Appendices and glossary

Appendices

A: Financial analysis

B: Key aspects of the legal framework

Glossary

Appendix A

Financial analysis

Contents

Appendix A 1
Financial analysis 1
Contents 1
Introduction 2
Summary of findings 2
Methodology: introduction to datasets and profitability 5
Datasets used in the financial analysis 5
Operating profitability 7
Economic profitability of Residential accommodation and replacement cost of Fostering agencies 10
Profit margin analysis (Fostering agencies) 22
Summary of our approach to profitability 24
Profitability results – 15 Large providers dataset using company-level data 25
Group level aggregated findings 25
Profitability of the Children's homes segment operated by the Large providers 28
Profitability of the Fostering services segment operated by the Large providers 34
Profitability of the Unregulated accommodation segment operated by the Large providers 43
Pricing and operating cost analysis using the 15 Large providers dataset and LA dataset 45
Average fee per child in Children's homes (operated by the Large providers) and LA operating costs 45
Average fee per child in Fostering agencies (operated by the Large providers) and LA operating costs 50
Average fee per child in Unregulated accommodation (operated by the Large providers) 53
Financial leverage and resilience results – Large providers dataset 54
Introduction 54
Financial leverage of providers primarily focussed on Residential accommodation 59
Financial leverage of Large providers primarily focussed on Fostering services 67

Introduction

1. This Appendix explains our methodology and shares our financial analysis of the UK's 15 largest providers of children's homes and Unregulated accommodation (which we refer to collectively as Residential accommodation') and Fostering services,[1] and 29 local authorities (LAs). It updates our Interim Report (IR) findings and considers parties' submissions in response to the IR. We refer to these 15 providers as the 'Large providers'.

2. The report's main body discusses the implications of the financial analysis findings of the Large providers. This Appendix is a factual presentation of our results.

3. Our financial analysis considers the following issues regarding the Large providers:

   (a) whether and to what extent their profits and prices were higher than would be expected in a well-functioning market;

   (b) how their operating costs compare to LA settings and what factors drive the differences; and

   (c) their debt levels, and how these vary between Private Equity (PE)-owned and non-PE-owned Large providers.

Summary of findings

4. Our findings for Children's homes operated by the Large providers between financial year (FY) 2016 and 2020 are that:

   (a) the average fee per child increased year-on-year from £154,800 in FY 2016 to £199,100 in 2020, representing an annual growth rate of 5.2%. While operating costs increased,[2] providers simultaneously benefitted from above-inflation increases in fee rates, thus keeping the operating profitability margin flat at 22.6% on average. The Large providers benefitted from stable occupancy rates (83% on average) and revenues during the five-year review period;

[1] We have used a combination of the Large providers' aggregated group (company) level data, which includes Wales, Scotland, England and Northern Ireland; and home and agency-level data for Wales, Scotland and England.
[2] One factor (among others) that led to operating cost increases was the Government's introduction of a new mandatory national living wage (NLW) for workers aged 25 and above, effective from 1 April 2016.

(b) profitability (measured by economic profit margins) was materially higher (equivalent to an uplift in prices of 10.4% to 16.5%) than we would expect in a well-functioning market.

(i) this analysis reflects the high real rate of return (return on capital employed (ROCE)) earned by the Large providers of 11.1% compared to our benchmark of a 3% to 6% expected real rate of return. We consider these economic profits to be supernormal as the Large providers have earned above-market returns over several years in a steady state, with an absence of factors that might justify high returns (in the short term), such as intellectual property, research and development (R&D), specialist technology or human capital; and

(ii) the economic profit margins that we have calculated reflect conservative assumptions, which therefore reflect a lower-bound;

(c) put in absolute terms annually, the Large providers earned economic profits of £18,400 to £29,000 per child on average and £29 million to £45 million in aggregate;[3] and

(d) LA operating costs were 30% higher on average than those of the Large providers. Higher LA staff costs per staff member and more LA carers per child drive this difference.[4]

5. Our findings for Unregulated accommodation operated by the Large providers between FY 2018 and 2020 are that:

(a) the fee per child remained stable at £49,300 on average. The very high operating profit margin declined from 39.9% to 35.5%, driven by operating cost increases. Unregulated accommodation had a relatively lower cost but was a higher margin segment compared to Children's homes;

(b) profitability (measured by economic profit margins) was materially higher (equivalent to an uplift in prices of 23.1% to 29.9%) than we would expect in a well-functioning market.

(i) we consider these economic profits to be supernormal for the reasons outlined above;

---

[3] The average number of children between FY 2016 and 2020 in Children's homes operated by the Large providers was 1,551.

[4] We recognise the challenges in comparing the operating costs of LAs to those of Large providers. Hence, we asked LAs and Large providers to submit operating costs with identical definitions to ensure completeness, accuracy and consistency of the data.

(ii) the economic profit margins that we have calculated reflect conservative assumptions, which therefore reflect a lower bound; and

(iii) this analysis demonstrates the high real rate of return of 16.2% compared to our benchmark of 3% to 6% expected real rate of return.

(c) put in absolute terms annually, the Large providers generated economic profits of £11,400 to £14,800 per child on average and £5.8 million to £7.5 million in aggregate.[5]

6. Our findings for the Fostering services segment operated by the Large providers between FY 2016 and 2020 are that:

(a) the fee per child and operating profit margin remained stable at £42,600 and 19.4%, respectively, on average. The cost structure remained unchanged;

(b) profitability (measured by economic profit margins) was materially higher (equivalent to an uplift in prices of around 19%) than we would expect in a well-functioning market. We consider these economic profits to be supernormal;

(c) put in absolute terms annually, the Large providers generated economic profits of about £8,000 per child between FY 2016 and 2020 on average and £87.4 million in aggregate;[6,7]

(d) earnings before interest and tax (EBIT) margins in Fostering services were 11.6 percentage points higher than those earned by similar companies in other sectors, which provides a useful cross-check to the above result in assessing the extent of high prices compared to that in a well-functioning market; and

(e) LA operating costs were about 26.2% lower, on average, between FY 2016 and 2020 than the equivalent for IFAs.[8] The Independent fostering agencies' (IFAs') higher allowance and fees to foster carers and higher overheads explain this difference.

---

[5] The average number of children between FY 2018 and 2020 in Unregulated accommodation operated by the Large providers was 506.
[6] The average number of children between FY 2016 and 2020 in Fostering agencies operated by the Large providers was 11,063.
[7] We used economic profit analysis (replacement cost) to estimate the economic profit margin and economic profits.
[8] Foster Care in England A Review for the Department for Education by Sir Martin Narey and Mark Owers in pages 60-62 also found that LA costs were lower than those of IFAs. The report also noted the challenges in comparing costs.

7. Large PE-owned providers had high financial leverage, debt serviceability and solvency metrics:

   (a) put in absolute terms when compared to a benchmark that reflects the average submissions from providers of their existing financial covenants and what they consider reasonable key performance indicators; and

   (b) put in relative terms when compared to Large non-PE providers.

8. Our other findings relating to financial leverage are that:

   (a) total debt exceeded reported fixed assets and notional property values for providers focussed on children's homes, and more so for PE-owned providers; and

   (b) despite the PE-owned providers having high operating profit margins, a significant proportion of their leftover cash is spent on servicing debt. This low headroom reduces their financial resilience, especially if the sector were to experience lower margins or the economy experienced heterogenous shocks.

Methodology: introduction to datasets and profitability

Datasets used in the financial analysis

9. We used financial data on Residential accommodation and Fostering services from two sources:

   (a) **Large providers' dataset**: We analysed six years of financial and operational data from the 15 largest providers.[9] This dataset comprises:

      (i) **Group (provider) level dataset** includes the group financial data and disaggregations by activity (Children's homes, Fostering services and Unregulated accommodation) of the Large providers, which is more granular than the audited accounts. In FY 2020, these providers generated aggregate revenues of £958 million from Children's homes, Fostering services and Unregulated accommodation. With 2,058 children in Residential accommodation and 11,935 children in foster care in FY 2020, the dataset accounts for approximately a fifth of Children's homes placements by independent providers and slightly

[9] See the glossary for a list of the Large providers.

over half of the placements by IFAs s based on data provided by the independent sector across the UK.[10]

(ii) **Home level dataset** includes financial and operational data at the home level for the 657 homes[11] operated by the Large providers.

(iii) **Agency level data** includes financial and operational data at the agency level for the 75 IFAs operated by the Large providers.

(b) **LA dataset**: We obtained five-year financial and operational data from 29 LAs. This dataset comprises:

(i) **Home level data** includes financial and operational data at the home level for the 128 homes operated by these LAs with 733 children in FY 2020.

(ii) **Fostering agency-level data** includes financial and operational data at the agency level for the 28 agencies operated by these LAs with 7,337 children in FY 2020.

10. We have presented aggregated results rather than individual providers' or LAs' results using the above datasets. The financial performance of some providers will differ from the aggregated results.[12] Nevertheless, our aggregate analysis provides a robust indication of financial performance for the Large providers because the distribution of critical results (eg operating profit margin) were clustered around the average. In other words, most companies earned operating profit margins reasonably close to the mean. The ones that generated profit margins away from the mean did not significantly alter the aggregated results.

11. In this Appendix, we focus on the Large providers. As noted above, these represent approximately a fifth of Residential accommodation placements and slightly over half of Fostering placements. We considered whether similar analyses could be completed for small and medium-sized providers. We obtained a Companies House dataset that included the audited financial information for 219 large and medium-sized companies and abbreviated accounts of 627 companies. However, we were unable to draw reliable conclusions from our analysis of this dataset because:

---

[10] We aggregated each Large provider's data on the average number of children in children's homes (excluding Unregulated accommodation) and foster care separately for the financial year (FY) 2020 to calculate the numerators. We used Tables 2 and 3 of our final report to calculate the denominators for the children's home places and the number of children in foster care, respectively, for non-LA provision.
[11] Excludes Unregulated accommodation. One Large provider did not provide adequate home level financial information and was excluded from our home level analysis.
[12] Occupancy, provider type, size, region and efficiency could drive variation in results.

(a) upon detailed inspection of the full accounts and their company profiles, only 15 non-large companies had activities primarily related to Children's homes and Fostering agencies and had financial data for the five years between FY 2016 and 2020. There was a wide dispersion of the results around the mean;[13] and

(b) the abbreviated accounts had minimal balance sheet data and no profit and loss account.[14]

Operating profitability

12. Operating profitability indicates a provider's ability to generate revenues to meet its operating (day-to-day running) costs such as staff, maintenance of assets, supplies, utilities, and head office costs. Management cannot significantly defer these costs.

13. Operating costs exclude capital expenditure (CAPEX) to purchase assets, dividends that management have the option to delay up to a point and corporation tax that loss-making companies do not pay. However, providers cannot often pause interest payments on debt. Therefore, a provider can remain viable in the short term, albeit within limits, if it generates adequate revenue to cover its operating costs and interest payments.

14. A standard metric to measure the operating profitability of the Residential accommodation and Fostering services sector is a profit margin. This metric is a return on revenue measure (in percentage terms) equal to revenue less operating costs divided by revenue. Table 1 explains the various profit margins:

Table 1: Profit margins

Profit margin	Definition	Costs included to calculate the margin and deducted from revenue
EBITDARM	Earnings before interest, tax, depreciation, amortisation, rent and management fees. EBITDARM is used to measure the true operating profitability of Residential accommodation and Fostering services at the group and individual homes and IFA levels.	Staff costs associated with providing care and services in the children's home or IFA. For example, payroll costs of care workers and foster carers. Non-staff operating costs incurred to run an individual home or IFA. For example, food, utilities, maintenance and other direct overheads.

[13] 204 companies either did not have 5 years of data (test for mature companies or trend analysis) or they primarily provided out of scope services such as schools.
[14] The CMA conducted a similar analysis in the Care Homes Market Study (adult social care (ASC)), where there are many more larger companies that filed full accounts over five years and whose primary activities related to ASC. In contrast, we have learned that the children's social care sector is currently more data-poor with smaller companies and a smaller market than the ASC sector.

		Central (head office) costs such as group finance, legal and management's salary.
EBITDAR	Earnings before interest, tax, depreciation, amortisation, and rent. EBITDAR is used to measure the operating profitability of providers. It is also used to assess the ability of providers to generate adequate profits (and cash) to meet rental payments. It excludes property-related costs such as rent, depreciation and interest costs.	Costs included in EBITDARM and • Management fees related to charges levied by shareholders (primarily private equity funds) for management services that they have provided the provider.
EBITDA	Earnings before interest, tax, depreciation and amortisation. EBITDA is used to assess the ability of providers to generate adequate profits (and cash) to meet interest payment obligations.	Costs included in EBITDAR and rent
EBITM	Earnings before interest, tax and management fee. EBITM is used to assess a provider's ability to meet its debt interest obligations. It excludes the management fee. In other words, the management fee is not deducted from revenue.	Costs included in EBITDA and depreciation and amortisation, which do not have a cash impact
EBIT	Earnings before interest and tax. EBIT is also used to assess a provider's ability to meet its debt interest obligations.	Costs included in EBITDA (including management fee) and depreciation and amortisation, which do not have a cash impact
PBT	Profit before tax	Costs included in EBIT and debt interest expense
Exceptional items	Non-recurring or one-off costs that a provider would not incur in the ordinary course of operating a home or Fostering services. Examples include: restructuring costs: gains or losses on disposal: foreign exchange gains and losses; and redundancy payments. The analysis of pre-exceptional margins gives a more accurate position of profitability.	

EBITDARM margin

15. We have used the pre-exceptional EBITDARM to assess the operating profitability of providers in Residential accommodation and Fostering services. This margin includes all costs to operate these businesses and central charges for shared services such as finance, legal and other professional

fees. However, it excludes property-related expenses (rent, lease, depreciation and interest), management fees, and exceptional items.[15]

16. We have excluded property costs when assessing operating profitability as providers can choose different ways to finance their Residential accommodation and Fostering agencies. These affect the profit and loss account (P&L) differently. For example, the relevant property-related charges in the P&L would differ depending on whether a property is:

    (a) bought outright with equity shareholder's cash, in which case there would be no property-related charge in the P&L;

    (b) rented, in which case the entire rental payment would be included as 'rent', with no depreciation charge in the P&L;

    (c) leased and classified as a finance lease[16] for accounting purposes. The P&L charges would consist of the financing cost (under interest) and depreciation; or

    (d) mortgaged, in which case the financing cost (only the interest element) would be included under 'interest', with a depreciation charge in the P&L.

17. By excluding property-related costs, the pre-exceptional EBITDARM margin provides a comparable margin to assess the operating profitability of Residential accommodation and Fostering agencies. The EBITDARM margin also excludes the effects of changes in accounting policy. For instance, changes in lease accounting could result in expenses switched among the rent, depreciation and interest line items of the P&L.

18. The EBITDARM margin excludes depreciation and amortisation on non-property assets such as intangibles and equipment. We have excluded intangibles for the reasons mentioned below. We have included equipment within capital employed (see below), and depreciating it would be akin to double counting the asset's cost. Rent is a minor component for Fostering agencies, and the EBITDARM margin provides an equally accurate measure comparable to our analysis of Residential accommodation.

[15] The management fee is not an essential operating expense. It is a discretionary expenditure. Hence, we have excluded it from EBITDARM. Most providers in the Large providers' dataset did not incur a management fee.
[16] The risks and rewards associated with owning the asset are with the lessee.

Economic profitability of Residential accommodation and replacement cost of Fostering agencies

Table 2: Calculations regarding economic profits

Measure	Calculation
Capital cost	Capital employed x % rate of return
Total cost	Operating costs + capital cost
Economic profit/(loss)	Revenue – total costs
Economic profit margin	Economic profit / revenue

19. In addition to measuring operating profitability based on accounting data (observable and audited numbers), we have estimated the economic profitability. Economic profitability analysis requires a broader set of assumptions compared to the analysis of operating profitability. Therefore, we have evaluated the asset values and rate of return to calculate the capital cost, which is not directly observable in the financial statements.

20. Economic profitability is a provider's returns after meeting its operating costs and investor returns. Debt investors receive interest payments, and equity investors receive dividends. The economic profit is the aggregate revenue less its operating costs and capital costs. In other words, providers need to earn sufficient profit to cover capital costs, over and above operating costs. A positive economic profit also means that investors have more than recovered their expected return.

21. The economic profit margin indicates the extent to which profits are higher than our expectations (benchmark) in a well-functioning market. Assuming that efficiencies do not drive operating costs, it also indicates the extent of high prices.

22. Economic profit analysis has traditionally suited asset-heavy businesses with a more precise benchmark for a standard market return. Nevertheless, we have also conducted replacement cost analysis for the Fostering services segment as our primary analysis.[17] Replacement cost estimates the cost of replacing the assets a company would consider investing in to enter the market to make a normal profit level. Replacement cost analysis assesses the asset values to use when determining economic profitability. For ease of reference in our study of Fostering services, we have referred to it as

[17] Replacement cost analysis involves estimating the market value of assets and applying a weighted average cost of capital.

economic profitability. The CMA has used such analysis in assessing the profitability of asset-light sectors such as pharmaceuticals and sectors with low levels of tangible fixed assets such as digital markets.[18] We have conducted a margin comparator analysis (see paragraphs 61 to 65 and 102 to 111) to sense-check the replacement cost results for Fostering agencies as a secondary analysis.

23. Finally, we need to distinguish between economic and supernormal profits. Economic profits may not be supernormal if companies earn above-market returns or charge high prices over the short term (till they compete away) if they benefit from unique assets or novel technologies for which buyers are willing to pay a premium. If, however, such conditions don't hold, then economic profits could be deemed supernormal, an economic rent.

Capital and total cost

24. The capital cost is the financial value of the actual return that equity and debt investors require to invest in a business. The capital cost is similar to accounting overhead expenses to the extent it is incurred to acquire and invest in the assets to operate Residential accommodation or Fostering agencies. The capital cost can be an actual cost for the provider and have a cash flow impact. For example, investors may pay interest to debt-holders and dividends to equity investors. However, the capital cost is not an accounting measure, and providers' P&Ls do not fully account for it. Therefore, it is not directly observable.

25. Where revenues are more than sufficient to cover total costs, it results in an economic profit. In such an environment, providers are incentivised to invest in the medium to long term, and they can continue replacing those assets if they continue making economic profits. The replacement of assets might arise out of wear and tear or requirements to meet quality standards. Where a provider generates an economic profit, investors also have the financial incentives to build new capacity and undertake CAPEX in existing Residential accommodation and Fostering agencies. Moreover, investors owning existing capacity are less incentivised to exit the market as the alternative use of the asset might not offer a higher return.

[18] Google's profitability. See Online platforms and digital advertising, Appendix D: profitability of Google and Facebook.

Rate of return (%)

26. When considering any capital investment, investors factor in the opportunity cost of that investment. It is the investor's return from investing in another company of a similar level of risk. This return is required to cover the cost of providing finance[19] and a margin to reflect the risk taken by investors.[20]

27. Risk is an unavoidable part of any investment. The general economic environment, such as the economic cycle and interest rate changes, is part of investors' risk. Risk can also arise from policy uncertainties specific to the sector. If investors consider that the risks of investing in children's social care (CSC) are high, they will seek higher returns. Returns need to account for the risk over the investment's life – this principle applies to providers of all sizes and complexities regardless of their operations and finance sources. Where expected returns from new investment are below the level required to compensate investors for risk, they may not invest in the sector. Where these returns are high relative to the risk, we would expect to see more significant investment activity by existing providers and new entrants. However, despite the Large providers generating extremely high rates of returns (well above the cost of capital), our review has also found undersupply of placements (see the main body of the Final Report).

28. Also, another lens of assessing economic profitability is through the annual returns on capital employed earned by the Large providers. It is widely called the return on capital employed (ROCE). In this Appendix, we refer to ROCE as the actual rate of return.

The rate of return applied to CSC and how it compares other sectors

29. In our analysis, we used a 3% to 6% real rate of return and a 4.5% mid-point, where appropriate.

30. However, Compass submitted that the rate of return should be in '…the upper end of the range' as the CMA used in the Care Homes Market Study, Private Healthcare Market Investigation or the Funerals Market Investigation (6.0% to 9.4% pre-tax nominal).[21]

---

[19] This relates to the time value of money. The essence is that an amount of money (e.g. £100) is worth more to an investor today than the same amount of money on any given date in the future.
[20] It is not just private sector investors that require a return. Even the public sector applies a discount rate of 3.5% in real terms with regards to its investment decisions. HM Treasury: The Green Book.
[21] Compass Community Limited response to the IR.

31. Hence, we considered other comparable and regulated sectors and previous investigations conducted by the CMA in evaluating the appropriate rate of return.

(a) the CMA's Care Homes Market Study estimated a 5-8% real rate of return in adult social care (ASC).[22] The risks in children's social care should be lower as self-funders account for more than half of the ASC sector's revenue, which increases bad debt risk[23] and affordability issues that could make revenues relatively more volatile;

(b) the CMA's private healthcare investigation found a pre-tax market rate of return on capital employed of around 9% in nominal terms (ie including inflation).[24] For that portion of the capital invested in long-lived assets such as land, a starting assumption was that prices, in the long run, would more likely remain constant in real rather than in nominal prices. Considering the Bank of England's Consumer Prices Index (CPI) inflation target of 2%, private healthcare investors would require a real annual rate of return of around 7% in the long run. Moreover, the CPI has increased over the 2% target since 2016, and debt financing costs have fallen over the last decade. Notwithstanding that the private healthcare sector is subject to quality and medical regulation, good quality CSC providers face lower risk than private healthcare firms because:

(i) the state guarantees CSC provider's revenue resulting in negligible bad debt risk from LAs.

(ii) CSC providers have greater income certainty with children requiring care, and the state is obliged to provide care and placements.[25]

(iii) our analysis of the Large providers' home level dataset shows that the Large providers benefitted from stable occupancy rates (83% on average) and revenues at the home level during the five year review period. Also, our review of the Large providers' Fostering agency-level data showed that the number of children and revenues rose year-on-year at a steady state. At the same time, the average fee levels (Figure 22) and operating profit margins (Figure 9) were relatively stable in Fostering services. Hence, the Large providers benefited from demand certainty and faced low utilisation risk.

---

[22] CMA's, Care homes market study Appendix D.
[23] Bad debt risk is a systematic as it increases during economic downturns and times of financial distress.
[24] CMA's Private healthcare market investigation, Final Report.
[25] The comment is for the sector as a whole. Some Children's homes and fostering agencies providing specific forms of care or in a particular location may face more significant uncertainty over income than for the sector as a whole.

(c) economic regulators of regulated monopolies have determined reasonable returns (pre-tax capital cost) of 2.5% to 4.5% relative to inflation.[26] Additionally, the CMA set an allowed real return of 3.2% for the appellant water companies for our recent water redetermination.[27] children's social care and regulated monopolies may face different company-specific risks. However, children's social care is unlikely to warrant a much higher rate of return for the reasons outlined above, such as a relatively high degree of income certainty during the contract duration, certainty of demand and the state is effectively required to buy these services.

32. Furthermore, market-wide estimates for the rate of return have been very low in the recent past, resulting in what the IMF has called the "*search for yields*".[28] The ultra-low and negative real interest rates in the Organisation for Economic Co-operation and Development (OECD), including the UK, have partly driven these low yields. It suggests that the actual estimates of the real rate of return in CSC should be lower than in ASC and private healthcare and in the lower region of 3% to 6%.[29]

Cross-check on the rate of return applied to children's social care

33. We have estimated the rate of return using the capital asset pricing model (CAPM) to cross-check the 3% to 6% real rate of return mentioned above. It is an established methodology with observable market data. Our approach uses generic CAPM assumptions from the CMA's recent water redetermination, reflecting the current market conditions[30] and estimating the industry-specific components.

34. There are two components of the rate of return[31]: the costs of equity and debt. The cost of equity (E[Ri]) depends on the risk-free rate (Rrf), the expected return on the market portfolio (Rm), and a firm-specific measure of investors' exposure to systematic risk (beta or β). The following equation represents CAPM:

$$E[Ri] = Rrf + \beta(Rm - Rrf).$$

---

[26] Recent CMA decisions are at: Regulatory appeals and references: detailed information.
[27] Anglian Water Services Limited, Bristol Water plc, Northumbrian Water Limited and Yorkshire Water Services Limited price determinations, Final report, 17 March 2021. Page 11, paragraph 7.
[28] Risk and Return: The search for yield by the IMF.
[29] OECD data: Long-term interest rates and short-term interest rates. World Bank data on the UK's real interest rates.
[30] Anglian Water Services Limited, Bristol Water plc, Northumbrian Water Limited and Yorkshire Water Services Limited Price Determinations.
[31] The rate of return is called the weighted average cost of capital (WACC).

35. The cost of debt is estimated using traded bonds and debt yields.

36. The rate of return (weighted average cost of capital - WACC) is the weighted average cost of debt (Kd) and equity. The following equation represents the rate of return:

Rate of return (WACC) = E[Ri] x E/(D+E) + Kd x D/(D+E)[32]

37. To estimate the cost of equity for CSC, we used 2016 to 2020:

(a) a total market return (TMR) point estimate of 6.81%,[33] based on our recent water redetermination. The CMA placed more weight on historical ex-post returns (from 1900 to the present day) than on the forward-looking evidence of stock market returns provided by market practitioners;

(b) risk-free rate (RFR) point estimate of -1.34%,[34] based on our recent water redetermination. The CMA calculated an RFR with reference to the highest-rated commercial debt, such as long-tenor index-linked gilts and AAA-rated non-government bonds;

(c) an unlevered asset beta of 0.41[35].[36] We used Caretech's 5-year monthly beta of 0.41 and recognised the limitations of only using one firm in our comparator sample.[37] We assume a debt beta of 0, and our implied equity beta (levered beta)[38] is therefore 0.82;[39]

(d) a gearing ratio of 50%[40]. We based our gearing assumption on our analysis of gearing ratios of the Large providers in our Large provider dataset; and

---

[32] D represents the value of debt and E represents the value of equity in the capital structure.
[33] Anglian Water Services Limited, Bristol Water plc, Northumbrian Water Limited and Yorkshire Water Services Limited Price Determinations, pages 25 and 27. It is a generic component of CAPM that is valid across sectors.
[34] Anglian Water Services Limited, Bristol Water plc, Northumbrian Water Limited and Yorkshire Water Services Limited Price Determinations, pages 25 and 27. It is a generic component of CAPM that is valid across sectors.
[35] Source: Yahoo Finance, 20th January 2022.
[36] The asset beta (unlevered beta) is the beta of a company without taking into account the impact of debt/financial leverage. It compares the risk of an unlevered firm to the risk of the market.
[37] Caretech is the only listed children's social care provider.
[38] The equity beta (levered beta) takes account a firm's capital structure/leverage and compares the risk of a levered firm to the risk of the market.
[39] Gearing refers to the amount of debt within a company's capital structure. Gearing is debt divided by the total capital base (debt plus equity).
[40] As highlighted in the section on financial leverage we note a marked variation in gearing levels between PE owned and non-PE owned firms in children's social care. We believe 50% represents a reasonable assumption for the gearing level of a firm in the sector.

(e) a tax rate of 19%,[41] which is the average corporate tax rate in the UK over our review period FY 2016 to 2020.[42]

38. We estimated the return to debt holders in the children's social care sector of 3.1%. We used the spreads on UK corporate bonds of various credit ratings and sectors for FY 2016 to 2020, particularly the iBoxx £ A/BBB[43] benchmark Non-Financial 10+ Annual Yield in % to proxy the sector's debt cost.

39. Table 3 below summarises the rate of return's components.

Table 3: CMA estimates of the rate of return for the CSC sector

Component	Input	Source
Gearing	50%	
Risk-free rate (RFR)	-1.34%	Water redetermination - (CPIH)
Total market return (TMR)	6.81%	Water redetermination - (CPIH)
Equity risk premium (ERP)	8.15%	Water redetermination - (CPIH)
Debt beta	0.00	
Asset beta	0.41	5 year monthly Caretech beta of 0.41
Equity beta	0.82	
Real cost of equity (post-tax)	5.34%	
Real cost of debt (pre-tax)	**3.11%**	iBoxx A/BBB benchmark
Real rate of return (post-tax)	**4.23%**	
Pre-tax nominal adjustment		
Pre-tax cost of debt (CoD)	3.11%	iBoxx A/BBB benchmark
Pre-tax CoE	6.60%	Assumes 19% tax rate
Real Pre-tax rate of return	**4.85%**	
Inflation (CPIH)	2.00%	ONS
Nominal pre-tax rate of return	**6.95%**	

Source: CMA estimates, HIS Markit, Yahoo Finance, HMRC and ONS

40. Table 3 shows a real rate of return (pre-tax) of 4.85% is within our 3% to 6% range and marginally above the midpoint of 4.5%. We, therefore, consider this is an appropriate range to use in our analysis.

Capital employed

41. Capital employed is the value of the assets invested in a business. The asset valuation should, in principle, be the market value of those assets. Market values reflect the sale price of those assets as an alternative to using those

[41] Source: HMRC.
[42] Interest to lenders is tax-deductible but on dividends to equity holders. Hence, where the rate of return is expressed as pre-tax, the cost of equity used must reflect the fact that the rate of tax will reduce the actual return to shareholders.
[43] A debt index showing the annual yield of non-Financial UK companies with a credit rating of A or BBB.

assets for their current purpose. For example, the everyday use of the property in Residential accommodation would be in providing care. The alternative use of property could be the redevelopment of that property into residential or commercial real estate.

42. We have assumed in our analysis that an investor in new Residential accommodation would purchase a property (land and building). The alternative would be to rent the property. In theory, over a given period representing the asset's useful life, the rental yield should result in a similar cashflow cost as buying the property, absent the unrealised gain from land appreciation.

43. An investor in new Residential accommodation or a new Fostering agency would also require upfront investment and contribute to funding the operations with working capital. The investor would require a return on those assets. Therefore, we intend to include these assets in the capital employed and apply a rate of return on those assets (capital employed) to estimate the capital costs.

Property (used for Residential accommodation)

44. The property valuation methodology should be similar to the standard practice chartered surveyors use to value similar houses in the real estate sector. It should represent the alternative use in children's social care (replacement cost)[44] or another sector, albeit without economic rents. This method should exclude the following economic rents:

(a) any valuation premium (in addition to regular acquisition costs) attached to a property that had received planning permission to operate as a children's home. The premium is akin to economic rent, as investors would have to charge higher prices to recover their investment; and

(b) an enterprise value valuation[45] that values fully equipped Children's home with property, equipment and staff that can be sold independently as a going concern. Since the valuation is based on enterprise valuation using current and near-future fee levels (see findings below), it includes economic rent. It is important to note that if enterprise value is higher than

[44] The CMA's CC3 Guidance describes the replacement cost is the current cost of acquiring assets, which yield equivalent services to those currently used by the provider. In other words, the replacement cost includes the following costs: market value to buy the property, equipment and operating costs of the regulatory process. If replacement cost is lower than the value in use, we use replacement cost.
[45] Enterprise value measures a company's total value as a going concern.

replacement cost, then in a well-functioning market, there are significant financial incentives to enter the market.

45. We obtained recent property market valuations from 9 Large providers that had recently valued 399 properties (out of a total of 657 properties) across the three nations and local areas, thus making it reasonably representative of the market. After that, we:

(a) matched these property values to the corresponding home-level annual revenue for the year of valuation for each home;[46]

(b) aggregated these revenues and the property valuations; and

(c) divided the aggregate revenue over the aggregated property valuation to calculate a ratio of aggregated revenue to aggregated property valuation of 0.52.

46. Since the Large providers valued 399 (60%) of their Residential accommodation sites, we applied the ratio of aggregated revenue to aggregated property valuation of 0.52 to the aggregated revenues of 657 homes (100%) to estimate the property valuation for inclusion in our capital employed. In other words, we have assumed the same ratio of aggregated revenue to aggregated property valuation of 0.52 (for the 60%) across all the homes (for the 100%) in our economic profitability analysis.[47]

47. We have used the ratio of aggregated revenue to aggregated property valuation of 0.52 in our economic profitability analysis. This approach is likely to overestimate the property market values for several reasons:

(a) some of the property values include economic rent discussed above from planning permission. We understand that property with the necessary planning permission for a Children's home may sell considerably higher than a similar property without planning permission. Chartered surveyors may factor in granting planning permission for Children's homes activities when they value Children's homes;[48] and

---

[46] For some Large providers we observed that the revenue reported during the year of property valuation did not represent a full year's revenue. Where this was the case, to ensure the revenue figure used for our calculation equated to a full year's revenue we used a future year's full year revenue.
[47] We used the same principle to evaluate the property values when disaggregating the economic profitability results between PE and non-PE providers.
[48] For example, one of the valuation reports had the following disclaimer, "*our valuation is undertaken on the special assumption that each of the subject units are being used as a dwelling (C3 use) and that the appropriate planning permissions are in place to allow this. Should permissions/building regulations not be in place our opinion of value may be subject to change. It is important that this is confirmed and should there be any changes our opinion of value may differ*."

(b) The valuation of 114 properties (of the 399 properties) operated by three Large providers appears to have been based on enterprise value.[49] For instance, the publicly available sale record for one of these three shows that one property bought in 2016 was subsequently valued at approximately seven and a half times the purchase price in 2018 using enterprise value.

48. Hence, our property value estimate is likely to be a significant overestimate that inflates the capital employed, increases the capital cost, and reduces economic profit. For example, if we excluded the 114 properties valued using enterprise values, the adjusted ratio of aggregated revenue to aggregated property valuation for the 285 properties would rise to 0.88.

49. Thus, our economic profitability results represent a conservative estimate and a lower bound.

Equipment (used for Residential accommodation and Fostering agencies)

50. The actual investment cost should determine the valuation methodology of fixed asset equipment required to operate a Children's home or Fostering agency (replacement cost), which depreciate to reflect the age of the assets. Examples of equipment include beds, vehicles and specialist equipment.

51. We obtained estimates of the actual capital expenditures in new Children's homes. These estimates were aggregated on a provider level and a per-child basis for 11 Large providers. The average equipment, fixtures and fittings for a new home was £13,335 per child.[50,51] The non-property CAPEX requirement for a Fostering agency will be less than that for a new home, and we have assumed that the equipment for a Fostering agency is half of that for a Children's home. Hence, we have included an average equipment cost of £6,668 per child for Fostering services. We then multiplied the average equipment costs by the number of children in Residential accommodation and Fostering agencies to calculate the equipment cost for inclusion in capital employed.

---

[49] For example, a Knight Frank Valuation Report for CareTech's property valuation noted the following in paragraph 3.18, "*The subject properties have been valued having regard to trading potential assuming that they are well maintained and effectively managed, offer high standards of care and/or education and meet the requirements of their registration*." And in paragraph 3.19, "*The portfolio premium has been applied. After the deduction for the head office costs the portfolio YP multiplier attributed equates to 11.97x the FMT EBITDA of £29.159 million*".

[50] We observed that the CAPEX per child in a submission from one provider was considerably higher than the average in 2018. We excluded this figure from our calculations.

[51] A sensitivity uplift of 20% to 30% to equipment would not significantly change the results, especially for Residential accommodation. It is because property is overwhelmingly the most significant component of capital employed.

Working capital (used for Residential accommodation and Fostering agencies)

52. Working capital is a provider's current assets (eg receivables) less its current liabilities (eg payables) on its balance sheet. It measures a provider's liquidity and short-term financial health. A positive working capital implies that when a provider converts its current assets and liabilities into cash, this should translate into a net positive cash amount. The opposite holds for negative working capital.

53. LAs generally pay providers of children's placements in arrears. Hence, we have assumed that an investor in a new Residential accommodation site or Fostering agency (replacement cost) would have to fund operations from working capital, which forms part of the capital employed.

54. We have excluded cash from capital employed. Including it would double count the cash balance because a positive working capital balance is a proxy for the money required for operations that providers fund through short-term financing, which banks credit to the cash account. Bar petty cash, providers could deploy the excess reported cash balance on the balance sheet elsewhere.

55. There are two methods for estimating working capital. The first is to use the reported figures from the balance sheet or to smooth the numbers using an average for the review period as we did in the Care Homes Market Study published in 2017. However, this measure may not provide an accurate picture of the working capital during the year because providers follow different strategies to manage their working capital – some providers collect their debts faster while others may delay payments longer. Also, a balance sheet is a snapshot at the year-end, and it may not give a valid indication of the actual (average) working capital levels required during the year to manage working peaks and troughs. Therefore, we have not used this method.

56. The second method is to estimate a notional level of working capital. LAs generally pay providers one to three months in arrears. Hence, on average, providers should have two months of their reported revenue due to them at any given time. Likewise, providers can defer payment for two months. Hence, on average, providers should owe two months of their reported operating costs. We have estimated working capital accordingly using the aggregate revenues and operating costs (EBITDARM) for inclusion in capital employed. For example, the Large providers of Children's homes generated aggregated revenue of £410 million and incurred aggregated operating costs of £313 million in 2020. Accordingly, we estimated they are due debts of £68.3 million and owe £52.1 million, resulting in working capital of £16.2 million for the Large providers.

57. The first method showed that providers have negative working capital in aggregate - it means that providers collect their debts from LAs more quickly than they pay their suppliers and employees. The second method results in significantly higher working capital, higher capital employed and capital costs and a lower economic profit. It is another reason to view our economic profitability of Residential accommodation and Fostering services as lower bounds.

Intangibles

58. Compass said that we should add intangible assets to capital employed because IFAs have:

(a) 'customer relationships with the LAs, which requires a targeted business development team;

(b) a skilled workforce, which requires ongoing investment in quality staff and training;

(c) brand value – both in the Compass brand and the home-level brand, which requires investment in regulation and compliance, marketing etc; and

(d) within fostering, the asset value of the foster carers, which require material upfront investment and remain with Compass for 5-6 years on average'.[52]

59. OFG also said that we should include intangible asset values to take account of '…the processes needed to recruit, induct, train and support foster carers'. These '…carry high investment costs (typically £ [✂] per carer), an innovative IT infrastructure' and '…start-up losses incurred to build a strong brand locally'.[53]

60. Our approach to intangibles is consistent with recent CMA cases.[54] We have excluded intangibles from capital employed on the following grounds:

(a) the costs of a business development team, recruitment, staff and foster carer training and support, regulation, compliance, and marketing are already included in the EBITDARM operating profit margin. Hence, including customer relationships, skilled workforces, and brand value

---

[52] Compass response to the IR.
[53] OFG response to the IR.
[54] Online platforms and digital advertising, Appendix D: profitability of Google and Facebook, paragraphs 59 to 61. And Liothyronine tablets: suspected excessive and unfair pricing, Annex 3 – Costs plus a reasonable rate of return (Cost Plus), paragraphs 3.72 to 3.76.

within intangible assets in capital employed would be double-counting, and thus further reduce economic profits;

(b) we have also excluded start-up losses as we are concerned with assessing the profitability of mature businesses in a steady state. Start-up losses are not additional costs to operating costs incurred to run the Large provider, and therefore, it does not meet the CMA's capitalisation criteria;[55] and

(c) we have excluded IT costs from intangibles as it is unclear that it is sufficiently separable and tradeable, and the same also holds for customer relationships, skilled workforces, and brand value. Moreover, we have not seen evidence that these costs meet the CMA's capitalisation criteria. It must be identifiable and an asset separate from that arising from the general running of the business.[56]

Profit margin analysis (Fostering agencies)

61. We have used replacement cost analysis as our primary tool to assess Fostering agencies' profitability (see above). It is very similar to economic profit analysis in this context. In addition, we have compared the profit margins of Fostering agencies to similar companies in other sectors to cross-check our findings using replacement cost analysis.

62. There are three reasons why high absolute levels of profit margins (or economic profits) in a sector or of a provider might persist compared to similar businesses:

(a) **Intellectual property (IP), research and development (R&D) or specialist technology**: These factors can justify an above-market return in the form of high-profit margins, at least until competitors catch up. The CMA considered this in assessing Google's profitability in a recent market study.[57] In contrast, IFAs are care service companies where suitable foster carers are the most significant value-added for children. Hence, IFAs do not need to develop IP or conduct R&D, such as in the pharmaceutical sector or develop IT systems to use as the essential tool to win new business;

(b) **Human capital or accumulated training**: It applies where the value of a business comes from its people, who have a high level of training,

---

[55] CMA's CC3 Guidance, paragraph 14.
[56] CMA's CC3 Guidance, paragraph 14.
[57] Online platforms and digital advertising, Appendix D: profitability of Google and Facebook.

accumulated experience, and knowledge. It is not driven by the scarcity of staff with these skills, though it could be one consequence of requiring a highly skilled workforce. Instead, competitors or the incumbent can earn high margins in the short term by acquiring or developing those people respectively. However, the value that these people bring is broadly shared with them through high wages and compensation for staff and drawings for partners, such as in law firms or management consultancies.

Polaris said the following regarding foster carers: 'a high level of training, accumulated experience and knowledge" is not sufficient on its own to create value for employing businesses, rather it is the scarcity of people with these characteristics that allows persistently high returns'.[58] However, we have explained why the scarcity of foster carers is an inappropriate ground.

Polaris said that it paid '…more in staffing costs, as a proportion of revenues, than the UK law firm that paid the most to its staff'.[59] In other words, IFAs have similar staff costs (including allowances for children) as a percentage of revenue to law firms, which should warrant high returns. However, a better measure of staff costs would exclude allowances and retain foster carer fees and head office costs in the numerator. Using the second measure would significantly lower the proportion of staff costs to revenue and demonstrate how law firms and consultancies have significantly higher staff costs as a proportion of revenue than Fostering agencies. Thus, it shows that law firms and consultancies have a considerably greater degree of reliance on human capital; and

(c) **Risk**: It applies to high-risk, high-return businesses. One symptom of the higher risk could be volatile cash flows, where equity investors, partners or lenders might need to underwrite the company to fund temporary liquidity shortfalls, for which they will want a return. An example of such a high-risk business is a restructuring consulting business. Investors (or partners) generate high returns with the potential for capital buffers during economic downturns but may face relatively adverse trading conditions during benign economic conditions, resulting in liquidity shortfalls. In contrast, we observe that the cash flows of IFAs were relatively stable during the review period for the reasons mentioned above.

[58] Polaris response to the IR.
[59] Polaris response to the IR.

63. Since none of the three factors mentioned above applies to IFAs to any significant degree, we would not expect high margins (or supernormal profits) to persist over time in Fostering services, in absolute terms.

64. However, high margins (or supernormal profits) might persist in a market that is not well-functioning due to market failures. Examples include a lack of competition, such as few competitors (lack of choice) or barriers to entry. We would expect more entry in a sector with high margins and without the constraints mentioned above until the high margins compete away.

65. Therefore, we have assessed whether the margins of Large providers of Fostering services are relatively higher than similar companies in other sectors to sense-check our economic profitability results. We have used the pre-exceptional EBITM (earnings before interest, tax and management fee) for Fostering agencies' margin analysis. It is appropriate for an asset-light business with minimal depreciation, amortisation, and property costs. We also excluded the management fee for the reasons outlined above.

Summary of our approach to profitability

66. As a starting point, we have estimated the operating profitability of Residential accommodation and Fostering agency services using the pre-exceptional EBITDARM profit margin. We have then evaluated the economic profitability of Residential accommodation by using a rate of return in real terms to market values of assets and a notional level of working capital. We have estimated the economic profitability (replacement costs) of Fostering services using the same method for Residential accommodation but excluded property.[60] We have used economic profitability as our primary tool for Fostering services. In addition, we have also compared the EBIT margins earned in the Fostering services sector to margins made by comparable companies to sense-check the economic profitability results.

[60] The property cost for a Fostering agency relates to the renting of office space and should be insignificant relative to operating costs.

Profitability results – 15 Large providers dataset using company-level data

Group level aggregated findings

Aggregated P&L of the 15 Large providers

67. We assessed the operating profitability of the 15 Large providers using the Large Providers dataset at the company level and disaggregated by their activities: Children's homes, Fostering agencies and Unregulated accommodation

68. Table 4 shows a 5 year aggregated average P&L from FY 2015 to 2020 along with the growth rates and the aggregated forecast P&L for 2021 for 15 Large providers of Children's homes, Fostering agencies and Unregulated accommodation.

Table 4: Aggregated P&L of the 15 Large providers, FY 2016 to FY 2020 actuals and FY 2021 forecasts

£ million	2016 to 2020 (Actual) Average	2016 to 2020 CAGR	2021 (Forecast)	2020 to 2021 YOY Growth
Revenue	941	14.3%	1,399	14.9%
Staff costs	509	14.0%	718	7.7%
Non-staff operating costs	232	14.9%	385	32.3%
EBITDARM	200	14.4%	296	13.8%
EBITDARM margin (%)	***21.3%***	-	***21.2%***	-
Management fee	13	-8.3%	9	-22.2%
EBITDAR	187	15.9%	287	15.6%
EBITDAR margin (%)	*19.8%*	-	*20.5%*	-
Rent	20	5.0%	21	10.5%
EBITDA (pre-exceptional)	167	17.1%	266	16.0%
EBITDA (pre-exceptional) margin (%)	*17.9%*	-	*17.5%*	-
Exceptional items (costs)	8	-	9	-
EBITDA post-exceptional	158	16.3%	257	17.0%
EBITDA post-exceptional margin (%)	*16.7%*	-	*18.3%*	-
Depreciation and amortisation	57	30.2%	83	-21.2%
EBIT	101	12.0%	174	51.9%
EBIT margin (%)	***11.1%***	**-**	***12.4%***	**-**
Interest expense	64	16.9%	83	-7.0%
Profit before tax	37	8.5%	91	255.7%
Profit before tax margin (%)	*4.4%*	-	*6.5%*	-
Analysis of costs				
Costs as a % of revenue	**2016 to 2020 (Actual) Average**	**2021 Forecast**		
Staff costs	53.9%	51.3%		
Non-staff operating costs	24.8%	27.5%		
Management fee	1.5%	0.7%		
Rent	2.2%	1.5%		
Depreciation and amortisation	5.7%	5.9%		
Interest expense	6.7%	5.9%		
Property-related expenses				
Rent and interest	8.9%	7.4%		
Rent, interest and depreciation	14.5%	13.3%		

Source: CMA analysis of P&L information submitted by the 15 Large providers (the Large providers' dataset).
Note:
1. CAGR is the compound annual growth rate and helps smooth growth rates. The CAGR represents the average yearly growth rate between 2016 to 2020.

69. Table 4 shows that the Large providers earned healthy operating profit (EBITDARM) margins between FY 2016 and 2020, which are forecast to remain stable in FY 2021. Between FY 2016 and FY 2020, staff costs accounted for 53.9% of revenue and operating costs (including staff and non-

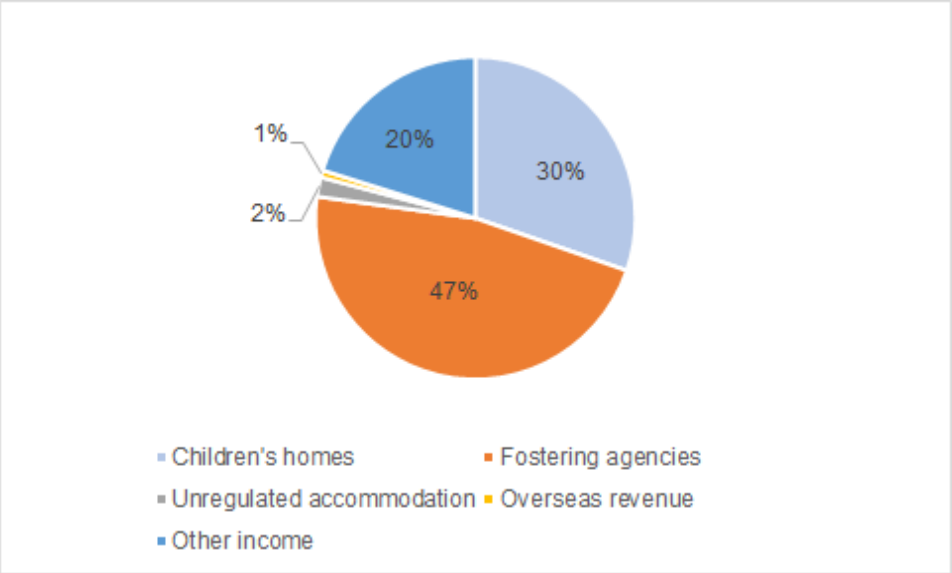
staff operating costs) accounted for 78.7% of revenue. It means that for every £100 in revenue, it costs approximately £79 to meet the day-to-day expenses of running Residential accommodation or Fostering agency services.

70. Property related costs, such as rent, depreciation and interest expense, accounted for 14.5% of revenue. Property associated costs that have a cash flow impact, such as rent and interest, accounted for approximately 8.9% of revenue.

Analysis of revenue streams

71. Figure 1 shows the revenue streams in aggregate by source for the 15 Large providers, whose profitability we have analysed below.

Figure 1: Revenue source of the 15 Large providers, FY 2016 to FY 2021



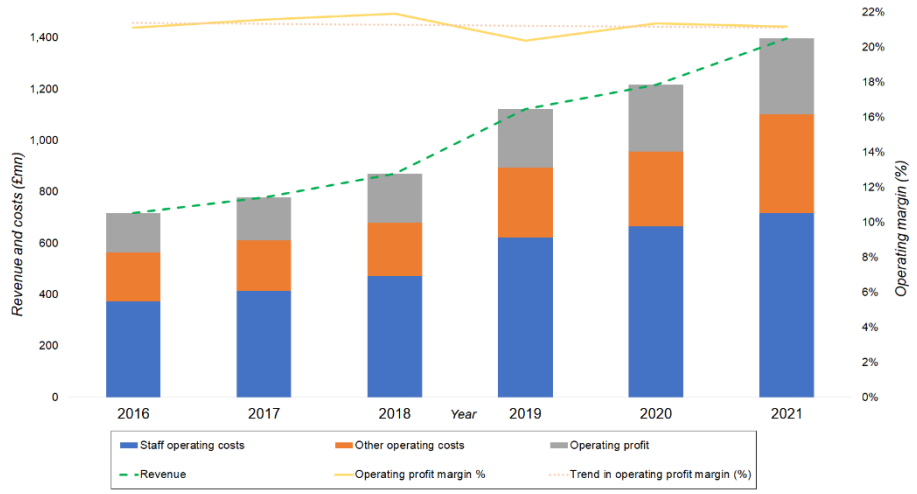
Source: CMA analysis of financial information of 15 Large providers.

72. Figure 1 shows the Large providers generated nearly half their revenue from Fostering services, just under a third from Children's homes, 2% from Unregulated accommodation and just over a fifth from activities unrelated to children's social care.

Aggregate operating profitability of the 15 Large providers

73. Figure 2 shows the trends in aggregate revenue, staff operating costs, other operating costs and pre-exceptional operating profit margin (EBITDARM %) of the 15 Large providers.

Figure 2: Aggregate operating profitability of the 15 Large providers, FY 2016 to 2021



Source: CMA analysis of Financial information of the 15 Large providers.
Note:
1. This analysis includes the results of children's homes, Fostering agencies and Unregulated accommodation.
2. The 2016 to 2020 results are actuals, and the 2021 figures are forecasts.
3. Operating profit margin is the pre-exceptional EBITDARM margin.

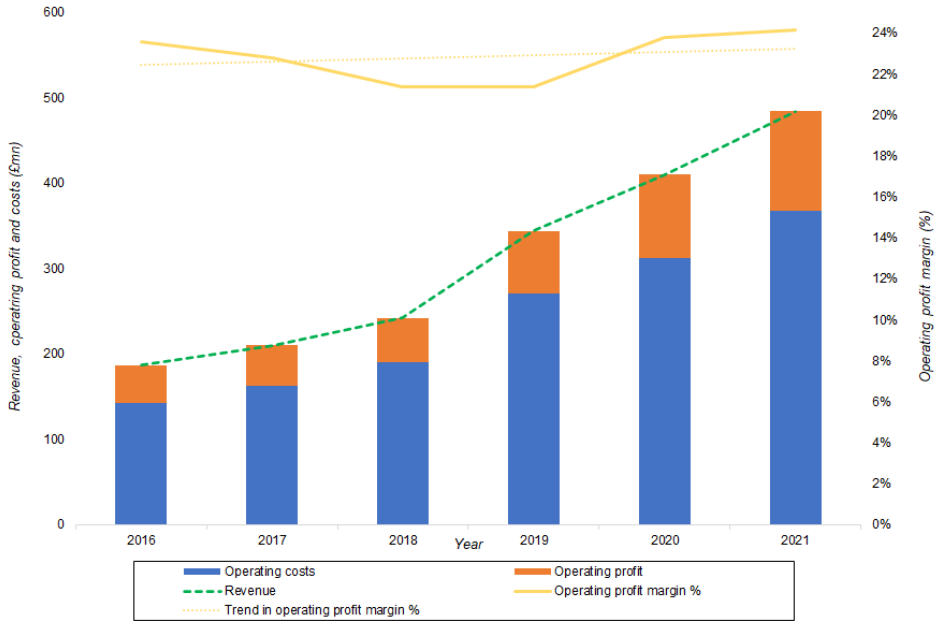
74. Figure 2 shows that aggregate revenue increased by 11.2% on average between FY 2016 and 2020. The operating profit margin (%) between FY 2016 to FY 2020 has remained flat, albeit slightly downward sloping, at an average of 21.3% and is forecast to remain flat in 2021. The cost structure has not significantly changed despite the National Minimum Wage that came into effect on 1 April 2016 and the COVID-19 pandemic from FY 2020 - both would have increased operating costs in absolute terms.

Profitability of the Children's homes segment operated by the Large providers

Aggregate operating profitability of the Children's homes segment

75. Figure 3 shows the trends in aggregate revenue, staff operating costs, other operating costs and pre-exceptional operating profit margin (EBITDARM %) of the 13 Large providers operating Children's homes.

Figure 3: Aggregate revenue, operating profitability and operating costs for the 13 Large providers that operate children's homes, FY 2016 to 2021



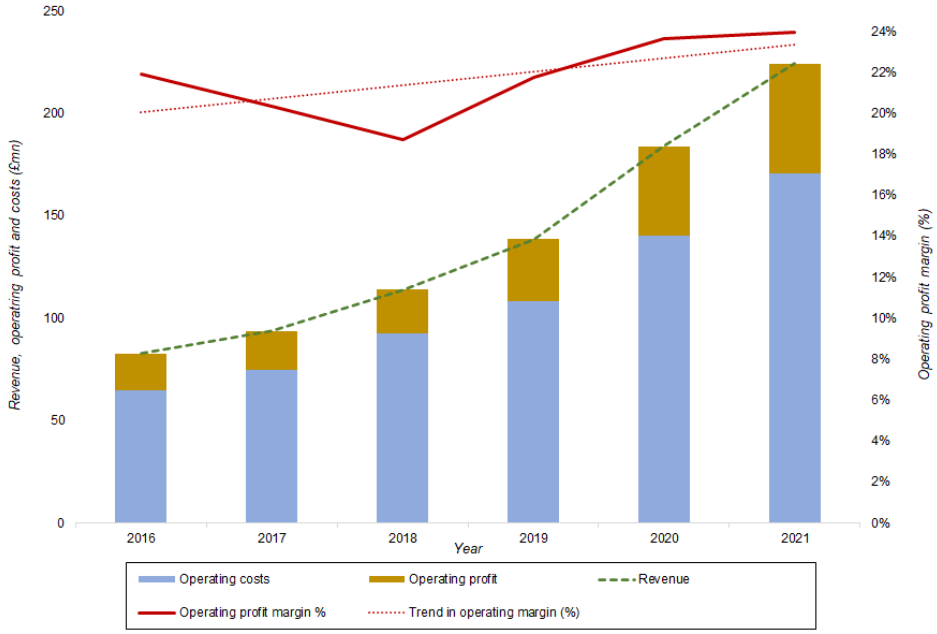
Source: CMA analysis of Financial information of 13 Large providers.
Note:
1.This analysis includes the results of children's homes and excludes Fostering services and Unregulated accommodation.
2. The FY 2016 to 2020 results are actuals, and the FY 2021 figures are forecasts.
3. Operating profit margin is the pre-exceptional EBITDARM margin.

76. Figure 3 indicates that aggregate revenue increased by 17% on average between FY 2016 and 2020. This increase reflects a 16.9% operating cost increase, 17.2% operating profit increase, 5.2% above-inflation fee increases (Figure 18), and the impact of acquisitions. The operating profit margin (%) has largely remained flat at an average of 22.6% between FY 2016 and FY 2020. It is forecast to remain flat in FY 2021, supported by stable occupancy rates of approximately 83%.

Disaggregated operating profitability of the Children's homes segment - PE vs non-PE

77. Figure 4 disaggregates figure 3 and shows the trends in the same metrics of the seven PE-owned Large providers that run Children's homes.

Figure 4: Aggregate revenue, operating profitability and operating costs for the seven Large PE-owned providers that operate Children's homes, FY 2016 to FY 2021

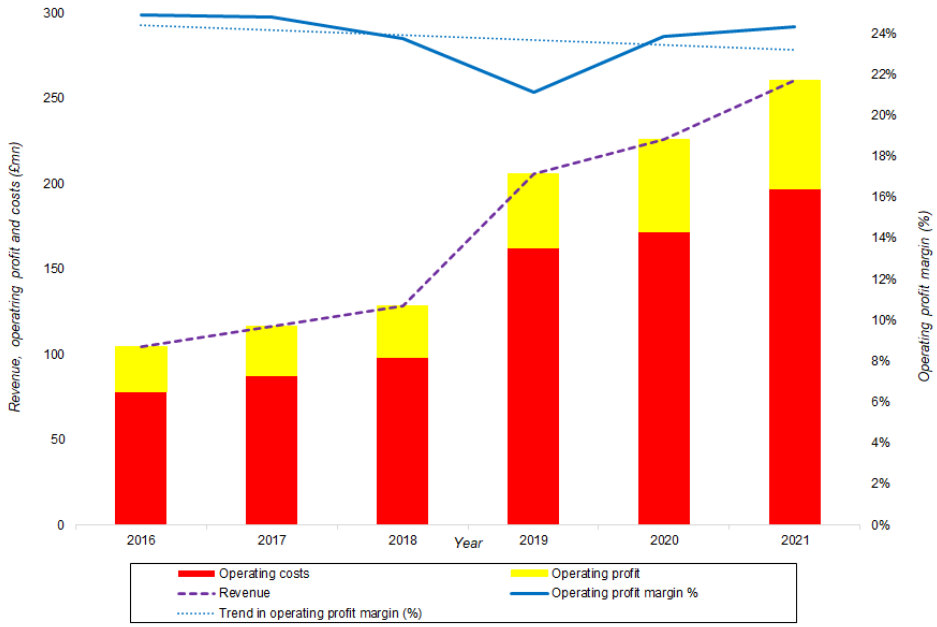


Source: CMA analysis of Financial information of seven PE-owned Large providers.
Note:
1.This analysis includes the results of children's homes and excludes Fostering services and Unregulated accommodation.
2. The FY 2016 to 2020 results are actuals, and the FY 2021 figures are forecasts.
3. Operating profit margin is the pre-exceptional EBITDARM margin.

78. Figure 4 illustrates that aggregate revenue increased by 17.4% on average between FY 2016 and 2020. It reflects a 16.8% operating cost increase, 5.8% above-inflation fee increase (Figure 19), 19.2% operating profit increase, and the impact of acquisitions. The operating profit margin (%) rose by 1.7 percentage points and averaged 21.3% between FY 2016 and 2020.

79. Figure 5 disaggregates figure 3 and shows the trends in the same metrics of the six non-PE-owned Large providers operating Children's homes.

Figure 5: Aggregate revenue, operating profitability and operating costs for the six Large non-PE-owned providers that operate children's homes, FY 2016 to 2021



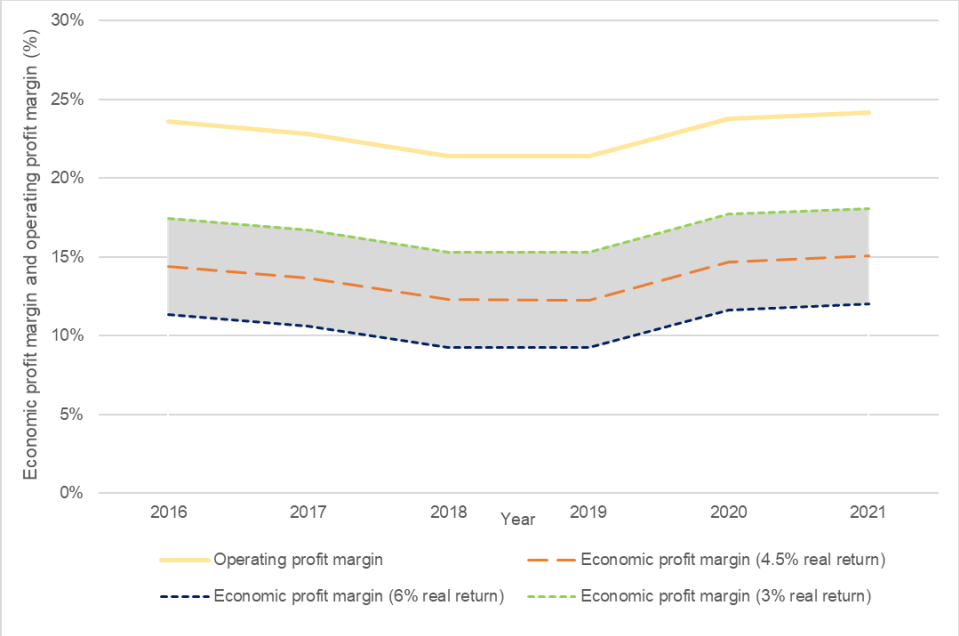
Source: CMA analysis of Financial information of the six non-PE owned Large providers.
Note:
1.This analysis includes the results of children's homes and excludes Fostering services and Unregulated accommodation.
2. The FY 2016 to FY 2020 results are actuals, and the FY 2021 figures are forecasts.
3. Operating profit margin is the pre-exceptional EBITDARM margin.

80. Figure 5 illustrates that aggregate revenue increased by 16.7% on average between FY 2016 and 2020. It reflects a 17.0% operating cost increase, 4.7% above-inflation fee increase (figure 20), 15.7% operating profit increase, and the impact of acquisitions. The operating profit margin (%) decreased by 1 percentage point and averaged 23.7% between FY 2016 and 2020.

Aggregate economic profitability of the Children's homes segment

81. Figure 6 shows the aggregate economic trends of the 13 Large providers that run Children's homes using a real rate of return from 3% to 6%.

Figure 6: Aggregate economic profitability for the 13 Large providers that operate children's homes, FY 2016 to 2021



Source: CMA analysis using data from Large Providers and CMA assumptions on asset valuations.
Notes:
1. Economic profit = EBITDARM – Capital cost. ie, the gap between the operating profit margin (yellow) line and the economic profit margin (dashed orange line - base case real return) is explained by the capital cost expressed as a percentage of revenue.
2. The grey shaded area shows the range of the aggregate profitability assuming a real required rate of return of 3-6%.
3. Operating profit margin is the pre-exceptional EBITDARM margin.
4. Using a ratio of aggregated revenue to aggregated property valuation of 0.52.

82. The grey shaded area in figure 6 shows that the aggregate economic profit margin (%) remained flat and averaged 16.5%, 13.5%, and 10.4% using a 3%, 4.5% and 6% rate of return, respectively, between FY 2016 and 2020. In other words, profits and prices have been between 10.4% to 16.5% higher than our benchmarks in a well-functioning market in the Children's home segment operated by Large providers.

83. As we described earlier, another way of looking at these economic profit numbers is through the annual returns on capital employed earned by the Large providers. Although there will be some variation in returns, these Large providers made substantial profits in aggregate, given that the actual rate of return (average ROCE) was 11.1%, on average between FY 2016 and 2020 compared to our benchmark of 3% to 6% real rate of return.

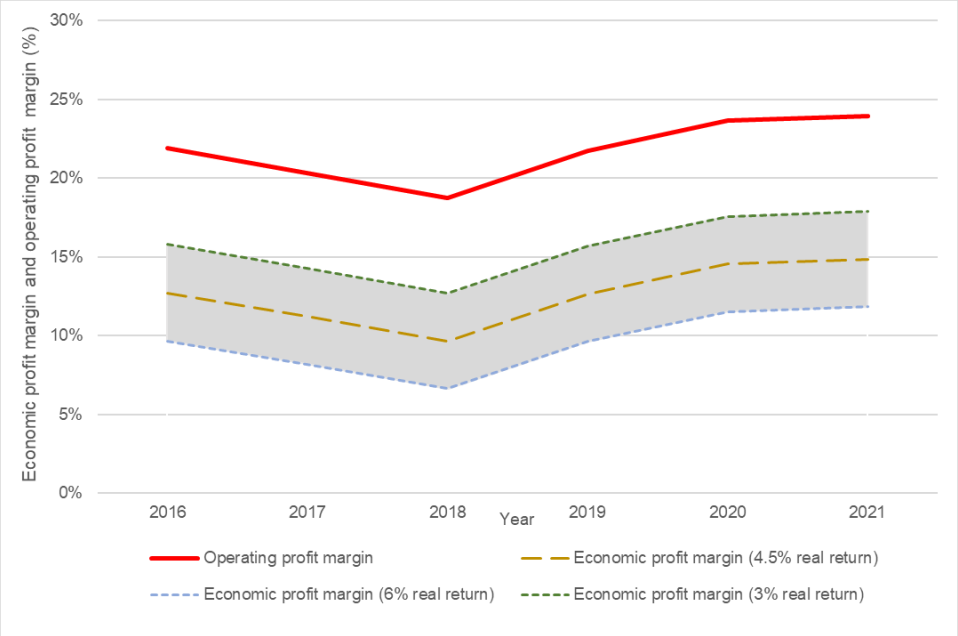
84. We used the ratio of aggregated revenue to aggregated property valuation of 0.52 for the results presented in the preceding paragraphs. However, using the adjusted ratio of aggregated revenue to aggregated property valuation of 0.88 (to exclude the above-mentioned economic rent), the actual rate of return increases from 11.1% to 18.2%. Moreover, the economic profitability margin

rises from 13.5% to 17% using a 4.5% rate of return - it means that prices were 17% higher than we would expect in a well-functioning market.

Disaggregated economic profitability of the Children's homes segment - PE vs non-PE

85. Figure 7 disaggregates figure 6 and shows the trends in the same metrics of the seven PE-owned Large providers that run Children's homes using a real rate of return from 3% to 6%.

Figure 7: Aggregate economic profitability for the seven large PE-owned providers that operate children's homes, FY 2016 to 2021

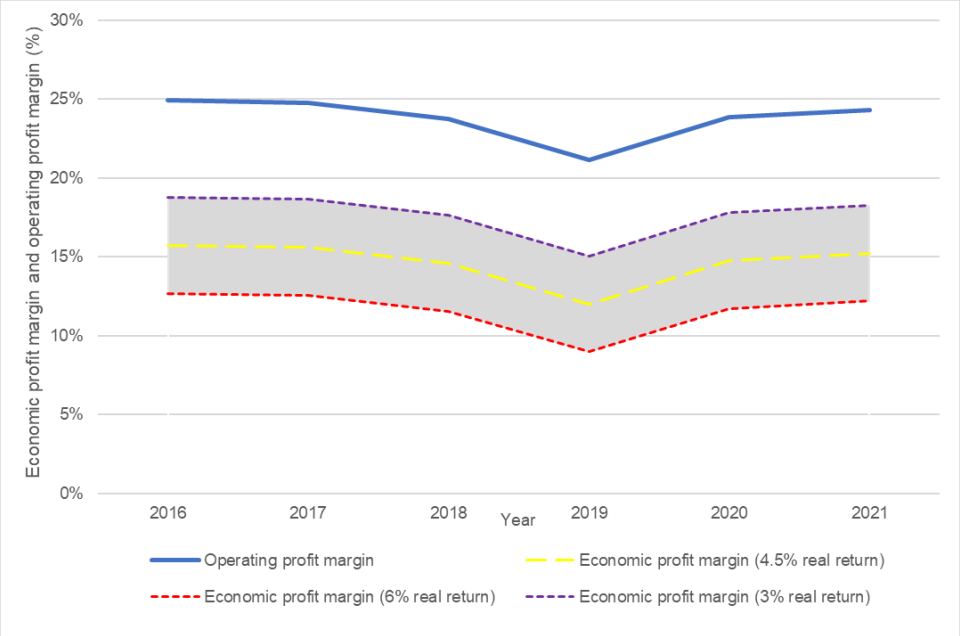


Source: CMA analysis using data from Large Providers and CMA assumptions on asset valuations.
Notes:
1. Economic profit = EBITDARM – Capital cost. ie, the gap between the operating profit margin (red) line and the economic profit margin (dashed gold line - base case real return) is explained by the capital cost expressed as a percentage of revenue.
2. The grey shaded area shows the range of the aggregate profitability assuming a real required rate of return of 3-6%.
3. Operating profit margin is the pre-exceptional EBITDARM margin.
4. Using a ratio of aggregated revenue to aggregated property valuation of 0.52.

86. The grey shaded area in figure 7 demonstrates that the aggregate economic profit margin (%) slightly increased by 1.8 percentage points and averaged 15.2%, 12.2%, and 9.1% using a 3%, 4.5% and 6% rate of return, respectively, between FY 2016 and 2020. It means that profits and prices have been between 9.1% to 15.2% higher than our benchmarks in a well-functioning market in the Children's home segment operated by the Large providers. Also, the actual rate of return (average ROCE) was 10.5% compared to our benchmark of a 3% to 6% real rate of return.

87. Figure 8 disaggregates figure 6 and shows the trends in the same metrics of the 6 non-PE-owned Large providers that operate Children's homes.

Figure 8: Aggregate economic profitability for the six non-PE-owned Large providers that operate Children's homes, FY 2016 to 2021



Source: CMA analysis using data from Large Providers and CMA assumptions on asset valuations.
Notes:
1. Economic profit = EBITDARM – Capital cost. ie, the gap between the operating profit margin (blue) line and the economic profit margin (dashed yellow line - base case real return) is explained by the capital cost expressed as a percentage of revenue.
2. The grey shaded area shows the range of the aggregate profitability of the Large provider dataset, assuming a real required rate of return of 3 - 6%.
3. Operating profit margin is the pre-exceptional EBITDARM margin.
4. Using a ratio of aggregated revenue to aggregated property valuation of 0.52.

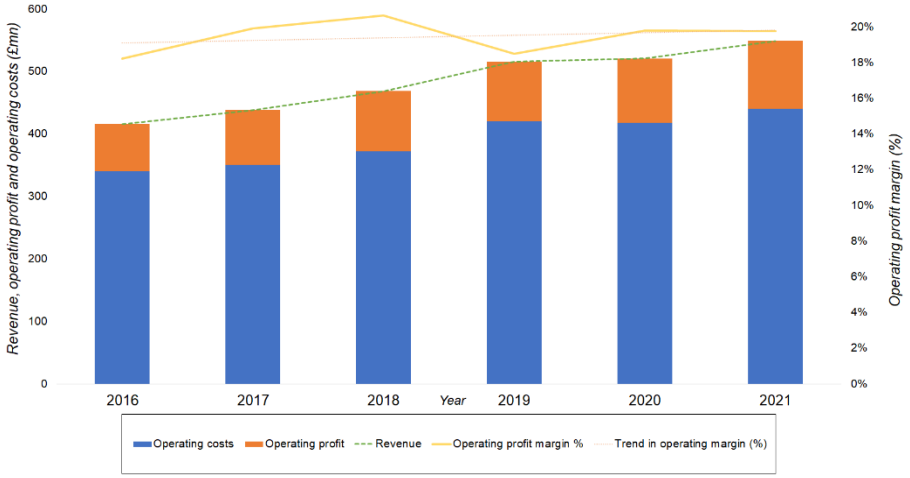
88. The grey shaded area in figure 8 demonstrates that the aggregate economic profit margin (%) declined by 1 percentage point and averaged 17.6%, 14.5%, and 12.2% using a 3%, 4.5% and 6% rate of return, respectively, between FY 2016 and 2020. It implies that profits and prices have been between 12.2% to 17.6% higher than our benchmarks in a well-functioning market in the Children's home segment operated by the Large providers. Also, the actual rate of return (average ROCE) was 11.7% compared to our benchmark of a 3% to 6% real rate of return.

Profitability of the Fostering services segment operated by the Large providers

Aggregate operating profitability of the Fostering services segment

89. Figure 9 shows the trends in aggregate revenue, staff operating costs, other operating costs and pre-exceptional operating profit margin (EBITDARM %) of the eight Large providers that operate Fostering agencies.

Figure 9 Aggregate revenue, operating profitability and operating costs for the eight Large providers that operate Fostering agencies, FY 2016 to 2021



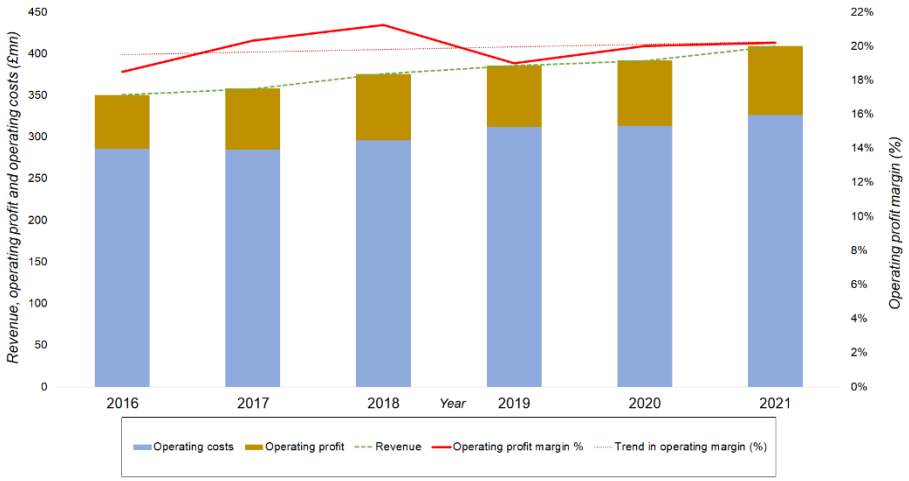
Source: CMA analysis of Financial information of eight Large providers that operate Fostering agencies.
Note:
1.This analysis includes the results of Fostering services and excludes children's homes and Unregulated accommodation.
2. The FY 2016 to 2020 results are actuals, and the FY 2021 figures are forecasts.
3. Operating profit margin is the pre-exceptional EBITDARM margin.

90. Figure 9 indicates that aggregate revenue increased by 4.6% on average between FY 2016 and FY 2020. It reflects a 4.2% operating cost increase and the impact of acquisitions while the average fee per child remained stable (figure 22). The operating profit margin (%) largely remained flat at an average of 19.4% between FY 2016 and 2020 and is forecast to be similar in 2021.

Disaggregated operating profitability of the Fostering services segment - PE vs non-PE

91. Figure 10 disaggregates figure 9 and shows the trends in the same metrics of the three PE-owned Large providers that run Fostering agencies.

Figure 10: Aggregate revenue, operating profitability and operating costs for the three Large PE-owned providers that operate Fostering agencies, FY 2016 to 2021

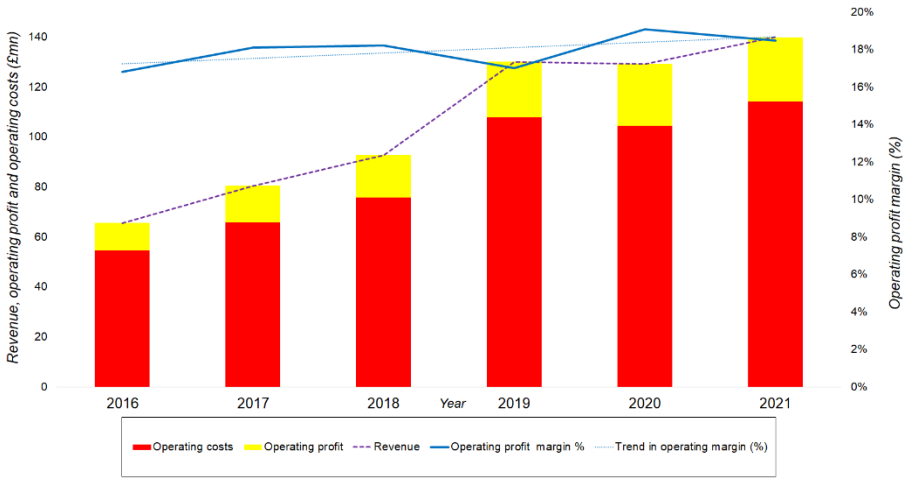


Source: CMA analysis of Financial information of the three PE-owned Large providers that operate Fostering agencies.
Note:
1.This analysis includes the results of Fostering services and excludes children's homes and Unregulated accommodation.
2. The FY 2016 to 2020 results are actuals, and the 2021 figures are forecasts.
3. Operating profit margin is the pre-exceptional EBITDARM margin.

92. Figure 10 illustrates that aggregate revenue increased slightly by 2.2% on average between FY 2016 and FY 2020. It reflects a 1.9% operating cost increase and the impact of acquisitions while the fee remained stable (figure 23). The operating profit margin (%) remained stable and averaged 19.8% between FY 2016 and FY 2020.

93. Figure 11 disaggregates figure 9 and shows the trends in the same metrics of the 5 non-PE-owned Large providers that operate Fostering agencies.

Figure 11: Aggregate revenue, operating profitability and operating costs for the five Large non-PE-owned providers that operate Fostering agencies, FY 2016 to 2021



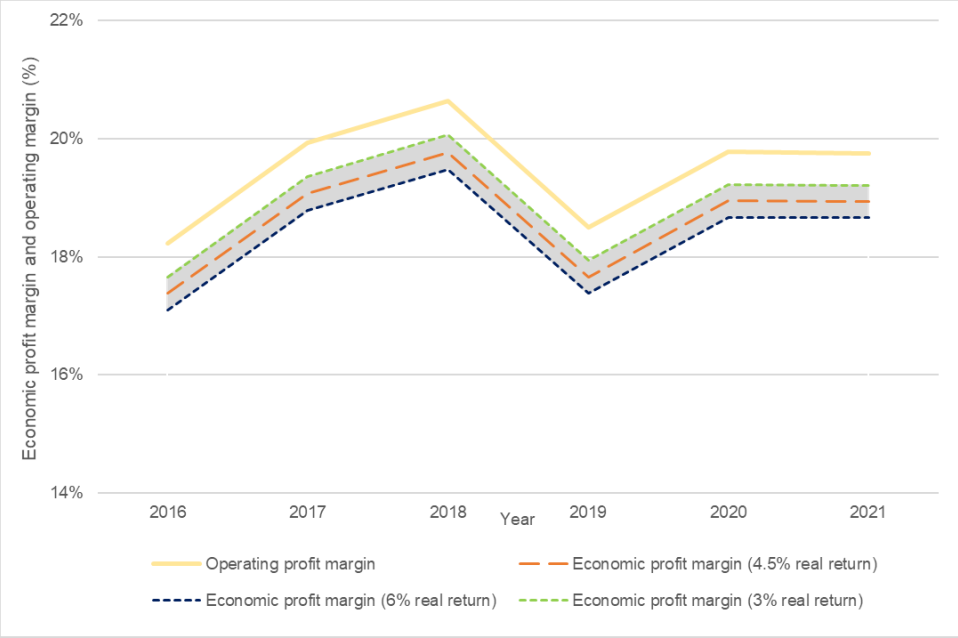
Source: CMA analysis of Financial information of five non-PE owned Large providers that operate Fostering agencies.
Note:
1.This analysis includes the results of Fostering services and excludes children's homes and Unregulated accommodation.
2. The FY 2016 to 2020 results are actuals, and the FY 2021 figures are forecasts.
3. Operating profit margin is the pre-exceptional EBITDARM margin.

94. Figure 11 illustrates that aggregate revenue increased by 14.5% on average between FY 2016 and 2020. It reflects a 13.9% operating cost increase, 17.5% operating profit increase and the impact of acquisitions while the fee remained stable (figure 23). The operating profit margin (%) remained flat and averaged 17.8% between FY 2016 and 2020.

Aggregate economic profitability (replacement cost analysis) of the Fostering services segment

95. Figure 12 shows the aggregate economic profit margin trends of the eight Large providers that run Fostering agencies using a 3% to 6% real rate of return.

Figure 12 Aggregate economic profitability for the eight Large providers that operate Fostering agencies, FY 2016 to 2021



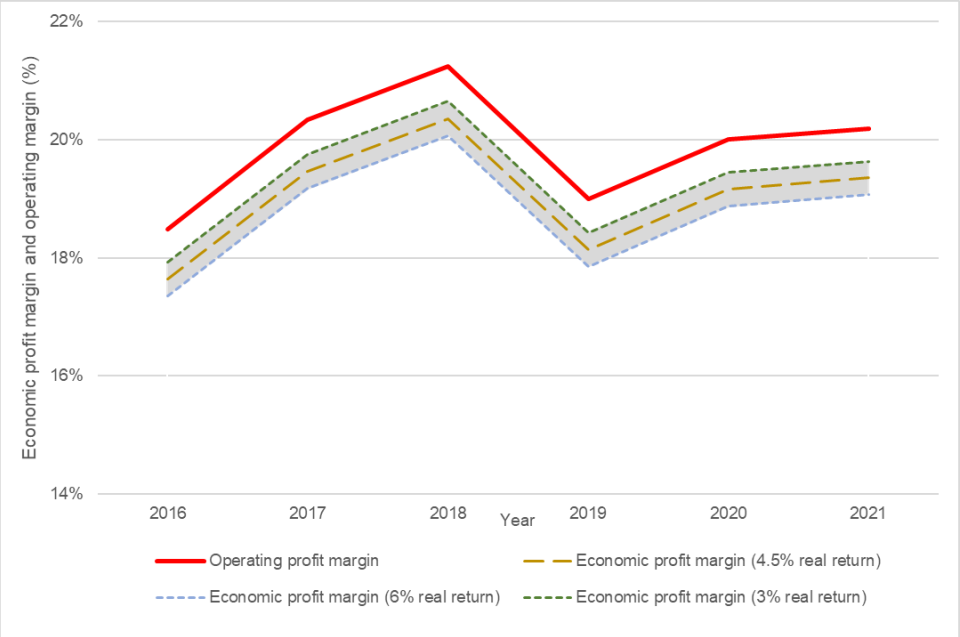
Source: CMA analysis using data from Large Providers and CMA assumptions on asset valuations.
Notes:
1. Economic profit = EBITDARM – Capital cost. ie, the gap between the operating profit margin (yellow) line and the economic profit margin (dashed orange line - base case real return) is explained by the capital cost expressed as a percentage of revenue.
2. The grey shaded area shows the range of the aggregate profitability assuming a real required rate of return of 3-6%.
3. Operating profit margin is the pre-exceptional EBITDARM margin.

96. The grey shaded area in figure 12 shows that the aggregate economic profit margin (%) increased by 1.5% and averaged 18.8%, 18.6%, and 18.3% using a 3%, 4.5% and 6% rate of return, respectively, between FY 2016 and 2020. Profits and prices have been approximately 18% higher than our benchmarks in a well-functioning market.

Disaggregated economic profitability of the Fostering services segment - PE vs non-PE

97. Figure 13 disaggregates figure 12 and shows the trends in the same metrics of the 3 PE-owned Large providers operating Fostering agencies.

Figure 13: Aggregate economic profitability for the three large PE-owned providers that operate Fostering agencies, FY 2016 to 2021

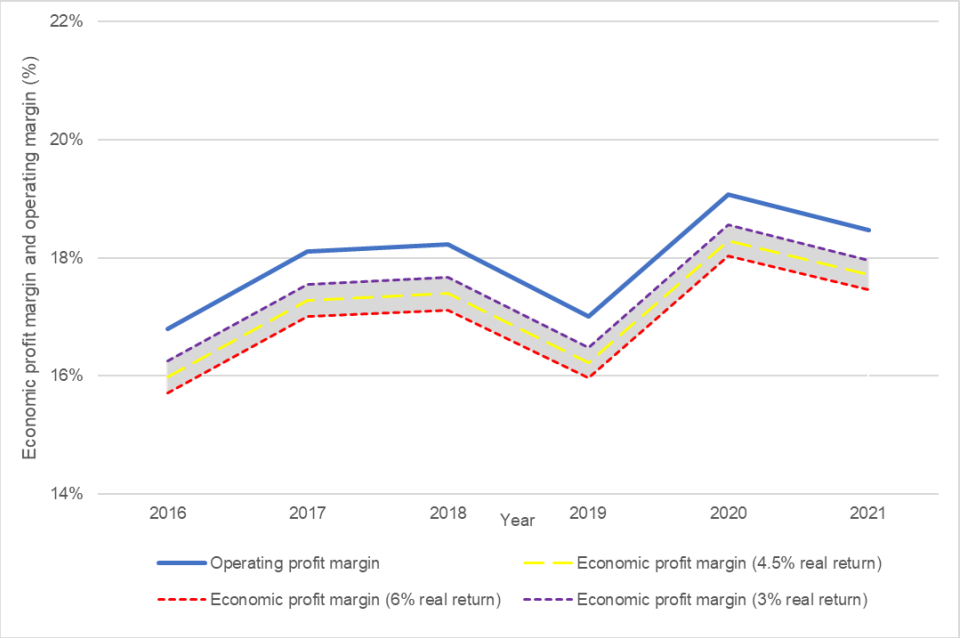


Source: CMA analysis using data from Large Providers and CMA assumptions on asset valuations.
Notes:
1. Economic profit = EBITDARM – Capital cost. ie, the gap between the operating profit margin (red) line and the economic profit margin (dashed gold line - base case real return) is explained by the capital cost expressed as a percentage of revenue.
2. The grey shaded area shows the range of the aggregate profitability assuming a real required rate of return of 3-6%.
3. Operating profit margin is the pre-exceptional EBITDARM margin.

98. The grey shaded area in figure 13 demonstrates that the aggregate economic profit margin (%) slightly increased by 1.5% and averaged 19.2%, 19.0%, and 18.7% using a 3%, 4.5% and 6% rate of return, respectively, between FY 2016 and 2020. In other words, profits and prices have been approximately 19% higher than our benchmark of a well-functioning market in the Fostering services segment operated by the large PE-owned providers.

99. Figure 14 disaggregates figure 12 and shows the trends in the same metrics of the five non-PE-owned Large providers operating Children's homes.

Figure 14: Aggregate economic profitability for the five Large non-PE-owned providers that operate Fostering agencies, FY 2016 to 2021



Source: CMA analysis using data from Large Providers and CMA assumptions on asset valuations.
Notes:
1. Economic profit = EBITDARM – Capital cost. ie, the gap between the operating profit margin (blue) line and the economic profit margin (dashed yellow line - base case real return) is explained by the capital cost expressed as a percentage of revenue.
2. The grey shaded area shows the range of the aggregate profitability of the Large provider dataset, assuming a real required rate of return of 3 - 6%.
3. Operating profit margin is the pre-exceptional EBITDARM margin.

100. The grey shaded area in figure 14 demonstrates that the aggregate economic profit margin (%) increased by 2.3% and averaged 17.3%, 17.0%, and 16.8% using a 3%, 4.5% and 6% rate of return, respectively, between FY 2016 and 2020. In other words, profits and prices have been approximately 17% higher than our benchmarks in a well-functioning market.

101. A comparison of figures 13 and 14 shows that PE-owned Fostering agencies earned a 1.9 percentage points higher economic profit margin than non-PE-owned Fostering agencies between FY 2016 and 2020.

Margin comparator analysis for the Fostering services segment

102. We have also assessed how the pre-exceptional EBITM margin in Fostering services compares to similar companies in other sectors.

103. First, we compared CSC margins to comparable listed companies providing services to the state:

(a) Capita Plc provides consulting, transformation and digital services to the state and private companies. Its average pre-exceptional EBIT (operating)

margin between FY 2016 and FY 2020 was 2.4%, ranging from -1% to 7.8%;

(b) Mitie Group Plc provides facilities management services to the state and private companies. Its average pre-exceptional EBIT (operating) margin between FY 2016 and FY 2020 was 2.8%, ranging from -0.3% to 4.1%; and

(c) Serco Group plc provides public services. Its average pre-exceptional EBIT (operating) margin between FY 2016 and FY 2020 was 3.4%, ranging from 1.4%% to 4.3%.[61]

104. The average pre-exceptional EBIT (operating) margin between FY 2016 and FY 2020 for these 3 companies was 2.9%.

105. Compass questioned the usage of a small sample of firms (see above) operating in materially different industries to foster care agencies. 'For such a comparison to be informative, the cost structure, investment profile, and risk profile would need to be very similar'.[62]

106. Despite the differences, the comparators could be helpful because:

(a) the service providers mentioned above and IFAs are asset-light businesses that supply services to the state. The service providers, as mentioned earlier, are often subject to a cost-plus margin model that controls operating costs and investor returns, thus reducing cost inflation (see Figure 15b that compares outsourcing to Fostering services). And in principle, Fostering services are very similar. The risk and investment profiles of the service providers mentioned above and Fostering agencies should be more similar than dissimilar. Also, staff costs and general overheads are the essential cost line items in all these businesses;

(b) regulation costs in the children's social care sector are already reflected in the (higher) operating costs; and

(c) allowances and fees are IFA's primary operating costs and only payable for the placement's duration. Thus the utilisation risk in Fostering services should not be high.

107. OFG said that 'if the CMA chooses to present benchmarks from other UK markets at all, it would likely be better to use a selection of firms involved in

[61] Source: Refinitiv Eikon
[62] Compass response to the IR.

healthcare and children's care (e.g. nurseries)'.[63] Polaris indicated '…that the most appropriate comparator firms for independent sector providers of foster care are likely to be other businesses that also care for people, whether personal or clinical'.[64]

108. Therefore, we expanded the comparators to include:

(a) Spire Healthcare Group PLC is a private healthcare company. Its average pre-exceptional EBIT (operating) margin between FY 2016 and FY 2020 was 6.6%, ranging from 3.1% to 10.0%;

(b) Nuffield Health is a private healthcare company. Its average pre-exceptional EBIT (operating) margin between FY 2016 and FY 2019[65] was 0.7%%, ranging from -0.6% to 2.3%;

(c) Busy Bees Nurseries Limited is an operator of children's nurseries. Its average pre-exceptional EBIT (operating) margin between FY 2016 and FY 2020 was 8.3%, ranging from 1.9% to 12.7%; and

(d) Bright Horizons Family Solutions Limited is an operator of children's nurseries. Its average pre-exceptional EBIT (operating) margin between FY 2016 and FY 2019[66] was 5.9%, ranging from 3.8% to 9.2%.[67] [68]

109. The average pre-exceptional EBIT (operating) margin between FY 2016 and FY 2020 for the seven companies in our comparator group was 4.4%

110. Figure 15 below compares the pre-exceptional EBITM margin for the Fostering services segment to an EBIT margin comparator of 3.9% to 4.9%. The grey shaded areas in figure 15a show the Fostering services segment's excess margin.

[63] OFG response to the IR.
[64] Polaris response to the IR.
[65] We exclude 2020 for Nuffield Health given the negative impact Covid-19 had on the Groups gym business.
[66] 2020 excluded. The company was heavily loss making and we presume this was due to nursery closures during the Covid-19 pandemic.
[67] We excluded two of the largest private healthcare companies because they were loss-making during the review period. HCA International Limited's and BMI Healthcare Limited's average pre-exceptional EBIT margins between FY 2016 and 2020 were -4.8% and -0.3%.
[68] The average pre-exceptional EBIT (operating) margin between FY 2016 and FY 2020 for these four companies was 5.8%.

Figure 15a: Average EBITM in the Fostering agencies compared to the average EBITM of the comparators, FY 2016 to 2020

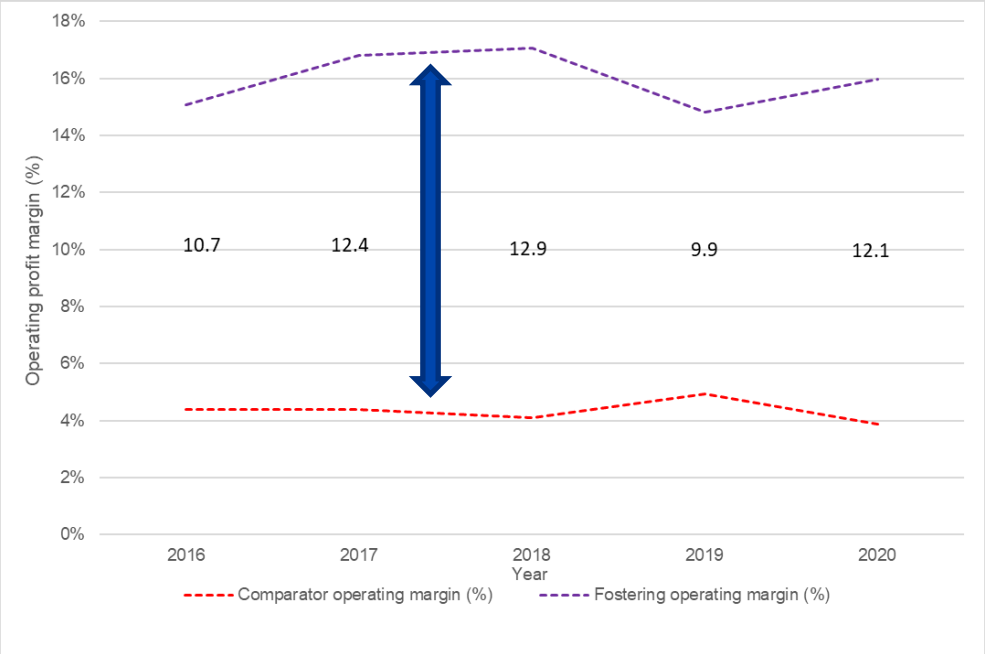
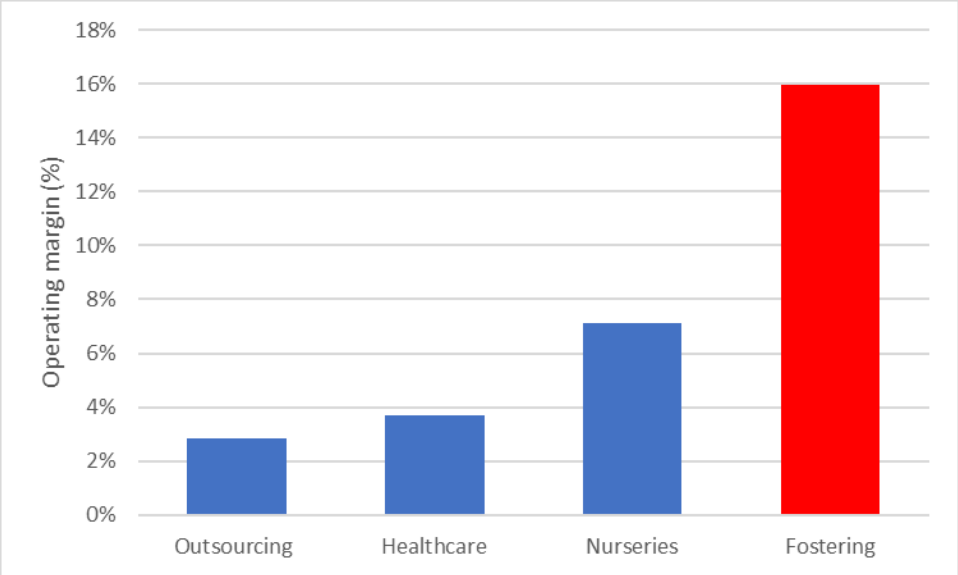


Figure 15b: Average EBITM in the Fostering agencies compared to companies in similar sectors, FY 2016 to 2020



Source: Refinitiv Eikon and Company Watch for the EBIT margin comparator and CMA analysis of Financial information of 8 Large providers for the EBITM margin.
Note:
1.This analysis includes the results of Fostering services and excludes Children's homes and Unregulated accommodation.
2. The FY 2016 to 2020 results are actuals, and the FY 2021 figures are forecasts.
3. Operating profit margin is the pre-exceptional EBITM margin for Fostering agencies and the pre-exceptional EBIT margin for the comparator peer group. The two-headed arrow in figure 15a highlights the differential (in percentage points) between the 2 margins, and the numbers between the two dashed lines represent the difference in the year.
4. Comparator peer group includes Capita PLC, Mitie Group PLC, Serco Group PLC, Spire Healthcare Group PLC, Nuffield Health, Bright Horizons Family Solutions Limited and Busy Bees Nurseries Limited.
5. We observed a pronounced increase in depreciation and amortisation in 2018 for 1 provider. As a result, for our EBITM calculations, we excluded the FY 2019 to 2021 depreciation and amortisation reported to us and used the 2016 to 2018 depreciation and amortisation as a % of revenue as a proxy for the FY 2019-2021 depreciation and amortisation figures.
6. We observed a pronounced decrease in depreciation and amortisation in 2021 for 1 provider. As a result, for our EBITM calculations, we excluded the FY 2021 depreciation and amortisation reported to us and used the FY 2016 to 2020 depreciation and amortisation as a % of revenue as a proxy for the 2021 depreciation and amortisation figures.
2016 to 2020.

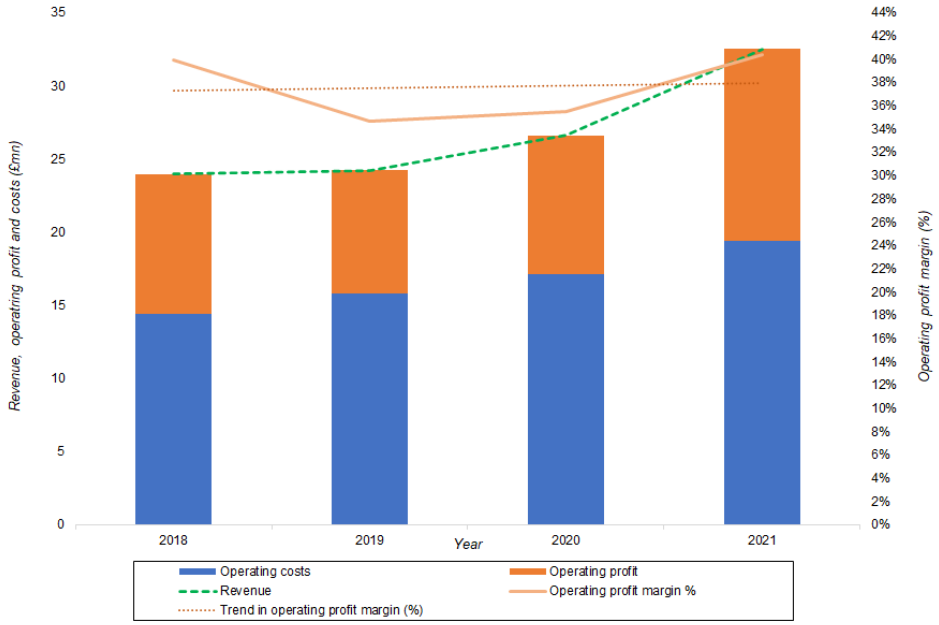
111. The key finding is that profits and prices in Fostering services were very high between FY 2016 and 2020, on average 11.6 percentage points (ie 16% minus 4.4%) higher than our expectations in a well-functioning market. Figure 15b shows that the EBITM margin in Fostering services was several multiples higher than the margins generated by similar companies in other sectors. This finding corroborates our earlier results of high profits and prices using the economic profitability analysis.

Profitability of the Unregulated accommodation segment operated by the Large providers

Aggregate operating profitability of the Unregulated accommodation segment

112. Figure 16 shows the trends in aggregate revenue, staff operating costs, other operating costs and pre-exceptional operating profit margin (EBITDARM %) of the five Large providers that run Unregulated accommodation. In FY 2016 and 2017, there was a minimal number of looked-after children at the Unregulated accommodation providers in our dataset. Therefore, we excluded both years from our analysis.

Figure 16 Aggregate revenue, operating profitability and operating costs for the five Large providers that operate Unregulated accommodation, FY 2018 to 2021



Source: CMA analysis of Financial information of the five Large providers that operate Unregulated accommodation.
Note:
1.This analysis includes the results of Unregulated accommodation and excludes children's homes and Fostering services.
2. The 2018 to 2020 results are actuals, and the 2021 figures are forecasts.
3. Operating profit margin is the pre-exceptional EBITDARM margin.

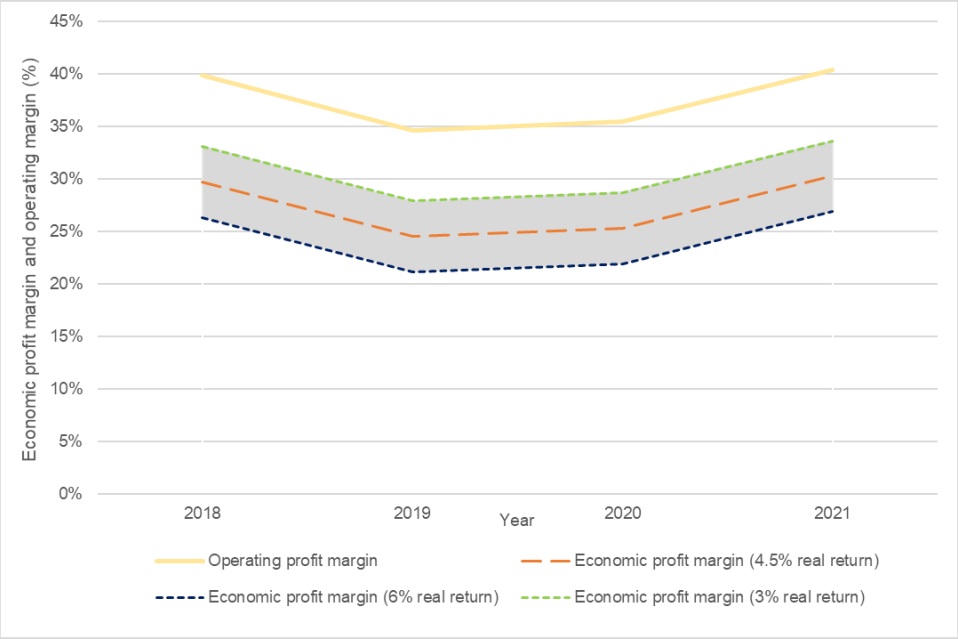
113. Figure 16 indicates that aggregate revenue increased by 3.5% on average between FY 2018 and FY 2020. It reflects a 6% operating cost increase and

the impact of acquisitions, despite a 0.8% fee decrease (Figure 25). The operating profit margin (%) averaged 36.7% between FY 2018 and FY 2020 and is forecast to rise in FY 2021.

Aggregate economic profitability of the Unregulated accommodation segment

114. Figure 17 shows the aggregate economic profit trends of the five Large providers that run Unregulated accommodation.

Figure 17: Aggregate economic profitability for the 5 Large providers that operate Unregulated accommodation, FY 2018 to 2021



Source: CMA analysis using data from Large Providers and CMA assumptions on asset valuations.
Notes:
1. Economic profit = EBITDARM – Capital cost. ie, the gap between the operating profit margin (yellow line) and the economic profit margin (dashed orange line) is explained by the capital cost expressed as a percentage of revenue.
2. The grey shaded area shows the range of the aggregate profitability of the Large provider dataset, assuming a real required rate of return of 3-6%.
3. Operating profit margin is the pre-exceptional EBITDARM margin.
4. Using the ratio of aggregated revenue to aggregated property valuation of 0.52.

115. The grey shaded area in figure 17 shows that the aggregate economic profit margin (%) averaged 29.9%, 26.5%, and 23.1% using a 3%, 4.5% and 6% rate of return, respectively, between FY 2018 and 2020. It implies that profits and prices were 23.1% to 29.9% higher than our expectations (benchmark) in a well-functioning market. Also, the Large providers' actual rate of return was very high at 16.2% compared to our benchmark of 3% to 6%.

116. We used the ratio of aggregated revenue to aggregated property valuation of 0.52 for the results presented in the preceding paragraphs. However, using the above-mentioned adjusted ratio of aggregated revenue to aggregated property valuation of 0.88, the actual rate of return increases from 16.2% to

25.1%. The economic profitability margin increased from 26.5% to 30.1%, using a 4.5% rate of return.

Pricing and operating cost analysis using the 15 Large providers dataset and LA dataset

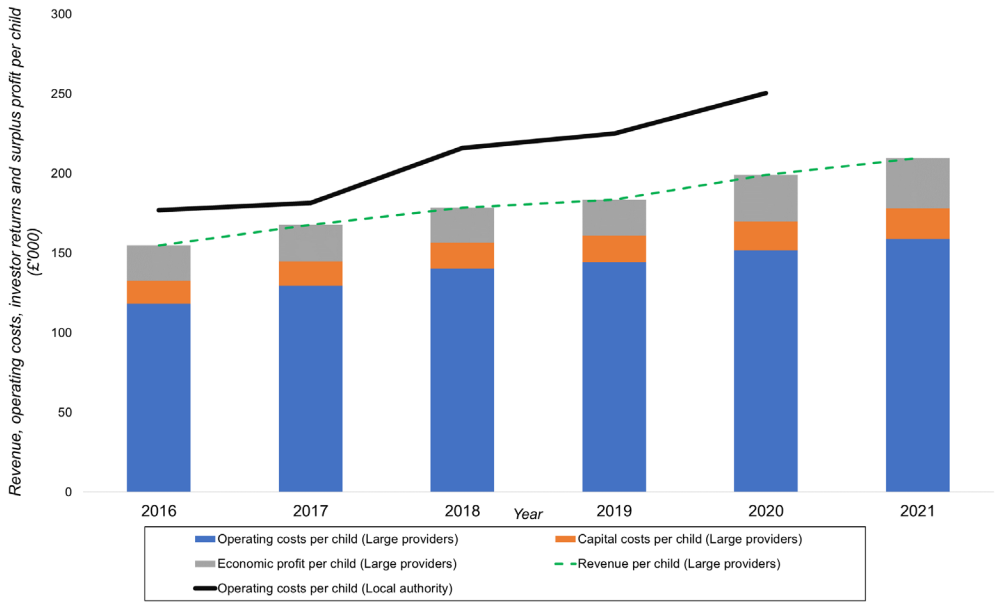
117. This section assesses the Large providers' average fee components using the company level dataset disaggregated by the relevant activity. It compares them to LA operating costs for Children's homes using the home level dataset. It also assesses the operating cost components using the home level datasets of the Large providers and LAs.

Average fee per child in Children's homes (operated by the Large providers) and LA operating costs

Average fee and LA operating costs per child in children's homes

118. Figure 18 shows the average fee per child for Children's homes run by 13 Large providers (at the activity level) and compares it to the average LA operating cost (at the home level).

Figure 18: Average fee per child for Children's homes run by 13 Large providers and the average LA operating costs per child, FY 2016 to 2021



Source: CMA analysis of Financial information of 13 Large providers and 29 LAs across England, Scotland and Wales.
Note:
1.This analysis includes the results of Children's homes (using aggregate Group level by activity data) and excludes Fostering services and Unregulated accommodation.
2. The FY 2016 to 2020 results are actuals, and the FY 2021 figures are forecasts.
3. Rate of return 4.5%.
4. Using a ratio of aggregated revenue to aggregated property valuation of 0.52.

119. Figure 18 demonstrates the following from FY 2016 to 2020:

(a) the average fee per child generated by the Large providers increased year-on-year from £154,830 in FY 2016 to £199,186 in FY 2020, representing an annual growth rate of 5.2%;

(b) operating costs per child increased,[69] and providers simultaneously benefitted from the above-inflation and rising fee rates, thus keeping the operating profit margin flat at 22.6% (figure 3);

(c) economic profits[70] per child were £23,776. It amounts to 13.5% of the average fee, suggesting that profits and prices were 13.5% higher than our benchmark of a well-functioning market; and

(d) LA operating costs (at the home level) were significantly higher than the equivalent for the Large providers (activity level) and the fees generated from LAs.

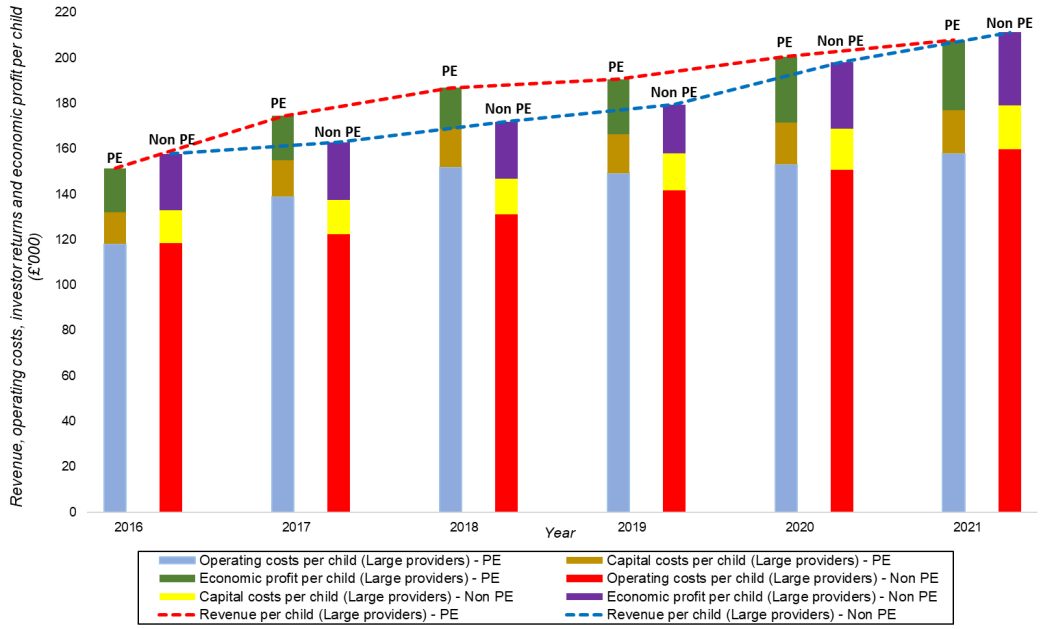
[69] From 1 April 2016, the government introduced a new mandatory national living wage (NLW) for workers aged 25 and above.
[70] Using base case 4.5% rate of return.

120. Using the adjusted ratio of aggregated revenue to aggregated property valuation of 0.88 (to exclude the economic rent), the annual economic profit per child increases from £23,776 to £30,032.

Disaggregated analysis of Large providers' average revenue and LA operating costs per child in Children's homes - PE vs Non-PE owned providers

121. Figure 19 disaggregates figure 18 by comparing PE-owned and non-PE-owned providers (at the activity level).

Figure 19: Average fee per child for children's homes operated by seven PE-owned Large providers and six non-PE owned providers, FY 2016 to 2021



Source: CMA analysis of Financial information of 13 Large providers and 29 LAs across England, Scotland and Wales.
1.This analysis includes the results of Children's homes (using aggregate Group level by activity data) and excludes Fostering services and Unregulated accommodation.
2. The FY 2016 to 2020 results are actuals, and the FY 2021 figures are forecasts.
3. Using a 4.5% rate of return.
4. Using a ratio of aggregated revenue to aggregated property valuation of 0.52.

122. Figure 19 shows that on average between FY 2016 and FY 2020:

(a) the average fee increased by 5.8% and 4.7% for PE-owned and non-PE-owned providers, respectively;

(b) PE-owned providers' average fee per child was approximately 3.9% higher; and

(c) PE-owned providers' average economic profit per child was approximately 12.6% lower.

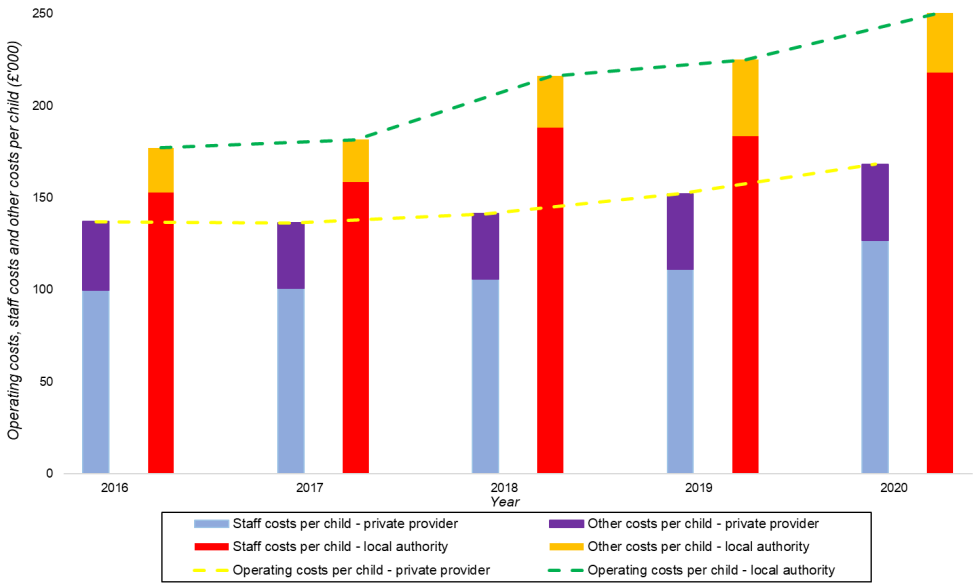
Children's homes operating costs and LA operating costs (both at the home level)

123. We have also compared the operating cost drivers of Large providers who operate Children's homes with those operated by LAs.

124. We obtained detailed and high-quality operating cost data from 657 homes in FY 2020 operated by 11 Large providers. We received the same from 128 homes run by 29 LAs.

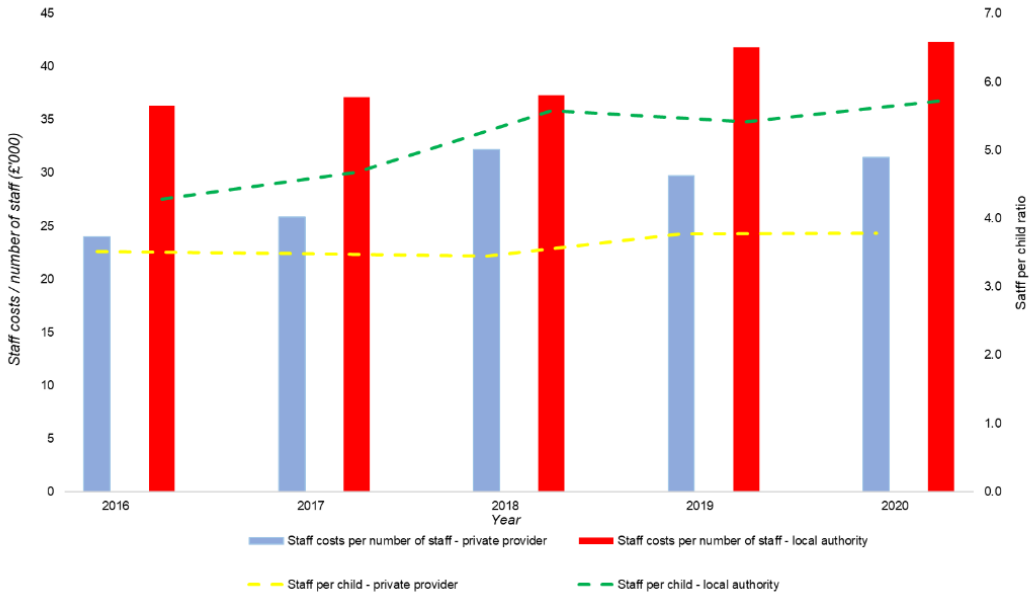
125. To minimise the risk of LAs under-reporting their overheads, we provided detailed cost guidance and engaged with the finance teams at the LAs to explain the categories of costs to include and exclude. We had a similar engagement with Large providers. We sent them clearly defined and simplified templates using identical definitions to reduce the likelihood of under-reporting or errors. Therefore, we have confidence in the quality of the data. We have no reason to doubt that the LAs have significantly unreported their overheads for Children's homes (and Fostering services – see below).[71,72]

126. Figures 20 and 21 compare the operating cost drivers of Large providers and LAs for Children's homes.



[71] It was a substantial piece of analysis with the master data/analysis spreadsheet running to 125 columns and 800 rows (children's homes) so up to 100,000 data points.
[72] Analysis excludes Unregulated accommodation and short break homes.

Figure 21: Comparison of staff costs per number of staff and staff per child ratio for 29 LAs compared to 11 Large providers, FY 2016 to 2020



Source: CMA analysis of Financial information of 11 Large providers and 29 LAs across England, Scotland and Wales. Children's home analysis uses data from our Large provider and home level data set.

127. Figures 20 and 21 show that for FY 2016 to 2020, on average:

(a) LA operating costs per child at 80% occupancy were on average £63,131 (30%) higher than those of the Large providers at 83% occupancy;

(b) LAs paid their staff £76,701 (41.4%) more per child annually and employed 1.5 to 2 more staff per child than Large providers. These factors are the critical drivers for higher LA costs. The underlying data suggests that LAs sometimes care for children with very high acuity levels, increasing staff costs.[73] Our LA home level dataset shows that in several Children's homes, a very high number of staff care for few children and at levels higher than any we have seen in the private sector.[74] It may indicate higher costs associated with the most challenging children in LA

[73] The higher LA staff costs could partly be explained by ICHA's submission to the IR, which stated that LAs provide a disproportionate number of short-stay services for children with learning and physical disabilities and high-cost assessment units. These placements require high staffing levels for shorter periods. While we removed short-stay services from our analysis, it nevertheless indicates that LA homes cater for high needs children.
[74] Outliers: Our approach to outliers is that we have accepted them as much as possible unless it is clear that they represent errors. We investigated any unusual values to determine whether the outliers were correct data points. Any errors were removed from the analysis. Other extreme values are legitimate observations that are a natural part of the population and have not been removed from the data set.

homes, hence the very high staffing requirement. The higher staff ratio in LA homes could also mean a higher quality of service provision; and

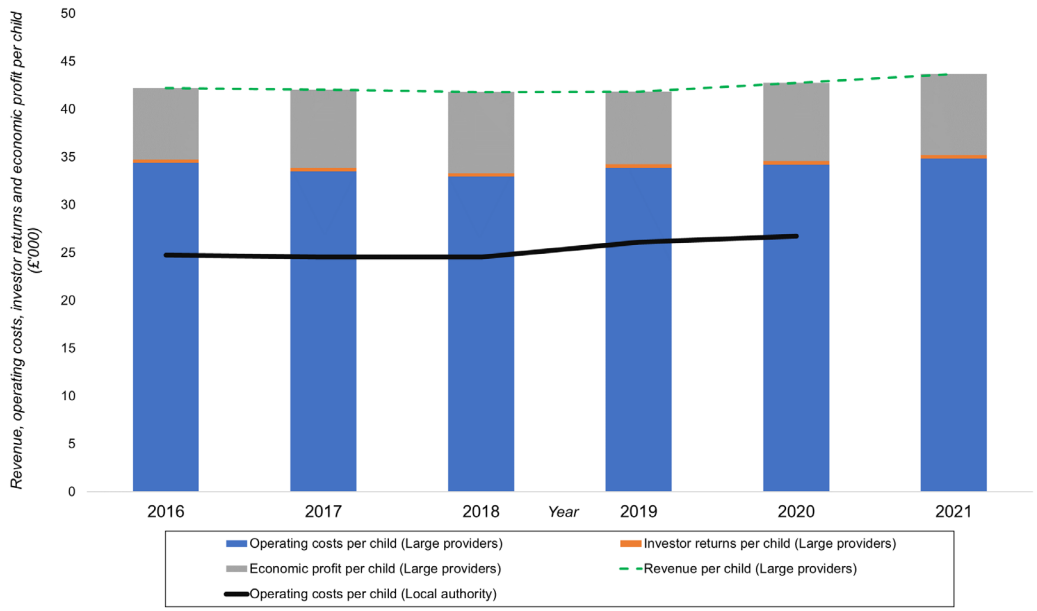
(c) LAs had £13,569 (55.1%) lower non-staff overhead costs per child, despite our steps to ensure LA did not underreport their overheads.

Average fee per child in Fostering agencies (operated by the Large providers) and LA operating costs

Average fee and LA operating costs per child in Fostering agencies

128. Figure 22 shows the trend in the average fee per child for Fostering agencies operated by 8 Large providers (at the activity level) and compares it to the average LA operating costs in Fostering services (at the agency level).

Figure 22: Average fee per child for Fostering agencies run by eight Large providers and the average local authority operating costs per child, FY 2016 to 2021



Source: CMA analysis of Financial information of eight Large providers and 27 LAs across England, Scotland and Wales.
1.This analysis includes the results of Fostering services (using Group level data by activity) and excludes children's homes and Unregulated accommodation.
2. The FY 2016 to 2020 results are actuals, and the FY 2021 figures are forecasts.
3. Rate of return 4.5%.
4. LA analysis from our Agency level data set.

129. Figure 22 demonstrates from FY 2016 to 2020:

(a) the average fee per child has remained flat at an average of £42,626. It is forecast to remain stable into FY 2021;

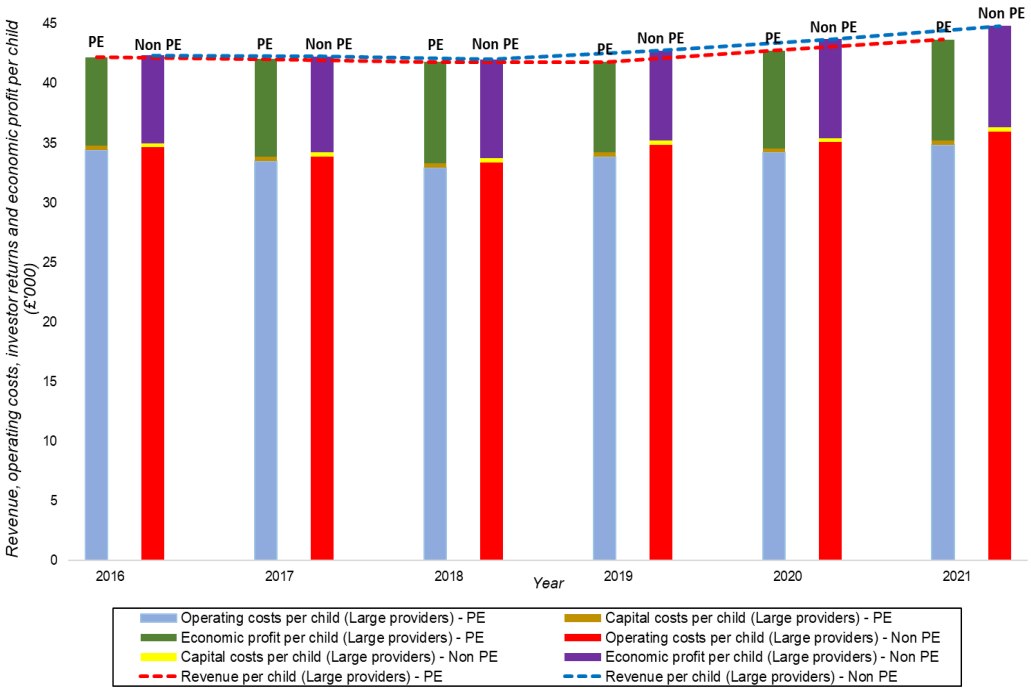
(b) operating costs per child have also been flat, thus keeping the operating profit margin flat at 19.4% (figure 9); and

(c) economic profits[75] per child were £7,913. It amounts to 18.6% of the average fee, suggesting that profits and prices were 18.6% higher than our benchmark of a well-functioning market.

Disaggregated analysis of the Large providers' average revenue and LA operating costs per child in Fostering agencies - PE vs non-PE

130. Figure 23 disaggregates figure 22 by comparing the average fees between PE-owned and non-PE-owned providers.

Figure 23: Average fee per child for Fostering agencies operated by three PE-owned providers and five non-PE-owned providers, FY 2016 to FY 2021



Source: CMA analysis of Financial information of eight Large providers and 27 LAs across England, Scotland and Wales.
1.This analysis includes the results of Fostering services (using Group level data by activity) and excludes Children's homes and Unregulated accommodation.
2. The FY 2016 to FY 2020 results are actuals, and the FY 2021 figures are forecasts.
3. Rate of return 4.5%.
4. LA cost analysis using our Agency level data set.

131. Figure 23 shows that on average between FY 2016 and FY 2020:

(a) the fee levels for both provider types have been stable;

[75] Using our base case 4.5% rate of return.

(b) PE-owned providers' average fee per child was 5.2% lower between FY 2016 and 2020; and

(c) PE-owned providers' average economic profit per child was approximately 5.5% higher.

Fostering agencies' operating costs and LAs' operating costs (both at the agency level)

132. We have also compared the operating cost drivers of the Fostering agencies run by the Large providers and LAs. In doing so, we have noted the analytical and interpretation challenges that parties raised in submissions to the IR. For example:

(a) Compass said that '…the average price per child that LAs pay for independent fostering provision is higher than the cost of their in-house provision is unlikely to properly take account of LA's overheads. It also does not take into account the fact that children placed with private foster carers typically have more complex needs. In any event, this comparison of pricing overlooks the fundamental issue that private providers spend significant amounts in recruiting and training carers which LAs also benefit from if these carers move to a different employer in the sector'. 'LAs also benefit from private firms' investments in recruiting and training foster carers, allowing them to operate at lower costs';[76] and

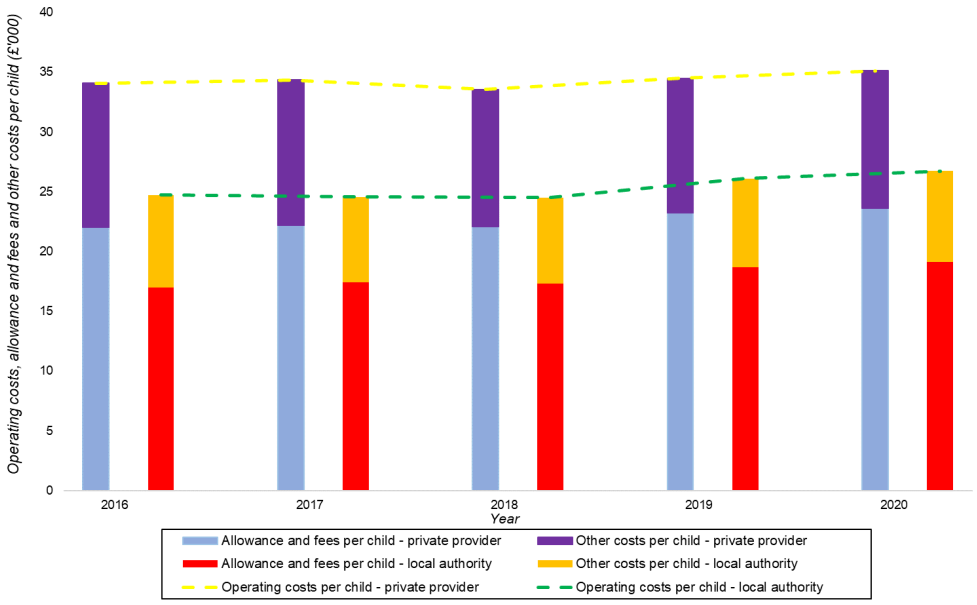
(b) OFG agreed 'with the points made by the CMA that a meaningful comparison must account for the significant differences in roles played by in-house and independent provision that drive material (and legitimate) cost differentials, such as meeting more complex and higher-acuity needs, and the need to ensure sufficient swing capacity'.[77]

133. We obtained detailed and high-quality operating cost data from 75 agencies operated by eight Large providers and 28 Fostering agencies run by 27 LAs. As explained above in paragraphs 124 and 125, we undertook the same approach for Fostering services as we did for Children's homes to ensure the completeness and accuracy of data, thus minimising the risk of LAs underreporting their overheads.

134. Figure 24 compares the operating cost drivers of the Large providers and LAs.

[76] Compass response to the IR.
[77] OFG response to the IR.

Figure 24: Comparison of allowance and fees, and overheads per child ratio for 27 LAs compared to eight Large providers, FY 2016 to 2020



Source: CMA analysis of Financial information of 8 Large providers and 27 LAs across England, Scotland and Wales.
Note:
1. Fostering analysis uses our Large provider and LA Agency level data set.

135. Figure 24 shows, on average, that IFA operating costs were 26.2% higher between FY 2016 and 2020, driven by:

(a) IFAs paying foster carers £4,725 (20.9%) more per child annually in allowance and fees; and

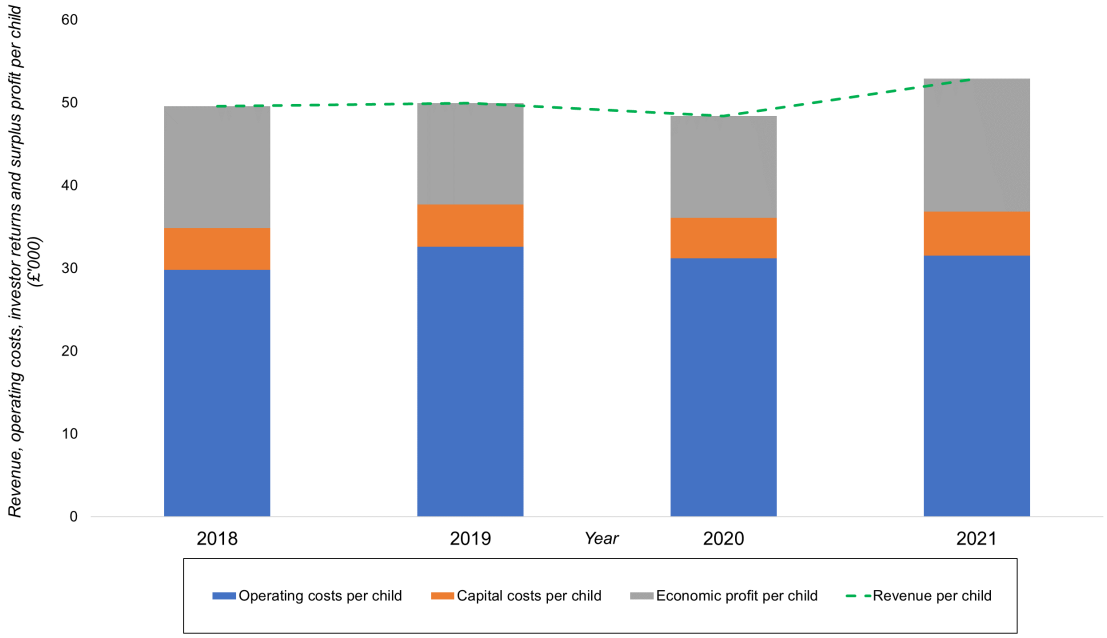
(b) IFAs have £4,262 (36.5.4%) higher overheads per child, despite our steps to minimise the risk of LAs underreporting overheads. It's implausible that lower utilisation by IFAs entirely explains this difference as acuity and other factors might also drive this result.

Average fee per child in Unregulated accommodation (operated by the Large providers)

Average fee per child in Unregulated accommodation

136. Figure 25 shows the average fees per child trend for five Large providers' Unregulated accommodation segment.

Figure 25: Average fee per child for Unregulated accommodation operated by 5 Large providers, FY 2018– FY 2021



Source: CMA analysis of financial information of five Large providers.
Note:
1.This analysis includes the results of Unregulated accommodation and excludes children's homes and Fostering services.
2. The FY 2018 to FY 2020 results are actuals, and the FY 2021 figures are forecasts.
3. Using the ratio of aggregated revenue to aggregated property valuation of 0.52.

137. Figure 25 demonstrates that the average fee per child decreased year-on-year from £49,593 in FY 2018 to £48,368 in FY 2020, representing an annual decrease of 0.8% before increasing in 2021. Over the same period, operating costs increased on average by 6%.

138. Using the adjusted ratio of aggregated revenue to aggregated property valuation of 0.88, the annual economic profit per child increased from £13,087 to £14,858 using a 4.5% rate of return.

Financial leverage and resilience results – Large providers dataset

Introduction

139. Some stakeholders have raised concerns about the risks to resilience arising from specific providers' high debt levels and off-balance sheet liabilities.[78] Therefore, we have undertaken some high-level analyses to assess the levels of debt in the industry.

[78] For example, The Balanced Economy Project response to the ITC noted that PE-owned providers had significant debt levels.

140. Providers operating Children's homes and Unregulated accommodation might require long-term debt to purchase assets such as land, building and equipment. A Fostering agency may require debt to purchase equipment. In practice, providers will use a combination of debt and equity to buy these assets. Providers might also require short-term debt to manage their working capital peaks. Our analysis in this Appendix mainly concerns long-term debt.

141. A provider's capital structure is critical in determining how well it can weather endogenous and exogenous shocks. A provider with industry average levels of operating profitability and whose capital structure is fully funded by equity capital would not, ordinarily, incur high additional non-discretionary finance costs as cash outflows after paying for its operational costs. The significant cash outflow post operating costs would be dividends, which is at the discretion of management. This capital structure provides considerable protection and headroom in avoiding adverse cash-flow movements that could trigger financial distress or insolvency.

142. However, if the same provider were to fund its capital structure almost entirely with debt, its financial risk profile would increase. The provider must generate regular and adequate cash flows to repay the interest and capital and adhere to its debt covenants. High levels of debt (gearing) can increase the financial risk profile of a provider because:[79]

(a) to avoid default, a provider must make regular capital and interest payments on its senior debt and subordinated high-yield debt.[80] Hence, it must generate a sufficient level of operating cash flows in each period. However, even relatively minor movements in a provider's cash flow from internal or external shocks could dramatically affect its ability to do so. In other words, it leaves little resilience if prices start to fall towards cost over time, and the overall returns on capital also begin to decline;

(b) a provider must also adhere to its debt covenants. These can either be financial (eg gearing ratios) or non-financial such as a negative pledge[81] that might restrict its ability to borrow further. An actual or potential breach of its covenants could trigger a restructuring event that could limit further funds to the provider from the lender, or at its worst, lead to insolvency; and

[79] Debt is booked as a liability on its balance sheet.
[80] The cash repayments relate to interest charges and capital repayments. The frequency and timing of these payments will depend on the type of debt instrument.
[81] An undertaking by the borrower (provider) to a specified lender not to create a class of creditor that ranks above that specified lender, with regards to priority for repayment.

(c) providers with long term senior debt are also likely to have pledged some or all of their assets as security.[82,83] During normal trading conditions, this restricts these secured assets for other purposes. However, it gives creditors the leverage to pursue their interests over other stakeholders such as equity investors during distressed trading conditions.

143. Also, providers using mezzanine financing such as payment-in-kind (PIK)[84] debt must generate very high returns rates or achieve attractive exit multiples to clear the outstanding debt on maturity. Rather than pay interest at regular intervals using trading cash-flows, the interest on PIKs is capitalised (rolled up) and added to the loan balance. PIKs can carry very high interest rates and are often used by investors with high-risk appetites such as PE investors. Since PIK debt is often payable during the PE fund's exit, it carries significant risk if buyers cannot be found at the exit multiple targets. In that case, this accumulated debt with very high interest rates can exacerbate the debt burden and associated risk of high financial leverage.

144. Table 5 defines the metrics that we have used in our analysis.

[82] Long term debt is usually secured debt such as term loans, which are the most common form of debt for companies that do decide to borrow.
[83] In the case of a Children's home, the security is likely to be its land and building.
[84] PIK often compromise a minority of most companies' debts. They have a longer maturity date than senior and high yield subordinated debts and could be rolled over as part of the exit (sale) by the PE fund.

Table 5: Definitions of debt metrics

Metric	Definition	Meaning
Debt levels and financial leverage		
Total debt	Loans and debt from third parties (eg banks), and other debt. Excludes hire purchase leases, lease liabilities and provisions. Base case excludes shareholder loans, and sensitivity includes shareholder loans	Money borrowed by a provider from a third party.
EBITDA leverage	Net debt / pre-exceptional EBITDA	Provider's ability to pay off its debt and the approximate time it can pay off all its debt. A higher value indicates that a provider may not service its debt appropriately. It is suitable for businesses without significant rental payments.
Adjusted EBITDAR leverage	Net debt/EBITDAR (pre-exceptional)	As above, however, it is suitable for businesses with significant rental payments.
Gearing (%)	Total Debt / (Total Debt + Shareholder Equity)	The percentage amount of funding that comes from lenders versus shareholders.
Years to pay the total debt	1 / (Cash flow available for debt servicing (CFADS) / Total Debt)	It measures how long it would take a provider to repay its total debt by using all of its cash flow to repay its debt.
Years to pay external debt	1 / (CFADS / External Debt excluding shareholder loans)	It measures how long it would take a provider to repay its external debt by using all of its cash flow to repay its debt.

Debt serviceability		
Debt service obligations (DSO)	Debt repayment commitments and interest obligations Excludes lease and hire purchase contract payments	Debt service is the cash required to repay the principal and interest of outstanding debt for a particular period. DSO includes current interest payments and principal repayments.
Cash flow available for debt servicing (CFADS)	Post-exceptional EBITDA +/- changes in working capital +/- corporation tax +/- capex +/- dividends.	Net cash generated to service debt obligations.
Cash flow cover	CFADS / DSO	Provider's ability to pay off debt obligations with its operating cash flows. A higher ratio is better.
CFADS as a percentage of total debt	CFADS/Total debt	Other than financial leverage (Debt/EBITDA), analysts are placing weight on this metric to assess the credit risk of companies in light of the very low-interest rates since 2009.[85]
Interest cover	Pre-exceptional EBITDA / Net interest expense	Provider's ability to pay interest on its outstanding debt. A higher ratio is better.
Rental cover	EBITDAR / Rent and lease expense	Provider's ability to pay its rents. A higher ratio is better.
Solvency		
Loan to value	Tangible fixed assets value / Net debt	Provider's ability to meet debt obligations through the sale of fixed assets. It is relevant in insolvency. A higher ratio is better.
Net tangible worth	Net assets - Intangible assets - Deferred tax	Total value of a company's physical and sellable assets. It is a close proxy to the amount realised in insolvency. A higher value is better.

145. We also reviewed the 15 Large providers' composition of debt instruments. Most of the outstanding debt for PE-owned and non-PE-owned providers was senior bank debt or term loans with insignificant levels of PIK notes.[86] Hence,

[85] Financial Times. Is leverage still the best benchmark of credit risk?
[86] Only one provider that was PE-owned had significant PIK and non-cash interest loan notes. These notes have a P&L interest charge due to the accruals principle in accounting, but no cash-outflow till the maturity date or a later date stipulated in the loan documents.

including PIK interest charges in the P&L does not significantly alter our aggregate interest cover results. Moreover, it is essential to assess the above metrics in the round and review their trends. For example, the cash-flow cover reflects these PIK loan notes that do not have an immediate cash-flow impact. Also, as explained above, a company with most of its debt in PIK notes would be very risky.

146. Also, finance professionals debate whether shareholder loans should be treated as equity or debt. We understand it is case-specific and depends on the debt instrument in question. Therefore, our analysis discloses results with and without shareholder loans.[87]

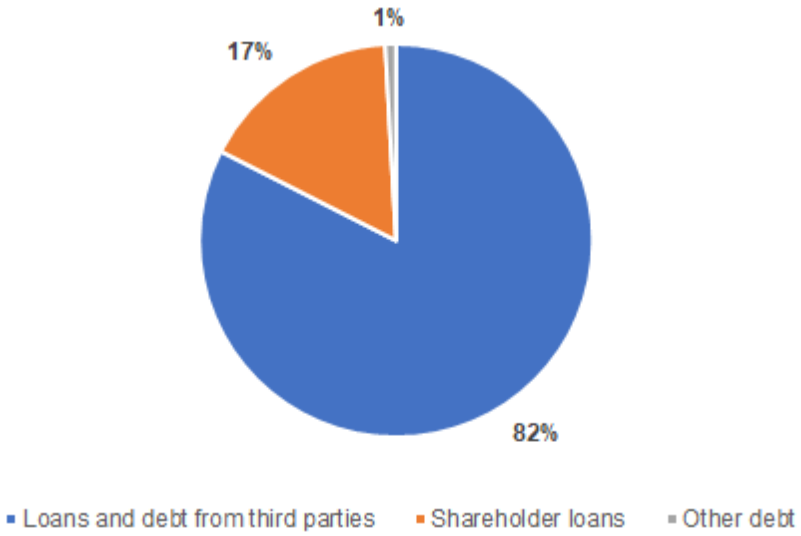
Financial leverage of providers primarily focussed on Residential accommodation

147. We have analysed the debt levels of the nine Large providers who generated most of their FY 2016 to 2021 revenue from Residential accommodation. [88] Of these nine Large providers, four were PE-owned.

Debt types

148. Figure 26 discloses the composition of Large providers' debt primarily focused on Residential accommodation.

Figure 26: Bank debt, third party loans, shareholder loans and other debt - FY 2016 to FY 2021 (average): 9 Large providers focussed on Residential accommodation



[87] We did not calculate interest cover excluding shareholder loans as several Large providers could not disaggregate their P&L interest charge for shareholder loans.
[88] One Large provider, which generated greater than 69% of revenue from Residential accommodation, was excluded from our analysis as it failed to provide adequate debt figures.

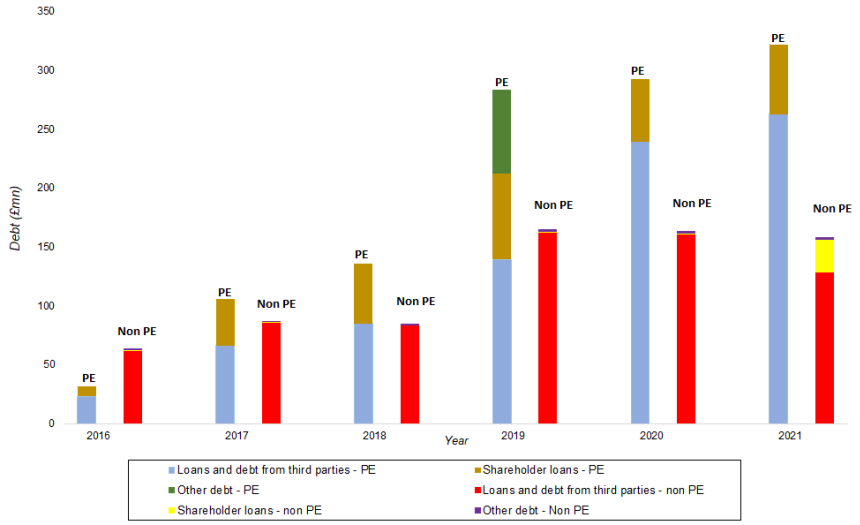
Source: CMA analysis of Financial information of 9 Large providers.

149. Figure 26 shows that providers focused on Residential accommodation obtained most of their debt from third parties. However, shareholder loans constituted a significant 17% of the overall debt. PE investors often use shareholder loans. Since they rank between junior debt and equity, their primary purpose is to guarantee investors a distribution in liquidation by placing them ahead of the other equity investors.

Disaggregation: Debt profile - PE vs non-PE Residential accommodation Large providers

150. Figure 27 disaggregates figure 26 by comparing the aggregate debt composition of PE and non-PE owned Large providers primarily focussed on Residential accommodation between FY 2016 and 2021.

Figure 27: Loans and debt from third parties, shareholder loans, and other debt - FY 2016 to 2021: 4 PE vs 5 non-PE Residential accommodation focussed Large providers[89]



Source: CMA analysis of Financial information of 9 Large providers.
Note:
1. This analysis includes the results reported at the Group level.
2. The FY 2016 to 2020 results are actuals, and the FY 2021 figures are forecasts.

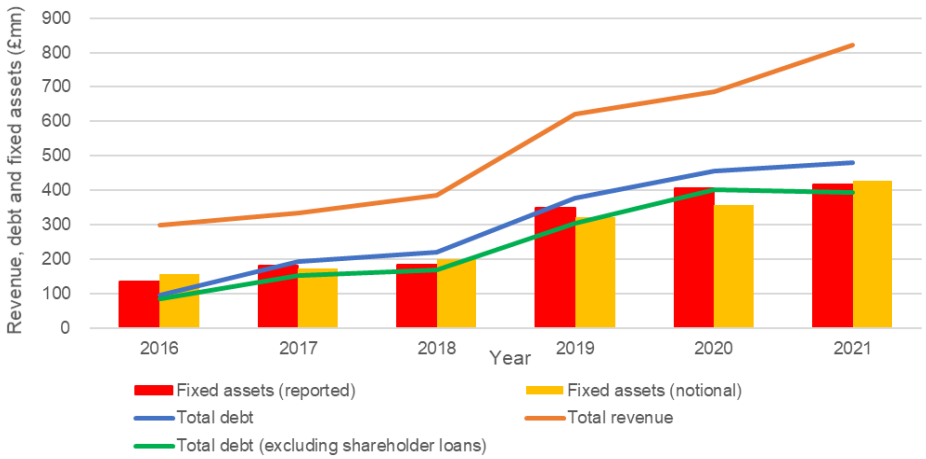
151. Figure 27 shows that the debt levels of PE-owned Large providers have increased at a faster rate than for non-PE-owned Large providers between FY 2016 and 2020. Acquisitions by PE-owned Large providers and new debt issuances may explain this rise. Also, only the PE-owned Large providers had shareholder loans until FY 2020.

[89] Some Large providers submitted P&L data for activities in scope (Children's homes, Fostering services and Unregulated accommodation), but group balance sheets for activities outside the scope of the study. Therefore, we adjusted the balance sheet and cash flows apportioning revenue to ensure that the financial statements had a like-for-like comparison.

Debt levels compared to assets and revenue

152. Figure 28 compares the debt levels of providers primarily focussed on Residential accommodation to their revenues and fixed assets. We have also estimated a notional value for the property's market value using the same method to estimate the capital employed above.[90]

Figure 28: Total debt compared to revenue and fixed assets (reported and notional property values), FY 2016 to 2021: 9 Residential accommodation focussed Large providers



Source: CMA analysis of financial information of nine Large providers.
Note:
1. This analysis includes the results reported at the Group level.
2. The FY 2016 to FY 2020 results are actuals, and the FY 2021 figures are forecasts.

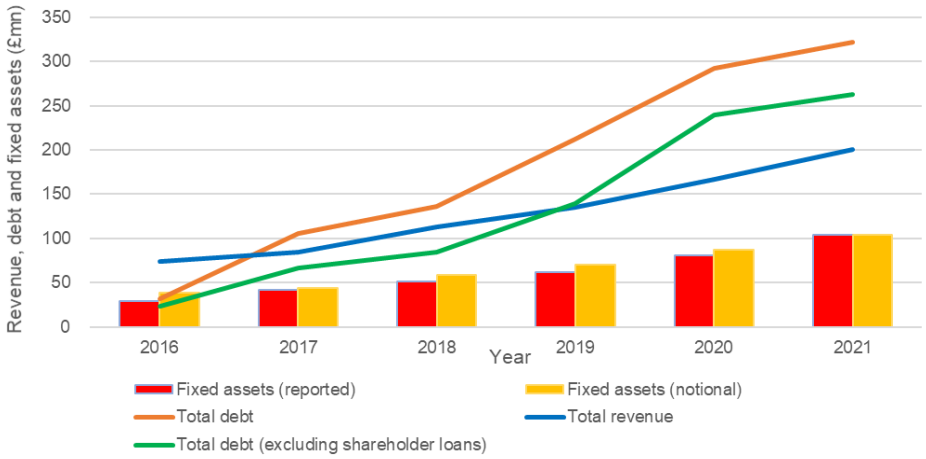
153. Figure 28 shows that the debt levels have increased in line with rising revenues, reported fixed assets and notional property values. Debt increased by 30.9% on average between FY 2016 and 2021, compared to 18.3% for revenues and 20.7% for fixed assets. Also, total debt exceeded reported fixed assets from FY 2018 and notional property values from FY 2017. It means that these Large providers are carrying more debt than can be secured by the underlying assets. It suggests that there may be limited headroom for all debt holders to recover their outstanding debt (principal amount and interest due) in insolvency.

Disaggregation: Debt levels - PE and non-PE Residential accommodation focussed Large providers

154. Figures 29a and 29b disaggregate figure 28 by comparing the revenue, fixed assets and debt levels of PE-owned and non-PE owned Large providers.

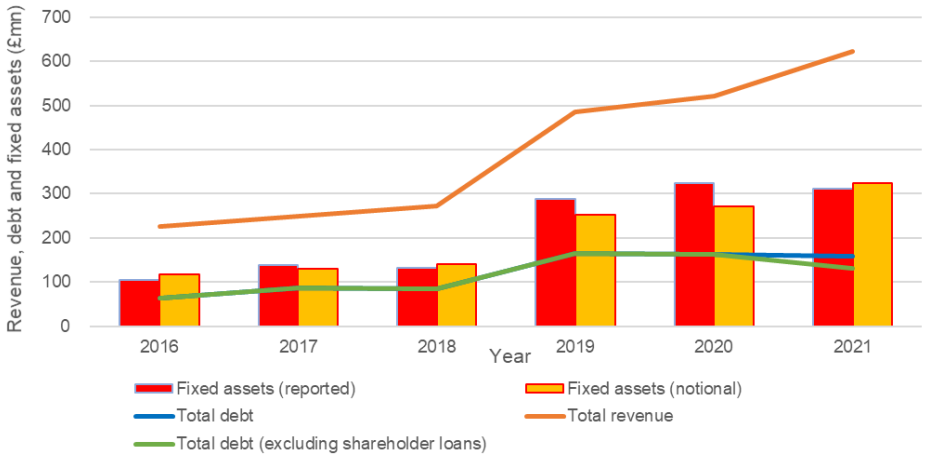
[90] We used a revenue to property value ratio of 0.52.

Figure 29a: Total revenue compared to debt and fixed assets (reported and notional property values), FY 2016 to 2021:4 PE Residential accommodation focussed Large providers



Source: CMA analysis of Financial information of four Large PE providers.
Note:
1. This analysis includes the results reported at the Group level.
2. The FY 2016 to FY 2020 results are actuals, and the FY 2021 figures are forecasts.

Figure 29b: Total revenue compared to debt and fixed assets (reported and notional), FY 2016 to 2021: 5 non-PE Residential accommodation focussed Large providers



Source: CMA analysis of Financial information of five Large providers.
Note:
1. This analysis includes the results reported at the Group level.
2. The FY 2016 to FY 2020 results are actuals, and the FY 2021 figures are forecasts.

155. Figures 29a and 29b show that between FY 2016 and FY 2021, the PE-owned Large providers' debt levels:

(a) increased faster than that for non-PE Large providers;

(b) grew faster than their revenue growth; and

(c) are significantly higher than their reported fixed assets and notional property values. It suggests that debt holders have limited headroom to

recover their outstanding debt in insolvency. A significant proportion of the debt is likely to be unsecured unless secured by inter-company guarantees.

Financial leverage, debt serviceability and solvency

156. In aggregate, tables 6 and 7 shows critical metrics to assess financial leverage, debt serviceability, and solvency of nine Large providers primarily focused on Residential accommodation. We have compared these to a benchmark that reflects the average submissions from PE and non-PE providers of their existing financial covenants set by their lenders and what they consider reasonable key performance indicators (KPIs) internally to manage their debt levels. Since this average includes PE-owned Large providers' higher tolerance for debt levels and non-PE Large providers' conservatism, our benchmark of financial ratios reflects a middle-ground. In other words, if we gave greater weight to non-PE owned Large providers' conservatism, the results disclosed in all the tables below (including for Fostering services) would have significantly more red (flag) markings.

Table 6: Financial leverage, debt serviceability and solvency of 9 Residential accommodation focussed Large providers - FY 2016 to 2021 (Base case: excluding shareholder loans)

	2016	2017	2018	2019	2020	2021	Benchmark
Debt levels and financial leverage							
Total debt (£ mn)	86.1	152.8	169.2	303.7	402.1	393.1	n/a
EBITDA leverage	1.4	2.8	2.5	2.7	2.5	2.1	>4.0
Adjusted EBITDAR leverage	1.2	2.4	2.1	2.3	2.3	2.0	>3.5
Gearing (%)	40.7	40.3	42.6	43.4	46.5	43.5	>60%
Years to pay the total debt	4.1	5.8	4.6	3.6	3.6	3.4	n/a
Years to pay external debt	4.1	5.8	4.6	3.6	3.6	3.4	n/a
Debt serviceability							
DSO (£ mn)	22.3	30.5	19.5	132.6	29.9	25.3	n/a
CFADS (£ mn)	20.8	26.5	37.0	83.2	111.8	114.9	<0
Cash flow cover	0.9	0.9	1.9	0.6	3.7	4.5	<1.3
CFADS as a percentage of total debt (%)	24.2	17.3	21.9	27.4	27.8	29.2	<50%
Interest cover	-	-	-	-	-	-	n/a
Rental cover	6.2	6.4	6.1	7.0	13.0	13.7	n/a
Solvency							
Loan to value	1.6	1.0	1.0	1.2	1.2	1.2	<1.0
Net tangible worth (£ mn)	49.4	106.6	92.6	102.1	70.6	96.6	<0

Source: CMA analysis of financial information of nine Large providers.
Note:
1. This analysis includes the results reported at the Group level.
2. The FY 2016 to 2020 results are actuals, and the FY 2021 figures are forecasts.
3. We could not calculate interest cover excluding shareholder loans as several Large providers could not disaggregate their P&L interest charge for shareholder loans.

Table 7: Financial leverage, debt serviceability and solvency of 9 Residential accommodation focussed Large providers - FY 2016 to 2021 (Sensitivity: including shareholder loans)

	2016	2017	2018	2019	2020	2021	Benchmark
Debt levels and financial leverage							
Total debt (£ mn)	95.4	192.7	220.6	376.9	455.9	480.1	n/a
EBITDA leverage	1.6	3.5	3.2	3.4	2.9	2.7	>4.0
Adjusted EBITDAR leverage	1.3	2.9	2.7	2.9	2.7	2.5	>3.5
Gearing (%)	45.3	49.6	54.7	54.1	53.7	54.7	>60%
Years to pay the total debt	4.6	7.3	6.0	4.5	4.1	4.2	n/a
Years to pay external debt	4.1	5.8	4.6	3.6	3.6	3.4	n/a
Debt serviceability							
DSO (£ mn)	22.3	30.5	19.5	132.6	29.9	25.3	n/a
CFADS (£ mn)	20.8	26.5	37.0	83.2	111.8	114.9	<0
Cash flow cover	0.9	0.9	1.9	0.6	3.7	4.5	<1.3
CFADS as a percentage of total debt (%)	21.8	13.8	16.8	22.1	24.5	23.9	<50%
Interest cover	5.8	4.0	3.6	2.9	3.3	4.3	<3.0
Rental cover	6.2	6.4	6.1	7.0	13.0	13.7	n/a
Solvency							
Loan to value	1.5	0.8	0.8	0.9	1.0	1.0	<1.0
Net tangible worth (£ mn)	49.4	106.6	92.6	102.1	70.6	96.6	<0

Source: CMA analysis of financial information of nine Large providers.
Note:
1. This analysis includes the results reported at the Group level.
2. The FY 2016 to 2020 results are actuals, and the FY 2021 figures are forecasts.

157. Tables 6 and 7 show that most metrics are within the benchmark range, irrespective of the impact of shareholder loans. However, cash flow generation to service debt obligations appears below this benchmark (in red).

Disaggregation: Financial leverage, debt serviceability and solvency - PE vs non-PE Residential accommodation focussed Large providers

158. Tables 8 and 9 disaggregate tables 6 and 7 by comparing the critical metrics for PE and non-PE owned providers primarily focussed on Children's homes.

Table 8: Financial leverage, debt serviceability and solvency - FY 2016 to 2021: 4 PE Vs 5 non-PE Children's homes focussed Large providers (Base case: excluding shareholder loans)

	2016	2017	2018	2019	2020	2021	Benchmark
Debt levels and financial leverage							
Total debt (£ mn) - PE	23.0	66.2	85.0	139.3	239.3	262.8	n/a
Total debt (£ mn) - non PE	63.1	86.6	84.2	164.4	162.8	130.3	n/a
EBITDA leverage - PE	3.1	11.3	7.2	7.3	7.0	6.1	>4.0
EBITDA leverage - non PE	1.1	1.5	1.3	1.7	1.2	0.8	>4.0
Adjusted EBITDAR leverage - PE	2.2	8.1	5.2	5.7	5.7	5.0	>3.5
Adjusted EBITDAR leverage - non PE	1.0	1.3	1.2	1.5	1.2	0.8	>3.5
Gearing (%) - PE	55.4	81.0	84.7	82.5	91.4	91.9	>60%
Gearing (%) - non PE	36.4	25.8	25.4	29.0	25.6	19.4	>60%
Years to pay the total debt - PE	16.4	57.7	10.0	11.3	9.3	11.0	n/a
Years to pay the total debt - non PE	3.3	3.4	3.0	2.3	1.9	1.4	n/a
Years to pay external debt - PE	16.4	57.7	10.0	11.3	9.3	11.0	n/a
Years to pay external debt - non PE	3.3	3.4	3.0	2.3	1.9	1.4	n/a
Debt serviceability							
DSO (£ mn) - PE	3.2	8.6	5.8	10.5	14.0	18.6	n/a
DSO (£ mn) - non PE	19.2	15.7	6.4	114.3	7.3	6.7	n/a
CFADS (£ mn) - PE	1.4	1.1	8.5	12.3	25.6	23.8	<0
CFADS (£ mn) - non PE	19.4	25.4	28.5	70.9	86.1	91.1	<0
Cash flow cover - PE	0.4	0.1	1.5	1.2	1.8	1.3	<1.3
Cash flow cover - non PE	1.0	1.6	4.4	0.6	11.7	13.7	<1.3
CFADS as a percentage of total debt (%) - PE	6.1	1.7	10.0	8.9	10.7	9.1	<50%
CFADS as a percentage of total debt (%) - non PE	30.7	29.3	33.8	43.1	52.9	69.9	<50%
Interest cover - PE	-	-	-	-	-	-	n/a
Interest cover - non PE	-	-	-	-	-	-	n/a
Rental cover - PE	3.6	3.5	3.6	4.5	5.3	5.8	n/a
Rental cover - non PE	7.3	7.5	7.6	8.2	26.4	28.4	n/a
Solvency							
Loan to value - PE	1.2	0.5	0.5	0.4	0.4	0.4	<1.0
Loan to value - non PE	1.8	1.7	1.7	2.0	2.5	3.1	<1.0
Net tangible worth (£ mn) - PE	-3.6	-74.8	-94.4	-156.8	-203.2	-203.0	<0
Net tangible worth (£ mn) - non PE	53.0	181.4	187.0	259.0	273.7	299.6	<0

Source: CMA analysis of Financial information of nine Large providers.
Note:
1. This analysis includes the results reported at the Group level.
2. The FY 2016 to 2020 results are actuals, and the FY 2021 figures are forecasts.
3. The benchmark reflects the average of submissions from providers of their financial covenants and what they consider reasonable KPIs.
4. We could not calculate interest cover excluding shareholder loans as several Large providers could not disaggregate their P&L interest charge for shareholder loans.

Table 9: Financial leverage, debt serviceability and solvency - FY 2016 to 2021: 4 PE Vs 5 non-PE homes focussed Large providers (Sensitivity: including shareholder loans)

	2016	2017	2018	2019	2020	2021	Benchmark
Debt levels and financial leverage							
Total debt (£ mn) - PE	31.9	105.7	136.0	212.2	292.2	321.5	n/a
Total debt (£ mn) - non PE	63.5	87.0	84.6	164.7	163.7	158.5	n/a
EBITDA leverage - PE	4.2	16.2	10.7	10.8	8.7	7.6	>4.0
EBITDA leverage - non PE	1.2	1.6	1.3	1.7	1.2	1.1	>4.0
Adjusted EBITDAR leverage - PE	3.0	11.6	7.8	8.4	7.0	6.3	>3.5
Adjusted EBITDAR leverage - non PE	1.0	1.3	1.2	1.5	1.2	1.0	>3.5
Gearing (%) - PE	74.7	116.1	126.2	122.0	113.9	114.6	>60%
Gearing (%) - non PE	36.7	25.9	25.5	29.0	25.8	24.9	>60%
Years to pay the total debt - PE	22.7	92.0	15.9	17.2	11.4	13.5	n/a
Years to pay the total debt - non PE	3.3	3.4	3.0	2.3	1.9	1.7	n/a
Years to pay external debt - PE	16.4	57.7	10.0	11.3	9.3	11.0	n/a
Years to pay external debt - non PE	3.3	3.4	3.0	2.3	1.9	1.4	n/a
Debt serviceability							
DSO (£ mn) - PE	3.2	8.6	5.8	10.5	14.0	18.6	n/a
DSO (£ mn) - non PE	19.2	15.7	6.4	114.3	7.3	6.7	n/a
CFADS (£ mn) - PE	1.4	1.1	8.5	12.3	25.6	23.8	<0
CFADS (£ mn) - non PE	19.4	25.4	28.5	70.9	86.1	91.1	<0
Cash flow cover - PE	0.4	0.1	1.5	1.2	1.8	1.3	<1.3
Cash flow cover - non PE	1.0	1.6	4.4	0.6	11.7	13.7	<1.3
CFADS as a percentage of total debt (%) - PE	4.4	1.1	6.3	5.8	8.8	7.4	<50%
CFADS as a percentage of total debt (%) - non PE	30.6	29.2	33.7	43.0	52.6	57.5	<50%
Interest cover - PE	4.6	0.9	1.0	1.0	1.2	1.4	<3.0
Interest cover - non PE	6.0	8.4	10.8	5.6	6.6	12.8	<3.0
Rental cover - PE	3.6	3.5	3.6	4.5	5.3	5.8	n/a
Rental cover - non PE	7.3	7.5	7.6	8.2	26.4	28.4	n/a
Solvency							
Loan to value - PE	0.9	0.3	0.3	0.3	0.3	0.4	<1.0
Loan to value - non PE	1.8	1.7	1.7	2.0	2.5	2.4	<1.0
Net tangible worth (£ mn) - PE	-3.6	-74.8	-94.4	-156.8	-203.2	-203.0	<0
Net tangible worth (£ mn) - non PE	53.0	181.4	187.0	259.0	273.7	299.6	<0

Source: CMA analysis of financial information of nine Large providers.
Note:
1. This analysis includes the results reported at the Group level.
2. The FY 2016 to 2020 results are actuals, and the FY 2021 figures are forecasts.
3. The benchmark reflects the average of submissions from Large providers of their financial covenants and what they consider reasonable KPIs.

159. Tables 8 and 9 show that PE-owned Large providers have had significantly riskier financial leverage, debt serviceability, and solvency indicators than non-PE Large providers and also compared to the benchmark (in red) even after adjusting for shareholder loans within equity. Despite the PE-owned Large providers having high operating profit margins (see above), they spend a significant proportion of their leftover cash on servicing debt. This low headroom reduces their financial resilience, especially if the sector were to experience lower margins or the economy experienced heterogenous shocks.

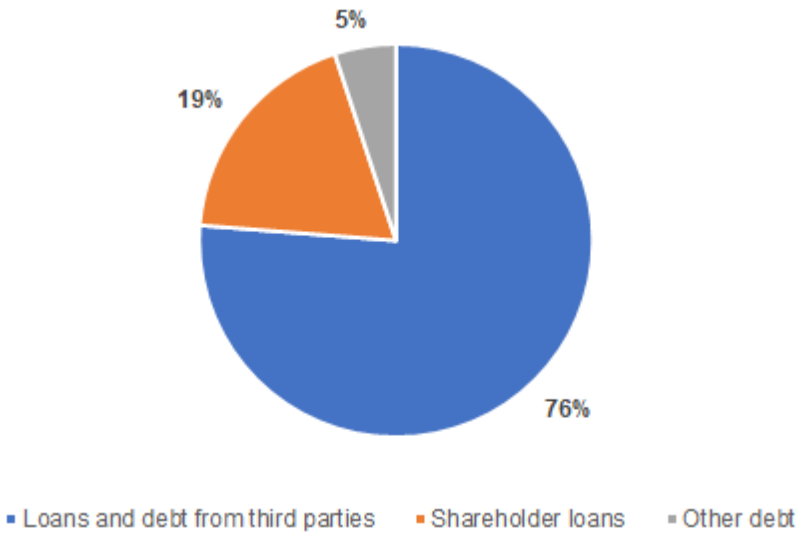
Financial leverage of Large providers primarily focussed on Fostering services

160. We have analysed the debt levels of five Large providers, who generated greater than 89% of their FY 2016 and 2020 revenue from Fostering services. Of these five providers, three were PE-owned.

Debt types

161. Figure 30 shows the composition of Large providers' debt primarily focused on Fostering services.

Figure 30: Bank debt, third party loans, shareholder loans and other debt - FY 2016 to FY 2021 (average): 5 Large providers focussed on Fostering services



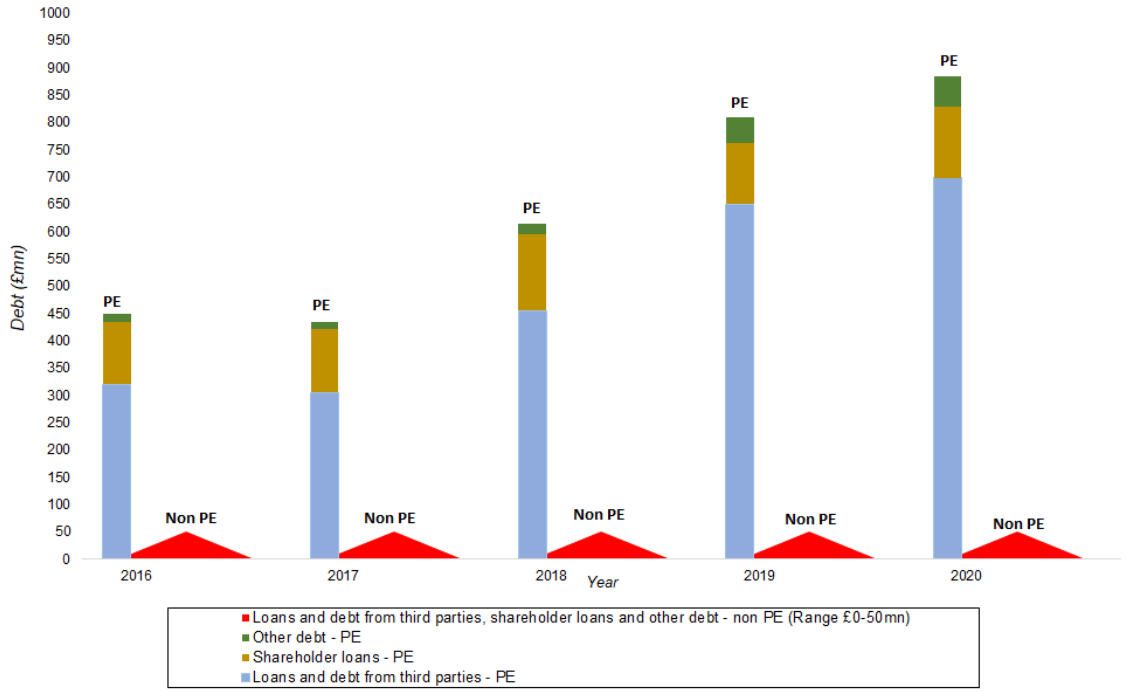
Source: CMA analysis of Financial information of five Large providers.

162. Figure 30 shows that providers focused on Fostering services obtained most of their debt from third parties. However, shareholder loans constituted a significant 19% of the overall debt. There is also a higher prevalence of non-bank debt and third-party loans in Fostering services at 5% compared to 1% for Large providers focused on Residential accommodation.

Disaggregation: Debt profile - PE vs non-PE Fostering services Large providers

163. Figure 31 disaggregates figure 30 by comparing the debt composition of PE and non-PE owned Large providers primarily focussed on Fostering services between FY 2016 and FY 2021.

Figure 31: Bank debt, third party loans, shareholder loans and other debt - FY 2016 to 2021: 3 PE vs 2 non-PE Fostering services Large providers



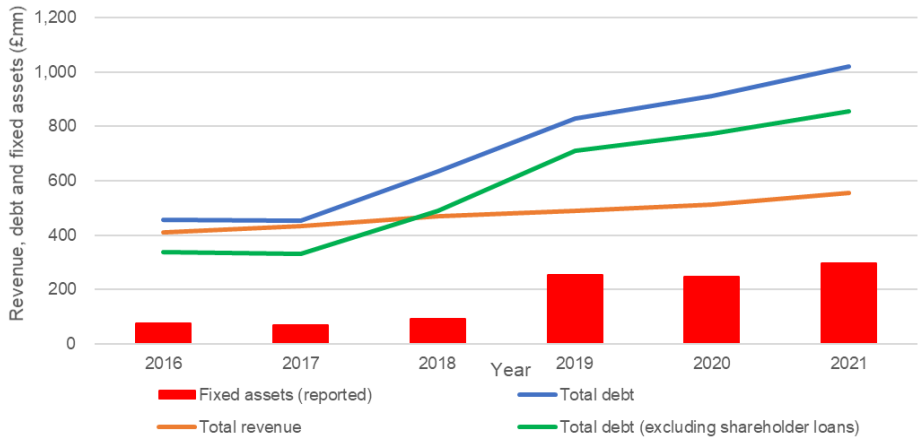
Source: CMA analysis of financial information of five Large providers.
Note:
1. This analysis includes the results reported at the Group level.
2. The FY 2016 to FY 2020 results are actuals, and the FY 2021 figures are forecasts.
3. There were only two non-PE providers in our dataset for this analysis. Therefore, we have included a range for the non-PE Large providers and combined the three debt types to protect commercially sensitive information.

164. Fostering services is an asset-light business, which requires very little long-term debt to finance the underlying assets. Therefore, the exceptionally high debt levels held by PE-owned Large providers are unusually high solely to fund service operations. Figure 31 also shows that the debt levels of PE-owned providers increased significantly and at a faster rate than for non-PE-owned providers. Acquisitions by PE-owned Large providers and new debt issuances may explain some of this rise.

Debt levels compared to assets and revenue

165. Figure 32 compares the debt levels of the Large providers primarily focussed on Fostering services to their revenues and fixed assets.

Figure 32: Total debt compared to revenue and fixed assets, FY 2016 to 2021: Five Fostering agencies



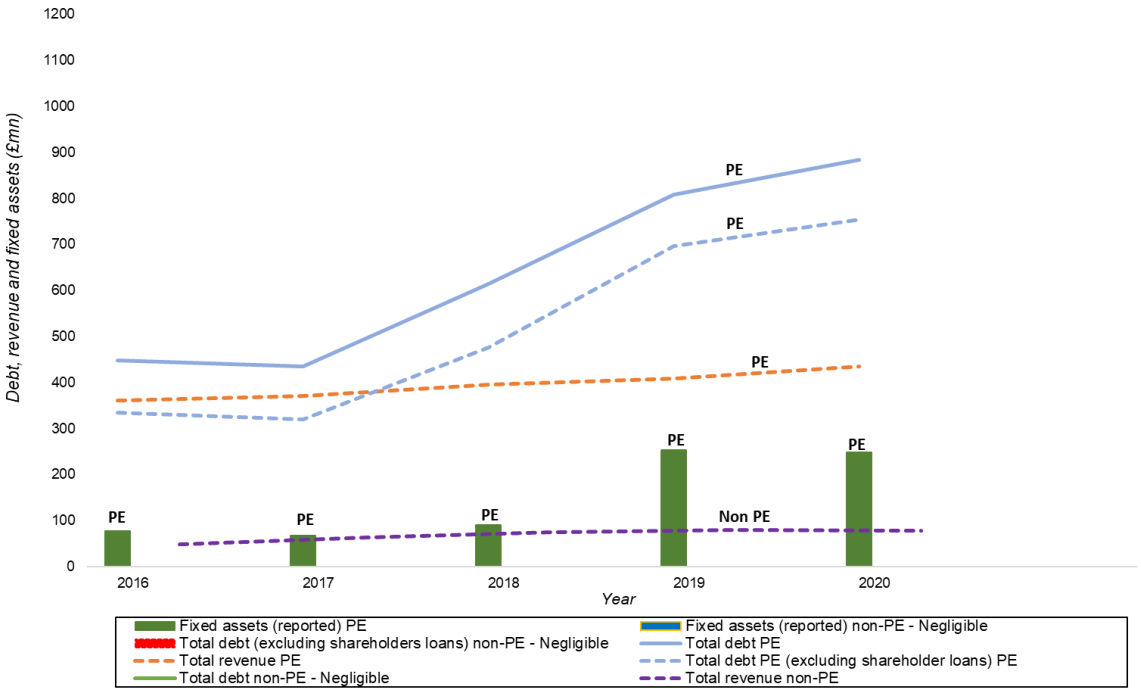
Source: CMA analysis of financial information of five Large providers.
Note:
1. This analysis includes the results reported at the Group level.
2. The FY 2016 to FY 2020 results are actuals, and the FY 2021 figures are forecasts.

166. Figure 32 shows that total debt significantly exceeded reported fixed assets, suggesting limited headroom for all debt holders to recover their outstanding debt (principal and interest) in insolvency. It also illustrates that debt levels have increased faster than revenues and growth in fixed assets. Debt increased by 14.3% on average between FY 2016 and FY 2021, compared to 5.2% increases for revenues and 25.1% for fixed assets.

Disaggregation: Debt levels - PE vs non-PE Fostering services focussed Large providers

167. Figure 33 disaggregates figure 32 by comparing the debt levels of PE-owned and non-PE owned Large providers.

Figure 33: Total debt compared to revenue and fixed assets, FY 2016 to 2021: 3 PE vs 2 non-PE Large providers focussed on Fostering services



Source: CMA analysis of Financial information of 5 Large providers.
Note:
1. This analysis includes the results reported at the Group level.
2. The FY 2016 to 2020 results are actuals based on group figures, and the FY 2021 figures are forecasts.

168. Figure 33 shows the PE-owned Large providers' debt levels:

(a) were substantially higher than the PE-owned providers' reported fixed assets and notional property values; and

(b) increased at a significantly faster rate than that for non-PE providers and PE-owned providers' revenue growth between FY 2016 and 2021.

Financial leverage, debt serviceability and solvency

169. Tables 10 and 11 shows vital metrics, in aggregate, to assess financial leverage, debt serviceability and solvency of providers primarily focussed on Fostering services compared to a benchmark level.

Table 10: Financial leverage, debt serviceability and solvency of 5 Fostering services focussed providers - FY 2016 to 2021 (Base case: excluding shareholder loans)

	2016	2017	2018	2019	2020	2021	Benchmark
Debt levels and financial leverage							
Total debt (£ mn)	338.7	332.1	488.7	711.0	771.6	854.9	n/a
EBITDA leverage	4.8	3.8	5.5	7.8	7.4	7.4	>4.0
Adjusted EBITDAR leverage	4.4	3.6	5.1	7.2	7.0	6.9	>3.5
Gearing (%)	69.7	71.9	77.4	88.5	99.3	102.3	>60%
Years to pay the total debt	6.4	4.8	5.5	7.8	7.2	5.9	n/a
Years to pay external debt	6.4	4.8	5.5	7.8	7.2	5.9	n/a
Debt serviceability							
DSO (£ mn)	25.1	38.9	99.5	41.2	52.7	57.5	n/a
CFADS (£ mn)	53.1	69.2	89.1	91.1	107.7	144.1	<0
Cash flow cover	2.1	1.8	0.9	2.2	2.0	2.5	<1.3
CFADS as a percentage of total debt (%)	15.7	20.8	18.2	12.8	14.0	16.9	<50%
Interest cover	-	-	-	-	-	-	n/a
Rental cover	13.7	15.1	11.9	13.5	15.0	15.4	n/a
Solvency							
Loan to value	0.3	0.2	0.2	0.4	0.4	0.4	<1.0
Net tangible worth (£ mn)	-410.0	-414.7	-591.5	-657.4	-733.2	-803.0	<0

Source: CMA analysis of Financial information of five Large providers.
Note:
1. This analysis includes the results reported at the Group level.
2. The FY 2016 to 2020 results are actuals, and the FY 2021 figures are forecasts.
3. The benchmark reflects the average of submissions from the Large providers of their financial covenants and what they consider reasonable KPIs.
4. We could not calculate interest cover excluding shareholder loans as several Large providers could not disaggregate their P&L interest charge for shareholder loans.

Table 11: Financial leverage, debt serviceability and solvency of five 5 Fostering services focussed Large providers - FY 2016 to 2021 (Sensitivity: including shareholder loans)

	2016	2017	2018	2019	2020	2021	Benchmark
Debt levels and financial leverage							
Total debt (£ mn)	457.6	452.6	633.2	827.5	911.6	1019.5	n/a
EBITDA leverage	6.7	5.4	7.3	9.1	8.9	9.0	>4.0
Adjusted EBITDAR leverage	6.2	5.1	6.7	8.4	8.3	8.4	>3.5
Gearing (%)	97.6	101.8	102.4	104.1	119.0	123.8	>60%
Years to pay the total debt	8.6	6.5	7.1	9.1	8.5	7.1	n/a
Years to pay external debt	6.4	4.8	5.5	7.8	7.2	5.9	n/a
Debt serviceability							
DSO (£ mn)	25.1	38.9	99.5	41.2	52.7	57.5	n/a
CFADS (£ mn)	53.1	69.2	89.1	91.1	107.7	144.1	<0
Cash flow cover	2.1	1.8	0.9	2.2	2.0	2.5	<1.3
CFADS as a percentage of total debt (%)	11.6	15.3	14.1	11.0	11.8	14.1	<50%
Interest cover	1.7	1.6	1.5	1.4	1.3	1.4	<3
Rental cover	13.7	15.1	11.9	13.5	15.0	15.4	n/a
Solvency							
Loan to value	0.2	0.2	0.2	0.3	0.3	0.3	<1.0
Net tangible worth (£ mn)	-410.0	-414.7	-591.5	-657.4	-733.2	-803.0	<0

Source: CMA analysis of Financial information of five Large providers.
Note:
1. This analysis includes the results reported at the Group level.
2. The FY 2016 to 2020 results are actuals, and the FY 2021 figures are forecasts.
3. The benchmark reflects the average of submissions from providers of their financial covenants and what they consider reasonable KPIs.

170. Tables 10 and 11 illustrate that several metrics are outside the benchmark range (in red), irrespective of adjusting for shareholder loans.

Disaggregation: financial leverage, debt serviceability and solvency - PE and non-PE Residential accommodation focussed Large providers

171. Tables 12 and 13 disaggregate tables 10 and 11 by comparing the critical metrics for PE and non-PE owned Large providers primarily focussed on Fostering services.

Table 12: Financial leverage, debt serviceability and solvency - FY 2016 to 2021: three 3 PE Vs two 2 non-PE Large providers focussed on Fostering services (Base case: excluding shareholder loans)

	2016	2017	2018	2019	2020	Benchmark
Debt levels and financial leverage						
Total debt (£ mn) - PE	334.8	319.5	475.4	697.1	753.5	n/a
Total debt (£ mn) - non PE	2 - 7	10 - 15	10 - 15	10 - 15	20 - 26	n/a
EBITDA leverage - PE	5.4	4.4	6.5	9.1	8.8	>4.0
EBITDA leverage - non PE	0.0	0.6	0.2	0.6	0.7	>4.0
Adjusted EBITDAR leverage - PE	5.0	4.1	6.0	8.4	8.2	>3.5
Adjusted EBITDAR leverage - non PE	0.0	0.5	0.1	0.6	0.6	>3.5
Gearing (%) - PE	73.3	76.4	81.8	92.6	105.9	>60%
Gearing (%) - non PE	-1.2	19.5	5.8	20.4	19.0	>60%
Years to pay the total debt - PE	6.7	5.1	6.3	8.8	8.1	n/a
Years to pay the total debt - non PE	1.3	2.0	1.0	1.2	1.3	n/a
Years to pay external debt - PE	6.7	5.1	6.3	8.8	8.1	n/a
Years to pay external debt - non PE	1.3	2.0	1.0	1.2	1.3	n/a
Debt serviceability						
DSO (£ mn) - PE	23.2	34.9	94.6	36.2	48.3	n/a
DSO (£ mn) - non PE	1 - 3	3 - 5	4 - 6	4 - 6	4 - 6	n/a
CFADS (£ mn) - PE	50.0	63.0	75.6	79.4	93.4	<0
CFADS (£ mn) - non PE	2 - 4	6 - 8	12 -15	10 - 13	13 - 16	<0
Cash flow cover - PE	2.2	1.8	0.8	2.2	1.9	<1.3
Cash flow cover - non PE	1.6	1.5	2.7	2.4	3.3	<1.3
CFADS as a percentage of total debt (%) - PE	14.9	19.7	15.9	11.4	12.4	<50%
CFADS as a percentage of total debt (%) - non PE	75 - 85	42 - 49	95 - 102	80 - 87	75 - 82	<50%
Interest cover - PE	-	-	-	-	-	n/a
Interest cover - non PE	-	-	-	-	-	n/a
Rental cover - PE	14.3	15.4	11.4	13.2	14.7	n/a
Rental cover - non PE	10.5	13.9	15.4	15.1	16.7	n/a
Solvency						
Loan to value - PE	0.4	0.4	0.3	0.5	0.4	<1.0
Loan to value - non PE	-0.4	7.2	2.0	10.0	14.9	<1.0
Net tangible worth (£ mn) - PE	-406.6	-406.3	-586.4	-649.3	-714.1	<0
Net tangible worth (£ mn) - non PE	(2) - (4)	(8) - (10)	(4) - (6)	(8) - (10)	(18) - (21)	<0

Note:
1. This analysis includes the results reported at the Group level.
2. The FY 2016 to 2020 results are actuals, and the FY 2021 figures are forecasts.
3. The benchmark reflects the average of submissions from providers of their financial covenants and what they consider reasonable KPIs.
4. There were only two non-PE providers in our dataset for this analysis. Therefore, we have included a range to protect commercially sensitive information.
5. The ranges do not reflect the mid-point and are only illustrative.
6. We could not calculate interest cover excluding shareholder loans as several Large providers could not disaggregate their P&L interest charge for shareholder loans.

Table 13: Financial leverage, debt serviceability and solvency - FY 2016 to 2021: three PE Vs two non-PE Fostering services providers (Sensitivity: including shareholder loans)

	2016	2017	2018	2019	2020	Benchmark
Debt levels and financial leverage						
Total debt (£ mn) - PE	448.5	434.7	614.7	808.3	883.6	n/a
Total debt (£ mn) - non PE	6 - 11	16 - 21	16 - 21	16 - 21	26 - 32	n/a
EBITDA leverage - PE	7.4	6.2	8.6	10.7	10.4	>4.0
EBITDA leverage - non PE	0.7	1.1	0.6	1.0	1.3	>4.0
Adjusted EBITDAR leverage - PE	6.9	5.8	7.8	9.9	9.7	>3.5
Adjusted EBITDAR leverage - non PE	0.6	1.0	0.5	0.9	1.2	>3.5
Gearing (%) - PE	101.2	107.5	107.4	108.3	125.7	>60%
Gearing (%) - non PE	24.8	36.0	21.4	32.9	37.5	>60%
Years to pay the total debt - PE	9.0	6.9	8.1	10.2	9.5	n/a
Years to pay the total debt - non PE	3.0	2.9	1.4	1.6	2.0	n/a
Years to pay external debt - PE	6.7	5.1	6.3	8.8	8.1	n/a
Years to pay external debt - non PE	1.3	2.0	1.0	1.2	1.3	n/a
Debt serviceability						
DSO (£ mn) - PE	23.2	34.9	94.6	36.2	48.3	n/a
DSO (£ mn) - non PE	1 - 3	3 - 5	4 - 6	4 - 6	4 - 6	n/a
CFADS (£ mn) - PE	50.0	63.0	75.6	79.4	93.4	<0
CFADS (£ mn) - non PE	2 - 4	6 - 8	12 -15	10 - 13	13 - 16	<0
Cash flow cover - PE	2.2	1.8	0.8	2.2	1.9	<1.3
Cash flow cover - non PE	1.6	1.5	2.7	2.4	3.3	<1.3
CFADS as a percentage of total debt (%) - PE	11.2	14.5	12.3	9.8	10.6	<50%
CFADS as a percentage of total debt (%) - non PE	30 - 37	30 - 37	67 - 82	54 - 66	47 - 59	<50%
Interest cover - PE	1.6	1.4	1.3	1.2	1.1	<3.0
Interest cover - non PE	9.1	11.5	13.4	17.9	37.6	<3.0
Rental cover - PE	14.3	15.4	11.4	13.2	14.7	n/a
Rental cover - non PE	10.5	13.9	15.4	15.1	16.7	n/a
Solvency						
Loan to value - PE	0.2	0.2	0.2	0.3	0.3	<1.0
Loan to value - non PE	8.2	13.4	7.3	16.1	29.3	<1.0
Net tangible worth (£ mn) - PE	-406.6	-406.3	-586.4	-649.3	-714.1	<0
Net tangible worth (£ mn) - non PE	(2) - (4)	(8) - (10)	(4) - (6)	(8) - (10)	(18) - (21)	<0

Source: CMA analysis of Financial information of five Large providers.
Note:
1. This analysis includes the results reported at the Group level.
2. The FY 2016 to 2020 results are actuals, and the FY 2021 figures are forecasts.
3. The benchmark reflects the average of submissions from providers of their financial covenants and what they consider reasonable KPIs.
4. There were only two non-PE providers in our dataset for this analysis. Therefore, we have included a range to protect commercially sensitive information.
5. The ranges do not reflect the mid-point and only illustrate.

172. Tables 12 and 13 show that PE-owned Large providers have had significantly higher debt levels and riskier financial leverage, debt serviceability, and solvency indicators than non-PE providers compared to the benchmark level (in red). Despite the PE-owned Large providers having high operating profit margins (see above), a significant proportion of their leftover cash is spent on servicing debt. This low headroom reduces their financial resilience, especially if the sector were to experience lower margins or the economy experienced heterogenous shocks.

Appendix B

Key aspects of the legal framework

Local authorities' statutory duties

1. Local authorities have statutory duties in relation to the children taken into their care and are obliged to safeguard and promote their welfare including (where appropriate) through the provision of accommodation and care. Where it is in the child's best interests, this should be provided locally in order to ensure continuity in their education, social relationships, health provision and (where possible and appropriate) contact with their family.

2. In England, local authorities are required to take steps that secure, so far as reasonably practicable, sufficient accommodation within the local authority's area which meets the needs of the children it looks after (the 'sufficiency duty').[1]

3. Statutory guidance published in 2010 provides details on how local authorities can ensure that they are meeting their obligations. The guidance states that local authorities 'should include in relevant commissioning strategies their plans for meeting the sufficiency duty' and 'be in a position to secure, where reasonably practicable, sufficient accommodation for looked after children in their local authority area'.[2]

4. In Scotland, local authorities shall provide accommodation for any looked after child[3] in their area who may require such provision.[4] Local authorities may also provide accommodation for any child within their area if they consider that to do so would safeguard or promote his welfare.[5]

5. Scottish local authorities and the relevant health boards are required to produce strategic plans (Children's Services Plans) every 3 years.[6] A guidance document on children's services planning was issued in 2020.[7] The guidance notes that children's services planning should drive 'the

---

[1] Children Act 1989, section 22G.
[2] 'Sufficiency: Statutory guidance on securing sufficient accommodation for looked after children', paragraph 1.16.
[3] Specifically, "any child who, residing or having been found within their area, appears to them to require such provision because - (a) no-one has parental responsibility for him; (b) he is lost or abandoned; or (c) the person who has been caring for him is prevented, whether or not permanently and for whatever reason, from providing him with suitable accommodation or care." Children (Scotland) Act 1995, section 25(1).
[4] Children (Scotland) Act 1995, section 25(1).
[5] Children (Scotland) Act 1995, section 25(2). This is subject to section 25(1).
[6] The Children and Young People (Scotland) Act 2014, section 8.
[7] Children and Young People (Scotland) Act 2014: Statutory Guidance on Part 3: Children's Services Planning – Second Edition 2020.

development of local commissioning processes which are based on robust information about needs, cost and quality, and ongoing engagement with service users and the wider community'.[8]

6. In Wales, local authorities have a general duty to 'take steps to ensure that, so far as is reasonably practicable', they are able to provide looked after and other accommodated children with 'accommodation that is within the local authority's area, and meets the needs of those children'.[9]

7. Part 6 of the Code of Practice on Looked After and Accommodated Children[10] states that in discharging this duty, the local authority must have regard to the benefit of having a number of accommodation providers in their area that is sufficient to discharge its duty, and the benefit of having a range of accommodation in its area capable of meeting different needs.

8. Welsh local authorities and local health boards are required to jointly carry out an assessment of the projected and current needs for care and support, and the support needs of carers in the local authority's area (a population needs assessment).[11]

9. Welsh local authorities, in partnership with local health boards and Regional Partnership Boards, will also be required to publish market stability reports every five years (with the first reports to be published by 1 June 2022). These reports will require an assessment of the sufficiency of care and support in meeting the needs and demand for social care as set out in the population needs assessment, and the stability of the market for regulated services providing care and support.[12]

Market oversight

10. Unlike for adult social care, in England there is no statutory market oversight scheme for the children's social care sector. Market oversight is the term used for the scheme established by the Care Act 2014 through which the Care Quality Commission assesses the financial sustainability of those organisations providing adult social care that local authorities would find

---

[8] Ibid., paragraph 28.
[9] Social Services and Well-being (Wales) Act 2014, section 75(1).
[10] Paragraph 123.
[11] Social Services and Well-being (Wales) Act 2014, section 14. Further details set out in chapter 2 of Social Services and Well-being (Wales) Act 2014, Part 2 code of Practice (General Functions).
[12] Social Services and Well-being (Wales) Act 2014, section 144B and The Partnership Arrangements (Amendment) and Regulated Services (Market Stability Reports) (Wales) Regulations 2021. Further detail is provided in the 'Code of Practice and Guidance under the Social Services and Well-being (Wales) Act 2014: Code of Practice and guidance on the exercise of social services functions and partnership arrangements in relation to market stability reports' 29 March 2021 (Code of Practice and Guidance under the Social Services and Well-being (Wales) Act 2014).

difficult to replace should they fail and become unable to carry on delivering a service because of their size, geographical coverage, or specialism. More generally, the term ‘market oversight’ is sometimes referred to as a way of obtaining a better understanding of how profit, consolidation and risk are affecting either the market or experiences in a particular sector.

11. In Wales there are statutory market oversight provisions which would cover both adult and child social care,[13] but these have not yet been commenced. However, the Welsh Government intends to develop a non-statutory market oversight framework. Local authorities, working together with Local Health Boards through the seven Regional Partnership Boards, are obliged to carry prepare and publish market stability reports.[14]

12. Currently, in Scotland, the CIS has no formal market oversight role or function in respect of care services (whatever the age group). Where data collection or inspection activity highlights an emerging concern in relation to provision, the CIS can highlight it in a national publication, but it is unable to do this in a systematic way. For example, in its annual statistical bulletin on fostering services it highlighted the continued challenge of finding suitable placements to avoid family groups being separated.

[13] Under the Regulation and Inspection of Social Care (Wales) Act 2016 (sections 59-63). These are a series of provisions aimed at identifying those providers of regulated services that provide a service which, if it were to fail, would have an impact on the care and support market in Wales and would be the trigger point for the local authority duties to be exercised under sections 189 to 191 of the Social Services and Well-being (Wales) Act 2014.

[14] Section 144B of the Social Services and Well-being (Wales) Act 2014 and The Partnership Arrangements (Amendment) and Regulated Services (Market Stability Reports) (Wales) Regulations 2021 set out the form these must take, matters to be included, and the prescribed period for carrying out market stability assessments. Statutory Guidance and a Code of Practice set out how local authorities must carry out their market stability functions. Matters which must be included in the market stability report are: the sufficiency and overall quality of provision of those services, current or developing trends, significant challenges, and the impact of commissioning and funding on local authority social services functions.

Glossary

Term/ Acronym	Definition
Care Order	A Care Order is an order made to protect a child from harm, abuse or neglect and often states that the local authority must look after the child and provide somewhere for the child to live.
Care Plan	A Care Plan is a plan which sets out what services and other help will be provided to the relevant child and their family. The Care Plan will state what the local authority and other agencies will do to meet the child's needs including health, education, identity, family relationships and hobbies and sets out the plan for the child's future.
The Care Inspectorate Scotland (CIS)	The Care Inspectorate Scotland is the independent regulator of social care and childcare in Scotland.
The Care Inspectorate Wales (CIW)	The Care Inspectorate Wales is the independent regulator of social care and childcare in Wales.
Care Quality Commission (CQC)	The independent regulator of all health and social care services in England.
Child	A Child means a person under 18 in England and Wales and a person under 16 in Scotland.
Children's home	A children's home is an establishment which provides care and accommodation for looked-after children and is registered with and inspected by Ofsted in England, or the Care Inspectorates in Scotland or Wales.
Distant placement	A distant placement is a placement outside the area of the responsible local authority and not within the area of any adjoining local authority.
Emergency Protection Order (EPO)	The local authority can apply to the court for an Emergency Protection Order if there is an urgent need to protect a child or young person. The order typically gives the applicant the power to remove or detain the child.
Fostering agency	A fostering agency is a local authority or privately run organisation which recruits, trains and connects foster carers with looked-after children.
Fostering services	Fostering services means the services provided by a fostering agency.

IR	Interim Report – published 22 October 2021, setting out our interim findings based on our initial analysis.
ITC	Invitation to Comment – following the launch of the market study the CMA invited comments on the issues raised in the invitation to comment, including from interested parties such as care and accommodation suppliers, local authorities, looked-after and care-experienced children and their advocates, and other interested parties.
Independent fostering agency (or 'IFA')	An independent fostering agency is a privately run fostering agency.
Independent Children's Home Association (ICHA)	The Independent Children's Home Association represents independent providers of children's homes and provide information and networking opportunities for companies working in the independent sector and running residential children's homes.
Independent provision	Care or accommodation which is not provided by the local authorities (including both for-profit and not-for-profit providers).
Large provider "*PE*" indicates private equity owned "*includes unregulated*" means a provider of unregulated accommodation, as well as children's homes	One of the fifteen largest providers of Children's homes/unregulated accommodation and/or Fostering services that submitted evidence to the CMA, namely: *Providers of Children's homes and Fostering services* Caretech Holdings Plc ('Caretech' - includes unregulated), Care Visions Group Limited ('Care Visions'), Compass Community Limited ('Compass' - PE), Homes2Inpsire Ltd ('Homes2Inpsire' - includes unregulated), Nutrius UK Topco Limited ('Polaris' – PE, includes unregulated), Aspris Children's Services Limited (formerly Priory Group UK 1 Limited), The Outcomes First Group Limited ('Outcomes First' - PE). *Providers of Children's homes only* Hexagon Care Services Limited ('Hexagon' - includes unregulated), Horizon Care and Education Group Ltd ('Horizon' - PE, includes unregulated), Keys Group Limited ('Keys' - PE, includes unregulated), Sandcastle Care Ltd ('Sandcastle' - PE), The Esland Group Holdings Ltd ('Esland' - PE), The Partnership of Care Today ('Care Today'). *Providers of Fostering services only* Capstone Foster Care Limited ('Capstone'), Orange Cloud Topco Ltd ('Orange Cloud').
LA	Local authority

Looked-after child (LAC)	A looked-after child is a child in the care of a local authority.
Local Government Association (LGA)	The Local Government Association is the national membership body for local authorities. Its core membership is made up of 339 English councils and the 22 Welsh councils through the Welsh Local Government Association.
Ofsted	Ofsted is responsible, under the Care Standards Act 2000, for (amongst other things) regulating establishments and agencies that provide children's social care services in England.
Nationwide Association of Fostering Providers (NAFP)	The Nationwide Association of Fostering Providers is trade association comprised of independent and voluntary sector fostering agencies, including large national organisations, medium sized providers and small local agencies.
Placement	A Placement refers to where a child is placed by a local authority and can include: (1) a placement with an individual who is a relative, friend or other person connected with the child, (2) a placement with a local foster carer parent or (3) placement in a children's home or (4) placement in unregulated accommodation.
Private Equity (or PE)	Private equity is medium to long-term finance provided in return for an equity stake in potentially high-growth unquoted companies.
Private provider (or 'for-profit provider')	A Private provider means a for-profit organisation that is owned by the private sector. It includes PE-owned providers.
Residential accommodation	This covers children's homes and Unregulated accommodation but excludes fostering services.
Smaller provider	Any provider of children's homes and/or fostering services that is not one of the fifteen largest providers listed in the definition above of Large provider
Residential setting	This covers children's homes, secure and semi-independent living and residential schools.
Supported accommodation	Supported accommodation is a form of temporary accommodation with support (not care) for young people who are not ready to live independently. It is unregulated provision.
Voluntary sector (or 'third sector')	The part of an economy comprising non-governmental and non-profit-making organisations or associations, including

	charities, voluntary and community groups, cooperatives, etc.
Unregistered accommodation	Unregistered accommodation means accommodation where care is being provided without registration. This is illegal.
Unregulated accommodation	Unregulated accommodation is residential accommodation for children in England and Wales where care is not provided.

Financial Glossary

Term/ Acronym	Definition
ASC	Adult social care
CSC	Children's social care
Large providers' dataset	Refers to the six years of financial and operational data we obtained from the 15 Large providers.
Group (provider) level dataset	Includes group financial data of those large providers that generated aggregate revenues in financial year 2020 of £958 million.
Home level dataset	Includes financial and operational data at the home level for the 889 homes operated by large providers.
Independent fostering agency (IFA) level data	includes financial and operational data at the IFA level for the 94 IFAs operated by large providers.
LAs dataset	Refers to the five-year financial and operational data we obtained from 40 local authorities.
Home level data	Includes financial and operational data at the home level for the 237 homes operated by the 40 local authorities we obtained date from.
Fostering agency-level data	Includes financial and operational data at the agency level for the 57 agencies operated by the 40 local authorities we obtained date from.