

Department of Education

	FY 2015 ACTUAL	FY 2016 ESTIMATE	FY 2017 APPROVED
OPERATING BUDGET			
<i>Full Time Equivalent Positions</i>	175.9	164.9	171.9 ^{1/}
Personal Services	4,543,100	5,297,300	6,110,100
Employee Related Expenditures	1,648,500	1,929,300	2,077,000
Professional and Outside Services	398,400	960,300	1,244,600
Travel - In State	19,700	22,600	24,600
Travel - Out of State	16,700	12,500	14,000
Other Operating Expenditures	1,888,600	2,136,800	2,329,100
Equipment	842,500	1,116,900	1,118,200
OPERATING SUBTOTAL	9,357,500	11,475,700	12,917,600 ^{2/3/4/5/}
SPECIAL LINE ITEMS			
Formula Programs			
Basic State Aid	3,341,523,300	3,621,149,600 ^{6/}	3,723,868,200 ^{7/-12/}
State Aid Supplement	0	50,000,000 ^{13/14/}	50,000,000 ^{13/14/}
Current-Year Funding Backfill	0	0	31,000,000 ^{15/16/17/}
Former District-Sponsored Charter Schools	0	0	1,148,000 ^{18/19/}
Additional Inflation	0	0 ^{20/}	0
K-3 Reading	40,005,400	39,917,300	0 ^{21/}
School Year 2013-2014 School District Charter School Conversions	24,500,000	0	0
Student Success Funding	18,746,600	0	0
Special Education Fund	33,242,100	32,242,100	32,242,100
Other State Aid to Districts	181,500	983,900	983,900
Property Tax Relief			
Additional State Aid - Homeowner's Rebate	354,994,900	359,303,700	391,456,100
Additional State Aid - 1% Cap	7,407,200	7,380,300	7,380,300
Non-Formula Programs			
Accountability and Achievement Testing	11,223,700	16,422,400	16,420,800 ^{22/}
Adult Education	4,486,900	4,500,000	4,498,200
Alternative Teacher Development Program	0	500,000	500,000
Arizona Structured English Immersion Fund	4,960,400	4,960,400	4,960,400
Code Writers Initiative Pilot Program	0	0	500,000 ^{23/24/}
English Learner Administration	6,451,100	6,507,900	6,495,000 ^{25/}
Geographic Literacy	0	0	100,000 ^{26/}
Information Technology Certifications	1,000,000	0	0
JTED Performance Pay	500,000	0	0
JTED Soft Capital and Equipment	0	1,000,000	1,000,000 ^{27/}
School Safety Program	4,125,800	3,646,500	3,645,600
State Block Grant for Vocational Education	11,575,400	11,560,900	11,576,300
Student Success Fund Deposit	22,400,000	0	0
Teacher Certification	1,656,100	1,834,500	1,828,100
Technology-Based Language Development and Literacy Intervention Pilot Program	0	246,800	0
Tribal College Dual Enrollment Program Fund	0	160,000	250,000
State Board of Education			
State Board of Education	1,036,500	0	0
AGENCY TOTAL	3,899,374,400	4,173,792,000	4,302,770,600 ^{28/-31/}

	FY 2015 ACTUAL	FY 2016 ESTIMATE	FY 2017 APPROVED
FUND SOURCES			
General Fund	3,831,124,100	3,941,873,900	4,069,375,800
<u>Other Appropriated Funds</u>			
Department of Education Empowerment Scholarship Account Fund	200,100	399,000	797,900
Department of Education Professional Development Revolving Fund	777,700	2,700,000	2,700,000
Permanent State School Fund	46,475,500	219,440,500	219,804,200
Proposition 301 Fund	0	7,000,000	7,000,000
State Web Portal Fund	0		500,000
Student Success Fund	18,746,600	0	0
Teacher Certification Fund	2,050,400	1,971,800	2,342,700
Technology-Based Language Development and Literacy Intervention Fund	0	246,800	0
Tribal College Dual Enrollment Program Fund	0	160,000	250,000
SUBTOTAL - Other Appropriated Funds	68,250,300	231,918,100	233,394,800
SUBTOTAL - Appropriated Funds	3,899,374,400	4,173,792,000	4,302,770,600
Other Non-Appropriated Funds	521,847,700	592,397,400	605,374,200
Federal Funds	1,135,613,800	1,175,376,900	1,175,376,900
TOTAL - ALL SOURCES	5,556,835,900	5,941,566,300	6,083,521,700

AGENCY DESCRIPTION — The Department of Education (ADE) is headed by the Superintendent of Public Instruction, an elected constitutional officer. For FY 2017 it is anticipated that the department will oversee 237 school districts, accommodation districts and Joint Technological Education Districts and approximately 430 charter schools in their provision of public education from preschool through grade 12.

- 1/ Includes 48.7 GF and 21.1 OF FTE Positions funded from Special Line Items in FY 2017.
- 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/ The amount appropriated for the department's operating budget includes \$500,000 for technical assistance and state level administration of the K-3 Reading program established pursuant to A.R.S. § 15-211. (General Appropriation Act footnote)
- 5/ The FY 2017 total includes \$231,200 and 2 FTE Positions from the General Fund and \$379,800 and 5 FTE Positions from the Teacher Certification Fund that are transferred to the department from the State Board of Education pursuant to Laws 2016, Chapter 138.
- 6/ Includes \$2,354,400 from the General Fund and \$172,081,000 from the Permanent State School Fund appropriated by Laws 2015, 1st Special Session, Chapter 1. Also includes \$74,394,000 that Chapter 1 transferred to Basic State Aid from a separate Additional Inflation separate line item in the original FY 2016 budget.
- 7/ Includes K-12 rollover appropriation of \$930,727,700 from Laws 2015, Chapter 8. Laws 2016, Chapter 117 also appropriates \$930,727,700 in FY 2018 to reflect the deferral of FY 2017 payments.
- 8/ 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 \$219,804,200 in expendable income derived from the Permanent State School Fund and from state trust lands pursuant to A.R.S. § 37-521B for FY 2017, except that if Proposition 123 is not approved by voters, the amount of expendable income derived from the Permanent State School Fund and from state trust lands pursuant to A.R.S. § 37-521B, for FY 2017 is estimated to be \$47,359,500. (General Appropriation Act footnote) Note: Proposition 123 was approved.
- 9/ Monies 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)
- 10/ 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, income from the investment of permanent state school 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)
- 11/ The following footnote did not become effective, since Proposition 123 was approved by voters in May 2016: The amount appropriated for Basic State Aid from the Permanent State School Fund for FY 2017 is reduced by \$172,444,700 if Proposition 123 is not approved by voters. (General Appropriation Act footnote)

- 12/ The following footnote did not become effective, since Proposition 123 was approved by voters in May 2016: If Proposition 123 is not approved by voters, the department shall allocate \$74,394,000 of the Basic State Aid appropriation for a separate additional inflation adjustment apart from the Basic State Aid formula. The additional inflation monies would be allocated to school districts and charter schools in FY 2017 in the same manner that they would be allocated if they were for an additional increase of \$54.31 in the base level prescribed in A.R.S. § 15-901B2, for FY 2017 and the department would increase budget limits accordingly. The department also would increase the budget limits of a school district that is not eligible to receive Basic State Aid funding for FY 2017 by the amount that the district's budget limits would be increased for additional inflation if the school district was eligible to receive Basic State Aid funding for FY 2017. The additional inflation amount is not an increase in the base level as defined in A.R.S. § 15-901. (General Appropriation Act footnote)
- 13/ Laws 2015, 1st Special Session, Chapter 1 appropriated \$50,000,000 annually for FY 2016 through FY 2020 and \$75,000,000 annually for FY 2021 through FY 2025 from the General Fund for school districts and charter schools conditional upon passage of Proposition 123 in May 2016. Note: Proposition 123 was approved.
- 14/ The Department of Education shall allocate the appropriated amount to school districts and charter schools on a pro rata basis using the weighted student count for the school district or charter school for the fiscal year pursuant to A.R.S. § 15-943, paragraph 2, subdivision (a) and increase the budget limits pursuant to A.R.S. § 15-947 accordingly. For the purposes of this subsection, the weighted student count for a school district that serves as the district of attendance for nonresident pupils shall be increased to include nonresident pupils who attend school in the school district. (Laws 2015, 1st Special Session, Chapter 1, Section 6 footnote)
- 15/ The appropriation consists of one-time monies to backfill the loss of base support level state aid for FY 2017 that school districts with declining student counts otherwise would experience in FY 2017 due to the implementation of current-year base support level funding. The Department of Education shall allocate the appropriated amount in a manner that backfills the loss of base support level state aid that school districts with declining student counts otherwise would experience in FY 2017 due to the implementation of current-year base support level funding. The department shall allocate current-year funding backfill monies for FY 2017 as if they were base support level monies for FY 2017 and shall increase budget limits for FY 2017 accordingly. For a school district with a declining student count that is not eligible to receive state aid for FY 2017, the department shall increase the school district's budget limits for FY 2017 by the amount that the limits would be increased if the school district were eligible for current-year funding backfill state aid for FY 2017. (General Appropriation Act footnote, Section 141)
- 16/ If the appropriation is insufficient to fully fund current-year funding backfill costs for school districts that are eligible to receive state aid for FY 2017, the Department of Education shall use monies appropriated for Basic State Aid for FY 2017 to make up the difference. (General Appropriation Act footnote, Section 141)
- 17/ If the appropriation exceeds the amount needed to fully fund current-year funding backfill costs for FY 2017 for school districts that are eligible to receive state aid for FY 2017, the Department of Education shall revert the difference to the state General Fund. (General Appropriation Act footnote, Section 141)
- 18/ The appropriation for Former District-Sponsored Charter Schools for FY 2017 consists of one-time monies to provide additional base support level funding on a one-time basis to school districts that operated district-sponsored charter schools in FY 2016 and that qualify for state aid in FY 2017. The appropriated amount shall be allocated to school districts that operated district-sponsored charter schools in FY 2016 and that qualify for state aid in FY 2017 on a pro rata basis based on the number of average daily membership pupils who attended district-sponsored charter schools in each school district for FY 2016. Monies that a school district receives from this line item shall be added to the district's base support level for FY 2017, and the Department of Education shall increase its budget limits accordingly. (General Appropriation Act footnote)
- 19/ The department also shall increase the base support level of a school district that operated a district-sponsored charter school in FY 2016 but that does not qualify for state aid in FY 2017 by an amount equal to the average per pupil base support level increase provided per former district-sponsored charter school pupil under this line item for a school district that qualifies for state aid for FY 2017, multiplied by the number of average daily membership pupils who attended district-sponsored charter schools in the school district in FY 2016, and shall increase the school district's budget limits accordingly. (General Appropriation Act footnote)
- 20/ The original FY 2016 budget appropriated \$74,394,000 for Additional Inflation, but Proposition 123 incorporated those monies into Basic State Aid starting in FY 2016.
- 21/ Beginning in FY 2017, formula costs are funded through Basic State Aid and administrative costs are funded through the department's operating budget.
- 22/ 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)
- 23/ Laws 2016, Chapter 124 appropriated \$500,000 from the State Web Portal Fund for a Code Writers Initiative Pilot Program.
- 24/ The appropriation for the Code Writers Initiative Pilot Program is exempt from the provisions of A.R.S. § 35-190, relating to lapsing of appropriations. (Laws 2016, Chapter 124, Section 40)
- 25/ 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)
- 26/ The Department of Education shall use the appropriated one-time amount to issue a grant to a statewide geographic alliance for the purpose of strengthening geographic literacy in the state. The appropriated amount is exempt from the provisions of A.R.S. § 35-190 relating to lapsing of appropriations. (General Appropriation Act footnote)
- 27/ 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)
- 28/ After review by the Joint Legislative Budget Committee, in FY 2017, the department may use a portion of its FY 2017 state General Fund appropriations for Basic State Aid or Additional State Aid to fund a shortfall in funding for Basic State Aid or Additional State Aid, if any, that occurred in FY 2016. (General Appropriation Act footnote)
- 29/ 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)

Summary

ADE's FY 2017 General Fund budget spending increases by \$127,501,900, or 3.2% above FY 2016. After adjusting for an estimated \$231,956,000 that public schools will receive from Proposition 123 in FY 2017 above the original FY 2016 appropriations, ADE General Fund and state land trust spending combined increases by an estimated 9.1%. Proposition 123 monies were added to the original FY 2016 appropriation upon voter approval of the Proposition on May 17, 2016 and remain in the department's budget for FY 2017. (See *October 2015 Special Session and Proposition 123 in Other Issues section for more information.*)

The \$127,501,900 non-Proposition 123 General Fund increase includes both current law formula adjustments and policy changes for FY 2017 in addition to 2 technical "base adjustments" for FY 2016:

Base Adjustments

- A decrease of \$(2,400,000) for higher-than-budgeted savings from multisite charter small school weight reductions in FY 2016.
- A decrease of \$(745,000) for lower-than-budgeted incremental costs for district-sponsored charter schools for FY 2016.

Current Law Formula Adjustments

- An increase of \$73,575,700 for 1.25% Average Daily Membership (ADM) growth in FY 2017.
- An increase of \$19,500,000 for higher average formula costs per pupil due to ongoing special education and charter growth.
- An increase of \$55,969,800 for a 0.99% inflator.
- A decrease of \$(50,151,200) for local property tax growth due to new construction offset by Homeowner's Rebate impact of \$6,023,800.
- A decrease of \$(363,700) to offset higher available endowment earnings under Proposition 123.
- An increase of \$700,000 for Empowerment Scholarship Accounts (ESAs).
- An increase of \$26,128,600 for higher Homeowner's Rebate costs due to recent statutory changes.
- A decrease of \$(67,300) for standard changes.

The current law formula adjustments total \$131,315,700.

Policy Changes

- A decrease of \$(31,000,000) to establish current year Base Support Level funding.

- A one-time increase of \$31,000,000 to backfill losses that otherwise would occur in FY 2017 under current year Base Support Level funding.
- A decrease of \$(1,000,000) for Joint Technical Education District (JTED) funding for high school graduates.
- A decrease of \$(6,500,000) for small school weight for multisite charter phase out.
- A one-time increase of \$6,500,000 to freeze the small school weight phase out for FY 2017 at the FY 2016 level.
- A decrease of \$(1,148,000) to eliminate district-sponsored charter schools.
- A one-time increase of \$1,148,000 to backfill losses that otherwise would occur in FY 2017 under the elimination of district-sponsored charter schools.
- An increase of \$231,200 due to a transfer from the State Board of Education.
- An increase of \$100,000 for Geographic Literacy.

The policy changes total \$(668,800).

As part of the budget's 3-year spending plan, ADE General Fund costs are projected to increase by \$86,389,600 in FY 2018 above FY 2017 and \$127,823,300 in FY 2019 above FY 2018. (See *Other Issues for more information.*)

Operating Budget

The budget includes \$12,917,600 and 102.1 FTE Positions in FY 2017 for the operating budget. These amounts consist of:

	FY 2017
General Fund	\$8,905,100
Department of Education Empowerment	
Scholarship Account Fund	797,900
Department of Education Professional	
Development Revolving Fund	2,700,000
Teacher Certification Fund	514,600

These amounts fund the following adjustments:

K-3 Reading Transfer

The budget includes an increase of \$500,000 and 2 FTE Positions from the General Fund in FY 2017 to transfer funding for administration of the K-3 Reading program from the K-3 Reading line item to the department's operating budget. The transfer is required for FY 2017 because the budget eliminates the separate K-3 Reading line item and instead funds program formula costs through Basic State Aid and program administrative costs

^{30/} 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)

^{31/} General Appropriation Act funds are appropriated as an Operating Lump Sum with Special Line Items by Agency.

through the agency's operating budget. *(See the Transfer K-3 Reading Monies policy issue under Basic State Aid for more information.)*

ESA Administration

The budget includes an increase of \$400,000 from the Department of Education Empowerment Scholarship Account Fund in FY 2017 for administration of the Empowerment Scholarship Account (ESA) program authorized in A.R.S. § 15-2402. This will provide the department with \$797,900 in ESA administration funding for FY 2017 after adjustments for standard changes. The budget continues a General Appropriation Act footnote stipulating that the budgeted amount 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 2017 would be as much as \$1,850,000 (an estimated \$37,000,000 in 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.) (See Empowerment Scholarship Accounts policy issue under Basic State Aid for more information regarding Empowerment Scholarship Account Administration.)*

State Board of Education Transfer

Laws 2016, Chapter 138 transfers \$611,000 and 7 FTE Positions in FY 2017 from the State Board of Education to the department to reflect the clarification of roles and responsibilities of the department and Board. This amount consists of:

General Fund	231,200
Teacher Certification Fund	379,800

The transferred FTE Positions consists of 2 FTE Positions from the General Fund and 5 FTE Positions from the Teacher Certification Fund.

Chapter 138 clarified statutory responsibilities for the department and the State Board of Education and transferred the amounts shown above from the State Board of Education to the department. *(See State Board of Education line item narrative for more information.)*

Professional Development

The budget includes no change in funding from the Department of Education Professional Development

Revolving Fund (DEPDRF) in FY 2017 for professional development activities provided by the department pursuant to A.R.S. § 15-237.01. The original FY 2016 budget did not appropriate any DEPDRF monies to the department, but the General Appropriation Act for FY 2017 (Laws 2016, Chapter 117) appropriates \$2,700,000 in supplemental funding from the DEPDRF to the department's operating budget in FY 2016 for estimated professional development costs for FY 2016. The budget maintains program funding for FY 2017 at the revised FY 2016 level of \$2,700,000.

A.R.S. § 15-237.01 establishes the DEPDRF and requires the department to deposit into it any tuition monies generated by its professional development courses.

Statewide Adjustments

The budget includes a decrease of \$(69,100) in FY 2017 for statewide adjustments. This amount consists of:

General Fund	(65,500)
Department of Education Empowerment Scholarship Account Fund	(1,100)
Teacher Certification Fund	(2,500)

(Please see the Agency Detail and Allocations section.)

Formula Programs

Basic State Aid

The budget includes \$3,723,868,200 in FY 2017 for Basic State Aid. This amount consists of:

General Fund	3,504,064,000
Permanent State School Fund	219,804,200

The \$3,723,868,200 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 2017 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 2017, as they also are non-appropriated. In addition, it excludes formula monies for State Aid Supplement, Current-Year Funding Backfill and Former District-Sponsored Charter Schools, as they are appropriated through separate line items apart from Basic State Aid for FY 2017.

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

Table 1
FY 2017 Basic State Aid Formula Summary (estimated)

General Fund	
FY 2016 Appropriation (original)	\$3,324,960,700
FY 2016 "Additional Inflation" transfer	74,394,000
FY 2016 Supplemental (special session)	<u>2,354,400</u>
FY 2016 Appropriation (revised)	\$3,401,709,100
Base Adjustment for multisite charter weights	\$ (2,400,000)
Base Adjustment for District-Sponsored Charters	(745,000)
Enrollment Growth @ 1.25%	73,575,700
Higher Average Cost Per Pupil	19,500,000
0.99% Inflator	55,969,800
Property Taxes from New Construction	(50,151,200)
Endowment Earnings	(363,700)
Eliminate Hold Harmless for Enrollment Losses ^{1/}	(31,000,000)
JTED Enrollment - No New Graduates	(1,000,000)
Multisite Charter Small School Weights ^{2/}	(0)
Eliminate District-Sponsored Charter Schools ^{3/}	(1,148,000)
Move K-3 Reading Funding	39,417,300
Empowerment Scholarship Accounts	<u>700,000</u>
FY 2017 Budget	\$3,504,064,000
Permanent State School Fund	
FY 2016 Original	\$ 47,359,500
FY 2016 Special Session Increase	<u>172,081,000</u>
FY 2016 Revised	\$ 219,440,500
Estimated FY 2017 Growth	<u>363,700</u>
FY 2017 Budget	\$ 219,804,200
Prop 301 Sales Tax (no change) ^{3/}	\$ 86,280,500
Local Property Taxes ^{3/}	
FY 2016 Base - estimated	\$2,379,675,400
Property Taxes from New Construction	50,151,200
Non-State Aid Formula Changes	<u>11,923,600</u>
FY 2017 Estimated ^{4/}	\$2,441,750,200
Grand Total (all sources) ^{5/ 6/}	\$6,251,898,900

- ^{1/} Backfilled through a separate line item apart from Basic State Aid.
- ^{2/} Frozen at FY 2016 level, so no funding change for FY 2017.
- ^{3/} Non-appropriated, so excluded from appropriated totals.
- ^{4/} An estimated \$398,836,400 of this total will be funded by the state through Homeowner's Rebate and 1% cap funding.
- ^{5/} 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 assumed to continue in the Budget on a session law basis, including the impact on non-state aid districts.
- ^{6/} Does not include \$50,000,000 for State Aid Supplement, \$31,000,000 for Current Year Funding Backfill or \$1,148,000 for Former District-Sponsored Charter Schools, which are appropriated to separate line items apart from Basic State Aid.

Base Adjustment – Small School Weights

The budget includes a decrease of \$(2,400,000) from the General Fund in FY 2017 for a higher-than-budgeted savings from multisite charter school small school weight reductions for FY 2016. The FY 2016 budget enacted a 3-year phase out of small school weights for multisite charter schools starting in FY 2016. It assumed a General Fund savings of \$(6,500,000) for this issue for FY 2016, but

the revised estimated savings is approximately \$(8,900,000), or \$(2,400,000) higher. This reduced starting point costs for Basic State Aid for FY 2017 by an estimated \$(2,400,000). (See *Multisite Charter Small School Weight Reduction policy issue for more information.*)

Base Adjustment – District Charters

The budget includes a decrease of \$(745,000) from the General Fund in FY 2017 for lower-than-budgeted incremental costs for district-sponsored charter schools for FY 2016. The FY 2016 budget assumed a cost of \$1,893,000 for this issue, but the revised estimate is \$1,148,000 based on updated data for a FY 2016 savings of \$(745,000).

Enrollment Growth

The budget includes an increase of \$73,575,700 from the General Fund in FY 2017 for enrollment growth. This assumes that K-12 ADM will increase by approximately 1.25% in FY 2017 (see *Table 2*). It does not reflect ongoing growth in the average cost per pupil, which is described separately below.

Fiscal Year	K-12 ADM (unweighted) ^{1/}				% Change
	District ^{2/}	Charter ^{3/}	Total	Change	
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	913,313	152,158	1,065,471	14,796	1.4%
2015	917,913	159,032	1,076,945	11,474	1.1%
2016 est	923,660	167,868	1,091,528	14,583	1.4%
2017 est	928,447	176,725	1,105,172	13,644	1.25%
2018 est	934,608	185,612	1,120,220	15,048	1.4%
2019 est	940,815	194,604	1,135,419	15,199	1.4%

^{1/} Actuals for FY 2010 through FY 2015 are from ADE payment data. Figures shown for FY 2014 and FY 2015 have been adjusted by JLBC Staff in an attempt to compensate for data anomalies caused by charter conversions for those fiscal years. 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 \$19,500,000 from the General Fund in FY 2017 for growth in the average Basic State Aid cost per pupil for FY 2017. 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. Special

education students receive “add on” funding that increases their average per pupil costs.

The \$19,500,000 estimate includes \$9,000,000 for charter school pupils and \$10,500,000 for special education students in FY 2017. The charter estimate assumes that board-sponsored charter schools will continue to grow by approximately 9,000 ADM in FY 2017 and receive approximately \$1,000 more per pupil than non-charter pupils (9,000 X \$1,000 = \$9,000,000). The special education estimate assumes that the statewide special education weighted student count will increase by approximately 3,000 ADM in FY 2017 (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.

Fiscal Year	Districts	Charters	Total	Change	% Change
2010	83,450	4,104	87,554	3,004	3.6%
2011	88,633	5,189	93,822	6,268	7.2%
2012	92,738	5,858	98,596	4,774	5.1%
2013	95,887	6,522	102,409	3,813	3.9%
2014	95,024	7,698	102,722	313	0.3%
2015	106,217	9,124	115,341	12,619	12.3%
2016 est	108,979	9,362	118,341	3,000	2.6%
2017 est	111,736	9,605	121,341	3,000	2.5%
2018 est	114,495	9,846	124,341	3,000	2.5%
2019 est	117,254	10,087	127,341	3,000	2.4%

^{1/} Actuals for FY 2010 through FY 2015 are from ADE payment data. Excludes “Group B” category that only receives funding weight of 0.003 (295 additional “weighted” students for FY 2015) and students enrolled at ASDB.

0.99% Inflation Adjustment

The budget includes an increase of \$55,969,800 from the General Fund in FY 2017 for a 0.99% 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 adjustments are all included in the FY 2017 K-12 Education Budget Reconciliation Bill (BRB) (Laws 2016, Chapter 124) and will result in a base level of \$3,635.64 per pupil for FY 2017 versus \$3,600.00 for FY 2016. Chapter 124 also included a contingency base level of \$3,460.66 for FY 2017 in case Proposition 123 was not approved by voters. The contingency base level did not take effect because Proposition 123 received voter approval.

The FY 2016 base level originally was \$3,426.74 per pupil, as established by the FY 2016 K-12 Budget Reconciliation Bill (BRB) (Laws 2015, Chapter 15). Laws 2015, 1st Special Session, Chapter 1 from the October 2015 Special Session, however, changed it to \$3,600.00 per pupil for FY 2016 contingent upon voter approval of Proposition 123 in May 2016. Chapter 124, however, would have changed the FY 2016 base level back to the original \$3,426.74 per pupil if Proposition 123 was not approved by voters. (See *Other Issues for more information regarding the October 2015 Special Session and Proposition 123.*)

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 FY 2017 adjustment is 0.99%, which equals the GDP price deflator for calendar year 2015. 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. (See the *FY 2016 Appropriations Report for background information regarding the related Cave Creek, et. al. v Ducey lawsuit.*)

Property Taxes from New Construction

The budget includes a decrease of \$(50,151,200) from the General Fund in FY 2017 due to a projected 2.29% increase in statewide Net Assessed Value (NAV) from new construction in FY 2017. This will increase local property tax revenues from the K-12 “Qualifying Tax Rate” (QTR) and State Equalization Tax Rate (SETR) by an estimated \$50,151,200 in FY 2017. It also will decrease state costs by \$(50,151,200), 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 0.88% in FY 2017, resulting in a net 3.17% NAV increase for new construction and existing property combined for FY 2017.

The projected 0.88% NAV increase for existing property will not affect net QTR or SETR collections in FY 2017 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 \$4.16 (from \$4.20 currently) and the SETR will decrease to \$0.5010 (from \$0.5054 currently) in FY 2017 in order to offset the estimated 0.88% NAV increase for existing property (see Table 4).

Table 4

TNT Tax Rates			
Tax Rate		FY 2016	FY 2017
Qualifying Tax Rate (QTR)			
• High School districts and elementary districts located within a high school district		\$2.0977	\$2.0793
• Unified districts and elementary districts not located within a high school district		\$4.1954	\$4.1586
• State Equalization Tax Rate (SETR)		\$0.5054	\$0.5010

On a related note, Proposition 117 from the November 2012 General Election, caps annual growth in property values at 5% starting in FY 2016. (See the FY 2016 Appropriations Report for more information.)

Endowment Earnings

The budget includes a decrease of \$(363,700) from the General Fund and increase of \$363,700 from the Permanent State School Fund in FY 2017 for endowment earnings funding for Basic State Aid. This assumes that K-12 endowment earnings from the State Land Department and State Treasurer combined under Proposition 123 will equal \$219,804,200 for FY 2017, which would be \$363,700 more than the \$219,440,500 total assumed for FY 2016 (see Table 5).

Table 5

Estimated K-12 Endowment Earnings for Basic State Aid ^{1/}

Source	FY 2016	FY 2017	Change
Original 2.5% ^{2/}	\$47,359,500	\$47,359,500	\$0
New 4.4% ^{2/}	<u>172,081,000</u>	<u>172,444,700</u>	<u>363,700</u>
Total	\$219,440,500	\$219,804,200	\$363,700

^{1/} K-12 Endowment Earnings also help fund School Facilities Board debt service and the Classroom Site Fund (see Table 11).

^{2/} The October 2015 Special Session increased the state trust land distribution percentage in the State Constitution from 2.5% to 6.9% (an increase of 4.4%) if voters approved Proposition 123 in May 2016, which did occur.

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. Of that total, an estimated \$46,475,500 will be used for Basic State Aid for FY 2017 and \$25,787,500 will be used for SFB debt service.

All endowment earnings above \$72,263,000 go to the Classroom Site Fund established by A.R.S. § 15-977, except that Laws 2015, 1st Special Session, Chapter 1 appropriates for Basic State Aid any increase in State Treasurer land trust distributions from the new 4.4% distribution starting in FY 2016. (See Other Issues for more information on the October 2015 Special Session and Proposition 123.)

The estimated \$219,804,200 in K-12 endowment earnings for FY 2017 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 remain at \$24,903,500 for FY 2017 based on input from SFB, which would be unchanged from the currently budgeted level. This would keep the amount of land trust monies available to fund Basic State Aid from the original 2.5% distribution rate unchanged for FY 2016 at \$47,359,500.

Eliminate Hold Harmless

The budget includes a decrease of \$(31,000,000) from the General Fund in FY 2017 in order to eliminate a “hold harmless” provision that currently delays for 1 year the impact of school district enrollment declines on their Base Support Level (BSL) funding. This change will reduce Basic State Aid funding to school districts statewide by an estimated \$(31,000,000) for FY 2017. The budget, however, appropriates \$31,000,000 to a separate Current-Year Funding Backfill line item for FY 2017 in order to fully offset the \$(31,000,000) Basic State Aid funding reduction for this issue for FY 2017. (See Current-Year Funding Backfill line item narrative below for more information.)

The FY 2016 K-12 Education BRB required the department to notify school districts by December 15, 2015 on how it planned to implement current year ADM funding in FY 2017 and report the estimated fiscal impact by district. In its report, which was based on ADM data from FY 2015, the department estimated that current year ADM funding would have resulted in a net state savings of \$(24,238,000) in FY 2015 if it had been in effect for that year.

The \$(24,238,000) estimate, however, assumed that both the BSL and District Additional Assistance (DAA) would be funded on a current year basis. The original policy intent was to fund only the BSL on current year ADM in order to eliminate the BSL “hold harmless.”

Funding both the BSL and DAA on current year ADM would increase DAA state aid costs by an estimated \$6,509,400 because growing districts would now receive DAA based on their current year (higher) rather than prior year (lower) ADM counts. Without the DAA increase, the department’s estimated net state aid savings would be \$(30,747,400).

The FY 2017 K-12 Education BRB, however, includes a statutory change clarifying that DAA will continue to be funded based on prior year ADM in FY 2017 and subsequent years, which will forego the DAA increase included in the department’s estimates. The budget therefore assumes a net state savings of \$(31,000,000) for this issue for FY 2017, which rounds the department’s

adjusted \$(30,747,400) estimate (without the DAA increase) given its preliminary nature. The actual savings for this issue will depend on final ADM counts for FY 2017, which will not be known until after the end of FY 2017.

(See Current-Year Funding Backfill policy issue for more information.)

JTED Funding for High School Graduates

The budget includes a decrease of \$(1,000,000) from the General Fund in FY 2017 for Basic State Aid funding for JTED students who have already graduated from high school.

The FY 2016 K-12 Education BRB (Laws 2015, Chapter 15) originally required Base Support Level (BSL) funding for students who attend JTEDs to be funded at 92.5% (a 7.5% reduction) for both the “sending” district or charter and for the JTED itself starting in FY 2017, except that districts and charters sending students to a JTED centralized campus would still receive full BSL funding for them. This change for satellite and central campus sites combined was expected to reduce state aid to JTEDs, districts and charters by an estimated \$(30,000,000) statewide for FY 2017.

Laws 2016, Chapter 4, however, repealed the JTED 7.5% BSL reductions scheduled for FY 2017 and instead amended permanent law (A.R.S. § 15-393D4c) to prohibit JTEDs from including students who had already graduated from high school in their ADM counts starting in FY 2016 with certain exceptions. The net impact of these changes is to restore all but an estimated \$(1,000,000) of the \$(30,000,000) reduction for FY 2017.

The FY 2017 K-12 Education BRB further amends A.R.S. § 15-393D4c to remove incorrect “exception” language from Chapter 4 and establishes corrected “exception” language in session law. The latter language allows any high school graduate under age 21 to remain in a JTED’s ADM count for FY 2016 and allows any graduate under age 21 who was enrolled in a JTED program on February 1, 2016 to remain in their JTED’s ADM count in FY 2017 until they finish the program or through the end of FY 2017, whichever occurs first. High school graduates who were not enrolled in a JTED program on February 1, 2016, however, must be excluded from JTED ADM counts starting in FY 2017.

That exclusion will reduce Basic State Aid costs by an estimated \$(1,000,000) in FY 2017 and by an additional \$(1,800,000) in FY 2018 for a total ongoing savings of \$(2,800,000) starting in FY 2018. The estimated savings is greater starting in FY 2018 because no exceptions to the new prohibition are allowed after FY 2017.

Chapter 4 also modifies statute in order to establish new program quality and accountability requirements for JTEDs. For example, it establishes additional criteria that courses and programs must meet in order to qualify for JTED funding and requires JTEDs to provide certain minimal services to all member districts. It also requires the department to review compliance of all JTED programs and courses with new requirements in the Act and stipulates that the Auditor General shall conduct a special audit of JTEDs, as scheduled by the Joint Legislative Audit Committee. In addition, Chapter 4 permanently extends a requirement that the Joint Committee on Capital Review (JCCR) approve all JTED leases that would establish a “leased centralized campus.” That requirement would have expired after December 31, 2016 under prior law.

The FY 2017 K-12 Education BRB also establishes new accountability requirements for JTEDs. It requires them to annually report the student enrollment of each JTED program and course and to also report student retention data.

On a related note, the FY 2017 K-12 Education BRB continues to suspend 4.5% of state aid for JTEDs with more than 2,000 ADM for FY 2017 by funding their state aid at 95.5% of the full funding amount apart from unrelated District Additional Assistance (DAA) suspensions. This is suspending an estimated \$1,747,400 of JTED formula funding for the East Valley Institute of Technology (EVIT), West-MEC and the Pima County JTED for FY 2017.

A.R.S. § 15-393 allows a Joint Technical Education District (JTED) to receive up to 0.75 ADM (versus 0.25 ADM in most situations) for each student who attends a JTED “centralized campus” or “leased centralized campus.” A.R.S. § 15-393R4 allows the latter to be located at a school district or charter school if the site is leased at fair market value and if the lease is approved by the Joint Committee on Capital Review (JCCR). The JCCR approval requirement is made permanent by Laws 2016, Chapter 4. It otherwise would have expired under prior law after December 31, 2016. To date, only 2 JTEDs have sought JCCR approval for JTED leases.

Multisite Charter Small School Weight Reduction

The budget includes no change from the General Fund in FY 2017 for a continued phase out of small school weight funding for multisite charter schools in FY 2017. Multisite charters schools generally are charters schools with common organizational or governance structures.

The FY 2016 K-12 Education BRB (Laws 2015, Chapter 15) originally reduced school weight funding for most

multisite charter schools by 33% for FY 2016, 67% for FY 2017 and 100% for FY 2018 and beyond unless their combined student counts were less than 600 for grades K-8 or high school. The FY 2016 budget assumed that the phase out would reduce Basic State Aid costs by \$(6,500,000) in FY 2016 and by an additional \$(6,500,000) in FY 2017 and \$(7,000,000) in FY 2018 for a total reduction of \$(20,000,000) over 3 years.

The budget, however, assumes no additional savings for this issue for FY 2017, as the FY 2017 K-12 Education BRB maintains for FY 2017 the same 33% reduction factor in effect for FY 2016. As a result, there will be no additional incremental savings for this issue for FY 2017. For FY 2018, Chapter 124 maintains the reduction at the original 100% factor assumed in Laws 2015, Chapter 15.

Chapter 15 assumed a savings of \$(6,500,000) for this issue for FY 2016 and additional savings of \$(6,500,000) and \$(7,000,000) in FY 2017 and FY 2018, respectively, for an ongoing savings of \$(20,000,000) starting in FY 2018, as noted above. The department, however, estimated in October 2016 that the savings for FY 2016 would be approximately \$(8,900,000) based on revised data. As a result, the budget assumes an additional \$(2,400,000) savings for this issue above the originally-assumed \$(6,500,000) for a total FY 2016 savings of \$(8,900,000), which is the savings again assumed for this issue for FY 2017. *(Please see the "Base Adjustment - Small School Weights" policy issue narrative above for more information.)*

For FY 2018 and beyond, the budget continues to assume an ongoing savings of \$(20,000,000).

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. Small school weights can increase a district or charter's BSL funding by up to 32%. Only isolated districts with fewer than 100 high school students, however, qualify for the highest small school weights (A.R.S. § 15-943).

Eliminate District Charters

The budget includes a decrease of \$(1,148,000) from the General Fund in FY 2017 from the elimination of all remaining district-sponsored charter schools (DSCS) in FY 2017. The budget, however, appropriates \$1,148,000 to a separate line item apart from Basic State Aid for FY 2017 in order to hold affected school districts harmless for this issue for FY 2017. *(Please see Former District-Sponsored Charter Schools line item narrative below for more information.)*

The FY 2017 K-12 Education BRB repeals statutes authorizing DSCS in order to permanently eliminate DSCS in FY 2017. It also repeals statutory language that otherwise would require school districts to repay all Charter Additional Assistance funding that they received while operating DSCS once they convert their DSCS back to non-charter status. In addition, Chapter 124 clarifies that increases in school district non-charter enrollment that result from the elimination of DSCS do not make a school district eligible for District Additional Assistance growth funding pursuant to A.R.S. § 15-961B3 for FY 2016 or FY 2017.

DSCS existed from FY 1996 through FY 2016 pursuant to A.R.S. § 15-183C. Fewer than 2,400 students attended DSCS in FY 2014. In FY 2015, however, that number increased to approximately 39,000 students, as many additional school districts established DSCS. This raised state costs substantially because DSCS students receive approximately \$1,000 more per pupil under the Basic State Aid funding formula than non-charter students.

In response, the FY 2015 budget eliminated after FY 2015 any DSCS that did not operate prior to FY 2014. It allowed a DSCS that operated prior to FY 2014, however, to remain in operation. The FY 2016 budget later reduced Incremental funding for the latter DSCS by 50% and included language indicating that the Legislature intended to eliminate all remaining district-sponsored charter schools after FY 2016.

As a result of the DSCS intent language in the FY 2016 budget, the FY 2017 Baseline assumed that the remaining DSCS would be eliminated in FY 2017. It also assumed that eliminating DSCS would reduce General Fund savings by \$(1,893,000) for FY 2017 based on preliminary estimates of incremental costs for DSCS for FY 2016. The revised estimate of incremental state aid costs for DSCS for FY 2016, however, is \$1,148,000 based on updated data. As a result, the amount appropriated by the budget to the Former District-Sponsored Charter School line item for FY 2017 in order to hold school districts harmless for this issue for FY 2017 is \$1,148,000. *(Please see Former District-Sponsored Charter Schools line item narrative for more information.)*

Transfer K-3 Reading Monies

The budget includes an increase of \$39,417,300 from the General Fund in FY 2017 to move K-3 Reading formula funding from a separate line item to Basic State Aid. This incorporates funding for the K-3 Reading Group B weight into Basic State Aid, which conforms to current practice for all other formula weights.

Prior practice did not display the full cost of the weight, as the annual appropriation to the K-3 Reading program only reflected the initial cost of the weight when it was created in FY 2013. Since then, enrollment growth and inflation have increased its cost by approximately \$5,560,000 through FY 2016, which has been funded through Basic State Aid as part of annual increases provided to that program for enrollment growth and inflation for the formula as a whole. The estimated \$5,560,000 cost increase for the program reflects 3.8% enrollment growth and 10.1% base level growth since FY 2013, including the base level reset from the October 2015 special session ($\$40,000,000 \text{ initial cost} \times (3.8\% + 10.1\%) = \$5,560,000$).

The budget also transfers \$500,000 and 2 FTE Positions from the K-3 Reading program to the department's operating budget for continued administration of the statewide K-3 Reading program. (*See the Operating Budget narrative for more information.*)

On a related note, Laws 2016, Chapter 245 clarifies that the department rather than the State Board of Education (SBE) is responsible for administering the K-12 reading program. As a result, school districts and charter schools will now submit their annual K-3 Reading program plans to the department rather than to the SBE. (Under Chapter 245, however, "A" and "B" school districts and charter schools now only have to submit K-3 Reading plans in odd-numbered years.) Chapter 245 requires the department to review those plans and make recommendations to the SBE for their approval or disapproval. It also allows the SBE to establish rules and policies for the K-3 reading program.

Rollover

The budget includes no change from the General Fund in FY 2017 for the K-12 rollover. This continues to defer through the General Appropriation Act \$930,727,700 of current year (now FY 2017) state aid payments until the following fiscal year (now FY 2018).

The FY 2017 rollover will 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 2017, which will continue 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 2017 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 2015, Chapter 8 advance appropriated \$930,727,700 from the General Fund in FY 2017 in order to fund the \$930,727,700 deferred obligation from FY 2016. Those monies,

therefore, do not appear in the FY 2017 General Appropriation Act (Laws 2016, Chapter 117). Chapter 117, however, advance appropriates \$930,727,700 from the General Fund in FY 2018 in order to fund the deferred FY 2017 obligation.

A continued \$930,727,700 rollover for FY 2017 will include \$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

The budget includes no change from the General Fund in FY 2017 for a continued partial suspension of the district additional assistance (DAA) and charter additional assistance (CAA) statutory funding formulas. This will continue to suspend \$(352,442,700) of DAA state aid and \$(18,656,000) of CAA for FY 2017.

School districts will receive approximately \$75,000,000 of DAA funding in FY 2017, including \$6,000,000 self-funded by non-state aid districts under current estimates. Without the continuing suspension they instead would receive approximately \$455,000,000 in DAA funding, including approximately \$34,000,000 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 budget will continue BRB language requiring 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. The budget, however, discontinues language extending this requirement to CAA reductions for non-state aid districts that have district-sponsored charter schools, since it eliminates district-sponsored charter schools after FY 2016. 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 2017 K-12 Education BRB also continues to cap total statewide DAA reductions for school districts with fewer than 1,100 students at \$5,000,000 for FY 2017.

Empowerment Scholarship Accounts

The budget includes an increase of \$700,000 from the General Fund in FY 2017 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 2017 (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 minimal net new cost based on formula modeling.

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.
- A child of a parent who is legally blind, deaf or hard of hearing (new for FY 2017 pursuant to Laws 2016, Chapter 353).

(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 5,500 new students annually. Current ESA growth is substantially below this level, as the 2,175 ESAs approved for FY 2016 represent an increase of only 864 net students above the FY 2015 level (see Table 6).

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.”

Since FY 2015 the department has interpreted this language as providing 90% of charter additional assistance to all ESA recipients, including those who did not previously attend charter schools. ADE has estimated that this change causes ESAs to cost about 9% more than apart from this policy, which was approximately \$2,430,000 for FY 2016 (\$27,000,000 estimated ESA cost for FY 2016 [from Table 6] X 9% = \$2,430,000).

Table 6 shows historical and projected data for the ESA program. For FY 2016, ADE estimated as of June 2016 that 2,502 students would receive \$27,000,000 in ESA funding, which represents an increase of 1,191 students. The FY 2017 budget assumes an increase of 864 students for the program based on earlier data. Of the assumed 864 new ESA students for FY 2017, an estimated 130 would increase state costs (primarily incoming non-special education Kindergartners who live within the boundaries of a “D or F” school and would attend private school with or without an ESA).

<u>Fiscal Year</u>	<u>Program Enrollment</u>	<u>Total Awards</u>
FY 2012	144	\$1,576,000
FY 2013	302	\$5,209,200
FY 2014	761	\$10,200,000
FY 2015	1,311	\$17,333,700
FY 2016 (est)	2,175	\$27,100,000
FY 2017 (est)	3,039	\$37,865,900

^{1/} Figures shown for FY 2012 through FY 2016 are from ADE as of November 2015. FY 2017 estimates are from the JLBC Staff based on historical data. “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. In June 2016 ADE revised its FY 2016 estimates to 2,502 students and a cost of \$27,000,000 and its FY 2017 estimates to 4,000 students and a cost of \$37,000,000.

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 retained monies, however, are subject to legislative appropriation and the department’s appropriation of ESA administration for FY 2017 is \$797,900, which is less than the maximum allowed amount of \$1,480,000 (\$37,000,000 from Table 6 X 4% = \$1,480,000). Any “4%” monies that are not appropriated or spent are carried forward in the Department of Education Empowerment Scholarship Account Fund to the next fiscal year. At the

end of FY 2015 the fund had a carry-forward balance of \$842,600.

The \$797,900 amount that is appropriated to ADE from the Department of Education Empowerment Scholarship Account Fund in FY 2017 for program administration includes an increase of \$400,000 from FY 2016 prior to standard changes. The budget also appropriates \$79,700 from the State Treasurer Empowerment Scholarship Account Fund in FY 2017 for ESA program administration, which is unchanged from FY 2016 (*see related narrative in State Treasurer Budget pages*).

Laws 2016, Chapter 112 allows a student with disabilities to continue to receive ESA monies until they reach age 22 if they meet eligibility criteria to be established by the department under the Act. For students who will turn 22 during the FY 2017, the department is to initially determine eligibility (until permanent eligibility criteria are established) based on the student's likelihood of meeting graduation requirements prescribed by the State Board of Education or obtaining a high school equivalency diploma pursuant to A.R.S. § 15-702.

Laws 2016, Chapter 353 makes a child eligible for an ESA if their parent is legally blind, deaf or hard of hearing, if they require instructional materials in a specialized format pursuant to A.R.S. § 15-731, or if they are the sibling of an eligible and newly-enrolled ESA student and the child meets other eligibility requirements, such as being a former public school student. Chapter 353, however, waives the prior public school student requirement for a child who attended a program for preschool students with disabilities.

In addition, Chapter 353 requires the department to accept ESA applications year-round rather than during a period determined by the department under prior law. (For FY 2017, the department accepted ESA applications from January 1, 2016 through April 1, 2016.) It also requires the department to enroll and issue an award letter to eligible ESA applicants within 45 days versus no deadline under prior law and changes other administrative requirements for the program, such as establishing minimum numbers of hours of instruction that Arizona Online Instruction (AOI) students must receive in order to be considered prior public school students for purposes of ESA eligibility and specifying the types of special education services that ESA students with disabilities may purchase with ESA funds.

State Aid Supplement (formerly "Additional Funding")

The budget includes \$50,000,000 from the General Fund in FY 2017 for State Aid Supplement funding. This amount is unchanged from FY 2016.

Laws 2015, 1st Special Session, Chapter 1 appropriated \$50,000,000 from the General Fund in FY 2016 for State Aid Supplement funding. It also advance appropriated \$50,000,000 annually for FY 2017 through FY 2020 and \$75,000,000 annually for FY 2021 through FY 2025 for State Aid Supplement funding. The amounts appropriated for all years were contingent on voter approval of Proposition 123, which occurred on May 17, 2016 (*see Other Issues for more information regarding the October Special Session and Proposition 123*).

Chapter 1 included a footnote instructing the department to allocate the State Aid Supplement monies for FY 2016 to school districts and charter schools on a pro rata basis using the weighted student count for the school district or charter school for the fiscal year pursuant to A.R.S. § 15-943(2a) and to increase budget limits accordingly. The footnote also stipulates that a school district's weighted student count is to include non-resident students who attend school in the district. It further stipulates that a school district may budget its State Aid Supplement funding in either its Maintenance and Operation (M&O) or Unrestricted Capital Outlay Fund. These footnote provisions also were enacted into law in advance for FY 2017 by Laws 2015, 1st Special Session, Chapter 1, so are continued in the FY 2017 budget. (*See Other Issues below for more information regarding the October Special Session and Proposition 123.*)

The State Aid Supplement amounts for FY 2016 through FY 2025 will not appear in the General Appropriation Acts for those years, since they already were advance appropriated by Chapter 1.

Current-Year Funding Backfill

The budget includes \$31,000,000 in one-time funding from the General Fund in FY 2017 for Current-Year Funding Backfill. This amount funds the following adjustments:

One-Time Backfill

The budget includes an increase of \$31,000,000 from the General Fund in FY 2017 for a one-time backfilling of funding reductions that school districts with declining enrollments otherwise would experience in FY 2017 due to the implementation of current year Base Support Level (BSL) funding.

The \$31,000,000 appropriation for Current-Year Funding Backfill for FY 2017 is based on the estimated \$(31,000,000) savings for current year BSA funding in the department's December 2015 report and is appropriated by Section 141 of the FY 2017 General Appropriation Act. Section 141 stipulates that the department is to allocate the appropriated amount in a manner that backfills the loss of BSL state aid that school districts with declining student counts otherwise would experience in FY 2017 due to the implementation of current-year BSL funding. Section 141 requires the department to make corresponding increases in the budgets of affected school districts that are not eligible for state aid, but those increases will be funded with local Qualifying Tax Rate (QTR) monies rather than state aid.

Section 141 further stipulates that the department shall use monies appropriated for Basic State Aid to make up a shortfall, if any, in Current-Year Funding Backfill monies and shall revert a surplus of those monies, if any, to the General Fund.

(See Eliminate Hold Harmless policy issue under Basic State Aid for more information.)

Former District-Sponsored Charter Schools

The budget includes \$1,148,000 in one-time funding from the General Fund in FY 2017 for Former District-Sponsored Charter Schools. This amount funds the following adjustments:

One-Time Backfill

The budget includes an increase of \$1,148,000 from the General Fund in FY 2017 for Former District-Sponsored Charter Schools to backfill funding reductions that otherwise would occur in FY 2017 due to the elimination of district-sponsored charter schools.

The FY 2017 K-12 Education BRB repeals statutory authority for district-sponsored charter schools after FY 2016, so they will no longer exist in FY 2017. The General Appropriation Act, however, appropriates \$1,148,000 in one-time funding to backfill associated funding losses for affected school districts for FY 2017 only.

The General Appropriation Act stipulates that the department is to allocate monies appropriated to this line item to school districts that are eligible for state aid in FY 2017 on a pro rata basis based on the number of ADM pupils who attended district-sponsored charter schools in those districts in FY 2016 and shall increase their budget limits accordingly. It further stipulates that the department shall increase the budget limits of an affected school district that is not eligible for state aid in FY 2017

by an amount equal to the average BSL increase provided per former district-sponsored charter school pupil under this line item for a school district that qualifies for state aid for FY 2017 multiplied by the number of ADM pupils who attended district-sponsored charter schools in the non-state aid school district for FY 2016.

The budget includes a decrease of \$(1,148,000) from the General Fund in FY 2017 from the elimination of all remaining district-sponsored charter schools (DSCS) in FY 2017. *(Please see Eliminate District Charters policy issue under Basic State Aid for more information.)*

Additional Inflation

The budget includes no funding from the General Fund in FY 2017 for Additional Inflation. This amount is unchanged from FY 2016.

The General Appropriation Act for FY 2016 (Laws 2016, Chapter 8) originally appropriated \$74,394,000 from the General Fund in FY 2016 for additional inflation. A footnote in Chapter 8 required the department to allocate those 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. Laws 2015, 1st Special Session, Chapter 1, however, amended Chapter 8 to incorporate the \$74,394,000 into Basic State Aid for FY 2016 pending voter approval of Proposition 123 in May 2016, which occurred. The amended FY 2016 budget therefore contains no separate funding for this line item.

K-3 Reading

The budget includes no funding from the General Fund in FY 2017 for the K-3 Reading program. These amounts fund the following adjustments:

Fund Program Through Basic State Aid

The budget includes a decrease of \$(39,917,300) and (2) FTE Positions from the General Fund in FY 2017 in order to fund formula costs for the K-3 Reading program through Basic State Aid and fund program administration through the department's operating budget. *(See Basic State Aid and Operating Budget narrative for more information.)*

The program is authorized by A.R.S. § 15-211, which, as amended by Laws 2016, Chapter 245, requires the department to administer a K-3 reading 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. Prior to Chapter 245, A.R.S. § 15-211 required the

State Board of Education to establish the program in collaboration with the department, rather than requiring only the department to administer the program. (See *Transfer K-3 Reading Monies policy issue under Basic State Aid for more information.*)

Special Education Fund

The budget includes \$32,242,100 and 1 FTE Position from the General Fund in FY 2017 for the Special Education Fund Special Line Item. These amounts are unchanged from FY 2016.

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 2017 for Other State Aid to Districts. This amount is unchanged from FY 2016.

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 \$391,456,100 from the General Fund in FY 2017 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 \$6,023,800 from the General Fund in FY 2017 for increased Homeowner's Rebate costs associated with new home construction. The \$6,023,800 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 2017 and that approximately 45.0% of the QTR taxes owed by new homes will be paid by the state through the Homeowner's Rebate.

Property Tax - Statutory Changes

The budget includes an increase of \$5,598,000 from the General Fund in FY 2017 to offset an anticipated increase in Homeowner Rebate costs for FY 2017 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. It also reduces the assessment ratio on agricultural property from 16% to 15% in FY 2017. These changes will reduce statewide property values for commercial and agricultural property in FY 2017. This will cause the statewide property tax base to be smaller in FY 2017 than it otherwise would be and Truth in Taxation would otherwise require the K-12 QTR to be increased accordingly. The latter change would increase the amount of QTR taxes paid by homeowners, which would increase Homeowner's Rebate costs by an estimated \$5,598,000 in FY 2016.

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

In combination, the higher TNT QTR and the rebate percentage change (described separately below) will cost an estimated \$26,128,600 in FY 2017.

Increased Rebate Percentage

The budget includes an increase of \$20,530,600 from the General Fund in FY 2017 for costs associated with an increased Homeowner's Rebate percentage required by Laws 2011, 2nd Special Session, Chapter 1. Chapter 1 requires the Arizona Department of Revenue (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 \$5,598,000 cost associated with the higher statewide QTR, the \$20,530,600 reflects the cost of the higher rebate percentage associated with keeping homeowner local property taxes from increasing.

For FY 2016, DOR increased the rebate percentage to 45.003% versus 43.559% in FY 2015. The currently estimated cost of the required rebate percentage increase for FY 2017 is \$20,530,600, which would reflect a rebate percentage of roughly 47.5%. DOR is not expected to determine the actual rebate percentage for FY 2017 until the summer of 2016.

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 2017 for the Additional State Aid - 1% Cap line item. This amount is unchanged from FY 2016.

The General Appropriation Act for FY 2016 appropriated monies for the 1% cap into a separate line item for the first time that year for greater transparency. In addition, the FY 2016 K-12 Education BRB amended 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 required the Property Tax Oversight Commission (PTOC) established by A.R.S. § 42-17002 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.

In March 2016, the PTOC determined that school districts statewide would forgo \$(19,832,900) of state 1% Cap funding for FY 2016 as a result of the new \$1,000,000 limit on state 1% Cap funding per county. This amount included reductions totaling \$(15,804,100) for 7 school districts in Pima County and \$(4,028,800) for 16 school districts in Pinal County (see Table 7).

The PTOC further determined that Pima County was required to backfill the entire \$(15,804,100) of foregone 1% Cap funding for FY 2016 for Pima County school districts. For Pinal County the PTOC determined that the County itself, Central Arizona College and 6 cities and towns in Pinal County collectively were required to backfill \$(4,028,800). The latter total included \$1,693,800 from Pinal County, \$1,271,100 from the City of Maricopa, \$974,000 from Central Arizona College and \$89,900 from 5 other cities and towns (see Table 8).

Table 7
1% Cap Backfill Required by School District for FY 2016

School District	Required Backfill
Pima County	
Tucson Unified	\$15,716,900
Altar Valley Elementary	53,000
Amphitheater Unified	24,000
Marana Unified	8,900
Sahuarita Unified	900
San Fernando Elementary	200
Vail Unified	200
Subtotal	\$15,804,100
Pinal County	
Maricopa Unified	\$2,946,700
Florence Unified	428,300
Coolidge Unified	163,800
Casa Grande Union	150,500
Casa Grande Elementary	100,500
Superior Unified	86,700
Toltec Unified	67,400
Mammoth Unified	50,200
Eloy Elementary	9,900
Apache Junction Unified	9,400
Santa Cruz Valley Union	9,300
Ray Unified	4,700
Stanfield Unified	700
J O Combs Unified	300
Red Rock Elementary	300
Picacho Elementary	100
Subtotal	\$ 4,028,800
Grand Total ^{1/}	\$19,832,900

^{1/} Excludes 8 Maricopa County school districts that collectively would have required \$639,400 of backfill funding for FY 2016. That amount was not backfilled because none of the overlapping taxing jurisdictions for those school districts (county, community college, city or town) had “above average” tax rates for FY 2016, so the latter were not required to provide backfill funding to the 8 affected school districts.

Table 8
Required Transfers for FY 2016 By Taxing Jurisdiction

Taxing Jurisdiction	Required Transfer
Pima County	
Pima County	\$15,804,100
Pinal County	
Pinal County	\$1,693,800
City of Maricopa	1,271,100
Central Arizona College	974,000
Town of Superior	46,400
City of Coolidge	29,200
Town of Mammoth	7,000
Town of Queen Creek	6,100
Town of Kearny	1,200
Subtotal	\$4,028,800
Grand Total	\$19,832,900

Pima County sued the state in June 2015 contending that the funding transfers required by the new 1% cap policy are not permissible for a number of reasons. On May 23, 2016 a Superior Court judge granted the plaintiff’s Motion for Summary Judgment in the case and indicated that it hoped to issue a signed judgment in the case by June 30, 2017. That judgment was not yet released at the time of this writing.

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 historically 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.

Beginning in FY 2016, A.R.S. § 15-972K required 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. (See the FY 2016 Appropriations Report for more information.)

Non-Formula Programs

Accountability and Achievement Testing

The budget includes \$16,420,800 and 2 FTE Positions in FY 2017 for Accountability and Achievement Testing. These amounts consist of:

General Fund	9,420,800
Proposition 301 Fund	7,000,000

These amounts fund the following adjustments:

Statewide Adjustments

The budget includes a decrease of \$(1,600) from the General Fund in FY 2017 for statewide adjustments.

Background – “AzMERIT” tests were administered to Arizona public school students for the first time during the spring of 2015. The State Board of Education awarded the initial contract for this new test in November 2014. ADE reports that it cost \$19,599,600 to administer AzMERIT in FY 2015 and that it will cost \$18,555,700 and \$18,439,200 to administer it in FY 2016 and FY 2017, respectively.

The Achievement Testing program, however, also includes components other than AzMERIT testing. It includes AIMS Science Tests, alternative exams for special needs

students, test security costs, information technology support and program administration. ADE estimates that the cost of all of these other functions and AzMERIT combined at \$26,092,000 in FY 2017 (see Table 9). This excludes costs for administering the AZELLA test for English Learners, which is funded separately through the English Learner Administration line item. (See English Learner Administration line item for more information.)

	<u>FY 2016</u>	<u>FY 2017</u>
Estimated Costs ^{1/}		
AzMERIT	\$19.0	\$18.4
AIMS Science Testing	2.8	2.8
Alternative Special Needs Exam	0.5	0.7
Test Security	1.0	0.7
Information Technology Support	0.7	0.8
Staff and Administration	<u>2.2</u>	<u>2.7</u>
Total	\$26.2	\$26.1
Estimated Available Funding ^{1/}		
General Fund	\$9.4	\$9.4
Proposition 301 - School Accountability ^{2/}	9.2	5.5
Federal Funds	<u>7.6</u>	<u>7.5</u>
Total	\$26.2	\$22.4

^{1/} ADE estimates for FY 2017 are preliminary. Estimates for both years exclude monies for funding the AZELLA test for English Learners, as it is funded separately through the English Learner Administration line item.

^{2/} Includes carry-forward monies in FY 2016. Up to \$7.0 million potentially could be devoted to Achievement Testing in FY 2017.

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, prohibited the department from assigning letter grades to schools for FY 2015 and FY 2016 based on achievement testing scores. It also prohibited 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.

Laws 2016, Chapter 226 revises how the department is to compute achievement profiles for school districts and charter schools, which serve as the basis for assigning letter grades to them. It requires multiple measures of academic performance to be used, deletes the current definition for each letter grade (A through F) and

stipulates that the replacement definitions, which must be adopted by the State Board of Education, are to have a letter grade of A reflect an excellent level of performance and a letter grade of F reflect a failing level of performance.

Laws 2016, Chapter 10 requires the State Board of Education to adopt a menu of locally procured achievement assessments to measure pupil achievement of the state academic standards. It allows each school district or charter school to administer a test from that menu, rather than administering the test selected by the State Board of Education, for purposes of testing high school students starting in FY 2018 and for purposes of testing students in Grades 3 - 8 starting in FY 2019.

(See Other Issues in FY 2016 Appropriations Report for more information regarding AzMERIT testing.)

Adult Education

The budget includes \$4,498,200 and 2 FTE Positions from the General Fund in FY 2017 for Adult Education. These amounts fund the following adjustments:

Statewide Adjustments

The budget includes a decrease of \$(1,800) from the General Fund in FY 2017 for statewide adjustments.

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 2016, 24 school districts, community colleges, counties and community-based organizations are operating state-funded Adult Education programs.

The program also received \$9,359,800 in federal funding in FY 2016. 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 2017 for an Alternative Teacher Development Program. This amount is unchanged from FY 2016.

The program is authorized by A.R.S. § 15-552, which requires the establishment of an alternative teacher development program for accelerating the placement of highly qualified individuals into low income schools.

Monies in the line item are distributed to the Teach for America program.

Arizona Structured English Immersion Fund

The budget includes \$4,960,400 from the General Fund in FY 2017 for the Arizona Structured English Immersion Fund. This amount is unchanged from FY 2016.

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 \$3,140,200 to public schools from the fund in FY 2015.

Code Writers Initiative Pilot Program

The FY 2017 K-12 Education BRB appropriates \$500,000 in one-time non-lapsing funding from the State Web Portal Fund in FY 2017 for a Code Writers Initiative Pilot Program.

Chapter 124 requires the department to allocate program funding on a competitive grant basis with input from the American Indian advisory council to participants who will leverage state monies by also securing non-state funding for the program. Program monies are to be used to introduce computer code writing curriculum for Native American students in grades 9–12.

English Learner Administration

The budget includes \$6,495,000 and 15.5 FTE Positions from the General Fund in FY 2017 for English Learner Programs. These amounts fund the following adjustments:

Statewide Adjustments

The budget includes a decrease of \$(12,900) from the General Fund in FY 2017 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 were expected to take the AzELLA in FY 2016,

including 47,500 for initial testing and 78,000 for retesting to see if they should continue to be classified as ELLs.

The department estimates that it will spend approximately \$1,000,000 in FY 2017 in order to replace existing AZELLA test questions. The current placement test questions have remained unchanged since FY 2013 for Kindergarten and since FY 2014 for Grades 1-12. The department indicates that AZELLA test questions need to be refreshed periodically so that they do not become overexposed and threaten the validity of test scores. The department plans to update questions during FY 2017 in preparation for FY 2018 testing.

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 it. Plaintiffs appealed the federal judge's ruling, but in June 2015 the federal appellate court upheld the earlier dismissal. In June 2015 the plaintiff attorneys asked for a rehearing in the case. (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.

Geographic Literacy

The budget includes \$100,000 in one-time funding from the General Fund in FY 2017 for Geographic Literacy. These amounts fund the following adjustments:

One-Time Funding

The budget includes an increase of \$100,000 from the General Fund in FY 2017 for Geographic Literacy. A General Appropriation Act footnote requires the department to use the appropriated amount to issue a grant to a statewide geographic alliance for the purpose of strengthening geographic literacy in this state and makes the appropriation non-lapsing.

JTED Soft Capital and Equipment

The budget includes \$1,000,000 from the General Fund in FY 2017 for JTED Soft Capital and Equipment. This amount is unchanged from FY 2016.

A footnote in the General Appropriation Act for FY 2017 requires the department to distribute the appropriated

amount to JTEDs with fewer than 2,000 ADM pupils on a pro rate basis for soft capital and equipment expenses.

School Safety Program

The budget includes \$3,645,600 and 1.2 FTE Positions from the General Fund in FY 2017 for the School Safety program. These amounts fund the following adjustments:

Statewide Adjustments

The budget includes a decrease of \$(900) from the General Fund in FY 2017 for statewide adjustments.

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 2017 K-12 Education BRB continues to require \$100,000 of the program's appropriation to be used for a pilot program on school emergency readiness. The FY 2017 K-12 Education BRB also requires the department to submit a report that summarizes the results of the FY 2017 program by November 1, 2017.

The FY 2015 K-12 Education BRB required the department to submit a report that summarizes the results of the FY 2015 program by November 1, 2015. That report indicated that the 3 school districts that participated in the pilot program in FY 2015 (Sunnyside Unified, Prescott Unified and Payson Unified) 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 plans, supported by exercises and drills, and 4) provided the Arizona Critical Terrorism Information Center (ACTIC) with relevant school infrastructure information.

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 was 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 \$11,576,300 and 27 FTE Positions from the General Fund in FY 2017 for the State Block Grant for Vocational Education. These amounts fund the following adjustments:

Technical Adjustment

The budget includes an increase of 0.7 FTE Positions from the General Fund in FY 2017 as a technical adjustment requested by the department in order to comply with federal maintenance-of-effort requirements for the program. A corresponding decrease of (0.7) FTE Positions is included in the agency's operating budget for FY 2017 resulting in no net change in total authorized FTE Positions for the agency for this issue for FY 2017.

Statewide Adjustments

The budget includes an increase of \$15,400 from the General Fund in FY 2017 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 \$25,000,000 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.

Teacher Certification

The budget includes \$1,828,100 and 21.1 FTE Positions from the Teacher Certification Fund in FY 2017 for Teacher Certification. These amounts fund the following adjustments:

Statewide Adjustments

The budget includes a decrease of \$(6,400) from the Teacher Certification Fund in FY 2017 for statewide adjustments.

Laws 2016, Chapter 138 transfers \$611,000 and 7 FTE Positions to the department from the State Board of Education budget in FY 2017 to reflect transfers of responsibility from the SBE to the department under that law. *(See the agency operating budget narrative, State Board of Education line item narrative and the Additional Legislation section for more information.)*

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.

Technology-Based Language Development and Literacy Intervention Pilot Program

The budget includes no funding from the Technology-Based Language Development and Literacy Intervention Fund in FY 2017 for the Technology-Based Language Development and Literacy Intervention Pilot Program. This amount funds the following adjustments:

Remove One-Time Funding

The budget includes a decrease of \$(246,800) from the Technology-Based Language Development and Literacy Intervention Fund in FY 2017 in order to remove one-time funding for the program. The FY 2017 K-12 Education BRB, however, makes an unspent \$300,000 appropriation for the program for FY 2015 non-lapsing through FY 2017, which would make \$300,000 available to the program in FY 2017. It also makes the program's \$246,800 appropriation for FY 2016 non-lapsing through FY 2018, making those monies available to fund program costs in FY 2018. In addition, the FY 2017 K-12 Education BRB changed reporting dates for this pilot program in A.R.S. § 15-217G to reflect the extended schedule.

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. The pilot program was to take place in FY 2015 and FY 2016, but ADE indicates that it did not begin in FY 2015 because the State Board of Education did not award the vendor contract for it until August 2015. As a result, program monies that were appropriated for FY 2015 went unused.

In addition, ADE now plans to start the program in FY 2017, so the program's FY 2016 appropriation of \$246,800 also will go unused. The FY 2017 K-12 Education BRB therefore amends Chapter 17 in order to extend the program through FY 2018 by making the original \$300,000 appropriation for FY 2015 non-lapsing through FY 2017 and the \$246,800 appropriation for FY 2016 non-lapsing through FY 2018, as described above.

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 enacted, 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 over 2 years than was originally intended.

The program seeks to promote English language development and literacy for public school pupils in Grades K-6.

Tribal College Dual Enrollment Program Fund

The budget includes \$250,000 from the Tribal College Dual Enrollment Program Fund in FY 2017 for the Tribal College Dual Enrollment Program Fund program. This amount funds the following adjustments:

Program Expansion

The budget includes an increase of \$90,000 from the Tribal College Dual Enrollment Program Fund in FY 2017 to enable the Tribal College Dual Enrollment Program Fund program to serve more students.

The FY 2016 Higher Education BRB (Laws 2015, Chapter 16) established the Tribal College Dual Enrollment Program Fund to be administered by the Department of Education (A.R.S. § 15-244.01). The fund compensates tribal colleges for tuition and fees that they waive for high school students who are dual enrolled in tribal college classes. Chapter 16 authorized the fund to annually receive 15% of unclaimed lottery prize monies up to \$160,000, subject to legislative appropriation, pursuant to A.R.S. § 5-568, plus any other appropriations, gifts, grants, devices and other contributions.

The FY 2017 K-12 BRB amends A.R.S. § 5-568 to allow the Tribal College Dual Enrollment Program Fund to annually receive 15% (unchanged) of unclaimed lottery prize monies up to \$250,000 (\$90,000 higher) of unclaimed lottery monies annually. Unclaimed lottery prize fund collections have totaled at least \$7,900,000 each year since FY 2005, so 15% of unclaimed monies would have equaled at least \$1,185,000 in each of those years.

The original FY 2016 budget did not appropriate any monies from the fund for FY 2016. The FY 2017 General Appropriation Act (Laws 2016, Chapter 117), however, appropriates \$160,000 in supplemental funding from it for the program for FY 2016.

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

State Board of Education

State Board of Education

The budget includes no funding for FY 2017 for the State Board of Education, as the Board is now budgeted as a separate state agency. *(See the FY 2016 Appropriations Report for more information.)*

Laws 2016, Chapter 138 transfers \$611,000 and 7 FTE Positions from the Board to the department to reflect the clarification of roles and responsibilities of the department and Board *(see Operating Budget section and the Additional Legislation section for more information).*

Other Issues

This section includes information on the following topics:

General Issues

- FY 2016 Supplemental
- Long-Term Budget Impacts

Ballot Proposition

- October 2015 Special Session and Proposition 123
- Endowment Earnings

Basic State Aid

- Basic State Aid Formula Description

Non-Formula Programs

- Education Learning and Accountability System

Non-General Fund Programs

- Proposition 301
- Budget Overrides

Information on these various issues is as follows:

FY 2016 Supplemental

The budget includes \$2,700,000 in supplemental funding from the Department of Education Professional Development Revolving Fund in FY 2016 to fund professional development courses. *(See the department's operating budget narrative for more information.)*

The budget also includes \$160,000 in supplemental funding from the Tribal College Dual Enrollment Program Fund in FY 2016 to fund professional development courses. *(See the Tribal College Dual Enrollment Program Fund line item narrative for more information.)*

The budget also includes a General Appropriation Act footnote authorizing the department to use a portion of its FY 2017 state General Fund appropriations for Basic State Aid (BSA) and Additional State Aid (ASA) to fund a shortfall in funding for BSA or ASA, if any, that occurred in FY 2016 after review by the Joint Legislative Budget Committee (JLBC).

Pursuant to this footnote, the JLBC favorably reviewed at its June 16, 2016 meeting a department request to use an estimated \$17,872,300 of its FY 2017 state General Fund appropriations for BSA or ASA, if necessary, to fund potential shortfalls in BSA or ASA for FY 2016.

The favorable review by the JLBC for this issue included the following provisions: 1) it required the department to report on the actual amount of FY 2017 funding used, if any, to fund FY 2016 shortfalls by September 1, 2016, 2) it required the department to spend down all available FY 2016 monies before using FY 2017 monies to address a FY 2016 shortfall, if any, and 3) it allowed the department to use more than \$17,872,300 of FY 2017 monies to address a FY 2016 BSA shortfall, if any, upon consultation with the JLBC chairman.

Long-Term Budget Impacts

As part of the budget's 3-year spending plan, ADE General Fund costs are projected to increase by \$86,389,600 in FY 2018 above FY 2017 and \$127,823,300 in FY 2019 above FY 2018. These estimates are based on:

- 1.4% ADM growth for both fiscal years.
- 9,000 new charter ADM and 3,000 new special education weighted ADM for both fiscal years.
- GDP inflators of 1.43% for FY 2018 and 1.84% for FY 2019.
- New construction NAV growth of 2.0% for FY 2018 and 2.1% for FY 2019.
- An \$(11.1) million decrease in FY 2018 to eliminate small school weight funding for most multi-site charter schools in FY 2018 (the final year of a 3-year phase out) (\$8.9 million of assumed \$20.0 million already accounted for).
- A \$(31.0) million decrease in FY 2018 in order to eliminate a one-time backfill for current year Base Support Level funding.
- A \$(1.8) million decrease in FY 2018 to eliminate remaining state JTED funding for high school graduates (only partially eliminated for FY 2017).
- An \$(1.1) million decrease in FY 2018 to eliminate a one-time backfill for former district-sponsored charter schools.
- GF decreases of \$(17.5) million in FY 2018 and \$(16.1) million in FY 2019 due to growing Land Trust monies

from Proposition 123 under assumed 1.4% ADM growth and 1.6% inflation for both years (assumptions used in the October 2015 Special Session).

- A GF decrease of \$(23.5) million in FY 2019 due to the elimination of debt service payments on School Facilities Board Land Trust Bonds authorized by Proposition 301 due to final payoff of those bonds in FY 2018, which frees up land trust monies for Basic State Aid in FY 2019.

October 2015 Special Session and Proposition 123

Laws 2015, 1st Special Session, Chapters 1 and 2 and HCR 2001 (the October 2015 Special Session legislation) make the changes described below. Changes made by Chapter 1 and HCR 2001 required voter approval of Proposition 123, which was received on May 17, 2016.

- Increase the per pupil "Base Level" in the Basic State Aid formula beginning in FY 2016 (Chapter 1).
- Fund part of the cost of that increase through higher land trust distributions through FY 2025 (HCR 2001).
- Appropriate monies for "Additional Funding" (now called "State Aid Supplement") through FY 2025 (Chapter 1).
- Authorized the special election for Proposition 123 that occurred on May 17, 2016 and appropriated \$9.3 million to the Secretary of State to conduct the election (Chapter 2).

The related funding increases for FY 2016 included an estimated \$248.8 million in state aid for the Base Level increase and \$50.0 million for the State Aid Supplement for an estimated state aid total of \$298.8 million.

Chapter 1 increased the Base Level from \$3,427 to \$3,600 per student in FY 2016 and will continue to further increase it by the lesser of inflation or 2% in subsequent years (unchanged from prior law). It also advanced appropriated \$50.0 million in State Aid Supplement funding annually from the General Fund in FY 2016 through FY 2020 and \$75.0 million annually from the General Fund in FY 2021 through FY 2025.

Proposition 123 and Chapter 1 provide additional state funding to schools by increasing the State Land Trust distribution rate from 2.5% to 6.9% per year through FY 2025, incorporating \$74.4 million of formerly separate "Additional Inflation" monies into Basic State Aid, and appropriating additional General Fund monies.

The increased Land Trust distribution rate will yield approximately \$170 million - \$250 million in additional K-12 distributions each year through FY 2025. Currently,

the K-12 State Land Trust Permanent Fund balance is approximately \$4.8 billion. Under Proposition 123, the balance is projected to equal approximately \$6.2 billion in FY 2025 versus \$9.0 billion in FY 2020 without Proposition 123.

Proposition 123 allows the Legislature to temporarily suspend future inflation increases during periods of economic slowdown, in which both sales tax revenue and employment grew less than 2% but more than 1% in the prior year. It requires this suspension if sales tax revenue and employment both grew less than 1% in the prior year.

Under Proposition 123, the Legislature also may reduce the land trust distribution rate to as low as 2.5% if the 5-year average Land Trust balance declines relative to the previous 5 years.

Beginning in FY 2026, the Proposition allows the suspension of the annual inflation adjustment and a reduction in K-12 funding for the next fiscal year equal to the current year inflation adjustment if K-12 spending surpasses 49% of the total state General Fund appropriations. If K-12 spending surpasses 50%, the state can temporarily suspend the annual inflation adjustment and reduce K-12 funding for the next fiscal year by twice the current year inflation amount. Currently, K-12 spending constitutes approximately 42% of total state General Fund appropriations.

On a related note, the FY 2017 Government Budget Reconciliation Bill (Laws 2016, Chapter 121) requires the State Board of Investment and the State Treasurer to take all actions necessary for the distributions of monies from the State Land Trust Permanent Fund to recipient funds as outlined in the Arizona Constitution and statute. If either the State Board of Investment or the State Treasurer fails to make these distributions, Chapter 121 authorizes the Governor, Speaker of the House or Senate President to file an action with the Supreme Court to obtain a writ of mandamus or other appropriate action to compel them to make the distributions. Chapter 121 also includes language stating that it is the intent of the Legislature that the State Treasurer fully implement Proposition 123 if approved by voters.

Chapter 121 requires the State Board of Investment and the State Treasurer to make land trust distribution on the fifteenth business day of each month. Laws 2016, Chapter 340, however, notwithstanding this requirement for FY 2017 and FY 2018 and requires land trust distributions for those years to instead be made on the last business day of each month. *(Please see the State*

Treasurer and State Land Department sections for more information.)

Twelve state land trust beneficiaries other than public schools also will receive additional land trust funding under Proposition 123 because of the higher (6.9%) land trust distribution percentage. *(Please see the State Land Department budget for more information.)*

The passage of Proposition 123 resolves the Cave Creek litigation and satisfies all outstanding inflation adjustment claims brought forth in that case.

(See the 0.99% Inflation Adjustment and State Aid Supplement policy issues above for more information.)

Endowment Earnings

In FY 2015, endowment earnings from state trust lands funded approximately \$129.2 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.

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. Prior to voter approval of Proposition 123 in May 2016, the State Constitution required 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 would have been in effect through calendar year 2021, but has now been superseded through FY 2025 by a new 6.9% factor required by Proposition 123. After FY 2025, Proposition 123 reestablishes the 2.5% factor on a permanent basis. *(Please see the October 2015 Special Session and Proposition 123 section for more information.)*

Prior to both Proposition 118 and Proposition 123 the formula in the State Constitution for computing expendable Treasurer land trust earnings was 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 depending on market conditions *(see Treasurer's earnings in Table 10)*.

In FY 2015, public schools received \$129.2 million of expendable land trust monies from the State Land Department and State Treasurer combined. That total included \$53.2 million from the Land Department and \$76.0 million from the State Treasurer *(see Table 10)*.

Source	2006	2010	2015	2016 est	2017 est ^{1/}
Land Department	67.6	38.1	53.2	43.9	43.9
Treasurer	<u>31.4</u>	<u>0.0</u>	<u>76.0</u>	<u>259.3</u>	<u>270.4</u>
Total	99.0	38.1	129.2	303.2	314.3

^{1/} Assumes no change in trust land lease revenues for FY 2017.

Table 10 shows that K-12 endowment earnings increased from \$99.0 million in FY 2006 to \$129.2 million in FY 2015 after dropping temporarily to \$38.1 million during the Great Recession. Under Proposition 123 they are

estimated to increase to \$303.2 million in FY 2016 and \$314.3 million in FY 2017.

Under the prior 2.5% distribution rate, the State Treasurer distribution of K-12 endowment earnings would have been \$87.2 million for FY 2016 based on land trust market values through calendar year 2014 only (prior 5 calendar years). Under the 6.9% distribution rate established by Proposition 123, the State Treasurer's distribution of K-12 endowment earnings instead was approximately \$259.3 million.

The State Land Department distributed an estimated \$43.9 million in K-12 endowment earnings for FY 2016 based on partial year data. The actual State Land Department distribution of K-12 endowment earnings for FY 2016 will not be known until after the close of the fiscal year.

Of the \$129.2 million in K-12 expendable earnings generated for FY 2015 \$47.3 million was used to help fund Basic State Aid pursuant to A.R.S. § 37-521B3 and \$25.0 million was used to help fund School Facilities Board debt service pursuant to A.R.S. § 37-521B2 *(see Table 11)*. The remaining \$56.9 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.

Source	2006	2010	2015	2016 ^{1/}	2017 ^{1/}
Basic State Aid	46.9	13.9	47.3	219.4	219.8
SFB Debt Service	25.4	24.2	25.0	24.9	24.9
Classroom Site Fund	<u>26.7</u>	<u>0.0</u>	<u>56.9</u>	<u>58.9</u>	<u>69.6</u>
Total	99.0	38.1	129.2	303.2	314.3

^{1/} Estimated

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 2017 (as modified by the FY 2017 K-12 Education BRB) equal \$1,752.10 per pupil for Grades K-8 and \$2,042.04 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.

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).

Since FY 2015, ELAS funding has been appropriated to the Arizona Department of Administration Automation Projects Fund (APF) rather than ADE. As a result, ELAS funding no longer appears in the ADE budget. For FY 2017 ADE is receiving \$7,300,000 in General Fund funding through the APF for continued ELAS development.

ADE indicates that other states have expressed interest in the system capabilities developed as part of the ELAS project and believes it may be able to recoup project development expenses and/or provide support for the ongoing operational costs through the sale or lease agreements with other states. Accordingly, Laws 2016, Chapter 317 establishes the Department of Education Intellectual Property Fund and allows ADE to deposit and retain 40% of the profits generated by the sale or lease of software, computer systems, or intellectual property that it develops. The remaining 60% shall be deposited into the General Fund.

Chapter 317 prohibits ADE from using monies in the Intellectual Property Fund for marketing purposes. Monies in the fund, if any, are subject to appropriation. The FY 2017 budget does not appropriate any monies from the fund.

(Please see the Arizona Department of Administration - Automation Projects Fund section for more information.)

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 12*).

As shown in *Table 12*, 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).

Table 12

**Proposition 301 Monies
(FY 2015 Actual)
(\$ in Millions)**

<u>Recipient</u>	<u>Amount</u>	<u>Comment</u>
School Facilities Board	\$64.1	For debt service on \$794.7 million of bonds authorized by Proposition 301 for school repairs and updates.
Universities	67.1	Receive 12% of monies remaining after SFB debt service is deducted.
Community Colleges	16.8	Receive 3% of monies after SFB debt service.
Tribal Colleges	0.8	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	\$173.8	
Additional School Days	\$86.3	To add 5 days to K-12 school year (180 days total).
School Safety and Character Education	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>347.3</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	\$450.1	
Grand Total	\$623.9	

- 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 \$347.3 million (55.7%) of the \$623.9 million collected for FY 2015 (see *Table 12*). The Proposition 301 sales tax expires after FY 2021.

Classroom Site Fund

Proposition 301 amended A.R.S. § 37-521B4 in order to dedicate 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 2015, the Classroom Site Fund received approximately \$50.7 million from K-12 endowment earnings, which resulted in total deposits of \$398.0 million (\$347.3 million from the 0.6¢ sales tax + \$50.7 million from endowment earnings = \$398.0 million).

Proposition 123 from the October 2015 Special Session further amends A.R.S. § 37-521B4 in order to dedicate all growth in state land trust revenues from the voter-approved 4.4% increase in the trust distribution percentage (from 2.5% currently to 6.9% through FY 2025)

to Basic State Aid, rather than to the Classroom Site Fund. The latter, however, will continue to receive all growth in the original 2.5% distribution after FY 2001 to the extent that those earnings plus related earnings from the State Land Department exceeded \$72.3 million. (See *October 2015 Special Session and Proposition 123 narrative above for more information.*)

The \$347.3 million that the Classroom Site Fund received from the 0.6¢ sales tax in FY 2015 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 12*. Those 2 amounts combined equaled \$450.1 million for FY 2015.

ADE distributed \$295 per pupil from the Classroom Site Fund in FY 2015. 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 \$332 per pupil for FY 2017, which would be \$5 per pupil higher than the \$327 per pupil amount estimated for FY 2016 pursuant to A.R.S. § 15-977G1.

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 2016, 91 districts statewide have M&O overrides pursuant to A.R.S. § 15-481, 5 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 2016 include \$401.0 million for M&O overrides, \$1.2 million for Special Program overrides and \$61.0 million for District Additional Assistance overrides. Grand total override funding for FY 2016 therefore equals \$463.2 million, which is \$(5.2) million below the \$468.4 million amount budgeted for all overrides collectively in FY 2015 (see Table 13). (See the School Facilities Board budget narrative for a related summary on K-12 Capital Bonding.)

Table 13

**K-12 Budget Overrides
(\$ in Millions)**

Type of Override	FY 2015	FY 2016	Change
M&O	387.3	401.0	13.7
Special Program	6.9	1.2	(5.7)
Additional Assistance	<u>74.2</u>	<u>61.0</u>	<u>(13.2)</u>
Total	468.4	463.2	(5.2)

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 13 are from the related ADE reports for FY 2015 and FY 2016.

Additional Legislation

Clarification of Duties

Laws 2016, Chapter 138 clarifies the duties and powers of the department and Superintendent of Public Instruction (SPI) versus the State Board of Education (SBE). In 2015, the SPI filed suit against the SBE over the authority to hire and dismiss SBE staff. In 2015 also, the SBE filed suit against the SPI seeking remote access to data housed at the department for the SBE’s teacher investigation unit. The unit’s staff, funded by an appropriation to SBE from the Teacher Certification Fund, could access required files in the Online Arizona Certification Information System (OACIS) only through terminals located at the Department of Education building.

The SPI and the SBE have agreed to settle all ongoing litigation between them as a result of provisions enacted in Chapter 138. The legislation clarifies that the SBE shall employ and direct its own staff without the recommendation of the SPI, who shall execute SBE policies and provide information to the SBE related to its statutory powers and duties.

Chapter 138 also requires the SPI, rather than the SBE, to direct the work of all investigations related to immoral or unprofessional conduct and requires the department and the SBE to submit a transition plan by August 1, 2016 to the Executive and Legislature related to the transfer of investigative unit personnel from the SBE to the department.

In conjunction with the clarification and transfer of responsibilities between the 2 entities, Chapter 138 transfers 7 FTE Positions and \$611,000 from the SBE to the department. Of this amount, \$231,200 and 2 FTE Positions are transferred from the SBE’s General Fund appropriation, and \$379,800 and 5 FTE Positions are transferred from its Teacher Certification Fund appropriation.

The SBE’s 4 remaining FTE Positions equal the number of non-investigative staff that were appropriated to the SBE line item in the department’s budget prior to the 2 entities’ separation.

Chapter 138 also requires the Department of Administration, rather than the SPI, to approve travel expenses and reimbursements for SBE board members, increases the statutorily-authorized number of board members by 2 to conform to the Arizona Constitution, and allows SBE to collect fees for the evaluation of certificates, name changes, duplicates or changes of coding to existing files or certificates.

Foster Care Children – Enrollment Preferences

Laws 2016, Chapter 248 allows school districts and charter schools to give enrollment preferences to children in foster care so that those children can have faster access to schools with waiting lists. It also establishes a foster youth education program in the Office of the Governor for the purpose of improving the educational outcomes of children in the Arizona foster care system. *(Please see sections for the Office of the Governor and the Department of Child Safety for more information.)*

Primary Property Tax Rates

Laws 2016, Chapter 364 removes the requirement that school districts adjust their primary property tax rates annually to reflect cash balances carried forward from the prior fiscal year. It also eliminates the current 4% cap on the amount of spending authority that a school district can carry forward each year. As a result, Chapter 364 will allow a school district to spend its cash in whichever fiscal year it chooses, as has historically been the case for charter schools. It does not modify existing statutory budget limits, however, so will not affect the amount of cash that a school district can generate each fiscal year under those budget limits.

Chapter 364 also makes a school district eligible for Supplemental State Aid pursuant to A.R.S. § 15-980 if its county treasurer certifies to a school district after January 1 that in the treasurer's reasonable belief more than 10% (versus 20% under prior law) of its primary property tax revenues will not be remitted due to property tax delinquencies or a decrease in assessed valuation due to a natural disaster such as a fire or flood.

School Property Sales and Leases

Laws 2016, Chapter 242 gives school districts greater flexibility on how they use the proceeds from property sales and leases that occur after June 30, 2016, but with relatively more flexibility being given to "low debt" than "high debt" school districts. It allows both to use sale or lease proceeds not exceeding \$100,000 for any maintenance and operation (M&O) or capital purpose, but does not allow either to use any proceeds above \$100,000 on M&O. Prior law instead allowed both to spend a portion of sale or lease proceeds on M&O expenditures with a lower proportion being allowed for "high debt" districts and with the allowable amount for both being based on a percentage of their Revenue Control Limit (RCL) and with no separate provision being made for the proceeds up to and beyond \$100,000.

Chapter 242 requires "high debt" districts to use at least 38% of sale or lease proceeds that exceed \$100,000 to pay off existing debt and permits them to use the

remainder for capital outlay. Prior law did not require "high debt" districts to use any proceeds to pay off debt.

Public School Tax Credit; CPR Instruction

Laws 2016, Chapter 216 requires public schools to provide their high school pupils with one or more training sessions in cardiopulmonary resuscitation (CPR). It also expands the Public School Tax Credit program authorized by A.R.S. § 43-1089.01 to allow an individual income tax filer to claim a state tax credit for fees paid or contributions made to a public school in support of public school CPR instruction.

Public School Tax Credit; Extracurricular Fees

Laws 2016, Chapter 331 changes the definition of "extracurricular activities" for purposes of the Public School Tax Credit program to mean school-sponsored activities that a school "may require" enrolled students to pay a fee in order to participate. Prior law allowed a tax credit for contributions in support of school-sponsored activities only if students had to pay fee in order to participate in them.

Community College Sponsorship of Charter Schools

Laws 2016, Chapter 331 removes the statutory requirement that a community college or group of community colleges must enroll at least 15,000 full-time equivalent students (FTSE) in order to sponsor a charter school.

Foreign Exchange Students

Laws 2016, Chapter 331 allows a school district or charter school to enroll without charging tuition as many non-resident foreign exchange students as is equal to the number of resident students enrolled in the school district or charter school who are participating in a foreign exchange program.

Concurrent Enrollment

Laws 2016, Chapter 331 allows a school district or charter school to include concurrently enrolled students in their ADM counts if it has received approval from the State Board of Education or its sponsor to offer concurrent enrollment courses, retroactive to July 1, 2010. Concurrent enrollment exists when a high school student enrolls in a community college class at a community college while they are still in high school.

Qualifying courses must meet for at least 40 hours per semester, award academic credit for high school graduation purposes, be taught at a higher level than the course taught at the school district or charter school in Grades 9-12. Participating students also must attend at least one course offered at the school district or charter school.

Chapter 331 includes session law language prohibiting the State Board of Education or the sponsor of a charter school from approving a school district or charter school to offer concurrent enrollment courses for FY 2017, but permits a school district or charter school that already had such approval prior to January 1, 2016 to continue to offer concurrent enrollment courses.