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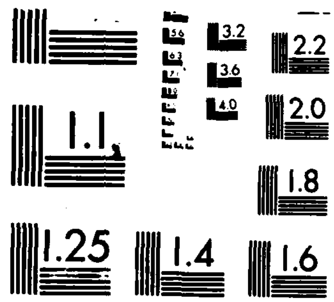

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PRIVATE-SECTOR FINANCING OF
CHILD DEVELOPMENT CENTERS

Report NA604R1

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The private sector is not interested because:

- The risk is too great. Building a single-purpose building on an installation that could be closed or significantly reduced in size is, at best, an uncertain financial venture.
- Extended services are required. Military child-care centers require infant care and evening and weekend service. Most private companies do not normally provide such service.
- Competition with Government CDCs is seen to be unequal. Third-party CDCs do not get the subsidies that the Government CDCs get, must pay insurance premiums and other fees, and must make a profit.

To resolve these impediments to private-sector interest, consideration must be given to:

- Guaranteed minimum occupancy, Government buyback of facilities, or both, in the event of base closure or major changes of mission

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January 1987

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Executive Summary

PRIVATE-SECTOR FINANCING OF CHILD DEVELOPMENT CENTERS

Because of the scarcity of funds for the construction and operation of Military Service child development centers (CDCs), Congress has directed the Military Departments to determine the feasibility of private-sector or so-called "third-party" financing of the centers. In this arrangement, land is made available to a firm to design, build, and operate a CDC. Currently, the CDCs are financed through Military Construction, general operating funds, and nonappropriated funds. An initial test of the concept, conducted by the Department of the Army and based on a service contract arrangement, showed that private-sector financing was not feasible.

Our review and analysis of a broader test by the Department of the Navy under a concession arrangement – where the private firm underwrites the costs but receives the revenues from the user fees – also showed the concept to be infeasible. Commercial firms do not wish to risk investment capital on CDC facilities on military bases. They are concerned about losing their facility in the event of base closures or cutbacks, operating CDCs where occupancy rates cannot be guaranteed, and providing more extensive child-care services than they normally provide. Commercial CDC firms prefer investments with lower risks and better returns.

Additionally, commercial firms would need to charge prohibitively higher fees to military families for child care to cover expenses for building construction and maintenance, utilities, materials and supplies, and insurance and license fees, which are not directly borne by the Government when it operates CDCs. Finally, even if all these obstacles could be overcome, the cost of private-sector CDCs would be no cheaper than Government CDCs and offer no advantage to the Government.

We considered four alternative arrangements – appropriated fund subsidies, increased fees, Government financing of the buildings only, and service contracting. We found that none offers a reasonable and effective solution to the economic problems of third-party financing.

We conclude, in light of these findings, that further Navy tests of CDC third-party financing are unnecessary. We recommend that the Navy seek to have Congress resume military construction funding for building the needed CDCs.

CONTENTS

CHAPTER 1

INTRODUCTION

The need for adequate child care is one of the urgent concerns facing the United States in the 1980s. Both the private sector and the military face this growing problem.

Demographic trends show we are entering an era in which the population of working-age men is declining. For the economy to continue growing, more women will have to enter the work force. By 1990, two-thirds of the new entrants into the labor market will be women, according to a report published by the Conference Board.[1] About 80 percent of those women will be of child-bearing age, and 93 percent will become pregnant sometime during their working careers. The report goes on to say that "their needs are likely to play a role in the design of recruitment efforts, productivity incentives, and benefit plans." Other social changes, such as the dramatic rise in the number of single-parent families, will also increase the need for reliable and affordable child care.

Many private employers realize the importance of child care in attracting and retaining qualified personnel and are beginning by various means to provide their employees with child care. The military, in the era of the all-volunteer force, must compete with the private sector in this respect for the people it needs.

The military, like the civilian work force, is affected by the growing numbers of single parents; some 50,000 single parents are currently in the Services. Military personnel, however, have special responsibilities that increase their need for child care. Deployment and duty schedules, for example, place extra pressures on military families, most of whom are young, cannot afford costly child care, and are far from available family support. Under such conditions, lack of adequate child support can harm morale, retention, productivity, and, in the end, mission readiness.

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[1]Friedman, Dana, "Corporate Financial Assistance for Child Care," The Conference Board Research Bulletin #177.

These factors have made child care a matter of major concern within the Department of Defense. Congress recognized these concerns in 1982, when it approved military construction (MILCON) funding for child-care centers. Child-care facilities must compete with many other requirements for scarce MILCON funds and progress has been slow.

In 1984, Congress directed the Military Departments to investigate the feasibility of private-sector funding – commonly known as "third-party financing" – for child care. The Government would make land available on Department of Defense (DoD) installations to entrepreneurs who would build, own, operate, and maintain the child-development centers (CDCs).

In the first test of third-party financing, the Army solicited bids on a service contract to design, construct, operate, and maintain three CDCs at Fort Lewis, WA. Upon completion of that test in early 1985, the Army reported that the results were "unfavorable to third-party contracting."[2] In fact, the Army request for proposals (RFP) evoked only one response, and it was later withdrawn. The Army then requested and received MILCON funding for CDCs in the FY86 MILCON program. The Congress, however, directed the other Departments to continue their efforts.

In response to the Congressional directive, the Department of the Navy tasked the Naval Facilities Engineering Command (NAVFAC) to develop an approach for third-party financing. Having noted the failure of the Army's contracting approach, the Navy developed a different approach, one based on a concession agreement. Under the Navy approach, land is made available and the concessionaire is offered a business opportunity to operate on base, but no funds are to be transferred by the Government to the private firm; instead, all costs must be covered by user fees. That approach removes many of the restrictions and conditions inherent in a Government contract, such as the need to build to military construction specifications provides for overall Government control in assuming provision of CDC services, and gives the entrepreneurs more opportunity to apply their special expertise and knowledge.

The Navy selected two sites in California for a pilot test of the concession arrangement; the first in the Murphy Canyon Housing area at Naval Station San Diego, and the second at the Marine Corps Air Ground Combat Center,

[2]"The Army's Test for Third Party Contracting for Child Care," Department of the Army, 30 July 1985.

29 Palms. Before soliciting bids, the Navy, with the assistance of Navy and Marine Corps child-care specialists, prepared a draft RFP and circulated it among firms in the child-care industry for comment and review.

The Logistics Management Institute (LMI) was called upon to promote industry participation, assess responses to the draft RFP, and determine whether third-party financing of CDCs will work. This was done through a series of industry contacts, including an open forum, mail, phone calls, and field visits.

LMI was also tasked to assess the economic feasibility of the third-party financing concept for CDCs and to recommend any changes that might be needed in the RFP. Current Government operations, including costs, fees, and subsidies, were reviewed at test sites. These operations were compared with child care in the private sector to determine whether the private sector could provide the military with affordable child care. To eliminate any influence of regional bias, similar analyses were conducted at two other sites in the east.

This report presents our findings on third-party financing of child care. Chapter 2 highlights concerns expressed by industry representatives. Chapter 3 reports an *economic analysis of third-party financing, demonstrating* differences between current Government costs and revenues, on the one hand, and, on the other, projected costs and revenues in the private sector. Chapter 4 summarizes our findings, conclusions, and recommendations.

CHAPTER 2

INDUSTRY INTEREST AND CONCERNS ABOUT PRIVATE-SECTOR FINANCING

In the handbook, Winning with Other People's Money, the Deputy Assistant Secretary of Defense (Installations) lists four factors that are required for successful ventures in private-sector or third-party financing:

- Need
- Land
- Community support
- Private-sector interest.

The statistics and trends cited in Chapter 1 demonstrate the need for adequate, affordable child care for military families. The concession agreement proposed by the Navy would make land available under lease authority to a private-sector child-care provider. It became apparent to the Navy early in the process that community support and private-sector interest would be the critical concerns in formulating a workable third-party financing agreement for military child care. To generate community support, NAVFAC formed a working group with representatives of the Recreational Services Division, Naval Military Personnel Command (NMPC), and the Morale Support Division, Headquarters Marine Corps (HQMC), the sponsoring activities for child care within their Services. Representatives of the selected activities on the West Coast also took part in formulating the draft RFP. To assess and promote private-sector interest, the Navy made the draft RFP available to child-care providers through a notice in the Commerce Business Daily and tasked LMI to assess industry interest through direct contact. This chapter summarizes our findings.

ASSESSING INDUSTRY INTEREST

As a first step in sounding out the industry, we contacted the representative trade association for proprietary child care, the National Association for Child Care

Management (NACCM). We sent a copy of the draft RFP for review by the directors and solicited their comments and suggestions. NACCM indicated they were not interested in helping to develop a final RFP. Furthermore, a representative of the association said she doubted that many members would be interested.

Nevertheless, we obtained a membership roster and sent a letter to more than 200 child-care providers, describing the draft RFP and soliciting comments. The letter also invited all interested firms to attend an industry forum to discuss third-party financing. The response to these requests and to the notice in the Commerce Business Daily, which also announced the forum, was minimal.

We followed-up the mail survey with phone calls to more than 50 firms. Again, the responses were generally negative. Most firms expressed skepticism about the possibility of making the concept work, and several even declined to discuss the concept. Many of the firms had been involved in the Army test or had heard about it and were convinced that the concept was not workable. Attempts to explain the differences between the concession approach and the Army's contract solicitation were to no avail; most firms cited the problems of guarantees, buyback, and subsidies, problems that still exist under the concession agreement. We brought these issues to the attention of the Navy and suggested possible solutions. They were investigated by legal and contractual specialists, and the RFP was modified to alleviate those problems which were correctable within existing legislative authority.

The key items were also placed on the discussion agenda for the industry forum, but even an opportunity to discuss them failed to attract many firms, despite a second mailing and more follow-up phone calls. In total, about 75 firms asked for copies of the RFP, but only seven agreed to attend the industry forum, and only one of these was a national child-care firm.

The industry forum was held in San Diego on 1 July 1986. Discussion quickly focused on the same primary issues although other concerns surfaced as well. The overall attitude was one of skepticism about the feasibility of the concept. Discussions of possible solutions to specific problems during and after the forum were not productive because most of the solutions proposed would require legislative action.

Industry follow-up, continuing after the forum, focused on one-on-one contacts with selected firms. Discussions with the director of development and marketing at one national firm proved especially enlightening in regard to the lack of interest on the part of the national firms: the child-care market is a wide-open, high-growth market in which demand far exceeds capacity. This means the national firms can be very selective about where they build. As prudent business professionals, they try to tap the most profitable, low-risk markets with their available investment funds. Naturally, they choose locations in upper-middle-class markets, where they can charge higher fees and receive a higher return on their investment.

The national and regional chains do not have unlimited investment funds; they must compete with other industries for investors' dollars. Child-development centers do not generate the revenues and profits per square foot that are generated by fast-food franchises, for example. Therefore, the cost of building cannot be recouped as quickly in CDCs as in many other uses.

A main method utilized by regional and national chains to solve the problem is sale and leaseback: the child-care company builds the CDC, sells it to a group of investors who seek the tax advantages such as a Real Estate Investment Trust (REIT), and then rents the building and land back under a long-term lease. The child-care company can then use its investment dollars over again to build more facilities. Investors are willing to enter into this arrangement with the child-care firm because, among other reasons, the land and building are assets that have alternative income-producing potentials and resale values. When the lease ends, or if child care at the CDC becomes unprofitable and the company wants to break the lease, the investor can lease or sell the building for alternative profitable uses.

Investors are not interested in buying buildings on military installations because the structures have no alternative use. Child-care companies would therefore have to tie up their own scarce investment funds, reducing the return on investment to stockholders.

The military markets are therefore unattractive to the national firms on several counts. First, military pay scales are much lower than the normal target market, which means lower fees and slower returns on investment. Second, the prospect of tying up growth capital for 25 years is unattractive, especially when so many more lucrative markets are available. In short, the national firms are not

interested in child care for the military. The industry is one of not only high growth, but also strong competition, and none of the major firms wants to fall behind by investing in a low-return market, such as military child care. Given the demographic trends discussed earlier, it appears that these market conditions will not change soon. Added to these drawbacks are a number of other factors such as longer operating hours, high percentage of infants, etc., that make the military child-care market even less desirable for the national firms.

Discussions with the editor of an information newsletter for the child-care industry revealed the same general skepticism about the feasibility of the concept. Nevertheless, the newsletter carried several items about the Navy and Marine Corps tests; however, little interest was generated. We were confirmed in our finding that there is minimal private-sector interest in third-party financing of military child care, and that interest is confined almost entirely to the smaller providers. As the next section shows, these firms expressed significant reservations about their ability to operate successfully under a third-party financing agreement.

INDUSTRY CONCERNS

Although private-sector representation at the industry forum was limited, the discussion and feedback helped point out industry concerns.

Industry expressed the following primary concerns about third-party financing of CDCs on military bases:

- The risk is greater because both the market and the freedom of action with regard to capital assets would be restricted.
- Military duty requirements impose special requirements for child care, e.g., infant care is essential.
- Inequalities between current Government operation, e.g., subsidies, make it difficult for private firms to be competitive.

Risk

The overriding concern is the risk and uncertainty associated with providing child care on a military installation. This view is reflected in the stated concerns regarding guarantees and Government buyback of facilities.

Private-sector firms are used to working with risk, but they normally operate in an open market and they have the option of recouping their investment by selling

capital assets. In the third-party financing arrangement, both the market and the freedom of action with regard to capital assets are restricted. Insofar as the market is concerned, the private-sector firm must serve the military market first. It can bring in other children only if space is available and the commanding officer approves. At some locations, such as 29 Palms, the civilian market is small, in any event. This, of course, is not a present concern because the military requirement far exceeds even the projected capacity of the new CDCs; it does, however, concern investors who must consider the market for the 25-year life of the building.

With regard to flexibility of capital asset actions, the child-care providers felt that in the event of a base closure or draw-down, they could be left with a 25-year agreement, an empty building, and a large loan from a bank. Because the building would be on Government land, the contractor could not sell the building to recoup his loss. This concern is critical because many firms cannot get financial backing for a third-party financing arrangement without some sort of assurance about future use, especially the smaller firms that expressed interest. A suggestion was made that locating the CDCs on severable land (i.e., land that could be easily separated from the base) would present an opportunity to buy the land and then sell the capital assets. However, as one attendee pointed out, a facility next to an abandoned military installation would probably not have much resale value.

In summary, the market restriction on sale of services and on the sale of the capital asset combine to place a significant risk on the third-party investment decision; for some firms, the restrictions make the risk difficult or impossible to define or at least too high to seriously consider.

Requirements and Standards

In addition to the risks and uncertainties of operating on a military installation, concerns were also expressed about Government requirements and standards. As noted in Chapter 1, some special requirements for child care are associated with military duty schedules. For example, since a female member of the Armed Forces is required to return to duty within 4 weeks of giving birth, infant care must be available. Such care is not normally offered by private-sector firms, and it adds significantly to their costs of doing business. Further, since military personnel may also have to be on duty on weekends or evenings, extended operating hours

must be provided. That requirement is not standard practice in the private sector, and it, too, adds to the cost of operation.

Military child-care standards were developed in response to a General Accounting Office report that called for improvements in Military child care.[3] These military standards do not create a problem at the California sites chosen for the tests (nor in many other states) because state standards there are already higher. In general, military child-care standards fall in the middle of the range of state standards.

Operational Inequalities

The last major area of concern expressed by industry forum participants had to do with the inequalities between the present Government operation and the proposed third-party arrangement. Subsidies were a major concern; the private-sector firms are well aware that building costs, maintenance, utilities, and even some staff costs are paid out of appropriated funds. In addition, there are expenditures that the Government does not have to make, such as insurance premiums and license fees, and, of course, the Government does not look for a profit. Under the *third-party arrangement*, all these costs must be covered by user fees, making it hard for private firms to be competitive. The specific economic effects of these subsidies are discussed in detail in Chapter 3, but the mere knowledge that these inequalities exist is another reason that many firms were not interested in participating.

SUMMARY

In general, child-development centers on military installations meet three of the four requirements for successful third-party financing: the *need* is there, the *land* is available, and *community support* exists. However, the fourth requirement, *private-sector interest*, is virtually nonexistent under current conditions.

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[3]"Military Child Care Programs: Progress Made, More Needed," GAO Report #OSD5929, June 1, 1982.

The private sector is not interested because:

- The risk is too great. Building a single-purpose building on an installation that could be closed or significantly reduced in size is, at best, an uncertain financial venture.

- Extended services are required. Military child-care centers require infant care and evening and weekend service. Most private companies do not normally provide such service.

- Competition with Government CDCs is seen to be unequal. Third-party CDCs do not get the subsidies that the Government CDCs get, must pay insurance premiums and other fees, and must make a profit.

To resolve these impediments to private-sector interest, consideration must be given to:

- Guaranteed minimum occupancy, Government buyback of facilities, or both, in the event of base closure or major changes of mission

- Subsidies, to keep fees affordable to military users

- Remedies for inequalities in such matters as insurance, licensing fees, etc.

Private-sector firms say they cannot provide military families with child care until these problems are solved. The economic impacts of, and possible solutions to, these problems are discussed in the following sections.

CHAPTER 3

ECONOMIC ANALYSIS OF PRIVATE-SECTOR FINANCING

This analysis compares the costs and fees of Government-operated CDCs with those of third-party financed, private-sector operated CDCs. Third-party financing of Navy CDCs has two objectives. It seeks first to reduce the cost to the Government of designing, constructing, operating, and maintaining CDCs at Navy installations, and second, to keep fees affordable. These objectives served as our guidelines.

The analysis is based on two primary test sites, Naval Station San Diego and Marine Corps Air Ground Combat Center, 29 Palms, CA. Those sites were chosen by the Navy and Marine Corps to test the third-party financing concept, and draft RFPs were developed for them. We analyzed data for two additional sites to ensure that the results do not contain a regional geographic bias. The two additional sites were Naval Station Norfolk and Great Lakes Naval Training Center. The majority of the analysis presented in this chapter is based on the two primary sites. Detailed data on all four sites is presented in the appendix.

CURRENT CDC COSTS, SUBSIDIES, AND FEES AT NAVY AND MARINE CORPS INSTALLATIONS

Costs and Subsidies

The total costs of CDCs consist of capital costs and operating costs. Capital costs include the costs of building design and construction and those for office and playground equipment. Operating costs include the annual costs of operating and maintaining the CDC. In our analysis, we added an annual amortization charge for the capital costs to the operating costs to arrive at the total, or full cost of CDCs.

During visits to the four CDCs included in this study, we gathered data on capital and operating costs. From those data we calculated total annual costs for each center, including building and equipment amortization. Annual costs were divided by 52 to yield average weekly costs, and those average costs were divided by the total number of children cared for to give the average fee needed to cover all CDC costs. The results of these calculations for San Diego and 29 Palms are presented in Table 3-1. Similar results for all four CDCs are presented in the appendix. The full

cost is $85 a week at Naval Station San Diego and $62 at 29 Palms. The main reasons that the cost per child is higher at San Diego than at 29 Palms are its smaller size (103 spaces maximum versus 236) and the larger number of infant spaces at San Diego as a proportion of total capacity.

TABLE 3-1

CHILD DEVELOPMENT CENTER CAPITAL COSTS AND OPERATING EXPENSES

Item	Naval Station San Diego		Marine Corps Air-Ground Center 29 Palms	
	Costs ($000)	Navy APF subsidies[a] ($000)	Costs ($000)	Navy APF subsidies[a] ($000)
Capital costs:				
Design and construction	1,163	1,163	1,749	1,749
Equipment and fixtures	119	119	152	152
Operating costs:				
Building amortization (25 yr, 10% interest)	127	127	191	191
Equipment amortization (10 yr, 10% interest)	19	19	24	24
Direct staff costs	190		385	20
Indirect staff costs	49		100	5
Other costs	71	13	62	17
Total costs[a]	456	166	762	266
Average weekly costs (100% occupancy)	85 (103 spaces)	31 (103 spaces)	62 (236 spaces)	22 (236 spaces)

[a]Total Navy APF subsidies include $7,200 at San Diego and $9,600 at 29 Palms

As our later discussion shows, fees charged do not cover the full cost of child development services at Navy installations, either Navy-wide or at any single location. At the very least, the Navy uses appropriated funds (APF) to cover all of the construction and maintenance of the physical structures in which CDCs operate. The APF subsidies for Naval Station San Diego and the Marine Corps Air-Ground Center 29 Palms are also shown in Table 3-1. For the four new facilities included in our study, the APF subsidies amount to about one-fourth of total funding.

No portion of fees has ever gone back into APF accounts to cover any of these costs. Over and above these capital costs, the Navy is authorized to use appropriated funds to cover such items as:

- Salaries of center directors
- Building maintenance
- Materials and supplies
- Utilities.

In type and amount, the costs of those four items varies from installation to installation. In addition, Department of Agriculture meal subsidies provide an additional APF (non-Navy) funding source. Taken together, for the CDCs in our study, about one-third of total costs are covered by Government-appropriated funds (i.e., APF subsidies).

Another source of CDC funding at many installations is Navy nonappropriated funds (NAF) dedicated to recreation. User fees are designed to cover noncapital operating expenses (i.e., not including building and equipment amortization). Sometimes user fees do not fully cover all of the noncapital operating expenses of an individual CDC. The difference between noncapital operating expenses and users fees (i.e., operating losses) of individual CDCs is made up by local recreation funds from other NAF activities. Often a base commanding officer, in consultation with a base recreation advisory committee, will absorb annual CDC operating losses, to keep CDC fees at a level that is believed to be reasonable for local members of the military. According to Navy and Marine Corps estimates, NAFs subsidize an average of 20 percent of CDC noncapital operating expenses Department-wide.

The proportion of total CDC costs covered by all APF and NAF subsidies varies from installation to installation; the range is 25 to 50 percent. Table 3-2 breaks down the costs, fees, and sources of weekly CDC subsidies at the four sites included in our study.

User Fees From the Client's Perspective

Fees currently charged to Servicepersons at the test sites are lower than the calculated full costs. The average weekly fees are $42 at San Diego and $31 at

TABLE 3-2

MILITARY CHILD-DEVELOPMENT CENTERS: COSTS, FEES, AND SUBSIDIES

(Dollars a week per child)

Sites	Full costs	Fees now charged by Government[a]	Subsidies			
			Total	Navy	NAF	USDA
San Diego	85	42	43	29	12	2
29 Palms	62	31	31	21	9	1
Norfolk	66	38	28	20	6	2
Great Lakes	59	35	24	23	0	1

[a]Fees vary at some CDCs. For each of these, an average fee was used for the Government's present fee.

29 Palms. The weekly difference per child between actual fees and full-cost fees is $43 at San Diego and $31 at 29 Palms.

Fee structures at Navy and Marine Corps installations are set by the base commanding officer, usually on the advice of a committee that oversees morale, welfare, and recreation (MWR) activities on base. These committees take the following factors into account in determining fee structures for CDCs:

- DoD policy on CDC rates
- Pay scales of the military personnel on base
- Operating costs
- Availability and fees of off-base centers
- Availability of nonappropriated funds from other MWR activities to cover CDC operating losses.

Child-care expenses represent one of the largest single drains on a military family's income. In previous studies, LMI has estimated income levels of single and married families for use in fiscal impact analyses of new and expanded military installations. The average gross income for a single-parent family in the Navy and Marine Corps is estimated at $11,500 a year, on average; that for two-parent

families is estimated at $30,000 a year.[4] For a single Serviceperson with one child needing care, CDC costs are 19 percent of annual income at San Diego and 14 percent at 29 Palms. For married couples with one child needing care, CDC costs represent 7.3 percent of annual income at San Diego and 10.8 percent at 29 Palms.

According to a recent survey by Working Mother magazine,[5] single-parent families in the private sector pay 14.9 percent and married couples, 6.9 percent of annual gross family income for child care – about the same shares as single-parent families at 29 Palms and less than single-parent families at San Diego. Whether private-sector or military, the costs are significant, and military families are not shielded from the high cost of child care by Government-subsidized facilities.

User Fees From the Government's Perspective

DoD policy on CDC rate schedules is "to provide . . . reasonable fees, affordable to lower-ranking personnel. . . . Fees and charges will be set to cover the remaining operating expenses [i.e., excluding center director salaries, utilities, and building and grounds maintenance]. . . . Nonappropriated funds generated outside child care centers . . . and contributions or donations from individuals or private organizations may be used to provide supplementary funding or for special equipment or supplies."[6]

Both the Navy and Marine Corps have issued instructions to their respective commands consistent with these DoD guidelines. The Navy's guidelines are stated in OPNAV Instruction 1700.9A, which directs the commanding officer at each installation to "establish reasonable fees and charges to defray the cost of operating the CDC. . . . User fees and charges should be reasonable enough to enable utilization of the CDC by all military personnel." The Marine Corps, in Marine Corps Order 1710.30B, has established essentially the same policy for CDCs at its installations. Judging by the shares of average military family income taken by child-care expenses, especially when compared with the same percentages for families purchasing child-development services in the private sector, the Navy and

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[4]Moore, William B., "Updated Fiscal Impact Analysis for the Expansion of the Naval Submarine Base, Kings Bay, Georgia," LMI Task FP605, November 1986.

[5]"The Cost of Child Care," Olivia Schieffelin Nordberg, Working Mother, February 1985, pp.53 - 56.

[6]DoD Action Plan in response to GAO Report, op. cit.

Marine Corps have successfully implemented DoD policy in the child-care center fee area.

The Congress is aware of DoD policy in this area and has recently reiterated its position on military CDCs in House Appropriations Committee Report 99-275 (page 15): "The Committee has continued its policy of recommending funding of child care centers at military installations. The Committee feels that construction of facilities for child care programs is a positive contribution to the quality of life in the military and therefore has recommended funding for these centers. The Committee has continually stressed that the Department [of Defense] is to follow the criteria established in the Committee's fiscal year 1982 report for child-care centers. One of the conditions is that the Department [of Defense] must determine that charges to users will substantially cover the operation of child care programs."

We believe that the DoD guidelines, the Navy and Marine Corps instructions to their commands, and the financial data obtained and analyzed in this study confirm the fact that the Department of the Navy is meeting the criteria established by Congress. DoD policy on CDC fees notwithstanding, the issue still remains whether the private sector can or would provide CDCs at lower cost than the Government now pays out.

ESTIMATED FEES WITH PRIVATE-SECTOR FINANCING

Detailed information on the availability and price of child-development services in the areas surrounding the military installations in the study was obtained from two sources. First, we contacted the "child-care resource and referral" agency in each locality. These local Government agencies maintain detailed information on most child-care facilities in each of the areas we visited. Second, CDC directors at Navy and Marine Corps installations periodically conduct their own informal surveys of facilities off-base to assist them in setting their own fee structures. We were, therefore, able to observe the range of private-sector fees in each area.

Today's estimated private-sector fees charged by for-profit centers near our study sites are shown in Table 3-3, along with present fees and estimated full costs at military CDCs. Since for-profit centers cannot sustain long-term losses and remain

in business, the estimated private fees are equal to full private-sector costs including profit and taxes.

TABLE 3-3

MILITARY CHILD-DEVELOPMENT CENTERS: GOVERNMENT AND ESTIMATED PRIVATE FEES

(Dollars a week per child)

Sites	Government full costs	Fees now charged by Navy	Private fees estimated[a]
San Diego	85	42	87
29 Palms	62	31	68
Norfolk	66	38	71
Great Lakes	59	35	81

[a]Adjusted to include the appropriate mix of infant care

The private-sector fees on military installations include a reduction for the free use of Government land. An important factor that would cause private-sector rates on-base to rise instead of fall compared with private-sector rates off-base is the "mix of care" that must be provided. Few private firms offer infant care; when they do, the fees are higher. We found that most of the private-sector CDCs around the sites in our study do not offer care for infants (i.e., 4 weeks to 24 months). The few private-sector centers that do offer infant care charge up to two to three times as much for infants as for toddlers (2- to 3-year-olds) and preschoolers (4- to 5-year-olds). Infant care fees of up to $120 a week are not uncommon. Infant care is significantly more costly because the required child/caregiver ratios are lower and because liability insurance for infant care costs more. Since the Navy CDC rates shown in Table 3-3 include infant care, we adjusted the off-base private-sector fees for toddlers upward to include the infant care mix required at the four sites.

Therefore, estimated third-party fees for military child-development centers would be about $87 in San Diego and about $68 at 29 Palms. These estimated fees are higher than present fees at these locations. *Even if the Government decided to subsidize third-party CDCs, these data indicate that third-party providers may not be able to charge less than the Government.* They cannot do so for several reasons. First, CDCs are not technologically complex operations and do not use large amounts of

supplies or other inputs that the private sector has any great cost or organizational advantage in providing. CDCs are labor-intensive operations, and both facilities and services are well-defined in private-sector and Government operations. The Government-run CDCs use nonmilitary, noncivil service teachers and aides, and, therefore, pay wages and benefits that are similar to those in the private sector. It is not surprising, therefore, that private-sector costs are as high as or higher than Government CDC costs. Second, Government CDCs do not have to make a profit, whereas most third-party providers must show a reasonable return on investment to stockholders to be able to attract the investment capital they need.

One of the few places where the private sector may have a cost advantage is in construction costs. According to a 1984 LMI study,[7] DoD child-development centers are slightly more costly than private-sector CDCs to construct. The study concluded that even though Government construction costs are a little higher, they are not out of line with the private sector. A 1982 GAO report[8] recommended that DoD establish a standardized design guide for military CDCs; this design guide has since been written and distributed to all four Services for future CDC construction.

The Government-versus-private-sector CDC cost issues are illustrated by the data in Table 3-4, which shows various cost categories as a percentage of the full-cost fee for both a Government and private-sector CDC at our study site in Norfolk. The private-sector figures were provided to LMI by a large regional CDC firm that prepared pro forma financial statements to match the CDC specifications we provided. The costs are close for all expense categories, even for the larger items of building amortization and staff salaries. The cost advantages of the private sector (e.g., building amortization) are offset by cost advantages of the Government (e.g., nonprofit).

Our conclusion on this point is that third parties cannot provide CDC facilities and services at costs significantly below Government costs; there is still a large discrepancy between estimated third-party fees and fees now charged by the Government, fees that take up at least as large a share of a military family's annual income as families in the private sector. We turn now to an investigation of whether cost-sharing options might enable the Government to reduce its level of

[7]Moore, William B., "Does DoD Construction Cost More?" LMI Task ML429, December 1984.

[8]GAO report, op. cit.

TABLE 3-4

COST COMPARISON FOR CHILD-DEVELOPMENT CENTER AT NAVAL STATION NORFOLK

Item	Percentage of weekly Government cost	Percentage of estimated weekly private cost
Operating costs:		
Building amortization (25 yr, 10% interest)	22.9	18.9
Equipment amortization (10 yr, 10% interest)	0.8	
Direct staff costs	53.9	41.4
Indirect staff costs	14.0	6.3
Other Costs	8.8	15.1
Local taxes	0.0	0.4
Profit (before federal taxes)	0.0	18.0
Total costs	100.0	100.0
Average fee (100%, 300 spaces)	$65.97	$71.00

subsidization and bring effective third-party CDC fees within the range of fees now charged to military families.

COST-SHARING ALTERNATIVES

In-kind subsidies and other direct subsidies by the Government were discussed at length during the industry forum. Apart from outright income guarantees, the following areas were considered within the realm of possibility for cost-sharing arrangements between the Government and third-party providers (some options might require new legislative authorization, especially under the concession arrangement):

- USDA food subsidy
- Utilities
- Janitorial services
- Janitorial and maintenance supplies.

USDA regulations now allow payment of meal subsidies to CDCs on military installations for the children of income-qualified members of the Services, and those subsidies defray a substantial portion of the food costs of the CDCs. If, however, a

profit-making company owned and operated the CDCs on military installations, the USDA subsidy would not be allowed for those same children because the provider is a profit-making company. Legislation to allow the subsidy to children of military Servicepersons in CDCs on-base, regardless of the profit-making status of the provider, would allow some amount of cost sharing, and, consequently, lower fees. Such an arrangement would not cost the Government more than it is now paying in meal subsidies.

Utilities, janitorial services, and janitorial and maintenance supplies are additional candidates for cost-sharing between the Government and third-party CDC providers. All other operating expenses of CDCs, including direct staff salaries, indirect staff benefits, insurance, building repairs, and state and local taxes, are not good candidates for cost-sharing.

It should be pointed out that private-sector firms may not want some or any of these subsidies even if offered by the Government. For example, even if the Government provided janitorial services, the private-sector firm would have to operate with the consequences of uncleaned facilities on a given day. They would have to clean the facility themselves on that day, or wait for the Government to do the cleaning; thus, they might not want janitorial services, preferring to totally run the business themselves.

We calculated the effect on weekly fees of the Government entering into cost-sharing arrangements with third-party providers for all four of the CDC sites in our study. The results of these calculations for San Diego and 29 Palms are presented in Tables 3-5 and 3-6, respectively. The effect at San Diego would be a $5 reduction in weekly fees (from an $87 original anticipated third-party fee), and the effect at 29 Palms would be a $4 reduction in weekly fees (from a $68 original anticipated third-party fee). These reductions do not even come close to eliminating the gap between present Government fees and anticipated third-party-provider fees. There are still gaps of $40 at San Diego and $33 at 29 Palms. These subsidies and the remaining gap between present fees and estimated third-party costs and fees that would have to be made up out of appropriated funds, are shown in Figure 3-1. The Government is currently paying out a subsidy of $31 per week at San Diego; under the third-party option the total APF subsidy (cost) to the Government would be $45.

or an additional $14 per week per child. At 29 Palms the additional APF cost to the Government would be $13.

TABLE 3-5

CHILD-DEVELOPMENT CENTER COST SHARING OPTIONS
NAVAL STATION SAN DIEGO

Item	Government cost	Navy APF costs	Cost sharing options
Capital costs:			
Design and construction	$1,163,089	$1,163,089	
Equipment and fixtures	$118,928	$118,828	
Operating costs:			
Building amortization (25 yrs, 10% interest)	$126,828	$126,828	
Equipment amortization (10 yrs, 10% interest)	$18,864	$18,864	
Direct staff costs	$190,400		$8,400
Indirect staff costs			
Other costs:	$70,737	$12,999	$16,133
Total costs[a]	$456,335	$165,891	$26,717
Average fee (100%, 103 spaces)	$85	$31	$5

[a]Navy APF Total Costs include $7,200 USDA subsidy

These cost-sharing options do not significantly narrow the gap because they represent relatively small proportions of the total operating expenses of CDCs. As demonstrated earlier (see Tables 3-1 and 3-2), the largest cost items are staff salaries and building and equipment amortization.

In-kind subsidies are not the answer to making third-party financing of CDCs attractive, either to profit-making companies or the Government.

SENSITIVITY OF MILITARY CDC COSTS TO ECONOMIC FACTORS

The analyses upon which our conclusions are based embody several assumptions about the economic environment in which military CDCs are constructed and operated. The following assumptions, based on Department of the Navy guidelines, were especially significant:

- Occupancy rate of 100 percent

TABLE 3-6

CHILD-DEVELOPMENT CENTER COST SHARING OPTIONS AT MARINE CORPS AIR GROUND COMBAT CENTER 29 PALMS

Item	Government cost	Navy APF costs	Cost sharing options
Capital costs:			
Design and construction	$1,749,000	$1,749,000	
Equipment and Fixtures	$152,048	$152,048	
Operating costs:			
Building amortization (25 yrs, 10% interest)	$190,716	$190,716	
Equipment amortization (10 yrs, 10% interest)	$24,108	$24,108	
Direct staff costs	$385,153		$12,408
Indirect staff costs (26%)	$96,933	$1,887	$3,226
Other costs	$62,178	$16,707	$23,360
Total costs[a]	$762,295	$265,814	$38,994
Average fee (100%, 236 spaces)	$62	$22	$3

[a]Navy APF Total Costs include $9,600 USDA subsidy

- Indirect personnel cost rate of 26 percent
- Building life (and, consequently, loan amortization) of 25 years
- Mortgage loan interest rate of 10 percent.

The 100-percent-occupancy rate is not unrealistic, given that all four centers in our study are operating at this level and that waiting lists exceed 100 percent. The 26 percent indirect rate for employee benefits is specified by the Naval Facilities Engineering Command's Economic Analysis Handbook, as is the 25-year building life. The 10 percent mortgage interest rate was selected as representative of the Government's borrowing costs in the next 5 years.

These assumptions could vary within fairly predictable bounds. To measure the effects of such variations on military CDC costs (equal to full-cost user fees), we performed sensitivity analyses. The results are shown in Table 3-7 and depicted graphically in the appendix.

The general conclusion is that varying these factors within expected limits does not have a significant effect on weekly CDC costs. Increasing building life has virtually no effect. Decreases in occupancy rates, however, have a strong effect, but we maintain that occupancy rates for military CDCs are likely to remain at, or close

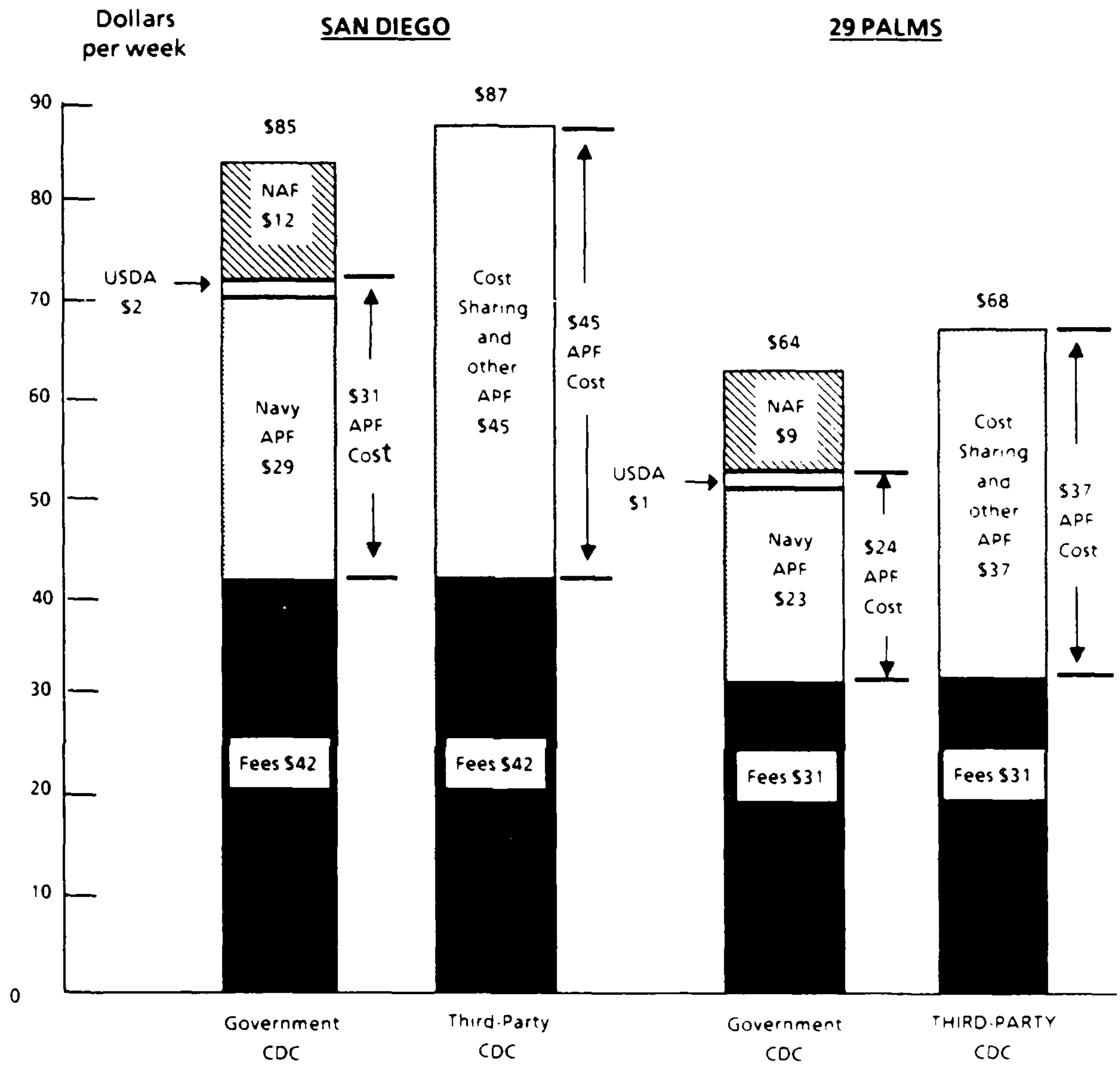

FIG. 3-1. CHILD-DEVELOPMENT CENTER POTENTIAL COST SHARING

to, 100 percent for the foreseeable future. Furthermore, low occupancy rates would have the same harmful effects on third-party CDC costs and fees, and therefore are not as relevant as variations in the other economic factors. We conclude that our analytical results – and, hence, our conclusions – are not biased by unrealistic economic assumptions.

TABLE 3-7

ANALYSIS OF THE SENSITIVITY OF CDC WEEKLY COST RATES TO CHANGES IN ASSUMPTIONS

Assumption	Full-cost weekly rates			
	San Diego	29 Palms	Norfolk	Great Lakes
Interest rate:				
7%	79.51	58.43	62.18	55.14
8%	81.34	59.62	63.24	56.43
9%	83.24	60.85	64.34	57.77
10%	85.20	62.12	65.97	59.15
Building life:				
25 years	85.20	62.12	65.97	59.15
30 years	84.39	61.58	65.47	58.56
35 years	83.92	61.28	65.17	58.22
Indirect cost rate:				
15%	81.29	58.66	62.06	56.08
20%	83.07	60.23	63.04	57.48
26%	85.20	62.12	65.97	59.15
30%	86.62	63.37	67.40	60.27
Occupancy rate:				
100%	85.20	62.12	65.97	59.15
90%	94.68	69.02	73.30	65.72
80%	106.51	77.65	82.47	73.94

SUMMARY CONCLUSIONS

We find that fees at Navy and Marine Corps CDCs are a third to a half lower than comparable fees at for-profit centers in the private sector and cover about one-half to two-thirds of CDC costs (including building and equipment amortization). This difference between full costs and fees is made up by subsidies. Of the subsidies, about two-thirds come from appropriated funds, primarily through MILCON funds. The remaining third of the subsidies come from revenues from Navy nonappropriated funds.

Although Servicepersons pay lower fees than are paid in the private sector, those fees represent at least as high a proportion of family income. Navy and Marine

Corps families are not shielded from the high costs of child care. The MILCON and other subsidies have merely brought them to parity with nonmilitary families in the portion of income spent on child care.

The expected costs of third-party CDCs operating on-base were found to be about equal to Government CDC full costs. However, the difference between current CDC fees and expected third-party fees is significant. We analyzed various cost-sharing alternatives under which the Government would provide in-kind subsidies to the third party provider (i.e., utilities, janitorial services, USDA food subsidies). Even combined with the free use of land, these cost-sharing alternatives will do little to reduce the gap between existing fees and expected third-party fees since the alternatives do not affect either of the large categories of CDC expenses – staff salaries and building amortization.

Elimination of the gap that remains between current fees and expected third-party fees after providing in-kind business subsidies through cost-sharing arrangements would require direct cash subsidies to third-party providers or to Servicepersons, or both. The total amount of direct and indirect subsidies necessary to equate current fees and expected third-party fees would essentially negate the Government's MILCON fund cost savings by trading current dollars for future dollars; no real savings would result.

CHAPTER 4

FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS

The concept of private-sector or so-called "third-party" financing is drawing considerable attention within the Government, and for good reason. It is a creative new way for the Government to obtain needed facilities and services quickly, with reduced budgetary impact. The concept has been applied successfully to family housing, fast food services, and utilities.

On the surface, child care for the military seems like another good candidate; the need for child care exists, and many private-sector firms are available to provide it. Closer investigation, however, reveals serious problems that detract from the feasibility of third-party financing for CDCs.

In housing and food service operations, the product or service required by the Government is exactly the same as that provided by the private sector and the price demanded by the private sector is essentially the same as the price charged by the Government. Neither of these conditions is true for military child care. The child-care services required by the military include a high percentage of infant care and extended operating hours because of the duty requirements and schedules of military families, and those services are not normally provided by the private sector. Should private-sector companies provide such services, their costs would increase and those costs would be passed on to the users in the form of higher fees. Unfortunately, even the normal fees charged by private-sector firms are well above the fees now paid by the military. This is a situation in which the military is asking the private sector to provide extended services at reduced fees. Viewed in this context, it is not surprising that very few private-sector firms are interested in participating in third-party financing of CDCs.

Many factors tend to limit the feasibility of the third-party financing concept in this application (and they are reviewed briefly in this chapter), but the main point is that the services required and the fees charged for military child care are not the same as the services provided nor the fees charged by the private sector, and the gap is too large to close.

FINDINGS AND CONCLUSIONS

In addition to the basic problems of standards of service and fees, another major concern is the issue of building ownership as specified in the proposed third-party financing agreement. We found, first of all, that many firms do not want to be involved in owning buildings. They do not want to tie up scarce development capital in a building for 25 years. For many, their usual mode of operation is to build, sell the facility to an investor, lease it for a specified period, and use the recovered capital for further development.

Another concern about the building, many firms said, is that they could not get financing for a building on Government land. Lenders are reluctant to put up \$2 million for construction of a facility on Government land with no assurances about what happens to the building in the event, for instance, that the base closes or reduces operations severely. In that case, the owner could not sell the building because he does not own the land and, thus, could not recover his capital. Private-sector firms made it clear that they would not even submit a proposal without some adjustments in this critical area.

Firms also expressed concern about assurances of maintaining the desired occupancy level. In normal operations, private-sector firms do extensive demographic and community research before deciding to open a center. They usually select fast-growing, mid- to- high-income areas as their target markets. In the case of the third-party financing arrangement on a military installation, the entrepreneur would have to accept the Government's estimate of the requirement and would have to rely on the Government market. While, in most cases, the length of the waiting lists for child care seems to indicate that there will be no problem filling the centers, the agreement is for a 25-year period, and the issue of possible base closure or mission change must, again, come into play. Furthermore, civil-sector markets are normally unlimited for private-sector firms. On military installations, however, the market is limited primarily to military dependents; others are allowed to use the facility only on a limited, space-available basis. The risk and uncertainty of operating on a military installation further decreased private-sector interest in third-party financing of CDCs.

We have reviewed briefly the principal issues that adversely affect private-sector interest in bidding on a third-party financing proposal. In addition, other

economic considerations would make the concept totally infeasible even if companies were interested in bidding. We have already mentioned the higher level of service, which would cause private-sector fees to rise. This would not be a crucial factor except that Government fees are now kept lower through subsidies.

All building costs, including maintenance and utilities, as well as materials, and some food and salaries, are paid for by the Government. In addition, the Government is self-insured and nonprofit and is not required to obtain a state license. In effect, the private-sector firm must recover through fees the following items that are not charged for in Government fees:

- Building construction
- Building maintenance
- Grounds maintenance
- Utilities
- Materials and supplies
- Insurance
- License fees
- Salaries of center directors
- Profits.

Understandably, the resultant private-sector fees will be substantially higher than current Government fees. Third-party financing of CDCs is economically infeasible under present conditions, and for that reason, the Navy decided not to release the final RFP for bids.

POSSIBLE ALTERNATIVES

One objective of this study was to find a way to make third-party financing work. Thus, in our investigation, we included consideration of alternatives for solving present problems. First, some assurances must be given the contractor regarding reimbursement for the value of the building in the event of contract termination for the convenience of the Government, as in a base closure. This action would remove a major stumbling block by enabling interested firms to get financial backing to bid on the proposal. It would not, however, change the fact that most

firms are simply not interested in owning buildings. That economic problem and others would still have to be solved.

We considered four alternatives for dealing with the economic issues:

- Government cost-sharing
- Higher fees
- Financing of the building only
- Service contract.

In Government cost-sharing, subsidies would defray the cost of child care; however, legislative action would be needed for this action. The subsidies could be provided either as in-kind services or as direct payments; if private firms are to be able to operate CDCs on military installations and make a reasonable profit while keeping fees at a reasonable level, the Government will have to consider direct subsidization. It could provide these subsidies either in the form of per capita subsidies to the third-party provider or in some form of voucher or cash payment to the Serviceperson. In order to meet the contractor's costs and maintain low fees to the Serviceperson, both appropriated and nonappropriated subsidies may be required.

As we have seen, the costs of constructing, owning, and providing CDCs on-base is not expected to be significantly lower for private firms than for the Government. Therefore, the Government would have to use up most, if not all, of its capital savings in the form of cash subsidies to third-party contractors. The net result would be a trading of current dollars for future dollars, with little or no net savings to the Government, and appropriated funds costs would actually increase.

Fees could be increased, but Navy and Marine Corps policymakers feel that the required increases (a third to a half of present fees) would place an undue burden on the Service members and have an adverse impact on retention. Our analysis of military pay and the percentage of Servicepersons' income going for child care shows that the percentage now paid by Service members is about the same as the reported national average. A large increase would create a great financial strain, especially for lower-rated enlisted personnel, those in greatest need of child care services.

Another suggested alternative is to use private funds for construction but continue Government operation of the CDCs. This option appears attractive because it makes it unnecessary to use scarce MILCON funds. In fact, it merely replaces them with annual outlays of Operations and Maintenance dollars for the building lease. Long-term leases of this type are generally not advantageous to the Government in terms of total costs.

The last alternative considered was to obtain services by service contract. That approach, of course, is not truly third-party financing. Under service contracting, all costs will have to be paid out of appropriated funds. As a result, the cost to the Government will be higher than under present operations, where a portion of the operating costs are paid out of nonappropriated funds. The Government would receive no benefit by pursuing this alternative.

In short, there does not appear to be any reasonable and effective way of overcoming the economic problems associated with private-sector financing of CDCs.

RECOMMENDATIONS

Given the current lack of private-sector interest and the economic problems in obtaining the required services at affordable costs, we recommend that the Navy and Marine Corps make no further attempts to solicit bids for design, construction, operation, and maintenance of CDCs through third-party agreements. In addition, since no viable alternatives have been identified, we recommend that the Department of the Navy seek Military Construction funding for building the centers needed.

We do recommend continued consideration of private-sector financing for other support services. The concept itself is practical and should prove beneficial to the Government in other applications; it is the unusual and special considerations of military child care that make third-party financing of child development centers infeasible.

APPENDIX

DETAILED CDC COSTS BY SITE AND SENSITIVITY ANALYSIS GRAPHS

TABLE A-1

CHILD-DEVELOPMENT CENTER CAPITAL COSTS AND OPERATING EXPENSES
NAVAL STATION SAN DIEGO

Item	Government cost	Navy APF subsidy
Capital costs:		
Design and construction	$1,163,089	$1,163,089
Equipment and fixtures	$118,928	$118,928
Operating costs:		
Building amortization (25 yr, 10% interest)	$126,828	$126,828
Equipment amortization (10 yr, 10% interest)	$18,864	$18,864
Direct staff costs	$190,400	
Indirect staff costs (26%)	$49,504	
Other costs		
Maintenance supplies	$600	
Repairs and maintenance	$4,666	$4,666
Utilities	$8,333	$8,333
Materials and support	$24,000	
Food	$29,200	
Staff travel and training	$1,350	
Insurance (.001 x personnel)	$190	
Miscellaneous	$2,400	
Total costs*	$456,335	$165,891
Average fee (100%, 105 spaces)	$85.20	$30.97

*APF total costs include $7,200 USDA subsidy

TABLE A-2

CHILD-DEVELOPMENT CENTER CAPITAL COSTS AND OPERATING EXPENSES
MARINE CORPS AIR GROUND COMBAT CENTER
29 PALMS, CA

Item	Government cost	Navy APF subsidy
Capital costs:		
Design and construction	$1,749,000	$1,749,000
Equipment and fixtures	$152,048	$152,048
Operating costs:		
Building amortization (25 yr, 10% interest)	$190,716	$190,716
Equipment amortization (10 yr, 10% interest)	$24,108	$24,108
Direct staff costs	$385,153	$19,590
Indirect staff costs (26%)	$100,140	$5,093
Other costs		
Maintenance supplies	$1,000	
Repairs and maintenance	$3,600	$2,900
Utilities	$12,760	$12,760
Materials and support	$27,776	$1,047
Food	$12,857	
Staff travel and training	$2,600	
Insurance (.001 x personnel)	$385	
Miscellaneous	$1,200	
Total costs*	$762,295	$265,814
Average fee (100%, 236 spaces)	$62.12	$21.66

*APF total costs include $9,600 USDA subsidy

TABLE A-3

CHILD-DEVELOPMENT CENTER CAPITAL COSTS AND OPERATING EXPENSES AT NAVAL STATION NORFOLK

Item	Government cost	Navy APF subsidy
Capital costs:		
Design and construction	$2,120,000	$2[illegible]
Equipment and fixtures	$53,272	$53,272
Operating costs:		
Building amortization (25 yr, 10% interest)	$231,180	$231,180
Equipment amortization (10 yr, 10% interest)	$8,448	$8,448
Direct staff costs	$554,491	$27[illegible]
Indirect staff costs (26%)	$144,168	$7[illegible]
Other costs		
Maintenance supplies	$1,800	$1,800
Repairs and maintenance	$27,151	$27,151
Utilities	$16,100	$16,100
Materials and support	$4,336	
Food	$39,027	
Staff travel and training	$1,380	
Insurance (.001 x personnel)	$554	
Miscellaneous	$500	
Total costs*	$1,029,136	$341,499
Average fee (100%, 300 spaces)	$65.97	$21.89

*Navy APF total costs include $22,800 USDA subsidy

TABLE A-4

CHILD-DEVELOPMENT CENTER CAPITAL COSTS AND OPERATING EXPENSES
NAVAL TRAINING CENTER, GREAT LAKES

Item	Government cost	Navy APF subsidy
Capital costs:		
Design and construction	$2,540,000	$2,540,000
Equipment and fixtures	$130,700	$130,700
Operating costs:		
Building amortization (25 yr, 10% interest)	$276,972	$276,972
Equipment amortization (10 yr, 10% interest)	$20,724	$20,724
Direct staff costs	$445,765	$23,258
Indirect staff costs (26%)	$115,899	$6,047
Other costs		
Maintenance supplies	$1,800	
Repairs and maintenance	$16,000	$16,000
Utilities	$16,100	$16,100
Materials and support	$5,920	$5,920
Food	$42,180	
Staff travel and training	$1,300	
Insurance (.001 x personnel)	$446	
Miscellaneous	$1,184	$1,184
Total costs*	$944,290	$387,517
Average fee (100%, 307 spaces)	$59.15	$24.27

*APF total costs include $21,312 USDA subsidy

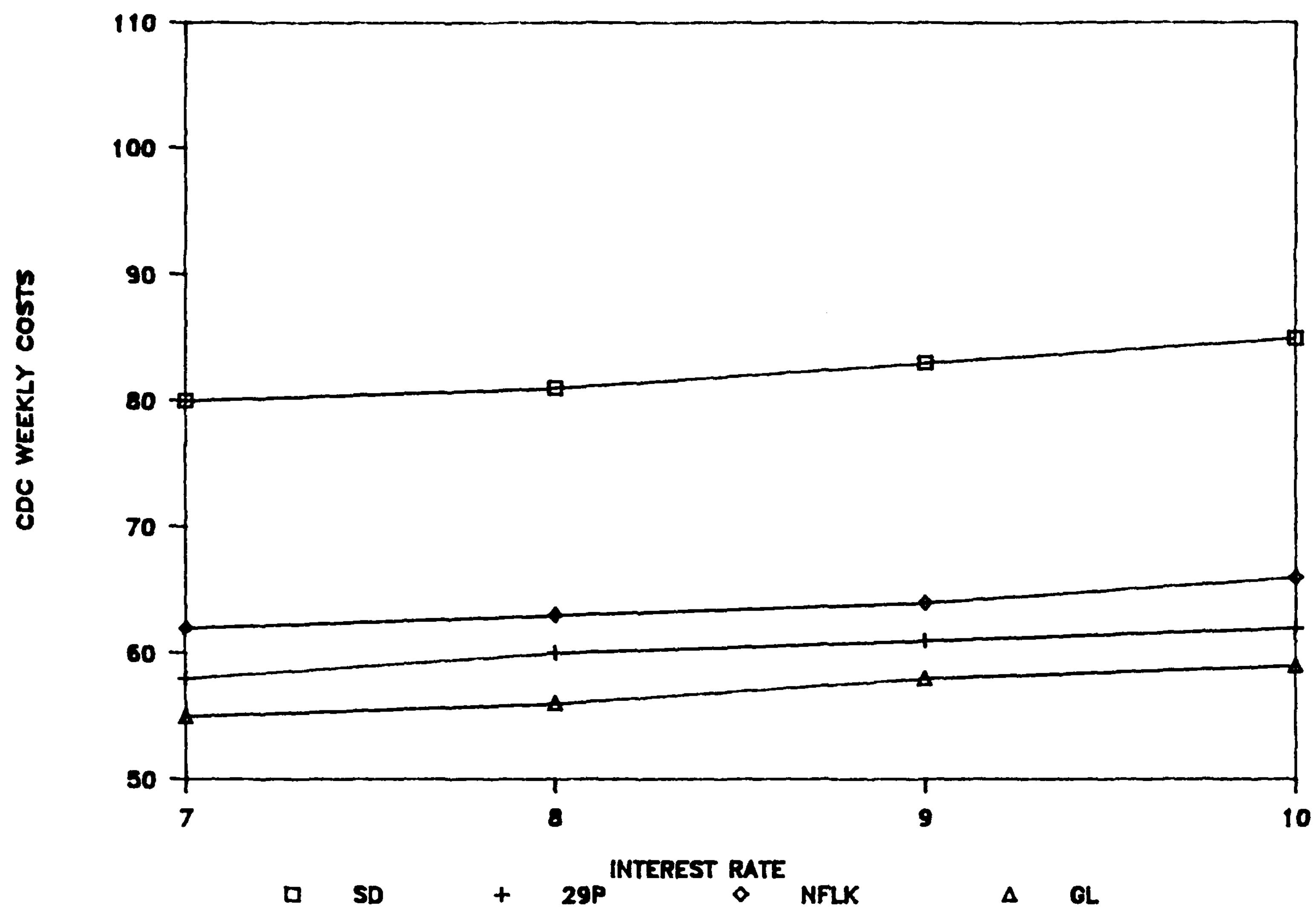

FIG. A-1. SENSITIVITY OF CDC WEEKLY COSTS TO INTEREST RATES

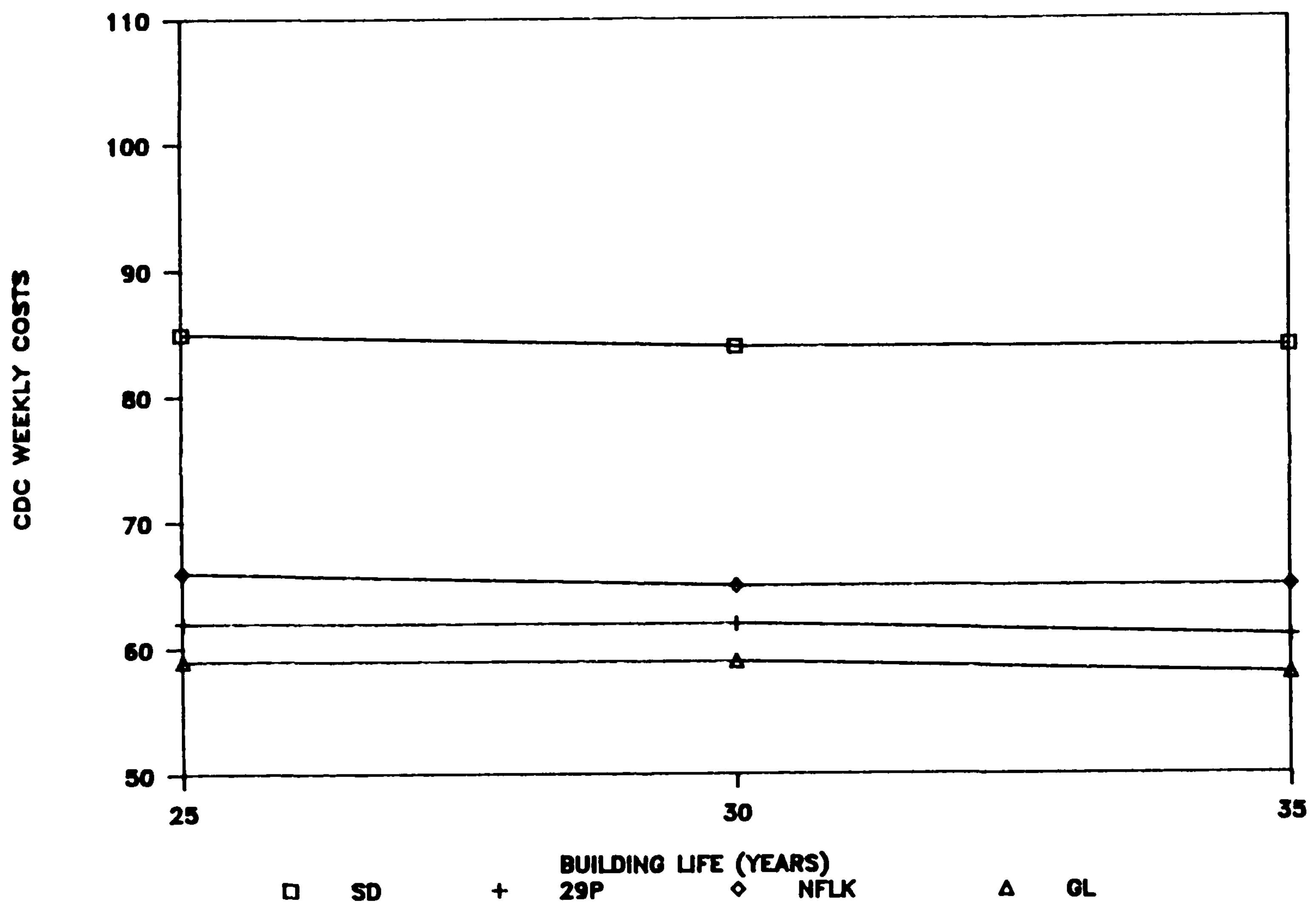

FIG. A-2. SENSITIVITY OF CDC WEEKLY COSTS
TO BUILDING LIFE

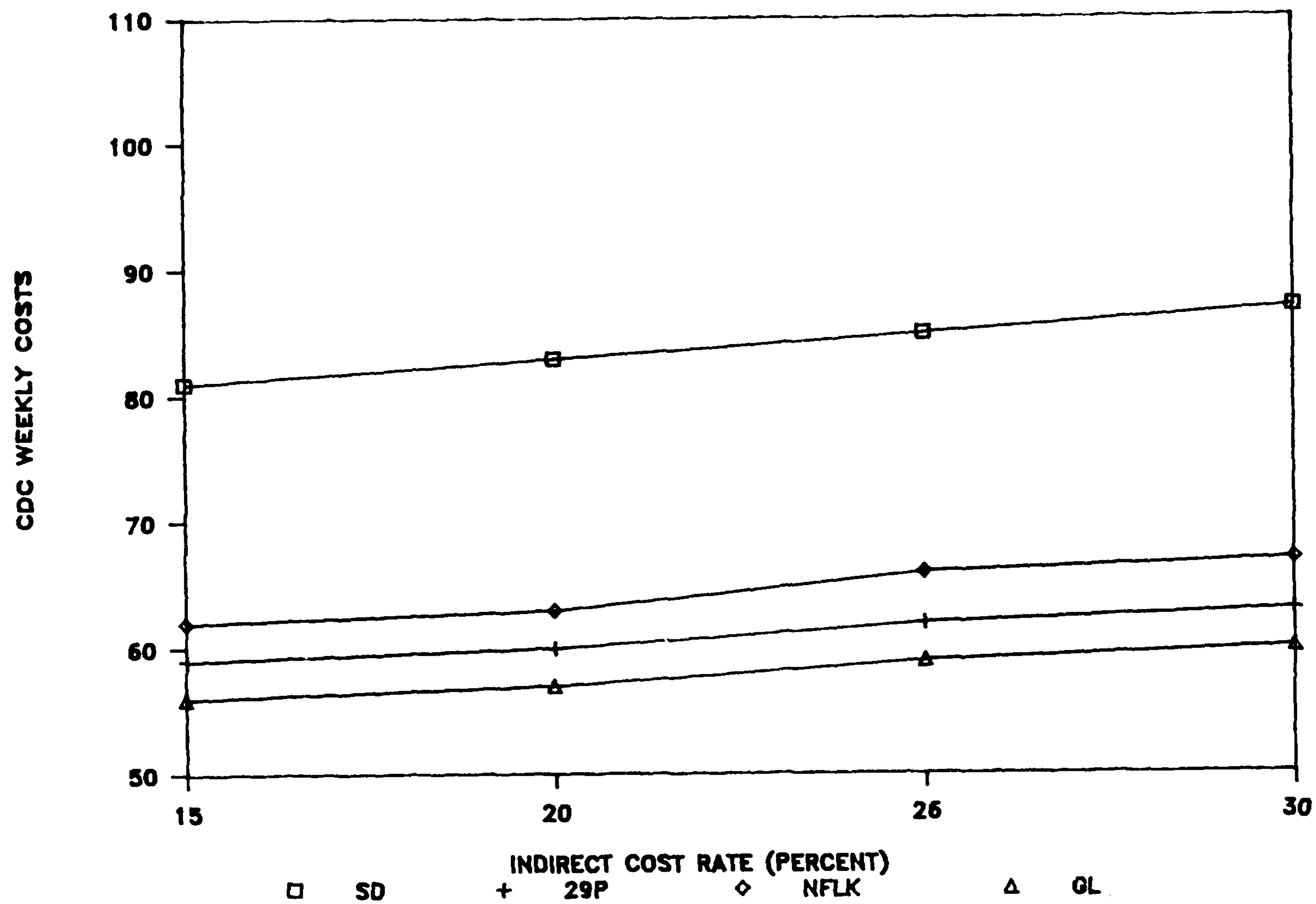

FIG. A-3. SENSITIVITY OF CDC WEEKLY COSTS TO INDIRECT COST RATES

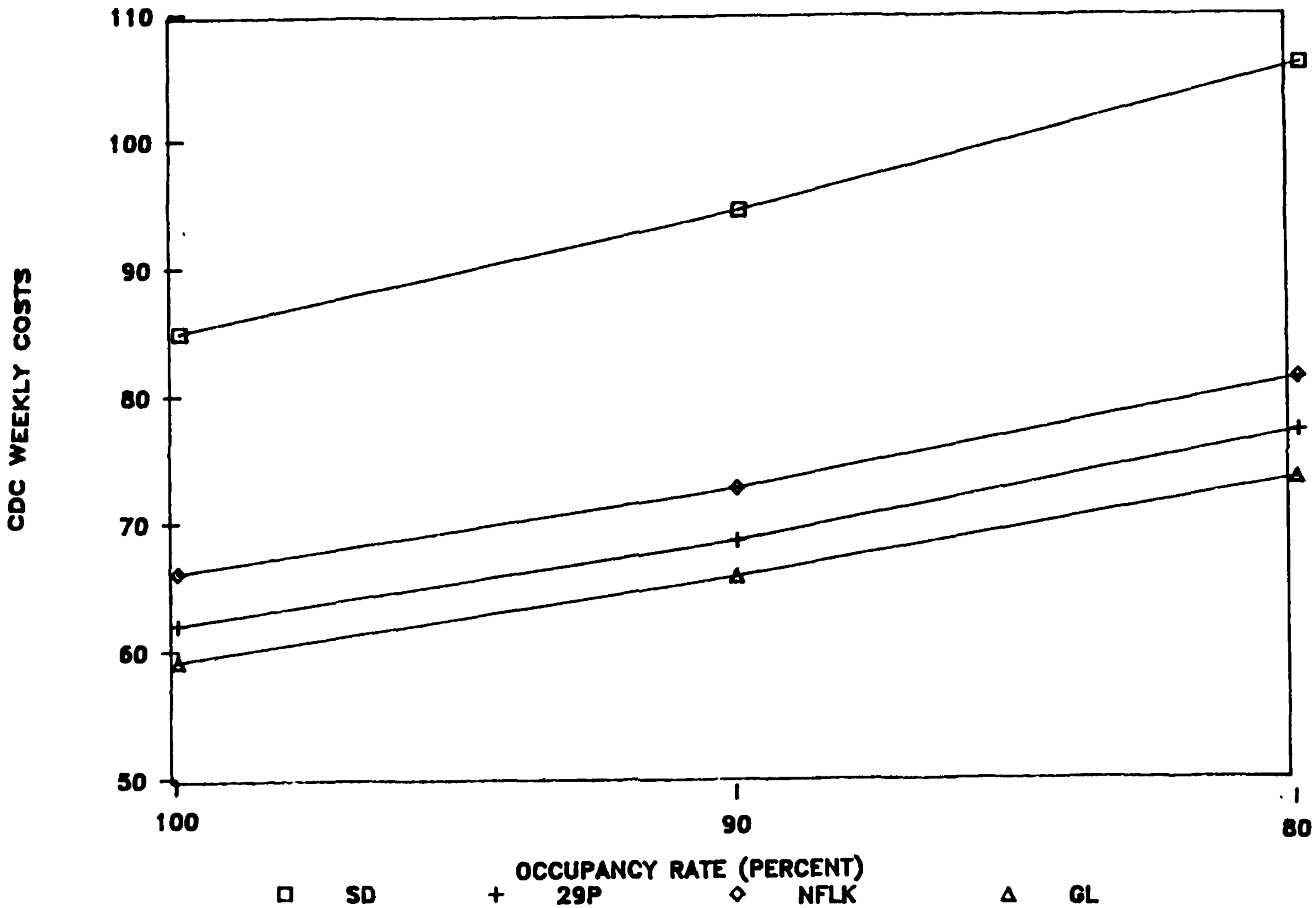

FIG. A-4. SENSITIVITY OF CDC WEEKLY COSTS
TO OCCUPANCY RATES

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Private-Sector Financing of Child Development Centers

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Adequate child care for dependents of working parents is an urgent national concern. Similar care for dependent children of Service personnel is of equal concern to the Congress and the Services. Currently, this need is met in the Services through the use of military construction (MILCON) funds to build child-development centers (CDCs) at installations and appropriated and some non-appropriated funds to support reasonable fees for their operation and maintenance.

In 1984, the Congress directed the Military Departments to determine the feasibility of alternative funding – third-party financing – to replace the scarce MILCON funds. In the first test of alternative funding, the Army attempted to use a service contract for designing, constructing, operating, and maintaining CDCs. It reported that the results were unfavorable, with only one response to its request for proposals (RFP) – a response that was ultimately withdrawn.

Under the continued direction of the Congress, the Navy has now completed its test of third-party financing – an alternative approach under which a concession agreement makes land on an installation available to a firm to design, build, operate, and maintain a CDC and all costs are covered by fees (i.e., no Government funds are used).

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The Navy initiated its test by preparing a draft RFP and circulating it to the child-care industry. We then assisted the navy by conducting an intensive review of the child-care industry, an economic analysis of private-sector financing, and an assessment of four alternative financing approaches. On the basis of our analysis and through discussions with private child-care providers, we conclude that third-party financing for CDCs is not feasible for two principal reasons:

- Private-sector interest in providing CDCs on military installations is virtually nonexistent.
- The fees that such firms would have to charge for the required services would be between a third and a half greater that those now charged by the Government.

The dearth of private interest is based on three principal factors; the risk of financing a building on Government land is too great, extended, cost-incurring services beyond those normally provided by private firms is required, and private companies cannot compete with the Government on fees.

Even though the fees for Service members are lower at Government installations because of subsidies, they represent between 7 and 15 percent of the Serviceperson's salary, which is very close to the national average for civilian parents.

Our assessment of four alternative arrangements – Government subsidies, higher fees, Government financing of the buildings only, and service contracting – shows that none offers a reasonable and effective solution to the economic problems of third-party financing.

After a thorough review of the availability and economics of third-party financing of CDCs on military installations, we recommend:

- The Navy make no further attempts to solicit bids for design, construction, operation, and maintenance of CDCs through third-party agreements.
- The Navy seek MILCON funding for building the needed CDCs.
- The Military Departments continue consideration of third-party financing for other support services. The concept is practical and beneficial in many applications; it is not for CDCs.

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