BALLOT PROPOSITION # I-16-2012

FISCAL ANALYSIS

Description

Proposition I-16-2012, if approved by voters, would enact a 1 cent per dollar transaction privilege and use tax (“sales tax”) beginning in FY 2014 and allocate those monies to education, transportation and human service programs (*see Table 1 and Attachment* 1).

Estimated Impact

State law requires the Joint Legislative Budget Committee Staff to prepare a summary of the fiscal impact of certain ballot measures. Proposition #I-16-2012 would enact a 1 cent per dollar transaction privilege and use tax ("sales tax") and allocate those monies to specified programs.

The 1 cent tax is projected to generate $971 million in revenue in its first year. Of that amount, $753 million would be distributed to education, $97 million to transportation and $121 million to human service programs.

The proposition would also have the following fiscal impacts:

1) Specified funding levels for the state’s kindergarten through 12th grade and state university systems cannot be reduced below the levels for fiscal year 2011-2012 or 2012-2013, whichever is greater.

2) Specific components of the K-12 school finance formula would be annually adjusted for inflation. This increase would initially be paid from the 1 cent sales tax. Given the proposition’s allocation formula, the 1 cent sales tax is projected to fully cover the cost of the cumulative increases through approximately 2018 and partially cover the cumulative cost after that time.

3) The limits on school district bonds and overrides cannot be below those in effect for 2012.

4) Vehicle license tax and related highway user revenues cannot be transferred to any other fund. Highway user revenues may continue to fund the Department of Public Safety’s Highway Patrol.

5) The sales tax base cannot be adjusted in a way that causes the amount of sales tax collected to be less than the amount collected in the prior year, plus six per cent, unless there is a corresponding change in the tax base that results in no reduction in the amount of sales tax collected.

Analysis

New 1% Sales Tax
The new state sales tax of 1% is expected to generate an additional $971.2 million in FY 2014, $1.02 billion in FY 2015, and $1.07 billion in FY 2016, and higher amounts in future years. The assumed 4.7% and 6.3% growth rates for FY 2013 and FY 2014 are the April “four sector” consensus revenue estimates. The analysis assumes a flat 5.0% sales growth rate for years after FY 2014. Monies generated by the Proposition will be allocated according to the distribution schedule prescribed in Proposition #I-16-2012, which is outlined in *Table I* and *Attachment 1*.

In the first year (FY 2014), the estimated $753 million distribution to education programs would consist of $508 million to the Quality Education and Performance Fund (QEPF), $10 million to the Education Learning and Accountability Fund (ELAF), $87 million to the Education Accountability and Improvement Fund (EAIF), $49 million to the University, Scholarship, Operations, and Infrastructure Fund (USOIF), and $99 million for K-12 inflation adjustments. The QEPF is projected to receive more than its “base” allocation of $500 million in FY 2014 because the proposition dedicates all unused inflation adjustment monies to the QEPF and the estimated K-12 inflation cost for FY 2014 is $26 million less than the estimated amount available for that purpose. All education recipients other than the QEPF, however, are expected to receive somewhat less than their “base” allocations in FY 2014 because the Proposition is estimated to generate $971 million rather than $1.0 billion in its first year.

Table 1

Distribution Formulas of Proposition #I-16-2012 Funding
Quality Education and Jobs Act

	Distribution	Use/Purpose	First $1 Billion Collected	Second Distribution	Third Distribution
1)	Quality Education and Performance Fund	Payments to local school districts and charter schools based on student count	$500 million, unless used for inflation costs in #8. Also receives unused inflation funding.	N/A	40%
2)	Education Learning and Accountability Fund	Statewide education data system	$10 million, unless data system is completed	N/A	N/A
3)	Education Accountability and Improvement Fund	Payments to local school districts and charter schools based on statewide performance measures	$90 million	N/A	7.5%
4)	State Infrastructure Fund	Transportation Projects	$100 million	11%, not to exceed $100 million	10%
5)	Children's Health Insurance Program Fund	Low-Income Children's Health Insurance Programs (KidsCare)	$25 million, unless lesser amount needed for program	N/A	N/A
6)	Family Stability and Self-Sufficiency Fund	Low-Income Health and Welfare Grants	$100 million	N/A	N/A
7)	University, Scholarship, Operations and Infrastructure Fund	University Scholarships and Performance Funding	$50 million	22.5%, not to exceed $250 million	7.5%
8)	Inflationary Adjustment for K-12 Funding Formula	Inflation adjustments to school funding formula for base support level and transportation support level	As necessary, cumulative costs above $125 million paid from Quality Education and Performance Fund distribution	N/A	N/A
9)	Payments to Districts/Charters Low-Income Student Counts	Payments to local school districts and charter schools based on low-income student count	N/A	33%, not to exceed $100 million	30%
10)	Community Colleges - Workforce Development. Accounts	Community College workforce development and job training programs	N/A	22.5%, not to exceed $66 million	2.5%
11)	Joint Technical Education Districts	Payments to local vocational education school districts	N/A	9%, not to exceed $29 million	2.5%
12)	Adult Education Programs	Adult Education Programs operated by the Arizona Dept. of Education	N/A	2%, not to exceed $5 million	N/A

Notes:
1) Distribution formula based on the Secretary of State Official Text Version posted on the Secretary of State website.
2) Second distribution affects allocation of funding above $1 billion as directed by the ballot proposition. Once second distribution cap is reached for any one category, any excess funds for that category would then be available for the third distribution category. Categories 9-12 are projected to reach their second distribution cap at $1.3 billion in total sales tax collections, thus their share of monies above that level would be available for the third distribution. Category 4 is projected to reach its second distribution cap at $1.9 billion in total sales tax collections, while Category 7 would reach its second distribution cap at $2.1 billion in total sales tax collections.

The estimated $121 million allocation for human services for FY 2014 includes $24 million for the Children's Health Insurance Program (CHIP) and $97 million to the Family Stability and Self-Sufficiency Fund (FSSF). These amounts likewise are somewhat less than the "base" amount prescribed in the Proposition because less than $1 billion in revenues are anticipated under the proposition in its first year.

Mandatory Spending Requirements

Proposition #I-16-2012 would prohibit the state from reducing General Fund appropriations to each state university below the amounts authorized in FY 2012 or FY 2013, whichever is greater. Given currently authorized spending levels, the amount is estimated to total $673 million. *Table 2* outlines these amounts below.

Table 2

Mandatory University Spending Requirements 1/

Agency	FY 2012 Budgeted	FY 2013 Budgeted	Base Year
Arizona State University	**$301,608,000**	$299,150,000	FY 2012
University of Arizona	265,086,200	**269,378,800**	FY 2013
Northern Arizona University	**102,439,400**	101,604,800	FY 2012

1/ In total, overall university General Fund appropriations could not be less than $673 million.

The proposition also would prohibit the state from reducing "the amount appropriated for equalization assistance pursuant to A.R.S. § 15-971" below the FY 2012 or FY 2013 amount, whichever is greater. A.R.S. § 15-971 pertains to state funding for school districts, but does not include charter schools, so this requirement would appear to prohibit the state from appropriating less for school district equalization assistance than is provided in FY 2013 (as it is budgeted to be higher than the FY 2012 funding level). The annual Basic State Aid appropriation does not earmark specific funding amounts for school districts versus charter schools. The cost of "equalization assistance" for school districts for FY 2013, however, is currently estimated at approximately $2.25 billion.

Mandatory K-12 Inflation Adjustments

Proposition #I-16-2012 also requires annual inflation adjustments to the K-12 "base level and other components of the revenue control limit." This would require annual inflation adjustments to the per pupil "base level" defined in A.R.S. § 15-901B2 and the transportation "route mile" rates established in A.R.S. § 15-945A5. The "base level" currently equals $3,267.72 per pupil and the "route mile" rates are currently $1.97 or $2.42 per mile depending on certain factors. Proposition 301 required annual inflation adjustments to the "base level" or "route mile" levels. Prior to FY 2011, the base level and transportation route mile rates were both adjusted annually for inflation. In FY 2012 and FY 2013, however, only the route mile rates and charter school "additional assistance" were adjusted for inflation, which will cost an estimated $8.9 million for FY 2013. The funding of only route mile rates and charter school additional assistance is the subject of on-going litigation. Also increasing the base level for inflation in FY 2013 would have cost an additional $87.5 million under current estimates.

The measure would specify that of the monies collected from the new 1% sales tax, "an amount sufficient to fund the inflationary adjustment required by A.R.S. § 15-901.01A shall be transferred to the State General Fund." The proposition limits this transfer to $125 million dollars, except that if the amount transferred "does not fully fund the inflation adjustment required by A.R.S. § 15-901.01, an additional amount sufficient to fully fund the inflationary adjustment shall be transferred to the State General Fund directly from the Quality Education and Performance Fund." Based on Legislative Council analysis, this provision is interpreted as applying to the cumulative value of inflation adjustments from the effective date of the proposition.

In FY 2014, the K-12 inflation adjustment required under the proposition would cost an estimated $99 million. Since the proposition dedicates $125 million for the inflation adjustment, the excess (approximately $26 million) is sent to the QEPF, as required by the proposition. In FY 2015, the second year of inflation adjustments would cost an additional $101 million under current estimates, for a cumulative 2-year cost of approximately $200 million. Under the proposition, the $200 million cumulative would be funded with the $125 million that the proposition allocates for K-12 inflation and $75 million redirected from the QEPF.

The cost of the annual K-12 inflation adjustment would be expected to increase over time from $99 million in FY 2014 to approximately $143 million by FY 2023 due to cumulative inflation and enrollment growth, both of which affect the cost of inflation adjustments. These estimates are based on long-term inflation forecasts from Global Insight and long-term K-12 enrollment growth rates currently projected by the University of Arizona Economics and Business Research (EBR) Center.

The proceeds of the 1% sales tax would initially cover the costs of the inflation adjustments. However, as the cumulative effect of the adjustments increases over time, the requirement will eventually lead to an unfunded fiscal impact in future years that would not be paid by the new sales tax. The 1% tax established by the proposition is projected to be insufficient to fully fund the expected inflation adjustment starting in FY 2019. (*See Attachment 1*.)

<u>Bonds and Overrides</u>
The proposition would prohibit a reduction in "the maximum indebtedness allowed for school district bonds and the maximum allowed for school district budget overrides… below that amount allowed by law on January 1, 2012." By referencing "amounts," this language is interpreted as meaning the maximum dollar value currently allowed. The state currently controls the dollar level of indebtedness and overrides by setting percentage limits. Indebtedness involves the issuance of "Class B" bonds to fund large capital items, such as buildings or buses pursuant to A.R.S. § 15-1021. Budget overrides involve the collection of additional property tax monies with voter approval for up to seven years (typically) without the issuance of debt in order to fund more "Maintenance and Operation" (M&O) or capital costs than would be permitted under statutory budget limits. The maximum statutory limits for bonds and overrides include the following:

- Class B Bonds: 5% or 10% of the district's secondary property tax base, depending on the type of district, or $1,500 per pupil, whichever is greater (A.R.S. § 15-1021)
- Maintenance and Operation (M&O) overrides (all types combined): 15% of the district's Revenue Control Limit (RCL) except for very small districts, which have a separate formula (A.R.S. § 15-491, Subsections G, H, & K)
- Capital Overrides: 10% of a district's RCL (A.R.S. § 15-491AA)

The "allowed by law on January 1, 2012" phrase in the proposition would make permanent the "alternate" (higher) formula for computing a school district's RCL for purposes of overrides that is authorized for FY 2012 and FY 2013 by Laws 2011, Chapter 344. The "alternative" RCL formula in Chapter 344 (Section 23) generates higher override limits than the "regular" RCL formula in A.R.S. § 15-947 because the "alternative" RCL is computed as if the former Kindergarten "Group B" weight still exists and as if the per pupil base level had been inflated for FY 2012 or FY 2013. These adjustments increased statewide school district override capacity by an estimated $27 million for FY 2012.

Under the ballot proposition, the dollar value of a school district's maximum bonding or override levels would not decrease below the dollar values in effect on January 1, 2012 as determined by the maximum percentages (such as "15% of RCL") prescribed in statute as of that date.

<u>Vehicle License Tax and Related Highway Revenues</u>
Proposition #I-16-2012 states that Vehicle License Tax (VLT) and Highway User Revenue Fund (HURF) monies may not be transferred to any other fund. There are no transfers of VLT or HURF to the General Fund or other funds in the FY 2013 budget; the FY 2012 budget, however, included transfers totaling $106 million from VLT into the General Fund.

Proposition #I-16-2012 also eliminates 2 statutory transfers of VLT monies to the General Fund. The elimination of the deposits of abandoned vehicle fees and 5-year VLT renewal fees into the General Fund are estimated to reduce General Fund revenues by approximately $3.3 million on an annual basis.

Proposition #I-16-2012 states HURF monies may continue to fund DPS' Highway Patrol Division.

<u>Sales Tax Base</u>
The proposition requires that the sales tax base cannot be adjusted in a way that causes the amount of sales tax collected to be less than the amount collected in the prior year, plus six per cent, unless there is a corresponding change in the tax base that results in no reduction in the amount of sales tax collected. This provision would prohibit the enactment of new exemptions to sales tax unless they are offset by other provisions to expand the sales tax base. If a change in the tax base is proposed in legislation, the Department of Revenue is to provide an estimate of the impact to the Legislature upon the written request of a legislator.

Local Government Impact

Receipts may be distributed to local governments such as cities and counties for health and welfare programs, as well as transportation projects.

7/3/12

This estimate was prepared by Jack Brown/Steve Schimpp/Breanne Bushu (602-926-5491).

Attachment 1

10-Year Projected Distribution of Proposition #I-16-2012 Funding
Quality Education and Jobs Act 1/
$ in Millions

	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
Revenues										
Sales Tax Revenues (1.0% Tax)	971.2	1,019.7	1,070.7	1,124.2	1,180.5	1,239.5	1,301.5	1,366.5	1,434.9	1,506.6
Expenditures										
1) Quality Education and Performance Fund 2/	508.4	425.4	320.9	211.8	97.7	0.0	0.0	0.0	0.0	0.0
2) Education Learning and Accountability Fund	9.7	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0
3) Education Accountability and Improvement Fund	87.4	90.0	90.0	90.0	90.0	90.0	90.2	93.3	96.7	100.3
4) State Infrastructure Fund - Transportation	97.1	102.2	107.8	113.7	119.9	126.3	133.4	144.7	156.8	169.4
5) Children's Health Insurance Program Fund	24.3	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0
6) Family Stability and Self-Sufficiency Fund	97.1	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
7) University, Scholarship, Operations and Infrastructure Fund	48.6	54.4	65.9	78.0	90.6	103.9	118.0	135.8	154.5	174.3
8) Inflationary Adjustment for K-12 Funding Formula 2/	98.6	199.6	304.1	413.2	527.3	625.0	626.1	642.5	660.7	679.8
9) Payments to Districts/Charters Low-Income Student Counts	0.0	6.5	23.3	41.0	59.6	79.0	100.3	113.1	126.8	141.1
10) Community Colleges - Workforce Development Accounts	0.0	4.4	15.9	28.0	40.6	53.9	66.1	67.1	68.2	69.4
11) Joint Technical Education Districts	0.0	1.8	6.4	11.2	16.2	21.6	27.2	30.1	31.2	32.4
12) Adult Education Programs	0.0	0.4	1.4	2.5	3.6	4.8	5.0	5.0	5.0	5.0
Total Distributions	971.2	1,019.7	1,070.7	1,124.2	1,180.5	1,239.5	1,301.5	1,366.5	1,434.9	1,506.6
Inflation Costs Not Funded by Sales Tax 3/										
Marginal Cost of Inflation Adjustment	98.6	101.0	104.5	109.1	114.1	119.4	124.9	130.6	136.6	142.9
Total Cost of Inflation Adjustment	98.6	199.6	304.1	413.2	527.3	646.6	771.5	902.1	1,038.7	1,181.6
Assumed Deflator %	*1.60%*	*1.40%*	*1.60%*	*1.70%*	*1.60%*	*1.50%*	*1.50%*	*1.50%*	*1.50%*	*1.50%*
Sales Tax Transfer for Inflation Adjustment	98.6	199.6	304.1	413.2	527.3	625.0	626.1	642.5	660.7	679.8
Marginal Inflation Adjustment Not Funded by Sales Tax	0.0	0.0	0.0	0.0	0.0	21.6	123.7	114.2	118.4	123.8
Total Inflation Adjustment Not Funded by Sales Tax	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**21.6**	**145.3**	**259.6**	**378.0**	**501.8**

1/ Represents JLBC Staff's current understanding of the distribution of the 1 cent sales tax, based on the Secretary of State Official Text Version posted on the Secretary of State's website.

2/ Monies from the Quality Education and Performance Fund (QEPF) are to be transferred to the General Fund for the inflationary adjustment if the amount of the inflationary adjustment is more than $125 million. Based on Legislative Council analysis, this provision is interpreted as applying to the cumulative inflation adjustment. As a result, the QEPF allocation declines after FY 2014. Conversely, monies to fund the inflationary adjustment are to be transferred to the QEPF if any excess monies are not necessary to fully fund the inflationary adjustment. As a result, the QEPF receives more than $500 million in FY 2014.

3/ The ballot proposition would require an inflation adjustment of the per pupil base level and the transportation support level. The proposition provides 1 cent sales tax monies to fund these adjustments, which is projected to be sufficient through FY 2018.