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
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
Course Overview

Take Away

• 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
Child Care

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
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
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**
Key Lending Characteristics for Child Care and Charter School Facilities

- Revenue Sources
- Borrower Characteristics
- Real Estate Characteristics
- Feasibility & Capital Sources
Child Care and Charter School Facilities Lending

Revenue Sources

• Government revenue sources
  – Federal
  – State
  – Local

• Parent contributions and fee for service

• Charitable contributions
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
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)
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)
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
Government Revenue Sources: Risks (Child Care)

- Federal and state budget cutbacks
- Political shifts
- Population changes
Key Lending Characteristics for Child Care and Charter School Facilities

• Revenue Sources
• Borrower Characteristics
• Real Estate Characteristics
• Feasibility & Capital Sources
Child Care and Charter School Facilities Lending

Borrower Characteristics

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

• **What to Evaluate:**
  – Track record
  – Breath and depth of capacity
  – Stability
  – Board experience
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
Key Lending Characteristics for Child Care and Charter School Facilities

• Revenue Sources
• Borrower Characteristics
• Real Estate Characteristics
• Feasibility & Capital Sources
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
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
Key Lending Characteristics for Child Care and Charter School Facilities

• Revenue Sources
• Borrower Characteristics
• Real Estate Characteristics
• Feasibility & Capital Sources
Underwriting Community Facilities

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

- **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
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)
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
Quality/Program

• What to Look Out for:
  – Difficulty of measuring quality
  – Difficulty of retaining quality staff
  – Program experience/knowledge may be centralized
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
Collateral/Real Estate

• What to Look Out for:
  – Lack of facility development expertise is real
  – Special purpose/single use facilities limits resale value and restricts flexibility
  – Development timelines are often under estimated
  – Project costs are often under budgeted
CASE STUDY
Charter Schools

Resources

• Center for Education Reform
  – [www.edreform.com](http://www.edreform.com)

• U.S. Department of Education
  – [www.uscharterschools.org](http://www.uscharterschools.org)

• Charter Schools Development Center
  – [www.cacharterschools.org](http://www.cacharterschools.org)

• State trade associations and resource centers
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
Contact Us

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