



# Arizona State Senate Issue Brief

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## ARIZONA'S SCHOOL FINANCE SYSTEM

### CURRENT SCHOOL FINANCE SYSTEM

Prior to 1980, Arizona's school finance system required school districts to rely heavily on local property tax revenues while receiving very little monetary support from state funds. This resulted in funding disparities among school districts, whereby school districts with high-property values could raise significant revenue with relatively low tax rates, while school districts with low-property values and higher tax rates could not generate the same amount of revenue. In the late 1970s, as a result of court cases in which similar systems in other states were found unconstitutional, Arizona began reforming its school finance system to address the potential unconstitutionality of its system and reestablish a "general and uniform" public school system.<sup>1</sup>

The current K-12 school finance system is based on a statutory formula enacted in 1980<sup>2</sup> and substantially modified in 1985. The established formula aims to "equalize" per-pupil spending among school districts, taking into account student enrollment and property values. Under the current school finance formula, school districts receive approximately the same amount of funding per pupil. Spending is also capped, preventing high-property value school districts from generating local revenues in excess of the funding formula and creating inequities. Some school districts with a very strong local property tax base are able to generate their entire formula funding entitlement. However, most school districts require revenues in the form of Basic State Aid in order to receive full funding under the statutory formula. The school finance formula for school districts is as follows:

*Equalization Base - Qualifying Tax Rate = Equalization Assistance*

*Equalization Assistance - State Equalization Tax Rate = Basic State Aid*

<sup>1</sup> Article 11, Section 1 of the Arizona Constitution requires the legislature to establish a "general and uniform" public school system.

<sup>2</sup> Laws 1980, 2<sup>nd</sup> S.S., Ch. 9

**EQUALIZATION BASE FOR SCHOOL DISTRICTS**

The equalization base, or a school district’s spending limit, is the sum of the following three elements: 1) Base Support Level (BSL); 2) Transportation Support Level (TSL); and 3) District Additional Assistance (DAA). The sum of the BSL and TSL are generally referred to as the Revenue Control Limit (RCL).

$$\text{Equalization Base} = \text{BSL} + \text{TSL} + \text{DAA}$$

**Base Support Level** – The BSL is the product of a school district’s total Weighted Student Count (WSC) multiplied by the Base Level Amount (BLA) multiplied by the Teacher Experience Index (TEI).<sup>3</sup>

A school district’s WSC is determined by applying different weights based on student enrollment. First, a school district’s student count is weighted based on the size and location of the school district. Small and isolated school districts receive an added weight to account for economies of scale. Larger and non-isolated school districts do not receive a weight but are not penalized. Second, school districts receive weights that are applied to a school district’s student count based on varying factors. “Group A” weights are applied based on the number of students taught in certain grade levels. “Group B” weights are applied using specific student characteristics and needs such as special education, English language learners and severe developmental disabilities. The WSC is then multiplied by the BLA, which is a statutorily set per pupil amount that has historically been adjusted for inflation.<sup>4</sup> For most school districts, the BLA is also increased by 1.25 percent for “teacher compensation”.<sup>5</sup>

<sup>3</sup> A.R.S. § 15-943

<sup>4</sup> In 2000, Proposition 301 authorized a 6/10<sup>th</sup> of a percent increase in sales tax to fund education programs. Proposition 301 included an inflation provision in the school finance formula that was challenged in *Cave Creek v. DeWit* and settled with the passage of Proposition 123 (see below) in 2016.

<sup>5</sup> A.R.S. §15-952 allows districts to get approval from the State Board of Education. This increase applies to most districts.

Finally, the product generated from the previous steps is multiplied by the TEI. The TEI allocates more money to a school district whose combined years of teacher experience exceed the statewide teacher experience calculation. The TEI increases a school district’s BSL by 2.25 percent for each year that the district’s average teacher experience exceeds the state average. The intention of including the TEI in the formula was to account for teacher pay scales that increased with years of service.

$$\text{BSL} = \text{WSC} \times \text{BLA} \times 1.0125 \times \text{TEI}$$

**FY 2015-2016 Base Level Amount = \$3,426.74**

**Transportation Support Level** – The main funding component of the TSL is computed for the transportation of students to and from school by multiplying a statutorily set amount, adjusted annually for inflation, by a school district’s approved daily route mileage per eligible student plus an amount spent for bus tokens and passes.<sup>6</sup> There is an additional component of the TSL formula for academic education, career and technical education and athletic trips; however, the amounts generated by this portion of the formula are lower than the formula that generates funds to transport students to and from school.

The TSL differs from the Transportation Revenue Control Limit, a voluntary program, which allows school districts to assess an additional property tax levy to generate additional revenue for transportation costs above the TSL amount.

$$\text{TSL} = \$ \text{Amount} \times \text{Route Miles} + \text{Tokens/Passes}$$

**FY 2016 – 2017 TSL per Route Mile**

<i>Approved Daily Route Mileage per Pupil</i>	<i>Dollar Amount</i>
0.5 or less	2.56
Between 0.5-1.0	2.09
More than 1.0	2.56

<sup>6</sup> A.R.S. § 15-945

**District Additional Assistance** – In 2013, the Capital Outlay Revenue Control Limit and the Soft Capital Allocation funding formulas for school districts were consolidated into one funding formula. DAA is calculated by multiplying a statutorily set amount by a school district’s unweighted student count for the particular grade ranges.<sup>7</sup> The formula has six different per pupil amounts based on the number of pupils and grade levels taught. Smaller school districts and grades 9-12 have a heavier weight than large school districts and grades K-8. Although these monies are considered capital in nature, school districts have the ability to move funds generated through DAA into their maintenance and operations account. Currently, the DAA formula is not fully funded, as approximately 84 percent of DAA funding is suspended for FY 2017.<sup>8</sup>

**DAA = unweighted count x per pupil amount**

FY 2017 DAA Per Pupil Amounts		
	Student count	Amount
Less than 100	K-8	\$544.58
	9-12	\$601.24
Between 100 – 600 (amounts multiplied by small school weight)	K-8	\$389.25
	9-12	\$405.59
More than 600	K-8	\$450.76
	9-12	\$492.94

**QUALIFYING TAX RATE**

The qualifying tax rate (QTR) is a statutory primary property tax rate used to determine the amount of revenue that will be generated from local taxpayers in support of the Basic State Aid formula.<sup>9</sup> Proposition 301 set the maximum QTR that can be applied at \$2.1265 for elementary and high school districts and \$4.253 for unified school districts. The school district is not under any obligation to levy the QTR or any other tax rate in order to receive state aid; however, the QTR is presumed to be the local

effort of the school district for the purposes of calculating the amount of state aid that a district will receive.

The QTR is subject to Truth in Taxation (TNT) laws. The Joint Legislative Budget Committee is required by February 15 of each year to report TNT rates, which are then used to adjust the QTR annually. The effect of TNT is to offset the statewide appreciation of existing property with a commensurate reduction in the QTR, ensuring that tax liability for existing properties remain unchanged despite increased property valuation.

The actual overall primary property tax rate for a school district may be lower than the QTR, or higher if the district is allowed to budget for items outside of the school finance formula, which include: 1) Desegregation<sup>10</sup>; 2) Adjacent Ways<sup>11</sup>; 3) Small School Adjustment<sup>12</sup>; and 4) Liabilities in Excess.<sup>13</sup> The FY 2017 QTR was set at \$2.0793 for non-unified school districts and \$4.1586 for unified school districts.

In addition to the QTR, a state equalization tax rate (SETR) is assessed on property owners to collect revenues to also (along with the QTR) offset state costs. The SETR is determined through the TNT process and is assessed in each county. The FY 2017 SETR was set at \$0.5010.

Counties are required to levy a primary property tax rate that is 50 percent of the QTR for property that is located outside of school district boundaries. These monies are collected by the counties and deposited into the state General Fund.<sup>14</sup>

Each county is also required to levy an additional primary property tax in school districts that are ineligible for state equalization assistance (“non-state aid districts”). This additional tax rate, sometimes referred to as the minimum qualifying tax rate (MQTR), is determined based on the difference between the levy that would be produced by 50 percent of a

<sup>7</sup> A.R.S. § 15-961

<sup>8</sup> Laws 2016, Ch. 124, Section 35

<sup>9</sup> A.R.S. § 41-1276

<sup>10</sup> A.R.S. § 15-910

<sup>11</sup> A.R.S. § 15-995

<sup>12</sup> A.R.S. § 15-949

<sup>13</sup> A.R.S. § 15-907

<sup>14</sup> A.R.S. § 15-991.01

non-state aid district’s applicable QTR and its equalization base. If the levy produced by 50 percent of the district’s applicable QTR is equal to or less than its equalization base, the MQTR will not be levied in the non-state aid district. Otherwise, the MQTR will be levied at a rate such that the additional tax generates an amount equal to the difference between 50 percent of the non-state aid district’s QTR and its equalization base. The revenue generated from the MQTR is deposited into the state General Fund.<sup>15</sup>

**BASIC STATE AID**

After a school district’s equalization base is determined, the net assessed property value of the school district is multiplied by the QTR in order to determine the portion of its funding that is assumed to come from local QTR tax revenue.<sup>16</sup> If the amount generated by the QTR exceeds the school district’s equalization base, the school district is not entitled to equalization assistance and will be completely funded by the revenues generated by the QTR. If, however, the QTR revenues are not sufficient to cover the equalization base then the school district is eligible for equalization assistance.

Equalization assistance occurs in two ways: 1) revenues generated from the SETR; and 2) Basic State Aid. First, a school district that is eligible for equalization assistance will receive funds generated from the SETR in that particular county. The county school superintendent, in conjunction with the county treasurer, is responsible for administering this form of equalization assistance. If a school district still has a remaining equalization assistance entitlement generated from the formula, the district will receive funds in the form of Basic State Aid. Basic State Aid is funded through the state General Fund.

*QTR > Eq. Base = No Eq. Assistance*  
*Eq. Base > QTR = Eq. Assistance*  
*Eq. Assistance > SETR = Basic State Aid*

<sup>15</sup> A.R.S. § 15- 992  
<sup>16</sup> A.R.S. § 15- 971

**CHARTER SCHOOLS**

State aid is also provided to charter schools, which are public schools that do not have geographic boundaries, operate under terms specified in a “charter” and do not have taxing authority.<sup>17</sup> Formula costs for charter schools are completely funded by state aid from the state General Fund and do not have any other revenue sources from local taxpayers. Because the funding formula for charter schools is completely funded with state aid, there is no equalization that takes place between local property tax contributions and state aid. Instead, the charter school funding formula consists of two components: 1) BSL; and 2) Charter Additional Assistance (CAA). The BSL for charter schools is determined under the same computational formula prescribed for traditional school districts, although charter schools are not eligible for TEI increases or a 1.25 percent increase for “teacher compensation.”

***Charter School Funding = BSL + CAA***

CAA funding amounts are established in statute and are roughly comparable to a traditional school district’s DAA funding. CAA amounts are larger than DAA amounts, at least in part, due to charter schools being ineligible for the TSL and do not have access to other sources of revenue from a taxing jurisdiction (i.e. bonds and overrides).

***CAA = unweighted count x per pupil amount***

<b>FY 2017 CAA per Pupil</b>	
<b>Grades K – 8</b>	\$1,752.10
<b>Grades 9 – 12</b>	\$2,042.04

**ENDOWMENT EARNINGS**

The Permanent State School Fund<sup>18</sup> acts as an endowment account for all proceeds from state trust lands whose beneficiaries have been designated as “common schools.” When

<sup>17</sup> A.R.S. § 15-185  
<sup>18</sup> A.R.S. § 37-521

designated state trust lands are sold, the sale proceeds are deposited into the Permanent State School Fund by the State Land Department and are invested by the State Treasurer. The monies deposited into the Permanent State School Fund from the sale of state trust lands are not considered expendable.

However expendable endowment earnings on state trust lands held in benefit of “common schools” are used to offset state General Fund costs of Basic State Aid. These earnings include: 1) Permanent State School Fund investment earnings; and 2) proceeds from the lease of state trust lands and interest paid by buyers who purchase state trust land on an installment basis.

Proposition 301 limited the amount of expendable endowment earnings available to the state at the FY 2001 level of \$72.3 million and dedicated any growth above that level to the Classroom Site Fund (CSF)<sup>19</sup>, established in conjunction with Proposition 301. In FY 2017, \$69.6 million is estimated to be deposited into the CSF from endowment earnings.

### **PROPOSITION 123**

In 2010, several school districts filed a lawsuit alleging the state did not adequately fund for inflation in FY 2010 through FY 2013 as required by Proposition 301.<sup>20</sup> After several rulings and appeals the Maricopa County Superior Court found in 2014 that the state should reset the base level to what it would have been if inflation had been fully funded. The state appealed the decision and the Court of Appeals asked the parties to enter mediation to reach a negotiated settlement. In the fall of 2015, the parties agreed on a settlement and legislation was passed in a special session. In May 2016, voters approved Proposition 123.

Proposition 123 increases the distribution from the State Land Trust from 2.5 percent to 6.9 percent through FY 2025 and allocates the increased revenues to Basic State Aid rather than the Classroom Site Fund. Additionally, Proposition 123 appropriates \$50 million annually from FY 2016 through FY 2020 and

\$75 million annually from FY 2021 through FY 2025. Together, K-12 state aid is projected to increase by \$3.5 billion in the 10-year period through FY 2025.

In addition to increased state aid, Proposition 123 allows for reductions in state aid under certain economic conditions. These potential reductions are referred to as “triggers”.<sup>21</sup>

### **ADDITIONAL STATE AID**

The state provides Additional State Aid to school districts through an automatic homeowner’s rebate.<sup>22</sup> The homeowner’s rebate requires the state to pay a portion of each homeowner’s school district primary property taxes, up to a maximum of \$600 per parcel. The homeowner’s rebate percentage can vary from year to year. For FY 2017, it is estimated to be approximately 47.19 percent.

Article IX, Section 18 of the Arizona Constitution caps primary property tax rates at no more than 1 percent of a home’s full cash value. The “1% cap” applies any time a homeowner’s net combined primary property tax rate for all taxing jurisdictions exceeds \$10 per \$100 of net assessed value, even after the homeowner’s rebate is applied. The Arizona Constitution does not specify a mechanism for enforcing the “1% cap.” Historically, the cap has been implemented by having the state General Fund backfill any primary property tax costs for homeowners that exceed the cap through the Additional State Aid program.

Beginning in FY 2016, Laws 2015, Chapter 15, limited the amount of Additional State Aid provided to school districts in excess of the cap was limited to \$1 million per county. The Property Tax Oversight Committee (PTOC) is charged with evaluating each county with school districts who require more than the state-funded \$1 million limit to determine the proportion attributable to each taxing jurisdiction located within the affected school district. The PTOC determines the amount that each taxing

<sup>19</sup> A.R.S. § 15-977

<sup>20</sup> *Cave Creek Unified School District v. DeWit*, 233 Ariz. 1, (2013).

<sup>21</sup> For more information see “Ballot Proposition 123: Fiscal Impact Summary”

<sup>22</sup> A.R.S. § 15-972

jurisdiction is required to transfer to compensate the district for the pro rata share of the reduction in Additional State Aid.

The PTOC determined Pima County was liable for \$15.8 million, most of which was due to the Tucson Unified School District. Pima County sued the state and the PTOC arguing Laws 2015, Chapter 15, was an unconstitutional delegation of taxing authority to the PTOC as the power. In May 2016, the Maricopa County Superior Court issued a preliminary ruling in favor of Pima County.<sup>23</sup>

## **OTHER STATE AID PROGRAMS**

Other state aid programs include: 1) Assistance to School Districts for Children of State Employees<sup>24</sup> (ASDCSE); 2) Certificates of Educational Convenience<sup>25</sup> (CEC); and 3) Special Education Fund.<sup>26</sup> The ASDCSE program supplements Basic State Aid for school districts that educate pupils whose parents are employed and domiciled at certain state institutions located within the school district's boundaries, such as correctional facilities. CECs allow students to attend school in a school district other than the one they live in if they are placed there by an authorized state or federal agency. CECs also apply to students who reside in unorganized areas. Finally, the Special Education Fund provides funding for special education costs of students at: 1) the Arizona Schools for the Deaf and the Blind; 2) the Arizona State Hospital; 3) developmentally disabled programs administered by the Department of Economic Security; and 4) private residential facilities when a student is placed there by a state agency.

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<sup>23</sup> *Pima County v. State of Arizona* (2016)

<sup>24</sup> A.R.S. § 15-976

<sup>25</sup> A.R.S. § 15-825

<sup>26</sup> A.R.S. § 15-1182

## ADDITIONAL RESOURCES

- “An Explanation of Arizona Property Taxes (2013 Edition)”, Arizona Tax Research Association, 2013  
[http://www.arizonatax.org/sites/default/files/publications/books\\_pamphlets/file/exp\\_property\\_tax\\_book\\_atra\\_2013pdf.pdf](http://www.arizonatax.org/sites/default/files/publications/books_pamphlets/file/exp_property_tax_book_atra_2013pdf.pdf)
- “Arizona School Finance,” Justin Olson, December 2009  
[http://www.arizonatax.org/sites/default/files/publications/books\\_pamphlets/file/ATRA-Arizona\\_School\\_Finance.pdf](http://www.arizonatax.org/sites/default/files/publications/books_pamphlets/file/ATRA-Arizona_School_Finance.pdf)
- “Ballot Proposition 123: Fiscal Impact Summary,” Joint Legislative Budget Committee  
<http://www.azleg.gov/jlbc/16tnratesltr.pdf>
- “Estimated Classroom Site Fund Per Pupil Amount for FY 2016,” prepared by the Joint Legislative Budget Committee, March 2015  
<http://www.azleg.gov/jlbc/CSF-FY2016-033015.pdf>
- “Fiscal Year 2016 Appropriations Report: Department of Education,” prepared by the Joint Legislative Budget Committee, June 2014  
<http://www.azleg.gov/jlbc/16AR/ade.pdf>
- “FY 2016 Baseline: Department of Education,” prepared by the Joint Legislative Budget Committee, January 2015  
<http://www.azleg.gov/jlbc/16baseline/ade.pdf>
- “FY 2016 Truth in Taxation Notice,” Joint Legislative Budget Committee  
<http://www.azleg.gov/jlbc/16tnratesltr.pdf>
- “K-12 Inflation Funding Lawsuit Update,” prepared by the Joint Legislative Budget Committee, July 2014  
<http://www.azleg.gov/jlbc/K-12InflationFundingLawsuitUpdateR.pdf>
- Laws 2000, Fifth Special Session, Chapter 1 (Proposition 301)  
<https://apps.azleg.gov/BillStatus/GetDocumentPdf/64679>
- Pima County v. State of Arizona (2016)  
[https://webcms.pima.gov/UserFiles/Servers/Server\\_6/File/Government/Administration/CHHmemosFor%20Web/July%202016/Final%20Judgment%20Pima%20County%20versus%20State%20of%20Arizona.pdf](https://webcms.pima.gov/UserFiles/Servers/Server_6/File/Government/Administration/CHHmemosFor%20Web/July%202016/Final%20Judgment%20Pima%20County%20versus%20State%20of%20Arizona.pdf)
- “Proposition 301 Publicity Pamphlet for November 7, 2000 General Election,” prepared by the Arizona Secretary of State  
<http://apps.azsos.gov/election/2000/Info/pubpamphlet/english/prop301.pdf>
- “2014 Tax Handbook,” prepared by the Joint Legislative Budget Committee, September 2014  
<http://www.azleg.gov/jlbc/14taxbook/14taxbook.pdf>