As Children England comment, seventy years ago residential child care was dominated by the voluntary sector "Voluntary sector organisations were without question the predominant type of child care provider, complemented by that time with a growing range of state owned and run services. The voluntary sector, it could be said, had the lion's share of the residential care 'market' – to use today's terminology. Residential child care the 21st century challenge, Children England <http://www.childrenengland.org.uk/wp-content/uploads/2012/06/Correcting-a-History-of-Market-Failure.pdf>

¹⁹ Children looked after placement data collection, Ofsted, 12 June 2014 based on placements as at 31st March 2013.

same product may be compared and visible in both absolute terms, by content and by weight. In care markets despite regional and local framework agreements the amount paid will frequently be individually negotiated with a wide range of factors and elements going to determine price.

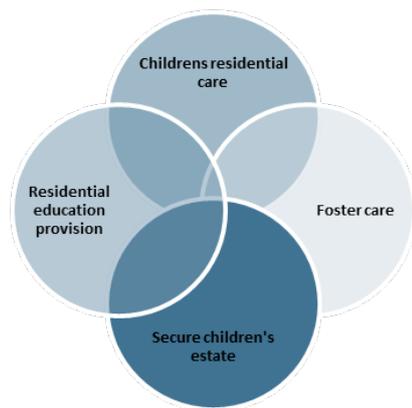
- **Large number of buyers and sellers.** Children's residential care might increasingly be seen as an oligopsonistic market, i.e., one where the number of buyers is small but the number of sellers is more plentiful although some might contend that given the market is state funded, it is closer to being a monopsony, i.e., one purchaser. However, whilst there are a number of providers within the market, the number who on any one given day, can meet the child's needs and has a place available in a location and at a price the purchaser wishes to pay, may be very limited. The market is also skewed by Local Authorities in many instances also being providers of accommodation services. Finally, although not normally listed as a market defining characteristic, the purchaser is not the recipient of the good, i.e., the place or service.

Therefore, purchasing behaviour does not operate under the same constraints as a normal market where the person spending the money is also the recipient of the good or service. Local Authorities would contend that they are purchasing on behalf of the child and in its best interests. However, there is always the potential for the Local Authority to be acting in its own interests which may not always be the same. In the interviews conducted as part of this project, both the Children's Commissioner and providers spoke of instances where children alleged they were being moved against their wishes, and for financial reasons, rather than in terms of what they saw as their interests²⁰.

As Figure 2 illustrates the children's residential care market is a market with permeable boundaries, where residential care is one part of a wider accommodation market.

²⁰ The Local Government Ombudsman also found against Walsall Council Sept 2013, when they tried to end a 13 year old girl's placement for financial reasons. See <http://www.wired-gov.net/wg/wg-news-1.nsf/0/1940AC5DC841D89C80257BF700424DD9?OpenDocument>

Figure 2. The relationship between other forms of children’s accommodation and the children’s residential care market



Consequently, demand for residential care places is heavily influenced by what is happening in these other markets. It is also of course part of a wider social care market where some Local Authorities invest in community based provision as an alternative to residential care and fostering.

For example, Berridge et al²¹ notes that the emphasis on using foster placements, wherever possible, has meant that children’s residential homes have increasingly come to be used:

- For older children with more serious difficulties,
- For children who may have difficulty settling in foster care or who may not want a foster placement, or when fostering fails²² or when no appropriate foster placements are immediately available.

Several of the providers interviewed as part of this project, discussed the permeability of the boundary between secure placements and residential care, of children moving from one form of accommodation to another. There is also a relationship between residential education provision and children’s residential care, although being registered as a care home does not necessarily mean children looked after are its residents. For example; some residential schools have a children’s home registration because children are resident for more than 295 days or there are schools for children with a disability who have been placed because of educational need but with parental consent. However, some looked after children are in educational placements and some children, in educational placements move to children’s homes because school is no longer an appropriate setting for them to live.

²¹ Living in Children's Residential Homes, 2012: Berridge, D., Biehal, N. and Henry, L., Research Report, DFE-RR201.

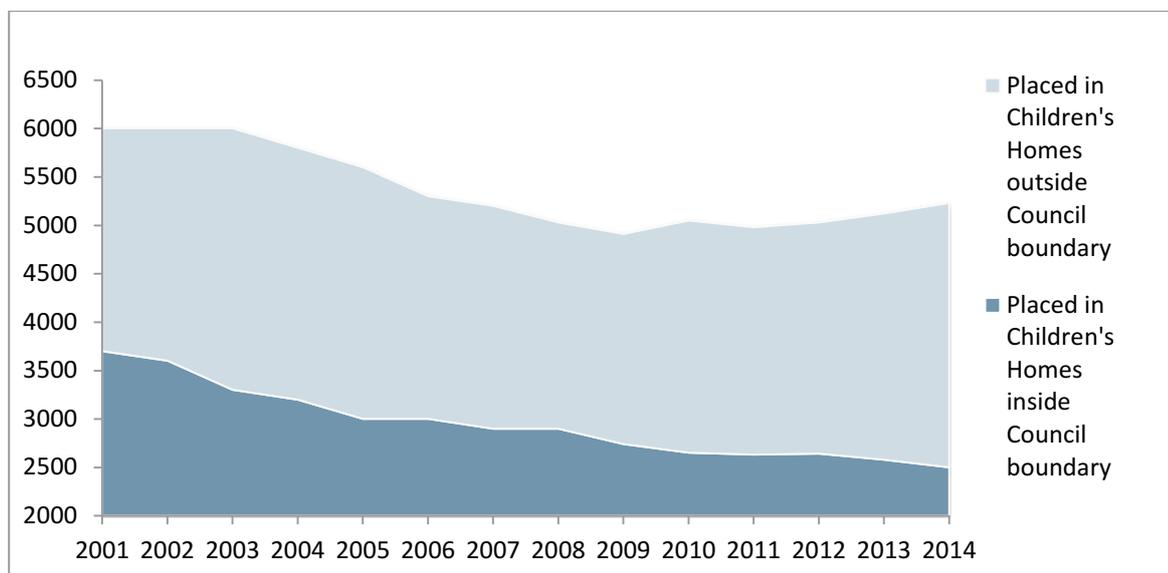
²² In the Jan 2015 workforce census for children’s homes, 79% of managers interviewed reported children being placed in a children’s home following previous disrupted foster placements.

Numbers placed

In 2013 there were 60,395 children placed with providers inspected by Ofsted of whom about 10% were placed in children's homes²³. As Berridge et al reported²⁴, use of residential care for children has been in decline for a long period of time, both numerically and in proportion to other forms of care. Numerically by the end of the 1970s around 95,000 children were in care; by 1987 this had dropped to around 66,000 with the number in residential care down from around 37,000 to 14,000 while the number in foster care rose from around 30,000 to 35,000.

This data is matched by the market proportion held by residential care. In 1978 this comprised 32% of the care population, 21% in 1986, but by 2010/11 only 9% (a figure which includes a small number of young people living in secure units and hostels). Policies at a local and a national level over this period has favoured adoption and fostering over residential services both ideologically and in costs terms²⁵.

Figure 3. Looked After Children in Children's Homes as at 31 March 2014



Although policy has continued to promote the use of fostering and adoption, after a relatively static period of demand for residential care, as Figure 3 suggests this may have begun to 'bottom out' with a 4% increase in use in recent years. This is as compared to a total increase in all children looked after of 16% between 2008-2014. The total spending

²³ Children looked after placement data collection, June 2014 Ofsted

²⁴ Living in Children's Residential Homes, 2012: Berridge, D., Biehal, N. and Henry, L., Research Report, DFE-RR201.

²⁵ See Office for National Statistics, Mike G Phelps, 2009: Measuring the Output of Children's Social Care: an alternative method for looked after children. Education Select Committee: Into independence, not out of care. Recommends Staying Put policy in fostering be extended into children's homes. Bristol City Council: Children's Specialist Commissioning Plan 2012-2015. 'Foster care is the preferred choice for nearly all children'.

reported for Children's Homes in England is £1.1bn²⁶. This is less than fostering expenditure (£1.4bn) and special education (£3.5bn), with 67% being spent in the independent and voluntary sector as compared to 33% in house²⁷.

Who, when, where?

As at 31 March 2014, of the 68,840 children reported as being looked after by Local Authorities in England only 7.6% were in residential care. Over 75% of children in Children's Homes are aged 14-17, and the cohort is skewed towards boys who make up 64% of the residential care population (as compared to 55% of the looked after children population as a whole). Partly related to the age at which many children are placed in homes, 80% of residential care placements last for less than one year.

When children are first placed in a children's home it is unlikely to be their first care placement. For three out of every four children's residential care placements the child or young person will have had at least one previous care placement. Thirty percent of children placed in residential care have had 6 or more previous care placements. National Looked After Children statistics²⁸ do not include a clear picture of how many children and young people move between different placement and service types during each reporting year, but the statistics do demonstrate a volatile picture with many placement moves. For example, 63% of children leaving care in the year to 31 March 2014 had experienced more than one placement during their time in care, and 16% had experienced five or more placements.

Compared to foster care, children in residential care are more likely to live further away from the point they first came into care with 45% of children in children's homes living within the local authority and less than 20 miles from home, but 31% living outside the Local Authority and more than 20 miles from home.²⁹ The disparate nature of the market across residential care and fostering is further illustrated by the Ofsted data for 2013³⁰ "As at 31 March 2013, each local authority had children placed within their boundary from an average of 27 other local authorities, although the number ranged from six Local Authorities placing in Redcar & Cleveland to 85 Local Authorities placing children in Kent".

²⁶ The total spending on Children's Homes annually is estimated using s251 reporting by Local Authorities. However there are weaknesses with this (see Appendix 2)

²⁷ Laing & Buisson: Children's Social Care & Special Education Services UK Market Report 2013. Figures are derived from s251 reporting by Local Authorities.

²⁸ Children's Homes Data Pack December 2014, DfE

²⁹ Children's Homes Data Pack December 2014, DfE

³⁰ Children looked after placement data collection, June 2014 Ofsted

Provision

Using data derived from the Children's Homes Data Pack³¹ it is possible to see a move away from local authority in-house provision within this sector, substantially driven by closures of local authority homes. Around a third of local authorities do not now run their own homes.

³¹ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/388701/Childrens_Homes_data_pack_Dec_2014.pdf The data pack exclude some types of homes.

Table 1. Market share of Local Authority owned homes as compared to the private and voluntary sector.

	Number (%) of Local Authority Children’s Homes	Number (%) of Private and Voluntary Children’s Homes
2000 ³²	61%	39%
2014	21%	79%

Recent improvements in Ofsted data gives greater visibility to the proportion of voluntary sector involvement. As at 31 March 2014 there were 97 voluntary sector homes accounting for just 6% of all homes. Hence private sector owned homes comprise 73% of all homes.

As mentioned above when talking about the overlap between residential special schools and care homes, Ofsted most consistently measure the capacity of the market at total residential market level. This means that as well as children’s homes that almost exclusively have looked after children in placement, the Ofsted register includes residential school capacity (a mixture of SEN based placements, only some of whom will be looked after children) and respite provision (most usually for children with disabilities and health needs). At this total aggregate level there is no evidence yet of contraction in the residential childcare market. This does not rule out the possibility of some shifts in the mix and location of provision in any one part of the market.

There has been considerable focus on the issue of out-of-authority placements including the highlighting of geographical disparities in the DfE Children’s Homes data pack³³. More children in residential care live inside their local authority boundary (52%) than outside, (48%)³⁴ although for some in large authorities this may still be at quite a long distance from their home. Equally there will be children that are geographically placed in another authority but still within twenty miles of their original home.

London local authorities place their children (in children’s homes) the furthest from their neighbourhood (an average distance of 52 miles compared to 28 miles nationally). Local authorities in the North West place their child the closest to their neighbourhood (average 16 miles). Both of these decisions are most likely to be driven by availability within local markets as well as by the approach to placement finding adopted by the local authority.

Research³⁵ suggests that placements away from home are often made in order to secure specialist provision for children with complex disabilities or severe mental health issues,

³² Children’s Homes England, Department of Health (2006)

³³ Children’s Homes Data Pack December 2014, DfE

³⁴ Children’s Homes Data Pack December 2014, DfE

³⁵ Childhood Wellbeing Research Centre 2014: Children’s Homes: understanding the market and the use of out of authority placements

or to establish some geographical distance to break patterns of risky behaviour (for example, child sexual exploitation (CSE), offending behaviour, gangs and guns).

Staffing

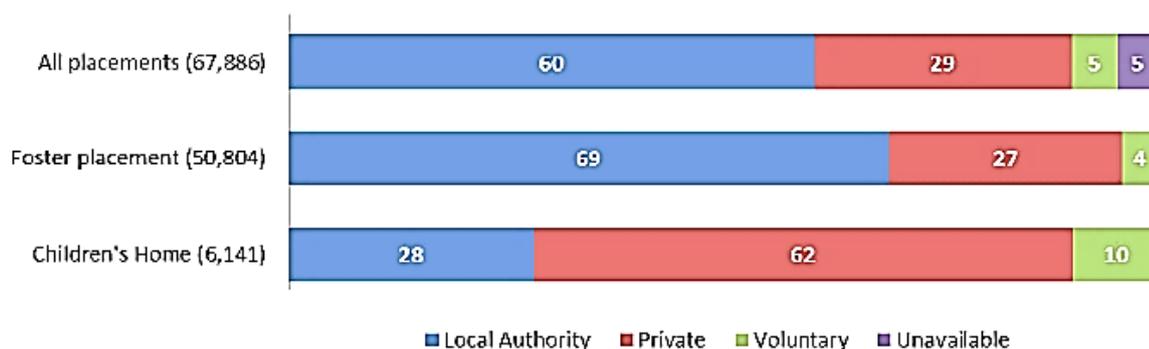
This sector like others in public care is predominantly a low wage economy. A recent survey for the DfE³⁶ showed that 11% of all staff were paid at or below the Living Wage Rate. Pay rates, particularly for managers, were lower in the private sector than in the local authority and voluntary sector. Noticeably over half of all managers in the survey said they found it difficult to recruit staff. This was put down to a lack of experience and qualifications amongst applicants. However, despite this, the most common route for people leaving their job was to take employment in another children’s home and many people come from another children’s home to work in their current employment.

Pay rates and vacancies are relevant to market stability. If the public sector still has fiscal restraint on salaries and fees, whilst other sectors of the economy, that traditionally have low wage employment, lift off then it will become increasingly hard to recruit staff and hence maintain homes at a price the local authority is able or willing to pay.

Models of ownership and governance

The Ofsted data derived from the register of homes and described in the previous sections gives the overall shape of the supply-side market in terms of the split between private sector, local authority and voluntary sector placements. As Figure 4 shows residential care has a high volume of private sector placements as compared to foster care.

Figure 4. Proportion of children looked after by placement type as at 31st March 2013³⁷



In 2013 the DfE and Ofsted reviewed (as far as publicly available information allowed) how many provider organisations made up the children’s residential private and voluntary

³⁶ A Census of the children’s homes workforce, DfE, January 2015

³⁷ Derived from, Children looked after placement data collection, Ofsted, 12 June 2014.

sector. Some 402 different provider entities were identified. This analysis showed that, of the 402, 280 (70% of providers) owned just one or two homes, making up 26% of all private and voluntary sector homes. By contrast the largest twenty providers (5% of the total number of private and voluntary providers) owned 37% of the total number of private and voluntary homes.

Therefore, whilst the sector does not have an overly dominant large provider (the largest provider in the private and voluntary segment has only 10% of the homes), it does have some significant sized providers as well as a large number of small providers at the other end of the market.

For many providers, in order to avoid being too dependent on the more volatile residential care market, the solution has been to diversify their products. In the population of the largest twenty children's homes providers (analysed elsewhere in this report), only 35% concentrate their activities on children's homes (and even those that do tend to also provide special education for a high proportion of the children placed with them). An examination of the marketing literature of providers also identifies how services interlink. For example, fostering being promoted as a 'step-down' service from intensive residential care, or residential care being developed by fostering providers as a 'bridge to fostering' service.

A number of different legal and corporate ownership structures are encountered in the market for children's homes³⁸. For example:

- Unincorporated partnerships
- Limited Liability Partnerships
- Private Limited Companies
- Public Limited Companies
- NHS Trusts
- Local Authorities
- Private Companies Limited by Guarantee
- Charitable Trusts

There are approximately 110 public sector providers who run homes (5 of which are NHS Trusts) registered as Children's Homes. In our review of the top 20 providers, ownership types comprised:

- 1 Alternative Investment Market, London listed
- 1 Public Stock exchange London listed and Private Equity

³⁸ The four main types of ownership model are described in Appendix 6.

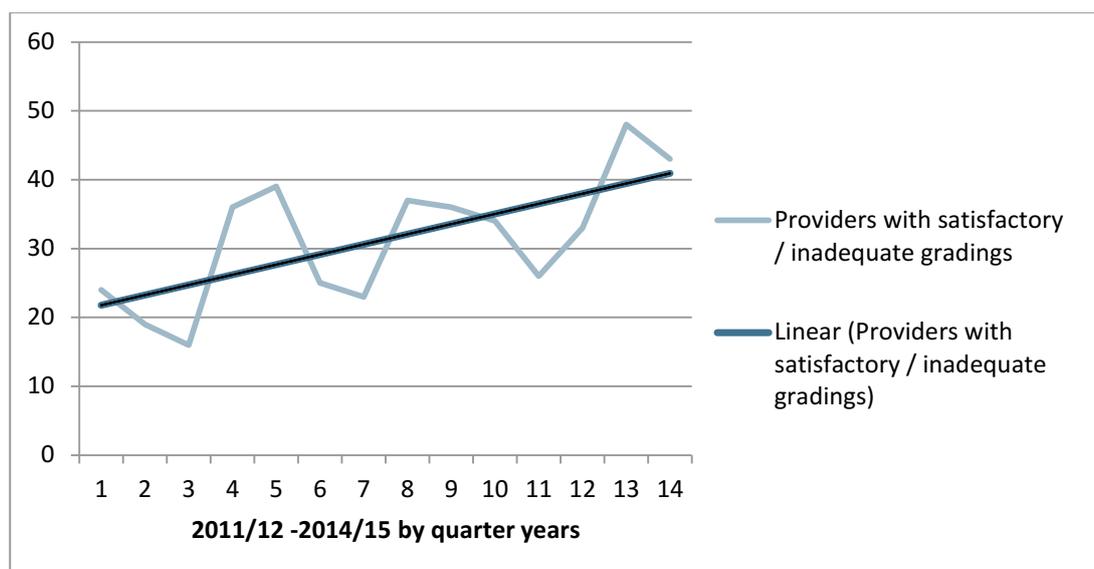
- 6 Wholly Private Equity owned
- 1 Bank owned
- 8 Private individuals or families (Limited companies)
- 3 Charities/Trusts

Based on a random sample of all other providers classified as private by Ofsted, over 95% are Private Limited Companies.

Registration

The data for 2013 showed that 75% of children living in children’s homes, lived in homes rated by Ofsted as Outstanding (18%) or Good (57%). However, although the figures vary considerably from one quarter to another the overall trend suggests that more homes are finding it harder to achieve the top two gradings as Figure 5 shows³⁹. We also know that homes rated as inadequate or adequate are more likely to close than other homes⁴⁰.

Figure 5. Chart showing number of homes with an adequate or inadequate Ofsted grading



³⁹ Fluctuations as shown in the graphic may occur because of the order in which inspections are completed, e.g., there is an upward trend roughly three to four quarters apart. It may also be influenced by changes in inspection.

⁴⁰ Children’s Homes Data Pack December 2014, DfE

Summary

The children's residential care market is somewhat removed from the theoretical model of a perfect market⁴¹, of which perhaps the largest distinction is that the consumer of the product is not the purchaser and that some procurers of services are also providers. It is a market on a continuum of different types of accommodation based provision and one that has been in numerical decline for a number of years, although the suggestion is that this trend has begun to stabilise.

At the same time many local authorities and voluntary organisations have moved out of this sector so a higher proportion of care has gradually been provided by the private sector. Within that element, 37% of all homes are owned by just 20 providers, although by contrast 70% of private providers own only one or two homes

Children's residential care is regulated by Ofsted as specified by the Care Standards Act 2000. Local authorities also set their own quality standards as well as controlling environmental factors such as planning consent. It is a market almost wholly funded by public sector purchasing.

For a variety of reasons the proportion of homes with a lower Ofsted rating has increased in recent years. Considering that residential children's homes often deal with some of the most troubled children in society wage levels look to be unacceptably low across all providers⁴². Residential care is also in many ways a market of last resort with 30% of children placed in residential care having had six or more previous care placements, although it is frequently not children's last placement.

⁴¹ This is not meant to imply that this is a bad thing given that a perfect market does not exist. It is just a benchmark against which other markets can be positioned.

⁴² See A census of children's homes workforce. A Thornton et al, DfE January 2015. Amongst a range of conclusions it shows that 11% of all staff surveyed were paid below the living wage. Pay was lower in the private sector than in the Local Authority sector. However, even in the Local Authority sector average pay of staff was only at £13.28 per hour

What did key stakeholders tell us?

A wide range of interviews were conducted with the following categories of organisations as well as a number of focus groups designed to capture the perspective of the market from smaller providers. The material here is the collected views of the participants. They are not quantified other than ‘most’ or ‘a few’. Instead they are designed to triangulate views of the market from a range of perspectives. A few provider organisations were represented more than once and obviously size and number of homes may vary from one organisation to another. A list of organisations interviewed and a list of organisations attending the Focus Groups are contained in Appendix 3.

Table 2. Contact by type of organisation

Type of organisation	Number of interviews conducted
Large providers	10
Investors	7
Local Authority commissioners	16
Regional consortia	12
Others, (Ofsted, ICHA, ADCS, ADASS)	6
Total	51
Focus groups	Numbers attending / number of organisations represented
	58 / 46
Total number of organisations involved in this part of the project	94

Providers

We interviewed ten providers from amongst the largest twenty companies and organisations. Where reasons were offered for non-participation they included pressure of operational demands meaning senior management were not available, and a belief that the project was too focussed on financial matters. Some of those who initially declined did nonetheless attend the focus groups.

Key points are as follows

- There was a strong sense that this sector was dealing with the most difficult children often for a short time with unrealistic expectations about what the home could achieve from the regulator and sometimes from Local Authorities. There were stories from more than one provider, of children being moved at very short notice because a cheaper price was available elsewhere, of social workers placing children with little knowledge about them and inadequate assessments, of good and poor inspectors (the latter, providers seeing as having unrealistic expectations

of what the sector could deliver for children that were with them for a very short time period).

- All providers said the degree of difficulty of the children they were being presented with had got greater, particular mention was made of gangs and child sexual exploitation.
- Greatest stability in the sector seemed to be reflected in providers who take children with profound and multiple disabilities where there was continued parental involvement. It was stated that these placements tend to last longer and attract a higher level of resourcing.
- There was a wide variability in the approach to pricing. This ranged from highly individualised 'menus' to one standard price with only 'add-ons' in extreme circumstances. In general, we were told that the prices being paid were static or falling.
- None of the large providers saw having homes in London as financially viable. Two reasons were put forward for this; the high cost of property and the high costs of employment. Some providers suggested that the influence of gangs within London made children easier to manage if they were not placed near home.
- There were a range of views as to whether the share of the market occupied by the Local Authority would continue to diminish or whether this trend had now plateaued.
- Some organisations are clearly struggling and are only managing through; diversifying their product range, closing their least profitable homes, driving greater efficiencies, and / or accepting a lower price for care.

Investors

We interviewed seven investors from amongst the largest twenty companies and organisations. Key points made were as follows

- This is a difficult sector to operate in, with comments such as *"Investment in this sector has so far been a disaster"* *"No-one has made any money"* *"One private equity investor took a write off of at least £20m"*
- *"If you are going to invest in this sector you really have to understand and embrace it, normal rules of private equity funding tend not to apply which is why some people have got their fingers burnt". "The sector is still over geared, i.e., too much debt as compared to equity"*.
- Still uncertainty over the continuing decline in Local Authority funding. Some people felt that the price paid for placements had 'bottomed out', some that there will be more hard to manage children within the system and hence the use of residential care will rise given that more foster placements will break down.

- *“There will be more consolidation within the sector as larger private providers look to balance up their portfolios”.*
- Incentives for providers within the sector were seen as perverse. For example if a provider works to ensure a child needs less care then they may be penalised by the child being moved or the purchaser may say a lesser payment is now needed. Because payment by outcomes is not present in the system then there are few incentives on providers to ‘add value to a placement, i.e. payment by the improvements in a child’s life or potential.
- All providers and investors supported the concept of regulation although none felt it worked well at the moment and some that it made the market more vulnerable.
- *“This sector is not going to attract new investors, capital or innovation given its current perceived state”.*

Commissioners

We interviewed sixteen commissioners from Local Authorities⁴³. Key points made were as follows:

- In most authorities that the commissioners represented, the numbers of looked after children had been relatively stable, along with demand for residential care, over the last few years. For about a quarter their numbers had risen.
- Almost without exception Local Authorities are experiencing increased demand for care for children aged 13 years and over with a range of very complex needs. These include:
 - Sexually harmful behaviours
 - High levels of violence and aggression
 - Gang affiliation – particularly in London
 - Radicalisation
 - Self-harm
 - Serious mental health difficulties but not requiring or considered unsuitable for Tier four in patient CAMH services
 - Child sexual exploitation
 - Autism and autism plus mental health needs

⁴³ Although not a representative sample we did ensure that at least one London borough, one metropolitan authority, one shire county and one unitary were interviewed

- Some commissioners were concerned that providers were becoming more risk averse in relation to inspections and that this may lead to reductions in supply and the withdrawal of smaller providers from the market.
- For all Local Authorities the financial pressures over the next few years loom large and all are exploring ways to reduce or contain costs primarily through reducing LAC or being able to manage LAC with higher needs at lower cost through fostering services.
- Three particular needs for future residential care placements were identified:
 - The need for local placements including for low incidence disability and SEN needs.
 - Placements for those with high risk behaviours e.g. CSE, going missing, self-harm, violence and aggression.
 - Specialist placements with expertise and competence to meet needs such as mental health, CSE, substance abuse.
- Nearly all Local Authorities have a policy of wanting to place in 'good' or 'outstanding' provision and only placing in 'adequate' after very careful review of the issues leading to the adequate judgment and sign off of the placement at Assistant Director or Director level.
- A couple of commissioners described a very clear hierarchy for making placements as follows:
 - Internal fostering
 - External fostering
 - Internal Residential
 - External residential with any block contracts used first.
- In our interviews four main mechanisms were suggested for determining price:
 - Research and knowledge of costs including of additional items and for specialist types of care. All commissioners believed they had good knowledge of their local market and the providers they use supplemented by their regular communication with other Local Authorities.
 - Framework agreements (which most Local Authorities were part of) or contracts provided a reference point for pricing as commissioners knew the frameworks had been developed through a competitive process.
 - Some commissioners try to negotiate through getting providers to breakdown costs. Some providers are resistant to doing this claiming commercial sensitivity or the time it takes, although others appear to do so without difficulty.
 - The last main mechanism is comparison with other provision the Local Authority knows the cost of, including its own provision and considering what the outcomes are in relation to that price or cost.

- Although commissioners undertake a number of processes to check the financial health of providers most acknowledged that these could be stronger and more systematic. Financial health did not feature as a significant worry for commissioners. Almost no one had any experience of a provider closing because of financial difficulties. When prompted they understood the concern but not as a practical reality as yet.
- Where a Local Authority maintained their own residential stock this was seen as delivering flexibility and availability within the system. Some authorities were enthusiastic about their own in-house provision although we were not confident that they accurately reflected the true cost of such provision, given that what gets included in unit costs often seems to vary widely.

Regional consortia⁴⁴

We held interviews with twelve ‘regional’ consortia⁴⁵, two interviews were cancelled at the last minute and seven consortia did not respond within the timeframe. With all of the interviews there was some degree of difficulty in disaggregating the view of an individual or an individual Local Authority as compared to whether this is a view held across the region or sub region.

- All consortia admitted to struggling with developing a regional needs analysis. Even where they had been developed, it had taken significant resource to manually collate and analyse the data. As Local Authorities use different data and criteria, it is difficult to find appropriate technological solutions to support with this.
- Property prices and staff costs have a significant effect on the market in London. Boroughs do not have access to the provision they need and they are currently left with little choice but to procure placements further afield. One commissioner stated, *“Placements in London are becoming unaffordable”*.
- Ofsted and the matching of placement criteria was seen as a problem by some consortia *“Providers have fed back that they have been unable to respond to placement requests as, although they think they could meet the young person’s needs, it would not meet the exact criteria we have specified and this could be challenged by Ofsted”*.
- It was not possible to identify one consortium that had formal arrangements for accessing a wide range of providers further afield. Not one consortium had links to

⁴⁴ Regional consortia and commissioning arrangements are now being reviewed in a wider piece of work which DfE has commissioned. It is due to report at the end of May 2015.

⁴⁵ The phrase regional consortia or consortium has been used here and throughout the report. However, this is not a simple concept. Some arrangements are regional, some are sub regional and some are across more than one region. Some consortia have a full time member of staff some do not.

all the other regional consortia holding information on specialist providers in their areas. This means that whilst commissioners may have access to good knowledge about their local provision, they may not have, or may not have access to, good knowledge about placements further afield.

- It was not possible to find any examples where Local Authority provision was included alongside independent provision on frameworks or databases. A range of concerns about the use of in-house provision was expressed, from it being given priority regardless of the child's needs or it would be used with a lower Ofsted grading than would external provision.
- In evaluating providers, most consortia apply a price / quality ratio. In the majority of cases a greater weighting is placed on quality, however there were some examples where price carried the larger weighting in the qualification process.
- Although there were many references to the 'National Contract' there seemed to be a number of variations on this theme, with some confusion as to whether people were or were not using the national contract or a variation of the contract⁴⁶.
- Monitoring the financial health of providers also seemed to vary widely and discriminate between setting up an initial contract or framework as compared to ongoing monitoring.
- Although there were different views regarding whether prices should be agreed when frameworks were set up or when placing individual children, the majority of consortia made the point that there will always be a need to negotiate fees for some children with specialist needs and that having skilled and knowledgeable officers to do this was invaluable.
- All those interviewed said that there should be discussion and consideration of a national outcomes framework. Some said that this might be difficult to develop, but that at the very least some good practice could be shared in a facilitated way. Three of the interviewees strongly emphasised the need for a national outcomes framework for all looked after children.

Other stakeholders

We interviewed a range of other key individuals and organisations. These included the Association of Directors of Adult Services, Independent Children's Homes Association, Association of Directors of Children's Services, Ofsted and The Children's Commissioner.

Some of the key points and quotes from these interviews include:

⁴⁶ National Framework Contract for the placement of Children in Children's Homes first published in 2007 under the Every Child Matters Programme by the then Department for Children, Schools and Families.

- Ofsted needs to *“ask more questions about ‘value added’ rather than just about absolutes. They need independent verification and monitoring as an organisation as they ‘mark their own work’”*.
- Ofsted follows its legislative responsibilities. In our interview we were told more than once that it does not have a mandate for oversight of the market.
- *“Because of the small size of children’s homes and their marginal viability people do not invest in the fabric of the building.”*
- Most parties said there was a lack of clarity about who or what residential care is for.
- There appears to be less monitoring of the cost benefit of complex Learning Disability placements. Prices are sometimes higher because parents argue effectively for more resources, they are individually negotiated and because the costs are split with health the price does not seem high to each individual party.
- *“Big chunks of the NHS seem to have forgotten that children exist”*.
- *“Everything is at arm’s length between commissioners and providers, there are deep suspicions by each of the other”*.
- The relationship between children’s commissioners and providers is not on a business footing. There is no concept of a level playing field between internally provided and externally purchased services.
- Providers feel they are disincentivised to take the most difficult children and it was repeated to us more than once that some children were shunted from one placement to another.

Focus groups

Focus groups were held in London, Birmingham, Manchester and Exeter, and attended by 58 officers and owners from 46 provider organisations. A full list of attendees is included as Appendix 3. The groups were mainly intended for small and medium sized providers, but some representatives of larger organisations also contributed. We are grateful to the Independent Children’s Homes Association (ICHA) for their promotion of these events to their members, and to all attendees and contributors to the events.

Key points arising from the focus groups:

- The most common needs being addressed by providers were emotional and behavioural difficulties (EBD) and complex mental health issues. However, a number of providers of services for children with physical and learning disabilities also attended. This latter group described a market where parental challenge and advocacy brings some additional stability to their sector, particularly to residential

special schools that are required to register their accommodation as children's homes.

- In the EBD segment of the market, providers described their services as being used "*only as a last resort*". Relationships between providers and Local Authorities were described as "*lacking in depth*" which was seen as contributing to instability in the market as providers felt they were not clear about long term Local Authority trends. Providers also said they were experiencing increased complexity of needs, and signs of demand exceeding supply for young people with more challenging and complex behaviour.
- Providers were critical of Local Authority commissioning and purchasing. They said that they sometimes encountered Local Authority staff with very little experience and knowledge of residential care, weak or non-existent needs analysis, a skewed preference to use in-house before external services, and in their view a misplaced focus on the relative importance of the location of the home.
- Occupancy levels were seen as the dominant factor contributing to financial stability. The groups especially identified the tensions in block contracts between lowest unit prices and the risk of inappropriate placement matching pressures.
- The majority of Local Authorities have, individually or with other Local Authorities, developed framework contracts as their preferred tool for purchasing placements. Providers reported the plethora of different approaches used by different authorities, regions and sub-regions to be a burden that adds to costs and detracts from service delivery. Despite the high number of framework contracts in existence, the majority of providers stated that most of their current placements had been spot purchased. This would tend to suggest that overall the framework arrangements are failing.
- Providers reported that up to 95% of referrals they received were inappropriate for their service/vacancies. This looks a high number but is inflated by purchasing systems that appear to treat all needs in a similar fashion and inefficiently circulate many referrals to multiple providers. Quality of processes and approaches vary considerably between Local Authorities. Many providers made the point that they were unable or unwilling to respond to requests to accommodate a child at short notice due to the ramifications it may have for their Ofsted inspection⁴⁷. Equally, processes often lacked an input from young people. Providers are increasingly risk averse in looking at referrals, as a perception by their Ofsted inspector that they

⁴⁷ For example although Ofsted inspections are unannounced if you have not had an inspection in the first nine months of the year then you know you are going to have one in the remaining three months. Hence, there may be a greater risk in taking a highly problematic child or one in an emergency but with a promise of later paperwork because it could jeopardise your inspection. Equally, given at least two inspection visits per year providers said they had to be alert at all times of the year to the impact that a difficult placement might have on a home and on the inspection rating of the home.

cannot meet all of the needs of a young person can lead to a downgrading. The lack of accurate and up to date information available from Local Authorities at time of referral was heavily criticised⁴⁸. Providers said this is a fundamental problem as this critical information determines both whether or not they can offer an appropriate placement and if they can provide this at an affordable price.

- Providers were highly frustrated that their services were used as a last resort. That despite available evidence based research that residential care can deliver significant long term efficiencies, commissioners were still failing to make proper use of the services available⁴⁹. Providers felt that commissioners are not supported to make professional judgements about value for money (considering the long term outcomes) but that instead there is pressure on commissioners to meet annual budget targets. Providers felt that whilst this pressure exists, Local Authorities will continue to make inappropriate placements ultimately leading to increased spend.
- Clear linkage was made between the Ofsted rating of a home and the policy of placing authorities. Many providers reported managing their decisions around young people and placements on the basis of the risk of creating the potential for an Ofsted grading of adequate or inadequate, and the fact that in many cases this may lead, as Local Authorities told us, to them ceasing to make referrals to that home.

In addition to the impact of occupancy a wide variety of other factors impacted on costs. These included; complexity of needs of young people, staff levels required, staff recruitment, retention and training challenges, payment terms, regulatory impacts.

- Property costs are seen as prohibitive to development of services in certain geographical locations, particularly in London.
- Voluntary sector bodies reported the need to raise charitable funds to subsidise their services.
- None of the providers that attended were able to give an example of a Local Authority with an effective methodology for evaluating value for money.

Summary

There are clearly some differences between providers, commissioners and investors although equally there were many occasions when it was felt you were simply looking at a different side of the same coin. All of those parties:

⁴⁸ Guidance specifies what information should be passed from commissioning authority to homes. This will change under the new outcomes framework, but will still be prescribed.

⁴⁹ A false economy: How failing to invest in the care system for children will cost us all, Eilís Lawlor, New Economic Foundation, 2008 and “What works in residential child care” NCERCC, 2009

- Agreed that residential care took the children with the highest degrees of difficulty, that it often took children when other placements had broken down and that the problems children were presenting were getting more serious and harder to manage.
- Agreed, if not in words then in practice, that framework agreements were there to be broken or at best simply used as a guide to pricing.
- Were critical of the way in which regulation worked and at times the disproportionate impact it had on placement decision making. People were more positive about inspection when it was undertaken by an experienced inspector with good knowledge of the children's homes sector.
- Were concerned about the costs of providing placements in London.
- Commented that information was in short supply although from differing perspectives. Information for commissioners about providers out of area, from providers about the child and from regional consortia about future demand.
- Agreed that given homes have shrunk in size then a major contributor to volatility in the market is occupancy levels, i.e. a home with four children could be financially viable, have a vacancy for a substantial period of time and it could mean serious financial problems for providers. Equally commissioners sometimes would have to trawl a large number of homes to find a suitable vacancy.

From providers, investors and others, there was everything from implication through to outright statement that placements were often made on the basis of price and the claim that Local Authorities used in house services first, regardless of the needs of the child. Local Authority run homes are also increasingly entering into the market as OPM reported⁵⁰ and consequently should be treated as such.

There were widely differing views about how sustainable the market currently was. Some providers spoke of 'being close to the edge' of mothballing homes and of falling prices meaning they were running at a loss. Commissioners indicated that they were not worried about financial health of providers and that nobody knew of a home going out of business. Investors often spoke of the difficulties of investing in this sector, uncertain returns and reputational risks being the most commonly described problems, together with a bleak future given falling Local Authority funding.

⁵⁰ Action research into the more effective strategic commissioning of children's residential care homes' OPM, July 2013, p26

Funding the market

This section on the financing of the children's residential care market has been derived from four sources.

- A detailed financial review of the largest twenty companies in the children's residential care market.
- A quicker review of the next twenty companies by size
- The telephone interviews with 50 providers described here as the financial review.
- Contextual material derived from the interviews and focus groups.

Provider financial performance

Largest 20 providers

The study of the top twenty providers illustrates the current profit/loss and debt levels of this segment of the market, with information being drawn from the most recent, publically available, financial accounts. The primary source of information was Companies House. Financial statements are filed at Companies House in accordance with Companies Acts requirements. Most, although not all, providers fall within this requirement.

Financial accounts contain a wealth of information that is subject to statutory disclosure. For this exercise we developed 21 indicators relating to financial performance and stability. These were derived from; textbook approaches of the accounting profession, banking industry and from those commonly used by credit rating analysts. A list of these is contained in Appendix 4. The aim was also to have a list of indicators that can be compared across all company accounts.

In order to obtain a comprehensive initial view of the performance of the top twenty providers, no weighting was applied to the indicators⁵¹. Hence the range of results was between 0 (none of the 21 indicators of potential weakness were triggered in the latest accounts of the provider), to 21 (every indicator of weakness was triggered in the last accounts of the provider). The results of this first screen were:

⁵¹ A list of the Indicators are provided in Appendix 7.

Table 3. Indicators of potential financial weakness in the top twenty care companies

Number of weakness indicators triggered	Number of top 20 providers in this category
0-5 lowest indications of weakness	5
6-10 some indication of weakness	5
11-15 over 50% of indicators triggered	6
16-21 highest indications of weakness	2
Information not available	2

Following on from the first screening a second source of information was accessed from a leading credit rating agency, Dunn & Bradstreet (D&B). The D&B reports were then analysed alongside a subset of indicators from phase one⁵². The subset consisted of:

Turnover trend – a reduction in turnover in the most recent period is the closest indicator available of potential reduced placement activity and hence occupancy rates. Clearly pressures on unit prices from Local Authorities looking to reduce prices or at worst hold them steady can also impact this indicator.

EBITDA and EBITDAR – These are some of the most widely used indicators of the operating performance of companies. The acronym EBITDA stands for ‘earnings before interest, taxes, depreciation, and amortization’⁵³, and EBITDAR the same but with ‘rent’ added in. EBITDA and EBITDAR are normally shown as a proportion of overall turnover or revenue. In sectors such as the care sector, where it is not uncommon for companies to hold a relatively high level of debt, this does have limitations as an absolute measure of performance⁵⁴. Poor performance or a loss at the EBITDAR level would potentially indicate severe short-term pressures.

The trend in EBITDA and EBITDAR is also indicative of whether the provider is seeing improvements or decline in operational financial performance

Balance sheet total – Specifically are the liabilities of the company greater than its assets? The balance sheet also captures the effects of the financing structure of the business.

However, the trend in balance sheet development is also indicative of whether, after all of the interest charges, taxes and other charges are taken into account the organisation managed to increase reserves (or not) in the most recent period.

The results of the analysis were as follows:

⁵² The tables are in Appendix 7

⁵³ Amortization can have more than one meaning. In some instances it used to describe debt repayment or the amount outstanding on a loan. In accountancy it more commonly means the value of intangible assets such as trademarks, patents or copyright.

⁵⁴ For example in the case of Southern Cross the company was carrying a high level of costs for the rent of property to the companies owning the properties in which Southern Cross ran their care business.

- Forty four per cent of the large provider cohort, where information is available, have negative net tangible worth, which is an indicator that the organisation may not be able to meet its liabilities as they become due. This measure of financial weakness is more acute for businesses that mainly or predominantly run children's homes, as their competitors with alternative forms of income, are able to support weaker children's homes businesses, from these other sources.
- Indicators of balance sheet weakness are exacerbated by the debt brought into the businesses when private equity or other financial institutions take ownership (predominantly via leveraged acquisitions⁵⁵). However, where owners or funders also have control over debt repayment terms and repayment scheduling the indicated weakness may be entirely within the owner's control.
- In their last reported accounts, half of the top twenty providers studied reported weakened balance sheets compared to a year earlier.
- Two thirds of the top 20 group of providers are trading below the bottom of the range typically seen in other asset based sectors such as care homes for adults⁵⁶ according to their latest accounts.
- For over half of the top 20 group those trading conditions worsened in the most recent period reported.

In general, looking across financial performance data over a period of years it would appear as if the relative profitability of the children's homes sector is lower than in adult services, fostering or residential special schools.⁵⁷ Children's Homes results are also the most volatile of children's services sector.

This is for example demonstrated in Figures 6 and 7 below.

Both figures use information for four particular large service providers over the last seven years. They are selected because their main business is children's homes (with education) and this provides a view of performance that is not compromised by other activities.

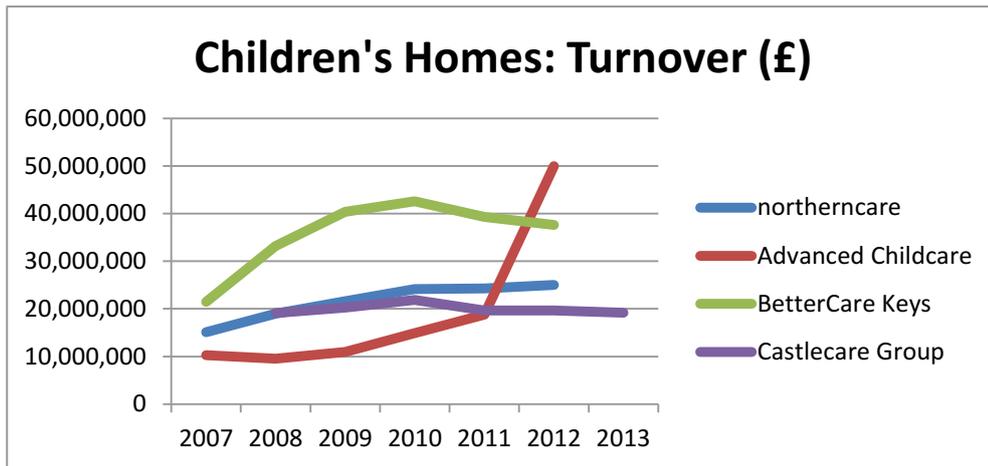
This represents the fees received for providing services to Local Authorities and can be seen in two cases to decline after previous steady growth (reported as being primarily price pressure driven, although placement numbers were also variable).

⁵⁵ A leveraged acquisition is where the purchaser borrows money against the assets and financial strength of the company they wish to purchase in order to complete the sale. The debt may then become part of the purchased company's balance sheet. A very public example of this was the Glazer family's purchase of Manchester United. The club was cash rich, free of debt and had an international profile. The family borrowed money against the asset and then loaded the debt onto the club.

⁵⁶ Laing and Buisson report to DfE October 2014 re Outsourcing of Children's Services

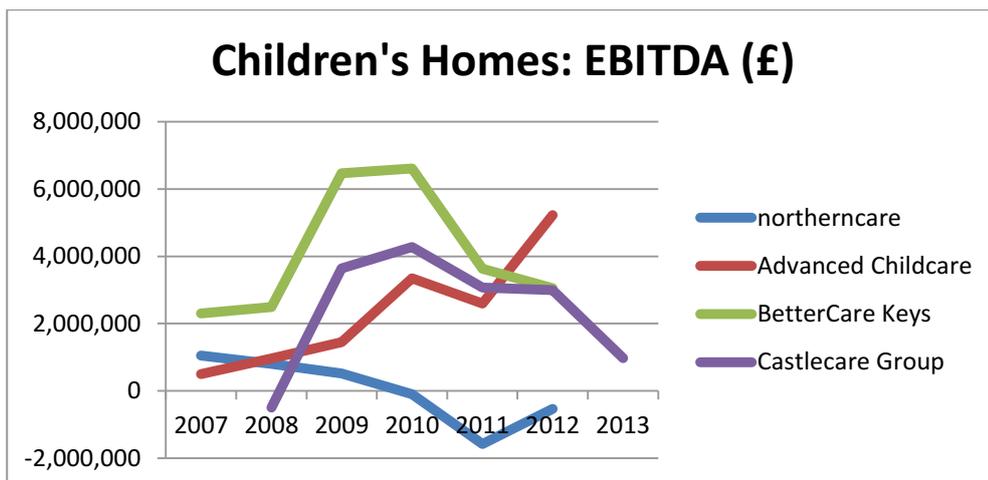
⁵⁷ Commissioning Support Programme ebook. Can be viewed at <http://www.revolution-consulting.org/publications.html>

Figure 6. Leading Residential Care providers by turnover



Advanced Childcare (Cambian from 2014) stands out in these graphs during this period due to growth fuelled by their acquisition activity. The other three providers did not mirror that level of acquisition activity and their turnover trends reflect the more general lack of growth in children’s homes markets during the period.

Figure 7. Leading Residential Care providers by EBITDA



Financial performance levels (as indicated by EBITDA in the graph above) for this same group of companies illustrate even greater volatility than for turnover. Again Advanced Childcare results buck the general trend due to the impact of their acquisitions after 2011.

The other three company results in figure 7 across the period also give insight and evidence about the financial dynamics of children’s homes services. It is notable that relatively small changes in turnover can be accompanied by much larger changes in profit levels. Overall, as can be seen above there is both considerable volatility in terms of earnings and turnover and not always a clear relationship between the two measures. In particular a modest decline in turnover can be accompanied by much steeper decline in earnings.

Medium size providers

The majority of private and voluntary sector homes are owned by smaller providers (63% of private and voluntary homes owned by 382 providers).

Although the financial performance and stability of the largest twenty providers may be indicative of the performance of the whole sector, two supplementary activities were undertaken to gather indications on the non-top 20 segment:

- A financial review of any accessible accounts of next-largest group of providers.
- Indicators were sought during telephone interviews with the 51 providers who took part in the financial review described below.

The results of the review of accounts of the second-tier of providers produced some key conclusions:

- An exploration of statutory accounts of providers beyond the top 20 quickly encounters the impact of reduced levels of disclosure requirements for small and medium sized businesses. We are grateful to those organisations that volunteered information not already in the public domain.
- Less than 50% of the private and voluntary sector market as measured by number of homes exists in entities where transparent, audited financial performance is publicly available.
- Immediately below the top 20 tier of providers are a group of providers amongst which can be found most of the voluntary sector charities. When subjected to the same 21-indicator test as was applied to the top 20, these charities fare better than their private sector counterparts. The reasons for this include the fact that the children's homes activities of those bodies are usually a minority activity, supported by other activities in adult services and/or fostering and/or social housing, and subsidised in some cases by charitable income. Historical and prudent reserves policies, combined with approaches that avoid borrowing unless for specific capital projects, result in this group of charities having some greater resilience to the volatility of the sector.
- In the tier of providers immediately below the top 20, 75% reported worsening profits or surpluses in their latest accounts. The presence of the charities in this tier introduces a new variable to performance related to the impact of funding final salary pension schemes that typically do not exist in private sector companies. Increasing final salary pension scheme liabilities, as valued annually by actuarial methods, have to be funded by charities from existing operations. In some cases the impact of the increased liabilities can be larger than the impact of all of the trading activity of the year combined.

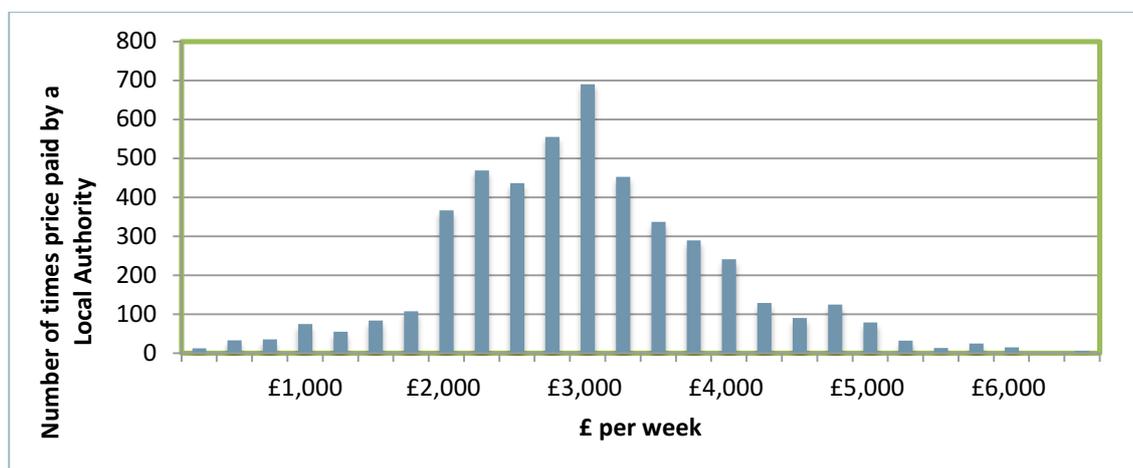
The price of care

From the interviews with commissioners they suggested the 'going rate' for placements ranged from £1,750 to £6,400 per week. The lowest costs are paid by Local Authorities with block contracts. The lower cost placements for Local Authorities without block contracts were generally £2,000 to £2,500 per week.

There are differing views amongst commissioners about the relative costs of their own children's homes provision to those of the external providers. There are weaknesses in national data collected (see footnote 17). The DfE Children's Homes' data pack (December 2014) concluded that average unit costs are comparable across sectors at around £2,900 per week⁵⁸.

Based on the data available for 111 Local Authorities⁵⁹ a review of pricing produces a wide distribution of results:

Figure 8. Independent Children's Homes' price per week - year to March 2013



There are wide variations in the price paid for care when comparison is made between Local Authorities:

⁵⁸ Children's Homes Data Pack December 2014, DfE

⁵⁹ This is taken from PSSRU: Unit Costs of Health and Social Care 2013: Based on a Freedom of Information request to all local authorities in May 2013.

Table 4. Proportion of placements costing over £3,000 by Local Authority

Five Local Authorities had more than 80% of their placements costing more than £3,000 per week.		15 Local Authorities had less than 20% of their placements costing more than £3,000 per week.	
Poole (SW)	87%	Westminster (ILB)	5%
Torbay (SW)	83%	Kingston Upon Thames (OLB)	6%
Central Bedfordshire (E)	82%	Tower Hamlets (ILB)	8%
North Yorkshire (YH)	81%	Lancashire (NW)	10%
Bristol (SW)	80%	Blackpool (NW)	11%
		Liverpool (NW)	11%
		Stockport (NW)	13%
		Hillingdon (OLB)	14%
		Hounslow (OLB)	16%
		Birmingham (WM)	17%
		Cumbria (NW)	17%
		East Riding (YH)	17%
		Blackburn (NW)	18%
		Essex (E)	18%
		St Helens (NW)	19%

Table 5. Other higher cost placements by amount

Cost per week	Placements costing £4,000 or more	Placements costing £5,000 or more	Placements costing £6,000 or more
Number of placements	516	95	8
Number of Local Authorities	92	44	6

Who invests and on what basis?

Most private operators in the market originated from small businesses set up by a variety of entrepreneurs. Interviewees have described typical backgrounds including people who have left Local Authority or health employment in order to set up children’s homes in the belief that the private sector would allow them greater freedom to design and deliver services they were constrained from doing in the public sector. Equally there are examples quoted of provider organisations where the origin of the business was simply a belief that higher than average returns could be made on property investment. The ever-increasing regulation of the market ensures that even where return on property investment is a driver, it should not be achieved at the expense of quality of service.

Beginning in the 1990s and since then a number of these businesses experienced growth especially during periods of Local Authority disinvestment in their own services. The present day location of many children's homes is likely to have been determined more by where an existing provider could add capacity near to existing resources than through market management by commissioners.

Either related to the retirement of key stakeholders, or simply because businesses reach a size where the founders no longer have the capacity or funding to take the business through further stages of growth, some of the larger providers began to experience private equity interest from the late 1990s.

Private Equity roles in the sector are described in the Key Questions section (starting on page 60), and often bring parallel investment from banks. Several of the mainstream banks in the UK have been involved in the children's homes sector off and on since the 1990s.

After a period that saw a slowdown in corporate transactions during the period following the banking crisis in 2008, activity has been slow to recover, and remains at low levels even today. One market commentator, as stated before, describes the children's homes market as *"unlikely to attract many new investors"*. However, ownership in the sector is still weighted towards smaller providers as noted in the Models of Ownership and Governance section above (page 18).

The voluntary sector plays a relatively small role in residential children's homes, but its prudent approach to reserves policies and its capacity to subsidise children's homes operations from other sources (including charitable income) is noted elsewhere in the financial review and focus groups.

Social Capital, e.g., via Social Impact Bonds has not yet made an entry to the children's residential care market despite the increase in social impact funds appearing in the funding market.

The financial review

The aims of the financial review as outlined in the original proposal were twofold:

- To examine, where accessible, the drivers of cost and fee rates at an individual home level.
- To access, where possible, indicators of how small and medium sized providers are experiencing financial stability and health in the market.

Methodology

At the outset of the research an approach was proposed to invite all providers to contribute data via an on-line survey. A small number of ICHA members volunteered to

pilot a prototype survey that looked to gather a comprehensive set of data. However, the feedback from the pilot was that:

- There were multiple factors that influence cost. Therefore, fee rates at the level of individual homes makes design of one common form of data collection extremely difficult and complicated.
- The detail required to capture the variables was so great that it made the completion of the exercise a time consuming and arduous task for providers. Smaller providers felt they did not have the resource to complete the survey, and often did not have the financial details at a sophisticated enough level to be able to attempt a response. Larger providers felt that to properly represent a range of their services the exercise would be too onerous and intrusive.
- It was not possible from the sample data returned to gain a uniform picture of pricing.

Therefore, after discussion with DfE agreement was reached that information would be collected via telephone interviews with providers using a common questionnaire⁶⁰. Providers were initially selected randomly from the full list of Ofsted registered providers. Initial contact response rates were low so more directed activity was necessary to build to a reasonable number of interviews. This then involved asking focus group attendees to volunteer to be interviewed. As a result of these activities 51 providers participated at some level. Therefore, care must be taken with the results, as the sample cannot be described as being truly random, although over and above the approaches described here no further selection of providers took place.

There were also some additional resistances to capturing the financial data required.

- The financial data being requested by the survey and telephone interviews was not information that there is any legal or contractual obligation to disclose. It is private and potentially commercially sensitive. Guarantees of non-attribution and confidentiality were not always sufficient to overcome this.
- To some providers this exercise seemed too intrusive and too focussed on unit costs and insufficiently on value for money and outcomes. A number felt such exercises were simply another tool to force down their prices.
- Some providers only seem to have a vague grasp of their financial performance data, sometimes referring the interviewers to their accountant.

The 51 providers who took part in a telephone interview were a mixture of all sizes of organisation (74% owned 10 or fewer homes, 41% owned just one or two homes).

⁶⁰ See Appendix 8

In total the organisations interviewed own 415 homes, although questions related to a specific home in each interview, and the needs of a specific exemplar child placed at the home.

They also reflected the geographical spread nationally, e.g., 31% of the homes owned by this group of providers are in the North West, 21% in the Midlands, and just 3 homes (<1%) are in London.

Results

Table 6. Analysis of the results of the financial information collected via telephone interviews (organised by theme):

Conclusion	Data	Comments
<p>There are multiple influences on price/fee strategy between homes owned by the same provider with staffing levels being the most predominant factor.</p>	<ul style="list-style-type: none"> • 75% of providers approach to pricing placements reflected basic fee with occasional variations. • 20% of providers approach to pricing placements reflects basic fee with a menu of standard additions. • 5% of providers approach to pricing placements reflects a bespoke fee. <p>Where providers had multiple homes, 60% indicated that this pricing approach did not vary.</p> <p>For those who indicated there was variation between homes, the variation was primarily due to:</p> <ul style="list-style-type: none"> • 50% of providers indicated the need for extra staff affected the price charged. • 17% of providers indicated the size of home affected the price charged. • 37% of providers indicated that there were no circumstances where they would vary price or offer discounts. • 35% of providers would offer a discount based on additional/multiple/volume of placements. • 12% of providers specified discounts as part of a contract (block, spot or other), framework 	<p>All providers surveyed were able to share their approach to pricing. The majority of providers overall approach to pricing placements reflected a basic fee with occasional variations.</p> <p>Whilst extra staffing and size of home were the most often quoted reasons for price variation, those who indicated there was a variation between homes also quoted other factors:</p> <ul style="list-style-type: none"> • The clinical model being used. • Specific add on for therapeutic input. • Specific pricing for emergency/crisis placements. • Waking night staff requirements. • Respite or short breaks slightly higher cost than longer term placements (as are residential school placements). • Rural location increases travel and staff time costs. • Framework agreements/block contracts impact on the cost of placements. <p><i>(Providers often indicated more than one factor)</i></p> <p>In addition to the variation between homes detailed above, other circumstances where price of placements could vary included:</p>

Conclusion	Data	Comments
	<p>agreement or consortia arrangements.</p>	<ul style="list-style-type: none"> • A discount based on additional/multiple/volume of placements. This was sometimes as part of a contract, framework agreement or consortia arrangements. Examples of the type of discounts offered included: <ul style="list-style-type: none"> • 2% discount for multiple placements. • 10% discount for 8 or more placements. • Agreement with 2 largest partners for 20% discount for 5th child placed. • Other reasons given for offering discounts included: <ul style="list-style-type: none"> • Long term placements. • Early payment. • If a sibling group. • For the first engagement with a Local Authority. • Arrangements with adjacent Local Authorities. • New referrals. • If some part of the provision is not required. <p>(See Appendix 5 for full list of comments).</p>
<p>Children placed residentially display a multiplicity and complexity of needs. This reflects into pricing which is similarly wide and</p>	<p>Each provider gave a profile of one exemplar child in placement. All children had more than one need identified.</p> <ul style="list-style-type: none"> • 2 needs = 5 children • 3 needs = 5 children • 4 needs = 11 children • 5 needs = 15 children 	<p>The data illustrates the complexity and multiplicity of needs of those placed in children’s residential care. A wide range of fee rates is consistent with the wider national survey results included elsewhere in this report. Education represented an average of 18% of the total fee (range 1%-29%) where reported as part of the fee. Therapeutic input represented an average of 11% of the</p>

Conclusion	Data	Comments
varied.	<ul style="list-style-type: none"> • 6 needs = 6 children • 7 needs = 8 children • 8 needs = 1 child • 77% of children were recorded as having EBD. • Other common needs identified by providers included: <ul style="list-style-type: none"> • Serious self-harm – 61%. • Risk of serious sexual exploitation – 59%. • Sexually harmful/inappropriate behaviour – 47%. • SEN – 35% • Mental health – 31%. • Criminal/antisocial behaviour – 29% • ASD/Asperger's – 25% <p>The average weekly fee was £3,289 but the range was from £1,900 to £9,325.</p> <p>71% of providers reflected a range of prices charged. The average variation was £1,158 (range £50-£6,255).</p> <p>In 39% of cases the weekly fee was reported to include education (£62-£2,640 per week). 39% of homes were registered as an education provider, with 75% of children/young people attending on site.</p> <p>In 57% of cases the fee was reported to include therapeutic input (£58-£3,702 per week).</p>	total fee (range 2%-40%).

Conclusion	Data	Comments
<p>It was not possible to detect the impact of specific needs on price</p>	<p>Looking at where specific needs were indicated:</p> <ul style="list-style-type: none"> • EBD average price paid £3,287 (range £1,900-£9,325). • ASD average price paid £3,258 (range £2,000-£4,769.50). • MH average price paid £3,483 (range £2,230-£4,769.50). • LD average price paid £3,090 (range £2,150-£4,500). • Physical/sensory impairment average price paid £3,041 (range £2,224-£4,182). • SEN average price paid £3,217 (range £1,900-£4,769.50). • ADHD average price paid £3,070 (range £2,000-£4,769.50). • Sexually harmful/inappropriate behaviour average price paid £3,250 (range £1,900-£5,000). • Schedule 1 offence average price paid £2,250 (range £2,250). • Criminal/antisocial behaviour average price paid £3,308 (range £1,900-£9,325). • Risk of sexual exploitation average price paid £3,277 (range £1,900-£9,325). • Serious self-harm average price paid £3,463 (range £1,925-£9,325). 	<p>The data suggests that there are no particular needs which drive price. Even where a significant need was present such as risk of sexual exploitation or Autistic Spectrum Disorder (ASD) there was a wide range of prices paid.</p> <p>It may be that the data set was not sufficient to establish such a correlation. However, all the indications from the interviews and focus groups was that there are a range of factors over and above need that impacts on pricing.</p>

Conclusion	Data	Comments
	<ul style="list-style-type: none"> Substance misuse average price paid £2,595 (range £1,925-£3,269). Communication difficulties average price paid £3,531 (range £2,400-£4,500). 	
Higher prices are more likely to include education or therapeutic input.	<p>94% of fees over £3,000 were reported to have education as part of the price.</p> <p>72% of fees over £3,000 were reported to have therapeutic input reported as part of the price.</p>	The data suggests that where higher prices are paid there is likely to be the inclusion of education and/or therapeutic input included in the price.
The price charged is considered to be fair.	88% considered the price they charge was a fair price for care	<p>Those who indicated 'no' reflected this was because costs were increasing but not fees (or decreasing fees). The reflection being that it's not fair on provider.</p> <p>Those who indicated 'yes' reflected this was because fees have not been increased or even that they have decreased. The reflection being that Local Authority are getting a good deal.</p> <p>(See Appendix 5 for full list of comments).</p>
The cost structure within homes is predominantly weighted towards staffing costs but varies considerably in terms of proportion between providers.	<p>Average percentage breakdown of costs (where recorded):</p> <ul style="list-style-type: none"> Staffing costs – 68% (range 45%-83%) 11% - property (range 3%-44%) 11% - direct costs (range 2%-30%) 11% - overheads (range 4.5%-26%) <p>90% of providers estimated their typical annual staff turnover (though one provider who did not provide figures reported turnover was very low).</p> <p>Average typical annual staff turnover was 17% (range 0%-50%).</p>	<p>All but one provider cited issues with staffing as the key driver of cost. This included difficulties around the recruitment and retention of staff, and the need for investment in training to ensure quality of staff. There were also concerns about pay reflecting in some cases that they pay above the going rate and in others that staff were not paid enough.</p> <p>Other key drivers of cost included:</p> <ul style="list-style-type: none"> Property costs to purchase the home as well as variable costs associated with damage to the property.

Conclusion	Data	Comments
	<p>98% of providers gave an estimate of their use of agency staff.</p> <p>41% of providers were not currently using agency staff. Of those who did use agency staff the average percentage was low 5% (range 1%-25%).</p>	<ul style="list-style-type: none"> • Insurance costs. • Ofsted fee (although this is clearly a small part of the total cost of a home). • Bills including utility, food and fuel. <p>(See Appendix 5 for full list of comments).</p> <p>Where providers reported a range, this has been converted to an average for this analysis. The provider estimating 20% use of agency staff qualified this use saying that the market was saturated with a very small pool of suitable staff in the area.</p>
<p>High staff turnover is not associated with high staffing costs.</p>	<ul style="list-style-type: none"> • Where staff turnover was 40% or higher average staffing costs were 65.7% (range 60%-69%). • Where staff turnover was 30% -39% average staffing costs were 55% (range 55%-55%). • Where staff turnover was 20% -29% average staffing costs were 66.6% (range 48%-83%). • Where staff turnover was 10% -19% average staffing costs were 73% (range 65%-82%). • Where staff turnover was 0% -9% average staffing costs were 65% (range 45%-79%). 	<p>The data does not suggest that homes with a high staff turnover also have high staffing costs.</p>
<p>Property ownership models are varied.</p>	<p>29% of providers indicated their homes were leased, 40% of providers owned all their homes with 31% of providers owning as well as leasing/renting homes.</p>	<p>A mixed picture of property ownership and leasing adds to the complexity of costing.</p>
<p>Providers are most focused on the point at which occupancy</p>	<p>Of those who indicated a target operating profit level (25%), this ranged from 5%-29%: average 13%.</p> <p>The occupancy rate at which providers break even</p>	<p>Where providers reported a range, this has been converted to an average for this analysis.</p>

Conclusion	Data	Comments
rate means that profit is generated, as opposed to setting a target profit rate.	(where revenues equal costs) averaged at 69% (range 40%-100%).	
Information provided was insufficient to substantively test the relationship of occupancy rates and profitability.	<p>The average percentage occupancy rate across providers was 83% (range 40%-100%).</p> <p>Occupancy rate versus reported profit:</p> <ul style="list-style-type: none"> • Where the average occupancy rate was 50%-75%: • 75% reported profit was up from the previous year. • 25% reported profit was down from the previous year. <p><i>NOTE: profit data was recorded for only 40% of this subset.</i></p> <ul style="list-style-type: none"> • Where the average occupancy rate was above 75%: • 50% reported that profit was up from the previous year. • 40% reported that profit was down from the previous year. • 10% reported no change. <p><i>NOTE: profit data was recorded in only 51% of this subset.</i></p>	<p>Where providers reported a range, this has been converted to an average for this analysis.</p> <p>Occupancy rates were tested against levels of concern below.</p> <p>A minority of providers surveyed were able to provide profit indicators.</p>
Financial information	<p>Balance sheet: data from 16 providers.</p> <ul style="list-style-type: none"> • 69% indicated balance sheet total was up from 	Some of the material from the financial review seemed to run contrary to the information we were given in the

Conclusion	Data	Comments
<p>available from small and medium sized providers is extremely limited and few firm conclusions can be drawn from it.</p>	<p>the previous year</p> <ul style="list-style-type: none"> • 6% indicated no change • 25% indicated balance sheet total had gone down from the previous year <p>Annual turnover: data from 21 providers.</p> <ul style="list-style-type: none"> • 62% stated annual turnover was up from the previous year • 19% indicated no change • 19% indicated annual turnover had gone down from the previous year <p>Profit before tax: data from 21 providers.</p> <ul style="list-style-type: none"> • 52% indicated profit before tax was up from the previous year • 10% indicated no change • 38% indicated profit before tax had gone down from the previous year. 	<p>interviews. There may be a number of explanations as to why this occurred.</p> <ul style="list-style-type: none"> • Whereas the rest of the survey received almost full responses these two sections had replies from as few as 40% of the respondents. Providers may have opted out of providing information if they felt it demonstrated financial weakness as compared to strength. • Large provider financial data was excluded because it was covered elsewhere. • The quality of the information received is also at issue. None of the information provided was from audited accounts (unlike the large provider accounts analysis). • The proportion of providers reporting reduced balance sheets (25%) is significantly different from the 38% reporting reduced profits. These factors would normally be closely related. This may be an indication that 13% of the providers have had to strengthen their balance sheets to counterbalance losses made, perhaps through new capital injection into the business.
<p>**</p>	<p>40% of providers reported an increase in capacity in the last 2 years. 10% reported a decrease in capacity and 43% reported no change in capacity and 7% did not provide information.</p>	<p>A mixed picture of growth and contraction. Providers are sometimes guarded in admitting closure of, or 'mothballing', homes.</p>

Conclusion	Data	Comments
<p>The smallest providers are slightly less worried about the financial state of the market than the rest of the market</p>	<p>All providers were asked to score their level of concern about the market between 1=not particularly worried, and 5=extremely worried).</p> <p>Concerns about the state of the residential care market averaged at a score of 3</p> <ul style="list-style-type: none"> • Score 1 (not particularly worried) = 10% of providers. • Score 2 = 6% of providers. • Score 3 = 29% of providers. • Score 4 = 38% of providers (30% of which scored 3.5 rounded up to 4). • Score 5 (extremely worried) = 17% of providers (38% of which scored 4.5 rounded up to 5 <p>Small providers:</p> <ul style="list-style-type: none"> • Score 1 – 5% • Score 2 – 5% • Score 3 – 38% • Score 4 – 52% • Score 5 – 0% <p>Medium providers:</p> <ul style="list-style-type: none"> • Score 1 – 18% • Score 2 – 6% • Score 3 – 18% • Score 4 – 35% • Score 5 – 23% <p>Large providers:</p>	<p>Definition for analysis: small = 1 or 2 homes; medium = 3-10 homes; large = more than 10 homes</p> <p>The data suggests that small providers are perhaps less worried than larger providers (though some numbers are small so need to be careful about judgements here. The majority of provider's occupancy was above 75% below that numbers are small).</p> <p>See Appendix 5 for full list of comments from providers regarding their rating concerning how worried they are about the market.</p> <p>Those whose score reflected not being particularly worried commented this was because:</p> <ul style="list-style-type: none"> • There was a demand for their specialist or niche services. <p>Those whose score reflected that there were extremely worried commented this was because:</p> <ul style="list-style-type: none"> • Move to fostering decreasing demand. • Needs of children increasing. • High expectations of Ofsted

Conclusion	Data	Comments
	<ul style="list-style-type: none"> • Score 1 – 12.5% • Score 2 – 0% • Score 3 – 12.5% • Score 4 – 37.5% • Score 5 – 37.5% 	
Where there are lower occupancy rates respondents are more concerned about the market	<ul style="list-style-type: none"> • Where occupancy was below 50% the average concern score was 4. • Where occupancy was 50% - 75% the average concern score was 3.75. • Where occupancy was above 75% the average concern score was 3.2. 	The data suggests that lower occupancy rates reflect greater concern about the market (though some numbers are small so need to be careful about judgements here. The majority of provider's occupancy was above 75%. Below that the number of data points are small).

What did we learn from the survey?

- The survey confirmed that although 75% of providers in the survey use a basic fee plus variations approach for pricing there are then a wide variety of factors that influence the price charged for any one placement.
- Additional staffing costs related to a placement is the most often quoted reason for a price variation, and this is consistent with staffing costs being on average the most significant cost for homes (68%).
- Prices are not only influenced by costs at the home level. The relationship and contract type with a placing authority and volume of purchasing by a Local Authority can lead to discounts.
- Prices reported to the survey fall into a wide range. The average weekly fee was £3,289 and ranged from £1,900 to £9,325.
- All children placed in homes and reported to the survey have multiple needs, with EBD (77% of survey) being the most prevalent.
- No correlations were detected between price and specific needs in this dataset. A more extensive dataset would be needed to be able to test relationships of combinations of needs and prices. However, other factors unrelated to need also influence price and these may continue to mask any significant correlations.
- The data suggests that where higher prices are paid there is likely to be the inclusion of education and/or therapeutic input in the price.
- Where fees included education it represented 18% of the total fee on average.
- Where fees included therapeutic input it represented 11% of the total fee on average although defining what constitutes a “therapeutic input” varies between providers.
- Most providers in the survey believe their prices to be fair, particularly as for some their prices have remained flat or decreased for several years whilst inflation has increased costs.
- There is consistency amongst surveyed providers as to the structure of costs at a home level, with staffing costs clearly the major influence. Related again to the complexity of need combinations and the different profiles of children placed in homes a wider dataset would be needed to detect correlations between home level costs and needs.
- Although on average, occupancy rates were reported in the survey as being above breakeven levels, there were wide ranges reported. The impact on profits could not be sufficiently tested due to profit data not being readily available from providers.
- Only 21 smaller providers interviewed in the telephone financial review provided turnover and profit indicators. Although 62% reported increased turnover, only 52%

reported increased profits. This is perhaps indicative of a sector having to work harder to stand still or to increase absolute returns.

- There was some indication that lower occupancy rates correlate with greater level of concern about the market.
- All 51 providers interviewed were asked to rate their level of concern about the market. The results in table 7 below suggest that smaller providers are perhaps marginally less concerned than their larger competitors, but the market as a whole shows that a majority of providers are either very or extremely worried about the state of the market and their ability to operate sustainable businesses within it.

Table 7. Levels of concern about the market

Level of concern	1= not worried	2	3	4	5 = extremely worried
All providers	10%	6%	29%	38%	17%
Small providers	5%	5%	38%	52%	0%

What did we learn about pricing

Although there is some commonality in the cost structures of children’s homes, (with staffing costs the dominant element), the factors that influence and drive the price charged for services are many and varied. The complexity of interrelations of these factors, combined with both reticence to share commercially sensitive information and simple unavailability of data from some providers in the short time-frame of this study means that a much larger and longer term piece of research would be necessary to be able to deconstruct and evidence potentially intricate statistical correlations. From the survey we would draw the following conclusions about what can drive variation:

- The needs and complexity and combinations of needs of the child and the resources required in meeting those needs relative to the size of the home.
- The inclusion of education service in the price, and the inclusion of therapeutic services within the price.
- The commissioning and purchasing framework within which a placement is made and whether the placement is made in an emergency or planned way.
- Occupancy rate is fundamental to the financial outcome of a home and therefore may influence pricing of any particular offer by the provider.

Anecdotal evidence from interviews quoted that prices have, in the most extreme instances slipped by as much as 25% across the last few years, especially when a block or preferred provider arrangement taking bids. The most positive views are that, at best, prices have held in absolute terms, meaning that in real terms price is reducing as compared to costs.

Only one provider regularly quotes an average price across all of their business in their statutory accounts. The trend they have reported is a decline from £3,065 in April 2010 to £2,759 in March 2014, a 10% decline in absolute terms over four years when inflation per year has run at between 1.6% and 5.2% (Consumer prices index). In real terms this level of price decrease amounts to around 25% across the 4 years.

Development of the benchmarking model

Previous sections (including the Financial Review) serve to illustrate some of the challenges involved in finding sufficient commonality of costing and pricing approaches in the children's homes provider market. Unlike other residential care markets (e.g. for adults) where there is greater homogeneity of model and greater stability of occupancy rates (and length of stay), the children's homes market is made up of wider variety of functional models of different size and ownership, and is subjected to greater volatility.

The appetite for a benchmarking model, based on the discussions held as part of this review is low amongst both providers and commissioners. Those who have tried and abandoned cost calculators in the sector experienced the complexity of detail that leads to a much greater resource requirement than could be justified, but a majority of buyers would still be interested if a tool could be developed.

Clearly a benchmarking tool will only have value if it is accepted by all parties involved. A separate paper, but developed as part of this review sets out a design for a collaborative benchmarking model approach that could be of value and discusses how it could be implemented, where ownership should lie, and how it might be developed and updated.

Summary

Accessing information to inform views about both the financial health of the market and the financial dynamics of providing children's homes services comes with a number of challenges but the evidence available paints the picture of a market that exhibits some signs of weakness.

- As noted in Section 2 of this report, there are large numbers of small, predominantly private limited companies that make up the provider base. Company Law specifies exemptions from accounting disclosures for many providers and these serve to limit the visibility of financial accounts of providers who operate less than half of the private and voluntary market homes.
- Where accounts are available they are always historical, generally representing a picture over 9 months old, and if the provider also provides other non-children's homes services the financial accounts may show a combined result where the children's homes segment cannot be separated. With a majority of providers operating in parallel care sectors that sometimes overlap there would be clear logic

in expanding financial market intelligence gathering to other children's services markets including fostering and residential special schools.

- Despite these restrictions, we have been able to form views as to the financial health of the market based on evidence collected in all tiers of size of providers, including:
- Significant numbers of the largest providers are reported as having negative tangible net worth (44%) and declining performance, including the impact of debt levels. Over half reported weaker balance sheets in the most recent reported period.
- Amongst the second tier of providers, including several charitable organisations, 75% reported weaker profit or surplus performance in the last reported period, and that children's residential care is often subsidised by other activities (e.g. fostering) or charitable income.
- The limited dataset of evidence indicates that the smallest providers appear to be having to work harder to be able to generate returns.
- As might be expected in any competitive market this is not a uniform picture. There are providers and investors expressing optimism about their role and position in the market but there are generally more providers expressing concerns.
- Despite some clear signs of financial stress on providers in the children's homes market it has not yet experienced large or wholesale corporate failures and closures. Where failures have occurred other providers have largely taken on the registered provision and maintained placements without disruption.
- However, the possibility cannot be ruled out that one or more larger providers, or a series of smaller and medium sized businesses may yet fail in the face of further spending pressures on Local Authorities and ever tightening budgets.
- In the period since private sector interests entered the market it has experienced a small number of corporate failures and a number of investors incurring losses and write offs. Where there have been failures other providers have stepped in to take over ownership of homes and thereby reduce the disruption effect. Several private equity investors and banks have taken write offs and experienced the need for much longer periods of investment than would normally be the case, eroding further any returns made.
- The complexity of needs and service types and the number of different influences on prices charged in the market, including the tensions between purchasing, providing and regulating, work to produce pricing that does not contain a great deal of homogeneity or consistency.
- The view gained through this study is certainly not of a market that is in a position to attract a new wave of investors with deep pockets of risk capital, innovative approaches, and motivation.

Key questions about the children's residential care market

Who is children's residential care for?

From both providers and commissioners we had a clear sense of a sector that was drifting. For us one of the critical questions was 'Who is residential care for?' i.e., for whom is this seen as a positive move to positive provision? This really repeats the statement made in the Office of Public Management report⁶¹.

"We recommend the sector makes arrangements for more longitudinal studies of the impact of different types of residential care provision on different sub-groups of children and young people. This would help clarify what residential care works for whom, why and under what conditions".

In our view, at the moment the system almost seems to be defined by who ends up in residential care rather than defined by what it can offer. Consequently, residential care is seen as failure, as a place of last resort; rather than it being seen as a valued and valuable service for some young people.

We also discussed in the interviews what outcomes residential care thought it was achieving and whether this was part of the commissioning arrangements. Respondents said it was often talked about, and sometimes outcomes were mentioned in framework agreements, but nothing was really funded by outcomes. For some, the children were with them for such a short time the only end product was sometimes just "containment".

Therefore, it follows from this lack of a sense of purpose or outcomes, that it is not possible to say what size the sector should be, whether it is currently too large or small, where it should be located, what should be provided and what price should be charged. It also feels as if this permeates the sector as a whole from staffing and premises through to attitudes between commissioners and providers.

The consequences of this as the recent National Audit Office (NAO) report⁶² suggests is not just in terms of the cost to children but also in the cost to the public purse.

"The Department needs to use its new Innovation Programme to understand what works, especially on early intervention, if it is to improve the quality of care and reduce short and long-term cost".

⁶¹ Action research into the more effective strategic commissioning of children's residential care homes, 2013, office of Public Management

⁶² Children in Care, National Audit Office, 2014

How might we judge stability and viability?

In terms of stability a variety of sources^{63,64} indicate what the characteristics of a stable market might be:

- Demand and supply roughly in equilibrium so prices remain reasonably constant.
- Consumers have good access to information and where producers or providers are readily able to respond to consumer demand.
- Any regulatory or legislative change contemplated is accompanied by ample warning to the supply side of the market.
- Entry and exit occurs (this divides a stable market from a stagnant market) but this takes place in an orderly fashion without consumers being disadvantaged.
- Providers are able to access reliable information about the market in order to plan for the future and make investments.

There are a number of characteristics that distort or influence the way in which the children's residential care market works from that of a 'perfect' market and where such characteristics have the potential to destabilise the market. For example:

- The purchaser is also on occasions⁶⁵ a provider of the same commodity although without the same constraints as competing with others in the market on price. Therefore, there is imperfect competition where either preferential treatment can be given to in-house provision as compared to external providers.
- Local Authorities have the potential to act as purchasing consortia thereby creating an artificial price for care and/ or enforcing unfair terms.
- An external party, i.e., the regulator has the power to terminate your business.
- Purchasers can terminate their purchase at very little notice.

If these are characteristics that make the market unstable then there are also some that work in the opposite direction. For example:

- Income is secure, in that authorities would probably only contemplate defaulting on a debt where there was some form of litigation or failure.
- Although having declined over a long period of time demand now seems to be relatively static⁶⁶. Potential providers may perceive future demand as rising if they

⁶³ <http://www.ecb.europa.eu/press/key/date/2002/html/sp021205.en.html>

⁶⁴ http://www.economicsonline.co.uk/Business_economics/Perfect_competition.html

⁶⁵ As shown earlier between a third and a quarter of all residential care placements are in local authority run homes

⁶⁶ Children's Homes Data Pack December 2014, DfE

believe that foster care breakdown will increase, or more children will be drawn into the care system.

In terms of viability there is an obvious link between viable finances and viable quality, i.e., if quality drops and homes are judged as inadequate then this can quickly lead to an organisation becoming financially non-viable. Many providers said that after 3 or 4 years of no price increases they are at the point where quality cannot be sustained or they believe that those who are undercutting them on price must be compromising on quality.

So is the market financially sound?

The contracting demand in the market after 2002 came at a time when private sector interests were becoming the owners of the majority of provision in the market. In the period since then the market has experienced a small number of corporate failures and a number of investors incurring losses and write offs. Where there have been failures other providers have stepped in to take over ownership of homes and thereby reduce the disruption effect⁶⁷. Several private equity investors and banks have taken write offs and experienced the need for much longer periods of investment than would normally be the case, eroding further any returns made.

Looking to the current performance of businesses in the market there are signs of weakness and financial concerns at all levels although as might be expected in any competitive market this is not a uniform picture. There are providers and investors expressing optimism about their role and position but there are generally more providers expressing concerns. Some of this was obviously reflected in our financial review. However, even allowing for the non-randomisation of the data in this part of the project, there were still significant numbers of providers (38%) indicating a fall in profitability over the last financial year.

In a market where there is relatively stable demand overall, this does not appear to translate into stable earnings. For example, in the larger provider interviews it was clear that there is margin pressure coming from the commissioning and purchasing focus on keeping prices flat or reducing them. More than one provider described that to maintain profitability in absolute terms they had to open more homes as the profit per home is being eroded through price constraint.

Sources of evidence, based primarily on audited financial accounts, demonstrate large sections of the market coming under increasing financial pressures as prices have declined or at best held during recent years (meaning a decline in real terms after the effects of inflation are taken into account). Smaller homes mean greater volatility in the market. If a home has four places, one vacancy means a loss of a quarter of its potential

⁶⁷ See table in the section on private equity

income for as long as the place is empty. If there is to be a market where places are available to match children's needs then price needs to be able to reflect the cost of those vacancies. Equally, if regulation is tightened more providers will find that they have homes which Local Authorities do not wish to place children in, even though the original quality has not changed.

Some providers subsidise their children's homes operations during periods when they become uneconomic from parallel operations in fostering, residential schools or adults services, sometimes subsidisation comes from charitable activities.

Where private equity and other financial investors have entered the market the pressures of debt levels associated to that entry are also present, sometimes compounding operating weaknesses.

Whilst the overall picture has not produced significant company failures, as was experienced in the adult sector, or where the rest of the sector has not been willing to step in to manage failures that have occurred, the current picture has clear weaknesses. A situation where nearly half of the top twenty providers have negative net tangible worth and half report weakened balance sheets, cannot be good for longer term viability. In addition, the view gained through this study is certainly not of a market that is in a position to attract a new wave of investors with prepared to put forward risk capital or take innovative approaches.

Therefore, the possibility cannot be ruled out that one or more large providers, or a series of smaller and medium sized businesses may yet fail in the face of further spending pressures on Local Authorities and ever tightening budgets, increased wage demands as the economy lifts of and tighter regulation.

Where is failure most likely?

Company failure in this and in other sectors, together with current market circumstances potentially gives some indication of where future provider failure may occur. It is also perhaps helpful to identify factors which may lead to a wider market failure as compared to a failure of individual providers:

- The marketplace detects a slippage in quality. This can lead to fewer referrals and fewer placements. Occupancy drops and due to the structure of costs in residential care losses are then incurred very quickly.
- Shifts in demand for services to be provided closer to the originating neighbourhood of children may lead to more remote providers, who otherwise provide good quality care, to experience a sudden drop in demand.
- Businesses that have no other forms of income other than residential homes are more vulnerable than those that have diversified during difficult trading periods. This may be particularly problematic where a provider only deals with one or two

authorities and if those authorities are experiencing particularly large drops in their income.

- A major stakeholder or debt provider loses confidence that the business can turn around weak or loss-making performance sufficiently to continue to pay back interest and capital as it becomes due for repayment to the lender. This then takes the form that the lender takes action to recover amounts due by putting the business into some form of administration or receivership.
- Providers where the operating model for care is split from home ownership (Often described as OpCo – PropoCo, where the company that operates the care is separated off from the proprietor or home owner), may be more vulnerable for a variety of reasons, e.g., rent increases which the care company cannot afford, less ability to raise finance because there is no equity to secure loans against.
- We have identified before that increased regulation may, if not force providers out of business, it may encourage some providers to leave the market. There may be a variety of reasons at work here. It could be the costs associated with complying with regulation, or where regulation means more providers move to a category where children are less likely to be placed with them or where regulation simply becomes too onerous a responsibility. For some this may not mean business failure but simply that they choose to exit the market.
- Costs incurred through changed market conditions can lead to failure. The opening part of this report referred to different types of markets. In a 'normal' market increased costs are frequently passed onto the consumer. However, this market could face a situation where labour costs rise as the economy picks up and viable labour is limited in supply but where the price Local Authorities will pay falls. Therefore, it may be sometime before the diminution in supply then forces an increase in prices.
- Finally, as was seen in the adult care sector with Winterbourne View, poor quality, reputational decline and company failure can occur very quickly, when poor quality standards are exposed by the media. Reputational loss may not only cause failure, the risk alone can be a disincentive for investors or providers to even enter the market in the first place.

What role does private equity investment play in this sector?

Private equity (PE) is a source of investment capital from high net worth individuals and institutions for the purpose of investing and acquiring equity ownership in companies.

Partners at private equity firms raise funds and manage these monies with the aim of yielding favourable returns for their funders. Typically their aims are to invest in a business, grow its value and sell it again, ideally at a price several times greater than the amount paid for the business. The usual timeframe for this would be four-seven years.

Although funders vary from wealthy individuals to sovereign wealth funds, it is not unusual for pension funds to allocate some investment funds to private equity firms. Local Government Pension Funds are permitted to allocate some of their investment monies to private equity funds and several take advantage of this.

Private equity funds will usually invest through purchase of shares of private companies, most often in companies that do not have shares that are traded on an open market (such as one of the London Stock Exchanges). Consequently, private equity investments are therefore most likely to be in medium sized companies not considered large enough for a public floatation. As such these investments are considered a higher risk than stock market investments, and funders aim for higher returns in exchange for taking that risk.

In a number of aspects, private equity performs a similar role to that of any owner of shares in a private company, be that individual founder(s), family members, employees with shareholdings, or investors who have at some stage acquired shares. That role is to monitor the performance of management of the company, challenge the business to adopt the best strategies and to implement those strategies effectively to yield a return on the share capital invested.

Some private equity funds advocate that they can add value to a market by bridging the gap between the owner/manager stage of a business' life and an organisation maturing into being a large-scale operator. Private equity professionalises management and funds the growth phase.

Private equity often comes hand-in-hand with bank borrowing, which is used to co-fund both the acquisition of a target investment and any development funding thereafter. Banks will usually only enter into these arrangements on terms that give the bank first rights of repayment and fixed interest on their lending, along with security over the assets of the business. It is that bank borrowing and terms that can create new financial pressures on a business that underperforms. The fate of business may then rest on the appetite of the bank and private equity owner to renegotiate terms to ease the financing pressures.

Private equity interests in children's homes operators have occurred in two waves, one either side of the financial crisis in 2008.

First wave of private equity investment 2000-2005

- Private Equity first appeared in the sector in 2000 with ECI Partners' acquisition of the Sedgemoor group. The Sedgemoor Group went into receivership in 2007, Keys group and others picked up some of the homes.
- Another of the early PE entrants, Baird Capital acquired Castlecare in July 2004 (only disposed of, to Priory Group in December 2014).

- Bowmark Capital first invested in Advanced Childcare in 2004 before the successful sale to GI Partners in 2011.
- From 2004, private equity company 3i put together four acquisitions (Green Corns, Farrow House, Herts Care and Cambrian Care) under the Continuum Care banner. It has been reported that 3i had to write off over £20m of their original investments before selling Continuum to Advanced Childcare in April 2012.
- 2004 Sovereign acquiring Herts Care. HSBC provided some leveraged finance and were later to be involved in the sale of the struggling group to 3i.
- 2004 Priory Group made their entry via the acquisition of the Solutions organisation in Herefordshire but also straddle the residential schools and children's homes boundaries following acquisitions such as Chelfam schools in Devon.

Caretech, floated on AIM in 2005 were originally PE backed. They have a presence in the children's homes sector following acquisition of Branas Isaf and Greenfields Adolescent Care, both of which operate homes in Wales as well as England.

Second wave of private equity investment 2009-2014

- In 2009 Options group entered a pre-packaged administration and Barclays Bank effectively took control.
- Similar to Priory, the Witherslack group is in the sector as a residential schools provider which registers its related homes as children's homes. Witherslack has been owned by ISIS (private equity) since January 2011.
- NBGI PE acquired both Horizon and Educare in two transactions during 2012.
- Bestport Ventures took a stake in Oracle care in January 2012
- Sovereign capital re-entered the sector with the acquisition of the Hillcrest Group in May 2013, and also own a number of other fostering interests.

GI Partners merged Advanced Childcare into the Cambian Group and floated the combined group onto the London Stock Exchange in April 2014.

The above list of private equity involvement is not an exhaustive list of all interests in the sector but illustrates that whilst children's homes have generated a level of private equity and investor activity in the last 14 years there are very few examples of the investors leaving the sector having made returns at the level that would have been their ambition at the outset. Indeed, some significant failures and write-offs⁶⁸ have been frequent. It is perhaps this track record that has discouraged new and innovative investment in the sector.

⁶⁸ See for example <http://www.independent.co.uk/life-style/health-and-families/health-news/the-venture-capitalists-and-the-scandalhit-childrens-homes-7782676.html>

However, the relative impact of private equity on the sector is a current work in progress. Early experiences have had a range of financial stability outcomes, from successful flotation and merger at one end of the spectrum to further sale and administrations and receiverships at the other end. Some commentators attribute less successful experiences to high levels of debt and transaction multiples prior to 2008.

The potential attractions of the children's homes market to private equity investment lie at a macro market level:

- The market is funded from sources considered sustainable in the long term, central and local government, and exists to meet demand that is coded into legislation.
- The customer base (Local Authorities) is considered low risk of default or non-payment.
- The private sector market is relatively new and has experienced growth but remains fragmented, offering opportunities from multiple acquisitions and consolidation of good practice and some economies of scale.
- The sector is highly regulated, which potentially offers participants in the market some protection from low quality entrants.
- Private equity investors can envisage, and fund, strategies that bring together operations from the multiple related segments of fostering, special schools and children's homes.

Finally, our analysis of Ofsted ratings (as at 31 March 2014) of homes did not detect significant differences in the profile of ratings for private equity providers compared to all providers, whereas there was a small improvement in ratings of the top 20 providers (in which private equity ownership is disproportionately represented) where 83% of provision was rated good or outstanding compared to 71% for homes outside of top 20 ownership.

Do current commissioning arrangements work well?

Commissioning arrangements are variable between Local Authorities and between regions and sub-regions. It is difficult to conclude whether these arrangements work well or not as there are differences of opinion across commissioners and providers.

The current picture is very strongly influenced by the need for Local Authorities to make substantial savings. Commissioning is one of the routes Local Authorities have sought to do this. For example commissioning teams have sought to hold or drive down provider prices or there has been a consolidation of commissioning functions, e.g., across children and adults.

Where arrangements are perceived to work well, Local Authorities believe they have achieved significant savings through improved commissioning arrangements and have developed relationships with providers that help them to meet need locally.

Commissioners report that framework and block contracts and the use of access to resources teams have brought a degree of discipline to the commissioning of individual placements, i.e., social workers seeking a placement have to work within prescribed Local Authority processes, for example, ensuring there is a proper statement of the child's needs and there is control on the agreement of costs and services. However, providers were critical of some arrangements where they believe that financial pressures had led commissioners leading placement decisions rather than these being led by social workers and their managers. Local Authority commissioners did not agree with this criticism of practice.

Despite this concern providers feel that the introduction of commissioning teams has provided a much needed access point in the Local Authority where information can be obtained and exchanged. There were providers who praised commissioning arrangements stating that having a clearer understanding of the population of looked after children and clarity over the direction of commissioning was enabling them to be more efficient and pass these savings on to Local Authorities.

Commissioning arrangements appear to work best, in the opinion of both commissioner and provider, where there is a dedicated post holder responsible for coordinating and managing the consortia arrangements. A lead for a consortia that appears to be working well commented that he saw his role as impartial and independent *"I act as a buffer between the Local Authorities and providers and I don't take sides."*

Both providers and commissioners said that the introduction of commissioning teams has provided a good foundation for sourcing individual placements although there are improvements to be made. There are differences of opinion as to where to focus effort on improving commissioning, with one example being the way in which referrals are sent to providers. Some commissioners feel this process is managed relatively well, whereas this was an area of concern to providers who feel that commissioners and providers need to work together to improve procedures.

In the focus groups, some providers stated that the cost of responding to commissioning requirements was substantial. Sometimes this relates to the level of financial detail, sometimes to authorities seeking similar information but different enough to have to prepare separate material for each bid or framework. They were critical of the level of resources responding to multiple tenders from Local Authorities or Local Authority consortia required and this led in some cases to providers not responding to tenders. These costs of course have to be found somewhere within the system.

Local Authorities do not in general apply the same commissioning approach to their own provision whether foster care or residential care. In that sense there is not a consistent approach across all types of provision. Those Local Authorities that have their own substantial residential child care provision relative to their needs are least likely to focus on developing external commissioning of residential care because they have no need to.

Some commissioners stated that in their area there was an oversupply of residential child care relative to local needs they have also, in some cases, limited their engagement with the independent sector. They see no benefit to them locally of such engagement and have concerns that it could be seen as encouragement when they wish to discourage more provision being developed in their area.

There are differences of opinion regarding the effectiveness and efficiency of monitoring arrangements. This appears to be an area where both commissioners and providers recognise that improvements are needed. There were very few examples of shared monitoring arrangements and we found that providers who had qualified to be on the same framework were being subjected to very different monitoring requirements, the more extensive of these adding considerably to a providers costs. Commissioners overall recognise that there is inequality and difficulty with monitoring arrangements and the need to ensure that future commissioning exercises take this into account.

It is evident that providers have very mixed experience of commissioners. This reflects the variable picture described above with the added dimension of the providers direct relationship with the placing Local Authorities, placement officers, social workers and independent reviewing officers. Where that relationship is weak, i.e., changes of social worker or social workers who do not know the child well this is an unhelpful addition to what is already a complex set of relationships.

The greatest area of weakness is probably in the development and use of sufficiency statements and strategies. As OPM reported⁶⁹;

“Interviewees agreed that placing in area is beneficial (for most children and young people) and would like to see the right mix of supply in their area; however there was general acknowledgement that many authorities have failed to complete, update or publish sufficiency assessments. Some Local Authorities are updating them currently. The sufficiency duty feels to some like an additional exercise rather than an integral part of the commissioning process”.

In theory sufficiency statements should help to drive strategic commissioning as distinct from procurement. It should help providers understand what Local Authorities need for their children, local supply and help Local Authorities identify the specialist needs they cannot effectively commission for at an individual Local Authority level. Ideally such a strategic view should help to drive innovation or at least identify where it is necessary.

In conclusion, we were unable to identify any consortia that had commissioning arrangements where there was an agreed view between commissioners and providers that they were working well. Local Authority commissioners believe they are achieving

⁶⁹ Action research into the more effective strategic commissioning of children’s residential care homes’ OPM, July 2013

improved value for money. We were however, able to identify elements of consortia arrangements which both commissioners and providers believed to be working well and which could be built on too improve the current arrangements.

Does the price of residential care equal value for money?

It is hard to explore this question without opening the debate about whether care should be funded on the basis of the outcomes it delivers as compared to the cost of places and from that as we asked in the opening question in this section, 'who is residential care for'. The National Audit Office clearly believes this impacts on value for money.

*"The numbers of children getting the right placement first time has not improved since 2009. Over the past 5 years, where data are available, improvements in outcomes have been, at best, mixed. Their learning and development needs, if not successfully tackled, can result in significant and avoidable detriment to themselves, and increased costs and risks to Local Authorities and the taxpayer in the long term"*⁷⁰.

Clearly if a straight financial comparison was made between foster care and residential care then the former is cheaper. Residential care providers would point out that they provide a different service to children with greater needs often when foster care has not worked for a child. On top of which are those who would say sometimes they have children for such a short period that the only realistic outcome measure would be whether they contained the child when they were placed with them.

Therefore, without wishing to appear tautological the answer is probably based on what is it that we expect residential care for children to achieve. From that position it can then be asked 'are those expectations feasible within the price that Local Authorities are prepared to pay.

In 2008 the New Economic Foundation published a report⁷¹ looking at the long term cost of residential care. It found that

- For every additional pound invested in higher-quality residential care, between £4 and £6.10 worth of additional social value is generated.
- In one of the case studies it suggested that the total value of these services is equivalent to almost £700million over 20 years. Put another way, what is saved on other social costs by investment in this kind of residential care would be enough to pay for the country's entire annual care bill for children in care.

⁷⁰ Children in Care, National Audit Office, 2014, p50

⁷¹ A false economy: How failing to invest in the care system for children will cost us all, Eilís Lawlor, New Economic Foundation, 2008

We would suggest, using the evidence available about for whom and how residential care works, there needs to be a dialogue between government, providers and commissioners which positively re-images residential care, that identifies the populations who need and can benefit from this resource and over what time period. From that, a stronger national picture of what size and shape this market should be can be drawn, which in turn should be at the centre of commissioning practice.

Does regulation help or hinder the market?

It was recognised by providers and by commissioners that inspection is not always an easy or comfortable role to perform. Equally, there was nobody involved in the interviews who suggested that inspection should not continue. In the current climate surrounding care homes and child sexual exploitation it is to be expected that inspectors will both be more vigilant and more cautious in their recommendations.

As Ofsted's data shows (see Fig 6) and reinforced by the ICHA report⁷² regulatory trends are a cause for concern because more homes are only achieving an adequate rating (whether this represents poorer performance or more rigorous regulation is a matter for debate). If Local Authorities are not placing children in homes that are adequate (62% of Local Authorities say this⁷³) then this restricts the pool of residential care available. In addition as ICHA argues it's not just the grading but also the speed at which a grading can be removed through re-inspection that also potentially has an impact on market viability.

What is not in dispute is the need to recognise that the regulator cannot be market blind⁷⁴. Three things are clear from the evidence we have reviewed; first that although from one quarter to the next there can be a wide variation, the overall trend is that the number of homes with an adequate /inadequate grading has risen. Secondly, many local authorities say they will not place in a home with an adequate grading. Thirdly, a higher proportion of homes in these two categories close as compared to the other two categories.

Given that the regulator is acting in the interests of children, if its actions contribute to restricting choice within the market and hence placements available, then this cannot

⁷² Remedying a worrying situation, Independent Care Homes Association 2015.

⁷³ Remedying a worrying situation, Independent Care Homes Association 2015.

⁷⁴ Ofsted in its current Social Care Registration Handbook describes its responsibilities as: "Ofsted registers providers and managers in order to: protect children, young people and vulnerable adults, ensure that children's social care establishments or agencies meet any relevant regulations and national minimum standards, ensure children and young people are safe, well cared for and take part in activities that contribute to their development and learning, promote high quality children's social care and provide reassurance to children and young people, adults using adoption support agencies or residential family centres, parents, parties responsible for placing children and young people, the government and the public".

necessarily be in children's best interests. Equally this is not to suggest that the regulator should change a grading to ensure a home can continue. However, regulation needs to go hand in hand with the means of, and demonstration of, improvement. The task cannot be just to inspect. Other regulators, in addition to the enhanced role in Adult Care for CQC, do have wider responsibilities towards their markets. For example, Ofgem and the Competition and Markets Authority work together to look at fair competition within their sector⁷⁵. The Financial Conduct Authority⁷⁶ has a clear role towards its market as it states on its website.

"We make risk-based judgments about whether the firm's business model and how it is run results in fair treatment for consumers, that it upholds market integrity and, for those firms that we prudentially regulate, that it is financially sound."

It is already part of Ofsted's role to seek information about financial viability of homes and providers. However, this information does not seem to form part of any overview of, or report on, the market and its viability. Given the information it already holds, as its guidance below indicates, consideration could be given to extending Ofsted's role in this way, i.e., to report on the state of the market not just on its regulatory role

Ofsted's guidance states: *"Regulation places the onus of proving financial viability on a provider. At registration, a provider's business plan should give Ofsted a good general indication of: an applicant's planned income and expenditure, how an applicant will manage the finances"*. It goes on to state. *"If the finances of each establishment or agency within an organisation are managed centrally Ofsted will require evidence of the financial viability of the overall organisation when an application for registration of a new service is received or where a registered service's financial viability is in question"*. Ofsted states that it has extensive financial expertise in its finance team, although we were not able to obtain information on how many referrals were made by inspectors to this team for advice, how many case reviews arose from this and how many providers were refused registration or where the primary reason for de-registration was down to financial impecunity.

Who is responsible for this market?

Alongside positively re-imagining residential care it is hard to define who is responsible for, or who has oversight or perhaps more pertinently care of, the market. We were struck by three particular aspects of the market:

⁷⁵ See <https://www.ofgem.gov.uk/ofgem-publications/89666/mougemaandthecmaconcurrentcompetitionpowersaugust2014.pdf>

⁷⁶ <http://www.fca.org.uk/about/what/regulating>

- In comparison to adult care there seems to be a much greater distance between providers and commissioners/Directors of Children's Services. It is perhaps a strange (and strained) relationship that the Local Authority, acting in loco parentis, gives their troubled children to somebody else to look after but then does not have a close, trusting or nurturing relationship with the organisation that looks after them.
- There seemed to be few forums where senior managers and providers sat down together at a national or regional level.
- As indicated above Ofsted, as compared to say CQC, are not responsible for the market, and it is not part of their legislative duties. Instead they see their responsibilities as being towards children and the quality of care in the homes they inspect.

One consequence of this distance is that trends in provision within the market place are neither routinely captured nor reported (the Children's Data Pack being an exception). There is no annual report, from the regulator or ministry, covering in detail the state of the children's residential care market and its financial health or across the markets dealing with children accommodated away from home. Given the squeeze on Local Authority funding, plus the fragile state of some providers, understanding the overarching viability of the market on an ongoing basis by both government and Local Authorities would seem to be critical.

Despite the majority of this market being run by private sector organisations there still seemed to be some reluctance to accept this and the role of larger commercial providers on the part of some commissioners. There were also concerns about the impact of large commercial providers on some smaller providers, e.g., they can sustain losses for longer. However, these are not the only pressures within the system. Corporate commissioning in places is at odds with children's commissioning, social workers and reviewing officers may have different views about placements from commissioners, regional consortia have a different view of the market from individual authorities.

It is easy to say somebody should be responsible for the market but harder to say who. Local Authorities can argue that often children are not placed within their local market and some Local Authorities have few homes whereas others have many. Therefore, there is not the same closeness between the market and an individual authority as there is in the case of adult residential care. Equally difficult, and as stated above, Ofsted does not have a mandate for wider market responsibility and, we felt, was saying it would not welcome this. Ofsted may well feel that having such market responsibilities could compromise its role, for example, is it in the best interests of a child if a home that it likes and has done well in closes down through the actions of the regulator. The logical place for market responsibility might be the regional consortia, but if so this would need formalising, have some statutory authority and maybe at more of a strategic, mid-point between providers and commissioners.

Conclusions

Introduction

In undertaking this project we were asked to focus on three particular areas:

- **Understanding financial profitability, stability, and the role of private equity.** This to be achieved through an analysis of the current financial health and stability of the market, including a detailed analysis of the viability of the largest providers, a summary of the publicly available indicators of financial health, their meaning and analysis of the factors that impact on the financial health of the sector.
- **Understanding the cost of residential care.** This to be achieved through research to understand the drivers of the cost of provision and the reasons why cost varies across the independent sector homes in the market.
- **A clear understanding of the types of commissioning and financing models used in the sector and their impact on the market and outcomes for children.** To be achieved through a review of the theory and evidence on the impact of commissioning method on market outcomes (both financial health of providers and wider social outcomes such as service quality).

It was outside the scope of this work to look at whether a market in children's residential care is a good idea, whether it costs more or less than state funded care and / or delivers better outcomes. This was also a project completed to a swift timetable and clearly there are other new areas which need exploration or existing areas that require greater depth.

From the preceding Key Questions section it might feel as if this report is often saying 'it depends on this or that' or 'there were a range of differing views'. Nonetheless that is often an accurate representation of this market, fragmented in a whole series of ways. In this concluding section we have tried to bring together an accurate picture of how we have seen this market based on the original topics we were asked to address. This followed by ten recommendations that we feel would help improve its performance and viability.

Understanding financial profitability, stability, and the role of private equity.

As we reported:

- Significant numbers of the largest providers are reported as having negative tangible net worth (44%) and declining performance, including the impact of debt levels. Over half reported weaker balance sheets in the most recent reported period.

- Amongst the second tier of providers, including several charitable organisations, 75% reported weaker profit or surplus performance in the last reported period, and that children's residential care is often subsidised by other activities (e.g. fostering) or charitable income.
- The limited dataset of evidence indicates that the smallest providers appear to be having to work harder to be able to generate returns, although because it is harder to obtain data across the largest part of the market we would suggest the picture here is less clear than for the larger providers above.

In addition, this is not a stable market and some of the factors present in adult care, which led to the development of its market oversight regime, are also present in this sector, such as falling or static prices, separation of property from care delivery, etc. However, this market does have some additional ways of dealing with a financial crisis such as mothballing homes. It would be hard to 'mothball a forty bedded home for older people. However, in a small market such decisions are not without consequences in terms of the availability of suitable placements.

If we have a private market then inevitably there will be different sources of funding to support that market. There are those who argue at a time when bank investment was and is limited, that the care sector for adults and children had to find other sources of funding and hence private equity (PE). However, the custom and practice rules by which private equity operates may not always be the best basis for promoting stability within the sector, although investors would argue it does promote good practice. Selling on a business that has a good reputation is always easier and more profitable than selling one that does not.

All the companies we spoke to identified this as a high risk market to enter, some of the private equity arrangements had incurred substantial losses whilst others seemed more like other residential care providers with a closer role in management than might be expected from private equity. Whilst this may be good for care it may not necessarily be good for their investors and may discourage others from entering the market. We also gained an impression that PE investment in this sector seemed to stretch over a longer time period than typical PE investments

Understanding the cost of residential care⁷⁷

As we have outlined clearly in the report there is no simple linkage between need, or level of need and price to be paid for a placement. Staffing costs remain the most significant factor in producing variance, mainly where either additional staffing resources are needed or because of the need for some specialist interventions. However there is not a consistent relationship that we could identify between these increased staffing costs

⁷⁷ Part of the commission of this piece of work was to produce a report concerning the potential for the development of a benchmarking cost model. The report on this will follow at a later date.

and the price paid. As reported from our discussions and survey there is also often little adherence to regional pricing frameworks; these can get overtaken by the urgency of placement need through to additional 'add ons' to a basic framework price. Some providers indicated they did not join framework agreements but nonetheless still seemed to enjoy a high number of placements.

There seemed to be little support from either commissioners or providers for a national benchmarking tool. Therefore, in the report to be separately provided we have adjusted, in consultation with the Department, the brief around this activity.

Perhaps the easiest link between price and need is in the sector where children and young people have profound and multiple disabilities and where the cost implications of high level staffing needs are at their clearest. Yet even here there is a wide range of pricing.

On a wider more macro level there is also a linkage between size of home and expectation of length of placement. For example, the smaller the home, the shorter the length of stay and the greater the degree of problems or needs the child presents, then the higher you would expect the price to be. Obviously location and staffing levels influence this but in general what is being paid for here is the management of risk. Smaller homes, taking emergency placements, mean vacancies have a higher impact on viability. The same may also be true in terms of managing children's needs as we have stated elsewhere partly through concern over inspection but also because it may cause compatibility issues of one child being able to live with another.

We were not able to look at the unit costs or costs per placement of Local Authority provision and it may be beneficial if this were to be included in any further work. Commissioners and others such as CIPFA have all indicated that there is not a uniform approach to costing.

A clear understanding of the types of commissioning and financing models used in the sector and their impact on the market and outcomes for children

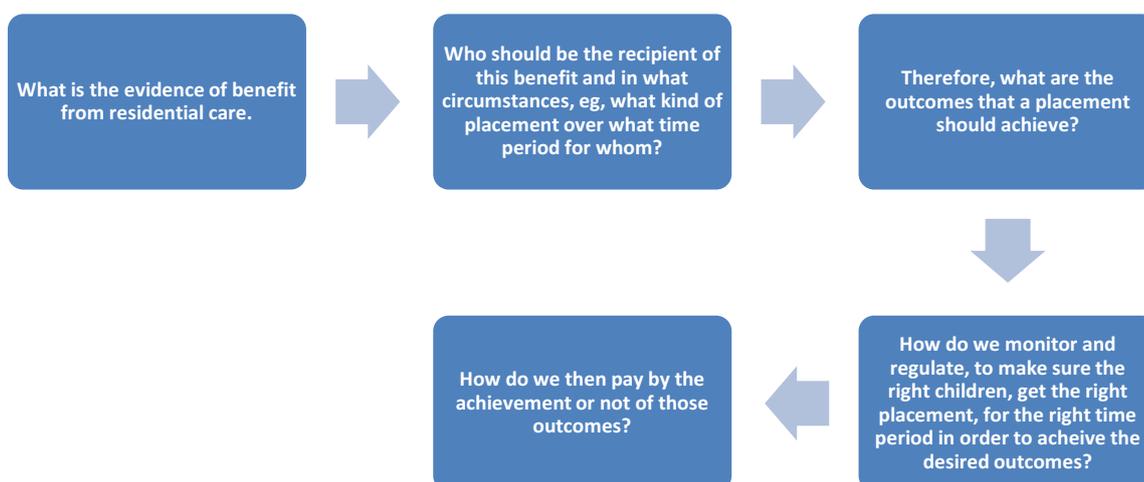
Commissioning is not working well enough either for Local Authorities or providers or children. The current processes such as framework contracts are complex and resource intensive and seem not to work well as there are so many places spot purchased. There is poor communication about needs from Local Authorities to the market and there is no overview in most regions of needs⁷⁸ and no national overview. We were concerned at

⁷⁸ The Department has commissioned an additional project concerning regional consortia. Therefore, these conclusions and recommendations will not deal with that activity.

the suggestion that in deciding on placements children's needs might not be paramount but that there was a hierarchy of placement provision that assumed in house fostering was first choice through to private external residential care at the end of the chain. We were equally concerned at the suggestion that some providers seemed to turn down children with complex problems or move them on, because of anxiety about forthcoming inspections.

Although it is a topic re-worked in a variety of reports to DfE the question of who should residential care be for is not just an academic exercise or a research question but needs answering from a practical perspective as a guide for commissioners. Failing to be clear about who residential care is for when and why means inevitably you end up with a reactive, last resort, service which is often seen as failure by social workers and children alike. Such a system automatically starts by being seen as low value. Obviously these are issues that should concern the regulator as much as commissioners and as Fig 9 suggests there is a relationship between purpose outcomes, monitoring and regulation.

Figure 9. From purpose to payment



In the key questions, we identified issues between the regulator, providers and commissioners as being of concern. Clearly the actions of the regulator have an impact on the market in two ways. If quality deteriorates or the regulatory bar is raised then more homes are likely to fall underneath that bar. If more homes fall beneath a level at which Local Authorities will place children then the market will retract giving less choice. Some of this depends on the speed with which homes can restore a good grading which also depends on the speed at which a home can change its regulatory status. Fear of getting a poor grading may also drive provider behaviour in terms of which children they are prepared to accept. No one party causes this but the interaction of all three can potentially have a detrimental effect on children.

Although only on the periphery of our brief we did gain an impression that there is not a lot of thinking about strategic commissioning jointly taking place in the children's sector between Directors of Children's services and chief executives of some of the larger children's residential care services providers. If we wish to introduce greater stability into

the market there needs to be greater trust and openness between strategic commissioning and planning by providers. We believe there is a desire for this but not the vehicle to deliver it.

There is no market oversight and there would be benefits to having such a national oversight of the financial health and development of the market. Therefore, it tends to mean that the market is always dealt with retrospectively, i.e. to resolve a problem or crisis. Given what we understand about the finances of some of the providers in the sector we think there is a case for developing oversight of this market. That is not to say that any national market oversight arrangements should be, or needs to be, the same as those in adult care.

At a local level, in adult care in recent years there has been the development by Local Authorities of market position statements. Documents intended to show what supply and demand is like in local care markets and publish where the Local Authority is heading in the future with its commissioning decisions and why. It might have been thought that sufficiency statements would have filled at least part of this role. Yet in our interviews and discussions few people mentioned these apart from some of the regional consortia and there seemed to be a feeling that they were not a core part of commissioning⁷⁹. Therefore, the MPS concept could be extended to children's services as a way of encouraging responsibility for the market by Local Authorities.

In adult care it is fairly easy to see that the Local Authority should be responsible for producing the statement on services within its boundaries. For children it is not so clear cut. Should it be with:

- The commissioning authority although this would be difficult given that several Local Authorities may place a child in a single home.
- Regional commissioning consortia. If so there would be a need to formalise the regional arrangements and give it some power and authority to access information on both the commissioning side and the supply side.
- A national commissioning body which is often mentioned as a possibility for highly specialised care but again would involve considerable work to set up and where there may be difficulty in defining boundaries between what remained a local responsibility and what should be national

Therefore, the logic is that if such statements are to be produced they should be by the host authority where a home is located. This would be consistent with the Children's Homes Regulations 2015 concerning location assessments.

⁷⁹ This matches the conclusions that OPM came to in their report 'Action research into the more effective strategic commissioning of children's residential care homes' OPM, July 2013

Recommendations

The wider market

Recommendation 1. We have looked at one part of what is a wider placement market for children. We understand that other parties are currently exploring and will report on the children's secure sector. In addition, given the close interplay between fostering and residential care we would recommend that a parallel review of the fostering market is undertaken.

As indicated at the start of this report, the market is really a placement market where fostering, secure accommodation and residential care all interact with each other. Therefore, the eventual view needs to be one of the whole market not just this segment.

Recommendation 2. As we noted at the start of this paper the voluntary sector has increasingly removed itself from residential child care over many years. We feel this has limited diversity and the potential for innovation, given that the voluntary sector has a track record of fund raising to help absorb some of the risk in being innovative. Equally, there is also little social enterprise and /or social investment taking place in this sector. The latter could provide a test bed for developing outcome based funding. **We would recommend that the innovation funding programme, with which DfE is currently engaged, considers how more diverse forms of funding may be encouraged to play a wider part in stimulating innovative practice in children's residential care.**

Regulation

We need to have a better factual understanding of the relationship between inspection, placement and closure. It was not possible to do this within the timescales we had available and without more data being available to us. However, we know already that homes that are rated inadequate or adequate are more likely to close. It would also be helpful to know:

- What is the pattern of openings (new registration) and closure (deregistration's) of homes, i.e. are particular types of homes from particular providers being closed, what kind of provision are people entering the market with and are these new or existing providers.
- The pattern of placement prior to adequate gradings and after. This might be in terms of the type of child placed, the problems they presented and the length of placement. This could probably only be obtained either from the details of inspections and / or with the cooperation of providers.

Recommendation 3. We would suggest in taking this report forward there should be an outline data set that can benchmark market stability based on a combination of factors. To achieve this would require the cooperation of Ofsted's data capability but

should also link into the recommendations below about the development of market intelligence prior to the commencement of any market oversight regime. Before any consideration of national market oversight there needs to be a period in which the data available can be reviewed on the basis of what it tells us about the market. This report is an important contribution to that process.

Promoting cooperation

Recommendation 4. We have mentioned already the need for closer relationships between Directors of Children’s Services and chief executives of residential care providers in order to improve strategic thinking about the future of the sector. One way of improving this could be **a facilitated joint enquiry between these two groups of leaders designed to review the evidence and come forward with practical working proposals on who is residential care for and how should this be implemented as a commissioning benchmark across the country.** There are three good proactive reasons for this:

- The discussion about the purpose of residential care and the outcomes it should deliver must not be an isolated academic debate but deliver a practical approach to future commissioning.
- We cannot be clear about the size and shape of the market in the future unless we are clear about what it can or should deliver
- Being clear about who, how and what, residential care delivers, enables the sector to play a more beneficial role in child care rather than being an unfortunate placement when all else fails.

We feel it is important that this is sector led rather than government or regulator led and focuses on implementation and monitoring of its achievement through voluntary but binding agreement. Once such guidance is produced it could help providers focus their efforts, enable the regulator to focus more on difference made / value added, not process/compliance issues and help commissioners and providers together develop more sophisticated outcome based approaches to developing and funding services.

Recommendation 5. Providers who straddle more than one authority spoke of the time consuming nature of covering many framework agreements and procurement arrangements where the information requested is often broadly similar but sufficiently detailed to mean the exercise has to be completed differently for every tender, for example finance data requested, insurance certificates. **We would recommend that the potential for a national depository for this information is explored to which authorities and providers could sign up so that the material is only written once but can be ‘unlocked for access’ by a provider who wishes to respond to a tender or a framework agreement.** The virtue of this approach is that it would mean greater but uniform detail could be supplied at less cost to providers and greater benefit to

commissioners. It would need to be to an agreed format. We understand the LGA, ICHA and others are currently reviewing the national contract. It may be appropriate that they also look at the potential for a single data depository as suggested above.

Recommendation 6. We would recommend there should be a common approach to the development and description of sufficiency statements for provision for looked after children to help providers understand need and enable Local Authorities to aggregate these statements more effectively at a sub-regional or regional level. Alternatively the sufficiency statement responsibility could be subsumed into market position statements (see recommendation 9) but again with a common framework to encourage aggregation.

Recommendation 7. We were surprised that many of the large providers spoke to us about the lack of informal opportunities for meeting, for blue sky thinking or for mutual discussion of problems and issues with Children's Services Directors and commissioners. At the same time both commissioners and providers spoke about the motivations of each party in rather suspicious terms. Our sample may have missed those commissioners or providers who do engage in this, but if not already in place **we would recommend there should be regular round table market review meetings between representatives of those who provide accommodation for children, Ofsted, DfE and Children's Services Directors. At a national level such a group should be able to make direct recommendations to ministers and should have an independent chair or chairing that is shared between the participants.** If successful at a national level this may be an activity that could be further developed by regions. This recommendation is in addition to, and separate from, the suggestions for the specific work in Recommendation Four.

Understanding the market

Recommendation 8. This exercise has been a one-off review of care markets and although it is to be hoped its conclusions and recommendations have a lasting impact, the data it relies on, is time limited. We do believe that this market needs an oversight function, as is being put in place in adult care. However, we would also suggest that the sector takes time to come to a view of what oversight would be of mutual benefit to government, commissioners and providers in order to help the sector to stabilise and some of our other recommendations to begin to have an effect. There is little point in putting in place processes that only become an additional burden on providers or collect vast amounts of data that remains unanalysed. Consequently, we would suggest there needs to be an effective and considered 'rehearsal'. **We would recommend that over the next two years a children's market review body is commissioned, which has two functions. To report and publish on a six monthly basis a 'state of the market' report to be widely disseminated throughout the sector. Secondly, to work with all key stakeholders, in developing a planned market oversight regime, of benefit to both providers and commissioners.** Such a body not only needs to consider the negative aspects of market oversight, e.g., how to maintain continuity of care in the event

of a large provider failing but also a positive approach, e.g., how can improved information about the state of the market stimulate new sources of investment, provision and innovation. Clearly it will need to consider and rehearse the data set needed to fully understand the market. This may entail considering what financial information should be disclosed by providers and to whom, if they wish to practice in this area.

Recommendation 9. We believe there is a good case for, and hence would recommend, the development of market position statements (MPSs) across children's accommodation services and would suggest that such statements should cover the entire accommodation market for children not just residential care. A case could be made for this task falling to properly constituted regional consortia but it would need development of this role for it to work well. At the moment the appropriate body is the Local Authority but this may require some financing and a balance of that financing based on where homes are located. If the MPS is a requirement then there should be a central depository in which statements could lie so that they could be accessed by any Local Authority or provider, they should be updated at least annually and they should be to an agreed national standard and framework.

Recommendation 10. Many commissioners spoke of the difficulty of wider placement finding outside their area. We were later informed by Ofsted that there is a national database of placement locations which some 109 local authorities can access. However, somewhat surprisingly in our discussions no local authority referred to this. We also know that some of the categorisation of information is not up to date and may only reflect a position at the time of initial registration. **We would recommend that there is a review of what information about wider placements is available to / sought by commissioners in local authorities and how current arrangements might be improved to cover the information authorities feel they need, e.g., location, whether they take children in an emergency, contact details etc.** A revised and more available facility would obviously need to have considerable data protection around it, but we feel the benefit to those looking for placements and hence the benefits to children outweigh the risks. We believe Ofsted as regulator would be well placed to take this forward, in consultation with LAs and providers, given its existing role.



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Any enquiries regarding this publication should be sent to us at:
rob.cartwright@education.gsi.gov.uk or www.education.gov.uk/contactus

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