Child's Play

CHILDCARE CENTRES ARE BIG BUSINESS IN NEW ZEALAND AND RIGHT NOW IT'S A SELLER'S MARKET AS DEVELOPERS AND INVESTORS SEEK TO CAPITALISE ON THE DEMAND. TOTAL PROPERTY IDENTIFIES THE KEY GROWTH AREAS.

ON ANY GIVEN workday, up to 60 children are running around Lollipops Educare Birkenhead in Auckland's North Shore. The childcare provider offers on-site day care and pre-school programmes for children up to five years old, and is viewed by parents as an essential to their lives and the community. The split-level centre, which sits on a 634m^2 section and is leased to Lollipops' parent company, Evolve Education Group, for 15 years, recently sold for $2.53 million at a 5.3 percent yield.

The price the property commanded is by no means unusual. A 270m^2 purpose-built childcare centre on 900m^2 of land in Hillcrest, Auckland, sold for $3.01 million at a 5.5 percent yield, while a 348m^2 centre on 1,090m^2 of freehold land in Otahuhu achieved $2.75 million at auction with a 5.75 percent yield. And a vacant 916m^2 freehold site in Birkdale with resource consent for the development of a childcare centre sold for $1.1 million.

Early childhood education (ECE) is all the rage in commercial property, with investors looking to capitalise on the surge in demand for places at childcare centres.

ECE is big business in New Zealand, and it's not just the major players who are reaping rewards, with the majority of ECE centres in New Zealand - more than 85 percent - run by small independent operators, who might own one or two and be licensed for less than 50 places.

The sector is viewed as more secure than other asset classes, because of not only the strength of the leases involved but also New Zealand's high childcare participation rate.

HIGH DEMAND

Since 2008, the proportion of children enrolled in ECE has risen from 93.6 percent to 96.6 percent, while time spent in ECE has reached an average of 21.7 hours a week, up from 13.5 hours in 2000.

Charges vary but the average hourly rate is $5-$6, with parents paying between $150 a $350 a week.

The required staff to child ratio for ECE varies on the service type, age of children and whether the service is sessional or all day. For example, the minimum staffing for children less than two years old requiring all-day care will range from one to five,

depending on the number of children.

Public funding for the sector is reliable and secure, rising from $860 million in 2008 to almost $1.63 billion. The Government, which fully funds 20 hours of care a week for all children aged three and four, committed an extra $396.9 million in last year's budget to fund care for an extra 14,000 children by 2019/20. It's stated goal is 98 per cent of children attending an early childhood service before starting school.

Population growth is also a key determining factor. Auckland's 1.5 million population is expected to grow by half a million within the next 10 years, and the reality for many families there will be signing up for childcare months before their child is born.

This will undoubtedly put pressure on existing childcare providers, but the boom presents an opportunity for smart property investors.

There are currently 4,596 ECE services in New Zealand, 141 of which were newly licensed in 2016. Nationally, on average 152 services open each year.

Auckland has 1,432 ECE services, 77 of which were licensed last year. The ministry is currently assessing 15 Auckland applications that may potentially open early this year.

Recent population forecasts indicate where demand for spaces will be high. A report by economic analysts Infometrics identifies Hobsonville, in west Auckland, as leading New Zealand's population boom, predicting it to grow 254 percent by 2023, as new housing supply expands.

Other areas tipped to accelerate include south-west Christchurch (105 percent), central Christchurch (83 percent) and Papamoa (74 percent). Earthquakes amplified the rate of development around Christchurch's city fringe urban areas, with the city's population drifting to the west and south, particularly to Rolleston, West Melton, Wigram, Prebbleton, Lincoln and Halswell.

An entity wanting to establish a new ECE service needs to apply to the Ministry of Education for a licence under the Education (Early Childhood Services) Regulations 2008 and Licensing Criteria for Early Childhood Education and Care Services 2008.

Katrina Casey, head of sector

enablement and support at the ministry, said: "To meet the increasing demand over the past three years between 70 and 80 new ECE services have opened each year in the Auckland region and we expect this trend to continue.

"Over the past 12 months more ECE services have opened in the south, central and east of Auckland than in the rest of the Auckland region."

The value of a childcare business is closely tied to the physical property it occupies and the resource consent for childcare use. Most ECE centres are single-tenant, hands-free investments, with the tenant managing all internal and external property-related issues. Once a centre is developed and sold, it tends to operate under the same owners for lengthy periods.

Building obsolescence in childcare facilities is also low, with most ECE businesses benefiting for the full economic and physical life of their buildings.

It's hard to find a commercial property investment class that competes, which is why the number of centres that come onto the market is small. Investors who have experienced their benefits tend to hold onto them.

ECE property expert Linda Harley said it was seller's market right now. "Demand is high and supply is tight, driving prices upwards. Sales of freehold properties and ECE businesses have been strong but the rise in property values and set-up costs has seen yields track downwards," she said.

COMPETITIVE MARKET

In inner-city Auckland, yields have dropped from 7.5 percent to 5 percent over the past two years while yields in the regions and provinces have gone from historic highs of 9 percent to 7.5 percent.

However, higher yields have been recorded for properties where there is a multiple offer negotiated or a prime tenant in place.

For those wanting to build from scratch, the rewards can be greater than buying an existing going-concern but the challenges are more substantial. Private entrants may find it difficult to build a viable enterprise in what is proving to be an increasingly competitive marketplace.

Larger operators have a significant financial advantage over smaller developers, especially in inner-city and metropolitan areas, where prices are soaring and land is scarce.

In metro areas, developers need to abide by strict government guidelines of $2.5m^2$ of indoor space and $5m^2$ of outdoor space per child, which can limit growth. And although land is cheaper and in greater supply in the regions, childcare place vacancies can be higher.

Set-up costs such as site purchase, development, staff, facilities, educational programs and equipment can also discourage smaller entrants, with larger owner-operators and institutions at an advantage when it comes to funding and having the ability to attract and retain staff, meet regulations and implement a variety of educational programmes.

Analysts predict the landscape will likely become increasingly competitive as major players drive consolidation within the sector.

Institutional investors such as Best Start Educare and Evolve Education Group are acquiring privately owned businesses to increase their market share, and the financial firepower they have at their disposal could make it increasingly difficult for smaller owner-operators and investors to compete.

Best Start Educare, which is owned by the Wright Family Foundation, a registered charity, is the largest childcare operator in New Zealand, owning more than 250 ECE centres and offering more than 15,000 long day care places.

Evolve, which has 119 centres across the

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AUCKLAND KINDERGARTEN ASSOCIATION CHIEF EXECUTIVE TANYA HARVEY country operating under several leading brands, including Lollipops Educare, Leaps & Bounds and i.Kids, only entered the market in 2014 but its aggressive acquisition strategy has seen it become a dominant player. It reported a net profit of $12.5 million in the six months ending September 2016, as revenue increased 9 percent to $76.4 million. Over the past year, Evolve has added 13 centres to its portfolio - all previously owned by independent owner-operators and providing an extra 450 places for children in Bay of Plenty, Taranaki and Christchurch – and is on track to meet its acquisition target of 15 to 20 centres this financial year.

One of the group's most recent additions is Nature's Play, in Pegasus Town, a new urban town under development northeast of Christchurch. The acquisition of the business, which is housed in a 363m² centre on 1,759m² of land, also included the right to lease a second ECE centre in the town and an opportunity for Evolve to work with developers to set up a centre in a new town.

Evolve expects further consolidation of the market will continue through the development of larger, purpose-built environments, and, according to its financial report, it has spent just over half of the $60 million debt facility it has set aside for acquisitions.

Auckland Kindergarten Association chief executive Tanya Harvey said that Evolve's spending spree would have an impact on property prices. "In Auckland, when Evolve Education first appeared on the scene and started to buy up centres, the price of childcare businesses skyrocketed, with operators getting on average four to five times their earnings. Prices dropped back a bit once Evolve slowed its pace of acquisitions, but Evolve has now just started buying again, so that's probably going to over-

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ECE PROPERTY EXPERT
LINDA HARLEY

inflate the market," she said. Ms Harvey said that those looking to build in areas where there was an under-supply of ECE centres in Auckland would face tough competition from residential developers. However, the recent increase in government funding had spurred new activity. "It does feel as if more centres are being built and there is momentum in the sector again," Ms Harvey said.

LOWER RISK

Ms Harvey believed the numbers right now suggested it was better to build a new centre than buying an existing business, but that even small independent operators were looking to grow – from two or three centres to now five or six – to achieve better economies of scale.

"Centres are also getting bigger, which can be off-putting to some parents. Whereas centres with capacity for 80 children used to be a high number, now centres are being built with capacity for 120 children. They need to get over the 100 mark to break even."

The limits on inner-city developments are likely to force developers to seek more creative solutions to building more ECE centres, including mixed-use developments, to keep up with growing demand.

Ms Harvey cited the provision of outdoor spaces and carparking as posing a major challenge to new entrants. "In Auckland, the requirement is one car park space for every two staff members – and that takes up a lot of space. You also have to provide spaces for parents, which is another cost. Centres built next to shopping malls are trying to use the car-parking spaces there to count as spaces for parents doing the drop-off and pick-up."

There is growing concern within the sector that landlords in parts of Auckland are setting top-end rents to offset their building and development costs. Many operators claim that higher rental rates are unsustainable and are putting their businesses under pressure, as well as putting off potential business buyers.

But it is likely that demand for inner-city ECE centres will grow due to their large and steady client base and the underlying value of the land. And as opportunities for centres in the city start to shrink, opportunities in the regions, where there are less restrictions on land availability, will increase.

Ms Harley said: "If the centre is a good quality business, buyers are prepared to pay significantly more now than they would have two years ago. Most business investors want to buy an existing going-concern. If they are looking for a business, that is the lower risk option."

She said that many investors preferred to hold onto the ECE business and sell the freehold property to free up cash to buy more businesses. "The return on the businesses is so much higher - about 20 to 30 percent. And that's driving supply and demand. Once people have got an ECE centre, they are holding onto them and not bringing them back to market."

Opposite page: Lollipops Educare in Takanini, Auckland. Right: Little World Early Childhood Centre in Auckland.