Low Income Investment Fund

Charter School and Child Care Facilities Lending
National Community Development Lending School

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Agenda

- Overview of Low Income Investment Fund (LIIF)
- Overview of Community Facilities Lending
- Underwriting Charter School and Child Care Facilities
  - General Underwriting guidelines
  - Borrower characteristics
  - Revenue and Cash Flow
  - Expenses
  - Real Estate
  - Refinance
- Case Studies
- Review of Exhibits

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LIIF Vision and Mission

Vision: The Low Income Investment Fund (LIIF) creates pathways of opportunity for low income people and communities.

Mission: LIIF is a steward of capital for housing, child care and education.

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Who We Are

- National CDFI headquartered in San Francisco with offices in Los Angeles, New York and Washington D.C.
- Has participated in projects in 26 states, but primarily focuses on West and East coasts.
- Makes loans to build affordable housing, charter schools, childcare facilities, and other community facilities
- Business lines include direct lending, structuring loan participations, capital raising, fund creation/management and loan servicing
- Has been allocated $139 million in New Market Tax Credits since 2007

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What We've Done

- $740 million deployed since inception (1984)
- $5.1 million of additional investments leveraged
- Created and supported:
  - 54,000 units of housing
  - 100,000 spaces for child care
  - 2.5 million square feet of commercial or facility space
  - 44,000 spaces for school students
- $110 million in community investment in 2008
  - 1,500 homes for families and kids
  - 26,000 spaces of quality child care
  - 3,800 spaces in schools

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Community Facilities Lending - Why

Poverty Alleviation Strategy

Stabilization of Communities

Job Creation

Community Redevelopment

Real Estate Revitalization

Builds Human Capital

Place Based Strategy

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Community Facilities - Characteristics

- Operate with thin cash flows
- Revenues mostly generated from government contracts
- Have a need to expand facilities or acquire new sites
- Complicated revenue and expense structure (different for charter school vs child care facilities)
- Charter school and child care underwriting is primarily based on the operating business (vs. real estate)
- Strong management team is key so entity remains viable
- Federal and state budget cutbacks
- Political shifts

Charter School Basics

- Charter Schools
  - Independent public Schools
  - Make an autonomy-accountability exchange – promise to provide a high quality education more efficiently
  - Governed by a board of trustees which oversees the school’s finances, management, and day to day operations

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Charter School Basics

- Charter Management Organizations (CMO) vs. Single Operators
  - CMOs are nonprofit organizations that oversee a network of charter schools linked by a common educational mission, instructional design or a specific geographic location
  - Provide significant ongoing support to their campuses
  - Expansion plans include 13-15 schools – considered breakeven
  - Some CMOs keep all schools under a single 501(c)(3) umbrella, whereas others start individual 501(c)(3) organizations for each school
  - The CMO structure will determine where the per pupil revenues flow
  - Take a 6-8% network/management fee from each school to support the CMO overhead expenses

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Charter School Basics

- Charter School Size
  - Typical school size ranges from 300-500 students, can be larger if there are several schools co-located
  - Over 70% of CMOs serve between 1,000 and 5,000 students in total
- School's educational philosophy
  - Important that principals and teachers share the philosophy of the CMO – There may be tension between quantity vs quality
  - Important to build leadership capacity at school sites
  - "Growth for what purpose", very important to understand
- Importance of board and management
  - Board oversees the school's finances, management and day to day operations
  - Management executes on the day to day decisions
  - Important to build leadership – There is no good school without a good principal

Child Care Basics

- 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

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Child Care Basics

- Government funding sources
  - State (CA Specific)
    - 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)
    - Department of Education (Voucher):
      - CalWORKs (parents participating in employment-related activities)
      - Alternative Payment (75% State Median Income)

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Child Care Basics

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

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Community Facilities – Loan Structure

- Revenue Sources
  - Charter Schools: Same as those received by public school (for the most part), and foundation/grant support.
  - Child Care: Government contracts (Head Start, Welfare to Work), parent pay, other private subsidies
- Loan Structure
  - Special Purpose Entity (SPE) as Borrower
  - Parent entity/Sponsor as guarantor
- If an SPE, site is leased to the tenant facility
- Lease payments must be sufficient to cover debt service on loan from SPE (therefore underwrite business cash flow)

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Community Facilities – Loan Structure

- Collateral includes
  - First trust deed on subject property (real estate)
  - Assignment of leases/rents
  - Assignment of other accounts (i.e. reserves)
- Loans are fully recourse to borrowers
- School's/Child Care operating cash flow is repayment source during the loan term
- Takeout source is
  - Refinance at maturity (usually not committed at closing)
  - Or a fully amortizing loan

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Community Facilities – Loan Structure

- Repayment Source – operating cash flow
  - Income: Stability, eligibility, timing
  - Expenses: Growth trend, ramp-up costs
  - Historical trends and patterns – Do they match projections
- Take-out sources
  - What is the refinance risk
- Coverage ratio depends on structure
  - If borrower is the school/child care center then measured at the school/child care center level
  - If borrower is SPE, them measured at the real estate cash flow level
  - But must still include a lease coverage ratio at the school level based on operating cash flow

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General Underwriting Guidelines

- What is source for debt service?
- What is takeout source?
- 5 C’s of Credit
  - Character
  - Capacity
  - Capital
  - Collateral
  - Conditions

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General Underwriting Guidelines

- Understand the programs
  - Is there a reliable measure of accountability
  - Academic Quality/Program Quality
  - Institutional and Financial Health
  - What is the target population
  - Assess the academic program/quality
    - Charter Schools – Academic Performance Index and Academic Yearly Progress
    - Child Care Centers – ECERS or other quality measurement
    - Assess the mission, curriculum, teacher/staff quality

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General Underwriting Guidelines

- Charter School Renewal / Child Care License
  - How likely is it to remain in good standing
  - Have they met the charter objectives
  - Have they met the licensing requirements
  - Have the met the quality performance objectives

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General Underwriting Guidelines

- Assess the real estate
  - What is the current zoning
  - What entitlements are needed
  - Prior use and condition
  - Age, size of facility, and degree of renovations required
  - Is the location desirable
  - Other charter schools/child care centers if tenant is replaced
  - What is the second highest and best use (if there is one)
  - Does the value support the uses
- Accessibility
  - Is it accessible to the targeted population and existing population
  - Is it located close to public transportation

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General Underwriting Guidelines

- Are parameters adequate per proposed charter petition or child care center description
  - Meets minimal space needs for projected enrollment
  - Meets current program needs (per charter or program description)
  - Complies with building and fire codes
  - Staff experience meets program needs
  - Do expenses reflect the educational/programmatic description
  - Are the proposed courses/programs being offered.

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General Underwriting Guidelines

- Does the timeline make sense
  - Construction
  - Entitlements (i.e. need a conditional use permit)
  - Is there enough community and political support
- Other items to look out for in Development Budget
  - Are the costs in sync with the proposed timeline / are carrying costs based on proposed timeline
  - What about the CUP (Are the reports and holding costs covered)
  - Are there sufficient contingencies
  - Are there contingency plans to cover delays (construction, CUP delays)

Contingencies, contingencies, contingencies!

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Borrower Characteristics: Management

- 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)
- Look for experience:
  - Management capacity
  - Board capacity
  - School principals / child care administrators
  - Center decision makers
  - Teachers/child care staff
- Understand the ramp up period

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Borrower Characteristics: Management

- What to look out for
  - Lack of facility development expertise
  - Key person/founder risk
  - Tension between board & management
  - Insufficient resources to handle growth

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Borrower Characteristics: Program Quality

- Program Quality:
  - Charter Schools: API, AYP
  - Child Care: ECERS, R&Rs
- Measures of quality and accountability
  - Achievement data (schools)
  - Accreditation (child care)
  - Certification/licensing (health care)
  - Funder requirements
  - It is a major driver of cash flow
- Quality influenced by management – is there a relationship with a Charter Management Organization (CMO)?
- Competitive advantage
- Response to community needs

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Borrower Characteristics: Program Quality

- What to evaluate:
  - Strength of Board
  - Strength of Parent Organization
  - Mission
  - Curriculum
  - Teacher/Staff Quality
  - Educational Resources
  - Assessment
  - Special Education

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Borrower Characteristics: Program Quality

- What to look out for:
  - Difficulty of retaining quality staff
  - Program experience/knowledge may be centralized
  - Charter Schools: What are the chances of charter renewal/revocation?
  - For expansion: Is there sufficient community and political support?

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Borrower Characteristics: Development Capacity

- Key questions:
  - Has the Borrower ever purchased a property?
  - Has the Borrower ever developed a building?
  - Check references

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Borrower Characteristics: Financial Capacity

- Balance Sheet
  - Examine ratio of Debt to Equity
  - Look at trends in Net Assets
  - Analyze liquidity
- Contingent liabilities
  - How many other guaranties is the Guarantor providing?
  - Is the guaranty meaningful?

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Revenue and Cash Flow

- Public Funding: Federal, State, Local
- Private: Grants, fundraising, Private pay (child care)
- Revenues vary:
  - By region but may be flat across grades
  - Consistent by region but may vary by grades
- Some of the funds vary by:
  - Eligibility (Free and Reduced Lunch, Special Needs, Head Start, Child Care Vouchers)
  - Availability (limited funding, application/income based)

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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

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Revenue and Cash Flow

- Growth rates
  - Must understand macro environment to determine the correct COLA.
  - Currently using 0% COLAs in California for early years
  - 3% expenses, additional for benefits
- ADA (Average Daily Attendance)
  - 92%, should be supported by historical average if higher
  - Note that in NY revenue is not a function of ADA
- Sensitivity (case by case)
  - Cuts in state funding
  - Break-even ADA

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Revenue and Cash Flow

- Enrollment
  - Compare projected enrollment with actual enrollment
  - Shifts in enrollment will directly impact staffing, space, and budget requirements
- Projections vs. Historicals
  - Variance between Historical and Projections (understand the differences)
  - Use result to identify red flags with budget rationales/funding flows
- Cash Flow Projection
  - Will they have sufficient cash on hand during the ramp up period

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Expenses

- Personnel
  - Teachers/Child Care Staff salaries, benefits
  - Student teacher ratios, Staff Child ratios
  - Other costs: staff development, substitutes, food service staff
- Operating
  - Books and supplies
  - Utilities, equipment, printing & copying
  - Assessment and testing
  - Business services
  - Insurance
  - Legal

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Expenses

- Facilities expenses include:
  - Mortgage payments
  - Lease payments
  - Expenses associated with operating the property (maintenance & taxes)
  - This cost should not be above 20% of total budget

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Expenses

- Rules of Thumb:
  - Occupancy cost per student should not exceed 20% of the total non-foundation revenue sources (this should include all costs i.e. taxes)
  - Compensation should be around 55%.
  - Debt service per student ranges between $800 - $1,300.
    - Safe to use $1,100 per student, but based on location
  - Total development costs per student range between $12,000 - $25,000.
    - Safe if less than $18,000. If above $18,000 should be a strong school
    - Child care is less if only one shift

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Charter School Revenue Risks

- 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

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Charter School Revenue (CA specific)

- Varies by School District, Area, and School.
  - State Funding: Largest revenue source. Approximately 59%
  - Local Property Tax: Approximately 22%
    - Aggregate (Local + State) based off State Funding Formula
  - Federal Funding: Approximately 12%
  - Lottery: 1%
  - Miscellaneous Local: Includes fundraising. Approximately 6%
- See Exhibit 1. Common Revenue & Expense Assumptions

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Real Estate

- 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

Refinance

- Minimum 300-350 bps cushion above estimated market rate at refinance (if rate is unsubsidized).
- Minimum 400-500+ bps cushion (if rate is subsidized)
- Calculate difference between mini-permanent rate after construction completion and (b) maximum rate cash flow can handle at maturity based on conventional products
- Use the following parameters:
  - Final year of Net Operating Income
  - Outstanding loan balance at Maturity
  - Assumed Lease Service Coverage of no less than 1.20x
  - Assumed amortization of no more than 25 years
- Rule of Thumb: test at 1.4 coverage should yield a rate in excess of 8.5%

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Case Studies

- Charter School
- Child Care Facility

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Attachments

- Let's review the underwriting attachments:
  - Exhibit 4: Operating Proforma
  - Exhibit 5: Property Proforma
  - Exhibit 6: Sensitivity Analysis
  - Exhibit 7: Refinance Analysis

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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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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Contact Us

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