

Following the “Five C’s of Credit” principles, this document is intended to be a guide when considering the capacity of a child care business to carry debt.

1. Cash Flow/Capacity to Repay

Will the child care business be able to meet its monthly payment?

This is typically determined by the debt service coverage ratio. When reviewing a child care business’ cash flow statement remember their margins are usually very thin so small fluctuations to revenue or expenses will have big implications. When determining a child care business’ capacity to carry debt, consider the following:

Revenue¹

- When expanding or opening a new location, a conservative monthly phased ramp-up budget should be developed
- No more than 90% enrolment & collections should be assumed
- Remember that government reimbursements take 30 -90 days
- Be sure to scrutinize sources for trends, future risks, local environment, and contingency planning
- Consider required staff/child ratios when adjusting enrolment if you’re trying increase the revenue stream

Expense

- Public subsidies don’t always cover expenses, especially in high cost areas
- Analyze expenses as fixed (rent, mortgage, insurance) and variable (staff, food) to determine a break even enrolment
- Expenses vary greatly due to several factors:
 - Location of the program and regional costs
 - Quality of child care provided
 - Age of the children being cared for (infants most costly)
 - Needs of the child (special needs children higher)
- Rules of Thumb:
 - Payroll 55% - 80%, very labor intensive sector
 - Enriched programs tend to have more staff
 - Recruitment costs should be budgeted on-going
 - Occupancy 8% - 25%²
 - Utilities tend to be high

¹Revenue sources may include Parent Fees (non-subsidized tuition), Head Start/Early Head Start, California Department of Education (Child Care, State Preschool, and Alternative Payment), CalWORKs, USDA Food Program, CDBG, Corporate or Philanthropic Grants, and other locally administered subsidies.

² It’s not uncommon for child care providers who serve low income families to pay as little as 8% for occupancy costs.

- Food 4% - 10%
- Full day programs have higher costs
- Materials/Supplies, Professional Development 1% - 6%
- Replacement reserves, \$0.50 to \$1.50 per sq ft, depending property condition³
- Account for operating reserves when allowable by government funding sources

2. Character/Capacity to be a Responsible Borrower

Is this a sound child care business? Is there leadership and technical capacity to effectively operate the business?

There are many nuances to a child care business. Continual fundraising to cover the full cost of operations, compliance with facility licensing regulations, and managing public subsidy contracts to name just a few. In order to evaluate this type of business it's helpful to understand some sector-specific quality business indicators.

Evaluating the Business

- Is there evidence of lengthy child care experience, community involvement and support?
- Do they have experienced and engaged board members, management, and staff?
- Is there low staff turnover and commitment to professional development?
- Do they have experience and are in good standing with public subsidy sources?
- What is their track record with Community Care Licensing?
- Has there been a high rate of avoidable liability insurance claims.
- Do they have a quality child care program (environment, staff/child interaction, parent involvement)?
- Have they prepared a detailed market analysis with current and reliable data? An analysis should describe supply and demand and include the following:
 - Target population growth and income trends
 - The impact of housing, jobs, education, and transportation on their market, site location and business operations
 - Evaluation of competition (openings, closures, location, slots, target market)
 - Subsidy sources and availability
 - Special market niche
 - Current waiting list
 - High rate of referrals and other successful marketing strategies

3. Capital/Equity Investment

What is the business' cash investment? What other equity sources are they investing?

Child care businesses are typically debt averse, historically relying on fundraising to cover the full cost of operations and to pay for capital improvements. However, some child care businesses can actually pay up to 40% of capital development costs with debt. Yet, in order to cover the entire cost of a capital improvement project, grants and equity investments are needed.

³ \$0.50 to \$1.50 per square foot should be deposited annually.

4. Collateral

What is the value of the property being pledged for repayment? If property isn't being pledged, what form of collateral will be used?

Determine the value of the property, leasehold improvement, and other business assets to insure it will meet a lender's minimum loan to value ratio. If there isn't sufficient collateral, a third party guarantor may be necessary and there are agencies that offer loan guarantees specifically for child care businesses.

5. Credit History

What is the credit history of the business (owner, principles, or nonprofit board)?

Inquire about recent credit reports. It is not unusual, however, for child care businesses to have no credit history, especially if they are debt averse. But, these businesses can verify their ability to pay bills and manage their finances by documenting their relationships with vendors.

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