Kindergarten plan may rescue flagging childcare sector [1]

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Federal Labor's mooted plans to reform negative gearing and capital gains tax may have scared the overall property industry, but its $1.75 billion scheme to fund kindergarten places for three year olds promises to be a boon for flagging valuations in the child care sector.

According to agent Burgess Rawson, the proposed scheme demonstrates a bipartisan approach to funding the sector which has been spooked by reports of oversupply.

"It's hugely significant," said Burgess Rawson associate director Adam Thomas. "There is some talk about oversupply but when you weight through the negativity ... the fundamentals are there because there is so much government funding."

In July the federal government's $3.5 billion Jobs for Families subsidy package came into effect, replacing two schemes that were less generous for most parents.

In June, the NSW government also announced a $200 million program to subsidise fees for three-year olds enrolled in community pre schools.

Peter Fanous, principal of the broker and advisory firm Peritus Childcare Sales said Labor's proposal was welcome, even though the measures were not slated to be effective until 2021.

"It's significant that government is treating child care as not just about child minding," he said.

Meanwhile, Burgess Rawson's 2018 report on the sector shows that volumes are tapering, but yields are hovering at steady levels of 5.5-6 per cent.

But problems are evident.

The second biggest operator behind the private Good Start, the listed G8 Education referred to "unprecedented" oversupply issues and consumer confusion over Canberra's funding changes.

"G8's occupancies were off a bit. That's bound to happen but the fundamentals of the industry remain very robust," Mr Thomas said.

As at the start of October, Burgess Rawson had sold 47 freehold child care properties worth around $174 million, compared with 79 for the whole of 2017.

The firm – which accounts for about 75 per cent of all sales in the sector -- handled 46 transactions in 2016 and 32 in 2015.

"We are still clearing most of the stock," he said. "There are still plenty of transactions before, during and after auction."

In 2017, yields in some isolated cases dipped as low as 3.57 per cent (in the case of a Vaucluse property tenanted by G8). But such ultra-low yields usually reflect the value of the underlying land for future residential purposes.

"Yields have come off slightly but that has happened in every property sector because of the (banking) royal commission causing banks to tighten lending criteria," Mr Thomas said.

In addition, local councils have tightened up on permit applications. For instance, Whittlesea council in outer Melbourne demands childcare centres to be built close to transport links or commercial and educational use.

Peritus Child Care Sale's Mr Fanous said industry conditions varied regionally because of factors such as income, female participation, unemployment and proximity to transport.

Even adjoining suburbs can have different dynamics: Sydney's West Ryde has more than double the number of long day care childcare places as neighbouring Eastwood: 442 compared with 189. Yet both areas have a similar catchment of under 5s: West Ryde's 1034 compared to Eastwood's 1089.

"There's a lot of noise in regards to oversupply and negative take up rates," Mr Fanous said.

“That is somewhat true, but a blanket approach to the sector is not right.”

Mr Fanous said the sector remains popular because valuations were underpinned by long tenancies of 15 to 20 years, annual rent reviews and triple net leases that made tenants responsible for all costs.

However the Melbourne based But Mayfield Childcare recently warned overenthusiastic new operators had pushed rents to an “unsustainable” $4000 per child, with typical fixed annual rent increases of 4 per cent over a ten year term.

The biggest holder of freehold childcare properties with a $900 million portfolio, Folkestone Education Trust reports “isolated pockets of oversupply but in small numbers.”

The landlord says new supply has abated to more sustainable levels after a period of required catch-up to cater for a boom in children in long day care.

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