ACF	U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES	
Administration for Children and Families	**1. Log No:** CCDF-ACF-PI-2018-01	**2. Issuance Date:** February 26, 2018
	3. Originating Office: Office of Child Care (OCC)	
	4. Key Words: Child Care and Development Fund (CCDF), Alternative Methodology, Narrow Cost Analysis, Payment Rates	

PROGRAM INSTRUCTION

To: State and Territory Lead Agencies administering child care programs under the Child Care and Development Block Grant (CCDBG) Act of 2014 and other interested parties.

Subject: Guidance on alternative methodologies and cost analyses for purposes of establishing subsidy payment rates.

References: The CCDBG Act, as amended (42 U.S.C. § 9857 *et seq*.); Section 418 of the Social Security Act (42 U.S.C. § 618); 45 CFR Parts 98 and 99.

Purpose: This Program Instruction provides guidance to State and Territorial Child Care and Development Fund (CCDF) Lead Agencies on developing and conducting alternative methodologies and narrow cost analyses to establish subsidy payment rates.

Background: Section 658E(c)(4) of the Child Care and Development Block Grant (CCDBG) Act , 42 U.S.C. § 9858c(c)(4), requires Lead Agencies to certify that their payment rates are sufficient to ensure equal access for eligible children that are comparable to child care services provided to children whose parents are not eligible for CCDF. The Act also requires Lead Agencies to provide a summary of the facts used to determine that their payment rates are sufficient to ensure equal access.

The Act and the CCDF final rule allow Lead Agencies the option to base their payment rates on an alternative methodology instead of a market rate survey. The market rate survey or alternative methodology must be conducted no earlier than two years prior to the submission of the CCDF Plan. The requirements for market rate surveys and alternative methodologies are outlined in a previously issued Program Instruction (see CCDF-ACF-PI-2016-08)[1]**.** The Act and the final rule do not define an alternative methodology, but

[1] CCDF-ACF-PI-2016-08 Attachment: CCDBG Act and Final Rule Requirements for Market Rate Surveys & Alternative Methodologies .

indicate that a cost estimation model is one possible approach. While a market rate survey examines prices charged to parents, a cost estimation model or cost study examines the cost to the provider of delivering services. The prices that parents pay in many cases do not align with the full cost of delivering child care services, particularly high-quality services, and therefore cost information provides additional facts to inform the setting of payment rates.

In addition, all states are required to take cost into account when setting payment rates even if the state is conducting a market rate survey rather than an alternative methodology. States carrying out a market rate survey may conduct a cost analysis that is more narrowly focused to ensure that base payment rates are adequate to cover the cost of child care services and to consider the cost of higher quality.

This Program Instruction is informed by an OPRE research brief.[2]

Guidance: The guidance in this Program Instruction is designed to assist states in determining whether to conduct an alternative methodology.

Conducting an Alternative Methodology. Two types of alternative methodologies that Lead Agencies might use to inform their rate setting process include (i) a cost estimation model and (ii) a cost study/survey. A cost estimation model is an approach that incorporates both data and a set of assumptions to estimate expected costs that would be incurred by child care providers under different cost scenarios.[3] A cost study collects data, typically through a sample of providers, at the facility or program level to measure the costs of delivering services.[4] Either a cost estimation model or cost study should account for key factors that impact the cost of providing care—such as: staff salaries and benefits, training and professional development, curricula and supplies, group size and ratios, enrollment levels, facility size, and other costs. When setting payment rates, an alternative methodology allows Lead Agencies to consider the full cost of delivering child care services, including variations in cost (i.e., geographic location, category of provider, age of children or levels of quality).

Advance ACF Approval of Alternative Methodology. The final rule at 45 CFR 98.45(c)(2) requires alternative methodologies to be approved in advance by ACF. Advance ACF approval is only necessary if the Lead Agency plans to replace the market rate survey with an alternative methodology, and is not

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[2] OPRE Report 2017-115 Market Rate Surveys and Alternative Methods of Data Collection and Analysis to Inform Subsidy Payment Rates (https://www.acf.hhs.gov/sites/default/files/opre/cceepra_methods_for_informing_subsidy_rates_508_compliant_v2b.pdf).

[3] STAM 2016 Presentation on Alternative Methodologies and Market Rate Surveys (http://www.occ-cmc.org/stam2016/resources.aspx).

[4] STAM 2016 Presentation on Alternative Methodologies and Market Rate Surveys (http://www.occ-cmc.org/stam2016/resources.aspx).

required if the Lead Agency plans to implement both a market rate survey and an alternative methodology. Lead Agencies must submit requests for ACF approval via letter to the OCC Regional Office well in advance of the deadline for submitting the CCDF Plan (*i.e.*, July 1, 2018 for the FY2019-2021 CCDF Plan). The Lead Agency should ensure that there is sufficient time after receiving ACF approval to complete the alternative methodology, develop and publish a detailed report (in accordance with 45 CFR 98.45(f)(1)), and set the payment rates. ACF will review and respond to requests for pre-approval of alternative methodologies within 60 days of submittal. The FFY 2019-2021 CCDF Plan Preprint will describe the items that must be included in a request. Pending finalization of the Preprint, Lead Agencies may submit a request, and have flexibility regarding the format and content. Lead Agencies must demonstrate that they have a rigorous approach and the capacity to gather valid and reliable data.

As one potential option, Lead Agencies may use the Provider Cost of Quality Calculator (PCQC) to develop alternative methodologies to inform rate setting. PCQC is accessible at www.ecequalitycalculator.com, and is funded by the Office of Child Care through the technical assistance network. PCQC is a publicly available web-based tool that calculates the cost of quality-based on site-level provider data for any jurisdiction. The PCQC tool allows users to model the costs associated with delivering high-quality child care services at varying levels of quality.

Narrow Cost Analysis. Regardless of whether Lead Agencies conduct a market rate survey or an alternative methodology, they are required to analyze the estimated cost of care (including any relevant variation by geographic location, category of provider, or age of child), in two areas:

- The cost of child care providers' implementation of health safety, quality, and staffing requirements (*i.e.*, applicable licensing and regulatory requirements, health and safety standards, training and professional development standards, and appropriate child to staff ratio, group size limits, and caregiver qualification requirements as required in 45 CFR 98.45(b)(3), (f)(1)(ii)(A), and (f)(2)(ii).
- The cost of higher-quality care, as defined by the Lead Agency using a quality rating and improvement system or other system of quality indicators, at each level of quality as required in 45 CFR 98.45(b)(4), (f)(1)(ii)(B), and (f)(2)(iii)).

While all states are required to analyze costs in these two areas, ACF recognizes that states conducting a market rate survey (rather than an alternative methodology) will focus their analytical efforts primarily on examining prices rather than costs. As noted in the preamble to the final rule (81 FR 67513), these states may conduct a cost analysis that is narrowly focused rather than a full alternative methodology (*e.g.*, cost estimation model) that looks more broadly at cost. Such an analysis is referred to as a "narrow cost analysis."

Lead Agencies have significant flexibility in determining the approach and methodology for the narrow cost analysis, and they may use existing information and data to limit burden. Advance ACF approval is not required for the narrow cost analysis. The purpose of the analysis is to provide additional information for states to consider when setting payment rates, but states should determine how much weight to assign these results in the rate-setting process depending on the rigor of the analysis and whether results are generalizable across provider types and geographic locations. Lead Agencies may consider the methodologies listed in the **Attachment** to satisfy at least a portion of the narrow cost analysis. The methodologies listed in the **Attachment** are meant to be illustrative rather than exhaustive.

Conclusion: Lead Agencies must use the information from their most recent market rate survey or alternative methodology for rate setting. While the 75th percentile[5] is a benchmark for where to set rates based on the price of care as collected via the market rate survey, there is currently no Federal benchmark for where to set rates based on costs to provide care. While we do not expect Lead Agencies in all cases to immediately set rates to cover the full cost to provide care, we expect Lead Agencies to use information from their cost analyses– the narrow cost analysis or the alternative methodology if used – to evaluate the gap between costs and payment rates as part of their strategic, long-term approach to setting rates that support equal access. Using cost information to narrow the difference between the cost of delivering services and the payment rates can help reduce the barrier to families for finding care by maintaining an adequate supply of providers who can afford to participate in the subsidy program.

Questions: Inquiries should be directed to the appropriate ACF Regional Office.

/s/

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cc: Office of Child Care Regional Program Managers

[5] As described in the preamble to the final rule (81 FR 67512), the 75th percentile is a proxy for equal access. The 75th percentile benchmark is the number separating the 75 percent of lowest rates from the 25 percent that are highest. Setting rates at the 75th percentile demonstrates that CCDF families have access to at least three out of every four available child care slots or programs.