

SUMMARY

Most child care centers do not appear to raise their rates to take advantage of the maximum reimbursement available from the Child Care Assistance Program. However, an unexpectedly high percentage of licensed family home providers charge the maximum rate for subsidized care. While the reasons for this are unclear, the Department of Human Services needs to examine whether some providers are charging rates higher than they are entitled to charge. Legal non-licensed providers almost always charge the maximum rates, but that is not surprising. These providers care for children of relatives and no more than one unrelated family, and most do not have regular rates.

Evidence from a 1999 study suggests that subsidized families in Minnesota choose child care centers, the most expensive form of care, more often than the general public. But, this evidence is somewhat inconsistent with the results from a 1997 Urban Institute study. In addition, families who receive child care subsidies in Minnesota are less likely to use center-based care than subsidized families in other states.

The freeze on maximum rates established by the Legislature in 2003 has reduced access to child care. But, in early 2004, subsidized families could still use about half of the child care centers and about two-thirds of the licensed family homes in the state without paying more than their required co-payment. Access to affordable child care may decline more before the freeze on maximum rates expires in July 2005.

The 2005 Legislature will face an important decision affecting the future of the Child Care Assistance Program. The two-year freeze on maximum reimbursement rates put in place by the 2003 Legislature expires on June 30, 2005. Continuing budget concerns may cause legislators to consider options for constraining the future growth of child care subsidies.

This chapter does not attempt to examine options for cost control. The 2003 Legislature asked the Department of Human Services to consider options and make recommendations by January 15, 2005. Instead, in this chapter, we examine certain issues that may impact the decisions legislators make about the future of

the Child Care Assistance Program. In particular, we address the following questions:

- **How do providers respond to maximum rates? Do they typically charge the maximum rate allowed by the state?**
- **Do families who receive child care subsidies tend to select the most expensive care available within the maximum rates? What do available data suggest about how the type of child care used by subsidized families differs from that used by other families?**
- **Although the state sets maximum rates based on the 75th percentile of market rates, what percentage of providers can a program participant access without any additional cost besides a co-payment by the time that the maximum rates are implemented?**
- **How has the freeze on maximum rates affected the access of participants to child care?**
- **What are the advantages and disadvantages of using alternative methods for calculating maximum reimbursement rates? Would setting combined, rather than separate, maximum rates for child care centers and family home providers be feasible and legal given federal laws and regulations?**

PROVIDER INCENTIVES

Some legislators have been concerned that too many providers charge the maximum reimbursement rate for subsidized care.

Some legislators have raised concerns that maximum rates for child care quickly become the rates charged by most providers, even though they are only intended to limit the rates that the Child Assistance Program will pay for subsidized care. If providers raise their rates, they do not risk losing subsidized customers as long as their rates do not exceed the maximum. But providers who raise their rates may risk losing private-pay customers. As a result, the providers with the greatest incentive to increase their rates to the state's maximum reimbursement rates are those with a high percentage of children in the state's Child Care Assistance Program.

Our ability to examine provider behavior in a comprehensive manner is limited for several reasons. First, the state lacks the data necessary to identify providers with a high percentage of children who receive subsidies. The Department of Human Services currently does not have information on how many children served by each provider are from the Child Care Assistance Program. Without this information, we cannot determine the extent to which these providers raised their rates to the maximum. Second, the providers who participated in the 2002 and 2004 surveys could not be matched with their responses from the 2001 survey. The department did not maintain data on the names of providers responding to the 2001 survey. As a result, we could not determine how much individual providers increased their rates.

Our ability to examine provider charges is somewhat limited by the lack of relevant data.

However, we were able to examine overall changes in the rates reported to the state between 2001 and 2004. The survey data on market rates help to indicate whether there have been a large number of providers at the maximum rates. Furthermore, the data show how the number of providers at the maximum rates changed following the implementation of new maximum rates in July 2002.

In addition, we compared the rates paid for child care assistance during the first half of 2004 with the rates reported by providers during the rate survey conducted by the state between February and April of 2004. A comparison of payment rates billed by providers serving program participants and market rates of all providers would indicate whether providers serving program participants were more likely to charge rates at or above the maximum than providers serving the general public.

Because the Department of Human Services does not have statewide payment data on child care assistance payments, our analysis was limited to 39 of the state's 87 counties. We examined payments from Hennepin County, as well as the 38 counties that had all of their child care assistance payments made by the state's payment system.¹ Altogether, these 39 counties had about half of the children participating in the Child Care Assistance Program.² Our comparison of payment and rate data was limited to the first half of 2004, because of the availability of data. Rate data were available from the 2001, 2002, and 2004 surveys. But, none of the counties using the state's payment system had all of their payment information on the system before mid-2003. As a result, complete payment data for these counties was not available from the state's system for critical time periods such as the periods just before and after the state set maximum rates in July 2002.

Child Care Centers

When we reviewed payment and rate data for child care centers, we found that:

- **The Child Care Assistance Program probably does not induce most child care centers to increase their rates to the maximum rate.**

Data from rate surveys suggest that child care centers typically increase their rates each year but generally do not increase their rates to the maximum rates. Rate survey data from 2004 indicate that the percentage of child care center rates that were at the maximum was relatively small (about 12 percent). As Table 3.1 shows, the percentage of rates at the maximum has not changed much in recent years. We consider this percentage of rates at the maximum to be small because it is normal for some rates to be at the maximum. For example, the vast majority of providers tend to charge hourly rates at 25-cent intervals, such as \$4.00, \$4.25,

¹ As of July 1, 2004, the state's computerized payment system—also known as the Minnesota Electronic Child Care Information System (or MEC³)—made all the assistance payments in 38 counties, as well as some of the payments in another eight counties. Counties not using the state's system are responsible for making payments to providers used by their residents.

² All of the MFIP participants and about three-fourths of the basic sliding fee participants are included in the payment data. The data do not include about one-fourth of the county's basic sliding fee participants because the Greater Minneapolis Day Care Association (GMDCA) administers that portion of the county's program. The GMDCA could not provide us with payment data that included the units of service—hours, days, and weeks—for which payments were made.

Table 3.1: Provider Rates Compared With Current Maximum Rates, 2001-04

| | Year of Provider Rate Survey | | |
|-----------------------------------|------------------------------|------|------|
| | 2001 | 2002 | 2004 |
| Child Care Center Rates | | | |
| Percentage of Rates | | | |
| Less than maximum rate | 68% | 59% | 39% |
| Equal to maximum rate | 13 | 11 | 12 |
| Greater than maximum rate | 18 | 30 | 49 |
| Licensed Family Care Rates | | | |
| Percentage of Rates | | | |
| Less than maximum rate | 61% | 50% | 40% |
| Equal to maximum rate | 22 | 27 | 29 |
| Greater than maximum rate | 17 | 23 | 31 |

NOTES: The percentage figures for survey rate data are averages across four child age categories and three types of units (hours, days, and weeks). We determined averages across child age categories by weighting each child care center rate by the center's licensed capacity for the applicable age group. If a center reported a rate for a particular age category but did not report the corresponding licensed capacity, we used the average licensed capacity for that age category among providers in the same region. For licensed family home providers, we used unweighted averages because overall licensed capacity for these providers does not vary much and information on capacity by age group is not available.

For both types of providers, we averaged the percentage figures across unit types based on the estimated share of service hours billed under each unit type. We assumed days included 10 hours of service and weeks included 50 hours. To estimate the share of hours billed, we used payment data for Hennepin County and the 38 MEC² counties and recipient data from the Minnesota Department of Human Services.

SOURCE: Office of the Legislative Auditor analysis of data from the Minnesota Department of Human Services.

However, available data suggest that the program does not cause most child care centers to increase their rates to the maximum rate for subsidized care.

\$4.75, and \$5.00 per hour. As a result, there tends to be a group of providers at a number of these 25-cent intervals. The 75th percentile of rates, and thus the maximum rate, is likely to be set at one of these rates that is charged by a number of providers. The relatively small percentage of rates at the maximum may reflect the minor influence that the subsidized program has on the rates of most providers. Those providers with a modest percentage of children from the Child Care Assistance Program cannot increase their rates without affecting their other customers.

The percentage of center rates that exceeded the maximum grew from 18 percent in 2001 to 49 percent in 2004. But most of this growth can probably be explained by inflationary rate increases typical of the service sector of the economy. Between fall 2001 and early 2004, child care center rates increased by an average of about 4 percent per year, slightly more than the 3 percent annual inflation rate in the service sector.³ At the same time, maximum rates for child care centers were unchanged. As a result, the inflationary growth in rates caused rates at a significant number of centers to increase past the maximum reimbursement rates. It is possible that the average increase in rates masks large increases by individual providers that may have been influenced by the maximums set by the state. But,

³ We compared increases in child care center rates with the increases in the Bureau of Labor Statistics' Consumer Price Index (for Urban Consumers) for services.

other than some anecdotal evidence, we lack the data necessary to isolate providers that primarily serve children who receive child care subsidies.

A comparison of payment and rate data shows that the percentage of actual child care center payments at the maximum does not appear unusually high in relation to the share of market rates at or above the maximum. In the 39 counties we examined, about 55 percent of payments for services during the first half of 2004 were at the maximum rate. As Table 3.2 shows, this is less than the percentage of provider rates reported in the survey from the same counties that were equal to or greater than the maximum (about 63 percent). Most of this difference was due to Hennepin County. The percentage of payments at the maximum rate (56 percent)

Table 3.2: Comparison of Child Care Payments with Provider Rates for Selected Counties, 2004

In fact, fewer payments to child care centers are made at the maximum rate than one might expect from examining provider rates.

| | <u>Provider Rates</u> | <u>Payments</u> |
|--------------------------------------|-----------------------|-----------------|
| Child care centers | | |
| Percentage of rates: | | |
| Less than 50 percent of maximum rate | 1% | 6% |
| 50 to 69 percent of maximum rate | 6 | 10 |
| 70 to 79 percent of maximum rate | 5 | 4 |
| 80 to 89 percent of maximum rate | 8 | 8 |
| 90 to 99 percent of maximum rate | 17 | 16 |
| Maximum rate or above | 63 | 55 |
| Licensed family providers | | |
| Percentage of rates: | | |
| Less than 50 percent of maximum rate | 0% | 2% |
| 50 to 69 percent of maximum rate | 4 | 3 |
| 70 to 79 percent of maximum rate | 5 | 3 |
| 80 to 89 percent of maximum rate | 17 | 8 |
| 90 to 99 percent of maximum rate | 13 | 8 |
| Maximum rate or above | 61 | 75 |

NOTES: This table is based on rate survey and payment data from Hennepin County and 38 MEC² counties. The percentage figures for survey rate data are averages across four child age categories and three types of units (hours, days, and weeks). We determined averages across child age categories by weighting each child care center rate by the center's licensed capacity for the applicable age group. If a center reported a rate for a particular age category but did not report the corresponding licensed capacity, we used the average licensed capacity for that age category among providers in the same region. For licensed family home providers, we used unweighted averages because overall licensed capacity for these providers does not vary much and information on capacity by age group is not available.

For both types of providers, we averaged the percentage figures for survey rate data across unit types based on the estimated share of service hours billed under each unit type. We assumed days included 10 hours of service and weeks included 50 hours. To estimate the share of hours billed, we used payment data for Hennepin County and the 38 MEC² counties.

To determine the percentage of payments in each of the above categories, we first calculated the percentage for each unit type. Then we averaged across unit types based on the estimated hours of service billed under each unit type, as we did for the survey rate data.

We excluded payments for special needs children in all 39 counties. We also excluded Hennepin County payments for special programs that pay non-standard rates.

SOURCE: Office of the Legislative Auditor analysis of rate survey and MEC² child care payment data from the Minnesota Department of Human Services and child care payment data from Hennepin County.

in Hennepin County was less than the percentage of rates at or above the maximum (66 percent).⁴

It appears that the system of setting maximum rates for centers limits the state's costs without creating significant incentives for providers to increase their rates to the maximum rate. There may be some child care centers that increase their rates to the maximum rates because they primarily serve children in the Child Care Assistance Program. But our findings suggest that there may not be a significant number of child care centers that serve mostly subsidized families.

Licensed Family Home Providers

We also reviewed rate and payment data on licensed family home providers. We found that:

- **Licensed family home providers were more likely to have rates at the maximum reimbursement rates than child care centers, but fewer had rates above the maximums.**

About 29 percent of licensed family home providers had rates equal to the maximum reimbursement rates in early 2004, compared with only 12 percent of child care centers. In addition, the percentage of licensed family home providers with rates equal to the maximums has increased modestly since before maximum rates were last increased in July 2002. As Table 3.1 indicates, the percentage of licensed home providers whose rates were at the maximum increased from 22 percent in the fall of 2001 to 27 percent in the fall of 2002 and to 29 percent in early 2004. The relatively high percentage of licensed family home providers with rates at the maximums might suggest that providers are influenced by the state's reimbursement system. However, there are other factors that could explain the relatively high percentage of rates that were at the maximum. First, within a county or region, licensed family child care rates tend to cluster within a narrower range than child care center rates because there are fewer differences in services offered. Second, family providers that were already at or slightly below the maximum in 2001 may have been reluctant to increase their rates above the maximum in 2004 because they did not want to risk losing their customers. In fact, licensed family providers raised their rates above the maximum less often than child care centers. For example, about 31 percent of licensed family provider rates exceeded the maximum in 2004, compared with 49 percent for child care centers.

We also examined payment data for Hennepin County and the 38 counties relying exclusively on the state's payment system. Payment rates during the period January 2004 through June 2004 were compared with provider rates reported to

⁴ We have some concerns about the accuracy of the payment data, particularly the payments that appear to be at rates less than 50 percent of the maximum rates. For example, in Hennepin County, payment data showed that 7 percent of the payments were at rates less than half of the maximum rates, while the survey indicated that no child care centers had rates that low. It is possible that some or all of these payments were made at higher rates than the data seem to indicate or that they reflect adjustments to prior payments and should not be included in the payment data. Even if all of these payments were at the maximum rate, the evidence would still show a slight tendency for child care centers to charge the state rates that were lower than those paid by the general public.

the state during the rate survey conducted between February and April 2004. We found that:

- **A higher percentage of the payments to licensed family home providers were at the maximum rate than one would expect from rate survey information.**
- **This difference raises concerns about provider behavior, particularly in some parts of the state. However, it is not clear what explains the higher share of payments at the maximum rate.**

As Table 3.2 shows, about 75 percent of the payments made to licensed family home providers in these 39 counties during the first half of 2004 were at the maximum rates. In contrast, the rate survey suggests that about 61 percent of the rates were at or above the maximum rates. In seven of the counties, the difference between payments and rates was substantial. For example, in Hennepin County, about 84 percent of the actual payments to licensed family home providers were at the maximum rates during the first half of calendar year 2004. The 2004 rate survey indicated that only 58 percent of providers in Hennepin County had rates equal to or greater than the maximum rates. Similarly, in six of the MEC² counties, the difference between the percentage of payments made at the maximum and the percentage of rates at or above the maximum was at least 20 percentage points.⁵

In 7 of the 39 counties we examined, significantly more licensed family home providers received the maximum payment than one would expect from rate survey information.

It is not clear why the difference between payments and survey rates was so large in these seven counties. There are two explanations that seem more plausible than others. First, it is possible that there are a significant number of licensed family providers in these counties that mostly serve children from the Child Care Assistance Program. These providers may recognize that they can raise their rates to the maximum without losing many of their customers.

Second, providers may have billed the maximum rate to the state even though they reported lower rates during the 2004 survey. Providers are required to bill the state the same rates they charge the general public if those rates are less than the maximum.⁶ Providers with rates below the maximum rates may be able to bill the maximum rates if neither the state nor counties check a provider's rate before paying a bill.

There are other possible explanations. First, it is possible that some providers raised their rates after reporting rates during the 2004 survey. Payment data for the months following the survey would then include payments at higher rates than were reported during the survey. Second, it is possible that payment data were not representative of all payments made in a county. For example, in Hennepin County, we could not include those payments made by the Greater Minneapolis Day Care Association. In one of the six MEC² counties with an unexpectedly high percentage of payments at the maximum rate, the state did not begin processing all of the county's payments until April 2004. Some of the payments

⁵ In 26 of the 39 counties, the percentage of payments at the maximum rate exceeded the percentage of rates at or above the maximum rates. However, in 11 counties, the percentage of payments at the maximum was less than the percentage of rates at or above the maximum. In two counties, the payment percentage was about equal to the rate percentage.

⁶ *Minn. Stat.* (2004) §119B.13, subd. 4.

to providers in that county from January through March 2004 would not have been included in the payment data we examined. Finally, it is possible that the rate data for a county was not representative of rates throughout the county. This seems unlikely, however, since the 2004 rate survey included rates from a high percentage of licensed family home providers in each county.

Even if it is true that the setting of maximum rates induces some licensed family home providers to raise their rates to the maximums, we think the rate setting system serves a useful purpose. The setting of maximum rates clearly limits the state's payments. Providers with rates above the maximum cannot charge more than the maximum rate for subsidized care. It may be difficult to eliminate the incentive for some providers to raise rates to the maximums without creating additional problems.

However, it is possible that some providers are billing the maximum rates even though they are not entitled to the maximums.⁷ Providers are required to file their rate information with counties prior to receiving any payments from the program and are required to update that information with the counties whenever their rates change.⁸ It is not clear that all counties receive and use this information when processing child care assistance payments to providers. The Department of Human Services instructs counties regarding how payments should be calculated. But the department does not provide counties with any direction about how to maintain and use the rate information they receive from providers.

It is not clear why so many licensed family home providers charge the maximum rate in certain parts of the state.

In addition, the state's MEC² payment system does not include information on a provider's rates that can then be compared with the rate the provider is charging to the program. The Department of Human Services is considering changes in the system that would add information about the rates reported to the counties. Effective use of that information would require counties to input the rate information reported to them by providers into the MEC² payment system on an ongoing basis.

We think that the Department of Human Services should conduct some additional research into this issue. Although counties do not bear any additional costs if incorrect payments are made to providers, the Department of Human Services is relying on counties to ensure compliance with rate policies. The department needs to examine what counties are doing to ensure compliance and whether noncompliance with this policy is a significant problem. The department could examine some of the same data we reviewed. That data would help to identify parts of the state where there may be a problem, although the data we examined only covers only 39 of the state's 87 counties.

The department could also do a limited audit of a select number of providers in those areas where billing the maximum rate is standard practice for licensed family home providers. The results would help determine whether billing practices are a problem. If the results show significant noncompliance problems, the department should expand its auditing efforts, enlist the help of counties, and

⁷ Providers that charge private unsubsidized customers a rate that is below the maximum cannot legally charge the maximum rate for subsidized care. They should instead charge the program the same rate they charge private customers.

⁸ *Minn. Rules* (2003) ch. 3400.0120, subp. 1a.

The Department of Human Services should make sure that providers are only charging the maximum rate when they are entitled to it.

make sure that other providers are aware that those not complying with billing policies are at risk.

RECOMMENDATION

The Department of Human Services should examine whether there is a problem in some counties with providers charging the Child Care Assistance Program a higher rate than they charge the general public.

Legal Non-Licensed Providers

The only data on rates charged by legal non-licensed providers comes from actual payment data because the state provider rate surveys do not include legal non-licensed providers. We examined the payment data from Hennepin County and the 38 counties that participated in the state's payment system and found that:

- **The maximum rate set for legal non-licensed providers almost always becomes the rate charged.**

Payment data indicate that less than 5 percent of legal non-licensed providers from these 39 counties charge less than the maximum. This result is expected since most legal non-licensed providers do not have regular rates. They may provide care only for children of relatives and no more than one unrelated family.

PARTICIPANT CHOICES

Legislators have also expressed concerns about how the setting of maximum rates affects the decisions made by program participants. One concern is that participants may be more likely to select the most expensive type of child provider—namely child care centers—because participant's costs do not increase unless the provider charges more than the maximum rate. For example, in Hennepin County, a participant pays \$15 more per week to select a licensed family home provider at the 90th percentile than a licensed child care center at the 75th percentile.⁹ But the center costs taxpayers significantly more because the maximum allowable rate for the center is \$184 while the maximum for the family home provider is \$135. This situation has caused some legislators to wonder if participants in subsidized programs receive child care that is more expensive and of better quality than higher-income families who are not eligible to participate in the program.

A second concern is that participants do not have a financial incentive to select care at rates below the maximum rates set by the state. While participants face higher costs for care at rates above the maximums, their out-of-pocket costs are the same for any rate at or below the maximum rate. As a result, some wonder whether participants are apt to select care at or close to the maximum rates,

Some legislators have been concerned that the program lacks sufficient incentives for participants to select less costly care.

⁹ In 2001, a family provider at the 90th percentile of family provider rates in Hennepin County charged \$150 per week, or \$15 more than the maximum of \$135. A center at the 75th percentile of center rates in Hennepin County charged \$184 per week, which was the same as the maximum rate.

perhaps because participants might think that more expensive care is higher quality care. That behavior would cost the state more than if participants selected providers in a manner more like unsubsidized families.

In this section, we first examine how the type of care used by program participants differs from that used by unsubsidized families. In particular, we examine the percentage of subsidized and unsubsidized families that use child care centers. Second, we consider whether program participants use child care centers that are more expensive than those used by the general public. We also analyze how the costs of licensed family home care used by participants differ from the costs of care used by the general public. Finally, we compare the rates paid by the state for legal non-licensed care to rates paid by the general public.

Type of Care

Information from a 1999 study suggests that program participants are more likely to use child care centers than the general public.

To examine whether subsidized families are choosing more expensive forms of care than other families, we looked at studies that have surveyed Minnesota families regarding their child care arrangements. In addition, we looked at comparisons of the type of care selected by families receiving child care subsidies in Minnesota and other states. We found:

- **Evidence from a 1999 study suggests that subsidized families in Minnesota use child care centers more than other families. Nevertheless, families in Minnesota’s Child Care Assistance Program use centers significantly less than families in subsidized programs in other states.**

Data from a sample of Minnesota families surveyed in 1999 by the Wilder Foundation suggest that subsidized families are more likely to use child care centers than other families.¹⁰ As Table 3.3 shows, 38 percent of families who said they received government subsidized child care used centers as their primary child care arrangement, compared with 20 percent for other families.¹¹ Unsubsidized families were more likely to use relative care, self-care, and activities.¹²

Among families who did not receive government subsidized child care, higher income families tend to use child care centers more than lower income families. For example, we found that unsubsidized families with incomes less than or equal to 200 percent of the federal poverty level used centers less often than unsubsidized families with incomes greater than 200 percent of the federal poverty level (12 percent compared with 23 percent).

But the results also suggest that subsidies make a greater difference than income in the use of child care centers. Not surprisingly, families participating in the Child Care Assistance Program use centers more than unsubsidized families with

¹⁰ The data we analyzed was prepared for the report: Wilder Research Center, *Child Care Use in Minnesota, Report of the 1999 Statewide Household Child Care Survey*, (St. Paul, MN: January 2001).

¹¹ The difference is statistically significant at the 99 percent confidence level.

¹² Relative care includes care by grandparents and siblings but does not include care by parents or stepparents. Activities include lessons, clubs, sports, community recreation, camp, and church activities.

Table 3.3: Primary Child Care Arrangement Used by Subsidized and Unsubsidized Families, 1999

| | Government Subsidized Child Care (N=108) | No Government Subsidy (N=1,229) |
|------------------------|--|------------------------------------|
| Child care centers | 38% | 20% |
| Formal home-based care | 31 | 25 |
| Relative care | 18 | 30 |
| Informal | 9 | 11 |
| Self care | 3 | 7 |
| Activities | 1 | 7 |

NOTES: The results include all child care arrangements except K-12 school during the regular school day and parental care. They are based on the youngest child from surveyed households with at least five hours of child care during the study week. The Wilder category for child care centers is similar to the center category used by the Department of Human Services (DHS). However, other Wilder categories do not correspond with categories used by DHS. The Wilder category "formal home based care" includes licensed family child care and some legal non-licensed care. The Wilder category "relative care" includes care by grandparents (legal non-licensed for DHS) and siblings (not eligible to provide subsidized care if they are less than 18).

SOURCE: Office of the Legislative Auditor analysis of data from the Wilder Research Center's 1999 child care survey.

similar incomes because the program substantially reduces the cost of center care. But these program participants also used child care centers more often than unsubsidized families with incomes greater than 200 percent of the federal poverty level.

However, the evidence that subsidized families are more likely to choose center care than unsubsidized families with higher incomes is not conclusive for several reasons. First, some of the results of the Wilder survey appear to be inconsistent with a 1997 study by the Urban Institute.¹³ The Urban Institute study found substantially higher use of child care centers by families with incomes above 200 percent of the poverty level than did the Wilder study (58 percent compared with 30 percent among children less than 5 years of age). Also, it found that low-income families (incomes below 200 percent of the poverty level) used child care centers much less often than higher income families (29 percent compared with 58 percent), while the data from the Wilder study indicate that use of centers was not significantly different between low and high-income families (19 percent compared with 23 percent). The Urban Institute study, however, did not directly compare subsidized families with other families. Low-income families are not a good proxy for subsidized families because data from the Wilder study indicate that most low-income families did not receive child care subsidies.

Second, while subsidies may cause greater use of child care centers, the use of centers by participants in Minnesota's Child Care Assistance Program is substantially lower than in most other states. In federal fiscal year 2001, only 33 percent of the children in Minnesota's program used licensed child care centers compared with 56 percent of the children receiving subsidized care nationwide.

But the evidence from the 1999 study is in part contradicted by an earlier study.

¹³ Kathleen Snyder and Gina Adams, The Urban Institute, *State Child Care Profile for Children with Employed Mothers: Minnesota* (Washington D.C.: February 2001).

Children in only six states used licensed child care centers less than children in Minnesota. As Table 3.4 shows, children in Minnesota's program were more likely to use licensed family home providers and unlicensed care than children receiving subsidized care in other states.

Program participants in Minnesota are much less likely to use child care centers than subsidized families in other states.

Table 3.4: Type of Subsidized Child Care Used in Minnesota and Other States, Federal FY 2001

| Type of Care | Minnesota | National Average |
|---------------------------------|-----------|------------------|
| Licensed Center | 33% | 56% |
| Unlicensed Center | <u>3</u> | <u>2</u> |
| Subtotal: All Centers | 36% | 58% |
| Licensed Family Home | 29% | 14% |
| Licensed Group Home | <u>0</u> | <u>4</u> |
| Subtotal: Licensed Home | 29% | 18% |
| Unlicensed Care by Relative | 12% | 13% |
| Unlicensed Care by Non-Relative | <u>22</u> | <u>12</u> |
| Subtotal: Unlicensed Care | 34% | 25% |
| Totals | 100% | 100% |

SOURCE: United States Department of Health and Human Services, Administration for Children and Families, *FFY 2001 CCDF Data Tables and Charts*; <http://www.acf.hhs.gov/programs/ccb/research/01acf800/setdet6.htm>; accessed August 5, 2004.

Finally, the evidence from the Wilder study is at least five years old. Child care use, as well as participation in the Child Care Assistance Program, may have changed with time over the last five years. For example, the use of legal non-licensed care by subsidized families has increased somewhat in recent years. The Department of Human Services is currently sponsoring another Wilder survey on the use of child care by Minnesota families in 2004. Unfortunately, data collection for the 2004 Wilder survey was not completed in time for inclusion in our study.

Cost of Care

Our comparisons of the costs of care used by participants and the general public are based on the same data we used to examine whether providers set their rates at the maximums. Table 3.2 shows whether program participants tended to use providers with rates at or above the maximum more often than the general public.

Child Care Centers

The data on child care centers indicate that:

- **The child care centers used by program participants were slightly less expensive than those used by the general public.**

Program participants seem to use more centers with rates below the maximum rate than the general public and fewer centers that charge rates at or above the maximum rate. In addition, if participants use centers charging more than the maximum, the state's cost are limited to the maximum rate. For participants, the

choice of a child center does not seem to depend on the center's rate as long as the rate is below the maximum rate. Participants may focus more on other factors such as familiarity with the provider and proximity to work or home when selecting a child care provider.

Licensed Family Home Providers

We also compared the cost of licensed family home care used by program participants with the cost of care used by the general public. As Table 3.2 indicates:

- **Program participants were generally more likely to use licensed family home providers that had rates at or above the maximum rates than the general public.**

In the 39 counties we examined, 75 percent of the payments were at the maximum rate, while 61 percent of the providers' rates were at or above the maximum. In seven of those counties, the percentage of payments at the maximum rates was more than 20 percentage points higher than the percentage of providers with rates at or above the maximum.

However, it is not entirely clear that participants use more expensive care than the general public. For subsidized care paid at the maximum rates, we do not know what share of the payments was for providers with rates above the maximums but limited to billing the maximum rates. Because of the additional out-of-pocket costs, participants may use care above the maximum rates less than the general public. In any event, the state's costs are capped at the maximum rate. If participants use care at rates above the maximums, the state does not pay any portion of the additional costs.

We suspect that the tendency of program participants to use licensed family home care at or above the maximum rates is not primarily due to deliberate choices on the part of participants. The more likely explanation is that providers choose to charge the maximum rate and participants have no financial incentive to look for another provider as long as the rate is no higher than the maximum.

Legal Non-Licensed Providers

We know approximately what the Child Care Assistance Program pays for legal non-licensed care. The vast majority of payments are made at the maximum rate. In fiscal year 2003, the maximum hourly rates varied from \$1.58 in seven rural counties to \$5.00 in several Twin Cities area counties. As a result of 2003 legislation, maximum rates for legal non-licensed care were reduced in fiscal year 2004. The maximum hourly rates now range from \$1.40 per hour to \$2.48.

The only current evidence of what the general public pays for non-licensed care comes from the 1999 child care survey conducted by the Wilder Research Center. Data from this survey show that unsubsidized families often did not pay for informal child care. In 1999, 79 percent of families who did not participate in a government subsidized child care program and regularly used grandparent care did not pay for such care. About 45 percent of unsubsidized families who

regularly used informal care by nonrelatives did not pay for the child care. Among unsubsidized families who did pay for non-licensed care, the median rate in 1999 was \$2.00 per hour for grandparents and \$2.75 per hour for nonrelatives.

These data suggest that unsubsidized families who paid for non-licensed care in 1999 paid more than what the Child Care Assistance Program currently pays for such care. In fact, the difference may be larger due to the inflation that has occurred since 1999. However, a significant proportion of unsubsidized families receive non-licensed care from relatives and nonrelatives at no cost. As a result, subsidized care probably costs more overall than the non-licensed care received by the general public.

ACCESS TO SUBSIDIZED CHILD CARE

The freeze on maximum child care rates has raised concerns among some legislators about whether families in the Child Care Assistance Program have sufficient access to affordable child care. To understand how the freeze has affected access to child care, we used the department's survey data to examine how many providers had rates less than or equal to the maximum rate at three points in time: (1) Fall 2001—the time of the 2001 survey, which was used to set the current maximums; (2) Fall 2002—about 3 to 6 months after the current maximums were placed into effect; and (3) early 2004—19 to 22 months after the maximums were first placed into effect.¹⁴

These measures provide a limited view of access to child care because they do not take into account the location of providers in relation to where the family lives or works. Nevertheless, it gives a useful perspective on how access has changed over the past few years. Overall, they indicate that:

- **The freeze on maximum rates has reduced access to child care providers. But as of early 2004, subsidized families could still use about half of the child care centers and about two-thirds of the licensed family homes in the state without paying more than the required co-payment.**

Minnesota maximum child care rates are set so that, at the time of the survey, families can access at least 75 percent of the slots at child care centers and at least 75 percent of the family home providers in a county or other geographic area without paying more than the required co-payment. But largely because rates tend to cluster at 25-cent intervals, more than 75 percent of provider rates are at or below the maximum rates at the time of the survey. As Table 3.5 shows, the maximums based on the 2001 survey would have permitted access to about 82 percent of child care center slots and about 83 percent of family care providers if they could have been implemented at the time of the survey.¹⁵

¹⁴ During fiscal year 2003, there were no maximums in effect for child care centers in 68 counties. Beginning in July 2003, DHS used regional or statewide maximums for those counties.

¹⁵ These percentages are greater than 75 percent since rates tend to be clustered at 25-cent intervals. The 75th percentile of rates can be the same as the 85th percentile and, in some counties or regions, the 100th percentile.

Table 3.5: Trends in Access to Child Care Providers by Region, 2002-04

The freeze on maximum rates has reduced affordable access to child care providers, particularly child care centers.

| | Percentage of Providers With Rates Equal to or Less Than Maximum Rate | | |
|-------------------------------|---|--|--|
| | Fall 2001 (Maximums Based on 2001 Survey Not Yet in Effect) | Fall 2002 ^a (First Effective Year For Maximums Based on 2001 Survey) | Early 2004 (19 to 22 Months After Maximums Were First Placed Into Effect) |
| Child Care Centers | | | |
| Twin Cities Metropolitan Area | 80% | 69% | 49% |
| Outstate Minnesota | 86 | 73 | 60 |
| State Total | 82% | 70% | 51% |
| Licensed Family Homes | | | |
| Twin Cities Metropolitan Area | 81% | 72% | 63% |
| Outstate Minnesota | 84 | 79 | 71 |
| State Total | 83% | 77% | 69% |

NOTES: The percentage figures for survey rate data are averages across four child age categories and three types of units (hours, days, and weeks). We determined averages across child age categories by weighting each child care center rate by the center's licensed capacity for the applicable age group. If a center reported a rate for a particular age category but did not report the corresponding licensed capacity, we used the average licensed capacity for that age category among providers in the same region. For licensed family home providers, we used unweighted averages because we lacked data on licensed capacity for these providers.

For both types of providers, we averaged across unit types based on the estimated share of service hours billed under each unit type. We assumed days included 10 hours of service and weeks included 50 hours. To estimate the share of hours billed, we used payment data for Hennepin County and the 38 MEC² counties and recipient data from the Minnesota Department of Human Services.

^aThe figures for 2002 represent what the access would have been under the current policy for setting maximum rates. In 2002, the actual access for child care centers would have been about one percentage point higher than shown because 68 counties did not have child care center maximum rates for at least some age categories. These counties did not have enough child care centers responding to the survey to set a maximum rate.

SOURCE: Office of the Legislative Auditor analysis of data from the Minnesota Department of Human Services.

By the time these maximum rates were implemented, however, access dropped below the 75 percent standard for child care centers. Data collection for the Fall 2001 survey was completed in December 2001, and new maximum rates were implemented in July 2002. By then, some providers had already increased their rates. By Fall 2002, 70 percent of child care center rates were at or below the maximums. While access also dropped for licensed family providers by this measure, it was still a little higher than the 75 percent level in the Fall of 2002.

After the 2003 Legislature froze the maximum rates for fiscal years 2004 and 2005, access declined. In early 2004, subsidized families had access to 51 percent of child care centers and 69 percent of licensed family home providers without paying more than their required co-payment.

It is important to recognize that access may have declined even more since the survey of early 2004. The 2004 survey reflected access during the first year of the two-year rate freeze. If child care rates continued to increase during the second

year of the freeze, access would be lower in 2005 than the levels shown for early 2004.

Under the Child Care Assistance Program, families have access to a slightly higher percentage of providers in outstate Minnesota than in the Twin Cities metropolitan area, as shown in Table 3.5. For example, in 2004, subsidized families had access to 60 percent of child care centers in outstate Minnesota without paying more than the required co-payment, compared with 49 percent in the Twin Cities metropolitan area. In addition, subsidized families had access to 71 percent of the licensed family home providers in outstate Minnesota, compared with 63 percent in the Twin Cities area.¹⁶

OTHER METHODS OF SETTING MAXIMUMS

Some legislators have been interested in reducing, or at least limiting any increase in, maximum reimbursement rates for subsidized care. For some, this interest in maximum rates comes from their desire to address state budget shortfalls by reducing expenditures. For others, a reduction in maximum rates could help maximize the number of children served by the Child Care Assistance Program.

Some legislators have expressed interest in setting a "blended" maximum rate that applies to both child care centers and licensed family home providers.

Some legislators and legislative staff have raised concerns about whether the maximum reimbursement rates for subsidized child care—particularly at child care centers—are too high. As mentioned earlier in this chapter, some have suggested that the state's child care programs provide an incentive for participants to select the highest priced care available. During the 2004 legislative session, one legislative proposal would have required that the Department of Human Services establish combined, rather than separate, maximum rates for child care centers and licensed family home providers. The combined maximum would be set at the 75th percentile of market rates for all licensed providers. The purpose of a "blended rate" proposal would be to eliminate the financial incentive to select the most expensive type of child care.

Other legislators have asked whether there are other ways to reduce maximum reimbursement rates. One possible method is to calculate a maximum rate based on a lower percentile than the 75th percentile of market rates. Alternatively, Minnesota could keep rates from rising by continuing the freeze on maximum rates.

The "blended rate" alternative has an advantage over other alternatives. It would substantially change the financial incentive of participants and cause them to consider the cost of child care across different types of care. However, there are significant feasibility and policy issues regarding the desirability of blended rates. First, it would be difficult to blend rates in a fair manner. In order to calculate a blended maximum rate for a particular age group, one would need to know what

¹⁶ These figures represent the average access to child care without payment of more than the required co-payment. However, they do not reflect the fact that there are differences within outstate Minnesota and the Twin Cities area. In addition, they do not consider access from an individual participant's perspective. A participant would be interested in whether there are affordable child care providers within reasonable driving distance from the participant's home or workplace.

rate represents the 75th percentile for both types of providers combined into one group. Because child care centers tend to have much larger licensed capacity than family home providers, a fair way to combine rates from both types of providers would be to weight each provider's rates by the provider's licensed capacity for that age group. Data are available on the capacity of child centers for each age group but are not available for licensed family home providers. Each licensed family home provider has an overall capacity but has flexibility to serve various age groups. Consequently, no information is available on the licensed capacity of family home providers by age group.

However, there are significant feasibility, policy, and legal issues regarding the use of "blended" maximum rates.

Second, it is unclear whether the use of blended rates would receive federal approval. The federal government requires subsidy programs to provide participants with equal access to various types of child care, including care at licensed child care centers. If rates were blended without regard to differences in licensed capacity, a blended rate approach would provide substantially unequal access in some counties. The problem would be of particular concern in Twin Cities metropolitan area counties because of the significant differences in market rates between centers and family home providers in those counties. Some outstate counties with large differences in rates, such as Olmsted County, would also be affected. In Ramsey County, blended maximum rates for preschool care would be equal or close to the current maximums for family home care and substantially less than the current maximums for child care centers. As a result, participants would be able to access fewer than 10 percent of the child care centers in Ramsey County without additional parental cost beyond a co-payment, while participants would be able to access about 75 percent or more of family home providers without additional cost.

Whether this difference in access would trigger federal rejection of a state's plan and cause a state to lose federal funding is not clear. Federal laws and rules require equal access but do not precisely define that concept. In addition, we are not aware of any cases in which a state has adopted a blended rate method and the United States Department of Health and Human Services has reviewed that method. As a result, we cannot provide any clear guidance on whether the blended rate proposal would be acceptable to the federal government.

Finally, it is difficult to predict what would happen to families currently using child care centers if a blended rate approach were adopted. Some families would most likely switch to lower cost providers. But others might leave the program if they cannot find alternative care or are unhappy with the options available to them. It is unclear whether their exit from the program would result in additional or longer enrollments in MFIP and greater costs to the state. Even if the adoption of a blended rate approach reduced the state's costs, some observers might question whether children taken out of care at a child care center would be receiving lower quality care. In addition, a significant increase in enrollment in licensed family home care could cause rates for that type of care to increase and reduce the potential savings to the state.

Other options for reducing or limiting the increase in maximum rates have been used in other states. The federal government has allowed some states to set maximum rates below the 75th percentile of market rates. In addition, the federal government has allowed some states to use out-of-date surveys to set maximum rates. These options, while potentially available to states, also raise some policy

issues. In particular, it is unclear how program participants would respond to lower maximum rates. The effects on workforce participation, future enrollments in MFIP, and school readiness of children are not entirely clear at this time.

A more direct way of addressing concerns about the cost of care used by participants would be to restructure the participant fee used in the Child Care Assistance Program. The methods for calculating maximum rates would not change, but the structure of participant fees would change to provide participants with a consistent financial disincentive to select higher-cost providers. In lieu of a fixed co-payment, participants would pay a percentage of the costs of child care. That percentage would apply to care provided at any rate, so that participants would have some disincentive to select care at higher costs. Under the current system, participants only face that disincentive if a provider's rate exceeds the state's maximum rate. To ease the burden on lower-income families, the percentage could vary depending on family income, although lowering the percentage would reduce the disincentive for participants to select care at higher rates. This option would not directly deal with the concern about participant use of child care centers by changing the maximum rate system. However, it would provide participants with an incentive to select less costly types of care, as well as less costly providers within each type of care.

While a percentage fee system may have some merit, it may not be allowable under current federal law. States are required to have a participant fee that is based on the income and size of the participating family.¹⁷ Federal rules allow the fee to be based on income and family size, as well as other "appropriate" factors.¹⁸ In adopting federal rules governing child care assistance programs in 1998, the Administration for Children and Families in the United States Department of Health and Human Services commented that basing fees on the cost or category of care would not be allowed.¹⁹ A percentage fee system would involve higher fees for higher-priced care and thus may not be allowable under federal law.²⁰

¹⁷ 42 U.S. Code, sec. 9858c. (c)(5), and 42 U.S. Code, sec. 9858n. (12).

¹⁸ 45 CFR sec. 98.42 (b).

¹⁹ 63 Fed. Reg. 39960 (1998).

²⁰ There may be other concerns about a percentage fee system even if it is permissible under federal law. For example, there may be concern that such a system would adversely affect the quality of care and the school readiness of children currently using child care centers. In addition, it is unclear whether a percentage fee system could be designed to provide sufficient incentives while also maintaining affordable fees for participants.