BUILDING CHILD CARE
A California Statewide Collaborative

Building Child Care:

A New Resource for Financing the Construction, Renovation and/or Acquisition of Child Care Facilities

Tuesday, June 4, 2002

Agenda

1. Facilities Development Process
2. Financing Considerations & Terms
3. Available Financial Resources
4. Case Studies
5. Resources
6. Questions & Answers

The Facilities Development Process

The process can be broken into three major phases…

1. Planning
2. Predevelopment
3. Development

The Planning Phase

Addresses three key questions:

1) Is there **market demand** for the proposed facility and services?
2) Is the proposed facility project **financially feasible**?
3) Is the sponsor **organization ready** to take on this project?

Market Demand

- Are there a sufficient number of families demanding the new child care services at the rate to be charged?
- Are the rates sufficient to generate operating revenues to meet staff, program and facilities costs?
- A business plan can be used to answer these questions.

Refer to: Child Care Financial Planning and Facilities Development Manual Chapter 3: Developing a Business Plan: Section 5: Market Feasibility Analysis, pg. 11.

Financial Feasibility

- What will it cost to build the new facility?
  - Hard costs (acquisition, construction, equipment)
  - Soft costs (design, permits, legal, financing)
  - Hidden costs (staff and board time, attention)
- What are the likely funding sources?
  - Equity
  - Debt (What can be financed?)

Refer to: Child Care Financial Planning and Facilities Development Manual Chapter 2: Developing Pro Formas and Determining Debt Capacity

Organizational Readiness

- Does the agency have the leadership necessary to undertake the project?
- Is the agency financially ready?
- Does the agency have community support?

Financial Readiness

Is the agency in a financial position to take on a facility project and/or debt?

- Red flags – factors that may inhibit provider from obtaining needed funding, meeting commitments, repaying loans.
- Green lights – factors that suggest project success

Red Flags

- Difficulty meeting payroll or taxes
- Borrowing from officers/ directors
- Unable to pay bills promptly
- Large amount of uncollected receivables
- Deficits in recent years
- Agency doesn’t know current financial position
- Agency can’t explain audit.
- There is no cushion or cash reserve

Green Lights

- Services are constrained by lack of space
- Agency is financially strong and growing
- Success identifying and obtaining new funding sources each year
- Financial systems are in place, strong
- Agency understands and guides your financial position

If a facility project has green lights for…

✓<u>Market demand</u>

✓<u>Financial feasibility</u>

✓<u>Organizational readiness</u>

Then its time for the next phase:

PREDEVELOPMENT

The Predevelopment Phase

- Everything an agency needs to do to begin construction on a new facility
  - Selecting a site
  - Obtaining site control & approval
  - Designing the project
  - Securing a Contractor
  - **Obtaining Financing**

Refer to: Child Care Financial Planning and Facilities Development Manual Chapter 4: The Facilities Development Process.

Obtaining Financing

- Finalize the business plan
- Determine the start up/capital budget for the project
- Identify likely sources (equity and debt)
- Apply for Funding
- Secure Commitments
- Close loans/have cash in hand

Refer to: <u>How to Start a Child Care Center in San Francisco: </u>Funding the Business, pages 31 to 52.

Once a site has been selected, secured & approved for child care,
the facility has been designed, a contractor has been selected,
financing has been secured…
its time to move to the next phase,

DEVELOPMENT

The Development Phase

- Construction or renovation
- Building sign off
- Equipping the classroom(s)
- Licensing approval (inc. fire clearance)
- Ramp-up
  - Phasing staff & children from day 1 to target enrollment

Note: Double time estimates for each step.

Facilities Development Summary

The process is comprised of three major phases…

1. Planning
2. Predevelopment
3. Development

Basic Finance Considerations And Terms

- Each phase of development requires funding
  - Planning and Predevelopment best funded via internal resources or grants or soft loans
  - Development costs (construction and permanent) better suited to loans
- Facility costs can be paid by equity or debt

Why Consider Financing?

Facility projects are costly.

- Costs vary by several factors including type of project, location, cost of land, labor…

Why Consider Financing (cont.)?

Financing enables a child care provider to meet high costs and get services to families faster.

- *It takes a long time to raise grants.*
- *Capital campaigns may compete with operating fundraising.*

Why Consider Financing (cont.)?

It's capital efficient.

- *Allows an agency to leverage savings/grants*
- *Pay for costs over time (the life of the property).*

Why Consider Financing (cont.)?

Financing may bring *ownership* within reach.

- Long term tenure
- Customize the space for kids and staff
- Build agency financial position

ABC's of Loans

- **Interest rate**: amount lender will charge.
- **Principal:** original amount of money borrowed.
- **Term:** agreed upon repayment term.
- **Amortization**: period of time on which monthly loan payments are based.

ABC's of Loans (cont.)

- **Balloon payment**: the final payment of a loan which has a longer amortization than term.
- **Points**: an up front fee a Lender may charge for a loan, expressed as a percentage.
- **Fees**: Charges from a Lender for making a loan.

ABC's of Loans (cont.)

- **<u>Collateral:</u>** the property pledged to a Lender to secure repayment of a loan.
- **<u>Lien:</u>** a claim a Lender will place on property in return for making a loan.
- **<u>Guaranty:</u>** A promise to repay a loan, usually from a third party.

ABC's of Loans (cont.)

- **Loan to Value Ratio**: The relationship of a loan to the appraised value of the collateral

  (loan amount/appraised value)=LTV

- **Debt Service Coverage**: A calculation a Lender uses to determine the ability to repay (net income/ loan payment) = DSC.

What Lenders Consider (5 C's)

1. Cash flow/Capacity to Repay
   - Will an agency be able to meet its monthly payment?
   - Typically determined by debt service coverage ratio
   - First step out of the box for most lenders

What Lenders Consider (5 C's)

2. Character/Capacity to Execute Project
    - Is there a sound vision and business plan?
    - Is there leadership and technical capacity to execute that plan?
    - Lenders will typically analyze agency leadership (staff and board) and experience of development team (consultants, architect, contractor).

What Lenders Consider (5 C's)

3. Capital/Equity Investment in Project
   - What agency dollars are invested?
   - What other equity sources are invested?
   - Lender's typically look for a significant investment by the agency.

What Lenders Consider (5 C's)

4. Collateral
   - What is the value of the property being pledged for repayment of the loan?
   - Lenders typically commission appraisals of property or other assets.
   - Most Lenders have policies regarding loan to value ratios e.g. will lend only 80% of value.

What Lenders Consider (5 C's)

5. Credit History

- What is the credit history of the agency, owners, and guarantors, if any?
- Credit reports are available on nonprofit and for profit agencies and will be reviewed
- Lenders will look at past performance carefully

Refer to: <u>Child Care Financial Planning and Facilities Development Manual Chapter 2</u>: Developing Pro Formas and Determining Debt Capacity, pg. 15.

Case Studies: Facilities Financing

Points to remember:

- There is no "standard" way to finance a project
- Financing structures vary widely from project to project depending upon the circumstances

Case Studies: Facilities Financing

Kids First, Inc.

- Located in Anytown, CA
- New site: leasing a modular unit and construction of a new building for more classrooms and administrative space
- Cost: $1,045,700
- Financing provided by:
  - City of Anytown Economic Development Department
  - Prop 10 Commission
  - A regional community development corporation

Case Studies: Facilities Financing

Child's Play

- Located in Bigtown, CA
- Purchasing and rehabilitating a single family home for use as a child care center
- Cost: $464,000
- Financing provided by:
    - A statewide loan fund
    - A local commercial lender
    - The owner's equity

SAMPLE PROGRAM--- PURCHASE PORTABLBE ON PUBLIC LAND

SOURCES	**Amt.**	**USES**	**Amt.**
Agency Savings	12,350	Deposit for leased land	1,000
Community Development Block Gran	77,000	Architecture/Engineering	10,000
Prop 10 Grant	60,000	Permits/Fees	5,000
Revolving Loan Fund Loan	120,000	Grading/Site Prep	30,000
Total	269,350	Portable	120,000
		Security System	6,000
		Fire Alarm	8,000
		Fence	12,000
		Playground	55,000
		Contingency (5%)	12,350
		Equipment	10,000
		Total	269,350

Cost per square foot (2400)	$112
Cost per space (48)	$5,611

Monthly Facility Costs	
Loan Payment (10 yr., O int)	$1,004.52
Lease Payment for Land	$250.00
Total	$1,254.52

Financial Resources for Facilities Development

- There's a broad "landscape" of facilities financing resources

  - Different institutions, different products

- One size does not fit all

  - Each facility development project will have its own unique financing needs

The Financial Institution Landscape

- Conventional Institutions
- Alternative Lenders
- Government-Certified Small Business Lenders
- Government Resources
  - **Local**
  - **State**
  - **Federal**

Sample Federal Resources

- U.S. Department of Housing and Urban Development (HUD)
- Small Business Administration Programs

Sample State Resources

- Low Income Housing Fund
- Department of Education: Child Care Facilities Revolving Fund Program

Sample Regional Resources

- Northern California Community Loan Fund
- Santa Cruz Community Credit Union

Where to turn for further information?

- Child Care Facilities Development Financial Resources and Technical Assistance in California (matrix form)

- A Resource Guide: Financing Child Care Facilities Development in California

  - Expanded version of matrix

Building Child Care Collaborative

- **Purpose**: To begin to build a statewide technical assistance infrastructure for facilities development finance.

- **The Members**: National Economic Development and Law Center, California Child Care Resource and Referral Network, Child Development Policy Institute Education Fund, Child Care Facilities Fund of the Low Income Housing Fund.