August 2021

Research

Australian Child Care Market Update

Contents

01. Overview

Australian child care real estate is supported by an underlying industry that has experienced strong growth over the past decade. Demand for child care services has been overwhelmingly driven by the rising female workforce participation rate alongside an increasing number of children with two working parents.

There are approximately 1.2 million children of all ages in child care services across Australia. According to the Department of Education, the proportion of children under the age of five attending a child care centre has risen from 39% in 2011 to 45% as of December 2020.

The Australian child care market has been a sought after real estate investment class over the past five years, with favourable demographics and increasing utilisation rates helping to stimulate investor appetite. Over AUD 1.8 billion of child care assets have transacted since 2015, with 2021 year-to-date (YTD) sales volumes rebounding to already surpass total sales volumes for 2020. Over AUD 170 million of assets have exchanged over the six months to 30 June 2021.

Recent sales in 2Q21 have continued to demonstrate the strength of the market, with initial yields averaging 5.33% nationally (including metropolitan and regional assets).

Child care assets present attractive lease structures for investors. Currently, many operators are seeking longer leases (typically 15-20 years), due to an increased operator focus on quality centre fitouts. Recently, Charter Hall Social Infrastructure REIT agreed to 20-year leases with fixed annual increases on 48 properties across their portfolio to major operator 'Goodstart'. Similarly, Arena REIT has recently renegotiated 87 leases to Goodstart, extending lease terms to 25 years.

The investable universe of Australian child care real estate is estimated to be approximately AUD 28 billion. Small individual asset sizes have enabled a broad range of investors to participate in the market, enhancing liquidity. A-REITs account for approximately 7% of the investable universe, with the remainder owned by a variety of private investors, syndicates, funds and owner-operators.

Like many industries, the child care sector has faced challenges throughout the global COVID-19 pandemic, with the industry experiencing reduced enrolment and attendance numbers, temporary closures of individual facilities and reduced fee revenue. However, the Department of Education reported that attendance at centre-based day care returned to pre-COVID levels, as of December 2020.

Growth in the Australian child care sector has undeniably been supported by government initiatives. Child care services were declared an essential service by the Australian Government at the beginning of the pandemic, with the federal government providing a AUD 2.6 billion relief package to ensure child care facilities remained open to essential workers.

Recent announcements in the federal 2021/2022 budget are considered substantial and are expected to support underlying demand for child care services going forward. The package will increase the affordability of child care for low and middle income families. It is estimated that the extra support will enable Australian parents to work an additional 300,000 hours per week in total; equivalent to approximately 40,000 people working a full extra day a week.

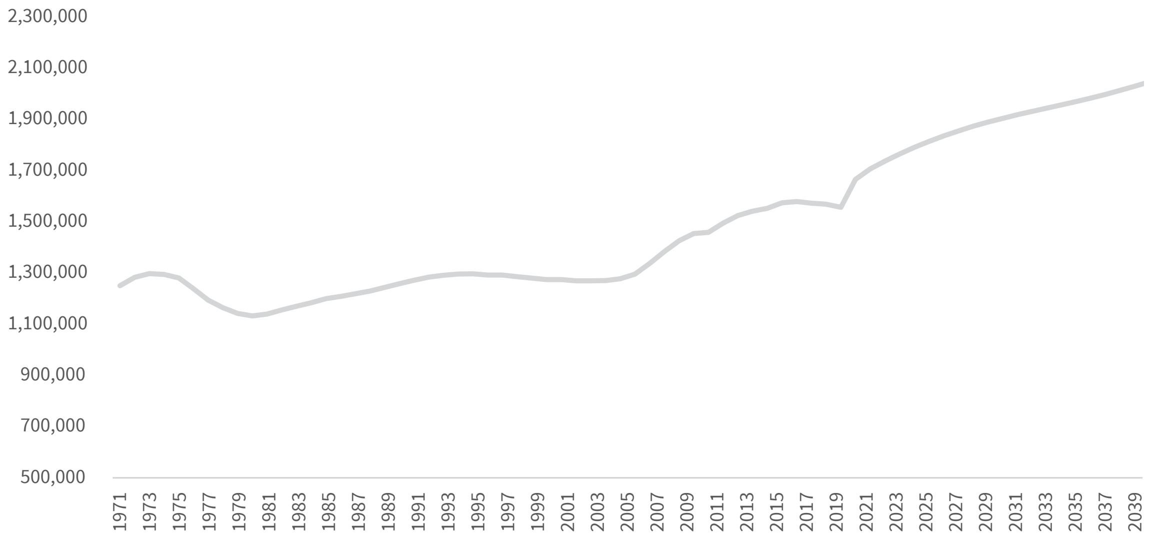
02. Demographic Drivers

Demand for child care services has been largely supported by three key demographic factors:

- Growth in the number of children aged 0-4
- Rising female participation in the workforce
- Growth in the number of two-working-parent families

Over the past decade, the number of children aged 0-4 has grown on average by 0.7% per annum. This age group comprises the highest number of children in long term centre-based day care. Currently, there are 1.67 million children in this age group across Australia. Over the next decade (2021 to 2031), this age group is expected to grow by 1.4% per annum, equating to an increase of around 240,000 children. It should be noted that some uncertainty remains around Australia's international border re-opening and the impact on migration-driven growth.

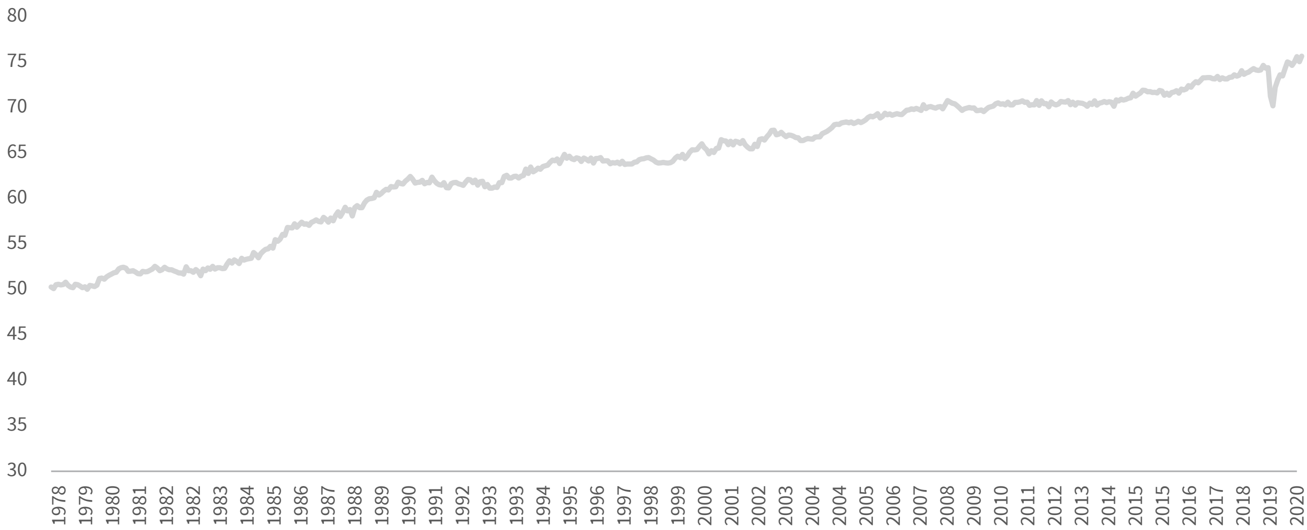
Figure 1: Number of children aged 0-4



Source: ABS

Societal shifts have led to rising numbers of women in the workforce rather than maintaining traditional full-time home-maker roles and the likelihood of more grandparents favouring active lifestyles over providing ‘free child care’. Female workforce participation has continued to steadily improve, even in the last decade. The female participation rate has gradually increased from 50% in 1978 to 70% in 2010 and up to the current high of 75% as of May 2021.

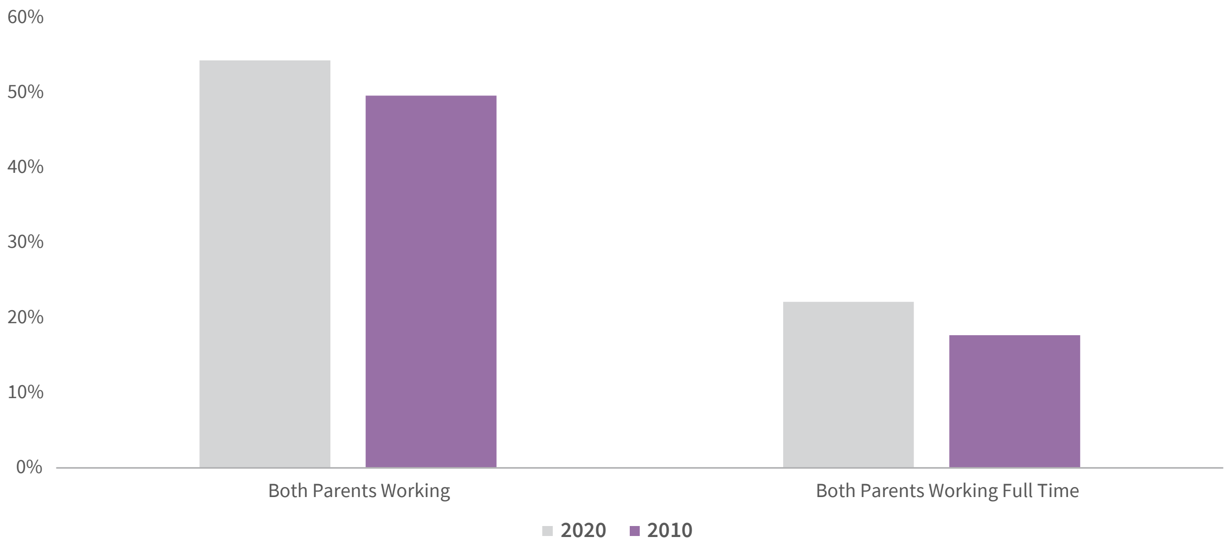
Figure 2: Female workforce participation rate



Source: ABS

Demographic data also suggests that the number of families with two working parents have increased. In 2010, 50% of two-parent families with dependents had both parents employed and 18% had both parents working full time. As of 2020, 54% of two-parent families with dependents had both parents employed and 22% working full time. The rising number of two-working-parent families has been driven both by aspirational motivations and also the need to support household income in a low wage-growth environment, while residential prices and other lifestyle costs continue to grow at a greater pace.

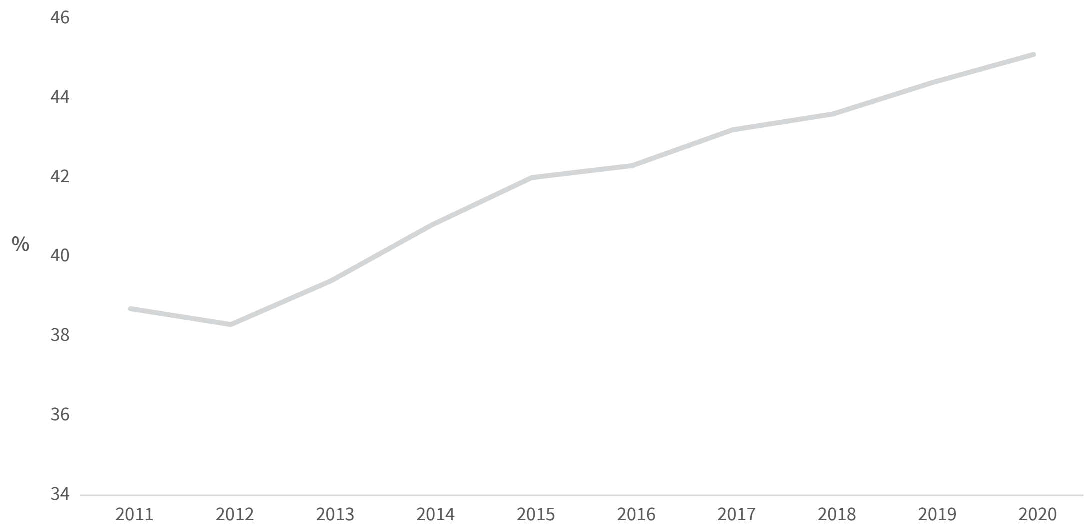
Figure 3: Two-working-parent families



Source: ABS

As a result of these demographic drivers, the proportion of children attending child care centres has risen significantly over the past decade. According to the Department of Education, the proportion of children under the age of five in child care centres has risen from 39% in 2011 to 45% in 2020.

Figure 4: Proportion of children in child care (0-5)



Source: Department of Education

03. Child Care Subsidy Explained

The Australian Government has announced changes to child care subsidy as part of the 2021-2022 budget, with the changes coming into effect in July 2022. The changes will increase subsidy amounts (percentage claimable) for families with more than one child in care under the age of six and remove the annual cap on the total amount claimable. The package will provide an additional AUD 1.7 billion support to the child care industry over a five year period.

The child care subsidy changes form a major part of the government's Women's Economic Security Package, which is aimed at supporting more women getting back into the workforce after having children.

The package will increase the affordability of child care for low and middle income families, with it estimated that 250,000 families will benefit from the subsidy, saving an average of $2,200 each year. Annual caps will also be removed, which is estimated to add as much as 300,000 hours of work per week for Australian parents; equivalent to approximately 40,000 people working a full extra day a week.

The previous child care subsidy policy came into effect on 2 July 2018, providing a single means tested payment directly to child care operators with the highest rebate amounts going to the lowest income families. The subsidy amounts vary by income, hours worked or studied, and the type of child care used.

Child care affordability remains a key issue for many Australian households, even with the recent child care subsidy announcements. According to the Mitchell Institute, child care services remain unaffordable for more than 40% of low and middle income families in Australia.

As reported by the OECD, Australian parents have been paying approximately 24 per cent of their combined income towards child care, compared to the global average of 14 per cent. New Zealand child care remains the most unaffordable, with parents outlaying 37% per cent of their combined income, followed by Switzerland (32%) and the UK (30%). In comparison, Norway (8%), Sweden (5%) and Finland (18%) have high levels of government funding on child care resulting in families paying a significantly lower proportion of their income. Countries with higher child care affordability tend to have greater uptake of services. In Norway and Sweden, 57% and 47% of children under the age of three attend an early childhood education or care service respectively, above the OECD average of 26%.

The issue of affordability will remain a key issue for governments. Improving child care affordability is expected to have a positive flow-on effect on real estate markets through boosting enrolment numbers and subsequently expanding the investable universe.

04. Types of Child Care Services

There are approximately 1.2 million children in child care services across Australia. There are multiple types of child care services for children under 12 years of age which can be approved by the Department of Education. These services receive and pass on the relevant government child care subsidies.

Centre-Based Day Care

The majority of child care real estate assets are tenanted by centre-based operators under current classifications. Centre-based day care includes long day care and occasional care, as well as pre-schools and kindergartens in some states. Care is provided across centres either all day or on a part-time basis and may offer educational or development programs as part of their services.

Family Day Care

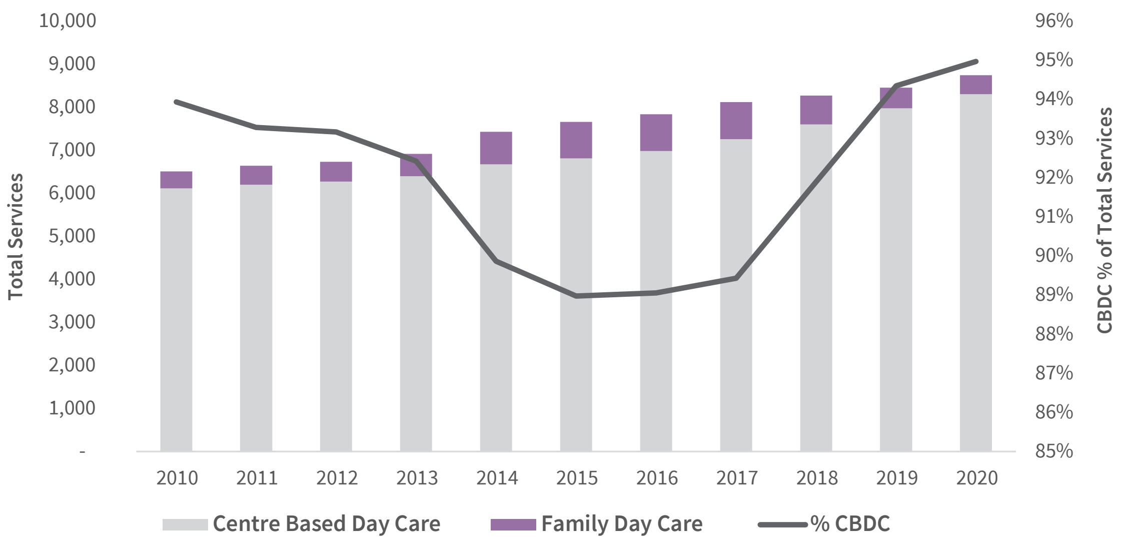
Family day care is provided in an approved educator's home either all day, part time, occasionally, before and after school and during school holidays. Family day care centres are often located in regional areas where fewer long day care centres are available.

Outside School Hours Care

This includes care provided to school-aged children, before or after school during the school term. Vacation care is also included, providing care services during school holidays.

The number of family day care services has decreased rapidly over the past few years, decreasing from 858 in 2017 to 440 in 2020. Preference remains for centre-based child care services which still dominate the market, accounting for around 63% of all approved services nationally.

Figure 5 - Total Australian child care services by service type, 2010-2020



Source: JLL, Department of Education

05. Major Operators and Covenant Features

The large number of participants in the Australian child care sector is reflective of the relatively low barriers to entry. The industry remains relatively fragmented across community groups, not-for-profit, private operators, local councils and large employers.

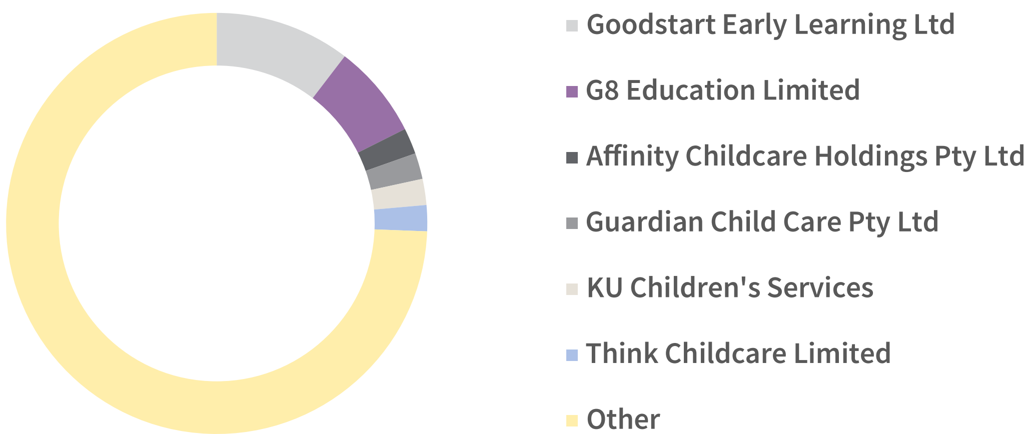
According to Australian Children's Education and Care Quality Authority (ACECQA) data (March 2021) small approved providers (managing one service) provide 37.0% of approved child care services across the country, while large approved providers (managing 25 or more services) provide 34.0% of approved services.

The two largest players in the market are Goodstart Early Learning, which operates on a not-for profit basis, and G8 Education (GEM), an ASX listed company. Collectively these two operators have an estimated market share of 17.6%, while the industry's top four players account for less than 30% of revenue (2020-2021).

Major operators are typically seeking 15-20 year leases with further 15-20 year options. New lease terms under 10 years are becoming less common with operators investing more capital into quality fitouts. Recently, Charter Hall Social Infrastructure REIT agreed to 20-year leases with fixed annual increases across 48 centres to a major operator – Goodstart. Similarly, Arena REIT renegotiated terms for 87 properties in their portfolio leased to Goodstart, increasing lease terms by 25 years in addition to the installation of solar renewable energy systems.

Child care centre rents are typically measured on a per place (child) basis. While older stock or home conversions yield $1,500 per place per annum, new purpose-built facilities can achieve around $6,000 to $7,000 per place per annum across major markets.

Figure 6 - Major operator market share

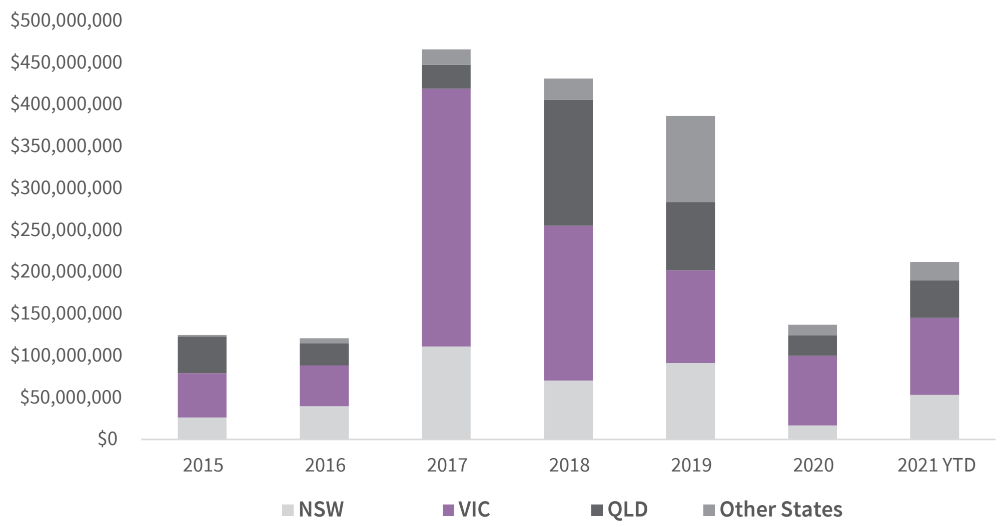


Source: IbisWorld

06. Investment Market

The Australian child care market has become a more desirable asset class over the past five years, with favourable demographics and increasing utilisation rates helping to stimulate investor appetite. Transactions volumes were high between 2017 and 2019 prior to the major disruptions of COVID-19 in 2020. The government classified child care as an essential service throughout the pandemic, highlighting the importance of the sector and increasing interest amongst investors looking to diversify their portfolios. The start of 2021 has seen YTD transaction volumes already surpass the volume traded in 2020, with over AUD 220 million of child care assets exchanging to 30 June 2021.

Figure 7 - Total child care transaction volumes



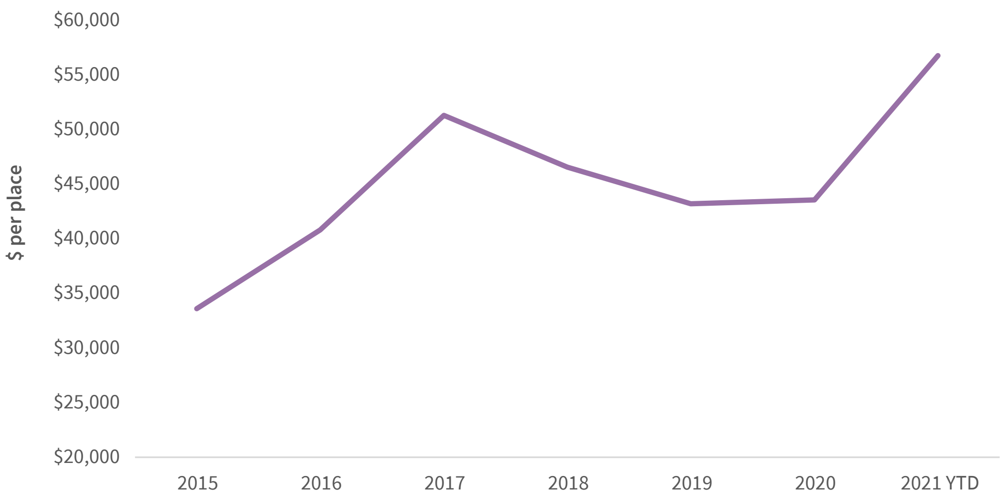
Source: JLL

The high watermark year for transaction volumes was 2017 (AUD 465 million), with 96% of sales occurring across the Eastern Seaboard. Since 2017, 89% of transactions have occurred across the eastern seaboard states, with investors particularly Victoria-centric in 2017 and 2018. Preference for metropolitan centres continues to drive the market, with approximately 65% of transactions since 2019 occurring in metropolitan locations. Increased demand from larger investors and institutions have supported transaction volumes with recent multi-asset acquisitions by HomeCo, Primewest and Assembly Funds Management.

Increased demand throughout 2017-2018 resulted in an increase in the average rate per place in transactions. Sales rates per child care place have steadily increased since 2015, growing by 68.9% from $33,598 per place to $56,750 per place. Sales rates are peaking nationally in 2021 YTD, previously, the strongest sale was in 2017 at $51,290 per place.

The strongest sales rate in 2021 to date has been at 4-8 Ramsay Road, Five Dock, NSW which was sold at $106,250 per place. The centre is licenced for 96 children and is leased to Greenwood Early Education.

Figure 8 - National average rates per child care place



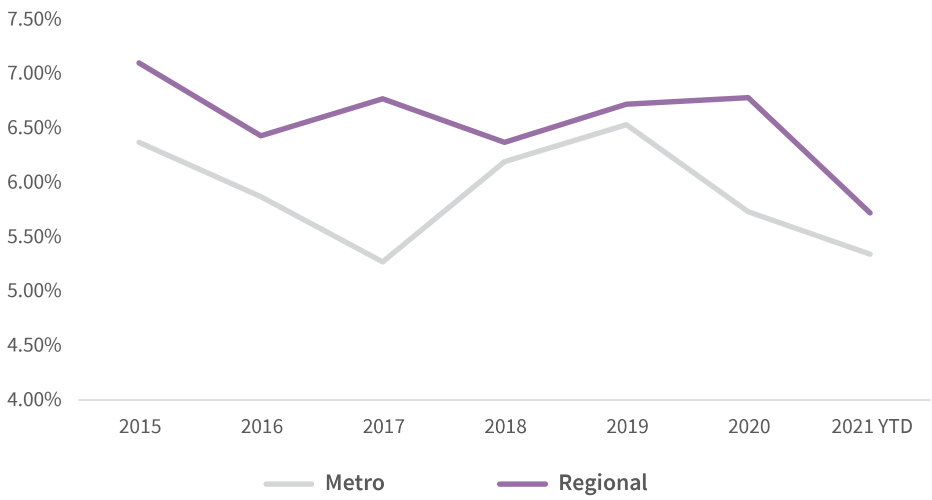
Source: JLL

This price growth has been primarily driven by yields across the child care sector, having continued to compress for both metro and regional assets over the five year period from 2015 by an average of 115 basis points to 5.34% in 2021 YTD. Increased investor demand, accessible price points, low borrowing costs and strong, long-term lease covenants have contributed to this yield compression. Notably, there was evidence of short-lived expansion in 2018, where buyers were likely to have priced in the increased risk of perceived oversupply during this period.

The yield spread remains wide across the sector, reflecting differences in asset quality, size of centres, lease covenants and individual asset level competition. Metropolitan yields in Sydney, Melbourne and Brisbane have compressed to an average of 5.26% in 2021 YTD, with regional yields for the respective states reflecting an average of 5.48%. Regional assets are typically priced at the softer end of the yield range due to their inherently higher risk profile.

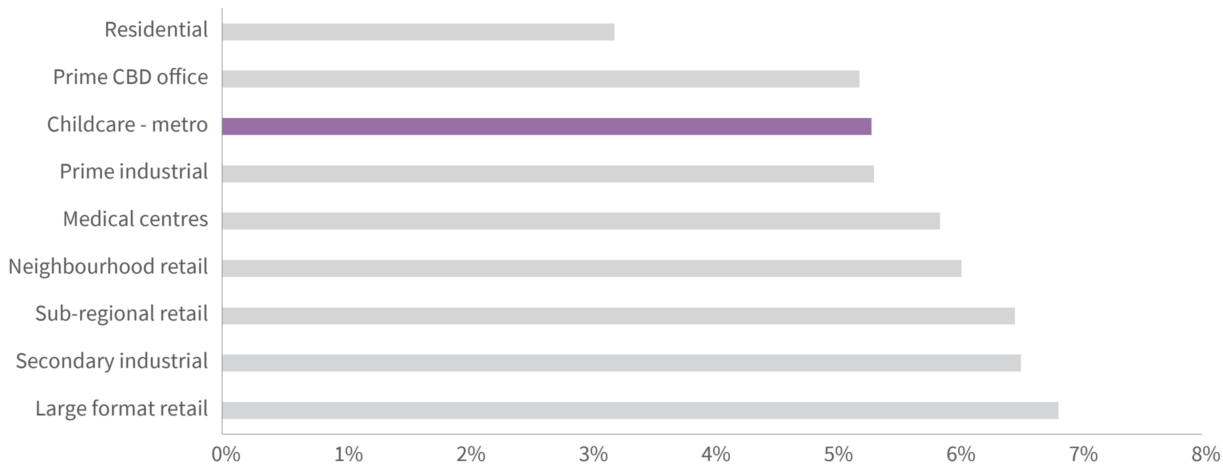
Sales in 2Q21 have continued to demonstrate the strength of the market, with yields averaging 5.33% across all assets sales (including metropolitan and regional). Yields as sharp as 4.40% have been recorded across multiple sales in June 2021. Figure 10 shows where metropolitan child care yields currently sit relative to other real estate sectors. Strong compression over the past 12-months relative to other commercial sectors have pushed yields to the tighter end of the range.

Figure 9 - Child care initial yields (metro vs. regional)



Source: JLL

Figure 10 – Metropolitan yields across key sectors



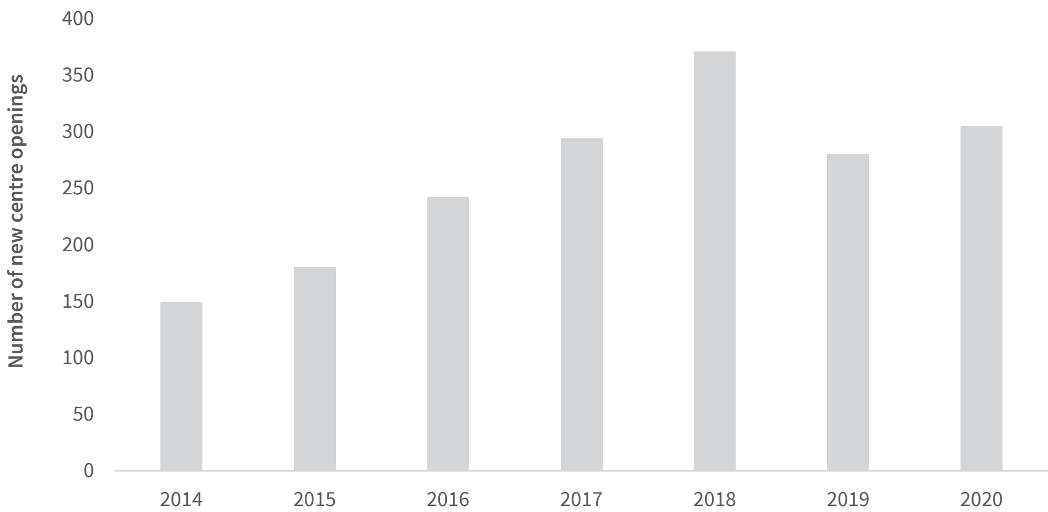
Source: JLL, Corelogic

07. Is oversupply still an issue?

In recent years there has undeniably been mentions of perceived 'over supply' regarding the child care sector. New child care centre openings reached a historical high in 2018 with 371 centres opening across Australia. However, the number of new centre openings have moderated in 2019 and 2020. Given variations in fee growth across major cities, it is evident that there are pockets of both over and under supply. Average hourly fee growth in 2020 ranged from -6.6% to +10.3% across precincts[1] in major metropolitan markets, reflecting the disparities in supply/demand balance across precincts. The moderation of new completions is likely to have been driven by lower construction commencements on the back of perceived market-wide oversupply by developers/owners and also from changes to the ACECQA National Quality Framework in 2018. The framework has overall raised centre-quality standards and increased barriers to entry for some operators.

The relatively small physical scale of many child care assets means that projects can activate quickly, making it difficult to project completions beyond the next couple of years. JLL has identified at least 320 active child care projects that are at advanced stages in the development pipeline – these are under construction, have plans approved or have plans submitted to the council. A number of these centres will form part of broader, mixed use developments which also include retail, commercial or residential uses. Overall, the majority of these new child care centres will be located in NSW (38%), VIC (27%) and QLD (20%).

Figure 11 - Child care openings by year



Source: Department of Education

[1] The Department of Education measures fee growth by SA3s (precincts of up to 130,000 residents)

08. Major States Focus

Major markets: key statistics

	NSW	VIC	QLD
Percentage of children in child care	33%	22%	24%
Total number of centre-based child care services	3,339	1,762	1,703
Total population aged 0-4 per centre-based child care service*	147	222	183
Forecast 0-4 population growth (2021 to 2041)	21%	26%	27%
Average hourly fees	$10.80	$10.85	$9.80

Source: Department of Educations Skills Employment, ABS
*includes children not attending and attending child care services

New South Wales

New South Wales (NSW) has the largest child care market in Australia with the highest percentage of children using an approved child care out of all states and territories. One-third of children in NSW use an approved child care service in comparison to 22% for VIC and 24% for QLD.

However, NSW has arguably dealt with the greatest supply concerns in recent years. NSW has the lowest ratio of population aged 0-4 compared to the number of center-based child care services. The relatively high number of centres per child in the target age group is somewhat reflected by the marginally lower average-hourly-fee across NSW centres compared to Victoria. Although NSW has dealt with the highest number of completions over the past five years, continued demand for services has been reflected by fee-hikes across certain locales.

Victoria

While supply has also been strong in recent years, Victoria has the lowest ratio of population aged 0-4 compared to the number of centre-based child care services. Victoria also has the highest average-hourly-fee across the states. Victoria has had the advantage of particularly strong population growth over the past five years, boosting the demand for child care services. Based on current population projections, growth in Victoria's 0-4 year age range is expected to outperform NSW over the next 20-years.

Queensland

Queensland has a large child care market with nearly the same number of centres as Victoria. However, Queensland has seen the lowest number of new openings over the past five years, supporting the values of existing stock. Queensland is forecast to have the strongest growth in children aged under four over the next twenty years out of the major states. Queensland has approximately 183 children aged 0-4 years per approved centre-based service, sitting between Victoria and NSW.

Top SA3s[1] for annual fee growth

Sydney	Melbourne	Brisbane
Rouse Hill - McGraths Hill 5.4%	Cardinia 3.8%	Everton Park 8.5%
Penrith 4.9%	Whitehorse - West 3.6%	Capalaba 5.4%
Wollondilly 4.6%	Dandenong 3.6%	Sunnybank 4.9%
Blacktown – North 4.3%	Maribyrnong 3.5%	Nundah 4.8%

Source: Department of Education (December 2020)

09. What’s next for Australian child care real estate?

Changing societal dynamics over 2020 have seen the emergence of a hybrid-working model and a higher proportion of people working from home. While this evolution will likely negatively impact demand for outside-school-care or care for older children, demand is anticipated to remain strong for the larger 0-4 age group in long day care that requires substantial hands-on care throughout the day.

Appropriate provision of child care services will remain essential to employee productivity whether employees are working at home or from the office. Employers are likely to increasingly address the issue of whether remote workers have adequate levels of child care support.

With perceptions of oversupply cooling over the past year and robust underlying demand, the outlook for child care real estate is compelling. Furthermore, enhanced subsidies as part of the 2021/2022 federal budget are likely to support child care operators as businesses.

A strong first half of the year for child care investment in terms of both sales volumes and yield compression demonstrates the high level of interest in the sector at present. Although desirable covenants are likely to continue to support pricing, modest yield compression is anticipated as the effects of pent up investment demand across most asset classes moderates.

Private investors are likely to remain the dominant buyer cohort while the sector remains in the early stages of institutionalisation. However, child care assets are anticipated to attract a broad range of investors looking to diversify their real estate holdings with the share of larger investors likely to increase. The challenges of asset aggregation from existing fragmented ownership within the market suggest that portfolios offerings are likely to achieve premiums. Portfolios are likely to remain highly desirable acquisitions to institutional investors looking to make scale purchases in the sector.

Major players in the sector are providing education services in addition to child care, highlighting the growing role of child care centres in providing early education and competing with the Preschool Education industry.

A key trend going forward is likely to be the incorporation of child care into retail and mixed-use assets. Many landlords are actively looking for child care operators to backfill retail space where physical structure suits. This trend may assist in further moderating the pipeline of stand-alone centres, subsequently supporting the values of existing stand-alone centres.

Merger and acquisition activity across the child care industry has been strong over the past few years, including the recently announced acquisition of Think Childcare by Busy Bees Early Learning Australia Pty Ltd. This merger activity is anticipated to continue over the next five years, with groups continually exploring expansion opportunities for both quality and scale of centres.

The two major A-REIT participants Arena REIT and Charter Hall Social Infrastructure Trust continue to dominate the industry, as the sectors largest institutional owners. The emergence of Home Consortium's HealthCo strategy, and Federation Asset Management's Federation Education REIT, has seen significant capital injected into the sector in the past 18 months.

Increased investment into child care real estate bodes well for the evolution and growth of the child care sector, with landlords likely to increasingly focus on the quality of their assets, ensuring they remain competitive and are able to maximise occupancy.

Institutional owners are likely to become increasingly selective in acquisitions, favouring newer assets supported by blue chip covenants. Potential multi-asset sale-and-leaseback offerings by owner operators are likely to be highly sought after amongst existing and new institutional participants in the sector.

Sector Specialists

Elisabeth Curtis
Senior Valuer - Alternative Investments
Elisabeth.Curtis@ap.jll.com
M +61 400 163 215

Louise Burke
Associate – Alternatives Research
Louise.Burke@ap.jll.com
M +61 408 5101 61

David Bruce-Clarke
Senior Director - Alternative Investments
David.Bruce-Clarke@ap.jll.com
M +61 411 505 297

JLL Alternatives Investments

Our growing **team of 20 specialists** help clients think strategically to anticipate the expectations of the next generation of investors and align real estate portfolios on the back of structural and demographic tailwinds. In emerging sectors which are set to grow exponentially in the coming years, we advise our clients on the most appropriate business model and structure, affordability and risks associated with investments. We provide our clients with intelligent solutions by combining our market-leading research with our advisory and transactional expertise. Through intelligent planning and sophisticated research tools, we can help clients align their vision with market expectations. JLL Alternative Investments provides a range of services including transactions, advisory, valuations, consulting and research.

We specialise in:

- Hospitals
- Medical Centres
- Retirement Villages
- Manufactured Housing Estates
- Aged Care Facilities
- Student Accommodation
- Build to Rent
- Renewables
- Data Centres
- Education
- Child Care Centres
- Specialist Disability Accommodation
- Co-Living

jll.com.au