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EARLY CHILDHOOD INITIATIVE

The Limitations of Using Market Rates for Setting Child Care Subsidy Rates

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Introduction

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The COVID-19 crisis has brought the fragility of the child care market to the national forefront, highlighting both the important role child care plays in enabling parents to work and the instability of child care businesses. In states where mandated closures did not include all child care programs, some programs stayed open without access to proper protective equipment or health guidelines because closing would have meant a loss of income for staff or permanent closure. Child care programs that are open and accessible during COVID-19 also provide a critical service by caring for the children of the doctors and nurses caring for patients, grocery clerks making sure communities have access to food, sanitation workers deep cleaning public spaces, and the many other people who help communities stay safe and maintain baseline functions. While most industries are concerned about the long-term impact of forced closures and drops in revenue, the child care industry faces additional issues, including extremely limited public financing, an artificially depressed market, and payment rates that represent only a fraction of the actual cost of child care. As we look beyond the current crisis, we must examine how the public funding of child care is handled so we can build back better. This brief examines how states set child care reimbursement rates and argues we must move past arbitrary market rates and instead focus on the true cost of providing high-quality child care.

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PUBLIC FUNDING FOR CHILD CARE

The Child Care and Development Fund, or CCDF, is the largest federal funding source that helps low-income working families pay for child care so they can obtain or maintain employment or attend job training or school.[1] CCDF is funded through the Child Care and Development Block Grant Act of 2014, or CCDBG Act. A portion of CCDF funds are also dedicated to improving the quality of child care for all families. In fiscal year 2020, Congress allocated about $8.7 billion in funding for CCDF. In March 2020, Congress also included an additional $3.5 billion in discretionary funding in the CARES Act to support child care for frontline and emergency workers.[2] In 2018, CCDF paid about 258,000 child care programs[3] to serve about 1.3 million children and 813,200 families each month[4]. This represents a small proportion of the number of children actually eligible to receive CCDF assistance, with 15% of federally-eligible children and 24% of children eligible based on state income rules receiving a subsidy.[5]

EQUAL ACCESS TO CHILD CARE SERVICES

One of the purposes of CCDBG is “to promote parental choice to empower working parents to make their own decisions regarding the child care services that best suit their family’s needs.”[6] States are required to provide parents receiving a child care subsidy the ability to take that subsidy to any type of child care program, including center-based, home-based, care in the child’s home, and relative caregivers.[7] Part of ensuring parents have the full range of options is making sure child care programs are willing to participate in the child care assistance program. Therefore, families receiving child care subsidies must have equal access to comparable services available to families not eligible for child care assistance. Equal access means subsidy payments are sufficient to ensure that children eligible for child care subsidies have access to child care services that are comparable to services provided to children whose parents are not eligible to receive child care assistance.[8]

> "FAMILIES RECEIVING CHILD CARE SUBSIDIES MUST HAVE *EQUAL ACCESS* TO COMPARABLE SERVICES AVAILABLE TO FAMILIES NOT ELIGIBLE FOR CHILD CARE ASSISTANCE."

Equal access has seven components.[9] These are:

1. A choice of a full range of child care programs is available across all geographic regions.
2. Adequate subsidy reimbursement rates are based on a market rate survey or alternative methodology and the cost of providing child care services.
3. Base subsidy reimbursement rates are sufficient to support requirements related to health, safety, quality, and staffing.
4. Higher cost of providing higher quality child care is addressed.
5. Parent co-payments are affordable and do not create a barrier to families accessing child care.
6. Payment practices, such as timely payments and paying for occasional absence days, are in place.
7. Considered differential payment rates based on different factors, including geographic location, age of the child, non-traditional hour care, and quality of care.

States are responsible for determining the policies related to these components, including how much child care programs are paid for serving children whose families are eligible to receive a child care subsidy. While states are not required to pay child care programs the same amount a program charges a typical private-pay family, states are required to set rates high enough that families receiving a child care subsidy have the same access to comparable child care options as families not receiving a subsidy. In other words, since a child care program does not have to accept a child care subsidy, the payment rate of the subsidy must be set high enough that most child care programs would be willing to accept it. If the subsidy rate is significantly lower than what a child care program charges private-pay parents, there is no market-driven reason for a child care program to give a slot to a family with a subsidy when other families are willing to pay the full rate.

The federal government does not require a specific payment rate, but it does recommend states set their rates at the 75th percentile of market rates as determined through the study of market prices. The 75th percentile market rate is the price at which 75% of the child care programs included in the market rate survey reported charging for child care services.[10] This does not mean that CCDF recommends rates be set at 75% of the market rate. Rather, it means that rates should be set at a level that would give families access to 3 out of 4 available child care slots or programs.[11] The 75th percentile is a proxy for equal access.

States must also set subsidy base payment rates at a level sufficient for child care programs to be able cover the costs of meeting CCDF health, safety, quality, and staffing requirements and take into consideration the cost of providing higher quality child care. Quality subsidy rate-setting includes considerations of the estimated cost of child care at each level of quality as defined in a state's quality rating and improvement system, or QRIS. States must do a *narrow cost analysis* to estimate these costs because they are not usually included in a market rate survey.[12] A narrow cost analysis looks at the estimated cost of providing child care in two areas: 1) the cost of child care programs implementing health, safety, quality, and staffing requirements, and 2) the cost of higher-quality care, as defined by the states QRIS or other system of quality indicators.[13]

DETERMINING MARKET RATES

To determine what the average private-pay rates are being charged in a state's child care market and establish a baseline rate structure off which to work, CCDF requires states to either do a statistically valid, reliable market rate survey or an approved alternative methodology. A *market rate survey* is a study of the prices or fees child care programs typically charge, and families typically pay for a given type of child care setting (for example, center-based child care programs or family/home-based child care programs), care by age group (for example, infants, toddlers, preschool, or school-age care), and per unit of care (for example, per week, full-day, half-day, or hour).[14] States are required to submit detailed plans to the U.S. Department of Health and Human Services every three years of how they will implement CCDF funds. Market rate surveys must be conducted no more than two years before submitting CCDF state plans. States must use the data collected through their most recent market rate surveys or alternative methodologies to inform their subsidy rates.

Each state does its own market rate survey, and may contract with an outside organization, such as a university, research organization, or child care resource and referral agency, for data collection and analysis. However, to be considered "statistically valid and reliable" as required in the CCDBG Act, the preamble to the CCDF final rule establishes the following benchmarks that the market rate survey should[15]:

- Include the full priced child care market
- Contain complete and current data
- Represent geographic variation
- Use rigorous data collection procedures
- Analyze data in a manner that captures market differences

ISSUES WITH USING MARKET RATES TO DETERMINE SUBSIDY PAYMENTS

The reauthorization of the CCDBG Act in 2014 included important improvements for how states determine child care subsidy payment rates. Market rate surveys must now be statistically valid and reliable, rate-setting methods must reflect the cost of meeting health and safety requirements, and rates should consider higher costs associated with quality improvements.[16] Expanding a state's rate-setting methodology beyond simple market rates collected in a survey is a step towards moving away from the pervasive, artificial infrastructure the child care market is built upon. By including the minimal costs of providing child care services, updated state payment rates established after 2014 are beginning to correct decades of artificially low rate determination.

> **"Expanding a state's rate-setting methodology beyond simple market rates collected in a survey is a step towards moving away from the pervasive, artificial infrastructure the child care market is built upon."**

Market rates represent the tuition and fees that child care programs charge private-pay families. However, the prices child care programs charge often do not reflect the true cost of providing child care that meets regulatory health and safety standards, and never meet the cost of quality child care. For example, cost modeling by the District of Columbia found in most cases a program's estimated cost of delivering child care services was more than the revenue generally available to the program, and this gap was the largest for small programs that mostly served infants and toddlers.[17] In order to fill slots, programs must charge what families can pay. They must also stay in line with what other child care programs in the community charge in order to not lose families to a less expensive program. Further, child care programs may have other sources of revenue in addition to private-pay tuition, such as grants and donations, that they can use to subsidize what they charge private-pay families and are not accounted for in reported market rates.

> "THE PRICES CHILD CARE PROGRAMS CHARGE OFTEN DO NOT REFLECT THE TRUE COST OF PROVIDING CHILD CARE."

Several components drive the cost of providing child care, including rent and utilities, materials and administration, food, and personnel. Personnel, including salaries and benefits, are by the far the largest budget item for child care programs.[18] If programs must hire additional staff to meet stricter teacher to child ratio and group size requirements or invest in teachers with higher levels of education, the cost of providing care will increase. However, if parents cannot afford to pay more, the program may not be able to increase its prices to cover those additional costs. The Center for American Progress estimates that the true annual cost of providing base level quality child care for infants is $14,700 and that providing high-quality care for infants costs $27,100.[19] In contrast, a report from Child Care Aware of America on the price of child care reported that the average annual price of child care for infants in a center is $11,444 and in a home-based program is $8,348.[20] These prices reflect what child care programs are charging families for child care and are significantly lower than the estimated cost of providing that care. The prices more closely align with market rates than the estimated cost of providing child care.

States use these market rates to set their child care reimbursement rates for child care subsidy, which are almost always lower than the actual market rates charged by child care programs. For example, for that same year, the average reimbursement rate was about $10,800 for infants in child care centers and $8,000 for infants in home-based child care programs.[21] These average reimbursement rates do not come close to covering the estimated costs of providing high-quality child care for the youngest children. Basing subsidy reimbursement rates on already depressed market rates instead of the cost of providing child care puts child care programs in a precarious business model and reinforces a cycle of poorly paid staff and low-quality care, even when the program's leadership and staff are committed to quality improvement.

Another limitation of using market rates to set subsidy reimbursement rates is that current market rates are used to set future reimbursement rates. States must revisit their rates every three years as part of the triennial CCDF plans, and the market rate survey or alternative methodology used to set those rates must be completed within two years of plan submission.[22] However, significant changes can happen during a three-year period that may influence the price and cost of providing child care. For example, changes in personnel costs due to increases in the minimum wage in states and localities across the country will significantly impact the cost of providing child care.[23] While some child care programs may be able to increase their private-pay tuition and fees to cover these increased costs, the previously set subsidy reimbursement rates will be much slower to respond. The prospective nature also makes it harder for states to respond to emergencies, such as the current COVID-19 crisis. Many states are increasing their reimbursement rates to cover the increased costs to child care programs continuing to care for the children of essential and frontline workers, but those increases are arbitrary additions to subsidy payment rates that are too low.

The cost of providing child care varies depending on the age of the child.[24] Caring for infants and toddlers is more expensive than caring for older children. These costs are driven by the requirement of lower ratios of children to adults for infant care. Even with the low-wages for child care workers, the cost implication of hiring one adult for every 4 infants is much higher than the cost of hiring one adult for every 12 4-year-olds in a classroom. Many child care programs rely on a mixed-age program to balance costs and expenses. In fact, recent efforts to expand public prekindergarten programs for 4-year-olds have created challenges for private programs who once balanced their costs by serving a mix of younger and older children.[25] Without being able to offset these costs, child care programs may have to charge parents more to care for their infant or toddler or choose to not provide care for infants and toddlers at all. This balancing act will be reflected in the market rates reported to the state in a market rate survey. The state then sets different subsidy reimbursement rates by age. Subsidy reimbursement rates based on distorted market rates increase the gap between what it costs to provide child care and what a state pays child care programs.

“ Subsidy reimbursement rates based on distorted market rates increase the gap between what it costs to provide child care and what a state pays child care programs.”

In addition, many types of child care may not be captured in a market rate survey because families have found informal child care arrangements that exist outside of the typical child care market. Families that live in communities with a limited formal child care supply, such as rural and very low-income areas, may rely on friends and family so that they can go to work or school. This may also be true for more specialized types of care, such as for infants and toddlers, children with disabilities, or children who need care during the evenings or weekends. Parents often still pay for these informal arrangements, but they likely would not show up in a market rate survey. By overlooking these regional and community-level variations, using the market rate survey to set subsidy reimbursement rates may reinforce inequities in the child care market.[26]

ALTERNATIVES TO MARKET RATES

As noted earlier, states may use an alternative methodology to set their child care subsidy rates, if they receive prior approval from the federal Office of Child Care. States have flexibility in choosing their alternative methodology, but the Office of Child Care explicitly points out two allowable methodologies in a program instruction.

The first alternative methodology is a *cost estimation model*, which incorporates both available data and certain assumptions to estimate expected costs associated with running a child care business.[27] The assumptions used in cost estimation models often deal with the structure of the program (such as the number of children, facility size and features, group size, teacher to child ratios) and any other required inputs (such as labor, materials and supplies, food service, administration, transportation), combined with the prices or cost of each of these inputs.[28] Two prominent cost estimation models are:

- **CBCSE Cost Tool Kit-** This tool kit from the Center for Benefit-Cost Studies of Education includes a cost-ingredient work sheet that allows the user to identify program "ingredients" and assign pieces for each. Users can calculate full costs, per-participant costs, and costs per unit of outcome.
- **Provider Cost of Quality Calculator (PCQC)-** The PCQC estimates costs based on specific inputs chosen by the user. It uses the cost-ingredient method and sums up the costs of the resources used by the program. The PCQC also includes training and professional development costs, and how much time a program spends on quality-improvement related activities. Users can also use the PCQC to determine the cost of providing services at a certain quality level, based on licensing or QRIS tiers, and to compare estimated costs with estimated revenues to assess sustainability.[29]

The second option is a *cost study or survey*, which collects data, usually through a sample of child care programs, at the facility level to measure the costs of delivering child care services.[30] Costs may be aggregated at the facility or program level and then computed per unit of care (for example, per child per month or per child per hour).[31] Cost studies may provide the most detailed data, but they require collection of extensive and detailed information from child care programs. Therefore, only a few large-scale cost studies have been completed, including ones in Massachusetts in 2001 and Maine in 2004.[32]

These two methods focus on the costs of providing child care, which is critical to setting subsidy reimbursement rates that support child care businesses. However, the current price of child care will also impact whether a family with a subsidy can access the child care program they prefer for their child. Overlooking the prices charged and setting reimbursement rates solely on the cost of providing high-quality child care may also lead to much higher subsidy reimbursement rates driving private tuition and fees higher. To capture data on prices and costs, states may use a hybrid approach that often does not require a full market rate survey and a full cost study or estimate.[33] For example, a state may choose to do a market rate survey with a limited cost analysis based on specific factors that may play a larger role in driving the costs of child care. This model aligns with the narrow cost analysis states must do to determine the cost of meeting health and safety regulations and providing higher quality child care services.

STATES USING ALTERNATIVE METHODOLOGIES

For the FY2019-2021 CCDF state plan period, the District of Columbia was the only state that applied for and received approval to conduct an alternative methodology to set its subsidy payment rates.[a,34] The District used a cost estimation model that examined the cost of providing child care at each level of the District's QRIS in center and home-based child care programs that serve children of various ages and needs. The District model is an interactive cost modeling approach adapted from the PCQC.[35] In doing the cost estimation, the District found that in most cases, a child care program's estimated cost of delivering child care exceeded the revenue generally available to provide care at different levels of quality.

> "THE DISTRICT OF COLUMBIA WAS THE ONLY STATE THAT APPLIED FOR AND RECEIVED APPROVAL TO CONDUCT AN ALTERNATIVE METHODOLOGY TO SET ITS SUBSIDY REIMBURSEMENT RATES."

a Links to all FFY 2019-2021 CCDF State Plans are available on the Office of Child Care website at https://www.acf.hhs.gov/occ/resource/state-plans.

Two additional states reported doing both a market rate survey and an alternative methodology to set their subsidy payment rates:

- Alaska combined information from its market rate survey for each type of child care and information from a geographic differential study.[36]
- Arkansas used a market rate survey to set base payment rates and a cost model study differentiating between rural and urban areas to set a tiered payment structure.[37]

Maryland also reported that, even though it currently only used a market rate survey to set subsidy payment rates, the state was in the planning phase of developing a hybrid methodology using the market rate survey and actual cost of care to determine the true cost of providing high-quality child care within the state.[38]

Conclusion

The fragility of the child care market is not new, but the current COVID-19 crisis has highlighted the many issues faced by child care programs and families, as well as how important child care will be when the nation emerges from the current pandemic. Many concerns will need to be addressed as part of the child care subsidy system, especially how we determine how much we will pay child care programs. The need to not perpetuate the broken child care market by basing subsidy reimbursement rates on broken practices is essential. Building a better child care market means starting with a better foundation, and a key piece of that will be how we treat our child care workers and the policies implemented to reimburse child care programs in the immediate future.

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