Building Pre-K

Philanthropy & CDFI Collaborations in Financing Early Education Facilities

Prepared by the Low Income Investment Fund
for the Deutsche Bank Americas Foundation

About the Low Income Investment Fund

The Low Income Investment Fund (LIIF) is dedicated to creating pathways of opportunity for low income people and communities. Serving the poorest of the poor, LIIF is a steward for capital invested in community-building initiatives. In so doing, LIIF provides a bridge between private capital markets and low income neighborhoods.

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Executive Summary

The success of contemporary pre-Kindergarten (pre-K) expansion efforts depends in part on finding a solution to the persistent challenges of financing and constructing quality child care facilities at scale. Decades of rigorous research and advocacy demonstrate the benefits of quality pre-K education for children, their families, and society. However, pre-K and other forms of early care and education (ECE) are often provided by small businesses whose economics provide insufficient cash flow to support the debt financing needed for facility development. These providers understandably channel their scarce resources to the immediate care and education needs of their students, leaving little left over for facilities maintenance or improvements. Child care facilities should be safe, healthy, and promote cognitive development, but finding financing is frequently a high barrier to developing and preserving high-quality facilities.

In light of these challenges, community development financial institutions (CDFIs) have partnered with foundations to find solutions to financing child care facilities development and renovation. These solutions have included a common suite of tools—loans, grants, technical assistance, and policy advocacy. However, research that synthesizes the lessons learned by multiple CDFIs is still in its early stages. Furthermore, the research and public debates about education emphasize topics such as curriculum and high-stakes testing, while rarely discussing investment in educational facilities. Through case studies of the Low Income Investment Fund, Children's Investment Fund, First Children's Finance, and Reinvestment Fund—four prominent child care lenders—this paper seeks to highlight current best practices across the country, while also exploring the questions: What new types of programs and initiatives could foundations provide funds to CDFIs to pursue? What are the steps to ensuring that child care facilities lending can expand, further cementing the accessibility of high-quality pre-K?

Our research suggests that foundations could fund:

1. Research and advocacy that makes the child care facilities problem tangible to politicians, funders, and families.

2. CDFIs and nonprofit lenders to collaborate with states and localities on child care facilities financing strategies, coordinating with early childhood organizations to complement advocacy work currently underway.

3. An expansion of child care business technical assistance training, emphasizing partnership with existing small business training and ECE educational institutions.

4. Facilities project management technical assistance, in addition to initiatives to train construction industry professionals in early childhood facilities design and development.

5. The formation of nonprofit, turn-key child care facilities development companies, modeled after those existing in the charter school field.

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Introduction

Photo courtesy of Purple Crayon, Brooklyn, NY

The success of contemporary pre-Kindergarten (pre-K) expansion efforts depends in part on finding a solution to the persistent challenges of financing and constructing quality child care facilities at scale. Decades of rigorous research and advocacy demonstrate the benefits of quality pre-K education for children, their families, and society. However, pre-K and other forms of early care and education (ECE) are often provided by small businesses whose economics provide insufficient cash flow to support the debt financing needed for facility development. These providers understandably channel their scarce resources to the immediate care and education needs of their students, leaving little left over for facilities maintenance or improvements. Child care facilities should be safe, healthy, and promote cognitive development, but finding financing is frequently a high barrier to developing and preserving high-quality facilities.

Nongovernmental organizations have long sought solutions to this facilities funding challenge. Child care businesses and their real estate are frequently difficult to finance with conventional tools, but community development financial institutions (CDFIs) and similar nonprofit lenders have experimented with methods for creating scalable and sustainable facilities investments. Since at least the early 1990s, CDFIs have collaborated with foundations, and at times the public sector, to finance and develop high-quality child care facilities using a combination of loans, grants, technical assistance, and policy advocacy. However, research that synthesizes the lessons learned by multiple CDFIs is still in its early stages. Furthermore, research and public debates about education emphasize topics such as curriculum and high-stakes testing, while rarely discussing investment in educational facilities, which requires substantial political backing because it is perhaps the most capital-intensive piece of the quality puzzle.

More can and must be done. Together, foundations and CDFIs are well suited to lead the way.

The Pre-K Consensus

This is a historical moment of opportunity to invest in pre-K. Abundant rigorous, scientific evidence undergirds a broad consensus that high-quality pre-K is critically important for children and families. Nationally, the consensus has manifested as support for pre-K at all levels of government and in the philanthropic sector.

Contemporary research on early childhood education, with origins as far back as the 1960s, indicates that investments in high-quality early childhood care and education are cost-efficient investments in family well-being and economic prosperity. The body of research is vast and nuanced, but the work of Nobel laureate and economist James Heckman is illustrative. Heckman demonstrated that high-quality early care and education for low-income children can dramatically improve children's life outcomes and deliver a 7 to 10 percent annual return on investment to society, primarily from cost savings to the criminal justice system.[2] Recent studies, which examine pre-K programs implemented at scale, have demonstrated that high-quality pre-K programs improve children's school readiness and thus set up children for improved life outcomes.[3] From a business perspective, family-friendly workplaces, including those with employer-sponsored child care, have been associated with benefits including increased productivity and retention,[4] while absenteeism resulting from child care issues costs businesses nearly two full work weeks per parent each year.[5] Access to high-quality child care has also been shown to support women's participation in the labor force, thus furthering gender equity and bolstering family income.[6] Detractors typically ignore the benefits to employers and families, instead choosing to argue against pre-K expansion because best practices are not yet unequivocally defined.[7] Yet, research and practice are evolving to allow for a "rapid-cycle, iterative process" of program design and development, which will ensure that pre-K is made available while being continuously improved based on real-time information about what works.[8]

The opportunities for improving early childhood care and education are therefore pressing and vast. Non-parental child care arrangements are widespread. Current estimates find that approximately 11 million children under age 5 are in non-parental care arrangements for an average of 36 hours per week.[9] Of these children, 35 percent (3.85 million) spend time in center-based care such as pre-K and preschool, and 26 percent (2.86 million) spend time in two or more child care arrangements each week. Yet, more than 90 percent of care arrangements are of insufficient quality to positively influence child outcomes,[10] and it is generally accepted that center-based child care remains unaffordable to families across the country due to limited government subsidies and high tuition—exceeding $10,000 per 4-year-old per year in the most expensive areas.[11]

Both politicians and foundations have taken action accordingly. Leading the way at the local level, in 2014 New York City Mayor Bill de Blasio promised to provide pre-K for all 4-year-olds in New York City and delivered on his promise within two years.[12] In 2015, states in the aggregate increased spending on pre-K over the prior year,[13] and at the federal level, the bipartisan Every Student Succeeds Act emphasized the importance of early education, making explicit the ability to use Title I and Title II funding for early childhood, and re-authorizing the Preschool Development Grant program for $250 million per year over four years.[14] Among foundations, the Deutsche Bank Americas Foundation, The Kresge Foundation, and The William Penn Foundation have collectively donated millions of dollars to support early childhood improvement initiatives in New York City, Detroit, and Philadelphia, respectively. Their work is notable among foundations in that they fund the financing and development of high-quality child care facilities. Additionally, a consortium of national funders including the Bill and Melinda Gates Foundation, the Buffet Early Childhood Fund, and The Pritzker Children's Initiative support the early childhood advocacy group called the First Five Years Fund.[15] Investing in pre-K is today a mainstream idea, but much work remains—especially with regard to pre-K facilities.

The Facilities Problem

Delivering on the promise of high-quality pre-K requires delivering on high-quality facilities. This is in addition to dimensions more commonly associated with program quality, such as curriculum, pedagogy, staff-child ratios, and teacher training. However, finding financing is frequently an immense barrier to developing and preserving an adequate number of child care seats in high-quality facilities.

The Children's Investment Fund—a child care facilities lender based in Boston—defines facility quality on a spectrum, ranging from baseline regulatory standards, to professional standards, to best practice standards.[16] Regulatory standards vary by state and ensure the safety of children and staff. They typically address fundamental aspects of buildings such as roof and flooring quality, installation of age-appropriate outdoor playground equipment over an approved safety surface, and the installation of proper bathroom fixtures. Professional standards, which are not enshrined in law or regulation, emphasize creating better learning outcomes in addition to ensuring child safety; they are typical of what parents might look for when deciding where to enroll their children. Professional standards include providing adequate heating, cooling, and ventilation, access to classroom sinks, adequate indoor gross motor space, and usable work space for teachers and administrators. Best practice standards distinguish the top-of-the-line facilities and are most readily achieved when designing a new facility. Examples include constructing children's bathrooms next to classrooms, ensuring each classroom has a direct exit to outdoor play space, and optimizing natural light.

In practice, two methods are used to assess facility quality above regulatory standards. The National Association for the Education of Young Children (NAEYC) accounts for the learning environment when evaluating child care providers for accreditation,[17] and an industry-standard for program evaluation called the "Early Childhood Environment Rating Scale – Revised" (ECERS-R) is used to rate programs in part on the basis of their indoor space, furniture, furnishings, the room arrangement, and both play space and equipment.[18] Some educators strive to push even further. In the Reggio Emilia pedagogy, created by prominent early childhood educator Loris Malaguzzi in post-World War II Italy, the environment itself is the "third teacher."[19] The child care facility is not a backdrop, but rather something with which children interact to create meaning. In all cases, the child care facility is integral to ensuring educational outcomes.

Low facility quality, however, is an endemic problem. An inventory of early education and school-age facilities in Massachusetts found that 20 percent of facilities had at least one classroom without windows; 22 percent had elevated carbon dioxide levels in indoor air; 34 percent lacked adequate heating and cooling; 54 percent lacked indoor active play space; and 70 percent lacked classroom sinks.[20] According to the Urban Institute, child care facilities and related expenses are "one of the most common and important in-kind resources" on which child care providers rely.[21] Child care businesses frequently cannot afford to lease, purchase, or build their own quality space, and must instead rely on the benevolence of churches, public schools, and landlords willing to accept below-market-rate rents for facilities in makeshift spaces. Available options range from the relatively quotidian—church basements—to the bizarre. While uncommon, child care centers have been known to locate in spaces including a repurposed hair salon, a former bar, and a converted turkey coop.[22]

Beyond quality challenges, overall supply is also problematic. In California, the Low Income Investment Fund (LIIF) found that from 2004 to 2007, $74 million in state child care operating subsidies were unspent because of insufficient child care facilities.[23] With sufficient facilities, an additional 60,000 low-income children could have benefited from early care and education. More recent figures were not available because studies on child care facilities are rare. However, it is easy to imagine how such conditions might persist.

In fact, the resources for facilities finance and construction are insufficient relative to the need. The Children's Investment Fund identifies and LIIF's experience confirms three uses for which capital is lacking: 1) facility repairs and maintenance, of items such as roofs, boilers, and carpeting; 2) capital improvements and facilities renovation; and 3) new facility construction.[24] There are no studies documenting the total facilities investment needs at the national, state, or local levels. However, using data from Massachusetts, it is estimated that nationally, $2 billion would be required to bring all child care facilities up to regulatory standards; $10 billion would be required to upgrade all facilities to professional quality standards; and at least $17 billion would be required to bring existing facilities up to best practice standards.[25] These estimates are low because they do not include the cost of ongoing maintenance or new facilities construction. By comparison, the federal Child Care and Development Block Grant received an appropriation of $5.68 billion in fiscal year 2016,[26] and state spending on child care in the aggregate was $767 million for the 2015 to 2016 academic year.[27] In addition, with rare exceptions, these public funds cannot be used for facilities construction and renovation.[28] However, the private sector is unable to make up for the shortfall.

Few nongovernmental facilities financing programs exist because it can be difficult to finance child care businesses using conventional means. Available equity, cash flow, and collateral constrain the amount that can be borrowed, resulting in either a loan amount insufficient for the center's needs or transaction costs that are disproportionately high. Centers' financial management capacities are another limitation, and a center's leadership may be justifiably debt-averse.[29] Indeed, the economics of the industry are challenging, in part because families are unable to pay the full cost of providing child care.[30] Where governments provide subsidies to make up the difference, the subsidies themselves can be problematic because they are often insufficient and paid on unpredictable schedules.[31]

Despite these conditions, through its signature programs such as the San Francisco Child Care Facilities Fund and the Deutsche Bank Pre-K Capacity Fund, LIIF has invested over $114 million in loans, grants, and technical assistance to create, enhance, and preserve 256,000 child care seats across the country since 1998. These signature programs have been backed in part by various financing tools including program-related investments, development impact fees, Community Development Block Grant Section 108 guaranties, and recoverable grants. In total, although LIIF is a national leader in this space, LIIF's child care investments represent a small portion of the $1.8 billion LIIF has invested nationally in affordable housing, charter schools, and community facilities since its founding in 1984.

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Case Studies Overview

This paper reviews and analyzes four case studies of child care capital programs at CDFIs and nonprofit lenders across the United States. As summarized in Table 1 (below), programs were selected to highlight the different uses of philanthropic capital in support of facilities finance, and for geographic diversity. Data was collected through a review of publicly available documents, interviews with child care centers, and interviews with programs' management. The case studies are distinct in their formation, capital provision, and use of technical assistance. The rest of the paper is organized along these three themes.

Start Up: Needs Assessment & Program Design

Providing the initial program investment is one of the most important roles foundations can play in order to advance child care facility quality. Initial investments today are largely awarded to CDFIs and nonprofit lenders with substantial child care experience for two purposes: child care needs assessment, and creating and implementing facilities capital programs that can be used to inform further program design and advocacy initiatives. The cases of LIIF, Reinvestment Fund, and the Children's Investment Fund most clearly illustrate the recent roles of foundations vis-à-vis nonprofit lenders and the public sector in these efforts. First Children's Finance also operates a facilities loan fund and technical assistance programs, discussed in the following sections.

Table 1: Summary of Case Studies

Organization	Fund Name	Use of Philanthropic Capital	Philanthropic Funder	Location
Low Income Investment Fund	Deutsche Bank Pre-K Capacity Fund	Loans to bridge public capital grants	Deutsche Bank Americas Foundation	New York City, New York
Children's Investment Fund	Early Education and Out of School Time Capital Fund	Establish a public capital grant program	Barr Foundation, among others	Massachusetts
First Children's Finance	Loan Fund	Loan loss reserves	W.K. Kellogg Foundation, The Kresge Foundation, & Northwest Area Foundation, among others	Primarily Minnesota; also 8 other Midwestern states and Washington state
Reinvestment Fund	Fund for Quality	Planning and capital grants; credit enhancement; blend down the interest rate	William Penn Foundation	Philadelphia, Pennsylvania

Low Income Investment Fund & the Deutsche Bank Americas Foundation

LIIF, which started its first child care program in 1998, received support from the Deutsche Bank Americas Foundation in 2015 to create the Deutsche Bank Pre-K Capacity Fund and support universal pre-K expansion in New York City. In 2014, New York City Mayor Bill de Blasio announced that he would make pre-K universal for all four-year-olds in the city within two years. Shortly after the mayor's announcement, LIIF obtained a commitment of both capital and operating support from Deutsche Bank and met with officials from the New York City Department of Education (DOE) and the Office of the Deputy Mayor for Strategic Policy Initiatives to determine the best way for LIIF to support the mayor's goals. City officials had determined that thousands of new seats would need to be created to enroll nearly 70,000 four-year-olds by the start of the 2015 to 2016 academic year, and facilities renovation would be critical for creating a portion of those seats.

As a result of the conversations, LIIF designed the $250,000 Capacity Fund as a program to provide zero-interest, construction-period bridge loans of up to $50,000 for facilities updates, improvements, and expansion to pre-K businesses that had preliminary pre-K contracts with the DOE. LIIF used funds from Deutsche Bank to bridge DOE contracts, rather than relying on the child care businesses' cash flows for repayment. The DOE had awarded facilities capital grants for start-up costs, but bridge financing was necessary because the City funded the grants on a reimbursement basis and the pre-K businesses needed immediate access to cash. LIIF assumed the risk that construction projects would be completed on time, along with the risk that the DOE-designated pre-K businesses might not receive final approval for their pre-K contracts from the city's comptroller. Because the loans were substantially below LIIF's average loan size of $2.9 million, they required grant funding for operations in order to support the associated transaction costs.

After the program launched in May 2015, LIIF in partnership with the City disbursed the full $250,000 to 8 centers in two months, initially in support of 312 seats. The final impact was 282 seats, for reasons discussed in the next section. Subsequent to the launch of the Capacity Fund, the City created a larger, construction-period bridge loan program with the nonprofit Fund for the City of New York, where the City had a long-established bridge loan program for working capital.

LIIF used funds from Deutsche Bank to bridge contracts from the New York City Department of Education, rather than relying on the child care businesses' cash flows for repayment.

Reinvestment Fund and the William Penn Foundation

Reinvestment Fund, which has invested $1.7 billion across its program areas and has more than 20 years of experience in child care finance, undertook an extensive needs assessment before launching the Fund for Quality in 2014. Unlike with LIIF in New York City, the City of Philadelphia had not quantified the overall need for child care seats prior to engaging Reinvestment Fund, and its leadership was looking for resources to create a detailed analysis. In response, the William Penn Foundation supported Reinvestment Fund to identify the neighborhoods in Philadelphia where investments in child care were needed most. Reinvestment Fund published the results on ChildcareMap.org, an interactive map based on the organization's PolicyMap geographic information system platform, which shows the location and quality of licensed child care providers and the potential demand for such services. Quality is displayed using the state's quality rating and improvement system called Keystone STARS, where 1 star is the lowest rating and 4 stars is the highest, and "high quality" is defined as 3 or 4 stars. In their analysis of the data, Reinvestment Fund identified a shortage of high-quality child care throughout Philadelphia.

These findings helped demonstrate the need for the Fund for Quality, which combines loans, grants, and technical assistance to help existing, high-quality child care providers expand their seat capacity. The program is jointly managed by Reinvestment Fund and the Keystone STARS administrator Public Health Management Corporation, and is funded by The William Penn Foundation. The program was initially capitalized at $7.6 million, with The William Penn Foundation contributing $4.5 million in grant funding over three years, and Reinvestment Fund committing $3.1 million in loan capital. The program provides capital grants of up to $300,000 to for-profit and nonprofit child care businesses seeking to expand in their existing space, and it provides loans to business owners seeking to expand to a new location whose project costs exceed $300,000. Reinvestment Fund staff expected that they could make lending feasible by blending down the loans' interest rates using a portion of the grant capital. The program offers planning and pre-development grants of up to $85,000, plus extensive, individualized training and advice in management topics including real estate project feasibility, business staffing, and operations.

By the end of 2015, Reinvestment Fund had committed $4.5 million in 17 grants and $1.4 million in one loan, ultimately supporting the creation of an additional 630 high-quality child care seats across 17 child care centers. The technical assistance provided also helped to build a pipeline of potential future borrowers, representing an additional 500 seats. Building on these results, in early 2016 The William Penn Foundation awarded Reinvestment Fund an additional $15 million for the Fund for Quality over five years.

Children's Investment Fund and the Barr Foundation

The Children's Investment Fund (CIF) undertook an extensive study of child care facility needs before working with the Commonwealth of Massachusetts to launch the Early Education and Out of School Time (EEOST) Capital Fund in 2014. Initially established in 1991 with funding from the United Way, CIF is a controlled affiliate of the Massachusetts quasi-public nonprofit lender known as the Community Economic Development Assistance Corporation (CEDAC). CIF was created for the sole purpose of improving nonprofit child care facilities serving low-income children in Massachusetts by using tools such as loans, grants, and technical assistance. Since its founding, CIF has invested approximately $43 million in grants and loans in child care businesses. In the study, CIF analyzed the facilities needs of nonprofit child care providers across the entire Commonwealth of Massachusetts.

Started in 2009 and published in the 2011 report *Building an Infrastructure for Quality,* the research project was an outgrowth of CIF's on-the-ground experience and a desire to make a broader impact. Through CIF's programs—funded in part by the Barr Foundation since 1999—staff knew first-hand that providers faced fundamental problems with their facilities, including but not limited to issues with emergency exits, ramps for accessibility, and building mechanical systems. One such grant program funded by the Barr Foundation provided grants from $50,000 to $75,000 to Boston-area providers to pay for repairs and minor facility improvements. Despite anecdotal evidence and programmatic data about facility quality obtained through this experience, CIF believed than an independent inventory of existing conditions in child care facilities was necessary to demonstrate the state-wide facilities investment need. CIF expected the study to reveal an extensive need for investment in child care facilities, and the data supported that expectation.

With $500,000 in support from the Barr Foundation, The Boston Foundation, the Massachusetts Department of Early Education and Care, and Thrive in 5 (a program of the United Way and the City of Boston), CIF's study quantified the dire nature of child care facilities in Massachusetts. As detailed earlier, 20 percent of facilities had at least one classroom without windows; 22 percent had elevated carbon dioxide levels in indoor air; and 34 percent lacked adequate heating and cooling. A key strategy for addressing these deficiencies, the report's authors argued, was to establish a sustainable public financing mechanism to improve child care facilities in low-income areas.

From 2011 to 2013, CIF used *Building an Infrastructure for Quality* to advocate for that large-scale public financing mechanism, which came to be known as the EEOST Capital Fund. The proposed program aimed to enable child care centers to provide high-quality classroom space along with quality workspace for educators and administrators. CIF's research and advocacy helped to cultivate support from key state legislators and from the local housing advocacy organization called the Citizens Housing and Planning Association (CHAPA). Provisions for the establishment of the EEOST Capital Fund were ultimately attached to a housing bond bill in early 2013 that was signed into law later that year. The Massachusetts Department of Early Education and Care selected CIF to administer the program and has funded the program at $4 million per year, enabling CIF to shift its fundraising priorities and to provide capital grants from $200,000 to $1,000,000.

Since the EEOST Capital Fund launched in 2014, there were funding rounds in fiscal years 2015 and 2016 that awarded a total of $11 million to 16 centers for the creation and preservation of 3,200 seats. A third allocation of $4 million is anticipated for fiscal year 2017. CIF continues to provide predevelopment and acquisition loans, and to provide technical assistance both through one-on-one support and its facilities project management training program called Building Stronger Centers, discussed at length below.

In Massachusetts, a key strategy for addressing the state-wide facilities investment need was to establish a sustainable public financing mechanism to improve child care facilities in low-income areas.

Originating Loans and Lending at Scale

In structuring their programs, the four nonprofit lenders have sought to understand the possibilities for sustainably providing loan capital to child care businesses at scale. For a typical business loan, repayment usually comes from the business's cash flows, but may sometimes come from an outside source such as another loan or investor equity. Sufficient collateral is also commonly required. The challenge for child care lenders, then, is to find techniques to address the equity, collateral, and cash flow constraints of child care businesses, either finding a structure to overcome the constraints or using subsidy to mitigate their risks.

Of the four programs surveyed, those that most readily overcame those constraints relied on repayment sources other than the businesses' cash flows. Programs that underwrote to cash flows aimed to mitigate the constraints and were partially circumscribed by factors outside of their immediate influence. The loan programs primarily originated shorter-term loans such as predevelopment, acquisition, and construction. These findings suggest that additional public subsidy is required in order to maintain and create quality child care facilities. That subsidy, however, may be structured in multiple ways.

Overcoming Constraints: LIIF and Children's Investment Fund

The two programs in this paper that most readily overcame the equity, collateral, and cash flow constraints relied on repayment sources other than business cash flows. These sources were identified, if not committed, in advance. LIIF, for instance, provided construction-period loans through the Capacity Fund that were structured as recoverable grants. The grantees repaid using pre-designated, pre-approved facility grant funds from the City of New York. Equity contributions were not relevant because the loans bridged public funding, and collateral was not relevant for the same reason. Cash flow was important to the extent that the child care center could demonstrate that it was operating above break-even.

In total, LIIF originated 8 loans totaling $250,000, for an average loan size of $31,250. In the end, seven of the eight centers repaid their loans. One center was forced to close early in the school year due to low enrollment, but the center still used its facility grant funds to repay LIIF. The sole center that did not repay encountered construction and permitting issues that delayed the center from opening for the school year. Ultimately, the business withdrew its pre-K contract with the City of New York, thus eliminating the source of repayment and demonstrating the need for facilities project management technical assistance, discussed in the next section.

In Massachusetts, CIF provided predevelopment and acquisition loans that were repaid by permanent financing, to which CIF facilitated access. EEOST grantees obtained construction and permanent financing from various banks and lenders—leveraging $7.45 million in EEOST funds with an additional $18.3 million in financing and capital fundraising in fiscal year 2015, and leveraging $3.6 million in EEOST funds with an additional $12 million in fiscal year 2016. This translates to a leverage ratio of 2.5:1.0 in fiscal 2015 and 3.3:1.0 in fiscal 2016, for a two-year program average of 2.74:1.0. According to CIF, the amount of private funds leveraged is a key metric of the program's success.

CIF identified four criteria that made it feasible for banks to lend these child care centers. First, the EEOST grant, combined with funds from a grantee's capital campaign, lowered the project's loan-to-value ratio to a viable amount. Grant funding stood in for equity in the project. Second, the EEOST grantees had sufficient collateral. They did not lease but rather owned their buildings beforehand, or they purchased their buildings using EEOST grant funds. Third, CIF provided intensive technical assistance to EEOST grantees in topics such as capital project planning and finance, capital campaigns, and child care facility development. Child care centers' management learned to evaluate how and when debt can be an effective tool for funding capital improvements. They also learned how to plan and execute large, complex capital projects. This training helped the child care centers to prevail over cash flow constraints. Fourth, EEOST grantees underwent a rigorous underwriting process, on which the construction and permanent lenders relied for secondary assurance in their own underwriting. Finally, economies of scale were likely important so that the child care centers could operate efficiently. While a typical provider may have one to two classrooms, nearly all of the first 10 EEOST grantees have capacity for at least 80 children, and more than half have capacity for over 100. Dedication of public resources to improve child care facilities was also critical for the programs run by CIF and by LIIF.

The two programs that most readily overcame the equity, collateral, and cash flow constraints relied on repayment sources other than business cash flows.

Mitigating Constraints: First Children's Finance and Reinvestment Fund

The programs that mitigated rather than overcame the equity, collateral, and cash flow constraints are notable for what they have achieved in spite of the nature of the child care business.

Founded in 1991, First Children's Finance is a CDFI with a history of using philanthropic and public funding sources to mitigate repayment risk. First Children's Finance provides loans for child care facility acquisition, construction, and rehabilitation, with an average loan size of $70,000 for center-based child care businesses and a maximum loan size of $400,000. Typically, the loans are subordinate debt backed by subsidized loan loss reserves, which First Children's Finance has historically obtained from the W.K. Kellogg Foundation, The Kresge Foundation, and the Northwest Area Foundation, among others.[32] FCF further mitigates repayment risk with its technical assistance programs, discussed in depth in the next section.

The achievements of First Children's Finance reflect the care that lenders must take when extending credit to child care businesses, absent public subsidy greater than what is commonly available. In total, FCF originated $11.5 million in 329 loans from 1998 to 2016 in order to create and preserve over 12,500 child care seats, leveraging other funds on average at 2.5:1.0. This loan volume is comparable to that of CIF, which before the EEOST Capital Fund was established, disbursed $10 million in loans from 1991 to 2013.

Reinvestment Fund likewise aimed to mitigate the constraints. Through the Fund for Quality, grants were available in amounts up to $300,000, and loans were available for projects with larger scopes. From 2014 to 2015, Reinvestment Fund committed $4.5 million in 17 grants and $1.4 million in one loan to a total of 17 child care centers. Grant funds were fully committed, but roughly half of the $3.1 million in available loan capital was committed because all but one of the businesses were hesitant to borrow. One business even reduced the scope of its proposed expansion to under $300,000 to avoid taking out a loan.

To make the loan feasible, Reinvestment Fund originally considered using a recoverable grant to blend down the interest rate from above 5 to below 4 percent. However, Reinvestment Fund ultimately committed grant funding to the child care center to use as capital in the center's facility project, reducing the amount of debt needed and bringing the loan-to-value ratio within the Fund for Quality's loan-to-value guideline of 90 percent. The CDFI's staff also dedicated hours of technical assistance, helping the business owners develop a business and facilities expansion plan before even starting to underwrite the loan. These strategies are comparable to the criteria that CIF identified as important for making it feasible for banks to lend to child care centers. As of publication, the loan was performing as expected. Reinvestment Fund was also in the process of underwriting a second loan in the amount of $500,000.

The achievements of First Children's Finance reflect the care that lenders must take when extending credit to child care businesses, absent public subsidy greater than what is commonly available.

Public Policy Solutions

Additional public subsidy is required to fund improvements to child care facilities, and a variety of subsidy program structures are possible depending on the nature of the available public funding and political environment. Supported by foundations, nonprofit lenders could collaborate with governments to structure public facilities funding that would leverage private capital sources to their greatest potential. Any such partnership should coordinate its efforts with the work of existing ECE advocacy organizations in order to complement existing advocacy aimed at increasing child care funding. A straightforward policy solution would be to increase per-pupil funding so that child care businesses with pre-K contracts can support debt. Alternatively, a facilities set-aside could be provided for within the per-pupil allocation.

If such increases are not possible, at least two other options exist. CIF's EEOST Capital Fund provides a model that is unique among the programs surveyed for the speed at which it was able to deploy a relatively large volume of capital. As discussed above, in two years the program committed $11 million in public grants to leverage an additional $30 million from banks and donors, for an average leverage ratio of 2.74:1.0. The San Francisco Child Care Facilities Fund, operated by LIIF in partnership with the City of San Francisco, is another model of a well-funded public subsidy program for child care facilities that could be considered.

Supported by foundations, nonprofit lenders could collaborate with governments to structure public facilities funding that would leverage private capital sources to their greatest potential.

Additionally, a government could guarantee debt assumed by a child care business while providing just enough funding to support debt service. Section 108 of the Community Development Block Grant is one source of funds that has been used to provide such a guaranty. For instance, the City of San Francisco partnered with LIIF to run a Section 108 loan guaranty program from 1998 to 2004. Ultimately, a successful public funding program could be replicated through model legislation across states, or for maximum impact it could serve as a model for a federal funding program.

Technical Assistance

Funded by foundations, some CDFIs and nonprofit lenders provide two types of technical assistance to child care businesses—business operations and facilities project management. Both forms of technical assistance are important and intertwined. However, they diverge in their purpose and their ultimate long-term potential. Through business operations training, nonprofit lenders create and strengthen customers for their lending products. Future expansion of this training would be best informed by partnerships with existing small business training and ECE education institutions such as the Early Childhood Training and Technical Assistance System through the federal Administration for Children and Families, the Small Business Administration, colleges, and universities. Nonprofit lenders provide facilities project management training to ensure higher quality capital projects and to mitigate risks in real estate acquisition, construction, and renovation. Unlike small business training, it is a stop-gap measure. Nonprofit lenders, with the support of philanthropy, can supplement facilities project management technical assistance by finding ways to develop an industry infrastructure of real estate project managers, general contractors, and architects that have expertise in early childhood facilities design and development.

Table 2: Facilities Capital Programs: Grants and Loans Disbursed

	Organization	Low Income Investment Fund (NYC only)	Children's Investment Fund	First Children's Finance	Reinvestment Fund
	Time Period	2015 (2 mos.)	2015–2016 (2 years)	1998–2016 (18 years)	2014–2015 (2 years)
	Loan Repayment Source	Public capital grant	Permanent financing	Business cash flow	Business cash flow
Grants	**No. Originated**	N/A	16	N/A	17
Grants	**$ Originated**	N/A	$11.05 million	N/A	$4.5 million
Grants	**Avg. Volume per Year**	N/A	$5.525 million	N/A	$2.25 million
Loans*	**No. Originated**	8	Data not available	329	1
Loans*	**$ Originated**	$250,000	Data not available	$11.5 million	$1.4 million
Loans*	**Avg. Volume per Year**	N/A	Data not available	$639,000	$700,000

**As discussed above, the loans originated by LIIF and CIF bridged public grant funding and did not rely on the child care businesses for repayment.*

Business Operations

First Children's Finance, similarly to Reinvestment Fund and to LIIF's child care programs in California, offers extensive business training and technical assistance to childcare providers in multiple states including Minnesota, North and South Dakota, Michigan, and Iowa. Individual training sessions are offered on topics including "Developing a Marketing Plan for Your Child Care Business," "Quality Staffing," "Planning for the Future: Accounting and Financial Statements," and "Classroom Break Even Analysis." One of FCF's signature programs is the Growth Fund Business Development Program. In this program, FCF invites high-performing child care centers to apply. Those who are selected enter into a cohort; the executive director and one board member from each organization participate in the program. FCF provides the participants grants to develop multiyear business plans, which become blueprints for additional technical assistance and investments from FCF.

The case of the Mary T. Wellcome Center shows how this works in practice. The Wellcome Center was originally founded in 1929 as a program of the Phillis Wheatley Community Center. According to FCF, it is one of the oldest continually operating child care centers in Minnesota. The organization enrolled in the Growth Fund in 2008 and worked to balance their budget while creating "a comprehensive business and facility-improvement plan."[33] In 2011, the Wellcome Center received a $400,000 loan from FCF for a $600,000 renovation project that would preserve a 14,000 square foot facility with 65 seats for children from low- and moderate-income families. After the project was completed, the organization achieved the distinction of NAEYC accreditation.

First Children's Finance provides Growth Fund participants grants to develop multiyear business plans, which become blueprints for additional technical assistance and investments.

To expand the reach of such programs, foundations could directly fund CDFIs and nonprofit lenders like those profiled in this paper to expand business operations training opportunities, emphasizing cross-sector partnerships. These lenders and their peers in the National Children's Facilities Network[34] have experience delivering technical assistance in the business operations of child care centers, and they have proven that they can deliver the training effectively. Combined with the reach of existing small business and ECE training infrastructure, there is the potential for large-scale impact. Such institutions include the Early Childhood Training and Technical Assistance System through the federal Administration for Children and Families, the Small Business Administration, colleges, and universities. These partnerships are likely more sustainable in the long-run because they generate their own momentum through cross-sector collaboration and funding opportunities.

Facilities Project Management

Facilities project management training is required because child care businesses frequently manage their facilities renovation and construction projects out of necessity, even though their expertise is in early care and education, not necessarily real estate development. Difficulties encountered by child care businesses in LIIF's Deutsche Bank Pre-K Capacity Fund illustrate this need. For about half of the centers, their facility renovation experiences were mixed but generally positive. Centers experienced the fewest issues with contractors when the job was simple or small in scope. Of the six centers that borrowed for facility renovation rather than just purchasing equipment, three did not report any substantial problems. One reported that the contractor, who was building out two classrooms, completed the work in a way that was 85 percent satisfactory to the center. In this case, center staff developed experience in construction management as the project proceeded. This experience is comparable to that of a homeowner who manages a general contractor for a home renovation project.

However, significant difficulties arose in projects that were either large-scale or high-stakes. Two of the child care centers in LIIF's program demonstrate these challenges. One child care business owner, whose scope exceeded $100,000, hired a contractor who had been referred by a friend; the owner was unable to obtain other referrals by word of mouth or online directories. After an extensive renovation job, the contractor installed a fire alarm system that was not to code, endangering the center's ability to open for the academic year. In order to open on time, the center paid an additional $24,000 out of pocket and hired a fire guard to keep watch during school hours until the fire alarm system could be fixed. The second business owner engaged a contractor, recommended by her landlord, who failed to properly rebuild a large staircase into which the pre-K program's entrance was built. Outside of New York City, CIF, Reinvestment Fund, and FCF affirmed that their child care center partners also face challenges with facilities project management.

Technical assistance, like that offered by the Children's Investment Fund, can mitigate these issues. Each year, CIF offers its flagship technical assistance program called the Building Stronger Centers Training Institute. Participants learn about the facility development process, capital budgeting, capital campaigns, high-quality design, how to identify and hire professionals for the project, and overall strategic thinking around the facilities process. Following the training institute, participants can access project-specific technical assistance, a learning community, and facilities financing. Staff from the EEOST grantees attended Building Stronger Centers and used the resources afforded to them in the development process. Additionally, as CIF requires of all EEOST Capital Fund grant recipients, each grantee hired a project manager to oversee the development process and used a formal bid process to hire consultants and contractors. As a result, their renovation experiences went more smoothly.

As identified by CIF and Reinvestment Fund, another important element in successful child care facilities development is being able to draw on an infrastructure of professionals who understand child care facilities. CIF in particular has built this infrastructure in Massachusetts over many years. Today, CIF has a shortlist of 15 to 20 architects with extensive child care facilities experience. The organization works with a set of development consultants who originally worked on housing development at CIF's affiliate, CEDAC. Furthermore, CIF has a shortlist of fundraising consultants who have expertise in child care operations and capital projects. Resources like this would have helped mitigate the facilities development challenges of the child care centers described above. Thinking on a larger scale, it is possible to imagine that foundations could help to fund a series of convenings, a learning community, and potentially a credentialing program to advance the understanding of child care facilities within the construction professions and make it easy for child care businesses to identify the professionals with the required child care expertise. Foundations could also fund the start-up of a turn-key child care facilities development company, modeled after an organization such as Civic Builders or Pacific Charter School Development, which are nonprofit developers of charter school facilities.

Participants in Building Stronger Centers learn about the facility development process, capital budgeting, capital campaigns, high-quality design, how to identify and hire professionals for the project, and overall strategic thinking around the facilities process.

Conclusions & Next Steps

Delivering on high-quality pre-K requires delivering on high-quality facilities. Within a context where pre-K quality is being improved in multiple domains, foundations, CDFIs, and the public sector are well-positioned to provide a combination of research and advocacy, capital provision, and technical assistance in order to facilitate the new construction of high quality facilities and the renovation of existing facilities into high-quality spaces. In particular, foundations could:

1. Fund research and advocacy that makes the child care facilities problem tangible to politicians, funders, and families.

- One such study would demonstrate and quantify the facilities investment need both nationally and by state. This baseline data would demonstrate the breadth and depth of the challenge and could be used to develop a national, multi-year plan for capital provision. As discussed above, the estimated magnitude of investment needed is at least $10 billion nationally, so any subsequently created funding plan would do well to find ways to leverage CDFI and private sector capital.

- At the local level, foundations could fund child care supply and facilities needs assessments in select municipalities, preferably ones that have growing or established public sector support for pre-K. Local data is important because public education is ultimately managed and implemented by local agencies such as school districts. Starting out, it is easiest to gain momentum when taking the path of least resistance.

- As the research base on child care supply and facilities evolves, an additional report or annual report series could compile the results of needs assessments and subsequent actions taken, with a focus on the municipalities or metropolitan areas that have taken the lead on child care facilities improvements. This report would be a barometer of the industry, similar in concept to *The State of the Nation's Housing*, published annually by the Joint Center for Housing Studies of Harvard University to provide insight on the latest national housing industry trends.

2. Fund an expansion of child care business technical assistance training, emphasizing partnership with existing small business training and ECE educational institutions.

- Several CDFIs have extensive experience training providers in operations and business administration. Business technical assistance training will strengthen the operations of child care businesses, helping these businesses become more efficient and effective.

- Partnership with the Administration for Children and Families, Small Business Administration, colleges, and universities would enable CDFIs to bring their child care business management expertise to a broader audience.

3. Fund CDFIs and nonprofit lenders to collaborate with states and localities on child care facilities financing strategies, coordinating with early childhood organizations to complement advocacy work currently underway.

- CDFIs with experience in financing child care facilities could coordinate with child care-focused industry organizations, to complement their advocacy efforts and suggest funding programs that effectively leverage both public and private capital.

- The details would vary by jurisdiction, but strategies to strengthen child care providers' ability to support debt could include establishing higher per-pupil funding or a facilities funding set-aside. If neither option is possible, alternative models to consider include the Early Education and Out of School Time Fund (Children's Investment Fund), the San Francisco Child Care Facilities Fund (LIIF), and establishing a public sector facilities loan guaranty program.

- Focus this funding in localities that are relying or considering relying on child care businesses to expand pre-K access. Pre-K expansion efforts across the country will rely on providing public pre-K funding to child care businesses, but implementation of such public-private contracting is uneven across localities.

- Ultimately, a successful public funding program could be replicated through model legislation across states, or for maximum impact it could serve as a model for a federal funding program.

4. Fund facilities project management technical assistance in addition to initiatives to train construction industry professionals in early childhood facilities design and development.

- Providing facilities project management technical assistance to child care businesses is important in the short and medium term, while more sustainable solutions are required for the long term.

- When increased funding is available for child care facilities, there will be financial incentives for real estate project managers, general contractors, and architects to develop expertise in early childhood facilities design and development.

- Early childhood facilities have unique requirements that take time to learn. In collaboration with construction industry trade groups such as the American Institute for Architects, funding and organizing learning opportunities such as convenings, a learning community, and a child care facility credentialing program are important steps to disseminating the expertise required to design and develop high-quality facilities. Additionally, a credentialing program would make it easy for child care businesses to identify professionals with the required child care expertise.

5. Fund the start-up of nonprofit, turn-key child care facilities development companies, modeled after those existing in the charter school field such as Civic Builders or Pacific Charter School Development.

- Nonprofit status is an important means to ensure the organizations are mission-driven.

- Staff would have expertise in ECE business operations and in the specialized ECE facilities design and building code requirements.

- Initial funding could be dedicated to creating a workable business model and start-up plan.

- Funding in the initial stages of growth could include capital grants, patient capital, and general operating support.

- The long-term sustainability of these organizations would depend on the ability to access reliable public and private sources of child care facilities capital.

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