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A Summary of Lending to Childcare Businesses Under Programs of the U.S. Small Business Administration

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Childcare

Childcare is a facilities-intensive industry and access to capital is critical for entrepreneurs seeking to open or expand childcare businesses. Yet experts tell us that thin profit margins and limited collateral can make it difficult for childcare business owners to get loans to operate their businesses and upgrade their facilities.

As part of the Chicago Fed's Spotlight on Childcare and the Labor Market, a targeted effort to understand how access to childcare can affect employment and the economy, we examined data on loans made by private financial institutions (both banks and nonbanks) to for-profit childcare businesses through the U.S. Small Business Administration's (SBA) 504 and 7(a) programs. These programs encourage financial institutions to lend to small businesses by guaranteeing loans. By compensating the lender when a small business fails to make loan payments, these guarantees reduce the risk a lender faces when they make the loan.

This article focuses on loans made during 2023 when all eligible small businesses borrowed more than \$42 billion through more than 70,000 loans under these programs—over \$27 billion under 7(a) and over \$15 billion under 504—with childcare businesses borrowing over \$1.1 billion.

The SBA data provide details—such as the interest rate and term length—on each individual loan that lenders issued under these programs. These data offer the public a rare glimpse into the borrowing terms that childcare and other small businesses face. In general, banks, credit unions, and nondepository financial institutions—such as nondepository community development financial institutions, small business lending companies, and real estate investment trusts—that lend to childcare businesses do not publish data on individual loans they issue. Of course, we only observe loans made under these SBA programs and are unable to confirm the extent to which their terms are similar or different from small business loans generally.

Our key findings for 7(a) and 504 loans made in 2023 are as follows:

- The two most common 7(a) loans to childcare businesses were 120-month (ten-year) loans with a 75% guarantee for expenses like capital and equipment (representing a quarter of all childcare loans) and 300-month (25-year) loans with a 75% guarantee for real estate (representing about one-fifth of all childcare loans).
- 100% of loans to childcare businesses under the 504 program were 20- or 25-year loans for real estate and more than 30% of 7(a) loans to childcare businesses were loans for real estate with a term length of 20 years or more.
- 7(a) loans issued by banks and credit unions have lower average interest rates than loans issued by nondepository lenders. Specifically, bank loans to childcare businesses have, on average, interest rates that are 10% to 15% lower than loans issued by nondepository institutions to childcare businesses.
- For ten-year 7(a) loans, average interest rates are 4% lower for childcare businesses than for non-childcare businesses.
- For 25-year 7(a) loans, childcare businesses are about 30% more likely than non-childcare businesses to take out loans from nondepository institutions. This contributes to, but only explains a small fraction of, 3% higher average interest rates paid by childcare businesses on their 25-year 7(a) loans.

The 7(a) and 504 programs facilitate access to credit for small for-profit businesses by providing partial guarantees.

SBA describes the 7(a) program as its primary business loan program, and in 2023 lending volume under the 7(a) program was almost twice as much as that under the 504 program. This section provides a general description of loans originated under the 504 and 7(a) programs.¹

The SBA’s 504 and 7(a) programs are designed to encourage private third-party financial institutions to provide credit to small businesses; they share some common features but have a few key differences.

A core common element is that each program features a loan issued by a third-party financial institution to a small business borrower. However, 504 pairs a loan issued by a nonprofit Certified Development Company (CDC) with the third-party loan. In general, the third-party loan under 504 is required to cover 50% of total project costs, and the CDC loan is required to cover no more than 40% of total project costs (with the borrower required to cover the remaining project costs). While the 7(a) program provides a partial guarantee to third-party lenders, the 504 program does not. Instead, it guarantees 100% of a separate loan (called a debenture) issued by the CDC. These 100% SBA-guaranteed debentures are pooled and sold, and CDCs use the proceeds to fund their loans to small businesses.

To be an eligible borrower under these programs, a business must meet certain requirements, including, among other things, that it be creditworthy, be in the United States, qualify as a “small business” under SBA size requirements, receive a lender certification that credit is not otherwise available to it on reasonable terms without SBA assistance, and be a for-profit operating business. Thus, we do not observe loans to nonprofit childcare businesses, which represent just under one-quarter of the almost one million employer establishments in the U.S. childcare services industry.²

Borrowers can use the proceeds of loans under 504 and 7(a) programs only for certain eligible purposes, many of which are the same across the two programs. These common purposes include real estate, such as the acquisition of land, the purchase or renovation of an existing building, and the construction of a building. Another common eligible purpose is the purchase or lease of fixed assets, such as machinery or equipment. A key difference is that the proceeds of some 7(a) loans may be used for a broader set of purposes, including inventory, raw materials, and working capital.

We use publicly available data that includes key terms for 7(a) and 504 loans.

The SBA loan-level data provide details on the origination of 7(a) loans. We focus on the following key terms for third-party loans under 7(a): the loan amount, the maturity or term length, the percentage of loan principal guaranteed by SBA, the initial interest rate at the time of origination, and whether the lender is a bank, a credit union, or neither (a nonbank). Data on third-party loans and CDC loans under the 504 program are similar but do not include interest rates on third-party loans. We focus on loans originated in 2023, the latest full calendar year of data.³

Childcare businesses borrowed over \$1 billion under the 7(a) and 504 programs.

As noted above and shown in figure 1, in 2023, lending under the 504 and 7a loan programs totaled \$42 billion. There were 58,896 loans under 7(a) and 5,829 loan pairs (CDC and third-party loans) under 504. Lending to childcare businesses through these two programs totaled to over \$1 billion, with \$565 million through 7(a) and \$538 million through 504. These amounts represent about 2% and 4% of total 7(a) and 504 lending, respectively. In 2023, third-party lenders made 793 loans to childcare businesses under 7(a) and 196 loans under 504.

1. Lending under the 504 and 7(a) programs totaled \$42 billion with over \$1 billion to childcare businesses

	Borrower industry	Number of loans	Total lending (\$millions)	Share of total lending (%)
7(a)	All childcare	58,896	27,068	100
		793	565	2
504	All childcare	5,829	15,168	100
		196	538	4
Both	All childcare	64,757 991	42,236 1,103	

Note: For 504, the number of loans is the number of CDC and third-party loan pairs, so the actual number of loans is twice the number shown, while 504 total lending (as shown) is sum of the CDC and third-party loan amounts.
Source: Authors’ calculations using SBA data.

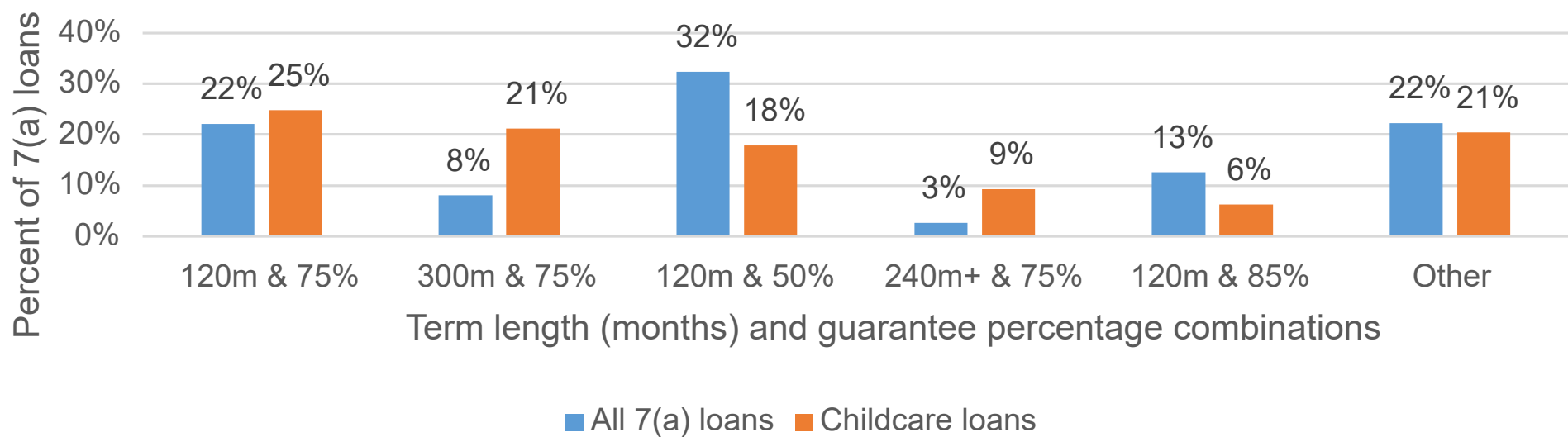
The most common loans to childcare businesses are 10-year and 25-year loans with 75% guarantees.

As mentioned above, these programs include loan guarantees intended to motivate lending by third-party borrowers to eligible small businesses. In general, the percentage of the partial guarantee under the 7(a) program depends on the amount of the loan and the loan type. Standard 7(a) loans generally have a guaranteed percentage of 75% or 85%, depending on the loan amount. SBA Express loans, however, have a maximum guaranteed percentage of 50%, regardless of loan amount. SBA Express authority allows a lender to use their existing documentation and procedures when making a 7(a) loan. SBA Express loans cannot exceed \$500,000.

How the small business will use the proceeds of a loan generally determines its term length or maturity. In general, real estate 7(a) loans have a maximum maturity of 25 years (300 months). The maximum maturity allowed for 7(a) loans for purposes other than real estate is generally ten years (120 months).

Figure 2 shows the five most common combinations of term length and guarantee percentage under 7(a) in 2023. Childcare loans share the same five most common combinations with all 7(a) loans, but the ranking is different. The most common combination for childcare 7(a) loans is a 120-month term with a 75% guarantee, while that is the fourth most common combination for 7(a) loans generally. The second most common combination for childcare loans is a 300-month term with a 75% guarantee, while that is the fourth most common combination for 7(a) loans generally. The third most common combination for childcare loans is a 120-month and 50% guarantee (these are almost exclusively SBA Express loans), while that is the most common combination for 7(a) loans generally.

2. Most common 7(a) term length and guarantee percentage combinations (2023)

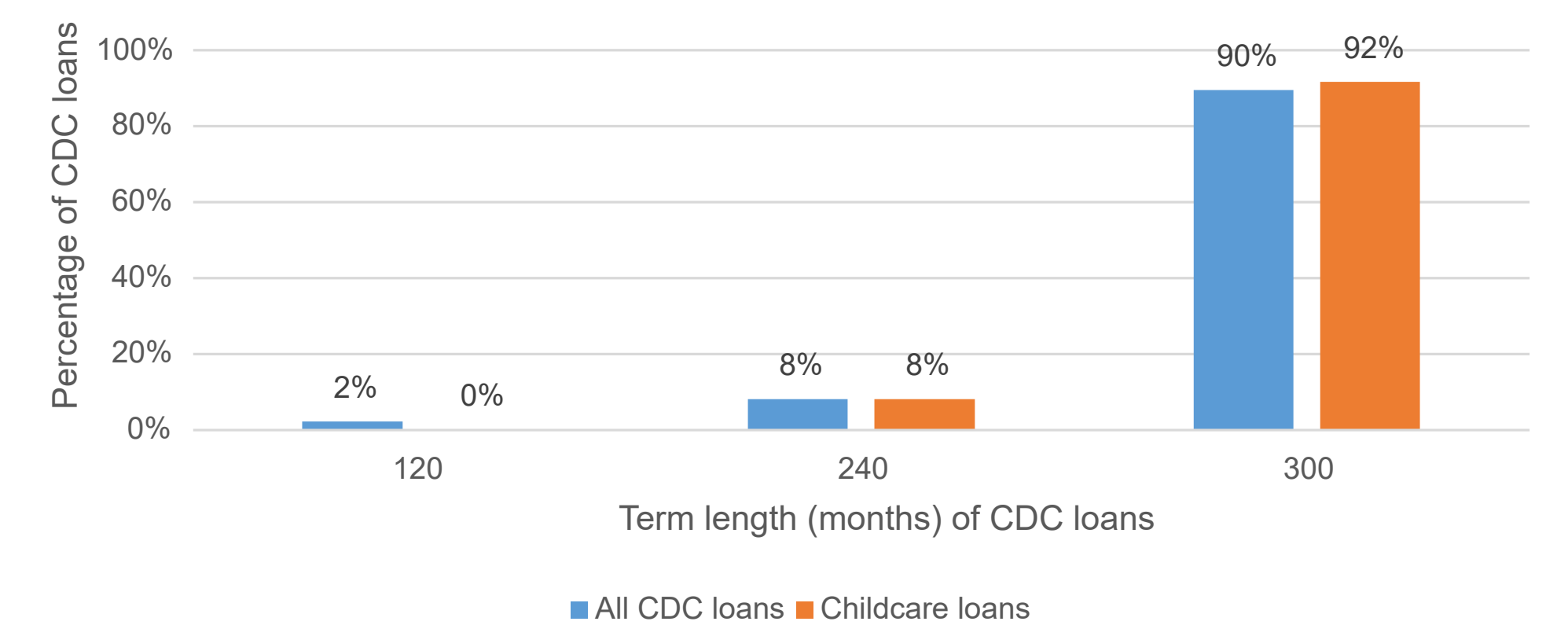


Note: Term length “240m+” means term lengths of 240 months or more but not including a term length of 300 months.
Source: Authors’ calculations using SBA data.

We don’t show combinations for the 504 program, because 100% of the CDC loan is guaranteed while none of the third-party loan is guaranteed regardless of term length.

Figure 3 shows the term lengths for CDC loans under the 504 program. Here again the use of proceeds defines the term length, with the term length generally 20 or 25 years for real estate and ten years for machinery and equipment. A 25-year term length is by far the most common at 90% of all CDC loans and 92% of all CDC loans to childcare businesses. About 8% of all CDC loans have a 20-year term length, and there are relatively few ten-year loans (none for childcare). Again, the SBA data only include the term length of the CDC loan and not the third-party loan.⁴

3. Most CDC loans have a 300-month term length (2023)

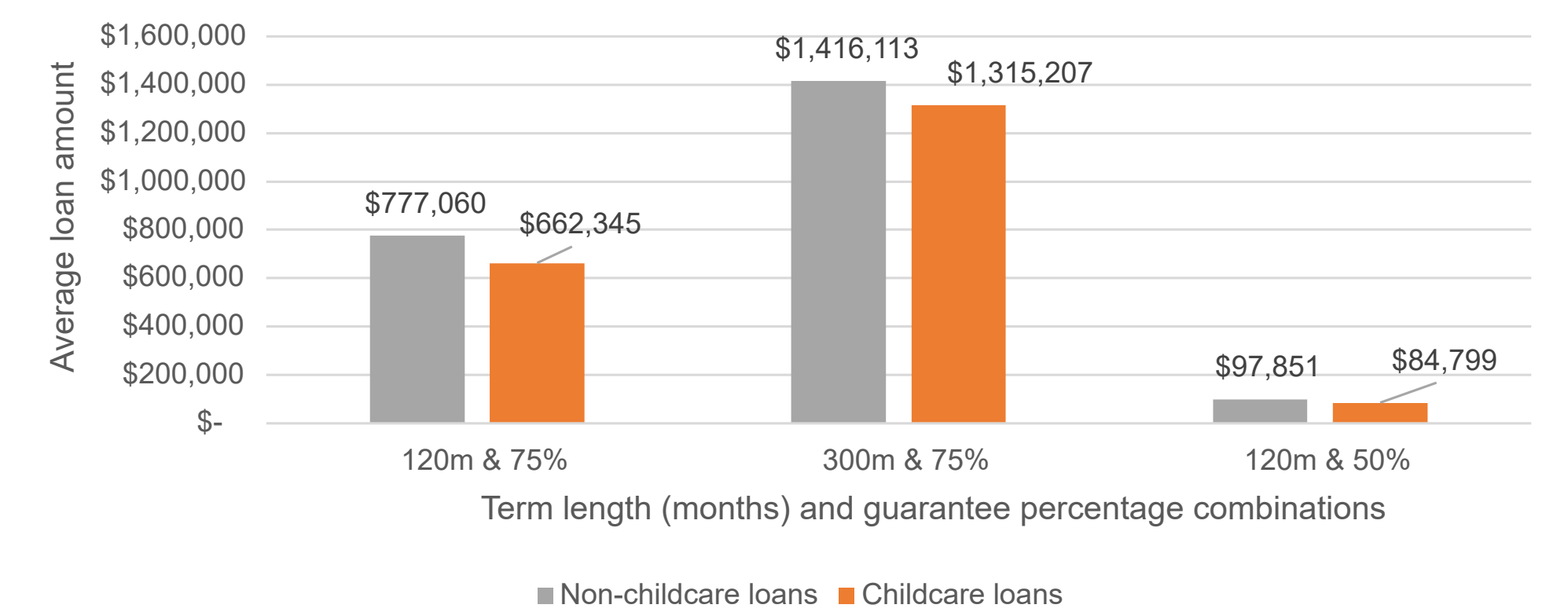


Source: Authors’ calculations using SBA data.

Average loan amounts increase as term length increases.

Figure 4 shows the average amount of 7(a) loans in 2023 for the three most common term length and guarantee percentage combinations. In general, the average loan amount increases as term length increases.

4. Average 7(a) loan amounts by term length and guarantee combination (2023)

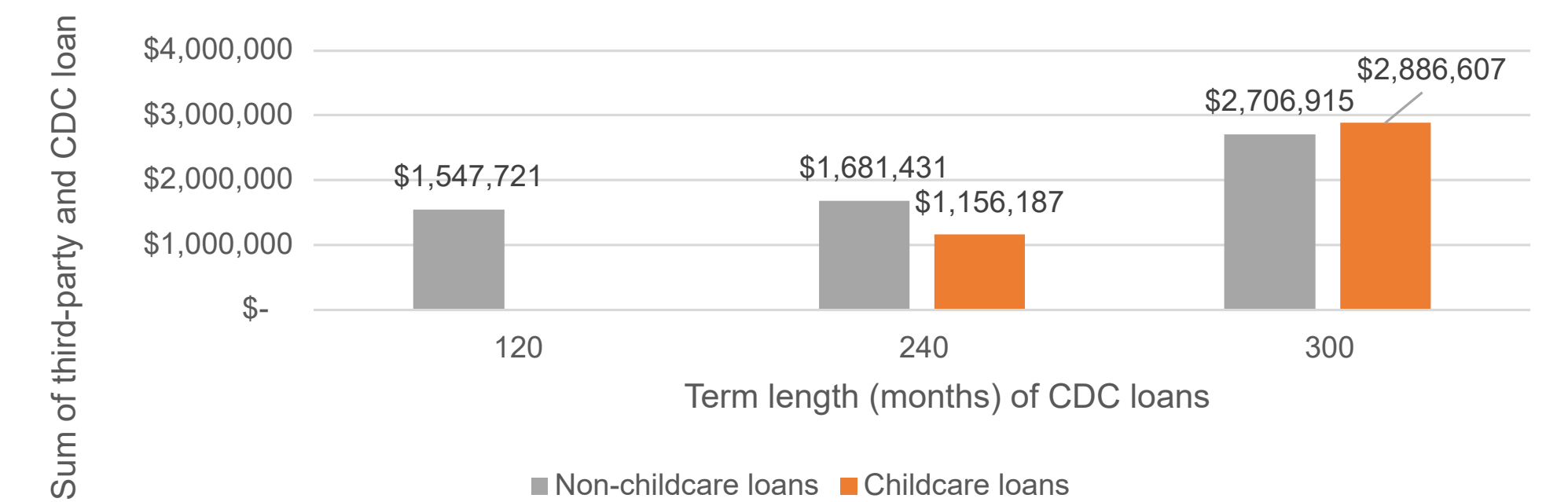


Source: Authors’ calculations using SBA data.

The average amount for 300-month childcare loans is about \$1.3 million, slightly lower than the average of \$1.4 million for non-childcare loans. The average amount of 120-month childcare loans with a 75% guarantee is about \$660,000, which is less than the average of \$777,060 for non-childcare loans. The average amount for 120-month loans with a 50% guarantee is much lower with the average childcare loan at about \$85,000 and non-childcare loans at just under \$100,000. Over 90% of these loans are revolving loan facilities and over 99% are via SBA Express. None of the 300-month loans are revolving loan facilities and about 0.5% of 120-month loans with a 75% guarantee are revolving loan facilities.

Again, loans with term lengths of 20 to 25 years are used for real estate, whereas loans with terms of ten years are generally used for purchasing tangible property, such as machinery or equipment. For 504 loans, figure 5 shows the average of the total amount of each of third-party and CDC loan pair by CDC term length. The average loan amounts are about \$2.71 million for 300-month non-childcare loans (\$2.89 million for childcare) and about \$1.66 million for 240-month non-childcare loans (\$1.16 million for childcare).

5. 504: Average total loan amount increases with term length (2023)



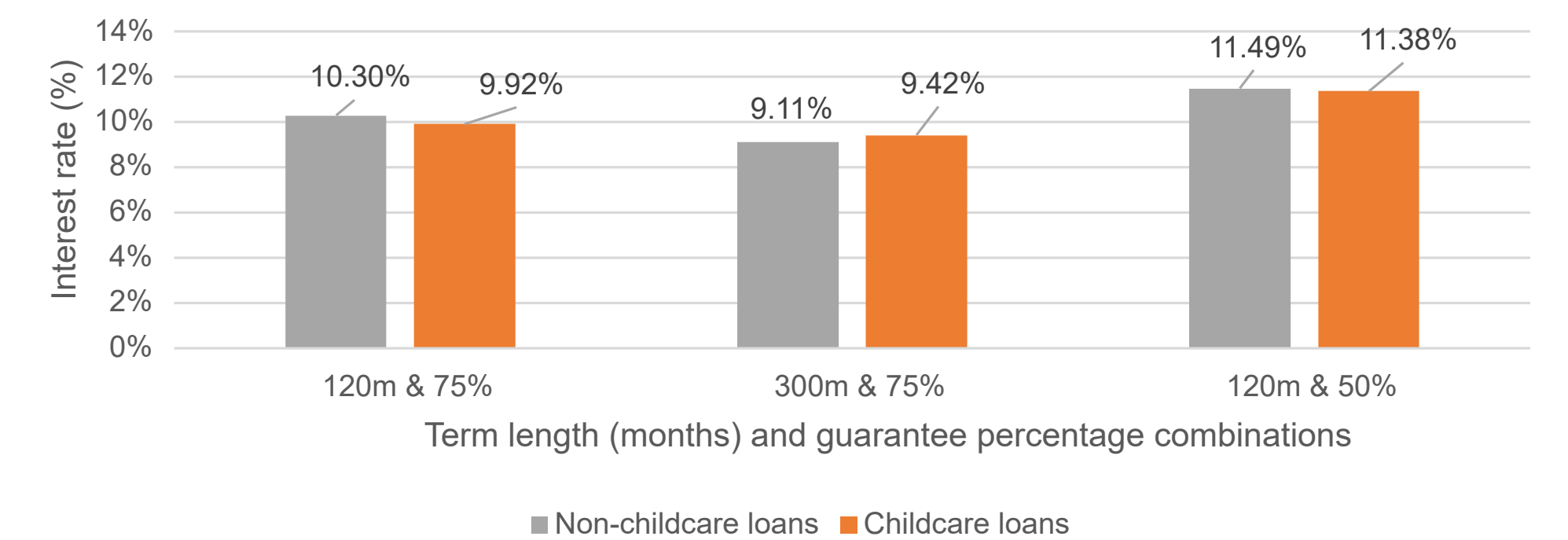
Note: There are no 120-month childcare loans.
Source: Authors’ calculations using SBA data.

Relative to non-childcare businesses, childcare businesses pay 3% higher average interest rates on 25-year loans and 4% lower average interest rates on ten-year loans.

Again, the SBA data only include initial interest rates at the time of loan origination for 7(a) loans.⁵ The interest rate for any 7(a) loan is negotiated between the lender and borrower, can be either fixed or variable, and cannot exceed a maximum allowable interest rate.⁶ For variable rate loans, the SBA data show the initial interest rate at origination for all 7(a) loans but do not track the rate over time. Loans must use an amortization schedule and there are no balloon payments. In 2023, just over 85% of all 7(a) loans had variable interest rates.

Figure 6 shows average initial interest rates for 7(a) loans for the three most common term length and guarantee percentage combinations. For childcare loans, it shows that the average interest rate on childcare loans is lower than for non-childcare 7(a) loans for 120-month loans with a 75% or 50% guarantee, while it is relatively higher for 300-month loans with a 75% guarantee.⁷

6. Average initial interest rates on 7(a) loans (2023)



Note: From left to right by maturity and guarantee combination, the number of childcare loans is 196, 169, and 142 and the number of non-childcare loans is 12,783, 4,639, and 18,900.
Source: Authors’ calculations using SBA data.

To help us understand the magnitude of these differences, we use an amortization calculator to determine the differences in monthly payments that these interest rate differences imply, assuming that the initial interest rate is fixed over the term of the loan. We use net present value (assuming a 5% discount rate) to measure the upfront value or cost to a borrower (today) of paying lower or higher monthly payments in the future over the loan term.

Figure 7 shows these calculations for the two most common term length and guarantee percentage combinations for 7(a) loans to childcare businesses. We assume a loan amount of \$450,000 for the 120-month and 75% guarantee loan, because this is close to the median amount of these loans. At that amount, amortization implies monthly payments of \$6,022 at the average non-childcare interest rate (10.30%) and \$5,928 at the average childcare interest rate (9.92%). That means the childcare loan monthly payments are \$94 per month lower than the payments for the average non-childcare loan. These lower monthly payments over 120 months have a net present value of \$8,857, meaning childcare businesses save almost \$9,000 during the lifetime of the loan relative to other businesses.

7. How interest rate differences between childcare and non-childcare loans affect monthly payments

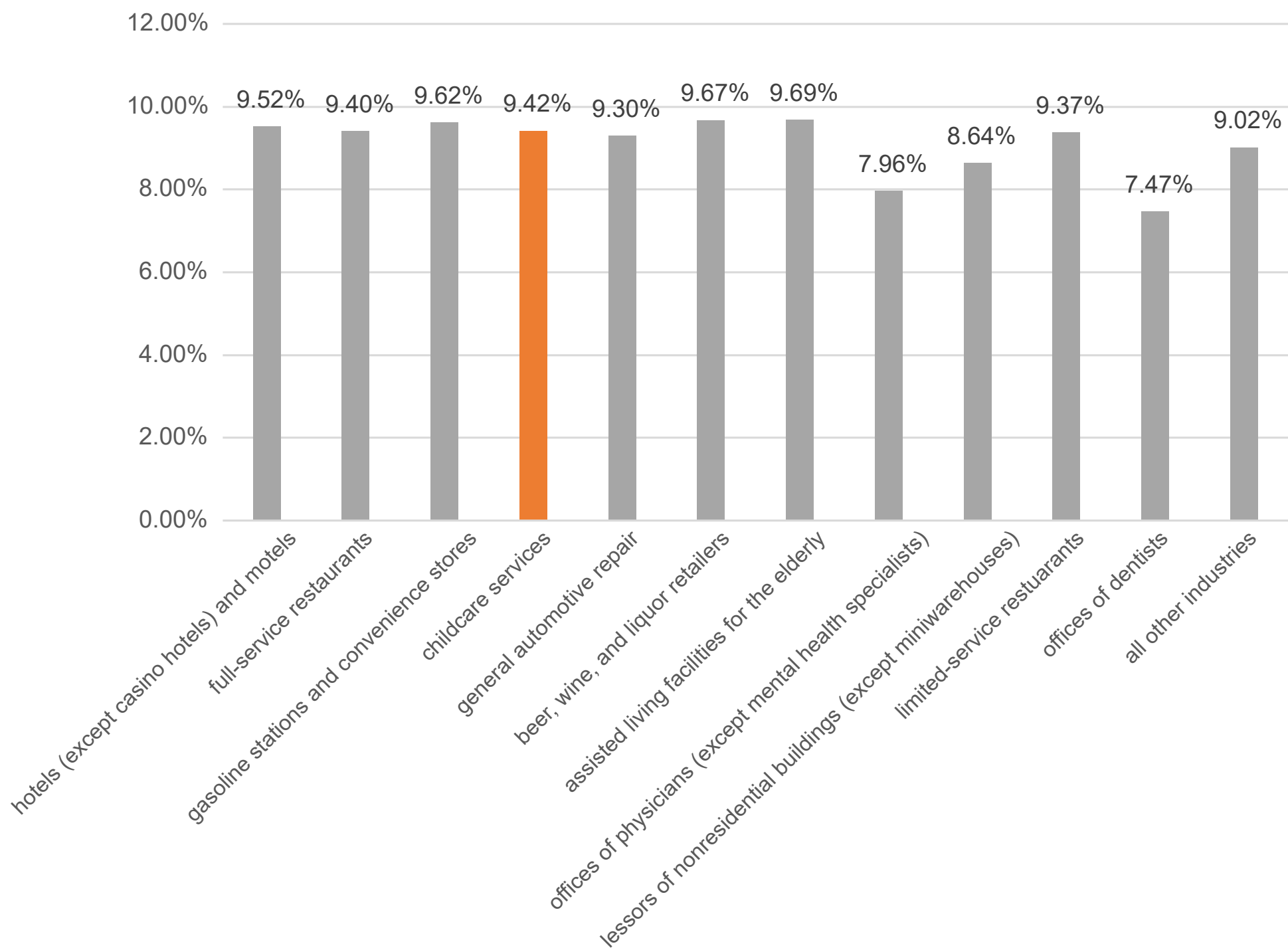
Two most common term length and guarantee percentage combinations	Assumed loan amount	Implied monthly payments at average initial interest rate (assumed fixed)		Monthly payment difference (childcare versus non-childcare)	Net present value of monthly difference
		Non-childcare loan	Childcare loan		
120 months, 75%	\$450,000	\$6,022	\$5,928	−\$94	\$8,857
300 months, 75%	\$1,000,000	\$8,469	\$8,679	\$211	−\$36,037

Notes: Net present value analysis assumes a discount rate of 5%. Calculations use actual average interest rates by borrow type. Figure 6 displays those averages rounded to two decimal places.
Source: Authors’ calculations (using Microsoft Excel PMT and PV functions).

The median loan amount for a loan with 300-month maturity and a 75% guarantee is about \$1 million. At that amount, amortization implies monthly payments of \$8,469 at the average non-childcare interest rate (9.11%) and \$8,679 at the average childcare interest rate (9.42%). That means the childcare loan monthly payments are \$211 per month higher than the payments on a non-childcare loan. These higher monthly payments over 300 months have a net present value of \$36,037, meaning that childcare businesses pay about \$36,000 more than other businesses over the lifetime of the loan.

To provide further context for these interest rate differences, figure 8 shows average initial interest rates across the 11 six-digit NAICS industries that received the most 300-month 7(a) loans with 75% guarantees. The industry with most loans (hotels and motels) had 451 7(a) loans in 2023, with an average interest rate of 9.52%, 10 basis points higher than the average interest rate for childcare loans. The six industries in these top 11 with lower average interest rates are full-service restaurants, general automotive repair, offices of physicians, lessors of non-residential buildings, limited-service restaurants, and offices of dentists.

8. 7(a): Average initial interest rate across industries for 300-month loans with 75% guarantee (2023)



Note: The figure shows average initial interest rates the six-digit NAICS industries with the most 300-month and 75% guarantee 7(a) loans in calendar year 2023 in descending order from left to right.
Source: Authors' calculations using SBA data.

These interest rate differences between childcare and non-childcare businesses exist for both bank and nonbank 7(a) loans, but average interest rates are higher for nonbank 7(a) loans.

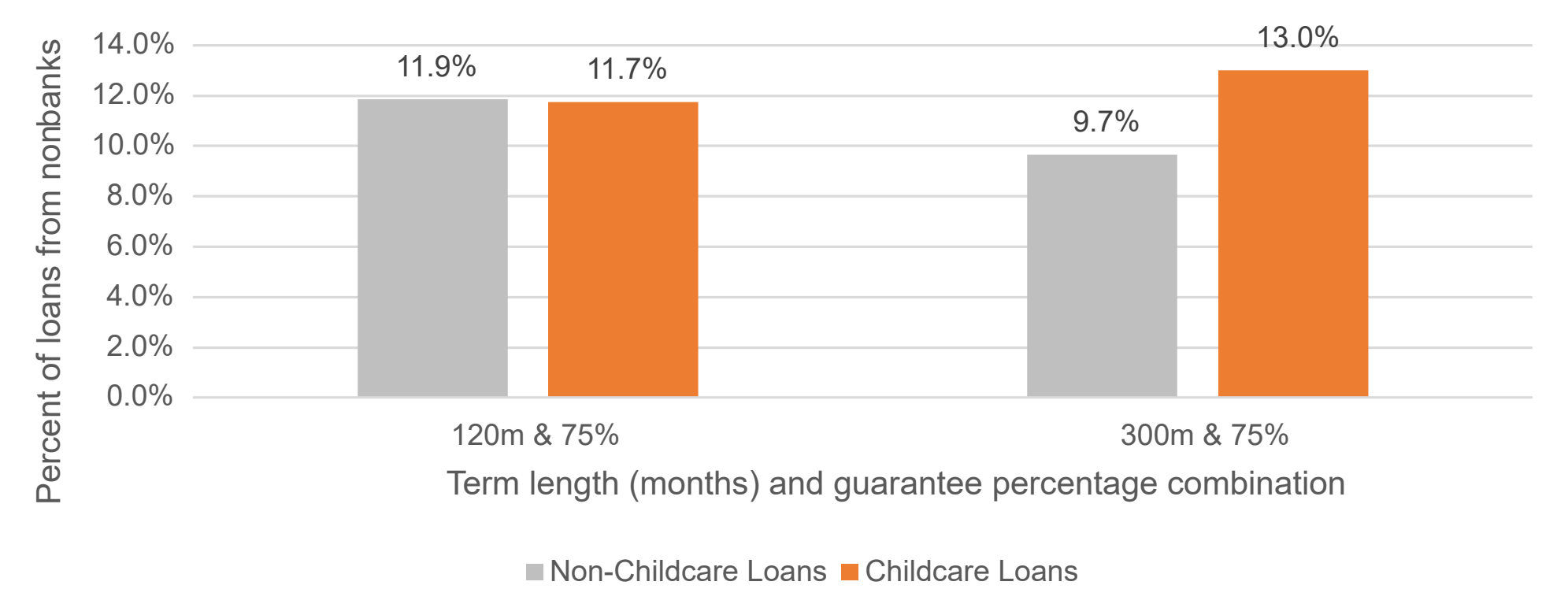
Our data do not allow us to identify the reasons behind the interest rate differences we describe above. We can, however, state a few facts.

First, the differences in average interest rates between childcare and non-childcare businesses are consistent across depository institutions (banks) and nondepository institutions (nonbanks). Figure 9 shows that for 120-month 7(a) loans, average interest rates for childcare businesses are about 42 basis points lower on bank loans (9.79% versus 10.21%) and 14 basis points lower on nonbank loans (10.84% versus 10.98%). For 300-month 7(a) loans, average interest rates for childcare businesses are 26 basis points higher on bank loans (9.24% versus 8.98%) and 24 basis points higher on nonbank loans (10.61% versus 10.37%).

Second, nonbanks issue 7(a) loans with higher average interest rates than banks and this holds for loans they issue to both childcare and other businesses.

Figure 9 shows that the 7(a) nonbank loans have higher average initial interest rates than bank loans. This is evident from the fact that the four nonbank bars on the right-side of the figure are each taller than any of the four bank bars on the left-hand side. For childcare loans, the average interest rate for 120-month nonbank loans is over 100 basis points higher than it is for bank loans (10.84% minus 9.79%). Similarly, again among childcare borrowers, the difference in average interest rates on 7(a) loans for 300-month loans between nonbanks and banks is almost 140 basis points (10.61% minus 9.24%). The equivalent differences for childcare versus non-childcare loans are 77 basis points (120 months) and 39 basis points (300 months).

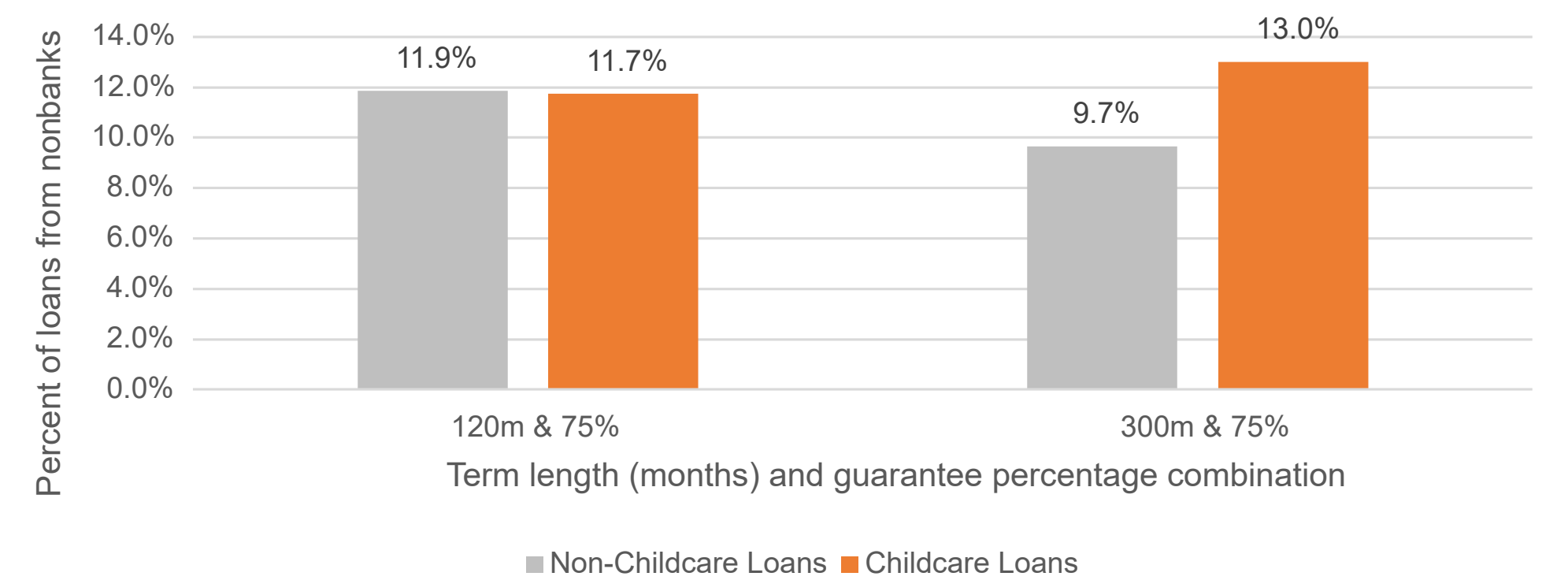
9. Average initial 7(a) interest rates by combination and lender type (2023)



Notes: The number of loans originated by nonbanks to childcare businesses with a 75% guarantee are 23 loans of 120 months and 22 loans of 300 months. The number originated by nonbanks to non-childcare businesses are 1,516 loans of 120 months and 448 loans of 300 months. Source: Authors' calculations using SBA data.

Third, childcare borrowers are more likely than non-childcare borrowers to get 300-month 7(a) loans from nonbanks. Figure 10 shows that nonbanks issue relatively more of the 300-month 7(a) loans issued to childcare businesses (13%) than they do to non-childcare businesses (10%). In contrast, the share of 120-month 7(a) loans issued by nonbanks is about the same for childcare and non-childcare businesses.

10. 7(a): Childcare real estate loans more likely to come from nonbanks (2023)



Source: Authors' calculations using SBA data.

We again use an amortization calculator to determine the differences in monthly payments that these bank versus nonbank interest rate differences imply. As before, we use net present value (assuming a 5% discount rate) to measure the upfront value or cost to a borrower (today) of paying lower or higher monthly payments over the loan term.

Figure 11 shows these calculations. We again use a loan amount of \$450,000 and assume a fixed interest rate. For the 120-month childcare loan with a 75% guarantee, amortization implies monthly payments of \$6,157 at the average nonbank interest rate (10.84%) and \$5,898 at the average bank interest rate (9.79%). That means the bank loan monthly payments are \$259 per month lower than the nonbank loan. These lower monthly payments over 120 months have a net present value of \$24,441, meaning childcare borrowers with a bank loan instead of a nonbank loan will pay about \$24,000 less over the lifetime of the loan.

For a 300-month childcare loan with a 75% guarantee, amortization implies equal monthly payments of \$9,523 at the average nonbank interest rate (10.61%) and \$8,555 at the average bank interest rate (9.24%). That means the nonbank loan monthly payments are \$968 per month higher than the bank loan payments. These higher monthly payments over 300 months have a net present value of \$165,531, meaning that childcare businesses with a nonbank loan instead of a bank loan pay about \$165,000 more over the lifetime of the loan.

11. Higher nonbank interest rates lead to higher monthly loan payments

Two most common term length and guarantee percentage combinations	Assumed loan amount	Implied monthly payments at average initial interest rate (assumed fixed)		Monthly payment difference (nonbank versus bank)	Net present value of monthly difference
		Bank loan	Nonbank loan		
120 months, 75%	\$450,000	\$5,898	\$6,157	\$259	−\$24,441
300 months, 75%	\$1,000,000	\$8,555	\$9,523	\$968	−\$165,531

Notes: Net present value analysis assumes a discount rate of 5%. Calculations use actual average interest rates by borrow type. Figure 10 displays those averages rounded to two decimal places.
Source: Authors’ calculations (using Microsoft Excel PMT and PV functions).

Conclusion

This article summarized key terms of loans to childcare and other small businesses that receive loan guarantees from the U.S. Small Business Administration via its 7(a) and 504 programs. In 2023, more than \$1.1 billion in loans to childcare businesses were made under these programs. We found that childcare businesses took out 300-month loans under both the 7(a) program and the 504 program to finance real estate acquisitions and improvements. We also found that childcare businesses paid a higher average interest rate than non-childcare businesses on these 300-month loans and lower average interest rates than non-childcare businesses on 120-month 7(a) loans.

These data do not allow us to determine an explanation for these interest rate differences. We were able to state a few facts, however. First, these interest rate differences are consistent across banks and nonbanks. Both banks and nonbanks issue 120-month loans to childcare businesses with lower average interest rates than to non-childcare businesses and 300-month loans to childcare businesses with higher average interest rates than to non-childcare businesses. Second, childcare businesses are about 30% more likely than non-childcare businesses to get their 300-month 7(a) loans from nonbanks. Third, nonbanks issue 7(a) loans with higher average interest rates than banks, and that this holds for loans they issue to both childcare businesses and other businesses.

Notes

- ¹ For a detailed overview, see the SBA document [SOP 10 50](#) on loan origination policies and procedures.
- ² U.S. Census Bureau, [County Business Patterns: 2022](#), U.S. file for NAICS = 624410.
- ³ These data do not include other important aspects of both 7(a) and 504 loans that affect the cost of capital, including loan fees charged to lenders and borrowers, requirements for personal guarantees from borrowers, and insurance requirements.
- ⁴ Third-party loans that accompany a ten-year CDC loan must have at least a seven-year term and third-party loans that accompany a 20- or 25-year term must have at least a ten-year term.
- ⁵ The CDC loan has a fixed interest rate determined when the loan is bundled with other 504 loans and sold to private investors.
- ⁶ The [SBA posts](#) the maximum fixed interest rate for 7(a) loans each month. For loans greater than \$250,000 it started at 12.5% on January 1, 2023, increased to 12.75% on March 1, 2023, increased to 13% on April 1, 2023, increased to 13.25% on June 1, 2023, and increased to 13.5% on August 1, 2023, and remained at that level throughout the remainder of the year.

⁷ These averages don't control for any effect of loan amounts on interest rates. We don't believe differences in loan amounts explain these differences in interest rates. To investigate this, we estimated an ordinary least squares regression run on the sample of 300-month loans with a 75% guarantee originated in 2023, with interest rates as the dependent variable and a binary indicator variable for whether the borrower is in the childcare industry. It generates a coefficient of 0.31 with a robust standard error of 0.11. Controlling for a linear or non-linear relationship between loan amount and interest rate does not change this coefficient materially.

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