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Australia's fertile ground spawns a childcare boom

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With a volatile sharemarket, minuscule deposit rates, and looming apartment oversupply in key capital cities, childcare centres have emerged as something of an investment haven.

Routinely, when a childcare centre comes onto the market in what is considered a 'good location' in a major capital city, it can now attract up to 60 buyer inquiries.

A Queensland-based online childcare broker claims to have 9,000 potential buyers currently on its books — the highest number yet.

Most are small private investors seeking a bricks-and-mortar investment that will give them stable returns and potential strong capital gains.

Such is the level of demand that, according to at least one broker who spoke to Business Spectator, developers are selling childcare centres 'off the plan' after obtaining development approvals.

These investors are paying a premium to secure such centres, which may not be built for another one or two years, he says disapprovingly.

Andrew Parker, principal of Sydney Childcare Sales, says some investors are "being silly and paying over the top" for childcare centres, and that they are not differentiating between leasehold and freehold properties.

Says Sydney childcare broker, David Ferguson: "When we advertise a centre for sale in a good area, like the Hills District (in Sydney's north west), we will get up to 50-60 inquiries and the centre will be sold within a couple of days."

Even in less popular areas, for-sale advertisements typically attract 20-30 inquiries.

Prices range upwards of $1.5 million to $4m for bigger centres in high sought-after locations, like inner-city suburbs favoured by young families.

There are some 6,700 childcare centres in Australia, but it is a fragmented industry.

Listed companies are competing with small owner-operators and small private investors for whatever comes to market.

"I have been told that some investors are prepared to accept yields of as low as 2-3 per cent just to get into the market," one leading property market researcher told Business Spectator.

Industry experts say that acceptable returns should be at least 4-5 per cent.

Nesha O'Neill, NSW president of the not-for-profit Australian Childcare Alliance, warns investors to be careful and not to overpay.

The demand for childcare is not uniform across the country. Like everything else, it is about supply and demand.

O'Neill says there are too many childcare centres on the Gold Coast and in parts of Sydney, such as Liverpool, where available land is relatively cheap.

She also questions the wisdom of accepting a 2-3 per cent yield from childcare centres and suggests that investors should consider other investment options.

The reality, however, is that most of the options no longer look attractive.

The demand for childcare centres does not surprise Nick Anagnostou. As chief executive of the listed Folkestone Education Trust, he plays no small role in creating awareness of the sector among investors.

Childcare centres are seen as an affordable commercial investment for a small investor who has $1.5m-$2.5m to spend.

"With that kind of money, they can buy a small retail shop, a strata-titled office, up-market residential or a small industrial building," he says.

But each of these sectors faces its own set of headwinds in an uncertain world, where the promise of stable income for the long term can prove illusory.

Take residential investment, the most popular choice among real estate investors. The outlook for rental growth and capital gains is no longer as rosy as it was two years ago.

According to CoreLogic RP Data, residential rental growth in September (latest figures) was the slowest in two decades. The forecast suggests the trend will continue.

This is because an ongoing apartment construction boom across Australia's capital cities, coupled with slowing population growth and low mortgage rates, is making home purchases possible for more renters at a time of heightened investor activity in the residential sector.

Anagnostou says owning traditional forms of real estate has its problems. Small tenants are constantly complaining of slow retail sales and they seek rent-free periods and other incentives to sign what are usually short-term leases. That doesn't occur in childcare.

There also seems to be a change of use of shops every five years: they go from being coffee shops to milk bars, fashion outlets, convenience stores and so on. This constant churn is a concern for small investors.

The Folkestone Education Trust, one of the best-performing listed REITs, sells about 15 childcare centres a year as it refreshes its portfolio — the largest in the country — to mostly small investors.

Anagnostou sums up why investors are increasingly drawn to childcare centres.

"They are located on land zoned for residential use. Our sites have versatility for alternate uses. If in say 15 years' time, when it might no longer viable to run a childcare centre, they can be used for residential development."

Land value of childcare centres typically makes up 60-70 per cent of the overall value, Anagnostou says. This means that on a $2m investment, the potential land value is $1.2m-$1.4m. “With land values doubling every 8 to 10 years you could have a site alone worth $2.4m,” he says.

The childcare industry is driven by demographics. Today, 7 per cent of Australia’s population (around 1.1 million) is made up of children.

Research by Folkestone Education Trust research shows the number of children aged 0-4 has grown 17 per cent in the past decade.

This age group is forecast to rise by 34.4 per cent across the Sydney, Melbourne and Brisbane metropolitan areas over the next two decades.

Demand for childcare is growing exponentially because two incomes are increasingly needed to support home ownership in capital cities.

Anagnostou says the Commonwealth Government is seeking to increase female participation in the workforce. If the participation rate can be increased by just 6 per cent, it’s expected to lift the country’s GDP by $25 billion a year. “Childcare then pays for itself.”

Successive governments have offered childcare support to families. The current subsidy is up to 50 per cent of the cost of childcare.

Although it is true that Australians are increasingly outsourcing childcare to professionals, government support cannot be taken for granted.

O’Neill says that as the government look for ways to cut its deficit, it could impose tighter rules on childcare subsidies.

More than buying a piece of real estate, Parker says, investors have to look at the lease and understand the strength of the leaseholders (the operators).

Many of those currently in the business do not yet have proven track records running childcare centres.

Investors have to understand that if their leaseholders (operators) fail, they need to have the wherewithal to go in and run the business at short notice.

And if they are going in for capital appreciation, they need to hang in there for quite some time to get in front.