LAO POLICY BRIEF

The 2011-12 Budget:

Child Care and Development

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Summary

Governor Proposes Significant Reductions to Child Care and Development (CCD) Programs. The Governor proposes a total of $2.2 billion for CCD programs in 2011-12—a reduction of $535 million, or 19 percent, compared to the current year. To achieve these savings, he proposes several significant changes to current policies, including reducing child care subsidies by35 percent, lowering maximum family income eligibility from 75 percent to 60 percent of the state median income (SMI), and eliminating subsidized child care for 11- and 12-year olds. Offsetting these proposed savings is the Governor's plan to partially restore the vetoed California Work Opportunity and Responsibility to Kids (CalWORKs) Stage 3 child care program, beginning April 1, 2011.

Use Three Guiding Principles to Assess Governor's Proposals. To help assess the Governor's overall approach to making CCD reductions as well as his individual CCD proposals, we recommend the Legislature use three guiding principles: (1) balance access to and quality of care, (2) prioritize services for those who most need them, and (3) prioritize direct service over administrative activities. Consistent with these principles, we recommend the Legislature reject the Governor's proposal to cut state subsidies by 35 percent, reconsider the Governor's proposal to restore CalWORKs Stage 3 child care, and approve—perhaps in modified form—his proposals to change eligibility criteria and reduce administrative and support activities.

Recommend Building CCD Package Based on Guiding Principles, Legislative Priorities. In building its own CCD package consistent with these principles and its own priorities, we offer the Legislature a menu of CCD savings options, including modifying the Governor's age limit proposal to apply to all school-age children (and prioritizing these children for before and after school services); modifying the Governor's income eligibility proposal to a higher or lower threshold; reducing reimbursement rates for licensed and/or license-exempt providers; increasing parent fees; and reducing funding for child care contract administration. After discussing each of these options, we provide three illustrative CCD packages. Recognizing that the Legislature, depending on its priorities, could cut child care by a lesser or greater amount than that suggested by the Governor—one package has a lower savings target than the Governor, one matches the Governor's proposed savings level, and one has a higher savings target.

INTRODUCTION

The Governor proposes substantial reductions to the amount of funding provided for CCD programs in 2011-12, along with several significant changes to current policies. In this brief, we provide an overview and assessment of the Governor's CCD budget proposals. Specifically, we describe the Governor's major proposals, analyze their potential effects on families and child care providers, and make recommendations as to which proposals the Legislature should consider adopting. Given the difficult trade-offs before the Legislature, we believe articulating a set of priorities can help guide decision making. As such, we suggest three guiding principles to help focus the Legislature's evaluation of the Governor's proposals and overall approach to making CCD reductions. Finally, we offer an expanded menu of options for generating savings from CCD programs so the Legislature can develop its own CCD budget depending upon its priorities and the magnitude of reductions that are necessary.

BACKGROUND

California currently supports a variety of CCD programs using state and federal funding. Figure 1 provides a description as well as funding and participation levels for each of the state's CCD programs. As described in the figure, California has traditionally guaranteed subsidized child care for families that are currently participating or have participated in the CalWORKs program. In contrast, the state funds a capped number of subsidized child care slots for low-income families that have not participated in CalWORKs. As a result, waiting lists are used to prioritize non-CalWORKs care.

GOVERNOR PROPOSES SIGNIFICANT CCD REDUCTIONS

In this section, we provide a high-level overview of the Governor's CCD budget package. We then describe the Governor's two largest CCD proposals—the significant reduction to state subsidies and the restoration of the vetoed CalWORKs Stage 3 child care program—in more detail before briefly describing his various other CCD proposals. Lastly, we explain the Governor's assumptions regarding how some proposed policy changes to the CalWORKs program would affect caseload in Stage 1 and 2 child care.

Governor Reduces Support for CCD Programs by 19 Percent. Figure 2 (see page 4) displays CCD funding from all sources in recent years, as well as the Governor's CCD budget proposal for 2011-12. The Governor proposes a total of $2.2 billion for CCD programs in 2011-12—a reduction of $535 million, or 19 percent, compared to the current year. As shown in the bottom half of the figure, state funding would decrease $465 million whereas federal funding would decrease $70 million. Two factors primarily explain the change in federal funding: (1) the Governor proposes to increase Temporary Assistance for Needy Families (TANF) support for Stage 1 child care, and (2) the budget recognizes the expiration of the two-year federal American Recovery and Reinvestment Act (ARRA) grant (which provided $220 million, split evenly among 2009-10 and 2010-11).

Package Includes Several Significant Policy Reductions. Figure 3 (see page 5) provides additional detail on the Governor's specific changes to the CCD budget. As shown, the Governor proposes several policy changes resulting in significant budget reductions. Specifically, the Governor's proposed reductions to state subsidies, income eligibility ceilings, and age eligibility total $750 million in savings ($716 million Proposition 98 and $34 million non-Proposition 98 General Fund).

Figure 1

Overview of State's Child Care and Development Programs[a]

(2010-11)

Program	Funding (In Millions)	Estimated Enrollment	Description[b]
CalWORKs Child Care			Recipients of CalWORKs assistance are eligible for subsidized child care. This care is administered in three stages. All CalWORKs providers are paid through a voucher reimbursement system based on regional market rates (RMR).
Stage 1	$494	51,236	Stage 1 begins when a participant enters the CalWORKs grant program. Stage 1 is overseen by the Department of Social Services.
Stage 2	440	59,980	CalWORKs families are transferred into Stage 2 when the family is deemed to be stable. Participation in Stage 1 and/or Stage 2 is limited to two years after the family stops receiving a CalWORKs grant. (A small portion of these programs are run through the California Community Colleges.)
Stage 3	193[c]	55,145[d]	A family may enter Stage 3 when it has exhausted its limit in Stage 2 (referred to as timing out), and remain as long as they are otherwise eligible for child care. Based on the 2010-11 veto, services discontinued January 1, 2011.
Non-CalWORKs Child Care			Low-income families not receiving CalWORKs assistance also are eligible for subsidized child care, though demand typically exceeds funded slots.
General Child Care (Title 5)	797	86,169	Care provided in a licensed center or family child care home (FCCH). Providers paid through direct contract with California Department of Education (CDE) at standard statewide reimbursement rate.
Alternative Payment	271	38,777	Care provided in licensed center, FCCH, or by license-exempt provider. Providers paid through voucher reimbursement system based on RMR.
Migrant and Severely Handicapped	35	7,561	Programs targeted for specific populations of children.
State Preschool	439	116,847	Early childhood education programs for three- to five-year-old children from low-income families.
Totals	**$2,669**	**415,715**	

[a] Excludes support programs, which do not provide direct child care services.

[b] All child care and development programs are overseen by CDE unless otherwise noted.

[c] Includes $129 million provided in *2010-11 Budget Act* and additional $64 million approved to continue services through December 2010. Does not include additional $53 million set aside by the Governor pending legislation.

[d] Represents estimated enrollment for program operations July through December 2010.

Proposed reforms to the CalWORKs program are projected to yield an additional $34 million in Proposition 98 savings from reduced Stage 2 caseload. The Governor requests that all necessary statutory changes be adopted quickly so that implementation can begin July 1, 2011, and a full-year of savings can be achieved.

Proposed Savings Offset by Augmentations, Also Need to Backfill for Temporary Solutions. Although the Governor's budget would achieve $784 million in policy-related savings and recognize an additional $106 million in technical and caseload savings, the net reduction across all child care programs is only $535 million. This is because the Governor's package contains two notable augmentations: (1) $215 million in additional TANF funds to cover projected increases in Stage 1 caseload and (2) a net increase of $192 million to partially restore funding for the CalWORKs Stage 3 program (both discussed in more detail later in this report). Also, as in other areas of the state budget, the state relied heavily on one-time child care solutions in the current year. To make up for most of the budget hole left by

Figure 2

Child Care and Development Budget Summary

(Dollars in Millions)

	2009-10	2010-11 Revised	2011-12 Proposed	Change From 2010-11 Amount	Change From 2010-11 Percent
Expenditures					
CalWORKs Child Care					
Stage 1	$547	$494	$611	$117	23.7%
Stage 2[a]	485	440	255	-186	-42.2
Stage 3[b]	412	193	200	8	3.9
Subtotals	($1,445)	($1,127)	($1,066)	(-$61)	(-5.4%)
Non-CalWORKs Child Care					
General child care[c]	$797	$797	$480	-$317	-39.8%
Other child care[c]	321	305	173	-132	-43.2
Subtotals	($1,118)	($1,103)	($654)	(-$449)	(-40.7%)
State Preschool[c]	$439	$439	$438	-$1	-0.2%
Support programs	109	100	76	-24	-24.2
Totals	**$3,110**	**$2,768**	**$2,233**	**-$535**	**-19.3%**
Funding					
State General Fund					
Proposition 98	$1,836	$1,262	$1,087	-$175	-13.9%
Non-Proposition 98	29	29	29	—	—
Other state funds[d]	66	290	—	-290	-100.0
Federal funds					
CCDF	541	602	526	-77[e]	-12.7
TANF	528	475	592	117	24.6
ARRA	110	110	—	-110	-100.0

[a] Includes $9 million for Stage 2 program run by the California Community Colleges. Does not reflect any reduction based on the $10.7 million the Governor proposes to sweep in 2010-11.

[b] Does not include $52.6 million the administration has indicated setting aside pending legislation for CalWORKs Stage 3 in 2010-11.

[c] For 2010-11 includes funding from local reserves.

[d] Includes prior-year Proposition 98 carryover and, in 2010-11, $6 million non-Proposition 98 General Fund redirected from the Assembly's budget and $83 million from local reserves.

[e] Year-to-year decrease due mostly to the use of one-time funds in 2010-11.

CCDF = Child Care and Development Fund; TANF = Temporary Assistance for Needy Families; ARRA = American Recovery and Reinvestment Act.

these temporary solutions, the Governor's budget includes a backfill of $363 million in Proposition 98 ongoing funding. (The Governor chooses not to backfill $52 million of the 2010-11 temporary solutions, resulting in a $36 million reduction to General Child Care and Alternative Payment programs—leading to a reduction of approximately 4,600 child care slots—and a $16 million reduction in quality improvement activities.)

Applies Across-the-Board Reduction To State Child Care Subsidies

Proposal Would Dramatically Reduce Amount Provided for Each Child Care Slot, Expect Families to Pay the Difference. The largest component of the Governor's CCD package is a proposal to save $577 million by reducing the amount provided to all CCD contractors, other than state preschool and CalWORKs Stage 1 contractors, by 35 percent. However, the Governor proposes not to allow contractors to absorb this reduction by serving fewer children. As a result, as shown in Figure 4 (see next page), this would decrease the average annual amount provided per child care slot in these programs by $2,604 compared to current-year subsidy levels. (The 4 percent reduction in slots shown in Figure 4 is primarily due to the Governor's policy proposals to change income and age eligibility criteria, as discussed below.) The Governor assumes that families would find a way to pay the difference between the amount their child care providers currently charge and the reduced state subsidy.

Local Agencies Would Have Some New Discretion Over How to Respond. While the administration assumes that the same number of children would continue to be served for the same number of hours, it does propose to grant some local discretion as to how the 35 percent cut is applied across families. Specifically, the proposal grants new authority to local child care contractors—Alternative Payment (AP) agencies and Title 5 centers—to apply a larger or smaller subsidy reduction to families of different income levels, as long as the reduction across all the families they serve totals 35 percent. (The AP agencies typically serve as the intermediary between the California Department of Education (CDE) and local child care providers, passing along state payments to child care providers, but

Figure 3

Major Proposed Changes to Child Care and Development Spending

(In Millions)

	Proposition 98	Federal/Other	Totals
Backfill for one-time 2010-11 actions	$363	-$399[a]	-$36
Sunset of two-year Stage 1 exemption	—	215	215
Restore CalWORKs Stage 3 child care veto	256	-64	192
Reduce state subsidies by 35 percent	-577	—	-577
Reduce income eligibility ceiling to 60 percent of SMI	-79	—	-79
Eliminate eligibility for 11- and 12-year olds	-59	-34	-93
Stage 2 workload adjustment based on CalWORKs policy change	-34	—	-34
Reduce quality improvement activities	—	-16	-16
Technical/caseload[b]	-44	-62	-106
Totals	**-$175**	**-$360**	**-$535**

[a] Includes one-time Proposition 98 funds, federal child care block grant carry over and ARRA monies, and a draw down of local center reserves.
[b] Includes shift of $7.9 million from centralized eligibility lists to child care programs.

SMI = state median income and ARRA = American Recovery and Reinvestment Act.

not typically providing child care services themselves. Title 5 centers have contracts with CDE to serve children directly.) For example, a contractor could reduce a *very* low-income family's subsidy by only 20 percent (decreasing the copay amount the family would have to pay). However, in order to absorb the 35 percent reduction to their overall contract, this would mean the contractor would have to reduce another low-income family's subsidy—and increase their new copayment—by 50 percent. Alternatively, the agency could cut each of their families' subsidies by 35 percent across-the-board without regard to income and expect each family to make up the difference through higher copayments.

Figure 4

Governor's Proposal Would Dramatically Reduce Amount Provided for Each Child Care Slot[a]

				Change From 2010-11	
	2009-10	2010-11	2011-12	Amount	Percent
Total child care funding (in millions)	$2,015	$1,736	$1,109	-$627	-36%
Estimated child care slots	252,422	221,339	211,708	-9,631	-4
Funding per slot (in dollars)	$7,984	$7,841	$5,237	-$2,604	-33

[a] Does not include CalWORKs Stage 1 or State Preschool.

Restores Some Funding for Vetoed CalWORKs Stage 3 Program

As part of the 2010-11 budget package, $256 million in Proposition 98 funds for CalWORKs Stage 3 child care were vetoed, with an expectation that services would end on November 1, 2010. The settlement of a subsequent lawsuit, *Parent Voices Oakland vs. O'Connell,* required that the state extend Stage 3 services until December 31 to allow parents sufficient eligibility screening for other subsidized child care programs. These additional two months were funded with $58 million in one-time federal child care block grant carryover and $6 million General Fund redirected from the Assembly's operating budget. At the time of the Governor's veto, the Stage 3 program served approximately 52,000 children. Based on anecdotal reports, at least one-fifth of these children have found other ways to access the state's subsidized care system—most either by obtaining a slot in a non-CalWORKs program or by counties authorizing an additional 24 months of Stage 2 care through CalWORKs "Diversion" for parents at risk of losing their jobs.

Governor Sets Aside Some One-Time Funding for Current Year, Restores Ongoing Funding for Budget Year. While not formally included in the Governor's budget proposal, the administration indicates it has "set aside" $52.6 million to fund Stage 3 services for the last quarter of the 2010-11 fiscal year (April 1 through June 30, 2011), pending legislation to appropriate the funds. (Technically, the Governor sets aside $52.6 million in Proposition 98 "settle-up" funds, which are funds provided in addition to all other Proposition 98 funds and which count toward unmet prior-year Proposition 98 obligations.) The administration does not set aside any funding for Stage 3 in the third quarter (January through March 31, 2011). For 2011-12, the Governor proposes a total of $200 million in ongoing funds to continue program services in the budget year. However, the administration's funding plan assumes the restored Stage 3 program incorporates its three major budget-year policy proposals (the 35 percent reduction to subsidies as well as lower income and age eligibility thresholds) beginning April 1 of this year.

Other Notable Changes

In addition to the major proposals to slash state subsidies and partially restore CalWORKs Stage 3, the Governor has several other proposals that affect child care funding levels, including two that would change program eligibility criteria and two that would reduce funding for support activities.

Eliminates Subsidized Child Care for 11- and 12-Year Olds. Currently, children who meet other eligibility criteria can participate in the state's subsidized child care system from birth through age 12 (with some extensions for children with special needs). While children used to be able to participate through age 13, the age limit was reduced by one year as part of the 2003-04 budget package. The Governor proposes to drop this age cut-off again, such that children could only receive care through age 10. The Governor estimates this change would terminate child care eligibility for approximately 14,000 11- and 12-year old children, thereby saving $93 million ($59 million Proposition 98 and $34 million non-Proposition 98 General Fund).

Reduces Income Eligibility Ceilings to 60 Percent of SMI. Currently, families eligible for the state's child care programs can earn up to 75 percent of the SMI. The Governor proposes to lower this income eligibility ceiling to 60 percent of the SMI for all state CCD programs except state preschool. For a family of three, this would drop the maximum eligible monthly income from $3,769 to $3,015. (Consistent with current statute and recent practice, the Governor proposes to continue using 2007 SMI data for purposes of determining eligibility ceilings.) After accounting for the age eligibility change, the Governor estimates that changing income thresholds would terminate child care eligibility for approximately 14,000 slots, thereby saving $79 million. (Assuming no change to 11- and 12-year old eligibility, we estimate this proposal would save about $90 million and affect about 16,000 slots.)

Reduces Federally Funded Quality Improvement Programs by $16 Million. As a condition of receiving federal child care block grant funds, the state must spend a certain amount on quality improvement activities. These activities typically include professional development, stipends for child care providers, and activities related to health and safety. In 2010-11, the state spent $88 million in federal funds ($69 million in child care block grant monies and $19 million in ARRA funds) on about 40 different quality improvement programs. Due to the expiration of the ARRA grant, the Governor's 2011-12 budget proposal reduces overall spending on quality improvement activities by $16 million. Under the proposal, 18 quality activities, including the California Preschool Instructional Network, California Early Childhood Mentor Program, and support for young English language learners, would be reduced or eliminated.

Redirects $7.9 Million From Centralized Eligibility Lists (CEL) to Child Care Programs. Since 2005-06, the state has provided a total of $7.9 million annually to the 58 counties to maintain countywide CELs. These CELs serve as master waiting lists for all eligible non-CalWORKs families in the county seeking subsidized child care. The lists rank families by income to help ensure the neediest families get first priority when providers have child care slots available. As of June 2010, there were almost 188,000 children on county CELs waiting for care. The Governor proposes to eliminate funding for the CELs beginning in 2011-12 and to redirect the $7.9 million to child care programs to help offset other proposed reductions. The effect of the proposal would be that eligible families once again have to sign up on multiple waiting lists at multiple child care centers rather than in one centralized place, and providers with available slots would only consider families that had signed up on their individual lists.

Caseload Assumptions

As noted in Figure 3, the Governor makes assumptions regarding how two proposed changes to CalWORKs policies would affect caseloads in child care programs, including a $215 million cost for Stage 1 and $34 million in savings for Stage 2. Additionally, he is proposing to sweep $11 million from the current-year Stage 2 appropriation (not noted in Figure 3).

Assumes Sunset of CalWORKs Work Exemptions Will Increase Stage 1 Caseload Costs. For 2009-10 and 2010-11, budget legislation exempted some CalWORKs recipients with young children from work participation requirements and, therefore, from the need for Stage 1 child care services. Those budgets assumed $377 million in county-level savings resulting from those exemptions, including $215 million in savings from decreases to Stage 1 child care caseload. Because these exemptions are scheduled to expire in 2011-12, the Governor's budget adds back $377 million in TANF funds, including $215 million for Stage 1 child care services. However, the Governor also reflects a new unallocated reduction of the same amount ($377 million) to county CalWORKs block grants, which primarily fund child care and welfare-to-work services, without providing the counties with the exemptions to manage the reduction.

Proposes Repealing Recent CalWORKs Reform That Would Have Increased Stage 2 Caseload by $34 Million. As one of a series of reforms to the CalWORKs program included in the 2009-10 budget package, the Legislature adopted legislation increasing sanctions for CalWORKs recipients who did not meet work participation requirements, beginning in July 2011. The intended effect of the policy was to encourage more CalWORKs recipients to participate in work, education, and training—which would also have the effect of increasing the number of participants needing child care services. The Governor's 2011-12 budget proposal, however, seeks to repeal those statutory sanctions before they take effect, and he correspondingly reduces his "workload" estimate of Stage 2 costs by $34 million.

Sweeps Anticipated Current-Year Savings From Stage 2. Based on the administration's assessment of underlying demographics and caseload trends, the Governor also assumes the CalWORKs Stage 2 program will not need the full *2010-11 Budget Act* appropriation. He proposes to sweep $11 million from the program and use it for other Proposition 98 purposes in the current year.

ASSESS GOVERNOR'S PROPOSALS BASED ON THREE GUIDING PRINCIPLES

Different approaches to reducing CCD spending will have differential effects on families, providers, and the overall CCD system. Some proposals would alter the overall mix of children served in the state's CCD system, some would affect families' ability to access and pay for quality subsidized care, and some would affect providers' capacity to operate. Given the difficult trade-offs before the Legislature, we believe articulating a set of priorities can help guide decision making. As such, we recommend the Legislature adopt guiding principles to help focus its evaluation of the Governor's proposals and overall approach to making CCD reductions. We recommend the three principles specified in Figure 5. First, we suggest the package of reductions strike a balance between providing access to care—serving as many children and families as possible—and ensuring that care is of reasonable quality. Second, if the state must reduce or eliminate services, we recommend preserving care for those who most need it. Finally, while some support and administrative activities are necessary to keep the system running and maintain the quality of its programs, whenever possible we recommend reserving limited dollars for serving children and families directly. In this section of the brief, we evaluate the Governor's CCD proposals based on these three principles.

Reject Governor's Deep Across-the-Board Reduction to Subsidies

We believe this proposal fails to preserve either access to or quality of care and recommend the Legislature reject it. Despite the Governor's assumptions, we believe many low-income families likely will be unable to make up for the drop in the state subsidy and will struggle to find affordable care. We also believe that many providers will be unable to notably lower their rates. As a result, some providers likely would end up closing, with other providers able only to serve families that are financially better off and could afford large copays. Below, we discuss these problems in more detail.

Low-Income Families Likely Would Struggle to Make Up for Drop in State Subsidy. We question the Governor's assumption that families would pay more to make up for the loss of state funds. Currently, families making below 40 percent of SMI (which for a family of three is about $2,010 a month) are not required to pay any fees. About two-thirds of the children served in the state's child care programs are from such families. While the amount the state currently pays for a family's child care services varies by county, age of child, and type of care, in many counties the reimbursement rate for a preschool-age child in full-time center-based care is roughly $650 a month. In this example, the Governor's proposal would reduce the state payment by about $220 a month, meaning families making 40 percent of the SMI would have to dedicate more than 11 percent of their incomes to maintain current child care arrangements. For the over 160,000 families making below 40 percent of the SMI and those that live in high-cost counties where child care is more expensive than in this example, absorbing this drop in state support could be prohibitive. Even if local agencies used the Governor's proposed discretion to assign very low-income families a slightly smaller copayment, we believe the increase in cost still would be unaffordable for most families.

Most Licensed Providers Likely Could Not Afford to Reduce Rates Dramatically. Assuming most families could not afford to assume notably higher payments, their current providers could choose to reduce their rates to make up for some or all of the lost state funding. However, many licensed child care providers would have few options for absorbing a revenue drop of this magnitude. State licensing regulations require that licensed providers maintain specific adult-to-child ratios, which currently limit their ability to reduce staff to save money. For many centers, local collective

Figure 5

LAO Recommended Guiding Principles for Child Care and Development Reductions

- ✓ Balance access and quality.
- ✓ Prioritize services for the neediest families and children.
- ✓ Prioritize direct services for children over administrative and support activities.

bargaining agreements may further limit their ability to accommodate the reduction by lowering salaries. Additionally, state law forbids providers from charging private-pay clients a higher rate than subsidized families, which would prohibit them from recapturing the lost revenue from other families. Moreover, the Governor's proposal would prohibit contractors from reducing the number of subsidized children served or hours of care offered. It is unreasonable to expect providers could maintain the exact same level of care for 35 percent less revenue and continue to stay in business. A more likely scenario is that licensed providers would opt *not* to lower rates so substantially, effectively resulting either in a shift away from subsidized clients to private clients or in closure.

Lower State Subsidy Would Limit the Pool of Providers From Which Families Could Afford to Choose. Currently, the state provides eligible families in the AP program and all three CalWORKs stages with a funding voucher sufficient to cover entirely the rate charged by about 65 percent of the licensed providers in their county. (Title 5 child care centers, which serve families in the General Child Care program, charge one statewide standardized reimbursement rate.) If the family chooses one of the 35 percent of providers that charge above the state reimbursement ceiling, then it must pay the difference. (The state's maximum reimbursement rates were set at the 85^{th} percentile of the regional market rates [RMR] in 2005, meaning they were supposed to be sufficient to provide subsidized clients access to 85 percent of the licensed child care providers in their county in that year. However, since state rates have not been updated in the intervening years and the amounts most providers charge have increased, we estimate the state's rates are now effectively at about the 65^{th} percentile of the RMR.) While the data were not available to compare exactly how the Governor's proposed reduction would lower the state reimbursement rate with respect to RMR data, it clearly would be well below the 50^{th} percentile. That is, fewer than 50 percent of licensed child care providers currently charge at or below the Governor's proposed level for state subsidies. Thus, families seeking *fully* subsidized care likely would face greater competition for licensed slots, countering the Governor's claim that his proposal maintains the same access to care.

License-Exempt Providers Might Have an Easier Time Absorbing the Reduction. The shortage of licensed providers who would be affordable under the proposed drop in subsidies might lead to an increase in the number of families who opt for license-exempt care. License-exempt providers, who currently care for roughly 15 percent of all children in the state's subsidized care system, might be able to absorb the drop in state subsidies more easily than licensed providers. Because these "kith and kin" providers typically care for their own family members in their own homes and do not have the administrative or overhead expenses of running a formal business or meeting licensing requirements, they might continue caring for children even at a lower subsidy rate. However, if the child care payment represents the license-exempt provider's sole income, he or she likely also would struggle with a 35 percent reduction in pay and could opt instead to seek a higher salary in another vocation.

Reduction Likely Would Decrease Both Access to and Quality of Care. While some families and providers might be able to "meet in the middle" and accommodate the reduction through a combination of lower rates and higher copays, the magnitude of the cut still makes this implausible in most cases. If most families cannot afford significant new copays and most providers cannot afford to reduce their rates dramatically, we believe most families would seek to accommodate the cut by looking for less expensive child care, including turning to a license-exempt provider. (Only about half of the children in the state's CCD system—those in the voucher-based CalWORKs stages and AP program—currently have the option of selecting a license-exempt provider.) In such cases, there would likely be a diminution in the quality of care provided.

Proposal Would Apply Reductions Inconsistently Across Programs and State. We have additional concerns with how the Governor's proposal would be implemented, including the inconsistency of not applying the reduction to CalWORKs Stage 1 or state preschool, and the new authority it provides to local agencies—many of which are not public agencies—to allocate the reduction in different ways across the state. In whatever approach it ultimately employs, we recommend the Legislature apply reductions more consistently across programs and regions.

Weigh Restoration of CalWORKs Stage 3 Against Other Priorities

We believe the Governor's proposal to restore CalWORKs Stage 3 child care is problematic, based on both implementation and policy concerns. Regarding implementation, the Governor's proposal leaves a three-month gap in services and assumes rapid approval of his other policy changes. More broadly, given the costs of restoring Stage 3 in both the current and budget years, we believe the Legislature must consider the priority of this program compared to other CCD services. We also think the Legislature should assess whether the Governor's approach meets the guiding principle of focusing on the *neediest* Californians.

Addressing Implementation Problems in Governor's Current-Year Plan Would Generate Additional Costs. The Governor's proposal to delay restoration of the CalWORKs Stage 3 program until April 1, 2011 raises questions as to how affected families will manage child care needs during the three-month gap in services. Additionally, if the Legislature chooses to reject some or all of the Governor's proposed policy changes, or opts for consistent July implementation across all programs instead of adopting them early for Stage 3, the $52.6 million the Governor has set aside for current-year costs will be insufficient. If the Legislature were to restore Stage 3 based instead on current law and provide sufficient funding to cover the January-through-June 2011 period, we estimate it would cost roughly $135 million, or about $85 million more than the Governor has set aside.

Should Former CalWORKs Participants Be Given Priority Over Other Working Poor Families? Although Stage 3 families have expired eligibility for all other CalWORKs benefits, the state has provided sufficient funding to guarantee these families access to subsidized care for children through age 12 for as long as they continue to meet work and income eligibility criteria. Given the costs of restoring Stage 3 in both the current and budget years, we believe the Legislature should reconsider the priority of this program compared to other CCD services. The justification for giving continued priority for child care to former CalWORKs participants over other working poor families, who may have lower incomes, is not particularly strong. While there may be a risk of former CalWORKs recipients going back on CalWORKs aid if they suddenly lose their child care, other working poor families are continually grappling with the same challenges, with the primary difference being they have not received cash assistance in the past. Moreover, we know of no other state that guarantees child care to former welfare recipients for such an extended period of time.

Is Restoring Stage 3 Worth Deeper Cuts Across All Programs? As discussed earlier, the Governor's decision to restore Stage 3 creates cost pressures that contribute to the need for his severe reduction proposals to all CCD programs (other than state preschool) in 2011-12. Were the Legislature not to restore the Stage 3 program, it would avoid costs of at least $52.6 million in the current year and $200 million in the budget year (compared to the Governor's budget) and could more easily preserve slots and funding in other CCD programs. We recognize that such a decision would result in former Stage 3 families continuing to struggle during the transition. Nonetheless, were Stage 3 restored and the Governor's other child care reductions imposed, many Stage 3 families still would lose care, and additional working poor families also would face the elimination of their child care benefits.

Use Guiding Principles to Evaluate Other Proposals

We believe the guiding principles articulated in Figure 5 can also provide guidance in evaluating the Governor's proposals related to eligibility and support programs.

Consider Eliminating Subsidized Care for Some Older Children to Prioritize Slots for Younger Children. Because there are more supervision options available for school-age children, we believe the Governor's proposal to lower the state's age eligibility threshold and prioritize services for younger children merits consideration, perhaps in modified form. California funds an extensive before and after school program in which slots could be prioritized for 11- and 12-year olds (and even younger school-age children) displaced from CCD programs. Specifically, the state annually spends almost $550 million on the After School Safety and Education (ASES) program and an additional $130 million in federal funds for the 21st Century Community Learning Centers. Many schools and communities also run a multitude of other locally based after-hours programs for school-age children. Taking better advantage of existing school-age care programs could allow the state to prioritize limited child care funds for infants and toddlers—for whom care typically is more costly and harder to find. While we know of no other state that sets its age limit for subsidized child care as low as age 10 (our review suggests other states set maximum age at 12 or 13), there are no federal prohibitions against prioritizing services for younger children.

Consider Eliminating Subsidized Care for Higher Income Families to Prioritize Slots for Lower Income Families. Because it prioritizes service for the most needy families, we believe the Governor's proposal to lower the income eligibility ceiling from 75 percent to 60 percent of SMI is reasonable. Moreover, our review of other states' eligibility policies for subsidized child care indicates the Governor's proposed level would be more comparable to policies in other states. Like California, all states set maximum income eligibility thresholds for subsidized child care based on their SMI. Even accounting for the outdated data used in our state's SMI calculation, our review indicates that only 15 other states set maximum income eligibility at or above California's current SMI threshold. In contrast, about half of all states set income ceilings at or below 60 percent of their SMI.

Reconsider Exempting State Preschool From Income Eligibility Change And Instead Prioritize Neediest Families. We question the Governor's policy of exempting state preschool from the proposed change to income eligibility. Besides leaving the income ceiling at 75 percent of SMI for this program, the Governor also does not propose changing current statute that allows these programs to enroll up to 10 percent of their caseload from families that make 15 percent *more* than 75 percent of SMI. In addition to the administrative complication that different eligibility ceilings would create for centers that run blended preschool and General Child Care programs for 3- and 4-year olds, preserving access to subsidized preschool for higher income families while lower income families remain on waiting lists does not prioritize service for the most needy children.

Eliminate Funding for CELs to Prioritize Direct Services. Because it prioritizes direct services for children over administrative activities, we recommend the Legislature adopt the Governor's proposal to redirect $7.9 million from supporting the CELs to child care programs. While the county-based CELs help facilitate and streamline the registration and enrollment process for eligible families waiting for care, in this fiscal climate keeping children off the waiting lists is a more important state-level priority than tracking how many children are on the waiting lists.

Reduce Funding for Specific Quality Improvement Activities to Prioritize Direct Services. The Governor's proposal not to backfill $16 million for quality improvement projects that were funded with ARRA funds also seems reasonable given the notable amount of funding ($69 million) that would remain for these activities under the Governor's budget. Nonetheless, we think the Legislature could improve upon the Governor's proposal by coming up with its own list of quality projects to maintain, reduce, or eliminate. We recommend taking a careful look at which quality initiatives are most effective, of highest priority, and complementary, then developing a package of initiatives strategically designed to work together in a concerted effort to improve the quality of the overall child care system.

Reject Governor's Problematic Caseload Assumptions

Ensure CalWORKs Stage 1 Funding and Policy Align With Counties' CalWORKs Funding and Policy. The Governor's restoration of $215 million to Stage 1 is offset by his commensurate reduction to county welfare-to-work block grant funds. Without an extension of the work participation exemptions—and subsequent drop in Stage 1 caseload—that accompanied these reductions in 2009-10 and 2010-11, counties will struggle to manage the reduction in funding and provide child care services to additional families. If the Legislature chooses to approve the Governor's block grant funding level, we recommend adopting similar work participation exemptions—or some other mechanism to allow counties more flexibility to accommodate the reduction—and to align Stage 1 funding and caseload assumptions with these larger decisions.

Reject Proposal to Sweep $11 Million From Current-Year Stage 2 Appropriation. We recommend the Legislature reject the Governor's proposal to sweep and reallocate $11 million from the current-year CalWORKs Stage 2 program. We believe it is premature to assume savings will materialize in this program, particularly given the current-year veto of the Stage 3 program. Due to unused Stage 2 eligibility and some counties' creative use of the CalWORKs Diversion program, we believe several thousand former Stage 3 children have reentered Stage 2 care, hence increasing current-year Stage 2 caseload.

BUILD CCD PACKAGE BASED ON LEGISLATIVE PRIORITIES

The Legislature has a number of available options for generating savings from CCD programs apart from the Governor's proposals. We recommend designing a package that more closely aligns with the guiding principles we set forth as well as legislative priorities. Moreover, the Legislature does not have to reduce the CCD budget by the exact same amount as the Governor. Depending on its priorities, the Legislature could cut child care by a lesser or greater amount. Additionally, were the Legislature to reject major solutions proposed by the Governor, it would need to consider additional reductions across all areas of the budget.

In this section, we offer various savings options for the Legislature to consider in crafting its CCD budget, including modifying two of the Governor's proposals, as well as additional ideas not included in his budget. (Because of our serious concerns with the Governor's across-the-board subsidy reduction, we do not include that approach among our suggested options.) We also provide illustrations of possible packages the Legislature could develop depending upon the magnitude of desired savings.

Options

Figure 6 provides a summary of options for achieving savings in the CCD budget. Below, we discuss these options in more detail.

Eliminate Care for School-Age Children During Traditional Hours to Achieve Greater Savings While Still Preserving Access to Care. One option the Legislature could consider would be to eliminate subsidized child care during traditional hours (7:00 a.m. to 6:00 p.m.) for school-age children (ages 6 through 12) given many of them could instead be served in school-based programs. If it chooses to pursue this option, we recommend the Legislature make corresponding changes to ASES and 21st Century requirements, including that these programs prioritize enrollment for low-income children and extend days of operation to stay open during summer vacation and extended school breaks. (Because most ASES programs are fully enrolled, under this option some higher income students who currently attend ASES programs would lose their spots.) To make this transition easier, the Legislature could explore offering ASES funding directly to child care centers. Even these changes, however, would not accommodate children whose parents work evenings and weekends when school-based programs are closed. As such, the Legislature could continue providing child care funding for those school-age children who can demonstrate that school-based programs cannot meet their needs, even with our proposed operating extensions. We estimate that up to 40 percent of current school-age caseload relies on services provided during non-traditional hours. Assuming the Legislature stopped providing CCD funds for 60 percent of current school-age caseload (and gave these children priority for ASES), we estimate the state could save approximately $300 million.

Choose a Different Income Eligibility Ceiling. Another option the Legislature has is to set maximum income eligibility at a different cutoff than that proposed by the Governor. For example, if the cutoff were set at 65 percent of SMI, approximately 9,500 instead of 16,000 slots would be lost and about $60 million instead of $90 million would be generated in savings. We estimate about 30 states set their cut offs at or below 65 percent of

SMI. By comparison, setting the maximum income even lower, at 50 percent of SMI, would eliminate 40,000 slots and save a total of $250 million. Our review suggests about seven states set eligibility ceilings at or below 50 percent of their SMI.

Apply Lower Income Ceilings to State Preschool. The Legislature also could choose to apply a more consistent approach and maintain the same income eligibility criteria across all CCD programs, including state preschool. Because a much higher proportion of children from families making above 60 percent of SMI are enrolled in the state preschool program (including some whose incomes exceed 75 percent of SMI), we estimate applying this change to all CCD programs would generate significantly more savings than the Governor's proposal—$150 million rather than $90 million. We estimate this change would

Figure 6

Options for Generating Savings in Child Care Budget

Age Limits

Current law: A child is eligible to receive state subsidized child care through age 12 (with some exceptions for children with special needs).

Governor's proposal: Eliminates services for children ages 11 and 12. (Savings: $93 million.)

Option: Could further reduce the maximum age at which a child is eligible to receive subsidized child care. (Savings: Between $70 million-$100 million for each additional year of denied eligibility.)

Alternative option: Could provide subsidized care for school-age children ages 6-12 only during non-traditional hours, while prioritizing spots in school-based programs for displaced children. (Savings: Approximately $300 million.)

Income Ceilings

Current law: Families are eligible for subsidized child care if income is less than 75 percent of state median income (SMI). Up to 10 percent of children served in state preschool program can come from families that make slightly more than this level.

Governor's proposal: Limits eligibility to families making less than 60 percent of SMI, with the exception of preschool. (Savings: $90 million.)

Option: Could further reduce the maximum allowable income level for families eligible for subsidized child care. (Savings: $250 million if reduce to 50 percent of SMI.)

Additional option: Could also apply to preschool eligibility. (Savings: $150 million at 60 percent of SMI, $370 million at 50 percent of SMI.)

Maximum Provider Reimbursement Rates

Current law: The maximum state reimbursement rate for licensed providers is set at the 85th percentile of regional market rates (RMR) based on 2005 data. License-exempt providers get 80 percent of licensed rate.

Governor's proposal: No explicit proposal to change maximum RMR levels, however 35 percent subsidy reduction would equate to defacto lowering of state's reimbursement.

Option: Could reduce the maximum reimbursement rate for licensed and/or license-exempt providers. Could base rates on updated 2009 data, as 2005 data no longer reflect current market rates. (Savings: Approximately $20 million if reduce licensed rate to 75th percentile of 2005 RMR. $40 million for each 10 percent reduction compared to licensed rate. Additional savings if adopt both proposals.)

Parent Fees

Current law: Families must pay a child care fee if their income is at or above 40 percent of SMI. Family fees range from $2 to $19 per day and are capped at 10 percent of total family income. These fees partially offset state reimbursement.

Governor's proposal: No explicit changes to family fee schedule; however, would have families pay providers directly to make up for 35 percent reduction in state subsidies. Would provide local agencies some discretion over how to change.

Option: Could reduce income level at which parents must begin to pay fee and/or increase amount of fee required for families at each existing income level. (Savings: Up to $30 million depending on how fee schedule changed.)

Funding for Administration

Current law: State provides Alternative Payment (AP) agencies with an administrative allotment equal to 17.5 percent of original contract amount.

Governor's proposal: None.

Option: Could reduce amount state provides to AP agencies for administration and support. (Savings: $15 million if reduce to 15 percent, $50 million if reduce to 10 percent.)

eliminate eligibility for approximately 15,000 children currently being served in state preschool. (We estimate dropping the income ceiling to 50 percent of SMI and including preschool could save a total $370 million, eliminating eligibility for almost 30,000 current preschoolers.) To avoid such massive reductions to the state's preschool efforts and to expand access for lower income children, the Legislature could choose to redirect a portion of these savings to serve more of the neediest children currently waiting for preschool slots.

Reduce Payment Rates for Licensed Providers. The Legislature could achieve savings and preserve child care slots by reducing current reimbursement rate ceilings. For example, we estimate the state could save about $20 million by dropping maximum rates from the 85^{th} percentile to the 75^{th} percentile of the 2005 RMR. (To be honest and transparent about what access current rates really provide to subsidized clients, however, we recommend the Legislature tie rate changes to updated 2009 survey data, which for this example would equate to about the 55^{th} percentile of RMR.) A reduction in the amount the state pays would undoubtedly be difficult for some child care providers to absorb and could force some families unable to afford higher copayments to seek less expensive care. We estimate that even with this change, California would still provide greater access to respective regional child care markets than about two-fifths of all states. (While non-binding federal guidance recommends that states set maximum rates at the 75^{th} percentile of RMR based on current data, only six states met this target in 2010.)

Reduce Payment Rates for License-Exempt Providers. Instead of or in addition to reconsidering reimbursement rates for licensed providers, the Legislature could lower how much the state pays for licensed-exempt care. Because licensed-exempt providers do not have administrative overhead costs, they likely would find a reduction easier to absorb than licensed providers. Moreover, license-exempt providers do not have to meet any standards or participate in any statewide quality improvement initiatives. Plus, our review of other states indicates that most do not provide any reimbursement to license-exempt providers, and those that do typically pay between 50 percent and 70 percent of licensed rates—well below California's current practice. We estimate the state could save roughly $40 million by reducing license-exempt reimbursement rates to 70 percent of licensed rates. If changed in tandem with a reduction to licensed rates, and/or lowered even further to align with policies in other states, the state would save even more.

Increase Parent Fees. The Legislature also has various options for increasing family fees to generate savings, including (1) lowering the income threshold at which families must begin to pay, (2) increasing the amount of copay required per family, and/or (3) charging fees on a per child basis rather than a flat fee per family. While other states structure fees in various ways—making comparisons difficult—California's sliding scale for fees seems generally lower than most other states. Depending upon the approach employed, we estimate raising family fees could generate savings of up to $30 million.

Reduce Funding for Administration. Lastly, the Legislature could reduce the amount of administrative and support funds AP agencies receive. These funds pay for required administrative activities (such as passing along state reimbursements to child care providers and certifying family income eligibility) and locally determined support services (such as training providers and providing counseling to families). We estimate capping the administrative fee at

15 percent would yield savings of about $15 million whereas reducing to 10 percent would generate savings of about $50 million. To help AP agencies accommodate this reduction, the Legislature should also consider a corresponding reduction to their administrative requirements.

Interaction of Different Proposals Will Affect Amount of Overall Savings. It is important to note that the savings estimates provided in Figure 6 assume the policy changes are implemented in isolation. Adopting multiple policy changes simultaneously would have interactive effects that could alter the amount of savings generated from each option. For example, were the Legislature to lower income eligibility to 60 percent of SMI, it would have eliminated eligibility for most of the families that currently pay the bulk of family fees, so a simultaneous increase to family fee levels could no longer generate $30 million in savings. Designing a package of reductions and developing a combined estimate of savings would be an iterative process dependent upon the specific combination of changes included.

Design Package From Menu of Options

We recommend the Legislature use the menu of options provided in Figure 6 to craft its own CCD budget package. Figure 7 provides three illustrations of CCD budget packages the Legislature could consider, depending upon the magnitude of savings it deems necessary.

Appropriate Approach Will Depend Upon Magnitude of Required Savings. The first example assumes CCD is reduced by only half as much as the Governor proposes ($375 million), the second matches the Governor's target but produces the savings in different ways ($750 million), and the third assumes an even higher savings level ($1 billion). These examples build upon each other; that is, the package worth $750 million assumes

Figure 7

Examples of Child Care and Development (CCD) Budget Packages

Lower Savings Target: $375 Million

- Subsidize care only during non-traditional hours for children ages 9 through 12.
- Reduce income ceilings from 75 percent to 65 percent of state median income (SMI) for all CCD programs, including preschool.
- Lower licensed rates from 85th percentile to 75th percentile of 2005 regional market rates (RMR).
- Lower license-exempt provider rates from 80 percent to 70 percent of licensed rates.
- Raise parent fees.
- Reduce Alternative Payment (AP) agency fees from 17.5 percent to 15 percent of contract amount.

Governor's Savings Target: $750 Million

Additionally:
- Subsidize care only during non-traditional hours for children ages 6 through 8.
- Reduce income ceilings to 60 percent of SMI for all CCD programs, including preschool.
- Lower license-exempt provider rates to 60 percent of licensed rates.
- Do not restore CalWORKs Stage 3.

Higher Savings Target: $1 Billion

Additionally:
- Do not provide subsidized child care for children ages 11 and 12, regardless of non-traditional care needs.
- Reduce income ceilings to 50 percent of SMI for all programs, including preschool.
- Lower licensed rates to 65th percentile of RMR.
- Lower license-exempt provider rates to 50 percent of licensed rates.
- Reduce AP agency fees to 10 percent of contract amount.

all of the policy changes that are included in the $375 million package and then makes an *additional* $375 million in reductions. (If the first package were adopted, the Legislature would need to make additional cuts to community colleges or K-12 education to achieve the same overall level of Proposition 98 savings as the Governor.) As evident from the figure, reducing CCD funding by any of these levels could entail multiple policy changes. Moreover, packaging to the highest savings target very likely would affect virtually every aspect of the state's current CCD system.

CONCLUSION

As in all other areas of the state budget, the Legislature faces difficult trade-offs when building the CCD budget. However, we believe that regardless of the magnitude of savings needed, the Legislature should work to craft a CCD package that strikes a reasonable balance between access to and quality of child care, while placing a priority on funding services for the families and children that most need it.

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This brief was prepared by Rachel Ehlers and reviewed by Jennifer Kuhn. The Legislative Analyst's Office (LAO) is a nonpartisan office which provides fiscal and policy information and advice to the Legislature.

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