‘Too Expensive, and Not Expensive Enough’

Investing in Child Care to Strengthen South Dakota’s Economy

September 2023

Joe Fretwell

About the Low Income Investment Fund (LIIF)

The Low Income Investment Fund (LIIF) is a national nonprofit community development financial institution with $900 million in assets under management. LIIF's mission is to mobilize capital and partners to achieve opportunity, equity, and well-being for people and communities. Since 1984, LIIF has deployed more than $3.2 billion to serve more than 2.4 million people in communities across the country from its five offices. An S&P-rated organization, LIIF innovates financial solutions that create more equitable outcomes for all by building affordable homes, quality education opportunity from early childhood through higher education, health clinics, healthy food retail and community facilities.

Acknowledgments

Funding for this project was generously provided by the John T. Vucurevich Foundation, a private foundation and grant maker dedicated to helping their low-income neighbors meet their needs one family at a time. Kayla Klein (Klein Visioneering Group), Louise Stoney (Stoney Associates), and Danielle Ewen (Sixth Street Associates) provided additional guidance and support throughout data collection and report development.

In nearly every community in the country, child care is both too expensive and not expensive enough. American families spend more than $10,000 on average per child for child care, a figure that exceeds typical mortgage payments and in-state college tuition in many states. Parents with children under age 6 tend to be at stages in their lives and careers where they have the least economic security and flexibility, yet we ask them to shoulder the most expensive time in their children's lives mostly out of their own pockets. This creates multiple dilemmas for young families, causing some parents to forego jobs to stay home with their children and others to settle for substandard or overly costly child care arrangements. The least certain, stable, and secure stage of parenthood is consequentially the most critical developmental stage in the life of a child.

Meanwhile, individual child care programs are plagued with financial challenges. During the height of the Covid-19 pandemic, between December 2019 and March 2021, nearly 16,000 child care providers shuttered operations. Many of these closures have proved permanent: in late 2022 there were 100,000 fewer child care workers than there were three years prior. Early childhood educators are among the lowest compensated professionals nationally, often earning close to minimum wage with limited or no benefits. Pay for individual workers is low, but program budgets for staffing and compensation makes up a disproportionate chunk of the child care business model. Overhead costs are effectively fixed, and many parents are already paying as much as they can.

Low margins and constant concern over day-to-day operations also means few programs have time, resources, or capacity to consider long-term expansion or facilities projects that would improve their operations or physical spaces. Few programs are able to qualify for debt financing, even from nonprofit or mission-aligned lenders. Between 2016 and 2020, just 1% of Small Business Administration (SBA) loans went to child care businesses, and federal grant funding for child care disallows investments in major construction projects. Staffing and facilities challenges constrain supply nationally. At least 31% of families who needed child care in 2019 could not find a licensed provider.

This paper uses interview data, market trends, and real-world program budgets from child care providers in South Dakota to create a sample program representative of the difficult economics defining the sector. As a state, South Dakota has one of the highest concentrations and lowest mean wages of child care workers nationally. It also embodies financing and expansion challenges facing the sector. Mid-size cities and small, rural towns and reservations that define much of the state rarely have the tax bases to support child care, and the typical capital sources for expansion and facilities projects – loans from the SBA and CDFIs and philanthropic grants – disproportionately support providers in large urban markets. South Dakota is also one of the fastest growing states in the U.S., logging more births than deaths in 2022 and far exceeding the national 50-state population change median. Despite population and job growth, the state lacks sufficient child care supply to meet demand. Seven counties have no regulated child care, and estimates suggest the lack of child care leads to nearly $150 million in economic losses per year.

Results of comprehensive financial modeling conducted using the Low Income Investment Fund's (LIIF) early care and education (ECE) fiscal model are presented throughout this report. Trends and findings represent how increased collective investment in early education would quickly stabilize essential business operations, prepare programs for future growth, and bolster pay for workers statewide. With the right mix of resources, incentives, and policy change, this paper makes clear that South Dakota could fulfill its promises to young children and families and unlock substantial new economic activity statewide.

Creating a Sample Program

Using data from interviews with providers in addition to South Dakota's 2022 Child Care Market Rate and Cost of Care reports, we can create a sample child care program indicative of trends in the regional market for early care and education. Importantly, the Market Rate report provides insight into the current *price* of child care to families while the Cost of Care study tells us the true *costs* borne by providers. Looking at data on both price and costs simultaneously allows for analysis of whether the rates providers are charging families align with what it actually costs them to run their programs.

Our sample program is a child care center in Pennington County, South Dakota, that enrolls 75 children full-time. As depicted in **Figure 1**, the program has three preschool classrooms serving 50 children, one toddler classroom with 15 children, and one infant room with 10 children. About 40% of children are from low- or moderate-income families that receive tuition subsidies from the State of South Dakota's Child Care Assistance Program (CCAP). Enrollment in each classroom corresponds with maximum child to adult licensing ratios in South Dakota. This means the program employs 2 infant teachers, 3 toddler teachers, and 5 preschool teachers. The program also employs an executive director, administrative assistant, general administrator, and 2 floating teachers who can fill in during planning time or off-days for other teachers and bring down ratios to bolster quality.

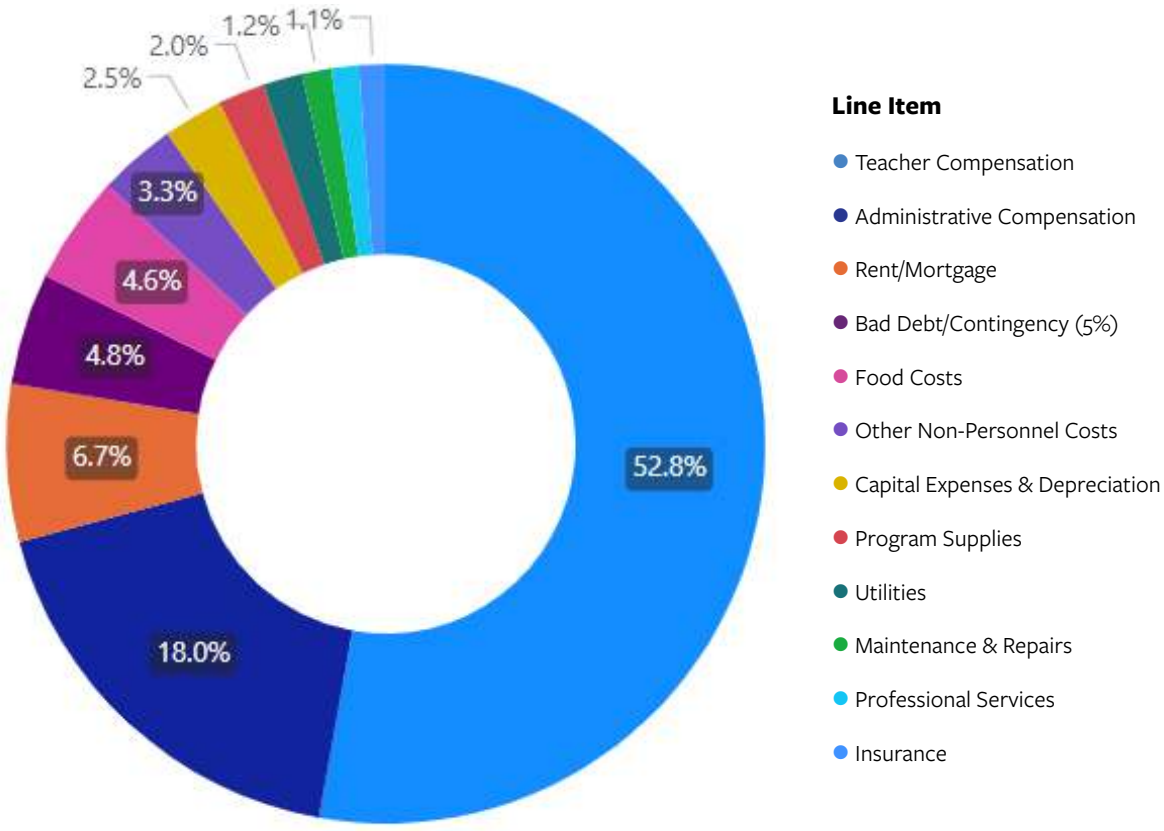
Figure 1. Sample Program Enrollment and Staffing by Age Group

Age	Total Enrollment	Total Rooms	Required Adult: Child Ratio	Total Teaching Staff	Total Floating Teaching Staff
Infants	10	1	1:5	2	1
Toddlers	15	1	1:5	3	
Preschoolers	50	3	1:10	5	1
Total	**75**	**5**		**10**	**2**

Given the size, location, and estimated revenues of the program, we estimate costs using aggregate data from the Cost of Care study. **Figure 2** displays the program's expected breakdown of expenses, approximately $650,000 total over a year of operation. A closer look at these estimates highlights a fundamental challenge in the child care business model. The South Dakota Department of Social Services (DSS) sets maximum ratios for the number of adults that must be in classrooms with children by age. Adult to child ratios are an important mechanism for ensuring health, safety, and quality of care, but they effectively guarantee high personnel costs. About 53% of our sample program's expenses are salaries and benefits for teachers and another 18% cover costs for administration. In other words, for every $100 spent by the program approximately $71 support personnel. Other big line items like rent, food costs, program supplies, utilities, and building maintenance make up much of the programs non-personnel operating budget and leave little room for contingency or reserves.

Figure 2. Sample Program Costs

Percent of $650,000 Annual Operating Budget by Expense Type



For any organization to keep its doors open – even one that is not concerned with generating a profit – it must earn sufficient revenues to cover its costs. This is difficult for child care providers because high, fixed overhead costs often exceed what new parents are reasonably able to afford. Analyses of the costs associated with running a child care business consistently show that required program expenses far outpace what families can afford to pay.

Examining the primary revenues of our sample program in **Figures 3 and 4** exemplifies financial challenges of the sector at large, as well as the more nuanced ways in which South Dakota's Child Care Assistance Program (CCAP) reimbursement policies make operations more difficult for programs that serve the children who need reliable care most. The program must cover about $650,000 in estimated expenses per year regardless of how many children attend day-to-day, but even at near perfect attendance, the program earns a margin of less than $14,000, or 2% of total revenues.

Figure 3. Estimated Revenues Collected, Base Resources

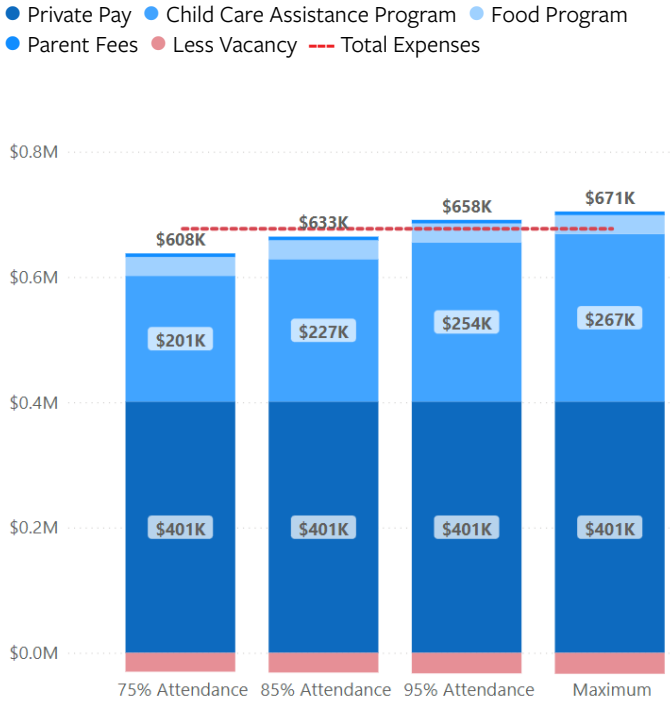
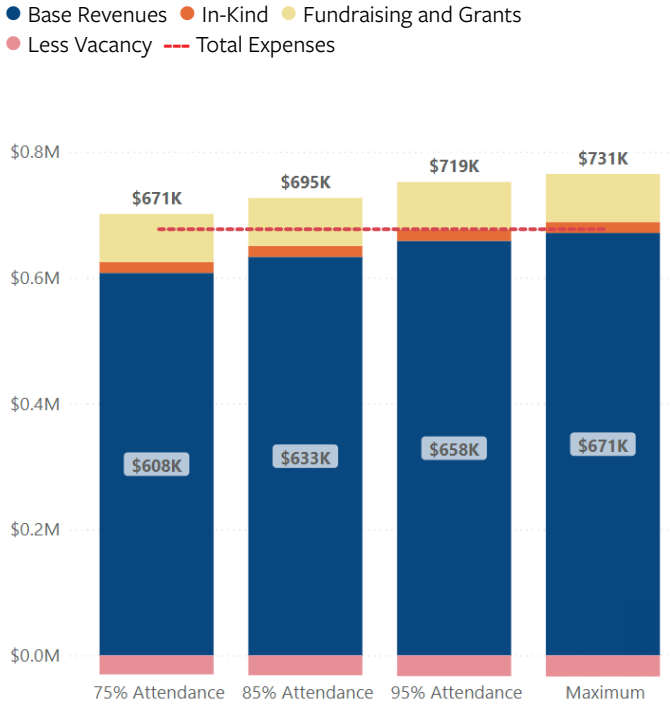


Figure 4. Estimated Revenues Collected, Expanded Resources



The State of South Dakota's reimbursement policies through the Child Care Assistance Program (CCAP) make these revenues less reliable than those collected from private pay families, who generally must cover tuition regardless of their child's hourly or daily attendance. Philanthropy and other funders are filling holes in operating budgets for many child care programs in South Dakota.

The outlook is much worse for programs that struggle with attendance because of differences in how providers collect tuition from private pay and subsidy-eligible families. Most programs charge a flat weekly or monthly tuition for private pay families that must be paid regardless of whether the child attends day to day. For low and moderate income families who receive tuition assistance, an absence means programs do not get paid fully by the state Department of Social Services (DSS).[1] In a scenario where enrolled children only actually attend 75% of the time, our program runs a $40,000 deficit despite stability of private pay revenues. Rate setting relies on trends in the market, but payment does not – a fundamental contradiction in state policy.

[1]DSS allows programs to claim up to 50 hours of subsidy payment per child per month to account for occasional absences. Scenarios presented in Figures 3 and 4 do not include these payments due to unpredictability in planning and to illustrate the ways in which hourly reimbursement further exacerbates challenges. By reimbursing for CCAP on an hourly basis, parents could change a child's enrollment schedule daily or weekly with little advance notice for the program.

Creating a Sample Program (cont'd)

Review of revenue trends in the Cost of Care study suggests that philanthropic grants and fundraising campaigns are keeping many programs afloat, particularly nonprofit centers. About 8% of overall revenue tends to come from these sources in a typical year, and this percentage has been substantially higher over the past several years as Covid-relief grants have further supported budgets. Without grantmaking and charitable giving – which also require staff time and resources to pursue – our sample program could quickly become insolvent and have to shutter operations.

Child care programs in South Dakota are a mix of public, nonprofit, and for-profit entities, but many rely on philanthropy and fundraising to make ends meet. This is one of the only industries in the U.S. where private businesses regularly seek out charitable giving to support core operations, exemplifying both the financial challenges of the market and the critical importance of child care in public life.

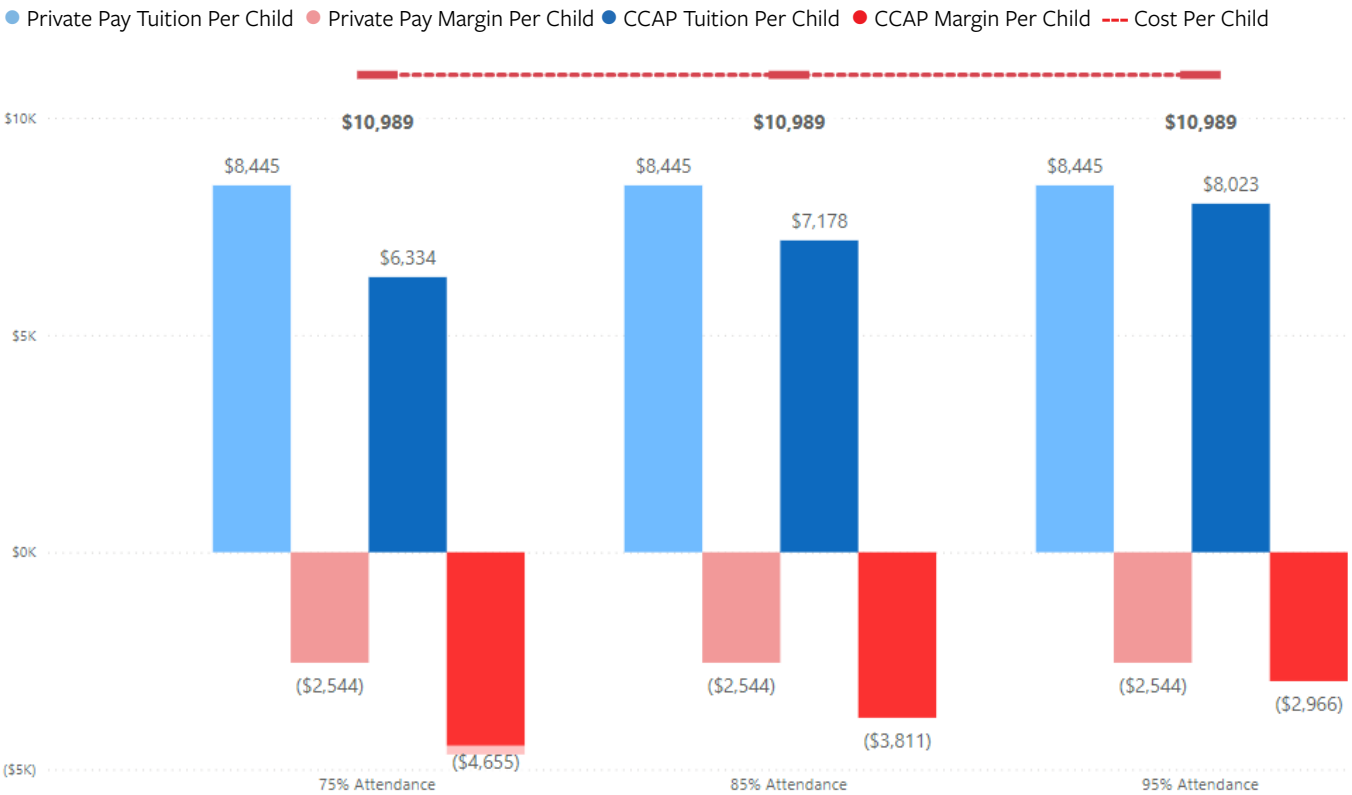
The availability of child care is unlike that of other goods available for purchase or consumption. The public good would only be marginally impacted if the costs of manufacturing televisions were so high that companies could only sell them to those who could afford to cover those costs. With early care and education, limited supply conflates with big drains on child and family wellbeing, economic activity and productivity, and many other indicators of the vibrancy of a community.

The Challenge of Market-Based Rate Setting

Most states nationwide, including South Dakota, rely on results of periodic Market Rate reports to set maximum child care subsidy reimbursement rates. A deep dive into the revenues and expenses of our sample program in Pennington County reveals fundamental flaws in this approach.

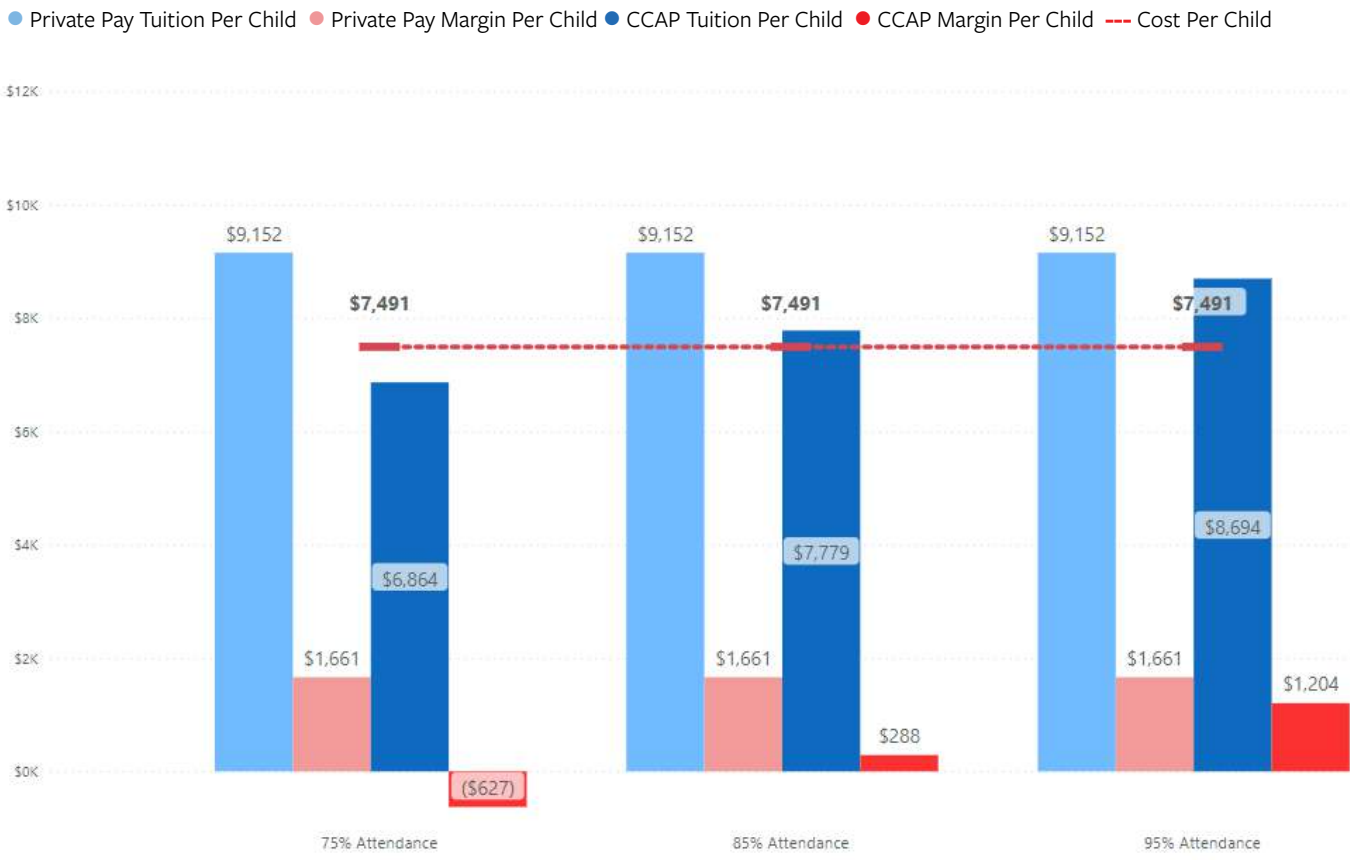
Surveys conducted as part of the 2022 Market Rate report found that the market tuition price for preschool-age care in Pennington County was higher than that for infants and toddlers, likely a sign of low overall supply of licensed care for younger children. By relying on the current state of the market to set CCAP reimbursement rates, huge disincentives arise for providers, as younger children tend to have much higher costs of care. **Figures 5 and 6** display results of a cost of care analysis for our sample program. Given projected program expenses, we estimate that it costs our program $10,989 per year to serve one infant, $10,830 per year to serve one toddler, and $7,491 per year to serve one preschooler, but actual collections from tuition revenues are misaligned with costs.

Figure 5. Costs Per Child and Tuition Revenue Collected by Source, Infants



The sample program loses money on all infants, but losses are more severe for low- and moderate-income families that rely on state Child Care Assistance Program vouchers to subsidize the cost of care. Even in a scenario with perfect attendance, tuition revenue for infants lags far beyond the nearly $11,000 per year it costs the program to enroll each child.

Figure 6. Costs Per Child and Tuition Revenues Collected by Source, Preschoolers



Market prices for preschool are higher than those for infant care in Pennington County, meaning the CCAP reimbursement rate is closer to the actual cost of care. Assuming close to full enrollment and full fee collection, programs can occasionally earn small margins on older children.

Current market prices are significantly lower than these costs – largely because prices are based on what families can afford and are willing to pay. At current tuition rates and a scenario where CCAP-eligible families attend fully 85% of the time, our program only collects $8,445 per private pay infant and $7,178 per CCAP infant. As shown in analysis of total program revenues above and **Figure 6,** fundraising revenue and margins on preschoolers are effectively subsidizing the cost of enrolling infants and toddlers. The same 85% attendance scenario shows the program earning $1,661 per private pay preschooler and $288 per CCAP preschooler.

Despite overwhelming evidence of benefits to individual children and broader communities, child care providers in Pennington County are financially disincentivized from serving families who qualify for CCAP, especially those with infants and toddlers. Artificially low reimbursement rates, restrictive state attendance policies, and limited ability of families to cover high costs of care are a recipe for market failure.

Calibrating Rates to Costs

Using data on costs per child by age group for our sample program, we can estimate more appropriate rates for tuition and CCAP reimbursement. To actually account for the cost of care, the program should invert its current rates, as represented in **Figure 7**.[2] Infants and toddlers should garner higher rates than they do in the current market rate environment at $5.28 and $5.21 per hour, respectively, and preschool tuition should decrease by about $.80 per hour. **Figure 8** represents how a shift from market-based rate setting to rates based on cost modeling would translate to expected total annual revenues for our program.

Given the current proportion of preschoolers, the program would see an aggregate decrease in total revenues with a continuation of policies that reimburse on the basis of attendance, but an increase if DSS reimbursed for care so long as a child was enrolled.

> "Calibrating rates to the actual cost of care takes away disincentives to serving children of certain age groups or funding streams, and it opens the door for future policy and funding decisions that incentivize desired behaviors, program qualities, or service populations."

Figure 7. Projected Hourly Rate Change by Age Group

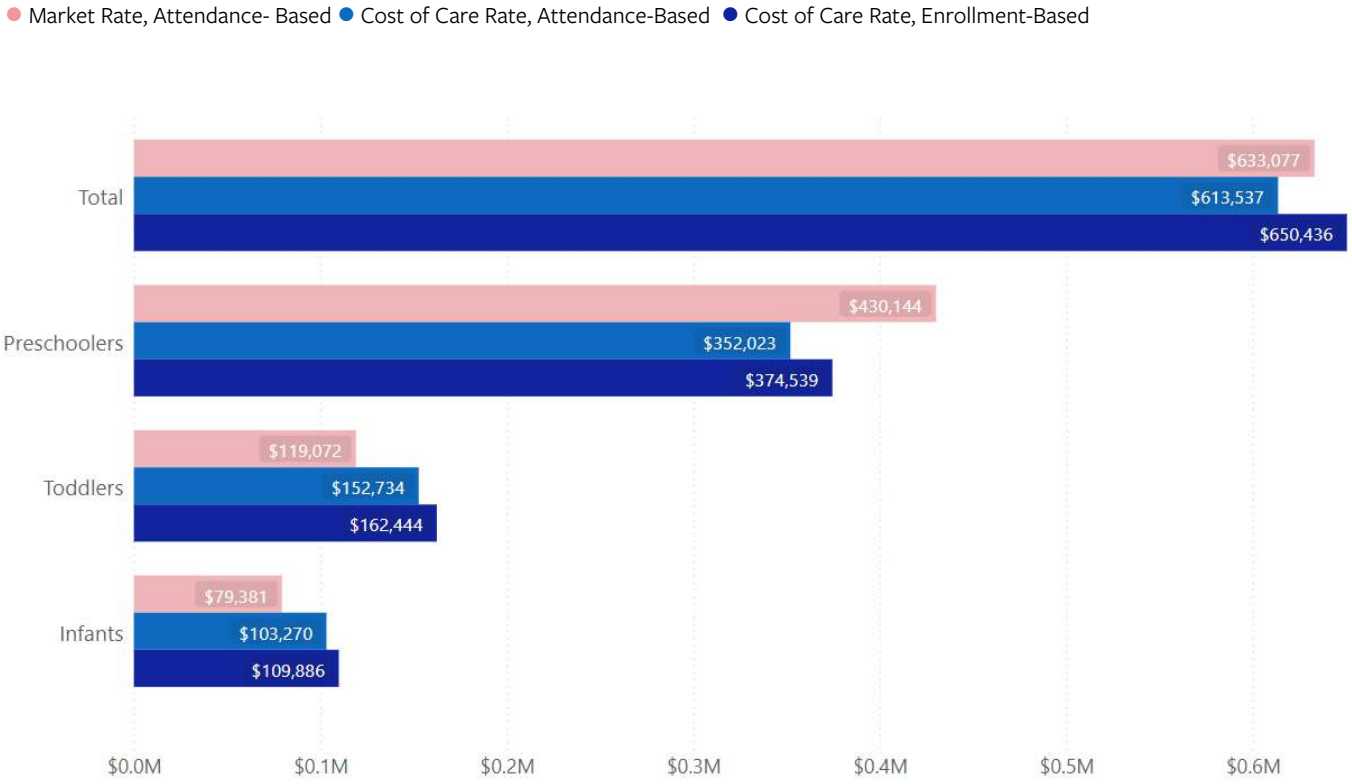
[2]This discussion uses hourly rates to align with South Dakota's reimbursement policies, but it is important to underscore the flaws in this approach. Most costs of running a child care program are fixed and cannot be paid by the hour. A program cannot send a teacher home without pay or refuse to pay rent because several enrolled children attended for fewer hours than expected.

Calibrating Rates to Costs (cont'd)

Importantly, the shift from market rates to the cost of care relies on analysis of *current* program costs. In **Figure 8,** the Cost of Care, Enrollment-Based scenario shows the program barely breaking even of its current costs, which still have low pay and limited benefits for staff, relatively high child to adult ratios, and limited facility quality. For our program to operate more effectively, improve pay and conditions for teachers, improve quality, and plan for future expansion, it would need to increase revenues even further beyond what it costs to care for children right now.

Precedent already exists for such action: some states tie the reimbursement rates programs receive to their quality ratings, and others provide a higher rate for programs that serve children with disabilities or from language minority households.

Figure 8. Revenue Projections with Rate and Reimbursement Policy Changes



At current enrollment, the sample program would only see an increase in total revenues if the state shifted CCAP policies to pay on the basis of enrollment rather than attendance. Figures in this graphic represent effectively what it would take our program to break even at current costs, but it does not include broader funding needs to increase pay for staff or bolster long-term program operations.

Modeling Potential for Stabilizing the Workforce and Expanding Child Capacity

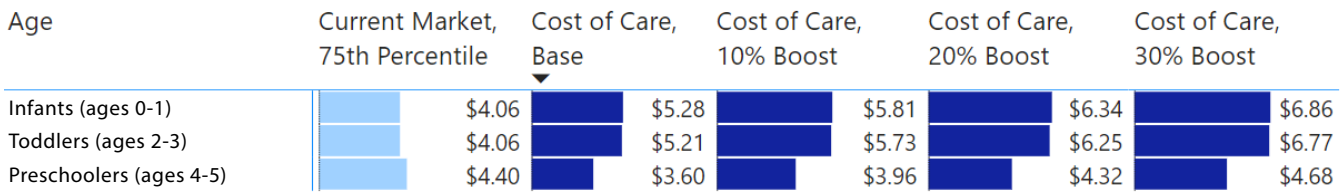
How might the outlook for child care change if breaking even was a guarantee? What if the real work of state government, philanthropy, business, and other funders was incentivizing innovation and best practice, not just keeping the sector afloat?

To answer this question, we model our sample program's capacity for increasing teacher pay and expanding child enrollment at three tuition tiers, a 10, 20, and 30% increase over the current cost of care. Each scenario assumes programs are reimbursed on the basis of enrollment rather than attendance. **Figure 9** represents how hourly rates would further increase beyond the base cost of care, with the maximum 30% rate hike equating to nearly $7.00 per hour for infants and toddlers and more than $4.50 per hour for preschoolers.

Two variations of each scenario are shown throughout to represent the tools available to policymakers and funders. In the first, only reimbursement rates for CCAP-eligible children are increased above the cost of care ("Subsidy Boosts"), and the second version shows further expected growth if rates were increased across the board regardless of funding source ("Tuition Boosts").

"How might the outlook for child care change if breaking even was a guarantee? What if the real work of state government, philanthropy, business, and other funders was incentivizing innovation and best practice, not just keeping the sector afloat?"

Figure 9. Projected Rate Change with Tiered Boosts



Modeling Potential for Stabilizing the Workforce and Expanding Child Capacity (cont'd)

Figures 10 and 11 display how overall annual revenues would change with boosts in each scenario. Given the current enrollment mix – where 60% of children come from families without CCAP subsidies – total revenue increases less significantly when rates are only increased for children receiving tuition assistance. However, such a policy change would flip the landscape of incentives, now driving providers to seek out children from low- and moderate-income families because CCAP reimbursement rates would be higher and more reliable. This could cause our program to eventually shift its enrollment mix and increase revenues by accepting more CCAP families. Even with existing enrollment, though, a modest 10% increase in rates increases our program's margin from effectively zero to nearly $30,000 annually with subsidy boosts and more than $65,000 with tuition boosts. Margins grow exponentially with rates because costs are assumed stable.

Figure 10. Tuition Revenue with Subsidy Boosts

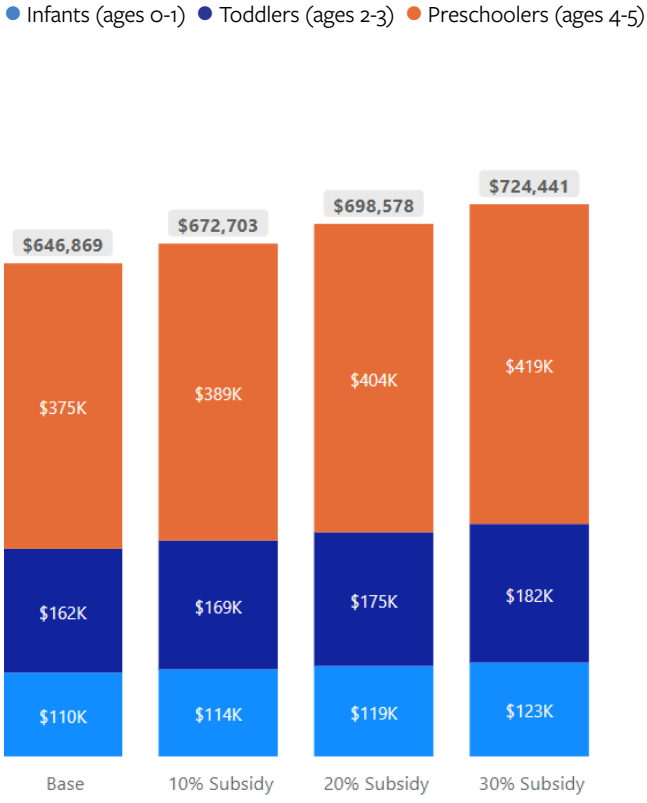
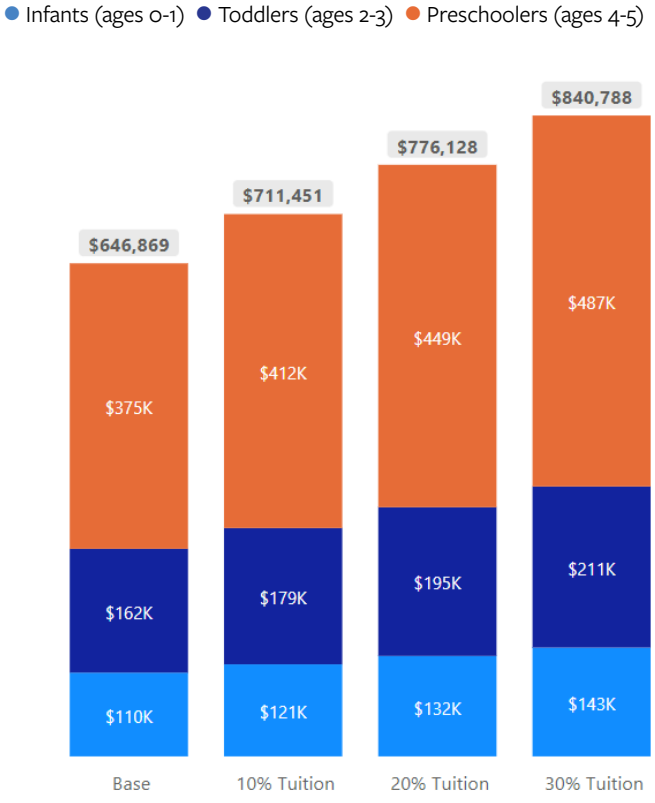


Figure 11. Tuition Revenue with Tuition Boosts



When rates are set based on actual costs, breaking even is a guarantee for the program. This would allow policymakers and other funders to incentivize certain behaviors to bolster innovation and quality through subsidy and tuition boosts. Importantly, interventions modeled in Figures 10 and 11 would require reinvestment back into teacher pay or expansion projects.

Capacity for Increasing Teacher Pay

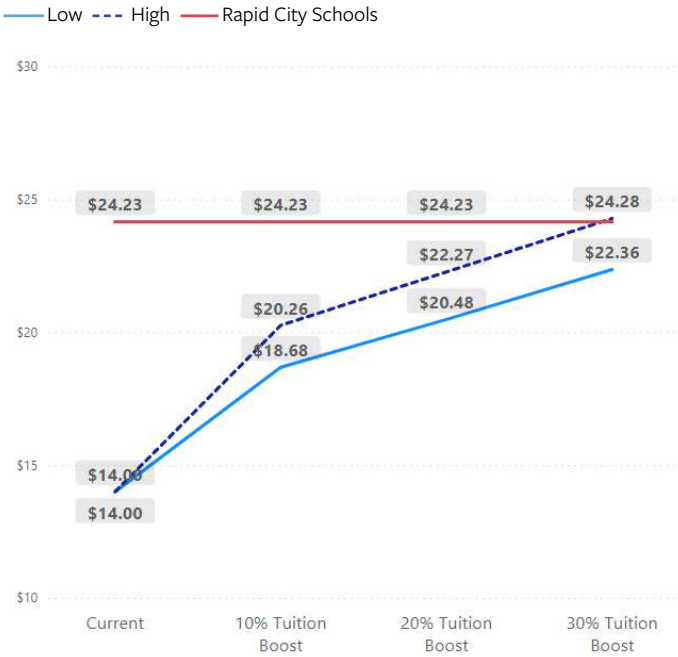
Like many child care providers across Pennington County and the state of South Dakota, attracting and retaining quality teaching staff is a significant challenge. The state's 2022 Cost of Care report suggests a whopping 83% turnover rate among classroom staff in child care centers year over year.

Figures 12 and 13 provide a maximum possible pay range for lead teaching staff in our sample program with expanded rate scenarios if the program decided to equally increase pay for teaching staff at all levels. The low estimate assumes that our program would continue to devote the same percentage of its budget toward compensation, and the high estimate reflects how wages passed on to teachers would change if nearly 80% of program expenses were guaranteed for personnel. **Figure 14** displays the full results of this compensation model for all of the program's 12 current teaching staff.

Understanding the true costs of providing child care allows policymakers and funders to consider reimbursement tiers that are only available to programs working toward increased pay for teaching staff. For example, DSS could offer percentage rate increases to programs that guarantee a certain salary for lead, mid-career, and new teaching staff. Findings in this report suggest our program could afford to pay lead teachers around $20 per hour, mid-career teachers $17 per hour, and entry-level teachers almost $15 per hour with 30% subsidy boosts.

Figure 12. Maximum Hourly Compensation for Experienced Teachers, Subsidy Boosts

Figure 13. Maximum Hourly Compensation for Experienced Teachers, Tuition Boosts



Figures 12 and 13 depict maximum hourly pay for experienced teachers in heightened rate environments where all teaching salaries are increased equally for the sample program. With 30% subsidy or tuition boosts, the program could increase annual salaries for lead teachers from about $28,000 to $38,000 or $46,000, respectively.

Until access to child care becomes more of a universal public good, philanthropy, business, and other funders could further drive wage increases with grants or scholarships that extend rate increases to private pay families. A scenario with full tuition boosts would make our program a legitimate competitor with the local school system in recruiting, retaining, and compensating highly qualified, experienced teaching staff.

Figure 14. Estimated Maximum Hourly Pay by Position with Rate and Policy Changes

Scenario	Entry-Level, Low	Entry-Level, High	Mid-Career, Low	Mid-Career, High	Experienced, Low	Experienced, High
10% Subsidy Boost	$12.78	$13.92	$15.17	$16.52	$17.50	$19.06
10% Tuition Boost	$13.60	$14.80	$16.15	$17.57	$18.68	$20.26
20% Subsidy Boost	$13.32	$14.50	$15.82	$17.22	$18.25	$19.86
20% Tuition Boost	$14.96	$16.26	$17.76	$19.31	$20.48	$22.27
30% Subsidy Boost	$13.87	$15.09	$16.47	$17.92	$18.99	$20.66
30% Tuition Boost	$16.33	$17.73	$19.39	$21.05	$22.36	$24.28

Interviews Reveal Interest in Expansion but Lack of Resources

"DSS recently had funding for expansion, but we can't actually use the money to expand. Capital, land acquisition, major construction, and transportation were ineligible uses of funds. We even worked with an architect and submitted plans showing how we would increase the size of our building."

"We have space that I could fill with kids by Tuesday if we had the staff."

"There are programs in town with space and interest in serving infants, but it just doesn't make economic sense."

"To qualify for a loan – even from the USDA – we have to show that our program is sustainable. How can you do that when you rely on grants that may not exist next year?"

Modeling Expansion and Debt Capacity

In addition to workforce challenges, many South Dakota child care providers report difficulties expanding their capacity because of inability to find appropriate space or financing for facilities projects. With increased tuition revenue, though, our sample program could begin to explore opportunities for a large capital project that might allow it to expand licensed capacity. **Figure 15** displays relevant inputs for modeling an expansion project that sees our program adding a new wing to its existing building to accommodate 45 additional children. Expanding would require nearly 5,000 new square feet of indoor space and 2,300 square feet of outdoor space and bring with it new personnel and other operating costs. In total, the financial model estimates that the expansion project would add $331,910 annually to the sample program's budget at current costs.[3] This number would increase if the program also decided to increase wages or add expenses beyond current costs.

Figure 16 suggests that the program could significantly add to its annual operating margin by expanding in an environment with increased subsidy and tuition rates, allowing for growth in the capacity of the program to qualify for and pay monthly debt service on a loan needed to complete the facilities expansion project.

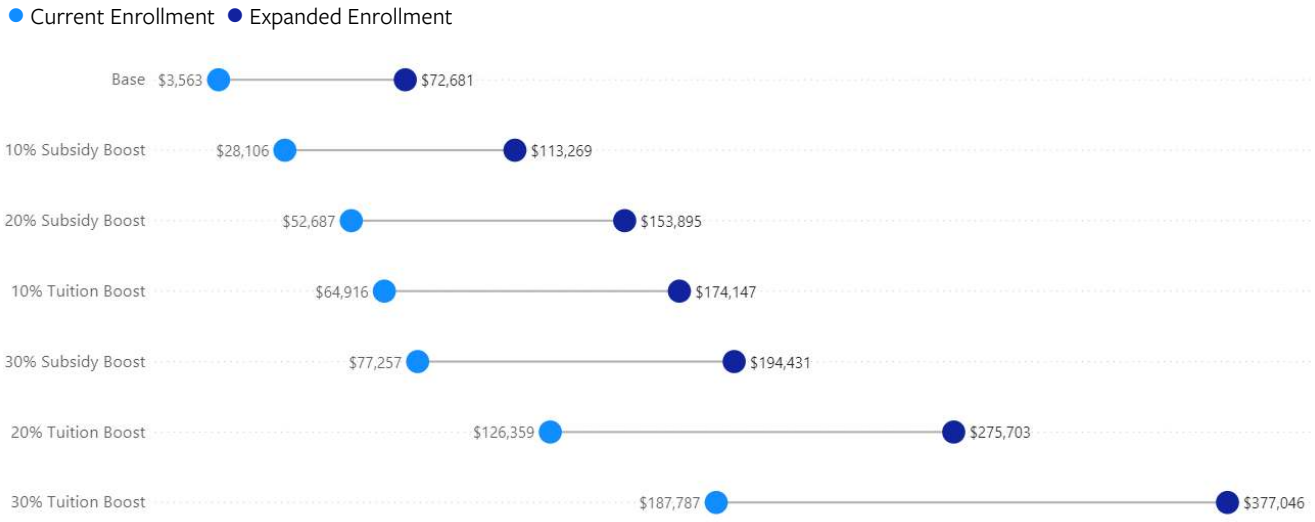
> "Calibrating rates to the cost of care makes expansion an attractive, viable option for our sample program. Even without a rate boost, the program would see its margin grow from barely above a break-even point to $72,681 annually. Economies of scale take over when rates actually align with per child costs."

Figure 15. Expansion Planning Inputs

Age	New Children	New Staff	New Indoor Space (square feet)	New Outdoor Space (square feet)	New Staff Costs	New Operating Costs	Total New Costs
Infants (ages 0–1)	10	2	1,300	500	$63,901	$25,297	$89,198
Toddlers (ages 2–3)	15	3	1,545	750	$93,579	$37,832	$131,412
Preschoolers (ages 4–5)	20	2	2,000	1,000	$63,901	$47,400	$111,300
Total	**45**	**7**	**4,845**	**2,250**	**$221,381**	**$110,529**	**$331,910**

[3]**Note:** This amount does not include future debt service payments, as analysis in this section is focused on what the program might reasonably be able to afford to add to its operating budget in regular payments on a loan.

Figure 16. Operating Margin Before Debt Service by Rate Change and Expansion Scenario



Economies of scale take over when rates actually align with per child costs. Figure 16 represents how the program's operating margin grows in all expansion scenarios, making qualification for the debt necessary to expand a real possibility.

Calibrating rates to the cost of care makes expansion an attractive, viable option for our sample program. Even without a rate boost, the program would see its margin grow from barely above a break-even point to $72,681 annually. Economies of scale take over when rates actually align with per child costs.

Currently, very few child care providers in Pennington County, the state of South Dakota, or across the United States can qualify for a loan that would pay for an expensive construction project necessary for expanding capacity. However, this quickly changes as margins grow under a reimbursement system tied to the cost of providing care. A maximum affordable loan our program might qualify for is estimated for each scenario with relatively affordable and favorable construction loan terms and conditions displayed in **Figure 17** that might be available from a mission-oriented or community-based lender like a credit union or community development financial institution (CDFI).

Figure 17. Loan Terms and Inputs

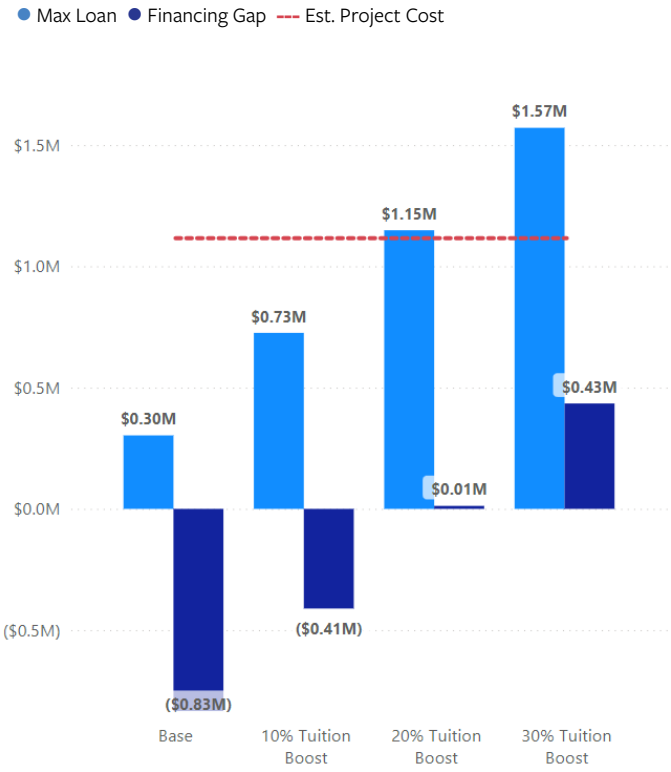
Equity	5%
Term	5 years
Construction period	12 months
Origination fee	1.25%
Minimum Debt Service Coverage Ratio (DSCR)	1.20
Cost of Construction	$300 / sf
Total Est. Project Cost	$1,136,433.00

Modeling Expansion and Debt Capacity (cont'd)

Using a cost of $300 per square foot for construction estimates, we come to a total estimated project cost of $1,136,433.00 to add 45 new slots to the program. As shown in **Figures 18 and 19**, the project cost would continue to exceed the value of a loan the program could afford until the 20% tuition boost scenario. With 30% tuition boosts, the program could both cover the full cost of construction through debt and increase expenses elsewhere, including through salary and compensation hikes. Even in scenarios where the program could not fully cover the cost of the project, rate increases significantly expand debt capacity and reduce burden on other funders to support the sector with patchwork facilities grants that rarely cover the full scope of need.

Figure 18. Debt Capacity with Subsidy Boosts

Figure 19. Debt Capacity with Tuition Boosts



Figures 18 and 19 show maximum debt capacity for the program across scenarios against the estimated cost of adding enough space to accommodate 45 additional children in the program. With 30% boosts above base tuition and reimbursement rates, the program could realistically both fully cover the cost of construction and increase staff salaries.

Implications and Policy Recommendations

Financial analysis and scenario modeling for our sample program in Pennington County reveals many of the fundamental challenges facing child care providers across South Dakota. To respond to the scale of the problem, substantial new investment from government, business, and other sectors that benefit from the positive externalities of a community's access to child care is clearly justified. This section includes recommendations for ways state and local government, as well as non-governmental actors like employers and the business community, can play a part in reimagining child care.

Many of the discussed recommendations would require South Dakota to examine its state revenues and expenditures to determine how such increases in funding for child care could actualize. Some states have committed additional general fund revenue to address a shortage of early care and learning spaces, and others have considered creative ways to change policy through dedicated federal revenue streams.

State Policymakers

1. **Use a cost modeling approach to establish Child Care Assistance Program (CCAP) reimbursement rates.** South Dakota's current reliance on market rates to set subsidy reimbursement rates disincentivize many providers from serving younger children and children from low- and moderate-income families. Rate setting that accounts for the likely cost of care would make programs more sustainable and improve efficiency of the CCAP program.
2. **Reimburse providers on the basis of enrollment rather than attendance.** Reimbursing providers only for the hours children attend does not align with market practices and creates a disincentive to serve CCAP families. With reasonable safeguards, DSS should pay full CCAP rate for any child that is enrolled to ensure program sustainability and make financial planning easier.
3. **Consider tuition and reimbursement rate boosts for programs seeking to improve quality, increase teacher pay, or expand capacity.** A system that provides higher rates for certain providers could help the state achieve policy goals through increased reimbursement rates for programs that meet certain criteria, such as improved teacher pay or expansion of child capacity. Such investments could spark public-private partnerships with requests to philanthropy and business sectors for further extension of rate boosts. For example, if government funded 10% boosts beyond the cost of care for program seeking to increase teacher pay, other funders could further drive wage increases and sector stabilization by matching boosts to programs already vetted by policymakers and agency staff.
4. **Help fund shared service alliances to improve child care business operations and reduce administrative costs.** The 2022 Cost of Care report showed significant administrative expenses that providers might be able to more efficiently outsource to shared services networks. The state could help subsidize costs to providers who participate in shared service networks, which can both reduce program costs and improve efficiency of operations.

State Policymakers (cont'd)

5. **Align state government programs with the needs of providers, particularly by allowing major construction and acquisition in expansion grants.** Any new grants for providers that seek to help with expansion of capacity should ensure that major facilities investments are allowable uses of funds.
6. **Incentivize developers to create space for child care through the Low Income Housing Tax Credit (LIHTC), Community Development Block Grant (CDBG), or innovative loan funds.** Existing affordable housing and community development programs can be important tools for bringing mostly nonexistent facilities and infrastructure resources into the child care sector. DSS should partner with South Dakota Housing to incentivize developers using LIHTC, CDBG, or other programs focused on housing supply to carve out space for child care programs.
7. **Consider tying child care requirements to economic development incentives for large employers.** South Dakota offers generous tax incentives to large businesses seeking to relocate or create new jobs in the state, but these investments rarely consider the ways economic development activity and growth might strain local child care providers. Just as the federal government is requiring semiconductor manufacturers seeking subsidies from the CHIPS Act to have a plan for supporting child care needs of employees and localities, so too should the state in programs that reduce tax liability of new industry.

Local Government Officials

1. **Identify vacant or underused public assets to convert or lease to child care**. Local governments across South Dakota should take stock of real estate that could be converted to child care. Various cities and counties nationwide have been successful in unlocking new space for child care by incentivizing child care in Request for Proposal (RFP) processes for development on public land.
2. **Review local zoning, building, and permitting regulations to assess impact on child care facilities projects.** Planning departments and other local regulating entities should study the specific impacts their policy decisions have on child care. This could include zoning changes that allow child care "by right" in more places within communities or reduced business or other development fees for small, low-margin providers.
3. **Consider short-term revenue generating strategies to help construct new facilities for child care.** Particularly in smaller rural communities with limited tax bases, local leaders may find success with small, time-limited tax increases to fund the development of new child care facilities. The development of one child care center in some communities could meet the majority of demand. The City of Warren, Minnesota, recently took such an approach to pay off a low-interest loan from the USDA Rural Facilities program.

Local Government Officials (cont'd)

4. **Fund tuition boosts tied to workforce compensation increases or expansion projects.** Although local governments often have limited resources, even small towns could create pilot programs that bolster private pay or CCAP revenues at target programs seeking to increase staff pay or debt capacity for expansion. Paired with less resource-intensive interventions above, small rate boosts for a handful of target programs could drive sustainability and child capacity in cities and towns of various sizes and help reduce gaps in supply and demand for licensed care.

Employers and Business

1. **Use a cost-modeling approach when providing child care tuition subsidies for employees.** Some employers in South Dakota are already supporting the child care sector by subsidizing tuition in community programs for their employes. As with CCAP rate-setting, though, these subsidies must consider the true costs of care borne by providers to bring down costs for families without affecting overall supply and sustainability of local programs.
2. **Consider investments in facilities as one-time capital supports.** Large employers or chamber of commerce members may be able to collaborate to make grants to local child care providers to help them renovate, expand, or purchase their facilities. These investments can bring down program costs and improve quality across a community.
3. **Invest in state or local revolving loan funds that support child care.** Employers could also make low or no-interest program-related investments that revolve once projects are completed or loans are paid off. These types of investments could pad the capital stack of individual child care programs seeking to take on a loan for an expansion project and buy down conventional interest rates from banks or other lenders.
4. **Make funds available to help child care programs purchase and effectively use modern technology.** Early care and education is one of the last sectors to benefit from a technology transformation. Indeed, industry leaders estimate that only a third of all child care programs use Child Care Management Software (CCMS) and even those who purchase it do not use the tool to maximum benefit. Strategic investment in technology and business coaching linked to it can have a significant impact on program and sector sustainability.
5. **Explore public-private partnerships for sharing child care costs.** Initiatives like Michigan's Tri-Share model for funding child care could help bring employers and business into the equation for supporting state and local markets for care. Such initiatives create formulas for splitting tuition costs between state and local funding streams, business or chambers of commerce, and parents. This both buys down costs for families and ensures that programs are reimbursed for the full cost of care.