m3property Update

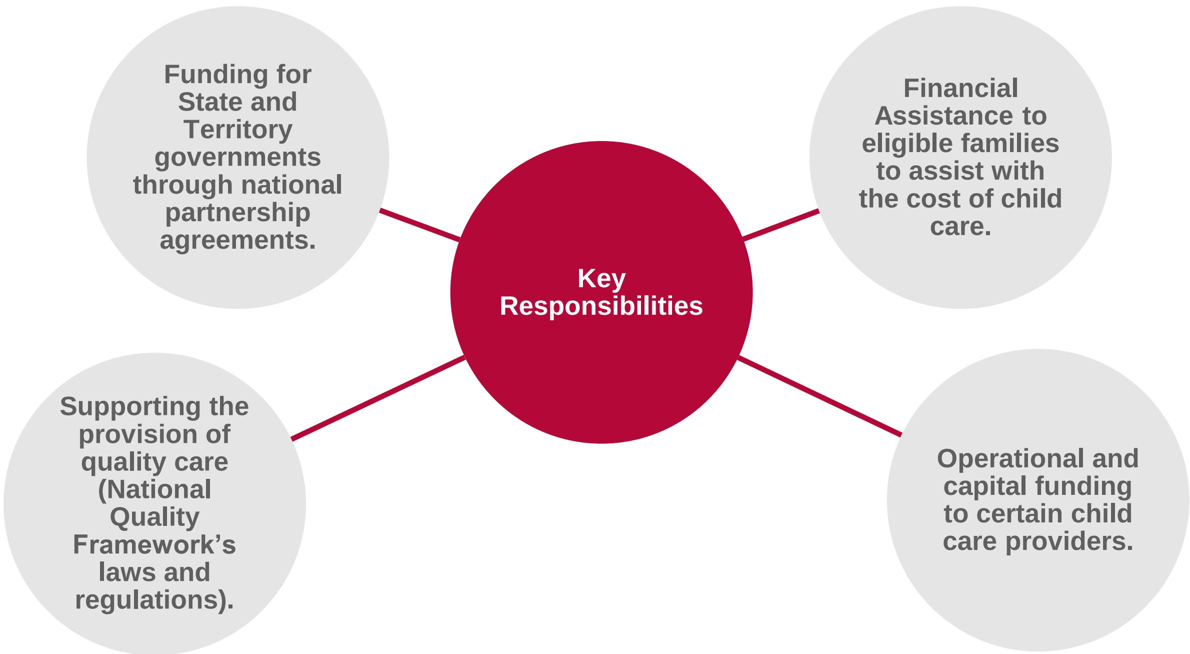
Child Care Funding Changes

June 2018

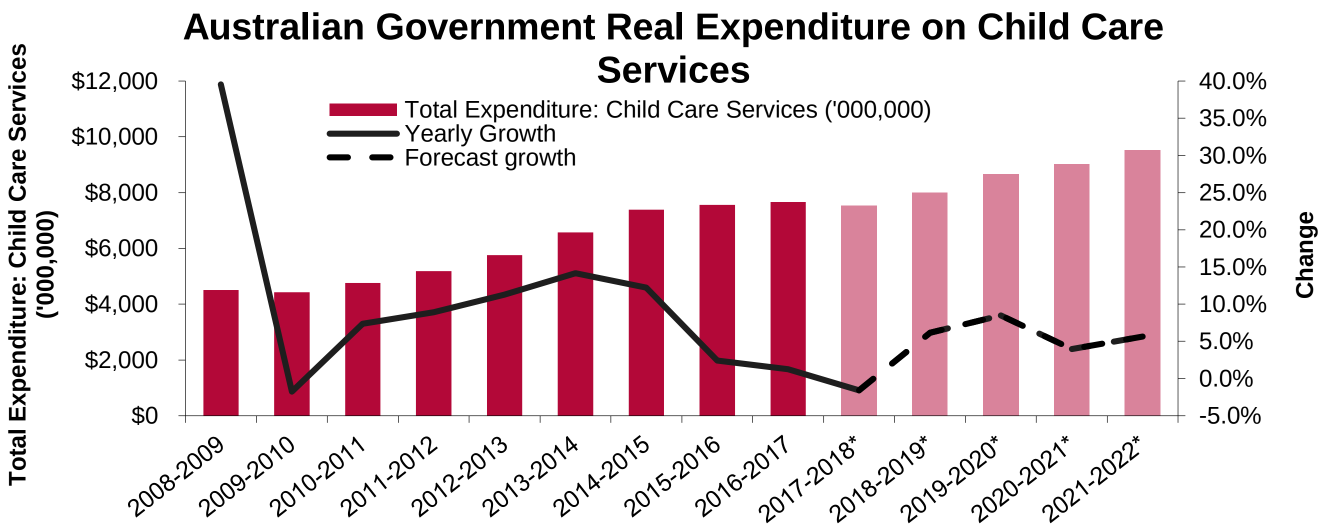
During 2017 and into 2018 child care centres have been a popular form of commercial property investment throughout Australia, with strong investor interest from institutional funds, small scale syndicates and individuals (both local and overseas). This is not surprising when properties are generally subject to long term leases, often to publicly listed entities active in an industry which is provided significant financial support by the Federal Government. However, when the viability of an industry is so dependant upon government funding, it is important to understand the mechanisms and motivations behind the Government's policies.

Government Support for the Child Care Industry

- Successive Federal Governments have been aware of the importance of accessible and affordable child care and early learning for both the growth of the economy through greater workforce participation and society through improved childhood education.
- The last decade has seen significant growth and change within the child care industry in Australia, largely as a result of changes to government subsidies such as the Child Care Benefit (CCB) and Child Care Rebate (CCR).
- Historic Federal Government policy changes have led to the industry moving essentially from a 'not-for-profit' sector to now being significantly influenced by private 'for profit' providers. Such policies have driven the percentage of Long Day Care (LDC) centres in private ownership to 46% (Australian Childcare Alliance 2016).
- Between 2013 and 2017 the number of Federal Government CCB approved child care services increased by 18.9%, whilst the number of children (aged 0-12 years) enrolled in Federal Government CCB approved child care services increased by 22.1%.
- The Federal Government's key child care responsibilities include:



- In 2015 the Productivity Commission released the Childcare & Early Childhood Learning Inquiry Report, which discussed the current state and future direction of Early Childhood Education and Care (ECEC) services and evaluated various strategies to ensure the development of Australian children while facilitating parental participation in the workforce.
- Following the Inquiry, the Federal Government introduced the new 'Jobs for Families' Child Care Package into Parliament in late 2015 that was passed in 2017. The main element of the new package is the Child Care Subsidy (CCS), which will be introduced on 2 July 2018.
- According to the Department of Education and Training (DET) 2018-19 budget statements, total Government expenditure on Child Care Services for the 2017-18 financial year is circa $7.5 billion increasing to circa $8.0 billion in the 2018-19 financial year. The chart below includes the budget forecasts through to 2021-2022.



Source: Productivity Commission (Report on Government Services 2018) DET (Early Childhood and Child Care Summary June 2017), Portfolio Budget Statement 2018-19, **m3**property Research

Current State of Play

- The child care fee assistance system is primarily made up of the CCB and CCR payments.
- The CCB is income tested and families can receive fee assistance for up to 24 hours of care per week without having to meet the Work, Training, Study test, or up to 50 hours of care per week if they do.
- The CCR is a payment to help with child care costs. It is not income tested and pays 50% of all out of pocket child care costs after the CCB and Job Education Training Child Care Assistance payments up to a cap of $7,613 per child per year. The CCR can be paid directly to the child care provider or a families nominated bank account. There is no minimum number of work hours, training or study required to receive this payment.
- The current system also includes the Jobs, Education and Training Child Care Fee Assistance (JETCCFA), which provides additional support to parents on income support payments while they study, train or work.
- Current income limits for the CCB are $156,914 for one child, $162,633 for two children and $183,655 for three children (plus $34,724 per child in excess of three) above which income limits the CCB is reduced to $0.
- The maximum CCB rate is provided to families earning less than $45,114 per annum, or to families receiving income support.

The New ‘Jobs for Families’ Child Care Package

The new child care package will replace the existing CCB and CCR with a single means tested CCS on 2 July 2018, with an additional Child Care Safety Net designed to assist the most vulnerable children.

CCR + CCB = CCS

Three key elements will determine the level of a family’s subsidy; combined family income; activity level of both parents; and the type of child care service.

Combined Family Income

Activity Level of Parents

Type of Child Care Service

Combined Family Income: There will be no cap on the amount of subsidy a family can claim if they have a combined annual earnings of $186,958 or less. Families earning over $186,958 up to $351,248 per annum will have an annual cap of $10,190 per child, and those family’s earning over $351,248 will not be eligible, as detailed in the following table.

Combined Family Income*	Subsidy Rate^
Up to $66,958	85%
Over $66,958 to under $171,958	Gradually declining to 50%
$171,958 to under $251,248	50%
$251,248 to under $341,248	Gradually declining to 20%
$341,248 to under $351,248	20%
$351,248 or above	0%

Source: Department of Education and Training. Note: Subsidy tapers by 1% for each $3,000 of family income.
*Figures are correct for 18/19 and are subject to change through indexation in following years.
^Subsidy rate of actual fee charges or maximum hourly rate cap (whichever is lower)

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Activity Level of Both Parents: The more hours of 'Activity', the more hours of subsidised care a family can claim (up to 100 hours per week). In two parent families, the hours of subsidised care will be based upon the parent with the lowest level of 'Activity', however that parent can combine different 'Activities' to increase the total hours undertaken. Activities include paid work, self employment, non paid work in family business, training courses, approved educational study, volunteering, actively looking for work and paid parental leave.

Hours of Activity	Max. Hours of Subsidy per Child
8 hours to 16 hours	36 hours
More than 16 hours up to 48 hours	72 hours
More than 48 hours	100 hours

Source: Department of Education and Training

Type of Child Care Service: The subsidy payable will be capped at an hourly rate depending upon the type of child care service provided. These caps place an upper limit on the amount of Child Care Subsidy the Federal Government will provide. The caps are considered an attempt to prevent the higher subsidies leading directly to higher daily child care fees.

Centre Based Day Care (LDC and Occasional Care) = $11.77 Hourly Rate Cap

Family Day Care = $10.90 Hourly Rate Cap

Outside School Hours Care (before, after and vacation care) = $10.29 Hourly Rate Cap

In Home Care (per family) = $25.48 Hourly Rate Cap

Child Care Safety Net: The Child Care Safety Net is designed to give the most vulnerable children the best possible start at early learning, while supporting parents into work. The Safety Net includes the following components:

1. Additional Child Care Funding
2. Community Care Fund
3. Inclusion Support Program

The Additional Family Care Funding includes an additional subsidy to families in circumstances that require help to support the child's safety and wellbeing, or to the grandparents on income support who are the principal carer of a child, or to families experiencing short term financial hardship, or to families who are attempting to transition to work from income support.

As part of the Child Care Safety Net low income families on $66,958 or less a year who do not meet the Activity Test will be able to access 24 hours of subsided care per child per fortnight.

Main Changes

- Two payments replaced by a single payment in addition to a Child Care Safety Net.
- Means-tested.
- A new activity test.
- Hourly fee cap per service type.
- Subsidy paid directly to service providers.
- More flexible operating hours for service providers.
- Families earning less than $171,958 will have their subsidy rate increased from 50% up to 85%, depending upon combined family income.
- The annual subsidy cap will either be removed or increase from $7,613 to $10,190 per child, depending on combined family income.
- Families earning more than $351,248 will no longer be eligible for any subsidies.

What this means for Families

- Families earning up to $186,958 will not be subject to an annual cap.
- Families earning up to $66,958 will have their subsidies increased from 50% to 85%.
- Low to middle income families will receive more subsidies due to the sliding scale which tapers down from 85% to 50%.

- Reduced hours of subsidised care that low income families who don't meet the activity test are entitled to.
- Families earning $66,958 or more, who do not meet the activity test, will no longer receive any subsides.
- Middle to high income families will receive less subsidies due to the sliding scale which tapers down from 50% to 20%.
- Very high income families will no longer be eligible for the subsidy.
- Families/parents who are shift workers, work casually, or do not have a set amount of work hours per fortnight may be affected by the new activity test.
- With a clear focus on increasing workforce participation, the funding changes will mean middle to upper income families (who aren't eligible for the Child Care Safety Net) on one income with a 'stay at home' parent are no longer likely to be eligible for the subsidy.

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2-4 Balhannah Road, Hahndorf, SA

What this means for Providers

- Overall, there is a greater level of funding for families with the removal of an annual cap for low to middle income families, which should improve occupancy levels.
- Increased flexibility in operation hours.
- Child Care providers may benefit from additional funding for children with additional needs.
- Improved debtor management is available as the new subsidy is paid directly to the child care service provider.
- Reduced administration & regulatory burden, improved access to information and compliance functionality due to the new IT system.

- The hourly fee cap may result in indirect pressure to reduce or limit daily fees.
- Potential withdrawal of children or a reduction of hours from very high income families.
- Families who do not meet the 'Activity' test may remove their child from care or reduce the hours.
- Additional initial costs for new IT software may occur. Anecdotally, some providers are passing this cost onto families by way of fee increases over the next financial year.
- Mandatory reporting of children's detailed attendance records.

What This Means for the Industry Moving Forward

The new child care funding changes are in response to the increasing costs that families have been experiencing for child care. Although the government cannot restrict child care service providers charges, the introduction of an hourly fee cap may place pressure on some child care service providers to limit fee increases. These hourly fee caps however, may exacerbate the gap that already exists between what high-end child care service providers and what low-end child care service providers charge. For example, child care service providers in wealthier suburbs of high employment may be able to charge well-above the rate caps, whereas service providers in poorer suburbs of low employment may have to comply with the funding rate caps to avoid a drop in occupancy levels, resulting in a decline in centre performance.

LDC providers charge daily rates instead of hourly rates and the introduction of hourly rate caps may encourage such providers to increase their flexibility by offering shorter session times or half day's. This has already started to occur, with Goodstart Early Learning and G8 Education recently launching shorter session times in addition to regular full day sessions (12 hours).

As a result of the means and activity testing, the new child care subsidy has the potential to create an early childhood education gap between 'working families' and single or no income families. With a primary focus on increasing workforce participation, the new subsidy provides more support to families with both parents working whilst reducing or removing support to families with one parent or no parents working. Additionally, an early childhood education gap may arise between areas of high and low income with high income families who typically spend proportionately less income on child care potentially being more likely to keep a child in care even though their subsidy has also been reduced/removed. How these issues affect the appeal of investing in child care facilities (both from a provider and investor perspective) in both high and low income areas remains to be seen.

Institutional service providers are expecting demand for child care to improve due to the new funding regime. This is primarily due to the removal of the $7,618 per annum fee cap for low to middle income earners. As a result, occupancy levels of child care centres may be positively impacted. Some families, have in recent years, seen their benefits and rebates run out earlier in the year, which has resulted in many having to withdraw their children from care.

As a property investment, leased child care centres are a specialised asset, with the tenants ability to meet rental obligations heavily reliant upon Federal Government policies and subsequent funding. Although this is a risk investors should seriously consider, it is likely the new funding regime will add to the already strong demand for child care centre assets.

Obviously the implementation of the new Job's for Families Child Care package (including the CCS) will have a major impact not only for providers, but for Australian families, with some clear winners from the changes.

According to the latest Child Care Services in Australia Industry Report (May 2018) by IBISWorld, revenue in the Child Care Service industry is forecast to grow by an annualised 5.6% over the five years to 2022/2023, down from the 8.0% growth over 2013/2018 (including expected revenue growth of 3.9% in the current year).

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