

Innovative Financing Strategies for Early Childhood Care

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Objective

Identify viable and underused or unused financial tools that:

- Increase the size and scope of investments in early childhood programs (e.g., parenting education, nutrition programs, health services, quality child care)
- Recognize the limited amount of public funding available
- Leverage public funds with private capital

Innovative financing strategies for early childhood care considered

- Qualified section 501(c)(3) bonds
- Real Estate Investment Trusts (REITs)
- Tax Increment Financing (TIF) districts
- Developer impact fees
- Paid family leave laws
- Credit enhancement
- Program-related investments (PRIs)

Qualified section 501(c)(3) bonds

- Make loan capital from private investors available to nonprofits
- Typically issued to help nonprofits finance capital improvements
- Government issues the bonds; nonprofit agrees to pay back the debt from the revenue of the project being financed.

Benefits:

- Interest is tax-exempt which lowers the cost of financing
- Does not require government to tap an existing public revenue source (e.g., taxes)

Challenges:

- Nonprofits may find it difficult to identify revenue sources for bond repayment

Real Estate Investment Trusts (REITs)

- REITs are companies that manage commercial properties, mortgages, and other real estate assets.
- REIT managers compile portfolios of properties, then offer shares to investors.
- Owners of EC programs could enter into contracts with REITs to manage their properties.

Benefits:

- More efficient asset management; reduces financial burden on early childhood providers
- Allows providers to focus on programs

Challenges:

- May be difficult to identify property for REIT
- May be challenging to secure political approval to contract with REITs to manage public assets

Tax Increment Financing (TIF) districts

- Prior to redevelopment, the local government designates an area as a “TIF district” and freezes the rate of taxes at the site.
- The expected rise in tax revenue serves as a revenue stream to finance a bond or loan, which pays for the redevelopment.
- Certain project costs (e.g., increased child care demand) may be financed using the future increase in tax revenues.

Benefits:

- Finances increased demand for child care in TIF districts

Challenges:

- States that have not done so already would need to authorize child care as a TIF-eligible project cost.

Developer impact fees

- Some states and local governments require real estate development projects to pay a share of the cost resulting from the project's impact on child care demand.
- Fees are used to construct new child care facilities or expand or improve existing facilities to meet the child care needs of the employees working in the new developments.

Benefits:

- Finances increased demand for child care in newly developed areas

Challenges:

- May face backlash from stakeholders affected by the fees, in particular politically connected developers

Paid family leave laws

- U.S. Family and Medical Leave Act (FMLA) requires employers to grant employees up to 12 weeks of unpaid leave during any 12-month period due to their illness or to care for a new child or immediate family member.
- Some state laws (CA, WA, NJ) provide paid leave under similar circumstances.

Benefits:

- Financed by employees, so does not pose large employer burden
- Generates cost savings to the state and employers (e.g., through lower reliance on welfare and lower employee turnover)

Challenges:

- Policies require state legislation to implement
- May face backlash from business community (due to anticipated employee absences)

Credit enhancement

- Reduces a lender's credit risk by increasing a borrower's creditworthiness
- Tools of credit enhancement include a letter of credit, liquidity enhancement, line of credit, or loan guarantee.

Benefits:

- Lowers cost of financing
- Allows the borrowing entity to possibly increase its credit rating

Challenges:

- Current credit market tightening could increase cost or decrease availability of enhancement agreements

Program-related investments (PRIs)

- Concessionary investments made by foundations to support charitable activities
- Examples: Loans, loan guarantees, equity investments, recoverable grants, among other financial tools
- Private foundations may count PRIs toward their IRS-mandated annual 5 percent payout, under certain conditions.

Benefits:

- Lowers cost of financing
- May leverage additional investment by private investors
- Allows the borrowing entity to possibly increase its credit rating

Challenges:

- Only a small percentage of foundations make PRIs
- PRIs best used for purposes which generate revenue to cover repayment

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