This case study describes the development of a child care center that is co-located with new affordable family rental housing in a major urban California setting. The housing development also includes a specially-designed apartment designated for occupancy by a licensed family child care provider.

Project Background

The new development lies in a formerly industrial area now rezoned for mixed-use development. Most of the new residential development is market rate housing built by for-profit developers. The affordable housing component was competitively bid by the City and awarded to a Community Development Corporation (CDC), whose service area is a predominantly Latino, immigrant neighborhood. The CDC built 100 affordable 1-4 bedroom units that were rented to tenants earning between 10% - 50% of area median income. Most of the apartments are designed for families, with 85% sized at 2-4 bedrooms. Some of the units are allocated to formerly homeless and special needs residents.

During the development's planning phase, the CDC hired a consultant to perform a child care needs assessment for the emerging neighborhood. Demographic projections showed a need for both subsidized and market rate slots for 0-13 year old children. The CDC set aside shell space for a 40 slot center at street level, and also designated two apartments within the complex for use as licensed family child care homes. These child care services were planned to be accessible to both the housing residents and the larger community.

While the project was still in the predevelopment stage, the CDC issued a Request for Proposals for a child care operator to help design, develop and ultimately run the center. They selected a well-regarded neighborhood social service agency that operates child care centers at multiple locations. The center was intended to serve infants, toddlers and preschool children, with allocations of Head Start and California Department of Education (CDE) subsidies as well as some private-pay spaces. The family child care apartments were planned to serve infants through school age children.

Child Care Provider Background

Founded in 1970, ABC Neighborhood Center offers programs that reflect over 30 years of community based services to low income families, primarily recently arrived immigrant residents in their dense urban neighborhood. ABC provides a range of culturally sensitive social services to individuals of all ages, with a special focus on the needs of minority young children, adolescents, and the elderly. ABC has been a Delegate Agency for Head Start since 1980 and operates Head Start programs at all of its centers, serving three hundred and forty children and their families. Full day services are available to 100 children through a blend of California Department of Education and Head Start funds. ABC also runs a multi-service youth center that offers comprehensive quality programming for youth ages 5 to 18 years old as well as a variety of programs for low-income elderly residents of the area.

Provider Selection

As noted above, ABC Neighborhood Center was selected through a Request for Proposal (RFP) process. The RFP described the proposed housing development, the construction timeline, and the expected role of the child care operator. Key components included:

- **Rough schematic designs** for the child care center, showing its siting within the development. The designated shell had 3,400 square feet of interior space, 3,400 square feet of outdoor space in an adjacent courtyard, and an entrance on a relatively quiet street with room for a dedicated drop-off zone, although with limited parking. The entrance was also two blocks from a transit hub. The shell space provided by the CDC included exterior walls and utility "stub outs" (electrical, plumbing, mechanical, fire protection hook-ups) but no interior improvements.
- **Center Development**: It was stated that the child care operator would be expected to obtain the funding needed to build out the center. The operator would hire its own architect and enter into a separate construction contract with the General Contractor performing the housing construction. The operator would assemble its own development team to manage the project and coordinate issues with the CDC's architect, contractor and project managers.

In the RFP response, the child care operators were asked to submit information about their agencies, including organizational history, program descriptions and full financial records, along with relevant development experience and a detailed proposal for the build-out and operation of the new center. The CDC conducted site visits and interviews to ensure that the child care programs' philosophies were consistent with their own mission as a community-based developer serving diverse populations. The proposals were scored by a panel, and ABC was selected. The CDC and ABC then entered into negotiations to develop a build-out plan and address administrative issues, including the development of a Lease Operating Agreement. Once these negotiations were complete, a contract was signed, formalizing the relationship.

The contract negotiation had some initial sticking points. Several early discussions involved educating the CDC about the constraints of child care operations. The CDC had expected the operator to serve infants, toddlers and preschool age children. The operator explained that the small size of the center (40 spaces) made this age mix fiscally untenable, and lobbied for just preschool enrollment. The CDC conceded, in part because the family child care units would be available to serve infants and toddlers.

A second point of contention involved the target income levels of the families. There is often a disconnect between the income ceilings of affordable housing residents and the ceilings for child care subsidy eligibility. Housing eligibility is calculated as a percentage of Area Median Income (AMI), typically 50% or 60% AMI. State-subsidized child care income thresholds are set at 75% of State Median Income (SMI), while Head Start eligibility is Federal Poverty Level. Particularly in high-cost counties, eligible housing residents are often over-income for child care subsidies. Housing developers typically include child care as an amenity for their residents, so prefer that operators bring subsidized or low-tuition slots that can be used by tenants.

In this case, many residents below 50% AMI qualified for CDE contracted slots, but few had incomes low enough for Head Start services. To complicate matters, the developer wanted the operator to offer some slots to neighborhood market-rate residents as a strategy for integrating the affordable housing into the community. After protracted negotiation, the parties agreed to use one 20-slot classroom for Head Start, with wraparound CDE contracts providing full-day services. The second classroom would have an allocation of CDE contracted spaces, but also be used for children with Alternative Pay vouchers and private-pay children. This approach has proved reasonably successful, although some of the Head Start children travel from ABC's main service neighborhood. There are also fewer market-rate children enrolled than were expected.

Having settled the proposed enrollment, ABC and the CDC also negotiated the lease agreement. The CDC had initially planned to charge $1 per square foot, but ABC requested a reduction to offset their payment for the center build-out. They ultimately negotiated a $ .49 per square foot cost, which was the actual cost to the owner of maintenance, insurance and other prorated building and management expenses. The CDC offered a 20 year lease with the option of a 10 year renewal.

<u>Planning and Predevelopment</u>

Once ABC and the CDC entered into a development agreement, ABC began assembling its development team and lining up project financing. The operator selection had taken longer than planned, so there was pressure to move forward quickly. The immediate need was to accelerate the center design so that construction drawings could be incorporated as an addendum to the housing's building permit. This would enable the center construction to be performed by the housing contractor, which was crucial as a cost and time saving measure. In a rare stroke of luck, the housing architect also had extensive experience designing quality child care facilities. ABC had secured grant funding to cover partial predevelopment costs (see budget in Financing section) and thus was able to quickly sign an architectural contract. They also engaged the construction manager for the housing as construction manager for the center. ABC designated the Director of Child Care programs as the agency's project manager. She had previously developed a child care center, so understood the process and the tremendous time commitment. The Assistant Director of Child Care was also part of the team, sharing development responsibilities and shouldering extra child care program management duties.

The architect was able to provide a rough cost estimate of approximately $1 million. This enabled ABC to start assembling construction financing. The architect concurrently continued with design development, keeping in constant communication with ABC staff to ensure that the center design matched program requirements. The design period from start to complete construction documents took about 9 months. Because of the architect's design and communication skills, the final design struck an excellent balance between cost-containment, functionality, and aesthetics.

Development Financing

As part of the RFP, the child care operator had been given very rough cost estimates along with a City commitment to support the project as much as possible. ABC thus understood from the start that while some public and private grant funding would be made available, they would also need to fundraise and obtain loan financing. They began to put together a development budget by assessing their realistic grant prospects. They also analyzed their funding gap and started discussing loan financing with the Low Income Investment Fund (LIIF), a community development lender with a dedicated child care facilities loan fund.

ABC initially had a $85,000 grant commitment from the Redevelopment Agency, which was sponsoring the entire development project. They were able to obtain a total of $95,000 in planning and predevelopment grants from the Child Care Facilities Fund (CCFF), a local funder. As a Head Start delegate they were eligible for Head Start capital financing, which is often available at approximately 20% of project cost. Working with the $1 million cost estimate, they applied for a $200,000 Head Start capital grant. Finally, they had a commitment of $120,000 in child care mitigation fees paid by local developers.

At this point, potential grant funding totaled $500,000. This projection was complicated by the timing of the Head Start grant cycle, which had a 6-9 month gap between application and award announcement, with another several months between commitment and funding. Nonetheless, ABC took a leap of faith and approached LIIF for a $500,000 loan to complete the financing package. The LIIF financing was available as a construction loan that would convert permanent financing at 5% interest with a 10 year term and the option of up to a 25 year amortization. LIIF's underwriting required a 1.1 debt service coverage ratio, which meant that the center's net operating income would need to be 10% greater than the loan repayment. Although ABC did not own any property for collateral, LIIF was willing to secure a loan with leasehold improvements.

After analyzing their cash flow, LIIF determined that ABC could just support a $500,000 loan if the amortization were stretched over 20 years. This would leave ABC with a balloon payment due at the end of the 10 year term, which would need to be paid down through capital campaign proceeds or refinanced. ABC went forward with the $500,000 loan application based on this analysis.

By this time, construction drawings were near completion. However, construction costs had risen over the past year, and despite an inflation allowance in the initial budget, cost estimates now came in at $1.12 million. ABC was unable to assume additional debt, so prevailed upon its development partners to increase their funding. The Redevelopment Agency ultimately contributed an additional $75,000, the CCFF added $25,000 and ABC contributed $20,000 of its own capital. The Head Start Capital grant was awarded and funded shortly before construction started.

The final project sources were:

Redevelopment Agency	$160,000
CCFF	120,000
Head Start Capital	200,000
Mitigation Fee (City)	120,000
ABC Neighborhood Ctr.	20,000
LIIF loan	500,000
Total sources	**$1,200,000**

Construction

The construction period lasted approximately 8 months, and coincided with the building's final construction phase. Toward the end of this period, ABC began marketing its services in the neighborhood, as well as in its primary service area. They received a $20,000 grant from CCFF to assist with start-up and equipment costs, and matched that amount with agency funding. ABC began enrolling Head Start children before the center opened, and filled that 20- slot classroom within a few months. It took approximately nine months to reach full enrollment of the second classroom, which has predominantly CDE–contracted slots and children with AP vouchers. The center is spacious, attractive and functional, which has helped retain staff and made it very popular among building residents.

Family Child Care Units

As noted above, the CDC also included two family child care apartments in the building. These are located at the podium (first story terrace) level, and open onto a large interior common area with open space and a playground. These units were specially designed to accommodate small family child care programs that are licensed for up to 8 children. Special design features include clear sightlines from the living room to kitchen, an extra half-bathroom, extra closets for storage, and siting near the building's playground.

These units were marketed separately from the other residential units, which were leased through a highly competitive lottery. The CDC solicited applications from licensed family child care providers with strong operating histories. The providers' families needed to meet the income and family composition qualifications for these 2 bedroom apartments. Prospective provider-tenants were interviewed and selected by the building's property managers. The providers' lease agreements stipulate that if they stop operating their child care business, they will relocate to the first available comparably-sized apartment, so that the family child care unit may be leased to another provider. This approach has proven successful in offering care to infants and school-age children who can not be accommodated in the preschool center.

The entire project took approximately three years from planning through start-up. It offers a successful model for incorporating child care services into multifamily housing development.