

## Proposition 123 Background

### Land Trust Endowment Distributions

- Proposition 123 amended the Arizona Constitution to increase the land trust distribution for K-12 schools and other beneficiaries from 2.5% of the average value for the previous 5 calendar years to 6.9%, or a 4.4% increase, from FY 2016 through FY 2025.
- The additional monies from the 4.4% increase for K-12 schools were used to offset the General Fund cost of an increase to the Base Level component of the K-12 Basic State Aid formula beginning in FY 2016 as part of the settlement of the *Cave Creek v. Ducey* litigation.
- Proposition 123 stipulates that the land trust distribution reverts to the previous 2.5% level beginning in FY 2026. The Base Level formula amount, however, would not automatically be subject to a corresponding decrease, as Proposition 301 stipulates that the Base Level and Transportation Support Level must be adjusted annually for inflation. As a result, absent legislative action to reduce other parts of the K-12 formula, the General Fund would backfill the amount of land trust distributions for the K-12 formula on a dollar-for-dollar basis.
- We currently estimate the cost of the General Fund backfill within the K-12 Basic State Aid formula in FY 2026 would be \$282.9 million.
- Proposition 123 also stipulates that if the 5-year average value of the land trust endowment declines in comparison to the 5-year average from the previous year, the Legislature, with the Governor's approval, may enact legislation that reduces the land trust distribution below 6.9% but no lower than 2.5%. In that circumstance, the Legislature may reduce the Base Level for the next fiscal year by an amount that is commensurate with the reduction in the Permanent State School Fund.
- The 5-year average market value of the fund has not declined since the implementation of Proposition 123. In May 2016, the market value of the fund was \$4.92 billion. As of November 2022, the market value of the fund had increased to \$6.89 billion.

### Extending Proposition 123

- The formula for the land trust distribution is established in the Arizona State Constitution. As a result, any changes to the formula or extension of Proposition 123 would require a voter-approved amendment to the Arizona State Constitution. The Legislature would need to determine whether such a ballot measure would be voted on as part of a special election or the next general election (November 2024).
- Arizona has also received Congressional approval for prior changes to the state's land trust distribution, as the Arizona Statehood and Enabling Act of 1910 establishes Congressional oversight of Arizona's distribution of state land trust monies. Congress most recently consented to state changes to our land trust distributions in December 1999 (P.L. 106-133) and in March of 2018 (P.L. 115-141). In both instances, Congressional consent occurred after Arizona voters had already approved amendments to the Arizona State Constitution.
- In recent state and federal litigation related to Proposition 123, the parties disputed whether the Arizona Statehood and Enabling Act Amendments of 1999 consented to only the changes to the distribution formula that were approved by Arizona voters in 1998 or if the amendments also authorized the state to modify the distribution formula through amendments to the Arizona State Constitution without further Congressional consent. The Courts did not decide whether Congressional consent would be required for future changes to the land trust distribution and, if so, whether such consent would have to occur before or after any formula changes go into effect.

### Economic and K-12 Spending Triggers

- Proposition 123 also establishes "triggers" that either permit the Legislature to suspend inflation adjustments to the Base Level and Transportation Support Level (TSL) that would otherwise be required by A.R.S. § 15-901.01 or prohibit such adjustments. These triggers are tied to economic conditions or K-12 spending and have not been met since Proposition 123 was implemented.
- The economic triggers are in effect now and do not expire. They are as follows:
  - If both the state Transaction Privilege Tax (TPT) growth rate and the total nonfarm employment growth rate are at least 1% but less than 2%, the Legislature is permitted, but not required, to suspend K-12 formula inflation adjustments for the following state fiscal year.
  - If both the state TPT growth rate and the total nonfarm employment growth rate are less than 1%, the Legislature shall not make K-12 formula inflation adjustments for the following fiscal year.
- The K-12 spending triggers do not take effect until the FY 2026 budget based on FY 2025 spending levels. The triggers do not expire. They are as follows:
  - If the General Fund appropriation to the Arizona Department of Education (ADE) is between 49% and 50% of total General Fund appropriations for the current fiscal year, the Legislature is permitted, but not required, to either: a) suspend the inflation adjustment for the following fiscal year or b) reduce the Base Level for the following fiscal year by the amount of the inflation adjustment that would have otherwise been required (maximum (2)% reduction).
  - If ADE's General Fund appropriation is 50% or more of total General Fund appropriations for the current fiscal year, the Legislature is permitted, but not required, to either: 1) suspend the inflation adjustment for the following fiscal year or 2) reduce the Base Level for the following fiscal year by two times the amount of the inflation adjustment that would have otherwise been required (maximum (4)% reduction).
  - In FY 2023, K-12 spending represents 43.7% of General Fund appropriations. Under our January Baseline projections, we estimate that K-12 spending would reach a high point of 49.7% of General Fund appropriations in FY 2026.

### State Aid Supplement

- Laws 2015, 1<sup>st</sup> Special Session, Chapter 1, which was adopted as companion legislation to the Proposition 123 referendum, advance-appropriated \$50.0 million from the General Fund in each year from FY 2016 through FY 2020 and \$75.0 million in FY 2021 through FY 2025 for a state aid supplement. Since these monies were not in the ballot proposition, they were not subject to voter approval.
- The state aid supplement distributed to districts and charters on a pro rata basis using weighted student counts. These amounts have been classified as ongoing in prior budgets.
- At its own choosing, the Legislature has the option of continuing the \$75 million or modifying the dollar amount.