

JLBC Staff Analysis of K-12 Aggregate Expenditure Limit

Key Points

- The Arizona Supreme Court has ruled that most of the monies generated by the 3.5% income tax surcharge created by Proposition 208 shall be classified as "local revenues" that count towards the K-12 aggregate expenditure limit (AEL) established for school districts in the Arizona state constitution.
- The Court ruling stipulated that a lower court shall determine whether school district budgets exceed the AEL. If district budgets exceed the AEL, the Court ordered that the lower court deem the income tax surcharge unconstitutional.
- We understand that the Arizona Department of Revenue will not allocate these surcharge monies until June 2022. As a result, these monies would not affect the AEL until FY 2023.
 - The AEL will also be affected by the expiration of Proposition 301. Proposition 301 education sales tax monies were constitutionally exempted from the AEL. Proposition 301 was replaced, however, with a substitute 0.6 cent sales tax established by Laws 2018, Chapter 74. Based on guidance from Legislative Council, the substitute 0.6 cent sales tax monies from Chapter 74 are not exempt from the AEL.
- The Chapter 74 education sales tax goes into effect in FY 2022. As a result, these monies would impact AEL expenditures in both FY 2022 and FY 2023.
- In FY 2022, the JLBC Staff estimates that school districts will budget \$7.26 billion of expenditures that would be included in the AEL. In comparison to the \$6.02 billion limit established in May 2021 by the Economic Estimates Commission (EEC) for FY 2022, the estimated \$7.26 billion of expenditures would result in an AEL exceedance of \$1.24 billion for FY 2022. ADE will compute actual AEL expenditures for FY 2022 by November 1, 2021.
 - In FY 2023, the JLBC Staff estimates that school districts will budget \$7.80 billion of expenditures that would be included in the AEL. We also estimate the AEL will increase to \$6.53 billion in FY 2023. The resulting AEL exceedance in FY 2023 would be \$1.27 billion. The EEC will compute the actual AEL for FY 2023 by May 1, 2022 and ADE will compute actual AEL expenditures for FY 2023 by November 1, 2022.

Our analysis is summarized in *Table 1*. Below, we describe our methodology for estimating the AEL in FY 2022 and FY 2023.

FY 2022

- In May 2021, the Economic Estimates Commission determined that the K-12 Aggregate Expenditure Limit (AEL) for school districts will be \$6.019 billion for FY 2022. (see row A)
- ADE will compute the actual district spending counting towards the AEL by November 1, 2021. As a result, the extent to which district budgets exceed or are below the AEL is not yet known. • To estimate districts' AEL expenditures using spending categories that counted towards the AEL in FY 2021 and earlier years ("Current AEL Components") we incorporated both "Formula Spending" and "All Other" spending.
- We estimate formula spending will reach \$6.32 billion in FY 2022 (see row B) and would consist of the following components:
 - \$5.49 billion of estimated Base Support Level funding for school districts in FY 2022 (A.R.S. § 15-943). This amount assumes district student counts reach 897,993 in FY 2022, or an increase of 40,854 in comparison to FY 2021, consistent with the assumptions of the enacted FY 2022 budget. The actual amount could be different depending on how district enrollment for FY 2022, which is not yet known, compares to the enacted budget assumptions.

Projected AEL Spending, FY 2022 and FY 2023

- 1/ FY 2021 and FY 2022 figures represent expenditure limit computed by the Economic Estimates Commission pursuant to A.R.S. § 41-563. FY 2023 represents JLBC Staff estimate, and assumes a calendar year 2021 inflation rate of 3.68% based on forecasts from IHS Markit and FY 2022 district student counts of 897,993 based on the assumptions from the enacted FY 2022 budget.
- 2/ FY 2021 AEL spending total of \$6,165,430,900 was reported by ADE on February 17, 2021 pursuant to A.R.S. § 15- 911. FY 2022 and FY 2023 totals are JLBC Staff estimates.
- 3/ Includes school district monies from the Base Support Level (A.R.S. § 15-943), Transportation Revenue Control Limit (A.R.S. § 15-946), District Additional Assistance (A.R.S. § 15-962), and State Aid Supplement funding pursuant to Laws 2015, 1st Special Session, Chapter 1. Excludes \$(86,280,500) in FY 2021 and \$(150,380,500) in FY 2022 and FY 2023 for education sales tax monies that finance Basic State Aid payments. Through FY 2021, ADE excluded these monies from its AEL spending calculation as a result of the constitutional exemption for Proposition 301 monies.
- 4/ FY 2021 "All Other" amount represents AEL expenditures computed by ADE for FY 2021 less formula funding. FY 2022 and FY 2023 estimates assume districts budget for desegregation expenses of \$208,130,400, adjacent ways expenses of \$71,911,400, small school adjustment expenses of \$28,608,900, and \$5,000,000 for other miscellaneous non-formula expenses within district M&O and unrestricted capital funds that are included in AEL calculations. The amount for All Other may not always correspond to non-formula budget amounts because adopted district budgets do not always match the final formula resources the district receives from ADE for that fiscal year.
- 5/ Includes \$150,380,500 of Basic State Aid expenses funded by education sales tax monies plus 78% of Classroom Site Fund (CSF) monies distributed to districts from education sales taxes collected from and after July 1, 2021. Excludes CSF distributions associated with prior year balances and land trust endowment earnings as well as CSF distributions to charter schools. Based on guidance from Legislative Council, the 0.6% sales tax will no longer be exempt from the AEL in FY 2022 because the existing constitutional exemption specifically applies to Proposition 301, which expires in FY 2022.
- 6/ Assumes districts receive 79.8% of income tax surcharge distributions for teacher and classroom support personnel, support services personnel, and teacher retention pursuant to A.R.S. § 15-1281 based on districts' estimate share of Group A and Group B weighted counts for the prior year. Assumes that gross income tax surcharge collections will be \$544,000,000 based JLBC Staff revised fiscal impact estimate after accounting for the impact of SB 1783 (Laws 2021, Chapter 436).

- \$346.7 million for Transportation Revenue Control Limit (TRCL) funding (A.R.S. § 15-946). This is the amount computed by ADE for the August 1, 2021 Basic State Aid payment and is based on district route miles and TRCL from the prior year (FY 2021).
- \$423.9 million for District Additional Assistance (DAA) (A.R.S. § 15-946). This is the amount of DAA funding calculated by ADE for the August 1, 2021 Basic State Aid payment and is based on prior year (FY 2021) student counts.
- \$60.0 million of State Aid Supplemental Funding pursuant to Laws 2015, 1st Special Session, Chapter 1. This is equivalent to districts' share of such funding from FY 2021, which amounts to about 79.9% of the available funds based on districts' share of Group A weighted counts in comparison to charter schools (the AEL does not apply to charter spending).
- "All Other" spending includes non-formula funding that does not qualify for an AEL exclusion, and primarily consists of local property tax levies that are not subject to voter approval. We assume this spending reaches \$313.7 million in FY 2022 based on district-adopted budgets in recent years for desegregation levies (A.R.S. § 15-910) (\$208.1 million), adjacent ways (A.R.S. § 15-995)(\$71.9 million), small school adjustment funding (A.R.S. § 15-949), and \$5 million for all other miscellaneous expenditures with no exclusion (see row C).
- Our Formula Spending and All Other spending estimates result in projected FY 2022 AEL spending of \$6.63 billion (see row D).
- Education sales tax monies are forecast to add another \$632.2 million to AEL spending in FY 2022, including \$150.4 million that fund Basic State Aid payments and \$481.8 million of Classroom Site Fund (CSF) distributions to school districts. The latter figure assumes school districts receive 78.0% of CSF distributions based on their share of Group A weighted counts compared with charter schools. It also assumes that CSF distributions associated with prior-year balances and land trust endowment earnings are excluded. (See row F)
- Proposition 208 income surcharge monies budgeted by school districts are assumed to be \$0 in FY 2022. Since surcharge monies would first be due on taxes paid in the spring of 2022, districts would likely not receive distributions until FY 2023. (See row G)
- The \$6.63 billion of spending on current AEL components plus \$632.2 million of education sales tax monies would result in \$7.26 billion of district expenditures counting towards the AEL. (see row I) • In total, we project that the \$7.26 billion of district spending will exceed the AEL by \$1.24 billion (see row J).
- Consistent with ADE's methodology for prior years, our estimates continue to assume that district amounts budgeted for grant programs funded with state monies, such as Results-Based Funding and Instructional Improvement Fund monies, are excluded from AEL calculations. According to Legislative Council, it would be very unlikely that such monies would qualify for exclusion as a grant based on the *Fann* court decision. We lack sufficient information, however, about the scope of the impacted programs to make a definitive determination that all such monies should be included. If these monies were added to our calculation, our estimates of district AEL expenditures would increase by approximately \$189 million in FY 2022.

FY 2023

- We estimate that the AEL will grow from \$6.019 billion in FY 2022 to \$6.53 billion in FY 2023. Our estimates assume prior year student counts (FY 2022) of 897,993 based on enacted budget district enrollment assumptions. We also assume inflation from 2 years prior (CY 2021) of 3.68% based on the current IHS Markit Inflation estimate for CY 2021. (see row A)
- We estimate formula spending will reach \$6.45 billion in FY 2023 (see row B) and would consist of the following components:

- \$5.60 billion of estimated Base Support Level funding for school districts in FY 2022 (A.R.S. § 15-943). This amount assumes district student counts reach 893,367 in FY 2022, or a decrease of (4,626) in comparison to FY 2022, consistent with the assumptions of the 3-year spending plan for the enacted FY 2022 budget. The actual amount could be different depending on how district enrollment for FY 2023, which is not yet known, compares to the enacted budget assumptions.
- \$350.2 million for Transportation Revenue Control Limit (TRCL) funding (A.R.S. § 15-946). This amount assumes the \$346.7 million from FY 2022 will increase by \$3.5 million based on the average TRCL increase over the past 5 years.
- \$444.5 million for District Additional Assistance (DAA) (A.R.S. § 15-946). This is based on districts reaching a student count of 897,993 in FY 2022 consistent with the enacted budget assumptions. (DAA is based on prior year student counts).
- \$60.0 million of State Aid Supplemental Funding pursuant to Laws 2015, 1st Special Session, Chapter 1. This is equivalent to districts' share of such funding from FY 2021, which amounts to about 79.9% of the available funds based on districts' share of Group A weighted counts in comparison to charter schools.
- "All Other" spending is assumed to be unchanged from FY 2022. (see row C) • Our Formula Spending and All Other spending estimates result in projected FY 2023 AEL spending of \$6.77 billion (See row D).
- Education sales tax monies are forecast to add another \$660.3 million to AEL spending in FY 2023. These amounts assume that education sales tax revenues grow by 4.5% in comparison to FY 2022 based on the 3-year spending plan associated with the enacted FY 2022 budget. (See row F)
- Proposition 208 income surcharge monies budgeted by school districts are assumed to be \$368.9 million in FY 2022. We assume that gross income tax surcharge collections will be \$544.0 million based on the JLBC Staff revised fiscal impact estimate after accounting for the impact of SB 1783 (Laws 2021, Chapter 436). Since distributions to charter schools are excluded from the AEL, we further estimate that districts receive 79.8% of income tax surcharge distributions for teacher and classroom support personnel, support services personnel, and teacher retention pursuant to A.R.S. § 15-1281 based on districts' estimate share of Group A and Group B weighted counts for the prior year. (See row G)
- The \$6.77 billion of spending on current AEL components, \$632.2 million of education sales tax monies, and \$368.9 million of income tax surcharge monies would result in \$7.80 billion of district expenditures counting towards the AEL. (see row I)
- In total, we project that the \$7.80 billion of district spending will exceed the AEL by \$1.27 billion (see row J).
- Similar to FY 2022, we continue to assume state-based grant programs are excluded from the AEL in FY 2023.

