

Fiscal Note

BILL # SB 1452

TITLE: Arizona empowerment scholarship accounts; revisions

SPONSOR: Boyer

STATUS: Senate Engrossed

PREPARED BY: Patrick Moran

Description

The bill would expand eligibility for the Empowerment Scholarship Account (ESA) program to include children eligible for Free and Reduced-Price Lunches (FRPL) and children receiving Title I services. It would also modify the financing of ESAs and make several other miscellaneous changes to the program.

Estimated Impact

We estimate that in comparison with current law the bill would result in K-12 Basic State Aid General Fund formula savings of \$(4.3) million in FY 2022, \$(1.6) million in FY 2023, and a cost of \$3.5 million in FY 2024. These estimates are speculative due to uncertainty about the rate of students switching from public schools into the ESA program as well as ESA participation among private school kindergartners who never attended a public school.

The impact after FY 2024 is even more speculative. Under our assumptions, the cost of the bill would grow by \$5 million to \$10 million annually starting in FY 2025 as the cumulative number of newly eligible private school kindergartners grows over time. The likelihood of these estimates depends on how the private school market responds to potential enrollment increases.

The main provisions of the bill increasing General Fund costs are as follows:

- Expanding eligibility for the ESA program among current public school students to include children that a) are FRPL-eligible, b) attend a school that qualifies for a Title I schoolwide program, or c) receive Title I targeted assistance services. We estimate that these changes would make approximately 836,000 public school students eligible for the ESA program, which represents a net increase of 580,000 in comparison to current law. We estimate that under the current law ESA financing formula, each district student that switches to the ESA program generates an average state cost of \$473, while students switching from charter schools generate an average savings of \$(757). We assume that the ESA participation rate among newly eligible public school students would be 3.83% based on participation rates among students currently eligible for an ESA and that the private school system has the capacity to absorb aggregate annual enrollment growth of 5%. Under those assumptions, we estimate the cost of the newly eligible recipients would be \$1.2 million in FY 2022, \$2.4 million in FY 2023 and, \$3.6 million in FY 2024.
- Expanding eligibility for the ESA program among private school kindergartners to include children that reside within the attendance boundary of a school that qualifies for Title I schoolwide funding. Based on ADE data, we estimate that approximately two-thirds of Arizona public school students attend such a school. We therefore assume that two-thirds of families already planning to send kindergartners to private school reside within the boundary of a school eligible for Title I schoolwide program funding, which we estimate would result in increases over time in ESA eligibility among private school students who never attended a public school. Over the course of 3 years, we project 75% of newly eligible private school kindergartners would sign up for an ESA. We estimate that private school kindergartners becoming newly eligible for the ESA program would generate state costs of \$1.2 million in FY 2022, \$5.0 million in FY 2023, and \$11.2 million in FY 2024.

The above costs would be offset by including ESA recipients in distributions of the Classroom Site Fund (CSF). This provision would result in General Fund savings because the bill stipulates that CSF distributions would "count toward," rather than being in addition to, the amount that ADE is required to pay to ESA recipients. We estimate that CSF distributions to ESA accounts under the bill would generate savings of \$(6.7) million in FY 2022, \$(9.0) million in FY 2023, and \$(11.4) million in FY 2024.

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The Department of Education (ADE) estimates the bill would result in additional ESA expenditures of \$137.1 million in comparison with current law, assuming that there would be 22,608 additional enrollees in the program. ADE did not attempt, however, to calculate the Basic State Aid savings associated with reduced public school enrollment or the impact of the CSF distributions to ESA accounts, which would lower the net impact of the bill.

ADE further estimates that the bill would generate administrative expenses of \$4.1 million annually to fund additional staff that the agency would use to process an increased number of applications to the program and manage a higher ongoing number of recipients. We concur that increases in ESA caseloads under the bill would increase workload for ADE staff, but the exact magnitude of the workload increase would depend on the actual participation rate of newly eligible ESA recipients, which is highly uncertain.

Analysis

Background: Cost of an ESA

Pursuant to A.R.S. § 15-2402C, students eligible for an ESA receive an allocation equal to 90% of the following components of the Basic State Aid (BSA) formula:

- Base Support Level funding that the student would have received in their Local Education Agency (LEA) of origin.
- Charter Additional Assistance (CAA) funding.

Because the ESA formula differs from the BSA formula for both school districts and charter schools, students switching from a district or a charter school into the ESA program generate a fiscal impact on ADE's BSA formula costs. In *Table 1* below we provide our estimates of the total cost difference for students previously enrolled in a district or charter school in comparison to the ESA program. Our analysis focuses on the cost of non-disabled students because children with a disability are already eligible for the ESA program pursuant to A.R.S. § 15-2401. We estimate that each non-disabled child that would shift their enrollment to the ESA program from a public school would generate \$473 of state costs if the child was previously enrolled in a school district, except that students switching to an ESA from non-state aid districts effectively generate a state cost of \$6,844 since their BSA costs would otherwise be funded with property tax dollars. Each student previously enrolled in a charter school would generate a state savings of \$(757).

Besides the cost of students switching from LEAs into the ESA program, there are additional costs for students that never enrolled or intended to enroll in a public school and subsequently receive an ESA. In that circumstance, the cost of the ESA is the full estimated cost of the award, as there are no offsetting savings for lower public school enrollment. Under current law, ESA recipients are generally required to have attended a public school for the first 100 days of the prior school year unless the child has a parent that is a member of the armed forces and is on active duty or was killed in the line of duty or the child is eligible to enroll in kindergarten or a preschool program for children with disabilities.

Table 1						
Estimated Per Pupil Funding for Non-Disabled Students Under BSA Formula and ESA Formula for Districts and Charters						
	Districts (BSA)	Districts (ESA)	Difference	Charters (BSA)	Charters (ESA)	Difference
Base Level	\$5,593	\$5,034	(\$559)	\$5,582	\$5,024	(\$558)
Additional Assistance	\$495	\$1,810	\$1,315	\$1,986	\$1,787	(\$199)
Transportation	\$283	\$0	(\$283)	\$0	\$0	\$0
Total	\$6,371	\$6,844	\$473	\$7,568	\$6,811	(\$757)

Eligibility Expansion – Current Public School Students

The bill would expand eligibility for the ESA program to include the following new groups:

- Children eligible for free or reduced-price lunches. These children are from families with incomes of 185% or less of the Federal Poverty Level, or \$48,470 in annual income for a family of 4. Based on data from ADE, we estimate

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that there were 595,924 students enrolled in Arizona public schools that were FRPL-eligible during the 2019-2020 school year.

- Children attending a school that qualifies for Title I schoolwide funding or children receiving Title I targeted assistance services. Under the Every Student Succeeds Act (ESSA), a school qualifies for Title I schoolwide funding if 40% or more of the student population within the school is FRPL-eligible. Based on school lunch data from ADE, we estimate that there are an additional 204,234 students that were not FRPL-eligible themselves, but attended a school that meets the eligibility criteria for Title I schoolwide services. There would also be an unknown number of additional students who are neither FRPL-eligible nor attending a school eligible for Title I schoolwide services, but are nevertheless receiving Title I targeted assistance services because they are failing or at risk of failing to meet the state's academic standards.

In total, we therefore estimate that at least 800,000 current Arizona public school students would meet one of the new eligibility categories. The actual number of newly eligible would be lower because some students meeting the new eligibility criteria are already eligible for an ESA under current law. We estimate that approximately 256,000 current public school students are already eligible for the ESA program, including:

- 148,000 students with disabilities
- 75,000 students that attend a school with a D or F letter grade rating from the State Board of Education
- 33,000 students in all other eligibility categories, including current or former foster children, children of active duty military, residents of a reservation, or siblings of current recipients.

Of the 256,000 currently eligible, we estimate that 220,000, or about 85.9%, would also be eligible for an ESA under the bill's new eligibility criteria related to FRPL or Title I. As a result, the "net" increase in eligibility as a result of the bill, in comparison to the 800,000 "gross" estimate of students meeting the new criteria, would be 580,000 ($800,000 - 220,000 = 580,000$). The total number of students eligible for an ESA would therefore rise to approximately 836,000. ($256,000$ currently eligible + $580,000$ net increase in eligible students = $836,000$).

In comparison to the JLBC Staff estimate of 836,000 total eligible participants, ADE estimates that the total number of eligible participants would be 886,518, or 50,518 more students than the JLBC Staff estimate. The primary difference appears to be that ADE also assumes that students in Title I targeted assistance schools who are not themselves receiving Title I targeted assistance services would be eligible, while such students are excluded from the JLBC Staff estimate.

The ESA participation rate among newly eligible students is highly uncertain. If the participation rate were to reach the estimated 3.83% participation rate among currently eligible populations ($10,208$ ESA population at beginning of FY 2021/ $266,208$ total eligible across public schools and private schools = 3.83%), there would be a long-run increase in ESA enrollment of approximately 22,200 among current public school students ($3.83\% \times 580,000 = 22,200$). The actual long-run participation rate could be higher as a result of other changes included in the bill that will likely facilitate greater utilization of the ESA program. These provisions include a reduction in the amount of days required to be in a public school from 100 under current law to 30 under the bill, as well as elimination of the current-law prohibition on children participating simultaneously in the ESA program and receiving a scholarship from a School Tuition Organization (STO).

Participation could be lower than 3.83%, on the other hand, given that the average value of the ESA award would be lower for newly eligible recipients in comparison with currently eligible groups, primarily because the majority of currently eligible recipients are students with disabilities that receive higher funding under the BSA formula. Based on ESA data from ADE, the average ESA award for current recipients is approximately \$14,200, while newly eligible recipients would receive an average of approximately \$6,800. As a result, newly eligible recipients may face net out-of-pocket private school expenses that are higher than current recipients, which may result in a higher share of newly eligible current public school students opting to remain in a public school.

There would also likely be constraints on growth in the ESA program in the short run based on current capacity in the private school system. According to the Private School Universe Survey administered by the National Center for Education Statistics (NCES), Arizona's private schools had enrollment of 45,673 during the 2017-2018 school year. A shift

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of up to 22,200 public school students to the private school system under the bill would therefore represent a nearly 50% increase in the number of private school students currently served in Arizona. We think private schools would likely face challenges in absorbing that level of enrollment growth in the short run. The challenges could include establishing new facilities to serve additional students, staffing constraints, and limits on availability of institution-based financial aid.

Given the above constraints, we assume that Arizona's private schools in aggregate would be able to absorb annual enrollment growth rates of no more than 5%, which would equate to approximately 2,284 net new students switching from public schools annually. As a result, our estimates assume that private school capacity grows by 5% annually. Table 2 below shows the estimated net impact on Basic State Aid formula expenses, which we estimate to be an increase of \$1,216,500 in FY 2022, \$2,432,900 in FY 2023, and \$3,649,400 in FY 2024. These costs are before factoring in the effects of Classroom Site Fund distributions to ESA accounts, which we examine separately.

ADE estimates that ESA participation under the bill could reach 32,358 recipients, which represents an assumed 3.65% participation rate among the department's estimate of total eligible students across all categories of 886,518 (3.65% X 886,518 = 32,358). The ADE estimate represents a net increase in enrollment above current law of 22,608, or 408 students above the JLBC Staff estimate. The department estimates the 22,608 enrollees would be associated with \$137.1 million in expenses based on the current average cost of an ESA for non-disabled students, but did not attempt to estimate what the net fiscal impact on BSA expenses would be after accounting for public school enrollment declines.

ADE further estimates that serving additional ESA enrollees would require the department to hire 60 additional administrative staff at a cost of \$4.1 million. The estimate assumes that the department would maintain its current staffing ratio of approximately 1 staff person for every 375 recipients (22,608 new enrollees/375 staffing ratio = 60 additional staff). The department states that the estimates do not account for additional workload associated with the bill's requirement that new applications be processed in 30 days instead of the current law requirement of 45 days.

We concur with the department that any ESA caseload increase resulting from the bill would increase workload for existing staff. The exact magnitude of the workload increase would depend on the timing of the caseload increase, which we anticipate would occur incrementally over the course of several years. For example, we estimate the actual ESA caseload growth above current law in FY 2022 would be 2,647 (2,284 shifts from public school + 363 private school kindergartners = 2,647), which under the department's methodology would only require approximately 7 additional staff (2,647/375=7). In addition, the department may be able to increase caseloads among existing program staff in lieu of hiring new staff. For example, in its April 2020 audit of ESA program administration, the Arizona Auditor General estimated that for FY 2021, the ESA program required 21 FTE Positions to administer the program, or 5 fewer positions than the 26 positions that are currently appropriated to the department.

Table 2			
SB 1452 Eligibility Expansion Costs for Current Public School Students			
	<u>FY 2022</u>	<u>FY 2023</u>	<u>FY 2024</u>
District Shift to ESA (State Aid)	1,709	3,418	5,126
District Shift to ESA (Non-State Aid)	111	222	333
Charter Shift to ESA	<u>464</u>	<u>928</u>	<u>1,391</u>
<i>Total Shifts to ESA</i>	<i>2,284</i>	<i>4,567</i>	<i>6,851</i>
District Fiscal Impact (State Aid)	\$807,800	\$1,615,500	\$2,423,300
District Fiscal Impact (Non-State Aid)	759,700	1,519,400	2,279,100
Charter Fiscal Impact	<u>(351,000)</u>	<u>(702,000)</u>	<u>(1,053,000)</u>
Total	<u>\$1,216,500</u>	<u>\$2,432,900</u>	<u>\$3,649,400</u>

Eligibility Expansion – Private School Kindergartners

The bill would also expand eligibility to incoming kindergartners that reside within the attendance boundary of a school that qualifies for Title I schoolwide services. Since kindergartners have not yet enrolled in a public school, this provision could expand ESA eligibility among families with kindergartners that plan to send their children to a private school

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regardless of the child's eligibility for an ESA. As a result, ESA eligibility among the 45,673 existing private school students would increase over time as each new incoming cohort of kindergartners enters the private school system.

Based on FRPL data published by ADE, we estimate that approximately two-thirds of current Arizona public school students attend a school with a FRPL-eligibility rate at or above 40%. We therefore assume that two-thirds of children eligible for kindergarten reside within the attendance boundary of a school that qualifies for Title I schoolwide services. We lack detailed data on the actual geographic distribution of families with private school children, so to the extent that private school families are more or less likely than public school students to reside within the attendance boundaries of a school qualifying for Title I schoolwide services, the level of ESA eligibility among kindergartners would change.

According to the NCES Private School Universe Survey, there were 3,296 kindergartners enrolled in Arizona private schools during the 2017-2018 school year. If an estimated two-thirds of these kindergartners were eligible for an ESA under the bill, the total number of new private school kindergartners receiving an ESA annually would be 2,197 (3,296 X (2/3) = 2,197). The net impact of the bill on eligibility would be lower, however, as some private school kindergartners already qualify for an ESA under existing eligibility criteria. A.R.S. § 15-2401 permits children currently eligible to enroll in kindergarten to receive an ESA even though they have not yet attended a public school as long as they meet other eligibility criteria for the program (e.g. the child resides within the attendance boundary of a school with a D or F letter grade, etc.).

We assume that the proportion of private school kindergartners that are already eligible for an ESA under existing eligibility criteria is 22.7%, which is equivalent to the estimated proportion of the current public school population that meets the eligibility criteria for an ESA (256,000 eligible ESA recipients/1,127,038 AZ public school students =22.7%). That would mean that approximately 747 new private school kindergartners become eligible annually to receive an ESA (22.7% X 3,296 = 747). The 2,197 kindergartners eligible under the bill would therefore represent a minimum increase in eligibility of approximately 1,450 (2,197 – 747 = 1,450).

We assume that the majority of the newly eligible 1,450 private school kindergartners would eventually opt to participate in the ESA program due to the strong financial incentive. Families with private school kindergartners would receive an average \$3,422 ESA award during the kindergarten year and \$6,844 each year thereafter that the family would otherwise have to finance out-of-pocket or through other sources. Lack of awareness or information may initially result in less than full participation, so we assume 25% participation in the FY 2022 kindergarten cohort (363 students), 50% participation in the FY 2023 cohort (725 students) and 75% participation in the FY 2024 cohort (1,088 students). These participation rates are higher than our estimates for prior proposals to expand ESA eligibility among kindergartners primarily because the bill permits families to receive a scholarship from a STO without losing eligibility for the ESA program as long as the combined total of the ESA award and the STO scholarship is less than the student would have received in total per pupil funding at the child's home district school, further reinforcing the incentive to enroll in an ESA.

Table 3 below provides our estimates of the kindergarten eligibility expansion. Given that private school kindergartners did not previously attend a public school, their cost is the full estimated cost of the ESA without offsetting public school enrollment savings. In the kindergarten year the ESA cost is assumed to be half of the average ESA amount (\$3,422) of a

Table 3			
SB 1452 Eligibility Expansion Costs for Private School Kindergartners			
	<u>FY 2022</u>	<u>FY 2023</u>	<u>FY 2024</u>
Private School Kindergartners	363	725	1,088
Previous Private School Kindergarten Cohorts	<u>0</u>	<u>363</u>	<u>1,088</u>
<i>Total</i>	363	1,088	2,175
New Private School Kindergartners Cost	\$1,240,400	\$2,480,800	\$3,721,300
Previous Private School Kindergartners Cohorts Cost	<u>0</u>	<u>2,480,800</u>	<u>7,442,500</u>
Basic State Aid Cost Increase	\$1,240,400	\$4,961,600	\$11,163,800

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student switching from a school district (kindergartners are counted as 0.5 ADM in the Basic State Aid formula) and \$6,844 each year thereafter. The resulting estimated BSA cost increase is \$1,240,400 in FY 2022, \$4,961,600 in FY 2023, and \$11,163,800 in FY 2024. These costs are before accounting for Classroom Site Fund distributions to ESA accounts, which are examined separately.

ESA Financing Changes – Classroom Site Fund

The bill would permit ESA recipients to receive per pupil distributions from the Classroom Site Fund (CSF). ESA recipients would be included in the weighted student counts used to calculate the per pupil amount based on what the student's Group A weighted count would have been if they had instead attended their district or charter of origin. The bill further stipulates that the CSF per pupil distribution for ESA recipients would "count toward" the ESA formula allocation to which the student is entitled from ADE, meaning that the CSF distributions would reduce the General Fund cost of the ESA on a dollar-for-dollar basis.

The current Classroom Site Fund per pupil amount for FY 2021 is \$425. That amount was based on estimated available CSF revenues of \$581,667,300 in FY 2021 in comparison with an estimated 1,368,651 weighted pupils. Based on preliminary ESA award information from ADE, there were 10,208 ESA recipients at the beginning of FY 2021. If those recipients received the average Group A weight allocated to districts and charters of approximately 1.22, the 10,208 recipients would generate Group A weighted counts of 12,468. If the 12,468 additional weighted pupils from ESA recipients had been included in the FY 2021 Classroom Site Fund calculation, we estimate the Classroom Site Fund amount would have been \$421 instead of \$425.

In *Table 4* below, we estimate the level of General Fund savings for both current ESA recipients and new recipients under the bill based on the revised \$421 per pupil funding level. At that funding level, the CSF distribution would reduce the General Fund cost of ESA awards by \$(6,748,400) in FY 2022, \$(8,957,800) in FY 2023, \$(11,353,200) in FY 2024. The actual level of savings in FY 2022 in subsequent years will likely be higher after the JLBC Staff has finalized the calculation for the Classroom Site Fund for FY 2022, which will not occur until March 30th. Due to FY 2021 student enrollment declines related to the COVID-19 pandemic and higher-than-budgeted sales tax receipts, we expect the CSF to increase above the original FY 2021 level of \$425.

Table 4			
SB 1452 General Fund savings from Classroom Site Fund Offset for ESA Awards			
	<u>FY 2022</u>	<u>FY 2023</u>	<u>FY 2024</u>
Existing ESA Recipients	\$5,482,400	\$(6,239,500)	\$(6,996,500)
Charter Students Shift to ESAs	(238,200)	(476,500)	(714,700)
District Students Shifting to ESAs	(934,700)	(1,869,400)	(2,804,100)
District Kindergarten	<u>(93,100)</u>	<u>(372,400)</u>	<u>(837,900)</u>
	<u>\$(6,748,400)</u>	<u>\$(8,957,800)</u>	<u>\$(11,353,200)</u>

Long-Run Impacts

Our short-run 3-year estimates are speculative, especially due to the challenges of forecasting ESA enrollment due to shifts from public schools and the participation rate of private school kindergartners. The post-FY 2024 estimates are even more speculative. We think that the full cost of the bill would likely not materialize until several years after the 3-year forecast primarily because the participation rate of newly eligible private school kindergartners cannot be known until each grade cohort of private schoolers has had the opportunity to apply for an ESA under the expanded kindergarten eligibility criteria. Based on the delayed timing of the full cost of the bill, we estimate that over the long run the bill would generate a net cost to the Basic State Aid formula, but the precise magnitude of that cost is highly uncertain. If the actual participation rates are consistent with our assumptions, we estimate the cost of the bill would grow by \$5 to \$10 million annually in the long run.

Summary

Table 5 below provides a consolidated summary of fiscal impacts associated with the bill, showing the net effects of eligibility expansions after accounting for the bill's ESA refinancing provisions.

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Local Government Impact

The bill would reduce the amount of Classroom Site Fund monies that would otherwise have been distributed to school districts and charter schools under current law. The net revenue reduction for districts (including non-state aid districts) and charters is estimated to be \$(6,748,400) in FY 2022, \$(8,957,700) in FY 2023, and \$(11,353,200). Districts and charter schools would also receive less BSA formula funding if public school enrollment is lower as a result of the bill.

Table 5

SB 1452 Fiscal Impact Summary			
Current ESA Recipients - Savings from CSF Distributions			
	<u>FY 2022</u>	<u>FY 2023</u>	<u>FY 2024</u>
Classroom Site Fund Distribution	<u>\$(5,482,400)</u>	<u>\$(6,239,500)</u>	<u>\$(6,996,500)</u>
	\$(5,482,400)	\$(6,239,500)	\$(6,996,500)
Current Public School Students - Fiscal Impact of Eligibility Expansion			
	<u>FY 2022</u>	<u>FY 2023</u>	<u>FY 2024</u>
District Students - Shift to ESA (State Aid)	\$807,800	\$1,615,500	\$2,423,300
District Students - Shift to ESA (Non-State Aid)	759,700	1,519,400	2,279,100
District Students - Less ESA CSF Distribution	<u>(934,700)</u>	<u>(1,869,400)</u>	<u>(2,804,100)</u>
<i>Net Impact - Districts</i>	<i>\$632,800</i>	<i>\$1,265,500</i>	<i>\$1,898,300</i>
Charter Students - Shift to ESA	\$(351,000)	\$(702,000)	\$(1,053,000)
Charter Students - Less ESA CSF Distribution	<u>(238,200)</u>	<u>(476,500)</u>	<u>(714,700)</u>
<i>Net Impact - Charters</i>	<i>\$(589,200)</i>	<i>\$(1,178,500)</i>	<i>\$(1,767,700)</i>
Total Districts/Charters Shifts	\$43,600	\$87,000	\$130,600
Private Kindergarten Students - Fiscal Impact of Eligibility Expansion			
	<u>FY 2022</u>	<u>FY 2023</u>	<u>FY 2024</u>
Private Kindergarten ESA Enrollment	\$1,240,400	\$4,961,600	\$11,163,800
Private Kindergarten ESA - Less CSF Distribution	<u>(93,100)</u>	<u>(372,400)</u>	<u>(837,900)</u>
Total Private Kindergarten	\$1,147,300	\$4,589,200	\$10,325,900
GRAND TOTAL ALL FISCAL IMPACTS	\$(4,291,500)	\$(1,563,300)	\$3,460,000