Family Child Care

Financial Planning and Facilities Development Manual

TABLE OF CONTENTS

About the Manual

Since 1991, the National Economic Development and Law Center (NEDLC) has been actively engaged in efforts to improve the financial skills of child care providers in order to facilitate the development of high-quality child care programs in centers and homes. Our research shows that there is a tremendous need in the child care field for information about financial management and the facility development process. To address this need, NEDLC, in collaboration with the Child Development Policy Institute Education Fund, has produced two manuals: *Child Care Center Financial Planning and Facilities Development Manual*, and *Family Child Care Financial Planning and Facilities Development Manual.*

If you have questions about either of these manuals, the National Economic Development and Law Center (NEDLC) can be reached at (510) 251-2600.

The goal of this manual is to help family child care providers manage and understand the financial side of their businesses. Beyond the basic importance of using budgets and financial statements to run a business successfully, understanding the financial status of a business is essential to planning and undertaking a facilities development project such as renovating or expanding a family child care home.

Because renovation and expansion projects are typically quite costly, it is especially important to be able to demonstrate to funders, primarily lenders, that the business owner has a clear idea of what size renovation/expansion is fiscally feasible, and an estimate of how large a loan the business can qualify for.

This Manual is *not* intended as a substitute for professional financial and business planning assistance. It is designed to help family child care business owners become more comfortable with the financial side of their businesses. The hope is that with this increased comfort, child care providers will be more prepared to access professional assistance and financial resources to help them succeed in renovating and expanding their family child care home facilities.

In addition, this publication does *not* discuss record keeping or tax issues related to family child care businesses. Most family child care providers are considered self-employed taxpayers who must report their business income and expenses to the IRS. Filing accurate tax returns is extremely important. There are also many tax deductions a business may qualify for. An accountant should be consulted regarding all aspects of family child care business taxes. Redleaf Press (**www.redleafpress.org** or 800-423-8309) also publishes several excellent books on taxes and record-keeping for family child care businesses.

This manual consists of five chapters, each of which addresses a key component of financial planning and the process of expanding or improving a family child care home. A summary of each chapter is listed below.

Chapter One: Budgeting

Planning for a new or expanded family child care business should be based upon a solid understanding of finances. This chapter introduces the concept of budgeting and provides a step-by-step description of how to develop a budget.

Chapter Two: Basic Financial Statements

This chapter provides an explanation of basic financial statements -- such as an income statement, a balance sheet, and a cash flow statement. In addition to helping a family child care business run smoothly, these statements are also very important to most lending institutions when they review loan applications.

Chapter Three: Understanding Loans and Determining Debt Capacity

When figuring out how to finance an expansion or renovation to a family child care home, it is extremely important to understand loans (debt) and to know how much debt a business can afford to carry. This chapter provides an explanation of how to determine a business' debt capacity and also explains other elements of the lending process.

Chapter Four: Developing A Family Child Care Business Plan

A business plan is a concisely written summary of a child care business and/or a proposed development project. Business plans are important for securing financing for a child care facility development project or just making a current child care business more successful. This chapter provides instructions about how to write a complete business plan. These instructions are especially useful for anyone who plans to apply for financing to start or expand a family child care business.

Chapter Five: Renovating or Expanding A Family Child Care Home

This chapter provides an overview of the process of renovating or expanding a family child care home. It includes detailed information about the many different tasks, roles, and responsibilities that must be managed in order to prepare for and execute a facilities development project.

Services Available from
The National Economic Development & Law Center (NEDLC)

The staff at National Economic Development & Law Center (NEDLC) has over ten years of experience in the child care field. The Children, Youth and Families Division of the organization is currently engaged in many activities related to child care financial management and facility development. For example, NEDLC has expertise conducting Child Care Economic Impact Reports (CCEIR's) that identify the economic benefits that child care services stimulate in various counties and states across the country.

Additionally, using the resources provided in this *Manual*, NEDLC collaborates with the Child Development Policy Institute Education Fund to provide trainings to child care providers throughout California titled, *Maneuvering the Maze: How to Finance Child Care Facility Acquisition, Construction & Renovation.* These workshops are designed to help child care center and family child care business owners in attaining the skills and tools to finance facility construction. For more information about these trainings contact Gary Kinley at the Child Development Policy Institute Education Fund or Jen Wohl at NEDLC.

Also, in 1997 NEDLC, acknowledging that child care is an essential part of any statewide economy, created the Local Investment in Child Care Project (LINCC). LINCC exists to stimulate public and private investment policy to meet the child care needs of all children and families in California. LINCC also enables local advocates and providers to facilitate the development of effective economic development infrastructures that support child care.

NEDLC also provides assistance to the child care field as the lead organization on the Building Child Care (BCC) Project. BCC is a collaborative project that operates as a clearinghouse of information and services designed to improve child care providers' access to financial resources for facilities development projects in California. The other three collaborative partners on this project are: the California Child Care Resource and Referral Network, the Child Care Facilities Fund of the Low Income Investment Fund, and the Child Development Policy Institute Education Fund. Through this collaboration, BCC provides technical assistance and information about facilities development and financing strategies to the child care community throughout the state.

To learn more about the resources available through BCC, visit the project web site, **www.buildingchildcare.org,** which contains information on community resources, publications, and financial resources; or, call the toll-free line, 888-411-3535, to ask questions related to child care facilities development and to learn more about resources available to help with the process of building, renovating, purchasing, and/or expanding child care facilities.

The Children, Youth, and Families Division of the National Economic Development and Law Center (NEDLC) can be reached at (510) 251-2600, and the organization's website is **www.nedlc.org**.

Acknowledgements

The revised version of these materials was made possible through the Building Child Care Project, which is funded by the California Department of Education. We would like to recognize the following individuals for playing a key role in revising these materials:

Gary J. Kinley, Ed.D., Child Development Policy Institute Education Fund, and Prudence Beidler, Jen Wohl and Brentt Brown, National Economic Development and Law Center.

In addition, we would like to thank the following NEDLC staff members who assisted with the original research, writing, and revisions of these materials:

Yolie Flores Aguilar, Brad Caftel, LaVerne Gardner, Jennifer Giambatista, Alex Hildebrand, Thomas Mills, Maria Raff, Julie Sinai, and Dianne Wightman.

We are also grateful to the following individuals who provided helpful guidance in the initial development of this project: Carla Dartis, formerly of Bank of America Community Development Bank; Michael McPherson, Oakland Small Business Development Corporation; Roma Cristia-Plant, California Department of Housing and Community Development; Mari Riddle, Los Angeles Community Development Bank; and Lloyd Sawchuk, East Bay Municipal Utilities District.

This manual would not be possible without Jan Stokley's pioneering work in the field of child care financing. This manual was largely developed from an earlier, unpublished manual Jan Stokley wrote for the child care field.

We also thank the hundreds of child care professionals throughout California who have participated in *Maneuvering the Maze: How to Finance Child Care Facility Acquisition, Construction & Renovation* workshops. The participants generously shared their experiences with financing and business development and offered valuable suggestions for creating relevant, easy-to-understand materials.

Finally, we are grateful to the David and Lucile Packard Foundation and the California Endowment for providing initial funding for the development and publication of this manual.

CHAPTER ONE:

Budgeting

Chapter One:
Budgeting

TABLE OF CONTENTS

Introduction

Gaining a clear understanding of the financial side of a child care business will strengthen it significantly, and will help to:

- Manage and plan the business better
- Assess the readiness of the business to take on financing of a development project
- Determine what size development project the business can take on
- Communicate with funders
- Satisfy funders' concerns that there is a clear understanding of the business' financial position and that a sound system of financial management is in place

The goal of this chapter is to help readers develop a budget for their child care business. It is not intended as a substitute for professional financial assistance. Instead, it is designed to help child care business owners gain a clearer understanding of how to design and implement program budgets-- an understanding that allows them to be more comfortable discussing budgets and financing with professionals who provide business assistance.

Section One:
Budgeting

A. What is a budget?

A budget is a child care business' plan of action, expressed in dollars. A budget estimates the expected income and expenses of a business for a specified period of time.

Budgeting offers several benefits:

- It requires planning ahead;
- It promotes a greater awareness of the business' overall operations;
- It creates an early warning system and helps to control expenses, and
- It is a useful guide for decision-making.

B. Developing a budget

Developing a budget requires estimating both the income a business will receive and the expenses it will pay out. The estimates used in a budget should be based upon a conservative set of clearly defined assumptions about the business. Because these assumptions will help determine the financial projections, they should be verifiable and based on past performance of the business. New programs should base assumptions on carefully conducted market research of similar family child care businesses. Some assumptions to consider include:

- The vacancy rate for the business;
- The number of children being served;
- The fees being charged, and
- The number of days and hours the business is open.

Developing a good budget requires considerable time and planning. It is a good idea to create a budgeting calendar to help keep track of the entire process as it unfolds, as well as the tasks involved.

The following are some of the key activities involved in developing a budget:

- ❑ **Establish the time period the budget will cover.**
  Before developing the budget, define the specific time period it will cover. A budget usually covers a one-year period, but can also be done monthly, quarterly, or biannually. The timeframe for a budget should be based on what best conforms to a business' funding contracts and/or schedule of operation.

- ❑ **Estimate the number of children who will be served.**

The number of children a program is able to serve is based directly on licensing standards for large and small family child care homes. This does not mean that a business will necessarily be at full capacity though, it just means that the business cannot go beyond those standards. When estimating the number of children to be served, consider the space available in the home, the number of staff to care for them, the ages to be served, and the provider's comfort level with various group sizes.

- ❑ **Estimate anticipated revenue.**
  Revenue can come from a number of different sources such as parent fees, public subsidies, and/or food programs. Each source should be listed as a separate line item in the budget. Revenue projections are based on assumptions such as vacancy rate, fees, and the days and hours the business is open. It is important that these assumptions are clearly stated, and for existing programs that they be based upon historical financial statements. These assumptions should be conservative. For example, even if 100% of the child care spaces are expected to be filled, a more conservative estimate (such as 90% or 95%) should be used for budgeting purposes.

- ❑ **Estimate expenditures.**
  The expense portion of a budget should include a complete list of all anticipated business expenditures. Expenses that are used for both business and personal purposes should be calculated using the time-space percentage – the percentage of the home used for business purposes. The resulting amount can be deducted as a business expense on your tax returns. For information on how to calculate time-space percentages, consult an accountant or refer to the Redleaf Press publication, *The Basic Guide to Family Child Care Record Keeping.*

  To be sure all expenditures are included in this estimate identify expenses in four steps:

  Step One: **Fixed expenses**
  Estimate all the costs incurred to operate the child care business, including rent, mortgage, insurance, utilities, and telephone. These expenses are considered **fixed costs** because they must be paid, and should remain the same, no matter how many children are served.

  ***Step Two**:* **Salary expenditures (if any)**
  If any staff are employed, be sure to include their salaries and benefits in the budget.

  ***Step Three**:* **Program or funder requirements**
  Identify any requirements specified by a funder. For example, if obtaining Accreditation is a requirement of a grant received by the program, the associated costs need to be included as an expense.

  ***Step Four**:* **Everything else**
  Calculate all other expenses, such as supplies, equipment, staff development, and advertising. If in-kind contributions are listed as income, also include them as

expenses. For example, if a copy shop has donated $500 in printing costs, this should be listed as income received as well as an expense. The family child care business owner can either identify his/her salary with an "owner's draw" or by assuming profit from the business is his/her compensation.

Any assumptions that are made in estimating expenditures should be stated in a footnote. See the vacancy rates example on the sample budget on page 13.

- ❑ **Evaluate the relationship between expenses and revenues.**

After estimating initial expenses and revenues, determine whether the budget is balanced. The relationship between revenues and expenses is reflected in the bottom line of the budget: "Excess of Revenue over Expenses." This is calculated by simply subtracting the total expense line from the total revenue line.

If revenues are greater than expenses, there is a **budget surplus**.

If expenses are greater than revenues, there is a **budget deficit**.

The budget surplus, calculated using time-space percentages, may not be an accurate estimate of the profit a business is making since it includes expenses, such as rent or mortgage, that would have to be paid out anyway. In such cases, the budget surplus will underestimate the amount of profit that will be earned.

When reviewing the relationship between expenses and revenues, be ready to make adjustments if expense projections are greater than revenue projections. In doing so, it may be helpful to look at how revenues and expenses vary as the number of children served changes. For example, in the process of growing from a small family child care business to a large one, due to increased enrollment, revenues may increase substantially while expenses increase only slightly. This is called **economies of scale**, where one dollar invested in expenses results in more than one dollar in revenues. Economies of scale work best when the additional expenses of serving more children are small.

The concept of economies of scale is a powerful business idea. However, economies of scale and other tools of financial analysis may not always be an appropriate guideline for decision making in a child care business. Although it may be profitable to provide care to large numbers of children, the quality of care may be compromised. In fact, a low child-to-staff ratio is one of the key quality indicators widely agreed upon by the early childhood education field and knowledgeable funders. Most importantly, low child-to-staff ratio is often a major factor in parents' decisions about child care arrangements for their children.

- ❑ **Compare actual to budgeted expenses at least once a quarter.**

A budget will only be a valuable tool if it is used throughout the year to help manage a business. Many organizations create a budgeted versus actual year-to-date income statement, which allows for the comparison of actual revenues and expenses for the quarter with the budgeted revenues and expenses. After reviewing a budgeted versus actual year-to-date income statement, it may be necessary to revise the budget for the remaining quarters. The budgeted versus actual year-to-date income statement is discussed in more detail beginning on page 20.

C. What to look for when reviewing a budget

- Are the revenue assumptions used to create the budget reasonable and realistic? Can they be supported by past financial statements? For start-up programs, can they be supported by extensive market research?

- Are expenses accurately reflected?

- What is the relationship between revenues and expenses?

- How much is the budget surplus or deficit?

- Compare the current budget with last year's budget. Have expenses or income increased or decreased? Why?

- If revenue projections aren't met, how will this be addressed? A funder will be very interested in a business' ability to handle unforeseen fiscal changes.

EXAMPLE A: Annual Budget

Sunshine Family Child Care
Annual Budget for January 1, 2003- December 31, 2003

Budget Assumptions:
Fees: $125.00 per week
Number of Weeks Open: 48
Number of Children Served: 6
Vacancy Rate: 20%

Revenue	
Parent Fees	28,800
Food Program	6,000
Total Revenue	**$ 34,800**
Expense	
Educational Supplies	300
Office/Cleaning Supplies	200
Food	5,600
Maintenance/repair*	150
Advertising	400
Insurance	600
Utilities*	175
Rent *	2,400
Travel	125
Phone	400
Dues	100
Tax Accountant	200
Total Expenses	**$ 10,650**
Excess Revenue Over Expenses	**$ 24,150**
(Owner's draw is taken from this amount)	

*Calculated based on the time-space percentages

CHAPTER TWO:

Basic Financial Statements

Chapter Two:
Basic Financial Statements

TABLE OF CONTENTS

Introduction

This chapter includes information about, and examples of, three different kinds of financial statements that a business needs to manage and record its financial position and to monitor any major changes in that position. Financial records in the form of these statements are also essential for any child care business owner that wants to apply for funding to expand or improve the program in the future. The three types of financial statements covered in this section are:

1. **The Income Statement**
2. **The Balance Sheet**
3. **The Cash Flow Statement**

While the previous chapter outlines the process of creating a budget – the financial plan of action for a child care business – this section demonstrates how an income statement can be used to measure business performance.

Section One:
Income Statement

A. What is an income statement?

The income statement identifies the sources and uses of funds for a business.

It is very useful because it shows what is actually earned and what it cost to earn that amount. The income statement can be prepared for the year that just ended as well as at intervals during the current year. This statement will be required by most lending institutions.

B. Components of the income statement

Although the format of the income statement may vary for each business, revenues are always listed on the top half of the statement and expenses on the bottom. A sample income statement is provided on page 21.

Revenues and Expenses:

The provider should list all **revenue** sources by type of revenue (e.g. parent fees, subsidies, child care food program). **Expenses** can be broken down by various categories such as food, rent and utilities. In this category, be sure to include any expenses paid relating to financing, such as interest or loan fees. Providers who conscientiously track and record all of their business expenses will be able to reduce the taxes they pay, since taxes are calculated after expenses are deducted. Time-space percentage rules apply to those expenses that are used for both business and personal purposes. For more information on time-space percentage rules, refer to *The Basic Guide to Family Child Care Record Keeping* published by Redleaf Press.

A note about depreciation: When equipment is purchased, a business owner may choose to depreciate the cost over its estimated useful life, instead of listing it as a one-time expense. If a $5,000 piece of equipment is purchased and is expected to last five years, the depreciation expense is $1,000 each year for five years. The income statement would show a $1,000 depreciation expense, not the $5,000 equipment purchase expense. The portion of the equipment *not* depreciated ($4,000) is considered an asset and is reflected on the balance sheet.

Net income:

Net income represents a business' profit. It is calculated by subtracting expenses and taxes from revenues. The net income does *not* represent the amount of cash earned by the business, and in many instances will understate the actual amount of money earned. This is because some of the expenses claimed on a tax return, such as mortgage and utilities, are incurred whether or not there is a business. Because expenses are subtracted from revenues to determine net income, providers who conscientiously track and record their expenses will have a lower net income than if they didn't record all expenses.

Lenders generally look at net income when considering a loan application to help them determine the applicant's ability to pay back the loan. Since net income may be reduced due to the deductions made on a tax return, it is important to explain to the lender that net income is not the true profit generated by the business. As will be discussed in Section Four, the cash flow statement is a much better indicator of the cash your business will have available to cover monthly debt payments. It may be helpful for a business's tax preparer to discuss this issue with the lender.

C. Budgeted versus actual year-to-date income statement

A budgeted versus actual year-to-date income statement is used to compare actual financial outcomes to budgeted projections (see page 22 for an example). It is very useful to do a budgeted versus actual year-to-date income statement at the end of a year, as well as at intervals during the year, in order to monitor the progress of the business and the accuracy of projections.

On a budgeted versus actual year-to-date income statement budget estimates are listed in the first column and actual revenues and expenses in the second column. Any discrepancies between the budgeted and actual income and expenses need to be noted in the third column labeled "Variance." Parentheses are used when actual income is lower or actual expenses are higher than projected. The fourth column is used to show by what percentage a business is over or under budget. Percentages can be misleading, however, because they do not tell the actual dollar difference.

D. What to look for when reviewing the budgeted versus actual year-to-date income statement

- Does the business have a net profit or loss?
- Are there any line items that differ from budgeted projections? How does this difference affect net profits?

EXAMPLE A:

Sunshine Family Child Care
Income Statement for Twelve-Month Period Ended December 31, 2003

Revenue:	
Parent Fees	$24,800.00
Food Program	5,000.00
Total Revenue	**29,800.00**
Expense:	
Educational Supplies	300.00
Office/Cleaning Supplies	175.00
Food	5,600.00
Maintenance/repair*	150.00
Advertising	400.00
Insurance	600.00
Utilities	175.00
Mortgage/rent*	2,400.00
Travel	125.00
Phone	400.00
Dues	100.00
Tax accountant	200.00
Total Expense	**$10,625.00**
Earnings Before Income Taxes	19,175.00
Self Employment Tax**	2,934.00
Income Tax***	5,369.00
Net Income	**$10,872.00**

*Calculated based on the time-space percentage of 40%

**Calculated based on the federal Self-Employment tax rate of 15.3%

***Calculated based on a Federal Income Tax rate of 28%.

EXAMPLE B:

Sunshine Family Child Care
Budgeted Versus Actual Year-to-Date Income Statement
for Twelve-Month Period Ended December 31, 2003

	Budgeted	Actual Year to Date	Variance (Unfavorable)	Actual as % of YTD
Revenue:*				
Parent Fees	$28,800	$24,800	$ (4,000)	(14%)
Food Program	6,000	5,000	(1,000)	(17%)
Total Revenue	34,800	29,800	(5,000)	(14%)
Expense:				
Educational Supplies	300	300	-	0%
Office/Cleaning Supplies	200	175	25	13%
Food	5,600	5,600	-	0%
Maintenance/repair*	150	150	-	0%
Advertising	400	400	-	0%
Insurance	600	600	-	0%
Utilities*	175	175		0%
Mortgage/rent*	2,400	2400	-	0%
Travel	125	125	-	0%
Phone	400	400	-	0%
Dues	100	100	-	0%
Tax Accountant	200	200	-	0%
Total Expenses	$10,650	$10,625	$ (25)	(0.2%)
Earnings Before Income Taxes	24,150	19,175	(4,975)	(21%)
Self Employment Tax**	3,695	2,934	761	
Income Tax***	6,762	5,369	1,393	
Net Income	$13,693	$10,872	$(2,821)	(21%)

* Calculated based on the time-space percentages

**Calculated based on the 2003 Self-Employment tax rate of 15.3%

***Calculated based on a Federal income tax rate of 28%

Section Two:
Balance Sheet

A. What is a balance sheet?

The balance sheet is typically prepared at the end of an accounting period and shows the financial position of the business as of a fixed date.

It is like a snapshot of a child care business at one particular moment in time. The balance sheet often includes a comparison between the current and previous years.

B. Components of a balance sheet

A balance sheet always has three categories: **assets**, **liabilities**, and **net worth** (equity).

ASSETS:
Assets are listed on the top half of the balance sheet. These include anything a business owns that has monetary value. There are two categories of assets: current and fixed.

Current assets include cash and other assets that can be converted into cash or generally used within a year. They include accounts receivable, or the amount of money owed to a business for services already performed. It is important to closely monitor the amount of money owed to a business. If accounts receivable are increasing, it could be an indication that families are not paying their fees on time or that subsidies are not being reimbursed in a timely manner. A general rule is that accounts receivable should not exceed one month's income. However, this may vary depending upon the billing cycle being used. Current assets also include prepaid expenses: goods, benefits, or services that a business buys or rents in advance, such as office supplies and insurance protection.

Fixed assets include all resources a business owns or acquires for use in operations that are expected to remain in their non-cash form for longer than one year. Fixed assets, except for land, are listed at **cost less depreciation**.

LIABILITIES:
The second half of the balance sheet reflects liabilities. These are debts owed by a child care business to any of its creditors. As with current assets, **current liabilities** are those debts that are expected to be paid within one year. The following are all examples of current liabilities:

Accounts payable: Amount owed to suppliers for goods and services purchased in connection with business operations (e.g., diaper service, copier rental, insurance, office supplies);

Debt payable: The principal balance of outstanding credit and/or debt financing. **Long-term** liabilities are those debts that do not have to be repaid within the upcoming year, such as a long-term loan. Use a brief narrative footnote to describe debt as either short term or long-term;

Interest payable: Any accrued fees due for use of both short and long-term borrowed capital and credit extended to the business;

Taxes payable: Amounts estimated by an accountant to have been incurred during the accounting period. These taxes include both payroll and income taxes, and

Payroll accrual: Salaries and wages currently owed.

NET WORTH:

Net worth is also referred to as **net assets** or **equity**. A business' net worth is the difference between what a business owns (assets) and what it owes (liabilities). This idea is represented in the equation below.

Total Assets – Total Liabilities = **Net Worth**

If a child care business owns more than it owes in liabilities, its net worth will be positive. Conversely, if a child care business owes more money to creditors than it possesses in assets, its net worth will be negative.

Does the balance sheet balance? Total assets should equal the total liabilities and net worth.

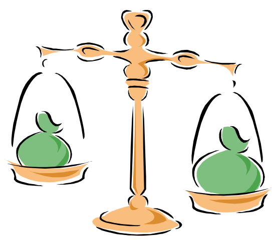
Total Assets – Total Liabilities = **Net Worth**

Therefore

Net Worth + Total Liabilities = **Total Assets**

C. What to look for when reviewing the balance sheet

- Does it balance?
- Is net worth positive or negative?
- Do current assets exceed current liabilities?
- Are accounts receivable “reasonable”?
- How does the balance sheet compare to those of previous years?



EXAMPLE C:
Balance Sheet

Sunshine Family Child Care
Balance Sheet at 12/31/02 and at 12/31/03

	at 12/31/02	at 12/31/03
Assets:		
Cash, checking	$ 1,200.00	$ 700.00
Cash, savings	800.00	1,400.00
Accounts Receivable	1,000.00	1,300.00
Equipment	2,500.00	2,800.00
Accumulated Depreciation	(- 1,500)	(- 1,250.00)
TOTAL ASSETS	$ 4,000.00	$ 4,950.00
Liabilities:		
Accounts Payable	$ 1,200.00	$ 1,000.00
Payroll Accrual	400.00	400.00
TOTAL LIABILITIES	$ 1,600.00	$ 1,400.00
Net Worth	$ 2,400.00	$ 3,550.00
TOTAL LIABILITIES AND NET WORTH	$ 4,000.00	$ 4,950.00

Section Three:
Cash Flow Statement

Cash flow management is the greatest challenge that small businesses face. Cash flow is the difference between (a) the amount of actual cash coming in to a business from support and revenues and (b) the amount of actual cash going out of a business in the form of expenses, such as salaries, rent, office supplies, and other payments. Difficulties in cash flow management often result when income lags behind expenditures.

A. What is a cash flow statement?

A cash flow statement helps track the cash in and out of a business.

In a cash flow statement, the focus is on the timing of receipt and disbursement of cash, regardless of when the income was earned or the expense was incurred. Cash flow statements may be done weekly or monthly, depending on how closely a business needs to monitor the flow of revenues and expenses.

A cash flow statement provides important information not available in the income statement. For example, the income statement may show $29,800 in income and $10,625 in expenses. Without looking at cash flow, a business may think there is sufficient money available to cover expenses. But what happens if the expenses were due before the income was received?

A cash flow statement helps identify when there is a cash management problem by breaking down the flow of resources in and out of the business.

In addition to helping a business run smoothly, adequate cash flow is very important to a lender who wants to be sure there will be enough cash at the end of each month to pay the debt service on a loan. Since the cash flow statement shows how much real cash is available at the end of each month, it is a much better indicator than the income statement of the ability of a business to meet monthly payments.

B. Components of a cash flow statement

There is no universal format for a cash flow statement, so a family child care business should establish a format that meets its particular needs. A sample cash flow statement from a family child care business can be found on page 29. Although the format varies for each business, a cash flow statement should include the following components:

> **Cash receipts**: This includes cash coming into the business from parent fees, loan or cash injections, food program, public subsidies, private sources, grants and fundraisers. **Total cash received** is the sum of all the cash receipts. **Total cash available** is the sum of total cash received plus the beginning cash balance from a previously recorded period.

Total cash available = Total cash received + Cash balance

Cash paid out/disbursements: This includes purchases, salaries, outside services, supplies, repairs and maintenance, advertising, accounting, legal expenses, rent, phone, utilities, insurance, taxes, and payments or interest on any debts or loans.

Cash balance/deficiency: This is total cash available minus total cash paid out. The ending cash balance from one month is carried forward to the next month's **beginning cash balance**.

Cash balance = Total cash available – Total cash paid out

Cash balance should be positive. If ending cash balance is negative, there is a cash flow management problem. The following are some strategies for addressing a negative cash balance.

- Speed up collection of receivables
- Require fees to be paid in advance
- Finance (obtain loans for) the purchase of equipment
- Apply for a line of credit at a local bank
- Negotiate a payment schedule with vendors

If cash flow is a recurring problem, a business owner should consider setting aside funds each year to build a cash reserve.

C. What to look for when reviewing a cash flow statement

- Is the cash balance positive?
- Is there a particular time of year when cash flow is a recurring problem?
- Is revenue received in a timely and consistent manner?
- Can the timing of receipts and expenses be improved to increase the monthly cash balance?

Example D:

Sunshine Family Child Care
Cash Flow Statement for Twelve-Month Period Ending December 31, 2002

		July	August	September	October	November	December	January	February	March	April	May	June
Beginning Cash Balance		$875	$2,415	$4,240	$6,505	$8,675	$10,455	$11,735	$13,170	$14,755	$17,255	$19,390	$21,170
Cash Receipts:													
Parent Fees	$25,000	$1,900	$1,900	$2,400	$2,300	$2,200	$1,900	$1,900	$1,900	$2,600	$2,200	$1,900	$1,900
Child Food Program	$4,980	$415	$415	$415	$415	$415	$415	$415	$415	$415	$415	$415	$415
Total Cash Received	$29,980	$2,315	$2,315	$2,815	$2,715	$2,615	$2,315	$2,315	$2,315	$3,015	$2,615	$2,315	$2,315
Total Cash Available		$3,190	$4,730	$7,055	$9,220	$11,290	$12,770	$14,050	$15,485	$17,770	$19,870	$21,705	$23,485
Cash Paid Out													
Educational Supplies	$300		$55			$100		$65		$80			
Office/Cleaning Supplies	$180	$90						$90					
Advertising	$400	$200				$200							
Food	$5,601	$450	$400	$400	$510	$500	$400	$600	$495	$400	$450	$500	$496
Travel	$120			$120									
Insurance	$600						$600						
Phone	$400	$35	$35	$30	$35	$35	$35	$25	$35	$35	$30	$35	$35
Dues	$100							$100					
Tax Accountant	$200								$200				
Total Cash Needed	$7,901	$775	$490	$550	$545	$835	$1,035	$880	$730	$515	$480	$535	$531
Cash Balance (deficiency) at Month's End		$2,415	$4,240	$6,505	$8,675	$10,455	$11,735	$13,170	$14,755	$17,255	$19,390	$21,170	$23,954

CHAPTER THREE:

Understanding Loans
and
Determining Debt Capacity

Chapter Three:
Understanding Loans and Determining Debt Capacity

TABLE OF CONTENTS

Introduction

This chapter is devoted to the basics of using loans for facilities development projects. It also provides detailed information about the financial criteria used to determine the capacity of a child care business to carry debt. Understanding loans and debt capacity are critical when planning for large expenditures such as those incurred by renovating or expanding a family child care home.

The goal of this chapter is to help family child care business owners become more comfortable discussing their capacity to apply for loans and to carry debt with financing professionals. It is not intended as a substitute for professional financial assistance.

Because this chapter builds upon the materials discussed in Chapters One and Two, it is recommended that readers not familiar with these subject areas read Chapters One and Two first.

Section One:
Understanding Loans

A. Why use loans for facilities development projects?

The idea of incurring debt through loans is not one traditionally welcomed by the child care field for a variety of reasons. But, financing, if used wisely, is truly one of the most viable options for providers looking to build, purchase, renovate or expand a family child care home. The four points below explain the benefits of using loan financing to pay for family child care home development costs.

1. **Meet Higher Costs; Serve Families Faster**
    - The supply of available loan capital is far greater than the supply of available grant funding. Another way of thinking about this is that loan funding is a revolving resource because all money that is lent has to return to the lender so she can lend it to someone else. Grant money on the other hand, is of one-time only use. Therefore, grants are part of a much smaller and more limited pool of money.
    - Loan applications have a fast turn-around time, which allows a project to move forward swiftly. In the field of child care, where an interruption in services can be both financially straining and very difficult for clients, being able to complete a facility project quickly is crucial.
    - Raising equity through grants, donations, savings and internal resources takes a long time.
    - Grant funding is generally limited to nonprofit organizations and is not usually available to for-profit child care centers or family child care providers.
    - Financing typically provides larger amounts of money than grant funding. Sometimes grant funding is available for local family child care providers to do small facility improvements and equipment purchases. However, such grant resources are rarely, if ever, large enough to cover the actual cost of a significant renovation or expansion project.
    - <u>The bottom line:</u> financing allows a provider to raise greater amounts of money in less time, which means he/she can meet higher costs and serve families faster.

2. **Capital Efficiency**
    - Financing allows a business to leverage other money (e.g. savings) and to make limited resources go farther. For example, a provider can use loan financing in combination with business savings and/or a small grant to pay for a renovation project instead of trying to do it through savings alone. With the additional funding available through a loan those savings can go farther and make more of an impact.
    - Financing allows the business to pay for costs over time instead of all at once. With a loan a provider can pay for the cost of a facility project over the term of the loan rather than all up front at one time.
    - It is quite common, and usually essential, to combine multiple funding streams in order to be able to make a facilities development project happen successfully. In

other words, it is likely that to do renovations a provider will need to combine loan financing with personal or business savings.

3. **Business Skills**
   - Community development and small business lenders often offer special technical assistance services to insure a high success rate on their loan products.
   - These services foster the development of a provider's business and financial planning skills.
   - Good lenders only make loans if they believe that the borrower is capable of repaying it on the designated terms. In other words, they do not want to invest in risky ventures that may result in both the borrower (you), and the lender (them), losing money.
   - Financing is a good way to bring homeownership within reach, which allows a provider to: gain long-term tenure, customize the space for kids and staff, and build financial position and stability.

4. **Expand Early Care and Education (ECE) Stakeholders**
   - Financing leverages interest in the ECE field from financial institutions and other economic entities such as local economic development corporations.
   - By demonstrating their success as businesses, child care providers help to encourage the expansion of additional funding streams for the field.

B. The lender's perspective

In attempting to qualify for a loan, it is vital to understand the perspective of the lender, and to ask the question: What does a loan officer look for in a loan application? The bottom line of lending is **Repayment Capability**. In other words, lenders consider lending only if they are confident that a borrower is able to repay the loan on the designated terms. The 5C's of lending are the main criteria by which a lender will judge an application for a loan. They are:

1. **Cash flow (Capacity to Repay the loan)**
   - Lenders use cash flow to identify whether an agency is able to meet its monthly payments to repay a loan. (Note that cash flow does not always reflect profit. Lenders are concerned with a borrower's capacity to meet a monthly payment rather than its end-of-year profits).
   - Lenders look at projected versus historic cash flow. Most lenders have a minimum debt service coverage (DSC) ratio requirement. (See the next section for more information on DSC ratios).

2. **Character (Capacity to Execute the Project Successfully)**
   - Does the borrower have a sound vision and a clear business plan?
   - Is there leadership and technical capacity to execute the plan?
   - Lenders typically analyze business leadership and the experience of any consultants hired to help with the development process (e.g. architects, contractors, lawyers).

3. Capital (Equity Investment in the Project)

- What money is the individual planning to invest?
- What other equity sources are invested?
- What percent of the total cost will be covered by the borrower's equity?
- Lenders typically look for a significant investment by the individual applying for the loan. Many lenders view a business owner's capital investment as a measurement of the owner's commitment.
- Some community lenders may be amenable to substituting cash equity with "sweat equity," an owner's work investment in the business. However, most lenders want to see some capital investment as well.

4. Collateral

- What is the value of the property being pledged for repayment of the loan?
- Lenders typically commission appraisals of property or other assets.
- Internal collateral comes from the business itself, whereas external collateral uses assets outside the business.
- Most lenders have policies regarding loan to value ratios (see next section for more information on this). For example, they will only lend 80% of the value.

5. Credit History

- What is the credit history of the business, the borrower, and the guarantors, if any?
- Lenders look at past performance carefully and evaluate the borrower on his/her potential for future bankruptcy.

It is important to note, in reading over the 5C's of lending, that if a borrower does not fit perfectly into each category, that does not mean that a lender will automatically turn down the application. It does, however, mean that other categories need to be strong enough to outweigh the weaknesses. For example, if the loan applicant has had bad credit in the past, but has been able to rebuild his credit in recent years and has solid collateral, significant capital investment, positive cash flow (or well-researched projected cash flow), and a clear and detailed plan for the project, then a lender will still be likely to consider the application.

C. What is the best way to apply for a loan?

The best way to apply for a loan to pay for renovating or expanding a family child care home is to provide the lender with a well thought-out, clear, concise and financially sound **business plan** that is developed with professional assistance. For more information about developing a strong child care business plan see Chapter Four.

In addition to the 5C's listed above, there are many other factors beyond the financial position of a business that a lender looks at when considering a loan application. For example, the lender is also interested in the strength of the current management of the program, knowledge of the industry, community reputation, and market research information articulated in a business plan.

Section Two
Determining Debt Capacity

A. What is debt capacity?

Debt capacity is the amount of debt a child care business is able to repay from its income. When planning what size loan a business applies for it is important to understand the business' debt capacity. A lender determines debt capacity based upon several financial factors such as **cash flow**, **debt service coverage ratio**, **collateral**, **loan to value ratios**, **equity**, and the **debt to equity ratio**. The following paragraphs define and describe these measures.

B. Cash flow/debt service coverage

Lenders want to know that the cash balance at the end of each month is sufficient to meet a monthly loan payment (debt service). In fact, most lenders require that the cash balance at the end of the month be larger than the debt service so that if income is less than anticipated, debt service payments can still be made.

The purpose of the **debt service coverage ratio** (DSC ratio) is to determine by what percent the cash available for debt service exceeds the debt service. The DSC ratio is calculated using cash flow projections and the following formula:

DSC Ratio = Cash available for debt service / Annual debt service

The DSC ratio is calculated monthly and/or annually. Annual DSC ratios will reveal the overall ability of a business to carry debt, whereas the monthly DSC indicates the ability of a business to meet a monthly loan payment.

Although DSC ratio requirements vary among lenders, it is generally between 1.1 and 1.25. For a DSC ratio of 1.15, the cash available for debt service exceeds the debt service by 15%. In other words, for every $1.00 of debt service to be repaid, $1.15 must be available by the business to pay the debt service. The higher the DSC ratio a business is able to show, the more confident a lender is that the business has an adequate cushion above the amount required for a debt payment.

To estimate the amount of annual debt service a business qualifies for based upon a given debt service coverage ratio, simply take the ending cash balance and divide by a given DSC ratio. For example, if ending cash balance (not including rental/mortgage payments) is $4,000 a year, and the lender requires a DSC ratio of 1.25, a business will qualify to carry $3,200 a year in debt service.

Example A:

Computing debt service coverage (DSC) ratio if the annual loan payment including interest is $3,200.

Step #1:
Income ($14,000) - Expenses ($10,000)= Available for Debt Service ($4,000)

Step #2:
Available for Debt Service ($4,000)/Debt Payment ($3,200) = 1.25

DSC ratio = 1.25

Example B:

Computing Debt Service Qualification if DSC ratio = 1.25

Step #1:
Income ($14,000) - Expenses ($10,000) = Available for Debt Service ($4,000)

Step #2:
Ending Cash Balance ($4,000) /DSC Ratio Required (1.25) =$3,200 per year

C. Collateral

Collateral is an asset that a borrower pledges to secure a loan. If the borrower defaults, the lender has the right to sell the collateral to liquidate the loan. Lenders will typically use the building being developed, and/or the land it is being built on, as collateral.

When lenders use the land as collateral, it is secured by a "deed of trust." Lenders determine the value of collateral based upon the appraised value, not the amount of money being invested in a construction or renovation project. This is an important factor for child care businesses to understand because the proposed improvements are often not valued in the general real estate market. For example, installing special child size toilets is a great improvement to a child care home, but will not be valuable to future occupants of the home who are not in the child care business.

D. Loan-to-value ratio (LTV)

When financing a renovation or construction project, a bank will not lend a business the entire cost of the project. Instead, financial institutions use a loan-to-value ratio (LTV), based on collateral, to determine how much they are able to lend. For example, if the LTV is 85%, a lender will lend 85% of the value of the collateral.

E. Equity

Equity is the amount of capital a business contributes toward financing the entire project. Lenders are concerned about equity because lending money is a risk and they want to ensure that the business has a stake in the project as well. The amount of equity needed is the difference between the maximum loan amount available and the total project cost. Sources of equity for a family child care program include personal savings, business savings, and any grants that may be acquired.

F. Debt-to-equity (net worth) ratio

The purpose of this ratio is to consider a business' existing long-term debt relative to its net worth. If a child care business already has a considerable amount of long-term debt relative to its net worth, a bank will be reluctant to make an additional loan. The lower the ratio, the more equity "buffer" there is in the event the business is unable to meet its loan obligations. The higher this ratio is, the greater the risk that the business will be unable to meet its maturing obligations. This ratio is not significant to a child care business that has little or no existing long-term debt.

CHAPTER FOUR:

Developing a Family Child Care Business Plan

Chapter Four:
Developing a Family Child Care Business Plan

TABLE OF CONTENTS

Introduction

This chapter introduces the idea of a business plan and explains how to write one for a family child care business. In particular, the explanations in this chapter focus on the process of developing a business plan to secure funding for a family child care facility development project. However, the information is designed to be helpful for any child care provider who wishes to think and operate more like a business or who wants to begin planning for business growth.

What is a business plan?

A business plan is a concisely written summary of a child care business, including a proposed facility development project. It contains key financial statements, market information, and management profiles.

Why develop a business plan?

Writing a business plan is an important step towards managing any business effectively. It is also a key element of applying for loans or grants.

1. **Internal planning and management:**

    A business plan helps ensure that sound business decisions are made because it encourages strategic thinking.

    The process of writing a business plan is a useful exercise because the business must be looked at in its entirety. A completed business plan also works as a road map to follow for future program developments.

2. **Access to external financial resources:**

    A comprehensive business plan is an essential tool for communicating a business' mission and goals to funders.

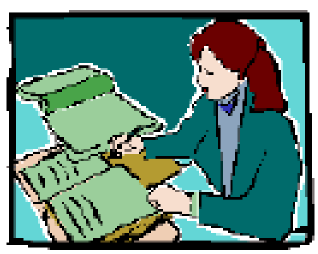
    It provides a lender or funder with detailed program information and provides a credible explanation of how the requested funding will further the business' goals. Lenders and grant makers who do not require a formal business plan instead ask questions or require written documentation on many of the same topics covered in a business plan, so it is always a good idea to have this information readily available.

What is *in* a business plan?

There are many different ways to organize a business plan. Regardless of the structure or design chosen, every business plan should include the following sections:

- Cover Sheet;
- Executive Summary;
- Organizational Capacity;
- Description of the Proposed Project;
- Market Analysis;
- Marketing Plan;
- Operations Plan;
- Financial Analysis, and
- Supporting Documents.

The following sections of this chapter provide more detailed information about each of these components.



General Tips for Developing a Business Plan

1. Presentation matters.

Never underestimate the value of a professional-looking document. Bank and grant officers look at hundreds of business plans and appreciate a plan that is easy to read and well-presented. Creating a professional looking business plan shows that a child care provider is serious about the business.

To make the document easy to read:

- Use headers;
- Leave plenty of white space on each page, and
- Include a table of contents.

2. Be concise.

A short, well-written plan is better than a long, drawn out one. On average, business plans for family child care programs should be between 10-15 pages.

3. Update the business plan regularly.

Because a business plan relies heavily on time-sensitive financial material, it should be a continually evolving document. An outdated business plan could reduce the credibility of a loan or grant application.

4. Present a balanced view.

In addition to highlighting the strengths of the child care business, a business plan demonstrates an understanding of the challenges the business faces. After a challenge is been identified, be sure to discuss a plan to overcome it. For example, if competition from a neighboring child care provider is identified in the market feasibility analysis, the plan should explain how the proposed business will serve a different market niche or how it will collaborate with the neighboring business to meet the community's child care needs.

5. Seek professional assistance.

While this chapter provides a good understanding of how to approach the business planning process for a family child care program, there is nothing more valuable in that process than receiving assistance from an expert in the field.

In Appendix A of this *Manual* there is more information available about where family child care providers can turn for further assistance (usually free of charge) on the topics of developing financial statements, business planning, and accessing financial resources to renovate and/or expand a family child care home.

Section One:
Cover Sheet

The cover sheet is the first part of a business plan that a funder sees. It is important that it appears neat and professional, and contain relevant information that is easily visible. A cover sheet should include the following:

- ❑ Name of the child care business;
- ❑ Address;
- ❑ Phone number;
- ❑ Logo (if applicable);
- ❑ Names, titles, addresses, and phone numbers of key contacts;
- ❑ Month and year in which plan was developed and/or revised, and
- ❑ Name of plan preparer/writer.

The business name, address, and phone number should appear in the top third of the page.

Information regarding the contact name should appear in the center of the page.

The date the document was completed and the name of the preparer should appear towards the bottom of the page.

EXAMPLE A:
Business Plan Cover Sheet

SUNSHINE FAMILY CHILD CARE
123 Main Street
Springfield, CA 91111
919/555-1234~voice 919/555-1235~fax
Sunshinechildcare@email.com~email

BUSINESS PLAN

Dorothy Ross, Director

Prepared by: Dorothy Ross, Director
June 1, 2003

Section Two:
Executive Summary

The executive summary is a brief one- or two-page synopsis of the business plan. Although the Executive Summary appears at the front of the business plan, it should be written last. This ensures that all the necessary information has been compiled and reviewed.

The executive summary should include the following information:

- ❑ Names, titles, addresses, and phone numbers of key contacts;
- ❑ Description of the child care business including: how many children are served, the organizational and legal structure (i.e. for-profit, nonprofit, family child care), and how long the business has operated with a child care license;
- ❑ Address;
- ❑ Description of the proposed project and its goals;
- ❑ Skills and experience of director and any staff, and
- ❑ (If applying for funding) Why the loan is needed, the amount of money being requested, and the amount and source of other funds that are being leveraged by the request for funding.

Section Three: Organizational Capacity

The organizational capacity section presents a brief overview of the child care business, including its history, organization, and community connections. The information should convey the following points:

- ❑ The business has a proven track record of programmatic success;
- ❑ The business has demonstrated evidence of fiscal soundness and has met financial obligations in the past;
- ❑ The business has a clear, consistent philosophy on early childhood education;
- ❑ The business employs high quality staff with experience, managerial competence, accreditations, permits, and early childhood education credentials;
- ❑ The business has strong local support, and
- ❑ (If applicable) the child care program is accredited through the National Association for Family Child Care.

The status of any state contracts should also be described in the Organizational Capacity Section of the Business Plan.

This section of the business plan is enhanced by referring readers to any supporting documents included at the end of the plan. See page 65 for more information on supporting documents.

Section Four:
Description of the Proposed Project

This section should include the following three components: project goals, a description of the project, and a plan for managing the facility development process.

A. Project goals

When describing the facility development project, it is important to state clear goals that can be easily understood by funders. The following are examples of goals:

- To create a more age - and developmentally appropriate environment in which to serve young children.
- To stabilize facilities expenses or avoid yearly rent increases.
- To enable the business to remain in a particular community or retain child care services for low-income families.
- To purchase outdoor play equipment essential to the success of the family child care program.
- To expand the business' capacity to serve a growing market or meet a growing demand for child care services.
- To meet the standards necessary to become accredited by the National Association for Family Child Care.

In this section of the business plan, it is particularly important to discuss how the project is related to the business' **mission statement**. A mission statement identifies why the business exists, who it serves, and how it operates. For example, the mission of Sunshine Family Child Care is "to provide high-quality, affordable child care to residents in the town of Springfield."

B. Description of the new or renovated facility

The following points should be addressed in this description:

- ❑ Whether a new home is being purchased or leased, or an existing home is being renovated:
- ❑ The community or market area the business will serve;

- ❑ The number of children to be served in the renovated or expanded home;
- ❑ The (new) hours of operation;
- ❑ The programs to be offered;
- ❑ The general design of the expanded facility, including:
    - The amount of space designated for the child care program
    - A detailed description of the outdoor play area
    - Information about separate areas for age-specific activities
- ❑ The attributes of the business' location that make it especially appropriate for child care, and
- ❑ The kind of site and location that is being sought (i.e. If a site has not yet been selected specify whether services will be offered in an apartment, home, condominium, etc.).

C. Plan for managing the facility development process

A detailed plan to manage the facility development process is essential; otherwise, important tasks may be overlooked, increasing the likelihood of project delays and cost overruns. Funders want to ensure that the process is well managed and organized. Therefore, this section should describe how the provider will manage each element of the facility development process, including:

- Which specialists need to be hired, or have already been hired for the project in question (e.g. an architect, a contractor, a lawyer, etc);
- How and when these specialists will be hired, and
- The percent of the program director's or other staff person's time that will go into the project.

It is important to describe all forms of assistance being received from architects, consultants, contractors, or any other experts involved in the project, and to indicate whether they have any prior child care-related project experience.

Section Five:
Market Feasibility Analysis

A market feasibility analysis has several objectives:

- To define the geographic boundaries of the market area of the proposed business;
- To estimate and analyze the demand for the proposed child care business, including the flow of subsidies into the market area;
- To evaluate the existing supply of child care;
- To highlight segments of the market for which there is a strong demand, and
- To provide a tool for decision-making.

A. Understanding need vs. demand

The issue of child care is often discussed in terms of need due to the vast number of children *needing* child care services who cannot get it because their families cannot afford it or waiting lists are too long. This kind of clear community need may in fact be the starting point for a project concept. However, **the existence of *need* does not establish that there is sufficient *demand*.**

Demand is established by finding out if there are enough families who not only need child care services, but also who will be able to access and use the proposed services. This means identifying families that have the capacity and willingness to pay fees at rates sufficient to generate the income stream necessary to satisfy the program's operating budget. In the case of low-income communities, demand is also measured by the availability of government contracts to provide subsidized care or the ability of parents to obtain child care vouchers.

For a facility development project to be successful, the market analysis for that project must prove that there is a market demand for child care at rates sufficient to generate revenues that cover expenses. When estimating those expenses though, it is necessary to account for both operating costs and debt service on any loans incurred to develop the facility.

In addition to providing data about current child care supply and demand in the community, if an existing family child care business provides a recently updated waiting list for services as part of the market analysis, this provides compelling evidence of demand for expanded services.

B. Basic elements of market analysis

A market analysis requires careful strategizing and information gathering about the potential market for the proposed business. Listed below are six steps that should be taken in preparing the market analysis.

1. Define the geographic area from which families are expected to be drawn.

Research demographics to determine if there is a strong demand for child care in your area.

- What are the area's boundaries?
- How many young children and families reside in the area?
- Are there couples or single adults in the area who are expecting children?
- What is the average age in the area?
- What is the average family income?
- What are the birth rates in the area?

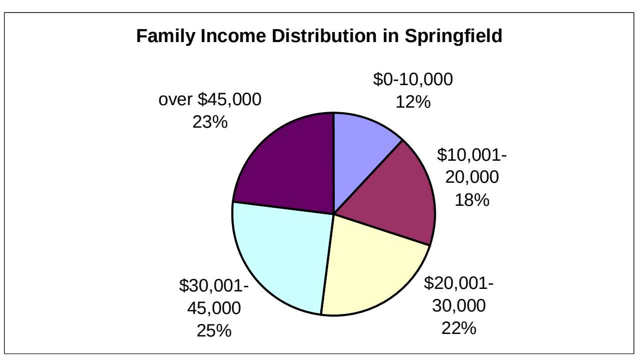
Sources of information:
Contacting the Local Child Care Resource and Referral agency and the Local Child Care Planning Council are steps in finding out where demand for child care is greatest. In particular, these local resources provide needs assessment data and other relevant information about the existing market for child care services in the community. (See Appendix A for more information about how to find these resources in your community).

Contact one of the following local government offices: the Local Planning Department, the Development Commission, or Council of Governments. It is likely that they have this type of information, since it is often used for planning purposes**.** Be sure to request information that is as specific to your geographic area as possible. For example, rather than requesting information for the entire city, seek information for the neighborhood being served.

The U.S. Census Bureau also maintains an internet site (**http://govinfo.library.orst.edu/cgi-bin**) that has data available for each city. This site contains official statistics from the U.S. Census Bureau as well as a wide variety of demographic information. Searches can be done by topic or by a search engine. A search for the subject "Population Topics" is particularly helpful in finding demographic information.

Gathering informal information is also very useful. Talk to people in the neighborhood and find out how they describe the demographics of the community. Also, talk to parents with young children in particular to find out if they are interested in using your child care services.

EXAMPLE B:
Local Income Chart



2. Identify the segment of the market being targeted.

This section indicates what kind of families are expected to bring their children to the new child care business. Are families that live in the neighborhood expected to use the services, or families that work nearby? Are CalWorks families with child care vouchers being targeted? Once the segment being targeted is identified, figure out their specific child care needs. For example, identify common work schedules, different cultures and languages spoken, and ages of the children.

Sources of information:
Contact the Local Child Care Resource and Referral agency to learn about the information it gathers about parents' child care needs in the community. Ask existing providers about the needs of the families they serve.

3. Research the existing supply of child care.

When reviewing a business plan, potential funders are particularly interested in an analysis of the competition. Research in this area includes:

- The number of other child care programs (both center and family based) that already exist in the community;
- The number of child care spaces already provided in the area;
- The vacancy rate of other programs in the area;
- The average cost of care;
- The length of waiting lists that other market-area child care programs currently have;
- (For existing programs) the length of the business' waiting list;
- Age groups being served (infants, toddlers, preschoolers, school-age, or a combination) or that are NOT being served by other programs;
- Locations of existing child care businesses in the vicinity;
- The history of local programs – have they been successful or unsuccessful;
- The services the proposed program or expansion will provide that other child care providers do not offer, and
- Types of services offered by existing child care businesses.

Sample questions to ask of existing child care businesses:

- Are they open only during the traditional work day?
- Do they offer after-school, evening, or night care?
- Do they serve children with special needs?
- Do they offer sick care?
- What languages are spoken?
- How culturally diverse are they?
- Are there any existing immersion programs?

Sources of information:
Contact the Local Child Care Resource and Referral agency for useful information about existing providers, their rates and vacancies. Also, contact and visit existing providers to find out about their vacancy rates and the kinds of services they offer.

4. Analyze the land use surrounding the business.

The area surrounding the business has a significant impact on how families perceive the business. For example, an elementary school nearby is probably a great asset, whereas a liquor store as a neighbor may deter potential families from using your family child care program. Be sure to answer questions such as these when analyzing the land use surrounding the business:

- How are the adjacent properties currently being used? What kinds of businesses are allowed under current zoning laws?
- Are there any new developments being planned in the area?
- How might these current or proposed uses attract or deter potential families?

Sources of information:
Take a walk around the neighborhood and discover who your potential business and residential neighbors could be. Contact the Local Planning Department to find out about any new construction or building permits recently approved in the area.

5. Consider how current and projected economic and political conditions could affect the business.

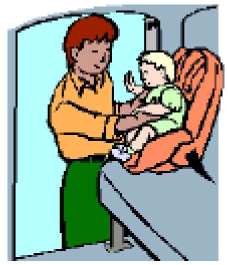
Child care needs vary notably with changes in the economy, so it is important to take the local economic environment into consideration when planning a facility. Also, be aware of potential policy changes regarding child care. Changes at the political level can directly affect your business.

Sources of information:
Contact the Local Child Care Resource and Referral agency for updates on legislation. In addition, contact state representatives to find out about new or potential legislation concerning child care.

6. Determine how accessible the facility is for commuting parents.

An important factor for many parents in selecting child care is whether the facility is conveniently situated relative to their daily commute from home to the workplace. Identifying whether the proposed customers will be commuting, what methods of transport they are likely to use, and whether public transportation and/or a highway interchange are near is a key component of conducting a thorough market analysis.

Sources of information:
Determine how accessible the program is from various areas of town. Ask nearby providers how the families they serve get to and from their child care homes. Gather information about nearby public transportation for those parents who need to use public transit.



Section Six:
Marketing Plan

Once a clear demand for the child care business is demonstrated through a market analysis, it is time to devise a plan to attract potential customers to the program. This is called a **marketing plan**.

Developing a marketing plan requires an investment in dollars, time, and effort. However, a good marketing plan can make the difference between success and failure.

The marketing plan requires two essential steps before it can be implemented:

A. Creating a unique message about the business, and

B. Devising an effective plan to promote the message

A. The unique message

A good message clearly and concisely describes to potential customers the qualities that are special about the child care business. This message may include years of service, staff qualifications and experience, capabilities, location, and the child development philosophy or mission statement of the program.

One way to generate ideas for the unique message is to ask existing customers what adjectives they might use to describe the child care business.

A short, descriptive message should clearly identify the services provided, the location and the price (if appropriate). Catchy phrases especially spark the interest of readers or listeners.

The uniqueness and benefits of the business should be contained in all promotional materials to help develop the program's image.

The following is an example of a brief description that can be used in promotional activities:

Sunshine Family Child Care offers a nurturing learning environment and a highly trained, caring staff. We have nutritious meals, a convenient location, small staff-to-child ratios and a large outdoor play area.

B. The promotional plan

A promotional plan differs depending on what works most effectively for a particular area and the families being targeted. As part of the business' expansion or start-up, set aside an advertising budget and determine how to get the most out of that budget.

The following is a list of potential strategies that are often used by child care businesses to attract new families. A business plan should detail which activities the program intends to pursue.

Word of mouth:
Word of mouth is the most important resource for new families. This means it is very important that current parents are satisfied with the service they are receiving. Conduct a survey or determine through informal conversations if parents are satisfied. Give parents flyers or brochures and ask them to distribute them to other parents they might know. One incentive is to offer a "referral reward" such as a free day of care or a free night out to any parents who refer a new client to your program.

Networking:
Go out and meet with people and groups in your community who work with families. Examples include: pediatricians; hospitals; schools, and family resource centers. Provide them with business cards, flyers, and brochures so they can knowledgeably talk to prospective clients.

An attractive facility:
Keeping up the appearance of the child care facility is a crucial form of promotion.

A memorable, consistent, and distinctive logo:
An effective logo helps get the business' message and image across.

Business cards:
This is a low-cost way to create a business-like image. Distribute cards to anyone who works with families and have them available at all times in case you meet prospective clients.

Flyers:
Flyers are an inexpensive way to advertise. Post them in community centers, grocery stores, laundromats, libraries, local colleges, gyms, and schools. Be sure to post them regularly.

Brochure:
A brochure allows a business owner to describe the most important features of the business in a professional and visually pleasing manner.

Signs:
The sign on a child care facility should be easy to read and appealing. In addition, a plastic magnetic sign on the door of a car or van attracts a lot of attention at a low cost. (Check with the local Business License Division for any possible use restrictions).

Community involvement:
Through participation in community events, recognition of the business can be increased. For example, if the town has a street fair, consider setting up a booth.

Direct mail:
While a mailing reaches many people, it can be costly. People who use a direct mail approach only expect a 2% response. Try targeting a direct mailing to families needing child care.

Promotional items:
These are a popular and low-cost method of promoting the name and image of a child care business. Examples include: mugs; t-shirts; key chains; pens, and bumper stickers.

Web page:
Consider creating a web page for the child care business with the help of a parent or other volunteer. Be sure to put the web address on business cards.

On-site workshop:
Host a workshop on an early childhood development topic for parents in the community.

An open house:
This allows prospective customers to tour the facility and meet staff.

A good first impression:
This is by far the most important component of marketing your services. If parents don't get a good feeling about a program the first time they visit it or call on the phone, it doesn't matter how extensively the program is advertised. Many families call first to find out about the child care business. Answering the phones professionally and in a friendly manner helps create a good first impression. Offer to send written materials describing the program. For times when the phone can't be answered, make sure to have an answering machine with a professional recording that provides pertinent information about the program (e.g. hours of operation).

Also, visiting parents want to see a clean and well-ordered facility inside and out. Major turn-offs for parents visiting child care programs include: incessant T.V. watching; a dark and gloomy room; bad smells; unprofessional attire of the child care provider (e.g. a bath robe or pajamas), and a run down yard. By contrast, presenting a well run, educationally stimulating environment with evidence that children are well cared for (e.g. photos and children's artwork displayed on the wall) gives parents a good take-home message about the program.

Also, make sure that the program is registered with the **Local Child Care Resource and Referral Agency** so that they refer parents in need of care to any slots available.

Section Seven:
Operations Plan

This section of the business plan describes how the child care business is (or will be) run on a day-to-day basis. It includes answers to the following questions:

- ❑ How is the business managed? (Include any pertinent printed materials, such as organizational charts and a schedule of staff meetings).
- ❑ What is the adult to child ratio?
- ❑ Who develops the curriculum?
- ❑ Who develops the policies and procedures for the program?
- ❑ How are staff hired and supervised?
- ❑ How is the billing done? What kinds of accounting procedures are used?
- ❑ What are the safety procedures for the facility? Include emergency evacuation and disaster plans.
- ❑ What kind of insurance does the business have?
- ❑ Are volunteers used? How?
- ❑ Are parents involved in any of the business or program activities? How?

Section Eight:
Financial Analysis

This section of a business plan describes how the funds being requested will be used. It also demonstrates that the proposed project is a good investment, and shows that the business is financially sound and well managed. The financial analysis section contains four components:

A. Summary of financial needs

This summary briefly describes why funding is needed, the type of funding being applied for, the total amount needed, and how the funds will be used.

B. Development budget

A well-prepared development budget shows that the costs involved in this project have been carefully considered. The development budget should include both the line item costs of the project and the known or anticipated sources of funding. A funder is interested in seeing other sources of funds in addition to its own resources. For example, if the provider has personal or program savings, a small equipment grant, or additional financial resources from family members, it is important to include those in the development budget.

C. Financial projections

Financial projections are financial statements used to predict the future profitability of a business. Projections are based on realistic research and reasonable assumptions. A business plan includes **cash flow projections** and **income and expense projections**. Each of these financial projections is described in Chapter Two of this *Manual*, *Basic Financial Statements.*

D. Financial statements

It is necessary to include financial statements that reflect the business' past financial activity. A business plan includes an **income statement**, **balance sheet**, and a **cash flow statement**. Generally, it is sufficient to include financial statements from the prior three years. However, check with the funder to determine how many prior years it requires. For a new family child care business the financial section consists of projected statements based on extensive market research of comparable programs.

Section Nine:
Supporting Documents

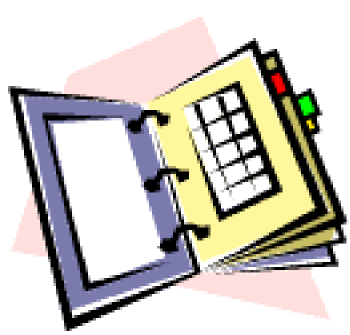
Supporting documents are records that support the information in the business plan. They should be arranged neatly at the end of the plan. It is be helpful to include a list of supporting documents at the beginning of this section to help the reader locate specific documents. Supporting documents may include:

- Consultant contracts;
- Funding contracts (current loan contracts, child care food program contracts);
- Legal documents (child care license, deed or lease to property. Note: When applying for a loan to renovate a leased facility the term of the lease must exceed the term of the loan);
- Location studies – from market feasibility study;
- A recently updated waiting list of parents who want to use the additional slots if the program expands, and
- Letters of support from:

  Resource and Referral agencies

  Parents

  Other community groups



CHAPTER FIVE:

Renovating or Expanding a Family Child Care Home

Chapter Five:
Renovating or Expanding a Family Child Care Home

TABLE OF CONTENTS

Introduction

When thinking about expanding, improving, or starting a family child care business, it is essential to think through the entire process by breaking activities down into four stages: **planning, predevelopment, development, and start-up**. Though the steps laid out in these stages are listed sequentially in this chapter, some occur simultaneously and others may not be necessary depending on the type and scale of your project.

While the following steps represent a number of the activities involved in developing a family child care home, each project varies; so, in addition to reviewing these steps, you should also identify what other steps might be required for your own project. Also, when starting a new program or changing the licensed capacity of an existing program, the first step is to attend a licensing orientation in the community.

This chapter of the *Manual* walks child care providers through the steps in each of these stages and gives them a sense of the overall process of renovating and/or expanding a family child care home.

Section One:
Planning Phase

The planning stage is perhaps the most essential in any facilities development process because the more time and attention that goes into planning the project the less likely it is that a provider will face costly mistakes in the later stages. Additionally, careful attention to the steps in the planning stage allows a provider to assess early on if she or her business are not ready to take on the financial risk of a facilities development project.

A. Market demand

Studies show that the need for increasing the capacity of child care in communities across the U.S. is tremendous. In planning to offer child care services, or to expand current services, it is extremely important, however, to understand the difference between a given community's **need** and **demand** for child care. Differentiating between these two words is important because in order to assess the feasibility of the development project, it is the *demand* for services, not the *need* that must be determined.

Demand is established by finding out if there are enough families who not only need child care services, but also have the capacity and willingness to pay fees at rates sufficient to generate the income stream (cash flow) necessary to satisfy the business' operating budget. In other words, a provider must identify that enough slots will be filled and paid for to cover the cost of operating the business. The existence of **need** does not always mean that there is sufficient **demand** in the community. It is also important to consider that, in low-income communities, demand can be measured by the availability of government contracts to provide subsidized care or the ability of parents to obtain child care vouchers.

In order to establish whether or not there is a demand for the business' proposed services the following steps need to be taken:

- Estimate the number of families demanding services in the area at the rates to be charged. Contact the Local Child Care Resource and Referral Agency and the Local Child Care Planning Council to find out about the demand and highest need for care, as well as information about the existing supply of child care services in the community.

- Decide whether services will target low-income, middle-income, and/or affluent families. This decision affects both the rates charged and the business' eligibility for subsidy programs.

- Decide what age group(s) the program will cater to. This affects an assessment of local supply and demand.

- Assess whether or not the intended parent fees will generate enough revenues to meet the costs of operating expenses and any debt incurred by the facility development project.

- If a provider is looking to expand an existing business, it is critical to look at the current number of children cared for, and to provide clear evidence of a demand for increased services. Consider these two examples and what they indicate about demand:

A. A small family child care provider is at capacity and wants to expand to a large license. She already has a waiting list with several children on it who will use her services as soon as they are available. B. A small family child care provider located in a high-need area is currently only serving two children, but wants to expand her facility because she thinks increased space will lead to increased clientele.

While the provider in example A has solid evidence that there is a demand for her increased services, the provider in example B should investigate the local market more closely and either improve her marketing techniques in the community, or find out why parents are not choosing her services. With that information she should make appropriate changes in order to build up her clientele mores solidly to insure the sustainability of the program budget before committing to the costs of an expansion project.

B. Organizational capacity

Analyzing a family child care business' capacity to provide the time and attention needed to plan, manage and ultimately complete the facility development process is a key component to getting started in the process. The result of such an analysis is that the child care provider has a solid sense of whether he/she can afford to devote the time and effort needed to complete a renovation or expansion project.

The first step in analyzing ability to take on a facility development project is to identify the tasks necessary to see the development process through. It is also essential to figure out who will be responsible for completing each task. If the business currently employs additional staff who can help, or if the provider has access to outside assistance, such as a contractor in the family, this is the time to evaluate who is able to help complete which tasks.

It is important, however, to ask to what degree the time and attention required by this additional work will impact the current program. For example, if it seems likely that these tasks will cause a big problem in meeting the day-to-day requirements of running the existing program then it is probably not a good idea to take the facility project on until additional support is put in place.

When assessing organizational capacity, a provider should always identify what community support exists for the family child care services being offered, or to be offered. To do this, a provider needs to know the community and have a clear sense of the demand for services and an understanding of any obstacles that may arise from the surrounding community.

C. Financial feasibility

In addition to estimating the time and attention necessary to expand or renovate a family child care home, it is also essential to evaluate the financial readiness of the business, or the individual looking to start a business. Identify red and green flags that respectively indicate whether or not a provider is in the position to move forward with the proposed project.

> ***Red flags*:** difficulty paying bills; deficits in recent years; large amounts of uncollected receivables (such as parent fees), and a lack of any cushion or cash reserve.
>
> ***Green flags*:** services are constrained by a lack of space, the provider and/or business are in a financially strong and growing position, and there is a clear *demand* for the proposed services.

If the Green flags are in place and the Red flags either do not exist, or are very slight, then it is time to address the question: How much will the renovations cost and how feasible is the facility development project from a financial point of view?

A child care provider's business plan (see Chapter Four) provides answers to many of these questions, but here is a list of steps that also help to answer this question:

- **Estimate the overall start-up or capital cost** of the facility development process and divide this into
    i. "Soft costs" (design, permits, legal and financing fees)
    ii. "Hard costs" (acquisition, construction, equipment)
    iii. "Hidden costs" (staff time and attention)
    iv. "Contingency costs" (a portion of construction costs set aside to cover unexpected "hard" costs)

  A contractor can typically help in the process of estimating these overall costs during the initial cost estimating stage.

- **Design an operating budget** for the child care business if it is a new program. Or, if it is an expanding program, make necessary changes to the projected operating budget. Note that in identifying expected revenues (incoming money from parent fees, vouchers, and the child care food program, etc.) it is important not to project that the program will ever be more than 90% full, because it usually takes at minimum six months to reach capacity for a new program. Even for an existing program, it is quite common for enrollments to fluctuate throughout the year.

- **Identify the financing necessary** to cover the start-up and operating budgets. Budget projections need to be adjusted as more specific details about incoming revenues become clear.

- **Analyze the program's capability to apply for financing** (i.e. loans) by determining debt capacity, or debt service coverage. (See Chapter Three: *Understanding Loans and Determining Debt Capacity* for more information).

- **Ensure that the business will have enough working capital** (cash available to fill in the gap between revenue and expenses) at the end of the facility development process to cover, at minimum, three months operating expenses – as it takes time for a program to build up its enrollment. It is best to have an even larger cash reserve, if possible, in order to prepare for any cash flow problems that may occur, especially if the program is just starting-up.

- **Identify donor relationships and look into new ones** especially for donations of toys, equipment, furniture, dress-up clothes, building supplies, etc. Also try to identify potential partnerships with community organizations like churches, hospitals, and child care centers that might collaborate with the business to provide certain services and share some expenses. For example, if a child care center only operates part-time it may want to refer parents to a family child care program in the community.

Certain financial statements must be in place in order to complete the steps listed above. These statements include:

- ❑ A detailed operating budget for the child care program in its current form;
- ❑ A detailed operating budget for the program after the renovation or expansion has been completed, including expected revenues from additional slots, as well as any long-term changes in costs related to the facility development;
- ❑ An annual cash flow statement that includes details of the business' monthly income and expenses, and,
- ❑ A monthly income and expense projection that provides information on the business' ability to carry debt over a certain period of time.

Refer back to Chapters One through Three of this *Manual* for more information about how to develop and update these financial statements.

Section Two:
Predevelopment Phase

A. Site control and approval

The process of renovating or expanding a facility calls for careful consideration before any structural work can begin.

At this point, communication with the local **Child Care Advocate** is key. Child Care Advocates can be reached at the Local Community Care Licensing office. Their role is to bridge the gap between the Licensing office and the community, including the provider in particular. More specifically, they can review site plans and advise providers on licensing requirements.

Also, at this point all providers should obtain a copy of the Community Care Licensing Division's information about Title 22 licensing requirements in the *Manual of Policies and Procedures for Family Child Care Homes*. (This document can be obtained free of charge on the Community Care Licensing Division's website at **www.dss.cahwnet.gov**).

Depending on the scale of the proposed renovations, working with an architect at this point can be extremely advantageous in order to translate design ideas into a workable physical design.

When preparing to expand or renovate an existing family child care home it is important to begin by evaluating the site and the neighborhood in relation to the:

- Project concept;
- Size of the lot;
- Zoning (conditional use permit requirements);
- Licensing requirements (fire, health and safety, accessibility);
- Quality of the existing structure;
- Traffic patterns;
- Parking accessibility;
- Repair or renovation costs;
- Design and engineering costs, and
- Recent or upcoming changes in the neighborhood.

When finding a new site in which to offer family child care services there are other elements of the site to consider in addition to those listed above. More specifically, a provider should also review:

- Site costs related to leasing or purchasing a home;
- Quality of the neighborhood;
- Infrastructure (utilities, roads, easements), and
- Transportation access.

When considering different site options, it is critical to consider the short and long-term advantages and disadvantages associated with leasing versus buying a home. For example, owning a home allows the provider to personalize the space and ensure a more stable long-term business location, but homeownership does require a larger financial investment in the short-term.

For more information about homeownership resources, visit the Fannie Mae Foundation website at **www.fanniemae.com,** or call them toll-free at 1-800-611-9566.

B. Land use and zoning

Land use controls and zoning usually create the most significant constraints for family child care programs expanding from small to large licenses. It is important to resolve zoning issues with the site early in the predevelopment process. Local design regulations, such as cumbersome review or approval processes and extensive public hearing requirements, deter, slow, or prevent the development. Additionally, parking, open space and other requirements can significantly raise costs. To develop a large family child care home contact the Local Planning Department at the beginning of the facilities development process to find out about any land use and zoning restrictions. Careful planning is the only way to avoid unexpected costs and delays.

C. Project design

As mentioned above, working with an architect during this stage can be extremely valuable, though it is not always necessary for family child care projects. Regardless of whether the project requires the assistance of an architect, the following steps should all be taken to ensure successful design:

- Review required vs. recommended elements of design for the project. In other words, take into account all zoning, fire clearance and licensing requirements, while also trying to incorporate recommended elements of design for children's environments.
- Visit other facilities in and around your community and talk with other child care providers to identify successful designs and mistakes to avoid.
- Research cost-effective design options, taking into account the initial costs *and* the long-term quality and maintenance consequences of using certain materials and equipment. For example, certain types of carpet seem less expensive initially but the cost of cleaning them and replacing them if they are not durable is, in the long run, more expensive than choosing high quality carpet initially.

D. Securing a contractor

There are several ways to find a contractor to do the construction work on a family child care home:

- Ask other providers for recommendations of contractors with child care facility development experience;
- Ask neighbors and friends in the community for recommendations of any good contractors for home improvement work;
- Find the local *Builders Exchange* or comparable contractors association in your area and inquire if they have any members with child care facility development experience, and
- Look in the phone book (though always be sure to check a contractor's license before making any financial commitments to him/her).

Building contractors are generally secured in one of two ways:

1. Guaranteed maximum price, or
2. Lump sum bid

In the "guaranteed maximum price" method, the organization selects a building contractor early in the development process based on a previous relationship or personal referral.

The "lump sum bid" is a competitive bidding process.

Guaranteed Maximum Price	**Lump Sum Bid (or) Competitive Bidding Process**
Contractor selected based on qualifications	Drawings and project information are prepared
Contractor provides input during design process	Using drawings and specifications, bids are solicited from multiple (at least 3) contractors
Contractor provides a guaranteed price based on drawings and technical specifications	Based on bids, preferred contractor is selected

Before selecting a contractor, <u>always</u> check his/her license, references, qualifications and insurance. Once the business owner selects a contractor, it is time to negotiate a contract. Any contract should include the following:

- A scope of work;
- A work schedule;
- A payment schedule;
- A cancellation policy;
- An agreement about what happens if there are cost overruns of delays;
- Specification about payment type (i.e. Lump sum or guaranteed maximum price), and
- Funder's requirements (if necessary).

When developing the final contract, the assistance of a legal expert should be secured. Asking an attorney to draw up a construction contract helps avoid any mishaps during the development phase. For more information about working with contractor's visit the Contractor's State Licensing Board or California website at **www.cslb.ca.gov,** or call them at 1-800-321-CSLB (2752). In addition to other resources, the publication, *What You Should Know Before You Hire A Contractor* contains invaluable tips for making the process work more smoothly.

E. Obtaining financing for the development process

In order to obtain financing to move forward with the development stage, and the actual construction process, the first step is to finalize the **business plan** with all the following components:

- Cover Sheet;
- Executive Summary;
- Objective of the Development Project;
- Market Analysis;
- Marketing Plan;
- Operations Plan;
- Financial Management Plan, and
- Supporting Documents (e.g. a current waiting list).

To learn more about a developing a business plan, refer back to Chapter Four, *Developing a Family Child Care Business Plan*. Additionally, the Small Business Administration (SBA) offers one-on-one assistance and workshops on the topic of business planning through their Small Business Development Centers (SBDC's) and Service Corps of Retired Executives (SCORE) offices across the state. To find contact information for the SBDC and SCORE office in your community call 1-800-8-ASK-SBA or look them up online at **www.sba.gov.**

To prepare for the process of applying for a loan from any lender it is essential that all financial statements outlined in the previous chapters be in order and that they demonstrate that the business has the financial capacity to pay back any money borrowed. **Repayment capability** is the most important factor in the review of any loan application.

The next step in the process of obtaining financing is to determine final figures of how much money the business needs to complete the renovation or expansion process, and how much debt the business can afford to carry. Largely, the cost estimate is determined based on the contractors' bids, while the capacity to carry debt is determined by the business' current and/or projected cash flow.

With the business plan, estimated budget and debt capacity information in order, it is time to identify and approach likely funding sources. Since Family Child Care is a for-profit business, most construction and renovation costs are paid for using internal resources (savings) and debt (loans). However, small grants to help with equipment costs and minor repairs are sometimes available through local resources.

To identify accessible loan resources look first to financial institutions already familiar with the business, or with the borrower. If there are none, think about local community lenders. The local SBA resources should be able to help in the process of identifying potential lenders as well.

Be sure to price shop for the best overall terms. (For more information on child care-friendly loan resources see the *Matrix of Financial Resources for Child Care Facilities Development in California* available online at **www.buildingchildcare.org,** or by phone 1-888-411-3535).

A family child care business should apply for funding, secure commitments, close loans and have cash in hand before construction starts. This means that while it is important to have estimates from contractors to gauge the overall costs of the project before applying for funding, a provider should *not* accept a bid or sign a contract until the financial resources are in place to pay for the contractor's services.

Section Three:
Development Phase

This is the period during which the facility construction is actually realized.

A. Managing the development process

At this point in the process a contractor has been secured and all the necessary funding is in place to begin construction. It is critical to re-evaluate all remaining tasks as they relate to preparing for the completion of the renovation or expansion process.

It is especially important that the family child care business owner identifies tasks and time to manage the facility development project. During this stage, someone needs to be in charge of overseeing the construction process and ensuring that it is conducted according to the arranged design, budget and timeline. Also, site visits with necessary individuals such as fire and licensing officials need to be scheduled.

B. Preparing to move in

The following steps must be dealt with during the development phase in order to prepare for the ultimate start of the program once construction is completed:

1. **Equip the classroom.** When purchasing appropriate furniture and curriculum specific materials for the classroom(s), make sure that the timing of this step correlates with the timeline established for developing and opening or re-opening of the business. It is also important to develop a specific plan for receiving, installing and taking inventory of all supplies and equipment to keep track of exactly what has been ordered and when it arrives.

2. **Obtain license approval for the facility.** Though extensive communication with Community Care Licensing should already have taken place with regard to the design and construction of the facility, the final step to obtain a license is to submit a completed application and pay fees to the local Community Care Licensing office. The completed application includes fingerprint cards, a child abuse index check and a fire inspection clearance.

   (Note: a fire clearance is only required for large family child care licenses, though small family child care licenses must have a fire extinguisher and smoke detector that meet standards established by the State Fire Marshall).

3. **Hire personnel.** Similarly to equipping the classroom, it is essential that the staffing of the program (if additional staff is necessary) be lined up before opening it to children and families. To begin this process, identify how many staff members will be needed, when they will work,

what their responsibilities will be, and how much they will be paid, including benefits and staff training opportunities. These logistics should already be outlined in the business plan.

The next step is to begin advertising for staff at least 60 days in advance of the program's anticipated start date or expansion date. Some ideas for advertising include contacting local teachers, college placement offices, vocational high schools, the state licensing office, the Local Child Care Resource and Referral Agency, and the local employment agency. Also, placing job advertisements in local papers and posting them at grocery stores, gyms and laundromats is very effective.

These advertisements should include a job title, brief job description, required qualifications, application deadline, resume request, the program's telephone number, address and name.

Make sure that, when staff are hired, the personnel expectations are very clearly laid out. In order to save staff time and costs it is also a good idea, when applicable, to recruit volunteers who can help with clerical and administrative tasks.

4. **Market the program in the community.** Chapter Four, *Developing a Family Child Care Business Plan*, provides additional information about this step: but overall, the most important thing to do is to create a unique message about the business that clearly and concisely describes what is special about the child care services offered.

   This message should be based on research about what parents look for in the child care services they seek, and where the highest needs are in the community. For example, if there is a lack of evening-hours care available in the area, despite the fact that there is a great need for it among the local families, this might be a good niche to fill, and the provider can then focus the business' advertising on this factor in order to appeal to what parents want most.

   It is best to start marketing the services about three months before the business opens, or before the expansion is complete. A marketing plan depends on the type of program being promoted, and the community to which it is advertised. It includes any of the following:

   - Word of mouth networking;
   - Creating a distinctive logo;
   - Distributing business cards, flyers, signs and brochures;
   - Participating in community events;
   - Seeking free media coverage;
   - Offering on-site workshops;
   - Listing your program in the yellow pages;
   - Hosting an open house, and
   - Making a good overall first impression!

Also, make sure that the program is registered with the Local Child Care Resource and Referral Agency so that they refer parents in need of care to any slots available.

Section Four:
Start-up Phase

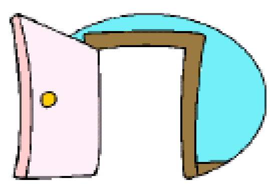
The start-up phase is when the new program or the expanded services are officially made available, once the facility project is complete.

A. Phase-in staffing and children

If the business is just starting, or if it has just completed an expansion, it is important to remember that the program needs to build up to full capacity. In other words, the program won't start with full enrollment the day its doors open. This is especially true for new family child care businesses that need to build up a reputation and trust in the community.

One way to encourage higher enrollment early on is to start up in the early fall (August/September) or at the beginning of a new year, because these are times when parents are most likely to make changes in care arrangements.

As enrollment builds, it is imperative to maintain the program's image and publicity efforts, even after the business is up and running. For example, bring business cards whenever out with the children, make T-shirts for the children to wear on field trips, and make sure the services are well known throughout the community. If the program does reach full enrollment, a waiting list should be established because child care enrollment fluctuates easily and it is important to fill vacancies as quickly as possible to ensure regular cash flow for the business.



B. Program sustainability

After the facility project is complete, it is essential to maintain relationships with funders and to seek new relationships with potential sources of funding consistently, even when money and equipment are not needed. It is important to stay aware of opportunities and to prepare for times when such resources will be sought.

To ensure the sustainability of a program, it is best to establish an operating reserves budget to prepare for unexpected expenses and cash flow inconsistencies.

Also, though it can be difficult, especially after developing close relationships with families, it is crucial to be realistic about the fees charged for care and to adjust them over time as the program's expenses change.

Above all, program sustainability hinges on balancing service obligations with business obligations. Simply put, without attending to the business matters of a child care program, high quality services cannot be maintained. Though the financial piece plays a particularly large role in the facilities development process, if the financial side of a child care program is not maintained and continually developed once it is up and running, that program cannot survive and grow as a viable business.

Appendix A:
Where to Go for Help

There are a variety of resources, from books to individual counseling available in California to offer assistance in budgeting, developing pro formas, determining debt capacity, business planning, and facilities development. Though some of the resources listed below are specific to the State of California, out-of-state readers can use this section as a guide to the types of assistance that may be available in other states as well.

Building Child Care

Building Child Care (BCC), a collaborative funded by the California Department of Education, is designed to improve child care providers' access to financial resources for facilities development projects in California. Along with the assistance and input of many others across the state, the four collaborative partners on this project have combined their experience, resources, and expertise to build a clearinghouse of information and assistance specifically for people interested in acquiring, building, renovating, or expanding child care center and family child care facilities. To learn more about BCC and its services you can call 888-411-3535, or visit **www.buildingchildcare.org.**

Small Business Administration (SBA)

The Small Business Administration has a variety of management and technical assistance programs to assist both new and expanding businesses. Its primary mission is to serve for-profit businesses, but some of its services are available to nonprofits as well. The SBA has offices located throughout the country. For the nearest location, look in the telephone directory under U.S. Government, or call (800) 8-ASK-SBA. The SBA also maintains an extensive internet site at **www.sba.gov.** Below are four examples of SBA programs that exist throughout the country and can offer you assistance in your local community.

Service Corps of Retired Executives (SCORE)

SCORE is an SBA-sponsored volunteer management counseling program comprised of active and retired business executives who volunteer their time counseling and advising small business owners on starting and managing their businesses. SCORE volunteers can offer a free one-on-one counseling session about financial statements. SCORE services are available for both for-profit and nonprofit organizations. There are SCORE offices located throughout the country. To find a local office, call (800) 634-0245 or visit their internet site at **www.score.org.**

Small Business Development Centers (SBDCs)

The purpose of the SBDC program is to further economic development by providing management and technical assistance to small businesses. SBDCs provide current and prospective business owners with counseling, management training, conferences, referrals, and reference libraries. They also frequently offer workshops on developing business plans. For information on the nearest location of an SBDC office, contact the SBA at (800) 8-ASK-

SBA or visit the SBDC web site at **www.sba.gov/sbdc.**

Women's Business Centers (WBCs)
Women's Business Centers provide a wide range of services to women entrepreneurs at all levels of business development. Their purpose is to teach women about the principles of finance, management, marketing and how to start a home-based business. The Women's Business Center maintains an excellent internet site (www.onlinewbc.gov) that has helpful information on financial management, marketing, developing a business plan, and a specific section about starting or expanding a child care business. More information about Women's Business Centers can be obtained by contacting the Office of Women's Business Ownership at (202) 205-6673, or by visiting its website at **www.sba.gov/womeninbusiness/wbcs.html**.

Business Information Centers (BICs)
Business Information Centers (BICs) provide a one-stop resource where current and future small business owners can receive assistance and advice. BICs have the latest computer technology (hardware and software) with an extensive small business reference library of hard copy books and publications and current management video tapes to help entrepreneurs plan their businesses, expand an existing business or venture into new business areas. Most BICs are stand-alone centers in Empowerment Zones. In addition to the self-help hardware, software, and reference materials, BICs have on-site counseling provided by SCORE. More information about BICs can be obtained by visiting their internet site at **www.sba.gov/bi/bics**, or by calling (202) 205-6665.

Community Colleges and Universities

Check with your local community college or university for courses on budgeting, accounting, or basic financial statements. Some programs may offer courses specifically for nonprofits. Some SBDC's are located on college campuses.

Regional Resource Centers (RRCs), funded by the California Department of Education, provide assistance to new and established child care providers intended to increase their capacity to deliver services to children and their families. The RRC's are located in ten different regions across the state. Your RRC can provide you with training, technical assistance and information about how to access sources of public and private funding and other forms of support in your community. To find the RRC that covers your county you can call (916) 323-4601, or visit **www.buildingchildcare.org** and look at the Community Resources section of the site.

Resource and Referral (R&R) agencies, funded by the state Department of Education, are community-based organizations charged with the mission of serving parents, providers, policy makers, businesses and communities throughout California by providing information, data, and support to build and improve the supply of quality child care. There is at least one R&R in every county of California. Your local R&R can provide you with county-specific information about the current supply of licensed child care, local demographics, the local demand for care, and market rates for child care costs and staff wages. R&R agencies also help providers with licensing and making their services known in the community, and they provide low-cost or free trainings on a range of subjects. To find the R&R in your community you can call 1-800-KIDS-793, or visit **www.rrnetwork.org**.

Local Planning Councils (LPCs) are responsible for determining local community child care needs, identifying priorities for the allocation of Federal Child Care and Development Block Grant Funds, and preparing county wide child care plans. For the purpose of writing a business plan Local Planning Councils can be particularly helpful in providing information about the greatest needs for child care in the county, and about the local priorities that are designed to meet those needs. To find the LPC in your area you can call (916) 322-6233, or visit **www.buildingchildcare.org/community.htm**.

Family Child Care Associations can be terrific sources of information and exchange about useful materials, professional development opportunities, business skills, upcoming conferences and events, curriculum development, etc. Additionally, because many associations are registered as nonprofits, they can sometimes receive donations of equipment and materials that they then distribute among their members. This is especially helpful since family child care businesses cannot themselves be classified as nonprofits, and are thus unable to attain certain types of donations. To find a family child care association in your area contact the California Association for Family Child Care (CAFCC) at (925) 828-2100, or visit the website at **www.cafcc.org**.

Appendix B:
Glossary of Terms

Accounts Payable: Amounts owed to suppliers for goods and services purchased in connection with business operations.

Accounts Receivable: The amount owed to a business for services already performed.

Accrual: An accounting system that records income when it is earned, and expenses when the obligation to pay arises, regardless of when payment is made.

Amortization: The period of time on which the repayment of loan principal and interest is based. Sometimes loans may have different amortization schedules and terms. There are three basic ways to repay a loan: (a) in equal installments, each containing a blend of principal and interest; (b) in varying but regular payments which result from paying off principal plus interest on the amount actually borrowed; and (c) in very irregular principal payments often incorporating a larger final payment (see Balloon Payment definition).

Assets: Anything a business owns that has monetary value.

Balance Sheet: Reflects the current financial position of the business at a given time. It lists assets and liabilities.

Balloon Payment: The final payment of a loan that has a longer amortization period than term. For example, if a monthly payment is based on a period of 10 years, but the actual term is 5 years, a large payment (roughly half of the loan amount) is due with the final payment at the end of 5 years.

Break-Even Point: The point at which revenues equal expenses.

Bridge Loan: Short-term loan made in anticipation of long-term funding or financing.

Budget: A business' financial "blueprint" for the coming months or years expressed in monetary terms.

Budgeted versus Actual Year-to-Date Income Statement: This income statement is used to compare actual income and expenses to the budgeted figures for the year. It can be very useful to do a budgeted versus Actual Year-to-Date Income Statement at the end of a year as well as at intervals during the year, in order to monitor the progress of the business and the accuracy of budget projections.

Building and Real Estate Costs:

a. Soft Costs – Expenses, other than hard costs, incurred in developing a real estate project, including legal and lending fees, architectural and design fees, permits, etc.
b. Hard Costs – The direct costs to construct a building or structure, otherwise known as “bricks and mortar” costs, including acquisition of property, construction, equipment, etc.
c. Hidden Costs – Less visible costs associated with the facilities development process, such as staff and board time and attention.
d. Contingency Costs – A portion of the construction costs set aside to cover unexpected “hard” costs.

Building Reserve: A capital improvement reserve fund. Money set aside to pay for facilities upkeep: where the amounts can be large, the ultimate need a certainty, but where the exact timing is uncertain. These are often big-ticket items, like replacing the roof, which are difficult to accommodate in a single year’s budget.

Cash Balance: Total cash available minus total cash paid out.

Cash Basis Accounting: A system that records income only when it is received and expenses only when they are paid out.

Cash Flow Projections: Projects the cash in-flow and out-flow for a business.

Cash Receipts: Includes cash from parent fees, loan or cash injections, or income from the food program, government programs, private sources, foundation grants, or fundraisers.

Collateral: The property a borrower pledges to a Lender to secure repayment of the loan. Collateral could include: a lien on your house, equipment from your business, or a bank account. If the borrower defaults, the lender has the legal right to seize the collateral and sell it to pay off the loan.

Current Assets: Cash and other assets like accounts receivable or grants that can be converted into cash. Current assets also include prepaid expenses such as the goods, benefits or services that a business buys or rents in advance.

Current Ratio: Expresses the relationship between current assets and current liabilities.

Debt: Money, goods or services that one party is obligated to pay another in accordance with an expressed or implied agreement.

Debt Service: A borrower’s periodic payment comprising repayment of principal plus payment of interest on the unpaid balance. Also referred to as a loan payment.

Debt Service Coverage or Debt Coverage Ratio: A calculation a Lender uses to determine ability to repay a loan. This calculation is typically expressed as a ratio. Most Lenders have minimum debt service coverage requirements ranging from 1.05: 1.00 (i.e. the net income must be projected to be 5% in excess of the loan payment) to 1.25: 1.00 (i.e. the net income must be projected to be 25% in excess of the loan payment).

$$\text{DSC or DCR} = \frac{\text{Net Income (after all expenses excluding debt service)}}{\text{Total Loan Payment}} = 1.10 : 1.00$$

Depreciation: A sum representing presumed loss in the value of a building or other real estate improvement, resulting from physical wear and economic obsolescence, and deducted annually from net income to determine net profit.

Equity: In real estate, the difference between fair market value and current indebtedness usually referred to as the owner's interest.

Expenses: The cost of assets consumed or services used in the process of earning revenues.

Fees: Charges by a Lender for making the loan. Fees can include a range of costs.

Fixed Assets: Includes all resources a business owns or acquires for use in operations and not intended for resale. Fixed assets, except for land, are listed at cost less depreciation.

Fixed Expenses: Expenses that do not fluctuate as services are expanded.

Forgivable Loan: A loan made with the understanding that if the borrower meets certain requirements, repayment of the loan will not be required.

Guarantee: A promise by one party to pay a debt or perform an obligation contracted by another if the original party fails to pay or perform according to a contract. Loan guarantee, or loan insurance programs are designed to make certain loans less risky for lenders, such as loans for community economic development projects and for small businesses like child care.

Income Statement: Identifies the sources and uses of funds. It is a very useful statement because it shows what a business actually earned and what it cost to earn that amount.

Interest: The cost of using loaned money, usually expressed as an annual percentage, that a lender charges a borrower for the use of the principal over time.

Interest Rate: The amount a Lender will charge for the use of their funds. Interest rates vary greatly from loan to loan and are frequently tied to industry measures such as Prime Rate. For example, if Prime Rate were 4.75%, then a "Prime Plus Two Percent" rate would mean a loan with a 6.75% interest rate.

Leasehold Improvements: Renovations to leased space to suit the renter's needs. These may be paid for either by the landlord or the tenant.

Liabilities: Liabilities are the amounts owed by a business.

Lien: A claim a Lender may place on property in return for making a loan. If a borrower is unable to make loan payments as agreed, it gives the Lender the right to try and collect repayment of the loan through selling the borrower's property. If the lien is placed on real property such as a house, this lien is often referred to a "Mortgage" or a "Trust Deed."

Line of Credit: A set amount of money available for the Borrower to borrow as needed. The borrowed amounts are then paid back in installments determined by the Lender. A line of credit is distinct from a loan because after the money is paid back a borrower can access it and use it again, which makes it similar to a credit card.

Liquidity: The ability to pay for current obligations or liabilities.

Loan: Transaction wherein a Lender allows a Borrower the use of a sum of money for a specified period of time at a specified rate of interest.

Loan Amount: The amount of a loan is determined by how much the Borrower needs to complete the project and the Lender's assessment of the Borrower's ability to repay. Some Lenders may have minimum and maximum loan amounts.

Loan-to-Value Ratio: The ratio of money a Lender is willing to loan relative to the appraised value of the property or other security.

Mortgage: Security instrument by which the Borrower (mortgagor) gives the Lender (mortgagee) a lien on property as security for the repayment of a loan.

Net Operating Income: The difference between effective gross income and operating expenses, including taxes and insurance. The term is qualified as net income before depreciation and debt service.

Net Profit: Total revenues minus total expenses.

Net Working Capital: Current liabilities subtracted from current assets.

Net Worth: The difference between all assets and all liabilities. Net worth is equal to the business' equity.

Notes Payable: The balance of principal to pay off short-term debt for borrowed funds. This also includes the current amount due of total balance on notes whose terms exceed 12 months.

Operating Reserves: Funds set aside annually to be used to offset possible operating losses due to unexpectedly low revenues or unusually high expenses.

Payroll Accrual: Salaries and wages currently owed.

Points: An up front fee a Lender may charge for a loan, expressed as a percentage of the loan amount. "One point" equals one percentage of the loan amount. Thus, one point on a $10,000 loan is $100 ($10,000 X .01).

Prime Rate: The rate, as announced from time to time by commercial banks, as the prime rate. (See "Interest Rate" definition).

Principal: The original amount of money borrowed, and the amount that the Borrower must pay back, not including interest.

Pro Forma Cash Flow Statement: Projects what a business needs in terms of dollars for a specific period of time. It also helps identify when cash is expected to be received and when bills must be paid.

Pro Forma Income Statement: A preview of the amount of income generated each month and for the business year, based on reasonable predictions of revenues and expenses.

Pro Forma Statements: Financial projections based on what is predicted to happen in the future. They are an essential business planning tool that assist in fiscal strategizing and are also required by many financial institutions.

Revenues: Total amount received or to be received later from parent fees, state contracts, grants, or foundation awards. Revenues are often classified by source and nature in order to reflect the change in revenue composition.

Term: The agreed upon period of time for which a loan is made. A loan provided for 10 years has "a 10 year term."

Variable Expenses: Expenses that fluctuate as services are expanded.

Note: Definitions provided by the Low Income Investment Fund and the Nonprofit Finance Fund are used in this glossary.

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