RWC

WESTERN SYDNEY INSIGHTS

NSW Childcare

ISSUE 1

RWC WESTERN SYDNEY

NSW CHILDCARE

Executive Summary

The childcare sector has continued to perform well unlike many other commercial assets during this time of increasing interest rates.

While overall activity has been somewhat subdued due to limited stock coming to market, demand remains high from a mix of buyer types. The long term, strategic nature of the asset class continues to be attractive to investors seeking out long term, secure, income producing assets for their portfolio. Structured rental increases which include outgoings together with land tax concessions in NSW, gives investors certainty around income returns and growth during a time where finance costs have escalated.

Spurring on this confidence has been the rapid upward population movements across NSW in particular the Western Sydney region, which has seen the bulk of transactions so far this year. The continued need for childcare facilities to cater for our growing population is giving further confidence to buyers and developers in this space. This is also enhanced by the robust subsidies on offer by the Federal Government, instrumental in keeping occupancy levels elevated and improving staff training needed to open more childcare places up across the State.

While investment demand remains, the increased financing costs have taken some urgency out of the marketplace. Buyers are now taking greater time and are more considered when purchasing, seeking out good value opportunities or those which offer future upside on competitive yields. This includes a move away from more regional markets which were particularly active over the last couple of years as savvy investors pivot back to more prime opportunities in the high grow nodes of the State.

PETER VINES
Managing Director,
RWC Western Sydney

536 new childcare facilities currently in the development pipeline across NSW.

NSW CHILDCARE TURNOVER

2023*	$48.14M
2022	$178.84M
2021	$279.77M

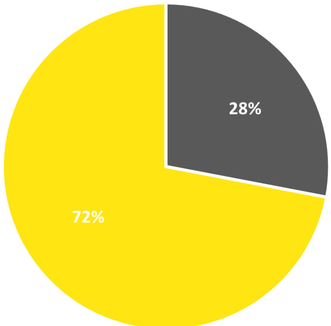
AVERAGE YIELD

METROPOLITAN	REGIONAL
5.20%	**5.92%**

REGIONAL VS METROPOLITAN SALES

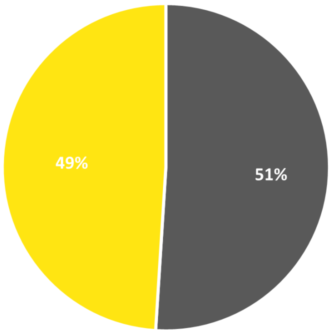
2023

METROPOLITAN	**72%**
REGIONAL	**28%**



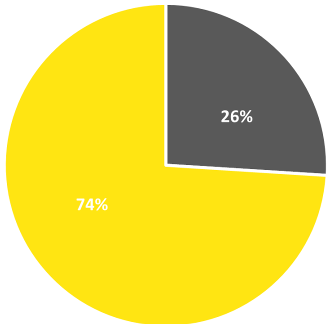
2022

METROPOLITAN	**49%**
REGIONAL	**51%**



2021

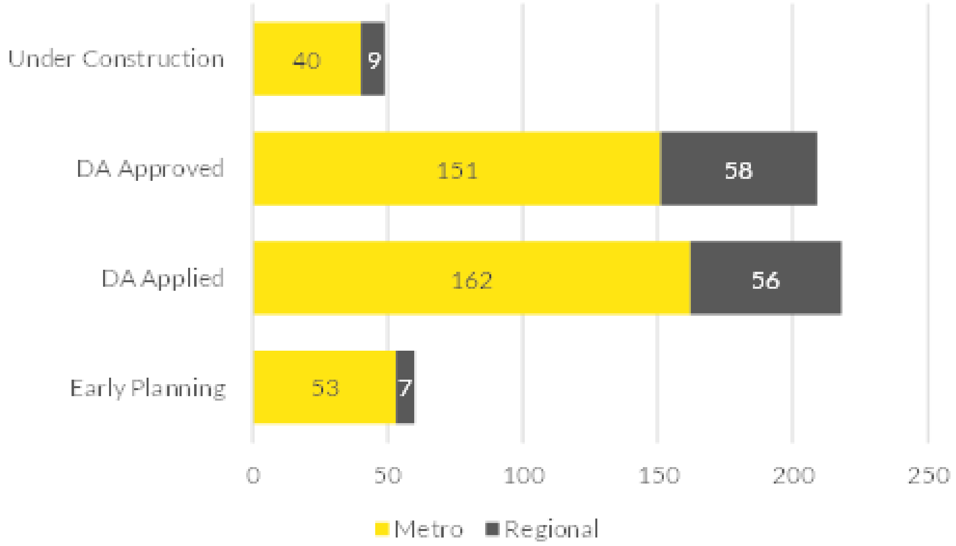
METROPOLITAN	**74%**
REGIONAL	**26%**



SOURCE: RWCWS *1Q 2023

NSW Supply Pipeline by Region

NO. OF PROJECTS



SOURCE: CORDELL CONNECT, RWCWS

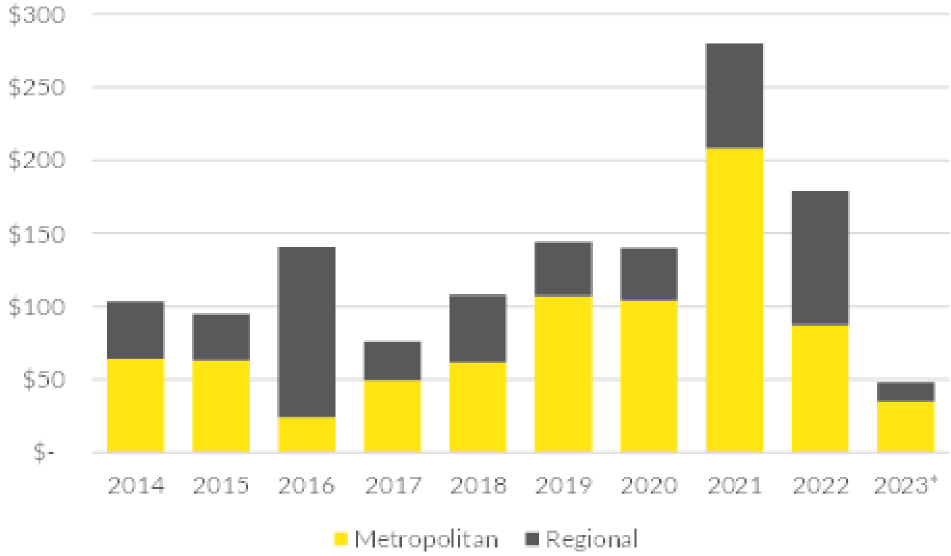
“There are 40 assets currently under construction across the metropolitan area with the bulk of projects in the western regions of Sydney, the LGA’s of Blacktown, Cumberland, Liverpool, and Parramatta the most active.”

The childcare development pipeline is vast with 536 projects in various stages of planning and construction. There are 40 assets currently under construction across the metropolitan area with the bulk of projects in the western regions of Sydney, the LGA’s of Blacktown, Cumberland, Liverpool, and Parramatta the most active. This strong weighting to the western precincts in response to projected population gains for the region as immigration has swiftly turned back on post COVID-19.

More than 200 projects are in the DA Approved category, this has been a growing category as the high construction costs has put a halt to many new projects raising concern of their viability. Encouragingly however has been the projects continuing though the planning phases spurred on by the government’s improvements to child care subsidies and our rapid population movements, another 218 currently DA Applied and a further 60 in early planning. Approximately 20% of all projects in the pipeline are in regional areas of NSW, there has been some reduction in this number as there have been some people movements back into metropolitan areas from regional markets after the COVID-19 period. Most of the regional assets currently in the pipeline are in coastal markets, with the regions from the Central Coast up to the Tweed accounting for the bulk of development projects.

NSW Childcare Transaction Volumes

$MILLIONS



SOURCE: RWCWS *1Q

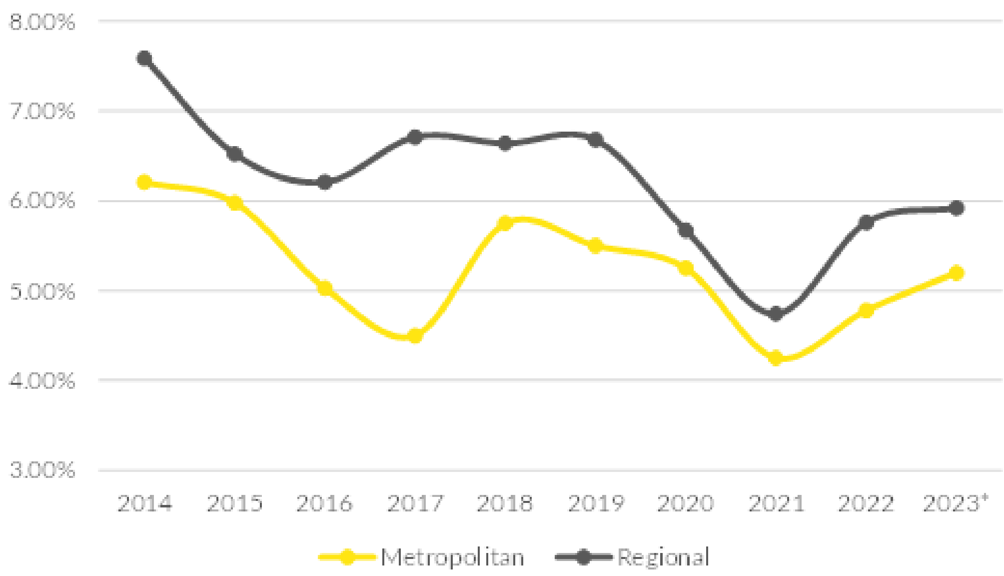
Childcare sales activity has been declining since the peak of investment activity in 2021. During this time, we saw an increase in buyers enter the market to take advantage of low interest rates and secure long-term returning assets both in metropolitan and regional areas of NSW. Sales peaked with close to $280million changing hands in 2021, this fell by 36.1% in 2022 as interest rates started their upward movement. As a result, we saw many investors exit the market and vendors were cautious, therefore limited stock has come to market keeping volumes low. We also saw a larger than usual share of regional assets transact, as owners look to capitalise on the strong capital gains made in the prior years as concerns on value movements emerge.

In late 2022 and into 2023 we have seen a strong uptick in childcare development site activity, this aiding in growing the 1Q 2023 sales to close to $50million. While construction costs remain high, the commitment by the Federal Government surrounding training and subsidies coupled with the growing population has resulted in some increased demand by investors and operators. Leasing activity this year has been strong as vacancy levels continue to remain tight across centres making them a profitable business as well as a secure tenant for investors seeking out stable returns.

"As interest rates rose, we saw many investors exit the market and vendors became increasingly cautious, therefore limited stock has come to market keeping volumes low."

NSW Average Childcare Yields

BY LOCATION



SOURCE: RWCWS *1Q

“Many buyers are seeking out these investments looking to capitalise on the stable income stream and inbuilt rental growth, keeping yields remaining competitive.”

Investment yields for childcare assets have seen much movement over the past few years. An asset class with growing demand particularly in the 2016-17 period as smaller private investors (many first-time buyers) converged on the “alternative asset class”. This was due to childcare’s strong lease covenants, land tax exemptions and stable returns during a time where financing was available and lending rates were low. High competition to secure investments resulted in yields moving quickly down to average a low of 4.50% for metropolitan assets still within the broad range of 3.80% and 7.20%. We also saw a strong weighting of investments from regional markets taking advantage of this increased demand, and as investors missed out would move up the risk curve into secondary locations where average yields sat at 6.71%. As we moved into the COVID-19 period, this brought new investors into the childcare space looking to take advantage of record low interest rates; during this time yields fell for both metropolitan and regional assets as the rush to secure assets grew. In 2021 average yields sat at sub 5.00% regardless of region however as the cost of funds increased, we saw these rates move back upward and the spread between regions again widen. This year we have seen average yields sit at 5.20% in metropolitan Sydney and 5.92% outside the city. Many buyers seeking out these investments are looking to capitalise on the stable income stream and inbuilt rental growth keeping yields remaining competitive albeit more than 100 basis points up on 18 months ago.

Conclusion

The childcare space is an interesting one from an investor's perspective. The attraction is clear, the "set and forget" nature of the tenancy, long term leases, land tax concessions, fixed increases and quality, regulated tenants making it an attractive investment option.

Couple this with the Government's continued commitment to subsidising childcare costs for families and the strong population growth projections, puts greater certainty around occupancy levels. Its affordable price point also has made it an accessible asset class for a range of investors and has been a feasible alternative to other "alternative" investment classes such as service stations, medical or fast food which have also been popular in recent years.

While the cost of finance is up, many buyers are considering now a good time to purchase at an elevated yield and capitalise on future income growth prospects as well as capital appreciation. However, with limited stock on the market we have seen vendors more cautious or not meeting the market resulting in subdued turnover levels, particularly as uncertainty remains around further interest rate rises. It is expected that 2023 will continue to see transaction volumes down however the average yield rate will likely consolidate on its current position, pending further rate rises.

The increase in development site sales this year highlights what will be a strong few years of new supply across the State in response to rapid increases in population, notably for the Western Sydney region. While construction costs still may be elevated, it is expected the building activity will grow this year and next and we will see more projects progress through the development pipeline. For regional markets, this may be a little slower as demand may dissipate as population movements occur back into metropolitan markets as the push for staff to return to work ramps up this year.

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Managing Director,
RWC Western Sydney

OUR OFFICE

With a strong foundation of experience and expertise, we bring a winning combination of dynamism and operational rigour to the commercial agency space.

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Who we are,
what we do,
why we do it

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