

Department of Education

| | FY 2014 ACTUAL | FY 2015 ESTIMATE | FY 2016 APPROVED |
|---|----------------------|----------------------|---|
| OPERATING BUDGET | | | |
| <i>Full Time Equivalent Positions</i> | 175.9 | 175.9 | 164.9 ^{1/} |
| Personal Services | 4,303,100 | 4,919,000 | 4,969,000 |
| Employee Related Expenditures | 1,575,000 | 1,842,200 | 1,805,000 |
| Professional and Outside Services | 125,600 | 241,300 | 241,300 |
| Travel - In State | 29,400 | 42,900 | 42,900 |
| Travel - Out of State | 130,600 | 110,700 | 110,700 |
| Other Operating Expenditures | 1,944,300 | 1,252,500 | 1,413,500 |
| Equipment | 476,400 | 193,500 | 193,500 |
| OPERATING SUBTOTAL | 8,584,400 | 8,602,100 | 8,775,900 ^{2/3/} |
| SPECIAL LINE ITEMS | | | |
| Formula Programs | | | |
| Basic State Aid | 3,251,186,200 | 3,347,264,200 | 3,372,320,200 ^{4/-7/} |
| Additional Inflation | 0 | 0 | 74,394,000 ^{8/} |
| K-3 Reading | 40,007,700 | 40,007,700 | 39,917,300 ^{9/10/} |
| School Year 2013-2014 School District Charter School Conversions | 0 | 24,500,000 | 0 |
| Student Success Funding | 0 | 21,500,000 | 0 |
| Special Education Fund | 33,242,100 | 33,242,100 | 32,242,100 |
| Other State Aid to Districts | 56,400 | 983,900 | 983,900 |
| Property Tax Relief | | | |
| Additional State Aid - Homeowner's Rebate | 336,785,700 | 352,502,000 | 359,303,700 |
| Additional State Aid - 1% Cap | 0 | 7,407,200 | 7,380,300 |
| Non-Formula Programs | | | |
| Accountability and Achievement Testing | 3,591,600 | 18,223,600 | 16,422,400 ^{11/} |
| Adult Education | 4,500,000 | 4,500,000 | 4,500,000 |
| Alternative Teacher Development Program | 0 | 0 | 500,000 |
| Arizona Structured English Immersion Fund | 8,791,400 | 4,960,400 | 4,960,400 |
| English Learner Administration | 3,999,200 | 6,516,800 | 6,507,900 ^{12/} |
| Information Technology Certifications | 0 | 1,000,000 | 0 |
| JTED Performance Pay | 0 | 500,000 | 0 |
| JTED Soft Capital | 0 | 0 | 1,000,000 ^{13/} |
| School Safety Program | 2,972,200 | 3,646,500 | 3,646,500 |
| State Block Grant for Vocational Education | 11,573,400 | 11,576,300 | 11,560,900 |
| Student Success Fund Deposit | 2,400,000 | 22,400,000 | 0 |
| Teacher Certification | 1,689,500 | 1,842,500 | 1,834,300 |
| Technology-Based Language Development and Literacy Intervention Pilot Program | 0 | 300,000 | 246,800 |
| State Board of Education | | | |
| State Board of Education | 1,543,300 | 1,614,600 | 0 |
| AGENCY TOTAL | 3,710,923,100 | 3,913,089,900 | 3,946,496,600 ^{14/-16/} |
| FUND SOURCES | | | |
| General Fund | 3,661,757,100 | 3,835,253,800 | 3,889,519,500 |
| Other Appropriated Funds | | | |
| Department of Education Empowerment Scholarship Account Fund | 200,000 | 200,100 | 399,000 |
| Permanent State School Fund | 46,475,500 | 46,475,500 | 47,359,500 |
| Proposition 301 Fund | 371,100 | 7,000,000 | 7,000,000 |
| Student Success Fund | 0 | 21,500,000 | 0 |
| Teacher Certification Fund | 2,119,400 | 2,360,500 | 1,971,800 |
| Technology-Based Language Development and Literacy Intervention Fund | 0 | 300,000 | 246,800 |

| | FY 2014 ACTUAL | FY 2015 ESTIMATE | FY 2016 APPROVED |
|--------------------------------------|----------------------|----------------------|----------------------|
| SUBTOTAL - Other Appropriated Funds | 49,166,000 | 77,836,100 | 56,977,100 |
| SUBTOTAL - Appropriated Funds | 3,710,923,100 | 3,913,089,900 | 3,946,496,600 |
| Other Non-Appropriated Funds | 543,237,300 | 555,357,800 | 602,768,300 |
| Federal Funds | 1,075,165,000 | 1,082,395,400 | 1,074,395,900 |
| TOTAL - ALL SOURCES | 5,329,325,400 | 5,550,843,100 | 5,623,660,800 |

AGENCY DESCRIPTION — The Department of Education (ADE) is headed by the Superintendent of Public Instruction, an elected constitutional officer. For FY 2016, it is anticipated that the department will oversee 237 school districts, accommodation districts and Joint Technological Education Districts and approximately 450 charter schools in their provision of public education from preschool through grade 12.

- 1/ Includes 50 GF and 22 OF FTE Positions funded from Special Line Items in FY 2016.
- 2/ The operating lump sum appropriation includes \$683,900 and 8.5 FTE Positions for average daily membership auditing and \$200,000 and 2 FTE Positions for information technology security services. (General Appropriation Act footnote)
- 3/ The appropriation from the Department of Education Empowerment Scholarship Account Fund includes \$100,000 in funding for one-time information technology changes. (General Appropriation Act footnote)
- 4/ Includes K-12 rollover appropriation of \$930,727,700 from Laws 2014, Chapter 18. Laws 2015, Chapter 8 also appropriates \$930,727,700 in FY 2017 to reflect the deferral of FY 2016 payments.
- 5/ The above appropriation provides basic state support to school districts for maintenance and operations funding as provided by A.R.S. § 15-973, and includes an estimated \$47,359,500 in expendable income derived from the Permanent State School Fund and from state trust lands pursuant to A.R.S. § 37-521B for FY 2016. (General Appropriation Act footnote)
- 6/ Receipts derived from the Permanent State School Fund and any other nonstate General Fund revenue source that is dedicated to fund Basic State Aid shall be expended, whenever possible, before expenditure of state General Fund monies. (General Appropriation Act footnote)
- 7/ Except as required by A.R.S. § 37-521, all monies received during the fiscal year from national forests, interest collected on deferred payments on the purchase of state lands, the income from the investment of permanent funds as prescribed by the Enabling Act and the Constitution of Arizona and all monies received by the Superintendent of Public Instruction from whatever source, except monies received pursuant to A.R.S. § 15-237 and 15-531, when paid into the State Treasury are appropriated for apportionment to the various counties in accordance with law. An expenditure may not be made except as specifically authorized above. (General Appropriation Act footnote)
- 8/ The Department of Education shall allocate the \$74,394,000 amount appropriated through this line item to school districts and charter schools in FY 2016 in the same manner that it would allocate the monies if the monies were for an additional increase of \$54.31 in the base level defined for FY 2016 in A.R.S. § 15-901B2, and increase budget limits accordingly. The department shall also increase the budget limits of a school district that is not eligible to receive basic state aid funding for FY 2016 by the amount that the district's budget limits would be increased under this line item if the school district was eligible to receive basic state aid funding for FY 2016. The additional inflation amount is not an increase in the base level as defined in A.R.S. § 15-901. (General Appropriation Act footnote)
- 9/ The appropriated amount is for funding costs of the K-3 reading weight established in A.R.S. § 15-943. (General Appropriation Act footnote)
- 10/ Laws 2015, Chapter 310 authorizes the department to use up to \$500,000 of the K-3 Reading appropriation for technical assistance and state level administration of the program. Prior to the expenditure of any monies for technical assistance and state level administration of the K-3 reading program the department of education shall submit the expenditure plan for those monies to the Joint Legislative Budget Committee for review.
- 11/ Before making any changes to the Achievement Testing program that will increase program costs, the State Board of Education shall submit the estimated fiscal impact of those changes to the Joint Legislative Budget Committee for review. (General Appropriation Act footnote)
- 12/ The Department of Education shall use the appropriated amount to provide English language acquisition services for the purposes of A.R.S. § 15-756.07 and for the costs of providing English language proficiency assessments, scoring and ancillary materials as prescribed by the Department of Education to school districts and charter schools for the purposes of Title 15, Chapter 7, Article 3.1, Arizona Revised Statutes. The Department of Education may use a portion of the appropriated amount to hire staff or contract with a third party to carry out the purposes of A.R.S. § 15-756.07. Notwithstanding A.R.S. § 41-192, the Superintendent of Public Instruction also may use a portion of the appropriated amount to contract with one or more private attorneys to provide legal services in connection with the case of Flores v. State of Arizona, No. CIV 92-596-TUC-RCC. (General Appropriation Act footnote)
- 13/ The Department of Education shall distribute the appropriated amount to joint technical education districts with fewer than 2,000 average daily membership pupils for soft capital and equipment expenses. The appropriated amount shall be allocated on a pro rata basis based on the average daily membership of eligible joint technical education districts. (General Appropriation Act footnote)
- 14/ The department shall provide an updated report on its budget status every 3 months for the first half of each fiscal year and every month thereafter to the President of the Senate, the Speaker of the House of Representatives, the Chairpersons of the Senate and House of Representatives Appropriations Committees, the Director of the Joint Legislative Budget Committee and the Director of the Governor's Office of Strategic Planning and Budgeting. Each report shall include, at a minimum, the department's current funding surplus or shortfall projections for Basic State Aid and other major formula-based programs and is due 30 days after the end of the applicable reporting period. (General Appropriation Act footnote)
- 15/ Within 15 days after each apportionment of state aid that occurs pursuant to A.R.S. § 15-973B, the department shall post on its website the amount of state aid apportioned to each recipient and the underlying data. (General Appropriation Act footnote)
- 16/ General Appropriation Act funds are appropriated as an Operating Lump Sum with Special Line Items by Agency.

Summary

ADE's FY 2016 General Fund budget spending increases by \$54,265,700, or 1.4%. The budget includes both current law formula adjustments and policy changes:

Current Law Formula Adjustments

- A decrease of \$(2,953,900) to eliminate one-time funding for a property tax settlement.
- An increase of \$82,177,100 for 1.4% Average Daily Membership (ADM) growth in FY 2016.
- An increase of \$22,500,000 for higher average formula costs per pupil due to ongoing special education and charter growth.
- An increase of \$87,040,300 for a 1.59% inflator.
- A decrease of \$(42,772,900) for local property tax growth due to new construction offset by Homeowner's Rebate impact of \$4,494,500.
- An increase of \$22,500,000 for higher Homeowner's Rebate costs due to recent statutory changes.
- A decrease of \$(24,500,000) for charter conversions.
- An increase of \$3,220,700 for a new Joint Technical Education District (JTED) in Yuma County.
- A decrease of \$(1,000,000) for lower special education voucher caseloads.
- A decrease of \$(884,000) to offset higher available endowment earnings.
- A decrease of \$(716,700) for final year of 5-year Career Ladder phase out (state aid portion only).
- A decrease of \$(500,000) to eliminate one-time funding for JTED Performance Pay.
- An increase of \$700,000 for Empowerment Scholarship Accounts (ESAs).
- A decrease of \$(49,900) for other base adjustments and standard changes.

The current law formula adjustments total \$149,255,200.

Policy Changes

- An increase of \$74,394,000 for additional inflation.
- A decrease of \$(113,457,200) for District Additional Assistance.
- A decrease of \$(3,000,000) for Charter Additional Assistance.
- A decrease of \$(1,325,200) to fund State Board of Education as separate budget unit. This amount includes \$(90,400) transferred from the K-3 Reading line item.
- A decrease of \$(1,181,400) to fund incremental monies for district sponsored charter schools at 50% for FY 2016.
- A decrease of \$(22,400,000) to repeal Student Success Funding.

- A decrease of \$(20,219,700) for 1% property tax cap limitations.
- An increase of \$500,000 for an alternative teacher development program.
- A decrease of \$(1,800,000) for Achievement Testing due to elimination of AIMS high school retests.
- A decrease of \$(6,500,000) for small school weight for multisite charter phase out.
- A decrease of \$(1,000,000) for information technology certifications.
- An increase of \$1,000,000 for JTED soft capital.

As part of the budget's 3-year spending plan, ADE General Fund costs are projected to increase by \$124,770,800 in FY 2017 above FY 2016 and \$156,605,200 in FY 2018 above FY 2017. (See *Other Issues* for more information.)

Operating Budget

The budget includes \$8,775,900 and 92.9 FTE Positions in FY 2016 for the operating budget. These amounts consist of:

| | FY 2016 |
|-------------------------------------|----------------|
| General Fund | \$8,239,400 |
| Department of Education Empowerment | |
| Scholarship Account Fund | 399,000 |
| Teacher Certification Fund | 137,500 |

These amounts fund the following adjustments:

ESA Administration

The budget includes an increase of \$200,000 from the Department of Education Empowerment Scholarship Account Fund in FY 2016 for administration of the Empowerment Scholarship Account (ESA) program authorized in A.R.S. § 15-2402. This will provide the department with \$399,000 in ESA administration funding for FY 2016. A General Appropriation Act footnote stipulates that this includes \$100,000 for one-time information technology changes.

The Department of Education Empowerment Scholarship Account Fund is funded with monies retained from students' ESAs pursuant to A.R.S. § 15-2402C. That law allows ADE to retain up to 5% of each student's ESA funding for program administration, which for FY 2015 would have been as much as \$865,000 (an estimated \$17,300,000 ESA cost for the year X 5%). A.R.S. § 15-2402C requires ADE to transfer 1/5th of the 5% to the State Treasurer to fund the latter's costs for ESA fund processing. The actual expenditure, however, is subject to legislative appropriation. (See *State Treasurer budget for State Treasurer's ESA administration funding*.)

Statewide Adjustments

The budget includes a decrease of \$(26,200) in FY 2016 for statewide adjustments. This amount consists of:

| | |
|---|----------|
| General Fund | (24,400) |
| Department of Education Empowerment Scholarship Account Fund | (1,100) |
| Teacher Certification Fund | (700) |

(Please see the Agency Detail and Allocations section.)

Table 1
FY 2016 Basic State Aid Formula Summary (estimated)

| General Fund | |
|---|------------------------|
| FY 2015 Appropriation (including supplemental) | \$3,300,788,700 |
| Base Adjustment – FY15 supplemental | (19,453,900) |
| Base Adjustment – FY15 enrollment growth | 16,500,000 |
| Enrollment Growth @ 1.4% | 82,177,100 |
| Higher Average Cost Per Pupil | 22,500,000 |
| 1.59% Inflation | 87,040,300 |
| Property Taxes - New Construction | (42,772,900) |
| Yuma County JTED | 3,220,700 |
| Career Ladder Phase Out | (716,700) |
| Endowment Earnings | (884,000) |
| District Additional Assistance | (113,457,200) |
| Charter Additional Assistance | (3,000,000) |
| District Charter Phase Out | (1,181,400) |
| Multisite Charter Small School Weight | (6,500,000) |
| Empowerment Scholarship Accounts | 700,000 |
| FY 2016 budget | 3,324,960,700 |
| Additional Inflation (separate Line Item) | 74,394,000 |
| K-3 Reading Program (separate Line Item) | |
| FY 2015 Base | 40,007,700 |
| Transfer to State Board of Education | (90,400) |
| FY 2016 budget | 39,917,300 |
| FY 2014 Charter Conversions | |
| FY 2015 Base | 24,500,000 |
| Eliminate One-Time Funding | (24,500,000) |
| FY 2016 budget | 0 |
| Permanent State School Fund | |
| FY 2015 Base | 46,475,500 |
| Growth in Available Earnings | 884,000 |
| FY 2016 budget | 47,359,500 |
| Prop 301 Sales Tax (no change) ^{1/} | 86,280,500 |
| Local Property Taxes ^{1/} | |
| FY 2015 Base - estimated | 2,356,192,800 |
| Property Taxes - New Construction | 42,772,900 |
| Career Ladder Phase Out Local Share | (14,400,000) |
| Non-State Aid Formula Changes | 12,212,300 |
| FY 2016 Estimated ^{2/} | 2,396,778,000 |
| Grand Total (all sources) ^{3/} | \$5,969,690,000 |

^{1/} Non-appropriated, so excluded from appropriated totals.
^{2/} An estimated \$366,684,000 of this total will be funded by the state through Homeowner's Rebate and 1% cap funding.
^{3/} Statutory formula cost would be approximately \$401,846,100 higher without the District Additional Assistance (DAA), Charter Additional Assistance (CAA) and large JTED reductions that are continued or increased in the budget on a session law basis, including the impact on non-state aid districts.

Formula Programs

Basic State Aid

The budget includes \$3,372,320,200 in FY 2016 for Basic State Aid. This amount consists of:

| | |
|-----------------------------|---------------|
| General Fund | 3,324,960,700 |
| Permanent State School Fund | 47,359,500 |

The \$3,372,320,200 total does not include \$86,280,500 in "additional school day" funding from Proposition 301 that will be allocated through Basic State Aid in FY 2016, because those monies are non-appropriated (see Table 1). It also excludes local property taxes that will help fund K-12 formula costs for FY 2016, as they also are non-appropriated. In addition, it excludes \$39,917,300 for the K-3 Reading weight authorized in A.R.S. § 15-943, as those monies are appropriated to a separate line item (see narrative for K-3 Reading line item below).

(See Basic State Aid Formula Description under Other Issues for background information regarding the Basic State Aid formula.)

Base Adjustment – FY 2015 Supplemental

The budget includes a decrease of \$(19,453,900) from the General Fund in FY 2016 in order to adjust the base budget for supplemental funding from FY 2015. The FY 2016 budget continues \$16,500,000 of this amount through the "Base Adjustment – FY 2015 Enrollment Growth" discussed separately below. The remaining \$2,953,900 is not continued because it was for a one-time property tax settlement in FY 2015.

Base Adjustment – FY 2015 Enrollment Growth

The budget includes an increase of \$16,500,000 from the General Fund in FY 2016 to reflect higher than budgeted enrollment growth for FY 2015. That growth will increase starting point costs for the program for FY 2016 by an estimated \$16,500,000.

Enrollment Growth

The budget includes an increase of \$82,177,100 from the General Fund in FY 2016 for enrollment growth. This assumes that K-12 ADM will increase by 1.4% in FY 2016, or slightly less than the 1.7% growth rate computed for FY 2014 (see Table 2). It does not reflect ongoing growth in the average cost per pupil, which is described separately below.

| Fiscal Year | District ^{2/} | Charter ^{3/} | Total | Change | % Change |
|-------------|------------------------|-----------------------|-----------|----------|----------|
| 2009 | 941,693 | 100,590 | 1,042,283 | 1,036 | 0.1% |
| 2010 | 936,594 | 110,231 | 1,046,825 | 4,542 | 0.4% |
| 2011 | 914,952 | 119,321 | 1,034,273 | (12,552) | (1.2)% |
| 2012 | 909,530 | 131,993 | 1,041,523 | 7,250 | 0.7% |
| 2013 | 910,476 | 140,199 | 1,050,675 | 9,152 | 0.9% |
| 2014 | 916,599 | 152,158 | 1,068,757 | 18,082 | 1.7% |
| 2015 est | 923,861 | 160,104 | 1,083,965 | 15,208 | 1.4% |
| 2016 est | 929,322 | 169,710 | 1,099,032 | 15,067 | 1.4% |
| 2017 est | 934,301 | 179,893 | 1,114,194 | 15,162 | 1.4% |
| 2018 est | 938,767 | 190,686 | 1,129,453 | 15,259 | 1.4% |

^{1/} Actuals for FY 2009 through FY 2014 are from ADE payment data (FY 2014 adjusted for one-time charter conversions). Figures for other years are current JLBC Staff estimates. Excludes students enrolled at the Arizona State Schools for the Deaf and the Blind (ASDB).

^{2/} Includes district-sponsored charter schools.

^{3/} Excludes district-sponsored charter schools.

Higher Average Cost Per Pupil

The budget includes an increase of \$22,500,000 from the General Fund in FY 2016 for growth in the average Basic State Aid cost per pupil for FY 2016. The average cost per pupil increases annually due to ongoing growth in the proportion of K-12 pupils who are enrolled in charter schools or special education programs. Charter school students typically receive more formula funding per pupil than non-charter school students (although they do not receive local bond and override funding) and special education students receive “add on” funding that increases their average per pupil costs.

The \$22,500,000 estimate includes \$12,000,000 for charter school pupils and \$10,500,000 for special education students in FY 2016. The charter estimate assumes that board sponsored charter schools will continue to grow by approximately 12,000 ADM in FY 2016 and receive approximately \$1,000 more per pupil than non-charter pupils (12,000 X \$1,000 = \$12,000,000). The special education estimate assumes that the statewide special education weighted student count will increase by approximately 3,000 ADM in FY 2016 (see Table 3) and an average per pupil base level “add on” of \$3,500 (3,000 X \$3,500 = \$10,500,000). The assumed \$3,500 base level amount is “add on” in nature for special education pupils because it is in addition to base level funding that they generate under the “main” (non-special education) part of the Basic State Aid formula.

1.59% Inflation Adjustment

The budget includes an increase of \$87,040,300 from the General Fund in FY 2016 for a 1.59% inflation increase in the per pupil base level prescribed in A.R.S. § 15-901B2, the transportation funding levels prescribed in A.R.S. § 15-945A5 and the charter school Additional Assistance amounts prescribed in A.R.S. § 15-185B. These inflation

| Fiscal Year | Districts | Charters | Total | Change | % Change |
|-------------|-----------|----------|---------|--------|----------|
| 2009 | 81,311 | 3,239 | 84,550 | 5,219 | 6.6% |
| 2010 | 83,450 | 4,104 | 87,554 | 3,004 | 3.6% |
| 2011 | 88,633 | 5,189 | 93,822 | 6,269 | 7.2% |
| 2012 | 92,738 | 5,858 | 98,596 | 4,774 | 5.1% |
| 2013 | 95,560 | 6,522 | 102,082 | 3,485 | 3.5% |
| 2014 | 95,034 | 7,698 | 102,732 | 650 | 0.6% |
| 2015 est | 95,984 | 9,748 | 105,732 | 3,000 | 2.9% |
| 2016 est | 96,944 | 11,788 | 108,732 | 3,000 | 2.8% |

^{1/} Actuals for FY 2009 through FY 2014 are from ADE payment data. Excludes “Group B” category that only receives funding weight of 0.003 (293 additional “weighted” students for FY 2014) and students enrolled at ASDB.

adjustments are all included in the FY 2016 K-12 Education Budget Reconciliation Bill (BRB) (Laws 2014, Chapter 15) and will result in a base level of \$3,426.74 per pupil for FY 2016 versus \$3,373.11 for FY 2015.

A.R.S. § 15-901.01 (established by Proposition 301) requires the Legislature to increase the “base level or other components of the Revenue Control Limit” (RCL) by 2% or by the change in the GDP price deflator for the most recent prior calendar year, whichever is less. The assumed FY 2016 adjustment is 1.59%, which equals the currently projected GDP price deflator for calendar year 2014. A.R.S. § 15-901.01 prohibits the Legislature from setting a base level that is lower than the FY 2002 base level of \$2,687.32.

The budgets for FY 2011 through FY 2013 provided inflation increases for transportation and charter school Additional Assistance only. The State Supreme Court ruled in September 2013 (*Cave Creek Unified, et. al. v. Ducey*) that the state must inflate the K-12 per pupil “base level,” as well as transportation and charter Additional Assistance. It also remanded the case to Superior Court for resolution of funding amounts needed in order to address its ruling.

In August 2014, the Superior Court issued a judgment requiring the state to reset the base level to \$3,609 per pupil (\$236 higher) for FY 2015. It also scheduled evidentiary hearings for late October 2014 in order to determine whether the state also had to make back payments to schools for unfunded inflation in prior years.

A \$236 per pupil base level adjustment would increase Basic State Aid costs by an estimated \$332,032,000 in FY 2015 and \$336,680,400 in FY 2016 relative to current law.

In addition, the plaintiffs are seeking an estimated \$1,262,966,600 in back payments for unfunded inflation in prior years. This amount equals the cumulative sum of estimated unfunded inflation from recent years when the

base level was not adjusted for inflation (FY 2009, FY 2011, FY 2012 and FY 2013). A ruling on the back payment issue remains pending as of May 2015.

(See Additional Inflation line item for more information.)

Property Taxes from New Construction

The budget includes a decrease of \$(42,772,900) from the General Fund in FY 2016 due to a projected 1.73% increase in statewide Net Assessed Value (NAV) from new construction in FY 2016. This will increase local property tax revenues from the K-12 “Qualifying Tax Rate” (QTR) and State Equalization Tax Rate (SETR) by an estimated \$42,772,900 in FY 2016. It also will decrease state costs by \$(42,772,900), since QTR and SETR revenues offset state formula costs on a dollar for dollar basis.

Statewide NAV for property already on the tax rolls (“existing property”) is expected to increase by 0.69% in FY 2016, resulting in a net 2.42% NAV increase for new construction and existing property combined for FY 2016.

The projected 0.69% NAV increase for existing property will not affect net QTR or SETR collections in FY 2016 because A.R.S. § 41-1276 (the “Truth in Taxation” or “TNT” law) requires the QTR and SETR to be adjusted each year in order to offset NAV changes for existing properties. As a result, the QTR will decrease to \$4.20 (from \$4.22 currently) and the SETR will decrease to \$0.5054 (from \$0.5089 currently) in FY 2016 in order to offset the estimated 0.69% NAV increase for existing property *(see Table 4)*.

| Tax Rate | TNT Tax Rates | |
|--|----------------------|----------------|
| | FY 2015 | FY 2016 |
| Qualifying Tax Rate (QTR) | | |
| • High School districts and elementary districts located within a high school district | \$2.1123 | \$2.0977 |
| • Unified districts and elementary districts not located within a high school district | \$4.2246 | \$4.1954 |
| • State Equalization Tax Rate (SETR) | \$0.5089 | \$0.5054 |

On a related note, Proposition 117 from the November 2012 General Election, caps annual growth in property values at 5% starting in FY 2016. The proposition will not affect K-12 QTR and SETR revenues from existing property, since they already are held constant from year to year by TNT. Proposition 117 also should not affect school district override revenues, since they are based on a district’s Revenue Control Limit rather than the size of its tax base. Proposition 117, however, could affect K-12 bonding, since caps on public school bonding are based on the size of a district’s tax base. Proposition 117 will slow tax base growth in the future for any year that otherwise would experience more than 5% growth in the value of existing properties. Laws 2015, Chapter 310 amends

statute regarding K-12 bonding limits in order to conform it to changes in Proposition 117.

Yuma County JTED

The budget includes an increase of \$3,220,700 from the General Fund in FY 2016 for estimated first-year Basic State Aid costs of a new JTED in Yuma County. Voters in that county approved the new JTED in November 2014 and its first year of operation will be FY 2016 pursuant to A.R.S. § 15-392B. The estimated Basic State Aid cost of \$3,220,700 for the new JTED for FY 2016 assumes that it will serve 800 ADM pupils in its first year based on input from member school districts.

Career Ladder Phase Out

The budget includes a decrease of \$(716,700) from the General Fund in FY 2016 in order to eliminate all remaining Career Ladder funding, as required by Laws 2011, Chapter 29. Chapter 29 phased out existing Career Ladder funding over 5 fiscal years, starting in FY 2012. Approximately \$(14,400,000) in local property tax funding for Career Ladder programs also will be phased out after FY 2015. A total of 28 school districts participated in the Career Ladder program.

Endowment Earnings

The budget includes a decrease of \$(884,000) from the General Fund and increase of \$884,000 from the Permanent State School Fund in FY 2016 for endowment earnings funding for Basic State Aid. This assumes that debt service costs for State School Trust Revenue Bonds and Qualified Zone Academy Bonds (QZABs) that were issued by the School Facilities Board (SFB) in prior years in order to fund deficiencies correction in public schools will be \$24,903,500 for FY 2016 based on input from the SFB, which would be \$(884,000) below the currently budgeted level. This would increase the amount of land trust monies available to fund Basic State Aid in FY 2016 by \$884,000, to a total of \$47,359,500. It also would reduce General Fund costs for Basic State Aid by \$(884,000), since Endowment Earnings reduce General Fund costs for Basic State Aid on a dollar for dollar basis.

A.R.S. § 37-521 caps the amount of K-12 endowment earnings that may be used for SFB debt service and Basic State Aid combined at the FY 2001 level of endowment earnings, which was \$72,263,000. All endowment earnings above \$72,263,000 go to the Classroom Site Fund established by A.R.S. § 15-977. *(See Other Issues for more information.)*

Rollover

The budget includes no change from the General Fund in FY 2016 for the K-12 rollover. This continues to defer through the General Appropriation Act \$930,727,700 of

current year (now FY 2016) state aid payments until the following fiscal year (now FY 2017).

The FY 2016 rollover continues to affect only school districts with more than 600 students, as has been the policy since FY 2013. The budget continues to exempt small districts from the K-12 rollover in FY 2016, which continues it at the \$930,727,700 level.

As a result of the continuing rollover, the 12 monthly payments that “large” school districts receive in FY 2016 will again consist of approximately 4.5 months of deferred payments from the prior year and 7.5 (rather than 12) payments from the current year. Laws 2014, Chapter 18 advance appropriated \$930,727,700 from the General Fund in FY 2016 in order to fund the \$930,727,700 deferred obligation from FY 2015. Those monies therefore do not appear in the FY 2016 General Appropriation Act. The Act, however, advance appropriates \$930,727,700 from the General Fund in FY 2017 in order to fund the deferred FY 2016 obligation.

A continued \$930,727,700 rollover for FY 2016 includes \$272,627,700 for the original FY 2008 rollover, \$330,000,000 for the additional FY 2009 rollover, \$350,000,000 for the additional FY 2010 rollover and \$(21,900,000) to exempt districts with less than 600 students.

Additional Assistance Suspensions/Classroom Spending

The budget includes a decrease of \$(116,457,200) from the General Fund in FY 2016 for a continued partial suspension of the district additional assistance (DAA) and charter additional assistance (CAA) statutory funding formulas. This amount suspends an additional \$(113,457,200) of DAA and additional \$(3,000,000) of CAA for FY 2016, as required by the FY 2016 K-12 Education BRB. This will suspend \$(352,442,700) of DAA state aid and \$(18,656,000) of CAA for FY 2016.

The FY 2016 K-12 Education BRB requires all school districts to hold a public meeting to discuss or present their plans for the FY 2016 reductions pertaining to DAA funding. It also requires “C,” “D” and “F” schools to allow the community to submit comments or recommendations on the proposed reductions within 30 days of the meeting and requires the governing board to consider the comments or recommendations at a subsequent public meeting. It also requires the governing board of all school districts to include the percentage of classroom spending in the school district’s adopted budget on the page that governing board members sign. It further states that it is the intent of the Legislature and Governor that school districts increase the total percentage of classroom spending in the combined

categories of instruction, student support and instructional support as defined by the Auditor General.

School districts will receive an estimated \$63,000,000 in DAA funding in FY 2016, including an estimated \$5,000,000 self-funded by non-state aid districts, based on FY 2014 actuals. Without the continuing suspension they instead would receive an estimated \$445,497,800 in DAA funding, including an estimated \$33,626,900 self-funded by non-state aid districts. DAA is authorized by A.R.S. § 15-961, which establishes DAA funding amounts (if fully funded) of \$450.76 to \$601.24 per pupil depending on the pupil’s grade level and the size of their school district.

As in prior years, the FY 2016 K-12 Education BRB requires non-state aid districts to reduce their budgets by the amount that their state aid would be reduced under continuing DAA suspensions if they did qualify for state aid. Non-state aid districts are school districts that are able to fully fund their K-12 formula costs with local property taxes only because of their strong local property tax base. The FY 2016 K-12 Education BRB also continues to extend this requirement to CAA reductions for non-state aid districts that have district-sponsored charter schools in order to conform to existing practice for DAA reductions.

The FY 2016 K-12 Education BRB also continues to cap total statewide DAA reductions for school districts with less than 1,100 students at \$5,000,000 for FY 2016.

JTED/Hold Harmless Provisions

In addition to suspending a portion of DAA and CAA, the FY 2016 K-12 Education BRB continues to suspend 4.5% of state aid for JTEDs with more than 2,000 ADM for FY 2016 by funding their state aid at 95.5% of the full funding amount apart from unrelated DAA suspensions. This will suspend an estimated \$1,747,400 of large JTED formula funding for FY 2016.

Starting in FY 2017, the FY 2016 K-12 Education BRB also permanently reduces Base Support Level funding to JTEDs and their member districts and eliminates a “hold harmless” for school districts with declining enrollments. *(See Other Issues for additional information.)*

District Sponsored Charter School Phase Out

The budget includes a decrease of \$(1,181,400) from the General Fund in FY 2016 for estimated savings from a phasing out of pre-2014 district sponsored charter schools. Post-2014 district sponsored charter schools already are eliminated after FY 2015. *(See the School Year 2013-2014 School District Charter School Conversions line item narrative for more information.)*

The FY 2016 K-12 Education BRB funds “incremental monies” (the difference between district and charter per pupil formula funding) for pre-2014 district sponsored charter schools at 50% for FY 2016. The 50% funding factor will reduce state aid to the remaining district sponsored charter schools by an estimated \$(1,181,400) for FY 2016. It also will reduce local funding to non-state aid districts by an estimated \$(1,115,000) in FY 2016.

The BRB also indicates that it is the intent of the Legislature that district-sponsored charter schools be phased out by FY 2017, thereby reducing General Fund support by another \$(1,181,400).

Small School Weight Funding for Multisite Charter Schools

The budget includes a decrease of \$(6,500,000) from the General Fund in FY 2016 to begin eliminating small school weight funding for multisite charter schools in FY 2016. Multisite charters schools generally are charters schools with common organizational or governance structures. The FY 2016 K-12 Education BRB funds small school weights for most multisite charter schools at 66% for FY 2016 and 33% for FY 2017.

Relative to FY 2015, the budget assumes that this will reduce Basic State Aid costs by \$(6,500,000) in FY 2016, \$(13,000,000) in FY 2017 and \$(20,000,000) in FY 2018. The FY 2016 K-12 Education BRB makes multisite charters ineligible for small school weight funding after FY 2017 unless their combined student counts are less than 600 for grades K-8 or high school.

Small school weights are authorized by A.R.S. § 15-943, paragraph 1. They generate additional funding per pupil for eligible entities that have fewer than 600 ADM pupils in Grades K-8 or high school.

Empowerment Scholarship Accounts

The budget includes an increase of \$700,000 from the General Fund in FY 2016 for Basic State Aid costs related to Empowerment Scholarship Accounts (ESAs) authorized by A.R.S. § 15-2402. This assumes that approximately 130 non-special education students who otherwise would attend private school (primarily incoming Kindergartners who live within the boundaries of a “D or F” school) will receive ESAs in FY 2016 (130 students X \$5,100 estimated average ESA cost for non-disabled pupils ≈ \$700,000). It also assumes that all other categories of new ESA students (such as disabled students who formerly attended school district or charter schools, and non-disabled students, such as from military families, who also qualify for ESAs) collectively would result in no net new cost based on formula modeling.

Laws 2015, Chapter 225 is the only new legislation impacting the program for FY 2016. (See separate discussion of Chapter 225 below for more information.)

Eligible students can use monies in an ESA to attend private school or fund other educational expenses, such as textbooks and tutoring. ESAs are funded primarily with Basic State Aid monies that a school district or charter school otherwise would have received for a student if they had remained in public school.

The program is open to Arizona resident students who meet at least one of the requirements listed below in addition to being either a full-time Arizona public school student in the prior year, a displaced or disabled School Tuition Organization (STO) scholarship recipient in the prior year, or an incoming kindergartner:

- A child with a disability.
- A child who is a ward of the juvenile court and is residing in prospective permanent placement foster care.
- A child who is a ward of the juvenile court and who achieved permanency through adoption.
- A child who is the sibling of a current ESA recipient.
- A child who attended a failing school in the prior year.
- An incoming Kindergartner who resides within the boundaries of a failing school.
- A child with an active duty military parent.
- A child who resides on an Arizona Indian reservation (new – see Chapter 225 discussion below).

(Please see the FY 2015 Appropriations Report for historical information on changes in program eligibility.)

Laws 2013, Chapter 250 caps the number of new ESAs approved by the department each year at 0.5% of total public school enrollment through calendar year 2019, or approximately 5,400 new students annually. Current ESA growth is substantially below this level, as the 1,869 ESAs approved for FY 2015 represent an increase of only 554 net students above the FY 2014 level (see Table 5).

| Fiscal Year | Program Enrollment | Total Awards |
|--------------------|---------------------------|---------------------|
| FY 2012 | 144 | \$1,576,000 |
| FY 2013 | 302 | \$5,209,200 |
| FY 2014 | 761 | \$10,200,000 |
| FY 2015 (est) | 1,315 | \$17,300,000 |
| FY 2016 (est) | 1,869 | \$24,400,000 |

^{1/} ADE data and estimates as of July 2014. “Total Awards” represent estimated ESA allocations rather than the net General Fund impact of the program after related Basic State Aid savings are deducted. The latter amount is unknown because it would depend in part on where individual ESA recipients would have attended school apart from the program, which is unknown.

Chapter 250 also amended the funding formula for the ESA program to include “. . . an amount that is equivalent to ninety percent of the sum of the base support level and additional assistance prescribed in sections 15-185 and 15-943 for that particular student if that student were attending a charter school.” The impact of this change has been unclear due to varying interpretations of the enacted language.

In May 2014, however, the Superintendent of Public Instruction indicated that starting in FY 2015 the department would interpret it as providing 90% of charter additional assistance to all ESA recipients, including those who did not previously attend charter schools. ADE estimates that this change will cause ESAs as a whole to cost about 9% than they would have without this policy change, which would be approximately \$1,557,000 for FY 2015 (\$17,300,000 estimated ESA cost for FY 2015 [from Table 5] X 9% = \$1,557,000).

The budget does not include a policy issue for this change for FY 2016, as it already would be reflected in the department’s base budget from FY 2015. It could be responsible, however, for part of the estimated \$16,500,000 Basic State Aid funding shortfall for FY 2015 (see *Base Adjustment – FY 2015 Supplemental for more information*).

Table 5 shows historical and projected data for the ESA program. For FY 2015, ADE estimates that 1,315 students are receiving \$17,300,000 in ESA funding. This represents an increase of 554 students, which is the same increase assumed in Table 5 for FY 2016 (1,869 students assumed for FY 2016 minus 1,315 assumed for FY 2015 = 554 student increase).

A.R.S. § 15-2402C authorizes the department to retain for administration up to 5% of the funding designated for each student’s ESA account, of which it is required to transfer one-fifth to the State Treasurer for related administration at the State Treasurer’s office. The budget appropriates \$399,000 to ADE from the Department of Education Empowerment Scholarship Account Fund (A.R.S. § 15-2402D) in FY 2016 for program administration (see *agency Operating Budget narrative above*). The budget appropriates \$79,700 from the State Treasurer Empowerment Scholarship Account Fund in FY 2016 for ESA program administration (see *related narrative in State Treasurer Budget pages*).

Laws 2015, Chapter 225 expands ESA eligibility to a child who resides within the boundaries of an Arizona Indian reservation and who meets other eligibility criteria for the program, such as being a full time public school student in the prior year or an incoming kindergartner. Chapter 225 also establishes a study

committee to review issues pertaining to special education services that are provided through ESAs.

Additional Inflation

The budget includes \$74,394,000 from the General Fund in FY 2016 for Additional Inflation. These amounts fund the following adjustments:

Additional Inflation

The budget includes an increase of \$74,394,000 from the General Fund in FY 2016 for additional inflation. A footnote in the General Appropriation Act requires the department to allocate these monies as if they were for an additional increase of \$54.31 in the base level defined in A.R.S. § 15-901B2 for FY 2016 and to increase budget limits accordingly. It also requires the department to increase budget limits of non-state aid districts accordingly so they will receive corresponding increases in local funding. The footnote further stipulates that the additional funding is not an increase in the base level.

K-3 Reading

The budget includes \$39,917,300 from the General Fund in FY 2016 for the K-3 Reading program. These amounts fund the following adjustments:

Transfer to State Board of Education

The budget includes a decrease of \$(90,400) and (2) FTE Positions from the General Fund in FY 2016 in order to transfer a portion of program funding to the now-separate State Board of Education budget for FY 2016.

A FY 2015 General Appropriation Act footnote for the program allowed the State Board of Education to use for technical assistance and statewide administration of the program each year up to \$1,500,000 of the program’s appropriation. The amount actually used and the breakdown by department versus the State Board of Education varied annually.

In establishing the State Board of Education as a separate budget unit for FY 2016, the budget transfers \$(90,400) and (2) FTE Positions from this program in the Department of Education budget to the operating budget of the newly-separate State Board of Education. The General Appropriation Act also deleted the \$1,500,000 technical assistance footnote.

Laws 2015, Chapter 310, however, subsequently authorized the department to use up to \$500,000 of its FY 2016 appropriation for K-3 Reading for technical assistance and state level administration of the program. Chapter 310 requires the department to submit the

expenditure plan for these monies to the Joint Legislative Budget Committee for review prior to spending them. Ongoing responsibilities of the State Board of Education and the Department of Education for the K-3 Reading program remain to be determined.

The program is authorized by A.R.S. § 15-211, which requires the State Board of Education, in collaboration with the department, to establish a program to improve the reading proficiency of pupils in Grades K-3. Program funding is generated by the K-3 Reading “Group B” weight of 0.040 per student as established by A.R.S. § 15-943.

This line item only reflects initial funding of K-3 Reading when it was created in FY 2013. Since that time, approximately \$2,480,000 in additional K-3 Reading funding has been authorized for enrollment growth and inflation, since statewide enrollment has increased by approximately 3% and inflation has increased formula costs by 3.2% since the program began in FY 2013 ($\$40,000,000 \times 6.2\% = \$2,480,000$). That additional funding is part of the Basic State Aid line item.

School Year 2013-2014 School District Charter School Conversions

The budget includes no funding in FY 2016 for School Year 2013-2014 School District Charter School Conversions. This amount funds the following adjustments:

Remove One-Time Funding

The budget includes a decrease of \$(24,500,000) from the General Fund in FY 2016 for the elimination of one-time funding for School Year 2013-2014 School District Charter School Conversions. This funding was one-time in nature, as Section 22 of the FY 2015 K-12 Education BRB (Laws 2014, Chapter 17) stipulated that new charter conversions from FY 2014 could continue to operate as charter schools only through FY 2015.

In FY 2016, only school districts that operated charter schools prior to FY 2014 can continue to operate and receive state funding for them. Laws 2014, Chapter 214, however, caps their charter school ADM at 120% of their FY 2013 charter school ADM (approximately 2,800 ADM statewide). In addition, the FY 2016 K-12 Education BRB funds their charter school “incremental monies” at 50% for FY 2016 and expresses legislative intent that remaining district sponsored charter schools be eliminated by FY 2017 (see *District Sponsored Charter School Phase Out policy issue above*).

(See the School Year 2013-2014 School District Charter School Conversions policy issue under Basic State Aid in

the FY 2015 Appropriations Report for additional information.)

Student Success Funding

The budget includes no funding from the Student Success Fund in FY 2016 for Student Success Funding (SSF). This amount funds the following adjustments:

Eliminate Program

The budget includes a decrease of \$(21,500,000) from the Student Success Fund in FY 2016 in order to eliminate the program. In addition, the FY 2016 K-12 Education BRB repeals A.R.S. § 15-917, which established the Student Success Fund.

(See the FY 2015 Appropriations Report for more information on the program.)

Special Education Fund

The budget includes \$32,242,100 and 1 FTE Position from the General Fund in FY 2016 for the Special Education Fund Special Line Item. These amounts fund the following adjustments:

Caseload Reduction

The budget includes a decrease of \$(1,000,000) from the General Fund in FY 2016 to reflect declining enrollment in residential programs at the Arizona State Schools for the Deaf and the Blind. *(See Arizona State Schools for the Deaf and the Blind narrative for more information.)*

The Special Education Fund provides funding for special education costs of students from 1) Arizona State Schools for the Deaf and the Blind, 2) Arizona State Hospital (ASH), or 3) programs for the developmentally disabled operated by DES (A.R.S. § 15-1202). It also funds costs of residential education for students who require a private residential special education placement, or who are placed in a residential education facility by a state placing agency.

Other State Aid to Districts

The budget includes \$983,900 from the General Fund in FY 2016 for Other State Aid to Districts. This amount is unchanged from FY 2015.

This amount includes \$880,200 (unchanged) for Certificates of Educational Convenience pursuant to A.R.S. § 15-825 and \$103,700 (unchanged) for Assistance to School Districts for Children of State Employees (ASDCSE) pursuant to A.R.S. § 15-976.

Property Tax Relief

Additional State Aid - Homeowner's Rebate

The budget includes \$359,303,700 from the General Fund in FY 2016 for the Additional State Aid (ASA) - Homeowner's Rebate line item. This amount funds the following adjustments:

New Homes

The budget includes an increase of \$4,494,500 from the General Fund in FY 2016 for increased Homeowner's Rebate costs associated with new home construction. The \$4,494,500 estimate assumes that Class 3 properties (owner occupied homes) will account for about one-fourth of statewide property tax growth from new construction in FY 2016 and that approximately 46.0% of the QTR taxes owed by new homes will be paid by the state through the Homeowner's Rebate.

Property Taxes - Statutory Changes

The budget includes an increase of \$4,400,000 from the General Fund in FY 2016 to offset an anticipated increase in Homeowner Rebate costs for FY 2016 due to tax law changes pertaining to commercial property. Laws 2011, 2nd Special Session, Chapter 1 phases down the assessment ratio on commercial property from 20% to 18% over 4 years beginning in FY 2014, which will reduce statewide property values for commercial property in FY 2016. This will cause the statewide property tax base to be smaller in FY 2016 than it otherwise would be and Truth in Taxation will require the K-12 QTR to be increased accordingly. The latter change will increase the amount of QTR taxes paid by homeowners, which will increase Homeowner's Rebate costs by an estimated \$4,400,000 in FY 2016.

In addition, Chapter 1 increases the rebate percentage for the Homeowner's Rebate in order to also hold homeowners harmless for non-QTR rate increases that otherwise would occur under Chapter 1 to compensate for the lower commercial property assessed value. These rates may affect K-12 non-QTR taxes for school bonds and overrides. In addition, non-school tax rates, such as for cities, counties and community colleges, may also increase.

In combination, the higher TNT QTR and the rebate percentage change (described separately below) will cost an estimated \$22,500,000 in FY 2016.

Increased Rebate Percentage

The budget includes an increase of \$18,100,000 from the General Fund in FY 2016 for costs associated with an increased Homeowner's Rebate percentage required by

Laws 2011, 2nd Special Session, Chapter 1. Chapter 1 requires DOR to adjust the Homeowner's Rebate percentages for FY 2014 through FY 2017 in order to offset homeowner tax rate increases that otherwise would occur in those years due to reduced assessment ratios for commercial property. Unlike the \$4,400,000 cost associated with the higher statewide QTR, the \$18,100,000 reflects the cost of the higher rebate percentage associated with keeping homeowner local property taxes from increasing.

For FY 2015, DOR increased the rebate percentage to 43.559% versus 41.825% in FY 2014. The currently estimated cost of the required rebate percentage increase for FY 2016 is \$18,100,000, which would reflect a rebate percentage of roughly 46%. DOR is not expected to determine the actual rebate percentage for FY 2016 until the summer of 2015.

Display 1% Cap Separately

The budget includes a decrease of \$(27,600,000) from the General Fund in FY 2016 to display costs of the 1% cap in a separate line item for greater transparency starting in FY 2016. An offsetting \$27,600,000 increase from the General Fund is displayed in that new line item starting in FY 2016, resulting in no net funding change for the Additional State Aid program as a whole (Homeowner's Rebate and 1% cap combined) relative to what it would have been under the prior format apart from new policy issues.

Background – The Additional State Aid program authorized by A.R.S. § 15-972 primarily pays a portion of each homeowner's school district primary property taxes, up to a maximum of \$600 per parcel.

Additional State Aid - 1% Cap

The budget includes \$7,380,300 from the General Fund in FY 2016 for the Additional State Aid - 1% Cap line item. This amount funds the following adjustments:

Display 1% Cap Separately

The budget includes an increase of \$27,600,000 from the General Fund in FY 2016 to display costs of the 1% cap in a separate line item for greater transparency starting in FY 2016, as noted above.

Cap State Costs

The budget includes a decrease of \$(20,219,700) from the General Fund in FY 2016 to reflect a new cap on state costs for the program. The FY 2016 K-12 Education BRB amends A.R.S. § 15-972 in order to cap state costs for the 1% cap at a maximum of \$1,000,000 per county. The FY 2016 K-12 BRB requires the Property Tax Oversight Commission (PTOC) to allocate the loss of state 1% cap funding among local taxing jurisdictions based on its

determination of their pro rata shares of the overall 1% cap exceedance.

Background – The Additional State Aid program funds the Homeowner’s Rebate and any portion of a homeowner’s primary property taxes for all taxing jurisdictions combined (not just schools) that exceeds 1% of the full cash value of their home. This second feature is referred to as the “1% cap” and pertains to Article IX, Section 18 of the State Constitution, which caps Class 3 primary property taxes at no more than 1% of a home’s full cash value and was added to the State Constitution in 1980. It applies any time a homeowner’s net combined primary property tax rate for all taxing jurisdictions combined exceeds \$10 per \$100 of NAV even after the Homeowner’s Rebate is applied.

In practice, the 1% cap has been implemented by having the state backfill any primary property tax costs for homeowners that exceed the 1% cap, rather than by requiring all taxing jurisdictions in an area (such as cities, counties, school districts and community colleges) to coordinate their respective primary property tax rates in order to keep their combined primary rate below \$10 per \$100 of NAV. The related language in the State Constitution, however, does not specify a mechanism for enforcing the 1% cap.

In FY 2016, the FY 2016 K-12 Education BRB language will now require all taxing jurisdictions that contribute to an exceedance of the 1% cap, as determined by the Property Tax Oversight Commission (PTOC), to share in the excess cost after the state pays a maximum of \$1,000,000 in 1% cap funding per county.

In FY 2014, the 1% cap accounted for an estimated \$10.9 million (3.3%) of the \$329.1 million in total Additional State Aid costs based on formula modeling. The remaining \$318.2 million (96.7%) was used to fund the Homeowner’s Rebate.

For FY 2015, 1% cap costs grew by an estimated \$16.7 million to approximately \$27.6 million of the estimated \$359.9 million total cost of Additional State Aid for the year. The large increase in 1% cap costs for FY 2015 is attributable mostly to a \$1.43 increase in the combined primary property tax rate for property owners in the Tucson Unified School District (TUSD) (from \$11.98 in FY 2014 to \$13.41 in FY 2015). The impact of the \$1.43 increase on homeowners is passed on to the state because the combined primary property tax rate for property located within TUSD already exceeded the 1% cap in FY 2014. Other classes of property, such as commercial property and rentals, however, must pay the \$1.43 increase on their own, since the 1% cap does not apply to them.

Non-Formula Programs

Accountability and Achievement Testing

The budget includes \$16,422,400 and 2 FTE Positions in FY 2016 for Accountability and Achievement Testing. These amounts consist of:

| | |
|----------------------|-----------|
| General Fund | 9,422,400 |
| Proposition 301 Fund | 7,000,000 |

These amounts fund the following adjustments:

No AIMS Retests

The budget includes a decrease of \$(1,800,000) from the General Fund in FY 2016 due to the elimination of AIMS retests for high school students. Laws 2015, Chapter 5 stipulates that a pupil is not required to pass a standardized test during school years 2014-2015 through 2017-2018 in order to graduate from high school, which eliminates the need for AIMS retesting. This is estimated to reduce statewide achievement testing costs by \$(1,800,000) for FY 2016. Apart from Chapter 5, high school students through the Class of 2016 would still need to pass AIMS in order to graduate.

Statewide Adjustments

The budget includes a decrease of \$(1,200) from the General Fund in FY 2016 for statewide adjustments.

Background – New “AzMERIT” tests are being administered to Arizona public school students for the first time during the spring of 2015. The State Board of Education awarded the contract for the new test in November 2014 and at that time it was estimated to cost \$19,000,000 for FY 2015 and \$18,500,000 for FY 2016. Actual costs will depend on the proportion of students taking computer versus paper and pencil tests, which is not yet known. The \$19,000,000 estimate for FY 2015 assumed that 50% of students would take the less expensive computer based version during first year testing.

The Achievement Testing program, however, includes more than just AzMERIT testing. It also includes AIMS Science Tests, alternative exams for special needs students, and program administration. All of these functions and AzMERIT testing combined are expected to cost approximately \$25,700,000 in FY 2015 (see Table 6).

Table 6

**Estimated Achievement Testing Costs and
Available Funding for FY 2015
(\$ in Millions)**

| | |
|---|-----------------------------|
| Estimated Costs | |
| AzMERIT | \$19.0 ^{1/} |
| AIMS Science Testing | 2.7 |
| Alternative Special Needs Exam | 1.8 |
| Staff and Administration | <u>2.2</u> |
| Total | \$25.7 |
| | |
| Estimated Available Funding | |
| General Fund | \$11.2 |
| Proposition 301 - School Accountability | 7.0 |
| Federal Funds | <u>8.2</u> |
| Total | \$26.4 ^{2/} |

- ^{1/} Assumed that 50% of students will take computer-based test and 50% will take paper and pencil test. Actual cost will depend on percentages observed when tests are administered.
- ^{2/} ADE anticipates that carry-forward Proposition 301 monies from prior years will be available in FY 2015 to fund any difference between actual testing costs and other available funding.

Approximately \$26,400,000 was available to fund achievement testing costs in FY 2015, not including prior year carry-forward monies available from Proposition 301 (see Table 6).

The budget continues an existing General Appropriation Act footnote that requires JLBC review of any changes to the Achievement Testing program that will increase program costs.

This line item funds costs of developing, administering and scoring achievement tests required by A.R.S. § 15-741. The Proposition 301 amount of \$7,000,000 for Achievement Testing is from the “up to \$7 million” allowable appropriation for School Accountability in A.R.S. § 42-5029E7.

Laws 2015, Chapter 76, prohibits the department from assigning letter grades to schools for FY 2015 and FY 2016 based on achievement testing scores. It also prohibits using a pupil’s achievement testing scores as a factor in determining their letter grade in any course in school years 2014-2015 and 2015-2016.

(See Other Issues for more information.)

Adult Education

The budget includes \$4,500,000 and 2 FTE Positions from the General Fund in FY 2016 for Adult Education. These amounts are unchanged from FY 2015.

The program provides instruction in the following areas to adult learners who are at least 16 years of age: 1) English Language Acquisition; 2) Adult Basic Education, including

GED preparation; 3) Adult Secondary Education; 4) Civics; and 5) Basic computer literacy skills. Program monies are distributed through a competitive grant process. In FY 2015, a total of 25 school districts, community colleges, counties and community-based organizations are operating state-funded Adult Education programs.

The program also received approximately \$11,300,000 in federal funding in FY 2015. Its federal monies are subject to non-supplanting and maintenance of effort requirements stipulated in federal law.

Alternative Teacher Development Program

The budget includes \$500,000 from the General Fund in FY 2016 for an Alternative Teacher Development Program. This amount funds the following adjustments:

New Funding

The budget includes an increase of \$500,000 from the General Fund in FY 2016 in order to fund an Alternative Teacher Development Program. A.R.S. § 15-552 authorizes the establishment of an alternative teacher development program. This line item was last funded in FY 2008, when it received a General Fund appropriation of \$1,000,000.

Arizona Structured English Immersion Fund

The budget includes \$4,960,400 from the General Fund in FY 2016 for the Arizona Structured English Immersion Fund. This amount is unchanged from FY 2015.

The Arizona Structured English Immersion Fund was established by Laws 2006, Chapter 4 (A.R.S. § 15-756.04). Monies in the fund are distributed to school districts and charter schools based on amounts that they request pursuant to A.R.S. § 15-756.04C. The department distributed \$5,705,100 to public schools from the fund in FY 2014. It also transferred \$7,858,400 in accumulated fund balances to the state General Fund during FY 2014, as required by Laws 2013, 1st Special Session, Chapter 3 (the FY 2014 K-12 Education BRB).

English Learner Administration

The budget includes \$6,507,900 and 17 FTE Positions from the General Fund in FY 2016 for English Learner Programs. These amounts fund the following adjustments:

Statewide Adjustments

The budget includes a decrease of \$(8,900) from the General Fund in FY 2016 for statewide adjustments.

The program is responsible for administering the Arizona English Language Learner Assessment (“AzELLA”) test, which is used to determine whether a student should be classified as an “English Language Learner” (ELL) as defined in A.R.S. § 15-901B9. Students who are classified as ELLs are required to enroll in English language education programs prescribed by A.R.S. §§ 15-751, 15-752 and 15-753 and qualify for ELL weight funding authorized in A.R.S. § 15-943. Approximately 125,500 students are expected to take the AzELLA in FY 2015, including 47,000 for initial testing and 78,000 for retesting to see if they should continue to be classified as ELLs.

The English Learner Administration program was originally authorized by Laws 2006, Chapter 4 in order to address the *Flores v. State of Arizona* litigation. The lawsuit was filed in federal court in 1992 by parents of children enrolled in the Nogales Unified School District. Litigation in the case continued until March 2013, when a federal judge dismissed the case. Plaintiffs in the case appealed the federal judge’s ruling in April 2013. The timeline for appellate action in the case is unknown. (See FY 2011 Appropriations Report for additional history on this issue.)

The line item funds costs associated with implementing the English Language Education requirements in A.R.S. § 15-751 through 15-757. Those requirements pertain primarily to additional testing, teacher training and instructional services prescribed for English Learners.

Information Technology Certifications

The budget includes no funding from the General Fund in FY 2016 for Information Technology Certifications. This amount funds the following adjustments:

Eliminate Program

The budget includes a decrease of \$(1,000,000) from the General Fund in FY 2016, which eliminates program funding.

The program was intended to prepare students for industry-recognized information technology certification exams and provide for bulk purchasing of those exams.

JTED Performance Pay

The budget includes no funding in FY 2016 for JTED Performance Pay. This amount funds the following adjustments:

Remove One-Time Funding

The budget includes a decrease of \$(500,000) from the General Fund in FY 2016 for the elimination of one-time funding. A General Appropriation Act footnote required

the department to distribute the appropriated FY 2015 amount on a pro rata basis based on the actual costs incurred to secure industry credential assessments and examinations for JTED students.

JTED Soft Capital

The budget includes \$1,000,000 from the General Fund in FY 2016 for JTED Soft Capital. This amount funds the following adjustments:

New Funding

The budget includes an increase of \$1,000,000 from the General Fund in FY 2016 for JTED Soft Capital. A General Appropriation Act footnote stipulates that the department shall distribute these monies to JTEDs with fewer than 2,000 ADM pupils on a pro rata basis based on their ADM counts.

Program funding is to be used for JTED soft capital and equipment expenses.

School Safety Program

The budget includes \$3,646,500 and 1 FTE Position from the General Fund in FY 2016 for the School Safety program. These amounts are unchanged from FY 2015.

The School Safety Program places trained school resource officers or juvenile probation officers in public schools and has existed in Arizona since FY 1995. (See the FY 2015 Appropriations Report for program history.)

The FY 2016 K-12 Education BRB continues to require \$100,000 of the \$3,646,400 appropriation to be used for a pilot program on school emergency readiness. The FY 2016 K-12 Education BRB requires the department to submit a report that summarizes the results of the FY 2016 program by November 1, 2016.

The FY 2014 K-12 Education BRB required the department to submit a report that summarizes the results of the FY 2014 program by November 1, 2014. That report indicated that the 3 school districts that participated in the pilot program in FY 2014 (Continental Elementary, Osborn Elementary and Prescott Unified) all accomplished the following: 1) improved emergency management functions and aspects of school emergency response plans, 2) enhanced coordination and collaboration of internal district emergency planning team with community response partners, 3) trained staff on emergency operations plan supported by exercises and drills, and 4) worked with local law enforcement agencies to implement related software.

All available state General Fund and Proposition 301 funding for the program is allocated annually by the School Safety Program Oversight Committee pursuant to A.R.S. § 15-153C. Monies are awarded on a competitive grant basis on a 3-year cycle. FY 2015 is the first year of the current cycle.

Program funding is used primarily to pay officer salaries and benefits. Law enforcement agencies typically cover associated costs for police cars, uniforms and equipment. School districts and charter schools typically pay costs for related overhead, supervision and supplies.

State Block Grant for Vocational Education

The budget includes \$11,560,900 and 27 FTE Positions from the General Fund in FY 2016 for the State Block Grant for Vocational Education. These amounts fund the following adjustments:

Statewide Adjustments

The budget includes a decrease of \$(15,400) from the General Fund in FY 2016 for statewide adjustments.

The program provides block grants to school districts and charter schools that have Career and Technical Education (CTE) programs. CTE programs also currently receive approximately \$24,000,000 in federal funding annually pursuant to the Carl D. Perkins Vocational and Technical Education Act of 2006. Those monies are subject to a federal maintenance of effort (MOE) provision that requires a state to continue to spend at least as much on CTE in a given fiscal year as it did in the prior fiscal year.

Student Success Fund Deposit

The budget includes no funding from the General Fund in FY 2016 for the Student Success Fund Deposit Line Item. This amount funds the following adjustments:

Eliminate Program

The budget includes a decrease of \$(22,400,000) from the Student Success Fund in FY 2016 in order to eliminate the program.

Monies in the line item were used in order to fund the Student Success Funding program. *(See Student Success Funding line item narrative above for more information.)*

Teacher Certification

The budget includes \$1,834,300 and 22 FTE Positions from the Teacher Certification Fund in FY 2016 for Teacher Certification. These amounts fund the following adjustments:

Statewide Adjustments

The budget includes a decrease of \$(8,200) from the Teacher Certification Fund in FY 2016 for statewide adjustments.

The program processes applications for teacher and administrator certification, including certification renewal. It is funded through fees paid by certification applicants pursuant to A.R.S. § 15-531.

The newly separate State Board of Education budget continues to receive \$379,800 (unchanged) from the Teacher Certification Fund in FY 2016 to investigate allegations of immoral or unprofessional behavior by teachers and other certificated school personnel. *(See State Board of Education budget for more information.)*

The board therefore continues to receive funding and perform duties pertaining to certification investigations, while the department continues to receive funding and perform duties pertaining to certification processing.

Technology-Based Language Development and Literacy Intervention Pilot Program

The budget includes \$246,800 from the Technology-Based Language Development and Literacy Intervention Fund in FY 2016 for the Technology-Based Language Development and Literacy Intervention Pilot Program. This amount funds the following adjustments:

Base Adjustment

The budget includes a decrease of \$(53,200) from the Technology-Based Language Development and Literacy Intervention Fund in FY 2016 in order to align the program's budget with available resources.

The FY 2015 K-12 Education BRB (Laws 2014, Chapter 17) established a 2-year pilot program on Technology-Based Language Development and Literacy Intervention to be funded through a new Technology-Based Language Development and Literacy Intervention Fund authorized by A.R.S. § 15-217H. Chapter 17 required the Commission for Postsecondary Education to transfer \$546,800 from the Commission for Postsecondary Education IGA/ISA Fund into the new fund by August 1, 2014 in order to help fund the pilot program. The \$546,800 amount consisted of unused funding from the now-eliminated Early Graduation Scholarship Program (formerly established by A.R.S. § 15-105).

As originally passed, Chapter 17 also required the Department of Education to transfer \$53,200 in state General Fund funding from its Accountability and Achievement Testing program to the Technology-Based

Language Development and Literacy Intervention Fund by August 1, 2014, which would have provided \$600,000 in total funding for the 2-year pilot. In 2014, the Governor, however, vetoed the latter provision. As a result, the program has \$(53,200) less in funding available for its second year (FY 2016) than the \$300,000 amount appropriated and available to it in FY 2015. The budget reduces the program's FY 2016 budget accordingly. Program funding for FY 2016 does not appear in the General Appropriation Act, since it has already been appropriated by Chapter 17.

The program seeks to promote English language development and literacy for public school pupils in Grades K-6. Chapter 17 requires the department to develop application procedures and selection criteria for school districts and charter schools that voluntarily decide to participate in the pilot program.

State Board of Education

State Board of Education

The budget includes no funding for FY 2016 for the State Board of Education. This amount funds the following adjustments:

Establish Separate Budget Unit

The budget includes a decrease of \$(1,234,800) and (4) FTE positions from the General Fund and \$(379,800) and (5) FTE Positions from the Teacher Certification Fund in FY 2016 in order to establish the State Board of Education as a separate budget unit.

The General Appropriation Act appropriates these amounts plus \$90,400 and 2 FTE Positions transferred from the K-3 Reading line item to the newly separate State Board of Education budget unit. *(See the State Board of Education budget unit narrative for more information.)*

The 11-member State Board of Education establishes programs, initiates policies and enforces laws and regulations relating to schools and the educational development of the individual child as provided in A.R.S. § 15-203. The board members other than the Superintendent of Public Instruction are appointed by the Governor for 4-year terms.

Additional Legislation

Tribal College Dual Enrollment Program Fund

The FY 2016 Higher Education BRB (Laws 2015, Chapter 16) establishes a Tribal College Dual Enrollment Program Fund. The fund is allocated 15% of unclaimed lottery prize monies, subject to legislative appropriation, plus any appropriations, gifts, grants, devices and other

contributions. The FY 2016 budget does not appropriate any monies out of the fund for FY 2016. The fund is to be administered by the Department of Education.

The department is to distribute monies in the fund to tribal colleges in order to compensate them for tuition and fees that are waived to allow high school students to attend tribal college campuses, including college classes taught electronically.

(See Arizona State Lottery Commission narrative for more information.)

JTED Satellite Courses at Charter Schools

Laws 2015, Chapter 309 allows a JTED governing board to contract with any charter school that is located within its boundaries to offer Career and Technical Education (CTE) courses or programs as a satellite campus. Previously only school districts could operate JTED satellite sites.

The bill will increase Basic State Aid costs by an estimated \$200,000 in FY 2017 and by \$1.0 million to \$2.0 million upon full utilization. These estimates are highly speculative, however, as the actual impact will depend on how individual JTEDs and charter schools will respond to new incentives created by the bill and on student interest in the newly-authorized JTED satellite programs.

Other Issues

This section includes information on the following topics:

- Fund Transfers
- Formula Changes for FY 2017
- Long-Term Budget Impacts
- Achievement Testing
- Education Learning and Accountability System
- Endowment Earnings
- Proposition 301
- Budget Overrides
- Basic State Aid Formula Description

Fund Transfers

The budget includes the following FY 2016 transfers from this agency's funds to the General Fund.

| | |
|---|-------------|
| State Facilities Special Education Fund | \$4,000,000 |
| Student Success Fund | 2,400,000 |

Formula Changes for FY 2017

JTED

Starting in FY 2017, the FY 2016 K-12 Education BRB permanently requires Base Support Level (BSL) funding for students who attend JTEDs to be funded at 92.5% for both the “sending” district or charter and for the JTED itself, except that districts and charters sending students to a JTED centralized campus will still receive full BSL funding for them. This is estimated to reduce state aid to JTEDs, districts and charters by \$(30,000,000) statewide for FY 2017.

The FY 2016 K-12 Education BRB allows a school district or charter school that experiences a funding loss due to the 92.5% BSL funding factor for JTED satellite students to use a portion of its JTED satellite funding to offset the loss, up to the amount of the loss. The FY 2016 K-12 Education BRB does not allow a school district to prohibit or discourage students from attending a JTED.

Hold Harmless

Starting in FY 2017, the FY 2016 K-12 Education BRB also permanently eliminates a “hold harmless” provision that currently delays for one year the impact of school district enrollment declines. This change will reduce state aid to school districts statewide by an estimated \$(40,000,000) for FY 2017. The FY 2016 K-12 Education BRB requires the department to notify school districts by December 15, 2015 on how it plans to implement current year Average Daily Membership funding in FY 2017 and report the estimated fiscal impact by district.

Long-Term Budget Impacts

As part of the budget’s 3-year spending plan, ADE General Fund costs are projected to increase by \$124,770,800 in FY 2017 above FY 2016 and \$156,605,200 in FY 2018 above FY 2017. These estimates are based on:

- 1.4% ADM growth for both fiscal years.
- 12,000 new charter ADM and 3,000 new special education weighted ADM for both fiscal years.
- GDP inflators of 1.86% for FY 2017 and 1.79% for FY 2018.
- New construction NAV growth of 2.03% for FY 2017 and 1.99% for FY 2018.
- A \$37.6 million increase in Homeowner’s Rebate costs in FY 2017 to hold homeowners harmless for tax rate changes associated with the final year of a 4-year phase down of the assessment ratio for Class 1 property. This cost remains in the base budget for FY 2018, but does not further increase that year, since

the assessment ratio phase down is completed after FY 2017.

- A \$(6.5) million decrease in FY 2017 and additional \$(7.0) million decrease in FY 2018 in order to fund small school weights for most multisite charter schools at 33% in FY 2017 and eliminate small school weight funding for most multi-site charter schools in FY 2018.
- A \$(1.2) million decrease in FY 2017 to eliminate remaining district sponsored charter schools.
- A \$(40.0) million decrease in FY 2017 to eliminate a one-year hold harmless provision for school districts with declining enrollments.
- A \$(30.0) million decrease in FY 2017 in order to reduce Base Support Level (BSL) per pupil funding for JTEDs and their “sending” districts and charters, as required starting in FY 2017 by the FY 2016 K-12 Education BRB. That law amends A.R.S. § 15-393 to require BSL per pupil funding to be funded at 92.5%

These estimates do not include additional funding that could be required for settlement of the current Proposition 301 inflation lawsuit. (*See the 1.59% Inflation Adjustment narrative under Basic State Aid for additional information.*)

Achievement Testing

The department is implementing a new statewide achievement test in the spring of FY 2015. The new test is aligned to new academic standards adopted by the State Board of Education in December 2010. There is no specific state statutory requirement regarding implementation of the new standards. The State Board of Education, however, adopted them in December 2010 under powers granted to it by A.R.S. § 15-203. In September 2013, the Governor issued an Executive Order requiring executive agencies to refer to these standards as “Arizona’s College and Career Ready Standards” (ACCR).

The ACCR standards list knowledge and skills that students are expected to learn each year in English language arts and Math in the 45 states that have adopted Common Core standards in some fashion. As a result, participating states will be able to use common exams and compare test performance of students across states. Prior to the adoption of ACCR standards, Arizona students were instead taught under state-specific academic standards and tested by Arizona Instrument to Measure Standards (AIMS) tests that were not comparable to tests used by other states.

Under AIMS, high school students could not graduate until they had passed AIMS Math, Reading and Writing tests that were administered separately from their high

school math and English classes. Under ACCR, the math and English content required for high school graduation will instead be incorporated into “end of courses tests” (final exams) for high school math and English classes themselves.

Students therefore will be able to graduate under ACCR if they pass all required classes without having to also pass separate graduation tests. Non-high school students generally will not have to pass annual ACCR exams in order to be promoted to the next grade, as is true under AIMS testing. Students in 3rd Grade, however, will still need to score at better than the “falls far below the 3rd Grade level” on ACCR English language tests in order to be promoted to 4th Grade under Arizona’s “Move on When Reading” law (A.R.S. § 15-701A2a).

States will be responsible for costs of administering the tests, once developed. Those costs are expected to rise under the new exams because of the more complex nature of their questions and of their subsequent scoring requirements.

Arizona used a competitive bid process to select a vendor to provide the new test and the scoring. As a result of this process, the State Board of Education awarded a contract for the new tests in November 2014 to the American Institutes for Research (AIR). The estimated cost of the new contract at the time of award was approximately \$19.0 million for FY 2015 and \$18.5 million for FY 2016. (See the Accountability and Achievement Testing line item narrative for more information.)

Education Learning and Accountability System

Laws 2011, Chapter 29 authorized development of the Education Learning and Accountability System (ELAS), in order to “collect, compile, maintain and report student level data for students attending public educational institutions that provide instruction to pupils in preschool programs, kindergarten programs, grades 1 through 12 and postsecondary educational programs in this state” (A.R.S. § 15-249A).

Beginning in FY 2015, ELAS funding is appropriated to the Arizona Department of Administration Automation Projects Fund rather than ADE. As a result, ELAS funding no longer appears in the ADE budget. (Please see the Arizona Department of Administration - Automation Projects Fund section for more information.)

The FY 2016 K-12 Education BRB continues to require community college and universities to transfer \$6 per Full-Time Student Equivalent (FTSE) to ADE by December 1 of the budget year for deposit into the ELAS Fund in order to continue to help fund ELAS.

Endowment Earnings

In FY 2014, endowment earnings from state trust lands public schools funded approximately \$125.1 million of Basic State Aid, School Facilities Board bond debt service and K-12 Classroom Site Fund costs.

Endowment earnings originate from the sale or lease of lands that the federal government deeded to Arizona in the Enabling Act in 1910 in order to provide support for public functions such as education. Approximately 9.2 million of the original 11.0 million acres of state trust lands remain, of which approximately 87% (8.1 million acres) are for the benefit of public schools, with the rest being designated mostly for the benefit of universities and corrections. K-12 education therefore is by far the largest beneficiary of earnings generated from state trust lands.

The State Land Department and State Treasurer both generate endowment earnings from state trust lands. The State Land Department generates endowment earnings primarily by selling or leasing state trust lands and natural products from trust lands. The State Treasurer generates endowment earnings by investing monies received from the State Land Department from the sale of state trust lands and related natural products in stocks, bonds and other income-earning investments.

State trust land earnings are considered either “permanent” or “expendable” depending on whether they are one-time in nature. Only expendable monies are distributed to beneficiaries, as permanent monies are considered to be part of the original endowment and must be reinvested rather than distributed to beneficiaries. Permanent monies include one-time proceeds from the sale of state trust lands and natural products from state trust lands.

Expendable monies include ongoing income that the State Land Department generates from leases, permits and interest from sales contracts and a portion of investment returns generated by the State Treasurer. In FY 2014, public schools received \$125.1 million of expendable land trust monies from the State Land Department and State Treasurer combined. That total included \$57.3 million from the Land Department and \$67.8 million from the State Treasurer (see Table 7).

| Source | 2006 | 2010 | 2014 |
|-----------------|-------------|-------------|--------------|
| Land Department | 58.7 | 38.1 | 57.3 |
| Treasurer | 31.4 | 0.0 | 67.8 |
| Total | 90.1 | 38.1 | 125.1 |

Table 7 shows that K-12 endowment earnings increased from \$90.1 million in FY 2006 to \$125.1 million in FY 2014 after dropping temporarily to \$38.1 million during the Great Recession.

For FY 2015, the State Treasurer distribution of K-12 endowment earnings will be \$76.0 million, which is a known number because it is based on land trust market values through calendar year 2013 only (prior 5 calendar years). The State Land Department will distribute an estimated \$46.5 million in K-12 endowment earnings for FY 2015 based on revenue data for the first 8 months of FY 2015. The actual State Land Department distribution of K-12 endowment earnings for FY 2015 will not be known until after the close of the fiscal year.

Of the \$125.1 million in K-12 expendable earnings generated for FY 2014, \$25.8 million was used to help fund School Facilities Board debt service pursuant to A.R.S. § 37-521B2 and \$46.5 million was used to help fund Basic State Aid pursuant to A.R.S. § 37-521B3. The remaining \$52.8 million was deposited into the Classroom Site Fund (A.R.S. § 15-977) pursuant to A.R.S. § 37-521B4. The latter law dedicates to the Classroom Site Fund all growth in K-12 expendable endowment earnings above the FY 2001 level, which was \$72.3 million.

The portion of Treasurer land trust earnings that is considered expendable is determined by a formula prescribed in the State Constitution, since the value of invested land trust monies fluctuates daily. Currently, the State Constitution requires the State Treasurer to distribute annually to each beneficiary (such as public schools) a flat 2.5% of the average monthly market value of the beneficiary's permanent fund for the immediately preceding 5 calendar years.

The 2.5% factor was enacted into law by Proposition 118 in November 2012 and will be in effect through calendar year 2021. It is intended to reflect the long-term average for investment returns on invested land trust monies, while eliminating large fluctuations in expendable earning distributions to beneficiaries that occurred in prior years due to market volatility.

After calendar year 2021, the distribution formula in effect prior to Proposition 118 would resume under current law. That formula computed expendable Treasurer land trust earnings based on inflation adjusted rates of investment return observed for invested land trust proceeds over the preceding 5 calendar years. Those rates of return fluctuated substantially from year to year in the past depending on market conditions (see *Treasurer's earnings in Table 7*).

The total market value of state land trust monies currently invested by the State Treasurer for all beneficiaries combined (not just public schools) recently surpassed \$5.0 billion for the first time (up from \$1.2 billion in FY 2004, for example), due largely to strong stock market performance in recent years. This will increase the amount of expendable land trust earnings distributed by the State Treasurer in the future, since it will cause the flat 2.5% annual distribution factor from Proposition 118 to apply to a larger 5-year average value for invested land trust monies.

Proposition 301

Proposition 301, which was passed by voters in November 2000, amended A.R.S. § 42-5010 in order to increase the state Transaction Privilege Tax (TPT) ("sales tax") rate on most purchases from 5% to 5.6% through FY 2021 in order to generate more funding for public education. It also amended A.R.S. § 42-5029 in order to prescribe how the new sales tax revenues would be allocated (see *Table 8*).

As shown in *Table 8*, Proposition 301 revenues are earmarked for the following items:

- Debt service on \$794.7 million of School Facilities Board bonds used for deficiencies correction.
- Universities (12% of the remainder after SFB debt service).
- Community colleges (3% of the remainder).
- Tribal Colleges (same formula as community colleges).
- Income tax credit for sales tax paid by low income households (to offset the additional 0.6¢ sales tax rate).
- Additional School Days.
- School Safety and Character Education.
- School Accountability.
- Failing Schools.
- Classroom Site Fund (A.R.S. § 15-977).

Proposition 301 dedicates to the Classroom Site Fund all 0.6¢ sales tax monies remaining after all other distributions are made. Its share equaled \$333.9 million (55.6%) of the \$600.2 million collected for FY 2014 (see *Table 8*). The Proposition 301 sales tax expires after FY 2021.

Classroom Site Fund

Proposition 301 also dedicated to the Classroom Site Fund all growth in K-12 expendable land trust earnings above the amount generated by the State Treasurer and State Land Department combined for FY 2001 (the last year before Proposition 301 took effect), which equaled \$72.3 million. In FY 2014, the Classroom Site Fund received approximately

Table 8

**Proposition 301 Monies
(FY 2014 Actual)
(\$ in Millions)**

| <u>Recipient</u> | <u>Amount</u> | <u>Comment</u> |
|------------------------------------|----------------|--|
| School Facilities Board | \$56.2 | For debt service on \$794.7 million of bonds authorized by Proposition 301 for school repairs and updates. |
| Universities | 65.3 | Receive 12% of monies remaining after SFB debt service is deducted. |
| Community Colleges | 16.3 | Receive 3% of monies after SFB debt service. |
| Tribal Colleges | 0.7 | Same formula as for community colleges. |
| Income Tax Credit | <u>25.0</u> | For income tax credit authorized by A.R.S. § 43.1072.01. |
| Subtotal - Non ADE Programs | 163.5 | |
| Additional School Days | 86.3 | To add 5 days to K-12 school year (180 days total). |
| School Safety | 8.0 | \$7.8 million for School Safety (A.R.S. § 15-154) and \$0.2 million for Character Education (A.R.S. § 15-154.01). |
| School Accountability | 7.0 | For school accountability pursuant to A.R.S. § 15-241 and § 15-1041. |
| Failing Schools | 1.5 | To Failing Schools Tutoring Fund (A.R.S. § 15-241CC). |
| Classroom Site Fund | <u>333.9</u> | Established by A.R.S. § 15-977. Receives all monies remaining after other distributions are made. Also receives all expendable K-12 endowment earnings above \$72.3 million. |
| Subtotal - ADE Programs | 436.7 | |
| Grand Total | \$600.2 | |

\$52.8 million from K-12 endowment earnings, which resulted in total deposits of \$386.7 million (\$333.9 million from the 0.6¢ sales tax + \$52.8 million from endowment earnings = \$386.7 million).

The \$333.9 million that the Classroom Site Fund received from the 0.6¢ sales tax in FY 2014 does not include approximately \$102.8 million in school-related costs also funded by Proposition 301 for items such as Additional School Days that appear in *Table 7*. Those 2 amounts combined equaled \$436.7 million for FY 2014.

ADE distributed \$310 per pupil from the Classroom Site Fund in FY 2014. Those monies were in addition to funds allocated through the Basic State Aid formula. School districts and charter schools may use Classroom Site Fund monies for any purpose listed in A.R.S. § 15-977H, which includes items such as class size reductions and teacher compensation.

The Classroom Site Fund is expected to distribute \$295 per pupil for FY 2015 and \$327 per pupil for FY 2016. The per pupil amount declined temporarily in FY 2015 due to the loss of one-time carry-forward monies.

Budget Overrides

Current law permits school districts to exceed statutory budget limits through “budget override” elections. This includes Maintenance and Operation (M&O) overrides (A.R.S. § 15-481E&F), Special Program overrides (A.R.S. § 15-482) and District Additional Assistance overrides (called Capital Overrides prior to FY 2014) (A.R.S. § 15-481L&M).

M&O and Special Program overrides together are capped at 15% of a district’s Revenue Control Limit (RCL). (“RCL” essentially equals a district’s total funding under the Basic State Aid formula minus its District Additional Assistance funding, pursuant to A.R.S. § 15-947.) District Additional Assistance overrides are capped at 10% of a district’s RCL.

M&O and Special Program overrides provide additional funding for school district operating expenses, such as teacher salaries. District Additional Assistance overrides instead must be used for the capital improvements listed in the publicity pamphlet for the override, except that up to 10% of the override proceeds may be used for general capital expenses, including cost overruns of proposed capital improvements, pursuant to A.R.S. § 15-481X.

Overrides are funded with additional local property taxes. All 3 types of overrides may be authorized for up to 7 years. M&O and Special Program overrides are phased down over the last 2 years of authorization unless re-approved by voters.

For FY 2015, 94 districts statewide have M&O overrides pursuant to A.R.S. § 15-481, 9 have “Special Program” overrides pursuant to A.R.S. § 15-482, and 23 have District Additional Assistance overrides. The total amounts budgeted for overrides for FY 2015 include \$387.3 million for M&O overrides, \$6.9 million for Special Program overrides and \$74.2 million for District Additional Assistance overrides. Grand total override funding for FY 2015 therefore equals \$468.4 million, which is \$25.5 million above the \$442.9 million amount budgeted for all overrides collectively in FY 2014 (*see Table 9*). (*See the*

School Facilities Board budget narrative for a related summary on K-12 Capital Bonding.)

| K-12 Budget Overrides (\$ in Millions) | | | |
|--|----------------|----------------|---------------|
| Type of Override | FY 2014 | FY 2015 | Change |
| M&O | 364.7 | 387.3 | 22.6 |
| Special Program | 19.0 | 6.9 | (12.1) |
| Additional Assistance | <u>59.2</u> | <u>74.2</u> | <u>15.0</u> |
| Total | 442.9 | 468.4 | 25.5 |

A.R.S. § 15-249.04 requires ADE to report by November 30 of each year the amount budgeted for school district budget overrides by district and type of override for the current fiscal year. The data cited in *Table 9* are from the related ADE reports for FY 2014 and FY 2015.

Basic State Aid Formula Description

Basic State Aid funding is based on a statutory formula enacted in 1980 and substantially modified in 1985. This formula “equalizes” formula funding among school districts, enabling them all to spend approximately the same amount of formula money per pupil from state and local sources combined. (Non-formula funding, such as from bonds and overrides, is not equalized.) Districts with a very strong local property tax base are able to generate their entire formula funding entitlement from local property taxes alone. Most school districts, however, require “Basic State Aid” monies in order to receive full formula funding.

The equalization formula for school districts consists of 3 components: the Base Support Level (BSL), Transportation Support Level (TSL), and District Additional Assistance (DAA). BSL and DAA funding are computed by multiplying specific dollar amounts in statute by a school district’s student count, adjusted for various weights. The TSL instead is computed by multiplying specific dollar amounts per route mile in statute by a district’s pupil transportation route miles. The sum of the 3 formula components equals what is referred to as a school district’s “equalization base,” which is its total funding entitlement under the K-12 equalization funding formula.

After a school district’s equalization base is determined, its net assessed property value (NAV) is multiplied by the statutory “Qualifying Tax Rate” (QTR) (A.R.S. § 15-971B) in order to determine the portion of its formula funding that is assumed to come from QTR taxes. This amount, plus the district’s share of State Equalization Tax Rate (SETR) revenues (A.R.S. § 15-994), if any, are then subtracted from its equalization base. If the district’s combined QTR

and SETR revenues exceed its equalization base, the district is not entitled to Basic State Aid. If, however, its “local share” funding does not exceed its equalization base, the district receives Basic State Aid funding to make up the difference. The actual local property tax rate for schools may be lower than the QTR (such as if the QTR would raise more than the district’s formula funding entitlement), or higher if the district is allowed to budget for items outside of its “Revenue Control Limit” (RCL) pursuant to A.R.S. § 15-910.

Basic State Aid is also provided to charter schools, which are schools that do not have geographic boundaries, operate under terms specified in a “charter,” and are sponsored by an entity such as the State Board for Charter Schools. The equalization funding formula for charter schools does not include DAA or separate transportation funding and instead consists only of BSL and CAA funding. BSL funding for charter schools is determined under the same formula prescribed for traditional public schools in A.R.S. § 15-943. CAA funding amounts are established separately in A.R.S. § 15-185B4 and for FY 2015 (as modified by the FY 2015 K-12 Education BRB) equal \$1,707.77 per pupil for Grades K-8 and \$1,990.38 per pupil for Grades 9-12. Charter schools receive all of their equalization funding through Basic State Aid, since they do not have authority to generate funding through local property taxes.