Australia's fastest growing commercial real estate investment class

Childcare Property

2018 Investment Report

burgess rawson

Burgess Rawson

Burgess Rawson is one of Australia's leading property agencies, with a proud history spanning over 40 years.

A full service agency, with offices in Brisbane, Canberra, Melbourne, Perth, Sydney and Kuala Lumpur, we are a true national network of dedicated property professionals, offering local expertise in all markets through our extensive regional partnerships. Our team provides sales, leasing, property management, advisory, development expertise and project marketing in both commercial and residential sectors.

Renowned for our iconic Investment Portfolio Auctions, we have long been considered the undisputed market leader by connecting our rapidly growing database of active investors with premium commercial investment properties Australia-wide.

Welcome to the 2018 Burgess Rawson Childcare Investment Report

The fastest growing commercial real estate investment class is childcare, driven by changing social needs which has led to increased supply, high investor demand and ongoing Government support.

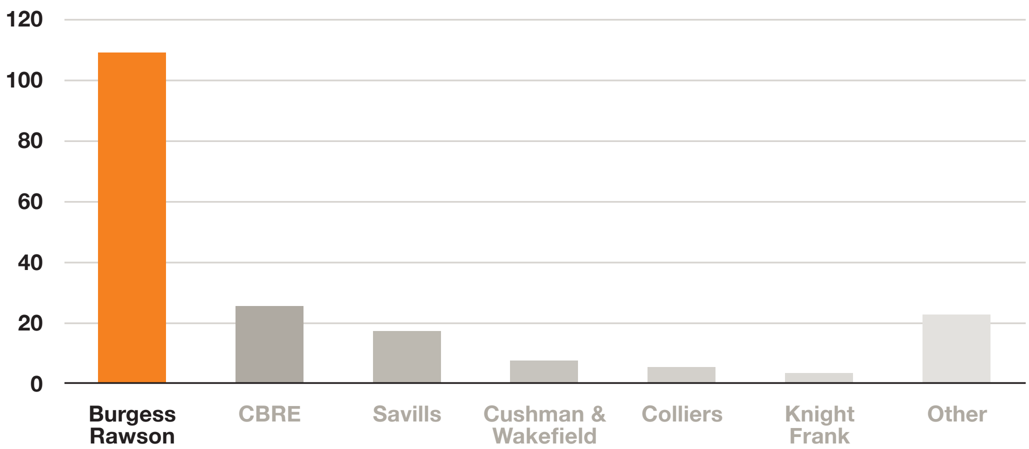
Childcare assets now rank amongst the most sought-after commercial investments in Australia, due to landlord friendly long term leases and strong lease covenants underwritten by established national operators. Burgess Rawson has been at the forefront of this unprecedented growth by negotiating numerous sales and leasing these transaction across its Australia-wide network.

Since our first industry renowned report in November 2017, Burgess Rawson have transacted a further $149 million in childcare investment sales.

As the undisputed childcare market leader, Burgess Rawson sold more than 76 per cent of the childcare assets Australia-wide in FY17. In the past 18 months alone Burgess Rawson has transacted 112 childcare properties, more than four times the number of childcare centres compared to that of our closest competitor.

Market Share Childcare Freehold Investment Sales

1 January 2017 to 20 June 2018



Fundamentals of Childcare Investment

Five key factors have contributed to the remarkable growth of this investment sector.

1 Both sides of Parliament have shown their support for the childcare industry over many years. The economic return of workforce participation far outweighs the cost to assist in childcare funding. The new subsidy seeks to add more funding to the majority of lower to middle income families.

2 The continued low cost of money in what is a relatively stable economic and political environment has led to unprecedented yield compression for quality assets.

3 Childcare property investment is realistically attainable across a greater cross-section of the commercial investor community than any other market sector. Childcare property has attracted entry level investors with a 30 place centre in regional NSW at an affordable $670,000 through to high level investors with 210 place centre at $21 million in metropolitan Sydney.

4 Robust landlord friendly lease terms, including blanket recovery of landlord expenses, often as far reaching to include structural maintenance and management fees. As the industry consolidates we predict these leases to be grandfathered and this will be a key value proposition for investors.

5 Exponential rental growth outstripping all other sectors. Profits in the sector have reached $934.1[1] million which underpins rental affordability.

1 *iBIS Word Child Care Industry Services Repor May 2018*

"Current market yields are trending between 5.5 and 6 per cent which continues to represent exceptional value for properties with strong fundamentals, such as lease covenants, tenure and favoured locations."

Adam Thomas

Government Funding

Since our original childcare report there has been a significant change in the Federal Government's childcare funding model, which came into effect 2 July 2018. These improvements under the Jobs for Families Child Care Package seek to simplify the way that families are given assistance in paying for childcare and signal the ongoing commitment of Government to accessible and affordable early education, particularly for lower income working families.

On 2 July 2018, the Federal Government replaced the Child Care Benefit and non-means tested Child Care Rebate with a single means-tested subsidy, known as the Child Care Subsidy (CCS). These changes affect more than 17,000 childcare providers and over 1.3 million families using childcare services.

Some of the key features of the new CCS include:[2]

- The subsidy will be paid directly to the provider on the families' behalf. Families will cover any gap between the level of subsidy they receive and the actual fee charged by the service.
- A new hourly cap applies to the CCS: $11.55 an hour for centre-based care.
- The maximum number of hours claimable under the CCS is subject to a new employment activity test. During a period of a fortnight the following is required;
  - 8 to 16 hours of activity equates to a maximum of 36 hours of subsidy
  - 16 to 48 hours of activity equates to a maximum of 72 hours of subsidy
  - More than 48 hours of activity equates to a maximum of 100 hours of subsidy
- Subject to the employment activity test, families earning up to $65,710 will receive an 85 per cent subsidy on the new hourly fee caps. The subsidy tapers down by 1.0 per cent for each additional $3,000 of family income.
- A family on between $170,710 and $250,000 will receive a 50 per cent subsidy on the new hourly fee caps, limited to $10,000.
- There will be no subsidies available for families earning more than $350,000.

At first glance this new CCS appears to be a simplified system, replacing two payments with a single subsidy. However, in practice it is quite complex and has ramifications for consumers and operators. Ultimately the amount of CCS individual families will receive is dependent on three things:

- Combined family income
- Employment activity test
- The type of childcare services the family uses

Nevertheless, Government figures project that almost 816,000 families will be better off. On average, typical families earning between $65,710 and $170,710 are expected to receive an additional $1,500 per annum. Conversely approximately 128,000 families will receive reduced subsidies, including 52,100 earning less than $65,710 a year, mainly due to the employment activity test. Whether the employment activity test in itself encourages more parents into work or training is yet to be seen.

Analysis of the reforms undertaken by the University of Canberra concludes that full-time working parents become better off regardless of their income level under $320,000 for single parents with non-school aged children. There is a consistent trend that those in the middle-income group are expected to gain most from the new scheme.[3]

Of course any improvement in the affordability and take up of childcare services is good news for the childcare sector and consistent with the Government objective of increasing work place participation, particularly that of women.

In conjunction, the Government will support access to preschool education through the National Partnership Agreement on Universal Access to Early Childhood Education which will be extended until 2019, at a cost of $440 million. Together with the funding extension provided in the 2017/18 Budget, this takes total Federal Government preschool funding to around $870 million[4] for the 2018 and 2019 school years.

The Federal Government has also undertaken to invest $37.3 billion[5] from 2017-18 to 2020-21 in childcare, including before and after school care, to further ease the cost of living pressures for around one million Australian families.

Government figures project that almost 816,000 families will be better off under the new jobs for families childcare package.

2 *goodstart.org.au*

3 *AUSBudget NATSEM*

4 *Budget Paper Guaranteeing the Essential Services 2018-2019*

5 *Budget Paper Guaranteeing the Essential Services 2017-2018*

6 *iBIS World Child Care Service Industry Report May 2018*

Government Funding Continued

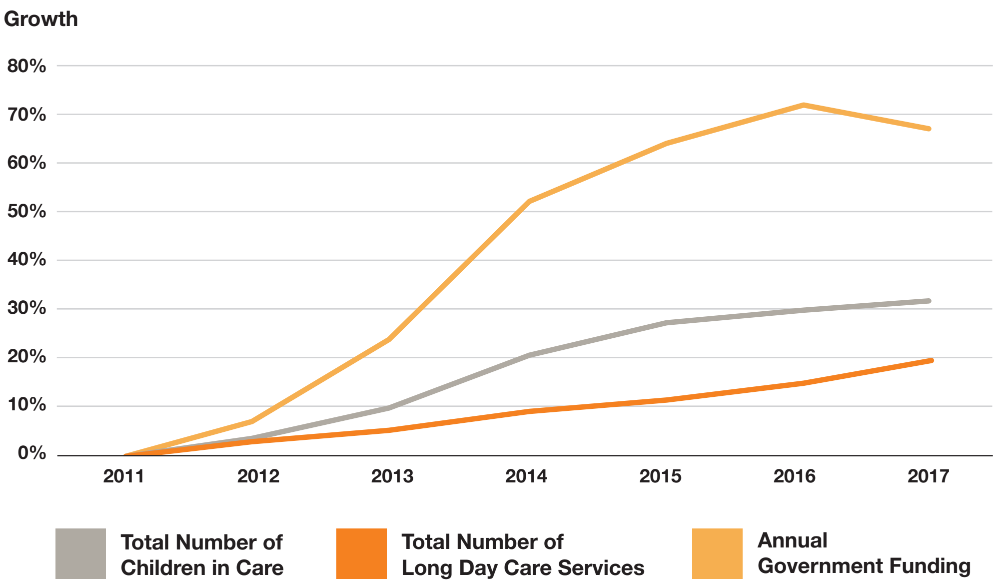
The social need for childcare and growth in the sector may be measured by a range of metrics including:

- The number of children in care
- The number of Long Day Care centres
- Government Funding to the sector by way of subsidies

Currently in Australia, we have 1.312 million[6] children accessing childcare services, of which 55 per cent are in Long Day Care Centres. This represents an increase of 11 per cent over the past five years.[7]

Since 2011, the total number of children attending all forms of care across Australia has grown by 31.6 per cent, whilst the number of Long Day Care centres has increased by only 19.2 per cent.

This continued gap demonstrates the enormous demand across the industry; and with Government Funding increasing by 67.8 per cent over the same period, the incentive for childcare operators to meet this demand is quite obvious. A 'catch-up' of supply is consequently making its way through the market with over 250 Long Day Care centres delivered during 2017.



Sources: education.gov.au, pc.gov.au

“Childcare centres are resistant to digital disruption and are an essential societal need underpinned by strong government support.”

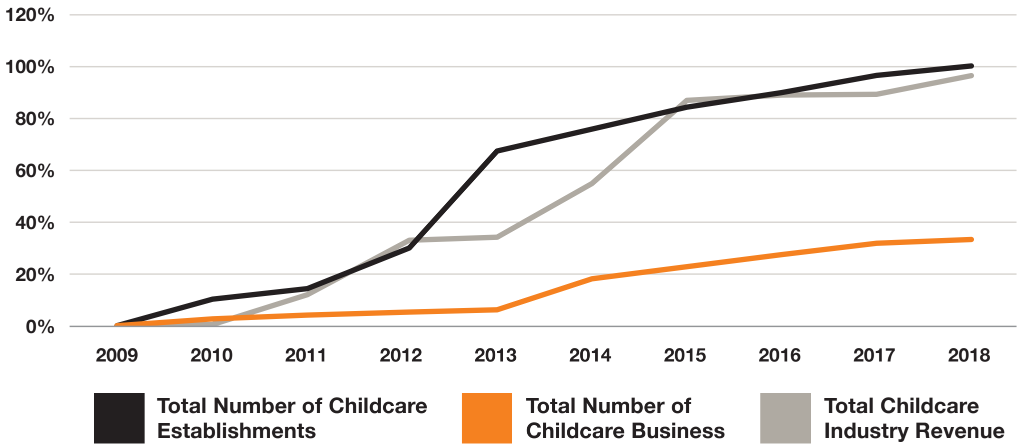
Michael Vanstone

Who are the Key Childcare and Early Learning Operators?

The childcare industry has been through a revolution since 2009.

Industry revenue has increased by 97 per cent,[7] whilst the number of businesses has only increased by 34 per cent. The ratio of businesses to establishments has increased by 41 per cent. The increase in multiple-holding businesses shows a level of corporatisation that has entered the industry. In 2009, the industry was dominated by family day care providers, not for profits and community organisations. As legislation has become more complicated, government funding increased and parent demands changed, so did the nature of the operators.

Profitability Rising



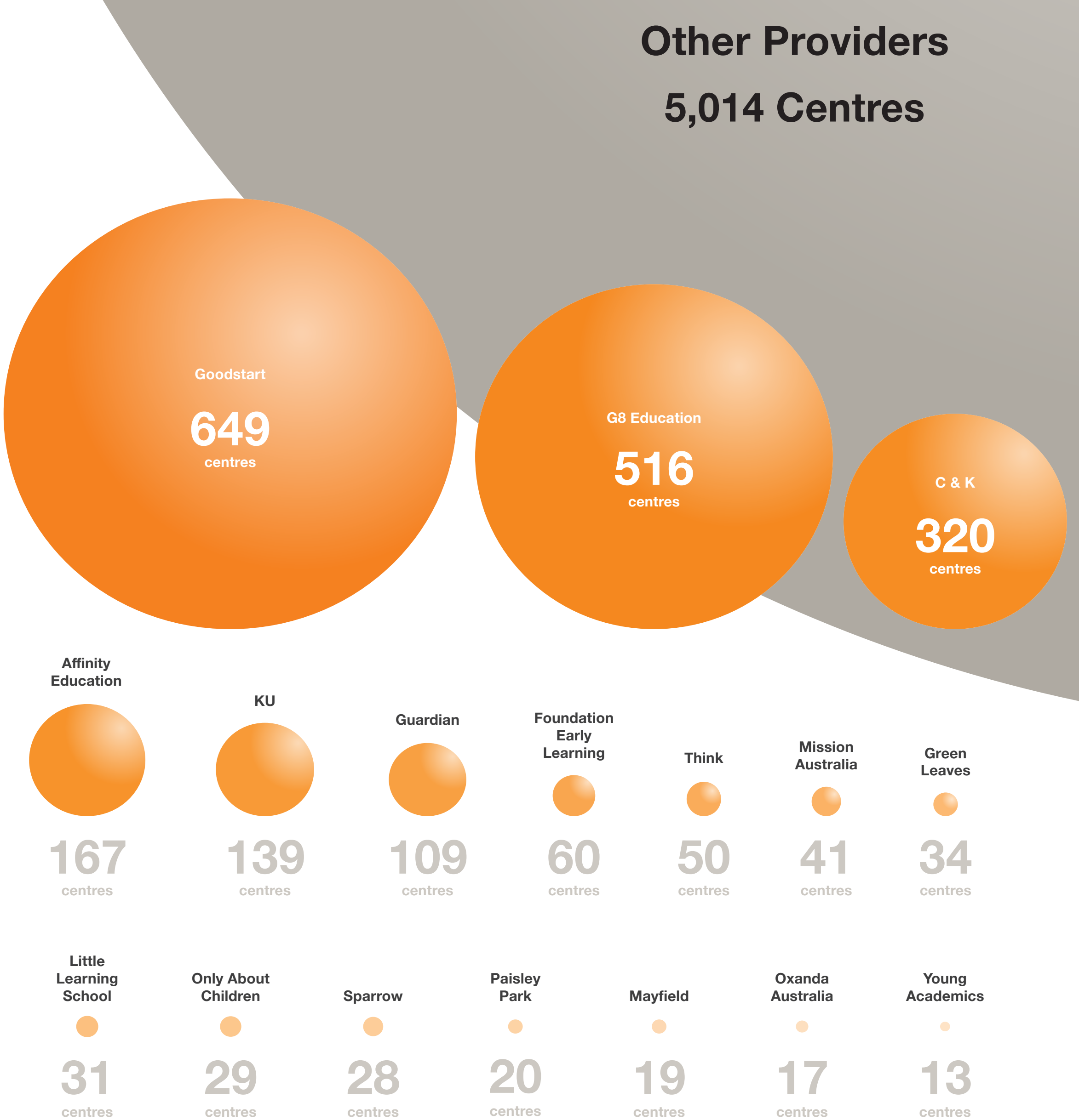
Notwithstanding ongoing evolution of the childcare market, around 75 per cent of the industry continues to be controlled by smaller groups and 'mum and dad' operators, meaning that this market is still uniquely fragmented compared to other industries in Australia. This fragmentation makes for a particularly interesting landscape; not only for childcare operators, but for property investors as well.

There are six stand out operators by size – Goodstart, G8 Education, C & K, Affinity Education, KU Childrens Services and Guardian Early Learning – but these businesses account for just 17.6 per cent of the market for now.

These six majors are constantly improving and rebalancing their networks through new development pipelines and acquisitions of smaller groups, whilst also shedding some of their smaller or poor performing centres.

7 *iBIS World Child Care Industry Report May 2018*

Market Snap Shot Childcare Long Day Care Centres



Rental Levels

Unlike many other forms of investment property the rentals of childcare centres are commonly rationalised by the number of permitted places rather than on a building area basis. Quite simply, for any given building size the greater the number of permitted childcare places the higher the rental.

Education and Care Services National Regulation specify a minimum area of 3.25 square metres of unencumbered indoor space per child, which in a practical sense equates to centres typically having a total floor area of between 6.0 and 8.0 square metres per child.

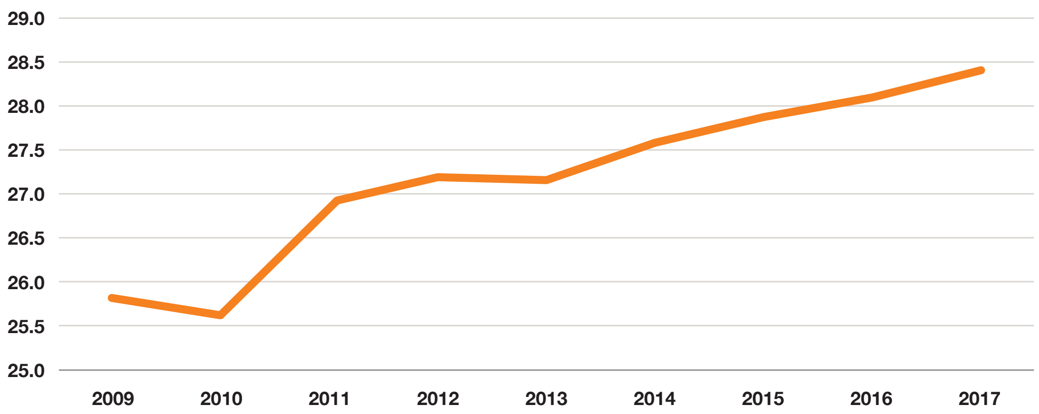
Burgess Rawson research indicates that rental levels for childcare centres have risen strongly over recent years, easily outstripping the underlying cost of living (CPI). Rentals for childcare are generally calculated on a per place basis. Rental rates on a net basis are now most commonly in the range of $2,000 to $5,000 per place, although in some instances rentals as high as $6,000 per place are now being achieved on a regular basis.

Key elements driving rental rates include:

- The rising cost of development land and building construction
- Increasing levels of appointment and facilities demanded by both Government and parent expectation

We have also recorded a steady increase in the average hours per week spent by children in long day care centres, which is also contributing to growth in rentals. In 2009 this was just under 26 hours per week, which by 2017 had risen to almost 28.5 hours per week, an increase of almost 10 per cent.

Hours per week spent in childcare



Mindful of the rising demand for childcare services, coupled with ongoing Government support to the sector, we anticipate that continued rental growth will remain a feature of childcare investment for a long time to come.

> "In the last six months the market has seen a clear flight to quality with operators divesting under-performing assets and replacing them with higher performers, whilst still increasing the size of their overall network."
>
> *Natalie Couper*

Investor Capital and Low Cost of Money

Ongoing low interest rates have caused some domestic investors to move from the security of cash and bonds to higher yielding direct property investment. Nonetheless income security and capital preservation remain at an absolute premium. Risk adverse buyers are therefore competing strongly for limited opportunities to acquire AAA grade retail and commercial assets.

The unprecedented growth of Self-Managed Super Funds (SMSF) has also changed the investment landscape. Currently Australia has over 597,000 SMSFs[8], holding close to $700 billion in assets. The average fund balance is around $1.17 million with allocation to AAA grade property considered by many to be a sound defensive strategy.

SMSFs are therefore seeking direct property assets which provide a secure and reliable cash flow and childcare satisfies these requirements. Security is underwritten by access to listed and premium quality tenants and the surety of Government funding to the sector.

Listed Funds have made aggressive forays into the childcare market to expand their portfolios. Arena and Folkestone are the largest REITs owning childcare investments. In the past 6 months Folkestone's Childcare Assets have grown by 33% through acquisitions, new developments and revaluations.

Fund Name	As at 20 June 2016	Increase	As at 20 June 2017	Increase	As at Dec 2017
Arena REIT[9] Total Value Australian Childcare Assets	$413 million	**23%**	$507 million	**17%**	$592 million
Folkestone Education Trust[10] Total Value Australian Childcare Assets	$584 million	**23%**	$720 million	**33%**	$954 million

8 ato.gov.au
9 arena.com.au
10 folkestone.com.au

Glen Huntly VIC
Sold: $7,350,000
Yield: 5.38%

Sold by Burgess Rawson
Investment Portfolio Auction

“Landlords are favouring childcare assets because tenants are constantly improving their offerings, driven by competition. G8 this year completed over 107 air conditioning upgrades, 101 painting upgrades, 17 flooring upgrades and 16 playground upgrades representing a capital investment of $17 million. This is direct landlord value.”

Jamie Dewe


plorers
Early
Learning

Market Analysis

Over recent years the childcare property market has seen a record increase in supply coupled with unparalleled yield compression. Having regard to our most recent auction results investor demand remains unabated and continues to outstrip supply.

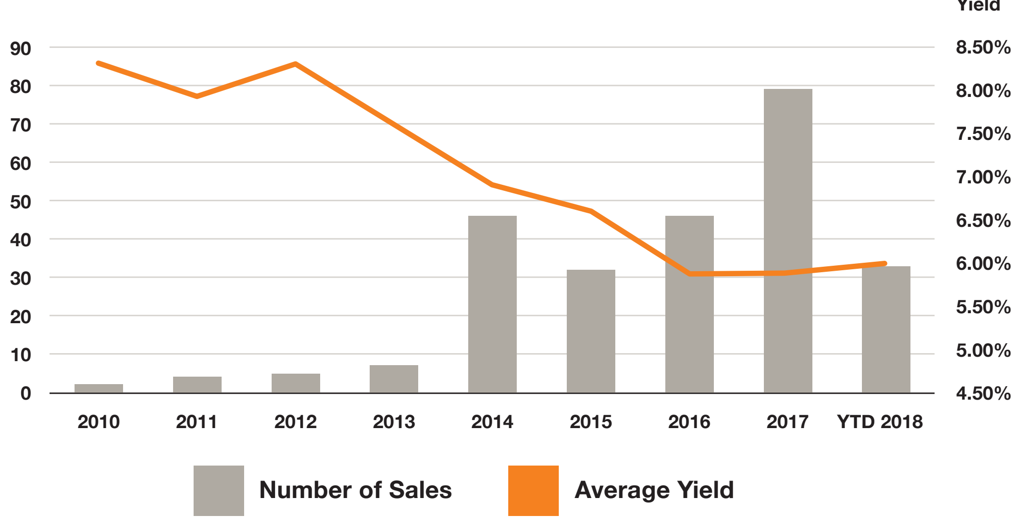
Key fundamentals of this asset class including security, income growth and significant Government support are significant positive influences serving to encourage investor activity. The growing stature of childcare as an investment class has coincided with the burgeoning availability of funds from both institutional and private markets seeking secure returns in a low interest rate environment.

High underlying land values are also a significant driver of childcare sales which further underpins the investment and contribute to longer term security of the asset.

Burgess Rawson on-market childcare sales

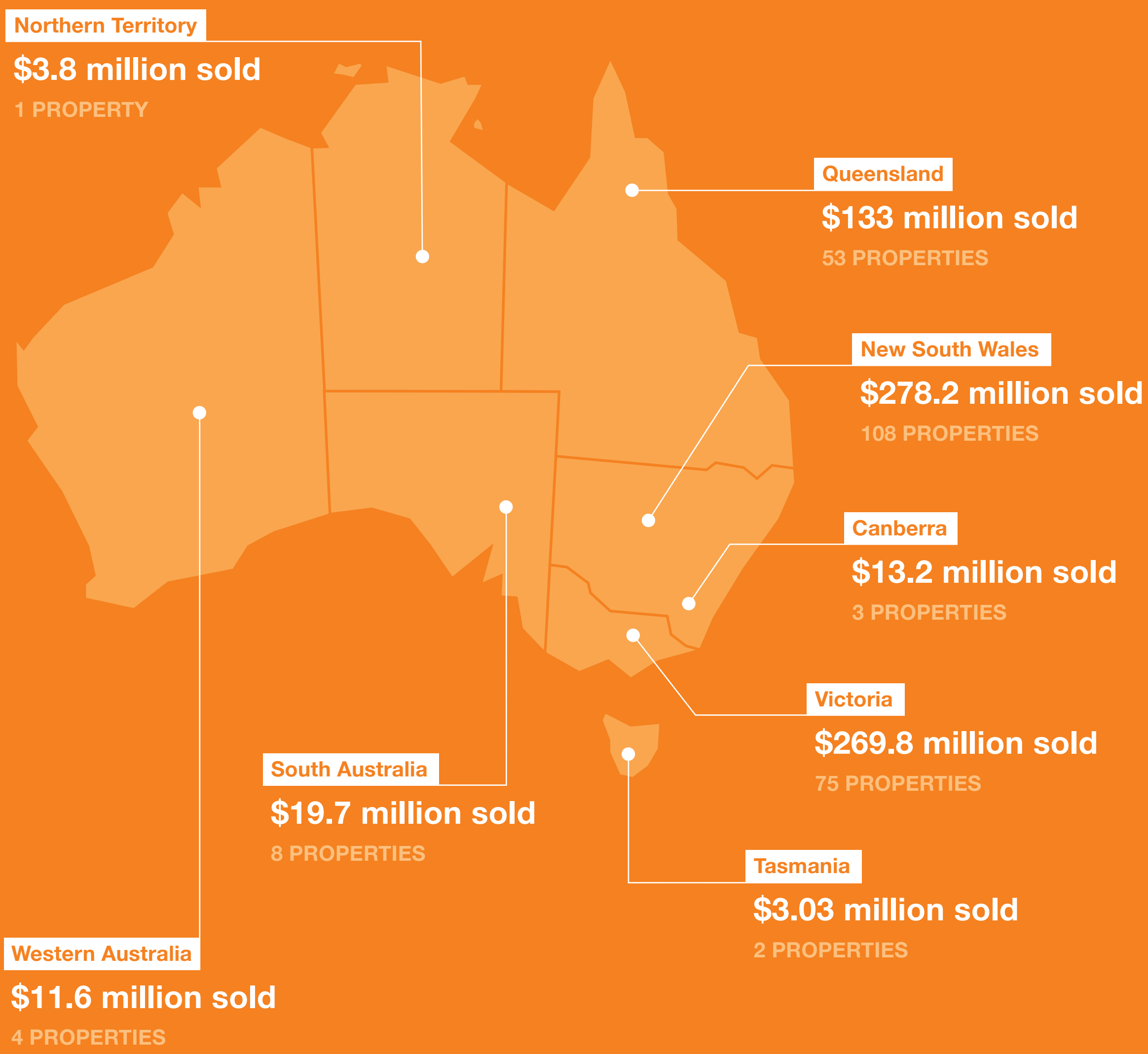
The sales history below shows that despite increased supply, compressed yields and greater price volumes, demand levels remain very strong for childcare investment property. Therefore equilibrium, where demand is met, in our opinion has not been reached. We see this trajectory continuing into the foreseeable future.

Total Number of Sales vs Average Yields (Australia-Wide)
Burgess Rawson Sales Only



Where is the Transactional Activity?

The Burgess Rawson childcare team has been active in every State and Territory, with the vast majority of the sales across the Eastern Seaboard.



Asset Management

Looking after your assets

Childcare can sometimes be viewed as a set-and-forget property class, however with constant consolidation landlords are receiving greater and more complicated tenant requests for landlord works, assignment of leases and lease variations. Quality property management is imperative to protect your investment.

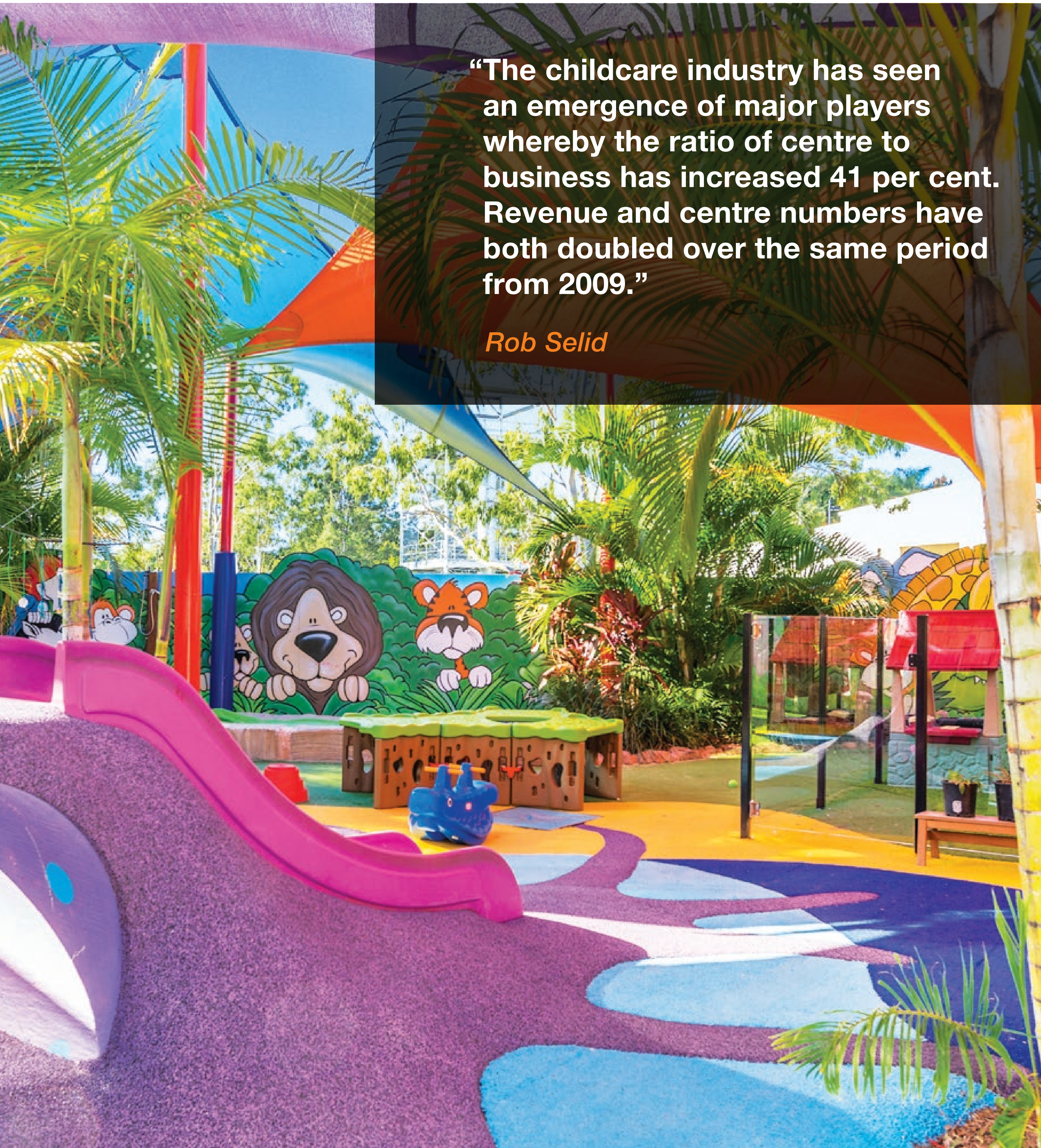
Ongoing management is also vital for proper representation at market reviews, negotiation and ensuring compliance with legislation. Many older leases have obsolete rents due to the multifaceted changes within the industry. This represents an opportunity for landlords if managed correctly.

Burgess Rawson manages in excess of $200 million of childcare assets across Australia as part of a $3.1 billion management portfolio. The dedicated teams can provide expert knowledge and advice regarding leases, compliance, landlord works and tenant requests.

Purchasing the property is the start of the journey. Good management will invariably underpin and increase value, seek opportunities for growth and protect returns.

Burgess Rawson offers solutions and expertise for childcare vendors, investors and developers, with a breadth of knowledge that encompasses everything from development sites through to leased investments with long term, established tenants.

Burgess Rawson services include not only direct asset management but also leasing, valuations, development feasibility and tenancy co-ordination, ensuring a full service offering for our clients.



> "The childcare industry has seen an emergence of major players whereby the ratio of centre to business has increased 41 per cent. Revenue and centre numbers have both doubled over the same period from 2009."
>
> *Rob Selid*

Burgess Rawson Childcare Highlights 2018

Buddies Early Learning

Glen Huntly VIC | Yield 5.38%
SOLD March 2018 $7,350,000

G8 Education

Thornton NSW | 5.41% Yield
SOLD June 2018 $3,660,000

Little Flyers Childcare

Caroline Springs VIC | Yield 5.43%
SOLD May 2018 $4,910,000

Kin Kin Childcare

Murray Bridge SA | Yield 6.71%
SOLD May 2018 $1,530,000

Happy Hippo Kindergarten & Childcare

Brunswick VIC | Yield 5.42%
SOLD April 2018 $7,375,000

Think Childcare Limited

Yanchep WA | Yield 6.47%
SOLD January 2018 $4,430,000

KIDS ELC

Capalaba QLD | Yield 6.00%
SOLD May 2018 $4,975,000

Burgess Rawson
Childcare Highlights 2018

Best Kidz Early Learning Centre

Alfords Point NSW | Yield 5.20%
SOLD March 2018 $3,270,000

G8 Education

Roxburgh Park VIC | Yield 5.75%
SOLD June 2018 $2,670,000

Deakin School for Early Learning

Deakin ACT | Yield 5.80%
SOLD February 2018 $5,275,000

C&K Childcare & Kindergarten

Strathpine QLD | Yield 5.90%
SOLD May 2018 $6,000,000

Elements Childcare

Geelong West VIC | Yield 6.34%
SOLD June 2018 $5,450,000

Affinity Education Group

Swan View WA | Yield 6.10%
SOLD February 2018 $1,200,000

Go Kindy

Rutherford NSW | Yield 6.13%
SOLD March 2018 $3,375,000

What You Need to Know

Long Term Ownership

Experienced property investors look to the childcare sector for long term investments, low-risk purchases that will deliver significant returns over time. As investments childcare tick all the boxes, with quality tenants, exceptional lease terms and consistent returns, while also attracting considerable government funding and support.

Childcare operators invest in their facilities and almost invariably seek long term leases to maximise their own returns and secure their business value.

For investors, this often means leasing agreements spanning a decade or more, with many leases including options to extend for more than 20 years.

This investment class provides certainty and security while the asset appreciates in value.

How to buy one

Properties leased to childcare operators are sold both privately and at auction.

Burgess Rawson sells the majority of the stock available in Australia. Many of these properties are transacted through our iconic Investment Portfolio Auctions.

Often more than 10 childcare centres are successfully auctioned nationally at our Burgess Rawson Portfolio Auctions, held every six weeks.

What you'll pay

Childcare centres have a wide ranging price point dependent on rent, location and operator. Investments can be accessed from less than $1 million up to more than $20 million.

This opens the market to a wide range of investors and budgets.

Rental returns

Key influencers of rental income on childcare are as follows:

- Number of places the centre is licensed for, generally larger centres can achieve better economies of scale
- Location and accessibility
- Land size and value
- Fees and occupancy of the centre
- Competition
- Zoning
- Age and design of the centre
- Quality of the tenant

What Does the Future Hold?

Key pillars of the sector are government funding, demand and growth of workforce participation. Substantial growth is forecasted in Federal budgets and population growth. There is a clear economic benefit to higher workforce participation and government policy will continue to support an industry that drives this.

We will see more industry consolidation as a key factor into the future. This consolidation will create stronger players who will underpin intrinsic values for childcare investors through yield compression.

Potential key impacts to the industry will be government planning controls to ensure smart buildings, which meet the individual community needs without a market saturation. This will increase values of coveted locations and existing sites.

Pipeline supply of new centres will drive performance measures of business. There is a strong sense that this next period will be defined by operators' willingness to disrupt and rethink their operations. The supply will also moderate the ferocity with which the lease deals have been struck and we predict a return to normalcy of lease fundamentals.

Centre occupancy rates will generally be lower over time as the pipeline of new centres and increased competition enters the market. This will drive changes by operators in the industry to seek costs savings and create performance efficiencies.

Burgess Rawson are experiencing a 39 per cent increase in sale and leaseback by operators. This type of ownership model allows operators to concentrate on their core business and unlocks capital for future expansion strategies while de-risking their future nest eggs. We see this trend continuing throughout 2018 and growing in 2019.

A Final Word from Our Childcare Specialists

The unprecedented growth and focus on childcare assets has led to the formation of a dedicated Childcare Team at Burgess Rawson. Our committed team has led to our agency being the undisputed market leader in this asset class.

Adam Thomas | VIC/SA/TAS
Childcare Specialist | 0418 998 971

"Current market yields are trending between 5.5 and 6 per cent which continues to represent exceptional value for properties with strong fundamentals, such as lease covenants, tenure and favoured locations."

Michael Vanstone | NSW
Childcare Specialist | 0403 580 528

"Childcare centres are resistant to digital disruption and are an essential societal need underpinned by strong government support."

Natalie Couper | VIC/SA/TAS
Childcare Specialist | 0413 856 983

"In the last six months the market has seen a clear flight to quality with operators divesting under-performing assets and replacing them with higher performers, whilst still increasing the size of their overall network."

Jamie Dewe | QLD
Childcare Specialist | 0410 350 273

"Landlords are favouring childcare assets because tenants are constantly improving their offerings, driven by competition. G8 this year completed over 107 air conditioning upgrades, 101 painting upgrades, 17 flooring upgrades and 16 playground upgrades representing a capital investment of $17 million. This is direct landlord value."

Guy Randell | ACT
Childcare Specialist | 0430 272 999

"Burgess Rawson research indicates that operators can run at 11 – 13 per cent occupancy costs."

Rob Selid | WA
Childcare Specialist | 0412 198 294

"The childcare industry has seen an emergence of major players whereby the ratio of centre to business has increased 41 per cent. Revenue and centre numbers have both doubled over the same period from 2009."

Our Team

Burgess Rawson has specialists in all sectors across Australia.

Melbourne


Ingrid Filmer
Director | Management
0413 860 312


Billy Holderhead
Director | Sales
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Shaun Venables
Director | Sales
0411 860 865


Raoul Holderhead
Director | Sales
0413 860 304


David Mark
Director | Leasing
0413 860 316

Sydney


Darren Beehag
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Kieran Bourke
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0429 103 979


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