



# **Financing K-12 Education in Michigan: Background and Current Status**

Presentation to:

*Antrim County Community Forums*

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# **School Funding Background**



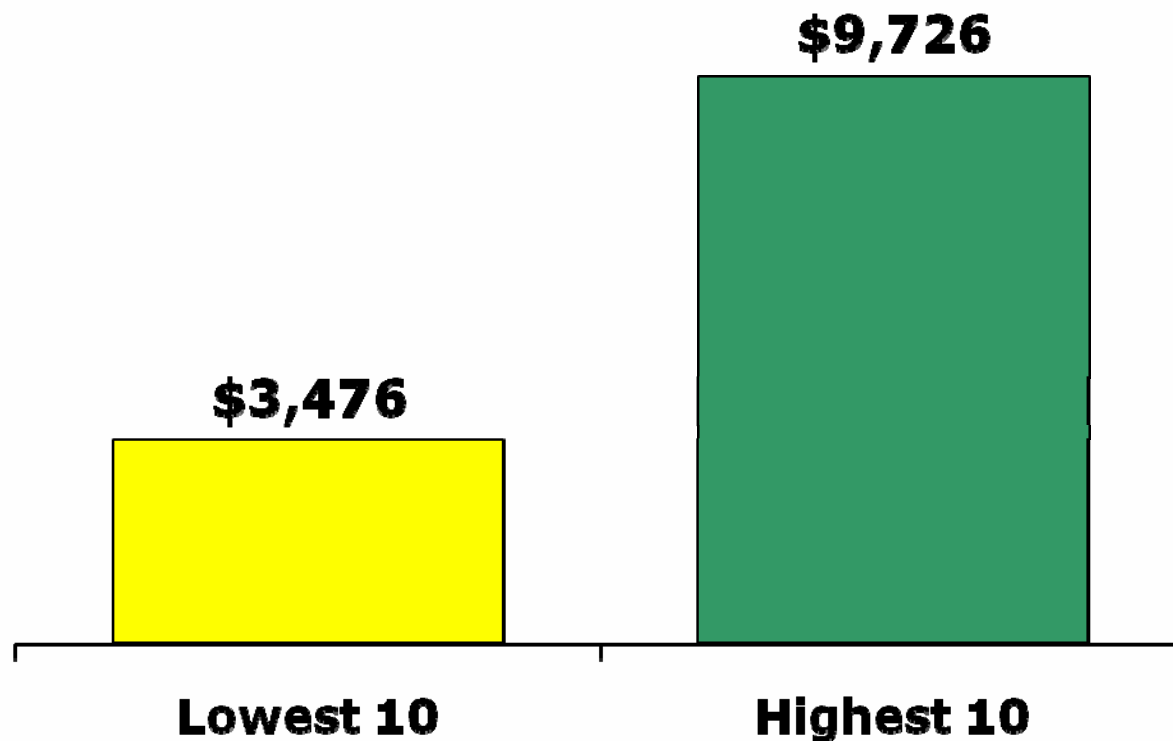
## **School Finances Before Reform**

### *Pre-Proposal A of 1994*

- 80 percent of K-12 revenue raised locally through property tax
  - Local voters choose spending level through property tax elections
  - School property taxes were rising faster than inflation and income resulting in pressure to reform
- “District power equalization” used to distribute state aid, but richest one-third of districts received no aid
  - Rich districts greatly outspent poor districts, often with lower tax rates
- Kalkaska schools close in March of 1993



## Rich Schools Out Spent Poor Schools More Than 3 to 1 In FY1994





## What Proposal A Did and What it Did NOT Do

### **Proposal A of 1994, an amendment to the 1963 Constitution:**

- Permitted school operating taxes to be imposed on a non-uniform basis.
- Limited assessment increases on individual parcels of existing property to the lesser of five percent or inflation beginning in 1995. Property would be reassessed at 50 percent of true cash value upon transfer in ownership.
- Increased the sales tax rate from 4 to 6 percent, beginning May 1, 1994 and dedicate revenue to the School Aid Fund.
- Required that the state guarantee each local school district in FY1996 and thereafter at least as much combined state and local operating revenue per pupil as in FY1995.
- Required a three-fourths vote of the legislature to increase school operating taxes beyond those in effect February 1, 1994.



# What Proposal A Did and What it Did NOT Do

## **Proposal A of 1994 did NOT:**

- Create the School Aid Fund (1963 Constitution did this).
- Permit the use of the School Aid Fund for “higher education” (again, contained in original 1963 Constitution).
- Eliminate the property tax as a funding source for schools (these taxes were eliminated in 1993, but later restored).
- Guarantee how much money is spent on schools (although it did create a per-pupil funding floor).



## School Aid Fund

- Created in the 1963 Constitution (Art. IX, Sec. 11)
- Dates back to 1908 Constitution as vehicle for providing state aid (sales tax) to local schools
- Language regarding “higher education” added to the 1963 Constitution
- Proposal A of 1994 – increase sales tax rate by 2 percentage points (from 4% to 6%) and dedicated revenue to SAF
- Since Proposal A, SAF used exclusively for local schools





## School Finance Reforms -- Revenues

- Major state and local tax reform
- Local school operating tax repealed – ave 33.9 mills
- Replacement taxes:
  - Sales tax 4% to 6% (constitutional amendment)
  - 6 mill statewide property tax
  - 18 mill non-homestead local tax
  - Cigarette tax from \$0.25 to \$0.75 (OTP 0% to 16%)
  - Real estate transfer tax 0.75% (new state tax)
- Taxable value cap imposed – limits per-parcel assessment growth to lesser of 5% or inflation



## School Finance Reforms -- Spending

- Spending goes from a local decision to a state set amount
- Schools are funded on a per-pupil basis using a "foundation program"
- Top spending schools allowed to keep old spending levels –levy "hold harmless" millages
- Bottom spending districts receive per pupil increases
- No adjustment is made for district costs
- Local districts cannot choose to spend more than the amount set by the state



# The Foundation Grant

## *How State Aid is Determined*

### **Illustration 1** **Foundation Grant Calculation**

Hypothetical district foundation grant: \$7,300

Non-homestead value of property in school district (taxable value): \$250,000,000

Non-homestead school operating property tax rate: 18 mills

Pupil membership used for foundation program: 3,000

#### **Local Component:**

(Taxable value (school district) \* Rate)/ Membership = Local amount

$(\$250,000,000 * 0.018)/3,000 = \$1,500$  per pupil

#### **State Component:**

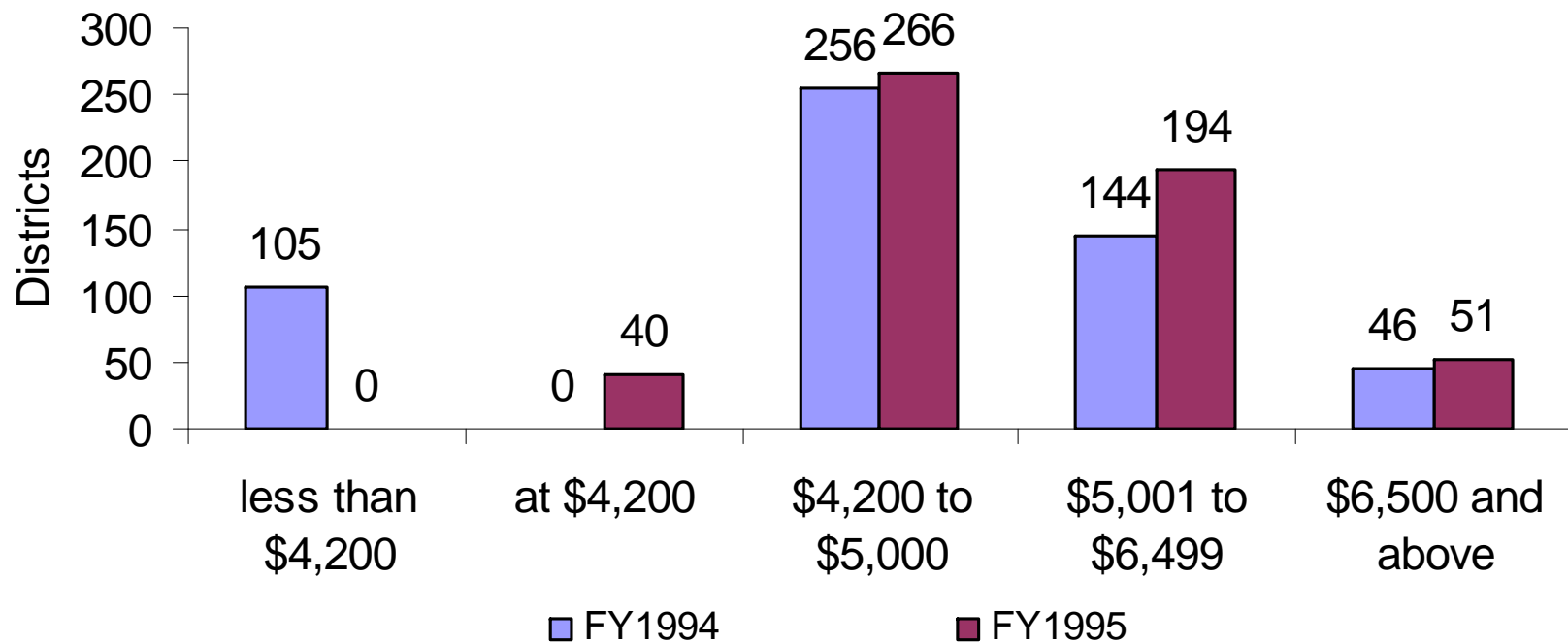
Foundation grant – Local component = State component

$\$7,300 - \$1,500 = \$5,800$  per pupil



# Immediate Effects of "Raising the Bottom"

School Districts by Per-Pupil Funding Grouping





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# **Recent History of School Funding**



## **K-12 Education Finances**

### *The Big Picture*

- Largest single outlay of combined state/local spending – \$17.2 B (2009)
- As result of Proposal A of 1994, we have a state-run state school finance system
- Revenues (foundation grant) determined by Lansing
  - Majority of taxes are economically sensitive
  - Very few options to raise add'l operating revenue locally, regardless of preferences
- Majority of spending decisions still set at local level
  - Spending concentrated in personnel (80% of total)
  - Required retirement spending set by state (9% of total)



## The Last Decade Was an Economic Disaster for Michigan

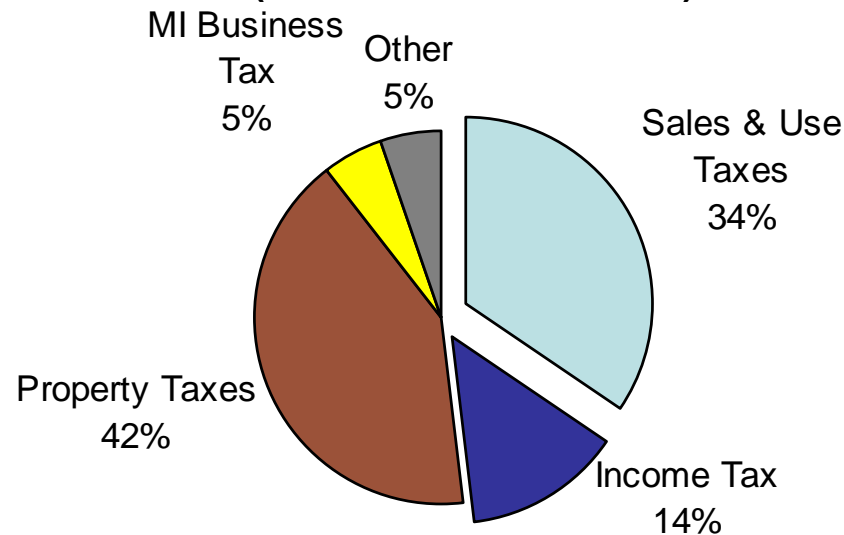
	Growth 2000 to 2010		Michigan Rank
	U.S.	Michigan	
Population	9.5%	-0.2%	51
Real Per Capita GDP*	4.7%	-11.9%	51
Employment	-1.5%	-17.4%	51
Real Per Capita Income**	5.7%	-4.4%	50



# Economically Sensitive Taxes Dominate

*Consumption and Income Taxes Make Up 48%*

**State and Local Education Operating Taxes by Source  
(FY2009 - \$14.0 billion\*)**

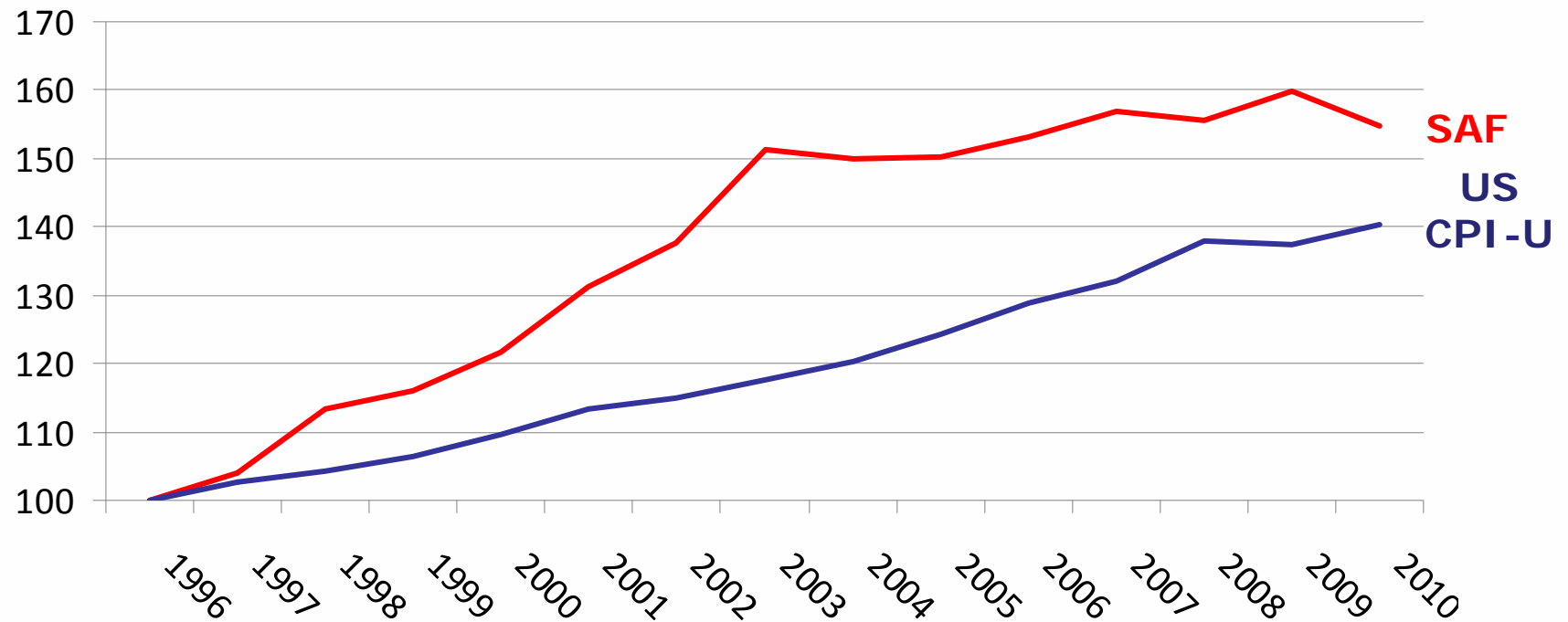


\* Note: Michigan Dept. of Treasury; Michigan Dept. of Education; CRC





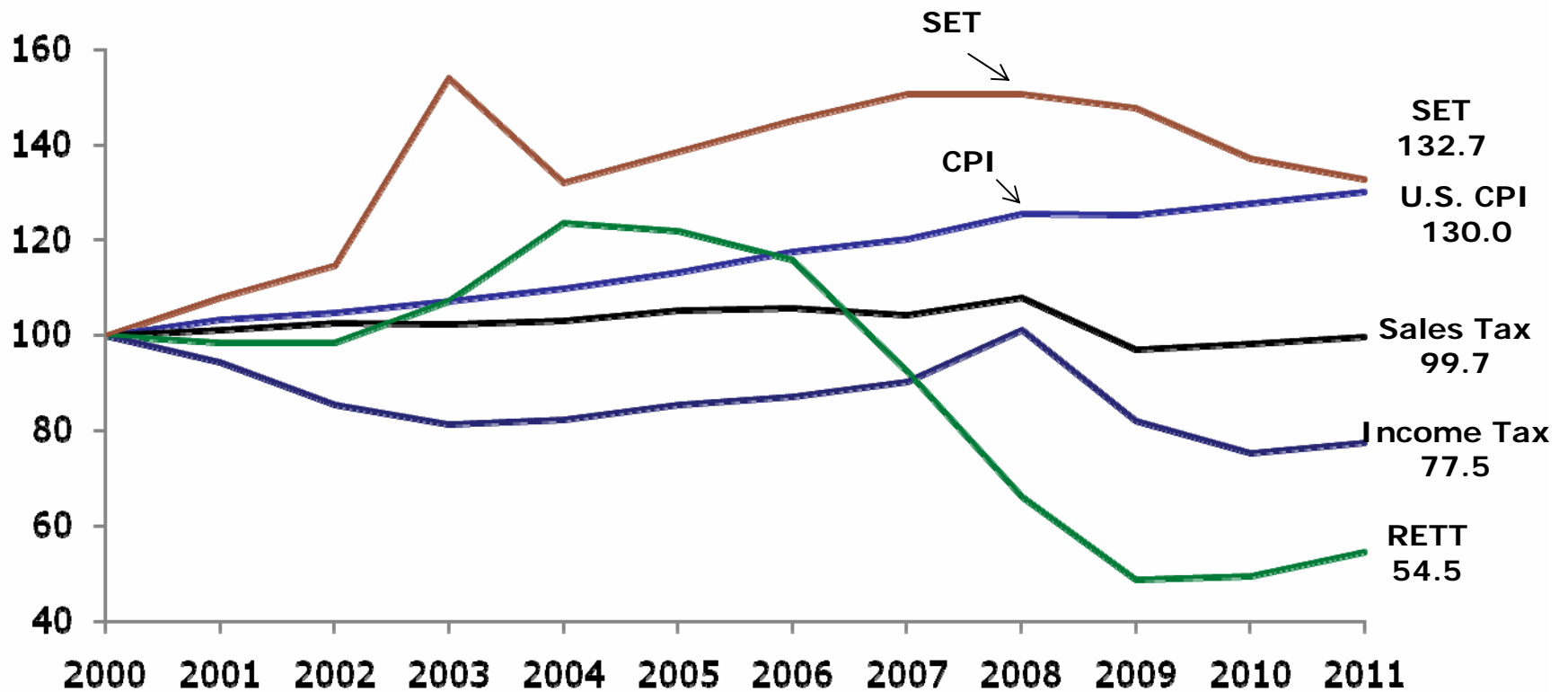
## Growth Exceeds Inflation: FY96 to FY01 Slower Than Inflation: FY01 to FY10





# Major SAF Revenue Sources Fail to Keep Pace with Inflation Since 00

Total Taxes Indexed - FY 2000 = 100



Note: 2010 and 2011 totals are the May 2010 Consensus estimates.



# Great Recession's Effects Severe

*Steep Revenue Declines and Slow Recovery*

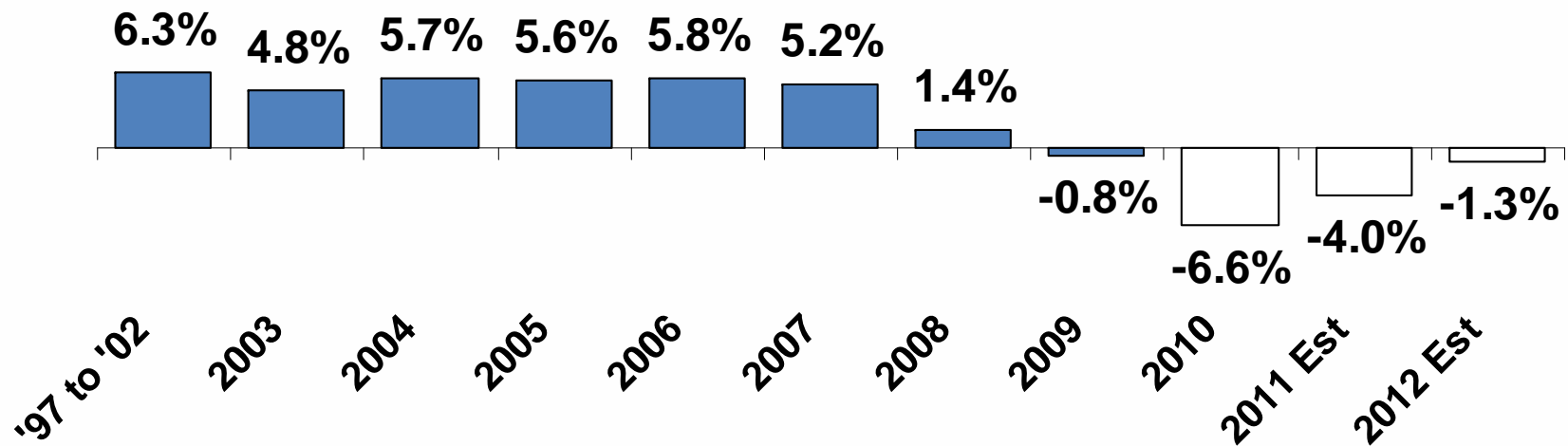
	annual growth rates			
	FY2009	FY2010	FY2011	FY2012
Sales	-10.1%	1.4%	2.9%	2.9%
Income	-19.0%	-5.5%	3.8%	0.4%
Use	-19.2%	9.3%	3.6%	4.3%
State Education	-1.9%	-5.4%	-3.7%	-1.3%
Real Estate Transfer	-26.2%	-3.0%	2.8%	8.8%
School Aid Fund	-5.1%	-1.0%	1.5%	2.0%
General Fund	-21.3%	-7.9%	6.5%	0.9%

*FY2011 SAF down \$680 million from FY2008*



# After Stable Annual Growth, Property Tax Revenues Decline

% Change in Total Taxable Value

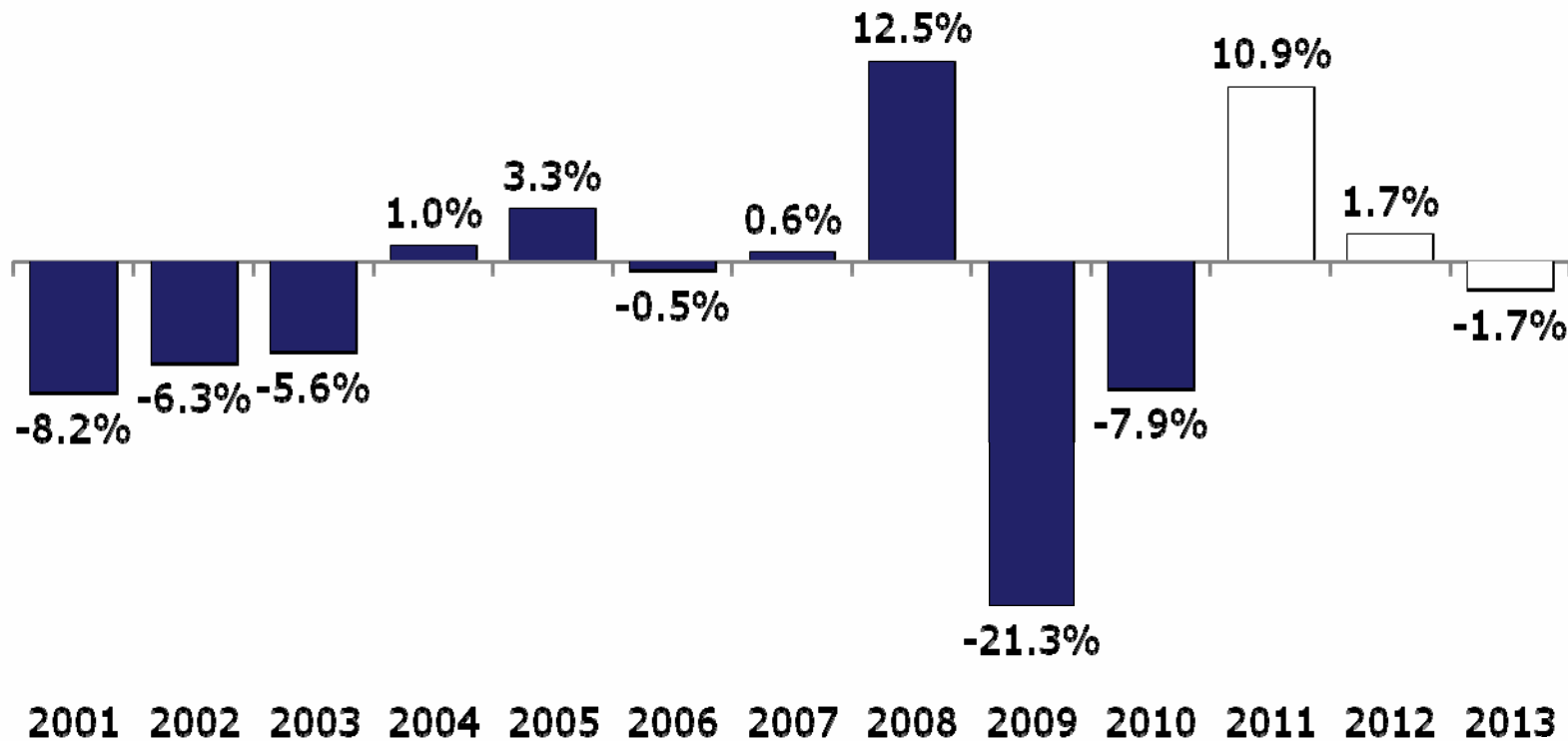


Source: State Tax Commission and Michigan Department of Treasury Estimates.



# GF-GP Revenue Performance Contributes to Budget Deficits

GF-GP Revenues  
Year-Over-Year Pct. Change

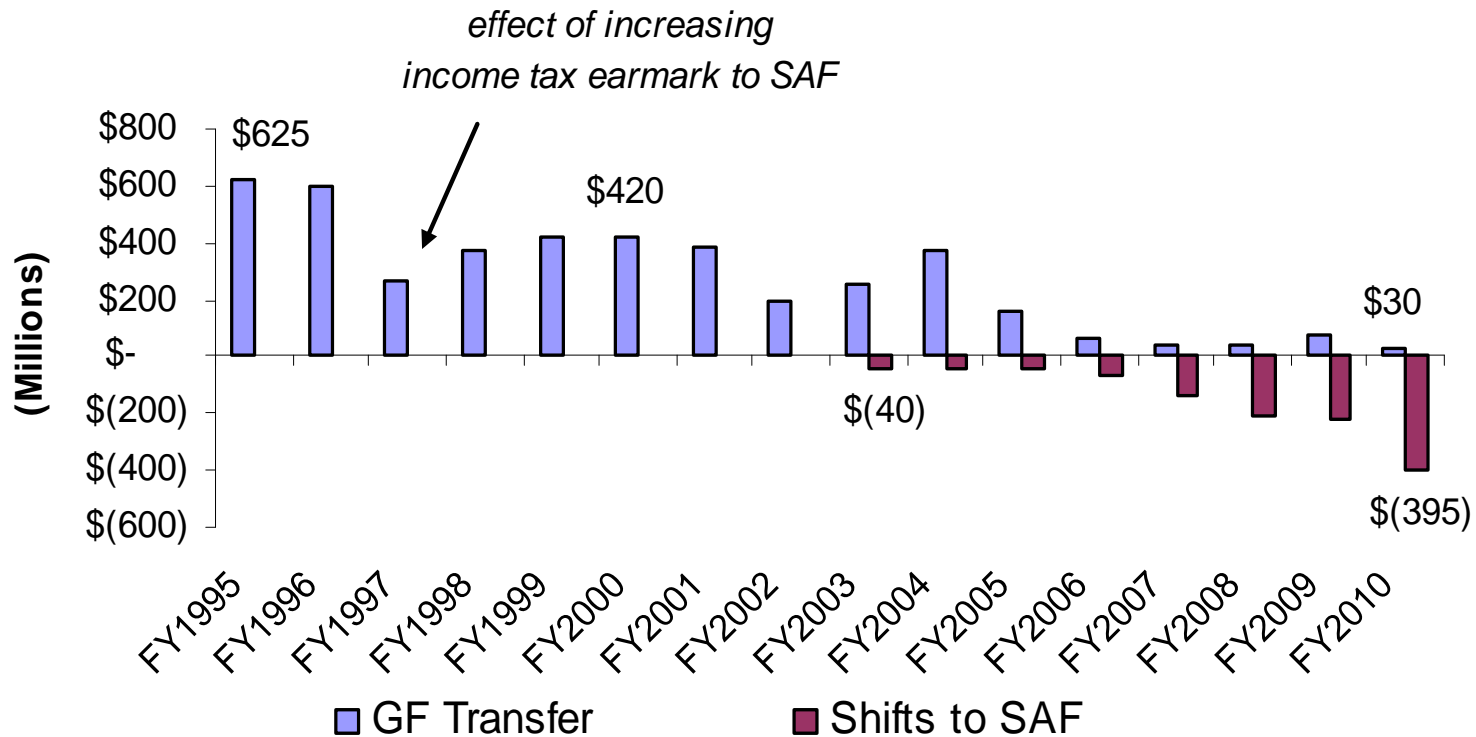




# GF Budget Problems Spill Over

## *Support for Schools Slashed*

### General Fund Transfers and Cost Shifts - School Aid Fund



\* FY2010 includes \$208 million for community college operations

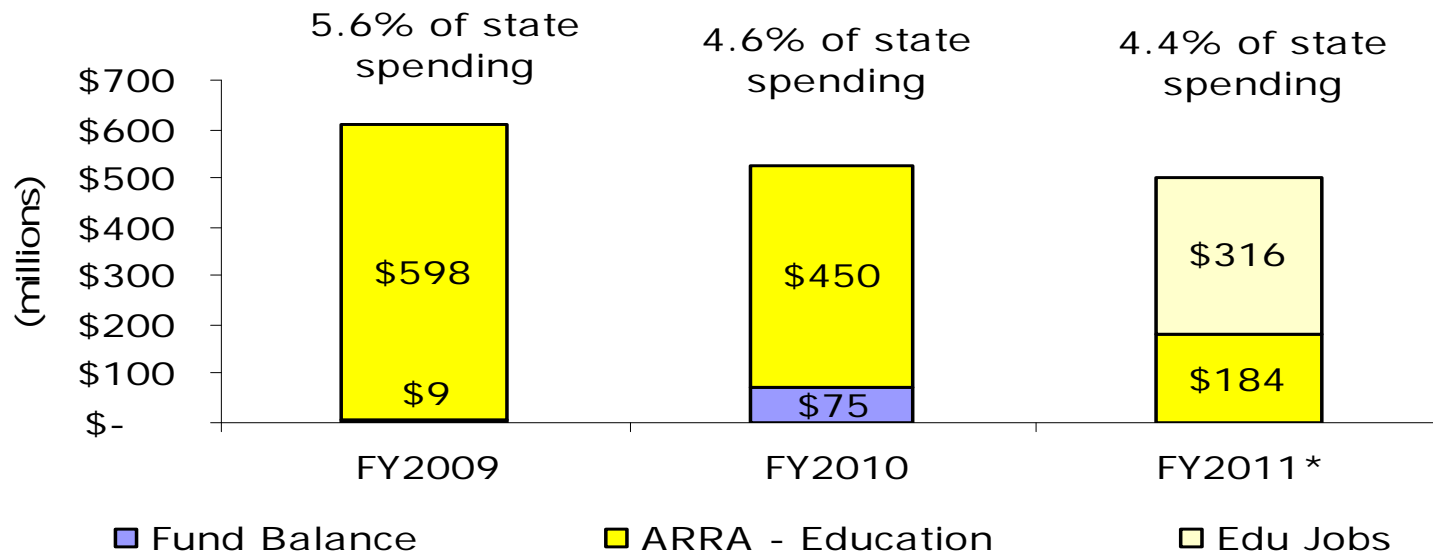
Source: Michigan Department of Education; House Fiscal Agency



# Major Cuts Avoided Thus Far

## *Non-Recurring Resources Used to Maintain Spending*

Non-Recurring Resources Used for SAF Budget



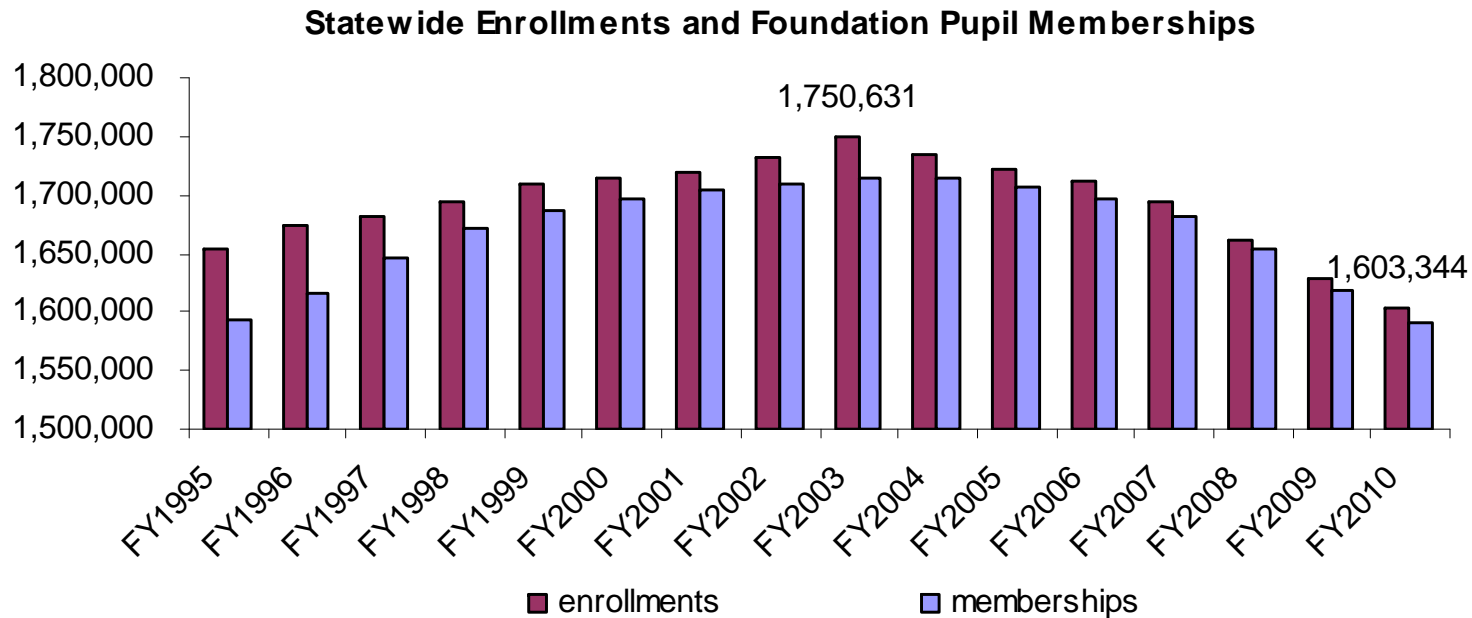
Fund Balance = \$247 million at 10/1/08. State spending excludes federal.

\* Based on enacted budget as of 7/10 and projected Edu Jobs funding.



# Two Periods of Enrollment Change

*Since FY2003 "Era of Declining Enrollments"*

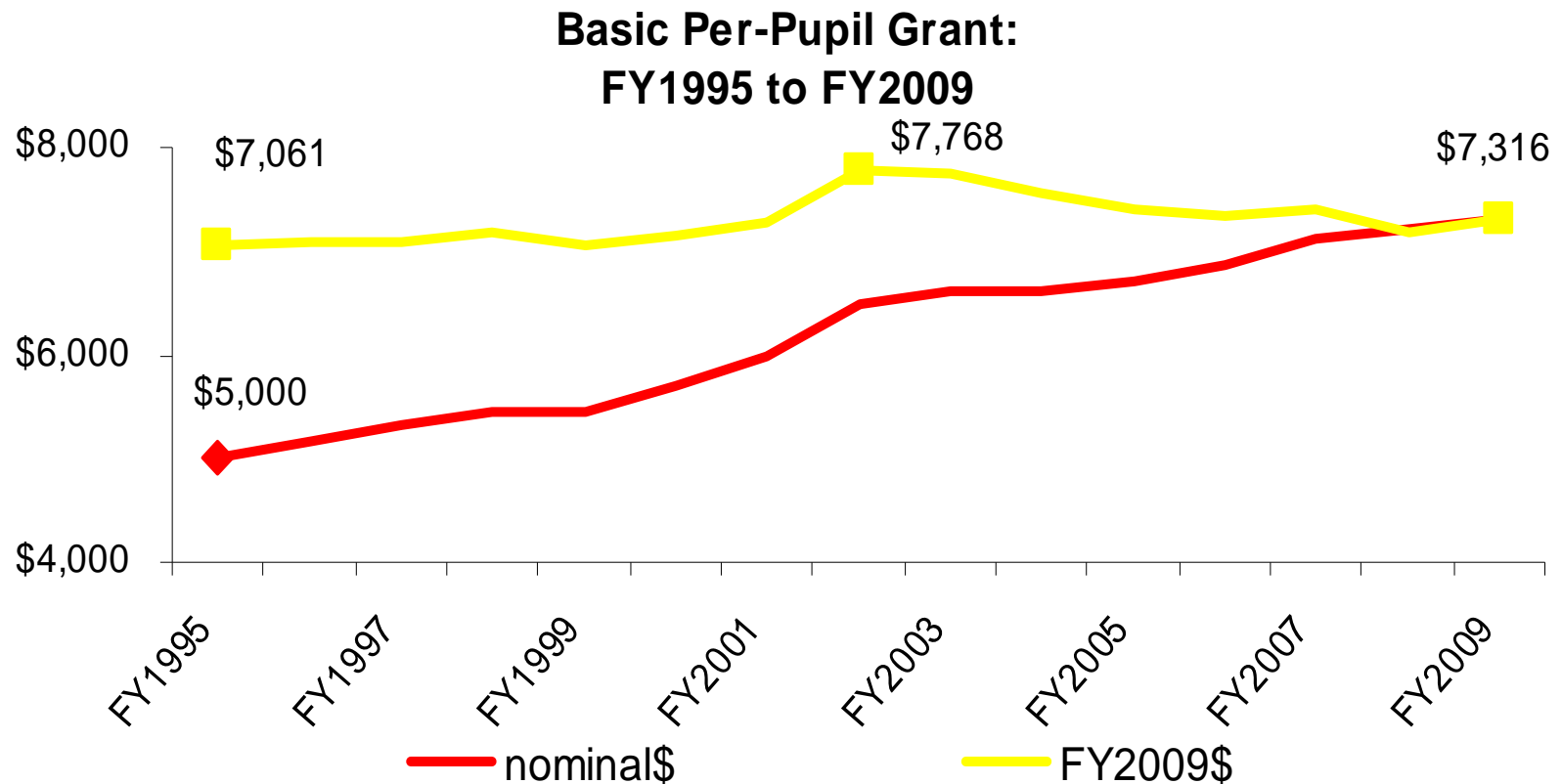


source: Michigan Department of Education, Bulletin 1014 and Financial Status Reports





# Since FY1995 Basic Grant Tracks Inflation, But Since FY2002 Grant Trails Inflation



\* Basic grant adjusted using U.S. Consumer Price Index (state fiscal year basis).

Source: Senate Fiscal Agency; US Bureau of Labor Statistics



# **School Funding Under Current Proposals**



## **Governor's Tax and Budget Plans Lays Groundwork for School Funding**

*Key Factors Involved*

- Basic changes in state budgeting - use General and School Aid Funds interchangeably
- Major state tax restructuring involving business and individual income taxes (revenue neutral when fully phased in)
- Changes to earmarking of state tax revenues involving General and School Aid Fund
- One-time federal funding coming to an end
- Budget recommendation covers two years, FY2012 and FY2013



## **Governor's Proposal** *Basis for School Funding Cuts*

- Exhaustion of one-time federal funding
- Proposed tax reforms
  - Eliminate MBT and replace with 6% CIT (\$750M loss)
  - Changes to Individual Income Tax (\$153M gain)
  - Increases in General Fund grant (\$349M gain)
- General Fund structural budget deficit of \$1.4B
  - Higher education funding shifts – replace GF with SAF
  - Community colleges (\$196M loss)
  - Universities (\$700M loss)

*Total SAF Revenue Loss: \$1.1 Billion*



## \$470 Per-Pupil Cut

*Combination of Existing and New*

- Expiration of one-time federal funds, used to back-fill FY2010 state revenue cut: \$170 per pupil (\$267M)
- Add'l foundation reduction: \$300 per pupil (\$453M)
- Eliminate/reduce various categorical grants (\$86M)
  - For many, per-pupil cut much larger because of categorical funding reductions

### Rebasing the Foundation Grants

	<b>FY2011</b>	<b>FY2012</b>	<b>Change</b>
Min. Grant	\$ 7,316	\$ 6,846	\$ (470)
Basic Grant	\$ 8,489	\$ 8,019	\$ (470)
Max. Grant	\$ 8,489	\$ 8,019	\$ (470)

*New \$300 per-pupil cut equals 4.2%*



## **Increased Retirement Spending Adds to Challenges Facing Schools**

- Required employer retirement contribution increase because of poor investment performance
- Will add to fiscal challenge facing schools
- Rate increase: 20.7% of payroll to 24.5% of payroll
  - Equivalent to \$245 per-pupil spending increase
- Combined with Governor's funding cuts, effective reduction amounts to \$715 per pupil or 10%



## House and Senate Proposals

### House

- Proposal mirrors Governor's budget in aggregate
  - Higher education funding shift of \$900 million
- 3.5% per-pupil cut (range: \$426 to \$468)

### Senate

- Reduces higher education funding shift to \$400 million
- \$170 per-pupil cut for all districts
- Half-day kindergarten payment (\$200 million)



## Where Things Stand Today

- Tax restructuring plan passed by legislature, increased size of net tax cut from \$254 million to \$560 million
- Improving economic picture will result in additional state revenues (FY2011, FY2012, and FY2013), but most will be needed to finance the tax cut (in FY2012 and FY2013)
- On net, approximately \$200 million in “new” revenue available for the state budget in FY2012 when compared against the Governor’s plan





## Summary of Recently Enacted Tax Changes

	<u>FY 2012</u>	<u>FY 2013</u>
MBT Current Law	\$2,159.0	\$1,990.6
Revenues from New Tax Law		
MBT (4th quarter 2011 and annual pymts)	\$604.5	\$0.0
New Corp Tax	\$460.2	\$342.9
Bus. Tax Under New Tax Law	<u>\$1,064.7</u>	<u>\$342.9</u>
Net Business Tax Cut	(\$1,094.3)	(\$1,647.7)
Income Tax Increases	<u>\$559.1</u>	<u>\$1,423.7</u>
Net Impact Tax Law Changes	(\$535.2)	(\$224.0)
GF	\$154.7	\$438.0
SAF	(\$689.9)	(\$662.1)



## May Consensus Revenue Changes

- FY 2011 revenue estimates increased by \$428M (\$296M GF; \$132M SAF)
- FY 2012 revenue estimates increased by \$499M but tax plan cost up by \$306M (compared to budget proposal) so net increase \$193M (\$147M GF; \$46 SAF);
- FY 2013 up \$564M but enacted tax plan up \$356M so set increase \$207M (\$184M GF; \$23M SAF)



## Announced Budget Deal\*

- Additional \$310 million (\$200 per student) added back to K-12 budget
- \$396 million in School Aid Fund to higher education and community colleges
- How will \$310 million (approx. \$200 per pupil) be distributed? Foundation grant? Categorical?
  - \$160 million to be set aside to meet retirement contribution (2 point reduction to 24.46%)
  - \$150 million to districts that meet “financial best practices”
  - Per-pupil amounts will vary by district
- Bottom line: Likely to still see \$470 per-pupil cut to foundation grant (“re-base”), with add'l money restored if certain criteria are met



## Recent Legislation Aimed at Controlling School Costs

- Senate Bill 7 (80/20): Requires all public employees to pay at least 20% of health care premium
- House Bill 4152 ("step" freeze): Freezes pay and benefit levels when collective bargaining agreement ends and prohibits retroactive pay increases
- Public Act 4 (Emergency Manager): Allows suspension, modification, and renegotiation of collective bargaining agreements and contracts



## Conclusion

- Since FY2000, state tax revenues trailed inflation
- On-going state tax revenues significantly affected by economic recession - FY2011 below FY2008
- Federal funding used to avoid full impact of revenue declines in FY2009 through FY2011
- General Fund budget problem of \$1.4B in FY2012 solved, in part, by use of School Aid Fund resources
- General and School Aid Funds used interchangeably for education
- Although \$310 million being restored to K-12, this may be temporary if the foundation grant is "re-based" by \$470
- School Aid Fund budget structurally balanced for FY2012 and FY2013