First Children's Finance

The Health of Minnesota's Child Care Businesses in the Post-Pandemic Era

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Executive Summary

Minnesota's Child Care sector remains in tenuous circumstances. Having weathered the height of COVID-19 pandemic restrictions, these small businesses are now beginning to observe how changes in workforce patterns and government funding are affecting both their ability to provide care and their bottom line. First Children's Finance, a Minnesota-based national nonprofit organization providing loans and business development assistance to child care businesses, has partnered with the Federal Reserve Bank of Minneapolis for a third year to determine the lingering effects of COVID-19 on the sector. This report analyzes 1,083 responses from the 2023 survey and performs some comparison with the previous year's study.

The survey indicated the following trends:

While overall enrollment has shown signs of stabilization and even growth in the state, there are disparities across different types of programs and regions. The Seven County Metro Area has experienced a notable decrease in enrollment, possibly due to changing work trends and the availability of remote work options.

A shift in enrollment preferences that highlights a greater need for care for infants than for preschool-aged children is causing a financial strain on child care businesses, as younger children are more expensive; the preference shift disrupts a long-time "loss leader" business model that has successfully carried many of these businesses for decades. Additionally, the expansion of Pre-Kindergarten programs in public schools is blamed by providers as having impacted preschool and school-aged enrollment.

Staffing shortages continue to be a significant challenge for the sector, with the difficulty of finding qualified staff increasing compared to the previous year. Low wages and the lack of benefits make it challenging to attract and retain child care workers, especially when other industries offer higher compensation. Unfilled slots due to staffing shortages have become more pronounced in the Seven County Metro area, potentially affecting the sector's capacity to provide care and remain stable.

Child care business owners continue to grapple with rising expenses, particularly in food and transportation. Increased costs have led business owners to raise tuition fees, which puts financial pressure on families. Providers, especially those operating under family child care licenses, are also resorting to high-interest financing options in increasing numbers, indicating financial stress and limited access to alternative funding sources.

While grants have been instrumental in mitigating some of the financial challenges for child care providers, the reliance on grants has become a source of stress as they are often temporary and uncertain. The Minnesota Child Care Stabilization Base Grants have provided support, but the sustainability of these grants remains a concern for survey respondents.

Alongside these challenges, an aging workforce – with an insufficient pipeline of business owners – may be signaling a concerning future for the sector. "I love what I do, but yes, financially it has been a struggle this past year," tells a Central Minnesota entrepreneur. "I am looking towards retirement, a few years out. It shouldn't feel this way after 30 years in the business."

Introduction

> “It has been very hard to get ahead since the pandemic.“

While this statement came from a 30+ year veteran of the child care business located in the Seven County Metro area, it could well have come from any of the hundreds of child care providers statewide. Already in a challenging circumstance before the COVID-19 pandemic and related restrictions upended their businesses, the years that followed have caused child care business owners to adjust to huge changes in enrollment preferences, changes to working family finances, and rising costs of all items required to care for Minnesota’s children. These rapid developments have left many business owners feeling unmoored.

Called out as an "essential" service during the height of pandemic restrictions, child care businesses have remained open over the past three years, providing a front-row view of the economy's ups and downs and the evolving work patterns of families. Initially, the sector experienced a significant decline in enrollment, raising concerns about its ability to sustain itself. However, Minnesota demonstrated leadership by offering grant funding from both state and federal sources such as the CARES Act and the American Rescue Plan, which played a pivotal role in sustaining the child care sector. Although these programs have been extended multiple times, providers worry about their ability to maintain services at their current or previous levels, which are already insufficient to meet the economic realities faced by small business owners catering to families with limited budgets.

First Children's Finance, a national nonprofit organization that focuses on the growth and sustainability of excellent child care, embarked on a comprehensive study to examine the impact of the COVID-19 pandemic on the child care sector in Minnesota. In collaboration with the Federal Reserve Bank of Minneapolis, they conducted a survey in spring 2021 (marking one year of pandemic-related economic conditions), gathering responses from nearly 800 child care providers across the state. The results revealed a range of concerns, including plummeting enrollment, reliance on high-interest financing, austerity measures, and staffing issues, painting a worrisome picture of a sector struggling to stay afloat despite government and private sector interventions. A subsequent survey conducted in 2022 showed some signs of improvement as the "new normal" began to take shape.

In 2023, First Children’s Finance undertook a third iteration of this survey to begin to identify how the “new normal” is landing in the changing child care landscape. This white paper provides an analysis of the 2023 survey, contextualizing hard data points with comments from real providers, to give voice to the thousands of child care entrepreneurs who are keeping Minnesota families running.

Context / Organizations Involved

The two primary organizations involved in this study are detailed below:

First Children's Finance

The mission of First Children's Finance (FCF) is to grow the supply and business sustainability of excellent child care. Founded in 1991, FCF is a national nonprofit organization based in Minneapolis, Minnesota, with regional offices in Iowa, Michigan, Minnesota, and Vermont. FCF works to launch, stabilize, improve, and expand high-quality child care businesses, particularly those serving low- and moderate-income families. FCF provides financing, child care business training, consulting, and coaching, and builds partnerships that connect child care businesses with the resources and expertise of the public and private sectors. FCF understands the issues and challenges child care businesses face in today's economy and in these wildly turbulent times. FCF has industry-specific expertise and a shared commitment to the success of high-quality child care.

With a unique perspective, approach, and experience to providing business planning and financial assistance to child care entrepreneur clients, FCF approaches child care leaders *as entrepreneurs,* increasing their capacity to start and operate financially sustainable child care businesses.

The Federal Reserve Bank of Minneapolis

Established in 1941, The Federal Reserve Bank of Minneapolis is one of 12 Federal Reserve Banks across the United States. The Bank maintains a headquarters in Minneapolis, MN, and a branch in Helena, MT. Responsible for the 9th District of the Federal Reserve, the Bank's area is composed of Montana, North Dakota, South Dakota, Minnesota, 26 counties in northwestern Wisconsin, and the Upper Peninsula of Michigan. The Bank conducts research and monitors regional economy to help determine the nation's monetary policy with an emphasis on 4 major areas: monetary policy, banking supervision, financial services and community development and engagement.

Definition of Terms

Many of these findings reference different types of child care businesses:

Family child care provider: Licensed Family Child Care (FCC) providers care for infants, toddlers, preschoolers, and school-age children, typically in their homes. In Minnesota, regulations limit the number of children in each Family Child Care program to 10, 12 or 14 children, based on license type.

Child care center: Child Care Centers (CCC) provide care in groups based on age and are located in free-standing buildings, businesses, community centers or places of worship. In Minnesota, the number of children enrolled in a center varies and is regulated based on the number of staff, with different ratios of staff to children based on age.

For the purposes of this study, the State of Minnesota was divided into the following **sectors:**

7 County Metro Area:

Anoka, Carver, Hennepin, Scott, Ramsey, Dakota, Washington

Central:

Cass, Wadena, Crow Wing, Todd, Morrison, Mille Lac, Kanabec, Pine, Stearns, Benton, Sherburne, Isanti, Chisago, Wright

Northeast:

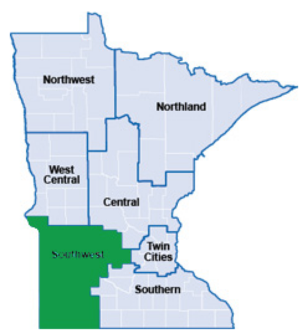
Koochiching, St. Louis, Itasca, Lake, Cook, Aitkin, Carlton

Northwest:

Kittson, Red Lake, Roseau, Norman, Lake of the Woods, Mahnomen, Marshall, Clearwater, Beltrami, Hubbard, Polk, Pennington

Southeast

Sibley, Waseca, Nicollet, Steele, Le Sueur, Dodge, Rice, Olmsted, Goodhue, Winona, Wabasha, Martin, Brown, Faribault, Watonwan, Freeborn, Blue Earth, Mower, Fillmore, Houston



Southwest:

Big Stone, Renville, Swift, McLeod, Kandiyohi, Lincoln, Meeker, Lyon, Lac Qui Parle, Redwood, Chippewa, Pipestone, Yellow Medicine, Murray, Cottonwood, Nobles, Rock, Jackson

West Central:

Clay, Grant, Becker, Douglas, Wilkin, Stevens, Otter Tail, Pope, Traverse

About the Data

The survey, titled *the Minnesota Child Care Survey 2023,* was conducted between February 27 – March 12, 2023, and received a total of 1,083 responses. While the survey was not randomized and may not be a full representation of the child care industry, the number of respondents accounts for roughly 13% of licensed child care providers in the State of Minnesota.

The data skews heavily towards family child care providers, with 76% of respondents identifying as such. Nearly 20% of responses were from child care centers, and the remaining 4% are made up of programs like Head Start and preschools.

Geographically, sampling remains mostly consistent with distribution across the state, with some slight oversampling from Greater Minnesota. Just over 35% of responses came from the Seven County Metro Area, with the remaining coming from Greater Minnesota.

When asked to provide information about racial/ethnic identity, 6% of respondents identified as racial and ethnic minorities, while 88% identified as non-Hispanic/white. (The remainder declined the question). While there is no publicly available data in Minnesota about the demographic diversity of child care business leadership, this breakdown aligns with past surveys. It is important to note, however, that this survey went to child care business leadership, which includes family child care businesses and center directors and owners. While this group tends to be primarily non-Hispanic/white, the broader child care workforce – including classroom teachers and aides - is a more diverse group.

Findings

Enrollment continues to stabilize, but only for some

> **I am full to capacity**

After the massive drops seen in 2020 at the height of the COVID-19 pandemic restrictions, last year's survey saw a rebound across the sector of enrollment, with 65% of respondents state-wide indicating either stability or a slight decrease in enrollment. This year, that rebound continued, and the sector is finally seeing growth. For the first time since the inception of this survey, over 66% of all programs, regardless of type, report either stable or increased enrollment. This is a marked improvement and is encouraging for the financial health of the sector. "I am full to capacity," says a child care center owner in Southeastern Minnesota with over 25 years in the business. "My parents are waiting for a green light to get pregnant when I have a child age out."

Yet this rosy outlook only tells part of the story.

Statewide, just over 34% of providers across types have seen a decrease in enrollment over the last 12 months. This discrepancy is most pronounced in the Seven County Metro area, where nearly 40% of providers are indicating decreases in enrollment, with half of those describing the declines as significant. Given their representation in the sample, and overall population density within the state, this is notable. Providers suggest that one factor in this decrease in the Seven County Metro area may be changing work trends: "Because of so many parents working from home now, [it] seems like a lot of parents just want part-time [care] or are not needing care for preschoolers as much," reports a Metro area family child care provider.

The permanence of remote work environments is also shifting rates for consistency of enrollment statewide. Nearly half of all providers note that their enrollment has been unpredictable throughout the year, regardless of overall increase or decrease. With parents working from home, full-time needs continue to be replaced with part-time children, who offer less predictable income to child care businesses, and less consistency. But that may not be the only factor. "It's hard to say because our enrollment is like a rollercoaster," notes the director of a Child Care Center in the Seven County Metro area. "We are steady for a couple of months then it decreases because of the economic issues."

Regardless of this variability, the need for child care remains strong, which portends additional stability within the sector, even if the return to normalcy equates to what was deemed a "crisis" prior to the pandemic[1] . Increasing enrollment demand equates to increased revenue for child care businesses, and an increase in revenue typically offers security and viability to business owners. Yet, providers do not seem comforted by these facts. Says one Southeast Minnesota child care entrepreneur: "It's not the enrollment that is the problem."

The model is shifting, with costly results for providers

The child care business model has historically relied on long-term relationships with families and children: children enter providers' care in their infancy, and frequently continue through the beginning of their time in school. Providers have built long-term relationships with families, often enrolling siblings who bring in additional income and offer stability for everyone involved.

This relationship-based model not only provides consistent care to the families, but it also serves an economic purpose for entrepreneurs. Minnesota's requirements for child care businesses require specific ratios based on age-group. Staffing requirements for infants, for example, set forward a 4:1 ratio in a Child Care Center setting, while staffing for school-aged children can be maintained at a 15:1 ratio. A family child care business with a single provider may enroll up to six children under school-age, with a maximum of two infants, or three infants and toddlers[2]. Because of these requirements, it is more costly to care for younger children and infants. Maintaining a balance of older children is essential for financial stability and ensuring full enrollment. Child care businesses often consider infant slots to act as a "loss leader," expecting that the length of relationship, and possibility of enrolling older siblings, will even out the associated costs.

Dynamics, however, have shifted.

"Most people are looking for infant care and many people have preschool openings," says a Seven County Metro Area Family Child Care provider. Another provider agrees: "The need is great for infants and toddlers, so I am taking that loss. I can only care for 10 children instead of 12."

The survey results bear out these comments. Comparing capacity against enrollment across all age ranges between last year's study and this year's, survey participants indicate relative stability in their infant and toddler enrollment. Across the state, infant slots are filled at roughly 75% of capacity, and 85% of available toddler slots remain filled. However, there has been a notable drop in preschool and school-aged children enrolling in programs. Last year, respondents indicated 71% of school-aged slots were filled. This year, that enrollment has dropped to 67%. These declines have been most notable in the Seven County Metro area, where survey respondents noted a 6% decline in school age enrollment, and 5% decrease in preschool enrollment.

While the study data do not indicate a reason for these declines, survey respondents appear to pinpoint two major sources for the decline in their comments. Their biggest areas of concern: the continued prevalence of remote work opportunities, as mentioned above, and the expansion of Pre-Kindergarten in public schools.

Minnesota's Voluntary Prekindergarten and School Readiness programs, which were initially rolled out in 2016 through at $25 million investment by the state legislature, are intended to provide publicly funded child care programs to eligible 4 year-olds[3]. While the program has continued to expand over the years, and currently operates in over 200 locations across the state[4] , it has remained a source of concern for child care business owners. Because of their unique business model, many have continued to view it as direct competition to their small businesses. "We will continue to see less [sic] preschoolers as they are going to the schools for care," remarks a West Central family child care provider.

Should this trend continue, child care providers will likely need to adjust their business model. Says a Seven County Metro Area entrepreneur, "Due to free pre-k, most families are looking for infant or toddler care only and pull their kids once the 'free' school is offered. FCC is limited by how many under the age of 2 we can take as well as it not being financially sustainable.... I raise them until potty trained and then parents pull them out for 'free'."

Staffing shortages continue - and are holding the sector back significantly

> **"We need to hire more staff**

This sentiment, from a Seven County Metro child care center director, echoes dozens of comments from center leaders across the state. While many family child care businesses are sole proprietors and do not rely on additional staff to operate their facilities, child care centers often have multiple employees to serve their children and families. This section of the industry has faced a tight labor market since the beginning of the pandemic. This year, those challenges continued.

When asked about the ease in finding qualified staff, 94% of child care center survey respondents described the circumstance as "difficult" or "very difficult." This is a slight increase over last year's survey results and shows the real challenge in providing the capacity that is needed to care for Minnesota's children. The survey also indicates that it is not uncommon for child care workers in Minnesota to be required to have some level of advanced training in the field, reflecting the fact that the provision of child care is a skilled profession. However, it is rarely compensated like one. According to state of Minnesota information, in the last quarter of 2021, the median wage for a "child care worker" in Minnesota was $11.65 an hour, with rates usually lower than that in rural areas. Says one center director in Southwest Minnesota: "When Target, Culvers, and McDonalds have higher starting wages, and we require college level training, it is clear that people will not want to be child care staff without benefits or livable wages."

These staffing shortages present a real challenge to the sector: as the state dictates staffing minimums for the care of children, lack of staff distinctly reduces both the capacity of care for Minnesota's children and the financial sustainability of child care businesses. Of the 230 child care center owners and directors surveyed, they indicated that a total of 3,302 slots at their 230 centers remain unfilled due to staffing shortages. This sample represents only a portion of Minnesota child care businesses, suggesting that the sector-wide unfilled slot total is much larger. It also represents lost revenue for these small businesses.

These unfilled slots have often been a problem for businesses statewide, but this year, the survey indicates that the Seven County Metro area is more notably affected. Compared to last year's study, child care centers in Greater Minnesota saw relative consistency among openings due to staff shortage, relative to total enrollment: 9% in 2022 versus 10% in 2023. The Seven County Metro, however, saw a near doubling in this metric, moving from 7% in last year's survey to 16% this year. Area providers blame this on the plethora of options for better-paying work nearby. "The pay for this field is just so low and it is difficult to attract any teaching staff," laments a Seven County Metro area center director. "We actually pay more than some other centers around us, but it is nowhere [near] enough."

Employers have continued to attempt multiple tactics to fill these staffing shortages. Most centers report raising hourly wages and offering bonuses to retain and attract staff. Others mention paid time off and health insurance, as well as reduced or free tuition for the children of employees. In almost all cases, these increases relied heavily on state-provided funds, most of which are set to expire in mid-2023. With this looming reality, 85% of centers indicate that they will likely be unable to sustain staffing levels without this support. This puts these small businesses in a challenging catch-22. "Without more staff, I can't increase the amount of children," indicates a Seven County Metro Area Center Owner, "and without the children I don't have the income coming in for bonus or raises."

Grants continue to make a difference, but are now a source of stress

> **Without ongoing grants my doors would be CLOSED**

One antidote to these cash flow issues – and the stress around tuition increases – has come in the form of grants. Says a West Central Minnesota provider, "I have not raised my rates due to qualifying for grant funding."

The most noted grant in the survey remains the Minnesota Child Care Stabilization Base Grants. While Minnesota utilized state funds to provide grants to child care providers during the beginning of the pandemic, in June of 2021, the Minnesota Department of Human Services provided a Child Care Stabilization Base Grant Program using federal funds from the American Rescue Plan Act to qualified providers that were licensed, open, operating and serving children during the funding period. The grants, calculated based on full-time equivalent (FTE) child care staff, included sole proprietors. With monthly amounts up to $435 per FTE staff, the grants were available on a monthly basis, with a requirement that 70% be used to "increase compensation for staff regularly caring for children[5]." These grants were made widely accessible to providers who met eligibility requirements. Over 88% of survey respondents indicate having received this grant, which is consistent with prior survey results.

Providers emphasized the importance of using these funds to pay for staff raises and bonuses and indicated that their ability to do so has been important in retaining their current teams. But the necessity of these funds since the onset of the pandemic has become a source of stress among providers statewide. "The stabilization grants have been a huge help in paying my staff," exclaims a provider in Central Minnesota. "I am worried that when those payments end, my employees will look for something that pays more."

Indeed, the Child Care Stabilization Base Grants program was created with an end date of June 2023, preceded by a gradual step-down process that began in April 2023. While additional funding opportunities have been put forward by the Minnesota legislature, the uncertainty of grant funding remains a frequently cited source of anxiety for child care entrepreneurs statewide. "The monthly grant is so helpful," reports a Seven County Metro Area Child Care Center director. "I don't know what I'm going to do if it ends in June." A center director in Southeast Minnesota was more blunt: "Without ongoing grants my doors would be CLOSED."

We may be heading towards a cliff

> **I have fewer children than I did a year ago because I'm not adding more...**

Impending closure remains a top-of-mind concern among providers. When asked about their ability to maintain their businesses given current conditions, 56% of respondents indicated that they are "unsure." While this is consistent with last year's survey, the comments this year indicate that the current child care business owners may be aging in ways that further destabilize the sector.

Of survey respondents, 50% of child care businesses in the study indicated that they have been in business for over 20 years, and 24% have been in business for over 30 years. Many of these long-term providers are licensed as family child care businesses, who often provide care for specific communities within the state. Looking more deeply at these respondents, many indicate a strong desire for – and planning around – retirement.

"I have fewer children than I did a year ago, because I'm not adding more, since I'm heading towards retirement," states a Seven County Metro Area family child care provider. This tactic – reducing enrollment with an eye towards retirement – was repeated by numerous respondents and may foreshadow a coming decrease in openings in a system that has struggled to meet the demands placed on it by Minnesota's families. With only 15% of respondents indicating having started their business in the last 5 years, replacing retiring child care entrepreneurs may be a challenge that the sector will have to confront sooner than later.

This focus on retirement may also be indicative of frustration and despair among business owners. After three years of challenges from the COVID-19 pandemic, compounding a system that was already identified to be in crisis, many child care business owners in this survey appear exhausted with the way child care businesses are forced to run. When asked to list their thoughts on how to help maintain a stable child care business, a Central Minnesota family child care provider was rather blunt: "I will retire in 2 years, so it doesn't matter."

Conclusion

While increasing enrollment paints an initially rosy picture, anxiety remains high among Minnesota's child care entrepreneurs. Changing work patterns, rising supply costs, adjustments in preferences around age groups in care and pending grant reduction have become strong stressors in the third year of this survey.

The changing ages of children in providers' care – increases in the costlier infants and decreases in the school-aged children – have put a unique stress on the business model. This, coupled with challenges in attracting and maintaining staff, has placed many providers in a bind. Those who have relied on grant funding to maintain wages and cash flow have the added stress of the uncertainty of these programs' continuation. With many respondents indicating that they are unsure of their ability to maintain services into the future, the sector risks sinking deeper into the crisis-level conditions that have already caused inadequate availability for families and financial instability for providers. And a workforce focused on retirement adds to the concerns around the sector.

Ultimately, Minnesota's child care business owners are starting to feel tired. "I love what I do, but yes, financially it has been a struggle this past year," tells a Central Minnesota business owner. "I am looking towards retirement, a few years out. It shouldn't feel this way after 30 years in the business."

Endnotes

1 https://mn.gov/deed/newscenter/publications/trends/september-2020/early-care-education.jsp
2 https://www.childcareawaremn.org/wp-content/uploads/2022/02/Why-Ratios-Matter-2022-final-1.31.22.pdf
3 https://www.minnpost.com/glean/2016/08/state-minnesota-doles-out-25-million-launch-pre-k-program/?hilite=universal+pre-k
4 https://education.mn.gov/MDE/fam/elsprog/vpk/
5 https://mn.gov/dhs/partners-and-providers/grants-rfps/child-care-stabilization/