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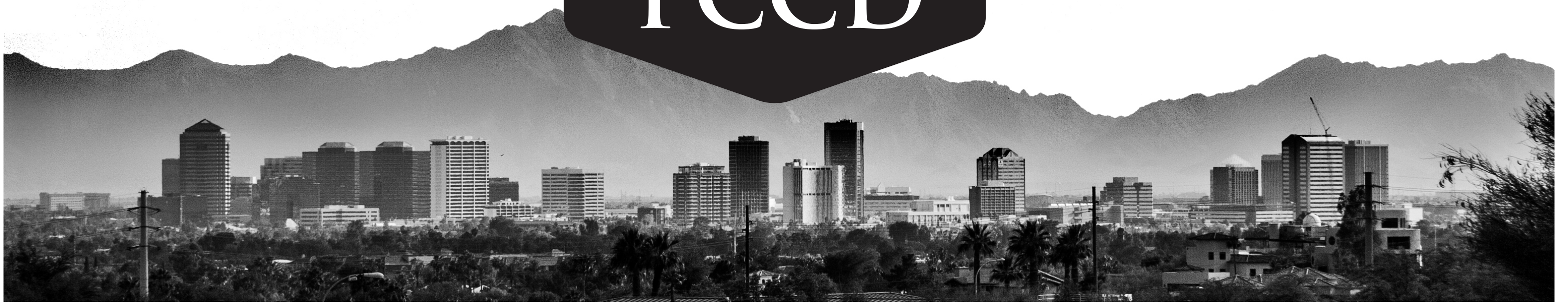

ARIZONA SCHOOL FINANCE: A BRIEF INTRODUCTION

As the largest consumer of state funds, K-12 education finance is a hotly-debated topic. This introduction explains the basics and lays the foundation for further discussions. School finance is fraught with exceptions, but the basic structure is simple enough. Improved understanding of where the system originated, how it has morphed over time and how it is presently changing is critical to an informed public debate.

WHERE WE WERE

The current state of Arizona school finance originated during the major reforms of 1980, when lawmakers created a system designed to equalize per-pupil spending and property tax rates. The state created an equalization base by multiplying the number of students in a district by the "base support amount" value set annually by the legislature. In 2000, the base level was $2,578 and for 2014 it was $3,327*. The student count is adjusted for cost discrepancies by adding variable "weights" to certain pupils who naturally incur higher costs. The weights are set by statute and provide more resources for pupils in grades 9-12, those in small and rural districts, and, particularly, children with special needs.

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Multiplying the weighted student count by the base level amount determines the **Base Support Level (BSL)**, which is adjusted by the Teacher Experience Index and any applicable performance pay programs. The Teacher Experience Index allows a district to increase its BSL by 2.25 percent for each year of experience by which the district's average experience exceeds the statewide average. The only current performance pay program is Teacher Compensation, which adjusts the BSL by 1.25 percent if a district qualifies under the performance evaluation criteria. (Nearly every district qualifies.)

Base Support Level (BSL)
Base means the revenue level per student count specified by the legislature. A.R.S. 15-901

The BSL is added to transportation expenses, setting a district's **Revenue Control Limit (RCL)**. Adding District Additional Assistance to the RCL determines a district's "equalization base," sometimes referred to as their "bucket of need." District Additional Assistance is a new, simplified formula which assigns per-pupil monies, replacing capital outlay revenues and soft capital formulas.

Revenue Control Limit (RCL)
The revenue control limit for a school district is equal to the sum of the base revenue control limit and the transportation revenue control limit. A.R.S. 15-901

*A July 2014 Superior court ruling has ordered this amount be changed to $3,560.

Qualifying Tax Rate (QTR)
Qualifying tax rate means the qualifying tax rate applied to the assessed valuation used for primary property taxes. A.R.S. 15-901

The state sets an annual budgetary **Qualifying Tax Rate (QTR)** to determine how much of the equalization base will be funded by state aid versus local property taxes. The intent is to have taxpayers across the state pay about the same amount per pupil. The amount of the equalization base not collected by the local levy is paid for in the form of state aid (see graphic).

This construct deflates the impact of disparities in property wealth in order to meet the constitutional requirement that the Arizona Legislature "…enact such laws as shall provide for the establishment and maintenance of a general and uniform public school system."

Maintenance and Operations (M&O)
Maintenance and Operations (M&O) refers to the day-to-day expenses of a district like salaries, benefits, and routine maintenance; often referred to as the "general fund."

The 1980 reforms didn't achieve complete **maintenance and operations (M&O)** equity, as they left in place voter-approved overrides. In addition, school capital finance, funded largely through voter-approved General Obligation bonds, was left unchanged. With this structure, wealthier districts were able to secure more bond money for school facilities and districts that were more amenable to approving overrides had increased per-pupil spending. The argument was local voters in school districts should have the authority to provide additional resources as required.

WHAT HAPPENED?

Shortly after the 1980 reforms were fully phased in, the Legislature began undermining equity through a series of changes. In addition to overrides, districts were authorized to levy property taxes for a variety of reasons that the state did not equalize, meaning whoever got access was able to spend more per pupil as a result. Excess Utilities, Excess Insurance and Adjacent Ways were just a few of these spending capacity authorities. By 2009, money expended outside of the RCL amounted to roughly $520 million annually, distorting per pupil equity. This doesn't include the impact of voter-approved overrides, which amounted to an additional $521 million of spending capacity that year and were accessed by fewer than half of all districts.

A large component contributing to inequitable spending is the desegregation levy, authorized in 1983 in order to allow districts to comply with court orders to desegregate. Only two districts ever received such orders (Tucson Unified and Phoenix Union) but 17 other districts eventually received permission to levy in order to remediate alleged discrimination. Expenditures grew rapidly until 2002, when the Legislature began capping the growth of the levy, culminating in a hard cap in 2009. Desegregation levies totaled $210 million in 2014, which simply adds to a district's M&O budget, allowing for significant increases in per pupil spending. The amount a district is authorized to levy for desegregation is not tied to pupils and is entirely extracted from local property taxpayers. Seven districts spend over an additional $1,000 per pupil as a result of this levy, which can be used for teachers' salaries and other normal expenses.

Finally, a significant source of expenditures authorized beyond the RCL is transportation dollars. Districts can levy for the highest amount ever spent on transportation (up to 120 percent of the highest formula authorization) but the difference between that amount and their current statutory authorization will be funded solely with property taxes, holding the district "harmless" from a drop in students. As some districts shrink, the delta between the historical high and current authorization has grown statewide and represented $75 million in 2014.

Small School
Districts that qualify for small school adjustment: A common school district with a student count in K-8 programs of 125 or less, a high school district with a student count of 100 or a unified school district or a an accommodation school with a student count of 125 or less in K-8 programs or with a student count of 100 or less in grades 9-12. A.R.S. 15-949

The **Small School** Adjustment, an original budget-limit exemption from the 1980 reforms, lets very small districts levy any amount under this authorization with few restrictions. The levy costs taxpayers $21 million in 50 small districts statewide for this authorization, creating some of the highest tax rates in the state for K-12 as a result. Ash Fork Unified in Yavapai County had an RCL in 2014 of just $1.3 million, but took another $1.6 million under the adjustment for a district with just 226 pupils, allowing them to spend $13,400 per pupil. Their primary property tax rate for K-12 is $7.38, far higher than the QTR of $4.25.

Roosevelt v. Bishop (1994) found that the capital finance system was not "general and uniform."

Equalization efforts have had essentially no impact on one-quarter of Arizona K-12 districts [due to small school adjustment].

In 2012, just 55 percent of [school district] issues passed the ballot, compared to 66 percent in 2007 and 82 percent in 2008.

The result of all this is a wide discrepancy in per pupil expenditures statewide. Many districts, such as Yuma Union, spend about $5,000 per pupil on M&O expenditures while a number of others, such as Phoenix Union, spend about $8,000 per pupil. Smaller, usually rural districts spend far greater amounts per pupil, such as Pine-Strawberry Elementary, which expends $23,000 per pupil, taking advantage of the small school adjustment.

Arguably the most important court case affecting Arizona K-12 finance in the last 30 years is *Roosevelt v. Bishop* (1994), which found the capital finance system was not "general and uniform." Following a series of rulings, the courts required the state to establish adequacy standards for school facilities. The legislature passed Students FIRST in 1998, which established the state funded School Facilities Board (SFB), whereby districts could qualify for both new construction and repair monies based on statutory requirements. The idea was the school districts would tap the SFB in lieu of using bonds, whose debt limits were reduced by two-thirds to marginalize their impact on inequitable capital funding. The state has since spent approximately $4.4 billion on Students FIRST capital programs.

Along the way, significant changes to the landscape of public education were made through open enrollment and charter schools. Beginning in 1995-96, parents could enroll their child at any public school of their choosing, provided it wasn't at capacity. Before, students were mostly limited to attending the schools in their residing district. The same year, charter schools were authorized and began steadily growing out of infancy. They are funded only through a per-pupil amount from state and federal funds, creating more choice and further eroding the district silo model. Finally, tuition tax credits have increased the amount of tax deductible money taxpayers can contribute to any school, increasing opportunities for students to attend private schooling.

WHERE WE ARE

The pressure stemming from the many issues facing Arizona's K-12 finance has created a chaotic scene. Equalization efforts have had essentially no impact on one-quarter of Arizona K-12 districts. Despite attempts through Students FIRST to equalize capital spending across public schools, the legislature voted to increase debt limits on bonds and overrides by 50 percent in 2013. Beginning in 2009, the SFB was largely defunded due to the recession; moreover, the lack of student growth in district schools over the past five years has led to few districts qualifying for new construction. The move to increase bonding and override capacity was significant because it signaled to school districts that they should not expect to receive significant additional funding from the state and should look locally. However, school districts are finding it increasingly difficult to pass bond and override ballot measures. In 2012, just 55 percent of issues passed the ballot, compared to 66 percent in 2007 and 82 percent in 2008. It stands to reason that open enrollment and the surge of charter schools play a role in minimizing the relationship between property owners and the school district they reside in, thus decreasing taxpayer desire to pay for bonds and overrides.

There have been some efforts to reduce the spending outside of the equalization formula such as the removal of Excess Utilities, which allowed growing districts in particular to significantly increase levying capacity and provided a disincentive to conserve energy costs. That levy alone amounted to $115 million in 2009, its last year of existence. Still, money spent outside the RCL in 2014 amounted to $375 million. With many districts shrinking in students, the "hold harmless" formulas for desegregation and transportation drive increasing inequity in the overall system.

Bringing these issues to a head is litigation, which could upend the current structure similarly to *Roosevelt v Bishop*. In July 2014, the Superior Court found the state improperly met Prop 301 mandates and should have adjusted the Base Support Amount to inflation in the years 2011-2013, when state coffers were depleted from the recession. The final amount owed by the state is currently unresolved, but could cost billions in retroactive and prospective funding. The more problematic lawsuits would be ones challenging equity. Arizona is highly exposed in this arena, in both per-pupil equity as described above, as well as taxpayer contribution inequity. Property tax liabilities vary dramatically throughout Arizona for property owners in similar circumstances. Either of these lawsuits could do what the legislature may not wish to do; completely redefine K-12 finance.

WHERE WE ARE GOING

There is little harmony in the K-12 education debate; there are far more points of contention than agreement. It is clear that any changes in policy should consider Arizona's current school choice model.

Charter school advocates, who originally billed their model as more economically efficient than district schools, are now demanding access to more of the funding sources available to district schools. Charters argue they are in direct competition with districts and the law should guarantee them equitable capital funding. Depending on the circumstances and the year, it is possible for a district school to have less money than a charter school, but historically speaking district schools spend far more per-pupil than charter schools. In 2008, including all expenditures, districts spent about $9,600 per pupil whereas charters spent $7,600. In 2013, the amounts were $9,084 and $7,413, respectively. Further, charters do not have access to the SFB or the ability to leverage the property tax base to bond for capital projects. Charters argue they deserve better access to capital as opposed to their current option of leveraging state tuition for expensive revenue bonds. Finally, the Legislature needs a resolution on district-sponsored charters, who represent some of the most obvious inequitable financing by reaping the advantages of both systems.

Picking up the pieces from lawsuits will be the next step in K-12 finance. While many groups call for increased funding, policymakers face equity challenges. Furthermore, the state is facing a structural budget deficit in 2017 estimated at $1 billion (with Superior Court K-12 inflation funding).

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Most discussions about K-12 finance begin and end with one statistic: Arizona's very low national per-pupil expenditures ranking. This simple comparison fails to account for variance in cost of living, economies of scale and different finance models, among other variables that would make for a more accurate comparison. In fact, the primary reason for Arizona's ranking is its expansive growth over the past few decades. Since 1992, the first year reliable data can be fairly compared, Arizona is third in the nation in increased K-12 M&O spending (189 percent); however, its K-12 population also grew 46 percent, second-highest in the country. Half of the states nationwide grew under 10 percent during the period and 12 actually declined. The fastest growing states in America share the trait of having low per-pupil education spending. Complicating the problem, Arizona ranks 49th in percentage of population ages 18-64, meaning it has fewer tax-paying workers as a percentage of its population, while its percentage of population under 18 is ranked eighth. Dramatic increases in funding resulted in favorable teacher pay. According to the National Education Association, Arizona's K-12 teacher's average salary ranked 14th-highest in 2013 when correcting for per capita personal income (29th, uncorrected). The reality is the vast majority of Arizona's students reside in highly urban areas in districts that operate with full classrooms, keeping per pupil costs relatively efficient.

All stakeholders want a public school system that is adequately and fairly funded. However, the system is fraught with complexity and certain groups currently benefit substantially from inequitable spending. Simple solutions will likely exacerbate current problems and court-ordered mandates could be catastrophic. Equalizing education spending, while fair, may have the painful effect of creating some losers along the way. The business community should encourage elected officials to find ways to bring balance to the system first; then find sensible and effective ways to spend taxpayer dollars.

SCHOOL FINANCE