

Community Investments Vol. 10, Issue 4

Financing Childcare: Challenges and Opportunities

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Fall 1998

The passage of a dramatic welfare reform bill in 1997 intensified the nation's focus on the lack of childcare options for low-income families. As a partial solution to the childcare problem, federal daycare subsidies are now available to help keep the cost of operations down so that the price per child stays low. That's great news for welfare parents who are required to find income-generating work that will likely lead them outside the home. But it also presents a predicament for many communities, largely due to a shortage of available facilities.

This article will outline many of the benefits and challenges inherent in childcare development and financing. Think about these points as you consider the direction of your community development initiatives in the coming years. September Jarrett from the Low Income Housing Fund offers an urban perspective on childcare and discusses the newly inaugurated Childcare Facilities Fund (CCFF) in San Francisco. Roderick Marshall from Rural Community Assistance Corporation (RCAC) provides a rural perspective on the issue, and shares information on financing options available through RCAC. Armed with this information, childcare facilities finance may yet find its way into your community development strategy.

Four Good Reasons to Support Childcare Development

1) Unprecedented Demand for Childcare

Between 1977 and 1993, the number of children under five in non-parental care facilities more than doubled from approximately three to eight million. By 1995, there were almost 10 million children in non-parental care programs.¹ Since the enactment of welfare reform, this figure has swelled even further.

Affordability issues are also a problem, particularly for low-income families. Nationally, poor families with small children spend an average of 18 percent of their income on childcare, compared to seven percent spent by wealthier families.²

The situation in San Francisco illustrates key points about both the demand for care as well as affordability issues. Today, 4,000 San Francisco families are on a waiting list for subsidized childcare. To make matters worse, the Department of Human Services estimates there is a need for 2,736 new, licensed childcare slots to meet the demand for families transitioning from welfare to work.³ San Francisco has received \$20 million in new subsidies, but a lack of space (with a one to three percent vacancy rate citywide) is hampering the ability of families to use these subsidies.

2) Childcare Development Supports Local Economic Development

Childcare development is also job development. New childcare facilities result in the creation of jobs for program directors, teachers, teacher's aides, janitors and cooks. In addition, the National Economic Development Law Center estimates that each \$1,000,000 invested in new childcare facilities development results in the creation of 23 "indirect" jobs (in construction, business services and retail) for the period of one year. And, unlike other

business sectors, virtually all jobs supported by the total dollars spent for childcare remain in the local community.

3) Childcare Investment Offers Great Social Returns

Well-publicized medical research has proven that important components of brain development occur during a critical window between birth and age three, and that human interactions and stimulation are essential to this development. Thus, participation in high-quality childcare can positively enhance a child's growth toward his or her full potential. This is especially important for "at risk" children, many of whom grow up surrounded by poverty. According to a recent report by the Rand Corporation, for every dollar spent on early childhood programs, society later saves several more dollars on social program and judicial system spending. One program cited a net savings of \$25,000 per child by calculating how later earnings and tax contributions could offset welfare, education and criminal justice costs.⁴



Photo by Jon Klein of the Low Income Housing Fund

4) CRA Benefits

The revised Community Reinvestment Act (CRA) considers loans, investments and services that support childcare facilities to be qualified community development activities. The most recently published "Questions

& Answers” (Federal Register October 6, 1997) provides some flexibility as to the geographic location of facilities. That is, childcare centers do not necessarily have to be located in a low- or moderate-income geography to receive CRA consideration. A facility must, however, serve children from low- and moderate-income families.

The Challenges of Financing Childcare Development

Despite these reasons to support childcare development, there are several challenges to developing and financing early childhood facilities. Some of these challenges include:

Development Resources and High Costs

While capital resources may be more abundant in urban centers, the high cost of areas such as San Francisco make it especially difficult to develop new facilities. In rural areas, development costs for new facilities may be lower, but access to capital is much more limited.

In San Francisco, it takes an average of \$16,000 per slot to create care for low-income children in nonprofit childcare centers. Development of home-based daycare centers costs an average of \$3,000 per slot.⁵ Experts in San Francisco estimate that at least \$30 million is needed to address the new demand presented by welfare reform. This doesn't include the funds needed to address the existing back-log of kids currently on waiting lists.

Low Reimbursements for Care

Subsidy rates are based on market rates for childcare in a given area. In San Francisco, the average subsidy for childcare is \$120 to \$185 weekly per child depending on his or her age.⁶ In some areas, this subsidy would be adequate, but it certainly leaves no room for facility improvements or the addition of programs, which help ensure long-term quality of care. In high-cost urban areas like San Francisco, this subsidy falls way short of the average \$231 weekly per child to provide quality care. Providers are thus

forced to spend their time fundraising to ensure the ongoing viability of the facility. In addition, most typical operating contracts run year-to-year, posing both development and financing challenges. Furthermore, subsidies have become increasingly parent-based (as opposed to project-based) posing greater financial risk to potential lenders.



Joe Simmons, formerly of the Low Income Housing Fund, at the Tenderloin Child Care Center (photo by John Harding)

Lack of Financing Experience

The shortage of funding for childcare development often leaves providers unable to save to meet equity requirements. In addition, childcare providers may not have sufficient operating income to service debt, and may lack experience in sophisticated debt-management techniques. To date, the vast majority of early childhood facilities are fully grant funded from a mixture of public and private (primarily foundation and corporate) resources. Loan programs are emerging, but significant technical assistance and flexible financing is needed now to better serve providers into the future.

The San Francisco Childcare Facilities Fund (CCFF)

The Low Income Housing Fund is a fourteen-year old community development financial institution with a strong track record in affordable housing lending. It recently launched a new public-private partnership, the San Francisco Childcare Facilities Fund (CCFF), in order to increase the

quantity and improve the quality of childcare in San Francisco. Initial capital for the CCFF was provided by the Miriam and Peter Haas Fund (\$300,000), The Mayor's Office of Children, Youth and Their Families (\$200,000), and Providian Financial Corporation (\$400,000). Additional support has been received by public, foundation, and corporate resources. A linkage fee (or special tax) tied to office space development in San Francisco is another key source of funding for the initiative.

To date, the CCFF consists of three core programs:

- 1) *The Family Childcare Assistance Program (FCCAP)* provides grants of \$1,000 to \$5,000 to meet one-time capital expenses of family (in-home) childcare providers. Applications for the first round of funding, in which \$100,000 was available, were received in May 1998. Twenty-three grants, serving 234 low-income children and supplementing the creation of 66 new childcare slots were awarded. Among the projects supported are facility renovations to provide improved access for disabled children, the purchase of equipment to expand infant care, and improvements to outdoor play space. Funds were entirely disbursed by the end of June. A second round of funding is anticipated in early 1999.
- 2) *The Childcare Center Assistance Program (CCCAP)* provides facilities finance for nonprofit childcare centers in San Francisco. Financial tools available include a limited number of capital grants, zero interest, mini-loans to support project planning, short-term direct loans, and access to conventional loans on favorable terms through CCFF guarantees or interest-rate write downs. Eleven preliminary applications for competitive capital grants have been received and seven awards, supporting the creation of 329 new childcare slots have been made. Five loan requests totaling more than \$2 million and representing 260 childcare slots are under consideration.

- 3) *Technical Assistance* is also provided in order to boost the facilities expertise and business management skills of childcare providers. Seminars on debt, facilities development, and business management are provided to both nonprofit and family-based childcare providers.

The Rural Perspective: RCAC Offers Financing Options

From a rural development viewpoint, the economic realities of financing rural childcare are often more brutal than financing urban facilities. There are two reasons for this:

- 1) Large childcare programs have greater opportunity to service debt, but the smaller population of rural communities doesn't support larger programs;
- 2) Capital infrastructure is generally more developed in large cities than in rural towns, enabling the city provider greater access to resources such as grants, corporate donations, soft seconds, or dollar-per-year property leases.

The amount of equity a rural childcare provider will need to raise depends on an often precarious balance between:

- a) the number of children served and availability of government subsidies, and;
- b) the price of real estate/new construction or the costs of remodeling an existing building. Limited experience in this type of lending means most providers currently have to raise as much as 50 percent of the cost to remodel and existing building and up to 75 percent of the cost to develop a new facility!

Rural Community Assistance Corporation (RCAC), designated by the U.S. Treasury as a Community Development Financial Institution, makes affordable, interim and long-term loans to create or enhance community

facilities in rural communities in 12 states. These facilities can include childcare, adult day-health care, domestic violence protection and medical care. An interim loan offers childcare or other providers up to three years to meet long-term loan conditions typically required by traditional lenders. *RCAC Interim Loans* span a crucial gap in time, between initial concept to actual operation of a needed facility. The loan can be used for:

- Building a new facility;
- Buying and/or rehabilitating an existing building; or,
- Remodeling to improve the quality of an existing facility for increased capacity or scope of service.

The interim loan allows a provider to complete predevelopment and construction activity, move its program to a new location, stabilize its revenue and expenses and become a more attractive borrower in the eyes of a long-term lender.

RCAC's Loan Guarantee Program provided through the United States Department of Agriculture--Rural Development (USDA-RD), enhances long-term facility financing. Having recently received eligible lender status to participate in this program, RCAC now has the ability to make long-term loans that are 80 percent guaranteed by USDA-RD. Borrower qualification under this program is the same as RCAC's program:

- The facility must be located in a rural area with a population of less than 50,000 people;
- The borrowing entity must be a nonprofit organization or legally organized for the benefit of the general public, e.g., a cooperative, municipality or association; and
- Fifty-one percent of the families benefiting from the proposed facility must earn at or below the area median income.

Given the amount of equity that childcare facilities require, ownership may seem nearly impossible, but there have been a few exceptions. One provider was able to obtain a \$300,000 community development block grant and raise \$50,000 from fundraising activities, individual cash contributions and in-kind donations from local merchants. This equity of \$350,000 plus a 25-year USDA-RD guaranteed loan for \$100,000 enabled the provider to build a facility for 60 children which employs 10 people. This is an increase from its former capacity of 32 children and five employees.

There are numerous examples of creative financing for facility ownership, but it's never as simple as finding "free money" or a lender with a mission. Facility ownership comes about as a result of finding the right technical assistance to mold cash from all sources into a structure that is economically viable for those dedicated to providing decent care in an enabling environment.

In Conclusion

The childcare industry cannot expand its capacity to serve more families and offer better quality of care unless it leverages its current capital base and strategically uses loans as a tool to do so. Financial institutions and community-based organizations must confront financing and development challenges head-on, and must act as partners to provide the necessary flexibility and support to create quality childcare facilities. After all, if the adage is true that "children hold the key to the future," isn't the extra effort now worth the social benefit later?

Technical information may be available to childcare providers through local Childcare Resource and Referral Centers. The National Economic Development and Law Center can also provide technical assistance to providers in California and referrals for other states. For more information, contact Julie Sinai (510) 251-2600.

For more information about the San Francisco Childcare Facilities Fund, please contact September Jarrett or Jonathan Klein at (415) 777-9804. For information about loan programs offered by RCAC, you are encouraged to call Rod Marshall at (916) 447-9832, (ext. 142) or Sondra Hartwell (ext.145).

¹The Economics of Child Care: A Report by the Council of Economic Advisors (December 1997).

²Ibid.

³San Francisco Department of Human Services, Capacity Projections (September 11, 1998).

⁴Los Angeles Times (April 23, 1998).

⁵ Survey of Nonprofit Childcare Centers completed by the Childcare Facilities Fund of the Low Income Housing Fund (April 1997).

⁶Regional Market Rate Ceilings for California Childcare Providers, California Childcare Resource and Referral Network (July 1997).

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