A Disaster Relief and Quality Improvement Loan and Grant Program for Childcare Providers

Dan Broun

In September of 1999, Eastern North Carolina experienced a natural disaster of epic proportions. Flooding as a result of Hurricanes Dennis, Floyd and Irene left entire towns under water. And now, even after the floodwaters have receded, the effects of the disaster are expected to linger for years to come. Unfortunately, it appears that federal funds for disaster relief will not be as much as originally hoped — the total package will only reach $800 million, far from the $1.76 billion which North Carolina elected officials determined was necessary to meet the needs of communities in the East. An example of this shortfall is that an estimated 1,000 to 1,500 flood-affected small businesses and non-profits will not be served by Federal Emergency Management Agency or Small Business Association disaster assistance, which will leave at least a $25 million gap in funding. In addition, the federal relief package failed to include $21 million to address child care needs that the governor of North Carolina originally requested.

Recognizing that child care providers were among the organizations most heavily hit and determining that quality child care is essential to rebuilding efforts, Self-Help, one of the largest community development financial institutions in the nation, has created a grant program supported by the state of North Carolina to finance loans to child care providers impacted by the flooding. The program uses $1.5 million committed from the North Carolina Division of Child Development and $3 million from the North Carolina Partnership for Children to finance the real estate needs of child care providers, a category of assistance that cannot be covered by state funds.

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As part of the project, Self-Help, through the Frank Porter Graham Child Development Center at UNC-Chapel Hill, plans to evaluate the program's most unique feature: up to half the state-funded loan can be forgiven if the child care demonstrates quality improvements. This component of the program offers an opportunity to determine whether child care operators will improve the quality of their operations if they are given an incentive such as loan forgiveness. In addition, the evaluation will assist Self-Help in determining which relaxed underwriting criteria impact loan performance of child care providers.

This program, although focusing on child care, has the potential to offer two important lessons for other economic development efforts. First, it represents a comprehensive approach to mitigate the impacts of a disaster. Second, it tests the hypothesis that tying grants or loan forgiveness to quality improvements can make a positive impact.

Background of Self-Help

As a community development financial institution, a major part of Self-Help's goal is to strengthen community resources. This is done through its Community Facilities Fund (CFF). Created in1994, the CFF works with organizations that support families and build community infrastructure in low-wealth neighborhoods and rural communities. Since its establishment, the CFF has made $27 million in loans to nonprofits and human service providers. The CFF works in three main areas: children and families; community-based health care; and other non-profits.

The primary way in which CFF works with human service providers is through the provision of loans. Self-Help offers loans to these organizations to acquire or rehabilitate real estate or equipment as well as for working capital. Self-Help also offers bridge loans as a way to see non-profit organizations through the time between when a pledge of support is made and when the funds are received. Self-Help staff also provide significant amounts of technical assistance to borrowers, offering them both pre- and post-loan closing help in facility development financing and operating a sound business operation. Staff from Self-Help travel throughout the United States working with states and community organizations to help them devise effective strategies for working with human service providers.

The Community Facilities Fund is part of an organizational structure at Self-Help that works to provide a "one-stop" shop for financial assistance for its constituents, particularly minorities, women, rural citizens, and low-wealth families. The Center for Community Self-Help, the parent organization of the Self-Help Credit Union and the Self-Help Ventures Fund, was founded in 1980 to help expand economic opportunity for low-income workers in North Carolina, where even today more than 27 percent of full-time workers earn less than $15,000 a year. It soon became evident that Self-Help could best achieve this goal by helping to remove a key barrier to economic opportunity: the lack of access to capital. These key constituencies not only had little or no net worth, but they were seldom able to obtain credit from traditional lenders. Thus, in 1984 the Center's founders created two financing affiliates, the Self-Help Ventures Fund and the Self-Help Credit Union, to begin to make loans to people not served by conventional financial institutions.

Of equal importance, Self-Help offered the non-financial assistance—management help for entrepreneurs, household budget counseling for individuals, and technical advice for nonprofits—that would help borrowers achieve their goals. When Self-Help cannot provide technical assistance in-house, it is able to refer borrowers to a wide range of agencies and organizations that can best meet their needs.

The Self-Help Ventures Fund, a 501(c)3 organization, manages Self-Help's non-traditional loans, such as higher risk commercial loans and low-income mortgage pools. The Self-Help Credit Union is a federally-insured financial institution that makes most of Self-Help's home- and real estate-based commercial loans.

Self-Help's Child Care Lending Program

The Community Facilities Fund began operations through an interest in supporting child care providers. The effort has been extremely successful. To date, Self-Help has made over $15 million in loans to child care providers and created or preserved almost 13,000 child care spaces. Self-Help's loans have assisted a broad spectrum of child care. From the small provider needing a loan to make improvements to become licensed by the state, to a Head Start program wanting to buy and renovate a building in a neighboring town to expand its services, to a provider using a loan to purchase a building to move from an in-home facility to a stand-alone center, Self-Help's assistance has been vital in improving access to child care across North Carolina.

A major part of that effort has been the Child Care Revolving Loan Fund (CCRLF). Under the program, Self-Help receives funding from the state Division of Child Development, which makes possible below-market loans to child care providers. One example of the way in which the CCRLF program works comes from a Self-Help loan made to a child care provider in Winston-Salem, North Carolina.

Self-Help used $20,000 from the state's Child Care Revolving Loan Fund to help an African-American child care operator expand her home-based center to a larger stand-alone facility. The CCRLF money, loaned at five percent interest, was used to support the working capital needs of the borrower. Because of the federal restrictions on CCRLF funding, Self-Help used its other loan capital to fund the remaining $95,000 needed to purchase a stand-alone facility. This money was loaned out at Self-Help's standard commercial loan rate based on the higher cost of funds. Combined with the CCRLF money, Self-Help was able to help the borrower serve even more children in a high-quality setting.

Creating a Disaster Relief Program

As the full extent of the flooding from the 1999 hurricanes was beginning to be understood, the state Division of Child Development approached Self-Help about expanding CCRLF. The state has invested $1.5 million in Self-Help to finance child care providers affected by the flooding. This emergency fund may be used by child care providers to recover from both physical and economic damage (e.g., business interruption or loss of customers). Specifically, these providers may use the loans to:

- recover physically and economically from the hurricanes and related flooding (renovations, working capital, lost equipment including playground surfacing and other supplies, vehicles);
- expand to fill gaps left by providers who were forced to close; or
- improve quality.

At the request of the Division, Self-Help has agreed to relax the credit requirements to help meet the needs of those centers/homes affected by hurricane floods. However, centers/homes must have been solvent prior to the disaster as part of the qualification requirements and individuals must meet minimum credit history standards. Loans are made available to providers at a five percent interest rate. Approximately $500,000 of the state's grant to Self-Help will be used to cover the forgiven portion of the loans, administrative fees, and potential losses that may occur due to the relaxed underwriting criteria.

Under the state's program, a portion of the loan can be forgiven if the child care provider makes improvements in its program quality. Quality improvement will be measured through the state's new "five-star" quality assessment system. The amount of the loan that will be converted into a grant will be tied directly to the number of stars that the provider has achieved by the fourth year of the loan. Child care providers that maintain a high quality standard are also eligible for loan forgiveness. The eligibility for loan forgiveness will be evaluated at the end of four years from the date of loan origination, or in the event of change of ownership or in prepayment of loan.

Expanding the Program

This program, ambitious as it is, was unable to meet some of the most vital needs of child care providers. Specifically, because the state's funding actually comes through the federal Child Care Development Fund program, money cannot be used to finance any real estate transactions or major renovations of a facility. If this emergency fund is to truly assist North Carolinians in their drive to recover from the flooding, then this funding gap must be closed.

Thus Self-Help proposed to complement the state initiative by making it a comprehensive source of subsidized funding. Working with the North Carolina Partnership for Children, Self-Help was able to secure a $3 million capital grant that allows it to offer the same low five percent interest rate for the real estate needs of child care providers as well as providing this initiative with adequate scale to make it a noteworthy experiment on the quality front. Funds gained through the partnership are not part of the forgiveness program.

Although the precise demand for these loans cannot yet be determined, the effects of the flood suggest that the market and need exists. As is the case with the state's investment, any funds not loaned to flood-affected child care providers would be made available to child care providers in other parts of North Carolina. As the funds are repaid, they will form a permanent loan pool for child care providers across the state.

Evaluating the Program

As a part of this program, Self-Help is working closely with the state to monitor the effect that the loan forgiveness program is having on improving the quality of child care. In addition, it will allow Self-Help to investigate how relaxed underwriting criteria impact the performance of loans to riskier borrowers. Preliminary investigations into other efforts around the country suggest that this program is unique; any lessons learned will be shared with policy makers, community development financial institutions, traditional lenders and governmental agencies across the nation.

The Frank Porter Graham Child Development Center has begun a proposed six-year evaluation of the program that will ask:

- "Does the quality of care in child care centers and family child care homes improve for providers who participate in the loan-forgiveness program? If so, is the quality improvement greater than that for providers who received traditional loans that did not include a loan-forgiveness component?"
- "*How* does the loan-forgiveness program influence (or not) the quality of care over the life of the loan? For example, do providers use the loan to purchase new equipment that increases their star rating? Do providers who participate in the loan-forgiveness program participate in more staff training and development activities than do providers who received traditional loans?"

According to the evaluation plan put forth by Frank Porter Graham, "the first question will be answered by comparing over the life of the loan the star ratings of providers who participate in traditional, non-forgiveness Self-Help loan programs. The second question will be answered by obtaining detailed information about how the loan was spent by providers, what additional funding the providers received, and what quality improvement activities the providers and their staff participated in over the life of the loan."

The Program to Date

Receiving funding in the early part of 2000, Self-Help immediately began to aggressively market the program to child care providers. Loan officers traveled throughout the eastern part of the state holding workshops and offering information about the program. To date, Self-Help has closed ten loans worth over $835,000. These child care providers serve over 800 children. The following is an example of one of the loans Self-Help made.

Step by Step Child Care is located near Princeville, one of the communities hardest hit by hurricane-related flooding. While the child care center itself did not suffer any physical damage, most of its clientele could not get to the center, causing a substantial business interruption. To assist the provider, Self-Help offered a $4,000 loan to provide working capital for the center. The loan will allow the provider make up for much of the revenue shortfall she suffered in the immediate aftermath of the flood. Governor Jim Hunt visited the center recently as part of a region-wide tour promoting state flood-relief efforts.

Conclusions

Self-Help believes that this disaster relief program offers a unique opportunity to bring quality child care to North Carolina and, through its example, to states throughout the nation. After the devastation of September 1999, the need for such a program has never been greater. If communities in the eastern part of the state are to recover completely, assisting in the care of their children must be a vital component of that effort. In addition, the unique loan forgiveness component of the program provides a chance to determine how such an incentive can impact quality improvement by child care providers. Thus, the flooding in Eastern North Carolina can be seen not only as a crisis but also as an opportunity. Through this program, Self-Help will not only assist in the rebuilding of Eastern North Carolina but in the creation of a program that will dramatically improve the quality of child care throughout the region. CP