LAO

The 2023-24 Budget:
Child Care Proposals

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SUMMARY

This brief provides an overview and initial analysis of the Governor's key child care budget proposals for 2023-24, estimates of child care program costs, and the effects of allowing some temporary policies to expire.

Governor's Budget Proposal to Delay Child Care Slot Increase Seems Reasonable. The 2021-22 budget agreement included a plan to add 200,000 child care slots by 2025-26. Since 2021-22, the state has added about 146,000 new slots, which more than doubled the number of subsidized slots in the state. The state partially funded these new slots with one-time federal relief funds. The Governor's budget proposes to delay the planned child care slot increases by one year, resulting in $134 million in General Fund savings in 2023-24. The administration intends to resume adding new slots in 2024-25, reaching the overall 200,000 new slots goal by 2026-27. We find that the Governor's budget proposal is reasonable because (1) the state is facing a projected budget problem, and (2) the majority of funding for new slots has not yet been allocated to child care providers. Overall, we do not expect access to child care to be significantly impacted given the amount of currently unfilled slots.

Seeking Clarification From Department of Social Services (DSS) on Key Questions Regarding Child Care Expenditures. We are still seeking clarification on key questions about child care expenditures, including, but not limited to, (1) how all federal relief funds are allocated, (2) how much federal relief funds would be freed up in the current year due to not all new slots being filled, and (3) whether the administration would fully backfill additional Proposition 64 revenue losses in 2023-24 and future years to keep child care Proposition 64 funding levels flat. Based on the information we receive from DSS, we may identify additional savings or costs in the child care program.

Potential Savings the Legislature Could Immediately Capture in Budget for Other Legislative Priorities. These potential savings include: (1) as much as roughly $800 million savings in 2022-23 resulting from delays in allocating 2021-22 slot increases, (2) $80 million to $100 million in excess funding related to allocating a cost-of-living adjustment to certain child care providers, and (3) several hundreds of millions of dollars in one-time federal relief fund savings across 2022-23 and 2023-24. We are in the process of verifying these potential savings with DSS and will update the Legislature as more information becomes available.

Consider Merits of Maintaining Temporary Changes to Family Fees and Reimbursement Flexibilities. During COVID-19, the federal government allowed the state to waive family fees. Additionally, the state modified reimbursement rules so that (1) child care providers receiving payments through vouchers were funded based on the maximum hours they were certified to care for enrolled children, rather than attendance, and (2) providers that directly contract with the state received 100 percent of their maximum reimbursable contract amount or actual reimbursable program costs, whichever is less. The expiration of the family fee waiver likely will create barriers to care for low-income families who are not able to afford these fees. The Legislature could ask the administration the benefits and trade-offs of different ways to mitigate the access barriers created by family fees. We also find that maintaining some form of reimbursement flexibility for voucher-based providers has merit, but maintaining the flexibility for direct contract providers is not aligned with the goal to maximize children served.

INTRODUCTION

In this brief, we provide an overview of the Governor's budget proposals related to child care programs administered by the DSS. Specifically, we analyze the Governor's proposals to (1) delay planned child care slot increases by one year; (2) continue to use one-time federal relief funds; (3) increase funding levels for certain child care programs based on an 8.13 percent cost-of-living adjustment (COLA); and (4) allow for the expiration of temporary COVID-19 relief activities, including family fee waivers and reimbursement flexibilities.

BACKGROUND

State Subsidizes Child Care, Primarily for Low-Income Families. Most of the state's subsidized child care is administered by DSS through three programs: (1) California Work Opportunity and Responsibility to Kids (CalWORKs) child care, (2) the Alternative Payment (AP) program, and (3) General Child Care (GCC). As **Figure 1** shows, these programs have different eligibility requirements and payment models. CalWORKs child care programs focus on families enrolled in or transitioning out of CalWORKs welfare-to-work activities. The remaining programs are primarily designed for low-income, working families that have not participated in CalWORKs. Families are eligible for subsidized child care if they have a family income of less than 85 percent of the state median income ($82,102 annual income for a family of three and $95,289 annual income for a family of four).

State Funds Child Care Programs in Different Ways. The state funds CalWORKs child care and the AP program through voucher payments. That is, the state provides funds to administering entities—either county welfare departments or AP agencies—which make child care voucher payments to child care providers on behalf of eligible families. In the case of GCC, the state contracts directly with child care providers to serve a specified number of eligible children.

Subsidized Child Care Costs Primarily Split Between Federal Government and the State. The state uses federal Temporary Assistance for Needy Families/Title XX funds to partially cover CalWORKs child care costs. Additionally, the state uses federal Child Care and Development Fund (CCDF) dollars to partially cover AP program and GCC costs. As a condition of receiving CCDF dollars, the state must spend a portion of funds on activities intended to improve the quality of child care and establish a sliding fee scale for families receiving federally funded subsidized child care. The state's share of costs for child care programs are primarily funded with General Fund.

State Also Funds Child Care Using Proposition 64 Revenue. In November 2016, California voters approved Proposition 64, which legalized the nonmedical use of cannabis.

Figure 1

State's Major Child Care Programs

Program	Payment Type	Key Eligibility Requirements
CalWORKs Child Care	Voucher	• Family is low income. • Parent(s) work or are in school. • Child is under age 13. • Slots are available for all eligible children.
Alternative Payment	Voucher	• Family is low income. • Parent(s) work or are in school. • Child is under age 13. • Slots are limited based on annual budget appropriation.
General Child Care	Direct contract	• Family is low income. • Parent(s) work or are in school. • Child is under age 13. • Slots are limited based on annual budget appropriation.

Proposition 64 revenues are allocated based on specific formulas. A portion of Proposition 64 revenues are deposited into the Youth Education, Prevention, Early Intervention and Treatment Account (Youth Account), which funds child care, cannabis surveillance and education, local prevention programs, and youth community access grants. Since 2019-20, the state has provided 75 percent of total Youth Account funds (minus $12 million that is earmarked for cannabis surveillance and education activities) for AP and GCC slots.

California Received Over $5 Billion in Temporary COVID-19 Federal Relief Funds for Child Care. During COVID-19, the federal government enacted three relief packages. Across these relief packages, the state received over $5 billion in one-time federal funds to support child care programs. The state must expend $3.7 billion by September 2023 and most of the remaining $1.4 billion by September 2024. The state has used these federal funds on various child care program activities. Most notably, the state used these funds to temporarily support provider rate increases and additional child care slots (discussed more in the next section). The state also used the funds for a variety of other one-time or temporary purposes, including temporary stipends and supplemental rate increases.

State Temporarily Modified Two Key Policies. These actions were first implemented in 2020-21 and are set to expire at the end of 2022-23. First, the state temporarily waived the requirement that certain families pay a fee to receive subsidized child care. (The federal government granted states temporary authority to waive these fees during the pandemic.) Second, the state modified its reimbursement policies to minimize the effects of pandemic-related attendance declines on child care programs (referred to as reimbursement flexibilities). Voucher-based providers were funded based on the maximum hours they were certified to care for enrolled children, rather than attendance. Direct contract providers were funded based on 100 percent of their maximum reimbursable contract amount or actual reimbursable program costs, whichever is less. (Typically, direct contract provider reimbursement is also generally based on the attendance of eligible children.)

RECENT CHANGES TO CHILD CARE SLOTS AND RATES

2021-22 Budget Agreement Intended to Add 200,000 Child Care Slots by 2025-26. Since 2021-22, the state has added about 146,000 new slots (from about 108,000 to about 254,000). These child care slots were split between the voucher-based program (about 96,000) and the direct contract programs (about 50,000). In the voucher-based child care program, contracts with AP agencies are proportionally increased to reflect the additional funding for the new slots. In the case of GCC providers, DSS awards funding for new slots through a request for application (RFA) process. In the first year of funding, the state provided partial year funding to reflect the time necessary for DSS to provide the funds to AP agencies and GCC providers. For voucher slots, the state provided nine months of funding, assuming slots would be issued beginning in October. Given the RFA process for direct contract providers takes more time to administer, GCC slots were funded assuming contractors would not begin serving additional children until the last two or three months of the fiscal year.

State Increased Child Care Provider Rates in Recent Years. Historically, the state has used two different provider rates: the Regional Market Rate (RMR) and the Standard Reimbursement Rate (SRR). The RMR varies based on the county in which the child is served and is based on regional market surveys of a sample of licensed child care providers. The SRR is the same rate for providers across the state. Historically, the voucher-based child care programs received the RMR while direct contract child care providers received the SRR. In 2021-22, the state increased rates for voucher-based providers to the 75^{th} percentile of the 2018 market survey.

(The state was previously using the 75th percentile of the 2016 survey.) In addition, the state shifted direct contract providers to the RMR to the extent the RMR was higher than the SRR. Currently, the state still provides a statutorily required annual COLA—the same rate provided to K-12 education programs—to the SRR. The 2022-23 budget included a 6.56 percent COLA to the SRR. The state typically has not provided annual rate COLAs to providers whose rates are based on the RMR. These providers typically only receive rate increases when the state takes action to increase the RMR (usually by using a higher percentile of the RMR or updating to a more recent survey).

State Also Increased Total Funding Levels for Voucher-Based Providers in 2022-23 Budget. While the state typically does not apply the annual SRR COLA to providers whose rates are based on the RMR, the state's longstanding budgeting practice is to apply the same COLA as an increase in total program funding to AP agencies. This effectively operates as a slot increase. The 2022-23 budget followed this longstanding practice by increasing total program funding by 6.56 percent (same value as the SRR rate COLA) for AP agencies.

2022-23 Budget Included Backfill for Potential Decline in Proposition 64 Revenue. As part of the 2022-23 budget package, the state eliminated the cannabis cultivation tax, which provided roughly one-fifth of Proposition 64 tax revenue. Recognizing the resulting fiscal risk, the budget package also established a target funding level for programs that receive Proposition 64 revenues (the "2020-21 baseline") and included provisions intended to keep funding from falling below that target. For example, the budget package included $150 million one-time General Fund that the State Controller's Office (SCO) could transfer to Proposition 64 programs in 2023-24 and 2024-25.

GOVERNOR'S BUDGET PROPOSAL

Budget Provides $6.6 Billion for Child Care Programs in 2023-24. As Figure 2 shows, the Governor's budget includes $6.6 billion for subsidized child care programs, a decrease of $802 million (or 10.9 percent) compared to the previous year. The change consists of $500 million in increases, offset by the expiration of $1.3 billion in temporary spending.

Annualizes Costs for 2022-23 Slots and Delays Planned 2023-24 Slot Increase. The Governor's budget includes an additional $149 million in 2023-24 to capture the annualized costs of new slots added in 2022-23. Additionally, the Governor's budget proposes to delay the planned increases in child care slots by one year—meaning no new slots would be added in 2023-24, resulting in $134 million in General Fund savings in 2023-24. The administration intends to resume adding new slots in 2024-25, reaching the overall 200,000 new slots goal by 2026-27.

Continues to Use One-Time COVID-19 Federal Relief Funds to Cover Costs for Rate and Slot Increases. The Governor's budget allocates $1.5 billion one-time federal funds in 2022-23 and $930 million in 2023-24 to cover costs associated with rate and slot increases. The administration has indicated that slot and rate costs previously covered with federal relief funds will shift to the General Fund as one-time federal funding is exhausted.

Provides $303 Million General Fund to Apply an 8.13 Percent COLA to Certain Child Care Programs. Figure 3 lists the various child care programs and activities that are currently budgeted to receive a COLA and the associated costs. In general, the cost of the COLA reflects 8.13 percent of total 2022-23 costs for GCC, AP, and other child care programs activities. The effect of the COLA-related augmentation, however, varies by program. For GCC and other direct contract programs, funding will be used to provide rate increases to those providers that receive the SRR. (Providers receiving the RMR would not receive a rate increase.) For the AP program, the COLA will be applied as an increase in total program funding, which effectively operates as a slot increase.

Figure 2

Child Care Budget

As Reflected in *2023-24 Governor's Budget* (In Millions)

	2021-22 Revised[a]	2022-23 Revised[b]	2023-24 Proposed[b]	Change From 2022-23	
				Amount	Percent
Expenditures					
CalWORKs Child Care					
Stage 1	$381	$518	$524	$6	1.2%
Stage 2[c]	290	314	364	50	16.1
Stage 3	643	636	606	-30	-4.7
Subtotals	($1,314)	($1,467)	($1,494)	($27)	(1.8%)
Non-CalWORKs Child Care					
Alternative Payment Program	$1,252	$1,866	$2,101	$234	12.5%
General Child Care[d]	750	1,750	1,960	210	12.0
Bridge program for foster children	54	97	115	18	18.7
Migrant Child Care	65	69	75	6	8.1
Care for Children With Severe Disabilities	2	2	3	—	8.1
Subtotals	($2,123)	($3,784)	($4,252)	($468)	(59.4%)
Support Programs	$1,443	$2,139[e]	$842	-$1,297	-60.6%
Totals	**$4,881**	**$7,390**	**$6,588**	**-$802**	**-10.9%**
Funding					
Proposition 98 General Fund[f]	$2	$2	$2	—[g]	8.1%
Non-Proposition 98 General Fund	1,671	2,835	2,729	-$106	-3.7
Proposition 64 Special Fund	295	292	292	—	—
Federal	2,914	4,261	3,564	-697	-16.3

a Reflects administration's revised estimates for CalWORKs Child Care and budget appropriation for all other programs.
b Reflects *2023-24 Governor's Budget* estimates.
c Does not include $11.1 million provided to community colleges for certain child care services.
d Includes family child care home education networks.
e Includes cost estimates for child care infrastructure; Child and Adult Care Food Program; and AB 131, AB 185, SB 116 supplemental rates.
f Reflects Proposition 98 funds for Child and Adult Care Food Program.
g Less than $500,000.

Figure 3

2023-24 COLA[a] Costs for Certain Child Care Programs

As Reflected in *2023-24 Governor's Budget* (In Millions)

Programs and Activities	COLA Costs
Alternative Payment	$151.7
General Child Care[b]	142.3
Migrant Child Care	5.6
Resource and Referral	1.8
Child and Adult Care Food Program	1.5
Care for Children With Severe Disabilities	0.2
Local Planning Councils	—
Total	**$303.2**

a Reflects 8.13 percent cost-of-living adjustment (COLA) estimate.
b Includes family child care home education networks.

(This has been the state's longstanding practice for the AP program.) The estimate of the COLA will be finalized as part of the May Revision.

Assumes Proposition 64 Funding for Child Care Will Remain Flat. The Governor's budget assumes that SCO transfers $95.7 million of the $150 million included in the 2022-23 budget to prevent reductions to Proposition 64 programs in 2023-24. As a result, the Governor's budget assumes Proposition 64 funding levels for child care will remain flat in 2023-24. The administration has indicated it intends to allocate a fixed amount of Youth Account funding to child care moving forward, regardless of changes in Proposition 64 revenue.

Allows Expiration of One-Time COVID-19 Relief Activities, Including Family Fee Waiver and Reimbursement Flexibilities. As shown in Figure 4, several COVID-19 relief activities that were funded with one-time federal relief funds in 2022-23 are set to expire June 30, 2023. This includes funding for family fee waivers and reimbursement flexibilities. We understand that the expiration of the state's family fee waiver aligns with when the federal government will no longer waive the CCDF family fee schedule requirement. (Prior to the pandemic, families with income greater than 40 percent of the state median income paid family fees.)

Figure 4

Key COVID-19 Relief Activities Set to Expire on June 30, 2023

(In Millions)

Policy	2022-23 Costs
Child care relief stipends	$320
Supplemental rates	184
Family fee waivers	136
Reimbursement flexibility for voucher-based providers	108[a]
Resource and Referral Capacity Support	5[b]
Licensing incentive	2
Total	**$755**

[a] Reflects costs to pay voucher-based program providers based on the maximum certified hours of care for the child and costs for the COVID-19 non-operational days policy.

[b] Reflects net amount of COVID-19 federal relief funds that will not be backfilled with General Fund in 2023-24 and ongoing.

LAO COMMENTS

In this section, we provide our key findings from our analysis of the Governor's budget proposals. We find the Governor's proposal to delay child care slot increases seems reasonable given the projected budget problem and delays in allocating new slot funding. Additionally, we identify various ways the Legislature could provide a COLA to child care providers. With regard to possible cost pressures, we find that the high risk of Proposition 64 revenues coming in lower than the Governor's budget assumption may result in an additional General Fund cost. We also explore what impact the expiration of family fee waiver and reimbursement flexibilities could have on access to child care.

Overall, we identify the following potential savings the Legislature could immediately capture in the budget and redirect to other legislative priorities: (1) as much as roughly $800 million savings in 2022-23 resulting from delayed allocation of annualized funds associated with 2021-22 slot increases, (2) $80 million to $100 million in excess COLA funding, and (3) several hundreds of millions of dollars in federal relief fund savings across 2022-23 and 2023-24. We are in the process of verifying these potential savings with DSS and will update the Legislature as more information becomes available.

Delay in Child Care Slot Increase Seems Reasonable Given Projected Budget Problem. As we noted in a previous brief, the Governor's budget addresses an $18 billion budget problem through spending-related budget solutions, including reductions, delays, and trigger restorations. The Governor's proposal to delay the slot expansion plan by not adding additional child care slots in 2023-24 would save $134 million General Fund. The proposed delay in the slot expansion plan seems reasonable given state's budget problem.

Delay in Take-Up of New Slots Not Surprising Given Magnitude of Recent Increases. The increases enacted over the past two years more than doubled the number of slots available in the AP program (from about 66,700 to about 161,300) and GCC (from about 28,400 to about 78,500). It was expected these slots would not be immediately filled given the amount of time needed by DSS to allocate funds to providers. Specifically, the past two budgets assumed DSS would require at least three months to modify AP agency contracts to reflect new slot funding. Additionally, the past budgets assumed DSS would not begin to award new slot funding to GCC providers until the last two or three months of each fiscal year. Moreover, we have heard from providers that even after they receive new slot funding from DSS, it takes time to advertise the additional slots, complete the required paperwork, and for families to select a child care provider. Based on our conversations with child care providers, filling new slots also has been challenging because providers are still building up program capacity to pre-pandemic levels and dealing with workforce shortages. Overall, we do not expect access to child care to be significantly impacted by the delay in the overall slot expansion plan given that providers likely will be able to serve additional families in 2023-24 with current unfilled slots.

Delay Also Reasonable Given Majority of Direct Contract Funding Has Not Been Allocated to Fill New Slots. As previously mentioned, the state provided funding to add about 50,000 new slots in GCC across 2021-22 and 2022-23. We understand that the majority of this funding has not been allocated to providers to serve additional children. This, in part, is due to contracting delays associated with funding awarded to GCC providers in spring of 2022. Additionally, DSS plans to award the majority of new slot funding through the 2022-23 RFA process, meaning the earliest these funds would be available to GCC providers is April 2023. We describe each of these two reasons in more detail below.

- ***DSS Still in the Process of Finalizing Contracts for About 8,800 New Slots.*** As a part of the 2021-22 RFA process, DSS awarded $257 million ongoing annual slot funding to 114 GCC providers in the spring of 2022. With this funding, GCC providers could begin filling about 8,800 slots (or roughly 20 percent of total new slots). We understand that DSS is still in the process of finalizing contracts with many of these GCC providers. As a result, many GCC providers have not been able to draw down all of the funding needed to begin to fill the new slots. We are working with DSS to identify the exact number of contracts still pending and how long it will take to finalize these contracts.
- ***DSS Has Not Yet Awarded Funding for Remaining 41,200 New Slots.*** DSS plans to award $800 million as a part of the 2022-23 RFA process. The earliest these funds would be available to GCC providers would be April 2023. However, given current contracting delays, it likely would take an additional few months for GCC providers to actually be able to draw down the funding. Moreover, we are clarifying with DSS if the annualized amount of funding associated with the 2022-23 slot increases ($90 million) will be fully or partially awarded in April 2023.

Expected One-Time Savings Due to GCC Providers Not Spending Full Amount of New Slot Funding. Given the delay in finalizing GCC contracts, it is likely that the $257 million awarded in 2021-22 will not be fully spent in 2022-23 (and possibly 2023-24). Similarly, GCC providers will not be able to fully expend $800 million in 2022-23 and likely 2023-24 since these funds will not be available until April 2023 or possibly a few months later depending on contracting delays. Overall, there may be as much as roughly $800 million in one-time budget savings in the current year, with some additional savings in 2023-24 likely. We will continue to refine our estimate of one-time savings as we receive more information from DSS.

Expected Growth in General Fund Backfill for Ongoing Rate and Slot Increases After 2023-24. One-time federal funds used to cover costs associated with rate increases are set to expire September 2023, while federal funds used to cover costs associated with slot increases are set to expire September 2024. As these one-time federal funds expire, the administration intends to use General Fund to backfill for these costs, resulting in higher General fund costs in 2024-25. We continue to work with DSS to understand the amount and fund source of backfill dollars included in 2023-24 and how these levels increase in future years as the remaining one-time federal funds expire in September 2024. The additional costs are likely to be several hundreds of millions of dollars in 2024-25.

Seeking Clarification From DSS on Key Questions Regarding Child Care Expenditures. We are still seeking clarification on key questions about child care expenditures. Some of these questions may identify General Fund and federal relief funds that could be freed-up in 2022-23 and 2023-24 and redirected to other legislative priorities. These questions include:

- ***How Does the Governor's Budget Allocate Over $5 Billion in Federal Relief Funds?*** Based on our analysis of DSS budget documents, we do not know how the administration plans to use $232 million of the over $5 billion in federal relief funds. We are working with the administration to confirm that our estimate is correct and, if so, when and how the $232 million federal funds will be used. Additionally, we estimate that the administration has shifted hundreds of millions of federal relief funds initially allocated in 2021-22 to 2022-23. We believe this is likely due to actual costs for certain child care program changes, such as slot increases, coming in lower than expected. We are working with DSS to identify what program costs came in lower and how DSS redirected the freed-up federal funds.
- ***What Amount of Additional Federal Funds Likely Will Be Freed-Up Due to Expected Current-Year Savings?*** Historically, child care program cost estimates are not based on the actual number of slots that likely will be filled in a given fiscal year. Instead, the Governor's budget fully funds each slot under the assumption that all slots will be filled immediately following the release of funds by DSS to providers. This means that the 2023-24 funding levels technically reflect costs of all 146,500 new slots being filled by July 1, 2023. However, the administration acknowledges that all 146,500 new slots will not be fully filled by the end of 2022-23 and providers will continue to work on filling all new slots throughout 2023-24. As a result, actual costs associated with slot increase likely will come in lower than the Governor's budget cost estimates. If cost estimates for slot increases were rightsized to reflect a more reasonable ramp-up assumption, then hundreds of millions of one-time federal funds and General Fund would be freed-up in 2022-23 and 2023-24. We will continue to refine our estimate of potential savings as we receive more information from DSS.
- ***What Fund Source Will Be Used to Backfill Federal Relief Funds Set to Expire in September 2023?*** We calculate that under the Governor's budget, General Fund costs associated with rate and slot increases remain flat between 2022-23 and 2023-24. This suggests that the administration is using another fund source to backfill federal relief funds set to expire in 2023-24. The alternative fund sources could be ongoing CCDF or other federal relief funds that are set to expire September 2024. To the extent other one-time federal relief funds are being used as a backfill, these funds would need to be swapped out with ongoing General Fund in 2024-25. This would increase future General Fund costs by several hundreds of millions of dollars, which the administration says is included in their multiyear budget. We are working with the administration to better understand their out-year backfill projections.

Governor's Budget Overestimates 2023-24 COLA Costs for GCC. The Governor's budget calculates COLA costs by applying the 8.13 percent to the total costs of each child care program. In theory, this amount of funding reflects the costs associated with providing an across-the-board funding increase to all child care providers by 8.13 percent. Under current law, however, only GCC providers receiving the SRR receive an increase to their rates based on COLA. We estimate the COLA-related costs for SRR providers are $80 million to $100 million lower than budgeted by the administration. (The final estimate of the COLA will be available in the May Revision, which will impact our potential savings estimate.)

COLA for AP Agencies Would Result in Additional Slots, Running at Odds With Proposal to Delay Scheduled Slot Increases. The Governor's proposal to increase the AP program based on COLA and effectively provide additional AP slots is consistent with the state's longstanding budgeting practice for the program. However, the Legislature may want to consider taking a different approach in the budget year considering the significant number of additional slots added in recent years and the existing barriers to get slots used in the current year.

Legislature Has Various Options for Distributing COLA-Related Funding. The Legislature could choose to apply the COLA-related funds as proposed under the Governor's budget (and score the identified General Fund savings). This approach would increase the number of voucher-based slots and would help GCC providers funded on the SRR to address inflationary pressure. One drawback to this approach is that GCC providers on the RMR would not receive any additional funding to help address inflationary pressures. Below, we outline different ways the Legislature could distribute the COLA-related funding. While some options would maximize the number of child care providers receiving some form of a funding increase, they would require forgoing the $80 million to $100 million in possible General Fund savings.

- ***Provide an Across-the-Board Rate Increase to All Child Care Providers.*** The Legislature could use all COLA-related funds to provide a rate increase to all child care providers, regardless of program and reimbursement rate type. The state would need to direct the COLA-related funding for AP agencies to be used for rate increases rather than additional slots.
- ***Reduce the Gap Between the RMR and SRR.*** Currently, GCC providers can receive either the RMR or SRR, whichever is higher. Consistent with current law, the Governor's budget would only provide a rate increase to GCC providers receiving the SRR, resulting in a larger gap between the RMR and SRR among GCC providers. The Legislature could address this gap by only providing a rate increase to providers receiving the RMR and keeping SRR levels flat. (This approach would require statutory changes.)
- ***Redirect COLA-Related Funds for Another Child Care Program Purpose.*** Rather than use COLA-related funds to provide rate and slot increases to certain child care programs and activities, the Legislature could redirect the $303 million General Fund for other legislative priorities. For example, the funds could be used to backfill any additional Proposition 64 revenue losses included in the May Revision.
- ***Forgo the COLA and Score General Fund Savings in Light of Broader Budget Problem.*** To the extent the projected budget problem is worse in the May Revision, the Legislature could forgo using the $303 million in COLA-related funds to reduce total program expenditures.

High Risk of 2023-24 Proposition 64 Revenues Coming in Lower Than Governor's Budget Assumption. As previously mentioned, the Governor's budget assumes that SCO transfers $95.7 million from the General Fund to Proposition 64 programs in 2023-24 and maintains Proposition 64 funding levels for child care flat in 2023-24. Based on recent declines in Proposition 64 revenue, we think there is a high risk that revenue levels will come in lower than the Governor's budget assumption. (We will update our Proposition 64 revenue assessment in late February.) As a result, the $95.7 million assumed in the Governor's budget might not be enough to maintain overall 2023-24 Proposition 64 funding levels. The Legislature may want to ask the administration if SCO will transfer a greater amount of the available $150 million General Fund in 2023-24 if Proposition 64 revenue is lower than the Governor's budget estimate. To the extent that the Proposition 64 revenue shortfall exceeds $150 million, the Legislature would need to consider whether to appropriate additional General Fund to backfill funding to child care and other Proposition 64 funded programs.

More Details Needed on Administration's Plan for Using Proposition 64 Funding for Child Care in Out-Years. Based on our conversations with the administration, the intent is to maintain Proposition 64 funding levels for child care at target baseline levels on an ongoing basis, irrespective of Proposition 64 revenue. (We are still confirming with the administration on the exact amount of the target baseline level for child care.) However, it is unclear to us how this can be guaranteed since the current General Fund backfill is temporary. To the extent that a backfill is not provided in future years where Proposition 64 revenues are low, this would result in a reduction to child care slots. The Legislature will want to ask the administration how it intends to ensure that Proposition 64 funding levels remain flat in child care in cases where Proposition 64 revenues decrease after 2024-25. For example, would the administration propose an additional General Fund backfill or reduce the Proposition 64 funding allocation to other Youth Account programs? Additionally, based on our conversations with the administration, there may be as much as $185 million in carryover Proposition 64 funds that were allocated to child care in prior years. The Legislature could ask the administration for greater information on how it plans to spend Proposition 64 funds moving forward, and for greater detail on the total amount of carryover funds and use of these carryover funds in the budget year and beyond.

Explore Ways to Mitigate Access Barriers Resulting From Family Fees. The specific fees families pay vary by family size and family income. For example, a family of four with annual income of $48,000 would pay $104 a month for full-time child care (or $52 a month for part-time child care), while a similarly sized family with annual income of $60,000 would pay $356 a month for full-time child care (or $178 for part-time child care). The expiration of the family fee waiver likely will create barriers to care for low-income families who are not able to afford family fees. (Families that began receiving subsidized child care during the pandemic may not be aware that the state has typically assessed fees.) The Legislature may want to ask the administration to report on how big of a barrier they expect the expiration of the family fee waiver will have on families seeking child care. Additionally, the Legislature could ask the administration the benefits and trade-offs of different ways to mitigate the access barriers created by family fees. For example, the Legislature could explore other options that reduce the negative effects of family fees, such as modifying the family fee schedule so that fewer families have to pay a fee and/or capping fees at a more affordable level (similar to legislation that was vetoed by the Governor in September 2022). In exploring options, the state will want to work with the federal government to ensure the state remains in compliance with CCDF rules.

While Maintaining Some Form of Reimbursement Flexibility for Voucher-Based Program Has Merit... The reimbursement flexibility enacted during COVID allowed voucher-based providers to receive more predictable child care payments. Prior to COVID-19, voucher-based child care payments would be based on the actual hours of care provided to a child. Providers that served families who did not always use all of the care they were authorized would experience fluctuations in their payments. We have heard from stakeholders that the general unpredictability of how many hours of care a family would ultimately use in any given month may deter some child care providers from enrolling families that receive vouchers. Maintaining the temporary reimbursement flexibility enacted during COVID-19 may improve the chances of providers enrolling subsidized families. Alternatively, the Legislature could explore other ways to improve the predictability of voucher-based payments.

...Existing Reimbursement Flexibility for Direct Contract Providers Does Not Align With Goal to Maximize Children Served. However, we do not see as strong of a rationale for continuing the existing reimbursement flexibility for direct contract providers. Although continuing the policy would provide more fiscal stability for child care providers as they are trying to fill all their slots, it would not address the root causes of why providers are struggling with filling slots (such as workforce shortages or parents electing to enroll their child in transitional kindergarten). Additionally, the policy does not incentivize providers to fill child care slots and disconnects program funding from the number of children served. The Legislature may want to ask the administration if there are other ways the state could help providers maximize the amount of funding they receive (ideally by providing child care to as many children as possible) while also maintaining the right program incentives.

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This report was prepared by Jackie Barocio, and reviewed by Edgar Cabral and Anthony Simbol. The Legislative Analyst's Office (LAO) is a nonpartisan office that provides fiscal and policy information and advice to the Legislature.

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