Decouple Rated License and Subsidized Child Care

Session Law 2025-36, Section 1.(b)

House and Senate Appropriations Committees

House and Senate Appropriations Committees on Health and Human Services

Joint Legislative Oversight Committee on Health and Human Services

Fiscal Research Division

By

North Carolina Department of Health and Human Services

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Reporting Requirements

Session Law 2025-36, Section 1(a-d) states:

SECTION 1.(a) The General Assembly recognizes the need to balance maintaining critical health, safety, and welfare standards for child care, as well as a well-established rating system used for informational purposes, with the need to move toward maximizing State funds for child care and increasing the supply of child care from State-funded sources. The General Assembly further recognizes the importance of weighing the need to decrease the cost of child care through deregulatory actions and at the same time maintain child care subsidy reimbursement rates. The purpose of this provision, in part, is to encourage the business community to partner with the State in achieving this goal.

SECTION 1.(b) To that end, by May 1, 2026, the Department of Health and Human Services, Division of Child Development and Early Education (Division), shall develop a proposed plan to separate the quality rating improvement system (QRIS) from the requirements and payments for participation in the State-subsidized child care program using the market rate study required by Section 1.(c) of this act and make recommendations on implementation of the plan while meeting the federal Child Care and Development Fund requirements including a quality standard measurement. The Division should report any difference in the proposed plan and the current reimbursement rate. The Division shall submit the proposed plan to the chairs of the House and Senate Appropriations Committees, the chairs of the House and Senate Appropriations Committees on Health and Human Services, the Joint Legislative Oversight Committee on Health and Human Services, and the Fiscal Research Division by May 1, 2026. The current plan will stay in full force and effect until such time as the General Assembly first considers and approves and adopts the proposed plan and any amendments to that plan and then the federal government approves the proposed plan and any amendments. The Division should also include an update on the QRIS Modernization rules process under S.L. 2024-34.

SECTION 1.(c) The Division shall complete a new market rate study by May 1, 2026. This market rate study shall be made available to the public by May 1, 2026. The Division shall ensure that the market rate study includes potential rates that are not segmented by star-rating and new market rates for the QRIS system. The Division shall not implement new reimbursement rates unless approved by the federal Administration of Children and Families and authorized to do so by the General Assembly.

SECTION 1.(d) Nothing in this section shall be construed as impacting the star-rating requirements for the NC Prekindergarten (NC Pre-K) program.

Evaluation of Reimbursement Methodologies
The North Carolina 2025 Child Care Market Rate Survey (see Appendix A), conducted by The Center for Urban Affairs and Community Services at North Carolina State University on behalf of the Division of Child Development and Early Education (DCDEE), establishes updated market-based reimbursement benchmarks for subsidized child care. The study was finalized on April 15, 2026.

The survey provides multiple rate reference points, including:

- 75th percentile market reimbursement rates by star-rating quality level, consistent with federal market rate survey benchmarks.
- Decoupled rates not differentiated by star-rating quality levels.
- Statewide floor rates intended to establish minimum reimbursement thresholds.

North Carolina must comply with federal Child Care and Development Fund (CCDF) requirements, which require states to establish child care subsidy reimbursement rates that support equal access to child care services for children receiving subsidy assistance. In addition, states must maintain activities designed to improve the quality of child care services, dedicate a portion of CCDF funds to quality improvement efforts, and identify a quality standard measurement within the CCDF State Plan. Compliance with these requirements is necessary for North Carolina's continued participation in the CCDF program and receipt of federal CCDF funding.

North Carolina led the nation in 1999 when it launched its Quality Rating Improvement System (QRIS), a star rating system for early childhood education facilities. Since that time, QRIS has served as the State's primary framework for measuring, improving, and communicating child care quality. Following extensive stakeholder engagement, research, and legislative direction, North Carolina is now implementing the most significant modernization of the system in more than two decades. QRIS encourages continuous quality improvement among providers, recognizes investments in quality, and provides families with meaningful information to help them make informed decisions when selecting a child care facility. As such, QRIS plays a central role in North Carolina's approach to meeting federal quality-related requirements under the CCDF and supporting high-quality early childhood education across the State.

DCDEE evaluated several reimbursement methodologies derived from the 2025 Market Rate Survey to identify potential approaches for restructuring how quality is recognized and supported within the subsidy reimbursement system while continuing to meet federal CCDF requirements related to equal access and quality. The methodologies vary in how reimbursement rates are structured, how quality is incorporated into provider funding, administrative complexity, and overall fiscal impact. As required by S.L. 2025-36, Model 5 – Decoupled Rate with Annual Quality Bonuses – fully separates QRIS from the reimbursement rate structure, while the remaining models maintain quality incentives through various reimbursement rate methodologies.

For the purposes of this analysis, DCDEE assumed no changes to the current eligibility requirements for participation in the Subsidized Child Care Assistance Program. Accordingly, the analysis is based on the existing subsidy participation framework under which providers

generally must hold a 3-star, 4-star, or 5-star rated license, or operate pursuant to N.C.G.S. § 110-106, to receive subsidy reimbursement. This analysis does not assume any expansion or reduction in provider eligibility and evaluates only changes to the reimbursement methodology.

The methodologies were grouped into two categories:

QRIS-Based Models
These methodologies incorporate QRIS ratings directly into the reimbursement rate structure.

1. Market Rate Methodology
2. Statewide Floor with Existing QRIS Differentials

Alternative Models
These methodologies recognize and support quality through alternative reimbursement structures or separate quality incentive payments.

3. 3-Star Statewide Floor with Quality Adjustment
4. 1-Star Statewide Floor with Quality Adjustment
5. Decoupled Rate with Annual Quality Bonuses

These methodologies were evaluated based on the following considerations:

- **Rate Consistency** – The extent to which reimbursement rates are standardized across providers, settings, and geographic regions.
- **Provider Funding Impact** – The effect on provider reimbursement levels, including the number of providers receiving rate increases and the magnitude of those increases.
- **Quality Approach** – The manner in which quality is measured, recognized, and supported under the methodology.
- **Administrative Efficiency** – The level of administrative effort required to implement, maintain, and manage the reimbursement methodology, including system complexity, rate administration, and provider communication.
- **Fiscal Impact** – The projected annual cost of the methodology and the additional funding required above current funding levels.

The following sections describe each methodology and highlight key considerations related to rate consistency, provider funding impact, quality approach, administrative efficiency, and fiscal impact.

QRIS-Based Models

1. **Market Rate Methodology**
   The Market Rate Methodology is the reimbursement approach currently used by the State and applies the highest of the current reimbursement rate, the newly established 75th percentile market rate, or the modeled rate identified in the 2025 Market Rate Study. While 75th percentile market rates are based directly on provider-reported prices, modeled rates are used in certain categories where additional rate estimation is necessary due to limited survey data. This methodology maintains the existing QRIS-based reimbursement structure, with rates varying by provider star rating, age group, care setting, and county.

This approach is most closely aligned with the traditional market rate framework used under CCDF, as it relies directly on the rates identified through the State's market rate survey when establishing subsidy reimbursement rates.

The current annual cost of this methodology based on the 2021 Market Rate Study is $590,174,405. Applying the same methodology based on the 2025 Market Rate Study would increase the annual cost to $688,316,024, requiring an additional $98,141,620 above current funding levels. Increasing rates using this methodology would provide reimbursement increases to approximately 2,500 licensed child care facilities.

Because this approach maintains county-specific and star-rated reimbursement levels, it results in more than 5,000 individual reimbursement rates statewide. This large number of rates creates administrative complexity for DCDEE and can be difficult for providers to navigate and understand. The methodology also results in significant reimbursement disparities across providers. In many rural counties, providers receive substantially lower reimbursement rates than providers elsewhere in the state despite meeting the same licensing and quality standards and providing similar early learning experiences.

2. **Statewide Floor with Existing QRIS Differentials**

The Statewide Floor with Existing QRIS Differentials methodology establishes a minimum subsidy reimbursement rate based on the 75th percentile market rates for each age group, care setting, and star level (3-star through 5-star) identified in Appendix G of the 2025 Market Rate Study. Under this approach, providers would receive the higher of their current subsidy reimbursement rate or the applicable statewide floor reimbursement rate. This methodology maintains the existing QRIS-based reimbursement structure by continuing to provide higher reimbursement rates for providers with higher star ratings.

By establishing a statewide reimbursement floor rather than relying solely on county-specific market rates, this methodology reduces variation in reimbursement rates across geographic regions and helps address disparities among providers. These impacts are particularly significant in rural counties, where reimbursement rates are often lower than those in other parts of the State. This methodology also maintains a direct relationship between provider quality ratings and reimbursement levels by continuing to incorporate provider quality ratings into the reimbursement structure.

Compared to the Market Rate Methodology, providers whose reimbursement rates fall significantly below the statewide floor would generally receive larger rate increases under this approach, directing additional funding toward providers with the greatest gap between current reimbursement rates and the statewide floor and helping narrow the gap between reimbursement rates and the cost of providing care.

The projected annual cost to implement this methodology based on the 2025 Market Rate Survey is $860,754,051, which is $270,579,646 over current funding levels. Implementation would provide reimbursement increases to approximately 3,000 licensed child care facilities.

This methodology would also significantly improve administrative efficiency by reducing the number of unique reimbursement rates to 27 base rates. The simplified rate structure would be easier for providers to understand and navigate.

Alternative Models

3. 3-Star Statewide Floor with Quality Adjustment

The 3-Star Statewide Floor with Quality Adjustment methodology establishes the statewide 3-star floor rate identified in Appendix G of the 2025 Market Rate Survey as the base reimbursement rate. Under this approach, providers rated 3-star, 4-star, and 5-star would receive the same base reimbursement rate for a given age group and care setting regardless of geographic location. A 15 percent quality adjustment is then applied and compounded only for 4-star and 5-star providers, resulting in progressively higher reimbursement rates above the base rate.

DCDEE selected a 15 percent quality adjustment to provide meaningful financial incentive for quality improvement while helping narrow the gap between reimbursement rates and the cost of providing care. In developing this approach, DCDEE reviewed quality support strategies used in other states, including quality improvement grants, workforce stipends, curriculum and technology supports, and accreditation assistance. The 15 percent adjustment was determined to provide a level of funding sufficient to support a range of quality improvement activities while allowing flexibility in how providers invest resources to strengthen program quality.

Unlike the Statewide Floor with Existing QRIS Differentials methodology, which maintains separate reimbursement rates for each star level, the 3-Star Statewide Floor approach establishes the statewide 3-star floor rate as the common base reimbursement rate and uses a standardized quality adjustment methodology to determine reimbursement differences above the base rate. As a result, reimbursement differences are determined through a consistent statewide quality adjustment rather than the existing QRIS-based rate differentials. By establishing a statewide reimbursement floor, this methodology reduces geographic variation in reimbursement rates while concentrating reimbursement differentials on providers rated 4-star and 5-star.

The projected annual cost of this methodology is $972,946,457, which is $382,772,052 above current funding levels. Implementation would provide reimbursement increases to approximately 3,000 licensed child care facilities. Because this methodology modifies reimbursement rates within the existing subsidy payment structure, implementation would largely align with the current functionality of the North Carolina Families Accessing Services through Technology (NC FAST) system.

4. 1-Star Statewide Floor with Quality Adjustment

The 1-Star Statewide Floor with Quality Adjustment methodology applies the same concept as the 3-Star methodology but uses the statewide 1-star floor rate as the base reimbursement rate. A 15 percent quality adjustment is then applied and compounded at each successive quality level, resulting in progressively higher reimbursement rates across participating providers.

Unlike the 3-Star methodology, which establishes the statewide 3-star floor rate as the common base reimbursement rate and applies quality adjustments only for 4-star and 5-star providers, this approach applies quality adjustments at each successive quality level. This approach also results in reimbursement increases for religious-sponsored child care facilities operating pursuant to N.C.G.S. § 110-106, which receive the 1-star reimbursement rate.

The projected annual cost of this methodology is $1,159,579,747, an increase of $569,405,342 above current funding levels. The higher cost reflects the application of quality adjustments at each successive quality level, resulting in higher reimbursement rates for 3-star, 4-star, and 5-star providers compared to the 3-Star methodology. Implementation would provide reimbursement increases to approximately 3,400 licensed child care facilities. Because this methodology modifies reimbursement rates within the existing subsidy payment structure, implementation would largely align with existing NC FAST functionality.

5. Decoupled Rate with Annual Quality Bonuses

The Decoupled Rate with Annual Quality Bonuses methodology establishes a uniform statewide reimbursement rate for providers serving the same age group and care setting, regardless of QRIS rating. The reimbursement rate would be the highest of the current reimbursement rate, the 75th percentile market rate, or the modeled decoupled rate identified in Appendix E of the 2025 Market Rate Survey.

Unlike the QRIS-based reimbursement methodologies, this approach removes the direct relationship between provider quality ratings and subsidy reimbursement rates. To maintain compliance with federal CCDF requirements related to quality measurement, providers meeting specified quality standards would be eligible to receive an annual quality bonus. Bonuses would range from 15 percent to 25 percent of a provider's total annual subsidy reimbursement amount, with bonus levels determined based on the quality criteria met by the provider. Potential quality criteria could include:

- Program standards strengthened through the use of evidence-based curricula, comprehensive child assessment systems, enriched classroom environments, and improved child-teacher ratios that support individualized learning and development.
- Practitioner workforce development supported through education and credentialing pathways, as well as ongoing engagement in targeted technical assistance to build competency and instructional quality.
- Quality assurance reinforced through systematic data collection, monitoring, and inspections that ensure continuous improvement and accountability.
- Consumer education through intentional family engagement strategies that empower families with clear, accessible information about program quality and help foster strong, collaborative relationships.

Implementation of this methodology would require significant modifications to NC FAST because the current system is designed to administer provider payments through the reimbursement rate structure than through separate bonus payments. New functionality would be needed to establish bonus eligibility criteria, evaluate provider status over the 12-month period, verify participation requirements, calculate bonus amounts, and distribute payments. Preliminary estimates indicate a minimum system investment of approximately $8

million; however, this figure represents an order-of-magnitude estimate and would require additional analysis to develop a more precise cost projection. Unlike the other methodologies, which could largely be implemented through updates to existing reimbursement rate tables, this approach would require the development of new system functionality.

The projected annual cost of this methodology is $889,781,992, an increase of $299,607,587 above current funding levels. In addition, implementation would require a one-time investment of approximately $8 million to modify the NC FAST system. Approximately 2,800 licensed child care facilities would receive reimbursement increases.

Summary of Analysis and Recommendations

The table below outlines the five different methodologies evaluated by DCDEE, including their projected annual cost, estimated State funding needed for implementation, and the estimated number of licensed child care facilities projected to receive a reimbursement increase.

Comparison of Reimbursement Methodologies*
Child Care Centers and Homes (All Ages)

Methodology**	Annual Cost Estimate	Additional State Funding Needed	Facilities with Increase
Current Market Rate Methodology (2021 Study)	$590,174,405		
Market Rate Methodology (2025 Study)	$688,316,024	$98,141,620	2,532
Statewide Floor with Existing QRIS Differential	$860,754,051	$270,579,646	2,993
3-Star Statewide Floor with Quality Adjustment	$972,946,457	$382,772,052	3,018
1-Star Statewide Floor with Quality Adjustment	$1,159,579,747	$569,405,342	3,449
Decoupled Rate with Annual Quality Bonuses	$889,781,992***	$299,607,587	2,825

*Calculations assume a hold harmless provision that ensures no provider experiences a reduction in reimbursement rates. Providers receive the higher of their current reimbursement rate or the calculated reimbursement rate under each methodology.
**All methodologies except the Current Market Rate Methodology (2021 Study) are derived from the 2025 Child Care Market Rate Survey.
***Estimate excludes an approximately $8 million one-time investment for NC FAST system modifications. Including this implementation cost, the total first year cost would be $897,781,992.

The methodologies evaluated by DCDEE vary significantly in their fiscal impact, administrative complexity, treatment of quality, and implementation requirements. While each approach is derived from the 2025 Child Care Market Rate Survey and is designed to support federal CCDF requirements related to equal access and quality, the methodologies differ in how quality is recognized and incorporated into provider funding.

Considerations for Implementation of a Fully Decoupled Model

As required by S.L. 2025-36, the Decoupled Rate with Annual Quality Bonuses methodology fully separates QRIS from subsidy reimbursement rates. Prior to implementation, several activities would need to occur, including but not limited to:

- Develop and submit an amendment to North Carolina's CCDF State Plan to the federal Administration for Children and Families (ACF), Office of Child Care.
- Work with federal partners to address policy and implementation questions, obtain technical assistance, and ensure ongoing compliance with federal CCDF requirements.
- Establish a quality bonus framework that identifies the quality standards eligible for bonus payments and defines how quality will be measured, recognized, and supported outside of the reimbursement rate structure.
- Develop the quality bonus methodology, including eligibility criteria, payment calculations, provider verification requirements, and accountability measures.
- Modify the NC FAST system to support bonus eligibility determinations, payment calculations, payment processing, reporting, and ongoing administration. Preliminary estimates indicate a one-time system investment of approximately $8 million.
- Develop provider communications, guidance, and training materials to support implementation and ensure providers understand the new reimbursement and quality bonus structure.

DCDEE estimates that approximately one year would be required following receipt of approval from the ACF Office of Child Care to implement the methodology and complete the associated systems, administrative, and operational changes.

After evaluating the methodologies described in this report, DCDEE recommends implementing the Statewide Floor with Existing QRIS Differentials methodology. This approach aligns with the recommendations of the Governor's bipartisan Task Force on Child Care and Early Education and balances the goals of reducing geographic disparities in reimbursement rates, strengthening provider funding, maintaining quality incentives, and leveraging existing NC FAST functionality. This methodology provides a practical path toward greater consistency in reimbursement rates across the State while continuing to support quality improvement. It also aligns with North Carolina's ongoing efforts to modernize QRIS and develop a more effective framework for measuring, supporting, and recognizing quality across the early childhood system. As providers across the State continue transitioning to the modernized QRIS framework, this approach allows North Carolina to build upon the significant investments already made in QRIS modernization while continuing to support provider choice, continuous quality improvement, and long-term system stability.

QRIS Modernization Update

In February 2023, the NC Child Care Commission (Commission) initiated a project to modernize North Carolina's QRIS, commonly known as the Star Rated License, in anticipation of impending legislation and with the intention of addressing workforce challenges. The Commission formed a QRIS Sub-Committee that was tasked with developing recommendations for QRIS Modernization.

In June 2023, S.L. 2023-40 became effective and required a plan for QRIS reform,

including use of national early childhood accreditations within QRIS, to be completed by March 2024. On March 28, 2024, a legislative report was submitted to the Joint Legislative Oversight Committee on Health and Human Services, outlining the work of the Commission and the recommended plan for QRIS reform.

In June 2024, S.L. 2024-34 became effective, further instructing the Commission to continue the QRIS Modernization work outlined in the legislative report through rulemaking. In addition, S.L. 2024-34 allowed immediate use of seven national accreditations as a pathway to licensure and implementation of an updated version of the program assessment tool used while rulemaking procedures were underway.

Since 2023, the Child Care Commission and DCDEE have invested a significant amount of time meeting the legislative requirement to modernize QRIS. This modernization was informed by extensive research and stakeholder engagement, including community sessions with child care providers, families, and early childhood partners. More than 1,800 early childhood professionals provided feedback that helped shape the design of the modernized framework, including the flexibility and options incorporated into the new system.

Following development of the proposed rules, the Commission, DCDEE, and stakeholder workgroups began the substantial planning necessary to support implementation. This work included developing curriculum review processes, competency evaluation procedures, supporting documentation, operational guidance, and other implementation resources. Throughout the process, DCDEE hosted webinars, statewide meetings, and community engagement sessions to share information, gather feedback, and support providers in preparing for the transition.

DCDEE has made significant investments in planning for implementation of the modernized QRIS framework and continues to support providers through technical assistance, communication, and resource development activities. These efforts reflect the State's ongoing commitment to strengthening and improving the system used to measure, support, and recognize quality in early childhood programs.

On July 1, 2025, the new QRIS requirements became effective in Child Care Rule 10A NCAC 09 .3200 (see Appendix B). Since that time, DCDEE has continued to invest significant time and resources in supporting the transition to the new QRIS requirements through outreach, training, technical assistance, and resource development for operators and early childhood education stakeholders (see Appendix C). Each licensed child care facility has been working with their assigned DCDEE consultant to develop a customized transition plan for licensure. This plan is designed to be provider-driven, allowing operators to select from expanded options related to education and program standards that best align with their program, workforce, and the needs of the children and families they serve.

As of March 2026, approximately 67 percent of child care facilities are actively working toward a Star Rated License under the modernized QRIS system and are expected to complete their transition within the year. The remaining 33 percent of facilities have either already transitioned to the new system or have not yet reached the point in their licensure cycle when reassessment is required.

Child care operators have demonstrated interest in all three licensure pathways as they plan their transition to the modernized QRIS framework:

- **Program Assessment Pathway** – This pathway is the most familiar to child care operators because many of its components were included in the previous QRIS system. Both child care centers and family child care homes have used this pathway to earn a Star Rated License. The NC Rated License Assessment Project (NCRLAP) conducts program assessments using updated versions of the Environment Rating Scale and has worked closely with child care operators through outreach assessments designed to prepare programs for formal assessments. NCRLAP has also developed extensive outreach and training resources to support implementation of the updated program assessment tool, reaching approximately 4,000 interested individuals. Operators participating in outreach and formal assessments are performing well and report that the process is achievable across the star levels they pursue. NCRLAP is receiving an increasing number of requests for program assessment as child care operators work toward their transition.
- **Classroom and Instructional Quality Pathway** – This new pathway focuses on curriculum implementation across all age groups served and individualized child assessment planning. Both child care centers and family child care homes have used this pathway to earn a Star Rated License. Since July 1, 2025, the Commission has reviewed and approved 58 new curriculum choices and nine new formative assessment choices to support implementation of this pathway.
- **Accreditation and Head Start Pathway** – This new pathway allows facilities with an approved accreditation and/or Head Start designation to demonstrate quality using the accrediting organization's programmatic requirements or the federal Head Start performance standards in lieu of QRIS program and/or education standards. This eliminates duplicative and burdensome requirements for child care operators. Accreditation and Head Start each correspond to designated star levels, and approximately 400 child care operators have used this pathway to earn a Star Rated License.

The modernized QRIS framework reflects years of collaboration among the North Carolina General Assembly, Commission, DCDEE, child care providers, families, and early childhood partners to strengthen the State's approach to recognizing and supporting quality. With implementation underway statewide, providers are actively transitioning to the new requirements and utilizing the expanded pathways and flexibility incorporated into the modernized system. As this work continues, North Carolina is positioned to build upon the significant investments already made in QRIS modernization while maintaining a consistent and sustainable framework for supporting quality across the early childhood system.

Appendices Referenced in Decouple Rated License and Subsidized Child Care Legislative Report

Appendix A: North Carolina 2025 Market Rate Survey, April 2026

Appendix B: Section .3200 of Chapter 9 Child Care Rules in North Carolina Administrative Code, 10A NCAC 09 .3200 Standards for Two Through Five Star Rated Licenses

Appendix C: QRIS training and resources for child care providers, DCDEE QRIS Modernization Webpage

Appendices including Supplemental Data and Resources

Appendix D: American Institutes of Research (AIR) Memo, "Findings from Focus Groups with Child Care Providers", March 10, 2026

Appendix E: American Institutes of Research (AIR) Summary, "North Carolina Child Care Providers' Perspectives on a Potential Decoupling Policy", April 2026

Appendix F: Division of Child Development and Early Education Access to Child Care Presentation to Joint Legislative Oversight Committee on Health and Human Services, March 10, 2026

Appendix G: NC Child 2025 Child Care Finance Report, "Building Blocks and Bottom Lines: The Financial Realities of Operating a Child Care Business in North Carolina", August 2025