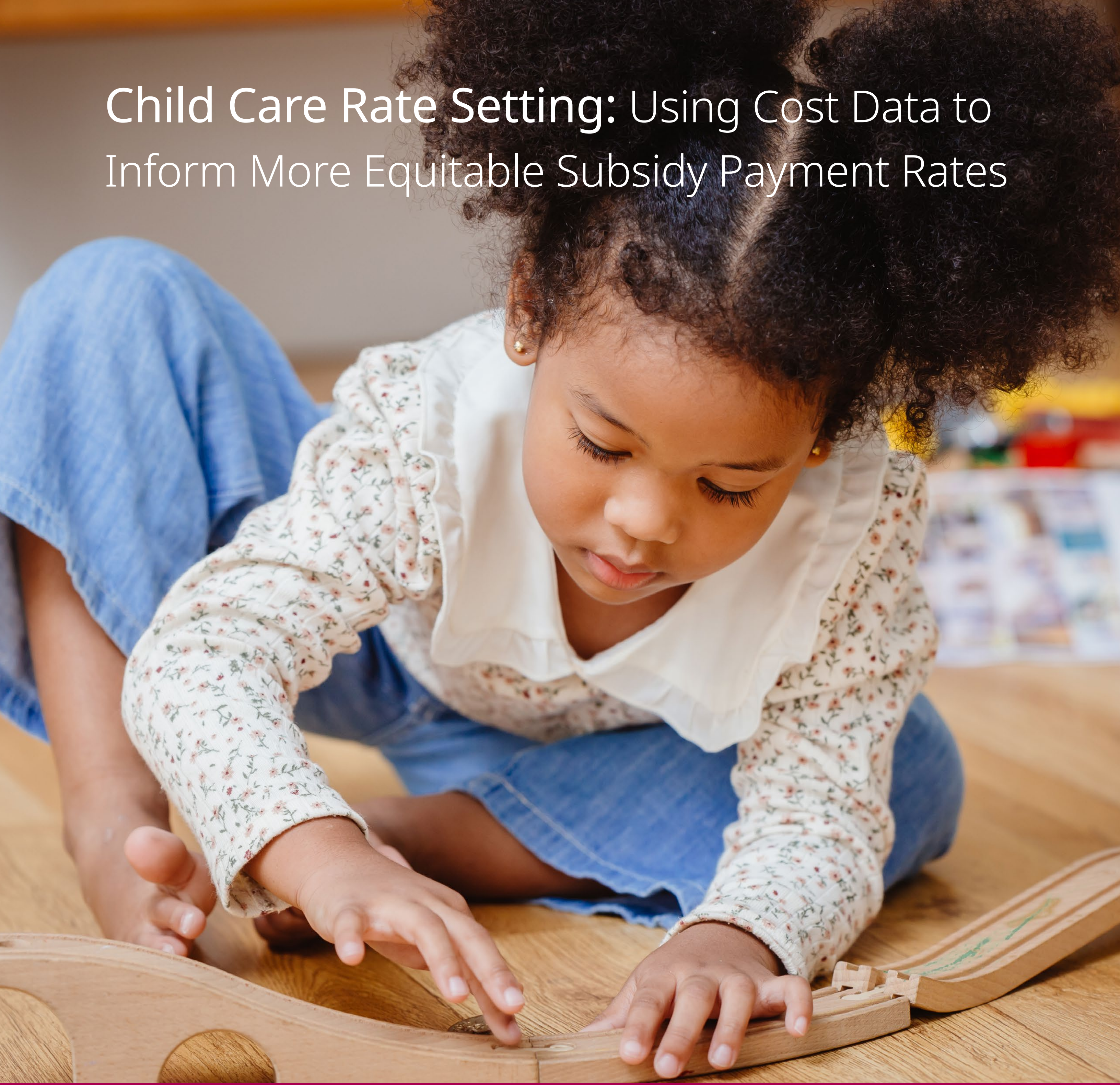
Child Care Rate Setting: Using Cost Data to Inform More Equitable Subsidy Payment Rates



Jeanna Capito and Simon Workman, Prenatal-to-Five Fiscal Strategies

Prenatal-to-Three CAPACITY BUILDING HUB
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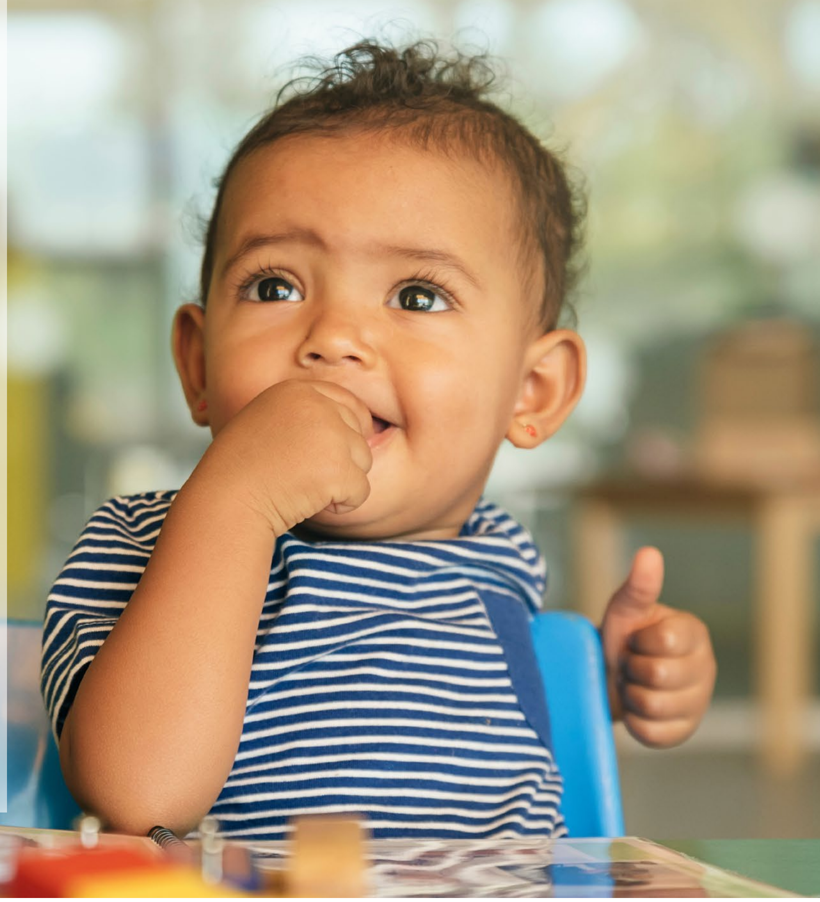

Introduction

States, territories, and tribes actively seek to ensure family access to child care and child care provider access to subsidized payment rates to support them in serving children and families. The Child Care and Development Fund (CCDF), a core part of the child care market, allows flexibility in its implementation by states, territories, and tribes. This flexibility supports access and quality and ensures that families whose child care is covered by subsidy funding have the same experience selecting and accessing it as families who are not eligible to receive child care assistance. This brief discusses the role policies related to subsidy-rate-setting can play in supporting equitable access for families and equity in funding amounts of reimbursement rates.

The Child Care Market

The child care market is primarily comprised of parents of young children. During the earliest years of children's lives, before they are age eligible for the elementary school system, parents typically rely on full-day and full-year child care. The cost of child care for a family with young children can be an overwhelming burden, particularly for a family earning a low income. Families meeting certain criteria, including working families with low incomes, may be eligible for assistance through the CCDF, a federal-state program that helps cover some or all the price of child care, up to a maximum level as set by the CCDF Lead Agency in each state or territory.

The prevalent method of setting CCDF payment or reimbursement rates for child care includes a market price approach. This approach relies on a study of market prices for child care through a market rate survey. Data from this survey are then used to set maximum reimbursement rates for subsidized child care with variations for age of care, geographic location, and other variables that are identified through the market survey. The problem with this approach is that the market rate reflects the prices that providers charge families, which in turn reflects what families can afford. Programs must set tuition at a rate families in their community are able to afford, rather than what the service costs. In a functioning market where parents can afford the true cost of care, setting rates based on price would allow subsidy-eligible families access to child care equal to those able to pay tuition. Unfortunately, this is not how the child care market works. Instead, the market rate reflects the prices that providers charge families, which are based on what families in that community can afford. The sad reality is that very few families can afford the full cost of quality child care.

Not surprisingly, this creates an inequitable system -- providers in communities where families cannot afford high tuition receive lower reimbursement rates than providers in higher-income neighborhoods. This, in turn, often results in lower educator compensation and higher turnover in these communities, which perpetuates the already woefully low wages that early childhood educators are paid. The impact of this market failure exacerbates lower-quality settings and lower wages across child care, disproportionately affecting low-income communities, minority groups, and communities of color. The market, driven by tuition or the price that families can pay, is not representative of the cost to programs of providing child care.

Since most families cannot afford the cost of high-quality child care, programs face a disincentive to serve children for whom the gap between what families can afford and what it costs to provide care are greatest, such as infants and toddlers. For example, a provider might be able to achieve financial stability when serving preschool-age children, or offering a program that meets the minimum state licensing standards. But if that same program serves infants and toddlers or meets higher-quality standards (such as those set by the state Quality Rating and Improvement System or national accreditation), this will likely leave it operating at a deficit. Because high-quality child care for infants and toddlers is significantly more expensive than it is for preschool-age children (primarily due to the lower staff-to-child ratios), many providers have historically been hesitant to implement or expand services for children aged birth to three, thus leaving a huge gap in access for families who need quality child care for their infants and toddlers.

The ongoing impacts of the COVID-19 pandemic have worsened a child care market that was already broken: the child care sector operated on razor-thin margins before the pandemic and has been reeling ever since due to the increased costs and decreased revenue it brought about. Early childhood programs are experiencing unprecedented staffing shortages as early educators leave the field for higher paying jobs that pose fewer health risks and provide benefits and job security. The need to address disincentives to quality, such as market-based payment approaches, and the impact of low revenues on child care compensation rates, is now more critical than ever.

Policymakers are increasingly recognizing the deficiencies of the market price-based approach to rate setting. As states across the country consider ways to stabilize and strengthen their early childhood systems, they are seeking ways to develop a deeper understanding of the true costs of operating high-quality child care and how public subsidies can cover those costs. To that end, states are seeking to develop cost estimation models as dynamic tools to estimate the true cost of care and understand how this cost varies based on program characteristics and policy choices. As part of this work to move to a cost-based approach to rate setting, states must unpack not only the federal regulations to which their child care subsidy system adheres, but also state-specific legislation and administrative rules related to the subsidizing of child care. While the federal CCDF funding gives states a fair amount of flexibility in their implementation of the child care funding, state-based policies and regulations may impede their ability to move to a cost-based approach to subsidy rate setting and payments.

Defining Terms

PRICE OF CARE means the tuition prices that programs set, which are usually based on local market conditions and what families can afford, ensuring that programs are competitive within their local market and can operate at as close to full enrollment as possible.

COST OF CARE means the actual expenses providers incur to operate their program, including any in-kind contributions such as reduced rent, and allocating expenses across classrooms and enrolled children based on the cost of providing service and not on what parents can afford.

TRUE COST OF CARE refers to the cost of operating a high-quality program with the staff and materials needed to meet quality standards and provide a developmentally appropriate learning environment for all children. *Cost of quality* is another term often used to refer to the true cost of care. The true cost includes adequate compensation to recruit and retain a professional and stable workforce.

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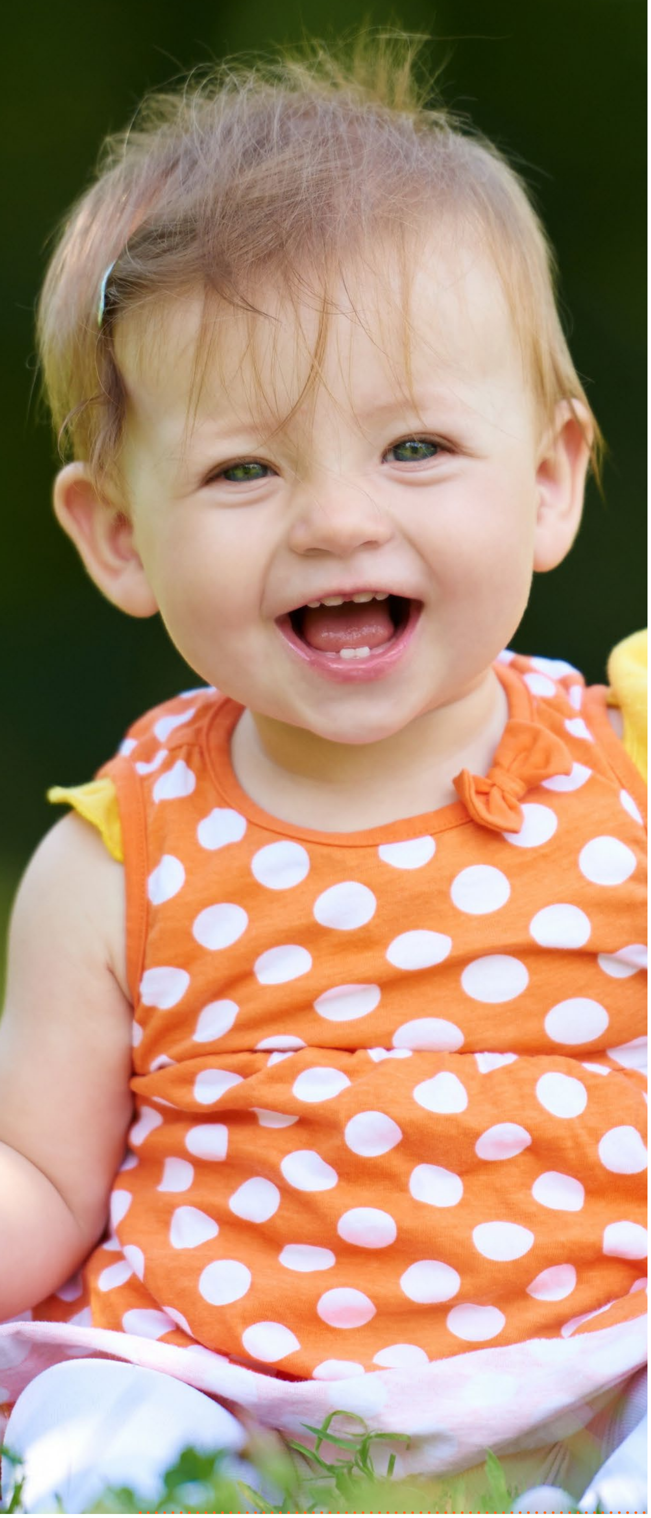


Child Care Rate Setting

Subsidy Rate Setting: Child Care Development Fund

CCDF is the primary source of public funding to support access to child care for working Americans with low incomes. Each state or territory sets the payment rates that child care programs receive when serving a child who is eligible for subsidies under this fund. In general, states have broad authority to set reimbursement rates but they are required to assess the cost of delivering high-quality services and then use this data to inform payment rates for subsidized child care.

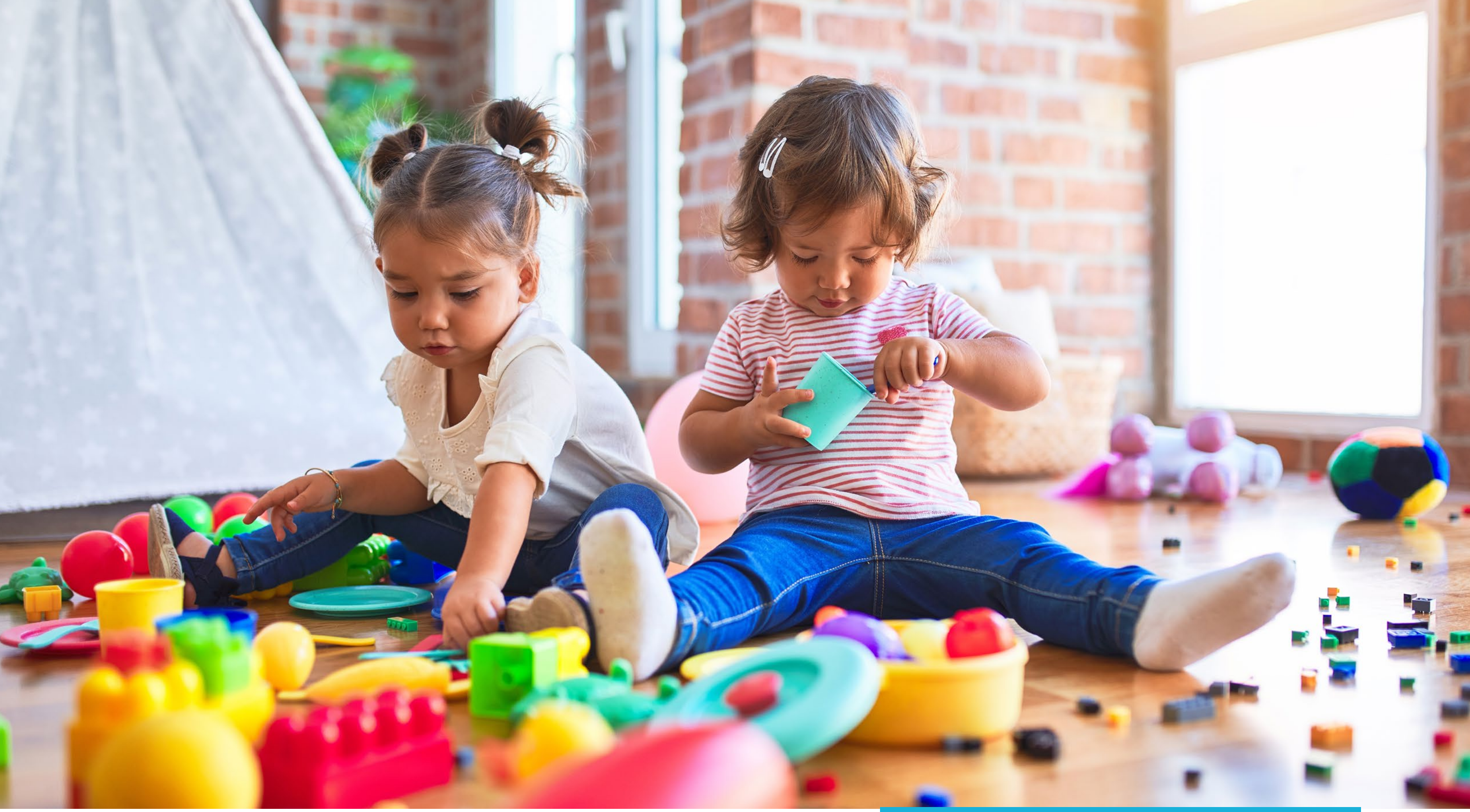
Since the 2014 reauthorization of CCDF, states have had options for how they set rates. States can either use the market survey-based approach, or they can conduct an alternative methodology, such as a cost estimation model. States are allowed to differentiate rates based on various characteristics of care.

Whichever approach is chosen, Lead Agencies must ensure rates are set at a level “sufficient to ensure equal access for eligible children…comparable to child care services provided to children whose parents are not eligible for CCDF.”[1] Payment rates are supposed to be sufficient to ensure equal access to the same services (type of care, quality of care) as children not receiving CCDF. Under equal access provisions, states are required to certify in their CCDF plans that their CCDF provider payment rates are sufficient to ensure that eligible children have equal access to child care services that are comparable to services purchased by families who are not eligible to receive child care assistance.[2] The federal government recommends that states set subsidy rates at the 75th percentile of the average market price for child care in a given region, with the assumption that subsidy-eligible families would then have access to 75 percent of the child care market. Under this approach, subsidy payment rates should provide eligible families equal access to most of the child care in their community.

While the federal Administration for Children and Families, which sets CCDF regulations, encourages but does not require CCDF Lead Agencies to set their payment rates at the 75th percentile of the market rate survey, the shift to this requirement alone would not resolve the broken state of the child care market. Continuing to use the price of child care, or the amount the market of parent consumers can bear, will not cover the actual cost of the child care services. Even in instances where Lead Agencies set their

1 https://www.acf.hhs.gov/occ/policy-guidance/ccdf-acf-pi-2018-01

2 Section 658E(c)(4)(A) of the Child Care and Development Block Grant Act of 2014.



child care subsidy payment rates above the 75th percentile, they are not necessarily paying for the cost of services, and instead are replicating the issues associated with child care tuition being limited to what families can afford in given communities, not the cost of the service delivered by the program.

"OIG recommended that ACF consider developing additional proxies for equal access and stated that this will become increasingly important as states move toward alternative rate-setting methodologies that collect and assess child care COSTS rather than market PRICE."

In 2019, the Office of the Inspector General (OIG) conducted a review of state's CCDF payment rates. The results of this review led to a recommendation for the Administration of Children and Families to develop additional proxies for meeting equal access in payment rate setting. This review found only seven states set payment rates at the recommended 75th percentile of the current market rate. Further, regardless of whether states were at the recommended 75th percentile, state payment rates for infant care were found to cover only 41 percent of the child care prices being charged.[3] This report underscored the gap that remains between tuition rates, or prices charged to families, and the publicly funded child care subsidy payment rates. The report acknowledged that this problem exists in the price-based system all but one CCDF State Lead Agency was using in 2019, and that additional proxies for equal access will need to be in place as states move to a cost-of-care-based approach to payment rate setting.

OIG recommended that ACF consider developing additional proxies for equal access and stated that this will become increasingly important as states move toward alternative rate-setting methodologies that collect and assess child care COSTS rather than market PRICE.

[3] U.S. Department of Health and Human Services Office of Inspector General (2019). States' Payment Rates Under the CCDF Program Could Limit Access to Child Care Providers

What is an alternative methodology for rate setting?

An alternative methodology for rate setting may be a cost study or a cost estimation model.

- A *cost study* involves collecting data from providers about their current costs of operating a program that meets licensing standards as well as other quality standards, reflecting point-in-time data about provider costs.
- A *cost estimation model* involves building a tool that is informed by provider data and that can run multiple scenarios to estimate the impact of several variables on cost, such as program characteristics (e.g., size and age mix), child populations served, program quality, and location in the state.

Whichever approach is used, an alternative methodology should:

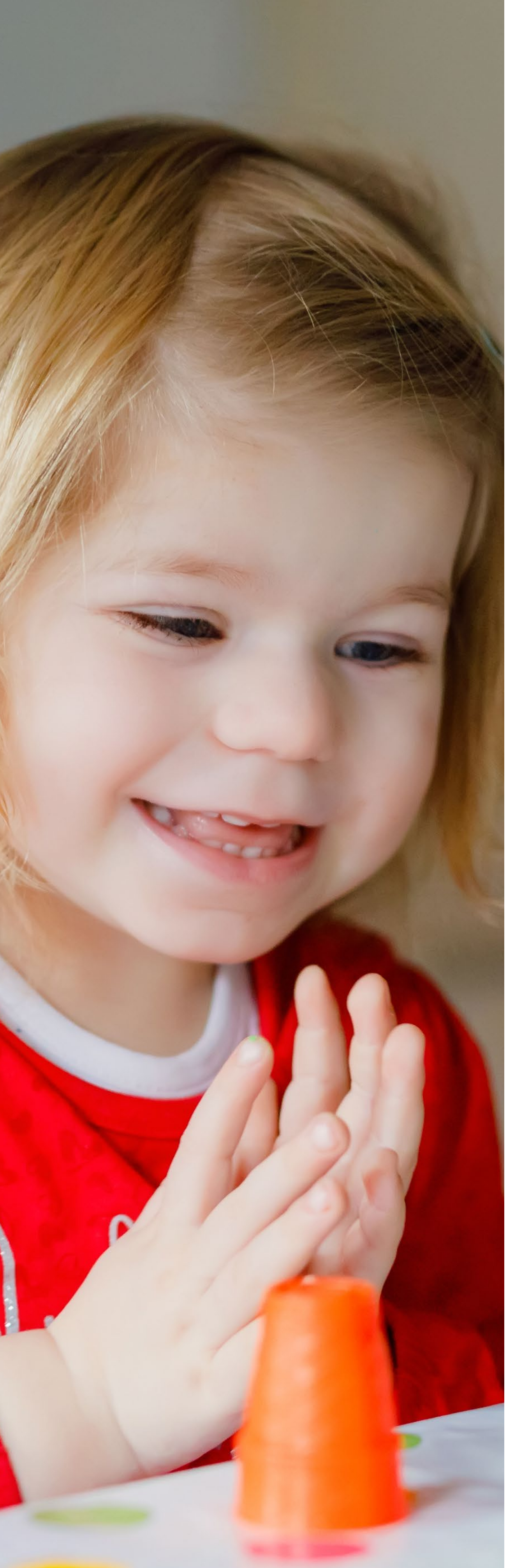
- Engage a diverse body of child care constituents in all elements of the process (vetting assumptions and model building, data collection, review of findings and more).
- Estimate the cost of providing care at varying levels of quality and the resources needed for a provider to remain financially solvent (key cost factors such as salaries and benefits, training and professional development, curricula, and supplies).
- Examine the impact of program and facility size, ages of children served, geographic region, enrollment, bad debt, and other factors.
- Demonstrate the impact of funding from multiple sources.

Why might states consider an alternative methodology?

The market rate survey approach means that the subsidy system replicates the inequities and inadequacies of the current market. As price-sensitive consumers, parents are constrained in what they can afford in tuition, so programs face a disincentive to invest in quality because families can't afford the higher cost of care. As mostly small businesses, child care providers need to fill all their slots to be sustainable, so tuition must be set at a level families can afford. But the subsidy system then replicates that constrained family tuition by using that family tuition information as a basis for rate setting. Within this broader broken system there are also significant inequities. Low-income communities are less likely to be able to afford cost of quality, resulting in lower public funding rates. Families of infants, toddlers, and children with special needs are also most likely to be unable to afford the higher cost of care required for these populations.

Alternative methodology can address the inequities in the current market because rates are set based on the cost of care, not based on what families can afford. This provides an opportunity for funding to drive change and quality improvement. Here are some ways alternative methodology can help:

- It can identify the true cost of providing programming for young children and families. This is critical to addressing the underfunding of the system as well as addressing the capacity needs of current and potential child care programs.
- It can set rates based on cost of care. This can ensure that providers receive sufficient funding to provide care that meets minimum standards and requirements, not based on what families can afford.
- It can set rates to include better compensation for the program staff.
- Using a cost estimation model can help account for the cost of providing child care in different types of programs and at varying levels of quality.
- Distinct from a budgeting tool, which would account for specific characteristics of a given program, a cost estimation model is intended to provide policymakers with an estimate of the cost of operating a child care program across geographic regions. It is informed by provider data and representative of various types of providers.
- Cost estimation models can also integrate revenue modeling to determine whether the revenue streams available to providers can cover the actual cost of care and to identify any gaps between revenue and expense.
- Cost estimation models are dynamic tools that can show current cost of operating a program, the cost of operating a program with higher quality standards, and costs associated with improved wages and benefits.



Subsidy Rate Setting: Variations by Lead Agency

As noted previously, states have authority for the implementation of the details of the CCDF child care subsidy program. This broad authority has resulted in very localized approaches to the publicly funded child care subsidy program across states, territories, and tribes that serve as Lead Agency for the funding. In addition to policies related to families, Lead Agencies have many policies and regulations specific to providers, as part of implementing the CCDF program in their state or territory. Many of the policies related to providers have to do with payment approaches. Lead Agencies are required to set base reimbursement rates at a level allowing for child care providers to meet health, safety, quality, and staffing requirements that have been established for these providers. There are many factors that could dictate differences in rates, such as provider type, amount of care, and age of children served. Lead Agencies are also allowed to set higher rates for providers that qualify by meeting higher quality criteria, above licensing, such as offering non-traditional hours of care or serving children with special needs.[4]

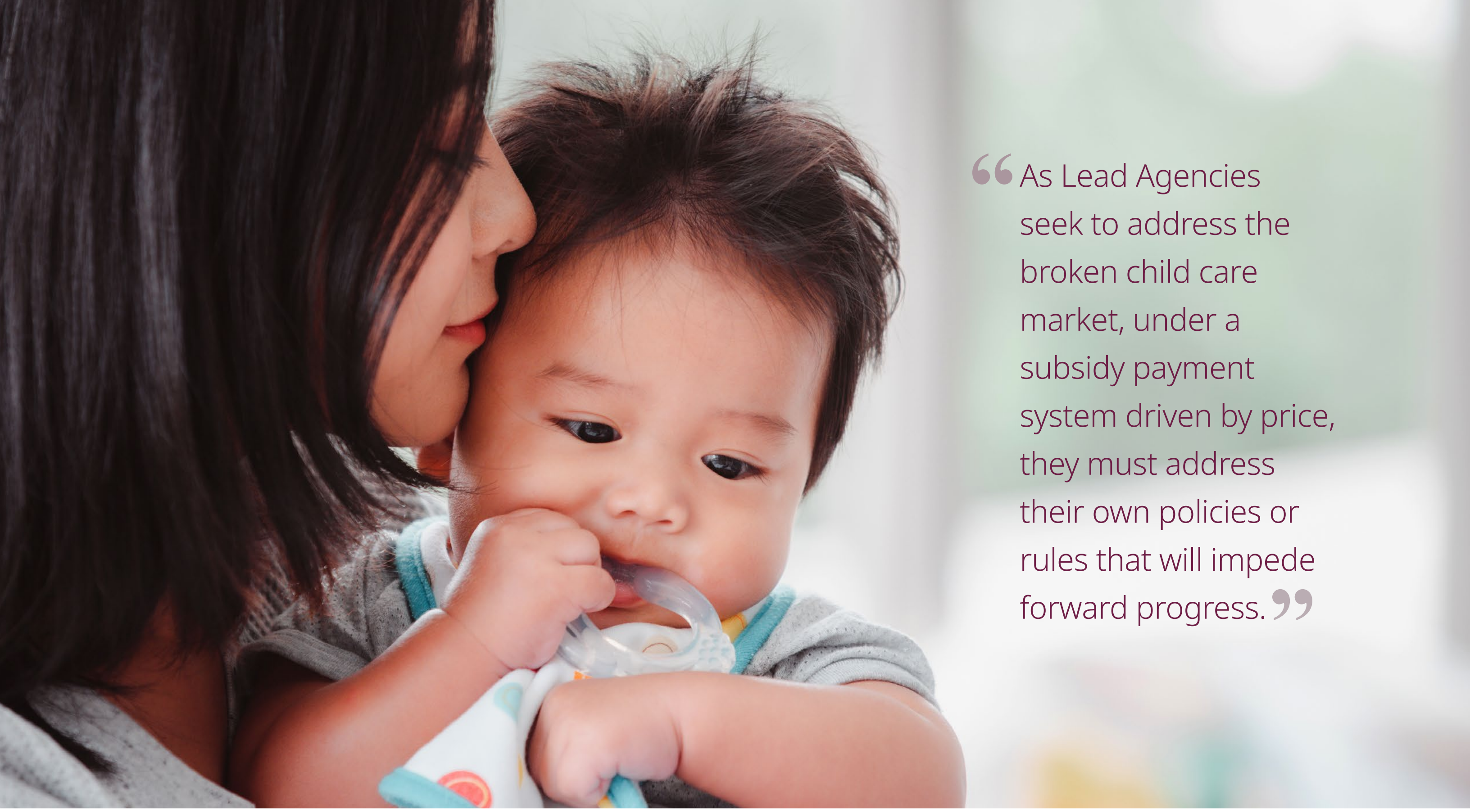
Lead Agencies also set payment policies related to maximum reimbursement rates and any add-ons related to special populations, such as children with special needs or infants and toddlers. These tiered or differential rates are allowed and, as part of their CCDF plan submission[5], a Lead Agency must describe if tiered or differential rates are implemented, with the following detail:

- Tiered or differential rates are not implemented.
- Differential rate for non-traditional hours.
- Differential rate for children with special needs, as defined by the state/territory.
- Differential rate for infants and toddlers.
- Differential rate for school-age programs.
- Differential rate for higher quality, as defined by the state/territory.
- Other differential rates or tiered rates.

According to the most recent analysis of variations across states/territories in their CCDF policies, Lead Agencies do utilize their local implementation flexibility regarding the CCDF funding. For example, the 2020 analysis, completed by Urban Institute,

[4] Dwyer, Kelly, Sarah Minton, Danielle Kwon, and Kennedy Weisner (2020). *Key Cross-State Variations in CCDF Policies as of October 1, 2019*: *The CCDF Policies Database Book of Tables*. OPRE Report 2021-07, Washington, DC: Office of Planning, Research, and Evaluation, Administration for Children and Families, U.S. Department of Health and Human Services.

[5] 2021-24 CCDF plan guidance


“As Lead Agencies seek to address the broken child care market, under a subsidy payment system driven by price, they must address their own policies or rules that will impede forward progress.”

utilizing the CCDF Policies Database, found in the areas of higher payment rates for higher levels of quality or accreditation, 31 states/territories use higher rates for some age groups in family child care homes and 33 states/territories use higher rates in the case of center-based settings.[6]

Variations reflective of the state or territory context are designed to be beneficial to the hugely variable circumstances across Lead Agencies. In recent work to understand the implications of moving to alternative methodologies for setting reimbursement payment rates, these state-by-state policies have come under deeper scrutiny. In some instances, states are finding policies or regulations that may prohibit their implementation of rates informed by cost of care, when this cost-based payment rate is higher than the tuition rate a provider is charging to families. Many states report a form of this limitation on payment rates going above tuition charged; in these states, the limitation may be found in statute, regulation, or policy. Given the wide variation in how states implement their CCDF program, there are also variances in whether details of implementation are in statute, administrative rule, policy, or other forms of regulations. An important note is that not all states have this limit on the rate paid by subsidized child care; further, this limitation is not a requirement of the federal CCDF regulations. Some Lead Agencies have elected to implement their CCDF program with a ‘rule’ that limits subsidy from paying more for child care services than the amount of the provider’s tuition rate, for the same service.

As Lead Agencies seek to address the broken child care market, under a subsidy payment system driven by price, they must address their own policies or rules that will impede forward progress. The concept of not paying a child care provider for the cost of care, because the tuition charged to families is lower than the cost, runs contrary to addressing the broken market: the cost of care is far more than the price (tuition) that providers are charging families, or what families can pay, especially in the lowest income communities. If state CCDF Lead Agencies want to address the broken market, they may seek to move to a cost-based

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[6] Dwyer, Kelly, Sarah Minton, Danielle Kwon, and Kennedy Weisner (2020). *Key Cross-State Variations in CCDF Policies as of October 1, 2019*: *The CCDF Policies Database Book of Tables*. OPRE Report 2021-07, Washington, DC: Office of Planning, Research, and Evaluation, Administration for Children and Families, U.S. Department of Health and Human Services.

approach to rate setting. If the cost-based approach is limited by state policies or regulations that do not allow the subsidy rate to pay more for a family than what a family can pay in tuition, the cost of care cannot be applied in a way that addresses the inherent inequity of a public payment system that is built upon what the consumers of that system can afford out of pocket.

Delinking subsidy payment rates from tuition rates

In places where the subsidy payment rate is limited by the tuition rates charged by providers, Lead Agencies are seeking to understand the impact of changing the local rule. Some refer to this exercise as 'delinking' or 'decoupling' subsidy payment rates from tuition rates. Given this approach is not part of a CCDF requirement, many state policy manuals are silent on the issue and, therefore, an exhaustive search of all states is not feasible, nor likely to generate significant additional information. In states where subsidy payment rates are linked to tuition charged, and thus cannot be higher than a provider's published tuition, Lead Agencies must determine the most appropriate path forward for their circumstances. Several are exploring the reality of their state policies or administrative rules on the movement to a subsidy rate system based on the cost of care. To support the exploration of local steps to delink, this section will review payment rate setting efforts in states where there is not a 'rule' limiting subsidy rates to the amount charged in child care tuition. Many states fall into this category, including Delaware, District of Columbia, New Mexico, Oregon, and Virginia; while this is not an exhaustive list either, the authors have direct experience with the efforts these states have promoted on cost of care and subsidy payment rates based on cost.

District of Columbia

The District of Columbia was the first Lead Agency to receive approval to move to alternative methodology for rate setting. The District developed a cost estimation model and used it to inform rate setting starting in 2016 and has continued to use the cost model for rate setting under alternative methodology, updating the model in 2018 and 2021.[7] The District is not limited by a maximum reimbursement rate policy that limits the subsidy rate to child care tuition charged. In moving to a cost-based approach to rate setting, the District retained higher payment rates for programs meeting higher quality standards (using their quality rating and improvement system) and serving children with special needs.

Six years of rate setting under alternative methodology has had several impacts for the District:

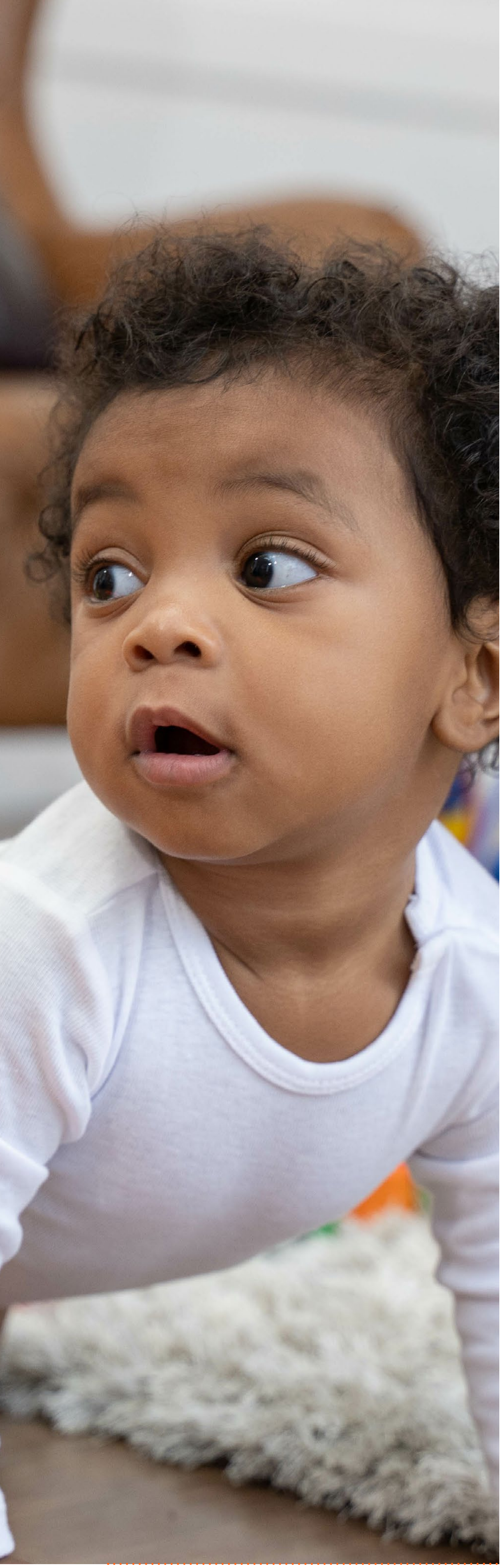
1. The payment rates reflect the full cost of care and have done so since the 2018 rate setting.
2. The 2021 cost model included a salary for family child care provider owners and the subsequent rate set in 2021 included the full cost of operating with this salary in place.
3. The District has seen increases in the child care worker wage reporting through the Bureau of Labor Statistics, ranging from an 8 to10 percent increase. With the high turnover of the child care industry, the child care worker position in the BLS database generally stays flat year over year, or goes down. A 10 percent increase in a region, when no previous increase has been reported, is significant and, while causality is not confirmed, the main change to the child care industry in the District has been subsidy payment rates set based on cost of care, instead of the market rate.

In 2022, the District is conducting a provider survey to gather data on tuition prices and cost of care, to ensure that the results of the cost estimation model continue to reflect the reality faced by providers in the District.

New Mexico

New Mexico was the first state CCDF grantee to seek and receive approval for full alternative methodology. During the early stages of exploring the movement to a cost-based approach, the provider community raised concern that tuition would have to be increased to keep in line with higher subsidy rates, thus pricing families out of being able to pay for care. These concerns came from operating under the assumption that

[7] https://osse.dc.gov/page/modeling-cost-child-care-district-columbia



subsidy rates cannot be higher than tuition charged to families. With education and engagement of the provider community in the effort to set subsidy rates based on cost, these inaccurate assumptions were addressed. The state did not conduct a market rate survey for its FY21-24 CCDF plan, and instead developed a cost estimation model to inform subsidy rate setting.[8]

The development of the cost estimation model included deep intentional stakeholder engagement to ensure the model was informed by the diversity of child care providers across the state. The model included higher salaries than currently paid to the ECE workforce, as well as benefits and a robust staffing pattern, to ensure the results reflected the resources needed to operate a quality and sustainable child care program. The cost estimation model included sufficient resources for family child care providers to pay themselves a salary equivalent to lead teachers in a child care center setting. These elements begin to reflect the true cost of care as opposed to the price of care that families can afford.

The state used the cost model to inform subsidy rate setting in 2021. Rates were set at 100 percent of the cost of care for family child care homes and an average of 94 percent for child care centers.[9] In addition to the rate increases, New Mexico increased subsidy eligibility significantly to ensure that families who would struggle to afford the cost of tuition at the cost of care rates, if providers elected to raise tuition, could also access assistance to cover the cost of child care. This approach acknowledges the other market forces that exist within the child care system, including the provider autonomy in tuition setting.

Virginia

Virginia recently began its work to address the impact of the broken child care market of publicly funded subsidy rate payments. Virginia developed a cost estimation model in 2022 and received approval from ACF to use this model to inform subsidy rate setting. Virginia's cost model includes cost estimates for nine regions across the state, and the model focuses primarily on compensation for the ECE workforce, with salary levels in the model aligned with kindergarten salaries in those same regions.

The Lead Agency set subsidy rates at 75 percent of the estimated cost of care as shown by the cost model using kindergarten parity. These rates went into effect in October 2022. In addition, Virginia also made it allowable for providers to receive the maximum reimbursement rate even if their tuition prices were lower, recognizing the limited impact increased rates would

8 https://www.nmececd.org/wp-content/uploads/2021/08/P5FS_NMReport_v.3d_for-Web.pdf

9 https://www.americanprogress.org/article/promoting-equitable-access-to-quality-child-care/

have if providers continued to be limited by what families can afford to pay.[10] Virginia is also significantly decreasing co-pays for families in the subsidy system as of January 2023.

Louisiana

In Louisiana, work to understand the cost of child care has had a significant impact on the payment rates available to providers. The state completed a market rate survey in 2020 but also conducted a cost analysis in 2021 using data from the grant applications providers submitted to access American Rescue Plan funding.[11] This analysis found that the cost of caring for an infant was almost three times as much as the cost to care for older children, even though the difference in subsidy rates is only a few dollars. This data was ultimately used by the state to significantly increase subsidy payment rates, with infant rates increasing 91 percent in child care centers and 106 percent in family child care homes.[12] The state also allowed providers to be reimbursed at the newly established rate, irrespective of their own rates.[13] The impact on the payment rates for infant child care would not have been possible if the subsidy payment rate was limited to the market tuition price charged of families for infant care.

Conclusion

The broken state of the child care market, the access and payment rate components in particular, place the most burden on the providers and the families they are seeking to serve. Due to the nature of a subsidy payment rate system based on price of care charged to families, those providers who are committed to serving large populations of families that qualify for subsidized care fare the worst in being paid for the cost of their care. Families accessing the subsidy for help in paying for child care are left accessing a payment rate that values the child care service at the amount families in their community can pay. These amounts are far below the actual cost of the services and far below the true cost of the care if providers were fully compensated with living wage and benefits. States and territories that are moving to a cost-based approach to setting subsidy payment rates are actively working on addressing the broken market.

About Prenatal-to-Five Fiscal Strategies

Prenatal-to Five Fiscal Strategies is a national initiative, founded by Jeanna Capito and Simon Workman, that seeks to address the broken fiscal and governance structures within the prenatal-to- five system with a comprehensive, cross-agency, cross-service approach. The initiative is based on a set of shared principles that centers on the needs of children, families, providers, and the workforce. This approach fundamentally rethinks the current system to better tackle issues of equity in funding and access. For more information about P5 Fiscal Strategies, please visit: www.prenatal5fiscal.org.

Acknowledgements

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[10] https://doe.virginia.gov/cc/community/index.html?pageID=15
[11] https://www.louisianabelieves.com/docs/default-source/child-care-providers/cost-analysis-and-arpa-grant-round-1.pdf?sfvrsn=e22a6518_2
[12] https://www.louisianabelieves.com/docs/default-source/child-care-providers/ccap-rate-changes.pdf?sfvrsn=2
[13] https://www.katc.com/news/covering-louisiana/ldoe-announced-changes-to-the-child-care-assistance-program

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