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
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.
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
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
Community Facilities Lending - Why

Poverty Alleviation Strategy
Stabilization of Communities
Job Creation
Community Redevelopment
Real Estate Revitalization
Builds Human Capital
Place Based Strategy
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
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
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
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)
Child Care Basics

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

• What is source for debt service?
• What is takeout source?
• 5 C’s of Credit
  – Character
  – Capacity
  – Capital
  – Collateral
  – Conditions
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
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
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
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.
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!
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
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
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
Borrower Characteristics: Program Quality

• What to evaluate:
  – Strength of Board
  – Strength of Parent Organization
  – Mission
  – Curriculum
  – Teacher/Staff Quality
  – Educational Resources
  – Assessment
  – Special Education
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?
Borrower Characteristics: Development Capacity

• Key questions:
  – Has the Borrower ever purchased a property?
  – Has the Borrower ever developed a building?
  – Check references
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?
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)
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
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
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

• 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
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
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
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
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
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
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
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%
Case Studies

- Charter School
- Child Care Facility
Attachments

• Let’s review the underwriting attachments:
  – Exhibit 4: Operating Proforma
  – Exhibit 5: Property Proforma
  – Exhibit 6: Sensitivity Analysis
  – Exhibit 7: Refinance Analysis
Child Care Resources

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

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