

Practice & Law

A FERTILE MARKET

Investment Government provision of free childcare has ensured that the demand for nurseries remains constant, but as the 2011 baby boomers grow up, that demand looks set to explode, writes Simon Rutman

With day care costs spiralling and availability in short supply in certain geographic locations, the childcare sector has become a political talking point and a seemingly lucrative investor class.

The sector comprises a diverse range of providers, with public, private, voluntary and independent operators offering a number of alternative forms of care. But, as with all sectors, there are particular issues that need to be taken into account when considering establishing, buying or investing in a nursery in England or Wales.

Financial state of the sector

The term “nursery” encompasses a variety of institutions, including full-time daycare

nurseries, nurseries attached to primary schools, and kindergartens open for limited hours. Profitability in this sector dipped in 2008/9 but has since been stable, and nurseries have performed better than other care sectors. Factors likely to influence profitability include:

Group operator or single-site business

There are often economies of scale to be made by a single operator running a chain of nurseries across the country. There are a few national childcare providers (around 15% of market share) but most are small chains or single units run by small private businesses. Many of the smaller independent institutions do not hold much security by way of cash reserves, and only a few are freeholders. Many are heavily

dependent on the money they receive from the local council as a result of the statutory entitlement to free places for some two year olds and all three and four year olds.

Location

A nursery in an affluent part of the country is more likely to be profitable than one in a less affluent area. Despite the property costs (rent and rates) being higher, this is often outweighed by the ability to charge a relatively high price for the service. The national minimum wage means that the payroll costs are broadly the same across the country, although in the most affluent areas, staff costs tend to be higher. Other running costs (such as utility bills, insurance premiums and consumables)



tend not to vary much between areas.

In less affluent areas, private nurseries have to compete with subsidised children's centres, such as those run by Sure Start, and run a greater risk of parents experiencing financial problems and ceasing to pay fees, moving their children out of nursery or reducing their hours.

The property itself

It will help if a site is visible from a main road and has safe parking. It must also comply (or be capable of being modified to comply) with the statutory requirements set out in the box overleaf.

Number and age range of children

Profitability also depends on the number of children attending the nursery.

A nursery should ideally run as close as possible to capacity, but the more children the better, ie, it would be preferable for a nursery offering 50 places to be half full with 25 children than for one with 30 children to be two thirds full with 20 children. It is also important to consider the effect on profitability of the statutory adult-to-child ratios (see box) and offer more places for older children who require less intensive adult input. Vacancy rates (the number of vacancies as a percentage of places) seem to have held steady throughout the last four years at between 17 and 21%.

Why invest?

Investors have been continuing to invest in this sector. Earlier this year, for instance,

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Legal notes

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ONLINE THIS WEEK

LAW REPORT The Estates Gazette Law Reports are now available exclusively on EGi each week and in bound volume three times a year. This week we report *Trustees of Coventry School Foundation v Whitehouse*.

Bright Horizons Family Solutions LLC, a global provider of employer-sponsored childcare and early education, bought Kidsunlimited Ltd, one of the UK's largest providers of nursery care, from private equity investor LDC. The main factors driving growth in this sector are:

The baby boom

More babies (813,200) were born in the UK in 2011-12 than in any year since 1972, according to the Office for National Statistics in its annual mid-year population estimate report (8 August 2013). This represents a 0.7% increase on the previous year and the highest growth rate in Europe, which has obvious implications for childcare and school places.

High levels of maternal employment

According to a report published by the Office for National Statistics in March 2011, it is estimated that around 66.5% of mothers are in work and consequently many of these will need to purchase some form of childcare.

Government backing for institutional childcare

- The Early Years Entitlement of 15 hours' free childcare in a qualifying institution for 38 weeks a year for all three and four year olds and from September 2013, those two year olds whose parents qualify for a means-tested benefit. Some commentators perceive this as a response to the slip in numbers of under threes attending nursery during 2011/12, presumed to result from the recessionary squeeze on family budgets. According to the Laing & Buisson market report 2012, this slip cancelled out the benefit to the sector of the rise in the under-fives population.
- Under the Childcare Act 2006, local authorities have statutory duties (including obligations to ensure sufficient childcare for working parents and to provide them with information about this provision), which encourage and support the establishment and survival of nurseries.

Issues faced by investors

Regulatory

Childcare is a heavily regulated sector. The key legislation includes the Children Act 1989; the Care Standards Act 2000; and the Childcare Act 2006, supplemented by governmental guidance, in particular the Statutory Framework for the Early Years Foundation Stage 2012 (EYFS), which contains learning and development requirements and welfare regulations.

In England, the nursery must be registered with Ofsted on the early years register. The main regulatory requirements are:

- Size: there are regulations governing

RULES AND REGULATIONS

| Age of child | Sq m per child |
|----------------------|-----------------------------|
| Under two years | 3.5m ² per child |
| Two years | 2.5m ² per child |
| Three to seven years | 2.3m ² per child |

| Age of child | Carers per child |
|----------------------|---|
| Under two years | One adult per three children |
| Two years | One adult per four children |
| Three years and over | One adult per eight children (or per 13 children where a qualified teacher is working directly with the children) |

A nursery must have:

- The sole use of the property as a nursery during its hours of operation.
- One toilet and handbasin for every 10 children over the age of two, and suitable hygienic changing facilities for children in nappies.
- Easily accessible space within the premises for storage of children's records, personal belongings, toys and any specialist equipment.
- A separate baby room for children under the age of two.
- An area to provide healthy meals, snacks and drinks and space for their hygienic preparation and storage.

the minimum size of premises required to house a nursery. The EYFS specifies that the premises will need to comprise a certain number of square metres per child (see box), calculated on the basis of the net areas of the rooms occupied by children (ie discounting storage areas, thoroughfares, dedicated staff areas, cloakrooms, utility rooms, kitchens and toilets).

- Layout of premises: the premises must comply with the requirements set out above.
- Health, safety and environment: nursery operators must undertake regular health and safety risk assessments to ensure that the premises, furniture and equipment are safe, secure, hygienic and clean, and that the appropriate policies and procedures are in place. Ofsted will inspect the property as part of its initial registration and periodically after that to assess its fitness as a nursery and the fitness of the staff as child carers. If food is going to be prepared on the premises, a food premises registration form must be completed.
- Insurance: employer's liability insurance and public liability insurance must be obtained.
- Training of staff: the owner of a nursery does not need any formal qualifications, but the manager will need to have a level 3 NVQ in Childcare and Education, and at least two years' childcare experience, or equivalent. At least half of the staff will need a level 2 NVQ in childcare education or playwork, and carers in a baby room will need specialist training. Ofsted will conduct background checks, but the owner is responsible for ensuring that all staff are "suitable" for working with children.
- Identity of owner: as part of the registration process, Ofsted will conduct checks on the owner (which it usually does by checking the organisation's credentials at Companies House) and will conduct background checks on all of its directors. Ofsted also requires the

organisation to appoint a "nominated person" who is the legal spokesperson for the organisation and is used as Ofsted's point of contact to deal with any legal or regulatory queries.

- Size of staff: the EYFS specifies that there must be a minimum number of adult carers per child (see box). Ofsted may decide that a higher staff-to-child ratio is required in particular instances to ensure the wellbeing of the children.

If the operator fails adequately to meet the requirements in the EYFS, Ofsted may issue it with a "notice to improve" (specifying what needs to be done to rectify the failure) and/or a welfare requirements notice if there has been a failure to comply with safeguarding and welfare requirements. Some such failures constitute criminal offences punishable with a fine.

Planning

Planning permission for class D1 use is required, so consent will be needed to convert a building that has been used for another purpose. If the property is listed on the national heritage register, listed building consent will also be required.

Local planning councils will consider applications for such changes of use in the light of their local plans. National policy favours developments that support economic development, but the needs of the local population will determine whether change of use to a nursery is acceptable and appropriate.

Future investment

Given the demand for childcare and the appeal of a fragmented sector, which is ripe for consolidation, the nursery sector is an investment trend that shows no sign of abating.

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