



Nonprofit
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Overcoming Financial Barriers to Expanding High-Quality Early Care & Education in Southeastern Pennsylvania

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Disclaimer: The opinions expressed in this report are those of the authors and do not necessarily reflect the views of the William Penn Foundation.

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Executive Summary

This report sheds light on the financial, business and systemic realities affecting the supply of high-quality programs. How can the field address how the ECE system is currently capitalized (and under-capitalized)?

High-quality early care and education (ECE) programs have been proven to create positive learning outcomes among children—especially among those living in poverty. Yet many low-income children have a hard time accessing quality child care settings and miss the critical developmental growth and foundation needed for academic and life success. According to Pennsylvania Partnerships for Children, only 23% of children who receive public child care subsidies attend a “high-quality” ECE program, as defined by the Commonwealth of Pennsylvania as quality designation “STAR 3” and “STAR 4.”

In 2013, NFF embarked on a multi-pronged study of 147 ECE providers to assess the financial challenges of operating high-quality ECE programs. In this report, NFF highlights the key financial, business, and systemic barriers to delivering high-quality programs—with a focus on nonprofit ECE programs serving the Philadelphia Region’s most vulnerable children.

Key Findings

ECE programs operate very close to the financial edge with little margin for error. Regardless of the quality of care and who is being served, providers operated very close to the break-even point (post-depreciation margin of 1%) and had limited cash reserves to weather the volatility of the ECE business model (year-end cash balances could cover only one month’s worth of operating expenses).

For many ECE operators, the decision to provide high-quality programs creates more financial and programmatic demands, without the promise of commensurate increases in financial revenue. ECE providers participating in Pennsylvania’s Quality Rating and Improvement System (“Keystone STARS”) achieved comparable financial metrics to those that did not participate. This finding highlights the absence of financial incentives for providers to pursue quality: There are few barriers to operating a child care business that meets minimal standards for health and safety and provides little educational content. In comparison, there are relatively significant barriers to operating a high-quality program that results in positive life outcomes for young children (e.g. greater costs for more credentialed, experienced teachers and substantial programmatic requirements and administrative compliance burdens associated with maintaining STARS designations).

There is little understanding of what the “full costs” are for providing high-quality care. NFF estimated an average cost of care of \$11,832 per child per year—with the cost per child substantially greater for high-quality providers (\$12,789 for STAR 3 and STAR 4 as compared to \$10,320 for STAR 1 and STAR 2). When factoring in essential costs beyond this “bare minimum” (such as investments in facilities, payments of debts, and contributions to reserves), these cost of care figures can increase substantially.

Existing ECE revenue sources do not allow high-quality programs (particularly those serving low-income children) to cover the relatively high fixed costs of care. Most sources of ECE revenue, including government subsidies for low-income children, are attached to a specific child (i.e., portable) and are variable depending on a provider’s changing enrollment and adherence to compliance requirements. Little funding is available directly for ECE providers (i.e., institutional). Without sufficient institutional funding, high-quality ECE programs struggle to cover the relatively high fixed costs of care.

Available child care subsidies in Pennsylvania fall far short of covering the full cost of care. This gap increases as quality of care goes up. The primary public revenue source for low-income children (Child Care Information Services, or CCIS) does not cover a provider’s minimum cost of care per child and leaves a revenue gap of at least 23% for high-quality providers and 15% for lower-quality providers.

Combining different types of funding to serve low-income children results in overly complex financial management practices. Some providers maximize revenue opportunities by “braiding” multiple revenue sources with child care subsidies. However, this strategy produces high financial management burdens and is unavailable for providers who serve low-income children who do not qualify for multiple subsidies.

Strict eligibility rules for child care subsidy result in disruptions in the continuity of care for low-income children, as well the continuity of revenue for the providers who serve them. There is a misalignment between the educational goals expected from high-quality programs and the limitations of the child care reimbursement model.

Further research is needed to understand how parents select a child care provider. High-quality providers described difficulty in competing with lower-quality providers, which were often more affordable for poor working parents. In addition to cost, other key factors include convenience, socio-economic alignment with a provider, and parental awareness about quality ECE. Without understanding the motivations driving parent choices, some providers shared concern that expanding the supply of high-quality ECE will result in unused slots.

Recommendations

Within the context of these challenges, NFF advises key recommendations for the primary decisionmakers that influence ECE delivery to Pennsylvania children: policymakers, funders, and ECE providers.

Policymakers

There is a need to address the systemic mismatch between how capital currently flows into the ECE sector and the transformative educational outcomes that are expected from these dollars. We advise policymakers to explore the following approaches:

- Bring current subsidy reimbursements to a level that better aligns with the actual cost of care and rate of inflation
- Reinforce subsidy eligibility policies that minimize disruptions to a child's continuity of care
- Complement portable funding to the sector with more direct institutional funding options
- Align funding agencies around a shared set of goals that prioritizes educational outcomes
- Explore incentives that more directly encourage and support parents to select high-quality care

Funders

Given the priority of many states (including Pennsylvania) to expand high-quality ECE access for low-income children, it is essential that philanthropic funding streams help providers achieve and maintain high-quality standards and prepare providers for the major organizational change associated with growth or quality improvement. We recommend that funders focus on the following strategies:

- Provide the right kinds of capital to high-quality ECE programs serving low-income children (flexible general operating support and change capital for growing and changing programs that will incur deficits until the new financial model stabilizes)
- Help programs pursue growth wisely, prepare for the financial obstacles associated with growth, and plan/build the necessary reserves
- Assess the drivers of parental demand for high-quality programs in order to best inform the most appropriate intervention for increasing demand (e.g., restructuring incentives for subsidies)

Providers

Given the public's growing interest in high-quality ECE expansion, it is important now more than ever before for providers to employ sound financial planning and data-driven decision-making practices. We advise providers to consider the following practices:

- Strengthen understanding of the core underlying economics of programs and the full cost of doing business so that providers can make well-informed decisions, adapt to changing financial dynamics, and clearly articulate their financial needs to funders, policymakers and other stakeholders
- Continue to seek opportunities for creative cost efficiencies, collaboration, and mentorship
- Proceed with growth activities with extreme caution and clarify the financial support that will be needed to address operating deficits that will occur en route to growth

Paradigm Shift Needed

Despite the existing financial and systemic obstacles, ECE providers continue the Herculean feat of delivering quality care to young children in Pennsylvania and across the country. This report begins to raise questions about how the current ECE system is capitalized (and under-capitalized) and sheds light on the inadequacies of the status quo to support the positive child outcomes expected from high-quality programs. Given the growing interest in expanding high-quality ECE across the country, a paradigm shift is needed now more than ever before to challenge the underlying ideologies and assumptions about ECE which directly influence the way in which the overarching system is funded and financed.

It is our hope that in articulating these issues here that a data-driven and comprehensive dialogue between policymakers, funders, providers, and parents can occur to advance the ECE sector and enable more children to successfully access excellent care during the critical first 2,000 days of life.

The First 2,000 Days: Infancy to Age 5

The quality of care a child receives in the first five years of life are a critical predictor for life-long success. Unfortunately, not all children have access to high-quality care. What are the barriers to access, and how can we solve them?

A child's path to either success or hardship is well-established within the first 2,000 days of life. It is within this critical window between infancy and age 5 that 90% of brain development and the formation of the brain's essential infrastructure occur—setting the pathways for learning for a lifetime.¹ During this narrow window of opportunity, a child's day-to-day experiences and surroundings—whether positive or negative—have a direct, powerful effect on the structural and functional development of the brain, including intelligence and personality.

While parents are a child's first and most important teachers, out-of-home child care programs provide early care and education (ECE) for millions of young children in the U.S. every day and profoundly influence their development and readiness for school. Every week, nearly 11 million children in the U.S. under age 5 attend some type of child care setting during their parents' work hours.² This care can vary widely from care by relatives, individuals who care for children in their private homes (described as "family care"), and centers (such as preschool and early education programs).

We also know that of the 20 million children under age 5 living in the U.S., over 4 million live in poverty.³ Research tells us that many of these children miss the developmental growth that is the critical foundation for success throughout life, tend to have less access to high-quality settings between infancy to age 5, and are at much greater risk for academic failure.^{4,5} High-quality ECE programs can be very effective in creating positive learning outcomes among children—and

"at risk" children living in low-income communities in particular stand to benefit significantly.⁶ Yet they are least likely to actually access high-quality child care.⁷ The number of high-quality "seats" available to a community are often far outnumbered by the total number of children needing care. For example, a total of 1,890 state-certified ECE programs operate across the city of Philadelphia, yet only 177 of these programs are of "high quality" (as defined by Keystone STARS, Pennsylvania's voluntary quality rating system).⁸ In total, high-quality programs provide 15,000 seats. This number pales in comparison to the 100,000 Philadelphia children under the age of 5.⁹ Lastly, there is an economic argument for high-quality ECE. An analysis by the Pittsburgh Public Schools found that early childhood education eliminated the need for special education services in kindergarten for 42% of children (reflecting a cost savings of \$570,000).^{10,11}

Through a ten-year initiative, Nonprofit Finance Fund (NFF) has had the opportunity to work with over 250 nonprofit child care centers in the five-county region of Southeastern Pennsylvania encompassing Bucks, Chester, Delaware, Montgomery and Philadelphia counties.¹² Over that time and through a project funded by The William Penn Foundation, we have learned that a variety of financial models and systemic barriers stand in the way of providing high-quality care—especially for vulnerable children who need it the most. In this report, we share the key findings of this work and demystify the primary barriers—with the goal of providing funders and policymakers with tools to close the achievement gap that begins in infancy.

Methodology

To complement its 10-year history of working with nonprofit ECE centers, NFF conducted a financial analysis and qualitative inquiry about the financial model and systemic challenges associated with quality early learning and education programs. Our approach included:

- Financial analysis of audited financial data (varying time spans between 1999-2012) for 147 nonprofit child care centers, and most recently, publicly available tax information for 93 nonprofit child care centers*

- Keystone STAR ratings for the cohort's providers between 2002-2013
- Low-to-moderate income data self-reported by the cohort providers (LMI%)
- Qualitative interviews of 20 Philadelphia child care operators and 10 leaders from the ECE community
- Literature review of sector research and studies
- Roundtable discussions convening 17 local child care operators and industry leaders.

*Note: Financial data was based on the population of nonprofit child care centers served by NFF's previous Child Care Initiative, which provided capital, financial capacity-building and technical assistance to eligible nonprofit child care centers seeking to improve the quality of their programs and facilities. It is important to note that this initiative was intended to help centers achieve and maintain state certification, municipal requirements, and quality standards (Keystone STARS, NAEYC, NAA, etc.), expand program capacity, and/or address necessary maintenance. As such, financial analysis was based on a population of centers that was predisposed to quality improvements and met NFF's financial due diligence criteria.¹³

Understanding High-Quality Care

Studies show that high-quality education is the most effective intervention strategy to improve long-term outcomes for low-income children. But what is quality, and what does it look like?

Quality Rating Improvement System (QRIS): rating and assessment system to evaluate early childhood education programs for children ages five and under, provide incentives and support to improve quality, and communicate level of quality to the public by attaching a rating to the program.¹⁴

In many states throughout the U.S., a child care program can be licensed to operate but only meet minimal standards for children’s health and safety without any meaningful educational content. In an effort to promote high-quality child care, Pennsylvania has established a voluntary Quality Rating Improvement System (QRIS) that offers financial support and other resources to help providers achieve higher standards in child care through improvements in educational content, staff accreditation, and administrative practices.

The characteristics of high-quality care have been widely studied by the field and defined as care that is “consistent, developmentally sound, and emotionally supportive” and goes well beyond minimum health and safety standards that are regulated by states.¹⁵ High-quality programs provide features that set the stage for higher quality adult-child interactions—a key predictor of children’s learning.¹⁶ These include:

- Smaller group sizes and fewer children per teacher to not only keep children safe but allow for more frequent and meaningful interactions between teachers and children.
- Higher credentialed teachers with the training, experience and capacity to understand and assess the developmental changes of young children and how to best support their learning.

Keystone STARS is Pennsylvania’s voluntary quality rating system, managed by the State Office of Child Development and Early Learning (OCDEL). Keystone STARS’ goals are “to improve, support, and recognize the continuous quality improvement efforts of early learning programs in Pennsylvania [...] and to offer incentives and

resources to help programs reach higher standards in areas such as staff credentials, curriculum, and management practices.” Providers earn STAR ratings from 1 to 4 (with 4 being highest) based on a number of factors including: small group size and low teacher-to-child ratios; developmentally and age-appropriate curricula; adequate teacher training and credentialing; parent-teacher communications; and safety of environment.

Pennsylvania defines high-quality programs as those with STAR 3 or STAR 4 ratings, that utilize evidence-based curricula and emphasize the development of children’s cognitive, social, emotional and physical skills. Such programs employ Bachelors’ or Masters’ level teachers trained in early childhood education (or related fields), conduct developmental screening, regularly communicate with parents, and emphasize kindergarten-readiness. As one provider describes: “Moving from STAR 2 to STAR 3 is when a provider moves from child care to education: you use a curriculum and credentialed teachers, you track your children [through] observation and assessment, and you report on outcomes.”¹⁷

Over the past decade, Pennsylvania has made substantial progress toward meeting quality standards: participation in Keystone STARS program has increased since its inception in 2003, the state’s financial incentives for pursuing quality are among the most generous in the country for a QRIS, and today more than 27,000 Philadelphia children are enrolled in STARS programs. Despite this progress, however, most participating programs are clustered below STAR 3.¹⁸

The Landscape of Providers in Pennsylvania¹⁹

Figure 1. This table reflects the number of state-certified child care providers operating in Southeastern Pennsylvania and throughout the state of Pennsylvania. Figures include all provider types: Centers (providing out-of-home care to 7 or more children aged 13 or under who are unrelated to the operator), Group providers (providing care for 7 – 12 children who are unrelated to the operator), and Family providers (operator providing care in their home for 4 – 6 children who are unrelated to the provider).

	non-STARS	STAR 1	STAR 2	STAR 3	STAR 4	Total
Bucks County	125	58	46	35	32	296
Chester County	133	59	44	11	30	277
Delaware County	233	55	25	23	33	369
Montgomery County	201	58	76	67	49	451
Philadelphia	1,134	360	219	105	72	1,890
Southeastern PA	1,826	590	410	241	216	3,283
Pennsylvania State Total	4,291	1,468	1,151	580	616	8,106

Financial Barriers to Achieving High-Quality ECE

Our research suggests that most child care providers want to offer high-quality ECE. Nonetheless, the majority of providers participating in Pennsylvania's QRIS are clustered below STAR 3. Why are more providers not achieving higher levels of quality?

■ ECE Finance: Walking a Tightrope With Little Safety Net

ECE programs universally have a difficult time covering their expenses from year to year, and many have little cash reserves or "safety net" available to withstand volatility.

This problem exists whether programs are higher quality or low, and whether they are serving children who are subsidized by the government or children whose parents pay full tuition. For any mission-driven organization (whether for-profit or nonprofit), the absence of surpluses to build up cash reserves forces the organization to live paycheck-to-paycheck and make decisions that are more short-term and reactive in nature. For ECE providers, the quality of programs delivered to children can be compromised.

NFF's financial analysis of 147 providers of ECE indicated that providers operated very close to the break-even point (post-

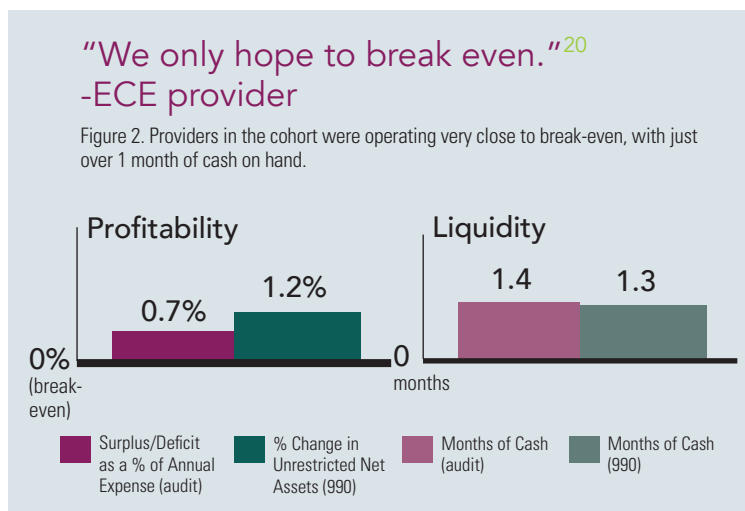
depreciation margin of 1% based on the median values for IRS Form 990 data; see figure 2). In addition, the median cash reserve size was equal to only 5 weeks of operating expenses—indicating

that, at any given time, providers had only enough cash in the bank to pay for about one month's worth of bills. Months of cash is one measure of liquidity, a key indicator for an organization's ability to survive and thrive.

Dynamics of the ECE financial model

Why do most ECE providers, regardless of their quality or who they serve, struggle to cover full costs? The

difficulty in generating operating surpluses and cash reserves is rooted in the dynamics of the ECE financial model. NFF defines financial model in simple terms as "how an organization makes and spends its money in service of its mission." It is composed



About the Graphs in This Report

In this and the following graphs, we show data sets across the following dimensions:

Audited Financial Data: This represents median values of audited data from all 147 providers in the cohort. Available data was for non-consecutive years, based on when a provider participated in NFF's Child Care Initiative (1999-2012). Median values across years were also calculated. This data is shown because the detailed and uniform reporting allows for analysis of annual activities (e.g. surplus/deficit). The limitations of this data pertain to the lack of uniformity in timeframes from one provider to another.

990 Data: This represents median values of tax filings from 93 providers, a subset of the total cohort. Available data was for consecutive years (2008-2012). Median values across years were also calculated. This dimension of data is shown to give us a more consistent timeframe over which to analyze data.

Profitability: Also called operating margins or surplus, profitability indicates the extent to which providers can cover annual operating costs. Margins need to be large enough to cover year-over-year budgets, facility/equipment needs, and debt principal payments. For nonprofits with volatile financial models, which include most ECE providers, margins should also be large enough to contribute to savings, working capital, cash flow, and/or reserves to help navigate unexpected changes in operations.

- **Surplus/Deficit as a % of Total Expenses** indicates the operating margin relative to the provider's overall budget size and is calculated by dividing the surplus or deficit (after depreciation) by total operating expenses for the same fiscal year. This metric is calculated as part of our analysis of audited financial statements.
- **Change in Unrestricted Net Assets (URNA) as a % of Total Expenses** is an analogous measure of profitability using IRS Form 990 data. This metric reflects the change in unrestricted net assets on the balance sheet.

Liquidity: This indicates to what extent providers are able to meet current expenses and obligations on existing cash levels. Distinct from year-over-year performance, liquidity illuminates how well capitalized an organization is. Is enough cash on hand to cover operating needs? And is the available cash restricted or 'spoken for'?

- **Months of Cash** indicates the number of months that a provider could operate on existing cash and is calculated by dividing the year-end cash balance by average monthly operating expenses.

The majority of providers had a substantial amount of fixed assets, such as buildings or equipment. Therefore, all graphs represent post-depreciation data, to reflect the annual wear and tear of facilities and equipment.

of revenue composition and expense composition.

To assess a nonprofit's overall financial health, NFF examines the predictability and reliability of revenue and the constancy (fixity) and flexibility of expenses. ECE operators manage the fundamental tension between balancing the relatively fixed cost of operations (with the majority of expenses related to skilled classroom teachers and facility needs) with revenues that vary depending on whether every enrollment slot is filled throughout the year and tuition is appropriately priced and collected from families and/or the government on time.

The operating challenges of the ECE model have been widely researched for the last several decades. Leading experts Louise Stoney and Anne Mitchell, co-founders of the Alliance for Early Childhood Finance, have emphasized in their 25 years of research that there is no room for error in the ECE financial model: every dollar of revenue is needed to maintain the delivery of services to children. According to Stoney and Mitchell, an ECE program can only reach sustainability when it achieves a perfect trifecta of these following components:²¹

Achieving Full Enrollment

Maximizing the revenue potential of each available enrollment slot is first priority for ECE providers. Funding is linked to the enrollment of each specific child—whether this revenue is from private-pay tuition paid by parents or subsidized funding paid by the government. While the number of students—and therefore, revenue—in a classroom may rise or fall, the biggest costs (such as teachers and space) are largely fixed. In order to fully cover costs, an ECE provider must achieve the virtually impossible ideal of at least 95% enrollment at all times.²² They must achieve this without over-enrolling, which would risk violating student-to-teacher ratio requirements.

Covering 100% of Costs with Tuition Fees

Due to competition among providers and price sensitivity of private pay families, ECE providers often cannot set tuition rates high enough to cover the full cost of care. For providers serving low-income families, government subsidies cover only a portion of a child's true cost of care.

Collecting 100% of Tuition Fees

The majority of revenue comes in the form of tuition attached to a particular child—either paid by families or, in the case of low-income children, government subsidy. Subsidy payments are often contingent on rigorous compliance and paperwork. For private pay tuition, providers must stay on top of billing and collections.

Little Financial Reward for Quality for Most Providers

For many ECE operators, the decision to pursue or provide high-quality programs creates more financial and programmatic demands, without the promise of commensurate increases in financial revenue.

Costs of Providing High-Quality Care for Every Child

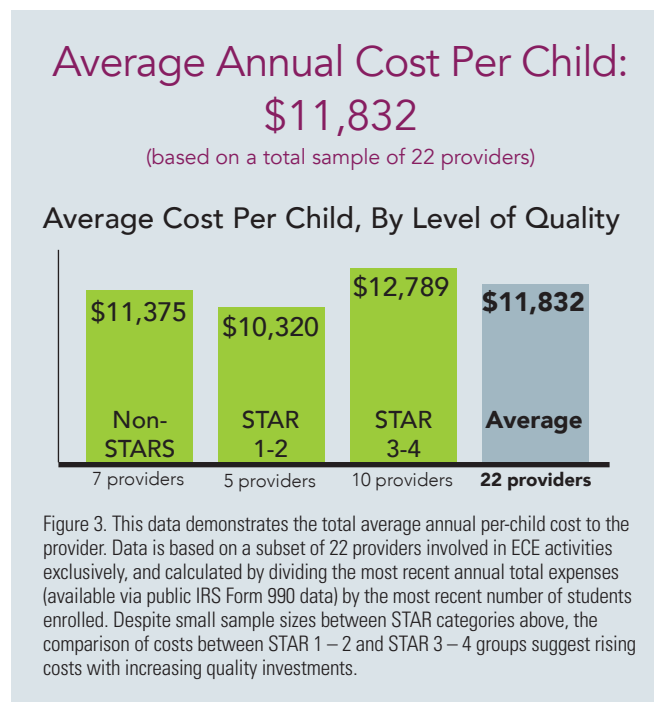
Currently, there is very little understanding of what the full costs are for providing high-quality care. In order to capture a high-level view, we looked at a subset of providers (22) that were ECE specialists who provided only ECE services and no others. We chose this subset because the costs incurred by these organizations could be assumed to be dedicated exclusively to the provision of ECE services for children.

Based on enrollment figures and operating expenses among this subset, the average cost of care is estimated at \$11,832 per child per year (see Figure 3.) When factoring in essential costs outside of the operating budget (such as investments in facilities, payment of debts, and contributions to reserves), NFF estimates that the full cost of care per child rises to \$13,400. The cost per child rises significantly as quality level increases—particularly between STAR 2 to STAR 4.

While it may seem obvious that high-quality programs cost more than low-quality programs, many providers expressed frustration that the financial impact of delivering high-quality remains largely misunderstood. Participants described the multitude of additional costs associated with higher quality programs—with the majority stemming from salary increases for more credentialed teachers, facility and environmental requirements, and the administrative and compliance activities associated with maintaining STARS designation. “The primary factor is teacher quality and certification,” shares one provider. “If you’re paying your teacher \$8/hour, that’s the quality you will get. If you pay \$16 - \$17 per hour, which is still not a lot,

you can achieve greater quality care in your program but it costs a provider a lot more money. That’s why so many centers do not pursue quality care, because they cannot afford quality teachers.”²³

Despite the costliness of employing credentialed teachers, it is worth noting the low compensation levels universal to the ECE industry: ECE staff who hold a four-year degree and work in a child care setting earn on average \$24,000 a year, roughly half the salary of their public school counterparts. Only 25% of child care staff receives employer-funded health insurance and fewer still have retirement benefits.²⁴



Providers maintaining the highest level of quality also suffer from more growth in expenses over time. NFF’s analysis showed that providers committed to the highest level of quality (STAR 4) experienced the highest annual growth rate of expenses (3.7%) while non-STARS programs experienced lower expense growth (1.7%).

On top of the requirements for achieving high-quality status, maintaining any STARS status at all can be difficult. Some participants noted that the difficulties of maintaining the costs of higher standards are disincentives for continuing with the program. For example, one provider described her

experience of losing her STAR 2 designation when the program was unable to afford the costs of a “floater” teacher to help cover staff absences due to sickness and adhere to teacher-to-child ratios.²⁵ “The problem is not the cost to get into the STARS system; it’s the cost to stay there.”²⁶

Despite these challenges, many providers still make the commitment to high-quality. In many cases, the motivation is deeply personal and mission-driven. “We do quality because it’s the right thing for the kids,” says one participant.²⁷ Unfortunately, the commitment to quality comes with financial risk.

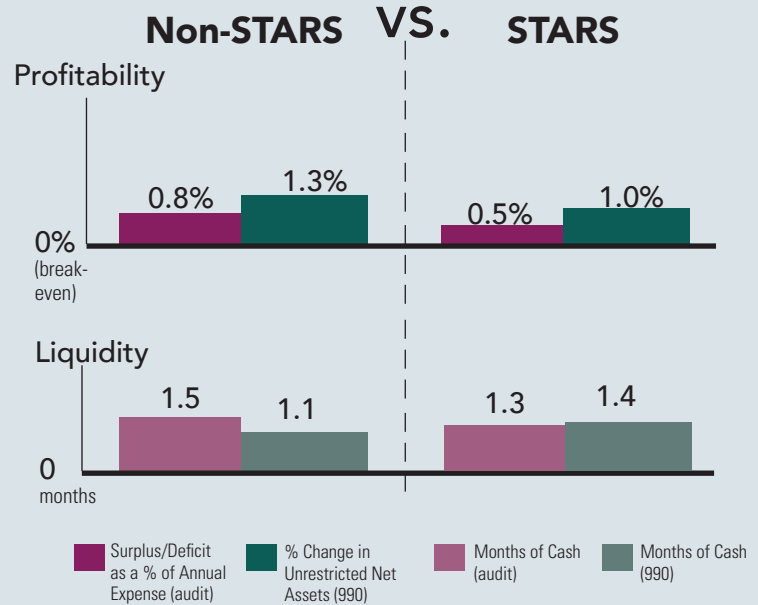
Financial Improvement is Not Correlated to Quality

In our first layer of analysis of the 147 providers in the cohort, NFF compared providers participating in the Keystone STARS program to those that were not participating. We asked: are there financial incentives or benefits to joining Pennsylvania's QRIS? Although no data exist to identify the level of quality for non-STARS providers, participating in the STARS system signifies an organization's commitment to high levels of quality. Our analysis revealed little difference between providers who participate in STARS versus providers who do not participate in STARS in two key financial metrics (profitability and liquidity) (see Figure 4).²⁸

In our second level of analysis, we asked if providers of higher levels of quality reported better financial health. The total sample of 147 suggests that there are no clear financial improvements for centers that aim to achieve higher levels of quality (See Figure 5.) In analyzing median indicators of the total cohort, providers who make the decision to deliver higher quality care (as defined by STAR 3 and STAR 4 levels) are not necessarily in better financial positions relative to their peers. Profitability and liquidity were mixed across levels of quality, and in some cases, profitability declined as quality increased.

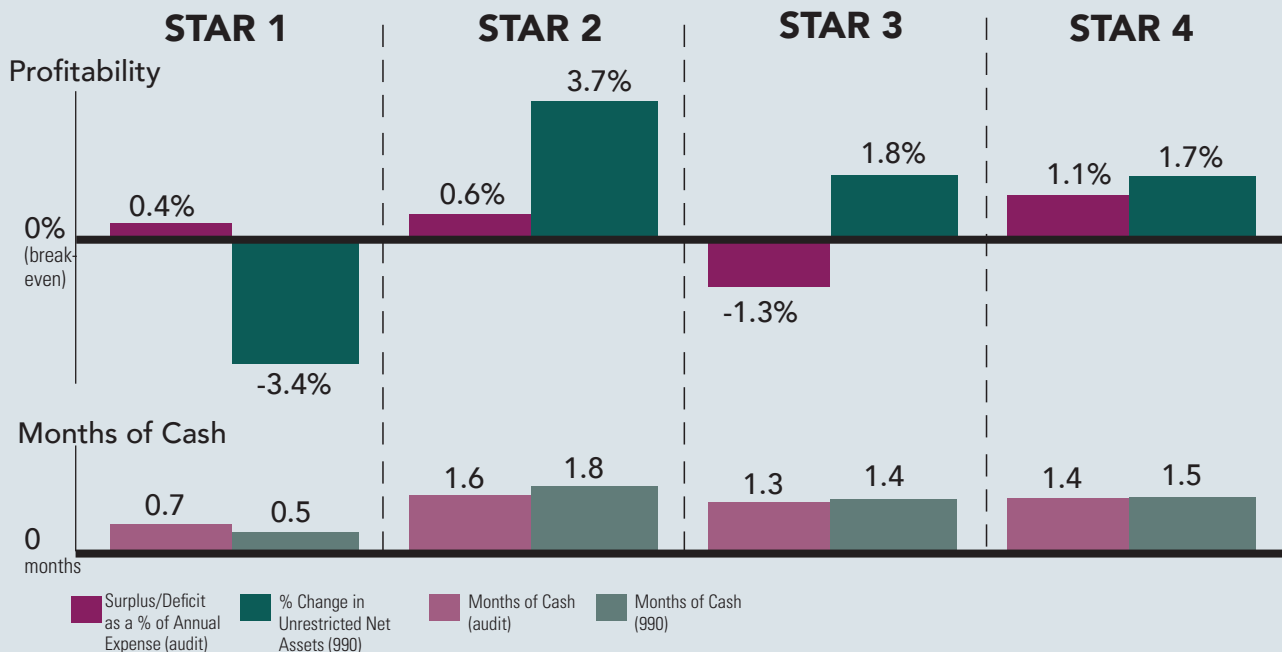
Non-STARS Providers vs. Providers in STARS

Figure 4. The median, post-depreciation surplus for both Non-STARS Providers and STARS Groups was equal to approximately 1.0% of total expenses, while cash reserve levels were equal to only 1.1 to 1.5 months of operations—both of which are comparable to median values for the total cohort. The majority (56% or 82) of NFF's sample of 147 providers participate in some level of STARS.



Providers By Level of Quality

Figure 5. In analyzing the total cohort, providers who make the decision to deliver higher quality care (as defined by STAR 3 and STAR 4 levels) are not necessarily in better financial positions relative to their peers—as indicated in the mixed, if not declining, profitability metrics and comparable cash reserves below (on average 1.5 months of operating expenses for providers at STAR 2, 3 and 4 levels).



Organizations Specializing in ECE

The cohort of 147 providers delivered ECE services in a variety of ways and through a variety of operating models. They included multi-service agencies, religious entities, and organizations exclusively dedicated to ECE activities (described here as “ECE specialists”). In our third level of analysis, we asked if ECE specialists showed stronger correlations between financial health and quality level. The vast majority of NFF’s sample was comprised of organizations delivering services beyond ECE. Comparing the overall cohort (which includes multi-service agencies) to providers specializing in a single service helps us better understand the impact of ECE business activities on financial health.

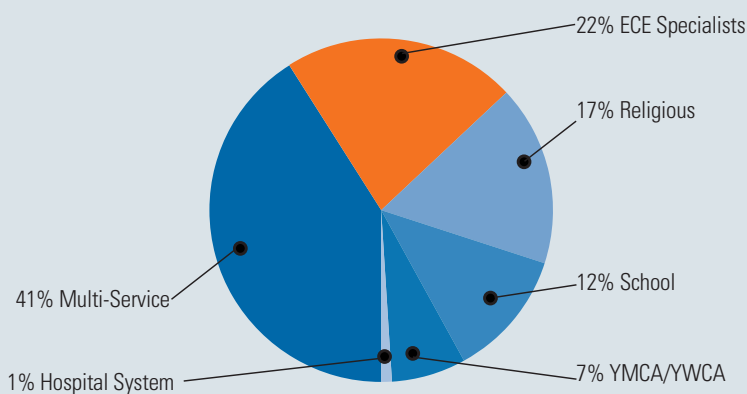
Our analysis showed that ECE specialists appeared to demonstrate modestly better operating margins, as compared to the overall cohort, while pursuing quality. However, the findings were less conclusive about the relationship between liquidity and quality; there was not a significant difference between the two groups.

We further examined whether there was a correlation between financial health and quality level specifically for ECE specialists. Although STARS specialists fared better than non-STARS specialists in both profitability and liquidity (see figure 8), those

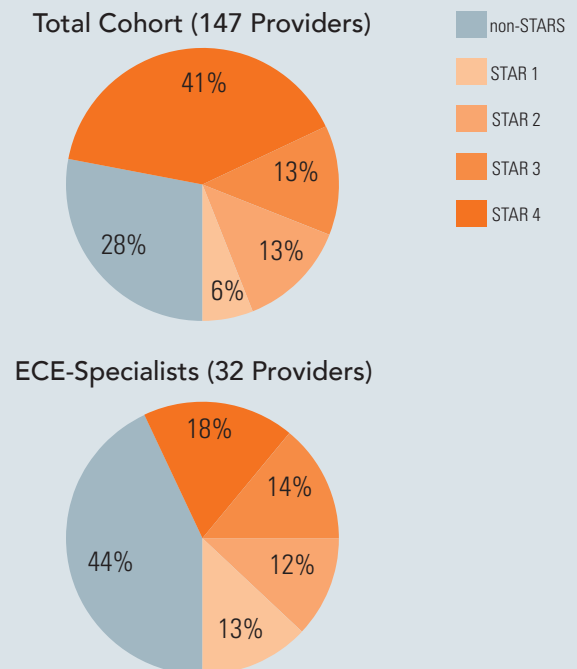
at the lower-quality ratings STAR 1 and STAR 2 demonstrated the highest margins (see figure 9) while those at the higher ratings at STAR 3 and STAR 4 showed better liquidity. Despite improved liquidity at the higher quality levels, the median value for the specialists group remained minimal at 1.7 months of cash—which is arguably an insufficient amount of cash reserves to remain adaptable in the volatile ECE market.

Despite the modestly stronger operating margins of ECE specialists, there is not a consistent connection between quality and financial health. Regardless of program model (whether solely ECE, multi-service, or other), our analysis raises questions about whether there are clear business and financial incentives for providers to pursue higher designations of STAR 3 and STAR 4. While outside of the scope of this project, it would be valuable to further investigate the factors driving this mixed story and analyze the financial cost vs. revenue associated with increasing STAR ratings.

Breakdown of ECE Providers by Type (Figure 6)



Total Cohort vs. ECE-Specialists (Figure 7)

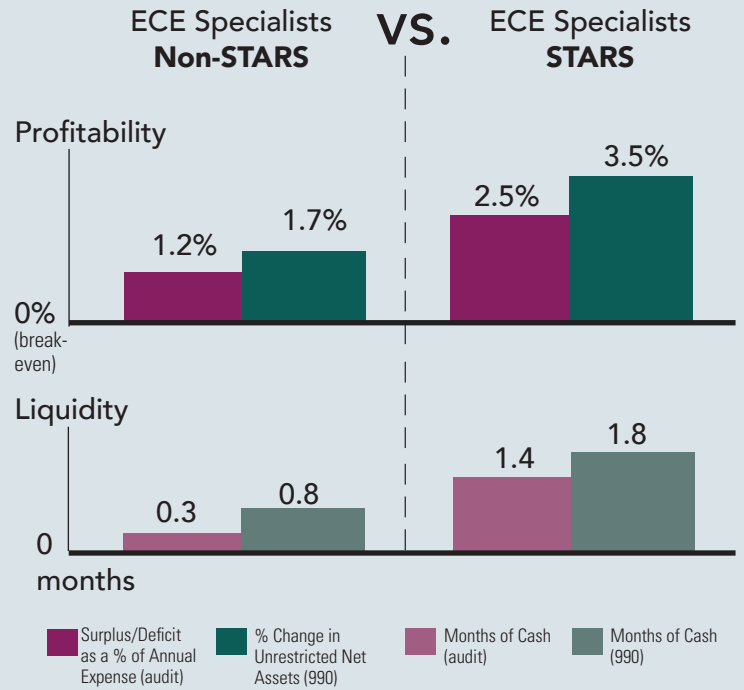


Organizations Specializing in ECE

Non-STARs ECE Specialists vs. ECE Specialists in STARs

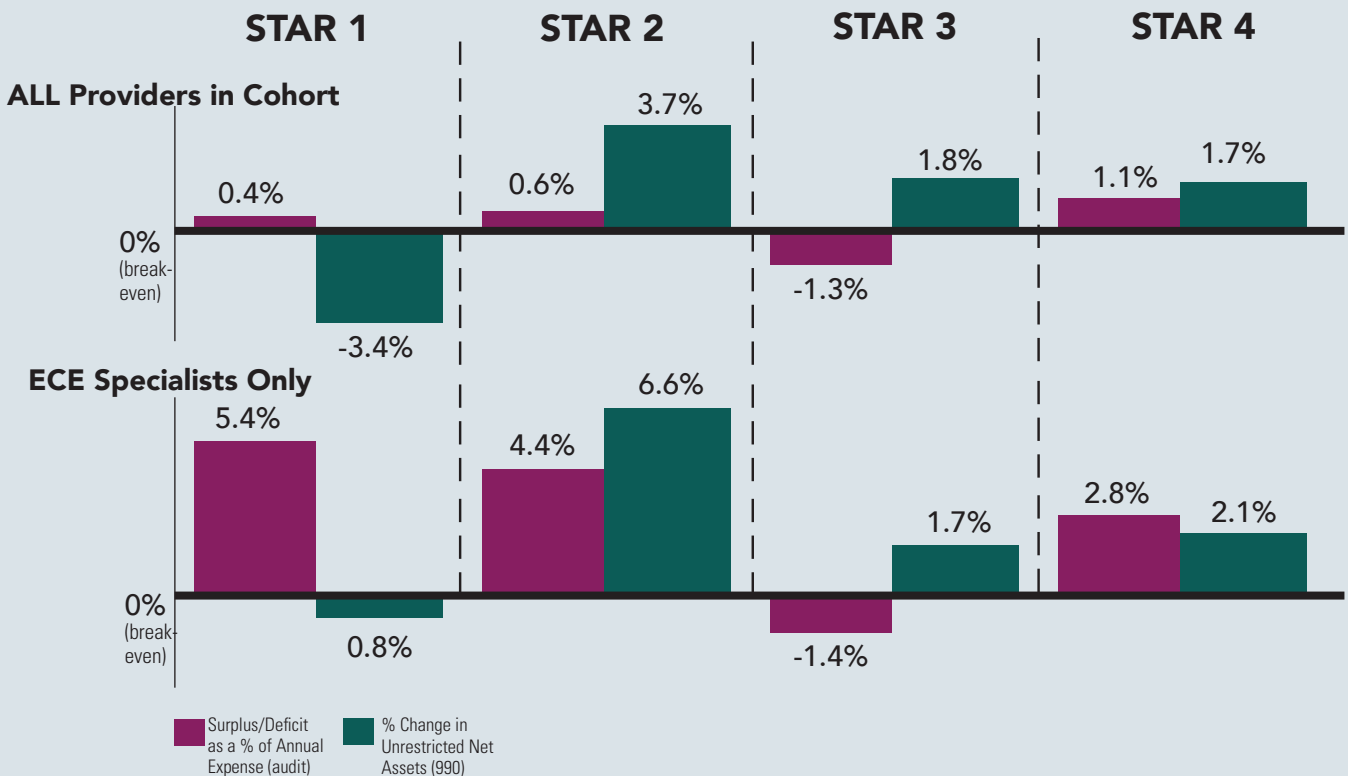
Figure 8. 990 data shows that the median operating surplus (post-depreciation) is equal to 3.5% of expenses for STAR participants vs. 1.7% for Non-STARs groups. Although not shown here, it is important to note that, before considering depreciation, surpluses appeared significantly higher for STARs participants. The median operating surplus for STARs participants was 6.7% vs. 1.8% for Non-STARs providers. The difference between the pre- and post-depreciation results was thus greater for STARs organizations—implying greater fixed asset investments for them.

On a liquidity basis, STARs-participating organizations had better cash reserve levels. However these levels were still at a minimal threshold of 1.6 months (as compared to one to three weeks of cash for Non-STARs groups).



Profitability: All Providers in Cohort vs. ECE Specialists, by Level of Quality

Figure 9. This graph shows how ECE specialists of different levels of quality compared to the overall cohort, when it comes to profitability. The data indicate no significant correlation between quality and financial health. Overall, operating margins still remain very close to break-even for most groups. 990 data for both ECE specialists and the total cohort show relatively low profitability at STAR 1, improvement at STAR two, before weakening for STAR 3 and 4. The median 990 value for the total cohort shows post-depreciation deficit equal to 3.4% of expenses. However, audited data suggests that ECE specialists at STAR 1 and 2 in particular have better financials when compared to the total group.



Barriers to Providing High-Quality Care for Low-Income Children

Providers who deliver high-quality programs for low-income children suffer more severe hardships than high-quality providers serving private pay clientele. What drives this dynamic?

The indisputable benefits of high-quality child care continue to rally public efforts to expand high-quality ECE programs in states like Pennsylvania, where only 23% of children enrolled in Pennsylvania's subsidized child care program receive care at a high-quality STAR 3 or STAR 4 provider.³⁰ Much of the focus of this public effort continues to place the onus on individual providers to achieve and maintain higher quality rankings (at the STAR 3 and STAR 4 levels). NFF's analysis found a clear disparity in financial health occurring along the nexus of two dimensions: the degree to which a provider served low-income children and the provider's quality designation (see Figure 10). Providers serving predominantly poor children faced greater

financial challenges and had a harder time covering expenses (as compared to their counterparts serving predominantly private pay families).³¹

While it may seem intuitive that providers serving low-income children face greater financial challenges (as compared to those serving private pay populations), one key driver of this dynamic originates in the manner in which Pennsylvania administers child care funding. Before we explore the possible reasons for this disparity, it is important to first understand how this funding works.

The Financial Health of Providers Serving Low-Income Children

Figure 10. This diagram helps us think about some of the main factors in the delivery of high-quality education to low-income populations. All providers can be plotted along the x-axis of Level of Quality (either Non-STARs or by STAR ratings) and the y-axis of % of Low-Income Children Served (%LMI). LMI refers to the percentage of low-to-moderate-income children served (self-reported by provider). Along Level of Quality, we have divided the cohort by Non-STARs, STARS 1-2 (LOWER quality), and STARS 3-4 (HIGHER quality). Along %LMI, we have divided the cohort into below 50% LMI population served (LOW) and 50% and above LMI (HIGH).

While there is no clear pattern across quality, there is a divide when comparing low versus high LMI populations served. Providers serving 50% and above LMI populations struggled to maintain a surplus, only hitting 1.2% in the higher quality group and suffering deficits in the lower quality group. However, providers serving below 50% LMI populations had better profitability. This suggests that it is much harder to achieve profitability while serving a higher percentage of subsidized, rather than private pay clients. Private pay thus appears to go farther than subsidy to cover the cost of care.



■ Surplus/Deficit as a % of Annual Expense (audit)
 ■ % Change in Unrestricted Net Assets (990)

Child Care Subsidies: How Does Child Care Work for Families Living in Poverty?

Child care is expensive and can consume up to one-third of the median wages for a family of four.³² High-quality care is even more costly for parents of all economic groups—but it is especially unattainable for families living in poverty. In recognition of the benefits of high-quality child care, states such as Pennsylvania provide financial assistance for low-income families in order to “make quality child care more affordable, support the healthy development of children and help low-income parents access the child care they need to go to work or to school and support their families.”³³ Low-income working parents are eligible for financial assistance to cover a majority of their child care expense. Financial assistance is provided in the form of subsidies or vouchers that follow the child to whichever provider parents select.

Payments are made directly from the funding agency to the provider. In Southeastern Pennsylvania, Child Care Information Services (CCIS) is the primary source of funding for low-income families needing help to pay for child care. The primary intent of CCIS subsidy is to incentivize low-income families— as well as current and former TANF recipients— to work, by subsidizing the cost of child care. CCIS is funded by a combination of federal block grants and state funds.³⁴ Currently, CCIS does not require parents to select quality programs in order to receive subsidies.

The CCIS subsidy is restricted to children 12 years of age or younger. In order to be eligible for the subsidy, families must:

1. Participate in an approved employment or education/training program(s), and;
2. Show annual income levels that are 200% or less of the Federal Poverty Guidelines. As an example, this means that the total income for a family of four cannot exceed \$47,700 per year (as of 2014).^{35,36}

Parents must pay a co-pay, or portion of the tuition that is based on the family household income. Co-pays typically range from \$10 - \$50 per week. However, despite the benefits of the subsidy, many eligible parents still struggle to meet co-pay requirements.³⁷

Understanding the challenges to managing government subsidies is a critical—and missing— ingredient for the sector to have a constructive dialogue about expanding the reach of high-quality ECE programs in any community. These challenges include insufficient reimbursement rates from state subsidies that do not cover the full cost of care, limited demand from parents for quality programs, and the misalignment between the goals of the state subsidy program and the educational goals of early childhood education—all of which directly threaten providers’ ability to survive in the long-term.

CCIS Eligibility: What Does 200% of the Federal Poverty Level Look Like?³⁸

Figure 11. This table shows a snapshot of the Federal poverty threshold for the 48 Contiguous States and the District of Columbia, as of 2014. Poverty guidelines are used to determine eligibility for various government services and conduct analyses on the state of financial prosperity in the US. We also show a calculation of 200% of the Poverty Level-- the amount that a family can make in order to be eligible for CCIS subsidy.

	Family of 2	Family of 3	Family of 4	Family of 5	Family of 6
Poverty Level	\$ 15,730	\$ 19,790	\$ 23,850	\$ 27,910	\$ 31,970
200% of Poverty Level	\$ 31,460	\$ 39,580	\$ 47,700	\$ 55,820	\$ 63,940

Government Subsidies Do Not Cover the Full Cost of Care

CCIS provides a basic reimbursement for child care for eligible low-income children. For example, in Philadelphia County, the base rate is no more than \$32.65 per day for preschool age children in full-time care. (This base rate is commensurately reduced for children in part-time care.)³⁹ The base rate applies to all providers regardless of whether or not they participate in STARS and quality investments.⁴⁰ (See Figure 12 for annual reimbursement figures.)

Historically, the gap between the cost of providing quality care and state reimbursement for children enrolled in CCIS has been substantial.⁴¹ Based on NFF’s estimated calculation of the average cost of care (approximately \$12,000), the base revenue provided by CCIS does not allow a quality provider to fully cover the cost of operations per child (see Figure 12).

In recognition of the limitations of the base rate and parent co-pays, Keystone STARS was established to provide small grants and awards to support providers wishing to invest in quality improvements. This program was developed to address the substantial gap between the cost of care at the STAR 3 and STAR 4 levels and state CCIS reimbursement. In addition to the CCIS base reimbursement, providers pursuing quality ratings through Keystone STARS are also eligible to receive “Tiered Reimbursement” STARS Awards (increases in the per-child subsidy rate awarded to providers who meet high-

quality standards). Tiered reimbursements increase commensurately with level of quality. For example, a STAR 1 facility receives a CCIS subsidy of \$0.35 per day for every eligible child in full-time care. Meanwhile, a STAR 4 facility receives \$5.00 in subsidy for every eligible child in full-time care.⁴²

However, despite this progress, the benefits of this program still do not allow a STAR 3 or STAR 4 provider to fully cover the cost of care—even under a “best-case” scenario in which maximum allowable revenue figures are reflected.⁴³ Based on anecdotal information shared during the interview process, this best case scenario is uncommon, due to the stringent child eligibility and attendance attached to the reimbursement process.

For many providers at the higher end of the STARS continuum, there is thus a misalignment between the educational goals and expectations around quality programs and the limitations of the reimbursement model. “Even though we receive the highest rate in our tiered reimbursement program, we receive just \$3.65 an hour [per child] through CCIS funding. You can’t park a car in Philadelphia for \$3.65 per hour,” according to one provider. “Yet there is an expectation that early childhood programs produce excellent outcomes. This is not possible without funding that mirrors high expectations.”⁴⁴

“Our costs keep increasing each year while the base rate hasn’t even increased at the rate of inflation since 2007.”⁴⁵—ECE Provider

How Far Short do Subsidies Fall in Providing Services for Low-Income Children in Philadelphia County?

Figure 12. This table demonstrates the economics of delivering quality ECE services to subsidy-eligible children. This example illustrates the revenue and expense dynamics associated with preschool age children in Philadelphia county. Revenue figures are based on the current CCIS base rate and STARS tiered reimbursement rates. While CCIS funding is available throughout a given year, the maximum revenue that can be earned through the CCIS subsidy is **\$8,489** per child per year based on a best case scenario that assumes 260 service days provided that a family maintains eligibility; with the maximum tiered reimbursement, total revenue increases to **\$9,789** at the STAR 4 level. As can be seen below, this revenue level does not cover the average cost of care. (Based on estimates for average cost of care and limited sample sizes shown in Figure 3.)

Per Child (Pre-School Age)	STAR 1	STAR 2	STAR 3	STAR 4
CCIS Base Reimbursement	\$8,489	\$8,489	\$8,489	\$8,489
STARS Tiered Reimbursement	\$91	\$247	\$728	\$1,300
Total Revenue	\$8,580	\$8,736	\$9,217	\$9,789
Average Cost of Service Delivery	\$10,320	\$10,320	\$12,789	\$12,789
Surplus (Deficit)	\$(1,740)	\$(1,584)	\$(3,572)	\$(3,000)
Surplus (Deficit) Per Classroom (20 children)	\$(34,800)	\$(31,680)	\$(71,440)	\$(60,000)



■ CCIS Reimbursements Are Variable and Risky

One of the major financial obstacles to providing high-quality care to low-income children involves the relatively risky nature of CCIS revenue. The primary intent of CCIS subsidy is to incentivize low-income families, as well as current and former TANF recipients, to work; as funds are directed through the Pennsylvania Department of Human Services, CCIS payments are thus contingent on the child's actual attendance in the child care program in which s/he is enrolled. This policy thus presumes that parents who are out of work can care for their children without the need for additional child care support. Based on this attendance reimbursement model, CCIS payments are made to providers on an incremental basis and are dependent on (1) the child's adherence to strict attendance requirements, and (2) the family's continued income eligibility and work status.⁴⁶

“Children lose eligibility for all sorts of reasons.... But these things are completely outside of the provider's control and in the end disrupt the continuity of care for the child and the [corresponding] subsidy revenue to the provider.”⁴⁹—ECE Provider

As a consequence of the system in which CCIS reimbursements are made, providers serving low-income children face ongoing threats to the continuity of care and the corresponding revenue flow for any CCIS child. One staff member at CCIS Northwest illustrates this dynamic: “Children lose eligibility for all sorts of reasons—either because paperwork wasn't submitted on time, or the parent loses eligibility because he lost his job or his training program was discontinued. But these things are completely outside of the provider's control and in the end disrupt the continuity of care for the child and the [corresponding] subsidy revenue to the provider.”⁴⁷

When children are dropped from the CCIS system, it can take as long as 10 days for a family's eligibility to be reinstated. One provider describes the lost revenue that can result from ineligibility or suspension issues: “Sometimes the child winds up coming back if it was just a matter of missed paperwork, but

other times the child never gets readmitted into CCIS. But in the meantime, I am in limbo because I'm holding that slot [and] that's a long period to lose revenue.”⁴⁸

Others argue that the variable nature of subsidies and tiered reimbursement revenue streams fail to acknowledge the educational goals and outcomes—and the required fixed cost investments (especially in teacher salaries and classrooms)—associated with higher quality programs. One provider shares: “In the subsidy world, your revenue fluctuates based on your enrollment and actual attendance of the child... when kids lose their eligibility, the revenue fluctuates and puts pressure on the financial model because you still have the same fixed costs... and that puts pressure on providers to make choices that compromise quality.”⁴⁹

Providers report common cost-cutting responses that ultimately lower program quality (e.g. sending teachers home early, holding back on purchasing necessary supplies and materials, and laying off administrative staff who often carry out key revenue-related activities such as staying on top of subsidy compliance requirements and responding to enrollment inquiries).⁵⁰

Overall, for many providers serving low-income children, the outcomes associated with high-quality programs cannot depend solely on the support from CCIS. As one provider explains, “Subsidized child care is not very viable [for educational outcomes]... There is a lack of consistent funding that leads to high turnover of teachers, instability of management and leadership [...] and that is not quality [care].”⁵¹

■ “Braiding Revenue” Results in Highly Complex Financial Models

An organization's ability to deliver on its mission and programs is highly dependent on its financial sustainability, the ability to pay for expenses in the short term and generate predictable and reliable revenue. To offset the deficiencies of the CCIS subsidy on both counts, ‘braiding’ is a critical strategy for providers to maintain financial stability while delivering high-quality programs. Experts define braiding as coordinating two or more funding sources to support the total cost of services

to individual children. However, this strategy often requires revenues and expenditures to be carefully tracked and allocated as required by various funding sources.⁵²

Louise Stoney and Anne Mitchell point out the mental gymnastics involved with tapping multiple revenue sources such as CCIS, Head Start, and other public sources: “Even in states [like Pennsylvania] that have ‘tiered’ child care subsidy rates

linked to the QRIS, programs at higher STAR levels typically need additional funding in order to break-even. And combining funds from multiple sources often requires careful accounting to avoid a challenge of ‘double-dipping.’⁵³ In braiding, cost allocation methods are required to assure that there is no duplicate funding of service costs and that each funding source is charged its fair share of program and administrative costs.⁵⁴

As a result of the need to braid, some high-quality providers in Philadelphia pursue Head Start revenue to complement the CCIS revenue stream. According to provider interviews delivering Head Start in partnership with the School District

“The insufficiency of CCIS to cover the cost of care is the reason we do so many blended programs – to ensure sufficient financing... We’re paid by Head Start and CCIS and hoping that together they will be enough.”⁵⁵
—ECE Provider

of Philadelphia, Head Start generally provides a “better funded slot” (when combined with CCIS subsidy) and serves as a more reliable and predictable revenue source (relative to CCIS). However, providers engaged in braiding Head Start with CCIS must manage the complexities of two sets of eligibility and requirements.

Despite the complexities, providers describe braiding as one of the few strategies available to better fund quality care for lower-income children that need extended hours of care throughout the year.

■ Demand for High-Quality Care is Low

Providers report low parental demand for quality—and therefore little incentive for providers to invest in quality programs. According to Pennsylvania Partnerships for Children, only 23% of the children receiving child care subsidies receive those services from a high-quality STAR 3 or 4 provider.⁵⁶ Providers reported a variety of reasons that parental demand appears low.

Knowledge Base: Providers observed that parents had limited understanding about Keystone STARS and quality ratings: “When I tell parents about our 4 stars, they think it’s a food rating [and don’t know] a high-quality environment means more than that we’ve filled out the paperwork correctly.”⁵⁷ This is consistent with a 2014 study conducted by John Weiser, in which 66% of 41 interviewed parents were not aware of Keystone STARS.⁵⁸

Price: For many parents living in poverty, the decision to choose a child care provider is based on economics.

“Far too many children are in poor quality settings, not because families chose such settings but because quality is expensive,” shares one member of the cohort. In many cases, parents choose lower-quality, lower-cost options simply to survive.⁵⁹

Maximizing Family Income: CCIS, along with its associated federal program TANF, allows parents to choose a family member as their child care provider, as long as that family member is registered with CCIS.⁶⁰ The requirements for registration are

minimal and not contingent on quality of care.⁶¹ In many cases, parents have a financial incentive to choose a relative as a child care provider. One provider explains this dynamic: “The majority of parents who receive child care through TANF payments or subsidies choose... a sister, grandmother, aunt or someone in the family... With low-income families, they need that money. The reality is that high-quality child care providers are directly competing with low-income families having direct resources to support their family.”⁶²

Time and Convenience: Others observed that when choosing among child care options, parents—especially low-income parents working long hours—had little bandwidth to prioritize the benefits of quality care over convenience.⁶³

Personal Fit (Culture and Race): Some interviewees noted that racial and cultural alignment was a key driver in parents’ decisionmaking process. Yet these factors are often unrecognized.⁶⁴

Currently, the Commonwealth of Pennsylvania does not require subsidy recipients to choose quality for their children. Some in the field argue that this eliminates a powerful incentive for the majority of the state’s child care providers who care for subsidized children to invest in well-credentialed staff and high-quality facilities.

Moving Forward

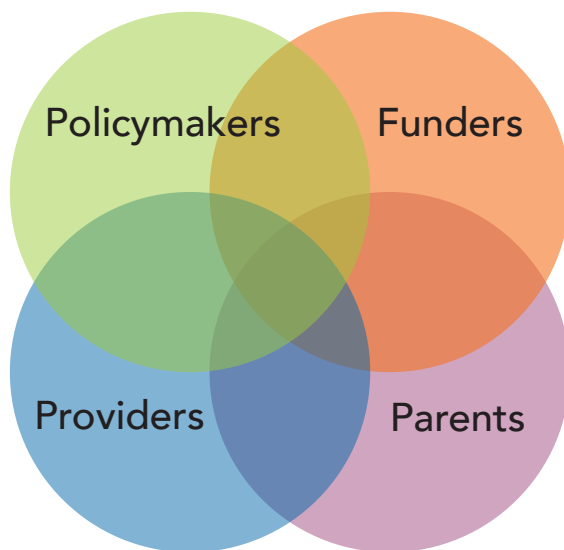
How do we address the multitude of challenges standing in the way of providing high-quality care to low-income children?

The ECE system—like most systems—is made up of a delicate balance of both collective and competing interests among different stakeholders with unique needs and goals. The more aligned these interests are, the more successful the system. When perfect alignment is not possible (and it rarely is) success depends on the willingness and ability of all parties to participate in open dialogue and cooperation.

There are four primary decisionmakers that influence the way in which ECE is delivered to children throughout Pennsylvania: policymakers, funders, providers and parents. Each of these stakeholders has a distinct set of goals and priorities that shape their decisionmaking processes, and each has a unique level of power and influence over the lives of children. At the center of these interests are the children themselves, whose life path is profoundly affected by the decisions surrounding this critical period between infancy and age 5.

In this final section of the report, we identify key recommendations for policymakers, funders, and providers to

address their own needs and challenges while responding to the key financial, business and systemic barriers that obstruct high-quality ECE access for children living in poverty. We offer these recommendations as a starting point to better equip the ECE field in the pursuit of greater access for children.



Although this research did not include direct conversations with parents, it is important to note that parents' voices are noticeably missing from this dialogue. We highlight for policymakers, funders, and providers the importance of better understanding the needs of parents—especially those of the working poor—in order to identify the best approaches to incentivizing greater parental demand for high-quality programs. Providing parents with knowledge and information about

the importance of quality ECE is just one component. More formal work and investigation is needed to address the myriad of factors that appear to affect parental demand for quality ECE (e.g., cost, convenience, personal and socio-economic alignment).

Actions for Policymakers

To Manage Right Now

Increase the base subsidy rate

CCIS's base subsidy rate falls far short of covering full costs. This problem is compounded by the fact that the base subsidy rate has failed to keep up with the rate of inflation since 2007 (and, in fact, is lower today than 2007 levels).⁶⁵ In addition to re-setting the base to a rate that better aligns with the actual costs of care, it is important to implement a year-over-year policy that allows the base subsidy rate to annually increase with the rate of inflation.

Increase tiered reimbursement rates to match costs

While tiered reimbursements in Pennsylvania are among the most generous in the country, they rarely enable high-quality providers to fully cover the cost of care. Additionally, the costs associated with each level of quality are not properly incorporated into the current reimbursement model. In order to adequately support providers seeking to achieve high-quality standards, tiered reimbursements must thoroughly align with the costs associated with each STAR level.

Implement eligibility policies that are more friendly to parents and providers

A child's family can lose eligibility for subsidy at any time—either due to changes in parents' work status or a child's missed days of school. For the family, strict eligibility requirements disrupt a child's continuity of care and do not serve the interests of the child. For the ECE provider, the interruption in CCIS subsidy contributes to the organization's financial volatility, keeping them at the edge of break-even as they juggle complex subsidy dynamics. Policymakers need to consider the impact of current eligibility requirements on children, parents, and providers and alternative policies that would better support the continuity of care for the child. The recent passage of the Child Care and Development Block Grant (CCDBG) Act of 2014 indicates an important first step in affording greater stability to parents, children and providers by establishing a 12-month eligibility re-determination period (i.e., families remain eligible during a 12-month period, regardless of changes in income or temporary changes in work status).⁶⁶

To Support Long-Term Adaptability

Complement portable funding with direct institutional funding options

Most ECE revenue streams (whether out-of-pocket tuition or public subsidies) are portable and follow a specific child. In the case of subsidies, portable revenues belong to an eligible

individual who may take that funding to an eligible institution of his/her choosing. While portable funding affords parents with much needed flexibility to cope with life changes and realities, this kind of revenue stream presents challenges for ECE providers. ECE directors must direct a significant level of attention and energies toward keeping each slot enrolled while also ensuring educational outcomes. When a child leaves an ECE program, the associated funding disappears from a provider's revenue stream—often creating financial volatility and risk to both the center and the children served within its walls. In comparison, an elementary school model often benefits from institutional funding in which a direct subsidy is provided for the delivery of services to eligible children.

In order to begin addressing the long-term financial viability of ECE providers tasked increasingly with educational outcomes, the sector requires more options for direct institutional subsidies to counterbalance the effects of portable funding. Bringing together these two types of funding into better proportion can take into consideration the needs of the parent and provider.

Align government agencies with shared goals for educational outcomes

The ECE public funding infrastructure encompasses a myriad of agencies with conflicting goals. For example, one conflict occurs between CCIS and Pennsylvania's Office of Child Development and Early Learning (OCDEL). CCIS's primary goal is to enable low-income parents to maintain employment, and as a result CCIS funding is contingent on the work status and income eligibility of parents. Children can thus be removed from high-quality care based on the work status of their parents, which disrupts the educational outcomes and continuity of care goals of OCDEL. Providers are thus challenged to manage the disparate regulations and requirements for each funding source. A shared set of goals between agencies will lead to streamlined compliance and reimbursement processes for providers while allowing funding to work in unison (rather than in conflict) in support of the child.

Explore incentives encouraging parents to choose high-quality care

As mentioned, the majority of high-quality providers interviewed struggle to achieve full enrollment. Our conversations with providers suggest that parents do not always prioritize high-quality care when selecting a child care provider. Policy options to increase consumer demand for high quality care may include restricting use of CCIS subsidies toward quality providers, providing a weighted financial incentive depending on the quality level of selected providers, more explicit recommendations provided to parents by Keystone STARS, and broader marketing and public education campaigns for parents.

Actions for Funders

To Support Providers Right Now

Provide flexible support

While awaiting systemic reform of the larger subsidy system, philanthropic investors can best support providers who are already delivering strong programs to the most vulnerable children by providing general operating support. This kind of flexible funding would allow providers who have already achieved and maintained high-quality status to address their structural operating deficits, focus on delivering quality care, and plan for the long term. Organizations need this type of flexible support on an ongoing basis—over many years—in order to reap its benefits.

For growing or changing programs, provide change capital

During periods of growth or change, most organizations incur deficits until their new financial model sets in. Unfortunately, they often struggle to raise the financial resources they truly need to achieve resounding success. Funders must understand the change capital requirements for those pursuing quality improvements and/or expansion. Change capital support can help organizations achieve major financial model changes, such as programmatic expansion, or invest in improvements in quality. It is important to note that most significant growth or change projects result in a long-term operating gap. Expansion should not just be funded as a one-time event; rather, funders must understand how long an organization expects the deficit to last and what it will truly take to emerge from growth as a more sustainable high-performing organization.

To Support Long-Term Adaptability

Help providers build necessary reserves

Quality improvement and expansion are both major change processes that cannot happen overnight. Funders can partner with providers to plan and build reserves that can best equip them to meet their long-term goals over a much more carefully planned period. In addition, funders can also help providers address day-to-day problems by helping them build working capital reserves and risk reserves to plan for the inherent volatility of their financial model.

Better understand parental choice

As of 2015, Pennsylvania's public dialogue is centered around expanding the number of slots for low-income children in high-quality centers. However, there are some who argue that the existing supply of high-quality seats is currently underutilized in some communities. Many high-quality providers interviewed for this report described recurring difficulty achieving full enrollment. With broader efforts underway to increase the supply of high-quality

child care in Pennsylvania, there is concern among some providers about the potential for underutilized high-quality slots.

The field still lacks sufficient examination into the key factors surrounding parental demand for quality care. Before moving forward with expansion, subsequent research should investigate the decision factors that determine consumers' choice of child care providers and other potential barriers. This investigation would then inform the most appropriate intervention for increasing parental demand for high-quality child care and how to best restructure subsidy incentives.

Approach expansion with extreme caution

Similar to providers, funders must beware the impact that expansion can have on an organization's financial health. An ECE provider is only ready for growth when it has a strong financial roadmap for sustainability and sufficient resources to manage deficits during period(s) of growth or change, among many other factors. Funders can help organizations pursue growth wisely, while also being a voice of caution when all of the ingredients for growth or change are not in place.

Actions for Providers

To Manage Right Now

Clarify core financial dynamics

In order to make well-informed decisions and adapt to changing financial dynamics, providers who are proficient in understanding the economic drivers of their programs are better able to make well-informed decisions that address both mission and financial needs. For example, one Philadelphia provider learned that for every new subsidized child served, her program would need to fundraise or identify an additional \$4,000 to cover the gap between subsidy revenue and expense to serve that child.

Budget conservatively

Providers who most effectively juggle the challenging revenue and expense dynamics of the ECE model are those who adhere to conservative budgeting practices, in which programs build in some margin for error by underestimating revenues, overestimating expenses, and aiming for beyond-break-even results. A conservative approach to the budgeting process can help soften the blow of unforeseen revenue losses or unplanned cost increases—both of which could otherwise threaten the continuity of services for children.

Plan ahead for cash hardships: monthly cash flow

The timing and reliability of payments—whether paid out of pocket by families or by government subsidies—drive a provider's ability to keep the lights on and doors open. Projecting month-to-month cash inflows and outflows can help identify the most cash constrained times of the year and a corresponding plan of response, such as tapping a line of credit or depleting any existing cash reserves.

Seek opportunities for cost efficiencies

In the ECE model, there are few opportunities for cutting expenses associated with delivering quality services. Yet, some providers reported creative strategies for realizing cost efficiencies for program and business needs. Some examples include: sharing the costs of back-office administrative infrastructure (such as financial or fundraising staff) across multiple programs or sites, and forming collaborative alliances in which participating providers share access to teacher training and mentorship opportunities (both of which are critical for quality programs).

Lean on mentors to better navigate the quality process

In the Philadelphia ECE community (as in other parts of the country), high-performing and experienced providers take it upon themselves to mentor and coach those who are newly entering the quality improvement process. Some providers reported the value of mentorship (whether on a formal or informal basis) in helping new agencies navigate the quality system while managing the operational and financial realities of the ECE model.

To Achieve Long-Term Adaptability

Understand the full cost of doing business

At present, public funding sources available to ECE providers rarely cover the full cost of offering high-quality care to low-income families in Philadelphia. However, among the financial complexities of juggling subsidies, many providers often struggle to understand what the full costs of doing business actually are. These include not only regular operating expenses, but also facility maintenance costs, replacement of equipment and systems, principal debt payments, and savings for the future. While no easy task, understanding the true picture of full costs can not only help inform financial decisions; it can help give funders and policymakers the information they need when they shape decisions that affect providers.

Consider growth with extreme caution

Providers need to beware of the myth that programmatic growth will lead to financial sustainability. Providers that expand may be faced with a widening gap between subsidy and the true cost of operations and require additional support (via fundraising or additional fundraising activities) to address structural operating deficits that often go hand-in-hand with growth.

Build designated reserves for higher quality

Many providers struggle to break-even and, as a result, often have a difficult time building cash reserves. Yet, the process for achieving and maintaining quality necessitates additional cash to help a program make the transition when it is ready (e.g., hiring teachers with higher credentials, making facility improvements, and upgrading environmental standards). Setting aside reserves to plan for these costs over time can help a program make the transition when it is ready.

A Paradigm Shift is Needed in ECE

How does ideology affect the way we support ECE organizations and the children they serve?
And what will it take to align policy and funding with the society we envision?

Today, the evidence supporting the role of high-quality ECE for a child's lifelong success is indisputable. Increasingly, research further demonstrates the direct linkage between the positive child outcomes gained from high-quality ECE and a region's economic strength (including a stronger workforce and cost savings achieved from public programs). There is also substantial evidence that vulnerable children who live in poverty stand to benefit the most from high-quality ECE settings.

Despite this evidence, low-income children continue to have the greatest challenges accessing high-quality programs, and high-quality providers continue to remain under-capitalized. Even under the best circumstances, high-quality ECE providers struggle to break-even and often operate with little safety net—leaving providers with very little margin for error to absorb the volatility of the underlying economic model. In the case of programs that serve low-income children, public subsidies fall short of covering the cost of quality care (leaving a revenue gap of at least 23% for high-quality programs). In addition to the insufficiency of subsidy levels, there is also a mismatch between reimbursement policies and the long-term educational goals and outcomes expected from high-quality programs.

This report begins to shed light on the financial, business and systemic realities affecting the supply of high-quality programs, and raises key questions about how the ECE system is currently capitalized (and under-capitalized). If the evidence to support high-quality care is so compelling, what are the underlying causes behind chronic under-capitalization? Based on our research, we believe that the existing characteristics of capital in the ECE system reflect a set of inherent beliefs and flawed myths about the care of young children in the U.S.

Myth #1: ECE is just about babysitting.

One longstanding myth assumes that caring for young children is merely a matter of providing basic custodial care, without the need for skilled labor and appropriately compensated staff. The consequence of this ideology results in an expectation of low costs of care and pressure for ECE providers to operate on very tight margins and not compromise on quality.

Myth #2: Although K-12 education is a public good, child care is the parents' responsibility.

Because ECE is not consistently valued as a public good—despite evidence pointing to its role improving economic and social outcomes that reverberate well beyond a single child—child care subsidies are often tied to the working circumstances of parents. As a result, children bear the consequences of their parents' circumstances. Eventually, society as a whole bears the consequences as well.

Myth #3: ECE is not a form of education.

ECE is not treated as a part of the formal education continuum, despite the growing body of evidence that links high-quality ECE to kindergarten readiness and grade 3 literacy. As a result, its funding sources are not as balanced between portable and institutional types of funding in comparison to primary, secondary, and higher education.

These historic misconceptions continue to directly shape today's realities in the levels and nature of capital in the ECE system. These influences are most reflected in the lion's share of ECE revenues remaining largely variable and portable, and the scarcity of institutional dollars for ECE; the lack of formal structure that both addresses the needs of working parents and incentivizes parent choice toward high-quality; and the stark disparity in ECE workforce compensation as compared to K-12 counterparts.

While some pursue widespread reform, ECE providers continue the Herculean feat of delivering excellent education and care to young children in Pennsylvania and across the country. However, in order for high-quality ECE to maximize positive impact on children who need it the most, there needs to be a paradigm shift that challenges prevailing ideologies and assumptions about ECE and begins to ask the question: how can the ECE system be better supported, financed and funded in order to provide high-quality programs to children who need them the most? It is our hope that in articulating these issues here that a data-driven and comprehensive dialogue between policymakers, funders, providers, and parents can occur to strengthen the ECE sector and enable more children to successfully access excellent care during the critical first 2,000 days of life.

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