Charter Insight

Market Update - Child Care

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Melbourne
Level 19/8 Exhibition Street
Melbourne VIC 3000
T +61 (0) 3 8102 8888

Sydney
Level 25/52 Martin Place
Sydney NSW 2000
T +61 (0) 2 8228 7888

Brisbane
Level 32/123 Eagle Street
Brisbane QLD 4000

Singapore
Level 24-01, CapitaGreen
138 Market Street, Singapore 048946
T +65 6679 6067

admin@charterkc.com.au
charterkc.com.au

Martyn Boyle
Director - Valuations
T +61 (0) 3 8102 8896
M +61 412 731 230
E martyn.boyle@charterkc.com.au

Sam Qualtrough
Social Infrastructure Consultant
T +61 (0) 3 8102 8853
M +61 (0) 433 635 421
E sam.qualtrough@charterkc.com.au

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Introduction

Charter Keck Cramer can provide rigorous and forward looking demand and supply analysis for customised geographical catchments and asset classes. The following insight touches on that capability to draw a market assessment of the Child Care industry and asset class.

The child care industry in Australia has experienced unprecedented growth in recent years, driven by a combination of demand-side and supply-side factors.

Since its introduction in 2012, the Federal Government's National Quality Framework has provided the foundation for a sustained focus on care, quality, qualifications and education in the child care industry. On the demand side, parents are also increasingly seeking the highest quality services for their children (within their financial means).

Strong population growth and rising female labour force participation rates have driven demand for child care services. This, in turn, has generated an ongoing supply-side response in the form of additional child care centres being developed.

As a result of this significant growth in supply, questions have been raised about the potential 'over-supply' of long day care facilities in some areas.

This Charter Insight considers a number of these supply and demand factors and provides an update on the market for child care property, based on our day-to-day experience across this emerging market.

Child Care Property Market & Industry Update

Supply and demand dynamics in the sector have produced a recent period of heightened investor activity in the Victorian and national markets, with child care centres transacting at historically strong prices. Sale prices have been increasing and have been supported by a clear downward trend in yields.

Investor confidence has been evident in the market for child care assets, as demonstrated by yield compression in Victoria from approximately 8.0% in 2009 to approximately 6% in 2017. Investors increasingly view child care centres as lower-risk assets given that quality affordable child care is now considered an essential service and form of social infrastructure due to the changing employment and lifestyle patterns of Australians. The underlying fundamentals of higher female labour force participation is expected to result in a higher demand for child care placements.

Investors are increasingly attracted to the strength of lease covenants on offer which typically include initial tenure of 10-20 years and annual rental increases above CPI. In addition, child care businesses are now highly valuable and with a lack of readily available alternate accommodation, tenants are considered less likely to vacate which reduces the risk profile of income cashflow. The risk profile is further reduced as centres often occupy large, strategically located sites, predominately within residential zones which offer strong reversionary redevelopment potential should the child care use discontinue.

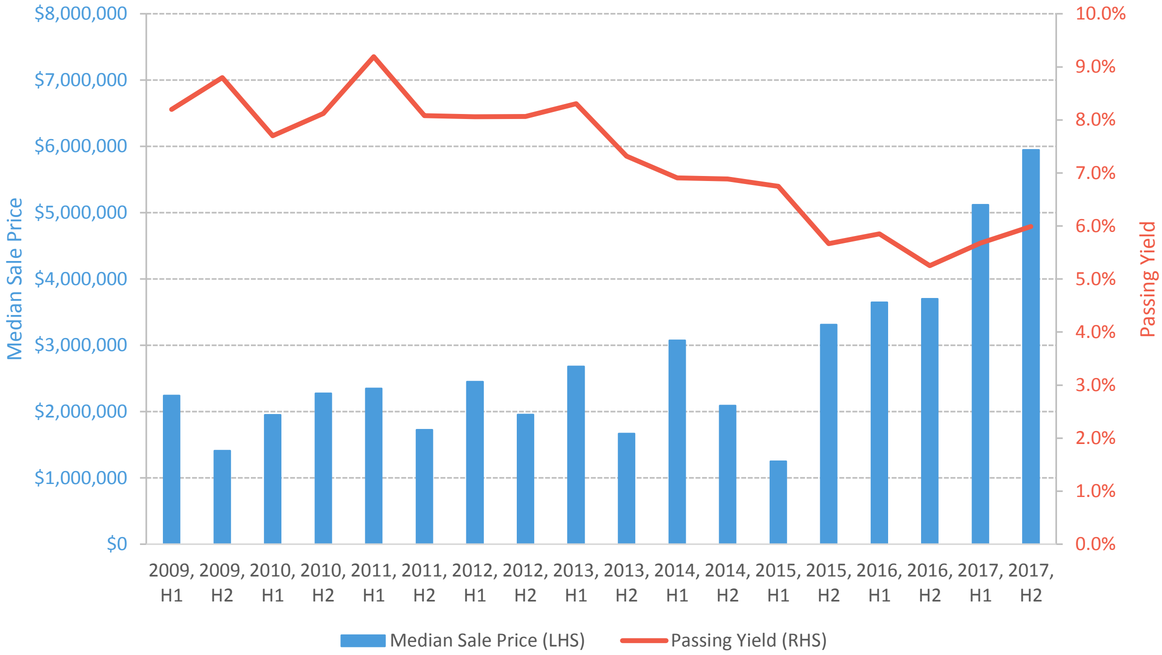
The industry has seen a relatively rapid increase in rental rates due to the emergence of new, higher quality and more efficient, purpose built centres. These centres, whilst highly attractive to parents, are now incurring higher rental costs which, in the absence of rent free periods or lease incentives, may become a financial burden for lessees, particularly during the start-up phase of new operations. Lease incentives if offered will go some way to alleviating the initial rental burden, however a high level of management expertise is critical in establishing sufficient trade and occupancy.

Government regulation within the industry continues to increase with the main objective being to ensure that quality child care services are provided throughout Australia. This has led to staff requiring a higher level of training and qualification which has translated to higher wage costs for operators. Recent changes in educator to child ratios (from 1 January 2016) have also contributed to increased operational costs. In Victoria the impact was largely felt in the children aged 36 months up to and including preschool age where the ratio was amended from 1:15 to 1:11. This change required operators of some older centres to either reconfigure rooms to accommodate the new capacities, increase staff numbers, or potentially operate at a reduced room capacity. Wages expense now accounts for approximately 50% to 55% of income generated by child care businesses.

Notwithstanding the current period of strong demand, it is important for those looking to invest in this sector to understand that the viability of a child care centre is often heavily reliant on the ability of the operator to achieve and maintain occupancy levels. The freehold value of a child care centre can be directly interrelated with the ability of the leasehold business owner to maintain sufficient revenue and profit level and hence maintain the ability to pay rent. It is generally recognised that child care centres require occupancy levels in the order of 70% to remain sufficiently profitable and it is therefore a critical requirement that new centres be developed within locations which demonstrate a strong demographic profile and an adequate demand for child care services.

Assistance for operators and families in the form of Federal Government Funding assistance over the last 5 years, coupled with the Government's future commitment to the industry in the form of the "Jobs for Families" Child Care Package available to the industry from July 2018, will continue to strengthen the industry. Reduced occupancy rates and the threat of future competition remains a concern for existing providers.

Figure 1: Victorian child care property sales, half yearly median sale price, passing yield (2009 to 2017)



Source: Charter Keck Cramer (2018)

Demand Considerations

The demand for long day care services has been driven by a number of demographic and economic factors including population growth in the cohort of 0-4 year olds and a significant long-term increase in the female labour force participation rate.

Population Growth

The total population of Victoria has grown at an average annual rate of 1.8% during the period 2001 to 2016, which has been stronger than the rate for the Australian population (which was 1.5% over the same period). Naturally, a significant proportion of Victoria's population growth has occurred within metropolitan Melbourne, with key growth areas such as Tarneit, Cranbourne East, Point Cook and Doreen experiencing some of the largest net additional population increases in Australia during this period. The observed growth in regional centres has also underpinned rising demand for child care centres outside metropolitan Melbourne.

Population growth in the 0-4 year old age cohort has been especially pronounced in the major urbanised areas of Victoria, with metropolitan Melbourne adding more than 89,900 persons aged 0-4 year old, between 2001 and 2016. The rate of growth has accelerated in recent years, with an annual average of 9,300 persons aged 0 - 4 year old being added to metropolitan Melbourne population between 2011 and 2016.

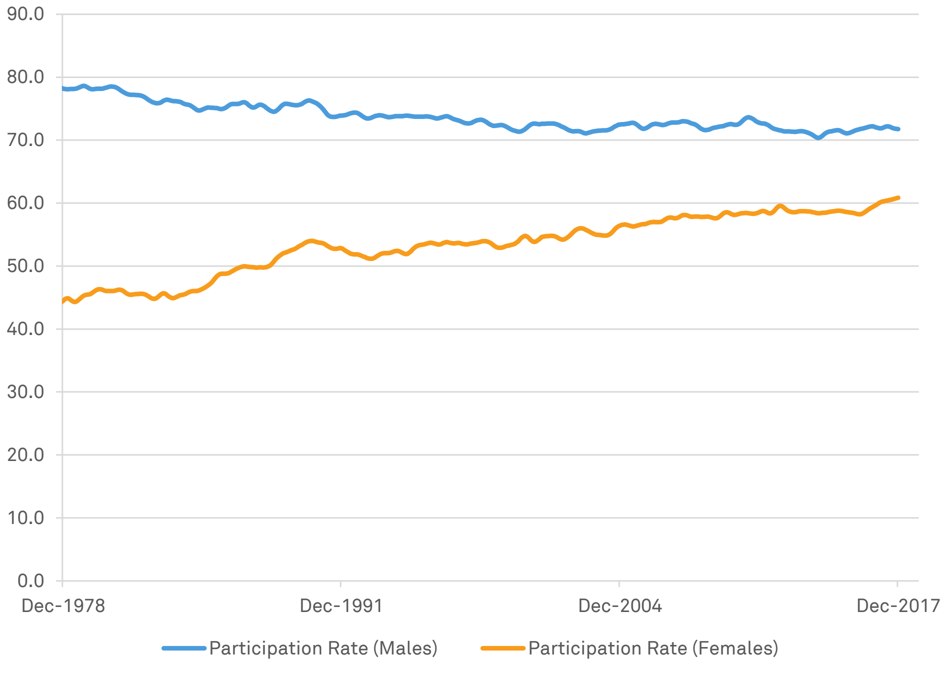
Key drivers of this strong population growth include fertility rates, net inter-state migration and Victoria's share of net overseas migration, which have all exceeded historical averages in recent years.

Labour Force Participation

The female labour force participation rate has steadily increased in Victoria, from approximately 44.5% in December 1978, to approximately 60.8% in December 2017[1]. The changes to female participation over this period reflect a range of social changes, including higher educational attainment, more flexible working arrangements and improved access to child care.

These labour force changes have coincided with significant growth in the child care industry in recent years, as illustrated by overall industry revenue, size of the Victorian Early Childhood Education and Care workforce (up by approximately 73.4% during the period 2010 - 2016) and government funding through the Federal Government's Child Care Benefit and Child Care Rebate schemes.

Figure 2: Labour Force Participation Rates - Victoria



Source: Australian Bureau of Statistics (2018); Charter Keck Cramer (2018)

Notwithstanding this significant historical increase in female labour force participation rates in recent decades, numerous surveys[2] indicate that mothers cite 'cost of childcare', and 'access to childcare' as some of the most significant barriers to re-entering the workforce. For example, the Australian Childcare Alliance Parent Survey indicated 84% of respondents reported the cost of childcare was the main barrier to work and study.

The upcoming Federal Government "Jobs for Families" funding package - expected to take effect from 2 July 2018 - seeks to address a number of these factors, by making the child care system more affordable, flexible and accessible. Should these policy goals be achieved, the industry will benefit as families utilise the new system.

Child Care Participation Rates

As a result of these demographic and economic drivers, Australia has witnessed steadily increasing child participation rates in long day care. The participation rate of 0-4 year olds attending long day care has risen from approximately 13% in 1996 to approximately 31% in 2014[3].

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[1] The ABS defines the labour force participation rate for any group within the population as the labour force component of that group, expressed as a percentage of the population in the same group.
[2] Significant surveys include those conducted by the ABS, the Child Care Alliance, Care4Kids, Daycare Decisions and Mission Australia.
[3] ABS Childhood Education and Care, Catalogue No. 4402

Since its inception in 2012, the National Quality Framework has been influential in raising quality standards throughout the industry. Furthermore, in recent years an increasingly significant proportion of long day care centres now also provide educational programs alongside their traditional day care services. Consequently, parents' expectations for the quality of care, and the educational standards delivered within these centres has also risen, driving further competition among centres to meet parents expectations.

Some operators have differentiated their service offerings by catering to this demand and in some cases are able to charge a premium in their fees as a result. With parents seeking more flexible operating-hours, quality educational programs and integrated care options, the long day care sub-market has become an increasingly important component of the broader child care market.

Supply Considerations

Supply Increasing

There has been a significant increase in the number of approved long day care centres in Victoria, with more than 320 additional centres being approved between 2012 and 2017, an increase of approximately 29%.

These centres contain more than 32,300 licensed places primarily providing long day care during this same period. The growth rate of licensed places (at approximately 37%) has out-paced the growth of centres, highlighting the trend of new centres being larger than the prevailing supply (including retro-fitted houses and other structures).

The majority (approximately 77%) of these new centres are located within the metropolitan Melbourne region with the balance in regional Victoria; a similar proportion as in other States.

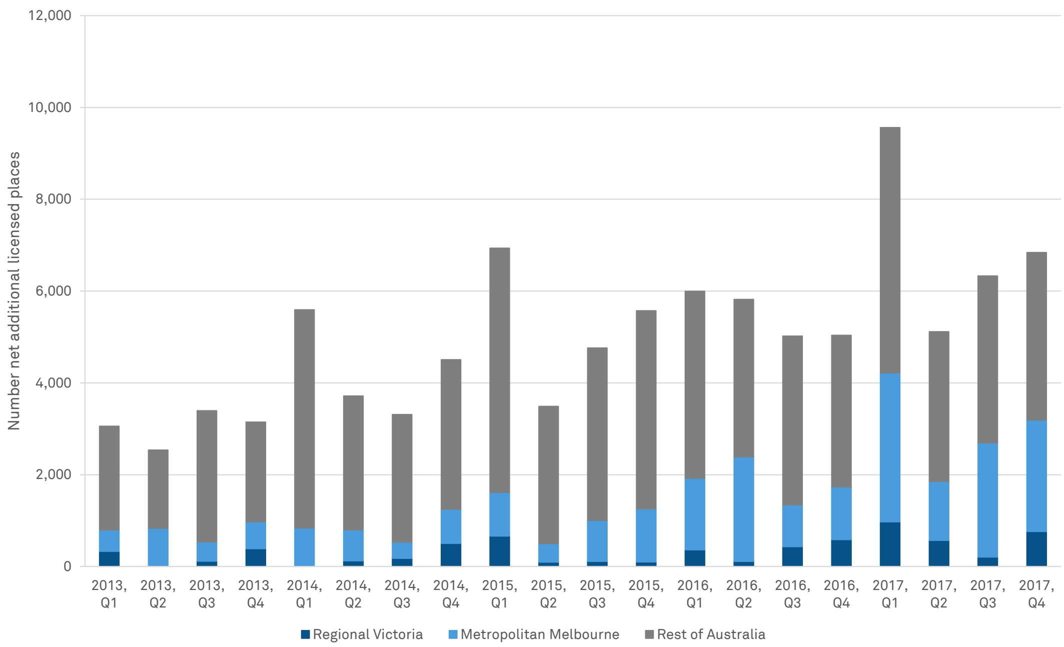
This increase has led to speculation about possible over supply amongst market participants, particularly in some of the rapidly expanding growth areas of Melbourne, although this simplistic analysis has often misunderstood that the new supply is replacing or rendering older centres obsolete and uncompetitive. The new supply needs to also consider the withdrawal of older and less efficient centres.

Federal Government Funding

The industry has benefited from a supportive policy environment which has seen Federal Government funding increase in recent years, as parents have accessed approved services with the Child Care Benefit and Child Care Rebate programs.

Furthermore, the Federal Government's legislated "Jobs for Families" Child Care Package is expected to provide additional funding for child care over the FY2019 to FY2021 period. This is expected to represent a significant increase from current funding levels and the new Child Care Subsidy will replace the existing Fee Assistance programs (including Child Care Benefit and Child Care Rebate). This new Child Care Subsidy is expected to streamline and simplify the current system and will be paid directly to service providers to be passed on to families. Operators are likely to benefit from efficiency gains, while property investors may benefit from reduced risk associated with alleviated administrative burden.

Figure 3: Net additional number of licensed places (primarily providing long day care) - Victoria



Source: Australian Children's Education and Care Quality Authority (2018); Charter Keck Cramer (2018)

Summary

A range of socio-demographic and economic factors have contributed to the significant growth of the child care industry in recent years.

While certain areas may be subject to over-supply of long day care centres, many regions throughout Melbourne and regional Victoria continue to demonstrate strong population growth with commensurate associated demand for child care services.

As dual-income working families continue to seek high quality child care for their children and as services cater to this need, growth and investment in the sector is expected to continue.

The viability of a child care centre is heavily reliant on the ability of the operator to achieve and maintain occupancy. Understanding the interaction of demand and supply in this sector is an important step for owners, operators and investors, in seeking to gain a thorough understanding of the market and meet due diligence requirements.

Charter Keck Cramer is well positioned to provide rigorous demand and supply analysis for customised geographical catchments. Please enquire with us to learn more about your area of interest.

Contact Details.

Melbourne
Level 19/8 Exhibition Street
Melbourne VIC 3000
T +61 (0) 3 8102 8888

Sydney
Level 25/52 Martin Place
Sydney NSW 2000
T +61 (0) 2 8228 7888

Brisbane
Level 32/123 Eagle Street
Brisbane QLD 4000

Singapore
Level 24-01, CapitaGreen
138 Market Street, Singapore 048946
T +65 6679 6067

admin@charterkc.com.au
charterkc.com.au

Martyn Boyle
Director - Valuations
T +61 (0) 3 8102 8896
M +61 412 731 230
E martyn.boyle@charterkc.com.au

Sam Qualtrough
Social Infrastructure Consultant
T +61 (0) 3 8102 8853
M +61 (0) 433 635 421
E sam.qualtrough@charterkc.com.au