

**Joint Legislative Budget Committee  
Staff Memorandum**

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DATE: July 20, 2018

TO: Richard Stavneak, Director

FROM: Matt Beienburg, Senior Fiscal Analyst  
Steve Schimpp, Deputy Director

SUBJECT: Proposition 305 – EMPOWERMENT SCHOLARSHIPS; EXPANSION; PHASE-IN

Proposition 305 will determine whether Senate Bill 1431 will take effect. SB 1431 made changes to the Empowerment Scholarship Account (ESA) program. Proposition 305 would do the following:

- 1) Expand ESA participation to any Kindergarten student.
- 2) Phase in eligibility of any prior public school student by FY 2021.
- 3) Revise the award amounts for ESA Kindergarteners and prior district students based on the level of district additional assistance (DAA), rather than the higher level of charter school additional assistance (CAA). This will affect students joining the program after June 30, 2017.
- 4) Allow the program to grow annually by up to 0.5% of the public school population through FY 2022, at which time overall enrollment would be capped at the FY 2022 level.

**Estimated Impact**

We estimate that Proposition 305 would decrease state General Fund costs by \$(2.4) million in FY 2020, \$(2.1) million in FY 2021, and \$(1.1) million in FY 2022 relative to current law. These estimates are speculative and actual costs will likely vary depending on several factors.

**Analysis**

Background – ESA Eligibility

The ESA program (A.R.S. § 15-2401) is currently open to Arizona resident students who meet specified criteria, such as having a disability, attending a failing school or district, living in foster care, or residing on an Indian reservation. An estimated 185,000 Arizona students will meet these or other criteria required to participate in the ESA program in FY 2019.

If Proposition 305 is approved, all public school students in grades K-3 and 6-11 would be eligible to apply for an ESA as of FY 2020. The remaining public school grades would become eligible beginning in FY 2021. Proposition 305 would only allow private school students to enter the program as Kindergarteners. These private school students could remain in the ESA program as 1<sup>st</sup> graders and beyond.

*Table 1* summarizes the estimated number of newly-eligible public school students each year under Proposition 305 based on the share of district and charter K-12 students in the applicable grades. As

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shown in the table, an estimated 725,500 public school students would become newly-eligible under the proposal by FY 2020. The cumulative number of newly-eligible public school students would rise to an estimated 966,300 in FY 2021 and 981,300 in FY 2022.

	<b>FY 2020</b>	<b>FY 2021</b>	<b>FY 2022 <sup>4/</sup></b>
Districts	584,500	762,200	763,000
Charters	<u>141,000</u>	<u>204,100</u>	<u>218,300</u>
<b>Total <sup>5/</sup></b>	<b>725,500</b>	<b>966,300</b>	<b>981,300</b>

<sup>1/</sup> An estimated 185,000 public school students are currently eligible for the ESA program under current law.

<sup>2/</sup> Under Proposition \_\_\_\_, all public school students in grades K-3 and 6-11 would be eligible for an ESA by FY 2020, the first full academic year in which the legislation would be in effect. The remaining public school grades would become eligible in FY 2021. Proposition \_\_\_\_ would only allow private school students to enter the program as Kindergarteners.

<sup>3/</sup> Based on the share of district and charter Average Daily Membership (ADM) in each grade (from Superintendent’s Annual Report, 2016-2017, Vol. I): 76.8% of district ADM in Kindergarten and grades 1-3 and 6-11; 23.2% in grades 4, 5, and 12. 73.9% of charter ADM in Kindergarten and grades 1-3 and 6-11; 26.1% in grades 4, 5, and 12.

<sup>4/</sup> Assumes 7.0% enrollment growth in charter school students and 0.1% growth in district students statewide in FY 2020, FY 2021, and FY 2022 based on recent historical trends and consistent with FY 2019 JLBC Baseline estimates.

<sup>5/</sup> Does not include the approximately 3,240 incoming private school Kindergarteners each year who will become newly-eligible under Proposition \_\_\_\_.

In addition to the estimated 981,300 newly-eligible public school schools students, the approximately 3,240 Kindergarteners enrolling in private school each year would become eligible to join the ESA program. These students could continue to receive ESA funding in the following year as 1<sup>st</sup> graders and through each subsequent year of their education. Private school students in grades 1-12 who did not join the program as Kindergarteners, however, would not be eligible to join.

ESA Participation and Costs Under Proposition 305

While the figures above reflect the number of students who would become *newly-eligible* for an ESA under Proposition 305, we estimate that fewer would *apply* and *participate* due to caps and other reasons.

Approximately 3,360 students participated in the ESA program as of FY 2017. Relative to FY 2017, participation would expand by approximately 8,000 by FY 2020 and by 19,500 by FY 2022 under Proposition 305. These estimates include the roughly 1,200 students who joined in FY 2018 and another 1,200 projected to join in FY 2019 under current law. Most of these students would receive lower ESA award amounts under Proposition 305 than under current law.

Table 2 summarizes the fiscal impact of Proposition 305 relative to current law. This impact consists of 3 different factors:

- 1) Expanding prior public school student participation would decrease General Fund costs each year, since the dollar value of ESAs under Proposition 305 is generally less than the public school formula amount. (Please see Appendix A for more information.)

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- 2) Newly-eligible private school students would increase General Fund costs each year. This impact reflects the new cost borne by the General Fund for students who otherwise would not have participated in the public school system. Not all private school students would become eligible immediately, however, as they could only enter the program as incoming Kindergartners.
- 3) Using the DAA standard in the calculation of ESA awards would also decrease General Fund costs associated with the roughly 1,200 students who enter the program each year under current law. These students would otherwise all receive ESA awards based on the higher CAA amounts. The newly-eligible public school and private school students in the above categories would also receive their award amounts based on the revised ESA formula.

**Table 2**

**Changes in Enrollment and Annual Costs for ESAs Under Proposition \_\_\_\_ Compared to FY 2017**

	FY 2020		FY 2021		FY 2022	
	#	\$	#	\$	#	\$
Prior Public School Students	4,929	(630,300)	9,783	(1,174,500)	14,455	(1,672,600)
Private School Students <sup>1/</sup>	147	385,100	365	1,423,400	750	3,196,800
Current Law New Applicants <sup>2/</sup>	2,944	(2,137,700)	3,569	(2,360,800)	4,291	(2,611,100)
<b>Total <sup>2/</sup></b>	<b>8,020</b>	<b>(2,382,900)</b>	<b>13,717</b>	<b>(2,112,000)</b>	<b>19,496</b>	<b>(1,086,900)</b>

<sup>1/</sup> Proposition \_\_\_\_ would only allow private school students to enter the program as Kindergartners. These private school students could remain in the ESA program as 1<sup>st</sup> graders and beyond.

<sup>2/</sup> Includes new applicants each year who are already eligible under current law, including 1,200 ESA participants who joined in FY 2018 and a projected 1,200 who will join in FY 2019, most of whose ESA awards would be reduced under Proposition \_\_\_\_.

The fiscal estimates shown in *Table 2* are based on the following assumptions:

- A. If approved, Proposition 305 would allow students to qualify as early as December 2018 for the revised ESA program. Given that it is midway through the 2018-2019 school year and that students cannot receive both an ESA and School Tuition Organization (STO) scholarship in the same year, we have assumed that the expansion impact would be limited in FY 2019.
- B. The application rate among newly-eligible “prior public school” students would grow from 1.5% in FY 2020 to 2.6% in FY 2022. The assumed 2.6% rate is based on historical program participation among currently-eligible students. Given that it took over 5 years from the inception of the ESA program to reach that level among the currently-eligible population (primarily students with disabilities and those from D and F districts), we assume that marketing ESAs to an entirely new population (non-disabled students and those from non-D and F districts) will likewise require more time to reach a long-term participation rate.
- C. Private schools will be able to absorb additional students to meet increased demand from those switching from public schools. Current private school enrollment is approximately 45,000. Based on a December 2016 EdChoice survey, there may be current capacity for approximately 16,000 more students. Our analysis assumes ESA enrollment grows by 19,496 through FY 2022. If all of these students go to private schools (rather than being home schooled), that would represent an increase of over 40%. If the private school system does not expand rapidly enough, ESA enrollment and savings could be lower.

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- D. The ESA application rate among newly-eligible incoming private school Kindergarten students would increase each year until it peaked at 40%. Based on estimates from the Catholic Dioceses of Phoenix and Tucson (which comprise nearly half of the state's private school population), approximately 2.7% of private school students currently participate in the ESA program. We assume an increase in applications to 10% among newly-eligible incoming Kindergarteners in FY 2020, doubling to 20% in FY 2021 and 40% in FY 2022.
- The existence of Student Tuition Organizations (STO) scholarships will affect the ESA application rate of incoming private school Kindergarteners. Private school students are eligible for STO scholarships funded via income tax credits, but students cannot qualify for both an ESA and STO scholarship at the same time. The 73,600 STO scholarships awarded in FY 2016 (the last year for which data is available) averaged roughly \$1,800 per award. Since students may receive multiple STO scholarships and the Department of Revenue reports only the number of scholarships awarded—rather than the number of individual recipients—we do not know how much each recipient typically receives on average. Over time, however, as the number of private school students participating in the ESA program increases, the number of STO eligible students would decline (given that students may not participate in both). As a result, STO scholarships would presumably be awarded to fewer students, but at a higher average award amount per recipient. This could ultimately render a STO scholarship larger, on average, than an ESA, eventually limiting the comparative appeal of, and participation rates in, the ESA program.
  - If the ESA application rate among these students were 85% each year beginning in FY 2020, those who successfully enroll under the cap would cause Proposition 305's net General Fund impact to be a \$137,400 cost, rather than the projected \$(2.4) million savings by FY 2020, and a \$8.6 million cost, rather than a \$(1.1) million savings by FY 2022. Given the existence of STOs and the dual participation prohibition, an 85% ESA application rate seems unlikely.
  - Over time, the long-term costs of newly-eligible private school students will likely continue to rise as additional incoming cohorts replace those who were not eligible for ESA participation when they began as Kindergarteners. This increase would continue through 2032 until all K-12 cohorts were eligible as Kindergarteners. These long-term impacts, however, would depend heavily on families' awareness of, and relative preference for, the ESA program versus STO scholarships.
- E. 60% of newly-eligible prior public school participants would qualify for the 100% ESA formula calculation. Under Proposition 305, a student whose family income does not exceed 250% of the federal poverty level (FPL) (currently \$62,800 for a family of 4) may qualify for ESA funding equivalent to 100%, rather than 90% of the formula. According to ADE, 56% of students qualify for free or reduced price lunch statewide, which requires a family income less than 185% of the FPL. We therefore estimate that approximately 70% of students have family incomes less than 250% of the FPL. Since some families may not seek the required Department of Revenue verification of their income, however, we assume that 60% of newly-eligible prior public school participants would qualify for the increased ESA funding.
- F. 50% of newly-eligible incoming private school Kindergarteners are projected to have family incomes below 250% of the FPL. This assumes that private school students are less likely to fall below 250% of the FPL than public school students.

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- G. 7% of new ESA applicants switching from district schools are estimated to come from non-state aid districts. Non-disabled students from non-state aid districts represent a new cost to the General Fund (since their Basic State Aid is otherwise funded by local funds) of approximately \$5,228-\$5,503 per student (depending on income level). However, the state General Fund already pays roughly \$1,000 of this cost via the “Homeowner's Rebate” per non-state aid student.
- H. 22% of non-state aid district students are from minimum qualifying tax rate (“MQTR”) districts. These students do not represent an additional cost to the General Fund. Although they will generate a new ESA formula cost, each student switching from a MQTR district increases the district's MQTR payment to the General Fund by an amount that meets or exceeds the new ESA cost.
- I. Approximately 1,200 additional students who are already eligible for ESAs under current law would seek to join the program each year. We assume 60% have family incomes below 250% of the FPL and 50% have disabilities. (FY 2018 ESA data from ADE indicate that 58% of current ESA participants are disabled.)
- J. If ESA demand exceeds the annual cap, available ESA slots each year would be filled by prior public school students, incoming private school Kindergarteners, and students eligible for an ESA under current law proportionately based on the number of applications from each. As a result, the actual participation rate of each group would be lower than their respective application rates beginning in FY 2020. *(Please see Appendix B for more information.)*

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**Appendix A**

Background – ESA Costs

Table 3 displays the estimated per pupil General Fund impacts of ESA participants under Proposition \_\_\_\_ compared to if a student remained in public school or other non-ESA programs. For example, a newly-eligible, non-disabled student whose family income exceeds 250% of the FPL and who switches to the ESA program would save the General Fund an estimated \$(369) if switching from a charter school and \$(549) if switching from a district school.

ESA Formula % <sup>2/</sup>	Estimated ESA (Savings) or Cost Per Pupil <sup>1/</sup>					
	Disabled Students <sup>3/</sup>			Non-Disabled Students		
	Former Charter	Former District	Other <sup>4/</sup>	Former Charter	Former District	Other <sup>4/</sup>
90%	\$(1,338)	\$(1,546)	\$24,187	\$(369)	\$(549)	\$5,114
100% <sup>5/</sup>	\$0	\$(273)	\$25,460	\$0	\$(273)	\$5,383

<sup>1/</sup> Estimated fiscal impacts as of FY 2020.  
<sup>2/</sup> Students whose family incomes exceed 250% of the FPL receive 90% of the BSL and additional assistance amount. An additional 5% administrative allowance is added to the General Fund cost for these students.  
<sup>3/</sup> Qualify for special education “Group B” funding pursuant to A.R.S. § 15-943.  
<sup>4/</sup> Includes ESA students who otherwise would not attend public schools, which could include some incoming private school Kindergartners, disabled preschoolers and military dependents, since A.R.S. § 15-2401 does not require these students to attend public school prior to receiving an ESA.  
<sup>5/</sup> Under Proposition 305, new ESA participants whose family incomes do not exceed 250% of the federal poverty level would receive 100% of the BSL and additional assistance amount they would otherwise receive as public school students. Students switching from a district school would still generate an average General Fund savings of approximately \$(273) due to savings from transportation funding costs, which are not included in the ESA formula.

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## Appendix B

### Impact of Enrollment Cap on ESA Participation by Student Type

Through FY 2019, marginal expansion of the ESA program each year is limited by Laws 2013, Chapter 250 to 0.5% of total Arizona public school enrollment in the prior year. The ESA cap has not been met in any year under current law.

Proposition 305 would extend this annual 0.5% expansion limit through FY 2022 before permanently capping ESA enrollment at the FY 2022 level starting in FY 2023. Consequently, no more than an estimated 5,548 students could join the program in FY 2019, followed by 5,620 in FY 2020, 5,697 in FY 2021, and 5,779 in FY 2022.

There are 4 main factors that will influence the level of ESA participation under Proposition 305:

- 1) Conversion of public school students to private schools.
- 2) Application rate of Kindergarteners who would have enrolled in private school anyway.
- 3) Enrollment among currently-eligible students (e.g., disabled students, foster children, etc.).
- 4) The annual cap on new ESA enrollments.

As described above, due to the cap on the number of new ESA accounts that may be opened in any given year, not all students seeking to join may be able to do so. As shown in *Table 4*, for example, an estimated 12,407 students would apply for an ESA in FY 2020 (including prior public school students, incoming private Kindergarteners, and currently-eligible students), but only 5,620 slots would be available, or enough to accept 45% of the applicants. Our analysis allocates the available ESA slots proportionally to each type of student. As a result, 45% of the applicants from each group (prior public school students, private school Kindergarteners, and currently-eligible students) would receive an ESA in FY 2020.

The backlog of public school students and current law applicants who are unable to join in FY 2020 would presumably attempt to do so again in FY 2021, so they are added back to the pool of applicants. The remaining private school Kindergarteners in FY 2020, however, would be unable to join the following year, as they would be neither prior public school students nor incoming Kindergarteners at that point, and therefore not qualify to apply again.

<b>Table 4</b>			
<b>Newly-Eligible ESA Students and Projected Participation Rates</b>			
	<u>FY 2020</u>	<u>FY 2021</u>	<u>FY 2022</u>
<b>Newly-Eligible Students under Proposition 305 <sup>1/</sup></b>			
Prior Public School Students	725,509	966,272	981,317
Application Rate	1.5%	2.0%	2.6%
Private School Students <sup>2/</sup>	3,240	3,240	3,240
Application Rate	10%	20%	40%
<b>New ESA Applicants Seeking to Participate <sup>3/</sup></b>			
Prior Public School	10,883	14,396	15,732
Private School Students	324	648	1,296
Current Law Applicants <sup>4/</sup>	<u>1,200</u>	<u>1,856</u>	<u>2,431</u>
Subtotal	12,407	16,900	19,459
<b>ESA Cap <sup>5/</sup></b>	5,620	5,697	5,779
<b>New Successfully Enrolled ESA Participants (marginal) <sup>6/</sup></b>			
Prior Public School	4,929	4,852	4,672
Private School Students	147	218	385
Current Law Applicants	<u>544</u>	<u>626</u>	<u>722</u>
Subtotal	5,620	5,697	5,779
Cumulative Growth Under Proposition 305 <sup>7/</sup>	8,020	13,717	19,496
<b><u>Backlog (added to following year) <sup>8/</sup></u></b>			
Prior Public School Students	5,953	9,544	11,061
Private School Students	--	--	--
Current Law Applicants	656	1,231	1,709

  

- 1/ Under Proposition 305, all public school students in grades K-3 and 6-11 would be eligible to apply for an ESA by FY 2020, the first full academic year in which the legislation would be in effect. The remaining public school grades would become eligible in FY 2021. Increase in eligibility in FY 2022 is due to statewide enrollment growth. Proposition 305 would only allow private school students to enter the program as Kindergarteners.
- 2/ Assumes 3,240 of the approximately 45,000 students attending private school in Arizona each year are incoming Kindergarteners. Under Proposition 305, these students would be eligible to join the ESA program in their Kindergarten year without having first attended a public school.
- 3/ Represents the number of students seeking to join the ESA program each year under Proposition \_\_\_\_\_. Estimates are based on the number of newly-eligible students multiplied by the assumed application rate. Includes any "backlog" from the prior year, except for incoming private school Kindergarteners, who cannot join in subsequent years if they miss the opportunity as Kindergarteners.
- 4/ Includes 1,200 new students expected to apply each year who are already eligible under current law. Does not include 1,200 students who joined in FY 2018 or 1,200 who are projected to join in FY 2019 whose ESA award amounts could be reduced by Proposition 305. (Under the legislation, students who received an ESA prior to June 30, 2017 may not have their award amounts reduced).
- 5/ Under the 0.5% growth cap, only 5,620 - 5,779 newly-eligible participants could join the program in each of FY 2020 - FY 2022.
- 6/ If the number of ESA applicants exceeds the annual cap, available ESA slots each year would be filled by prior public school students, incoming private school kindergarteners, and students eligible for an ESA under current law proportionately based on the number of applicants among each type. (For example, if only half as many ESA spots are available as there are applicants, then half of all prior public school applicants, half of all incoming private school Kindergarten applicants, and half of all applicants eligible under current law would receive a spot). As a result, the actual participation rate of each group would be lower than their respective application rates.
- 7/ Student counts correspond to total estimated enrollment shown in Table 1. Includes 2,400 students assumed to have joined in FY 2018 and FY 2019 who are already eligible under current law and whose ESA award amounts could be reduced by Proposition 305.
- 8/ Represents the number of students seeking to join the ESA program in each year who would not receive a spot due to the ESA enrollment cap, but who would be eligible to reapply the following year.