

Confusion reigns; at best, the state of the state seems to be unsettled.

# EDUCATION FINANCE IN ARIZONA: 1997 THE UNSETTLED STATE OF THE STATE

Mary P. McKeown

As the 1997 session of the Arizona Legislature began on January 13, the state's largest newspaper, the *Arizona Republic*, proclaimed in its headlines that school finance was the most important topic to be taken up by the legislature. The senate majority leader declared school financing "the first among equals" in the issues to be addressed during the legislative session.<sup>1</sup> At the same time, the Governor filed a law suit asking the state supreme court to remove a deadline on fixing the school finance system which the supreme court in 1994 found unconstitutional. The Governor claimed that the system's problems had been corrected and no further remedies were needed.

These mixed messages—on the one hand, a legislature intending to repair inequities in a school finance system that the state supreme court had declared unconstitutional; and on the other hand, a Governor who thinks the system is "fixed" by a \$100 million construction fund—are delivered at the beginning of what promises to be an historic year for Arizona schools, perhaps the year of reform of elementary and secondary school funding.

This confused state of the state has existed before in Arizona. The 1993, 1994, 1995, and 1996 sessions of the Arizona legislature also were expected to mark watershed reform of elementary and secondary education. And just like the last four years, the 1997 legislative session has the potential to be especially rancorous. For example, 45 votes were needed to elect the Speaker of the House, who then immediately fired all the senior education House staff. In addition, in a state that has a Republican legislature and a Republican governor, there has been an amazing amount of discord between the governor and the legislative leadership over education funding.

Arizona is enjoying another boom year related to state finances; revenues have increased over 6 percent so far during the current fiscal year. Fiscal Year 1998 revenues are pro-

jected to increase another 6 to 8%. At the beginning of the current fiscal year, the state had a budget surplus of over \$300 million (approximately 5% of the state general fund), which is kept in a rainy day fund. Funds in the rainy day fund grew to over \$400 million by January 1, 1997.

Yet, despite increasing state revenues and a state supreme court ruling that the school finance system is unconstitutional, little additional funds are earmarked for education in the Governor's or the legislative budget staff Fiscal Year 1998 budget proposals. The legislature and governor appear to disagree on how to fix the school finance formula, with the state's top Democrat calling the Governor "arrogant, removed, and distant" from the state's school finance dilemma.<sup>2</sup> It is against this backdrop that reform of Arizona school finance will take center stage in 1997.

## History of Arizona School Reform

The current "reform" movement in Arizona began in 1990 when Governor Symington appointed a task force of educators, citizens, and business persons who proposed a sweeping package of over 60 educational reform items, including vouchers, charter schools, site-based management, and additional at-risk programs. The cost of the proposals exceeded \$200 million the first year. Despite significant publicity, nothing passed through the 1991 legislature.

During the 1992 and 1993 sessions, notable legislation to reform education was introduced by the chairs of the House and Senate Education Committees. Severe differences of opinion among legislators and the Governor appear to have prevented passage of any of these legislative packages. The Governor insisted that public school reform should follow sound business principles of competition (which he defined to be vouchers for private schools), before he would support additional funds for the public schools. The majority of legislators seemed to believe that the public schools should be funded adequately before any private school funding could be approved.

Adequate funding of the current school finance formula likely would require new taxes. (The current formula has been in effect since 1980.) However, Arizona's citizens passed Proposition 108 in the fall of 1992, and that proposition requires a two-thirds majority of both houses of the legislature for any tax increase. Given Arizona's political climate of fiscal conservatism, and Republican control of the Governor's office and both houses of the legislature, new taxes are unlikely.

During the 1994 session of the legislature, a series of bills reforming the public schools were pre-filed, i.e., filed before the session began. Called the "Essentials of Education Reform," the legislation stated that it was the legislature's intent to ensure that the state would provide quality educational opportunities and to revise taxation so that the school funding formula could be corrected. A critical component of the reform effort was parental involvement in the schools so that attendance, discipline, and school safety would be improved.

## Charter Schools

The charter schools components of the reform package passed in modified form in 1994. Charter schools are permitted for the purpose of providing a unique setting for learning that would improve student achievement. As a primary part of the "choice" component of the 1994 reform package, charter schools were envisioned as providing choices outside the public schools, but are funded like a public school, and are expected to more closely meet the unique needs of child(ren).

Any applicant for a "charter" may petition a school district governing board or the state board of education to approve establishment of a charter school. The application includes a mission statement for the school, a financial plan, hiring policy,

---

Mary McKeown, Arizona Board of Regents and Past President, American Education Finance Association.

description of facilities, and an outline of the criteria to be used to measure effectiveness of the school. The school or state board must act on approval within 90 days. Local school boards assume no legal responsibility for schools chartered by the state board of education, but do have responsibility for schools chartered by the local school board itself.

The charter is effective for five years, and requires that the school be non-sectarian and non-discriminatory. Teachers previously employed by a school district do not lose any rights of certification, retirement, salary status, or any other benefits provided by law if the teacher returns to the school district from the charter school within three years. Funding for charter schools is based on the same method as the public schools, with assessed values of property and student counts determined, and included in the state funding formulas. Pupils "move" from school districts to the charter schools exactly as if this "move" was from one school district to another, and this movement impacts funding for the local school district in the same way as a move to another district. The loss of one student to a charter school increases the district's assessed value per student, and has the same impact as a student's dropping out or moving out of a district.

Local districts may "sponsor" charter schools, with the local district receiving current year funding for students in their charter schools. The distinction of "current year" funding is an important one in Arizona's funding formula, which bases the general state aid formula on the prior year's student count, except for charter schools. Consequently, any new student added to a school district through its sponsorship of a "charter" school which had been a private school adds state general fund support for the local district. This provision will be discussed further below.

During Fiscal Year 1997, local school districts enrolled approximately 3,100 students in schools the districts chartered; and \$10.7 million was appropriated for these schools. The Governor's budget proposal included \$28 million for Fiscal Year 1998. In addition to operating funds, district sponsored charter schools may receive state appropriations for capital costs of charter schools start-up. Capital funding is allocated to the district through a provision in the funding formula called the "Capital Outlay Growth Factor."

For Fiscal Year 1998, the Joint Legislative Budget Committee (JLBC) staff recommend a reduction in funding for district sponsored charter schools, and a change in the manner by which capital funds are allotted. JLBC staff state that the current funding formula for capital provides an incentive for schools wishing to become "chartered" to affiliate with small districts (i.e., districts with few students) so that the growth factor in the funding formula would be higher and result in additional state dollars.<sup>3</sup>

Approximately 46 schools received state charters to begin operations in Fall, 1995, but only 42 state approved charter schools were in operation in 1997, enrolling over 14,000 students at a total cost of \$62 million.<sup>4</sup> School districts watched anxiously the impact these schools had on state revenues through the school funding formula. In Fiscal Year 1996, \$16,300,000 was appropriated for the operation of state charter schools as part of the basic aid formula. For Fiscal Year 1997, this appropriation increased to \$66.4 million, and the Governor's budget proposal for Fiscal Year 1998 includes \$92.6 million, based on 21,500 students. The Governor's recommendations include \$175 per student for transportation costs.

The largest of the charter schools, Valley Academies, with about 500 students, faced financial difficulty almost from the beginning of its existence. Disaster, in the form of forced closure, was averted when a parent "loaned" the fledgling school several million dollars to make required repairs to bring the school up to state building codes and to cover payroll costs for

the teachers and other personnel. Almost all of the charter schools are in the state's two metropolitan areas, Phoenix and Tucson, in predominantly middle and upper-middle class neighborhoods. In January, 1997 one of the charter schools had its charter revoked because of financial irregularities.

#### *Site Based Management*

In addition to charter schools, the 1994 legislative package included provisions for reform of the schools through a "decentralization process" that empowered school councils and site based management teams. Parents, principals, teachers, non-certified employees, pupils, and community members could become members of school councils for each school and develop plans to improve the school and achieve goals reflected in an annual report card. Annual report cards would describe the current academic goals of the school, the previous year's goals and progress in achieving the goal, test results, attendance rates for teachers and pupils, number of career ladder teachers, number of violent incidents, and a description of services available.

#### *Vouchers*

Included in the Governor's 1994 package were provisions for "parental choice grants" or vouchers for students attending any Arizona public or private school accredited by the North Central Association. During Fiscal Years 1995 and 1996, 2,000 students not enrolled in a private school during the previous year were to be included; the program would expand to 4,000 students in 1997 and 1998, and reach 8,000 pupils by 1999. Parental choice grants would be available to students who met the economic eligibility requirements for free lunch.

The state superintendent, who campaigned on a platform of vouchers and educational reform, and who is a former Chair of the House Education Committee, had a voucher bill introduced in the 1995 legislative session, with the full support and endorsement of the 1995 chairs of House and Senate Education committees and the Governor. Despite these endorsements, vouchers did not pass in 1995; they reappeared during the 1996 legislative session, met a quick death, but are expected to return during this session.

#### *Property Tax Reform*

In addition to school reform, both the 1995 and 1996 legislatures provided \$200 million tax reductions. The 1996 \$200 million tax reduction was a property tax reduction. Maintenance of current levels of funding for local school districts will require tax overrides for many districts; tax overrides have about a 50% chance of passing in Arizona. The 1996 legislation eliminated the state property tax rate, which had been 47 cents per \$100 of assessed valuation, and it reduced the qualifying tax rate for state school aid. This legislation will be watched closely to determine the impact on local school district revenues.

#### **Legal Challenges to Funding Formulas**

In 1993, four school districts and several parents filed suit challenging the provisions of the Arizona school finance system related to expenditures for buildings, equipment, and other capital items. The plaintiffs alleged that the capital funding formulas resulted in massive inequities in the quality and types of capital facilities available to students in the various Arizona school districts and that these inequities were in violation of Arizona constitutional mandates for a general and uniform public school system and equal protection of the law. The suit also claimed that Arizona violated its constitutional duty to maintain, develop, and improve the common schools and high schools by failing to fund sufficiently property-poor districts that had substandard and unsafe facilities.

Oral arguments on the case were heard in the Arizona supreme court in November of 1993. The Court ruled that not only was the capital funding portion of Arizona's school funding scheme unconstitutional, but that the entire school finance method did not meet the general and uniform provisions of the constitution. The finding for the plaintiffs requires revision of the capital funding formulas and the entire general state aid formula. It also requires that the state must provide an adequate education, but that disparities caused by local control above the statewide system did not "run afoul of the state constitution."

The court directed the legislature to develop a statutory scheme for funding of the public schools that would comply with the general and uniform provisions of the constitution. The legislature was "to enact appropriate laws to finance education in the public schools in a way that does not itself create substantial disparities among schools, communities or districts."<sup>5</sup> No time limit was specified.

Arizona provides some capital funding for local school districts through a special capital funding portion of the general state aid formula. However, the primary source of facilities funding is school district bonding. Just as in other states, the ability to sell bonds is dependent upon on local school district property wealth. Arizona's school districts vary widely in the amount of property wealth per pupil, ranging from near \$1,000 per student to over several million per student. Such great variation in property wealth is difficult to correct in a general state aid formula. The law suit was brought over this provision of the funding formula.

During spring of 1996, the legislature was directed to meet in special session to reform school finance to meet the directive of the state supreme court. (Arizona's legislature may meet in special session at the call of the Governor at any time, including at a time concurrent with the regular session.) During a special session concurrent with the regular 1996 session, the legislature established a Capital Equity Fund, and a State Board for School Capital Facilities to oversee distribution of revenues to local school districts. The Board itself is comprised of nine members appointed by the President of the Senate, Speaker of the House, and the Governor. The Board has a staff of five and operating budget of \$600,000.

The legislation appropriated \$30 million a year for the next ten years from the earnings of the Permanent State School Fund to be distributed as loans or grants to school districts for buildings, land, capital improvements, vehicles for pupil transportation, equipment, or technology. Distributions are made according to need, as determined by priorities set by the Board. Districts are eligible for aid if they have low wealth, high tax rates, or insufficient bonding capacity. A local share related to district wealth is required, but may be waived by the Board. The Board also may choose whether to distribute aid in the form of a loan or a grant.

The plaintiff school districts believed that the \$30 million appropriated was insufficient to meet the outstanding needs of school districts, and asked for additional resources. The plaintiffs also threatened to return to court to have the amount declared inadequate. Others in the education arena agreed that the amount was insufficient to address all the needs but believed that the system should begin operation to assess what actual needs were, and what the second stage of reform should involve. Conservatives, like the Governor, denied the existence of a problem, and appear to resent the intrusion of the court.

As a result, the Governor indicated that he would call another special session of the legislature as soon as agreement on a solution could be reached. But, no agreement could be reached between the Governor, the state superintendent, and the legislative leadership until July. On July 18, 1996 the Governor signed into law a bill that critics say does nothing to

solve the underlying funding inequity that prompted the supreme court decision.

The second special session legislation added \$70 million from the State General Fund to the original \$30 million from the earnings of the Permanent State School Fund. The operating costs of the State Board for School Capital Facilities are a part of the \$100 million appropriation. Consequently, \$99.4 million is available during Fiscal Year 1997 for grants and loans.

This special fund for school repairs and construction has as its top priority correction of emergency health and safety needs. The Board established a three stage priority process for eligible districts: first, there is an expedited process for buildings that have potentially serious health and safety issues as identified by the legislative Joint Committee on Capital Review (JCCR). The JCCR is comprised of members of the House and Senate Appropriations Committees. The second priority are those projects identified as health and safety issues that do not fall into the first category; all other capital needs are given third priority.

School leaders quickly identified over \$600 million of needs for this \$100 million fund. About \$25 million needed for 18 priority projects fall into the expedited category. Over 600 projects totaling \$154 million are in category 2, and 680 projects with a cost of \$420 million are in category 3. As of January 1, 1997, a little more than \$4 million has been awarded for projects that have potentially serious health and safety issues. The Board intends to review all 1,300 applications for aid and award the entire \$99.4 million during the fiscal year. (They will be very busy during the next six months.) Awards will not be made or funds disbursed until projects go through a design, bid, and review process. Staff of the Board have determined that approximately 25% of the cost of the projects would be funded by the state, and the remainder should be funded by the districts.

A commission to study the issuing of bonds for capital needs also was created by the special session legislation. The Governor is calling the legislation "a permanent fix," but others (including the lawyer representing the school districts that brought the original case) say that the bill is only a first step because it does not end discrepancies in funding.

In November, 1996, a superior court judge warned lawmakers that, unless they act to revamp the entire school funding system by June 30, 1998, she will order the state to shut down the entire school system. Judge Rebecca Albrecht ruled that, although the legislature had taken a few positive steps, legislators have not systematically removed the disparities created by the school finance system. The judge said that a reasonable time had passed to correct the problems. The state superintendent lauded the rules, but the Governor immediately appealed the ruling to the supreme court, contending that the system was fixed by the establishment of the capital fund.

In January, 1997 the state supreme court upheld Judge Albrecht's ruling, confirming that June 30, 1998 is the deadline for reform of the school finance system. The Governor continues to maintain that the system is fixed, while legislators have produced a number of proposals. None of the proposals have details worked out, and none of the proposals has a majority of legislators supporting it.

There is disagreement among legislative leaders on how extensive reform should be, with those supporting the Governor reluctant to tinker at all, and some leaders arguing for complete structural overhaul. A district power equalizing plan with recapture has been proposed by some, including the Senate majority leader. The chair of the Senate Education Committee, on the other hand, prefers to solve the problem by targeting aid to only those districts which truly need help, without making any structural changes. Another proposal would pool commercial property taxes and distribute equal amounts statewide, and yet another would change assessment ratios.

Education organizations have proposed their own reform, which calls for funding for special and bilingual education, and an increase in the special construction fund. In any case, reform will occur, or the courts will develop their own plan.

#### Arizona School Funding in 1997

The majority of state funding for elementary and secondary schools in Arizona is distributed through the Basic State Aid formula. The formula is comprised of components that limit funding for maintenance and operation of the schools, capital expenditures, and transportation. For FY 1997 Basic State Aid for the schools was estimated to be \$1,802,989,600; or \$1,949,269,000 when "additional state aid" is included. Beside Basic State Aid there are five other formula programs and 20 non-formula programs that comprise a total of \$50 million in funding.

The statutory funding formula for K-12 was enacted in 1980, modified in 1985, and equalizes funding among the school districts while placing limits on the amounts that can be spent. Districts with similar characteristics have similar budget limits. The Basic State Aid formula limit is based on the district's prior year average daily membership, weighted by handicapping conditions, size of school, and other factors. The student count may be modified for districts whose enrollments decline more than 5% for the budget year or for those districts who experience growth in excess of 3%. The 1997 budget bill included \$20 million to change this to the current year enrollment count, and reduced the requirement for growth funding to 2% in 1997 and removed the percentage limit totally in Fiscal Year 1998. Cost to implement current year enrollments in the funding formula is over \$33 million for 1998. Weighted student count is multiplied by a dollar amount to determine the Base Support Level. Districts with teacher experience greater than the state average or those with career ladder programs have higher base levels. The base level was adjusted each year by the growth in the Gross Domestic Product Implicit Price Deflator. The inflation factor was not fully funded for a number of years, and was eliminated completely in 1995 for the 1996-97 year. As a result, school districts have frozen salary schedules, increased class size, and transferred capital funds to operating. This transfer is allowed under state law, and was mentioned by the supreme court as one of the exacerbating factors in their ruling of inequity in the school finance system.

The 1995 state aid budget rolled forward into the next fiscal year \$53,500,000 of Basic State Aid, as it has since 1988 to "balance" the state budget. In 1996, this practice was stopped, and school districts received the full amount of the funding formula. In addition to the Basic State Aid formula, "Additional State Aid" is given to school districts whose revenues are affected by the "homeowners' property tax rebate program." Under this program, the primary tax liability of homeowners in certain income classes is reduced by 35%. The 1990 Tax Reform Act included provisions to reduce the rebate by 5% per year until phase out in 2001. However, the FY 1995 budget froze the rebate at 35%.

#### Conclusions

The Arizona legislature is likely to continue to "reform" the elementary and secondary schools and the school finance system. Since the supreme court ruled that the deadline for reform of the finance system is June 30, 1998, the legislature may need to meet again in special session to rewrite the basic state aid formula as well as the capital funding formula. Because the Governor and legislative leadership do not agree on reform measures, crafting an acceptable funding compromise that could meet the requirements of the court may be an impossible mission. The acrimony that accompanied the beginning of the legislative session does not portend a positive outcome, unless the rhetoric is toned down and reasonable behavior prevails.

Charter elementary and secondary schools are just beginning to operate, and will have long-term impacts on basic school funding formulas. "Parental choice" and open enrollment in the elementary and secondary schools also are likely to be continuing areas of interest to a very conservative legislature.

1996 was an election year for all state legislators in Arizona. Because the pressures of campaigning were great, there was some question about whether the legislature really would meet in special session to address school funding issues. When they did meet and passed out a bill, it was a temporary measure that did not "fix" the underlying inequities.

Over 25% of the 1997 Arizona legislature are freshmen; both senate and house leadership are new to their leadership positions. House staff also are new since the incoming speaker fired all staff who had served in House staff positions for many years. In addition, the Governor is in bankruptcy court, and has been indicted on 23 federal felony charges. His trial is likely to begin during the legislative session. Democratic legislative leadership and the Governor publicly traded insults and name calling.

These events are "signs" that do not portend agreement on school finance reform. Confusion reigns; at best, the state of the state seems to be unsettled. If the past can be used to predict the future, it appears unlikely that school finance reform will occur in Arizona in 1997.

#### Footnotes

- 1 Mattern, Hal. "Legislators ready to fix school funding," *Arizona Republic*, Sunday, January 12, p. A12.
- 2 Mayes, Kris. "Top Dem brands governor 'arrogant' on schools," *Arizona Republic*, January 8, 1997, p. B1.
- 3 Joint Legislative Budget Committee Staff, "Proposed budget FY1998 and FY1999, analysis and recommendations," January, 1997, p. ADE-9.
- 4 Joint Legislative Budget Committee, "Proposed budget FY1998 and FY1999, analysis and recommendations," January, 1997.
- 5 Supreme court ruling, *Roosevelt v. Bishop*, p. 24.