The Dollars and Cents of Early Learning: Investing in Success

A Summary of Findings from groundWork's Early Childhood Financing Project

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groundWork

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groundWork is a nonprofit, nonpartisan advocacy organization that advances quality early learning and development as the most transformative strategy to improve school outcomes, increase the life-long success of Ohio’s children, and lay a strong foundation for economic prosperity in our state.
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Executive Summary

No one needs experts to prove that young children who grow up being nurtured physically and emotionally are more successful in school and throughout their lives. It’s common sense.

But science is increasingly showing:

• **how** much better off children are when they are enriched by high-quality learning experiences before they start kindergarten

• **how** providing those experiences in the critical first years can pay off for a lifetime for the child, for communities, and for taxpayers

To have the 21st century workforce that keeps and attracts employers, Ohio must invest when it counts most – when children’s brains are at their most active, when lifelong habits and values are being instilled. Remedial education, special education, healthcare expenses, reduced earning power, welfare benefits, and prisons – these are just some of the costs we all pay if we don’t invest in children from the start.

Study after study show that providing high-quality learning experiences for children growing up in poverty has among the greatest returns on investment of any government expenditure

Currently, the most Ohio reimburses any childcare provider for caring for an infant is $40 per day. Reimbursement for a preschooler is just $30.

Many providers get even less. In more than a quarter of Ohio’s 88 counties, reimbursement is $22 per day for an infant and $19 for a toddler.

In its Early Learning Challenge Grant, Ohio set a goal of funding only high-quality early learning by 2020. To keep that commitment, it is critical to determine how much it costs to provide high-quality early learning in Ohio. That is the purpose of this analysis: to take an important step in determining *The Dollars and Cents of Early Learning*. 
Purpose

Children, families, and our communities all depend on our continued investment in quality early childhood and development opportunities. Research shows that positive early experiences set the foundation for future learning, health, and behavior through adolescence and adulthood. But currently, only 13% of Ohio’s children who receive Publicly Funded Child Care, from birth to age five, attend high-quality programs (Ohio Department of Job and Family Services).

In 2014, to better understand the gap in providing high-quality experiences to Ohio’s state-funded children, groundWork began the Early Childhood Financing Project, partnering with national early childhood financing expert Anne Mitchell to produce an in-depth analysis of Ohio’s childcare financing system. To reach the goal set out in Ohio’s Early Learning Challenge Grant of funding only high-quality early learning with state dollars by 2020, more data was needed to understand the cost of high-quality early learning based on the standards of Ohio’s revised Tiered Quality Rating and Improvement System—Step Up to Quality (SUTQ)—and the financing options to support that level of quality. Through the Early Childhood Financing Project, groundWork sought to complete the following tasks:

• Create an estimate, based on the best available data, of the cost of delivering early learning in all settings and every level of SUTQ (non-rated and one through five stars). The goal is to eventually analyze the costs in all early childhood settings, with the first phase focused on community-based providers. Data will be collected in future phases to analyze costs in school-based preschools, and home-based providers (Types A and B).

• Create estimates, based on the field survey data, of the one-time costs necessary to move up the quality ladder.

• Use the cost-of-quality data to create recommendations on the most effective early learning financing options for Ohio.
groundWork partnered with Anne Mitchell, state officials, and county partners across the state to calculate the cost of early education in Ohio’s early childhood centers licensed by the Ohio Department of Job and Family Services (ODJFS), in all levels of quality, using the Provider Cost of Quality Calculator (PCQC). With the help of data provided by ODJFS, the Ohio Department of Education (ODE), the Ohio Child Care Resource and Referral Agency (OCCRRA), and the Ohio Head Start Association, Inc., we analyzed the number of children currently being served in high-quality early childhood programs receiving state and federal funding. Calculations were then made of the total cost required to move all high-needs children into high-quality early education programs, which Ohio defines as programs rated 3 Stars or above. Based on all cost estimates generated through the PCQC findings, recommendations were developed on the best financing mechanisms to fund Ohio’s quality early learning system. Preliminary findings and recommendations were shared with early learning field leaders in October 2014, with final recommendations subsequently shared with key policymakers within Governor John Kasich’s administration and key legislative leaders in early 2015.

**Counties Selected for Participation**

Six representative counties were asked to participate in the Early Childhood Financing Project: Auglaize, Coshocton, Hamilton, Lawrence, Lucas, and Montgomery. Counties were asked to provide a county-level analysis of early learning using the PCQC. Participating counties were chosen based on a number of factors designed to produce the most accurate cost estimates for the state of Ohio. These factors included distribution across the state, mix of different sizes and quality levels of programs, representation of key state legislative districts, existence of active provider networks, and representation from all four market clusters. Ohio’s most recent market rate study determined there to be four market tuition rate clusters.

**Cost Analysis for Community-Based Providers**

A cost analysis was completed for community-based provider education settings in Ohio. These cost estimates represent the cost to operate a program at each level of quality, defined by the five star levels of Step Up to Quality (SUTQ). The baseline scenario is an
unrated, regulated program of average size in Ohio. Cost estimates for all settings relied on field survey results and were further refined based upon the feedback from focus groups comprised of childcare providers and county officials.

**STEP UP TO QUALITY: IDENTIFICATION OF COST DRIVERS**

The PCQC analyzes the cost of quality by determining the cost drivers for each quality requirement. Cost drivers are those items that add ongoing additional costs, and are calculated by considering the additional hours, staff, or direct costs required above and beyond the immediately preceding level of quality. Cost drivers do not include items that have a one-time cost or items that are considered standard practice.

On May 30, 2014, county partners and center-based providers met to identify cost drivers for each level of quality within SUTQ. Teams from 10 counties reviewed all program standards in all four domains of SUTQ: Learning & Development, Administrative & Leadership Practices, Staff Qualifications & Professional Development, and Family & Community Partnerships. The teams deliberated thoroughly within a facilitated focus group setting to determine which items are cost drivers related to maintaining a level of increased quality, and the cost of each. The final results were based upon survey results and feedback from the focus groups, along with an analysis of the actual point profiles of centers rated at four and five stars (which are determined by points). Since the items for which points are earned can vary, these additional data are critical.

**Strategy for Determining One-Time Costs**

In addition to ongoing costs captured by the PCQC, we calculated the one-time and system capacity costs related to improving quality. The primary capacity-building cost identified was workforce development—assuring every child has a qualified teacher. Staff qualifications are a significant part of SUTQ and the ongoing cost of employing higher-qualified staff is higher compensation.

Increasing practitioner qualifications is generally a one-time cost from the perspective of the practitioner, although it may occur over a number of years. Increasing practitioner qualifications overall is an ongoing cost and system capacity issue from the perspective of the State of Ohio. There is an initial cost to ramp up the workforce qualifications and then ongoing costs to maintain teachers at appropriate wages. Staff turnover caused by inadequate wages was identified as a significant issue in maintaining quality with a 22%
turnover rate for ODJFS teachers and a 30% turnover rate for ODJFS assistant teachers according to the 2013 Early Childhood Advisory Committee Workforce Study. An increase in compensation is needed to reduce turnover to a reasonable level.

Data was collected from the Ohio Child Care Resource and Referral Association, the U.S. Bureau of Labor Statistics, and the Ohio Education Research Center to determine the size and qualifications of the current workforce and the cost to provide professional development for the remaining number of needed qualified teachers based on the cost of TEACH Early Childhood Ohio scholarships.

Validation of Cost Analysis Data

Using the results from the field survey, further refined through focus groups with our county partners and childcare providers throughout Ohio, we completed a PCQC analysis for community-based providers for each participating county.

In September 2014, feedback meetings were held in all six participating counties to review preliminary cost analyses with county partners and community-based providers. Following this round of feedback, additional adjustments were made to some of the initial assumptions that supported our preliminary analysis for each county. A follow-up survey (see attached document) was sent to a sample of center providers to further clarify questions on personnel and non-personnel costs, including class size, teacher/student ratios, attendance, enrollment, and bad debt. For more details on our revised assumptions, please refer to Early Childhood Financing Project: Overview (October 23, 2014). See attached document.
To estimate the cost of operating at each level of Step Up to Quality (SUTQ), we used the Provider Cost of Quality Calculator (PCQC). This is a web-based tool offered by the National Center on Child Care Quality Improvement (NCCQI), part of the U.S. Department of Health and Human Services. The PCQC was developed by Augenblick, Palaich and Associates (APA) and the Alliance for Early Childhood Finance, co-founded by Anne Mitchell. It is designed to help policymakers understand the costs associated with high-quality early care and education. The tool can be used to demonstrate the financial implications for a provider to produce a given level of quality. The design of quality initiatives and financial supports can be informed by the size of the gap between revenue and expenses at different quality levels and for various provider types.

As with any estimation tool, the PCQC rests on “good data in, good estimates out.” The accuracy of the output is dependent on credible and accurate data and is informed by the field survey results and focus group feedback from county partners and childcare providers.

**Basic Structure of the PCQC**

The PCQC estimates the cost of operating at the provider level; it produces an annual revenue and expense statement for a center (or home) of a specified size, age mix, and quality level. All the typical expense and revenue categories for an early learning/childcare program are included and can be customized to the characteristics of any state or other jurisdiction. The PCQC models the essential determinants of financial sustainability: revenue sources sufficient to cover costs, full enrollment, and full revenue collection. A key feature of the PCQC is inclusion of operational efficiency factors for enrollment and revenue collection, which can be adjusted.

**EXPENSES**

The majority of expense in any early learning program is personnel, typically between 60 to 80% of total expenses. The PCQC provides salary data from the U.S. Bureau of Labor Statistics for several relevant occupations for each state to guide the choice of salary levels for various positions. Federal payroll taxes for Medicare and Social Security are built in; state-specific mandatory payroll taxes and optional benefits can be entered. Personnel costs for teaching staff are strongly influenced by the class size of each age group and the ratio of adults to children. In effect, the proportion of teaching
personnel to children is a fixed cost of doing business in early learning, since both are regulated at the base level (state licensing rules) and both necessarily are improved (e.g., smaller classes, more teaching staff per child) to produce higher quality.

Non-personnel costs include the major categories of occupancy, classroom materials and supplies, food service, and administration. The PCQC contains default values for non-personnel expenses that can be modified. These non-personnel items are calculated in the revenue and expense (R&E) statement using the number of classrooms, the number of staff, or the number of children.

**REVENUE**

The PCQC is set up to include the primary available revenue sources: private tuition paid by families, public state and federal funds for childcare subsidy, federal funds for food or food service from the U.S. Department of Agriculture’s Child and Adult Care Food Program (CACFP) reimbursement, and any additional revenue sources that are state-specific, such as annual quality awards or preschool funding; these are all user-defined values. The federal CACFP is built in. For more details on the PCQC, see the PCQC User Guide.

**EFFICIENCY FACTORS**

Providers are staffed for their desired capacity of children, and efficient programs are able to enroll close to that capacity. Achieving 100% enrollment efficiency is unattainable even for a provider that is in high demand as evidenced by an extensive waiting list. Such a provider might achieve 95% enrollment efficiency. The industry standard is to keep enrollment at or above 85% of desired capacity.

The proportion of revenue that goes uncollected, due to families’ inability to pay, is commonly called bad debt. The industry standard is to keep bad debt to less than 3% of revenue; programs with clear tuition payment policies and effective collection practices may perform better than the industry standard. Providers attempting to collect large co-payments from low-income families may do worse than the industry standard.

**Customizing the PCQC for Ohio**

The Ohio Department of Job and Family Services and the Ohio Department of Education provided published studies with current data on the workforce, market tuition rates, subsidy rates and SUTQ financial supports.
URBAN/RURAL

The primary adaptations of the PCQC for Ohio were made to reflect genuine differences found between urban and rural centers. The revenue sources used are the current market rate survey for tuition (urban and rural) and current subsidy rates (urban and rural) with the addition of tiered reimbursement levels and quality achievement awards that are part of SUTQ.

PERSONNEL

Ohio providers and other leaders reviewed both personnel and non-personnel expense items as well as efficiency factors. Salaries were carefully reviewed. After extensive deliberation, a salary framework was developed that reflected the strengths of the various data sources—both Ohio and federal—to clarify the genuine differences between urban and rural providers in Ohio.

NON-PERSONNEL

Occupancy costs and operational efficiency were also examined. To be certain that key features of financial sustainability were accurate, a survey was sent to a sample of centers. The survey covered class size, ratios, capacity, desired enrollment, attendance, enrollment efficiency, and bad debt.

Primary adaptations are summarized below.

<table>
<thead>
<tr>
<th>Personnel</th>
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<tbody>
<tr>
<td>Salaries</td>
<td>Urban salaries are higher than rural for all positions and all quality levels</td>
</tr>
<tr>
<td>Staffing</td>
<td>Urban centers reduce ratios in preschool classrooms to meet higher quality levels</td>
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<tr>
<td></td>
<td>Average-size rural centers do not employ non-teaching staff (education coordinator, office staff) while urban centers are likely to have these employees part-time in order to meet higher-quality standards</td>
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<table>
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<tr>
<th>Efficiency</th>
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<tbody>
<tr>
<td></td>
<td>Urban centers have higher occupancy costs than rural centers</td>
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<tr>
<td>Efficiency</td>
<td>Bad debt is higher for subsidy revenue than for private tuition in both urban and rural settings</td>
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<td></td>
<td>Subsidy bad debt is the result of state payment policies on attendance and absences and the limited time period for corrections for parents who fail to use swipe cards consistently, also known as “back-swiping”</td>
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<td></td>
<td>Enrollment efficiency (keeping enrollment at a high percentage of desired capacity) is a challenge for both urban and rural settings. The challenge is greater for rural centers, which experience more competition from fully publicly funded programs such as Head Start and public preschool.</td>
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One of the primary reasons to accurately estimate the cost of quality early learning is to gauge the adequacy of Ohio’s current revenue sources and financial supports for quality and the efficiency of Ohio providers. One approach is to compare the net annual revenue of centers at different levels of quality.

Barely breaking even is not a healthy financial situation. Healthy year-end net revenue for a small business, whether it is organized as for-profit or not-for-profit, is in the 7 to 10% range. Modest profit allows a center to contribute to a reserve fund for emergencies, capital improvements, learning materials, and other investments that contribute to a high-quality learning environment. Additionally, since programs receiving state childcare subsidy are reimbursed for their expenses in arrears, programs must maintain an appropriate reserve to meet payroll in a timely manner.

Financial Sustainability of Typical Centers

To examine sustainability by quality, we used the average size center in Ohio (74 children, 4 classrooms with infants, toddlers and preschoolers). Typical urban centers vary widely on the proportion of subsidized children versus private paying families served. To account for this wide range we examined both a high- and low-subsidy urban center. For the typical low-subsidy urban center, the average percentage of subsidy families (as opposed to private tuition-paying families) is 15%, enrollment efficiency is 80%, and bad debt is 5%. After examining operational efficiency costs, it was determined that bad debt is higher for subsidy revenue than for private tuition in both urban and rural settings, resulting in an increased percentage of bad debt for the typical high-subsidy urban center.

Based on the data collected in this project, a typical high-subsidy urban center has an average percentage of subsidy families is 75%, enrollment efficiency at 80% and bad debt of 15%. For the typical rural center, the percentage of subsidy families is 50%, enrollment efficiency is 80%, and bad debt is 10%. For urban and rural centers, both efficiency factors differ from the industry standard based on Ohio data. The comparison of financial sustainability is based on the net annual revenue of these typical centers at each level of quality.
• In urban areas the center serving 15% subsidy families or more will be unable to reach a healthy year-end net revenue at any level and will be completely unsustainable at higher-quality levels (3-, 4-, and 5-Star programs have negative net revenue).

• In urban areas the center serving 75% subsidy families or more will be unable to reach a healthy year-end net revenue at any level and will be completely unsustainable at higher-quality levels (3-, 4-, and 5-Star programs have negative net revenue).

• In rural areas the typical center is completely unsustainable at any level (negative net revenue at all quality levels)

Figure 1. Annual net revenue percentage, typical Ohio low-subsidy urban community-based provider (15% subsidy families, 80% enrollment efficiency, and 5% bad debt)

* Calculated as positive annual net revenue equal to 10% of total annual revenue
Figure 2. Annual net revenue percentage, typical Ohio high-subsidy urban community-based provider (75% subsidy families, 80% enrollment efficiency, and 15% bad debt)

*Calculated as positive annual net revenue equal to 10% of total annual revenue*

Figure 3. Annual net revenue percentage, typical Ohio rural community-based provider (50% subsidy families, 80% enrollment efficiency, and 10% bad debt)

*Calculated as positive annual net revenue equal to 10% of total annual revenue*
**Adequacy of Subsidy Base Rate and Tiered Reimbursement Levels**

Adequacy of current subsidy base rates and tiered reimbursement levels can be examined by modeling a center with 100% subsidy enrollment, to show what many urban centers look like in practice. When modeling a center with 100% subsidy enrollment, bad debt was increased to 15% for both urban and rural settings. The increase in bad debt reflects our finding that bad debt is higher for subsidy revenue than for private tuition. Current subsidy tiered reimbursement begins with 5% additional payment for 1-Star and rises by 5% for each additional Star level to 25% for 5-Star.

- In urban settings, the 100% subsidy center will have net revenue in the 5% range at lower quality levels (below 3-Star), just break even at 3-Star (0% net revenue) and become unsustainable at higher quality levels (4-Star and 5-Star).
- In rural areas, the 100% subsidy center is completely unsustainable at any level (consistently negative net revenue).

*Figure 4.* Annual net revenue percentage, model Ohio all-subsidy urban community-based provider (100% subsidy families, 80% enrollment efficiency, and 15% bad debt)

*Calculated as positive annual net revenue equal to 10% of total annual revenue*
To support financial sustainability of higher-quality settings, the base rate and the tiered reimbursement levels can be adjusted to bring the hypothetical 100% subsidy center into the sustainable range. We increased the base rate for urban settings by 3% and increased the base rate for rural settings by 23% in order to allow programs to cover the costs needed to operate a program at the unrated level. In addition, we increased the tiered reimbursement levels for all levels of quality for both urban and rural settings to cover the costs needed to operate at each level of quality. Larger increases at the highest levels of quality (3- to 5-Star) were designed to counter the current prohibitive costs of operating a high-quality program and incentivize providers to move up the quality ladder and serve subsidized children.

*Figure 5. Annual net revenue percentage, model Ohio all-subsidy rural community-based provider (100% subsidy families, 80% enrollment efficiency, and 15% bad debt)*

*Calculated as positive annual net revenue equal to 10% of total annual revenue*
Figure 6. Annual net revenue percentage, model Ohio all-subsidy urban community-based provider (100% subsidy families, 80% enrollment efficiency, and 15% bad debt) with increased base rate (3%) and increased tiered reimbursement (total increased funding: unrated = 3%; 1-Star = 5%; 2-Star = 8%; 3-Star = 14%; 4-Star = 28%; 5-Star = 29%)

* Calculated as positive annual net revenue equal to 10% of total annual revenue

Figure 7. Annual net revenue percentage, model Ohio all-subsidy rural community-based provider (100% subsidy families, 80% enrollment efficiency, and 15% bad debt) with increased base rate (23%) and increased tiered reimbursement (total increased funding: unrated = 23%; 1-Star = 25%; 2-Star = 28%; 3-Star = 36%; 4-Star = 53%; 5-Star = 54%)

* Calculated as positive annual net revenue equal to 10% of total annual revenue
Childcare programs meet the needs of today’s working parents and are a critical part of the early childhood education system. Approximately 116,700 children in Ohio, from birth to school-age, receive Publicly Funded Child Care assistance from the state. It is vital we ensure the programs our children attend have the ability to meet Ohio’s definition of high quality—a 3- to 5-Star Rating under the Step Up To Quality system. Currently, 66% of children receiving Publicly Funded Child Care are served in unrated settings, 21% are served in 1- or 2-Star Rated programs, and only 13% attend high-quality programs.

Recommendations for Center-Based Programs

Based on our findings from the Provider Cost of Quality Calculator, we offer a number of recommendations to adjust state funding to enable centers serving publicly-funded children to move up the quality rating system and ensure Ohio’s most at-risk children attend high-quality early childhood programs, better ensuring that children start school ready to learn.

1. Adjust the Tiered Reimbursement Rates to Cover the Actual Costs for Each Increase in the Level of Quality

Currently, programs are awarded an enhanced reimbursement rate based on their Star rating: 1-Star rating =5%, 2-Star rating =10%, 3-Star rating =15%, 4-Star rating =20%, 5-Star rating =25%. These current tiered reimbursement rates do not reflect the actual cost of increasing quality levels in centers and, in fact, provide a disincentive to proceed beyond the 2-Star level of quality. High-quality programs are most important for at-risk children so reimbursement of actual costs is critical to ensuring subsidized children are enrolled in quality programs. Our analysis indicates that programs at the 3-, 4-, and 5-Star levels need increases above the current tiered rates in order to cover the associated costs of operating at higher levels of quality.

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2 Ohio Department of Job and Family Services, Step Up to Quality Effort Projection Report, November 2014.
2. **SIMPLIFY THE BASE RATE STRUCTURE AND INCREASE THE LOWEST RATE**

   After analysis of the center base rates we have concluded current base rates for all levels of payment rates for Public Funded Child Care are insufficient to operate even unrated programs, causing particular hardship in rural areas of the state. Preliminary data point to the possibility of condensing to two rate categories. We recommend combining and increasing the base rates for Categories A/B and C to create a Rural Base Rate and combining Categories D, E, and F to the F reimbursement rate to create an Urban Base Rate. Our analysis indicates that, once combined, both the Urban Base Rate and Rural Base Rate should be increased to allow programs to generate the minimum annual net revenue needed for operations.

3. **METHODS OF PAYMENT SHOULD REFLECT BUSINESS PRACTICES**

   In the private market a family pays the community-based provider a fee to make a slot available for a child. Providers must pay all costs—facilities and personnel—associated with each slot, whether or not a child attends every day, so the purchaser must pay a fee for the slot. The state has a compelling interest in ensuring that children it supports receive the benefits of attendance and that the provider can cover fixed costs. A reasonable policy would cover the full cost for the slot for each state-subsidized child and require a standard of attendance that benefits the child. The family and the provider are jointly responsible for the child's attendance meeting or exceeding the attendance standard. We recommend the state considers the Head Start model that pays for the costs associated with each child and requires an average daily attendance of 85%. If that is not possible, the attendance tracking system utilized should be aligned to more closely reflect the typical business practices for private paying families, the costs of serving each child, and reduce the labor involved in the tracking process.

4. **ESTABLISH A “BRIDGE TO QUALITY” TO ENABLE CENTER TO INCREASE THEIR RATING**

   In order to achieve a higher-quality rating, programs must operate at that level for a year before they can receive their increased Star rating, thereby incurring additional costs. Increased costs are most significant at the 3- to 5-Star rating levels. We recommend that if a center has achieved a 1-Star rating and wants to increase in quality, it needs a one-year financial incentive that allows them to cover the additional costs prior to being awarded the next level of quality.
5. ANALYZE THE COST OF PROVIDING HIGH-QUALITY EARLY LEARNING IN PUBLIC PRESCHOOL AND HOME PROVIDER SETTINGS

Additional analysis should be conducted to determine the cost of providing high-quality learning in all of Ohio’s childcare provider settings. While this analysis thoroughly reviews the revenue and expenses associated with operating a typical community-based provider in Ohio, additional research must be conducted to determine the true cost of providing high-quality early learning in public preschool and home provider settings.
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See attached document
Appendix

**Surveys Used in Ohio**

1. Provider Characteristics and Efficiency  
   See attached document

2. Cost of Family Child Care in Ohio  
   See attached document

**Additional Materials**

1. Cost Driver Worksheet (Centers)  
   See attached document

2. Cost Drivers & SUTQ  
   See attached document