



INCREASING QUALITY IN EARLY CARE AND EDUCATION PROGRAMS: EFFECTS ON EXPENSES AND REVENUES

Introduction

The Provider Cost of Quality Calculator (PCQC) is an easy-to-use, dynamic Web-based tool from the Office of Child Care's (OCC) National Center on Child Care Quality Improvement (NCCCQI), available for use by state and territory policymakers to help them 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.

The purpose of this issue brief is to demonstrate how the PCQC can be used to model and understand the impact of increasing quality on the revenue and expenses of an early childhood center or family child care (FCC) home. The brief discusses the effects of the following variables on provider financial health and viability:

1. Increased levels of quality;
2. Ratios and group sizes; and
3. Compensation increases.

Understanding how these variables affect program finances can help inform policy and business decisions for child care providers and policymakers. For example, States designing quality rating and improvement systems (QRIS) must evaluate if proposed standards are financially feasible and sustainable for participating providers. If QRIS standards—such as ratios—have a significant fiscal impact, States must identify the level of financial supports needed for programs to succeed. The PCQC can provide cost and revenue projections illustrating the fiscal impact at different quality levels. Some

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States have used these data to target additional resources to programs serving a large percentage of children receiving subsidy.

Defining Provider Characteristics and Quality Levels

The basic cost of operating an early childhood center or FCC home is defined by basic child care regulations. In the base scenario, a moderate size center for as many as 66 children enrolls infants, toddlers, and preschoolers. The program receives Child Care and Adult Food Program (CACFP) assistance, and the percent of children receiving subsidy is projected at 25, a common proportion in settings that accept subsidy. Additional ongoing costs are associated with the provider's level in a QRIS. The cost drivers in a QRIS tend to fall into three categories:

- **Qualifications:** Nearly all QRIS have increasing qualifications by level; some QRIS require employee benefits. Both the increased wages and any additional or expanded benefits are ongoing costs;
- **Ratios:** Reduced ratios for all, or for younger age children, are included in some QRIS, often at the higher levels. Reducing ratios reduces revenue and increases cost per child since costs are spread among fewer children; and
- **Staff Time:** Most QRIS include some criteria that add staff time beyond what state regulations require. This might include staff meetings, paid planning time, child assessment, parent engagement, or transition activities. In addition to time, some QRIS requirements have other ongoing costs. For example, child assessment systems have an annual cost per child and take time for staff to conduct, record, and report.

The higher quality level scenarios discussed in this brief are built upon a baseline scenario that represents compliance with state regulations and estimates averaged from several states. While the data are useful in illustrating the impact of increased quality on costs and revenues, the amounts will vary from State to State. States are encouraged to utilize data specific to their State when using the PCQC.

- For centers, the baseline scenario assumes a qualified director and two teaching staff in each classroom, and at least one full-time administrative staff person;
- For Level 2, the QRIS scenario requires that a child assessment system and aligned curricula are used, requiring increases in teaching staff qualifications, staff hours, salaries and benefits; and
- For Level 3, the QRIS requires more intensive planning and family engagement and more highly qualified and compensated staff to spend additional time on those activities.

For homes, the scenario assumes these same requirements by quality level for assessment, curriculum, and family engagement. In addition, it assumes that these are accomplished by the provider working additional hours each week (5 hours more at Level 2, and 10 hours more at Level 3).

For a complete list of the assumptions built into the base scenario, please consult the Appendix at the end of this issue brief.

Cost of Quality Levels

Effect of Increased Levels of Quality on Provider Financial Health: Centers

Table 1 illustrates the expenses and revenues at three levels of quality. The net annual revenue and expense statements below show that the center at Level 1 can break even, with net revenues of \$2,537. The Level 2 center is slightly in the red, while the Level 3 center is showing a reasonable profit (positive net revenue). The Level 3 center is benefiting from the higher private pay tuition rates at this level and the generous tiered subsidy rates. In this scenario, ratio and group size requirements remain the same at each quality level.

**Table 1. Center: Annual Net Revenue (25 Percent Subsidy Enrollment),
Quality Levels 1 – 3**

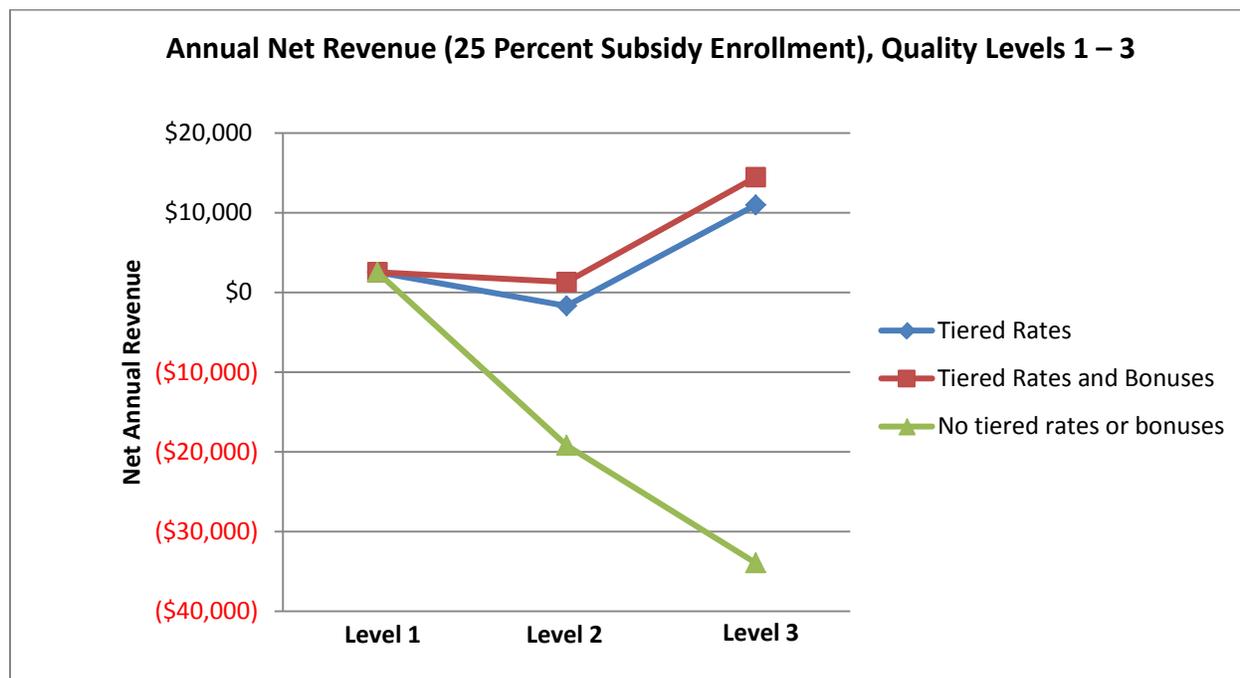
EXPENSES	Quality Level 1	Quality Level 2	Quality Level 3
Total Personnel Expenses	\$299,832	\$391,745	\$442,195
Total Nonpersonnel Expenses	\$200,900	\$202,550	\$202,550
TOTAL EXPENSES	\$500,732	\$594,295	\$644,745
REVENUE			
Subsidized Children	\$143,702	\$164,918	\$198,172
Tuition-based Children	\$434,538	\$521,664	\$564,954
Tuition Total	\$578,240	\$686,582	\$763,126
CACFP	\$31,188	\$31,188	\$31,188
Bad Debt and Enrollment Inefficiency	(\$106,159)	(\$125,173)	(\$138,607)
TOTAL REVENUE	\$503,269	\$592,597	\$655,707
NET REVENUE			
Net Revenue	\$2,537	(\$1,698)	\$10,963
Net Revenue As Percent of Total Revenue	0.50%	-0.30%	1.7%

This analysis illustrates the impact of tiered rates. States might consider doing a similar analysis to help inform whether their financial incentives allow a typical provider to remain profitable. As this table illustrates, expenses increase by quality level. And although revenue also increases, revenue at Level 2 is not high enough to support the increased expenses associated with higher quality.

As noted in a separate issue brief on program characteristics, modest increases in enrollment efficiency above the base setting of 85 percent can reverse small net annual losses like those of the Level 2 center above, but few programs can successfully maintain enrollment efficiency beyond 90 percent. (See *Early Care and Education Program Characteristics: Effects on Expenses and Revenues* at <https://childcareta.acf.hhs.gov/resource/early-care-and-education-program-characteristics-effects-expenses-and-revenues>.)

Because financial supports (including tiered subsidy rates and financial incentives) are a significant policy issue for States, it is worth comparing the effect on the financial health of a center that receives tiered rates, tiered rates and bonuses, and no tiered rates or bonuses. As the graph below illustrates, financial supports have a substantial impact on a program's bottom line. In this scenario, an annual bonus of \$3,000 for Level 2 and \$3,500 for Level 3 brings this center's net revenue at Level 2 out of the red.

Figure 1: Comparison of the Effect of Financial Supports on Annual Net Revenue at Levels 1, 2 and 3.



Effect of Increased Levels of Quality on Provider Financial Health: Homes

FCC homes are small home-based businesses. In this example, the net annual revenue is the provider’s income, and there are no personnel expenses or benefits projected for a provider working alone. Because providers at higher quality levels work more hours, it is useful to compare hourly wages as well as annual revenue when examining the effects of increasing quality.

Table 2 shows expenses and revenues for a home provider working without an assistant. A provider at Level 1 can make a profit equivalent to 75 percent of revenues, or slightly more than \$34,000. Increasing quality levels provides greater revenues, equaling \$47,779 for a Level 3 home. The increase occurs because by increasing quality, the provider can increase tuition rates (depending on the local market) with relatively few additional expenses. The additional expense for Levels 2 and 3 is the cost of a child assessment tool.

Table 2. Home: Annual Net Revenue (25 Percent Subsidy Enrollment), Quality Levels 1 – 3

EXPENSES	Quality Level 1	Quality Level 2	Quality Level 3
Total Personnel Expenses	\$0	\$0	\$0
Total Nonpersonnel Expenses	\$11,381	\$11,581	\$11,581
TOTAL EXPENSES	\$11,381	\$11,581	\$11,581
REVENUE			
Subsidized Children	\$13,728	\$16,510	\$19,825
Tuition-based Children	\$42,783	\$51,402	\$55,575

Tuition Total	\$56,511	\$67,912	\$75,400
CACFP	\$6,193	\$6,193	\$6,193
Bad Debt and Enrollment Inefficiency	(\$17,087)	(\$20,194)	(\$22,234)
TOTAL REVENUE	\$45,617	\$53,912	\$59,359
NET REVENUE			
Net Revenue	\$34,237	\$42,331	\$47,779

To understand the annual net revenue for a FCC provider in context, it is useful to compare this revenue, which is essentially the provider's gross annual salary, with the wages of teachers. Table 3, below, provides this comparison at three quality levels. The table shows that home providers can make a reasonable income at all quality levels. However, it is important to note that a teacher's hourly wage is based on a 40-hour work week. As shown in the table below, when a home provider's annual salary is converted to an hourly wage, the provider makes less, per hour, than a teacher in a child care center at levels 2 and 3. For example, the equivalent hourly wage for a home provider at Level 2, based on a 60-hour work week, is \$13.57 per hour, whereas the hourly salary for a center-based teacher at Level 2, based on a 40-hour work week, is \$14.78.

Table 3. Home: Hourly Wage Comparisons at Three Levels of Quality

Quality Level	Hours worked per week (home provider)	Home Provider Hourly Wage	Teacher Hourly Wage (40 hour work week)
1	55	\$11.97	\$11.68
2	60	\$13.57	\$14.78
3	65	\$14.14	\$16.26

Cost of Changing Ratios and Group Sizes

Group size and the associated ratio of adults to children are strongly related to measures of program quality and to improved child outcomes. The evidence is substantial over many studies and many years.[†] In States in which licensing rules contain higher group sizes and ratios (or in which they are not addressed at all), stronger requirements are often addressed within the QRIS standards.

When ratios and group size are reduced, overall program enrollment capacity and resulting revenues are also reduced. Using the Level 3 assumptions of staff:child ratios of 1:3 for infants, 1:5 for toddlers, 1:9 for 3-year-olds and 1:10 for 4-year-olds, the center with 4 classrooms now has full enrollment potential for only 54 children, 12 fewer than before.

Effects of Ratio and Group Size on Financial Health of Centers

Table 4 presents expenses and revenues for the highest quality center, Level 3, with more stringent group size and ratios (ratios and group sizes are listed in the appendix). The reduction in total children from 66 to 54 does not change the cost of occupancy for the classrooms, and staffing for each classroom

[†]For more information about the rationale for reducing ratios and group sizes, see *Caring for Our Children: National Health and Safety Performance Standards Guidelines for Early Care and Education Programs*, 3rd ed. National Resource Center for Health and Safety in Child Care and Early Education (eds.). Retrieved from <http://cfoc.nrckids.org/>.

stays the same. However, there is less revenue to cover the fixed expenses.

Table 4: Effect of Reducing Ratios for All Ages in High Quality Level 3 Centers

EXPENSES	Quality Level 3 25% Subsidy
Total Personnel Expenses	\$363,759
Total Nonpersonnel Expenses	\$185,558
TOTAL EXPENSES	\$549,316
REVENUE	
Subsidized Children	\$161,252
Tuition-based Children	\$459,888
Tuition Total	\$621,140
CACFP	\$25,518
Bad Debt and Enrollment Inefficiency	(\$112,838)
TOTAL REVENUE	\$533,820
NET REVENUE	
Net Revenue	(\$15,496)
Net Revenue As Percent of Total	(2.9%)

More commonly, however, ratio reductions are made only for infants and toddlers; that would result in an enrollment capacity of 60 children. In Table 5, the Level 3 center has negative annual net revenue of \$10,225.

Table 5: Effect of Reducing Ratios for Infants and Toddlers in High Quality Level 3 Centers

EXPENSES	Quality Level 3 25 Percent Subsidy
Total Personnel Expenses	\$406,551
Total Nonpersonnel Expenses	\$194,054
TOTAL EXPENSES	\$600,605
REVENUE	
Subsidized Children	\$178,256
Tuition-Based Children	\$508,560
Tuition Total	\$686,816
CACFP	\$28,353
Bad Debt and Enrollment Inefficiency	(\$124,789)
TOTAL REVENUE	\$590,380
NET REVENUE	
Net Revenue	(\$10,225)
Net Revenue As Pct. of Total	(1.7%)

Cost of Compensation Increases in Higher Quality Providers

Another key aspect of quality is compensation, defined as the combination of wages and benefits. In order to examine how tiered compensation and benefits affect a provider's bottom line, compensation in the centers at the three levels of quality is examined.

Wage assumptions increase with quality levels to reflect the reality that higher quality requires higher skilled staff and more competitive wages. Table 6 uses the U.S. Bureau of Labor Statistics' mean annual wage as the basis for the Level 2 center, with Level 1 salaries at 80 percent of the mean, and Level 3 at 110 percent of the mean.

Table 6. Wages by Position and Quality Level

QRIS Level	Director	Classroom Teacher	Classroom Teacher Assistant	Administrative Assistant
Mean Annual Wage	\$51,060	\$30,750	\$21,310	\$34,410
Level 1 wages	\$40,337	\$24,293	\$16,835	\$27,184
Level 2 wages	\$51,060	\$30,750	\$21,310	\$34,410
Level 3 wages	\$56,166	\$33,825	\$23,441	\$37,851

Mandatory benefits include payroll taxes: Social Security, Medicare, unemployment insurance, and workers' compensation insurance. Employee benefits increase modestly as quality increases. The base scenario allows for additional annual employer-paid benefits at \$500 per staff for Level 1, \$1000 per staff at Level 2, and \$1200 per staff at Level 3. These benefits can include life insurance, dental and vision insurance, and retirement savings, among others. To provide access to and pay for health insurance, the additional benefit allowance is minimal even at Level 3: \$100 per month per employee is about 10 percent of the cost of a modest individual health care insurance plan.

Table 7 compares different scenarios associated with compensation improvements. The "Increase Benefits for All" scenario assumes that our Level 3 center (with 25 percent subsidy enrollment) increased annual benefits per employee by \$6,000, to \$7,200 per employee. The "Raise Teacher Wages" scenario leaves benefits at the minimal level (\$1,200 per staff) and instead increases wages for teachers to the U.S. mean annual wage (according to Bureau of Labor Statistics) for preschool teachers who work in schools. The "Both Compensation Improvements" shows the combined effect of improved benefits for all and higher wages for teachers. It's also worth noting that increasing teacher wages to the U.S. mean annual wage for kindergarten teachers (\$53,030 per year) would result in an annual loss of nearly \$73,000 if all other assumptions remained the same.

Table 7: Comparison of Compensation Improvements (Level 3 Center with 25 Percent of Children Receiving Subsidy)

Scenario	Annual Benefits, per Employee	Annual Salary per Teacher	Center's Net Revenue
Base Scenario	\$1,200	\$33,825	\$10,963
Increase Benefits for All	\$7,200	\$33,825	(\$64,037)
Raise Teacher Wages	\$1,200	\$44,760	(\$36,648)
Both Compensation Improvements	\$7,200	\$44,760	(\$111,648)

These scenarios indicate that raising either salaries or benefits has a negative impact on the financial health of the high quality center. The center that increased benefits for all staff will have a loss of almost 10 percent of net revenues, or about \$64,000, while the center that raised teacher wages will see a loss of more than \$36,000 (5.6 percent). Losses of this size can be addressed by increasing enrollment efficiency from 85 to 94 percent and 90 percent, respectively.

Overcoming the financial effects of establishing both compensation improvements would require the center to increase enrollment efficiency to 98 percent and reduce bad debts from 3 to 1 percent, resulting in annual net revenue of \$3,594. However, that level of efficiency is rarely achieved in practice. The establishment of quality awards for providers specifically designed to cover compensation improvements represents another strategy to address this gap.

Conclusion

This brief has illustrated the impact of quality increases, tiered subsidy rates, bonuses, ratios and group sizes, and compensation improvements on the net revenue of child care providers, in both center and home settings. These variables have a significant impact on the financial health of providers, with many scenarios producing an unacceptably large net loss. The PCQC can be used to model the impact of changing these variables. From a State perspective, the PCQC can model the impact of changing subsidy rates, establishing quality awards, or amending ratio and group size policies. From the provider perspective, the PCQC can model the impact of increasing employee compensation or operating at an increased quality level and the effects of improving efficiency in enrollment and debt collection. For additional information on the PCQC or for additional details on the assumptions used in this analysis, contact the National Center on Child Care Quality Improvement at OCCQualityCenter@icfi.com.

APPENDIX: SCENARIO ASSUMPTIONS

This appendix describes the data and assumptions used for the scenarios described in this issue brief. The assumptions are based on national data, data from center and home-based providers in seven States in which cost estimation studies have been done, and the professional judgment of the developers of the PCQC. The scenarios represent a provider in a hypothetical State, and aim to illustrate the lessons that can be learned in using the PCQC with state-specific data.

Age Group Categories for Homes and Centers

- The following age group categories were used:
 - ◆ Infants –younger than 18 months;
 - ◆ Toddlers – 18 months to 3 years old;
 - ◆ Preschool 3 – 3-year-olds; and
 - ◆ Preschool 4 – 4-year-olds.

Expenses

Centers

PERSONNEL

Salaries: For all positions, the following Bureau of Labor Statistics data are used:

- Director <http://www.bls.gov/oes/current/oes119031.htm>
- Education Coordinator - <http://www.bls.gov/oes/current/oes119031.htm>
- Teacher - <http://www.bls.gov/oes/current/oes252011.htm>
- Teacher Assistant - used *Child Care Worker* - <http://www.bls.gov/oes/current/oes399011.htm>
- Administrative Assistant - <http://www.bls.gov/oes/current/oes430000.htm>

Number of Staff: For personnel cost drivers, the number of teachers and assistant teachers is driven by ratios, as is the number of administrative assistants (ratio of 1 to 60 children). Other required staff are calculated based on enrollment.

- A full-time director is included when there are 60 or more children enrolled.
- A part-time educational coordinator is included when there are 70 or more children enrolled.
- A full-time educational coordinator is included when there are 120 or more children enrolled.
- The base scenario has an enrollment of 66 children and therefore includes a director and a full-time administrative assistant.
- All scenarios that have an enrollment between 60 and 66 children include a director and a full-time administrative assistant.
- The scenarios that have fewer than 60 children include a part-time director and no administrative assistant.
- Scenarios with between 70 and 120 children also include a part-time education coordinator and more than one full-time administrative assistant.
- Scenarios with more than 120 children include a full-time education coordinator and at least two full-time administrative assistants.

Insurance and Paid Leave: Unemployment insurance is projected at 2 percent and workers' compensation at 1.2 percent and no disability insurance is provided. Staff have 10 paid holidays and 5 days of paid leave annually.

NONPERSONNEL

- The PCQC's default nonpersonnel cost driver assumptions are used.

QRIS Level 1 Cost Drivers

- The Level 1 and 2 scenarios include one classroom for each age group, for a total of 66 children enrolled:
 - ◆ One infant room (staff:child ratio of 1 to 4 with a maximum group size of 8);
 - ◆ One toddler room (ratio 1 to 7 with a maximum group size of 14);
 - ◆ One room of 3-year-olds (ratio 1 to 10 with a maximum group size of 20); and
 - ◆ One room of 4-year-olds (ratio 1 to 12 with a maximum group size of 24).
- For all positions, 80 percent of U.S. mean wages per the federal Bureau of Labor Statistics data are used.
- Child assessment cost per child: \$0;
- Additional staff time: 20 percent; and
- Additional benefits: \$500 per year per staff.

QRIS Level 2 Cost Drivers

- Level 2 includes the same ratios as Level 1;
- U.S. mean wage values per the federal Bureau of Labor Statistics data are used for all positions;
- Child assessment cost per child: \$25;
- Additional staff time: 25 percent; and
- Additional benefits: \$1,000 per year per staff.

QRIS Level 3 Cost Drivers

- For all positions, 110 percent of U.S. mean wage values per the Bureau of Labor Statistics data are used;
- Child assessment cost per child: \$25;
- Additional staff time: 30 percent;
- Additional benefits: \$1,200 per year per staff; and
- Ratios and group size are reduced, as shown below.

Age Category	QRIS All Levels Ratio	Group Size	Reduced Group Size & Ratio, at Level 3 ONLY	
Infants	1:4	8	6 (1:3)	6 (1:3)
Toddlers	1:7	14	10 (1:5)	10 (1:5)
Preschool 3	1:10	20		18 (1:9)
Preschool 4	1:12	24		20 (1:10)
Total =		66	60	54

Homes

- Eight children with one provider: two infants, one toddler, three 3-year-olds, and two 4-year-olds.
- The defaults for hours worked per week are set at 55 hours for Level 1, 60 hours for Level 2, and 65 hours for Level 3.
- Unemployment insurance is projected at 2 percent and workers' compensation at 1.2 percent, and no disability insurance is included.
- The tool's default cost driver assumptions for home providers are used for business expenses.
- \$25 per child is included for child assessments at Levels 2 and 3.

Revenue

- Full attendance is set at 52 weeks to model a full-day, full-year program.
- The program receives CACFP, and current CACFP rates for centers and homes are used for the 48 contiguous States. The assumption is that breakfast, lunch, and two snacks are served daily.
- In these scenarios, it is projected that 12.5 percent of the families have income below 100 percent of the Federal Poverty Income Guidelines (FPIG) and 12.5 percent are between 100-185 percent FPIG. The remainder have incomes above 185 percent FPIG.
- The percent of children receiving subsidy is projected at 25, a common proportion in settings that accept subsidy.
- Under Efficiency Factors, enrollment efficiency is set at 85 percent for centers and 75 percent for homes. The efficiency for homes is lower as they tend to be less fully enrolled than centers, based on data from center and home-based providers in seven States in which cost estimation studies have been done, and in the professional judgment of the developers of the PCQC.
- Bad debt is set at the default of 3 percent for both centers and homes.
- In Image 1, Level 2 receives a \$3,000 annual bonus and Level 3 receives a \$3,500 annual bonus.

Subsidy Reimbursement

- Subsidy reimbursement rates for the Level 1 scenario are derived from state data in the National Women's Law Center's, *Pivot Point State Child Care Assistance Policies 2013* (available at http://www.nwlc.org/sites/default/files/pdfs/final_nwlc_2013statechildcareassistancereport.pdf).
 - ◆ The highest and lowest monthly state reimbursement rates for centers among States for 1-year-olds and 4-year olds were averaged for each age and calculated as weekly rates.
- Subsidy 'tiered' rates were devised for Levels 2 and 3 by adding 15 percent for Level 2 and 20 percent above Level 2 for Level 3.
- The center rates at each level are discounted to 80 percent for homes, with the exception of infant rates for level 1, which are discounted to 70 percent (this was done so that the subsidy rates would not be higher than private tuition).

WEEKLY SUBSIDY QRIS LEVEL 1

Age Category	Centers	Homes
Infants	\$210	\$144
Toddlers	\$173	\$138
Preschool 3	\$158	\$126
Preschool 4	\$158	\$126

WEEKLY SUBSIDY QRIS LEVEL 2 (PLUS 15 PERCENT ABOVE LEVEL 1)

Age Category	Centers	Homes
Infants	\$242	\$193
Toddlers	\$199	\$159
Preschool 3	\$181	\$145
Preschool 4	\$181	\$145

WEEKLY SUBSIDY QRIS LEVEL 3 (PLUS 20 PERCENT ABOVE LEVEL 2)

Age Category	Centers	Homes
Infants	\$290	\$232
Toddlers	\$238	\$191
Preschool 3	\$218	\$174
Preschool 4	\$218	\$174

Weekly Tuition

- Tuition levels for the Level 1 scenario were derived using 2012 data from Child Care Aware of America, *Parents and the High Cost of Child Care: 2013 Report* (available at <http://www.usa.childcareaware.org/costofcare>).
 - ◆ The average annual cost for the highest and the lowest tuition rates among States were averaged for each age and care type and then calculated as weekly rates (see “Appendix 1. Average Annual Cost of Full-Time Care by State” in the above referenced report).
- Tuition rates for Levels 2 are set at 20 percent above Level 1, and for Level 3, at 30 percent above Level 1.

WEEKLY TUITION QRIS LEVEL 1

Age Category	Centers	Homes
Infants	\$210	\$144
Toddlers	\$173	\$139
Preschool 3	\$160	\$134
Preschool 4	\$160	\$134

WEEKLY TUITION QRIS LEVEL 2 (PLUS 20 PERCENT ABOVE LEVEL 1)

Age Category	Centers	Homes
Infants	\$252	\$173
Toddlers	\$208	\$167
Preschool 3	\$192	\$161
Preschool 4	\$192	\$161

WEEKLY TUITION QRIS LEVEL 3 (PLUS 30 PERCENT ABOVE LEVEL 1)

Age Category	Centers	Homes
Infants	\$273	\$187
Toddlers	\$225	\$181
Preschool 3	\$208	\$174
Preschool 4	\$208	\$174