



A Brief History of Group Home Rate-Setting in California

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County-Established Rates Prior to 1982

Prior to 1982, counties were responsible for paying most of the nonfederal share of foster care costs and for establishing their own foster care rates. The State provided a small “match.” For children who were eligible (i.e., in a family receiving AFDC, or eligible to receive AFDC, when they were removed from their homes), 50% federal financial participation was obtained under the AFDC-Boarding Homes and Institutions (BHI) program, then part of Title IV-A of the Social Security Act.

The rate-setting systems used by the counties prior to 1980, and the level of payments provided by those systems, varied widely throughout the State. The counties in the San Francisco Bay Area, for example, created a consortium, the Bay Area Placement Committee (BAPC), one its responsibilities being to establish foster care rates. In simple terms, each group home program developed a proposed budget for the next fiscal year and then negotiated a rate with a panel of BAPC representatives composed of BAPC staff and placement workers that were familiar with the program they were reviewing. Generally, the rates established by BAPC were significantly higher than those established by Los Angeles and other Southern California counties.

The State Takes Over in 1982

The State government assumed responsibility for establishing foster care rates, including those paid to group homes, in the early 1980s in the aftermath of two events: the passage of Proposition 13 in California in 1978 and the enactment of Public Law 96-272 by the federal government in 1980.

In the State “bail-out” of the counties that followed the passage of Proposition 13, the State assumed responsibility for 95% of the nonfederal share of foster care costs, leaving the counties with only a 5% share. With this increased level of financial responsibility, the State was reluctant to allow counties to retain the authority to establish foster care rates.

The State’s financial interest in taking over rate-setting was reinforced by pressure from federal officials. Although still linked to AFDC for eligibility purposes, PL 96-282 established AFDC-Foster Care as a separate program, Title IV-E of the Social Security Act. As part of the implementation of this new program, federal officials informed California that they did not believe that allowing counties to establish foster care rates using different systems met the “statewideness” requirement under Title IV-E.

Further, PL 96-272 made it clear that the federal definition of “foster care maintenance payments” did not include social work services as one of the “allowable” activities, a cost that was included in California’s foster care rates. Finally, the enactment of PL 96-272 was also the catalyst for major changes in the role of the State government in the administration of the broader Child Welfare Services (CWS) system by the counties, leading to the enactment of SB 14.

State Establishes “Cost-Based” Rates

In 1982, the Legislature enacted AB 2695 through which the State government took over responsibility for establishing foster care rates in California. AB 2695 required that group home rates

be “established based on actual allowable costs.” For the first year of implementation, 1983-84, group homes were limited to their prior year rates that had been established by the counties plus the COLA in the State budget. The legislation also required the California Department of Social Services (CDSS) to develop a plan for “controlling” the rates based on actual, allowable costs. In the end, the development of the group home rate control system took two years and was not implemented until 1985-86; it continued in effect until 1990

Since the counties had included the costs of social work services in the rates they established for group homes, AB 2695 continued to include social work services in the “allowable” activities covered by California’s group home rates although social work activities are not federally reimbursable under Title IV-E. The State, therefore, began factoring out the costs of social work services before it claimed federal reimbursement under the new Title IV-E program.

How the “Cost-Based” System Determined Rates

Under the “cost-based” rate-setting system, group homes submitted their actual costs for the prior calendar year to the State each spring. The State eliminated costs that they determined to be “unallowable” for foster care funding and reduced costs that were determined to be “unreasonable.”

These “actual allowable and reasonable” costs were adjusted by the California Necessities Index (CNI), to take into account the fact that costs would be greater in the next fiscal year than they had been in the prior calendar year. These adjusted costs were divided by 85% of an agency’s licensed capacity, yielding a “per child per month” cost rate.¹

The cost rate was compared to the program’s Foster Care rate for the prior fiscal year, adjusted to reflect any rate increase granted by the Legislature in the State budget for the next fiscal year. The State then granted the group home a rate for the next State fiscal year based on the lesser of these two amounts.

“Cost-based” System Did Not Reimburse for Costs

Very few programs received a cost-based rate under this ostensibly “cost-based” system. The vast majority of programs (well over 90% each year) were simply capped at their prior year rate plus the COLA, regardless of the costs they incurred.

State Implements Program Peer Groups

The rate control system implemented by CDSS in 1985 was used primarily to establish the rates for new group home programs and to create some of the “reasonableness” standards used to evaluate group home costs. All group home programs were categorized into one of four “Program Peer Groups:”

1. Psychiatric Model
2. Psychological Model
3. Social Model
4. Family Model.

Nine criteria were used to classify programs into each Program Peer Group: (a) treatment focus, (b) psychiatric services, (c) psychological treatment services, (d) social work activities, (e) intensity of basic care, (f) housing pattern, (g) community involvement, (h) education, and (i) planned activities.

¹ Prior to July 1, 1985, these costs were divided by the greater of (a) the program’s average actual occupancy for the prior calendar year, or (b) 85% of its licensed capacity.

CDSS concerns over the cost-based system.

By the late 1980s, CDSS had become concerned with its “cost-based” rate-setting system. One concern was that it led to the establishment of rates for new providers that were substantially higher than those paid to existing providers. The system included a “ceiling” for the rates of new providers at the 85th percentile of the rates for existing group homes classified in the same Program Peer Group as the new provider. In practice, nearly every new provider entered the system at the 85th percentile of rates in their Program Peer Group. In addition, the “cost-based” system imposed massive and duplicative administrative requirements on the State. In order to have effective oversight, CDSS would have been required to audit both a program’s cost and its compliance with the requirements of its Program Peer Group. CDSS had the resources to do neither of these tasks effectively.

Providers Concerned with Rate Control System Sue State

Providers too had concerns with the system. They believed that the Legislature had mandated in AB 2695 the creation of a rate-setting system that paid the actual allowable and reasonable costs of individual group home programs. The system implemented by the state, that capped programs at their prior year’s rate plus COLA, did no such thing, they argued. A group of provider agencies filed suit against the State in Superior Court on this point in 1989 [Booth Memorial Center v. DSS, et al].

Development of the “Flat Rates” System: The RCL System is Born

In response to these colliding forces, CDSS had begun working with counties and providers on the development of an entirely new rate-setting system based on classifying programs into one of ten (10) Rate Classification Levels (RCLs) according to the level of care and services they offered. This proposal became known as the “flat rates” system because all of the group home programs classified into the same RCL would be paid the same “flat” rate, regardless of their individual “allowable” costs.

The level of care and services was to be determined by measuring the level of direct care staffing and the education, experience, and training of those staff. The schedule of standard rates would be determined by using the average historical costs of existing group home programs. Since the vast majority of group homes received a rate that was significantly lower than their actual costs, the implementation of this new “flat rates” system was projected to increase average group home rates, resulting in higher costs to the State government.

Provider Concerns with Proposed “Flat Rates” System

Prior to 1989, the State and the providers were unable to come to an agreement on a schedule of standard rates and on an implementation plan for the “flat rates” system. The providers argued that at least two additional RCLs, with appropriate standard rates, needed to be added at the top of the proposed rates schedule to reflect the costs of the programs offering the highest levels of care and services. Providers also expressed concerns about the methodology used by the State to convert the historical cost data into the proposed schedule of standard rates, arguing that it did not fully reflect average program costs.

Controversial CDSS Implementation Plan

The most critical stumbling block, however, was the implementation plan proposed by CDSS. The CDSS implementation plan called for the establishment of a rate “floor” at 80% of the standard rate for each RCL. The rates for all new programs would be established at the rate “floor” for their RCL: group home programs with rates below the “floor” would be raised to the “floor” for their RCLs

and group home programs with rates above the rate “floor” would be frozen. Each year following the implementation of the new “flat rates” system, the schedule of standard rates was to be increased by the same percentage as the percentage COLA provided in the State budget. The funds appropriated for the COLA would first be used to provide rate increases to all programs at the rate “floor.” Since programs with rates above the “floor” were frozen, some funds would be left over. These funds would be used to increase the rate “floor” to a higher percentage of the standard rate for each RCL; e.g. from 80% to 83%, then from 83% to 86%, etc. Eventually, depending on the size and frequency of COLAs, the rate “floor” would increase to 100% of the standard rate for each RCL.

The CDSS implementation plan was unacceptable to providers for a number of reasons. First, providers argued that the CDSS implementation plan was inconsistent with the premise on which the “flat rates” system was based: that the standard rate for each RCL was the appropriate rate that should be paid to all programs in that RCL. The implementation plan, however, would deny COLA increases to programs with rates above the “floor” but below the standard rate for their RCL. If the standard rate was the appropriate rate, why would programs with rates above the floor but below the standard be denied COLAs?

Second, it would take several years before the “savings” generated by frozen rates increased the rate “floor” to 100% of the standard rates, even using the optimistic assumption that the State budget would include a foster care COLA each year. The providers wanted a guaranteed and shortened time frame for moving the rate “floor” up to 100% of the standard rates.

Court Ruling on Provider Suit Requires State to Reimburse for Allowable Costs.

The Superior Court ruled in favor of the providers in 1989 (*Booth Memorial Center v. DSS, et. al.*) requiring the state to reimburse for actual, allowable costs. This ruling provided a basis for breaking the stalemate between CDSS and the providers by requiring the State to set foster care rates that would pay the actual allowable and reasonable costs of each group home program.

CDSS Concerns About Paying Allowable Costs

At the time of the Superior Court ruling, the State paid 95% of nonfederal share of AFDC-FC costs and CDSS estimated that paying full actual cost rates to group homes would increase State General Fund costs for the five-year period between 1989/90 and 1993/94 by \$425.3 million. CDSS also feared that the implementation of an actual cost system would encourage providers to spend more on allowable and reasonable costs in their group home programs thus further driving up state costs.

CDSS reasoned that providers would use current year funding to incur additional reimbursable costs, assured that the foster care rate for the next year would be increased accordingly and that the rate would then provide the funding necessary to sustain these expenditures in future years.

State Compromises on Schedule of Flat Rates and Implementation Plan

Faced with this prospect, the State agreed to make changes to the schedule of standard rates and to its implementation plan of the proposed “flat rates” system. The standard rates were increased to reflect a higher percentage for employee benefits (from 18.65% to 20.325%) and the impact of an increase in California’s minimum wage. Two additional RCLs were added to the top of the rates schedule, but only for programs that would become licensed as Community Treatment Facilities (CTFs) caring for the most seriously emotionally disturbed children in a secure environment.² Two

² Subsequently, when CTF implementation was stalled, the requirements for becoming classified as an RCL 13 or 14 program were modified.

additional RCLs were also added to the bottom of the rates schedule, to make a total of 14 RCLs.

Of equal importance, the implementation plan was modified to reflect provider concerns. First, only programs with rates above the standard rate for their RCL were to be frozen (so-called “grandfathered” rates). Second, the rate “floor” for the first year was established at 85% of the standard rate for each RCL, scheduled to rise to 92.5% for the second year, and to 100% in the third year. Third, the schedule of standard rates was modified to receive a statutory (not discretionary) CNI-based COLA during this three-year implementation process. After the phase-in period, group home rates would have to compete with other budget priorities for discretionary COLAs.

With these negotiated revisions, the additional State General Fund costs of the new “flat rates” system for the five-year period between 1989/90 and 1993/94 were estimated at only \$189.2 million reflecting \$236 million in savings over the projected five-year costs of the court ordered cost-based system.

Why Providers Agreed to the “Flat Rate” System

Although the “flat rate” system did not provide for an actual cost-based reimbursement system as mandated by the court, providers accepted the negotiated revisions to the CDSS “flat rates” proposal for several reasons.

1. The vast majority of group homes, many of which were already struggling, received immediate and significant rate increases. If providers had been unwilling to accept the revised “flat rates” proposal, the State would have appealed the Superior Court ruling and potentially delayed its implementation for a number of years.
2. The providers faced the risk that an Appeals Court might overturn the Superior Court decision and they would have been stuck with a rate system that was both inequitable and under-funded.
3. The significant new costs that would have accrued to the State, had the providers won on appeal and had an actual cost-based reimbursement system been implemented, may have driven reactive legislation establishing a rate-setting system that was even less attractive than the revised “flat rates” system being offered by the Administration.
4. The “capitated” nature of the “flat rates” system meant that providers no longer would be subject to the risk of overpayment assessments based on the idiosyncratic determinations of DSS auditors. Provider had already experienced situations in which DSS auditors had determined that they had spent foster care funds for costs that did not fall within the technical definition of “allowability” or were not “reasonable” from the perspective of the auditor. The elimination of potential disputes with CDSS about “allowability” and “reasonableness,” and the flexibility to use foster care funds as they saw fit to meet the needs of children in their care, was one of the most attractive features of the “flat rates” proposal from a provider perspective.

Provider Organizations Agree to Dismiss Action

As a condition for signing the legislation to implement the new “flat rates” system, the Administration insisted that the two statewide provider associations (the California Association of Children’s Homes and the California Association of Services for Children, the forerunners of the California Alliance) make a formal written commitment to limit the settlement of the Booth Memorial case to the original plaintiffs, to dismiss other pending legal action [Group Home Society, Inc., et al. v. DSS], and not to undertake future litigation challenging the rates established prior to

the implementation of the new “flat rates” system. Both associations made such a commitment.

What Happened to the Money That Was Saved?

As a historical note, the success of the Booth Memorial lawsuit indirectly made funding available for several other parts of the foster care system. In developing legislation to implement the “flat rates” proposal, key members of the Legislature noted that the estimated cost for the implementation of the “flat rates” proposal was only \$189.2 million, over \$236 million less than the \$425.3 million that originally had been allocated to cover the estimated costs of paying the full actual costs of group homes for the five-year period between 1989/90 and 1993/94. These “leftover” funds were used to provide:

1. A 12% increase to the foster family home basic rates, clothing allowances, and specialized care increments, effective January 1, 1990;
2. Another 5% increase to the foster family home basic rates, clothing allowances, and specialized care increments, effective July 1, 1990;³
3. Funding for the initial development of the Child Welfare Services Case Management System (CWS/CMS);
4. A separate allocation to counties to be used for foster children with specialized care needs; and
5. Additional staff to CDSS for the administration of the foster care program.

What Happened to the Flat Rate System Implementation?

The State had established both a standard rate for each of the 14 Residential Care Levels (RCL) and a rate floor. In FY 1990-1991, each provider submitted data on rate, costs and staffing levels from the prior fiscal year that substantiated the RCL at which their program would enter the flat rate system. Within each RCL, there were providers with rates higher than the standard rate, a few were at the standard rate, most were below the standard rate and some were below the rate floor.

Increases in the CNI Used to Reflect Average Actual Costs

In order to meet the court mandate to pay actual costs, the State had designed the standard rates to reflect average actual costs of providing the level of service defined in each RCL. The State accurately anticipated that the actual costs would rise each year and that actual costs would vary between programs in any RCL, so there would have to be some mechanism to determine the changes in average actual costs.

To avoid an annual study to determine average cost increases, the State decided to use the CNI (on which AFDC increases were based) as an index on which to base group home rate increases. The State would raise the standard rate for each RCL by the increase in the CNI annually for the first three years, as noted above, then group homes would compete with other budget priorities for COLAs in subsequent years.

Getting All Providers to the Standard Rates

The State planned to raise the standard rate for each RCL by the CNI each of the first three years to reflect increases in average actual costs. At the same time, individual group homes were to be raised

³ It is interesting to note that funds, which would otherwise have been paid to group homes, were used to cover the costs of the largest single increase ever granted to the foster family home basic rates in a single 12-month period: a cumulative increase of 17.6%.

to the standard through a phased in process. During the first year of implementation in 1990-1991, each group home with a rate below the floor for its RCL was to be brought up to 85% of the standard, each group home above the floor but lower than the standard would receive COLA increases up to the standard rate, and each one above the standard rate would be frozen until the standard rate caught up. The same was to occur in the next two years with the floors being raised to 92.5% and 100% of the standard respectively.

By FY 1992-1993, the State was to have raised the standard rate for each RCL twice according to change in the CNI to reflect increases in average actual costs and the State was to have raised every program in each RCL to the standard flat rate for its RCL.

The State Reneges and Never Fully Implements the System

In FY 1990-1991, the flat rate system was implemented as planned and nearly all group home programs received a long awaited rate increase. The next year, 1991-1992, the State faced a budget crisis and began to renege on its deal. The State did not raise the floor on all RCLs to 92.5% of the standard as planned, did not increase standard rates as promised although the CNI increased by 5.48%, and did not increase the rates of those programs whose rates lay between the floor and the standard.

The State provided no rate increases of any kind in FY 1992-1993 and 1993-1994. Group home providers were stuck for three years in a partially implemented rate system. In FY 1994-1995, the State finally increased the floor to 100% of the standard, so that after five years, all group home programs were being paid at the standard rate for their RCL. But the standard rates for each RCL no longer reflected anything near the average actual cost of operating the programs. The CNI had risen 13.5% while standard rates had remained static.

Group Homes Receive No Standard Rate Increase Until 1998

It was not until FY 1998-1999 that group homes received the first increase in their standard rates, a 6% raise, but by then the CNI had increased by over 20%. Remarkably, there are still a few group home programs with “grandfathered” rates that exceed the standard rate for their RCL. They have received only one rate increase since 1990 and the standard rate has never caught up.⁴

Realignment

The State’s assumption of responsibility for 95% of the nonfederal share of foster care costs was one of the primary reasons the State elected to take over exclusive responsibility for group home rate setting in the early 1980s, as discussed above. By the early 1990s, a subsequent State fiscal crisis led to a major “realignment” of State-county revenue and costs. The counties now pay 60% of the nonfederal share of foster care costs, leaving the State with only a 40% share. Taking into account the number of Title IV-E eligible children, foster care funding for group home costs is divided approximately as follows: federal share 30%, State share 28%, and county share 42%.

⁴ The budget trailer bill for 1999-2000 allowed programs with “grandfathered” rates to receive the rate increase granted that year: a CNI-based COLA of 2.36% on July 1, 1999, and another 2.36% increase on January 1, 2000.