A rollercoaster ride

As we find ourselves in the middle one of the most significant changes to the UK nursery sector since 2017, Cairneagle's managing partner **Arun Kanwar** and manager **Madeline Alcock** discuss the demand outlook and key issues facing operators in 2025 and beyond.

Fifteen hours of free childcare have now been rolled out to children aged nine months and up, subject to eligibility requirements, with the full 30 hours set to roll out as planned in September 2025.

A spot survey we conducted in September 2024 during a speech at the NMT Owners Club indicated a year-on-year uptick in enrolment for most providers. While a large part of this improvement would be driven by the extended funding offer, it will also have been because of general improvements, including continued recovery from Covid and the cost-of-living crisis, as well as a slightly improved staffing situation.

Demand did not improve uniformly across the board. Catchments with higher earners have benefited less because of the £100k individual earning limit on accessing funding (which has never been adjusted for inflation). Some of the uptake of funded hours has been substitutional rather than stimulating new demand.

Looking ahead, we expect 2025 to be the first year that enrolment will exceed 2019 levels, with significant growth projected through to 2030, even after accounting for declining numbers of nought- to four-year-olds and staffing constraints. In our May 2024 survey of operators, respondents expected an overall 14% increase in occupancy by September 2025.

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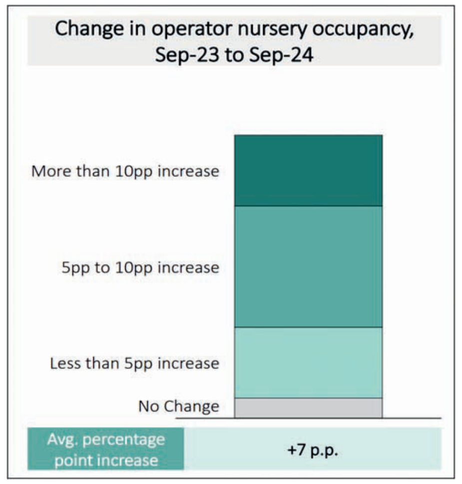


Key issues

Despite unprecedented growth in demand, several persistent issues could impact demand or profitability and impact the sector's outlook.

Schoolification

The government plans to meet new demand by building capacity for 100,000 children in 3,300 state schools (though the budget conversion cost of £40,000-£50,000 per nursery is likely to be insufficient). These schools are increasingly looking to play a role in nurseries as their rolls decline due to demographics.

Additionally, independent school providers are extending down or creating nursery strategies, putting pressure on the premium segment of the market. Part of their rationale is to diversify revenue on account of VAT changes on private school fees.

Historically, school nurseries – state or independent – haven't supported younger children or offered full-day/all-year-round childcare as well as private nurseries, but this is changing. The extent to which this will be disruptive will depend on local dynamics, with some focus on "childcare deserts" and potential impacts in London due to higher demographic declines in school-age children.

Comparison of school-based vs private group-based childcare offerings, 2024

	School-based	Private group-based
% offering full-year care	6%	77%
Average number of hours per day	7 hours	10 hours
% which serves children under 3	10%	51%
% of childcare in most deprived areas	26%	14%

Demographics and supply imbalances

In some regions, increased demand from the funded offer will not offset a declining population of nought- to four-year-olds. We were recently discussing a specific London borough with a nursery group, where the number of nursery-aged children has declined by around 40%. In October last year, the government published its view of childcare "oases" and "deserts", which indicates areas of "high supply" or "over-supply" and "under-supply". Many of the childcare oases are in London and the Southeast.

Staff recruitment and retention

While our work in the sector and operator interviews point to staffing improvements, major challenges remain. The Department for Education's view is that 40,000 new staff need to be recruited by September 2025, but the majority of operators we have spoken with feel that recruitment improvements will be insufficient.

Margins

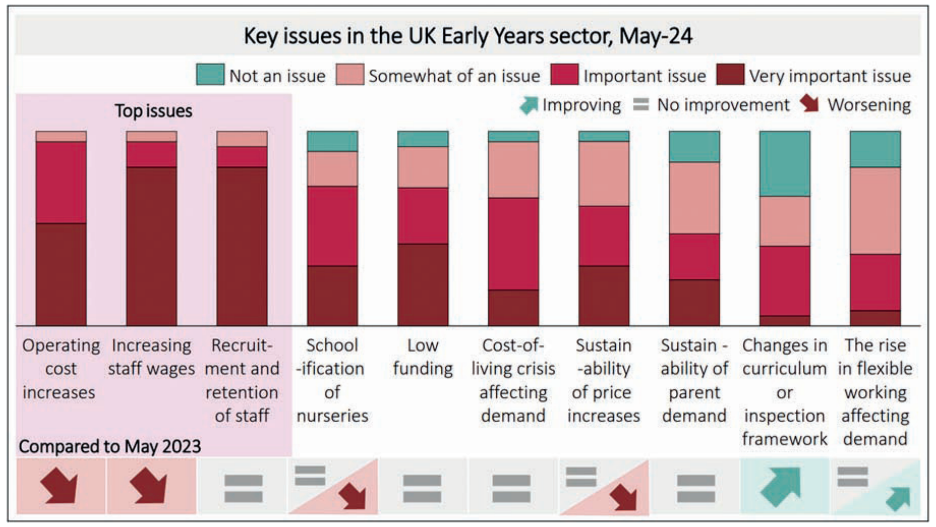
The sector has faced a number of challenging years on both revenue and cost fronts, including changes to the demand profile post-Covid, enrolment held back by staffing constraints, inflation and the cost-of-living crisis, the cost of agency staff, and living wage increases.

Funding rates haven't kept up with nursery-specific inflation, driving operators to charge above-inflationary fee increases. Margins have been improving due to increasing demand, a better staffing environment, and favourable funding rates for under-threes. However, last October's budget is likely to offset much of that on account of continued significant increases in the living wage and employers' National Insurance contributions.

The government has now published its 25/26 funded rates – an average 3.4% increase for under-twos, 3.3% for two-year olds, and 4.1% for three and four-year-olds, alongside an increase in the pupil premium. These increases fall below the cost inflation facing nurseries, and they will need to consider making up the difference through occupancy gains, fee increases, cost control and extras charges. However the government is simultaneously making noises on cracking down on charging extras, which doesn't help in the context of these pressures.

Looking forward

Given the market's tailwinds, operators' top priorities are related to growing enrolment, either organically or through expansion, to capitalise on the funding rollout. After a slowdown of M&A activity, there has been some resurgence in deals. Data from Grant Thornton, which tracks deals of three or more nurseries, shows an increase in deal activity in the third quarter of this year, although this may be partly due to the desire to get deals completed before budgetary capital gains tax changes.



Notable transactions last year include Downing's investment in Chalk Nursery Group, the acquisition of Children 1st by Storal, the acquisition of Red Bus, Livingbridge's investment in Kindred, and continued consolidation by Kids Planet and Bright Stars. Reduced interest rates have been helpful, and the speed at which they continue to decline will influence how quickly the M&A market picks up.

Strategies for growth

To navigate these changes discussed and to capitalise on opportunities, operators should consider the following strategies:

- **Target parents:** Are middle-market parents more attractive with the extended funded offer, or is premium still the right strategy? Is there an opportunity to play in both markets? For independent schools pursuing a nursery strategy, how should they balance nursery performance versus feed for their school?
- **Location:** Which geographies align with your strategy for the extended funded offer or premium?
- **Age-group mix:** What is the optimal mix of ages for a setting?
- **Pricing:** What are sustainable options to defend and improve margins, mitigate cost inflation, and make up potential shortfalls in funding?
- **Your proposition:** How do you win in local markets? What advantages and constraints does your proposition or offering have (space requirements, local industry connections)?
- **Avenues for growth:** What efforts should be weighted between capacity expansion, new build, and M&A?

Operating in the nursery sector continues to be a rollercoaster ride, with lows and highs - after a sustained tough environment and then an improvement, government policy has now turned the screws on the sector again. Nevertheless, it remains one of the most attractive and investable sectors in UK education. ■