

# Fiscal Note

**BILL #** SB 1657

**TITLE:** ESAs; STOs; student empowerment fund

**SPONSOR:** Boyer

**STATUS:** As Introduced

**PREPARED BY:** Patrick Moran

**Description**

The bill would make several changes to the Empowerment Scholarship Account (ESA) and the tax credit programs for donations to School Tuition Organizations (STOs).

**Estimated Impact**

We estimate the bill would result in a General Fund savings of \$(8.4) million in FY 2023. The savings would become a net cost of \$0.4 million in FY 2024 and \$7.0 million in FY 2025, primarily as a result of revenue reductions associated with increases in the maximum tax credit available for donations to STOs. The impact is summarized in *Table 1* below. In addition, the bill would reduce Classroom Site Fund distributions to district schools and charters by an estimated \$(38.0) million in FY 2023, \$(39.7) million in FY 2024 and \$(43.1) million in FY 2025.

By FY 2025, we estimate that the bill would increase ESA participation among current public school students by 8,900 pupils. In the long run, we anticipate the bill would increase this participation level to 32,900 pupils. These enrollment increases would occur incrementally over the course of several years, however, given short run constraints private schools may face in increasing the number of students they serve.

We consider these estimates to be highly speculative. We lack the detailed student demographic data that would be needed to determine with precision the number of newly eligible ESA enrollees, as there are very likely students who would be eligible under multiple categories. We also do not know how STO donation activity may change in response to the higher tax credits available under the bill, or whether growing participation in the ESA program would increase or decrease STO donations. In the short run, any of these factors could change the impact in a given year from a cost to a savings or a savings to a cost. In the long run, however, we expect the bill to be a cost as the ESA participation rate among private schoolers that never attended a public school grows over time.

| <b>Table 1</b>   |                |                |                |
|--|----------------|----------------|----------------|
| <b>SB 1657 General Fund Impact Summary</b>                   |                |                |                |
| (\$ in Millions) <sup>1/</sup>                               |                |                |                |
|  | <u>FY 2023</u> | <u>FY 2024</u> | <u>FY 2025</u> |
| ESA Eligibility Expansions – Current Public School Students  | 1.4            | 2.8            | 4.1            |
| ESA Eligibility Expansions – Current Private School Students | 1.3            | 3.7            | 8.3            |
| Student Empowerment Fund                                     | (2.1)          | (4.2)          | (6.4)          |
| CSF Distributions to ESA Accounts                            | (13.0)         | (14.7)         | (18.1)         |
| STO Individual Income Tax Credit Expansion                   | 0.0            | 8.7            | 14.7           |
| Displaced/Disabled Corporate STO expansion                   | <u>4.0</u>     | <u>4.2</u>     | <u>4.3</u>     |
|  | <b>(8.4)</b>   | <b>0.4</b>     | <b>7.0</b>     |

<sup>1/</sup> General Fund losses are displayed as positive numbers and General Fund gains are displayed as negative numbers.

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We have asked the Department of Education (ADE) and the Department of Revenue (DOR) for their analysis of the impact of the bill. We have not yet received their estimates.

## Analysis

### ESA Eligibility Expansions

The bill would expand ESA eligibility to children meeting any of the following criteria:

- Has parents who are veterans.
- Is eligible for the federal Free and Reduced-Price Lunch (FRPL) program.
- Receives Supplemental Nutrition Assistance Program (SNAP) benefits, Temporary Assistance for Needy Families (TANF) cash assistance, or Section 8 Public Housing Assistance.
- Receives Title I Targeted Assistance Services or attends a school that qualifies for Title I schoolwide services.
- Participates in the Executive's educational benefit recovery program or the open for learning recovery benefit program.
- Resides within the attendance boundary of a school that has requested new school construction funding from the School Facilities Division (SFD) of the Arizona Department of Administration (ADOA) within the preceding 2 years.
- Has parents who are peace officers, firefighters, emergency medical technicians, or paramedics.
- Has parents who are licensed or certified health professionals.

In a 2021 Fiscal Note, we [estimated](#) that approximately 836,000 total current public school students would be eligible for the ESA program if eligibility were expanded to children who are FRPL-eligible, attending a school that qualifies for Title I schoolwide services, or who receives Title I Targeted Assistance services. In comparison to the estimated 256,000 currently eligible pupils, the 836,000 represents an increase of 580,000 in comparison with current law and corresponds to approximately 75% of the estimated public school population in FY 2023. We estimated that 22,200 of the 580,000 newly eligible pupils would eventually participate in the program.

We estimate the additional eligibility categories established by the bill may have the following additional impacts:

- Children receiving SNAP, TANF, or Section 8 public housing assistance would not materially increase eligibility rates relative to our prior estimate, as such households would very likely already be FRPL-eligible.
- Children of health professionals, first responders, or veterans may represent approximately 15% of the student population based on occupational data for Arizona published by the Bureau of Labor Statistics. Assuming that approximately 50% of such children would already be eligible under another category (e.g. students with disabilities, attending a school that qualifies for Title I schoolwide services, etc.), the net increase in eligible students would be an estimated 86,500.
- Children residing within the attendance boundaries of schools that applied for SFD new school facilities funding may represent approximately 9% of the public school population based on new school facility construction funding distributed for FY 2021 and FY 2022. Assuming approximately 75% of such students are already eligible under one of the above categories, the net newly eligible students would be 25,000.
- Children enrolled in the Executive's educational benefit recovery program or open for learning recovery benefit program may add 134 additional eligible individuals based on current participation.

In total, the above calculations would suggest that total eligibility for the ESA program would grow to 947,500, or approximately 85% of the current public school population. In comparison to the 256,000 currently eligible, the net increase would be 691,500.

Of the 691,500, we estimate that 4.2%, or 29,043 of the newly eligible students may eventually opt to participate in the ESA program. The 4.2% rate is based on the estimated participation among current ESA enrollees using FY 2022 enrollment data. Private schools may, however, face capacity constraints in serving new students switching into the ESA program in the short run, including constructing or renovating facilities to accommodate new students and hiring new staff. As a result, we assume private school enrollment would increase by no more than 5% annually under the bill. According to NCES, private school enrollment in Arizona was 59,171 in FY 2020. A 5% enrollment increase would

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therefore result in 2,959 additional private school students annually beginning in FY 2023. Given that there would also be new ESA enrollees funded by the Student Empowerment Fund as discussed below, we estimate that 2,612 of the 2,959 new ESA enrollees would be from the expanded ESA eligibility categories discussed above based on their proportionate share of the long-run participation increase among newly eligible enrollees.

We estimate that the average cost of a non-disabled public school student switching into an ESA under current law would be approximately \$529 per pupil in FY 2023. The cost is associated with district students switching to the ESA program, which increases General Fund Basic State Aid formula costs because 1) ESA formula calculations are based on Charter Additional Assistance (CAA), which exceeds District Additional Assistance (DAA) by approximately \$1,500 per pupil on average; and 2) District students in non-state aid districts have their formula expenses covered by local property taxes, whereas all ESA expenses are covered by the General Fund. Approximately 5.7% of district students are enrolled in a non-state aid district. Charter school students switching into the ESA program partially offset the costs associated with district students, as the ESA formula provides 90% of what the charter formula would normally allocate.

Based on the above assumptions, the state cost associated with eligibility expansions to current public school students in the bill would be \$1.4 million in FY 2023, \$2.8 million in FY 2024, and \$4.1 million in FY 2025.

#### ESA Eligibility Expansion – Current Private School Students

The bill would also expand eligibility to certain private school students who never attended a public school. Private school kindergartners and children of veterans enrolled in private schools would not be subject to the requirement to have attended a public school prior to receiving an ESA. As a result, the state cost of the eligibility expansions for these groups would be the full cost of the ESA without offsetting savings for reduced enrollment in public school. We estimate the average cost of an ESA for a non-disabled kindergartner will be \$3,483 in FY 2023 and would grow to \$6,966 once the child enters first grade.

Based on the NCES private school enrollment data referenced above, we estimate there are 4,552 total private school kindergartners. We estimate that the share eligible for an ESA would increase from 23% under current law (256,000 eligible/1,115,343 estimated public school students in FY 2023 = 23%) to 85% under the bill based on the eligibility expansion categories above, or a 62% increase. Of the newly ESA-eligible kindergartners, we assume that 5% would opt into the ESA program in FY 2023, 10% in FY 2024, and 20% in FY 2025 based on our participation assumptions from prior analyses. We further assume that approximately 5.6% of non-kindergarten private school students are children of veterans and would opt into the ESA program at the same rate. The associated cost would be \$1.3 million in FY 2023, \$3.7 million in FY 2024, and \$8.3 million in FY 2025.

#### Student Empowerment Fund

The bill also establishes the Student Empowerment Fund, which would be funded by a \$25.0 million annual allocation from the Education Sales Tax. Monies in the fund could be used for ESAs for students that reside within the attendance boundaries of school districts that receive more in annual funding per pupil than the amount charged for tuition and fees per student at Arizona State University, the University of Arizona, or Northern Arizona University in the same fiscal year. Annual per pupil funding would be based on the Arizona Auditor General's school district spending reports, while university tuition would be the full annual resident undergraduate base tuition and fee rate per student before the application of any scholarships, grants, or tuition waivers.

Based on our analysis of school district spending data reported by the Auditor General for FY 2020 (most recent year currently available), we estimate that there are 121 school districts that represented 32.0% of the district student population, that expended revenue that exceeded the undergraduate resident tuition at ASU, which was \$11,338 in FY 2020.

We anticipate, however, that the number of eligible districts would increase once the Auditor General publishes data for FY 2021. Due to pandemic-related student enrollment declines and disbursement of federal covid-relief monies, we estimate that district per pupil revenues increased by approximately 9.9% based on school district annual financial report (AFR) data. As a result, we estimate that the number of eligible districts would increase from 121 to 175 and that the percentage of district students from such districts would increase to 68.5%. In FY 2023, we anticipate the 175 eligible

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districts would have total enrollment of approximately 613,000. The number of potentially eligible students will likely decline in future years as federal COVID-19 relief funds expire.

Student Empowerment Fund monies would be reserved, however, for students in eligible districts that are not already eligible for another ESA category. Given our estimate that the bill would extend ESA eligibility to approximately 85% of public school students statewide, only 15% of the 613,000, or 91,950, would be newly eligible for an ESA from the Student Empowerment Fund. If their ESA participation rate is comparable to the 4.2% rate for existing eligibility categories, an estimated 3,862 district students would enroll in the ESA program.

As noted above, however, we anticipate that private schools in aggregate would be unlikely to absorb more than 5% enrollment growth annually from newly eligible ESA enrollees. Given the 2,612 additional ESA enrollees that would be associated with expanded ESA eligibility categories, we assume that there would only be 347 new Student Empowerment Fund enrollees annually, so the full 3,862 participation rate would only be reached incrementally over several years.

The 347 Student Empowerment Fund enrollees would each generate Basic State Aid savings of approximately \$(6,489) per student annually. Given that their ESA would be funded via Student Empowerment Fund monies instead of the General Fund, there would be no offsetting General Fund cost. As a result, Student Empowerment Fund enrollees are assumed to generate General Fund Basic State Aid enrollment savings of \$(2.1) million in FY 2023, \$(4.2) million in FY 2024, and \$(6.3) million in FY 2025.

#### CSF Distributions to ESA enrollees

The bill would reduce the cost of ESAs by stipulating that Classroom Site Fund (CSF) monies be distributed to ESA accounts, which would reduce the net General Fund cost of ESA awards on a dollar-for-dollar basis because the General Fund would only cover ESA costs that remain after CSF funds are distributed to the account. The CSF provides a per pupil weighted allocation (Group A only) of \$733 in FY 2022. Given the average Group A weight of 1.22, we estimate that the ESA recipients (both current and newly eligible) would increase Group A weighted counts used for the Classroom Site Fund computation by 18,861 in FY 2023, 24,616 in FY 2024, and 30,780 in FY 2025, which would reduce the CSF per pupil amount relative to current law. The \$25.0 million education sales tax distribution to the Student Empowerment Fund would further reduce CSF fund monies on a dollar-for-dollar basis. Based on these assumptions, we estimate that the adjusted CSF per pupil amount for FY 2023 approximately \$705, or \$(28) lower than under current law. We further assume that the CSF per pupil amount would decrease to \$618 per pupil in FY 2024 and \$615 per pupil in FY 2025 based on elimination of current one-time balances in the fund as well as growing ESA enrollment.

The resulting General Fund savings from the above assumptions would be \$(13.0) million in FY 2023, \$(14.7) million in FY 2024, and \$(18.1) million in FY 2025. The total reduction in CSF distributions to districts and charters would be higher than the General Fund impact because of the allocation of Education Sales Tax monies to the Student Empowerment Fund, as noted above. After accounting for the Student Empowerment Fund, CSF distributions to public schools would decline by an estimated \$(38.0) million in FY 2023, \$(39.7) million in FY 2024, and \$(43.1) million in FY 2025.

#### STO Individual Income Tax Credit Expansion

The bill would consolidate the 2 existing individual income tax credits for donations to School Tuition Organizations (STOs) that provide tuition scholarships to students attending private schools. Currently, the "original" credit is capped at \$623 for individuals (\$1,245 for married filing jointly), while the "switcher" credit provides an additional credit of \$620 for single filers (\$1,238 for married filers) for individuals who have already received the maximum credit from the "original" program. A.R.S. § 43-1603 requires STOs to use switcher donations to pupils that attended a public school in the prior year for at least 90 days, are homeschooled, moved from out-of-state, or previously participated in the Empowerment Scholarship Account (ESA) program. The "original" STO credit had a cost of \$71.1 million in FY 2021 while the switcher credit had an impact of \$43.2 million, for a total impact of \$114.3 million.

Under the bill, the "switcher" credit would no longer be available, but the "original" credit cap would be increased by an amount equal to the current value of the "switcher," such that the individual cap in Tax Year 2022 would be \$1,243 for singles and \$2,483 for married couples filing jointly. Given that the total current cap of the combined original and

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switcher credit is the same as in the bill, we do not anticipate the consolidation of the 2 credits would have a material impact on donations and corresponding credit utilization in FY 2023.

After FY 2023, however, the cap on the maximum credit would be increased annually by the greater of the change in the Phoenix-Mesa Consumer Price Index (CPI) or \$250 for single filers and \$500 for married filers. Under current law, the cap would only be increased by the Phoenix-Mesa CPI. We estimate that the dollar increases would provide a larger increase than the CPI. The credit caps would therefore increase to \$1,493 for individuals (\$2,983 for married couples) in TY 2023 (FY 2024) and \$1,743 for individuals (\$3,483 for married couples) in TY 2024 (FY 2025).

According to DOR data, the 5-year average number of claimants of the original credit is 93,282. Given that the credit is non-refundable, we estimate that a married couple filing jointly would need to have adjusted gross income of at least \$127,000 in FY 2024 in order to be able to at least partially benefit from the credit increase. Based on DOR data, we estimate that 29.2% of claimants in FY 2024 and 21.6% in FY 2025 would potentially have sufficient tax liability to receive an increase in the credit. Assuming donors to STOs have the same income would therefore imply that 27,250 claimants would receive an increased credit under the bill in FY 2024 and 20,138 in FY 2025. The corresponding decrease in General Fund revenues would be approximately \$(8.7) million in FY 2024 and \$(14.7) million in FY 2025.

#### Displaced/Disabled Corporate STO Credit Expansion

The bill would also increase the aggregate cap on corporate income tax credits for donations to STOs providing scholarships to displaced or disabled pupils from \$6,000,000 in FY 2022 to \$10,000,000 in FY 2023. Beginning in FY 2024, the cap would be adjusted annually for the annual percentage change in the metropolitan Phoenix consumer price index or 2%, whichever is greater. Corporations have applied for credits that have reached the current aggregate cap in every year. As a result, we assume this provision would decrease General Fund revenues by \$(4.0) million in FY 2023, \$(4.2) million in FY 2024, and \$(4.3) million in FY 2025.

The bill would eliminate the cap on scholarships granted by school tuition organizations from corporate STO donations. Scholarships are currently capped at \$5,800 for K-8 pupils and \$7,700 for private school pupils. The elimination of the cap would likely increase average scholarship grants from corporate STOs. The increase in scholarships per pupil, however, would not impact the availability of Corporate STO tax credits, which are subject to an aggregate cap. As a result, we do not anticipate any direct fiscal impacts from this provision.

#### **Local Government Impact**

The bill would reduce Classroom Site Fund distributions to school districts and charter schools by \$(38.0) million in FY 2023, \$(39.7) million in FY 2024, and \$(43.1) million in FY 2025. This includes a \$(25.0) million reduction annually for the allocation to the Student Empowerment Fund as well as distributions to ESA accounts as required under the bill.

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