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## ABSTRACT

Noting that one of the objectives of the Learning between Systems project was to design family loan programs as a potential form of financing to help families pay for early care and education, two studies examined the feasibility of such loan programs. First, focus groups were conducted in five American cities, wherein parents were asked to comment on the feasibility of adapting higher education finance approaches to early care and education; they were also asked to react to a plan that would increase the quality and price of early care and education and offer new loan programs to assist families in meeting expenses. Second, U.S. Census Bureau data on incomes and characteristics of families with children were analyzed to determine how much a family might reasonably afford to borrow under various circumstances. Focus group findings indicated that parents agreed unanimously that loans for early care and education currently were both infeasible and unnecessary. Most parents saw their child's level of care as adequate and viewed additional early care and education expenses as unnecessary when compared to higher education expenses. Findings from the Census Bureau analysis indicated that it would be very difficult for many families to rely on loan programs to help cover early care and education expenses. It was concluded that using long-term, low-interest loans to help parents pay for early care and education represents a viable strategy for only a very limited number of families with young children, with those families with incomes between \$60,000 and \$100,000 most likely to benefit. (Questions and loan scenarios used in the focus groups are appended.) (KB)

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## TECHNICAL REPORT

### Assessing the Feasibility of Family Loans for Early Care and Education

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**Assessing the Feasibility of Loan Programs  
for Early Care and Education**

**Technical Report**

**Learning Between Systems:  
Adapting Higher Education Financing Methods to Early Care and Education**

by  
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**June 2001**

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The authors are indebted to Barbara J. Ash for her extensive research with U.S. Bureau of the Census data files to determine the numbers and characteristics of families with children under age 6. Her findings and recommendations guided and informed our analysis. Teresa Vast, the study director for the project, gave us extensive and helpful advice on the final drafts. Sandy Baum, professor of economics at Skidmore College, and others reviewed drafts and offered helpful comments.

While we received significant help and advice in conducting the research and writing this paper, the final document is our responsibility. Any errors of omission or commission are solely ours.

Jerry S. Davis  
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June 2001

## Introduction

One of the objectives of the Learning Between Systems project was to design family loan programs as a potential form of financing to help families pay for early care and education. However, before we could design any such programs, we had to determine if they were feasible. So we launched an inquiry into the efficacy of subsidized and unsubsidized loan programs. We wanted to propose program designs that would be appropriate to the circumstances of families with young children, considering their other financial obligations and income levels. We addressed these questions:

- Which families might benefit from the availability of loans for early care and education?
- What is the potential market for early care and education loans?
- What are the potential sources of capital?
- What design elements would make loans feasible for families? For lenders?

At an early stage in the inquiry we concluded that designing a specific early care and education family loan program was beyond our available resources and time. We could, however, develop some good answers to our key questions. They are reported here and in the final report, *Learning Between Systems: Adapting Higher Education Financing Methods to Early Care and Education*.

### Higher education loan programs

Starting in the 1960s, public and private loan programs have been widely available to help students and parents finance expenses for higher education. More than half of all full-time students at four-year colleges now use student loans to meet expenses. About one in 16 dependent students' parents use federal or private loans to help pay the bills. Student and parent loans make it possible to afford costs of attendance because they stretch education payments over extended periods of time and allow borrowers to pay for current expenses with future earnings.

The vast majority (more than 95 percent) of loan dollars for students and parents are made available through federal programs that offer subsidized and unsubsidized loans. There are three basic ways that the federal government subsidizes student loans. First, it can pay interest on behalf of the borrowers while they are in school or otherwise unable to afford payments. In the case of the Federal Family Education Loan Program (FFELP), these payments are made on behalf of borrowers to the lenders that provide the loan capital. Under the Federal Direct Student Loan Program (FDSLP), the government provides the capital to the colleges for distribution to borrowers, so it forgoes collecting interest during "in school" or other specified periods.

Second, the government can subsidize loans by guaranteeing payments of interest and capital to private lenders when borrowers cannot pay their loans due to default, death, disability, or bankruptcy. In the FFEL Program, these amounts are paid to private lenders to cut their risks of lending to students and enable them to make loans at lower interest

rates because they do not have to earn interest payments to cover these losses. In the FDSLSP, the government provides the loan capital and accepts the losses due to default, death, disability and bankruptcy.

The third way to subsidize loans is to pay private lenders an additional percentage rate payment (called a Special Allowance Payment in the FFEL Program) on the borrowers' behalf. This means that the government supplements the borrowers' interest payments to lenders so borrowers don't have to pay the higher "market" rate lenders would otherwise have to charge them. In the Direct Loan program, the government subsidizes the interest rates simply by not charging borrowers as much as needed to cover losses on the capital it has loaned.

Not paying the "in school" or loan grace period interest is the primary feature of the "unsubsidized" student loans offered through the FFEL and FDSL programs. "Unsubsidized" student loans actually receive considerable subsidy from the federal government in that the government insures these loans against losses due to default, death, disability and bankruptcy. (Without this insurance, borrowers would have to pay much higher loan interest rates to offset the government's or the lenders' losses.) Because borrowers do not receive a direct subsidy in the form of government payment of interest during the "in school" and grace period (the six-month period in which the borrower is no longer enrolled but does not yet have to begin making payments on the loan principal), the loans are called "unsubsidized." In reality the government does not offer any education loans that are 100 percent "unsubsidized." The importance of the distinctions between "subsidized" and "unsubsidized" loans will become clearer below.

The federal government also operates another important student loan program, the Federal Perkins Loan Program. In this program colleges and universities annually apply for "federal capital contributions." These amounts are placed in a "revolving fund" from which the institutions make loans to certain eligible students, usually those least able to pay for expenses. When the students graduate or leave school, they repay Perkins Loans directly to their colleges who gave them the loans. These payments are deposited in the "revolving fund" and are loaned to new student borrowers. In contrast, private lenders service and collect loan payments in the FFEL Program. In the FDSLSP, the government contracts with private loan service bureaus to service and collect loan payments.

In addition to the student loans described above, the federal government offers loans to parents through the Parent Loan for Undergraduate Students (PLUS) program, which operates within the FFEL and FDSL programs. In this program, the government guarantees the loans and caps the interest rate, but does not pay "in school" interest, because the parent borrowers are not enrolled in school.

## **Adapting student loan programs to serve early care and education**

Families with young children, like college students, need additional sources and types of aid to help them pay the full price of early care and education. We thought that early care and education loan programs might be helpful to families who, without such assistance, run the risk of amassing high-interest credit card debt in trying to make ends meet. At the same time, we recognize the important differences between obtaining loans for college and borrowing for early care and education. Parents who borrow to pay for early care and education cannot count on higher earnings as a direct result of this investment, as can students who rely on loans to complete their college degrees. Yet, there may be good reasons in some situations to consider including a loan in a family's financial aid package.

We hypothesized that subsidized and unsubsidized loan programs would be appropriate to the circumstances of some families with young children. We also hypothesized that programs could be designed to offer affordable loans to pay current early care and education expenses without encumbering the families' savings to meet future responsibilities for financing higher education. In considering the higher education loan programs that could be adapted, we excluded the Perkins Loan Program as a potential model for an early care and education loan program because of its administrative complexity and because only a few providers would have the ability to administer loans and collect them over the long periods of time parents would likely need to repay them.

To see if our hypotheses had merit, we conducted two kinds of studies. The first study involved conducting a series of focus groups with parents of children in early care and education or after-school programs to gauge their potential interest in participating in different kinds of loan programs if they were available. These focus groups were intended to assess parent interest in borrowing under different financial circumstances. The second study involved analyzing United States Census Bureau data on incomes and characteristics of families with children to determine how much they might reasonably afford to borrow under various circumstances. In this study, we were trying to see how many families might be able to afford to borrow and repay different loan amounts, and how the amounts they might borrow would help them pay for early care and education.

### **Focus group study findings**

Focus groups were held in Chicago, Colorado Springs, Indianapolis, Seattle and Washington, DC. In these groups, parents were asked to comment on the feasibility of adapting higher education finance approaches to early care and education. Parents were asked for their overall reactions to a plan that would increase both the quality and price of early care and education, but that would also offer new loan programs to assist families in meeting the increases in expenses.

Experienced, professional facilitators were used in each group. Each focus group involved a cross-section of parents with various family demographic and financial characteristics. Parents in attendance varied in family size, marital status, race and



ethnicity, homeownership or rental status, level of postsecondary educational attainment (varying from none, some, or many years), and age of children (varying from 0 to 12 years). Their incomes typically ranged from moderate to upper income, as these groups would be the most likely to qualify for loans. The number of participants in the focus groups ranged from a low of four in one group to a high of eleven in three other groups. The sessions lasted from one hour and 20 minutes to two hours. All participants received a small stipend for participating. (The questions asked by the focus group facilitators are displayed in Appendix A.)

The facilitators asked parents for their reactions to an imagined future scenario in which there was a coordinated way for families to get help paying for high-quality early care and education. It was suggested that in this future situation the price of early care and education would be greater than the current prices and that all families who needed help to pay the higher expenses, not only the poorest families, could seek financial aid. In this scenario, participants were to envision an early care and education system where qualified professionals were compensated to match their level of expertise, no stigma was attached to applying for and receiving financial aid, children were thriving, and tuition was a portion of parents' discretionary income. The future scenario in its entirety appears on the next page. The one that was to parents is displayed in Appendix A.

The focus group parents were virtually unanimous in their agreement that loans for early care and education currently were both infeasible and unnecessary. They offered several reasons for their unwillingness to borrow.

Foremost among these reasons is that the focus group parents did not want to pay higher tuition. They argued, "If it isn't broke, don't fix it." Most parents said that their child's level of care was adequate, and they saw no reason to take on another debt for a promised improvement in the quality of care. The parents generally felt the current care was sufficient, and most were already paying for it without credit. Thus, taking out loans would involve accepting what they considered an unnecessary debt. Perhaps the harshest critic of loans said that borrowing would be "like taking out a loan to buy milk."

The resistance to borrowing does not mean the parents are unwilling to spend money to improve their children's education. However, they appeared to view additional early care and education expenses as unnecessary when they compared them to the very necessary expenses they will incur later for higher education. Few parents could envision spending more for early care and education when they were unsure it would produce great results for their children. They did not want to borrow for something that several described as an "intangible" outcome. Many said they could justify borrowing to pay for their child's college education because that results in a higher-paying job.

Parental resistance to borrowing for early care and education, and to the "Imagine" scenario, is partially attributable to their experiences with financial aid for college. Many exhibited a cynical attitude toward the whole college financial aid system. Some parents said they were confused by the aid application process. Others were frustrated and

thought that they were misinformed or somehow cheated out of money, or that they generally did not receive the aid they thought was due them.

### **Imagine\***

*Imagine* an early care and education system in which programs are staffed with qualified early care and education professionals. Compensation matches the level of their education, expertise, and responsibilities. Staff working conditions are excellent, turnover is low, and children are thriving.

*Imagine* that early care and education programs participating in the system receive subsidies that help to defray the costs of providing high-quality services and meeting accreditation standards. Operating subsidies are provided by government, philanthropy, business and individual donors, with a portion from the community early care and education endowment fund. State and local bonds provide funds for capital expenses.

*Imagine* that early care and education programs set tuition prices to cover the full costs of operating a quality program—including equitable staff compensation. Yet, all families pay less than the full cost of the program, thanks to subsidies received from other sources that reduce tuition prices. Some families pay the full tuition price without assistance; some families qualify for financial aid that helps pay the price of the program they choose.

*Imagine* that all families follow the same process to apply for aid: They complete the standard application form, and send it to the central processing service or submit it on-line from home or a public library. All families—whether poor or non-poor—are assisted through the same one-stop financial aid office in a community-based agency. As in a college financial aid office, there is no stigma associated with obtaining assistance to pay for education.

*Imagine* that the amount each family is expected to contribute toward their children's early childhood program fees is a portion of their discretionary income — it is not needed to pay for basic expenses like food, shelter, health care and taxes. Each family's ability to pay is calculated using a national method that considers family size, income and assets, and basic living expenses in their area.

*Imagine* that the amount of financial aid a family can receive is related to the full price set by the program they choose for their child. Their choices are not limited to lower-price programs, since the old system of providing subsidies according to a market rate has been abandoned. There is no cap on the tuition price or the amount a family needs in aid to pay it. A simple formula is used to calculate need: price (tuition & fees) - expected family contribution = need for aid.

*Imagine* that parents may choose to receive financial aid as an income support to stay home with an infant instead of paying for early care and education services.

*Imagine* that a community financial aid office "packages" aid, combining funds from a variety of sources for which the family is eligible. Sources include earnings from the community's early care and education endowment fund, and funds from federal, state and local governments, employers, foundations and individual donors. Aid families receive might be in the form of grants, loans, tax credits, or a combination of these.

*Imagine* that each family takes their financial aid "package" to the program they have selected, and the provider is paid directly from the financial aid office for the months ahead.

*Imagine* an early care and education system in which parents can access high-quality early care and education; early childhood professionals are equitably compensated; and children are healthy, secure and developing to their fullest potential.

\*Adapted from: Vast, T. 1998. *Learning Between Systems: Higher Education as a Model for Financing Early Care and Education. The Financial Aid Think Tank Report, p8.* Minneapolis, MN: The Minnesota Early Care and Education Financing Partnership. Available online: <http://nccic.org/pubs/lbs1998.pdf>

Many parents complained that the intrusiveness of the paperwork was simply too much of an inconvenience. Others were concerned that credit checks may disqualify some people who most needed the loans. A few believed that the turnaround time needed to get assistance would be too long, because this had been their experience with loans for college. Some parents suggested that, if the "Imagine" scenario was implemented, parents should not have to reapply annually (as they must to get aid for college) if nothing had changed on their application. The focus group parents clearly considered the "Imagine" scenario to be very similar to the student financial aid system for college. Because of that, early care and education providers, governments and the private sector partners who hope to implement the *Learning Between Systems* recommendations must make sure that their new system is less confusing and more "user-friendly."

Questions about the parents' goals in enrolling children in early care and education continually arose in the focus group sessions. Although it was never expressly stated, more than a few parents seemed to consider early care and education more of a "time out" for parents than a time for children to learn. They spoke of how they looked forward to the time that their children spent in care. If the parents' primary goal for early care and education is a "time out" for themselves, they are likely to resist an increase in tuition to pay for what they describe as a "grade up from a babysitting service." As one parent stated, "At age 4, my daughter just needs to be safe."

Almost every participating parent stressed that, in the early years, socialization was a priority over education in general. Some expressed the opinion that teaching children anything other than social skills could lead to the children feeling too much pressure. Other parents worried that improved early care and education would involve "pushing" their children. They were concerned that their children might become burnt out with education if they were approached "too early." One parent stated, "I wouldn't want my child to learn calculus or cursive that early. Who cares if she can write in cursive? She'll do it anyway in second grade. We just need to start them out on the right foot." Another commented, "I don't want her to be pushed to be Einstein if she's not ready." Overall, there was a general consensus that if the social skills were acquired, the rest would come in due time.

Interestingly, a few parents worried that if their child received a better education too early, the child would eventually become bored in traditional classes in elementary school. They reasoned that equipping children with too many skills too quickly could cause them to continually need advanced classes throughout their elementary and high school years. These particular parents seemed to see starting early as a threat to their financial security because they might have to pay more for advanced classes in elementary and secondary school. By this logic, it appears that these parents would rather have their children learn less so that they can save more money. It is clear that many of these parents do not recognize the economic potential of investing in a child's early education.

When these parents were asked if they would be willing to consider a loan if it could be proven that investing in better-quality care would not hurt, but would help, their children,

very few said they would accept a loan. Again, this suggests a low assessment of the value of early care and education. To the overwhelming majority of participants, the family's financial security came first.

Many parents worried about the extra stress that might be put on the family if they borrowed to finance early care and education. One focus group parent noted that he worked sixty hours a week in order to pay for a higher quality school for his child's care. Although the schooling she receives may be flawless, he said, "the strain on a family of my working 60 hours a week may be overwhelming in its own right."

It is important to note that although resistance to borrowing was firm, at the end of the focus groups a few parents appeared willing to consider the possibility of taking out a loan because they acknowledged that child-care prices are rising. However, many of their peers fell back on the fact that college prices are also rising and saw this as the priority for their borrowing and savings.

### **Parents' reactions to different loan scenarios**

Despite the parents' opposition to borrowing for early care and education expenses, the facilitators were able to get them to consider different loan-payment scenarios and describe which features of the scenarios were most and least appealing. Parents were shown different scenarios in which the loan principal, interest rates, terms and origination fees were changed. (See the scenarios in Appendix A).

These loan characteristics were based on those found in private loan programs offered to parents to pay for private elementary and secondary school charges. There was a great consensus among focus group parents that the typical interest rates offered in the scenarios (ranging from 7.1 percent to 12 percent) were too high. Many commented that an educational loan should have lower rates. Also, some stated that they could get a 1.9 percent interest rate on their credit card, and would rather do this than take out a loan with a higher rate. Others noted that if the interest rate were not lower, they saw no advantage of taking out an early care and education loan over any other kind of traditional loan. Furthermore, some stated that the loan amounts were too small to adequately cover the already rising prices of child-care for any sustained period of time.

Of all of the scenarios presented, the fifth was considered the best. Parents liked the fact that there was no lender fee and that payments and interest rates were low. Many participants stated that this type of loan should have a fixed interest rate. Others said they would have liked to have seen a loan scenario with a shorter term. Based on the parents' reactions, we concluded that a saleable loan program would have to feature interest rates that are equal to or less than rates offered in current federal student aid program—generally between 6 percent and 8 percent.

When asked about their preferred loan administrators, similar proportions of the parents chose banks or credit bureaus, federal or state agencies, and the child-care centers. Those

who picked governmental agencies thought they would offer more lenient repayment terms. Those who chose banks or credit bureaus reasoned that they already had comfortable financial dealings with them. Some who chose private lenders reasoned that successful repayment would improve their credit rating more than would a loan from the other sources. And those who preferred their child-care centers believed the centers should use the profits from loan interest to improve their child-care services. Some parents opposed loans from their providers because they thought such loans could inhibit their ability to transfer their children to other centers.

The parents preferred monthly loan payments with most choosing to have loan payments taken directly from their paycheck, or their bank. No parents wanted to make payments only once every six months, reasoning that if they had that much cash at one time they would not need a loan. No parents wanted to borrow enough at one time to pay for more than one year of expenses. Nearly everyone agreed that loans for early care and education should be paid off by the time children enter intermediate school or high school, not wanting to interfere with savings for college expenses.

Focus group parents were asked to comment on what might make the process of applying for early care and education loans worth their while. Many answered that a system that combined both loans and *grants* would be much more appealing and would make them more willing to complete an application process. Others acknowledged that loans might help to relieve the stresses that they currently encounter while trying to find ways to pay for childcare. Still others commented that they would be willing to complete the application if it would equalize the system and raise the quality of care for others.

Although virtually no parents thought that borrowing was a good solution for them, they did offer some suggestions for making early care and education worth a higher price. They suggested improving student to teacher ratios, implementing higher standards and licensing of care providers, recruiting better trained staff, increasing teacher' wages, increasing educational opportunities for the children, such as field trips and foreign language classes, expanding hours, providing sick care and supplying "extras" such as formula and transportation.

Some parents were concerned that a system intended to improve the quality of early care and education for everyone may do just the opposite. These parents said the current system was a fair one. They were concerned that increased quality not be negatively affected by what they saw as problematic with Medicare. That is, in attempting to provide a minimum of universal service, standards at many child-care centers would drop. A few expressed concern that raising the price of child-care might cause some parents to leave their children home alone instead of enrolling in a higher priced program. Others said that if the price was raised to the point where loans were necessary, they would first consider leaving their jobs and staying home with their children instead of paying more for care.

Many parents suggested improvements to the early care and education system. They said that there should be stringent guidelines for all providers; that incentives should exist for



providers who exceed the guidelines or minimum standards; and that there should be multi-child discounts, or some other type of deduction for parents who have more than one child in early care and education. Foremost, the vast majority called for a financial aid package that included not only loans, but also grants and better tax credits.

Other parents suggested what they considered better alternatives to the financial aid proposal. They said to encourage employers to provide matching funds for child-care and/or provide on-site child-care, raise the tax credit for child-care, govern local child-care financing by using a parent board, offer financial aid as income support for parents to stay home with children, get child-care centers to lower their rates, and concentrate loan funding efforts on educating parents so they can make more money and afford child-care.

### **Summarizing the focus group results**

The significant finding in all the focus groups was that parents, for a variety of reasons, were extremely reluctant to take out loans to pay for early care and education. For the most part, it appears that they are satisfied with their quality of care and are not anxious to take out loans to pay to improve a service with which they are already content. Few parents, if any, made the connection that charging more for care could greatly improve its quality. This appeared to be a major factor in parents' unwillingness to borrow to pay for charges that were greater than their current ones.

For the majority of parents in all groups, improving quality was not a priority. It is very doubtful that these parents would oppose improvements, they just seemed to oppose paying for improvements out of their family budgets. These parents did not take time to get past their resistance to borrowing to the broader issue of the reason for loans---improving the condition of early care and education. It was difficult for them to accept the idea that tangible educational improvements would come with increased spending. Aversion to loans seems, in part, a consequence of universal concerns about financing their children's college education. It is also a consequence of bad experiences with college student loan programs.

Another major conclusion to be drawn from the focus groups is that most parents fail to understand the importance of early care and education to their child's development and future educational experiences. If parents can be made more aware of evidence that shows how beneficial and fun early education can be, they might be more willing to consider the possibility of paying more for it. Parents also need to be shown that these benefits can carry throughout their child's schooling without costing them more money. It is possible that if the majority of children begin to receive a better education before kindergarten, the standards for education throughout schooling will improve. Thus children will not be bored, or require "advanced schooling" that costs parents more money.

For those who would design loan programs for early care and education, one of the biggest hurdles in implementing a successful program will be convincing parents that

borrowing represents a positive step on behalf of their children. Put another way, an early care and education loan program will have to devote considerable funds to marketing in order to get large numbers of parents to participate.

### Census Bureau data analysis findings

While the focus group research was being conducted, we were simultaneously attempting to develop estimates of how much parents might be able to afford to borrow to pay for early care and education. We assumed — overzealously, we think now — that many parents would be *willing* to borrow. So we attempted to estimate how much parents might be *able* to borrow under different loan-repayment conditions. In designing a loan program for any group of borrowers, not just parents of preschool-age children, one must estimate how many are willing to borrow; how much they might be able to afford to borrow under loan different conditions (e.g., interest rates, terms, and principal); and whether there are public and/or private organizations that might be willing and able to make loans that borrowers can afford.

We first analyzed data from the U.S. Census Bureau’s Current Population Survey for 1999 as of March 2000, to see how much different parents earn. The median annual income of all primary families with young children was approximately \$35,800. The median for married couples was \$50,500; for single fathers, \$22,600; and, for single mothers, \$14,000. About 25 percent of all families with young children have just one child and 86 percent have three or fewer children under age 18. Counting children and parents, the average size for all families was only 3.17 persons.

There were significant regional differences in the family income distributions. These differences suggest that the demand for early care and education loan programs will vary considerably by region. They also suggest that loan programs might have to be structured differently between regions because the ability to repay loans will be different. Here are the family income data:

	<u>Northeast</u>	<u>Midwest</u>	<u>South</u>	<u>West</u>	<u>Nation</u>
Under \$20,000	27%	25%	32%	32%	30%
\$20,000 to \$29,999	11	12	14	15	13
\$30,000 to \$39,999	10	11	12	13	12
\$40,000 to \$49,999	10	11	9	10	10
\$50,000 to \$59,999	8	11	8	8	9
\$60,000 to \$69,000	7	9	6	6	7
\$70,000 or More	27	21	19	16	19
All Incomes	100%	100%	100%	100%	100%
Median	\$42,000	\$41,800	\$33,300	\$32,300	\$35,800

In the Northeast, 27 percent had incomes of \$70,000 or more versus 19 percent of the national total. Incomes were more evenly distributed in the Midwest region than the

others. Higher percentages of families in the South and West had incomes of less than \$20,000.

When we looked at family size by region, we found that families in the South were more likely to have fewer young children; only 31 percent had more than one child under age 6. However, 40 percent of Midwest families had two or more young children, versus 35 percent for all the regions. Western families matched the national percentage of 35 percent with more than one child under age 6, while only 33 percent of families in the Northeast had multiple children under age 6.

Examination of parental education levels revealed that about 21 percent of families with young children were headed by someone who had not finished high school, and 29 percent were headed by persons who only had high school diplomas. Half the families were headed by persons with at least some college education, with 17 percent having bachelor's degrees and 8 percent having earned graduate or professional degrees.

About 61 percent of families with children age 6 or younger owned their residences. Another 37 percent lived in rental properties, and the remaining 2 percent lived in residences without cash rents. As expected, lower-income families were much less likely to live in homes they owned. Only 34 percent of families with annual incomes below \$30,000, but 75 percent of families with higher incomes, owned their homes. About six out of 10 families owned their homes and their average home equity was about \$32,000. Home ownership was important to our analyses because homeowners generally have better credit ratings and, therefore, represent a more attractive market to lenders.

The census data show that families with young children generally are not very good candidates for loans or increased debt. Four out of 10 such families earned less than \$30,000 per year. Three out of 10 families were headed by a single parent, which generally means there is only one salary earner in that family. Three out of 10 have more than one child under age 6. The census data revealed that six out of 10 parents were only working part time. Thus the analyses of the census data demonstrated what we had anticipated: It would be very difficult for many families to rely on loan programs to help cover early care and education expenses.

### **Who might benefit from early care and education loan programs?**

The focus group and census data made it clear that the original study goal to design loan programs for early care and education could not be achieved. However, we decided to develop some estimates in order to examine what types and sizes of loans might be of interest to parents—particularly if early care and education program prices were to rise significantly and the benefits of high-quality early care and education were better understood by families.

If loans were to be offered, we envision their use primarily as a supplement to the amount that families are expected to contribute from their own current resources and savings. For example, if a family could afford to pay \$500 per month for early care and education,

but the price of the program they chose was \$900 per month, they might be interested in obtaining a loan to pay the difference, assuming they did not receive grant aid.

Because it is unreasonable to suggest that families with incomes below \$30,000 borrow to pay for early care and education expenses, we looked at the characteristics of families with incomes above that amount in the census data. The approximate mean and median family income for families with incomes above \$30,000 was about \$60,000.

We first calculated how much a family that earned \$60,000 could afford to spend on early care and education loan payments. We then calculated how much a family that earned \$45,000 per year could afford. Banks and other lenders that participate in the Federal Family Education Loan Program (FFELP) have a rule of thumb that student loan payments should not exceed 8 percent of the borrower's gross monthly income before taxes. Because many parents of young children have had some college experience and, therefore, may be making payments on their own college loans, and because many are homeowners who are paying more than 30 percent of their monthly earnings on mortgages, we decided it would be better to calculate the maximum payment ratio for early care and education loans at 6 percent of gross monthly earnings. That amount is \$300 for a family earning \$60,000 per year (\$60,000 divided by 12 months equals \$5,000 per month, times 6 percent equals \$300). For a family earning only \$45,000 per year, the maximum amount is \$225 per month (\$45,000 divided by 12 equals \$3,750 per month, times 6 percent equals \$225).

So how much could these families afford to borrow? The answer depends in large part on the interest rate and term of their loans. When interest rates are lower and the time allowed to repay the loans longer, the principal amounts borrowed can be higher. The focus group results indicated that low interest rates were a critical condition for parents to even consider borrowing for early care and education expenses. If loans are to offer low interest rates, they must come from a program that subsidizes them. It was assumed that subsidized interest rates would fall somewhere between 6 percent and 8 percent, because this has been the historical experience in loan programs for college students. College students have 10 years, sometimes longer, to repay their loans. The focus group participants thought five to seven years was as long as they would consider repaying loans for early care and education, in part because parents would want to begin saving for college expenses for their children.

We wanted to estimate how much parents could afford if the government offered them the three kinds of subsidies available through student loans—covering their payments if they default, die, become disabled, or go bankrupt; supplementing their interest payments (either by making supplemental interest payments to private lenders or by forgoing some earnings on interest if the government makes the loans); and subsidizing their payments by paying their interest while their children were in early care and education and the parents cannot afford to make payments.

The PLUS loan program for parents of college students does not pay interest on loans while the parents' children are students. It would cost taxpayers a great deal to support

such payments. Moreover, most parents are working and can afford to make payments (they cannot get the loans without passing a credit check), so there is little political support for providing government subsidies to PLUS borrowers. Additionally, many PLUS borrowers have above-average incomes. For these reasons, we assumed that an early care and education loan program would also require parents of young children to pay interest while their children were enrolled in early care and education.

The parents could pay the interest charges in three ways: (1) begin loan repayment immediately after getting their loans by making payments on both interest and the principal as they are amortizing their loans; (2) make interest-only payments while their children are in early care and education and then start making payments on principal and interest when early care and education is no longer needed; and (3) capitalize the interest payments by adding them to the loan principal while their children are in school and then making payments on the combined amounts after early care and education is no longer needed.

We believe it would be very difficult for many parents to make loan payments on both the principal and interest while they were making payments for early care and education expenses. Since it would cost parents much more to repay loans if they capitalized the interest while their children are in early care and education, we focused on how much parents could afford to borrow if they paid the “in school” interest as it accrues and then started repaying their loan principal and interest when their children enter kindergarten or elementary school.

Because the focus group parents said they would want to repay any early care and education loan in no more than five to seven years, and they wanted subsidized interest rates, we estimated the maximum amounts parents could afford to borrow under three interest rates and three different terms of repayment. First, here is how much the family earning \$60,000 could afford to borrow:

<b>Months to Repayment:</b>	<b><u>60 Months</u></b>	<b><u>72 Months</u></b>	<b><u>84 Months</u></b>
<b>Interest Rates</b>			
6%	\$15,400	\$18,100	\$20,500
7%	\$15,100	\$17,600	\$20,000
8%	\$ 14,800	\$17,000	\$19,200

At a cost of \$800 per month per child for early care and education, the \$20,500 maximum amount above would pay for just under 26 months of services (\$20,500 divided by \$800 equals 25.625). That would mean that one child’s expenses could be covered for just over two years and two children’s expenses could be covered for 13 months. But we assume that the parents making \$60,000 can, by the standards of the ECE Financial Need Analysis Methodology, afford to pay \$500 per month for early care and education services. This means they would only need to borrow \$300 per month to meet the full charges. Now, with the maximum \$20,500, they could afford to purchase more than 68 months of services (\$20,500 divided by \$300 equals 68.33). This would be more than enough months to cover all years from age 0 through 6. So borrowing to pay for early



care and education might be feasible for the family earning \$60,000 per year and with one child under age 5.

What do the calculations say for a family earning only \$45,000? Here are the estimates:

<b>Months to Repayment:</b>	<b><u>60 Months</u></b>	<b><u>72 Months</u></b>	<b><u>84 Months</u></b>
Interest Rates			
6%	\$11,600	\$13,500	\$15,400
7%	\$11,400	\$13,200	\$15,000
8%	\$11,100	\$12,800	\$14,400

At a price of \$800 per month per child, the \$15,400 maximum amount would pay for 19 months of early care and education services (\$15,400 divided by \$800 equals 19.25). One child's expenses could be covered for just over a year and a half. We estimated that a family of four with one child of early care and education age and earning \$45,000 can afford to pay less than \$200 per month for early care and education. This means the family would need to borrow \$600 per month to meet the estimated \$800 charges. Their borrowed \$15,400 would help them afford just under 26 months of early care and education expenses (\$15,400 divided by \$600 equals 25.66). This would hardly be enough to get one child through five years of early care and education.

In addition to not being able to afford payments on a large loan for early care and education expenses, there is another very important disadvantage to borrowing—the total cost of repaying loans plus interest. To illustrate this disadvantage, we assume that the family earning \$60,000 per year borrows one-fifth of the affordable amounts noted above for five consecutive years, pays the interest as it accrues, and then begins making payments on the interest and principal at the end of the fifth year. The family that can borrow \$20,500 at 6 percent to be repaid over seven years would borrow \$4,100 each year (\$20,500 divided by five equals \$4,100). They would pay 6 percent interest each year, so their annual interest costs in the first year would be \$246 (6 percent times \$4,100 equals \$246). In the second year, their annual interest costs would double, to \$492, because they would now have borrowed \$8,200—\$4,100 for each of two years. By the third year, their annual interest charges would be \$738 (6 percent times \$12,300); by the fourth year, \$984 (6 percent times \$14,480); and, by the fifth year, \$1,230 (6 percent times \$20,500 equals \$1,230). By the end of the fifth year, the parents would have paid \$3,690 in interest for the \$20,500 they borrowed, and they would not yet have paid anything on their loan principal. If they take seven years to repay their total loan amount at 6 percent interest, it will cost them another additional \$4,600 in interest payments.

Thus, after paying the accruing interest for five years while their child was in early care and education and making payments on interest and principal for seven years, these parents will have made about \$28,800 in loan payments in order to have \$20,500 to spend on early care and education. Put another way, they will have increased their early care and education expenditures by \$8,300 more than they would have paid had they not borrowed. Here are the total repayment costs for the family with \$60,000 annual income, at the rates and terms indicated:

Months to Repayment:	<u>60 Months</u>		<u>72 Months</u>		<u>84 Months</u>		
	Interest Rates	Borrowed	Repaid	Borrowed	Repaid	Borrowed	Repaid
	6%	\$15,400	\$20,700	\$18,100	\$24,900	\$20,500	\$28,800
	7%	\$15,100	\$21,100	\$17,600	\$25,300	\$20,000	\$29,500
	8%	\$14,800	\$21,600	\$17,000	\$25,600	\$19,200	\$29,800

Depending on the interest rates, the parents who take five years to repay their early care and education loans, after paying accruing interest when their child was in early care and education for five years, will spend between \$5,300 and \$6,800 on interest, depending on their loan interest rate. The parents who take six years will spend between \$6,800 and \$8,600, and those who take seven years will spend between \$8,300 and \$10,600 on interest. So if the families borrow as we have illustrated in these examples, their interest payments will be equivalent to between six and 13 months of early care and education expenses at our assumed cost of \$800 per month.

This analysis suggests that families with at least \$60,000 annual income might possibly find borrowing to pay for early care and education feasible under low-interest circumstances. Some families might find long-term, low-interest loans preferable to their current means of paying for early care and education with credit cards (or by paying for other essential purchases with credit cards in order to pay cash for early care and education). If we assume that families with incomes above \$100,000 would not be good loan candidates, because many would be able to pay for early care and education charges from current income, then the number of families with annual incomes between \$60,000 and \$99,999 would be about 1.5 million:

**Families with children under age 6  
and incomes between \$60,000 and \$99,999**

<u>Types of families</u>	<u>Number</u>	<u>Percent</u>
Married Couples	1,499,000	95.8%
Single Fathers	29,000	1.9%
Single Mothers	36,000	2.3%
All Families	1,564,000	100.0%

Given the resistance to borrowing expressed by the focus group parents, and given the fact that not all of these families have children who are participating in paid early care and education, we speculated that up to 20 percent might, *under some circumstances*,

wish to get loans to help them pay for early care and education. That would represent about 313,000 families. If they borrowed \$4,800 each year (about half of an estimated \$9,600 in charges for high-quality early care and education), then the annual loan volume would be about \$1.5 billion per year.

### **Is establishing an early care and education loan program feasible?**

Would \$1.3 billion to \$1.5 billion per year represent a large enough demand (or market) to make it feasible for government and/or private lenders to establish an early care and education loan program? Possibly, under some conditions. We know from the experience of college student loan programs (and PLUS loan programs) that it is expensive to administer education loan programs. It costs a great deal to develop and maintain loan administration software and hardware and to pay for loan servicing. We also know that lenders who provide private capital for federal education loans make well under 1 percent profit on their investments. To minimize per-loan costs and maximize loan profits, the government and private lenders must achieve economies of scale. Therefore, for an early care and education loan program to be feasible, it would have to serve relatively large numbers of borrowers and involve substantial average loan balances as well as annual loan volumes.

The PLUS program as operated under the FFEL Program currently serves about 320,000 borrowers annually who borrow about \$2.5 billion. The average annual loan is just under \$8,000. Private lenders provide the capital for these federal loans. Thus, it appears that the estimated 313,000 early care and education loan borrowers and \$1.5 billion annual loan volume could be large enough to make an early care and education loan program feasible. It is unlikely that private lenders would see this potential early care and education loan market, which is spread over a 50-state area, as worth the expense of developing all new systems and an administrative structure to make and service early care and education loans.

However, if the federal government were to modify the PLUS loan program and make its loans available to parents to pay for early care and education expenses, some lenders that now participate in the PLUS program might decide to make early care and education loans—if they could do so without major modifications to their PLUS loan-servicing systems. The private lenders would, of course, need the subsidies offered by the federal government before they could make loans at an interest rate low enough to meet the parents' repayment needs.

Thus, it is economically and administratively feasible that an early care and education loan program could be funded and operated to serve some portion of all middle- and upper-middle-income families. Whether it is politically feasible is beyond the scope of this research.

There is a second method of offering long-term, low-interest early care and education loans to parents that may be feasible: State governments could fund an early care and education loan program and administer it through the guaranty agencies that currently

operate in the FFEL Program. These agencies have loan-servicing capabilities that could be applied to early care and education loans, if the loan capital were available. It is conceivable that states could get the loan capital from private lenders by insuring the lenders against losses due to default, death, disability and bankruptcy, and assuring them some interest rate of return. This way, the lenders, rather than taxpayers through appropriations, would be providing the capital for a state early care and education loan program. The states could also raise the loan capital by selling revenue bonds. A major drawback to a state-operated early care and education loan program is that the estimated number of borrowers served would be small. Based on our assumption that there might be 313,000 early care and education loan borrowers nationwide, it seems unlikely that more than 50,000 of these families would be in any one state. Whether a potential demand from 50,000 families is sufficient to propel state governments to consider funding an early care and education loan program is unknown.

### Conclusions

It appears that using long-term, low-interest loans to help parents pay for early care and education represents a viable strategy for a limited number of families with young children. The families who are most likely to benefit from borrowing would have incomes between \$60,000 and \$100,000. They would be disproportionately located in the Northeast and in California.

For early care and education loan programs to be feasible, they would have to be subsidized and guaranteed against losses due to default, death, disability and bankruptcy. These guarantees would keep the borrowers' interest rates low and the terms acceptable to borrowers. Without the guarantee, the costs of borrowing would be so high that few parents would accept loans.

If the federal or state governments were to modify current higher education loan programs to allow borrowing for early care and education, this may attract the participation of private lenders and allow for cost-effective loan servicing. However, unless parents view the price of high-quality early care and education as an investment in their children's future, the demand for early care and education loans is likely to be minimal. Thus, the ultimate feasibility of loans rests not only on willing lenders, the government's backing, and administrative capacity, but also on parents' perceptions of the value of early care and education and their willingness to borrow.

Over time, as support for early care and education grows and quality increases, there may be enough demand to justify the development of a loan program, particularly if prices were to rise significantly. A well-targeted early care and education loan program could help some families pay for high-quality early care and education during the years that early care and education expenses exceed families' ability to pay, allowing loan repayment and college savings to begin during the elementary school years when child care expenses generally decrease.

## About the authors

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## APPENDIX A

### QUESTIONS AND LOAN SCENARIOS FOR THE FOCUS GROUPS

The focus group leader's conversations and work with the parents were guided by the following outline of questions. (The instructions to the leaders are shown in italics.)

*After your introductory remarks, read the "future scenario" (portions of the "Imagine" handouts) to the parents.*

1. What do you think of the idea of a coordinated way for families to get help paying for early care and education—not just the poorest families, but all families who need help—for example, having a place where all families could go that doesn't have a "welfare stigma," a place where even middle-income families could get a package of assistance to help cover the costs of high quality early care and education? This could be similar to a financial aid office in a college, where all students are served---whether from low or higher income families---but in a central location and respected agency in your community
2. Do any of you have experience applying for financial aid for college? (For yourself or for another family member)?

What about that experience would you want to avoid in a financial aid system for child care?

What would you want to build on? What were some positive things about that experience of applying for financial aid for college?

Now we are going to move into talking about borrowing money to pay for early care and education.

3. If the cost of education and care would rise, would you be willing to accept a long-term loan, that is, a loan that is repaid over a period of five or more years, to help pay for these higher education and care expenses?

*Find out who is willing, unwilling or undecided and in each instance find out why they feel as they do. Here we have to get as many reasons as possible for whatever answers the parents might give. The proportions who are willing, unwilling, or undecided are not as important as the reasons for falling into those three categories.*

We have looked at loan programs designed to help parents pay for private elementary and secondary school. There are many loan options that could be available to help parents pay for early care and education. I am passing out a handout that describes five options. The first three we have outlined on these pages would be typical of what's available for parents paying for private school. Please take a minute or two to examine the options.

*Distribute handout with the loan options. Ask the parents first to answer the questions at the top of the sheet about borrowing. Next, describe the components of each option: principal, lender fee, interest rate, months of repayment, monthly payment, total amount paid, and total cost of amount borrowed. Give a simple definition of each to help to call their attention to each variable as they consider the options.*

*Ask them to react to each of the scenarios. Go through each one at a time. Tell them that if they want to write something to record additional reactions to please do so. Tell them you will collect the papers at the end of the evening.*

4. Which of the first three options seems most acceptable to you? Which is least acceptable? Why?

*Here we want to determine if the lender fees, interest rates, monthly payments, total loan repayment costs of principal and interest, or something else is important to the parents. The focus here is on finding out what they are seeking (or resisting) in a loan program. It would be a good idea to ask parents to jot their comments on the loan option pages so that we might examine them after the focus groups are over.*

5. What is your reaction to the last two scenarios, in which the government subsidizes the interest ?

6. How could lenders make their “subsidized loans” most attractive to you?

- By lowering the loan interest rate by 1 or 2 percent?
- By cutting the “loan fee” in half?
- By extending the time you have to repay the loan?
- Cutting monthly payments?
- By doing something else?

7. If you decided to accept a long-term loan to pay for early education and/or child care, from which of the following lenders would you most prefer to borrow: (a) a private lender such as a bank or credit bureau; (b) a federal, state, or local governmental agency; or (c) a child care center that serves your child?

From which of these potential lenders would you *least* prefer to borrow? Why?

*Here we need to determine how parents feel about interactions with different types of lenders. We are especially interested in whether the parents express a preference for or resistance to borrowing from their child care providers.*

8. What do you think of the federal government subsidizing loans for middle-income families who need help to pay for child care?

*This is another way of getting at the factors that most affect parental interest in or resistance to borrowing.*

9. After this discussion, and considering what you have learned, can you please tell us now how much you or people in comparable income brackets might be willing to borrow---per year and in total---to pay for early care and education?

*Here we are just interested in whether the discussion has changed minds and whether resistance to borrowing has hardened or softened. Even though the numbers of parents will be small, it will be helpful to record their answers so we can see the range of responses.*

10. There are several ways to make loan payments. Which of the following would you most prefer using?

- Automatic withdrawal and transfer from your bank account
- A monthly payroll deduction plan
- Writing a check each month
- A lump sum payment every six months

11. How important would it be to have loan repayments completed before your child/children are ready to start college?

12. If you were to borrow to pay for early child care and education, would you be most interested in borrowing all of the program price at once, or just a portion of it?

13. Are there additional comments or observations you would like to make?

*Collect the handouts from the parents now, before they leave. You will need to submit these with your report.*

Scenario to be read to parents prior to the questions about loans:

*Imagine* an early care and education system in which parents can access high-quality early care and education; early childhood professionals are equitably compensated; and children are healthy, secure, and developing to their fullest potential.

*Imagine* an early care and education system in which programs are staffed with qualified early care and education professionals. Compensation matches the level of their education, expertise, and responsibilities. Staff working conditions are excellent, turnover is low, and children are thriving.

*Imagine* that early care and education programs participating in the system receive subsidies that help to defray the costs of providing high-quality services and meeting accreditation standards. Operating subsidies are provided by government, philanthropy, business, and individual donors.

*Imagine* that early care and education programs set tuition prices to cover the full costs of operating a quality program. Yet, all families pay less than the full cost of the program, thanks to subsidies received from other sources that reduce tuition prices.

*Imagine* that all families follow the same process to apply for aid: They complete the standard application form, and send it to the central processing service or submit it on-line from home or a public library. As in a college financial aid office, there is no stigma associated with obtaining assistance to pay for education.

*Imagine* that the amount each family is expected to contribute toward their children's early childhood program fees is a portion of their discretionary income— it is not needed to pay for basic expenses like food, shelter, health care, and taxes. Each family's ability to pay is calculated using a national method that considers family size, income and assets, and basic living expenses in their area.

*Imagine* that the amount of financial aid a family can receive is related to the full price set by the program they choose for their child. Their choices are not limited to lower-price programs.

## LOAN SCENARIOS

A. Do you customarily borrow money now? This would include maintaining a balance on your credit card, having a home equity loan or use some other means of credit.

Yes  No If yes, what kinds of loans do you use?

credit cards  home equity loan  other: \_\_\_\_\_

B. Are you currently using a credit card, home equity loan, or some other means of credit to help pay for early child care expenses?

Yes  No If yes, what kinds of loans do you use?

credit cards  home equity loan  other: \_\_\_\_\_

Please read over each of the loan options and record your responses for each option

### LOAN SCENARIO ONE

Principal Borrowed	\$6,000	<input type="checkbox"/> I like this option
Lender Fee* 2%	\$ 120	Why? _____
Interest Rate	12%	_____
Months of Repayment	60 (5 Years)	_____
Monthly Payment	\$ 133	<input type="checkbox"/> I dislike this option:
Total Amount Paid	\$8,128	Why? _____
Total Cost of Borrowing	\$2,128	_____
Total Cost/Amount Borrowed		_____
35.5% (\$2,128 divided by \$6,000)		

### LOAN SCENARIO TWO

Principal Borrowed	\$6,000	<input type="checkbox"/> I like this option
Lender Fee* 8%	\$ 480	Why? _____
Interest Rate	10%	_____
Months of Repayment	60 (5 Years)	_____
Monthly Payment	\$ 127	<input type="checkbox"/> I dislike this option:
Total Amount Paid	\$8,129	Why? _____
Total Cost of Borrowing	\$2,129	_____
Total Cost/Amount Borrowed		_____
35.5% (\$2,129 divided by \$6,000)		

### LOAN SCENARIO THREE

Principal Borrowed	\$6,000	<input type="checkbox"/> I like this option
Lender Fee* 6%	\$360	Why? _____
Interest Rate	10%	_____
Months of Repayment	120 (10 Years)	_____
Monthly Payment	\$ 79	<input type="checkbox"/> I dislike this option:
Total Amount Paid	\$ 9,875	Why? _____
Total Cost of Borrowing	\$3,875	_____
Total Cost/Amount Borrowed		_____
64.6% (\$3,875 divided by \$6,000)		

\* The "Lender Fee" is an amount that lenders charge when the loan is given to the borrower. The borrower can pay the fee and receive all the principal balance, or the lender will deduct the fee from the loan amount and give the borrower the remaining balance. This fee is used to insure the lender against losses due to borrower default, death, disability, and bankruptcy.



Some loan programs for parents of college students are “subsidized,” meaning that a public or private donor pays lenders a “subsidy” so that they can make the loan repayment more favorable to borrowers. The “subsidy” allows lenders to change different conditions of their loans to parents.

THE FOLLOWING SCENARIOS ARE BASED ON THE FEDERAL FAMILY EDUCATION LOAN PROGRAM (AVAILABLE FOR COLLEGE STUDENTS):

#### LOAN SCENARIO FOUR

Principal Borrowed	\$6,000	<input type="checkbox"/> I like this option
Lender Fee** none	\$0	Why? _____
Interest Rate	7.5%	_____
Months of Repayment	60 (5 Years)	_____
Monthly Payment	\$99	<input type="checkbox"/> I dislike this option:
		Why? _____
Total Amount Paid	\$7,214	_____
Total Cost of Borrowing	\$1,214	_____
Total Cost/Amount Borrowed		
20.2% (\$1,214 divided by \$5,000)		

#### LOAN SCENARIO FIVE

Principal Borrowed	\$6,000	<input type="checkbox"/> I like this option
Lender Fee** none	\$0	Why? _____
Interest Rate	7.5%	_____
Months of Repayment	120 (10 Years)	_____
Monthly Payment	\$71	<input type="checkbox"/> I dislike this option:
		Why? _____
Total Amount Paid	\$8,546	_____
Total Cost of Borrowing	\$2,546	_____
Total Cost/Amount Borrowed		
42.4% (\$2,546 divided by \$6,000)		

\*\*Lender fees currently are unnecessary in the Federal Family Education Loan Program, because the federal government guarantees the loans for the private lenders against losses from default, death, disability, and bankruptcy.

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