Child Care and Charter School Facilities Lending

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Low Income Investment Fund

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Agenda

- Course Overview
- Key Lending Characteristics for Charter School and Child Care Facilities
  - Revenue Sources
  - Borrower Characteristics
  - Real Estate Characteristics and Capital Structure
- Underwriting & Case Study

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Course Overview

Topics

- **Why** Invest in Child Care/Charter Schools
- **How** is the Market & Sector Unique
- **What** to Know when Underwriting a Loan
- **Who** Can Help After Today

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Course Overview

<u>Take Away</u>

- Community Development Connection
- Revenue & Capital Sources
- Applied Underwriting Experience
- Tools & Resources for Your Practice
- Contacts for On-going Support

Child Care and Charter Schools

LIIF’s Involvement

- Poverty alleviation strategy
- Community development tool
  - Stabilization of communities & job creation
  - Revitalization of real estate
- Response to our customers
- Need for LIIF’s financing expertise
  - Thin cash flow and unconventional revenue
  - Facilities need
  - 1st time borrowers

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LIIF’s Involvement

- Quality child care lays a foundation for school and future life success
  - $1 invested in quality child care for low income families saves $7 in future public costs (special education, social services, incarceration, lost taxes)
- Fuels the economic engine
  - Businesses have consistent workers
  - Parents earn income

Child Care

LIIF's California Initiative

- Purpose
  - Build a comprehensive and sustainable financing and support system for child care facilities development
- How
  - Employ a combination of grants, loans, technical assistance, training and policy advocacy

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Child Care

LIIF's ABCD Fund

- Purpose
  - Assist in creating a financing system for child care center facilities by providing capital for the acquisition, construction, expansion, rehabilitation, refinancing of new or existing child care center facilities
- Criteria
  - Center-based child care providers – both nonprofit and for profit – serving at least 20% low-income children
- $25 million Fund

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Key Lending Characteristics for Child Care and Charter School Facilities

- Revenue Sources
- Borrower Characteristics
- Real Estate Characteristics
- Feasibility & Capital Sources

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Child Care and Charter School Facilities Lending

Revenue Sources

- Government revenue sources
  - Federal
  - State
  - Local
- Parent contributions and fee for service
- Charitable contributions

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Government Revenue Sources:
Charter Schools

- Government funding sources
  - **Revenue Limit (aka “General Purpose Block Grant)**
    - **State & local district portion**
    - **By far, largest share of revenue**
  - **Federal Income**
    - **Planning/Implementation Grant**
    - **Title I (Low-income)**
    - **Child Nutrition**
    - **Title II (Teacher quality)**
    - **Drug/Alcohol/Tobacco**

Government Revenue Sources:
Charter Schools

- Government funding sources
  - **Other State Revenue**
    - **Categorical Block Grant**
    - **Special Ed**
    - **EIA**
    - **State Lottery**
    - **SB 740**
  - **Local Revenue**
    - **District portion of Revenue Limit**
    - **Fundraising**
    - **Proceeds of Loans**

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Government Revenue Sources:
Risks (Charter Schools)

- Typical revocation provisions:
  - “Material violations” of charter
  - Failure to meet or pursue pupil outcomes identified in charter
  - Gross fiscal mismanagement
  - Violations of any provision of law
- Important to assess local experience

Government Revenue Sources:
Child Care (Center-based)

- Government funding sources
  - Federal
    - Head Start & Early Head Start Contract
      - Income: Federal Poverty Level
      - Preschool, Infant Care, Family Support
      - Performance Standards
      - Contracts Negotiated with Regional Office
    - Child & Adult Food Program (USDA)

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Government Revenue Sources:
Child Care (Center-based)

- Government funding sources
  - State (California)
    - Department of Education
      - Contract:
        - » 75% State Median Income
        - » General Child Care (0-13 year olds, full day)
        - » State Preschool (3-4 year olds, part day)
      - Voucher:
        - » CalWORKs (parents participating in employment-related activities)
        - » Alternative Payment (75% State Median Income)

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Government Revenue Sources:
Child Care (Center-based)

- Government funding sources
  - Local
    - First 5 School Readiness/Preschool (California)
    - Community Development Block Grant
- Other
  - Parent Fees
  - Foundations
  - Employer Sponsored Child Care

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Government Revenue Sources:
Risks (Child Care)

- Federal and state budget cutbacks
- Political shifts
- Population changes

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Key Lending Characteristics for Child Care and Charter School Facilities

- Revenue Sources
- Borrower Characteristics
- Real Estate Characteristics
- Feasibility & Capital Sources

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Child Care and Charter School Facilities Lending

Borrower Characteristics

- Management capacity
- Real estate finance/development capacity
- Financial capacity

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Management

- **What to Evaluate:**
  - Track record
  - Breath and depth of capacity
  - Stability
  - Board experience

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Management

- **What to Look Out for:**
  - Often 1st time borrowers
  - Lack of facility development expertise
  - Key person/founder risk
  - Tension between board & management
  - Insufficient resources to handle growth

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Key Lending Characteristics for Child Care and Charter School Facilities

- Revenue Sources
- Borrower Characteristics
- Real Estate Characteristics
- Feasibility & Capital Sources

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Collateral/Real Estate

- **Summary: Valuation complicated**
  - Limited market of true comparables
  - Location in undervalued low-income communities
  - High costs in urban areas
  - Use of temporary or leased facilities often only option for many providers

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Charter Schools

Facilities Need

- Typically insufficient public funding for facilities
- Limited ability to locate in school district facilities
- As a result, charter schools typically:
  - Start in small spaces
  - Move often
  - Endure instability that can impact programs

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Key Lending Characteristics for Child Care and Charter School Facilities

- Revenue Sources
- Borrower Characteristics
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- Feasibility & Capital Sources

Underwriting Community Facilities

- Common Underwriting Issues
  - Revenue and Cash Flow
  - Management
  - Quality/Program
  - Real Estate/Collateral

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Revenue and Cash Flow

- **What to Evaluate**
  - – Public and private sources
    - Stability, frequency, eligibility, timing
    - Fundraising track record, pipeline, funding conditions
  - – Trends and growth patterns
    - Per student, child, or patient encounter
    - Changes in payer

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Revenue and Cash Flow

- **What to Evaluate, cont'd:**
  - Age and type of population served
    - e.g., additional subsidies for low-income
  - Demand in community
  - Retention/turnover
  - Timing of ramp-up
  - In some cases, location
  - Labor and facility costs

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Revenue and Cash Flow

- **What to Look Out for:**
  - Ramp-up: enrollment or attendance often not discounted in projections
  - Waiting lists may not match open spaces
  - Restrictions on funding sources
    - Eligibility, disbursement conditions, track record, future risks, contingency plans
  - Seasonality

Revenue and Cash Flow

- **Summary: Publicly Funded, Under funded and Thin Margins**
  - Primarily funded by public sector
    - Annual or short-term contracts
    - Inherent instability, especially in tough economic times
    - Delays in receiving funds
  - Funding for operations often doesn't include funding for capital
  - High cost areas impacted by statewide funding policies
  - Dependent on fundraising

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Management

- **Summary: Along with cash flow, management analysis is a critical underwriting area for community facility loans**
  - Important factor in borrower's ability to maintain and increase cash flow (primary source of repayment)

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Quality/Program

- **What to Evaluate:**
  - Competitive advantage
    - Response to community needs
  - Measures of quality and accountability
    - Achievement data (schools)
    - Accreditation (child care)
    - Certification/licensing (health care)
    - Funder requirements

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Quality/Program

- **What to Look Out for:**
  - Difficulty of measuring quality
  - Difficulty of retaining quality staff
  - Program experience/knowledge may be centralized

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Quality/Program

- **Summary: Often hard to quantify, quality of program will drive cash flow and be influenced by management**

Collateral/Real Estate

- **What to Evaluate:**
  - Zoning, permitting, and licensing requirements
  - Prior use and condition
  - Age, size of facility, and degree of renovations required
  - Accessibility, transportation availability, and proximity to targeted population

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Collateral/Real Estate

- **What to Look Out for:**
  - – Lack of facility development expertise is real
  - – Special purpose/single use facilities limits re-sale value and restricts flexibility
  - – Development timelines are often under estimated
  - – Project costs are often under budgeted

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CASE STUDY

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Charter Schools

Resources

- Center for Education Reform
  - www.edreform.com
- U.S. Department of Education
  - www.uscharterschools.org
- Charter Schools Development Center
  - www.cacharterschools.org
- State trade associations and resource centers

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Child Care

Resources

- **National Association for Education of Young Children** (local, state chapters) www.naeyc.org
- **National Association of Child Care Resource and Referral Agencies** www.naccrra.org
- **National Children's Facilities Network** www.ncfn.org
- **LIIF, ABCD Initiative** www.liifund.org
- **Building Child Care** www.buildingchildcare.org

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Contact Us

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