

**Joint Legislative Budget Committee
Staff Memorandum**

1716 West Adams
Phoenix, Arizona 85007

Telephone: (602) 926-5491
azleg.gov

DATE: July 14, 2017

TO: Richard Stavneak

FROM: Matt Beienburg, Fiscal Analyst
Steve Schimpp, Deputy Director

SUBJECT: SB 1431 AS ENACTED – EMPOWERMENT SCHOLARSHIPS; EXPANSION; PHASE-IN

On April 6, 2017, we sent a memorandum to you on the impact of the Senator Worsley floor amendment to SB 1431 concerning the Empowerment Scholarship Account (ESA) program. We have now updated that memorandum to reflect SB 1431 as enacted (Laws 2017, Chapter 139). After the floor amendment, there were no further changes to the bill.

The fiscal estimates in the April 6th memorandum are the same as contained in this memorandum. We have just updated our technical references relative to the Senate floor version having been enacted into law. The major provisions of SB 1431, as enacted, are as follows:

- 1) Expand the definition of a qualified student under the ESA program to effectively allow any Kindergarten student to begin participating in the ESA program in FY 2018 and phase in eligibility of prior public school students in grades 1 – 12 over 4 years.
- 2) Any new ESA kindergarteners and prior district students would have their awards based on the level of district additional assistance (DAA), rather than the higher level of charter school additional assistance (CAA). This will not affect the calculation of assistance for students already in the program.
- 3) If a family's income does not exceed 250% of the federal poverty level (FPL), 100% of the amount of formula funding would be deposited into an ESA rather than 90%. This provision only applies to new applicants. To qualify, a household must agree to have the Arizona Department of Revenue (DOR) verify its family income using information already available at DOR.
- 4) Extend the cap on new ESA accounts that may be opened per year at 0.5% of the public school student population through 2022. Under current law, the cap is scheduled to expire at the end of 2019.
- 5) Beginning in FY 2023, permanently cap the total number of ESA accounts at the FY 2022 level.

Our fiscal note for the bill as introduced is attached.

Estimated Impact

We estimate that SB 1431, as enacted, would decrease General Fund costs by \$(1.6) million in FY 2018, \$(2.9) million in FY 2019, \$(3.5) million in FY 2020, and \$(3.4) million in FY 2021 relative to current law.

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As we noted in the fiscal note of SB 1431, as introduced, this estimate is highly speculative, and actual costs could vary substantially depending on the actual participation rates of newly eligible students, both among current public school students and among incoming kindergarteners who would have enrolled in a private school even without an ESA. Among the latter, for example, ESA participation could depend heavily on families' awareness of, and relative preference for, the ESA program versus the School Tuition Organization ("STO") scholarships currently available (students may not participate in both programs).

SB 1431, as enacted, would expand the definition of a qualified student under the ESA program to include any kindergarten student to begin participating in the ESA program in FY 2018. The bill would also expand eligibility to any former public school student, rather than only certain sub-categories of kindergarten and public school students, such as disabled students. This provision would be phased in over 4 years.

Analysis

	FY 2018		FY 2019		FY 2020		FY 2021	
	#	\$	#	\$	#	\$	#	\$
Prior Public School	2,800	(950,100)	6,900	(2,316,700)	10,900	(3,650,200)	14,800	(4,950,200)
Private Kindergarteners	200	450,000	500	1,575,000	1,000	3,375,000	1,600	5,850,000
Current Law New Applicants ^{2/}	1,300	(1,072,500)	2,600	(2,145,000)	3,900	(3,217,500)	5,200	(4,290,000)
Total	4,300	(1,572,600)	10,000	(2,886,700)	15,800	(3,492,700)	21,600	(3,390,200)

^{1/} Represents cumulative ESA enrollment and costs of new ESA applicants under SB 1431 in each year.
^{2/} Represents 1,300 new ESA participants expected to join each year who are already eligible under current law. Modified award amounts for these students under SB 1431, as enacted, would reduce their net expected General Fund cost relative to current law.

Table 1 summarizes the fiscal impact of SB 1431, as enacted, relative to current law. Overall, General Fund costs would decrease by an estimated \$(1,572,600) in FY 2018 and by an estimated \$(3,390,200) in FY 2021. This impact consists of 3 different factors:

- Newly eligible prior public school students participating in the ESA program would decrease General Fund costs by \$(950,100) in FY 2018 and \$(4,950,200) by FY 2021.
- Newly eligible incoming private school kindergarteners would increase General Fund costs by \$450,000 in FY 2018 and \$5,850,000 by FY 2021.
- Using the DAA standard in the calculation of ESA awards would also decrease General Fund costs associated with the roughly 1,300 students who would enter the program each year under current law. The modified award amounts would reduce General Fund costs by \$(1,072,500) in FY 2018 and \$(4,290,000) by FY 2021.

Table 2 displays the estimated per pupil General Fund impacts of SB 1431, as enacted, relative to existing law.

A newly eligible, non-disabled student whose family income exceeds 250% of the FPL and who switches to the ESA program would save the General Fund \$(300) if switching from a charter school and \$(500) if switching from a district school.

For a newly eligible, non-disabled student whose family income is below 250% of the poverty level (\$61,500 for a family of 4), SB 1431, as enacted, would fund ESA awards at 100% of the base support level (BSL) and additional assistance (with no additional administrative allowance). Among these students, ESAs would have \$0 net impact per student switching from a charter school and a \$(300) savings per student switching from a district school. The latter is due to savings from transportation formula costs, which are not funded under the ESA formula.

ESA Formula % ^{1/}	Estimated ESA (Savings) or Cost Per Pupil					
	Disabled Students ^{2/}			Non-Disabled Students		
	Former Charter	Former District	Other ^{3/}	Former Charter	Former District	Other ^{3/}
90%	\$(1,200)	\$(1,400)	\$21,300	\$(300)	\$(500)	\$4,400
100% ^{4/}	\$0	\$(300)	\$22,500	\$0	\$(300)	\$4,600

^{1/} Students whose family incomes exceed 250% of the FPL receive 90% of the BSL and additional assistance amount. An additional 5% administrative allowance is added to the General Fund cost for these students.
^{2/} Qualify for special education "Group B" funding pursuant to A.R.S. § 15-943.
^{3/} Includes ESA students who otherwise would not attend public schools, which could include some incoming kindergartners, disabled preschoolers and military dependents, since A.R.S. § 15-2401 does not require these students to attend public school prior to receiving an ESA.
^{4/} Under SB 1431, as enacted, new ESA participants whose family incomes do not exceed 250% of the federal poverty level would receive 100% of the BSL and additional assistance amount they would otherwise receive as public school students. Students switching from a district school would still generate an average General Fund savings of approximately \$(300) due to savings from transportation funding costs, which are not included in the ESA formula.

The analysis maintains the following assumptions from the original analysis of SB 1431, as introduced:

- 1) The ESA participation rate of newly eligible public school students would, over four years, reach the current 2.6% ESA participation rate for students already eligible for an ESA.
- 2) The participation rate of newly eligible incoming private school kindergartners would increase from an assumed 5% in FY 2018 to 40% by FY 2021.
- 3) An additional 1,300 students who are already eligible for an ESA under current law would join the program each year, filling a portion of available slots under the enrollment cap currently in effect.
- 4) Available ESA slots each year would be filled by prior public school students and incoming private school kindergartners proportionately based on the number of each type seeking to participate in the program each year.

In addition, the analysis includes the following new assumptions:

- 5) 70% of newly eligible prior public school students are estimated to have family incomes below 250% of the FPL and therefore would qualify for the 100% ESA formula calculation. According to ADE, 56% of students qualify for free or reduced price lunch statewide, which requires a family income less than 185% of the FPL. Since some families may not seek DOR verification of their income, we assume 60% of newly eligible prior public school students who apply for an ESA would have family incomes below that threshold.

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- 6) 50% of newly eligible incoming private school kindergarteners are projected to have family incomes below 250% of the FPL. This assumes that private school students are less likely to fall below 250% of the FPL than public school students.
- 7) Among the additional 1,300 students who are already eligible for an ESA under current law that would join the program each year, even in the absence of this legislation:
 - A. 50% will have family incomes exceeding 250% of the FPL.
 - B. 50% will have disabilities. As reported in a 2016 Auditor General analysis, 58% of current ESA participants are disabled.

In addition, this analysis incorporates our revised understanding of the ESA administrative cost calculation. Currently, the ESA program deposits into a student's account 90% of the BSL and charter school additional assistance. There is also a 5% administrative allowance. Our prior fiscal analysis assumed that this amount was funded from the 90%. The Arizona Department of Education (ADE) has subsequently clarified, however, that the 5% administrative allowance is made in addition to the 90% student award. Therefore, this analysis assumes the net ESA savings is 5% for each prior public school student, rather than 10%.

Local Government Impact

School districts would serve fewer students under the bill than they would under current law due to increased student participation in ESAs. This would reduce the amount of budget override taxes that school districts would be eligible to generate relative to current law, since that funding is based on a percentage of a school district's K-12 formula funding. It also potentially would reduce tax rates in non-state aid districts to the extent that those districts served fewer students than under current law because of the bill, since those districts self-fund their own K-12 formula costs.

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Attachment

BILL # SB 1431

TITLE: empowerment scholarships; expansion; phase-in

SPONSOR: Lesko

STATUS: As Introduced

PREPARED BY: Matt Beienburg

Description

The bill would expand the definition of a qualified student under the Empowerment Scholarship Account (ESA) program to effectively allow any Kindergarten student to begin participating in the ESA program in FY 2018 and phase in eligibility of prior public school students in grades 1 – 12 over 4 years.

Estimated Impact

Based on the estimated increases in ESA participation and the estimated fiscal impact of each student who opts into the ESA program, we estimate that the bill would increase state General Fund costs by \$2.1 million in FY 2018, \$5.8 million in FY 2019, \$12.9 million in FY 2020, and \$24.5 million when all prior public school students are eligible in FY 2021.

This estimate is highly speculative, and actual costs could vary substantially depending on the actual participation rates of newly eligible students, both among current public school students and among incoming Kindergarteners who would have enrolled in a private school even without an ESA. Among the latter, for example, ESA participation could depend heavily on families' awareness of, and relative preference for, the ESA program versus the School Tuition Organization ("STO") scholarships currently available (students may not participate in both programs).

The fiscal note assumes that participation among newly eligible "prior public" students would grow from 1.0% in FY 2018 to 2.6% in FY 2021. It also assumes that participation among newly eligible incoming private school Kindergarten students would roughly double each year. Based on estimates from the Catholic Dioceses of Phoenix and Tucson (which comprise nearly half of the state's private school population), approximately 2.7% of private school students currently participate in the ESA program. We assume an increase to 5% among newly eligible incoming Kindergarteners in FY 2018, followed by continued doubling to 10% in FY 2019, 20% in FY 2020, and 40% in FY 2021.

There appears to be a financial incentive for private school Kindergarten households to apply for an ESA. The bill's cost could increase to \$35.4 million in FY 2021 if the participation rate among incoming Kindergarteners reaches 80%. Conversely, the bill's cost could fall to \$21.4 million in FY 2021 if the factors described above (e.g. lack of awareness, preference for STOs) limit participation to no more than 20% by FY 2021.

The cumulative costs of newly eligible private school students will also continue to rise as additional incoming cohorts replace those who were not eligible for ESA participation when they began as Kindergarteners. This increase would continue through 2030 until all K-12 cohorts were eligible as Kindergarteners.

ADE does not have a fiscal impact estimate for this bill.

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Analysis

Background – ESA Eligibility

The ESA program (A.R.S. § 15-2401) is currently open to Arizona resident students who meet at least one of the following requirements:

- A child with a disability.
- A child attending a failing school or school district.
- An incoming Kindergartner who resides within the boundaries of a failing school or school district.
- A child with a military parent or guardian on active duty or who was killed in the line of duty.
- 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 or previous ESA recipient or of a student eligible for an ESA.
- A child who lives on an Indian reservation.
- A child of a parent who is legally blind, deaf, or hard of hearing.

The ESA participant also must meet at least one of a second set of conditions:

- A full-time Arizona public school student who attended at least the first 100 days of the prior year.
- A prior ESA participant.
- A student who received or was eligible to receive a displaced or disabled School Tuition Organization (STO) scholarship and previously attended public school full time.
- An incoming kindergartner.
- A child who currently is eligible to enroll in a public school program for preschool children with disabilities.

The bill would add to the first set of conditions 3 grades per year (plus Kindergarten in the first year) in which public school students would become newly eligible for the ESA program. As a result, all incoming Kindergarteners and prior public school students in grades 1-12 would be eligible for an ESA by FY 2021.

The bill would also expand the definition of a student who previously attended public school to include any student who attended *any* 100 days of the prior year, rather than the *first* 100 days.

Laws 2016, Chapter 353 expanded the ESA application window by requiring the Arizona Department of Education (ADE) to accept ESA applications year-round. As a result, SB 1431 would allow newly eligible families to enroll in the ESA program beginning in FY 2018.

Background – ESA Costs

Eligible students can use monies in an ESA to attend private school or fund other educational expenses, such as textbooks and tutoring. The ESA has a dollar value of approximately \$5,600 for a non-disabled student.

The program's net cost or savings largely depends on the student placement in the absence of the ESA. Under current law, ESAs are funded at 90% of Basic State Aid per pupil costs. Charter schools receive more funding than traditional district schools under the Basic State Aid formula. ADE interprets statute as setting the starting point of the 90% at essentially the charter school level of reimbursement for all students. As a result, the non-disabled student ESAs would save \$(600) if the student were otherwise in a charter school. The ESA would cost \$800 more if the student were otherwise in a traditional district school. (*See Table 1.*)

If a non-disabled student would have otherwise attended a private school in any circumstance and receives an ESA, the state's cost is approximately \$5,600.

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Cost/(Savings) Per Pupil	Estimated ESA (Savings) or Cost Per Pupil					
	Disabled Students ^{1/}			Non-Disabled Students		
	<u>Former Charter</u>	<u>Former District</u>	<u>Other</u> ^{2/}	<u>Former Charter</u>	<u>Former District</u>	<u>Other</u> ^{2/}
	\$ (2,700)	\$ (1,400)	\$ 24,700	\$ (600)	\$ 800	\$ 5,600

^{1/} Qualify for special education "Group B" funding pursuant to A.R.S. § 15-943.
^{2/} Includes ESA students who otherwise would not attend public schools, which could include some incoming kindergartners, disabled preschoolers and military dependents, since A.R.S. § 15-2401 does not require these students to attend public school prior to receiving an ESA.

Current Eligibility and Newly-Eligible Students Attending Public Schools

ESA eligible populations total approximately 186,100 of the students attending Arizona district or charter schools in FY 2018. Of this amount, an estimated 124,100 represent special education students (111,300 district students + 12,800 charter students), while approximately 62,000 students are eligible through the other criteria (approximately 50,000 attending schools and districts rated a D or F letter grade + 7,000 residing on a reservation and attending non-D or F school districts + an estimated 5,000 from the remaining categories = 62,000). Assuming a roughly proportional number of charter and district students are eligible through the non-special education criteria, an estimated 52,700 are district students (62,000 X 85%) and 9,300 (62,000 X 15%) are charter students. The total number of ESA eligible district students is therefore estimated to be 164,000 (111,300 special education students + 52,700 other), and the total number of eligible charter students is 22,100 (12,800 special education students + 9,300 other).

In FY 2018, an estimated 931,800 students will attend district schools in Arizona, and 190,100 students will attend charter schools (totaling 1,121,900 students in public schools statewide).

Of these amounts, an estimated 767,800 district students would be newly eligible for ESAs under full K-12 expansion (931,800 district students total – 164,000 currently eligible district students = 767,800), and 168,000 charter students would be newly eligible (190,100 charter students – 22,100 currently eligible = 168,000).

Given the phased-in expansion of ESA eligibility under SB 1431, these students would incrementally become eligible over 4 years. *Table 2* below summarizes the estimated number of newly-eligible students each year under the bill based on the share of district and charter K-12 students in grades made eligible each year. In FY 2018, an estimated 285,000 students (233,200 district students + 51,800 charter students) would become newly eligible under the bill. The cumulative number of newly eligible students would rise to 509,400 in FY 2019, 736,600 in FY 2020, and 975,600 in FY 2021.

	Newly-Eligible K-12 District & Charter Students (Cumulative) ^{1/ 2/}			
	<u>FY 2018</u>	<u>FY 2019</u>	<u>FY 2020</u>	<u>FY 2021</u>
Districts	233,200	419,400	608,000	800,500
Charters	<u>51,800</u>	<u>90,000</u>	<u>128,600</u>	<u>175,100</u>
Total	285,000	509,400	736,600	975,600

^{1/} Based on share of district and charter Average Daily Membership (ADM) in each grade (from Superintendent's Annual Report, 2015-2016 Vol. I): 30.4% of district ADM in Kindergarten and grades 1, 6, and 9; 23.5% in grades 2, 7, and 10; 23.1% in grades 3, 8, and 11; 23.0% in grades 4, 5, and 12. 30.8% of charter ADM in Kindergarten and grades 1, 6, and 9; 22.0% in grades 2, 7, and 10, 21.6% in grades 3, 8, and 11, and 25.5% in grades 4, 5, and 12.
^{2/} Assumes 1.4% enrollment growth in FY 2019, FY 2020, and FY 2021.

Estimated Increase in Participation from Students Currently Attending Public Schools

The cost of ESA expansion depends heavily upon the percentage of students whose parents would avail themselves of the expanded program. Under current law, we estimate that 4,825 students will participate in FY 2018, or approximately 2.6% of currently-eligible students.

Given the relative newness of the program, reported uncertainty among parents regarding eligibility, and continued growth in ESA participation, it is unclear that 2.6% represents a reliable, long-term estimate of the share of eligible students who would participate in the ESA program.

The Nevada Education Savings Account (ESA) Program is the nation's only analogous savings account program to offer near-universal eligibility. Due to a September 2016 court ruling, implementation of the Nevada ESA program has been delayed until a dedicated funding source is provided by the state legislature. However, as of January 2017, approximately 8,500 applications have been filed, representing approximately 1.8% of the state's public school population (8,500 applications / 473,700 students = 1.8%).

The U.S. Department of Education's evaluation of the D.C. Opportunity Scholarship Program (DCOSP)—a \$7,500 scholarship usable for tuition, fees, and transportation to private schools for low income students (those with family incomes less than 185% of the poverty line) in Washington D.C. found that 5.7% of all traditional and charter students applied and 3.2% ultimately used a scholarship to transfer from their current school. Among traditional public school students, 16.4% applied for a scholarship, compared to only 1.8% among charter school students. With fewer than 90,000 students enrolled in traditional public or charter schools in D.C., however, the DCOSP may not be directly applicable to Arizona's 1.1 million public school student population.

Absent other reliable indicators of the likely long-term program participation rate, this analysis estimates the long-term fiscal impact assuming the continuation of a 2.6% participation rate among eligible public school populations. It assumes that in the first 3 years, however, a smaller proportion of eligible public school students would participate due to more limited awareness of the program's expansion. We assume, therefore, that 1.0% of newly eligible public school students in year 1 (FY 2018) would participate, 1.5% of the cumulative newly eligible students in year 2 (FY 2019) would participate, 2.0% of the cumulative newly eligible students in year 3 (FY 2020) would participate, and 2.6% of the cumulative newly eligible students in year 4 (FY 2021) would participate.

Based on these participation rates, an estimated 2,800 newly-eligible students from public schools would opt into the ESA program in FY 2018 (1.0% X 285,000 newly-eligible students as shown in *Table 2* = 2,800), 4,800 additional students would join in FY 2019 ((1.5% X 509,400 cumulative newly-eligible students) – 2,800 who had already joined in FY 18 = 4,800), 7,100 additional students would join in FY 2020 ((2.0% X 736,600 cumulative newly-eligible students) – 7,600 who had already joined in FY 18 and FY 19 = 7,600), and 10,700 additional students would join in FY 2021 ((2.6% X 975,700 cumulative newly-eligible students) – 14,700 who had already joined in FY 18, FY 19, and FY 20 = 10,700)

Through FY 2019, however, yearly marginal expansion of the ESA program is limited by Laws 2013, Chapter 250 to 0.5% of total Arizona public school enrollment. Consequently, no more than an estimated 5,600 and 5,700 new marginal ESA accounts may be opened in FY 2018 and FY 2019, respectively.

The populations currently eligible for ESAs (students with disabilities, students from failing districts, etc.) are already projected to open 1,300 new ESA accounts each year. This would leave at most 4,300 and 4,400 potential new ESA accounts to be opened in FY 2018 and FY 2019, respectively, by students from the expanded eligibility pool (5,600 new ESAs allowed under the cap in FY 2016 – 1,300 filled by growth from currently eligible population = 4,300 new ESAs that could be opened by the newly eligible population).

The number of public school students who would be able to join the ESA program under the cap would be further limited due to incoming Kindergarteners who would already intend to enroll in a private school (without an ESA)

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who would also become newly eligible for an ESA under SB 1431. As described in the section below ("Estimated Costs from Additional Private School Student Population"), we estimate that 200 of these private school students would seek to enroll in the ESA program in FY 2018 and 400 would in FY 2019.

Therefore, the total number of newly eligible students seeking to join the ESA program would be 3,000 in FY 2018 (2,800 public school students + 200 incoming private school kindergarteners = 3,000) and 5,200 in FY 2019 (4,800 public school students + 400 private school Kindergarteners = 5,200). Since the 3,000 new applicants in FY 2018 fall below that year's cap, the ESA cap would affect only FY 2019 ESA growth, limiting it to 4,400 new students (5,700 cap – 1,300 filled by growth from currently-eligible students = 4,400), compared to the estimated 5,200 newly eligible that would seek to join the program that year. (See *Table 3*).

Since the combined number of newly eligible prior public school students and incoming private school Kindergarteners seeking an ESA in FY 2019 would exceed the number of ESA slots available, we assume a proportional allocation of ESAs to each group. Of the 5,200 total newly eligible students seeking an ESA in FY 2019, prior public school students make up 92%, and incoming private school Kindergarteners make up 8% ((4,800 prior public school students) / (5,200 total newly eligible students seeking an ESA) = 92%). Therefore, we assume that 4,100 of the 4,400 ESAs available to newly eligible students would go to prior public school students, and 300 would go to incoming private school students (4,400 available ESAs X 92% to prior public school students = 4,100).

Upon expiration of the enrollment growth cap, an estimated 7,800 additional students would participate in the program in FY 2020 ((2.0% X 736,600 cumulative newly-eligible students) – (2,800 who had joined in FY 18 + 4,100 who had joined in FY 19) = 7,800). (The 7,800 new ESAs would include the 700 prior public school students who would otherwise have joined in FY 2019 but were deferred until the next year by the FY 2019 cap).

The annual marginal increases in ESA program participation from prior public school students due to the bill therefore would be 2,800 in FY 2018, 4,100 in FY 2019, 7,800 in FY 2020, and 10,700 in FY 2021. These would translate to a cumulative rise in ESA participation due to the bill of 2,800 in FY 2018, 6,900 in FY 2019, 14,700 in FY 2020, and 25,400 in FY 2021.

Estimated Cost of Additional Students from Public Schools

Based on the estimated increases in ESA participation described above and the net change in state costs per pupil who joins the ESA program, we estimate the bill will increase state General Fund costs due to students joining from public schools by \$1,540,000 in FY 2018, \$3,840,000 in FY 2019, \$8,120,000 in FY 2020, and \$13,880,000 as shown in *Table 4*.

Table 3

Newly-Eligible Students from Public Schools Participating in ESA Program

	<u>FY 2018</u>	<u>FY 2019</u>	<u>FY 2020</u>	<u>FY 2021</u>
Cumulative Newly Eligible	285,000	509,400	736,600	975,600
<u>Newly Eligible to Participate</u>				
Participation Rate	1.0%	1.5%	2.0%	2.6%
Students (Cumulative, before Cap)	2,800	7,600	14,700	25,400
Students (Marginal, before Cap) ^{1/}	2,800	4,800	7,100	10,700
Marginal Cap (0.5%)	5,600	5,700	N/A	N/A
Spots Filled by Currently Eligible	(1,300)	(1,300)	N/A	N/A
Max Marginal Students from Bill	4,300	4,400	N/A	N/A
<u>Participating</u>				
Marginal (Not to Exceed Cap) ^{2/3/}	2,800	4,100	7,800	10,700
Cumulative	2,800	6,900	14,700	25,400

^{1/} Calculated as difference between Cumulative Newly Eligible in current year – Cumulative Participating in prior year.
^{2/} Calculated as the lesser of Newly Eligible to Participate (Marginal, Before Cap) and Max Marginal Students from Bill (maximum marginal spots for students newly eligible under the bill).
^{3/} Under the 0.5% growth cap, only 4,400 newly eligible participants who would otherwise join the program in FY 2019 would be able to do so. Due to newly eligible incoming private school kindergarteners also competing for available ESAs, the number of prior public school students obtaining an ESA in FY 2019 would be further limited to 4,100. As a result, the additional 700 prior public school students prevented from obtaining an ESA in FY 2019 would presumably do so in FY 2020 instead.

Table 4

Newly Participating ESA Students from Public Schools and Their Estimated State Fiscal Impact under SB 1431

	<u>ESA Cost</u> (<u>\$</u>) ^{1/}	<u>FY 2018</u>		<u>FY 2019</u>		<u>FY 2020</u>		<u>FY 2021</u>	
		<u>ESAs</u> ^{2/}	(<u>\$</u>)						
Charter	(600)	500	(300,000)	1,200	(720,000)	2,600	(1,560,000)	4,600	(2,760,000)
District	800	2,300	1,840,000	5,700	4,560,000	12,100	9,680,000	20,800	16,640,000
District + Charter ^{3/}		2,800	1,540,000	6,900	3,840,000	14,700	8,120,000	25,400	13,880,000

^{1/} Net increase (decrease) in state costs to fund ESA student switching from charter/district school from Table 1.
^{2/} Cumulative new ESA participants, under annual new enrollment cap of 0.5% statewide public enrollment
^{3/} Assumes that newly eligible students at district schools and charter schools would participate in the ESA program at the same rate (e.g. that 1.0% of the 233,200 newly eligible district students and 1.0% of the 53,200 newly eligible charter students would participate in FY 2018)

Estimated Costs from Additional Private School Student Population

Based on estimates from the National Center for Education Statistics, approximately 45,000 Arizona students attend private schools. Under SB 1431, current private school students are not eligible to participate in the ESA program. However, each incoming cohort of Kindergarten students who would have attended private school without an ESA would become eligible to receive ESA funding, and these students could continue to receive that funding throughout their K-12

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education. As a result, we estimate that over time, an increasing share of the private school student population will participate in the ESA program.

Based on the average percentage of district and charter school students who are in Kindergarten (7.0% and 8.8%, respectively), we assume that approximately 7.9% of private school students, or 3,600 ($45,000 \times 7.9\% = 3,600$), are currently in Kindergarten. Assuming a similar share in the future, the roughly 3,600 students entering private schools as Kindergarteners each year could receive ESA funding under SB 1431.

As with students who currently attend public schools, we assume that not all newly eligible students entering private schools as Kindergarteners would immediately avail themselves of the ESA program. Based on estimates from the Catholic Dioceses of Phoenix and Tucson (who comprise nearly half of the state's private school population), approximately 2.7% of private school students currently participate in the ESA program. We assume an increase to 5% among newly eligible incoming Kindergarteners in FY 2018, followed by continued doubling to 10% in FY 2019, 20% in FY 2020, and 40% in FY 2021.

The assumption that participation would rise to 40% by FY 2021 is based on the strong economic incentive (roughly \$5,600 per year) for families to take advantage of the program.

Offsetting the financial incentive, however, parents may continue to lack awareness of the program, perceive the application process to be complicated, or already benefit from a School Tuition Organization ("STO") scholarship and therefore not pursue assistance from the ESA program.

As a result, we estimate that 5%, or 200, Kindergarteners who would have attended a private school without an ESA would join the ESA program in FY 2018 ($3,600 \text{ students} \times 5\% \text{ participation rate} = 200$). In FY 2019, these students would then be eligible to continue receiving ESA funding as 1st graders, while 400 new Kindergarteners would join the ESA program ($3,600 \text{ students} \times 10\% \text{ participation rate} = 400$). This pattern would presumably continue in FY 2020, FY 2021, and beyond.

As described in the section above ("Estimated Increase in Participation from Students Currently Attending Public Schools"), the combined number of newly eligible prior public school students and incoming private school Kindergarteners would exceed the number of ESAs available in FY 2019 under the 0.5% cap. As a result, we estimate that only 300 of the 400 incoming private school Kindergarten students desiring an ESA in FY 2019 would be able to obtain one.

As shown above in *Table 1*, non-disabled students who join the ESA program from neither a district nor charter school increase General Fund costs by approximately \$5,600 per ADM.

Under current law, a Kindergarten student generates 0.5 ADM. As a result, each of these potential new ESA participants could receive approximately \$2,800 ($\$5,600 \times 0.5 \text{ ADM} = \$2,800$) in their first year and \$5,600 each year they remain in the ESA program thereafter.

Table 5 summarizes the estimated increase in ESA participation and General Fund costs associated with providing ESA funding to this population of students. Funding the 200 students in the first cohort of eligible Kindergarteners at \$2,800 per student would cost \$560,000 in FY 2018. In FY 2019, funding this same cohort at \$5,600 in their first grade year + the new cohort of 300 Kindergarteners at \$2,800 would cost \$1,960,000. Funding the incoming Kindergarten cohort + the continuing 1st and 2nd grade cohorts in FY 2020 would cost \$4,760,000. Funding the respective cohorts in FY 2021 would cost \$10,640,000.

(Continued)

Table 5**Estimated Enrollment and Costs of New ESA Participants: Students Who Would Attend Private Schools without ESA ^{1/}**

	<u># of Students (Fiscal Year)</u>				<u>Cost / Student (\$) (Fiscal Year)</u>				<u>Total Cost (\$ M) (Fiscal Year)</u>			
	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>
Cohort 1	200	200	200	200	2,800	5,600	5,600	5,600	0.6	1.1	1.1	1.1
Cohort 2		300	300	300		2,800	5,600	5,600	0.0	0.8	1.7	1.7
Cohort 3			700	700			2,800	5,600	0.0	0.0	2.0	3.9
Cohort 4				1,400				2,800	0.0	0.0	0.0	3.9
Total	200	500	1,200	2,600					0.6	2.0	4.8	10.6

^{1/} Assumes 5% of incoming private school Kindergarteners would join the ESA program in FY 2018, 10% would join in FY 2019 (less those prevented by the 0.5% ESA enrollment cap), 20% would join in FY 2020, and 40% would join in FY 2021.

Arizona's STO program will provide an estimated \$175 million in scholarships to students attending private schools in FY 2018, with an average award amount of \$1,900 (students may receive multiple awards). Because students may not participate in both the ESA and STO program simultaneously, increases in General Fund costs from additional ESA funding for the private school population could be offset, at least in part, by a decrease in STO tax credits over time. However, we do not estimate that this would occur until available STO scholarship funding exceeds the amount of private school tuition paid by non-ESA participants. Until that point, we assume that any reduction in STO use among incoming cohorts switching to the ESA program would simply result in the reallocation of STO funds to students in higher grades not yet eligible for ESAs.

Over time, as the number of private school students participating in the ESA program increases, the number of STO eligible students would decline (given that students may not participate in both). As a result, STO scholarships would presumably be awarded to fewer students, but at a higher average award amount per recipient. This could ultimately render an STO scholarship larger, on average, than an ESA, eventually limiting the comparative appeal of, and participation rates, in the ESA program.

Estimated Costs from Additional Public and Private School Student Population

Based on the increased ESA participation of newly eligible prior public school students and incoming Kindergarteners (who would have attended private school without an ESA), we estimate that General Fund costs would rise by \$2,100,000 in FY 2018, by \$5,800,000 in FY 2019, by \$12,880,000 in FY 2020, and by \$24,520,000 in FY 2021, as shown in *Table 6*.

Table 6**Estimated Enrollment and Costs of New ESA Participants: All Newly Eligible Students Under SB 1431**

	<u>FY 2018</u>		<u>FY 2019</u>		<u>FY 2020</u>		<u>FY 2021</u>	
	<u>#</u>	<u>\$</u>	<u>#</u>	<u>\$</u>	<u>#</u>	<u>\$</u>	<u>#</u>	<u>\$</u>
Prior Public School	2,800	1,540,000	6,900	3,840,000	14,700	8,120,000	25,400	13,880,000
Private Kindergarteners	200	560,000	500	1,960,000	1,200	4,760,000	2,600	10,640,000
Total	3,000	2,100,000	7,400	5,800,000	15,900	12,880,000	28,000	24,520,000

^{1/} Represents cumulative ESA enrollment and costs of newly eligible students under SB 1431 in each year.

(Continued)

Additional Costs

Upon the expiration of the state ESA enrollment caps in FY 2020, it is possible that enrollment would increase significantly beyond the estimates provided above. If ESA participation were to reach 5% of newly eligible public K-12 students by FY 2021, for example, there would be an estimated 48,800 newly eligible students participating in the ESA program from public schools under the bill at an estimated state cost of \$26,767,100 (\$32,020,700 in additional costs for students switching from district schools + \$(5,253,600) savings from charter students switching to ESAs). In comparison, the current projected cost of newly eligible prior public school students is \$13,880,000 in FY 2021 (see *Table 6*).

Secondly, the overall General Fund cost will depend heavily on the ESA participation rate of incoming Kindergarten students who already intended to enroll in private school (without an ESA) who are newly eligible. If, for example, their ESA participation rate were to reach 80% by FY 2021, we project a General Fund cost of \$21,560,000 from incoming private school Kindergarteners in FY 2021. In comparison, the current projected cost of newly eligible incoming private school Kindergarteners is \$10,640,000 in FY 2021 (see *Table 6*).

The cumulative costs of newly eligible private school students will also continue to rise as additional incoming cohorts replace those who were not eligible for ESA participation when they began as Kindergarteners. This increase would continue through 2030 until all K-12 cohorts were eligible as Kindergarteners.

Increases in ESA participation over time would be mitigated by students who leave Arizona private schools (e.g. to move to another state or to switch to a public high school in grade 9) without an offsetting increase from any students who might replace them (since, for example, private school students moving to Arizona would not be eligible for an ESA without first attending public school the year prior).

Local Government Impact

School districts would serve fewer students under the bill than they would under current law due to increased student participation in ESAs. This would reduce the amount of budget override taxes that school districts would be eligible to generate relative to current law, since that funding is based on a percentage of a school district's K-12 formula funding. It also potentially would reduce tax rates in non-state aid districts to the extent that those districts served fewer students than under current law because of the bill, since those districts self-fund their own K-12 formula costs.

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